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# Future of the European Social Model in a global economy

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## Introduction

The member states of the European Union (and some other European countries) have developed institutional structures – such as social security systems, labour market regulations, and institutionalised forms of social dialogue – that contain and channel market forces. While considerable differences of institutional form are to be found among the European countries, viewed from a global perspective and in comparison with other advanced capitalist countries, a number of common features emerge that justify the use of the term 'European Social Model' (ESM). These features refer both to outcomes – Europe performs substantially better than other countries on indicators such as inequality and health – and to structures. For, despite differences, such as different degrees of reliance on law or on collective agreements to establish the 'rules of the game' in each country, common institutional features do emerge including regulations that set a floor for labour markets and seek to ensure 'fair' treatment of weaker bargaining parties; the provision of key public services; substantial redistribution through the tax and benefit system; social protection/insurance against risks; social dialogue and the organised participation of workers. Lastly, Europe is unique also in having a genuinely supranational, in other words a 'European', dimension to national systems, in the form of the social *acquis*, Community laws, etc.

These institutional arrangements were achieved over time as a result of social struggles involving, not least, Europe's trade unions. More recently, however, against the background of disappointing economic and employment performance in many countries, and faced with the increasing internationalisation of the economy and the rise of new competitors, the ESM has been subjected to sustained attack at the ideological level, and steps have been taken in many countries to 'roll back' a number of its core features. In this debate, globalisation is frequently used as an argument that social Europe is no longer affordable and is a barrier to necessary reforms and to competitiveness.

Against this background, this note turns first to the facts about Europe's position in the global economy, moving on to consider possible links from globalisation to the ESM and the alleged necessity of reform. It then looks in more detail at specific features of the model and at arguments about the (in)efficiency of social institutions, before closing with a number of questions that Europe's trade unions need to address in the coming years.

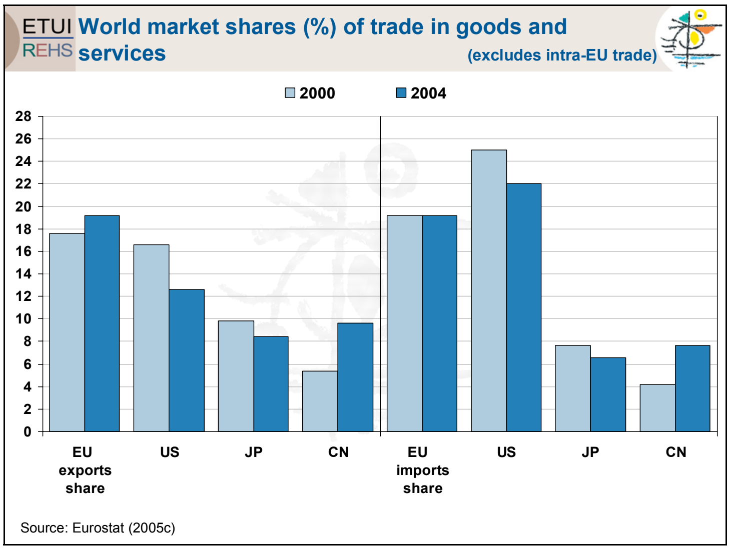
# I. The links between globalisation, competitiveness and labour market and social policy

## Europe in the global economy

Many of the claims made about Europe's tenuous position on world markets, its alleged lack of competitiveness, and the threat from low-cost (China, India) or dynamic and flexible (US) economies, are either wrong as matters of fact or flawed in their conception. This can be shown by looking at three key facts about the EU economy.

