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Full Employment with Good Work, Strong Public Services, and International Cooperation – Democratic Alternatives to Poverty and Precariousness in Europe

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EuroMemorandum Group

Full Employment with Good Work, Strong Public Services, and International Cooperation

Democratic Alternatives to Poverty and Precariousness in Europe

EuroMemorandum 2007
December 2007

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This Memorandum was formulated on the basis of discussions at the 13th workshop of the working group "European Economists for an Alternative Economic Policy" (EuroMemorandum Group) on September 21 – 23, 2007 in Brussels.

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Summary

The adoption of the new „Reform Treaty“ for the EU comes at a time of financial crisis, enhanced economic uncertainty and rising social inequality. Additional risks arise from the precarious situation in the areas of energy use and climate change and from mounting imbalances in the world economy. The new Treaty will not enable the EU to master these problems and challenges. On the contrary it will strengthen the neo-liberal policy framework which has contributed to the critical situation.

Current problems. The current economic upswing will certainly be affected by the fall-out from the financial crisis. But it will also be impeded by insufficient wage developments and the weakness of consumption and public expenditure. Redistribution of income and wealth from the poor to the rich occurred in the years of economic slow-down and recession, and it continues in the years of recovery and upswing. Poverty has not decreased but in many cases increased in the last years of overall growth and exploding profits. The alarming problems in the prevailing pattern of energy provision and consumption and their harmful consequences on climate change have been demonstrated in different ways by the monopolistic price policies on liberalised energy markets and by a number of environmental catastrophes.

Critique of EU policies. The EU does not respond in any convincing way to these uncertainties and increasing social and ecological problems. Strong declarations are not followed by corresponding concrete measures, and policies go often in the opposite direction:

- With regard to the *financial crisis* current efforts aim not at limiting but at opening further the door for financial speculation. It is alarming that the EU regards member states’ rules to protect pension funds against the entry and strategies of financial investors as an obstacle to the free movement of capital which must be removed – thereby delivering the incomes of pensioners to the risks of financial losses.

- A *macro-economic policy* perspective responding to the current problems is simply absent from the EU conception, and efforts to control the exchange rate are not undertaken.

- The declared respect and high regard for *services of general interest* as an essential pillar of the European Social Model is accompanied by initiatives to undermine the core of these services – health care and social services - by integrating them into the framework of internal market and competition rules. This is an obvious attempt to re-conquer areas which were lost in the discussions about the services directive in that they were – after strong public critique exempted from this directive. Also in the recent initiative for “flexicurity” on the labour market the deregulatory obsession is dominant, while on the other hand migration policy is too restrictive.

- In an attempt to offset the economic problems created by the disregard for internal demand the EU has – under the title of “Global Europe” - started a more *aggressive external strategy* to open markets and conquer market shares in the world. Main instruments for this purpose are bilateral free trade and investment agreements and the neo-liberal re-shaping of Economic Partnership Agreements with developing countries. Instead of concentrating on the building of an attractive alternative to the aggressive US model the Union is trying to underline its enhanced ambitions in the world through the build-up of military power.

- In *energy and climate policy* the contradiction between words and actions is particularly evident. Neither the strong rhetoric attacks against the price policy of energy monopolies nor the declared commitments to change the pattern of energy consumption in the EU have been followed by concrete measures. Energy policy is still dominated by the theory of free markets and the practice of monopolistic behaviour. To replace the current unsustainable regime of fossil energy provision the EU continues to consider the nuclear option which is another unsustainable regime.

Proposals for alternatives

To overcome the ***financial crisis and achieve financial stability*** in the EU immediate measures against financial speculation should be combined with steps to stabilise the financial systems in Europe and to re-embed them into coherent European development strategies.

- Against *financial speculation* transparency requirements should be raised, leverage limited and securitisation and trading of loan packages only be permitted when explicitly approved by supervisory authorities. Also higher taxation of short-term capital gains and taxes on stock exchanges and currency transactions serve this purpose. Investments of pension funds and life insurance in hedge funds or other risky financial instruments must be prohibited.
- To *protect firms and employees against harmful activities of financial investors* voting rights of such investors should be linked to a minimum duration of equity holdings and the rights of employees to veto decisions against their interests should be strengthened. In a still longer-term perspective the trend to redistribute income from bottom to top and to base pension systems on capital markets must be stopped and reversed, because these trends are at the roots of an increasingly finance-led and unstable development.

A ***more active macro-economic policy*** of the EU should promote more and better employment and sustainable development in the EU. Measures in this direction are public investment programmes on the national and on the EU level – for the restructuring of transport systems, energy provision, social housing, urban refurbishment et al. – as well as initiatives for the reduction of individual working time in different forms. Initiatives should also be taken to control the Euro exchange rate vis à vis the US dollar and the Chinese Renminbi and for this purpose to seek for more international monetary cooperation

Public services – or "services of general interest" – must be recognised not only rhetorically but also through corresponding policies as a central element of a European Social Model based on solidarity and fairness. Public service provisions in the liberalised sectors must be strengthened and implemented and where this becomes increasingly difficult, a tighter direct public control should be envisaged, including new forms of public ownership and administration. The exemption from the internal market and competition rules should apply to all public services – even if they are of an economic character. The European dimension of these services can best be served by the definition of minimum standards with upward convergence, co-operation in border regions and joint research and educational projects.

Special emphasis should be put on ***anti-poverty policies.*** The abolition of poverty should be made a top priority in the Reform Treaty. In the pursuit of this objective the EU should urge the member states to adopt action plans (minimum wages, child benefits etc.). At the same time the EU should support such national anti-poverty measures through European transfers.

Climate and energy policy should more actively and concretely take measures to effectuate the shift from the prevailing fossil system to a sustainable regime based on energy saving and development and use of renewable energy sources.

In its ***external policies*** the EU should adopt the principal aim to promote a fundamental transition towards a model of balanced and equitable global development. In particular it should embark on a fair trade agenda for cooperation and development. In the relationships with developing countries this includes trading relations based on non-reciprocity, specific assistance to fulfil human rights and environmental and social sustainability standards. In its relation to developed countries the EU should contribute to the reduction of the large imbalances and in a longer perspective aim at balanced current accounts and a jointly managed exchange rate which supports such balance. In such a policy framework there is no room for the threat or use of military force

Introduction

According to declarations by European Institutions, 2007 has been a year of economic and political progress. The economy grew relatively fast, and employment increased, too. Problems like climate change and financial crisis were themes of high priority at summits. But everything was overshadowed by the negotiations on the new “Reform Treaty”, and the adoption of this Treaty in October topped every other event and was celebrated as the decisive end of the longstanding crisis of the EU.

This view is far away from reality. The adoption of the Reform Treaty comes at a time of financial crisis, enhanced economic uncertainty and rising social inequality. Additional risks arise from the precarious situation in the areas of energy use and climate change and from mounting imbalances in the world economy. The new Treaty will not enable the EU to master these problems and challenges. On the contrary it will strengthen the neo-liberal policy framework which has contributed to the current situation.

In this memorandum we will present a view which is fundamentally different from that of the EU Commission and most governments. We will in the first part briefly highlight the most urgent economic, social and ecological problems in the EU, and in the second part criticise the policies of obsessive liberalisation and deregulation, the disregard of active macroeconomic policies to promote sustainable development in the EU, and the attempt to offset internal shortcomings by the development of a more aggressive trade and investment policies and to underpin the stronger global position of the EU increasingly by the enhancement of military power. This is followed by a presentation of proposals for a thorough turnaround of economic and social policies and for alternative policies in the financial markets, macroeconomic stimulation, anti-poverty and sustainability policies and of external economic relations which are guided by the principle of peaceful cooperation, fair trade and efficient development aid.

We see this memorandum as a contribution to the scientific critical discussion of European economic and social policies. We see it at the same time as a support for the political forces and social movements which fight against the subordination of the world under the neo-liberal imperatives of universal competition and unlimited profits. And it should also contribute basic elements and cornerstones of an alternative, fairer and sustainable pattern of European and global development.

Part 1:

Enhanced risks, imbalances and inequalities – Current economic and social problems

According to official declarations of the EU Commission the robust economic upswing will only be very slightly affected by the financial crises and will continue during the next year. It will bring more and better jobs and further improve the economic strength and social welfare in the EU.

We criticise these assertions not only for their overly optimistic outlook for macroeconomic development in the EU but also for their complete disregard of the deepening of social and ecological problems which has taken place in the past years and continues in the current upswing. Beyond the still incalculable risks of the financial crisis and weaknesses of macroeconomic development and employment, persisting regional disparities we see that poverty has not declined but in many cases risen, and the precarisation of employment is an overall trend; ecologically responsible energy provision does not really advance and climate change is generating increasing threats also for Europe. The EU is by no means safe with regard to the growing imbalances in the world economy, and it will be severely affected by a failure to find solutions for these problems.

1.1. Financial crisis: More to come?

In September 2007 Britain saw the first bank run since 1866. Although the immediate crisis was contained through the intervention of the Bank of England (BoE) the event reveals the fragility of the present global financial system, and uncertainties about further developments remain.

The background to current financial disturbances is a general abundance of investible resources. This is often referred to as a situation of **excess liquidity** but it should be noted that there are both monetary and real factors behind it. After the collapse of the high-tech equity boom in 2000/1 the US Federal Reserve repeatedly lowered its main interest rate, from 6.5% at the start of 2001 to a low of 1% by 2003. This enabled banks and corporations under financial pressure to refinance themselves on easy terms. At the same time generally high levels of corporate profitability and an increasingly unequal distribution of income have persistently tended to promote a high volume of savings. The consequence has been that interest rates and the yields on many types of financial asset have been low.

Many banks and other financial institutions, unwilling to accept these low returns, have responded by increasing their **leverage**, that is by issuing debt in order to finance larger positions in a wide range of financial assets: such leverage will often give rise to higher returns on a portfolio but can involve much higher risks. Many institutional investors, especially pension funds, are required by regulators to avoid using leverage but they have been circumventing these restrictions by investing in other institutions, such as private equity companies and hedge funds, which make massive use of leverage. This has tended to weaken both sides of their balance sheets – the assets they hold are riskier and give more volatile returns and this in turn makes their liabilities less secure and exposes their investors, creditors and depositors to greater risks. Related developments compound the resulting rise in **systemic risks**. There is a general hunt for new types of assets and of investment with high yields. The resulting complex new financial instruments are often very difficult to evaluate. The ratings agencies which are supposed to inform the buyers of financial claims about the levels of risk involved are subject to a serious conflict of interest. They are paid by the issuers of securities and in recent years have made more than half their profits from rating just such innovative instruments.

In an increasingly **fragile** financial system the probability of disruption rises over time although it is not always possible to predict which particular assets will be affected or when. In the event, trouble broke out in the finance of "subprime" mortgages in the US, that is the mortgages advanced to less credit-worthy, usually lower-income, house-buyers which earns interest rates of 3 – 4% above a normal mortgage. Under pressure in the labour market in many regions of the US, and rising interest rates, large numbers of these borrowers have been failing to maintain payments. In consequence the extremely complex financial instruments through which the mortgages were financed have lost much of their value.

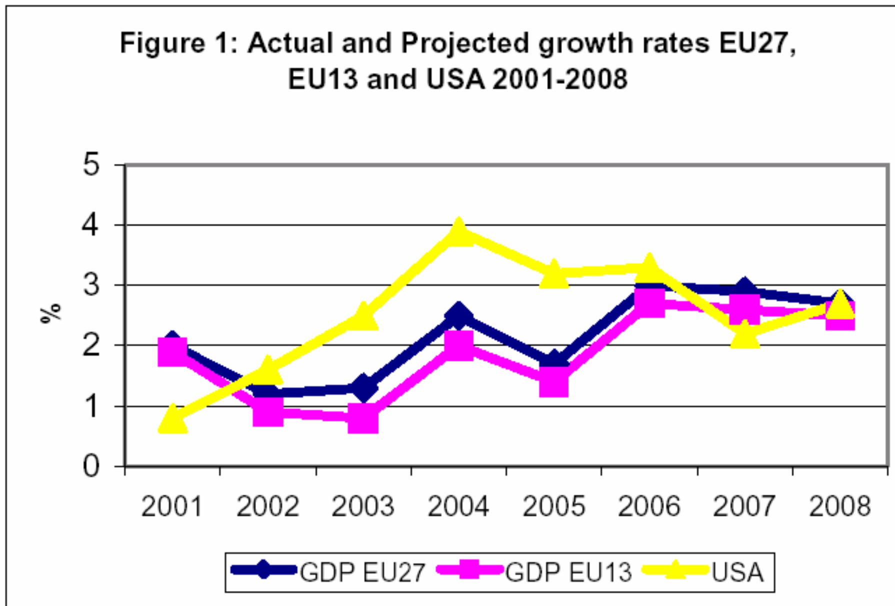
The widespread distribution of these claims through the networks of global finance has meant that it has not been easy to identify which banks and other institutions have suffered losses and on what scale. This has greatly increased **uncertainty** within the financial system. In July 2007 two hedge funds owned by Bear Stearns, a leading New York investment bank, failed as a result of large exposures to mortgage-backed securities. Shortly thereafter two German public sector banks, IKB and SachsenLB, revealed large losses on US subprime assets which necessitated their refinancing by other banks in the German system. Such events have

initiated a process of **contagion** in that they called into question the position of other hedge funds and hence of banks and other financial institutions which had invested either in hedge funds or in subprime-based assets. Some of the securities issued to finance mortgages were short-run and these short-run positions could not be rolled over after investors became alarmed about the developing crisis. The holders of mortgage-backed securities thus turned to the banks for emergency refinance and this also increased suspicion about the banks' exposures.

By early-August there had developed a serious crisis in the **money-markets** and the interbank market on both sides of the Atlantic and this threatened widespread financial pressures because both markets are central to the functioning of the financial system. Faced with these growing threats, both the ECB and its US counterpart, the Federal Reserve, injected large amounts of cash into the interbank market and made it clear that they were determined to avoid a build-up of financial tensions. This was certainly a necessary response, given the situation. However, in at least two respects the role of the **authorities** is open to question. Firstly, although they have responded promptly to the outbreak of crisis, they did little or nothing to prevent the move to increasingly risky positions by the main financial actors. Secondly, the two key authorities in the EU, the ECB and the Bank of England (BoE), adopted completely opposed and incoherent tactics. While the ECB pumped funds into the Eurozone money markets, the BoE initially tried to limit its interventions, on the grounds that this could encourage further excessive risk-taking by the banks. Although the BoE was later forced to reverse its position and rescue Northern Rock the original failure to coordinate the interventions of these two key European public authorities does not bode well for the future.

1.2. Low wages, precarious jobs, political complacency - Prospects for macro-economic decline

The current financial crisis has a negative impact on the macroeconomic development of the EU, and forecasts have been generally revised downward. How big this impact is, remains uncertain. In any case the relatively favourable upswing of the business cycle has come to an end and a new slow-down is imminent.



Source: European Economy 7/2007, T. 1.1 and 2.2; Statistical Annex, Spring 2007, T. 10.

Growth. In 2006, the economy of the EU27 grew on average at a rate of 3%. This was the highest growth rate of GDP in six years (Fig. 1). After the recession in 2001 and slow recovery in 2002 macroeconomic growth has picked up and - after a short interruption in 2005 culminated in 2006 and the first half of 2007. Major driving factors in 2006 as in the years before were exports and investment, whereas on the other hand public expenditure and private consumption lagged behind (see Table 1.1) The former reflects widespread government inactivity, i.e. the fact that in spite of the improvements in the budgetary positions as a consequence of the favourable overall development governments and the EU maintained their course of restrictive fiscal policies and did not meet the necessities to renovate public infrastructures, to upgrade the level of education and to improve the social situation of the disadvantaged members of society.

Table 1.1: Macroeconomic development in the EU

	EU 27					
Yearly growth rates in %	2003	2004	2005	2006	2007	average
GDP	1,3	2,5	1,8	3,0	2,9	2,3
Private Consumption	1,7	2,2	1,7	2,2	2,3	2,0
Total investment	1,1	3,2	3,0	5,9	5,6	3,8
Government expenditure	2,2	15	1,7	2,0	2,0	1,9
Exports	1,8	7,2	5,3	9,2	7,0	6,1
Imports	3,4	7,4	5,8	9,1	7,2	6,6
wage share in % of GDP(EU25)	67,4	66,8	66,5	66,2	66,0	66,6
current account in % of GDP	0,1	0,4	-0,3	-0,7	-0,8	-0,3
	Euro area					
GDP	0,8	2,0	1,5	2,8	2,6	1,9
Private Consumption	1,2	1,6	1,5	1,8	1,7	1,6
Total investment	1,1	2,2	2,7	4,8	4,7	3,3
Government expenditure	1,8	1,3	1,4	1,9	2,0	1,7
Exports	1,1	6,9	4,2	8,2	6,7	5,4
Imports	3,1	6,7	5,2	7,7	6,7	5,9
wage share in % of GDP	65,5	65,0	64,7	64,2	63,9	64,7
current account in % of GDP	0,5	1,0	0,2	-0,1	0,0	0,3

Source: European Economy, Economic Forecasts, Spring and Autumn 2007.

The continuing weakness of private consumption is due to the remarkable fact that the long-term trend of redistribution of income from the bottom to the top continues in the upswing (see figure 2).

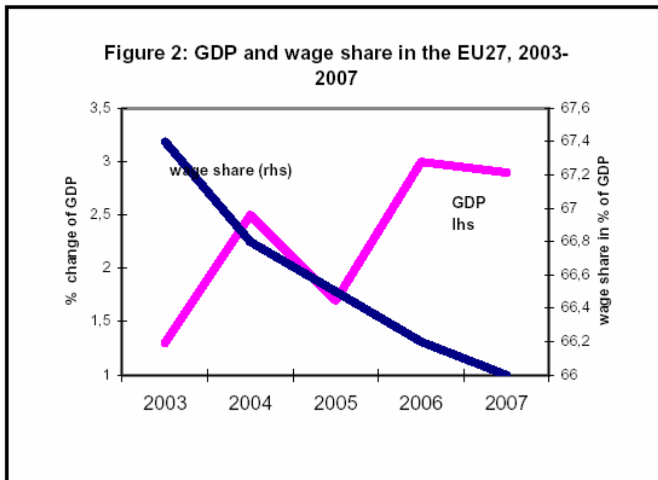


Figure 2: GDP and wage share in the EU27, 2003-2007

The shortcomings of wage development and government activity will negatively impact macro-economic development in the near future.

The forecasts of the Commission, published in November 2007, confirmed the declining growth rate of the EU as a whole and for the Euro-area both for 2007 and for 2008, with

minor exceptions across countries. This slow-down takes account of the global financial market turmoil.

Employment Since 2002, there has been a slow increase in employment and a gradual drop in unemployment in EU27. The implications of this for growth are however ambivalent, given that the share of temporary and part-time employment (in total employment) has been steadily increasing and that unemployment has hit especially hard certain segments of the labour market, namely the young (15-24), women and the long-term (over 1 year) unemployed, where no improvement has taken place (Table 1.2). Many people who are without employment do not appear in any unemployment statistic.

Table 1. 2: EU27 Employment Indicators, 2002-2006

	2002	2003	2004	2005	2006
Employment growth (%) National Accounts	0.3	0.4	0.8	1.0	1.6
Temporary employment (% of total employment)	12.4	12.5	13.1	13.9	14.3
Part-time employment (% of total employment)	15.6	16.0	16.7	17.1	17.4
Unemployment rate (% of labor force)	8.8	9.0	9.0	8.7	7.9
Young (15-24) unemployed (% total 15-24)	17.9	18.3	18.8	18.7	17.4
Female unemployment (% total female)	10.0	10.0	10.1	9.7	8.8
Long term unemployment (% of total unemploy ment)	45.2	45.7	44.9	46.0	45.7

Source: European Economy 7/2007, EU Labour Developments, p.p.201 & 202.

1.3. Persistent poverty amidst exploding profits – Inequality on the rise

The latest data about poverty in the EU (relating to 2005) indicate that in general the situation has not improved and in many cases it has deteriorated. By the end of the 1990s the average EU-15 poverty rate had declined from 18% in 1995 to 15% in 2000. After it had remained constant for a couple of years, the poverty rate has increased by one percentage point to 16% in 2004 and remained there in 2005. (table 1.3)

Table 1.3: Poverty Rates in the EU in %, 2005

	EU25	EU15	EU10	Maximum Value	Minimum Value
All age groups	16	16	17	Poland, Lithuania (21, Greece, Spain, Ireland (20), Portugal, Latvia (19)	Sweden (9) Czech Republic (10)
Adults (16-64 years)	14	14	17	Poland (21) Lithuania (19)	Sweden (9)
- Women (16-64 years)	15	15	17	Poland (20) Lithuania (19)	Sweden (9)
- Men (16-64 years)	14	13	18	Poland (22) Lithuania (20)	Czech Republic, Sweden (9)
Children (< 16 years)	19	18	24	Poland (29) Lithuania (27)	Sweden (8) Denmark, Finl. (10)
Elderly people (> 65 years)	19	20	9	Cyprus (51), Ireland (33), Spain (29)	Czech Republic, NL (5) Hungary (6)
Employees (>16 years, incl. self-employed)	8	7	10	Poland(14),Greece (13), Portugal (12)	Czech Republic (3), Finland (4), Denmark (5)
Unemployed (>16 years)	40	37	47	Lithuania (63), Estonia (60), Latvia (59) Czech Republic (51) UK (50)	Slovenia (25), Denmark, Schweden (26), Netherlands (27)
Households without dependent children	15	15	12	Cyprus (27) Ireland, Latvia (20)	Czech Republic (7) Slovak. ,NL, Lux(8)
Households with dependent children	17	16	21	Poland (25), Lithuania (23), Italy (22)	Sweden (8), Finl., Denmark, (9)
Households with two adults and three or more children	24	22	37	Poland (45), Portugal, Latvia (39), Spain (36)	Sweden (9), Finland (12), Germany (13)
Single Parent with dependent children	32	32	37	Malta (49), Lithuania (48), Ireland (45), Greece (44)	Sweden (18), Finland (20), Denmark (21), Slovenia (22)

Source: Eurostat-Database (November 2007).

High poverty risk: children, old age, unemployment: While the poverty rate for adults in the EU-25 is at 14%, children, households with many children, and elderly persons belong to those groups of the population, that are particularly exposed to poverty: In EU-25, almost one fifth of the children under 16 years old live in poor households, and in Poland, Lithuania, Spain and Italy even every fourth child lives in poverty. Households with children, too, are more exposed to poverty than households without children (poverty rates of 17% and 15% respectively). Particularly alarming is the situation in Poland and Lithuania, where poverty rates for most groups of the population are the highest ones in the EU.

The average poverty rate of elderly people (aged 65 or more) is 19%. In Cyprus, every second person aged 65 or more is hit by poverty. In contrast, the poverty rate of the elderly in the Czech Republic, the Netherlands, Hungary, Poland, Slovakia and Luxembourg is less than

10%. Similar to the unemployed, increased exposure to poverty of elderly people is mainly caused by the loss of earned income.

The highest share of poverty is to be found amongst the unemployed. Overall two fifth of unemployed persons throughout the EU25 are poor. For the 10 new member countries this share has dramatically risen from 38% in 2003 to 47% in 2005.

Working poor. The number of people who are poor in spite of employment is about 14 million; this is almost twice as high as the number of unemployed poor people (about 7 million). Obviously, increasingly frequent insecure employment conditions raise the risk of poverty. E.g., the type of the working contract makes a significant difference, since the poverty rate for employees with fixed-term contracts is three times as high as for employees with permanent contracts (poverty rate of 11% for the former in comparison to 4% for the latter in EU-15); and with a poverty rate of 16% self-employed are exposed to poverty despite full-time occupation (European Commission 2005b: 193).

Growing wealth. As well as the scandalous increase of poverty in the EU, there has been a substantial increase in the concentration of wealth in the EU. While much data is published by Eurostat on poverty, no information can be found on the distribution of wealth in Europe, so that we have to refer to the statistics of Merrill Lynch and CapGemini (2007): According to the World Wealth Report 2007, the number of $-millionaires and other rich people in Europe – so called high net worth individuals (HNWI) – has steadily increased in the last years and reached 2.9 million in 2006. At the same time, the wealth of these HNWI has increased even faster, which means that the rich became even richer, so that the concentration of income at the very top of the income scale has increased. In 2006, the financial assets of this 0.6% of the European population rose up to $ 10.1 trillions, corresponding to 2/3 of all European financial assets managed by institutional investors ($ 15.6 trillions in 2005, see International Financial Services 2006: 5).

1.4. Threats of dependence and catastrophes: Energy and climate change in the EU

Energy. The EU is one of the main consumption areas of energy world-wide, without being able to supply a sufficient amount of energy for its energy needs from its own sources. On the basis of the prevailing energy system, which is based on fossil energy sources, with a priority

for oil (and gas)[1] the EU area has a durable energy supply deficit (see table 1.4). The deficit is currently covered by imports from a small number of trade partners (Russia, Algeria, Norway) which may create a situation of unilateral dependency, especially with a view to foreseeable shortages of available oil and gas.

Table 1.4: Energy Consumption and (net)imports in the EU

	Consumption Mio t oil Equivalent (2005)	**Import Mio t (2005)**	**Dependency ratio, % (2005)**	***Consumption 2007***		
				Industry Mio t	Transport Moi t	Per capita kg
EU 25	1.637,2	949,7	56,2 %	313,0	354,9	2.470
Germany	324,2	212,6	65,1 %	56,1	62,0	2.640
Spain	139,5	125,7	85,1 %	31,0	39,4	2.280
France	257,3	141,9	54,5 %	37,4	49,8	2.540
UK	224,1	29,4	13,0 %	33,9	55,2	2.540
Poland	86,2	15,9	18,4 %	16,4	12,1	1.500
Slovenia	6,3	3,5	55,8 %	1,7	1,5	2.440
Finland	27,0	18,7	69,3 %	12,1	4,8	4.820
Italy	181,9	160,9	86,8 %	40,7	43,6	2.300

Comments: Imports including 60% oil and 25% gas (EU 25). Cyprus has the highest dependency rate with 105,5 %, Portugal = 99,4%; Luxembourg = 99,0%; Ireland = 90,2%.
Denmark is producing energy for export (dependency rate = -58,8%).

It is now generally agreed[2] that increasing the part of renewable energy sources in the energy use of the EU and investing in energy efficiency and sufficiency with the objective of energy saving should be central elements of an energy strategy for Europe. The EU Action plan for Energy efficiency – COM/2006/545 – gives the figure of € 100 billions for the annual energy saving potential for the EU and aims at 20% of energy savings by 2020 compared to the baseline scenario as forecasted in 2005.The most important energy source is energy efficiency, i.e. energy not used by saving policy or innovation and it is already the largest energy source in the EU.

Climate

The latest climate change report of the **IPCC** – "Impacts, Adaptation and Vulnerability"

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[1] An increased use of the still sizeable coal reserves of the EU seems hardly possible because of the existing configuration of energy transforming apparatuses, the prohibitively high investment costs of their replacement or conversion to coal use, as well as the important side effects on climate and on the environment more generally.

[2] EU Commission Memo, January 2007: A Renewable Energy Roadmap – Paving the way towards a 20% share of renewables in the EU's energy mix by 2020.

(April 2007) – has provided a new sense of urgency to the debates on climate policy: An apocalyptic future is rapidly approaching, if action is not taken fast. Millions of people, ecosystems and species in all regions of the world are already suffering form the effects of human induced climate change, and more harmful effects are forthcoming: billions of people facing water scarcity, increased drought, sea level rises, storm surges, river flooding – and even more hunger and misery through reductions in food producing capacities.

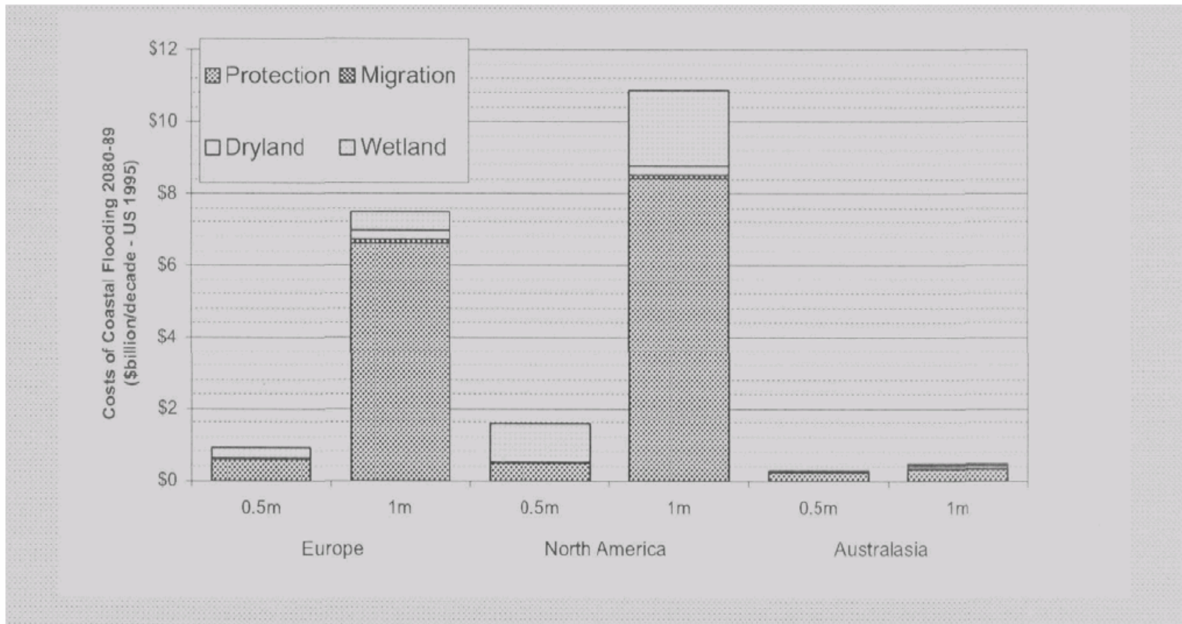
The report of the Working Group II of the IPCC has highlighted the potential consequences of climate change over the next forty years: violent rainfall and more frequent inundations; increased vulnerability of eco-systems, especially with regard to their capacity of binding carbone, accompanied by the disappearance of 20 to 30 % of known animal and plant species; deep modifications in the global distribution of fish species, with important consequences for fishing and aquaculture; increase of the sea level, coast erosion and more frequent floods; augmentation of the frequency and intensity of extreme meteorological events.

These tendencies are also visible in Europe. Unfortunately they still tend to be seen as specific problems of singular member states, as increasing coast-line fortification requirements in the Netherlands or summer fires in the Mediterranean member states.

The Stern Report published in 2007[3] has predicted, that, if nothing is done "in Europe, sea level rise will affect many densely populated areas. An area of 140.000 km^2 is currently within 1-m of sea level. Based on today's population and GDP, this would affect over 20 million people and put an estimated $300 billion worth of GDP at risk. The Netherlands is by far the most vulnerable European country to sea level rise, with around 25% of the population potentially flooded each year for a 1-m sea level rise."

[3] Stern, Nicholas. The Economics of Climate Change: The Stern Review, Cambridge Univ. Press, UK 2007). www.hm-treasury.gov.uk/media/9/1/Chapter_5_Costs_ofClimate_Change_in_developed_Countries.pdf, p.13.

Figure 3:Costs of coastal flooding in developed country regions:



The Potsdam Memorandum of October 8th to 10th 2007 has summarised this dramatic situation very clearly: "The world-economic acceleration after World War II has pushed our planet into an unprecedented situation: humanity is acting now as a quasi-geological force on a planetary scale that will qualitatively and quantitatively alter the natural Earth System mode of operation – should business as usual be pursued" (www.nobel-cause.de/potsdam-memorandum).

Although there still is a considerable knowledge gap on gender aspects of the impact of climate change, it can be stated that e.g. with regard to European countries, it is known that private and public transport are differently being accessed by women and men and used for different purposes. Therefore "integrating a gender perspective" would make it possible "to make transport systems more user-friendly and more climate-friendly" at the same time, e.g. by addressing the needs of the 'child-run', thereby avoiding the use of private cars.[4]

In spite of increased public awareness created by recently published authoritative reports, climatic change through human activity, the loss of biodiversity, the scarcity of resources, and the deterioration of the human habitat continue as unsustainable trends. With regard to greenhouse gas emissions the hope for a compliance of the Kyoto targets by the EU remain unsubstantiated by the actual development (cf. Euro-Memo 2006). Only drastic changes of policy will make certain that the

[4] Minu Hemmati and Ulrike Röhr, A Huge Challenge and a Narrow Discourse – Ain't No Space for Gender in Climate Change Policy? – in Women & Environment Magazine No. 74/75, Toronto, Canada, Spring/Summer 2007.

EU will fulfil its reduction commitments.[5]

The "Second ECCP Progress Report" ('**E**uropean **C**limate **C**hange **P**rogramme') gives an overview of the implementation activities and an indication on the EU's ability to meet its Kyoto targets of the first commitment period 2008-2012. The actual emission trends in the EU and the Member States are addressed in the Commission's annual greenhouse gas monitoring report. But what goal will the EU set (and concretise) for itself?

1. 5. Macroeconomic imbalances in the world economy

The financial crisis discussed above is closely related to a serious imbalance in the world economy. The huge current account deficit of the US is being financed by increasingly dubious methods, including the complex packaging and reselling of mortgage debt to banks and institutional investors around the world.

Deepening economic relations between the US on the one hand and China and South-East Asia on the other have been central to recent developments in the world economy and have contributed to rapid rise in incomes in many developing countries. On average, real GDP growth in developing countries has been above 7% per annum since 2004 and this is forecast to continue through 2007 and 2008.

But these relations have been characterised by a growing US payments deficit. In 2006 this amounted to some 800 billion dollars or approximately 6.5% of US GDP (see fig. 1.5). The need to find this amount of external finance for the US economy is an important part of the context in which the international financial crisis broke out.

The counterpart to these deficits is found in the massive surpluses of Japan, China and other Asian economies. To some extent this pattern derives from the Asian financial crisis of the late nineties which disrupted financial relations between Asian economies and the West. In many cases, for instance in China, it would be desirable for the development process to be less directed towards exports and more centred on the needs of the domestic population, but such a reorientation will require time to bring about.

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[5] see critique on the EU Commission's Green Paper "Adapting to climate change in Europe – options for EU action", COM/2007/354.

Table 1.5: Current Account Surpluses and Deficits (-) as Percentage of GDP

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
US	-3.2	-4.2	-3.8	-4.5	-4.8	-5.7	-6.4	-6.5	-6.1	-6.0
Eurozone	0.3	-0.7	0.0	0.6	0.4	1.0	0.1	-0.3	-0.3	-0.4
Japan	2.6	2.6	2.1	2.9	3.2	3.7	3.6	3.9	3.9	3.6
Newly Industrialised Asian Economies	5.8	3.5	4.7	5.1	6.9	6.6	5.6	5.6	5.3	5.1

IMF World Economic Outlook, April 2007. Forecasts for 2007 and 2008

The scale and persistence of the US deficit are unprecedented for a major industrial economy. It relates to both a big deficit in public finance and to an excessive reliance on debt by many American households. Unfair tax cuts for corporations and for the wealthy and widening economic inequalities are major factors behind this situation.

There is no prospect that market adjustments can bring about an appropriate correction because changes will be needed on a scale which is bound to disturb the general views which market agents have formed. The resulting disorientation in the markets would be likely to lead to a drastic fall in the exchange rate of the dollar or a drastic rise in US interest rates or both. In such circumstances there could be a marked decline in production and employment around the world. The US might "correct" its payments imbalance through a recession which would impact severely on its trading partners. The sudden narrowing of American markets might, in particular, slow down the economic development of China and other Asian economies.

Although the European Union does not itself have an aggregate balance of payments problem, it could be seriously affected by the problems of the dollar – export markets could be disrupted both by recession in the US and other important markets and by a drastic rise in the value of the euro. This appreciation of the euro might not be limited to the consequences of swings in international trade; any significant loss of confidence in the dollar would make the euro into a key store of value around the world, even for wealth holders with no concrete relationships to the European economies. Thus many Eurozone producers might suffer a drastic loss of competitiveness. At the same time European financial systems, increasingly interconnected with those of North America, might experience a range of disturbances. It would be in the interests of the EU itself, and an acknowledgement of its international responsibilities, to help promote a gradual correction. In this context it becomes vital that the EU stimulates domestic growth to offset the growing current account deficit which would accompany such a correction of the imbalances in the USA.

Because a purely market-based correction would be inadequate and would almost certainly involve multiple crises, a political solution is imperative – the largest economic groupings need to formulate a broad strategy for a medium term return of the US balance to a more sustainable position – an adjustment which is in their general interest.

There are precedents (the Plaza and Louvre agreements of the 1980s) for international cooperation to deal with the dollar's exchange rate problems. However, these were shallow agreements in that they only involved exchange rate interventions, not macroeconomic policies. Today, joint interventions by the major central banks in the foreign exchange markets may still be an important policy instrument but it also seems imperative to arrive at some commitment to mutually supporting changes in macroeconomic policies in the major economic zones. Some moves to reduce public sector deficits in the US seem necessary while an obvious contribution from the Europeans to a lowering of international financial tensions would be to move to a higher level of domestic activity, and to accept at least a temporary weakening of the overall European current account.

Also, the days are gone when global economic adjustments could be decided by the rich countries alone. The reduction of international financial imbalances today makes the participation of developing countries – above all China but also that of other large states and of regional groupings – an economic as well as a political necessity.

The existing macroeconomic regime in the EU is ill adapted to meet these global responsibilities. The ECB has a mandate completely centred on internal questions – this is a weakness in its institutional design quite comparable to the weakness most often discussed, that is the overriding priority given to price stability. Indeed, the ECB is likely to be hostile to any formal monetary agreement between the EU and external governments because such an agreement would imply a transfer of power away from the ECB and towards the EU's political leaderships.

Table 1.6

Eurozone Countries: Current Account Surpluses and Deficits (-) as Percentage of GDP

	2003	2004	2005	2006	2007	2008
Germany	1.9	4.3	4.6	5.1	5.3	5.2
France	0.4	-0.3	-1.6	-2.1	-2.2	-2.3
Italy	-1.3	-0.9	-1.6	-3.2	-2.2	-2.2
Spain	-3.5	-5.3	-7.4	-8.8	-9.4	-9.8
Netherlands	5.4	8.9	6.3	7.1	7.7	7.6
Belgium	4.1	3.5	2.5	2.5	2.4	2.5
Austria	-0.2	0.2	1.2	1.8	1.9	1.6
Finland	6.4	6.4	7.8	5.3	5.1	5.2
Greece	-5.6	-5.6	-5.0	-9.4	-9.3	-8.7
Portugal	-6.1	-6.1	-6.7	-9.6	-9.1	-9.1
Ireland	0.0	-0.6	-2.6	-4.1	-4.4	-3.0
Luxembourg	7.5	11.8	11.8	11.7	11.7	11.4
Slovenia	-0.8	-2.7	-2.0	-2.3	-2.6	-2.5

IMF World Economic Outlook, April 2007. Forecasts for 2007 and 2008.

The situation regarding budgetary policies is even more problematic. The approximate current account balance of the eurozone as a whole disguises internal strains: Germany has a large export surplus while many of its EU partners have corresponding payments deficits (see fig. 1.6). Coordinated changes in budgetary policy to lower these tensions would again be advantageous both internally, in that they would support higher levels of employment, and externally in that they would facilitate a more positive EU response to global problems. These internal payments imbalances do not give rise to exchange rate problems because of the use of a single currency but they represent geographical imbalances which may constrain economic activity in economies under competitive pressure.

At present, however, the institutional structures of the EU, as well as the conservatism and lack of ambition of its political leaderships, are keeping this kind of coordination off the European agenda. The consequent passivity of the EU in the face of growing international economic tensions represents a serious abdication of political responsibility.

Part 2:

Undermining the European Social Model - Critique of economic and social policies

In this part we undertake a critique of EU policies in the main areas of economic and social development. We start by showing that the content of the much praised Reform Treaty is still nothing else than the neo-liberal content of the old draft; it has maintained its thrust to strengthen the EU military power; the improvements in the codetermination rights of the European Parliament do not overcome the basic democratic deficits of this Treaty. We criticise the continuation of the deregulatory obsession of the Commission in its initiative to integrate basic public services in the internal market framework and to impose even more flexibility onto the labour markets. Against this deregulatory thrust European immigration policy is much too rigid and restrictive, while in climate and energy policy we cannot discover concrete actions behind strong rhetoric. In our view it is alarming that the EU, instead of taking a course of stronger orientation towards more internal stability and cohesion, embarks on an increasingly aggressive external trade and investment policy and on a neo-liberal reshaping of relations with Less Developed Countries.

2.1. The "Reform Treaty" – The EU elites' counter-reform under a new cover

Those who expected that after the French and Dutch "No" to the draft constitution in 2005 there would be a broad participatory consultation with the people of the European Union on the future of Europe were thoroughly disappointed. The "period of reflection" provided no meaningful efforts in that direction from the side of the EU institutions. Instead, the political leaders rushed through the Treaty reform at the highest possible speed without any broader consultation. On 19 October 2007, the European Council in Lisbon adopted a new "Reform Treaty" for the EU. It will be signed at the summit in December and then the ratification process will start. Governments are firmly determined not to submit the Treaty to the people and to avoid any referenda with the risk of new failure. This anti-participatory staging of the reform process is a clear indication of the fact that the Reform Treaty is an entirely elitist project.

Perhaps the most remarkable change with regard to the failed draft constitution is the absence of the term "constitution" and of all symbols of the EU as a united entity. This is surprising because for several years Europe's political leaders and mainstream media had argued that the

EU needs a "constitution" to progress towards what was called the "finality of European integration". It was claimed that the EU could not continue with gradual Treaty reforms in the style of Maastricht, Amsterdam and Nice. But the now adopted Reform Treaty is exactly this, a "Modification Treaty", just as the Treaty of Nice is a modification of the Amsterdam Treaty.

This was not the point of the public critique in 2004/5 against the draft constitution. Such critique was not directed against the project of a European Constitution as such but against the ***content*** of the proposed draft: the democratic deficit of the Union, the neo-liberal character of economic and social policy orientations, the strengthening of the military component of EU policies. European leaders could have responded to this critique by proposing a shorter and more comprehensible text containing basic values, institutions and procedural rules for a democratic EU and avoiding "constitutionalising" neo-liberalism and stronger military capacities of the EU. Instead they took exactly the opposite way: abandoning the term constitution and maintaining the content of the former text.

Mainstream media want people to believe that negotiations are just about some watered down "Mini-Treaty". Nothing could be further from the truth. In fact more than 90 per cent of the content of the draft Constitution is to be found in the new "Reform Treaty". Especially the former part III is maintained (neo-liberal policy design), as is the heavily criticised provisions for the Common Security and Defence Policy etc. The limited number of changes mainly refers to institutional issues: the number of Commissioners is reduced; the strengthening of the role of President of the Commission is postponed to 2014; the new voting system (double majority) in the Council is also postponed to 2014/2017; the proposed "Minister for Foreign Affairs and Security Policy" will be called "High Representative of the Union"; a protocol on the role of national parliaments is added and the period in which they can respond to a legislative proposal from the Commission extended from 6 to 8 weeks; the policy areas that require qualified majority voting in the Council and co-decision of the European Parliament are extended. While the latter is welcome the basic institutional shortcoming remains that the European Parliament does not have the right to initiate European legislation.

Concerning our areas of work as economists, there are also no serious changes in the "Reform Treaty". Amongst the EU´s objectives the "internal market" is mentioned without the former addition "with free and undistorted competition". Proclaimed by French President Nicolas Sarkozy as a victory for a more social Europe, the impact of that change will be zero. The formulations on the internal market in the "Treaty on the Functioning of the Union" remain

the same as in the "Constitution Treaty" Part III, and a new "Protocol on the Internal Market and Competition" clarifies that the internal market "*includes a system ensuring that competition is not distorted*" and empowers the Union to take action accordingly. We are not against competition within a well defined framework of common rules, but we oppose the competition of rules which is prevalent in the Treaty. A new "Protocol on Services of General Interest" is annexed to the Treaties, stressing the "essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interests as closely as possible to the need of the users". While this may possibly serve as a basis for less strict interpretations of internal market and competition rules by the European Court of Justice vis a vis public services and services of general interest, the protocol nonetheless does not abolish the subordination of services of general economic interest to these internal market rules. For non-economic services it states that the "provisions of the Treaties do not affect in any way the competence of the member states to provide, commission and organise non-economic services of general interest." This could also be an interesting point for new discussions, but the Commission has made it quite clear that services are almost always economic services and fall under the internal market rules.

To summarize: the draft "Reform Treaty" essentially presents the content of the failed "Constitution Treaty" in a new format, while the ratification process to be followed does not in any way "move the popular will". We reject it on the same grounds which we gave for our opposition to much of the content of the "Constitution Treaty" in our 2004 Euro Memorandum and the reservations we expressed regarding the two year "reflection period" in our 2005 EuroMemorandum.

2.2. Service directive through the backdoor - The deregulatory obsession continues

Since January 2007 the controversial services directive (SD) is in force. It establishes the principle of free movement throughout the Union and treats special – administrative, social, environmental – regulations of member states for the provision of services on their territory as infringement of the EC Treaty. This deregulatory thrust has been maintained in the directive although terminology has been softened and some areas have been exempted from the application of the services as a consequence of public debate and critique. The main energy and activity of the Commission, particularly its Internal Market directorate is now aiming not only at a very narrow interpretation of the directive through the publication of a handbook,

but also and most importantly at developing similarly deregulatory community frameworks for those areas which have been exempted from the SD. Thus it tries to re-conquer the territories which it had lost in the preceding debates and to introduce the SD through the backdoor. At the same time, the discussion on the status and possible perspectives of services of general (economic) interest which had gained momentum through public protest against excessive liberalisation and privatisation is widely disregarded by the Commission. The tactic seems obvious: by adopting free-movement-frameworks for as many areas of services, including public services, there should remain no or very little room for genuine public services which are not governed by the rules of competition.

Social services. Immediately after social services had been exempted from the coverage of the services directive the Commission announced in an official communication in April 2006 the way in which it envisages to proceed in this area (Com (2006)177 final), not without emphasizing the role of these services as "pillars of European Society and the European Economy".

In this paper the Commission then develops an argument in five steps which is so remarkable that it deserves full quotation (see box):

> In general, the case law of the Court of Justice ("the Court") indicates that the EC Tre gives Member States the freedom to define missions of general interest and to establish organisational principles of the services intended to accomplish them.
>
> However, this freedom must be exercised transparently and without misusing the notion general interest, and the Member States must take account of Community law when fixing arrangements for implementing the objectives and principles they have laid down. example, they must respect the principle of non-discrimination and the Community legislat on public contracts and concessions when organising a public service.
>
> Moreover, when it comes to services of an economic nature, the compatibility of tl organisational arrangements with other areas of Community law must be ensured particular freedom to provide services and freedom of establishment, and competition law).
>
> In the field of competition law, the Court has established that any activity consisting supplying goods and services in a given market by an undertaking constitutes an econoı activity, regardless of the legal status of the undertaking and the way in which it is financed
>
> With regard to the freedom to provide services and freedom of establishment, the Court ruled that services provided generally for payment must be considered as economic activi within the meaning of the Treaty. However, the Treaty does not require the service to be p for directly by those benefiting from it[13]. It therefore follows that almost all services offe in the social field can be considered "economic activities" within the meaning of Articles
>
> European Commission, Implementing the Community Lisbon programme: Social services of general interest in the European Union, Com (2006) 177, final 26.April 2006, p.6.

The first step gives member states ***freedom*** to define and organise social services. The second step raises a warning finger against any "***misusing***" of this freedom, which would be the case if member states breach Community law. For services of an "***economic nature***", step three explains that member states have of course to respect the freedom to provide services (Art. 43 and 49 of the EC-Treaty). What is a service of economic nature? Step four explains that "…any activity consisting of supplying goods and services in a given market by an undertaking constitutes an economic activity…" And to make the matter quite clear it adds in step five that "…services provided generally for payment must be considered as economic activities" and finally drives the point home: "***It therefore follows that almost all services offered in the social field can be considered 'economic activities" within the meaning of Articles 43 and 49 of the EC treaty***." The decisive point is, that if a service is provided for money – regardless of the appropriateness of the price and of the ultimate source of finance – it is regarded as an economic activity and must be subordinated to the internal market and competition rules. Therefore an entity providing a social service against money has to behave as if it were a private firm in a private market. It seems logical that under such circumstances there is no reason why they should not be privatised.

Health care. Health care is essentially a matter for national regulation and there are a number of very different systems in force in the Community. Problems of "patient mobility" – for instance who pays if tourists or temporary workers from one member state need and get care in an other member state – have been dealt with through coordination. This had already since 1971 been codified in a specific regulation (EC 14008/71) which was updated and enlarged in 2004 (883/2004). It is based on the right of member states to choose the structure, organisation and management of their specific health systems and deliver a fairly comprehensive framework for the resolution of such intra-EU problems – although further improvements are desirable and possible. However, the Commission, while formally accepting this arrangement, aims at integrating national health systems into the overarching framework of the internal market. It has recently circulated a proposal for a directive "on safe, high quality and efficient cross-border healthcare" in which it proposes to "put in place a parallel mechanism based on the principle of free movements and building upon the principles underlining decisions of the Court of Justice. This would allow patients to seek any healthcare abroad that they would have been provided at home and be reimbursed up to the amount that would have been paid had they obtained that treatment at home, but they bear the financial risk of any additional costs arising" (p.4). It can easily be seen that such a "parallel

mechanism" is a formidable instrument to put national healthcare system under increased competitive pressure. In the course of their numerous health care reforms member states cut public spending, introduce more market based instruments and competition in the provision of health care, propose outsourcing, privatisation and public private partnerships (PPPs). Reforms of statutory health insurance lead to a reduction of coverage to basic services, while for all treatment beyond these the patients must pay individually – for which cases "supplementary health insurance schemes" are offered from the financial market actors.

Posting of workers. In an attempt to compensate for the deletion of the articles of the draft services directive relating to the posting of workers from other member countries the Commission has in April 2006 published a "Guidance on the posting of workers in the framework of the provision of services" in which it clarifies its position that special requirements of host countries for the admission of workers from other member countries– like appointment of a representative in the host country, prior registration of the posting of workers, obligation to keep documents on posted workers in the host member states etc. – should be regarded and treated as illegal. Such provisions are not the removal of administrative obstacles to "good governance" (another big deregulatory project of the Commission) but they open the road for social dumping and for more or less criminal practices of firms and for work agencies operation beyond any legal control.

2.3. „Flexicurity" – Labour market reform with a neo-liberal bias

The European Commission is promoting a new twist for implementing "structural reforms" in the labour markets. In the recent communication on Flexicurity (COM 2007/0359), it broadens the approach which it has been advocating for since many years and already concretised in the "Green Paper on modernising labour law" (COM 2006/0708) of November 2006. The Commission seems to be aware that the spreading of non-standard labour arrangements entail the danger of increasing labour market segmentation and the growth of often poorly protected and often precarious types of employment. But instead of promoting the phasing out precarious "atypical" employment, the Commission develops the assertion that the standard regular employment relationship (permanent contracts based on full-time employment) has become the main obstacle for reversing labour market segmentation and needs to become more "flexible". For this purpose the level of job protection must be lowered and reduced to a "floor of rights" covering standard and atypical employment alike. This

concept of "flexicurity" shall in the perspective of the Commission become the overarching approach for the next 3-year cycle of the European Employment Strategy and the "Integrated Guidelines for Jobs and Growth" (2008 – 2010).

The Commission proposes to establish an EU indicator on the "strictness of employment protection legislation" (EPL). Where this indicator is regarded as being too high member states are encouraged to impinge on "reforms" to lower the level of protection. Apart from that, the old orientations already contained in the revised Lisbon Strategy and the Integrated Guidelines for Jobs and Growth are simply maintained: "activating" labour market policies "making work pay", "establishing a balance between rights and obligations", promoting "employability" and "adaptability" of workers and the unemployed, contributing to "sound and financially sustainable budgetary policies" etc.

The Commission's central aim is to reinvigorate the "Jobs and Growth" Strategy by focusing its employment policy component more strongly on "flexicurity" – claiming that "new forms of flexibility and security are needed, for individuals and companies as well as for Member States and the Union." The Commission's position strongly points towards a change in the notion of security, which moves from the protection against risks to the capacity to adapt to change by means of a process of constant learning. 'Old' types of security are deemed to obstruct the necessary flexibility and should be reduced. Concretely this means a reduction of benefit schemes where they are regarded as too 'generous', and a lowering of employment protection. The 'new' security should facilitate flexibility and is based on learning. Learning should lead to greater adaptability and employability, which in turn should lead to employment, considered the best recipe for security.

These proposals serve neatly the employers' demands for increased flexibility, while workers as well as the unemployed see their job protection and income security decline, in exchange for the mere promise of better lifelong learning opportunities and "activating" labour market policies increasing conditionality, reducing rights and strengthening obligations of workers and unemployed persons. Compared to 'old-style' job protection and income security the 'new' security also seems rather insecure. Although it is in general true that the better qualified have a lower risk of unemployment, access to education or training does not provide enforceable guarantees to the individual. Moreover, the Commission refrains from proposing

training, education and lifelong learning as a right for workers and unemployed persons and also does not want oblige employers to properly finance such measures.

The Commission's analysis of the reasons for labour market segmentation ("insiders" and "outsiders") is far away from reality. Firstly, as the European Parliament rightly pointed out in its resolution on the Green Paper on Labour Law, "recent OECD and other studies have shown that there is no evidence for the claim that reducing dismissal protection and weakening standard employment contracts facilitates employment growth", and equally "the example of the Scandinavian countries shows clearly that a high level of dismissal protection and employment standards is fully compatible with high employment growth". Secondly, it can be observed that the strategies of employers and Member State's governments to increase labour market flexibility are at the root of labour market segmentation. Working time accounts and flexible working time schemes make it possible for companies to work with a smaller regular workforce and thus meet market fluctuations by adapting weekly working time accordingly. This "internal flexibility" is often combined with "external flexibility", relying on fixed-term, temporary and project work during peak periods. Annualised hours and the concept of the 'breathing enterprise' contribute to the spreading of precarious employment and prevent that an 'upswing' translates into increased permanent and regular employment. Therefore, the Commission's proposals for flexicurity should be more honestly called a programme for increasing "***flexploitation***" of workers throughout the European Union. They should be rigorously rejected.

2.4. Against European interests and fairness – Too restrictive immigration policy

Modern migratory movement can best be understood in the context of a globalised market economy that directs and regulates the flows of goods, money and labour. Unlike other goods labour is embodied in human beings with all its physical, gendered and cultural characteristics that are shaped by history giving labour migration its political and cultural dimensions.
Migration is functional for the economic organization of EU countries and complements native labour. Globalisation has accelerated the pace of liberalization, deregulation and flexiblisation of labour markets. Whilst native workers abandon the low paid jobs, in many sectors the demand for different types of low paid unskilled workers has been on the rise, that has been increasingly filled by migrant workers, employed under precarious conditions. In the past male migration dominated migratory flows to the EU, but now female migrants are at

least as numerous as male migrants. The feminization of migration is driven by the demands of the care/health, leisure and sex industries.

The EU enlargement project has led to migration given the disparities in living standards and income differentials between the new member states and the EU15. All the EU15, except the UK, Ireland and Sweden, imposed a seven year ban on free movement of labour from the new member states. This has diverted the flow of migration to these countries whilst illegal migration for work to other EU15 countries has continued. Over time the intra-EU migratory flow will slow down as the disparities within the EU decline and the demand for labour picks up in the new accession countries, a trend that has been observed in the migratory flows from the earlier accession countries.

Similar economic forces govern migration from the third world countries to the EU, but given that the income gap between the EU and these countries is not going to narrow substantially soon and while the other factors like war, repression and persecution would still be at work, immigration from outside EU will continue. The young age structure of these immigrants would help to provide support for a European ageing population indirectly through tax contributions and directly through work in the care and other areas of service industry.

These positive impacts on destination economies are often ignored in the media and popular debate on immigration in the EU in which immigrants are blamed for increased crime, pressure on the public transport, health and education system and erosion of national identity. Influx of immigrants and their concentration in specific areas would create tensions with the natives over the existing resources. But the poor state of public services in some EU countries is due to the lack of state support and budgetary constraints and not to immigration. Public information campaigns and advocacy on the real impact of immigrants are essential if such conflicts were to be resolved. It is also stated that 'immigrants take jobs from the natives' and that 'they depress wages' of native population. Neither of these claims is borne out by evidence. In general immigrants complement the skills of native labour that often could result in increased demand for native labour, especially if a sector relies heavily on immigrant labour. The negative impacts of immigration on native wages are sector specific, temporary, and on the low end of the wage distribution. Over time increased profitability in these sectors leads to new firms moving in, that will increase demand for labour and gradually raises wages.

The EU internal market project has reduced or eliminated intra EU border controls at the expense of tighter control of external borders and introduction of a new 'border control'

regime that relies heavily on stricter visa regulation and cross border cooperation between EU and third countries on security matters. A 'border land' has gradually replaced the geographical 'border line', that has brought the 'border' into the heart of EU countries where immigrants are expected to provide their credentials to the police and immigration officials in public spaces like train and bus stations, or when using public services like hospitals and schools. The Sarkozy government's plan to introduce DNA testing for family reunion of French immigrants from outside the EU is part and parcel of this 'border land' approach. With increasing difficulty of entering the EU, illegal immigration will become the only alternative contributing to people smuggling and trafficking. Illegal entry is no bar to employment where labour markets are tight and in sectors with a short supply of native labour. Immigrants, especially the illegal ones, are mostly doing the dirty, demanding and dangerous jobs that few natives would do. They are hired on a casual basis, especially if they are un-documented. Their precarious condition contributes to their super-exploitation.

Immigration policy at the EU level has been viewed more as a security than a labour market or human rights issue. This view has to change if an immigration policy were to be formulated on the principles of: EU labour market needs, accepting immigration as an important dimension of globalization, freedom of movement as a fundamental human right, and integration of immigrants in the EU. In the short term, EU countries should regularize the status of illegal immigrants and offer permanent status to legal immigrants. This will remove the illegality and wasteful policing, whilst helping to promote an integration policy based on active participation of immigrants. On humanitarian grounds, any restriction on immigrants' access to key public services such as health and education should be removed. In the medium to long run attempts should be made to move towards a common immigration policy across the EU based on international justice, solidarity and integration of immigrants, drawing on the best practices of EU member states policies on admissions, naturalization, family reunion and labour market related issues.

2.5. Global Europe – Threatening ambitions

The EU likes to project an image of itself as pursuing socially inclusive policies, not only within Europe, but also in its relations with the rest of the world. But in a series of recent strategy papers it has stressed that, with some 450 million citizens, the EU is now a force in the world, and that it must take advantage of this to promote its own interests. According to a document prepared by the EC Presidency in October 2007 "the EU of 27 Member States

offers a route for Europe to act on a continental scale, with a critical mass and a reach which should be used to the greatest advantage".[6] This reach can be observed in an increasingly forceful global assertion of the interests of European business and, more worryingly, policies designed to promote the EU's capacity to conduct overseas military operations.

Opening markets*:* The EU's Lisbon strategy, first presented in 2000, and re-launched in 2005, set out an externally-oriented growth strategy which claimed that Europe would achieve full employment by becoming the most competitive economy in the world. This vision of Europe locked in competition with other countries for a larger share of world exports, especially in higher-value products, was expounded even more starkly in October 2006 in a new trade-strategy document entitled *Global Europe: Competing in the World*. According to the document, one of the key requirements for European competitiveness is ensuring greater openness and what it calls 'fair rules' in other markets. Here it is especially critical of the major emerging economies, singling out China, India and Brazil as countries which combine high growth with unnecessarily high barriers to EU exports.

In order to achieve greater access to other markets, the EU strongly supported the World Trade Organisation (WTO) and the negotiations associated with the Doha round, and it says that it was willing to make concessions in order to reach an agreement. But, despite the rhetorical support for a multilateral agreement, once it became clear that the Doha talks had stalled, the EU began to radically reorient its strategy towards securing bilateral trade deals. To this end, it has started negotiations for Free Trade Agreements (FTAs) with the Central American countries, the Andean Community, Korea and India. At the same time, the EU is seeking to pursue negotiations for a new series of agreements involving the liberalisation of services and investment with the Mediterranean countries. It is also in the final phase of trade negotiations with the ACP countries, and is pushing hard for them to accept so-called Economic Partnership Agreements (EPAs) by the beginning of 2008 – a deadline that was set by the WTO, but which now seems to be unrealistic. The EU-Africa summit in Lisbon in December 2007 will launch the Europe-Africa-Energy Partnership which focuses on the conservative energy interests of the EU, not on the needs of Africa and an energy change. Finally, the EU is working towards an intensification of the Transatlantic Dialogue with the US, although the chance of initiating negotiations for an EU-US Free Trade Area do not, at present, seem high.

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[6] European Commission, The European Interest: Succeeding in the age of globalization, Brussels, 3 October 2007, p. 3.

Promoting investment. The EU is, after the US, the second most important source of foreign direct investment. As *Global Europe* puts it: 'Establishing a "physical presence" in a foreign country helps EU companies realise business opportunities, makes the flow of trade more predictable, and consolidates the image and reputation of the firm and of the country of origin'.[7] Following the defeat of earlier attempts by the EU, together with the US, to achieve a highly-liberal investment code, first through the OECD's Multilateral Agreement on Investment, and then as part of the so-called Singapore issues at the WTO, both countries have now turned to bilateral FTAs as a means of opening developing countries to their direct investment. So far, the EU has concluded FTAs with Mexico, Chile, South Africa, Tunisia, Morocco, Egypt, Turkey and Lebanon. These agreements all involve commitments to substantial liberalisation of FDI by the developing countries concerned, often in return for very limited concessions by the EU.[8]

For the EU, trade agreements are seen not only a way of gaining access to foreign markets, but also as a means to guarantee the property rights of EU companies and to facilitate their operations in other countries through the creation of regulatory environments which eliminate burdensome rules and regulations. This approach is explicitly aimed at reducing the room for policy discretion in the partner countries. *Global Europe* states quite bluntly: "The EU has a strategic interest in developing international rules and cooperation on competition policies to ensure European firms do not suffer in third countries from unreasonable subsidisation of local companies or anti-competitive policies".[9] In this way, policy initiatives that could have a detrimental effect on EU companies are to be curtailed, and kept to a minimum through provisions that effectively place national policy makers in a straitjacket.

This approach must be challenged. Firstly, it is based on an uncritical identification of European interests with the interests of EU-based multinationals. Secondly, investment in developing countries has often been associated with the privatisation of public services, leading to the introduction of a commercial logic and price rises, and thereby undermining important instruments of redistribution. Thirdly, by aligning itself with the US government's approach to investment, the EU is supporting the perpetuation of a mono-polar world, rather than lending its weight to the emergence of a multi-polar world, in which China, India and other emerging economies will play an increasing role in shaping international economic rules.

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[7] Global Europe, p. 8.

[8] 'Signing away the future: How trade and investment agreements between rich and poor countries undermine development', Oxfam Briefing Report, March 2007.

[9] Global Europe, p. 8.

