



5. Ludwig-Erhard Dialog The Social Market Economy in a Globalised World

**Remarks by Yves Leterme,
Deputy Secretary-General
OECD**

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Ladies and Gentlemen,

Ich freue mich, hier an der Goethe-Universität, die auf eine so reiche und bedeutende Tradition zurückblicken kann, einen Vortrag halten zu dürfen. Die in dieser Universität entstandenen Arbeiten zur sozialen Marktwirtschaft reichen weit über die Grenzen Deutschlands hinaus. Das von Ludwig Erhard und anderen entwickelte Konzept der sozialen Marktwirtschaft ist in der Tat, wie so viele andere deutsche Produkte auch, zu einem Exportartikel avanciert.

Let me first tell you why I am personally particularly interested and fascinated by the figure of Ludwig Erhard.

First, there is what I would call the personal coincidence. I happen to be born in Wervik, a little town on the Belgian-French border, and grew up in the village of Zillebeke (Seelbach), located in the southern part of leper. As a kid, I used to play on the soil where, on September 28th 1918, Ludwig Erhard, then gun aimer in the German army, was severely hit and wounded at his left shoulder, neck and leg by an Ally artillery. Two weeks later, Adolf Hitler, the na young soldier, was injured in an Ally gas attack in Wervik, my place of birth. Unlike Hitler, Ludwig Erhard did not embrace the concepts of revenge and hate but remained loyal to democratic and liberal values, and engaged in rebuilding his life in such an impressively positive way.

The second reason why I am so interested in Ludwig Erhard is because he is rightly considered as one of the “Social Market Economy” founders. Although, according to historian Alfred Müller Armach, the expression “Social market economy” appeared in 1946, Ludwig Erhard used it first in a speech he delivered to the Economic Council on August 17 1948.

The afterwards continuously used these words to summarize his vision (notably at the Congress Bad Godesberg), although as you know that vision of him was quite different from the content we now use to confer to the concept of “Social market economy”

Ladies and Gentlemen,

I would like to structure my remarks in two parts. First, I will discuss the state of the social market economy today as we see it in international perspective. In the second part I would like to examine the challenges for social protection systems, both in the short term, coming from the economic crisis, and in the longer term, emanating especially from population ageing, and outline what this means for policy reforms to ensure that the social market economy remains a viable and successful model in the future, taking account of the challenges posed by a globalised world.

The social market economy as a model for Europe

The Social Market Economy is often contrasted with the Anglo-saxon capitalist model. While its tradition is German and the term “social market economy” (soziale Marktwirtschaft) in its original sense is used primarily in Germany and Austria, other countries have introduced variations of this concept, such as Blair’s so-called Third Way in the United Kingdom, state capitalism in France or the Nordic model in Scandinavian countries. It is difficult to make a clear distinction between the different concepts and variations, especially since many of these models are in flux, they are being modified in line with economic, social and demographic realities.

Deshalb möchte ich heute nicht auf das Konzept der sozialen Marktwirtschaft im engeren und ursprünglichen Sinn eingehen, sondern über ein weiter gefasstes Konzept sprechen. Ich werde mich mit dem unter der Bezeichnung „europäischer Wohlfahrtsstaat“ bzw. „europäisches Sozialmodell“ bekannt gewordenen Modell beschäftigen. Dieser Begriff ist zu einem zentralen Element der politischen Debatte im Zusammenhang mit der Globalisierung und der Wettbewerbsfähigkeit der europäischen Länder geworden. In einigen Kreisen, insbesondere außerhalb Europas, bekam das Modell eine schlechte Presse, vor allem angesichts der Schwierigkeiten der Länder, die große Rezession zu überwinden. Die Kritik am europäischen Sozialmodell legt den Fokus auf die Kosten des Modells und auf seine Folgen für die Staatsverschuldung, woraus die Schlussfolgerung abgeleitet wird, dass das Modell nicht mehr finanzierbar sei und eingeschränkt werden müsse. Für viele europäische Länder ist ihr jeweiliges Sozialschutzmodell jedoch Teil der gesellschaftlichen DNA, also ein integraler Bestandteil ihrer Identität. Die wirtschaftlichen, geschäftlichen und sozialen Beziehungen in diesen Ländern beruhen auf einem auf diesem Konzept basierenden Konsens.

