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European Socio-Economic Models:

Experiences and Reform Perspectives

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This article explores the differences in economic and social performance across European welfare models to learn about successful strategies for Europe. How did the various models cope with the new challenges of the welfare state and what can we learn from recent developments and strategies? We largely follow the standard definition of model types in the tradition of *Esping-Andersen*, distinguishing between an Anglo-Saxon, Scandinavian, Continental and Mediterranean version of the European model.

Is there a feasible European social model?

„The simplest difference between the USA and Europe is that we have welfare states, and they do not"

(J. Wickham, National Forum on Europe, 2002:1)

Although Europe is diverse in many respects, at a broad level we can speak of a 'European economic and social model' characterised by a high level of taxation, state activity, redistribution and social cohesion. After all, all European member states share a common commitment to social justice and even in the UK, one of the most liberal market economies in Europe today, the public social expenditure to GDP ratio is about 20 percent, not much less than in the Scandinavian country Finland.

In the decades after World War II Europe was a great economic and social success story: In this "Golden Age" European welfare states combined strong growth, low unemployment and a solid social safety net. According to most economic indicators Europe had caught up vis-à-vis the United States in these years, but fell behind again in the last decade. Europe has performed rather poorly since the mid-1990s: Economic growth and the growth of productivity were lower than in the past and lower than in the US. Unemployment has been persistently high.

As to the reasons for this European underperformance, there is no lack of competing explanations: Some people claim that the inferior performance is the consequence of restrictive macroeconomic policies in Europe, blaming both monetary policy (first the German Bundesbank and later the ECB) and fiscal policy due to the Maastricht criteria and the Stability and Growth Pact as well as insufficient wage increases as reasons for slow growth. Others blame explicitly and implicitly high welfare costs and low market flexibility for the disappointing growth. The European model with its emphasis on social protection is seen as barrier to competitiveness in a global world.

This paper rests on the assumption that, in a complex reality, no straightforward explanation is apt to shed light on the question of Europe's lacklustre economic performance. First, we have to take into account that the world has changed since the "Golden Age": On the one hand, international competition has intensified through globalisation, a development that in Europe was reinforced by the fall of the iron curtain and European integration. These factors have strengthened the potential for growth, but at the same time more flexibility was required both on goods and labour markets. On the other hand, welfare state institutions have come under pressure by demographic ageing, rising unemployment, flexibility requirements and a process of individualisation. Second, it has to be pointed out that economic policies and reform activities (or reform inertia) have been rather diverse across countries. As a third point, we also have to bear in mind that economic performance, too, has varied: 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, all large continental European economies fell behind in the last decade.

The aim of this paper is to investigate what kind of welfare state architecture is required in Europe in the face of intensified competition due to globalisation and European integration, higher flexibility requirements and demographic ageing to fulfil the ambitious Lisbon agenda; i.e. to achieve the virtuous triangle social cohesion, full employment and dynamic economic growth. Starting off with Esping-Andersen's well-known classification of welfare models we look at the differences in recent developments between the European countries and the United States and at their institutional differences and reform strategies. Then, policy strategies of the successful countries and the changes they performed over the past 10 to 15 years are analysed. We summarise features of reform, which lead us to a vision of a reformed European model, which is no barrier to growth but a comparative advantage in the struggle for international competitiveness.

1. Models of European society

There exists a vast literature on the European social model, holding very diverse positions. With reference to the great institutional and socio-cultural differences among European states, the existence of a common social model has been questioned (e.g., *Kleinman*, 2002). Nevertheless, most authors agree on the distinctiveness of the European social model. According to *Grahl – Teague (1997)* "the European Social Model, [...] is understood as a specific combination of comprehensive welfare systems and strongly institutionalised and politicised forms of industrial relations". This definition, which can be used as starting point of discussion, focuses on the role of the state as a mediator between the individual and the market, and between workers and employers. However, opinions differ as to which characteristics constitute a "model", how many of them exist, and which countries can be subsumed under which model. According to *Aiginger – Guger* (2005) a pragmatic definition of the European model can be based on the terms of responsibility, regulation and redistribution.

Responsibility

Society takes rather broad responsibility for the welfare of individuals and reduces individual risks, i.e. sheltering them against poverty, and providing support in case of illness, disability, unemployment and old age. Society encourages, and actively promotes and often provides education, health, and the support of families (the latter through transfers as well as through the provision of care and housing facilities).

Regulation

Labour relations are institutionalised; they are based on social dialogue, labour laws and collective agreements. The business environment is rather regulated and is shaped by social partners (on the branch and firm level). Administrative and economic regulation for product markets exists. Business start ups depend on permits and partly on qualification of owners or managers.

Redistribution

Redistribution between income groups and over the life cycle: Transfers, financial support and social services are open to all groups; differences in incomes are limited by redistributive financial transfers, taxation and taxes on property.

These three basic characteristics reflect the fact that the European model is more than just a social model in the narrow sense. Indeed, it also influences production, employment and productivity and thus, growth and competitiveness and all other objectives of economic policy. Hence, it seems more appropriate to speak about a European socio-economic model rather than merely about a social model. This perception is not new and it coincides with a traditional notion whereby the economic and social spheres are closely interlinked, and a function of the same interests. In the 19th century Bismarck forged the first alliance between state and enterprise, social provision and economic production. This synergy was mainly aimed at containing the rise of socialism, but it also proved conducive to efficiency and competitiveness. In today's world, where the goal of advanced post-industrialist countries is to become "competitive and dynamic knowledge economies", attention must also be paid to the mechanisms that drive learning and the creation and diffusion of knowledge. Accordingly, in our understanding the European socio-economic model comprises economic life and social security, but also social relationships, cultural institutions and the innovation system.

In our comparative analysis we look at indicators of economic and social performance, on growth drivers and regulations. We include the educational system as well as other aspects that shape the "knowledge-based society". The basis for this analysis is nevertheless provided by seminal work on welfare state regimes by *Esping-*

Andersen (1990) and others.[1] It is standard practice[2] to distinguish between clusters of Scandinavian universalistic, Continental corporatist, Anglo-Saxon liberal and Mediterranean welfare regimes within the EU, each with its different problems and potentials for reform.[3] The question whether to cluster the new EU member states in a separate group or rather to assign them to one of the other ideal-types has not been answered satisfactorily yet. Moreover, since the history of these countries as market economies is comparatively short, we have opted for their exclusion from our overview. Outside of Europe, the US model serves as the standard benchmark for a group of countries that includes Canada, Australia and New Zealand and that can be defined as the overseas variety of the Anglo-Saxon model.

1.1 Scandinavian universalistic model

The Scandinavian model is the most comprehensive one, with a high degree of emphasis on redistribution, social inclusion and universality. These goals are pursued through a generous infrastructure of social services, which are designed to be both affordable and of high quality. Benefits are largely de-commodified, meaning that dependence of the individual on the market and on his labour is lowest. Unemployment benefits, which are characterised by high replacement rates, and the health system are financed through the tax system. Taxation is very progressive and includes elements of property taxation, while business taxes are rather low. The countries that can be subsumed under this ideal-type (Denmark, Finland, Sweden and, outside the EU, Norway) are characterised by a strong social dialogue and close cooperation of the social partners with the government. Trade unions are strongly involved in the administration of unemployment insurance and training, and the model is characterised by an active labour market policy and high employment rates. The Scandinavian countries have been successful at generating high employment rates and at reducing gender inequalities on the labour market.

