European Economists for an Alternative Economic Policy in Europe

EuroMemorandum Group

Beyond Lisbon

Economic and social policy orientations and constitutional cornerstones for the European Social Model

EuroMemorandum 2004

Summary

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Summary

1. The brief economic recovery of the EU is over. It was always weak and never broke the long-term vicious circle of low growth, high unemployment and rising inequality. Inadequate domestic demand continues to make the European economy very fragile. Enlargement, although it is to be welcomed as a historic contribution to peace in Europe, has increased regional imbalances. Both persistent unemployment and rising disparities require strong political countermeasures. But the EU is a long way from taking such measures.

2. The Lisbon strategy, launched in March 2000 with the objective of making the EU the "most competitive economic region in the world" by the year 2010, has clearly failed. This is not due to the failure to implement its agenda but to the false policy orientations of the Lisbon Strategy itself, namely
- the narrow macroeconomic framework, which is hostile to growth and employment,
- the very strong bias towards further liberalisation and deregulation of markets which, together with the wave of privatisations, is damaging the economic fabric and the social cohesion of the EU,
- the lack of transparency and of opportunities for broad democratic discussion and participation; this has further alienated large parts of the population from the structures and policies of the EU.

3. To bring the EU onto a more balanced path of economic and social development, the **following measures** are proposed:

- A large ***coordinated public investment programme of 1% of EU GDP*** (= ca. € 90 bn.) should be set up. Resources should go to infrastructure and ecological restructuring, including restructuring of the energy sector. Most of the programme should be financed through loans from the European Investment Bank which do not count against the deficit.

- Monetary policy should be further relaxed through a ***reduction of the central interest rate to 1,5 %.***

- The budget of the EU should be gradually and continuously ***increased to a level of 5% of EU GDP***, to make it possible for the EU to fulfil its enhanced responsibilities.

- To ***put an end to the current, extremely damaging, corporate tax competition among member states*** the EU should harmonise the corporate tax base throughout the EU and impose a ***uniform minimum rate of 40%*** (30% in countries with a per capita income below 75% of the EU average).

- With regard to the obvious problems of private capital-funded pension systems the EU should redirect efforts to improve the economic and social position of the older generations. What is needed here is to ***strengthen public pay-as-you-go systems*** with guaranteed minimum pensions and to finance them by contributions out of all forms of income, not just from wages and salaries.

- To fight poverty and exclusion more effectively the EU should use part of the increased Union budget for ***direct transfers*** to the most affected persons.

- To stop the race towards more deregulation and competition the EU should ***withdraw the Commission's proposal for a directive for a single market in services*** and recommend to the member states a ***moratorium on privatisation of public services*** until a thorough independent audit, in

both economic and social terms, of the previous rounds of market liberalisation, deregulation and privatisation has been carried out and publicly discussed.

- To prevent the further deterioration of working conditions the EU should ***withdraw its proposal for a new working time directive*** with longer working time limits and instead explore the potential for working time reductions.

4. A thorough reform of economic and social policy in the EU, with the goal of establishing a specific **European Social Model** as an alternative to the US model, should be based on the following core elements, on 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 helplessness,

- ***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.

5. The **European Constitution,** which was signed at the end of October and which is now subject to ratification procedures, is not helpful but in many ways hostile to the achievement of the European Social Model.

In the first place the much criticised ***democratic deficit*** of the European Treaties is not challenged in any of its central features. The European Parliament still has no right to initiate legislation, and key areas such as taxes and workers rights remain outside its reach.

The rules in the Constitution ***for economic and social policy turn the narrow and counterproductive provisions of the existing Treaties into constitutional imperatives*** which will be very hard to change – even in the light of new knowledge and new political majorities. In part III of the Constitution there is an attempt to protect very controversial neoliberal conceptions against growing theoretical criticism and political opposition by giving them constitutional status. The attitude behind this attempt is not only anti-scientific but also deeply anti-democratic.

Our central criticism is that ***the overarching framework for economic and social policy in the Constitution consists of liberalised markets and competition***. The Constitution sees no room for a public sector under democratic political control, although such a sector is vital for the functioning of the economy and for social cohesion. The absolute priority which the Constitution gives to competition will open the door to more ruinous races to the bottom and to more social dumping. The macroeconomic policy framework in the Constitution is so restrictive as to impede sustainable economic development and full employment. The Constitution leaves the EU with virtually no power or competence to enhance welfare, workers rights or social cohesion throughout the Union, while the rights of employers are continuously enhanced.

Introduction

The year 2004 saw a number of important developments for the EU. In May the Union was enlarged by ten new members. In June a new Parliament was elected and a week later the heads of states adopted a Constitution for the EU. In July they appointed a new president of the European Commission. In October this president was forced to withdraw his proposal for the new Commission and to exchange several commissioners after an unprecedented conflict with the European Parliament. 2004 is also the year of economic recovery, with "positive growth surprise", as it was put by one commissioner. Is the stage now set for a "big leap" forward towards a more dynamic and equitable development after a long period of weak growth, high unemployment, growing social inequalities and an underdeveloped democratic culture? Will the "Lisbon Strategy" of March 2000 at last materialise which envisaged to transform the EU into the "most competitive economic region of the world", with "more and better jobs" and full employment until 2010?

Hopes in this direction are not well founded and are likely to be disappointed. The main reasons for this are on the one hand the persistent democratic deficit of the Union and on the other hand the continuing underlying weaknesses of its economy. There is a remarkable deficit of political resolve and capability to cope with either of these fundamental problems.

