The Crisis of the European Union

Weakening of the EU Social Model

Vincent Navarro and John Schmitt

Many observers argue that recent votes unfavorable to the European Union are the result of specific factors in each country. The authors argue there is a more central problem. The European social model has been seriously undermined, partly because of budgetary agreements of the EU and a zealous European Central Bank.

The political institutions of the European Union are in trouble. The distance is increasing between the elites that govern Europe's political, economic, and financial institutions and Europe's popular classes. The popular classes' disenchantment with the European Union affects primarily, but not exclusively, the social democratic parties, because their electoral base is in the sectors (particularly the working classes) most alienated from EU institutions. Results of the recent referenda on the proposed European constitution in France, the Netherlands, and Luxemburg showed clear signs of rejection by the working classes. In France, where the constitution was rejected, 79 percent of blue-collar workers, 67 percent of service workers, and

***VINCENT NAVARRO** is professor and director of the Public Policy Program at The Johns Hopkins University, USA–Pompeu Fabra University, Spain. **JOHN SCHMITT** is senior economist at the Center for Economic and Policy Research, Washington, DC.*

Challenge, vol. 51, no. 1, January/February 2008, pp. 69–77.
© 2008 M.E. Sharpe, Inc. All rights reserved.
ISSN 0577–5132 / 2008 $9.50 + 0.00.
DOI: 10.2753/0577–5132510104

98 percent of trade unionists (as well as 56 percent of socialist voters and 62 percent of socialist militants) voted against the constitution. In the Netherlands, where the constitution was also rejected, 68 percent of manual workers and 62 percent of service workers voted against it. And in Luxemburg, the constitution was approved, but 68 percent of voters from working-class neighborhoods voted against it. Also, in several popular opinion polls in Germany, Denmark, and Sweden that asked whether people would approve the European constitution if it were put to a referendum, 68 percent of manual workers and 57 percent of service workers in Germany, 72 percent of manual workers in Denmark, and 74 percent of manual workers and 54 percent of service workers in Sweden answered no.

To fully appreciate the intensity of this rejection, it is important to note that in all these countries where the working class rejected the EU constitution, the major parties and trade unions actively supported it. The response to the EU constitution had a clear class basis: the majority of the 30–35 percent high-income sector voted in favor, while the majority of the working classes voted against.

Why This Rejection by the European Working Classes?

The European establishments' most widely held explanation attributes the rejection of the EU constitution to country-specific circumstances, such as (among other reasons) the unpopularity of the erstwhile President Jacques Chirac in France and the fear of Muslim immigration in the Netherlands. Undoubtedly, local circumstances did contribute to the rejection, but the widespread "no vote" among the working classes reveals some reasons far more important than the peculiarities of each country. At the root of the rejection was the current crisis of the social model in most countries of the European Union. The working classes (correctly) attribute this crisis to public policies promoted by the major European institutions, which are therefore perceived as responsible for the weakening of the social model. This deterioration of the social model is evident in (1) high

unemployment; (2) growing income inequalities, resulting from an unprecedented increase in profits occurring side-by-side with wage stagnation; and (3) reductions in social benefits. All of these negative indicators are a consequence of the specific form of European integration and globalization.

High Unemployment

Europe's unemployment difficulties are often exaggerated and misrepresented by critics of European-style welfare states. Nevertheless, Europe as a whole has a serious unemployment problem. Figure 1 shows the evolution (from 1960 to 2003) of average unemployment in the United States and the EU-15 member countries. As the figure shows, the European average was lower than the U.S. average until the beginning of the 1980s, after which it exceeded the U.S. average. Most popular opinion polls show that unemployment is among the top concerns of Europe's working classes (another, related, top concern is the explosion of temporary work). The figure also shows that unemployment in the European Union started to increase in the mid-1970s, when the countries that would later constitute the EU-15 initiated policies geared toward monetary union, including public policies agreed upon in the Maastricht Treaty, which established the EU's Stability Pact. At the same time, the European Commission encouraged governments to reduce their central government deficits (to less than 3 percent of GNP) and their public debt (to less than 60 percent of GNP), aiming at an inflation rate no higher than 2 percent. (It is of interest that as Eastern European countries have started to follow the same policies in preparation for monetary convergence with the eurozone, their unemployment has also increased.)

