**EUROPEAN NETWORK OF ECONOMIC POLICY RESEARCH INSTITUTES**

***OCCASIONAL PAPER NO. 5/NOVEMBER 2003***

# SOCIAL EUROPE

**SJEF EDERVEEN**

**AND**

**RUUD DE MOOIJ**

ISBN 92-9079-466-6

*Available for free downloading from the ENEPRI website (http://www.enepri.org)*
*or the CEPS website (www.ceps.be)*
© Copyright 2003, Sjef Ederveen and Ruud de Mooij

Place du Congrès 1 • B-1000 Brussels • Tel: (32.2) 229.39.11 • Fax: (32.2) 219.41.51 • VAT: BE 424.123.986
e-mail: info@enepri.org • website: http://www.enepri.org

# CONTENTS

Preface ........................................................ i

Introduction and summary ........................................................ 1

1 From Rome to Lisbon ........................................................ 3

1.1 The development of European social policy in the last century ........................................................ 3
1.2 The Lisbon process ........................................................ 4

2 Welfare states in Europe ........................................................ 5

2.1 Esping-Andersen ........................................................ 5
2.2 Social-democratic countries ........................................................ 7
2.3 Liberal countries ........................................................ 7
2.4 Corporatist countries ........................................................ 8
2.5 Mediterranean countries ........................................................ 8
2.6 Conclusion ........................................................ 9

3 Social policy and economic performance ........................................................ 9

3.1 Three objectives from Lisbon ........................................................ 9
3.2 Can the Lisbon objectives be reconciled? A first exploration ........................................................ 17

4 The influence of labour market institutions ........................................................ 22

4.1 Social security ........................................................ 22
4.2 Pensions ........................................................ 24
4.3 Progressive taxes ........................................................ 26
4.4 Labour market regulation ........................................................ 28
4.5 Active labour market policy ........................................................ 30
4.6 The method of wage formation ........................................................ 32
4.7 Labour market institutions and the Lisbon objectives: Conclusions ........................................................ 33

5 Trends and the Lisbon agenda ........................................................ 34

5.1 Internationalisation and ICT ........................................................ 34
5.2 Economic integration and policy competition ........................................................ 35
5.3 EU enlargement and immigration ........................................................ 35
5.4 Ageing of the population and Baumol's Law ........................................................ 36
5.5 Individualisation and flexibilisation ........................................................ 37
5.6 Challenge for social policy ........................................................ 37

6 Social Europe ........................................................ 37

6.1 The subsidiarity principle ........................................................ 37
6.2 Subsidiarity and social security expenditure ........................................................ 38
6.3 Subsidiarity and labour market regulation ........................................................ 43
6.4 International coordination by trade unions ........................................................ 45
6.5 Lisbon and Social Europe ........................................................ 45

References ........................................................ 46

# Preface

With the ongoing economic integration in Europe, questions on the desirability and the consequences of policy competition become increasingly important. What are the consequences of these developments for European welfare states? Does it lead to social dumping? Does it call for more coordination in the field of social policy?

These questions are at the heart of the research agenda of the 25 institutes that together comprise ENEPRI. Indeed, when CPB organised a conference on these topics in November 2002, the attendance and interest were large. The papers presented at the conference and the discussions at this event form the basis for this Occasional Paper.

At the November conference, Jan-Willem Oosterwijk (Secretary General of the Dutch Ministry of Economic Affairs and Chairman of the Economic Policy Committee of the European Union) opened by discussing why social policies have remained within the national domain for such a long time. Still, discussions on social policy increasingly take place at European level. The European Union has, for example, formulated directives on working conditions, non-discrimination and various forms of labour market regulation. These directives are binding for the member states. During the EU summit in Lisbon in 2000, moreover, a raft of social objectives was formulated for the member states. Henceforth, each member state will draw up an action plan every two years, setting out the policy it intends to pursue in order to realise these objectives. This ENEPRI Occasional Paper seeks to provide a broad analysis of the various aspects of the social dimension of European integration. The aim is to provide a clear framework for discussion of this topic and review the relevant theoretical and empirical literature on it.

In writing this study, we have used material from a joint publication between CPB and the Dutch Social and Cultural Bureau called 'Social Europe'. This study was published as part of the Dutch State of the European Union, and has been sent to the Dutch Parliament on 17 September 2003. The publication can be downloaded from the CPB website, as well as from the CEPS and the ENEPRI websites.

Sjef Ederveen (J.P.Everdeen@cpb.nl)
Ruud de Mooij (radm@cpb.nl)
The Hague

# SOCIAL EUROPE

## *ENEPRI OCCASIONAL PAPER NO. 5/NOVEMBER 2003*

**Sjef Ederveen and Ruud de Mooij***

## Introduction and summary

Building a Social Europe has received due attention since the founding of the European Community in Rome. The European summit in Lisbon in 2000 was an important milestone in this process. European leaders committed themselves to working together through the ‘open coordination’ method to develop a policy to combat poverty and social exclusion. The open coordination approach means that countries exchange information and encourage each other to pursue policies geared to their social objectives. The European Union does not itself play an active role in the way in which individual member states set about achieving those objectives. It has however been agreed that member states will draw up a National Action Plan every two years setting out the way in which they plan to realise their objectives.

Member states differ in the way they have structured their social policy. Chapter 2 offers a description of the different European welfare states. It is based on a widely used typology that was developed 10 years ago by Esping-Andersen. Broadly, he identified three types of welfare states: the liberal welfare state, which has the least generous provisions (the United Kingdom and Ireland); the social-democratic welfare state, which is geared primarily to reducing income differentials (the Scandinavian countries); and the corporatist welfare state, which places emphasis on social insurance for employees (Germany, Austria, France, Luxembourg and Belgium). Chapter 2 shows that in the Mediterranean countries (Greece, Spain, Portugal and Italy), a particular type of welfare state is emerging in which the social safety net is still under development.

The European Union is also committed to achieving economic objectives. In Lisbon, EU leaders pronounced their ambition to make Europe the most competitive and dynamic knowledge economy in the world, capable of achieving sustainable economic growth with more and better jobs and greater social cohesion. Objectives were formulated among other things on promoting employment and increasing productivity. The question is whether the economic objectives can be reconciled with the social objectives. Will the European ambitions face dilemmas because social cohesion can only be maintained at the expense of economic performance? The analysis in chapter 3 shows that the social-democratic welfare states have succeeded in combining an egalitarian income distribution with high productivity and high labour participation rates. This illustrates that the trade-off between economic and social performance does not necessarily appear.

Nonetheless, there is ample evidence of a trade-off between social and economic objectives with respect to particular labour market institutions. Chapter 4 shows that individual welfare state arrangements, such as an extensive social security system, progressive income tax and stringent labour market regulation, generally have a favourable effect on social cohesion but reduce the incentive to participate. In order to achieve the objective of high labour participation rates, rationalising the welfare state might be considered. The price for this is greater income inequality. For many countries the challenge will be to structure the welfare state in such a way that social and economic objectives are in balance.

This challenge will become more urgent in the coming decades in light of a number of national and international trends. Chapter 5 discusses these trends: ageing, immigration, information and communication technology, individualisation and increasing policy competition. They all point in the same direction: they put the European welfare states under pressure and reduce the scope for reconciling economic and social objectives. Trends thus pose a particular threat to the social cohesion objectives of the European Union.

* CPB (Netherlands Bureau for Economic Policy Analysis), The Hague.

Does this call for a greater role for 'Europe' in social policy? The principle of subsidiarity, which applies within the European Union, means that an active role for Europe can only be desirable if it produces advantages for the member states compared with national policy. The analysis in chapter 6 shows that this is currently the case only for the removal of institutional obstacles to labour mobility. In other areas of social policy, it does not appear to be the case. For example, there are no indications of 'social dumping', where individual countries systematically relax social policy in order to attract businesses and talent from other countries. At the same time, the diversity in institutions within the EU is large, as is also evident from the characterisations in chapter 2. The enlargement of the European Union, with 10 new member states joining in 2004, will increase this heterogeneity further and boost the need for diversity in social policy. Harmonised social policy will then become less attractive. As public opinion in the European Union also provides no support for a common European social policy, the 'open coordination' approach would appear to be a better way of achieving the aim of a Social Europe.

# SOCIAL EUROPE

## *ENEPRI OCCASIONAL PAPER NO. 5/NOVEMBER 2003*


## SJEF EDERVEEN AND RUUD DE MOOIJ


## 1 From Rome to Lisbon

The desire to give Europe a social as well as an economic identity has a long history. Yet, social policy in the European Union is still largely a prerogative of the individual member states. This chapter shows how European social policy has evolved over recent decades.

### 1.1 The development of European social policy in the last century

The idea of a European social policy is not new; even during the run-up to the Treaty of Rome, in 1957, the French prime minister and socialist Guy Mollet attempted to have the harmonisation of social regimes ensconced as a condition for the unification of Europe. We can therefore justifiably say that the idea of a Social Europe is as old as the road to Rome.

The French proposal was prompted by fears that increasing trade liberalisation would lead to social dumping, with possible negative consequences for the already weak competitive position of the French industry. This idea was not supported by the five other founding members of the European Economic Community. Yet, by way of compromise a clause was inserted in the Treaty containing a commitment to closer cooperation in the areas of training, employment, working conditions, labour relations and social security. Explicit reference was also made to the possibility of harmonising legislation with a view to achieving equal pay for men and women, and the social security rights of migrant workers were also covered. It was expected that the national welfare states would eventually converge towards a uniformly high level of social protection, but no compulsory mechanism was attached to this expectation.

The promise of harmonisation was not fulfilled in the subsequent 15 years. The reason for this was the requirement of unanimity. It meant that progressive proposals had little chance to be passed. In addition, it was a time of steady economic growth, and citizens were less concerned about jobs being lost to low-wage countries. When the economy arrived in a recession after the first oil crisis, attention turned to the idea of limiting competition in the area of social regulations. This led to the first Social Action Programme (1974), which focused on the equal treatment of men and women, employment laws and improved working conditions. The ambitions of harmonisation of social policy were however quashed by the entry of the new member states Ireland, the UK and Denmark, all of which set great store by their autonomy.

In the 1980s the European Community expanded southwards. This led to renewed fears of social dumping in the more developed economies of Northwestern Europe, with countries featuring lower standards. As a result, from the mid-1980s onwards, partly under the influence of the increasing integration *en route* to the internal European market, the idea of a pan-European social policy gathered momentum. The Single European Act (1986) introduced decision-making based on a qualified majority in a number of areas of social policy. This led to a considerable strengthening of the competence of 'Europe' to act in the social domain: the European Commission could now circumvent threatened British vetoes, for example, and a great deal of legislation on working conditions was produced, such as minimum safety standards at the workplace. In 1989, the idea of a pan-European social policy led to the 'Social Charter' (the Community Charter on Fundamental Social Rights), which further developed the ideas of harmonisation and mutual recognition. The United Kingdom did not participate, because it refused to tolerate any intervention from Europe in its social policy.

The development of a European social policy was continued in the 1990s in the 'Dutch Treaties' (Maastricht and Amsterdam). In the latter treaty, social policy was included in the treaty for the first time, as the Social Chapter, and ratified by all member states of the EU, including the United

Kingdom. Among other things, this Social Chapter set out guidelines on the role of the social partners, protection in the event of mass redundancies, working hours, parental leave and proportional payment for part-time and full-time workers. The fight against social exclusion was also explicitly included as one of the policy aims of the EU (Arts. 136 and 137 of the Treaty of Amsterdam). This did not mean that from that time on the member states of the European Union were committed to complete harmonisation of social regulations. In fact, limits were set for this by embedding the subsidiarity principle in the Treaty of Maastricht. This underlined yet again that, despite all the steps towards European unification, social policy remained largely a national affair.

### 1.2 The Lisbon process[1]

In March 2000, a new dimension was added to the Social Chapter, when the European Council in Lisbon launched a ten-year strategy for the European Union directed towards economic, social and environmental objectives. The aim of this strategy was to enable Europe "to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion". This required an overall policy which included a commitment to modernising the European social model in addition to encouraging knowledge and innovation, strengthening competitiveness and promoting sustainable development. Ultimately, the strategy was – and is – intended to create the conditions for full employment in the European Union and to reduce welfare differences across Europe.

Since the Lisbon Summit, the European Council has translated the broad strategic aims into an ever-growing list of more concrete targets (currently around 190). These cover a host of areas such as investment in training, research and development, innovation, entrepreneurship and environmental protection. A 10-year programme has been drawn up for the achievement of these ambitions, which includes reforms of the labour, capital and goods markets. Each year, the progress of the member states in achieving the targets is evaluated by the European Commission and discussed by government leaders during the spring European Council.

The European Council stressed in Lisbon that the strategy had to be focused on investments in human capital and the development of an active and dynamic welfare state. The number of residents of the EU living below the poverty line is regarded as unacceptable, and the Council stated that the strategic aim of securing the world's most competitive knowledge-based economy must not be accompanied by a worsening of the existing problems in the areas of unemployment, social exclusion and poverty. The European Social Agenda was adopted during the European Council in Nice. This Agenda is intended to lead to the modernisation of the European welfare state. Social policy is defined as 'policy to combat poverty and social exclusion'.

As in other areas of the Lisbon process, a number of core social policy ambitions have been agreed by the member states. The first is the promotion of employment. Being in work is regarded as the best insurance against social exclusion. Moreover, high employment rates can broaden the tax base, allowing financing social protection for those who are unable to work. This is important in the light of the ageing of the population.

Another core objective of European social policy is to reduce the number of people at risk of poverty and social exclusion. During the recent European Summit in Brussels in the spring of 2003, this commitment was emphasised again. In order to demonstrate the genuine desire to achieve this ambition, individual member states must set explicit targets for the reduction of poverty up to the year 2010.

The European Summit in Lisbon deliberately made no agreements on the way in which the objectives should be attained; this is regarded as the responsibility of member states. The European Council in Brussels reaffirmed that the objectives had to be achieved "with full account being taken of the

[1] See also WRR (2003) about the Lisbon process.

subsidiarity principle and the national competences relating to the organisation and funding of social security".

This is in line with the Open Method of Coordination which is being applied in more and more policy domains in the EU. This method gives countries the freedom to choose the measures that best fit their particular society and welfare state model. The correspondence between the performance of the member states and the objectives set is assessed by the European Commission and by periodic 'peer reviews'. The aim of these evaluations and reviews is to enable national policy to be adjusted by confronting it with standards and practices in other countries. If necessary, the European Council can issue recommendations. Although there are no sanctions, political pressure means that this method goes further than non-obligatory forms of benchmarking.

The translation of the European objectives into national policy is thus of crucial importance for the success of the Open Method of Coordination. All countries accordingly compile National Action Plans every two years in which they set out how they intend to combat poverty and social exclusion in their country. The priority given to the social policy proposed in the National Action Plans will differ between the various member states, as the present arrangements reveal.

## 2 Welfare states in Europe

The regulations governing social security and the labour market differ in every member state of the European Union. In some member states, for example, pension provisions are mainly in private hands, while others regard this as an important task of the government. There are also differences in the minimum wage, the legislation covering dismissal, the level of benefits and the conditions for receipt of social security benefits. Despite these differences, however, it is possible to classify the different member states broadly on the basis of their social security legislation and labour market policy into four models. This section looks at the classifications devised by Esping-Andersen, extends it and gives a description of the different types of welfare state.

### 2.1 Esping-Andersen

Although all member states of the European Union have a different social security system, they can nonetheless be grouped into a number of clusters or types. An example is the classification adopted by Esping-Andersen (1990, 1996, 1999). He argues that three types of welfare states can be distinguished in Europe. First there is the *liberal* welfare state, which in Europe includes the United Kingdom and Ireland. In Esping-Andersen's typology these countries offer fairly limited collective provisions and the target group of those provisions is limited to those who cannot meet their own needs in any other way. The better-off groups have to cover their own risks through private arrangements or employee benefits provided by their company. The government often facilitates such schemes through the tax system.

In addition to these liberal welfare states, Esping-Andersen also identifies the *social-democratic* welfare states; this category mainly includes the Scandinavian countries (Denmark, Sweden and Finland). Reducing income differentials is a prime objective in these countries, and their social security systems are largely universal, in that all inhabitants are entitled to collective provisions for a large number of social risks. The conditions for access to the system are generous and benefits are generally high. The policy in general is strongly geared to encouraging people into work, since high employment is an absolute necessity in this type of welfare state. An active integration policy is in place to help the unemployed and incapacitated to work back into employment quickly, and according to Esping-Andersen there are also good leave arrangements which make it easier for women to accept jobs. Not surprisingly, therefore, the labour market participation of women is high in these countries.

Esping-Andersen's final category is the *corporatist* welfare states; within the EU, Germany, Austria, France and Belgium are the main examples of this approach. According to Esping-Andersen, these countries are characterised by schemes specifically aimed at different occupational groups. Civil servants are privileged because of their links with the state. Because of these separate programmes for different occupational groups, the various schemes are funded mainly through the levying of

premiums; employees pay collectively for their own provisions. This also means that the relationship between contributions paid and benefits received later is stronger than in the liberal and social-democratic countries. Another feature of the corporatist countries cited by Esping-Andersen is the low labour market participation rate of women compared with the social-democratic countries. This is partly because of the limited availability of provisions like parental leave schemes.

Esping-Andersen says nothing in his discussion about the Mediterranean countries or the new EU member states. Italy is the only exception, being characterised as corporatist because many arrangements are organised on a sectoral basis. Ferrera (1996), however, argues that the Mediterranean countries of Greece, Portugal, Spain and Italy could be regarded as a separate type of welfare state. A key characteristic is that these countries generally have no clear social safety net in the form of a subsistence benefit. On the other hand, pensions are relatively high, mainly because of the widespread patronage and clientelism in these countries (Arts & Gelissen, 1999), whereby politicians sought to gain the favour of the electorate by promising good pension provisions. Welfare states in the southern European countries thus appear to have followed a course of its own.

It has become customary since to categorise the European welfare states in these four models. Only the names associated with the four types sometimes differ; some authors e.g. Boeri (2002) and Delsen (2002), use the geographical reference for all four categories (*Anglo-Saxon*; *Scandinavian* or *Nordic*; *Continental*; *Mediterranean* or *Southern Europe*), but most studies use the original Esping-Andersen typology with only minor modifications. Goebel and Otto (2002) for instance use the term *corporatist-conservative* instead of just *corporatist*. In the remainder of this paper, we will follow common practice and refer to the original Esping-Andersen categories, extended with the Mediterranean welfare state. Fortunately, there is almost no discussion in the literature about the countries associated with the different categories, the only exception being the Netherlands.

The Netherlands was initially regarded as a social-democratic country according to Esping-Andersen's typology. Other authors, however, such as Ferrera (1996) and Goebel & Otto (2002) place the Netherlands among the corporatist countries. In a later work Esping-Andersen accordingly qualifies the Netherlands as a 'hybrid', a country with both social-democratic and corporatist features. This practice is for example followed by Boeri (2002). For example, the Netherlands has a fixed basic pension to which every inhabitant is entitled, which is a common feature of the social-democratic countries; on the other hand, leave arrangements in the Netherlands are relatively limited and supplementary pensions are organised on an individual sector basis; these are typical corporatist features. The activity rate is on the low side.

In addition to the countries discussed above, ten new member states will join the European Union in 2004. The four most important countries in this group, Poland, Hungary, the Czech Republic and Slovakia, formed part of the Eastern bloc until 1989, where full employment was an important objective. In addition, these countries had a strong equality ideal. As a result, social provisions made no distinction according to employment history or occupational status. After the revolution in 1989, however, the affordability of these schemes came under great pressure. All the countries have been forced to overhaul their social regimes and the weak economic situation means that they can now generally be described as meagre. For example, the subsistence benefits in these countries are among the lowest in Europe (OECD, 2002).

The remainder of this chapter provides a more extensive description of the four welfare state models. It should be noted, however, that these models are by no means static givens. In fact, many institutional changes have occurred over the last decades. Boeri (2002) counts almost 200 reforms in the European Union over the period 1987-99; that is more than one per year and country. Although most of these changes have been marginal, it is safe to say that the institutional complexity of the European landscape has increased. It has been argued that as a result, it has become more difficult to define the boundary between the different models. Delsen (2002) for instance claims that "there seems to be a creeping convergence towards a mixture of Beveridgean universal flat-rate low coverage and a Bismarckian supplementary system, mainly based on labour market participation".

## 2.2 Social-democratic countries

Denmark seems to be the clearest representative of the social-democratic model. A key reason for this is that Denmark has relatively extensive provisions, spending more than 1.8% of GDP on reintegration programmes for job-seekers, for example – the highest percentage in Europe. Unemployed people are thus helped back into work by the government as rapidly as possible. Moreover, unemployment benefits in Denmark are relatively high: based on figures from the OECD, an average employee in Denmark receives 81% of his most recently earned salary during the first five years after becoming unemployed (OECD, 2002). Denmark thus pays a relatively high percentage of salary for a long period, whereas in many other countries unemployment benefits are stopped or reduced after a shorter period.

