

One market, how many social models?

Policy and performance indicators for the EU-27

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Abstract

In this paper I reappraise the Boeri-Sapir analysis of four EU social models, in reference to the EU-27 countries. I conduct a simple fact-finding exercise by comparing indicators of policy inputs, outcomes and of economic performance, for the period 2000-2005.

The first three sections elaborate on the motivations for this exercise. Here, I argue that the debate on "social Europe" fits well within the agenda for the internal market. However, I also argue that there is no need to harmonize social policies across member states, and that their differences are a value in itself.

In section four I document to what extent labor market policies of the EU members differ from each other, how can they be synthetically identified and whether or to what extent differences in labor market outcomes are related to policy differences.

The main suggestion of this part is that the simplest ways to describe countries is in terms of the overall size of their Labor Market Programmes relative to GDP. On the basis of this indicator, more "generous" countries generally display high employment rates and appear more successful than others at reducing poverty risk.

Two other broad questions motivate this study: whether the new member states of the EU can be meaningfully compared to the older members, and whether the observed changes in social policies point to a possible *de facto* convergence of the different social models. Tentative answers to both questions are positive (albeit, for the second one, possibly only in the long run).

1. Introduction

In a recent Eurobarometer Survey on "European social reality" (2007), a majority (51%) of European Union citizens declared their *satisfaction* with the quality of the social welfare system in their own country². The report also notes that "over two-

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² The specific question asked to the EU-25 citizens was whether their welfare system "provides wide enough coverage" (Eurobarometer Survey, 2007, p.76)

fifths of European Union citizens feel that their welfare system could serve as a model for other countries (42%). This belief is most widely held in Finland (79%) and Denmark (78%) and least widely so in Portugal (5%), Latvia (6%) and Greece (8%). In Romania and Bulgaria this view is shared by respectively 7% and 2% of respondents. People's propensity to feel that their country's social welfare system could serve as a model for other countries is strongly related to whether they feel it provides enough coverage." (id., p.77).

Clearly, social policies matter to the EU citizens. A relevant question is then how should this be taken into account in the definition of the EU's goals, competences and policies. An official document presented at the Working Group on Social Europe at the European Convention thus posed this question: *"The EU cannot be a credible force for good in the wider world if it is indifferent to questions of social justice in European society or how its citizens are treated at work. Therefore it is important that the values and objectives we all share as Europeans are set out with clarity in the Constitution. The Constitution needs to set out with equal clarity the respective competences of the Union and Member States in the fulfillment of these shared values and common objectives. Shared values and common objectives do not necessarily imply EU competences or EU legislative action.... We all accept that there are social values that are distinctively European. We often describe these as the "European social model". However there is huge diversity between how these values are implemented in the social systems of Member States".³*

These observations provide one motivation and starting point for the present paper. My thesis can be summarized as follows. Social policies characterize in essential ways the welfare of European citizens. In all cases where these policies originate from values that are commonly shared among the EU members, these values should be clearly stated and embodied in the fundamental treaties. However, diversity in the implementation of these values is a value in itself, and to subscribe to these values does not imply that their implementation should be harmonized across member states. In fact, in most cases subsidiarity implies that they should not. As the above quote from the Eurobarometer implies, many citizens are indeed happy with the diversity of social policies in Europe – what make some of them unhappy are the shortcomings of their national welfare systems.

³ European Convention (2003). Emphasis added.

Before I address the diversity of social policies (or more precisely, of labor market policies) directly, let me discuss however how they fit within the agenda for EU integration. The EU originated around, and to date is still largely based upon, the notion of the common market, which later evolved into the single and now the internal market.⁴ How does then the theme of a social Europe fit in the objectives and policies, and possibly also in the institutions of the European Union? Should a social Europe imply a reduced emphasis on the internal market? Or has the internal market become obsolete, as a founding concept for European integration?

These questions deal with complex and controversial issues. They are hard to address satisfactorily, for at least four motives: (i) the facts they refer to are hard to know and to measure properly; (ii) they belong to the domain of not one, but of all the social sciences; (iii) the interpretation of such facts often falls prey, within each of the social sciences, to ideology and prejudice; and finally (iv) the EU itself is an object of uncertain definition.

This last motive should not be interpreted as a sure sign of faulty design.⁵ But clearly it is difficult to assess how appropriate is the design of an object we have never experienced before. In any case, I cannot propose to deal with any completeness with all these questions. But, in order to be straightforward and open, I will at least anticipate what my prejudices concerning these issues are, as Gunnar Myrdal once recommended that we should do.

In order to study the diversity of policies and outcomes across the EU, I have put together for the purpose of this paper a rather large set of indicators. Below I shall provide a first descriptive account of such indicators, but I am confident that some interesting facts may already emerge, and that they will stimulate further research.

The paper is organized as follows. First, I shall express some general views (some might call them "positive prejudices") with respect to the internal market (IM) project (Section 2). Then I will examine some aspects of the complexity of the

⁴ Four Treaties and Communities mark the first decade of European integration: the European Coal and Steel Community (ECSC, 1951); the European Defence Community (EDC, 1952 but rejected 1954); European Economic Community (EEC, 1957); and European Atomic Energy Community (Euratom, 1957). Of these, only the EEC has survived to our times, evolving into the EU as it is today. March 2007 marks the 50th anniversary of that Treaty, also known as the Treaty of Rome.

⁵ For example, at one time the PC might have looked as something in between a TV set, a typewriter, a telephone and a scientific calculator: difficult to define *ex ante*, but this was certainly not the sign of a doomed design!

agendas that evolve around the IM (Section 3). In Section 4 I will introduce the analysis of some diversities within the IM. As much as possible, I will take into consideration all the 27 members of the EU. The purpose of this analysis is two-fold: first, to identify which stylized facts can usefully characterize the evolution of, and interrelations between, labor market policies and economic performances within the EU member states; second, to identify promising areas for further research. Finally, in Section 5 I will draw some (tentative) implications for the governance of the EU.

2. The internal market as the core

What part does or should the internal market play in the process of European integration? I believe there are two opposite mistakes, which should be avoided when appraising this role. First, we should not look at the IM as some sort of picklock, which would lead us into opening the doors to a political union (whether federalist or otherwise).

Nor should we take the opposite direction, that the EU should be nothing else, or perhaps little more than an area of free trade, where a larger market allows us to reap the benefits of more competition while at the same time also benefiting from economies of scale. Frankly, there is more to it.

Instead my suggestion is that we should appraise the internal market as the point of departure and the fulcrum for a set of institutions and policies, upon which also the notion of the EU as a political actor (both in the internal and external dimensions) must be based. This vision I believe to be in complete agreement and coherence with the Treaty of Rome.

To this end, I would first like to argue that this idea is well grounded in the classical, founding principles of our civilization. As historians remind us, the European heritage originates around the Mediterranean Sea. There are at least two principles which I would like to recall from the initial stages of that civilization. The first statement of both principles I am aware of is from the Odyssey:

For the Cyclopes have at hand no ships with vermilion cheeks, nor are there ship-wrights in their land who might build them well-benched ships, which should perform all their wants, passing to the cities of other folk, as men often cross the sea in ships to visit one another - craftsmen, who would have

*made of this isle also a fair settlement. For the isle is nowise poor, but would bear all things in season.*⁶

Men build and navigate their ships in order to trade (this goes without saying); but this also induces them to “perform all their wants” and “visit one another”. That is, the outcome of trade is not only the exchange of goods (although that is perhaps the prime motive): it is to see other cities and other men, and thus get to know each. On the opposite side those, such as the Cyclops, who do not do travel and trade, throw away the opportunity to benefit from the fertility of their land and lead themselves to poverty both in their material and social life.

So Homer’s words bear out these two principles:

- (1) trade is a necessary condition for material prosperity, *and*
- (2) trade is a necessary condition among peoples for mutual knowledge and enrichment.

The second statement I would like to recall is from a pagan philosopher, whom I guess would have found himself quite sympathetic – if he had had an opportunity to - to the Scottish Enlightenment thinkers:

*God did not bestow all products upon all parts of the earth, but distributed His gifts over different regions, to the end that men might cultivate a social relationship because one would have need of the help of another. And so He called commerce into being, that all men might be able to have common enjoyment of the fruits of the earth, no matter where produced.*⁷

Here again are the two principles: that trade enables men to enjoy more of the fruits of the earth; and that, through trade, men “might cultivate a social relationship” between each other.

Allow me to jump forward. I do not think that here we are much distant (except in time) from the ideas that were perhaps storming Jean Monnet’s mind when he wrote in a 1943 *memorandum* to Schumann:

⁶ Homer. *Odyssey*, Bk. IX. Trans. A.T.Murray (1919).

<http://www.perseus.tufts.edu/cgi-bin/ptext?lookup=Hom.+Od.+9.116> .

⁷ Libanius, *Orationes*, III. Libanius was born in Anthiochia in 314. He was educated in Athens, but then returned to Constantinople and thereafter in Anatolia. He was a friend, correspondent and later apologist of the Emperor Julian, who tried to restore some form of religious eclecticism (today we might say tolerance) in the early Roman empire. The quotation is from Griswold (2001).

*The countries of Europe are too small to give their peoples the prosperity that is now attainable and therefore necessary. They need wider markets. ... To enjoy the prosperity and social progress that are essential the States of Europe must form a federation or a 'European entity' which will make them a single economic unity.*⁸

These ideas (from Homer to Monnet, I would like to think) are naturally embodied in the Treaty of Rome:

*Article 2. The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.*⁹

Note that it is in this Article that the objectives of the Community are defined for the first time. But then also notice that, strange as it may appear, even before knowing *which* is the task to be realized, we are told *how* it should be realized: "by establishing a common market" and a common money and a set of related policies. So the common (or internal) market is clearly instrumental to the objectives to be chosen: but, in this rather awkward construction, the instruments precede the listing of policy objectives, in order – we might guess - to underline how essential and inescapable that instrument is to the pursuance of the objectives.

Thus, essential as it may be, the internal market is an instrument towards higher levels of welfare, and not an end by itself. As it is the case, growth within the IM may generate costs, by displacing the initial allocation of resources through the process of creative destruction and induced (re-)specialization. These costs may also persist for considerable time, and might even give rise to poverty traps.

⁸ Jean Monnet (1976, Engl. transl 1978, p.222).

⁹ Treaty establishing the European community (1957). Consolidated version.

http://eur-lex.europa.eu/en/treaties/dat/12002E/pdf/12002E_EN.pdf

For some countries within the internal market (or which are newly joining it), these costs may be especially burdensome, and may also become socially or politically unbearable, and ultimately result in policy reversals. This may be true in particular for poor countries, where mechanisms and opportunities for redistributive policies are scarce and which are characterized initially by lower labor skills and human capital and lower total factor productivities, and for small countries, where economies of scale might be more difficult to reap. Although poor and small countries are those who stand to gain more, in the long run, from participation to the IM, they are also likely to face the larger share of transitional costs. Of course, this applies in a specific way to transition countries *strictu sensu*.

For these reasons, it is not enough to get the bureaucrats out and the markets in, as Jeffrey Sachs once put it. It is also necessary to provide institutional arrangements and policies, to enhance the adaptability of the labor force, within each country, to relocate and re-specialize.

3. The internal market: no hidden agenda, but a transparent one. And which relations with other agendas?

As I anticipated above, I do not believe that the IM carries with itself a hidden agenda – and especially not a federalist one. However, there are several other agendas – quite transparent ones – that come out from or go together with the IM own agenda.

But first let us be clear about federalism. Since there is no way of building a federal state without a federal budget,¹⁰ it follows quite clearly that the federalist option has been discarded the very moment it was decided to limit the own resources of the EU below the ceiling of 1.24% of the EU GNI¹¹. Thus, how could possibly a

¹⁰ Cfr. William E. Oates (1999). One central notion of fiscal federalism is that at least the redistributive function of public finances should be centralized. Clearly the EU budget is structured in the opposite way.

¹¹ The ceiling for own resources was set on 24 June 1988 as 1.14% of EU GNP, and 1.27% from 1999 onwards. It was later redefined to 1.24% of EU GNI. See <http://europa.eu/scadplus/leg/en/lvb/l34011.htm>. This decision limits the EU budget to the size of that of Denmark, or about 1/10 of that of Germany.

federalist evolution take place out of such a programmatic prohibition of fiscal federalism? No way.¹²

Instead, the EU has by now reached its own, stable albeit still imperfect, equilibrium, as some political scientists have observed. Let me quote à propos Andrew Moravcsik:

The multi-level governance system of the EU is the only distinctively new form of state organization to emerge and prosper since the rise of the democratic social welfare state at the turn of the twentieth century. Recent events suggest that it may now have reached, through a characteristically incremental process, a stable political equilibrium. This 'constitutional compromise' is unlikely to be upset by major functional challenges, autonomous institutional evolution, or demands for democratic accountability. There is, moreover, an undeniable normative attraction to a system that preserves national democratic politics for those issues most salient in the minds of citizens, but delegates to more indirect democratic forms those issues that are of less concern, or on which there is an administrative or legal consensus. Contrary to what Haas and Monnet believed, the EU does not (or no longer needs to) move forward to consolidate its current benefits. This is good news for those who admire the European project. When a constitutional system no longer needs to expand and deepen in order to assure its own continued existence, it is truly stable. It is a mark of constitutional maturity. (p. 376).¹³

The functional evolution has almost come to a standstill; policy competences have been attributed and this allocation is precisely described (without introducing any substantial innovation) in Articles I-12 to I-17 of the proposed Constitutional

¹² The decision on own resources could be revised but, even under the rules proposed under the now obsolete Constitutional Treaty, any revision would require unanimity of the member states.

¹³ Andrew Moravcsik (2005). Moravcsik writes in reference to the Constitutional Treaty signed by all the EU Heads of States and which, despite the high number of ratifications achieved (15), will surely not enter into force. However, on the specific issue of defining the EU vs. member states policy competences, the Treaty was merely a ratification of the already existing status quo. Hence the constitutional compromise to which Moravcsik refers himself characterizes the current situation, independently of the fate of the Constitutional Treaty.

Treaty.¹⁴ So if a federalist agenda is out of question, is then Europe only to be identified with the IM?

As I anticipated, I do believe that the IM lies at the core of the European civilization, and thus must also be at the core of the EU. But then this does not mean that the EU is nothing more than a free trade area. In particular, let me suggest three important incremental differences:

1) The IM is also a socializing device. Social inclusion lies also at its core. Competition is the key to efficiency and successful innovation; it is not a mechanism for social exclusion or punishment. Hence (for the same reasons which I have outlined in Section 2) policies for social inclusion should naturally come together with pro-market policies. Whether they should be allocated to Brussels or to member states is another question, which I will discuss later on; but that they should be conceived and enacted at the same time as policies to complete the IM, this I believe to be out of question. This is probably what some call the concept of a *social market economy*. I understand that there are different interpretations of this concept. The one I would subscribe to is that of an economy of properly functioning markets, where outsiders (which include both unemployed people and new entrant firms) have the opportunity to get inside, even as this threatens the interest of insiders and incumbents.

2) Prominent among the areas where there are Europe-wide policy externalities, and where uncoordinated actions may lead to unpleasant prisoners' dilemma equilibria, are now energy and the environment. Any solution, which might be adopted in a group of countries for one of these areas, would have radical implications or spillovers also for the other area and for the IM as a whole. Hence without doubt in these cases we need an increasing number of solutions conceived and enacted at the EU level, and no longer only at the level of individual members.

3) In addition, the increasing size and external openness of the IM have implications that extend to the field of international relations between the EU members and other states. Using the blunt words of Thomas Friedman:

¹⁴ Treaty establishing a Constitution for Europe. Official Journal C 310, 16 December 2004. <http://eur-lex.europa.eu/en/treaties/dat/12004V/htm/12004V.html>. One innovation which the Constitutional Treaty would have introduced is some reduction of the veto powers of Member states in the Council of Ministers.

*The Dell Theory stipulates: No two countries that are both part of a major global supply chain, like Dell's, will ever fight a war against each other as long as they are both part of the same global supply chain.*¹⁵

And probably there is more than just this. As Robert Cooper has observed, for post-modern states "foreign policy is the continuation of domestic concerns beyond national boundaries and not vice-versa".¹⁶ In the case of the EU, this has some specific implications. Quoting again from Moravcsik:

*Europe is a "quiet super-power", wielding influence over peace and war as great, perhaps greater, than that of the United States. (...) Over the past decade, Europe has deployed these instruments to help democratise and pacify up to 25 countries on its Eastern periphery – a record US military power cannot match.(...) Europe, the United States, the West, and the world as a whole would be better off if each side of the Atlantic did what it does best. Complementarity and comparative advantage, not conflict and competition, should be the watchwords.*¹⁷

So it seems likely that there is an agenda for international relations on top, or at the side, of the agenda for the IM. However, this clearly would not be my cup of tea, so for what follows I'll stick with the first agenda.

