European Foundation for the Improvement of Living and Working Conditions

FOUNDATION FORUM 2006

Competitive Europe – Social Europe Partners or rivals?

Foundation Forum 2006
Background paper

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Wyattville Road, Loughlinstown, Dublin 18, Ireland. - Tel: (+353 1) 204 31 00 - Fax: 282 42 09 / 282 64 56
email: postmaster@eurofound.europa.eu - website: www.eurofound.europa.eu

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Introduction

Since the Commission's spring 2005 Communication to the European Council, the competitiveness of the European economy has re-emerged as perhaps the key policy priority. One of the messages of the Communication was that the Lisbon goals *may* not be met. This realisation, together with the perception of poor EU productivity performance and concerns about the viability of European enterprises in the face of intensified competition from India and China, have prompted a revitalisation of efforts to enhance European competitiveness. Similarly, in June 2006, Prime Minister Vanhanen announced that competitiveness was to be one of the four priorities of the current Finnish Presidency.

It is competition that drives the efficiency of the market economy. The market rewards the winners at the expense of the losers and competitive performance forms the basis of material welfare. Enterprises are at the heart of this process, since growth and employment depend essentially on their ability to compete in the global markets, remain profitable, prosper and create jobs. The growth and competitiveness of enterprises depends on their ability to adjust quickly to change, to restructure and to exploit their potential for innovation. While the real players on the ground are enterprises, policy makers make rules which impact on the outcomes for the players within their jurisdiction. Policy makers can also provide the framework for innovation and productivity improvement. With a significant legislative mandate in single market and competition policy, the potential role of the European Union in enhancing the competitive environment for enterprises in Europe is considerable. Similarly, the EU plays a vital role in providing access to foreign markets through its trade policy. This is a matter of fundamental importance for European enterprises.

However, the European Union also has other goals. The famous phrase from the Lisbon European Council sums up the objectives of the strategy as making Europe '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'. The social aspect is reiterated in the spring Communication which cites the draft European Constitution's vision of a 'highly competitive social market economy'. The obvious question, to be posed at the Foundation Forum, is the extent to which the social and competitive goals and policies support or contradict each other.

Is a highly developed social model a luxury that only affluent nations can afford? – and only then when times are good – or is it a necessary element in a well functioning and competitive market economy? While historically it is clear that the development of the welfare state coincided with the growth of the market economy and political democracy, the identification of causal relationships is much more complex and there are several interpretations. Was the welfare state created in order to deal with the new risks arising from dependency on wage labour? Was the re-distribution resulting from social policies only politically possible against a backdrop of rapid economic growth, and what role did political democracy and the labour movement play? Did publicly funded health and education services come into being as a result of rising incomes; or was this an economic necessity as production became more complex; and was this also primarily a result of political democracy?

The third Foundation Forum puts forward the question: *Competitive Europe – Social Europe: partners or rivals?* The question is not here of course viewed from an historical perspective but rather in terms of how the various European social models are currently compatible with competitiveness. More specifically, the issue is how recent trends in globalisation, new technologies and the ongoing economic integration of Europe influence the relationships between social models and competitiveness. While the Forum will not be able to answer the basic question in a conclusive way, it may shed some light on what is today a very pertinent issue. The following more specific questions may be useful in focusing ideas and structuring debate:

1) Is an extensive social model compatible with competitiveness? Can they co-exist?

2) Does an extensive social model *promote or hinder* competitiveness? Are there causal relationships?

3) Is it better to be competitive with or without a social model?

4) What *specific aspects* of social policy are conducive to or compatible with competitiveness?

5) Is social policy that is conducive to or compatible with competitiveness *transferable* to other countries?

This background paper outlines the main issues around the central topic of competitiveness and the social model. The arguments presented reflect some topics in the current debate. In addition some basic facts and figures are presented. The real discussion will begin in November in Dublin Castle.

Defining and measuring competitiveness

Enterprises are at the heart of all concepts of competitiveness and they are acutely aware of their competitive position. Competitiveness is a multi-dimensional concept and, depending on the specific circumstances, can be made more concrete in terms of market share, profitability, productivity and capacity to restructure, adapt and be innovative. The fundamental role of the state in this context is to provide access to markets and to secure property rights. From the single market perspective in particular, there is much left undone. Not surprisingly, these are politically sensitive matters. The issues raised in the Services Directive and recent controversies surrounding 'economic patriotism' highlight conflicts with social goals and the sovereignty of the Member States.

There are, however, competitiveness issues that are not obviously in conflict with social goals. European employers argue strongly for an easing of the administrative burdens in the setting up and running of businesses and the harmonisation of European patent and company laws would undoubtedly enhance the European competitive environment. The removal of red tape is a particularly pressing issue for small and medium-sized enterprises, whose lack of access to venture capital poses additional problems.

The most commonly cited measure of national competitiveness is the Growth Competitiveness Index (GCI) compiled by the World Economic Forum (WEF). The 2005 ranking is presented in Table 1. The index is constructed by a weighting of a '… collection of factors, policies, and institutions which determine the level of productivity of a country, and that therefore, determine the level of prosperity that can be attained by an economy'. The GCI is conceptually close to productivity – GDP per hour worked. It also has a productivity and growth *potential* dimension. Aware of the difficulties in using hard data to measure productivity, the World Economic Forum uses a mixture of hard data and findings from their Executive Opinion Survey. The calculation is based on three pillars: 1) macroeconomic environment, 2) state of the public institutions in the countries and 3) level of technological readiness.

While the macroeconomic climate does not directly impact on competitiveness, some degree of stability is important. For example, decision-making, especially investment decisions, may be difficult when inflation rates are volatile. A total of 21 indicators are used to measure the macroeconomic environment. The macroeconomic pillar places much importance on the size of public deficits. Among the many reasons attributed to this is the impact on the banking system and problems in the provision of necessary public services when interest re-payments are high. The role of institutions is increasingly seen to be important for competitiveness. The GCI indicators for this pillar relate mainly to securing property rights, the observance of contracts and the elimination of corruption. The 27 institutional indicators also include bureaucratic efficiency, public trust and freedom of the press.

When ranking the developed world, the GCI places most emphasis on the technology pillar. The World Economic Forum argues that once institutions are in place and functioning and the macroeconomy is more or less stable, further improvements in these pillars will have little effect on overall competitiveness. On the other hand, the scope for improvement in technological capacity is, in principle, without limit and the main source of competitive advantage. The WEF distinguishes between innovation and imitation. For the more developed countries innovation, i.e. developing new products and processes, is a more relevant aspect of technological capability than simply doing the same thing cheaper than competitors. The 21 technology indicators place much importance on information and communication technology and they include company-level technological application and university/industry research collaboration.

