

European Economists for an Alternative Economic Policy in Europe

Alternative Economic Policy Guidelines for Full Employment and Social Cohesion in Europe

Introduction

Chapter 1: A counterproductive approach – the economic policy programme of the EU

1. More jobs and less welfare – the neo-liberal way to full employment - Critique of the 2000 Broad Economic Policy Guidelines
2. The threat of more compulsion and inequality – Comments on the Employment Guidelines
3. New monetarism - Critique of the theoretical basis for the European economic policy concept
4. Market fundamentalism – A broader perspective for the critique

Chapter 2: The drive to inequality – Economic and social development of the EU

1. Slow growth, high joblessness, more inequality - Basic macro-economic trends
2. Convergence towards self-imposed constraints - Economic policy trends and results
3. Increasing fragility and inequality in employment and unemployment
4. The persistent gender inequality
5. Deepening East-West economic gap

Chapter 3: Creating a strong social model in Europe – Alternative Economic Policy Guidelines

1. A more efficient and democratic macro-policy for full employment

- 1.1. Introduction
- 1.2. A less restrictive and better co-ordinated budgetary policy
- 1.3. A more accountable monetary policy with a broader perspective
- 1.4. Co-ordinating budgetary and monetary policy
- 1.5. Making wage formation consistent with macro-policy

2. Defending and strengthening the European social models

- 2.1. A better climate for national social policies
- 2.2. Positive social policy at EU level
- 2.3. General social standards with upward convergence
- 2.4. Social dialogue and wages policy
- 2.5. Strengthening social protection
- 2.6. Building on the Luxembourg process

3. A more balanced structural policy

- 3.1. A more pragmatic approach to European competition policy
- 3.2. A more active research and innovation policy
- 3.3. A strategic industrial policy at EU level
- 3.4. More powerful but more selective regional policies
- 3.5. A more pro-active European trade policy

4. Better preparation for the next enlargement round

5. A broader perspective for a more social and equitable society

- 5.1. No priority for growth but for welfare
- 5.2. Elements of welfare
- 5.3. Exploring the possibilities of co-operative welfare models
- 5.4. Final remarks: interests, power and movements

Introduction

With these *Alternative Economic Policy Guidelines for Full Employment and Social Cohesion in Europe* we intend to challenge to the official economic policy of the EU by criticising its theoretical approach and political thrust and proposing an alternative economic policy course which is more conducive to employment and welfare in Europe.

We take as our point of departure the current versions of the two most important yearly economic policy documents, in which the EU formulates her programmatic views and policy intentions and recommendations: the “Broad Guidelines of the Economic Policies of the Member States and the Community” (BEPG) and the “Guidelines of the Employment Policies of the Member States” (EG) introduced in 1993 and 1997 respectively and adopted shortly before the June (BEPG) and the December (EG) summits each year. We criticise these guidelines for their extremely narrow and counterproductive approach to economic development and for their underlying tendency to erode the social content of employment by the introduction of an increasing number of compulsory elements. To the extent that these policy recommendations have been followed during the last decade they have in our view contributed much to the current social problems of the EU. We see our concerns confirmed by the outcome of the Lisbon summit in March, where – although on the one hand the objective of full employment was re-introduced into the European agenda – the trend toward thinning out and erosion of social cohesion was reinforced under slogans like “activating social state”, “knowledge-based society” and “new economy”. In our *first chapter* we analyse and criticise these tendencies and the underlying theoretical concepts and social forces.

This critique is followed in the *second chapter* by a presentation of the long term tendencies and current economic and social situation in the EU as a whole. On the one hand we formulate doubts about the sustainability of the current economic upswing and concerns about the absence of preparation of the EU to intervene in a coming recession. On the other hand we underline the many forms of increasing polarisation and inequality in terms of continuing high levels of unemployment, growing inequality of income distribution, high levels of poverty, the persistent gender gap and the new and widening divide between East and West in Europe.

The largest part of the paper, the *third chapter*, consists of proposals for an alternative approach to European economic policy. They relate to a more efficient and democratic macro-economic policy, a strong social constitution, more balanced structural policies, a more determined eastern enlargement policy, and they reach from immediate measures which can be taken largely within the given institutional framework, to institutional changes which are regarded as necessary to achieve a more democratic, socially and ecologically sustainable pattern of economic development, in which new forms of full employment and economic organisation play a vital role.

It may appear that this year is a particularly unfavourable time for proposals for an alternative economic and employment policy. It seems – and governments and the EU administration assert this very strongly - that European economic policy has at last started to generate the positive effects which have been promised since more than 10 years. Growth is relatively strong, about two million additional jobs will be created during the year, exports are booming and the European economy appears to gain in competitiveness every month. Why now criticise this successful policy ?

There are two reasons why we think that in spite of the current favourable growth situation the economic policy of the EU is essentially wrong and should be thoroughly changed:

First, we regard the current recovery as rather fragile: It is largely a cyclical phenomenon which will sooner or later (rather sooner) reach its turning point, from which on the next downturn begins. Also an end of the US boom will have very negative consequences for the EU economy. The EU needs policy instruments for either case in order to support a further increase in socially acceptable employment, but she does too little to develop them.

Second, the recovery does not stop the tendency to undermine and paralyse the specific social content of the European development pattern, which used to make Europe a much praised alternative model to the American neo-liberal system. It is true, that during the last three years social movements and intellectual critique have had a certain impact in the EU: social democratic governments were voted into office, employment was officially introduced as a matter of European concern into the Treaty, and recently even full employment was declared officially a key objective of the EU. At the same time we observe that real policy on the EU-level has not changed much. In some areas changes of rhetoric cover even tendencies of further undermining the content of a genuinely European social model.

Therefore we regard it as very necessary that the discussion on economic and social policy priorities should be intensified and extended beyond the fields of experts and official policy-makers. We have engaged in this discussion with our previous two Memoranda in 1997 and 1998, which were supported by 230 and 500 signatures by European economists. With this paper we want to continue this engagement and to give it a new and regular form. It is our intention to publish regularly *Alternative Economic Policy Guidelines* as a critical counterpart to the official policy guidelines coming from the Commission and the Council.

This paper is the result of a collective and joint effort of a number of economists from different EU and eastern European countries who are critical of the current – largely neo-liberal - economic policy stance in the EU and who believe that there are viable alternatives to this course. There is no uniform approach to economic policy amongst us, and as can be seen from the following text, many themes – e.g. trade policy or research policy - need further clarification and discussion. Some themes are completely missing in the present paper – amongst them most painfully an appropriate treatment of ecological problems and of working time reduction. We will try to improve our arguments, clarify the positions and fill the gaps in our further work. We invite all economists who are critical of the current course of economic and social policy in the EU and feel that alternatives should be developed and promoted, to join our efforts. At the same time we know that the formulation of alternatives will not lead to their implementation without wide public discussion and democratic political pressure which must be strong enough to overcome not only intellectual dogmatism but also the political interests and forces which benefit from neo-liberalism.

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Chapter 1

A counterproductive approach – The economic policy programme of the EU

In this chapter we criticise the programmatic position, which the EU has adopted for economic and employment policy and which we regard as counterproductive for economic development and harmful for social welfare. We start with a critical account of the “2000 Broad Guidelines of the Economic Policies of the Member States and the Community” (BEPG2000) (section 1) and the “Guidelines for Member States’ employment policies” for the year 2000 (EG2000) and for the year 2001 (EG2001), the latter being still a proposal of the Commission to be adopted in December by the Council (sect. 2). It follows an analysis and critique of the theoretical basis of the Commissions’ neo-liberal approach (sect. 3). We conclude this chapter with remarks about a broader perspective of our critique (sect. 4).

1. More jobs and less welfare – the neo-liberal way to full employment Critique of the 2000 Broad Economic Policy Guidelines

1.1 Full employment as “key objective” !

For the first time since their introduction in 1993 this year’s BEPG declare that “the return to full employment remains therefore the key objective of economic and social policy” in the EU. This declaration is in accordance with the conclusions of the Lisbon summit in March, in which the achievement of full employment within 10 years was formulated as policy objective, together with a stronger social cohesion. Further goals of the Lisbon summit which are taken up in the guidelines were the transition to a knowledge based “New Economy” and the transformation of the welfare state into an “activating social state”.

This first emergence of full employment as an objective of the BEPG is an ambiguous event:

On the one hand it marks an advance and progress in the discussion on economic policy. It indicates that the concept of full employment, which has been pushed aside as either not viable or not desirable or both for two decades by economic policy makers and mainstream economists has after all not been eradicated from social memory. It has survived and is currently experiencing a come-back in economic policy debates. The reason for this is the growing dissatisfaction of large parts of the people over persistently high unemployment, sharpening social polarisation, erosion of the social tissue and the continuing neo-liberal economic policy orientation in the EU. Social movements and heterodox economists – amongst them our working group on alternative economic policy in Europe with two memoranda in 1997 and 1998 - have during the last years enhanced their criticism against this policy. In the context of these critical debates and movements the concept of full employment is one of the key cornerstones of a policy turn-around aiming at an alternative economic and social development. That this concept has by now found a broader public and that the notion is taken up even in official economic policy documents can certainly be regarded as a step forward. This is the positive side of the event.

However, there are strong negative sides, too. They concern the way in which full employment is incorporated into the BEPG – as into the overall social policy approach of the EU.

First there is no explicit concretisation in the BEPG of what is meant by full employment. It is obvious that a schematic return to the post-war concept of full employment is neither possible nor desirable. Progressive changes in economic structures and technological procedures, work organisation, gender relationships and family structures have to be taken into account to fill the concept with adequate content. On the other hand the social aspirations connected with the programmatic vision of full employment as the centre of a democratic, free and equitable society should be maintained. Nothing of this is visible in the BEPG. Full employment is at first sight simply a word incorporated into the BEPG because it is in the public air. However, at second sight it becomes clear that there is an implicit content in the use of the word by the BEPG, and this content is widely adapted to the neo-liberal policy orientation of the EU.

For – second and worse - there is no indication for new policy approaches in the new BEPG. One would expect that the introduction of a new strategic policy “key objective” should entail significant new elements in the design of economic policy. Such expectations are refuted: The same neo-liberal austerity, deregulation and privatisation prone economic philosophy, which has been at the heart of economic policy since Maastricht is also governing the BEPG 2000, and some of its most pronounced and restrictive features – cuts in public expenditure, low wages, deregulation and removal of social benefits and work protection as obstacles to more jobs - have even been underlined and reinforced in the current version. This has a definite impact on the concept of full employment and on the “benchmarks” applied on the way to full employment. Whereas the concept was for decades embedded in a context of safe jobs, decent wages, social security and a certain standard of workers rights and protection in a free society it becomes in the new context subordinated to the claims of employers and politicians who want to get everybody at work under whatsoever conditions in order to foster growth and international competitiveness. Yardsticks and benchmarks are shaped accordingly: A person with two hours paid work in a specific week appears as employed in the statistics, and an official rate of 4-5% of registered unemployment is declared to be full employment. The overall benchmark of the BEPG, to reach an employment rate of 70% by 2010, does not say anything about the quality of the achieved employment, and it is to be feared that the social substance of the objective will be widely thinned out and paralysed. Full employment in the “New Economy” becomes compatible with social erosion, or even more: social erosion is seen as the way to full employment in the New Economy.

In the BEPG2000 the Commission maintains and emphasises its uniquely narrow view of economic and social development and policy recommendations. The fact that this strategy has been applied in the EU since more than a decade and has, contrary to forecasts and promises, not improved the economic dynamics and social position of the majority of people in the EU and not even prevented a further rise of unemployment during the 1990s has not – as one could expect – led to a critical examination of the main strategy but on the contrary led the Commission to assert the correctness of this strategy. According to the BEPG (sect.2.1.) during the last decade a solid institutional and political framework has been set up and implemented. If this framework has not generated positive effects and has not even prevented the rise of unemployment this is - so the BEPG assure us - not due to deficits and flaws in the framework but to the severity of previous imbalances. In the future the positive effects would certainly come up. Karl Popper would call this structure of argument a classical intellectual immunisation against criticism.

We find it hard to believe that this is just a matter of stubborn intellectual ignorance. Instead we regard the current mainstream resistance against theoretical criticism and empirical refutation as a reflection of strong social forces and interests. In this view the mistakes and wrong guidance which we criticise are at least partly the deliberate intention and result of a strategy of these forces, aiming at more social inequality, from which they benefit at the cost of the majority. We have the impression that the BEPG2000 – like their predecessors of previous years – are a kind of ritualised exercise which is undertaken because the Treaty requires them. They seem to have no real importance neither for their authors, nor for politicians, because their result is predetermined and reflects the policy carried out anyway. There is no serious effort for an in-depth analysis, but instead we find – particularly in the country specific part – a schematic application of four categories and stereotype results. We will demonstrate this in the following remarks.

1.2 On the verge of a virtuous circle of growth ?

The BEPG see the EU “on the verge of a virtuous circle”, in which “output growth, high confidence and strong employment creation” (p.5) reinforce each other. They forecast a “growth rate of 3% for the EU as a whole as a realistic prospect for the coming years”.

This forecast rests on weak theoretical and empirical arguments. The Commission concedes that the current positive growth situation is partly based on “the influence of cyclical factors” and on a “buoyant global activity”. Now cyclical upswings are bound to come to an end and be reverted to cyclical downswings, and the buoyant global activity is mainly borne by the boom in the USA, which is getting increasingly fragile. The EU herself does nothing to contribute to the stabilisation of the world economy, the current recovery in Europe is mainly due to the boom in the USA.

The Commission is aware that until now the European recovery remains rather fragile, and that it needs “a coherent and comprehensive economic policy strategy for the medium-to-long term.” (7) This strategy is exclusively based on growth and nothing but growth. “The focus of this strategy should be to enhance the capacity of the EU economy to generate high rates of non-inflationary growth over a prolonged period” (7) The basic instruments to achieve this growth are:

- a **supportive macroeconomic policy** and
- right **structural** policies.

We will first examine the content of these tools and then come back to the objective of growth.

1.3 The “supportive macroeconomic policy” – Continuous support for harmful strategy

Macroeconomic policy consists of three basic parts:

- Monetary policy, including exchange rate policy
- Fiscal or budgetary policy and
- Wage policy.

The BEPG are quite clear on *monetary policy* insofar as it does not deal with it: Monetary and exchange rate policies are regarded as an external framework which are not to be addressed by economic policy considerations. They are in this view no major economic policy tools which have to be applied in co-ordination with other tools in order to achieve full employment

as the “key objective” of economic and social policy. Monetary policy is no part of economic policy but a set of external data on which economic policy - or for that matter policy in general - has no influence – and should have no influence. Monetary policy has no responsibility for employment. What is worse, it has a built-in hostility to full employment. For the theory underlying the structure of the European System of Central Banks (ESCB) associates a strong rise in employment automatically with a higher inflation rate, against which the ECB must according to the Treaty act uncompromisingly in taking restrictive measures. These will lead to lower growth and higher unemployment.

It is true that the Commission does not have the power and competence to change this state of affairs which has been cemented by the Treaty. But the Commission could of course engage in a debate about the benefits and possible disadvantages of the current rules and statutes of the ECB and on the necessity of future changes. Such discussions are presently going on in several areas involving Treaty changes, particularly as to vote weighing, majority voting, number of Commissioners and other institutional measures appearing necessary with regard to the coming enlargement round. It is of course possible to start a discussion – or to take-up an ongoing external discussion - on the harmful implications of the present extraterritorial status of monetary policy in the EU. That the BEPG do not even take into consideration such perspectives of a critical examination is a reflection of its own narrow policy conceptions.

It is also strange that a report about the general economic outlook for the EU and economic policy recommendations does not deal with exchange rate policy. It is certainly not enough to remark with satisfaction that the current recovery has been partly due to a “competitive euro exchange rate”(p.5). Why not criticise, firstly, that the initial exchange rate has been falsely set, secondly, that the exchange rate plays a major role and its development includes considerable risks and constraints for the European economy, and thirdly that the EU does not dispose of an exchange rate policy nor of a concept for such a policy but instead leaves this important area of economic policy to the hidden agenda of the ECB.

Things are not better with regard to *fiscal policy* where the competence and sovereignty of member countries is greater and policy co-ordination should have greater room for manoeuvre for pursuing the “key objective” of economic policy. But the generally improved conjunctural situation with higher public revenues does not lead the BEP to the recommendation to use fiscal policy for a bold attack on the still high unemployment via public employment programmes. On the contrary it recommends to take advantage of the recovery by using higher revenues for a quicker budget consolidation. This prolonged stampede for balanced and surplus budgets is as astonishing as it is absurd. It is the third part of a seemingly endless spectacle of budgetary obsession: the first part were the provisions relating to the convergence criteria and the prevention of excessive deficits in the Treaty of Maastricht, which were already without any sound economic foundations. The second part was the Stability and Growth Pact which imposed upon the member states to pursue balanced and surplus budgets in the medium term. Now the BEPG recommend to make this a short-term objective.

We think it does not make economic sense to declare a balanced budget as economic policy objective as such. In our view the budget should play a functional role and be set to achieve the highest level of employment. This may involve deficits but need not – depending on the levels of savings, investments and exports. What we criticise is that the current obsession with deficit reduction is completely abandoning fiscal policy as economic policy tool in subordinating it to an external rule of consolidation – not unlike monetary policy is subordinated to the rule of price stability. Under the prevailing circumstances of high unemployment in

the EU as a whole and her major member countries this means that fiscal policy has not more responsibility for employment than monetary policy – i.e. it has no responsibility.

What remains is *wage policy*. If full employment is the key objective for economic policy, and if monetary and fiscal policies are not applicable for this objective, then the entire responsibility for more and full employment rests on wage policy which should pursue “wage increases consistent with price-stability and more jobs”. This is the final and decisive point of the recommendations for supportive macroeconomic policy measures. The wage related recommendations are – probably due to their political sensitivity - full of ambiguous and obscure formulations, but in the last instance they amount to two points:

First, while wage rises should never go beyond productivity increases they should regularly be “taking into account the need to strengthen, where necessary, and subsequently maintain, the profitability of capacity enhancing and employment creating investment”. The translation of this strange formulation - taken from the conclusions of the Cologne summit in June 1999 – amounts to the recommendation that wage increases should remain largely below the rate of productivity growth, i.e. the working population should accept a further redistribution of income in favour of profits.

Second, the introduction of a low wage sector should, where it has not already taken place, be actively promoted by economic policy via tax subsidies for firms and benefit cuts for workers. This is on the one hand bad macroeconomics, because it lowers private consumption and moreover, tax subsidies will – taken the deficit reduction imperative – eventually be financed by cutting public expenditure and lead to lower effective demand. On the other hand it is a further step to empty the concept of full employment of its social connotation, which includes decent wages. Thirdly such recommendations are an implicit rejection of the freedom of wage negotiations between the social partners. In our view the EU should not impede the role of free wage bargaining as an important ingredient in the European social model – although states and the EU can and should define frameworks and limits as regards working conditions.

1.4 The “right structural policies” – more freedom for markets, less freedom for workers

The structural policies recommended by the BEPG2000 follow the well known line of deregulation and liberalisation of markets for goods and services, for capital and for labour (in which the social benefit system is included). While market deregulation goes along with a number of general other recommendations in the general first part of the BEPG – including reminders about the need for social cohesion, environmental sustainability and a the avoidance of tax competition – in the second country-specific part nothing of this is taken up and the recommendations relate exclusively to deficit reduction and deregulation on the three markets. This is what counts for the Commission, the rest is lip-service.

While the BEPG are fairly – not completely - satisfied about the deregulation progress in the markets for goods and services as well as those for capital, it criticises the slow reforms of the labour market and the social benefit system. Right in the introduction the Commission deplores that “benefit systems and rigid employment protection legislation have been tackled in only a few” (member states). It pushes for reforms in the tax and benefit systems so as to support, on the one hand, the set-up of a tax-subsidised low wage sector and on the other hand to “ensure appropriate incentives and rewards for participation in an active working life, assess in particular duration and eligibility criteria in benefit systems.” This is again one of those obscure formulations which conceal the intention of the argument. Who would be against “appropriate” incentives ? However, on closer examination many of them turn out to consist

in sanctions, i.e. the reduction or removal of benefits for those who are not capable or flexible enough to take up any low paid work. In all but three of the country-specific reports the BEPG recommend to review the benefit system so as to set up “proper”, i.e. tighter incentives to take up work. This is even true for countries with low unemployment like Luxembourg and the Netherlands. In some cases – Spain, France, Portugal – the easing of dismissals is proposed. Better opportunities for dismissals as a way to enhance employment and return to full employment !

This seems to be the philosophy underlying large parts of the BEPG: Extensive work protection and social benefits are not regarded as a positive achievement which should be preserved and defended against the rules of competition and attacks from markets. They are on the opposite regarded as a disincentive to take up work and therefore as an obstacle to more jobs, which consequently should be removed or at least loosened. To this end increasingly disciplinary and authoritarian measures are taken – welfare perverts to workfare. Thus the content of full employment is progressively emptied of social content except that of having any kind of job for any kind of payment and very little or no social protection at all. An intended effect of such replacement of benefits by compulsion public expenditure for social purposes will fall. The “activating social state” is indeed a very active state in that it actively shifts its regulatory emphasis from organising social cohesion through benefits for the weak to forcing the weak into work. This is in sharp contrast to the freedom which is inherent in the traditional concept of full employment.

Relating to *working time reduction* the BEPG2000 display a very restrictive stance, too: On the one hand they insist that working time reductions should never lead to an increase in labour unit costs, i.e. the prevailing pattern of income distribution should not be changed. On the other hand there is an outright hostility to working time reduction in the form of early retirement – which is regarded as a major instrument of employment policy in several member countries. The Commission takes the opposite view: It recommends “incentives” - concretely the reduction of payments in cases of early retirement - to keep older workers on work and to remove or weaken early retirement schemes for instance in Germany, Denmark and Austria. Here again, a social achievement – i.e. the possibility to leave work from a certain age on at a freely chosen point of time without major welfare reductions – is not seen in its positive aspect of enhancing the quality of life and contributing to the reduction of youth unemployment. It is only regarded from the viewpoint of fiscal consolidation: early retirement means additional claims on pension payments and the termination of contributions to the social security funds. The latter is outrightly wrong if new workers replace the retirees, the former is no problem, if the distribution of productivity gains is addressed properly. This policy recommendations against early retirement are not only authoritarian against those who after a life of work want to leave; if followed they would also be a specific contribution to the prolongation of otherwise much deplored youth unemployment – in the name of growth.

The main thrust of the new rhetoric of “New Economy”, “modernisation” and the “activating social state” which have experienced a new boom since the Lisbon summit aims at the dismantling of a welfare system based on collective solidarity, and at replacing it by an increasingly individualistic and privatised system based on financial markets. The result of such a policy will be increased uncertainty, risks and vulnerability particularly of the socially weaker parts of the population.

1.5 Conclusion: Growth for full employment or full employment for growth ?

It has been said in numerous documents and is reiterated in the BEPG 2000, too, that high and durable growth is a necessary means to generate more and eventually full employment. However, when the Commission unfolds the essential elements of her growth strategy, it appears with ever mounting evidence that growth is leaving this status as instrument and tool behind and is becoming an end in itself. One can even observe an exchange of places between growth and employment in the Commissions conception. Growth is no longer an instrument to achieve full employment, an instrument which has to be used in conformity with the content of full employment in a socially meaningful sense: appropriate payment, security, protection and rights of workers. Instead the end-means relationship has been reverted: The objective is growth, for which all available employment is needed. Therefore the term full employment is kidnapped from its welfare environment and adapted to the needs of sheer growth, international competitiveness and profits. To this end employment has to be stripped from every previous connotation in terms of social content, aspiration and entitlement. This is the perverted sense in which the term full employment is presently used – or abused.

We do not reject the notion of growth as such. We also hold that more paid work and wage income – and therefore growth of GDP as national income - is necessary to fulfil the needs of our societies. What we criticise and reject is

- a. the concept of growth as the exclusive way to full employment, leaving aside other ways - in the first place the reduction of working time – which are also necessary and in many respects more conducive means to achieve more and full employment
- b. the social ruthlessness, with which growth is pursued at the cost of those to whom it should benefit. As an alternative we insist on an employment strategy which preserves and implements the social content connected with the objective of full employment.
- c. the environmental ignorance and irresponsibility which goes along with the prevailing concept of growth. The BEPG mention in 10 lines that growth should be sustainable, but that is it. The theme is nowhere taken up, neither in the general, nor in the country specific part. It is sheer lip-service. Economic development and growth in an environmentally sustainable way cannot exclusively rely on markets but has to invest in environmentally beneficial infrastructure, promote energy saving and prohibit the use of environmentally harmful materials and procedures.

All this is not even mentioned in the BEPG2000. The neo-liberal kind of growth strategy does not only entail most harmful ecological consequences for the people – employed and unemployed. It also leads to – and has been leading since more than 20 years to – massive redistribution of income and wealth in favour of profits and high incomes, to the detriment of the majority of low and medium income earners. This redistribution– via labour market and (tax and social security) policy - has perhaps been the most marked event during the last two decades. Ironically it has also – via the medium term demand dampening effects of growing income inequality – contributed to lower growth, against which the neo-liberal policy of market deregulation, cutting of wages and social benefits, i.e. further redistribution has had only limited success. This trend to greater inequality, which in our view is at the heart of the unsatisfactory economic and social situation in Europe, is not even mentioned in the BEPG, not to speak of being criticised.

The policy recommendations of the BEPG2000 do not mark the start for a virtuous circle of reasonable growth, employment and social welfare in a socially meaningful and acceptable way. Instead they show the way to a new round in the vicious circle of perverted growth, poor employment and growing inequality.

2. The threat of more compulsion and inequality - Comments on the Employment Guidelines

The *Employment Guidelines* for 2000, hardly changed from 1999, essentially derive from the “Luxembourg Process” (European Councils at Luxembourg 1997 and Vienna 1998). These Councils committed member states to National Action Plans (NAPs) aimed at improving the functioning of labour markets. Although most of the measures involved remain within member state competence, the NAPs are subject to an unprecedented degree of monitoring at EU level and member governments are committed to detailed, and increasingly quantified, reports on their labour market initiatives.

A key aspect of the Luxembourg process is the promotion of “active” measures to deal with unemployment. In some cases concrete targets are set for labour market measures, particularly in order to prevent the rise of long term unemployment. The four “pillars” of the Luxembourg process are declared to be employability, entrepreneurship, adaptability and equal opportunities.

In the Commission proposal for the EG for 2001 the full employment objective is taken up from the conclusions of the Lisbon summit and a new quantitative target has been formulated: to reach a participation rate of 70% by the year 2010. The four-pillar structure is complemented by horizontal objectives like the involvement of the Social Partners and the development of Lifelong Learning.

