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The European Social Model and its dilution as a result of EU enlargement

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THE EUROPEAN SOCIAL MODEL AND ITS DILUTION AS A RESULT OF EU ENLARGEMENT

Marilena GIANNETTI and D. Mario NUTI ¹

1. Introduction

Social and labour market policies are not part of the obligations of European Union membership, or *acquis communautaire*; they are left to the discretion of member states. Yet both official EU documents and economic literature on types of capitalism refer to the *European Social Model (ESM)*: for instance, a document of the Nice European Council of December 2000 states “*The European social model, characterised in particular by systems that offer a high level of social protection, by the importance of social dialogue and by services of general interest covering activities vital for social cohesion, is today based, beyond the diversity of the Member States’ social systems, on a common core of values*” (European Council, 2000, para. 11, p.4). This characterisation was emphasised in the Barcelona summit of 2002 and on many other occasions, such as in European Parliament 2006.

The model is also known as the *European model of social dialogue*; the label of *co-ordinated market economies (CMEs)* has also been used (see section 2 below). These expressions are virtually interchangeable, in that co-ordination takes the form of a dialogue leading to a social pact, and welfare provisions are an integral part of such a pact; thus the choice of label is not even a matter of emphasis, but simply of focus.

The European Social Model is a controversial subject. It has been praised and blamed respectively for positive and negative aspects of European economic performance; it is claimed to be in a crisis, to be on the wane or to have collapsed, while others detect three or four European models instead of one, or deny that it ever existed.

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We take the view that the death of the European Social Model has been grossly exaggerated, that it is alive and well and has considerable merit, but that the European Union enlargement to the post-socialist countries of central eastern Europe (Czech Republic, Hungary, Poland, Slovakia; Slovenia; Estonia, Latvia and Lithuania on 1 May 2004; Bulgaria and Romania on 1 January 2007), all of whom adopted a hyper-liberal socio-economic model, has considerably diluted the ESM both in the new European average characteristics and – by imitation, competition and active promotion of hyper-liberalism – in some of the older EU members.

This dilution, rather than other factors – such as the greater fiscal discipline introduced by the Maastricht and the Amsterdam Treaties (1992 and 1997 respectively), the affordability of the model by new members averaging about 40% of the older members' GDP *per capita*, or the cost of enlargement itself – is today the major threat to the European Social Model's continued existence.

2. The European model of social dialogue

Vaughan-Whitehead (2003) provides a detailed and long list of ESM characteristics: a comprehensive approach to social matters; increased minimum rights in working conditions; sustainable and universal social protection systems; strong and well-functioning dialogue between social partners at different levels; collective bargaining; forms of participation and democracy in the workplace, and other forms of citizens participation; an inclusive society; the fight against poverty and social exclusion; priority to employment; maintaining public services and services of general interest; equal opportunities and the fight against discrimination; regional cohesion; transnational social policies and tools (*ibidem*, pp. 6-10).

The ESM – Vaughan-Whitehead argues – is an evolving model. The Treaty of Rome (1956) did not develop social considerations, regarding social progress as dependent on economic growth. Initially, the important instrument of structural funds was developed, but the coordination of social security systems aimed at facilitating free mobility of labour was systematically blocked by the UK government (*ibidem*, p. 11). The Single Market (1986) and Jacques Delors' presidency called for an *espace social européen*, again with UK opposition: "In 1989 the charter guaranteeing minimum social rights was drawn up and accepted by 11 member states – the UK refrained – in the form of a non-binding political declaration" (*ibidem*, p. 12). The Maastricht Treaty (1992) set up the road to a single currency but also strengthened the commitment to *economic and social cohesion*; the social protocol annexed to the Treaty

extended the Community competences on social issues, introduced qualified majority voting in social areas (health and safety, working conditions, information and consultation, equal opportunities) and extended the role and rights of social partners. In 1994 the European Council adopted a resolution on EU social policy.