In addition to the reintegration programmes, the social-democratic countries also seek to encourage employment participation by leave arrangements. Each country accordingly has forms of parental leave in which the government reimburses part of the costs. The three social-democratic countries are also relatively generous when it comes to disability benefits. In all three countries all working people, including the self-employed, are insured for employment disability and receive benefits totalling more than 60% of their most recently-earned salary. In most other countries of the EU, a lower percentage is paid or the benefit is set at a minimum level.

The Scandinavian countries generally offer reasonable pensions. All three have a separate scheme for older people without an employment history, so that these people are not forced to rely on subsistence benefits. Only Sweden has a fixed pension for older people; in Denmark and Finland the pensioner's other income and assets are first assessed before the pension is paid, and as a result the distinction between the pension paid in these countries and the subsistence benefit paid in other countries is somewhat limited. Pensions for people with an employment history are however relatively high on average in Sweden compared with the other countries, at around 74% of the average salary (state pension) (OECD, 1998). In Denmark and Finland the percentage is 56% and 60%, respectively, putting these two countries considerably closer to the European average than Sweden. As a result of the high pension costs, Sweden modified its pension system in 1999; in addition to the basic pension, there is now also a compulsory defined contribution system for the employment-related part of the pension.

An obvious consequence of the relatively generous schemes is the high cost of the social security system. Not surprisingly, therefore, tax and insurance rates are high in the social-democratic countries. In 2000, tax and premium revenues by the governments of these three countries exceeded 55% of GDP, higher than anywhere else in the EU. The figure for the Netherlands is 47.4% while the average for the EU is 46.7%. Another feature of the social-democratic countries is that the lion's share of the costs of social security are funded through taxes. This is because the schemes apply for all citizens and no specific distinction is made between different (occupational) groups. This makes collection via the tax system the simplest option.

## 2.3 Liberal countries

In the liberal welfare states – the United Kingdom and Ireland – the state pension is considerably lower than in the other countries of the European Union. Older people without an employment history are dependent on a means-tested subsistence benefit. In addition, both countries have a relatively small employment-related pension scheme which is implemented by the state and is compulsory for all employees. As the employment-related state pension is relatively low, many employees are members of a private pension fund via their employers. A key difference compared with the Netherlands is that these schemes are not compulsory.

The maximum national assistance benefits payable in the United Kingdom and Ireland are comparable with the EU average; they are generally lower than those in the social-democratic countries but substantially higher than in the Mediterranean countries. The amounts roughly correspond with those in the corporatist countries Belgium and Germany, and are lower than in the Netherlands; unemployment benefits in the United Kingdom are much lower than in the Netherlands. The level of

benefit is not dependent on most recently earned salary in the two liberal countries, but is a fixed amount which is slightly higher than the subsistence minimum. As a result, the drop in income on becoming unemployed is very severe. On top of this, the duration of unemployment benefit is limited; in Ireland unemployment benefits are converted to national assistance benefits after 15 months, while in the United Kingdom this happens after only six months. In addition, the availability of reintegration programmes is very limited in these countries; the United Kingdom spends around 0.36% of GDP on job reintegration programmes, the lowest in Europe. The liberal countries prefer to use financial incentives such as 'employed person's tax credits' in order to boost the labour supply.

An important consequence of the lower pensions and unemployment benefits is that the costs of the social security systems in the liberal countries are limited. This means that tax and insurance rates are lower than in the EU countries: total government revenues amount to less than 45% of GDP in both countries. It should be borne in mind, however, that the costs of the private schemes are not included in this figure.

### 2.4 Corporatist countries

The welfare states in the corporatist countries (Germany, France, Belgium, Austria and Luxembourg) emerge as moderate. The most important areas of the social security system, such as pensions, unemployment or parental leave arrangements, are generally neither particularly generous nor particularly mean in these countries.

Typical for the corporatist countries is the relationship between occupation and entitlement to provisions. As a result, the coverage can vary from one sector to another. The system is thus geared mainly towards sustaining a standard of living that has already been achieved, rather than on reducing income differences. This also means that social security is funded mainly via premiums, which account for more than 70% of social security funding in all these countries. Only Spain and Greece equal this percentage. France scores highest with 83%, while the Netherlands is at the European average of 52%.

Since the schemes are often related to occupation, unemployment benefits in the corporatist countries are reasonably high, and are particularly striking because of the length of time for which they are paid. In France, for example, an unemployed person can receive benefits for five years, while in Belgium there is no time limit at all. As unemployment benefits last for a long time, the national assistance benefits can in turn be fixed at a lower level, since the target group for these benefits is already considerably smaller. As a result, national assistance benefits in the corporatist countries are lower on average than in the United Kingdom and Ireland.

### 2.5 Mediterranean countries

In contrast to the Scandinavian countries the Mediterranean countries such as Spain, Portugal, Greece and Italy have small social security systems. This is apparent *inter alia* from the national assistance benefit levels in these countries: Portugal and Greece do not have this provision at all, while in Spain and Italy the standard amounts for a single person are among the lowest of the present 15 member states. Unemployment benefits are also low, especially in Italy and Greece: in Greece an employee has a right to 40% of his most recently earned salary for one year; in Italy the same employee has a right to 80% of salary for six months. Unemployment benefits in Portugal are more generous: here, an unemployed person receives 65% of his/her most recent salary for a period of 30 months.

The Mediterranean countries are also characterised by the nature of their leave arrangements. All Mediterranean countries have paid maternity leave systems, but only Spain also offers paid paternity leave, which allows the father to take two days off after the birth. The parental leave arrangements are limited to entitlement to unpaid leave. Another characteristic of the Mediterranean countries is the low level of child benefit; none of these countries spent more than 1.2% of GDP on child benefits in 1998, considerably less than in the social-democratic and corporatist countries.

In contrast to the other provisions, retirement pensions in these countries are high. For example, an employee in Spain can build up a full old-age pension in 35 years which is equivalent to 100% of his

salary. He can then retire on this pension at age 65. On average, therefore, these three countries spend a higher proportion of GDP on pensions than the rest of the EU. The fact that these countries in particular are confronted with an ageing population means they are likely to face relative difficulties in keeping their pensions affordable. For this reason Italy has already pushed through a number of reforms in its pension system, for example switching to a defined contribution rather than a defined benefit system. This means that the ultimate pension will no longer be calculated on the basis of the most recently earned salary, but on the basis of contributions paid during a person's working life. This represents a clear reduction in the generosity of the pension system.

### 2.6 Conclusion

At present, Europe is by no means uniform in terms of social security and labour market arrangements. Four different types of welfare states can be identified in the present-day EU. First there is the social-democratic type, in which income differentials are kept as small as possible and labour participation rates are high. This type of system is found in Denmark, Sweden and Finland. Then there are the corporatist countries France, Germany, Luxembourg, Belgium and Austria. The social security system in these countries is geared to maintaining the standard of living that has been achieved. Each occupational group has its own system. The liberal type of welfare state, in which provision is made only for the most necessary benefits to combat poverty, is found in the United Kingdom and Ireland. Finally there is the Mediterranean type. This system has corporatist characteristics, except that national assistance levels are low while pensions are high. The Netherlands combines elements of the social-democratic and corporate type of welfare state.

## 3 Social policy and economic performance

The European member states have formulated a number of social and economic objectives in the light of the Lisbon process. This chapter examines the feasibility of the ambition of creating a socially responsible and highly productive Europe.

### 3.1 Three objectives from Lisbon

In this chapter the emphasis will lie mainly on three aspects from the strategic Lisbon agenda, viz.:[2]

1. Productivity
2. Employment
3. Social cohesion

Like the European Commission, we will translate these three aspects into verifiable objectives, which will serve as a basis for further analysis.

**Productivity**

The first element in the Lisbon objective is: "To become the most competitive and dynamic knowledge-based economy in the world..." This objective is generally given a central role when discussing the Lisbon agenda. Formally, the European Union has not defined any specific targets in this regard; however, the European Council does state that annual economic growth averaging 3% should be attainable if the measures set out in the Lisbon agenda are implemented. Given the reference to other countries in the world, it is logical to compare the productivity levels in Europe with those in the United States. This is also what the European Commission itself does in its report on the progress of the Lisbon strategy (EC, 2003).

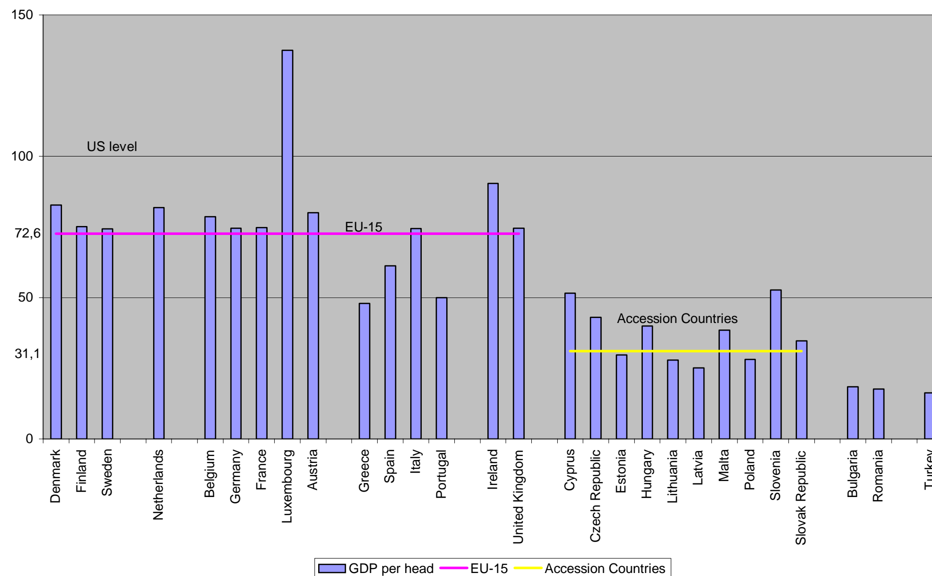
Figure 1 shows that per capita GDP in Europe (measured by purchasing power parities) lagged a long way behind that in the US in 2002. The countries are grouped in the figure in accordance with classification described in the previous chapter: first the social-democratic countries, then the

[2] The aspect of 'sustainability' is left out of consideration here. For an analysis of the reconciliation of economic growth and environmental sustainability in the light of the Lisbon objectives, see e.g. De Mooij & Van den Bergh (2002).

Netherlands, which occupies an intermediate position, followed by the corporatist, Mediterranean and liberal countries. These are then followed by the ten countries which will be joining the European Union in May 2004. Finally, there are other countries that are scheduled to join the EU in 2007: Bulgaria and Romania, with which detailed agreements have been reached, and Turkey, which is currently still awaiting approval for its entry.

The member states of the European Union trail the US by more than 25% on average in terms of per capita GDP. Luxembourg is a positive exception, with a GDP per inhabitant that is actually higher than in the US. The Mediterranean member states of Spain, Portugal and Greece, by contrast, are well below the European average. The new entrants have a per capita GDP that is more than 50% lower than the average for the EU and is approximately a third that in the US. Slovenia and Cyprus form positive exceptions among the new member states, with a per capita GDP that is higher than in Greece and Portugal. Bulgaria, Romania and Turkey lag even further behind, with a per capita GDP that is only a quarter that in the current 15 EU member states (EU-15).

*Figure 1. GDP per head of the population in various countries compared with the US (2002)*




*Note:* GDP is measured in purchasing power parities and set at 100 for the US. Data for Malta and for the accession countries as a whole relate to 1999. Data for both the other individual accession countries as well as the EU-15 countries are for 2002.

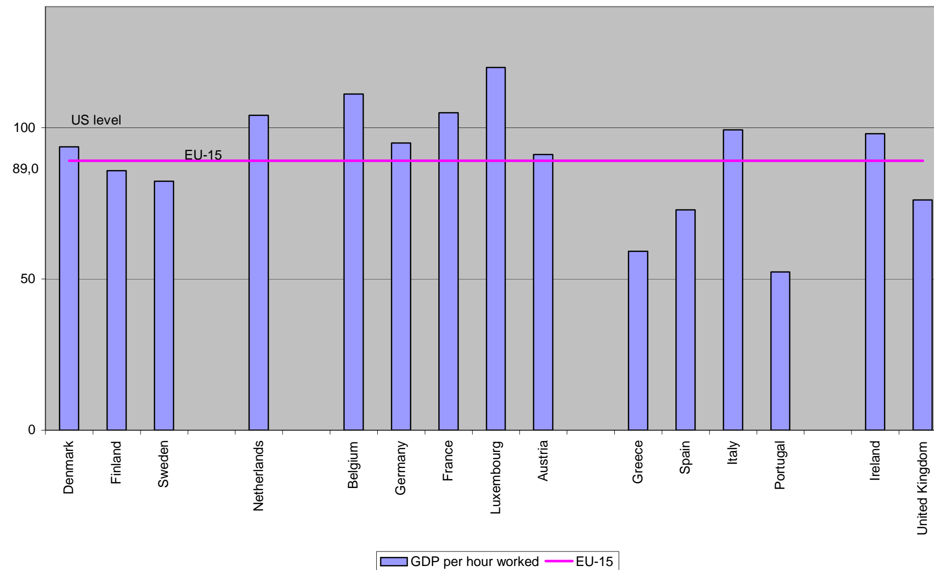
*Source*: Eurostat and own calculations.

GDP per head of the population is considerably influenced by the labour participation rate and is therefore not entirely suitable as a criterion for measuring differences in the productivity of workers. A better indicator for this is GDP per worker. Figures from Eurostat for 2002 show that the distance between Europe and the US is then considerably smaller, with GDP per worker averaging around 85% that in the US. Measured in this way, Belgium and Ireland join Luxembourg in having a higher labour productivity than the United States. GDP per worker is also closer to that of the US in the new member states than the per capita GDP. However, with a relative level of slightly over 40%, the gap is still wide.

Nevertheless, GDP per worker is still not the most suitable yardstick for measuring comparative productivity rates. Differences in productivity measured in this way can be distorted by differences in hours worked per employee, which is something that is often a free choice and partly reflects differences in preferences. A better way of measuring progress in achieving the Lisbon objective is therefore to correct for the number of hours worked and to look at the GDP per hour worked. Figure 2

provides an insight into the productivity differences measured in this way between different countries, again compared with the US.[3] We now see that a number of European countries do not score so badly in comparison with the US; on average, GDP per hour worked in the EU is 11% below that in the US. It is mainly the Mediterranean countries of Spain, Portugal and Greece that record a relatively low productivity level. The same applies, although to a lesser extent, for the social-democratic and liberal countries in Europe. By contrast, the Netherlands and a number of corporatist countries – Belgium, France and Luxembourg – score well. In fact these countries score better than the US in terms of productivity per hour, making them the most productive countries in the world.

*Figure 2. GDP per hour worked in European countries compared with the US (2002)*




*Note:* GDP is measured in purchasing power parities per hour worked and is set at 100 for the US.
*Source:* Eurostat and own calculations.

Is Europe as a whole now closing the gap relative to the United States? According to McGuckin and Van Ark (2002), labour productivity in the EU rose considerably faster than in the US in the first half of the 1990s; Europe was thus in the process of catching up. Between 1996 and 2001, by contrast, labour productivity in the US grew by an average of 2% per annum compared with 1.3% in the EU, so that Europe lost ground again relative to the US. This is partly the reason for the creation of the Lisbon agenda. The reason for the slower productivity growth in Europe in the second half of the 1990s is often sought in the ICT sector. Nahuis & Van der Wiel (2003), for example, show that this sector accounted for 8% of GDP in the US in 2000, compared with less than 6% in the EU. In addition, productivity growth in Europe was considerably lower than in the US in the ICT-intensive services sector: 1.1% in the EU compared with 4.6% in the United States. According to McGuckin & Van Ark (2002), the main reason for the latter fact is the slower diffusion of ICT within Europe.

**Employment**

The second element in the Lisbon strategy refers to: "… *with more and better jobs …*". This objective is also translated into the achievement of 'full' employment by reducing unemployment and promoting labour market participation. During the European Councils of Lisbon (2000) and

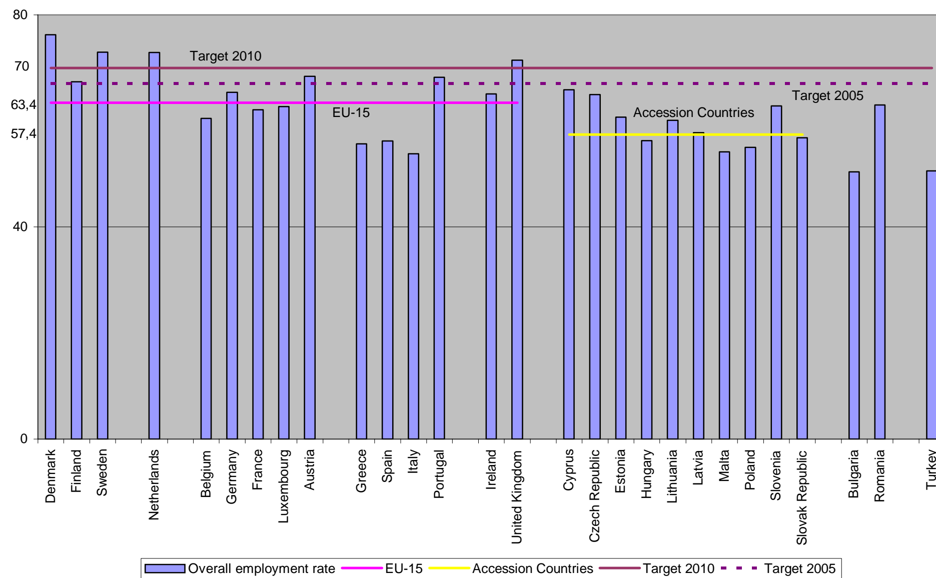
[3] These figures are not available for the new member states.

Stockholm (2001), the following tangible employment objectives were formulated for the European Union as a whole:

- Raising the general employment rate to 70% by 2010 (and 67% by 2005)
- Raising female employment to at least 60% by 2010 (and 57% by 2005)
- Raising the employment rate of older persons (55-64 years) to 50% by 2010.

Figures 3-5 show how far away the European Union was from these objectives in 2000. Figure 3 shows the total employment rate in the countries of the European Union and the new member states. On average the general employment rate in the EU-15 is slightly above 63%. This means that an increase in employment averaging 4 percentage points is needed in order to achieve the interim target for 2005.

*Figure 3. Overall employment rate for the European countries in 2000*




*Note:* The employment rate is defined here as the number of employed persons aged 15-64 as a percentage of the total population of that age group. The data for Malta and Turkey relate to 2001.

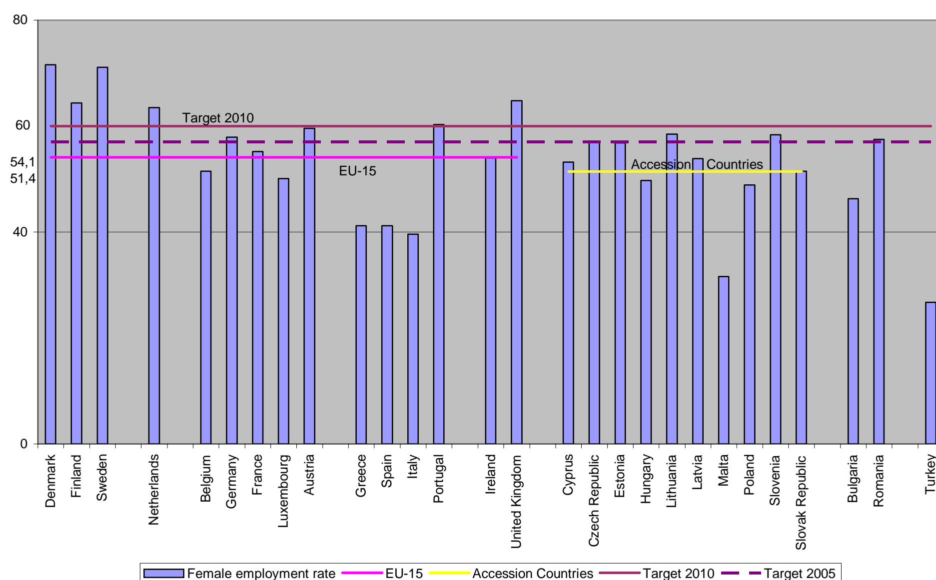
*Source:* Eurostat.

Although the target does not apply for the individual member states, it is interesting to see how the different countries score. In seven countries the employment rate is above 67%, while four countries (including the Netherlands) have an employment rate which is already above 70%, the target for the whole of the EU for 2010. The Scandinavian countries, in particular, score relatively well on this point. On the other hand the southern European countries, with the exception of Portugal, are still a very long way from achieving the ambitions of Lisbon. The new member states also have lower employment rates: in Poland it is only 50%, for example. On average, the employment percentage in the countries that will be joining the EU in 2004 is slightly more than 57%.

The female employment rate in the European Union is almost 10 percentage points below that of the population as a whole (see Figure 4). There is a strong correlation between the two participation rates: the seven European countries with a relatively high total employment rate also already meet the target for 2010 of 60% female employment. The high position of the Netherlands presents a slightly distorted picture because of the large number of women working part-time: expressed in full-time equivalents, the Netherlands falls back to slightly below the EU average. The good performance of the seven leading countries is offset by the relatively large shortfall with respect to the target for Greece, Spain and Italy. If the Lisbon objective were to apply for each country individually, these three countries

would need to raise female employment by almost 20 percentage points in the coming years in order to meet the target. The new member states also face a challenge on this point, with female employment rates averaging almost 10 percentage points below the target figure for the EU as a whole. There are however wide differences between the new entrants: whereas Slovenia, Lithuania and Romania have already achieved the target figure for 2005, Malta fails by more than 25 percentage points, while Turkey is even further behind.

