
European Agenda

European Agenda provides a location for the publication of more specialized research notes, or short articles to promote scientific debate, on matters falling within the Journal's domain (see inside front cover). Additionally, it will provide occasional reviews of important policy developments. Prospective contributors should consult the notes on the last text page of this issue.

Modernizing the European Social Model: Developing the Guidelines*

NICK ADNETT

Staffordshire University Business School

The European Union is confronted with a quantum shift resulting from globalisation and the challenges of a new knowledge-driven economy. These changes are affecting every aspect of people's lives and require a radical transformation of the European Economy. The Union must shape these changes in a manner consistent with its values and concepts of society.....

Presidency Conclusions: Lisbon European Council (2000) p. 1

Introduction

The Amsterdam Treaty introduced a new title on employment into the EC Treaty requiring the development of a 'co-ordinated strategy for employment'. At the Luxembourg jobs summit in November 1997, a common employment

* An earlier version of this paper was presented at the 'Third Ways and Ways Forward: Policy Transfer in the European Union' conference organized by UACES and the University of Bath Jean Monnet Centre of Excellence in June 2000. I am grateful to the participants at that conference and to two anonymous referees and the editor for their comments.

strategy was agreed with specific targets being transposed annually into policies by each Member State in National Action Plans for Employment (NAPs). This raising of the profile of employment policies within the EU, encouraged by both the French and Swedish Presidencies, has coincided with plans to modernize the European social model. Following agreement at the Lisbon European Council meeting, a European social agenda was approved by the Council at its Nice meeting, with progress in implementation first reviewed at the Stockholm meeting in March 2001. These developments represent acceptance of the need to redesign welfare systems and labour market regulations to achieve the overarching goal of creating full employment within a competitive and inclusive knowledge-based European economy. The full extent and consequences of these initiatives remain unclear, but it is evident that, in the new 'regulation for competitiveness' environment, economic and social objectives of labour market regulation are more directly juxtaposed.

Building on the analysis of Gregg and Manning (1997), Bean *et al.* (1998), Buchele and Christiansen (1998), Agell (1999), Nickell and van Ours (2000) and Scharpf (2000), I seek to look behind the rhetoric of these developments. I consider their consequences for the design and co-ordination of economic and social policy-making in the EU. I ignore questions on the appropriateness of the 'New Economy' label (OECD, 2000), and concentrate on the desirability of uniform reforms to labour market regulation in the EU. In the following section, I briefly review the main weaknesses of the European social model identified by its critics, and attempt to assess its appropriateness by summarizing the empirical evidence. This is followed by a review of the recent employment policy initiatives developed within the Luxembourg process. This leads to a final section in which broad guidelines are proposed for the modernization process.

I. The European Social Model: Modernization or Renewal?

A continuing objective of European integration has been to promote both economic and social cohesion; an objective now formalized in Art. 2 of the Treaty on European Union. At the Lisbon summit, the need to modernize EU social policy was agreed, though the Portuguese Presidency preferred to use the term 'renewal' and the *European Social Agenda* refers to 'reinforcement and modernization'. This emphasis is in keeping with the history of the European social model as recently reinterpreted by Eichengreen and Iversen (1999). They maintain that strong European economic growth after the Second World War was based upon Fordist technology supported by solidaristic wage bargaining. Centralized wage bargaining compressed the distribution of wages and was associated with a growth of welfare programmes and labour market

regulation. These developments were initially sustainable, but with the emergence of flexible specialization and the growth of holistic firms, these institutions and employment regulations no longer sustained the EU's competitiveness in the fast growing sectors of the global market (Gual, 1998). The emphasis on social cohesion had led to an over-expansion of welfare and regulation. The resultant strengthening of insider power was identified as a cause of chronic unemployment amongst the unskilled, falling male participation rates (through early retirement and permanent disability), and slow employment growth in the high-tech and service sectors. This Anglo-Saxon version of the history of regulation of EU labour markets was effectively legitimized by the OECD's *Job Study* (1994) with its strong advocacy of greater labour market flexibility.

