Three ways of tackling Europe’s social problems from the outside

1. Growing inequality in Europe

While the EU institutions are absolutely intent on attaining the goal proclaimed at Lisbon in March 2000, namely to close the one-point gap in GDP growth by which Europe has lagged behind the United States for at least a decade, a perhaps even more crucial challenge looms within the EU. The very cohesion of the European Union and the integrity of its social fabric are at stake. Confronted by the twin pressures of globalisation and enlargement, the EU is facing the dilemma of inegalitarian growth. Whereas European integration was long associated with a virtuous win-win scenario, another reality is now dawning: growth will only be increased at the cost of a fall in relative real wages as compared with income from capital. This discrepancy already exists and is mounting. It will moreover be perpetuated in retirement incomes in the long term: these will decline for the majority of poorly skilled workers who have insecure and patchy working lives, whilst they will grow for people on high professional earnings and those with savings.

This divergence in the distribution of primary incomes will gradually be compounded by a reduced capacity of governments to effect redistribution. On the one hand, income taxation is no longer as progressive as it once was, with consumption taxes being raised by way of compensation; on the other, there is growing pressure on social expenditure, both on expenditure geared to equal opportunities – education, housing and culture – and on that aimed at solidarity – unemployment, pensions and healthcare.
What is to be done? How can we prevent the social dislocation which is insidiously at work today in Europe and is a major reason for public disaffection with the EU?

The causes must be examined first of all. But, before that, we should point out that the debate is often skewed by two factors.

Firstly, the very fact that inequality is rising is deliberately played down or even denied by economists who readily overlook distribution problems to focus on growth, which they mistakenly see as a miracle cure for all social problems. There is moreover a lack of sound, up-to-date statistics: too few indicators of relative poverty exist; developments on the margins of society, if counted at all, are wrongly assessed; and it is difficult to evaluate the informal economy, sometimes verging on petty crime – which does of course prevent exclusion from the consumer society but only at the cost of appalling social marginalisation in the suburbs of our cities.

It is therefore difficult for experts to give serious consideration to these issues, while it is easy for politicians to evade them. The (ineffectual) discourse about growth and employment which has prevailed in Europe for the past twenty years thus appears to be a case of pressing on regardless despite the persistent, irksome reality that social indicators are deteriorating.

Secondly, the European level can easily offload these issues onto governments since its responsibilities are circumscribed by the Treaties: the EU is in charge only of the function of efficiently allocating resources for the entire EU, and of the stabilisation function for the euro zone. As concerns the third function of economic policy, redistribution with a view to equity, the EU is confined – with its budget of 1% of GDP – to peripheral activities, now with reduced funding, in support of convergence by the new Member States. On the other hand, it abstains in the name of subsidiarity from intervening in an area as central as interpersonal equity; this is left to governments, expected to exercise their social and fiscal sovereignty within a large market where factors and goods move around freely. In doing so, the EU sidesteps the consequences of integration and of opening up the single market (its responsibility) on the living conditions of the majority of European people.
Let us return to the deep-seated causes of the social dislocation process underway in Europe, whose political and institutional consequences will differ depending on whether the shocks currently confronting the European economy remain brutal or are in future cushioned by EU measures. EU-level politics bears a key responsibility here.

Before addressing the crucial role of the economy in creating inequality in Europe, let us look briefly at the impact of certain societal changes, themselves partly brought about by economic change.

European society is in crisis. How could we fail to notice? Grounds for optimism do of course exist: peace on the continent, rising standards of living for most people, longer life expectancy, remarkable technological progress, tolerance (despite the heightened tension between some Muslim communities and their host countries) and environmental awareness.

But some current developments give cause for concern: the link between single-parent families and poverty, the link between consumerism and excessive debt, rampant illiteracy, symptoms of depression especially among young people and the very elderly, and the onset of addictions related to behavioural and emotional disorders which add to the difficulty of getting a foothold in the labour market.

Europe is at present going through a period of doubt, and even pessimism, which is reflected in the increasingly widespread conviction that our children’s future will no longer be better than the existence of their parents today. What a terrible admission for a rich, advanced society! How much of this European malaise is attributable to the economy and how much to the more fundamental crisis in society? We shall not explore this question here. Let us merely note that opinion polls have revealed such sentiments in very diverse countries: old and new Member States, countries where growth is rapid and others where it is slow.

Many observers dismiss this state of affairs from their radar screens because only a minority of people in our still well-to-do societies are affected; thus it is easy to gain the impression that with a bit of political will and social know-how one could return to square one and get back on track. That is a dangerous illusion: the three forces underpinning the
upsurge in inequality – technology, globalisation and social change – will keep nibbling away to such an extent that the social tension, anxieties and controlled political responses will filter through to the middle classes who ensure political balance and stability in our democracies. The more cynical commentators should at least factor in this risk of mounting populism.

Let us return now to the European economy and the origins of the new social question in Europe.

Among the changes liable to affect primary income distribution, reference is normally made to technological progress, a powerful element in both creating and destroying jobs, as well as to the distribution between capital and labour, and wage differentiation between skilled and unskilled workers.

Mention is also made of the changing balance of power between employers and employees resulting from a transformation in production structures: from large “Fordist” firms offering jobs for life, rising wages and social benefits to a strongly unionised working class, we are moving to companies which are fragmented into subcontracting and outsourcing networks and to more or less Schumpeterian – i.e. innovative – SMEs, where true industrial employment gives way to genuine or sham service jobs where trade union membership is scarce.

We have already spoken of sociological transformations, such as the breakdown of family structures which exacerbates poverty due to the existence of a single wage and a reduced capacity for intra-family solidarity. These changes no doubt also affect performance at school and mean that young people are less well prepared for the labour market.

