Creating an EU Flexicurity System: An American Perspective

Richard V. Burkhauser*

Introduction

The United States of America (US) and individual European Union (EU) countries have weighed individual liberty and collective protection quite differently in establishing limits for their internal economic market arrangements and in forming public policies aimed at reducing their population's economic risks. What will ultimately drive the debate about "what *flexicurity* will mean for future EU labor market policies" is the more fundamental question of how individual EU countries' historical "liberty vs. social protection" equilibriums will be reconciled within a fully integrated EU marketplace. A marketplace that itself will have to adjust to an increasingly integrated world economy.

What strikes an American about the EU flexicurity debate is its failure to explicitly recognize what is known in the US as the "state" vs. "federal" debate – a debate that has been raging among us for well over 200 years. The debate about what it means to be both an American and a citizen of one of our 50 states. Hence the typical examples in the flexicurity literature show how a specific country – Denmark, the Netherlands, etc. – moved "on the margin" to make their labor market somewhat more flexible, while maintaining or not greatly changing their politically established level of social insurance protection and its within country distributional consequences. (For example: European Commission 2006; Gazier 2006; Madsen 2006.)

The emphasis is on how a given EU country's social institutions have been made "more efficient" in response to external market forces or internal demographic forces that required some adjustment to its social contract. There has been little consideration of the relevance of these within-country adjustment examples to the ultimate across-country adjustments to come. Coming, at least in an EU where individual country labor and all other factor and product markets are as open across EU countries as are the 50 individual state markets that make up the common US market. This lack of investigation of how the US resolved its flexicurity issues while integrating its 50 states into a single US marketplace is surprising. Since capturing the productivity gains from fully integrating its individual country markets is presumably the growth engine that will make the whole of EU growth greater than the sum of its individual country parts. And, will best position the EU to thrive in a more integrated world economy.

From my perspective, it is likely that the more fully EU country markets are integrated into a single EU marketplace, the more EU country social institutions will need to be integrated to encompass at least some minimum level of social protection for its now more heterogeneous populations. Therefore, the right question to ask is: "What will an EU system of social institutions look like that, like the US, is founded on the proposition that social cohesion and solidarity do not stop at each state's border but encompass all EU citizens?"

More appropriately comparing economic inequality in the US and the EU

The US social model is often dismissed by Europeans who argue that US inequality and labor market flexibility levels (lack of social cohesion and social solidarity) are so extreme that its social institution building offers no insight to policymakers laboring to achieve EU flexicurity. But comparing the US to any single EU country is like comparing apples to oranges, or perhaps better an apple to a mixed bag of fruit. While there is greater inequality in the US than in most individual EU countries, Alber (2006) shows that differences in the level of economic well-being along most dimensions (in-

* Cornell University. Professor Burkhauser completed this paper while he was the R.I. Downing Fellow in Social Economics in the Faculty of Economics and Commerce, University of Melbourne.

come, employment, health, poverty, etc.) across EU countries is wide enough that US economic outcomes lie well within EU country extremes.[1] Hence, in comparing social outcomes between the US and the EU or rather an EU striving to have its marketplace as fully integrated across member states as the US, it is important to consider the social institutions that such an economic integration are likely to bring.

Measuring income inequality

The EU as a whole is closer to the US in both size and heterogeneity of geography and population than is any one EU country. The same is true with respect to comparisons of income inequality. Beblo and Knaus (2001) demonstrate the importance of across-country inequality in the EU by tabulating the income distribution of the combined populations of the ten founding EU countries as well as the percentage of each decile of the distribution originating in each country. In 1995, those living in Germany made up 28.9 percent of the total EU-10 population but a disproportionately higher 42.0 percent of the top decile and a disproportionately lower 20.1 percent of the bottom decile. In contrast, those living in Portugal made up 3.5 percent of the total EU population but 1.4 percent of the top decile and 10.6 percent of the bottom decile. Likewise, those living in Italy made up 20.1 percent of the entire EU-10 population but 9.3 percent of the top and 26.2 percent of the bottom decile. Accounting for such cross-country differences increases measured inequality in the entire EU-10. They find that there is a wide range of inequality across countries, with Portugal (highest inequality) having measured inequality 75 percent larger than the Netherlands (least inequality). Once they make the necessary calculations, the variation across countries contributes 9.3 percent to total EU-10 inequality.