The establishment of EMU has intensified a concern that EU social policy based on levelling-up may be inconsistent with increased economic integration and the retention of international competitiveness (Bean *et al.*, 1998). As Otmar Issing (2000), a member of the Executive Board of the European Central Bank, has argued, what orthodox economics indicates is required in this environment is greater labour cost variability between, and within, EU labour markets. Perversely, however, integration itself tends (slowly) to promote both greater wage interdependence and wage convergence (Andersen *et al.*, 2000). Finally, globalization has been identified as a further reason why Social Europe is no longer sustainable. The growth of trade and capital mobility increases labour cost elasticity of demand for labour, while rigidities in wage adjustments increase the employment consequences of regulating labour market behaviour. In extending this argument, Saint-Paul (1997) claims that Europe's rigid labour markets encourage concentration on producing a small range of relatively secure goods and services at a late stage of their product life cycle. This specialization is associated with low market growth, low innovation, low learning externalities and therefore generates low potential economic growth. As international trade and capital mobility increase, an international product cycle becomes established with specialization in new goods and services in those economies with decentralized wages and 'employment at will'.

In summary, it is claimed that the emergence of new production technologies, the growth of the knowledge-driven economy and globalization, together with the adoption of EMU, have fundamentally changed the trade-off between the EU's economic and social objectives.

II. Assessing the Costs and Benefits of Social Europe

To examine the need for a modernization of Social Europe we initially return to basic economic analysis. In a world of perfectly competitive labour markets, legal and institutional restrictions are either completely ineffective or prevent the signing of efficient contracts between workers and firms. In such markets only equity considerations provide a rationale for such restrictions. In practice, dynamic considerations and the presence of monopoly and monopsony power (Gregg and Manning, 1997), incomplete contracts and asymmetric information and hence the importance of trust and co-operation (Deakin and Wilkinson, 1999), provide the potential for efficiency-enhancing regulations in the labour market. Subsidiarity considerations then determine the appropriate level at which any regulations should be decided. Given the real world presence of both market and government failures, then *a priori* beliefs about the relative merits of deregulated, flexible labour markets as opposed to regulated ones need to be subjected to appropriate empirical examination.

Most empirical assessments of the European social model's impact on economic performance and social cohesion have been limited to studying income and employment convergence, though Freeman (1998a) raises the issue of social alienation, and Micklewright and Stewart (1999) analyse child welfare. These latter indicators suggest a slow convergence within the EU, though measures of child poverty, household worklessness and youth unemployment provide exceptions. In the absence of broader composite indicators of economic and social cohesion, research has centred upon a very limited range of economic indicators, often just employment and productivity growth rates and unemployment persistence.

Labour market regulations cover a very diverse group of policies, from minimum wages, through job security and anti-discriminatory provisions, to health and safety and working time, maternity and parental rights, to the legal treatment of collective bargaining and contract enforcement, and the design and operation of the welfare system. Individually, these policies affect labour market behaviour in very different ways. Initial attempts to generalize and encapsulate national differences within a single proxy have quite rightly been abandoned, though Buchele and Christiansen (2000) use factor analysis to summarize the information contained in ten different measures of workers' rights. Examining recent evidence (Gregg and Manning, 1997; Nickell, 1997, 1998; Buchele and Christiansen, 1998, 2000; Pissarides, 1999), some common findings emerge which we now summarize, though the precise interaction between institutions and shocks within the EU has only recently begun to be explored (Blanchard and Wolfers, 2000).

Concentrating on the impact on unemployment, evidence suggests that some institutions tend to raise the equilibrium rate of unemployment, such as

weakly policed, generous unemployment benefits of long duration. Others predominantly affect the composition of equilibrium unemployment, such as employment protection measures. The latter, since they have offsetting effects on inflows and outflows to unemployment, create a more stagnant labour market with a higher incidence of long-term unemployment. Still other labour market institutions may have little effect on unemployment or participation, instead affecting wages. Thus, the 'tax wedge' seems generally to affect wage levels, though minimum wage regulations at the lowest wage levels cause these charges to fall on employers, and hence affect employment. Finally, some institutional forces affect unemployment and participation rates in different ways depending on other characteristics of labour market behaviour. Thus, where employers and trade unions co-ordinate wage bargaining then strong unions no longer raise the sustainable rate of unemployment.