Economic Partnership Agreements: The EU places a high value on its contribution to development cooperation. In *Global Europe,* however, it says that while current bilateral agreements support development objectives well, the EU's trade interests have been less well served. Despite protestations that it is not pursing a commercial agenda in the Economic Partnership Agreements (EPAs) being negotiated with the African, Caribbean and Pacific countries, the EU has been concerned to achieve a greater opening of markets to European exports, the main difference being that such agreements are sweetened by the promise of development aid. The EU is also keenly aware of Europe's dependence on imports of raw materials, and the need to ensure access to these. In a throwback to the classic age of imperialism, Africa has become something of a geo-strategic hot spot, where the EU and the US now also face rivalry from China in securing access to strategic raw materials, and more generally of establishing zones of politico-economic influence.

Economic and financial vulnerability. A key weakness of the externally oriented model being promoted by the EU is its heightened vulnerability to an international economic downturn. The global economy is currently driven by an axis between the US, with its huge current account deficit, and the Asian exporters, who have been acquiring ever-increasing quantities of US-dollar denominated financial assets. The US can, however, not continue to run a deficit on this scale indefinitely, and if China continues to restructure it's huge foreign currency reserves this would have a further destabilising impact on the US economy. Europe – as other parts of the world – remain vulnerable to a reduction of US demand, and a weakening of the dollar.

The vulnerability of the EU economy was emphasised by the speed with which the fall-out from the US financial crisis in August-September was transmitted to European financial institutions. The EU bears a responsibility for this because its policy of promoting the creation of a deregulated US-style market-based system of finance has made European financial institutions more vulnerable to such a crisis. Competitive pressure encouraged European financial institutions to invest in riskier, higher-yielding assets in an attempt to achieve US-style rates of return. At all events, the EU now faces a cyclical weakening of external demand as US growth slows in response to tighter credit markets in North America. At the same time, demand is also likely to weaken within Europe as banks respond to the crisis by reigning in the supply of domestic credit.

As the Federal Reserve responded to the crisis by lowering its lead interest rate, this led – predictably – to a further weakening of the dollar. The corresponding rise in the value of the euro to its highest level since being introduced highlights the paucity of the EU's exchange-rate policy. In contrast to the Japanese government, which has continually sought a more co-operative international approach, the European authorities have abnegated responsibility for exchange-rate policy, leaving the exchange rate to be determined by the short-term calculations of private financial investors. To that extent that policy decisions are able to influence investors' calculations, the EU is, in effect, leaving the US central bank to determine the value of the euro.

Stronger military ambitions. Greater economic assertiveness has also been followed by a concern to strengthen the EU's military capabilities. It seems that these ambitions are based on an agenda which is wider than the mere involvement in humanitarian and rescue tasks, peacekeeping and crisis management, including the deployment of combat troops in peacekeeping. An indicator of this is the famous paper by Javier Solana which was adopted by the European Council in 2003. Globalisation the paper argues, has increased Europe's external dependence and its vulnerability to threats from abroad, like nuclear proliferation, terrorism and 'failed states'. It concludes from this that: " With the new threats, the first line of defence will often be abroad."[10] And when it turns to the policy implications it states: "We need to be able to act before countries around us deteriorate … Preventive engagement can avoid more serious problems in the future".

2.6. Too little action behind the rhetoric - Climate and energy policies

The need for a joint European energy strategy became obvious already during the first oil shock of 1973, and the need to combine a European energy policy with a climate strategy at the latest with the 'Earth Summit' of 1992 in Rio de Janeiro. At Rio de Janeiro the EU and its major member states had taken commitments for the reduction of CO2 emissions – thereby establishing a direct link between its climate policy and its energy policy. But this has not been followed by the formulation and adoption of a joint strategy. European energy policies have continued to be different between member countries. Their European dimension has *de facto* been merged with the project of the single market, based on the neo-liberal promise that,

[10] A secure Europe in a better world, Brussels, December 2003.

in the long run, market opening would solve all problems. The main content of European energy policy has therefore been the opening up of energy markets and often the privatisation of state-owned energy corporations.

After the short crisis around Russia's stopping the flow of gas into both Ukraine and Belarus, which serve as transit states to the EU, the European institutions have again undertaken a number of initiatives for a common energy policy, like the *Green Paper* of March 2006 or the European Energy plan of April 2006 with the priority aim to secure the provision of energy. But in spite of resounding statements and ambitions no clear and binding plans were adopted.

Recently the efforts of the European Commission to launch a common and co-ordinated European energy policy resulted in the presentation of an ***"integrated energy and climate change package"*** (January 2007**).** In this document a number of projects were announced: the preparation of a *European Charter on the Rights of Energy Consumers*; the appointment of European coordinators for key energy projects; the publication of TEN-E guidelines; the organisation of "structured international dialogues" The package also included actions to raise public awareness like a renewable energy roadmap or a sustainable energy week. There still is, however, a central contradiction even in these limited actions: As the Commission puts competitiveness, supply security and sustainability on the same footing, without any indication on how to decide in cases of conflicts between these objectives, there is a strong tendency that the objective of competitiveness will dominate in all concrete decisions, relegating the other two objectives to a secondary role. This corresponds to the observation that the only area in which effective action is being taken by the Commission to enforce member state compliance is the infringement procedures against member states which have failed to open their energy markets 'properly'.
The European Council on 9 March 2007 in principle has backed the Commission proposals on energy and climate change, and agreed on an action plan to put in place a European energy policy by year 2009. But the steps forwards achieved in the following areas have been riddled by loopholes and indecisions:

- *Greenhouse-gas reduction*: A binding target has been laid down to reduce EU emissions by 20% by 2020, regardless of progress in international negotiations for a post-Kyoto agreement, and a binding 30% target was envisaged in case other industrialised nations including the US

take similar steps. This has not been concretised, however, by at least defining a mechanism translating this general commitment into specific obligations for each member state;

- *Renewable energies*: Again a binding target has been agreed to have 20% of the EU's overall energy consumption coming from renewables by 2020, including the specific commitment to a (problematic) binding minimum target for each member state to achieve at least 10% of their transport fuel consumption from biofuels. - *Energy efficiency*: a relatively bold objective - saving 20% of the EU's energy consumption compared to projections for 2020 – has been laid down as a binding target. At the same time the specific proposals for implementation which the Commission is required to make during the next years are targeting relatively limited fields of action, like increased energy savings from office and street lighting.

At the same time, the summit rejected the proposals made by the Commission in the direction of an even further increased marketisation of the area. It limited itself to underlining the existing commitments, i.e. referring to "full implementation of the letter and spirit" of existing legislation as a "first step" before going further with more radical options.

There are, in fact, some positive elements in the EU energy and climate strategy which would deserve to be strongly expanded and further improved, particularly with regard to effective energy use. This is true for encouraging the use of truly renewable energy sources, and for policies of supporting and stimulating energy saving

On the other hand in the transport sector the EU Strategy for reducing CO2 emissions of cars is still in the stage of a consultation procedure The third legislative package on the EU Electricity & Gas markets (September 2007) is still exclusively geared to market opening 'liberalisation'.

Another clearly negative element is the direction of important investments to dangerous, illusionary and strategically counter-productive options which should not be included into a sustainable European energy strategy – the nuclear option (including fusion), the coal and lignite option, and the option of first generation biological fuels:

- The nuclear option cannot be considered sustainable: It is either based on limited uranium supplies which are estimated to last for a maximum of another 40 years, or it is linked to a

plutonium cycle which is inseparable from nuclear weapons production – and, in any case, there is no solution to the problems of high risk and of waste storage over some 10,000 years.

- The coal and lignite option is less evident in the public debate – because of its all too visible side-effects in the climatic dimension. Yet it has not entirely dropped out of the European energy policy mix, due to its strong traditional positions inherited from the ECCS.

- The bio-fuel option is strongly championed by EU policies, internally as well as in international fora and in bilateral agreements. This is, however, not a step towards sustainable development – for first generation bio-fuels have two main downsides: on the one hand, they are not climate neutral, as it is claimed. On the other hand, they do compete directly for fertile soils with food production, thereby exacerbating rural poverty and food shortages in the areas concerned.

Part 3:

Stability, solidarity and cooperation –Alternatives for economic and social policies

In this part we present our proposals for alternative European economic and social policies, starting with immediate and medium-term measures to restrict financial speculation and restore financial stability. The range of policies for full employment, solidarity and sustainability include a strengthening and full recognition of public services as a second basic pillar of the European Social Model, as well as a more energetic use of macroeconomic policy instruments to stimulate sustainable development. We propose specific measures to eliminate poverty in the EU and other steps to shift to a new pattern of energy use. In our proposal for international economic relations we propose the transition to a regime of peaceful cooperation, fair trade and efficient development aid.

3.1. Limits for speculation and financial investor pressure - Policies against financial crises

To deal with financial crises policies should be developed on three levels. Firstly, they should draw lessons from the recent events and the concrete mechanisms which led to the build-up and international proliferation of the current financial crisis. On the second level they should envisage further reaching and preventive measures to stabilise the international financial system and democratise its central institutions. On the third level they should address the non-financial causes for the pressures and recurrent disruptions in the financial system.

With regard to the ***first level*** the analysis of the current crisis has shown, that lack of transparency, securitisation and trading of loan packages, highly leveraged financial investment and the failure of rating agencies have contributed to its outbreak. Therefore the following policy responses should be given:

- ***Banks and non-bank financial institutions alike*** should be required to give full information to the supervisory authorities about their engagements and risk exposures.
- Mutual information and ***cooperation of supervisory bodies*** must be enhanced on the global and on the European level. The set-up of a financial market supervising agency on the European level for all financial institutions with international activities should be considered.
- ***Rating agencies*** should be put under much stronger public control. Particularly conflicts of interests should be avoided through the provision that a rating agency may not assess the quality of financial activities of an institution which is at the same time financing this agency. The set-up of independent public rating agencies should be envisaged. They could be financed out of a pool of contributions from financial institutions.

- The securitisation of loans and ***trading of loan packages*** is in the first place a means to circumvent capital requirements and extend borrowing activities beyond the limits set by the Basle framework. They should be either forbidden or required to obtain formal approval from the supervisory agencies. The risk and the corresponding capital requirement should in any case remain in the books of the selling bank.
- The current situation has been much aggravated through the use of ***high leverage*** to finance the purchase of loan packages or other financial investment and take-overs. This happened in an environment not of scarcity but of abundance of capital and contributed to enhance the excess of liquidity on the financial markets. Such techniques should be severely restricted, either by imposing legal limits to the degree of leverage for the debtor side or by imposing much higher capital requirements for such loans on the lending banks.

On the ***second level*** the stability of the international financial system should be promoted by the following measures:
- ***Offshore centres*** (OFC) which are because of their lack of efficient financial supervision a particular threat to financial stability must be treated in a much more restrictive way. This should include OFC within national territories like Delaware or the City of London as well as territories outside the legislative reach of EU member countries. In the latter cases policy should restrict national institutions to do business with these OFC.
- The ***International Monetary Fund***, which is in permanent crisis of legitimacy for more than ten years, should be thoroughly reformed to serve as a pillar of a democratic financial architecture. This requires a new distribution of voting power in the Fund and a new stability and cooperation oriented monetary policy.
- An important step towards a stable financial order is the orderly ***management of exchange rates*** through continuous cooperation between the US, the EU, Japan, China, Brazil, and a number of other countries. The IMF could play an important role in facilitating and monitoring such exchange rate cooperation. Amongst the instruments to prevent short-term currency flows with disruptive effects on exchange rates a flexible ***currency transaction tax*** should be introduced.

On the ***third level*** the non-financial market roots of financial crises are addressed, which are located in the strong redistribution of income and the expansion of private pension funds:

- Policies for a ***more egalitarian distribution of income and wealth*** would take much of the steam and pressure out of the financial system. While a policy for higher wages is basically a challenge for trade unions, such redistribution from the top to the bottom can also be organised by governments through decent minimum wages and incomes and through a much stronger taxation of capital gains, corporate profits and high personal income and wealth.
- The steady expansion of ***private pension funds*** and the shift in many countries from public pay-as-you-go to capital funded pension systems is one of the major reasons for the accumulation of profit-seeking financial assets. Since such private pension funds are less reliable, less comprehensive and much more expensive than PAYGO system, their further expansion should be stopped wherever possible. The supervision of existing capital funded systems should be tightened. Particularly all current plans within the Commission to loosen pension funds investment rules and to force member states to do the same, should be strictly rejected. Instead rules for pension funds on the European level should be reformulated so as to prohibit any engagement in risky financial instruments.
- Lastly the wave of privatisation of banks in the 1990s has triggered competition without clear rules and thus contributed to financial instability. Therefore it is important to retain a certain ***base of public financial institutions*** with democratic governance and clear economic and social missions on the national, regional and local level

3.2. Policies for full employment, solidarity and sustainability

3.2.1. Alternative to the dominance of markets – strong and democratic public services

The thrust for deregulation projects currently underway will not be stopped or reverted through reflection and critical self-revision from the side of the Commission and most member states. Continuing and rising awareness and resistance will be necessary to preserve and revitalise the essence, enhance the reach and public participation and also to modernise and democratise the organisation of public services in the EU. Experience shows that local and regional initiatives and movements are of crucial importance as conditions for success. But it is also necessary to act and develop movements and alternative proposals on the European level. Three approaches are possible: sector specific regulations, a general framework directive and a new foundation of public services outside the competition framework.

Sector-specific approaches. This concept takes up the approach of the Commission for network services (telecommunications, electricity, gas railways etc.) for which European liberalisation has been accompanied by the formulation and imposition of "universal service obligations", either by national or European legislation. For already liberalised sectors these obligations could be tightened, their implementation could be more strictly and efficiently enforced. However, the experience with network services is not encouraging and perspectives are even less so. With rising power and dominance of financial investors privatised corporations will find it increasingly difficult to fulfil public service obligations. Therefore the expansion of European regulations to new ***network sectors*** cannot be really recommended. The alternative should be democratic re-organisation of public sector networks and infrastructures. For other sectors like ***health care and social services*** the question is whether such EU-wide regulations are necessary and how far they should go. Health care and social services are in a broad majority services which are supplied and consumed locally. Instead of the introduction of competition in health care (and this applies to other social services, too) European action should be developed on four levels:

- The *first* and most important level is the promotion of sufficient ***high quality health care in each country and region.*** Minimum standards (e.g.. number of doctors for 10 000 persons) should be defined and assistance given from the EU for their achievement.

- A *second* mission would be to ensure that residents of one member country A who are in country B and need (occasional or hospital) medical treatment get it in country B, at terms corresponding to his or her country of origin.
- A *third* perspective is the close *cooperation in border regions*.
- The *fourth* reasonable European activity in health care is the extension of already existing *European reference centres* for the treatment of very rare diseases and to guarantee equal access for all residents in the EU to these. In this context also common European medical research centres are to be recommended.

While European activities relating to point 1 are missing and should be energetically addressed coordination in areas of points 2 , 3 and 4 takes place on the basis of a EU regulation (883/2004), which could be further expanded and improved. The essential point here is, that health care is not a matter of the internal market (where freedom of services and competition prevail) but a service with a special value in itself.

A European Framework directive on services of general (economic) interest. The European Trade Union Congress (ETUC) and other civil society groups have demanded the insertion of an overarching framework directive for services of general (economic) interest. ETUC has also in spring 2007 started a "campaign for high-quality public services, accessible to all".

The conception behind these initiatives is to be welcomed and should be strongly supported. It contains a definite perspective for shifting regulatory requirements more to the improvement of the quality of network and infrastructure services and the employment conditions. Here, the reconciliation between public interest and internal market seems possible to a certain degree – although under existing law there is a clear hierarchy in favour of the latter.

Problems arise when it comes to non-economic services like health and social services. The current Treaty contains no provisions for services of general interest but only services of general *economic* interest. The negotiations on the Reform Treaty have missed the opportunity to correct this inappropriate and biased approach. Therefore the attempt to integrate public services into the existing (and the future Reform) Treaty is always under threat to be captured by and subordinated under the rules of internal market access and competition, and this threat is enhanced through the jurisdiction of the ECJ.

Public services as new pillar for EU. To give public services a stronger place in the European Social Model without subordinating them to the dominance of market and competition rules it seems therefore necessary to establish them as a genuine pillar of its own weight

corresponding to and of equal importance as private enterprises, markets and competition. The most comprehensive perspective would be if public services – economic and non-economic ones – which are defined after political discussion by parliaments and governments on all (national, regional, local) levels would then be exempted from the internal market and competition rules and put under the umbrella of "public services rules". While public services are essentially a matter of member states regulation there remains ample room for a European perspective which is necessary to avoid regression to national isolationism and chauvinism and to benefit from the social, economic and cultural potential of the continent. Such European perspectives could be:

- enhanced and improved cross-border *cooperation* between existing public service structures; the model for this is the existing cooperation in health care services,
- formulation of certain *minimum standards* for public services, particularly social services, anti-poverty strategies, pension systems, education etc.; this should be substantiated through financial assistance to member countries to fulfil these standards,
- joint planning and implementation of large *European education, research and infrastructure projects* which are financed through member states, the European budget, and EU bonds.

3.2.2. More active use of macroeconomic policy tools

The EU economy as a whole and most member states rely heavily on domestic demand. If this is weak, the economy cannot be expected to do better. This simple fact seems to evade the present EU policy makers. This is not a mere omission of policy, rather, it is a question of political orientation. As the share of wages in total income falls, that of profit rises. Thus, a weak labour market is preferred by the EU political elites, as opposed to a strong labour market.

The EuroMemorandum Group has long argued for macroeconomic policies that promote sustainable development and full employment. Such policies include the following guidelines and proposals:

- ***Monetary policy*** should be accommodating and closely linked to the overall framework of economic and social policy, and it should become democratically accountable. In the current situation the ECB should lower the rate to stimulate productive investment and employment, while at the same time it should promote a tighter supervisory framework for financial institutions to prevent purely speculative and risky financial behaviour.

- The EU should accept the perspective of ***exchange rate policy*** (for which the Council is in the last instance responsible) as an instrument to deal in an orderly way with the worldwide macroeconomic imbalances, which have led to a strong appreciation of the Euro against the dollar and thus also against the Chinese Renminbi. While unilateral steps should be regarded as very last emergency measures and are currently not recommended, the EU should make strong efforts to reach cooperative arrangements with China and the US to bring exchange rates more in line with the basic economic relationships.

- The very rigid arithmetic rules guiding ***fiscal policy*** across the 27 member states should be abolished. Fiscal policy needs to adjust to and serve the goals of economic and social policy, rather than the other way around. Under current circumstances this requires a shift from the priority on debt and deficit reduction towards a more expansionary course to offset the negative impact of the financial crisis upon the European economy. Member states should be encouraged to step up their public investment programs for better infrastructure, ecological restructuring and repair, healthcare and education according to their specific needs. Such programs should be complemented by joint European research, development and infrastructure projects.

- The ***public sector*** must be given back its role as the guarantor of social welfare and also of macroeconomic stability. It should be upgraded, modernized and reshaped in a transparent and democratic way. The provision of public services is much more than an economic issue. It is the very substance that holds European societies together and a necessary pillar of the often invoked European Social Model. Under the current circumstances the EU should refrain from initiatives to liberalize public services and integrate them into the internal market and competition framework.

- To ***finance*** the stimulation of sustainable growth and strong public services the EU should on the one hand set an end to tax competition by developing a common tax base and a minimum rate for corporate profits (at 40% in general and 30% for poorer countries), interest and dividend income and capital gains. On the other hand the necessary increase in the budget of the EU should be financed through a new progressive GDP-per-capita based revenue and through financial market transaction taxes. Temporary additional expenditures to counter

recessions and to finance long-term projects should be financed via loans; on the EU level such loans should be extended by the European Investment Bank.

- One indispensable tool to stimulate sustainable development is also a considerable ***reduction of individual working times***. This objective should be included into the European employment guidelines, and implementation should be organised in different forms according to traditions and priorities of member countries. At the same time it should be ensured that reduction of working time must not lead to a deterioration of working conditions and social benefits.

- ***Social policy*** needs to be upgraded and included in the overall EU policy framework in its own right, rather than being subjugated to the dictates of such rigid rules as those set by the Stability Pact and the ECB. Social policy has also a role in an overall macroeconomic policy mix, when it provides the weaker parts of societies with necessary means for their living and thus supports private consumption as the main component of aggregate demand. Social cuts must be stopped and expenditure to fight poverty and exclusion needs to be increased.

- The EU's ***trade relations*** with the rest of the world and especially with poorer countries need to be based on mutual respect for the integrity and well-being of all partners concerned. Such relations must be equitable and development-friendly (see section 3.3.).

3.2.3 End "flexploitation" – Promote full employment with "good work"

We call on the European Council to abandon the "flexicurity agenda" and instead to embark on the "good work agenda" contained in the conclusions of the informal Council of Labour Ministers in Berlin on 19 January 2007: *"GOOD WORK means employee rights and participation, fair wages, protection of safety and health at work as well as a family friendly work organisation. Good and fair working conditions as well as an appropriate social protection are indispensable for the acceptance of the European Union by its citizens."* We welcome this approach and at the same time propose that it should be broadened. The "good work" agenda should encompass the ILO minimum labour standards and, going beyond these, aim at social sustainability in all its aspects. It demands shaping working conditions in a way that the quality of employment is improved and that preventive and participation-oriented health and safety regulations at work create an environment which enables workers to stay fit

and healthy during and beyond their working age. The "good work" agenda furthermore must aim at developing the personality and competences of workers on the basis of enhanced participation rights and rights to education, further education, training and lifelong learning, also by way of strengthening collective co-determination rights. It aims at defending and renewing the standard employment relationship, based on a core of equal workers rights, a high level of job and employment protection and working conditions, the right to strike, collective action and collective bargaining, a high level of social protection and decent remuneration, and full-time employment as the norm. This also includes establishing norms for part-time employment, so that only substantiated and socially protected part-time work (15 - 25 hours weekly) will be offered to those who wish to work part-time.

Good work requires adequate ***remuneration*** ("a living wage"). Therefore, the EU and the Member States must commit themselves to phasing out all forms of precarious employment by abolishing existing incentives (in-work benefits, tax and social security breaks) for marginal atypical forms of employment or for employment in the low wage sector. An instrument for this purpose could be a system of progressively rising social security contributions (or taxation) of employers, according to the principle 'the lower the employment status (short period, weak perspectives, high risks), the higher contributions to social security'.

Against the background of increased labour mobility as a result of the freedom to provide goods and services in the internal market, there is an urgent need for a ***European minimum wage policy***. The aim of such a policy is to halt the spread of poverty-level wages as well as preventing the menace of cross-border wage dumping, a phenomenon to which the low-wage sector is particularly vulnerable. A European minimum wage policy would also tend to narrow wage differentials between men and women and improve the quality and productivity of work. Finally, regarding its macroeconomic function, a European minimum wage policy would contribute significantly to stabilising private demand and serve as a buffer against deflationary tendencies. We propose that the EU urges member states to introduce national minimum wages which correspond at least to 60% of the median average wage.

There is as well an urgent need for work organisation and ***working time*** organisation to support the reconciliation of employment and personal life for women and men. The latter needs a commitment to the project of a new European working time standard aiming at shorter full-time employment for all. The EU must establish a clear limitation of the

maximum working week at EU level (down from the present norm of 48 hours per week to 40 hours in a first step, abolishing all present derogations and loopholes of the existing EU working time directive), which would provide member states with an incentive for working time reduction at the national level. With regard to the present debate on the revision of the EU working time directive, we insist on three demands:

- the provisions on applying individual and sector-specific opt outs from the maximum weekly working time provided for by the directive must be completely abolished,
- the ECJ case law must be fully implemented and integrated into the directive (on-call time spent at the workplace must be regarded as working time, compensatory rest must be granted immediately after time spent on duty),
- any lowering of the level of protection granted by the existing directive must be blocked (this mainly concerns flexible annualized hours, introduction of 'inactive part of on-call time etc.).

3.2.4. Minimum standards and European transfers - Anti-poverty policy

The persistence and even rise of poverty in the EU in spite of the relatively favourable overall economic development is a scandal which must be addressed as a challenge with very high priority. Of course the most important way to overcome mass poverty and social exclusion is the creation of decent and well paid jobs alongside with the provision of high quality social services and adequate standards for a minimum income at all levels.

Therefore a macroeconomic strategy for full employment through public investment, working time reduction and extension of public employment is in the long run the indispensable basis for overcoming poverty in the EU. Such a strategy must not exclusively be directed at a high number of jobs but also target their quality: the recent rise in precarious work conditions with low remuneration, a lack of work protection involuntary part-time contracts etc. is the main reason for the increase in the number of working poor in an environment of economic growth. European anti-poverty policies must go beyond stocktaking, declarations and appeals and have to limit and roll back the wave of precarisation in labour relations. Furthermore every effort should be taken to include those furthest to the labour market (migrants, lone parents, people with disabilities, long term unemployed) and to reconcile employment policies with care policies which safeguard the necessary care for children, sick persons and the elderly.

The political will to eradicate poverty has to be reflected in the EU's strategy on growth and jobs (Lisbon strategy) and consequently in the Integrated Guidelines that are shaping this strategy. Moreover, the EU should define minimum standards in labour relations including setting minimum wages, work protection, maximum working times and related issues, as well as minimum standards for social income and access to high quality social services. Such standards should be different for different countries depending on the level of economic development of member countries. There is almost universal agreement that the high level of child poverty is one of the biggest scandals in many countries in the EU, destroying the moral quality and the economic and social future of society. At the same time some member states like Sweden and Denmark have demonstrated that it is possible to keep child poverty at considerably low levels. Going beyond pure reporting exercises the EU should set a strong target for every member state to visibly reduce the rate of child poverty, set minimum standards and to introduce mechanisms of consultation, assistance and sanctions to reach this objective. Such mechanism of monitoring and enforcing the abolition of child poverty and other binding coordination instruments in the fight against poverty certainly make much more sense than the hitherto coordination mechanism imposed by the Stability and Growth Pact.

The high poverty rate of the elderly must also be a matter of special concern and activity for the EU. An effective countermeasure against old-age poverty is the introduction of a general guaranteed minimum pension for those whose working time earnings were so low that their pensions are not sufficient to prevent poverty. The resources necessary to bring factual pensions upon an above poverty level should be financed partly through public budgets for PAYGO systems; in capital funded system they should come from a fund financed through contributions of private pension funds.

Beyond such specific measures it should be the general policy of the EU to require member countries to strengthen their anti-poverty policies and to define minimum amounts of resources in each country, which are necessary to lead an independent life for individuals and households. Such standards should not be lower then 60% of the mean individual or household income and they should be raised in a process of upwards convergence. Minimum standards do not only relate to income and monetary benefits but also have to reflect costs of necessary expenditure, such as housing and food and to the free access to a broad range of social and cultural services from which people experiencing poverty are often excluded. Access to public goods, such as water, energy etc. has to be safeguarded.

A priority for anti-poverty policies has to be reflected in the overall economic and financial framework of the Union and certainly must not be contradicted by them. As most of the anti-poverty measures will have to be funded by the member states, they must shape their public budgets accordingly and measures have to be taken to end the harmful tax competition. It is noteworthy that those countries in the EU which have the lowest rates of poverty and particularly child poverty have at the same time the highest share of tax revenue. The fight against poverty can be won, but, although it is not exclusively a matter of money, it costs money. Governments must be prepared to recognise this fact and increase their anti-poverty budgets accordingly.

Anti-poverty policy on the EU-level should not exclusively consist in initiatives to encourage and stimulate member states to become active. We propose that the EU should and could dampen the destroying effects of poverty upon the individual and the society through monetary transfers. We therefore repeat our proposal that the EU makes a payment of 20€ per month to each of the ca. 80 million poor persons in the Union, and that this amount should be increased by 10 Euro each year until it reaches the level of 50 euro. This would cost € 17.3 bn. in the first year, and to finance this and the rising amounts for the subsequent years an increase in the European budget appears indispensable. Such a relatively moderate anti-poverty transfer from the EU would improve the living conditions of the poor in the EU in a very visible and tangible way, it would limit social exclusion and soften the otherwise growing disparities within the Union. It would be understood that the EU is not a project of the elites for the elites but concerned with the welfare of all people.

3.2.5. Focus on energy saving and renewables – Climate and energy policies

An alternative internal strategy in the area of the energy and climate policies of the EU and its member states could start by addressing two priorities: It should make an ambitious push forward in the fields of renewable energy sources, thereby securing first-mover advantages for the EU, and it should address the challenges of energy saving strategies which would not lead to any reduction of human well-being (cf. Euro-Memo 2006). The long-term perspective should be to reduce the energy inputs required to meet human needs, and to provide these inputs fully from renewable energy sources, especially solar energy.

An improvement of the European emission trading system would be required for reaching these objectives. In order to win some additional time for the implementation of such a

strategy, reforestation programmes in Europe would be helpful. The internal alternatives in EU policies should be connected with a corresponding shift to a co-operative strategy, especially with Eastern Europe (including Russia and the Caspian region) and with Africa.

On this basis, a three-pronged strategic approach can be elaborated and implemented within the EU which combines energy saving with a transition to renewable energy sources and an improved European system of emission permit trading:

Energy saving should start by
- avoiding unnecessary transport (by changing urban planning towards car-free cities, specifically addressing the gendered requirements of transportation in order to avoid imposed private car use, and by increasing transportation costs, in order to prevent transportation based on marginal price differentials from taking place);
- switching to less energy intensive modes of transportation (investment programmes for the shifting of freight transport from road to rail or waterways, limiting car traffic and velocity in urban areas and generally reducing the average speed and weight of vehicles in order to achieve gains in energy efficiency and reductions in the emission of greenhouse gases);
- avoiding energy waste (distribution systems, stand-by, eliminating older, energy wasting appliances),
- accelerating the introduction of low energy housing (investment support programmes and tax incentives, with the main objective of upgrading the stock of housing to a high standard);
- accelerating the introduction of lower energy appliances in industry and in households (R&D programmes, tax incentives, top-runner approach).

A transition to renewable energies sources could be accelerated by:
- supporting the introduction of renewable energies by giving them priority in all public procurement (binding all public agencies to climate and energy objectives, with quality criteria in particular for biomass) and by creating immediate incentives for the production and use of the respective energy interfaces (public investment programmes and tax benefits for introducing elements of a new energy system based on truly renewable energy sources),
- creating taxation advantages (combined CO_2 emission and energy use taxation, reduced VAT for products with very high energy efficiency and very low climate gas emissions) and introducing subsidies (especially supporting the introduction of truly renewable energy

sources, guaranteeing prices for energy supply from renewable sources for a transition period) for the production and use of renewable energies,
- imposing tax disadvantages on fossil energy sources.

The European system of emission permit trading should be applied more rigorously,
- with permissions auctioned and the cappings reduced,
- with very ambitious reduction targets, automatically reducing the quantities permitted on a yearly basis,
- with a strict limitation to intra-EU trading and trading with countries with similar trading systems and enforcement and monitoring mechanisms (like California), closing all loopholes towards shifting the reductions to developing countries,
- with strict supervision by a European Energy Agency capable of effectively controlling target implementation, and – if needed – imposing additional rules.

These actions should be accompanied by programmes guaranteeing the supply for basic energetic needs for all residents in the EU, in order to avoid side-effects of social disruption or polarisation. In order to avoid a decoupling of the new member states from such a common strategy special programmes should be developed and implemented to increase their capacity for an energetic self-reliance compatible with a strategy of sustainable energy supplies, i.e. overcoming their dependence on nuclear energy and coal by rapidly enhancing their potential for energy saving and for expanding the use of renewable energy sources.
Such a strategic approach requires a conscious embedding of European policies on energy and climate in a deepening and an effective implementation of the EU Sustainable Development Strategy (SDS) (cf. Euro-Memo 2006).

3.3. Fair trade, development aid and peaceful relations – Global perspectives for the EU

The principal aim of an alternative external policy should be to promote a fundamental transition towards a model of sustainable global development, in which overcoming the mass poverty in developing countries is the greatest priority, and where international relations are guided by long-term cooperation based on mutual interests and a peaceful negotiation of conflicts. The realisation of the Millennium Development Goals must be the central orientation for responsible external policy in relation to developing countries. So a

moratorium of all negotiations which don't respond to the MDG agreement would be logical The following specific proposals seek to further this aim:

Trade. In order to reduce Europe's vulnerability to a downturn in the US, and the longer-term fallout from a major readjustment of the US's external demand, the EU should fundamentally re-direct its macroeconomic policy mix so as to foster internal demand. This would serve, not only to stabilise economic development in Europe, but also to contribute to eliminating global macroeconomic imbalances in a way that avoids a severe systemic crisis.

As part of such a reorientation, the EU should completely revise its aggressive bilateral trade strategy, above all in relation to emerging and developing countries. Instead, the EU should shift towards a fair trade agenda. The contradictory aims of trade and development policy should be overcome by explicitly taking account of the social, and in particular gender impact of trade policies on developing countries to this end, the following measures should be taken:

- Sustainability Impact Assessments of EU Trade Policy must explicitly include a system of indicators that assess the social impact of trade policies, and this should give particular attention to the gender impact of trade in so far as it affects both paid and unpaid areas of work.
- All requirements that would result in a serious restriction on national policy making in less-developed countries should be withdrawn. This applies in particular to the liberalisation of investment conditions, the opening up of markets in services and government procurement, and the protection of intellectual property rights.
- Trade relations with less developed countries should be guided by the principal of non-reciprocity. The scope of 'special and differential treatment' has been curtailed, and now only involves exempting a small number of products from tariff reductions, and granting longer transition periods for the implementation of free market access. This might spread the adjustment costs of trade liberalisation over a longer period, but it does not contribute to promoting sustainable development in these countries. The EU must seek a means of maintaining non-reciprocity in trade policies with less-developed countries on a *de facto* basis, even if this is formally not compatible with WTO law.
- Specific measures that strengthen countries' ability to fulfil universal human rights, and to promote environmental and social minimum standards, should be introduced in bilateral trade agreements. A first step has been taken with the EU's recently reformed GSP-Plus regime,

which allows duty-free access to European markets for certain countries that have ratified international conventions on human and labour rights, governance and environmental protection. A more developed system should facilitate the transition to an approach which implements minimum standards. A further step would be to establish an appropriate system of monitoring and control, which, in the case of violations, provides institutionalized mechanism for consultation and mediation, but which, in the case of persistent and severe violations, also contains the possibility of invoking trade sanctions.

- The deadline for the negotiations between the EU and the Africa, Caribbean and Pacific (ACP) countries should be extended, as it will be impossible to complete these by 1 January 2008. While these negotiations continue, the EU must continue to grant ACP countries the trade preferences which were agreed in 2000 under the terms of the Cotonou Agreement.
- More generally, bilateral agreements like the Economic Partnership Agreements, which divide countries into groups on a regional basis, should be abandoned in favour of multilateral agreements, in which a common basis is established for negotiating relations with all the countries concerned.

Banking and financial markets. The internationalisation of banking and financial markets has been highlighted by the impact in Europe of the US sub-prime mortgage crisis. The vulnerability of the financial system to such a crisis reflects the highly deregulated approach which has been achieved as a result of persistent pressure from financial institutions. Alternatives to the subordination of financial markets to the interests of financial investors should aim at the following:

- The risks of financial investment should be controlled through, for example, limiting the leverage of private equity funds and hedge funds; introducing higher capital requirements for banks' investment in private equity funds and hedge funds; and prohibiting or strongly limiting the securitisation and sale of bank loans.
- Social security systems should be protected from financial market risks. Where such systems are not public PAYGO-systems but capital funded, the associated investments should be strictly separated from all risky investment holdings. Pension funds and insurance should not be allowed to invest in private equity and hedge funds.
- Employees and firms should be protected from being exploited and plundered by short-term investors. This could be done by linking voting rights to a minimum holding period for shares (for example one year) and through enhancing employees' rights in the management of the firm.

- Sources of public financing should be enhanced, in particular for small and medium firms.
- Public development banks should be employed to support and implement national and European economic policy orientations based on public discussion and democratic political decisions. At the same time, they should be restricted from engaging in risky international financial transactions. Public banks should not be global investment banks or securities traders.

The bottom line of a sustainable alternative approach to European financial markets is monetary, fiscal and tax policies which stimulate employment and prevent the accumulation of financial assets for which there are no productive investment opportunities.

The Euro. The current international monetary order benefits private financial institutions, in particular the big banks, which have profited from the huge business in foreign currency transactions, and in the various hedges against exchange rate instability. The uncertainty associated with exchange-rate instability has a negative impact on trade and investment, not only for the European economy, but also for developing countries. The main points of an EU currency policy should include the following:

- The Council of Ministers should take its responsibility for exchange-rate policy seriously, and cease to hide behind the notion that leaving the exchange rate to the market will yield an optimal result.
- Co-ordinated intervention in the currency markets should be mounted in order to penalise private traders and demonstrate that there is a downside risk to taking large positions against a currency.
- As a matter of urgency, the EU should push for the establishment of agreed bands within which the movement of the principal exchange rates will be restricted.
- The EU should seek to build support for the creation of new international monetary system based on a truly international reserve currency.

Sustainability. One major strategic objective of the external policies of the EU should be to contribute to worldwide climate protection and particularly to the reduction of greenhouse emissions. This objective must on the one hand be pursued through international negotiations aiming at binding international commitments and on the other hand through international assistance in the development of renewable energy sources and methods for energy saving. A key to success will be convincing the USA, and China, of the necessity for a long-term stabilization target and a global reduction in the emissions of greenhouse gases in the range of

50 percent until the year 2050. For rapidly industrializing countries it should be the aim for European negotiators to reach binding commitments to emissions reductions without setting a fixed cap on emissions per country but rather per sector, like steel or cement. A further goal should be that until 2020 a minimum of 30% of energy supply should stem from renewable sources, which requires the development and diffusion of climate-friendly/energy saving technologies. At the same time the Least Developed Countries (LDCs) will not have to take on any reduction or limitation commitments, but are aided in their energy needs via renewable energies and in their adaptation to climate change.

Such a climate centred alternative strategies could be broadened to energy policy in general and to trade policy by:

- Building and developing a 'coalition of the willing' for the development of truly renewable energy sources and strategies of energy saving (efficiency and sufficiency);
- Negotiating long-term common strategies with regard to climate and energy and technology exchange with the big emerging countries (China, India, South Africa, Brazil) as well as with groups of partner countries (ACP);
- Developing the structured dialogue the EU is building with the OPEC countries to a process of constructive participation in all dimensions of global energy and climate policies;
- Introducing a strong element of co-operation in a strategy on energy and climate into the European Neighbourhood Policy, making it an obligatory chapter of all negotiations on Neighbourhood Agreements.

Development. EU policy should be inspired by the desirability for the rich developed countries to adopt a far-sighted approach to underdevelopment, by limiting their short-term profits in order to overcome the widening gap between the rich and poor on a global scale. The guiding principal of development cooperation should be a clear recognition of each country's right to define its own pattern of development. In particular, the EU should not impose conditions that are primarily concerned to reflect its ideology and the interests of European business, rather than the interests of the developing countries themselves. To this end, the following policies should be supported:

- Aid should be multilateral. At present EU programmes are characterised by both multilateral and bilateral aid. The future expansion of aid should be oriented primarily at strengthening the multilateral component.
- Aid should not be tied. Despite discussions reaching back to the 1960s, current regulations do not cover Member States' bilateral aid. It is now high time that all bilateral and multilateral

aid should be completely de-linked from the obligation to buy goods and services from the donor country.

- The EU should press for the WTO rules to be amended in order to re-establish non-reciprocal preferences for the poorest ACP countries. Trade agreements should allow ACP countries to protect their domestic and regional markets in order to facilitate the support of 'infant industries'.

- The EU should push for the setting up of an effective system to ensure that developing countries are protected from a deterioration in their terms of trade. This is especially important in the case of the poorest African countries. Here, the Stablex and Sysmin schemes, which functioned in the 1970s, provide a valuable basis for building on[11]. An important requirement of such a system is that it should provide countries with automatic support to stabilise their export revenues.

- The Common Agricultural Policy should be extended in order to give full and free access to the EU market for the agricultural products of ACP countries.

Security. The guiding principal of EU policy should be to support a strengthening of the United Nations (UN), and a democratisation of its decision making structures. One of the primary objectives of the United Nations is securing universal respect for human rights and fundamental freedoms of individuals throughout the world. In this connection, few topics are of greater importance than the fight against impunity and the struggle for peace and justice and human rights in conflict situations in today's world. The creation by the UN in 1998 of a permanent International Criminal Court is therefore a decisive step forward. The EU should now seek to push for the ICC to be extended to those countries that have not ratified it, in particular, the United States, which is now able to escape the court's jurisdiction.

3.4. A democratic constitution for the EU

The "Reform Treaty" does not promote the "finality of European integration". It will encourage a European Union of different speeds and variable geometry, but not a deepening of integration across its Member States. Thus, for the European integration project as a whole, the spectre of the post-Maastricht crisis of legitimacy remains. What prevails, is the

[11] Stabex and Sysmin are the acronyms for, respectively, 'System for the Stabilisation of Export Earnings' and 'System for Stabulising Minerals'.

continued unleashing of market forces based on the neo-liberal policy design of the Treaty, promoting ever stronger competition and a race to the bottom in the EU's internal market.

The EuroMemorandum Group has in previous memoranda called for a comprehensive European Social Model based on solidarity and equality and striving for sustainable development. We have defended the notion of a "constitution", but stressed that a proper constitution can only formulate certain basic principles of the Union, fundamental rights and a thorough democratic design of its institutions and procedures. Such a "constitution", which leaves room for developing and changing political majorities and orientations to shape the economic order of the Union, should promote a European Social Model with the following core elements, about which a broad political debate should take place:

- ***full employment*** with decent working conditions and with wages and salaries sufficient to lead an independent life,
- ***the protection of public goods*** and the provision of high quality public services and socio-cultural services of general interest. Such services must be exempted from the rules on competition, the internal market, state aid and procurement.
- ***social welfare*** as a guarantee that nobody is exposed to poverty and social exclusion,
- ***social equity*** as the absence of discrimination and of excessive inequalities in income, wealth or access to public goods and opportunities,
- ***ecological sustainability*** as the preservation of the natural basis for individual and social life,
- ***cooperative*** **and** ***balanced international relations and efficient development aid*** as the long-term preconditions for peace and political stability.

A draft constitution based on these principles should after a broad political debate throughout the Union be submitted to a democratic all-European referendum. This would avoid that the European people shall have no say on the emerging elite project of the Reform Treaty, which in our view must be strongly opposed.

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

Declaration of support

I support the general direction, main arguments and proposals in the EuroMemorandum 2007:

"Full Employment, Strong Public Services, and International Cooperation Democratic Alternatives to Poverty and Precariousness in Europe"

List of the signatories of the EuroMemorandum 2007: "Full Employment with Good Work, Strong Public Services, and International Cooperation - *Democratic Alternatives to Poverty and Precariousness in Europe*"

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144.Jefferys, Steve	London	United Kingdom
145.Jeldan, Erinc	Amherst	Turkey
146.Jessop, Bob	Lancaster	United Kingdom
147.Karamessini, Maria	Athens	Greece
148.Karanikolas, Pavlos	Athens	Greece
149.Karasavvoglou, Anastasios	Kavala	Greece
150.Kardasis, V.	Rethymnon	Greece
151.Karrass, Anne	Göttingen	Germany
152.Kavouriaris, Makis	Athens	Greece
153.Kepplinger, Hermann	Linz	Austria
154.Keysers, Loes	Den Haag	Netherlands
155.Kisker, Klaus P.	Berlin	Germany
156.Kitsios, Manolis	Athens	Greece
157.Klug, Friedrich	Linz	Austria
158.Koch, Klaus T.	Bad Nenndorf	Germany
159.Koch-Panzer, Horst	Bruchköbel	Germany
160.Köpnick, Klaus	Haan	Germany
161.Köppen, Margit	Frankfurt	Germany
162.Koratzanis, Athanasios	Athens	Greece
163.Kouzis, Yiannis	Athens	Greece
164.Kowalik, Tadeusz	Warsaw	Poland
165.Kraemer, Ralf	Berlin	Germany
166.Krätke, Michael R.	Amsterdam	Netherlands
167.Kühn, Wolfgang	Bernau	Germany
168.Kurtzke, Wilfried	Frankfurt	Germany
169.Lang, Dany	Galway	Ireland
170.Langers, Jean	Luxemburg	Luxemburg
171.Laski, Kazimierz	Vienna	Austria
172.Lawson, Neal	London	United Kingdom
173.Liagouras, Yiorgos	Thessaly	Greece
174.Lieber, Christoph	Hamburg	Germany
175.Lopes, Helena	Lisbon	Portugal
176.Lorant, Karoly	Budapest	Hungary
177.Lötzer, Ulla	Berlin	Germany

178.Luft, Christa	Berlin	Germany
179.Mahnkopf, Birgit	Berlin	Germany
180.Maissin, Gabriel	Brussels	Belgium
181.Mamede, Ricardo	Lisbon	Portugal
182.Mané-Estrada, Aurèlia	Barcelona	Spain
183.Marcher, Brigitte	Vienna	Austria
184.Markov, Helmuth	Oranienburg	Germany
185.Marquardt, Jochen	Hagen	Germany
186.Martinelli, Flavia	Reggio Calabria	Italy
187.Martinez Castells, Àngels	Barcelona	Spain
188.Martinez Lucio, Miguel	Manchester	United Kingdom
189.Martinez Sanchez, Jose M.	Barcelona	Spain
190.Mazier, Jacques	Paris	France
191.Melas, Kostas	Athens	Greece
192.Menahem, Georges	Paris	France
193.Mencinger Joze	Ljubljana	Slovenia
194.Messkoub, Mahmood	Den Haag	Netherlands
195.Michailidis, George	Volos	Greece
196.Miehl, Fritz	Cologne	Germany
197.Milios, John	Athens	Greece
198.Moser, Rudolf	Linz	Austria
199.Mota, Julio M.	Coimbra	Portugal
200.Moysidis, A.	Athens	Greece
201.Mpalaouras, Makis	Athens	Greece
202.Müller, Bernhard	Hamburg	Germany
203.Müller-Maig, Siegfried	Cairo	Egypt
204.Nadel, Henri	Paris	France
205.Neunteufel, Marta	Vienna	Austria
206.Nickel, Dieter	Bremen	Germany
207.Nöbauer, Toni	Vöcklabruck	Austria
208.O'Dorchai, Sile	Brussels	Belgium
209.Oetsch, Walter	Linz	Austria
210.Onaran, Özlem	Berlin	Germany
211.Padilla, Emilio	Bellaterra	Spain
212.Pakos, Theofanis	Athens	Greece
213.Palacio-Vera, Alfonso	Madrid	Spain
214.Papadopoulou, Elena	Athens	Greece
215.Papakonstantinou, Spyros	Athens	Greece
216.Pascual-Molinas, Núria	Girona	Spain
217.Paust-Lassen, Pia	Berlin	Germany
218.Pellegrini, Lorenzo	Den Haag	Netherlands
219.Perraton, Jonathan	Sheffield	United Kingdom
220.Perraud, Daniel	Ivry	France
221.Peschel, Peter	Essen	Germany
222.Pfister, Helmut	Erlangen	Germany
223.Piacentini, Paolo M.	Rome	Italy
224.Pippert, Matthias	Berlin	Germany
225.Pixley, J.F.	Sydney	Australia
226.Podkaminer, Leon	Vienna	Austria
227.Polt, Wolfgang	Vienna	Austria
228.Popp, Michael	Berlin	Germany
229.Pufal, Marion	Hannover	Germany
230.Puig, Allbert	Barcelona	Spain
231.Quaißer, Gunter	Frankfurt	Germany
232.Raffer, Kunibert	Vienna	Austria
233.Ramskogler, Paul	Vienna	Austria
234.Raza, Werner	Vienna	Austria
235.Realfonzo, Riccardo	Benevento	Italy
236.Reati, Angelo	Brussels	Belgium
237.Recio, Albert	Barcelona	Spain
238.Reitzig, Jörg	Ludwigshafen	Germany
239.Reuter, Norbert	Berlin	Germany

240. Ribera-Fumaz, Ramon	Barcelona	Spain
241. Richter, Gerhard	Berlin	Germany
242. Rodrigues, Joao	Lisbon	Portugal
243. Roever, Sally	Den Haag	Netherlands
244. Rosell, Jordi	Barcelona	Spain
245. Ross, Richard	London	United Kingdom
246. Rothschild, Kurt W.	Vienna	Austria
247. Roumpakis, Antonis	Bath	United Kingdom
248. Rovid, Marton	Budapest	Hungary
249. Runje, Jacqueline	Dortmund	Germany
250. Russo, Enzo	Rome	Italy
251. Sadowski, Zdzislaw L.	Warsaw	Poland
252. Saith, Ashwani	Den Haag	Netherlands
253. Sakellaridis, Gabriel	Athens	Greece
254. Samary, Catherine	Paris	France
255. Sand, Alain	Lyon	France
256. Sauer, Christoph	Göttingen	Germany
257. Sauer, Thomas	Jena	Germany
258. Sawyer, Malcolm	Leeds	United Kingdom
259. Scacciati, Francesco	Torino	Italy
260. Schmid, Ingo	New Westminster	Canada
261. Schui, Herbert	Berlin	Germany
262. Schulmeister, Stephan	Vienna	Austria
263. Schulten, Thorsten	Düsseldorf	Germany
264. Schulz, Jan P.	Stuttgart	Germany
265. Schumm-Garling, Ursula	Frankfurt	Germany
266. Schustereder, Herbert	Linz	Austria
267. Senft, Gerhard	Vienna	Austria
268. Setterfield, Mark	Hartford	USA
269. Sezer, Haluk	Oxford	United Kingdom
270. Shiphorst, Freek	Den Haag	Netherlands
271. Shmanev, Sergei	Orel	Russia
272. Siebecke, Gerd	Hamburg	Germany
273. Sifakis, Catherine	Grenoble	France
274. Sirovàtka, Tomàs	Brno	Czechia
275. Sommer, Jörg	Bremen	Germany
276. Sorg, Richard	Hamburg	Germany
277. Spangenberg, Joachim H.	Cologne	Germany
278. Speckmann, Guido	Hamburg	Germany
279. Stackelbeck, Martina	Dortmund	Germany
280. Staritz, Cornelia	Vienna	Austria
281. Stathakis, Giorgos	Rethymnon	Greece
282. Steinitz, Klaus	Berlin	Germany
283. Stockhammer, Engelbert	Vienna	Austria
284. Stroppa, Marco	Stuttgard	Germany
285. Supinska, Jolanta	Warsaw	Poland
286. Svensson, Eva-Britt	Brussels	Belgium
287. Swyngedouw, Erik	Manchester	United Kingdom
288. Szikszai, Szabolcs	Veszprém	Hungary
289. Tamàs, G.M.	Budapest	Hungary
290. Tamàs, Morva	Budapest	Hungary
291. Tasiran, Ali	London	United Kingdom
292. Tcherneva, Pavilna	New York	USA
293. Teles, Nuno	Lisbon	Portugal
294. Tesch, Joachim	Leipzig	Germany
295. Theisinger-Henkel, Elke	Kaiserslautern	Germany
296. Thomasberger, Claus	Berlin	Germany
297. Thöne, Ulrich	Frankfurt	Germany
298. Tiainen, Pekka	Helsinki	Finland
299. Tombazos, Stavros	Nicosia	Cyprus
300. Tomidajewicz, Janusz	Poznan	Poland
301. Toporowski, Jan	London	United Kingdom

302.Torres, Adelino	Lisbon	Portugal
303.Tosi, Dario	Brussels	Belgium
304.Tridico, Pasquale	Rome	Italy
305.Troost, Axel	Bremen	Germany
306.Truong, Thanh-Dam	Den Haag	Netherlands
307.Tsakalotos, Euclid	Athens	Greece
308.Urban, Hans-J.	Frankfurt	Germany
309.Van Maasakker, Henry	Nijmegen	Netherlands
310.Vergés, Joaquim	Barcelona	Spain
311.Vergopoulos, Costas	Paris	France
312.Vertova, Giovanna	Bergamo	Italy
313.Vinokur, Annie	Nanterre	France
314.Vorbach, Judith	Linz	Austria
315.Wagner, Alexandra	Berlin	Germany
316.Ward, Allan	Plymouth	United Kingdom
317.Wehlau, Diana	Bremen	Germany
318.Wehr, Andreas	Brussels	Belgium
319.Weitzenegger, Karsten	Hamburg	Germany
320.Weston, Richard	Preston	United Kingdom
321.Wettstein, Karl-P.	Mannheim	Germany
322.White, Ben	Den Haag	Netherlands
323.Wolf, Frieder O.	Berlin	Germany
324.Zabkowicz, Anna	Warsaw	Poland
325.Zedler, Lothar		Germany
326.Zimmer, Gabriele	Brussels	Belgium
327.Zinn, Karl Georg	Wiesbaden	Germany

The international financial turbulence[1]

Trevor Evans[2]

> 'What is happening in credit markets today is a huge blow to the credibility of the Anglo-Saxon model of transactions oriented capitalism'.
> Martin Wolf, chief economic commentator, *Financial Times*[3]

In the last decade or so there have been a whole series of major financial crises, but they have virtually all occurred in developing or transition economies. In the second week of August 2007, however, the US banking system was faced with a serious breakdown as the inter-bank money market, where banks borrow and lend money between themselves, began to dry up, and the Federal Reserve had to pump money into the banking system in order to keep it working smoothly. The European inter-bank market was hit almost simultaneously, obliging the European Central Bank to provide the Euro-area banking system with large amounts of additional liquidity. The Bank of England was initially more taciturn about providing funds, but quickly reversed its position after the mortgage bank Northern Rock experienced a run – the first in Britain since 1866 – and pictures were beamed around the world showing alarmed customers queuing up outside the bank's branches in order to rescue their savings.
The direct cause of the crisis arose from problems in the US with so-called sub-prime mortgages – housing loans for households with poor credit records – but it reflects much broader recent developments involving the deregulation and expansion of the financial sector. The full impact of the crisis is not yet clear as it involves highly complex financial instruments whose ownership is widely dispersed, and which are very difficult to value. In the US, some of the most renowned New York banks have already announced losses running into billions of dollars, and the heads of both Citibank and Merrill-Lynch have been forced to resign. In Europe, two German banks have had to be rescued, while the repercussions of the crisis have stretched into the Norwegian Arctic Circle, where the small town of Narvik has encountered losses on investments that threaten its financing for schools and the care of the elderly.

As US banks have had to divert funding to resolve their own problems, the key question is how seriously this will affect the supply of credit to the rest of the economy. Economists are busy debating whether the US will suffer a slowdown in economic growth or whether a full-blown recession is more likely, something that would leave virtually no country untouched.

The emergence of finance-led capitalism

In the aftermath of the 1929 stock market crash and the subsequent banking crisis, the US government introduced extremely tight controls on the financial sector, and these continued largely in force until the 1970s. However, partly in response to financial innovation by the

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[1] Concluded in December 2007.

[2] Berlin School of Economics, evans@fhw-berlin.de. This is an updated version of a talk first given at the University of Campinas, Brazil, on 29 August 2007. The source for information and figures, unless otherwise given, is the Financial Times.

[3] 'Why the credit squeeze is a turning point for the world', *Financial Times,* 12 December 2007.

banks, which sought ways of getting round legal restrictions, these regulations began to be liberalised. The main changes were introduced in the 1980s, notably under the Reagan government, and continued in the 1990s under the Clinton Government. The process of innovation and deregulation has led to a marked expansion of the financial sector and this has contributed to the emergence since the early 1980s of a new phase of US capitalism in which finance has played a central role in driving growth and investment.
In the 1980s there was a major wave of corporate mergers and takeovers in the US. Many of the takeovers involved leveraged buy-outs, where the buyers only put up a small part of the capital themselves, and borrowed the rest, either from banks or, more significantly, by issuing bonds on the capital market. After the takeover, firms would be rationalised, and the least profitable units closed, while the permanent threat of job loss served to depress real wages throughout the decade. This process, immortalised in Oliver Stone's film *Wall Street,* led to a significant rationalisation of the corporate sector in the US, but came to an end in 1989, when the banking system abruptly curtailed the expansion of credit after several years of over-lending, leading to a brief recession in 1990-91. The Federal Reserve moved to relieve pressure on the banking system by lowering interest rates, and as US-assets became less attractive to international investors, the dollar weakened, providing a significant boost to US exports.

In the 1990s, after a period of slow 'job-less' growth in the first half of the decade, the US economy registered sustained high growth on the back of the information technology boom. For several years, high profits, rising share prices, and strong investment in fixed capital mutually reinforced one another. However, the boom was dependent on a further major expansion of credit, as firms borrowed huge sums, not only to finance fixed investment, but also to repurchase their own shares – thereby contributing to the 'bubble' in stock market prices which developed at the end of the decade. As is well known, the stock market bubble burst in early 2000, and share prices fell by some one third over the next two and a half years. In the second half of 2000, fixed investment collapsed, and from January 2001, as output and employment began to fall, the US economy entered a recession.

The Federal Reserve contains the stock market crisis

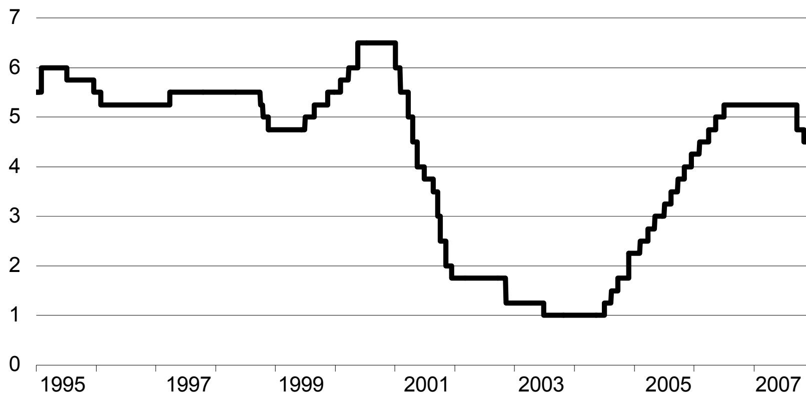
The bursting of the stock market bubble in 2000 following several years of feverish investment was in many respects comparable with the stock market crash in 1929.[4] However, it didn't lead to a chain of bank failures and a prolonged depression, as it had in the 1930s, because of the decisive response of the Federal Reserve. In January 2001, the Federal Reserve began to aggressively cut the lead interest rate, which was reduced from 6.5 per cent to 1.75 per cent in the course of the year, and to a mere 1 per cent in 2003 (see Figure 1).[5] Since inflation was running at 2 per cent or more for most of the time, this meant that, in real terms, the rate was negative for some three years. The result was a very significant expansion of credit which ensured that the recession was relatively brief, and economic growth began to recover in 2002. The highly expansionary US monetary policy ensured that the supply of

[4] By some measures, the US stock market was even more over-valued in 2000 than in 1929: the price to earnings ratio of shares, whose long-term average is around 15, and which peaked at 32.5 in September 1929, hit 42.2 in December 1999. See Robert Shiller's data base at www.econ.yale.edu/~shiller/

[5] The Federal Reserve conducts monetary policy by announcing a target for the interest rate in the federal funds market – the overnight inter-bank market – and then providing the quantity of reserves required to achieve this rate through open market operations.

credit – or liquidity – in capital markets was also high and, as a result, the long-term interest rate on bonds was also unusually low.

Figure 1. The Federal Reserve's target for the Federal Funds interest rate (%)



One result of the abundant and cheap supply of liquidity was a new boom in leveraged buy-outs, and the strong growth of private equity funds, which were the leading actors in promoting such buy-outs. This was reflected in the growth of lending for leveraged loans in the US, which increased from $216 billion in 2001 to $612 billion in 2006.[6]

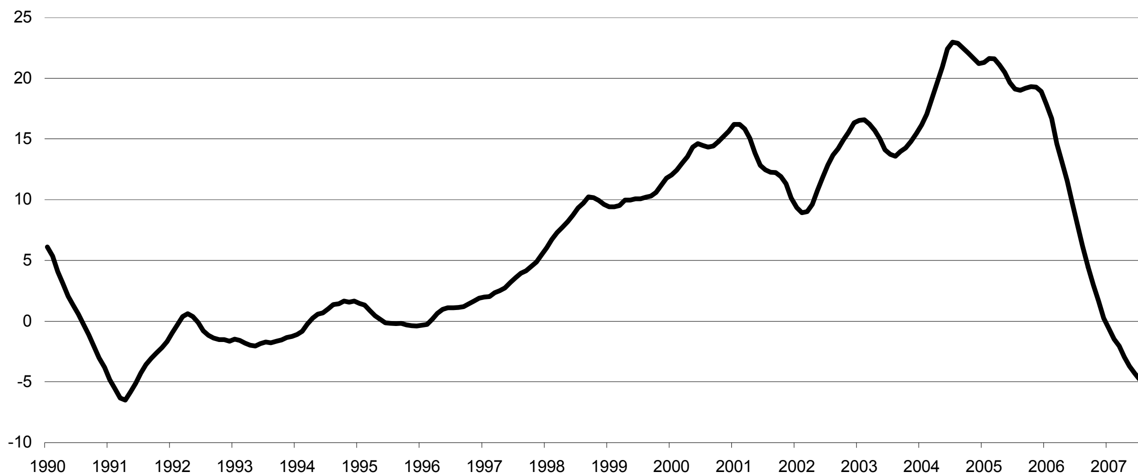
The most significant expansion of credit, however, occurred in the area of mortgage lending. From $385 billion in 2000, net household borrowing for mortgages increased to a peak of $963 billion in 2005, before falling back slightly in 2006.[7] Although the supply of new houses increased strongly, the availability of finance had a big impact on house prices. These had begun to rise in the mid-1990s, as US economic growth strengthened. After interest rates were cut in 2001, however, house-price inflation began to increase even more strongly, rising from about 10 per cent at the start of 2002 to around 20 per cent a year in 2005 (see

Figure 2).

[6] Reuters Loan Pricing Corporation, www.loanpricing.com. Lending strengthened to $427 billion in just the first half of 2007, but then fell sharply in the third quarter in response to the unfolding crisis.

[7] Board of Governors of the Federal Reserve System, *Flow of Funds Accounts,* Table D2.

Figure 2. US house-price inflation (%)



Source: S&P/Case-Shiller Home Price Index

Between 2001 and 2006, average house-prices in the US doubled, and this proved to be the main channel by which the Federal Reserve's monetary policy had an impact on economic growth. Many households took advantage of the low interest rates to refinance their mortgages – something that is relatively easy under the US system of housing finance. Because of the increased value of their homes, households were able to borrow more than required to pay off their old mortgages, and the balance was mainly used to finance consumption. Other households simply borrowed against the rising value of their homes to finance additional consumption (so-called 'home equity withdrawal'). Together, the amounts raised in this way were very large, rising from $226 billion in 2001 to $485 billion in 2005.[8] This borrowing explains a large part of the increase in consumption spending in these years and, because fixed investment remained rather weak, it was this that was principally responsible for driving the economic expansion which began in 2002.

Sub-prime mortgages

The present system of housing finance in the US was developed in the 1930s by the Roosevelt government, which set up the Federal Housing Administration to promote cheap, long-term housing loans. The main form of financing that emerged was a 30-year mortgage with a fixed interest rate about one per cent above the rate on federal government 10-year bonds. In terms of capitalist finance, it was a good deal for home buyers. However, in order to qualify for such a mortgage, households have to put up about 20 per cent of the price, and to demonstrate that their income is sufficient to meet the repayments.