However, many more indicators are used which do not obviously fall exclusively into one of the three pillars but may impact on all three. These are indicators on aggregate country performance, human resources (education, health and labour), general infrastructure, company operations and strategy and the environment. While all the indicators can be applied to a greater or lesser degree, the difficult issue is to determine their relative importance, i.e. to assign weights in order to derive a composite index. This is a complex process and is to a considerable extent arbitrary.

Table 1: *Growth Competitiveness Index 2005*

1	Finland	31	Belgium	61	Kazakhstan	91	Mozambique
2	United States	32	Slovenia	62	Croatia	92	Kenya
3	Sweden	33	Kuwait	63	Namibia	93	Honduras
4	Denmark	34	Cyprus	64	Costa Rica	94	Gambia
5	Taiwan	35	Malta	65	Brazil	95	Bosnia and Herzegov ina
6	Singapore	36	Thailand	66	Turkey	96	Mongolia
7	Iceland	37	Bahrain	67	Romania	97	Guatemala
8	Switzerland	38	Czech Republic	68	Peru	98	Sri Lanka
9	Norway	39	Hungary	69	Azerbaijan	99	Nicaragua
10	Australia	40	Tunisia	70	Jamaica	100	Albania
11	Netherlands	41	Slovak Republic	71	Tanzania	101	Bolivia
12	Japan	42	South Africa	72	Argentina	102	Dominican Republic
13	United Kingdom	43	Lithuania	73	Panama	103	Ecuador
14	Canada	44	Latvia	74	Indonesia	104	Tajikistan
15	Germany	45	Jordan	75	Russia	105	Malawi
16	New Zealand	46	Greece	76	Morocco	106	Ethiopia
17	Korea, Rep.	47	Italy	77	Philippines	107	Madagascar
18	United Arab Emirates	48	Botswana	78	Algeria	108	East Timor
19	Qatar	49	China	79	Armenia	109	Zimbabwe
20	Estonia	50	India	80	Serbia and Montenegro	110	Bangladesh
21	Austria	51	Poland	81	Vietnam	111	Cameroon
22	Portugal	52	Mauritius	82	Moldova	112	Cambodia
23	Chile	53	Egypt	83	Pakistan	113	Paraguay
24	Malaysia	54	Uruguay	84	Ukraine	114	Benin
25	Luxembourg	55	Mexico	85	Macedonia, FYR	115	Guyana
26	Ireland	56	El Salvador	86	Georgia	116	Kyrgyz Republic
27	Israel	57	Colombia	87	Uganda	117	Chad
28	Hong Kong	58	Bulgaria	88	Nigeria		
29	Spain	59	Ghana	89	Venezuela		
30	France	60	Trinidad and Tobago	90	Mali		

Source: *The global competitiveness report 2005–2006: Policies underpinning rising prosperity*, World Economic Forum, Geneva 2005, Palgrave Macmillan.

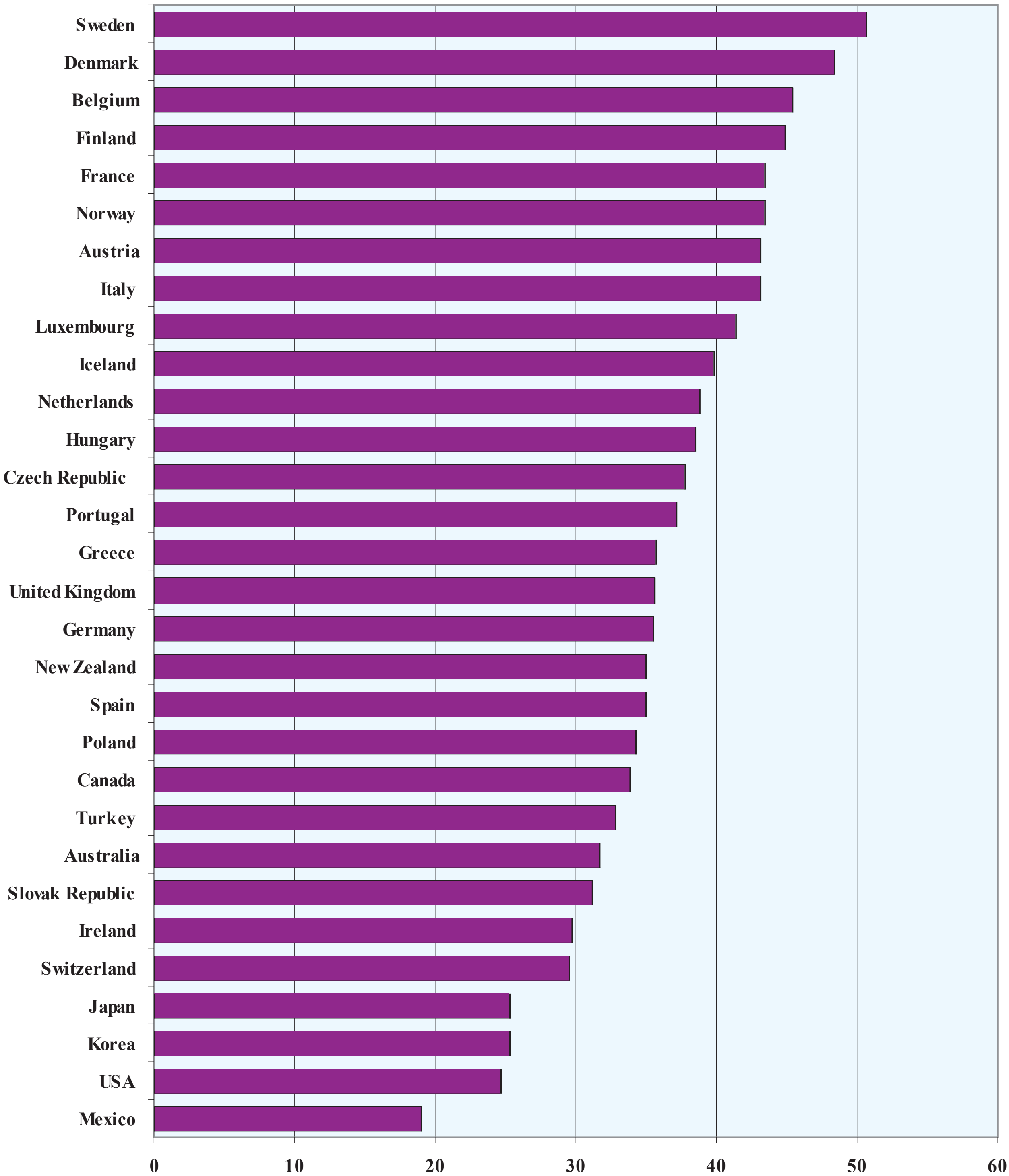
A striking feature of the ranking is that all five Nordic countries are in the top ten, scoring highly in all three dimensions of macroeconomic environment, public institutions and technology. USA takes second place due to its very high technology score but scores poorly on macroeconomic environment and will presumably score even lower in the next ranking. Taiwan's strongest score is in technology and Singapore has the top ranking macroeconomic climate in the world.