Should we perhaps add the as yet little-known impact of temporary immigration, especially from the East, and permanent immigration, especially from the South, on jobs and wages? When these workers take up posts left vacant by the indigenous population, they contribute to growth; when they themselves drift into unemployment and/or operate in the informal economy, they adversely affect wage levels and employment. In addition, the very poorest ones swell the ranks of the
least well-off population groups, particularly because of their language and training handicap.

All these factors have a bearing on primary income distribution, but as a rule they are manageable because they arise gradually; they can be anticipated and dealt with, mainly by improving the quality of employment and social integration policies. The challenge is nevertheless immense, whether it be a matter of housing, education, training or access to a minimum amount of cultural knowledge, because improving the quality of social policies is an extremely complex matter. It is however worth a try, provided that the financial wherewithal exists. This is where the EU bears direct responsibility, because of the tax competition which it tolerates and facilitates.

Let us turn now to the external dimension of our countries’ social problems: firstly globalisation, whose effects are augmented by European integration in the new context of enlargement; secondly, the prevalence of the financial sphere over the real sphere in the global economy; and thirdly the question of disparities in labour law between the North and the South.

The overlapping of these issues, coupled with their ever-increasing relevance, is currently provoking a wave of restructuring and relocation. This in turn has an adverse impact on most people’s jobs and wages, both by creating unemployment where there is strong resistance to a reduction in real wages, and by pushing down wages elsewhere. And yet, like technological progress, the globalisation of markets and progressive “financiarisation” (see below) constitute undeniable sources of efficiency and factors of long-term growth.

In order to understand how factors of efficiency in allocating resources can result in a loss of well-being by exacerbating inequality and poverty, we need to grasp the means by which globalisation operates nowadays.

First of all, our adjustment to exports from countries with emerging economies, which has until now been a gradual and continuous process, is undergoing a step-change now that China – and more gradually India – is bursting onto the international labour market, knocking it off balance. These countries are opening up to foreign investment, massively so in the case of China, and their use of an export-driven
growth strategy is prompting an unprecedentedly large and rapid transfer of operations from industrialised countries to emerging parts of Asia.

Secondly, a new paradigm of international trade is coming to light: until now the South had an abundant supply of unskilled, cheap and relatively unproductive labour, while the North compensated for the high cost of labour through high productivity based on advanced technology. Today, thanks to multinational companies’ investments and technology transfers into China, that country combines two hitherto contradictory comparative advantages: cheap labour on the one hand and cutting-edge technology on the other. All of a sudden, the North needs to create not only unskilled jobs to replace those lost but also even more highly skilled jobs, which presupposes a faster rate of innovation and of course sufficient protection for intellectual property.

Thirdly, there is now a marked dissociation between capital and labour in the process of adjusting to this globalisation dominated by foreign direct investment. For example, when businesses relocate to China or expand their operations there, the European or US shareholder wins out because he will obtain either additional dividends or capital growth. The worker, by contrast, whether skilled or unskilled, will lose his job. Net added value is created in Europe if the dividends and capital accumulation resulting from outsourcing exceed the wages no longer being paid, but the distortion of distribution patterns is severe.

It would of course be feasible to redress the balance: inasmuch as the income from capital is reinvested in new jobs in Europe or is subject to a tax levy to finance job creation in the non-commercial sector, then alternative jobs will be available to the dismissed workers; in that case the problem is confined to easing the worker’s transition and retraining. There is no guarantee, however, that the real wages provided by these new jobs will be as high!

Nor is there any guarantee, in actual fact, that any such mechanism will be put in place: if the profits are reinvested on the spot in Asia, or in the United States, and moreover if capital gains tax is evaded, then – all other things being equal – there will not be any replacement jobs. In other words, now that China and India are bursting onto the global economic scene, we are experiencing new situations in which the
winners are on one side and the losers on the other. The compensation for gains and losses which used to be come from the market and from politics is no longer so readily available. Unemployment used to be transitional but is now becoming structural because the creation of replacement jobs is no longer keeping pace with the rate of job destruction.

EU enlargement reproduces this scenario on a smaller scale from the point of view of labour in the old Member States, but with one important distinction: the process turns full circle within the EU! Added value and business activity are indeed transferred from West to East, but it contributes to real per capita GDP convergence by the new Member States, so that eventually we can in turn expect growth to be stimulated in the old Member States and jobs to be created. In the meanwhile, though, the lot of the old Member States will be stagnating or even falling real wages, or else worsening unemployment. What is more, if tax incentives are used to attract investors from West to East, the shift in the tax base from an old to a new Member State will limit the capacity of the former to perform its role as provider of social safeguards.

And what of integration itself, which the Lisbon Strategy undertook to kick-start, above all in financial services and in the network industries? There can be no doubt that it improves efficiency, thanks to a combination of economies of scale and heightened competition, provided of course that competition is effective — which is far from being the case at present! But the growth generated in the twenty years since the 1985 White Paper on the Single Market of 1992 has not been sufficient to make significant inroads into structural unemployment, despite the jobs created both in the run-up to the single market and owing to the switch to the euro. Thus not even the policy at the very core of European integration is able to generate job-creating growth. Three factors counteract the effects of the micro-economic and structural dynamic of integration: the macro-economic policy mix does not fuel growth; the attempt to achieve competitiveness by lowering real wages has a deflationary effect; and, lastly, differing degrees of rationing still exist on labour markets, financial markets and in the utility sector.
2. The new distribution scenario

No economist doubts the link between growth—and hence employment—and global trade liberalisation: these two processes interact and are mutually reinforcing. By the same token, all economists point out that no country has ever developed in isolation.

