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THE EUROPEAN SOCIAL MODEL CONSTRUCT: AN EXAMINATION IN LIGHT OF THE FLEXICURITY GOAL

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The concept of a European Social Model, though commonly employed, masks the considerable degree of variation across the nations of Western Europe in the provision of welfare, worker protective legislation, and associated rigidities in labor markets. Although the European Union's emphasis on "flexicurity" would promote a greater degree of uniformity in the labor market institutions of Europe, the contention of this paper is that substantial differences remain, and that the construct of a European Social Model is inaccurate and potentially misleading. Differences across nations are examined by employing World Bank data on impediments to doing business around the world.

INTRODUCTION

It is quite conventional among scholars of the European Union (EU) to use the term "European Social Model" in reference to the supposed distinction

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between the larger role that government plays in Europe and the smaller role it plays in the United States (US), in reference to the provision of social welfare programs, and in reference to the regulation of labor and product markets (Zeff and Pirro, 2006: 351). It is undoubtedly the case that the role of government in the European economy is greater than it is in the US; however there are also substantial differences in the roles that governments play in the economies of the older members of the EU, commonly referred to as the EU-15. Some of these differences are long-standing; others are in part attributable to the considerable cross-country variation in recent attempts to implement so-called flexicurity programs. Such programs have three objectives: (1) making labor market adjustment easier for employers, (2) providing extensive financial security for workers who lose jobs, and (3) implementing active labor market policies that impose obligations on workers to accept available employment. Objective (1) is the major focus of this paper.

This paper has two purposes: The first is to describe qualitatively four semi-distinct social models that have been used to characterize Western European members of the EU. The second, and major purpose is to document quantitatively the substantial variation in institutional labor market rigidity across Western European members of the EU (as well as between Western EU nations and the US), and, in the process, to evaluate critically the accuracy of the four-model depiction of Western Europe.

FLEXICURITY AND THE LISBON AGENDA

The development of the EU has produced periods of both optimism and pessimism regarding member nations' economic prospects. Integrating first six and then fifteen countries into the union's single market resulted in faster growth of the European economy than of the US economy. Further expansion has led to very large increases in the volume of trade across the countries of the EU (Nwabuzor and Nwakanma, 2007). However, European economic performance during the last decade and a half has been relatively poor, and although another twelve nations have joined the EU (with yet others seeking to join), the earlier optimism has in large measure dissipated. During the three decades following World War II, the unemployment rate in Western Europe averaged well below the rate in the US. During the last three decades however, successive business cycles have generated increasingly higher peaks in European unemployment rates. This phenomenon has given rise to the concept of "hysteresis," the tendency of the unemployed to remain unemployed so that the natural rate of unemployment rises with each recession (Blanchard and Wolfers, 2000). Before the recent US recession began in December of 2007, the unemployment rate in the EU was typically much higher than the US rate. For example, the EU unemployment rate in 2006 was 8.3 percent, compared to 4.6 percent in the US. (Slower productivity advances in Europe have resulted in their falling further behind the US in per capita GDP, resulting in per capita income (calculated by the purchasing power parity method) in 2008 being about 40 percent higher in the US than in the EU-15; Eurostat, 2009). US recessions tend to spread to Europe with a lag. The one exception to that tendency was the recession following the "dot com bust" and the 9/11 attacks (Eurostat, 2007). Nonetheless, European average unemployment remained substantially above US unemployment throughout that recession. If the past continues to be prologue, the recession that began in the US in December of 2007 will produce abnormally high unemployment for a much longer period of time in Europe than in the US. The relative inflexibility of labor markets in most of Europe often is hypothesized to be the culprit in the persistence of cyclical unemployment in Europe (Blanchard and Wolfers, 2000).

