European Economists for an Alternative Economic Policy in Europe

Economic Policy against Recession and Polarisation in Europe !

Proposals to overcome ideological sterility and policy blockades

Introduction:

A new period of risk and uncertainty: The need for action and democracy

The current social and economic situation in Europe is marked by growing instability and insecurity and by the beginning of an economic recession, the depth and duration of which are still unknown. Unemployment is rising again The threats and risks inherent in recent developments have been enhanced by the shock of the attacks of September 11 in the USA, but they were present and visible well before those events.

One of the striking and most worrying features in this situation is the complete lack of an appropriate political response from the side of the EU. Both the Commission and the Council, widely known as very strong proponents of flexibility, adjustment and creativity among the European people have come out as astonishing examples of intellectual narrow-mindedness, political fundamentalism and practical immobility. An outstanding example of this rigidity is the “Broad Economic Policy Guidelines for the Member States and the Community” (BEPG) for 2001, adopted in June 2001 as, supposedly, the leading economic policy document of the EU.

Beyond the absence of any political reaction to the current threat of instability and recession, the EU continues to pursue its medium-term strategic objectives: on the one hand the “modernisation” of the European welfare state by replacing unconditional social rights with “activating” social incentives and sanctions, and on the other hand the establishment of a deregulated and liberalised European financial market without social objectives or social control. Thus the historical project for European unity tends to become more and more a project for the greater freedom and benefit of capital at the same time as less welfare for, and more constraints on, the people of Europe.

These developments, and the almost complete absence of public discussion and democratic participation in the decision-taking process have recently met with growing criticism and resistance from an increasing number of people, groups and social movements. They criticise the subordination of welfare and democracy to the regime of financial markets for which there is allegedly no alternative. Arguments against this increasingly neo-liberal orientation in the EU and proposals for alternative policies, although persistently and obstinately rejected by most governments and by the European authorities, are gaining ground in public discussions. It is the purpose of this short memorandum to help further clarify the critique of existing policies and the proposals for alternatives in Europe. We see this as a contribution from one part of the social movements for more democracy, full employment and social welfare in Europe.

1. From slowdown to recession - The need for intervention

In the second half of 2001 the EU faces the risk that the incipient recession could deteriorate into a full economic crisis if no energetic counter-action is taken. However, so far neither the European authorities nor, in most cases, national governments have envisaged an appropriate response. Contrary to official assertions, immediate and efficient steps to counter the recession are both necessary and possible; they should be followed by thorough medium-term economic policy reforms in order to achieve full employment in the context of steady and sustainable economic development.

A marked economic slowdown. The current slowdown started well before the tragic events of 11 September. It began before the relatively strong recovery of the years 1998 and 1999 had been able to repair the severe damage done to the European economy by the transition to the euro under the Maastricht rules. There are many reasons for the slowdown, and most of them are home-made. The growth of private consumption, which had played a clearly positive role during the recovery, weakened as a result of an inadequate increase in wages. The rise of oil prices has also resulted in a reduction of domestic incomes. The lack of momentum in productive investment even during the upswing, has had a braking effect on the demand side and has blocked the development of the supply side by limiting potential output - this is a characteristic difference between European and the American developments. Instability and then collapse in stock markets have further exacerbated the lack of investment. And lastly, foreign trade, the strength of which had supported growth in Europe except for the years of the Asian crisis, has been hit by a fall in exports since the end of 2000. The world-wide slowdown has had an increasing effect on Europe, and this will become even more accentuated in the future: recession in the USA will aggravate simultaneous weakness of economic activity in all major parts of the world economy.

In this context a new decline in employment appears inevitable after the sometimes remarkable level of job creation in certain countries. Unemployment has begun to rise again in many countries, particularly Germany since the beginning of 2001 and France since the summer. Inequality of incomes and regional disparities which had remained high and, in certain cases, even widened during the upswing, will very probably rise to unprecedented levels.

Finally, although there exists a certain convergence in the cyclical movements of different European countries, national peculiarities remain which must not be neglected. The recovery was more limited and less persistent in Italy and Germany, countries more sensitive to the international conjuncture. On the other hand it was particularly strong in certain smaller countries such as Ireland. The persistence of asymmetric patterns of development should not be a surprise and it is not an element of weakness, quite the opposite. But it makes the management of a joint economic policy at Community level much more complicated. So far the EU has failed to meet this challenge.