Most recently, Brandolini 2007 compares the EU-wide income distribution in 2000 for the EU-15 and EU-25 with the income distribution of the US in 2000. He shows inequality (based on a Gini calculation) within the EU-25, with its greater heterogeneity of populations, is substantially greater (0.378) than for the EU-15 (0.294) and that US income inequality (0.369) is within them.[2]

[1] See Alber and Gilbert (in press) for a richer comparison of US and EU country social models and their economic outcomes.
[2] See Burkhauser and Couch (in press) for a more detailed comparison of income equality between the US and EU countries over the last two decades. See Burkhauser, Feng, Jenkins and Larrimore (2008) for a discussion of measurement issues in cross-national comparisons of US income inequality trends.

The US began its struggle to establish a set of principles that would ensure social cohesion when, as a confederation of 13 states (some free and some slave), it formally united in 1789. It has continued to adapt them as it expanded its geographical borders to 50 states and opened each to more ethnically and culturally diverse populations. Today, the US continues to be much larger and more heterogeneous geographically, ethnically and culturally than any single EU country. But it is much closer in size, geography, ethnicity and culture to the entire population of the EU-25. Comparing the two, EU-25 citizens are about as unequally distributed across their income distribution as are US citizens, but their mean real income is substantially smaller.

As the country level marketplaces of the confederation of EU-25 countries become more fully integrated, it is likely that average real EU income will rise and that average incomes across EU countries will narrow, especially so, given the proposition that social cohesion and solidarity do not stop at each state's border. But it is hard to believe that the wide differences in the levels of social protections currently existing across its member countries will be maintained. The question then becomes what will be the level of social protection offered to all EU citizens?

This is the reality that confronts EU policymakers as they seek a set of social policies which will move a still relatively loose confederation of nation states towards a united Europe. In so doing, member states will be forced to confront the broader regional, ethnic, cultural and religious differences that have shaped US social policies in our efforts to both reduce inequality and raise living standards for the entire population.

Because cultures have varied so significantly in the US across states and regions, our collective national policies have tolerated greater differences than is the case in the more homogeneous societies of any given EU country. Our national policy is one that specifically allows for deviations at the state and local level. Moreover, national policies that redistribute resources across regions and states required collective approval. No doubt, this has also limited the extent of that redistribution. Nonetheless, to accommodate the broad regional and national differences that exist across the EU countries, it appears likely that policy formation will evolve in a manner that is bounded by similar considerations. In the context of earnings and income inequality, one challenge to a united EU is convincing citizens of its member states that reduction of income inequality in the united EU that requires redistribution across national boundaries is in their collective interest. Similarly, it is also likely that the extent of generosity in the approval of income redistributions across borders will be tempered by the interests of the member states just as it has been in the US.

These same "state" vs. "federal" issues will determine what it means to be both an EU citizen and a citizen of one of its member states (and the rights and responsibilities that go with each) and they are inescapably part of the flexibility debate. Given the more heterogeneous EU-25 population over which these decisions will be made, it is likely that EU social policies will evolve more toward those of the US than to the current policies of the more homogeneous individual EU countries from which most flexicurity examples are drawn. Hence it is useful to consider the foundation of US flexicurity.

The cornerstone of solitary and flexicurity in the US

"Anyone who works hard and plays by the rules shouldn't live in poverty."
President William Jefferson Clinton, 1993 Inaugural Address (Clinton and Gore 1992)

Most working-age Americans support themselves and their households through market work. Historically economic growth has boosted the living standards of nearly all working American households. In President Clinton's words, working-age Americans, who have "worked hard and played by the rules," not only avoided poverty, but have experienced substantial increases in economic well-being. The key to understanding American flexicurity is our emphasis on employment as the path to economic success and our reluctance to directly regulate wages or working conditions so as not to interfere with how workers and their agents (unions) negotiate with employers.