Studies summarized in Bertola (1999), suggest that whilst job turnover in EU labour markets is similar to that in other OECD countries, wage-setting and employment regulating institutions in the EU have generated greater employment stability, more reliance on internal flexibility and resulted in lower wage inequality. The more segmented labour markets in the EU also reinforce insider power which is associated with the unemployment persistence problem discussed above. To the extent that European workers are risk averse and have egalitarian norms and communitarian values, then such outcomes may be socially desirable. Agell (1999) develops this argument, suggesting that unrestricted market forces create excessive wage differentials, and that private insurance market failures provide a further rationale for adopting rigid labour markets, notwithstanding globalization. Any assessment becomes more problematic, however, if workers' tastes, institutions and labour market outcomes are all viewed as endogenous at the national level.

Contrary to both the predictions of simple factor price equalization models and the fears of 'high' social protection Member States, continued European economic integration appears to have produced no 'race to the bottom' (Freeman, 1998b; Andersen *et al.*, 2000). Product market integration has not, as yet, created major macroeconomic pressures on wages, regulations or the welfare state. Evidence suggests that if the EU wished to maintain labour market institutions that had a net negative spillover effect on labour productivity, then the costs can be absorbed in three ways: through falling nominal wages; rising consumer prices rise, and/or depreciating exchange rates. The ability to sustain these costs over time depends crucially upon how the particular regulatory measure affects the dynamics of productivity growth.

In the light of this assessment of Social Europe, we now examine the evolution and operation of the European Employment Strategy, assessing its implications for the modernizing process.

III. The Luxembourg Process and Labour Market Reforms

The Luxembourg Process has co-ordinated the packaging and targeting of Member States' employment policies around a four-pillar (with, currently, 19 guidelines) structure of improving employability, entrepreneurship, adaptability and equal opportunities (outlined in Table 1). Member States must transform these guidelines annually into medium-term National Action Plans (NAPs) which incorporate three horizontal objectives: raising overall employment rates; extending lifelong learning and strengthening social partner

Table 1: Guidelines for Member States' Employment Policies 2001

Pillar 1 Improving Employability

- tackling youth and long-term unemployment
- adopting an employment friendly approach to benefits, taxes and training
- developing policies for active ageing
- developing skills for the new labour market in the context of lifelong learning
 - improving quality of education and training
 - developing e-learning for all citizens
 - assisting the unemployed's acquisition or upgrading of skills
- enhancing active policies to improve job matching
- promoting a labour market open to all

Pillar 2 Developing Entrepreneurship

- making it easier to start up and run businesses
 - reducing overhead, administration and start-up costs
 - encouraging the take up of entrepreneurial activities
- exploiting new opportunities for job creation
- developing actions at the local and regional level
- making the taxation system more employment and training friendly

Pillar 3 Encouraging Adaptability of Businesses and their Employees

- modernizing work organization
 - achieving the required balance between flexibility and security
 - assisting the development of an appropriate regulatory framework
- supporting adaptability in enterprises

Pillar 4 Strengthening Equal Opportunities Policies for Women and Men

- adopting a gender mainstreaming approach
 - tackling gender gaps in employment, unemployment and pay
 - reconciling work and family life
-

involvement. NAPs are submitted for scrutiny to the Council and Commission. At the supranational level, the Commission produces an *Annual Report* reviewing labour market trends, adjusting guidelines if appropriate and assessing individual NAPs. Throughout the EU, the current emphasis is on a range of 'third way' measures derived often from Scandinavian experience: activating passive policies; targeting of long-term unemployed and socially excluded; increasing incentives to re-enter and remain in paid work; reducing tax burdens on employers; increasing working time flexibility; active ageing policies, and promoting lifelong learning. In addition, the European Employment Strategy calls for much more extensive policy evaluation. The Lisbon summit agreed to a greater emphasis on establishing quantitative and qualitative indicators, benchmarking against best world practice and target-setting to be combined with periodic monitoring, evaluation and peer review organized as 'mutual learning processes'. The emphasis at Lisbon was on a 'new' open method of co-ordination as the means of spreading best practices and achieving greater convergence towards the EU's main goals.