Most of the EU15 countries lead the European pack. The major exception is Italy, ranked in 47th place – behind, for example, Estonia which is the highest ranked eastern European country. The big fall in Italy's ranking (from 26th place in 2001) reflects hard data on macroeconomic indicators but also widespread concern about its public institutions. The lowest ranked new Member State is Poland, reflecting its poor macroeconomic and institutional environment.

European social models

It has often been stated that there is no single European model. However, what most European social models have in common is that they are extensive and expensive. A simple measure of the state's overall involvement in the economy is the level of taxation. Moreover, the most obvious reason why social policy may not be compatible with competitiveness and growth is that it is financed by taxation or social contributions. Taxation on labour may reduce labour supply and all taxation may impact negatively on profitability and investment. Figure 1 shows the tax revenue share of GDP for OECD countries. It is clear that European countries have a very large public sector defined in these terms, much of it used to finance social policy. However, there is no obvious simple negative relationship between tax and competitiveness: the Nordic countries have the highest tax revenues in the world, yet also score highly in competitiveness

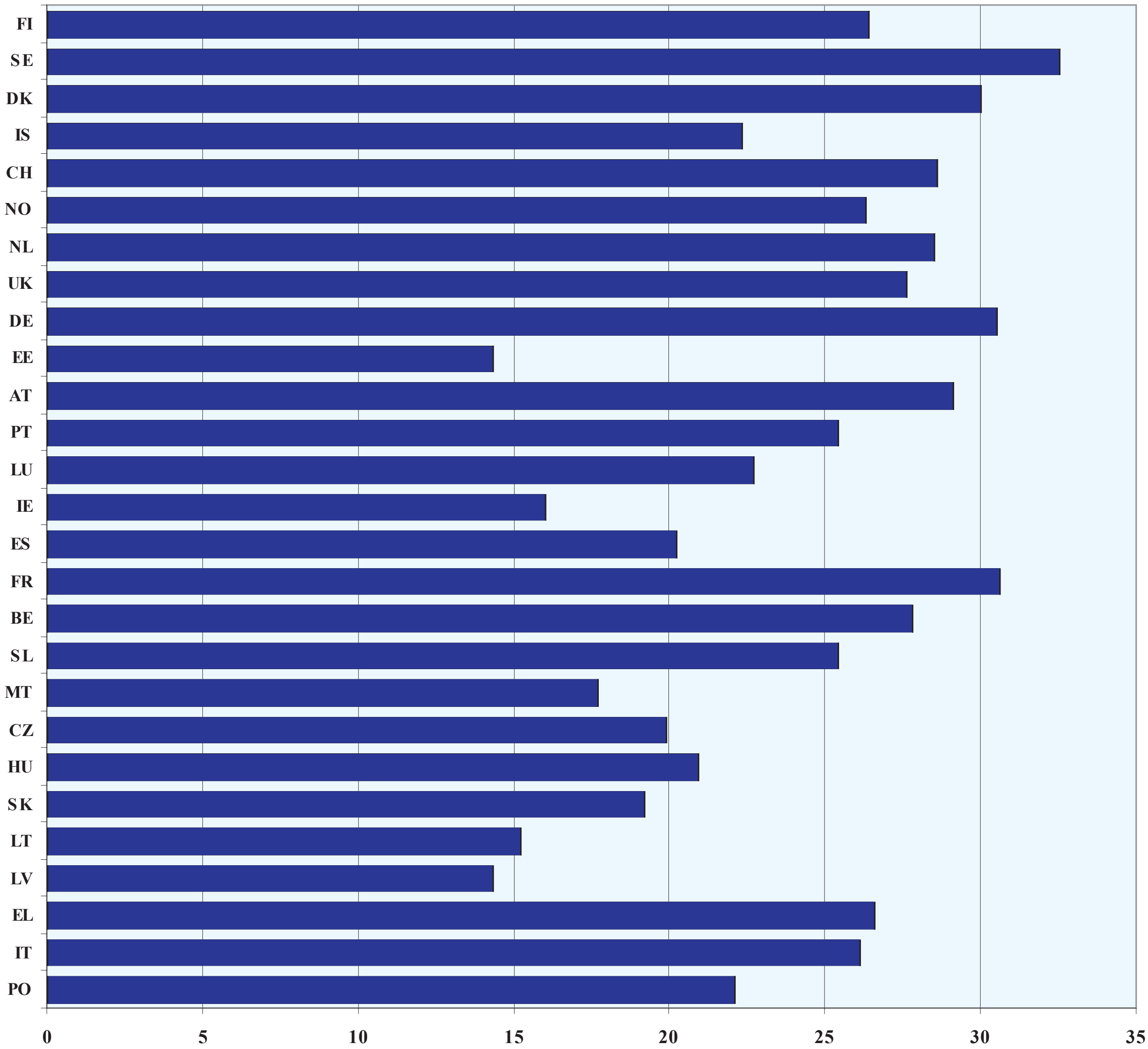
Figure 1: *Total tax revenue as a percentage of GDP, 2003*



Source: *OECD, Revenue Statistics 1965–2004, 2005*

Taxes are not only spent on social policy. One measure of the extent of state involvement in social policy is social protection expenditure as a percentage of GDP, shown in Figure 2.

Figure 2: *Social protection expenditure as a percentage of GDP (2002), with countries ranked in descending order of their Growth Competitiveness Index ranking (2005)*



Another measure of the extent of the social model is public sector employment. In most countries this is a good measure of the scale of public provision of social services. Unfortunately, compatible data is limited. However, it is clear that the ranking of the share of public sector employment broadly reflects the tax revenue data presented in Figure 1. Thus, even according to this measure, the Nordic countries have the largest public sector. Among OECD countries Japan, the United States, Turkey and Mexico have the smallest.

Competitiveness and social model compatibility

In the introduction, the first question posed was ‘Is an extensive social model compatible with competitiveness? – Can they co-exist?’ The presentation of competitiveness and social expenditure rankings above shows clearly that the answer is ‘yes’. The Nordic countries are best proof of this. All five countries rank among the top ten most competitive countries in the world and have had, for many decades, the largest publicly funded social model with the highest levels of public employment in the developed world. There is no question that an ambitious, publicly financed social model can indeed be compatible with competitiveness. However, it is just as obvious that even a modest social model *can* co-exist with high competitiveness, as exemplified by the United States. Within the EU, Ireland serves as such an example.