Against the background of increasing unemployment, social exclusion and marginalisation, the Amsterdam Treaty (1997) strengthened social provisions: the European Commission was given new powers in industrial relations and the capacity to act against exclusion and discrimination, although the principle of unanimity continued to apply to decisions on social protection and workers' participation in decision-making. (For a deeper discussion of the ESM, and in particular of the European Social Charters see Vaughan-Whitehead 2003). Ultimately "*The most distinctive feature of the model [is] its absence in other parts of the World*" (ibidem, p.23).

A lucid characterisation of the ESM-European model of social dialogue and the American model is provided by Freeman (2005). In some respects the two economies are like "two peas in the same pod": advanced capitalist systems, abiding by the rule of law, protecting private property, guaranteeing freedom of association, with various degrees of social safety and welfare systems, combining "institutional regulations and markets to determine economic outcomes. The difference is in the weights they place on institutions versus markets, not the qualitative differences that divided capitalism from communist state planning" (Freeman 2005, p. 3).

The distinction drawn is virtually identical to that of Hall and Soskice (2001), between their "co-ordinated market economies" (CMEs) of continental Europe, exemplified by Germany, and their "liberal market economies" (LME) exemplified by Britain and the United States – except that Freeman does not exclude the UK from the first group. In view of the repeated opt-out obtained by the UK excluding it from the ESM might seem axiomatic, but there is empirical evidence to favour UK inclusion (see below, Composto 2007). Eichengreen (2006) also considers co-ordination and social arrangements as the distinctive features of the European economy. A broader discussion of varieties of capitalism is in Hall and Soskice (2003); a survey is provided by Sopart (2005).

For Freeman (2005) the US economy, in its idealised form, conforms to the neoclassical theory of markets "where the Invisible Hand of exit and entry determines outcomes" (p. 3). Trade Union membership has declined to a low level and wages and employment have become largely market-driven. Firms'

employment policy and wages policy do not have to be negotiated with employees, who can take it or leave it. Product markets are little regulated and firms can enter and exit easily. Employment is the primary form of social protection, including access to health care. University activity and funding are geared to the demands of business communities.

The EU system, instead, “relies more on the non-market institutions of ‘voice’ to determine outcomes, particularly in the labour market” (ibidem). The EU requires dialogue between social partners at the company level, through the Works Councils (EC 94/45/EC), at sectoral and inter-professional level through sectoral and Social Dialogue Committees, at the aggregate level through the Standing Employment Committee, and Advisory Committees (e.g. on social security); there are also Occupational Health and Safety committees. Wages are determined by collective bargaining through agreements between federations of employees and employers applying also to firms that are not party to the agreement. Firms entry and closure, and employee lay-offs, face greater administrative obstacles in most EU countries. Welfare state financing requires higher taxes. Higher education is funded and run by the government, with lesser concern for and support by business circles.

Some quantitative measures of the differences between the two systems are given in Table 1, from Freeman (2005). The Economics Freedom Index of the Fraser Institute seeks to measure the market-friendliness of economies, on a score of 100 for a neo-classical model (approached by the US, Hong Kong and Singapore) and lower for the EU and even lower for developing countries (for the latest set, see Gwartney *et al.*, 2006).

The share of tax revenues in GDP is significantly higher in Europe (42% of GDP) than in the US (32%). In three OECD indices of government intervention in product market, administrative and economic regulations, the US score is lower than the EU, i.e. is closer to the neo-classical paradigm (Conway *et al.*, 2005). It takes on average 64 days to open a firm in the EU, against just 7 in the US (in Italy in 2007 the Prodi government, committed to reduce this number to 1 day, succeeded in reducing it to 23 days). On the basis of these and other comparisons Freeman, however, concludes that the main differences between the EU and US models occur in the labour market, where the social partners are employers and workers federations or Unions.

Table 1. Measured Differences between US and EU Models of Capitalism

	US	EU
<i>Aggregate Measures</i>		
Economic Freedom Index	90	82
Tax/GDP ratio	32	42
<i>Goods Market</i>		
Days to form business	7	64
Product market regulations	1.0	1.4
Administrative regulations	1.1	1.5
Economic regulations	1.3	2.0
<i>Labour Market</i>		
Employment Protection Legislation Index	0.7	2.4
Unionisation [lower in the US]		<
Collective bargaining coverage per cent	14	76

Source: Regulations, OECD, ECO/WKP 2005 6, Table 24.
 From: Freeman 2005, p. 16.