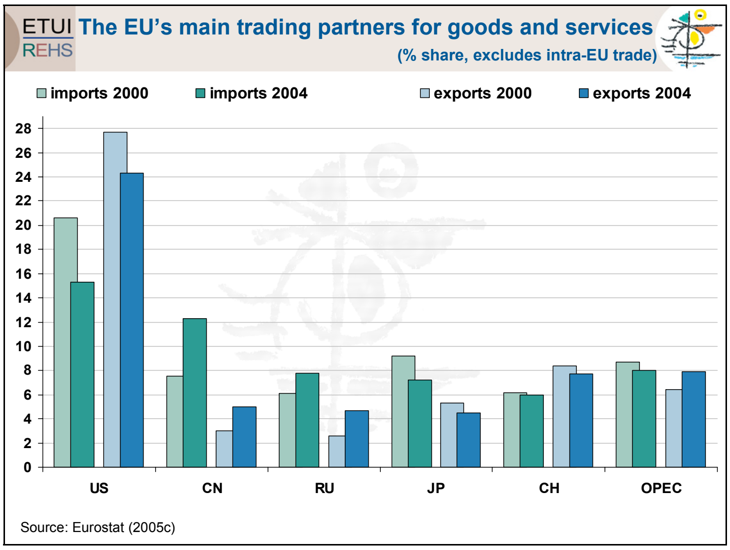
- The EU25 is the largest trading block in the world in terms of exports and has increased – in the face of the rise of China and other newly industrialising countries – its share of world exports. Overall it records a slight surplus on its trade balance, in stark contrast, notably, to the US. It is particularly strong in the – rapidly expanding – trade in services.

**Figure 1**



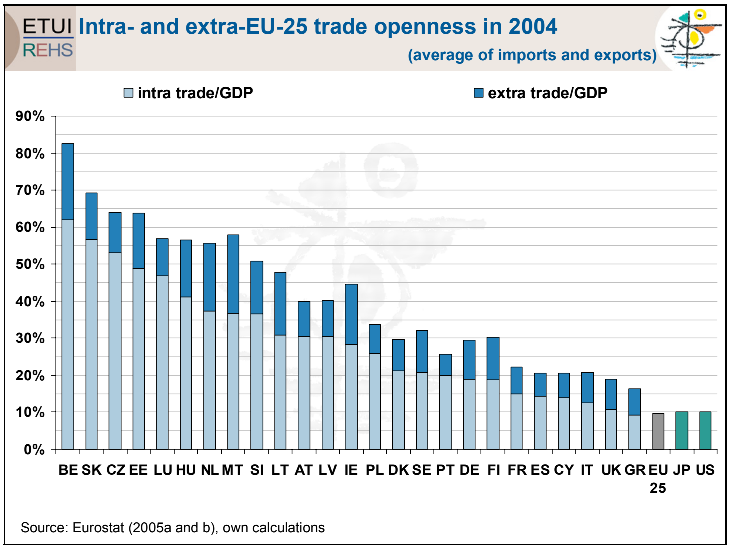

- Europe trades primarily with other advanced capitalist countries (and with oil suppliers), rather than low-cost producers. The same is true also of foreign direct investment. There is one important exception, namely, China which now accounts for 12% of EU25 imports and some 5% of its exports. Importantly, the EU25 trade deficit with China has widened only recently. Even now, at around EUR70 billion, it is about the same size as Europe's trade *surplus* with the US (a surplus that has proved resilient in the face of substantial appreciation of the euro against the dollar).

**Figure 2**



- Perhaps most fundamentally, although individual European countries are indeed highly open to trade – in many of the smaller ones exports represent more than half of output – this is very largely intra-European trade. As a whole, the EU25 is almost exactly as 'open to the world economy' – or should that be 'closed'? – as the US or Japan, with exports representing around 10% of output.

**Figure 3**




Already these basic facts suggest a need to be extremely cautious about jumping from 'globalisation' to 'the need to reform the European social model'. Rather, policymakers should focus more on how to manage Europe's *internal* economic affairs so as to promote the welfare of its citizens. Seen as a whole, Europe is not a cork bobbing on a stormy global sea. Nor does it suffer, at the aggregate level, from lack of international competitiveness. The same facts also imply that Europe need not – as some siren voices on the Left suggest – withdraw behind a protective tariff wall. The future is, of course, uncertain, but wages in China (and also in eastern Europe!) are already rising rapidly, and China's exchange rate will also at some time adjust. The examples of Japan and South Korea in earlier decades show that the rise of new industrial powers does cause major adjustment pressure at the sectoral and local/regional level, but that, appropriately managed, the overall impact is benign.