In part this 'soft convergence' process seeks to progress the European social dimension without further legislation, but it permits a great diversity of strategies and policies at the national level (Abraham, 1999). A reading of the *Joint Employment Reports* for 1999 and 2000 indicates this diversity. At one extreme we have Britain, with a more competitive approach to labour market regulation, strong 'welfare to work' employment policies, low implicit taxes on labour, absence of training plans in collective agreements and weak social partner involvement in policy-making. At the other extreme we have France, which has generally retained high labour taxes and championed strengthening regulation, such as in its flagship policies of tighter working time restrictions and promoting lower VAT rates on certain labour-intensive services. Whilst national employment policies in Britain, Germany and Sweden were the centre of interest at the beginning of the 1990s, those of Denmark, the Netherlands (Barrell and Genre, 1999; Nickell and van Ours, 2000) and more recently Ireland, Italy and Spain have moved centre stage. This change reflects relative performance, disenchantment with the consequences of neoliberalist freeing of labour markets and doubts about the sustainability of the German and Swedish corporatist models. It also reflects some dramatic changes in fashion amongst policy analysts. For example, until recently its continued resistance to rapid deindustrialization was seen as one of the strengths of the German economy. However, in the 1999 *Joint Employment Report*, Germany was criticized for its relatively low growth in service sector employment that was claimed to be constraining growth in the new economy. This was notwithstanding data in the same report that indicated Germany was only relatively deficient in low-skilled service sector employment.

We have suggested that the European Employment Strategy has promoted the convergence of packaging and targeting of employment policies within the EU, what is less evident is any overall convergence of policies or processes. Indeed policies under pillar 4 (equal opportunities) and particularly pillar 3 (encouraging adaptability of business and their employees) have clearly been diverging. For example, Belgium, France, Germany, Italy and the Netherlands have responded by introducing reductions in working hours, elsewhere collectively agreed frameworks on working time have become a component of local (Austria and Finland) or sectoral (Sweden) agreements, whilst in other countries (Britain and Ireland) working time restrictions have been resisted. In general, such divergence should not be disparaged. Consider pillar 1 (improving employability) which has stimulated a general strengthening of incentives to work and active labour market policies targeted at the long-term unemployed. Martin's (2000) survey of OECD countries illustrates that there are no 'magic bullets' in tackling unemployment. The impact of employment policies on labour market behaviour is dependent on the particular national, institutional and social environment, and associated macroeconomic and microeconomic policy measures. For example, the relaxing of regulations on temporary contracts in Spain led to a widespread displacement of permanent contracts, whilst in Germany employers continued to hire apprentices for permanent jobs (Freeman, 1998b). The large national differences in the involvement of the social partners in policy formulation and implementation provide another illustration. Finland, Greece and Ireland have attempted income policy agreements in recent years and wage moderation can be effective in small open economies. However, Dutch style policies require institutions for co-ordinated bargaining and mutual trust among the social partners that just do not exist in countries such as Britain and Spain.

IV. Modernizing the European Social Model: A Case for Subsidiarity?

The development of the European Employment Strategy has generated convergence in the targeting of employment policies in Member States and the current political dominance of the centre-left has encouraged the imparting of a 'third way' spin to their design, packaging and presentation. Expanding active labour market policies, strengthening work incentives, investing in people and combating social exclusion are the declared targets of almost all current policy initiatives. However, detailed examination of specific policies indicates the extent of national differences. Whilst policy transfer is to be encouraged to the extent that it promotes symmetrical labour market adjustments to symmetrical shocks within the EU, differences in labour market fundamentals provide a continuing rationale for national policy divergence.

That there are desirable limits on policy convergence within a modernizing process should not be a cause for concern: both the European social model and national variations are sustainable in the modern global economy. There is no universal 'law of one institution': institutional competition between countries has yet to promote convergence on a single social model. There is little evidence that institutions, workplace norms of behaviour, gender balances of employment or degrees of social solidarity are being harmonized within the EU. This absence of convergence in labour market fundamentals sustains differences in national labour market behaviour and adjustment, and implies that enforced policy convergence would be expensive in both economic and social terms. Moreover, both the benefits of increased flexibility and the costs of extensive regulation may be lower than anticipated. As Freeman (2000) has argued, following the Coase theorem, firms and workers adjust to the property rights determined by existing regulation. What those regulations predominantly affect is the form of labour market adjustment and the distribution between firms and workers of the resulting benefits, not overall labour market efficiency.