The link between growth and trade liberalisation at the level of each country individually is a good deal more complex, however: the degree of success in opening up to trade is determined in particular by its size, specialisation and whether growth preceded liberalisation or vice versa. Moreover, the benefits and costs of opening up commercially are shared out according to an intractable law: national resources made rare by being exported gain in value, while resources made more abundant by being imported lose in value!

Finally, one crucial question arises here: are governments willing and able to arrange for solidarity between the winners and losers, in the form of transition incomes and retraining policies? Because in reality it is politics, and politics alone, which transforms growth into fair and sustainable development. On the other hand, if the market places excessive constraints on politics, efficiency gains will indeed be made but may be snapped up by the winners. “Winner takes all”, as they say!

When trade takes place between countries, for example ones in the North and ones in the South, which are differently endowed in factors of production—skilled or unskilled labour, high or low capital reserves, advanced or basic technology—the problem of sharing out efficiency gains arises above all within each partner. When trade occurs between countries at similar levels, such as for example the EU-6, what makes the difference is the specialisation of each economy: the main issues here are agglomeration effects linked to the status of “front-runner”, economies of scale and product differentiation. Distribution will in principle be easier to manage because the resources used in production are more mobile.

However, we are now seeing a new distribution between capital and labour, between skilled and unskilled labour, not only within but also between countries and even between continents, as a result of two major developments which go hand-in-hand with globalisation:
“financiarisation” of the economy and the rapid emergence of China in the world economy.

We should say at the outset that it is not a matter of pouring contempt on globalisation, which has distinct advantages, and less still of succumbing to protectionism, whose consequences would be unpredictable and probably disastrous for prosperity and peace in the world. But we must realise that if politicians, internationally and nationally, do not exercise proper control over globalisation, distribution problems will arise. Inequality will worsen as a result of structural unemployment and a relative drop in real wages for many people, if not most, and social cohesion in our countries will be at risk. History teaches us that, when confronted by a tear in the social fabric, governments take matters in hand and interfere in the self-regulating mechanism of the market: the collapse of the gold standard in the early 1930s was brought about by political decisions made in the wake of the 1929 stock-market crash. A unifying international system undermined by “beggar-thy-neighbour” policies was replaced by alternative and conflicting models: increasingly radical collectivisation in the Soviet Union, the New Deal in the United States, and the autarkic, militaristic models of Germany, Italy and Japan.

Let us not repeat the mistake of the past, namely dismissing the eventuality that nations or regions might withdraw into themselves on the grounds that economies are now so globally interdependent that conflict would be impossible. Alas, this argument does not stand up in the light of history.

We shall now make what is a difficult admission in this era when the economy reigns supreme: politics always takes back control from the market when a country’s social integrity comes under threat. Therefore only a robust system of multilateral governance, based on solidarity including (this time) the social order, could halt the slide into protectionist behaviour and rivalry between continental blocs. Such an international system is still only in its infancy. Only a united and determined EU can hasten the advent of a system of global economic governance, the guarantor of fair and sustainable development, since the initiative will not come from either the United States or China.
Let us turn our attention to two systemic changes occurring in tandem with globalisation.

2.1 Finance holds excessive sway over companies

We now look at financiarisation, without doubt a complex phenomenon but one whose complexity is in part a deliberate ploy to discourage researchers from analysing it and, even more, to deflect politicians’ attention.

Let us attempt to keep things simple so as to explain what is at stake and reveal the scope for corrective action.

Finance in itself is of course a productive activity, in that it adds value to savings and makes it possible to invest at reduced cost: the provision of capital contingent on the soundness, liquidity and competitiveness of financial markets contributes significantly to development. Conversely, finance is at the same time an activity plagued by parasitism and speculation, where greed easily spills over into fraud and tax avoidance is rife.

Over the past two decades there has been a growing trend worldwide for the financial sphere to win out over the real sphere of the economy: the obligation on companies to obtain financial “best value” no doubt makes them more competitive in the short term, as measured by their profits; but that competitiveness comes at the cost of excessive restructuring, owing to the priority attached to short-term profitability rather than to long-term strategies determining corporate growth, job stability and rises in real wages. This pressure on companies is compounded by pressure on governments.

2.1.1 Pressure on companies

Financiarisation is situated at the meeting-point of three developments: corporate governance, information technology and the international liberalisation of capital movements.

Since the 1980s, initially in the United States, immediately afterwards in Great Britain and then gradually throughout the EU, a new logic of governance has gained ground, whereby the shareholder and the stock market take over the place traditionally occupied by company managers and, at least in Europe, bankers. The concept of “stakeholder value”,

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where the interests of everyone having a stake in the company – shareholders, workers, suppliers and subcontractors, local authorities – are taken into account by managers seeking a compromise between competing interests for the sake of long-term growth, has given way to a form of governance oriented towards “shareholder value”, the creation of value for shareholders as demanded by new players on the financial markets.

These new players are institutional investors: pension funds and mutual funds. They now represent individual shareholders, and their presence in the financial game unsettles shareholders, who, formerly sedentary, have now become nomadic or even “fly-by-nights”, quick to pocket their profits and hence easily seduced for example by hostile take-over bids, whatever the long-term effects on corporate growth.

The combination of this mobile shareholding class and the pressure exerted on households by institutional investors through the financial markets over the past two decades is a key factor in the steady rise of capital as a share of added value in Europe and the United States, and consequently in the decline in the share of wages. This fundamental alteration in the pattern of distribution is a major cause of widening income disparities – along with the growing individualisation of pay.