*Figure 4. Female employment rate in 2000*




*Note:* The female employment rate is defined here as the number of employed women aged 15-64 as a percentage of the total female population of the same age group. The data for Malta and Turkey relate to 2001.

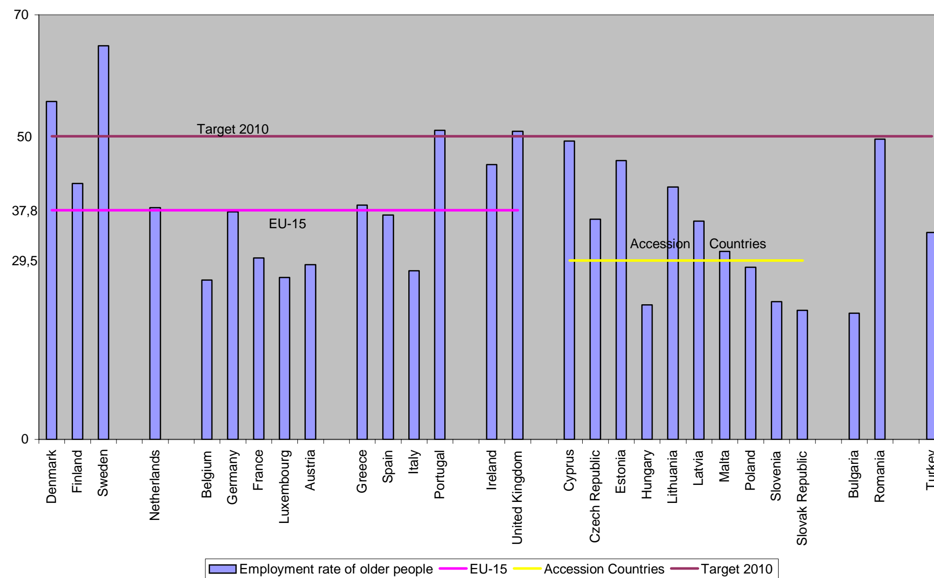
Source: Eurostat.

Employment rates for people aged between 55 and 64 are a source of worry in many European countries (see Figure 5); on average, only 38% of older people in the European Union are in work. The Netherlands is no exception to this, with an employment rate that is only 0.4% above the EU average. A relatively large number of older people are in work in the social-democratic Scandinavia, while the figure is particularly low in the corporatist countries. The performance of the new member states in this respect is even less rosy on average: the percentage of older workers is generally below 30%. However, the individual differences are wide: countries such as Cyprus and Estonia as well as Romania have relatively high employment rates for older persons, while in Hungary, Slovenia, Slovakia and Bulgaria fewer than a quarter of older people are in work. It will prove to be a difficult task for the European Union as a whole to change this picture in the years ahead and to meet the Lisbon target of 50% by 2010.

Europe will thus have to make a substantial effort in order to achieve the Lisbon employment targets. The number of people in work has in fact grown significantly over the last decade, with female employment growing particularly strongly from 49% in 1994 to 55% in 2001. The number of working women is expected to continue growing in the years ahead, although the growth is likely to flatten slightly. In the Netherlands, for example, this is because the activity rate of women aged 25-29 is simply reaching the limits of expansion (see Kuipers, 2001). Yet the target for female employment for the EU as a whole would appear to be quite attainable. There is also some prospect that the Lisbon target on general employment will be reached. If the growth of 1% per annum seen the last decade is continued in the years ahead, the ultimate figure in 2010 will be close to the target. However, the

OECD's medium-turn scenario is less optimistic than this and predicts employment growth averaging 0.5% per year for the eurozone. This would make the target unattainable. As regards employment among the older population, the target appears to be too high under all circumstances. Although the percentage of working older people did increase between 1994 and 2001 from 36% to 39%, this is still more than 10 percentage points below the target for 2010. In order to achieve the target for older workers, growth of 3% per annum would be needed in the years ahead.

*Figure 5. Employment rate among older people (aged 55-64) in 2000*




*Note:* The employment rate of older people is defined here as the number of employed persons aged 55-64 as a percentage of the total population of the same age group. The data for Malta and Turkey relate to 2001.

Source: Eurostat.

## Social cohesion

The third element in the Lisbon objectives relates to: "…and greater social cohesion". In order to measure progress in the area of social cohesion, the European Commission looks among other things at indicators for inequality of the income distribution. In 2003 the Commission concluded that there are still wide differences between member states in terms of income distribution (EC, 2003). The indicator used shows the ratio of the income of the 20% of the population with the highest incomes to the income of the 20% with the lowest incomes.

Many indicators for measuring income inequality are found in the literature. To obtain a clear picture of the relationship between the types of welfare states described and the degree of income inequality and poverty, it is important to incorporate several indicators in the comparison. The indicators we use are constructed by SCP on the basis of the European Community Household Panel (ECHP) 1999. These are updated figures from earlier country-comparative SCP research (Wildeboer Schut et al., 2000) on poverty and income inequality.

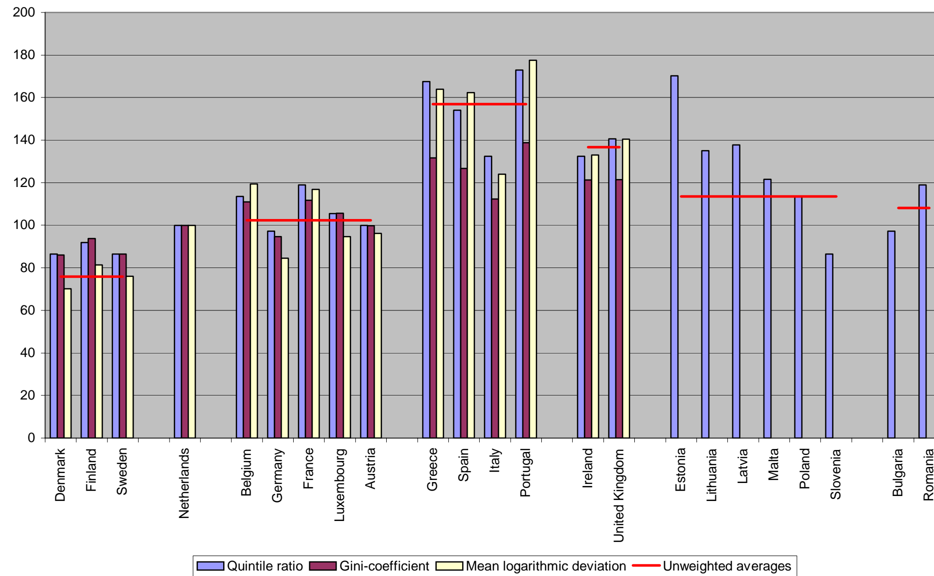
Differences in inequality and poverty between countries may be caused by all manner of factors. As well as differences in economic structures in the different welfare-state types, there are also differences in demographic structures and in the economic stages which the countries were going through when the income measurements were carried out. The constructed indicators attempt to

correct for this latter factor by adjusting the unemployment in the measurement years to the structural unemployment (OECD, 2000).[4]

*Income inequality*

Figure 6 provides an insight into the income inequality in the European Union. Summarising income inequality in a single figure means that certain information is by definition ignored. An attempt is made by using several indicators to shed light on different aspects of the income distribution. As well as the income quintile ratio, the figure also presents the Gini-coefficient and the average logarithmic deviation. The different coefficients all point in the same direction.[5] This suggests a certain robustness of the results.

*Figure 6. Income inequality in Europe (1999)*




*Note:* The different indicators have been rescaled, with the Dutch inequality level being set at 100. Both here and in the following graphs, the averages per welfare-state type are calculated as unweighted averages for the countries in that particular cluster.

*Source*: Eurostat, SCP and own calculations.

The figure reveals wide differences between individual countries. The degree of inequality is far and away the lowest in the social-democratic countries. Wildeboer Schut et al. (2000) cite the relatively equal distribution of returns on capital and labour, as well as the high level of redistribution from economically active to economically inactive persons as the chief reasons for this phenomenon.

The liberal countries are to some extent the mirror image of the social-democratic category. Workers in liberal countries are less well-organised and have less statutory protection. This encourages a more unequal distribution of market incomes. The lower, income-dependent benefits and a less progressive tax system mean that the redistributive effects are relatively small. The inequality in Ireland and the United Kingdom is relatively great.

---

[4] In order to obtain the best possible approximation of the wealth situation of each respondent, disposable household incomes were standardised. This was carried out using the so-called 'modified OECD method'.

[5] The correlation between the indicators used is more than 95% for each pair. For more information on the definition and properties of the various indicators, see Wildeboer Schut et al. (2000).

The corporatist countries are situated between the liberal and social-democratic clusters. Although the redistributive effects of the tax and social insurance system are less pronounced than in the social-democratic welfare states, the distribution of market incomes appears less unequal than in the liberal states. Germany's position here is however striking; Germany achieves a better score on all three indicators than the Netherlands and in terms of inequality, it resembles the Scandinavian countries more than the other countries in the corporatist cluster. In addition the inequality in the Netherlands, Luxembourg and Austria is comparable with and considerably lower than in Belgium, France and Italy. Based on these indicators, the French income distribution is a good approximation of the average for the European Union.

As stated in chapter 2, Esping-Andersen does not say anything explicitly about the countries of Southern Europe. In particular the lack of an official guaranteed minimum income appears to foster high inequality levels in these countries. The figure shows that Greece, Spain and Portugal have the highest inequality in the EU.

Also striking is that income inequality in Slovenia is at the same level as the Scandinavian countries. In the other new member states for which data are available, the inequality is greater, though still a good deal lower than in the Mediterranean countries.

Based on the data used, the typology of Esping-Andersen broadly appears to have an empirical basis as regards income inequality: inequality is lowest in the social-democratic countries, followed by the corporatist, liberal and Mediterranean welfare states.

*Poverty*

International comparative research often uses relative poverty thresholds, or poverty lines. These are dependent on time and place and reflect the general level of prosperity of the society to which they relate. This means that in principle households at the bottom of the income distribution are regarded as poor. The threshold used here has been applied for a number of years by the European Commission to enable the percentage of poor households in the different member states to be compared.[6] In order to determine the level of the threshold, incomes are first standardised.[7] The median of the standardised income distribution is then calculated. This median divides the income distribution into two halves: the number of people earning more than this median amount is precisely the same size as the number of people earning less. The poverty line is usually drawn at 60% or 40% of the median value.

A number of objections can be levelled against this approach (cf. Wildeboer Schut et al., 2000). First of all, it is not clear what the relationship is between a given percentage of the median income and people's needs. In particular, it is not made explicit whether people are able to make ends meet with the amount represented by the poverty line. In the second place, the height of the poverty line in different countries may differ so much that the poverty rates found say little more than that the households considered poor are at the bottom of the respective income distributions. Thirdly, the poverty line is maximised: it is never possible for more than half the total number of households to be considered poor, since the median line divides the total distribution into two equal halves. It is not clear whether this assumption is realistic for Third World countries, for example.

Figure 7 shows the percentage of poor people in each country according to both indicators. If we look at the percentage of poor people below the 60% threshold, we see the ranking of country clusters found with the scores on the inequality indicators return to some degree. In general the Southern European countries have the highest poverty rates, followed by the liberal cluster (especially the United Kingdom). The social-democratic countries have the smallest number of poor people according to this indicator. The corporatist states occupy an intermediate position. However, the ranking is less

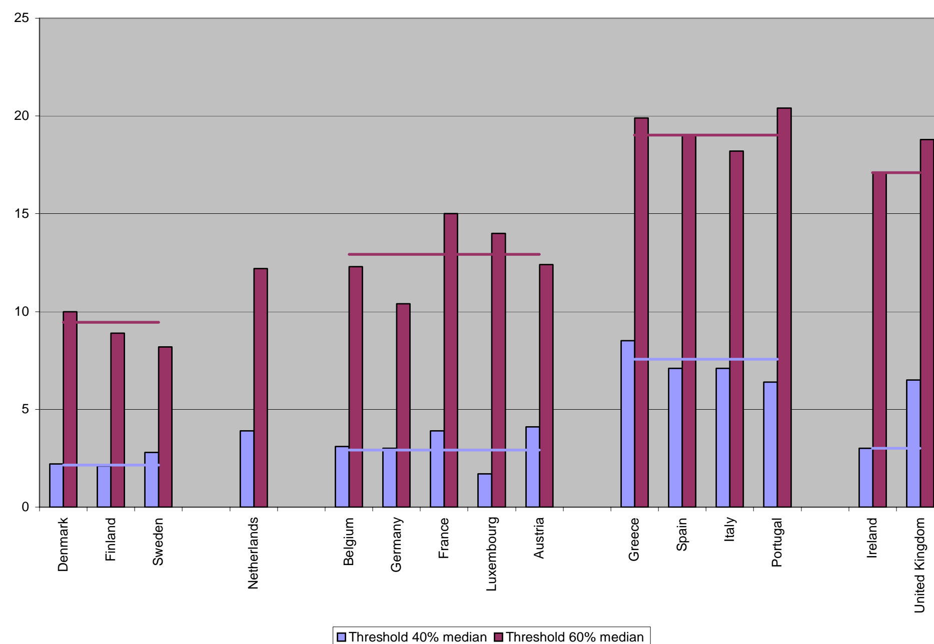
[6] During the European Summit in Laeken (2001) the member states agreed a number of indicators of social exclusion. One of these indicators is the percentage of households below 60% of the median standardised income. The percentages of households below 40%, 50% and 70% of the median were taken as additional indicators.

[7] The same procedure as above was used to measure the inequality in incomes.

clear than with the scores for the inequality criteria. The Netherlands has a higher percentage of poor people (over 12%) than the social-democratic countries, and according to this indicator appears to resemble the corporatist cluster more, occupying the middle ground along with Belgium, Luxembourg and Austria. The relatively low poverty rate in Germany is again striking; for a corporatist country Germany has relatively few poor people.

The 40% threshold divides the countries roughly into two groups. In the United Kingdom, Italy, Greece, Spain and Portugal, more than 5% of the population are below this poverty line. For the other countries the figure is lower, sometimes several percentage points lower. The fact that the percentages below this threshold correspond much less closely with the typology of Esping-Andersen may well be due to the fact that the institutional minimum income schemes in some countries are just above or just below this threshold. In this respect the 60% threshold differentiates more, because the distance from minimum income schemes is much greater.

*Figure 7. Poverty in the EU (1999)*




*Source*: European Community Household Panel 1999; SCP.

Goebel & Otto (2002) have analysed how successful the EU member states are in reducing poverty. To that end, they compare the real world with a simulated world 'excluding social transfers'. Surprisingly, they find that in Denmark and Sweden the poverty intensity in a simulated world excluding social transfers would be higher than in the Mediterranean countries. In other words, according to their conclusions, the social-democratic welfare regimes exhibit not only a successful policy of combating poverty, but they also start their poverty-combating policy from a relatively high level of poverty intensity.

### 3.2 Can the Lisbon objectives be reconciled? A first exploration

The trade-off between equality and efficiency is deeply rooted in economic theory. Okun (1975, p. 120) states for example: "The pursuit of efficiency necessarily creates inequalities. And hence society faces a trade-off between equality and efficiency". This could mean that the different Lisbon objectives are irreconcilable with each other, since it suggests that promoting employment and raising

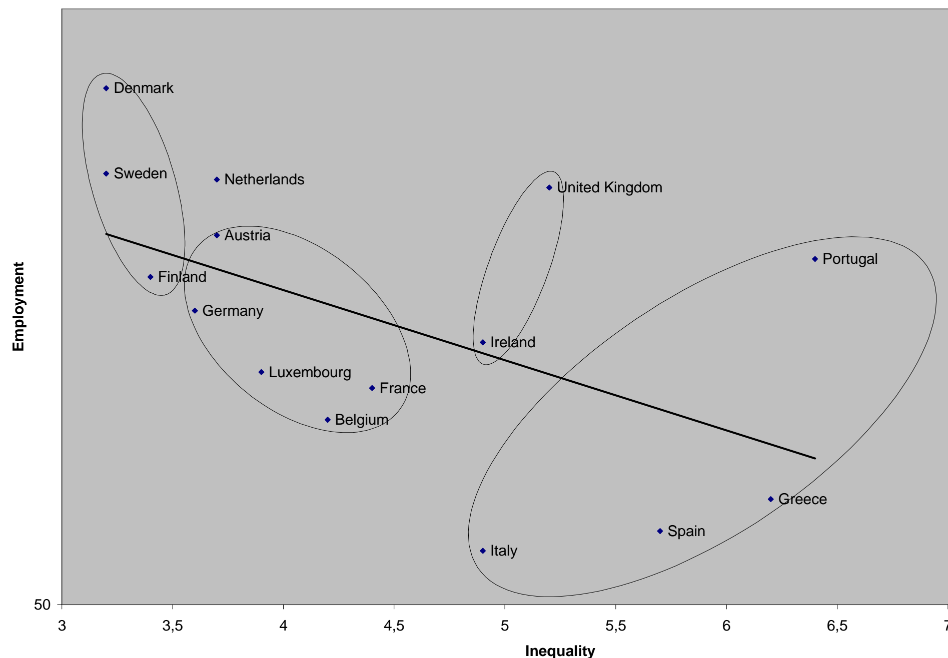
worker productivity (= *efficiency*) are diametrically opposed to reducing income inequality (= *equality*). What can we say about the socio-economic achievements of EU member states?

**Equality and employment**

The idea of a trade-off between income equality and employment receives a great deal of support in the literature: the extensive welfare states in Europe achieve good results when it comes to income equality, but discourage participation in employment (Lindbeck, 2001). Redistribution of income from economically active to inactive people reduces the incentive for people to undertake activities and to become or remain active in their own right.

The trade-off is often substantiated by a comparison between the US and the EU. The United States combines a relatively unequal income distribution with a relatively high employment participation rate. Figures from the Luxembourg Income Survey 1995 show that income inequality is greater in the US than in any European country, while the employment rate is 75%, well above the Lisbon target for the EU. The question is whether this relationship between equality and participation also systematically applies within the EU. To illustrate this, figure 8 shows the performance of the present EU member states on total employment, as well as an indicator for income inequality as presented in the foregoing section, namely the income quintile ratio between the highest and lowest 20% of the population. The figure shows that in European countries with an equal income distribution, the employment rate is generally relatively high. This suggests a positive correlation rather than a trade-off. In fact in the European country with the least income inequality, Denmark, the employment rate is actually higher than in the United States. The other Scandinavian countries and the Netherlands have also been successful in getting people to work in a relatively egalitarian society. The Mediterranean countries, by contrast, score less well on both aspects, with the exception of Portugal, where the employment rate is relatively high.

*Figure 8. Income inequality and employment (1999)*




*Note:* Inequality is defined here as the income quintile ratio (top 20% / bottom 20%).

*Source:* Eurostat.

The table below shows the correlations with other indicators for social cohesion. The observation from figure 8 is found to hold for other indicators as well. The table also shows the correlations with the labour participation rate of women and older people. The correlations for women turn out to be the same, but for older people they are less clear-cut.

*Table.1. Correlations between employment and various indicators for social cohesion (1999)*

| | Inequality (80/20) | Gini-coefficient | Mean log. deviation |
|---|---|---|---|
| Total employment rate | -0.53 | -0.54 | -0.53 |
| Female employment | -0.59 | -0.59 | -0.58 |
| Employment rate of older people | -0.04 | -0.14 | -0.08 |

*Source*: Eurostat and own calculations.

**Equality and productivity**

It is also often thought that social cohesion cannot be accompanied by high productivity growth. For instance, Jensen et al. (2002) claim that "a society valuing both equity and efficiency is faced with a dilemma: According to which principle should social security systems be organized?". More in general it is often argued that productivity growth depends on innovation, entrepreneurship and knowledge-building, and these activities can only flourish if people and businesses are able to respond flexibly and rapidly to new developments. European institutions are sometimes accused of undermining the vital dynamism of the economy and discouraging innovation and entrepreneurship. This could perhaps explain why productivity growth in the United States was faster in the second half of the 1990s than in the EU (see section 3.1).[8]

Yet not all economists are convinced of this trade-off between productivity and equality. Several authors have investigated whether there is a systematic correlation between the inequality in different countries and the growth of their GDP. Studies by different researchers, including Persson & Tabellini (1994) and Alesina & Rodrik (1994) show that greater equality can be accompanied by high growth (see Aghion et al., 1999, for an overview). Several reasons are put forward for this. For example, productivity growth and social cohesion can go hand in hand because rich countries can afford greater solidarity. Income equality is a luxury good, as it were, which only a wealthy society can afford.[9] Secondly, political economics suggest that in a more unequal society a relatively greater number of electors benefit from redistribution through higher taxes. These taxes reduce the return on investments, and in very unequal societies thus ultimately result in fewer investments and lower growth. It should be remembered here that this is 'pre-tax inequality'. The reason why equality and productivity can be reconciled is that there must be sufficient public support for policies aimed at improving economic efficiency – consider the issues of European integration, liberalisation of trade or privatisation. Such policies are often accompanied by substantial economic reforms. Public support for these reforms can be increased by creating a system of social protection which protects the losers from the painful consequences of those reforms. Finally, the endogenous growth theory argues that more unequal societies invest less in training, because capital market imperfections imply that not everyone can borrow money to pay for their studies. The inequality therefore leads to lower investments in knowledge-building and thus slows down growth.

