Flash Economics

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Does the European social model really benefit European households?

When we compare continental Europe with the United States, we see that the European social model is very different from the American model: strong redistribution policies in Europe and weak in the United States, strong job protection in Europe and weak job protection in the United States. The consequences are as expected: poverty and inequality are higher in the United States than in Europe, and entrepreneurship is more dynamic in the United States than in Europe.

But it is interesting to note that some European countries (Denmark, Sweden) manage to maintain a high level of social protection and achieve a high level of economic dynamism. These countries have the characteristic of having moved from a high level of employment protection to a high level of employee protection.

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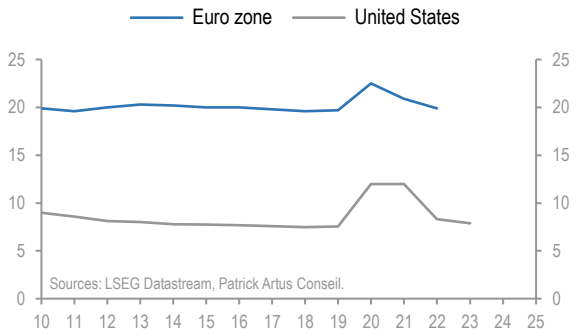
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The major differences between the European social model and the American social model

The European social model is very different from the American social model. In particular, there are:

- **Much larger redistributive policies** in Europe (euro zone) than in the United States (**Chart 1**);

Chart 1
Public expenditure on social protection
(as % of nominal GDP)



- **income inequalities are fairly low and have been greatly reduced in Europe by redistributive policies**, which is not the case in the United States (**Charts 2A/B**);

Chart 2A
Euro zone : Gini indices of income inequality
(before and after redistribution, 0-1 scale)

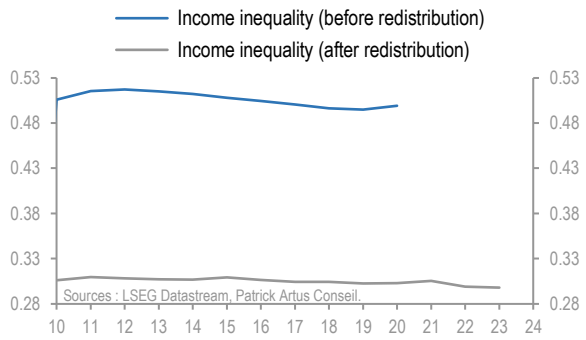
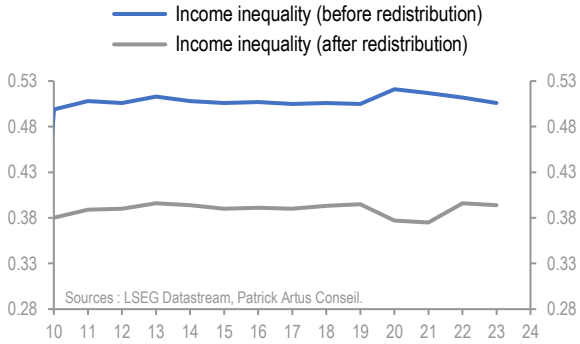


Chart 2B
United States: Gini indices of income inequality
(before and after redistribution, 0-1 scale)



- **employment protection** is much stronger in Europe than in the United States (**Table 1**);

Table 1: Strictness of employment protection* (2019)

Strictness of employment protection	France	Germany	Spain	Italy	United States
Individual and collective dismissals (regular contracts)	2.68	2.33	2.43	2.86	1.31
Collective dismissals	3.25	2.61	2.43	3.19	1.33
Individual dismissals (regular contracts)	2.45	2.22	2.43	2.72	1.30
Temporary contracts	2.58	1.67	2.47	2.82	0.27

Source: OECD

(*) Scale from 0 to 6, with values increasing with the degree of stringency of regulation

Consequences intuitively consistent with these differences between social models

1. Inequality and poverty

The weakness of distributive policies in the United States is a direct consequence of the **high levels of income inequality (Chart 3) and poverty** (**Chart 4**).