Defining the European social model, however, is a difficult task. In fact, there is no such thing as a single model. Across Europe, we find a range of different approaches to social and health policy - with vastly different implications for public expenditures, for social security contributions and tax rates, as well as for the role and responsibilities of the public sector, the private sector, and the individual.

What all of these different models do have in common is a basic vision of what is needed for social cohesion. All of them seek to provide comprehensive coverage to the entire population against a standard set of risks, which include unemployment, poverty, sickness and disability as well as old age; in addition, there are benefits in cash and in kind for families to ensure

that having children does not result in economic insecurity. And in a wider sense, this ambition also includes equality in access to good quality education. Finally, another goal, even though not explicitly targeted is to keep income inequality at low levels; most European countries use their tax and benefit systems as well as publicly-provided services to this end.

Am stärksten unterscheiden sich die Sozialmodelle der einzelnen Länder jedoch hinsichtlich der jeweiligen Rolle der Sozialpartner. In einigen Ländern, wie Deutschland, Österreich, den Niederlanden, Belgien und den nordischen Ländern, gibt es eine lange und starke sozialpartnerschaftliche Tradition, was sich in der Art der Unternehmensführung, in der Aushandlung von Löhnen und Arbeitsbedingungen sowie in der Ausbildung der Arbeitskräfte, etwa in Berufsausbildungsprogrammen, widerspiegelt. Diese Tradition steht im Gegensatz zu jener in Ländern wie etwa Frankreich oder den Mittelmeerländern, wo Gewerkschaften zwar eine gewisse Präsenz haben und am Diskurs teilnehmen, jedoch häufig nicht in so großem Maße an wirtschaftlichen Entscheidungsprozessen mitwirken.

Let us now take a look at the evidence. Where does the European social model stand in international comparison?

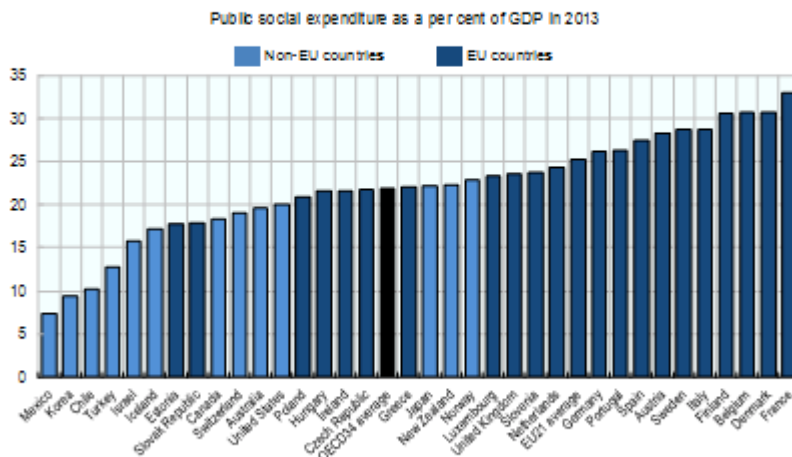
The cost factor

As I mentioned earlier, one of the main criticisms of the European social model is that it is expensive and constitutes a drag on economic growth. Let us take a look at the numbers

(Slide 1)



The league of public social expenditure is led by European countries



Source: OECD Social Expenditure database (SOCX, www.oecd.org/social/expenditure.htm).

The league of public social spending is indeed led by European countries: France tops the list with about 33% of GDP going to publicly provided social protection, while Belgium, Denmark and Finland spend around 30% on social spending. Germany currently spends about 26% of GDP, compared to an OECD average of 22%. Outside of Europe we find lower shares of GDP going to public social expenditures: In Australia, Switzerland and the United States they account for about 20% of GDP, and in Canada 18%. All of these countries have large shares of private social spending, in particular for pensions and health care.