However, the co-existence of competitiveness and an ambitious social model in some countries does not necessarily mean that it is feasible in others. Moreover, the question ‘Does an extensive social model promote or hinder competitiveness – are there causal relationships?’ is far too generally phrased to be answered in a meaningful fashion. There are reasons why social models may both promote or hinder competitiveness irrespective of their size, and both large and small social models may be compatible with competitiveness. It is not prudent to try to establish the impact of the amount of government expenditure on social insurance and services on competitiveness. For example, spending more money on good education is likely to do more to promote competitiveness than spending the same amount of money on unemployment benefits or pensions. Similarly it does not make sense to try to establish the impact of total taxation rate on competitiveness. High marginal family taxation rates or high corporation taxes may impact negatively on competitiveness, while value added and green taxes may have less effect.[1]

There are two possible approaches to addressing the interesting causal question. Gösta Esping-Andersen and others have identified the essential features of social models (in terms of more than just the amount of social spending) to establish various welfare typologies. Such an approach also recognises the interrelatedness of specific social policies as part of an integrated package. The types of social models can then be related to economic and social outcomes such as growth, income distribution and welfare.[2] Another possible approach is to generate testable hypotheses on the relationships between specific social policies, such as income tax or unemployment benefits, on specific factors that impact on competitiveness such as labour supply or investment behaviour.

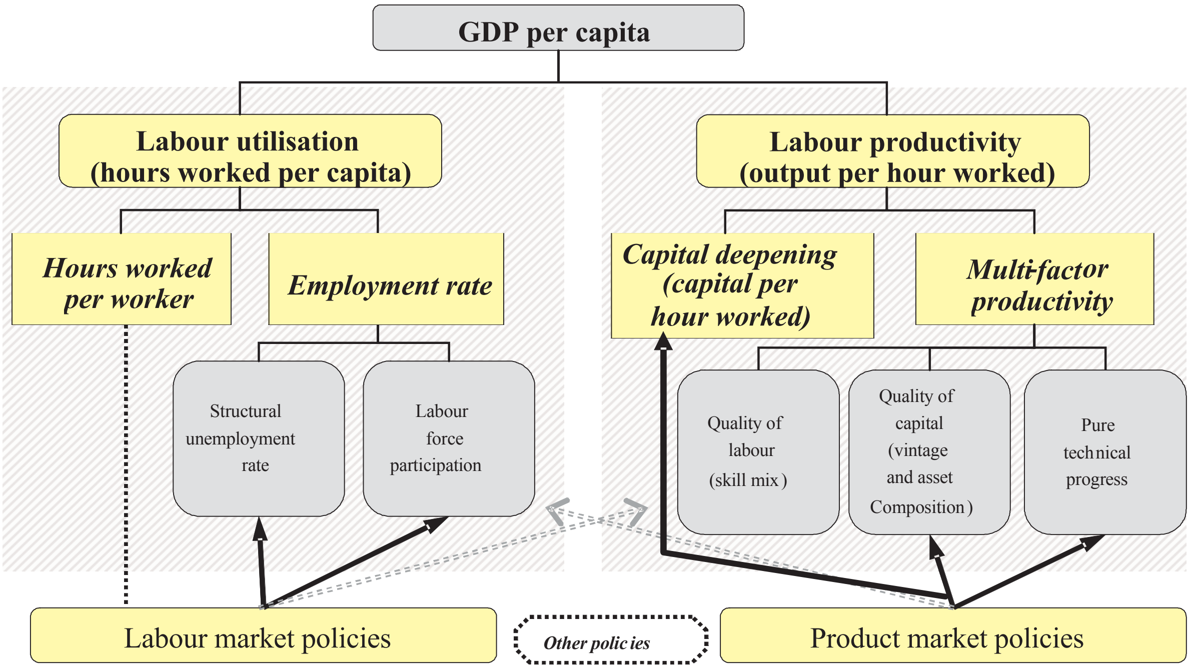
Specific social policy measures and competitiveness

Figure 3 presents a broad overview of the factors that the OECD considers to influence growth and competitiveness. A useful way of examining the competitiveness and social policy issues is to examine how various types of social policy influence each of the employment elements shown in the boxes – this could serve as a basis for further discussion at the Forum.

1 Nevertheless, economists have tried to answer this question by econometric estimation of cross-country growth regressions. Not surprisingly, the empirical evidence of the impact of the size of the public sector on growth is inconclusive. See, Agell J, Ohlsson H. and P. Skogman Thoursie, “Growth effects of government expenditure and taxation in rich countries: A comment” *European Economic Review*, Vol 50, pp 211-218, 2006.

2 Goodin, R,. Bruce Headey, Ruud Muffels, and Henk-Jan Dirven, *The real worlds of welfare capitalism*, Cambridge, Cambridge University Press, 1999.

Figure 3: *The determinants of growth*



Taxation

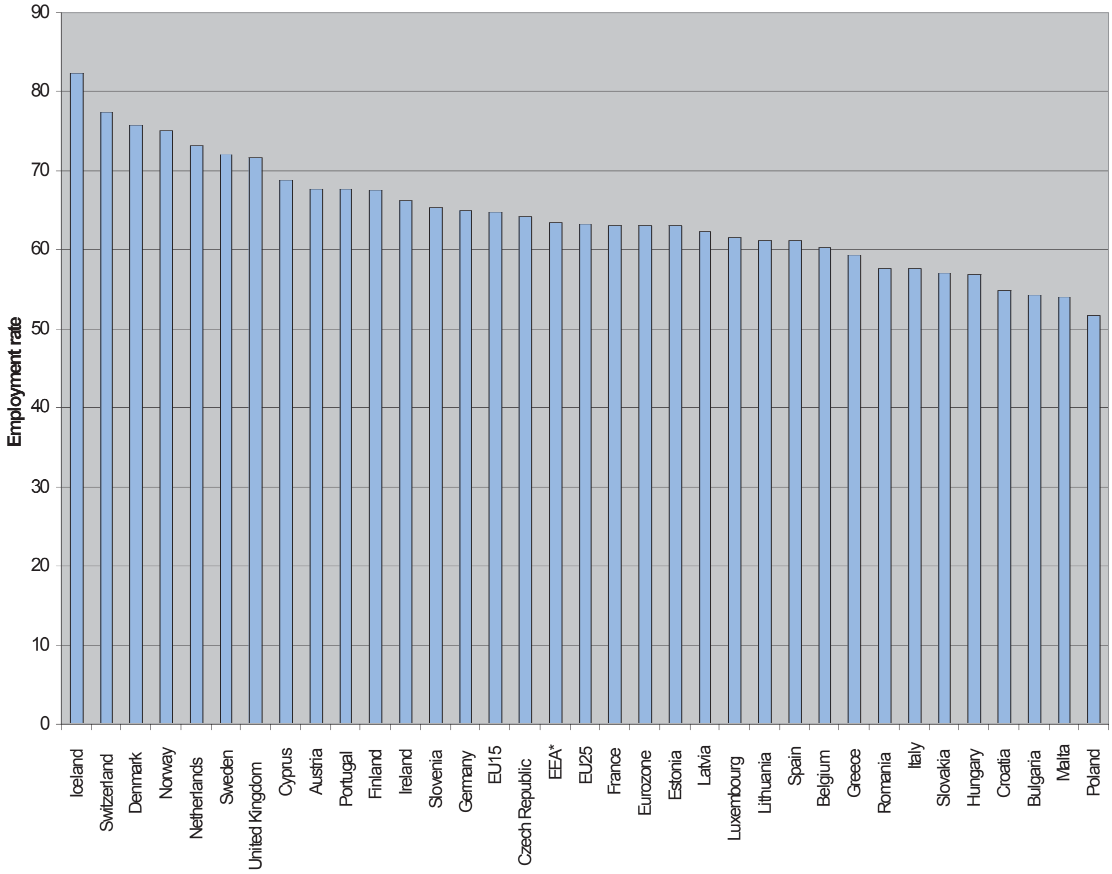
Perhaps the strongest argument against social policy in terms of being compatible with competitiveness is that the required taxation may inhibit investment, reduce labour supply and distort competition. Here it is useful to reiterate the point illustrated in the simple presentation of competitiveness and taxation ranking: that high tax levels are not necessarily incompatible with high competitiveness. How taxes are raised is fundamental. Some of the relevant issues are sketched below.