Modernization has to discriminate between labour market rigidities in the EU that are dynamically harmful to economic and social cohesion, and those rigidities which may be benign in the face of product and labour market failures. Only by exercising such discrimination will reform generate the 'positive and dynamic integration of economic, employment and social policies' promised in the *European Social Agenda*. Our arguments suggest two further guidelines for reform. Firstly, given the diversity of national labour market behaviour, discriminating between harmful and benign rigidities is better informed by reliance on evidence from individual Member States than from a wider sample of OECD countries (Freeman, 2000). The current infatuation with scoreboards and benchmarking at the national, EU and OECD level has associated dangers: overly simplistic comparisons of policies across diverse markets are unlikely to be informative.

Increased benchmarking may also encourage a 'pick and mix' approach to policy-making, which leads to our second guideline. Ideally reform should not be piecemeal: the existence of policy complementarities means that modernizing reforms need to be co-ordinated and mutually consistent. As Coe and Snower (1997) have argued, labour market reform, to be successful, has to dismantle a broad range of harmful rigidities, whilst achieving the distributional objectives of previous policies via alternative and more efficient means. Designing a package of complementary modernizing reforms has therefore to be conducted at the national, not supranational level. For example, attempting to emulate the Dutch model by concentrating solely upon wage moderation is unlikely to be successful. In the Netherlands, the expansion of part-time

employment meant that, although individual real income was often lower, increased participation generated offsetting rises in household income. It may be that the French have discovered an alternative complementary package based on work-sharing and increased internal flexibility. In practice, prevailing policies and behavioural norms limit the ability to introduce complementary policy packages. Given these constraints, policy-makers need to reflect on the reality that if policy changes are invariably marginal ones, we cannot simply extrapolate from their initial effects to forecast their final overall impact.

My analysis suggests that the setting of common broad targets for both employment and social policy reform in the EU is to be preferred to the requirement of greater uniformity in national reforms. The Commission still needs to co-ordinate their employment targets with those for macroeconomic policy, and continue to police cross-border spillovers from national policies. However, the Luxembourg process has encouraged an emerging decentralized modernization of policy. This promises a more flexible and targeted response to the current employment environment than that proffered either by an 'Americanization' of European labour markets or further supranational harmonization.

Correspondence:

Nick Adnett, Economics Division
Staffordshire University Business School
Leek Road, Stoke-on-Trent, ST4 2DF, England
Tel: +44 (0)1782 294077
email: n.j.adnett@staffs.ac.uk

References

- Abraham, F. (1999) 'A Policy Perspective on European Unemployment'. *Scottish Journal of Political Economy*, Vol. 46, No. 4, pp. 350–66.
- Agell, J. (1999) 'On the Benefits from Rigid Labour Markets: Norms, Market Failures and Social Insurance'. *Economic Journal*, No. 109, pp. 143–64.
- Andersen, T., Haldrup, N. and Sørensen, J. (2000) 'Labour Market Implications of EU Product Market Integration'. *Economic Policy*, April, pp. 105–33.
- Barrell, R. and Genre, V. (1999) 'Employment Strategies for Europe: Lessons from Denmark and the Netherlands'. *National Institute Economic Review*, April, pp. 82–99.
- Bean, C., Bentolila, S., Bertola, G. and Dolado, J. (1998) *Social Europe: One for All?* (London: Centre for Economic Policy Research).
- Bertola, G. (1999) 'Microeconomic Perspectives on Aggregate Labor Markets'. In Ashenfelter, O. and Card, D. (eds) *Handbook of Labor Economics Vol. 3C* (Amsterdam: Elsevier).