The complete lack of transparency which surrounded the nomination and appointment of the president of the Commission was a striking demonstration of the democratic deficit. Such events are likely to widen the gap between the EU and its citizens. They underline the current crisis of legitimacy which has led to the historically low turnout at the European elections, whereby 54 per cent of the potential voters in the 25 member states of the Union chose not to vote. Against this background the recent refusal of the Parliament to accept the proposed Commission was a success and a step forward in the attempt to enhance democracy within the European institutions. But this success remains fragile. The Constitution, though it contains some positive provisions, will not carry the process further to a new consolidated level of democracy into the Union.

In the following we will undertake a critical assessment of the development and present economic situation of the EU (section 1) and analyse the reasons for the failure of the Lisbon strategy (2). Subsequently we present proposals for policy changes to improve the European performance with regard to sustainable development, full employment and social welfare.(3) In the following section (4) we present our conception of core elements of the European Social Model and in the final section (5) we will undertake a critical analysis of the European Constitution with regard to these elements.

1. Vicious circles and growing disparities: The need for economic development

The economic recovery of the EU is already over. It had only lasted one year and remained weak, with growth rates of less than 2,5% at the peak and a sharp fall in the third quarter of 2004. It has not reduced the rate of unemployment. The higher than expected growth of the EU in the first half of 2004 was largely due to an increase in net exports, while domestic growth components remained weak. Therefore the European economy will be strongly affected by a slowdown in the US. Additional risks from higher oil prices and a further appreciation of the Euro (which is only a small relief for the domestic oil bill but a considerable threat to European exports to third countries) make the situation particularly vulnerable. All this should require energetic political action from the Union. But nothing is happening. Initiatives from member countries like France for joint action to cope with the threats from higher oil prices for the economy are turned down in the ECOFIN Council, and at the same time plans for national actions are criticized. Not only is there no concept for joint European action, but on the contrary there is a majority sentiment for joint non-action.

In a *long-term perspective* the recent short economic recovery has not led the EU out of the vicious circle of low growth, high unemployment and increasing inequality which was characteristic for the development of the EU-15 for more than 25 years. Growth was not high enough to offset the rise in productivity and to absorb the additional entrants into the labour market. Therefore unemployment rose and remained high even during recoveries. This put workers under pressure and the result was a fall in the wage share in national incomes, from a historic peak of 73,4% in 1962 to a historic low of 68,0% in 2004 (European Economy 4/2003 and 6/2003,Table 32). This tendency is reinforced by EU taxation policy favouring profits. On the other hand, profitability has strongly risen again since the beginning of the 1980s and now exceeds the record levels of the early 1960s. However, this has not stimulated investment but has instead been a driving factor for the development of financial markets and speculation.

This pattern has not changed since the Lisbon strategy was adopted almost five years ago. *Over the past four years,* the average annual growth rate has been in the region of 1.5%, compared with 2.8% in the second half of the 90s. This is half of the average annual value which was envisaged for the current decade. It is to be noted however, that the growth rate in the new member countries (3,1%) was twice as high as in the EU-15. On the macroeconomic level the envisaged catch-up process is taking place, although the effects upon the reduction of unemployment are very limited.

Table 1: Growth components of GDP in EU-25 and EU-15 (annual % changes)

	EU-25					**EU-15**				
	1996-2000	**2001**	**2002**	**2003**	**2004**	**1996-2000**	**2001**	**2002**	**2003**	**2004**
GDP	2.8	1.8	1.1	1.0	2.5	2.7	1.7	1.1	0.9	2.4
Private Consumption	2.8	2.0	1.4	1.5	2.0	2.7	2.0	1.2	1.4	1.9
Government Consumption	1.7	2.5	3.1	1.9	1.8	1.7	2.5	3.2	1.9	1.9
Investment	4.5	0.3	-1.4	0.0	3.2	4.3	0.4	-1.5	-0.1	2.9
Public Investment*		2.4	2.3	2.5	2.4	2.3	2.4	2.3	2.4	2.4
Exports	8.1	3.3	2.0	1.5	7.4	7.8	2.9	1.6	0.6	7.0
Imports	8.7	1.6	1.4	3.0	7.4	8.3	1.3	1.1	2.4	6.9

* as a percentage of GDP
Source: European Commission, Economic Forecasts, Autumn 2004

As in previous years, investment has been the main factor dragging economic activity down. For the first four years of the decade investment in EU-25 rose only by 0,5% on average, in the Euro-zone it even decreased (-0,2% average), and 2004 was the first year with an increase in investment (+3,2%) at all. This development is not only worrying, but also embarrassing for the prevalent EU paradigm. It is worrying because it works "to the detriment of the priority areas identified by the Lisbon Strategy: projects of European interest, such as trans-national network infrastructures and the knowledge sector" (CEC, 2004:10). Furthermore, it is embarrassing to the extent that it is not responding to such "supportive fundamentals" as low interest rates, increased profitability and restructured balance sheets (Quarterly Report in the Euro Area, 3.3:9).

Public investment has also been in decline, so that it is currently considerably lower than in the US and Japan: 2.4% of GDP from 2001 to 2004 on average as compared to 2,9 % in the US and 4,3% in Japan. Present policy however is not about to overturn this. For example, the European Growth Initiative and the Quick Start Program is a recent policy initiative in this area, expected to mobilize resources in the infrastructure and knowledge sectors. This is to be financed on a 60/40 split between the private and the public sector. The latter's share however amounts to a meagre 0.05% of EU GDP. Not surprisingly, both the Initiative and the Program are hardly visible!

What has actually prevented the anaemic growth from a further fall was the increase in private, as well as particularly in public, consumption (1.5% and 2,3% respectively, on average in EU-25). It was however too weak to set the EU economies on an upward trend. During this period, fiscal policy remained largely contractionary, for although there was a limited increase in the EU average fiscal deficit (-2.7% of GDP as opposed to -1.1% in 2002), there was a tendency to reduce the budget deficit calculated on a cyclically adjusted basis.