There is much to be welcomed in the process. The procedures, first of all, represent a major step forward in the co-ordination of European social policies. The policy communities (at member state and EU levels) concerned with social exclusion and unemployment will be better informed and better connected one with another. On the implementation of the guidelines through the NAPs, it is very positive that national policy measures are subject to detailed reporting and assessment procedures, involving the use of “benchmark” standards. If this process is strengthened and filled with appropriate social content the result could be a significant levelling up in the quality and coverage of labour market policies in the member states. It is important that the guidelines call explicitly for the involvement of the social partners in the design and implementation of labour market strategies; in countries such as Britain where workers’ representatives have been marginalised this may help to move them back to the centre of policy debate.

2.1 Strengths and Weaknesses of the Employment Guidelines

It is inevitable that the Luxembourg Process should be marked by differences among member state governments as to their conceptions of labour market reform, their strategic priorities and their chosen policy instruments. Consequently, both the Guidelines and their implementation display certain ambiguities.

In the Guidelines 2000 themselves one can only welcome the following elements:

- guideline 9, according to which “Each Member State will give special attention to the needs of the disabled, ethnic minorities and other groups and individuals who may be disadvantaged.....to promote their integration into the labour market”;

- guideline 19 (gender mainstreaming) and guideline 20, calling for a reduction in gender employment and income differentials, particularly in the context of guideline 21, which calls for family-friendly policies including “affordable, accessible and high-quality” child-care;
- as mentioned above, the encouragement of a “partnership approach” to issues of labour market reintegration and training (guidelines 5 and 6) and to questions of work organisation (guidelines 16, 17); strong and effective representation of worker interests is needed to ensure that reform in these areas is consistent with social progress;
- the emphasis on tackling educational disadvantage (guideline 7, on reducing school drop-outs and guideline 8, on developing and modernising apprenticeships).

On the other hand it is a critical point, that only for three out of 22 guidelines (1, 2 and 3) concrete targets have been set, for the rest the formulations remain rather vague. It is important to begin to constrain in a concrete and quantified way national policy also in other areas, such as childcare provision and apprenticeships.

Moreover, one should criticise that *all guidelines* have only the status of *non-binding recommendations* with no effective sanctions against non-complying member states. This is a telling and unjustified difference in comparison to the provisions relating to sanctions in the case of excessive public budget deficits in the Stability and Growth Pact.

There are also a number of elements in the Employment Guidelines which could cover mostly socially regressive and authoritarian measures:

- reform of the tax and benefit system to enhance incentives is called for (guideline 4), without specifying whether these incentives are positive (for example, higher minimum wages, a more progressive tax structure) or negative (reduced unemployment indemnities, tougher eligibility rules); this could be particularly important for older workers – an increase in labour market participation brought about by reduced pension entitlements is not the same, in terms of the well-being of older workers, as one promoted by better protection against dismissal on grounds of age;
- the encouragement of individual enterprise and of self-employment (guidelines 10 and 11) must not become a cover for more insecurity or less social protection; there is already a great deal of pseudo-self-employment in some member states and it is important to block the use of “independent” status to circumvent established employment conditions;
- the call for lower taxes and social charges on (particularly lower-paid) workers (guideline 14) is combined with the suggestion that “green” taxes are the best alternative. A switch to eco-taxes is indeed indispensable, but it is necessary to review the distributional impact of tax reform and this cannot be done while no effort is made to reverse the continuous decline in the taxation of capital assets and revenues.

2.2 The Threat of Workfare

A danger to the Luxembourg process arises from attempts to generalise the present British approach to labour market reform, an approach which is in turn deeply influenced by US models of “workfare”. This involves a narrow view of unemployment, which is understood essentially as an economic malfunction or as a problem of the so-called “underclass”, without being related in an adequate way to its full social context. Particularly since the Vienna summit in December 1998, EU policy-making has been significantly influenced by the conceptions of the British government and it is clear that official British thinking is, in its turn,

deeply influenced by certain US practices which are fundamentally inconsistent with the values and objectives of European social models.

In order to illustrate these claims, one can refer first to the economic theories which inspire British labour market policy and then to the serious deficiencies of this policy itself.

Unemployment and Labour Market Competition

The thinking behind current British policy is accurately represented by the labour market analysis of Richard Layard (see, in particular, Layard, R. (1997) "Preventing long-term unemployment: an economic analysis" in Snower, D. and de la Dehesa, G. (eds) *Unemployment Policy*, CUP, Cambridge). According to this kind of theory, a significant level of unemployment is necessary to restrain inflation (the concept of the NAIRU, itself exposed to important theoretical and empirical objections, see section 3 below). From this view, *long-term unemployment* may be dysfunctional because the real or perceived competitiveness of the long-term unemployed is impaired and thus they no longer exercise downward pressure on wage settlements. The central rationale for intervention into long-term unemployment, in this framework, is to render an uncompetitive pool of workers into an effective disciplinary force on wage formation and thus to improve the trade-off between inflation and unemployment.

The "active" employment measures advocated by Layard are explicitly presented as compulsory, as an obligation on the unemployed rather than as an entitlement for them. Thus, after a certain period in "passive" receipt of indemnities, they should be "activated", i.e. required to accept subsidised work or retraining on terms laid down by the authorities. It is recognised *and presented as an advantage of this approach* that it will lead some of the unemployed, those unwilling to submit to this tightened discipline, to simply disappear from the register of unemployed claimants.

The adoption of this kind of model as the basis for labour market reforms in Britain (in particular the "New Deal" aimed at the young unemployed and now to be extended to older workers) is clearly influenced by developments in the US, where the slogan, "welfare to work", indicates that so-called "active" measures are closely related to the erosion of social protection and the withdrawal of established social entitlements.

This is the kind of thinking which has been, to a significant extent, accepted by the EU since the Vienna Council. It can be detected in the Commission's call for "the activation of benefits" in its *Proposal* for implementation of the Employment Guidelines in 2000 (para. 7) and in the declarations of Lisbon. In the tradition of European social policy these benefits are *entitlements* and should not be available as a source of finance for interventions imposed on the unemployed.

Similarly, the Commission, in its undifferentiated advocacy of higher labour market participation rates, fails to distinguish a widening of labour market opportunities on the one hand from, on the other, a tightening of eligibility conditions for unemployment indemnities and a reduction in benefit levels. The social interpretation of employment data and benchmarks, however, is impossible if this distinction is not made.

The social interpretation of the "welfare-to-work" strategy and of orthodox labour market analysis must start from the reality of labour market stratification. The unemployed are a vulnerable and disadvantaged group simply as a consequence of their unemployment as such.

But, typically, individuals exposed to unemployment also suffer from multiple social and economic disadvantages, concerning, for example, levels of education and qualification, access to decent housing, lack of financial and other assets, membership of disadvantaged minorities and so on. It is extremely cynical to attempt to use these people - victims of the imbalances of contemporary economic development - as a means with which to intensify competitive pressures in the labour market as a whole. It is unlikely that these vulnerable groups will be able to cope with the intense market disciplines which they will have to meet if labour market reform is guided by the kind of strategy which inspires British policy.

For the same reason, the forced reintegration of the long-term unemployed is likely to be of very limited *economic* significance. The levels of productivity associated with an insecure attachment to the labour market at very low wages are not high enough to make a significant contribution to output: thus the very high levels of labour market participation seen in Britain correspond to levels of productivity well below that of most other member states. It is logical to conclude that, in spite of the economic rationale advanced for “welfare-to-work” policies, these have more to do with disciplining the disadvantaged groups in society than with economic development.

Just as the activity rate is not a simple maximand, the number of people dependent on social benefits is not a minimand. It is poverty and social exclusion which must be minimised: at given levels of poverty and disadvantage, more expenditure on social protection and a wider coverage of individuals at risk are *desiderata*. The economic approach to unemployment which can be detected throughout the Luxembourg process is expressed by a failure to articulate data on unemployment with evidence and analysis on poverty and social division.

2. 3 The “New Deal” in Britain

The Employment Guidelines, nos. 1 and 2, require member states to offer a “fresh start” to young people before six months and to adults before 12 months of unemployment. In Britain these targets have been met only for the young (through the so-called “New Deal”) while analogous measures for adults are still at a pilot-study stage. Nevertheless, the Council’s *Joint Employment Report* (Council of the European Union (1999), *1999 Joint Employment Report*, Part I: *the European Union*, Brussels, p31) records that, “the UK claims a non-compliance rate of zero both for young and adult unemployed, which is linked to strict benefit sanctions.” This is an “offer” which it is hard to refuse. (There are, of course, refuseniks but they are no longer registered as “job-seekers”).

Now it is impossible to deny that much good work has been accomplished through the “New Deal” initiatives. Unlike many of the initiatives of the previous Conservative government, the present programmes are well-funded and a serious effort has been made to adapt the work placements and training courses proposed to the interests and ambitions of the individuals concerned. However, the initiatives also exhibit serious deficiencies. One of the most important concerns is the integration of the unemployed into mainstream British educational programmes (A-levels and undergraduate courses). Almost insuperable obstacles face unemployed young people and other welfare claimants (such as single parents) who wish to follow these standard educational paths. The reason for this situation is the government’s determination to compress social protection expenditures.

The element of compulsion in the “New Deal” also results in the statistical “disappearance” of many young people who vanish from the unemployment registers without being recorded as

having entered into either employment or education. Although this situation should not be dramatised - it is likely that only a few of them are driven into semi-legal activities; for the most part they have become dependent on family support to avoid what they perceive as inappropriate or oppressive "active" measures - this outcome testifies nevertheless both to an unacceptable tightening of eligibility conditions (the unemployed are, of course, already required to be available for standard offers of employment; it is quite unjustifiable to place further constraints upon them) and to a possibly damaging failure of quality control in the implementation of the "active" policies: the only guarantee that a training course or a temporary work placement is genuinely useful to an unemployed worker would be the fact that it is freely accepted.

Inequalities in Britain

More generally, the question can be raised of the relevance of "New Deal" interventions to social problems in Britain. In spite of labour force participation rates second only to those of the Scandinavian countries, Britain exhibits one of the worst figures for poverty in the EU and has an extremely high proportion of workless households. The key social problems arising in the labour market are the distribution of employment and its extremely unequal remuneration, rather than the number of registered unemployed.

It seems unlikely that these basic problems can be addressed while British governments maintain their strong commitment to "flexible" labour markets and to minimal regulation of, and intervention in, the employment relation. The free market which results from these neo-liberal policies is an inequality machine - no amount of tinkering with the social protection regime can make it yield "fair" or socially cohesive outcomes.

For example, the *Joint Report* shows that gender pay inequalities in Britain are among the widest in the EU. This is only to be expected, since the withdrawal of public control and the intensification of market disciplines in employment do not provide an environment in which these historic inequalities can be successfully challenged. It is also noteworthy that the *Joint Report* does not include any British initiatives among its examples of "best practice" in active employment measures.

Two recent studies, one by the OECD, the other by the British Office for National Statistics, have documented the alarming increase in social inequalities in Britain. According to the first,

Two decades of Conservative rule left Britain with the worst poverty record in the developed world...Poverty affected 20% of the British population a year on average between 1991 and 1996...Britain performed worse than the US on every count - average poverty rates, long-term poverty rates and the proportion who experienced poverty at some point over the six years..... Long-term poverty is virtually unknown in the rest of Europe. In the Netherlands, less than 1% of the population suffered poverty for the entire six years of the study, while in Sweden and Germany the proportion was under 2%. (*Guardian*, January 12, 2000)

And according to the ONS study:

The gap between the rich and the poor in Britain continued to grow right through the 1990s..... with April 1998 figures showing that about 3million children were still living below the poverty line in families with incomes of less than 60% of the me-

dian...The pay gap between men and women remains as wide as ever. Average gross annual earnings for April 1999 show that men in full time jobs earned about £23,000 a year - 42% more than the average £16,000 a year earned by women in full time work..... When it comes to social class, the differences are even more striking...(Guardian, May 11, 2000)

2.4 The Ambiguities of US Experience

Since the appeal to rapid employment growth in the US is an important element in the argument for looser regulation of European labour markets, it may be useful to indicate that the conventional interpretation of US employment record (deregulation = employment growth) is highly questionable.

Many European commentators have frequently pointed to the seamy side of the US employment “miracle” – for example, it is stressed, quite correctly, that many disadvantaged people, who would be supported by social protection systems in the EU, become enmeshed in the criminal justice apparatus in the US, which has recently incarcerated its 2 millionth prisoner. Such criticism is certainly well founded. The countless victims of the US growth model testify to its complete incompatibility with the values underpinning the European social states.

However, it is also true that there are positive features to the US social model, and their contribution to high levels of employment are frequently neglected in an official discourse which can only repeat the mantra of “flexibility”. Two aspects of the US social model are particularly relevant here.

The first of these is *macroeconomics*. If US citizens have to face, in their daily lives, acute market disciplines, they tend also to insist, in their political choices, that the market works. Governments held responsible for any lengthy period of stagnation face a drastic electoral sanction and this is a key factor in the higher levels of activity that have been achieved in the US relative to Europe over the last two decades.

Secondly, it should be remembered that there is a significant amount of redistribution and intervention in the US labour market (for example, through the system of tax credits). These measures certainly compare unfavourably with the efforts made in many individual EU states; on the other hand, they are economy-wide and produce redistributive effects on a continental scale which are much stronger than those to be found *between* different states of the EU (Galbraith, J., Conceicao, P. and Ferreira, P. (1999) “Inequality and Unemployment in Europe: the American cure”, *New Left Review*, 237)

In other words, the conception of active or “activating” employment policies as exclusively transitory, as simply preparing the way for a purely market-based solution of the employment problem, is a prejudice which does not correspond to the reality of US employment experience, where redistribution and intervention are an indispensable and permanent support for high levels of employment. From this point of view the continuing increase in competitive pressure on national employment systems which is built in to the process of European integration is a critical disadvantage. The Employment Guidelines demand “employability” and proclaim the virtues of “entrepreneurship” (often, in practice, more involuntary self-employment). However, if these goals are pursued through widening wage differentials then the outcome may well be to exacerbate unemployment as increasing numbers of very badly paid workers fight for a diminishing pool of well paid jobs.

2.5 Conclusion

It is a major step forward that the EU is seeking to co-ordinate and monitor active employment measures in the member states. Threats to the Luxembourg process arise from a narrow conception of intervention which would divorce the problem of unemployment from its full social context and from a dogmatic misinterpretation of developments both in Britain and in the US. The challenge today is to enrich and re-orientate the process in ways which make it more compatible with European social objectives and at the same time a more effective response to unemployment and disadvantage. Therefore in our view, social cohesion should become, alongside the existing themes, a fifth “pillar” of the guidelines.

The development of EU employment policy in these directions, however, will require that thought is given not just to national employment programmes but also, and increasingly, to an integrated European employment strategy with both a macroeconomic and a redistributive dimension.

3. New Monetarism – critique of the theoretical basis for the European economic policy concept

It is rather unlikely that national governments, the European Commission and the ECB have a single and coherent economic model underlying their economic policy agenda. In laying out an economic model, as we do below, there are the dangers of giving more coherence to European policy making than exists and also imposing a economic framework from which there are substantial departures in practice. However, the basic argument here is that there is a strong influence of a body of economic theory which underpins many of the economic policies of the European Union. With that ‘health warning’ in place we proceed.

3.1 Economic Framework: the Classical Dichotomy and Say’s law

There is a general acceptance of two basic postulates of pre-Keynesian economics, namely the classical dichotomy and a form of Say’s Law. The classical dichotomy is the idea that there is an essential separation between the real side of the economy (level and composition of output and employment, relative prices) and the monetary side of the economy. In particular, the stock of money determines the price level, and hence changes in the stock of money determine the rate of inflation. Say’s Law is often summed in the phrase ‘supply creates its own demand’, and the willingness to supply is also an intention to demand. The application of Say’s Law is then taken to mean that there will not be any general inadequacy of aggregate demand.

The major implication of the classical dichotomy is that monetary policy is assigned the role of control of inflation, and that monetary policy can be operated without regard for effects on the real (or supply) side of economy because there are no such effects. Inflation is viewed as generated by monetary factors, and hence is then seen to be controllable by monetary policy. But further the performance of the real side of the economy depends on supply-side factors, which are viewed as operating independently of monetary policy. (There is always the noted

paradox that anticipated inflation, which leaves relative prices unchanged, has no real effects, yet the control of inflation is regarded as a, if not the, major policy objective).

The general implication of Say's Law is that aggregate demand from the private sector is sufficient to ensure the supply-side determined level of employment and hence there is no requirement for a budget deficit. In practice, it would be recognised that the budget position will fluctuate with the economic cycle. The imposition of an upper limit of 3 per cent of GDP on national budget deficits is not greatly different from imposing a rule of a balanced budget over the cycle given the observed fluctuations in the budget positions over the cycle. The original formulation of Say's Law was taken to mean that there would be sufficient demand for full employment. But the new orthodoxy interprets it in terms of the NAIRU (non accelerating inflation rate of unemployment) which is the supply-side determined equilibrium rate of unemployment.

The market economy is viewed as essentially stable, and that macroeconomic policy (particularly discretionary fiscal policy) may well destabilise the market economy. Markets, and particularly the financial markets, operate with something like 'rational expectations'. It should be noted that most of the literature on 'rational expectations' and on credibility does not distinguish between different markets and hence all are assumed to hold 'rational expectations'. However, it is the financial markets which are seen as crucial in determining whether a policy is deemed to be credible. Specifically, financial markets make well informed judgments on the sustainability ('credibility') of economic policies.

Monetary policy is to be used to meet the objective of a low rate of inflation. However, monetary policy should not be operated by politicians but by experts (whether banks, economist or others) in the form of an 'independent' Central Bank. Further, there is the idea that those operating monetary policy should be more 'conservative' (that is place greater weight on low inflation and less weight on level of unemployment than the politicians). Politicians would be tempted to use monetary policy for short term gain (lower unemployment) at the expense of long term loss (higher inflation). An 'independent' Central Bank would also have greater credibility in the financial markets and be seen to have a stronger commitment to low inflation than politicians do. It is argued that a policy which lacks credibility because of time inconsistency is neither optimal nor feasible. In situations of repeated games the authorities are forced to take a longer-term view, since the future consequences of current policy decisions will influence the *reputation* of the authorities. In these situations, the authorities incentive to renege is reduced because they face an intertemporal trade-off between the current gains from renegeing and the future costs which inevitably arise from riding the Phillips curve. The overall conclusion is that the only credible policy is the one that leaves the authority no freedom to react to developments in the future, and that even if aggregate demand policies matter in the short run in this model, a policy of non-intervention is preferable. In view of the time-inconsistency and credibility problem monetary policy should be assigned to a 'credible' and independent Central Bank which should be given as its sole objective that of price stability.

3.2 The NAIRU

On the real side of the economy, the level of economic activity fluctuates around the non-accelerating inflation rate of unemployment (NAIRU). The source of domestic inflation (relative to the expected rate of inflation) is seen to arise from unemployment falling below the NAIRU, and inflation is postulated to accelerate if unemployment is held below the NAIRU.

Monetary policy is then seen as the instrument to keep the economy close to the NAIRU to avoid accelerating inflation. In the long-run it is postulated that there is no trade-off between inflation and unemployment, and the economy has to operate (on average) at the NAIRU if accelerating inflation is to be avoided. In this long-run, inflation is viewed as a monetary phenomenon in that the pace of inflation is aligned with the rate of increase of the money supply.

The key element of the NAIRU approach is that the (equilibrium) level of unemployment is not only determined on the supply-side of the economy (and generally viewed as unaffected by the demand-side of the economy) but also that it is essentially a labour market phenomenon. Hence if the NAIRU is relatively high (as estimates of the NAIRU for many countries undertaken over the past two decades would suggest) then the policy recommendation is to 'improve' the operations of the labour market. In general, 'improving' the operations of the labour market is described in terms of making the labour market more 'flexible'. For proponents of this policy, 'flexible' is a useful word to use – for who would wish to argue in favour of being inflexible? Although 'flexible' has been used in many different ways, in this approach it could reasonably be said that making a market more 'flexible' means making that market become more like the spot competitive market as envisaged in neo-classical economics.

Policies which have been seen to make the labour market more 'flexible' and to reduce the NAIRU can be placed into (at least) three groups. The first set has been to seek to remove institutions from the labour market which would not be present in a perfectly competitive setting – the clearest examples being the reduction of trade union rights, removal of minimum wages as in the UK under the Thatcher government. The second set has been (though not unrelated to the first) to reduce wages. The third set has been policies to increase the effective supply of labour, whether by lowering unemployment benefits, increased pressure on unemployed to find work or through targeted training programmes and assistance to increase 'employability'.

3.3 Discussion and Critique

The monetarist 'story' indicated that control of the growth of the money supply was the necessary and sufficient condition for the control of inflation. However, we live in economies in which banks create money in the process of loan creation and in which the amount of money which remains in existence is largely demand determined. These are economies in which it is more the case that the rate of inflation determines the rate of growth of the stock of money than the reverse causation. Governments have largely abandoned any idea of controlling the growth of the money supply, and have recognized that monetary policy operates through interest rates (with the Central Bank setting the key discount or 'repo' rate). The effectiveness of monetary policy on inflation then depends on two elements, namely the extent to which interest rates influence the level of demand, and then the extent to which the level of demand influences the pace of inflation. There are reasons to argue that each of those elements is relatively weak, and hence the ability of monetary policy to control inflation is suspect. But on the other hand the extent to which monetary policy does influence aggregate demand may cause detrimental effects on the economy. Higher interest rates (perceived to be required to slow inflationary pressures) may influence the level of investment (and hence the level of aggregate demand), which has detrimental effects on the productive capacity of the economy and on the possibilities for the economy to sustain high levels of employment without generating inflationary pressures. Higher interest rates may also tend to raise the exchange rate (and

thereby dampen inflationary pressures through the reduction of import prices in domestic currency). Slowing inflation then comes at the expense of raising export prices and reducing the volume of exports.

The role of budget deficits

Keynes, in effect, argued that Say's Law was not applicable in a monetary production economy, and the corollary of Say's Law that *ex ante* savings and investment would be equal at full employment (or at any other arbitrary level of employment such as the NAIRU) did not apply. The consequence of that idea was that the maintenance of full employment may require a sustained budget deficit in order to secure the high level of demand required for full employment. The national income accounting identity gives :

$$(S - I) = (G - T) + (X - M)$$

If this identity refers to a situation of full employment, and assuming that savings may run ahead of investment, then some combination of a budget deficit ($G > T$) and trade surplus ($X > M$, and hence a capital outflow) is required. The excess of private savings over investment has to be mopped up by the domestic private sector lending to government or overseas, and correspondingly there has to be a willingness for government or other countries to borrow.

From this perspective, a government budget deficit is not taking savings away from the private sector (and hence away from investment) but rather is allowing the savings to occur. Consequently, running a budget deficit in these circumstances does not place upward pressure on interest rates. It could also be noted that the base interest rate is set by the Central Bank in pursuit of the Central Bank's objectives : the Central Bank has the single objective of low inflation in many countries including the eurozone.

One fear associated with a budget deficit is that it entails borrowing and that the national debt and interest payments on that debt rise over time, and a continuing budget deficit becomes intolerable. It is also sometimes argued that the payment of interest on the national debt is a transfer from relatively poor tax payers to relatively rich wealth holders. These arguments are however misleading. First, it is well-known that the condition for the national debt to rise continuously relative to national income is that the post-tax rate of interest (on government debt) is greater than the rate of growth of national income. The emphasis on monetary constraint in the past two decades has led to unprecedentedly high real rates of interest and to lower rates of growth.

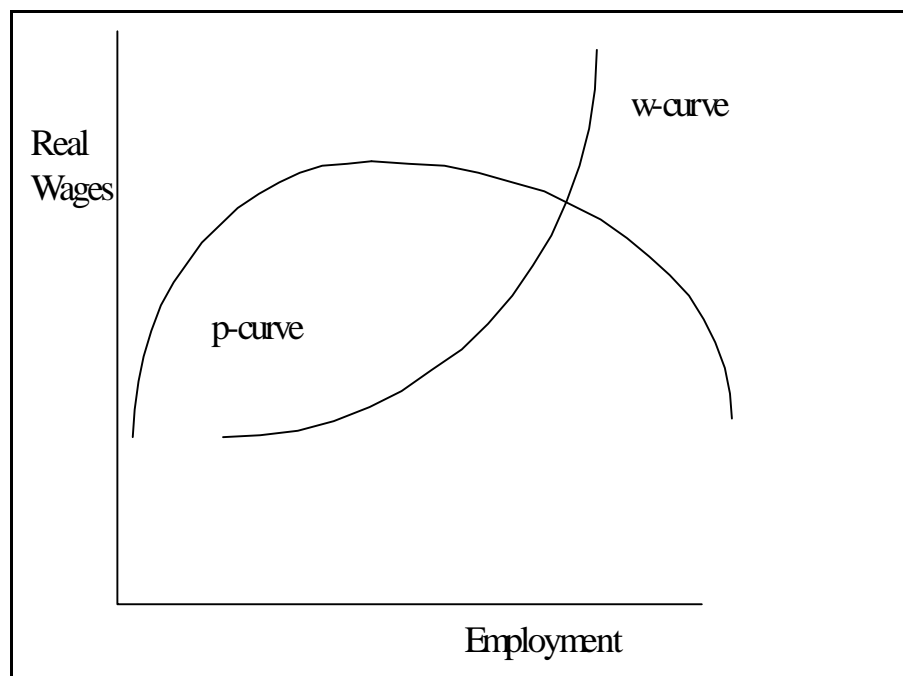
It should also be noted here that the national debt to income ratio will grow continuously (if the above condition holds) whatever the size and whatever the cause of the budget deficit. Thus, invoking rules such as the so-called 'golden rule' that deficits can be used to finance capital expenditure but not current expenditure would not help. The feature of both government capital expenditure and current expenditure is that expenditure is incurred for which there is no future income stream. Public investment is generally economically beneficial but unlike private investment does not generate an income stream (with the exception of public investment which leads to the provision of goods and services for which a specific charge is made, e.g. a toll bridge).

Labour market and employment

The focus of the NAIRU on the labour market and the idea that making labour markets more 'flexible' increases employment is faulty in two major respects. The first is the presumption more 'flexibility' is necessarily beneficial. The obvious counter example is that short term employment contracts (presumed to be more 'flexible' than long term contracts) inhibit the provision of training and skill formation.