But the effects of this “dissociation” of company ownership and corporate responsibility in the minds of shareholders and the importance of institutional investors would not have reached today’s dimensions if two other major changes had not occurred at the same time.

Information technology (IT) has first of all revolutionised accounting methods and has flushed out the unexploited potential of “shareholder value” at the core of the most complex companies, revealing it to the market-place. IT has also enabled profit opportunities based on risk transfer to be converted into financial products. Lastly, it has permitted the interconnection and real-time operation of global financial markets, heightening the pressure on industrialists and governments.

But what has created the operational framework for international financial markets is the liberalisation of capital movements, gradual initially until the mid 1980s and thereafter extremely rapid. The
principal function of this liberalisation is to reallocate global savings according to the yields offered on different national markets. At a stroke, the pressure exerted by institutional investors on companies with a view to producing (untenable) double-figure yields is redoubled as a result of the internationalisation of markets.

This liberalisation has occurred despite a lack of institutional supervision of financial markets in countries with emerging economies. Short-term capital flows have therefore had a destabilising effect on these economies, which were exposed to repeated financial shocks from 1982 (Mexico) to 1997 (Asia).

2.1.2 Pressure on governments

The globalised financial markets have another strategic function: to fund public deficits. In doing so, they use exchange rates as a means of influencing the nature of public finances because they reward financial orthodoxy. However, short-term capital movements also exert indirect influence on governments’ macro-economic and financial policies, depending on the judgements they make about the sustainability of key equilibria (public debt, external deficit, inflation, currency reserves, unemployment). Such pressure not only promotes financial orthodoxy but can also be detrimental to the position of heavily indebted States by obliging them to adopt overly deflationary policies or reforms not conducive to development; it can have a destabilising effect by putting speculative pressure on exchange rates to begin with and then subsequently on interest rates.

But the financial markets do not treat all indebted countries in the same way. For instance, they do not – far from it - lessen major structural imbalances such as those now characteristic of the link between the US external deficit (which reflects a shortage of private and public savings) and the external surpluses in Asia (which reflect an excessive propensity to save). Thus Chinese savings finance excessive US consumption.

Above and beyond its ambivalent impact on governments’ financial management, and in the absence of multilateral fiscal standards, liberalisation furthermore encourages tax avoidance on income from mobile factors: savings and company profits. The integration of tax havens into “normal” financial circuits and the fact that many
governments attempt to attract non-residents to invest in their countries, by offering favourable tax rates, now place unbearable strains on the ability of governments to tax income from capital.

These grave constraints on the redistributive function of governments is a crucial factor in exacerbating inequality in advanced countries, due to the under-provision of public goods and a loosening of solidarity. Taxes on labour and consumption cannot compensate for the erosion of the tax base deriving from financial savings and company profits; the result is a serious distortion in tax equity.

2.2 China's unbalanced growth strategy

The emergence of China alters the global economic order, which is only logical given its size and potential. In itself, China’s rise to prominence is good news, both legitimate and, ultimately, a force for prosperity and peace in the world. But the transition from the inward-looking phase of the Mao years to the country’s dramatic arrival on the international economic scene is too sudden and poses adjustment problems which may get the better of our countries.

Some historical background to the Chinese phenomenon may help to explain it.

On the one hand, after the Communist victory of 1949, a successful attempt was made to restore China’s internal unity and to reconstruct a State which had long been stratified and corrupt. But all of this went on behind closed doors, in a repressive political climate and with a degree of economic self-sufficiency. The economy remained unchanged until it was transformed into a socialist market economy and until the Chinese Communist Party under Deng Xiaoping decreed in 1979 that it must open up to the world. That process culminated in China’s accession to the WTO in 2001.

On the other hand, Japan underwent rapid reconstruction after the defeat of 1945, South Korea took off during the war of 1950-1953, and then, as from the 1970s, the “flying wild geese” of Japanese industry spread to ASEAN, Korea and Taiwan, marking the emergence of the Newly Industrialised Countries, the “Asian tigers”, in the 1980s.
These two developments came together with China’s simultaneous entry into eastern Asia’s regional industrial integration networks and into the world economy. The key to its integration is foreign direct investment, coming from the region and from the West, which chose to use China as a platform for exporting manufactured goods, largely made from components imported from the area, mainly to the US and European markets.

The uniqueness of the Chinese model lies not only in the size of the new entrant but also in the new paradigm of international trade which provides the context for the country’s integration. Technology brought in thanks to US, Korean, Japanese and above all European investment in the country means that China combines two advantages: low wages and high productivity. At a stroke, the phenomenon of China’s enormous size becomes less of an issue for our markets: the problem for the EU increases in scale and complexity, and the challenge becomes much more difficult to meet in both quantitative and qualitative terms.

The (apparent) paradox is striking: China’s success results from a previously unthinkable alliance between multinational companies, the spearhead of advanced market capitalism, and a Communist Party possessing the necessary powers to ensure a stable social and political environment for the activities of these companies. What the Chinese government has to do is in fact to manage the huge internal pressure caused by regional and social disparities, as well as by environmental difficulties, both of these generated by an exceptionally high pace of growth over an exceptionally long period of time.