Yet there are even more fundamental reasons for such caution. Global production is not a zero-sum game. Rapid economic growth in the rest of the world, especially in poor developing countries, is to be welcomed not only for its contribution to raising living standards there but also because it has concrete overall benefits for the European economy, in terms of export opportunities and a chance to move production higher up the value chain. Globalisation indeed implies that lower-added value activities are to an increasing extent transferred (or 'delocalised') to low-wage economies. This has and will continue to cause substantial disruption and hardship for individual sectors and regions, and for the workers (and their unions) affected. At the same time, however, globalisation offers the European economy the opportunity to use these resources being 'freed up' by restructuring to set up new activities and sectors which make better use of Europe's competitive advantages as a 'knowledge' and high technology economy.

The essential point to be stressed and noted here is that the key determinants of the material welfare of Europe's workers and citizens – productivity, employment opportunities, income distribution and public welfare provision – are almost exclusively determined by the economic, employment, structural and social policies that we implement in Europe, at national and at European level, and not by what happens in China or elsewhere. We are not getting poorer because China is getting richer. (This is not, of course, to argue that European trade unions should be unconcerned about respect of core labour standards, dumping and exchange rate manipulation – see below)

**How might globalisation affect the ESM?**

Does the above mean that 'globalisation' is merely a mirage, a convenient excuse for employers and politicians to demand changes that run counter to the interests of working people? No. Production, distribution and financial structures have changed fundamentally in recent decades and globalisation is indeed a real phenomenon. What is needed is a careful reflection on the implications of those changes for workers, trade unions and the social model in Europe, an absolutely key issue being the mobility of capital or the employers' 'exit option'.

In the past, firms seeking to sell on a given national market were, to a considerable extent, also required to produce there. This meant that unions and governments could impose upon producers conditions of production (decent wages, adherence to social and environmental standards, etc.) that firms/capital owners had to accept as a condition of production. Moreover, they were ultimately *willing* to accept these conditions insofar as they represented a level playing field for all producers on the cost side and also had positive effects in terms of ensuring reliable demand-side growth. (In the course of European integration, this increasingly became a European, rather than a national, phenomenon, but then standards and wage levels were not too far apart in most cases and some – albeit limited – European-wide regulations and standards were set.)

Increasingly firms have become freer (for reasons both technological and political) to split up production chains to seek the lowest cost production location, often without concern for the 'quality' of the location in terms of sales market, social provisions, etc. At the same time financial capital has become more global in its reach, raising the demands for returns on capital invested in producer enterprises. Faced with such competitive pressure, employers in each country have increasingly sought to force down production costs, depressing wages and calling into question social achievements (many of which are financed through various charges on labour). This, in turn, has had the effect of pitching countries' regulatory regimes into competition with one another, as 'capital' demands the same (risk-adjusted) returns as it can earn in other countries. This step change in the mobility of capital (compared with that of labour) lies at the heart of many of the debates, across Europe and in the labour movement, about 'delocalisation', the role of hedge and private equity funds, GATS and the services directive, or unfair tax competition. There is a clear need for policies in these areas in order to reduce the extent to which capital can play off national labour movements and governments against each other. In principle the European level offers an arena for doing just that, although the practical difficulties of getting the required political majorities – often enough unanimity – to adopt and enforce the required legislation are well known.

It is important for the labour movement to be clear about the right lessons to draw from this. It is clearly a difficult issue. As a first step it is important to be clear what it does NOT mean.

Europe does *not* have to reduce its wages and other standards to those of developing countries. *Nor* does it have to abandon its welfare state model(s). European workers are among the most productive in the world. In a very real sense they 'earn' their relatively high wages. As shown above Europe remains 'competitive' on world markets and attracts major shares of global FDI. Nor does a necessity to ensure that capital earns the global rate of return impose specific choices regarding welfare and social policies.

