

The European Model of Society – Challenge or Utopia?

Professor Helmut Kramer, Austrian Institute of Economic Research

Only a few days ago the European Union increased from 15 to 25 member states and from 380 to nearly 460 million inhabitants through the accession of two small Mediterranean islands and 8 former communist republics. I think, May first 2004, marks a historical date not only for Europe as a whole, but especially for Austria.

We are witnessing a historical first in Europe, for nearly all Western and Central European countries are ruled under common political and economic institutions. That was not the case with the old Roman Empire, that was not the case in the Carolingian era and was never the case since then. A continent divided for centuries by conflicting national aspirations, mistrust, belligerent pursuit of interests and by more or less strangling obstacles against stimulating exchange of ideas, people and cultures finally gets now the opportunity to make full use of its cultural and innovative potential.

As for Austria, EU enlargement ends the separation of this country, of its people and of its economy from their regional and cultural surroundings of the North, the East and the South East. A separation which was triggered by the end of the Habsburg monarchy in 1918 and which became even more severe after seizure of power by Moscow-led Communist regimes in the period after World War II.

It is not my ambition today to elaborate on the possibilities this new situation offers to the Austrians and to the Austrian economy. The new ties to these central Europe countries gives also the chance to people from all sides to intensify cultural, scientific and human exchanges.

Austrian companies have been the first who took the opportunity to cooperate and to invest in these neighbouring -and for them very familiar- regions of Central Europe. According to statistics Austria is, together with the Netherlands, the strongest partner of the new European Union members amongst all EU and other Western countries. Austria's direct investment stocks per capita in the new EU countries are worth four times as much as the German investments in those

countries. They are also 10 times as much as the investments of France, the United Kingdom or Italy in these new EU member countries.

I think this is the beginning of a fruitful reaping due to the dynamic advantages of intensive cooperation networks with most of those countries.

But there is much scepticism among the public and also among experts on the economic and social perspectives of (nearly) unified Europe. One question these sceptics ask themselves is whether Europe's economy will be competitive on global markets given technological leadership of the United States and the significant cost advantages of some Asian countries, most of all China.

In open world markets, to be competitive, European producers will have to adapt their prices to world market prices, which are in general significantly lower than direct and indirect production costs in Europe.

The higher costs in Europe are due mainly to the comparatively high labour costs and the high costs of public services and social security.

Those are mainly translated in a high and perhaps rising level of overall taxation. Cutting taxes could mean cutting the generosity of the social system, whereas lowering labour costs could mean decreasing domestic demand and stagnant or shrinking production. These prospects come along with already high unemployment, persistent lack of political leadership and the looming of an ageing crisis in the decades to come.

There are others who conclude from this pessimistic scenario that Europe has to develop the architecture of a fortress, to be self-sufficient and to at least slow down the process of globalisation. In protecting its traditional social institutions as well as product, services and labour markets from global competition, Europe could retain the most important elements of the so-called European Model of society.

This expression does not come out of the blue; it is indeed the wording that the proposed Draft of a European Constitution uses in its article nine when it deals with the objectives of the European Union.

Quotation: "The Union shall seek to promote the European model of society by a sustainable development of economic and social activities, the flowering of cultures of the Member States, a high degree of protection of the environment and solidarity between all its regions, whether they be central, peripheral or insular."

This task is, however, not very well defined. Neither the labelling of a specific European model envisaged is explained in some detail, nor the ways and means to promote it. Many who have contributed to the recent lively discussion on the specifics of the European in comparison to the US model agree on a number of gradual differences. May be that summing up them results in a more essential qualitative divide: more extensive public services and higher social standards, inevitably implying higher taxes and social contributions and implicitly assuring a more equal distribution of incomes and wealth in most European economies. Furthermore a higher degree of regulation in labour markets and environmental standards, comparatively higher efforts for regional cohesion and development assistance complete this picture and eventually accentuate possible competitive disadvantages. There are obviously some more differing characteristics of the European Model as distinct from the American, which could easily translate into economic disadvantages: the United States have assumed the role of the only superpower globally which could be used for the pursuit not only of police functions but also of economic interests. Next difference: the ageing of population will be more pronounced in Europe – Old Europe! – than in America, and by the year 2040 the US population will still be increasing whereas the European one most probably will be shrinking. At the moment Europe is – plagued of many political quarrels – in the process of turning into an immigration region, which the United States ever have been since their founding.

In the Draft European Constitution there is no explicit commitment to the role the EU is willing to play in global questions whether they are economic, ecological, social or cultural. On the other side, it is already political reality, that the European Union is in some important aspects acting rather protective of its internal market, most importantly in regards to agriculture and labour markets.