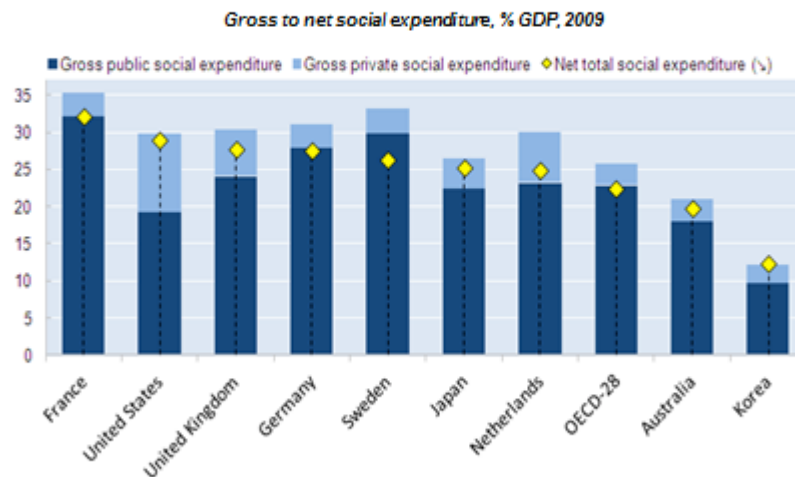
Private provision of social protection, however, does not necessarily mean that the cost is reduced.

(Slide 2)



Similarity in spending totals

In many OECD countries net total social spending is around 20-25% of GDP



Source: OECD Social Expenditure database (SOCX, www.oecd.org/social/expenditure.htm).

As you can see on this slide, European countries and the United States have similar levels of social spending once you factor in two things: first, many European countries tax social benefits which means that the state claws back some of the expenditures – this takes you to net public spending; and second, the United States and several other countries give tax incentives to employers and individuals to promote private provision of social protection, in particular for health care and pensions (the light blue bars) . Adding the two takes you to total social expenditure. Moving from gross public (the dark blue bars) to net total social expenditure (the yellow diamonds) not only leads to greater similarity in spending levels across countries, it also changes the ranking among countries.

As private social spending is so much larger in the United States compared with other countries, its inclusion moves the United States from 23rd in the ranking of the gross public social spending effort to 2nd place after France when comparing net total social spending across countries. However, the implications for the distribution of social benefits – that is

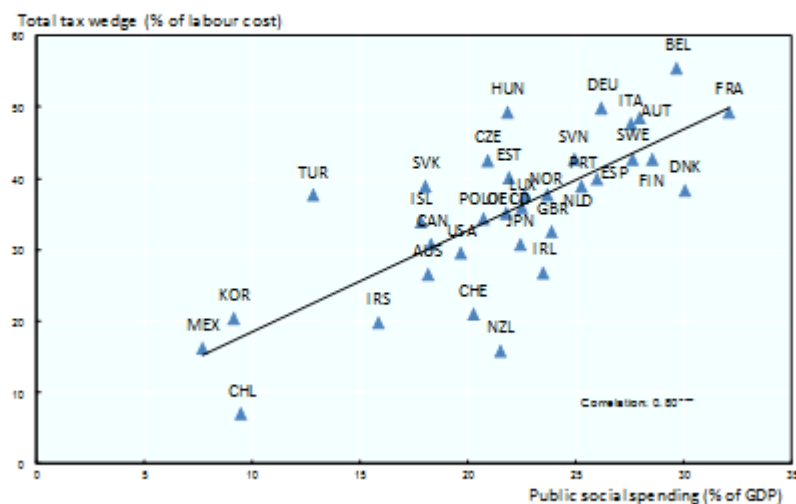
which groups of people are covered to what degree by social protection – can be very different.

Was bedeuten diese Sozialausgabenniveaus für die Löhne und die Wettbewerbsfähigkeit? Da die meisten Sozialschutzsysteme überwiegend durch lohnabhängige Sozialversicherungsbeiträge finanziert werden, gehen hohe Sozialausgaben häufig mit hohen Arbeitskosten einher. Diese wiederum können die Wettbewerbsfähigkeit beeinträchtigen und das Wirtschaftswachstum gefährden.

(Slide 3)



Relationship between public social spending and total tax wedge (2011)



Sources: OECD Social Expenditure database (SOCX, www.oecd.org/social/expenditure.htm) and OECD Tax database (www.oecd.org/tax/tax-database.htm)

This slide shows the relationship between public social spending and the total tax wedge, that is the difference between the cost of labour for an employer and the pay that the employee takes home. You can see that along with France and my country, Belgium, Germany is one of the countries with the largest tax wedge. This indicator shows that the

margin for further increases of the tax wedge are limited in many European countries; other sources of financing of social policy measures will have to be explored than wage-based social insurance contributions.

