Democratic Policy against the Dominance of Markets

Proposals for an Integrated Development Strategy in Europe

Euromemorandum 2005

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Summary

1. The year 2005 has added to the long experience of economic weakness and social downsizing in the EU the clear perception of the obvious crisis of legitimacy and political acceptance by large parts of the public in the Union. The European institutions have responded by declaring a 'period of reflection'. Such reflection could be helpful if it addressed in a critical analysis the basis of the failed economic and social policies and the powers and interests behind it, and if it embarked on the search for thorough policy changes. But it would be wasted time and counterproductive if it envisaged to better 'explain' and convey to the people the current policies and thus to make these more acceptable. It is to be feared that this is the Commission's agenda for the coming debate.

2. The economic and social development in the EU is marked by the end of the weak recovery and by falling growth rates with rising unemployment and again lower wage shares which indicate a further deepening of inequality in Europe. The negative macroeconomic picture is to a large degree influenced by the weak performance of Germany and Italy while other countries fare much better. The particularly strong redistribution from wages to profits had the effect that real domestic demand in Germany in 2005 was lower than in the year 2000. Poverty, and particularly child poverty in the EU, is on average still at unacceptably high levels, with on the one hand the exception of the Scandinavian countries and, on the other hand, particularly scandalous figures for the United Kingdom.

3. The Commission has explained the failure of the Lisbon Strategy of 2000 by pointing to over-ambitious objectives and an over-complex programme structure. It has also interpreted the wave of critique and rejection of the draft constitution in France and the Netherlands as an opposition of the ordinary citizens to a supra-national state with a grip on traditional national welfare systems. In a move of apparent modesty the European institutions are now about to adopt a new kind of ***European minimalism***:

- Firstly, they launched a second version of the Lisbon agenda, the "*new partnership for growth and jobs"* which is considerably less ambitious, has less objectives and benchmarks, and concentrates almost exclusively on growth and jobs. The social quality of jobs and the ecological sustainability of growth in this agenda are pushed even more to the background than before.

- Secondly, they declare the intention to cut *back on red tape* and reduce the number of European rules and provisions in the interest of citizens. Welcome as such removal of bureaucracy may be in theory, in practice it includes attacks on standards for health or environmental protection.

- Thirdly, another important aspect of European minimalism is reflected in the determination to further *reduce the already much too small European budget*, allegedly to ease the tax burden for the citizens.

What remains after such correction of "over-ambitious visions" for Europe is the trust in open markets, deregulation, competition, and flexibility. In reality the new modesty

in the current minimalist policy reflects and reinforces the core programme of neo-liberalism.

4. Against this narrowing of the perspective for European development we propose to *broaden the perspective* and enhance the ambitions towards a comprehensive European development strategy. This includes on the one hand a widening of the strategic scope to include with equal weight economic, social and ecological perspectives, and to establish a real – as opposed to rhetoric – ***balance between the economic, social, and ecological dimensions of social live and European integration***. For economic policy on the other hand it means a broadening and enhancement of the range of measures and tools, which should include more intensive macroeconomic and structural intervention, stricter rules for capital, and a broader use of the public sector.

5. The objective of ***full employment*** should be maintained and instruments to achieve it should be:
- a large *public investment programme*, of the size of 1% of EU GDP, primarily in the areas of ecological restructuring,
- an extension of *public employment* in social services, education, utilities, and network services, and
- a new effort for *working time reductions*.

6. The EU should reinforce its ***social policy*** and to this purpose:
- enhance its tools and financial resources to fight poverty and social exclusion in the Union,
- promote the adoption of – differentiated – minimum standards for social welfare throughout the Union, with strict barriers against the reduction of existing standards, and
- use the open method of coordination to promote a public Pay-as-you-go system for pensions which ensures a decent standard of living for the elderly.

7. To respond to the increasing costs for traditional energy and to contain global warming the EU should act much more pro-actively to promote a new energy regime which is primarily based on renewable (solar) energy sources.

8. To enable the EU to launch relevant initiatives for the above objectives it is necessary to considerably raise the size of the ***European budget,*** while at the same time ensuring democratic procedures and transparency. We propose to increase the European budget from its present level of a little more than 1% of European GDP by 0,5 percentage point every year until it reaches about 5% of GDP. At the same time the revenue basis should be reformed to the effect that the main source of the EU budget would be a progressive GDP-related European income tax.

9. The EU should prepare the coming ministerial meeting of the WTO in Hong Kong with the primary aim to change the scope of the ***GATS negotiations*** so as to include full respect of national rules for services, to end the decisive role of the Dispute Settlement Body and to exclude the public sector from the GATS framework.

Introduction

The year 2005 has seen two developments with rather contradictory consequences for the further development of the EU, revealing the two sides of the present European process. On the one side the Brussels 2005 spring summit decided to launch a “new partnership for growth and jobs”. This is basically a purified edition of the hitherto failed Lisbon strategy of 2000. It concentrates on even more liberalisation of markets and leaves aside social and environmental aspects. This re-launch reflects the obstinacy of the neo-liberal policy pattern and the powerful forces behind it. It will not overcome the vicious circle of low growth, high unemployment, and rising social inequality. On the other side the first half year of 2005 brought a wave of critique and opposition against this policy pattern to the forefront, which forced the Commission and the summit to – temporarily – make a step backwards with regard to the draft directive on services and culminated in the rejection of the draft Treaty for a Constitution for Europe in referenda in France and the Netherlands. The success of the critique demonstrates mainly the formation and slowly growing strength of new social movements who fight for more open discussion, democracy, and reforms in the interest of the majority of the people.

The European Commission has responded to the obvious political crisis of the EU by declaring a “period of reflection”. At the same time it continues to pursue its neo-liberal Lisbon agenda with undiminished determination. It seems that the envisaged reflection is merely meant to better explain, justify and make tolerable an economically failed, socially and ecologically harmful, and unacceptable policy. In contrast in our view a comprehensive reflection should critically analyse the course of economic and social developments, assess the roots and the outcomes of the adopted policies of the European institutions as well as the interests and powers behind it, and explore the potential for alternatives to this policy. In the face of the present crisis the basis for the necessary reflection should not be the desire for preservation but the movement for change. In this sense we present the following analyses and proposals.

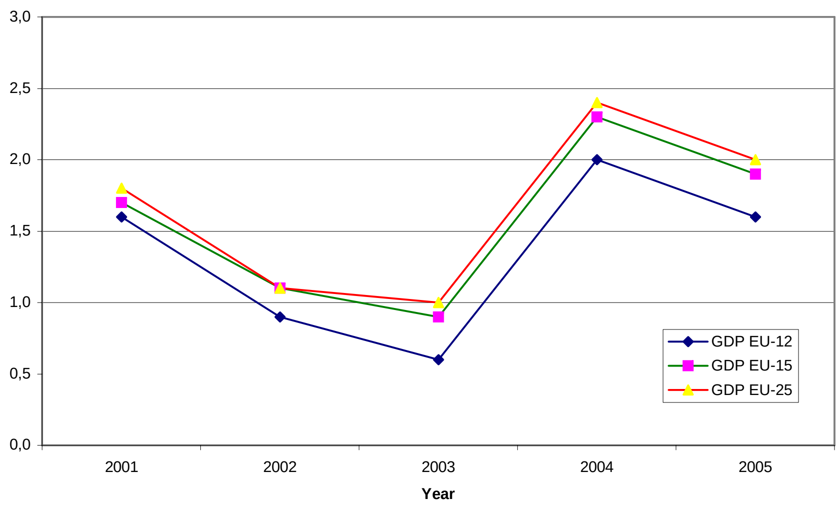
1 Economic and social developments in the EU

1.1. Failure of the Lisbon strategy – Macroeconomic developments

The overall picture – weak growth, rising unemployment.

Macroeconomic developments in the enlarged Union point to a return to low growth in 2005, after a moderate recovery in the previous year. As a most alarming consequence of this unemployment in EU-25 has risen to 9%, against 8,6% in 2000, while the rate of increase in employment remained under 1% p.a. in the EU on average during the last five years. As can be seen in the graph below, the overall rate of GDP-growth declined steadily over the period 2000-2003, while the fall was very dramatic in 2003. This is especially true for the EU-12 (the Euro-zone) and less so for the EU-25, because the ten new member states have been growing at higher rates.

GDP EU-12, EU-15, & EU-25 (annual change in %)



In terms of growth components (see table 1), *exports* picked up considerably in 2004, following the acceleration in world economic activity, especially in the USA. After a decline in 2002-2003, *investment* also recovered, although not as much as expected, given that most economic policy measures – such as tax concessions, labour market flexibility and wage constraint, product and service market integration – have aimed at providing an investment-friendly environment. *Private consumption* continued to

provide only a small stimulus to growth, as did *government consumption*, which has tended to move along with the tide, rather than against it.

