THE 2004 JEAN JACQUES ROUSSEAU LECTURE

A SOCIAL CONTRACT FOR THE 21st CENTURY

The Honourable Laurens Jan Brinkhorst
Minister of Economy, the Netherlands
Chairman, Competitiveness Council, Council of the European Union

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A Social Contract for the 21st Century

Ladies and gentlemen,

[Introduction]

In his famous treatise *"Du Contrat Social"*, Rousseau attempts to answer the question about what kind of collaboration in society both optimally serves the collective interest and minimally hampers individual freedom. His *"Contrat Social"* regards the State as a contract in which individuals surrender none of their natural rights but rather agree to the protection of them.

I will not exaggerate the comparison of Rousseau's *contrat social* with today's social model. *Du Contrat Social* was published in 1762 in Amsterdam and became the "textbook" of the French revolution 27 years later. When we look around Europe today, we see a significantly different social contract from the one Rousseau had in mind. For example, Rousseau stated that the collective interests could only be fulfilled when there were no special interest groups. Interest groups would naturally only be concerned with certain selected interests, which would thus hamper the promotion of general interests.

Today our model, times and challenges have changed. And needless to say, I do not foresee a European equivalent of the French Revolution in the near future. However, questions regarding the relationship between citizens and State and the position and involvement of interest groups are just as relevant today as they were in Rousseau's time. I will focus on these issues hereafter and present some ideas on the modernisation of the current European *contrat social*.

Without being able to sketch the final blueprint, I will argue that the updated European Social Model should differ distinctly from the current one. It will inevitably resemble the US model more than is the case today. But it will still be a European model, reflecting European preferences for social inclusion and environment. The main conditions for achieving this are enhancing growth and employability.

But first of all, I would like to express my thanks to the organisation of the Jean-Jacques Rousseau lecture – the Lisbon Council – for inviting me here to share my thoughts with you on this highly topical and challenging topic.

[Current European Social Model]

Let us first look more closely at the features of the current European Welfare States. They were largely built up during the post Second World War recovery phase, when comprehensive action was needed to combat urgent problems and new institutions were developed to build the cohesive and inclusive society. You could call this the post-war social model.

Looking around Europe, we see a variety of different patterns in this development. The same applies to the actual design of the welfare state. In some countries state pensions are only provided to former employees, whereas other countries provide all senior citizens with a state pension. Furthermore, the level of benefits can vary quite considerably. Take disability benefits, for instance. Some countries give disabled people about seventy percent of their former salary, whereas other countries only provide a minimum allowance. Distinguishing groups of countries in the field of social security and the welfare state, it is clear that the Nordic countries have made very different choices from the Mediterranean countries.

Moreover, the welfare states developed in these countries are certainly not a copy of the ones chosen by either Anglo-Saxon type regimes or continental “Rhineland model” countries. With the recent enlargement of the EU, a different branch has been added.

Yet these designs do have a solid set of common features: the European preference for a sustainable standard of living, together with high quality public services such as education, health care and safety and a social inclusive society, caring for relatively deprived groups in society.

Our challenge will be to sustain this model of our choice in the future. Before I enlarge on this topic, I would like to say a few words on benchmarking. It is common practice to benchmark the US and Europe economic performances – I will do so myself in this speech. However such a benchmark makes no sense unless we bear our differences in mind. Europe is not the US! We make our own, unique choices. Our different preferences are and should be reflected in a different design of the welfare state. Europe has its own agenda, in which there is plenty of room for national differences.

Having said that, I will now turn to the long-term sustainability of the European welfare states and the need to take urgent action.

[Performance of the European welfare states]

How then does this European model perform? Our economic growth is lagging behind. Since the early 1990s, the US has largely outpaced the EU in terms of economic growth. From 1991 to 2003, the US economy grew by no less than 47 percent in total, whereas the EU economy achieved only 28 percent growth. China and India are *hors category*. With average annual growth rates of nine percent, China has tripled its production over this period.