Natürlich sind Steuern und Sozialversicherungsbeiträge nicht die einzigen Faktoren, die für die Wettbewerbsfähigkeit eines Landes bestimmend sind. Deutschland ist Weltmeister, was den Export eigener Produkte und Dienstleistungen angeht, obwohl das Land eine der höchsten Steuer- und Abgabenbelastungen aufweist. Das zeigt, dass die Sozialausgaben und die Höhe der Sozialversicherungsbeiträge nicht die einzigen bestimmenden Faktoren für eine globale Wettbewerbsfähigkeit sind. Auch andere Faktoren, wie Bildung und Kompetenzen der Arbeitskräfte, Innovationskapazitäten oder Energiekosten spielen für Unternehmen und Länder, die dem Wettbewerb auf globalen Märkten ausgesetzt sind, eine maßgebliche Rolle. Gleichwohl sind Reformen nötig, und zwar nicht nur, um in einer globalisierten Welt wettbewerbsfähig zu bleiben, sondern auch um die enormen Herausforderungen der Zukunft zu bewältigen.

The world, and most of Europe, is currently facing three key challenges: low economic growth, high unemployment, and rising inequality.

Economic recovery in Europe is lagging and uneven. Growth is resuming at a low pace in most EU countries outside the euro area. But in 2013 the euro area itself experienced a second year of recession (-0.4% growth), and a slow improvement over the near term (1.0% in 2014 and 1.6% in 2015).

Unemployment, the second key challenge, remains unacceptably high, at 8% this year for the OECD countries on average, and falling only slightly to 7.5% by 2015. In the euro area, we expect unemployment to hit 12% this year and only to fall back below this level after mid-2015. Furthermore, long-term unemployment is increasing. Long-term joblessness ranges between 45-55% in some European countries, including Spain and Italy.

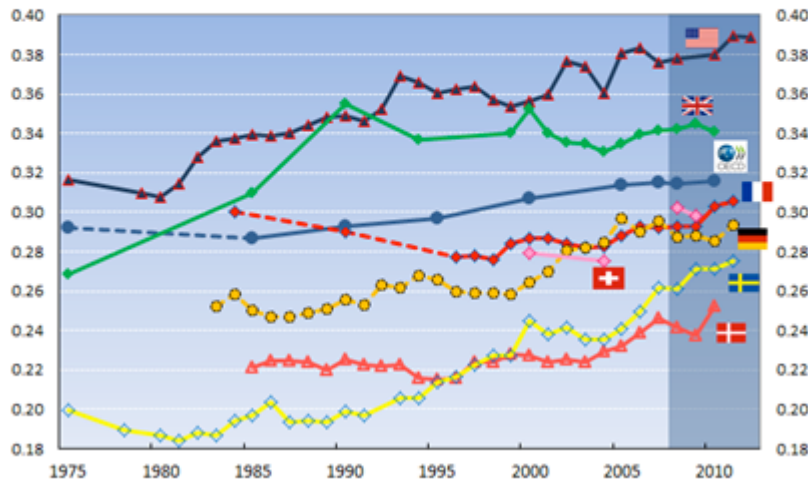
Auch die Jugendarbeitslosigkeit hat in manchen dieser Länder (mit etwa 60% in Griechenland, 56% in Spanien) ein alarmierendes Niveau erreicht. In diesen Ländern hat sich der Anteil der Jugendlichen (im Alter von 15-24 Jahren), die weder in Beschäftigung noch in Bildung oder Ausbildung sind (NEETs), seit Beginn der Krise verdoppelt. 2012 fielen mehr als 20% aller Jugendlichen in diese Kategorie. Deutschland ist neben Österreich das einzige Land, das im Hinblick auf die Jugendarbeitslosigkeit gut abschneidet (unter 10%).