4. One market, many social models. Up to what point?

In this section I propose to examine some diversities of economic performance that emerge, within the IM, among the different member states. In particular, I will tentatively correlate such diversities with the different models of social policies that have been adopted within each EU country. Also, I shall document to some extent how both policy inputs and economic performances have evolved in recent years. On the other hand, I have chosen not to deal with the different characteristics and current shortcomings of the IM across the EU.

In addition, I have chosen to extend the comparison, as far as feasible, to the whole set of the current EU 27 members. In order to do this in a meaningful way, I

¹⁵ Thomas L. Friedman (2006, p. 522). Hopefully this theory will last longer than its predecessor, the so-called "theory of democratic peace". See Kiron K. Skinner and Thomas Schwartz (1999).

¹⁶ Robert Cooper (2003, p.53).

¹⁷ Andrew Moravcsik (2003).

will focus only on the short period from 2000 to 2005. This choice is motivated by two reasons. First, by the year 2000 the ten transition countries which have now entered into the EU had by most standards completed the period of transitional “confusion”. Everywhere post-transition output had completed its U-shaped path; each country had been fully democratic for quite some time; and each was about to qualify as a full market economy. Second, Eurostat has now assembled a rich data set of indicators, where all EU-27 members are adequately represented at least since 2000.¹⁸

Moving on to the analysis of these data, the questions I want to address are:

- Is it correct to group EU members within 4 social models, as it had been suggested by, among others, by Boeri (2002) and Sapir (2004)?
- Do the groupings within each model stay constant across time?
- Do all the 27 members fit within these models, and precisely where?
- What defines countries to be member of one or another social model? Is it the adoption of certain policies (“policy inputs”), or the realization of certain achievements (“outcomes”), or both?
- What can we say about the economic performance of countries within each model? ¹⁹

This section is divided in several parts. Section 4.1 describes the “four models” at the basis of the analysis. In section 4.2, these are re-appraised in reference to the member states of EU-27. Outcomes of social policies are examined in some more detail in section 4.3, and in section 4.4 they are related to different policy inputs. Selected indicators of economic performance are presented in section 4.5. Section 4.6 sums up the evidence gathered in the previous parts (some readers may possibly prefer to jump directly there), while section 4.7 poses the question

¹⁸ Although the Eurostat data play the greater part in my dataset, in many cases I have complemented them with data from other sources. See the Data Appendix.

¹⁹ In addition to these, there are other questions that I would like to address, but have postponed for the time being: Why do countries (choose to) belong to one social model or the other? Are switches between models feasible? Or instead, is it more likely to observe convergence? What causes the decision to switch, or to converge? Do we also see model (or policy) reversals? And what does cause them? In particular, is a decision about policy change related to the bad performance of the policy itself, or to its unfavorable economic performance? How are economic performances reflected in the policy choices of each member state, and in particular how are they mediated through the changing preferences of the electorate? These questions, however, will hopefully be addressed in some follow-up papers.

whether the data suggest that any convergence is taking place across the different models.

4.1 The Four models

Box 1 recalls a well-known definition of the four models of social policy prevailing in the EU at the end of the 20th century.

Box 1

The Four social policy models according to Boeri (2002)

Tito Boeri (2002), following Ferrera (1998) and Bertola et al. (2001). suggests that the EU-15 members could be assigned to four different social policy models, covering four different geographical areas:

“There are, first of all, the **Nordics** (Denmark, Finland and Sweden, plus The Netherlands which is a hybrid between the Scandinavian and the Continental models and has recently moved Northwards) featuring the highest levels of social protection expenditures, and universal welfare provision based on the citizenship principle. Extensive fiscal intervention in labour markets, based on a variety of “active” policy instruments, substantial tax wedges, and relatively extensive employment in the public sector also belongs to this model while unions' presence in the workplace and involvement in the setting and administration of unemployment benefits generates compressed wage structures.

Next, we have the **Anglo-Saxon** countries (Ireland and the UK), which are closer to the Beveridgian tradition and feature relatively large social assistance of the last resort schemes. Cash transfers are primarily oriented to people in working-age. Activation measures are important as well as schemes conditioning access to benefits to regular employment. On the labour market side, this model is characterized by a mixture of weak unions, comparatively wide and increasing wage dispersion and relatively high incidence of low-pay employment, half-a-way between Europe and the US.

Continental European countries (Austria, Belgium, France, Germany, and Luxembourg), the third group, rely extensively on insurance-based, non-employment benefits and old-age pensions. Large invalidity benefit schemes are also present, which rely on contributions on employment income, along the Bismarckian tradition. While unions' membership rates have been falling quite dramatically in the last 20-25 years (Boeri, Brugiavini and Calmfors, 2001), a strong unions' influence has been to a large extent preserved by regulations artificially extending the coverage of collective bargaining much beyond unions' presence.

Finally, we have the **Mediterranean** countries (Greece, Italy, Spain and Portugal), concentrating their spending on old-age pensions and allowing for a high segmentation of entitlements and status. Their social welfare systems typically draw on employment protection and early retirement provisions to exempt segments of the working age population from participation in the labour market. Also in this case, strong unions' influence has been preserved by practices (e.g., jurisprudence) artificially extending the coverage of collective bargaining. As a result, wage structures are, at least in the formal sector, covered by collective bargaining and strongly compressed in these countries."

Boeri also suggests that: "Three are the main tasks assigned to labour and social policies: (i) reduce poverty and, more broadly, income inequalities, ii) protect against uninsurable labour market risk (and its interactions with longevity risk), and iii) increase the rewards from labour market participation."

Of these tasks, according to Boeri the third one is especially crucial to the macroeconomic performance of the EU, and also to the success of the Lisbon Strategy:

"The macroeconomic performance of Europe in the years to come, its ability to become "the most dynamic economy of the World" will very much depend also on its capacity to score better than the US also **on the third criterion.**"

"... Increasing **competition among systems** in Europe have the potential to result in better outcomes in Europe in terms of the third criterion and are not incompatible with a persistently better record of Europe in terms of criteria i) and, possibly, ii)."

"However, competition among systems take a long time to materialise. **EU supra-national authorities may play some role in speeding up this process** only if they resist the temptation to impose a particular social model over the others and rely instead on the mobility of the European workforce as a driving force of political integration and social policy convergence."

But why do different countries choose different models of social policy? In his analysis, Boeri observes that "protection against uninsurable labour market risk is typically provided in two ways: (i) by imposing legal restrictions against firing – the so called employment protection legislation (EPL); (ii) by providing unemployment benefits in addition to those established by collective bargaining (UB). The differences between these two systems are clear: EPL protect those who already have a job, and do not impose any tax burden; UB can also be targeted to specific groups, but generally provide insurance to the population at large and are typically financed by a tax on those who work. Thus insiders, those with a stable and regular job, typically prefer EPL to UB".

Figure 1 effectively shows how EU countries, toward the end of the 1990s, were characterized by different positions along the EPL-UB tradeoff. In this picture, the four models emerge with sufficient distinction from each other.

[Figure 1 : Boeri 2002]²⁰

[Figure 2 : Sapir 2004]

Following along similar lines of reasoning, Sapir (2004) evaluates the performance of the four models according to the third criterion, that is how they may stimulate labor market participation. He observes that the performance of the four models can be usefully compared “with a typology based on two criteria: efficiency and equity. A model will be considered **efficient** if it provides sufficient incentives to work and, therefore, if it generates relatively high employment rates. It will be deemed **equitable** if it keeps the risk of poverty relatively low.” This comparison is depicted in Figure 2. The four models again appear neatly.

4.2. The four models and beyond: a reappraisal for the EU-27

Two questions immediately spring out from the previous section:

- (i) Is the diversity of labor market policies adequately described by the EPL-UB tradeoff?
- (ii) Is there a systematic link between the adoption of a policy stance and the specific position which the adopting country takes on the equity-efficiency tradeoff?

In short, the answer to both questions will be negative. To begin, we examine to what extent the four models proposed in the previous section are still helpful to characterize the EU members. Three things have changed, since the studies we referred to previously: time has passed and so, possibly, some countries have had time to improve the old, or adopt new policies; new members have joined in the EU; and we have more and better statistics.²¹

²⁰ All the figures are shown at the end of the paper.

²¹ The Data Appendix briefly describes the sources from which we have assembled the data analyzed in these sections.

Table 1 – Labor market programmes and EPL strictness

		Expenditure in LMP, % of GDP 2005						EPL Strictness Index 1-6 - 2003	
		Active	Rank	Passive	Rank	Total	Rank		Rank
European Union (15)	eu15	0,55	=	1,41	=	2,20	=	=	=
Austria	at	0,46	12	1,51	7	2,14	8	2,2	10
Belgium	be	0,85	3	2,36	2	3,45	2	2,5	6
Bulgaria	bg	0,44	13	0,22	21	0,73	15	..	
Czech Republic	cz	0,12	20	0,24	20	0,49	21	1,9	13
Denmark	dk	1,43	1	2,51	1	4,10	1	1,8	14
Estonia	ee	0,05	24	0,12	24	0,19	24	..	
Finland	fi	0,71	5	1,90	5	2,75	5	2,1	12
France	fr	0,66	6	1,63	6	2,52	6	2,9	4
Germany	de	0,62	7	2,35	3	3,32	4	2,5	7
Greece	gr	0,06	23	0,44	15	0,51	20	2,9	3
Hungary	hu	0,20	16	0,39	16	0,68	16	1,7	15
Ireland	ie	0,48	10	0,83	12	1,50	11	1,3	17
Italy	it	0,46	11	0,82	13	1,31	12	2,4	8
Latvia	lv	0,15	18	0,32	18	0,54	19	..	
Lithuania	lt	0,15	19	0,12	23	0,34	23	..	
Luxembourg	lu	0,22	15	0,67	14	0,89	14	..	
Netherlands	nl	0,85	3	2,02	4	3,36	3	2,3	9
Poland	pl	0,36	14	0,86	11	1,22	13	2,1	11
Portugal	pt	0,52	9	1,29	9	1,95	10	3,5	1
Romania	ro	0,10	22	0,36	17	0,49	22	..	
Slovakia	sk	0,17	17	0,27	19	0,61	18	1,6	16
Spain	es	0,58	8	1,46	8	2,13	9	3,1	2
Sweden	se	1,10	2	1,20	10	2,48	7	2,6	5
United Kingdom	uk	0,12	21	0,19	22	0,67	17	1,1	18
Rank correlation		Between Active and Passive: 0,87				Between Total and EPL: 0,27			
<i>Legenda:</i> Active = categories 2-7 (LU: only 3-7); Passive = categories 8-9 Total = includes also ex. in labor market services (cat. 1), except for LU and PL									
<i>Sources:</i> Expenditure data: Eurostat (n.a. Cyprus, Malta, Slovenia) EPL data: OECD (n.a. Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Slovenia)									

4.2.1. EPL vs UB: no longer a tradeoff?

In this section I would like to ascertain whether a tradeoff still exists between the amount of (ex ante) protection (measured by the strictness of EPL) and the amount of (ex post) insurance (measured by the payment of UB) and possibly also by the participation to other, labor market programmes). Let us first look at the data assembled in Table 1. The first six columns display expenditures in LMP as a ratio to GDP for all available EU countries, as well as their respective rank. We distinguish between expenditures on active programmes, passive (UB, redundancy and early retirement) and total. As a reference, the average expenditure in the EU 15 for active programmes is 0.55% of GDP, and for passive programmes is 1.41: roughly a 2:5 ratio. In general, countries that are generous on one dimension tend to be so also on the other: The rank correlation between expenditures in active and in passive countries is 0.87.

The group of the most “generous” countries includes, in the first 7 positions, the four Nordic and three Continental countries (BE, DE, FR). Most of these countries keep the same rank for both active and passive LMP: the two exceptions are SE, which is 2nd in the ranking for active programmes, and 10th for passive, and DE, which on the contrary is respectively 7th and 3rd.

The group of the least generous includes the three Baltic countries and CZ, GR, RO, SK: and also in these cases each country has similar positions in both rankings.

On the other hand, if we compare generosity in LMP with strictness in EPL, the rank correlation is very low (0.27), but on the whole positive. The group of the seven “strictest” countries (index 2.5 or above), includes four which are also among the most generous (BE, DE, FR, SE). With the exception of SE, the other Nordic countries however are out of this group.

The same data are shown in Figure 3.a, where I have plotted the index of EPL strictness against the GDP ratio of total expenditure (active and passive) on all labor market programmes (LMP).

[Figure 3.a : graph_1.0.5_2005a]

In Figure 3.b, instead, I have plotted EPL strictness against a measure of standardized UB.²² The overall picture is similar to the one that we have already observed. Countries seem to fall essentially in three groups, according to the generosity of the UB system:

- *less than 25% of YPC*: GR, UK, and the four Visegrad countries (CZ, HU, PL, SK);
- *between 30-60%*: all the Continental countries; three Mediterranean (IT, ES, PT); two Nordic (FI, SE); IE;
- *above 80%*: DK and NL.

[Figure 3.b : graph_1.0.3_2005b]

On the other dimension (EPL strictness), eight countries (from the first two groupings) are rather strict (between 2.5 and 3.5): the four Mediterranean countries, plus Belgium, France, Germany and Sweden. However, the two dimensions do not seem correlated, and it is hard to identify the four models suggested by Boeri. In general, however we chose to look at the data, the tradeoff does not appear anymore.

Let us then search for other, possibly revealing ways of differentiating labor market policies across countries. Countries differentiate from each other not only for the amount they allocate to each of these (sub)programmes, but also for the number of intended beneficiaries: although the target is in general the stock of those currently unemployed, of course not all unemployed will always be entitled to payments, and on the other hand in many cases the beneficiaries may extend beyond those currently registered as unemployed. A simple way to look at this question is to compare the number of unemployed person to the number of participants to all LMP. As Figure 4 shows, in many countries the latter group is much larger: especially so in BE and DE, but also in all other Continental and Nordic countries, and in IE and ES.

[Figure 4: graph_0.3]

This graph suggests that we should look at how are participants to LMP divided between those who take part in "active" and "passive" measures (the latter being UB, redundancy and early retirement programmes). This is done in Figure 5, where

²² In Figure 3.b, UB are measured by taking for each country the total expenditure on out-of-work income maintenance and support, divided by the number of unemployed people and by that country's income per capita.

both variables are measured as % of the labor force. In addition, the size of each circle is proportional to the GDP share of all LMP expenditures for that country.

[Figure 5: graph_0.4]

Most countries fall along a 2:1 line, that is, of approximately two participants to passive policies (mostly UB) for each one participant to active policies. Within this line, there are more generous countries (the four Continentals and the four Nordics, plus Ireland), and less generous countries (the UK and most new member States, NMS).^{23,24} This picture also makes clear that those countries, which are more generous in terms of participants to LMP, are also often more generous in terms of the share of GDP devoted to such policies.

Another way to characterize the data is to single out on one side the expenditure on UB, and on the other all kind of labor market related expenditures: not only for active and passive LMP, but also payments of sick leave. This is done in Figure 6, where policies are again weighted by their share in GDP. The more a country is closer to the 45° line on the vertical axis, the more its labor market policies rely on UB.

[Figure 6: graph_0.2]

The main division line appears again on the basis of relative generosity: in the least generous group (between 0.5 and 2.5 of GDP) we find three Mediterranean countries (GR, IT, PT), the two Anglo, and AT, CZ, HU. All the other countries spend between 3-5% of GDP on LMP, while DK is close to 6%. However within each group some countries rely more on UB (GR, AT in the first; DE in the second), the others less. In particular CZ, HU and UK from the first group and SE from the second allocate less than 1/3 of total expenditures on LMP to UB.

Summing up, in 2005 and after the new members' accession, the EPL-UB tradeoff does not provide a useful way to summarize the different attitudes of EU members towards labor market policies. Instead, it seems more reasonable to distinguish essentially two groups:

²³ PL, SI, and GR are not included in the graph, but they would fit in this group too. PT, instead, would appear considerably more generous, and also with a remarkable preference for passive measures.

²⁴ Only few countries have more participants to active than to passive LMP (that is, they fall below the 1:1 line). Of these, the more generous ones, in terms of participants involved, are ES and SK.

- Countries with generous LMP: the four Nordic, plus BE, DE and FR, followed by AT, ES and PT and, in terms of participants involved, especially for UB programmes, also IE. Within this group we find both countries with strict EPL regulations (PT, ES, FR, SE, BE, DE) and others that are very permissive (DK, FI).
- Countries with least generous LMP: the three Baltic states and most other NMS (with PL relatively more generous), followed by GR, UK and IT. Also here we find countries with permissive EPL (UK, IE, SK, HU, CZ) and other which are very strict (GR).

On average, the beneficiaries of UB are double in number than those on other (active) LMP – except in ES, SK, BG, IT, LT, where the ratio of beneficiaries is closer to 1:1. However, if we look at expenditures, the budget for UB in most countries is about half of the overall budget for LMP and sick leave: hence, on average, beneficiaries of UB are treated much more cheaply relative to beneficiaries of other programmes.