Neither Freeman (2005) or Hall & Soskice (2001, 2003) claim superiority for the European Social Model, despite showing an implicit preference for it. “Absent a strong theory of how social partner systems operate – on a par with economic models of markets – there is no clear template or benchmark against which to measure social dialogue economies” (Freeman 2005, p. 2). However, he adds: “Some theories, such as the Coase (1960) analysis of property rights and efficient bargaining predict that a social dialogue system will work as well as a competitive market driven model”. This conclusion is strengthened by game theory considerations such as the prisoners’ dilemma: an inter-temporal social pact between employees and employers representatives, monitored and guaranteed by the government with fiscal incentives and penalties, can deliver something that markets cannot deliver: wage restraint today in exchange for price restraint and higher investment and growth tomorrow. Both Freeman (2005) and Hall & Soskice (2005) stress that the models characterised as EU and US partake of the advantages of market economies and are viable systems, though with differences that possibly confer relative advantages and disadvantages.

Hall and Gingerich (2003) use the technique of principal component analysis to construct a “coordination index” in the varieties of capitalism. They find complementarities in the macro-economy of different versions of capitalism, between labour relations and corporate governance, between labour relations

and training systems, and between corporate governance and inter-firm relations. These complementarities are found to be resilient and efficient with respect to structural shift (from manufacturing to services), to technological change and to international liberalisation. Firms vary their strategies across nations to exploit the complementarities available in different systems. Investigating the impact of coordination on growth Hall and Gingerich find that at the extreme ranges of both liberal and strategic coordination both perform well, with poor performance for intermediate cases.

On the alleged superiority of the US system in terms of growth, job creation and reducing unemployment, Freeman points out that the US outperformed the EU in the 1990s up to the mid-2000s, but some of the smaller EU social dialogue countries, like Ireland, Austria, the Netherlands and Denmark, had an exemplary performance in the same period, while the EU outperformed the US from the 1950s through to the 1990s. Eichengreen (2006) also stresses that relative EU and US performance depends strictly on the periods selected. After the second World War labour productivity in the west of Europe was only half that of the US, whereas now it is not far below and some countries, such as France, do better. “Since the turn of the century, the euro zone has created more jobs than the United States” (*The Economist*, 27 January 2007). In 2007 Europe’s growth rate has overtaken that of the United States, though the gap is small (only 2.3% versus 2%); Germany, a paradigm of the ESM, in 2007 is growing at 3% and is accelerating. Income inequality is lower in the EU than in the US, also, and with better universal health care at lower cost in the EU than in the US.

A major problem in system comparison is to what extent performance differences can be attributed to institutional differences (Freeman 2005). Ultimately Freeman prefers the EU model because there is evidence that “workers want some forms of social dialogue with their employers”, and because he expects a better performance from “the way the EU countries deal with pension and health expenditure problems of their ageing societies, compared with the way the US deals with similar problems” (p. 11).

3. The critics

Critics of the European model are much bolder and aggressive than its supporters. Robert Goodin (2003), for instance, claims that CMEs “are naturally doomed to extinction”, because non-market co-ordination takes a long time to build and can be disrupted very fast; the system is vulnerable and unstable. “LMEs ultimately [will] prevail”. Shackleton (2006) considers the

model “not so much as a descriptive category, more as an aspiration” (p. 46), yet he deems it responsible for EU slower growth, slower job creation and higher unemployment (looking only at 2003-2005), attributed primarily to labour and product market rigidities, higher levels of government spending and taxation and social partners involvement; the model “is in crisis” and has no future. The challenges of globalisation – he and others argue – require institutional de-regulation and welfare retrenchment.