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[1] In his classic comparative study *Esping-Andersen* (1990) found that variations of welfare state cluster around the three ideal-typical regimes of liberal, corporatist and social-democratic welfare. Leibfried (2000), among others, has further refined this classification.

[2] E.g., *Taylor-Gooby* (2001), *Ferrera* (1998).

[3] See *Ferrera – Hemerijck – Rhodes* (2000).

1.2 Continental corporatist model

The Continental model emphasises employment as the basis of social transfers, benefits are at a more moderate level and they are linked to income. Accordingly, transfers are financed through the contributions of employers and employees. The redistributive efforts of the fiscal system are less pronounced than in the Scandinavian countries as the tax system contains some regressive elements (i.e. low wealth and high income and consumption taxation). Social partners play an important role in industrial relations, and wage bargaining is centralised. The institutions of social dialogue as well as parts of the economic regulatory framework bear the imprint of a corporatist system. Classification of countries to this variety of European model is less straightforward and undisputed than in the case of the Scandinavian model. We opt for the inclusion of six countries in this cluster – France and Germany, which are the two biggest continental countries, plus Belgium, Netherlands, Austria and Switzerland, four countries with top positions in per capita GDP. It is striking that the social model typology groups Germany and France together into one group. When analysed in terms of intervention (high in France, low in Germany), mode of industrial policy (sectoral in France, horizontal in Germany) or the importance of nationalisation and competition policy (with France favouring nationalised champions, while in Germany competition policy is similar to a holy grail), these two countries would be ascribed to different models. But the literature is undivided when it comes to the inclusion of France and Germany into the same group of "social models". The inclusion of the Netherlands in this group is the most contentious choice, because the Dutch welfare regime looks very different depending upon which basis for classification is used (*Goodin – Smitsman*, 2000). There is also certain amount of disagreement as to whether Italy fits better into this group or into the Mediterranean group.

1.3 Anglo-Saxon liberal model

The liberal model emphasises the responsibility of individuals for themselves, its labour market is not regulated and its competition policy is rather ambitious. Social transfers are smaller than in the other models, more targeted and "means tested". 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). Labour relations are decentralised, and bargaining takes place primarily at the firm level. The Anglo-Saxon model is championed in Europe by the United Kingdom. As far as the low degree of regulation and the social system are concerned, Ireland exhibits a certain degree of similarity to the United Kingdom, but policy interventions have been intense. This can be ascribed to the particular position of Ireland, which has rapidly moved from being a low-income country to being one of the richest and best-performing European economies.

1.4 Mediterranean family-oriented model

In the Mediterranean countries, social transfers are smaller than in the remaining regimes. 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, at the same time some traits of a paternalistic society and pronounced gender inequalities characterise these countries. Trade unions and employer representatives are important to the rather centralised bargaining process for wages and work conditions. Employment rates, specifically those of women, are low. The Mediterranean group of countries comprises Spain, Italy, Portugal and Greece.

Public social expenditure

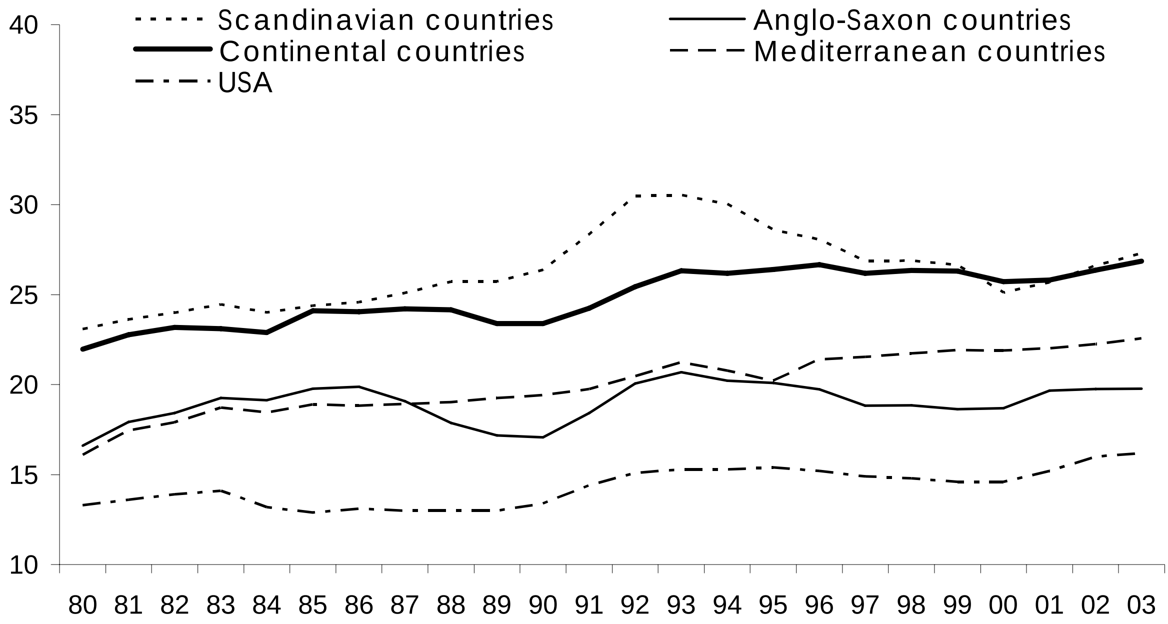
A core indicator of welfare state activities is public social expenditure, which is relatively high in the Scandinavian and Continental European countries and relatively low in the Mediterranean and Anglo-American countries. The fluctuations of social expenditure as a percentage of GDP are strongly affected by cyclical developments (see *figure 1*). Since 1980 public social expenditure has been rising in all country groups, with the smallest increase in Anglo-American countries (see *table 1*). During the last decade, social expenditure ratio has been relatively stable in all country groups.

Table 1: Public social expenditure and taxes

	Public social expenditure		Tax revenue
	2003	1980-2003	2005
		Percent of GDP	
Scandinavian countries	**27.3**	**+ 4.2**	**48.6**
Denmark	27.6	+ 2.4	51.2
Finland	22.5	+ 4.1	44.0
Sweden	31.3	+ 2.7	52.1
Norway	25.1	+ 8.2	45.0
Anglo-Saxon countries	**19.8**	**+ 3.2**	**38.1**
Ireland	15.9	– 0.9	32.2
United Kingdom	20.1	+ 3.5	38.6
Continental countries	**26.9**	**+ 4.9**	**42.7**
Germany	27.6	+ 4.6	40.2
France	28.7	+ 7.9	45.8
Belgium	26.5	+ 3.0	47.7
Netherlands	20.7	– 3.4	39.2
Austria	26.1	+ 3.5	43.6
Switzerland	20.5	+ 6.6	
Mediterranean countries	**22.6**	**+ 6.5**	**38.7**
Greece	21.3	+ 9.8	36.7
Italy	24.2	+ 6.2	40.8
Portugal	23.5	+ 12.7	36.3
Spain	20.3	+ 4.8	36.4
EU 15	**24.6**	**+ 4.9**	**41.1**
United States	**16.2**	**+ 2.9**	**–**

Source: Eurostat, OECD, WIFO calculations

Figure 1: Public social expenditure
Percent of GDP



Source: Eurostat

2. Economic and social effects of the European welfare state models

2.1 Economic performance

It is well known that 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 authors 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. Other authors emphasise the role of "growth drivers", macroeconomic policies and the housing cycle.