In view of the above developments, the rate of unemployment has been rising steadily from 7,4% in 2001 to 8,1% in 2004 in the EU-15 on average. The situation is much worse in the new member states, where in spite of higher growth the average rate for the four past years was 14,4%.

Inflation has been hovering around the 2% level, while real compensation per employee increased only by hardly 1,0% per year from 2001 to 2004. Real unit labour cost fell by 0,3% on average each year from 2001 to 2004. Fears of inflationary pressures as a result of an increase in oil prices have already given rise to worries about possible increases in wages and to calls for wage moderation.

In view of the rising unemployment and the modest increase in wages, the wage share in GDP decreased further, from 69.2% of GDP over the period 1991-2000 to 68,0% in 2004 in the EU-15.

Disparities in employment, unemployment, per-capita income and poverty have since long been a problem in the EU which has not been sufficiently dealt with. Following the latest enlargement regional inequality has strongly grown: The ratio of per-capita-income in the richest country to that in the poorest country was 3:1 in the EU-15 and rises with enlargement to 5:1. At the same time the regional structure of inequality has dramatically shifted to the Eastern countries, without a real improvement in the weaker regions of the West and South. According to the Third Cohesion Report (February 2004), the number of backward regions in the EU (that is regions with a per-capita income of below 75% of EU average) increased from 50 in the EU-15 before enlargement to 69 in the EU-25, and the share of total population living in such regions rose from 19,2% to 27,1%. These overall figures conceal the dramatic character of the development. Since the average per capita income of backward regions fell from 65,5% to 56,2% of EU-25 average, the number of such regions in the EU-15 fell from 50 to 33 with a population of 11,9% of EU-25, without any real improvement in the standard of living or employment in the 17 regions which disappeared from the statistics. On the other side the per-capita incomes of 33 regions from the new members is below the 75% threshhold, covering 92% (!) of the population of these countries or 15,2% of the EU-25 population.

The size of disparities in the EU-25 makes it increasingly illusionary to speak of **one** European economy, which was already in the old EU-15 a fragile concept. The justification for this term has already in the past not been the fiction of an economic and social homogeneity behind all differences and disparities. It has always been borne by a political conception to create economic dynamism and social cohesion through cooperative and joint action which exploits differences in resources and skills, organises catch-up processes and creates cohesion through transfers. With higher disparities after enlargement such political efforts should be multiplied. But this is not the case.

2. After the failure of Lisbon: A new development strategy is necessary

In March 2005 the strategy of Lisbon will be five years old and will be submitted to a mid-term review. This will be based on a report of a high-level expert group chaired by the former Dutch prime minister Wim Kok. The report recognizes that the Lisbon agenda has badly fallen behind schedule. It recommends to speed up the process, to cut the list of over 100 to 15 indicators, to set up national action plans and to install a continuous procedure of monitoring by the Commission and the European Parliament. Neither the objectives of the Lisbon agenda nor the method to achieve them are re-examined, but both are explicitly restated and confirmed. This is a very short-sighted approach which fails to address the real reasons for the European problems. These reasons relate to the basic paradigm underlying the Lisbon strategy:

- the very narrow framework for macroeconomic policy which is hostile to sustainable growth and full employment,
- the strong bias towards liberalisation and the almost exclusive regulation of the economy through markets and competition at the expense of the political control of the main directions of development and of a democratic public sector ,
- the persistent democratic deficit which prevents a broad public debate and decisions about a sustainable and productive balance between markets and competition on the one hand and public sector and political intervention on the other hand as tools of economic regulation.

A solid analysis and assessment of the Lisbon strategy should proceed from the recognition of practical failure to the critical examination of the underlying economic and social paradigm. Accelerating and streamlining the Lisbon Strategy, while leaving its core elements intact, is not going to deliver improvements. Continued and exclusive preoccupation with supply-side reforms directed to making the labour market more 'flexible' is not only inadequate, but also dangerous in dealing with the EU's present problems. The ongoing discussion about the reform of the Stability and Growth Pact to make it more flexible and responding to concrete circumstances is a first step in the right direction, which is not even mentioned in the Kok-Report. But such punctual reform is not sufficient. A broader perspective is needed, encompassing vital issues of social cohesion across the new EU formation, environmental sustainability and democratic control. Therefore the consequences from an appropriate assessment of the Lisbon strategy should start with establishing on the European level objectives and benchmarks which are not subordinated to the overarching and simplistic goal of growth. Instead they should relate to the social content, the ecological sustainability and the internationally peaceful and cooperative quality of economic development in and of the EU.

The fact that the neo-liberal strategy has not yet been corrected can only be explained by the existence and power of interests which are not affected by but benefit from the overall economic weakness. These are in the first place large trans-national corporations and financial institutions with great market power who find ways to invest their capital abroad. They combine waves of downsizing, dislocations and closures of production sites with a comprehensive roll-back strategy against a wide range of social achievements of the last 50 years. Most prominent amongst these attacks are the increasingly concerted actions for the unpaid extension of working time, reduction of employers contribution to social security systems, against work protection and binding labour contracts, the role of trade unions etc. This stampede against almost every aspect of social and democratic progress in the economy strongly evokes the picture of class struggle from above.

The European authorities have nothing to say against such activities which undermine the essence of social cohesion in the Union. Instead the Lisbon strategy supports them through ever new and ever repeated appeals for more flexibility on the labour side. In addition it concentrates on a further round of liberalization opening even more room for corporate strategies. The centre of this effort is the services sector which the EU, in accordance with worldwide neo-liberal strategies in the framework of GATS, plans to open up to competition in an unprecedented way during the next few years. This would lead to a new wave of privatisation of public services with in many cases more social exclusion and deterioration of working conditions for the employees concerned.