Third, the crisis has intensified the increase in income inequality. But growing inequality is not new, we have been experiencing it for the past three decades. [Slide 4]



The crisis has intensified the increase in income inequality

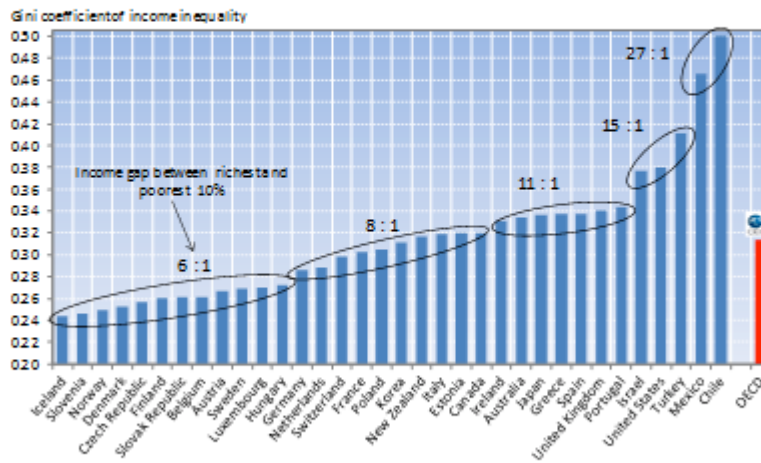
Long-term trends in inequality of disposable income (Gini coefficient)



In OECD countries today, the average income of the richest 10% of the population is about nine and a half times that of the poorest 10% – a ratio of 9.5 to 1. In the mid-80s, that same ratio was 7.5 to 1. In the US, the increase in this ratio has been even more dramatic, from 11 to 1 in the mid-80s to about 16 to 1 today. European countries have generally experienced a more muted increase in inequality. But now even traditionally egalitarian countries, such as Germany, Denmark and Sweden, are seeing the gap between rich and poor expanding – from 5 to 1 in the 1980s to 6 to 1 today. The contrast between the experiences of France and Germany after the Great Recession is instructive. The steep trend rise in inequality in Germany came to a halt as rising employment offset the effects of a widening earnings distribution. Inequality in France, however, rose to exceed the German level in 2010 under the pressure of rising unemployment.



Large differences in levels of income inequality across OECD countries (2010)



Source: OECD Income Distribution Database, via www.oecd.org/social/income-distribution-database.htm

Reforming the European social model

Social protection systems in Europe have been undergoing substantial reforms, partly in response to the economic crisis and the needs for fiscal consolidation, but also in a longer-term perspective to prepare for population ageing.

The population structure is a key driver of social spending. Countries with a young population are much less likely to have higher social-spending-to-GDP ratios than countries with older populations, but have a greater share of education spending. The proportion of elderly in the population is around 15% across the OECD and on average they "receive" 40% of all public spending on education and social policy. In countries where only one in ten persons or less is over 65, only a quarter of social spending goes to the elderly. In Japan and Italy where 1 in

5 citizens is senior, about 60% of all public social and education spending goes to the elderly.

In addition to the crisis and fiscal consolidation efforts which have put pressure on social protection systems, population ageing will thus be a key driver of future increases in social spending. OECD projections suggest that public spending on health and long-term care services might almost double from 7% in 2009 to 13% in 2050 on average across the OECD.

But OECD Pensions at a Glance and OECD Pensions Outlook show that in many countries pension reforms have improved the financial sustainability of pensions systems. The crisis has triggered faster reforms and more rapid phase-ins of already decided changes, for example in Greece, Spain and Italy. The pace and content of reforms has varied across countries but a common aim has been to promote longer working lives. While Germany was among the first to go beyond the age of 65 years, many countries have followed in recent years and now you could say that “67 is the new 65”. Often, pension promises for future retirees were lowered and more and more countries are introducing automatic links of key pension parameters to future increases in life expectancy. Some countries are also promoting private retirement savings.

Benefit systems for the working-age population have been particularly tested by the Great Recession. As unemployment benefit entitlements run out after certain periods and long-term unemployment has increased in many European countries, more pressure is now on last-resort social assistance systems. It is important to keep these schemes intact and also continue to help people on those benefits get back into the labour market.

Policy measures to boost job creation need to be cost-effective and focus on the most vulnerable groups. Action is needed on both the demand and the supply side of the labour market. Labour market programmes can make a difference, including higher impact activation policies, effective counselling, job-search assistance, and even temporary hiring subsidies for people with low skills. Also needed are better incentives for job-seekers and greater flexibility in labour markets. And more investment in training would make the re-employment of jobseekers easier. As the OECD showed in the “Adult Skills Survey” - the “PISA for adults”- skills are very unequally distributed and this is a major source of entrenched inequality.