The economic performance is summarised in the following tables: In the long run (1970-2006), there were rather small growth differentials between the different country groups ("social models") in Europe. Long-run GDP growth (+2½ percent p.a.) was about the same in the Anglo-Saxon, Scandinavian and Mediterranean countries, but somewhat lower in Continental Europe.

High growth dynamics in Ireland, Spain etc. resulted in immigration waves so that the differences in GDP growth rates per capita across countries were even smaller. In the period 1970-2006, GDP per head increased by 2,0 percent in the EU-15, in most countries 0.4 percentage points less than GDP. Only the immigration countries revealed a much larger difference.

Even more interesting for international comparisons appears to be the development of GDP per capita, corrected for the initial level of GDP per head. It is, of course, 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, Austria, Finland and Norway. Greece, Portugal, France, Germany, Italy and Spain were under-performing.

Growth differentials between EU countries have become larger since the nineties. In the period 1990 to 2006, GDP growth per head was substantially higher in the Anglo-Saxon and Scandinavian countries than in Continental and Mediterranean Europe. The effects of house prices on consumption and residential building have been an important reason for increasing growth differentials.

The strikingly good long-run economic performance of the Scandinavian countries and Austria makes it dubious to blame the welfare state for poor economic performance. Public social expenditure is much higher in the Scandinavian countries and Austria than on EU average. A cross-country diagram (see *figure 2*) rather gives us the impression that countries with healthy social standards had a better economic performance.

Table 2: Economic performance

	Real GDP growth		Real GDP growth per capita		Actual minus hypothetical real GDP growth per capita	
	Percent p.a.		Percent p.a.		Percent. points p.a.	
	1970/2006	1990/2006	1970/2006	1990/2006	1970/2006[1]	1990/2006[2]
Scandinavian countries	**+ 2.5**	**+ 2.4**	**+ 2.1**	**+ 2.0**	**+ 0.3**	**+ 0.7**
Denmark	+ 2.0	+ 2.2	+ 1.7	+ 1.9	– 0.0	+ 0.5
Finland	+ 2.9	+ 2.3	+ 2.5	+ 2.0	+ 0.3	+ 0.6
Sweden	+ 2.1	+ 2.2	+ 1.8	+ 1.8	+ 0.2	+ 0.6
Norway	+ 3.4	+ 3.2	+ 2.9	+ 2.5	+ 0.7	+ 1.2
Anglo-Saxon countries	**+ 2.5**	**+ 2.7**	**+ 2.2**	**+ 2.2**	**+ 0.2**	**+ 0.4**
Ireland	+ 5.2	+ 6.4	+ 4.1	+ 5.1	+ 1.3	+ 2.4
United Kingdom	+ 2.3	+ 2.4	+ 2.1	+ 2.1	+ 0.1	+ 0.3
Continental countries	**+ 2.2**	**+ 1.7**	**+ 1.8**	**+ 1.3**	**– 0.1**	**+ 0.0**
Germany	+ 2.0	+ 1.5	+ 1.8	+ 1.3	– 0.1	– 0.1
France	+ 2.4	+ 1.8	+ 1.8	+ 1.3	– 0.2	– 0.2
Belgium	+ 2.4	+ 2.0	+ 2.1	+ 1.6	+ 0.2	+ 0.3
Netherlands	+ 2.5	+ 2.3	+ 1.8	+ 1.8	+ 0.1	+ 0.4
Austria	+ 2.6	+ 2.2	+ 2.3	+ 1.8	+ 0.4	+ 0.7
Switzerland	+ 1.5	+ 1.2	+ 1.0	+ 0.6	+ 0.4	+ 0.8
Mediterranean countries	**+ 2.6**	**+ 2.0**	**+ 2.2**	**+ 1.5**	**– 0.1**	**– 0.5**
Greece	+ 2.8	+ 3.1	+ 2.2	+ 2.5	– 0.4	– 0.7
Italy	+ 2.3	+ 1.3	+ 2.0	+ 1.1	– 0.1	– 0.4
Portugal	+ 3.1	+ 2.1	+ 2.6	+ 1.7	– 0.3	– 1.5
Spain	+ 3.2	+ 3.0	+ 2.4	+ 2.2	– 0.1	– 0.5
EU 15	**+ 2.4**	**+ 2.0**	**+ 2.0**	**+ 1.6**	**– 0.0**	**– 0.1**
United States	**+ 3.1**	**+ 3.0**	**+ 2.0**	**+ 1.8**	**+ 2.0**	**+ 1.8**

[1,2] 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) $\Delta Y = 3.2523 - 0.5115 * Y_{ti}$

$R^2 = 0.60$ *(9)* *(25)*

1970/2006, ti ... 1970

(2) $\Delta Y = 3.0049 - 0.0835 * Y_{ti}$

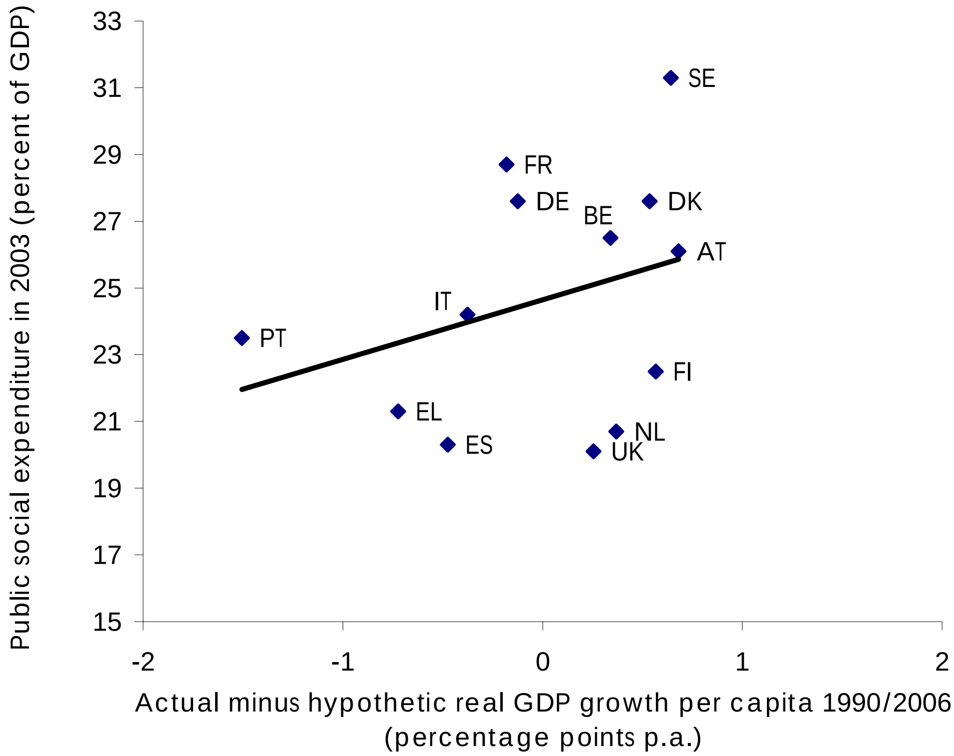
$R^2 = 0.28$ *(21)* *(49)*

1990/2006, ti ... 1990

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: Public social expenditure and economic performance



Source: Eurostat, WIFO calculations

In summing up the economic performance in Europe in recent history, we can conclude that blaming the welfare state for low growth and weak competitiveness may be premature. 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. We may infer that the asserted trade-off between efficiency and equality or between economic competitiveness and social justice is rather shaky. Economists are inclined to see the financial burden of social services and public transfers but to reduce individual and public costs of social exclusion and large inequalities in particular in terms of public security and health. They rarely point to the productive effects of the welfare state, of social cohesion, general public education, public health services, and cooperative industrial relations.