Table 1

EU GDP growth components

(annual change in %)

	EU-25						EU-15					
	1991-2000	2001	2002	2003	2004	2005	1991-2000	2001	2002	2003	2004	2005
GDP	*na*	1.8	1.1	1.0	2.4	2.0	2.1	1.7	1.1	0.9	2.3	1.9
Private Consumption	*na*	2.0	1.4	1.5	1.8	1.9	2.0	2.0	1.2	1.4	1.7	1.8
Government Consumption	*na*	2.5	3.1	1.9	2.0	1.7	1.7	2.5	3.2	1.9	2.1	1.7
GFCF*	*na*	0.3	-1.4	0.1	3.0	3.6	2.0	0.4	-1.5	-0.1	2.8	3.3
Exports	*na*	3.3	1.8	1.2	6.2	5.9	6.6	3.1	1.6	0.6	5.7	5.6
Imports	*na*	2.1	1.3	2.6	6.6	6.5	6.1	2.0	1.1	2.1	6.1	6.1

** GFCF = Gross Fixed Capital Formation (investment); 2004: estimates; 2005: spring forecasts; na: not available;* Source: Statistical Annex of European Economy, Spring 2005.

Given the overall sluggish economic conditions, the average rate of *inflation* in the EU declined in 2004, mainly caused by labour market and wage developments. In particular, real compensation per employee increased by less than 1% for the fourth year running in the EU on average. As a result, the *share of wages* in GDP declined further, so that by the end of 2005 it is forecast to be 67.4%, as compared to 68.3% in 2000 in EU-25.

Overall, since the year 2000, macroeconomic developments in the EU have gone into in the opposite direction to that aimed for by the Lisbon Agenda, which set the Union's strategic goals until 2010. Rather than becoming the "world's most competitive economy", the EU is becoming a laggard – at great social cost. A major reason for this is the continuing neglect by EU economic policy of the role of aggregate demand in reviving the economy, as shown for example in the constraints imposed by the Stability and Growth Pact. Although both the Lisbon Agenda and the Stability and Growth Pact were reviewed in spring 2005, their reform cannot be expected to alter the course on which the EU economy is set, because the amendments adhere to the same basic structure and the underlying neo-liberal conceptions.

Germany and Italy: the large laggards

The weakness of the overall performance of the EU is to an important degree due to the developments in two member states, that – together – account for more than one third of the GDP of the EU: Germany and Italy. The former suffers largely from a domestic demand squeeze, the latter, from a declining competitive advantage. In both instances, mainstream theory and policy seek the answer in ever increasing labour market flexibility, as well as in other restrictive measures.

Table 2

Germany, Italy and EU-25: Macroeconomic development

(rates of change)

	2005 (estimate)			2001-05 (average)		
	EU-25	Germany	Italy	EU-25	Germany	Italy
GDP growth	2,0	0,8	1,2	1,7	0,6	1,0
Domestic demand	2,1	0,6	1,3	1,7	-0,2	1,2
- private consumption	1,9	0,7	1,4	1,7	0,3	1,0
- government consumption	1,7	-0,1	1,0	2,2	0,7	1,9
- total investment	3,3	2,0	1,6	1,0	-2,3	1,0
Exports	6,4	6,9	5,1	4,1	5,6	1,0
Real compensation of employees per head	0,9	-0,8	0,9	0,9 (EU15)	-0,3	0,5
Current account (% of GDP)	0,4 (EU21)	4,4	-0,9	0,3 (EU21)	2,6	-0,6
Real unit labour costs	-0,4	-0,2	-0,1	-0,3	-0,6	0,3
Relative unit labour costs	-1,3	-0,4	0,4	-0,5	-1,8	0,9
Wage share (% of GDP)	67,4	64,4	67,9	68,1	66,1	67,8

Source: European Economy 2/2005, Statistical Annex, own calculations.

Germany has had a growth rate of about a third of the EU-25 over the last five years and domestic demand in 2005 was in absolute real terms lower than in 2000. The main reason for this is the weak development of salaries and wages, which push the increase of private consumption close to zero and to a sixth of the EU rate. The only factor supporting the German economy is its strong export position, with growth rates above those of the EU. In 2004 the German current account surplus has reached 4,2% of GDP, i.e. € 92 billion in current market prices, while the overall current account of the EU-21 (excluding Luxembourg, Hungary, Malta, and Cyprus), was 0,4% of GDP

or € 42,2 billion, less than half of the German value in absolute and less than one tenth in relative terms. Thus the factor which keeps the German economy at all afloat – although it cannot offset the weakness of domestic demand – causes at the same time considerable imbalances within the EU. To face these imbalances, well targeted structural policies would be necessary. But these are not in sight.

The problems of the ***Italian*** economy, too, are not new. In the industrial sector, a strong de-industrialisation took place, expressed by the disappearance of big firms and of entire sectors, in the total absence of active industrial policies. In recent years the backbone of Italian manufacturing sectors, i.e. industrial districts, has also suffered from the revaluation of the euro and from Asian competition. With regard to public debt, its origins go back not only to the profligacy of the government in the 1980s but also to a rate of interest which the Central Bank set at a level high enough to favour capital inflows. In the 1990s, the effort to enter the European Monetary Union (EMU) depressed the economy even further, and the huge wave of privatisations meant that the State lost firms and banks that could have helped to frame a long-term structural policy for an upgrading of sector specialisation. Under these circumstances the only factors of adjustment both for right and left governments have been the welfare state, the labour market, and the pressure on workers.

New Member Countries: strong growth and considerable differences

During the last few years economic development in the new member states has been characterised by strong overall growth, little progress in employment, and considerable differences between these countries.

Since 2002 economic growth in the new member states has been – with very few exceptions – on average more than twice as strong as in the old member states. However, since the economies of the new member states remain comparatively small this extraordinarily strong performance has raised the growth rate of the EU-25 by only one tenth of one percentage point above that of the old EU-15. The high rate of economic growth in EU-10 is mainly due to the dislocation and relocation policies of Western European multinationals. These have brought no relevant increase in employment or considerable decrease in unemployment. Especially in Poland and

Slovakia the rates of unemployment remained extremely high (17.5% and 15.2% in August 2005).

With regard to income distribution, inequality in the new member countries is similar to that of the EU-25. While three countries (Slovenia, Hungary, and the Czech Republic) find themselves at the very bottom of the ranking of Gini Coefficient, five other (Estonia, Latvia, Slovakia, Poland, and Lithuania) are among the nine countries with the highest coefficient. It is worth to notice that inequality measured by the Gini Coefficient is highest in those new member countries, which have implemented flat tax rates on personal income tax (Baltic countries), or in which tax progression applies in practice to a very small fraction of taxpayers (like Poland, where the tax rate progression applies only to 5.5% of taxpayers).

Although all ten countries have current account deficits, there are huge differences among them, ranging from less than 1% (Slovenia and Slovakia) to above 13% (Estonia). In most countries no clear tendency of this ratio could be observed in the last few years. Exceptions are Poland, Estonia, and Hungary. In Poland current account deficit ratio was decreasing gradually from 7.6% in 1999 to 1.5% in 2004 while in two other countries the opposite development took place (increase from 5.3% to 13.2% in Estonia and from 5.1% to 9.0% in Hungary between 1999 and 2003). The general reason behind the current account deficit is the fact that these countries, applying the neo-liberal policies forced first the World Bank and the IMF, later the EU, lost a substantial part of their home and foreign market, because their firms were not able to compete with the western multinationals.

Differences continue in inflation. All countries except Cyprus, Slovenia, and Slovakia faced an increase in inflation in 2004. But in 2005 the upward trend continued in three countries only, and in five of ten countries (Czech Republic, Cyprus, Poland, Slovenia, and Slovakia) annual inflation in August 2005 was below the EU-25 average of 2,2%. Public deficits and government debt in the new members are not particularly different from those of the old EU, the former being slightly higher and the latter slightly lower than the EU average.

Global imbalances

The weak performance of the EU economy as a whole and the strong and growing differences between member states are embedded in an unstable global context. The USA remains the engine of the world economy and it tries to maintain its leading position in the world through the power of its military apparatus and its currency. Both are challenged from outside and not supported by a convincing and sustainable strength of their domestic economy.

