CHAPTER 5

The European Social Model - One size doesn't fit all

Chresten Anderson

Europe's leaders should keep two points in mind:

- First, the imposition of a single welfare state model is unjustified from an economic perspective and undesirable politically.

- Second, the EU Commission's Social Agenda is too heavily focused on job creation, which does not benefit Europeans at large.

A Joint Model?

The EU institutions insist on the need to come up with a single model for a Social Europe, and the idea rests on the assumption that convergence towards one model is desirable both economically and politically. But there are no empirical economic arguments that support the need for it. Coordination could potentially be relevant in the presence of economies of scale and spill-over effects, as well as increasing efficiency of the welfare state (read: slimming it down substantially).

However smaller countries have a better redistribution record than large countries. They have proved better able to reduce poverty, protect citizens against risks such as unemployment and reward labour market participation. This is probably because in smaller entities local information is more easily available – this is effectively an argument in favour of social policy decentralisation.

So while Europe doesn't need a 'one size fits all' approach to the social model, it must instead make use of political decentralisation, which is grounded in diversity and take account of the various traditions across Europe.

But should other European countries look to the Nordic region for answers to a politically decentralised European Model? The answer is no!

It is of course true that the Nordic countries have achieved success in recent years. But most of that success is owed to the enactment of free-market and market-oriented reforms, rather than the welfare system. It is these reforms to which Europe should look for inspiration, for they form the nucleus of a new, *second-generation* model.

This *new* model contains two very different and distinct aspects – both of which seem highly unlikely to pass in most other countries in Europe.

The first aspect of the *new* model is exemplified in the social model of Denmark. Due to its highly homogenous population it has to a very large extent been possible to slowly, and mildly, reform the present welfare system – to such a degree that bankruptcy is not around the corner – but rather a few blocks away.

In the mid-80s the conservative government started pension reform, which included more private savings – both individual and employment based. This created a three pillar system where most people will get an additional pension on top of the unfunded government pension. During the 80s and 90s there have been a number of adjustments to the unemployment system and early retirement plans, all of which has helped reduce the pressure on government coffers, reforms which are comparable to those introduced by Jason Turner and Rudi Giuliani in New York. These reforms have been passed in Denmark, mostly with support from the Social Democrats, and it seems very unlikely that they would pass in many other European countries – all we have to do is look to Germany and France these days.

The second, and potentially even more important, aspect of the *new* Danish model is the level of economic freedom in Denmark. In Heritage's most recent Index of Economic Freedom, Denmark ranks as the 8th most free country in the world. On a scale where a low number means a more free economy, most scores are at an incredible 1.00, except for the Fiscal Burden (where Denmark scores 3.8), and government intervention (where Denmark ranks 3.00). Overall Denmark scores 1.78. This is the true secret behind the Danish model – and why Denmark is so economically successful, despite the high and counter-productive welfare state.

There are many defenders of the big state model and they often point to the Nordic countries as evidence of its viability. But the exact opposite is true. The Nordic countries still have high taxes, a regulated labour market and extensive public monopolies that create problems. It is the reforms *away* from that Model that are producing good results.

The Nordic countries need much more market-oriented reform. The current situation should not be seen as an argument against reform, but for more of it – for the Nordic countries as well as others.

But what about job creation? Shouldn't the EU keep that in mind?

A substantial aspect of the European Commission's Social Agenda is a focus on "job creation". Last year the EU Commission sent out a communication report on the Social Agenda, with the motto: "A Social Europe in the global economy: jobs and opportunities for all." This is all part of the Commission's proposed Lisbon Agenda, after it was re-launched with a new focus on the "social agenda."

The long-winded aim of the European Union, in accordance with the Lisbon Agenda, is to ensure the "sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress and a high level of protection and improvement of the quality of the environment."

This is the basis for the European Social Model, which is focused on jobs and growth. But the problem is that the focus on job creation has nothing at all to do with the focus on growth – or even improving welfare.

In the book *What Everybody Should Know About Economics and Prosperity,* Professors Gwartney and Stroup write:

> "Politicians often erroneously talk as if the creation of jobs is the source of economic progress. While campaigning, a recent political leader argued that his economic program had three pillars: "Jobs, jobs, and jobs." But focusing on jobs is a potential source of confusion. More employment will not promote economic progress, unless the employment expands output. We do not need more jobs, per se. Rather we need more productive workers, more productivity-enhancing machinery, and more efficient economic organization so we can produce more output per capita."