2.1.1 Growth drivers

There exists a broad consensus in contemporary growth theory 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 into 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.

Deregulation as an indicator of high competition may also foster economic growth. By definition, liberal countries are the most deregulated, Mediterranean countries (especially Portugal) are the most regulated.

Table 3: Growth drivers – investment into the future

	R&D Expenditure	IT expenditure	Youth education attainment level
	2005	2005	2005
	Percent of GDP		Percent
Scandinavian countries	**2.9**	**3.7**	**86.5**
Denmark	2.4	3.4	77.1
Finland	3.5	3.7	83.4
Sweden	3.9	4.4	87.5
Norway	1.5	3.1	96.2
Anglo-Saxon countries	**1.7**	**4.0**	**78.8**
Ireland	1.3	2.0	85.8
United Kingdom	1.7	4.2	78.2
Continental countries	**2.3**	**3.3**	**77.3**
Germany	2.5	3.1	71.5
France	2.1	3.4	82.6
Belgium	1.8	2.9	81.8
Netherlands	1.8	3.9	75.6
Austria	2.4	3.0	85.9
Switzerland	2.9	4.3	82.5
Mediterranean countries	**1.0**	**1.8**	**69.1**
Greece	0.6	1.2	84.1
Italy	1.1	1.9	73.6
Portugal	0.8	2.2	49.0
Spain	1.1	1.7	61.8
EU 15	**1.9**	**3.1**	**74.6**
United States	**2.7**	**4.0**	**–**

Source: Eurostat, WIFO calculations

Table 4: Product and labour market regulation

	Product market regulation		Labour market regulation		
	1998	2003	1990	1998	2003
Scandinavian countries	**1.9**	**1.2**	**2.9**	**2.4**	**2.3**
Denmark	1.4	1.1	2.3	1.8	1.8
Finland	2.1	1.3	2.3	2.2	2.1
Sweden	1.8	1.1	3.5	2.6	2.6
Norway	2.4	1.4	2.9	2.7	2.6
Anglo-Saxon countries	**1.1**	**0.9**	**0.6**	**1.0**	**1.1**
Ireland	1.4	1.0	0.9	1.2	1.3
United Kingdom	1.1	0.9	0.6	1.0	1.1
Continental countries	**2.0**	**1.4**	**2.9**	**2.6**	**2.6**
Germany	1.8	1.3	3.2	2.6	2.5
France	2.4	1.6	2.7	2.8	2.9
Belgium	1.9	1.4	3.2	2.5	2.5
Netherlands	1.8	1.4	2.7	2.3	2.3
Austria	1.8	1.3	2.2	2.4	2.2
Switzerland	–	–	–	–	–
Mediterranean countries	**2.5**	**1.7**	**3.7**	**3.1**	**2.8**
Greece	2.7	1.7	3.6	3.5	2.9
Italy	2.7	1.8	3.6	3.1	2.4
Portugal	2.2	1.7	4.1	3.7	3.5
Spain	2.1	1.5	3.8	3.0	3.1
EU 15	**2.0**	**1.4**	**2.7**	**2.5**	**2.4**
United States	**1.3**	**1.0**	**0.2**	**0.7**	**0.7**

0 ... unregulated, 6 ... regulated

Table 5: Labour market indicators and standard of living

	GDP per capita	Employment rate		Unemployment rate
		Total	Female	
	2006	2006		2006
	PPS	Percent		Percent
Scandinavian countries	**31,238**	**73.8**	**71.0**	**5.7**
Denmark	29,965	77.4	73.4	3.9
Finland	27,751	69.3	67.3	7.7
Sweden	28,495	73.1	70.7	7.0
Norway	42,008	75.4	72.2	3.5
Anglo-Saxon countries	**29,108**	**71.3**	**65.3**	**5.2**
Ireland	34,321	68.6	59.3	4.4
United Kingdom	28,741	71.5	65.8	5.3
Continental countries	**27,515**	**66.9**	**61.2**	**7.9**
Germany	27,038	67.5	62.2	8.4
France	26,224	63.0	57.7	9.4
Belgium	28,973	61.0	54.0	8.2
Netherlands	30,820	74.3	67.7	3.9
Austria	30,181	70.2	63.5	4.8
Switzerland	31,437	77.9	71.1	4.0
Mediterranean countries	**23,332**	**61.4**	**49.7**	**7.7**
Greece	20,896	61.0	47.4	8.9
Italy	24,418	58.4	46.3	6.8
Portugal	17,289	67.9	62.0	7.7
Spain	23,947	64.8	53.2	8.6
EU 15	**26,470**	**66.0**	**58.6**	**7.4**
United States	**36,223**	**72.0**	**66.1**	**4.6**

Source: Eurostat, WIFO calculations

2.1.2 Labour force participation as an indicator of success

The employment rate is closely related to economic performance. It is the highest in Scandinavia, followed by the Anglo-Saxon countries. Public services (child care etc.) largely explain the high employment rate in Scandinavia, marketisation of household services (low-wage service jobs) the high employment rate in the Anglo-Saxon countries. The employment rate in the Continental and Mediterranean countries is substantially lower. In line with employment, joblessness is much lower in the Anglo-Saxon and in some of the Scandinavian countries.

One obvious indicator for success is represented by labour force participation of groups like women, youths and older persons. Particularly the full integration of women in the labour market can be understood as a proxy for the capacity to use available human capital resources. European labour market institutions and welfare-state transfers need not have harmed employment and growth over the last decades (*Allard – Lindert*, *2005*).

Empirical evidence indicates that, among the core institutions of the welfare state, the most negative record is held by regulations that have created insiders and outsiders on the labour market. In particular, employee protection laws have favoured male workers at the expense of women and other outsider groups (*Allard – Lindert*, *2005*).

It does not come as a surprise, that differences in female labour force participation mirror differences in welfare regimes, with the Scandinavian countries characterised by the highest and the Mediterranean countries by the lowest employment rates of women. Among the countries at the bottom of the distribution, Ireland and Spain have witnessed the strongest catching-up process, with an increase in female employment rates by around 20 percentage points over the period 1995-2006. In countries with a less buoyant economic performance, like Germany, the increase in female labour force participation has been more moderate.

2.1.3 Better jobs, training and working conditions

In order to highlight the role played by human capital for the performance of European socio-economic models, we can also look at indicators on working conditions that reflect both present and future developments. As can be seen from the table, qualitative indicators support the view that Scandinavian countries come closest to achieving the aim of creating not only more, but also better jobs. Whereas in the Mediterranean countries only two workers out of three share the opinion that they are learning new things at work, among countries belonging to the

Scandinavian group almost 9 workers out of 10 have a positive view of their learning curve on the job. Both the Anglo-Saxon and the Continental countries are between these two extreme positions, with the Netherlands (and Switzerland) as outliers that come close to the Scandinavian group.