A counterproductive economic policy. The economic policies of recent years at both national and European levels have failed to grasp the opportunities opened up by the positive developments of the late 1990s and are incapable of facing the challenge of the present slowdown. This is best illustrated by this year's BEPG: Although the economic situation has deteriorated severely since 2000 the BEPG have remained practically unchanged from those of the previous year. They assert as before that the European economy "has entered a virtuous circle of growth firmly rooted in domestic demand" and that the existing economic policies (reduction of public deficits, wage moderation, flexibilisation of the labour market, deregulation and liberalisation) should be continued. Such an approach, more a caricature than a serious analysis, is unacceptable for various reasons.

Firstly: The prospective slowdown was clearly visible from the beginning of this year. Although, with the advent of the euro, the European economy became less dependent on developments abroad, there remain very significant transmission channels from the international environment. There is still a significant, direct and indirect, trade dependency with regard to the USA, and there is also a strong impact through financial markets as a result of financial globalisation. In this context, it comes close to absurdity to go on recommending even more restrictive budgetary policies in order to “counter demand-side pressures” and to plead for further wage moderation.

Secondly and even more seriously: the current institutional arrangements of the EU and the sacrosanct principle of ECB independence have the weird effect that not a single word on monetary policy is to be found in the BEPG. Monetary policy is simply not regarded as part of economic policy, and the policy of the ECB is completely left out of the picture, although it has an enormous impact on the European economy. Last year’s development is one more illustration of this deeply unsustainable state of affairs: Although the slowdown had already begun in Europe too, the ECB, obsessed by its inflation target of 2% and by its desire to achieve credibility in eyes of financial markets, raised its key interest rate six times and thus contributed to a further decline of investment. The weakness of economic activity was reinforced and the potential for development further reduced. This is the decisive factor in ECB monetary policy. By being too restrictive from the very beginning of any expansion it limits further investment and, in doing so, disregards the fact that a continuing accumulation of capital leads to larger productive capacities which reduce the risks of future inflation. The ECB's conception of credibility, based on a simplistic understanding of inflation and market expectations, is too narrow.

Thirdly, monetary policy is not the only policy at fault. The majority of national governments were unable to benefit from the recovery, particularly in 1998-1999. They failed to organise a budgetary adjustment process “from above” either by implementing co-ordinated common projects at EU-level or by refraining from fiscal competition - instead they locked themselves up in restrictive fiscal policies at the level of each individual country. A joint co-operative effort could have made room for more rapid development, particularly in the less dynamic countries, and it would have generated additional revenues and thus contributed to deficit reductions.

It is hard to conceive of a less productive or more harmful policy-mix than to fetter national budgetary policies to the Stability and Growth Pact and at the same time to impose an unnecessarily restrictive monetary policy.

The year 2001 gives further illustration of the paralysis of European economic policy, which stands in sharp contrast to the strong responses of the USA. Facing a cyclical downturn the Fed has lowered its interest rate ten times since the beginning of the year - in order to limit the impact of the slowdown and the corresponding adjustments in financial markets. This rapid loosening of monetary policy - in spite of a rate of inflation above 3% - has not done any harm to the credibility of the Fed, because the latter has the double objective of keeping inflation low (without a maximum threshold being defined) and preserving growth and full employment. Things are quite different with the ECB: On the one hand the 2% upper limit for inflation is unnecessarily restrictive and was breached as a result of the rise first in oil and then in food prices. On the other hand there is no objective for growth or for employment, not to speak of full employment. Relaxations by the ECB (reductions of 0.25 per cent in interest rates in May and in August and of 0.5 per cent in September and November) have come too late and have been too small to have any decisive effect on the economy. The ECB has dug in behind its endlessly reiterated demands for continuous budgetary restrictions and its mistaken view that a major downturn in the USA would only have a limited impact on the European economy, which is seen as a relatively closed economy. These positions, which are the essence of the BEPG 2001, were already untenable by the early summer of this year.

The shock of 11 September has made the situation much more critical and it has illustrated dramatically the enormous difference between Europe and the USA in their capacity to react. The US has very rapidly and forcefully responded with a large budgetary package of the order of 2% of GNP, in which a comprehensive range of measures is included: help for the victims, reconstruction support, subsidies for air lines, broader tax cuts for households and enterprises, as well as increases in military expenditure, although the last of these must be criticised for political reasons.. In contrast to this rapid reaction, European governments have remained without any answers, pointing to the limited room for budgetary manoeuvre in many countries, particularly the larger ones, and arguing that the economic situation in Europe was less critical than that in the USA. Even the reassuring declaration that the automatic stabilisers should play their role was accompanied by the contradictory statement that this would only be tolerated if the provisions of the Stability Pact permitted. The only exception to this disastrous picture of political abdication was the participation of the ECB in the concerted response by central banks in September, which provided a necessary increase in liquidity and at the same time lowered euro interest rates by 0.5%. The reduction in November obviously had as its purpose the maintenance of the differential between US and EU interest rates. In view of the start of recession in the EU it should and could have been stronger.