For Sapir (2005) there is no single European Social Model but four models, represented by 1) *Nordic* countries (Denmark, Finland, Sweden, plus the Netherlands) with the highest levels of social protection and universal welfare provision; 2) *Anglo-Saxon* countries (Ireland and the United Kingdom), with relatively large social assistance of last resort, with a mixture of weak unions, comparatively wide and increasing wage dispersion and relatively high incidence of low-pay employment; 3) *Continental* countries (Austria, Belgium, France, Germany and Luxembourg) relying extensively on insurance-based non-employment benefits and old-age pensions; with strong unions and collective bargaining coverage; 4) *Mediterranean* countries (Greece, Italy, Portugal and Spain), concentrating their social spending on old-age pensions and allowing for a high segmentation of entitlements and status. Sapir regards both Continental and Mediterranean models as inefficient, the latter without the benefit of higher equity; in his view two thirds of the EU and 90 per cent of the Euro-zone are made up of inefficient models. The alleged inefficiency of re-distribution, however, requires necessarily two conditions: 1) that GDP is reduced by such re-distribution, and 2) that the government values such loss of GDP more than the improvement in income distribution that it has implemented. The first is far from proven, especially if it comes to pension payments; the second is a value judgement which neither André Sapir nor anybody else are in a position to impose on anyone. A gross political judgement here is being dressed up as a purely technical statement.

Amable (2003), who first introduced the taxonomy used by Sapir (2006), though adding Asian capitalism, argues that institutional change is not a move towards a hypothetical “best way” but the outcome of a political process; on that ground he believes that the continental European model will stay very different from the market-based economies, in the face of political opposition to convergence.

Composto (2007) verifies the validity of the four-fold ESM classification in the EU of 15 on the strength of principal component analysis, applied to 20

variables representing economic policies and performance in 2005.² If we exclude from the analysis Luxembourg – an outlier usually neglected due to its very small size, very high income *per capita* and large cross border movements – Composto (2007) finds three clusters of countries. Those classed by Sapir as Nordic now include Austria and Belgium; the Mediterranean group now includes Ireland and the Continental Group now includes the UK and Italy, while the so-called Anglo-Saxon group vanishes. Although the UK welfare state has been reduced under the successive attacks of Conservative and Labour governments, evidently there is still enough of it left for the UK to be classed with the Continental group. Also, membership of the ESM is best viewed as a case of “family resemblance” à la Wittgenstein; members look alike although there may be no single distinctive feature, let alone a set of features, that they all share in common.

Sapir et al. (2003) had claimed already that Europe needs to undertake massive economic and social reforms in order to promote growth and respond to the challenges of globalisation. Sapir (2006) argues even more strongly that international competitiveness puts pressure on labour costs and for the reform of “outmoded” labour market and social policies (p.11). He takes very seriously certain EU policies that are no more than acronyms, labels stuck on empty boxes, such as the 1997 EES (European Employment Strategy) or the subsequent OMC (Open Method of Coordination). He recommends “*a two-handed strategy* combining product and capital market reform at the EU level with labour market and social policy reform at the national level”; this was to be the purpose of the Lisbon Agenda (March 2000), that was supposed to make Europe the most competitive economy in the world by 2010. He complains that “Unfortunately Lisbon has not delivered” (p. 14), but Lisbon has been not so much a failure as a non-event, a set of vague targets left entirely to the voluntary action of member states and therefore largely ignored. Ultimately Sapir’s proposals are reducible to the completion of the Single Market – which is still pending from 1993, made harder by EU enlargement – and to Member States’ greater economic flexibility and better social protection, or Danish style “flexicurity” – itself made harder to achieve by the fiscal stringencies of the so-called Growth and Stability Pact. Objection to these arguments is dismissed as “left conservatism” (Policy Network, 2006), a particularly unhelpful use of the

² These are: social contributions of employers, of employees and of independent workers, of the government; unit labour costs; fiscal wedge; long term unemployment for both men and females, youth unemployment; *per capita* GDP at purchasing parities; Gini coefficient; integration of the market for goods, and for services; private investment; labour productivity per person; days of strike; expenditure on active labour market policies; social expenditure on unemployment; total social expenditure; the unemployment trap. Auxiliary variables are: inflation rate, public debt; labour activity rate among those aged 16-64.

term conservatism which is strongly associated with measures of the right; presumably what is meant here is left intransigence in the defence of secured advantages.