Table 6: Qualitative indicators of employment situation

	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			
Scandinavian Countries	**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
Norway	43.0	87.7	70.5	72.0
Anglo-Saxon Countries	**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
Continental Countries	**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
Celgium	40.5	74.4	64.1	52.3
Netherlands	31.6	83.6	70.8	72.1
Austria	37.5	76.8	60.2	59.9
Switzerland	45.4	85.6	66.3	68.1
Mediterranean Countries	**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
EU 15	**27.4**	**70.5**	**59.2**	**60.8**

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

There is a strong correlation between the responses to this question and the findings with respect to the amount of training undergone by workers. The levels of training are not very high in general in the European countries, with an average of less than 30 percent in the 15 'old' member states of the European Union, and they have been fairly constant over the last 10 years (*European Foundation*, 2006). Again, however, there are significant differences across countries, with the Scandinavian group at the top and the 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 (see *table 6*). 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, more than two thirds 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 the Anglo-Saxon and Continental countries. In Mediterranean countries, hardly half of the workers think that their current employment is suitable for older persons. These results correlate highly with satisfaction levels with working conditions (*European Foundation*, 2006).

In advanced economies, social spending can be understood as a form of human capital investment (*Iversen*, 2005). Recent research has highlighted the vital role played by the first years of life for future cognitive development. Accordingly, next to expenditures that have been subsumed under the "future investment" heading (see *table 3*), spending on the youngest groups of population can be scrutinised on its own account. *Table 7* displays OECD data on the sums that European countries devote to the care and upbringing of children in pre-school age. As can be seen, the share of GDP that goes to child care and pre-primary education is considerably higher in the Scandinavian countries than in the other European countries. The most notable exception is France, where the level of public spending (even when adjusted for the number of children) is similar to that in Sweden and Finland. In general, differences in spending for pre-primary education are comparatively small, whereas the observed cross-country disparities are more pronounced with respect to child care.

Table 7: Expenditure on pre-primary care and education

	Public expenditure		
	Child care	Pre-primary education	Total
	Percent of GDP		
Scandinavian Countries	**0.8**	**0.5**	**1.3**
Denmark	1.0	0.7	1.6
Finland	1.0	0.3	1.4
Sweden	0.8	0.5	1.3
Norway	0.7	0.3	1.0
Anglo-Saxon Countries	**0.2**	**0.3**	**0.6**
Ireland	0.1	0.1	0.2
United Kingdom	0.2	0.3	0.6
Continental Countries	**0.2**	**0.5**	**0.7**
Germany	0.0	0.4	0.4
France	0.5	0.7	1.2
Belgium	0.2	0.6	0.8
Netherlands	0.2	0.4	0.5
Austria	0.2	0.4	0.6
Switzerland	0.1	0.2	0.3
Mediterranean Countries	**0.1**	**0.4**	**0.5**
Greece	0.2	0.2	0.4
Italy	0.1	0.4	0.6
Portugal	0.4	0.4	0.8
Spain	0.1	0.5	0.5
EU 15	**0.2**	**0.4**	**0.7**

Source: OECD, Family and Education Database; WIFO calculations.

2.2 Social performance

The political target of the Lisbon strategy is not only high economic, but also high social and environmental performance. The main question is: Is good economic performance positively or negatively correlated with good social performance?

We chose a number of indicators to explore this topic:

- life satisfaction ("happiness")
- income inequality
- poverty rate
- life expectancy
- infant mortality
- hours worked
- number of prisoners

To summarise the results of the tables given below: The social performance in the United States and the liberal European countries is worse than in the Scandinavian and Continental European countries:

- Public social expenditure as a percentage of GDP did not change very much over the last decade (see figure 1).
- Poverty rates are significantly higher in the liberal and Mediterranean countries, reflecting the unequal income distribution.
- Life expectancy is somewhat lower in the Anglo-Saxon countries than in Scandinavia, Continental Europe and the Mediterranean countries.
- Infant mortality which may be interpreted as an indicator of the inefficiency of the health system is substantially higher in the liberal countries.
- The share of prisoners is extremely high in the United States, and also relatively high in the United Kingdom.
- High GDP per capita in the liberal countries is partly due to a high number of hours worked, i.e., a preference of income vis-à-vis leisure.
- Annual working hours are relatively high in the US and the Anglo-Saxon countries, relatively low in Continental Europe (France, Germany).
- Across countries there is a positive relationship between living standards and happiness (life satisfaction).

Table 8: Happiness

	Life satisfaction		High life satisfaction		Inequality of income distribution	At-risk-of-poverty rate after social transfers
	Percent of total responses				Income quintile share ratio	Percent
	2006	1996/2006	2006	1996/2006	2005	2005
Scandinavian countries	**95**	**+ 1**	**48**	**+ 7**	**3.6**	**11**
Denmark	96	± 0	66	± 0	3.5	12
Finland	94	+ 3	33	+ 6	3.6	12
Sweden	94	± 0	46	+ 11	3.3	9
Norway	–	–	–	–	4.1	11
Anglo-Saxon countries	**87**	**– 2**	**34**	**+ 5**	**5.6**	**19**
Ireland	91	+ 1	37	+ 3	5.0	20
United Kingdom	87	– 2	34	+ 5	5.6	19
Continental countries	**85**	**+ 5**	**21**	**+ 2**	**4.0**	**13**
Germany	82	+ 1	17	– 1	4.1	13
France	85	+ 11	19	+ 7	4.0	13
Belgium	91	+ 4	31	+ 6	4.1	15
Netherlands	95	+ 1	44	– 2	4.0	11
Austria	85	+ 4	23	– 6	3.8	12
Mediterranean countries	**78**	**+ 2**	**16**	**+ 4**	**5.7**	**19**
Greece	67	+ 6	11	+ 2	5.8	20
Italy	76	– 3	14	+ 2	5.6	19
Portugal	55	– 15	4	± 0	8.2	20
Spain	88	+ 13	22	+ 8	5.4	20
EU 15	**83**	**+ 3**	**23**	**+ 3**	**4.7**	**16**

Source: Eurobarometer, Eurostat, WIFO calculations

Table 9: Social indicators

	Life expectancy at birth		Infant mortality rate	Hours worked per year[1]	Prison population rate
	Years		Per 1,000 births	Number	Per 100,000
	2004	1990/2004	2004	2004	2005
Scandinavian countries	**79.4**	**+ 3.2**	**3.5**	**1,658**	**75**
Denmark	77.6	+ 2.7	4.4	1,613	77
Finland	78.8	+ 3.9	3.3	1,673	75
Sweden	80.6	+ 3.0	3.1	1,676	78
Norway	79.9	+ 3.3	3.2		68
Anglo-Saxon countries	**78.5**	**+ 2.8**	**5.1**	**1,701**	**139**
Ireland	78.3	+ 3.4	4.9	1,802	85
United Kingdom	78.5	+ 2.8	5.1	1,693	143
Continental countries	**79.4**	**+ 3.3**	**4.1**	**1,634**	**96**
Germany	78.6	+ 3.4	4.1	1,662	97
France	80.3	+ 3.4	3.9	1,568	88
Belgium	78.8	+ 2.7	4.3	1,748	90
Netherlands	79.2	+ 2.2	4.1	1,633	127
Austria	79.3	+ 3.8	4.5	1,717	108
Switzerland	81.2	+ 3.8	4.2		83
Mediterranean countries	**79.7**	**+ 3.1**	**3.9**	**1,708**	**115**
Greece	79.0	+ 1.9	4.1	1,800	90
Italy	79.7	+ 2.8	4.1	1,672	97
Portugal	77.4	+ 3.5	4.0	1,748	123
Spain	80.5	+ 3.7	3.5	1,729	143
EU 15	**79.3**	**+ 3.1**	**4.1**	**1,668**	**109**
United States	**77.5**	**+ 2.2**	**6.9**	**1,824**	**738**