The need for a European recovery initiative. In the current context of increasing risks and obvious economic deterioration economic policy needs to be thoroughly re-oriented, so that it makes full employment its central objective and takes monetary and fiscal policies as tools to achieve this goal. In the short term, immediate measures are necessary and possible to stimulate economic activity and employment. But more ambitious medium-term reforms are also required to avoid the European economies ending up with inadequate rates of development and with more unemployment and exclusion. It is also necessary to deal with the inadequate levels of both democracy and efficiency which characterise the conception and implementation of macroeconomic policy at the European level.

In a ***short-term*** perspective a co-ordinated action in terms of national budgets should stimulate demand and prevent an aggravation of the recession which is beginning now. This plan for recovery would be formulated around various projects according to specific national priorities: public investment in transport infrastructure (e.g. TGV and rail tracks) and telecommunications, housing and social infrastructure in suburbs, environmental protection, renewable energies, expansion of public services in education, health and neighbourhood services. With regard to the coming enlargement there is also urgent need for additional infrastructure expenditure in the border regions of the EU and the future new member countries. On the other hand the policies of tax relief for corporate profits and capital income should be stopped in order to halt tax competition. Additional finance could be generated by joint issuance of securities on the European level, the proceeds of which should go mostly to the member countries, which would be the beginning of a market for European public debt. The total volume of such measures should be in the order of 1% of European GNP. Monetary policy should contribute to the stimulation of economic activity by a more determined reduction of interest rates.

In a ***medium-term perspective*** more profound reforms appear indispensable in order to really place full employment in a sustainable way at the heart of economic policy. Only some brief indications are given here, while more comprehensive conceptual developments can be found in our previous memoranda:

- the ***mission of the ECB*** should be reformulated so that it is not exclusively focused on price stability but also includes a target for growth and full employment following the model of the Fed. The problem of the absence of any democratic control is difficult to resolve, because there is no supranational economic policy authority with a clearly established legitimacy. But it is possible to enhance the responsibility of the ECB to the European Parliament and to the Council and to broaden and intensify the dialogue with the national political authorities, while the ECB should maintain its independence in day-to-day activities.

- The ***co-ordination between monetary policy and national fiscal policies*** should be made more effective. With much higher status the Euro-group would become the main interlocutor for the ECB with regard to the conduct of monetary policy. If the principle of the BEPG, that governments should formulate their strategic choices and build them into multi-annual programmes for public finances, is to be of any use then their very narrow content has to be overcome. Monetary policy should be explicitly included and the effects of policies conducted by other countries should be taken into account so that the gains which can be attained by co-ordinated action are better analysed.

- The extreme complexity of the problems which must be resolved, however, means that progress in these areas will remain relatively limited. There can be no sustainable solution without the creation of a ***federal budget*** which provides on the one hand tools for stabilisation or recovery on a European level in the case of common shocks (this is the situation at present in the USA) and on the other hand tools for interregional redistribution in order to cope with asymmetries. In view of the existing deep reluctance to expand the EU budget only a moderate increase - by 0,9 percentage point per year up to a level of about 5% of European GNP by 2006 - can be envisaged. But even this limited expansion would represent a break-through, given the present blockade. It could be based on a reform of own resources and on the introduction of new taxes at the European level. This would also be a good response to other urgent problems: to counter tax competition a tax on incomes from savings and on corporate profits would help: financial instability could be mitigated with a Tobin tax, and a tax on energy consumption (except for renewable energies) would help to protect the environment. With these additional resources new expenditure could be financed, for example a European fund for employment stabilisation (of the order of 1% of European GNP to be transferred to countries affected by an above average increase in unemployment), or the extension of the European structural funds and of the financial measures envisaged for the eastern enlargement and co-operation with Mediterranean countries, a strengthening of research and innovation policies etc.

2. The welfare state under attack - The need for defence and reinforcement

The development of a Welfare State in which the social security system provided extensive coverage of the population was perhaps the major advance in social organisation in European economies during the second half of the 20th century. Since the last decade of the 20th century this welfare state has come under attack and it now faces some major challenges and pressures.

