

## Will the European Social Model wreck the Irish miracle?

**Dr. Constantin Gurdgiev**

Ireland is commonly regarded around the world as a shining example of private markets at work. Yet, unnoticed by many, over the last five years, the country has been sliding into the abyss of rising government spending, indirect taxation increases and more regulation and state involvement in the economy.

Ireland's corporatist government and the so-called Social Partners - a group of narrow and self-centred vested interests that includes the largely public sector-centred Trade Unions, welfare-hungry NGOs and the official business interest bodies - have recently started a new round of negotiations aimed at securing a new "Partnership" deal for the future of Ireland. The new Partnership will replace the existing arrangements that effectively set the floors for wage increases across the economy and dictate the long-term labour markets and social spending programmes in the economy.

Over the last 15 years, as the relevance of the Trade Unions in the Irish economy steadily declined, the government continued to promote the interests of the organisations that, by-and-large, represent the employees in the public sector and semi-state monopolies. The government has begun to insist on collecting an ever rising share of domestic private sector added value and distributing it to the Partners at the expense of the general taxpayers. This has contributed to higher inflation and an astronomically high cost of living in general, leading to growing voter discontent with the government.

Yet, judging by his statement made at the opening of the new social partnership talks, our Taoiseach (Prime Minister) believes in a bipolar world of economic and social policy making. On one side of Mr. Ahern's imaginary divide, there are 'liberal' free-market ignoramuses, who believe in the theory of freely operating labour markets and oppose the corporatist non-meritocratic model of wage setting – a model that has insured a 20-45% wage premium for the public sector without asking for an ounce of accountability and efficiency from state employees. On the other side, there are the 'enlightened' policy makers who firmly adhere to the idea of Social Partnership, because "partnership works in practice".

Speaking about his vision for the future of Ireland, Mr Ahern left no doubt in anyone’s mind as to which camp he belongs. “I don’t want any race to the bottom... I want improved take home pay and an improved quality of life” stated Ireland’s leader, fully endorsing the idea that a closed-doors agreement on wages between the state, large corporate interests, the NGOs and the Trade Unions is the only means for delivering prosperity for all.

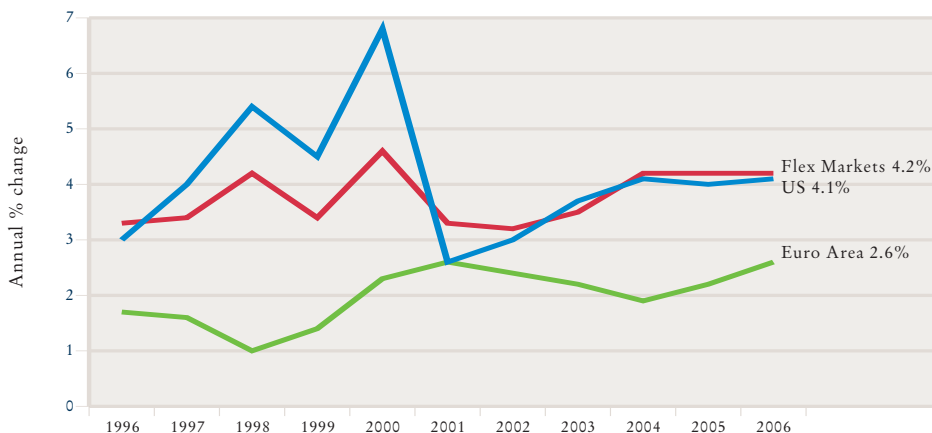
Let us test the European Socialist Model proposition that labour markets with more centralised bargaining arrangements deliver better (a) pay, (b) working conditions and social integration, and (c) quality of life than the markets with free wage setting arrangements.

The figures below are based on comparing Australia, New Zealand, the UK and the US - the countries with more flexible labour markets - to the more partnership-styled labour markets of the eurozone countries, including Ireland.

### Delivering a better pay...

As shown in the figure below, the wage growth rates in the countries with more flexible and less corporatist models of labour markets have been consistently higher than in the ‘partnership’-styled eurozone countries. In fact the US - the economy that is commonly cited throughout old Europe as an example of “race-to-the-bottom” capitalism - saw higher wage growth in the business sector than both the eurozone and indeed the other flexible economies.