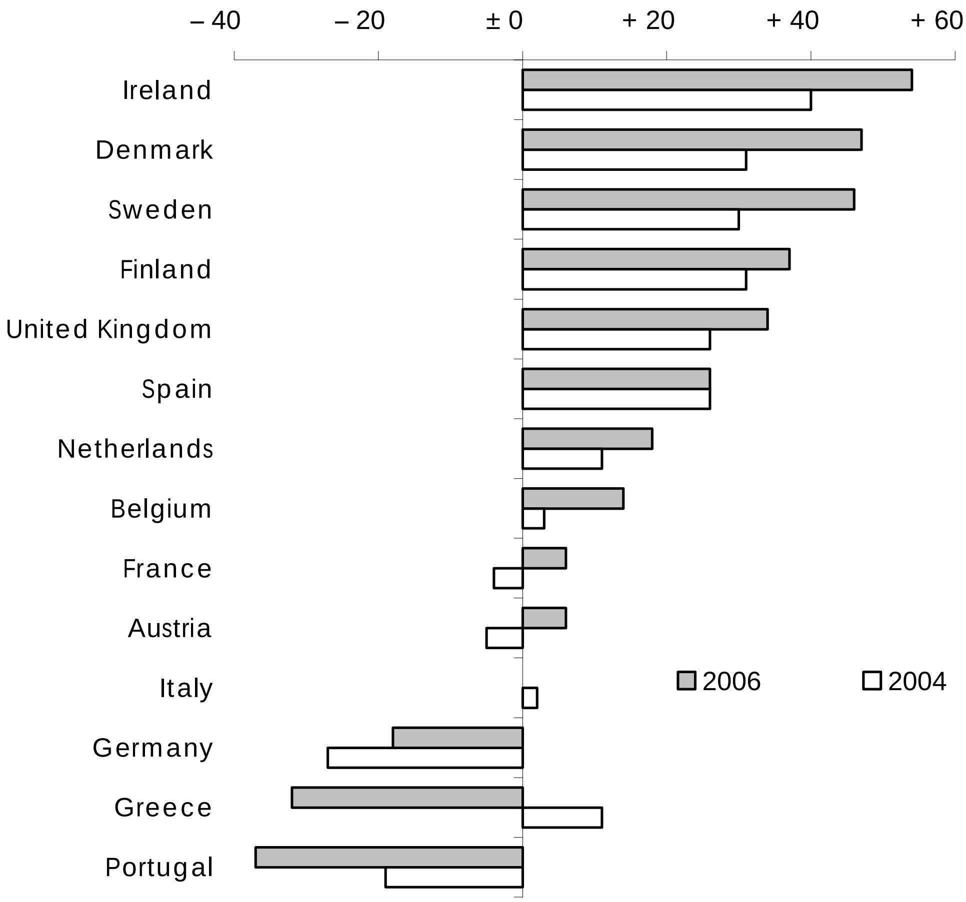
[1] EIRO data for Europe, OECD data for the USA
Source: EIRO, OECD, UNDP, WIFO calculations

2.3 Happiness and economic performance

The world economy has been doing quite well in recent years, but does this make people happy? *Layard* (2003) pointed out that GDP per capita has risen enormously over the last fifty years, but "happiness" – as it is being measured by surveys – hardly changed at all.

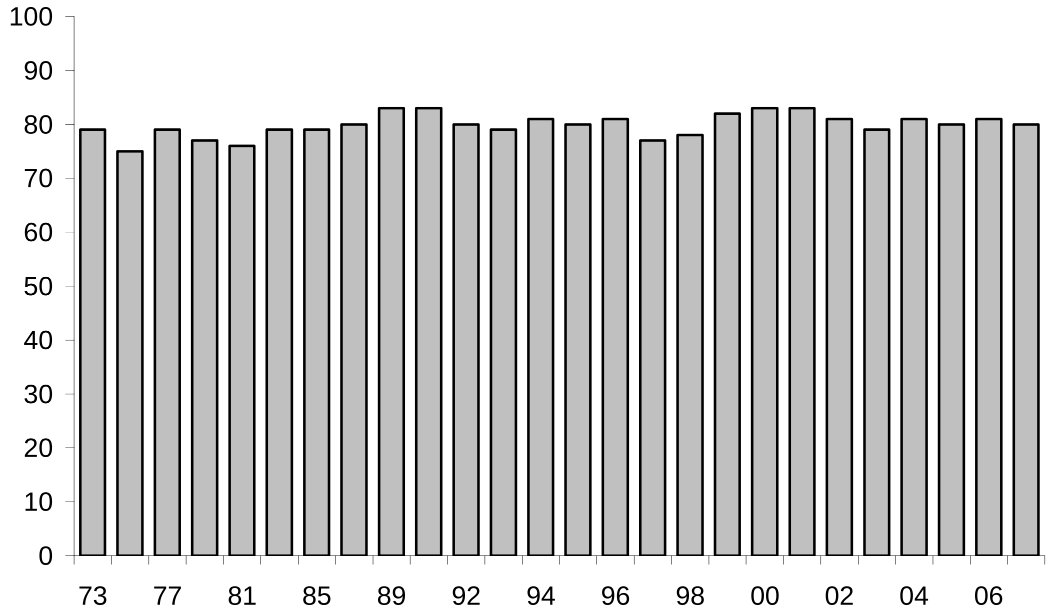
In surveys (e.g., Eurobarometer) people are asked whether their overall situation is satisfactory or not and whether it improved or got worse during the last five years. According to Eurostat surveys, happiness (“utility”) in the European Union has been rather stable over decades, although GDP per head increased substantially. However, the country ranking (see *figure 3*) of the change in life satisfaction is a mirror of recent economic and labour market developments.