In response to the diminution of EU growth and unemployment performance relative to that of the US, the European Council introduced its Lisbon Agenda. The objective of the Council was to make Europe "the most competitive and dynamic knowledge-based economy of the world, capable of sustainable economic growth with more and better jobs and greater social cohesion by 2010" (European Commission, 2000: 1). The specific goals involved numeric targets for things such as labor force participation and R&D expenditure, but the means to these ends were supposed to be inducements to entrepreneurship along with product and labor market reform. Such reforms are commonly referred to as the "flexicurity" objective. The term flexicurity, first coined in reference to Danish labor market policy, describes the coupling of strong income security (social welfare) with reforms that would make adjustments in labor markets less hampered than they have been traditionally. Although the European Council can establish these goals, only the governments of the individual member nations have the power to put them into effect. However, in every member nation there are forces both for and against the reforms called for by the Lisbon Agenda, and for the most part the forces against the reforms have been more formidable (Viebrock and Clasen, 2009). In fact, some critics (e.g., Lewis, 2009) view the drive for more flexible labor markets as little more than a political tool for altering the distribution of income away from labor. While some countries, particularly in Scandinavia, have made considerable progress, there have been only half-hearted attempts at progress in the other countries. Where serious efforts have been made, they have created a serious popular backlash, e.g., Germany, France and Italy, which together constitute over half of the EU-27 nation economy. The absence of political backlash in the Scandinavian countries is probably the result of a simple fact; these nations, particularly Denmark, were nearest to the flexicurity ideal before it became an objective of the European Commission and thus had the least need of change. Moreover, the fact that these countries already were closer to the ideal suggests the possibility that the culture of Scandinavia may be more amenable to labor market flexibility and adaptation to change.

CONFLICT BETWEEN THE LISBON AGENDA AND THE "EUROPEAN" SOCIAL MODEL

To many interest groups and intellectual circles in Western Europe, the Lisbon Agenda is seen as an attempt to abrogate the social compacts that characterize Western European economies and which distinguish them from the institutional framework of other advanced economies such as those of Japan, the "Asian tigers," and the US. In rather simplistic terms, Europe is sometimes seen in its supposed social model as putting greater emphasis on "social justice." But social justice is a value-laden term that does not have a uniform meaning across individuals, groups and cultures with varying degrees of emphasis on equity versus equality (Williamson and Fadil, 2009). Although it is undoubtedly true that European economies place a great deal more emphasis than does the US on business and labor regulation, on social protection against unemployment, and on government provision of health care and old age and disability income security, it is nonetheless a bit misleading to speak of a relatively uniform European Social Model. It is slightly more appropriate, though arguably still an overgeneralization, to identify four different social models (Bertola, Jimeno, Marimon and Pissarides, 2001).

One is a "Mediterranean" model which relies more heavily than the others on product and labor market regulation, combined with much less in the way of unemployment and other welfare benefits. Italy and Portugal, and especially Spain and Greece, have best fit this model description. Another model is the "Nordic" or Scandinavian model, whereby there is a great deal less reliance on regulation, but in which a very extensive welfare state overlays the market economy. Denmark, Finland and Sweden are in this grouping. (Norway and Iceland are not members of the EU.) While the EU-15 average annual social welfare spending per head was 5.4 thousand euros in 2000, the respective averages for Denmark and Sweden were 8.4 and 8.5 thousand euros (Molle, 2006: 306). However, unlike much of the rest of Europe, the high unemployment benefits are provided for a short period of time. Moreover, unemployed workers face both considerable assistance in finding employment, as well as considerable pressure to accept available employment. In general, the Nordic model most closely follows the flexicurity ideal.

A third is, loosely speaking, a "Continental" model, inclusive of France, Germany, Austria, Belgium, Luxembourg and the Netherlands. This grouping of nations combines more modest features of the previous two models but strong government mandated roles for trade unions. One can also distinguish a fourth model, sometimes called the "Anglo-Irish" model, that is characterized by less reliance on regulation and less extensive welfare systems than are typical of continental Europe. Clearly, as a result of the substantial impact of Margaret Thatcher, the United Kingdom (UK) has, to a degree, separated itself from the rest of Europe through de-nationalization of industry, the diminution of union power, and a restraining of the growth of the welfare state. This institutional variant is sometimes referred to as the Anglo-American model, particularly when the intent is to demonstrate contempt. Nonetheless, in most important respects both the UK and Ireland have social protection systems that are more similar to those of the rest of the EU-15 than to those of the US.

