The Welfare State and the fight against inequality:

The European Social Model as an element of European identity. With special reference to the German case

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Since the Treaty of Rome in 1957, the European Union countries progressively developed a set of national and collective regulations and institutions relating to social policy and welfare. The social dimension accompanying the Economic and Monetary Union became the so-called "European Social Model", a fundamental part of the EU acquis that Member States have implemented in different ways. Solidarity and responsibility sharing, in line with the letter and spirit of the Lisbon Treaty is needed.

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What are the principles of the European Social Model?

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In comparison with other regions and countries, the European approach is characterized by high expenditure on social protection. Yet, more than a socio-economic construct, the European Social Model should be seen as a system of values, which is embodied in the way Europeans see the role of the state and the relationship among the citizens.

Hence, the EU Social Model is ultimately a key element of the European identity based on the principle of solidarity and often seen as the 'soul' of the European Union. Most Europeans are looking at it as a step forward in social if not human progress.

What are the main elements of the EU welfare systems?

A major component of the Social Model is the welfare system. Generally, welfare systems in the EU entail largely free health care and education; unemployment support, a broadly accessible social security system and sound maternity and child care benefits. Key differences apply across countries, reflecting historical and cultural divergences. As expressed by the literature, and most notably in the 1990 work by Esping-Andersen, there are four types of welfare regimes: the social democratic or Scandinavian; the conservative or continental regime; the liberal or Anglo-Saxon; and the Mediterranean or Southern model.

Different types of welfare regimes in Europe

- The *social democratic regime*, typical of Denmark, Finland, Norway, Sweden, and the Netherlands places large emphasis **on redistribution**, **social inclusion** and **universality.** Hence benefits are high and universal, women are encouraged to work.

- The *conservative or continental regime* places less emphasis on the need to redistribute wealth; sees **employment as the basis of social transfers**, thereby benefits are linked to income. It protects the traditional role model (for instance the role of women) and maintains differences between social classes. (Austria, Belgium, France, Germany, Luxembourg).

- The *liberal* or *Anglo-Saxon regime* (Ireland, United Kingdom) pivots around **market-based social security schemes**, with smaller social transfers, and the co-existence of private schemes. The benefits are targeted and means-tested.

- The *Mediterranean* (Greece, Spain, Italy) regime features low social transfers, with social policies characterised by **particularistic and clientelistic traits** (Ferrera 1996).

	Social-Democratic	Conservative	Liberal	Mediterranean
Aim	Social Citizenship, Equality, Full Employment	Social Cohesion, Social Integration	Poverty Reduction, Poverty Alleviation	Clientelism
Eligibility	Citizens/ Residents	Workers/ Insured/towards quasi-universalism	Poor	Insiders/very limited coverage
Financing	Taxation	Social-insurance Contributions	Taxation	Contributions + taxes
Benefits	Flat and Universal	Earnings-/ Contributions-related	Means-tested	Earnings-/ Contributions-related

Source: Martin Seeleib-Kaiser (2015)

For several reasons, this scheme, as usually presented by the literature, does not encompass Eastern European countries. Central and Eastern European economies have been transitioning from large social protection and benefits to systems which mix the forms and features of the regimes just mentioned.

Also, the ways these have been mixed are different country by country and they are still evolving.

Each regime bears implications regarding the economic and social outcome in an economy, there are remarkable divergences across regimes in terms of poverty and inequality. The following table reports the Gini coefficient for each group, where the Gini coefficient captures the dispersion of disposable income in an economy. The higher the more unequal is the society. The second column reports instead the relative poverty rates, with respect to the threshold of 60 per cent of the median income. This means that for example in Scandinavia and the Netherlands on average about 12 per cent of the population has an income that is below the 60 per cent of the median income in that country.

	Gini Coefficient	Relative Poverty Rates (60% median)
Social-Democratic Regime	0.247	12.615
Conservative Regime	0.273	14.353
Liberal Regime	0.332	21.110
Mediterranean Regime	0.327	20.202

Source: Martin Seeleib-Kaiser (2015) from Luxembourg Income Study

The German welfare system

The German model belongs to the continental or conservative regime, it is based on traditional role models and standard employment figures, and its core aim is to secure that the achieved standard of living is maintained.