Figure 3: Present situation compared with 5 years ago
Balance of responses ('Improved' – 'Got worse') as percent of total responses



Source: Eurobarometer

Figure 4: Life satisfaction in the EU
Percent of total responses

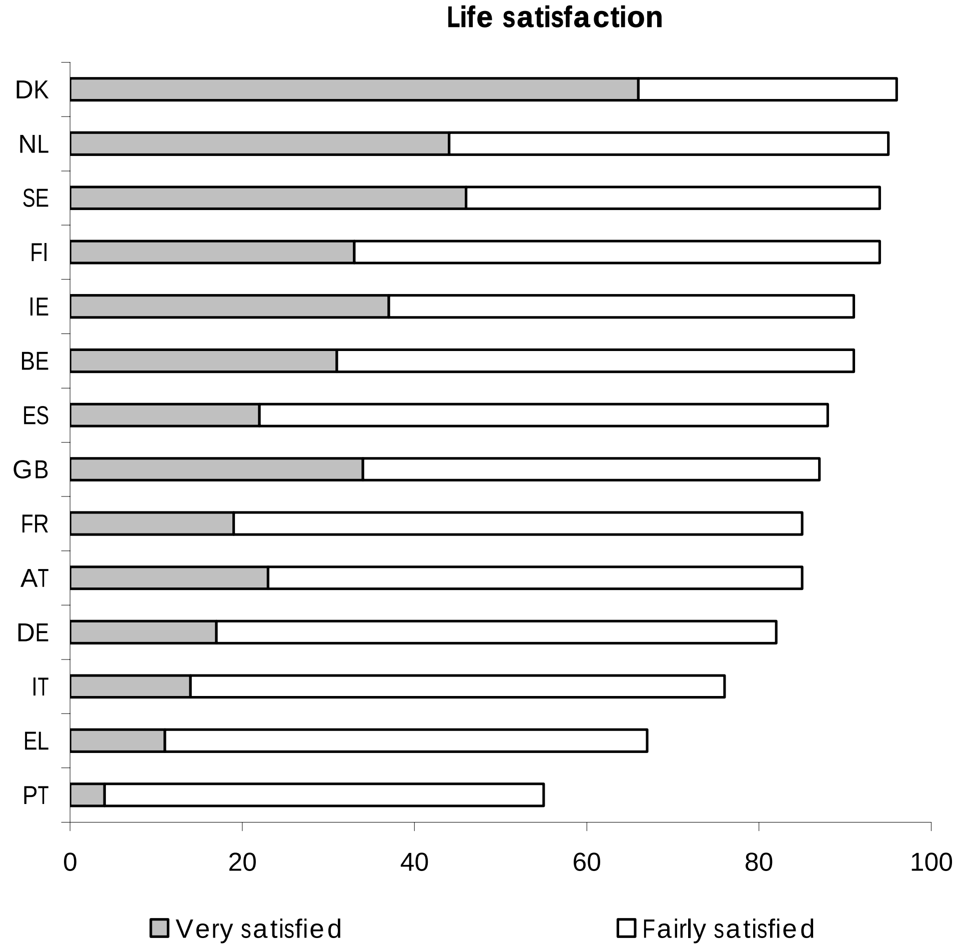


Source: Eurobarometer

There is also a positive relationship between GDP per capita and life satisfaction across countries (see figure 7). Life satisfaction is very high in the Scandinavian countries. They have been able to combine economic efficiency with decent social standards. Happiness is also relatively high in the Netherlands, which are close to the Scandinavian model, and in the Anglo-Saxon countries. In the Mediterranean countries, life satisfaction is rather low. There is a pronounced North-South-trend with respect to GDP per head and life satisfaction, which may be explained by religion, climate and other factors. Surprisingly, happiness in Austria has been relatively low and it deteriorated over time despite relatively good economic performance; the increase in unemployment may explain this development. Across EU countries there is a close negative relationship between life satisfaction and unemployment.

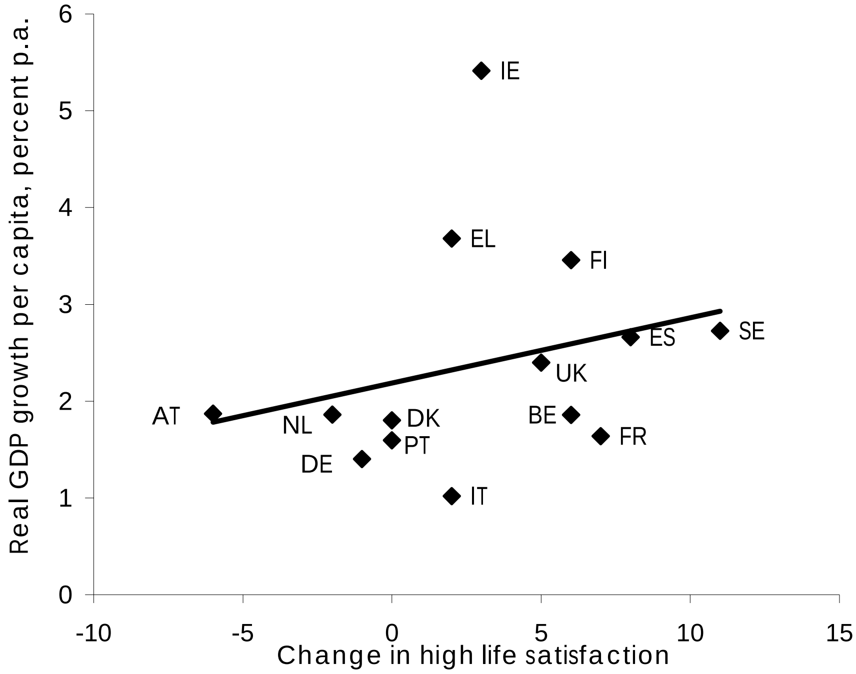
In short: The living standard is not as important for happiness as the relative living standard (“keeping up with the Joneses"). This result is corroborated by the indicator of happiness for social groups.

Figure 5: Life satisfaction in different EU countries in 2006
Percent of total responses



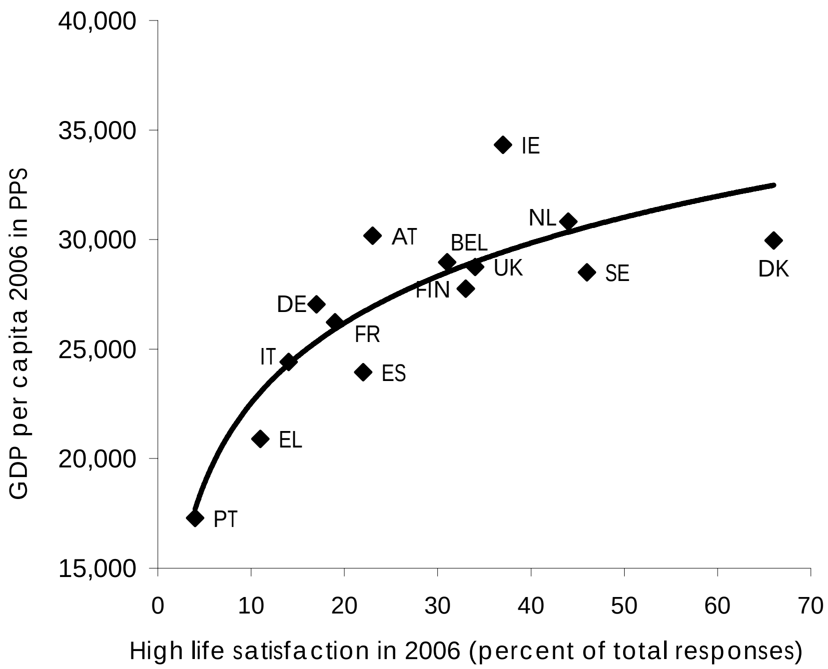
Source: Eurobarometer

Figure 6: Change in high life satisfaction and GDP growth per capita 1996 to 2006