THE CONSEQUENCE OF INFLEXIBLE LABOR MARKETS

In a world of perfect information, perfectly competitive product and labor markets, and zero adjustment costs or institutional impediments to adjustment, cyclical unemployment would not be a problem. Labor markets would quickly re-equilibrate in response to any particular dis-equilibrating event. Of course in no nation in the world do these conditions prevail, hence absolute labor market flexibility exists in no country. The degrees of rigidity in labor markets, however, do vary substantially across nations. There are numerous and well-known explanations for the inflexibility of labor markets—particularly the inflexibility of wages in response to excess demand. For example, the implicit contracts literature (Azariadis, 1975) argues that even in the absence of explicit labor contracts, the provision of wage stability (at the cost of employment instability) is a Pareto-optimal result between employers and workers. When contracts are made explicit through collective bargaining, insider-outsider theory (Lindbeck and Snower, 1986) explains the preference of employed workers (the insiders) for wage stability in terms of the inability of unemployed workers (the outsiders) to influence bargaining outcomes. The fact that an explicit contract exists means that by definition wages will be perfectly inflexible over the length of the contract, but the extent of collective bargaining and the power of unions influence the degree of longer-term inflexibility of wages.

Wage inflexibility is not the only aspect of labor market rigidity. Government mandates may present a hindrance to the hiring of new workers on the part of existing firms and to the formation of new firms that might absorb workers displaced in declining firms or industries. These hindrances may come in the form of both the monetary and time costs of bureaucratic requirements and will be discussed below. In addition to mandates that affect the cost of hiring workers, well-intentioned mandates often aim to make firing costly in order to discourage it. Ultimately though, mandated firing costs and related hindrances are indirect impediments to the hiring of workers inasmuch as employers, who are uncertain of future product demand, must take into account the possibility of the cost and difficulty of firing when making hiring decisions.

LABOR MARKET FLEXIBILITY ACROSS THE EU

While it is undoubtedly true that Western Europe is characterized by labor markets more rigid than those of North America, the fact remains that the variations in rigidity across the western members of the EU are quite substantial.

Indeed, the variations are significant enough to call into question the usefulness of both the so-called European Social Model and even the four-model distinction described above. In what follows, the 15 advanced Western members of the union are compared quantitatively on a variety of measures available from the World Bank and other sources. This comparison suggests some likely sources of labor market rigidity in Western Europe. The analysis excludes the less developed, mostly formerly communist countries that have been added to the EU since 2004.

In Table 1, the EU-15 are grouped into the four models described above. The second and third columns indicate, for 2008 and 2009, each country's ranking in the World Bank index of the Ease of Doing Business (based on information gathered in the previous year). For 2008 and 2009, that index ranks nations from 1 (least impediments to doing business) to 181 (most impediments). The rankings are based on World Bank measures of the monetary and time costs in ten areas: Starting a Business, Dealing with Construction Permits, Employing Workers, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading across Borders, Enforcing Contracts, and Closing a Business. Each of these areas is in turn made up of measures of several sub-areas and is explained in World Bank (2009). (The full report, which explains in detail the methodology and procedures involved in constructing these measures, is available at http://www.doingbusiness.org/features/DB2009Report.aspx.) Table 1 also includes the rankings for one of the components included in the Ease of Doing Business index, Starting a Business, because the difficulty associated with starting a business presents a major impediment to private-sector job creation. The Starting a Business ranking is a composite of four items: the number of procedures involved, the duration (in days) of the process, the cost of the process, and the paid-in minimum capital requirement, the latter two as a percentage of per capita Gross National Income. Such difficulty particularly impedes the ability of newly formed firms to absorb workers displaced in declining industries and to absorb new labor force entrants who are not absorbed by firms in mature industries.

