



UNION EUROPEENNE DE L'ARTISANAT ET DES PETITES ET MOYENNES ENTREPRISES  
EUROPÄISCHE UNION DES HANDWERKS UND DER KLEIN- UND MITTELBETRIEBE  
EUROPEAN ASSOCIATION OF CRAFT, SMALL AND MEDIUM-SIZED ENTERPRISES  
UNIONE EUROPEA DELL'ARTIGIANATO E DELLE PICCOLE E MEDIE IMPRESE

## **The European Social Model and the European economic reform agenda - a contradiction or complementary policies?**

UEAPME's contribution to the EU Summit on Globalisation,  
October 27, 2005 in Hampton Court Palace, UK

### **1. A debate on the interaction between the European economic reform agenda and the European Social Model(s) is necessary**

Europe will only be able to respond to the challenges of globalisation by fully engaging in economic and social reforms. While the economic reform agenda uses an integrated European policy approach with a strong focus on competitiveness and dynamic labour markets, the responsibility for the necessary reforms of the different social models in the Member States lies with the national level (national governments, authorities and social partners). The failure, or shortcomings in the implementation, of these reforms in many Member States demonstrate that political actors at the national level have difficulties to integrate their economic and social reform agendas and to explain the necessity and the purpose of these reforms to their constituencies. In addition, the differencing pace of reform in the Member States has a negative impact on economic growth.

Many European citizens and also many small entrepreneurs regard at least some of these economic reforms as a threat to their social model. As a result, the European integration project is losing more and more of its support. For this reason, the upcoming informal European Summit could be a starting point for a more integrated discussion of the different aspects of both policy reform projects (economic reforms and social reforms) and should serve to promote better coordination between the respective actors at the different policy levels.

UEAPME welcomes the effort made by the UK Presidency and calls on the Heads of Government to use this opportunity for a meaningful review of the compatibility of the European integration process with their own social models in the context of an increasingly globalised world. With this contribution, UEAPME aims to present the views of crafts and small and medium sized enterprises. It expects the European Summit to take the specific situation of this sector, covering 99.8% of Europe's enterprises, into account, in its conclusions and in agreeing on further actions.

## **2. Main challenges for the European Social Model(s)**

### **Is there a European Social Model? Yes and no!**

There is a common understanding that a single European Social Model does not exist, and at least four different types are identified in literature on the subject (the Continental European, the Southern European, the Scandinavian and the Anglo-Saxon Model). However, some common key principles of the social models can be identified, such as unemployment and health care schemes, pension schemes, fight against poverty, support for child care and disabled persons, non discrimination and social dialogue.

However, the level of support, the instruments used to achieve specific targets and the targets themselves vary significantly across Member States.

### **Main threats for the European Social Models**

During the last fifteen years, the European Social Models came under pressure from three different main areas:

- The political change in Central and Eastern Europe and the integration of these countries into the European Union, on one side, and ongoing globalisation (WTO, economic reforms in China and India, technical advancements and decreased transport costs), on the other side, have caused enormous changes to the European economy and put pressure on the high labour cost economies in the EU15. These countries lost a lot of jobs to the new market economies, especially low qualified workers; initially in the manufacturing sector and, later, also in the services sector. The high level of structural unemployment of people with no or insufficient qualification in most of the 'old' Member States shows that these economies could not adapt adequately to these external shocks. This has given rise to serious problems for the sustainability of their social models, while also contributing to political instability and a negative perception of European integration and globalisation.
- Increased external competition has uncovered some dysfunctions of the existing social systems. Many elements of these systems go back to an economy with old industrial structures and are not compatible with a modern knowledge-based, services-driven economy. Vested interests in specific (public and / or protected) sectors and the trade union movement defend these old instruments, despite the fact that they provide false incentives and create more problems as they solve. This is especially true for the mobility in the labour market (women, young and older persons) and the flexibility of labour as regards working time, wages, labour contracts and qualifications. Low participation rates, increasing numbers of 'a-typical' working relations and a reduction of the potential for growth are the consequences.
- The ongoing demographic change in Europe presents a serious challenge to the sustainability of the European Social Models. This change has included a decrease of total population, a reduction of the share of the working-age population and an increase of older people, which are in pension schemes and need more and more expensive health care. A decreasing number of contributors to systems, which are mainly financed by social contributions based on labour income, have to finance an increasing number of retired persons, higher costs for health care and child care (due to higher employment rates of women) and high levels of unemployment.