Social protection in Germany has a long history, which stems from the 1880s when the Bismarck government granted workers insurance for health, industrial accidents, invalidity and old-age. The country had its first system of unemployment insurance in 1927, based on employers' and employees' contributions. The welfare system was then deepened in the post-war period, and consolidated in the 1960s and 70s with government social expenditure increasing substantially as a share of GDP.

In the years after re-unification, the country undertook pension and care reforms. Overall, by the end of the 1990s the country had a welfare regime, predominantly conservative, but with some elements of liberal welfare regime, notably a means-tested and tax-financed social assistance system for the poor.

At the turn of the century, Germany's economy had been stagnating, with growth averaging only about 1.2 percent from 1998 to 2005 and unemployment was on the rise (11.1 percent in 2005). The country was called the *sick man of Europe* (Dustmann et al. 2014).

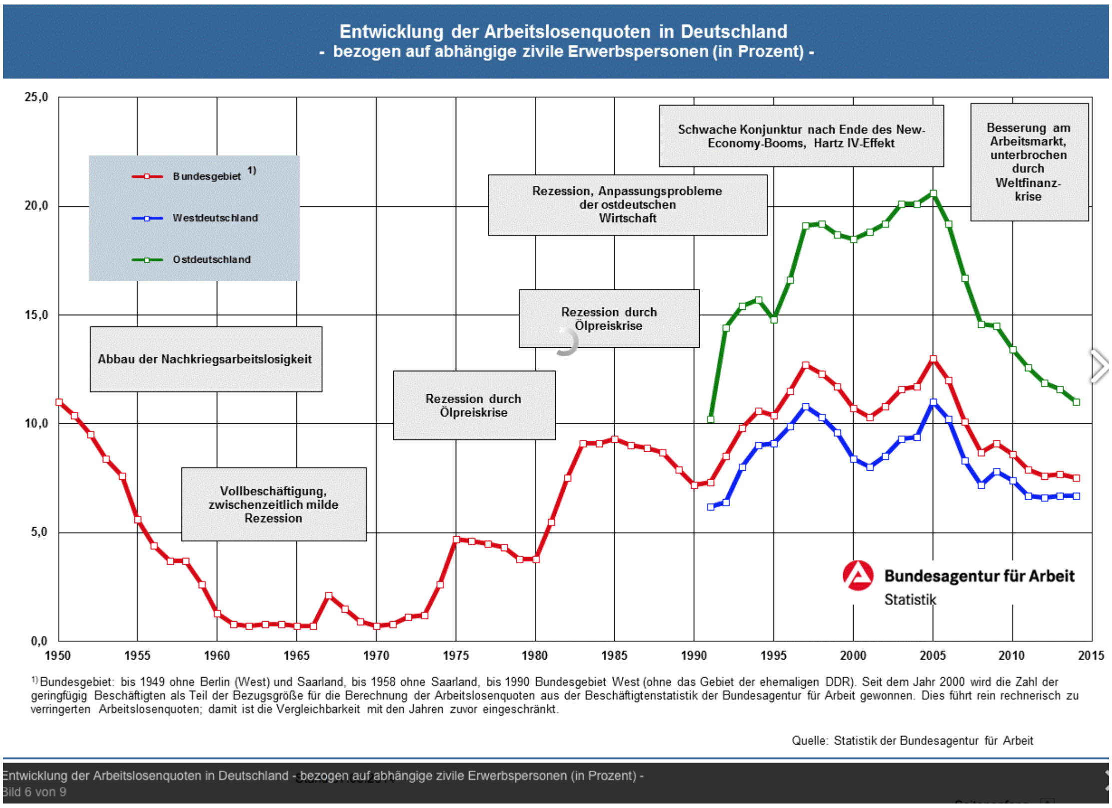
As an attempt to make the labour market more dynamic, the social democratic government by Gerhard Schröder embarked in a series of reforms in the early 2000s: a health care system reform (in 2004) and more importantly a series of labour- market reforms. Four, so called 'Hartz laws' were enacted from 2001 to 2005, which particularly concerned active labour market policies. The reforms constituted a clear break with the continental or conservative legacy. They deregulated the labour market, and reduced spending in unemployment insurance.