3. Proposals for policy changes

The following proposals relate to measures to stabilize and improve the current weak economic and social performance of the EU. Such measures should be based on tight coordination between countries and be subject to flexible application and modification according to changing needs. They can be realized on the basis of the present Treaty and the Constitution – although some of them require unanimity and are therefore even more unlikely to be taken than others. Long-term stabilization of economic and social policy as a basis for the European Social Model requires thorough institutional changes which we have discussed in previous memoranda.

1. The EU should respond to the pressure of high oil prices in the first place by enhanced efforts to ***restructure the system of energy provision and to promote energy saving*** and thus to reduce the dependency on the ecologically harmful fossil energy source. For a very short period the effects of rising oil prices should be mitigated by the ***release of a part of the oil stocks*** in the EU or via temporary ***targeted subsidies*** to middle and low income households and to sectors which are particularly affected by high oil prices.

2. To stimulate sustainable economic growth and employment member states should start a ***coordinated public investment programme of 1% of EU GDP***. The resources should primarily be used for improvement of the transport and telecommunication infrastructure,

for ecological clean-ups and restructuring and for technological research and development. In the latter area it should be complemented by projects on the EU level. Such a programme, which we have already proposed in previous memoranda, can be financed by bond issues and on-lending of the European Investment Bank (EIB), which are not counted against national debt in most member states. A recovery focussed on social investment is readily feasible granted the remit of the 1997 Luxembourg European Council to the EIB to investment in health, education, urban regeneration and urban environment.

3. ***Monetary policy should be relaxed*** through a reduction of the central interest rate in the Eurozone by 50 basis points to 1,5%. Cooperation with other actors should be intensified, not least in the Macroeconomic Dialogue, in order to ensure an optimal policy mix to strengthen sustainable growth while constraining inflation.

4. The EU should ***abandon the current plans to change the working time directive*** so as to facilitate longer maximum working hours. Instead it should try to reach a consensus and adopt a position to the effect that extension of working time is no suitable way to promote employment. This should lead to a recommendation that member states explore different ways of working time reduction as one central element of a coordinated employment strategy. They could do so through the innovation agreements recommended to the social partners by the June 2000 Lisbon Council which offer both flexible production and continuous improvement by consent and a more flexible balance of work time and personal time for employees.

5. In the preparations for the financial period 2007-2013 the EU should ***abandon the plan to keep the limit of the EU budget below its present value of 1,24 of EU GDP***. Instead, a continuous increase of this share up to 5% of EU GDP should be envisaged to give the EU the necessary resources for stabilisation and redistribution purposes. At the same time a considerable shift in the structure of expenditure should occur towards structural and social policies, for which together more than 50% of the Union's budget should be used.

6. To ***halt the current tax competition*** which undermines the revenue basis of member states the agreed system of mutual intra-EU information about interest income should be extended to dividends. It should be complemented through a reform of corporate profit taxation: A full harmonisation of the tax base should be followed by the setting of a regular minimum tax rate of 40% (and of 30% for countries with a per-capita income below 75% of EU average).

7. The EU should ***halt its efforts to adopt the directive for the liberalisation of services*** until a thorough and independent assessment of previous rounds of liberalisation has been undertaken. At the same time it should recommend to the member states a ***moratorium on further privatisations of public services*** until the results of previous privatisations have been explored and discussed.

8. In social policy The EU should undertake a ***critical assessment of the effects of the (partial) privatisation of pension systems*** and explore alternative ways to maintain and extend public pay-as-you-go-system (PAYGS) which guarantee the elderly a decent living standard. In this a strong preference should be given to making contributable all income recipients and all categories of income.

9. The EU should take stronger initiatives in the ***fight against poverty*** and other forms of social exclusion. For this purpose it should use a part of the increased EU budget for direct transfers to poor persons in the Union.

4. Core elements of the European Social Model

Apart from the policy changes proposed above it is necessary to discuss and advance certain common social objectives that constitute the core element of the European Social Model (ESM). This discussion is particularly pertinent at the present time, in view of the Constitution that has just been signed. The concept of the European Social Model has been much invoked in the last few years from many different sides. However, the content has remained rather vague, reaching from an alternative to the American social model in some declarations by European authorities to an alternative to the current neo-liberal policies of the EU herself, proposed by critics, who see the EU on the way towards the introduction of the American model.

The Union is very reluctant to take active measures for common social progress, pointing to the fact that the social models of the member states are very different and this diversity should be respected. At the same time the EU pushes forward for more liberalisation, deregulation and privatisation. But the single market for services, which is very high on the European agenda will have a destructive impact on social services in the EU, exposing most of them to the uniform pressure of competition and deregulation, and not in the least respecting the diversity of national systems. In this way the concept of a European model of society will be kept weak and core elements like full employment, social security and equity remain subordinated to the overarching principles of markets and competition.

Against this we recognize on the one hand the diversity of social and welfare systems as an asset of the EU, but at the same time think that it is possible and necessary to anchor this diversity in a ground of common social objectives which should neither be abandoned for the benefit of markets nor – and this is currently more pertinent – shaped according to the need of the markets. Central amongst these goals are full employment, social security and equity.