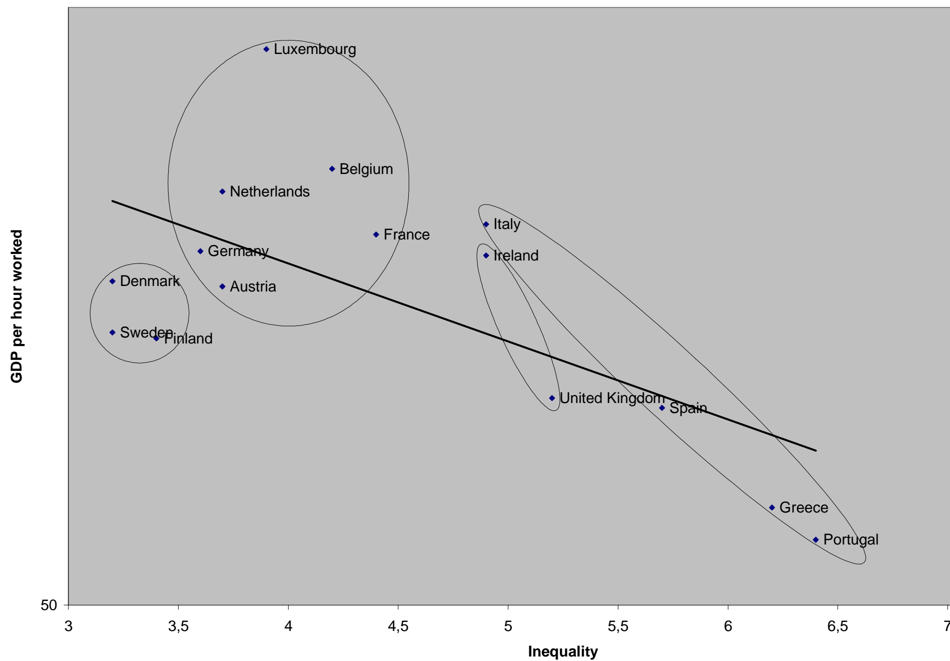
The theoretical evidence of a trade-off between equality and productivity is thus not as clear as is sometimes assumed. Attention over the last decade has therefore shifted somewhat towards empirical evidence. Figure 9 gives an impression of the correlation between productivity and equality in the EU using a scatter diagram for 1999. We see that productivity in more egalitarian EU member states is

[8] For an analysis of the economic dynamics of the EU compared with the US, see also OCFEB (2003).

[9] Some observers suggest that there is a 'U-shaped' relationship between income *in*equality and productivity. In other words, as societies become more productive, income inequality first decreases, but will begin to rise again after a certain point. According to Atkinson (2003), however, there is no convincing evidence for this theory.

higher than in less egalitarian member states.[10] As with participation, this does not suggest a trade-off but indicates that productivity and equality go hand in hand. The empirical literature shows that this correlation with inequality not only applies for productivity levels, but also for economic growth (see Aghion et al., 1999).

*Figure 9. Income inequality and productivity (1999)*




*Source:* Eurostat.

The table below shows that this result still holds when other indicators are used. Both high labour productivity and a high per capita GDP show a good correlation with a high level of social cohesion. The relationship with per capita GDP is also found by Fouarge (2002), though he also shows that the high level of economic growth and the rise in labour market participation during the 1980s and 1990s in the Netherlands, Germany and the United Kingdom did not lead to a reduction in poverty in those countries.

*Table 2. Correlations between productivity and inequality indicators (1999)*

| | Inequality (80/20) | Gini-coefficient | Mean log. deviation |
|---|---|---|---|
| GDP per hour worked | -0.65 | -0.53 | -0.61 |
| GDP per worker | -0.48 | -0.37 | -0.46 |
| GDP per capita | -0.56 | -0.46 | -0.57 |

*Source:* Eurostat, SCP and own calculations.

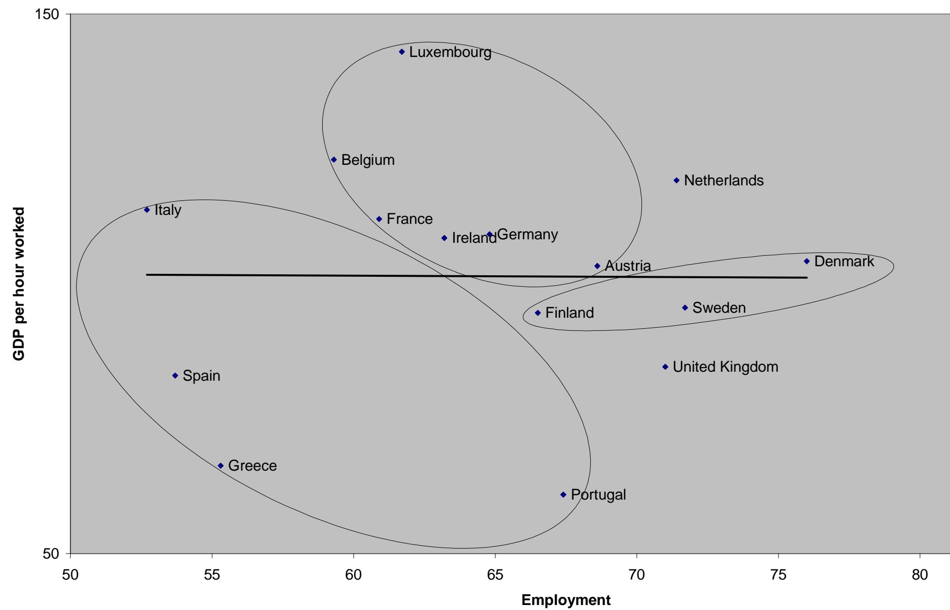
**Employment and productivity**

Discussions about trade-offs in the strategic Lisbon agenda usually focus on the question of whether economic performance is achieved at the expense of the social face of society and vice versa. This

[10] This result is determined largely by the Southern European member states. Without these countries there is no statistical correlation between productivity and equality.

opposition manifests itself most clearly in the relationships as discussed earlier between productivity and employment on the one hand and the social dimension of income inequality on the other. However, a third relationship between these three objectives is also possible, namely that between employment and productivity. Work is regarded by the European Council as the best insurance against social exclusion, and encouraging participation in employment is therefore a core aim of European social policy. In this sense, therefore, there may also be a trade-off between economic and social policy, i.e. a highly productive economy versus a society in which everyone has a job.

*Figure 10. Employment and productivity*




*Source:* Eurostat.

The above figure shows the correlation for the countries of the European Union. It is striking that Ireland appears to be situated in the corporatist cluster in the figure: productivity and employment are at about the same level as in Germany. The Netherlands combines relatively high productivity with a relatively high employment rate. The figure reveals neither a directly positive nor a directly negative relationship between the two aspects. Nevertheless, there is some suggestion of a possible trade-off between employment and productivity. If the Southern European countries are left out of consideration, a clear negative correlation becomes evident, and a negative correlation is also found within the cluster of Mediterranean countries. This provides some empirical support for the idea that increasing employment within the EU is achieved mainly using relatively unproductive labour.

## Trade-off or not?

The United States combines wide income differentials with high productivity and high employment participation rates compared with the EU. This suggests that there is a trade-off between equality and efficiency. Within Europe, however, this trade-off appears to be largely absent; countries with an equal income distribution, such as the Scandinavian countries and the Netherlands, in fact have relatively high levels of employment and productivity. The American model may therefore not be a panacea. This offers some perspective for the Lisbon agenda of reconciling social cohesion with more employment and higher productivity. The question is, how is this to be achieved? There are no hard and fast relationships, and not every policy aimed at achieving social cohesion is automatically beneficial for employment participation and productivity.

The above analyses mask any trade-offs that may be occurring with respect to specific institutions. The following chapter therefore looks in more detail at possible trade-offs within specific labour market institutions.

## 4 The influence of labour market institutions

The Lisbon agenda embraces a broad policy agenda. Social policy is just one part of this agenda, aimed mainly at promoting participation, insuring social risks and reducing inequality in income distribution. Other components of the Lisbon agenda are directed more towards productivity and promoting employment. The empirical analysis in the previous chapter suggests that the overall raft of policies pursued by individual countries need not imply a trade-off between the objectives for productivity, employment and social cohesion. There may however well be trade-offs with respect to specific labour market institutions. This chapter discusses the effect of specific instruments on the Lisbon objectives and illustrates the importance of the different institutions on the basis of recent data for the European Union.

### 4.1 Social security

In essence, social security comes down to insurance of risks. It offers certainty to people that they will be able to continue living at a reasonable subsistence level if they should become unemployed, ill, incapacitated for work or old. Although people benefit from greater certainty, it is perhaps not immediately clear why the private insurance market could not cover the risks to which people are exposed. Private insurance could work perfectly well if the risk distribution is known and is an independent variable for the different individuals. In practice, however, particularly as regards the unemployment risk, the probabilities are interdependent. Compulsory, state-run social insurance resolves this problem at source. This is why insurance against unemployment cannot be left to the private market.[11]

Social insurance also introduces risk solidarity between good and poor risks. Those who run little risk have to pay the same premium as people with a high risk: social insurance does not in principle differentiate between individual risk profiles. Moreover, social insurance implies redistribution of income: *ex-ante* insurance is in effect *ex-post* redistribution; fortunate people who are not struck by disaster pay for their less fortunate fellow citizens who have not managed to avoid their fate. This reduces income differentials in the society concerned.

While social insurance is good for income equality, it can also influence the stimuli for participation and innovation. This is because people who are insured before an event takes place behave differently from those without insurance. This can have a favourable effect; for example, people may be inclined to take more risks, such as starting a business, undergoing training or accepting a job, because if things should go wrong they are still assured of a reasonable income. This fosters the dynamism of the economy and benefits productivity. However, the impact on behaviour can also be unfavourable; for example, workers see their bargaining position improve if their loss of income is limited if they should become unemployed. This could lead to higher wage demands and rising unemployment. In addition, social insurance may mean that people or businesses make less effort to avoid an unpleasant event: for example, companies will be less concerned with preventing workers from becoming incapacitated for work, while workers no longer give their best at work because if they are dismissed they are still assured of a reasonable income.

Social insurance can also elicit different behaviour from people after an event has taken place. For example, people in receipt of benefit may be less inclined to seek work and become more discriminating in accepting job offers. Abuse of the social security system is also a risk. For the

[11] Government intervention is also justified in the case of correlated risks. If an eventuality affects many insured parties at the same time, the insurance company is no longer able to spread the risk over a large group of people. In addition high transaction costs, fundamental uncertainties or risks with a probability close to 1 may be reasons for government intervention.

government, it is difficult in many cases to verify whether people are making genuine claims to benefit because this (privacy-sensitive) information is not easy to obtain.

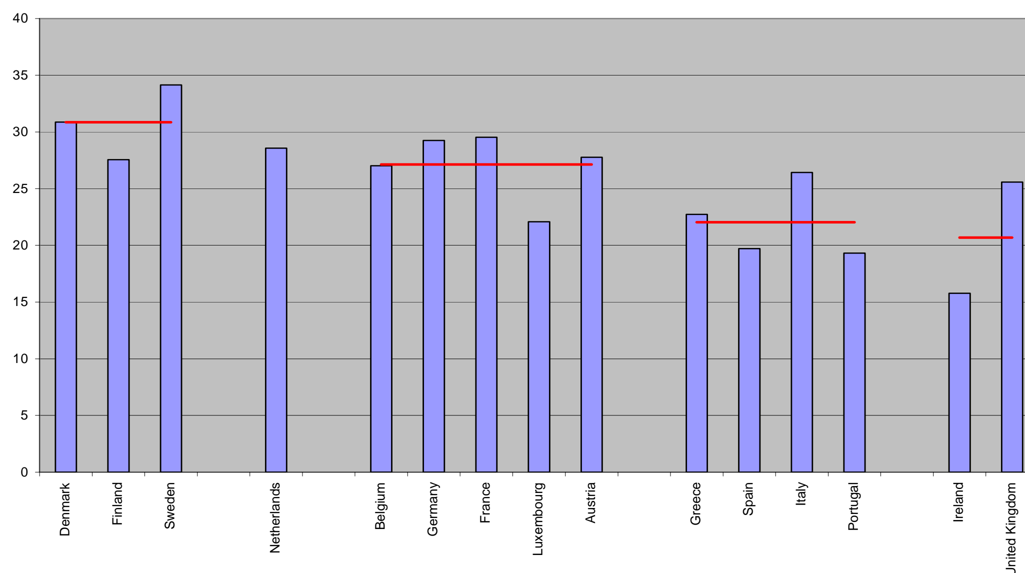
Risk solidarity and income solidarity in the social security system also imply that people will perceive social insurance contributions as a tax, since the relationship between the compulsory contributions and the expected benefit is blurred by the compulsory solidarity. The tax-like nature of social insurance premiums affects the decision by households on whether to offer their labour: social security thus reduces employment. The trade-off between equality and participation is thus an unavoidable consequence of social security.

Empirical research illustrates the consequences of social security for employment. Van der Horst (2003) shows that the replacement rate, defined as the ratio of net unemployment benefit to net wages, puts significant upward pressure on wages in France, the United Kingdom and the Netherlands, among others. Other studies reach similar conclusions. High benefits lead to an increase in (equilibrium) unemployment.

De Grauwe & Polan (2003) look at the influence of social security spending on the competitive position of the countries concerned, where productivity is a key factor. They find no empirical substantiation for the trade-off: social security spending thus appears to have no adverse effect on competitiveness. The explanation for this may be two-fold. On the one hand, a good competitive position facilitates higher levels of social security; on the other hand, social security spending implies less social unrest and more opportunities for investing in high-risk projects.

Figure 11 gives an impression of social security in the EU in 1998. It presents social security spending as a percentage of GDP, with social security spending being defined as the sum of public spending in respect of pensions, sickness and disability, surviving dependents, unemployment, healthcare, national assistance, children, housing and active labour market policy. It should be noted here that the comparability of figures of this sort often leaves something to be desired. For example, benefits for the Netherlands are shown gross, whereas in many other countries they are net amounts. Nevertheless, the figures do provide some insight into the differences between countries. We see for example that social security spending is lowest in the Mediterranean and liberal countries. As expected, social security spending is relatively high in the social-democratic and, to a slightly lesser extent, corporatist welfare states.

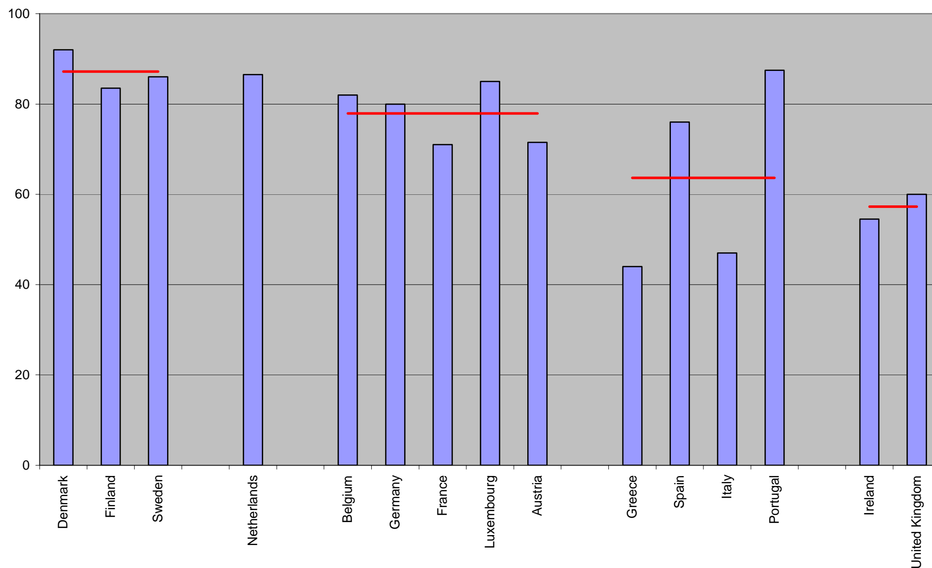
*Figure 11. Social security spending as a percentage of GDP, 1998*




*Source:* OECD.

Figure 12 gives an impression of the replacement rate in the EU member states, calculated as the average for single persons and families at the minimum income level. Here again we see the highest values in the social-democratic countries and the lowest values in the liberal and Mediterranean countries – with the exception of Portugal, which has a strikingly high replacement rate. The replacement rate in the corporatist countries is somewhat lower than in the social-democratic welfare states.

*Figure 12. Net replacement rate at minimum level, 1999*




*Note:* The figures presented are the averages of the replacement rates for single persons and families at minimum income level.

*Source:* OECD.

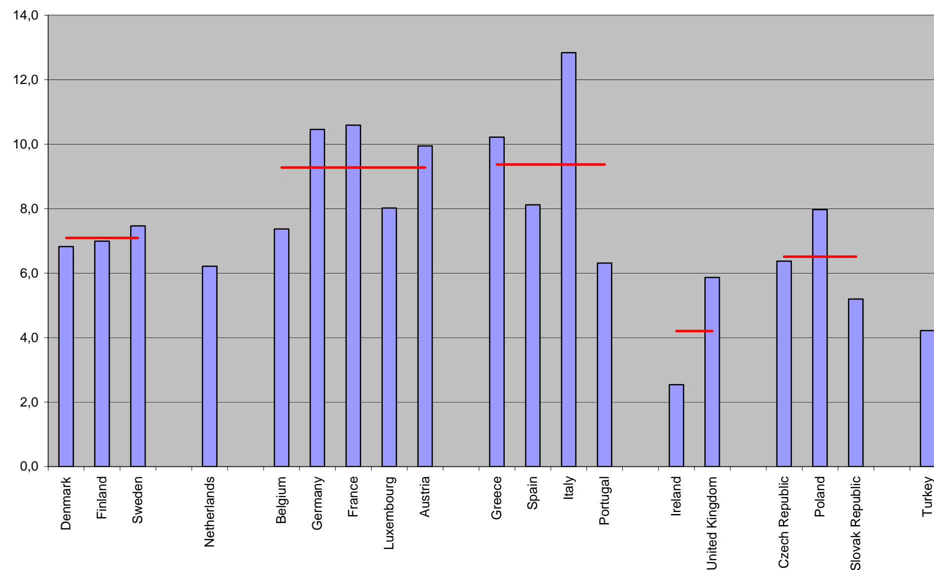
### 4.2 Pensions

Pensions are one aspect of the system of social security. The special thing about public pensions based on a pay-as-you-go (PAYG) system is that it provides income redistribution between generations. In such a system, working generations pay taxes to finance the old-age benefits of the retired generations. These systems are based on an implicit contract between generations. As it is easier for younger people to accommodate to shocks in income than for the old, this risk-sharing enhances total welfare. Moreover, the type of shocks faced by young and old is generally not the same, so that they can gain by pooling their risks.

An alternative is to finance pensions by a funded scheme. In such a system, individuals invest in funds today from which they draw their old-age income later. This provides insurance against the risks of longevity. However, financial risks cannot be diversified within one generation. In particular, the rate of return on assets is uncertain and liabilities may experience economic shocks, for example if pensions are indexed to wages. To assure intergenerational risk-sharing, either pension schemes should be mandatory or the government should intervene.

Few European countries fully finance their pension systems by funded schemes. In some countries, such as the Netherlands, a combination of both systems is used. In most countries in the European Union, however, the PAYG system is used to pay for the pensions. Germany, France and Italy are important examples. In these countries, the PAYG pension systems are both generous and expensive. This can be seen from figure 13, which depicts the expenditure on pensions in the 15 EU member states, as well as in some accession countries.

*Figure 13. Public social expenditure on pensions as a percentage of GDP, 1998*




*Source:* OECD.

From the figure, it is clear that the burden of pensions weighs heavily on France, Germany and Italy: the public pension system is the single largest item in the social budget of these countries and accounts for more than 10% of GDP. This provokes heated debates about possible reforms in these countries. As a matter of fact, Italy has already pushed through a number of reforms, for example switching from a defined benefit system to a defined contribution system. This means that the ultimate pension will no longer be calculated on the basis of the previously earned salary, but on the basis of contributions paid during a person's working life. This represents a clear reduction in the generosity of the pensions system.

Looking at the different welfare-state types, pensions are relatively high in the Mediterranean countries. Considering that these countries spend less on social security than social-democratic or corporatist countries, it is remarkable that these countries spend a higher proportion of GDP on pensions than the rest of the EU. Portugal is an exception, however. Public pension expenditure is also high in the corporatist countries. It is much lower in the social-democratic countries, including the Netherlands. Still, these countries generally offer reasonable pensions. On the low side of the spectrum, we find Ireland and the United Kingdom, representing the liberal welfare state. Here, the state pension and accordingly the public expenditure on pensions are considerably lower than in the other welfare-state types. Older people without an employment history are dependent on a means-tested subsistence benefit. Also the employment-related benefit system is very low in these countries.