What politicians forget is that:

> "A higher income and standard of living are dependent upon higher productivity and output. There is a direct relationship between a nation's per capita (per person) income and its per capita output. In essence, output and income are opposite sides of the same coin. Output is the value of the goods and services produced, as measured by the prices paid by purchasers. Income is the revenue paid to the people (including the entrepreneur's residual revenue), who supply the resources that generate the output. This too, must equal the sale price of the goods.

> Consider the following example: suppose that a construction company hires workers and purchases other resources, such as lumber, nails, and bricks, to produce output - in this case, a home. When the home is sold to a buyer, the sale price is a measure of output. Simultaneously, the sum of the payments to the workers, suppliers of the other resources, and the residual income received by the construction company (which may be either positive or negative) is a measure of income. Both the output and income add up to the sale price of the good, which represents the value of what was produced.
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> Once the linkage between output and income is recognized, the real source of economic progress is clarified. We improve our standard of living (income) by figuring out how to produce more output (things that people value). Economic progress is dependent, for example, on our ability to build a better house, computer, or video camera with the same or a lesser amount of labour and other resources. Without increases in real output - that is, output adjusted for inflation - there can be no increases in income and no improvement in our living standards."

But clearly the European Commission has not made this linkage yet, since they write in their communication that the EU's Social Agenda develops a two-pronged strategy:

> "Firstly, it emphasises its role in strengthening citizens' confidence. This confidence is essential for managing the process of change and plays a key role in encouraging economic growth. The Agenda describes the combination of Community instruments for improving the quality of its implementation and presents, in this context, three key conditions for success: an intergenerational approach, a partnership for change and the need to seize the opportunities offered by globalisation.
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> Secondly, it presents key measures under two major headings, which are covered by the Commission's strategic objectives 2005-2009: (1) employment (under the prosperity objective) and, linked to that, (2) equal opportunities and inclusion (under the solidarity objective). The Agenda combines the consolidation of a common European framework with the implementation of diversified measures to respond to specific needs. In this way, it supports the motto "United in diversity", which is proclaimed by the draft Constitutional Treaty."

This strategy (particularly the second part) will be a major roadblock in promoting economic growth, which is the only way to secure the economic wellbeing of European citizens.

The European Commission should discard the whole Social Agenda, and drop its desire to centralise all political decisions in Brussels – and it should put a halt on its "job creation" policies. Until the European Commission recognises this key economic truth that jobs do not create wealth by default – rather growth and wealth creation can help ensure jobs – then the focus on economic well-being in Europe may very well turn out to be counterproductive.
What may very well happen when politicians seek to "create jobs" is that they re-allocate resources from one area of the economy to another – at best this does not create growth or jobs but simply moves them around. Of course politicians will point to the jobs in the industry sector that they have supported and happily exclaim "We did this!", but will never look to the areas of the economy from which the resources have been taken away and point to the job losses there.

This is as described by the French economist Frederic Bastiat in his well-written *What is Seen and What is Not Seen*:

> "Have you ever been witness to the fury of that solid citizen, James Goodfellow, when his incorrigible son has happened to break a pane of glass? If you have been present at this spectacle, certainly you must also have observed that the onlookers, even if there are as many as thirty of them, seem with one accord to offer the unfortunate owner the selfsame consolation: It's an ill wind that blows nobody some good. Such accidents keep industry going. Everybody has to make a living. What would become of the glaziers if no one ever broke a window?
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> Now, this formula of condolence contains a whole theory that it is a good idea for us to expose, *flagrante delicto,* in this very simple case, since it is exactly the same as that which, unfortunately, underlies most of our economic institutions.
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> Suppose that it will cost six francs to repair the damage. If you mean that the accident gives six francs' worth of encouragement to the aforesaid industry, I agree. I do not contest it in any way; your reasoning is correct. The glazier will come, do his job, receive six francs, congratulate himself, and bless in his heart the careless child. *That is what is seen.*

> But if, by way of deduction, you conclude, as happens only too often, that it is good to break windows, that it helps to circulate money, that it results in encouraging industry in general, I am obliged to cry out: That will never do! Your theory stops at *what is seen.* It does not take account of *what is not seen.*"

And that is what European politicians forget in the Social Agenda – when they focus on job creation.

It cannot be done – because all that happens when the focus is on jobs rather than on growth creation is that we simply scramble to redistribute the same pie, rather than making it bigger.

Chresten Anderson is the president and founder of the Copenhagen Institute, the leading free market think tank in Denmark.