4.2.2 Equity vs. Efficiency: making room for the new entries

Let us now turn to the equity vs. efficiency tradeoff. To this purpose I update Figure 2, including 25 out of the 27 EU members.²⁵ Also, since in this case we have data over a longer period, let us begin to examine the year 2000 (Figure 7a). For this year we notice:

- The “Continental” group is quite reduced: only BE and LU remain as countries with low poverty risk and also low employment rate, but have been joined by HU and SI.
- DE and CZ have joined AT and the “Nordic” group (low poverty risk, high employment rate)
- The Anglo group (high poverty risk, high employment rate) continues to include IE, UK and also PT.

²⁵ Note that in passing from Fig. 2 to 7a the vertical scale has been inverted. Also I will continue to name the four groups according to the Boeri-Sapir distinction, although they have lost part of their geographical connotation.

- Most of the new entries are in the “Mediterranean” group (high poverty risk, low employment rate): in addition to GR, ES, IT there are now most NMS: BG, EE, LT, LV, PL, RO. Also FR and MT have approached this group.

In any case, the graph maintains a heuristic value, as it vividly represents the “Equity vs. Efficiency” choices of different countries, with the Mediterranean model being ineffective on both counts.

[Figure 7.a : graph_1.1_2000]

[Figure 7.b : graph_1.1_2000-2005]

However, things move, and sometimes even for the better. The race to abandon the Mediterranean model before it sinks is open, and some do succeed! Figure 7.b documents this dynamism, over the period 2000-2005. Overall, the EU-15 average has moved towards the Anglo model, but (taking account of all 25 countries):

- The prevailing fact is that employment rates have increased, especially in the Mediterranean group.²⁶
- The three Baltic countries are now in an intermediate position between the Mediterranean and Anglo groups.
- FR (back in the Continental group) is the only country that has considerably improved its position on the Equity dimension.
- PL and RO unfortunately move out in the wrong direction, drifting towards both inefficiency and inequity.

4.3 Social policy outcomes

The benchmark measure of equity assumed by Sapir (and several others) is the poverty rate after social transfers. Let us examine some additional closely related measures of social outcomes.

i) How good are social systems at reducing poverty risk? To answer, we look at the data for 2005, in Figure 8.a. Notice that:

²⁶ The increase in employment rates is not related to cyclical factors. To ascertain this possibility, we recomputed the employment rates, adjusting them for the output gap (Details of the adjustment are available from the author). The resulting new graph is however not meaningfully different from Figure 7.b.

- ✓ Countries more to the right have, in general, a harder task at reducing poverty.
 - ✓ Countries above the line do, in general, a worse job at this task.
- Nordic, Continental, and CEU (that is: CZ, HU, SK) are all quite good, although some (BE, DK, FI, HU, SE) start with tougher cases: at which, however, they seems to be quite successful!
 - Mediterranean, Anglo and Baltic countries seem to be rather worse, although the harder initial task is for IE and PL

[Figure 8.a : graph_2.1_2005]

In general, it is noteworthy how the countries that we identified as “generous” in section 4.2.1 are also, with the exception of ES, those most successful at reducing poverty risk.

ii) Figure 8.b compares the same performances between 2000 and 2005. This I found interesting: in particular, it is striking how most countries (especially: HU, FI, SE; but also: BE, CZ, DE, MT) managed to keep almost unchanged the poverty risk after social transfers, despite the heavy worsening of the ex ante conditions. Instead, the opposite can be said of PL: grave ex post deterioration with no ex ante worsening.²⁷

[Figure 8.b : graph_2.1_2000-2005]

iii) How representative is the poverty risk measure? As we can see, it is well correlated with other measures of the income distribution, such as the quintile ratio (Figure 9) and the Gini coefficient (Figure 10).

[Figure 9 : graph_2.2_2005]

[Figure 10 : graph_2.3_2005]

4.4 Policy outcomes vs. inputs

How do policy outcomes relate to the policy inputs? Let us first examine the relation between expenditure on all LMP (relative to GDP) and poverty risk (Figure 11). Three groups of countries stand out:

²⁷ There is no evidence that this deterioration is purely cyclical, since the GDP of PL for 2005 is almost identical to the potential.

- *High poverty risk, low expenditure* on LMP: the three Baltic states, the four Mediterranean states, the two Anglo states, plus PL and RO;
- *Low poverty risk, low expenditure* on LMP: three of the four Visegrad countries (CZ, HU, SK), plus BG and LU;
- *Low poverty risk, high expenditure* on LMP: the four Continental and the four Nordic countries.

[Figure 11 : graph_3.3_2005]

In general, Figure 11 shows a clear, negative relation between the ex post poverty risk and the extent of expenditures on LMP. In relation to our previous findings, we observe that:

- All countries with a high proportion of people at risk of poverty after transfers belong in the group of countries previously identified as least generous in terms of LMP
- Among the countries with a low (below 15%) poverty risk, we find both some of those previously identified as “least generous” countries and all the generous ones (with the exception of ES).

Moreover, as Figure 12 shows, expenditures on LMP are also positively (albeit weakly) associated with employment rates. On the other hand, the relation between expenditures on LMP and unemployment rates exhibits a wider dispersion, since, at lower rates of unemployment, one finds the coexistence of countries with both high and low levels of expenditures.²⁸ However the overall impression (Figure 13) is of a negative relation, thus pointing to the fact that LMP do not appear to encourage unemployment, or to contrast the attainment of high employment rates.

[Figure 12 : graph_3.8_2005]

[Figure 13 : graph_3.13_2005a]

If we examine other indicators of labor market policies, instead, their relation with labor market outcomes is less favorable. For instance, Figure 14.a depicts a weak but negative association between the Union Protection Index and employment rates, and Figure 14.b gives no evidence of any degree of association between EPL and employment rates.

[Figure 14.a : graph_3.10_2005]

²⁸ The same relations emerges if, instead of payments for all LMP, we consider only UB.

[Figure 14.b : graph_3.9_2005]

These graph point to the fact that, contrary to LMP, purely defensive policies, that attempt to “rule out” supposedly labor-unfriendly behavior, are not associated with positive employment outcomes. On the contrary, Figures 15.a and 15.b show that, if anything, they are associated with negative unemployment outcomes

[Figure 15.a : graph_3.15_2005]

[Figure 15.b : graph_3.14_2005]

4.5 Economic performance

Although the main purpose of this section is to show the diversity of labor market policies across EU members, it may be useful to conclude this overview by showing that employment rates are favorably associated to various indicators of economic performance. Hence, ranking countries on the basis of their employment rates provides a reasonably good preliminary indicator of an efficient economy.

First, Figure 16 shows that most countries that have increased their employment rates between 2000 and 2005 have also, at the same time, improved or kept their GDP *per capita*, relative to the EU 25 average. This is true in particular for BG, CY, EE, ES, GR, IE, LT, SI: a *prima facie* dismissal of the “lump-of-labor” fallacy.

[Figure 16 : graph_4.1_2000-2005]

Focusing in particular on long-term unemployment, we see from Figure 17 that reduction in long-term unemployment and increase in employment rates generally move together (and *viceversa*). An unfortunate exception is SK.

[Figure 17 : graph_4.4_2000-2005]

What about employment rates and growth rates? If we plot growth rates for 2000-2005 against the employment rate in 2005, we really see two groups (see Figure 18, where I have fitted separate lines of best fit for each group):

- EU-15 countries, with growth rates on average quite low and a widely dispersed employment rates.
- NMS, where employment rates and growth rates (in the previous five years) appear positively correlated.

- Each group has its own “defectors”: GR and IE for the EU-15 and CZ and SI for the NMS.

[Figure 18 : graph_4.2_2005a]

It would be interesting to explore at length possible links between policies and outcome in the economic and social dimension. This is not feasible here, but I would like to use some space, before concluding, to point out at some interesting associations (or correlations) between policy indicators or outcome measures.

First, countries that have ensured their macroeconomic stability through disinflation (Figure 19) and/or by reducing their Government deficits (Figure 20) between 2000 and 2005 have done this at apparently no cost to their employment rate.

[Figure 19 : graph_5.1_2000-2005]

[Figure 20 : graph_5.2_2000-2005]

Similarly, while government size (measured as % of Govt. expenditures on GDP) is in general unrelated to employment rates, countries which have reduced the size of their government sectors have often also increased their employment rates: this is true for GR, ES, the Baltics, SI and SK. The main significant exceptions are RO and PL (who has done badly on both accounts) (Figure 21).

[Figure 21 : graph_5.9_2000-2005]

Employment rates seem also associated negatively (which means favorably) with the Ease of Doing Business (Figure 22) and Ease of Paying Taxes (Figure 23) indicators²⁹: Nordic and Anglo countries share the best positions with respect to these indicators.

[Figure 22 : graph_5.5_2005]

[Figure 23 : graph_5.7_2005]

Looking specifically at transition countries (among the EU NMS), Figure 24 shows that employment rates have increased in parallel with the process of enterprise restructuring.³⁰ PL and RO are the two only exceptions.

[Figure 24 : graph_6.3_2000-2005]

²⁹ Source: World Bank.

³⁰ Source: EBRD.

Finally, we look at three indicators that are related to how countries may be “laying the grounds for future growth and innovation”. Figure 25 documents the positive association between Expenditure on R&D and Employment rates, with the Nordic group again performing on top of the scale.³¹ Figure 26 documents the same positive association for the number of Graduates in science and technology and Figure 27 for IT expenditures.

[Figure 25 : graph_7.4_2005]

[Figure 26 : graph_7.6_2005]

[Figure 27 : graph_7.8_2005]

4.6 Summing up

What have we learned from this fact-finding exercise? I’ll tentatively sum it up as follows:

- Labor market policies are quite different across EU members. Although of course labor market insiders may still be fighting to defend or secure EPL, the extent of this protection does not seem to be the main discriminant line. Instead, it appears that both UB and Active Labor Market Programmes, and the relative mix between the two, are used quite differently across countries. The simplest way to describe countries is to say that Nordic and Continental countries plus Spain have broadly similar policies, in terms of both the *policy coverage* (which extends beyond the number of the currently unemployed) and of *policy generosity* (the size of LMP expenditures relative to GDP). However, within the group of the more generous countries, some are leaning more towards the use of UB (like Germany), others more towards active LMP (like Sweden).
- In terms of policy outcomes, the equity-efficiency paradox noticed by Sapir (2004) still appears: countries with a high poverty risk are also countries with low employment rates. In the first group or close to it one still finds (in 2005) Greece and Italy and most NMS (with the exceptions of the Czech Republic and Slovenia).
- A clear, negative relation appears between the ex post poverty risk and the extent of expenditures on LMP. Here three groups of countries emerge: *High*

³¹ Figure 25 and 26 are for 2005. The same pictures for 2000 would be very similar.

poverty risk, low expenditure on LMP (the three Baltic states, the four Mediterranean states, the two Anglo states, plus PL and RO); *Low poverty risk, low expenditure* (three of the four Visegrad countries - CZ, HU, SK), BG and LU); *Low poverty risk, high expenditures* (the four Continental and the four Nordic countries).

- In particular, however, it seems clear that countries which are more “generous” in terms of LMP are also those most successful at reducing poverty risk. Spain and Portugal provide an exception to this fact.
- Employment rates have increased in many countries (although for many the Lisbon objective is still far away). At least for the NMS, this is associated with higher growth rates.
- Countries that have been reducing inflation rates, or the government deficits, or the size of government expenditures, did not suffer any deterioration in their employment rates.
- In another dimension, several indicators of reform and of investment in a country’s future seem positively associated with employment rates. In particular, this is true for indicators of the Ease of Doing Business, Ease of Paying Taxes, Enterprise Restructuring (in NMS), R&D Expenditures and other Science and Technology-related indicators.
- Many of the above correlations can be interpreted as suggesting that policy measures that appear generically advisable in reference to sound micro and/or macro principles (in the social and in other dimensions) can be implemented without compromising overall efficiency. However, it will be interesting to study formally how different mix of labor market and social policies contribute to generate better economic and social outcomes: this will be a topic for future research.

4.7 Wither convergence?

Several of the graphs we have examined point to the fact that countries do “move”; that is, within our period of observation they have modified some policy indicator and possibly some outcome or performance indicator. A natural question to pose is: do such moves point to a pattern of convergence? Are countries

implicitly coordinating towards the acceptance of one *de facto* “European” social model? On these issues, I propose the following remarks:

- Most NMS (with the exception of the wealthier ones) featured in 2000 some aspects which rendered them affine to the Mediterranean model. Probably this was more a matter of fact (initial conditions) than of choice. But in general most countries have shown a tendency to move out of that model (the “sinking ship”), towards the Anglo model.
- The Continental model is on the move, and on many accounts Belgium, France and Germany (as well as Austria and the Czech Republic) have adopted some of the efficiency-improving features of the Nordic models. Spain is also moving in the same direction.

Table 2. Not yet an Anglo-Nordic model

	DK	SE	UK-IE
Net Replacement rates	Hi	Hi	Lo
Tax Wedge (cost of LM policies)	Hi	Hi	Lo
EPL	Lo	HI	Lo
UB duration	Hi	Me-Hi	Me
Spending on ALMP	Hi	Me-Hi	Lo

Source: Information provided in Zhou (2007).

- At the same time, the Anglo model itself has been evolving. For those aspects which we have examined in this paper, this is especially true for Ireland. Nevertheless, the differences between the Ireland and UK and most Nordic and Continental countries to date persist, at least in the field of LMP. Table 2, which has been drawn on the basis of Zhou (2007), confirms this point, in reference to various policies having a direct impact on labor markets. While some of the differences (such as the lower tax wedge) point in favor of the Anglo countries, others place the Nordic countries in a more favorable light. In any case, the two group of countries still seem rather apart from each other.³²

³² There are other dimensions of social expenditures by the public sector, which are not directly related to labor markets, but which have nevertheless an indirect impact on it. In this paper we have not examined them. Some scholars have pointed out that, if we took these policy measures into account, the UK would appear much less distant from the Nordic countries. This is not necessarily so. If we look at total social expenditures as % of GDP, the UK ranks 16th out of the 19 countries included in the OECD Dataset. However, a closer look at more disaggregated data suggests that it ranks 8th in terms of social expenditures towards the family, and first in terms of housing expenditures (in-kind benefits). Thus it might well be the case that these policies in the UK are an efficient substitute for LMP, which would be aimed more directly at the labor markets, and that

- However, it would be incorrect to think that all that matters is for each country to find and then possibly adopt the “best” (or possibly even a reasonably good) social model. A good social model is expensive (as also the Nordic experience proves), but high expenditure can produce good results and support a high degree of participation to the labor market if it is also coupled with other policies and institutions. It is up to these policies and institutions to generate sufficient incentives and mobilize enough resources, which in turn are conducive to high and increasing levels of productivity and of technological progress. Thus perhaps it is also in some of these characteristics³³ that lay the secrets of the Nordic success.

5. Conclusions

The EU is unique in many dimensions. Foremost among these is that its member countries share the largest common or internal market. Maybe this will not be for long, if other countries in other continents follow suit, which would be good, but at present it is a unique arrangement, unrivalled in scope and achievements.

The Internal Market is truly a common good. The IM itself is not a goal, but is the essential tool for many goals, and for many dimensions of our welfare. It needs to be completed and improved (although here I have deliberately chosen to gloss over all its current shortcomings). It needs to be complemented by other policies and other, non-conflicting agendas: among the former, social policies. Among the latter a common environmental and energy policy, and a common foreign, security and defense policy.

Some of these policies, as most policies that concern the IM directly, require centralization: hence exclusive or prevailing competence of the Community institutions. This goes for competition policy and for the common commercial policy in particular. In this field, individual member states should have no power of veto.

they might have contributed to ensure high employment rates. It is nevertheless true that on the basis of several measures of social outcomes (poverty rates, inequality measures) the UK still performs quite differently from the Nordic countries.

³³ These include informal institutions, such as the “civicness” so often referred to in expositions of the Danish welfare system. It also includes policies that lead to deregulation of product markets, high levels of R&D expenditures, that promote the importance and quality of scientific training and the ability of the financial sector to promote the growth of innovative firms. Some of these aspects are discussed in the EAAG Report (2007), chapter 4.

But the IM also thrives on diversity. And just as trade thrives on the diversity of the goods exchanged, so a Union of many peoples and cultures can only thrive on the diversity of social policies and institutions within its members. The first reason is subsidiarity. Following the principle of subsidiarity, social policies must be chosen and implemented democratically within each member state.

Another reason is that the same policies, even good policies, will have different effects when exported from one context into another. Many such effects will be unforeseen; some will be counterproductive. And there is no way to be sure *ex ante* what they are going to be. Each country must find its own way, by trial and error, but also by benefiting from the others' experiences.

The only possible reason to adopt uniform social policies, other than the arrogance of bureaucrats or of born-again central planners, is the fear that, left to their own, individual member states would engage in a competition to the bottom, leading to the disappearance of our welfare states. To take this fear seriously, however, requires a serious disregard for the ability of democracies (and electorates) to learn from mistakes and to ultimately yield welfare-improving choices. We should not share these fears. If one conclusion can be drawn from the data that I have described and interpreted so far, it is that they give no support to those who argue that decentralized social policies are leading to the disappearance of the welfare states. Quite to the contrary, the winners are often those who also chose to invest in their social policies and improve the institutions that implement them.