Chart 3
Gini index of income inequality (after redistribution)

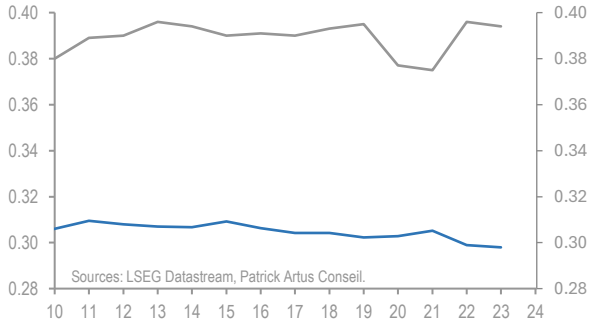
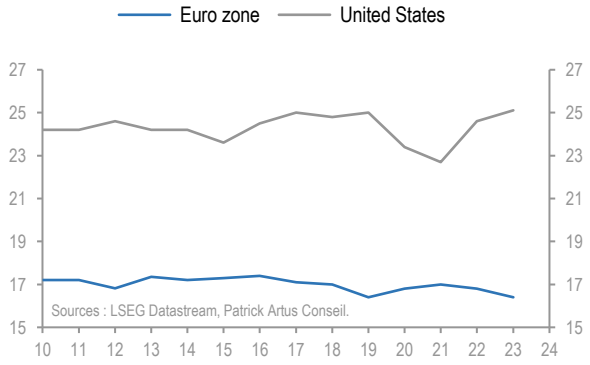


Chart 4
Poverty rate*



(*) Poverty rate based on disposable income, 60% of the national median disposable income

2. Entrepreneurial dynamism

The weakness of redistributive policies and employment protection in the United States compared with the eurozone has several consequences:

- **Higher funds available to finance research and development or investment in new technologies** (**Charts 5 A/B, Chart 6**), since public or private spending associated with redistribution is lower in the United States.

Chart 5A
Total R&D spending (as % of nominal GDP)

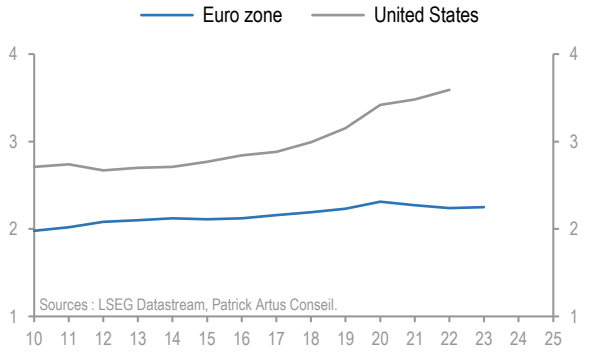


Chart 5B
Corporate R&D spending (as % of nominal GDP)

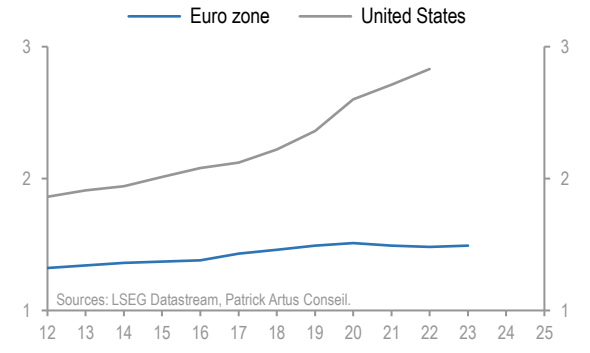
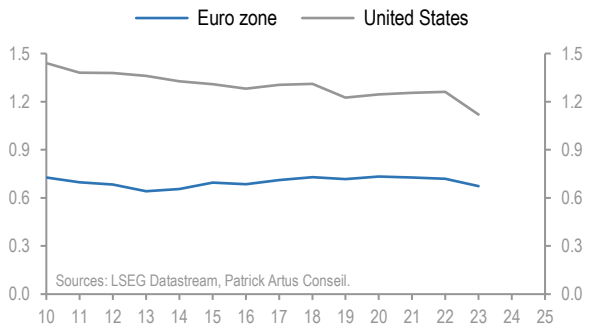
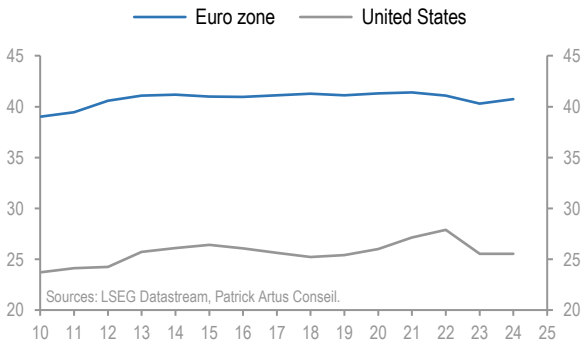


Chart 6
Investment in information and communication technologies (in value terms, as % of nominal GDP)



- **The tax burden is much higher in Europe than in the United States** (**Chart 7**), which reduces risk-taking and the incentive to invest.