Public expenditure on pensions as a percentage of GDP in the accession countries is at about the same level as in the social-democratic welfare state. Krieger & Sauer (2002) provide a detailed description of the pension systems in Poland, Hungary and the Czech Republic. They conclude that these are relatively no less generous than in the present EU member states.

Another useful way of classifying the European retirement schemes is into "Bismarckian" systems (France, Germany and Italy), where earnings-related pensions mainly are financed by earnings-related contributions, and "Beveridgean" systems (UK, Netherlands and Denmark), characterised by tax-financed, flat-rate benefits based on the individual need to avoid poverty in old age. Jensen et al. (2002) use this distinction and find that a Bismarckian system with actuarial adjustment is likely to offer the highest level of utility to all citizens.

An important question is how the balance for risk-sharing is going to change as ageing causes the weight of older generations to increase relative to younger generations. If the age structure of the population were stable, neither party would have an incentive to break the social contract. The root of the problem is, however, that the age structure of the population is changing during the coming decades. The baby boom, lower fertility, and longevity will raise the dependency ratios and put the social contract between generations under pressure. As there will be fewer young people to bear the shocks in the financing of pensions, their risk exposure tends to increase. This would make present arrangements for intergenerational risk-sharing more costly. There are also political risks. When the burden of ageing is shifted to the young generations, this might put the system of intergenerational risk-sharing at risk. These problems especially apply to PAYG systems.[12] Most economists are therefore in favour of reforming these systems. Börsch-Supan (2002) for instance proposes a new arrangement of Germany's pension system. A possibility is a switch from a PAYG system towards a funded system. Such a regime switch is, however, difficult to accomplish. This is because current generations tend to lose since they have to pay twice: for the currently old (via the PAYG system) and for themselves (via the funded system). Although several EU member states have already introduced reforms to their pension systems recently, it seems certain that the search for a sustainable mix of private and public arrangements in providing pension insurance will continue for the next decades. Bovenberg (2002) stresses that governments should invest in both physical and human capital to effectively deal with the ageing problem.

### 4.3 Progressive taxes

In addition to the social security benefits system, progressive taxes also play a role in the redistribution of income. They imply by definition that people with a high income will pay proportionately more tax than people on a low income. Using the MIMIC model developed by the Netherlands Bureau for Economic Policy Analysis (CPB), we can show how redistribution through progressive taxation influences productivity and labour participation rates. MIMIC is a general equilibrium model specifically developed to enable the influence of labour market institutions on the economy to be analysed (see Graafland et al., 2001). The model is calibrated for the Dutch economy, but the economic mechanisms modelled also feature in other European countries. While the quantitative results apply to the Dutch situation, therefore, the qualitative conclusions are also applicable to the other member states of the EU.

Table 3 shows the results of two simulations. In both variants the general tax credit is increased, with a total budgetary impact of €0.5 billion. This loss of revenue is compensated for in a budget-neutral way by an increase in the rates in the first two tax bands and by raising the highest rate.

The higher progression coefficient in Table 3 means the tax system becomes more progressive, and thus leads to greater redistribution between high and low employment incomes. The fiscal progression increases because both experiments imply more redistribution from rich to poor. This is because the higher general tax credit is the same for all taxpayers, whereas the tax increases weigh relatively more heavily on the higher incomes.

The fiscal progression has negative consequences for the labour supply. It reduces the incentives for people to work harder because free time becomes more attractive than consumption. The employment rate of women also falls in both variants because the average tax rate on employment increases; this makes it less attractive to swap economic inactivity for a small part-time job.

[12] Jousten and Legros (2002) show that the monetary union context is important for the analysis of the effects of ageing; specifically, countries with a fully funded scheme will bear part of the burden of the problems in countries with PAYG systems.

*Table 3. Economic effects (change in %) of more redistribution through the tax system in two budget-neutral variants[a]*

| | Higher tax credit<br>Higher rate 1st band | Higher tax credit<br>Higher top rate |
|---|---|---|
| Fiscal progression[b] | 0.6 | 3.6 |
| Labour supply | -0.4 | -0.7 |
| Participation of women | -0.3 | -0.1 |
| Employment | -0.7 | -0.8 |
| Labour productivity | 0.1 | -0.3 |

[a] In each variant the general tax credit is increased by around €200. The measure is compensated for in a budget-neutral way by applying a different method of tax increase in each case.

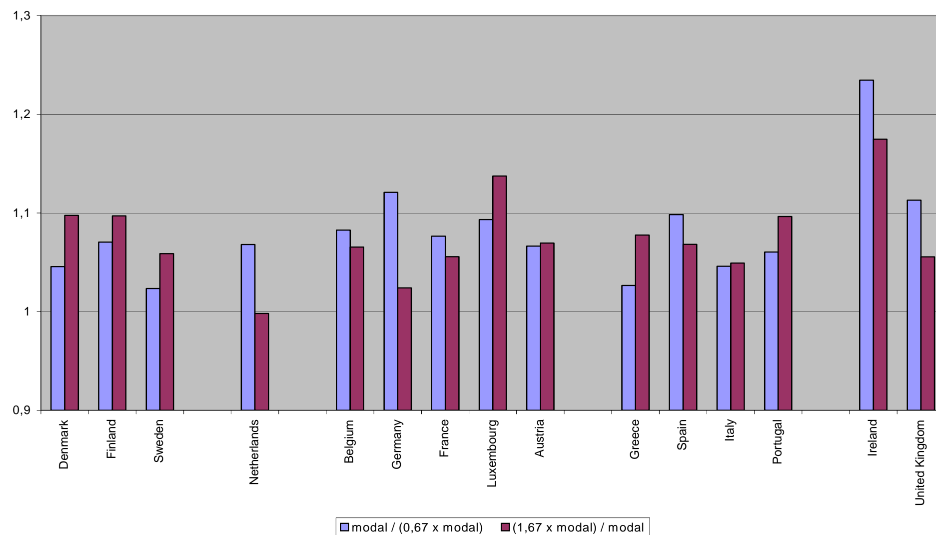
[b] This is defined in such a way that a higher coefficient indicates more fiscal progression. The precise definition is (1-Ta)/(1-Tm), where Ta represents the average tax rate and Tm the marginal rate. This indicator is thus the inverse of the coefficient for fiscal progression which is usually used in the economic literature.

*Source*: Graafland et al. (2001) and own calculations.

A more progressive tax system also has an unfavourable impact on investments in human capital, since it makes it less attractive for employees to undergo training because the rewards of that training in the form of a higher future salary are largely siphoned off by the government in taxes. This will ultimately lead to a decline in labour productivity. We see in Table 3 that this is particularly the case when the top rate of tax is increased. The increase in the first tax band has precisely the opposite effect, boosting labour productivity because in this variant it is mainly employment among the low-skilled which falls; as a consequence, the average productivity per employee increases.

The simulations in Table 3 suggest that fiscal progression is attractive from the perspective of equality, but can also have negative effects on employment and productivity. This implies a clear trade-off.[13]

*Figure 14. Fiscal progression in 1999*




*Note:* The figures show the relationship between the average tax and social insurance premium rates for different income levels.

*Source:* OECD.

[13] This trade-off becomes less clear-cut if market failures are not resolved in other ways. Van Ewijk et al. (2003), for example, show that failing labour, capital or insurance markets can make fiscal progression attractive from the point of view of efficiency.

Different European countries make different choices with regard to this taxation trade-off. Figure 14 illustrates this using two indicators of fiscal progression: (i) the relationship between the average tax and social insurance contribution rate for people with a modal income and people with an income of 0.67 x modal, and (ii) the same ratio, but this time between people with an income of 1.67 times modal and modal income. Since the average tax rate generally increases with income, these ratios are generally larger than 1 in Figure 14. The degree of fiscal progression in fact says nothing about the average tax and social insurance contribution rates. The liberal countries have a relatively low tax burden but the highest fiscal progression, particularly below modal income. The fiscal progression rate is also relatively high in the corporatist countries. The Mediterranean and social-democratic countries have somewhat less progressive tax systems, though the average tax rate is rather higher in the social-democratic countries than in the Mediterranean states.

### 4.4 Labour market regulation

Social policy not only involves expenditure, but also regulation, among other things, with regard to health and safety at work, working hours, dismissal protection and the minimum wage. These regulations protect workers against unsafe situations at work and against exploitation by employers, or are intended to avoid high transaction costs. Having clear rules means that individual workers do not need to familiarise themselves individually about the rights and obligations arising from an employment contract or about the working conditions in a company.

Labour market regulation can also affect the three Lisbon objectives. Strict dismissal protection, for example, makes it more difficult and more expensive for businesses to lay off staff.[14] This reduces the number of dismissals and can thus lead to a fall in unemployment. On the other hand, it also makes employers more cautious in taking on new staff, and this makes it more difficult for the unemployed to find work. Dismissal protection is therefore attractive for those who have a job, but unfavourable for job seekers. The strengthened negotiating position it gives people in work can lead to higher wage demands and rising unemployment. The ultimate effect on the labour market is therefore ambiguous on the basis of theoretical arguments.

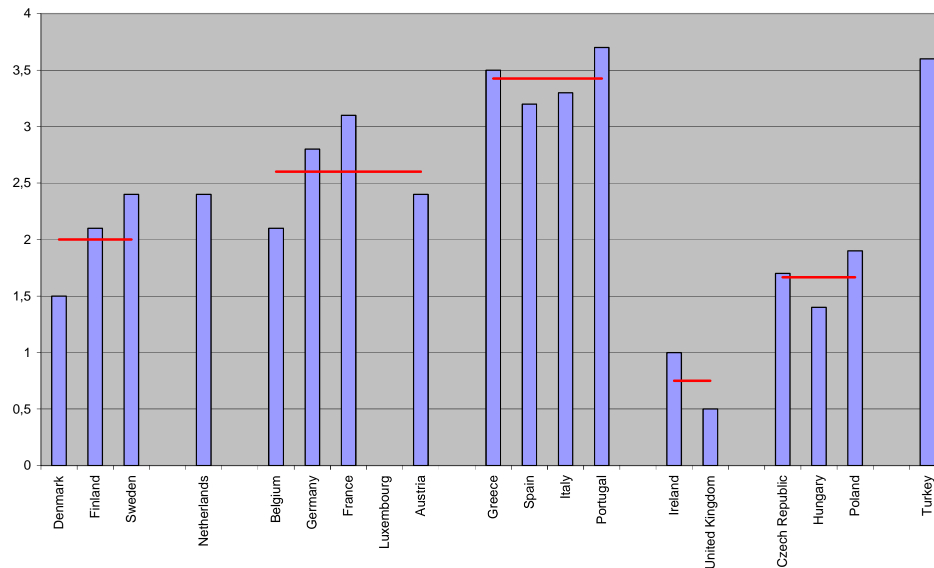
Empirical research into the effect of employment protection on the labour market also fails to reveal any uniform effects. Boeri & Jimeno-Serrano (2003) discuss 11 studies, only three of which report a significant negative impact on employment and two a significant positive impact on unemployment. Most of the studies reach non-significant or ambiguous conclusions. Employment protection does appear relevant for the dynamics of the labour market: according to virtually all available empirical studies it leads to fewer dismissals and lower recruitment. Although the level of unemployment does not appear to change significantly on balance, employment protection does lead to a significant increase in the length of unemployment, and thus widens the gap between those in work and the unemployed.

It is also not immediately obvious how employment protection affects productivity. On the one hand the reduced dynamism of the labour market resulting from employment protection can have a negative impact on productivity because people continue working for too long in companies that are doing badly. Dismissal protection can also exacerbate the depreciation of knowledge and skills on the part of job seekers, by lengthening the average duration of unemployment. On the other hand, employment protection encourages employers and employees to invest in company-specific knowledge and skills; employers and employees have to rely on each other more, so that it pays to invest in the long-term relationship. Moreover, the flexibility within companies can increase if the flexibility between employers reduces. When it comes to employment protection, therefore, there is a trade-off between flexibility and stability.

[14] According to Boeri (2002), employment protection is an alternative form of insurance against labour market risks. He shows that there is a trade-off between employment protection (particularly relevant in the Mediterranean countries) and social security (mainly relevant in the corporatist and social-democratic states).

Figure 15 gives an impression of the extent to which European workers are protected. Although employment protection is the main element here, the indicator presented is broader. The figures are taken from Nicoletti et al. (1999) and are also used by the OECD. We see that worker protection is relatively important in the Mediterranean countries; in the liberal countries, by contrast, there is very little employment protection. The other European countries are situated between these two extremes, with the social-democratic countries having less worker protection than the corporatist welfare states. Figures are also known for this indicator for a number of new entrants, as well as Turkey. The employment protection legislation in the new entrant states is not very strict and compares well with the protection offered in the social-democratic countries. Turkish workers, by contrast, enjoy a high level of protection, comparable with that in the Mediterranean welfare states.

*Figure 15. Employment protection legislation in various countries (1998)*



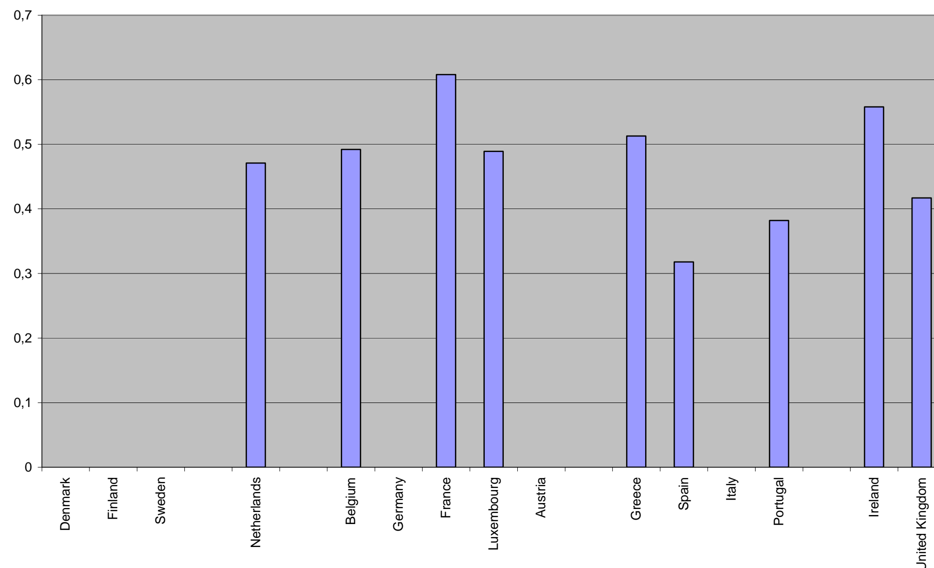

*Note:* The scale ranges from a minimum of 0 (least restrictive) to a maximum of 6 (most restrictive). No figures are known for Luxembourg.

*Source*: Nicoletti et al. (1999)

Another form of labour market regulation is the minimum wage, which contributes to reducing income differentials. Its influence is not limited to low wages: Teulings (1999) shows that minimum wages exercise a major influence on pay distribution up to median wage levels. It is therefore important for the income distribution of a large number of workers.

According to economic theory, a minimum wage leads to a reduction in employment. Employers find it too expensive to continue employing low-skilled workers at a wage that is higher than their productivity. This may explain why unemployment among the low-skilled is higher than among skilled workers. Despite this theoretical prediction, empirical literature from the United States suggests that the minimum wage has few effects on employment levels. Time series analyses show that an increase in the minimum wage of 10% leads on average to a fall in employment among teenagers of 1-3%, i.e. a fall in total employment of between 0.1% and 0.3% (Brown et al., 1982). Cross-sectional studies show even smaller effects (Card & Krueger, 1995).

*Figure 16. Ratio of statutory minimum and median wage in EU countries, 2000*




*Note:* The six EU member states without a minimum wage are also included in the graph.
*Source:* OECD.

Figure 16 shows that six countries in the EU do not have a minimum wage. In the other EU member states, the statutory minimum wage varies from 31.8% of the median wage in Spain to 60.8% of the median wage in France. In most EU member states the statutory minimum wage is higher than in the United States (roughly 35% of median wages). The fact that American empirical research finds that changing the minimum wage has virtually no effect on employment may be related to its low level there: even if the minimum wage were increased by several percentage points, it would still be low. It may therefore be that the minimum wage has a greater effect in the EU member states. Empirical estimates for the Netherlands by Van Opstal (1990) do indeed suggest greater employment effects in the 1980s. More recently, Van der Horst (2003) also finds that the minimum wage has a substantial effect on unemployment in France and Spain. In the Netherlands, the minimum wage was for a long time nominally frozen after the 1980s, so that in real terms it has fallen. In 1975, for example, the statutory minimum wage in the Netherlands was more than 60% of the median wage; in 2000 it had fallen to 47%. A comparable trend has occurred in Belgium, Spain and Greece. The question is whether the minimum wage still has a marked effect on employment in the Netherlands. According to Gelauff & Graafland (1994), this is not the case; they use the MIMIC model to simulate a reduction of 10% in the minimum wage in the Netherlands, though without reducing the benefits that are linked to the minimum wage. Their findings suggest an increase in total employment of only 0.1%, an effect that is comparable with the empirical findings for the US. The main reason for this is that the minimum wage lies below the lowest pay scales negotiated in most collective bargaining agreements, and therefore has no direct relevance for most employers.

## 4.5 Active labour market policy

An active labour market policy can take various forms. In the first place it involves the creation of jobs for certain groups of unemployed people in the public sector. In the Netherlands, for example, these are jobs created within the framework of the Jobseekers Employment Act (WIW) and the Entry-level and Step-up Jobs Scheme (*Regeling Instroom- en Doorstroombanen*). Active labour market policy also includes wage cost subsidies for specific forms of employment in the private sector. For example, the Netherlands pays subsidies under the Long-term Unemployed Reduction Act (*Wet Vermindering Langdurig Werklozen*).

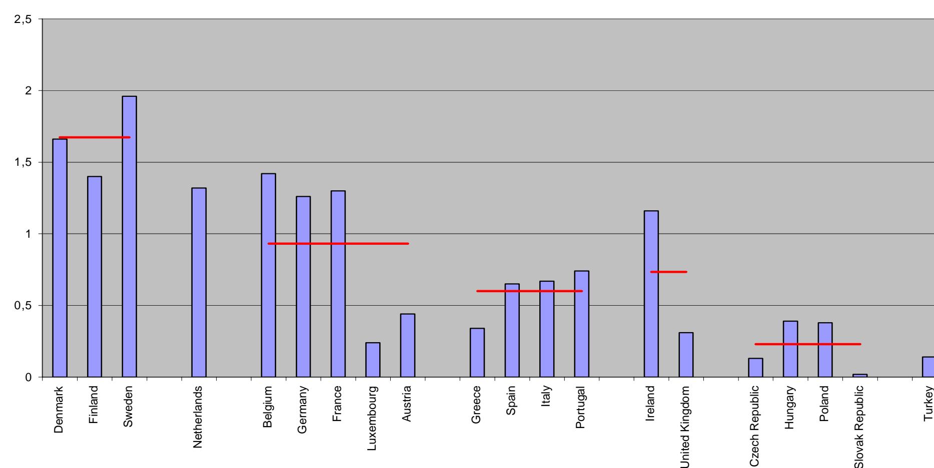
Active labour market policy can be seen as an instrument that is complementary to the welfare state arrangements. The threat of falling into the poverty trap makes it less attractive for low-skilled people to go to work. In order to ameliorate these negative consequences of the policy, the government can actively seek to help people get back to work. This is a way of avoiding unemployed people remaining outside the employment process for long periods and their human capital being written off. The policy is usually focused explicitly on disadvantaged groups, such as the long-term unemployed and low-skilled.

Active labour market policy is attractive from the perspective of social cohesion, since tax revenues are used to help disadvantaged groups to improve their position on the labour market. However, research shows that active labour market policy ultimately generates less sustained employment than is initially created. Extra employment in the public sector, for example, leads to a reduction in employment in the private sector because vacancies there become more difficult to fill. Dahlberg & Forslund (1999), for example, reach the conclusion for Sweden that the ultimate net employment effect of the active labour market policy is 35% of the number of jobs created. For the Netherlands, Jongen et al. (2003) find a net employment effect of between 31% and 48% of the number of jobs created in the public sector. Account is taken here of the costs of active labour market policy, i.e. the higher taxes needed to fund the policy (and which discourage participation in employment).

Active labour market policy is thus potentially an effective instrument for combining social cohesion with the promotion of labour participation. It does after all have a net positive effect on employment and mainly benefits disadvantaged groups. Whether it also increases productivity is by no means certain, however. On the one hand the human capital of disadvantaged groups is sustained by promoting (on-the-job) training; on the other hand, employment is encouraged that is less productive, thus depressing the average labour productivity of workers.

Figure 17 gives an impression of the expenditure on active labour market policy in various EU countries as a percentage of GDP. Although this says nothing directly about the effectiveness of active labour market policy, it does give an impression of its importance in the various member states. We see that active labour market policy is particularly relevant in the Scandinavian countries, the Netherlands and three corporatist countries. Spending is lowest on active labour market policy in the Mediterranean countries. The figure also includes data on a number of candidate member states. These countries also pursue an active labour market policy, but they spend only a small percentage of GDP on it – although in Hungary and Poland that percentage is higher than in the United Kingdom or Greece.