The second is that the focus on the labour market is misplaced. The figure below is a typical example of a diagram used to illustrate the NAIRU. The upward-sloping w-curve is based on wage determination consideration: the precise mechanism behind the curve varies from collective bargaining through efficiency wages and insider-outsider models. The (eventually) downward-sloping p-curve is based on price determination considerations, and represents the idea that with increasing marginal costs prices rise as output increases, which is reflected here in declining real wages and rising employment. Because the representation is in the real wage-employment plane, there is a temptation (which is usually not resisted) to think in terms of a demand for and supply of labour framework. But this overlooks four rather important points.

- The first is that the position of the p-curve (in our terminology) depends on the capacity of enterprises. Their ability to offer employment and pay real wages depends on the productive capacity at their disposal. In turn, that productive capacity depends on past and present levels of investment. Deflationary policies which tend to restrain investment lead to lower levels of capacity, and diminished possibilities for employment without inflation.



- The second point arises from the question of what lies behind the w-curve. Whilst the upward sloping curve is reminiscent of a supply of labour curve, it is generally based on ideas as to how wages are determined. A frequently used idea is that of efficiency wages and the idea of the cost of job loss. Expressed crudely, workers put in effort only if there is some cost to

them of not doing so, that is the cost of job loss. The cost of job loss depends on the present wage relative to wages elsewhere, the level of unemployment benefits and the probability of remaining unemployed if dismissed (which in turn depends on the level of unemployment). An implication which is often derived is that reducing the NAIRU requires increasing the cost of job loss, which in turn can come from lowering unemployment benefits. We would draw a rather different implication. But first it should be noted that considerable doubt should be cast on the general notion underlying this curve, namely that workers will 'shirk' unless there are costs associated with doing so (or at least costs associated with being caught). The implication which we draw is that alternative forms of work organisation (degree of worker participation etc.) can, in effect, influence the position of the *w*-curve. Thus rather than seek to increase the cost of job loss, the alternative (albeit difficult and perhaps utopian) path is to develop alternative forms of work organisation.

- The third point is that this simple diagram may provide a macroeconomic equilibrium level of employment but it tells us nothing about the regional (or other) distribution of employment. Estimates of the NAIRU present a single figure covering the economy to which it relates, and it is rare for the estimates to be broken down by, say, region or ethnic group. For example, an estimate of 6 per cent of the NAIRU for the USA does not usually specify what that would entail for the more depressed regions or for ethnic groups.

- The fourth point is that the equilibrium level of employment in this figure (which reflects a supply-side approach) may be a 'weak attractor' of the actual level of employment, and that the level of aggregate demand plays a significant role in determining the actual level of employment. There is no particular reason to think that the level of aggregate demand will just be the right level to provide the equilibrium level of employment. Aggregate demand has a further role – the path of aggregate demand influences the pace of investment, and hence capacity.

3.4 Dealing with Crisis

Two basic premises appear to underlie the economic policies of the eurozone (and EU member countries in general), namely that the private sector is essentially stable and does not suffer from crises generated by problems of aggregate demand and that inflation is essentially a phenomenon generated by the interplay of excessive demand (relative to the NAIRU) and the monetary sector. We take a rather different perspective, namely that there are recessions due to insufficiency of aggregate demand, and that inflation can result from a variety of factors including forms of cost push and imported inflation. It is argued here that the eurozone does not have in place economic policies which are able to deal with insufficient aggregate demand nor with an upsurge of inflation. It would also be argued that the high levels of unemployment experienced by most, though not all, eurozone *countries* during the 1990s has largely been a result of inadequate aggregate demand.

Unemployment: Inadequate aggregate demand can strike relatively quickly, as at the onset of recession, or in a more prolonged manner (and as observed through much of the eurozone for the past decade or more). The proposition here is that coping with swings in aggregate demand (and the associated swing in the balance between savings and investment) generally requires a swing (into deficit) of the government's budget position. The combination of the 3 per cent maximum limit on the national budget deficits and the requirement that the EU budget is balanced appears to preclude significant budget deficits to cope with high levels of net private savings.

Inflation: The mainstream mechanism to control inflation is variations of interest rate in pursuit of a low inflation objective. Typically the variations in the interest rate (the 'repo' rate) are a quarter or at most half a percentage point. Further, there are significant limits as to how far interest rates can be varied within the EU relative to interest rates in the rest of the world. It would, for example, be difficult to believe that a real interest rate of say 10 per cent could be set by the ECB if real interest rates elsewhere (say in the USA) were 2 or 3 per cent. There would be severe doubts on the sustainability of such rates (and hence a credibility problem) and there would be clear implications for the exchange rate of the euro.

The use of interest rates as the mechanism to control inflation rests on two linkages namely from interest rates to the level of demand, and from the level of demand to the rate of inflation. We would doubt that either of those linkages is strong, whether in the form of the impact of interest rates on demand and of demand on inflation being in some sense large or in the form of the impact being reliable. The simulations reported in Bank of England (1999, p.36) for a 1 percentage point shock to nominal interest rates, maintained for one year, reaches a maximum change in GDP (of opposite sign to the change in the interest rate) of around 0.3 per cent after five to six quarters: 'temporarily raising rates relative to a base case by 1 percentage point for one year might be expected to lower output by something of the order of 0.2% to 0.35% after about a year, and to reduce inflation by around 0.2 percentage points to 0.4 percentage points a year or so after that, all relative to the base case' (Monetary Policy Committee, 1999, p.3). The cumulative reduction in GDP is around 1.5 per cent over a four year period. Inflation responds little for the first four quarters (in one simulation inflation rises but falls in the other over that period). In years 2 and 3 inflation is 0.2 to 0.4 percentage points lower: the simulation is not reported past year 3. It should be also noted here that the simulation which is used varies the interest rates for one year : in the nature of the model, there are limits to how far interest rates can be manipulated, and this has some reflection in reality. We would argue that the effects of interest rate changes in the UK are likely to be larger than the effects within the eurozone for two reasons. First, much of the effect of interest rates comes via the exchange rate, and the UK is a more open economy than the eurozone, and hence exchange rate variations are likely to have more impact in the UK than in the eurozone. Second, there may be greater use of variable rate borrowing in the UK than in the eurozone.

We would suggest that the use of small and possibly frequent changes in interest rates to meet an inflation target some time ahead runs into the problems which any form of fine tuning faces. But the concern here is more that at best interest rates can only address small upswings in inflation which are stimulated by the level of demand. Upswings in inflationary pressures which arise from other sources such as imported inflation, struggles over income shares cannot be dealt with by variations in the interest rate. Even significant demand inflation could not be tackled through interest rate changes, which would be too weak a policy instrument.

3.5 Conclusion

The 'old monetarism' which believed in controlling the money supply to control inflation, and which saw the economy as moving to the 'natural rate of unemployment' has been replaced by a 'new monetarism'. which is (rather paradoxically) rather close to 'new Keynesian' economics (with little relationship to Keynes or Keynesian economics). This new Keynesian economics focuses on a supply-side in which the NAIRU reigns, and in which monetary policy in the guise of interest rate variation is used to control inflation. The theoretical and empirical support for this approach is very weak and indeed not convincing, and the consequences for economic policy are economically counterproductive and socially regressive.

4. Market fundamentalism - A broader perspective for the critique

In the following we will briefly summarise our critique of the two programmatic documents and extend it to the ideological context in which they are embedded.

Continuity of policy regardless of changing conditions. The General Economic Policy Guidelines and the Employment Guidelines for 2000 imply the same supply side oriented economic model that has been used since the early eighties. They largely ignore that the economic policy following this model has been unable to face the main economic problems, like slow growth, widespread unemployment, permanent regional disparities, the deterioration of working conditions (precariousness of work) and the rise of poverty and marginality for significant parts of the population in the European Union countries. Where lack of success is acknowledged not the chosen strategy is made responsible but it is deplored that the supply side policy had not been implemented rigorously enough. This view also ignores that during the last twenty years of the end of the century an astonishing rapid evolution of society has taken place, and many things have changed in the economic and social sphere, which an efficient policy must take into account. Because this has not been done the situation has deteriorated in many aspects.

The reasons for the persistency of the neo-liberal option seem to lie in economic interests and power instead of intellectual poverty and stubbornness. The very significant and growing power of financial capital during this period, which is almost exclusively interested in price stability (including exchange rates), explains much of the disinflationary bias of economic policy during the last decade. The fact that even after the monetary union has started and inflation almost disappeared from the European scene (even traditionally inflationary countries presenting low inflation figures), when even the threat of deflation has been causing significant preoccupation, the policy pack is hardly altered, shows the strength of the powers behind this policy option, and leads to an increasingly conspicuous subordination of the EU policy to the interests of powerful financial and entrepreneurial interests.

Narrowness of the approach to policy. The policy of the Union and its own assessment of its performance focus largely on the consideration of a few macroeconomic equilibria ignoring all other issues like structural elements, welfare of the population or social problems. This implies a very narrow conception of the economy and of economic policy tasks. In this view social problems are considered as economic malfunctions which can be more or less easily redressed if the model would function properly.

The first relevant question seems to be who defines what is policy and what are the policy objectives. Is the objective of policy only to ensure macroeconomic equilibria? Which macroeconomic equilibria? It seems that they have been reduced to price stability and budgetary equilibrium. Policy recommendations are derived from specific macroeconomic options that have achieved the status as fixed parameters which cannot be discussed still less altered. Then all other choices have to be adapted to those previous options. Why not consider which would be the policy recommendations if the priorities would be reversed: Fixing other broader social and economic objectives, like rate of growth, rate of creation of employment, limits on the level of unemployment, welfare provisions and many others, and then analyse the different macroeconomic ways of fulfilling those objectives? .

As regards *poverty, exclusion and many other social problems* they are hardly considered as a matter of economic policy at Union level. If anything they are - to a very insufficient degree - dealt with in small programmes of the structural funds, and most of it is referred to the member states. All of it under the argument that social structures are too different for common decisions at Union level. Which might be a very convenient way out were it not for the fact that this is a decision that has been taken by the same decision makers that are prepared to act very firmly in other policy areas which are not less connected to national idiosyncracies.

Moreover specifically in the BEPG *workers* as such and their living situation do not seem to exist. Considerations about the labour market deal only about how to attain 'efficiency' or be 'responsible'. There is no reference to the impact that the measures proposed in these Guidelines may have on the workers and their welfare. The main reference is the warning against the dangers of lower working time or the preoccupation with the need to improve the supply of labour (with 16 million people unemployed !).

It might be argued that since the Policy Guidelines are complemented by the Employment Guidelines the issues related to labour correspond to the later. It is true that there are some progressive provisions in the latter recommendations like the one about ensuring equal access to the labour market for women and men. But even in the EG the main issue is how to ensure that people work somehow, regardless of other considerations like about what type of employment or participation of workers in the decisions of the enterprises, circumstances which have a very relevant impact on the situation of labour and welfare. The modest and timid deliberations in the EG to improve the labour situation are then contradicted and brushed aside by the BEPG: The extremely high priority given to price stability and the monetary and tight fiscal measures taken to sustain it have important and serious consequences for the situation of the workers. A more explicit consideration of real social relationships and on how to avoid negative consequences of economic policy on social welfare of the majority of people should have been a substantial part of the Policy Guidelines.

Perhaps the most important critique of both documents relate to the fact that they show a *complete neglect of the question of the distribution of income, wealth, opportunities, welfare, and empowerment of the population*, revealing a very conspicuous lack of sensibility about these issues. For instance the distribution of income does on the one hand encompass very fundamental facts and determinants of the social reality of the people; on the other hand it is a basic factor of economic growth and development in a more restricted sense. But even this narrow dimension of distribution escapes the BEPG – they are still more narrow. The reason for this, again, may lie not primarily in ignorance but in the politically sensitive character of all distribution issues.

Lack of consideration of the structural problems that the working of the Community itself causes: An economic model based on external competitiveness, liberalisation of external relations, deregulation and privatisation accompanied by a monetary union that provides new facilities for the unrestricted flow of financial and productive capital, leads to a very radical restructuring of productive units that benefits the stronger enterprises and countries, where the more dynamic activities are concentrated. It generates on the other hand severe negative consequences for the productive structure of the poorer areas where activities of a subsidiary character, dependant on light and 'banal' technologies and making intensive use of energy and less skilled labour are developed, while, unable to compete, they lose important parts of their previous productive structure.. A very asymmetric European productive structure is being formed leading and perpetuating regional imbalances and polarisation within and between member countries, that may produce an acute threat to the European construction, fostering beggar-my neighbour and negative-sum policy games among member states. Here again, such problems seem to be regarded not as problems of economic policy, they find no mentioning neither in the BEPG nor the EG. They are not completely neglected but referred to the special area of structural policies. We regard this as very inappropriate.

Ambiguity and deliberate darkness (obscurantism) of language. An additional but not irrelevant point that should be mentioned here is also that of the type of language that is used in the official documents. We have the impression that the language used there is often deliberately ambiguous and confusing, leading to obscure and even misinform about the real meaning of many of the questions tackled and proposed. This is particularly true in matters of political controversy and sensitivity. It leaves everybody a choice of interpretation of central sentences and thus tries to avoid being criticised for outrightly harmful policy recommendations. For instance 'adequate evolution of wages', what does it mean? Lower wages, higher, growing according to productivity, below, above? The expression as it stands means nothing. The same with the need for 'economic reform', what does it mean? What type of economic reform?, for what?. However, this verbal ambiguity should not lead to doubts about the hard core thrust of the recommendations, which becomes unambiguously clear in the context in which they appear: "Adequate wage evolution" means lower wages, and economic reform means reform towards deepening of the market. The ambiguity of language is a means to avoid open public discussion of controversial policy recommendation and possible alternatives.

The fundamentalist approach to the market. Both the Economic Policy and the Employment Guidelines point out clearly to the will to continue placing into the market, only submitted to the private norms of business, the responsibility for the economic and social organisation. Considered as a whole, the measures which are presented go in the direction of facilitating the working of the markets according to an hypothetical 'greater freedom of operation' and the less and less submitted to any kind of political regulation and control. Allegedly in order to enhance competition and increase welfare, willingly ignoring that most measures which are proposed nominally to increase competition are full of qualifications regarding the need to take into account the working of the world markets and consequently of a critical size to operate competitively in them, which, of course, means that competition is only a rhetoric image. We are not advocating for a situation in which it would be difficult to compete in world markets but for the need for the necessary social and political regulation to balance and frame the huge power of the enterprises, financial and industrial, operating all over the world. As it stands, the policy of the European Union implies the facto rejection of political (democratic) responsibility for the main directions of economic and social development in spite that they

are one of the cornerstones of modern democratic societies that care about the welfare of their populations.

Moreover, these deepening and unbridling of the market as the unique mechanism of social organisation goes accompanied by an increasingly technocratic and authoritarian approach towards public regulation. The way in which the European Central Bank has been established and operates and the requirements of the Treaty of Maastricht and the Stability Pact are very conspicuous examples of the narrowing of the capacity of policy making of the member states in some specific issues - once more those that are considered more important for monetary stability - but they are not the only ones, as it is shown by the persistent and universal recommendations of the Union to 'restructure' the welfare systems regardless of the willingness of the different countries, while the principle of subsidiarity is applied for most elements of a positive social policy .

Lack of considerations of external relations or about the policy of the Union about other countries (nor central countries, like US or Japan, neither countries in the periphery). Only two paragraphs on page 1 to demand stability of the rate of exchange and adequacy to the world financial markets. Absolutely nothing about measures related with the enlargement of the Union.

Overall, taking the economic policy guidelines as a whole, they reveal first, that their conception of 'policy' refers only to the very short term macroeconomic need for price stability and budget equilibria since they ignore other elements of macroeconomic policy, and particularly broader issues as welfare, income and wealth distribution and so on; second, they base their analysis and recommendations in a very definite and tough neo-classical conception of economic life. That is, the consideration of the economic organisation as something that has to be left totally to the market and private economic agents without any hindrances from public regulations (which does not mean that there are not very tough private norms) except the ones necessary to ensure price stability. At the back of that conception, although very significantly it is nowhere made explicit, there is the postulate that the working of unregulated markets will provide the benefits for a good life to the majority of the population. It is well known this is the present philosophy of the EU but at least some reflection of the problems caused by that system might have seemed worth of consideration.

The *European Economists for an Alternative Economic Policy in Europe* question that assumption and consider that justification on that basis is purely window dressing for the consumption of public opinion. Decision makers and their advisers know very well that the market system does not operate in such a way and that the policies they are advocating, designing and imposing at the EU level and in the member countries are the policies directed to maintain and improve a social and economic environment directed primarily to the development of big business and especially financial capital. If that provides also good conditions for the population so much the better- legitimacy will be ensured- if not, policies will be nonetheless pursued and some other means - ideology and/or repression- will be used for justification. The present economic European Union policy is not primarily directed to the well being of her population but to the attainment of profits for private capital. That is why we consider that a very substantial reversal of the policy measures is required gradually leading to a substantial change in the priorities in the objectives and organisation of the economic life.

Chapter 2

The drive to inequality – Economic and social development of the EU

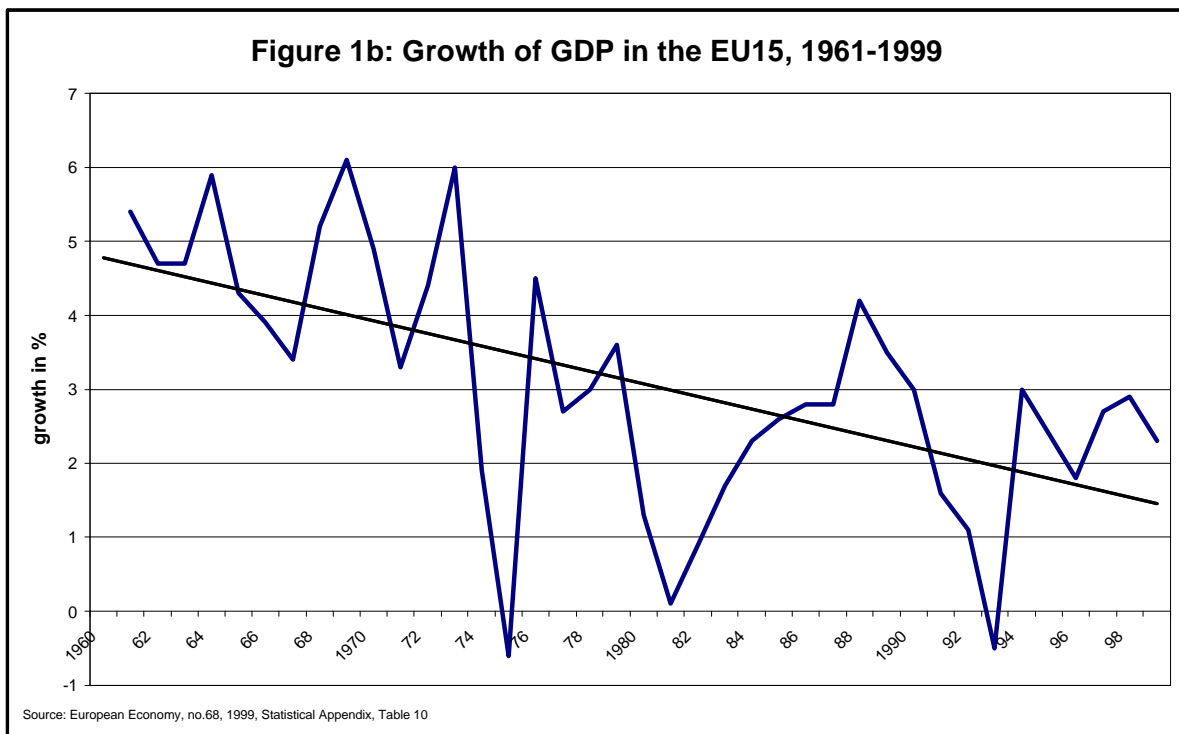
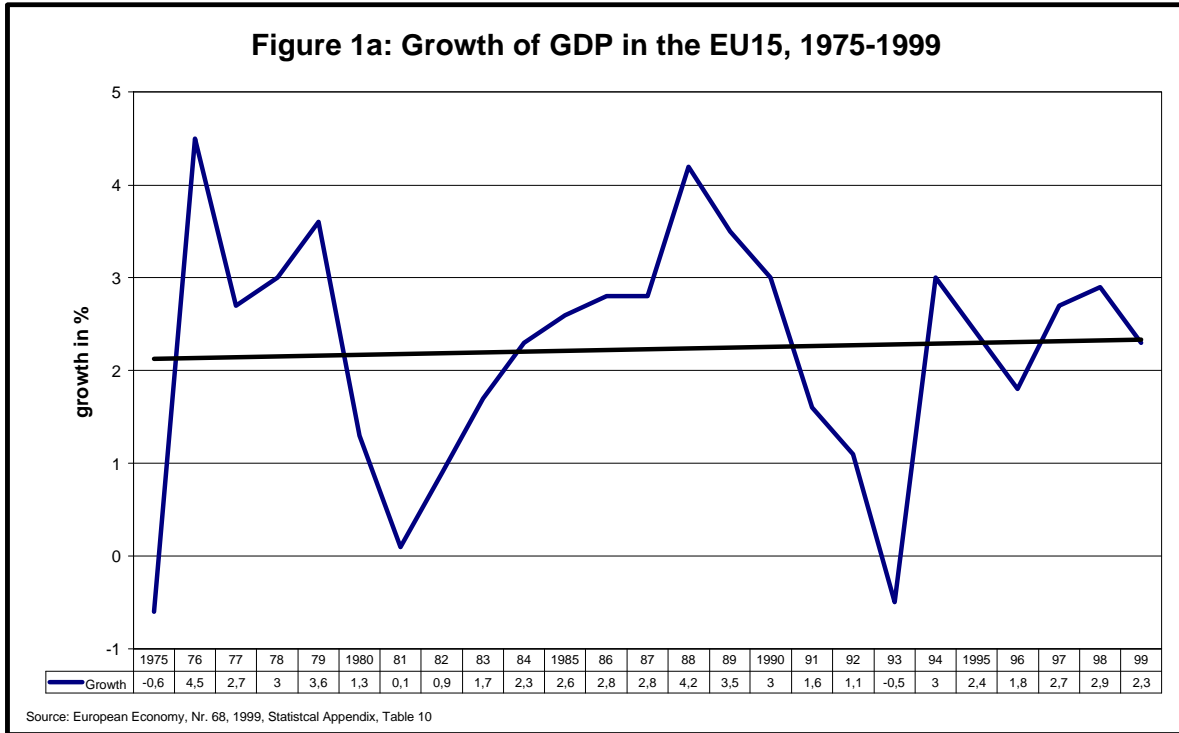
In the following we will first (section 1) briefly sketch our view of some basic macroeconomic trends of the European economy, which can be observed over the last 25 years and – in order to show the deep break in the mid 1970s - over the last 40 years. This overview serves two purposes, namely firstly, to dampen the political euphoria about the current economic recovery and the allegedly long term growth prospects of the EU by demonstrating their rather modest dimension within a long term framework. Secondly we want to show that the mainstream pattern of explanation for the long-term rising trend of unemployment, namely in one way or the other excessive wage claims of the workers, is completely unfounded and that there are good empirical reasons for arguing the other way round: It is a shift in distribution in favour of profits and thus more income inequality which has impeded and still impedes growth and raises unemployment. This distributionary bias has been reinforced by an economic policy bias under the imperative of deficit reduction after Maastricht (sect. 2). Thus unemployment, though currently slightly falling, remains on the overall EU level on an unacceptably high level and attains increasingly problematic structures, and employment, though currently slightly growing in number of employed persons, is increasingly organised in unsatisfactory forms and regional disparities are widening (sect. 3). As a particularly comprehensive feature of inequality the gender gap has, in spite of various programmes of the EU, largely persisted (sect. 4). Finally, we will deal with a completely new and dangerous dimension of growing inequality in Europe, which has emerged during the last decade, i.e. the East-West divide between the EU and the eastern European countries (sect. 5)

Although we are aware that the situation in particular member states of the EU is often rather different from the one in others, we confine ourselves in this report largely to the presentation of the EU as a whole. The reason for this is – apart from our limited work capacity – that it is the declared ambition of the EU (at least on the single market and for 11 countries on the monetary level) to be regarded as one unified economic and social space. This is not to deny that there are very substantial and severe regional and social differences and disparities between member countries. We hold on the contrary that these disparities exist and are partly growing and that they are a matter of concern and a responsibility for the EU as a whole.