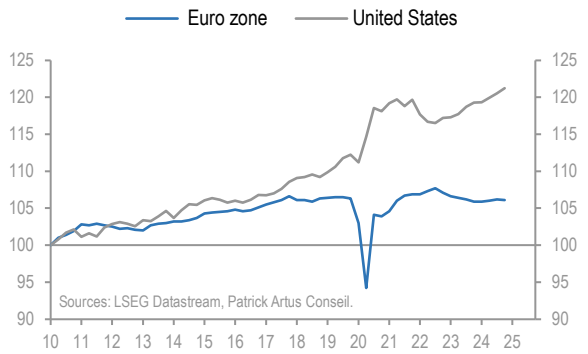
Chart 7
Tax burden (as % of nominal GDP)



- **Much greater development of pension funds in the United States** (they represent 142% of GDP in the United States and 24% of GDP in the eurozone), since the pay-as-you-go pension system is small there, **resulting in a much larger quantity of risky savings in the United States than in Europe** (funds raised by venture capital will represent 22 billion euros in 2023 in Europe and 280 billion dollars in the United States; the market capitalisation of the United States (S&P 1500) is 165% of GDP, and that of Europe (STOXX Europe 600) is 50% of GDP;

- As a result of the United States' ability to finance risky investments, due to both the availability of funds and the risky nature of savings, the size of **the US new technology industry** ($1,900 billion in 2023) **is significantly greater than that of Europe** ($400 billion in 2023). This much greater development of new technology industries in the United States explains a large part of **the gap between productivity gains in the United States and in the eurozone** (**Chart 8**);

Chart 8
Productivity per head (2010.Q1 = 100)



Should we choose between a generous social model and a dynamic economy?

The above comparison between the United States and the eurozone could lead us to believe that we have to choose between a generous social model and a dynamic economy.

However, this article argues that some European countries have managed to maintain **a generous social model while at the same time having dynamic businesses and economies**. We take the example of **Sweden and Denmark**.

Income inequality after redistribution is low in these two countries, as is the percentage of people below the poverty line (**Charts 9/10**).

Chart 9
Gini index of income inequality (after redistribution)

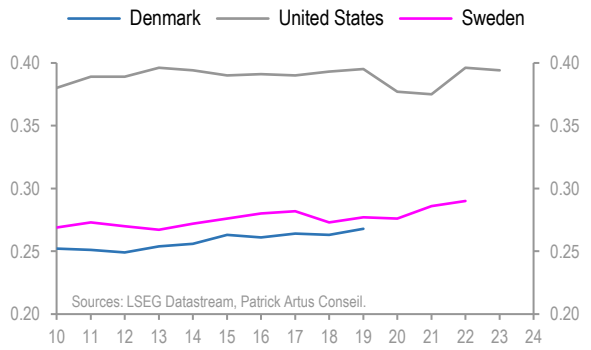
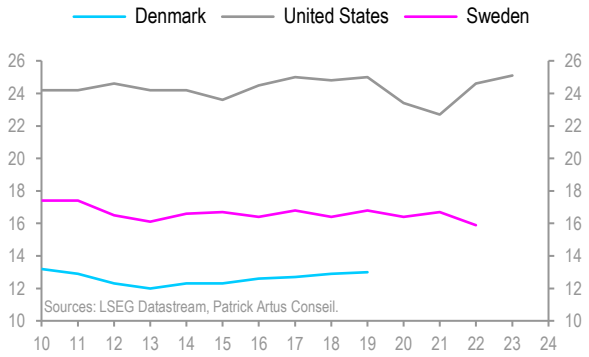


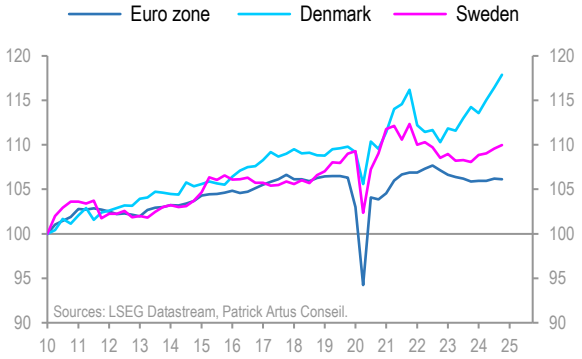
Chart 10
Poverty rate*



(*) Poverty rate based on disposable income, 60% of the national median disposable income

Yet both economies are dynamic (**Chart 11**) and have succeeded in developing major companies (in Sweden, Assa Abloy, Electrolux, Ericsson, H&M, IKEA, Skanska, Spotify; in Denmark, Maersk, Novo Nordisk, Vestas, Carlsberg...).