The formation of the single European market with free movement of labour between member countries is one such challenge. Each country has developed a different form of the welfare state, though there are often considerable similarities between countries. A number of distinct models have been identified which vary in terms of the degree of inclusiveness and the balance between social insurance and social assistance. These differences in tradition and approach to the welfare state cannot and should not be swept away. But it is also becoming urgent to ensure that there is an effective welfare system covering the whole of the European Union. This requires measures to build on the interchangeability of rights to welfare provision between member countries. The single market and the increased mobility of labour across national frontiers must be complemented by changes in the operation of national social security systems. Agreements over minimum levels of social protection at the EU level are becoming necessary to prevent social dumping to avoid a “race to the bottom” in national welfare systems.

Another challenge for the European welfare state is the tendency towards a more authoritarian system of social benefits often covered by the title of an “activating” welfare state according to the American model. This approach suggests that the reasons for unemployment are not primarily the lack of jobs but the lack of willingness and flexibility of the unemployed to accept existing job offers and that therefore increased pressure on the unemployed will help to increase employment. This workfare approach will inevitably lead - and where it was applied has very visibly led - to a sharp deterioration of working conditions in terms of wages, working time, social protection and workers' rights. It undermines the social content of the welfare state. The same activation approach is applied with regard to older people: Early retirement - often a good thing for the elderly as well as for the unemployed who could follow them in the job - is increasingly blocked by reductions of pensions, thus pressuring older workers into agreeing to stay longer in their jobs.

Competition between nations to reduce taxes and social security contributions also contributes to the erosion of the welfare state. A reduction in social security contributions by enterprises may appear to make the cost of labour cheaper and to encourage inward foreign direct investment. But this overlooks the question of who bears the cost of such contributions and what the costs of alternative provision would be. There are clear dangers that such competition will lead to an all round deterioration of public services and welfare state provision.

The ageing of the population in most EU countries will generate a need to transfer more resources than before from the working population to those who are retired. This has been presented as a critical problem for the welfare state when it seeks to raise tax and social security revenues to pay for increased retirement pension bills. It is then further argued that private pension arrangements should be encouraged and expanded to overcome these problems. This is a false analysis. A rise in the retired population relative to the working population requires more resources to be transferred from the working to the retired population, however that transfer is undertaken. Privatised pension arrangements may mask the transfer which is taking place, but does not alter the underlying situation. The recent declines in most stock markets serve as a reminder of the unreliable nature of privatised pension provision. Those relying on high returns from the stock market to underpin their retirement pension (whether directly through their own savings or, more usually, through payments into pension funds) are now finding that the promised level of private pensions will not be available. The reality of the transfer of resources from the working to the retired population cannot be avoided by any pension scheme. A comprehensive public pension system can ensure that a decent pension is paid to all citizens. It can and should ensure that those who have been outside the labour market for some of their time (as parents, as disabled, for the purpose of training etc.) can still receive a decent pension. Privatised pension schemes cannot achieve that, and they involve considerable administrative and marketing costs which make them less efficient than public schemes.

The European economies are marred by unacceptable and often growing inequalities and disparities. Most affected by this social discrimination are women, older people, ethnic minorities and children This last age group, in particular, has in recent years been exposed to an increasing risk of poverty, the enduring effects of which - in terms of life-long social and labour market exclusion - have not yet been fully evaluated. The current pressures on the welfare state tend to sharpen these disparities and increase already existing inequalities. Growing inequalities can further undermine the welfare state as the more affluent seek to withdraw from it and thus undermine its financial basis. These risks of a downward spiral give us good reason to defend a strong welfare state and to develop it so as to achieve more equality and guarantee minimum acceptable standards of living.

Immediate issues in the defence of the welfare state should include

- ***resistance against further privatisation of social security systems*** (particularly pensions and health) and public services such as education, transportation and public utilities. These areas of social well being must not be subordinated to the logic and risks of markets and to the priority for profit. They should remain a safe and reliable basis of welfare for all people;
- the ***rejection of workfare*** and other authoritarian schemes with regard to the unemployed; employment policy should instead be based on an expansionary macroeconomic strategy and on the development of attractive work opportunities. The concept of full employment, which the EU has – since the summit of Lisbon in March 2000 - declared to be one of its major goals refers not only to a sufficient number of jobs but also to freedom of choice and decent working conditions including decent wages.
- the introduction of ***minimum wages*** and agreed and co-ordinated provisions to prevent wage dumping.

In a ***medium-term perspective*** the EU should formulate and implement a ***comprehensive set of minimum standards for a European welfare system***, which takes national differences and peculiarities into account but at the same time prevents a competitive “race to the bottom” among member states. Minimum standards should - as we explained in more detail in our previous memorandum - firstly refer to a minimum share of GNP, which member countries dedicate to the maintenance and strengthening of the welfare system, without specifying a specific allocation of these funds. But secondly minimum standards should be defined for each area of social provision.