More precisely and in a nutshell they:

- turned the government employment office into a body that aimed at activating the unemployed, and was more efficient in placing job-seekers;
- cut unemployment insurance from 32 months to 12 months, and forced the unemployed to be actively seeking work;
- merged unemployment assistance and social assistance now taxed based and not contribution based
- gave more support to SMEs and to start-ups in order to stimulate employment
- and stimulated labour market deregulation, easier dismissal and more temporary contracts

Much has been already said regarding the impact of these reforms, some authors (notably Seeleib-Kaiser 2013) see them clearly as a move towards a more liberal welfare system. Many are arguing that the positive economic performance that Germany experienced in the late 2000s including during the crisis could be largely attributed to the reform.

The German labour market has seen impressive developments even during the crisis in 2008/2009 and now even more impressively since 2012. Between 2005 and 2009 the unemployment rate dropped from 13.0% to 7.9%. The labour market was quite robust in 2009 and unemployment did not increase. From 2009 onwards unemployment is constantly decreasing. The latest figures from 2014 show an unemployment rate of 6,7% .



Source: Bundesanstalt für Arbeit 2015

First of all, establishing causality might be hard; the early 2000s were years of great changes for Germany and the EU with the implementation of the the Euro and the EU enlargement. Hence I believe it is difficult to fully capture the impact of these reforms.[1]

Some authors have argued that the stellar German performance was due to the evolution of the economy and trade balance in the context of the Eurozone. Some others claimed that the opening of Eastern European countries entailed access to labour and inputs of production that were cheaper than those in Southern Europe (the traditional trading partner of Germany).

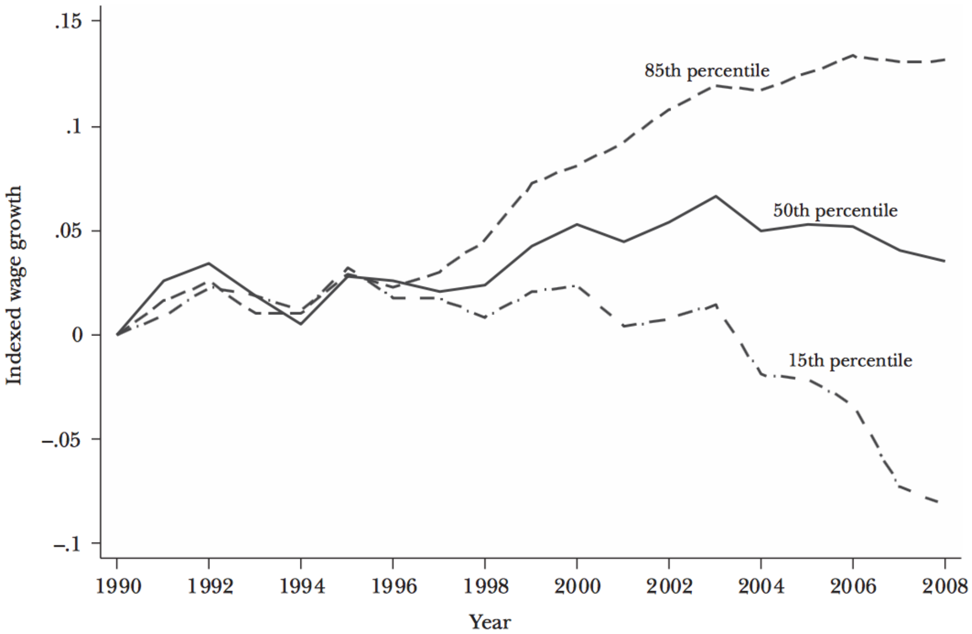
By definition, the reforms allowed for more dynamism in the labour market. On the one hand, this may have enhanced productivity of German workers, but, on the other hand it may have increased the number of atypical forms of employment, which tend to be largely unprotected; and divergence in income, in particular wage-inequality (SLIDE 5).

Further, while the country (and its employment level) has not been affected as many others by the crisis, the number of long-term unemployed is still stubbornly high at more than 40 per cent of the

[1] Also, when it comes to inequality, some studies do not see evidence that the labor reforms contributed to the decline in income inequality that Germany experienced in the late 2000s (see Rehm et al. 2014).

total unemployed and which poses serious problems as their absorption back to the labour market is very difficult.