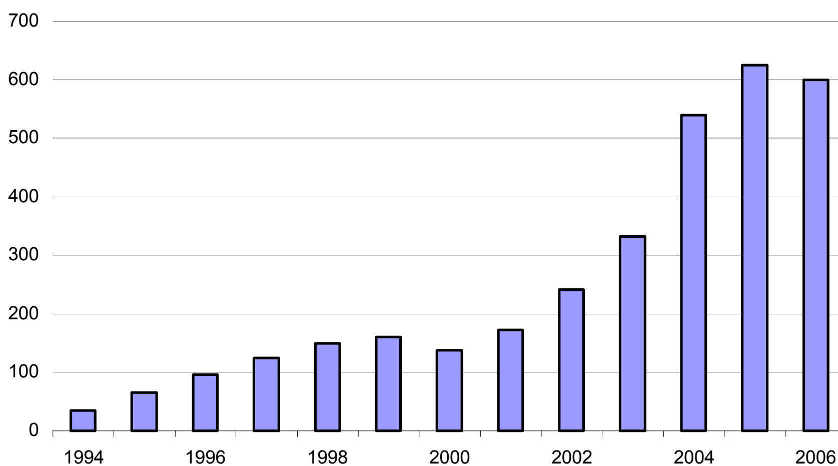
With the deregulation of the US financial system since the 1980s, new forms of mortgage were developed.[9] The most significant change was the abolition of the legal limit on interest rates which enabled banks and other lenders to provide loans to riskier borrowers at higher

[8] Figures kindly provided by Jim Kennedy, updating figures in Alan Greenspan and James Kennedy, 'Estimates of Home Mortgage Originations, Repayments and Debt on One-to-Four Family Residences,' Federal Reserve Board, Working Paper 2005-41.

[9] For a summary of the key regulatory changes, see the speech by the Federal Reserve Governor Edward M. Gramlich, 'Subprime Mortgage Lending: Benefits, Costs and Challenges', 21 May 2004, www.federalreserve.gov/newsevents/speech/2004speech.htm

than usual interest rates. These loans, known as sub-prime mortgages, take various forms, but include not requiring documentation of income; mortgages that cover 100 per cent of the house price; and so called 'teaser rates', where payments during an initial period do not even cover the interest charges and where the difference is added to the capital borrowed. The interest rate on sub-prime mortgages is usually adjustable, and such loans are attractive for lenders because the rate is on average about 5 per cent above the rate on government bonds.[10] Sub-prime mortgages have mainly been taken up by poorer households and include a relatively high proportion of black and Hispanic families.[11] This has made it possible for more people to buy their own homes, but it has given rise to aggressive marketing tactics and extensive misselling. Loan officers would, for example, go from door to door in poor neighbourhoods and, stressing the initial 'teaser rates', convince households that the repayments on a mortgage compared very favourably with the rent they were currently paying. In the period after 2001, when house prices were rising strongly, being able to purchase a home appeared particularly attractive. In addition, as house prices increased, higher income households began to purchase second or even third houses as purely speculative investments, and financed these with sub-prime mortgages. They could cover the whole cost of the investment with the mortgage, and repayments would be very low during the first year or two – by which time they planned to have sold the property and benefited from the capital gain!

Figure 3. US sub-prime mortgage originations ($ billions)



Source: Mortgage Bankers Association

Lending for sub-prime mortgages increased very strongly between 2001 and 2005, rising from $173 billion to over $600 billion a year (see Figure 3). The share of sub-prime mortgages in total mortgage lending also increased during this period, rising from around 5 per cent to 14 per cent. However, because these were mainly adjustable rate mortgages and, furthermore, because some had very low initial 'teaser' repayment rates, a high proportion of the loans granted during this period were liable to upward revisions in repayments as interest rates rose, and as teaser rates expired.

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[10] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, 'The 2006 HMDA Data', *Federal Reserve Bulletin,* vol. 93, December 2007.

[11] Ibid.

Securitisation

A second important innovation that has occurred since the 1980s is that many banks no longer hold mortgages on their own books until they are repaid. Instead, the mortgages are grouped together into a bundle which is then sold as a bond on the capital market. The bank which originated the mortgage makes its profit from the fees it receives, while the investor who buys the bond obtains the rights to the stream of income generated as households repay their mortgages with interest. This process, know as securitisation, enables the banks to avoid having to tie up capital against these loans, and received an important boost after 1988, when an international agreement, known as the Basel Accord (now referred to as Basel I) came into force, which required banks to hold capital equal to 8 per cent of such loans.

US mortgage-related bonds have become one of the largest pools of bonds in the world. By January 2007, their value totalled $5.8 trillion, of which 14 per cent represented sub-prime mortgages and a further 12 per cent represented so-called Alt-A mortgages – a category somewhere between prime and sub-prime mortgages. Foreign holdings of mortgage-related US bonds were also significant, amounting to around $850 billion.[12]

In order to sell a bond on the capital market it is necessary to obtain a rating from one of the private agencies that have been set up for this purpose. The three best known agencies, all based in the US, are Standard & Poor's, Moody's and Fitch Ratings. For a fee, they evaluate the risk they consider is associated with a particular bond, and issue a grade. The exact system varies between the agencies, but bonds with the lowest risk are graded AAA, and the system continues with AA and A, through BBB, BB and B, and so on to CCC, or something similar, as the degree of risk rises. The rating is important because the lower the rating, the higher the rate of interest that must be offered in order to sell a bond. Furthermore, some institutional investors, such as pension funds, are required by law to invest in bonds with the top ratings.

Because sub-prime mortgages involve households with a weak credit record, bonds based on sub-prime mortgages do not receive the highest ratings. In practice a rating in the region of BBB is more typical. This means that such bonds are not attractive for investors who wish – or are required – to hold bonds with the highest ratings. However, investment banks have developed a new type of instrument, known as a collateralised debt obligation (CDO), which makes it possible to transform securities with a lower rating, such as those based on sub-prime mortgages, credit card debt, or car leasing agreements, into securities with the very highest rating.

The basis of a CDO is the stream of repayments accruing to a bond based on sub-prime mortgages, or some other relatively risky form of debt. New instruments, known as tranches, are then created, which slice up the right to the income flow on the basis of risk. This can be visualised like a waterfall, where the flow of income only reaches down to the lower levels if the flow is large enough. The first charge on the flow of income is the fees of the investment bank that has constructed the CDO. After meeting the fees, the next call on the flow of income is the so-called senior tranche, which carries an AAA rating. The income then goes, in turn, to what are known as the mezzanine tranches, with ratings typically from AA to BBB. The final tranche, known as the equity tranche, is unrated. The rate of return on the tranches increases as the rating declines. In this way, the whole risk of the sub-prime mortgages is distilled out and concentrated in the lower tranches, an explosive concoction described in the financial press variously as 'toxic' or 'radioactive'.

The exact construction of CDOs, which are highly complex, is the result of a process of bargaining between the investment bank which puts them together, and the ratings agency which provides the ratings for the different tranches. The investment bank is interested in

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[12] IMF, *Global Financial Stability Report,* April 2007, p. 4.

creating as large an AAA tranche as possible, while the ratings agency, supposedly, is concerned to ensure that certain standards are maintained. However, the agencies are subject to a serious conflict of interest as the fees for rating CDOs are, because of the complexity of the task, about twice as high as those for rating traditional corporate bonds, and in recent years this work has generated a substantial part of rating agencies' income.[13]

The first CDOs were issued in the late 1980s, but it has been in the last few years that they have expanded very rapidly. Total issues increased from $157 billion in 2004 to $549 billion in 2006;[14] those based on mortgages increased from $45 billion in 2004 to $166 billion in 2006.[15] Because CDOs appeared to offer higher rates of return than other assets with comparable ratings, they were quickly bought up by investors, including insurance companies, pension funds, banks and especially hedge funds.[16]

Securitisation has been – at least until very recently – strongly welcomed by orthodox, neoclassical economists because it is said to provide a way of distributing risk amongst a wider range of parties and, in this way, of making the financial system more stable. Certainly, bonds based on mortgages, and more complex instruments such as CDOs have been bought up by a very wide range of financial institutions. But, precisely because ownership of such instruments has become so diversified, a new form a system-wide risk emerged. Because no-one knew for sure who was holding the securities, once their value was called into question, virtually everyone was treated with suspicion and trust between financial institutions broke down.

The origins of the crisis

By 2004, the US economy had begun to register fairly sustained growth, driven primarily by a strong credit-financed expansion of consumer expenditure. In the second half of 2004 the Federal Reserve began to raise interest rates, and this continued throughout 2005, thereby bringing the period of exceptionally low interest rates to an end. Predictably, this had a significant impact on the housing market. From the beginning of 2006, house-price inflation began to fall sharply, declining from around 20 per cent to zero in the course of the year, according to the Case-Shiller index.

The development that initiated the crisis in credit markets was a rise in payment defaults on sub-prime mortgages. Because sub-prime mortgages were created for households with weaker credit ratings, defaults have always been higher than those on prime mortgages. Between 2002 and 2005, so-called delinquency rates on sub-prime mortgages actually fell somewhat. But for sub-prime mortgages with adjustable interest rates, the figure for delinquencies began to rise dramatically in 2006, and by mid-2007 had reached 16 per cent (see Figure 4). As houses were repossessed, forced sales added to the downward pressure on house prices. And in areas with weak or even falling prices, households with payment difficulties were trapped, since even selling their house would not enable them to pay off the mortgage.

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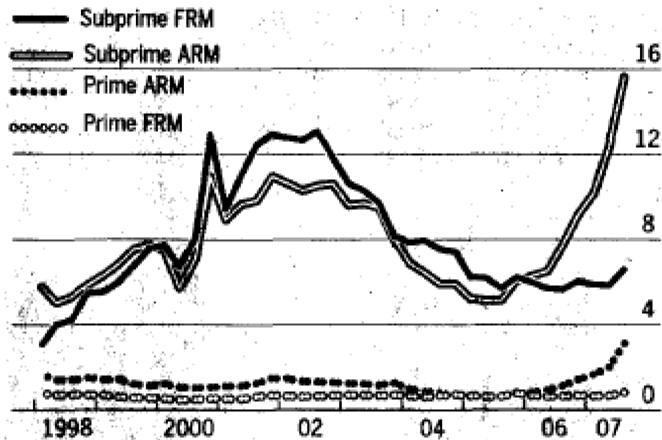
[13] See Aaron Lucchetti and Serena Ng, 'How Rating Firms' Calls Fueled Subprime Mess: Benign View of Loans Helped Create Bonds, Led to More Lending', *Wall Street Journal*, 15 August 2007.

[14] The Securities Industry and Financial Markets Association, *CDO Issuance Data 2007*.

[15] International Monetary Fund, *Global Financial Stability Report,* October 2007, p. 13.

[16] For a breakdown, see International Monetary Fund, *Global Financial Stability Report,* October 2007, Figure 1.11..

Figure 4. US mortgage delinquency rates (%)



Source: Financial Times, 10 December 2007 / Mortgage Bankers Association.
ARM = Adjustable Rate Mortgage; FRM = Fixed Rate Mortgage

As repayments on sub-prime mortgages began to falter, the value of the bonds that were backed by such mortgages began to be thrown into question. Towards the end of 2006, the rate of return on the bonds began to rise, reflecting the increased danger that they could default. This danger was dramatically brought home to many market participants in June 2007, when Bear Stearns, one of the leading New York investment banks, announced that two of its hedge funds had made big losses on sub-prime securities. Then in July, the rating agency Standard and Poor's threatened to downgrade some $12 billion of sub-prime backed bonds.

The crisis moved to a head due to developments in something called Structured Investment Vehicles (SIVs). SIVs are legal constructions, in many cases set up by the big banks, which make it possible to hold assets off the books of the bank, so that capital will not have to be held against such investments. The SIVs purchased high yielding assets, including sub-prime based securities, which generally had a maturity of 5 to 10 years, and financed this by selling short-term securities, including commercial paper ('asset backed commercial paper', or ABCP), often with a maturity of as little as 90 days. Because the return on the sub-prime securities was higher than the cost of the commercial paper, the SIVs could generate a nice profit – although it involved having to regularly issue new commercial paper every 90 days or so. This proved to be very attractive business, and by July 2007 there were 29 SIVs, 20 of which were managed by banks, with assets amounting to some $368 billion.[17] However, shortly after the Bear Stearns fiasco had hit the headlines, investors took fright of anything linked to sub-prime mortgages, and the SIVs were faced with a funding crisis as they could no longer sell new issues of asset backed commercial paper.

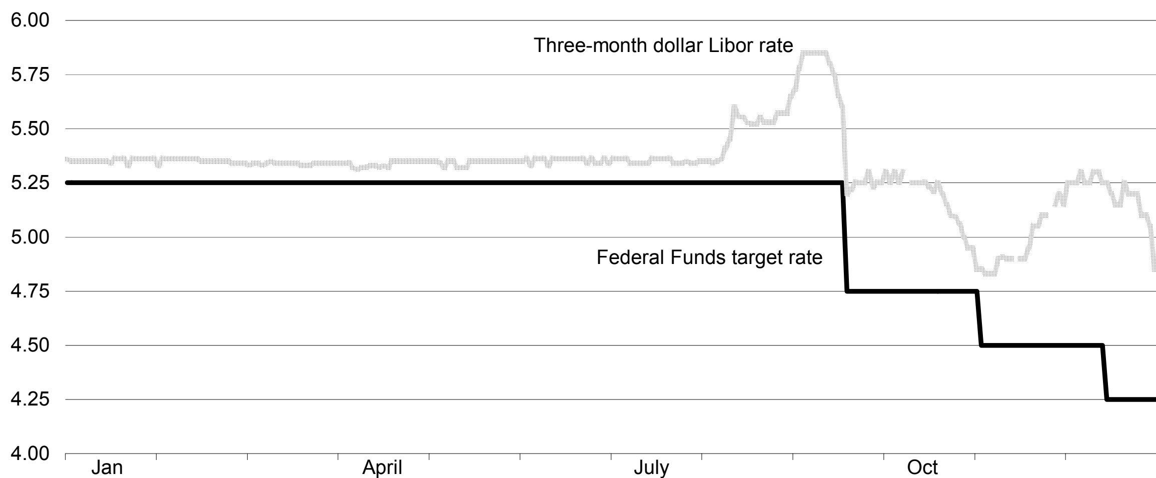
The banking crisis

The focus of the crisis shifted to banks because, once the SIVs could no longer roll-over their commercial paper, they turned to the banks for loans. The SIVs had credit lines with the banks precisely to cover this eventuality, but they had rarely been used. Now, because of the large sums involved, banks that were suspected of being exposed to demands arising from the breakdown of the asset backed commercial paper market found that other banks were

[17] Fitch Ratings, *SIVs: Assessing Potential Exposure of Sponsor Banks,* November 2007.

reluctant to lend to them. In the memorable words of the *Financial Time's* Gillian Tett, this was when the balance of sentiment in financial markets changed from greed to fear.[18]
The crisis came to a head in the second week of August, when the breakdown in trust between banks led to a serious lack of liquidity in the inter-bank money market. It is demonstrated most clearly by the interest rate on three-month inter-bank loans (
Figure 5): the margin between the three-month rate and the Federal Reserve's target for the overnight rate is usually around 0.1 per cent, but in the second week of August it began to rise, and by the beginning of September had reached 0.6 per cent. The Federal Responded by reducing its discount rate (the US lender of last resort facility) by 0.5 per cent on 17 August, but banks were reluctant to draw on this because of the possible stigma (the names of borrowers are published, and drawing on the facility could be interpreted as a sign of difficulties). As the problem in the inter-bank market deepened, the Fed therefore reduced its main interest rate by 0.5 per cent on 18 September, with further cuts of 0.25 per cent on 31 October and on 11 December. Since the Federal Reserve had been discussing *raising* interest rates due to concerns about rising inflation until shortly before, this represented a significant shift in policy.

Figure 5. US inter-bank market interest rate (%)



Source: Board of Governors of the Federal Reserve System

The Fed's response involved injecting substantial amounts of additional funding into the US banking system, but it was only a limited success. Although the three-month inter-bank rate began to decline in October, banks were concerned that the problem was not simply one of liquidity, but rather that many banks had made big losses. Because it was not clear exactly who held sub-prime based bonds or CDOs, everyone was suspect. Furthermore, as there is no secondary market in CDOs, their value is unclear.[19] In November, banks began to announce their third quarter results, and many of the big New York banks revealed serious losses on sub-prime related investments (see
Table 1). But amidst fears that the true figures could be even larger, tensions in the money market began to rise again in December. As the crisis threatened to deepen, on 12 December

[18] Gillian Tett, 'A delicate balance of greed and fear is upset', *Financial Times,* 11/12 August 2007.

[19] IMF estimates of losses on CDOs range from 40-70 per cent (*Global Financial Stability Report,* October 2007, p. 13).

the Federal Reserve announced a further injection of liquidity in an unprecedented joint intervention coordinated with the European Central Bank, the Bank of England, the Bank of Canada and the Bank of Switzerland.

Table 1. Banks' sub-prime or CDO-related losses, Third Quarter & November 2007

Bank	*$ billion*
Citigroup	9.5
Merill Lynch	7.9
HSBC	3.4
Bank of America	3.0
Barclays	2.7
Wachovia	1.3
Bear Stearns	1.2

Source: National Mortgage News, December 2007

The impact in Europe

The financial system in what is today the Euro area has, traditionally, relied far less on capital markets than has been the case in the US. But since the 1990s this has begun to change, partly under the influence of regulatory changes. In 1999, the European Commission launched its Financial Services Action Plan, 42 measures to be introduced by 2005 to create an integrated, more market-based financial system in the EU. Furthermore, the Lisbon strategy, announced in 2000 with the aim of making Europe the most competitive knowledge-based economy in the world, stressed the importance of developing a US-style market-based financial system in Europe. As European banks were subjected to greater competition they too were attracted by the apparently high returns offered by sub-prime related securities originating in the US. In Germany, furthermore, the important public-sector savings banks, which account for around one-third of the banking system, were seeking to compensate for a decline in earnings after an EU ruling had led to the end of regional-state guarantees that had enabled them to borrow funds more cheaply than privately-owned banks. This had encouraged a number of banks to set up off balance sheet SIVs which, as in the US, financed holdings of long-term sub-prime securities by issuing short-term commercial paper (see

Table 2). And as investors baulked at further purchases of asset-backed commercial paper in July 2007, the European banks that had set up SIVs faced the same problem as those in the US.

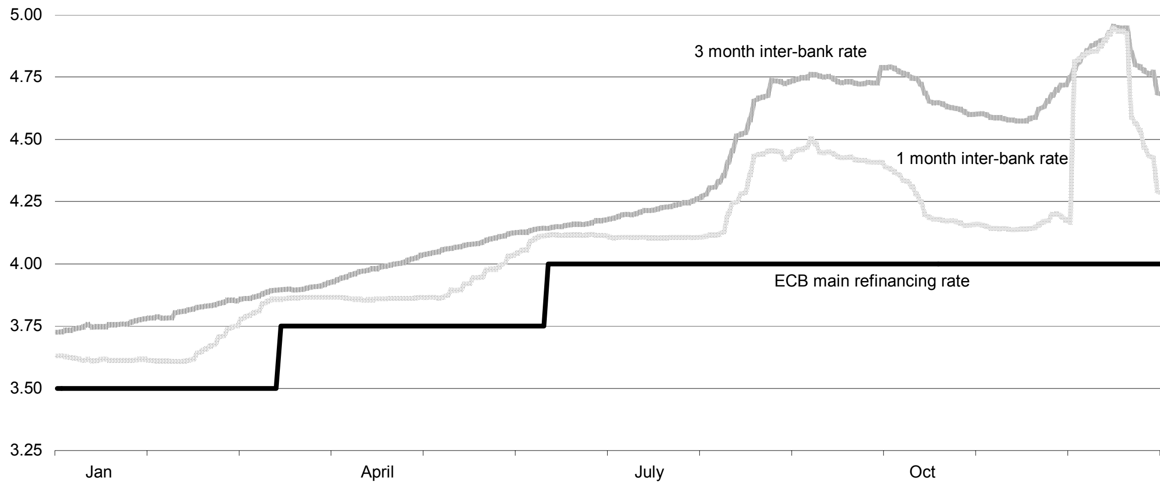
Table 2. Selected German banks' exposure to their own off balance sheet vehicles

Bank	Total assets (€bn)	Off balance sheet vehicle	Credit facilities (€bn)
Sachsen LB	68	Ormond Quay	17.3
LBBW	428	Lake Constance	8.2
IKB (KfW)	52	Rhineland Funding	8.1
West LB	285	Compass	6.2
Bayern LB	353	Giro Lion	6.2
HSH Nordbank	189	Poseidon	5.2
DZ Bank	439	Coral Capital	3.0
Landesbank Berlin	141	Check Point Charlie	1.7
Helaba	168	Opusalpha	1.5

Source: 'Not uncritical: Subprime exposure drags down German banks', *Financial Times*, 22 August 2007, based on Moody's Investors Service.

One of the first casualties was the Industrie Kredit Bank (IKB), a small German bank that is privately registered, but whose principal owner is the public-sector development bank, KfW. On 30 July it announced that its off balance sheet SIV, Rhineland Funding, had made substantial losses on €17 billion of CDOs, and the bank only survived thanks to an €8 billion guarantee by the KfW and other banks, put together by the German government. Shortly after, on 19 August, another German public-sector bank, the Sachsen Landesbank, had to be rescued for €17.3 billion, after its Dublin-based SIV, Ormond Quay, registered big losses on CDOs. Meanwhile, Frances largest bank, BNP Paribas, announced on 9 August that it was freezing three of its funds due to losses on US sub-prime related investments.
As in the US, the suspicion of exposure to sub-prime related losses led to a breakdown of trust between banks, and the interest rate on inter-bank loans began to rise sharply in the second week of August (see Figure 6). As the inter-bank money market dried up, the European Central Bank embarked on a series of large funding operations. On 9 August, the ECB pumped a cool €94.8 billion into the Euro-area banking system. This was followed by a further €61.05 billion on 10 August, and yet another €47.67 billion on 13 August and €7.7 billion on 14 August. This massive intervention stabilised the overnight interest rate, but as the one-month and three-month inter-bank rates remained substantially above the normal level, the ECB began – rather unusually – to inject three-month funding, with €30 billion at the end of August, and anther €75 billion in mid September. In October and November, the tension in the money market appeared to abate somewhat, although there continued to be widespread suspicion that many banks were holding sub-prime related securities of dubious value. But, as interest-rate margins again begun to rise steeply towards the end of the year, the ECB took part in the unprecedented coordinated Central Bank intervention, together with the Federal Reserve and other central banks. The ECB announced it would provide two-week funding at below market interest rates to all the banks that needed it – apparently expecting that this would amount to some €180 billion. In the event, the demand from the banks was so strong that the ECB finished up supplying a staggering €348.6 billion. As intended, this brought inter-bank rates down considerably, although the margin over the ECB's main refinancing rate remained higher than before the crisis. As part of the coordinated initiative, the ECB also provided euro area banks with funding in dollars to the tune of $20 billion which it obtained through a swap agreement with the Federal Reserve.

Figure 6. Euro area interest rates, 2007 (%)



In Britain, the country's largest bank, HSBC, had announced losses on sub-prime related investments early in 2007. But, after the crisis in the inter-bank money market broke in August, the Bank of England, unlike the Fed and the ECB, argued that supplying additional funding would only encourage banks to continue risky lending in the expectation of a central bank bale-out (so-called 'moral hazard'). As the sterling inter-bank market dried up, this proved fatal for Northern Rock, a fast-growing mortgage bank that had relied on the inter-bank market for much of its funding. After four days in mid September in which Northern Rock customers lined up in the street to withdraw their savings, the government stepped in to guarantee all the bank's deposits. Only then, did the Bank of England reverse its position. In what the *Financial Times* described as a breathtaking U-turn, it provided banks with an additional £10 billion of three-month loans, for which it accepted an unusually wide range of collateral, even including mortgage loans! Further Bank of England injections of £10 billion in three-month loans followed at the end of November, and again as part of the coordinated central bank intervention in December.

Regulatory laxity

Since the 1980s, the US economy has developed a form of capitalism in which, following extensive financial deregulation, growth is strongly driven by the financial sector. This has enabled the US economy to achieve strong bursts of growth, but at the cost of heightened exposure to booms and crises. The Federal Reserve's response to the bursting of the stock market bubble in 2000 enabled the US to escape with a relatively short recession in 2001, and a massive increase in mortgage lending led to a boom in house prices which, in turn, fuelled consumer spending and economic growth. But the expansion of sub-prime mortgages, made possible by financial deregulation, only led to a displacement of the crisis. Mortgage lenders employed hard-sell tactics, pushing many households to take on debt they couldn't afford, which the banks then sold on in the form of mortgage-backed securities which, in turn, were transformed into unfathomably complex CDOs designed to obscure the true risks from view.
Under Alan Greenspan, the Federal Reserve was reluctant to intervene, partly to avoid anything that might jeopardise the economic recovery that started in 2002; but also due to a blind belief in the self-regulating capacity of capitalist financial institutions. In 1994, the US Congress gave the Fed authority to regulate deceptive and predatory lending, but Greenspan

rejected a proposal in 2000 by Edward Gramlich, a Federal Reserve governor, to use this to protect people from risky mortgages they could not afford. In an editorial after the crisis had broken, the *New York Times* pointed out that, although five bodies have responsibility for regulating US banks, the Fed is the most important, and it noted, pointedly: 'Its regulatory laxity under Mr. Greenspan set the tone for laxity throughout the system.'[20] It was not until the end of 2007, that the Fed finally announced plans to protect borrowers from unscrupulous mortgage lenders.[21]

The most direct victims of the sub-prime crisis have been those who have lost their homes. By December 2007, 994,000 households were facing foreclosure which, since the average household has just over three people, will affect some 2.5 million people. In December 2007, the Treasury secretary, Hank Paulson, announced a plan to reduce foreclosures, which includes freezing payments on some variable rate sub-prime mortgages, but this has been widely criticised for its limited applicability.[22]

Originating mortgages, packaging them into bonds and slicing them up into CDO tranches, generated spectacular profits for the financial sector, especially during the boom years between 2004 and 2006. But in the second half of 2007, banks had to take big write-downs on their sub-prime related assets. Many senior bankers have lost their jobs, including the heads of Citibank and Merrill Lynch, but their pain has been cushioned. Notoriously, Merrill Lynch allowed its chairman and chief executive, Stan O'Neal to retire as chairman and chief executive, rather than sacking him, so he qualified for a $160 million departure package.[23] Many institutions were persuaded to buy complex securities, such as CDOs, which they did not understand. Although Federal Reserve intervention succeeded in containing the crisis in the money market during the final months of 2007, at the end of the year it was still not clear who was holding sub-prime related securities, and what they were worth. Two big US banks, Citibank and Morgan Stanley, had turned to investors in the Middle East and Asia – including China's sovereign wealth fund – to raise additional capital. There are calls for other institutions to come clean on their liabilities so as to avoid a long-drawn out crisis, as in Japan in the 1990s. But, the more the banks are called upon to meet sub-prime related losses, the more sharply they will be forced to tighten lending to commercial and industrial firms.

Europe is affected by the impact of the sub-prime crisis in at least two important ways. The EU's dependence on exports as a source of economic dynamism means that growth in Europe is highly vulnerable to a downturn in demand from the US. The idea that this might be compensated for by increased demand from China and India is wrong, partly because their economies are still so much smaller than that of the US, but also because China's own growth is strongly influenced by demand from the US.

Europe is also vulnerable as a result of the move towards a more US-style financial system, and the possibility that sub-prime related losses could spill over into a credit contraction. In fact, according to the ECB's banking survey, credit conditions for new loans did begin to

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[20] 'Mr Greenspan Spins the Bubble', *New York Times,* 18 September 2007; see also Edward Andrews, 'Fed Shrugged as Subprime Crisis Spread', *New York Times,* 18 December 2007.

[21] Edmusnd Andrews, 'IN Reversal, Fed Approves Plan to Curb Risky Lending', *New York Times,* 19 Decembere 2007.

[22] See, for example, Clive Cook, 'The trouble with the Paulson Plan', *Financial Times,* 10 December 2007. A Treasury-organised plan to set up a $75 billion 'superfund' to buy up sub-prime securities, announced in October 2007, was widely criticised as impractical, and dropped in December.

[23] David Wighton and Ben White, 'Merill Lynch allows O'Neal to retire with a package of $160m', *Financial Times,* 31 October 2007.

tighten at the end of 2007.[24] In response to the crisis in European financial markets, the EU tabled proposals in September 2007 aimed at avoiding future problems, largely at the instigation of the French finance minister, Christine Lagarde. The proposals involved a tighter regulation of rating agencies, a call for less complex securities, and for capital requirements to be levied on all bank assets, including those held in off balance sheet vehicles.[25] To what extent these will be implemented remains to be seen. Even within the framework of capitalist finance, there is a wider problem in Europe involving the regulation of the system. The crisis in Northern Rock was partly due to regulatory responsibility being divided between three institutions, the Bank of England, the Financial Services Authority, and the Treasury. In the euro area, despite the common currency and an EU policy of promoting European financial integration, responsibility for financial regulation is fragmented between a host of different national authorities. Furthermore, the key centre for many euro-denominated financial markets is London, outside the jurisdiction of either the Bank of England or the euro-area authorities.[26]

20 December 2007

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[24] ECB, *Financial Stability Review,* December 2007, p. 65.

[25] See Christine Legarde, 'Securitisation must lose the excesses of youth', *Financial Times,* 9 October 2007; and Tony Barber, 'EU roadmap aims to avoid turmoil in markets', *Financial Times,* 10 October 2007.

[26] This point is made by Gillian Tett, 'Market squeeze no regulator has the ability to resolve', *Financial Times,* 14 September 2007.

The EU in the world[27]

Trevor Evans, John Grahl, Jörg Huffschmid, Georges Menahem, Werner Raza & Jan Toporowski

While the US continues to play the leading role in the world today, the European Union has sought to position itself as representing a more social, peaceful and development oriented approach to world affairs. Nevertheless, in recent years, the EU has begun to adopt an explicitly more assertive approach in its relations with the rest of the world. In a paper prepared for the meeting of EU Heads of Government in October 2007, the Presidency of the European Commission stated: 'the EU of 27 Member States offers a route for Europe to act on a continental scale, with a critical mass and a reach which should be used to the greatest advantage'.[28] The aim of this paper is to present a brief account of how this reach is proceeding in a number of key areas. In summary, the results are as follows:

Trade: As the WTO Dohar Round stalls on the edge of collapse, the EU has aggressively reoriented its strategy towards securing bilateral trade deals. This corresponds to the externally-oriented growth strategy that the EU has been pursuing, and remains vulnerable to a downturn in the US-led global economy. Agreements with developing countries, although promoted in the name of development, oblige developing countries to open their economies and relinquish many of the instruments used by developed countries when they faced the challenge of development. Furthermore, such deals are often motivated by securing access to raw materials in the face of competition from the US and China.

Investment: The EU has supported US policies for an ultra-liberal international investment regime. Investment in developing countries has particularly focussed on privatised public services, obliging utilities to function on a commercial logic which implies price rises. Since the collapse of the Multilateral Investment Agreement, the EU has turned to bilateral FTAs as a means of ensuring access for EU firms to developing countries, and it is quite explicit that its aim is to promote the interests of European multinationals.

Banking: In place of the earlier pattern of European banks investing in their countries' colonies, the recent expansion of European banks in emerging markets has been determined principally by domestic factors in those countries, including financial liberalisation, and capital account liberalisation. The sole exception is provided by the monetary unions of France and Portugal with former colonies. The result, however, has often been the drying up of local money markets as local banking becomes a branch activity of global banks. This is a paradoxical result, since it is usually claimed that liberalisation promotes financial development. It suggests financial liberalisation may not be the best way of supporting the under-banked small and medium enterprise sector in developing countries.

Financial markets: The overall size of European capital markets are comparable with those of the US, and although some markets are more developed in one rather than the other, their

[27] Concluded on December 22nd, 2007.

[28] European Commission, *The European Interest: Succeeding in the age of globalization,* Brussels, 3 October 2007, p. 3.

size is tending to converge. However, this understates the influence of the US. US banks have a greater holding in European banks than *vice versa*; more seriously, as European financial institutions are pressed to achieve an acceptable return on ever larger amounts of assets, they are adopting the strategies pioneered by US hedge funds and private equity funds. EU policies are based on the doctrine of opening markets of increasing competitiveness. By contrast, it is argued, there is a need for strong limitations on more speculative investments, and for regulation to protect workers and industrial firms, especially small and medium enterprises, from the ravages of financial exploitation.

The Euro: The international use of the euro increased after monetary union in 1999, although this has tended to stabilize since around 2003. Although the size of the euro-area and the US are comparable in terms of output and the size of their capital markets, the dollar continues to be the dominant international currency, while the euro is clearly the second most important. The largest threat to the position of the dollar appears to be the US current account deficit, which could lead to a depreciation of the dollar, and hence a decline in its role as a store of value for international reserves. A shift towards a more diversified system of reserve holdings then seems likely, although this is premised on a system of private financial markets which make it easier to move from one currency to another – to the benefit of financial institutions and at the cost of deepening risks of financial crises.

Military: Since the late 1990s, the EU has been involved in developing and strengthening its military capability with the aim of being able to intervene with force outside the EU. To this end it has created new institutions aimed at coordinating policy, military procurement, and the conduct of military operations. This has gone hand in hand with a process of rationalisation in the defence industry, and a shift from state to private producers. The whole process is taking place in coordination with NATO, and envisages a close cooperation with the US. But it lacks transparency and any significant democratic control.

Trade[29]

Trade has always been an important field of European Union politics. Indeed, since the creation of a Costums Union with the Treaty of Rome it can be listed among the earliest fields of competence of the European Communities. Though not the core of the European integration process itself, from an economic point of view, much of what was materializing in terms of economic integration – in particular the creation of the Single Market – was motivated by the idea that the removal of barriers to trade through the creation of a common market would be beneficial to welfare and growth. This is in essence the conceptual basis upon which external trade politics in general is founded. Not surprisingly then, the Common Commercial Policy of the EU was seen as an outward-oriented complement to the central economic dimension of European integration. With the implementation of the European Single Market, the liberalisation of public utilities (telecoms, electricity, gas, post, transport services) and the evolution of big European corporations with an explicitly international outreach in the 1980s and 90s, both the internal structure of economic and political interests and the distribution of competences between the Member States and the European Union, upon which external trade policy rests, have however undergone a profound transformation. As a consequence the economic significance of trade policy has increased, and the political

[29] Drafted by Werner Raza, werner.raza@aon.at

importance attached to trade policy by major political actors and corporate interests, in particular, has expanded considerably.

This is indeed well reflected in the figures for European trade since the 1990s. Extra-EU trade has expanded considerably both in merchandise and service trade. According to Eurostat, from 1991 to 2004 the share of external merchandise trade (exports plus imports) to EU-15 GDP rose from 14.9 to 21.9%. For services, the share of external trade to EU-15 GDP rose from 5.5 to 7.1 % from 1990-2004. Measured against world exports, the EU was able to expand its market share in merchandise trade from 16% in 1991 to 20% in 2004. The same holds true for services: Though the EU's share of world exports in services decreased from a high of 24,5% in 1990 to 20.7% in 1992, it was able to maintain this level over the period to 2004, when it reached 20.8%. On the other hand, over roughly the same period the share of US exports in world merchandise exports exhibited a decline of 3% to less than 15%, and of 1.7% to 15.3% for services (cf UNCTAD 2004, 2005). In addition, while the EU-15 had usually incurred a current account deficit before 1992, it has been able to convert that into a surplus in the late 1990s and early 2000s. With the accession of 10 new Member States, which are in sum net importing economies, the current account balance has again turned negative since 2004. Nonetheless, the overall balance still looks rather favourable with the EU exhibiting permanent surpluses in services trade, while overall current account performance in recent years showed deficits of around 1% of EU GDP, which could still be qualified as balanced from a macroeconomic point of view. Thus, compared to its main rivals in international trade, the EU's performance turns out to be quite favourable. The EU has become the world's largest and most important trading bloc. Against the spectacular emergence of Asian countries, in particular China and India, on the global scene, it was able to increase its market share in merchandise trade and it has maintained its leading role in services trade.

Trade policy, thus, has become an important element of economic policy at EU level. In the following, we will endeavour to explain the politico-economic factors that contributed to the increasing external orientation of the EU and the central role that trade policy played in that process. Starting from a discussion of the conceptual foundation of EU trade policy, we will then discuss the recent initiative of the EU, which shifted the focus from a multilateral trade policy within the framework of the WTO onto a bilateral track. This re-orientation towards bilateralism will be interpreted partly as a reaction to the sluggish evolution of the WTO's Doha Round negotiations, but more significantly as a radicalization of an increasingly outward-oriented growth regime, which seeks to foster the expansionary strategies of EU businesses by opening up markets and aligning regulatory barriers of third countries to EU standards. A specific version of this policy is applied in North-South trade agreements by the EU, the on-going negotiations with the ACP countries being a case in point.

Bilateralism reloaded: the Global Europe Strategy of the European Commission

With the publication of its strategy document 'Global Europe: Competing in the World in October 2006, the European Commission signalled a clear shift in the direction of its trade policy from multilateralism to an enforced use of bilateral agreements. The motivation behind the move is straightforward: with the WTO Doha negotiations, which started in November 2001, likely to produce results well below the high initial EU expectations, or possibly failing

completely, it is strategically rational to shift to the bilateral track in order to pursue further market opening. Disappointment from EU business groups over the lack of progress in the Doha Round had mounted in 2005-2006 and allegations were voiced that the exclusive prioritisation of the multilateral track by the European Commission was putting EU businesses at a disadvantage compared to US companies which profited from bilateral agreements the US administration had concluded in parallel to the WTO negotiations. Hence, EU policy makers wanted to avoid a situation where they would be blamed for backing the wrong horse in the likely case that the WTO negotiations failed to deliver.

The new type of bilateral free-trade agreement (FTA) proposed by the Commission is essentially based on two aims: On the one hand liberalization would be extended beyond WTO obligations or obligations under existing agreements (WTO+ agreements). On the other hand, the future bilateral agreements target countries with considerable economic potential (size and growth) and with extensive trade barriers in place against EU imports and investors. These criteria were mainly relevant for the selection of the ASEAN countries (Brunei, Indonesia, Cambodia, Laos, Malaysia, Myanmar, the Philippines, Thailand, Singapore, Vietnam), India and South Korea as well as the Andean Community of Nations and Central America as targets for bilateral free trade agreements. The current negotiations with the ACP-group of countries (Africa, Caribbean, Pacific), which are supposed to be concluded at the beginning of 2008, play another important role, in particular in securing access to strategic raw materials and in protecting EU investments in those countries. Furthermore, negotiations with the Mediterranean countries (Euromed-countries) regarding market liberalization for European service providers and investors are on-going.

Given the strong mercantilist bias of the new strategy, it is not surprising that the new bilateral FTAs take up issues which have been pushed for by the EU in the Doha Round, but which had to be dropped due to fierce resistance from developing countries. These are in particular the so-called Singapore Issues, which include the liberalization of investment and establishment, the liberalization of public procurement, as well as regulatory discipline on competition. The liberalization of services and the protection of intellectual property rights, especially the enforcement of existing international standards (in particular the TRIPS-agreement of the WTO), also feature prominently among the issues covered by the bilateral trade agreements. Last but not least, in the negotiations the EU targets a wide variety of regulations, which are considered as non-tariff barriers to trade, and pushes either for their elimination or harmonization with EU standards.

Trade liberalisation as the panacea for development?

In contrast to the explicit liberalisation agenda of the Global Europe Strategy, the European Commission and Peter Mandelson in person have repeatedly claimed that it was not commercial interests but developmental concerns that were the primary motivation for negotiating Economic Partnership Agreements (EPAs) with the ACP countries. While Mandelson in a recent speech to the Committee on International Trade of the European Parliament conceded that 'trade is not the panacea for development', he insisted that 'only domestically driven policy reform built on firm foundations of good governance and an enabling environment for business and investment can secure the economic growth and development which the ACP countries need', and that 'trade is critical to support and build on this reform and, in so doing, deliver inclusive growth and jobs'. He continued by saying he

was ‘so keen that EPAs address issues such as competition policy, public procurement and trade facilitation’. On the basis of this recipe, which is firmly rooted in the liberal mainstream of development economics, the Commissioner seems to believe that ACP countries might escape, in his words, ‘commodity dependence and decreasing diversification’ and enter a path of ‘sustainable development, not unsustainable poverty’.[30]

In reality, the trade policy agenda that the Commission is proposing to the ACP countries resembles all the basic elements of the Global Europe strategy, both in terms of market access requests and regulatory disciplines proposed. Based upon GATT Art.XXIV, which stipulates a regional trade agreement to liberalise ‘substantially all the trade’ between the contracting parties, market access commitments demanded from ACP countries infer a significantly higher adjustment burden upon them than for the EU, which is already a rather open economy. Thus, for instance, the EU asks for tariff reductions covering up to 90% of traded goods, enhanced market access in services, liberalization of investment regimes as well as public procurement, enforcement of IPR protection legislation, and abolishment of non-tariff barriers.

The development content of the EPAs comes in via two channels: the first is given by the WTO legal framework on special and differential treatment. Instruments applied are longer transition and implementation periods, less than full reciprocity in tariff reduction commitments, and exemptions for a number of sensitive products. The second set of measures relates to the mitigation of adjustment costs and the elimination of supply side constraints. Here, funds are to be supplied by EU and Member States’ development cooperation programmes, in particular the European Development Fund, in order to stabilise the public budgets for the loss of tariff revenues after the implementation of tariff reduction commitments. Given that tariffs are responsible for up to 40% of total public revenues in many ACP countries, the importance of this issue becomes evident. In addition, under the heading ‘Aid for Trade’ money shall be made available to support infrastructure investment, diversification of export-oriented production activities and their marketisation, technical training and similar activities. For that purpose the Commission has offered to set up regional funds in each of the six EPA regions, that administer the proper use of those financial resources. However, no precise numbers have been announced yet, since the Commission wants to make funding dependent on the extent of market liberalization commitments accepted by the ACP countries.

Thus, clearly, the European Commission’s view on the nexus between trade and development is informed by what some critics have termed the augmented Washington consensus. Augmented in the sense, that it sticks to the original agenda of the Washington Consensus with its agenda of liberalisation & deregulation plus tight fiscal policy, but augments it with regulatory and governance reforms. Thus some limited aspects of the mainstream critique of the Washington consensus, which have been voiced by prominent economists such as Joseph Stiglitz (e.g. Stiglitz and Charlton, 2005) or Dani Rodrik (e.g. Rodrik, 2004) are taken into account. Unfortunately, recent economic studies are not very positive about the results of implementing policies along the lines of the augmented Washington Consensus. An analysis by Rodrik, Hausman and Velasco (2005) has shown, that while episodes of high economic growth were quite frequent during the second half of the 1990s, almost none of these had their

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[30] All citations are from ‘Remarks by Peter Mandelson, European Parliament debate on Economic Partnership Agreements’, Strasbourg, 22 May 2007, http://ec.europa.eu/commission_barroso/mandelson/speeches_articles/sppm149_en.htm

origin in comprehensive policy reform. Secondly, comparative historic studies have clearly shown that, in contrast to present-day institutional and regulatory structures, virtually all successful industrialised countries have extensively employed a wide set of discriminatory or protectionist policy instruments, the application of which is severely restricted if not prohibited under current international economic law. In a seminal study, Chang (2002) argues convincingly that decades of protectionist investment, trade, technology and other economic policies were a decisive factor for the industrial development of the UK, the US, Germany, Japan or Korea. Thus, the approach taken by the EU vis-à-vis the ACP countries risks throwing the baby out with the bathwater. Institution building to the likes of liberal economic states does not only surpass the capacities of most developing countries, it additionally risks blocking effective policies to foster growth and development by 'kicking away the ladder' which industrialized countries employed to achieve their success.

Thus, the error of the EU's approach in the EPA negotiations is exactly that it wants to implement an institutional structure, that may – under certain circumstances – be suitable for today's industrialized countries, but which is certainly not suitable for the current politico-economic conditions in the ACP countries, in particular the 38 Least-Developed-Countries (LDCs) among them. Thus the EU's strategy is likely to forfeit the economic development potential of the ACP countries, instead of unfolding it, against what has been repeatedly stressed by the European Commission. Unfortunately, the economic strength of the EU provides it with disproportionate negotiating power compared to the ACP countries. Certainly the EU will not hesitate to apply pressure on the ACP countries to coerce them into agreements, that might turn out to impose not only temporary but long-term 'adjustment costs' upon them.

Given the negative outlook regarding the likely results of these negotiations, would a failure of the negotiations not be a preferable outcome? On an abstract level, the answer to this is a clear yes. The policy recommendation would be: accept failure of the current negotiations and go back to the start! In terms of real-world politics, existing power asymmetries and relations of economic dependence between the EU and the ACP countries, a complete break-down of the negotiations is however not very probable. Indeed, by November 2007, it had become clear that, while the completion of comprehensive EPAs by 01/01/2008 was no longer a realistic goal, a majority of ACP countries were willing to conclude WTO-compatible interim agreements with the EU. Although these interim agreements only covered trade in goods, and exluded services, investment, government procurement and other issues, it had become clear that the fear of losing preferential access to EU markets had prevented most ACP countries from risking an outright break-down of negotiations. These countries were also committed to continuing negotiations on the out-standing issues in 2008.

Under these conditions, what can then be hoped for? Is there any room for improving on the current state of affairs of the negotiations in 2008? For assessing this question we should again look at the geo-political context of the negotiations. In contrast to the public claims that there are no commercial interests at stake, and that these negotiations are evidence of its benevolent altruism, the EU has a clear interest in securing access to strategic raw-materials (hydrocarbons, metals, diamonds etc.) in Africa. The aggressive strategies of the US and China have recently increased the continent's strategic importance and unleashed a race for securing strategically important investments in Africa. Clear indications exist that EU decision makers fear that Europe might lose influence in the region, unless the strategies of the US and China are countered with determined action by the Union. Therefore, ACP

countries could go further in testing the EU's propensity to compromise on points of major interests for ACP governments.

Overall, however, a major conceptual re-orientation of EU trade policy towards ACP countries would be necessary. Such a re-orientation would need a long-term commitment from the EU and a prioritization of the specific needs and economic weaknesses of each country in order to spur the development potential of each of them. Amongst other things, this would mean the construction of diversified productive structures with a prioritisation of production for the internal market, the development of infrastructure for the satisfaction of basic needs in nutrition, health and sanitation, investment in education, as well as the eradication of epidemic diseases which continue to plague large parts of the population. Within such an approach, trade policy would only play a subordinate, but supporting role for the gradual development of the ACP economies. Policy space in terms of the definition of tariffs and non tariff instruments in order to foster local development would have to be broadened instead of restricted as is currently proposed. Trade liberalisation, investment de-regulation and the like would only be implemented subsequently, as a consequence of successful economic development, and not mistakenly used as a panacea for development. For, only the development of underdevelopment would be the likely outcome.

Conclusions and policy recommendations

At first sight and from a mercantilist perspective, EU trade policy during the last 15 years has been a success. The current account balance improved considerably during that period, the EU has become an increasingly competitive economic region, being able to maintain or even improve its position as an exporter of goods and services. Nevertheless, the increasing external orientation of the EU's economy has not resulted in a significant improvement of macroeconomic performance. In particular economic growth has been weak, unemployment and social exclusion have been on the rise. A macroeconomic policy mix that is centred on monetary and fiscal austerity, wage moderation and the flexibilisation of the labour market has led to a chronic contraction of internal demand. Soaring exports have however not been able to compensate for the stagnation of domestic consumption. Indeed, the emphasis on exports and outward foreign direct investment must be identified as an essential element of an economic paradigm, in which increasing competitiveness remains the key ingredient of growth policy. Thus, the current macroeconomic framework of the EU resembles many elements of conventional supply-side economics, with economic growth being primarily driven by structural reforms and deregulation. In this model, the contribution of aggregate demand to growth remains centred upon exports and the extraction of surplus value via outward foreign direct investment.

Given the accumulating global economic imbalances and the recent financial crisis, it becomes ever more dubious if this policy can be sustained for much longer. With the US increasingly unlikely to be able to finance its huge current account deficit, a contraction of US import demand and a continued devaluation of the US dollar will be inevitable. The latter will of course reduce export opportunities for the export-oriented nations of Europe and South-East Asia. Thus, the EU will be forced to accept larger current account deficits, which in turn will imply that the burden for sustaining economic growth in Europe as well as in Asia must shift to stimulating internal demand. Hence, if the EU wants to avoid an economic recession

as a consequence of the downturn of the US economy, it must fundamentally re-direct its macroeconomic policy mix upon an expansionary path. That might serve both the purpose of stabilizing growth in the EU and helping to rebalance the world economy without a severe systemic crisis. It remains however to be seen if EU policy makers, and trade officials in particular, are ready to accept that task.

Direct investment[31]

In recent years EU corporations have more than matched US corporations in the scale of their foreign direct investment. Between 2000 and 2004, there were two years in which FDI by US firms exceeded that by EU firms, against three in which the opposite was the case. In 2004 itself, outflows from the EU were 115 billion euros against 183 billion from the US. In 2005, however, presumably because of the weak dollar, US companies repatriated a very high proportion of their foreign earnings. The unusual outcome that US-sourced FDI was actually negative in 2005, while EU-sourced FDI reached 136 billion euros, rising to 183 billion in 2006. Unless the problems of the dollar are rapidly resolved European firms seem likely to remain the world's biggest international investors. (Eurostat, 2006 and 2007). (In order to make the EU and the US directly comparable, the figures given here exclude investment by EU companies in other EU countries, and treat that as domestic investment.)

FDI Outflows from the EU

EU-25 for 2001-2004, EU-15 for 2000 (EUR mn)

	1999	2000	2001	2002	2003	2004
World	738 674	1 126 186	633 969	496 095	396 224	306 913
Intra-EU	411 600	689 140	327 828	362 199	260 710	191 963
Extra-EU	327 073	437 044	306 140	133 897	135 512	114 951
EFTA	13 617	79 765	9 768	25 752	12 999	-5 111
United States	202 122	186 368	158 706	2 704	47 055	-2 681
Canada	5 152	45 480	5 784	1 399	5 936	1 425
Japan	10 744	5 458	-8 875	10 193	5 847	8 116

Source: Eurostat (2006)

The EU has consistently supported the US in pressing for an ultra-liberal investment regime throughout the world. Although the liberalisation of international investment raises serious social, political and economic problems for developed countries, the problems arising in developing countries can be taken to be more acute and more serious. The multinational enterprises which gain access to developing countries' economies may present a challenge to all aspects of social control over the economy – labour conditions and employment regulation; access to and prices of important services; the functioning of domestic enterprises including SMEs; technological progress and the diffusion of technologies; the distribution of income and macroeconomic control.

[31] Drafted by John Grahl, Middlesex University, London, J.Grahl@mdx.ac.uk.

Western enterprises have attached increasing importance to the scope they have for investments in utilities and the provision of public services. In this they are backed by Western governments which have exerted pressure on developing countries to privatise public services and deregulate service provision. The outcome has frequently been a rise in the prices of such services or a decline in the standards of provision. In developing countries, where large-scale income transfers are difficult, the provision of public goods and subsidised services may be the only form of social policy which is practical. When foreign enterprises impose a purely commercial logic on the sectors concerned they undermine these social policies.[32]

These considerations are also relevant to the financial services sector: liberalisation and the free entry of western financial corporations may undermine such important methods of social control as subsidised credit for indigenous SME's or access to transactions systems for low-income groups. The incomers may compete only for the strongest and least risky lending opportunities and by doing so impair the ability of domestic banks to lend on a wide basis. A recent IMF study (Detragiache et al., 2006) confirms that the entry of foreign banks into developing countries may reduce access to credit in just this way.

Similarly, developing countries may use public procurement to achieve certain objectives of industrial policy such as the expansion of skilled employment opportunities or the widening of markets for key domestic firms. Unfettered liberalisation of procurement, which may mean that the related high-value activities are moved out of the country, may make it more difficult to achieve these goals.

The EU's external trade Commissioner, Peter Mandelson, makes it clear that his first priority is to promote the global interests of European corporations. He writes:

> But what do we mean by the external aspects of competitiveness? For me this means setting out a clear programme of measures to maximise the competitiveness of European companies when they trade. If our economic strength is built on trade, then our prosperity is directly linked to the openness of the markets we try to sell to.[33]

There has been growing resistance from many developing countries to Western pressure for unrestricted trade and investment liberalisation. Several Latin American countries have adopted a tougher position on inward investments. Data from UNCTAD (2006) suggest that, although liberalisation measures are still being forced through, there is an increased readiness to assert national interests against those of the multinationals: although they are still greatly outnumbered by liberalisation measures, worldwide new measures to control FDI have more than doubled since 2001.

The EU and the US have made parallel changes in their strategy to secure investment liberalisation. Until recently their efforts were concentrated on securing global agreements. The failure of the OECD's Multilateral Agreement on Investment and the developing countries' collective refusal to make big concessions in the Doha round of WTO negotiations has prompted both US and EU leaderships to switch to a bilateral strategy. Bilateral Free Trade Agreements are sought with individual developing countries or with small regional

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[32] For the example of water see Hall (2003).

[33] Speaking points by Commissioner Mandelson, Press room, European Commission, 4 October 2006.

groupings. So far the EU has concluded FTAs with Mexico, Chile, South Africa, Tunisia, Morocco, Egypt, Turkey and Lebanon. These agreements all involve commitments to substantial liberalisation of FDI by the developing counties concerned, often in return for very limited concessions by the EU (Oxfam, 2007).

Several arguments can be advanced against the current stance of the EU on these issues. Firstly, they are based on an uncritical identification of European interests with the interests of EU-based multinationals. It is not clear that an increase in the global profitability of the latter contributes to the welfare of European citizens. It will certainly fail to do so if the profits concerned are obtained at the expense of economic development in poor countries which is a key precondition for stability and security around the world.

Secondly, there are no longer impenetrable barriers between the developed and the developing worlds. The drive to commercialise public services in the EU itself is supported by the same political forces and economic interests as in developing countries. To the extent that FTAs and other devices weaken public provision and social control elsewhere they make it easier to undermine public goods, to lower regulatory standards and to impair redistributive mechanisms in Europe itself. In the context of the developed countries, where economic integration is already very high, the domestic or foreign origins of investment as such may be somewhat less significant than in developing countries. But it remains the case that liberalisation and the emergence of a global economy pose serious challenges to established modalities of social control.

Thirdly, in aligning their strategies with those of the US government, EU leaders are taking a narrow and short-sighted view of the global economy. Clearly the US has dominated early responses to globalisation: its massive financial system, its leadership in some key aspects of technology and the sudden collapse of its Soviet rival all reinforced US influence (as perhaps also did the persistently restrictive economic policies which have held back EU development over a long period).

It is obvious, however, that a multi-polar world economy is now emerging in which China, India and other giant economies will be increasingly able to affect the rules governing international economic relations. Although these countries are unlikely to challenge the process of economic integration as such they are equally unlikely to adopt ultra-liberal positions on trade and investment. Already, they are becoming important sources of international investment and as they do so the ability of western states to dictate the conditions of international investment will be challenged.

In these circumstances EU policies should aim at effective economic governance of the new multi-polar system, not at exploiting the last years of a declining hegemony for the narrow interests of corporate leaderships.

Banking[34]

The easing and, in some cases, elimination of controls on foreign capital inflows, has led to a major expansion of European banks in developing countries. Whereas hitherto such banks were mainly represented in former colonies, many European banks have taken advantage of banking crises in developing countries to buy local banks. In many cases this has been actively encouraged by governments in developing countries anxious to find new and solvent owners for local banks plagued with bad debt, backward technology, and inadequate methods of credit risk assessment. Geo-politics has also played a role in that many of those governments are reluctant to allow U.S. multinational banks (the only banks, other than European ones, active in merger and acquisition activity in developing countries) to buy up such a large share of local banks that might reduce them to branches of the U.S. banking system.

Nevertheless, this does not mean that the European banking systems operate independently of the financial system in the United States. Many European banks own subsidiaries in that country. But their operations there are marginal to markets in which large U.S. financial firms dominate trading and credit. However, the exposure of European banks to the U.S. and growing international financial integration means that credit conditions in North America have a disproportionate influence outside. A clear example of this has been the sub-prime credit market crisis in the summer of 2007. The resulting freezing of the market for mortgage backed bonds caused difficulties for European banks, like Northern Rock, which were unable to refinance their balance sheets in that market.

The first section looks at the rise in foreign bank ownership of banks in developing countries. The second section then examines European bank activity in developing countries. Finally, the third section discusses some of the policy implications of this expansion.

Foreign banks in developing countries - background

The rise in the very visible presence of foreign banks in developing countries is due largely to two factors. One is an autonomous process of financial development, in which economic activity is increasingly conducted using bank credit, rather than cash, as means of payment. Banks are required to settle such payments, and bank balance sheets expand as the bank deposits that are used as means of payment expand. Most developing countries started off with banking systems that mostly financed foreign trade. Banks became associated with foreign influence and, during the 1950s and 1960s, many newly independent governments nationalised banks in their respective countries, and set up state banks to promote economic development in particular sectors, such as agriculture, industry, and foreign trade. Banks were also used to finance government deficits incurred in pursuit of state-sponsored economic activities. All this had some effect in promoting the use of bank credit as means of payment.

However, a second factor came into operation during the 1980s, when fluctuations in commodity prices left many governments in developing countries with unmanageable foreign

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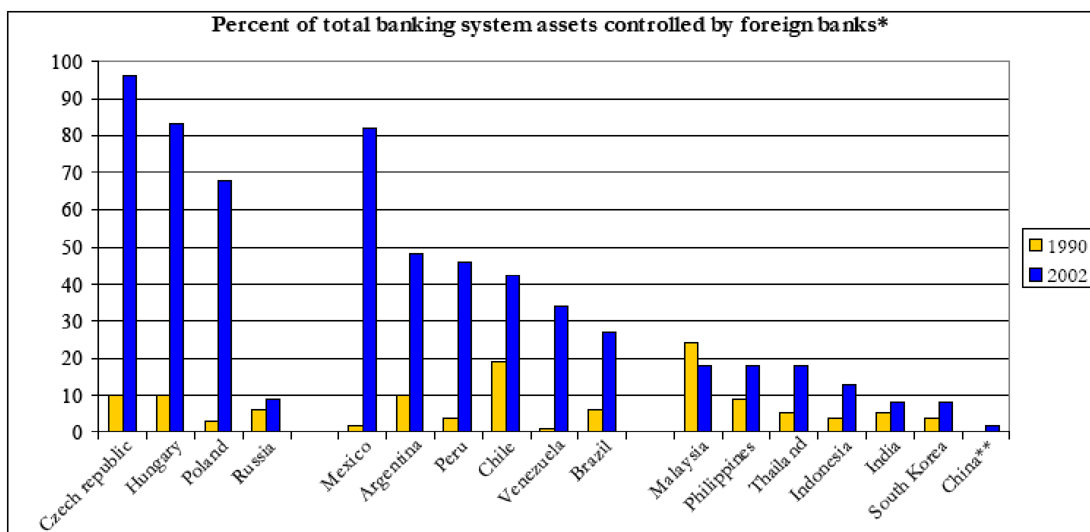
[34] Drafted by Jan Toporowski, jt29@soas.ac.uk. Research assistance from Ami Nath Mihdhi and John Roche is gratefully acknowledged.

debts. After various attempts at restructuring that debt through official and multilateral agencies such as the World Bank and the International Monetary Fund, a more practical solution was found at the end of the 1980s. This consisted in financial liberalisation and specifically removing controls on cross-border capital movements. Inflows of foreign capital then facilitated the management of foreign debt. Foreign direct investment in plant and machinery brought in little foreign currency. But privatisation of companies brought in more. The transfer of local banks to foreign ownership proved to be a solution to a number of difficulties: excessive bad debts in local banks; backward technology; poor systems of credit assessment; a lack of business among multinational companies whose investment was supposed to power the economic recovery of developing countries from their debt crises; and weak capital inflows. Multinational banking offers the possibility of overcoming all these difficulties by facilitating capital inflows.

In this way, during the 1990s, foreign participation in banking increased in many transition and developing economies. This increase was especially notable in the middle-income countries of Latin America, East Asia, and Central and Eastern Europe. Many of these countries now allow foreign entry through new branches and subsidiaries (*de novo* entry), but also through the acquisition of existing domestic banks. Total foreign direct investment in the financial sector has grown rapidly from $2.5 billion in 1991–95 to $51.5 billion in 1996–2000 and to $67.5 billion in 2001–5 (Martinez-Diaz, 2007).

In central Europe, the share of foreign banks in total assets and capital is now around two thirds or higher. Banking systems in this region have become the most highly integrated with the international banking system. In Latin America, foreign banks increased their share of deposits to 40% in 2000 from an average of 7% a decade ago. In Asia, foreign banks have increased their presence in Thailand and the Philippines. However, in some countries, foreign bank presence has declined as a result of expansion by domestic banks (Hong Kong and Singapore) and government-led restructuring (Malaysia). Overall though, the region has become more open to foreign banks: Korea, Indonesia and Thailand have raised the permitted equity levels in local banks to around 100%; the Philippines now allows 50% foreign ownership, and only Malaysia has retained a 30% ceiling on foreign ownership. Between 1995 and 2002, foreign banks increased their share of banking sector assets in 104 developing countries from 18 percent to 33 percent (Cull and Peria, 2007).



Sources: Based on data from John Hawkins and Dubravko Mihaljek, The Banking Industry in the Emerging Market Economies: Competition, Consolidation, and Systemic Stability: An Overview, BIS Paper 4 (Basel: Bank for International Settlements, 2001), 25; and Committee on the Global Financial System, Bank for International Settlements, 'Foreign Direct Investment in the Financial Sector of Emerging Market Economies,' March 2004, 9.

East Asia had the lowest levels of foreign bank participation throughout the period 1995-2002 and also exhibited the smallest increase. The share of assets held by foreign banks was close to 7 percent throughout the entire period. In terms of levels of foreign bank presence, South Asia follows East Asia as the region with the lowest levels of foreign bank participation. In South Asia, the share of assets held by foreign banks was almost 9 percent in 1995 and rose to 12 percent in 2000 only to drop to 10 percent by 2002. Finally, foreign bank participation in Middle East and North Africa was close to 12 percent in 1995 and rose only to almost 13 percent by 2002 (Martinez-Diaz 2007)

European banks' cross-border expansion

Until recently, and with the exception of currency areas in which capital movements were allowed, European banks did not undertake mergers with banks in developing countries due to capital controls. However, the elimination of capital of capital controls, in 1979 in the U.K., and at the beginning of the 1990s in the rest of Europe, was followed by the encouragement of cross-border merger activity in Europe in pursuit of a single European market in financial services (Chick 2000). In particular, banks with easy access to buoyant capital markets found it easy to raise finance to buy other banks at home and abroad.

The example of ABN Amro is illuminating. Having taken over banks in its home market as much as Dutch regulators would allow, ABN Amro rapidly expanded its cross-border consumer-banking operations, especially in Asia and Latin America. ABN Amro acquired a major interest in Thailand's Bank of Asia in early 1998, and in
mid-1998 became the first international bank in Kazakhstan. In late 1998, ABN Amro became the first Dutch bank permitted into Beijing, and also bought Banco Real, the fourth largest bank in Brazil, for $2.1 billion.13 It also operates branch networks in Costa Rica, Guatemala, Hungary, and South Africa. (Dymski 2002)

While in Africa, many of the foreign banks have been operating since colonial times,
entry in Eastern Europe and Latin America has been more recent. Foreign banks have come into Eastern Europe and Central Asia largely following the privatization of state-owned banks following the fall of communism in the region. The largest five foreign banks with operations in Eastern Europe and Central Asia are KBC Bank (Belgium), Erste Bank (Austria), HVB Group (Austria), Société Générale (France) and Unicredito Italiano (Italy). There are regional specializations of some foreign banks: large Scandinavian banks like Swedbank and Skandinavska Enskilda have large stakes in the banking systems of the Baltic States; Greek banks such National Bank of Greece, Piraeus Bank, Alpha Bank, and Emporiki Bank of Greece are present in the Balkan countries. Austrian banks (Erste Bank, HVB Group and Raiffeisen) have large shares of banking assets in most Eastern European and Central Asian countries, with the exception of the Baltic States. In Latin America, entry has been driven by foreign bank acquisitions of domestic banks. Two Spanish banks – Banco Santander Central Hispano and Banco Bilbao Viscaya Argentaria (BBVA) – have been particularly active in

buying banks in the region. However, other non-Spanish banks such as Citibank from the U.S. and HSBC from the U.K. also have an important presence in the region (Cull and Peria 2007).