The relative use of the federal minimum wage and the Earned Income Tax Credit (EITC) as mechanisms to ensure that "anyone who works hard and plays by the rules doesn't live in poverty" provides a useful example of how American style flexicurity has evolved over time. Social reformers of the late nineteenth and early twentieth century confronted by an emerging capitalist system saw direct government regulation of labor markets as the best means of insuring a living wage for all (Ryan 1906). In an era without state or federal income taxes (and hence small revenue bases), without labor unions, and with few government programs to provide income assistance for the working poor, early state minimum wage and hours laws sought to ensure a minimum income for the households of all workers via regulatory boards of "social partners" (government, labor and management). The laws were intended to directly intervene in the marketplace by establishing a set of socially just hourly wage rates. But most such efforts by state legislatures in the early twentieth century were ruled unconstitutional.

The Fair Labor Standards Act of 1938 established the first federal minimum wage. This act marked the culmination of a long struggle to establish that state and federal legislatures could regulate the "freedom to contract" in the marketplace, found in the fourteenth amendment of the US Constitution. But the act steered clear of the "corporate state" type of regulatory boards that still attempt to directly influence market outcomes and through that intervention the economic well-being of their citizens. Instead, the Fair Labor Standards Act simply set one national minimum hourly wage that applied to all states and could be raised as appropriate by Congress. Each state was then free to increase its own minimum wage law above the Federal minimum hourly wage.

Instead of direct intervention in the labor market to affect employment contracts, US social reforms have primarily left it to workers and their agents (unions) to negotiate these contracts within relatively unrestrictive government minimum wage, maximum hours, and workplace safety and environmental regulations. The result is that wage inequality is much greater in the US than in most EU countries but employment is higher and movement into and out of the labor force, and across employers within a state and across states is greater.

While the American social safety net protects those not expected to work – children, aged, disabled – President Clinton captures the board outline of the "social contract" as understood by the majority of voting Americans in his proclamation that anyone who works hard and plays by the rules shouldn't be poor. But he also provides the boundary of that protection by implicitly agreeing that anyone who doesn't work hard and play by the rules cannot depend on government support – there are no guaranteed social minimums in the US. In an American population diverse in regional concerns, race, ethnicity, culture and religion, and one that has historically been willing to accept various waves of new immigrants both across our states and over our national borders, it is this common willingness to provide government support (via redistribution from higher to lower income households) to those who are willing to work that underpins our sense of solidarity. And, it is the expectation of social mobility, given this social insurance rule, which binds us together.

But rather than making "work pay" by directly mandating employers to provide a living wage – in May 2008 the Australian Fair Pay Commission (2008) found that the minimum wage in the US was the tenth highest among the 14 OECD countries with minimum hourly wages, and less than one-half that of the three highest countries based on either nominal exchange rates or purchasing power parity: Luxembourg (EUR 9.29), France (EUR 8.63) and the Netherlands (EUR 8.33) – the US (USD 5.85) has chosen to directly subsidize the working poor via our tax system.[3]

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, passed by a Republican dominated Congress, signed by President Clinton, and reauthorized in 2006, fundamentally altered the way America provides social protection to single mothers. It ended a federal program of guaranteed cash support for single mothers living outside the mainstream economy (Aid to Families with Dependent Children) and replaced it with a federally funded state-based program of temporary support, pro-work incentives, and a federal commitment to make work pay (Temporary Assistance for Needy Families). In so doing, it encouraged single mothers to invest in themselves, engage in the labor market and break the cycle of public benefits and poverty. Essentially, welfare reform reclassified a population heretofore "not expected to work" – single mothers – to one "expected to work": This package of 1996 welfare reforms is an example of an American style political compromise that both dramatically reduced the number of single mothers on the welfare rolls after 1996 (from around five million before welfare reform to under two million today), but even more dramatically increased their employment so that on average their income rose and their poverty rates fell (Meyer and Rosenbaum 2001; Blank 2002; Burkhauser, Daly, Larrimore and Kwok 2008).