External imbalances between some major global economic areas — notably the United States, Asia, and oil producers — are currently at record levels. Between 1997 and 2004, about two-thirds of the increase in the U.S. current account deficit has been balanced by higher external surpluses in emerging market and oil-producing countries, with the rest matched by larger surpluses in industrial countries (mainly Japan). The extremely high current account deficit of the USA requires huge amounts of capital inflows from abroad, and it is questionable whether these can be upheld in the future. When capital inflows become smaller this will affect growth in the USA and from there in the whole world. To avoid a breakdown of the world economy a strong and determined response from the side of the EU would be required, for which it is not prepared. The oil price increases are a further factor of instability and risk, which require short-term management and long-term strategies for a shift of the energy system towards the use of renewable energy sources. Finally, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) have repeatedly formulated their preoccupations about potential new risks for systemic financial instability. It seems that the lessons from financial crises in the 1990s have been largely forgotten and financial speculation – which drives the redistribution of income towards the top of the pyramid and creates insufficient demand – is on the rise again, including a new tide for hedge funds and other speculative instruments. As the IMF points out in its latest World Economic Outlook, corporate profits as a share of GDP in industrial countries currently are at historical highs, while private non-residential investment is unusually low. Apart from China, high corporate profits do not translate into increased investment, thus illustrating a situation of persistent post-bubble problems and excess capacities in the ‘real economy’.

1.2 Rising inequality, persistent risk of poverty – Social developments

Social developments in the EU are especially marked by the persistently high level of unemployment. At the same time, EU social and labour market policies in many cases punish the unemployed instead of providing decent jobs while unemployment compensations do not suffice to prevent the unemployed from the risk of poverty (see table 3). In addition, the share of precarious employment in total employment has considerably risen in the EU-25 in recent years: In 2004, the continuation of this rising trend was not only observed for employees with fixed term and temporary contracts (13.7 % of all persons in employment), but also for the self-employed (15.9 %) and for workers with short working hours and part-time contracts (17.7 %). The proportion of about one sixth of employees that work part-time *involuntarily* has been increasing since 2002, i.e. a rising share of part-time employees have contracts with short working hours because they were unable to find full-time work.

Table 3

EU Social development indicators – Precarious employment and poverty

	EU-25 2004	**EU-15** 2004	**EU-10** 2004	**Peak country**	**Bottom country**
Rate of Unemployment	9,0	8,0	14.3 (2003) +	Poland (18.8)	Luxemburg (4.2)
Precarious employment in % of total employment					
- **Part-time employment**	17.7	19.4	8.0 (o.c.).	Netherlands (45.5)	Slovakia (2.7)
- **Fixed-term contracts** (n.a.)	13.7	13.6	14.3 (o.c.)	Spain (32.5)	Estonia (2.6)
- **Self-employed**	15.9	14.9	22.0 (o.c.)	Greece (40.2)	Sweden (4.9)
Risk of poverty rate in %	**EU-25** + 2001/2002	**EU-15** # 2001	**EU-10** + 2002	**Peak country**	**Bottom country**
- **all age groups**	15.0	15.0	15.0	Ireland and Slovakia (21.0)	Czech Republic (8.0)
- **unemployed**	38.0	38.0	38.0	Ireland (54.0)	Sweden (19.0)
- **children**	19.0	19.0	20.0	Slovakia (30.0)	Finland (6.0)
- **households *without* children**	13.0	14.0	10.0	Cyprus (30.0)	Czech Republic (4.0)
- **households *with* children**	17.0	17.0	17.0	Slovakia (25.0)	Denmark and Finland (6.0)
- **households of single adults with children**	34.0	35.0	26.0	Malta (59.0) and UK (50.0)	Finland (11.0)

o.c.: own calculations based on the statistical annex of the European Commission 2005. n.a. = no data available for Denmark, the Netherlands, Sweden. Please note: EU-25 and EU-10 averages are calculated as population-weighted averages of the available national values and are based on a mix of reference periods.
Sources: European Commission, 2005, Employment in Europe 2005, Recent Trends and Prospects.
+ = European Commission, 2005, Report on social inclusion 2005.
# = European Commission, 2004, Joint report on social inclusion 2004.

These developments have considerable impact on the distribution of income and thus on the standard of living in the EU: *Firstly*, the long term trend of falling wage shares has continued during the last five years, bringing the wage share of EU-25 from 68,6 in 2001% to 67,4% in 2005. Here again, developments differ among member states: 13 states have falling and 12 have rising wage shares. *Secondly*, due to the lack of an efficient social policy, the risk of poverty – defined as living with less than 60% of the median income – remains a major threat for large parts of the population: According to the Joint Reports on Social Inclusion for 2004 and 2005, throughout the EU-25, 15% of the population – i.e. more than 68 million people – lived at the risk of poverty in 2001/2002, with large differences between countries. For unemployed persons, the risk of poverty is more than five times higher (38%) compared to 7% for employed persons in EU-25. In Ireland to be unemployed meant in 54% of the cases to live at the risk of poverty; the corresponding figures for Malta, Italy, and the UK were 52%, 51%, and 49% respectively.

An outstanding feature of poverty in the EU is child poverty. Throughout EU-25, the risk for a child to become poor (19%) is higher than the poverty risk for all age groups (15%). In Slovakia, Portugal, Ireland, and Spain more than one quarter of all children live at the risk of poverty. A particular scandal is the fact that in EU-25 more than one third (34%) and in the UK even one half (50%) of all households of single adults with children were poor in this sense in 2001/2002.

With regard to social expenditures, among old member states, those which devote least spending to social protection – Greece, Spain, Portugal, and Ireland – have the worst poverty figures. It has to be noted, that available EU-statistics on poverty do not even cover some of the most exposed groups, e.g. victims of people trafficking and the homeless.

2 The 'period of reflection' – for public persuasion or for a change in policy?

The French and Dutch 'No' to the constitution and the failure of the EU Summit to agree on the Financial Perspectives 2007 - 2013 in June 2005 have left the European

Union in a state of severe political crisis. The Council and the Commission opted for a one year 'period of reflection' on the European constitution, but no real activities have been developed.

Meanwhile, the Commission called to extend the 'period of reflection' to three or four years and submitted a 'plan D for democracy, dialogue and debate'. Its declared objective is to stimulate a wider public debate on the European project in general. National debates shall be organised around three main themes: 'Europe's economic and social development', 'Feelings towards Europe and the Union's tasks', and 'Europe's borders and its role in the world'. In the view of Commissioner Wallström, 'we have to go back to explaining why people should support the European Union' and to 'change the current atmosphere of disillusionment'.

We welcome an open and democratic debate on the present state and policies of the European Union and any democratic confrontation of different proposals to shape its future. But we cannot see any intention on the side of the Commission for a reflection to change its policy orientation. To a great extent, the 'No' to the constitution reflected people's concerns about unemployment, the dismantling of the welfare state, deregulation and privatisation, and the lack of a social Europe. The Commission 'responds' to these concerns by embarking on a populist discourse of 'explaining' and 'bringing Europe closer to the people' by 'cutting red tape' for business, removing 'bureaucratic obstacles' to competition and implementing the reformed Lisbon Strategy. There could not be a stronger misinterpretation of the 'wake-up call' the European institutions received by the French and Dutch 'No'.

The British presidency of the European Union had initially claimed to launch a debate on the ***European Social Model*** in order to provide a new 'vision' on the future of Europe. Such a debate would be welcome, if it puts the focus on the content and how to achieve a social Europe.

The Euromemorandum Group, too, has in previous memoranda called for a comprehensive European Social Model based on the following core elements, about which a broad political debate should take place:

- ***full employment*** with decent working conditions and with wages and salaries sufficient to lead an independent life,
- ***social welfare*** as a guarantee that nobody is exposed to poverty and social exclusion,
- ***social equity*** as the absence of discrimination and of excessive inequalities in income, wealth or access to public goods and opportunities,
- ***ecological sustainability*** as the preservation of the natural basis for individual and social life,
- ***balanced international relations and efficient development aid*** as the long-term preconditions for peace and political stability.

But the vision of the British government is rather different: Europe must modernise its social model first and foremost in order 'to enhance our ability to compete'. Under these priorities, the welfare state would no longer be about universal and unconditional social rights of the citizens but become a subordinated function to increase 'competitiveness'. Thus the envisaged discussion on the European Social Model turned towards an ideological offensive on strengthening Europe's global competitiveness against China, India and the USA. This was the re-orientation which the British presidency gave to the informal summit on October 27.

Such messages are not new. They are echoing earlier debates about the loss of Europe's 'international competitiveness'. In the first round in the 1980s, both the USA and Europe (especially Germany) were obsessed with Japanese high-tech, high-quality, and high-price products wiping out their respective manufacturing base and global export markets. The second round in the 1990s resounded with fears that the emerging 'East Asian Tigers' would flood EU markets with cheap consumer goods and information technologies and slash EU industries' export shares. The third round of the debate since the mid-1990s was about the USA as a 'global competitiveness challenge', with a 'New Economy' propelled by prospering financial markets, stable economic growth, an innovative and expanding IT-Sector, and increased labour productivity. With hindsight we know how the stories went on: a decade of Japanese stagnation, the Asian crisis and the bursting of the American speculative bubble.