Full employment – more than high participation rates

Since the summit in Lisbon full employment is back on the agenda of the EU. The concrete objective is to raise the participation rates throughout the EU to 70% for men and to 60% for women throughout the EU until 2010. It certainly makes sense to quantify the general objective and establish measurable and intermediate goals. On the other hand the concentration on the sheer employment rates (which is reinforced through the recommendations of the recent Kok-Report) threatens to impose mechanistically a “one-size-fits-all” strategy of enhanced economic growth and to overlook the often very substantially different roots for low participation rates which require much more differentiated political approaches, including modification of working time arrangements and institutional change to accommodate changing social, family and life-style patterns. Continuing low female participation rates in Mediterranean countries are no sign of a lack of flexibility but are rooted in weak social support and protection systems (lack of childcare or part-time jobs, insufficient pensions) and higher rates require much deeper changes than just higher growth. High participation rates for those over 60 can be the result of attractive work opportunities and work conditions for the elderly, as in the Nordic countries, but it can also be the result of insufficient old age security which forces the elderly to stay on the job, the US pattern. The tendency of the EU to regard generous pension schemes as "employment obstacles" goes clearly in the second direction and a higher participation rate as a consequence of cuts in the pension systems would certainly not improve the quality of the European Social Model. Or take low participation rates for young people: They can be the result of difficulties of access to the labour market or the reflection of longer time for education. While access obstacles should be removed education at secondary and tertiary levels must be regarded as an asset and investment in the future.

Higher participation rates should not be pursued at the cost of the quality or the remuneration of work. The assertions that the lack of jobs is the result of excessively high labour costs or of reductions in working time are not founded. On the contrary low wages account for the marked weakness in domestic demand and longer working hours contribute to overcapacity and dismissals (and by the way to lower participation rates, too).

The objective of full employment in the EU includes of course full employment in the new member countries, too. Therefore investments of European firms in these countries are to be welcomed, and this can include relocations from one EU country to another. What makes the process currently so destructive is the fact that the threat of relocation is used by employers as a lever for blackmailing the employees and trade unions in the old EU countries. If this strategy remains without answer the result would be to relinquish the objective of full employment at decent conditions in the whole EU. Instead of raising work and living conditions in the new countries it would deteriorate them in the old EU. To prevent a downward spiral in welfare and work standards political intervention is necessary.

Full employment should be defined as a situation in which everybody, who is able and willing to work can get a job corresponding to her or his talents and can work in decent conditions and for a wage or salary which enables him or her to lead an independent life.

Social welfare and security - basis for a dignified life

Social welfare and security means that old age, sickness, accidents or other adverse circumstances should not force anyone into a state of poverty or helplessness. It includes the *unconditional right* for all residents to a level of material resources which enables them to lead a dignified life and to get access to all basic social and cultural institutions, and a broad range of other public goods. The definition of "public good" should be flexible and follow the development of productivity and material wealth of the society. Essential for the achievement of comprehensive social welfare are a strong and publicly maintained network of social security systems (like pensions and health care) and the provision of public services like education and child care. The eradication of homelessness and poverty must be made a social responsibility.

The existence of fairly comprehensive social security systems can be regarded as one traditional achievement in all EU countries – although they have been developed in very different forms in different countries. However, over the last few years public systems have come under heavy attack and have been undermined to varying extents. The "modernisation" of social security which is high on the agenda of the EU emphasizes the responsibility of the individual for his or her health or living standard in old age and places more financial burdens upon the individual for these purposes. Correspondingly, social security systems are increasingly privatised and their management delegated to corporate actors on financial markets. Against this trend we maintain that welfare, social security and protection for everyone are essentially social responsibilities and the best way to meet them are public systems.

One central element of social welfare is a stable pension system. This is also on the agenda of the EU. At the end of 2001 the European Council in Laeken agreed a common set of principles to guide the adjustment of pension systems that could have been threatened by the ageing of the populations and the consequent rise in the number of pensioners. These principles were that 1) every pensioner is entitled to an adequate income and standard of living, 2) pension systems should be sustainable in both financial and political terms (e.g. fair for the future generations), and 3) benefits and contributions should not be adversely affected by changes on the labour markets (be it increased mobility or longer spells of unemployment).

These principles are fine, but they have been massively used to pursue a pension reform in many countries which would partly replace the current public pay-as-you-go-system (PAYGS) by private pension schemes. Such schemes cannot guarantee the security of old age income and living standard to the extent that PAYGS can. They are less reliable because their success depends on the development of financial markets. The management of private systems is very much more expensive than that of public systems. Different from public systems private systems do not cover periods of unemployment or sickness. They are inferior in every respect to public PAYGS. If there were a real crisis in the pension system, a privately funded system would be less capable to cope with this challenge than a public one. The "modernisation" of pension systems serves the interests of the financial sector, not the interests of the pensioners or the employees.

Social equity

Social equity means the absence of social discrimination and excessive inequality in the distribution of income, wealth, and access to material resources, institutions and channels of democratic public discussion and decision making. It has a class specific, an interpersonal, and a regional dimension. Social responsibility for class-specific equity requires the reversal of three general trends of the last two decades: first, the distribution of income in favour of profits at the cost of wages, second, the shift of the tax burden from capital to labour and consumers and, third, severe reductions or abolition of financial support to low income and poor groups in the society. Interpersonal equity refers most importantly to measures to end the lasting discrimination against women with relation to career opportunities and wages. Regional equity invokes a public responsibility for special efforts in support of weak and underdeveloped regions in the EU and member countries.

Social equity is on the agenda of the EU only in the second and third sense. Efforts are made to cope with gender discrimination and to establish equal employment opportunities for men and women. But real successes have been few. Gender discrimination in payment and in access to higher positions in corporations and public administration is still very strong. In most other areas the call for more gender-related equity remains largely rhetorical, because the EU has no real competence in social policy and cannot deal efficiently with growing inequalities. Regional policies have been successful in that they have moderately diminished the variations in per capita incomes between member countries of the EU. But they have not prevented the increase of disparities between *regions* in the EU. Therefore stronger efforts and new approaches are required, particularly after the recent enlargement which has been accompanied by great increases in disparities of productivity, income and wealth.