Compensation per employee in the business sector

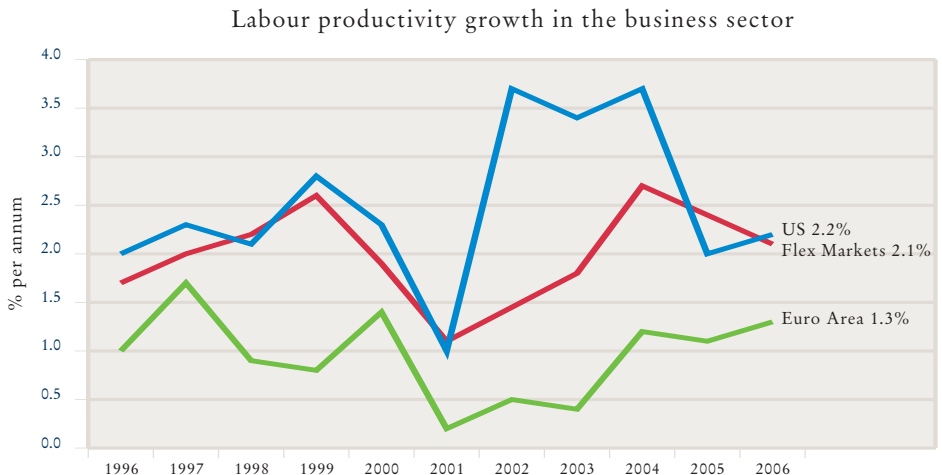


A recent study by US and European researchers found that since 1976, the wage and benefits returns to long-term employees in France have been consistently lower than in the US. The authors conclude that “in a low-mobility country such as France, there is little gain in compensating workers for long tenures because they tend to stay in the firm for most... of their career. In contrast, [in] a high-mobility country such as the United States... firms are induced to pay the premium... to avoid losing their most productive workers.” In fact, the long-term workers in France tend to earn 3.05 times less per each extra year they stay with the firm than their American counterparts. <sup>1</sup> Studies by the Stockholm Institute and the IZA institute in Berlin reported similar trends for Sweden and Germany.

So instead of benefiting workers with longer tenures, social partnership agreements ironically lead to the under-payment of more skilled employees. This explains at least in part why the majority of unionised skilled workers in Ireland take any opportunity to exit their ‘protected’ jobs for the business sector, leaving the less skilled segment of our labour force in the unionised employment.

**... a better workplace...**

The chart below shows the effects of the labour market restrictions on productivity growth rates in the euro area relative to that of the countries with more flexible labour markets. Since 1996, the cumulative effect of the productivity gap between the two groups stands at 13.4% in favour of the more flexible labour market arrangements. Amongst the latter, the US workers have gained 31.1% in their productivity relative to 11% in the eurozone since 1996.

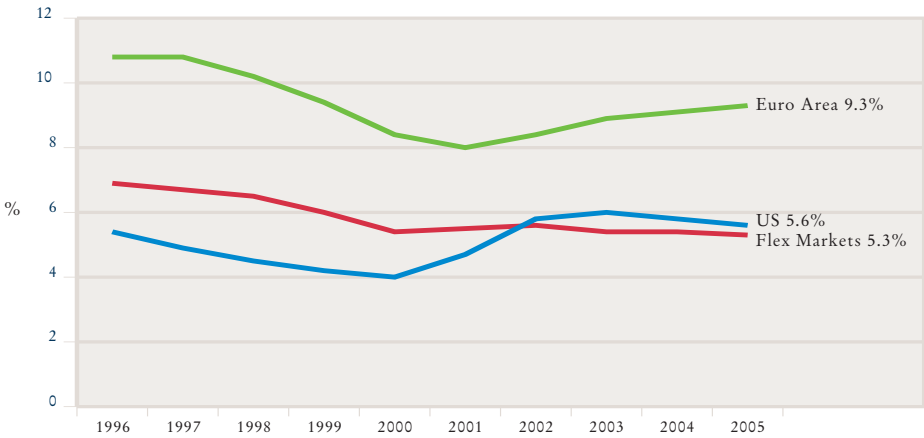


The productivity gains mentioned above coincide with the period of lower unemployment in the flexible markets than in the ‘social partnership’ economies. The latter fact disputes the argument that US productivity increases are due to workers’ displacement through capital investment and outsourcing. Yet, European Socialists are keen on insisting that the US model of development favours large capital owners at the expense of the workers. The whole premise of the European social model based on partnership agreements over wages, including the one practised in Ireland, is supposed to ensure that the state protects workers’ interests.