- Firstly the risks associated with producing in Europe are much lower than elsewhere in the world – a fact that reflects, not least, the existence of a European Social Model that provides security and reduces extreme inequalities and as a result of which actual returns may be lower than elsewhere (so as to equalise risk-adjusted returns).
- Secondly, and more fundamentally, the link between the need to earn a rate of return on capital and the features of a social or welfare model is a very tenuous one. Even within the – seen from a global perspective – decidedly homogeneous group of countries that was the EU15, it is well known that the institutional features, 'generosity' of benefit levels, modes of financing, etc., vary substantially. As was argued above, globalisation does not mean that a country cannot maintain a 'costly' system of, say, unemployment benefit. Given the need to achieve a given rate of return, those costs will, in the end, be borne by workers and consumers in the country concerned. Reforming the system may enable those costs to be reduced (and overall welfare increased), but this is a debate that is largely separate from that about globalisation. What globalisation does is ensure that the costs can no longer be passed on to capital.
- Thirdly, and equally fundamentally, it is important to be very clear about the nature of 'costs' when discussing welfare regimes. The direct costs are usually easy to measure. But they must be weighed against the – perhaps more difficult to measure – benefits in terms of economic efficiency. Labour market and social policies can be seen as an investment. (This is the subject of the next section.)

The above suggests that policymakers – at least those without an ulterior motive – would be well advised to distinguish clearly between the globalisation debate and that on welfare reform and the ESM. Globalisation does throw up challenges, but many of the responses should come from policy areas other than those of national labour market and welfare reform, where employers, some politicians and the media tend to locate them.

These policy areas include:

- specific adjustment policies (structural, industrial policy, globalisation adjustment fund, etc.);
- macro policies (globalisation and trade have benefits only in a fully employed economy, and this requires a proactive macroeconomic policy that has been lacking in the euro area, particularly in recent years); and
- policies to fight the 'unacceptable face' of globalisation (some activities of hedge funds, Tobin tax, core labour standards, WTO, etc).

Important as they are, these issues will not be developed further here.

The second part of this note seeks to respond to critics of the ESM and its alleged responsibility for Europe's poor performance in the context of globalisation. The central argument is that proactive social and welfare policies can actually help firms and workers adapt successfully to the challenges of globalisation, rather than prevent such adaptation.

## II. The European social model and the challenge of structural change

### Europe too slow to change? 'Modern' instead of 'old' social policy?

Central to the present policy discussion on Social Europe is the argument that globalisation implies rapid change and that the so-called 'old' social agenda of workers' rights stands in the way of this process of 'creative destruction'. Specifically, many policymakers, at both European and national level and across the political spectrum, argue that instead of protecting existing jobs and financing non-activity, policy needs to shift attention to investing in a highly skilled labour force. Such a skilled labour force would then take advantage of the job opportunities offered by the internal market and globalisation and which make labour market regulation superfluous. The discussion on 'flexi-curity' represents an enlightening example. The concept of 'flexi-curity' is, to an increasing extent, being used to assert that policy should not protect the job but should, *instead,* protect the worker by providing workers with the skills necessary to find new jobs. In this way, a very 'business-friendly' solution of 'free-firing' is being put centre stage, which can have the side-effect of constraining trade union action at the workplace.

### Social Europe and 'modern social policy' opening up the 'high road'

How should the European trade union movement react to the attack on Social Europe? A first part of the answer is to *not* step into the trap of rejecting all structural reform of labour market institutions or social protection schemes. Europe does indeed need to invest more in the agenda of skills, upward mobility and increased but productive labour market participation in general. We need to ensure that as many workers as possible are able to participate in the process of upgrading the economy.

This implies the following set of reform priorities:

- *Investing in a skilled workforce.* At present, there is too little progress on key educational benchmarks important for fostering social cohesion (early school leavers, key competences, share of upper secondary). Progress in participation in lifelong learning is merely skin deep and is attributable to changes in statistical method. One problem is that employers are failing to deliver on lifelong learning. Collective bargaining on training can overcome the employers' collective action problem here, but such bargaining is rather low in Europe (Commission 2005).
- *Investing in upward mobility.* In the US, displaced workers do find new jobs somewhat more rapidly, in comparison with European workers. However, an important segment of US workers (about a quarter) have to accept pay cuts of over 30% in the new job. This represents a waste of human resources. Workers should receive assistance in finding the way to a new job with at least similar levels of productivity and pay. If this is not the case, then potentially productive resources are going to waste. To avoid this, we need to invest in policies that will offer displaced

workers and the unemployed in general the possibility to upgrade their skills and to receive assistance in looking for a job that matches these upgraded skills. Collective bargaining practice in Sweden and Finland, where every retrenched worker is entitled to career transition assistance, may serve as a benchmark. Additionally, the idea of 'sabbatical' years for older workers, financed by social security to allow them to direct their career along new paths, is useful as a means of keeping older workers in good jobs on the labour market.