Given the scale of the adjustments required of China’s partners, two types of reaction are becoming apparent: one highlights the contradictions and conflicts being experienced by China’s economy and society. It predicts an imminent end to the Chinese miracle, dangerously underestimating the adverse effects on the country, the region and the world if Chinese growth were to come to a halt. The other reaction emphasises the restrictions placed by the Communist regime on civil, political and trade union freedoms in order to justify applying pressure and defensive trading measures above and beyond legitimate anti-dumping actions and measures to protect intellectual property.
Curiously, this defensive reaction does not come exclusively from civil society or trade unions, but also from business circles whose members are active in China and have to an extent thrown in their lot with the regime. In actual fact, even though this point of view can claim to be rooted in high-minded principles, it overlooks the fact that the Chinese State is pursuing – in its own way, a way that is proving effective – a project which is fundamentally geared to long-term integration and sustainability. Without ignoring the undoubted problems of respect for human rights and of corruption which, alas, are by no means any more serious in China than in innumerable other countries supported by the EU and the USA, these problems must be viewed in conjunction with China’s ambition to wrest an entire continent from poverty while lending an environmental dimension to this monumental undertaking. These efforts deserve encouragement from Europe, in that they are utterly legitimate and desirable: it is more certain that democracy will arise out of development than, sadly, out of what has happened recently by way of developing democracy in the emerging economies of East Asia.

3. Responses available to the European Union

Our societies are insidiously and inexorably reaching the point of social breakdown and its corollary, political instability followed by authoritarian repression.

Tackling the consequences of the drift into inequality is not enough. Moreover, it would be neither politically feasible nor economically desirable to radically alter primary income distribution, on account of the excessive distortions of supply which would result from prohibitive tax takes and excessive, dependence-inducing transfers.

We must therefore tackle the root causes of inequality. Let us rank them, without taking into consideration social changes only indirectly connected with the economy. Technological progress and European integration can be mentioned briefly, after which we need to focus on two factors with an important external dimension: China’s growing power and the pressure exerted by finance over the real economy.

Technological progress is obviously a vital necessity for our economies, with their low birth-rates and prospects of a worsening ratio of active to
inactive populations. It must of course be stimulated by all useful development and innovation policies. But equally essential is a redressing of the balance between basic research work, necessarily in the public domain since it serves the collective good, and applied research whose results are liable to be appropriated and which may as a result be funded either out of taxation or by the market. Nowadays, especially under the Lisbon Strategy, there is too great a propensity to “privatise” research, especially by granting tax breaks or subsidies, rather than to properly fund public research. Adequate funding could improve Europe’s inadequate research output, caused by a lack of equipment and administrative and technical back-up for research activity worthy of the name.

In a knowledge-based society, the borderline between public and private becomes a major political issue in two senses: firstly in terms of efficiency, which means striking the right balance politically between research output and the dissemination of its findings; and secondly in terms of fair access to knowledge and its use. In other words, equal opportunities in accessing education and in enabling small operators – such as farmers – to share in technological progress are important factors in wage-setting and in primary distribution.

The appropriation of research results by large companies or by business start-ups serves in fact to heighten inequalities between the owners of knowledge and of commercial patents on the one hand and other economic operators on the other.

Economic integration in itself is a very good thing for Europe, strengthening its control over its own internal development and its capacity to interact with the wider world. Nonetheless, although in principle integration generates efficiency and hence growth, especially due to the combination of economies of scale and competition, its impact on primary distribution will differ according to whether it occurs on the basis of an upward harmonisation of social and fiscal standards or as a result of a social and fiscal race to the bottom. The more heterogeneous the Member States become due to the accession of increasingly outlying countries, the greater the risk that convergence between national economies will be achieved only at the cost of worsening inequalities within both the converging countries and the old
Member States. Conversely, the fact that the Bolkestein directive on freedom to provide services was adopted by the European Parliament only once the initially fundamental “country of origin” principle was abandoned – a wise decision under the circumstances – indicates the scale of that heterogeneity and the cost, in terms of freedom of movement, arising from the absence of harmonisation.

But let us concentrate here on the two truly external dimensions which we have identified as being closely connected with the issue of inequality: globalisation, dominated as it now is by the growing power of China, and financiarisation, resulting from the combination of an international liberalisation of capital movements, where shareholders reign supreme and stock markets become volatile and unstable, with an unequal distribution between wages and profits within the company. We shall then raise the important matter of workers’ rights in the developing and emerging economies.

Let us resume our examination of these complex issues, which need to be tackled all together in order to deal with their underlying principles. Only in this way can the efficiency of globalised market capitalism be preserved while effectively halting its natural drift towards instability and unfair distribution.

3.1 China: stimulation of domestic development

The first way in which the EU can intervene is by reorienting the Chinese model of development from an export-led strategy to a more endogenous pattern of development.

The overall game-plan behind China’s industrial breakthrough is strategically brilliant: rapidly attaining a threshold of advanced and broad-based industrialisation by allowing multinationals from Japan, Korea, the United States and Europe to draw upon the country’s formidable pool of labour was a bold move. Only a country with an immense domestic market – a little like that of the United States in the 19th century while its population was being bolstered by immigration – could successfully pull off such a move. Where the United States brought in labour and capital at that time, China has attracted managerial know-how and technology.

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The pace of change was a crucial factor of success: a high level of advanced, diversified industrialisation had to be reached right away, as a basis for a network of manufacturing and service industries gradually penetrating the entire country, and for establishing an appropriate institutional framework for Chinese companies themselves to pursue modernisation.

To have implemented this strategy without running the risk of incurring the massive external debt which a classic industrialisation process would have entailed – namely surplus imports of capital goods over exports of consumer or intermediate products – would have made China dependent on the G7 and the IMF. That would have been incompatible with its original political blueprint: a socialist market economy. The handling of the 1997-98 financial crisis in Asia by the IMF and the US Treasury demonstrated the reality of that risk. The US budget deficit and over-consumption by US households facilitated the industrialisation process, for which they would moreover be the macro-economic precondition. But this “blitzkrieg” style of industrialisation is today reaching its internal and external limits. Internally, there is tension between towns and countryside, between coastal and inland regions, and there is pollution. Externally, the pace and scale of the adjustments necessitated by the growing power of China, not only in advanced countries but also in developing countries – we need only think of textiles – are becoming excessive. We must of course, and we can, considerably improve our adjustment capacity, above all by creating replacement jobs, but we shall not be able to do so fast enough.