- Blanchard, O. and Wolfers, J. (2000) 'The Role of Shocks and Institutions in the Rise of European Unemployment: The Aggregate Evidence'. *Economic Journal*, No. 110, pp. 1–33.
- Buchele, R., and Christiansen, J. (1998) 'Do Employment and Income Security Cause Unemployment? A Comparative Study of the US and the E-4'. *Cambridge Journal of Economics*, No. 22, pp. 117–36.
- Buchele, R. and Christiansen, J. (2000) 'Workers Rights and Socio-Economic Performance in the OECD'. Paper presented at 22nd International Working Party on Labour Market Segmentation, Manchester, UK.
- Coe, D. and Snower, D. (1997) 'Policy Complementarities: The Case for Fundamental Labour Market Reform'. *IMF Staff Papers*, No. 44, pp. 1–35.
- Deakin, S. and Wilkinson, F. (1999) 'Labour Law and Economic Theory: A Reappraisal'. In De Geest, G., Siegers, J. and Van den Bergh, R. (eds) *Law and Economics and the Labour Market* (Cheltenham: Edward Elgar).
- Eichengreen, B. and Iversen, T. (1999) 'Institutions and Economic Performance: Evidence from the Labour Market'. *Oxford Review of Economic Policy*, Vol. 15, No. 4, pp. 121–38.
- Freeman, R. (1998a) 'Does it Fit? Drawing Lessons From Differing Labour Practices'. In Gual, J. (ed.) *The Social Challenge of Job Creation: Combating Unemployment in Europe* (Cheltenham: Edward Elgar).
- Freeman, R. (1998b) 'War of the Models: Which Labour Market Institutions for the 21st Century?' *Labour Economics*, No. 5, pp. 1–24.
- Freeman, R. (2000) 'Single-Peaked v. Diversified Capitalism: The Relation Between Economic Institutions and Outcomes'. *National Bureau of Economic Research Working Paper* No. 7556.
- Gregg, P. and Manning, A. (1997) 'Labour Market Regulation and Unemployment'. In Snower, D. and de la Dehesa, G. (eds) *Unemployment Policy: Government Options for the Labour Market* (Cambridge: Cambridge University Press).
- Gual, J. (1998) 'The Employment Debate: Employment Performance and Institutional Change'. In Gual, J. (ed.), pp. 1–33.
- Gual, J. (ed.) (1998) *Job Creation: The Role of Labor Market Institutions* (Cheltenham: Edward Elgar).
- Issing, O. (2000) 'Europe: Common Money – Political Union?' *Economic Affairs*, March, pp. 33–9.
- Martin, J. (2000) 'What Works Among Active Labour Market Policies: Evidence from OECD Countries' Experiences'. *OECD Economic Studies*, Vol. 30, No. 1, pp. 79–113.
- Micklewright, J. and Stewart, K. (1999) 'Is the Well-Being of Children Converging in the European Union?' *Economic Journal*, No. 109, pp. 692–714.
- Nickell, S. (1997) 'Unemployment and Labor Market Rigidities: Europe versus North America'. *Journal of Economic Perspectives*, No. 11, pp. 56–74.
- Nickell, S. (1998) 'Employment Dynamics and Labour Market Institutions'. In Gual, J. (ed.), pp. 34–48.

- Nickell, S. and van Ours, J. (2000) 'The Netherlands and the United Kingdom: A European Unemployment Miracle?'. *Economic Policy*, April, pp. 135–80.
- OECD (1994) *The OECD Job Study: Evidence and Explanations*, Vols I and II (Paris: OECD).
- OECD (2000) *Economic Outlook*, May (Paris: OECD).
- Pissarides, C. (1999) 'Policy Influences on Unemployment: The European Experience'. *Scottish Journal of Political Economy*, Vol. 46, No. 4, pp. 389–419.
- Saint-Paul, G. (1997) 'Is Labour Rigidity Harming Europe's Competitiveness? The Effect of Job Protection on the Pattern of Trade and Welfare'. *European Economic Review*, No. 41, pp. 499–506.
- Scharpf, F. (2000) 'The Viability of Advanced Welfare States in the International Economy: Vulnerabilities and Options'. *Journal of European Public Policy*, Vol. 7, No. 2, pp. 190–228.