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Inclusive Growth: What Future for the European Social Model?

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Inclusive Growth: What Future for the European Social Model? ([1])

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Abstract:

After a short introduction on the importance of "inclusive growth" from a German point of view, a brief outline is given of a model explaining the trade-off between comparable productive capacity (CPC) and flexibility. Since monetary union, this trade-off has become more acute for many EU Member States whose CPC now falls below this line. To compensate for the lack of comparable productive capacities, flexibility measures would be necessary (e.g. downward wage flexibility, regional mobility) to an extent which is unrealistic or would erode social cohesion and democracy. What are the alternatives? Apart from macroeconomic measures (e.g. strengthening control of banks or financial transactions and enhancing effective demand through investment in a European-wide infrastructure), which are not the subject of this paper, the possible future role of the European Social Model could consist in implementing four strategies: first, investive social transfers to stabilise weak Member States; second, protected flexibility, in particular internal functional flexibility; third, investing in people, in particular to induce mobility chains (making transitions pay); and fourth, efficient (European) labour market regulation to improve the use of existing capacities and restrain inefficient forms of flexibility. Examples for each strategy are presented, as illustrations and to stimulate the debate.

Introduction

Inclusion is a valuable thing. Only a couple of weeks ago the German government again lost a regional election in Lower Saxony. Opinion polls gave as one possible explanation the results of a survey: "Would you prefer more growth or more equal opportunities?" 40 percent answered more growth, 48 percent more equal opportunities. Obviously, Germany has a social inclusion problem, despite an apparent so-called 'Job Wunder' (employment miracle).

At European level, however, the situation looks even worse: there is no job miracle lurking anywhere on the horizon, not even as a mirage, and inclusive growth bringing the economies of 27 Member States closer together is not yet in sight. Why is this so? Does it make sense to again call upon the European Social Model? Would it not simply be better to first do the necessary homework on creating better conditions for economic growth?

Why is it like this? Figure 1 presents a small model inspired by a recent paper by Frank Vandenbroucke (2012). The vertical axis measures economic inclusion, which I call *'comparable productive capacity'*, modifying thereby the concept of 'symmetry' used by Vandenbroucke. The members of a monetary union must have a minimal amount of comparable productive capacity, i.e. accumulated capital, a qualified workforce, material and immaterial infrastructure, reliable rule of law, an effective tax system and an incorruptible public administration. The horizontal axis measures economic flexibility, in other words the ability to cope with external shocks through flexible wages, variable employment contracts, regional mobility and inbuilt stabilisers.

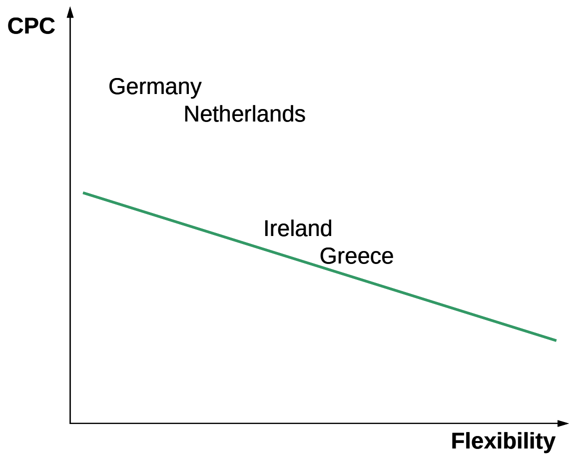

Fig. 1: The Trade-off between Comparable Productive Capacity (CPC) and Flexibility

There is a trade-off between these two dimensions: a lack of comparable productive capacity has to be balanced out by increased flexibility, otherwise state debt or unemployment will rise. In order to illustrate this, the figure displays the potential situation of a few countries: Germany and the Netherlands lie above the line; Ireland and Greece are on the line, each presenting different trade-off constellations.

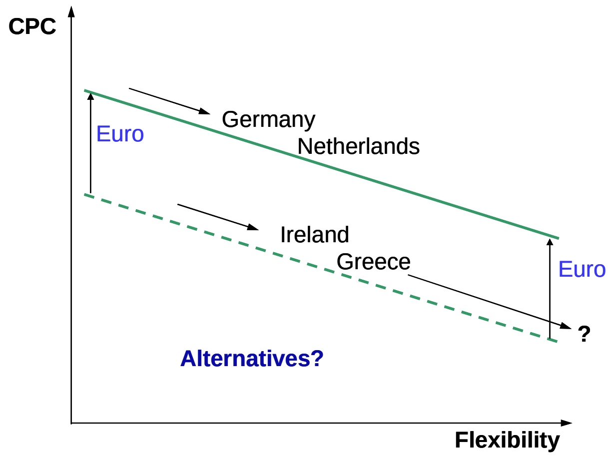

Fig. 2: The Impact of the Monetary Union on the CPC-Flexibility Trade-off

The introduction of the Euro has caused this line to move upwards, as Figure 2 shows. The demands for comparable productive capacity have grown, due to increased competition and the loss of currency sovereignty. Although Germany and the Netherlands might now find themselves directly on the line, they have already moved downwards in terms of more flexibility. Ireland and Greece are now both clearly below the line. Although measures for flexibilisation have already been introduced there, they would have to go much further than in Germany or the Netherlands compared to their productive capacity. This would be unacceptable for the majority of the population, in particular for workers. Democracy would become endangered and Europe could break apart.