The ***long-term objective*** in strengthening the European welfare state is a European social constitution which gives every person living in the EU the unconditional right to those levels of income, social protection and welfare which are necessary to lead an independent and dignified life. There must be also a right to democratic participation in social life, which is equally necessary to individual independence and dignity.

In this context the problems arising from the increasing globalisation of the labour market deserve special attention. 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. To reconcile the interests of European workers and those in developing countries a policy of co-operation is necessary to plan both the flows of immigrants – so that they can find regular jobs without discrimination – and development paths, which the EU must strongly support.

Although the welfare state can and must help to alleviate the pain of unemployment, it cannot itself establish full employment. It must be supported by a wide range of other measures including macroeconomic, regional and industrial policies designed to reduce and eliminate unemployment.

3. Threats from deregulated finance: The need for social control

Financial developments are taking place in Europe and beyond which pose real dangers for European economies and societies. The lack of a clear and coherent political response is aggravating these dangers.

Within the EU monetary integration has significantly accelerated the process of financial integration. At the same time, under global pressures, the structure of finance is changing rapidly. Patterns of intermediation are changing - asset markets are playing a larger role in the allocation of financial resources; the strong banks and insider investors, closely tied to their industrial clients, which in the past dominated many national financial systems are facing competitive challenges and have to operate in a much less stable environment.

The economic response of the EU is clear. It is trying to accelerate these changes by identifying and removing all those institutional factors which could obstruct the free flow of money and credit in these new circumstances. The Lamfalussy Report is central to this agenda, but other areas of policy, such as the rules governing take-overs, are also involved. Thus, whereas European financial integration at the time of the Single Act concerned, above all, banking, the new agenda is centred on securities markets - markets for debt, equity and their derivatives.

The specific objectives of the European Commission and the European Council amount to a complete, and completely uncritical, Americanisation of European financial systems. Supposed strengths of the US system, such as its large market for venture capital or the low level of transactions costs in many markets, are emphasised. The weaknesses of that system - notably its instability and its adverse impact on the distribution of income and wealth - are never mentioned.

The bursting of the equity bubble has made very clear the many dangers linked to the substitution of competitive asset markets for the "relational" finance of the past. These include:

- macroeconomic instabilities as both consumption and productive investment are increasingly tied to highly volatile valuations of equity;
- very high levels of income insecurity for workers who become dependent on capital market assets for their pensions and their insurance entitlements;
- increased job insecurity for employees whose enterprises must conform to the requirements of "shareholder value".

In addition, there are very clear political dangers for the European project in the present approach to European financial integration. The commitment of political leaderships in the EU to a rapid growth of asset markets is not matched by a corresponding concern for the impact of this growth on social conditions in member countries. The consequence is to exacerbate the imbalance between economic and social objectives which is already, in the view of many commentators, undermining the democratic legitimacy of EU institutions and methods of decision-making.

The refusal of the European Parliament to endorse the Take-over Directive is evidence of - and a first modest step of resistance against - these political dangers, because it rejected the straightforward transfer of the "market for corporate control" which is an essential element of US financial mechanisms, to the EU. The Commission and the Council seemed to aim at establishing such a market on an EU-wide basis, with quite inadequate consideration of its social effects. The Commission asserted that the disposal of securities by the shareholders of a targeted company "concerned no one but themselves." This view is as illogical as it is cynical: when it is control over an employing enterprise which is being traded, how can the transaction not concern the employees, the local community and the other stakeholders of the enterprise in question?

We are not opposed in principle to a certain consolidation of European financial systems, which could even strengthen the autonomy and collective power of initiative of Europe within the global economy. But the consolidation which is necessary must proceed in parallel with a reinforcement and consolidation of the European social models, not in conflict with them, if it is to express a genuinely democratic European project.

In different ways, all the European social models have attempted to modify the employment relation to meet democratic objectives and to establish income security for retired workers on a socialised basis. These efforts are now threatened by the financial integration programme which is being developed by the Council and the Commission.