Now a new round has begun in which China and India are presented as the next contenders in the battle for global competitiveness. As both countries can command huge resources of cheap labour and are able to enhance their capacities not only in low-tech, low-price products but also in high-tech, knowledge intensive but relatively cheap products and services, it is hard to see how Europe can win this battle, even with a strategy based on knowledge-intensive and high quality products and services.

But even the Commission admits that ‘most jobs are created and lost within a country’s economy, not as a result of shifting production to another part of the world’ and concedes that ‘globalisation does not mean that if others get richer, we must get poorer.’ Indeed – the rise of the USA as the ‘workshop of the world’ from the 1880s to 1910 during the first phase of capitalist globalisation did not result in Europe’s de-industrialisation or a decline in average living standards. Neither did Europe and the USA become poorer because Japan rose to a high-tech manufacturing country, or because the East Asian Tigers became strong industrialised economies in the 1980s.

On the other hand, workers, employees, and the unemployed were forced during the whole period from the 1980s to the first years of the new Millennium, to make sacrifices in terms of income or wages, working conditions and social security to help domestic corporations to meet the supposed ‘challenges’ from ‘competing economic regions’. The promise that finally there would be some light at the end of the tunnel never materialised for the great majority. What happened instead regularly in these campaigns about saving the countries’ competitiveness was a strong redistribution of income and wealth from the bottom to the top of the social pyramid, rising inequality and social polarisation.

We agree in principle with the Commissions’ statement that ‘prosperity is a dynamic concept’ and that ‘globalisation is the chance to increase the size of the whole cake, so that everybody gets a slice.’ But why then strive for global economic supremacy – to ‘become the most competitive knowledge-based economy in the world’ – which implies that others must be on the loosing side, out-competed by Europe? Why should Europe continue with cost-cutting strategies and ‘beggar thy neighbour’ policies in a race to increase its own export share at the expense of others? The domestic results of such strategies are increasing inequalities, social insecurity and – in spite of all efforts – a weak economic performance, and the external results contribute to increasing global economic imbalances.

We hear the well known 'Third Way' rhetoric about 'empowering people' to embrace the opportunities of globalisation and to avoid its dangers, about social values and fairness. But when it comes to EU level policies, such declarations are not followed by concrete proposals on how to strengthen the 'social dimension of the internal market', let alone initiatives for European social legislation. 'Modernising the European Social Model' is a nice sounding metaphor to make a more crude and far reaching 'open market agenda' more acceptable. The discourse of Tony Blair, Gordon Brown and of the Commissions’ communication on ‚European values in the globalised world’ constitute an all too apparent move to distract attention from the fact that the UK presidency could not contribute any considerable results in resolving the current crisis of the EU.

In order to set conditions right for a true 'period of reflection', we call upon the Commission to formally withdraw its draft directive on services in the internal market (Bolkestein-directive) and its proposal on amending the working time directive. This would be a valuable contribution for 'better regulation' in Europe. It would prevent a complicated, highly contradictory, unworkable and damaging framework on services being pushed through against the resistance of a multitude of citizens and organisations. It would also take back the worrying signal that the European Union for the first time in its history wants to lower the minimum standards on social protection instead of improving them. As these two proposals of the Commission had gained some prominence as motivating the 'No' in the referenda, withdrawing them would also be confidence-building measure for 'plan D for democracy, dialogue and debate'. A fair and open debate about the future of Europe and its social model can not be pursued in an atmosphere of threats to dismantle the few and modest first elements of this model.

3 Neo-liberal continuity instead of correction – Critique of economic and social policy

3.1 Narrowing the perspective – Back to the core of neo-liberalism

The response of the European institutions and policy makers to the double pressure of economic failure and enhanced political critique and opposition seems to develop on two levels. On the surface level they declare a “time for reflection” and launch a broad and open debate which, as we have argued above, envisages more a better explanation of neo-liberalism to the people than a real change of policies. On a second level the response consists in the development of a certain minimalism which, under the pretext of scaling down on over-ambitious programmes and incomprehensible strategies abandons a number of objectives and achievements and concentrates on the very essence of integration, thus allegedly making it easier for the citizens to understand the EU. This essence is of course the liberalisation of markets, the rule of competition and the flexibility of workers. A strong indicator for this new minimalism – which in reality aims at the maximum room for manoeuvre for the dominant players on the markets – is the reformulation and streamlining of the Lisbon strategy with the “postponement” of social or ecological objectives; another one is the declared intention to reduce the number of European regulations and provisions, to be welcomed as a means to contain bureaucracy but also with the obvious potential effect to make things easier for business at the expense of consumers and workers, health and safety, as can be seen for instance in the attempt to water down the REACH provisions for chemical products. A third indicator is the plan to further reduce the size of the EU budget below its already unsustainably low level (see 3.6.).

The economic theory behind these developments emphasised that they would contribute to more efficient allocation of resources. This is supposed to make Europe more competitive in world markets, as well as supplying European households more efficiently. The coordination of monetary policy, once convergence with a trans-European economic cycle has been achieved, is supposed to allow for the regulation of the economic cycle in countries within the monetary union by monetary policy alone, that is by changes in short-term interest rates. Therefore no additional regulation would be necessary. Against this we have long argued that a combination of free trade, the policing of competition, and active monetary policy, is insufficient to stabilise economic activity at or close to full employment. This critique has been confirmed by the intractability of the long recession that has affected core countries within the Euro-zone since 2001. Neither the competitiveness induced by the Single European Market, nor the reduction of interest rates down to their present historically

low levels, have managed to engineer anything other than a weak recovery in economic activity in large European economies like Germany, France and Italy.

Faced with this ineffectiveness of competition and monetary policy, politicians and spokespersons for the European Central Bank have been arguing that their policy ineffectiveness is caused by a lack of flexibility in product and labour markets. Evidence for this is adduced from the continuing economic recovery in the U.K., and the renewed economic activity in the U.S., which are supposed to be due to those countries’ more ‘flexible’ labour and capital markets. This argument ignores the considerable fiscal stimulus that has been applied with apparent success in the U.S, and U.K., and also in Scandinavian countries where labour markets are much more regulated. Moreover, blaming the alleged inflexibility of European labour markets for the ineffectiveness of competition and monetary policy is a direct attack upon the institutions of social solidarity that underlie the ‘European Social Model’ and have been associated with years of successful economic management with virtual full employment in the past. Because of the weakness of Europe-wide social institutions, the European Commission and the European Central Bank have been able to mount a case for dismantling *national* institutions of social solidarity as an alibi for the European Commission’s and the European Central Bank’s inability to deliver on their prospectus of economic prosperity.

3.2 Curtailed Ambitions – The Review of the Lisbon Agenda

The Lisbon Agenda (LA) was set by the European Council in March 2000, with the explicit strategic goal of turning the EU economy until the year 2010 into “the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”. This objective should be reached on the basis of an average growth rate of 3% for the decade, at the end of which full employment should be achieved.

It is by now almost universally accepted that this agenda has completely failed to realise its ambitious objectives. In view of this disappointing results the spring summit 2005 decided to launch a new, less ambitious and much more focussed version of the Lisbon Agenda, a “***New partnership for jobs and growth***”, requiring greater commitment from the member states. However, the basic approach remains the same: a rigorous policy of liberalisation of all markets and a strong discipline in budgetary policy, complemented by an increase in the technological base of the economy. It is clear that on this unchanged basis – exclusive concentration on the supply side and complete neglect of the demand side of the economy – the outcome will also remain unchanged: persistently slow growth, high unemployment, and rising inequality.

The concept of social inclusion was originally included in the Lisbon Agenda on a par with other policy areas, although it was too narrowly defined. A year later, at the 2001 summit in Gothenburg the environmental dimension of the Agenda was re-enforced and a design was presented for a "Sustainable Development Strategy". Under the Lisbon Agenda II, it is to be feared that social inclusion and ecological sustainability – although rhetorically maintained – will disappear even further from the horizon of European policies and attention will concentrate on the sheer rates of growth and employment, which can reflect very different qualities of work and welfare and of the environment. The social and ecological aspects of policy were and will be even more peripheral to its economic core, while the assumptions on which the whole edifice rested remain unrealistic.

In addition, the crippling short-termism of the Stability and Growth Pact (SGP) has in no way been overcome, in spite of its much publicised reform. Such changes are likely to have almost no impact on the ability of the SGP to become a serious impediment to the EU falling back into recession, as happened in the first years of the new century. On the other hand, there has been no change in favour of a more active co-ordination of national fiscal policies and the role of the EU budget is declining.