In recent decades, capital has become extremely mobile. The Irish experience indicates that low corporate taxation is important in attracting foreign investment. If a country needs tax revenues to finance the welfare state, which taxes are likely to keep domestic capital and attract foreign investment? Which tax bases are immobile? Probably the most immobile taxes bases are property and household energy taxes. The issue does, however, require serious thought, as even these taxes could be passed on to other economic agents. The income tax base, at least for the rich, has become very mobile, and personal wealth and inheritance taxes have become so mobile – or avoidable by some other means – that some countries have recently abolished them altogether. In the absence of international harmonisation of tax rates, some countries need to re-evaluate the means of raising taxes to finance social policy without inhibiting competitiveness.

High marginal tax rates may reduce incentives to work. Empirical research suggests that the effects are not very large, but larger for women than for men. Where problems do arise, they appear to be located at lower income levels where welfare benefits also kick in and may result in very small returns to work. There is an obvious need to avoid such poverty traps. Negative income tax schemes and other means of lowering the effective tax rate for low paid workers can be used to offset this situation.

However, there is much evidence to indicate that the structure of taxation is more important than the level. For example, there is a strong relationship between female labour force participation and the extent to which tax is based on individual, as opposed to family, income. Again the Nordic countries show that high marginal tax rates on labour can co-exist with high employment rates with an appropriate tax structure. See Figure 4.

Figure 4: *Employment rate (age 15–64) in 2004*



Source: *ELFS, Eurostat*

Social benefits and social insurance

A common charge against social benefits (social assistance, unemployment benefit, disability payments, old age pensions, etc) is that they reduce the incentive to work. However, properly designed, they may also increase labour force participation. Of course, there are clear cases when the availability and level of social benefits reduces labour supply. This is particularly the case for means-tested benefits like social assistance. One clear result of the many evaluations of the welfare-to-work programme in the United States is that tougher welfare regimes do reduce welfare caseloads. Examples of social benefits reducing labour supply have included disability pensions in the Netherlands and early pension schemes in Belgium and France.

However, a high level of benefits does not necessarily inhibit labour supply. If benefits are related to contributions, they may in fact increase labour supply. Old age pension systems that closely link pension income with contributions provide very strong incentives to participate in the labour market throughout the life course. Parental leave schemes that link income while on leave with previous income are a strong inducement for young women to participate in the labour market before having children. It appears that there is a potential to design social insurance in a way that both provides security and stimulates labour supply – and hence competitiveness.

Labour mobility is an important feature of a competitive labour market. One obvious benefit of public pension systems, as opposed to company-based schemes, is that pension rights are fully transferable between companies and sectors. There is also some evidence that compulsory social insurance can be relatively efficient. Another advantage of state-run systems is the financial security that such systems typically offer. The pension fund crisis at General Motors is a graphic illustration of how company insurance schemes can have very serious consequences for company competitiveness.

Public versus private provision of social services

Much social expenditure is devoted to the state provision of services, in particular, health and education. There are good social reasons for public involvement – not least to ensure an equal distribution of these services – but is such involvement efficient and does it promote or inhibit competitiveness? The basic argument for the efficiency of markets assumes competitive producers and rational consumers. These assumptions may be more valid in some types of economic activity than in others. The provision of health services may be an example of the latter case, particularly as regards the difficulty for consumers to be equipped with sufficient information to make rational choices. In addition, even if performed on the open market, health will usually be financed through insurance which typically removes the consumer's incentive to sanction poor quality or expensive producers. It is widely believed that the inefficiency of private health care in the United States is related to such market failures.

Table 2 shows that health care in the United States is very expensive, largely private, and does not yield more extensive health care services or result in better health than in other more publicly financed health care systems. In addition, roughly 40 million people in the United States have no health insurance at all. The United States uses almost double the share of GDP on health compared to many EU countries, leaving more resources in Europe to be put to other uses. Could education be viewed in a similar fashion? What is the role for publicly and privately financed education in the globally competitive economy?

Table 2: *International health comparisons*

	Canada	France	UK	USA
Health spending per capita, 2002	$ 2,931	$ 2,736	$ 2,160	$ 5,267
Private share of spending	30%	24%	17%	55%
Life expectancy	79.9	79.2	78.1	77.1
Infant mortality per 1,000 births	5.2	4.5	5.0	6.8
Physicians per 1,000 people	2.1	3.3	2.0	2.7
Nurses per 1,000 people	9.9	7.0	9.0	8.1
Hospital beds per 1,000 people	3.2	4.2	3.9	2.9

Source: *OECD Health data 2004* [3]

In practice, the issue is seldom a simple choice between all public or all private. Sometimes the provision of these services may be private while consumption is subsidised and there are many variations on this theme. Much of the discussion on public and private is ideological, whereas a pragmatic approach would be preferable. Some types of economic activities are best performed in the market, others are not and each case should be evaluated on its individual merits. Even conventional economic theory does not always conclude that private is always more efficient than public.