*Figure 17. Active labour market policy spending as % of GDP, 1998*




*Source:* OECD and own calculations.

### 4.6 The method of wage formation

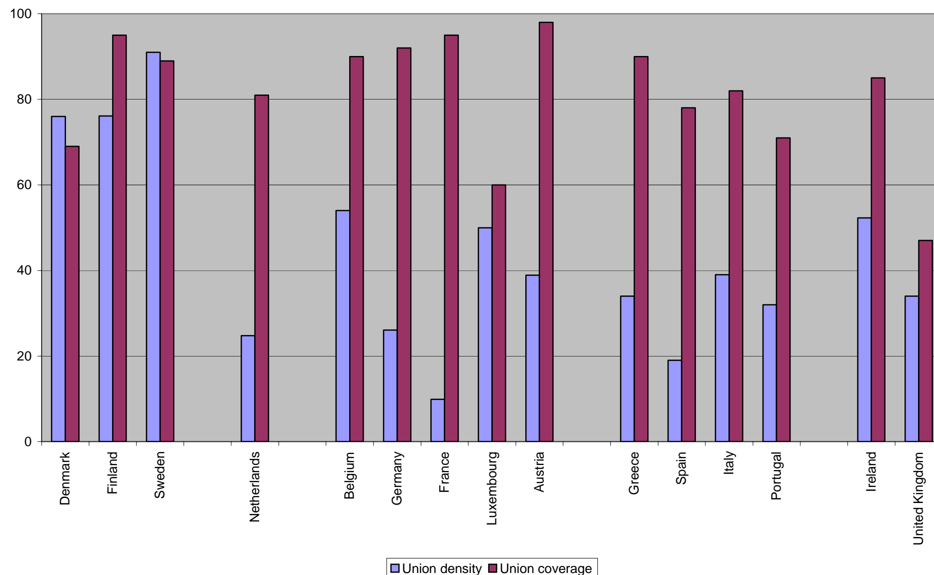
Wage formation in the Netherlands is determined by the interplay of employers' and employees' organisations. On the one hand this structure fosters the efficiency of the labour market, for example reducing the transaction costs in pay negotiations between employers and employees and potentially contributing to investments in company-specific knowledge. This in turn promotes productivity (Teulings and Hartog, 1998). It can also have a positive effect on social cohesion; for example, the empirical literature shows that more central wage bargaining results in a substantial reduction in wage inequality between different sectors and regions (Flanagan, 1999).

On the other hand, trade union power can have a negative impact on employment. For example, if trade unions have a strong bargaining position vis-à-vis employers, they can exploit this to push up wages and thus claim part of the company profits. This can lead to higher unemployment.

Smaller regional pay differentials as a result of more central wage bargaining also imply that unemployment can rise sharply in certain regions, since wages in the productive regions will not correspond with regional productivity levels. As a result of this phenomenon, we see that unemployment is very high in some Spanish and Italian regions as well as in Eastern Germany, for example.

Figure 18 shows two indicators which reflect the importance of different organisations in wage formation in European member states. The left-hand column shows the percentage of workers who are members of a trade union. The figures show that this percentage is particularly high in Scandinavia. The coverage of collective bargaining agreements shown in the right-hand column is high in virtually all member states, with the exception of the United Kingdom. In most countries, the number of people who are member of a trade union does not say much about the importance of collective bargaining agreements, because the coverage of those agreements often varies considerably, partly due to the high degree of organisation of workers and whether or not collective bargaining agreements have been declared generally binding.

*Figure 18. Union density and union coverage*




*Note:* Data for different years, 1994-98. The coverage in Greece has been set at 90% based on information from the European Industrial Relations Observatory (2003).

*Sources:* Borghijs et al. (2003) and Belot (2003).

### 4.7 Labour market institutions and the Lisbon objectives: Conclusions

This chapter has shown that the member states of the EU make different choices with regard to their labour market institutions and social policy. This mirrors the differences between the four clusters of welfare states described in chapter 2. To a large extent these choices reflect differences in social preferences. Daianu (2002) argues that there is substantial scope for institutional and policy variety as a means to foster economic development. Although institutions can have different effects in practice, a number of general statements can be made about the impact of different welfare state arrangements.

The discussion in this chapter reveals that there may well be a trade-off in individual labour market institutions between equality and economic efficiency. All labour market institutions discussed are capable of increasing social cohesion. In many cases, however, this may take place at the expense of employment. Thus social security reduces inequality in society, but high and long-lasting benefits have a negative impact on employment. Increasing the progressiveness of the tax system and raising the minimum wage also imply a similar trade-off, although the empirical effects on employment of increasing the minimum wage are small. Only active labour market policy appears to avoid this trade-off: it has a positive impact on both employment and equality. Against this is the fact that it has to be paid for in some way. Here again, therefore, we see that there is no such thing as a free lunch.

Several authors have carried out direct empirical research on the extent to which labour market institutions affect the functioning of the labour market. The findings of Nickell & Layard (1999) and De Groot et al. (2003) confirm the effects on employment as revealed in our analysis. However, most studies look only at the influence of labour market institutions on unemployment. Table 4 summarises the main findings of five of these studies. An upward arrow in the table means that the variable concerned leads to rising unemployment; a downward arrow implies the reverse, and an ‘equals’ sign means that the variable in question has no significant effect. Where a cell is left empty, no variable was included in the analysis.

Table 4 shows that a generous social security system and a high tax on labour lead to more unemployment. The effect of employment protection is not the same in all studies. This reflects the ambiguous results from the empirical literature on worker protection. As regards active labour market policy, two studies find a significant negative impact on unemployment rates. All studies find that stronger trade unions (more members) result in high unemployment, but that coordination in wage bargaining implies lower unemployment. One explanation for this is that in coordination processes, employer and employee organisations take more account of the external effects of their wage demands (Calmfors & Driffill, 1988).

*Table 4. Labour market institutions and unemployment*

| | Nickell et al. (1999) | IMF (2003) | De Groot et al. (2003) | Nickell et al. (2002) | Belot (2003) |
|---|---|---|---|---|---|
| Social security | | | | | |
| - Replacement rate | ↑ | = | ↑ | ↑ | ↑ |
| - Duration of benefits | ↑ | | | ↑ | |
| Progressive taxation | | | | | |
| - Average wedge | ↑ | ↑ | = | ↑ | ↑ |
| Labour market regulation | | | | | |
| - Employment protection | | ↑ | ↑ | = | ↓ |
| - Minimum wage | | | | | |
| Active labour market policy | ↓ | | ↓ | | |
| Wage formation | | | | | |
| - Union density | ↑ | ↑ | = | ↑ | ↑ |
| - Coverage | ↑ | | ↑ | | |
| - Coordination | ↓ | ↓ | ↓ | ↓ | ↓ |

It can be concluded that specific labour market institutions have a contrary effect on the various Lisbon objectives. Nevertheless, the analysis in chapter 3 shows that some countries do succeed in reconciling these objectives. Apparently the right mix of social and economic policy can enable countries to combine an equal income distribution with high employment and high productivity. The question is whether such a mix will be sustainable in the future in the light of a number of trends.

# 5 Trends and the Lisbon agenda

The possible trade-offs between the Lisbon objectives or combinations of them are not static givens. All manner of international, technological and social developments can influence both equality and efficiency and the ability to combine them. They may therefore necessitate reforms of (social) policy. We examine a number of these trends below. Some of them have been under way for some time and will continue in the coming decades. Other trends which could manifest themselves are new and could reinforce other trends.[15]

## 5.1 Internationalisation and ICT

Globalisation and European integration are leading to growing international trade. The fruits of this manifest themselves in a more efficient allocation of production and better exploitation of advantages of scale. All countries can ultimately benefit from this, as both income and production increase. The process of internationalisation will continue in the coming years; the rate at which this happens will depend on the willingness of countries to cooperate and to dismantle the barriers to further integration. With internationally mobile skilled labour, globalisation and accordingly declining migration costs can eventually raise the welfare of the mobile workers at the expense of the unskilled labour force (see Haupt & Janeba, 2002). Internationalisation will also lead countries to specialise more and more in the activities where they can derive a comparative advantage. For the wealthy EU countries these are generally knowledge-intensive economic activities; developing countries and the newly acceding EU member states will concentrate mainly on labour-intensive products. If the rich EU countries do indeed become more knowledge-intensive, the demand for highly trained employees will increase relative to low-skilled workers. This process could be greatly reinforced by technological developments, such as ICT (information communications technology), which demand adequate knowledge and skills in order to use them.

Internationalisation and ICT can thus have a major influence on income distribution as the growing demand for skilled workers makes them more scarce, and thus more expensive, so widening the pay gap compared with low-skilled workers. Whether this actually happens will depend on the development of the supply of skilled workers. In the last decade, for example, the skill level of the workforce in the Netherlands has steadily increased. This has enabled the growing demand for skilled labour to be accommodated by a growing supply and has limited the growth in wage inequality between skilled and low-skilled workers (Stegeman & Waaijers, 2001). In the coming decades, however, this trend is expected to level off. If globalisation and technological development continue, therefore, the growing demand for skilled workers could widen the gap in pay between skilled and low-skilled workers in the decades ahead (see also Nahuis & De Groot, 2003).

Although internationalisation and ICT can be good for productivity, they reduce the equality in income distribution. Countries can seek to avoid or compensate for this through the use of labour market institutions. Wage inequality could for example be avoided by providing more training to low-skilled workers.[16] Jacobs (2004), however, shows that this instrument is not very effective as a means of combating rising wage inequality. Avoiding inequality via labour market institutions could moreover lead to higher unemployment among low-skilled workers as they price themselves out of the market. Compensating for higher wage inequality would require that countries redistribute more

[15] The trends are taken from De Mooij & Tang (2003).

[16] Dur & Teuling (2002) claim that education subsidies in combination with progressive taxation can help to redistribute income.

income, for example via a more progressive tax system. However, this has adverse consequences for the activity rate, the number of hours worked and training efforts. In short, technological development and internationalisation offer the prospect of increasing productivity, but reduce the scope for the EU to even out income inequality.

### 5.2 Economic integration and policy competition

If different government authorities compete with each other for the same investors or the same talent, we speak of policy competition. This is good from the perspective of efficiency of policy, since inefficient policy is punished by the departure of businesses. Policy competition thus makes government authorities more efficient and more reliable, and less susceptible to lobbies by specific interest groups. However, policy competition can be unattractive from the point of view of equality. Welfare state arrangements aimed at income redistribution come under pressure because they redistribute from mobile to immobile factors (Sinn, 2003). The political economy of generational distribution of public expenditures furthermore suggests that pressure to cut public budgets has an asymmetric generational effect.[17] Policy competition thus reinforces the trade-off between equality and efficiency.

Economic integration intensifies policy competition. For example, Economic and Monetary Union has resulted in greater capital mobility within Europe. This makes investments more sensitive to differences in policy. Governments can take advantage of this by continually stepping up the policy competition. This will put more and more pressure on social policy and redistribution of income within EU member states.[18]

Capital mobility and policy competition are relevant for Lisbon. For example, Gianetti et al. (2002) suggest that the integration of capital markets via the EU action plan for financial markets could generate an extra growth of around 1% per annum over the next decade. Heightened policy competition will also produce more efficient government policy, which again could benefit employment growth. On the other hand, policy competition will limit the scope for income redistribution, by making reducing income inequality more ‘expensive’ in terms of productivity and participation.

### 5.3 EU enlargement and immigration

The EU will be enlarged in 2004 by the addition of ten new member states,[19] swelling the population of the EU by a total of 75 million inhabitants. The average income in the new entrants is less than 40% of the average in the EU-15. These wide income differentials could spark off a migration flow as soon as free movement of persons in the other EU member states applies for the new members. For many Poles, Hungarians and Czechs, entry to the EU offers the opportunity to go to work legally in the richer EU countries. It is difficult to estimate how great the flow of immigrants will be. A number of studies have attempted to do this on the basis of historical migration patterns, although the figures they produce are hedged in by great uncertainties. On average, these studies suggest that around 3 million migrants will enter the EU-15 over the next 15 years.[20] The majority will settle in Germany and Austria; the number of immigrants expected to enter the Netherlands is approximately 30,000.

---

[17] See Gal (2002) for an empirical test of these predictions with Hungarian data.

[18] The literature on the new economic geography suggests that economic integration could also lead to less policy competition as agglomeration effects become more important because of integration, so that businesses will be less likely to leave a core area even if they are relatively heavily taxed. See De Mooij et al. (2003).

[19] Other countries in the queue are Bulgaria and Romania, with which negotiations on entry are already under way; and Turkey, with which negotiations have not yet commenced. The total population of these three countries is 96 million.

[20] Krieger & Sauer (2002) summarise three detailed studies of potential migration from the accession countries to Germany.

These calculations take no account of any restrictions which Germany and Austria may apply – for up to seven years – when accepting immigrants from the accession countries. This could boost the number of immigrants coming to the Netherlands. In addition, the number of immigrants from other regions could also increase; for example, Turkey could join the EU. Estimates suggest that this would lead to an influx of a further 3 million immigrants to the EU, of whom more than 100,000 would move to the Netherlands (De Mooij & Nahuis, 2003).

What will immigration in the EU mean for the Lisbon objectives? The effect on participation rates in the Western European member states will depend on the profile of the immigrants. Recent experiences in the Netherlands with non-western immigrants offer little promise, given the relatively poor labour market position of this group (Roodenburg et al., 2003). It remains to be seen, however, what the profile will be of the new immigrants from Eastern Europe. If they are young, highly trained workers who are able to find work easily, this could lead to an increase in the activity rate.

The consequences of immigration for the equality of the income distribution are not particularly rosy. In the first place, immigrants often end up in low-paid jobs and thus exert downward pressure on the wages of low-skilled workers. Immigration then exacerbates the trend referred to earlier towards greater wage inequality. In addition, immigration can put pressure on the welfare state. Leibfritz et al. (2002) conclude from a review of the recent public choice literature that immigration can lead to changes in existing welfare systems, although the size and even the sign of any resulting changes may be difficult to predict. A study by Roodenburg et al. (2003) shows that the existing non-western immigrants in the Netherlands place heavy demands on social provisions, and on balance cost the government more than they contribute. Whether this will also apply to the immigrants from the accession countries is difficult to assess in advance.

### 5.4 Ageing of the population and Baumol's Law

The ageing of the population is inevitable in the EU. It will lead to a drastic fall in participation rates. In 2040, for example, there will be 4.3 pensioners for every ten people working in the Netherlands; at present the figure is 2.2. As a result, spending on state pensions will double over the coming decades, from 4.7% to 9% of GDP. The situation in other countries is even more worrying because pensions are funded to a greater extent by pay-as-you go systems.

The ageing population will also increase the costs of health care. This will be exacerbated by the fact that productivity in the health care sector grows more slowly than elsewhere in the economy, while wage costs continue to grow at the same rate.[21] Since the rising price of care will not lead to a major downturn in its take-up, the substitution opportunities are limited, and spending on health care will accordingly account for an increasing share of the economy. This trend is known as Baumol's Law.

Together, the ageing of the population and Baumol's Law imply a sharp rise in public spending in the next few decades (CPB, 2000), which will have to be funded by tax revenues collected from a steadily shrinking labour force. This suggests that we are heading for an intergenerational conflict, in which the shrinking working generation has to meet the costs of public provisions for a steadily growing older generation. The question is how this potential conflict can be averted. This is of crucial importance for the Lisbon agenda. Increasing the tax burden on the working generation will lead to an increase in tax avoidance and discourage formal economic activities. This will jeopardise both the participation and the productivity objectives. Moreover, it will become more difficult to sustain public spending for the younger generations if spending on older people increases. The scope for social provisions will then be undermined by the growing costs of pensions and health care. This in turn will jeopardise the social cohesion objective.

In short, the ageing of the population and Baumol's Law make it more difficult to reconcile efficiency and equality.

---

[21] ICT may offer opportunities for increasing productivity in the services sector.

### 5.5 Individualism and flexibility

European welfare states are faced with the challenge of individualisation. The last few decades have seen greater variety in forms of cohabitation, women have become more independent in the labour market and people are choosing to spend their lives in increasingly different ways. This is changing the need for security (social insurance and social provisions). The growing labour market participation of women, for example, is making families less vulnerable to labour market risks because partners are better able to accommodate loss of income by a family member. Against this, new needs are arising, for example in the area of childcare and care leave.

The labour market is also becoming more flexible. A growing proportion of employment consists of part-time jobs or jobs with flexible contracts. This flexibility has in fact created a substantial increase in the labour supply. People change jobs more frequently and are better able to choose the number of working hours that suits them best. As a result, however, the labour supply can also become more sensitive, among other things to taxation. This increases the costs of redistribution.

Individualism and flexibility are the driving forces behind the growing labour participation of women in particular in recent years. They thus bring the participation objective of Lisbon within reach and help reduce social exclusion and poverty. The consequences for the scope for redistributing income to those left outside the employment process are however less favourable, especially if the costs of social policy increase.

### 5.6 Challenge for social policy

Table 5 summarises the consequences of the five trends referred to above for the achievement of growth in productivity and participation and reducing income inequality. A plus sign in the table means that the trend brings the achievement of that objective closer; a minus sign means this is made more difficult. If a cell is empty, the effect is unclear or absent. It is clear from Table 5 that it will be more difficult in the future to guarantee an equal income distribution within European member states. The consequences for productivity and participation are not always clear.

*Table 5. Influence of trends on the Lisbon objectives*

| | Productivity | Participation | Equality |
|---|---|---|---|
| Internationalisation / ICT | + | | - |
| Policy competition / Capital mobility | + | | - |
| EU enlargement / Immigration | | | - |
| Ageing / Baumol's Law | | - | - |
| Individualisation / Flexibilisation | | + | |

The trends will therefore demand a response in the form of policy innovation. In order to reduce income inequality, the most efficient means of redistribution will have to be sought. Although this is desirable anyway, the trends described will make it more urgent in the coming decades; the challenge of Lisbon of marrying social cohesion with greater productivity and higher participation demands this. Analysis of precisely what form such policy innovation would need to take falls outside the scope of this study. However, the next chapter does look at what role Europe could play in the quest for the required policy innovation.

## 6 Social Europe

### 6.1 The subsidiarity principle

Since the signing of the Treaty of Maastricht in 1992, the EU member states have applied the subsidiarity principle in arranging the division of competencies between individual member states and the EU. This principle means that the EU should only be given central powers if there are solid grounds for assuming that this will produce better results for the member states than a decentralised

policy. Since countries differ from each other in their history, culture, preferences and circumstances, competencies are in principle situated at the lowest possible level. Moreover, a decentralised policy has a number of other advantages. Decentralised governments are closer to their citizens and therefore better able to gather information about people's preferences, enabling policy to respond more effectively to local preferences and circumstances. They might also find it easier to agree upon institutional changes and, therefore, perform better in terms of economic development (Burda, 2002). In addition, the public choice literature argues that central policy leads to more government failures than decentralised policy (Brennan & Buchanan, 1980). Decentralised policy thus implies better democratic control, because politicians can be held accountable for their actions more quickly. Where policy is centralised, defective democratic control is more likely to lead to an overly large government as politicians, under the influence of pressure groups, seek to promote interests that do not correspond with those of the median voter. Politicians will then be more inclined to listen to small interest groups asking for transfers or subsidies. The costs of this policy are spread out over the largely unorganised group of silent taxpayers. If democracy fails to punish this behaviour by politicians adequately, policy competition can supplement the disciplinary function, temper the natural tendency of governments to expand, and make the government more reliable and efficient. At the international level, finally, decentralisation makes the method of open coordination possible, in which countries experiment with policy and learn from each other's experiences. This can make policy both more efficient and more effective.

However, subsidiarity is not the same thing as decentralisation. There may be solid arguments for centralised European coordination, for example in relation to scale effects or external effects. Scale effects occur when policy is more effective and more efficient if implemented jointly. External effects arise when policy in a particular member state has consequences for other member states and countries take no account of these cross-border 'spillovers'. As an example, the labour costs associated with social policy, such as social insurance premiums or costs relating to labour market regulation, account for an estimated 40% of total wage costs in EU member states (Chen & Funke, 2003). These indirect wage costs can influence the decisions of businesses in deciding where to settle. Governments can respond to this by pursuing a less generous social policy which reduces the indirect wage costs; they will then attract investments which can boost the prosperity of the population as a whole. If all countries operate in this way, however, they may become bogged down in a competitive battle which ultimately leads to social dumping. To free each other from the grip of policy competition, therefore, countries can agree to harmonise their policy.

The arguments in favour of centralisation must ultimately be weighed against the disadvantages. In making this judgment, not only should centralisation or harmonisation of policy be analysed as an alternative to national policy autonomy, but also less far-reaching alternatives such as minimum standards or other basic rules within which the process of policy competition can take place.