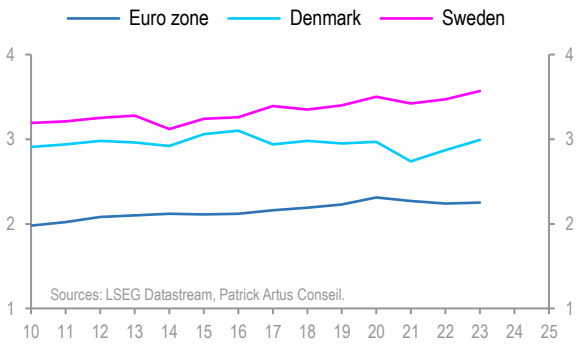
Chart 11
Productivity per head (2010.Q1 = 100)



The European dynamism of Sweden and Denmark can be attributed to:

- **The existence of a largely funded pension system**;
- **High spending on research and development** (**Chart 12**);

Chart 12
Total R&D spending (as % of nominal GDP)



- **The transition from a labour market focused on job protection to a labour market focused on employee protection**. In these countries, it is easy to make people redundant (employment protection is weak, especially in Denmark, **Table 2**), the unemployed are subject to strong constraints which push them to return to work quickly, but unemployment benefits are high (90% of previous salary) and training for the unemployed is well organised, leading to very low long-term unemployment, especially in Denmark (**Chart 13**) and a very high employment rate in Denmark and Sweden (**Chart 14**).

Table 2: Strictness of employment protection* (2019)

Strictness of employment protection	France	Germany	Spain	Italy	Denmark	Sweden
Individual and collective dismissals (regular contracts)	2.68	2.33	2.43	2.86	1.94	2.54
Collective dismissals	3.25	2.61	2.43	3.19	2.18	2.72
Individual dismissals (regular contracts)	2.45	2.22	2.43	2.72	1.84	2.48
Temporary contracts	2.58	1.67	2.47	2.82	1.60	1.55

Source: OECD

(*) Scale from 0 to 6, with values increasing with the degree of stringency of regulation

Chart 13
Long-Term Unemployed (as % of unemployed)

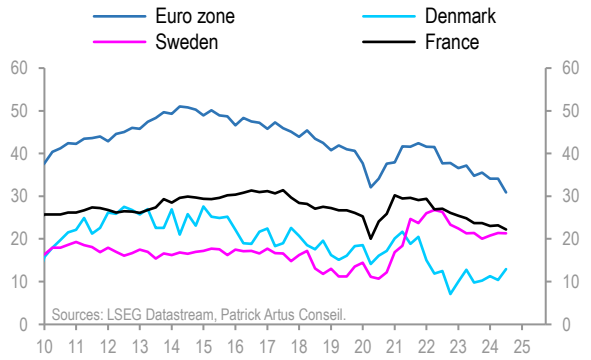
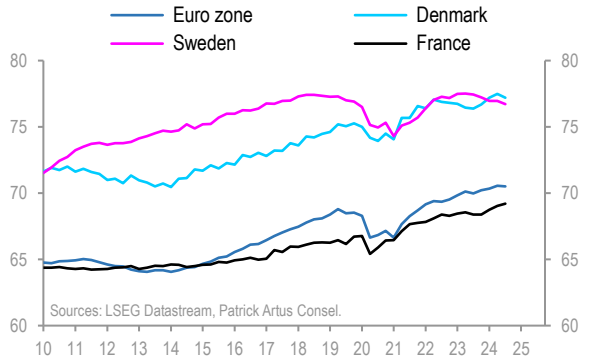


Chart 14
Employment rate of population aged 15 to 64 (as %)



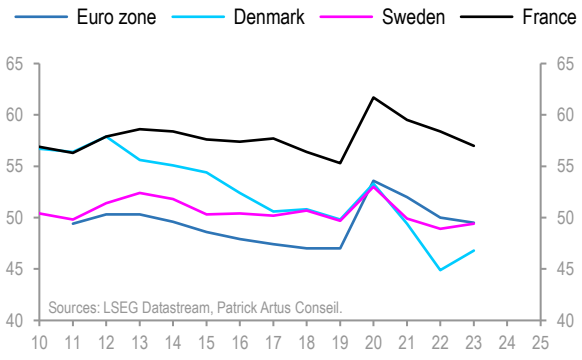
The transition from strong employment protection to strong employee protection improves employees' skills and accelerates labour market turnover, which means that it is easier for employees to move from low-skilled to higher-skilled jobs.

Summary: how can generous social protection be reconciled with a dynamic economy?

The example of the Nordic European countries shows that it is possible to have both generous social protection and a dynamic economy, provided that:

- There is room for manoeuvre to invest public money in training, technological investment and research and development, which means controlling public spending (**Chart 15**);

Chart 15
Public spending (as % of nominal GDP)



- Give priority to protecting employees rather than jobs;
- To have substantial savings invested in risky projects, which requires a pension system that is at least partially managed on a funded basis.

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