Globalisation, new technologies and the Welfare State

It could be argued that while ambitious and expensive social spending was in the past compatible with competitiveness, ongoing globalisation makes the reconciliation of social and economic goals more difficult. In some respects this is almost certainly true: for example, Keynesian demand management is difficult in the global economy and the issue of capital flight, mentioned above, can be problematic.

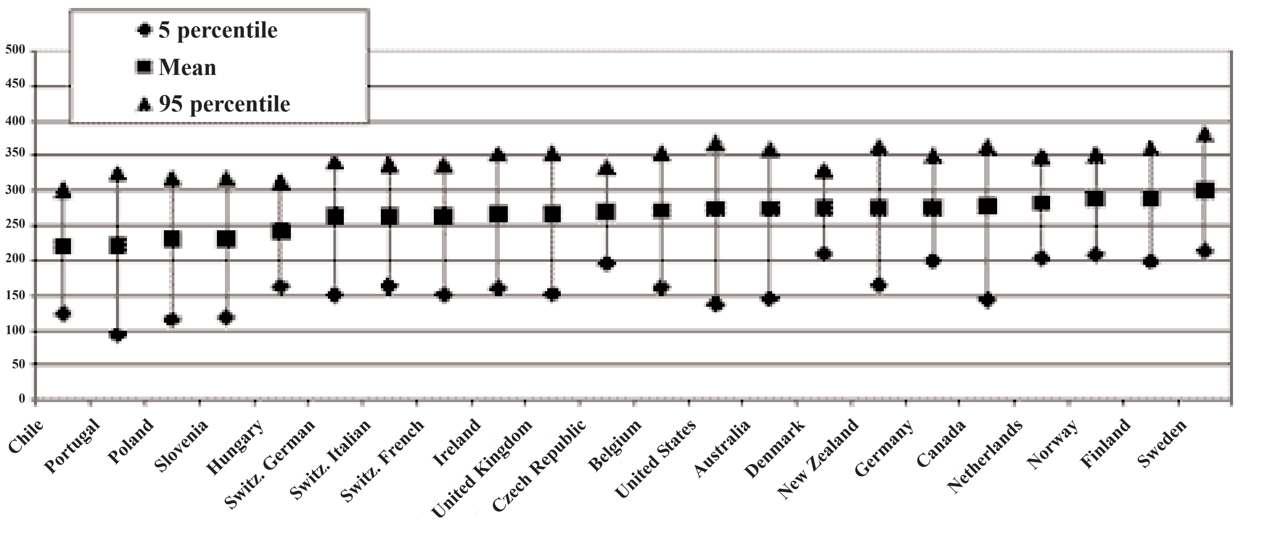
[3] Cited in Paul Krugman and Robin Wells, 'The Health Care Crisis and What to Do About It', *New York Review of Books, Volume 53 Number 5, 23 March 2006.*

However, there are factors that suggest that the challenges of globalisation could be addressed with some type of social model. It surely is the case that Europe cannot maintain international competitiveness in the low wage and low skill segment of the global market. Moreover, it is becoming increasingly common to view the technological capability of a country as a key component of competitiveness, and indeed 'technological readiness' is one of the three pillars of the Growth Competitiveness Index. It would appear far-fetched to suggest that there could be a negative relationship between social policy and technological readiness. But could there be a positive relationship?

To what extent does the current knowledge society really represent a new paradigm? What may be new is that current modes of production require that a larger share of the workforce is able to use this new technology. The worker in Henry Ford's factory was not required to perform highly skilled tasks or to interact with other workers. Efficiency was driven by economies of scale and an ever-increasing division of labour to perform very socially limited and simple tasks. However, contrary to the predictions of many, the trend towards a simplification and division of the tasks of the labour process was subsequently reversed. Creative and highly skilled 'engineers' have always been required to obtain competitiveness. What may have changed is that nowadays the application of new technologies requires a higher and more generally skilled workforce than before. The knowledge society is characterised by employment in services, flatter organisational structures, a higher general skills level and better information and communication skills for the majority of workers.

It cannot be disputed that our economies must continue to invest more in human capital – and not only at the top end of the skill distribution. Whether this should be publicly or privately financed may not be always clear but surely there is a very good case for public funding, particularly for the less skilled. Figure 5 shows the average scores (and the spread) in standardised literacy of the adult population in several OECD countries.[4] The European countries that rank highly in competitiveness also rank highly on average literacy scores. However, in some respects the most striking result is the difference in the spread between countries. It should also be noted that the biggest difference between countries is for the lowest score in each country: the 5th percentile.

Figure 5: *Average scores and spread from standardised literacy test*



Source: Highlights from the final report of the International Adult Literacy Survey *Literacy in the Information Age – Skills for the twenty-first century. OECD and Statistics Canada (2003)*.[5]

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[4] This was a very comprehensive and high quality study conducted by the OECD and Statistics Canada that tested literacy skills (mainly text comprehension) using fully compatible texts to a random sample of the adult population. Similar tests were conducted for numeric skills.

[5] http://www.hrsdc.gc.ca/en/hip/lld/nls/Surveys/ialsfrh.shtml

How what accounts for these results? The most obvious explanation is variations in the quality of basic school education. But this is far from being the only possible reason, as the survey was addressed to adults of working age. Policies such as further adult education and active labour market policy may also influence these scores. This is not an issue that has been pursued in detail by the research world; but could it be that an even skill distribution is the key to explaining why some countries have a more even income distribution than others? Could it even be the case that the level of skills – even at the lower end of the skill distribution – is an important source of competitive advantage?

Another important role for social insurance and publicly financed services is their role in facilitating labour market adjustment to structural change. This role may become more important in the future, as it is commonly believed that global competitive markets require a higher degree of labour market adjustment than before, both in terms of numbers affected and the required skills upgrade. Competitive environments are risky. One view of the public sector (including social insurance, public employment, and labour market policy) is that it is an insurance device designed to cope with a risky environment and there is some empirical evidence to suggest a relationship between international trade and the size of public sector. This role of social policy in structural adjustment has been recently popularised as 'flexicurity' The Danish version is weak employment protection, generous unemployment insurance and active labour market policy. This is backed up by a high level of basic education and policies to promote lifelong learning. Indeed, even the classic Swedish model originating in the 1950s was also a socially acceptable means to effect a rapid structural transformation of the economy. It could be argued that much of the Nordic economic and social success is related to how they have been able to deal with restructuring. In this context, the consensual nature of Nordic industrial relations and the state's refusal to subsidise unprofitable firms and sectors is also important.

Single market and social policy dilemmas

Most of the features discussed above are primarily the prerogative of the Member States. The EU has a very limited social policy legislative mandate in terms of, for example, taxation, social insurance and benefits and aspects relating to the provision of public contra private social services – see Table 3.