Competition is the principle that is enforced within the fortress but a levelled playing field is by no means automatically granted to outside producers. Of course there have been acts of generosity towards developing countries in terms of lowering import barriers or of giving substantial support to their economic and social development, but, as you know, this is not the case for agricultural products markets, and that, in turn, has been one of the major obstacles that stopped abruptly WTO negotiations in Cancun earlier this year.

Is there no alternative between those two very unfavourable scenarios: Protectionism on one hand and the dismantling of standards in order to remain competitive on world markets on the other?

Public opinion is sometimes pessimistic about the future of the European Model of society. That is especially the case, when strategic European policy decisions seem caught between the diverging national interest, differing interests of sectors and of generations, differing priority given to social security and to ecological standards. And it is quite easy for each of you to think of striking examples of that lack of cooperation and that amount of "reformstau" (in German, that can be translated by "reform blocage").

I think it is very important to think of a much more optimistic perspective. But a more optimistic perspective means there is an important challenge waiting to be tackled by us all in Europe. A European Model of society is no utopia or impossible to achieve.

Let me start with labour costs: they are undoubtedly higher in all European countries than in China or in Malaysia. And they are undoubtedly higher in Austria than in Portugal. Why didn't the bulk of Austrian producers shift their production sites to Portugal or to China? Admittedly, some of them did that, or are planning to do this. And in general, they are right in doing so, if they do not find other equally important advantages of producing in Austria. But labour costs are not the only consideration for the industry when deciding on the site of production.

Let me take another example: tax rates or – more correctly – effective taxation is undoubtedly higher in Europe than in the USA. And it is higher in Austria than it

is, for example, in Slovakia. Why then have not all Austrian producers shifted at least their taxable headquarters to Slovakia? Of course, some of them did, or are assessing costs and benefits to do so, but, again, taxation is not the only consideration for businesses to choose a location.

Here is another observation: in recent years international surveys – such as that of the World Economic Forum- on the attractiveness of national economies to international investors, rank persistently some high-tax countries, especially Finland, Sweden and Denmark, as the highest in international comparisons. Those countries do not offer, apart from high taxation, remarkably low wages or very affluent labour market supply. They, furthermore, are situated somewhat peripheral to the main agglomerations of consumers and producers. But despite all these obvious disadvantages, they are attractive locations.

Why that? I think this can only be explained by a combination of advantageous conditions, not all of them unmeasurable factors in terms of production costs, such as the political climate, the quality of education, or the cultural background :

They offer a first-class education system, they offer highly interesting research and development institutions and incentives, they are offering a sustainable social system already oriented towards the demands of an aging population. It goes without saying that they are offering world-class wide-band telecommunication and very well organised administrative procedures. They give domestic and foreign investors the impression that the public system is oriented towards making full use of the innovative capacities of their populations, not also in terms of technological innovations but also in terms of institutional innovations and what they call "social capability".

Maybe some countries on the European continent, especially those who managed to recover from the damages caused by World War II quite rapidly – for example Germany, Italy and, alas, also Austria – have too long stuck to political methods from that time. These political methods, effective in post-war times, are now obsolete and need to be revised. Japan is another example of such an economy. Their successful political models got, under changed global conditions, into crisis, and obviously needed fundamental overhauling. One of

the problems of reforms lays with the difficulty for some governments to explain to the population the importance of these reforms. On the contrary, some governments would rather try to get some support by assuring the electorate that nothing will be changed. Maybe the political economy of fundamental reform can be easier communicated to the population in a situation of dramatic deterioration of conditions. That was true for the Netherlands in the early eighties and that was true for Finland and, less dramatically, for Sweden in the early nineties.

High social costs, high contributions to social security, that seem obviously a comparative disadvantage in international competition and an obstacle to widen labour inputs, are not under all conditions negative influences on the economy. The general social security systems in more or less all European countries served, in the post-war era, as a precondition to rapid changes of socio-economic structures. Only the establishment of such a system made the opening of the markets towards international competition politically viable. The stepwise opening of the national markets in turn brought both rapid growth of the social product and of productivity. The public social net eased defeating obvious opposition of forces defending obsolete economic structures.

So, my confidence into the sustainability of the European Model of society is conditional to political creativity, to their imagination, their good political eye for sizing chances and problems up and for strategic far-sightedness. If it grows in a general innovative climate, in a setting of adequate communication of priorities between the government and the population, this European Model, would have a good chance. That is, what I call a challenge rather than a utopia.

I admit, it is a rather ambitious challenge compared with how policy is made in Europe today.