In order to take advantage of globalisation opportunities it is not necessary to expel labour from existing employment, it is amply sufficient that there should be labour available. Recently the UK Labour Party former leader asked the question “What kind of Social Model is it that leaves almost 20 million unemployed?” (Policy Network, 2005). In truth, the answer needed is to the question: why is more labour market flexibility being advocated in Europe when there is such abundance of unemployed labour?

Recently labour market rigidities have been considerably reduced, in Germany, France, Italy. The impact of increasing labour flexibility has not been, as expected, a greater international competitiveness but higher profit margins, leading to an increased share of profits in the functional distribution of national income at the expenses of the share of wages. Instead of promoting exports, greater labour flexibility has reduced purchasing power and consumption demand, making recovery slower and harder. There has been an increased precariousness of employment, not compensated by higher wages in comparison to longer term contracts but on the contrary accompanied by lower wages, signalling the segmentation of the labour market and the exploitation by employers of their monopsony position in labour demand. Effectively there has been an increased privatization of the cost of social risks insurance. Poverty has increased, especially for children and the elderly; income inequality has also increased with the progressive reduction of the “middle class” population.

In an important respect the challenge of globalisation, well known to create winners and losers, needs precisely the kind of re-distribution mechanisms that are present at the EU level as an integral part of the ESM, such as cohesion and structural funds, and the special *European Globalisation Adjustment Fund*, recently proposed by the European Commission specifically to support workers whose jobs are destroyed by processes of *outsourcing* and *off-shoring*. The problem is the Adjustment Fund’s relatively small size – euro500 million for 2007-2013 – and restrictive conditions (Euromemorandum Group 2006).

Giddens et al. (2006) advocate the reform of the European social model/models on the grounds of population ageing, slower growth and globalisation. A similar demand for reform on the same grounds is made in a recent document of the European Parliament (2006). But ageing and pension reform is often misunderstood: a Pay as You Earn or redistribution system whereby current

pensions are paid out of the pension contributions of the currently employed is not in debt to the tune of the entire present value of future pensions, but only to the much more limited extent that current and future total pensions exceed current and future contributions – taken year by year at their present value. Pension reform through the switch to a capitalisation system causes the difference between these two ways of measuring the pension debt to surface as an overestimate of debt quite unnecessarily, conditioning current fiscal policy and debt management (Eatwell et al, 2001). Growth may be harmed by the deflationary implications of welfare reform, and globalisation opportunities are not necessarily enhanced by labour flexibility – given high unemployment.

Giddens et al. (2006) also argue that “to compete, Europe need not adopt neo-liberal orthodoxy ... Europe’s common goal should be a developmental, empowering welfare state that tackles the inequalities globalisation exacerbates and equips out citizens for the knowledge-based economy” (p. 3). But a developmental state by definition requires significant state intervention, the inequalities exacerbated by globalisation will worsen with the ESM dilution, and the so called knowledge-based economy is an empty concept deflated by the burst of the *dot.com* bubble.

4. The Social Model of New Member Countries

The first to suggest that EU enlargement would conflict with the ESM is probably Ferge (2000), writing on social security reform in accession countries: “The implicit model for Central and Eastern Europe is different from the European model. The consequence may be that the countries that would like to join the union may destroy institutions which might ultimately become conditions of admittance” (p.14).

A fuller and forceful discussion of the EU enlargement impact on the ESM is provided by Vaughan-Whitehead (2003), who concludes unambiguously that “the current EU enlargement may bring serious risks for Social Europe and endanger the survival of the European Social Model” (p. 493). Vaughan-Whitehead stresses the improvement of economic indicators in accession countries and the parallel deterioration of their social indicators. He notes the “meanness and hypocrisy” of EU cohesion policy towards the new members; their transfers from the Eu budget under structural funds are subject to a ceiling of 4 per cent of their GDP, thus representing a maximum EU commitment equivalent to 0.02 per cent of EU GDP (as the combined GDP of new members is 5 per cent of EU GDP). The same can be said of the seven year restrictions on labour migrations imposed by most of the EU old members. Vaughan-

Whitehead also notes the growth of unemployment to mass levels, especially for unskilled workers untouched by foreign direct investment, and the decline of working and social standards with respect to previous EU levels (on the diversity of working conditions in the EU see also Vaughan-Whitehead 2005). The scope of collective bargaining in the new member countries is only of the order of 10-20 per cent of the labour force. Social dialogue is practically non-existent in small-medium enterprises. Works Councils, profit-sharing and other forms of workers' participation are not being implemented. A large scale informal sector is totally unaffected by ESM policies.