3.3 Subordinated and without social control – European social policies

The dominance of neo-liberal economic policy is one of the major causes for the following three key problems that hinder a move to more effective and positive European social policy:

Firstly, social policy is subordinated to as well as inconsistent with economic policy goals formulated on EU-level. Social objectives which are declared in official documents of the EU are deeply inconsistent with EU economic strategies which cannot help but aggravate the social problems facing European populations. This is true both of macroeconomic policies which generate unemployment and curtail social expenditures and of internal market policies which attempt to reinforce competition to the neglect of equity and labour standards. Although the preservation and development of the "European Social Model" is, in principle, a key aspect of the Lisbon Agenda, it has always been subordinate to the economic components of that agenda. The "refocussing" on priorities called for in the Kok report will tend to narrow and restrict European social policies even more and the revisions to social aspects of Lisbon amount to accepting a less ambitious approach to social policy in general and to restating a labour market strategy which has already failed. Some social policy initiatives will continue via the open method of coordination (OMC). But since the OMC is introduced as a soft-policy instrument and as a process of 'learning among member states' without any legal binding, not much progress should be expected from this process. In addition, legal constraints of the EU for other policy areas limit the scope of national social policy. E.g. the fiscal constraints of the SGP, lead to reductions in social expenses of the member states as to comply with the convergence criteria, as long as no legally binding minimum standards for social security systems, are in place.

Secondly, European social policy is based on an extremely low budget. Social Fund expenditure was planned to be € 62.5 billion over the period 2000 - 2006, and no significant expansion is envisaged. The annual average of about € 9 billion should of course be related to the 450 million inhabitants of EU member states – the € 20 per head that this sum represents can be compared to the nearly € 2,000 per head in purchasing power terms which is spent on social protection in Slovakia, the EU member with the least provision. Additionally, no resources are made available to encourage low income countries to make necessary social safety net improvements as adequate response to poverty.

Thirdly, in the field of *labour market legislation*, there seems to be a rather unwelcome change in Commission policy. Future regulation will be less ambitious and even existing legislation might be relaxed, for example it is envisaged to soften the working time directive. These would be retrograde steps: On average, EU labour market rules are already much weaker than those in the most socially advanced member states. The EU makes no attempt to harmonise regulatory systems but only to set certain floors to protect employees from bad practice. Without these rules it is highly probable that a “race to the bottom” in employment conditions occurs among some member states, particularly in those without strong systems of worker representation.

To justify the direction of labour market policies some economists, politicians and the European Commission often claim that Europe suffers from too many labour market rigidities, excessively generous unemployment insurance, high employment protection, and high minimum wages. This claim does not consider that actual labour markets are far from being the textbook perfectly competitive markets. By contrast, information problems, bargaining and market power on both the workers’ and firms’ side are common in them and perfectly competitive labour markets would not function effectively. For this reason they will not work well without proper institutions. The *flexibilisation* or Americanisation of labour markets may result to be counterproductive and cannot be assessed without taking account of the whole economic system, first and foremost the goods markets.

Europe shows large differences in unemployment rates and at the low end of the spectrum there are countries with different institutions. On the one hand, Ireland, following a policy of liberalisation and flexibilisation has been able to reach an unemployment rate of 4.4%. However, Ireland’s policy is also the result of a corporatist process involving all the social partners. On the other hand countries like Austria, Denmark and the Netherlands have achieved surprisingly low unemployment levels in 2004 without adopting American-type labour market institutions. The debate is clearly more complex than simple slogans seem to suggest. Here we focus on the role played by trade unions and their interrelations with other policymakers. Unions’ strength is mainly measured by the degree of unionisation and by the level where wage bargaining takes place (centralisation), which varies between two extremes: the economy level and the plant level. It is well known that (partial) decentralisation has negative external effects. These arise because each union has a reduced perception of

the inflationary consequences of its wage setting for other unions, which tend to make them more aggressive, as they can beggar their neighbour. This is a powerful argument in favour of centralisation of wage bargaining not only at a national level but also at a European level: this would be the most obvious way of solving the problem of coordination of wage setting. In addition, the possibility of a corporatist agreement at a European level and the scope for a European social pact stating a political exchange between public expenditures and wage setting choices should be explored.

As regards the *European Employment Strategy* (EES – dealt with in more detail in our 2003 Memorandum, chapter 4), the various types of supply-side labour market policy which are included in the EES will not have any significant impact on growth or jobs. The first few years of the EES did coincide with a reduction in EU unemployment levels, and the Commission was very quick to attribute this to a “structural improvement” brought about by labour market reforms. This poses the somewhat embarrassing question of how to account for the subsequent drastic deterioration. Certain types of labour market intervention can compensate for the disadvantages faced by certain social groups and might widen the range of choice open to individual members of the same groups. However, the EES does not involve a clear commitment to such positive interventions; it has, for example, proved to be compatible with the recent weakening of employment standards and of social protection in Germany.

Both the failure of the Constitutional Treaty and the difficulties to push through the Bolkestein-directive on “services in the internal market“ show, that European citizens are increasingly aware that the EU’s economic integration strategies are a threat to social achievements – the Bolkestein-directive would subject important public services to external competition without regard to the social and distributional consequences of these reforms. It was a success of popular mobilisations against this directive that the Brussels 2005 summit criticised the draft as not providing a sufficient balance between the objectives of deepening the internal market and safeguarding social cohesion. But it has to be noted that that the draft Directive was not withdrawn by the Commission and that the European Parliament is set to deliver its opinion on the unchanged original text early in 2006. And it is very worrying that Conservatives, Liberals and the populist Right in the European Parliament, which together can command a majority of that Parliament, are strongly pushing for a defence of the strategic core of the Commissions' proposals (country-of-origin principle, general liberalisation of services etc.).

Persistence in error has become almost the distinguishing feature of the EU, and it seems that concrete evidence of policy errors never results in policy change. However, the sheer unpopularity of the European project in its current form and the growing hostility of European citizens towards that project may soon compel a change of direction.

3.4 Missing the challenge – Energy policy

The energy policy of the EU is currently still crippled by three unresolved problems:

- by an inbuilt reliance on fossil energy or on other highly centralised and investment intensive energy sources in its energy system (generation, distribution, and use);
- by a scarcely discussed acceptance of a framework for global energy policy based on the principle of universal consent which makes any progress difficult and very slow;
- by some inveterate consumption models geared on wasting energy.

Furthermore, the EU energy policy is suffering from an uncritical acceptance of the exclusive reliance on market mechanisms, especially the utopian quest for 'internalising' all externalities in the definition of prices, while neglecting the dimensions of planning horizons, provisioning priorities, and public distribution criteria.

In the face of the urgency of the problems posed by finite fossil resources and by global warming, the lack of a consistent overall sustainability strategy in the field of energy use has hampered the potential of the EU to make full use of the high potential of renewable energy sources and of energy saving existing in Europe, to become a more effective global player in the field of energy policy, and to fully exploit the particular traditions of careful energy use and energy saving existing on regional and local levels.

The EU-Directive on renewable energies (2001) aims to increase the share of renewable energy sources from 6% to 12% of the EU`s total energy consumption by 2010. Although this is not sufficient and a more ambitious target is needed, (20% or 25% for 2020), the EU has not been able to fulfil this modest objective. Three years after the adoption of the directive, in May 2004, the European Commission published a first progress report, showing that member States are not on track to meat their national targets set out. (COM 2004/366). Renewables are still not granted fair access to the electricity grids and they face administrative barriers which hamper their growth.

The on-going liberalisation of the electricity market in Europe presents new problems for a sustainable European energy strategy. The development of a pan-European electricity market is an ongoing process and wholesale electricity markets have developed fast in a number of countries. The liberalisation package adopted by the EU in 2003 provides common regulatory principles and sets clear market opening dates for European electricity markets. In its progress reports the European Commission has underlined that besides market development, it is equally important to make the energy sector secure and sustainable. The current electricity market favours traditional power sources and companies, which are economically profitable, because environmental costs, such as emissions and nuclear waste costs, are not taken into account. Despite claims of support for renewable energy by national and EU authorities, nuclear power continues to receive the majority of research and development funding. Within the European Union research and development budgets, over the last twenty years, fusion research has received annually the double amount allocated for all renewable energy technologies.

In addition to R&D funding, Member States and the EU continue to grant huge amounts of public finance as state aid for fossil fuelled power stations. From 1994 to 2004, over 70 billion € went to the coal sector in Member States. Established fossil fuel and nuclear technologies also benefit from "indirect" subsides. Public financial support through structural funds for both the extension of the gas and electricity networks is expected to reach 4 billion € between 1994 and 2006. Most of such projects exacerbate the current unsustainable energy system by decreasing reliance on small-scale, locally produced power. Renewable energy will receive € 650 million from structural funds over the same period, or 16% of the total.