Furthermore, non-wage labour costs, which were increased in order to keep the social budgets in balance, priced an additional number of mainly low paid jobs out of the market (de-location, undeclared work) and created a certain kind of ‘vicious circle’, by increasing the number of people benefiting from the social system, while decreasing the number of jobs and contributors.

### **3. Reform prospects for the European Social Models**

National differences between social models, as regards their aims and instruments, affect the compatibility between these social systems and the economic reform process in Europe (Lisbon Agenda). In addition, the actual structure of the different social models cannot be seen in isolation from the general institutional structure in the respective Member States. As a result, the need for reform, the urgency of reform and the content of reform will differ significantly between Member States.

#### **The European dimension of social reforms at Member State level**

The need for social reforms at Member State level, their targets and their concrete content, have to be seen in the context of the general economic and political environment, along with the need for economic reforms within the European Union (Lisbon Agenda for competitiveness). This means that the EU defines not only the political and economic framework for the reforms of the various social models, but that it can also provide some common principles and can help to exchange experiences on reform processes between Member States (Open Method of Coordination).

Given that there is interdependence between the European economic policy agenda, as set out in the Lisbon Strategy, and the future of the European Social Models, a comprehensive discussion about the compatibility of the Lisbon Strategy with the European Social Models, which is needed and hopefully forthcoming, has to include:

- further economic and social analyses on the interdependence of economic and social reforms;
- greater efforts to define some common principles and aims for social reforms in Europe, such as ‘Flexi-curity’, re-establishing consumer and investor confidence and support for the project of European integration, involvement of stakeholders (social partners) in the reform process etc.;
- a European checklist for a review of national social models with regard to their compatibility with a competitive open economy; as well as
- a review of different elements of the economic reform agenda (internal market policies, trade policy – WTO, competition policy) and the EU integration process with regard to their compatibility with a sustainable social model.

#### **Policies to cope with the labour market challenges of globalisation**

European integration and globalisation initiated an enormous economic restructuring process, which requires a new allocation of resources (labour and capital). One of the main consequences is a dramatic reduction of job opportunities for low qualified employees in the EU 15, especially in economies in which there are certain minimum income expectations,

guaranteed by their social models. This has the most influential effect on the social systems in these countries.

Potential policy approaches to tackle this problem include:

- an increase of the adaptability and employability of the work force through well-targeted active labour market policies, reform of labour market institutions (agencies) and training measures (already part of the Lisbon Agenda);
- an increase of economic dynamism – making Europe more attractive for investors and employees (already part of the Lisbon Agenda) in order to stimulate growth.

The high level of structural unemployment, especially of low qualified workers, shows that some people are not able to benefit from such upward strategies because they cannot acquire professional qualifications beyond a certain level.

If minimum wages (defined by collective bargaining or indirectly by social schemes), which are sufficient to pay for an acceptable life, but are above productivity, are guaranteed, these individuals will:

- remain as beneficiaries in the social model
- and/or be active in the shadow economy (both of which endanger the financial sustainability of the economy).

Without such minimum wages, they will be forced to take jobs that do not provide sufficient income (endangering social stability).

An additional policy option for certain economic sectors (labour intensive social and personal services, construction sector, household services) could be to introduce lower minimum wages in combination with income subsidies (tax credits, negative income tax) could be allowed or the total labour costs could be reduced (lowering non-wage labour costs and/or taxes). Such instruments would help to make work pay. Both would not affect the net income of the persons concerned, while reducing unemployment and social payments.

Positive experiences from some Member States and the USA should trigger additional analyses, discussions and pilot projects.

### **Policies to adapt the social models to a knowledge-based and service economy**

Modern society is characterised by a high degree of flexibility in private and working life. While private flexibility is mostly welcomed by citizens, involuntary working life flexibility may create fears and reduces confidence. People will cope with changes more positively if they see new chances and if they get support to adapt with the new situation. Therefore, a certain amount of security may support flexibility, which is necessary for economic restructuring processes.