Vaughan-Whitehead blames the significant income gap between new and old members, the transition trends towards de-regulation, systematic liberalisation and privatisations, the curtailment of expenditure on social protection, IMF and World Bank preference for targeting re-distribution only to the needy. All these arguments are undoubtedly important in explaining the ESM dilution as a result of enlargement, but need some qualification. The incidence of social protection is not a fixed cost *per capita* regardless of income levels, but is some fixed proportion of income *per capita*; therefore the income gap between new and old members should not be all that important. Fiscal restraint is compelling for new members only in the one year preceding euro-zone accession, while there are no penalties in practice for their exceeding the Growth and Stability Pact fiscal ceilings before or after (except for the threat of losing access to structural funds, which is not credible, see Nuti 2006). IMF and World Bank targeted re-distribution policies are seldom part of strict conditionality.

The ESM dilution as a result of EU enlargement appears to be due to a more general cause rooted in the nature of the so-called "Transition" – the transformation of Soviet-type economies, characterised by dominant public ownership and enterprise and by central planning, into market economies with dominant private ownership and enterprise, re-integrated in the global economy and in particular into Europe. On the re-bond from the old to the new system the transition countries gave shape to their systems at the peak of Reaganite and Thatcherite hyper-liberalism. They were subject to the strong pressures of Bretton Woods institutions and – as we have seen, to a much blander extent and in only in some directions, like privatisation – of the European Union. In the end the transition countries have embraced a hyper-liberal version of the market economy, very different from the model that dominates in the rest of Europe, converging towards the US model of capitalism rather than the European model (see Kolodko 2000 and 2001; Giannetti 2003; Nuti 2007).

This could have happened because European authorities monitored macroeconomic discipline through the convergence of major parameters (such

as the fiscal parameters of the Growth and Stability Pact, or the Maastricht Treaty parameters for Euro-zone candidates), and the convergence of market institutions. Thus EU candidates adopted EU competition policy; restrictions on state aid; improvements in state governance associated with implementation of the *acquis communautaire* (Hanson 2006). But the EU authorities did not require of the new members the convergence of those policies that add up to the social dialogue model that – though to different degrees and in a flexible and non-codified fashion – characterised the pre-enlargement European model. As noted by Hanson (2006), “in those chapters of the *acquis* that seem likely to have a bearing on business regulation and labour-market regulation, accession requirements generally leave wide scope for institutional variation within an acceding country’s economic institutions”.

Hanson (2006) investigates institutional variation among the pre-2004 fifteen members of the EU and the new eight central-eastern European members of May 2004, using the World Bank’s Ease of Doing Business scores (EoDB, www.doing.business.org), the Kaufmann/World Bank measures of “governance” (<http://info/worldbank.org/governance/>), Transparency International long established Corruption Perception Indices, and Knell and Srholec (2006) who provide a classification of a country’s position on a scale from liberal market arrangement to strategic coordination (including “social cohesion”, labour market and business regulation).