- *Tackling the gender gap, ensuring a policy of gender mainstreaming.* Another waste of human resources that Europe simply cannot afford is the loss in employment and productivity potential caused by the chronic gender gaps on the labour market. With a gender pay gap as well as an employment rate gender gap of 15%, not to mention reduced career opportunities for women, much remains to be done. In particular, the provision of high-quality and affordable (child) care facilities (Barcelona target of 33% of children aged 0 to 3 years and 90% of children from 3 years to school age) as well as policies to improve the quality of work and a good work-life balance are essential.

**Social Europe and labour standards 'closing down the low road'**

New social policies investing directly in skills and upward mobility of workers should definitely be part of our concerns and demands. But what about the more 'traditional' approach of designing labour standards in order to protect workers from possible abuse by their employers? Is this, as the mainstream policy discussion is arguing, an outdated policy approach?

A closer look at the relationship between the 'traditional' agenda of workers' rights and the 'new' social policy agenda reveals that these two agendas are in fact highly complementary and interdependent. Workers' rights are essential as the basis on which to build the skills and mobility agenda:

- **Matching workers' skills and quality jobs.** It's all very well to focus on the skills agenda but what if firms are mostly offering 'bad' jobs because of 'cut-throat'/cost-cutting competition? In that case, firms are forced on to a low-road approach, and any incentive to invest in skills and raising productivity will be weakened.

  Here, the function of labour standards is to provide a level playing field ruling out unfair competition and making it impossible for business to take the 'easy way out' (by cutting wages, imposing long working hours and insecure labour régimes). Labour standards prevent bad job practices from spreading. They help business to avoid becoming stuck in a short-run market 'equilibrium' based on simple exploitation of labour. Instead, they help put business on the road to genuinely innovative workplace practices.

- **Workers caught in 'bad' job traps.** It is not just business that can become trapped in a low innovation/low productivity equilibrium in the absence of decent labour standards. Workers also suffer from these 'bad job' traps. The majority of workers holding 'second-tier' jobs (low-pay jobs, temporary jobs, part-time jobs) remain in such jobs or bounce in and out of employment without transiting to better jobs (European Commission 2004).This is why atypical jobs should not be allowed to become the rule, a stance on which the European Social partners agreed at the end of the nineties. And it is why labour standards are required, as a corrective for the perverse aspects of atypical jobs. For example, long working hours coupled with low pay make it materially impossible for workers to engage in training and lifelong learning, while also undermining work-life balance and gender equality.

- **Rapid change must be managed.** To avoid wasting labour resources, it is important not only to get displaced workers into new jobs but also to ensure that they move into productive jobs. Here, institutions such as employment protection and unemployment benefits systems can be a big help:
  - In the absence of unemployment benefits, retrenched workers will have to accept any job, even a 'bad' job, and risk becoming stuck in it. Unemployment benefits allow the unemployed to invest in training, mobility and active job search. Moreover, by ensuring a safety net, they help workers to accept change instead of fighting it (trade unions in the US, for instance, tend to be much more protectionist than their European counterparts).
  - Advance notification gives retrenched workers a 'head start' and the possibility of preparing themselves for structural change. Workers enjoying advance notification of dismissal find new jobs more rapidly than workers fired on the spot. This is why even countries with the reputation of having a 'free hire-and-fire' system have this specific form of job protection. In Denmark, for example, collective agreements require firms to respect a 4-month notification period in case of collective dismissals for a worker with 4 years of tenure. According to OECD statistics, advance notification in Denmark is among the highest in Europe (apart from Sweden)[1] (see table in annex).

- **Social exclusion, the worst enemy of the knowledge society.** Societies with low social cohesion and high inequality and poverty are in a bad position to build the 'knowledge society'. With children born in poor households rapidly accumulating learning difficulties, poverty tends to reproduce itself over the generations. Intense redistribution policy, high public spending on social transfers and education produce social mobility over the generations. Whereas 40% of those born into the poorest quintile in the US remain in this relative income group, the corresponding figure is limited to around 25% in the Nordic countries and 30% in the UK (Bratsberg 2006). Europe may be considered by some to be economically rigid but it is certainly socially mobile.