1. Slow growth, high joblessness, more inequality - Basic macroeconomic trends

Economic Growth: The long term trend (1975-1999) of economic growth of the EU as a whole has been remarkably constant at 2% p.a., with one short (1975 – 1981), and one long cycle (1982-1993).(cf. figure 1a). In a still longer perspective, going back to the 1960s we see that the trend of growth is negative. (cf.figure 1b). Currently the EU goes through a further cycle, which has hitherto been weaker than the previous two; this will still be the case if the predicted growth rate for this year (3,4%) were realised. We therefore see no reason to believe that the current upswing will develop to a new longterm wave of high growth like the ones in the 1960s. We think on the contrary that the European economic recovery has hitherto re-

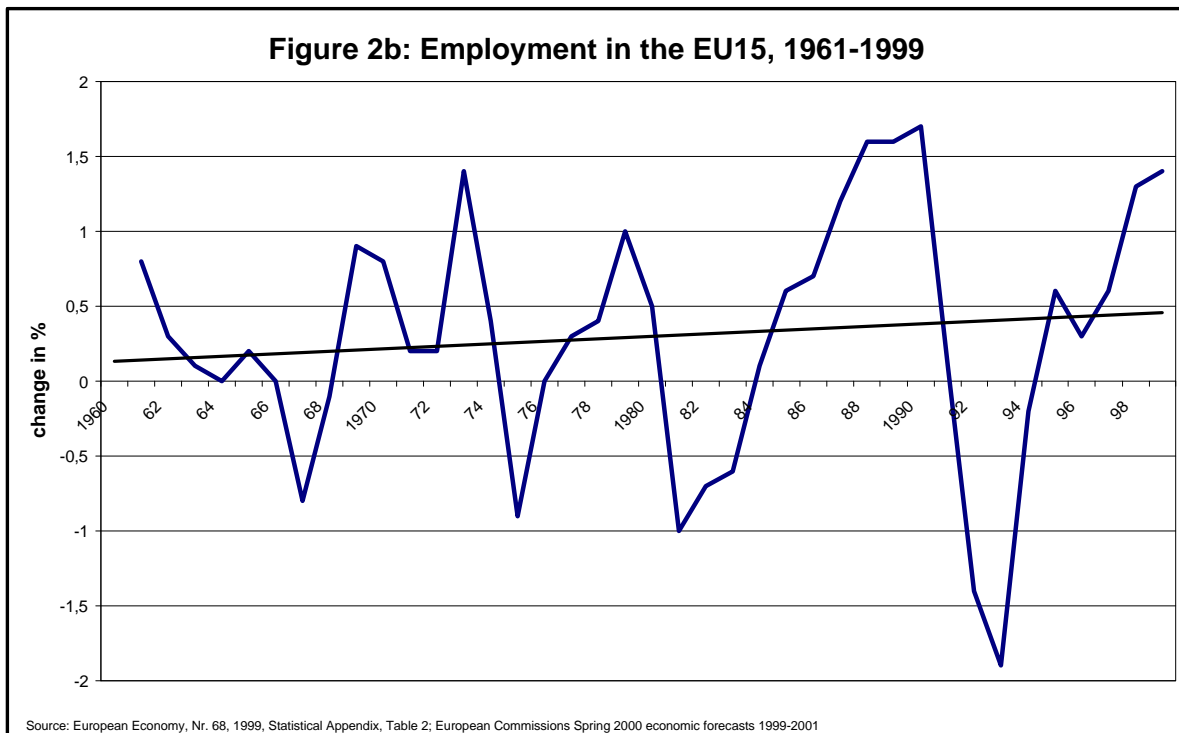
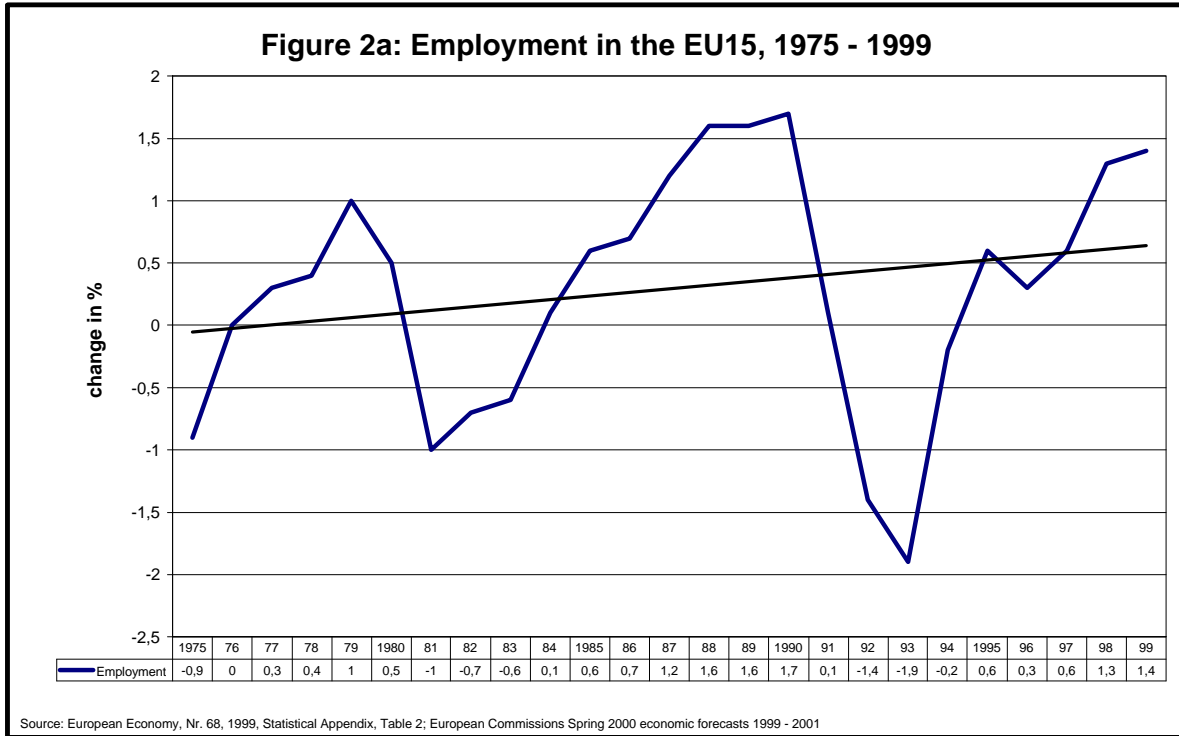
mained very fragile, because it is to a considerable part based on two external factors, the persistency of which cannot be expected. The first is the boom in the USA which is an engine for the world economy, reinforced for the Euro-zone by – second – the weak Euro.



Both factors lead to strong increases in exports, and both will, when the American boom comes to an end and the Dollar becomes weaker against the Euro, leave the EU without strong domestic pillars for growth. Most importantly, unlike the USA the EU (euro-zone) has so far not seen a strong rise of private consumption, which has become the basis of the long lasting American boom. In the EU private consumption remained remarkably weak during the first

quarter of this year, with an increase of only 1,5% on an annual basis and with no increase at all against the preceding three months. Is this already the end of the much praised recovery ?

Employment: In the last 25 years total employment (including self employment, part-time and temporary employment) in the EU15 has only risen marginally, the trend coefficient being close to zero (cf. figure 2a). In absolute numbers, employment was about 20 million higher in



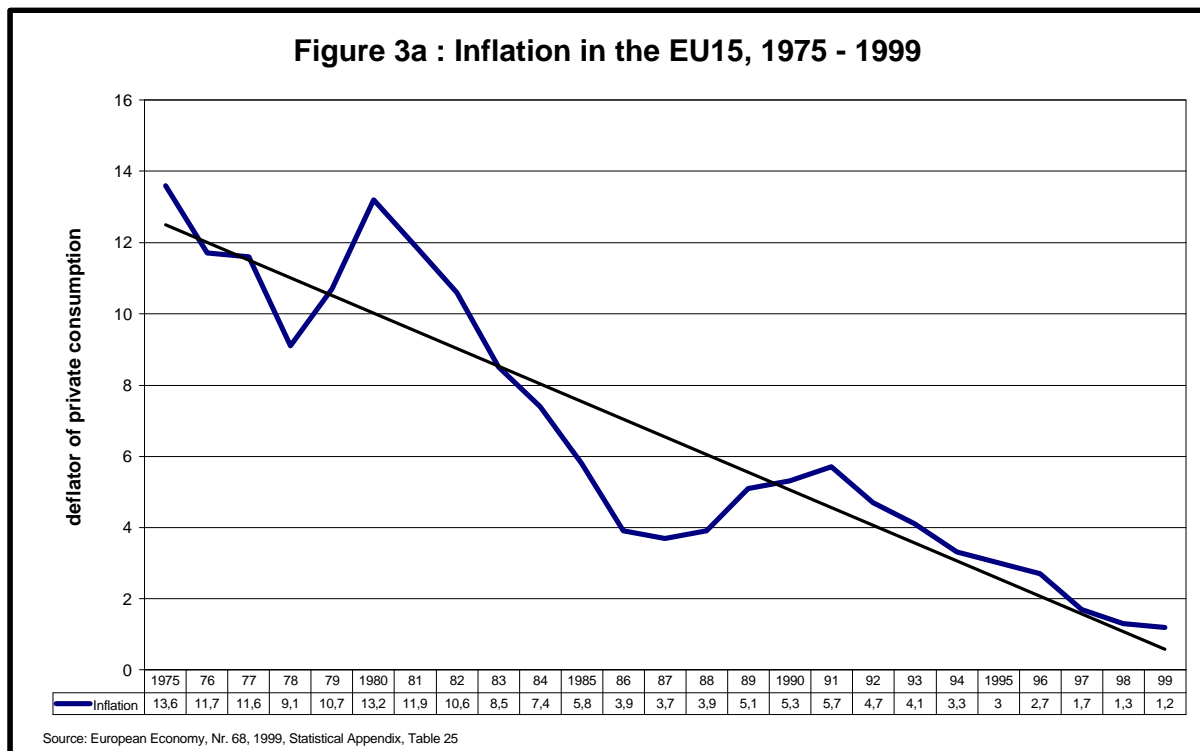
1999 than in 1975, but of the net increase 7 millions are due to the accession of East Germany. This leaves an average yearly employment increase of 0,3% in the EU as a whole, re-

ardless of sectorial restructuring and the changes in the quality and conditions of work and in individual working times.

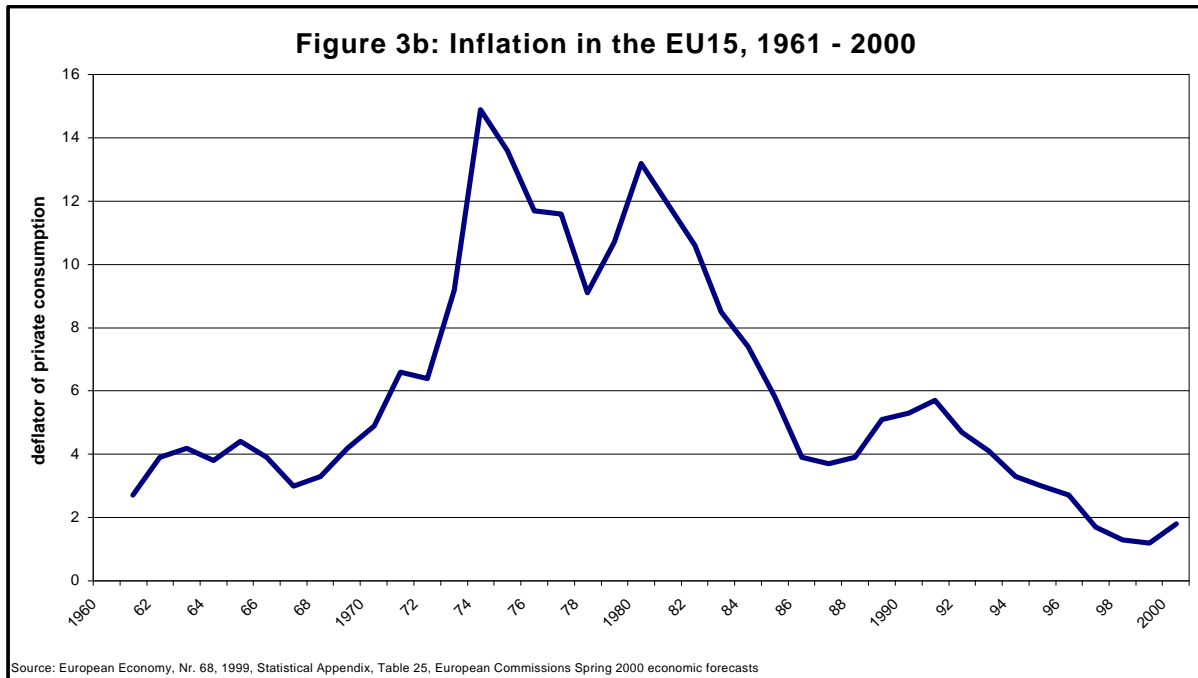
The gap between 2% GDP growth and 0,3% employment growth is due to productivity and working time increase (minus working time reduction). Again there is no reason to believe that long-term endogenous forces will lift employment growth over that very modest threshold which is by no means sufficient to restore full employment. Here, too, one has more reasons to assume that further progress in productivity – dispersion of information technology, technical progress in the services sector – will impede the creation of jobs as a result of mere growth.

Within this framework of slow GDP growth and almost no employment growth three marked changes have taken place which – as we see it - have decisive repercussions on the growth-employment framework itself:

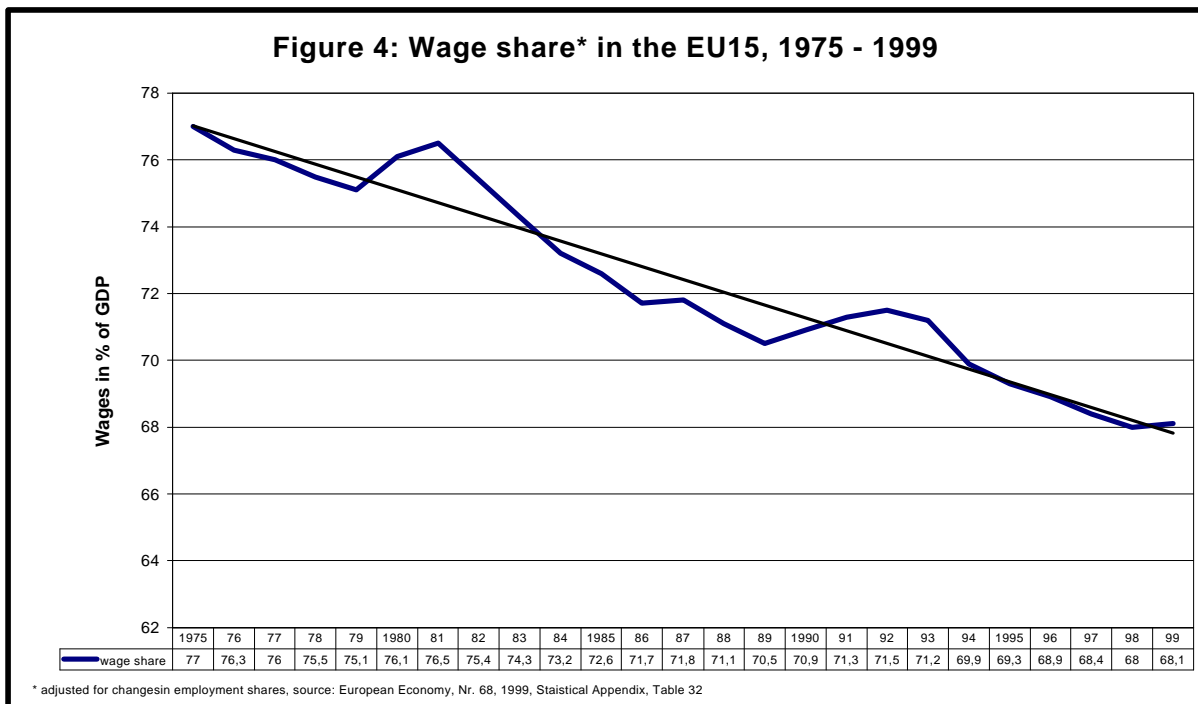
First, from the second half of the 1970s onwards *inflation*, which had risen to 14,9% in 1974 (cf. figure 3b) – and thus contributed (as one factor amongst others) to the very steep fall in GDP in 1975 (cf. figure 1b) - has fallen almost continuously to less than two percent in the last three years, bringing core inflation close to zero, with the danger of deflation (figure 3a, 3b). This reversal has been achieved through a very restrictive monetary policy which has



triggered and reinforced two severe recessions (in 1981 and in 1991) and dampened or even (in the 1991 case) very brutally cut off the ongoing recoveries. The continuing exclusively disinflationary policy stance of the ECB is a severe brake for the current recovery and will impede stronger growth. It is to be feared that the current (September/October 2000) modest increase in the rate of inflation due to higher oil prices and the depreciation of the EURO will lead to a further tightening of monetary policy which has already started by successive increases of the interest rate that have been imposed by the ECB recently and for fiscal policy on the recurrent emphasis on the maintenance of balanced budgets.

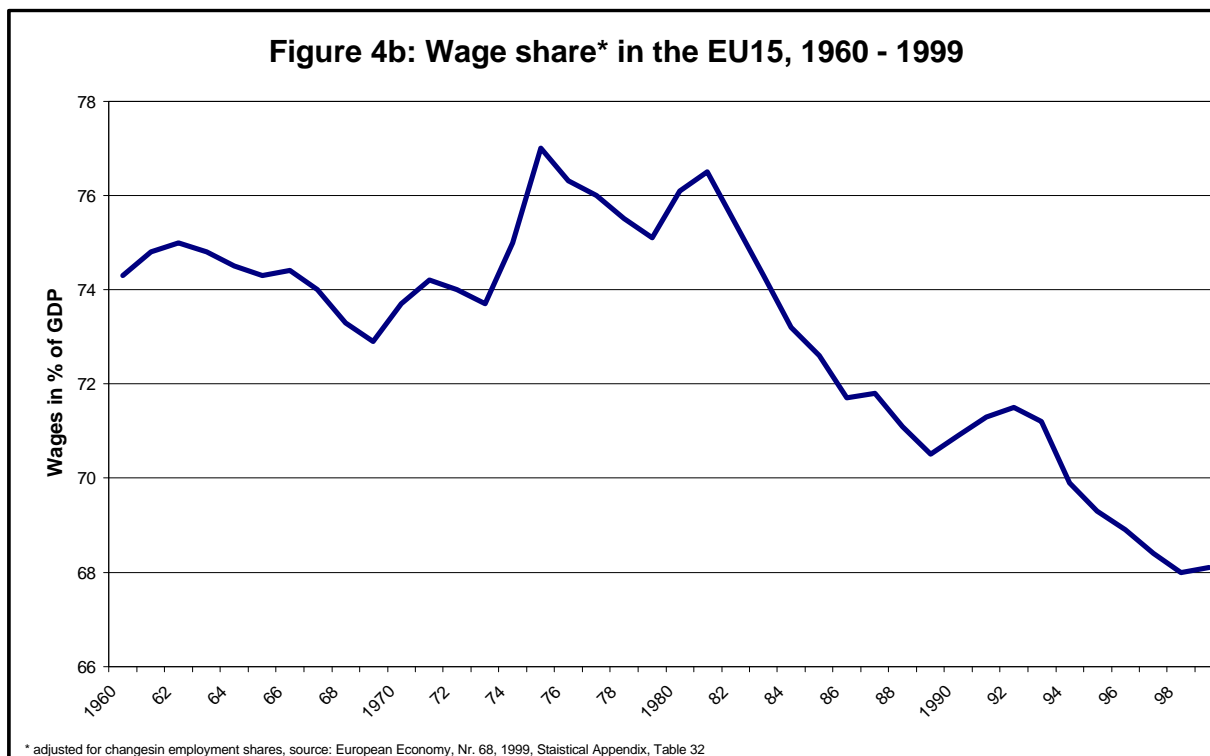


Second, *income distribution* has undergone a marked shift in favour of profits at the cost of wages. The wage share, which had been oscillating around 74% throughout the 1960s and the first part of the 1970s (cf. fig 4b) and rose to more than 75% during the last half of the 1970s,



fell almost continuously in the 1980s, has remained below 70% ever since 1994 and reached historical lows in the last two years. (*figure 4a*). This is not only lower than Japan but – recently – also lower than the USA. This shift in income distribution has been sharper in the countries of the present monetary union than in the EU as a whole. (However, the extremely

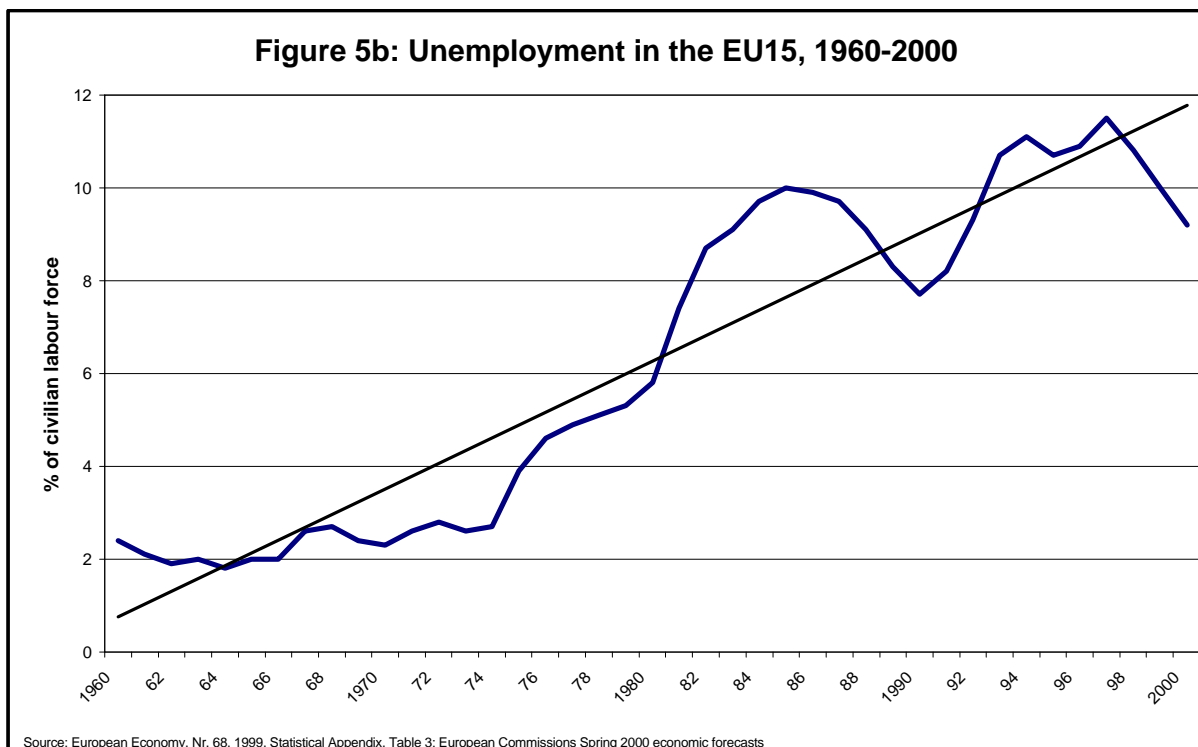
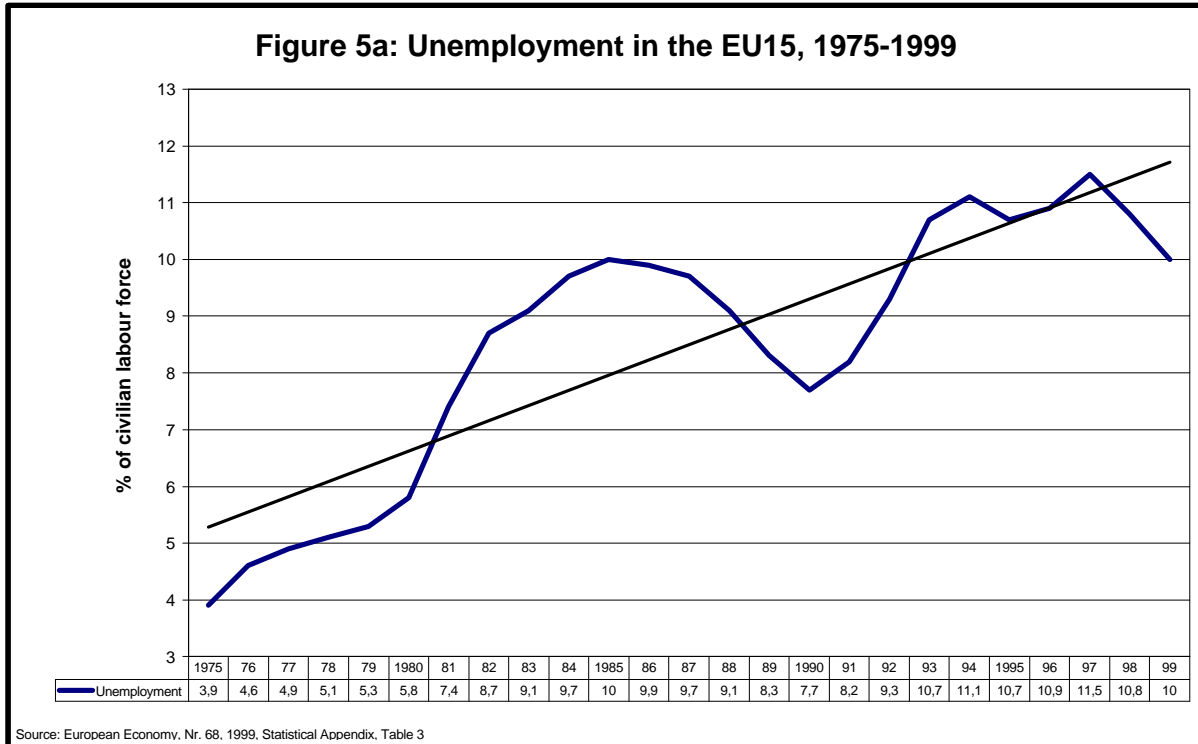
sharp fall in some small countries - in Ireland the wage share fell from 84% in 1975 to 58% in 1999, i.e. by 26 percentage points, in Portugal from 92% to 69% and in Spain from 80% in 1975 to 67% in 1999 – is partly due to a statistically misleading bias of the correction factor). In seven out of 15 member countries the fall was more than 10 percentage points. In terms of the basic categories of income distribution, the distribution between wages and profits, the EU has definitely become markedly more unequal since the midst of the 1970s.



Third, the *rate of unemployment* has risen drastically in all member countries of the EU and in the EU as a whole. While it remained below 3% during the 1960s and until 1974 (*cf. figure 5b*), it started to rise steeply from 1975 to 1985, from 3,9% to 10,0%. At the peak of the recovery of the late 1980s it was still twice as high as in the deep crisis of 1975 and rose again to unprecedented heights until 1994 (*cf. figure 5a*). Since then it has only very slightly diminished. As a consequence the development of unemployment takes less and less the form of a cycle (rising, falling and rising again) but approaches that of a staircase: rising, remaining and rising again.

These three trends indicate *deep changes on the one hand in the basic power relations between labour and capital, and on the other hand equally deep changes in economic policy orientations* in the EU. They are mutually linked amongst each other and together form a pattern of circular causation and reinforcement: low growth leads to low or zero additional employment and generates – under conditions of a growing population and higher participation aspirations – higher unemployment. This weakens the bargaining position of trade unions with “moderate” nominal and increasingly often zero real wage increases or even losses as a consequence. This dampens private consumption as by far the biggest part of effective demand and therefore – via the multiplier mechanism - economic growth. At the same time rising profits are – due to narrower market outlooks - to a lower degree invested in employment creating domestic equipment. The uncertainties of further domestic development leads management and private moneyholders rather to invest in increasingly liquid assets on the finan-

cial markets. This strengthens the position of the financial sector in the economy and gives them enhanced possibilities to impose their interests upon economic policy makers. To the extent that governments and the EU bow to these pressures and pursue a policy of strong monetary and budgetary austerity, growth is further impeded and unemployment remains high.



Exchange rate developments: At the time of the formation of the euro in January 1999 the value of the euro in terms of the dollar was relatively high, compared with the past values of a

'synthetic' euro (that is based on the currencies which compose the euro). It is therefore not surprising that it depreciated after its introduction and some of the depreciation can be seen as undoing the initial relatively high level. The resulting stimulus to net exports from the euro zone has been a significant ingredient in the growth of the eurozone in the past 18 months, and has made for a more balanced distribution of economic activity between the EU and the USA. – But the euro has continued to decline in value despite the eurozone having a balance of trade surplus while the USA has been running an increasing balance of trade deficit. The capital flows from the EU towards the USA in pursuit of what are seen as greater investment opportunities in the USA as compared with the EU appears to be a significant reason for the further decline of the euro. Inflation remains subdued and the depreciation of the euro does not justify a restrictive monetary response. Indeed a restrictive policy by the ECB could be self-defeating as continued stagnation and a reduction in investment opportunities in the eurozone might well accelerate capital outflows to the USA.