Hanson finds that there is a reasonably close correspondence between Ease of Doing Business (EoDB) and Governance. There is considerable diversity both within the 15 old and the eight new members, and institutional convergence is not a feature of EU membership: “*convergence towards either Continental or Anglo-Saxon way of doing things is not being enforced*” (p. 4; emphasis added). The EoDB ranking for Greece is just over half that of Denmark or the UK, and below that of any 2004 accession states and Bulgaria and Romania, while that of Italy is below that of all the 2004 accession states and Bulgaria. High coordination is not a barrier to a high EoDB ranking. The most significant finding is that “*most of the eight accession states (five out of eight) have coordination indices suggesting they are towards the competitive (Anglo-Saxon) end of the spectrum, while the majority of the established EU countries (nine out of fourteen) are towards the coordinated end*” (p.4; emphasis added). By using the Knell-Srholec index of “social cohesion” the results are even more striking: Bulgaria, Romania and the 2004 new members except for the Czech Republic and Slovenia are on the liberal, non-redistributive end of the re-distribution scale, while all the established members except for Ireland are on the redistributive end of the dividing line.

Hanson (2006) attributes this partition between old and new members primarily to the accession negotiations over “chapters” of the *acquis communautaire* (i.e. the obligations of membership), which “did not cover, and were not meant to cover, many of the elements that make up a distinctive national economic regimes” (p.10).

The resulting ESM dilution, therefore, did not happen by design but by default. The fact that the EU did not intend to establish an ESM in the new member states, or at any rate did not succeed in doing so, meant that the new members were left to their own unbridled development process. It is well known that neophytes are usually the strictest fundamentalists. Examples of such hyper-liberal features are:

- an immediate unilateral opening of international trade, frequently revoked and therefore premature;
- a much faster capital movements liberalisation than in the earlier experience of other European economies, which caused important currency and financial crises such as those of the Czech Republic in 1993, and Russia in 1998 which affected other central European countries;
- an unprecedented form of mass privatisation (everywhere except Hungary) through the distribution of free or symbolically priced vouchers to the population, a veritable experiment in social engineering of questionable effectiveness, which did not change governance mechanisms, nor access to investment funds and managerial resources;
- a pension reform from a distribution system (Pay as You Go, “defined benefits”) to a capitalisation system (“funded”, “defined contributions”) that
 - as argued above - made a hidden form of public debt come to the surface while at least partly it could have remained buried;
- particularly bland and non-progressive taxation of companies and households, as witnessed by the widespread “flat tax” and by the lack of a “capital gains” tax, accompanied by a greater incidence of indirect taxes; Giddens et al. (2006) argue that “The reality in most of the new member states is that they are not low-tax nirvanas, but have expensive, poorly designed welfare states badly in need of radical reform” (p.3). Their welfare systems may well be in need of reform, but the urgency of that need would be less great if they were not tax-nirvanas, which they are.

- a central bank not just independent, but exceptionally independent and not subject to any control, and without any coordination with fiscal policy;
- a particularly restrictive monetary policy, with real interest rates at usury levels, that have contributed greatly to the deep and protracted recession that accompanied the transition everywhere in central-eastern Europe, discouraging investment and unduly strengthening exchange rates;
- a particularly flexible labour market (in spite of occasional protection of employment in some crisis sectors), with weak Trades Unions and scarce diffusion of collective bargaining;
- a lack of mechanisms for consultation and *concertation* between social partners and with the government;
- in general, a dominant weight of markets with respect to institutional mechanisms.

This hyper-liberal model differs significantly from the European socio-economic model of “social dialogue” and resembles instead a USA-type socio-economic model described by Freeman (2005).

According to Lucien Cernat (2002), the institutional and economic conditions typical of the Anglo-Saxon type of capitalism are more growth enhancing in Eastern Europe than alternative institutional arrangements and policies. On the contrary, features usually associated with developmental and Continental models of capitalism were negatively associated with annual growth rates (an unusual result, however, is that an increase in banking activities in transition economies does not seem to encourage economic growth). Cernat (2002) gives an articulate characterisation of varieties of capitalism (table 2; here the Mediterranean model is missing).