## 6.2 Subsidiarity and social security expenditure

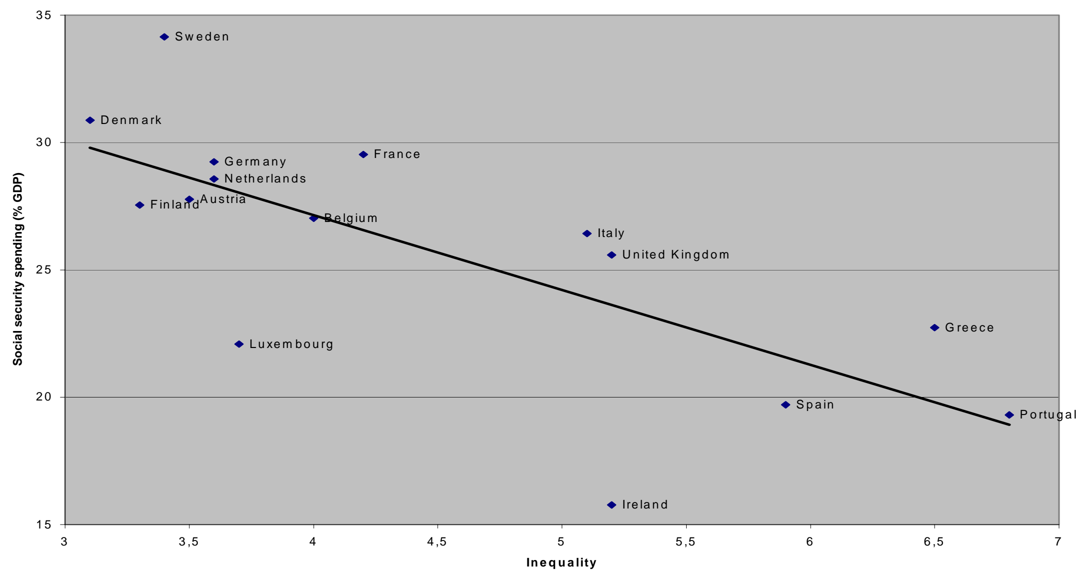
How does the subsidiarity test turn out if we apply it to social security? To answer this, we need to weigh any scale effects and external effects against the importance of heterogeneity in social policy.

**Scale effects**

Scale effects occur when the social security system is more effective and efficient when operated at European scale than at national scale, for example because of lower implementation costs or better insurance. With regard to this latter aspect, countries could insure themselves at European level against asymmetrical macroeconomic shocks by means of a European unemployment fund, for example. A country that was hit by a negative macroeconomic event would then receive money from this fund, to which countries where unemployment does not increase would contribute. In this way the fund would stabilise shocks occurring in specific EU countries. Insuring against asymmetrical shocks also raises potential problems with its implementation, however, and creates moral hazard, i.e. the risk that governments could become less alert to the need to prevent unemployment because the unemployment benefits are paid by someone else (Beetsma & Oudshoorn, 1999). It is therefore not clear whether the benefits of such an insurance scheme outweigh the disadvantages.

Another scale effect could arise in the implementation of social security. We investigated whether there are any empirical indications for this by examining whether large member states achieve more efficient redistribution than small member states. Figure 19 shows the relationship between social security spending and income inequality in the countries of the European Union in 1999. The downward sloping line shows that countries with high social security expenditure have a more equal income distribution. It is important to note that the four largest countries in the EU are all above this regression line; compared to the average in the European Union, therefore, they spend a relatively large amount on social security in order to achieve the same degree of equality. This offers no empirical support for the idea of scale effects in the implementation of social security. Boeri (2002) explains the better performance in redistribution of the smallest EU countries by their advantage in exploiting local information.

*Figure 19. Social security spending and inequality (1998)*

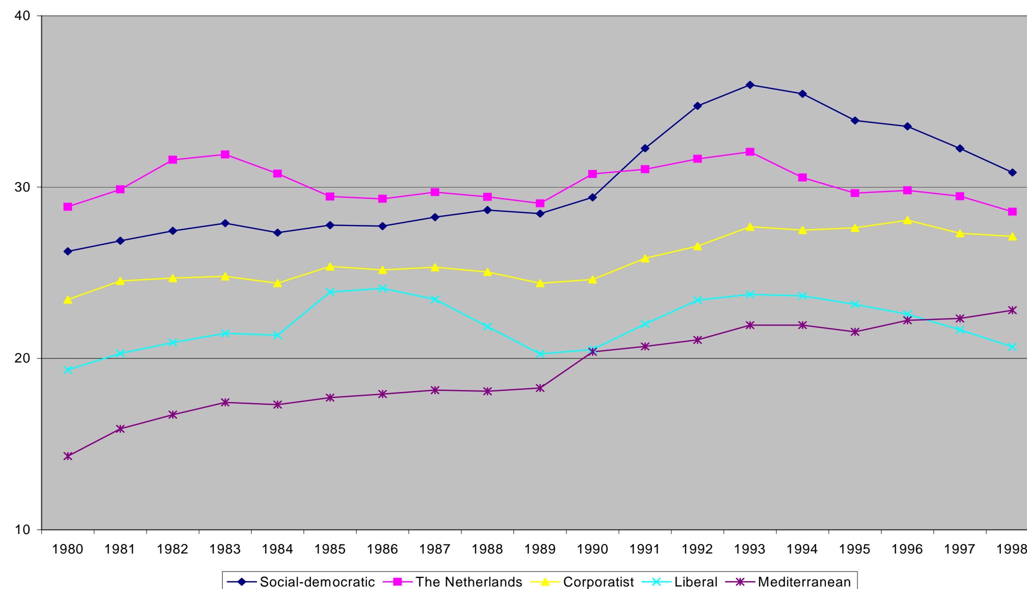



## External effects

Might policy competition in social security lead to social dumping as a result of cross-border external effects? Figure 20 shows the trend in social security spending as a percentage of GDP between 1980 and 1998. The EU member states have been classified according to the categories described in chapter 2. On average, social security spending in the EU rose from 21.5% of GDP in 1980 to 25.8% in 1998. This percentage has been falling since the second half of the 1990s, especially in the social-democratic and liberal countries, though to a large extent this is related to the decline in unemployment over this period.[22] All in all, there are no indications of social dumping in the EU. This observation finds broad support in several studies (Bean et al., 1998). For the time being, therefore, cross-border external effects offer no convincing argument for the harmonisation of social policy.

[22] The correlation coefficient between social security spending and unemployment is 0.7.

*Figure 20. Trends in social security spending as a percentage of GDP, 1980-98*




*Source*: OECD.

**Heterogeneity**

As we saw in chapter 2, there are considerable differences between countries in terms of their welfare states. On the other hand, countries can converge over time. For example, policy competition can give governments the feeling that they cannot afford to deviate too markedly from other countries; this can prompt a process of spontaneous convergence. Figure 20 gives an indication of the degree of convergence in social security spending. Particularly striking is the strong increase in social security spending in the Mediterranean welfare states. While social security spending as a percentage of GDP rose by an average of 20% in the EU over the period 1990-98, it grew by 50% in the Mediterranean countries. This gives a first indication that spending on social policy in the EU has converged.

In order to investigate convergence in a more scientific way, the empirical literature mainly uses the concepts of β-convergence and σ-convergence. The first concept refers to the relationship between the initial level and the growth in the subsequent years. There is evidence of β-convergence if social security spending in the period 1981-98 increased relatively sharply in countries with a low social security spending quotient in 1981, and vice versa. This can be measured by regressing the growth rate to the initial level of the spending quotient. The term β-convergence refers to the coefficient β in this regression. Our estimate shows that there is significant β-convergence in social security quotients. The estimated coefficient suggests a convergence of 4% per annum, i.e. the deviation between a particular country and the EU average reduces by 4% each year.[23] In other words, an arbitrary European country will have made up half the difference between its social security spending and the EU average after approximately 17 years.

It is possible that, although social security spending has grown faster in the Mediterranean countries than in the social-democratic countries, the spread of the distribution has not decreased. For example, the figure shows that social security spending in the liberal countries has fallen so sharply in recent years that the spending quotient has dropped below that of the Mediterranean countries. There is no

[23] Boeri (2002), who performs a similar analysis, finds a barely statistically significant convergence of only 0.2 % per year. It is not clear what drives the difference with our findings.

assurance that the spread in the distribution has also decreased. This is precisely the essence of σ-convergence (σ is often used as a symbol for the standard deviation). If social security spending in different countries displays less variation over time, we can speak of σ-convergence. This proves to be the case: the spread between countries in terms of social security spending has reduced considerably. The variation coefficient (the standard deviation divided by the average) fell from 27% in 1981 to 19% in 1998. Although there are still substantial differences in the level of social security spending, the heterogeneity has reduced over time. This lowers the costs of harmonisation. However, the forthcoming enlargement of the EU will increase the heterogeneity of social security spending once again.

**Judgment**

Scale effects and cross-border external effects appear to be irrelevant at present for social security spending. They therefore offer hardly any justification for harmonisation of social policy. This conclusion is also reached by Boeri (2002) who claims that “there is a strong case for maintaining prerogatives over social policies to national Governments” (p. 11). External effects could become more important if increasing labour mobility in the EU leads to intensified policy competition between national governments. A large influx of immigrants, for example from the accession countries, could also put pressure on social provisions, particularly if generous provisions were to act as a magnet to new immigrants.[24]

Harmonisation of social policy becomes even less attractive following the enlargement of the EU; enlargement will increase the heterogeneity of the EU, thus increasing the need for diversity.

Ultimately, subsidiarity demands a political judgment. The costs of collaboration are for example also determined by the perceived disadvantage of giving up one’s own sovereignty.

Table 6 shows the views on common European policy for a number of policy domains and social problems.[25] For the sake of clarity, the domains have been ranked by the extent to which a preference for European policy exists in the European Union on average, the changing numbers of ‘don’t know’ responses have been left out of consideration and scores above the national average have been printed in bold.

[24] In order to prevent social dumping after EU enlargement, Sinn & Ochel (2003) suggest that newcomers should only be eligible for social provisions after a long period of delay. Employment immigrants would then be entitled to social insurance schemes immediately in the country where they work – unemployment and disability benefits, for example – but would have to wait several years before gaining entitlement to provisions funded via the tax system, such as national assistance, child or housing benefits. This could prevent the immigration wave following the entry of the accession countries from putting too much pressure on the European welfare states.

[25] Note that respondents are asked to express a preference for policy ‘within the European Union’, and that need not necessarily be ‘Brussels’. The formulation of the question, at least in the Dutch and English versions, does not rule out the possibility of collaboration between several EU member states, separate from the institutions of the EU itself.

*Table 6. Preferences for common European policy, autumn 2002( % of the population aged 15 and older)[a]*

| | DK | FI | SE | NL | BE | DE | FR | LU | AT | GR | ES | IT | PT | IE | UK | mean |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Foreign policy on countries outside the EU | **62** | **65** | **59** | **79** | **87** | **80** | **81** | **83** | **68** | **71** | **83** | **88** | **74** | **78** | **63** | **75** |
| Aid to regions with economic problems | **69** | **56** | **59** | **69** | **72** | **67** | 56 | **80** | **61** | **77** | **77** | 62 | **66** | **81** | **62** | **68** |
| Tackling poverty and social exclusion | **57** | **52** | **52** | **59** | **62** | **66** | **68** | **66** | **59** | **77** | **74** | **76** | **66** | **70** | **58** | **64** |
| Environmental protection | **51** | **38** | **50** | **72** | **63** | **66** | **67** | **63** | **54** | **72** | **71** | **67** | **61** | **58** | **53** | **60** |
| Tackling the problem of ageing population | 25 | 27 | 23 | 32 | 56 | 51 | **65** | **56** | **59** | **75** | **72** | **72** | **60** | **64** | **43** | **52** |
| Immigration policy | 39 | 16 | 29 | **57** | **59** | 41 | **63** | 45 | 36 | **68** | **69** | **76** | 57 | 46 | 28 | 49 |
| Tackling unemployment | 37 | 29 | **38** | 39 | 51 | 46 | **57** | 39 | **51** | **68** | 57 | **66** | **60** | 55 | 35 | 49 |
| Defence | **43** | 7 | 19 | **62** | **60** | **53** | 51 | **65** | **48** | 41 | 57 | 62 | 52 | 36 | 35 | 46 |
| Justice | 17 | 22 | 18 | 37 | 35 | 30 | 38 | 37 | 25 | 44 | 46 | 51 | 43 | 46 | 25 | 34 |
| Health and social security | 16 | 9 | 9 | 33 | 34 | 28 | 26 | 31 | 25 | 60 | 45 | 46 | 49 | 39 | 31 | 32 |
| Education | 25 | 18 | 22 | 24 | 28 | 31 | 31 | 31 | 31 | 53 | 44 | 50 | 41 | 38 | 20 | 32 |
| Police | 26 | 20 | 17 | 25 | 30 | 29 | 35 | 34 | 24 | 40 | 42 | 43 | 43 | 36 | 17 | 31 |
| Average preference for European policy | 42 | 33 | 35 | 51 | 56 | 52 | 56 | 54 | 46 | 64 | 64 | 65 | 58 | 55 | 41 | 51 |

[a] 'Can you say for each of the following areas whether you think that decisions should be taken by the [national] government or within the European Union?' The percentages shown are for 'within the EU'; together with the responses '[national] government' and 'don't know', they add up to 100%. EU preferences above the national average are printed in bold. The (selected) areas are presented in order of decreasing popularity of EU preference in the Netherlands.

*Source:* Eurobarometer 58.1 (October-November 2002); weighted results.

As in earlier surveys (see e.g. SCP, 2000, p. 150), a majority of people everywhere, and often a large majority, are in favour of European decision-making for international and large-scale problems. However, when it comes to traditional areas of the welfare state such as health care and social security and education, there is rarely if ever a majority in favour of European policy.

It appears that European citizens have little enthusiasm for a European social security system, which means that these costs are evidently high. This reinforces the above conclusion that harmonisation of social policy is not called for as of yet. Whether this will change depends on the extent to which European citizens display solidarity. This solidarity currently manifests itself in the form of the EU Cohesion Policy (see the box on 'Redistribution via the Cohesion Policy').

**Redistribution via the Cohesion Policy**[a]

Solidarity between European member states is expressed in the European Cohesion Policy. The aim of this policy is to reduce the wealth differentials within Europe by subsidising projects that promote economic growth in disadvantaged regions. A number of simulation studies suggests that the Cohesion Policy can make an important contribution to this aim. In practice, however, the Cohesion Policy is all but ineffectual. Econometric estimates show that the actual effect of Structural Funds on economic growth in poorer regions has been zero. The reason for this meagre effectiveness must be sought in the design of the policy. For example, the distribution of the cohesion budget is decided every six years during the budget negotiations, following which regions may submit projects to absorb the budget already allocated. This procedure carries a number of inherent risks. In the first place, rich countries are able to corner a substantial part of the aid during the budget negotiations; as a result, more than half of all cohesion aid ultimately goes to countries with a per capita income that is above the EU average. This reduces the effect of the policy on convergence. Secondly, central governments tend to reduce their support for poor regions as soon as money is released from Brussels. The requirement of cofinancing by the recipient countries is evidently unable to prevent the fact that national support for these regions partially dries up. This again reduces the growth effect of cohesion aid in disadvantaged regions. Thirdly, regional governments have no incentive to select the most viable projects; often they are simply concerned with absorbing subsidies that have already been allocated. The most viable projects are either already being undertaken, or are avoided precisely because this can lead to the ending of cohesion aid in the next period. Finally, the involvement of Brussels leads to a great deal of bureaucracy, with concomitant high implementation costs, and reduces the flexibility of regions in selecting projects. The poorest regions in particular therefore have difficulty in actually absorbing the aid allocated to them.

The problem with the Cohesion Policy is that it tries to serve two masters. On the one hand it is used in the budget negotiations as an instrument to adjust the net position of member states. On the other hand, the Cohesion Policy seeks to contribute to reducing the wealth differentials within Europe. The lesson of Tinbergen that it is impossible to achieve two objectives with a single instrument appears to have been forgotten. It would be more consistent to make a choice either to use the Cohesion Policy as a redistribution instrument between national governments, or as an instrument to reduce wealth differentials permanently. If the EU decides to use the Cohesion Policy as an instrument to ensure that the budget negotiations proceed smoothly, the involvement of the European Commission is in reality no longer necessary. The endless pumping round of money could then cease; the Cohesion Policy would need to do no more than facilitate net income transfers between national governments. If on the other hand the EU wishes to realise its objective of convergence, the Cohesion Policy would have to be redesigned and aid distributed on the basis of objective criteria, not of political negotiations on the budget.[b] Moreover, the process of selecting projects for aid would have to be designed in such a way that governments were encouraged to select projects with a high potential return. This could be achieved, for example, by allocating subsidies on the basis of competition between different projects, with effectiveness being a key assessment criterion alongside the degree of wealth in a particular region.

[a] For a detailed analysis of the European Cohesion Policy, see Ederveen et al. (2002).

[b] See also Sapir et al. (2003).

## 6.3 Subsidiarity and labour market regulation

The same subsidiarity test as that used for social security spending can also be applied to labour market regulation. The EU has already agreed a number of (minimum) standards here, relating among

other things to working hours, holidays, health and safety at work, and various other worker rights (see chapter 1). These harmonised rules have been developed in response to fears of social dumping. However, it is unclear how relevant the threat of social dumping would have been if the rules within the European Union had not been harmonised. There are no clear indications of such external effects in this area. But how important are scale effects and heterogeneity?

**Scale effects**

The creation of an internal European market could be interpreted as a scale effect. This not only applies for goods, services and capital, but also for labour, because the creation of an internal European labour market through the removal of institutional barriers to labour mobility can increase prosperity in Europe. It implies that people are able to respond better to wage differentials and can more easily go to work in the country where they are able to achieve the highest return on their knowledge and skills. This fosters competition in the labour market, improves the efficiency of the allocation of labour in Europe and increases productivity. In addition, migration can reduce regional inequality in unemployment and boost the flexibility of the labour market by enabling the labour volume in a particular region to adapt more quickly to changing circumstances.

At present, however, labour mobility within Europe is low, for example in comparison with the United States. This is caused on the one hand by language and cultural differences between countries, which hamper European labour migration. On the other hand, there are institutional obstacles to labour mobility. These barriers are both financial – pensions, for example – and information-related. For example, an employee with Dutch nationality who goes to work in another EU member state falls under the regulations of the host country. The complexity and diversity of those regulations tend to prevent people from looking for work outside their own national borders.[26]

How could Europe achieve the goal of an internal European labour market by promoting labour mobility? An analogy can be made here with the goods market. The institutional barriers to labour mobility can then be compared with the technical trade barriers in product markets, such as differences in product standards. The internal market has removed these trade barriers through harmonisation and mutual recognition. Harmonisation of labour market regulations and social policy appears to be a step too far in the light of the heterogeneity of the EU. However, in parallel with the internal market for goods and services, it would be possible to introduce a system of mutual recognition in the labour market. Padoa Schioppa (2002) has developed this idea further, suggesting that social provisions should no longer be based on the host country principle, but on the home country principle. Migrants could then go to work anywhere in the Union under the conditions and with the social provisions that apply in their home country. This could help promote labour mobility. On the other hand, the home country principle would lead to unequal treatment of indigenous and foreign workers, making this a very controversial proposal.

**Heterogeneity**

Harmonisation of regulations ignores the fact that countries differ from each other. EU enlargement will increase those differences. The harmonised social regulations will be expensive for the majority of new member states and will not match their level of economic development: the preferences for social standards are simply different for rich and poor countries. Differences in regulations need not in fact be harmful; they can help the economic development of new member states because they will be able to attract more capital and strengthen their competitiveness with lower social standards. Western European consumers will ultimately also benefit from this through increased trade and specialisation. Convergence could then subsequently lead to adaptation of social policy to the EU norms. If on the other hand high social standards are imposed on the new member states immediately, this could make it more difficult for them to achieve the growth necessary to catch up with the West. The enlargement of the EU thus exposes the disadvantage of harmonisation of social policy. Differences between countries create a need for a cautious approach in transferring powers to the EU.

---

[26] See SER (2001) for a detailed analysis of the obstacles to cross-border labour mobility in the EU.

### 6.4 International coordination by trade unions

Trade unions in Europe are under pressure. Membership has been falling since the 1980s, while pay negotiations are increasingly held at local and regional level. On top of this, the environment in which trade unions operate is becoming more international, which weakens their relative bargaining position vis-à-vis employers. In response to this situation, trade unions in the EU member states have suggested that they should cooperate more.

Wage coordination can have major consequences for the European labour market, although the form that coordination takes is crucial. Borghijs et al. (2003) show that internationally coordinated wage demands can strengthen the bargaining position of trade unions vis-à-vis employers. This could lead to higher wage demands, thus depressing profits and boosting unemployment. Yet this need not happen; joint wage demands can also mean that trade unions take more account of the consequences of those demands for inflation in Europe and the policy of the European Central Bank. This can give rise to more sustainable wage increases and lead to a fall in unemployment. The net effect of wage coordination on unemployment is thus not fixed in advance.