2. Convergence towards self-imposed constraints - Economic policy trends and results

Economic policies in the member states of the EU have during the last 20 years, starting with very different institutional arrangements, social relations and political objectives, been submitted to a process of increasingly tight convergence towards the neo-liberal market oriented policy pattern. The beliefs underlying this pattern hold that private enterprises, open markets and stable prices are the three basic pillars of a well functioning economy which economic policy must provide. The rest should be left to firms and markets. The British government pioneered the wave of privatisation, the German Bundesbank imposed – through a mercantilist monetary policy, assisted by capital account liberalisation - price stability as the one superior objective upon the rest of Europe, and it was the European Commission which reinforced the Single Market process in the midst of the 1980s – as a project of deregulation instead of harmonisation, negative instead of positive integration.

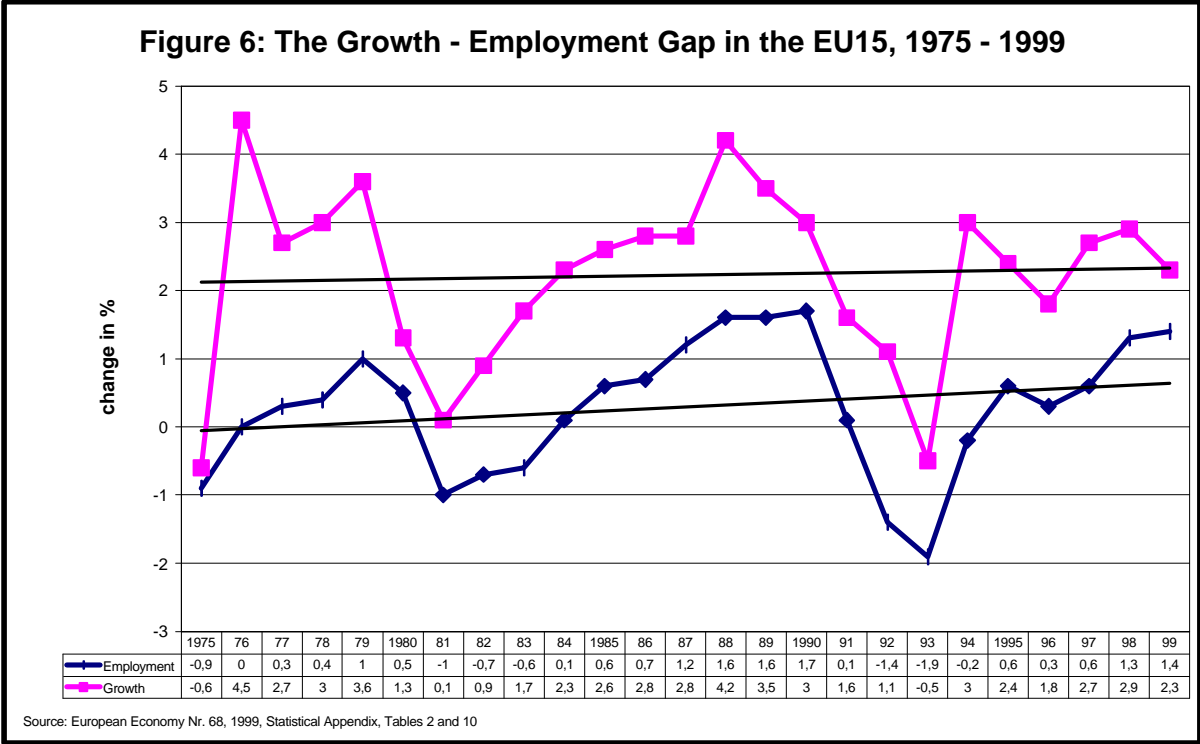
Since the Treaty of Maastricht economic policy in the EU has been even more narrowly focused on the fulfilment of the self-imposed convergence criteria for entry into the monetary union – most prominently the price stability and deficit reduction objectives. In the 1990s in most member states the statutes of the Central Banks were changed towards complete independence and price stability as exclusive objective for monetary policy. In the 1970s and 1980s their rather fragile national currencies made it difficult or simply impossible for most governments – with the partly exception of the German government - to make full use of and expand their productive capacities and to pursue an autonomous economic policy course against the strong position of the US \$ and the policy preferences of Germany as the strongest EC country. France has experienced the strength of this external exchange rate constraint at the beginning of the 1980s. While at present the dollar is still strong the monetary union has removed this intra-European exchange rate risk for the members of the Euro-zone and thus provided considerably more room for manoeuvre for national (or European) expansionary policies. But instead of using it the EU has now imposed the fiscal constraint upon the member countries, which works in much the same harmful way.

Fiscal policies became increasingly contractive in order to lower public deficits and debt (and yet the latter continued to rise in most countries until 1998) and the monetisation of public debt was prohibited. It is remarkable and hardly understandable that policymakers in the EU, after having overcome a severe external obstacle to more growth and employment in the

1990, have at the same time imposed upon themselves another in no way less harmful internal budgetary constraint. The latter is considerably reinforced by the trend towards tax reductions which are currently been implemented in most European Union countries. The reductions in corporate taxes and/or tax rates on incomes in most countries of the Union (often coupled with increases in indirect taxes or social security contributions) are frequently presented either as necessary to stay competitive in Europe or as the best procedure to return the budget surpluses to the people. However, besides leading to increased policy competition between countries, the result is that governments get less income (in some countries this has not happened in absolute terms because of the positive impact of growth in the public revenue, but it will certainly happen if the rate of growth slows down), which compels countries with deficits to tighten the pressure on the expenditure side in order to reduce their yearly negative balances and total debt. The net result is that public expenses must be reduced while private net incomes, especially of the richer people are increased.

What are the results of this increasingly neo-liberal policy orientation throughout the EU ?

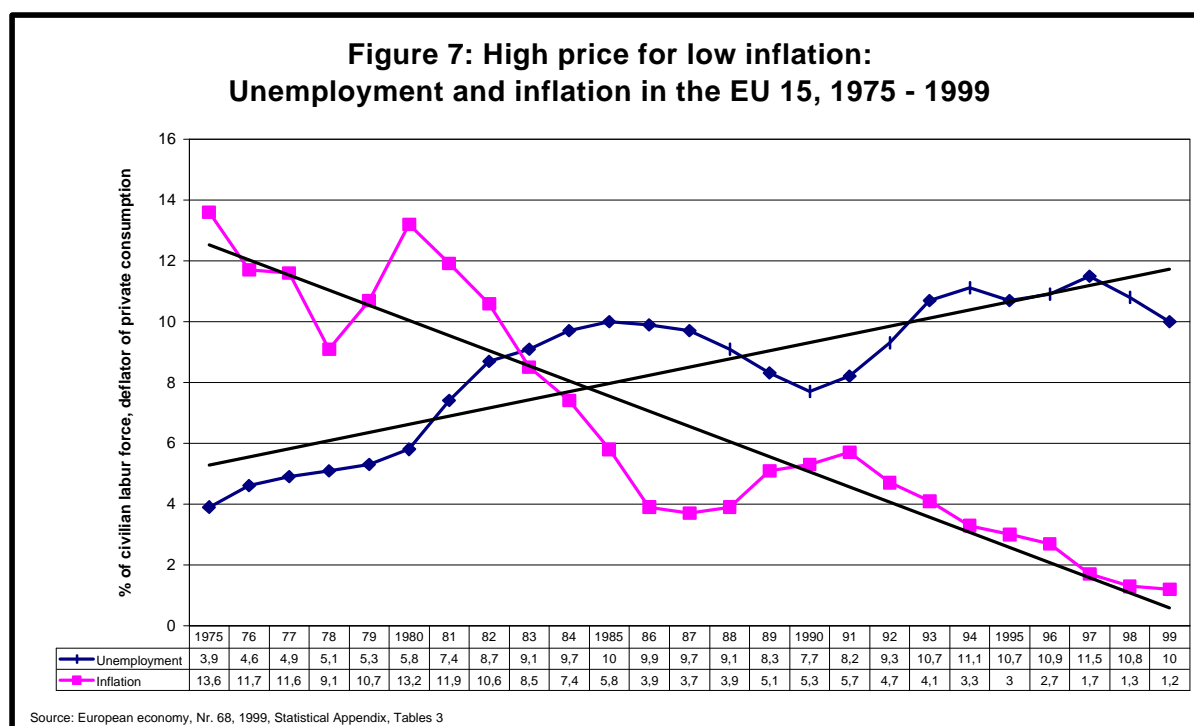
First: Contrary to almost all forecasts the completion of the *Single Market* in 1993 has not pushed the EU into a new phase of enhanced growth and dynamic development. Neither the GDP nor the employment trends have moved upwards, growth has remained weak and employment low. Nor, for that matter, has the single market led to a visible push in productivity increase. The gap between growth and employment remained roughly the same. (cf. figure 6)



With regard to the macroeconomic forecasts the single market project has not been a particular success.

Second: With regards to *privatisation* there have been mixed results: While in some sectors (telecommunication) the performance of the privatised sector is satisfactory (although this could change with the consolidation of few groups into a narrow oligopoly) in others – most prominently railways – deregulation and privatisation have led to inferior service and sometimes chaotic structures. In all cases privatisation has been accompanied by massive dismissals. The privatisation of social services has made them more expensive and contributed to the exclusion of the socially weak who are particularly dependent on such services.

Third: There has, however, been a marked policy success in the achievement of *price stability*. Inflation has during the last quarter of a century fallen to negligible (and even dangerously low) levels as a consequence of the obsessive and exclusive concentration of monetary policy on this goal. However, this concentration has had repercussions on employment, which has risen to unprecedented high levels during the last 25 years. The exclusive policy concentration on price stability has generated far-reaching social and employment destabilisation. The social price for low inflation has been very – we think: too – high (cf. figure 7).



This policy bias towards the exclusive priority for disinflation and price stability must be all the more criticised because the strong assertion of the negative consequences of inflation for growth and employment, which underlie this policy option is not only theoretically unfounded but also empirically not corroborated. Such a negative result will only be achieved if one includes into the empirical analysis all kinds of inflation: moderate, high and galloping inflation. Only for this case an overall negative impact on growth and employment can be observed. For the OECD countries this result is highly misleading, because they do not have and have not had since more than 50 years any kind of galloping inflation and only very rarely high inflation. For moderate inflation, however, there is no proof of a negative impact on growth. Quite on the contrary, a number of empirical studies (cf. Barro 1997, Stiglitz 1999, Sarel 1997) show that there is either no relation at all or even a slight positive impact of (moderate) inflation – Sarel sees the threshold at 8% - on growth. If the ECB maintains its outspoken preference for zero core inflation in spite of this evidence it acts not in the interests

of more growth and employment but in the interests of the holders of financial assets, who benefit from zero inflation – and would even more benefit from outright deflation.

Fourth: Inequality is increasing substantially. Although European Union countries are among the richest of the world, poverty and exclusion are increasing and not the least among the working poor. Meanwhile public policy with regard to the provision of essential services to the population shrinks. The changes in taxation are leading to 'private enrichment and public impoverishment' that go hand in hand, precisely in a period when price stability, higher rates of growth than in the recent past and better budget balances should have been taken advantage of to provide many of the much needed public services. The increase in inequality that this trends of policy causes is much broader and farther-reaching than when we look only at incomes and wealth. For the dynamic is that essential public sector services become less available, and you have to have money to buy them privately (health, education, pensions). Thus we find that in many countries in the Union, both in the richer and poorer ones, the reduction of taxes proceeds hand in hand with diminishing expenditure in education or health or very significant cuts in social security services (even with surplus social security budgets), lengthening of the queues for services for elder people and so on and so forth, while private services are booming.

3. Increasing fragility and inequality in employment and unemployment

Employment: More jobs and more precariousness: Employment is currently rising in the EU. 1,8 Million new jobs were created in 1998, 1,9 Million in 1999 and this year forecasts predict even 2 Million more jobs for the EU15. This development is not negligible. However, there is no indication that it will survive the current cyclical upswing, which will, even if optimistic forecasts become true (which has almost never been the case in the past) remain weaker than the previous ones. There is no serious indication supporting the assumption, that without much more energetic policy efforts the long term trend of a 0,3% employment increase will be shifted to a significantly higher level. It would only provide an additional 5 million jobs in 10 years whereas presently more than 15 million are required. Even if the demographic factors – less labour markets entries in the decades to come - are taken into account, this is certainly not enough to overcome persistent high unemployment in the EU, at least in the large countries.

Moreover there are specific problems associated with the recent job increase, as reported in the Commissions report Employment in Europe 1999.

Employment is increasingly *part-time employment*. The share of part-time jobs in total employment rose from 13,0% in 1985 to 17,4% in 1998. However, this figure conceals the underlying dynamic: Out of the 4 Million additional jobs created between 1994 and 1998 more than 3 millions were on part-time. The job increase in 1996 and 1997 was exclusively due to part-time hiring, and in 1998 half of the additional jobs were on a part-time basis (70% for women and 28% for men). In several cases a small rise in employment was a result of a sharp decline in full-time jobs and a compensation by part-time ones. (p.8)

Part-time employment is fine as long as it is taken up voluntarily and goes along with sufficient wages and appropriate social security. With few exceptions (Netherlands) the latter is not the case in the EU, part-time work is working time reduction without any wage compensation and with no sufficient coverage for pensions and retirement. This is the major reason

why many people are reluctant to go on part-time work. There is no comprehensive EU-wide overview about the degree to which part-time work is only accepted because full-time jobs are not available. But case studies suggest that this share is high and is increasing.

Employment in the EU is increasingly organised as *temporary work*: the share of total employment, which was 8,4% in 1985, has risen to 12,8% in 1998 (according to the ECB Monthly Report for May it was 14,9% in 1999). From the additional 1,8 Mill. new jobs created in 1998 more than 40% were on a temporary basis. The ECB interpretes a high share of temporary work as an indicator of “rigid work protection regulations, which make firms reluctant to hire on a permanent basis.”(p.63). We are strongly opposing this view: the current pattern of rising temporary work implies a fundamental loss of social security and is thus a very definite deterioration of working and living conditions for those concerned.

There are many other seriously precarious employment situations: many labourers, who work in fact as wage workers, are required by their employers to register as self-employed entrepreneurs in order to avoid the social security charges. It happens more often in the construction industry but also in other branches. Furthermore, long working hours with substantial unpaid or poorly paid overtime may also be found in many trades affecting mainly to both extremes of the range of jobs (unqualified workers and highly paid personnel that is considered to live for the job). Also, although it does not appear in official statistics, and only rather unreliable statistical estimates about its quantitative importance exist, mention should be made of informal or 'grey' employment - people working in jobs, often of a temporary nature which are not declared officially and therefore are not submitted to labour laws nor enjoy social security benefits. This kind of paid work seems to be increasing in the Northern countries of the Union, while it has diminished in some of the Southern countries, where in the recent past it was estimated that it might have reached 25% of the total labour force. A significant part of this informal labour is 'by the piece' work made at home, which is particularly taken up by women, and which often reproduces the worst features of the old time 'putting up' system.

Unemployment: high level and enhanced exclusion: Official declarations and documents by the EU are full of positive records of the latest development and optimistic forecast for a further “progressive fall in unemployment” (BEPG) in the EU.

A closer look on the long-term tendencies and structures delivers a more sobering picture and at the same time a terrible lack of aspiration from the side of the officials.

The rate of unemployment in the EU15	
1960s	2,2
1970s	4,0
1980s	9,0
1990s	10,1

Even if the most optimistic forecast of early April became true, i.e. the official unemployment rate, which was 9,2 % in 1999 (10% in the EU11) would fall to 8,5% (EU11: 9,2%) this year and 7,9 (8,5% for EU11) in the year 2001, it would be still higher than at the end of the

1980s (1989: 8,3%), more than twice as high than in the 1970s and almost four times as high as in the 1960s.

Even on this unacceptable minimalist basis of ambition it is quite questionable whether the “optimistic” forecast is realistic. For it is based on the assumption that the current growth is more than a cyclical upswing, followed by a cyclical recession which leads to a stronger rise in unemployment. As argued above, this assumption is very weak for theoretical as well as empirical reasons. In a new slow-down or cyclical recession unemployment would rise again and thus continue its staircase pattern.

Moreover not only the *level* of overall unemployment has risen but its *structure* has considerably deteriorated:

Today 49% of the total number are long-term unemployed, i.e. without a job since more than a year. Ten years ago it were 45%. Almost one third of the unemployed (31%) have no job since more than two years. And in almost all countries the eligibility criteria for unemployment benefits have been tightened or/and the amount or/and time of these benefits have been reduced. Today not only many more people are unemployed than 25 years ago. The average time of unemployment and the share of long-term unemployment have risen, too. Those who are unemployed are relatively – and in many cases absolutely - worse off than 25 years ago.

During the next 20 years in most member countries and in the EU as a whole the number of new labour market entrants will decrease, which will reduce somewhat the gap between labour supply and labour demand. But this does not mean that high unemployment will quasi automatically be eradicated by demographic factors. Persistently slow growth and increasing productivity progress will keep the employment gap high and the explicit endeavours of the EU to keep elder people longer on the job will enhance the problem.

Income Poverty: Unemployment, poorly remunerated work and other kinds of precarisation lead to high and widely rising levels of poverty, whereas profits and income from financial investment – which is on a large scale only open for high income individuals – are rising conspicuously. In the midst of the 1990s about 18% of the population in the EU lived in conditions of poverty (income below 60% of median income). In the UK (20%), Greece and Ireland (21%) and Portugal (24%) the proportion was even higher. On an EU-average the incidence of poverty is three times higher for single parents (i.e. women!) with one or more children than for the rest of the population; in the UK the poverty-risk for this group is five times higher than for the whole population.

Regional inequalities in employment and unemployment: While there has been a – very modest and insufficient – convergence of per capita income between member countries and also between regions, this is not the case for employment and unemployment. Instead “disparities in employment rates between regions have remained wide and, indeed in most countries seem to have increased slightly over this period.” (Employment in Europe 1999, p.11) In many cases, since the single market and European policy facilitate the restructuring of enterprises at an European level, many regions suffer from the negative effects on employment of the changes of location and concentration on the richer regions of enterprises previously located in poorer regions. Even in a country with a relatively low rate of unemployment like the UK the recent wave of announced closures and/or dismissals – in the automobile industry

but also in the financial sector - will lead to a drastic rise in unemployment and de-industrialisation of regions and to enhanced stress and insecurity. It has been pointed out that, while in a comparison between member countries in the EU and states in the US, inequality in Europe is lower, it is in fact higher when regions are compared. This is not only a clear lack of social cohesion but it also "imposes an inevitable constraint on the conduct of economic policy and on the achievement of high and sustained rates of economic growth." (ibid.)

4. The persistent gender inequality

Although between 1994 and 1999 a slight narrowing of the gender gap in employment rates occurred and between 1998 and 1999 the EU female employment rate rose from 51,2% to 52,6% - compared to a smaller rise from 70,8 to 71,6% for men -, the pace of change is too slow. The gap in 1999 was still 19 percentage points when considered in terms of any type of employment but, due to the overrepresentation of women in part-time work, it reached 25,6% in full-time equivalents (counting full time as two part-time workers which is a rather loose measure).

Including elements as education and parenthood the picture becomes more striking: While women and men with a high degree of education have similar rates of employment (73 and 79% respectively), with low levels of education the women employment rate is only half of that of men (27% and 50% respectively). The gender gap increases very substantially with the presence of children in the household: In the UK, Germany and Italy employment rates of women with children are more than twenty points lower than for women without children, in another six countries they are about ten points lower. These patterns open the gender gap in employment rates to over 45% in Ireland, Italy, Spain and Greece. Only in Austria and Belgium does the gap fall below 30%.

Wages differences vary accordingly. Pay data for 1995 Structure of Earnings Survey show that across the EU women on average are paid 73% of men's gross hourly wages and 75% if only full timers are considered. (The data are likely to underestimate somewhat the earnings of women because they do not include the public sector which is an important provider of equally paid jobs for women). Differences among countries are substantial. Recent policy developments in a number of member states have contributed to a narrowing of the gender gap in payment, in particular the implementation of a minimum wage in the UK and Ireland.

Although within Europe, it is generally acknowledged that the position of women on the labour market merits particular attention and that the integration of women in it should be promoted through appropriate and energetic action, such action is, as for most social issues, largely left at the hands of the member states. In this regard, one of the most innovative aspect of the European Employment Strategy, providing new impetus to the integration of equal opportunity issues into the employment framework has been the inclusion of a fourth pillar (alongside the pillars of employability, adaptability and entrepreneurship) for equal opportunities into the guidelines for the National Action Plans on Employment. Moreover, the 1999 guidelines required a gender mainstreaming policy and the introduction of the gender pay gap as a policy issue to be integrated into the employment strategy.

According to Plantenga (2000) in a majority of member states ' the incorporation of the fourth pillar has had a tangible and positive impact on both the visibility of women in employment policy and on the development of a policy approach which has the prospects of improving

gender equality'¹. An assessment of the efficiency and scope of this mainstreaming is difficult to establish both because it is rather recent and also spread throughout all the member states. Nevertheless a few issues may be worth commenting upon:

Although the mainstreaming concept is becoming increasingly accepted and understood by European governments there are still major differences in how gender mainstreaming is interpreted and implemented. Some of the problems refer i) to definitions of gender equality - most governments seem to take for granted women's role as primary carer and policies are designed to facilitate women's dual role; ii) to the transformatory potential of gender mainstreaming - unwillingness of governments to recognise the linkage between equal opportunities and the other employment pillars, policies related to women being concentrated in pillar four instead of being integrated into the first three pillars among which there is a clear preference for the use of 'gender neutral' language; and iii) to the role of public policy, which tends to focus on policies which affect the labour market behaviour of individuals and not on the characteristics or structure of the labour market itself such as policies which impact on the 'discretion' of employers or trade unions to shape the labour market, when in fact, the policy agenda under both the adaptability pillar tackling gender gaps in pay and occupational representation involves challenging existing labour market structures rather than simply influencing how men and women fit into these structures. Governments are less happy with adopting responsibilities for policies to change employment practices within enterprises. Yet some of the aspirations of moving towards a more gender equal society will not be achievable without a willingness to take positive policy actions to change the organisation of the world of work.

In general the fourth pillar has tended to be the least developed section of the NAP in many countries with a tiny share of the budget (where this is detailed). For some countries there is still a failure to identify the links between the fourth pillar and the overall employment strategy, for others there is evidence of a complacency and self satisfaction with what has already been achieved. For others yet the priority attached to equal opportunity issues is overshadowed by the priorities attached to other issues. There is a tendency towards vagueness and a lack of clarity over which parties are responsible for implementing the measures and providing the budget line. Furthermore, even when shortcomings in policies are clearly identified there still appears to be little link between this analysis and the implementation of policies to remedy them.

Summing up it is possible to conclude that both the gender mainstreaming and the gender equality approach within the National Action Plans can be considered positive in reference of their intention and preoccupation for the gender issue, even if the assessments have to be strongly differentiated by country. However, according to evidence, it is not too clear to what extent gender equality issues are developed because of the European Community policy stimulus or because of internal processes of the concerned countries, since the latter have always the potential to reverse the influence of the European guidelines but, at the same time, the inclusion of the mainstreaming guideline seems unquestionably helpful in maintaining internal momentum.

Gender mainstreaming is a long term process and objective and as such there are always new areas and policies to be tackled. It seems there is a consensus about the need for better gender monitoring and gender impact assessment as well as better feedback loops from assessment to

¹ Plantenga J., 'The European experience of Gender auditing of National Action Plans'. Mimeo, Paper prepared for the International Workshop on Gender Auditing of Government budgets, Rome, 15-16 September 2000. Many of the comments that follow draw heavily from this paper.

policy modification. In general there is a need for more active measures related to pillar III to change the organisation of work, working hours and wages at the enterprise level to enable greater equality within work and not simply equality of access to work without attention to work quality. There is still too little attention paid to changing male behaviour as a means of calling attention to the two sided nature of gender mainstreaming.

It is necessary to avoid relating gender mainstreaming exclusively to the fourth pillar, instead of dealing about how gender mainstreaming has been implemented in the three other pillars. The need for gender mainstreaming has to be underlined by making clear to the member states the gender implication of each guideline: for example the gender mix within the social economy on the one hand and the information society on the other hand needs to be considered and addressed; taxation and benefit systems have to be identified as almost always having clear gender impacts; similarly member states need to be reminded of the impossibility of separating out modernisation of work and working time arrangements under the adaptability pillar from policies to desaggregate the labour market or to reconcile work and family life under pillar four.

Several instruments of the employment strategy and its evaluation do also need reassessment: the definition of unemployment which is left to member states, when different definitions have different implications for gender equality; changing the employment targets, which are expressed solely in terms of head counting, that overstates the integration of women into employment, finally the guidelines in pillar four need to be strengthened and expanded in particular to focus on gender hours gap, the desaggregation objective by focusing specifically on issues of vertical segregation and to include a more specific commitment to move towards a more equal sharing of care work between men and women.