On the positive side, although social policies are ultimately to be designed and improved within each member state, EU institutions can be of help by suggesting flexible regulations, based on minimum standards, leaving room to the possibility for derogations and by proposing non-binding recommendations. But that would be a different story.

Also on the positive side, and an interesting topic for research, is the question of what makes the adoption of social models with desirable features possible in some countries, and quite difficult in others. Models of the status quo bias obviously provide the starting point for this analysis, but since we know that in principle such biases can be overcome by an appropriate design of credible compensations, the question remains open to analysis. In this respect, it is interesting to look at both

the old³⁴ and new member states of the EU. NMS are a particularly intriguing object of study, since they were all in need of extensive reforms, but then they chose quite different paths to reform from each other, thus coming close to being a sort of natural experiment.³⁵ To reach a proper understanding of the different motivations and outcomes of these experiments is another task for future research.

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³⁴ On reforms in the "old" EU members, and more generally in OECD countries, see Castanheira et. al. (2006) and Høj et al. (2006).

³⁵ The literature on the political economy of reforms (and of partial reforms and reform reversals) in transition countries is growing in size and interest almost by the day. See e.g. Hellman (1998), Roland (2002), World Bank (2002), Byung-Yeon Kim and Jukka Pirttilä (2006), and the Symposium edited by Jan Fidrmuc and John E. Jackson (2006).

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Appendix: The Data

For the purpose of this and subsequent research we have assembled on March-May 2007 a data set for the EU-27 members, based on several sources available through the Internet. The sources used for the calculations and the figures presented in this paper are:

Eurostat (<http://epp.eurostat.ec.europa.eu>): National Accounts and Public Finance data. Growth rates. Structural indicators on innovation and research, education, employment, unemployment, inequality and social cohesion, market integration and business demography. Expenditure and participants to labor market programmes.

OECD (<http://stats.oecd.org/WBOS/Default.aspx>): Expenditure on labor market programmes and EPL indicators.

European Bank for Reconstruction and Development (<http://www.ebrd.com/country/sector/econo/stats/index.htm>): Transitional indicators on privatisation, restructuring, liberalisation, and other reforms.

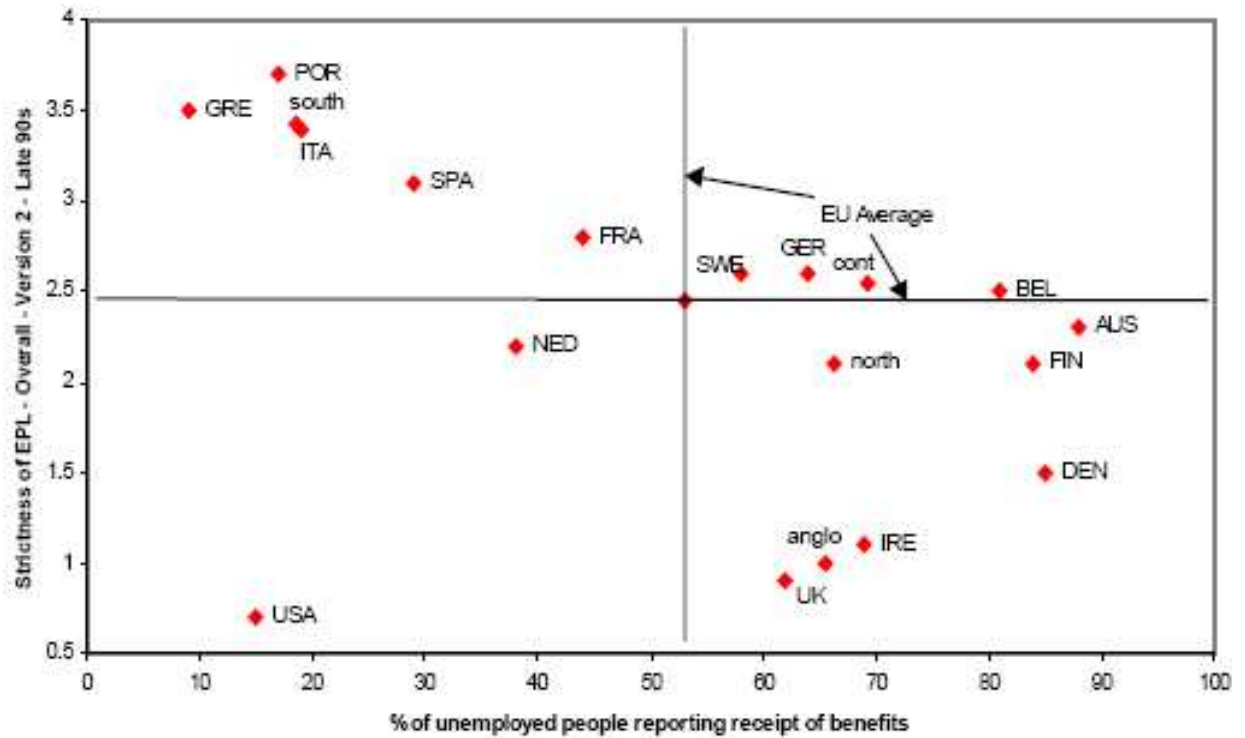
World Bank - World Development Indicators 2006 (<http://devdata.worldbank.org/data-query/>): Data on agriculture, energy, FDI, inflation, population.

World Bank - Doing Business (<http://www.doingbusiness.org/EconomyRankings/>) Data on ease of doing business, of employing workers and of paying taxes.

FIGURES

Figure 1

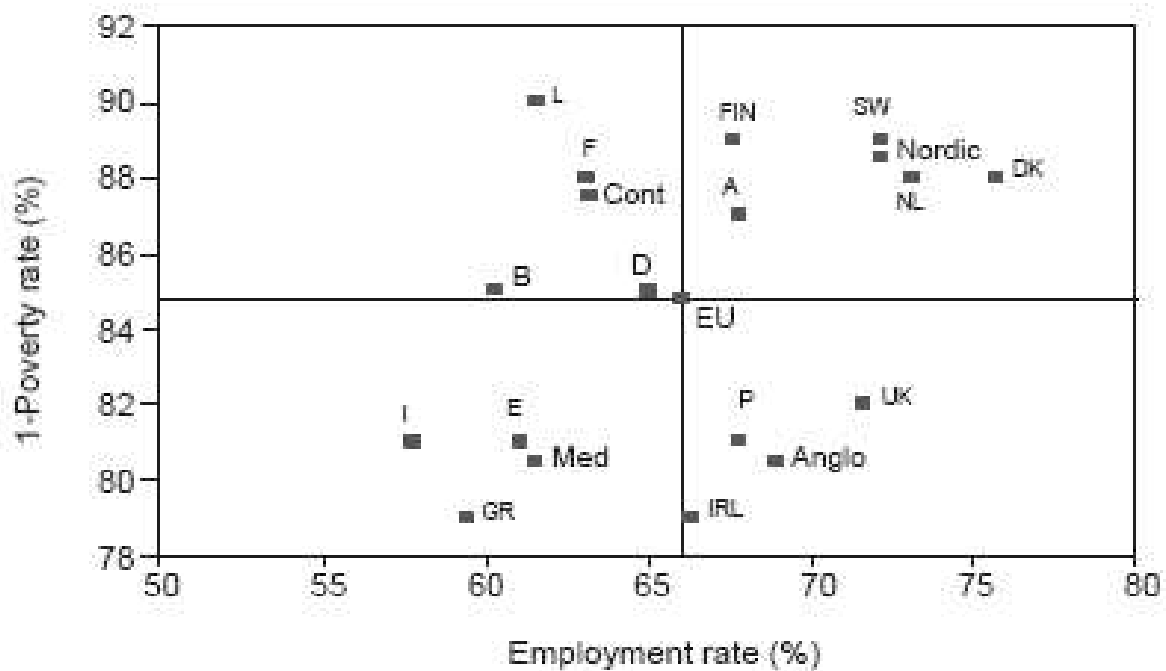
The EPL / UB Trade-Off



Source: Boeri (2002)

Figure 2

The Equity / Efficiency Trade-Off



Source: Sapir (2004)

Figure 3.a

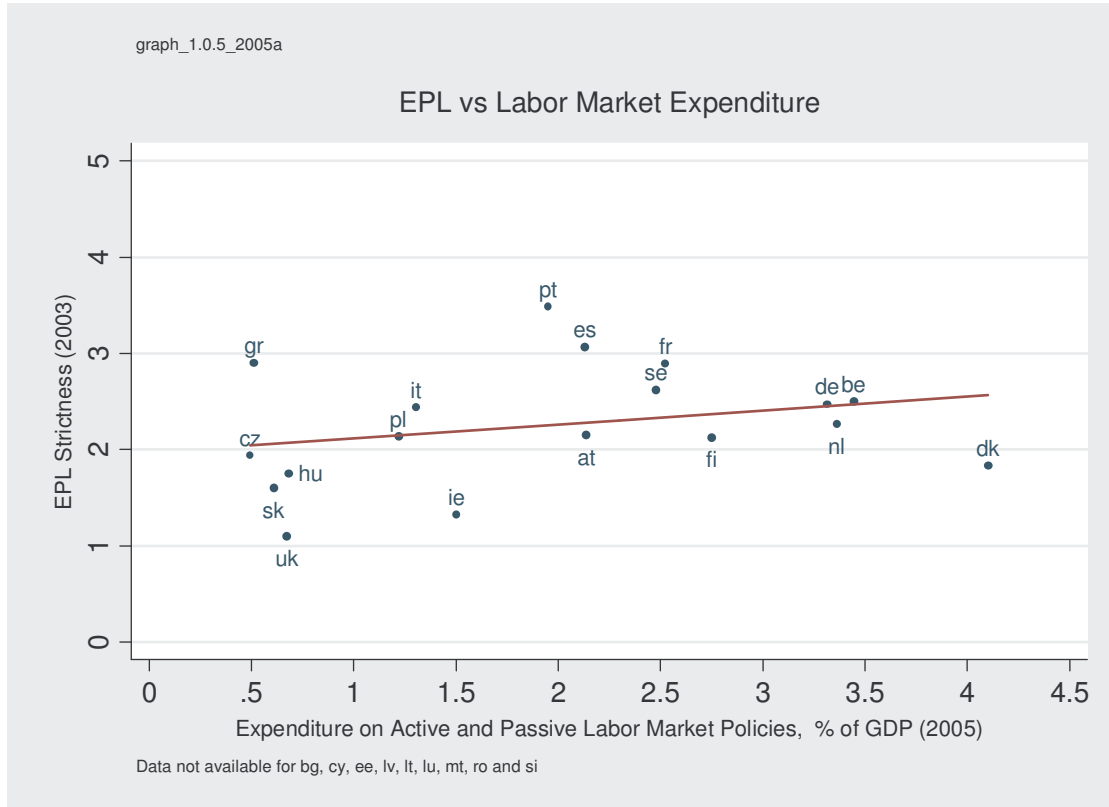


Figure 3.b

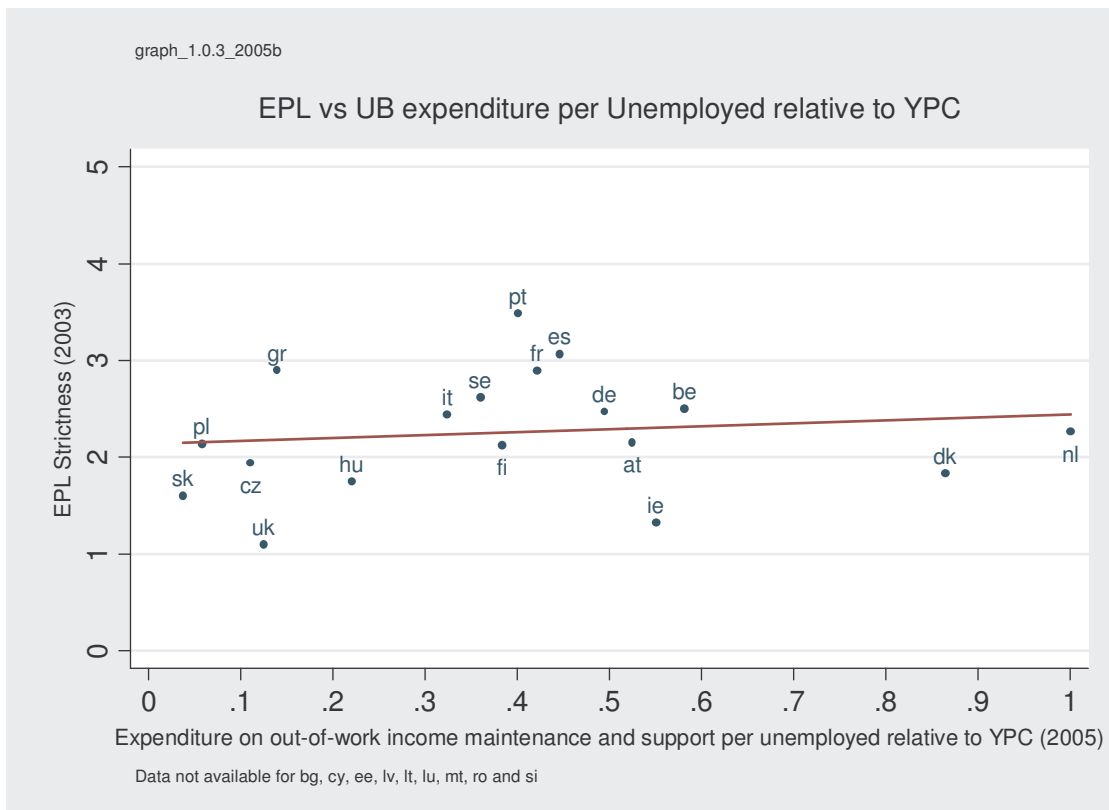


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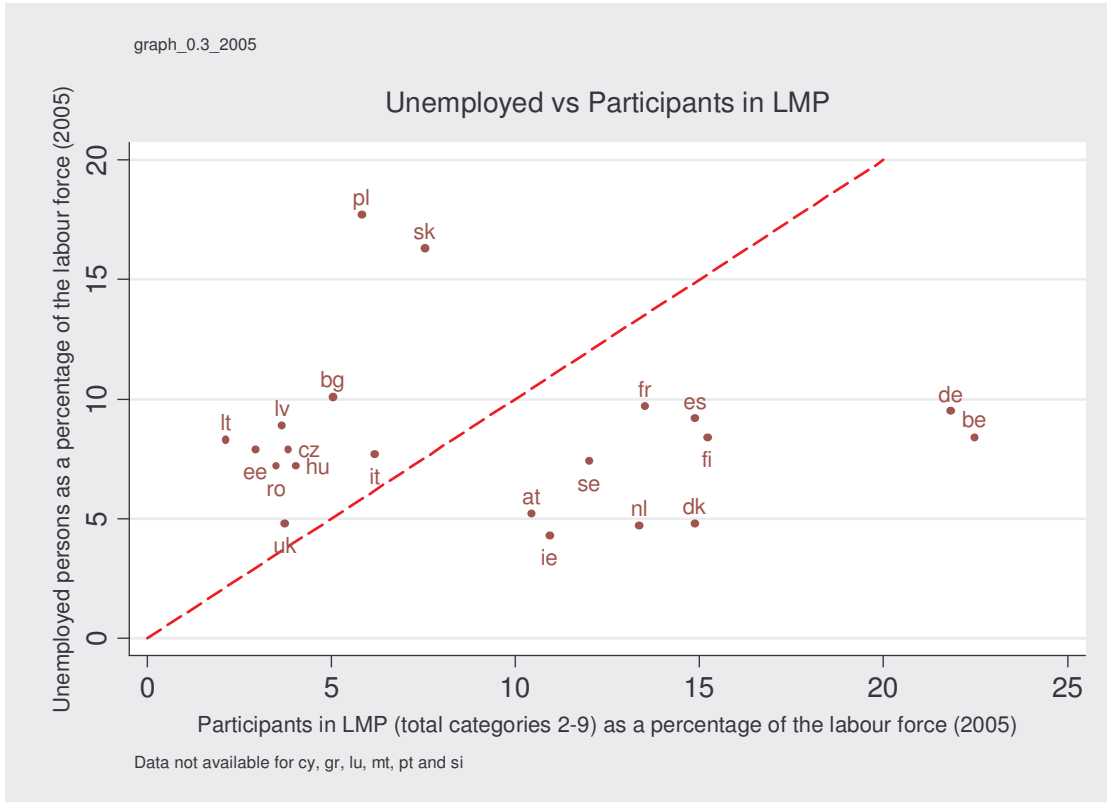