There are however other potential dangers of wage coordination. For example, it can have consequences for the flexibility of wages: if wage demands are formulated in international consultation, individual countries lose their autonomy to fix wages as they see fit. The question then is whether sufficient regional flexibility remains to enable country-specific shocks to be accommodated. Another danger is that international wage coordination can lead to smaller differentials in wage levels between countries. Empirical literature shows that centralisation of wage bargaining within countries leads to a substantial reduction in regional wage differentials. In Spain, Italy and the former East Germany, this has led to high unemployment in some regions. If European wage coordination also reduces the wage differentials between European countries, this will have serious consequences for countries with lower productivity levels.

### 6.5 Lisbon and Social Europe

Do the member states need a Social Europe in order to realise their ambitions as expressed in Lisbon? Economic integration in Europe, achieved inter alia through the further completion of the internal market and the creation of Economic and Monetary Union, has made a significant contribution to the increased wealth of the member states. However, growing competition and restructuring of economies means there are not just winners. Some businesses or sectors will be unable to withstand the force of competition, while other economic activities will relocate. This could give rise to resistance against the integration process. A social component in Europe can increase public support in the EU for economic integration. This is important for Lisbon. The alternative of stagnating economic integration is considerably less attractive.

The question, however, is to what extent this social component of Europe requires centralised European competencies. After all, social security systems within the individual member states will be able to accommodate a large part of the consequences of economic restructuring. Moreover, the European Cohesion Policy already reflects the solidarity between rich and poorer member states. Ceding more powers to 'Europe' has important disadvantages, particularly as the heterogeneity in the EU increases as a result of enlargement. It is therefore to be hoped that the Open Method of Coordination will prove to be an effective means of giving Europe a social face and will offer a framework within which policy competition can be given tangible form. Particularly in the light of the pressure on social cohesion which appears unavoidable in the coming decades, it is all the more important to combine the national approach to social problems with a successful European coordination approach.

## References


Aghion, P., E. Caroli and C. García-Peñalosa (1999), 'Inequality and economic growth: The perspective of the new growth theories', *Journal of Economic Literature*, 37, pp. 1615-1660.

Alesina, A. and D. Rodrik (1994), 'Distributive politics and economic growth', *Quarterly Journal of Economics* 109 (2), pp. 465-490.

Ark, B. van and R.H. McGuckin (2003), *Performance 2000: Productivity, Employment, and Income in the World's Economies*, The Conference Board, Report R-1328-03-RR.

Arts, W. and A. Gelissen (1999), 'Verzorgingsstaten in soorten – op zoek naar ideaal- en reële typen', *Mens en maatschappij* 74 (2), pp.143-165.

Atkinson, A.B. (2003), *Income inequality in OECD countries: data and explanations*, CESifo Working Paper no. 881.

Bean, C., S. Bentolila, G. Bertola and J. Dolado (1998), *Social Europe: One for all?, Monitoring European Integration*, CEPR, London.

Beetsma, R. and C. Oudshoorn (1999), *Tools for regional stabilisation*, AEP Research Memorandum 9903, Dutch Ministry of Economic Affairs, The Hague.

Belot, M.J.V.K. (2003), 'Labor market institutions in OECD countries: Origins and consequences, Thesis', Tilburg University.

Boeri, T. (2002), 'Social Policy: One for all?', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November 2002.

Boeri, T. and J.F. Jimeno-Serrano (2003), *The effects of employment protection: Learning from variable enforcement*, CEPR Discussion Paper no. 3926, CEPR, London.

Borghijs, A., S. Ederveen and R.A. de Mooij (2003), *European wage coordination: Nightmare or dream to come true*?, CPB Discussion Paper No. 17, CPB, The Hague.

Börsch-Supan, A. (2002), 'Sustainable social security systems design, implementation, political economy', presented at the CPB-ENEPRI conference on Policy competition and the welfare state, The Hague, 30 November 2002.

Bovenberg, L. (2002), 'Financing Retirement in the European Union', presented at the CPB-ENEPRI conference 'Policy competition and the welfare state', The Hague, 30 November.

Brennan, G. and J. Buchanan (1980), *The power to tax: Analytical foundations of a fiscal constitution*, Cambridge: Cambridge University Press.

Brown, C., C. Gilroy and A. Kohen (1982), 'The effect of the minimum wage on employment and unemployment', *Journal of Economic Literature* 20, pp. 487-528.

Calmfors, L. and J. Driffill (1988), 'Bargaining structure, corporatism and macroeconomic performance', *Economic Policy*, 6, pp.13-61.

Card, D. and A.B. Krueger (1995), 'Time series minimum-wage studies: A meta analysis', *American Economic Review* 85, pp. 238-243.

Chen, Y-F. and M. Funke (2003), *Labour demand in Germany: An assessment of non-wage labour costs*, CESifo Working Paper No. 952, Munich.

CPB, 2000, *Ageing in the Netherlands*, The Hague: Sdu Uitgevers.

Dahlberg, M. and A. Forslund (1999), *Direkta undantrangingereffecter av arbetsmarknadpolitiska atgarder*, IFAU Working Paper No. 99.6.

Daianu, D. (2002), 'Institutional and policy variety: Does it matter for economic development?' paper presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Delsen, L.(2002), 'Positive versus negative policy competition', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Dur, R. and C. Teulings (2002), 'Education, Income Distribution and Public Policy', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

EC (2003), Commission Staff Working Paper: *Progress on the Lisbon Strategy*.

Ederveen, S., J. Gorter, R.A. de Mooij and R. Nahuis (2002), *Funds and Games*, The Hague: CPB.

Esping-Andersen, G. (1990), *The Three Worlds of Welfare Capitalism*, Cambridge: Polity Press.

Esping-Andersen, G. (1996), 'Welfare States in transition: National Adaptations in Global Economics', London: Sage.

Esping-Andersen, G. (1999), *Social Foundations Of Post-Industrial Economics*, Oxford University Press, Oxford.

Eurostat (2002), *Eurostat Yearbook 2002*, Eurostat, Luxembourg.

Ewijk, C. van, B. Jacobs, R.A. de Mooij and P.J.G. Tang (2003), 'Tien argumenten voor een progressieve inkomstenbelasting', *Tijdschrift voor Openbare Financiën* No. 1, pp. 30-35.

Ferrera, M. (1996), 'The "Southern" model of Welfare in Social Europe', *Journal of European Social Policy* 6 (1), pp. 17-37.

Flanagan, R.J. (1999), 'Macroeconomic performance and collective bargaining: An international perspective', *Journal of Economic Literature*, 37(3), 1150-1175.

Fouarge, D. (2002), *Minimum protection and poverty in Europe: An economic analysis of the subsidiarity principle within EU social policy*, Thela Thesis, Amsterdam.

Gal, R. (2002), 'A generational impact of competition of governments', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Gelauff G.M.M. and J.J. Graafland (1994), *Modelling welfare state reform, Contributions to Economic Analysis*, Amsterdam: North Holland.

Goebel, J. and B. Otto (2002), 'The impact of social transfers on poverty in the member states of the EU: Findings from the fifth wave of the ECHP', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Graafland, J.J., R.A. de Mooij, A.G.H. Nibbelink and A. Nieuwenhuis (2001), *MIMICing tax policies and the labour market*, Amsterdam: Elsevier.

Grauwe, P. de and M. Polan (2003), *Globalisation and social spending*, CESifo Working Paper No. 885, Munich.

Groot, H.L.F. de, R. Nahuis and P.J.G. Tang (2003), *Is the American Model Miss World? Improving European economic performance: Should we copy the Anglo-Saxon blueprint or is there a 'Rhenish' alternative?*, CPB document, in preparation.

Haupt, A. and E. Janeba (2002), 'Education, Redistribution and Brain Drain in Developing Countries', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Horst, A. van der (2003), *Structural estimates of equilibrium unemployment in six OECD economies*, CPB Discussion Paper No. 19, CPB, The Hague.

IMF (2003), *IMF World Economic Outlook*, IMF, Washington, D.C.

Jacobs, B. (2004), 'The Lost Race between Schooling and Technology', *De Economist*, in preparation.

Jensen, S.E.H., M.I. Lau and P. Poutvaara (2002), 'Retiring Europe: An assessment of alternative social security rules', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Jongen, E.L.W., E. van Gameren and J.J. Graafland (2003), 'Exploring the macroeconomic impact of subsidized employment', *De Economist* 151 (1), pp. 81-118.

Jousten, A. and F. Legros (2002), 'Pensions and savings in a monetary union: An analysis of capital flows', presented at the CPB-ENEPRI conference on Policy Competition and the welfare State, The Hague 30 November.

Krieger, T. and C. Sauer (2002), 'Will Eastern European migrants happily enter the German pension system?', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague 30 November.

Kuipers, B.J. (2001), *Arbeidsaanbod op middellange termijn*, CPB Document 1, CPB, The Hague.

Leibfritz, P. O'Brien and Dumont (2002), 'Immigration and its economic effects', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Lindbeck, A. (2001), 'Improving the performance of the European social model', presented at the conference on Building a More Dynamic Europe, Barcelona.

Mooij, R.A. de and J.C.J.M. van den Bergh (2002), 'Growth and the environment in Europe: A guide to the debate', *Empirica* 29, pp. 79-91.

Mooij, R.A. de and R. Nahuis (2003), 'Kansen en bedreigingen van de EU-uitbreiding', *Tijdschrift voor Politieke Economie* 24(3), pp. 3-29.

Mooij, R.A. de, J. Gorter and R. Nahuis (2003), Vestigingsplaatsconcurrentie, to be published in the Preliminary reports for the Royal National Economy Society of the Netherlands (Pre-adviesen voor de Koninklijke Vereniging voor de Staathuishoudkunde).

Mooij, R.A. de, and P.J.G. Tang (2003), *Four Futures of Europe*, CPB Special Study, CPB, The Hague.

Nahuis, R. and H. van der Wiel (forthcoming), *The 'new economy: Where do we stand and where do we go?: The ICT policy agenda, Lisbon or back to Cardiff?,* CPB Discussion Paper, in preparation.

Nahuis, R. and H.L.F. de Groot, *Rising Skill Premia: You ain't seen nothing yet?*, CPB Discussion Paper No. 20, CPB, The Hague.

Nickell, S.J. and R. Layard (1999), 'Labor market institutions and economic performance', in Ashenfelter, O. and D. Card (eds), *Handbook of Labour Economics*, vol. 3c, Amsterdam: Elsevier.

Nickell, S.J., L. Nuziata, W. Ochel and G. Quintini (2002), *The Beveridge curve, unemployment and wages in the OECD from the 1960s to the 1990s*, CEP Discussion Paper 502, School of Economics, London.

Nicoletti, G., S. Scarpetta and O. Boylaud (1999), *Summary indicators of product market regulation with an extension to employment protection legislation*, Economics Department Working Paper 226, OECD, Paris.

OCFEB (2003*), Economische integratie in Europa*, a summarising literature study commissioned by the Dutch Ministry of Social Affairs and Employment, Rotterdam.

OECD (1998), *Retirement income systems: The reform process across OECD countries*, OECD, Paris.

OECD (2000), *OECD Economic Outlook* 2000, OECD, Paris.

OECD (2002), *Benefits and Wages OECD Indicators*, OECD, Paris.

Okun, A. (1975), *Equality and efficiency, the big trade-off*, The Bookings Institution, Washington, D.C.

Opstal, R. van (1990), *Minimum loon en werkgelegenheid: een empirisch analyse op micro-data uit 1979 en 1985*, CPB Research Memorandum No. 69, The Hague

Padoa Schioppa, F.K. (2002), 'Mutual recognition, unemployment and the welfare state', presented at the CPB-ENEPRI conference on Policy Competition and the Welfare State, The Hague, 30 November.

Persson, T. and G. Tabellini (1994), 'Is inequality harmful for growth?', *American Economic Review* 84, pp. 600-621.

Roodenburg. H., R. Euwals and H. ter Rele (2003), *Immigration and the Dutch Economy*, CPB Special Publication, The Hague.

Sapir, A., P. Aghion, G. Bertola, M. Hellwig, J. Pisani-Ferry, D. Rosati, J. Viñals and H. Wallace (2003), *An agenda for a growing Europe – Making the EU economic system deliver*, report of an independent high-level study group established on the initiative of the President of the European Commission.

SCP (2000), *Nederland in Europa; sociaal en cultureel rapport 2000*, Social and Cultural Planning Office of the Netherlands, The Hague.

SER (2001), *Arbeidsmobiliteit in de EU*, SER-advies 01/04, The Hague.

Sinn, H-W and W. Ochel (2003), *Social union, convergence and migration*, CESifo Working Paper No. 961.

Sinn, H-W (2003), *The new systems competition*, Oxford: Blackwell Publishing.

Stegeman H. and R. Waaijers (2001), 'Wage inequality in the Netherlands', *CPB Report* 2001/1, pp. 50-54, CPB,The Hague.

Teulings, C.N. (1999), *Bridging the gap between Joe Sixpack and Bill Gates*, Erasmus University, Rotterdam.

Teulings, C.N. and J. Hartog (1998), *Corporatism or competition? Labour contracts, institutions and wage structures in international comparison*, Cambridge: Cambridge University Press.

Wildeboer Schut, J.M., J.C. Vrooman and P.T. de Beer (2000), *De maat van de verzorgingsstaat,* Social and Cultural Planning Office of the Netherlands, The Hague.

WRR (2003), *Slagvaardigheid in de Europabrede Unie*, The Hague: Sdu Uitgevers.

## TITLES PUBLISHED BY ENEPRI

**WORKING PAPER SERIES (€12 in print or available for free downloading from www.enepri.org or www.ceps.be)**

No. 24 *Time-Varying Nairu and Real Interest Rates in the Euro Area,* Camille Logeay and Silke Tober, October 2003

No. 23 *Back on Track? Savings Puzzles in EU Accession Countries,* Mechthild Schrooten and Sabine Stephan, October 2003

No. 22 *Structural Estimates of Equilibrium Unemployment in Six OECD Economies*, Albert van der Horst, July 2003

No. 21 *Fiscal Policy in the New Open Economy Macroeconomics and Prospects for Fiscal Policy, Coordination*, Leonor Coutinho, June 2003

No. 20 *European Wage Coordination: Nightmare or dream to come true?,* Alain Borghijs, Sjef Ederveen and Ruud de Mooij, June 2003

No. 19 *Youth Employment in the OECD: Demographic Shifts, Labour Market Institutions and Macroeconomic Shocks*, Juan F. Jimeno and Diego Rodríguez-Palenzuela, March 2003

No. 18 *Convergence in Social Protection across EU Countries, 1970-1999*, Simón Sosvilla-Rivero, José A. Herce and Juan-José de Lucio, March 2003

No. 17 *The Impact of the Euro on EMU Trade: The (Early) Effect Is Not so Large*, Sergio de Nardis and Claudio Vicarelli, February 2003

No.16 *Mutual Recognition in Goods and Services: An Economic Perspective,* Jacques Pelkmans, March 2003

No. 15 *Estimating the Effects of Fiscal Policy in OECD Countries*, Roberto Perotti, October 2002

No. 14 *How to Finance Eastern Enlargement of the EU: The Need to Reform EU Policies and the Consequences for the Net Contributor Balance,* Christian Weise, October 2002

No. 13 *Mutual Recognition, Unemployment and the Welfare State,* Fiorella Kostoris Padoa Schioppa, September 2002

No. 12 *Internal Migration in Regions of Germany: A Panel Data Analysis*, Ashok Parikh and Michiel Van Leuvensteijn, September 2002

No. 11 *Interdependent Growth in the EU: The Role of Trade*, María Garcia-Vega and José A. Herce, September 2002

No. 10 *Equilibrium Rates and Wages Flexibility in Europe,* R.C.M.H. Douven, August 2002

No. 9 *Midlife Caregiving and Employment: An Analysis of Adjustments in Work Hours and Informal Care for Female Employees in Europe,* C. Katharina Spiess and Ulrike Schneider, February 2002

No. 8 *Turkey's Performance in Attracting Foreign Direct Investment: Implications of Enlargement*/Henry Loewendahl and Ebru Ertugal-Loewendahl/October 2001

No. 7 *Is the ECB sufficiently accountable and transparent?* Lorenzo Bini-Smaghi and Daniel Gros/September 2001

No. 6 *Maastricht and the Choice of Exchange Rate Regime in Transition Countries during the Run-Up to EMU*, György Szapáry, September 2001

No. 5 *What drove relative wages in France? Structural Decomposition Analysis in a General Equilibrium Framework, 1970-1992,* Sébastien Jean and Olivier Bontout, September 2001

No. 4 *Foreign Direct Investment and Corporate Income Taxation in Europe,* Agnès Bénassy-Quéré, Lionel Fontagné, and Amina Lahrèche-Révil, April 2001

No. 3 *European Labour Markets and the Euro: How much flexibility do we really need*?, Michael Burda, March 2001

No. 2 *Asymmetric Labour Markets in a Converging Europe: Do differences matter?* Ray Barrell and Karen Dury (NIESR), January 2001

No. 1 *Fiscal Federalism in Western European and Selected Other Countries: Centralisation or decentralisation? What is better for economic growth?,* Ulrich Thiessen, January 2001

**OCCASIONAL PAPER SERIES (€12 in print or available for free downloading from www.enepri.org or www.ceps.be)**

No. 4 *Population Ageing and International Capital Flows*, Eric Canton, Casper van Ewijk and Paul J.G. Tang, October 2003

No. 3 *Funds and Games: The Economics of Eruopean Cohesion Policy*, Sjef Ederveen, Joeri Gorter, Ruud de Mooij and Richard Nahuis, October 2003

No. 2 *Welfare Intergenerational Distribution and Households: What does generational accounting tell us?,* 3 papers by Reijo Vanne; Nicola Santor, Carlo Assarri, Maria Cozzolina, Carlo Declich, Veronica Polin and Alberto Roveda; and Bernard Seidel, October 2003

No. 1 *Asymmetries in European Labour Markets and Monetary Policy in Euroland*, , Daniel Gros and Carsten Hefeker, September 2003

# ABOUT ENEPRI

The European Network of Economic Policy Research Institutes (ENEPRI) is composed of leading socio-economic research institutes in practically all EU member states and candidate countries that are committed to working together to develop and consolidate a European agenda of research. ENEPRI was launched in 2000 by the Brussels-based Centre for European Policy Studies (CEPS), which provides overall coordination for the initiative.

While the European construction has made gigantic steps forward in the recent past, the European dimension of research seems to have been overlooked. The provision of economic analysis at the European level, however, is a fundamental prerequisite to the successful understanding of the achievements and challenges that lie ahead. ENEPRI aims to fill this gap by pooling the research efforts of its different member institutes in their respective areas of specialisation and to encourage an explicit European-wide approach.

ENEPRI is composed of the following member institutes:

| | |
|---|---|
| CASE | Center for Social and Economic Research, Warsaw, Poland |
| CEBR | Centre for Economic and Business Research, Copenhagen, Denmark |
| CEPII | Centre d'Etudes Prospectives et d'Informations Internationales, Paris, France |
| CEPS | Centre for European Policy Studies, Brussels, Belgium |
| CERGE-EI | Centre for Economic Research and Graduate Education, Charles University, Prague, Czech Republic |
| CPB | Netherlands Bureau for Economic Policy Analysis, The Hague, The Netherlands |
| DIW | Deutsches Institut für Wirtschaftsforschung, Berlin, Germany |
| ESRI | Economic and Social Research Institute, Dublin, Ireland |
| ETLA | Research Institute of the Finnish Economy, Helsinki, Finland |
| FEDEA | Fundacion de Estudios de Economia Aplicada, Madrid, Spain |
| FPB | Belgian Federal Planning Bureau, Brussels, Belgium |
| IE-BAS | Institute of Economics, Bulgarian Acadamy of Sciences, Sofia, Bulgaria |
| IE-LAS | Institute of Economics, Latvian Academy of Sciences, Riga, Latvia |
| IER | Institute for Economic Research, Ljubljana, Slovenia |
| IHS | Institute for Advanced Studies, Vienna, Austria |
| ISAE | Istituto di Studi e Analisi Economica, Rome, Italy |
| ISCTE | Instituto Superior de Ciências do Trabalho e da Empresa, Lisbon, Portugal |
| ISWE-SAS | Institute for Slovak and World Economy, Bratislava, Slovakia |
| NEI | New Economy Institute, Vilnius, Lithuania |
| NIER | National Institute of Economic Research, Stockholm, Sweden |
| NIESR | National Institute for Economic and Social Research, London, UK |
| NOBE | Niezalezny Osrodek Bana Ekonomicznych, Lodz, Poland |
| PRAXIS | Center for Policy Studies, Tallinn, Estonia |
| RCEP | Romanian Centre for Economic Policies, Bucharest, Romania |
| TÁRKI | Social Research Centre, Budapest, Hungary |

This ENEPRI Occasional Paper series aims at making the research undertaken by the member institutes or in the context of special ENEPRI events known to a wide public. Unless otherwise indicated, the views expressed are attributable only to the author in a personal capacity and not to any institution with which he or she is associated.

ENEPRI publications are partially funded by the European Commission under its Fifth Framework Programme – contract no. HPSE-CT-1999-00004.

**European Network of Economic Policy Research Institutes**
c/o Centre for European Policy Studies
Place du Congrès 1 ▪ 1000 Brussels ▪ Tel: 32(0) 229.39.11 ▪ Fax: 32(0) 219.41.51
Website: http//:www.enepri.org ▪ E-mail: info@enepri.org