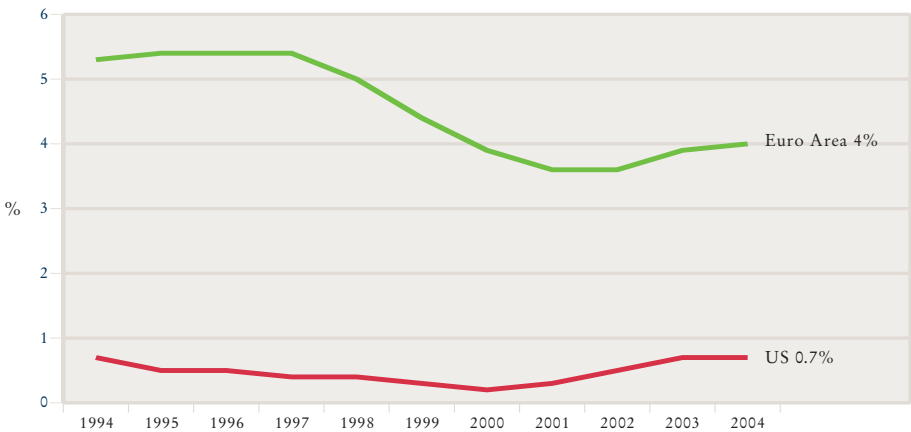
This stated objective of the European corporatist model is not supported by hard evidence. In fact, cumulative wage growth in the US since 1996 was 55.7% - a full 24.6% higher than labour productivity gains alone, making US workers the greatest beneficiaries of the total productivity growth. For the eurozone, the cumulative wage growth was just 24.2% as opposed to 44.6% in the group of flexible labour market economies. Thus, less partnership-driven economies saw greater gains to workers, while more corporatist economies saw greater returns accruing to the capital owners - hardly evidence in support of the ‘caring partnership’ vision of our Taoiseach.

Economists around the world agree that happier workers are more productive than those facing adverse workplace conditions. In an October 2005 study, the German Institute for the Study of Labour showed that more competitive “high performance workplaces elicit greater involvement and productivity from employees”. According to the authors, “the evidence reveals that high performance workplaces are more likely to keep commitments to provide family friendly workplaces.” The study compared employer practices in Britain in competitive flexible firms against those in the unionised and public sectors. In the end, “[union] members report their employers do less well than nonmembers’ firms in keeping the [workplace] commitment.” The public sector employers fared even worse. Another study from the UK shows that labour market arrangements supported by the unions are associated with reduced availability of flexible hours and work at home arrangements but greater availability of leaves and job sharing, “leading to lower reported job satisfaction including satisfaction with employers keeping a commitment to provide family time”. Similar results were found in the US.

### Standardised unemployment rates



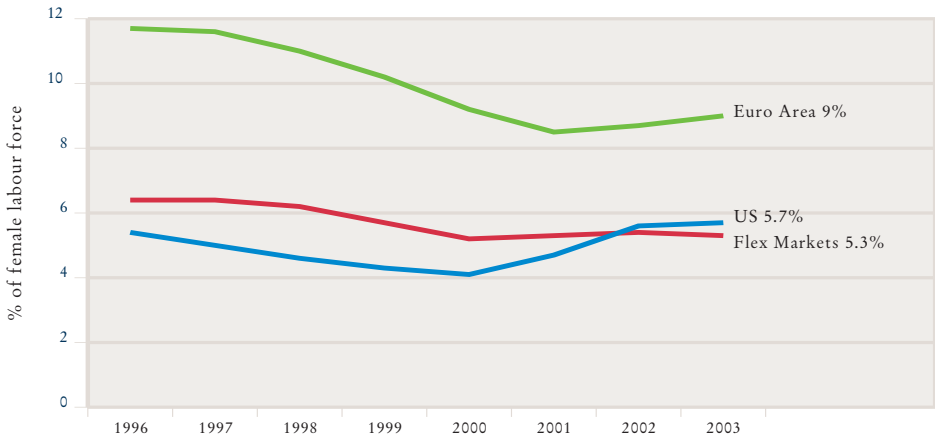
### Long term unemployment rate



Macroeconomic data from the OECD shows that more flexible labour markets support lower long-term unemployment, with a gap between the eurozone countries and flexible wage economies remaining relatively stable at approximately 25% between 1996 and 2005, as illustrated above. Amazingly, unemployed residents of the ‘socially caring’ eurozone have a 4 times greater probability of being out of work for the rest of their lives than their counterparts in the ‘race-to-the-bottom’ US.

Looking at the data for unemployment among women in the chart below dispels the myth that less flexible public partnership arrangements are capable of improving workplace opportunities for women. Similar results hold for the ability of labour markets to support integration of foreign migrants.