3.4 Inefficient and risky for welfare – Privatisation policy

In the European Union the public sector, although in principle protected by article 295 (ex-222) of the EC Treaty[1], has in reality been subjected to criticism and legal actions from the side of the European Commission for violating competition rules. These attacks have been enhanced and multiplied during the last two decades in accordance with the worldwide rise of neo-liberalism, and they have led to a wave of liberalisations, privatisations, and deregulations especially in network industries like transport, telecommunication, gas, water, and electricity. The Commission argues that because of administrative barriers, European markets remained fragmented, and as a result, prices are too high, productivity growth is too low and so forth. Therefore sheltered and protected sectors should be opened up especially in the services of public interest, which, beside network industries include non-economic services like healthcare, education, and social provisions. The Commission argues for at least the partial privatisation of health care and pension systems also on the basis that the present systems are economically unsustainable – as a consequence of the ageing population in the Union.

However, neither theoretical reasons nor experience underpin the Commission's case. First of all the empirical fact that economic growth has more or less continuously fallen since the 1970s is certainly not a sign of higher efficiency in economies where large infrastructure sectors are privatised, although the decline can certainly not exclusively be assigned to the wave of privatisations since then. Furthermore microeconomic analytical evidence does not confirm the superiority of private companies. A study on the Finnish privatisation proved that despite stronger focus on profit there is no evidence of improved financial or cost efficiency of privatised companies. Other international research results suggest that privatised water monopolies in England and Wales are far more costly for their users than municipal monopolies in Sweden or Scotland. The experience of the new member states also

[1] Article 295 (ex Article 222): "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership."

proves that unconditional privatisation and liberalisation can cause severe economic problems instead of improving efficiency. The continuously deteriorating Hungarian current account clearly shows the damage that privatisation and liberalisation may bring about for less developed countries.

The privatisation of the public welfare system produces even worse social results. It means basically that the management of welfare risks is more and more assigned to individuals and to firms whose main interest is rather to increase their profits than to provide reliable welfare to individuals. This implies increasing costs and less provision for the individual. In Italy, for instance, the public share of health provision declined quite rapidly from more than 80% to little more than 60%, with both an increase in costs and a deterioration of quality.

Shifting public pension systems from public Pay-as-you-go (PAYGO) financed schemes to privately funded capital market schemes exposes the living standard of future pensioners to the incalculable risks of financial markets, greatly increasing the vulnerability and the risks they bear, since for most of them pension is an essential part of their total income. Besides, empirical evidence about the consequences of privately funded systems – in Latin America, Great Britain and some CEECs – show that they have no comparative advantage against public PAYGO systems, in many cases are clearly inferior and in all cases they are much more costly.

3.6 Counterproductive plans for further decline – The EU Budget

We have since long criticised the European budget for its insufficient size. We have referred to the McDougall Report of 1977, which estimated that a budget of 5-7% of GDP would be required to keep an economic and monetary union in Europe working, and of about 10% if a common defence policy is included. The real budget of the EU is very far from these figures. In an Inter-Institutional Agreement of May 1999 an upper limit for EU expenditures of 1,27 % of EU-GDP was set for the period 1999 - 2006 This is by far too small to generate any Europe-wide impact in delivering European public goods, stimulating sustainable growth, or promoting social cohesion. In practice, during the last years this limit has not even been reached, with expenditures remaining at 1,14% in the year 2004. Also the fact that the EU budget may not incur any deficits is not helpful to make it a useful instrument for European policies.

Things are set to become even worse in the next financial period, which will according to current planning include the five years from 2007 to 2011. Although the European Commission has proposed to maintain the – in our view insufficient – ceiling for commitments at 1,24% over the whole period, it seems certain, that at the end of the ongoing negotiations it will even be considerably lower. The European Parliament has already come up with a recommendation to lower the ceiling to 1,18% and to decrease actual payments to 1,07% of GNI. Compared to the proposal of the Commission, this would amount to a reduction of € 47,5 billion over the whole period. But this is probably not the last word, because some member countries – particularly the UK, the Netherlands, and Germany – have publicly declared that the budget should fall to or below 1% of EU-GDP. It can be taken as certain that the new German government will not easily recede from this position – which, if adopted would mean a more than 10% cut in the EU budget relative to EU-GDP. Also the Commission had made the reasonable proposal to create a “Growth Adjustment Fund” of € 1 billion within the budget which could be rapidly used in response to changing circumstances. This proposal was rejected by the European Parliament.

Apart from the size, the structure of EU expenditure is of importance. Here a complete reshuffle of the major headings is envisaged which makes it very difficult to identify and assess shifts in priorities for the allocation of resources. What can be seen, however, is a very unequal development of resources during the next financial period, as proposed by the recent parliamentary report.

Table 4

Financial Framework 2007 – 2011

Commitment appropriations	2007		2011		Change 2011/2007	
	Bn €	structure	Bn €	Structure	Expenditure in %	Structure in pp
1. Sustainable Growth	57,6	44,8	67,7	47,6	+17,5	+2,8
a. competitiveness	11,0	8,5	19,2	13,5	+74,3	+5,0
b. cohesion	46,6	36,3	48,5	34,1	+4,1	-2,4
2. Preservation and management of natural resources	56,7	44,1	56,5	39,7	+0,4	-4,4
a. agriculture	43,1	30,3	41,5	29,2	-4,0	-1,1
b. other	13,6	9,6	15,1	10,6	+11,0	+0,4
3. Citizenship, freedom, security and justice	1,8	1,4	3,1	2,2	+74,2	+0,8
4. The EU as a global player	8,2	6,4	10,8	7,6	+30,9	+1,2
5. Administration	3,7	2,9	4,2	3,0	+15,0	+0,1
Total commitments	128,5	100	142,3	100	+10,8	-
Total payments	116,4	90,6	129,0	90,7	+11,7	-
Commitments as % of GNI	1,17	-	1,18	-	-	-
Payments as % of GNI	1,06	-	1,07	-	-	-

Source: Report on Policy Challenges and Budgetary Means of the Enlarges Union 2007-2013 PE 353.270v04-00, page 26, own calculations.

Some shifts of emphasis can be observed:

- Under the first heading a redistribution will take place from cohesion to competitiveness; this will in all probability have a negative effect on structural policies.
- The main looser will be the CAP, which seems reasonable.
- Heading 3 will remain modest in comparison within the whole budget, but will have the highest increase. In the explanations to this headings it becomes quite clear that the bulk of the increase will be spent for strengthening internal security including a restrictive migration, asylum, and refugee policy.
- Large increases in expenditure are also envisaged to enhance the role of the EU as a global player, which was one of the main priorities of the draft constitution.

3.7 Too liberal – Trade policy

The failure of the WTO-Cancun summit in September 2003 has been a turning point with the emergence of a serious conflict between North and South. Southern countries thought they had been cheated since the Marrakech agreements. They had given in on the Intellectual Property Right Agreement which proved more costly for them than expected, in exchange for more liberal practices in the agricultural and industrial sectors. Yet, the European Union and mostly the USA, failed to honour their commitments. The USA largely increased their subsidies to their farmers and reached a compromise with Europe on the agricultural issue. The European Union did not carry out the gradual dismantling of the textile sector as planned, but had postponed it until 2005. In such a context, developing countries have been able to form coalitions first of all within the G20, where many emerging countries, among which Brazil, India, and China are gathered, and then within the G90, with a larger number of developing countries. The EU made a series of mistakes during the negotiations by betting on the heterogeneity of the G20 coalition and overemphasising the "Singapore issues" discussed at the 1996 Singapore meeting: competition, international investment, access to public markets, and the facilitation of exchanges. Developing countries have appeared as new protagonists in international negotiations, but the USA do not seem embarrassed by this new configuration. They reassert their commitment to multilateralism while continuing to be actively addicted to bilateralism.

The Geneva deal in July 2004 barely changed the global context, although an agreement with the EU and the USA has been reached to progressively eliminate export subsidies and subsidies in the agricultural sector, but without a precise agenda and with many exceptions. The discussion on tariff cuts was more controversial with an open conflict between the main agro exporters like Brazil and Argentina and the poorest countries who prefer to protect their domestic markets.

The new Geneva meeting in July 2005 – as usual prepared in a very informal and undemocratic manner – was a failure. Participants were unable to agree on the four main subjects, agriculture, non agricultural products, services, and development. For the next conference in Hong-Kong in December 2005 the EU should urgently and radically change its negotiation mandate to impulse new practices inside the WTO. One of the main points would be the necessity of a renegotiation of the GATS.

The liberalisation of trade in services is the new issue in the future negotiations with the GATS, which was signed in 1994 within the WTO framework. The stake is essential as many services are produced in accordance with specific national standards that are the very foundations of our societies. All services are concerned, including education and health. The negotiation process is a step-wise procedure but all sectors are due to be concerned by the liberalisation trend through successive bargaining waves.