5. Deepening East-West economic gap²

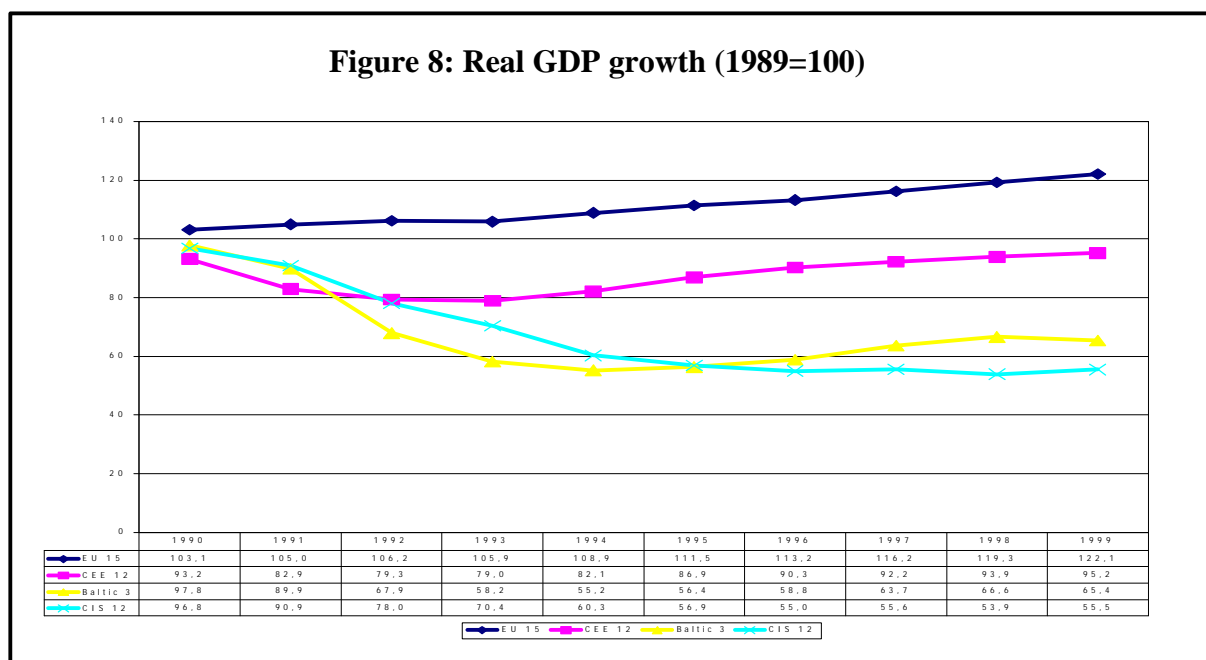
During the last decade a completely new dimension of inequality has become visible, has widened and become politically highly relevant in Europe: the East-West gap. While in the western part of Europe economic growth of the nineties corresponded to the after 1975 trend, – in its second half it was even slightly better, – in countries of the East³ these years were characterised by the transition from centrally planned to market economies. In all eastern countries the economic performance fell back sharply.

Between 1960 and 1990 the eastern countries closed the economic gap to Western Europe to a certain degree, but differences in development level remained important. In the last years before the system change the per capita GDP level of eastern countries generally varied between one half and one fifth of the level of developed European market economies. In the nineties the gap in GDP output increased dramatically (see figure 8).

² In preparing this chapter the authors used the findings of the case study: The Impact of Structural Adjustment Programs on the Socio-Economic Development in Hungary (2000), which was prepared by a broad group of civil organisations in co-operation with World Bank and government experts.

³ The following country groupings are applied for Eastern Europe: Central and Eastern Europe (CEE 12), Baltic States, Commonwealth of Independent States (CIS 12). *CEE* refers to the countries of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia, The former Yugoslav Republic of Macedonia, and Yugoslavia. The *Baltic States* are Estonia, Latvia and Lithuania. *CIS* refers to Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Several factors contributed to this negative effect, a number of which were unavoidable. For instance, the collapse of the Soviet Union and CMEA trade was an inevitable consequence of the political events and had a large (in some cases even a devastating) impact on the economic situation of concerned countries. However, the main role was played by the economic policies imposed by the governments of G7 countries, which were formulated and applied by the leading international financial organisations (IMF and World Bank) and often called "Washington consensus". The economic policy of the new governments in the East could be characterised equally by the triple slogans: deregulation, liberalisation and privatisation. At the beginning of transition gradual implementation of changes were often emphasised, but in pra-



ctice both international organisations and governments pushed forward the application of relevant measures in a time span usually not more than 3-5 years. In this process many values accumulated in the past were destroyed, although they could have been used also in the future. Multinational corporations and banks seized the opportunity for the extension of their activity in the newly emerging markets.

The application of the same principles to all countries didn't bring about the same results of transformation. Tradition and culture, past roots of market economy, aims and views of governments, responses of population on the applied policies caused deep differences in implementation. Therefore, the emerged social and economic structures, the role of state policy, forms of ownership and the ratio of private ownership, the role of direct foreign investments, and many other factors strongly vary among countries and in most countries of the region the transformation will still go on for a longer future.

Main features of the actual economic situation of eastern countries are shown in the annexed table. Economic performances are generally far below past levels, a decade of negative growth sit heavily on them. Only a few countries are beyond stabilisation and started recovery and a more or less stable growth (first Poland, and then Hungary).

Extended and lasting unemployment combined with high rates of inflation accompanied the transition. Two types of employment policies could be observed: a) in countries which followed the Washington principles more consequently, the fall in employment is deeper than in

performance data (e.g. Hungary, Poland, Slovenia), which indicates a rapid growth of labour productivity; b) in countries where traditional constraints are stronger, employment fell less than GDP and industrial output, which refers to a policy trying to keep employees and limit unemployment increase. In this second case that was typical to former Soviet Union member states labour productivity further declined.

Inflation was also a general concomitant of transition. In many south-eastern and CIS countries hyperinflation developed and though in 1995 or 1996 successful stabilisation efforts took place, uncertainty is still prevailing and inflation rates are high. In most Eastern European and the Baltic countries inflation remained more under control and stabilisation brought a lasting decline of inflation rates. In these countries consumer prices rose with ten percent or less in 1999.

During transition foreign trade structures of the Eastern European countries changed basically. Trade within the sub-region declined sharply, exports and imports to and from developed market economies (mainly the EU) increased to 60-70% of each country. Consequently economic dependency on European markets increased to a high level. This is the case also in financial relations; the region is an important target of foreign direct investments coming from EU countries. However, the countries of the East produce large trade and current account deficits with the exception of Russia and Ukraine (see the table).

Table 1: Balances and Inflows of FDI of the Region

	Merchandise trade 1998	Current account 1998	Inflows of FDI 1998	Cumulated sum of FDI 1990-1998
CEE countries	- 40,0	- 17,5	13,7	53,6
Baltic states	- 5,0	- 2,5	1,9	4,9
CIS	+ 25,1*	- 6,1	6,8	31,7
Total above	- 19,9	- 26,1	22,4	90,4

Source: Economic Survey of Europe, 1999 3. United Nations, New York and Geneva, E. 99.II.E.4.

*/ Russian Federation + 25,3; – Ukraine + 1,7; – other CIS countries - 1,9 .

The fall of production and employment caused the decline of consumption expenditure. A part of concerned countries could avoid the lasting retrenchment of total consumption and gradually increased it above the past level (e.g. Poland, Slovenia, and the Czech Republic), while in others consumption didn't recover yet.

Total consumption data indicate only partly if at all the social impact of transition. In consequence of unemployment, consumer price inflation, abolishing of subsidies on consumer goods and services, diminishing of social provisions strong income differentiation took place in all countries with rapid impoverishment of broad strata of the population. Ethnical exclusion and hatred is expanding for instance against gypsy population, who in large proportions lost workplaces in the heavy and construction industries, live in backward areas and have large families, thus suffer from all negative impacts of the changes.

This short review of the economic situation in the East shows how far the gap between Western and Eastern Europe increased during the last decade. The performance level and even

more the living standard of the majority of the population are subjects of deep concern. Successful integration in the West is not possible without a co-operative relationship towards the East, and for the East economic co-operation with the West is one of the main means and faith for improvement.

Table 2: MAIN ECONOMIC INDICATORS FOR EASTERN EUROPEAN COUNTRIES

Latest year (1999) indices, 1989 = 100 – except inward FDI; FDI data stand for 1998

	GDP	Total employment	Industrial Output	Gross fixed capital formation	Inward FDI stock as percentage of GDP	Total Consumption**
CEE countries, of which	95,2	83,1*	77,9	..	..	..
Albania	95,7	75,3*	26,3	..	12,6	..
Bosnia and Herzegovina	..	37,6	9,6	..	..	..
Bulgaria	70,7	72,2	40,8	50,1*	12,3	68,8*
Croatia	77,9	76,5	56,0	177,9	13,1	115,9 (1991)
Czech Republic	95,3	90,2*	76,9	103,4	26,1	103,2
Hungary	99,4	72,9	113,9	126,4	33,2	94,4
Poland	121,8	92,9*	122,4	171,1	15,1	136,3
Romania	75,8	80,5*	42,7	62,1	10,4	99,1
Slovakia	101,7	81,8*	76,4	93,8	12,1	88,8
Slovenia	105,3	80,2	75,6	178,1	14,5	125,9 (1990)
TFYR Macedonia	76,8	65,0*	45,8	77,6	5,5	102,4 (1990)
Yugoslavia	41,6	89,7*	35,2	..	..	..
Baltic States, of which	65,4	80,5*	40,7	..	..	..
Estonia	78,3	76,4*	55,7	156,3*	35,6	131,9* (1993)
Latvia	59,6	74,1*	43,6	38,9*	25,2	55,7* (1990)
Lithuania	64,2	87,0*	35,3	147,8*	15,2	119,1* (1995)
CIS, of which	55,5	87,4*	52,1	..	..	..
Belarus	81,4	86,0	91,6	62,5*	3,3	81,2* (1990)
Russian Federation	57,6	85,3	49,7	17,4	5,0	72,6 (1990)
Ukraine	39,3	86,5	51,2	16,0*	6,6	57,1* (1990)

Source: Economic Survey of Europe, 2000 No. 1. United Nations, New York and Geneva, E. 00. II. E. 12. Data of FDI stock: World Investment Report 2000, TableB6 United Nations, New York and Geneva, E. 98. II. D. 5. .. not available or not pertinent — */ 1998 — **/ Base year in bracket, if not 1989

Chapter 3

Creating a strong social model in Europe - Alternative Economic Policy Guidelines

In this chapter we present proposals for an alternative economic policy in and of the EU corresponding to our criticism of the official Broad Economic Policy Guidelines and the Employment Guidelines in the first chapter above. In the *first section* we outline our view of a more efficient, employment-oriented and better co-ordinated *macro-policy*, as an alternative to the extremely narrow approach of the Broad Economic Policy Guidelines. In the *second section* we present a perspective for a European *social constitution*, which, while taking up the positive elements of the Employment Guidelines takes account of our critique of the built-in tendency to base labour market success increasingly on elements of compulsion and on inequality, thus undermining the substantial common content of the European social model. Although structural policies are not mentioned in either document – apart from the incessantly reiterated call for breaking up labour market regulation as a structural obstacle to employment – in our view economic policy has to deal with specific structural problems of the European economy – and the way this is done in the EU must raise several objections and criticism. Therefore in the *third section* we present a very brief account of this critique together with proposals for *more balanced structural policies*. In the *fourth section* we formulate some considerations and proposals with regard to *eastern enlargement* as the basic new challenge for European integration in this first decade of the new century. Finally we conclude in the *fourth section* with some reflections about a *perspective beyond the basic structures of a growth oriented capitalist economy*, and about the de-coupling of economic growth and sustainable welfare, in a social, ecological and political sense.

As will be seen economic policy in the EU always includes central provisions, measures and institutions on the EU level on the one hand and on the other hand provisions, measures and institutions on the member state level (we do not thematise the regional and local level here, although they play an important role, too). Whereas for central measures the main challenge is to achieve a high degree of transparency and democratic legitimacy, policies on the national level must be efficiently co-ordinated in order to exploit their potentially mutually reinforcing dynamics. On both levels successful economic policy is not merely and not even primarily a matter of the application of particular measures or instruments; it is primarily a matter of setting up strong and reliable democratic institutions.

1. A more efficient and democratic macro-policy for full employment

1.1. Introduction

In the view of many commentators, the failure of the European countries to co-ordinate their macroeconomic policies and take into account their growing interdependence is one of the main explanations for their weak growth since the 1970s. This question remains critical at the beginning of the new century. Growth rates have in fact recovered but with significant divergences. The nature and size of these gaps has surprised many economists who were expecting more convergence after the completion of the single market, the Maastricht convergence process and the launch of the euro.

Contrary to some expectations, factors of divergence persist. European economies are subject to asymmetric shocks and, especially, to asymmetry in their structural development. This latter form of asymmetry, neglected for a long time, is linked to differences in institutions, in productive systems and in social structures across the European countries. There are different responses to interest rate changes because of differences in financial systems. Differences in industrial relations systems give rise to different responses to the same shock and result in an unequal ability to control wage pressures. There are different rates of structural inflation (although these were, for a time, hidden from view) because of different levels of development and the significant weight, in some countries, of traditional and/or low-productivity sectors. Regional specialisation patterns have become more marked during the 1980s and 1990s and these are another factor making for asymmetry in spite of economic diversification at national level. Finally the growing specialisation of economies in terms of technology and product quality is an important source of asymmetries.

It is difficult to carry out macroeconomic policy in the euro zone because monetary policy, although unified, is independent, because national fiscal policies are autonomous and, in many countries, constrained, because there is virtually no European budget and because common wage policies do not exist. Standard macroeconomic theory suggests that the best response to the depreciation of the euro is to adjust the macroeconomic policy mix towards easier fiscal and tighter monetary policy. In this context it is disappointing that ECB and Commission officials ceaselessly repeat their demands for even faster fiscal retrenchment. It may be the case that these demands reflect an acute awareness that the penalties for excess deficits which are laid down in the Growth and Stability Pact are, in reality, politically unenforceable; thus the authorities are concerned to avoid any practical test of these procedures. The outcome is that the co-ordination of fiscal policy within the euro zone has been reduced to the systematic pursuit of lower budgetary deficits, regardless of the cyclical position of each country; this impedes recovery in the short run and has perverse effects on the euro exchange rate.

Although the present macroeconomic situation shows some improvement, it certainly does not justify the present lack of action on policy coordination procedures and the absence of public attempts to discuss the status and the policy of the ECB. It is necessary to anticipate macroeconomic disequilibria and to make progress on four issues: the coordination of national budgetary policies and moves towards a federal budget; a more accountable monetary policy; a better coordination between budgetary policy and monetary policy; and the recognition of wage formation problems, which have up to now been neglected.

Co-ordinated European macro-policy for full employment includes central European as well as national measures. Whereas the first group should be decided in a transparent, democratic and accountable way on the European level, the latter group, while falling in the competence of national parliaments and governments should be co-ordinated so as to not contradict but reinforce each other.

1.2. A less restrictive and better co-ordinated budgetary policy

Immediate Steps

Co-ordinated expansionary policy: In those member countries where unemployment remains high – which is the case in most of them, in spite of the present upswing – the main goal of

budgetary policy should be to help to reduce unemployment through an active macroeconomic policy for employment. This kind of policy would be based on:

- public investment programmes (for example, in infrastructure or in regenerating run-down urban areas);
- public-sector employment (for example in education or local social services)
- or targeted subsidies for private investments in job-rich activities.

The Commission and the Council should recommend and encourage these kinds of spending programme in their annual reports by giving them priority over the reduction of public sector deficits which was imposed by the Stability and Growth Pact (SGP). This can be done without contravening the SGP if a high rate of unemployment is regarded as one of the “other relevant factors” which the Commission “shall also take into account”, according to article 104, clause 3 of the Treaty of Amsterdam, in determining what public sector deficit is acceptable in a given member state.

Better co-ordination of national budgetary procedures: Since the late 90s each member state has presented, as required by the Stability Pact, a four year budgetary plan for examination by the Commission. But this exercise puts too much emphasis on the reduction of deficits and it takes the European growth rate as given for each country without any genuine co-ordination among countries. A better medium term target than a low deficit or a balanced budget would be an objective for public spending in order to achieve full employment over the medium term. This would allow much more scope for the working of automatic stabilisers - in contrast to past policies which have worked in a pro-cyclical way.

The first step is to bring budgetary procedures closer together in terms of both time schedules and definitions. Harmonisation of the data should be accompanied by an improvement in the economic content of budgetary policy. Other objectives besides just the deficit should be brought to the fore – both expenditure objectives (for training, research, infrastructural investment or health) and revenue objectives.

Co-ordinated multi-annual budget planning by the member states should become a more meaningful process. A multi-annual perspective is useful because it allows budgets to be assessed over the whole cycle rather than within a rigid annual framework. In the course of time a unified accounting system would allow the Commission to sketch out a budgetary plan for the whole of the euro zone which would become available each spring and which could then, in return, be taken into account in the development of national budgetary policies. If a country departed from the medium term strategy which had been laid down it would have to inform its partners.

More ambitious institutional reforms

The foregoing proposals represent marginal adjustments designed to preserve a measure of national autonomy and to take a few first steps towards policy co-ordination. They are a long way from guaranteeing the kind of adaptability that could be achieved by a genuinely federal budgetary system. There are various kinds of institutional change which would make it possible to go further forward. Medium-term reforms of budgetary policy should be on the agenda of the Inter-Governmental Conference (IGC) because they are critically important both for the financial outlook and for the issue of economic policy co-ordination.

A gradual increase in the EU budget: The present ceiling on the Community budget (1.27% of EU GDP) is not viable if the European Union intends to become a stable, coherent economic

region. The EU must be able to spend more than this – both for stability and for social cohesion. In principle the introduction of a federal budget would be the best response to the co-ordination problem because it would create at the same time both an instrument for overall macroeconomic stabilisation or stimulus and instruments for redistribution to handle asymmetries. But this solution is not conceivable in the present situation. Thus only a limited and gradual expansion of the European budget is suggested here, to reach 5% of EU GDP by 2006. This would give the EU better instruments to stimulate and underpin economic policy co-ordination with own resources. But it would still be too small to redistribute resources to meet asymmetric shocks.

Reform of the revenue system: The present system of resourcing the European budget, which is complicated and even to some extent chaotic, would be replaced by a simpler and fairer system both in order to provide more resources and in order to promote greater fairness and social cohesion. This would represent a desirable change in the pattern of competition among member states. We suggest:

- the EU's third resource (linked to VAT) and fourth resource (linked to GDP) should be abolished and replaced by a progressive European tax paid by each member state according to its wealth, measured by per capita income. This means that if the total revenue from this tax were 4% of European GDP (assuming that customs duties and other resources amount to 1% of GDP), this percentage would be higher or lower than average for each member state according to the gap between its own income per head and the European average: a country with an income per head equal to 80% of the European average would have to pay $0.8 \times 4\% = 3.2\%$ of its GDP while a country with an income per head above 120% would have to pay 4.8% of its GDP.
- taxes on capital (on interest, capital gains and corporate profits) would be gradually harmonised because intense tax competition among European countries is threatening to undermine these revenues. In the first phase of harmonisation, the principle of taxation in the country of residence would be established for the whole EU, with deductions for taxes paid by firms in the countries where their profits are made and taxed at national rates. In the second phase the differences between national rates of tax on interest, capital gains and company profits would be reduced, which would also minimise the tax incentives for companies to relocate.
- new taxes would be introduced at European level to meet particular objectives: a tax on CO₂ emissions to help preserve the environment, a Tobin tax on foreign exchange transactions to reduce the short-term mobility of capital.

Expenditures: New expenditures as well as certain expenditures transferred from the national level should both be carried out at the European level. The exact content of these spending programmes needs to be specified in detail according to the policy fields concerned; here we only suggest their broad outlines:

- a European employment stabilisation fund (of the order of 1% of GDP) would allow resources to be transferred to countries affected by unfavourable employment trends.
- an expansion of the structural funds and the cohesion fund of the order of 10% a year would reverse the reduction in these funds which is envisaged in existing policies.
- not enough resources have been provided so far to prepare for EU enlargement; they should be considerably increased to 20 billion euros.
- Mediterranean countries should also benefit, to help respond to the growing problems which these countries are facing.
- a more ambitious research and innovation policy would be introduced at Union level to avoid the duplication of effort and the damaging competition which often characterise national policies in these fields.

- major all-European programmes could at last be financed: the trans-European networks and environmental programmes.

A European Employment Stabilisation Fund: Along with this growth of the budget there should be a European Employment Stabilisation Fund. Financed from the EU budget, the fund would make transfers to support the employment policies of member states where unemployment rates were growing more rapidly or falling more slowly than the European average. The Fund could be flexible and relatively inexpensive (of the order of 1% of EU GDP) while at the same time bringing about a significant redistribution among regions. It was already proposed by the Commission itself at the start of the 1990s in the form of an automatic budget rebate, up to a certain ceiling. According to simulation studies (using past unemployment data) its main inconvenience would have been a bias in favour of redistribution to certain countries but this objection does not have the same relevance today. In any case it is not necessary to keep the principle of automaticity – allocations from the fund could be decided by Ecofin on the basis of an economic evaluation of the specific situation in the country concerned.

EU deficits: In order to give the EU necessary competence and flexibility to fulfil its co-ordination task, it would be reasonable to permit the EU to run a deficit, contrary to the present rules which require a balanced budget. This deficit would be of a limited scale, of the order of 1% of GDP, so that debt service did not grow into a problem in the future. With a ceiling on total debt of 10% of GDP, debt service would not go above 0.35% of GDP even in the long run which would represent a very limited burden on EU finances and a small, but realistic move towards fiscal federalism. The sums mobilised in this way would be transferred to member states facing cyclical downturns to finance specified national programmes. Transfers would either be made automatically in accordance with agreed rules or on a discretionary basis agreed on each occasion and would help to resolve co-ordination problems. But in contrast to the first proposal, the use of EU borrowing would make it possible to circumvent the debt constraint which confronts some European countries. In the case of asymmetric economic developments this mechanism would bring about a real redistribution of resources.

Contingency budgets: An efficient further instrument of budgetary co-ordination would be to set apart, within each national budget, a special budget which would only be implemented in the case of an unexpected cyclical downturn. Implementation would depend, either on an agreement within Ecofin or on the fact that certain indicators, agreed in advance (such as the unemployment rate or the inflation rate), had gone through their specified thresholds. Such a mechanism would give back to national budgets the ability to play an active anticyclical role but it would only be useful for countries without a very high level of public debt. A temporary suspension of the Stability Pact ceilings might be envisaged for these countries.

1.3. A more accountable monetary policy with a broader perspective

Legitimacy and effectiveness of the ECB: The ECB as presently established lacks both transparency and credibility. The absence of any form of democratic control, a situation without parallel among central banks, remains a major problem but one which is difficult to resolve while there is no supranational authority in Europe with full legitimacy. There is strong resistance at national level to the development of genuinely federal institutions so that it appears that a full solution to this problem can only emerge as the fruit of a gradual process of political maturation.

Although only institutional change could bring about major improvements, more modest reforms are nevertheless necessary to strengthen the legitimacy and effectiveness of the ECB. A first step would be the full publication of internal debates and votes. The European Parliament's powers to interrogate the President at its quarterly hearings could be reinforced, but the status of these hearings will remain ambiguous given the Parliament's lack of power within the present set-up. It follows that dialogue between the ECB and national political instances ought to be developed.

Relax the inflation target: The ECB's chosen inflation target (rate of inflation below 2%) is problematic. It can be contrasted with the target adopted by the British chancellor (between 1.5% and 3.5%) and the situation of the Federal Reserve which is even less constrained. This kind of decision should follow an exhaustive debate with the ECB's political interlocutors, not be the outcome of a unilateral move by the ECB alone. There is the danger of locking the economy in a "liquidity trap", similar to the situation in Japan, if all inflation is rapidly eliminated. Complete price stability limits the efficacy of the monetary policy instrument in maintaining economic activity and makes economic policy in general more difficult.

Widen the objectives of the ECB: It would help to put employment at the centre of economic policy if the inflation target was made more flexible and combined with a full employment objective. Such a change, which would make economic coordination easier, would only amount to establishing the ECB on the same lines as other central banks - notably the Federal Reserve in the US.

Various studies have shown that it would be easier to manage structural asymmetries within the EU if the ECB had a more sophisticated objective function which was not limited to stabilising the average inflation rate of the monetary union as a whole; it should also take into account the dispersion among national inflation rates. This also would require a modification of the ECBs targets.

1.4. Co-ordinating budgetary and monetary policy

The relation between fiscal and monetary policy is treated in a very restrictive way in the present institutional set-up because of central bank independence. At both EU and member state levels there are frequent contacts (so-called "dialogue") between ECB representatives and members of the Council, the Commission and national governments, but this is a very one-sided process. This is a very sensitive question and it is necessary to approach it in a pragmatic way. There are four changes which could be usefully made in the immediate future.

First: Strengthen the Euro11 Council. Reforms within the "euro-11" Council (where membership, limited to countries in the euro-zone, is smaller than that of Ecofin as a whole), should aim to go beyond the present "informal" dialogue on economic policy guidelines - in the course of time the euro Council should become a more binding body, which is sometimes called an "economic government", that is, an institution undertaking the coordination of national economic policies and acting as an interlocutor to the ECB in the determination of monetary policy.

Second: Reassert control over exchange rate policy. Instability in the foreign exchange markets does point to a key design fault in Europe's monetary institutions: the absence of any clear external orientation. The events of the last year have indicated that more active US-EU policy co-operation could provide mutual benefits. These do not only include exchange rate stabilisation; at present the major risk of a US recession is not compensated by any mechanisms to undertake the decisive expansion in Europe that would be necessary. It is not clear

who has responsibility in this area and the mandate of the ECB is too narrow to permit an effective response in such a contingency.

Today, exchange rate policy is in practice completely in the hands of the ECB since the Council can only intervene in exceptional circumstances, in the case of an “obvious misalignment”, for example. Even in this case the ECB can overrule the Council if it considers that its recommendations are inconsistent with its main objective, that is price stability. The thorny question of representing the euro zone at international level only adds to the difficulty. It is essential for the Council to reestablish control over exchange rate policy because of its strategic importance in the world economy and its differential impact on European economies. It would help to indicate the reallocation of responsibilities for exchange rate policy to the Council if the latter designated one of its members as a representative spokesperson on the euro (“Mr. Euro”). This would make it easier to gradually build up a “European economic government” which would be able to specify the policy mix in a more coherent way by taking the exchange rate into account. It would also be more in accordance with democratic principles because the Council, as representing national governments, is the only EU institution with unquestioned legitimacy. The move would also bring the EU into line with Japan and the US, neither of which simply entrust exchange rate policy to the central bank.

Third: Establish a system of “flexible target zones” between the euro, the dollar and the yen. There is considerable debate on the monetary regime which should be established between the three major currencies: euro, dollar and yen. The experience of the last twenty-five years shows that a floating exchange rate system leads to excessive instability and damaging misalignments. It would be preferable to establish a managed system which could avoid excessive fluctuations in exchange rates. This is the advantage of a “flexible target zone” regime.

In the framework of a “flexible target zone” system, governments lay down reference parities corresponding to estimates of exchange rate equilibrium as well as acceptable fluctuation margins around these rates (+ or – 10% or 15%, for example). They make the agreed parities and margins public, in order to influence market expectations, but without any strict obligation to intervene so that it is possible for a currency to leave its target zone. This type of arrangement has the advantage of expressing the commitment of the governments concerned to coordinated economic policies. But the difficulties of putting it into practice have to be spelt out:

- there would be particular difficulties for the EU countries which still have a long way to go to develop an internal coordination of monetary and budgetary policy.
- It would be necessary to make it clear that reference parities could be adjusted in function of changes in the economic fundamentals, which are certainly not fixed. The system would have to avoid excessive rigidity, while still preserving the credibility of the targets.