Table 3: *The EU social policy mandate*

Social issue	Mandate
Free movement of labour	Qualified majority
Gender equality of pay and labour force	Qualified majority
Working environment	Qualified majority
Working conditions	Qualified majority
Worker information and consultation	Qualified maj ority
Integration of those outside the labour market	Qualified majority excl. funding
Social security and protection	Unanimous
Employment protection	Unanimous
Collective interest, rep. & Co-determination	Unanimous
Employment of 3rd country nationals	Unanimous
Funding for employment policy	Unanimous
Social security co-ordination	Unanimous
Pay	Excluded
Right of association	Excluded
Right to strikes and lock-outs	Excluded

Source: Leibfried, Stephan, and Paul Pierson, 'Social policy: Left to courts and markets?', in Wallace and Wallace, *Policy-making in the European Union*, pp. 267–292, 2001.

Consequently, legislation aimed at harmonising social policy has been quite limited. However, other fields of the EU's legislative mandate do impinge on the social policies of Member States and on social issues generally. This is most obviously and most importantly the case for Single Market legislation, of which the single market for services remains to be completed. In contrast to the free movement of goods, which can be manufactured in one country and exported to another, the fully free movement for services is inconceivable without free movement of labour and the right of establishment. The issue arises as to whether host country (where the service are performed) or country of origin (where the firm is based) rules are to apply. Currently the principle is that it is the host country rules that apply. Social dumping has always been among the most controversial of social issues facing the European Union and has recently re-emerged in full force as a consequence of recent enlargement and the Services Directive.

Free movement within the single market also impacts more directly on social policy in Member States. In principle, social security is the prerogative of the Member States but only in so far as it does not hinder the functioning of the single market.[6] In order to promote the free movement of labour, all EU citizens must receive equal treatment by national authorities. Thus the Member States no longer unilaterally decide who receives social benefits and services. There is much media scaremongering on the issue of 'welfare tourism'. However, there is little firm evidence that this is a significant problem.

The principle of non-discrimination applies also to social services. While the legal issues are complex, free movement implies that an EU citizen may obtain health treatment in one Member State while the costs are borne by insurance schemes in another. What impact would a full application of this principle have on the publicly financed universal health system? Another issue is the free establishment of health care companies in other Member States and their impact on the relationships between domestic providers and insurance systems. Again the legal issues are complex, but it would appear that as long as the domestic providers are not 'economically active', they may be awarded preferential treatment within the national welfare systems. Similar questions arise regarding the provision of education services.

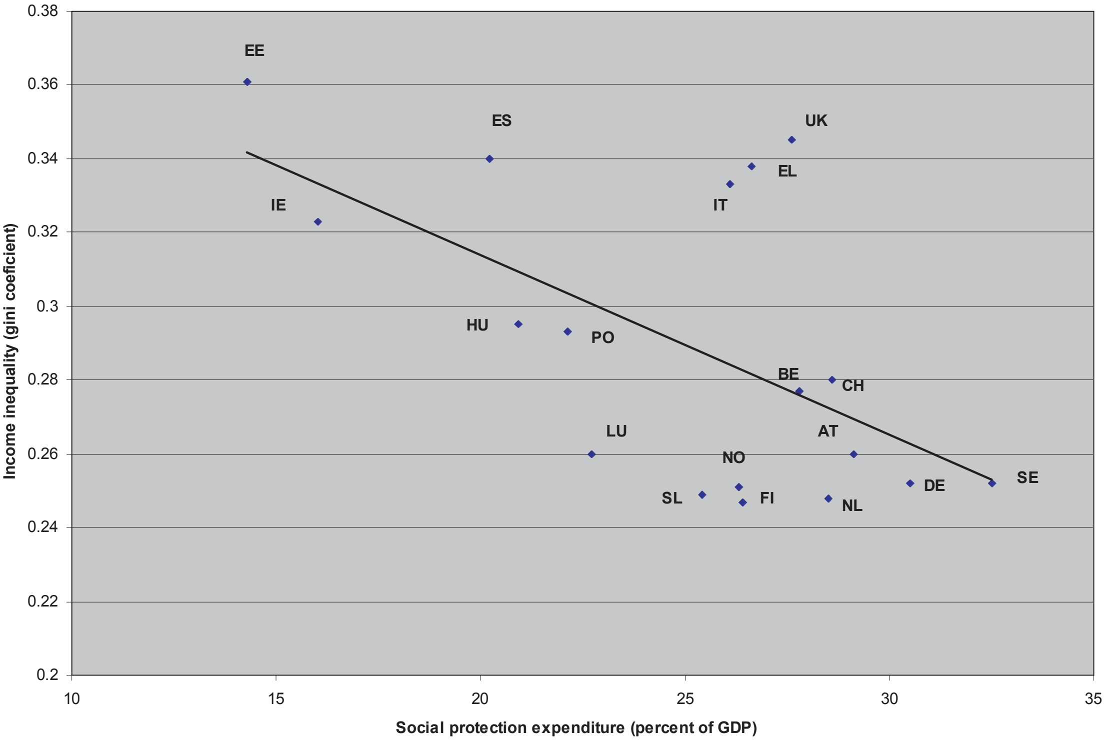
Health and education are very important for the welfare of citizens. These sectors employ a large proportion of the labour force and are crucial factors in the competitiveness of countries. While single market legislation has already undermined some national sovereignty in this respect, it would appear that the provision of welfare benefits and services to other EU nationals is not currently a major financial issue for any Member State. However, the single market is fundamental to the economic future of the union. The question is: to what extent is the extension of free movement of services to the typical preserves of welfare state necessary to promote economic efficiency and competitiveness. Furthermore, as the example of health care in the United States showed, it is far from clear that the market is the most efficient means of organising such economic activities. Is there thus a means by which a pan-European basis for such activities could be created other than through the market economy?

[6] See Council Regulation 1408/71 on the co-ordination of social security systems.

Competitiveness with or without a social model

The assumption behind the title of the Foundation Forum is that competitiveness with a social model is desirable: competitiveness for material well-being and the social model to ensure social cohesion. While ambitious social models are the political expression of a stronger declared intention to promote social cohesion than market-based systems, do they achieve this aim? It would appear so. European countries have on average a more even distribution of income than similar countries outside Europe with less ambitious social models. A similar relationship is observed for the EU15 Member States – see Figure 6.