Policy Implications

The bulk of recent research on foreign bank operations in developing countries (e.g., Cull and Peria, 2007) discusses issues of banking competition abstracting away from diverse levels of financial development in different countries, and from diverse economic structures, other than banking regulation, which determine how banks operate in particular situations. This kind of abstraction makes their analysis somewhat unreal, to say the least. The key policy factors affecting the operations of European banks in developing countries may be summarised as follows:

1. A number of European banks have always operated in the former colonies of their home countries, a development that owes its origins to the collapse of the gold standard, and the resulting concentration of international payments within imperial currency areas. The remnants of this today are the currency boards operated by France and Portugal, for the Franc Zone and Cape Verde. These currency boards are managed by the governments of France and Portugal. The effective conduct of international banking business in the currency board areas requires access to money and foreign exchange markets in Paris and Lisbon respectively. The result is that private sector banking business in these areas is dominated by French and Portuguese banks respectively. To assist in maintaining the currency board, capital controls are used, and this limits the access of foreign banks. In any case, the economies covered by these currency boards are tiny, with their GDP amounting to less than 3 per cent of French or Portuguese GDP. Currency board rules also specify strict financial limits on the governments in the currency boards, and these have tended to restrict economic growth. These economies therefore do not offer much attractive business to banks from other European countries.

2. The structure of banking markets in most countries is usually segmented in line with the segmentation of business. There is a household sector which, in developing countries, is largely unbanked. The sector of small and medium-sized enterprises accounts for most private sector employment in most countries, but in developing countries is largely unbanked. Large companies, which usually employ only a minority of the labour force, account for the bulk of private sector fixed capital investment. Through this activity large companies largely determine the dynamics of the private sector, i.e., economic growth, inflation and so on. Large companies are increasingly influenced in this by the extent of their financial liabilities in relation to their liquid assets rather than, as the textbook theory suggests, extending their financial liabilities up to the point where the return from their marginal investment just exceeds the payments on its financing (Cozzi and Toporowski, 2006). In most developing countries, with the significant exception of China and India, the local private sector is in any case dominated by multinational companies. Multinational companies diversify their financing across a number of international sources, as well as hedging their local financing needs, e.g., borrowing in the currency in which an investment is paid for. This makes multinational companies less influenced by competition in national banking markets, and less affected by the entry of foreign banks into such markets.

3. The business segment in developing countries in which the entry of European banks could make a major difference is that of small and medium-sized businesses. This segment has huge employment potential but has traditionally been unbanked. While much is made of the

difficulties that small businesses have in raising finance, in practice little additional finance can be made available without making these businesses vulnerable to problems of over-indebtedness. A large number of small industrial businesses in any case sub-contract work from large companies and multinationals and expanding the finance available to small businesses may simply increase competition in their markets to the point where profits are eliminated. This is therefore a risky segment for foreign banks. In any case, the point at which small businesses need finance most is in crisis or recession. No sensible bank would lend to such prospects. For these reasons European banks have concentrated on making the most of their international connections to win the business of multinational companies, and firms engaged in foreign trade.

4. Particular problems arise in circumstances where foreign banks take over the bulk of foreign trade and international payments business. This makes those banks, and the businesses using international banking services, much more vulnerable to foreign exchange risk. The stabilisation of the exchange rate then becomes a major object of policy. Even where the exchange rate is nominally allowed to float, the disproportionate effect of that rate on the rate of inflation cannot be ignored by central banks (Levy and Toporowski, 2007). Exchange rate risk can be hedged by holding sufficient liquid assets in currencies in which liabilities are liable to arise. By and large therefore, banks and businesses will maintain liquidity in excess of their business financing needs when exchange rates float. In this situation, the banking system will tend to be more liquid. However, once the exchange rate has been stabilised, and still more in a currency board, the liquidity of a foreign-owned banking system will tend to revert back to the country in which its head office is located because that is the location in which its regulatory capital is assessed. The liquidity needs of international bank branches in smaller developing countries with a stable exchange rate against the Euro (or the dollar) can be more effectively met from global financial centres, rather than from undeveloped local banking markets. The result is a drying up of local money markets, and the increasing dependence of central banks in such emerging markets on operations in foreign currency markets, rather than in their own currencies. Thus, a paradoxical result of financial development is a suppression of money markets, and a weakening of monetary policy tools. European banks have contributed to this not only in currency board areas like the Franc Zone, but also in parts of Eastern Europe such as Estonia. This in turn makes those countries vulnerable to a withdrawal of credit when banks abroad perceive difficulties in those emerging markets.

5. International financial integration makes European banks vulnerable to shifts in the liquidity of financial markets in the U.S., such as the crisis in the mortgage-backed bond market in the summer of 2007. With the expansion of European banks outside Europe, there is a greater possibility that those banks may transmit difficulties in other financial markets to credit markets dependent on European banks. This may happen simply by withdrawing credit from markets that the European banks may perceive as most risky.

6. In conclusion, the dynamics of economic activity in developing countries are increasingly influenced through financial liberalisation by credit cycles. European banks do not themselves determine this course of events, but they increasingly participate in it.

Financial markets[35]

'Europe is a major player in global financial markets, comparable to the US.' This statement in the European Commission's Financial Integration Monitor of July 2006, can, on the one hand, be substantiated through evidence provided by the London based International Financial Services institute. Table 1 shows (in the last column) that in eight out of 16 sub-sectors of financial markets Europe (in the IFSL study including Switzerland) has larger volumes of assets or turnover than the US and is world market leader. The three largest asset management firms of the world are UBS of Switzerland ($2 trillion), Allianz Group of Germany ($1.5 trillion) and Barclays Global Investors ($1.4 trillion).

Table 1 Financial markets in US and Europe

Sectors	Markets	Date	Currency	Market size Europe	Market size US	% share of world market Europe	% share of world market US	Rest of world	Europe index (US=100)
Banking	Investment banking revenue	2005	$bn	16.63	23.39	*32*	*44*	*24*	**71**
	Cross-border bank lending	end-2005	$ trillion	14.13	1.92	*67*	*9*	*24*	**736**
	Commerical banking, assets	end-2005	$ trillion	41.7	10.9	*65*	*17*	*18*	**383**
Insurance	Insurance, global premiums	2005	$bn	1288	1143	*38*	*33*	*29*	**113**
	Marine insurance premiums	2005	$bn	10.30	1.90	*60*	*11*	*29*	**542**
Fund mgt.	Funds under management	end-2005	$ trillion	15.63	26.49	*28*	*48*	*24*	**59**
	Assets of high net worth individuals	end-2005	$ trillion	9.4	10.2	*28*	*31*	*41*	**92**
	Hedge funds, assets under mgt.	end-2005	$bn	325	715	*29*	*63*	*8*	**45**
Securities	Equity market turnover	2005	$ trillion	13.03	24.82	*26*	*49*	*25*	**52**
	Foreign equity trading	2005	$ trillion	3.04	1.83	*67*	*32*	*1*	**166**
	Domestic bonds, amounts outstanding	end-2005	$ trillion	11.06	20.31	*25*	*46*	*29*	**54**
	Int. bonds, amounts outstanding	end-2005	$ trillion	8.63	3.53	*59*	*24*	*17*	**244**
	Securitisation issues	2005	$ trillion	0.40	3.02	*11*	*83*	*6*	**13**
Derivatives	OTC derivatives, av. daily turnover	Apr 2004	$bn	1001	355	*66*	*24*	*10*	**282**
	Exchange-traded derivs. turnover	2005	$ trillion	487	819	*35*	*58*	*7*	**59**
Forex	Foreign exch., av. daily turnover	Apr 2006	$bn	1727	577	*55*	*18*	*27*	**299**

Sources: Sources as listed in charts in each section of the report

Source: International Financial Services, *Financial Market Trends, Europe vs. US 2006*, October 2006, p.2

On the other hand, the same table shows that the structural differences of financial markets between the EU and the US are very large. This is reflected in the enormous differences between the index-figures (with US=100) ranging from 13 to 542 (leaving aside cross-border lending, for which the European figure has to be substantially higher for logical reasons). The European share in marine insurance is more than five times higher than in the US, that in commercial banking assets four times higher, and there is also a clear lead– two thirds of world market - in foreign exchange trading, concentrated in London. On the other hand equity market turnover is half of the size of the US figure, and in securitisation issues (which triggered the current financial crises) Europe reaches only 13% of the US volume. A slow process of convergence is going on: in all eight sub-sectors where the European share was smaller in 2001 it had increased by 2005, while in four of the eight sub-sectors, where it was larger in 2001 it had declined (in the other four sub-sectors the dominant position of the EU was reinforced), as shown in table 2.

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[35] Drafted by Jörg Huffschmidt

Table 2 Financial markets in US and Europe

Index for Europe where US = 100				Change in index in 2005	Change in index in 2005
Markets where Europe was larger than US in 2005	**2001**	**2004**	**2005**	*over 2004*	***over 2001***
Cross-border bank lending	634	738	736	-2	+102
Marine insurance	425	641	542	-99	+76
OTC derivatives daily turnover[1]	341	421	---	---	+80
Commercial bank assets	411	383	383	0	-28
Foreign exch. daily turnover[2]	349	274	299	+25	-50
Int. bonds amounts outstanding	156	246	244	-2	+88
Foreign equity trading	247	213	210	-3	-37
Insurance, global premiums	84	109	113	+4	+29
Markets where Europe was smaller than US in 2005					
High net worth individuals assets[3]	108	96	92	-4	-16
Exchange-traded derivs turnover[3]	53	69	59	-10	+6
Domestic bonds amounts outstanding	46	64	54	-10	+8
Funds under management	42	61	59	-2	+17
Inv. banking revenue	53	58	71	+13	+18
Equity market turnover	42	53	52	-1	+10
Hedge funds assets under mgt[4]	17	39	45	+6	+28
Securitisation issues	7	11	13	+2	+6

[1]*Final column represents change between 2001 & 2004*
[2]*Data for April 2006 not April 2005* [3]*North America not US* [4]*First year 2002 not 2001*
Source: Sources as listed in charts in each section of the report

Source: International Financial Services, *Financial Market Trends, Europe vs. US 2006*, October 2006, p.7

While one therefore cannot say that in terms of size and volume US financial markets are in general more important than European ones, there are two indicators which point to a larger weight of the US in European financial markets. The first one is the fact, that the US share-holding in the top European banks is larger than the European share-holdings in US banks (see Table 3).

Table 3

: Top ten European and US banks – bilateral shareholding in 2003 – in %

European bank	US shareholding	American bank	EU shareholding
Credit Suisse Group	2,8	Citigroup Inc	4,2
UBS AG	7,6	JP Morgan Chase & Co	4,4
ABN Amro Holding NV	21,2	Bank of America Corp	7,4
ING Groep NV	23,0	Wells Fargo & Co	0,0
BBVA Bancomer S.A.	n.a.	Wachovia Corp	1,1
Santander Central Hisp. Group	n.a.	American Express Co	1,3
BNP Paribas	12,5	Morgan Stanley	1,9
HBSC Holdings Plc	n.a.	US Bankcorp	1,1
Royal Bank of Scotland Group Plc	15,00	Goldman Sachs Group, Inc	1,3
Barclays Bank Plc	n.a.	Merrill Lynch & Co, Inc	1,2

Source: BIPE/PWC (January 2006)

The second indicator is that, in terms of strategy and behaviour, financial-market actors in Europe are adjusting themselves to the US pattern. This is particularly evident in two segments of so-called ‘innovative’ financial products imported from the US: private equity and hedge funds. Both have been developed in the US since the early 1980s and did not play a role in Europe before the late 1990s. The majority of private equity capital invested in Europe still comes from the US, and the largest PE firms operating here are US-firms (KKR, Blackstone, Cerberus etc.). The same is true for hedge funds. The most important consequences of this are those for corporate governance and culture: the dispersion of short-termism – PE buy in order to sell a few years later – and of shareholder value orientation (implemented through hedge funds via shareholder activism for quick and large dividends). The effects take place not only in areas in which PE-firms and hedge funds invest but there is a strong contagion effect upon all firms, even upon those without direct PE ore hedge fund investments.

The strategic behaviour of European financial-market actors emulates US patterns but it is not imposed by these. Rather it corresponds to the interests of European financial investors and is a response to the same basic constellation: the increasing difficulties of generating an adequate return on the steadily growing amount of financial assets which is itself a consequence of the continuous redistribution of income from bottom to top and of the privatisation of pension systems. Therefore we see all large and even some smaller European financial institutions – and even as was the case in Germany, public banks - active in more or less risky financial activities all over the world, including the acquisition of sub-prime mortgages about which they have no knowledge. Leading European banks were involved in all major financial failures in the last 15 years, from LTCM to Amaranth etc.

European policies

European policies with regard to financial markets are almost entirely shaped and dominated by the doctrine of market opening, cost reductions and gains of efficiency and international competitiveness through open markets. Most of the liberalisation programme has been fulfilled via the Financial Services Action Plan (1999-2005). With the amendments of 2002 of the 1985 directive on ‘Undertakings for Collective Investments in Transferable Securities’ (UCITS) investment fund managers obtained enhanced freedom to invest in risky products, particularly derivatives and asset-backed securities (without the provision for the latter, the current mortgage crisis would not have been possible). What is even more alarming is that the pension fund directive (Directive on the activities and supervision of institutions for occupational retirement provision, 2003/41/EC) of June 2003 has largely widened the range of investment opportunities for pension funds so as to include foreign exchange and derivatives and to give – in principle - PE and hedge funds access to the resources of pension funds. However, this directive left open some options for member states to limit the range to which it will apply by national legislation. This has triggered strong attacks from the financial industry, particularly the hedge-fund lobby, and the current thrust of work within the European Commission is directed at the removal of these restrictions which are seen as an illegal obstacle to the free movement of capital. The same is happening to the ‘Market in Financial Instruments Directive (MIFID) of 2004 which leaves some room for member states to control and restrict strategies of financial investors for the sake of consumer protection and social security.

Alternatives

Alternatives to this subordination of financial markets to the interests of the financial investors should aim at:

- controlling the risks of financial investment through (e.g.) limiting the leverage of PE and hedge funds, higher capital requirements for banks' investment in PE and hedge funds and the prohibition or strong limitation of the securitisation and sale of bank loans;
- protecting social security systems from financial market risks: Where such systems are not public PAYG-systems but capital funded they should be strictly separated from all risky investment strategies: pension funds and insurance should not be allowed to invest in PE and hedge funds;
- protecting employees and firms from being exploited and plundered by short-term investors: this could be done by linking voting rights to a minimum holding period (e.g. one year) of shares and through enhancing employees rights in the management of the firm;
- maintaining and enhancing public financing opportunities particularly for small and medium firms; and
- using public development banks to support and implement national and European economic policy orientations based on public discussion and democratic political decisions, while limiting their international activities. Public banks should not be global investment banks or securities traders.

The bottom line of a sustainable alternative approach to European financial markets are monetary, fiscal and tax policies which stimulate employment and prevent the accumulation of financial assets for which there are no productive investment opportunities.

The Euro[36]

The creation of a common European currency has been argued for on a number of different grounds. Firstly, supporters of European integration have seen a common currency as an important political symbol. Secondly, following the creation of the currency snake (1973) and the European Monetary System (1979), the introduction of the euro (1999) has been the final step in dealing with the problems of exchange-rate instability between European countries since the collapse of fixed exchange rate in 1973. Thirdly, a common currency has been seen an important step in completing the project of a single European market (1986), since a common measure of value is supposed to promote greater competition in product markets. Fourthly, by pooling their strength, the single currency was intended to provide the members of the euro area with a greater degree of monetary-policy autonomy, especially for smaller countries which were particularly vulnerable to private capital markets – and the policy decisions of the German Bundesbank. Finally, and of concern here, the creation of a common European currency has also been seen as a means of challenging, or at least providing an alternative to, the leading international position of the dollar.

[36] Drafted by Trevor Evans, evans@fhw-berlin.de.

Background

The dollar was officially established as the leading international currency at the end of the Second World War under the terms of the Bretton Woods agreement, although the British pound continued to play a minor international role for a time. Following the collapse of the Bretton Woods system in the early 1970s, the dollar continued to serve as the main form of international money, reflecting its established use ('network externalities') and the still predominant international position of the US. The Deutschmark and the Yen also began to play a minor international role, but this was discouraged by the German and Japanese central banks due to their concern at losing control of monetary policy. Although the IMF issued small quantities of SDRs in the 1970s, these did not play a significant economic role.

The international role of the dollar benefits the US in a number of ways. First, US companies are able to conduct international business in their own currency and, unlike companies in other countries, are not exposed to exchange-rate risk, or the cost of covering such risk. Secondly, the US benefits from *seigniorage*: in a narrow sense this arises from the use of US currency in other countries (half the US currency in circulation is estimated to be held outside the country and was obtained by providing the US with something of value); in a broader, and economically more significant sense, it is able to finance a current account deficit, and it has done this on an increasing scale in every year but one since the early 1980s, thereby allowing the US to sustain a level of domestic demand far in excess of its domestic production. Thirdly, the US is insulated from some of the most serious negative effects of currency depreciation: because primary commodities are invoiced in dollars, a depreciation of the dollar does not lead to an automatic increase in their domestic prices; similarly, because the US's external liabilities are denominated in dollars, their value does not increase if the dollar depreciates. Fourthly, because of the dominant international position of the US capital market, there is pressure on other countries to emulate US regulatory standards.

Despite the privileged international position of the dollar, it has faced certain limits. The US government favoured the end of fixed exchange rates in 1973 in order to give it more policy autonomy, and it then attempted to promote US exports by encouraging a depreciation of the dollar. However at the end of the 1970s the depreciation threatened to spin out of control, as even the mighty dollar was not immune to the preferences of financial investors, and the US government was ignominiously obliged to issue bonds denominated in Deutschmarks; at the same time it agreed to a set of secret military and financial commitments with the Saudi Arabian government in order to head off a threat to begin pricing oil in SDRs. The international standing of the dollar was only re-established through a huge increase in US interest rates. Under the cover of a monetarist anti-inflation policy, this led to a major global recession in 1980-82 and ignited the Third World debt crisis. When the dollar then soared to unsustainable heights, the US government engaged in a rare moment of international collaboration, seeking support from other leading capitalist countries, first to cushion a decline in the dollar (the Plaza Accord in 1985) and then to stabilise the dollar (the Louvre Accord in 1987). Since that time, the US government has largely disdained from further international cooperation, using free-market ideology to justify the acceptance of a system which provides it with privileges not afforded to any other country.

The challenge of the Euro

The main factors which determine the choice of lead currency include (1) the size of an economy and its weight in international trade; (2) macroeconomic stability; (3) the depth and liquidity of the home country's financial markets; and (4) inertia arising from the benefits of network externalities – the pound continued to serve as the key currency for many years after the US had overtaken Britain in terms of economic output –although a corollary of this is that when change occurs, it can be quite rapid.

Table 1 shows that the existing Euro area is slightly smaller than the US in terms of share of world GDP, but somewhat larger as regards share of world trade.

Table 1

International comparison of key indicators, 2005

	Unit	Euro area	US	Japan
Population	m	313.6	298.2	128.1
GDP as % of global GDP*	%	14.8	20.1	6.4
GDP per capita*	EUR '000	25.5	35.6	25.9
Industry share of GDP	%	26.6	21.1	29.2
Service share of GDP	%	71.3	78.2	69.6
Unemployment rate	%	8.6	5.1	4.4
Export share (goods and services)	% of GDP	20.2	10.4	14.9
Share of global exports	%	15**	8.7	5.7
Current account balance (2006)	% of GDP	-0.2	-7.0	3.9

* Euro area: Figures for US and Japan at purchasing power parity in accordance with OECD
** Euro area exports excluding intra-EMU trade

Source: Deutsche Bank Research, *Euro riding high as an international reserve currency,* May 2007

The issue of macroeconomic stability is probably the one where the dollar faces the greatest problem. There is almost universal agreement that the US current account deficit, which reached $811bn (6.1% of GDP) in 2006, is not sustainable. Depending on the policies adopted by the US government, this could lead to a significant depreciation of the US currency, or inflation, or some combination of the two. Either would make the dollar significantly less attractive as a reserve currency.[37]

When it comes to comparing the depth and liquidity of financial markets, the key market is that in government bonds, since it provides the main form in which foreign reserves are normally held. At the end of 2005, the total stock of government bonds in the Euro area

[37] This point is stressed by Barry Eichengreen, 'Sterling's Past, Dollar's Future: Historical Perspectives on Reserve Currency Competition', University of California, Berkley, April 2005.

amounted to $4.7 trillion, while that in the US was $4.2 trillion.[38] However, although the US total is slightly smaller, its market is deeper and more liquid. First, the US issues far more short-term treasury bills, which are highly liquid. Second, the Euro area government-bond market is fragmented, and while the US has one issuer with AAA ratings, the Euro area includes several countries with lower ratings. Thirdly, the dollar repo market is the largest, most developed in the world, amounting to $6.1 trillion in 2005, compared with $4.8 trillion in the Euro area, which suffers from a lack of standardised legal documentation.

As far as so-called network externalities are concerned, a comparison of the extent to which the dollar and the euro are currently employed internationally yields the following results.

Trade: Global figures are difficult to come by. Estimates from 1998 indicated that 50% of world trade was invoiced in dollars, and around 15% in Deutschmarks, which was roughly equal to Germany's share of world trade.[39] Since its introduction in 1999, the use of the euro has increased.[40] In 2005, around 60% of the euro area's exports to countries outside the euro area were invoiced in euros; the figure for imports was slightly lower (oil is invoiced in dollars). Most of the remaining euro-area trade was invoiced in dollars. In the case of trade between the euro area and non-euro area EU members and candidate members, the share denominated in euros was somewhat higher.

Foreign-exchange transactions: At the time of the BIS survey in 2004, 89% of foreign exchange transactions involved the dollar on one side, while 37% involved the euro (the yen and the pound followed, with 20% and 17%).[41] In the case of exchanges between many other currencies, the cheapest procedure was first to buy dollars, so that the dollar continued to hold its position as the premier vehicle currency.

Banking: The role of the euro in international bank lending has increased since 1999, but its share remains considerably below that denominated in dollars. In 2005, excluding inter-bank loans, the total share of cross-border loans denominated in euros was 19.8%. The composition of these loans is shown in table 2. It can be seen that about one third of euro-area bank loans abroad are in euros. However, as with trade, the euro accounts for a larger share in the case of lending to Central & Eastern Europe (60%), and also to Africa and Asia (around 50% each).

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[38] This paragraph is based on Gabriele Galati and Philip Wooldridge, 'The Euro as a reserve currency: a challenge to the pre-eminence of the US dollar?', BIS Working Papers No. 218, October 2006.

[39] Quoted in Benjamin Cohen, 'Global Currency Rivalry: Can the Euro Ever Challenge the Dollar?', University of California, Global & International Studies Program, Paper 8, 2003.

[40] The rest of this paragraph is based on ECB, *Review of the International Role of the Euro,* June 2007, pp. 34-39.

[41] Bank for International Settlements, *Triennial Central Bank Survey, Foreign exchange and derivatives market activity in 2004*, March 2005.

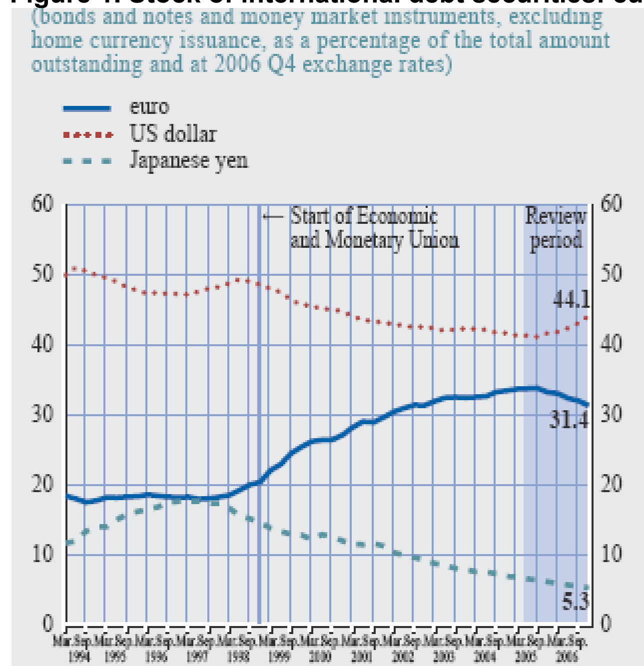
Table 2. Cross-border loans between euro area and non-euro area entities*

	Amount	Share (%)			
		Euro	Dollar	Yen	Other
Euro-area banks to non-euro area non-banks	$1,077bn	36.3	44.8	1.4	17.5
Non euro-area banks to euro area non-banks	$591bn	54.2	27.6	2.5	15.7
Non euro-area banks to non-euro area non-banks**	$1,067bn	16.7	50.1	4.8	28.5

Source: ECB, *Review of the International Role of the Euro,* June 2007, p. 27.
* Exluding inter-bank loans. ** Excludes loans to/from Japan, Switzerland, the UK and the US in domestic currency.

Capital markets: The issue of euro-denominated bonds in the international capital markets increased rapidly after the introduction of the euro. Famously, the issue of securities denominated in euros exceeded those in dollars during the first year of the euro's existence (the investment boom in the US was partly financed by borrowing in the euro area, where interest rates were, at the time, below those in the US). The evolution of the euro's share in the total stock of cross-border bonds is shown in figure 1: the euro's share rose from 19% to 34% after the introduction of the euro, although this was at the expense of both the dollar and the yen's share. The decline in the share of euro-denominated bonds in 2006 was due to a large increase in the issue of dollar-denominated long-term international bonds. At the end of 2006, the stock of euro-denominated international bonds amounted to $2.3bn while those in dollars amounted to $3.2 bn and those in yen to $0.4bn. Banks and other financial institutions accounted for the largest share of international bonds in all three currencies, but this was especially marked in the case of the euro, where they accounted for 67% of the total.

Figure 1. Stock of international debt securities: currency shares



Source: ECB, *Review of the International Role of the Euro,* June 2007, p. 15.

Primary commodity pricing: Primary commodities continue to be priced in dollars. (Iran invoices its oil in euros for political reasons, but this is not economically significant.) Some commentators have suggested that the recent rise in oil prices has, at least in part, been a compensation for the depreciation of the US currency. If commodity-producing countries, notably of oil, were to change their pricing policy, it seems the most likely option would be to shift to using a basket of currencies, which would presumably include a significant proportion

of euros. Since the composition of a country's reserves is linked to the currency in which its imports are priced, this would imply a greater reserve role for the euro. But that has not happened yet.

Currency anchor: According to the ECB, there are around 40 countries that anchor their exchange-rates to the euro, or to a basket of currencies which include the euro.[42] These include members of ERM II; currency boards; pegs and managed pegs based on the euro; and pegs and managed pegs based on a basket of currencies which includes the euro. As in the case of trade and bank lending, this includes a significant number of countries that are members or candidates to join the euro, or are geographically close to the euro-area. Among larger countries, Russia broke its de facto peg to the dollar in 2005, and pegged to a basket of currencies which included the euro, whose share was increased to 45% in 2007. Although it is not mentioned by the ECB, in 2005 China shifted from a peg against the dollar to a peg against a basket of currencies in which the main currencies are the dollar, the euro, the yen and the Korean won, although the precise composition of the basket has not been revealed.

Official reserves: Figures here are incomplete, as several important countries do not reveal the currency composition of their reserves. According to IMF data, the share of the euro in foreign reserves increased from 17.9% in 1999 to 25.3% in 2003, after which the share levelled out. Over the same period the share of the dollar fell from 71.0% to 65.9%. Table 3 shows that the share of euros held by developing countries was larger than that for industrial countries. The euro's share is second only to that of the dollar, and is far ahead of the pound, which recently replaced the yen in third place. China, which has the largest official reserves in the world, amounting to some $1.3 trillion by the end of 2006, is one of the countries which do not reveal the composition of its reserves. These have been held largely in dollars, but the government has announced a long-term policy of diversifying its holdings, so that dollars and euros will eventually have a similar weight.

Table 3. Currency composition of official foreign reserves (%)

	1999	2000	2001	2002	2003	2004	2005	2006
All countries								
US dollars	71.0	71.0	71.4	67.0	65.9	65.8	66.5	64.6
Euros	17.9	18.4	19.3	23.9	25.3	25.0	24.4	25.9
Yen	6.4	6.1	5.1	4.4	3.9	3.8	3.6	3.2
Pounds	2.9	2.8	2.7	2.8	2.8	3.4	3.7	4.4
Industrial countries								
US dollars	73.5	72.5	72.7	68.9	70.5	71.5	73.7	71.6
Euros	16.1	17.1	18.0	22.4	22.1	20.9	19.2	20.7
Yen	6.7	6.5	5.6	4.4	3.8	3.6	3.3	3.5
Pounds	2.2	2.0	1.9	2.1	1.5	1.9	2.1	2.5
Developing countries								
US dollars	68.2	69.3	70.1	65.2	61.3	60.2	60.5	59.5
Euros	19.9	19.8	20.6	25.4	28.5	29.0	28.8	29.6
Yen	6.0	5.8	4.6	4.4	4.0	4.1	3.8	3.0
Pounds	3.7	3.5	3.5	3.5	4.0	4.9	5.1	5.7

Source: IMF, Annual Report 2006 and Databank.

Conclusions

Although the size of the euro-area economy and of its capital markets is approaching that of the US, the dollar is still the lead international currency, while the euro is now clearly the second most important currency. (The role of the yen has declined, falling behind the pound

[42] ECB, *Review of the International Role of the Euro,* June 2007, p. 41.

in key areas.) There is a group of countries, generally close to, or with close links to, the euro area which might be considered a euro-zone of influence, but this is much smaller than the comparable dollar-zone of influence, which includes all of Latin America and parts of Asia.

The largest challenge to the position of the dollar would seem to be the US current account deficit. A sharp depreciation would seriously impede its function as a store of value. The Left has tended to argue that, due to rivalries between capitalist states, a cooperative solution ('super imperialism') to the issue of international money is unlikely. Following Kindelberger, it is often argued that international monetary stability requires a single hegemonic power. However, Eichengreen shows that the currency composition of major countries' reserves prior to 1914 was not as dominated by pounds as often supposed, and argues that recent financial innovation has made it far easier to move from one currency to another, therefore reducing the advantage of network externalities. On this basis, he considers that any displacement of the dollar is likely to give way to a more diverse set of reserve holdings.

However, the process of innovation which Eichengreen refers to involves the growth of private financial markets which have enabled financial institutions to absorb an increasing share of the economic surplus, and which have been at the heart of increased international financial stability since the 1970s.

While some leading political figures have welcomed the euro's potential for challenging the dollar, neither the ECB nor the EU Commission appear to have pushed the international role of the euro. Indeed, the Maastricht criteria, together with the EU's trade policies, militate against this role.[43]

The development of the euro might provide certain developing countries with the possibility of reducing their dependence on the US currency. For the left, however, the proposal for a truly international money organised outside the framework of private markets, as advanced by Keynes, remains a more desirable goal.

Military capability[44]

In our changing world, the European Union would like to play a larger role on the international stage. For this purpose, the EU is trying to obtain the necessary means and capabilities to assume its responsibilities for fulfilling the so-called 'Common Foreign and Security Policy' (CFSP) and the 'European Security and Defence Policy' (ESDP). The EU has been increasingly involved in this process since 1998, when the United States resumed the arms race after the brief decrease in military expenditure during the period 1991-1998, following the breakdown of the Warsaw Pact. This involvement increased even further in November 2001, when the US commitment to the Great War against terrorism allowed it to further increase military spending.

According to Javier Solana, the EU's High Representative for Common Foreign and Security Policy, 'we need to build an international order based on effective multilateralism. Finally, we must tackle the threats, new and old*'*. In a paper welcomed by all EU heads of government, he

[43] This point is made by Jörg Bilbow, 'Global imbalances, Bretton Woods II, and Euroland's Role in All This', The Levy Institute, Working Paper No. 486, December 2006.

[44] Drafted by Georges Menahem, menahem@irdes.fr.

states that the European Union has to mainly focus its military strength: 'As a Union of 25 members, spending a total of 160 billion Euros on defence, we should, if required, be able to sustain several operations simultaneously. We need to develop a strategic culture that fosters early, rapid, and when necessary, robust intervention.' 'In a world of global threats, global markets and global media, our security and prosperity depend on an effective multilateral system.' Solana concludes: 'This is a world in which there are new dangers but also new opportunities. If it can become a fully effective actor, the European Union has the potential to make a major contribution, both to dealing with the threats and to helping realise the opportunities. An active and capable European Union would make an impact on a global scale. In doing so, it would contribute to an effective multilateral system leading to a fairer and more secure world.'[45] This is a call to battle against the 'unilateral world order' with the USA as the single world power, as promoted by the US government. The European Union is to become something like the second world power in a 'multilateral' world system.

A long-term process has prepared this policy. The types of military tasks which the EU might undertake were agreed as part of the Petersburg humanitarian tasks, which were first defined in the 1992 Maastricht Treaty, and reaffirmed as part of the Amsterdam Treaty in 1997. They involve humanitarian and rescue tasks, peacekeeping and crisis management, including the deployment of combat troops in peacekeeping. The 1999 Cologne document stressed that the EU should ensure the development of effective mutual consultation, cooperation and transparency between the European Union and NATO and that a stronger European role would contribute to the vitality of NATO in the 21st century. So, without the direct involvement of the US, the EU should be able to lead operations using NATO assets and capabilities. As scheduled in 1999 and 2000 at the Cologne, Helsinki and Nice Summits, the EU has sought to make substantial progress in harmonising military requirements and the planning and procurement of arms. In December 2000, the Nice European Council approved the creation of three new permanent political and military bodies:[46]

- The *Political and Security Committee (PSC or COPS)* is a permanent body in Brussels which consists of representatives with both political and military expertise. It is charged with keeping track of the international situation in the areas falling within the common foreign and security policy. The PSC maintains a privileged link with the Secretary-General/High Representative.
- The *EU Military Committee (EUMC)* is the highest military body established within the Council. It consists of the chiefs of defence of the Member States, and makes recommendations to the Political and Security Committee. During an operation, the EUMC monitors the proper execution of military operations. The EUMC is chaired by a 4-star flag officer from an EU member state, elected by the fifteen Chiefs of Defence and appointed by the Council for a period of three years.
- The *European Union Military Staff (EUMS)*, within the Council structures, provides military expertise and support to the ESDP, including the conduct of EU-led military crisis-management operations. The EUMS is to perform early warning, situation assessment and strategic planning for implementing the Petersberg tasks, including the identification of European national and multinational forces, and the implementation of

[45] See *A Secure Europe in a Better World,* prepared by High Representative for EU Common Foreign and Security Policy Javier Solana and approved in June 2003 by EU leaders meeting in Thessaloniki.

[46] Cf. an European Union Institute for Security Studies paper on ESDP bodies written by Antonio Missiroli.

policies and decisions of the EUMC. It is composed of some 70 officials seconded from the member states or contracted ad hoc.

Since 2001, this European military structure has been developed in greater depth:

- Under a joint Council action in July 2001, the EU decided to transfer two agencies from the Western European Union to EU structures, namely the Satellite Centre (located in Torrejón, Spain) and the Institute of Security Studies, in order to support the Union in the context of CFSP and in particular of the ESDP.
- In 2004, in order to have the capability to react rapidly and forcefully in trouble spots outside EU territory, the concept of EU Battlegroup units of 1,500 troops was launched, although these do not have to include a specific number of Member States. The initial commitment to form 13 Battlegroups has now been extended to 15, which are supposed to be operational by 2007.
- EU defence ministers have had the possibility of attending meetings of the European Council, together with foreign ministers, in order to decide where and how to intervene, and to define the different EU armament programmes.

So far, the EU has had two options as to how to run a military operation at the Operation Headquarters (OHQ) level:

- One option when carrying out a so-called 'autonomous' operation is to make use of facilities provided by any of the five Operation Headquarters (OHQs) currently available in European member states. These are: the French OHQ in Mont Valérien, Paris; the UK OHQ in Northwood; the German OHQ in Potsdam, Berlin; the Italian OHQ in Rome; and the Greek OHQ in Larissa. For example, in 2003, Operation 'ARTEMIS' in the DR Congo used the French OHQ, while the current EUFOR Congo military operation employs the German OHQ.
- A second option involves drawing on NATO capabilities and common assets (under the so-called 'Berlin plus' arrangements) to make use of command and control options such as the Operation Headquarters located at Supreme Headquarters, Allied Powers Europe (SHAPE) in Mons, Belgium and D-SACEUR as the Operation Commander. This is the option used in the conduct of Operation ALTHEA, where EUFOR operates in Bosnia and Herzegovina.

Lastly, since 2004, the *European Defence Agency* (EDA) has been established in order to improve the military capabilities of member states and to rationalize the fragmented European defence market. The head of the Agency, which is based in Brussels, is the High Representative for CFSP in person, and its Steering Board comprises the Defence Ministers of the 24 participating member states (all but Denmark) and a representative of the Commission.

These aims need money, but money also has to be invested better. For this purpose the European Defence Agency is to streamline the procurement of military equipment and to finance technological research in the defence sector. However, military operations cannot be financed from Community funds, and an administrative and financial mechanism called Athena was therefore established in 2004 to pool funds from all Member States (except Denmark).

EU policy has been the main impulse behind this process. But the defence industry has not stood idly by. On one hand, the government has a very special relationship with the defence

industry – as customer, regulator, and principal source of research and development funding. But, on the other hand, as was stated in a 2006 report of the EDA: 'less and less does it remain owner; and, as defence companies move progressively from government to private ownership, and as shareholder funds become increasingly prominent in the control of companies, so one may expect the normal laws of a globalised economy to apply; capital will migrate to optimise returns. This pattern of 'industry following the money' is already apparent in, for example, BAe Systems' significant acquisitions in the US, and the developing presence of other European companies in the UK market.'[47] Another example is given by French industry: since 1990, several major defence firms such as Thomson-Csf, Aérospatiale, CGE, SNECMA, Eurocopter, Sextant avionique, RVI, Hispano-Suiza, Messier-Bugatti, Auxilec and Socata have been privatised. At the same time, new European firms have been built by merging different national entities, such as EADS (merging French, German and Spanish firms) or Thales (merging French and English entities). And European and national firms are highly interconnected: in military concerns, EADS holds 75 per cent of the space company Astrium, 100 per cent of the helicopter manufacturer Eurocopter, 43 per cent in the Eurofighter jet fighter program, 37.5 per cent in the missile company MBDA, and 100 per cent of EADS Launch Vehicles, which is involved in Ariane and French ballistic missiles; meanwhile in civil concerns, EADS owns 80 per cent of Airbus and Britain's BAE Systems owns the remaining 20 per cent stake in Airbus. On the other hand, however, a number of the biggest firms in the sector have given up their military activities: this is the case with Siemens in Germany (373,000 jobs in 1990), Fiat in Italy (303,000 jobs), GEC in the UK (118,000 jobs), and Mannesmann in Germany (124,000 jobs).

As a result, compared with 1990, the average size of defence firms was smaller in 2005: there are only four groups with more than 100,000 workers, compared with ten 15 years before; and the average employment at the 32 biggest firms was only 40,000, compared with 71,000 in the early period. The table below summarizes some of the main differences concerning the concentration and specialisation of the defence industry in three countries: the United Kingdom, France and Germany.[48] One can notice that British and French firms' trends are closer than the German ones.

[47] Cf. a Long-Term Vision document (LTV), which was discussed by the EDA Steering Board on 3rd October 2006 and endorsed as a reasonable foundation for the EDA's medium-to-long term agendas.

[48] According to the SIPRI, *Yearbook 2007*, Oxford University Press, Oxford , 2007, compared with the SIPRI, *Yearbook 1992, World Armaments and desarmament*, Oxford University Press, Oxford , 1992.

Ratio of European defence firms ranked in the Top 100 according SIPRI data

	UNITED KINGDOM	FRANCE	GERMANY
Military turnover as per cent of total turnover			
1990	40	54	36
2005	52	64	29
Output per worker ($)			
1990	101 575	153 703	198 982
2005	207 081	266 708	309 913
Profits as per cent of net turnover			
1990	3	1	2
2005	7	4	2

The European armament industry is thus more privatised, concentrated and, above all, more autonomous than previously.[49] But new ways of directing and influencing the decision-making of armaments firms have been set up which are less state-centred and more globalised. For example, in the case of China's demand for high technology armaments, on one hand, EADS and Thales were inclined to extend their market toward the Far-Eastern countries. But, on the other hand, there have been a number of other types of deal: there was the possibility of orders from the US Air Force as a result of joint ventures between EADS and Boeing, since the two companies have been partners for several years on smaller projects, including the marketing of the Meteor air-to-air missile. Rainer Hertrich, the co-chairman of EADS, was very clear on this topic:

> Even if the EU did decide to lift the embargo, as a company we would follow our own policy […] A growing market such as China's is interesting for all companies and we are implementing a series of civil cooperation projects. But we are very aware of our interests. And we are strongly determined to make a very attractive offer to the US Air Force for the replacement of its fleet of aerial tankers and to establish ourselves on the American defence market – the biggest in the world. The American threat to stop all transfers and exports of technology to Europe shows clearly that we have to be aware of the United States in everything concerning China and Taiwan. We are dependent and vulnerable.

> *«Même si l'UE décide d'une levée (de l'embargo), en tant qu'entreprise nous devons suivre notre propre politique. /.../ Un marché en croissance comme la Chine est intéressant pour toutes les entreprises, et nous menons une série de projets de coopération civils. Mais nous connaissons très bien nos intérêts. Et nous sommes fermement décidés à faire une offre très attractive à l'US Air Force pour le renouvellement de sa flotte d'avions ravitailleurs, et à nous établir sur le marché de la défense américain - le plus grand du monde. Les menaces américaines de cesser tous les transferts et exportations de technologies vers l'Europe montrent clairement que nous devons tenir compte des Etats-Unis pour ce qui touche à la Chine et à Taiwan. Nous sommes dépendants et vulnérables»*[50].

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[49] Cf. Jean-Paul Hébert, *« Le débat stratégique sur l'armement 1992-2005 »*, Cahier d'Etudes stratégiques, N°38-39, Paris, 2006.

[50] AFP, April, 12, 2005.

The EU now has the capacity for autonomous action, backed up by credible military forces, the means to decide to use such force, and the readiness to do so. According to the Solana document, this will be done in accordance with the principles of the UN charter. However, referring to UN principles is not the same as requiring that operations are only possible on the basis of a UN mandate. This leaves open the possibility that the EU could act independently, without the consent of the UN – as occurred in the case of eleven EU member states who supported the NATO intervention in Kosovo, which was presented as a peace-keeping operation.

Appendix 1: European Bank Branches Abroad

BANKS COUNTRIES	HSBC	Group Santander (Abbey)	UBS	Clayton (Credit Agricole CIB)	Deutche Bank	ABN AMRO	Barclays	Nordea
AFRICA								
Algeria	1			1	1			
Angola		1						
Botswana							23	
Comoros				1				
Congo, Republic of				1				
Gabon				1				
Ghana							26	
Ivory Coast				1				
Kenya							53	
Madagascar				1				
Mauritius	12				1		19	
Morocco		1		3				
Mozambique		1						
Nigeria					1		1	
Senegal				1				
Seychelles							6	
South Africa	4	2	1	1	2	1		
Tanzania							4	
Tunisia				1				
Uganda							8	
Zambia							23	
Zimbabwe							25	
MIDDLE EAST								
Bahrain	7		1		1			
Cyprus	2		1	1	1			
Egypt	43		1	1	2	2	14	
Iran		1		1				1
Israel	4		1		1			
Jordan	3							
Kuwait	1							
Lebanon	6		1					
Libya	2			1				
Oman	6							
Palestine	1							
Qatar	6							
Saudi Arabia	74			2	1	1		
Syria								
UAE	16		2		3	4	3	
Yemen				1				
ASIA								
Armenia	5							

Bangladesh	9							
Brunei	12							
China, People's Republic of	83	2	3	10	3	4		1
Hong Kong	344		1	7	4	4	1	
India	70		2		9	5	4	
Indonesia	14		1	2	2			
Japan	5	1	4	6	1	2		
Kazakhstan	1			1	1	1		
Korea, Republic of	14		1	3	3	2		
Macau, SAR	6							
Malaysia	47	1	2	3	2	1		
Maldives	1							
Pakistan	5				2	1		
Philippines	27	1	1	1	3	1		
Singapore	27		1		5	5		1
Taiwan	16		1	2	3	4		
Sri Lanka	14				2			
Thailand	1		1	2	2	1		
Turkmenistan					1			
Uzbekistan						1		
Vietnam	4			2	1	1		
EUROPE								
Albania				1				
Austria			1	1	4	1		
Belgium	2	1	2	5	2	6		
Bulgaria				1	1			
Croatia					1			
Channel Is	36		1		1	1		
Czech Republic	11	1	1	2	1	2		
Denmark				1		3		340
Estonia								1
Finland				3	1	3		440
France	834	1	8	48	17	8		
Germany	12	5	12	6	934	6		1
Gibraltar						1		
Greece	27		1	3	2	2		
Hungary	11	1		2	1			
Ireland	14		1	2	3	1		
Italy	4	1	9	6	14	6		
Latvia								1
Lithuania								2
Luxembourg	4	1	1	5	1	3		
Malta	54							
Monaco	2		1	1				
Netherlands	1		1	3	2	6		
Norway		1		2	1	3		140
Poland	16	1	1	3	41	1		4
Portugal		1	1	5	48	3		
Romania				1	1	1		
Russia	2		1	2	3	1		1
Serbia					1			
Slovakia	3			1				
Spain	2	4	6	7	173	5		

Sweden	3		1	3	1	4		260
Switzerland	10	2	237	9	7	4		
Turkey	197			1	4	2		
Ukraine				2	1			
United Kingdom	1672	4	11	6	2	4		1
NORTH AMERICA								
Bahamas	8		1					
Bermuda	15							
Canada	334	1			4	3		
Honduras	74							
Mexico	1623	1	1		1	1		
Panama	83		1					
United States	1905	9			36	6		1
Virgin Is. (BOT)	1							
SOUTH AMERICA								
Argentina	248	1	1		2			
Brazil	1727	1	5		1	7		1
Chile	2	1	1		1	1		
Cayman Is.	6		1		1			
Colombia	32	1	1			1		
Ecuador		1				1		
Paraguay		1				1		
Peru	1	2						
Uruguay	5	1	2			2		
Venezuela	1	2	1			1		
OCEANIA								
Australia	35		2	4	2	6	1	
Cook Islands	1							
New Zealand	9		1		1	2		

Source: From respective banks' websites

Appendix II: Foreign Bank Participation in Developing Countries 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
DEVELOPING COUNTRIES	**18.1%**	**18.5%**	**21.2%**	**22.6%**	**24.5%**	**28.9%**	**30.5%**	**32.7%**
East Asia & Pacific	**15.0%**	**14.5%**	**15.1%**	**14.6%**	**12.6%**	**8.2%**	**7.7%**	**11.7%**
Cambodia						8.5%	8.3%	7.9%
China	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%
Indonesia	4.4%	4.7%	5.8%	6.0%	3.0%	5.7%	4.1%	3.9%
Korea, Rep.	2.1%	2.1%	2.2%	5.0%	4.7%	7.6%	4.9%	9.2%
Malaysia	24.9%	24.9%	25.0%	26.0%	23.1%	25.4%	22.7%	22.8%
Mongolia					0.0%	7.1%	11.3%	45.3%
Papua New Guinea	71.7%	67.0%	70.3%	63.9%	63.1%			
Philippines	7.9%	8.2%	8.5%	8.3%	8.6%	9.4%	9.8%	8.3%
Thailand	7.2%	6.9%	7.1%	6.5%	10.2%	9.0%	7.3%	6.7%
Vietnam	1.4%	1.8%	1.7%	1.0%	0.8%	1.0%	1.0%	0.9%
Europe & Central Asia	**13.0%**	**13.3%**	**14.7%**	**18.2%**	**21.1%**	**28.4%**	**32.7%**	**35.7%**
Albania						10.9%	15.6%	19.7%
Armenia			17.6%	24.6%	34.9%	49.3%	60.1%	59.1%
Azerbaijan	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Belarus	0.0%	0.0%	0.0%	7.2%	4.3%	3.8%	8.4%	9.5%
Bosnia and Herzegovina		5.3%	6.5%	7.4%	12.4%	34.0%	46.1%	45.1%
Bulgaria	8.2%	10.3%	10.3%	19.5%	30.9%	70.1%	55.5%	51.7%
Croatia	9.8%	13.6%	14.1%	14.6%	15.8%	19.1%	20.6%	42.1%
Czech Republic	14.2%	10.6%	13.7%	17.3%	31.0%	48.9%	61.4%	58.7%
Estonia	80.7%	78.9%	72.1%	74.0%	73.5%	73.1%	73.0%	72.7%
Georgia		10.6%	7.7%	6.4%	4.8%	20.0%	35.8%	36.2%
Hungary	22.4%	23.1%	42.1%	62.9%	67.8%	63.5%	63.3%	58.7%
Kazakhstan	12.6%	10.6%	15.8%	18.7%	18.6%	11.7%	12.6%	20.0%
Kyrgyz Republic						30.3%	33.3%	20.8%
Latvia	17.8%	30.4%	32.7%	35.3%	37.0%	37.6%	38.6%	38.8%
Lithuania	18.9%	28.4%	35.5%	36.9%	41.8%	62.5%	92.2%	91.3%
Macedonia, FYR	28.4%	27.1%	25.8%	23.3%	23.6%	47.8%	43.8%	41.8%
Moldova		1.6%	1.8%	1.8%	2.5%	7.9%	18.8%	18.3%
Poland	3.7%	8.4%	13.8%	27.1%	34.1%	37.8%	50.7%	49.3%
Romania	0.0%	0.2%	0.5%	12.9%	17.2%	25.9%	27.0%	26.5%
Russian Federation	2.0%	1.4%	2.7%	2.1%	4.5%	11.5%	13.7%	15.6%
Serbia and Montenegro						0.0%	0.0%	0.0%
Slovak Republic	8.7%	11.9%	18.0%	20.4%	21.5%	54.6%	56.6%	81.5%
Slovenia	6.8%	6.5%	6.4%	6.5%	6.1%	10.3%	14.3%	25.8%
Turkey	0.4%	0.3%	0.3%	0.4%	0.5%	0.9%	1.8%	1.8%
Ukraine	0.0%	0.0%	0.0%	0.0%	2.3%	5.8%	6.2%	6.8%
Uzbekistan			0.0%	0.0%	0.0%	0.6%	0.6%	0.8%
Latin America & Caribbean	**19.3%**	**19.4%**	**24.3%**	**25.0%**	**25.4%**	**29.6%**	**30.2%**	**33.2%**
Antigua and Barbuda						0.0%	0.0%	0.0%
Argentina	25.6%	28.1%	36.7%	40.0%	39.6%	47.8%	44.2%	37.5%
Bolivia	42.7%	40.5%	39.7%	44.4%	44.2%	40.9%	39.4%	39.4%
Brazil	9.0%	9.7%	14.4%	15.1%	17.3%	26.4%	30.4%	27.9%
Chile	31.0%	35.3%	36.0%	37.6%	38.8%	38.4%	40.0%	44.8%

Colombia	6.3%	10.9%	15.9%	18.0%	16.4%	25.8%	21.1%	17.4%
Costa Rica	0.0%	0.2%	0.6%	5.1%	5.0%	18.0%	18.4%	18.8%
Dominican Republic	11.1%	10.8%	9.9%	2.0%	17.5%	16.2%	17.7%	17.5%
Ecuador			26.0%	27.4%	28.2%	0.0%	0.0%	0.0%
El Salvador	1.0%	1.8%	2.9%	8.3%	8.3%	13.6%	13.5%	14.2%
Guatemala	6.0%	5.6%	6.1%	6.3%	7.0%	8.4%	8.6%	8.1%
Guyana	0.0%	0.0%	24.7%	27.5%	26.7%	23.5%	23.6%	23.1%
Haiti				0.0%	0.0%			
Honduras	2.3%	2.1%	2.1%	1.5%	1.5%	4.4%	5.0%	5.8%
Jamaica	24.3%	21.2%	32.9%	35.8%	21.9%	18.9%	19.3%	50.3%
Mexico	2.3%	4.3%	7.2%	7.5%	9.9%	28.5%	30.0%	61.9%
Nicaragua	0.7%	1.4%	3.0%	3.9%	3.8%	5.1%	4.3%	4.4%
Panama	59.7%	54.9%	51.5%	50.8%	48.4%	64.9%	64.2%	58.1%
Paraguay	69.3%	56.2%	73.9%	76.8%	77.2%	79.9%	81.7%	83.3%
Peru	51.7%	59.5%	63.1%	66.1%	64.8%	66.1%	66.7%	86.4%
Trinidad and Tobago	14.0%	13.5%	16.2%	17.1%	17.7%	11.2%	10.4%	10.4%
Uruguay	24.3%	14.2%	18.1%	24.4%	30.6%	91.8%	95.5%	94.5%
Venezuela, RB	4.8%	17.4%	29.1%	33.7%	34.3%	20.7%	30.2%	26.6%
Middle East & North Africa	**11.9%**	**12.3%**	**12.5%**	**12.8%**	**12.8%**	**14.4%**	**15.9%**	**18.8%**
Algeria						59.0%	67.5%	60.0%
Egypt, Arab Rep.	4.0%	6.0%	6.1%	6.1%	6.2%	6.9%	6.4%	7.1%
Iran, Islamic Rep.						0.0%	0.0%	
Jordan	12.8%	12.4%	12.9%	12.8%	12.8%	13.5%	13.7%	13.3%
Lebanon	29.6%	29.4%	29.4%	31.5%	31.2%	30.5%	28.9%	28.0%
Libya						0.0%	0.0%	
Morocco	18.6%	19.3%	19.5%	19.8%	20.4%	16.9%	17.3%	16.4%
Oman	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	8.0%	8.7%
Tunisia	10.8%	11.0%	11.5%	11.7%	11.9%	12.1%	14.9%	14.8%
Yemen, Rep.	7.3%	7.8%	8.2%	8.0%	7.3%	5.0%	2.0%	2.4%
South Asia	**8.6%**	**9.4%**	**9.7%**	**9.3%**	**9.4%**	**12.0%**	**10.9%**	**10.4%**
Bangladesh	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
India	0.9%	1.1%	1.3%	1.3%	1.3%	1.7%	1.4%	0.5%
Nepal	38.9%	41.7%	42.0%	39.4%	40.0%	52.8%	46.7%	45.4%
Pakistan	1.4%	1.5%	2.3%	2.4%	2.4%	3.4%	4.3%	6.0%
Sri Lanka	2.2%	2.5%	3.1%	3.2%	3.3%	2.3%	2.4%	0.3%
Sub-Saharan Africa	**30.2%**	**28.7%**	**32.4%**	**33.1%**	**37.4%**	**45.3%**	**45.3%**	**45.0%**
Angola							38.1%	43.0%
Benin		49.4%	48.2%	46.0%	46.0%		51.8%	53.1%
Botswana	79.6%	79.5%	79.7%	80.7%	83.0%	84.2%	84.7%	84.0%
Burkina Faso				44.4%	43.8%	24.4%	29.4%	30.4%
Burundi	39.2%	37.3%	37.6%	37.2%	36.4%	16.2%	23.6%	21.5%
Cameroon			65.4%	64.0%	63.9%	54.9%	56.7%	59.0%
Cote d'Ivoire	20.3%	19.7%	20.0%	23.8%	53.6%	58.3%	62.8%	61.8%
Ethiopia	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Ghana	28.4%	29.9%	53.8%	53.9%	57.6%	64.7%	52.1%	52.8%
Kenya	26.6%	27.6%	27.6%	29.4%	28.6%	31.6%	34.4%	36.0%
Lesotho						84.9%	86.1%	86.3%
Madagascar	42.3%				63.3%	62.1%	61.4%	62.0%
Malawi		8.9%	8.2%	8.1%	8.9%	33.7%	27.5%	27.9%
Mali	41.1%	41.3%	40.6%	40.3%	40.8%	57.6%	49.9%	48.9%
Mauritius	9.5%	19.7%	22.5%	32.8%	42.4%	24.6%	25.3%	24.7%

Mozambique		22.0%	38.4%	40.6%	44.8%	60.0%	72.2%	72.5%
Namibia	45.2%	42.6%	35.5%	33.8%	35.3%	47.4%	68.6%	66.9%
Niger						51.0%	51.1%	43.7%
Nigeria	10.1%	10.1%	10.1%	9.5%	12.5%	15.0%	10.5%	11.2%
Rwanda		22.4%	22.8%	21.1%	23.7%			
Senegal		43.1%	42.5%	42.6%	42.8%	42.3%	40.9%	39.1%
Seychelles		12.6%	13.1%	13.6%	13.8%			
Sierra Leone			0.0%	0.0%	0.0%	31.6%	32.2%	29.5%
South Africa	0.3%	0.2%	0.2%	0.2%	0.2%	11.4%	10.4%	10.8%
Sudan	0.0%	0.0%	0.0%	0.0%	0.0%	3.0%	2.9%	4.7%
Swaziland						79.1%	74.7%	71.1%
Tanzania		26.0%	31.5%	31.5%	34.6%	63.5%	64.3%	64.3%
Uganda	39.7%	38.5%	36.3%	69.8%	76.0%	53.8%	53.9%	55.4%
Zambia	55.2%	52.9%	93.6%	57.2%	61.1%	69.7%	68.4%	66.6%
Zimbabwe	45.8%	46.9%	49.8%	47.3%	58.2%	51.5%	33.8%	33.3%

Source: Cull and Peria (2007)

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EUROPEAN DEVELOPMENT AID POLICY: from a progressive track to the Washington consensus[*]

Angelo Reati

1. Introduction

My analysis of EU development aid policy establishes causal links between the evolution of economic theories and corresponding changes in policy. It accords with the conviction that the economic structure of any given epoch and the state of power relations at international and national level exert a major influence on economic thinking and policy. When international power relations have been relatively favourable to underdeveloped countries, and labour movements have been strong (for example, during the 1970s), economic theory has emphasized the importance of government action to eliminate development barriers and poverty traps, and economic policy has been actively applied towards this end. When workers' movements have been weak and the balance of international power relations have favoured developed countries (as in the 1980s), neoclassical theory has dominated economic thinking and a free market regime has ruled economic development policy.

My paper is organised as follows. I assess the motivations for EU aid to underdeveloped countries in section 2.[51] I then describe the current development gap between Europe and the recipients of EU aid, and the relative importance of this aid in section 3. These sections provide the background for my analysis of the parallel evolution of theory (section 4) and policy (section 5). Section 6 assesses current trends and section 7 presents some tentative proposals for progressive and mutually beneficial policy reform.

2. Reasons for the EU aid

The Treaty of Rome (1957) established the basis for European aid and development policy in its specific provisions for "associated countries". In the 1960s, the end of the era of European colonialism and a growing awareness among many Europeans of colonialism's responsibility for underdevelopment in Africa, Asia and Latin America (through outright plunder, enslavement and support for corrupt indigenous ruling classes) led many European policymakers to consider development aid as a moral obligation to undo an historical injustice. Of course, this altruistic motivation played only a minor role in the design and

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[51] The term "underdeveloped countries" is preferred to the current – and misleading – term of "developing countries" for two reasons. First, we shall see that the gap between the industrialised countries and the poorest countries still persists in spite of decades of policies to help their development. In other words they are not "developing" relative to the rich countries. Second, the causes of underdevelopment are only partially attributable to the countries involved, since the rich countries have strong responsibilities in maintaining underdevelopment. Thus in no way the term "underdeveloped" should be taken with a negative connotation towards the countries in question.

implementation of post-colonial European development policy. Two more powerful motivations inspired EU development aid after 1957.

There was, first, a *mutual interest* in offering development aid -- it helped both its developing country recipients *and* its European donors. Poverty reduction in underdeveloped countries created new export markets for the products of European countries. Second, there was a political and strategic interest in development aid – European states and policymakers saw aid as a means to insure *political* and strategic *influence* over their former colonies and, during the cold war, as a means to limit the influence of the Soviet Union. In recent years, the political motive has become more prominent. The EU now wants to be an active player in global affairs and, consequently, it has expanded its aid to Latin American, and to some Arab, Asian and Eastern European countries.

More recently, three additional motivations for development aid have played an important role in the design and implementation of EU policy: (*i*) development aid is crucial in the *safeguarding of international peace*: a stable international order can be achieved only if inequality among peoples is relatively low; (*ii*) aid helps *control immigration flows* towards Europe by reducing the economic incentives for migration from the poor South to the rich North;[52] (*iii*) aid can contribute to *environmental protection*, by reducing the need or incentives to destroy natural resources in the less developed countries (e.g. rain forests) in order to cope with extreme poverty.

3. The present situation

1. The development policy of the EU concerns essentially the former colonies of France and Great Britain, the so-called ACP or African, Caribbean and Pacific states. The policy is applied to 48 African countries,[53] 15 Caribbean countries, and 14 Pacific countries. The Human Development Index (HDI), designed and used by the United Nations as a broader measure of national well-being than GDP[54], indicates that the African States covered by EU-ACP policy suffer from extreme poverty; while the Caribbean and Pacific countries are on average somewhat better off. As shown by Table 1, the gap between the developed world and the poorest ACP countries is huge and has only been reduced slightly since 1975 (table 2).

2. In absolute value, the EU has been the world's largest donor of development aid since the 1990s. The European Union and its Member States have provided some 45% of total official development assistance, whereas the US has granted less than 20%. In 2005, these percentages were 52.2% for the EU Member States and 26% for the USA.[55] However, in relative terms, the European contributions have been low – less

[52] See European Parliament, Council, Commission (2006: the "European consensus", paragraph 40)

[53] They concern the totality of African States, except the Northern African countries. South Africa has a special agreement with the UE.

[54] The Human Development Index (http://hdr.undp.org/hdr2006/statistics/indicators/10.html) is a composite indicator on average achievements on:

(i) Long and healthy life: life expectancy at birth; access to health services, drinkable water; daily calories;
(ii) Knowledge : adult literacy rate; enrolment ratio for primary, secondary and tertiary schools;
(iii) Decent standard of living: Real GDP per capita; diffusion of newspapers, TV, etc.

HDI ranges between 0 and 1. HDI is a better indicator of the degree of development of a country that the simple GDP per capita.

[55] Source OECD: www.oecd.org/dac/stats/idsonline

than 0.5% of their Gross National Income (GNI) in the 2000s. Although this figure exceeds the 0.16% offered by the USA (Table 3), it is below the UN target of 0.7% of GNI. European Union institutions have recently pledged to achieve the 0.7% objective by 2015, with an intermediate collective target of 0.56% by 2010 (European Parliament, Council, Commission 2006, par. 23).