The protectionist pressures evident in the textile and footwear sectors will continue to mount. Just think what effect a Chinese breakthrough in the automobile sector could have on the international market.

In short, action must be taken at source. China must be encouraged to shift the centre of gravity from an accumulation of physical and immaterial capital, from exports, towards domestic demand for and consumption of collective goods and towards restoring the environment, which is in very poor shape. The Chinese leadership is well aware of the need to redress the social, regional and environmental balance; this will paradoxically only be possible due to a high rate of growth.
It does not take a genius to imagine the political tension which could be caused by an economic crisis in China. In actual fact the indebtedness of its State enterprises, and the potential public debt which that represents, is such that China is very vulnerable to a slowdown in its growth.

Reorienting that growth towards domestic demand, rather than slowing it down, is the only viable option for China today.

Such strategies would ease the pressure on our labour markets by reducing at source the rate of penetration of imports and by increasing the rate of our exports to China.

Another justification for this action derives from the need to curb excessive consumer demand in the United States. With an external deficit of 6.5% of GDP fuelling an external debt of between 2 and 3,000 billion dollars (the margin of appraisal is enormous), greater than the total debt of the South, the US is creating the conditions for a worldwide recession. Once investors lose confidence in their dollar assets, the corrections they make to their portfolios could send shock-waves through the European economy. Imagine what it would mean for the euro zone in terms of competitiveness and jobs if the dollar were suddenly to depreciate by between 25 and 30%. It is an urgent matter of priority for Europe that the US external deficit be cut and that the Chinese surplus be reduced at the same time. Yet, for the time being, the EU institutions are little exercised by this problem: no sound analysis and no sign of getting to grips with it.

The self-effacement of the EU as such within the G7-G8 shows that the world's number-one commercial power refuses to act as the number-one financial power that it also is in terms of savings and foreign direct investment. Of course, in order to express its views and take action, the EU would have to cut a path to the IMF Board and sit at the helm on a par with the United States. This could perfectly well be done immediately, as soon as the EU countries – all members of the IMF – or at least the twelve members of the euro zone decided to speak with one voice and vote all together. If they did so, they would out-vote the United States.
The EU’s role in the IMF is critical because the IMF’s role in correcting the binomial US deficit / Chinese surplus could be a decisive factor in re-establishing East Asian confidence in the international financial institution. If these countries, first and foremost China, have opted to accumulate currency reserves, the reason is that they are rightly distrustful of the IMF after its questionable handling of the Asian financial crisis from a growth perspective, serving the interests of US commercial and financial interests. They intend in future to shield their domestic development strategies from the Washington Consensus and the covetousness of Wall Street. A stronger European presence, developing a more pluralist and objective approach to crisis situations, could reassure China, encouraging it to export less and import more.

Could such a European strategy work? But of course it could! It is a matter of political vision, will and leadership. It is naturally not possible today to envisage a single seat for the EU in the Bretton Woods institutions, no more than it would be feasible to bring on board the United Kingdom, in hock to Washington, or the new Member States, not yet ready to play with the big boys. But an initiative by the twelve members of the euro zone, backed by one or other of the Nordic countries, would be quite possible. What is needed is an analysis and a capacity to join forces, and hence a unifying force to make the Eurogroup speak with one voice. Ideally that should be the Commission. But the Chairman of the Eurogroup, Jean-Claude Juncker, is perfectly able to mastermind this policy and create the political, institutional and operational conditions for its implementation.

By means of small, practical steps such as these the EU could assert its presence on the international stage and restore the confidence of the European people in its capacity to act. Institutionalisation will come later, once there are signs of movement and success has been reaped.

3.2 Financiarisation: prevention of unwarranted restructuring and payment of taxes

Under the organisational conditions currently taking shape on global markets, financial traders have excessive power to cream off a share of added value out of all proportion to its contribution. It is therefore necessary to reduce financial income at source, to enforce the payment of taxes on savings, and to prevent volatile and irrational stock-
Three ways of tackling Europe’s social problems from the outside

exchange movements and unstable short-term international capital flows from disrupting and compromising the real economy, especially long-term corporate strategies.

We need to look at the trends underway to find those deriving from meaningful and irreversible changes, and those deriving from reversible political decisions. This is the key to our approach: establishing a new balance of power between capital and labour, between capital and governments, by reintroducing scope for negotiation and collective action at two levels, namely at the stages of primary distribution between capital and labour, and of secondary redistribution by governments.

To govern means above all else to anticipate: once they are up and running, certain market developments gather momentum and thwart the capacity of politics, and hence of democracy, to correct them. The inherent complexity of finance is compounded here by the additional difficulty for the political sphere to enter and appropriate the European dimension, the only relevant level for involvement in global economic governance.

What corrective action should be taken?