New finance and pensions. A major shift from public and collective to private pension provision is clearly intended by the Commission in its strategy for financial market integration. The supposed "unsustainability" of present arrangements is repeated and it is suggested that future pensioners would be among the main beneficiaries of integrated equity markets. We want to reiterate our view expressed above that an essentially financial approach to pension provision is misconceived: the problem should be addressed in the first instance as a question of *resources*, that is, of labour and production; if increased resource flows to retired citizens are not secured then there is no purely financial reform which can guarantee socially adequate pensions; if, on the other hand, resources are made available through higher levels of employment and economic activity, then the very pessimistic assessments which are being made of current systems are no longer applicable.
British experience makes very clear the dangers of current projects for pension reform. The drastic decline in public provision since the early eighties (when Britain's universal state pension was frozen in real terms) has led to a big increase in poverty among pensioners. Access to private pensions is distributed in a highly unequal way; this is only to be expected since it is well known that the ownership of financial wealth, including private pension entitlements, is extremely unequal. Even among those with some private provision, there have been serious difficulties, related both to the failure or misbehaviour of individual financial institutions and to the general fluctuations in financial markets. Yet it is just the British experience which is being taken as a model by the governments of other European countries anxious to develop their bourses and to rein back public expenditures. This is a pattern of integration which jeopardises social achievements across Europe and threatens to place quite unbearable risks on the most vulnerable citizens. Only a complete change in priorities, a subordination of economic policy measures to social objectives, can avert these dangers.

New finance and industrial relations. In many European countries also social objectives have in the past been supported by a particular constitution of business enterprises. It has often been possible to see the enterprise as a coalition of interests, within which workers, consumers, supplying enterprises, local communities and public authorities were all included and where all these stakeholders had some say in the formulation of company strategies - even though the dominant influence remained with capital. The co-determination system in Germany, for example, can be seen as a set of institutions which give employees a certain influence over the broad strategies of the larger companies. Provisions for the information and consultation of employees, both at national and at EU level, derive their democratic significance from the possibility of such influence.

Current trends in equity markets and in corporate governance represent a serious challenge to these achievements. They work to replace existing elements of industrial democracy and social control over enterprises with a shareholder autocracy, where the only measures of business success are dividends and equity prices. One aspect of this development is an increase in job insecurity as new patterns of corporate restructuring place much higher levels of risk on individual companies. More generally, the social coalitions which have exercised a measure of control over company strategy are being narrowed as the weaker parties within them are subjected to direct market disciplines and as shareholder interests become almost totally exclusive. At the same time, rewards become more unequal as stronger or more privileged groups have their incomes geared to profit indicators while weaker groups are pushed towards the reservation wages they could obtain elsewhere.

Such changes in corporate governance are a clear threat to European social models. Yet, like the retreat from public pension provision, they are a logical consequence of the integration strategy which is being pushed through by EU leaderships. In all three spheres which have been mentioned - social protection, industrial relations and macroeconomic policy, current strategies can only diminish Europe's ability to define its own social and economic future and further subordinate European development to the global hegemony of US finance.

Democratic control of financial markets. New democratic movements, now active throughout the EU and beyond, are posing a direct political challenge to the hegemony of the deregulated, globalised US financial system. We consider these movements (of which the association ATTAC is the best known and a leading example), to be of great importance for the political and economic development of the EU. Arising out of concerns and debates in many countries a coherent argument is being advanced for a reassertion of democratic control over the power of financial systems, and a broad mobilisation of citizens and their organisations is taking place. It becomes increasingly evident that some mechanism to regulate international capital flows is a basic requirement to prevent the destabilisation of international finance and financial crisis, the consequences of which reach far beyond the area of finance. We believe that it is incumbent on national governments and the EU authorities (including the ECB) to enter into a genuine dialogue with these movements and to search for effective measures to protect the social achievements of the past as well as to promote further progress towards social justice and security. For this purpose banks, dealers and other intermediaries in the financial area should be under strict rules of openness, fairness and supervision, including stricter collateral requirements and higher barriers against short-term speculation.

An important demand of these movements and many of their allies is the introduction of a ***Tobin Tax***. There is a wide range of views (among the European Economists for an Alternative Policy as elsewhere) on the merits of this proposal. The advocates of a Tobin Tax see it as one instrument among many others which should be deployed to safeguard economic stability and to redistribute wealth and income on an international scale. Although some technical problems must be solved in the implementation, in our view the Tobin Tax is both a feasible policy and one with the merit of reasserting social priorities within the international financial system. If governments and EU authorities reject this instrument they should propose others which they consider to be technically superior in meeting the same objectives; a simple dismissal of the demands of these movements, abandoning any prospect of reforming the international financial system, would lead to serious problems both in Europe's political life and in its economic development.

4. The democratic gap – The need for reform

Democratic reform is a real and extremely urgent challenge in European integration. In effect the lack of democracy in building Europe has started to become a direct political concern for citizens. This awareness comes precisely at the time when new needs are becoming more pressing - new needs for solidarity and for political interventions based on broad democratic debates and consent. This applies firstly to the need to re-orient economic policy towards the priorities of full employment, environmental sustainability and strengthening the welfare state rather than to deficit reduction and financial market requirements. It also applies to the historic issue of enlargement. Democratic reform cannot be confined to traditional forms, but must also include the development of new forms of democracy which can meet the challenges arising at all levels and all locations. It is of crucial importance for the future of Europe to develop a coherent democratic vision and a democratic project widely supported by European citizens.