However, neither aggregate aid figures nor aid as a percentage of GNI are adequate measures of the significance of aid contributions, or of their likely impact on development. The American Center for Global Development has attempted to assess the importance and impact of development assistance policies by evaluating how coherent they are. For instance, they note that "tied aid" reduces the impact of development policies on receiving countries, and thus should be taken into consideration when assessing the absolute amount of aid granted by an industrialised country. Since 2003 the Center has used a "Commitment to development Index" (CDI) that adjusts aggregate aid figures by seven additional policy factors that likely modify the impact of aid (see Table 4).[56] The index penalizes countries that give with one hand (through aid or investment) but take away with the other (for instance, by having import barriers or by instituting development polices that generate more pollution in the recipient state).[57] It appears from table 4 that EU member States perform in quite different ways. While three of them obtain a very high score (Netherlands, Denmark, Sweden), three others display a very poor performance (France, Italy, Greece), and most of the remaining States range in the middle.

4. From theories .....

1. Economic theory had perceived the problem of underdevelopment and laid down the rationale for foreign aid as already as the 1950s, but it is only when labour movements in Europe became stronger, and when the international power relations and social consciousness were mature that theory was put into practice through structured policies of international aid. Two main theoretical approaches emerged:

(*i*) The *structuralist* approach, which analyzed the structures of and the interactions between the different parts of economic systems (Lewis 1954);
(*ii*) The *dependency* approach and the core-periphery analysis, which studied the nature of the North-South domination through exchange (Prebisch 1950; Singer 1950; Emmanuel 1972) and the appropriation by developed countries of the peripheral surplus through financial networks, direct investments and the action of their multinational corporations (A. Gunder Frank, S. Amin)

In Lewis's structuralist model, industrialization is achieved through the recruitment of a near unlimited supply of labour from the agricultural sector, which assures that wages would remain low and fixed at the level of subsistence. For Lewis, the only scarce factor is capital, whose rate of accumulation depends on the level of profits in the manufacturing sector. Since such profits are generally insufficient to provide the savings (and investment) necessary to increase growth and generate development, underdeveloped countries have to rely on two other avenues. Either their governments has to raise their levels of savings and

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[56] See www.cgdev.org

[57] See the footnote of table 4 for details, and Charnoz and Severino (2007, p. 111-114) for a discussion.

investment through public planning, or their savings have be financed by flows from abroad, by means of private and public loans or by international aid. Chenery and Strout (1966) theorised this aspect arguing that underdeveloped countries suffer from two gaps: (a) a savings gap: their domestic savings are insufficient to meet their investment requirements, and (b) a foreign exchange gap: their capital goods have to be imported and their exports may be insufficient to finance these imports. Foreign sources of finance thus become necessary.

Dependency theorists identified a series of more severe and systemic barriers to the development, such as the multifarious forms of the domination effect (Perroux) that characterises North-South relations. Prominent examples are: (i) the influence on economic structures that, for instance, prevents the local transformation of raw materials, (ii) the conditional aid, that subordinates development assistance to economic policy mandates imposed from outside (ex. IMF policy), or that requires recipients to purchase imports and transport services from donor countries, and (iii) the deterioration in the terms of trade.

Dependency theorists thus argued that poor countries could only break out of their poverty trap through endogenous development--- by insulating themselves from the world economy since "*by itself* 'freer trade' would even tend to perpetuate stagnation in the underdeveloped regions' (Myrdal 1956, p. 2, emphasis in the original).

The argument that the terms of trade were likely to continually deteriorate to the detriment of less developed countries was originally formulated by Prebisch (1950) and Singer (1950). Singer argued that: "technical progress in manufacturing [of industrialised countries] showed in a rise in income while technical progress in the production of food and raw materials in underdeveloped countries showed in a fall of prices" (Singer 1950, p. 478). Underdeveloped countries have to give a growing quantity of their primary products in order to import the same quantity of manufactured goods from rich countries (see also Emmanuel's (1972) "unequal exchange").

Prebisch and Singer's work inspired the UN "philosophy" on development[58] articulated in a 1952 General Assembly resolution that called for the 'correction of mal-adjustments' resulting from, among other things, secular movements in the value of primary products in terms of manufactures (quoted by Sarkar 2001, p. 313)

The Prebisch/Singer thesis was the subject of considerable empirical discussion and debate in the 1960s and 1970s and has been reconsidered again in recent times. The evidence has been mixed. Oil exporting countries have shown no secular deterioration in their terms of trade during the last decades. Middle-income export manufacturers such as Brazil, Mexico and several Asian countries have experienced mixed results.[59] Meanwhile, a group of about 45 less advanced and poorer countries, the majority of them on the African continent, have experienced unambiguous and long run deterioration in their terms of trade. In a wide-ranging survey of empirical and theoretical literature, Sarkar (2001) concluded: "the empirical base of the Prebisch-Singer hypothesis is much stronger that it appeared in earlier decades" (cit., p. 309). See also Szirmai (2005, p. 288-294 for further discussion and data).

2. The above contributions – and the abundant literature that followed (see Szirmai 2005) – did not supersede neoclassical theory with its pretension to solve the underdevelopment problem by simply extending to the economies involved its policy recipes for the rich

[58] Actually both economists worked for the UN. In particular, Prebisch was responsible for the Latin America Department and, from this position, he could see directly the deterioration of terms of trade that afflicted this part of the world.

[59] This countries are "developing" in the genuine sense of the word

countries. As we know, the basic tenet of this theory is that the market can automatically generate growth. Thus, development policy should just aim at freeing market forces, at removing government controls and market distortions in order to have the "right" prices, and to favour competitiveness. Apart from some limited periods, such a theory inspired the conduct of the international financial organisation (World Bank and IMF).[60] International aid is admitted as an exceptional measure to overcome bottlenecks and poverty traps, but is subject to strict conditionality. This materialised in the so-called Washington consensus, which called for the imposition of a policy regime on underdeveloped countries that included fiscal discipline, lower and less progressive tax rates, reductions and redirections of public expenditure towards health, education and infrastructure, trade and foreign direct investment liberalization, the privatisation of productive assets, the deregulation, of business activity and the security of property rights from the threat of socialization or nationalisation.[61]

5. ...to policy: the evolution of EU/ACP Conventions

1. The Treaty of the European Union assigns three objectives to its development cooperation policy (article 177):

(i) to foster sustainable economic and social development
(ii) to gradually integrate developing countries into the world economy
(iii) to campaign against poverty

In addition, Community policy in this area should contribute to developing and consolidating democracy and the rule of law as well as the respect of human rights and fundamental freedoms. This reference to democracy and human rights represents the main innovation with respect to the original provisions of the Treaty of Rome (1957).

The implementation of these provisions materialised in four stages of conventions, whose political approach evolved considerably, from a colonial to a more balanced relation, then to the WTO rules (Jennar 2005). We had:

- the Yaoundé (Cameroon) Convention, signed in 1963 with 18 African countries
- the first Lomé (Togo) Convention, signed in 1975 with 46 ACP countries, drawing in the former British colonies, and
  Lomé 2 signed in 1979 with 58 countries
- Lomé 3, 4 and 4 bis, from 1984 to 1995, extended to 70 countries
- the Cotonou (Bénin) Convention, signed in 2000 for a 20 years term with 77 countries: 48 African, 15 Caribbean and 14 Pacific countries (ACP).

2. In the 1960s, the predominant aim of European policy was to tighten links with former colonies but we can also perceive the influence of structuralist theories.

[60] During the 1960s and 1970s the World Bank's policy was much less free-market inspired than IMF. From the 1980s, however, the two institutions adopted the same theoretical line. Nevertheless, it is worth noting that, during the recent years, the World Bank has attenuated its previous strong neo-liberal stance.

[61] The term "Washington consensus" was initially coined in the early 1990s to describe the set of free market oriented reforms prescribed by the Washington-based institutions (IMF, World Bank, US Treasury Dept.) to solve the crises of Latin American countries. Subsequently, the Washington consensus acquired a broader - pejorative - connotation to describe the gamut of policies promulgated by the neoliberal economists.

The Yaoundé Convention provided aid to support economic and social infrastructures as well as financial, technical and institutional cooperation (the so-called "integrated approach"). On trade, it established the principle of non-reciprocal tariff preferences: access of associated countries products to the Union was facilitated without imposing on these countries the obligation to open their market to products from Europe. This was in line with the conclusion of economic analysis, particularly with the "infant industry" argument to justify protection.

3. The 1970s were characterised by a very interesting policy change, as the two Lomé Conventions reflected the progressive approach prevailing in that period – the awareness of the responsibility of the rich World in creating underdevelopment as well as a concern for social justice at the international level.

Under the influence of internal and international social movements and of dependency theory, financial support became an automatic right and, in addition, Europe gave a practical implementation of the 1952 UN resolution on the problem of the deterioration of the terms of trade. Thus Lomé 1 Convention created *Stabex*,[62] a fund to compensate ACP exporters for losses resulting from price fluctuations in global markets.

At the level of principles, Stabex marked a dramatic progress – a progress that was reinforced by the Lomé 2 Convention, which extended the Stabex guarantees to mining products by establishing *Sysmin*, applied to associated countries that were heavily dependent on the mining sector. [63] Stabex and Sysmin were strongly criticised as being ineffective and under-funded, but this does not undermines their importance as a concrete acknowledgment by official policymakers that underdevelopment was a problem of "unequal exchange" resulting from the evolution of the terms of trade.

Lomé 1 Convention also contained a protocol favouring ACP exports to the Union for sugar, beef meat and bananas, granting also financial support for infrastructures and farm programmes. On trade, it confirmed the principle of non-reciprocal tariff preferences.

Two other aspects are worth noting – one positive and the other negative. The first point concerns the increase of the share of multilateral aid with respect to bilateral aid that occurred in the 1970s.[64] This represented a progress for the receiving countries since aid flows from multilateral sources are allocated essentially in accordance with recipients needs criteria, while bilateral aid is made largely in support of donors' economic, political and security interests (Jepma 1991, p. 13).

The second aspect – linked with the previous one – refers to tied aid. While the awareness of the negative effects of this practice for the receiving countries increased in relation with the progressive climate of this period, no real progresses were done to solve the problem. In fact, at that time the EU Institutions discussed only the possibility of a political compromise consisting in replacing the tying of bilateral aid by a tying to the EU as a whole.[65] This would have improved the situation of the underdeveloped countries by

[62] Stabex stands for "System for the Stabilization of Export Earnings"

[63] Sysmin is the acronym for "System for Stabilizing Minerals"

[64] The average share of aid by multilateral agencies with respect to total was 14.5% in 1970-1971, while it attained 25.7% in 1979-1980 (Jepma 1991, p. 37). During the 1980s it stabilized at approximately 25% (id., p. 13)

[65] See Jepma (1988) for an estimation of the likely effects of such a measure.

Indeed, discussions on untying had already started in the 1960s, in connection with the Yaoundé convention

widening the range of their possible suppliers but, even on this modest scale, no decision was taken.

4. Development policy in the 1980s and 1990s suffered from the upheaval of the social relations that started in the second half of the Seventies with the entry of the world economy into the long stagnation. The economic depression in Europe dealt a mortal blow to the labour movement, and free market ideology and neoclassical theory regained its hold over the minds of economists, opinion makers and policy elites in all countries. As European policy makers adopted austerity measures at home, they progressively shifted their development thinking towards what came to be known as neo-liberalism and the "Washington consensus".

In fact, while disbursement of money under Lomé 1 and 2 was not subject to any qualifications, Lomé 3 introduced some measures of conditionality, measures that were tightened under Lomé 4. In practice, European aid is increasingly linked to the fulfilment of IMF and World Bank programs of structural adjustment (see below) and to support for the private sector (Jennar 2005, p. 2). However, the decisive step towards the neo-liberal order in EU-ACP relations was taken with the Cotonou Convention.

5. The Cotonou Convention creates a system for staged development aid ("rolling programming") that is centred on results: grants are allocated on the basis of an assessment of requirements and performances in accordance with criteria negotiated between the receiving countries and the EU. The main instrument for this programmed aid is the country support strategy, a document drawn up for each ACP country by the Commission and the State in question, fixing the guidelines for using the aid. An indicative operational programme foreseeing specific operations and timetable for their implementation supplements the country support strategy.

Some provisions of the Cotonou agreement will, no doubt, help the ACP countries tackle the challenges of economic development. For instance, there is an emphasis on good governance: a specific procedure is applied in serious cases of corruption in any case where the EU has financial interests and where corruption is an obstacle to development (Moussis, pp. 498-9). However, other elements of the Convention will likely hinder their economic and political development. I note four of them below.

(a) The fact that aid is centred on results – i.e. it is conditional – *de facto* means that it will be offered only if recipients adopt the neoliberal policy agenda of the "Washington consensus". Indeed, in a recent document[66] the EU authorities state that the preferred modality for fostering economic and fiscal reforms is budget support for general public spending, and precise that "such programmes will normally require the *support* of the International Financial Institutions, *with which the Community's support will be co-ordinated*" (par. 113 of the "European consensus" already quoted; emphasis added). This will preclude ACP countries from pursuing independent development strategies and will drastically reduce the scope for government intervention.[67]

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[66] European Parliament, Council, Commission (2006): the "European consensus"

[67] See Chang and Grabel (2004) for an analysis of the multiple paths to development to be achieved via an array of heterogeneoius strategies that do not rely on the neoliberal agenda.

(b) As part of the objective of "gradually" integrate associated countries into the world economy, the post 2000 EU-ACP development agenda must conform to WTO rules. Trade preferences must now become reciprocal, in contrast with the pre-Cotonou regime where the poorest ACP States (44 out of 77) could benefit from some derogation of WTO rules. It has been estimated that, by removing duties on imports from EU, ACP States will loose between 15 and 60% of their total public revenue (Maputo Declaration 2004, par. 5). Moreover, it is likely that international competition will destroy a good part of their domestic industries, and the so-called "trade related technical assistance" on offer by the EU will do little to prevent this. In contrast, the Cotonou agreement does not reform European agricultural policies that protect Europe's farmers from international competition.

(c) To foster regional integration, the Cotonou agreements divide the ACP States into regional groupings, each of which are asked to negotiate separate Regional Economic Partnership Agreements with the EU. They too must conform to WTO regulations and they will prevent ACP countries from negotiating together as a bloc in protecting their interests in international forums.

(d) Under the Cotonou agreement Stabex and Sysmin are terminated. Price support can only be granted through a looser system of flexible programming within the framework of the "country support strategy".

Finally, the problem of tied aid remains intact. While estimates vary, at least half of the bilateral assistance offered by EU countries to their ACP partners is given in the form tied aid (Szirmai 2005, pp. 600-601). The main consequence is that ACP countries pay on average 15 to 30% more for goods and services procured under tied aid requirements than they would buy from other suppliers (Jepma 1991, p. 15).[68] Indeed, in 2001 the OECD recommended that such practices be ended, at least for aid programs to the least developed countries. In 2002 the European Commission addressed a communication to the Council (COM(2002)639 dated 18 November 2002) proposing an almost complete untying of Community aid, and advised the Member States to follow the same rule in their bilateral aid programmes. Unfortunately, these recommendations and communiqués resulted in the untying of only a limited portion of the aid granted by the European Institutions, and did not result in any obligation for the Member States to end this practice in their bilateral relations with ACP countries.[69]

6. Assessing the current trends

In this paper, I have tried to establish a link between the evolution of social and power relations in Europe and the parallel evolution of theories on underdevelopment and European development-aid policies. It appears that European development strategies passed through three distinct phases after 1950.

At first, European states sought to keep and reinforce their links with their former colonies, in order to secure privileged access to primary resources and export markets and to maintain political influence in Africa and other ACP countries. Of course, this phase was not

[68] European Commission (2003, p. 20) quotes 20-25%

[69] Regulations 2112/2005 and 2110/2005 dated respectively 21 November 2005 and 14 December 2005, in *Official Journal of the European Union* L/344 dated 27 December 2005

exclusively dominated by European self-interest but, following the prescriptions of the structuralist approach, some elements of this policy were beneficial for the recipients of aid – for example, the support for infrastructures, the financial and technical assistance, and the acceptance of trade policies to protect infant industries. This implicit recognition that free trade cannot promote industrialisation laid the basis for the non-reciprocal trade preferences granted with the Yaoundé agreement.

The 1970s marked a very interesting turn in European thinking and policy on development. Under the influence of the intense social struggles in Europe that started at the end of the 1960s and of the parallel wave of independence movements in the underdeveloped world, social consciousness progressed. A growing number of economists developed and successfully advanced various theories of dependency and unequal exchange. European governing elites took these on, applying these ideas in their development policies. Aid was considered a right for the underdeveloped countries, and two significant measures were taken to stabilize the receipts from exports of primary products – Stabex first and Sysmin later. Even if these measures were insufficient to solve the problem of dependency through exchange, their relevance at the level of principles is of paramount importance.

The third phase coincided with the deep regressive change in social relations in Europe from the second half of the 1970s. The economic depression and long stagnation that characterised this period and the 1980s, and the defeat of the working class that they produced, had profound influence on theory and policies. Economic analysis was redirected towards neoclassical theory and free-market doctrine permeated all internal and external policies. In consequence, development policy was increasingly inspired by the Washington consensus. This conservative shift started with Lomé 2 and Lomé 3 agreements and was definitively sanctioned by the Cotonou Convention.

The effects of the most recent agreement could be particularly harmful for the less favoured ACP States. In some cases, it will likely preclude the possibility of any industrial take-off. This holds particularly for the aim to insert ACP countries in the international trade system by eliminating the non-reciprocal preferences and by abolishing the derogations to WTO rules that were foreseen for some of them. Also the neglect of the problem of deterioration of terms of trade is especially negative. Instead of reinforcing Stabex and Sysmin and making them effective, the Cotonou agreement just suppressed them and replaced them with a loose form of support. In addition, the bargaining position of the ACP States has been seriously weakened by their division into separate groups for the conclusion of the "Regional partnership agreements" – *divide et impera*!

Some innovations introduced by Cotonou could be positive. I think of the fact that aid is now linked to results and to good governance. However, all depends on which grounds are used to define "results". Let us take an example. If the result of a policy is the increased number of persons having access to drinking water in an underdeveloped country, this criterion could be fulfilled when a private subsidized firm provides water to the solvent population living at the outskirts of a large city, leaving all the poor people without such a service.

Similar considerations apply to "good governance". By itself this is a good thing, particularly if it is an effective instrument to combat corruption. However, if the criteria for governance were the conformance with neoliberal policies – particularly the implementation of market-oriented instruments – the developing countries' right to autonomous development would be undermined (Grabel 2007).

7. Proposals for reforms[70]

1. A reform of the EU policy should be inspired by the desirability for the rich countries to adopt a far-sighted approach to underdevelopment, by limiting their short-term profits in order to build a more egalitarian world. In this way the moral motive to fight underdevelopment becomes fully compatible with an intelligent view of mutual interest.

Resuming the progresses made in the 1970s could be a useful starting point for searching ways to re-establish the most positive aspects of that policy and for its further deepening. The following preliminary points could provide the general background of the reflection:

- there is a gap between the reality and the intentions and programmes displayed by the European authorities
- it is misleading to speak of "partnership" – as it is now the case between EU and ACP States – when the relative power of the two parties is very unbalanced
- the present neo-liberal orientation in the EU/ACP relations will have catastrophic consequences for ACP countries, as it could definitely stick them with the poverty trap.

2. Taking into consideration the previous analysis, we suggest the following priorities:

• On conditionality and the Washington consensus

As noted above, the implicit reference to the IMF and World Bank structural adjustment programs is particularly negative – the past experience having abundantly demonstrated how they exacerbate the sufferings of the majority of people in the underdeveloped world. Consequently, EU should clearly recognise the right of each country to pursue its own way to development, without pretending to impose conditions that obey more to the ideology and interests of the rich world than to the long-term well being of the receiving countries.

• On multilateral *versus* bilateral aid.

For the reasons stated above, aid should be multilateral. This means that EU should aim at replacing the present situation where multilateral and bilateral aid coexist with a single system of multilateral aid obtained by pulling together the resources presently devoted by Member States. Obviously, within the present situation of nationalistic outburst, we are far from a possible political compromise in this sense that, as a side effect, will considerably strengthen the political dimension of the Union.

However, the European institutions should strive against this drift and present a schedule to pass from the present mixed system to a unified multilateral system managed by the EU Commission

• Untying of aid.

Discussions on untying date back to the 1960s and the recent regulations are very disappointing; among other things, they do not cover the bilateral aid granted by the Member States. It is now high time to solve the problem by deciding that all bilateral and multilateral aid must be completely de-linked from the obligation to buy goods and services to the donor country.

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[70] For a review of the heterodox economic literature on "pro-poor" macroeconomic policies see Saad-Filho 2007.

• On the deterioration of terms of trade.
We have seen that, particularly for the poorest African countries, this is a continuing phenomenon. Consequently, a new effective instrument, similar to Stabex and Sysmin, should replace the present loose system of support. The new system should foresee the right of an automatic support to stabilize export revenues.

• On the full exposure of ACP countries to the WTO rules.
The non-reciprocal preferences in favour of the poorest ACP countries should be re-established. Also, trade agreements should allow protection for ACP producers' domestic and regional markets (the "infant industry" argument fully holds)
By the same token, the reform of the Common Agricultural Policy should be extended in order to give full and free access to the EU market for the agricultural products of ACP countries

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Issues on Migration

by Mahmood Messkoub and Miren Etxezarreta

1 October 2008.

This paper is based on the debates and papers presented at the Work-shop on Migration held in Ljubljana , on the 28th of June by the Group on Migration of the European economists for an Alternative Economic Policy (Memorandum Group). The members of the PRESOM Migration Group are: Claudine Blasco, Mouhoud El Mouhoub, Markus Euskirchen, Miren Etxezarreta, Mahmood Messkoub. The contribution of all the members of the Migration Group to the debate is greatly appreciated.

ISSUES on MIGRATION

Modern migratory movement can best be understood in the context of a globalised market economy that directs and regulates the flows of goods, money and labour. Liberalization of trade and capital markets has resulted in goods, money and financial assets to move across boundaries with far less restrictions than labour. Unlike other goods labour is embodied in human beings with all its physical, gendered and cultural characteristics that are shaped by history giving labour migration its political and cultural dimensions. It is people who move and offer their labour in different countries and contribute to a globalised labour market.

Globalisation has accelerated the pace of liberalization, deregulation and flexibilisation along with deterioration of working conditions and wages of native workers in the low paid and low skill occupations of the EU. This situation has increased the demand for different types of low paid unskilled workers, employed under increasingly precarious conditions, a demand that has increasingly been filled by immigrant workers prepared to work in poor conditions. Migration is functional for the economic organization of rich countries, reducing labour costs and facilitating the existence of small and medium size firms. Who are these migrants?

In the past male migration dominated migratory flows to the EU and other rich countries, but now female migrants are at least as numerous as male migrants: 51% of immigrants to the developed countries are women. The feminization of migration is to a large degree driven by the demands of the care/health, leisure and sex industries.

Is EU and the North in general the main destination of international migrants? No, the bulk of international migration in the 20th century has always been South-South that has accelerated in the recent years due to rapid economic growth in the South. Moreover, the

difficulty of reaching the EU has forced tens of thousands of immigrants from sub-Saharan Africa to end up in the North Africa countries of Tunisia and Morocco Libya, Algeria, Mauritania and Egypt.

All migration flows have an illegal component that leads to over-exploitation of the migrant labour as well as creating an environment of fear and instability for migrants. This section of the memo deals mainly with economic migration. People however move for variety of reasons, including family reunion, fear of persecution in their home country, war and violence, all of which have social and economic causes and consequences for the immigrants and their host country.

The EU enlargement project has increased migration from the new member states given the disparities in living standards and income differentials between the new member states and the EU15. This is despite a seven year ban that all EU 15 countries (except the UK, Ireland and Sweden) imposed on labour migration from the new member states at the time of their accession in 2004. This has diverted the flow of legal migration to countries that have remained 'open' to EU labour migration, whilst illegal migration for work to other EU15 countries has continued. The impact of the seven year ban on overall level of migration has probably been limited, because people from new accession countries are free to move under the free movement of people rule but unable to work legally. Moreover, the cultural impact of 'freedom to travel' and 'to discover' has also influenced the recent migratory flows, as it has always done. Over time the disparities among the EU countries with regard to migration rules within the EU tend to decline. The easing of restrictions on mobility within the enlarged EU will imbed the 'freedom of movement' in people's lives, in other words people from the new accession states will not necessarily migrate permanently in fear of never being able to migrate again that may well lead to a circulatory migration pattern. This combined with the increased economic activity in the new accession countries and the narrowing down of the wage gap between within the enlarged EU would slow down flow of migration from the new members to the EU15. A case in point is the current experience of Polish migrants in the UK (which does not have any restriction on migration from Poland). A large number of them have been returning to Poland to take advantage of rising wages and the increased demand for labour in Poland. Similar patterns have been observed in migratory movements from earlier accession countries of Greece, Portugal, Spain and Ireland. In short there should not be any social and economic panic from the surge in migration from the new accession countries. These migrants have contributed to ease labour shortages at all levels of skill in the EU15.

Similar economic forces govern migration from the non-EU countries to the EU. However given that the income gap between the EU and the poorer countries outside the EU is not going to narrow in the foreseeable future and while the non-economic factors of war, repression and persecution would still be at work, migration flows from non-EU countries will continue. The young age structure of these migrants would help to provide support for a European ageing population directly through work in the care and other areas of service industry and indirectly through tax and social security contributions.

These positive impacts on destination societies and economies are often ignored in the media and popular debate on migration in the EU in which migrants are blamed for increased crime, pressure on the public transport, health and education system, and erosion of national identity. Influx of migrants (irrespective of origin as the case of Irish immigrants in the UK has shown) and their concentration in few areas would create tensions with the natives over the existing publicly provided resources. Public information campaigns and advocacy on the real impact of immigrants are essential if such conflicts were to be resolved. This is all the more important when it is noted that the underlying reason for the shortage and poor quality of public services (e.g. housing, education and health) in most countries is the erosion of these services due to the neo-liberal state policies of cutting back public expenditure that have been practiced in most EU15 countries in the 1980s and 1990s.

The impact of immigrants on the labour market is another major area of public debate on immigration. It is often stated that 'immigrants take jobs from the natives' and that 'they depress wages' of native population. Neither of these claims is borne out by evidence. In general immigrants complement the skills of indigenous labour that often could result to increased demand for native labour, especially if the sector relies heavily on immigrant labour. This complementarity means that immigration contributes to job creation. Studies in the US show that the declining industries like garments and leather goods experienced a revival in states such as California where cheap immigrant labour was available.

If there were to be any negative impact on the native wages as a result of immigration, these are usually sector specific, temporary, and on the low end of the wage scale. Over time increased profitability in these sectors leads to new firms moving in, that will increase demand for labour and gradually raises wages. Wages like any other price are only partially set by forces of supply and demand and the role of trade unions in wage settings and government regulatory framework on pay and conditions should not be ignored. In the UK, the minimum wage regulation has insulated, to some extent, the lower paid workers from the negative impact of migrants on wages.

The impact of immigrants on their country of origin has often been used as an argument against immigration. It has been argued that immigration results in brain drain and general loss of skills in the country of origin. This is a potentially serious problem but the available evidence shows that the loss of skills at origin is a matter of scale of emigration and employment opportunities for the skilled labour force. A 10-15 per cent emigration of skilled labour is argued to be the threshold that can be managed by the economy of the origin either through more effort by the remaining skilled people or replenishing the lost skill through training and education of the existing work force at origin. However, the brain drain argument is difficult to sustain once we note the income gap between origin and destination countries and at times lack of employment opportunities for the skilled people at origin. On the positive side, immigrants' remittances have contributed greatly to the foreign exchange reserves of the country of origin, that in some countries account for 5-10 per cent of GDP. In 2005 inflow of remittances to developing countries was as large as foreign direct investment to these countries.

The EU internal market project with its planned downgrading of internal borders has improved the flow of goods, services and EU nationals within the EU. This has been at the expense of tighter control of external borders and introduction of a new 'border control' regime by relying heavily on strict application of visa regulation (as in the case of visa application to Schengen countries), cross border cooperation between EU and neighbouring countries on security matters. A 'border land' has gradually replaced the geographical 'border line', that has brought the 'border' into the heart of EU countries where immigrants are expected to provide their credentials to the police and immigration officials in public spaces like train and bus stations, or when using public services like hospitals and schools. The Sarkozy government's plan to introduce DNA testing for family reunion of French immigrants from outside the EU is part and parcel of this 'border land' approach.

With the increasing difficulty of entering the EU, illegal immigration will become the only alternative contributing to people smuggling and trafficking. Illegal entry is no bar to employment in a tight labour market and especially in sectors where there is little supply of native labour. Immigrants, especially the illegal ones, are mostly doing the dirty, demanding and dangerous jobs that few natives would do. They are also hired mostly on a casual basis. Their precarious condition contributes to their super-exploitation. Even legal immigrants are not immune from such practices.

Marginalization of immigrants to low productivity and low pay occupations, slow progress through the ranks, temporary or short term work contracts, all of which contribute to

immigrants' low income and accumulation of assets. In countries where social entitlements like unemployment and public pensions are related to income, years of residence/employment/social security contributions will discriminate against immigrants, as they do against sections of native workforce (like women) who have similar work histories as immigrants, that is a shorter and interrupted working life as well as working in low pay occupations and sectors.

The EU is in urgent need of an immigration policy that combines its demand for labour with the social, human and economic rights of immigrants. Yet immigration policy at the EU level have always been viewed more as a security issue than a labour market or human rights issue. This view has to change if an immigration policy were to be formulated on the principles of: EU labour market needs, accepting immigration as an important dimension of globalization, freedom of movement as a fundamental human right, and integration of immigrants in the EU. In the short term, EU countries should regularize the status of illegal immigrants and offer permanent status to legal immigrants. This will reduce illegality and wasteful policing, whilst helping to promote an integration policy based on active participation of immigrants. On humanitarian grounds any restriction on the access of immigrants (whether they are legal and illegal) to basic public services such as health and education should be removed. In the medium to long run attempts should be made to move towards a common immigration policy across the EU based on international justice, solidarity and integration of immigrants, that draws on best practices of the EU national policies on admissions, naturalization, family reunion and labour market related issues.

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Table 1: The present gap in development

	Human Development Index (0 < HDI < 1) 1975	2004
USA	0.868	0.948
Japan	0.859	0.949
Ireland	0.813	0.956
Sweden	0.868	0.951
Belgium	0.849	0.945
Portugal	0.791	0.904
Mali	0.232	0.338
Sierra Leone		0.335
Ethiopia	0.293 *	0.371
Niger	0.234	0.311

* year 1985
Source : http://hdr.undp.org/hdr2006/statistics/indicators/10.html

Table 2: The gap narrows very slowly

	Human Development Index 1975	2004
USA/Niger	3.71	3.05
USA/Ethiopia	3.08 *	2.56
USA/Mali	3.74	2.80
Sweden/Niger	3.71	3.06
Sweden/Ethiopia	3.04 *	2.56
Sweden/Mali	3.74	2.81

* year 1985

Table 3. Net aid of the Member States as a % of Gross National Income

	1960-65	*1966-70*	*1971-75*	*1976-80*	*1981-85*	*1986-90*	*1991-95*	*1996-2000*	*2001-06*
Belgium	0,64	0,45	0,53	0,52	0,58	0,45	0,38	0,33	0,47
France	1,10	0,65	0,46	0,41	0,57	0,59	0,61	0,40	0,41
Germany	0,41	0,37	0,35	0,39	0,47	0,41	0,35	0,28	0,30
Italy	0,15	0,17	0,12	0,12	0,22	0,37	0,27	0,16	0,19
Netherlands	0,36	0,51	0,63	0,86	1,00	0,97	0,83	0,81	0,80
Spain					0,10	0,12	0,26	0,23	0,27
Sweden	0,12	0,31	0,58	0,86	0,87	0,89	0,93	0,77	0,86
United Kingdom	0,53	0,42	0,40	0,43	0,36	0,30	0,31	0,27	0,39
EUR-8	***0,47***	***0,41***	***0,44***	***0,51***	***0,52***	***0,51***	***0,49***	***0,41***	***0,46***
United States	0,57	0,41	0,27	0,24	0,24	0,20	0,16	0,10	0,16

Source: OECD (www.oecd.org/dac/stats/idsonline)

Table 4 – Commitment to Development Index 2006

Rank	Country	*Aid*	*Trade*	*Investment*	*Migration*	*Environment*	*Security*	*Technology*	*Average*
1	Netherlands	8.5	6.2	7.8	4.8	7.5	6.1	5.3	6.6
2	Denmark	10.0	5.9	5.3	5.0	6.1	6.9	5.5	6.4
3	Sweden	9.8	6.1	6.2	4.8	7.0	4.9	5.4	6.3
4	Norway	9.3	1.2	8.0	4.6	6.1	8.1	5.9	6.2
5	New Zealand	2.2	7.6	3.7	6.9	6.4	7.4	4.9	5.6
6	Australia	2.5	6.4	6.9	6.4	3.9	8.1	4.6	5.5
7	Finland	3.9	6.1	6.2	2.7	6.7	6.3	6.3	5.4
7	Austria	2.7	5.9	3.3	10.5	6.2	4.5	4.5	5.4
9	Germany	3.3	5.9	6.8	6.2	6.7	3.7	4.3	5.3
10	Canada	3.3	6.8	7.7	4.7	4.5	3.0	6.6	5.2
10	Switzerland	4.8	3.1	7.2	9.5	5.3	1.6	5.1	5.2
12	United Kingdom	4.6	5.9	8.6	2.6	7.8	1.6	4.5	5.1
13	United States	2.2	7.4	6.9	4.6	3.2	5.9	5.0	5.0
13	Ireland	5.9	5.7	2.5	4.6	7.5	5.9	3.0	5.0
15	Belgium	5.1	5.9	6.5	2.6	6.6	3.4	4.5	4.9
16	Portugal	2.3	6.1	6.2	1.4	6.4	6.2	5.1	4.8
16	Spain	2.5	6.0	6.7	5.2	3.8	3.5	6.1	4.8
18	France	4.1	6.0	5.9	2.6	6.1	0.5	6.9	4.6
19	Italy	1.6	6.1	5.5	3.2	4.8	3.9	5.1	4.3
20	Greece	2.7	5.9	4.0	1.7	5.2	5.6	3.0	4.0
21	Japan	1.1	–0.4	5.6	1.7	4.3	2.8	6.3	3.1

source: www.cgdev.org

Notes to table 4

Aid: The index retains gross international aid as percentage of donor's GDP, but it corrects for the quality of aid. Thus the index penalizes tied aid, subtracts debts payments to the rich countries and also looks whether aid favours the poor uncorrupted nations.

Trade: The index measures all kind of obstacles to exports of underdeveloped countries such as tariffs, taxes and subsidies to national producers.

Investment: The index looks, on the basis on 22 criteria, at what rich countries are doing in promoting investment that is actually good for development. For instance, do the government offer political risk insurance? Do they filter out projects likely to do environmental harm or to exploit workers? Do they control for corruption of their domestic enterprises when investing in poor countries? Etc.

Migration: The index considers the gross inflow of migrants from underdeveloped countries, weighting it by a number of factors. It rewards immigration of unskilled people, the openness to students from poor countries, aid for refugees and asylum seekers.

Environment: The index looks at what rich countries are doing to reduce their disproportionate exploitation of the global commons. How complicit are the in environmental destruction in underdeveloped countries? Etc.

Security: The index quotes positively contributions to peacekeeping and humanitarian interventions approved by the UN and withdraw points when weapons are exported to authoritarian governments

Technology: The index rewards policies that support the creation and dissemination of innovation in underdeveloped countries and penalises policies of intellectual property rights that can inhibit the international flow of innovation.

For more details see www.cgdev.org

Poverty and social inequality in the European Union

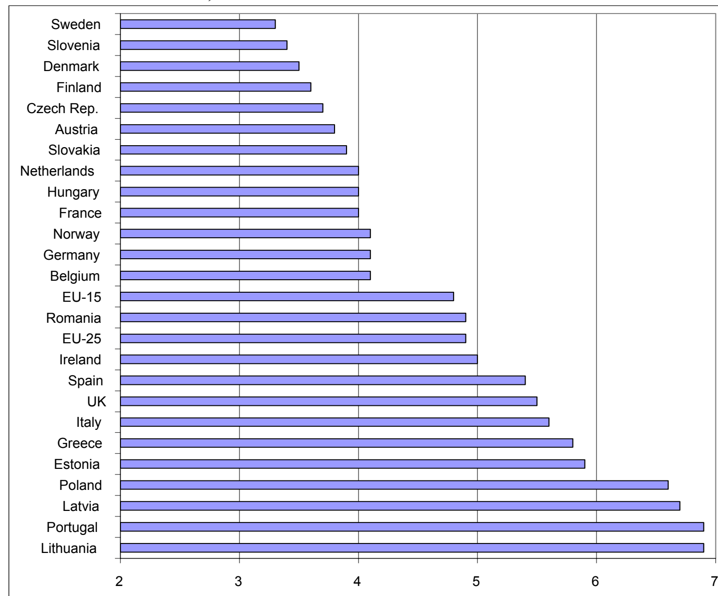
Anne Karrass, Michaela Moser, Susanne Uhl, Diana Wehlau

Some general remarks on social inequality

Inequality has been a major political issue in Europe for centuries. It declined substantially from very high levels in the early 20th century to the mid-1970s, with the development of workers' organization (trade unions, political parties) and the spread of parliamentary democracy.[71] This was reversed from the late 1970s, when inequality began to rise again, right up to today. The reversal began with the UK and US and spread to other countries as liberalisation and deregulation took hold. In some countries such as the UK or the US, the shares of those at the top have returned to the levels of the 1920s or 1930s (Atkinson/Piketty 2007: 11; Fig. 3 below). The changes are having a profound impact on society.

Levels of inequality and their changes[72]

Figure 1. Level of inequality of incomes, Europe, 2005
(Ratio of top 20% to bottom 20%)



Notes: Disposable income, after direct taxes and benefits, equivalised for household membership.
Source: Eurostat

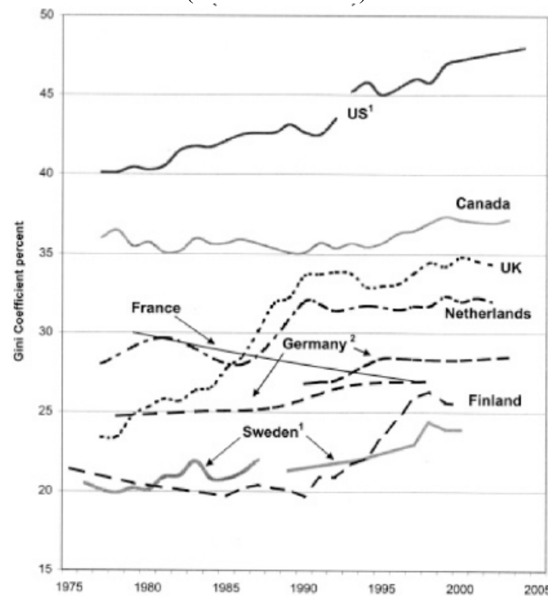
[71] A major increase in income inequality as measured by the top incomes took place in the 1930s in Germany, France and the Netherlands, which did not occur in the other countries for which data are available (Atkinson/Piketty 2007: Fig 13B). Piketty and Atkinson take the view that incomes at the very top were hit severely by the two World Wars, and were prevented from being reconstituted by the development of progressive taxation afterwards.

[72] The data used in this section concentrates mainly on inequality of *incomes*, keeping in mind that inequality of *wealth* is considerably greater than that of incomes and itself very much affects people's lives.

There are major differences in levels of inequality between the countries of Europe (Fig. 1); nevertheless they form a certain more or less clear pattern between different groups of countries, or social models. The *Scandinavian* countries have the least inequality, followed by the *Central European* new Member States (CZ, HU, SI, SK), then the *North-Central Continental European* countries (DE, FR, NL, BE, AT) and then in turn – with considerably higher levels of inequality – the *Anglo-Saxon* (UK, IE), *Southern European* and remaining *Central and Eastern European* Member States. If the United States were included, it would be at or below the bottom.[73]

Following its post-World War II decline, inequality increased considerably in many European countries as well as the United States since the 1970s (Fig. 2). Particularly notable is the first major increase, which occurred in the UK from the late 1970s and throughout the 1980s, in the context of the policies of the Thatcher government, taking the UK from a relatively moderate level of inequality in international terms to one of the highest in the world among developed countries, a position it has maintained since under different governments.

Figure 2. Trend in inequality for a number of countries, 1975-2004
(Gini Coefficient)



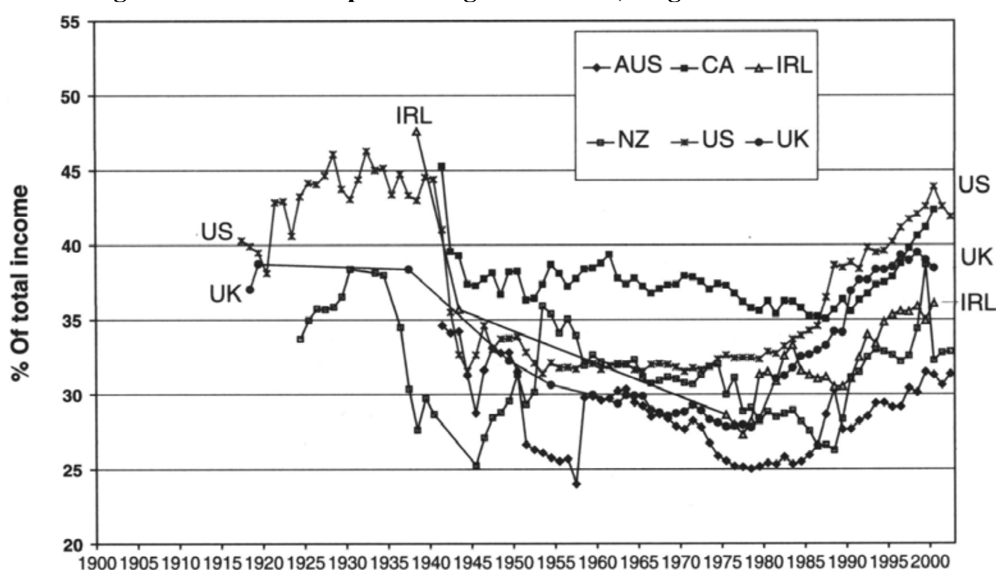
Notes: These particular data series were selected by the authors to show consistently trends over time. Cross-country comparisons of levels of inequality are unreliable using these series; instead the data in Figs. 1 and 5 should be used. For Germany, the first series is without the new Länder and the second with.
Source: Brandolini/Smeeding 2006

The biggest changes in income have been for those at the very top. This has occurred most of all in liberal economies, i.e. the Anglo-Saxon countries. Fig. 3a shows that in these countries the top 10% have increased their share strongly from the late 1970s to today. Further, even within the top

[73] US: Förster/Mira d'Ercole 2005: Table A.4. And if the other Anglo-Saxon countries (AU, NZ, CA) were included, they would be in the same location as the other Anglo-Saxon countries, towards the bottom.

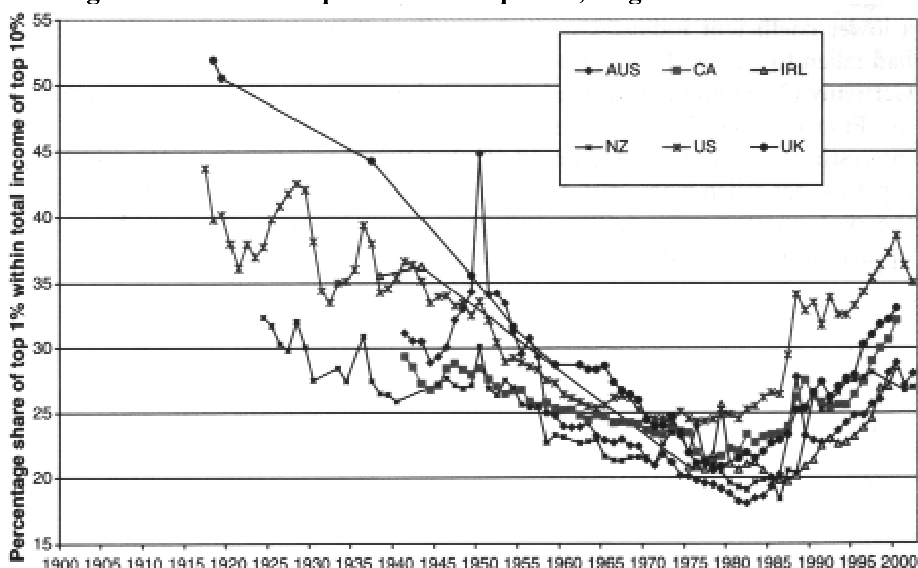
10%, the top 1% have increased their share of this group sharply in this period (Fig. 3b). In the continental European and Scandinavian countries for which data are available, the increase of the top shares since the 1970s is significantly less, according to this measure (gross income as measured by tax returns) – though an increase is nevertheless apparent for Germany and France. Yet Sweden has seen a major increase in the share of its top group, and especially the very top (Roine/Waldenström 2006). It is also notable that in Germany the actual share of the top 10% is almost as high as that of the Anglo-Saxon countries.

Figure 3a. Share of top 10% in gross income, Anglo-Saxon countries



Note: Gross income before deductions
Source: Atkinson/Piketty 2007: 540

Figure 3b. Share of top 1% within top 10%, Anglo-Saxon countries



Source: Atkinson/Piketty 2007: 543

It is important to note that the measure of income used for example in Figs. 3a and 3b leads to an underestimation of both the share of top incomes and its increase in all countries. It does not include certain important sources of income which are very much concentrated at the top. Firstly, *realised capital gains*.[74] Second, *income from offshore financial holdings*; in 2003 wealthy Europeans hold an additional third of their financial holdings in offshore financial centres, an estimated $2.6 trillion (Tax Justice Network 2005). Third, these figures use gross income (before tax), and there have been *major tax reductions at the top* over this period. Fourth, the figures for the Continental countries miss the changes due to *people moving their country of residence for tax purposes*, e.g. to the UK, Belgium, Luxembourg or Monaco. Fifth, it does not include *benefits in kind obtained by e.g. company executives*.

Change in wage inequality, fall in the share of wages and rise in the share of profits

Most of the change in *wage* inequality since 1980 occurred at the top, with those in the top 10% pulling away strongly from the middle, though several countries also suffered a drop in the share of the bottom 10% relative to the middle (OECD 2007, Atkinson 2007). Minimum wages played a major role in the evolution of *low pay*, with the difference in performance between France and Germany (which had a substantial increase in wage inequality) generally regarded as being due to the minimum wage in France; and the introduction of a minimum wage in UK, though at a low level, has kept low wages there from falling further.[75] These differences are, according to the OECD Employment Outlook "at least suggestive that globalisation is creating opportunities for a small elite of workers and investors to pull away from everyone else. The fact that no such trend is evident for [certain countries] suggests that differences in national policies and institutions also play an important role in determining the income share going to the top 0.1% and how it is affected by international economic integration." (OECD 2007: 117). In other words, globalisation does not determine such levels of inequality, and leaves considerable scope at national level.

While the figures just discussed referred to the distribution within wages, there has been an overall fall in the share of wages as a whole in the economy over the past 3 decades and a corresponding rise in profits (Fig. 4). The share of wages fell a full 10 percentage points of GDP, a decline which continues right up to the present (Fig. 4, left scale).

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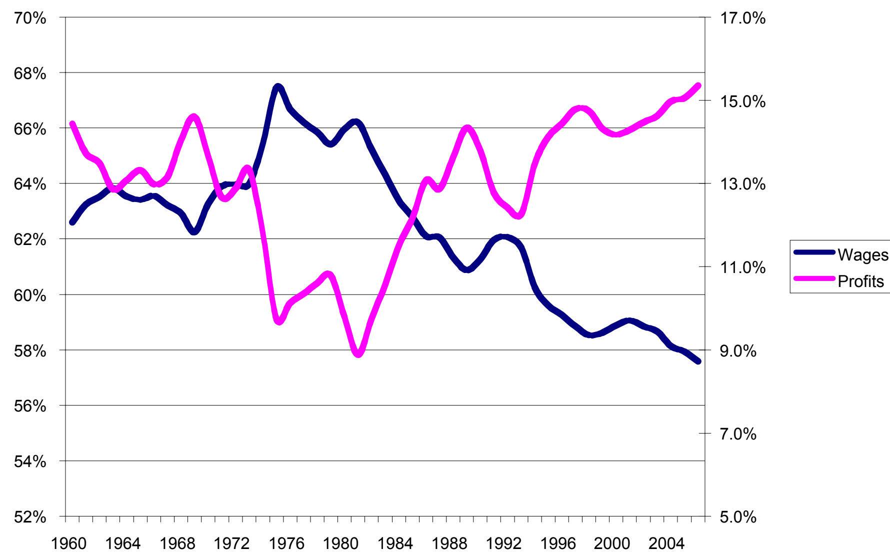
[74] Capital incomes are very concentrated towards the top. In the United States, for example, the top 1% receive 57% of total capital income (2003), a share that has been rapidly increasing since the 1970s (Mishel,/Bernstein/Allegretto, 2007, Fig 1S).

[75] A major factor in its introduction is considered by researchers to be the achievement of considerable savings in the government budget of welfare payments that would otherwise have had to be made under the UK welfare system.

This means that the value created in the economy due to growth and the increases in productivity went disproportionately to the owners of capital over the last 30 years. The share of profits in Europe and most other rich countries is now at a very high level historically, significantly above even that in the period of very strong growth of the 1960s (Fig. 4 and Ellis/Smith 2007). One of the arguments advanced by employers and many governments for increasing the rate of profit and depressing wages has always been that this would lead to reinvestment of profit to create growth. Given the relatively low growth rates in Europe over most of the last 3 decades, this has not materialised.

Figure 4. Share of wages and profits in GDP, 1960-2006, EU-15

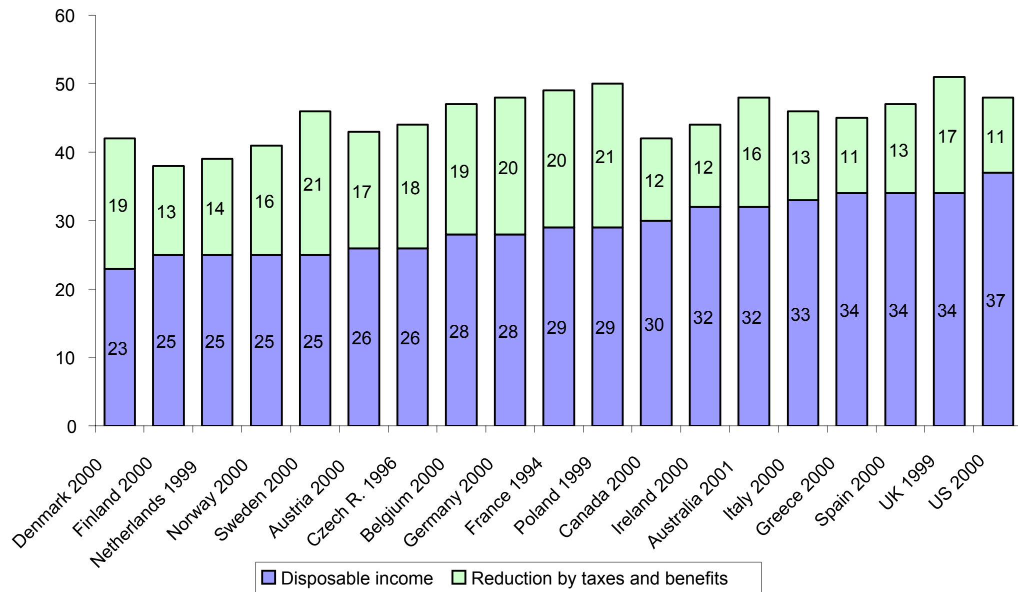


Note: Wages (left scale): Compensation per employee/GDP at market prices per person employed; Profits (right scale): Net operating surplus (excluding compensation for self-employed)/GDP at market prices.

Source: AMECO database, European Commission.

The impact of taxes and transfers/benefits on inequality

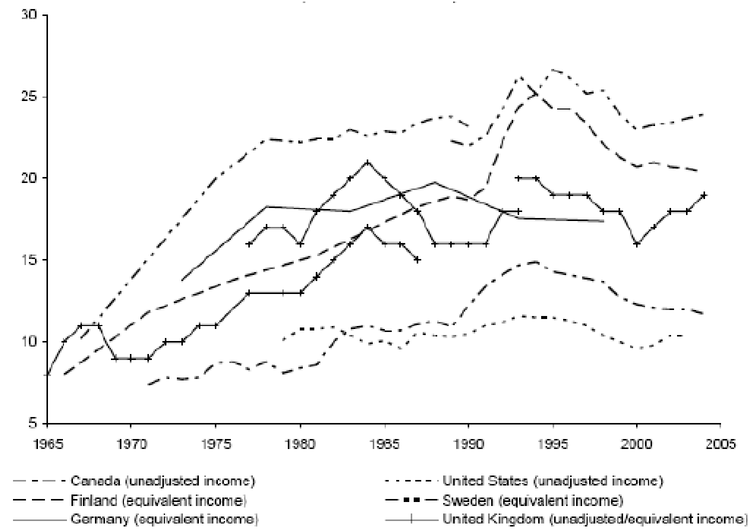
Figure 5. Effect of taxes and benefits on inequality: Comparison between countries
(Gini coefficient)



Notes: The first-round impact is addressed here, and not the dynamic impact over time.
Source: Brandolini/Smeeding 2007; Brandolini/Smeeding 2006: 21-26.

The total bar (dark- plus light-shaded) for each country in Fig. 5 gives the inequality of *market* incomes, with the shaded part alone giving the inequality of *disposable* incomes. The difference (the light part) is the impact of direct taxes and benefits. The key importance of the welfare state and public spending in Europe to keep inequalities down can be clearly seen. General attempts to cut back on these are very likely to further increase inequalities by a substantial margin. Fig. 6 shows the change over time in the impact of taxes and benefits on inequality. Following a considerable increase in these expenditures in the Continental/Nordic countries up to the early 1990s, the changes since then show a decline in the welfare state's impact, and account for a significant part of the increase in inequality since then. The substantial reduction in the impact of the UK welfare state took place considerably earlier, from the early 1980s.

Figure 6. Change over time in reduction in inequality through taxes and benefits
(Gini coefficient)



Source: Brandolini/Smeeding 2007

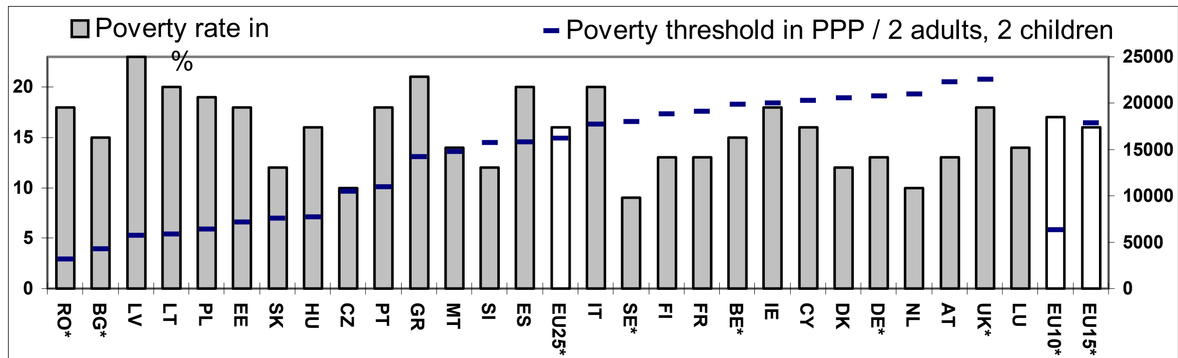
Increasing Poverty and Social Insecurity in Europe

Recent social developments in the European Union are characterized by a further increase in social inequality. By the end of the 1990's the average EU-15 poverty rate had declined from 18% in 1995 to 15% in 2000, which was primarily caused by an improvement of the labour market situation. After it remained constant for a couple of years, the poverty rate increased again by two percentage points to 17% in 2004. According to the latest figures of Eurostat, the poverty rates of EU-15 as well as of EU-25 is at 16% in 2005, while it increased to 17% in the new member states (EU-10). Expressed in absolute figures, 80 million people in the EU-25 live with a disposable income of less than 60% of the median income of their home country.[76] The poverty rates in the member states differ from country to country and range from 9% in Sweden up to countries like Spain, Greece, Italy, Latvia or Lithuania, where every fifth person lives in poverty (Fig. 7).[77]

[76] The definition of poverty at EU level is a relative measure, that refers to individuals, those with an income below the threshold of 60% of the national equivalised median income. The decision for a 60% threshold is conventional, but neither a necessary nor a sufficient condition of poverty. Therefore, the EU refers to this indicator as a measure of *poverty risk*. The concept of a relative poverty measure accounts for national income relations, since individual income is set in relation to the wealth of the society.

[77] If no other sources are mentioned, all following data is extracted from the database of Eurostat (January 2008). The averages for EU-25 and EU-15 are calculated as population-weighted averages of the available national values of the survey year 2005. See Eurostat (2005a) and European Commission (2006).

Figure 7: Poverty rates and poverty thresholds in the EU, 2006



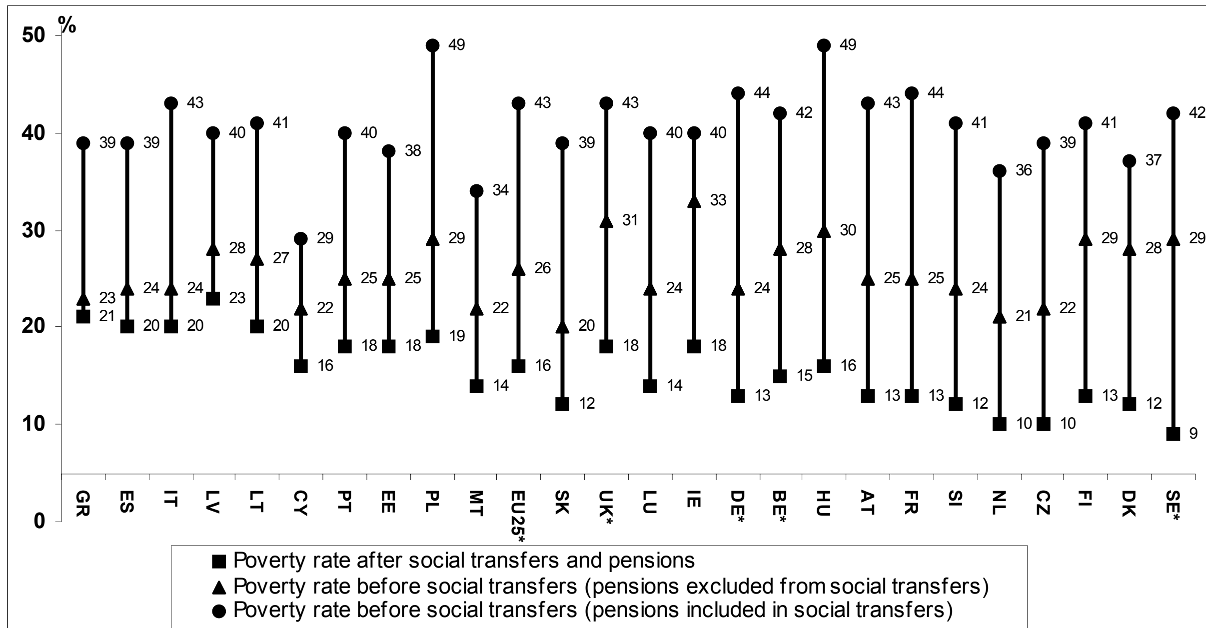
Source: Eurostat Database (January 2008); * = survey year 2005 and 2004 for BG, EU10, EU15, EU25. Threshold LU 36.136.

However, even similar poverty rates may reflect very different standards of living and levels of economic well-being across the EU. Since the poverty line of 60% refers to *national* sources and income relations, individuals from different member states with similar real incomes may be classified as being poor in one member state but would not be in the other. Therefore, the real differences in living conditions in the EU-10 and EU-15 are tremendous, although their poverty rates are similar to one another. In EU-15 the poverty threshold of households consisting of two adults and two children was €17,861 in purchasing power parities and a person living in a single household was considered to be poor when he or she had an annual income of less than €8,505 in 2004. In the new member states these values were less than half as high, which reflects the much lower living conditions there: the poverty level for households with two adults and two children was at €6,344 and for households of single persons €3,021 (using a common purchasing power standard).

Since social transfers and public pensions reduce the risk of poverty, social security systems play a major role in preventing poverty. This becomes obvious when hypothetically comparing poverty levels, if no social transfers and no public pensions were paid at all (Fig. 8). In EU-25 the poverty rate would be almost three times higher if no social transfers and no public pensions were paid, and in Poland and Hungary almost every second person would be threatened by poverty.[78] The difference between the middle and the bottom value in figure 8 represents the extent to which national social security systems reduce poverty. The values are sorted by the poverty-reducing extent of social transfers, i.e. social security systems of countries on the left side have little effect on reducing poverty. On the other end of the scale are countries with social transfers that reduce the poverty by more than a half.

[78] However, the significance of this hypothetical comparison is limited, because it is based on the assumption that – despite the abolition of all social transfers – all other factors remain unchanged. Additionally, most pension payments are not considered to be transfers but individual entitlements based on contributions.

Figure 8: Poverty rates after social transfers and pensions (bottom), before social transfers after pensions (middle), before social transfers and before pensions (top), 2006



Source: Eurostat Database (January 2008); no data available for BG and RO; * = survey year 2005.

POVERTY OF SPECIFIC SOCIAL GROUPS

In fact, one of the main causes for poverty is the loss of earned income when individuals are hit by unemployment or when they reach the retirement age. In EU-25, more than one third of the unemployed are poor because unemployment benefits do not suffice to prevent them from poverty. The poverty rate of the unemployed in EU-25 is five times higher than the one of the employed (40% versus 8%). However, although shifting from unemployment to employment considerably lowers the likelihood of being exposed to poverty, even earned income does not guarantee protection against poverty. In EU-25 the number of people being employed and poor (about 14 million so-called working poor) is almost twice as high as the number of people being unemployed and poor (about 7 million). The increase of these so-called ‘working poor’ is mainly caused by changes on the labour markets, namely the expansion of low paid jobs and the increase of precarious, involuntary part-time and short-time employment (Wehlau 2006). The average poverty rate of elderly people (aged 65 or more) is also higher than the average poverty rate of people aged 16-64 (19% vs. 14%). However, in comparison to unemployment assistance, it seems as if old-age security systems do a better job in preventing poverty because pension benefits are more adequate for avoiding poverty than unemployment assistance. Finally, children and households with many children belong to those groups of the population that are particularly exposed to poverty. In EU-25, almost every fifth child (younger than 16 years) is poor and in Poland, Hungary and Latvia even every fourth child lives in poverty. Households with children,

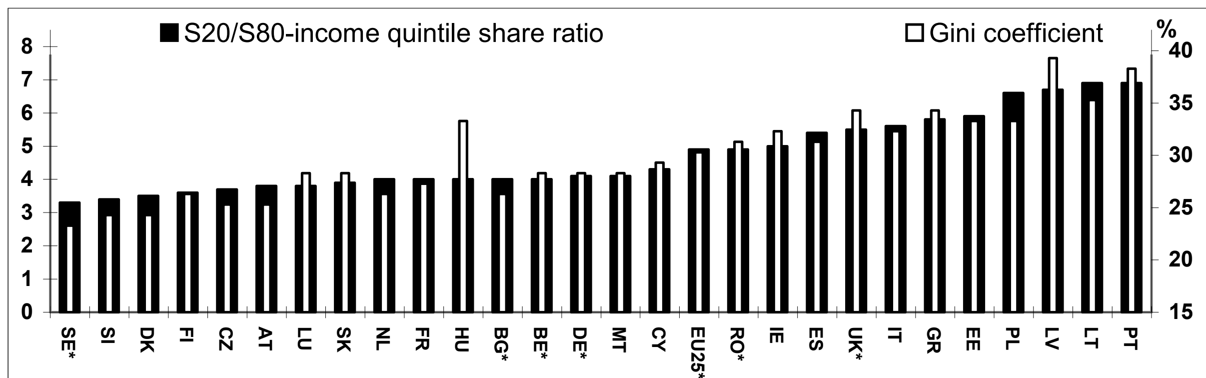
too, are more exposed to poverty than households without children (poverty rates of 17% and 15% respectively), and the poverty risk increases with the number of children. If reliable and sufficient systems of childcare are missing, the poverty risk is especially high for (single) parents, who are very often only able to work part-time. Hence almost one third (32%) of single parents live in poverty.