### Europe needs both an agenda of modern social policy and an agenda of fair working conditions

The present European policy discussion on the modernisation of the European social model in a globalising world is misleading. Yes, European labour market policies need to do more to accompany the process of moving the economy higher up the ladder of international specialisation. Yes, we need to pay more attention to the agenda of skills, upward worker mobility and gender equality.

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[1] US policy also recognizes the importance of advance notification. In the US, a two-month notification period is obligatory in case of collective dismissals. The US also has a system of 'experience rating': Firms transferring the costs of adjustment to the state and its unemployment benefit systems do have to pay special contributions, depending on the extent to which they adjust by retrenching workers. So, even in the US, firing is not an entirely 'free lunch' for employers and the burden of adjustment is to a certain extent also carried by the business side.

But no, this does not mean that the agenda of workers' rights and social protection is outdated. On the contrary, globalisation is also increasing the relevance of this latter agenda. Indeed, if we want to advance the agenda of investing in skills and mobility, then we need to make sure that the other agenda of ensuring fairness and promoting workers' rights on the labour market is also respected and promoted. The two approaches are actually highly complementary.

So, instead of 'throwing out the baby with the bathwater', a more intelligent approach is to use the agenda of fair working conditions as a basis upon which to build the agenda of skills and mobility and to improve the degree to which the latter agenda complements the former.

On the one hand, this probably does involve some reform of certain details of workers' rights. More attention needs to be paid to the objective of upward mobility for workers by, for example, linking prior notification and unemployment benefits more closely to (upward) career transition arrangements.

On the other hand, this approach also supposes that in cases where fair treatment of workers is not (sufficiently) ensured, workers' rights need to be strengthened.

Basically, what is needed is to shift the emphasis in the present policy discussion from 'modern instead of old social policies' to 'modern social policies and_rights on fair working conditions'; from 'free' firing systems to job protection schemes that focus on adequate prior notification combined with career transition arrangements; from 'workfare' policies driving the unemployed into any kind of job to 'learn-fare' benefit systems combining social protection with skills upgrading and active job search assistance.

## Questions and issues for discussion

- It is a fundamental mistake to leave the domain of structural reforms to employers, politicians and international economic institutions. Trade unions in Europe should return to occupy this ground once more. How can we best put forward our own 'trade union agenda for structural reform' as an alternative to the current agenda of deregulation of workers' rights? On what points should we focus? What are the points on which we would need 'to move' ourselves?
- How do we deal with the distinction currently in vogue in policy discussion in Europe between 'modern' and 'old' social policies, between supposedly outdated rights and protection and new and modern approaches to protecting workers in the labour market? Do we accept such a distinction? If not, what other approach do we offer on existing protection standards and new forms of worker protection?
- The European Social Model does exist. Amongst member states, there are shared principles and objectives of social equity, equality, protecting workers against possible abuse from employers, social protection and social dialogue. However, there are differences in approach and social tradition amongst member countries and trade unions. Whereas some models of workers' protection are based on almost complete autonomy of the social partners, others rely much more on the legislative role of the state. This divergence in approach may leave the trade union movement in Europe

vulnerable to strategies of 'divide and rule'. How is it possible to cope with this divergence within the European Social Model?

- The discussion on the European Social Model and a modern agenda of structural reform is important. But the discussion on the European economic model with an unbalanced policy focus on stability instead of growth is surely equally important? How are these two discussions to be combined? Does the work programme of European social partners on issues such as 'flex-security' and macroeconomic policy offer a way to open up a more fruitful discussion of the European Economic Model? Can we offer any practical suggestions on how to handle this?
- What is to be the role of the European level in all of this? What role can/should the ETUC play? Can we offer practical suggestions for concrete action?

**Attachment**

**Notification period in case of collective dismissal for a 4-year tenure worker**

| | |
|---|---|
| Denmark | 4 months |
| Austria | 2 months |
| Belgium | 4 months |
| Finland | 2 months |
| France | 2 months 20 days |
| Germany | 2 months |
| Italy | 2,5 months |
| Sweden | 6 months |
| UK | 3 months |

Source: OECD Employment Outlook 2004

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