Fourth: Re-establish control over financial markets. Lastly, to make the foregoing kinds of arrangement operational, the monetary authorities have to recover a certain autonomy against the power of the international financial markets. This means a break with the movement to financial deregulation and liberalisation which has been at work since the 1980s. Hence the significance of measures towards a re-regulation of finance: an anti-speculation requirement for compulsory reserves to be held by financial intermediaries against their open FX positions; “grains of sand” to introduce some friction into the international financial machine – through the introduction of a Tobin tax; adoption of common measures for the constraint of excessively risky loan and security activities like the OTC trade in derivatives; a much more determined policy against offshore centres outside and inside the EU.

1.5 Making wage formation consistent with macro-policy

The level and the structure of wages are decisive factors of a country's macroeconomic stance. Therefore considerations on wage developments and wage determination cannot and should not be excluded from the discussion of macroeconomic development. This problem is ignored by the neo-liberal doctrines which prevail in the Europe of Maastricht and Amsterdam and which assume that wage determination should be a decentralised procedure on deregulated labour markets. The risk is that, if wage negotiations are too decentralised, destabilising dynamics will be released. There are two contrasting patterns of how this could come about.

In the "Dutch" scenario, each country would use its wages policy to try to become more competitive, which would involve a reduction in domestic expenditure. Since every country was doing the same thing, the outcome would be an inadequate level of aggregate demand in the euro zone and the risk of a cumulative slowdown. This kind of dynamic may already have contributed to reducing the average wage share in the euro zone to a level which has been significantly below that in the United States since the mid-90s. In this context national budgetary policy would be too constrained to support economic activity and monetary policy would also become rather ineffective.

In the "East German" scenario, by contrast, comparison of wages in euros would tend to squeeze nominal wage differentials more than is consistent with productivity growth in the lower wage economies. The outcome involves a risk of deindustrialisation and a tightening of monetary policy by the ECB in the face of re-emerging inflationary pressures in these countries.

It is one of the constituent features and achievements of the European social model that wage formation is largely a matter of free negotiations between the social partners. This achievement should not be abandoned. But for wage formation between social partners macroeconomic framework conditions also apply and should be taken into account. In the past years employers have widely pushed the development of wages below reasonable macroeconomic levels and thereby slowed down growth and destroyed jobs. It is therefore to be welcomed that several EU trade unions have started to counteract jointly. At the meeting in Doorn they envisaged more co-ordination in their wage policies and as rough orientation for this a multi-level system of negotiations based on the same overall inflation forecast but taking into account both national specificities (in terms of productivity differentials or different unemployment rates) and sectoral factors. It will not be easy to organise this kind of system. A starting point might be the existing wage negotiation systems in the European countries with a social democratic tradition; they could provide reference points for the other countries. The minimum wage system should be extended to all member states, taking account of actual differences in productivity levels.

The very wide differences in present practice among member states imply that a gradual learning process is needed and this would take different forms depending on what decisions are made about the future of social Europe. Public authorities could support this attempt at concertation by encouraging negotiations between employers and employees and by improving the statistical base for international comparisons of wages, costs and productivity. The "macroeconomic dialogue" introduced into the Cologne process can be regarded as a first step and it ought to be taken much further.

2. Defending and strengthening the European social models

What is sometimes called the “European social model” is in reality a family of national models: in spite of important differences among themselves, they have certain similarities which distinguish them clearly from the US and Japanese models. In particular, European traditions have tended to make the living conditions of the population as a whole a matter of political concern. The increasing constraints imposed by competition within the monetary union are tending to call into question this key characteristic of the European models: there are general pressures towards more decentralised negotiations, for competition between tax systems, towards the growth of private and individualised systems of insurance and service provision, towards an expansion of private pension funds.

However, the European models have strengths with which to meet these threats. It is still generally true that the political nature of both industrial relations and social protection systems are seen as legitimate (more legitimate, in fact, than the business enterprises which are seen by elites as the only source of economic salvation) and a wide range of social forces are committed to the reconstruction of the models. In addition, one of their strengths is their very diversity, which means that different countries can draw on their own traditions and specific advantages in the attempt to preserve and develop the social achievements of the past. Thus, for example, the legitimacy of state intervention in France may make for one kind of response, the tradition of wide-ranging collective bargains in Germany for another, but both approaches might be well adapted in the particular national context. Even in Britain, where both industrial relations and social protection systems have been seriously degraded in the last twenty years, there are specific advantages, such as a strong tradition of public service and a contestatory tradition within the workforce, which could, in a more encouraging political context, help to renew the British social model. Again, in some of the lower-income countries, competitive pressures on social models are mitigated by their present underdeveloped state: although these are the countries where social expenditure has been rising most rapidly in recent years the fact that their social protection systems are relatively inexpensive creates a certain room for manoeuvre.

It is important to take advantage of this diversity wherever possible: it makes for policy initiatives which are better adapted to specific national circumstances. In general, it is the case that diversity is one of Europe’s strengths and any drive towards homogeneity in industrial relations or social services and social protection is likely to have the perverse effect of weakening all the social models because it would no longer be possible to respond to specific priorities such as the Scandinavian concern with redistributive solidarity or the German view that it is important to protect family incomes.

Nevertheless, the competitive forces tending to destabilise social models are very powerful and there exists the danger of a race to the bottom, of a levelling down towards a “competitive social Europe”. These forces include not only direct pressures for lower levels of social provision and less organised industrial relations; perhaps even more important are fiscal pressures, encouraged by the convergence criteria of the Maastricht Treaty, towards lower social expenditures and reduced taxation of capital revenues. In this respect, the path actually taken by the process of monetary integration has been an important factor destabilising the social achievements of the past. Of course, such a process of competitive degradation would not express itself in a uniform and homogeneous way: one of the most insidious aspects of such a process is that it would widen differentials in working conditions and social protection among

different groups of workers according to their existing positions and thus exacerbate social exclusion at both national and international levels.

We regard the firm commitment to a welfare society, a kind of social constitution, as one of the most essential objectives of the European unification... It must comprise a wide and non-bureaucratic welfare system, a fair distribution of income, wealth and opportunities as well as democratic structures and commitment on all levels of society' (Memo 98)

To establish a European social model means that every person living permanently in the EU shall have the guaranteed and unconditional right to a level of income, to social protection and welfare as well as to democratic participation in social life which are necessary to lead an independent and dignified life. This objective should become a firm and central cornerstone of the European constitution. Only if social objectives cease to be a relatively superficial addendum to a central process of reinforcing market mechanisms and if they take on this constitutional force in a way which modifies the agendas of the single market and counter-inflationary monetary union will it be possible for the EU to be seen as protecting and advancing the broad interests of its citizens. While the key agendas of the EU continue to drive forward market-led "adjustment" in opposition to employment and income security, redistribution and equality, there is no conceivable solution to the EU's "democratic deficit".

For this reason it is necessary to take action at EU level to defend and develop social achievements. These actions should be directed both to improving the environment within which national social policies function and to implementing common social policies in certain fields.

2.1. A better climate for national social policies

Of these two lines of action, the first is at present most important - both in the concrete contribution which can be made to social advance and in restoring some legitimacy to the European project among populations who have come to see, often with considerable justification, the process of European integration as a threat to their employment and income security. This point should be recognised because if EU social actions are confined to certain all-European initiatives, then the inevitable result will be a weak European social policy which only counteracts in a token way the impact of more intense international competition and rising capital mobility on existing social models. Indeed, if the continuing and predominant effect of European integration is always to increase these pressures then the EU will be objectively a factor of dissolution of European social systems.

Some of these "defensive" measures follow directly from our discussion of macroeconomic policy and public expenditure: a more employment-oriented macroeconomic stance and a harmonisation of taxes on capital revenues would go a long way to providing a more congenial climate for national social progress according to the specific values and priorities of citizens in different countries. We can regard a more responsible interpretation of the Growth and Stability Pact in the same light: acute social problems, just like the persistent unemployment with which they are often associated, should be grounds for a derogation from these constraints on public expenditure.

Indeed, the nature of EU constraints on social expenditures at national level should be reversed: member states should be required to devote first a stable then a rising share of national resources to clearly identified social objectives, such as the battle against child poverty, the strengthening of the labour-market position of marginalised groups and the dignity and secu-

rity of older citizens. Thus the proposed social constitution should lead to deep changes in the existing macroeconomic constitution of Stability Pact and Single Currency. Governments must not be permitted to fulfil macroeconomic targets by eroding their social protection systems and should be confident that higher public sector deficits incurred in meeting social priorities, far from running the risk of sanctions, will be supported by solidaristic action from other members and the EU itself.

A more structural measure contributing to an amelioration of the climate for national social policy concerns the mobility of productive capital. The activities of the largest enterprises in the EU, which are already increasingly bound by EU, rather than national, competition policy, can lead to acute employment crises for particular localities and regions. But there are no *social* constraints on the use these enterprises make of the mobility which European integration has given them and national constraints, such as the requirement for “social plans” in France in the case of mass dismissals, are compromised by this mobility itself. What is needed is a generalisation and levelling-up of the rules which already exist in the most advanced countries so that giant companies would have to bear at least some of the social costs generated by their relocation decisions. A readiness to take such action against socially irresponsible giant companies (which at present can throw the social costs of their relocations onto public budgets) would make for a less cynical attitude to the integration project among working people.

2.2 Positive social policy at EU level

Thus our first argument is not for a European social policy as such, but for a Europe which does more to respect and protect national social systems. But there are also many positive actions which can be taken in the framework of social Europe. The basis for these lies in the increasing interdependence brought about by economic integration. At present the EU has only a minimal presence in the field of social protection: there exists little more than the rule according national treatment to employees from other member states, on the one hand, and a certain contribution to regional employment and training initiatives, on the other. This limitation is of course linked to the inadequacy of the EU budget and, as is discussed below, there are now plans to cut the structural fund budget which, in our view, are quite unacceptable.

In the field of industrial relations the EU is present by virtue of what has become, by now, a considerable body of legislation - since Maastricht this has been largely in the framework of the social protocol, incorporated in the Treaty since Amsterdam. The impact of these laws varies from country to country, depending on the stringency of national employment law. There is little impact in France, Germany or the Netherlands, for example, because national labour law or collective bargaining already promulgates stricter standards - indeed one origin of this EU legislation lies in the desire of employers, particularly in Germany, not to be undercut by “social dumping”, that is, by firms exempt from strict labour codes of north-west Europe. Nevertheless, this legislation has worked to improve the position of female workers, to strengthen health and safety standards at work, to improve processes of employee consultation and, most recently, to enhance the status of part-time workers.

Given the emphasis which is often placed on the “social dialogue” sponsored by the EU - a set of negotiations between the social partners at EU level - it should be remembered that these negotiations only became meaningful when the employers’ side were faced by the likelihood of legislation. The tendency of the Commission to internalise UNICE’s analyses of unemployment - with an uncritical acceptance of such themes as “employability” - weakens the EU’s ability to influence working conditions.

In our view, EU actions can be developed usefully in both spheres - that of industrial relations and collective bargaining on the one hand and of social protection on the other. In all versions of the European social model these two sides are interdependent: a deterioration of social protection systems paves the way for an erosion of employment conditions; while the loss of social control over the nature of employment generates exclusion and poverty and thus puts impossible burdens on social security structures.

However, we consider that EU initiatives in social policy should complement, without attempting to supplant, national social models. An important aspect of such initiatives should therefore be the *promulgation of general standards* which firstly prevent negative forms of competition among national social states and reinstate the objective, enshrined in Article 117 of the Rome Treaty, of “improved working conditions and an improved standard of living for workers”; the article specifies that harmonisation should take place, “while the improvement is maintained”, so that only levelling-up, not competitive economies and “flexibilisation”, is legitimate. A European Social Constitution is needed precisely to give real effect to this provision which, in practice, has been subordinated to the free market agenda. A second theme would be the *reconstruction and development of the social dialogue* so as to take into account the new macroeconomic interdependence which follows from monetary union.

2.3 General social standards with upward convergence

A useful approach here would be the adoption of the model of *welfare policy corridors* which could start to have a positive impact on social and welfare systems without requiring lengthy or bureaucratic harmonisation of institutions and practices. Based on a uniform European procedure a social services quota would be ascertained for each of the countries (e.g. share of all social services in GDP). Should expenditures fall below this level in one of the countries in the years to follow that would entail a concertation procedure at European level. The country concerned would have to present a series of measures with which to reestablish that quota, if necessary with the help of the EU budget. This way at least any kind of pressure to lower standards would be avoided.

This mechanism could also be used for agreeing on and monitoring binding programmes for social service provision. On top of this, it makes sense to agree on specific objectives for convergence with quantitative and qualitative standards in social policy. Even in countries where there is considerable scepticism about the EU, a process of emulation and levelling-up in standards of social provision can be seen as legitimate; in Britain, the government has reluctantly accepted a major programme of investment in the national health service because the widening gap between British and Northern European standards of provision was unacceptable to the electorate. In its paper for the EU Lisbon summit, the Portuguese presidency proposed that the removal of child poverty by 2010 be decreed as an objective of European and national policies. Similar convergence targets could also be formulated for other spheres of social policy (such as health or the gradual adaptation of welfare payments to the EU poverty level of 50% of the average per capita income). All in all such a policy would make an effective contribution to reasserting social objectives in the European Union.

2.4 Social dialogue and wages policy

We advocate a fuller and more consistent social dialogue at EU level within which the participation and the responsibility of the social partners would be strengthened. Trade unions

would mobilise, in different ways in different countries, for common objectives: a return to full employment, the reintegration of groups excluded from normal employment opportunities, more comprehensive social protection. Employers might find it useful to renew the social dialogue in this way because it would allow them to negotiate more rapid and effective introduction of new technologies and organisational changes which enhance productive flexibility. Several countries, with very different social structures, made use of “social pacts” to help them satisfy the Maastricht convergence criteria and the positive aspects of these experiments can be built on.

Although the negotiation of wages cannot take place at EU level, intense communication between national bargainers should help to internalise an overall view of wage developments, while taking into account the variety of industrial relations systems and national traditions in collective bargaining (regional sectoral negotiations in Germany, economy-wide negotiations in Sweden, sectoral negotiations in the Netherlands, “social pacts” elsewhere). The outcome should be differentiated wage developments which would, through a gradual learning process, make for a pattern of earnings consistent with the stance of macroeconomic policy, as was suggested above. We have already made it clear that in our view this consistency must be reciprocal – that is monetary and fiscal policy should be consistent with labour market possibilities.

To distinguish our view of responsible wage bargaining from the Commission’s unstated but insidious pressure for unlimited bargaining concessions by employees we insist on the principle of *productivity bargaining* in the broad sense that the share of labour in production, which has fallen generally and significantly in Western Europe, should be at least stabilised and probably begin to rise. It is not desirable that wage growth should match productivity growth for every sub-group of employees, but an overall balance at aggregate level provides an orientation for bargaining consistent with macroeconomic stability in both real and price terms.

A major step forward in the stabilisation of earned income would be the introduction of the obligation of member countries to establish *a minimum wage*, which would of course differ from country to country according to productivity differentials, social aspirations and bargaining power. (This need not be achieved by statute where unions are strong enough to impose a genuinely universal minimum through the bargaining process). It has been shown, that contrary to catastrophic forecasts minimum wages have not led to increased unemployment and de-industrialisation. On the contrary, in the UK the introduction of a minimum wage has gone along with rising employment and in the US even a rise in minimum wage did not stop the strong built up of employment.

It should still be remembered that successful negotiations are unlikely to be the result of pure enlightened self-interest on the part of the employers - what is needed is a political climate within which agreement with trade union organisations is seen by the employers as the most fruitful strategy.

2.5 Strengthening social protection

We recognise that an EU-level capacity in the field of social protection can only be developed gradually. Countries can and should continue to have different systems of social protection. But it is necessary to promote a sense of belonging to a European community and to avoid excessive inequalities in levels of social insurance and in access to social and public

services such as health services or assistance to families. Therefore we propose minimum European standards should be introduced in each field, in addition to the *corridors*, mentioned above, which would be more specific to the circumstances of individual countries. The level of these minima would be renegotiated periodically in the framework of the discussion procedures established for employment and social policy. Transfer payments, financed by the EUs own resources, should be introduced to assist those countries which have insufficient public revenues to meet the minimum standards by their own efforts. This proposal corresponds to the notion (mentioned above) of a gradual move towards a federal budgetary regime.

2.6 Building on the Luxembourg Process

Finally, there are some areas within which there is more scope for specifically EU social action because they relate to the consequences of integration itself. One example concerns refugees and asylum seekers where it is increasingly necessary to oppose a humane, liberal and rational European regime to the fragmented and often oppressive responses of nation states. It is becoming urgent to secure a base of civic rights for non-EU citizens resident in any member country.

A second is the field of active employment measures and “life-long learning” which we also discuss in relation to the Employment Guidelines. The Luxembourg Process has already defined a role for the EU in this area, not to constrain national initiatives, but to insist on benchmarks for national action, to encourage experimentation and the exchange of information and to disseminate best practice. This could be a very promising development in European social policy; the notion of “life-long learning” can become an important theme marking the presence of the EU in social life; conditions for this are that access to educational resources are conceived basically as entitlements, not obligations, and that learning is seen as the fullest access to all the riches of the European (and other) cultures, not as the mere implantation of “skills” defined by and for business enterprises. The danger of the Commission’s present approach to “life-long learning” is that it remains a collection of palliative measures which take it for granted that some groups of disadvantaged workers will suffer from chronic job insecurity and repeated spells of unemployment. The educational and civic meaning of learning disappears in an assembly of low quality training schemes which form part of a repressive response to the unemployed. All European social models would be strengthened by an improvement in public educational services and by wider and more continuous access to educational opportunities for the disadvantaged; the presence of the EU in this field would also make for a view of the EU as a positive factor for social progress.

3. A more balanced structural policy

European structural policies are characterised by several weaknesses: the priority accorded to EU competition policy; the logic of the single market which favours the pursuit of scale economies through the breaking down of barriers to national markets; the weakness of research and innovation policy at EU level; the absence of industrial policy and the lack of strategic vision for Europe as a whole; the weakness and lack of a clear direction for trade policy in response to US activism.

The major step taken by EU for the desired economic integration was the creation of the internal market based on the principles of free mobility of goods, services, labour and capital,

including enterprises. This followed up the original creations of the customs union, the coal and steel policy, the agricultural policy and other common regulations. In several steps of international bargaining and treaty-making, structural impacts on the EU economy were achieved, like in the Lomé agreement, in GATT/WTO rounds and for instance in adopting OECD recommendations and regulations. The liberalisation of capital movements on a global scale was undertaken in a wave of similar actions by major countries under the conditions of mutuality in regulations.

Under assumptions of good economic balance and reasonable factor utilisation the internal market creation was expected to create considerable extra growth during a six-year period, to improve overall efficiency and competitiveness of the EU economy. This performance did not come true, mostly due the prolonged period of high unemployment. The strong relative recession in Europe created strong sentiments in favour of domestic subsidies, external protection of markets and a defensive attitude in international trade negotiations. The limited scale of new investments in the EU retarded probably wide absorption of new technology and the propensity for private sector R&D efforts and thus exacerbated structural deficiencies.

In principle, the diversity and differentiation of European products are major advantages but the logic of uniformity within the “big market” prevents these advantages from being utilised to the full. In practice, priority is given to increasing labour market flexibility and to reducing wage costs. All these tendencies make for an underestimation of the non-price elements in competitiveness and make it more difficult to sustain the medium term development needed to restore full employment. Finally, reinforcing competition and pursuing economies of scale are potent factors of polarisation, which exacerbate regional inequalities.

Public interventions with a structural character should be renewed in order to promote stronger and less unequal development. These interventions, while in principle at national level, are often not sufficiently co-ordinated or even severely constrained on the European level. For instance in many cases European competition policy imposes increasingly tight constraints. In accordance with the dominant free-market doctrines, restrictions are being imposed on national interventions without being compensated by any widening of interventions at European level.

It is desirable to bring about a more balanced situation by taking a more pragmatic view of competition policy, by promoting a more active research and innovation policy, by introducing an industrial policy at community level, by strengthening regional policy at the same time as making it more selective and, lastly, by preparing a more assertive trade policy.

3.1 A more pragmatic approach to European competition policy

Competition policy includes four main fields: regulation of agreements among firms; supervision of mergers and takeovers; controls on national subsidies; and supervision of public service activities. It is especially in the last two fields that changes are needed.

A more coherent and adaptable control of subsidies: At present, state assistance to industry is ruled out to prevent actions by individual governments from distorting the market and competition. The only measures permitted, in theory, are horizontal policies which do not favour particular sectors or enterprises. In practice exceptions are already made - for assistance to problem regions, for support for small and medium-sized businesses, for measures to protect the environment, for R&D support. The present control procedures should be made both more flexible and more coherent. More flexible, by abandoning the present attempt to push for

simple reductions in state assistance measured in purely macroeconomic terms (percentage share of annual GDP devoted to subsidies). More coherent, by trying to establish a closer link between the control of national subsidies and existing EU policies, such as the regional assistance financed through the structural funds or EU research policies. A deeper understanding of intervention would lead in some cases to more active EU interventions, in others to the acceptance of national measures where the latter are more appropriate.

The example of the US is instructive here. Individual states intervene actively - with aids for innovation, technology parks, financing mechanisms and even assistance for industries with problems. Measures at state level are very differentiated without anyone thinking that the overall logic of competition in the US as a whole is being falsified. Differences are permitted, with a kind of competition among the individual states of the union, but in the framework of a strong federal system - notably for research and innovation policy.

Safeguarding the concept of public services: There must be a modification of the policy, introduced in the 1990s, of a forced march towards liberalisation and exposure to competition in public service activities (more precisely, “general economic services” in Commission terminology). In several fields of the “service networks”, such a policy was made necessary by the pressure of globalised markets, the rise of new, high value-added markets and the need for the main players to move towards international alliances. The opportunity for significant reductions in charges was also an important factor. The most representative example is telecommunications because of the scope of the technological transformations in this field; overall developments in this area have been positive.

In other fields – like electricity, gas, water, postal services or railways - the outcomes are rather less positive. The experience of privatisation of the railways for example, does not demonstrate that private firms are superior to public enterprises – even although the latter need to be modernised in many ways. In many fields the quality and availability of previously public services have got worse. Spending restrictions in education and child care have led to serious problems in these services. For this reason we are critical and opposed to the general drive to privatise public services, which is promoted and reinforced by the Commission.

The concept of public services, embracing objectives of general interest such as solidarity, social cohesion, regional development, environmental protection and security of supply, needs to be maintained instead of the narrower concept of “universal services”. Member states must have the freedom to establish at national level both what their public service missions are to be and how their objectives will be achieved, according to their previous practices and their own traditions (methods of financing, whether service provision is to be in the public or the private sector). The logic of competition should be constrained by these national choices, rather than the other way round.

3.2 A more active research and innovation policy

The paradoxical situation in Europe is well known: on the one hand there is a high level of research, and workers are often highly qualified; on the other, performance in high-technology sectors - especially the key sectors of ICT and biotechnology - is far from adequate. There are many reasons for this situation both on the community and national levels.

In spite of all the efforts which are being made, European policies remain, in comparison with those of the United States, too fragmented, lacking in coordination and political drive, and in many cases, inadequately financed.

The Framework Programme for Technological Research and Development (FPRD) has been marked by several weaknesses: an inadequate involvement of big companies which are reluctant to co-operate on major projects and frequently have only put forward second rank projects; the complexity of the procedures, which is an obstacle for SMEs; the multiplication of targets in a way which is inconsistent with a single set of rules; the inappropriate nature of the pre-competition requirement for co-operative research; the distortions introduced by the requirement for unanimity which has prevented concentration on priority projects and tended to scatter resources; the fact that some countries have used the FPRD programme to replace and reduce national R&D finance; and the general lack of funding (15 billion euros for the 5th FPRD between 1998 and 2002).

On the other hand, the intergovernmental EUREKA programme is widely recognised as functioning in a flexible way, based on the initiatives of companies and laboratories and with a variable geometry approach to participation by different countries. However, it has gradually been eroded as certain states have withdrawn, as the scale of projects has been reduced and financial credibility has been lost.

Recently there have been several improvements. The removal of the unanimity rule from June 1999 has opened the way to greater selectivity within the FPRD. It has been accepted that the pre-competition requirement is out of date and this allows projects closer to actual industrial application to receive funding.

Making the procedures more rational

- Community support for SME innovation ought to be delegated to regional bodies to increase its effectiveness.
- Some spending in the FPRD is in reality a matter of assisting economically weaker member states. It should be taken over by the structural funds as a form of regional assistance.
- FPRD procedures have become too complex - specific rules should be applied according to the nature of the project to be financed. For pre-competitive research there should be more scope in making proposals. In industrial research the priorities should be based on the continuous participation of industry itself, with a genuine commitment by the biggest firms. The achievements of EUREKA should be built on for projects to be carried out quickly and in particular for projects to support SMEs. To overcome the present obstacles to a dynamic research policy EUREKA should be integrated into the FPRD in a way which would preserve its flexibility.
- National systems of support for innovation should be rationalised to take community actions into account and to avoid duplication of effort and eliminate pointless intra-European competition.

A broader research perspective for information and communication technology (ICT) and biotechnology: These two fields should be given special attention because of their strategic character and because of the many problems they pose far beyond the mere technological field. They should become focal themes of a renewed community research policy and should, because the emergence of the information society and the ethical and health issues surrounding biotechnology are major social questions, be embedded and debated in a much wider democratic framework involving both national and EU levels and including alternative paths of development.

3.3 A strategic industrial policy at EU level

The notion of industrial policy is foreign to many member states and has been difficult to introduce at EU level. Only recently has it been recognised to a certain extent in the form of “industrial competitiveness policy”. In theory, this is limited to horizontal measures aimed at improving the business environment and these are, in practice, rarely spelled out in an explicit way. Industrial policy is subordinated to competition policy. In fact research and innovation policy - gradually put into place in the context of the FPRD - has been the only instrument of this kind. Apart from the FPRD and the improvements to it which are proposed above, a more broadly conceived industrial policy could be developed around the four following themes:

A policy for patents and standardisation: A well-designed European standardisation policy could be a powerful instrument to improve the position of European companies, as is shown by the GSM standard for mobile telephone systems. Stronger European standardisation institutions should therefore be promoted, using the model of the European Telecommunications Standards Institute.

Encourage European diversity: Instead of relying completely on economies of scale and on the advantages of uniform products within the single market, Europeans should seek to make more use of the diversity of European products and European skills. This means promoting and protecting trademarks and product names which are often anchored in specific localities. It is necessary to create more scope for interventions at a regional and national level because they are often better at taking local realities into account. These interventions have to be organised in the framework of regional policy.