Also included in Table 1 are two measures relevant to labor market inflexibility associated with collective bargaining: the presence of an extension law, and the percent of a nation's labor force that is covered by collective bargaining. The percent of collective bargaining coverage has a straightforward relation to labor market flexibility. However inflexible unionized sectors might be in response to demand shocks, the non-unionized sector presents an escape valve, via spillover effects, if there is sufficient flexibility in the non-union sector. Of course, the spillover effect results in depression of non-union wages as explained in Bellante and Jackson (1983: 233-45). The presence, however, of so-called extension laws in many Western European economies complicates the

Table 1. Impediments to Employment in The EU and the US

	Per capita GDP 2008[1]	Ease of Doing Business: Overall Rank[2] 2008	2009	Ease of Starting a Business Rank:[2] 2008	2009	Presence of Extension Law:[3] 2000	Estimated Collective Bargaining Coverage (% of Labor Force)[4] 2004
Continental Model							
Austria	$39,200	23	27	83	104	Yes	98%
Belgium	$38,300	19	20	19	20	Yes	90%
France	$32,700	32	31	12	14	Yes	90%
Germany	$34,800	20	25	75	102	Yes	70%
Luxembourg	$85,100	45	50	60	69	Yes	60%
Netherlands	$41,300	27	26	41	51	Yes	80%
Nordic Model							
Denmark	$38,900	5	5	16	16	No	77%
Finland	$38,400	13	14	15	18	Yes	90%
Sweden	$39,600	22	30	22	30	No	90%
Mediterranean Model							
Greece	$32,800	106	96	150	133	Yes	65%
Italy	$31,000	59	65	70	53	Yes	90%
Portugal	$22,000	43	48	40	34	Yes	80%
Spain	$36,500	46	49	123	140	Yes	80%
Anglo-Irish Model							
Ireland	$47,800	7	7	5	5	No	44%
UK	$37,400	6	6	6	8	No	40%
US	$48,000	3	3	4	6	No	14%

Notes: [1] From CIA (2009) *The World Factbook*: (Purchasing Power Parity method)
[2] From World Bank (2009) *Doing Business* Indicators, out of 181 countries
[3] From CESifo-DICE (2009) database
[4] From OECD (2004)*Employment Outlook*

matter by extending collectively bargained wage levels, and, by inference, the associated degree of inflexibility, to non-unionized employers.

In examining the World Bank's ranking of the EU-15 on the overall Ease of Doing Business it is apparent, first, that there is some merit in the argument that there is no monolithic European Social Model, and second, within the commonly used sub-European model categories there are substantial variations in the overall impediments to doing business. In each of the first four model categories there is an outlier that either "belongs" in one of the other categories (e.g., Denmark) or in a category by itself (Greece). It seems that Denmark has more in common in this regard with Ireland and the UK than it does with the other two Nordic countries or, for that matter, with the countries of any other category. Other oddities are that although all of the nations included in the Continental and Mediterranean models have extension laws, neither of the two countries in the Anglo-Irish model do. The Finnish presence of such a law makes it a Nordic exception. For the record, Norway, though not an EU member, has no extension law and ranks 10th in overall Ease of Doing Business and 33rd in Starting a Business. In this regard, Norway, like Denmark and to a much lesser extent Sweden, is distinct from the Continental and Mediterranean countries, as well as from Finland.

Much the same can be said, though more emphatically, about variation in the Ease of Starting a Business. It is worth noting that in the comprehensive Ease of Doing Business rankings, Spain and Portugal appear quite similar. This obscures the fact that the Spanish and Portuguese approaches to regulation rely on different devices. While in Spain it is far more costly to start a business than in Portugal, their similar overall rankings make it obvious that in some other area Portugal must be more restrictive than Spain is, as will be shown below. Note also that the world-wide rankings of most of the EU-15 did not change significantly between 2008 and 2009, though some did fall slightly in the rankings. It is not so much the case that these nations have retrogressed in terms of the objectives of the Lisbon Agenda. Rather, some of them have either made slow or no progress while many nations outside the EU-15 have tended to eliminate impediments at a faster pace.