Increasing unemployment in the European Union has created enormous insecurity in the labor force, which explains the popular resistance (much greater among the working classes than other sectors) to enlargement of the European Union to include the Eastern European countries and Turkey. This insecurity has weakened labor unions' ability to demand higher wages. Today, most of the collec-

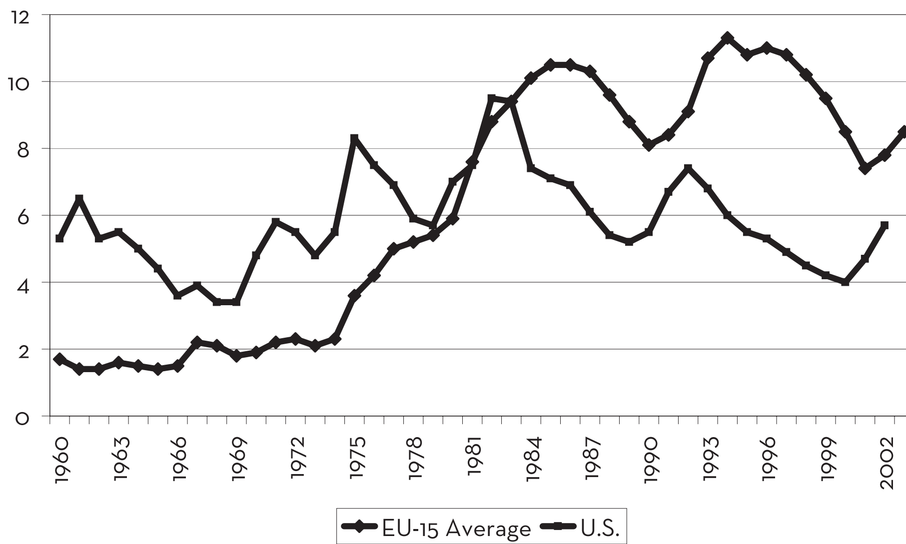

Figure 1. Evolution of Unemployment (as % of active population), EU-15 Average vs. U.S. Average, 1960–2003

Source: OECD Health Data 2001, 2004, and 2005.

tive bargaining agreements in the European Union focus more on job security than on improving wages or working conditions.

Redistribution of Income: Favorable to Capital, Unfavorable to Labor

The European Union has recently witnessed a huge growth in profits for financial and productive capital and a stagnation of wages and salaries. Andrew Glyn has documented in *Capitalism Unleashed* (Oxford University Press, 2006), for example, that across the Organization for Economic Cooperation and Development (OECD), the gross profit share of value added in manufacturing rose by over one-third between the late 1970s and 2000. Data no longer published by the OECD showed large increases in the profit share in total income in the business sector in the 1980s and 1990s in Germany, France, and other major European economies. Meanwhile, salaries and wages have remained stagnant in most European countries. In Germany, for example, the Fundation Hans Bockler, close to the trade unions, has

reported a salary increase in the last four years of only 1.2 percent. The remuneration of the top brass in large industries increased 11 percent, however.

Reduction of Social Benefits

Essentially all of Europe's major economies offer social and labor-market protections well above those provided in the United States. However, even Europe's most successful and generous welfare states have seen important erosions in key social expenditures and labor standards. As shown in Table 1, rates of wage substitution for sickness, occupational accidents, and unemployment, for example, were cut in all countries of the European Union during the period 1975–95. The table also shows how the cuts were even greater in the liberal Anglo-Saxon countries of the European Union (Ireland and Great Britain) and the OECD (Canada, United States, New Zealand, and Australia) than in countries within the Christian democratic and social democratic traditions. Meanwhile, the reductions in health insurance were more accentuated in the social democratic countries than in the Christian democratic ones, with the reverse being true for occupational and unemployment insurance.

All of these indicators demonstrate the weakening of social protections for working people, which is the primary reason for their rejection of the type of Europe the political, financial, and economic elites are promoting. The weakening of the social model is a direct result of (1) cuts in public and social expenditures stimulated in part by the Stability Pact and in part by the broader political climate in Europe; (2) reductions in taxes, primarily benefiting higher income groups; (3) maintenance of a high interest rate by the European Central Bank, far above that needed to reduce inflation; (4) reductions in social protections; and (5) deregulation of the labor markets. All of these policies have become part of the "Brussels Consensus" and are not only accepted but actively promoted by the leadership of most social democratic parties. Actually, many of the European commissioners who promote such policies—including Pedro Solbes and Joaquin Al-

Table 1. Reductions in Social Benefits (in percent)