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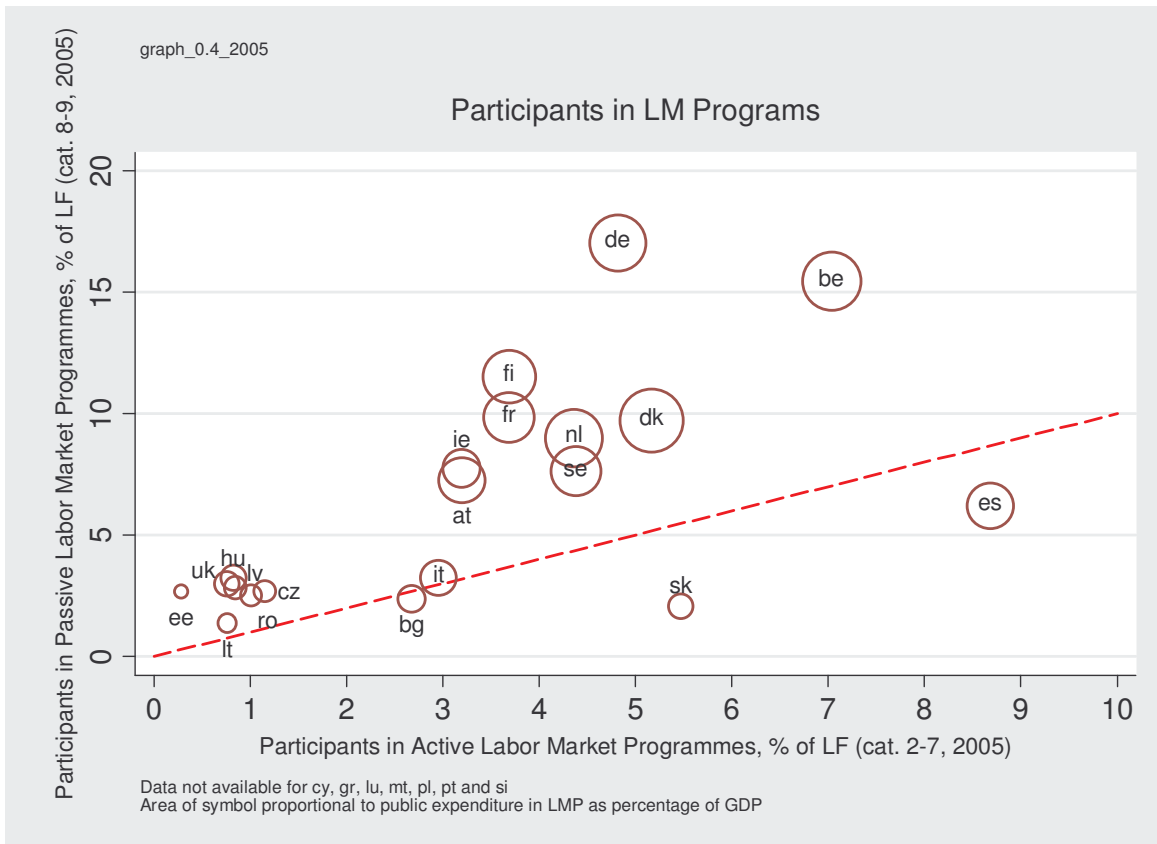


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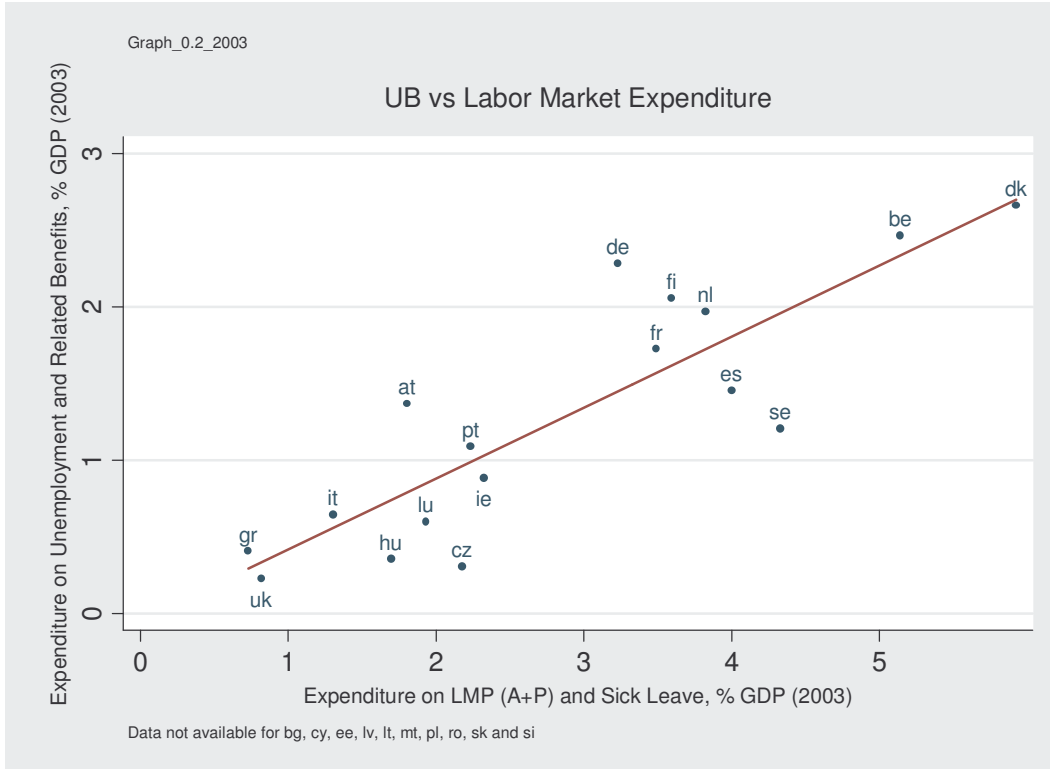


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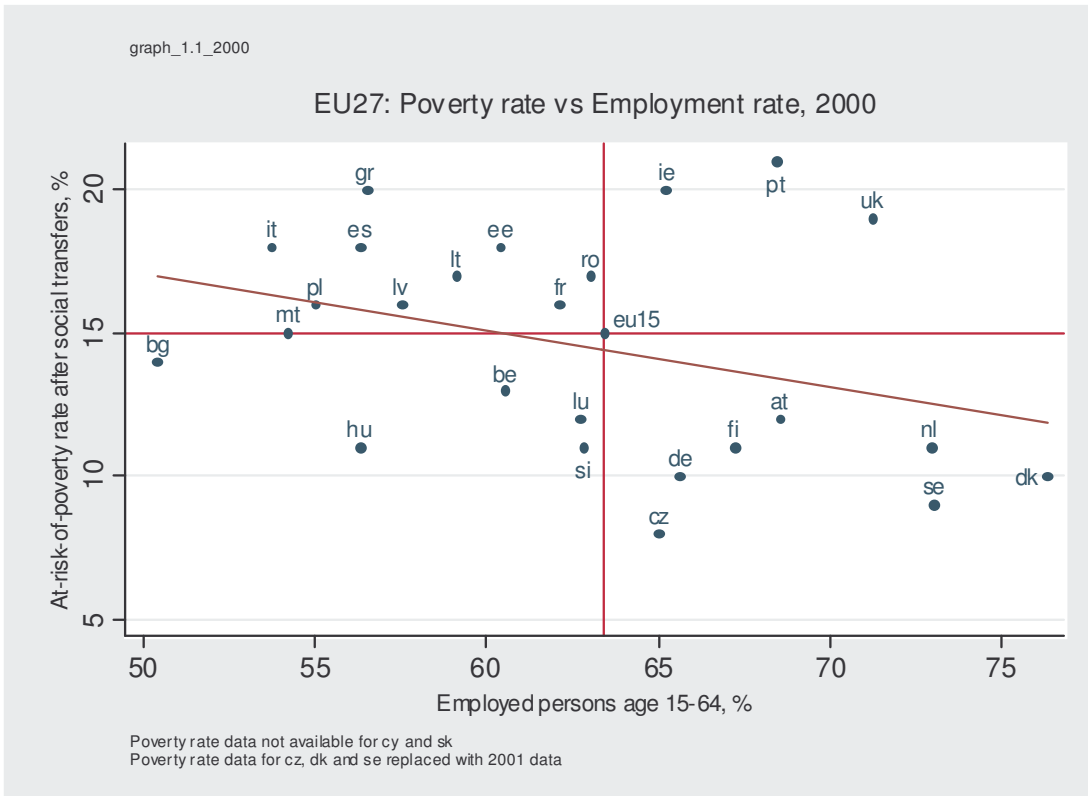


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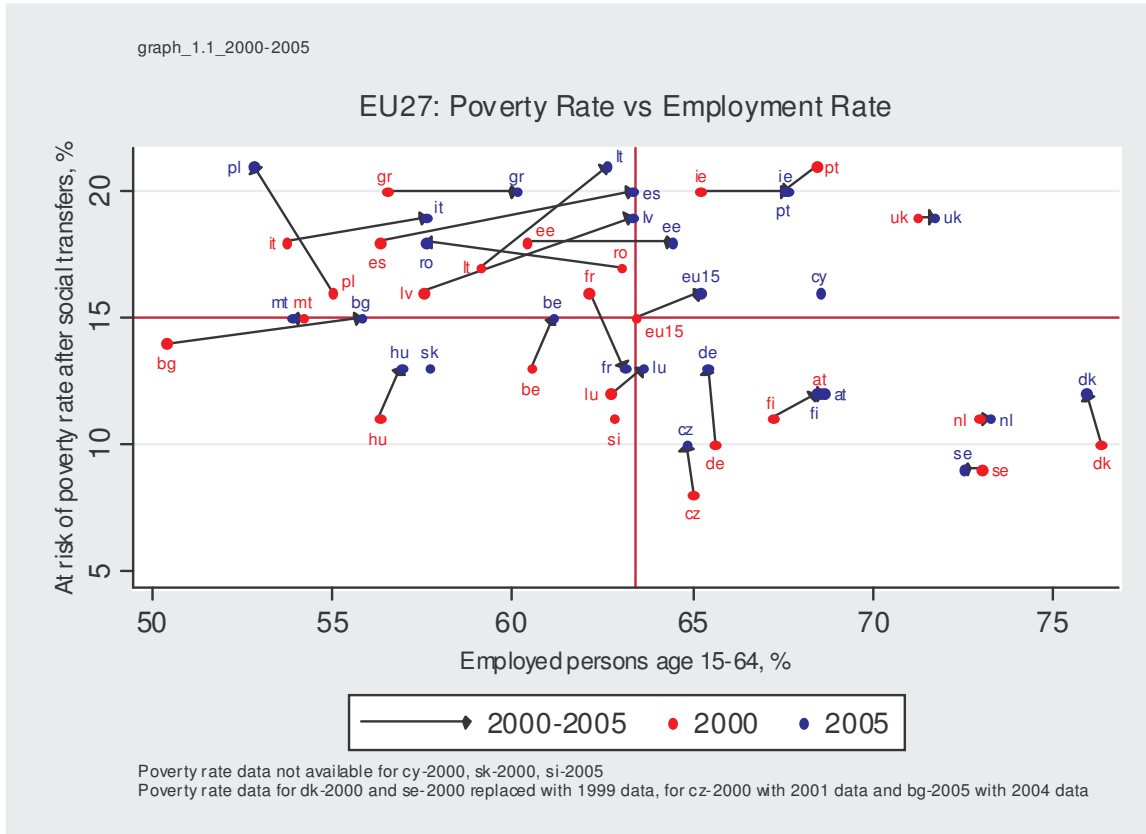


Figure 8.a



Figure 8.b

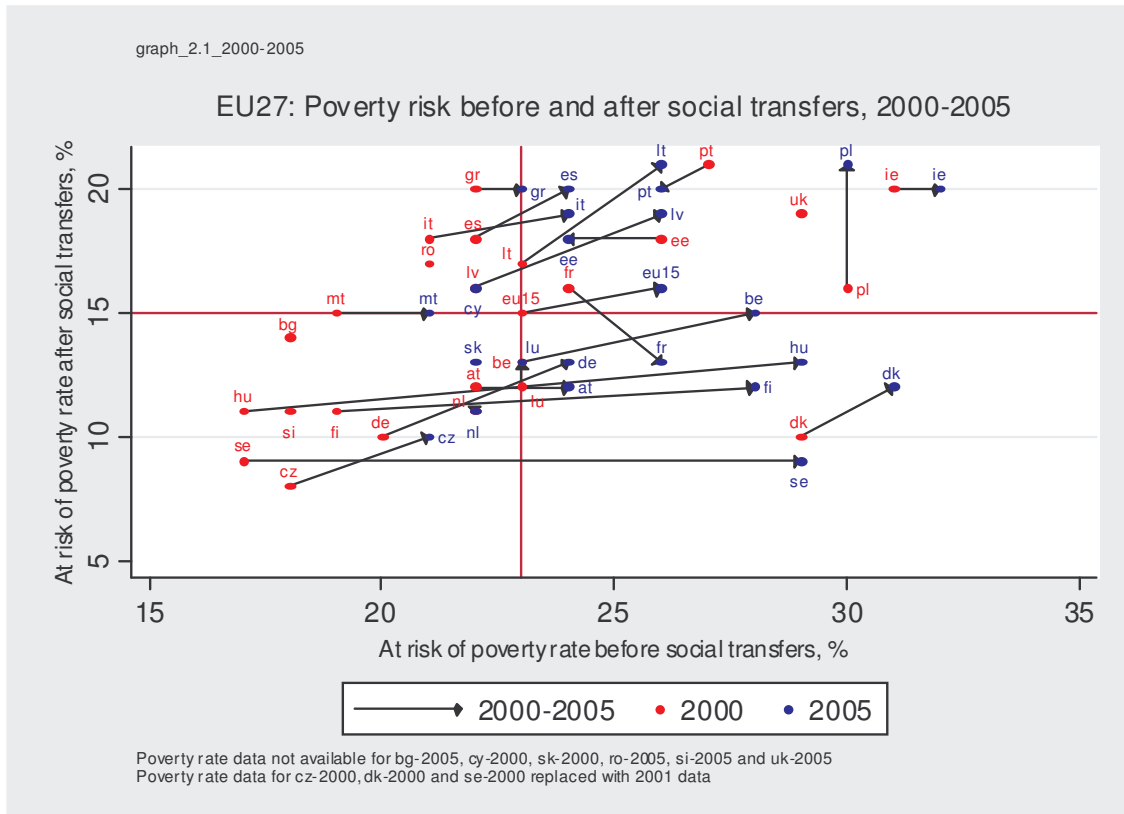


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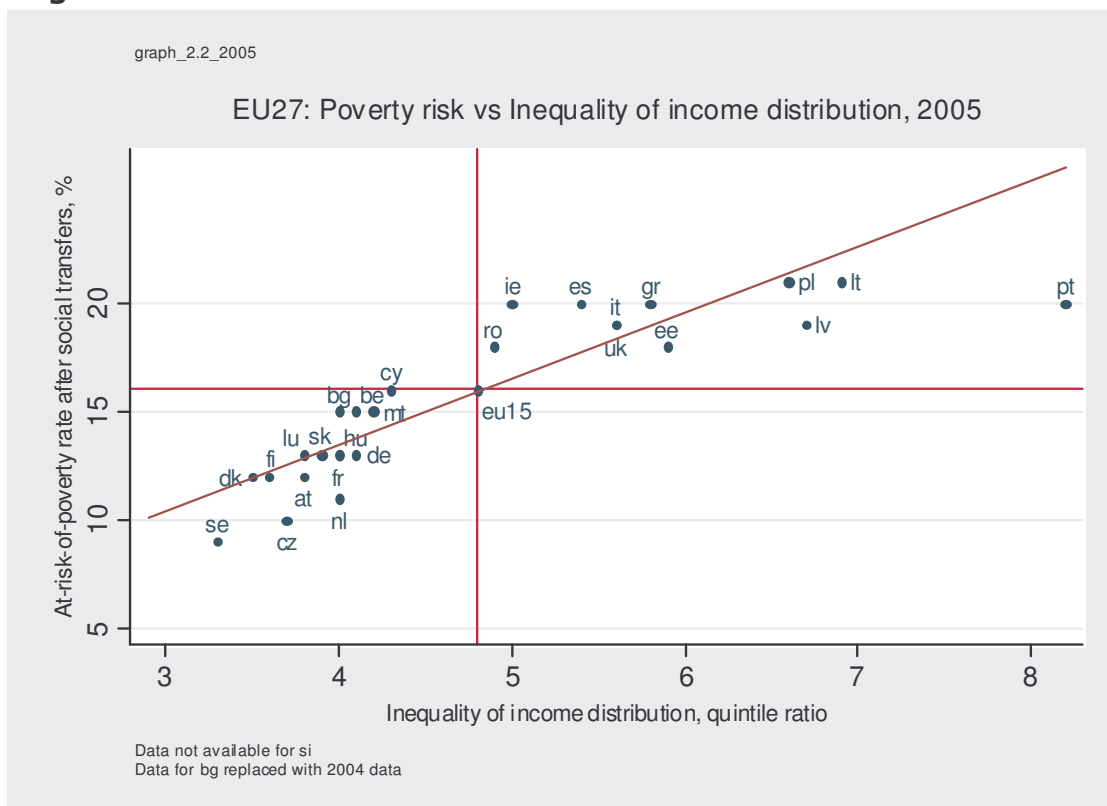