With respect to the GDP per capita, Europe ranks significantly below the world's best performers. In 2003, America's GDP per capita was 55 percent higher. Despite Japan's severe economic troubles during recent years, its GDP per capita was still 15 percent higher than the average EU figure.

This picture does not become any rosier when we compare individual EU Member States to US states. Only one Member State – Luxembourg – could compete with most US states in terms of GDP per capita. The average person in Germany, France and Italy earns less than the average American in all but four of the US states. [Arkansas, Montana, West Virginia and Mississippi].

Of course, one could say that the more even distribution of income in Europe makes the emerging picture of lower growth less of a matter of concern. It will not surprise you that I doubt this claim. Moreover, I would like to stress that trends like internationalisation, ageing and individualisation will only increase pressure on the European welfare states. Ageing, for instance, will not only put considerable pressure on public budgets as a result of rising costs for health care and pensions, it will also cause a decline in the working population. This in turn will have a significant impact on the level of structural growth.

The IMF predicts a structural growth of 2% for the European GDP. This is well below the Lisbon goal of 3%. These are not just blunt figures! Economic growth is crucial for a high and sustainable standard of living for future generations, for the provision of high quality public services like education, health care and safety and for a socially balanced policy that cares for relatively deprived groups in society. Failure to take action will have serious consequences. Without immediate measures, we will lack the means to sustain the model of our own choice in the long term.

Besides these more means-oriented arguments, I doubt whether the European post-war institutions of the welfare state are sufficiently aligned to current circumstances. Let me give you two examples. Firstly, although life expectancy has increased dramatically in recent decades, in many countries people retire well before the official retirement age. As a consequence, the productive capital of older workers remains unused and costs of pension systems rise. This results in higher taxes that in turn discourage working. Certainly not a result that fits well in the picture I have just presented! We will simply have to work longer.

Secondly, the number of hours worked per employee has been reduced significantly in many of the EU-15 Member States and flexibility of working time is relatively low. These are developments which do not help the EU much in times of increasing global competition. I predict that these excesses will be tackled in the coming years by new government policies but especially driven by companies. Companies will – in my view – increasingly demand a change towards more flexible working hours (see Siemens in Germany) and they will increasingly negotiate with their own employees about the conditions that have to be met for them not to transfer production abroad.

However there is no need to think that our future will inevitably be gloomy. There is ample room for improvement. Allow me a hypothetical line of thought. We take the best performing EU member states on each of the three drivers of growth – participation in hours, persons and productivity. If all member states equalled their performance on each of these growth drivers, the GDP per capita of the EU would be 30 percent higher than the US GDP per capita.

And only a small change can make a big difference. If Europeans worked two hours longer a week - which would still be less than on some other continents or 30 years ago - EU GDP could increase by about 6%.

However, the need to change is not a philosophical issue fit for years of further analysis at research desks and coffee tables. Modernising the European model is a necessity now.

[How to proceed: Modernising the European Model]

As I said, our future need not be gloomy.

The answer about what route to take towards the new Social Contract was already very adequately formulated in March 2000, when European leaders in Lisbon formulated the strategic goal for the European Union to become *the most dynamic and knowledge-based economy in the world by 2010, capable of sustainable economic growth with more and better jobs and greater social cohesion.*

The Lisbon strategy provides a comprehensive agenda on how to increase economic growth, whilst taking into account the European desire for a cohesive and inclusive society. I need not elaborate here on all the criticism aimed at the lack of progress so far. It is all very true. However there is no need to be overly pessimistic either. Much has in fact been done and reforms have been set in motion. But we do need to get into a higher gear and redirect the agenda to target enhancing economic growth, employment and competition.

It is worthwhile noting the broad consensus among EU politicians and policy makers that the Lisbon strategy is indeed the right way forward.

Along the path of an ambitious but feasible time schedule – like the 1985 White Paper for the completion of the Internal Market – the EU must concentrate on increased labour participation by reforming social security and provide incentives to seek work and work longer. Labour markets should become more flexible. Stimulating innovation through research excellence and increased competition will increase productivity growth and last but not least, Europe must improve its business climate with better legislation and lower tax rates.