What are the alternatives? Macro-economic measures, of course, have already partly been embraced, but not yet sufficiently implemented, for example controlling the financial markets and banks or a European-wide investment programme in material infrastructure such as energy, transport, sewerage, and information and communication technology. I shall leave that aside for now and instead ask what role the European Social Model could actually play? I can see four starting points which must be partly interlinked (Figure 3).

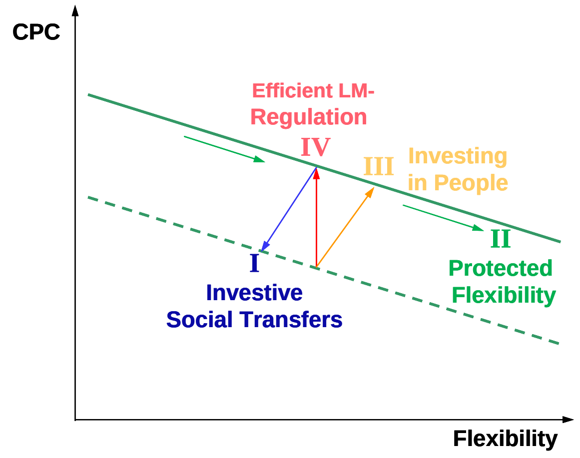

Fig. 3: Possible ESM-Strategies to mitigate or to cope with an enhanced CPC-Flexibility trade-off

First, *investive social transfers* could push the trade-off line downwards, hence relieving Member States below the line from having to resort to further flexibility measures.

Second, the demands for greater productive capacities could be offset or supplemented by *protected flexibility*.

Third, productive capacities could be improved by *investing in people*; this would at the same time increase potential flexibility.

Fourth, productive capacities could be enhanced by establishing a real European labour market through *efficient labour market regulation*, which could better utilise existing capacities and, at the same time, reduce inefficient flexibility.

I. *Investive social transfers* between the EU Member States are nothing new. The European Social Fund, the ESF, is one example. Here I refer to *investive* social transfers from the strong to weak Member States with low productive capacities, because the legitimacy of permanent social transfers is always problematic. With this in mind, it is no secret that ESF resources could be more effectively implemented. However, the role of this fund could be extended in two ways, in particular to foster *institution building* related to (un-) employment insurance and modern employment services. Recent research shows that generous unemployment benefits during the first six to nine months should be regarded not as a 'passive', but rather as an 'active' investment in the search for jobs. Unemployed people with decent income support find more productive *and* more sustainable jobs than those without such support. Research even shows that jobless people covered by unemployment insurance remain healthier and more self-confident than jobless people without unemployment insurance. There is, then, a strong case for the ESF to support the setting-up of effective unemployment insurance in the many

Member States in which such a system does not yet exist. Apart from the benefits for the many unemployed, this measure would enhance the Member States' ability to use automatic stabilisers and redistribution to balance out discrepancies in regional living standards.

Secondly, there are good reasons to establish at least a rudimentary system of European Unemployment Insurance. In the short term, this would enable transfers to Member States whose unemployment rates exceed a certain threshold. Above all, such transfers would serve as a stabiliser, sustaining regional purchasing power and reducing the brain-drain of skilled workers.

Thirdly, these transfers could also be applied conditionally, for example for education purposes or as 'youth guarantees'. Wage-cost subsidies for companies recruiting additional workers from the pool of unemployed should also be considered. Nikolas Kaldor (1936), an intellectual contemporary of Lord Keynes, pointed out long ago that if employment cannot be boosted through devaluing the currency, then temporary wage-cost subsidies can be used as a functional equivalent.

II. A typical example of *protected flexibility* is a short-time work allowance to maintain employment in recessions, by temporarily reducing working hours and compensating for the temporary loss of income with unemployment insurance. This instrument allows workers to accept some wage flexibility in exchange for job security, and employers to accept some fixed wage-costs in exchange for workers' loyalties and skills. The state plays the role of moderator, co-financer, and insurer of conditionality, in particular through employment services which have built up trust relationships with employers. During the last recession, this instrument was successfully implemented in many Member States, especially in Germany. Germany also has a number of other effective possibilities for protected flexibility which can be negotiated by the social partners at the level of industrial branches or firms, in particular working-time accounts and wage corridors (Schmid 2012a, 2012b).