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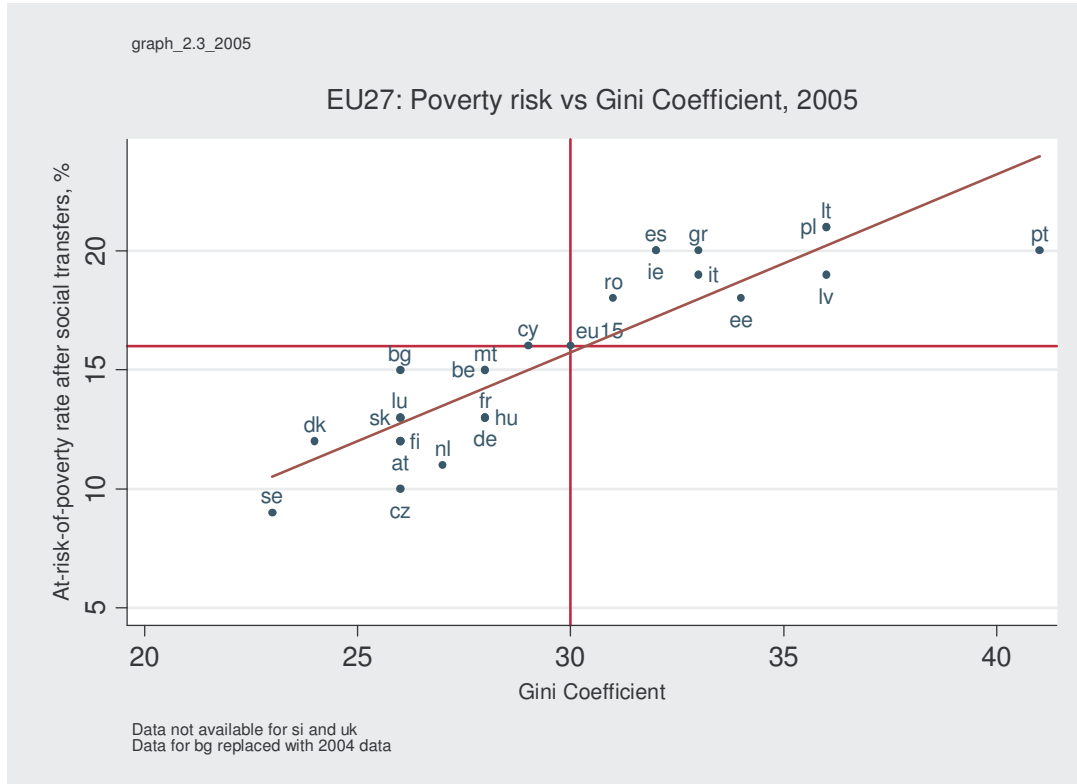


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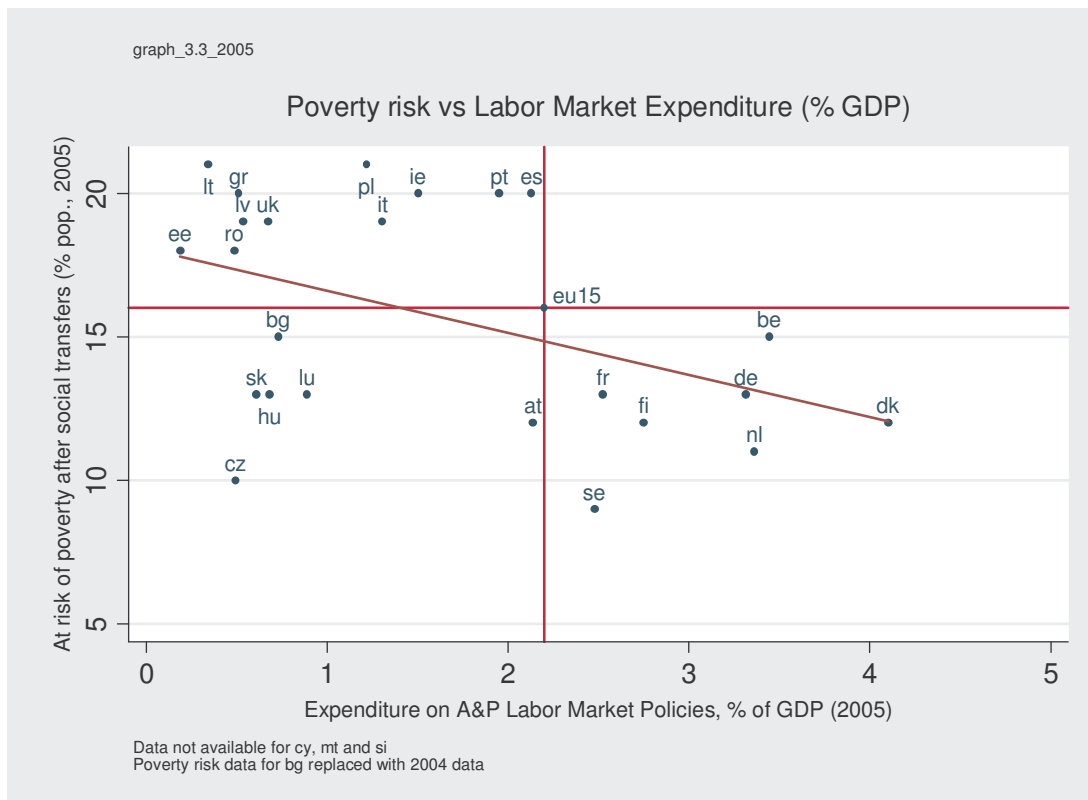


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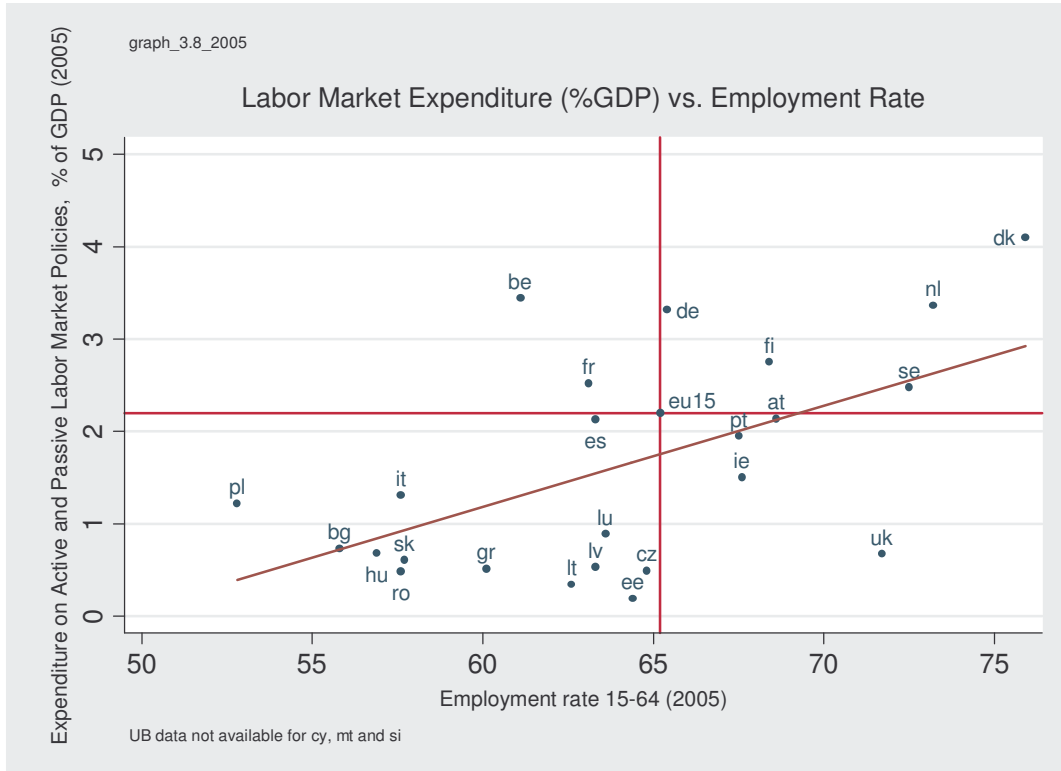


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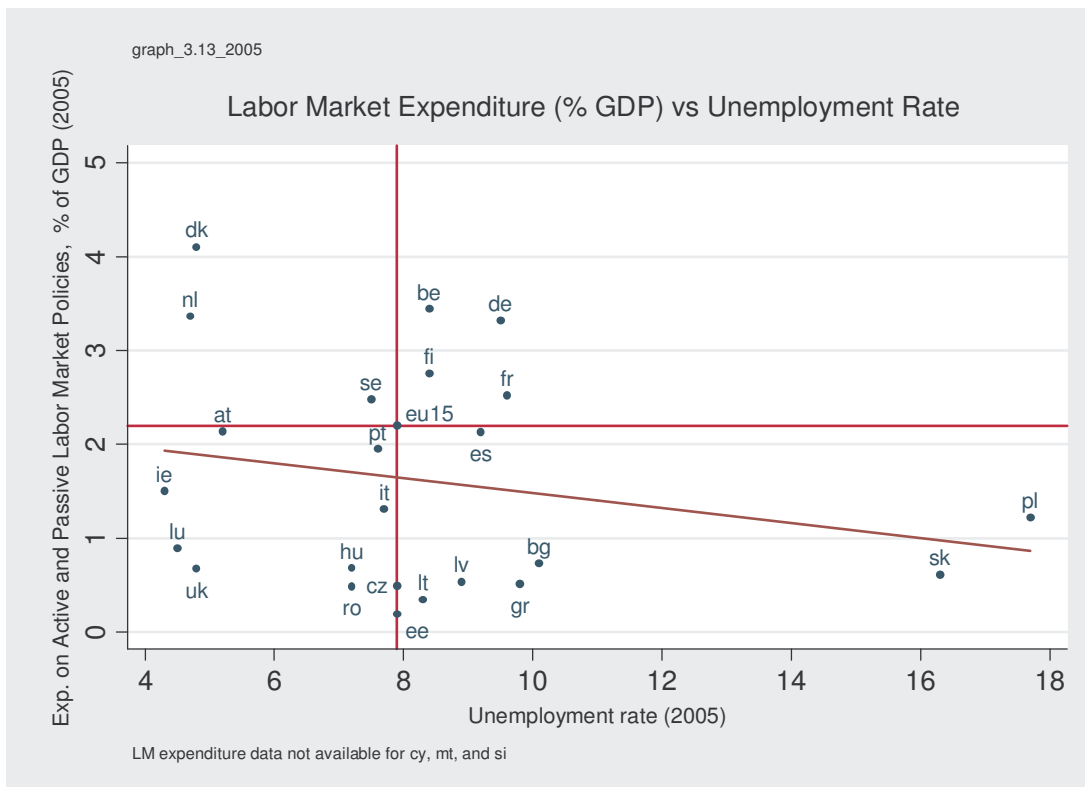


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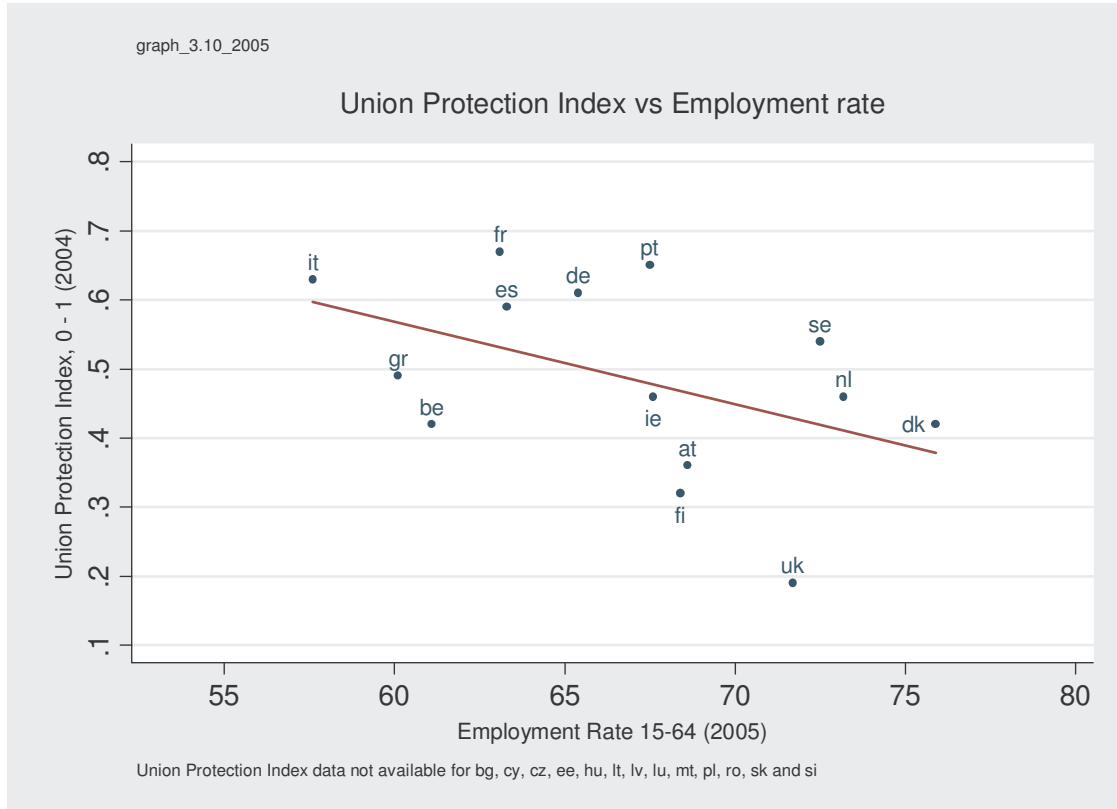


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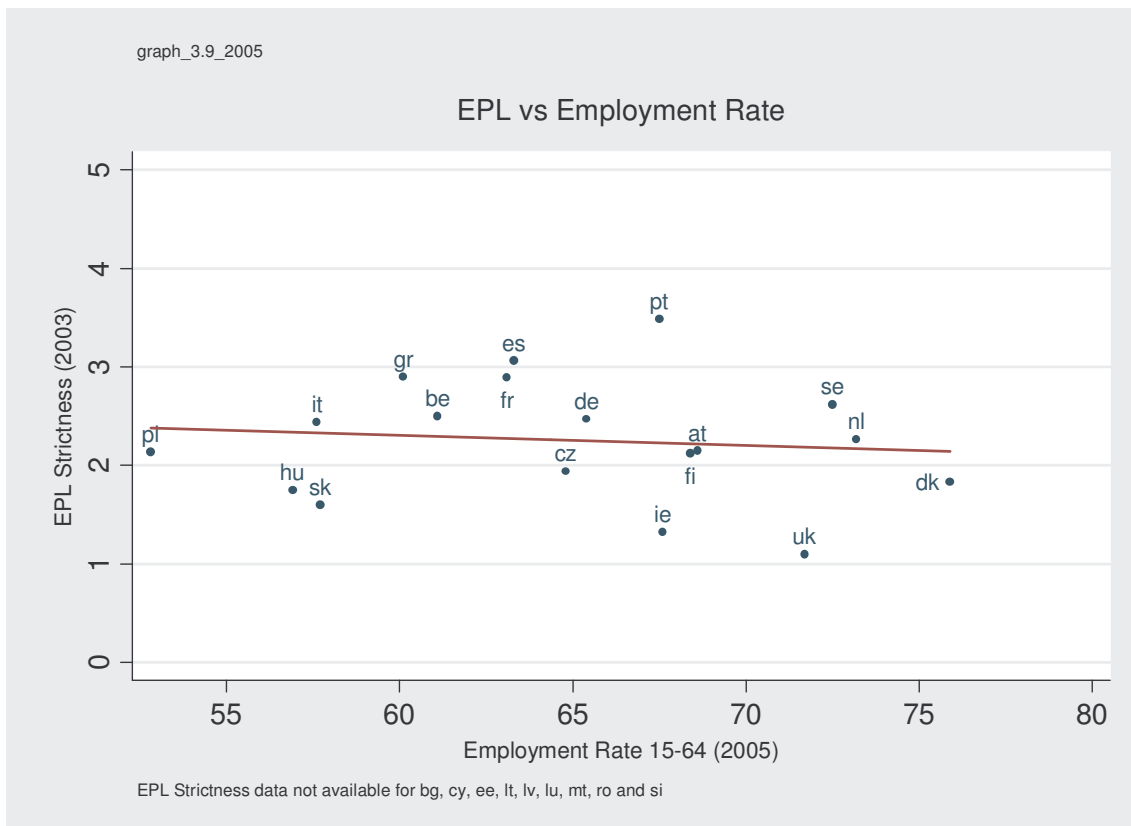