An adaptation of the social models, based on the principle of ‘Flexi-curity’, has to tackle the following aspects:

- providing the necessary labour market flexibility (time, wages, dismissals) together with needed security (child care facilities, sustainable income, unemployment schemes which motivates to take a new job);
- an increase of mobility by improving the employability of workers;

- measures to improve competences should become a common concern of social partners and labour market authorities to ensure future employability;
- support of economic change – the creation of new jobs should be given priority over the protection of old ones.

### **Policies to tackle the problem of demographic change**

In order to ensure financial sustainability of the social security system and to break the ‘vicious cycle’ of fewer contributors, which have to pay more and more, and more beneficiaries, which receive less and less,

- the employment rate has to be increased (elderly people, women, young persons);
- the effective working age has to be extended;
- benefits have to be better targeted and combined with insurance and capital market based instruments (second and third pillar pension schemes, private health care schemes, etc.);
- abuse and excessive use of social benefits has to be discouraged (i.e. by introducing ‘own contributions’, by reducing early retirement payments, etc.) and
- an active immigration policy has to be implemented.

Due to the fact that demographic change is not an unforeseeable event (external shock), but a slow and continuous process, the adaptation can be done smoothly and without creating demand side shocks by reducing nominal available income for larger groups of the population, but should start as early as possible.

## **4. Open questions as regards the compatibility of the European Social Models and the Lisbon Agenda**

There is a common understanding that the economic reforms needed to tackle the challenges of European integration and globalisation will affect the existing European Social Models, which will need to adapt in response (Lisbon Agenda, High Level Group on Employment – ‘Jobs, Jobs, Jobs’ and Communication from the European Commission on ‘Make Work Pay’). These reforms have to be carried out by the national governments in cooperation with the social partners and have to tackle specific national problems (see below).

On the other hand, there is less discussion as to whether or not there are certain aspects or elements of the economic reform agenda, which are not compatible with the future of the European Social Models? Or, put another way: Do economic reforms need to be adjusted in order to support a smoother adaptation of the social systems?

### **Questions to be tackled at the European level**

If the European institutions are to take the recent criticism expressed by the citizens (in referendums, elections and opinion polls) seriously and if they want to re-establish confidence in the project of European integration, they will have to address questions like:

- Are the economic actors able to adapt to the changed environment created by new internal market rules or further integration steps without unacceptably high transitional costs and

damages? What would be the appropriate pace to reconcile economic and social reforms more effectively?

- Is there a need to support a more comprehensive economic change, in order to create new employment opportunities for low qualified persons, even though these activities are not in sectors typically regarded as innovative or located in the High-Tech sector?
- Do European competition and state aid rules endanger the provision of accessible, affordable and high quality services of general interest?
- Can the global market – created by the international rules introduced by the WTO (for goods and services) and by the IMF and the World Bank (for capital) – provide stability at international level?
- Have the reforms gone far enough to be capable to respond to further globalisation in the medium and long term?
- Have the achievements of the reform so far (benefits for entrepreneurs and employees) been sufficiently positively communicated?

Even though some or all of these questions may not pose insurmountable challenges, they express the fears of many in Europe and must be addressed in order to re-establish confidence in the European institutions and the European project as a whole.

### **Questions to be tackled at the national level**

The main challenges for the different national reform agendas are the need to adapt the social models and to increase economic competitiveness.

In order to determine which reforms of the social model are the most pressing, the following questions should be answered:

Is the current social model

- able to improve the adaptability and employability of problem groups in the labour market?
- encouraging people to take a new job or to remain in the labour market?
- supporting the (re)integration of young persons and women into the labour market?
- discouraging undeclared work?
- providing acceptable / sufficient (net)income also for low qualified jobs?
- ensuring that total labour costs are in line with productivity to secure competitiveness?
- capable of promoting entrepreneurship?
- capable of ensuring its medium and long-term financial sustainability?

Economic competitiveness has to be increased along the lines of the renewed Lisbon Agenda and its priorities regarding capacity for innovation and attractiveness for investors. This has to include aspects like reducing red tape, simplifying tax systems, improving qualification levels, investing in infrastructure, facilitating market access and improving the institutional set up (social dialogue, labour market agencies, business support services).

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**For further information on this position paper, contact:**

Gerhard HUEMER, Director of Economic and Fiscal Policy,  
UEAPME,  
Rue Jacques de Lalaing, 4,  
B-1040 Brussels.  
Tel: +32 2 2307599  
E-mail: [g.huemer@ueapme.com](mailto:g.huemer@ueapme.com)



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