		Disease			Labor Accident			Unemployment		
Political Tradition	Country	Level	Reduction		Level	Reduction		Level	Reduction	
Liberal	Australia	48.4	–10.1	a*				48.4	–10.1	a
	Canada	62.9	–15.4	a				72.7	–13.1	a
	United States							59.8	–12.8	a
	Ireland	56.3	–33.5	c*	64	–31.5	c	56.3	–34.9	c
	New Zealand	57.5	–34.7	c	94.3	–16	a	57.5	–25	a
	United Kingdom	63.4	–43.1	a	71.6	–51.3	a	63.4	–39.9	a
Christian Democrat	Germany	100	0		100	0		74.3	–6.4	a
	Austria	99.2	–4.6	c	100	–3.4	c	47.4	–10.1	c
	Belgium	91.9	–0.3	a	100	–3.7	a	76	–28.1	b
	France	55.7	–6.8	a	66.8	0		41.1	–7.2	c
	Italy	68.1	0		74.1	0		66.8	–23.8	b
	Netherlands	84.7	–14.7	b*	84.7	–14.7	b	81.6	–13.2	b
Social Democrat	Denmark	74.7	–21.4	b	74.7	–21.4	b	81.9	–24.5	a
	Finland	86.1	–10.3	d*	100	0		59.1	–5	d
	Norway	55	0		55	0		73.5	–10	a
	Sweden	90.3	–13.8	c	92.6	–21.8	c	77.1	–7.3	d

Source: Walter Korpi and Joakim Palme, "New Politics and Class Politics in the Context of Austerity and Globalization: Welfare State Regress in 18 Countries, 1975-95," *American Science Review* 97, no. 3 (August 2003).
*Years of previous maximum: a = 1975, b = 1980, c = 1985, d = 1990. Rate of wage substitution in health care, accident, and unemployment insurance and the higher percentage of reduction in those rates of substitution, 1975–95 (in five-year periods). Information classified by political tradition.

munia, past and current European commissioner for economic and monetary affairs—were appointed by socialist parties in the European Parliament. A similar consensus exists among most economic theorists of the governing socialist parties. A leading member of prime minister of Spain José Luis Rodríguez Zapatero's economic team, Jordi Sevilla Segura, wrote, for example: "Is there anyone today who believes that a social democratic program should favor more taxes and more public expenditures?" (*De nuevo socialismo* [*A New Socialism*] [Barcelona: Crítica, 2002]). This was written in Spain—the country with the lowest public expenditures (as a percentage of GNP) and the lowest taxes in the EU-15. Not surprisingly, Spain (along with Greece and Portugal) has one of the least developed welfare states.

Indeed, social democracy in Europe has generally accepted the major tenets of neoliberal dogma, interpreting high unemployment as resulting from excessive social protections and rigidity of the labor markets. Paradoxically, this interpretation sees the low unemployment in the United States as being a consequence of its flexible labor market and restricted social protections, and fails to consider other, far more important causes of the higher economic growth and lower unemployment than in the European Union. The United States, among other factors, has had larger public deficits (on average, 4.6 percent of GNP during the years of economic expansion) and, at comparable points in the business cycle, much lower official interest rates than the European Union. Moreover, the U.S. federal budget is about 19 percent of GNP, which allows for active redistributive policies among the states. By comparison, the EU budget represents only 1.1 percent of the European GNP, allowing for very limited redistributive policies across member countries.

Possible Solutions

From a technical point of view, it is fairly easy to determine what public policies are needed to strengthen the European social model. These policies should include, as advocated by Oskar Lafontaine, minister of finance in Gerhard Schröder's government in Germany, (1) making the

Stability Pact more flexible, with a redefinition of its internal rules to allow for greater stimulation of the economy, including permission for higher fiscal deficits; (2) the general lowering of interest rates by the European Central Bank, most sensibly through a modification of the European Central Bank's charter to put maintaining full employment on an equal footing with the ECB's current charge to promote price stability; (3) an increase in the EU central budget to stimulate redistribution and economic growth at the European level; (4) coordination of economic and fiscal policies, with the return to relying on public expenditures to act as the primary generator of economic growth during economic downturns; (5) development of full-employment policies at the European level; (6) further development of labor and social rights, including making membership in the European Union conditional on the existence of such rights; and (7) development of legislation to allow collective bargaining at the EU level.

The last point, on collective bargaining agreements, is almost a necessity for the development of all the other proposals. Indeed, underlying the welfare state in each nation is a social pact between capital and labor. This social pact, however, does not currently exist at the EU level. Indeed, it cannot exist in the absence of legislation. Large employers and banking institutions in the European Union oppose any move toward EU-level collective bargaining, since they benefit from the current absence of a social pact. In this respect, one of the greatest successes of Europe's large employer associations and major financial interests has been the creation of a situation in the European Union that is much like that in the United States. The absence of national-level bargaining between large union and employer federations is an important reason that the United States does not have a developed welfare state.

It is highly unlikely that the policies suggested above will be developed in the European Union, since they run completely against the Brussels Consensus. The paradox is that the existence of the euro allows, in principle, the use of expansionary fiscal and monetary policies at the EU level, which would otherwise be impossible to carry out at the country level (as President François Mitterrand discovered

in France in the early 1980s). But such policies would clearly be opposed by the interests that dominate the European institutions and reproduce the Brussels Consensus.

To order reprints, call 1-800-352-2210; outside the United States, call 717-632-3535.