Indexed Wage Growth of the 15th, 50th, 85th Percentiles, West Germany, 1990–2008



Notes: Calculations based on SIAB Sample for West German Full-Time Workers between 20 and 60 years of age. The figure shows the indexed (log) real wage growth of the 15th, 50th, and 85th percentiles of the wage distribution, with 1990 as the base year. Nominal wages are deflated using the consumer price index (1995 = 100) provided by the German Federal Statistical Office.

Source: Dustmann et al. (2014)

Hence even if it is considered the current labour market and also the economic performance as impressive, one has to argue that the improvement is relatively recent and holds in comparison with the disastrous developments happening in the rest of the Euro area. Secondly, part of the performance is due to the expansion of what has become one of the largest low-wage markets in Europe.

The performance in terms of working hours has been much less impressive than the increase in the number of jobs and therefore Germany has seen one of the most pronounced rises in inequality of all the OECD countries (Andrew Watt, Queries 2014).

However, the strong tradition of corporatism and social partnership – especially in the German export-oriented industry – benefitted a lot in not seeking the hiring and firing but in the longer-term orientation with investment in capital and skills and negotiated working flexibility as for example part-time working schemes. As a consequence these “social policies” absorbed much of the labour market shock expected in 2008/2009 and permitted a smooth swift return once global demand picked up in 2010.

The European discussion on Social Europe

In which way did the European Social model respond to the challenges due to the global crisis?

Since 2000 the EU is talking about creating the most innovative and sustainable growth to put the continent in the 'fast lane' compared to other economies. It was the Lisbon Agenda reviewed in 2005, and then in 2010 the Europe 2020 strategy. The results of the Lisbon Agenda were disastrous. They missed all key targets. The only positive element, as could be read in the final report of the Commission, had been that there was greater awareness of the need for reform in the Member States!

The Europe 2020 Strategy defined five core objectives

- ***Employment***

  75% of 20 to 64-year-olds should be employed.

- ***Research and Development***

  3% of EU GDP should be spent on research and development.

- ***Climate Change and Sustainable Energy***

  Reduction of greenhouse gas emissions by 20% (or even by 30%, if the conditions for this are right) relative to 1990; increase of the share of renewable energy to 20%; increase of energy efficiency by 20%

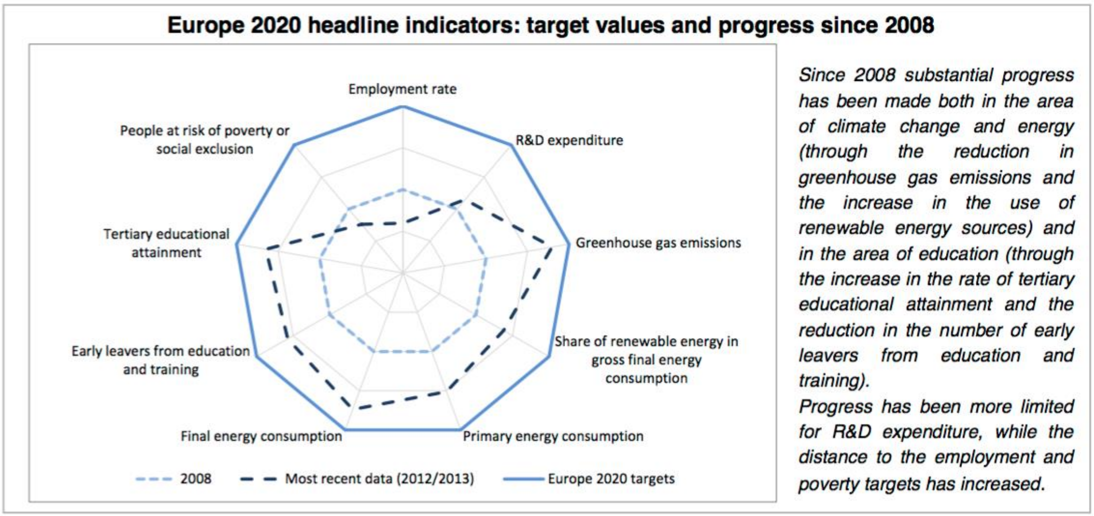
- ***Education***

  Reduction of the rate of early school leavers to below 10%; increase in the proportion of 30 to 34-year-olds with completed tertiary education to at least 40%.