The primary positive incentive offered to single mothers who worked was the EITC. It provided them with a substantial wage subsidy. It is the primary federal cash transfer paid to the vast majority of never-married single mothers who now work. The EITC effectively raised the minimum wage for single mothers and has played a large role in their movement into the labor force. In addition to the Federal EITC, in 19 states, those eligible for the federal EITC also receive additional state EITC benefits (Schmeiser 2008). The dramatic improvement in the employment and income of never-married single mothers in the US since 1996 was the result of a policy change that raised the effective wage of low-skilled workers (Meyer and Rosenbaum 2001). But unlike a minimum wage increase, the EITC did not do so by mandating that employers raise the wages they pay to poor and non-poor workers alike. Hence, this policy has none of the negative employment effects of minimum wage increases on employment and on net has increased employment and total hours worked of single mothers (Hotz and Scholz 2003).

As the EU struggles to find the mix of marketplace flexibility and social protection consistent with fully integrating its individual EU country labor markets into a single EU labor market, it will also have to establish the basis for a compatible set of social institutions that will protect the economic security of all its workers. Making that choice is likely to eventually require substantial changes in each EU country's mix of current employment protection legislation and social welfare protection. That is, each country to some degree will have to change from a flexicurity system originally established to satisfy the needs of its more homogeneous population to a flexicurity system that better reflects the willingness of its population to protect and redistribute income across a more diverse EU population. Perhaps when the smoke clears and each EU country has finally agreed to some common basis for each of their flexicurity systems that is compatible with a common EU marketplace, ensuring that EU citizens who work hard and play by the rules do not live in poverty, may not be seen as such a meager standard after all.

[3] See Neumark and Wascher (2008) for a comprehensive review of minimum wage legislation on the employment and poverty rates of low skilled workers.

References

Alber, J. (2006), "The European Social Model and the United States", *European Union Politics 7* (3), 393–419.

Alber, J. and A. Gilbert, eds., *European and American Social Models,* Oxford University Press, in press.

Australian Fair Pay Commission (2008), *Wage-setting Decision and Reasons for Decision,* Australian Fair Pay Commission Publication, Melbourne.

Beblo, M. and T. Knaus (2001), "Measuring Income Inequality in Euroland", *The Review of Income and Wealth* 47(3), 301–20.

Blank, R.M. (2002), "Evaluating Welfare Reform in the United States", *Journal of Economic Literature* 40 (4), 1105–66.

Brandolini, A. (2007), "Measurement of Income Distribution in Supranational Entities: The Case of the European Union", in S. P. Jenkins and J. Micklewright, eds., *Inequality and Poverty Reexamined,* Oxford University Press, 62–83.

Burkhauser, R. V. and K. A. Couch, "Are United States Inequality and Mobility Trends in the European Union's Future?" in J. Alber and A. Gilbert, eds., *European and American Social Models,* Oxford University Press, Oxford, in press.

Burkhauser, R., M. Daly, J. Larrimore and J. Kwok (2008), "The Transformation in Who is Expected to Work in the United States and How it Changed the Lives of Single Mothers and People with Disabilities", *Working Papers,* University of Michigan Research Center.

Burkhauser, R. V., S. Feng, S. P. Jenkins and J. Larrimore (2008), "Trends in United States Income Inequality Using the Internal March Current Population Survey: The Importance of Controlling for Censoring", *NBER Working Paper* 14247.

Clinton, W.J. and A.A. Gore, Jr. (1992), "Putting People First".

European Commission (2006), "Flexibility and Security in the EU Labour Markets", in Employment in Europe Report, Brussels.

Gazier, B. (2006), "Flexicurity and Social Dialogue: European Ways", DB EMPL Seminar on Flexicurity (May), mimeo.

Hotz, J. V. and J. K.Scholz (2003), "The Earned Income Tax Credit", in R. Moffitt, ed., *Means-tested Transfer Programs in the United States,* University of Chicago Press, Chicago, 141–198.

Madsen, P.K. (2006), "Flexicurity: A New Perspective on Labour Markets and Welfare States in Europe", DB EMPL Seminar on Flexicurity (May), mimeo.

Meyer, B. and D. Rosenbaum (2001), "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers", *Quarterly Journal of Economics* 116(3), 1063–114.

Neumark, D. and W. Wascher (2008), *Minimum Wages,* MIT Press, Cambridge, MA.

Ryan, J. A. (1906), *A Living Wage,* McMillan, New York.

Schmeiser, M. D. (2008), "Expanding New York State's Earned Income Tax Credit Program: The Effect on Work, Income, and Poverty", PhD dissertation, Cornell University.