This general framework is particularly constraining for public services and the European Social Model. In terms of the global liberalisation of services, no reference whatsoever is made to the specificity of public services. The participating nations jointly determine, on the basis of mutual concessions, the sectors to be liberalised, but

all exceptions and restrictions must be re-examined every five years. The WTO then decides whether the conditions that justified those restrictions are still acceptable. In case of dispute and if a complaint is lodged by an "operator", the WTO's Dispute Settlement Body (DSB) – a court whose legitimacy may be questioned with regard to democratic principles – will be the only one to judge, on last appeal. The WTO is ruled by a British "common law" principle according to which the law is empirically established through the judgments of the DSB.

The Commission, that negotiates on behalf of the EU, has appeared as a zealot of the liberalisation dogma. The proposals of March 2003 for sectoral liberalisation are considerable in postal and environmental services, transport, and telecommunications. If the right to impose universal service goals in postal or telecommunication services is maintained, the procedure allows the speeding up of the liberalisation process and to overcome member states' reluctances. Most of all, liberalisation within the GATS becomes non-reversible and the remaining obstacles are likely to be removed at a later stage in negotiations. Though education, health or cultural activities are not concerned for the moment, there is no guarantee for the future.

4 Towards an integrated European development strategy – Proposals for alternatives

4.1 Broadening the perspective – Dimensions of the European Social Model

As an alternative to the continuation of neo-liberal policies in the EU we propose a new democratic offensive which broadens the perspective for European integration in two ways: on the one hand, in the field of economic policy the scope should reach beyond markets (albeit relate to markets and to their being regulated,) and include macroeconomic, social, and structural intervention as well as corresponding institution-building. On the other hand, the broader view aims at the reconciliation and integration of different dimensions of the material basis of individual and social life which include:

- the *economic* dimension, relating to production, distribution and consumption, markets, wages and profits, growth, innovation.

- the *social* dimension aiming at full employment, decent wages and a good standard of life, good working conditions, gender equity, ending of poverty and homelessness, social security, access to public goods, democratic participation.
- the *ecological* dimension comprising the preservation of the natural basis of human life, the reduction of energy consumption and waste production.

Under the pressure of vested interests and the ideology and policy of neo-liberalism, it is certainly not easy to reach consensus about the need of a balance and integration between the three dimensions of material reproduction. But what is at stake is even much more difficult. To achieve such a balance requires strong and long-term **re-**balancing efforts, i.e. on the one hand, policies to contain and roll-back the current bias to subordinate all aspects to the economic imperative and the vested interests behind them, and, on the other hand, policies to put particular emphasis upon the hitherto neglected social and ecological dimensions.

Translated into proposals for an alternative European development strategy or for a European Social Model, with a comprehensive meaning of "social", this has two implications:

Firstly, in the traditional area of economic policy the market and competition biased approach must be matched and countered by a stronger emphasis on political – macro-, structural-, trade-policy etc. – intervention and control. This includes halting the current wave of deregulations and imposing a moratorium on further privatisations until a comprehensive assessment has been submitted and publicly discussed. It also includes particular support for the new member countries.

Secondly, social and ecological policy must be considerably upgraded in the policy agenda of the European Union, and given priority over purely economic considerations of enhancing competitiveness and strengthening international market positions. The challenge is the ecological and social restructuring of the traditional capitalist economies. Of course this reorientation requires strong economic policy consequences which in neo-liberal terms are regarded as impossible. But there is a multitude of political instruments and tools which can be mobilised for such objectives in a democratic society: they range from administrative rules via regulation

of markets, tax policies, redistribution of income and wealth to the enhancement and use of the public sector for environmental clean-ups as well as ecological modernisation etc. To mobilise and apply such instruments for a policy re-orientation towards a balanced integrated development strategy in the EU is neither technically nor economically nor legally impossible – even within the framework of the present Treaty. It is a matter of political will, induced by public discussion, the force of social movements, and the power of democracy.

4.2 Macroeconomic policy for sustainable growth and full employment

There is a need for co-ordination between monetary policy and national fiscal policies to be much more effective, and to focus on the creation of high levels of economic activity. This should include a move away from the *sub*ordination of national fiscal policies to the arbitrary budgetary limits imposed by the Stability and Growth Pact and to the dictates of monetary policy and the ECB. The strengthening of the status of the Euro-group would transform the latter into the main partner of dialogue for the ECB with regard to the conduct of monetary policy. Monetary policy should be explicitly included in these dialogues and the effects of policies conducted by other countries should be taken into account.

A reform of European monetary policy should seek cooperation, co-ordination, and where necessary compromise between the various macroeconomic objectives growth, employment, and price stability as well as between the ECB and the other macroeconomic actors, i.e. national governments, social partners, and the European Commission. Also the complete independence of the ECB, protecting it from democratic discussions and decisions is counterproductive and undemocratic and should be changed.

In accordance with our arguments in previous memoranda we propose that
- the objectives of the ECB be reformulated to include high and sustainable levels of employment and economic growth, and drop any 'reference level' for growth of money stock;
- the ECB be made accountable to the European Parliament, and involved in the co-ordination of fiscal and monetary policies;

- the ECB undertakes the role of lender of last resort and accepts responsibility for the stability of the European financial system.

Member state actions should be coordinated for the orientation of ***fiscal policies,*** too, to support high levels of economic activity, full employment, social cohesion, and environmental sustainability. Since the large majority of public resources will remain with the member states even if the European budget is raised beyond its present minimal size (which we regard as necessary, see 4.5) the main challenge for European fiscal policy is the *coordination* of member state actions. To make such coordination work, the Stability and Growth Pact must be abandoned. The main guideline for fiscal policy should not be the balancing of the public budget but a maximum contribution to the achievement of the economic, social and ecological objectives and ambitions of the EU.

On the expenditure side fiscal policies should firstly relate to S*tabilisation policies for sustainable growth and employment*. We therefore propose an agreement to increase national ***public investment*** by an amount equivalent to ***one percent of the respective national GDPs*** per year for a period of five years. Also the ongoing cuts in the public services and personnel should be stopped and reversed.

Secondly, coordinated *long-term infrastructure programmes* should be pursued. Scattered patterns in telecommunications, motor-, rail- and waterways, air traffic, and large research pose substantial obstacles to European unity. Especially after enlargement the concept of European infrastructure must be extended to include the new members and this requires additional efforts.

Although the diversity of *social policies* throughout Europe is an asset to be preserved, it is certainly a challenge for the EU to strengthen the financial basis to support the common achievements of the European social model (see 4.3) .

On the revenue side the main issue is to restructure national tax systems and policies in a way which avoids tax competition and increases revenues. Some modest steps have been taken in this direction with regard to interest income. But more must be done. We propose

- to extend the agreement about the treatment of interest income to *dividends, rents, and capital gains,*
- for *corporate income* to accelerate the introduction of a harmonised tax base, the setting of a minimum rate of 40 % (with a rebate for poor new member countries), and the application of the world income principle in the form that worldwide profits are taxed in the country where the main operating basis (as possibly different from the legal headquarter) is located, with taxes paid in other countries being deductible from the domestic payments,
- for VAT to shift the present complicated and fraud-vulnerable system of calculation for intra EU transfers to a system based on national accounts.

4.3 Anti-poverty policy and minimum standards – Social policy recommendations

A move to more effective and positive social policies in the EU has to be considered as part of a wider change in the policy agenda which would move away from the priorities adopted at Lisbon. European countries are not being decisively outstripped by the United States, least of all in the sphere of social policy. The main lesson to be deduced from US experience is simply the value of expansionary fiscal and monetary policies.

Although it is true that social policies can often contribute to production, the Lisbon approach, which regards the “European Social Model” primarily as a productive factor, is too narrow and should be replaced by a vision of social policy which emphasises all aspects of well-being and not just economic objectives.

The *first* requirement for a more positive contribution by the EU to the development of social policies is a substantial increase in the resources devoted to this purpose. The work currently being done by the EU on minimum income programmes should be developed from its present level – exchanges of information and research into poverty – to become a genuine European anti-poverty programme. For this, all member states should prepare national anti-poverty strategies; and the strategies of the lower income countries should, after critical scrutiny, be partly financed out of EU resources. This would be the Open Method of Coordination, but on this occasion backed up with resources, and therefore with far more impact on policies.

Secondly, the EU should leave specific objectives and tools of social policy in the hands of the member states but promulgate minimum standards, obligatory for all member states, in the main fields of social protection and in the key social services – education, health care, social housing. It should be made clear that these standards will gradually rise towards those which prevail in the most advanced systems. To prevent this structure from being abused, it should also specify that existing standards of social provision must not be lowered – that what is envisaged is a method for controlled advance, as indeed is stated in the founding documents of the EU.