- ***Combating Poverty and Social Exclusion***

  The number of those affected by or at risk of poverty and social exclusion should be reduced by at least 20 million.

Eurostat gave a statistical presentation in a press release in March this year of the progress on the implementation of the Europe 2020 Strategy:



Source: Eurostat Press Release 38/2015 of 02.03.2015

Some progress can be seen in climate policy through the reduction of greenhouse gas emissions and increase in the use of renewable energy sources. Progress has also been made in education.

This is accompanied by very limited additional expenditure on research and development. Gross domestic expenditure on Research & Development as a percentage of gross domestic product is slightly higher, rising from 1.85% in 2008 to 2.02% in 2013, but still far from the target of 3%.

But the outlook is grim in the core area of employment and poverty reduction. The employment rate fell from 70.3% in 2008 to 68.4% in 2013. The goal is to have 75% of the population aged 20-64 in employment.

And the figures from the Eurostat report for persons threatened with poverty and social exclusion are nothing short of catastrophic. While this affected 116.6 million in 2008, the number for 2013 had increased to 121.4 million, far from the target of 96.6 million in 2020.

A major focus of getting people out of unemployment by creating 20 million jobs by 2010 was not reached. A crucial pillar of the European social dimension agenda was to help member states in their pension and health care reforms. Related to this is the EU Charter of Fundamental Rights (2000) which introduces principles of social protection at the EU level among others the right to maternity leave and the entitlement to social security benefits and social protection in cases of illness, accidents or loss of employment. Overall, the Maastricht treaty of 1992 which was establishing the monetary union and the Euro currency has restricted the scope for fiscal policy in a way that may conflict with maintaining sound and sustainable social security systems. The failure of the Growth and Stability Pact in assuring a compatibility with social and economic standards emerged clearly during the crisis.

How has the European Social Model been affected by the crisis?

The social dimension of the EU has been weakened tremendously during the crisis. Faced with sky-rocketing debts and financing needs, some countries embarked in reforms that saw cuts in social protection especially in Spain, Ireland and Italy.

Countries like Greece, Latvia, Portugal, and Romania saw dramatic decreases in their social security budgets. At the same time public sector services, social transfers, and collective bargaining have been eroded; labour markets are being deregulated, with tightened rules to limit eligibility of the unemployed and disabled to receive benefits.

The austerity policies have inflicted a heavy toll on the European Social Model, with the well-known consequences on inequality, poverty and ultimately aggregate demand.

And, as they did take place during a recession then they caused the double-dip recession in 2011. As argued by the seminal 2013 Oxfam report, European austerity programs have dismantled the mechanisms that reduce inequality and enable equitable growth. As a result, almost one in ten working households in Europe now lives in poverty, often referred to as 'in-work' or 'working poverty'. Real value of wages is falling fastest in countries implementing aggressive spending cuts. Income is being increasingly unequally distributed; rising for the richest and falling for the poorest. Long-term unemployment went from 34 per cent of the total unemployed in 2008 to above 50 per cent in 2014, and youth unemployment went from 15 per cent of the corresponding labour force in 2008 to 22 per cent in 2014 (OECD data).

As a reaction to these figures the European Council expressed in 2012 a timid need for a road map of Social Europe but nothing has been so far done.

How can social Europe help us out of the crisis?

Europe is in deep need of stimulating aggregate demand. Yet, liquidity is not helping nor is Commissioner Juncker's plan on stimulating investment and its effects can be meaningless in macro-economic terms. The effectiveness of both strategies, quantitative-easing and investment policies, is limited by the prevailing sense of uncertainty in the EU countries. Investors and families save when prospects are weak. Yet, clearly families save more when jobs are precarious, when the government cuts care-spending and when pensions are uncertain.

Three main challenges are at the moment at the core of the debate.

- Firstly, addressing unemployment and poverty. This should remain the biggest priority not only for its own sake but also because these problems undermine public debt, sustainability and growth. Total unemployment rates stood at 10,3% in 2014 (11,6% in the Eurozone)
- Secondly, more and more, it becomes obvious that Europe needs a solid system of European economic and fiscal governance
- Thirdly, national tax and benefit systems have to be reviewed for improved efficiency, intergenerational equity and a fair burden sharing between the wealthy and the poor.