Table 2 focuses directly on the labor market regulatory environment in the EU-15 and the US. The second and third columns indicate each nation's value for the World Bank's overall Rigidity of Employment Index, which is a simple average of the three indexes shown in the next three pairs of columns. These in turn are based on a scale of 0 to 100. The three indexes measure a variety of regulations that impede employer flexibility in hiring (e.g., restriction of temporary employment), firing (e.g., the requirement of government permission) and hours restrictions (e.g., whether overtime is permitted). Note however that no regulation is deemed to contribute to inflexibility if it meets International

Table 2. Labor Market Adjustment Difficulties in the EU and the US

	Overall Rigidity of Employment Index		Difficulty of Hiring Index		Rigidity of Hours Index		Difficulty of Firing Index		Firing Costs (weeks of wages)		Hiring Costs (% of salary)
	2004	2009	2004	2009	2004	2009	2004	2009	2004	2009	2006
Continental Model											
Austria	33	33	0	0	60	60	40	40	2	2	31.4%
Belgium	27	20	11	11	60	40	10	10	16	16	55.2%
France	56	56	67	67	60	60	40	40	32	32	47.4%
Germany	44	44	33	33	60	60	40	40	69	69	19.3%
Luxembourg	62	62	67	67	80	80	40	40	39	39	N.A.
Netherlands	42	42	17	17	40	40	70	70	17	17	18.1%
Nordic Model											
Denmark	10	10	0	0	20	20	10	10	0	0	0.7%
Finland	44	48	33	44	60	60	40	40	26	26	24.6%
Sweden	39	44	17	33	60	60	40	40	26	26	32.7%
Mediterranean Model											
Greece	55	51	44	33	80	80	40	40	24	24	31.2%
Italy	38	38	33	33	40	40	40	40	2	11	41.6%
Portugal	53	48	50	33	60	60	50	50	95	95	23.8%
Spain	56	56	78	78	60	60	30	30	56	56	30.1%
Anglo-Irish Model											
Ireland	17	17	11	11	20	20	20	20	13	24	10.8%
UK	7	14	11	11	0	20	10	10	22	22	11.0%
US	0	0	0	0	0	0	0	0	0	0	8.5%

Source: World Bank (2009) *Doing Business* Indicators

Labor Organization conventions on labor standards. These data are available for as far back as 2004 and these earlier values are included for comparison. They support the notion of stability in the indexes, as ten of the sixteen nations did not change their overall index values, and the six that did change did not do so to a remarkable degree. Also shown are two more concrete indicators of costs that impede labor market adjustment: Firing Costs (notice requirements, severance payments and penalties due when terminating a redundant worker, the total costs of which are expressed in weeks of salary) and Hiring Costs (expressed as a percent of one month's salary). 2006 was the last year for which this data was reported by the World Bank.

Some of the generalizations made with reference to the overall impediments to doing business from Table I also hold for overall legislated rigidities in employment. Denmark again stands out as an extreme outlier in the Nordic region, as its degree of rigidity is markedly less than either Ireland or England, two countries that are commonly regarded as having the most flexible labor markets. A number of anomalies exist: Belgium, for example, places few legislative restrictions on hiring (its index value is 11) and the monetary costs of hiring workers that it imposes on employers are the highest in Europe. Likewise, Austria imposes no hiring restrictions (true also only of the US and Denmark) and imposes the lowest monetary firing costs in the EU-15. It does, however, significantly restrict hours of work and is above the median in terms of hiring costs. In fact, only Greece and Luxembourg had more restrictive legislation with respect to work hours.

Luxembourg itself is sufficiently anomalous to merit an explanation. The nation has the most labor market rigidity among the EU-15. It also has the highest per capita income in Europe by far ($85,100 US) which is substantially higher than that of the US, and is the only nation in the EU with a per capita income that greatly exceeds the US average. If labor market rigidity is argued to be an economic handicap, then Luxembourg contradicts that argument. However, Luxembourg is quite small, with a population of 486,000 that is more comparable to Washington DC (DC), which has about the same per capita income as Luxembourg, than to a country. More than 86 percent of Luxembourg's GDP comes from services, again similarly to DC, and financial services and government make up most of that (CIA, 2009). It receives a higher per capita expenditure (net of taxes contributed) from the EU government than does any other European country, mostly because two EU government branches (The European Parliament and Court of Justice) are located there. Thus it may be that highly inflexible labor markets are not much of an inhibitor to high income in such a setting.