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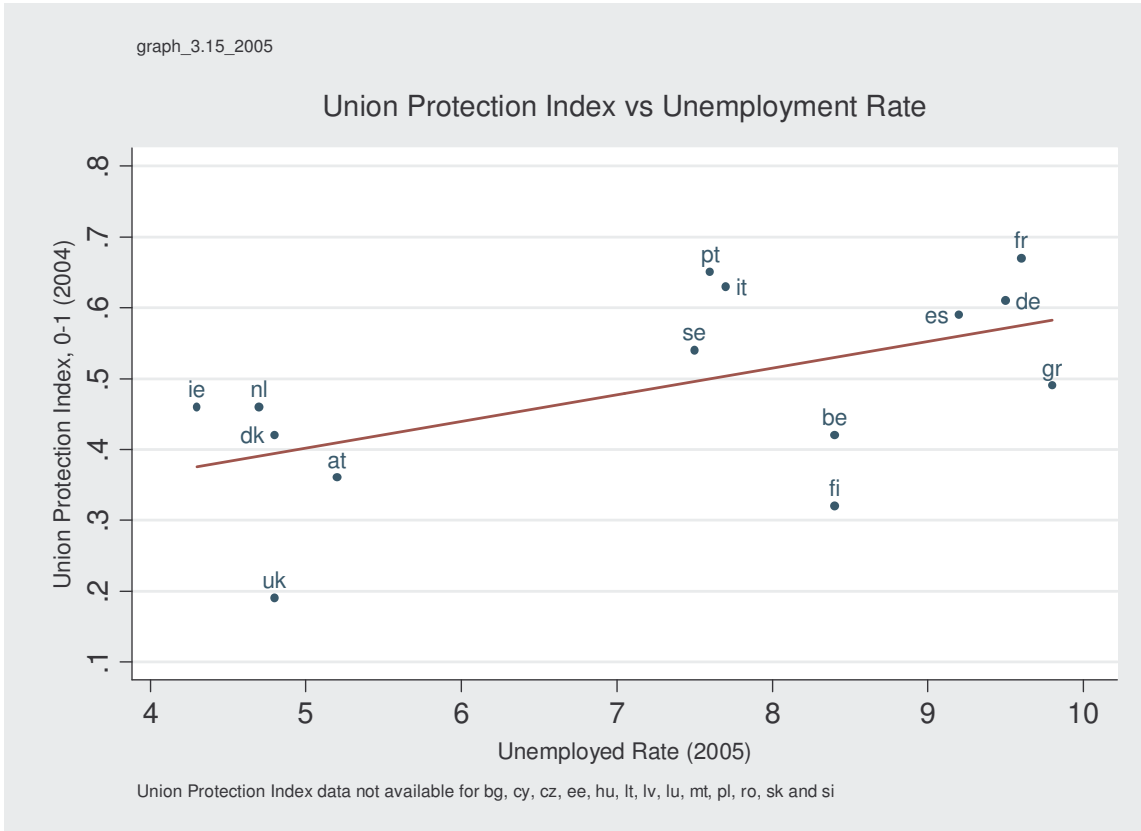


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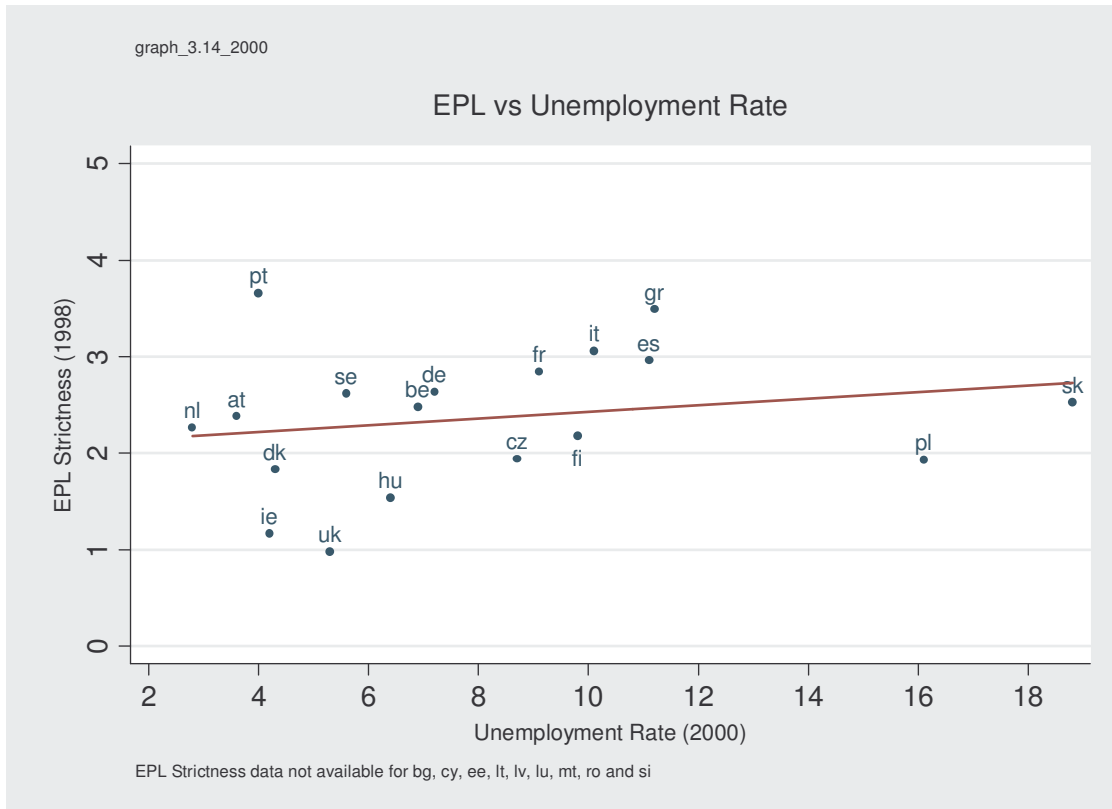


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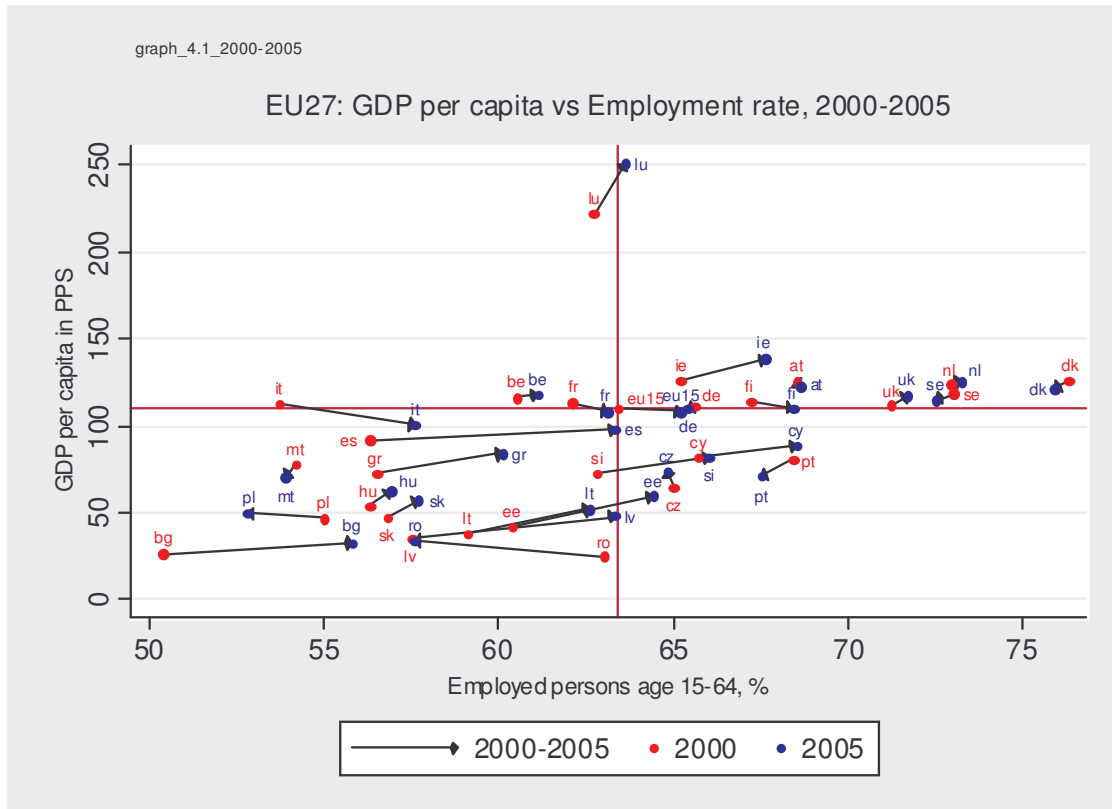


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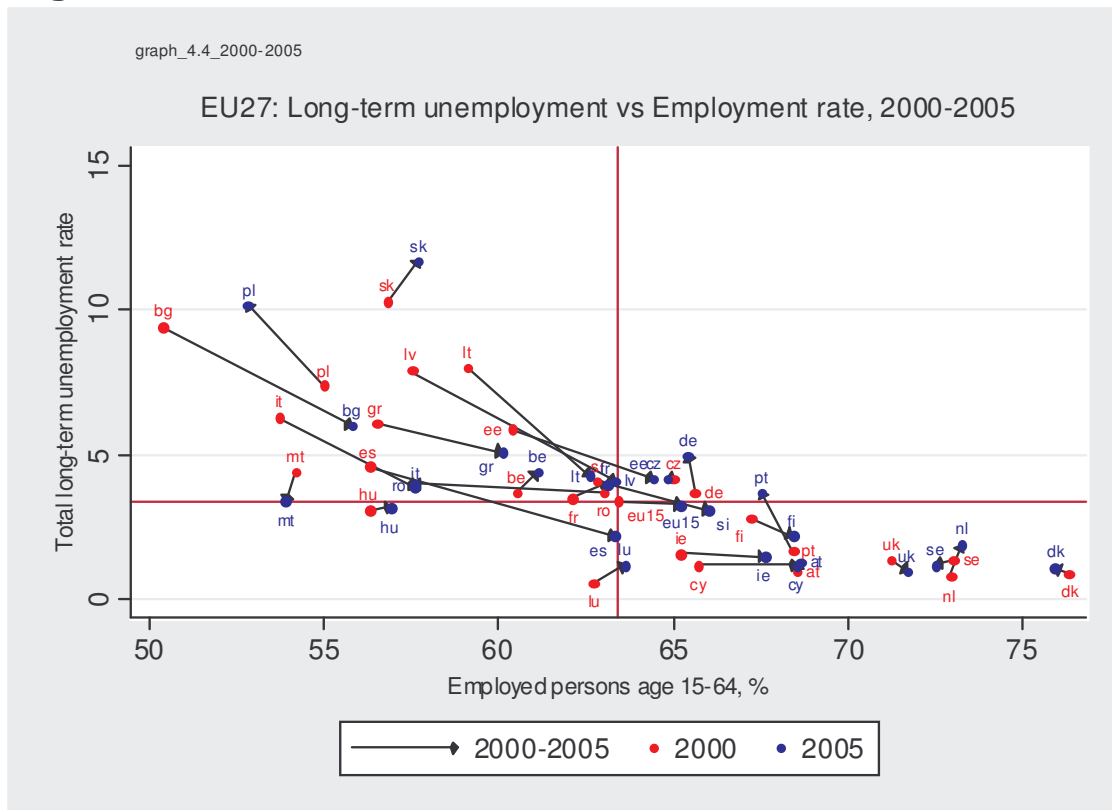


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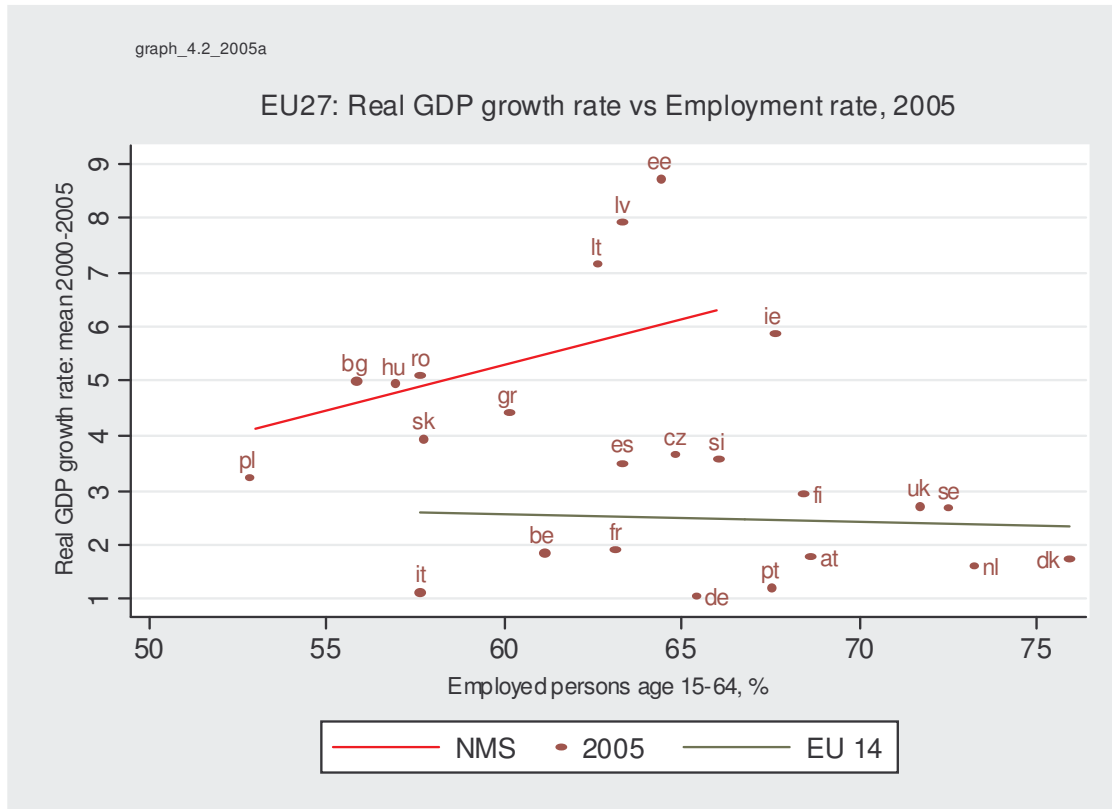


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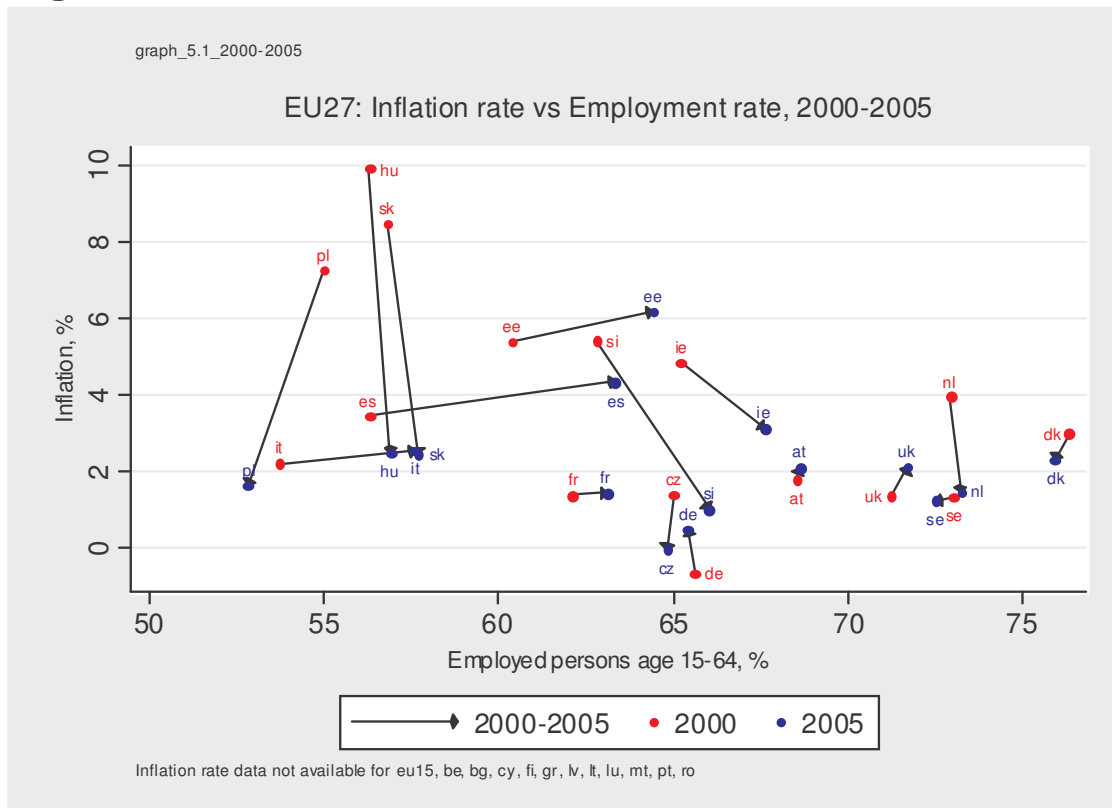