Hawkish economists could be concerned about high levels of debt and fiscal unsustainability. But firstly, if social spending stimulates growth as it has been proven, then debt to GDP would decline. Secondly, addressing inequality could provide an additional and sizeable source of revenues. Policies such as harmonising corporate taxation, increasing progressivity of personal income, fighting tax evasion, continuing with the FTT and to start addressing the revenue loss associated with the digital economy.

Another aspect of the euro crisis that a better EU social model would help contain is *euro-scepticism*. There are several reasons to understand current euro-scepticism. Yet, investing in social Europe could be a way forward to reduce scepticism and re-launch the European integration process. There are two practical proposals:

The concept of '*social dumping'* refers to the idea (often a wrong conception) that internal labour migration in the EU works in the direction to exploit the differential of benefits across countries. An Italian worker might flee to Denmark to use unemployment benefits. A Polish worker might go to the UK to use its health-care. Such fear is very strong in the UK and in the Nordic countries. More evidence is warranted to show that the phenomenon as I just mention is occurring in several ways and with several implications. If this is what happening, would a EU centralized unemployment insurance system help? It could be constructed in a way that any worker in the Union would know that if they lose their job then the EU central government would pay for at least 9 months.

Would this not for instance improve perception towards the EU?

Another interesting proposal, as widely discussed also in North-America and more and more in Europe, is the provision of a basic income guarantee. It will be revolutionary because it will have an even more overall approach on pre-distribution.

This is a very old proposal and the idea is a quite simple one. A universal income guarantee can eliminate the worst problems of destitution. It is interesting to see that as the welfare state gets eroded more and more through the austerity measures, an even more comprehensive form of welfare can be proposed through the basic income. The assumption is that it decreases inequality and could help to bring the poor to the lower middle class line.

It could also guarantee for those who work in the digital economy, those who generate innovative ideas through start-ups and even provide artistic performers with a back-up to avoid them having to dig up ways to make ends meet at the end of each month.

FEPS recently held a conference in Brussels on the working conditions in the digital economy and a study carried out by the University of Zurich, Switzerland is stipulating that the average monthly income of a "click-worker" is 543€. (Blöhm, I., 2015) This is disastrous and also desperate because such people have working contracts with no access to social security, health care or pension schemes.

Some social experiments point the success of this scheme in eradicating poverty, reducing unemployment and alleviating social exclusion and drug addiction. While more evidence on the effects will be welcome, (and on this developments in the town of Utrecht in the Netherlands should be tightly monitored), an aspect that makes this guarantee preferable to unemployment benefits is that it will be acyclical.

As a result, while unemployment benefits will expand in recession, thereby complicating public finances in difficult times, the income guarantee will not expand or contract with the cycle. On the other hand, as this guarantee provides equal transfers to each individual we need to make sure that a level playing field is in place. Hence, it must be remarkable the point regarding progressive taxation and a fair taxation of the financial sector.

However much more importantly it could help decrease diverging living standards in Europe and hence should therefore also in the interest of the richer member states regarding flows of migration from the poorer to the richer states.

Would this also not improve perception towards the EU?

In conclusion, the increase in social and economic inequalities in Europe is profoundly affecting the view of the citizens towards the further development of the European Union, its political and economic institutions and the democratic mandate of their respective governments and the European Union.

Diverging living standards are increasingly splitting Europe apart. Within this the “soul” of Europe is not easy to maintain and the growing divide between Europe’s regions is the most dangerous threat in Europe politics today.

Therefore it will be possible to launch a more comprehensive agenda in Europe to provide a real and genuine alternative to austerity in reforming towards economic and social European governance

Finally, 7 years or more have passed from the onset of the crisis. The crisis was ultimately a financial sector problem. After all these years, the problem remains. We can no longer afford governments that spend more on banks than on people. According to Oxfam, we spent much more on the financial sectors than on other people. One may argue that spending on the financial sector ultimately prevents damages on the people. But could there not be another way to protect households?

Source: Oxfam (2013)

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