Ecological Sustainability

The objective of ecological sustainability aims at the preservation of the natural basis of individual and social life. It relates to the exploitation of natural resources and the pollution of the natural environment and includes a most careful approach to unknown risks in physical, chemical and biological technologies.

Achieving ecological sustainability requires a far-reaching restructuring process in core areas of economic and social reproduction. Replacing energy- and waste-intensive production and consumption patterns is one of the most important aims. Measures such as energy saving, greater use of renewable energy sources, attractive public transport infrastructures, less use of chemical fertilizers and other pollutants in agriculture, construction of low energy housing etc. should all be politically promoted.

Ecological sustainability cannot be achieved through the exclusive use of market mechanisms. It also requires strong administrative measures and public sector activities, and these must not be subordinated to the imperative of market competition. In the past, environmental degradation has been linked to energy- and waste-intensive industrial growth. The necessary shift to a more sustainable development pattern does not necessarily mean that economic growth must be removed from the economic policy agenda altogether. But it should not be pursued at any price, regardless of its environmental consequences. Instead it should go along with and take the form of economic restructuring in an environmentally sustainable direction and it should be governed by the principle of precaution with regard to the natural resources and environment. This is for instance the case if development takes place as expansion of private and public services which often are less energy consuming and waste producing sectors than industrial production or mining.

Balanced international economic relations and efficient development aid

This objective envisages a European contribution towards stopping the increasing polarisation between rich and poor countries and towards initiating a process of true international division of labour and development for developing countries. Measures in this direction include the increase of official development aid and the waiving of debt for highly indebted poor countries. Another important element is a radical change of position in the trade negotiations within the framework of WTO and GATS, and particularly opening EU markets for products from developing countries (although this alone will not solve the problems of the third world but many other structural transformations and a different model of development is required). Such new policy orientations require thorough and careful adjustments and restructuring of the European economy, particularly in agriculture.

The pursuit of balanced international economic relations must replace the current endless efforts to increase international competitiveness through dismissals, relocations, aggressive cost-cutting and endless attempts to conquer market shares at the expense of competitors. While this is – at least to a certain extent – a reasonable and even an inevitable goal for individual businesses, it should not be pursued as an overall policy goal for countries: such policies create international imbalances and make competition harder, without offering any perspective of a general improvement of the situation. Imbalances of current and capital accounts between developed and developing countries are to a certain extent reasonable in order to provide development finance to countries with insufficient saving rates and/or weak credit institutions. However such imbalances can also reflect speculative capital flows; or they can lead to unsustainable positions on the side of debtor countries. To avoid both, the EU should support a dynamic catch-up process of developing countries through extended official financial and technical development aid. It should at the same time accept protective measures against financial speculation. In the long run balanced international relations should be reflected in current and capital account structures which avoid the continuous accumulation of external debt on the side of the weaker countries – which is unsustainable in the long run. Such balanced relationships are fully compatible with intense international trade and investment relations, provided these are organised in an orderly and fair way. They are also compatible with international competition if this is contained in a politically stable macroeconomic framework. They are incompatible with massive speculative capital flows which tend to lead to financial instability, turbulence and financial crisis. Therefore measures to promote international financial stability are a further element of balanced international economic relations. These also include the capacity to protect the European economy against external attacks through unfair trade practices or through destabilising financial flows.

5. The Constitution: Not helpful for the European Social Model

The draft Constitution was adopted at the second attempt by the EU summit in Brussels on June 18, and signed by the heads of states on October 29, 2004. The intention to proceed from a mainly economic and monetary union to a political union with more visibility and unity in the world and with more internal cohesion is certainly to be welcomed. It is also positive that the Constitution, which will now go through the procedure of ratification contains a number of progressive elements, such as the charter of fundamental rights (part II) and the reference to political and social values in part I which should form the basis of joint institutions and activities of the EU. Amongst these elements the value of solidarity deserves particular mentioning because in the current document it bears much more weight than in the previous Treaties. The emphasis which some provisions in part I and part II put on the democratic character of the EU should also be appreciated. These provisions should be taken as yardsticks and benchmarks in the assessment of the general thrust and orientation of the Constitution as a whole during the current ratification procedure.

However, strong objections must be raised against central parts of the Constitution. We leave aside here the problem of security and defence policy with a thrust towards enhanced military commitment. Although this is of course also a worrying matter for us as citizens we concentrate here on economic and social policy, which is the area of our professional expertise and activity. Our critique here relates to the persistent democratic deficit and to the biased and counterproductive rules for the economy, which the Constitution embodies.