WEALTH AND INCOME INEQUALITY IN EUROPE

In scandalous contrast to the increase of poverty in the EU, the concentration of wealth in the EU has increased, too. While much data is published by Eurostat on poverty, no EU-level information can be found on a definition or on the extent of wealth in Europe, so that we have to refer to the statistics of Merril Linch and CapGemini (2007). According to their World Wealth Report 2007, the number of $-millionaires in Europe – so called high net worth individuals (HNWI) – has steadily increased in recent years and reached 2.9 million in 2006. At the same time, the wealth of these HNWI has increased even faster, which means that the rich became even richer, so that the concentration of income at the very top of the scale has increased. In 2006, the financial assets of this 0.6% of the European population rose to $10.1 trillion, corresponding to 2/3 of all European financial assets managed by institutional investors ($15.6 trillion in 2005, see International Financial Services 2006: 5).

Even though Eurostat data do not include information on this top one percent of the European population, figures on the concentration of income are published using rough indicators for the relation between the poor and the rich part of the population. One ways of expressing this relation is by the S80/S20 income quintile share ratio, which is the ratio of the total equivalised income of the top income quintile (those 20% of the population with the highest income) and the income of the bottom income quintile (those 20% with the lowest income). The EU-25 average of 4.9 means that the income of the wealthiest quintile is almost five times higher than the income of the poorest quintile (Fig. 9, left axis). National values of this ratio vary between 3.3 in Sweden and 6.9 in Portugal. Another way of showing the (in-)equality of income distribution is using the Gini coefficient. If income distribution were completely equal, i.e. each and every person had the same share of national income, the Gini coefficient would be 0%; if one single person had the entire national income the Gini coefficient would be 100%. On average, the EU countries have a Gini coefficient of 30% (Fig. 9, right axis).

Figure 9: Inequality of income distribution, 2005/2006



Source: Eurostat Database (January 2008). Survey year 2005 for the S20/S80-ratio, BG 2004. Survey year 2006 for the Gini coefficient, except for * = survey year 2005 and BG 2004.

MATERIAL DEPRIVATION

The data on poverty rates and on equality indicators reveal that 80 million people live in relative poverty and that this number is expected to increase, while on the other hand, the number of millionaires and their monetary wealth increased too. Together, these indicate a further widening of the income gap and an increasing level of inequality within the member states. However, all relative poverty data refers to *monetary* poverty only and is a relative measure that depends on *national* income relations. Therefore, we have to go beyond mere relative income measurements, in order to get a more comprehensive picture of the differences in living conditions across the member states. The indicators of “material deprivation” imply absolute measures with regard to “economic strain, enforced lack of durables and problems with housing” (Eurostat 2005b). Some examples reveal tremendous differences across countries: in six out of the ten new member states, more than every second household cannot afford a week’s annual holiday away from home, while this rate exceeds 50% only in Spain and Portugal. The access to basic necessities varies significantly, too. The economic situation of more than a third of the households in Latvia, Lithuania, Hungary and Slovakia, does not enable them to eat meat, poultry or fish every second day, if they wanted. On the other hand, in the old member states, the highest value of this specific form of economic strain is in Spain with 13%, while the other old member states are at or clearly below 9%. Furthermore, the housing conditions reveal tremendous differences in living standards across the EU: while the dwellings of almost each and every household in the old member states have an indoor flushing toilet, in some countries of the new member states, especially in the Baltic countries, more than 20% of the households lack this amenity. Furthermore, a much smaller share of households in the old member states live in dwellings with a leaky roof, rot in the window frames, damp walls, etc, than in the old member states, where the fraction of households living in similar bad and partly unhealthy living conditions is about twice as high.

The impact of poverty and inequality on society

This brief overview of poverty rates, inequality and levels of material deprivation was simply a numerical analysis to give a brief summary of the extent of poverty and social exclusion in the EU. However, the analysis has to go far beyond this. Poverty and inequality have a very corrosive effect on society, as can be seen from numerous studies of its effect over time and of comparisons across countries or regions. It affects all aspects of society, from the political sphere to social relations and to people's health and intimate domestic affairs.

It is very important to note that inequality has an effect that is *in addition to* material poverty or deprivation per se. As an illustration, the poorest areas of the United States, such as Harlem or the South Side of Chicago, have death rates that are higher at most ages than in Bangladesh – one of the poorest countries of the world – despite having a far higher material standard of living (Wilkinson 2005: 15). When inequality increased strongly in the UK in the 1980s, life expectancy *fell* there by an astounding 4 years on average for men. Similar effects were seen in the ex-communist countries of Central and Eastern Europe after 1990; again, the rise in death rates was greatest not where poverty was greatest as might be expected, but where income inequality was widest (ibid: 118-9). Further, children's development is restricted among those lower down in society, for example, they typically have lower birth weight – not related to nutritional deficiencies in pregnancy – and which has effects on the child throughout life.

Huge differences in living, education and health standards undermine the social cohesion, solidarity and the so called "social capital" within a society. International and within-country studies have shown that where inequality is greater, the societies typically have higher levels of distrust and lower participation in community life, lower levels of voting and of trust in government, conflictual as opposed to cooperative ways of dealing with problems, higher levels of violence, drug abuse and poorer levels of educational performance (Wilkinson 2005: passim). Racial, ethnic and religious tensions are higher. Relations tend to be based more on dominance and power (ibid). There are higher levels of imprisonment, strongly related to criminalisation of the poor, and these increase as inequalities increase (Wacquant 2004, Western 2006).[79] The increasing appearance of "gated communities" in Western societies and subsequently in the major cities of developing countries, with security fences, often protected by guards (armed in certain societies), video cameras and electronic detectors, is another manifestation of these developments. A generalised sense of insecurity often follows also, with temptations towards authoritarian government to remove it.

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[79] It is worth noting that criminalisation of the poor was also a way of dealing with them in the 18th and 19th centuries.

As inequalities increase, those in the upper echelons tend increasingly to opt out of public services in the fields of health, education and other services such as care, substituting them with private provision instead. The public services may then become residual services, as many have become in the Anglo-Saxon countries, increasingly targeted at the poor. Universal rights to services as a citizen then replaced by narrower views such as means-testing. There is then often less willingness among many to pay taxes for these services. With greater inequality there is a much greater emphasis on social distinction and on consumer expenditure as a way of trying to achieve it, often incurring high levels of debt which may not be repayable (Frank 1999, Schor 1998). As those in the upper layers of society find increasing ways of perpetuating their position and passing this to the next generation, social mobility also declines. There is a strong link across countries between higher levels of inequality and lower social mobility (Andrews/Leigh 2007). The major increase in social mobility that took place in the post-WW II period has been arrested in the US and the UK in recent decades, and gone into a sharp decline in the latter. Contrary to widespread belief, social mobility is now considerably lower in these two countries than in continental Europe and especially the Nordic countries (Blanden et al 2005; Mishel et al 2007, 101ff). In addition to the effect on political participation mentioned above, with increased inequality the upper levels of society can protect their position by, for example, funding political parties and other political actors such as think-tanks to influence policy debate to further their interests.

The relationships mentioned above between major social problems and inequality hold in general both across countries and between regions or cities within countries, as well as over time.[80] It is important that the issue of inequality comes back into mainstream democratic debate in Europe and people express their views on the matter. The neo-liberal agenda has tried to maintain that there is no alternative to increased inequality; this is clearly not the case, as can be seen for example from the major differences between countries or regions.

A social Europe for all: False promise or feasible reality?

Taking into account the available data on poverty and inequalities in Europe it seriously has to be doubted that the idea of a social Europe as it keeps reappearing in EU policy talks and papers is anything more than a false promise. Although it cannot be denied that social and labour market policy initiatives have long been on the EU's agenda, the impact that has been made in this area has been very low and the lack of political energy to bring about visible results in the fight against poverty and social exclusion is obvious, even if recent EU policy papers keep proclaiming a

[80] Many of these studies are based on very large statistical samples and they control for factors other than inequality such as age differences, etc. (Wilkinson 2005)

'social vision' for Europe's future. The high number of people living below the statistical poverty line – about 80 million – is a clear indication that the official EU goal ”to make a decisive impact” in the fight against poverty and social exclusion by the year 2010 – as was proclaimed at the European Council of Lisbon in the year 2000 – is far out of reach.

This is partly due to the lack of appropriate instruments. The *'Open Method of Coordination'* (OMC) was meant to function as a key instrument to bring forward the *EU's Social Inclusion Agenda.* Its objectives were defined as guaranteeing access to rights and resources for all, introducing measures to protect the most vulnerable groups and investing in the prevention of poverty and exclusion. But it has proved to be too weak. The bi-annual *National Action Plans on Social Inclusion*[81] which were meant to report both national progress and planned actions, proved to be a reporting rather than a planning exercise by EU member states' governments. They lack both a strategic approach in the fight against inequalities as well as the necessary budget provision to implement foreseen measures in almost all of the member states. Finally, *peer reviews* have been organised around 'Best Practice' examples in various specific areas, such as 'Rough Sleeping', 'Women's Poverty', 'Over-indebtedness', 'Active Aging' etc. They might have worked well as interesting exchange platforms but so far have failed to become real mutual learning exercises due to a lack of courage to address also 'bad practices' and failures, as well as the absence of efforts to transform the presented 'success stories' into transferable analytical tools for poverty reduction policies. Joint European reports by the Council and the Commission have summarised but unfortunately only partly went on to analyse the results of the process so far, highlighting nevertheless key challenges at European and member state level, with the issues of child poverty and active inclusion being at the focus of the most recent reports.

Recently, the Commission launched a consultation on 'Active Inclusion' with a communication that proposes a more 'holistic approach' in the fight against povery and social exclusion and addresses specific policy objectives, which indeed are of high importance, such as the EU-wide introduction of *minimum income* systems, a guaranteed access to *high quality social services* and *active labour market policies* (European Commission 2007a)**.** The communication suggests a deepening of social policy cooperation at EU level through the adoption of a set of common principles to guide the implementation of these three strands of active inclusion and their subsequent monitoring and evaluation, while fully respecting the different situations and needs of the member states. This might sound promising at first sight; as usual however, the devil lies in the details and the fact that the EU's approach to labour market policy places great emphasis on a

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[81] From 2005 on they were combined with national plans on pension and health and long term care, thereby forming three chapters of what has been named the *Strategic Report on Social Protection and Social Inclusion*

certain understanding of the principle of *flexicurity* gives reason to seriously doubt that developments towards *'good work'* can be expected.

There are also serious contradictions to be found with regards to the promotion of access to high quality social services on one hand and EU policy priorities and measures in the area of services of common interest on the other hand. Further, there is a clear deficit in implementing social policy objectives within the *Lisbon agenda* of growth and jobs and the refusal to truly strengthening the goal of greater social cohesion and sustainable development as it had been defined in Lisbon in 2000 and reconfirmed in the Union's Strategy on Sustainable Development. Yet, people's concerns with regards to growing inequalities in Europe cannot be overlooked and even official EU papers can no longer deny the fact that the positive effects of economic growth are questioned by "a significant number of European citizens [who] see globalisation, liberalisation and the drive for greater competitiveness as much as a threat to their well-being as a facilitator of it" (Liddle/Lerais 2007: 5). Intending to get closer to its citizens and to appear to take seriously their concerns, *'An Agenda for European Citizens'* (European Commission 2006) was launched by the Commission in spring 2006, including what is called a 'Single Market review' and a 'social reality check'. With regards to the latter a Consultation Paper written by a think-tank for the president of the Commission, José Manuel Barroso, was published to launch "a debate on Europe's social reality" and the aims of "building a new consensus on the common social challenges facing Europeans" and to "strengthen the partnership between the European Union and its Member States in the delivery of the Lisbon Growth and Jobs Strategy" (Liddle/Lerais 2007: 6).[82] Although the paper clearly does not move away from the overarching growth and jobs strategy, it 'reduces' it symbolically to a means to an end, with the latter identified as the well-being of European citizens. The aim of creating a 'social vision' for Europe however stays vague and even if it was to be understood as a serious intention with regards to guiding Europe's future policies it keeps being undermined by other more prominent, influential and effective policy objectives, such as recommendations to cut on social expenditure, the liberalisation of public services or the reduction of employees' rights through flexibilisation.

Alternatives and ways forward

Despite all the – well-founded – criticism of the OMC process, experience has shown that even an instrument that weak at least contributes to keep social policy issues at the agenda, and should be used as a jumping board for lobbying activities with regard to strengthening the development of

[82] The very fact that this paper was commissioned to be written by authors that became 'famous' for contributing to New Labours 'third way' in the UK of the 90s – a policy approach that is hardly known for its decisive impact to eradicate poverty, decrease social polarisation and promote equal society - speaks for itself.

National Action Plans on Social Inclusion in terms of both content and process. In order to become more effective, the OMC, however, clearly needs new tools, more participative mechanisms, more clear cut targets, recommendations and evaluation. In addition to this, the goal of greater social cohesion and sustainable development as defined in various EU documents has to be reinforced. If the goal of a sustainable social Europe is to be taken seriously substantial changes need to be introduced in the scope of developing future *National Reform Programmes*, which are due again in 2008. Models of good governance as they have slowly started to be applied for the OMC on Social Protection and Social Inclusion process have to be strengthened and also adopted for the work on the Reform Programmes. In addition to this an impact assessment for specific groups and regions of the policies undertaken has to be made so that it becomes clear who gains and who loses and policies can be amended appropriately.

Given the importance of the *Lisbon Strategy* and the connected new Integrated Guidelines for economic and employment policies, the intention to work towards the eradication of poverty needs to be reflected there also. Three options of strengthening the social content of Lisbon have been discussed at Commission level – only to be downplayed as 'just a proposal' put forward for discussion by the Social Protection Committee little later: the full integration of the OMC into Lisbon, the creation of a new social chapter in the Integrated Guidelines and/or the strengthening of the process of 'Feeding in and Feeding out'. 'Full integration' however, could easily turn out as ‘absorption' and there is a certain risk that a specific social chapter in the Integrated Guidelines would lead to making the OMC seem redundant. Adding a 'social' chapter on the other hand would not do away with the current problem of a lack of coherence between social and economic policies. A serious strengthening of the so-called 'feeding in and feeding out' could only be reached through the incorporation of social objectives in the Integrated Guidelines to ensure a coherent macro, micro, employment and social model within a sustainable development vision. This would have to include substantial changes in the guidelines on a tax and expenditure system towards a system that ensures a more equal redistribution of income and wealth (*see part of chapter on taxes*) and has to go hand in hand with the explicit recognition of the vital role of investment in social infrastructure. Growing inequalities as described above would have to be identified as contradicting the goal of social cohesion and wage developments would need not to be regarded only under the perspective of 'competitiveness' but also with regards to their impact on eradicating poverty. At the level of microeconomic guidelines, social economy and inclusive entrepreneurship have to be supported, the promotion of communication technologies has to be given a specific focus to promote e-inclusion and to develop measures that ensure universal access to ICT services, to name just a few of the necessary changes.

The employment guidelines have to put the provision of quality work as an overarching priority. Setting full employment as an objective without developing strategies for a non-stigmatizing inclusion of those who at present are most far from the labour market won't do, nor will the 'activation' of people supposedly not willing to work through increasingly aggressive control and punishment systems. Instead, structural barriers need to be addressed and the fight against discrimination needs to be included in the guidelines. In addition to this there also is a need to reassess employment policies that have been introduced under the heading of 'flexicurity' and make sure that the latter is not used as the Eurospeak for introducing weakening workers rights.

Next to the need of transforming the Integrated Guidelines and building more coherence with an active and strategic OMC process and the work on the National Reform Programmes, a new approach and use of the Structural Funds has to be introduced and access to high quality services of general interest guaranteed.

Minimum social standards

While many share the belief that European-wide social standards could play an important role in the fight against poverty in most regions and states, the challenge to define what adequate social standards might mean at EU level, how they could be defined and introduced in all member states in a way that would strengthen the fight against poverty across Europe while respecting the diversity of social systems and approaches, has hardly been taken up by EU institutions. Concrete proposals by civil society stakeholders that have been published recently with regards to both content and process, need to be taken up here (Euromemorandum Group 2007, EAPN Ireland 2007). Minimum standards thus have to be defined in "labour relations including setting minimum wages, work protection, maximum working times and related issues, as well as minimum standards for social income and access to high quality social services" (Euromemorandum Group 2007: 46). Such standards clearly will have to be different depending on the socio-economic context in the various member states but also need to reflect the real needs of people living in poverty in these countries and the levels of income and services that are needed to lift them out of poverty.

On the trade union side, the introduction of a coordinated, EU-wide, minimum wage policy has already been suggested (cf. Schulten et al., 2005; see also the short version of the Euromemo, 2007). The European Commission had already recognised in the early 1990s that a European minimum wage policy was necessary for the implementation of the right to an "adequate wage" which is contained in the EU Social Charter. A statement from the Commission in 1993 called on the member states to take "unified measures to ensure that the right to an adequate wage was

protected.”

Today, in view of the rapid growth of low-wage sectors in all member states, and in view of the increasing posting of workers across frontiers in the framework of the free provision of services, it is necessary to deal with this problem and to prevent social dumping and poverty wages. This requires the EU-wide coordination of national minimum wage policies on the basis of specific common objectives and criteria. The EU should introduce a benchmark that, as a first step and by a definite date, the minimum wage, whether set by law or on the basis of branch-specific collective agreements, must not be less than 50% of the corresponding national or branch-specific average wage. As a second step, this level would be raised to 60% of the national or branch-specific average. In this way minimum wages would be coordinated in accordance with national traditions through collective agreements, national legislation or a combination of these two methods of regulation. The specification of the minimum level for each minimum wage must be anchored in the employment policy section of the Integrated Guidelines which would provide the framework for the coordination and supervision of member state policies.

In a similar way, a specific target for social policy integration should be introduced in the framework of the open method of coordination: that the basic social income (for example in Germany the basic level of social security in phase 4 of the recent Hartz reforms, or the basic social security for the old) should, within a specific time-frame, correspond to at least 60% of the mean individual or household income and should be raised in a process of upward convergence. This basic social security “benchmark” is guided by Eurostat’s definition of poverty in terms of income, and its aim is that, in all member states, the basic social income should be high enough to prevent poverty.

A process of dialogue between EU institutions, member states, people experiencing poverty, social researchers and the general public, to agree on 'sets' of essential goods and services needed in each member state for a life in dignity thus has to be started across Europe. (EAPN Ireland 2007). This could be pursued as a part of a strengthened OMC thereby drawing on experiences on developing standard budgets for households (EAPN Ireland 2007: 33). In addition to this – or as an alternative – an EU Directive to require member states to guarantee the resources needed for a dignified life could possibly provide useful added value. Such a Directive might require Treaty changes and create competencies and certainly would raise far-reaching research issues and debates which could be very fruitful for the Unions overall development. A third option could be to put additional stress on the application of international instruments such as the European Social Charter and the UN's International Covenant on Economic, Social and Cultural Rights which would amount to a strong basis for social standards. This would demand the introduction of clear

monitoring and support processes and could possibly lead to a reinvigorated OMC process and attention to standards such as those referred to under the options mentioned above.

Progressive tax policy against poverty and inequality

From the 1980s the notion of redistribution was also gradually eliminated in the sphere of taxation. Previously the state as a tax authority was always closely tied to the functions of the welfare state: state revenues would not only be used to finance the public expenditures which were considered socially necessary; these revenues would also be raised in as just a way as possible; by, among other methods, a progressive income tax covering all sources of income (wages, rents, profits and so on) on the same basis (Uhl 2006). The basic idea was that those who had more income should contribute correspondingly more to the common good. For someone who has only a low wage income needs correspondingly more money to cover day-to-day necessities. People with higher incomes on the other hand spend a smaller fraction for this purpose so that they can make a bigger contribution to public spending. The use of the tax system itself to achieve redistributive objectives was a distinguishing feature of the European welfare states until the 1980s. Since then, however, redistributive tax policies have come up against tax competition which is based on the strategy that the home territory must be kept attractive for mobile enterprises and capital, to prevent the whole tax system being undermined by capital flight.

Against this background, different models of taxation have spread throughout Europe since the early 1990s: so-called "flat taxes" – that is a single tax rate applied to all forms of income – or the so-called dual taxation have acted as models for tax reforms. Estonia, Lithuania, Latvia and Slovakia, which all have flat taxes, became members of the EU in 2004. All forms of income are treated the same way and are subjected to a usually very low proportional (that is, not progressive) tax rate. Finland, Norway and Sweden introduced dual income taxes at the start of the 1990s. With this kind of tax system, they abandoned the principle of treating all types of income the same way in order to apply a system differentiated according to the income source: business profits and the income from private capital were subjected to a relatively low, proportional, rate which in Sweden in December 2006 was 28% (for business profits) and 30% (on private capital income). All other forms of income, above all wage income, were subjected to a progressive tax structure with a relatively high top rate of 55.5%. The Nordic states also justified this reshaping of their tax systems by the need to adapt to challenge of tax competition. Thus the dual income tax system concentrates tax reductions on those forms of income which, really or supposedly, are involved in tax competition, that is business profits and personal capital income. Other EU member states had in the past already made moves towards a dual income tax system. For example, Austria, Belgium and Italy introduced a special, proportional, tax rate on interest and dividend income in the first

half of the 1990s. Greece (in 1993) and the Netherlands (in 2001) have also taken significant steps in this direction. Germany too will, through the tax reform of 2008, introduce a tax system based on the separation of different types of income: the rate of so-called withholding tax on private capital income will then be at 25%, and the corporate tax rate at 15%. In comparison with the year 2000, when the corporate tax rate was at 40%, this means a reduction of more than half.

This differentiated tax treatment of different forms of income is also extremely problematic because it makes an artificial separation of income forms which are very closely connected in the framework of the tax system. Thus the reduction in the business tax rate leads to an erosion of the progressive nature of the personal income tax. In order to make it impossible for taxpayers to hide their personal incomes in companies, and thus achieve a lower tax rate when consumption took place, in the past the top rate of personal income tax and the business tax rate were kept as close as possible to each other. Therefore the reduction of the business tax rate in the context of tax competition has led to pressure on the rate of personal income tax (Ganghof 2006, Ganghof/Genschel 2007). Apart from the loss of revenue to the public sector, key issues of social justice are raised because the progressive nature of the income tax system is significantly eroded so that the whole notion of redistribution through the tax system comes into question.

However, there are alternatives to the policy of lowering tax rates throughout the system. The keyword is cooperation at the European level. Thus in the past it was possible, through cooperation among member states, at least to control the taxation of interest received by individuals – since the middle of 2005, there has been automatic sharing of data on interest payments across borders. So someone who has deposited money in Belgium must take into account that the Belgian banks will report their interest payments to the German authorities who can then tax it at the correct rate. Instead of continuing and extending this cross-border cooperation, the German government has introduced a withholding tax of 25%, and thus a significant tax break, for capital income. Until now capital income was taxed within the progressive personal income tax system – and thus at up to 42% – but from 2008 it will be taxed at a proportional rate of 25%. Wage-earners, or at least those with lower incomes – will thus be doubly disadvantaged: on the one hand wage incomes will be treated less favourably than capital income in the tax system; on the other hand, people with otherwise high incomes mostly also have the highest capital incomes – after all in the past they had more opportunity to invest and to accumulate the corresponding interest payments and so on. It was by no means necessary for the German government to proceed in this way: it would have been very worthwhile to continue on the path of European cooperation and to extend it to cover other forms of capital income besides interest. Further, there is no advantage in intensifying Europe-wide competition to undercut tax rates.

The introduction of a Common Consolidated Corporate Tax Basis (CCCTB) is under discussion in the context of business taxation. This means that all businesses throughout Europe would have to determine their profits by the same rules quite regardless of the member states in which their head office and branches were situated. These enterprise profits would then, in a second step, be allocated among the member states according to a formula which is still to be fully worked out and the member states would then be able to apply their own tax rates. This initiative would get rid of distortions of competition among enterprises. Besides this, it is emphasised by the Commission that the CCCTB would largely eliminate the incentive for companies to shift their profits to subsidiaries in low tax countries. But this is only half the story. Tax competition would then, according to the thinking of the Commission, simply be shifted onto other factors and especially onto those where the basis of assessment would differ among the member states: such as payroll, turnover, or total assets. Accordingly, the pressure on corporate tax rates and, in consequence, on the top rates of personal income taxation would not decrease, but only be switched or restructured (Rixen/Uhl 2007). This can only be prevented by a harmonisation of corporate tax rates: ideally by a complete equalisation of rates at a high level. But because this does not appear to be politically acceptable or feasible for the time being, the case should be made for a Europe-wide minimum tax rate which should be at least 30% on a relatively broad tax base. Only in this way can it be to some extent ensured that the member states would be able to organise their income tax systems from the point of view of redistribution, and hence with progressive tax structures applied to all forms of income, and in this way to distribute the costs of public expenditure in a fair way among their citizens. Distortions of competition among enterprises would be thereby more effectively reduced than in any other system currently under discussion. However, there is a further precondition: the governments of member states would in the end have to change their view of competition as a policy instrument against each other: capitalism is a question of putting enterprises into most undistorted competition against each other that is possible – the classical liberals hardly expected that states would have to compete against each other in the most ruinous way.

Closing Remarks

There is no argument about the fact that poverty and inequality are powerfully forcing themselves back onto the political agenda. The data are unambiguous – even if the upper ranges of the income and wealth distributions are still insufficiently explored. However, the measures to be taken to resolve these problems are most certainly in dispute. An effective approach to poverty and inequality must cover a range of policy areas – besides the areas of social policy and taxation policy briefly discussed here, it must include general economic policy. And it requires a change in

the direction of European Union policy. A greater measure of social justice would not only alleviate the deep social problems discussed here, but also make the EU more acceptable to European citizens. It is important that all the above mentioned approaches are pursued with a close view on the daily realities of people experiencing poverty, encouraging direct participation of the people concerned in the definition of concrete proposals and monitoring of anti-poverty policies. Initiatives such as the annual European meetings of people experiencing poverty and similar processes on member state level thus must not be seen as 'events' that pretend to give voice to people experiencing poverty without taking them seriously, but rather be incorporated in policy development and monitoring strategies. Only then would the EU's intention to get closer to its citizens also include the many millions of 'poor people' and in combination with the proposals mentioned above could be taken seriously as an honest attempt to work towards a social Europe for all.

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Energy & Climate

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2007 / 2008

I Introduction: The ecological dimension of EU politics[83] and the example of energy policy

European politics have to be analysed as key elements of a complex human ‘political ecology’ in which ways of life, models of production and consumption, as well as the strategies of economic agents interact within a complex and multi-level historical reality. In this perspective, its specifically ecological dimension cannot be left out from a realistic long-term strategy of economic development. This ecological dimension clearly and patently extends beyond the areas of competence of the Council of Ministers for the Environment, although their concerns for eco-efficiency and for nature protection are undeniably of considerable importance for it. It also extends beyond the problem areas addressed by the environmental dimension of the EU strategy of sustainable development – with the Common Agrarian Policy, as the main area of policy affecting the ecological situation within the Union, and the trade policy, as the main area of policy affecting the ecological situation on a global scale, still practically without the reach of this common strategy[84].
Central political concerns of the present European debates are certainly part of the ecological dimension of the EU politics, like the debates on REACH, on the security of European energy supplies, or on the European contribution to the climate policy according to the commitments of Rio and Johannesburg, and their implementation by the Kyoto regime and its foreseeable follow-up regimes, where the EU has been active as a key player in the negotiation.

I.1 Sustainability Strategy

Since mid 2004 the European Union has proceeded to a review of the so-called Gothenburg Strategy adopted in 2001. The “renewed Strategy”, which was adopted by the European Council in June 2006, sets out strategic objectives until 2010. The document mainly restates commitments made elsewhere but for the first time incorporates the international commitments into one single framework. This is a limited step forward, but it fails to address the strategic question of defining an interface between the long term Sustainable Development Strategy (SDS) and the revised Lisbon strategy followed in the short and middle term.

Under the main objectives the revised sustainability strategy (EU SDSII) explicitly addresses its “international responsibilities” - including the Millennium Development Goals set by the United Nations in 2000 - and identifies global poverty and sustainable development challenges as one out of seven priority actions.[85] The overall objective is “to actively promote sustainable development worldwide and ensure that the European Union’s internal and external policies are consistent with global sustainable development and its international commitments.” At the same time, and in open contradiction to this, the EU is developing a military dimension for its foreign policy, redefining its development co-operation in terms of short-term export support for European industries, and is deploying a trade policy by bilateral agreements which does not even refer to the aims and objectives of the EU SDS.

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[83] In the following text expression ‚European politics’ will be used to refer to the multi-level reality of the politics of the EU and its member states, whereas the specific politics practiced on the EU level will be referred to as EU politics, policies or strategies.

[84] As a specimen of the ‘method of open co-ordination’ this EU strategy primarily concerns the co-ordination of member states’ policies which are still considered to be the lead agents in this field. The co-ordination with and between the EU’s ‘community policies’ is not directly addressed by it.

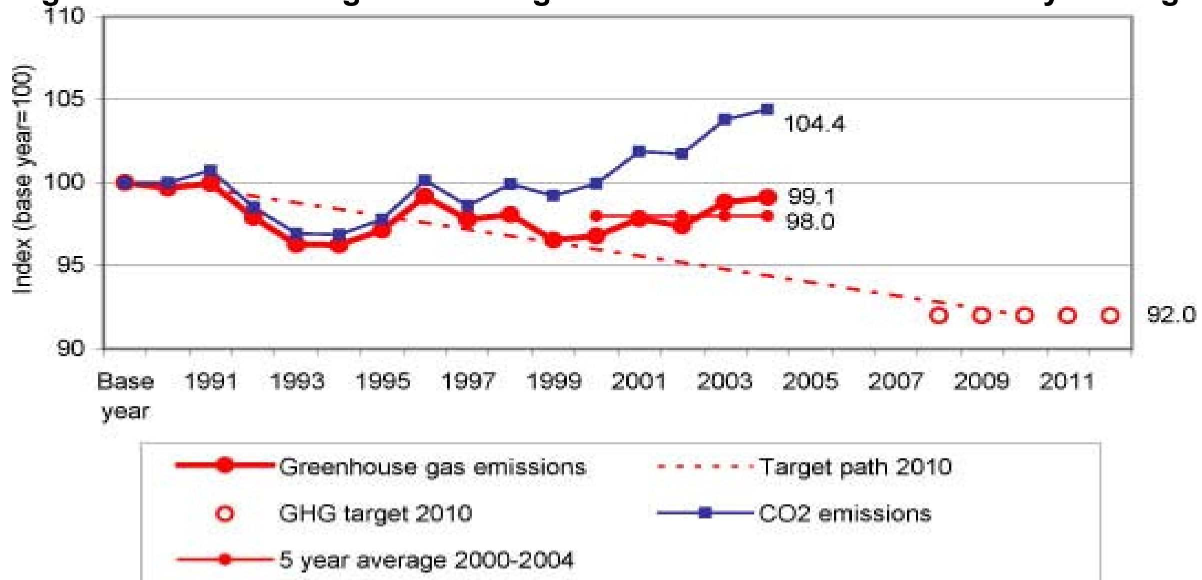
[85] Climate change and clean energy, Sustainable transport, Sustainable consumption and production**,** Conservation and management of natural resources, Public health, Social inclusion, demography and migration,Global poverty and sustainable development challenges.

In the main areas of environmental threats the situation remains critical or is even worsening, at a global level and within the EU itself and deeply unsustainable tendencies continue unchecked. This is true for climatic change through human activity, the loss of biodiversity, the scarcity of resources, and the deterioration of the human habitat.

I.2 Greenhouse gas emissions

Greenhouse gas emissions provide a telling example of this general trend: In spite of clear international commitments and a rising awareness of the problem by European citizens, the EU is not even approaching an active compliance with its Kyoto targets (see figure 2).

Figure 2: Total EU-15 greenhouse gas emissions in relation to the Kyoto target



Source: European Environment Agency, 2006.

The hopeful optimism advertised by the EU commission in this field is not based on visible real developments. The European Commission's claim (in its *Green Book on Energy Efficiency, 2005)* that 20% of the EU's current energy use could be saved by 2020 at no cost and would cover half of Europe's commitments under the Kyoto Protocol, is more a statement on the high potential of alternative strategies than on the effective orientation of current developments.

A systematic analysis of the complexity of the specifically ecological dimension of European politics is beyond the possibilities of this text.

In 2007, the euro-memorandum will concentrate on the EU energy policy as a telling example, for which the state of the debate, on the issues as well as on possible alternative strategies, have come to be elaborated to a high and reliable level. Other examples will be focussed upon in the following years, attempting to combine considerations of actuality or urgency with the reliance on well-developed debates.

II. The policy of the EU

The energy policy of the EU, objectively considered, has three dimensions: The EU is an important player in global energy politics, the EU level is challenged in important ways by developments in the field of energy, and the EU called for to co-ordinate the energy policies of its member states in important ways, in order to avoid harmful side-effects of competition in the single market.
In all of these aspects it faces a situation of mounting urgency: The double task of energy policy of reducing the emissions of greenhouse gases and of securing the supply of energy resources for coming generations has not yet been properly addressed, especially as its main instruments have been conceived upon the assumption that the era of an abundance of energy supply based upon fossil fuels at cheap prices would last well into the 21st century, so that a mere complementary strategy using market price instruments for orienting the consumers of energy in their economic decision making (demand-side strategy) was considered to be sufficient. Moreover, these policies have tended to reactive, quantitatively insufficient, and have neglected the high transaction costs occasioned by them. Policies addressing the supply-side have not really been implemented, or have remained mere token efforts. At the same time, programmes, measures and recommendations for action for reducing energy consumption, increasing energy efficiency in terms of end use, and in switching to really renewable energy sources have not been strongly developed.

II.1 Focus on oil.

The European political debates on energy politics have remained focused on cheap oil supply from abroad – which is clearly unsustainable in the face of the 'peak oil' debate – and broadly limited to the question of (Russian) gas as an alternative energy source. It is no surprise that this orientation has led to a renewed emphasis on military power projection and control of the most important oil producing countries. Likewise, the attempts of the nuclear industry to recommend its own come-back as a way out of reinforcing human induced climate change by CO_2-emissions, have not been clearly rejected by European politics which continue to subsidize its development.

II.2 Climate change and energy scarcity

The double task of energy policy of reducing the emissions of greenhouse gases and of securing the supply of energy resources for coming generations has not yet been properly addressed, especially as its main instruments have been conceived upon the assumption that the era of an abundance of energy supply based upon fossil fuels at cheap prices would last well into the 21st century, so that a mere complementary strategy using market price instruments for orienting the consumers of energy in their economic decision making (demand-side strategy) was considered to be sufficient. Moreover, these policies have tended to reactive, quantitatively insufficient, and have neglected the high transaction costs occasioned by them. Policies addressing the supply-side have not really been implemented, or have remained mere token efforts. At the same time, programmes, measures and recommendations for action for reducing energy consumption, increasing energy efficiency in terms of end use, and in switching to really renewable energy sources have not been strongly developed.

II.2.1 Energy resources

Cheap oil, and (Russian) gas or nuclear energy continue to be the main concerns of a still fragmented and un-co-ordinated European energy policy – leading to a renewed emphasis on

military power projection to compensate for the lack of a coherent long-term policy (cf. Euro-Memo 2006).
The EU is one of the main consumption areas of energy world-wide, without being able to supply a sufficient amount of energy for its energy needs from its own sources. On the basis of the prevailing energy system, which is based on fossil energy sources, with a priority for oil (and gas)[86] the EU area has a durable energy supply deficit. This deficit is currently covered by imports from a small number of trade partners (Russia, Algeria, …) which may create a situation of unilateral dependency for the EU area, especially with a view to shortages of available oil and gas which are to be expected. The only options for coping with this situation (and for opening a perspective for overcoming it) can be seen in the development of long-term stable exchange relations with these partners, on the one hand, as well as on the transformation of the energy system.

It is now generally agreed that increasing the part of renewable energy sources in the energy use of the EU should be a central part of any European energy strategy, as well as, to a lesser degree, that investing in energy efficiency and sufficiency with the objective of energy saving should be a major element of an energy strategy for Europe. How far a common energy strategy of the EU will be required for coping with this situation, is still controversial – especially European member states with own oil resources or special relations to oil exporting countries still tend to see advantages in 'bowling alone' in a medium term perspective. Although the environmental damages and energy network inflexibilities linked to coal use, and the unsolved waste problems, high risks (and dual use vulnerability) of nuclear energy production, have lead to broad tendencies of reducing the role of these energy sources, strong sectors of public opinion have used the – factually incorrect – argument of the climate neutrality of nuclear energy (or of a new coal or lignite based energy technology relying upon carbon sequestration) to argue for renewed technologies of nuclear energy production (or of carbon sequestration) as an indispensable pillar of a sustainable European energy strategy. In view of the very high investment costs and technological improbabilities inherent in these options, it seems far more rational to invest in energy saving by lowering energy needs (pex. in the heating and cooling of houses or in transport and mobility) and in the rapid increase of the use of renewable energy sources, while at the same time diversifying and stabilising trade relations to oil and gas importing countries for the inevitable time of transition to a transformed energy system. It is highly improbable, however, that a sustainable reduction of the European energy deficit will be feasible without addressing questions of sufficiency – i.e. on how much end use of energy is needed to satisfy human needs.

The European energy policy, as it is emerging today[87], is 'in the making' at least since the oil shock of 1973[88], when member states began looking for individual and common strategies to

[86] An increased use of the still sizeable relevant coal reserves of the EU seems to be excluded by the installed configuration of energy transforming apparatuses – i.e. by the forbidding investment costs of their replacement or conversion to coal use, as well as the important side effects on climate, as well as on the environment more generally.

[87] The 'older history' of the European energy policy concerns the European Community for Coal and Steel which has been following a state centred, corporatist and developmentalist logic, heavily relying on planning instruments. This is also true, although to a lesser degree of *Euratom* which has remained more limited as a European community because of the links of the respective nuclear industries to military concerns of 'national security'.

[88] The history of the nuclear illusion in energy policy which promised unlimited supplies at minimal prices to be produced in a regenerative cycle hampered by no limitations due to available natural resources can only be seen as its prehistory, even though its main products, the Euratom treaty and the fusion research programme, are still with us today.

secure long term security for the availability of supplies at interesting prices.[89] The readiness for pooling political resources for a common effort in this direction was, however, not really forth-coming on the side of the leading member states, which preferred to follow individual strategies using traditional patterns of diplomacy and influence, as well as relying upon their respective configurations of available natural resources. This situation has not changed after the 'Earth Summit' of 1992 in Rio de Janeiro, where the EU, alongside with its major member states, has taken commitments for the reduction of CO2 emissions – thereby establishing a direct link between its climate policy and its energy policy. A number of strategic documents emanating from the European Commission since 1995 have attempted to find a path towards effectively establishing such a European Energy Policy which would make sense as well in terms of energy supply security as in terms of avoiding human induced climate change. The results of these attempts have been less than convincing.

II.2.2 Energy policy and the promise of 'market instruments'

This generation of attempts by the European Union to develop a common energy policy – which proceeded on a rupture with the kind of corporatist energy politics centred on coal reserves characteristic of the ECSC – has been centred on the promise of 'market instruments' to combine cheap energy prices with long-term security of supply and 'good quality' of input, output and throughput, i.e. with regard to the availability at the right time and in the right spot of the specific kinds of energy needed for specific purposes, with regard to avoiding environmentally negative outputs (like toxic gases or, increasingly, CO_2) and with regard to minimising waste in the distribution of energy produced to the end users. This approach does not only raise a number of general problems which shall be summarised in this section. It also has to come to grips with deeply differing and engrained traditions of public policy in this field existing in key member states which tend to react in differing ways to the wave of neo-liberal policy changes unfolding in parallel since the 1970s which go under the heading of the 'challenges of economic liberalization'. The responses especially in France, Germany, Italy and the UK have been so significantly different in this field, where a high degree of oligopolisation, if not outright state monopolies, have been characteristic of the highly segmented markets, that the attempts at defining a common and co-ordinated European energy policy would remain unintelligible, if not referred back to the possibilities of compromise existing between these different approaches. At the same time, although to a lesser degree, environmental concerns began to influence European policy definitions. On the basis of the assumption that the 'market instruments' based on deregulation and privatisation would present the best strategic option for implementing ecological requirements these concerns have served to reinforce the strategies of marketisation and contributed to giving the European energy policy increased leverage against national statist or corporatist structures of energy policy in
which elements of regulation and long term planning were of central importance.
Unfortunately, the EU is concentrating its political efforts on installing an emission trading system which does not force through a rapid reduction of climate gas emissions.
Therefore, for a considerable time period, European energy policy has *de facto* merged with the project of the single market, consisting simply in bringing the European Single Market for

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[89] In reaction to the 1973 Oil Crisis the European Council of 1974 adopted a common programme that prioritised diversifying energy sources, so as diminish the bargaining power of the OPEC countries.

goods and services fully to bear on the segmented and oligopolistic energy markets, starting by dissolving existing state monopolies and privatising state owned energy agencies and firms.

II.2.3 Recent developments

European Commission documents, published in 1995[90] and again in 2001 and 2003, have attempted to define 'An Energy Policy for the EU' have focused solely on liberalising the energy market with the promised outcome to promote competition, business transparency, and security of supply. In the face of the strong interest of some member states to remain in control of national energy markets the implementation of this strategy has met with little success. The two underlying ideas can be spelt out to be the idea to negotiate energy more effectively in international exchanges when acting as a united bloc, while diversifying supply and promoting competition as a hopeful instrument for ensuring security and sustainability of energy supplies. It is quite evident, however, that the contrary is also plausible in the perspective of most member states – to get better conditions for energy supplies on the basis of special relation to large supplier countries, and to expect an improved security and sustainability of energy supplies from consistent and long-term public programmes.

II.2.3.1 The Green Paper of March 2006

After the short crisis around Russia's stopping the flow of gas into Ukraine and Belarus respectively, which serve as transit states to the EU, and therefore had a clear repercussion on supply security. The *Green Paper* of March 2006 claimed to prepare further steps in the direction of a common and co-ordinated policy in this field, by re-opening the debate on a future common European Energy Policy, starting from the resounding statement that "Europe has entered into a new energy era", but arriving at more timid proposals, if taken in real terms. Its main suggestions may be grouped into three categories:

- proposals for enhancing market efficiency and European competitiveness by completing the opening of European gas and electricity markets, which are clear and practical;
- proposals for securing supplies by stepping up relations with major suppliers such as Russia and OPEC, which are not really specified; and
- other key suggestions aiming at steps towards energy sustainability like boosting renewable energies, energy efficiency, and research on low-carbon technologies.

There is an evident gap in this list of concerns which is especially grave in the face of the insistence on competitiveness, i.e. keeping energy prices down: the rebound effect and the question of defining strategies for influencing directly the quantities of energy demanded and used are not addressed within the European Commission's strategy. On the other hand, the EU member states have repeatedly made it clear that they would not tolerate any 'interference with national sovereignty' in this field, thereby severely limiting the reach of the Commission's actions and proposals. At the spring summit of April 2006 the European Council have limited themselves – under the resounding title of a new Energy Plan for Europe (EPE), which will eventually lead to a Common Energy Policy (CEP) – to agreeing on a

[90] White Paper: An Energy Policy for the European Union. COM (95) 682 final, 13 December 1995

minimal programme consisting of warm words (a common approach to address crisis situations “in a spirit of solidarity”), confirming policies already in place (completing the Single Market in the field by “developing regional gas and electricity energy markets”) declarations of principle (diversification of energy sources), declarations of intent (developing electricity interconnections to reach the target of “at least 10% of member states’ installed production capacity”, with financing borne “mainly by the enterprises involved”) or commitments to further consideration (raising the share of renewable energies, implementing the ‘biomass action plan’).

This has been laid down in general commitments to creating a common energy foreign policy and an internal market for energy, to guaranteeing security of supply, to promoting the use of renewable energy, and to promoting research into energy technology.

Sustainable energy strategy. The attempts made by the EU commission to define a sustainable European energy strategy have remained inconsequential and, even, partly counterproductive. The priority areas listed in its “Green Paper on Secure, Competitive and Sustainable Energy for Europe” (May 2006) - developing a coherent EU external energy policy, further market integration in order to secure long-term energy supply, triggering technology development, creating jobs and growth, tackling climate change – exhibit an excessive trust in market instruments and technological efficiency. At the same time the EU does not clearly distance itself from the potential use and usefulness of military instruments in external policy. It reduces the issue of long-term co-operation with energy suppliers to the question of pipelines and trade agreements, while leaving the commitment of the EU to become less dependent on foreign imports unaddressed. It is still paying much too little attention to the two key areas of an alternative approach to energy policy, i.e. cutting energy waste and tapping into the full potential of renewable energy sources. It fails to target the transport sector, although this sector is currently consuming between 70% and 80% of all oil imported by the EU.
The Green Paper does not seriously face the risks of nuclear power which continues to be the most dangerous form of energy production, with the radioactive pollution and proliferation issues inseparable from it, and which – if considered over its entire life cycle – is far from being emission free or economically viable. This is even more remarkable as a clear majority of European citizens are deeply critical of this option.

Energy efficiency. It is to be welcomed that the Green Paper underlines the economic and environmental advantages of increasing energy efficiency and suggests making Europe the most energy-efficient economy in the world. This is, however, not implemented by current EU policies, for which no binding framework has been defined for a common orientation towards increases in energy efficiency. The few real policies in this field are not clearly targeted. The directive on energy end-use efficiency that originally proposed mandatory targets for reducing energy waste has finally been so watered down that it now facilitates a business-as-usual practice. The directive on the efficiency of buildings addresses only about a tenth of the total potential to save energy in the household sector, which alone accounts for a staggering 40% of European energy use. Another EU directive on the promotion of simultaneous generation of electricity and heat, neither sets targets nor standards and limits itself to requiring EU member states to do little more than to study the issue.

Friends of the Earth comments:
“The Green Paper lists six priority areas, ranging from developing a coherent EU external energy policy and further market integration in order to secure long-term energy supply to triggering technology development and creating jobs and growth -- and to tackle climate change.

Unfortunately, the European Commission fails to make cutting energy waste and tapping into the full potential of renewable energies the central elements of its strategy.
Embarrassingly, the transport sector is largely absent in the paper, despite the fact that the sector accounts for about 70-80% of all imported oil.
The paper lacks vision, targets and concrete proposals and misses the opportunity to propose an integrated strategy that delivers both: providing competitive energy to households and industry and cutting back greenhouse gas emissions as part of the global effort to limit climate change.

The Green Paper notes the importance of the latter, but gives it less attention than e.g. securing long-term oil & gas imports, e.g. through new pipelines, new agreements especially with politically unstable regions, or improved access to global oil & gas resources for European companies.
This is in contrast with the EU's intention to become less dependent on foreign imports but also with the aim to make Europe's energy more sustainable.
Instead, a key priority of the paper is to further integrate and liberalise the European electricity and gas markets. But the European Commission completely ignores that this must, first and most, lead to removing market distortions such as billions of Euros worth in perverse subsidies that governments channel to fossil and nuclear energy industries every year, keeping the dirty forms of energy artificially cheap against their renewable competitors. Also, liberalising markets must not disallow governments to regulate markets to promote the increasing use of renewable energies, e.g. through granting priority access to electricity grids.
The paper fails to acknowledge that nuclear power remains the most dangerous form of energy that is neither emissions-free nor economically viable. The majority of European citizens are opposing nuclear power -- promoting it despite public opposition, the dangers and economic sense will not bring Europe closer to its citizens.
The Green Paper fails to make increasing energy efficiency the central pillar of European energy policy, despite that the cheapest, fastest and most effective way to secure energy supply will always be to reduce our huge demand for energy, thereby also reducing energy costs for households and industry and curbing greenhouse gas pollution. Europe should set a binding target to cut total energy consumption by 20% by 2020.
The Green Paper notes the economic and environmental benefits of increased energy efficiency and suggests making Europe the most energy-efficient economy in the world. This is clearly positive. But the Green Paper does not accompany this objective with a viable vision and concrete targets.
The European Commission noted in last year's *Green Book on Energy Efficiency* that 20% of the EU's current energy use could be saved by 2020 at no cost and delivering (for free!) half of Europe's commitments under the Kyoto Protocol[4]. The saving potential is even greater in new Member States where despite improvements over the last decade, energy consumption in relation to economic output is still up to three times higher than in the EU-15. Also, the cost-effective savings potential would be several times higher if the external costs of conventional energy, such as increased health care costs as a result of air pollution were part of the equation. Savings can be achieved across all sectors with existing technology: Germany has shown that 50% of the energy consumption of buildings can be saved through better insulation -- with the initially higher construction costs turning, over time, into net savings for house-owners.
The few existing policies on the EU level are weak, and there is no binding framework to capture the multitude of energy conservation benefits. A recent embarrassing example is the EU directive on energy end-use efficiency that originally proposed mandatory targets for reducing energy waste but ended up with little more than business-as-usual. The EU directive on the efficiency of buildings, for example, addresses only about a tenth of the total potential[6] to save energy in the household sector, which accounts for a staggering 40% of European energy use. Another EU directive on the promotion of simultaneous generation of electricity and heat, neither sets targets nor standards but requires EU Member States to do little more than to study the issue." (Friends of the Earth)

II.2.3.2 Integrated energy and climate change package 2007

Since then the European Commission has taken a number of initiatives to launch a common and co-ordinated European energy policy where it fell into its competence – reaching from the presentation of an **"integrated energy and climate change package" (January 2007), in** which the preparation of a *European Charter on the Rights of Energy Consumers* is supposed to play a central role, via the appointment of European coordinators for key energy projects or the publication of TEN-E guidelines to the participation in structured international dialogues (UNESCO, with the OPEC states, with Russia, with Turkey, with other European Neighbourhood countries, which has led, *inter alia*, to the creation of an common 'Energy community' with the main Balkan states) to actions of public awareness raising like a renewable energy roadmap or a sustainable energy week. There still is, however, a central contradiction plaguing even these limited actions: As the Commission puts competitiveness, supply security and sustainability on the same footing, without any indication on how to decide in cases of conflicts between these objectives, there is a strong tendency that the objective of competitiveness will win out in all concrete decisions, relegating the other two objectives to a secondary role. This corresponds to the observation that the only area in which effective action is being taken by the Commission to enforce member state compliance is constituted by the infringement procedures against member states which have failed to open their energy markets 'properly', in implementing the respective EU legislation. Moreover, the meagre results of the **2007 spring** summit (as of the spring summit of 2006) have confirmed that the "common interests" of the member states have remained "elusive", as the European Policy Centre had titled its analysis: Although the European Council on 9 March 2007 in principle has backed Commission proposals on energy and climate change, agreeing on an action plan to put in place a European energy policy by year 2009. The most significant progress achieved in the following areas has been riddled by loopholes and indecisions:

- Greenhouse-gas reduction: A binding target has been laid down to reduce EU emissions by 20% by 2020, regardless of progress made in international negotiations for a post-Kyoto agreement, and a binding 30% target was envisaged in case other industrialised nations including the US take similar steps. This has not been concretised, however, by at least defining a mechanism translating this general commitment into specific obligations for each member states;
- Renewable energies: Again a binding target has been laid down to have 20% of the EU's overall energy consumption coming from renewables by 2020, including the specific commitment to a problematic binding minimum target for each member state to achieve at least 10% of their transport fuel consumption from biofuels, which is fortunately conditioned by "production being sustainable" and "second-generation biofuels becoming commercially available"
- Energy efficiency: a relatively bold objective - saving 20% of the EU's energy consumption compared to projections for 2020 – has been laid down as a binding target, while limiting specific proposals for its realisation which the Commission is asked to make during the next years to relatively limited fields of action, i.e. increased energy savings from office and street lighting and increased energy savings from incandescent lamps and other lighting in private households.

At the same time, the summit rejected the proposals made by the Commission in the direction of an even further increased marketisation of the field. It limited itself to underlining the existing commitments, i.e. referring to "full implementation of the letter and spirit" of existing legislation as a "first step" before going further with more radical options.

As the optimistic appraisal of this outcome by the German presidency does not seem to be borne out by real agreements, it should be read as a declaration of intent to try again: Angela Merkel said that the summit results in this field would "open the door to a new dimension of European co-operation in the years to come" and that the energy action plan "will give the initial spark for a third technological revolution". The description of the targets on climate change and renewables laid down by the summit as both "ambitious and credible" may only be shared on the optimistic assumptions on technological fixes voiced by the same German presidency: "We'll be going down completely new roads as far as technology and innovation are concerned" – which can clearly be seen as inherently improbable as a spontaneous process, by looking at the history of Global and European Energy Policy since the early 1970s. Without stronger common and co-ordinated political action by the community and by the member states such a 'new industrial revolution' – as it has been referred to in the summit rhetoric – will not materialise.

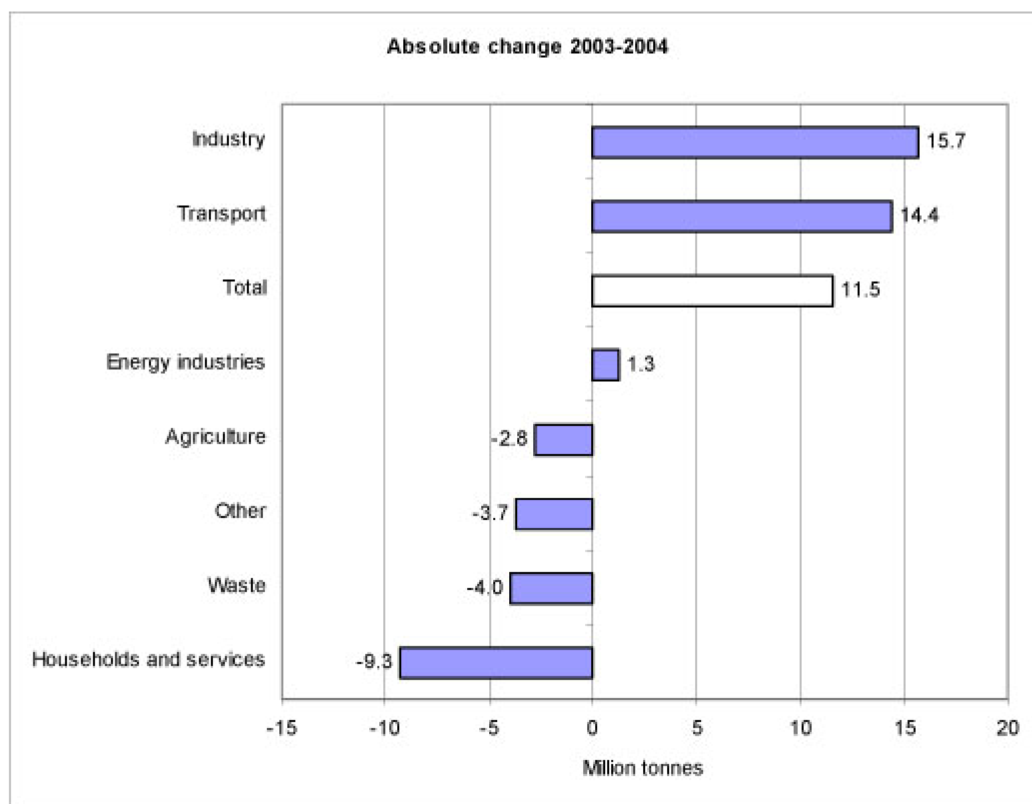
Table 1: Greenhouse gas emissions trends and Kyoto Protocol targets for 2008-2012 (source: European Environment Agency, 2006)

MEMBER STATE	Base year [1] (million tonnes)	2004 (million tonnes)	Change 2003–2004 (million tonnes)	Change 2003–2004 (%)	Change base year–2004 (%)	Targets 2008–12 under Kyoto Protocol and "EU burden sharing" (%)
Austria	78.9	91.3	-1.2	-1.3%	15.7%	-13.0%
Belgium	146.9	147.9	0.3	0.2%	0.7%	-7.5%
Cyprus [2]	6.0	8.9	-0.3	-3.0%	48.2%	-
Czech Republic	196.3	147.1	-0.5	-0.3%	-25.1%	-8.0%
Denmark	69.3	68.1	-6.0	-8.1%	-1.8%	-21.0%
Estonia	42.6	21.3	0.1	0.7%	-50.0%	-8.0%
Finland	71.1	81.4	-4.2	-4.9%	14.5%	0.0%
France	567.1	562.6	1.5	0.3%	-0.8%	0.0%
Germany	1230.0	1015.3	-9.1	-0.9%	-17.5%	-21.0%
Greece	111.1	137.6	0.3	0.3%	23.9%	25.0%
Hungary	122.2	83.1	-0.2	-0.2%	-32.0%	-6.0%
Ireland	55.8	68.5	0.1	0.1%	22.7%	13.0%
Italy	518.9	582.5	5.1	0.9%	12.3%	-6.5%
Latvia	25.9	10.7	0.0	0.4%	-58.5%	-8.0%
Lithuania	50.9	20.3	3.1	17.9%	-60.1%	-8.0%
Luxembourg	12.7	12.7	1.3	11.3%	0.3%	-28.0%
Malta [2]	2.2	3.2	0.1	4.2%	45.9%	-
Netherlands	214.3	217.8	2.5	1.1%	1.6%	-6.0%
Poland	565.3	386.4	3.7	1.0%	-31.6%	-6.0%
Portugal	60.0	84.5	0.9	1.0%	41.0%	27.0%
Slovakia	73.2	51.0	-0.1	-0.1%	-30.3%	-8.0%
Slovenia	20.2	20.1	0.4	2.0%	-0.8%	-8.0%
Spain	289.4	427.9	19.7	4.8%	47.9%	15.0%
Sweden	72.5	69.9	-1.1	-1.5%	-3.6%	4.0%
United Kingdom	767.9	659.3	1.3	0.2%	-14.1%	-12.5%
EU-15	**4265.7**	**4227.4**	**11.5**	**0.3%**	**-0.9%**	**-8.0%**

1. The base year emissions in this table are preliminary and the final emissions will be agreed in 2006 within Council Decision (2002/358/EC). The base year for CO2, CH4 and N2O, for the EU-15-15, is 1990; for the fluorinated gases 13 Member States have chosen to select 1995 as the base year, whereas Austria and France have chosen 1990. As the EU-15 inventory is the sum of Member States' inventories, the EU-15 base year estimates for fluorinated gas emissions are the sum of 1995 emissions for 13 Member States and 1990 emissions for Austria and France.

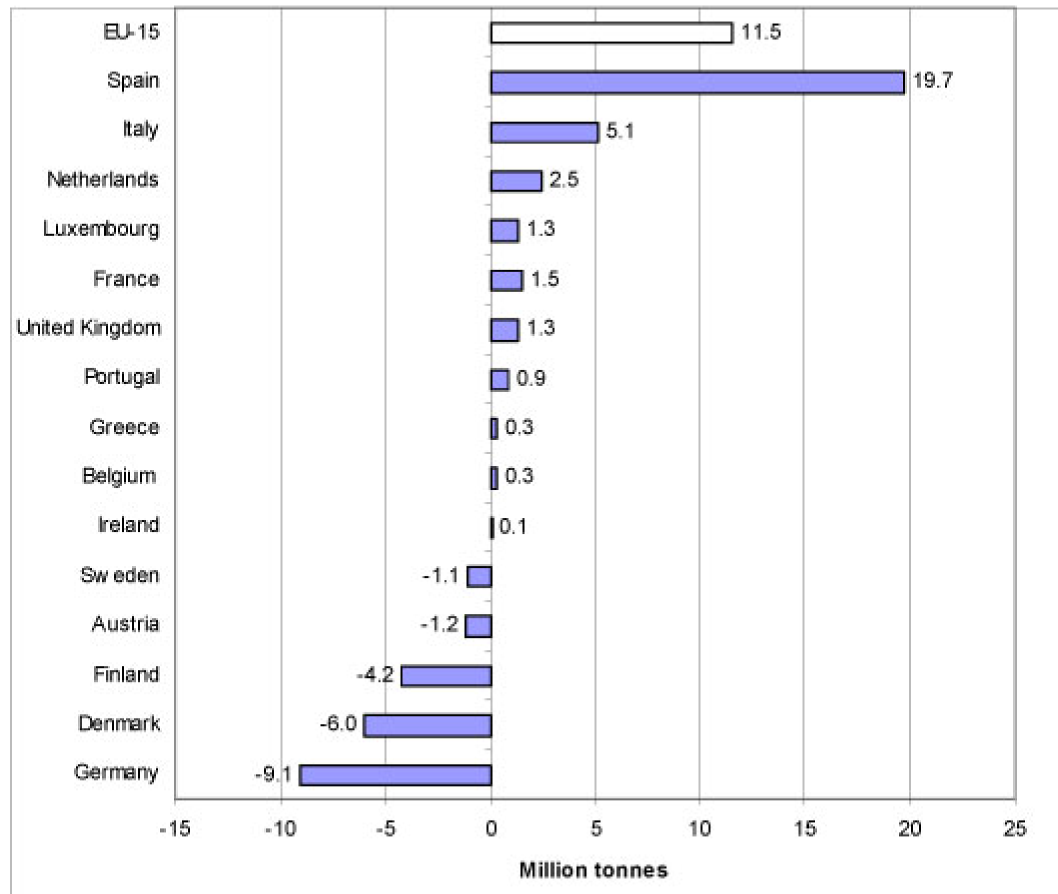
2. Malta and Cyprus did not provide GHG emission estimates for 2004, therefore the data provided in this table is based on gap filling.

Figure 2: Absolute change in GHG emissions 2003-2004 in EU-15 by sector
(source: European Environment Agency, 2006)



Note: 'Energy industries' includes 'Public electricity and heat production' 'Petroleum refining' and 'Manufacture of solid fuels and other energy industries'; 'Industry' includes energy related emissions from 'Manufacturing industries' and emission from 'Industrial processes'; 'Other' includes mainly 'Fugitive emissions from fuels', emissions from 'Solvent and other product use'.

Figure 3: Absolute change in GHG emissions 2003-2004 for EU-15 Member States
(source: European Environment Agency, 2006)



Links:
To view the full report, follow this link to the EEA Website:
http://reports.eea.europa.eu/technical_report_2006_6/en

II.3. Global perspectives of Climate Change

In spite of increased public awareness created by recently published authoritative reports, climatic change through human activity, the loss of biodiversity, the scarcity of resources, and the deterioration of the human habitat continue as unsustainable trends. With regard to greenhouse gas emissions the hope for a compliance of the Kyoto targets by the EU remain unsubstantiated by the actual development (cf. Euro-Memo 2006). Only drastic changes of policy will make certain that the EU will fulfil its reduction commitments.