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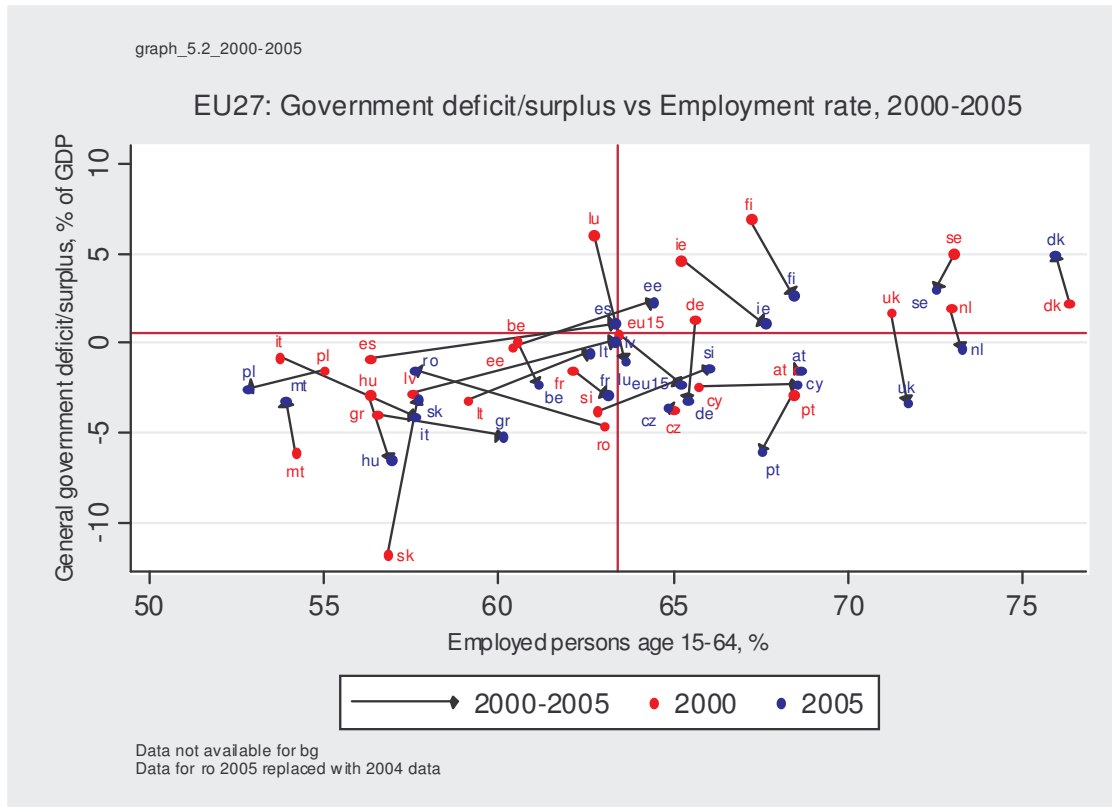


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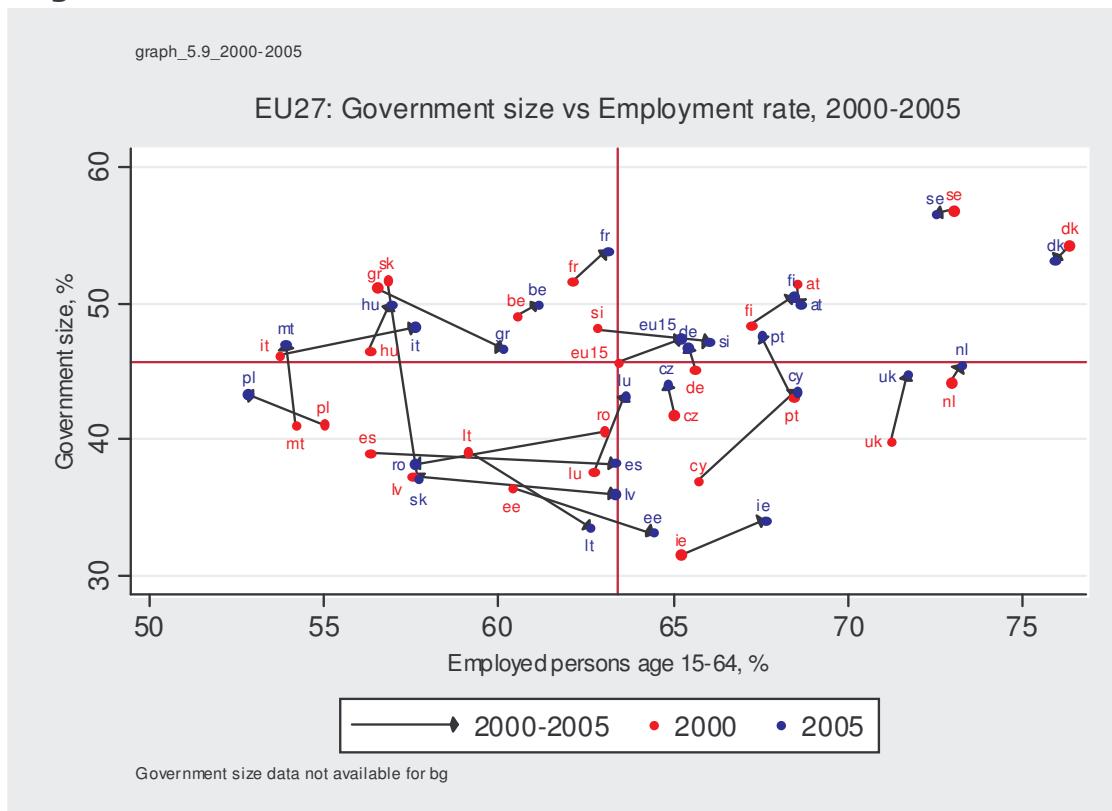


Figure 22



Figure 23

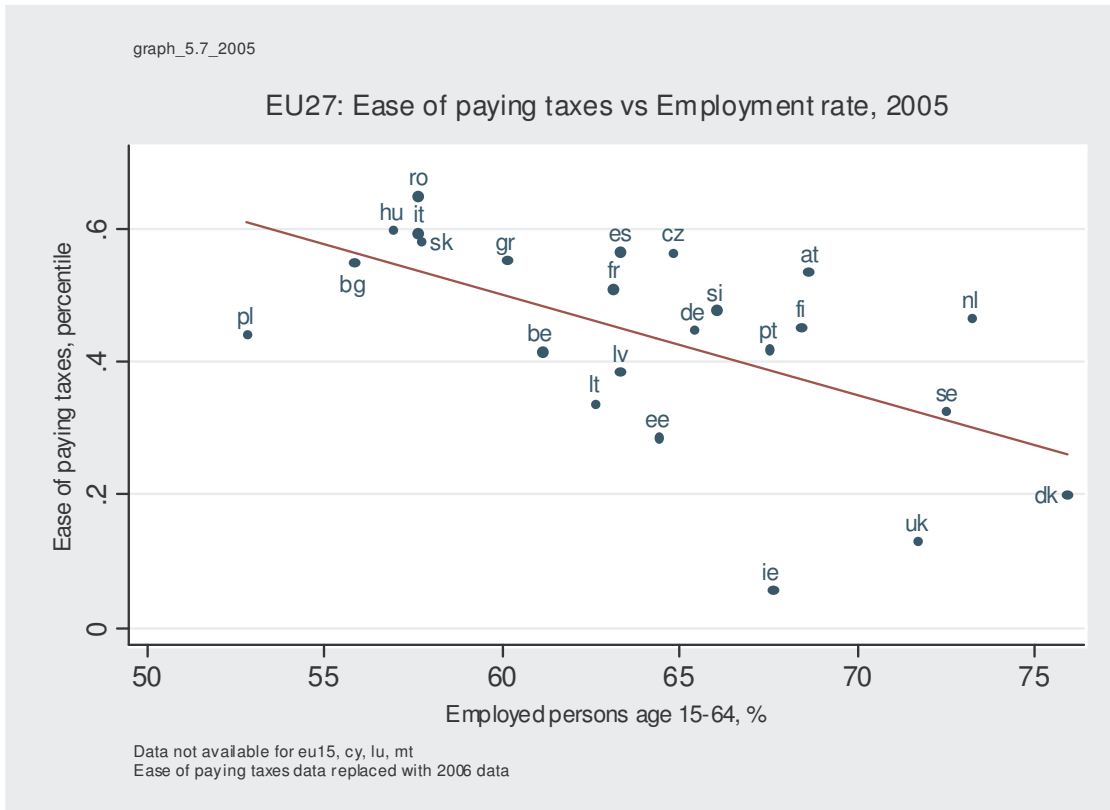


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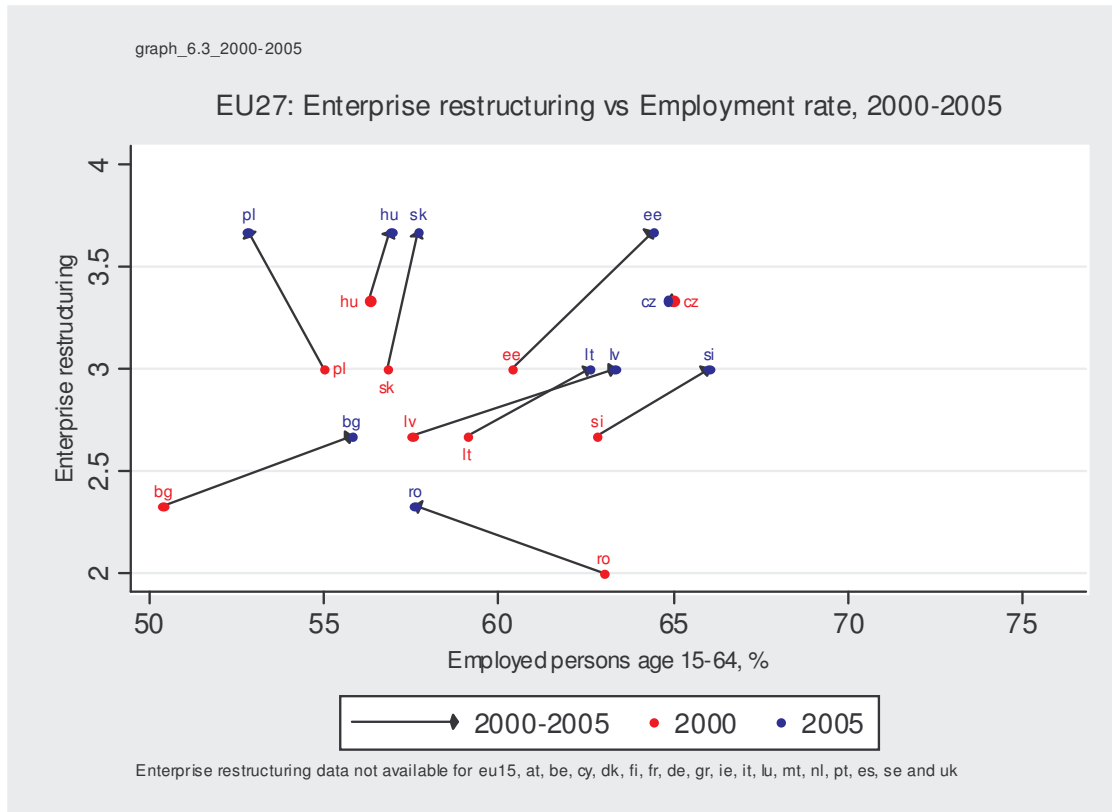


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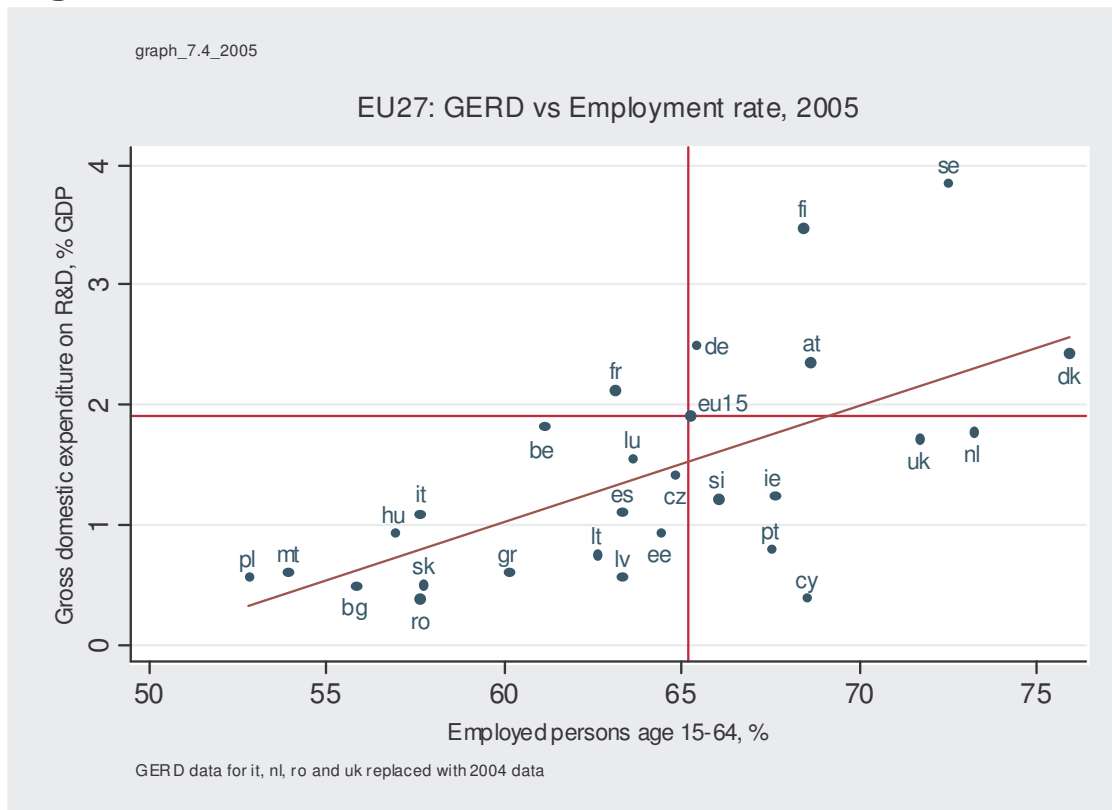


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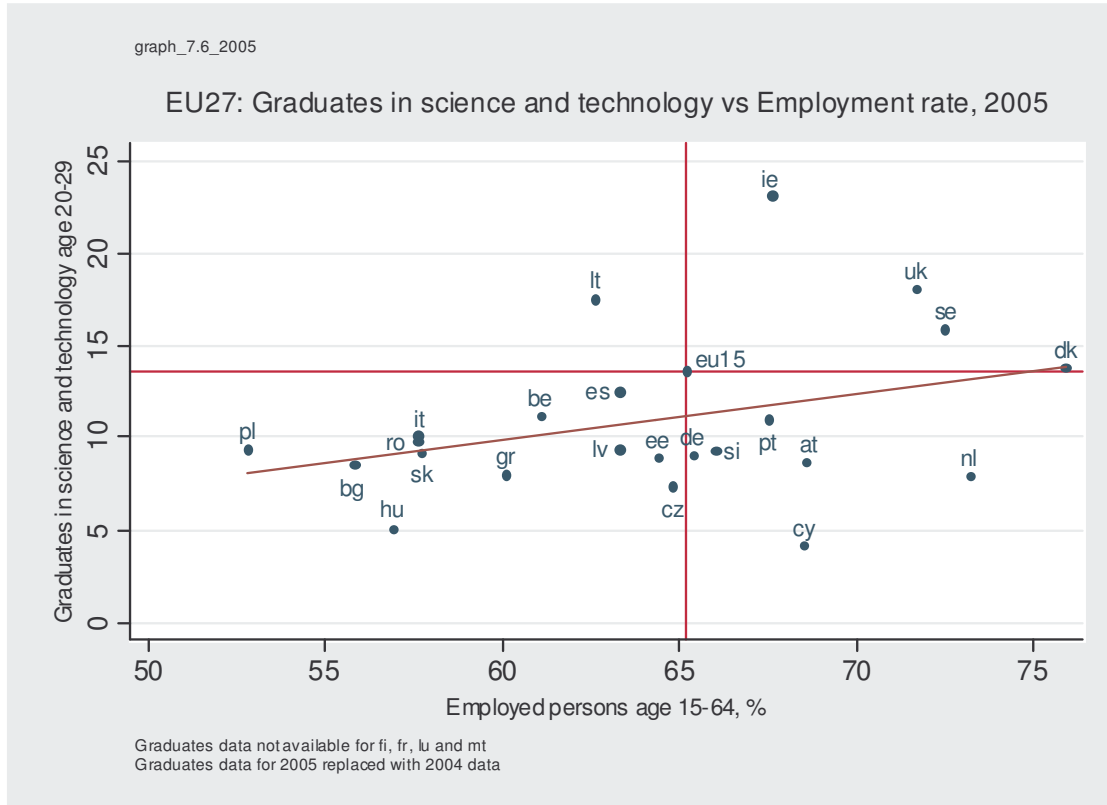


Figure 27