Endangered species: the European social fabric. The democratic deficit is all the more worrying because member countries are facing new pressures and challenges, which threaten the welfare of their people and their social cohesion. These pressures make concerted action necessary in many fields. The constraints set on public spending, the general ideology that welfare expenditures should be reduced, the inability to think of strong, democratic and efficient welfare systems both as means of social cohesion and as an economic leverage - all these factors have seriously degraded welfare and have accumulated into serious threats to the social fabric of the EU. One of the most alarming indicators of these threats is the rise in inequalities - both among wage earners and between regions or generations - which was already a significant trend in the last two decades while economies were still growing. These inequalities are now occurring in a new context - for the unqualified, for those who have not yet entered the labour market and for those living in depressed areas, especially derelict urban areas. The new disparities in income and employment that are developing within our populations are neither being well identified nor responded to in an effective way. The result of this is a major risk that the inequalities will accumulate. Outbursts of violence among some of the youth in the poor quarters of large and small cities indicate the frustration and anger which has been developing. The routine social and political measures which were taken in response have been neither appropriate nor effective. Loss of welfare and increasing inequalities seriously endanger the legitimacy of the European project. It is obviously urgent to reverse this trend, to improve social cohesion and to restore the social fabric. But it should be equally obvious that in a monetary and economic union the necessary reform and reinforcement of the welfare states of member countries cannot be carried out by each country in isolation, and that they cannot succeed without the participation and effective inclusion of all the people.

A new development instead of the Stability Pact. The Stability and Growth Pact as it stands places constraints on budgetary policies regardless of the capabilities and needs of member countries. The Pact is a clear sign of the malaise in the European integration process. It obstructs the rebuilding of social cohesion in individual member countries without proposing any common or collective way out at the level of the union. To abandon this sterile and counterproductive position by replacing the repressive stability pact with a social development pact would be an important political signal and a major social and democratic advance. The reorientation could be organised in different forms and work at various speeds. National parliaments and the European Parliament, in dialogue with groups in civil society and among academics, could take initiatives to reformulate the mission of the ECB and could develop proposals for the social development pact. The new pact would centre on full employment and would involve setting guidelines for social budgets and social policies. Extensive public discussion of such initiatives and proposals is essential - to give them a high degree of democratic legitimacy and to win the necessary political support for their adoption by national and European institutions.

The stresses of the present world crisis certainly help to focus these European social perspectives but the key objective is a response to widening social divides. To turn away from a repressive pact towards a new development pact aimed at stronger social welfare would be a clear sign that in a troubled world Europe is ready to assume some of its responsibilities as an organised community. The feeling that the time for such initiatives has come is widespread, as is shown by the fact that social cohesion ranks first in the agenda of the Belgian presidency, and also by the development of strong social movements against the undemocratic and unrealistic nature of existing international arrangements (seen at the Genoa events, for example, which followed similar clashes at previous international meetings).

The enlargement of Europe is part of the democratic agenda. The entry of new member countries from eastern Europe is an enormous opportunity and challenge for the Union. It is not primarily a geopolitical strategy but rather an opportunity to establish a coherent development agenda within a large economic sphere sharing many common ideas on life and welfare inherited from the long history of Europe.

The candidate countries of eastern Europe faced in the nineties the challenge of dual – political and economic – transformation. On the political level multi-party systems, parliamentary democracies and new legislation and institutions were introduced. These political systems have by now evolved and gained credibility.

Simultaneously deep structural changes were carried out aimed at the establishment of market economic relationships. The main common guiding principles of economic transition were: (a) dismantling central constraints on enterprises and setting up the legal framework for free market competition; (b) liberalisation of prices, wages and foreign trade; and (c) a broad privatisation of the enterprise and finance sectors making a fundamental change in the ownership structure of these economies. The complexity of the tasks meant that they were accomplished in several phases and characterised by a large diversity between countries as regards concepts, timing and methods of transformation. However, a deep "transition crisis" developed due to inherited structural backwardness, lack of experience, inadequate preparation and the pace and extent of the structural changes imposed on eastern European countries by western investors, creditors and governments. Output and national income fell sharply followed by a decline in the living standards of the population and accompanied by a steep increase in income inequalities. After a historical period of full employment unemployment reappeared and increased to very high levels.