Further examples are the hedging against income-risks during further training or retraining by providing education vouchers, or hedging against income-risks during leaves for parenting, taking care of sick family members or for sabbaticals. Non-standard employment is becoming increasingly standard. It would therefore be a distinct task for the European Social Model to further develop *and* maintain mutual standards of social protection for life-course transitions which are common in Europe, such as the right to return from a part-time job to an equivalent full-time job. Often the legal framework for such protection is already available, but effective implementation is hampered by a lack of procedural securities and control. The Open Method of Coordination could enhance efficient implementation by encouraging Member States to establish binding procedures and control measures according to their administrative culture;

for instance work inspectors, legally endorsed collective agreements or administrative agreements such as the covenants in the Netherlands or regional employment pacts in many Member States (Bekker 2013, Schmid 2008, 2012b).

Final examples are wage insurance for workers who have to change into lower-paid jobs as a result of diminished productive capacities, and targeted in-work-subsidies for workers whose income capacity is temporarily restricted through unpaid care obligations, in particular single parents.

III. *Investing in people* is central if Europe wishes to remain competitive. The issue is not just about preventing skill shortage due to, for example, our ageing society; the issue is above all about combating a central cause of rising inequality. Across the whole union, the employment rate for the highly qualified is 83 percent; the employment rate for low-qualified workers is only 53 percent. This makes a difference of 30 percentage points. It should become an objective of the European Social Model to narrow this gap.

The costs of not investing in skills are enormous: a skill shortage hampers not only the creation of new jobs but also innovation and thereby competitiveness. One of the many studies on growth and skills has found that 50 additional points on the PISA scale induce 0.6 percentage points more growth. This makes 30 percent more income measured after forty years. But we do not just need to invest in high levels of formal education. As the current unemployment situation among highly educated young adults in some countries shows, we must also ensure a good balance of simple, professional and high-level qualifications. Europe needs not only academics but also engineers, skilled artisans and competent labourers.

Since we cannot wait until the education system has produced the new skills for new growth, an essential component of a future European Social Model would be to strengthen the links between the education system and the labour market over the whole life-course. Easy transitions between education and work or the combination of both should not only be possible after secondary or tertiary education, but also for the rest of one's adult working life. This would not only improve horizontal and vertical mobility, but also induce mobility chains that would together increase potential flexibility. Why is it still very much the exception, if not impossible, for a nurse to gradually take the steps to become a professional doctor? Education or training should not stop at a certain age. Recent research shows a clear positive correlation between participation in training and labour force participation for elderly people, even having taken account of other factors. And the link between the labour market and the education system exists even beyond retirement: knowledge-intensive goods need knowledgeable people for their demand.

IV. Productive capacities and flexibility could be enhanced by establishing a real European labour market through *efficient labour market regulation*. The basic principle must be to diminish inefficient flexibility by better utilising existing capacities. This may sound like squaring the circle. However, plausible examples exist. Recent research shows that excessive use of fixed-term contracts, including temp-agency work, hampers innovation and productivity. Some restriction of fixed-term contracts, therefore, would enhance and not erode productive capacities in the long-term. One way to do this would be by setting the right economic incentives, for instance internalisation of risks, or in other words risk-related contributions to social security and training funds. Fighting inefficient flexibility would also support the life-course planning of young adults who are hardest hit by non-standard and often precarious forms of employment. Another example would be the EU-wide recognition of qualifications. This would improve mobility, especially in areas threatened by skill deficits. A directive for a European Professional Card is already in the making. However, this should not lead to an erosion of quality standards in order to guarantee a sustainable rise in productive capacities. We may not, just to name one example, praise dual vocational training and education as a successful tool against youth unemployment and, at the same time, risk undermining the quality of this qualification.

One highly controversial example is the suggestion of legislating on a Europe-wide minimum wage. Of course, this cannot be done by setting one uniform minimum wage, which would be economic suicide. It would, however, be sensible to establish common rules, for example to set the minimum wage at national level and to monitor the impact through the Open Method of Coordination in close cooperation with Social Partners. One rule could be that the minimum wage should not be lower than a certain proportion of national average wages, e. g. fifty percent. Member States could then make annual adjustments according to their individual experiences. Joint European monitoring of minimum wages would not only avoid cut-throat competition by wage dumping. It would also stimulate investment in quality work and increase the domestic purchasing power of strong economies, thereby enhancing the export chances for weaker countries. Looking at the unit wage-cost trends of the last decade, we can understand why many people gained the impression that Germany has been playing a beggar-thy-neighbour policy by having insufficient minimum wages and by rapidly expanding the low-wage sector.

To summarise: the best aspects of a European Social Model could still be on the way. This little glimmer of hope, however, might soon be extinguished if Europe does not succeed in controlling the financial markets and bringing weak economies onto a path of inclusive growth. In turn, the only ways to support and ensure the *sustainability* of this growth would be through *institution building*, and striving towards a *European* Social Model, as suggested here (although the point is still very much up for discussion) and in other recent publications (e.g., Vandenbroucke 2012) as well as through more binding coordination of social policies (e.g., Bekker 2013).

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