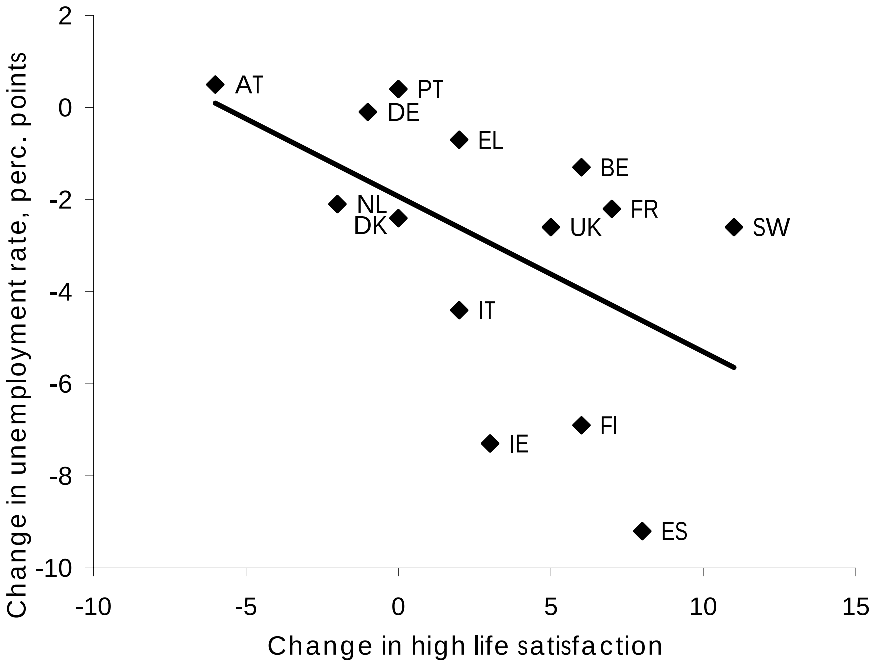
Source: Eurobarometer, Eurostat, OECD, WIFO calculations

Figure 7: High life satisfaction and income level



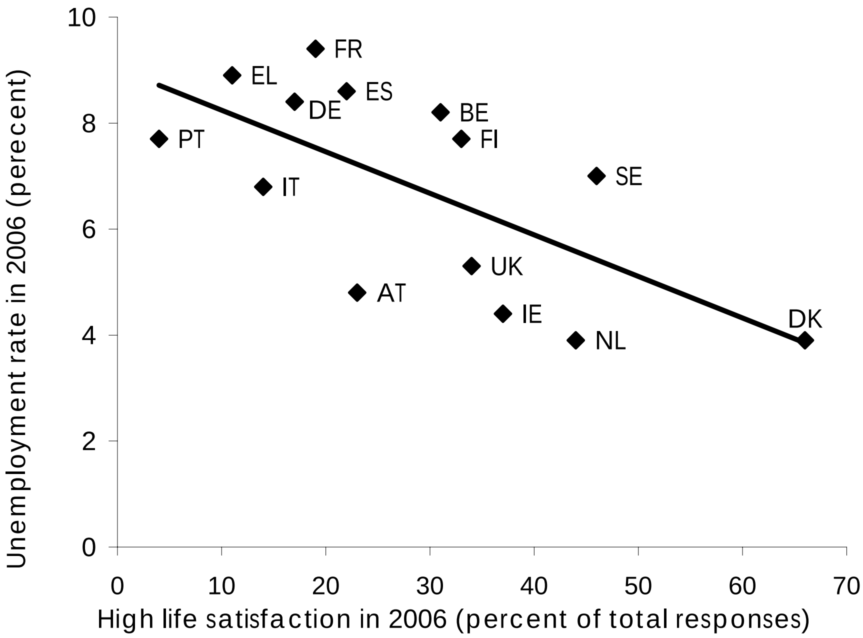
Source: Eurobarometer, Eurostat

Figure 8: Change in high life satisfaction and unemployment 1996 to 2006



Source: Eurobarometer, Eurostat, OECD, WIFO calculations

Figure 9: High life satisfaction and unemployment rate



Source: Eurobarometer, Eurostat

3. Key elements of a New Welfare State Architecture

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.

When it comes to the central issue of modernisation of the European socio-economic model we have to keep in mind that 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 of the European Commission - 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.

But, at the same time, we have not to forget the demand side, which is rarely mentioned in the ongoing reform discussion. Here, we refer to the Keynesian argument of effective demand failures and agree with *Blanchard* (2006) who insists on 'active macroeconomic policy' as a third constitutive leg of 'a viable European social and economic model', because "there is no guarantee that actual output will always equal potential output." (p. 6)

When we try to identify policies, which have worked in the recent past from our analysis above, we can conclude that we can learn most from the Scandinavian countries. Their social system remains inclusive and tight, but social benefits are partly made dependent on the input of the individual and transfers become conditional to certain obligations; replacement rates are lower than they used to be in order to provide stronger incentives to work but are still high by international standards.

They 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. Accordingly, they seem to be best prepared to tackle the emerging societal and economic challenges of the future.

As key elements of the Scandinavian welfare states and their recent reform activities for a new welfare state architecture we dare to 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 investments 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.

  Due to 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 successful 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 to prevent child poverty and safeguard welfare must be seen as social investment 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 stabilising fertility rates and increasing women's labour market participation.

- 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 highest barriers to labour market participation of older workers.

- Restructuring the welfare state – from transfers to social services. While the post-war welfare state relied heavily on monetary transfers – in particular in Continental Europe – the welfare state of the future will have to be more service oriented 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 higher poverty risks also 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 – more than subsidising old industries. This contradicts the approach that governments have just to deregulate the markets, and just to wait that innovation and growth will rebound automatically ("Paris consensus").
- An active role of social partners. Social partners (institutions representing employers and employees) play a decisive macroeconomic role in wage formation. Since national macroeconomic policy lost monetary and exchange rate policies, due to the common currency in the European Monetary Union, wage policy (together with fiscal policy) is left for adjustments to country-specific shocks; i.e. the higher wage mobility and wage flexibility the smaller and shorter are painful adjustment processes to macroeconomic shocks and diverse international developments. (cp. *Blanchard*, 2006).
- Active macroeconomic policy. Having outlined a supply side strategy to integrate social policy and welfare expenditures as productive which enhances potential growth, we have to respect the cumulative warnings of well-known macroeconomic theorists to Europe's economic policy strategies: "Increasing potential output is good; making sure actual output is equal to potential is just as important, and requires active macro-economic policy" (*Blanchard*, 2006, p. 6).[4]

[4] By the same token, already a few years earlier, *Baily – Kirkegaard* (2004, p. 1): "Even the most successful structural reform in Europe will not generate growth if the macroeconomic conditions are not right. Weakness in aggregate demand can ruin any economic party."

4. Conclusions

The 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 to this hypothesis. The worst performance is seen for the Continental corporatist and the Mediterranean family-oriented model, which produced low growth and high unemployment.

The Scandinavian countries were able to reform their institutions and incentives in a manner to be competitive in the globalising economy (after several periods of turmoil). They made their economies more flexible in a managed and balanced strategy and reduced both fiscal deficits and debt. But most importantly they went for a strategy of excellence in innovation, education and technology diffusion. The same adaptability is not to be seen in the big continental European countries.

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.

Blaming the welfare state for low growth and weak competitiveness in the EU is premature:

- 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.

- The assumed trade-off between competitiveness and social justice (or efficiency and redistribution) is shaky: Cooperative industrial relations and social cohesion may be a productive resource; social exclusion and large inequalities may be costly in terms of public security and health.

- Solidaristic or individual risk-taking is a matter of preferences, as the experience shows the welfare state offers sufficient room of manoeuvre to combine efficiency and social cohesion. It is a matter of normative policy and does not follow from inherent necessity.

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