During the last decade a general recovery took place and a number of countries (e.g. Poland, Hungary, Czech and Slovak Republics) achieved and exceeded their previous performance levels. But the recovery remained precarious and has had little impact on the living standards of the population. After the years of systemic change the majority of people see their hopes for rapid improvement disappointed and are now looking towards EU accession. The, as yet, still weak democratic foundations of the transition countries played a role in the emergence of many economic difficulties, while the state of their economies imposes a threat to the future of democracy. To counter this it is important to build up the appeal of Europe as a centre of creative democratic practice, and to assure the candidate countries that their integration will not be delayed and that they will be rapidly inserted into a general process of social development, which must be democratic in order to be efficient. This requires that the EU give up its present reluctance in the accession procedures, speed up the necessary institutional reforms and invest not only more resources but also more political energy in the historical process of enlargement.

The role of Europe in the democratisation of globalisation. The necessity of democratic reforms is of course not confined to Europe and the EU. It comprises a thorough restructuring of international and global economic relations. The forms which globalisation has taken over the last two decades has led to sharp inequalities throughout the world and to more poverty and misery in many countries. The strategies of European firms and the increasingly neo-liberal policies of the EU are in part responsible for this polarisation, and therefore there exists also a strong European responsibility to support reforms. Such reforms should include the full right of developing countries to decide for themselves the degree of openness of their countries to trade and capital flows They should have the guarantee that nothing in treaties about trade, services and patents and other intellectual property will obstruct the provision of public health and other public goods. Europe should play a leading role in advocating further debt relief and it should lead the way in rapidly increasing official development aid to the level of 0,7% of GNP in all member countries. Democratic reform of international institutions such as the IMF and World Bank must give developing countries greater weight and more voting power.

The democratic gap. The thorough re-orientation of economic, social and environmental policy which we are proposing can only succeed if it is actively supported by the citizens of Europe. This support is critically dependent on the degree of popular participation, on the intensity and scope of democratic debates and on the forms of action taken. We observe major deficiencies in the present state of the union in regard to these basic political requirements.
Democratic debate and control have largely been absent over the last decade. The result is a lack of momentum in European integration which can be seen in polls and in various elections where opponents of the EU are much more visible than those in favour of closer integration. In our view this is due to an increasing feeling that the whole procedure lacks democracy and that the main projects of European integration have been imposed upon the people without giving them an opportunity for relevant participation in decision-making. We observe that the populations of the member countries are much less ready than in the past to support policies without control and debate over the actions which are taken. Furthermore, as the European Union is taking over more power from member countries the process of integration seems also to be a factor in the weakening of democracy within member states, and this loss is not compensated by more democracy on the European level. At the present stage the deepening of the union appears to be associated with a retreat from democracy in each member country. This has not always been the case: in the past integration in the European community has represented for some countries a definitive access to democratic government. The development of democracy has stalled, and the lack of democracy is attracting much - in our view, justified - criticism and leading to disenchantment.

The importance of new forms of democracy. Some of the difficulties met by individual countries in addressing their social problems stem from the fact that new forms of democracy have to be developed but are not yet in place. Political life and social organisation are developing in a new context where the involvement of people has to be grounded on new practices:

a closer definition of objectives, more accountability, more deliberation on the rationale for policy measures. These practices may differ across groups, issues and places but by and large they apply generally to all collective actions. In some cases these new requirements may lead to some loosening of ties to traditional social and political organisations, in other cases they lead to a new militancy. Local, decentralised actions are gaining increased importance in this process. Although centralised co-ordination of actions is sometimes necessary it will be accepted only if central organisations for their part acknowledge the importance of local actions and local involvement. Europe has supported some regional initiatives, in particular in its regional structural policies. It therefore has an opportunity to continue in this direction, setting new perspectives, schemes and general objectives for measures of participatory democracy.

Prospects for a European development model. At the present stage of integration Europe might well be the most important level at which to relate a broad social vision to practical, co-ordinated policy measures.. New growth regimes can only develop if a broad perspective for social progress, informed by democratic practice, is made explicit. This is the urgent objective that Europe should pursue through all democratic channels. The forthcoming introduction of euro notes and coin, making the monetary union a visible reality to everyone, is an occasion which should be used to propose and initiate a broad and intense public debate on the nature of, and the prospects for, a genuinely European development model. This debate should articulate economic and social alternatives to the neo-liberal formulae of social polarisation and destabilisation. Burt it must go beyond this to propose new ideas about the forms of enhanced democracy and cultural identities. It should strongly oppose a new wave of armament and militarisation. Instead, debate should enhance Europe's contributions to restoring and preserving peace, and to co-operation and development in an increasingly polarised, unstable and therefore vulnerable world.