Table 2. Varieties of capitalism: main characteristics

	Model	Anglo Saxon	Continental	Developmental
Features				
Macroeconomic				
Role of the state		Minimal state	Regulatory state	Embedded autonomy Pro-developmental Interventionism
Cooperation between social partners		Conflictual or minimal contact	Extensive at national level	Formal and informal state-business networks
Labour organisations		Fragmented and weak	Strong, centralised unions	Relatively weak
Microeconomic				
Shareholder sovereignty		Widely dispersed ownership; dividends prioritised	Banks and other corporations are major shareholders; dividends less prioritised	The role of individuals, banks and intercorporate shareholders are somewhere in between.
Employee influence		Limited	Extensive through works councils and co-determination	Strong shop floor participation
Role of stock exchange		Strong role in corporate finance	Reduced	Intermediate
Role of banks		Banks play a minimal role in corporate ownership	Important both in corporate finance and control	Important in corporate finance but less in corporate control

Source: Adapted from Rhodes and Apledoorn (1996: 174-5).

From: Cernat (2002)

Table 3. Identifying emerging models of capitalism in Eastern Europe

Dominant type of labour bargaining ^a	Country	State intervention ^b	Domestic credit as a percentage of GDP(1992-98 average) ^c	Stocks traded as a percentage of GDP ^c (1992-98 average)
Company level	Czech Republic	23.4	70.5	7.20
	Estonia	11.8	18.3	12.34
	Hungary	43.9	62.7	8.00
	Poland	16.4	35.5	3.58
	Slovak Republic	54.2	65.7	5.08
National level	Bulgaria	17.4	84.9	0.03
	Lithuania	20.8	14.6	0.97
	Latvia	n.a.	16.7	0.49
	Romania	25.1	23.8	0.34
	Slovenia	29.8	33.8	2.22

Sources: a. ILO (1997); b. Average state intervention index, EBRD (1999); c. World Bank (2000)

From: Cernat 2002.

Cernat finds no evidence that centralised labour bargaining had an effect on growth rates, whether positive or negative, while state intervention had a negative impact on growth. But the characterisation illustrated in Table 3 is not convincing: state intervention indices are not inversely related to collective bargaining (indeed Hungary and the Slovak Republic, supposedly characterised by company level bargaining, have the highest rate of state intervention, while the highest share of domestic credit over GDP is in Bulgaria, supposedly a country with dominant collective bargaining). Ultimately, this approach suffers from Freeman's contention about the indeterminacy of the extent to which performance differences can be attributed to institutional differences (Freeman 2005) rather than, say, exchange rate regime, closeness to Brussels or Berlin, or the bridging of income gaps.

Whatever the impact of such differences, there remains a significant divergence between the model typical of transition countries and the European model – albeit within a common system of open market economy. This has not been considered at all in the various analysis and criteria of convergence between the two groups of countries. Economic integration of the new EU members with the older members inevitably dilutes the traditional European social model in two ways: by lowering the average characteristics of the ESM through the accession of less committed members, and by competition with and imitation by new members (e.g. Angela Merkel's reduction of German company tax rates from 42% to 38% under the competitive pressure of tax regimes in the new member states). The same thing happened within unified Germany, where “wage-setting has become less centralised and the labour market freer, at least at the margins”. The number of generally binding agreements fell in Germany from 627 in 1995 to 446 in 2006, according to the Institute of Social and Economic Research. “De-regulation has led to a sprouting of part-time and temporary employment, in which people have less job protection and less bargaining power than those in full time, permanent work” (*The Economist*, 3 March 2007). As pointed out by David Harvey (2006), many emerging countries – not only EU accession candidates but also Russia along with China and India – rather than being simply recipient of neo-liberalism have turned into its vigorous exporters, thus affecting the social structure of the West and especially the ESM (see also Golubchikov 2008).

These considerations on the partition between the eastern and western European models raise the need for further research on its implications for the competitiveness and cohesion of the new members and the sustainability of this unexpected divergence.

5. Conclusions

The European Social Model, also known as the European model of Social Dialogue, has been praised by some and blamed by others for various aspects of European economic performance; it is claimed to be in a crisis, to be on the wane or to have collapsed, while others deny that it ever existed.

The European Social Model is alive and well and has considerable merit, but European Union enlargement to the post-socialist countries of central eastern Europe, all of whom adopted a hyper-liberal socio-economic model, has considerably diluted the ESM both in the new European average characteristics and, by imitation and competition, in some of the older EU members. This dilution, rather than other factors, is today the major threat to the European Social Model's continued existence.

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