1) From international liberalisation to the traceability of capital flows

During the four decades following the War, the world experienced sustained growth and European countries achieved a high degree of shared prosperity under a system based on government controls of capital movements. It was the crisis in the international monetary system caused by financial laxity in the United States which led to the replacement of fixed exchange-rate discipline, based on national foreign-exchange controls managed with IMF assistance, by a globalised financial market discipline, in the form of floating exchange rates. This change was the product of an alliance between the United States and the United Kingdom, beginning with the creation of the Eurodollar markets in the 1960s and ending under the leadership of Reagan and Thatcher in the 1980s. The EU in turn completely abolished exchange-rate controls by Member States as from 1 July 1990, the first stage in the transition to the euro. Such liberalisation was unavoidable within
economic and monetary union. It is however optional, and theoretically reversible, in the EU’s relations with the rest of the world: a Europe producing financial surpluses would not be deprived of capital.

But such an alternative would not be desirable from various points of view: efficiency, the remuneration of savings, competition between financial intermediaries, and pressure on governments to ensure a minimum degree of financial orthodoxy. Nor would it be necessary in order to correct the financial excesses underway. On the other hand, it is now technically conceivable to arrange for the traceability of international capital flows: that would make it possible to combat effectively not only financial crime and terrorism but also tax avoidance.

2) Stabilise shareholding to promote long-term corporate growth

Shareholders cannot claim, in the name of ownership rights, to exert exclusive control over the company while at the same time ensuring the liquidity of their investment.

That, of course, is precisely how pension funds and other institutional investors operate. But this construct, ingenious from the point of view of the “predatory” shareholder, runs counter to the legitimate interests of the other stakeholders, be they within the company – first and foremost the employees – or outside of it.

Very fortunately, the European company statute, which emerged from the work of the Davignon Committee and constitutes the founding matrix of a European conception of the company, allows for the establishment of companies constituted as partnerships and not only ones with shareholders. There is so much scope for interpretation when this legislation is transposed into national law that it will be possible to consolidate the partnership concept once the “case law” of the European directive becomes established.

If this concept does prevail, the full potential of company law and commercial law must be exploited: worker participation in oversight, prohibition of stock options for managers who collude with shareholders and stock-market traders, employee investment funds aimed at stabilising the shareholder group, measures to deter hostile take-over bids and share exchange offers, etc.; standardisation of
accountancy methods geared to long-term management and not to the creation of stock-market value.

The EU must develop at its level a full and well-integrated body of legislation to promote a model of corporate governance in Europe which returns to the concept of partnership and stakeholder value, and which puts value creation for shareholders in its proper place in a broader equilibrium taking due account of the interests of all other stakeholders.

The information technology revolution in corporate governance enables the financial markets to operate internationally, 24 hours a day and in real time with the productive economy and political decision-making by governments. It also means that, using the international accounting standards currently on the drawing-board, precise data on the internal life of a company can be provided in real time to financial-market traders, which places added constraints on the actions of company managers.

Owing to their highly technical nature, the definition of these standards is ignored by politicians, who rely on specialists coming mainly from the private sector in the US and the UK. Accounting standards founded on an exclusively shareholder-based notion of the company brings the stock market to the very heart of management practice.

It is rather surprising that the EU, which has experienced far fewer financial scandals and – apart from Parmalat – much less serious ones than the United States, should draw inspiration mainly from the new accounting standards and new forms of regulation in the US when establishing a European framework for the integration of financial markets. In particular, the “fair value” accounting principle in the US favours providing information to shareholders about opportunities to enrich themselves when market values rise by keeping an eye on the markets, rather than providing information to managers engaged in internal trade-offs and long-term development strategies.

The EU must redirect its standardisation of accountancy systems towards a concept where companies are partnerships and not shareholder vehicles.
3) Go back to sustainable rates of return

The double-figure rates of return demanded by institutional investors on behalf of opportunist and uncommitted shareholders are neither fair nor tenable. Nor are they in line with productivity trends, which constitute the real measure of return on capital in the long term. In a context of moderate economic growth, such figures are obtained at the cost of company restructuring for purely financial reasons, with no regard for long-term corporate objectives, or jobs and wages, or local and national communities.

Ultimately, this financial remuneration extorted from companies by shareholders in search of windfalls constricts growth and, by sending stock-market expectations to dizzy heights, feeds either stock-market bubbles or “creative accountancy”. It handsomely rewards an army of professionals – auditors, consultants, business bankers, market traders – who take huge commissions and fees, usually out of all relation to the company’s long-term performance. Half of all mergers/buy-outs take place for no other reason than to enrich financial intermediaries: they do not contribute in any way to raising the company’s long-term productivity and profitability.

Of course, stock-market values reflect not so much a company’s true output as its expected output. Savings grow more rapidly than companies’ tangible investments, in view of wage rises, extra social security contributions and pension contributions because of the current demographic balance; and there is a preference for shares in a climate where rates of return on bonds are lower. All of this creates a favourable, but perhaps only temporary, climate for rising stock-market values.

Rising stock-market values must however be contained within sustainable limits: a new bubble could get the better of international growth this time round. The ECB and the FED still have a crucial role to play in curbing the irrational exuberance of stock markets.

4) Impose taxation on capital

An ageing society is developing a preference to save money for pension purposes based on (very inegalitarian) money purchase schemes rather than pay-as-you-go schemes, which offer greater solidarity. It is worth
noting that, in money purchase and pay-as-you-go schemes alike, there is always the same transfer of resources in the real economy from active to inactive persons.

Remuneration from capital (company profits and returns on financial savings) is boosted because they are less effectively taxed. The long-term trend is perfectly plain: the mobility of these two types of income enables them at one and the same time to play on the downward tax competition between States which it helps to strengthen, and also to illegally avoid taxation by exploiting the opportunities afforded by tax havens in Europe and elsewhere.

The results are twofold: first, increased taxation on a fixed basis (property, consumption and labour); second, a reduction in financial resources for governments to use in confronting the requirements of growth (supply of public goods) and a decline in solidarity (equal opportunities and safety nets).