The persistent democratic deficit

The first and more general level is the persistent severe deficiencies in the democratic structure and legislative procedures of the Union. They affect the Constitution as a whole and undermine its ability to serve as a stable legal basis for the European Social Model. The most important of these deficiencies is the fact that the European Parliament, different from any other parliament in democratic societies, has still no right to initiate legislative acts of the Union. It can only request from the Commission to make proposals for such acts. The Commission is not obliged to fulfil such requests (although it must give reasons for not doing so, Art.III-332) and if such proposals are not submitted legislation is not possible. Another point is that, although the number of areas, in which the EP has a say in the legislative process of the EU has been more than doubled, central areas like taxation and workers rights and interests remain outside the reach of the Parliament. To these the Convention newly has added the removal of parliamentary participation and intervention in trade negotiations (Art.III-315), although the EP has maintained the right to reject the results. This is particularly problematic with regard to the ongoing negotiations about the envisaged comprehensive liberalisation of the markets for services in the framework of GATS. It is also not true that the election of the president of the Commission by the Parliament from 2009 onwards is a big democratic progress, because the Commission can only confirm or reject the candidate whom the European Council proposes. Finally, it is an outright retrogression that the heads of states introduced some last minute changes to the declarations and "explanations" attached to the text of the Constitution to the effect that essential social rights in the "Charter of Fundamental Rights of the Union" are in fact taken back and downsized to the national level. For instance, in Art. II-88 in the Charter it is laid down that workers have the right "to negotiate and conclude collective agreements at the appropriate levels and, in cases of conflicts of interest, to take collective action to defend their interests, including strike action". In the corresponding "explanations" it is explained: "The modalities and limits for the exercise of collective action, including strike action, come under national law and practices, including the question of whether it may be carried out in parallel in several member states". From the Charter one could expect a Union-wide right to strike action, in the explanations – which were only in the last minute attached as a genuine part of the constitutional text and "shall be given due regard by the courts of the Union and the Member States" (Art. II-112) - this is clearly rejected.

Biased and counterproductive: The rules for economic and social policies

With regard to the provisions for economic and social policy of the Union in part III of the Constitution we criticize that the current neo-liberal course of economic and social policy is transformed into a constitutional imperative. This precludes in practice any change of orientation. It is our belief that the current economic and social policy is wrong and has led the EU on a path of low growth, high unemployment and increasing inequality. But even if we did not have this strong critique we think that economic and social policies should be open to scientific and political debate and to changes of orientation if the results of critique and debate and new political majorities underpin such changes. This has happened before and the door for further changes should not be shut and locked. But this is exactly what the Convention has done. It has simply not taken notice of the fact that empirical evidence during the last 10 years did not confirm the theoretical approach to economic policy which underlay the Treaties of Maastricht and Amsterdam. It has also ignored the broad discussion about and the critique of the neo-liberal policy agenda. If it had taken notice of both it should have been more cautious in its prescriptions and more open to new knowledge and policy recommendations. That it has not done so makes it extremely difficult, and for all practical purposes impossible to change the orientation of economic policy again as it has been changed in the past. It seems that policy makers have taken the opportunity to protect themselves from the consequences of theoretical critique and refutations and from the political consequences of growing unemployment and inequality by freezing the neo-liberal agenda into the Constitution and thus making it practically invulnerable. This is not only a deeply unscientific attitude but also an undemocratic procedure. From this critique we draw the conclusion that a Constitution should be more open than the present one. It should contain and anchor the basic values, objectives and institutions of the European Social Model and leave detailed rules and procedures about their working – for instance procedures of monitoring and sanction of excessive deficits - to European laws and regulations on this basis.

Our main more specific points of critique of the economic and social policy orientation of the Constitution are the following:

Competition as the overarching principle of the economy. The Constitution maintains the general theoretical framework of neoclassical welfare economics according to which comprehensive property rights, open and free markets and stable prices are necessary and sufficient conditions for general economic and social welfare. Market and competition are the comprehensive framework for economic development. In this the Constitution repeats the nonsensical formulations of the Treaties when it imposes “the principle of an open market economy with free competition favouring an efficient allocation of resources…” in transforming a hypothesis (based on a stack of controversial assumptions) into a legal obligation. Exceptions to the rule of competition are permitted, but only under certain narrowly defined circumstances and they must be tightly monitored with regard to their lasting necessity. The theoretical and historical complement and counterpart to the competition driven market economy, a public sector under democratic political control is completely banned from the text of the Treaties and the Constitution. Public services, a concept central in the tradition of many member states is mutilated into "services of general economic interest" in the Treaties and this formulation is repeated in the Constitution (III-122). The discussion which has during the last years started about the necessity and functions of a democratic public sector as a necessary pillar for good economic performance and social cohesion and welfare for all has not found its reflection in a more open perspective in the Constitution. Instead, the new provision of article III-122 demonstrates again the priority of competition rules as the overarching principles and by invoking art. III-166 and III-167 gives services of general economic interests only a narrow room for manoeuvre. This asymmetry is completely in line with the Commissions activities which put most of its thrust on the completion of the single market and particularly on creating a single market for services and are on the other hand very reluctant in taking measures to stabilize and strengthen services of general interest. The Convention has adopted the neo-liberal view that democracy ends where economic undertakings begin.

Ruinous competition and social dumping. Although the number of unanimity requirements for Council decisions have been considerably diminished they remain in areas which are essential for the economic and social development of the union, namely taxes, free movements of persons and the rights and interests of workers. The lack of a framework of common regulations in these areas will give rise to ruinous competition and social dumping. Tax competition which has started years before and is exacerbated after the accession of the new members undermines the financial basis for a policy for sustainable growth, full employment and social welfare on the member state as well as on the European level. Low wage- and social benefit-competition not only work against the value of solidarity which is frequently invoked in part I and II of the Constitution. They also reduce private consumption as the most important component of aggregate demand and make economic growth dependent on ever growing current account surpluses, which are very difficult to sustain. Therefore it would be desirable to take measures on a European level against excessive tax competition and social dumping by adopting certain minimum standards for taxation, work conditions, minimum wages and social security. These standards should not be determined by the Constitution but by European law. If for such a law unanimity is required – as is the case in the Constitution (art. III-210) - it is very doubtful that it will ever be adopted and the standards be realised. The alternative perspective that a certain number of member states introduces such minimum standards in a framework of "enhanced cooperation" could offer a way out of such deadlock but would generate new problems of divisions within the EU.