Ein weiterer entscheidender Bereich ist die Familienpolitik. Kinderbetreuungsmaßnahmen unterstützen die Haushalte in der Krise, indem sie eine Erwerbstätigkeit beider Elternteile und somit einen Ausgleich der krisenbedingten Einkommenseinbußen ermöglichen. Darüber hinaus ist die frühkindliche Betreuung und Bildung zentral für die weitere Entwicklung von Kindern. Für Länder, die mit einer raschen Bevölkerungsalterung konfrontiert sind, sind derartige Maßnahmen besonders wichtig, da sie Grundvoraussetzung dafür sind, dass mehr Frauen die Möglichkeit zur Erwerbstätigkeit haben und ihre Arbeitszeit erhöhen können. Daher ist es essenziell, dass die Länder darauf achten, diese wichtigen Unterstützungsmaßnahmen für Menschen im erwerbsfähigen Alter nicht zu kürzen.

Summing up, let me set out a vision for the future. Even in a globalised world, this underlying philosophy of European welfare policies is unlikely to change. I believe that governments will continue to pursue the objectives of comprehensive coverage with a high degree of public sector involvement, be it as direct provider or as regulator and supervisor of private provision.

Allerdings dürfte sich das Ausmaß der für alle bereitgestellten Sozialleistungen ändern. Durch den aus dem globalen Wettbewerb und der Bevölkerungsalterung resultierenden Druck wird es meiner Einschätzung nach in Zukunft zu einem gezielteren Einsatz von Sozialleistungen und einer stärkeren Fokussierung auf eine Unterstützung der am stärksten gefährdeten Gruppen kommen, während bei jenen, die für sich selbst sorgen können, mehr der persönlichen Verantwortung überlassen werden wird. In anderen Worten: Sozialschutzsysteme werden wahrscheinlich in stärkerem Maße umverteilen. Ein gezielterer Einsatz kann zu erheblichen Einsparungen führen und zugleich gefährdete Gruppen schützen. Insbesondere Gesundheitsreformen sollten den Fokus auf den Schutz der am stärksten gefährdeten Personen legen. Dabei ist jedoch eine Feinabstimmung der zielgruppenorientierten Ausrichtung erforderlich, um die Schaffung widersinniger Anreize zu vermeiden, die Menschen davon abhalten, einen Arbeitsplatz zu suchen.

Before I conclude, in line with this European Welfare policies approach, and in view of the discussion that will follow, I also wanted to share with you a thought that occurs to me when speaking about this issue. We know that social policies play a critical role in the transformation of emerging economies. What if social market economy and, more precisely, welfare policies were not only a model for Europe, but also a precondition for a sustainable growth in developing countries and emerging economies?

Social policies are too often seen as either no fit or even as a threat for the growth of emerging economies, notwithstanding the fact that there is of course no single model to apply to very diverse situations. As stated in our 2011 OECD "Divided we stand" publication, growth is not sustainable when it is not balanced, which calls for a better distribution of the economic gains between individuals and between countries of the world, to achieve a truly inclusive growth and social development. I will not enter into the details now that I've almost

reached the end of my speech, but a better welfare model in emerging economies would help in many ways:

- in a global market for talents, it could help individuals to develop their skills so that they are well-equipped for a constantly evolving labour market, and can claim for better wages
- it could also drastically account for a more homogeneous tax system, providing a comprehensive pension scheme and allowing for more private consumption
- finally, an efficient social system could also impact citizen's trust in their institutions and governing bodies

Could a balanced approach between labour market, social protection policies, good governance and social dialogue, i.e the basics of our European welfare model, serve as a catalyst for a sustainable growth in emerging economies?

Back to the old continent, we should aim to create the conditions that the European social model can not only survive but thrive. I am confident that the social model will continue to evolve over time and adapt to a changing global economic context. This will require structural reforms which will inevitably have winners and losers and therefore be politically challenging at times. This, however, should be no reason for delaying action. We know that there will be no economic paradise on social ruins, but we also know that there will be no social paradise on economic ruins.

Thank You