Standardised unemployment rate for women



### ... and a higher quality of life

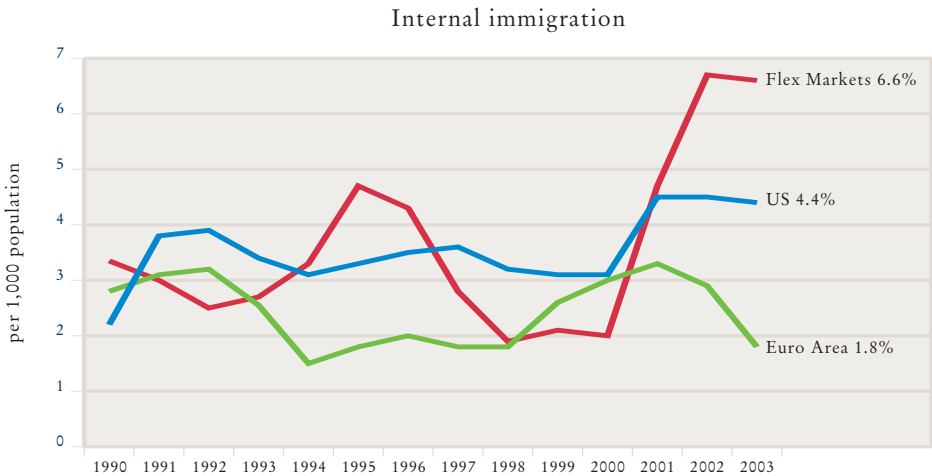
Another CEPR (July 2005) study forcefully argued that less flexible “European labour market regulations, advocated by unions... explain the bulk of the difference between the US and Europe” in hours worked.<sup>2</sup> Since the 1970s, corporatist labour policies “do not seem to have increased employment, but they may have had a more society-wide influence on leisure patterns” inducing higher demand for leisure in Europe than in the US.

However, despite taking more time off from work, Europeans, who spend more of their free time in household production, enjoy less time in quality-adjusted leisure than Americans. A University of Chicago study from 2004 showed that adding together time spent working at home and at work, Swedes labour 29 days more per annum than their American counterparts - largely due to lower utilisation of professional services.<sup>3</sup> This is not surprising, given that in Sweden for each €1 collected by a contractor for services rendered, Swedish consumers are forced to pay €12 in costs and taxes.

Higher taxes, coupled with far lower incomes in Sweden than in the US make it hard to argue that taking more time off formal work yields greater quality of life for social-partnership-bound Swedes. This explains why self-reported happiness is at best weakly correlated with hours outside work in the eurozone. The same holds within the US, with less flexible, more unionised states trailing behind the states with higher mobility in terms of quality-adjusted leisure.

The fact that more flexible markets support better economic and social environments is strongly supported by data on the inflows of foreign migrants. Since 1990, with the

exception of 3 years, the flexible labour market economies have consistently outperformed the eurozone countries in the number of foreigners willing to immigrate into developed economies. Adjusting for refugee inflows, the economic immigrants almost unanimously voted with their own feet in favour of the US, UK, New Zealand and Australia in every year reported.



All of this evidence strongly contradicts the assertion, forwarded by supporters of the Working Time Directive, that the costs of limiting working hours allowed in the economy yields quality of life benefits that offset the policy costs in terms of lower productivity and income. It also negates the arguments that heavier regulations of labour markets practiced in the eurozone are conducive to better worker protection and more equitable pay.

## Conclusion

The above discussion establishes that the Irish government is wrong in supporting the proposition that European social partnership-styled agreements on wages and labour markets can deliver on their objective of better pay and life for workers. Instead, global experience has time and again shown corporatist controls over labour markets to be an impediment to workers' interests.

To assure that Ireland Inc delivers the benefits of growth to our working taxpayers and consumers, Mr. Ahern should walk away from the partnership table once and for all.

To achieve conditions required for robust growth, entrepreneurship, efficient investment and betterment of taxpayers' lives throughout Europe, the Continental model of serial surrenders to the blackmail of the militant trade unions must be chugged into the dustbin of history.

- 1 Beffy, M et al, 2006, The Returns to Seniority in France (and why are they lower than in the United States?), CEPR
- 2 Alesina, A et al, 2005, Work and Leisure in the US and Europe: Why so different?, CEPR
- 3 Freeman, R & Schettkat, R, 2005, Marketisation of Household Production and the EU-US Gap in Work, Economic Policy 20 (41): 6-50

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