A *third* proposal for EU social policy concerns pensions. A concrete way in which the EU could advance the social model in present circumstances would be to promote, using the open method of coordination, the reinforcement of public pay-as-you-go pensions and their introduction where they do not exist yet. Here again, coordination should be supported by financial resources, so that the union makes a small contribution to the public pensions paid in each member state. Again the idea would be that this contribution would grow to form a significant part of the basic pensions enjoyed by EU citizens.

A *fourth* essential requirement to strengthen social policy on the EU level is the substantial increase of resources for this purpose. Although most member state governments are at present determined to resist any expansion of the EU budget, it is also the case that without such an expansion it will be impossible to address the most acute social problems within the EU and hence also impossible to counter the growing alienation of European populations from the European project.

Fifthly, employment policy should not be based on *workfare* or other authoritarian schemes, but should be supplemented by an expansionary macroeconomic strategy, the development of attractive work opportunities, and the introduction of minimum wages as well as agreed and co-ordinated provisions to prevent wage dumping. Competition between European workers and immigrants – compelled and willing to sell their labour capacity for almost any wage and with neither social protection nor

welfare benefits – must not be allowed to lead to a race to the bottom in wages and working conditions. It is therefore necessary to extend minimum wages and minimum levels of protection and rights to all workers. No worker, whatever her/his nationality should be paid a wage beneath the level necessary to their dignity and as a fair reward.

A *sixth* point regards *working time*. The EU should resist the pressure of employers and some governments to undermine the existing working time directive by increasing the maximum weekly working time beyond the current 48 hours, extending the reference periods and by facilitating individual opt-outs. European working time regulation should go in the opposite direction: towards a clear limitation of the maximum working week at a limit closer to the present average of 40 hours and of the reference period for flexibility; a further movement to reduce actual working time; the complete abolishment of individual opt-out clauses which put employees under pressure; and by establishing norms for socially protected part-time work for those who wish to work shorter hours.

Several objectives would be achieved by this policy, even if the level of financing were, to begin with, rather modest. There would be a redistribution from high income to low income member states, reinforced in practice by the greater purchasing power of the euro in lower income economies. There would be a decisive recognition of the superiority of social provision over individual market provision in a sphere where all the available evidence indicates that this is the case, so that the logic of the ESM would be forcefully asserted. The pooling of national resources would relax some of the constraints on the finance of public pensions within individual states. And there would be a concrete expression of European solidarity to place against the widespread experience, demonstrated in the debate on the Constitutional Treaty, that the EU only works in practice to dissolve social models by the intensification of competitive pressures and market forces.

4.4 Steps towards a non-fossil energy regime – Environmental policy

A first step for stronger European environmental policy should be the adoption of more ambitious and legally binding targets for greenhouse emissions as an essential element in a long-term strategy to fight global warming, on the European as well as on the global level. A new Commission proposal (Oct.2005) which calls for a “global carbon market” after 2012 remains too vague, and it ignores the urgency of starting the post-Kyoto-process with a clear end date for the completion of negotiations. For the EU, a reduction of at least 30% by 2020, referring to the greenhouse gas emission levels of 1990 should be pursued.

Measures centred on improving eco-efficiency in the use of energy and raw materials could constitute a second layer of EU wide action programmes, An increase in energy efficiency by 3% per year the EU would help to set global standards and at the same time to maintain and to create good quality jobs. To realise such goals strategic investments are needed in the long term with restructuring efforts towards a replacement of energy- and waste- intensive patterns of production and consumption.

A proactive environmental policy will have to include a far-reaching restructuring process of consumption and production, on the EU level as well as regionally diversified within its member states. An important starting point for such a restructuring process can be found in the comprehensive stock-taking of known and unknown risks implied in physical, chemical, and biological technologies which could be based on a reinforced and extended REACH (Registration, Evaluation and Authorisation of Chemicals) initiative.

We propose that the EU gives five strategic restructuring programme lines special urgency to develop with member-states’ co-operation and co-financing:

- Increased reliance on decentralised sources of renewable energy, allowing for differences of focus according to specific conditions in member states and their regions; this could make a relevant contribution to keep the Rio commitments, while reducing the dependence on fossil energy sources.
- The reinforcement of attractive public transport infrastructures, especially in urban areas; this would be self-financing in the medium term by preventing urban degradation and lowering the burden of road maintenance.
- The reduction of the use of fertilizers and pesticides in conventional agriculture, accompanied by an increased share of ecological agriculture in local and regional

consumption; this would help to rebuild biodiversity in rural areas, while creating jobs of good quality.
- Public support programmes for building and reconstructing low energy housing; this would reduce the dependency on combustible energy sources, while helping to reinforce local and regional economies.
- Specific programmes aiming at giving targeted support to catching-up processes in the new member countries with regard to best practices in the fields of environmental and energy policy, while helping to preserve existing environmental policy advantages.

Such programmes should be embedded in a general policy shift towards a more proactive environmental orientation combining a broad spectrum of regulatory instruments from legislation on thresholds and ceilings via licensing of specific locations for enterprises to public service institutions guaranteeing specific standards of service. Market instruments should not be relied on without a binding definition of aims and objectives, as well as a significant procedure of continuous monitoring and evaluation. On the EU level this would especially call for a voluntary reactivation of the Cardiff II obligation to integrate environmental concerns into all areas of EU legislation.

In order to fulfil EU’s global environmental commitments, a new EU horizontal financial budget on global environmental issues is needed. The Commission’s strategic priorities for 2005-2009 (COM 2005/12) stipulate that EU’s external relations must “target effective implementation of key goals in the area of environmental protection” (article 4.2). For these commitments a European Global Environmental Budget will be needed which has been estimated, with regard to the financial perspectives 2007-2013, at 250 million Euro per year – a total of 1,75 billion euro.

The environmental policy of the EU should also reinforce its global perspectives. The same principles of precaution and accelerated emissions reduction should be applied to joint programmes, allowing developing and emerging countries to find their own paths and patterns of implementation and sustainable development. This would provide the basis to find a common strong policy on global warming between the EU and potential partners, without having to accept the logic of the lowest common denominator or of the slowest ship determining the velocity of the convoy.

4.5 A stronger budget with more equitable financing – Financial perspectives for the EU

In order to create the ability of the EU to pursue an effective policy for full employment, social cohesion, and ecological sustainability the EU budget should be considerably expanded – which can of course only be justified if the procedures which determine the size and structure of the European budget are thoroughly democratised and made much more transparent. There will be no sustainable solution without the creation of a federal budget which provides on the one hand a support for coordinated stabilisation policies on a European level in case of shocks and on the other hand the tools for interregional redistribution in order to cope with asymmetries and for ecological re-structuring.

We propose that during the next financial planning period, i.e. for the years 2007 - 2011 the budget should be raised by 0,5 percentage points of GDP per year to reach 3,6% of EU-GDP in 2011 and in the subsequent years should further increase to a level of around 5% of EU-GDP. This should not be taken as a rigidly fixed upper limit or minimum requirement but as a rough guideline which leaves room for downward and upward flexibility.

For the ***revenue side of the EU budget*** we propose a thorough reform of the current system of own resources to the effect that the VAT related component should be abandoned and in addition to the traditional tariffs the only other revenue source should be a progressive GDP related European income tax, applying the ability-to-pay-principle within the EU. The country specific tax rate should be fixed in correspondence to the relative strength of the country in the EU, measured in income-per-capita in purchasing power standards. Thus a per-capita-income of 120% of EU average would lead to a tax rate that is 20% higher than the average EU rate of 5% (leaving aside the income from tariffs) i.e. 6 % of GDP, whereas a country with a per capita income of 50% of EU average would have to pay only 2,5 % of its GDP in European taxes. It would be mainly left to the discretion of the member states to

decide about the way in which the European tax is domestically refinanced, although the method of levying it should not be used for a new round of tax competition.

We also propose that the strict prohibition of ***European debt*** (art. 269 of the Treaty) should be abandoned, and the EU should be allowed to finance long-term European projects like Trans-European-Networks or investment in common technological development through loans, using the European Investment Bank as its agent on capital markets. Such projects have self financing effects insofar as they strengthen the productive basis and thus also the tax basis of the European economy. Therefore it is justified in terms of intergenerational equity to shift a part of the financial costs for this infrastructure to future generations who are the main beneficiaries of an improved infrastructure.

To:

European Economists for an Alternative Economic Policy in Europe
(EuroMemorandum Group)

Declaration of support

I support the general direction, main arguments and proposals in the EuroMemorandum 2005:

"Democratic Policy against the Dominance of Markets –
Proposals for an Integrated Development Strategy in Europe"

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I would like to be informed about the regular work of the working group and be invited to their meetings.

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Please return this form as soon as possible - **not later than 27th November 2005** - by e-mail to Prof. Dr. Jörg Huffschmid: Huffschmid@ewig.uni-bremen.de or to Diana Wehlau: Wehlau@uni-bremen.de or by fax to: **++49-421-218-4597**.