II.3.1 The IPCC-Report 2007

The latest climate change report of the **IPCC** – "Impacts, Adaptation and Vulnerability" **(April 2007)** – has provided a new sense of urgency to the debates on climate policy: An apocalyptic future is rapidly approaching, if action is not taken fast. Millions of people, ecosystems and species in all regions of the world are already suffering form the effects of human induced climate change, and more harmful effects are forthcoming: billions of people facing water scarcity, increased drought, sea level rises, storm surges, river flooding – and even more hunger and misery through reductions in food producing capacities.

The report of the Working Group II of the IPCC has highlighted the potential consequences of climate change over the next forty years:

- violent rainfall and more frequent inundations;
- increased vulnerability of eco-systems, especially with regard to their capacity of binding carbone, accompanied by the disappearance of 20 to 30 % of known animal and plant species;
- deep modifications in the global distribution of fish species, with important consequences for fishing and aquaculture;
- increase of the sea level, coast erosion and more frequent floods;
- augmentation of the frequency and intensity of extreme meteorological events.

(www.ipcc.ch)

These tendencies are also visible in Europe. Unfortunately they still tend to be seen as specific problems of singular member states, as increasing coast-line fortification requirements in the Netherlands or summer fires in the Mediterranean member states.

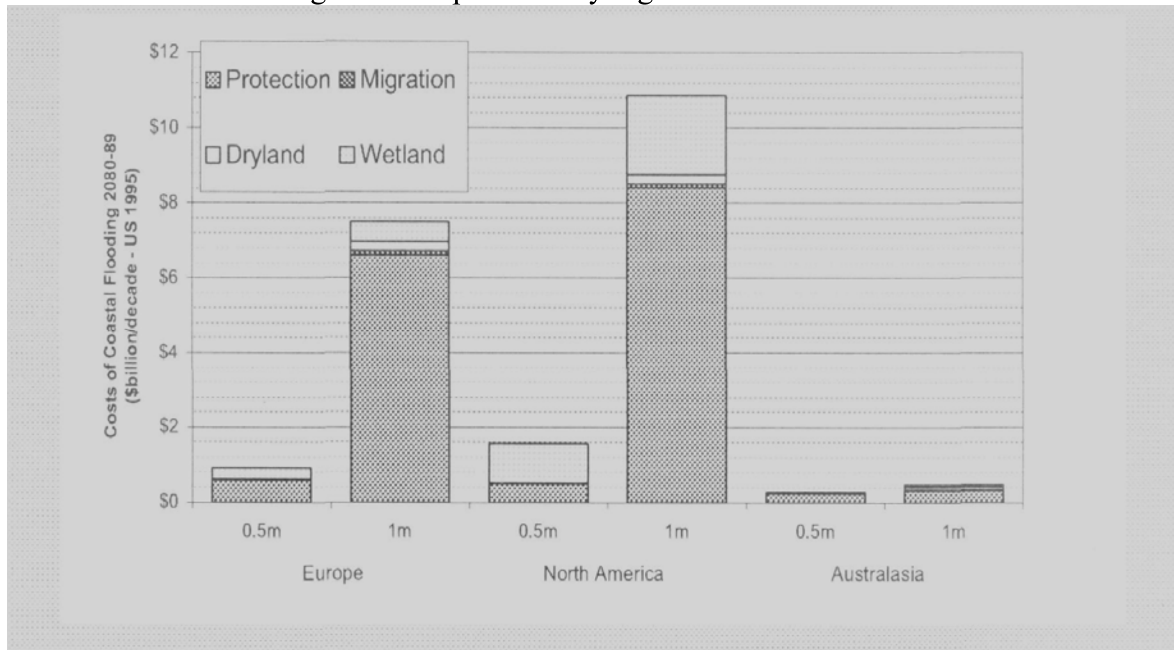
II.3.2 The Stern Report 2006

The Stern Report published in 2006 (Stern, Nicholas. The Economics of Climate Change: The Stern Review, Cambridge Univ. press, UK) has predicted the economic cost in damages to be expected, if nothing is done about these tendencies, as shown in the following example:

"**1-m** of sea level rise is plausible by the end of the century under rapid rates of warming, particularly if one of the polar ice sheets begins to melt significantly (Greenland9 or collapses (West Antarctic). This could impose significant costs on developed countries with long, exposed coastlines. For North America, an area just under half size of Alaska (640.000 km^2) would be lost with 1-m of sea level rise, unless defences are in place to protect the land. Much of this land will sparsely populated areas, but a significant proportion covers the Gulf Coast and large parts of Florida. These areas will be particularly vulnerable as rising risks of tropical storms combine with rising sea levels to create sharp increases in damages from coastal surges. In Europe, sea level rise will affect many densely populated areas. An area of 140.000 km^2 is currently within 1-m of sea

level. Based on today's population and GDP, this would affect over 20 million people and put an estimated $300 billion worth of GDP at risk. The Netherlands is by far the most vulnerable European country to sea level rise, with around 25% of the population potentially flooded each year for a 1-m sea level rise.

Costs of coastal flooding in developed country regions:



Project costs of coastal flooding over period 2080-2089 under different sea level rise scenarios
(Source: Anthoff et al. / 2006, analysing data from Nicholls and Tol /2006)
Note: Costs were calculated as net present value in US $ billion (1995 prices). Damage costs include value of dryland and wetland lost costs of displaced people (assumed in this study to be three times average per capita income). The protection costs only include costs to protect against permanent inundation. Infrastructure damage from storm surges is not included. Discounting with a constant growth rate (2%) and a pure time preference rate of 0,1% per year increases values by around 2,5 fold. (Stern Review, Part II, Box 5.5/p 13)

II.3.3 The Potsdam Memorandum 2007
The Potsdam Memorandum of October 8th to 10th 2007 has summarised this dramatic situation very clearly: "The world-economic acceleration after World War II has pushed our planet into an unprecedented situation: humanity is acting now as a quasi-geological force on a planetary scale that will qualitatively and quantitatively alter the natural Earth System mode of operation – should business as usual be pursued." (www.nobel-cause.de/potsdam-memorandum)

II.4 Critique of EU policies

The European energy policy, as it is emerging today[91], is 'in the making' at least since the oil shock of 1973[92], when member states began looking for individual and common strategies to secure long term security for the availability of supplies at interesting prices.[93] The readiness for pooling political resources for a common effort in this direction was, however, not really forth-coming on the side of the leading member states, which preferred to follow individual strategies using traditional patterns of diplomacy and influence, as well as relying upon their respective configurations of available natural resources. This situation has not changed after the 'Earth Summit' of 1992 in Rio de Janeiro, where the EU, alongside with its major member states, has taken commitments for the reduction of CO2 emissions – thereby establishing a direct link between its climate policy and its energy policy. A number of strategic documents emanating from the European Commission since 1995 have attempted to find a path towards effectively establishing such a European Energy Policy which would make sense as well in terms of energy supply security as in terms of avoiding human induced climate change. The results of these attempts have been less than convincing.

The EU energy strategy today is centred on the promise of 'market instruments' to combine cheap energy prices with long-term security of supply and 'good quality' of input, output and throughput, i.e. with regard to the availability at the right time and in the right spot of the specific kinds of energy needed for specific purposes, with regard to avoiding environmentally negative outputs (like toxic gases or, increasingly, CO_2) and with regard to minimising waste in the distribution of energy produced to the end users.
This approach does not only raise a number of general problems which shall be summarised in this section. It also has to come to grips with deeply differing and engrained traditions of public policy in this field existing in key member states which tend to react in differing ways to the wave of neo-liberal policy changes unfolding in parallel since the 1970s which go under the heading of the 'challenges of economic liberalization'. The responses especially in France, Germany, Italy and the UK have been so significantly different in this field, where a high degree of oligopolisation, if not outright state monopolies, have been characteristic of the highly segmented markets, that the attempts at defining a common and co-ordinated European energy policy would remain unintelligible, if not referred back to the possibilities of compromise existing between these different approaches. At the same time, although to a lesser degree, environmental concerns began to influence European policy definitions. On the basis of the assumption that the 'market instruments' based on deregulation and privatisation would present the best strategic option for implementing ecological requirements these concerns have served to reinforce the strategies of

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[91] The 'older history' of the European energy policy concerns the European Community for Coal and Steel which has been following a state centred, coporatist and developmentalist logic, heavily relying on planning instruments. This is also true, although to a lesser degree of *Euratom* which has remained more limited as a European community because of the links of the respective nuclear industries to military concerns of 'national security'.

[92] The history of the nuclear illusion in energy policy which promised unlimited supplies at minimal prices to be produced in a regenerative cycle hampered by no limitations due to available natural resources can only be seen as its prehistory, even though its main products, the Euratom treaty and the fusion research programme, are still with us today.

[93] In reaction to the 1973 Oil Crisis the European Council of 1974 adopted a common programme that prioritised diversifying energy sources, so as diminish the bargaining power of the OPEC countries.

marketisation and contributed to giving the European energy policy increased leverage against national statist or corporatist structures of energy policy in which elements of regulation and long term planning were of central importance. Therefore, for a considerable time period, European energy policy has *de facto* merged with the project of the single market, consisting simply in bringing the European Single Market for goods and services fully to bear on the segmented and oligopolistic energy markets, starting by dissolving existing state monopolies and privatising state owned energy agencies and firms.

European Commission documents, published in 1995[94] and again in 2001 and 2003, have attempted to define 'An Energy Policy for the EU' have focused solely on liberalising the energy market with the promised outcome to promote competition, business transparency, and security of supply. In the face of the strong interest of some member states to remain in control of national energy markets the implementation of this strategy has met with little success. The two underlying ideas can be spelt out to be the idea to negotiate energy more effectively in international exchanges when acting as a united bloc, while diversifying supply and promoting competition as a hopeful instrument for ensuring security and sustainability of energy supplies. It is quite evident, however, that the contrary is also plausible in the perspective of most member states – to get better conditions for energy supplies on the basis of special relation to large supplier countries, and to expect an improved security and sustainability of energy supplies from consistent and long-term public programmes.

After the short crisis around Russia's stopping the flow of gas into both Ukraine and Belarus, which serve as transit states to the EU, and therefore had a clear repercussion on supply security. The *Green Paper* of March 2006 claimed to prepare further steps in the direction of a common and co-ordinated policy in this field, by re-opening the debate on a future common European Energy Policy, starting from the resounding statement that "Europe has entered into a new energy era", but arriving at more timid proposals, if taken in real terms. Its main suggestions may be grouped into three categories:

- proposals for enhancing market efficiency and European competitiveness by completing the opening of European gas and electricity markets, which are clear and practical;
- proposals for securing supplies by stepping up relations with major suppliers such as Russia and OPEC, which are not really specified; and
- other key suggestions aiming at steps towards energy sustainability like boosting renewable energies, energy efficiency, and research on low-carbon technologies.

There is an evident gap in this list of concerns which is especially grave in the face of the insistence on competitiveness, i.e. keeping energy prices down: the rebound effect and the question of defining strategies for influencing directly the quantities of energy demanded and used are not addressed within the European Commission's strategy. On the other hand, the EU member states have repeatedly made it clear that they would not tolerate any 'interference with national sovereignty' in this field, thereby severely limiting the reach of the Commission's actions and proposals. At the spring summit of April 2006 the European Council have limited themselves – under the resounding title of a new Energy Plan for Europe (EPE), which will eventually lead to a Common Energy Policy (CEP) – to agreeing on a minimal programme consisting of warm words (a common approach to address crisis situations "in a spirit of solidarity"), confirming policies already in place (completing the Single Market in the field by "developing regional gas and electricity energy markets") declarations of principle (diversification of energy sources), declarations of intent (developing electricity interconnections to reach the target of "at least 10% of member states' installed production capacity", with financing borne "mainly by the enterprises involved") or

[94] White Paper: An Energy Policy for the European Union. COM (95) 682 final, 13 December 1995

commitments to further consideration (raising the share of renewable energies, implementing the 'biomass action plan'). This has been laid down in general commitments to creating a common energy foreign policy and an internal market for energy, to guaranteeing security of supply, to promoting the use of renewable energy, and to promoting research into energy technology.

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- Greenhouse-gas reduction: A binding target has been laid down to reduce EU emissions by 20% by 2020, regardless of progress made in international negotiations for a post-Kyoto agreement, and a binding 30% target was envisaged in case other industrialised nations including the US take similar steps. This has not been concretised, however, by at least defining a mechanism translating this general commitment into specific obligations for each member states;
- Renewable energies: Again a binding target has been laid down to have 20% of the EU's overall energy consumption coming from renewables by 2020, including the specific commitment to a problematic binding minimum target for each member state to achieve at least 10% of their transport fuel consumption from biofuels, which is fortunately conditioned by "production being sustainable" and "second-generation biofuels becoming commercially available"
- Energy efficiency: a relatively bold objective - saving 20% of the EU's energy consumption compared to projections for 2020 – has been laid down as a binding target, while limiting specific proposals for its realisation which the Commission is asked to make during the next years to relatively limited fields of action, i.e. increased energy savings from office and street lighting and increased energy savings from incandescent lamps and other lighting in private households.

At the same time, the summit rejected the proposals made by the Commission in the direction of an even further increased marketisation of the field. It limited itself to underlining the existing

commitments, i.e. referring to "full implementation of the letter and spirit" of existing legislation as a "first step" before going further with more radical options.

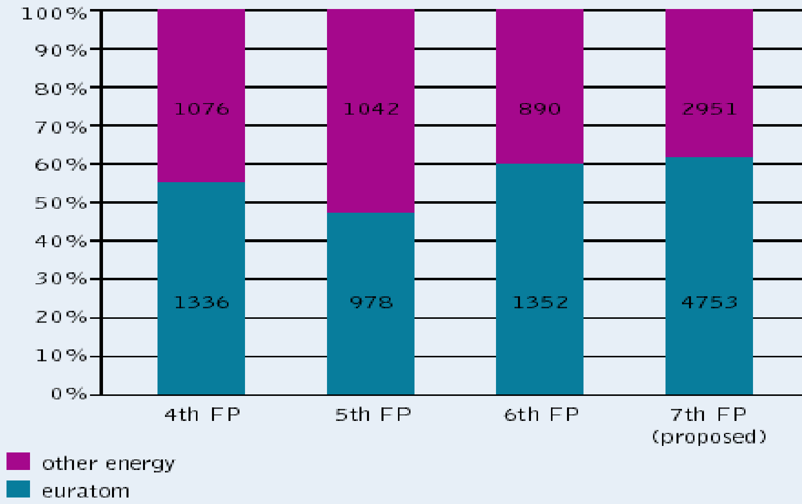
The optimistic appraisal of this outcome by the German presidency does not seem to be borne out by real agreements; it should rather be understood as a declaration of intent to try again: Angela Merkel said that the summit results in this field would "open the door to a new dimension of European co-operation in the years to come" and that the energy action plan "will give the initial spark for a third technological revolution". The description of the targets on climate change and renewables laid down by the summit as both "ambitious and credible" may only be shared on the optimistic assumptions on technological fixes voiced by the same German presidency: "We'll be going down completely new roads as far as technology and innovation are concerned".

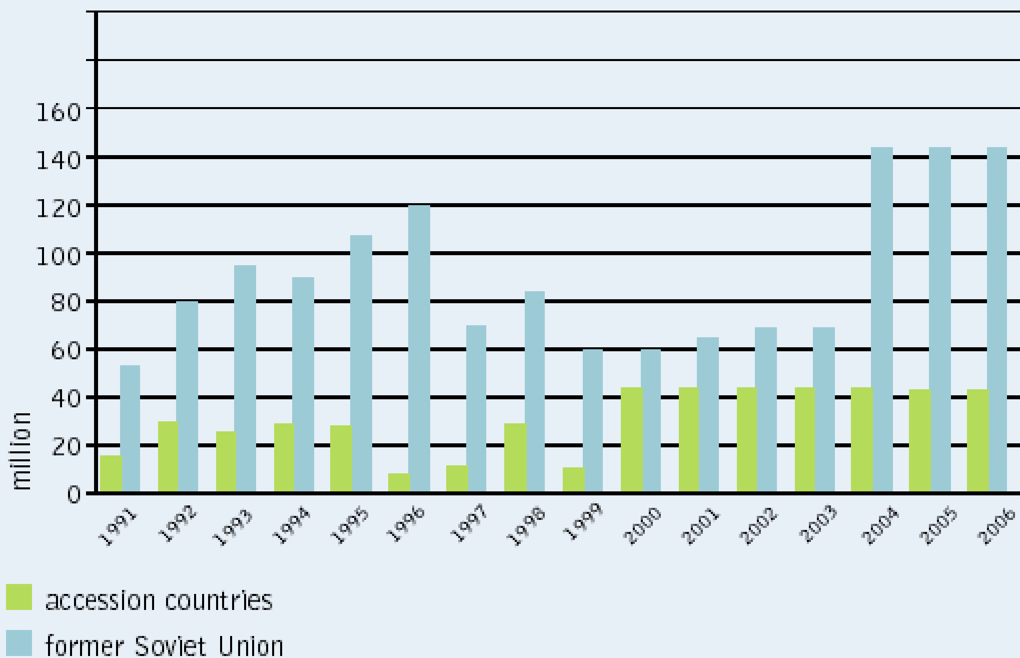
This can clearly be seen as extremely improbable as a spontaneous process, simply by looking at the history of Global and European Energy Policy since the early 1970s: Without stronger common and co-ordinated political action by the community and by the member states such a 'new industrial revolution' – as it has been referred to in the summit rhetoric – will not materialise.
There are, in fact, some positive elements in the EU energy and climate strategy which would deserve to be strongly expanded in their size and to be improved in their specific efficiency with regard to effective energy use: This is true for encouraging the use of truly renewable energy sources, and for policies of supporting and incentivating energy saving (by sufficiency considerations, as well as by sheer efficiency).
In the Transport Sector the EU Strategy for reducing CO2 emissions from cars is still in the stage of a consultation procedure (July 2007). The third legislative package on the EU Electricity & Gas markets (September 2007) is still exclusively geared to market opening 'liberalisation'.

A structural problem of EU policies in general is also exemplified by the EU energy strategy: Although on the level on declarations and general commitments some key principles of a sustainable strategy are acknowledged, this is countermanded in important ways by the subvention policies of the EU as they are effectively implemented in the areas of the Common Agricultural Policy, the planning of the Trans-European Networks for transport, or of research policy, which indirectly lead to increased energy needs and greenhouse gas emissions.

There also are clearly negative elements, namely the binding of important investments to dangerous, illusionary and strategically counter-productive options which should not be included into a sustainable European energy strategy – the nuclear option (including fusion), the coal and lignite option, and the option of first generation biological fuels:

- The nuclear option cannot be considered sustainable: It is either based on limited Uranium supplies which are estimated to last for a maximum of another 40 years, or it is linked with a Plutonium cycle which is inseparable from nuclear weapons production – and, in any case, there is no solution to the high risk problem and to the unsolved problem of waste storage over some 10.000 years. It would be required to agree on a European moratorium in this respect, and at least avoiding the construction of new nuclear power plants for the time being, and refusing attempts to guarantee a European future for the nuclear industry.





<u>Source of figure 4 and 9:</u> "Invest in a Clean Energy Future" – Greenpeace Exposes the EU's Dirty Energy Subsidies; Report July 2005 by Greenpeace International.

- The coal and lignite option is less evident in the public debate – because of its all too visible side-effects in the climatic dimension. Yet it has not entirely dropped out of the European

energy policy mix, due to its strong traditional positions inherited from the ECCS.

- The bio-fuel option is strongly championed by EU policies, internally as well as in international *fora* and in bilateral agreements. This is, however, not a step towards sustainable development – for first generation bio-fuels have two main downsides: on the one hand, they are not climate neutral, as it is claimed. On the other hand, they do compete directly for fertile soils with food production, thereby exacerbating rural poverty and food shortages in the areas concerned.

III. Proposals for alternatives

An alternative strategy in the area of the energy and climate policies of the EU and its member states would still have to base itself on two priorities: It should secure first mover advantages in the fields of renewable energy sources and it should address the challenges of energy saving strategies which would not lead to any reduction of human well-being (cf. Euro-Memo 2006).
The urgency of the situation calls for radical action. In view of this, the Potsdam Memorandum: Global Sustainability a Nobel Cause" is calling for a "'third way' between environmental destabilization and persisting underdevelopment" which will consist in nothing less than a "Great Transformation" bringing about "rapidly and ubiquitously, a thorough re-invention of our industrial metabolism".

III.1 First practical steps

Often, even by the EU European Council, referred to as an "energy revolution", the acknowledgement is explicitly voiced that there is an urgent need for a profound transformation of the energy systems and energy regimes in place, with the long-term objective of creating a carbon free economy, and the intermediate goal of reducing greenhouse gas emissions to a level that keeps the global average temperature increase well below 2 degrees C, which seems to be the only way to avoid the most catastrophic impacts. The time of waiting for the situation to go by is definitely over.
A continuation and strengthening of the existing climate policy regime aiming at reinforcing their contribution to climate protection is the unavoidable first step in any alternative strategy:
For the EU this would mean the implementation of a revised mechanism of internal emission trading with clear and rapid reduction aims and closing all loopholes for delegating emission reduction to countries of the Global South.
Insisting on Kyoto compliance does not imply an uncritical acceptance of the limitations of the Kyoto agreements, which would be a negative input for reaching improved post-Kyoto agreements. Two points deserve to be highlighted here: First, it would be an illusion to expect that market instruments alone (especially not under the condition of trying to achieve *competitive*, i.e. cheap energy prices) will have the effect of a transition to a post-carbon society – market instruments, like tradable CO2 emission permits, may, in principle, be useful in certain phases of the transition process, under the two conditions of an open, non-oligopolistic market competition and clear political imperatives and implementation mechanism for radically decreasing the overall amount of emissions within a given regulation arena. But the kind of lax and give-away emission trading system the EU is preparing to set up will not meet this challenge.
Only a rapid absolute emission reduction will be capable of achieving relevant effects in the field of climate policy, and only massive reductions in energy end use will make it possible to achieve long term supply security. Without such a significant change it will not be possible to avoid the catastrophic effects predicted for 'tipping points' even by the most moderate credible scenarios (like pex. The IPCC's). This is a precondition for the meaningful institutionalisation of market

instruments in this field, like a global carbon emission permit market or regional ‘bubbles’ for tradable permits.
In face of the existing investments in out-dated and non-renewable energy interfaces the vested interests existing in this field will have to be addressed directly and treated politically, without falling victim to the illusion that free market competition as such would be a sufficient instrument for achieving this aim. The carbon neutrality to be achieved will not emerge automatically from the implementation of market instruments (cf. TNI/Carbon Trade Watch) – it requires strong political measures like legal interdictions and permissions and the legal definition of binding reduction targets (cf. Kevin Smith): Only in the area of optimising the methods and strategies by which these aims are pursued market instruments may be really usefully relied upon. Without a binding framework of reduction strategies these instruments cannot bring about a post-carbon society – and even their contribution in pushing or pulling towards a low carbon society may be very limited. Other political, government or civil society driven, political and legislative frameworks will be needed to make sure that real substitutions and reductions will take place in time.

Evident first steps can be found in the action fields of getting rid of big energy wasters and limiting unneeded energy use. Here the instruments of direct state intervention will be immediately effective on a short time scale, without creating significant negative side-effects for the medium and long-term perspectives – pex. by speed limits and by an interdiction of all transport on chosen days or by introducing the obligation to offer an effective ‘off’ switch on all electrical appliances. Such steps can also be started on the lower levels of government and administration, and reinforced by trans-national networks of such political initiatives. Likewise, consumer action can be rather effective in these fields – from boycotting certain types of cars as ‘square’ via implementing slow traffic campaigns to practising a low energy consumer pattern.
First steps should also address immediate priorities under other policy aspects (health, general environmental concerns) like phasing out “old and dirty fuels’ or phasing out nuclear energy supplies, because of their unacceptably high risks, unsolved waste storage problems, and its inseparable links to military technologies. Anyway, in a time of rising prices for oil and gas, of political instabilities in many supplier countries, of rapid human induced climate change, and of still growing mountains of radioactive waste, a common and co-ordinated policy of the EU on energy should be geared to achieve the aims of rapidly minimizing energetic waste (throughput and output), while organising a take-off for truly renewable energy sources (especially solar and wind energy) and their required energy interfaces. Effectively pursuing this double objective will make a European energy policy truly climate-friendly and securing required supplies in the long run.

In order to avoid a decoupling of the new member states from such a common strategy special programmes should be developed and implemented for increasing their capacity for an energetic self-reliance compatible with a strategy of sustainable energy supplies, i.e. overcoming their dependence on nuclear energy and coal by rapidly enhancing their potential for energy saving and for expanding the use of renewable energy sources.

This strategic approach asks for a conscious embedding of European policies on energy and climate in a deepening and an effective implementation of the EU Sustainable Development Strategy (SDS) (cf. Euro-Memo 2006).

III.1.1 Proposals for policies within the EU

According to recent studies significantly positive effects can be expected from strong policies of climate protection and energy saving in Europe on the development of employment.

In the face of durably mounting oil prices, on the one hand, and a mounting pressure from climate effects, on the other hand, the EU and its member states can rely on a number of short term emergency measures which are not counter-productive in the medium or long term:

- avoiding unnecessary transport
- avoiding energy waste (distribution systems, stand-by)
- avoiding energy sources with high impact on climate change
- accelerating the introduction of low energy housing by investment support programmes
- accelerating the introduction of renewable energies by giving them a priority in all public procurement and creating immediate incentives for the production and use of the respective energy interfaces
- concluding long-term supply treaties on gas and oil with key suppliers

These actions should be accompanied by programmes guaranteeing the supply for basic energetic needs for all inhabitants of the EU, in order to avoid side-effects of social disruption or polarisation.

Specific policy instruments for implementing these actions could be found in the areas of

- tax policy (combined CO2 emission and energy use taxation, reduced VAT for products with very high energy efficiency and very low climate gas emissions;
- subsidy policy (supporting the introduction of truly renewable energy sources, guaranteeing prices for energy supply from renewable sources for a transition period),
- public investment and procurement policy(binding all public agencies to climate and energy objectives, investment programmes for increasing energy efficiency and reducing energy needs),
- housing policy /(investment programmes and tax incentives for low energy housing),
- transport policy (investment programmes for the shifting of freight transport from road to rail or waterways, limiting car traffic and velocity in urban areas and generally reducing the average speed and weight of vehicles in order to achieve gains in energy efficiency and reductions in the emission of greenhouse gases).
- Binding public assessment procedures should make sure that the aspects of climate and energy are taken on board in all public investment decisions, as well with regard to all major investment projects.
- A comprehensive reassessment of existing programmes and subsidies granted on the EU level should be undertaken, eliminating all practices running counter to a sustainable energy strategy.

III.3.2 Peace, co-operation and development: Proposals for an alternative external policy – sustainable development

Sustainable development and the reliable transition to it would constitute a material basis for an alternative external policy based on long-term co-operation in the mutual interest and peaceful development.

A first example for this can be taken from the area of climate policy where an “eco-fair scenario”[95] would provide significant possibilities for implementing a new type of co-operative external policy of the EU:

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[95] (Hermann Ott et al. 2004, 26-29)
[Ott, H.E., Winkler, H, Brouns, B, Kartha, S., Mace, M.J., Huq, S., Kameyama, Y., Sari, A.P., Pan, J., Sokona, Y., Bhandari, P.M., Kassenberg, A., La Rover, E.I. & Rahman, A. (2004): South-North Dialogue on Equity in the Greenhouse. A proposal for an adequate and equitable global climate agreement; GTZ Climate protection Programme, May 2004 - http://www.wupperinst.org/upload/tx_wiprojekt/1085_proposal.pdf]

If climate negotiations are resumed by the end of 2009, there is some hope that market agencies will continue to trust in emission trading and the long-term binding character of the target of climate protection. Due to the already unavoidable delay in the ratification of the post-2012 commitments there will be an interim period – which will have to be covered by an extension of the existing commitments. A key to success will be convincing the USA, and China, "of the necessity for a long-term stabilization target and a global reduction in the emissions of greenhouse gases in the range of 50 percent until the year 2050" (ib., 27). Only if this goal is binding for the process it will be possible to formulate " a strategy for the global allocation of emission rights on a rational basis" (ib., 27).
This presupposes a generalized transition to a "solar economy", not only "in Europe and Japan, but also in the United States", with "oil 'dinosaurs'", like Exxon, after having established a large renewable energy branch, fully going in this direction. (ib., 28) Likewise, for "the rapidly industrializing countries of the South" it is presupposed that they "show their willingness to commit themselves to emissions reductions" without agreeing to set targets on the national level as for the industrialized states: "i.e. they do not set a fixed cap on emissions per country", but for certain sectors (e.g. steel, energy, cement etc), the countries agree on concrete measures for greenhouse gas reductions. And it is assumed that "until the year 2020, a minimum of 30 percent of energy supply in these countries shall stem from renewable energies", while "cooperation in the development and diffusion of climate-friendly technologies – including energy efficiency" is duly promoted by agreed forms of international technology cooperation. Such political obligations will not be imposed uniformly to all developing countries, but only on "the 'emerging economies' the rapidly industrializing countries that have reached a certain level in their economic development and emissions" which is "calculated via a complex index, combining criteria of historical responsibility, economic power and mitigation potentials of the states". At the same time the Least Developed Countries (LDCs) will not have to take on any reduction or limitation commitments, but are aided in their energy needs vie renewable energies and in their adaptation to climate change." (ib., 27)

Such a climate centred alternative strategy could be broadened to energy policy in general and to trade policy by

- negotiating long-term terms of trade and technology transfer to be offered to fossil energy supply partners in order to stabilize mutually advantageous exchanges;
- building and developing a 'coalition of the willing' for the development of truly renewable energy sources and strategies of energy saving (efficiency and sufficiency);
- negotiating long-term common strategies with regard to climate and energy and technology exchange with the big emerging countries (China, India, South Africa, Brasil) as well as with groups of partner countries (ACP);
- developing the structured dialogue the EU is building with the OPEC countries to a process of constructive participation in all dimensions of global energy and climate policies;
- introducing a strong element of co-operation in a strategy on energy and climate into the European Neighbourhood Policy, making it an obligatory chapter of all negotiations on Neighbourhood Agreements.

In the long-term perspective such efforts should contribute to the development of a "World Energy Charter" as proposed by the WBGU, and to the creation of an 'International Agency for Sustainable Energy", as well as of an "International Renewable Energy Agency", proposed by the same body, capable of addressing the diplomatic tasks of integrating the OPEC countries into the development of a common global strategy of limiting energy consumption based on the use of non-renewable energy sources (cf. Massarrat 2006).

It should be made sure that gender and women's aspects will be adequately addressed. This calls for

the breaking of the vicious circle presently in place: lack of integration of women's organization or gender experts into deliberation processes reproduces the lack of awareness of the gender dimension, which in turn helps to maintain the non-participation of women's organizations: Recent efforts of sensibilising the parties of the UNFCCC and Kyoto Protocol negotiations to gender issues should be reinforced, making the emerging post-Kyoto regime an entry point for a comprehensively gendered perspective.

III.3.3 Gender and Climate change:

Men and women have different roles, responsibilities and decision-making power, leading to disadvantages for women. It is therefore **not surprising** that gender also plays a role in relation to climate change.

There are a number of issues that point to the crucial role of gender when understanding the causes of climate change, aiming to mitigate it, and working towards successful adaptation to inevitable climate change:

- Women and men – in their respective social roles – are **differently affected by the *effects of climate change.*** Reasons are inter alia to be found in different responsibilities for care work and income generating work, in dependency on natural resources because of lacking access to environmental services, or in knowledge and capacities to cope with the effects because of differences in the access to education and information systems.
- Women and men – in their respective social roles – **are differently affected by *climate protection and adaptation instruments and measures.*** If these mechanisms and measures are developed in a non-gender-sensitive way – which most often is the case – they again do not take into account different responsibilities and financial options.
- Women and men **differ with regard to their respective *perceptions of and reactions to climate change.*** It is well known, especially in industrialised countries, **that women have a higher risk perception than men,** and thus also recognize climate change as a more serious problem than men do. Gender differences are crucial when it comes to assessing adequate measures, too. While men trust in technical solutions, women vote stronger for lifestyle changes and reduction of energy consumption.
- Women's and men's *contribution to climate change* differs, especially with regard to their respective CO2 emissions. This is especially proven in regard to transport systems. For example, in Sweden men consume up to double amounts of energy compared to women. Difference results mostly form gendered car use and mobility patterns.
- Social roles and responsibilities of women and men lead to different degrees of *dependency on the natural environment.* Women are usually the ones engaged in household subsistence activities, thus degradation of forests, watersheds, foreshores and agricultural land in developing countries can have a severe effect on their ability to perform the daily household maintenance tasks.
- As the male perspective is dominating, climate protection and climate adaptation measures often fail to take into account the *practical and strategical needs* of large parts of the population (e.g. infrastructure, energy supply);

- The *participation of women in decision-making* regarding climate policy – mitigation and adaptation – and its implementation in instruments and measures is very low. Thus, in general it is men's perspectives which is taken into account in planning processes.

Women and men are not homogenous groups but include people of various age, ethnicity, education, income. These social categories also relate to differences in influence, attitude and in contribution to climate change, to how people are affected by it and which possibilities they posses to adapt to climate change. This applies to developing as well as to developed countries.
Principally, however, the situation of women in the global South differs significantly from the situation in the global North. While women in the South are more dramatically affected by climate change, women in the North are expected to play a significant role as consumers without having appreciable influence on decision-making as it relates to emission reduction

Learning from UN processes
If women's organizations are not actively involved, gender and women's aspects will not be addressed. Thus, it is like a vicious circle: because women's organization or gender experts are not involved, women's /gender aspects are hardly addressed. And because they are not addressed, women's organizations don't take part. Recently some efforts have been undertaken to sensitize the parties of the UNFCCC and Kyoto Protocol as well as the constituencies taking part in the process on gender issues.

Because negotiations were coming into a **new phase, because the post-Kyoto regime may provide an entry point for gender perspective, situation is improving slowly**. There are more women's organizations interested in the UNFCCC process now, and thus hopefully the vicious circle will be opened.

Additionally there is another lack preventing the 'mainstreaming of gender' into climate change policies, which is the lack of data and research. This applies to the IPCC Assessment Reports, for example: IPCC is not undertaking research by itself, but reviewing existing research. If there is no research available on gender and climate change, the issue cannot be highlighted in the Assessment Report. Regarding the Stern report[96] we are facing a similar situation: the report is focussing on the economical impact of climate change only, based on a conventional perspective on economics: unpaid labour or care work is not taken into account. Both of the reports certainly would look different if gender experts were involved and gender perspectives were shaping the structures.
However, it is not only research and international institutions related to climate change that are lacking gender perspectives. The same applies to donor organizations and development departments in national governments of industrialized countries. And it is for the same reasons: lacking gender sensitivity and lacking knowledge on how to integrate gender perspectives and what the specific women/gender aspects are in a concrete situation /measure. In the same time it is the very technical and science orientated view to climate protection and often to adaptation to climate change too, that make people believe that the policies are 'gender neutral'.
Available ***knowledge about impacts*** *in areas where women are involved in or dependent on:*
Areas which will be effected by climate change and where adaptation measures should be implemented include water, agriculture/nutrition, energy, transport, housing, forestry, fishery/coastal zone management, biodiversity, natural disasters/conflicts/risk management. Currently a research review funded by the FAO is collecting available data and knowledge in most of these fields. The study is expected to be published in autumn 2007, and will provide a more in-depth insight to gender aspects in these issues. Detailed information and support are also provided by international gender networks. Regarding the energy issue a wide range of studies from many developing countries can be found at the website of ENERGIA, the

[96] Stern, Nicholas: The Economics of Climate Change: The Stern Review; Cambridge Univ. press (2006) UK

International Network for Gender and Sustainable Energy (www.energia.org). The Gender and Water Alliance has a website with detailed information and recourses on gender aspects in integrated water resource management (www.genderandwater.org). The same applies for the Gender and Disaster Network (www.gdnonline.org), which provides a gender and disaster sourcebook on their website as well as checklists and practical guidance.

To ensure success, adaptation policies and measures need to be gender sensitive. In principle, gender could be integrated relatively easy into, for example, stakeholder analyses, livelihoods analyses and multi-criteria decision tools if the users were aware of the need and choose to do this. A lot of tools are available aiming at integrating gender perspectives into development planning. These tools need to be adopted into adaptation policies, programmes and measures and should be tested and evaluated.
Gender dimensions can serve as 'searchlights' for different degrees of gender-specific implications of climate change.

Gendered division of labour
This refers to the gendered responsibility for certain types of work, e.g. gender aspects related to income-generating activities, (paid work, self-employment, subsistence production), domestic work and care work (caring for children, sick or elderly people).

Human reproduction, health
This dimension refers to the physio-biological conditions of women's/men's constitutions; gendered sensitivities/vulnerabilities, gendered perceptions of environmental change.

Regarding adaptation to climate change, the focus should be on

- Gendered impacts of climate change on health (carrying heavy loads, air pollution, vector-borne and waterborne diseases, disasters)
- Special vulnerabilities during pregnancy or breastfeeding (at any given time, an average of 18-20 percent of the female population of reproductive age is either pregnant or lactating)
- Personal security issues (e.g. when searching for firewood/fetching water way beyond their villages, domestic violence after disasters)
- Socio-cultural construction of male/female identities (risk perception and risk behaviour, attitudes towards appropriate mechanisms and measures)

Power and decision-making
Further gender aspects relate to self-determination, participation in decision-making (participation of women/men in decision-making, participation of women/men in project development, proportion of women/men in stakeholder groups, etc.), participation in community planning. (vgl. U. Röhr, M. Hemmati 2007; U. Röhr 2007)[97]
"Closing knowledge gaps relating to gender and climate change: All climate protection measures and programmes and all instruments for mitigating climate change or adapting to climate change must be subjected to a gender analysis. All climate change related data, scenarios, etc. need to be disaggregated by gender. Gender experts and climate researchers need to engage in the issues.

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[97] Röhr, Ulrike/ Hemmati, Minu 2007. Solidarity in the Greenhouse: Gender Equality and Climate Change. In: Grovers, Velma (ed). Climate Change: Kyoto, ten years and still counting. To be published.

Röhr, Ulrike 2007. Gender and climate change, introduction to the gender dimension; Background paper to be published.

There is a range of established analytical and practical tools that can and should be used, such as gender analysis, gender impact assessment, gender budgeting, and the knowledge and practical experience gained in participatory community development that is particularly relevant for adaptation.
Energy, mobility and transport, agriculture and forestry, water, biodiversity, disasters and extreme weather, land use and urban planning, building and housing, and health are among the range of issues, practices and events that affect and are affected by climate and its protection. The availability of gender-disaggregated data varies considerably, depending on which issues and which regions of the world we look at.
Energy production and demand are particularly closed linked to climate protection. From a women's perspective in developing countries, we know of the lack of women's access to energy; the need for affordable energy supporting women's income generating activities; the high number of victims of indoor air pollution, particularly women and children, and the need to replace inefficient biomass stoves; the physical burden of collecting firewood and the impacts on women's time.

Industrialized countries: Private and public transport, we know that women and men have access to different kinds of transport and that they use them for different purposes.

Integrating a gender perspective would enable us to make transport systems more user-friendly and more climate-friendly. (p. ex: If public transport routes and schedules were designed so that women can take their children to school and get to work in time, they would not need to use a private car.)"[98]

III.3.4 The intricacies of 'bio-fuels'

The EU has not yet clearly ended the orientation of its policies to the massive support for the use of bio-fuels of all kinds – although it is clear by now that bio-fuels of the first generation are a pseudo-solution with dramatic negative effects in social as well as in environmental terms. And the criteria for chosing sustainable bio-fuels of a second generation are still not fully worked out and are not implemented in shaping the EU's and its member states' energy policies. Therefore, the policy of indiscriminate support to the use of bio-fuels has to be stopped, while research and trial programmes on second-generation bio-fuels have to be stepped up. In view of the immediacy of the destructive effects of the present bio-fuel policy of the EU this policy change is urgent and should take effect at once.

The paper on "Biofuels: A Disaster in the Making" signed by NGOs, Indigenous People Organizations, farmer's movements and individuals as of December 1st 2006 has summarized the destructive effects of the present use of bio-fuels impressively:
"Meanwhile, international trade in biofuels is already causing a negative impact on food sovereignty, rural livelihoods, forests and other ecosystems, and these negative impacts are expected to accumulate rapidly. Large-scale, export-oriented production of biofuel requires large-scale monocultures of trees, sugarcane, corn, oilpalm, soy and other crops. These

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[98] Minu Hemmati and Ulrike Röhr, A Huge Challenge and a Narrow Discourse – Ain't No Space for Gender in Climate Change Policy? – in Women & Environment Magazine No. 74/75, Toronto, Canada, Spring/Summer 2007.

monocultures already from the number one cause of rural depopulation and deforestation worldwide. The rapidly increasing demand for these crops as a source of biofuel will lead to:

- Increased land competition leading to further land concentration, the marginalization of small-scale agriculture and the widespread conversion of forests and other ecosystems;
- arable land that is currently used to grow food being used to grow fuel, leading to staggering food prices and causing hunger, malnutrition and impoverishment amongst the poorest sectors of society;
- rural unemployment and depopulation;
- the destruction of the traditions, cultures, languages and spiritual values of Indigenous Peoples and rural communities;
- the extensive use of agro-chemicals, which deteriorate human health and ecosystems;
- the destruction of watersheds and the pollution of rivers, lakes and streams;
- droughts and other local and regional climate extremes; and
- the extensive use of genetically modified organisms leading to unprecedented risks.

These effects will have particularly a negative impact on women and Indigenous People, who are economically marginalized and more dependent on natural resources like water and forests.
Biofuels are a disaster in the making. Existing legally binding standards, regulations and enforcement mechanisms in the (potential) production countries are absolutely insufficient to prevent the above-mentioned impacts.
There is nothing green or sustainable to imported or exported biofuel. …”

IV. Conclusions: medium term and long term challenges for a European energy policy combining climate sensitivity with improvements in supply security

Even if the institutional conditions for a common and effectively co-ordinated European energy policy continue to be difficult, it is already possible to give reliable broad outlines for the challenges such an energy policy would have to meet. To begin with, it will be essential for avoiding losses of effectiveness due to policy incoherence to construct this European policy field by combining from the very beginning measures, programmes and strategies for improvements in climate sensitivity with improvements in supply security.
Likewise, in order to avoid the counter-productive effect of short-term measures or medium term strategies preventing any possible achievement it is required to arrive at a sufficiently clear understanding of the long-term aims and objectives to be followed in such a dual perspective.

IV.1 Long-term objectives

Three criteria for acceptable solutions in the field of energy policy can be derived from the global debate which still seem relevant today:

a) relieving global pollution e.g. CO_2,
b) relieving local pollution e.g. toxic gases from burning (e.g. tree in stoves) and
c) enhancing economic development, especially in peripheral areas.

This can be specified by the following arguments:
Sustainable patterns of energy use should be reached in the end of a process of developing energetic sustainability - not necessarily just one, to be implemented irrespective of cultural and political traditions – combining a reliance of fully renewable[99] energy sources and energy carriers, with a reliable avoidance of destructive ‘throughputs’, and an effective prevention of polluting outputs (from greenhouse gases via non-recyclable waste to toxic substances needing specific sinks or even cautionary treatment). The sustainability of such patterns should be defined in terms of input, output and throughput simultaneously, and should be effectively monitored over the long term.
This would imply meeting the requirements of climate sensitivity at the same time with those of supply security. With regard to climate sensitivity the long-term aim and objective to be achieved can be described adequately as a combination between the prevention of further emissions of greenhouse gases affecting the climate – where the capacities of the respective ‘natural sinks’ would be defining the admissible thresholds for emissions of each and every greenhouse gas – and the required adaptations to the degree of climate change due to the emissions of the past as well as of the unavoidable time of transition, however with a realistic option to return to a situation when the continued presence of greenhouse gases will cease to present a real problem – after having returned to pre-crisis levels. In the present state of the debate, when the hope of effectively reaching a situation of energy sustainability seems to have been almost given up, in favour of concentrating on adaptation and mitigation measures, it may seem over-ambitious to present such an aim and objective. It should be understood that such a pragmatic lowering of objectives is not only contributing to the effective impossibility of reaching more ambitious long term goals – it also, and still more importantly, would have the effect of losing the criteria for distinguishing between short term measures and medium

[99] There are well-founded doubts to include bio-fuels into their definition, due to the sharpening problems of soil scarcity, desertification and human hunger.

term strategies which would be helpful (or neutral) for the pursuit of such long-term aims and objectives, and those which would function as additional impediments for getting any nearer to them.

Such a transformation and transition strategy will require a deep change in the very constellation of the agencies participating in European politics. If the present constellation of hegemony remains in place, a transition towards sustainable reproduction patterns remains highly improbable. The transition required may only be realised, in so far as the present constellation of hegemony realises that admitting it at least selectively will be more advantageous for European elites than following the USA on their present path of preferring to use political might – backed up by military power - to control existing fossil energy reserves. Very probably, however, this may only achieved by an at least partial change of the present constellation of hegemony in Europe – in the direction of taking on board a new type of socio-political representation of the forces of – visible and 'invisible' – labour which continue to be the effective agents of societal reproduction processes in their concrete realisation.
In the very long run, there will be no sustainable solution to European societal reproduction processes without a full participation of the forces of labour – and not just of selected segments of organised 'visible' labour, as it has been the case in the 'historical compromise' of fordism. This time, in order to adequately address the dimensions of ecological and social sustainability simultaneously, it will be unavoidably required to integrate the 'submerged' continent of providing and caring labour into the horizon of the necessary labour going into the reproduction of human societies as the key dimension of the metabolism between human beings and the terrestrial biosphere. This will, it is true, go far beyond a change of policies or of economic strategies: It will require a deep change of the very conceptions of the economic and the political as they are put into practice within the societies participating in this deep transition and transformation process which it is to be hoped for in the 21st century.

The measures and strategies implemented to achieve a situation of energy sustainability will, of course, vary according to the starting situation and the specific pattern of sustainability pursued within the respective societies. The criteria needed for distinguishing sustainable from unsustainable situation will not. The variety of situations and sequences will be the result of the kind of industrial policy pursued in developing new energy interfaces, in the kind of energy, of energy sources and of energy carriers to be used for different purposes, as well as in the cultural patterns underlying definitions of sufficiency or the 'pursuit of happiness' valid within a given society. There are however common dimensions to all situations of energy sustainability:

- the reliance on easily available renewable energy sources as inputs,
- the avoidance of throughput effects leading to high losses between energy inputs and the effective energy use,
- the minimisation of outputs to the thresholds defined by reference to existing 'natural sinks'.

This is not linked – if we look at empirical findings so far – in any way specifically to the number of energy users: If successful substitution to pollution-free and readily available energy technologies is realised, multiplication by more users would be unproblematic.
These long-term aims and objectives should clearly be defined in terms of *post*-carbon (or Zero-carbon) societies, overcoming the use of fossil fuels for heating, for driving motors or for producing electricity. A 'low carbon society' would only be a meaningful objective in this respect as a realistic medium term goal, linked to a clearly defined perspective of transition to such a *post*-carbon society.

IV.2 Managing the transition to energy sustainability: Medium term strategies for a European energy policy

It is possible now to identify the main areas which will be decisive for building a common and co-ordinated European strategy for arriving at a kind of energy sustainability for Europe which will be ecologically durable, provide for a secure energy supply, and rely upon a long-term exchange with other world macro-regions based on mutual advantage, while at the same time respecting internal European cultural and ecological diversity.

1. A common and co-ordinated European tax regime could contribute to accelerating the transition to low energy consumption patterns, as well as to renewable energy sources, by selective pricing according to energy content. This could be concentrated, in a first phase, due to its urgency in terms of climate change, on taxing the CO_2 set free in energy production[100], to be enlarged, in a second phase, to all kinds of energy content.
2. A common and co-ordinated industrial policy should plan the framework of incentives and disincentives needed for the acceleration of the introduction of renewables, of the transformation of transport systems (avoiding 'enforced transportation', and reducing the energy needs of voluntary transportation), of the reduction of the energy needs of housing, of the transformation of production systems to using easily available types of energy in the most efficient ways, and of the modernisation of energy distribution systems to avoid energy waste by an optimal combination of effective ways of energy transportation and of reducing the need for it. It should be made clear that the over-riding aim of this strategic effort should be the lowering energy end use needs, and not just energy efficiency.
3. A legislative package creating the framework for a common and co-ordinated European strategy of energy transition should address the issues of transparency, access to information and public accountability to be demanded from all kinds of energy providers, while at the same time binding them to the aims and objectives of public policy defined for the field.
4. The EU could create an example for other macro-regions by embedding its strategy of using tradeable permits (as an instrument for an effective distribution of CO_2 emissions) in a clearly defined logic of reduction of emissions as well as of energy end use, by imposing an ambitious pace of decrease in the amount of emissions permitted over time, and combining it with defined objectives of reducing the quantity of energy used.
5. The EU should use its presence in the global arena, as well as in the kinds of structured dialogue it has been building over time – with the main energy suppliers, as well as with ACP and European neighbourhood states – for systematically building long-term agreements on exchanges in the mutual and common interest, as well as for sharing technologies needed in the process of energy transition. In the long run this could be extended to a continuous exchange of information on the functioning and problems of diverse regulation regimes in place within this specific field.
6. A common and co-ordinated strategy should be defined on the EU level and beyond it (e.g. EUREKA) for developing and securing an adequate knowledge base for the transformation of the energy system and for managing the transition required by it. This could be adequately reinforced by the creation of a European joint research and research communication agency in the field of energy policy.

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[100] Which should, it is to be underlined, take into account the entire amount of CO_2 set free in the life cycle of the respective energy interfaces, not just in the act of its application for generating energy.

7 The introduction of a European regulator for the energy markets as a EU agency directly depending from a Commissioner for Energy policy should be used as a first step for the introduction and development of a European energy planning agency capable of monitoring actual developments inside and outside of the EU, as well as laying down long-term requirements and goals, and defining programmes of common and co-ordinated action to reach them.

Appendices

Appendix 1: The definition of Greenhouse Gases

Greenhouse Gas (GHG) definition:

CO_2 = Carbon dioxide; CH_4 = Methane; N_2O = Nitrous oxide ;

Fluorinated greenhous gases (F-gases) :
PFCs = Perfluorocarbons
HFCs = Hydrofluorocarbons
SF6 = Sulphur hexafluoride
F – gases are synthetic compounds used as refrigerants, solvents, aerosol propellants, etc. – This three sets form a part of a basket of six gases, which the EU has committed to reducing by 8 % below 1990 levels in the 2008 – 2012 commitment period.
(Global Warming Potentials (GWP) are used for presentation in terms of CO_2 equivalent – for GHG emission data.)

Further information:
UNFCCC 2007 (http://unfccc.int/ghg_emission_data/items/3800.php)

Appendix 2: "Ozone Layer" and The Protocol of Montreal

20 Years Protocol of Montreal:

2007, on September 16th, the Protocol of Montreal was 20 years old, the landmark international treaty to protect the stratospheric ozone layer. To date, 191 countries have signed the Protocol, which prompts countries to phase out the production and consumption of ozone depleting chemicals (CFCs – chlorofluorocarbons).

HFCs – Hydrofluorocarbons were introduced as a replacement for CFCs and to some extent for Hydrochlorofluorocarbons (HCFCs), which are being phased out under this Montreal Protocol. They are also powerful greenhouse gases (GHGs). So while HFCs do no damage to the ozone layer (lacking chlorine or bromine atoms), they are still strong greenhouse gases.

The UNEP / Nairobi, Montreal, 14 September 2007:

"Ozone Treaty's Role in Combating Climate Change – Two Decades of Success and Future Years of Achievement Take Centre Stage at 20th Anniversary Celebrations of Montreal Protocol"

"An accelerated freeze and phase-out of hydrochlorofluorocarbons (HCFCs), chemicals that were used to replace more ozone-damaging substances known as CGCs, is to be considered by governments at an international meeting in Montreal, Canada.

New science and technical assessments indicate that speeding up a freeze and phase-out of HCFCs and their related by-products could not only assist in the recovery of the ozone layer. An acceleration could also play an important role in addressing another key environmental challenge – namely climate change.

A record nine countries – developed and developing – have submitted six different proposals which will be on the table when up to 191 parties or governments meet in the Canadian city between 17 and 21 September (2007).

The Protocol was negotiated in response to growing international concerns over the emergence of a hole in the ozone layer over Antarctica from the use of ozone-depleting chemicals in products from hair sprays to fire fighting equipment.

HCFCs, promoted over a decade ago as less damaging replacement for the older CFCs, have now become widespread in products such as refrigeration systems, air conditioning units and foams.

Under the Montreal Protocol, the United Nations ozone layer protection treaty which was adopted in 1987, use of HCFCs is set to cease in developed countries in 2030 and in developing ones in 2040.

However, scientists and many governments are now studying a range of options for a more rapid freeze on consumption and production of these replacements and the bringing forward of the final phase-out by around 10 years.

It follows research indicating that acceleration could, over the coming decades deliver cumulative emission reductions over the equivalent to perhaps 18 to 25 billion metric tonnes of carbon dioxide (18 gigatonnes – 25 gigatonnes) depending on the success of governments in encouraging new ozone and climate-friendly alternatives.

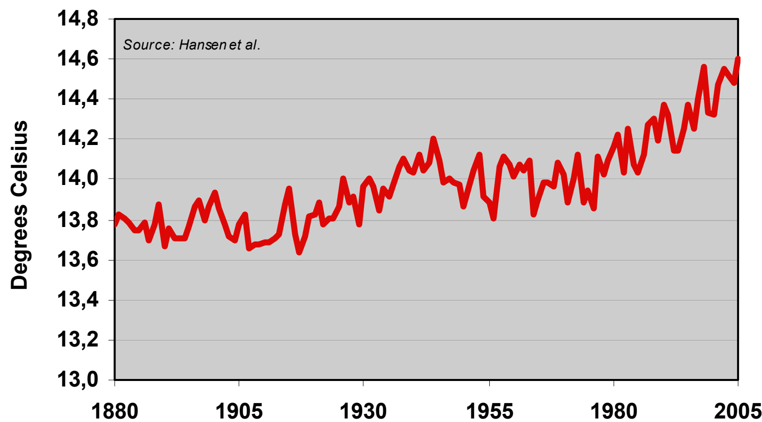
Annually, it could represent a cut equal to over 3,5 per cent of all the world's current greenhouse emissions. In contrast the Kyoto Protocol was agreed with the aim of reducing developed country emissions by just over five per cent by 2012.

For example a faster switch to alternatives to HCFCs may well stimulate technological innovation including a more rapid introduction of energy efficient equipment that in turn will assist in reducing greenhouse gas emissions even further.

The ozone layer and human health too will benefit. Under some of the accelerated phase-out scenarios, ozone levels could return to healthy pre-1980 levels a few years earlier than current scientific predictions. Benefits would include a reduction in skin cancer, cataracts, and harm to the human immune system alongside reduced damage to agricultural and natural ecosystems.

The urgency of the situation calls for radical action. Often, even by the EU European Council, referred to as an "energy revolution" there is an urgent need for a profound transformation of the energy systems and energy regimes in place, with the long-term objective of creating a carbon free economy, and the intermediate goal of reducing greenhouse gas emissions to a level that keeps the global average temperature increase well below 2 degrees C, which seems to be the only way to avoid the most catastrophic impacts. The time of waiting for the situation to go by is definitely over, as it is illustrated by the following table:

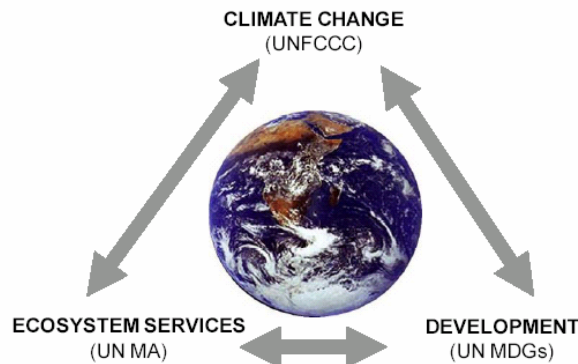
Worldwatch Institute 2007:



Appendix 3: The Global responsibility !

Linking three disconnected UN-Processes:

Climate change, as clearly pointed out in the IPCC 4th Assessment Report, is already today impacting on the lives of poor communities. The most vulnerable are most hardly hit, and expected to bare the largest burden of a climate crisis they have not caused. Already the 2015 UN Millennium Development Goal (MDG) targets of halving hunger, poverty and health threats are at risk due to climate change. At the same time, nowhere are ecosystem services so fundamental for human wellbeing as in the fight against poverty, and these ecosystems are negatively affected by climate change. Despite these close inter-relations between climate change, ecosystems and development, there is a disconnect between the three UN processes supporting the governance and management of these domains – the UN Framework Convention on Climate Change (UNFCCC), the UN Millennium Ecosystem Assessment (UN MA) and the UN Convention for Biological Diversity as well as the UN MDG process.



There is an urgent need, and possibility for a comprehensive policy-coherent effort to connect these processes within the framework of the UN system.

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Liberalization, privatisation, and the public sector in EU policies

Background, milestones, current issues, and options for alternatives

Introduction

Debates about the necessities and benefits and about limits and damages of liberalisation and privatisation have developed strongly during the last years in several member states of the European Union (EU). They were particularly fuelled in 2004 by the publication of two proposals for legislative acts: one for a directive on "services in the internal market" (the famous Bolkestein directive, see EC 2004a) in spring and one for a "Treaty establishing a Constitution for Europe" in June of that year (see OJ 2004). The constitution was rejected in France and the Netherlands by referenda and therefore failed. The services directive was adopted only in a modified version. Both results indicate that the theoretical and political critique of and resistance against the radical neo-liberal conceptions and policies which the EU authorities and most member states have increasingly adopted during the last three decades is gaining ground. However, they do by no means indicate a defeat of neo-liberalism in Europe. The deregulatory thrust of the services directive has survived in the final version albeit in a rhetorically softened way, and the Commission is working almost obsessively to transfer it to the excluded areas. And the "reform treaty" which heads of states signed on December 13, 2007 preserves the essential cornerstones of a market and competition driven Union with increasingly strong geopolitical and military ambitions. Theoretical critique and deliberations and proposals for alternative patterns of European development remain therefore necessary. This paper envisages to contribute information and arguments to this debate. It does not deal with the development of the public sector but the development of European policies with regard to this sector. After a brief sketch of the global and western European background and starting points for the rise of liberalisation and privatisation in the EU (section 1) the main milestones for liberalisation (2) and waves of privatisation (3) are presented and briefly discussed. Section 4 deals with current issues in European policies with regard to liberalisation and "services of general interest". This is followed by considerations for policies which constrain the overarching role of competition and re-enforce a democratic public sector not as exception from but as alternative to the rules of competition (5).

1. Background

Global background. **Liberalisation and privatisation are no specifically European but worldwide phenomena with a strong impact on the EU. It can be argued that since the 1990s Europe has taken the lead in opening markets and privatising public assets and services. However, the global historic background were on the one hand the dismantlement of the Bretton Woods System of international economic cooperation in the 1970s and on the other hand the breakdown of state socialism in the 1990s, both no specifically European events.**

With a system of fixed exchange rates, the acceptance of capital controls and the set-up of international monetary institutions (IMF, WB) the *Bretton Woods system* had provided a fairly cooperative framework for the economic development of the Western world. The political decision to abandon fixed exchange rates and to liberalise capital movements enhanced the intensity of international competition, opened domestic markets to much stronger competition from foreign private corporations (TNCs), gave rise to the main actors on financial markets as increasingly important forces of contemporary capitalism and challenged the balance between the private and the public sector. This was the beginning of a comprehensive roll-back strategy against the reform agenda of the post-war period which had generated not only strong economic growth but also substantial progress in welfare and democratic participation for the people in most countries. In the new period full employment and social welfare were replaced by international competitiveness as main objectives for economic policy.

The second global event which reinforced this neo-liberal trend was the breakdown of the economic and social systems of socialism which had been established after the first and the second world war. This collapse started with the GDR in the late 1980s and was followed by the Eastern European countries; in China the transformation from a policy driven to a market driven economy and society is presently at a crucial stage. Whereas in the West liberalisation was followed by privatisation, in the East the sequence was often the reverse: privatisation often preceded liberalisation.

The European Economic Community. **The specific (Western) European dynamic and problematic of liberalisation and privatisation was shaped by a sharp asymmetry and contradiction between the economic and social structure and policies of the six member states of the European Economic Community (EEC) as "mixed economies" on the one hand and the structure and pillars of the European integration agenda essentially based on market liberalisation and competition on the other hand.**

All founding members of the EEC and also those who became later the EU-15, were ***mixed economies*** with substantial public sectors, which, although differing in size, historic genesis, structure and mission were regarded as not open to competition. They included almost everywhere education, health and welfare services, in most countries infrastructure like railways, postal services and utilities and in some countries financial services and large industrial firms e.g. in the steel, shipbuilding, aircraft and automobile industries and even larger industrial conglomerates like Instituto di Riconstruzzione Industriale (IRI) in Italy (created in 1934) and Instituto Nacional de Industria (INI) in Spain (1941). The theoretical and political conceptions behind these public sectors were not limited to the provision of basic services to everyone regardless of her or his income and social status. They extended to political responsibility for the functioning of the economy by providing and maintaining a good infrastructure and they even included in some cases, e.g France, Spain, Italy and the Netherlands the determination to control the main developments of the economy as a whole via the public sector. Some parts of the public sector have since before the second world war been public, some were nationalised after the war, partly as sanction for cooperation with fascism, partly to gain controlling positions in the economy. In some countries – UK, Spain, France – nationalisations occurred still in the 1970s and even 1980s.

However, the EEC Treaty of 1957 does not reflect the existence and importance of this public sector and has no concept of public good. Although it states in Art. 222 “This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership” (a formulation which has survived all subsequent Treaties, the failed draft constitution and it reappears as article 345 in the new Lisbon Treaty) has remained a purely formal statement which has never taken into account the specific roles and functions of public property and services as “public goods” different from private property and competition. . The basic and increasingly exclusive pillar for European integration is market liberalisation (often called “structural reforms”) and the basic regulatory principles are the *competition rules*. There is no specific section in the Treaty for the public sector or for public services. Only in the context of the competition rules mention is made of “services of general economic interest”, “public undertakings” and “undertakings to which member states grant special or exclusive rights” (art. 86), and even there it is requested that such undertakings should as far as possible be subordinated to the competition rules. In the Treaty of Amsterdam (1997) a special article (16) on “services of general economic interest” was inserted into the text but subjected to the same qualifications.

This asymmetry and contradiction between the two structural patterns between member states as mixed economies and the EEC as competition-led community existed from the beginning on. Theoretically it could have been softened and to a certain degree offset through two provisions of the Treaty. Firstly, the main instruments to achieve the objectives of integration were not only "establishing a common market" but also "progressively approximating the economic policies of member states" (art. 2). Secondly, the EEC Treaty had established the principle that in conjunction with the opening of markets a process of "approximation of laws" should take place, so that competition in the EU should work in a framework of common laws and rules. However, in the course of the 1960s and 1970s the potential of both provisions to integrate non-market aspects into the economy was largely undermined and eliminated.