As increased competitiveness of the EU is a core element in stimulating growth, the Competitiveness Council has a key role to play in attaining the Lisbon goals. Together with the preceding and forthcoming presidencies and as current chairman, I will give priority to developing the Lisbon Agenda whilst working on the effectiveness of the Competitiveness Council as a whole.

So, we know *what* to do, but not yet *how* to get there.

This brings us back to the stakeholders in the Social Contract and their role when essential, urgent reforms are to be carried out.

Commitment to the final goal of all stakeholders involved is the key issue here. Modernizing and maintaining the future European welfare state should be a joint project involving all Europeans. European leaders, governments and parliaments, businesses, citizens and both sides of industry will have to take this long-term goal into account and understand what it is about. A key word is *communication.*

We have to make it clear that reforms are for the benefit of future generations and not merely to accommodate Ministers of Finance in their struggle with budget deficits or to support employers facing the challenge of remaining competitive in a globalising economy. There will be no reforms without pain – labour market reforms for example - but understanding their necessity might make the pain easier to endure.

And next, there is *leadership* and *taking responsibility*.
It is naturally understandable that painful reforms are not received with loud “bravos”. But what is the alternative to reform? There are times when politicians should look beyond the most recent opinion poll and remember the long term goal. Although it may seem difficult, politicians should show leadership and courage by setting out their long term plans and sticking to them. No guts, no glory.

It is, ladies and gentlemen, always a challenge to look beyond one’s own interests and take responsibility for a common goal. This brings me to the issue of vested interests. In modern European society, the *baby-boom generation* is preparing for their well-earned pensions, with high quality health care and extended holidays to distant resorts.

Is it possible that – with most leading positions in society filled by this generation as well – their vested interests are overrepresented at the expense of younger generations? And is this not especially true of the social partners? I am sure of it. And I also feel that as important stakeholders in shaping a new European social contract, they should be at the forefront – together with the European leaders - taking responsibility for the future of both current and future generations. Taking the right position now will largely decide their place in the modernized Social Contract of Europe.

For now, we face a period of transition. While working together on a new design – incorporating national patterns – for the European social model, it would be unwise to sit back and wait for consensus. Sometimes it will be impossible to reach agreement with particular interest groups. Discussions with labour unions on early retirement in the Netherlands are an example of this. At the same time, there is plenty of common ground for progress such as good education, illness prevention and conditions on the "work floor" [think of introduction of performance-based wage schemes, self-managing teams].

[Conclusion]

Ladies and gentlemen. I cannot yet give you a complete blueprint of the future European model. However I do know the reforms required to sustain the future model and I know a few characteristics by which we will be able to recognize the final new model.

It will still be a European model, reflecting our European choices. Europe will still have a high level of social security, but not as high as it is now. We will, for example, still be happy to pay more for our petrol for environmental reasons. We will have to work more and longer, while maintaining a good deal of leisure time and we will have made our leap forward towards a knowledge-based industrialised service economy. The European model will change from a welfare state towards a *guarantee* state, guaranteeing the wellbeing of the individual and self-competent citizen.

In short:

- The agenda for reform is clear: the Lisbon agenda with focus and improved implementation.
- There is ample room to improve European economic performance. Among the member states we can learn from each other, by exchanging best practices. And here the new member states contribute dynamism from which we can all benefit.
- Reforms are no free lunch. They require all stakeholders involved to show leadership, communicate clearly and take full responsibility for modernizing the social model.

There is a momentum for change now. The new constitution has been agreed, the new member states have successfully entered the EU. We can now concentrate on reforms. And, although we are in a completely different time and situation, like Rousseau we are dealing with important questions concerning the future of the European *Social Contract.* However unlike his time, we do so in a peaceful, stable Europe without bloodshed.

Thank you for your attention.