Macroeconomic policy against growth and full employment. The provisions in part III of the Constitution about economic and monetary policy do not take account of the progressive formulations in part I and fail to transform these into correspondingly progressive concretisations. In spite of more than a decade of experience with the harmful consequences for growth and employment of an overly restrictive monetary and fiscal policy the Constitution maintains the narrow and detailed rules of the Maastricht and Amsterdam Treaties and gives them the status of constitutional imperatives.

- Although it cannot be and is not denied that *monetary policy* does have an impact on growth and employment, the Constitution sticks to the prescription that European monetary policy should not seek cooperation, co-ordination and where necessary compromise between the various macroeconomic objectives growth, employment and price stability but should regard the latter as the overarching goal to which all other objectives must be subordinated. Support for the general economic policy of the Union is made conditional on the maintenance of price stability. Price stability is certainly a desirable goal for economic policy, but so are stability of employment (at high levels), sustainable development and social welfare. If all objectives cannot be fully attained, economic policy must make compromises and determine priorities to follow. This requires cooperation and democratic discussion and decision procedures. The rules for monetary policy prevent such coordination in assigning a constitutional priority to price stability. This asymmetry is underpinned by the provision that the ECB acts in complete independence and no European institution (including the EP) or member state government should try to exert any influence upon its policy. This is counterproductive and undemocratic.

- The rules for *fiscal policy* in the Constitution are confined to the prescription that member states must avoid excessive public deficits, which are defined in the corresponding protocol as deficits beyond 3% of GDP. This rule, which goes back to the Treaty of Maastricht of 1992 and was 1997 reinforced by the Stability and Growth Pact (SGP) (and made more severe by moving to a requirement for balanced budget over the business cycle and a maximum 3 per cent deficit limit) has also had harmful effects on the development of the European economy in the past decade. The fact that it was broken by an increasing number of member countries during the last years has triggered a discussion about the necessity to reform the SGP and to replace it by more flexible and growth promoting regulations. However, if the deficit rules of the Treaties are carried over to the Constitution this leaves no room for assigning a broader range of tasks to fiscal policies. Such an approach should regard public budgets as an important instrument to promote economic activity, employment and welfare; the yardstick for sound public finance should be the performance with regard to these objectives instead of the balance of the budget. A reform of the SGP should enforce stronger fiscal policy coordination in the positive sense of joint activities for the provision of European public goods, economic stabilisation and social cohesion. The formulations in the Constitution are an obstacle to such necessary reforms.

- A further counterproductive element with regard to public finance is the provision (in Art. I-53,2) that the *European budget* must not incur any deficit at all (not only avoid "excessive" deficits, as for member states). This rule, too, excludes financial flexibility of the EU which is however necessary to create the power and credibility of the Union to act as the representative of the European people.

No effective European tools to promote employment. Compared to these strong restrictive rules on monetary and fiscal policies the provisions on *employment* – which were only introduced in the Treaty of Amsterdam against strong resistance of several member states – remain extraordinarily weak and confined to labour market policies. Although these have some effects for particular groups of unemployed, they cannot stimulate employment on a macroeconomic scale. The Convention has missed the opportunity to correct the obvious asymmetry in European objectives and in European tools in the area of employment. Full employment, which is mentioned in part I (Art. I-3) as an objective of the Union, does not play any role in part III when it comes to implementation and instruments (and is not even mentioned except in article I-3). Here the role of the Union is very weak. Although it is said that "the union and the member states work towards developing a coordinated strategy for employment" the Union's contribution to this central pillar of the European Social Model is confined to continuous monitoring, facilitating, supporting and complementing, "where necessary" the cooperation amongst member states and the formulation of annual (non-binding) guidelines for employment policies of the member states. These guidelines are subordinated to and must be in compliance with the "Broad Economic Policy Guidelines", the central thrust of which is to create open markets and to pursue balanced public budgets. Although the regular and broad employment reports and the discussions on employment on the European level have improved the level of information and developed a certain dynamic of their own, the EU has no tools to pursue an active employment policy. There are no resources from the EU budget assigned to the employment objective, and the employment committee (Art. III-208) is (different from the committee of the regions) not even mentioned in the list of institutions of the EU in part I of the Constitution. The Convention has missed the opportunity to correct the enormous bias in the Treaty in favour of price stability and to establish full employment in the Constitution as an equally important pillar and to provide the Union with powerful tools to avoid "excessive unemployment".

Very weak power to promote enhanced social welfare in the Union. The chapter on social policy stands under the "need to maintain the competitiveness of the Union economy". It is different from the chapter on employment in that it opens the possibility for the adoption of certain laws or framework laws which not only "encourage" cooperation between member states but also "establish minimum requirements for gradual implementation, having regard to the conditions and technical rules obtaining in each of the member states." However, the formulations also contain a number of caveats which make it very difficult to adopt rules which will really have a positive effect on the people. In addition, in important fields of social policy – social security and protection of workers, especially where their employment contract is terminated, representation, collective defence and participation and work conditions for third country nationals – unanimity voting is required, and the two essential areas of welfare policy – the combating of social exclusion and the modernisation of social protection systems - are completely excluded from binding European regulations.

As a conclusion of this short review it must be stated that the present Constitution is very insufficient. It is no productive contribution and in some respects even an obstacle to the development of a European Social Model.

To: **European Economists for an Alternative Economic Policy in Europe**

Declaration of support

I support the general direction and main arguments and proposals in the EuroMemorandum 2004: **“Beyond Lisbon. Economic and social policy orientations and constitutional cornerstones for the European Social Model”**

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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 3rd December 2004** - by fax –or e-mail to: Prof. Dr. Jörg Huffschmid, fax: +49-421-218-4597, e-mail: Huffschmid@ewig.uni-bremen.de or Jacqueline Runje, fax: +49-421-218-4597, e-mail: jrunje@ewig.uni-bremen.de .