Countries in the Mediterranean category, for the most part, do seem to be properly grouped together in terms of labor market rigidity. Although they may not be readily distinguishable from the Continental-model countries, it should be remembered that the Mediterranean countries tend to rely much less on re-training, income support for unemployed and disabled workers, and similar programs than does the rest of Europe. The Mediterranean countries rather rely chiefly on business regulation for workforce security, and so depart most significantly from the "flexicurity" ideal aimed for in the Lisbon Agenda. As a group, the Mediterranean labor markets also have been the poorest performing labor markets among the EU-15.

CONCLUSION

Four contentions were offered in the introduction of this paper: (1) the idea of a uniform European Social Model is highly inaccurate; (2) the four sub-models commonly used to characterize European nations also do not exhibit a great deal of uniformity across their included nations; (3) Ireland and the UK are more like the US than they are like the rest of Europe in terms of labor market rigidities, and (4) in spite of the first three contentions, all EU nations have significantly more rigid labor markets and business regulations than the US does. The data presented here that were released recently by the World Bank strongly support the second contention and very strongly support the first. Less support exists for the third and fourth contentions, especially because Denmark is not only an outlier with respect to the other Nordic countries, but also because in some respects its labor market characteristics are even more similar to those of the US than are the labor market characteristics of the two Anglo-Irish model economies.

Some cautionary remarks are in order. Although the data in Tables 1 and 2 may serve well as very rough measures of relative labor market rigidity, they cannot indicate the relative importance of the various measures offered. For example, the index of overall rigidity of employment is an unweighted average of its three component indexes, and each of these is compiled by simply adding a value for the presence of certain characteristics. Clearly though, some of these rigidity characteristics may be of much greater consequence than others. Furthermore, some may have interactive effects and, although the indexes are additive, their combined effects may have even greater, non-additive consequences for the flexibility of labor markets. Other issues that affect labor market rigidity, but are not included in the present data, involve such matters as the degree of centralization of collective bargaining. In some countries, bargaining includes an allowance for local variation while in other countries bargaining is entirely centralized and makes little or no such allowance (Calmfors, 2001). Effects cannot be quantified though, because the degree of bargaining decentralization does not indicate the degree to which variation in local conditions are adequately accommodated. Finally, some aspects of labor market flexibility have to do with individual behavior rather than with institutional influences. When there are significant differences in regional income and unemployment levels, migration can mitigate the effects of institutional rigidities. Fatas (2001) documents that in response to regional differential demand shocks, Americans are more likely to migrate than Europeans, whereas Europeans are more likely to drop out of the labor force and remain out of it. On one hand, this tendency undoubtedly aggravates the effects of institutional labor market rigidities. On the other hand, retraining programs can at least partially offset the effects of institutional rigidities. The Scandinavian countries have historically put a great deal of emphasis on so-called active labor market policies that substantially involve retraining as well as job placement assistance and mobility bonuses. For example, Sweden has expended about 3 percent of GDP on active labor market programs, compared to about 0.5 percent for the US (Forslund and Krueger, 1994).

It is hazardous to predict the future course of labor market flexibility and progress toward meeting the goals of the Lisbon Agenda, but the global financial crisis originating in 2008 is likely to result in popular demands for greater regulation, not only in the financial sector but much more generally and including labor markets. Ultimately, this effect may be detrimental to the populations of Europe, but the hope (and illusion) that rigidity of labor markets protects and improves labor's standard of living is likely to be stronger rather than weaker in the near future.

SUGGESTIONS FOR FURTHER RESEARCH

The data compiled by the World Bank has permitted a documentation of differences in degrees of institutionalized labor market rigidity in Western Europe, but mere documentation does not demonstrate the effects of such rigidities. Nor does it demonstrate the relative importance of the various components, but future research may do so. The conventional belief, of course, is that rigidity is responsible for the high average incidence of unemployment in Europe, but this, and related hypotheses, can be subjected to objective hypothesis testing. For example, it would be quite feasible to examine variation in estimated natural rates of unemployment across countries using the various index components examined in this paper as independent variables. Additionally, the present study should be extended to Eastern European members of the EU. Of particular interest is whether the variety of success in the liberalization of markets in these transforming economies can significantly account for the variety of results in economic performance.

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