The issue of company taxation and savings in Europe is stymied by the unanimous voting system and hence the right of veto. This institutional dysfunction is intolerable and incompatible with the ambition of a Social Europe.

Two possible solutions exist: fully-fledged harmonisation of both forms of taxation or, better still, the replacement of national taxes by European federal taxes. Either method would ensure that European public goods (research, defence, security, network services, convergence between States, etc.) were properly financed. Moreover, in cooperation with the United States, past masters at such policies, a fiscal EU would become an agent in the fight against tax avoidance by people moving their money to third countries and tax havens. Finally, in a context of global public goods, one could envisage the introduction of unitary taxation of capital on a worldwide scale, which would ensure tax equity especially in the countries of the South.

3.3 Effective promotion of fundamental workers’ rights in the South

To what extent are low wages in emerging countries attributable to low productivity and a plentiful supply of labour, and to what extent can they be attributed to a lack of trade union rights and protection for
children, women and minority groups? Just as it is inevitable that low productivity will be reflected in low wages, it is equally intolerable that workers in developing countries do not receive their legitimate share of productivity gains. For that, they must in effect be granted the right to organise into trade unions and to negotiate their wages and working conditions collectively. Even a very poor country can ensure compliance with the framework Conventions of the International Labour Organisation on minimum social standards. Most countries have in fact ratified in these Conventions but do not enforce them on the ground.

The linkage of trade and human rights is thwarted by the refusal of developing countries, expressed clearly and unanimously at the WTO Ministerial Conference in Seattle in December 1999, to establish any such link. In the foreseeable future we can expect nothing from that quarter apart from technical cooperation and a dialogue between the ILO and WTO secretariats which will not lead to much. Indeed, the key problem still remains the fact that the ILO has no real powers of coercion.

During the term of office of Michel Hansenne (1989-1999), and now under Juan Somavia, the ILO has been attempting to devise methods of putting pressure on its members when they fail to comply with Conventions which they have ratified. There is however a long way to go, and progress is being made at snail’s pace.

The EU for its part normally incorporates at least three aspects (politics, cooperation and trade) into its bilateral agreements with third countries, and is exploring the possibility of using these agreements as levers to promote the ILO Conventions. But only in extreme cases – such as Myanmar – does the loose connection between these three aspects allow human rights to be linked to trade preferences.

The political message is there, but the leverage effect is weak. It is in fact hard to imagine the EU using trade as a weapon to enforce compliance with workers’ rights, even in a bilateral context on the basis of contractual provisions derogating from the WTO principle of non-discrimination.
Three practical approaches still need to be explored. First of all, fair trade, i.e. the establishment of a voluntary social label intended to guide the choices made by consumers. Secondly, compulsory codes of conduct, i.e. obliging European multinational companies to apply minimum social standards – particularly in respect of trade union representation – in all countries where they operate throughout the world. Thirdly, why not form a “good social governance club”, based on a multilateral pact, consisting of those countries which agree to subject trade among themselves to effectively monitored enforcement of the ILO Conventions, backed up by sanctions? The EU-25, the United States and Japan could set the ball rolling in the hope of expanding this club to take in the largest possible number of emerging and developing countries, and could take diplomatic action to that end.

Surely the Economic and Social Council and the European Parliament could push in all three of these directions?

Conclusions

Once again, we are taking issue not with market globalisation, in particular the gradual opening-up of markets to trade, nor with the legitimate and welcome emergence of China, nor even with financial liberalisation, but with the conditions for the implementation or occurrence of these phenomena.

At the heart of the debate is the neoliberal mindset which originated in the US and the UK and determines the rules of the game as well as the conduct of macro-economic and financial policies. This is what must be fought resolutely, and it is to this that an alternative must be found. Europe is suffering from a lack of serious debate about its responsibilities and its capacity to act at the level of global economic governance. Weak analysis and the resignation of the European social-democratic Left too readily discourage Europe from identifying the scope for reform inherent within globalised market capitalism: that scope can be exploited by the European Union, provided that the EU unites around these policies. Only by containing the social dislocation taking place today can we, in our European societies, protect ourselves from populism and its inevitable drift towards the instability and crises.
that will thoroughly unhinge Europe’s democracies with unforeseen international consequences.

Reform movements are never an overnight success, but if they all too often fail it is because their thinking was too timid, too partial and too lacking in coherence. The impotence of the reformist Left in Europe over the past two decades can be explained by its refusal to dream up and assert realistic alternative ideas. The trade union movement, itself motivated by damage control, has not yet found within it the necessary analytical resources and unity to back political action at the only appropriate level to exercise leadership, namely the European level. The EU is nowadays dominated by neoliberal thinking, bent on shaping economic and social Europe in the Anglo-Saxon mould, thereby further confirming the EU’s status as a subset of an Atlantic entity improperly extended from the field of strategic security (where it makes sense) to that of a “civilisational bloc”, with the inherent risk of a confrontation of blocs and a clash of civilisations.

Europe must act. One day the Commission will be the natural architect of this change in Europe’s globalisation strategy. Indeed, only a strong European executive body can provide the requisite momentum and coordination. But the Commission too must drag itself away from the “Davos mania” which has overtaken the successors of Hallstein, Jenkins and Delors. It will only resolve to do so under pressure from the pan-European political and social groups organised and active within the European Parliament and the EESC. What has to be done is to arouse awareness and give heart to those women and men who aspire to reconcile freedom and justice in Europe. In that way it will be possible for the EU to enter the history books as the successor to a glorious and tragic European civilisation, whose aspiration today is modernity within its trademark humanist context.