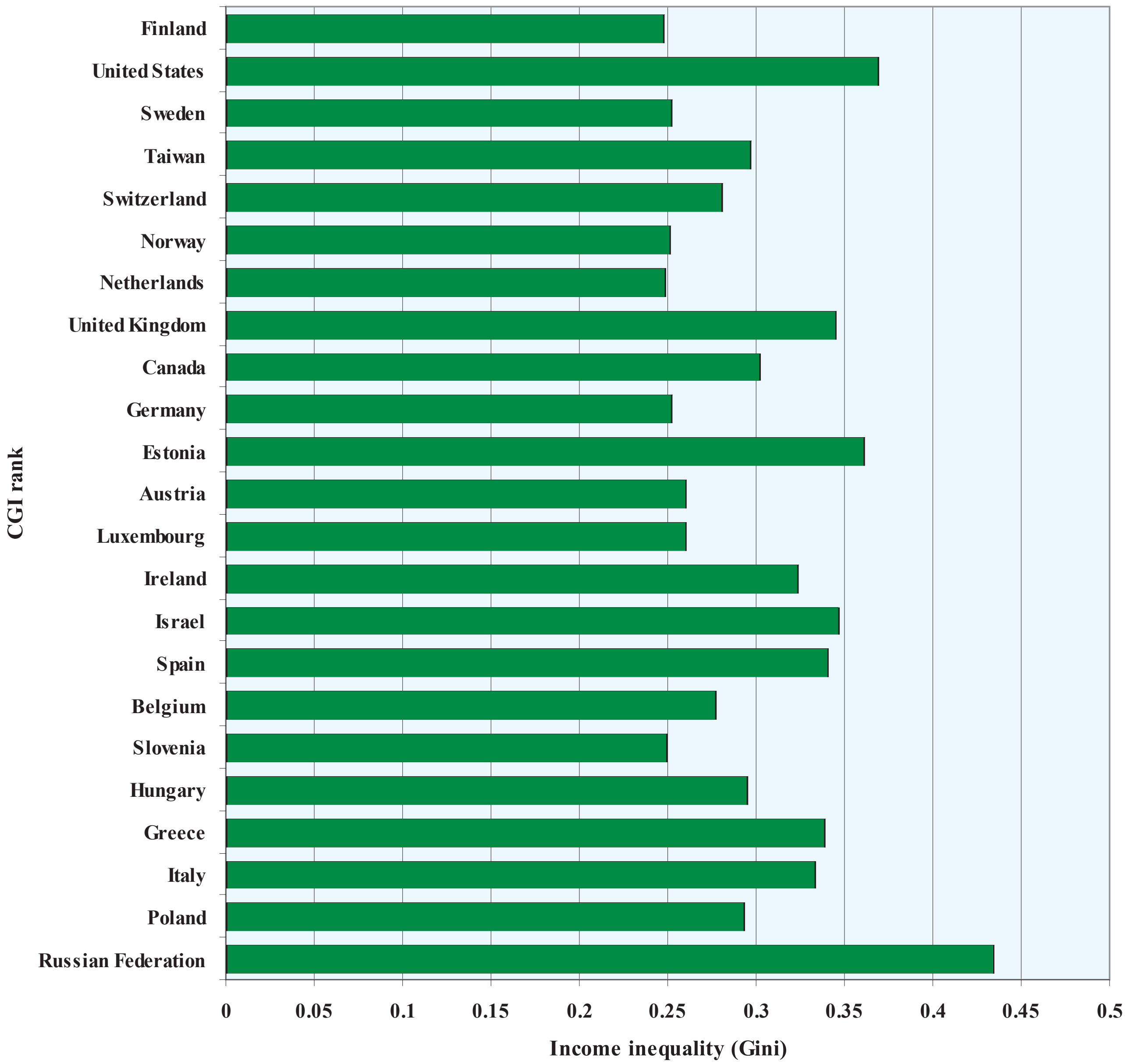
Figure 6: *Income distribution and social expenditure as a percentage of GDP.*



Source: *Social Protection – ESSPROS database Eurostat, Gini coefficients Luxembourg Income Study (most recent year since 1999).*

Given that a social model is conducive to more equality, does equality yield other benefits apart from the intrinsic value of equality per se? And, relating this to the theme of the Forum, does equality promote or hinder competitiveness? There are arguments both for and against – and both unequal and equal countries can be competitive. The best example of the latter is Finland: the most competitive country in the world and with the most equal distribution of income in the developed world – see Figure 7.

Figure 7: *Income distribution in some countries ranked by the Growth Competitiveness Index.*



Source: *Income distribution (Gini coefficients) from the Luxembourg Income Study Competitiveness ranking from the World Economic Forum, 2005.*

Concluding remarks

The reconciliation of social and economic goals is one of the classic dilemmas facing any society. There is a widespread belief that there is a trade-off between efficiency and equity. One message of this paper is that while this can be the case it is not necessarily always so. Finding positive sum solutions which promote both economic and social goals, is indeed a challenge for policymakers at both the national and European level. It is hoped that the work of the Foundation and the discussions of the Foundation Forum can provide some guidelines as to how this can achieved.

Much mention has been made of the Nordic countries in this paper, as they provide irrefutable proof that a high degree of competitiveness is compatible with an extensive and expensive social model. But is the Nordic model – or other similarly attractive models – transferable? Or do they require social behaviour and institutions that are not for export? It is claimed that the Nordic model only works due to the high levels of civic responsibility and institutional trust in the countries concerned. This is not something that can be simply adopted by passing a law. Political scientists such as Robert Putnam view such qualities as part of individuals' historical heritage. While there is probably some truth in this, in the long term very little is non-transferable. Civic responsibility and trust are not genetic and one should not underestimate the power of sensibly designed incentive structures. The economic principles of competitiveness compatible or enhancing social policy are reasonably straightforward. The challenge for all Member States is to apply these principles to their own social, economic and institutional settings.

Most of the new Member States cannot afford to adopt the extensive social models of countries like Germany or Denmark. They can, however, make reasonable choices according to their own strengths and limitations, and based on the realisation that social and economic goals are not intrinsically incompatible. Lessons have surely been learnt since the early 1990s, when the 'shock therapy' recommendations basically rejected the social dimension of competitive markets. Maybe they should look less to the EU15 for integrated social models which are embedded in their historical experience, but learn from the principles of competitiveness enhancing social policy. The Polish pension system appears to be a case in point, combining some social cohesion with sound incentive structures.

Social cohesion was a founding principle of the European Union and since then Member States, with varying degrees of success, have reconciled both economic and social goals. As the 50th anniversary of the Treaty of Rome approaches, it is clear that the economic and social environment has changed radically. The global competitiveness of Europe depends more than ever on a highly motivated and well-educated labour force. The potential role for social policy to promote competitiveness in such an environment has never been greater. Since 1957 much has been learned about which types of social policy are conducive to productivity and competitiveness. The forthcoming discussion at the Forum should, at the very least, inform about the lessons learnt and possible paths forward. After all, it should be remembered that the fundamental goals of the Treaty (Article 2) include '… the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.' Perhaps the Foundation Forum can make a modest contribution towards a fuller realisation of these goals.

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