Make use of the experience acquired from previous industrial policies: The traditional instruments of national industrial policy - often trying to make use of big investment projects and public sector purchasing - have been called into question by economic liberalisation and technological revolutions. Nevertheless, the results of this phase of industrial policy and the experience derived from it should not be written off. Some aspects of these experiments can be made use of at EU level, based on the new industrial alliances which are being formed and on new infrastructural investments which can still have a significant impact.

Developing clean products: Lastly, a strategy to promote clean technologies and products would make for sustainable development and at the same time allow the companies which participated to acquire comparative advantages for the future. A whole range of instruments can be deployed (innovation assistance, standardisation).

3.4 More powerful but more selective regional policies

EU regional policies are already significant because the structural funds and the cohesion fund together represented on average 28 billion euros and 0.45% of EU GDP between 1994 and 1999, with contributions to peripheral countries which are relatively much more than this (4% of GDP in Portugal, 2.8% in Greece, 2.8% in Ireland and 1.7% in Spain). The common agricultural policy (CAP) delivers also a strong regional impact. But Agenda 2000 intends to cut expenditure for structural funds from 32 bn. Euro in 2000 to 29 bn. Euro in 2006.

The structural funds seem to have helped economies to converge in the 1980s and 1990s but this was by raising overall growth rates in the lower-income countries without, in general, reducing the regional inequalities within these countries. Apart from the convergence observed among countries, regional inequalities tended to increase in the 1990s, particularly in the southern countries. Some writers argue that infrastructural investments, especially in transport, can have a perverse effect by making it easier for the products of the most developed regions to be sold into peripheral regions.

The reduction in the structural funds which has been programmed up to 2006 is unacceptable and, on the contrary, increased finance (of the order of 10% a year) should be found, either in the framework of the EU budget, or by using funds from the EIB. But targets and projects have to be selected carefully if a real reduction in regional inequalities is to be brought about. While the multi-annual planning horizon should be retained, the rule according to which EU funds must be matched by national funds should be relaxed. The monitoring and evaluation of projects should be strengthened to avoid a tendency sometimes to use funds in an inefficient way.

3.5 A more pro-active European trade policy

The EU's present trade policy is irresolute and lacks clear guiding principles; the result is that the European economic area could be dangerously weakened. There is an on-going discussion about how to strengthen trade policy and to bring it in line with social and ecological requirements. The popular movements around the WTO conferences in Seattle and Kuala Lumpur are demonstrations of the concern behind these discussions. The EU must better define her policy in this area, taking into account that external competition can promote rationalisation and absorption of new technologies. The best strategy would be to seek for cooperation with our trading partners but at the same time to develop appropriate instruments which could be deployed if cooperation is not forthcoming. There are several ways in which these instruments could be deployed.

An escalation in response to American trade policy, through the preparation of an equivalent to the Trade Act in the US or through a reformulation of existing documents (strengthening anti-dumping procedures; retaliation measures in case of discriminatory practices or other breaches of the rules; reactivation of the "new trade policy instrument") would have the advantage of making a political statement which can be readily understood. However, there are problems in such an approach, ranging from the lack of political and economic strength over fall-out effects on third countries from retaliation measures against specific countries to divergences of interest among member countries who would be affected in different ways and to varying extents by any turn towards a more bilateral trade policy, especially if Japan or the US were involved. Thus this strategy could exacerbate conflicts within the EU.

An alternative strategy would involve a new form of multilateralism in trade policy. Customs duties would be brought back into play as instruments, because they are more transparent than other trade measures, but this should not imply any notion of tariff rearmament. Tariffs would be used to replace certain long-term anti-dumping penalties and, to replace bilateral arrangements, equivalent tariffs would be used. However, the EU would maintain the principle of safeguard clauses and of the right to a certain degree of protection in response to breaches of the rules. This new multilateral orientation would go along with the principle of reciprocity in, for example, opening up public markets or service sector liberalisation. In principle it would be easier to counter unilateral or bilateral moves by the US. But a necessary condition would

be the ability of European countries to bring their trade partners along with them and it is far from clear that they would be able to do so.

For this reason more assertive measures could be adopted which emphasise the European Economic Area. Community preference would be reasserted in the form of specific tariffs to replace the established “new trade policy instruments”. These tariffs would be selective and would decrease over time. Europe’s geographical neighbours (Africa, the Mediterranean countries) should be brought into regional development agreements in ways which recognise the specific difficulties faced by each country. Such preferential concessions can be an efficient and powerful instrument of development aid for third world countries.

The result would be a multilateral strategy combined with a recognition of regional preference. If a growth of administrative controls over trade is to be avoided then some recourse to bilateral measures is inevitable in the present world trade context. But one can argue for greater transparency and for all international agreements to be made public.

These measures would only be meaningful in the context of exchange rates stability, at least between the three main monetary zones, US, EU and Japan, each of which could develop into a regional monetary system. The experience of the last decades and of the euro depreciation since the end of 1998 has shown clearly that exchange rate fluctuations can easily outweigh the effect of tariffs or trade arrangements. Thus we come back to the need for financial re-regulation to limit departures from equilibrium exchange rates while at the same time maintaining a certain flexibility (the flexible target zone regime). The WTO can only become a fully meaningful trade institution if this stability is achieved.

At present it is doubtful whether the EU has the capacity to introduce this kind of trade policy. The Council should have complete responsibility for trade policy decisions, with the Commission playing only an executive role. A political figure, a “Mr. Trade” should be designated with responsibility for trade, with a role similar to that of the Trade Secretary in the US or of MITI in Japan.

4. Better preparation for the next enlargement round

Although the coming round of EU enlargement is not primarily an economic but a political process it implies a number of economic and social problems and has raised serious economic policy challenges. If these are not met in an appropriate way, reservations against enlargement will grow on both sides and can take the form of open hostility, rejection, national chauvinism and xenophobia, which will pose serious threats to the historic project of comprehensive European unification and peace and democracy for Europe as a whole. Such developments are already visible and should be a matter of great concern. They are partly a reflection of the insufficient political dealing with the economic and social side of a larger union.

The European Union started negotiations on accession with seven central and east European (CEE) countries, i.e. Bulgaria, Croatia, Czech Republic, Hungary, Poland, Slovakia, Slovenia, and with the three Baltic states: Estonia, Latvia and Lithuania. Five countries of south-eastern Europe have no place yet on the table of negotiations; these are Albania, Bosnia and Herzegovina, Romania, the former Yugoslav Republic of Macedonia and Yugoslavia, though their governments – for the time being with the exception of Yugoslavia – expressed the wish for future membership. The fifteen countries together form a buffer zone between the East and

West, a theatre of sanguinary wars in history during long centuries. The fifteen countries' population amounts to around 130 million, somewhat more than one third of the actual population of the EU.

The difficulty of eastern enlargement policy lies not only in the size of the problem, but much more in the deep differences in traditions and cultures, development levels, economic and social structures, which divide the countries from each other and even more from the West. To try to solve the problem in a few years would be economically unfeasible and politically counteracting. However, in the history there has never been such a good opportunity as today to progress for sustainable and peaceful solution of East-West differences. EU enlargement is the central part of this policy perspective.

Why EU membership is important for the eastern countries? – The serious economic and social situation in the eastern part of Europe is displayed in chapter 2.5. With the bad experiences behind, people confine themselves to only moderate hopes, but governments and most right or left-wing parliamentary parties alike see no other way out from the prevailing difficulties, than via EU accession. The economies should be modernised and reconstructed, and need capital and new technology imports. Domestic markets should be revived and the range of exports broadened. And many long-term tasks need assistance from the West as large scale East-West projects, the development of up-to-date infrastructure, environmental protection, education and social systems.

Many complementary features of the economies may sustain the development of East-West economic relations. Foreign direct investments were the most dynamic factors of world economic development in recent years. The fifteen member states of EU occupy a leading role in FDI outflows, e.g. in 1999 63,7 percent of the world FDI outflows originated from EU countries, the sum of which amounted to 510 billion dollars. FDI inflows to Eastern Europe (the Russian Federation, Belarus and Ukraine included) made 23 billion dollars in the same year. Although the EU plays a leading role as investor – 60% of FDI inflows to Eastern Europe come from the EU - FDI to eastern Europe is still a small share – in 1999 it was 2,7 and somewhat more in the years before - in total EU FDI. On the other hand eastern countries' structural transformation has created the basic institutions and instruments for market economy, and the richness in natural resources and the availability of an educated labour force provide by now a solid background for rapid reconstruction.

Economic interests of EU countries are in favour of developing economic co-operation with the eastern part of the continent. A reconstruction in the East would sustain economic growth in the West and contribute to the creation of new workplaces. Economic co-operation between the two parts of Europe is much more than an economic question. It would promote the reconciliation among countries and people after centuries of conflict. Common investments and development of trade would strengthen security on both sides more efficiently than military expenditures. Whatever is said about the reasons why defence expenditures have to be increased in Western Europe, the transfer of the money from military aims into East-West economic projects would add much more to the stability and peace of the continent.

The enlargement of EU should be supported by a broader economic co-operation with eastern countries remaining temporarily or permanently outside the Union. In the past most central and eastern European countries had good economic connections with Russia. It should be referred for example on oil and gas pipelines and supplies, which are also at present basic

elements of their economies. The development of trade and economic relations among eastern countries is also a precondition of successful modernisation and recovery of the region.

What would be the consequence of postponing the enlargement process? A poor and further declining Eastern Europe would be an economic burden and a threat for peace in the continent. A policy of isolation could provoke a similar situation that exists between the US and Mexico, and though US is integrated and stronger, it often pays high price for its short-sighted policy. A positive evolution of economic co-operation and integration between the Union and Eastern Europe including Russia is an existential interest of the European democracies.

The choice is to be made between two ways of possible future development: either to build a "fortress" Union, or follow a policy of gradual opening and integration into the direction of outsiders in the East. Both ways would need capital investments. At the beginning the first solution may cost less in money terms, but more on the political level with a very dangerous future outlook. And the EU will never become a real fortress with a poor and hostile Eastern Europe behind its back. The second way needs the enhancement of EU funds, but a broad integrative approach would mobilise positive reactions in the East from which also the West would benefit, and finally not only the political, but also the financial balance would turn positive.

An integrative policy orientation would need an elaborated long-term strategy including many transitory and flexible policy instruments. Some countries could be admitted at an earlier phase, others somewhat later, but important is to widen gradually economic co-operation with all countries of the region.

Three types or degrees of relations to eastern countries could be developed:

- preferential agreements (similar to those concluded with developing countries) that would be open for all countries of East including CIS countries;
- partnership agreements for closer co-operation and preparation of EU membership; and
- agreements of accession.

The EU in preparing on the accession of central and eastern European countries should consider particularly the following guidelines:

1. Accession should not be made dependent on the achievement of full institutional reforms inside the EU.
2. EU should negotiate generous transition periods and provisions, which are beneficial for both sides. For the eastern European countries the transition to a complete liberalisation of their markets for industrial products should be prolonged in order to give firms more time to adapt to stronger competitive pressure and avoid either further de-industrialisation or further reduction of wages and social standards.
3. On the western side considerable transition periods should be provided for the liberalisation of labour market in order to prevent further pressure through excessive migration from eastern to western countries, which could lead to increased hostility against enlargement. Such transition periods have been negotiated and agreed in the cases of the accession of Greece, Spain and Portugal.
4. Special arrangements are needed in the agricultural policy, but it would not be acceptable that Eastern countries were for a long time denied western market access in one of the few sectors in which they have a potential competitive advantage.

5. The resources for structural policies must be increased considerably, because they are completely inadequate to manage the structural problems, which the enlargement will generate. The accession of the new members will enhance the income and social disparities between member countries and regions of the new EU to a much higher degree than they have grown with the previous accessions of Greece, Spain and Portugal. It is also not acceptable that the modest structural support for the future new members should be almost completely financed by reductions in the structural funds for the current member countries. If the EU is serious in her often reiterated assertion that the eastern enlargement is the most important challenge of the coming decade and if she is interested in managing this challenge successfully than the resources for structural support of the accession must be enhanced.
6. Enlargement must be prepared and accompanied by an appropriate macro-economic policy. Generous room for manoeuvre for growth orientated policies should be conceded to the new members, including an accommodating monetary and fiscal policy. This should include special attention and treatment of exchange rate bands for the accession countries within the European Monetary System (EMS2), to which they become members upon entry in the EU.

The EU should resolve uncertainties concerning enlargement policy in the next summit and set into force a concrete – in terms of dates and provisions - program of eastern enlargement and widened economic co-operation with countries of the East in general.

5. A broader perspective for a more social and equitable society

'The ruinous consequences of the rule of neoliberalism during the last two decades have prepared the ground for a new fundamental change and for the evolution of a new paradigm containing explicit individual and collective welfare objectives as well as the overarching values of solidarity, equity and ecological sustainability. If this is to be more than a change in words and individual instrumental measures it requires a remaking and restructuring of the whole institutional structure and fabric of the EU and Europe, reaching far beyond the economy and including broader problems of social emancipation and democracy' (1998 Memo)

In the foregoing sections of this chapter we have made proposals for an alternative economic and social policy in Europe which we consider more adequate to improve the situation of employment and welfare. However, these measures – while including a great number of institutional changes - take as given the overall framework and the basic options of present societies. They do not change the underlying structural framework of modern capitalism. This basic framework embodies in itself very significant contradictions, problems and power structures which not only pose serious difficulties for the adoption of our proposals but also weaken many of the results that could be achieved with them.

Moreover, the level of wealth and productive capacity that industrialised societies have achieved and some new social perceptions associated with them, do also lead to the need to face the economic and social organisation and the possibilities and limitations that they imply in thoroughly new and radical ways. Therefore it may be of interest to start exploring the feasibility and scope of different recommendations about models that do not stop at the improvement of the present status but intend to go further and aim at more radical changes.

We live in rich countries, where the capacity to produce the goods and services needed to cater for the material needs and wishes of the populations is high, plentiful and might even result excessive. This situation allows - and should oblige - us to consider imaginative new formula that allow for really substantial changes in the living conditions of the population. Markets alone will not produce this type of society. The working of the market will have to be oriented and complemented with the decisions taken by the political will of the people.

5.1. No priority for growth but for welfare

Even if in the short run expansionary measures may be necessary, in the medium and long run high rates of growth should not be the main objective of an Alternative Economic Policy. Our societies do not need to strive for ever growing provision of goods and services but have to organise around a sufficient provision and fair distribution of material and immaterial goods that constitute social welfare.

There is a broad mainstream consensus amongst economists that the rate of economic growth or growth per capital is an indicator (even though imperfect indicator) of economic well-being, or at least, of potential economic well being. This view can be challenged on good reasons.

One important aspect is that economic growth has always been linked to ecological deterioration and thus has had a negative impact upon the quality of life. Without thorough restructuring of the whole economy this is likely to remain so. When we generate added value using non renewable resources or using renewable resources in an unsustainable way, this is counted as an addition to net value and not – as it should be – a subtraction from net value. In the long run this deterioration could even decrease the future GDP.

Moreover, the macroeconomic indicators can increase for a lot of different factors and the significance of these factors in terms of quality of life are completely different. Therefore overall economic growth should not be considered an objective in itself. We should go beyond the term “economic growth” and even beyond the term “sustainable growth”. The success of economic policy should be directly measured in terms of improvements of the quality of life and specially the satisfaction of basic needs. The term sustainable development can be used to indicate these objectives.

5.2. Elements of welfare

Once a certain level of satisfaction of the material needs is achieved, the wellbeing of the working population depends not so much on permanent growth and increasing wages leading to consumption of still more private goods but on the feeling of ***security, reliability and belonging*** that provides a ‘decent’ job and a secure social environment. Uncertainty and anguish about the future of labour may be more relevant than the immediate threat of personal unemployment; tensions and poor treatment at the working place may be more important than stagnant wages; good working conditions and working times that allow for personal life may be more appreciated than higher wages. This is far from implying that workers should renounce to all increases of wages (for instance, those due to increases of productivity or a better distribution of economic surplus) but that growth need not and should not be the main aim of an alternative policy and that the distribution of social wealth is a more relevant issue.

An *increased role for workers in the decisions of their enterprises* is also relevant in order to advance towards a more satisfactory and democratic society. The importance of an active co-operation of workers at the shop floor for improvements in productivity has already been proven, but we consider that workers, as full partners in the production process have to take part in the decisions in connection with the main decisions of the firm. It is well established now that workers and their representatives are able to understand the complexity of the economy and the economic life of the firms and therefore there should be no problems for them to take part responsibly in the main decisions of the firms. Issues about investments, level of wages and profits, restructuring of the firm's activity, the type of goods and services produced, and so on should be discussed and jointly decided upon. The view of the firm as a place of expression for different interests among *equal partners* to act should be recovered and enhanced.

The challenge our societies have at present is how to create 'decent' and satisfactory jobs for those people that need and wish to work in such a variety of circumstances without necessarily having to promote high rates of growth. Certainly this implies a wide process of *redistribution of income* that allow for the provision of jobs in areas where the quality of life improves instead of merely increasing the quantity of goods and services available. The issue of distribution of income comes to the centre of the stage.

The idea that private affluence and individual 'consumerism' are not the only source of satisfaction should be seriously enhanced. The achievement of *other goods, many of them of a collective nature* may be more important: a social environment where safety and security are ensured, good quality and healthiness in the provision of food and water, a good design of the territory and cities that allow for good housing and environmental conditions, adequate provision of public transports so that not long hours are needed for reaching work, the provision of adequate education, health and other welfare services as well as many other issues of a political and ideological nature like the opportunities for democratic participation in public affairs, or avoiding corruption in the public sphere, the fight for greater public freedom or against conspicuous unfairness towards groups of people like immigrants or solidarity with poor people in poor countries and so on and so forth - may be felt as important as mere improvement of individual economic rewards. Not to mention the preoccupation with environmental issues. For most of these issues not growth but a much more profound transformation of values and structures is the solution.

An important contribution to welfare is the provision of an *ample and modern system of social services* for the whole population. A European welfare system should be established. We consider the EU should be an active agent to gear a co-ordinated social welfare policy for member states. In front of the present trend of policy of privatisation of social services, we advocate for a fully restructured and modernised social service system in the direction of widening their scope and improving the services. An important issue is the decentralising of the social services well below the national level in such a way as to provide the services the population wishes and reduce bureaucratic problems.

Welfare should not only include the traditional welfare social services (education, health, unemployment, pension, social assistance, eventually a basic income provision...) but also the *public provision of many other services* required for an harmonious development of social life as housing, energetic and public transport policy. The policy on infrastructures at the European Union level has mainly been directed towards big infrastructures of transport such as

high speed trains and highways. It is considered here that lower level projects, should also be taken care of, included in the coordinated/convergent welfare systems of the member countries geared by the EU.

This improved and expanded social system would provide for additional jobs that could make up for the smaller expansion of jobs on private production of goods and services. Also these jobs may provide for employment of people with medium type training that may be very convenient to cater for groups of population that look for this level of jobs and often suffer from high unemployment, like young people and women.

Basic Income: A fair and equitable distribution of income and wealth, and the reduction of inequalities is also part of the welfare option. Besides exploring new ways within the traditional fiscal policy other means may be explored. As part of this expanded and improved social redistributive system the possibility of providing with a Basic Income for all citizens should be explored and aimed at. Rich societies have to secure all citizens, regardless of any personal circumstances, the income necessary to provide for their basic needs. This has to be considered a basic right of the population. Moreover, in rich societies, sooner or later new forms for the distribution of income other than paid work will have to be found. In fact we should say that new forms should be analysed, improved and rationalised since family transfers and many scattered provisions for social assistance for the unemployed and poor people already exist. Therefore the possibilities of establishing a basic income for the whole population as a citizens right should be explored, its consequences assessed and its gradual implementation planned.

Reduction of working time and basic income: Reduction of working time has become a controversial issue even amongst alternative economists. While many regard it as a very important instrument on the way to full employment others are more concerned about the loss of potential production and income going along with less working time. We are not discussing these controversies here but put the question in the context of the broader perspective of a welfare instead a growth oriented society, which we have outlined in the preceding paragraphs. In this context working time reduction will be able to absorb progress in productivity without loss of income. In order to generate positive effects on employment, it is necessary that at least three conditions are fulfilled with the reduction of working time, within the framework of free negotiations on major employment conditions within varying industrial relations systems. First, the reduction has to be sudden and drastic: already going to the 35 hours week is today insufficient, because with a growth of the productivity around 4% (in the machinery sectors, also of 5-6%), the 35 hours week doesn't produce new employment. Therefore, it becomes necessary to go down at least to 30-32 weekly hours. Second, the costs which are accompanying a drastic and sudden reduction of working time cannot be borne by the workers (in the sense, lower time, lower wages); otherwise, instead of increasing employment, there is an increase of labour precariousness to the advantage of profits and productivity/flexibility. Moreover, an excessive loss of the purchasing power of wages could weaken the mechanism of accumulation insofar as internal effective demand is affected. Third, the cost of working time reduction can also not be imposed from the beginning on the productive system; initially, the gains from productivity and from a more rational labour organisation induced by working time reduction can only after a certain time finance the initial cost of time reduction. It follows that the cost of a drastic and sudden working time reduction must be brought up by general taxation. This raises the question of social income distribution and is a strong argument for the introduction of a basic income.

Linking the question of working time reduction to the question of income distribution, serves the very important strategic function of unifying the different forms of job, which do not operate inside the logic of accumulation. More particularly, social income distribution can be the political and economic objective that not only allows the reduction of labour time but becomes the tool of homogenisation of the following three categories of workers:

- the unemployed: with basic income, besides guaranteeing them an immediate purchasing power without driving them to illegal profits, they know that a reduction of labour time can be practicable;
- the independent “heteromanaged” and precarious workers, partly expelled by the fordist production process: for them the introduction of a basic income makes it possible to reduce their working time without a reduction of their own income;
- the employed salaried people: They, too, can, thanks to basic income, get a reduction of labour time that involve an improvement of the quality of their own life.

Similar considerations about reduction of labour time can be also developed as it regards the activation of non profit alternative jobs or the development of self-organised productions. In this case, in fact, the greater individual freedom deriving from the availability of income would allow to more people to be able to tightly develop no-merchant activities, without being submitted to the selective tie imposed by market hierarchies.

Poverty is intolerable. In rich societies no form of poverty whatsoever can be tolerated. The fight against poverty and exclusion has to be one of the main focus of an alternative economic policy. Against poverty the existence of an adequate non discriminating welfare system is paramount. Not only should social security systems give priority to cater for poor people but permanent provisions should be taken to eradicate poverty in origin. In this connection the right to a Basic Income for all citizens above what is considered the poverty level could be a good measure and should be prioritised.

An environmentally sustainable development. The shift from an environmentally destructive to a sustainable path of economic development will require a thorough reshaping of the mode of production and consumption in Europe. This restructuring is a time consuming process which will take decades to complete. In this connection, the choice for non-growth will facilitate the achievement of a more sustainable environment. The EU can and should encourage and subsidise, to a much greater extent than in the past, environmentally friendly national and regional projects to restructure transport networks. On the European level such policies should be supported by special taxes for aviation fuel and road transport. National and regional programmes for waste saving and waste recycling, etc. can also be reinforced through European channels. Such measures are, as a rule, labour intensive. Therefore a larger share of the considerably enhanced structural funds should be reserved for them.

5.3. Exploring the possibilities of co-operative welfare models

The negative consequences of the ‘neoliberal’ model based on world competitiveness are so great for the people and dangerous for the continuity of the system that it seems real new ways will have to be explored. It appears that increasingly the opinion is developing in important decision making quarters that the unhindered working of globalised markets might lead the whole system to recurrent crises and an important deficit of legitimation even leading to serious social unrest. Even if the powers favouring the status quo have been able to stop changes taking place for the time being, new systems of regulation of private interests and the articulation of private/public decisions seem to constitute open fields for exploration of new strategies.

However, new strategies by themselves do not guarantee a better result for the population unless their objectives are geared towards general welfare instead of at the profits of business. It seems we are in a crucial time in which the objectives of the working of the economic system have to be revised and the need to improve the wellbeing of the population as the central objective of economic strategy firmly asserted. In the sense of exploring new strategies of growth not so much based in world competitiveness led by unhindered markets and enormous centralised corporations but on the welfare of the population and on fair international relations with other countries. It is an enormous challenge for the present European Community to work towards a new economic and social system able to combine and articulate the paramount objective of the wellbeing of the population with the working of a powerful private system. Is it at all possible? Is it possible to combine public regulation and action and the working of the market in such a way as to lead to a fair, good for all and profitable society? It seems the time has come to face such a challenge if we do not want to see our societies destroyed by private greed and converted into enormous consumers camps surrounded by a very substantial part of population excluded from satisfactory consumption and still a more enormous part of the world to whom we have made unable to share even in that consumption.

The European Union is in a very good position to explore these possibilities. The EU constitutes one of the richest parts of the world with only 10% of trade external to its area. It has a long tradition of a powerful welfare system and all its member countries practice parliamentary democracy. The EU may well explore the possibilities offered by a strategy more based in the co-operation for welfare instead of world competitiveness. It seems the part of the world better suited for trying new strategies of social organisation. It seems almost its historical responsibility.

5.4. Final remarks: interests, power and movements

The assessment and evaluation of economic strategy and economic policy depends on the values, options and interests from where that assessment is made. There are multiple possibilities of economic action and the ones that are chosen reflect the main interests of the social groups that have the economic or political power to impose them. In their assessment of economic policy and proposals for an alternative the Economists for an Alternative Economic Policy (EAEP) place themselves squarely with the interests of the majority of the population, that is, the workers and popular classes.

Trying to enhance these projects raises the issue of their feasibility. It is impossible not to wonder if a society that has as its leading economic objective the attainment of benefits for private capital and has developed such powerful agents aiming at it will not be essentially hindered towards the possibilities of creating a fully harmonic society directed to the welfare of all its members. It is within the basic nature of capitalism to be built upon the inequality of the agents -capital owners or workers- that take part in the production process and the share they enjoy of the wealth and income thus produced. Therefore it seems the present economic system hardly will be able to produce a fully satisfactory, fair, equitable society. It is the task of the people who believe in the desirability and possibility of advancing from the present society into a more equitable one to show that it is possible to work towards its attainment.

Within the context of that broad framework, in our present world it is necessary to start from where we stand now and advance gradually towards winning spaces for alternative objectives, institutions and ways of doing things, as well as alternative ways of using the available in-

struments and devising new ones. In such a way that the real possibilities of exploring new venues and strategies can be explored and some results may be achieved, even if limited and partial. The widening of those new venues and results will increase the space of the new society eventually leading to its total transformation.