2. Milestones of liberalisation

Liberalisation and deregulation as the dominant principles of European integration developed in a discontinuous steps and sequences before they reached their present dominant position.. In a slightly schematic view five milestones can be identified.

a. The *first* and perhaps the most important milestone is the adoption of the ***Single European Act of 1987,*** following the Commission's White paper on the completion of the Single Market" of 1985.(see EC 1985) It established a new conceptual and political basis for the Common Market. The imperative to harmonise differing rules in member states in order to make the common market work was largely abandoned. It was replaced by the principle of "mutual recognition" which postulated that a good or service produced or offered in one member country according to the rules of this country should automatically get a "European passport" i.e. should be admitted to the markets of every other member country even if the rules in this other country were different from those of the first country. This "*country of origin principle*" triggered the "biggest push of deregulation in economic history" as one former Commissioner put it. The result was that economic competition between firms *within a framework of common political and social rules* – relating for instance to work protection, taxation or product safety – was increasingly complemented and transformed into *competition of rules* between countries: this is the background for tax competition, social dumping etc. Rules constitute no longer a common framework for competition through economic and technological parameters, but become parameters of international locational competition.

b. A *second* group of milestones were the ***Treaties of Maastricht (1992) and Amsterdam (1997)*** and the ***Stability and Growth Pact (1997***). They re-enforced the market-oriented thrust in establishing very strict constraints on macroeconomic (i.e. fiscal and monetary) policies and interventions. The mission of monetary policy was limited to the maintenance of (narrowly defined) price stability, renouncing responsibility for growth and employment. Before being admitted to the European Monetary Union created in 1999, all members had to change the legal status and provisions of their national central banks accordingly. The objectives of fiscal policies were reduced to the avoidance of, first, "excessive" deficits (Maastricht), and later on (Amsterdam), deficits at all; fiscal policies should aim at public budgets in balance or surplus. Thus the possibilities for economic policy to stabilise economic growth or to determine the main directions of development through democratic political decisions were severely curtailed in favour of the markets.

c. *Thirdly*, the ***Financial Services Actions Plan (FSAP)*** was adopted in 1999 and envisaged some 40 measures to open up financial markets for banks and financial investors, removing obstacles to capital movements and specific national provisions. By 2005 most of these measures had been adopted by the EU and many were implemented by the member states. (see EC 2005)

d. A *fourth* decisive step of liberalisation was the adoption of the ***Lisbon strategy*** at the summit in March 2000, at the peak of the new economy boom and financial speculative bubble – which burst a few weeks after the Lisbon summit. The agenda of Lisbon integrated several strings of the neo-liberal reforms into one comprehensive agenda, focussing on three main issues:

- *structural reforms*, i.e. further market opening and deregulation as had already been postulated by the single market strategy
- *macroeconomic discipline* as had already been imposed in the Treaties of Maastricht and Amsterdam and the EMU, and
- the "*modernisation" of social systems*, which is basically the privatisation of pension systems.

e. The *fifth* and hitherto latest milestone of liberalisation is the directive on ***"services in the internal market"*** (Bolkestein Directive, 2004-2006). The aim of this directive was to generate

new thrust for the implementation of the single market program in the area of services where the implementation had remained rather sluggish. The draft which was published in January 2004 covered a very comprehensive range of services (including social and health services) and contained the explicit confirmation of the country of origin principle. (see EC 204) However, unlike the first codification of this principle at the end of the 1980s this orientation remained not unchallenged and was met with a wave of critique, protest and mobilisation in several member countries, notably in France and Germany. Even the European Parliament did not accept the neo-liberal thrust and requested changes. As a result the Commission formulated a second version of the directive, in which the term "country of origin" had disappeared and from which several areas of services (social and health services, labour regulation) had been removed. This version was then accepted by the majority of the EP and adopted in the spring of 2006. It is in force since January 2007. Although the critique had some impact on the final version it should not be overlooked that the basic deregulatory content was maintained.

3. Waves and forms of privatisation

Privatisation in the EC started in the 1960s and developed in four waves which correspond largely to four targets of privatisation: Manufacturing, network services, core public services. In Eastern Europe all levels were addressed simultaneously in the 1990s. (see Blaas et al. 2007, Huffschmid 2005, Wright 1993)

- ***1970s and 1980s***: The first wave started on a moderate scale in Germany (sale of majority of Volkswagen already in 1961, VEBA in 1965)(see Wright 1993).It continued on a larger scale from 1979 onwards in the United Kingdom under the Thatcher government. (see Florio 2005) It concerned mostly *manufacturing industries* which had previously been nationalised (steel, coal, carmakers, shipbuilding). This first wave was not justified driven by the thrust of globalisation or pressures of the EEC. It was mainly motivated by ideological reasons (to create "peoples capitalism") and the pressure of private capital to reverse the preceding nationalisations. Also the re-privatisation of a large part of the financial sector in France belongs to this wave which started only in the mid-1980s - after the first years of that decade had seen a second wave of nationalisations

- ***From the 1990s***: The second wave of privatisations was, in contrast to the first one, mainly caused by the policies of market opening and deregulation in the EU. It started in the 1990

and is still going on. It related mainly to *utilities, network services, and media*: Gas, electricity and water, railways, postal services and telecommunication, radio and TV stations etc. The rationale behind this wave was that stronger competitive pressure would force corporations to lower their prices and to improve the quality of goods and services offered. This forced the state-owned corporations to behave increasingly like private profit-maximising firms, trying to extend market shares throughout Europe or to become global players. Under such circumstances of subordination under the rules of competition it is difficult to justify the public status of such services and privatisation appears as a logical step. A further motive for privatisation were pressures on public budgets stemming from the strict limits on public debt and deficits imposed by the EU. By selling public assets or service providing entities to the private sector governments wanted to relax these pressures.

- ***From the 1990s***: The third wave took place in parallel to the second one in the former GDR and Central and Eastern European countries(CEEC). It was part of the *transformation the whole economy from a state economy to a private market economy*. This included a huge transfer in different forms of property rights from the state to private firms and households and was accompanied by a large diversity of regulations. It is remarkable that large parts of the most valuable production facilities and an overwhelming majority of bank assets in the CEECs were bought up by western corporations and made the CEECs to a large extent dependent on the decisions of these foreign firms.

- ***From 2000***: The fourth wave started only recently and relates to other than network services, envisaging the *core of the provision of public goods*: science, education, public housing, social services like health care, old age care and social security systems. The privatisation of publicly financed research results, of community hospitals, and the (partial) transformation of public pay-as-you-go pension systems into private capital funded systems are milestones of this wave. Further perspectives reach to the privatisation of nature like genes, wild animals etc., of cultural heritage like monuments etc. In this new round the EU plays a leading role.

Forms of privatisation

Privatisation in the EU is no one-off or big bang event but has taken place along a continuum between the completely public provision of a service through a public authority to the complete transfer of property rights and the termination of a public mission. There are a large number of stations and milestones between these extremes.

- The first (and weakest) form of privatisation is a *change of organisation*. Particular public services (e.g. postal or hospital services) are separated (outsourced) from the state apparatus and organised in state-owned corporations without change in the public mission: postal or telecommunication services are no longer provided by the respective ministries but by state-owned public firms. The declared rationale for this ***corporatisation*** is to stimulate and enhance competition and by this efficiency and transparency for these services.

- A second form is a (partial or complete) *transfer of property rights* from the state to private firms, households or individuals. However, the use of the new private property remains restricted in the sense that the obligation to provide public goods or services is not terminated but maintained and imposed as an obligation upon the new owners of the firm. The monitoring and enforcement of these obligations is subject to public regulation and supervision through regulatory authorities. This has been the case for the privatisation of most liberalised and privatised network services, and it has given rise to the concept of ***universal network obligation*** which must fulfil requirements like universal access, reliability, safety, affordable prices etc. throughout the EU. Directives to this extent have been adopted for telecommunications, gas, electricity, railways, and postal services. The open question is whether the enforcement of such service obligations for private providers is possible under enhanced pressure from financial investors.

- A third form are ***Public Private Partnerships*** (PPP): Infrastructures like motorways, airports etc. or buildings necessary for public services like school or hospital buildings or city halls, are built and financed - and sometimes operated - by the private sector and leased back by the public authorities. The declared rationale is to ease the burden for public budgets by avoiding to go to capital markets in order to finance such large projects. The question there is whether such projects are really less expensive for the state if one takes into account the costs over their whole life-cycle.

- The final form of privatisation is the sale of the public firm to private investors without any conditionality, i.e. the ***termination of the public mission***. In this case the state assumes that there is no longer a need for a public good because the market provides the good or service in sufficient quantity and quality. This is often the case with public residences which are sold to private investors.

4. Current Issues

In the area of liberalisation and deregulation the main emphasis of the EU – particularly the Commission – is now on

a. the comprehensive and rapid implementation of the services directive in its most radically market-oriented interpretation

b. the re-introduction of the liberalisation and competition philosophy through the backdoor into those sectors which had - as a result of social protest and intervention of the EP - been excluded from the services directive

c. the further opening and deregulation of financial markets.

d. the restrictive and market-biased discussion of the question of public services, or in Commission terminology, services of general (economic) interest.

a. Creating facts through extensive interpretation: Implementation of the services directive

After the fight about the services directive it must be clear that in many areas there will emerge conflicting interpretations on how to apply the rules, and particularly what is covered by the directive and what not. It seems that the Commission is trying to compensate its partial defeats in the debate through a very strict and comprehensive interpretation of the directive and a very restrictive interpretation of the various exclusions from the directive. The spearhead in the attempts to impose the radical free-market interpretation upon the other institutions and upon the public is the Directorate-General for Internal Market and Services under Commissioner Charlie MacCreevy. Shortly after the publication of the final text of the directive it published a "Handbook on Implementation of the services directive" (see EC 2007) where it offered a very narrow interpretation of the areas which are excluded from the coverage of the directive. This is particularly obvious for health care and social services. Right at the beginning of the section dealing with excluded areas the handbook asserts that

"In any event, it is clear that national rules and regulations relating to excluded services have to comply with other rules of Community law, in particular with the freedom of establishment and the freedom to provide services as guaranteed in Articles 43 and 49 of the EC Treaty. (p11)

With regard to the exclusion of healthcare from the directive the restrictive reading of the handbook asserts that

"services which are not provided to a patient but to the health professional himself or to a hospital such as accounting services, cleaning services, secretarial and administration services, the provision and maintenance of medical equipment as well as the services of medical
research centres, are not covered by this exclusion. Moreover, the exclusion does not cover activities which are not designed to maintain, assess or restore patients' state of health. For example, activities which are designed to enhance wellness or to provide relaxation, such

as sports or fitness clubs, are covered by the Services Directive and will have to be covered by implementing measures." (p.13)

The method here is to describe as undisputable fact what should be open to political discussion and democratic decision. The same method is used for social services, where it is declared:

"Similarly, social services relating to the support of families and persons who are permanently or temporarily in a state of need because of their insufficient family income or total or partial lack of independence and for those who risk being marginalised, such as services concerning care for elderly people or services to the unemployed, are excluded from the scope of application of the Services Directive only to the extent that they are provided by any of the providers mentioned above (i.e. the State itself, providers mandated by the State or charities recognised as such by the State). Thus, for instance, private household support services are services not excluded from the Services Directive and have to be covered by the implementing measures." (p.15)

These questions are by far less clear than the handbook suggests and leave much room for interpretation. The Commission seems to fear that in this discussion positions could prevail which are less market-oriented.

b. Service directive through the back door: Commission plans for social services and health care

Social services

Immediately after social services had been exempted from the coverage of the services directive the Commission announced in an official communication in April 2006 the way in which it envisages to proceed in this area. (see EC 2006), not without emphasizing the role of these services as "pillars of European Society and the European Economy". As social services it regards basically two groups (apart from health services which are dealt with in another communication)

1. statutory social security schemes
2. other essential services provided to the person, notably
   - assistance for persons faced by personal challenges (debt, unemployment, drug addition)
   - (re)-integration measures (rehabilitation, occupational training, language training for immigrants)
   - integration of persons with long-term health or disability problems
   - social housing.

For these services the Commission then develops an argument in five paragraphs which is so remarkable that it deserves full quotation (see box):

> In general, the case law of the Court of Justice ("the Court") indicates that the EC Treaty gives Member States the freedom to define missions of general interest and to establish the organisational principles of the services intended to accomplish them.
>
> However, this freedom must be exercised transparently and without misusing the notion of general interest, and the Member States must take account of Community law when fixing the arrangements for implementing the objectives and principles they have laid down. For example, they must respect the principle of non-discrimination and the Community legislation on public contracts and concessions when organising a public service.
>
> Moreover, when it comes to services of an economic nature, the compatibility of their organisational arrangements with other areas of Community law must be ensured (in particular freedom to provide services and freedom of establishment, and competition law).
>
> In the field of competition law, the Court has established that any activity consisting of supplying goods and services in a given market by an undertaking constitutes an economic activity, regardless of the legal status of the undertaking and the way in which it is financed[12].
>
> With regard to the freedom to provide services and freedom of establishment, the Court has ruled that services provided generally for payment must be considered as economic activities within the meaning of the Treaty. However, the Treaty does not require the service to be paid for directly by those benefiting from it[13]. It therefore follows that almost all services offered in the social field can be considered "economic activities" within the meaning of Articles 43 and 49 of the EC Treaty.
>
> European Commission, Implementing the Community Lisbon programme: Social services of general interest in the European Union, Com (2006) 177, final 26.April 2006, p.6

The first paragraph sounds promising because it gives member states ***freedom*** to define what they regard as public services and how they organise their provision. The second paragraph raises a warning finger against any "***misusing***" of this freedom, which would be the case if member states breach Community law. For services of an "***economic nature***", paragraph three explains that member states have of course to respect the freedom to provide services (art. 43 and 49 of the Nizza-Treaty). What is a service of economic nature? Paragraph four explains that "…any activity consisting of supplying goods and services in a given market by an undertaking constitutes an economic activity…". And to make the matter quite clear it adds in paragraph five that "…services provided generally for payment must be considered as

economic activities” and finally drives the point home: “It therefore follows that ***almost all services offered in the social field can be considered ‘economic activities” within the meaning of Articles 43 and 49 of the EC treaty***.” (emphasis added JH) The decisive point is, that if a service is provided for money – regardless of the appropriateness of the price and of the ultimate source of finance – it is regarded as an economic activity and must be subordinated to the internal market and competition rules. Therefore an entity providing a social service against money has to behave as if it were a private firm in a private market. It seems logical that under such circumstances there is no reason why they should not be privatised.

Health care

The original draft of 2004 of the services directive included also provisions on health care.. But, as the Commission writes in its Communication on “Consultation regarding Community action on health services”: “This approach, however, was not considered appropriate by Parliament and Council, which invited the Commission to develop specific proposals in this area.” (EC 2006: 2)). The Commission followed this invitation by formulating a communication which introduced through the backdoor exactly the free market principles which had been rejected previously by the EP. A proposal for a directive on “high quality health care and patient mobility” is due for the end of the year.

What are the issues? Health care is essentially a matter for national regulation and there are a number of very different systems in force in the Community. Problems of “patient mobility” – for instance who pays if tourists or temporary workers from one member state need and get care in an other member state – have been dealt with through coordination. This had already since 1971 been codified in a specific regulation (EC 14008/71) which was updated and enlarged in 2004 (883/2004). It is based on the right of member states to chose the structure, organisation and management of their specific health systems and delivers a fairly comprehensive framework for the resolution of such intra-EU problems – although further improvements are desirable and possible. However, the Commissions approach is totally different: it attempts to integrate national health systems into the overarching framework of the internal market. In an almost triumphant way it refers as justification for this approach to several rulings of the European Court of Justice, which according to the Commission have made clear, “that when health services are provided for remuneration, they must be regarded

as services within the meaning of Treaty and thus relevant provisions on free movements of services apply." (p.3) Particularly one recent ruling of May 2006 (Case C-372/04 Watts, judgement of 16 May 2006, not yet published) has according to the Commission provided "two clarifications":

"First, some Member States with systems based on integrated public funding and provision of health services had argued that the Treaty provisions on the freedom to provide services did not apply to them; the *Watts* judgement confirmed that they do. Second, some Member States have argued that the requirement in Article 152, paragraph five of the Treaty to "*fully respect the responsibilities of the Member States for the organisation and delivery of health services and medical care*" prevented binding obligations under Community law regarding health systems. In the judgement, the Court stated that this provision does not exclude the possibility that the Member States may be required under other Treaty provisions, such as Article 49 EC, or Community measures adopted on the basis of other Treaty provisions, such as Article 22 of Regulation (EC) 1408/71, to make adjustments to their national systems of social security." (p.4)

In the same paper the Commission emphasizes that future Community action will also have to contribute to controlling costs and improving efficiency of health care provision.(p.5). This perspective is attractive for member states which are under strong fiscal pressure and are struggling for financial sustainability of their health systems. In the course of their numerous health care reforms they cut public spending, introduce more market based instruments and competition in the provision of health care, propose outsourcing, privatisation and PPPs. Reforms of statutory health insurance lead to a reduction of coverage to basic services, while for all treatment beyond these the patients must pay individually – for which cases "supplementary health insurance schemes" are offered from the financial market actors..

c. Financial market: Removal of last obstacles against the freedom of financial investors

In the area of ***financial markets*** particularly two developments are remarkable:

On the basis of a report on "*Special rights of public authorities in privatised EU companies: the microeconomic impact"* (Oxera 2005) the Commission has recently brought to the European Court of Justice (ECJ) an increasing number of cases for infringement of the provisions on free capital movements. In these cases the countries had either retained or created obstacles for take-overs of domestic privatised firms through a foreign investor, or retained special voting rights after such take-overs. The recent ruling in the case of Volkswagen – where the voting power of single shareholders as limited to 20% - shows the ECJ supports the position of the Commission. On its homepage the Commission mentions

recent cases against Belgium, Denmark, France, Germany, Italy, France, Hungary, Luxemburg, Netherlands, Poland, Portugal, Spain, and the United Kingdom.

In a recent *White paper on Enhancing the Single Market Framework for Investment Funds* (European Commission 2006b:13) the Commission declares its intention to "examine the types of marketing and sales restrictions that should be removed in the context of the shift to conduct of business rules at the level of the investment firm…" In this respect it seems to follow the recommendations of two reports of expert groups on Hedge Funds and Private Equity Funds (see EC 2006c and EC 2006d) which were published in July 2006. Remarkably these expert groups who were appointed by the Commission consisted exclusively of representatives of financial institutions as if these were the only ones affected by the organisation of HF and PE. Not surprisingly they recommended a further liberalisation of the markets. Particularly they advocate the removal of the modest national limits for investment of institutional investors in risky asset classes (like HF and PE) "which entail relatively high probability of very adverse investment outcomes" (EC 2006b:13.). This recommendation reinforces the deregulatory approach which was already the core of MiFID. It replaces plain restrictions for investments of institutional investors like pension funds in risky financial instruments with a system which places responsibility on the investment firm to ascertain, on a client-by-client basis, whether a particular investment is suitable or appropriate. The prohibition of such national barriers would probably lead to a new stream of investment from pension funds to private equity and hedge funds.

d. Services of general interest

The Treaty of Maastricht transgressed the boundaries of exclusively economic integration and created space for closer political cooperation particularly in foreign and security policies In the economic and social area, however, the predominance of the regime of competition and deregulation survived and was even reinforced. It was not until the Treaty of Amsterdam that an explicit article referring to "services of general economic interest" (SGEI) was inserted into the Treaty (art. 16), as a response to growing criticism and opposition to the neo-liberal direction of the EU. The same article is also included in the new Lisbon Treaty (art. 14) . This article enables the European Parliament and the Council to establish via regulations the "principles and conditions, particularly economic and financial conditions" for SGEI which "enable them to fulfil their missions." At the same time the Lisbon Treaty reconfirmes and

underlines the priority of competition as the overarching approach to services when it begins the article on services of general economic interest with the words “Without prejudice to Article 4 of the Treaty on European Union and Articles73, 86 and 87, ” - articles which all refer to the rules of competition.

Growing concerns in the member states about the future of the public sector have been recognized and to a certain extent taken up by the European Commission. An outcome of this response is the publication of several communications including one Green Paper on services of general interest (see EC 2003) in which the EC claims to launch a public debate on the issue. A year later the Commission gave an account of this debate and presented some preliminary conclusions from it in a White Paper on services of general interest. (See EC 2004) The publication of these documents demonstrate the persistently narrow approach, which reveals the congenital defect of the biased development of the EC as a market- and competition-based economic community.

Both papers go rather far in recognising the existence, justification and importance of services of general interest. The Green Paper asserts that the concept has to reach beyond the narrow borders of services of general *economic* interests and should where necessary be extended to “services of general interest” (SEI), although these are not conceptualised in the rest of the document and although there is no such term or concept in the Treaty. The significance attributed to SGEI and SEI is underlined in the *Green Paper* by repeated reference to them as “an essential element of the *European Model of Society”,* their, “role as essential for increasing quality of life for all citizens and for overcoming social exclusion and isolation.” (par.2). The same line of argument is repeated in the White Paper, which calls services of general interest “one of the pillars of the European model of society” (page 4).
Both papers also explicitly confirm and underscore the (exclusive) right of member states to define, organise, finance and monitor such services according to their traditions and choices. With regard to the competition rules the White Paper even asserts that “the effective performance of a general interest task prevails, in case of tension, over the application of Treaty rules.” (EC 2004:7). Such remarks could feed the expectation that the EC has at last broadened its approach beyond the perspective of competition and that it is making room for the recognition and support of SGI as a cornerstone of a genuinely democratic public sector, which operates on different principles to those of markets and private profit.

However, such expectations would be not much more than wishful thinking, as the text in the White paper and more recent publications demonstrate. For there remains one decisive restriction to the discretion of member states: "However, providers of services of general economic interest, including in-house service providers, are undertakings and therefore subject to the competition rules of the Treaty." (EC 2004:15, see also EC 2003: par. 80). In other words: Once the public service has left the orbit of direct administrative provision and is managed through a separate public entity, the prevalent framework for operation is set by the competition rules. The seemingly broad range of discretion for the member states or for regional or local authorities in opting for certain ways of providing public goods is in reality rather small and largely fictitious.

The general thrust of both papers is – in spite of all the public interest rhetoric – quite unambiguous. Even when SGI are recognised as justified, they are regarded as an ***exception*** to the general rule of competition and/or as a small niche in the world of competition. In the view of the Commission these exceptions have to be restricted as much as possible and they must be closely monitored to see whether they are still justified. The overarching frame of reference remains the competition driven market economy.

A novelty in the new Lisbon Treaty is the fact, that the terms "services of general interest" and "services of general non-economic interest" are for the first time mentioned in a Treaty text, although only in a protocol (protocol nr.9).With regard to services of general economic interests the requirements which have in various sector-specific directives been established as universal service requirements are upgraded to as "shared values" and have now the status of primary law. These are besides the "wide discretion of national, regional and local authorities" and the "diversity between various services of general economic interest" particularly: "a high level of quality, safety, and affordability, equal treatment and the promotion of universal access and user rights". This codification could provide useful instruments for the monitoring of the provisions of the existing directives and their implementation and it can serve as a basis for the formulation of new requirements for new directives for such services. For non-economic services of general interest the protocol brings no progress, because for those the provisions of the Treaty not apply: "The provisions of the Treaties do not affect in anyway the competence of Member states to provide, commission, and organise non-economic services of general interest." The term "service of non-economic general interest" is introduced in the Treaty, but only through the provision that the Treaty

does not apply. The important question, what are services in the general interest and what are services in the general *economic* interest is neither raised nor answered.

5. Approaches to alternatives on the European level

From the presentation of deregulation projects currently underway it should have become clear that this trend will not be stopped or reverted through reflection and critical self-revision from the side of the Commission and most member states. On the contrary, the small achievements in the fight against the complete deregulation and the wave of privatisations – and the not so small success in the struggle against the ”port package 2” – were only possible on the basis of broad and critical public debates and strong social movements which exerted political pressures on national parliaments and governments, and on the European Parliament who in turn passed this pressure on to the Commission. Continuing and rising awareness and resistance against the subordination of social services and other public goods will be necessary to consolidate such small successes and to preserve the essence, enhance the reach and public participation and also to modernise the organisation of these services. Experience shows that local and regional initiatives and movements are of crucial importance as a necessary condition for success. But experience also shows that only the bundling of such initiatives in national campaigns which reach several countries really have a – hitherto modest - impact on politics on the European level. Lastly the lesson has to be learned that from a certain stage on the involvement and participation of trade unions in such campaigns is indispensable.

However, the strength of resistance against neo-liberalisation of the EU depends not only on public critique and social movements but also on well founded and convincingly formulated concepts about alternatives to complete liberalisation and comprehensive privatisation. Only such concepts will in the long run have the effect to stimulate more people to get involved.
On the European level, which is at stake here, three alternative approaches to public services are discussed, relating to

a. improvement of existing and adoption of further sector-specific directives,
b. a framework directive on services of general (economic) interest, and
c. a new part on public services in the “reform Treaty” which establishes public services (economic and non-economic ones) as genuine form of social activity for which the competition and internal market rules do not apply.

4.1. Sector-specific approaches

The first concept takes up the approach of the Commission for network services (telecommunications, electricity, gas railways etc.) for which European liberalisation has been accompanied by the formulation and imposition of "universal service obligations", either by national or European legislation. These obligations could be tightened, their implementation could be more strictly and efficiently enforced for already liberalized sectors, in a case—to-case approach and corresponding rules could be designed for new sectors. Two problems must be discussed here, the experience with existing network services and their regulation and the extension to new sectors like water, health and social services.

a. The experience with existing liberalised and privatised (at leased corporatised) network services is at least mixed. Performance indicators do not show substantial improvements in productivity, price reduction (except telecom), universal access etc. (see Thomas 2006, Hall 2004, 2007). Also regulatory efficiency is often insufficient (see Ugur 2007). In the case of electricity the Commission itself finds that liberalisation and privatisation have resulted in the establishment of monopolistic structures harmful to competition and consumers. It now considers as a resolution of the situation the unbundling of network structures and service provision. It is questionable whether this is reasonable, because the power of private network providers would not be curtailed. Also with rising power and dominance of financial investors such corporations would come under increased pressure to raise profits and exploit their monopoly position. Under such circumstances public service obligations would be increasingly difficult to fulfil or/and the costs of supervising and enforcing their fulfilment would become extremely high. This would in turn put in question the budgetary rationale for liberalisation and privatisation. Would public (in the sense of government) ownership and management of the infrastructure of network services not be much more efficient and less expensive than their exposure to monopolistic or oligopolistic competition (and collusion)? Under this perspective a re-nationalisation and more European cooperation between governments in the operation, maintenance and modernisation of existing infrastructure networks and in the design and construction of new ones could be more efficient and more democratic options.

b. The expansion of European regulations to new sectors. For infrastructure areas like water, waste, local transport the previously mentioned arguments apply and public operation should be seriously regarded as a viable option. For other sectors like health care and social services the question is whether such EU-wide regulations are necessary and which character they

should have. Health care and social services are in a broad majority services which are supplied and consumed locally. In the EU only about 1% of health care services are delivered or received from one to another country. Therefore the orientation of the Commission (and increasingly also the EP) on “patient mobility” seems misguided. “Health care shopping” through market liberalisation put national health systems under pressure to the disadvantage of all those who cannot afford Europe-wide shopping tours.
Instead of the introduction of competition in health care (and this applies to other social services, too) reasonable European action should be developed on four levels

- The *first* and most important level is the promotion of sufficient ***high quality health care in each country and region*** of the EU. This could be promoted by the definition of minimum standards (f.i. number of doctors for 10 000 persons) and assistance (also in financial terms) for the achievements of these standards.

- A *second* mission would be to ensure that residents of one member country A who are as workers or tourists or students etc. in country B and need (occasional or hospital) medical treatment get it in country B, at terms corresponding to his or her country of origin. This is to a large extent already the case but the existing cross-country cooperation could certainly be improved.

- A *third* perspective is the close *cooperation in border regions*. This is already taking place, could be improved but does not need an internal market based new directive.

- The *fourth* reasonable European activity in health care is the extension of already existing *European reference centres* for the treatment of very rare diseases and to guarantee equal access for all residents in the EU to these; in this context also common European medical research centres are to be recommended.

While European activities relating to point 1 are missing and should be energetically addressed coordination in areas of points 2 , 3 and 4 takes place on the basis of a EU regulation (883/2004), which could be further expanded and improved. The essential point here is, that health care is not a matter of the internal market (where freedom of services and competition prevail) but a service with a special value in itself. The services directive on health care envisaged by the Commission (and not rejected by the EP) integrates health care into the framework of the internal market. This should be rejected, instead the objective for

European health care policy should be the promotion of high quality local health care and cooperation of the national protection schemes.

4.2. A European Framework directive on services of general (economic) interest ?

The European Trade Union Congress(ETUC) and other civil society groups have demanded the insertion of an overarching framework directive for services of general (economic) interest. (see ETUC 2006). The main requirements are:

" General interest should take precedence over market laws: this means contributing to sustainable development and to a high level of employment.
The fundamental principles should be reiterated and applied, as should the Charter of Fundamental Rights.
The principle of subsidiarity and the responsibilities of the public authorities at all levels (both national and local) should be reiterated and should determine how these services will be provided, regardless of the status (specifically public) of the party providing those services.
The directive should ensure legal certainty which will pave the way for funding of services of general economic interest in the long term and investment vital to the continuity and quality of these services.
Good governance and social dialogue are to be the primary guiding factors.
Users, trade unions and consumers are to be consulted and are to be stakeholders in methods of regulation.
Involvement and consultation of workers and their representatives within the context of social dialogue at every level should be affirmed.
An assessment shall be conducted at all levels and workers and their representatives shall be involved in this process.
An evaluation report shall be compiled." (p2/3)

In addition the European Public Services Union (EPSU) has in spring 2007 started a "campaign for high-quality public services, accessible to all" for which by September more than a million signatures should be collected. (see EPSU 2007)

Although the campaign calls only for "European legislation" and therefore leaves open the question of the form of this legislation (it could be a regulation, directive or a new article in the Treaty), from the context it is clear that a framework directive is envisaged. In the ETUC statement it is postulated that "services of general interest are to be cited in the same context as services of general *economic* interest, despite the fact that only the latter term formally exists in Community legislation".

This addresses a difficult legal but also political question: Since in the Treaty only services of general *economic* interest are mentioned a framework directive has – without changes of the Treaty to relate to these. There is certainly a perspective for shifting regulatory requirements

more to the improvement of the quality of the services and the employment conditions; and these could be addressed in such an overarching directive without necessarily transgressing the internal market provisions in the Treaty. Therefore the reconciliation between public interest and internal market seems possible to a certain degree – although under existing law there is a clear hierarchy in favour of the latter.

But what about non-economic services, like health car, welfare agencies, other social services, education? In the view of the Commission (and the ECJ) such non-economic services are basically a contradiction in adjectu.(see Krajewski 2006:7-11) A *service* is ***defined*** as an activity offered on a market against remuneration (Art. 50 ECT), i.e. by definition an economic activity and therefore subordinated to the internal market and competition rules. Only activities which are not carried out against remuneration are excluded from these rules - and they are excluded from the reach of the Treaty altogether. But then it follows from the principle of subsidiarity that there is no legal basis for any European legislation for such activities (which are erroneously called non-economic "services"). As we have seen the Commission increasingly tends to minimize their non-economic character and thereby to integrate them primarily into internal market rules. Therefore the claim of the ETUC "General interest should take precedence over market laws: this means contributing to sustainable development and to a high level of employment", is in the Commissions view no basis for legislation on the basis of the present Treaty.

To overcome this difficulty one could argue (and it has been argued, see Krajewski: 15-17) that well functioning common or coordinated social, health and other non-economic "services" are necessary for the functioning of the internal market and must therefore be harmonised (art. 95 ECT) and for this purpose a general framework directive is necessary, into which economic and non-economic activities could be included. Whether this and similar auxiliary arguments (based on articles 16 or 86 ECT) are viable to bear a construction of a framework directive for services of general interest (not only general *economic*) interest remains to be seen. In any case it would be a fragile construction because the general interest would have to be formulated so as to serve the general economic interest, and not the other way round, as it should be from a democratic point of view.

4.3. Public services as new pillar for the genuine "reform Treaty"

To give public services a stronger place in the European Social Model without subordinating them under the dominance of market and competition rules it seems therefore necessary to establish them in a genuine "reform Treaty" as a pillar of its own weight corresponding to and of equal importance for material reproduction as private enterprises, markets and competition. The most comprehensive perspective would be if public services – economic and non-economic ones – which are defined after political discussion by parliaments and governments on all (national, regional, local) levels would then be automatically exempted from the internal market and competition rules and put under the umbrella of "public services rules". The first and most important rules is that public services are a matter of member states regulation. Beyond this basic "hands-off "-rule there remains ample room for European dimension and perspectives for public services. These are after all necessary to avoid regression to national isolationism and chauvinism and to benefit from the social, economic and cultural potential of the continent. European perspectives for public services could be established and enhanced via three different tracks:

- the first track is enhanced or improved cross-border *cooperation* between existing public services structures; the model for this is the existing cooperation in health care services,
- the second track is the formulation of certain *minimum standards* for public services, particularly social services, anti-poverty strategies, pension systems, education etc.; this track should be substantiated through financial assistance to member countries to fulfil these standards,
- the third track is the joint planning and implementation of large *European research and infrastructure projects* which are financed through member state and the European budgets and EU bonds.

Conclusion:

The EU has no competence for questions of private or public ownership, but it has competence over the behaviour of economic undertakings. Via comprehensive liberalisation it has enforced deregulation and privatisation throughout the EU and shifted the structures of the formerly mixed economies of the EU15 into neo-liberal spaces. This shift was reinforced through the transformation of the CEECs. Current developments are shaped by the almost obsessive attempts to subject the remaining areas of public services to the rules of the market and competition – against growing critique and protest from the side of social movements and

even European institutions like the EP. Perspective for alternatives need in the first instance further social and political mobilisation and resistance on a local, regional and national level. On a European level three approaches can be envisaged: these are a. the improvement of existing network directives and their implementation, b. the adoption of a general framework directive for services of general economic and non-economic interest on the basis of the existing Treaty and c. the introduction into a genuine "reform" Treaty a second "public services pillar" which establishes public services not as an exception within the internal market and competition framework but as a second and alternative pillar of material reproduction.

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Economic performance of the New Member Countries in 2000-2006 Successes and failures

Paper presented to the 3rd Alternative Ecofin, Ljubljana, 3rd–4th April 2008[101]

The accession has, in general, undoubtedly positively influenced the macro-economic development of the New Member Countries. They have made considerable progress in many areas, especially in economic growth and unemployment. However, particular countries differ considerably on that score and in some of them strong negative side effects have been disclosed. The aim of the paper is to give some insight into this question. The following analysis relates – in principle – to the period 2000-2006.

Economic growth

During the last years the average annual rate of GDP growth in 12 New Member Countries (NMC12) has been 2.5 times higher than that of the old EU15 members. In 2001-2006 the average annual rate for 12 NMC was 4.6% and for EU15 only 1.8%.[102] As a result between 2000 and 2006 NMC have increased their GDP by 31.1% while EU 15 by only 11.4%. The share of 12 NMC in the EU27 GDP has increased from 4.8% in 2000 to 5.3% in 2003 and then to 6.4% in 2006. According to preliminary data this share has reached 7% in 2007.[103] It is worth to point out that after the 2004 enlargement, the NMC advantage of economic growth over the EU15 has increased by 1.5 percentage points as compared with the pre-accession period (from 2.1 to 3.6 – see: Table 1). It means that from this point of view NMS has benefited relatively more from enlargement than EU15.

Growth achievements have been very differentiated among the countries (see: Table 1). Total percentage growth in GDP between 2000 and 2006 ranges from less than 8% to nearly 66%. The country lagging far behind the other is Malta, which experienced a growth recession in the first half of the period under examination. On the opposite side are three Baltic Republics with GDP growth between 57 to 66 percent. The middle group with the moderate but still above or very close to theNMC12-average growth includes two states that

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[102] Own calculations based on Eurostat data on GDP (constant prices) at 2000 exchange rates.

[103] Own calculations based on Eurostat data on GDP at market prices in euro.

joined EU last year and Slovakia. Aside from the two Mediterranean countries, the lowest increase in GDP among remaining countries has been observed in Poland, the biggest economy among all NMC. Poland, like Malta, experienced an economic slowdown (though not so deep) at the beginning of the decade.

Table 1. Real GDP growth in Old and New Member Countries in 2000-2006 (in %)

	Average annual rate of growth 2001-2003	Average annual rate of growth 2004-2006	Total GDP growth in (2001-2006)
EU15	1.40	2.24	11.4
NMC12	3.46	5.80	31.1
Latvia	7.23	10.39	65.9
Estonia	7.63	9.89	65.5
Lithuania	7.92	7.63	56.7
Romania	5.33	6.85	42.7
Slovakia	4.33	6.76	38.2
Bulgaria	4.53	6.17	33.4
Hungary	4.23	4.27	28.4
Czech Republic	2.67	5.76	28.0
Slovenia	3.20	4.73	26.3
Poland	2.16	5.03	23.5
Cyprus	2.66	4.03	21.8
Malta	0.22	2.32	7.8

Source: Own calculations based on Eurostat data on real GDP growth rate and GDP at constant prices.

Altogether, passing over Cyprus and Malta, the above data suggest, that dynamics of the NMC' economies are related to two its characteristics: the size of the economy and the initial level of its development. The question needs, however, further investigation.

The increase shown in Table 1 looks significant, but it should be pointed out that the total GDP of 12 NMC still makes only about 1/3 of the German GDP. The picture improves if GDP in PPS is compared (see Table 2). Then the total GDP of NMC makes nearly 3/5 of the German one and 1/9 of the EU27 total (2006). However, if this measure is used, an increase of the NMC's share in EU27 GDP turns out to be only very moderate: from 9.8% in 2000 to 11.4% in 2006 and to 11.7 in 2007[104].

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[104] Own calculations based on Eurostat data on GDP in PPS.

Table 2. GDP of NMC12 in proportion to GDP of EU27 and Germany (%)

	GDP in euro		GDP in PPS	
	2000	2006	2000	2006
EU27	4.8	6.4	9.8	11.4
Germany	21.2	32.2	47.7	58.6

Source: Own calculations based on Eurostat data on GDP at market prices.

External balance

Fast economic growth in the NMCs, though necessary in the catching-up process, is one of the causes of serious problem of the CEECs: huge and intensifying negative balances in current accounts in most countries. This is particularly true for Latvia (-22.3% of GDP), Bulgaria (-15.7%) Estonia (-15.5%), Lithuania (-10.8%) and Romania (-10.4%). What's worse, in all these countries the external deficit has increased incredibly since 2000: almost five times in Latvia, nearly three times in Bulgaria, Estonia and Romania, and two times in Lithuania[105]. The main factor contributing to the deterioration of current account of these countries is an increasing deficit of trade in goods. Its increase has been particularly sharp in Romania (2.7 times), Bulgaria (2.4 times) and Latvia (1.9 times). In last two countries deficit of trade in goods reached 22.2% and 25.4% of GDP respectively that rank them as third and second among all 27 EU member countries, just behind Cyprus (see Table 3.). Cyprus, however, to a large extent counterbalance its deficit of trade in goods with large surplus in balance of trade in services. [106]

A sober contemplation leads to the conclusion that, if current tendencies continue, the negative current account and the indebtedness of most NMC will increase until they will

[105] It is worth to mention that when, in the second half of ninetieth, the ratio of current account deficit to GDP in Poland had been on its upward path and reached 3.7 % in 1997, the situation was defined as alarming and "cooling" policy had been applied since 1998. Despite that, the upward trend continued over next two years, hiking the ratio to more than 8% with any symptom of monetary crisis. Only then the trend reversed. However, the side effect of the "cooling" policy was dramatic slowdown of economic growth and huge increase in unemployment.

[106] All data for 2006. Source: Eurostat.

become insolvent and have to renegotiate their debts. A Latin-American type development is looming and there seems to be no power or movement willing and able to change this tendency. The IMF type stabilization packages, trying to solve the imbalances by cutting the expenses on health care or education, or the general government reforms, an euphemism for privatization of government services, can hardly improve the competitiveness of the manufacturing industries in the CEECs , nor indeed improve the current account (even if they 'improve' the budget deficit position)[107].

Table 3. New Member Countries with highest current account deficit

	Current account deficit as percentage of GDP		***Trade in goods deficit as percentage of GDP***	
	2006	Increase since 2000	2006	Increase since 2000
Latvia	22.3	4.6x	25.4	1.9x
Bulgaria	15.7	2.9x	22.2	2.4x
Estonia	15.5	2.9x	17.7	1.3x
Lithuania	10.8	1.8x	14.1	1.4x
Romania	10.4	2.8x	12.2	2.7x

Source: Eurostat and own calculations (x=times).

The neo-liberal concept says that liberalization and deregulation would increase the performance of the country because the resources would be allocated efficiently and everybody would produce what is most suitable and profitable. However, in practice it often resulted in serious imbalances both in foreign trade and current account due to significant efficiency differentials to western competitors. The succeeding waves of privatization to a large extent were tantamount to selling off the national companies of the CEECs to foreign capital with the consequence of the emergence of a dual economy. In this dual structure the foreign companies are flourishing, while the national ones are often stagnating and – because of huge losses in market shares since the systemic change – have very serious imbalances. What's more, though the foreign owned companies produce the growth, they transfer their income abroad (repatriation of profits) and are usually subject to subsidies and temporary tax relief. This dual character of the economy explains, why the budget and current account of these countries are deteriorating, while they experience relatively high economic and export

[107] See: A Democratic Economic Policy Alternative to the Neo-liberal Transformation of Europe, EuroMemorandum 2006, EuroMemorandum Group, December 2006, p. 12.

growth[108]. This applies first of all to Hungary, Estonia, Czech Republic whose incomes transferred abroad in 2006 make 12.3%, 11.3% and 9.5% of their GDP respectively, while incomes earned from abroad are by 2/5 (Estonia) to 3/5 (Czech Republic and Hungary) less. As a result the negative net balance of income for last two countries equals to 5.5% and 7.0% of their GDP respectively[109]. The import of foreign capital to new member countries in the form of FDI enabled the establishment of internationally competitive plants and creation of much needed jobs, however there is not necessarily a positive correlation between FDI and economic growth and foreign trade balance[110].

Public finances

Public Balance

The ratio of public deficit to GDP for the EU as a whole has changed its trend from upward to downward in 2004 (see: Table 4). However, in NMC12 the trend reversed already in 2003. In the first stage relative changes were bigger in EU15. While the ratio tripled in EU15 in 2003 as compared to 1999 (3.1% and 1.0% respectively)[111], in NMC12 it only doubled (from 2.9 in 1999 and 2000 to its peak value of 5.9% in 2002). Afterwards, systematic decrease in deficit ratio has been observed. In both groups the deficit has been reduced nearly by half (from 3.1% to 1.6% in EU15 and from 5.9% to 3.3% in 2006 in NMC12)[112].

Table 4. Public balance deficit as percentage of GDP in 1999-2006

EU15			NMC12		
1999	2003	2006	1999	2002	2006
1.0	3.1	1.6	2.9	5.9	3.3

Source: Eurostat data and own calculations.

[108] Ibidem, pp. 12-13.

[109] Own calculations based on Eurostat data.

[110] See: Jože Mencinger, *Direct and indirect effects of FDI on current account*, paper presented to the 13th Workshop on Alternative economic policy in Europe, Brussels, 21-23 September 2007.

[111] In 2000 the public balance of EU15 changed temporarily to positive one (+0.4% of GDP) and then deficit reappeared (-1.2% in 2001).

[112] Average rates for NMC12 calculated by the author on the base of Eurostat data on public balance and GDP at current prices in absolute terms for particular countries.

Improvement in public balance has been observed in most of the NMC. In particular, two countries, Estonia and Bulgaria, with increasing surpluses (3.6% and 3.2% respectively in 2006), stand out above the rest of the countries. Below the EU15 average and decreasing deficit have Latvia (0.3%), Lithuania (0.6%), Slovenia (1.2%) and Cyprus (1,2%). In all of them considerable reduction has taken place during last years.

More than two times higher deficit in NMC12 as compared to EU15 is the result of still excessive (in the meaning of the Article 104 of the Treaty and the corresponding Protocol) deficit in three of the five largest: NMC: Poland (3.8% in 2006), Hungary (9.3%) and Slovakia (3.7%). Particularly alarming is the situation in Hungary, where the ratio has more than tripled since 2000. On the other hand Czech Republic managed to reduce its deficit from 6.8% in 2000 to 2.9% in 2006. Steady though slow progress has been also observed in Poland since 2004.

General government debt

During the whole period 2000-2006 the ratio of public deficit to GDP in most of NMC has been much lower than in the EU15 average. The only exceptions are Hungary, which debt, continuously growing since 2002, has reached 65.6% in 2006, and two Mediterranean countries with similar but already diminishing debts. As regards other NMC, the only one, in which the debt is slowly increasing and relatively high (47.6% in 2006) is Poland. In Czech Republic, after considerable increase in previous years, the debt has stablized since 2003 at about 30%. More or less stable debt is also in Slovenia (27-28% since 2001). In remaining countries there is clear downward trend and their debts range from 4% in Estonia to 30.4% in Slovakia.

Inflation

Since 2005 the European Union is experiencing an increase in inflation. The annual average rate of change in Harmonized Indices of Consumer Prices has increased from 2.0% in 2003 and 2004 to 2.3% in 2007 and the trend continues. While inflation rates in most countries are growing rather slowly and are still moderate or even low, in some NMC they has reached alarming level. This is particularly true for the Baltic Republics and Bulgaria (see: Table 5)

Table 5. New Member States with highest increases in inflation rates

	Annual average rate		Two-digit annual rate since	Annual rate Apr 08/Apr 07
	2003	2007		
Bulgaria	2.3	7.6	September 2007	13.4
Estonia	1.4	6.7	January 2008	11.6
Latvia	2.0*	10.1	August 2007	17.4
Lithuania	-1.1	5.8	January 2008	11.9
EU27	2.0	2.3	-----------	3.6p

(*) 2002; p=provisional.
Source: Eurostat.

The inflation rate in Latvia has jumped from 2.0% in 2002 to 10.1% in 2007 and further acceleration is in process. Since the annual rate exceeded 10% in August 2007 it has been quickly increasing. In April 2008 it has already reached 17.4%. As a result, the 12-month average rate is already equal to 13.0%. In Bulgaria the annual rate became two-digit in September 2007 and in April 2008 reached 13.4%, while the 12-month average one is 10.1%. Though in two other Baltic Republics, Estonia and Lithuania, the 12-month average rates are still much lower (8.8% and 8.0% respectively), similar trend is currently present also there. Both countries has joined the "two-digit-club" this year with annual rates in April equal to 11.6% and 11.9%.

It seems to be legitimate to conclude that such high inflation rates in these countries are mainly the result of wrong economic policies adopted by their governments. Probably the main mistake has been maintaining a system of fixed exchange rates (*Currency Board Arrangement* in Bulgaria, Estonia and Lithuania, and *Fixed Peg Arrangement* in Latvia). The Baltic Republics are now paying the bill for not being able to stop overheating of their economies.

In addition to the above-mentioned countries, serious problems with inflation have arisen in three other countries. In Hungary annual average rate reached 7.9% in 2007. Fortunately in that country the trend has then reversed. On the other hand, in Romania and Czech Republic strong upward trend in inflation rate has been observed since autumn 2007 and at the beginning of 2008 their annual rates have approached 8.0%. Latest data (for April 2008) show that while in the former increase is still in progress, in the latter it has been reversed in February.

Unemployment and labour emigration

Among unquestionable successes of most NMC, which formerly had centrally planned economies is considerable reduction of unemployment. At the end of 1990' or the beginning of 2000' they had reached peak values of their unemployment rates. In six of them they were two-digit (see: Table 6). Since then until 2007 unemployment rates have been reduced by nearly ¾ in Lithuania, by 2/3 in Bulgaria, by 3/5 in Estonia and Latvia, by more than 1/2 in Poland and by 2/5 in Slovakia. The last country has remained a single one with two-digit rate. In 2007 five out of eleven countries with unemployment rate below 6% were former socialist ones. On the other hand only two former socialist countries (Slovakia and Poland) are among the seven with the rate of 8 % or more. What's more, it is very likely that Poland will soon leave this group.

Table 6. Unemployment rate in NMC (annual average)

Country	Peak value in the period 2000-2007		2007
	Rate	Year	
Poland	19.9	2002	9.6
Bulgaria	19.5	2001	6.9
Slovakia	19.3	2001	11.1
Lithuania	16.5	2001	4.3
Latvia	13.7	2000	6.0
Estonia	12.8	2000	4.7
Czech Republic	8.7	2000	5.3
Romania	8.4	2002	6.4
Malta	7.6	2001, 2003	6.4
Hungary	7.5	2006	7.4
Slovenia	6.7	2000, 2003	4.8
Cyprus	5.2	2005	3.9

Source: Eurostat.

There is however the downside of this success. In spite of the fact that the main factor of falling unemployment has been an increase in domestic demand for labour, most NMC experienced mass emigration of the labour force after accession. For example, the Polish Central Statistical Office has estimated that in 2006 number of temporary emigrants from Poland was nearly 2 million that makes about 8% of the population in working age. The reason for this has been possibly not so much high unemployment *per se* as considerable wage differentials between new and old member states. The mass emigration of labour force, while producing some positive effects (decreasing unemployment, increasing transfer of incomes from abroad) brings also strongly negative ones. First of all, reducing labour supply on domestic market it causes structural shortages of labour when economic growth accelerates. This is clearly seen, for example, in Poland since 2006. Mass temporary emigration has also extremely negative influence family life and bringing up children in particular. A phenomenon of "migratory orphanhood" has become an acute social problem in some countries. For example, according to the recent rapport of Soros Foundation Romania, at the end of school year 2006/2007 ca. 16-18% of all junior high school students had at least one parent working abroad. One third of them had just mother working outside Romania and one fifth - both parents. 46% of the later group have been living without their parents for at least one year and 34% for more than two years[113].

It is worth to pay attention that – on average – human capital imported by EU15 countries from NMC is substantially underutilized and underpaid. A confirmation of this statement can be found in recent report on published by the British Institute for Public Policy Research. It reveals that Polish-born immigrants (the only national group from NMC taken into consideration) "exhibit lower than average wages (and would seem to be working largely in low-skilled employment) despite their relatively high ranking in the education" and very high ranking in average hours worked. While ranked sixth among 26 nationalities (UK-born included) according to education and second according to average weekly hours worked, Poles occupy the last position in average gross hourly pay ranking and 23rd position as regards estimated gross annual income[114]. So, that there is no reason to assume that, in the long-run, temporary work abroad contributes to an increase in individual human capitals of migrants and national human capital of the country of their origin.

[113] Effects of Migration: Children Left at Home, Soros Foundation Romania, October 2007, p. 8. (Research summary of the report has been just published in English: http://www.osf.ro/en/publicatii.php#)

[114] Britain's Immigrants. An economic profile, Institute for Public Policy, September 2007, pp. 20-23.

Employees participation in fruits of economic growth

In the NMC12 as a whole the share of employees' compensation (including employer's social contribution) in GDP has decreased from 41,5%% in 2000 to 39.9% in 2006, that is by 1.6 percentage points.[115]. In the same period in the EU15 a decrease of the ratio has been lesser, in spite of its much higher initial level. It has gone down by 1.2 percentage points (from 50.5% in 2000 to 49.3% in 2006). It is worth to pay attention to different speed at which the share of compensation in GDP has been decreasing in each group of member countries before and after the 2004 enlargement. In EU15 acceleration in downward tendency followed the enlargement, while in NMC12 slowdown has been observed (see: Table 7). This slowdown can be ascribed to rapidly decreasing unemployment in these countries.

Table 7. Compensation of employees as percentage of GDP in EU15 and NMC12

	2000	2003	2006	Range 2000	Range 2006
EU15	50.5	50.2	49.3	33.2 – 55.5	35.9 – 55.5
NMC12	41.5	40.5	39.9	34.6 – 52.2	32.2 – 51.4
Difference	9.0	9.7	9.4	x	x

Source: EU15 – Eurostat; NMC12 – own calculations based on Eurostat data on compensation of employees and GDP at market prices.

In 2006 differences between maximum and minimum ratios are nearly the same for both groups of member countries (EU15 19.6% and NMC12 19.2%). One should however to point out that while in EU15 countries ratios has been converging (the difference has diminished by 2.7 percentage points), in NMC countries they were diverging (increase in the difference by 1.6 points since 2000).

There are also significant differences in direction of change of the compensation-to-GDP ratio among particular NMC. From this point of view one can distinguish following situations:

- high ratio with frail downward trend: Slovenia (decrease from 52.7% in 2001 to 51.4% in 2006),
- above the NMC12 average and more or less stable and ratio: Czech Republic (around 42-43%) and Estonia (around 44-45%),
- above average ratio with relatively strong upward trend: Hungary (increase from 43.4% in 2000 to 46.5% in 2005),

[115] Own calculations based on Eurostat data on compensation of employees and GDP at market prices.

- above average ratio with trend changing from upward to downward in the middle of the period: Cyprus (42.7% in 2000 and 44.8% in 2006), and Malta (43.8% and 43.9% respectively),
- below average ratio with strong downward trend: Poland (decrease from 40.2% in 2000 to 35.6% in 2006), Slovakia (decrease from 40.8% to 36.8% in the same period),
- below or close to average ratio decreasing at the beginning of the period and then showing moderate upward trend: Latvia (41.4% in 2000 and 43% in 2006) and Lithuania (39.5% and 42.7% respectively),
- below the average ratio with trend changing from downward to upward in 2004: Romania (41.1% in 2000 and 39.2% in 2005).
- very low ratio with relatively strong downward trend: Bulgaria (decrease from 34.9 in 2001 to 32.2 in 2006).[116]

These data show that only in few NMC the share of compensation in GDP has increased in 2006 as compared with 2000. These are three former socialist countries (Hungary, Latvia and Lithuania) and Cyprus. In three other (Czech Republic, Estonia and Malta) the shares remain approximately the same. In the remaining five they are lower. Spectacular decrease by 1/9 has taken place in Poland, not held in spite of considerable fall of unemployment rate in 2005 and 2006. – (April 2008 (data for 2007 and 2008 updated 31st May 2008))

[116] All data concerning particular countries according to Eurostat.

The Lisbon Treaty – Implications for social and economic policy

On 13 December 2007, the European Council meeting in Lisbon adopted the new EU "Lisbon Treaty", thereby ending the so-called two-year "period of reflection", proclaimed by the Council following the French and Dutch "No" to the draft constitution in 2005 and the embarrassment this caused to the European elites.

The new Treaty will enter into force after it has been ratified by all 27 member states, although such ratification need only be by parliament. In fact, only Ireland is going to hold a referendum in this respect, while the other member states are at pains to process the ratification of the treaty as fast and as quietly as possible. Interestingly enough, the first member states to ratify the new treaty are Hungary (17/12/2007), Slovenia (29/1/2008) and Malta (30/1/2008). Overall, speed is of essence, as the goal is to have completed the ratification process by the end of 2008 and to hold the 2009 European elections under the new treaty.

The Lisbon Treaty is a hefty document of 271 pages, including 13 Protocols and 65 Declarations, that have the same legal standing as the treaty itself[117]. It amends the two existing treaties, the Treaty on European Union (TEU) and the Treaty establishing the European Community, under the title "Treaty on the Functioning of the European Union" (TFEU)[118]. Perhaps the most remarkable difference by comparison to the failed draft constitution is the absence of the term "constitution" and of all symbols of the EU as a united entity.

This is disturbing insofar as the public critique against the draft constitution was directed against the content of the proposed draft and in particular, the democratic deficit of the Union, the neo-liberal character of its economic and social policy orientations and the strengthening of the military component of EU policies, rather than against the project of a European Constitution as such. However, instead of proposing a shorter text, containing basic values, institutions and procedural rules for a democratic and social EU, the European leaders moved in exactly the opposite direction, abandoning the term 'constitution', while maintaining much of the content of the former text.

The unanimity of the European leaders in concurring with the proposed treaty is indeed remarkable. As Perry Anderson recently wrote "In the disinfected universe of the EU, … unanimity becomes virtually de rigueur on all significant occasions, any public disagreement, let alone refusal to accept a prefabricated consensus, increasingly being treated as if it were an unthinkable breach of etiquette…. Nothing is left to move the popular will, as democratic participation and political imagination are each snuffed out." (London Review of Books, 20/9/2007:17).
While an exhaustive treatment of the Lisbon Treaty is outside the premise of this chapter, we shall outline certain amendments and their implications in the area of economic and social

[117] OJ of the EU C306/Vol..50/17-12-2007

[118] Where the Treaty on European Union is the Maastricht Treaty, amended by the Amsterdam Treaty and the Treaty of Nice, while that establishing the European Community is the Treaty of Rome, amended by the subsequent treaties since 1957.

policy. We shall focus on the following: (i) competition; (ii) economic policy; (iii) social policy; (iv) Charter of Fundamental Rights; (v) public services; (vi) health and social security and (vii) transport.

I. Competition - Following Nicolas Sarkozy's intervention, the reference to "free and undistorted competition" as a goal of the EU was not included in the new treaty. The principle of free competition remains however embedded in numerous articles of the treaties. For example, Article 105 of the TFEU underlines the "principle of an open market economy with free competition". Furthermore, Protocol 6 of the Lisbon Treaty clearly states that "the internal market as set out in Article 2 of the Treaty on European Union includes a system ensuring that competition is not distorted", where Article 2 is about the objectives of the Union. "Undistorted competition' is thus reintroduced in the Union objectives, albeit through the back door. Overall, the principle of competition remains as powerful as ever in the EU. It remains the operative and overarching rule of the Union.

II. Economic policy – Under the existing TEU, price stability is not listed as one of the EU objectives. It is only an objective of the European Central Bank (ECB). However, according to Art. 2, para 3, price stability is now one of the EU objectives. Furthermore, a new Article 245a has been included, according to which "The primary objective of the European System of Central Banks shall be to maintain price stability. Without prejudice to that objective, it shall support the general economic policies in the Union in order to contribute to the achievement of the latter's objectives".

In addition, Declaration 30 underlines the commitment of the IGC to the Lisbon strategy and to the provisions concerning the Stability and Growth Pact. In particular, it is stated that "The Union aims at achieving balanced economic growth and price stability. … This should be reflected in the orientations of budgetary decisions at the national and Union level through restructuring of public revenue and expenditure while respecting budgetary discipline in accordance with the Treaties and the Stability and Growth Pact". In other words, the current economic orthodoxy is part of the Lisbon Treaty and thus thoroughly institutionalised.

III. Social policy – The title of the relevant section in the Treaty has been changed from "Social policy, education, vocational training and youth" to simply "Social Policy", while a new article (136a) has been added, whereby "The Union recognises and promotes the role of the social partners at its level taking into account the diversity of national systems". However, as Declaration 31 specifies, "measures to provide encouragement and promote coordination to be taken at Union level in accordance with this Article (140) shall be of a complementary nature. They shall serve to strengthen cooperation between Member states and not to harmonise national systems. The guarantees and practices existing in each member state as regards the responsibility of the social partners will not be affected". In other words, social policy remains a national domain. Therefore, overcoming social disparities at the national and at the Community level is essentially a national concern.

IV. Charter of Fundamental Rights - According to Article 6 of the Lisbon Treaty, "The Union recognises the rights, freedoms and principles set out in the Charter of Fundamental Rights of the European Union … which shall have the same legal value as the Treaties". Furthermore, Declaration 1 states that "the Charter of the Fundamental Rights of the European Union, which has legally binding force, confirms

the fundamental rights guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms".

In practice, the social rights included in the Charter are weak. The right to gainful employment is replaced by the right "to engage in work." Similarly, the right to social security is replaced by an "entitlement to social security benefits and social services." Furthermore, the Charter does not create a set of European social rights, as a counterweight to the prevailing right to free competition. In particular, it is stated that "The Charter does not extend the field of application of Union law beyond the powers of the Union or establish any new power or task for the Union, or modify powers or tasks as defined by the Treaties".

In spite of the above, a number of Declarations by certain member states further limit its scope of application (e.g. Declarations 61 and 62 by Poland).

V. Public services - Article 16 of the Treaty establishing the European Community recognizes the services of general economic interest (SGEI) as a "shared value of the Union". This is now Article 14 of the Lisbon Treaty. It explicitly transfers to the Union and its member states the requirement to ensure that the SGEI "fulfil their missions". At the same time, the overarching rule of competition is clearly stated, insofar as the relevant article of the Lisbon Treaty starts with a caveat. Namely, "Without prejudice to Article 4 of the Treaty on European Union and Articles 73, 86 and 87", where article 4 refers to the subsidiarity principle and articles 73, 86 and 87 to the competition rules.

In addition, Protocol 9 of the Lisbon Treaty refers to "services of general interest" (SGI). The Treaty of Lisbon (LT) is in fact the first primary law document of the European Union in which this term appears. The first article of the Protocol explains Article 14 about the SGEIs. It recommends "a high standard of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights". The second article states that: "the provisions of the Treaties do not affect in any way affect the competence of member states to provide, commission and organise non-economic services of general interest." The problem, however, is in defining what constitutes "non-economic services". For example, a ruling by the Court of Justice (C-180-184/98) has declared that "an economic activity is any activity consisting of offering goods and services on a given market". In this way, the distinction between economic and non-economic services becomes blurred, so that article 2 of the Protocol may well have no practical implications[119].

VI. Health and social security –The amendment of article 152 of the Treaty establishing the European Community, emphasizes the responsibility of the member states to set and to finance their health policies. In view of the great disparity amongst social protection systems, especially since the 2004 enlargement, it would, however, have been useful and necessary for the treaty to set down more precise objectives for public health, a minimum standard for health expenditures in proportion to the GDP for each country and a long-term convergence process towards the higher end of the range of social protection systems[120].

[119] See J. Huffschmid's discussion of the concept in "Public Services after the Treaty of Lisbon", paper prepared for PRESOM, Jan 2008

[120] See Pierre Khlafa. "EU Reform Treaty – Unacceptable on account of its method and content" Aug 2007

VII. Transport - Paragraph 2 of Article 71 TFEU has been amended, whereby the requirement for unanimity when adopting measures within the framework of the common transport policy, *the implementation of which could affect the standard of living, employment, or the operation of transport facilities*, has been lifted. Instead, all that is necessary under the amendment is that such factors "shall be taken into account." A safety factor for public transport services is gone.

Overall, the Lisbon Treaty is likely to encourage a European Union of multiple speeds and of a variable geometry. Thus, for the European integration project as a whole, the spectre of the post-Maastricht crisis of legitimacy remains. This is especially so, in view of the fact that the ratification process does not in any way "move the popular will", nor has it been designed to do so.

The Euro Memorandum Group stresses the fact that a constitution can only formulate certain basic principles, fundamental rights and a thorough democratic design of the Union's institutions and procedures. More particularly, such a "constitution" should promote a European Social Model displaying the following core elements:

- ***full employment,*** with decent working conditions and with wages and salaries sufficient to lead an independent life;
- ***the protection of public goods*** and the provision of high quality public services and socio-cultural services of general interest;
- ***social welfare,*** as a guarantee against poverty and social exclusion;
- ***social equity,*** as the absence of discrimination and of excessive inequality in income, wealth or access to public goods and opportunities;
- ***ecological sustainability,*** as the preservation of the natural basis for individual and social life;
- ***co-operative*** **and** ***balanced international relations and efficient development aid,*** as the long-term requirements for peace and political stability.

Furthermore, such a draft constitution should be submitted to a democratic, paneuropean referendum. In our view, the emerging elite project of the Lisbon Treaty must be strongly opposed not only for its content, but also for its ratification process and the fact that it is to be imposed on the European people as a whole.