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Michael Dauderstädt

EU EASTERN ENLARGEMENT: EXTENSION OR END OF THE EUROPEAN SOCIAL MODEL?

How does the Eastern enlargement of the EU affect the prevailing social model in Europe? This is the question we will try to answer in the following paper. The object of the assumed threat, the European Social Model (ESM), is not a very precise construct, but a vague ensemble of different institutions, policies, values. The Treaties of the EU protect social rights, the social dialogue and require from the Union to promote economic and social progress, a high level of employment, and to strengthen economic and social cohesion (Art. 2 TEU). Trade unions are an acknowledged pillar of that model. More generally, it is assumed that Europe – more than other societies such as the U.S., for instance – cares for equality which it tries to achieve by a mix of decent wages and relatively low wage dispersion, redistributive policies, and a wide range of free or cheap public goods and services.

Let us start discussing the effect of enlargement with the pessimistic view, whose elements we will then analyse in more depth:

The association and imminent accession of eight to ten very poor post-communist transition countries to the European Union are increasing the adjustment pressures on labour markets and social policies. A prominent German economist, Hans-Werner Sinn, the director of one of the leading economic think tanks, the ifo Institute in Munich put it the following way: "Die durch die hohen Löhne verursachten Standortprobleme unseres Landes werden sich potenzieren, wenn die Europäische Union im Jahre 2004 um zehn Länder erweitert wird. ... Man muss kein Ökonom sein, um zu erkennen, dass sich das deutsche Standortproblem zu einer äußerst schweren Strukturkrise der gesamten Wirtschaft auswachsen wird, wenn keine Maßnahmen zur sofortigen und tief greifenden Flexibilisierung des deutschen Arbeitsmarktes ergriffen werden." (Sinn 2002: 15-16). Low-skill jobs will become less and less competitive in the exposed tradables sector of the richer member states. The emergence of new jobs in the service industries could well depend on lower wages and less protective labour market regulations. The correction of those pressures on the primary distribution of incomes by redistributive public policies or active employment policies is increasingly constrained by the common monetary policy, the Stability and Growth Pact, and tax competition.

How do these arguments stand up to more searching empirical and theoretical scrutiny? We will start with an analytical description of the perceived threat to the ESM, the post-communist transition and accession countries. In section 2, we analyse and largely discard possible causal links between the integration of these economies (and globalisation in general) and the decline of the ESM. However, evidence presented in section 3 shows that social justice, in particular employment and equality, has declined in the EU during the 1990s.But, as we see in section 4, deepening the EU might have a stronger impact than widening on the ESM. However, that impact varies strongly from member state (section 5). Finally, the last section 6 argues that enlargement actually affects an ESM which is already subject to a double transformation on the national as well as on the EU level.

1. THE THREAT OF ENLARGEMENT: POOR POST-COMMUNIST COMPETITORS

How could the ESM be threatened by enlargement?

The association and (later) accession of several post-communist countries has integrated a large pool of low-wage labour in the emerging pan-European economy which will affect employment, growth and income distribution through import competition, investment flows, relocation of production and migration. The candidate countries will not reach the levels of income and social security available in the richer countries for a long time (see Tables 1 and 2).

Table 1: Income gap of the accession countries relative to the EU

Country	Level of GDP per capita in PPP (EU-15=100)			Years required to reach 75% of EU-15 average
	1996	2000	2004	
Bulgaria	25	24	31	31
Czech Republic	65	60	68	15
Estonia	33	38	48	19
Hungary	47	52	64	11
Latvia	26	29	36	27
Lithuania	29	29	35	31
Poland	36	39	45	33
Romania	33	27	33	34
Slovakia	46	48	56	20
Slovenia	66	72	85	1

Source: UN-ECE, *Economic Survey of Europe*, No. 1 (2002), p. 183.

Enlargement adds more potential locations to the integrated European economy that are conveniently close to the industrial core regions of Europe. Moreover, Central and Eastern Europe has structures of income, skills, infrastructure, regulation, industrial relations, and social protection that are (still) very different from those of the present member states. These differences create opportunities for competitive advantage. The combination of lower transaction costs and higher cost differentials in the enlarged Euroland could produce a "globalisation-effect" within the larger Europe that would then exert adjustment pressures that dwarf those traditionally associated with the term "globalisation" and the competition of low-wage countries of the Third World (see Dauderstädt 2002a).

Table 2: Labour markets in the accession countries

Country	**Unemployment rate**		**Average real monthly wage (€)**	
	1994	1999	1994	1999
Bulgaria	20.5	17.0	77	65
Czech Republic	4.3	8.7	201	294
Estonia	7.6	11.7	116	217
Hungary	10.7	7.0	267	274
Latvia	18.9*	14.5	109	177
Lithuania	17.4	14.1	68	166
Poland	16.5	15.3	195	286
Romania	8.2	6.8	71	69
Slovakia	13.7	16.2	155	231
Slovenia	9.0	7.6	617	785

* 1995

Source: Belke and Hebler, op. cit., pp. 40 and 60.

The accession of the post-communist candidate countries could also be seen as a means of reducing the differences between the socio-economic structures there and those in current member states. Neoliberal critics of the enlargement in particular warn that the "premature welfare states" (to use a term coined by János Kornai) of the transition countries will render catch-up growth difficult if not impossible (see Belke and Hebler 2002). In fact, social spending in the transition countries is relatively high given their level of income.

Table 3: Inequality and social spending in accession countries

Country	Gini index*		Social spending 1997 (% of GDP)	
	1987–90	1996–8	Pensions	Health and education
Bulgaria	0.23	0.41	6.2	7.4
Czech Republic	0.19	0.25	8.9	11.2
Estonia	0.24	0.37	n.d.	12.2
Hungary	0.21	0.25	9.4	11.4**
Latvia	0.24	0.32	10.7	9.5
Lithuania	0.23	0.34	7.0	9.7
Poland	0.28	0.33	15.1	11.2
Romania	0.23	0.30	n.d.	5.9
Slovakia	n.d.	n.d.	8.0	10.7
Slovenia	0.22	0.30	n.d.	13.3

* The Gini index is an indicator for inequality ranging from 0 (perfect equality) to 1 (absolute inequality with all income going to the richest person or household)

** 1996

Source: Gini index: World Bank, *The First Ten Years. Analysis and Lessons for Eastern Europe and the Former Soviet Union*, Washington (2002), p. 9; pensions: Nicholas Barr, "Reforming welfare states in post-communist countries", in Lucjan T. Orlowski (ed.), *Transition and Growth in Post-Communist Countries. The Ten-Year Experience*, Cheltenham (2001), p. 186; health and education: EBRD, *Transition Report 2001*, London (2001).

It is not yet completely clear which model or type of welfare state they will adopt. On the one hand, they show the characteristics of the continental type (financing social security by wage-related contributions), while on the other hand, they have established multi-pillar pension systems (Wagener 2002). Labour market flexibility is at the level of the most flexible EU member states (Belke and Hebler 2002:70). Although trade unions and industrial relations are well established in Central and Eastern Europe, they tend to be weak where it counts, namely in the new private sector. Trade unions and defenders of a strong welfare state in the present member states, in particular Germany and Austria, which are more exposed to developments in the East, hope that enlargement will prevent a "race to the bottom" by forcing the new members to adopt higher social standards. EU-membership will actually limit the choice between different "varieties of capitalism" (Hall/Soskice 2001) that the transition countries basically had after the collapse of communism. Neither liberal, free-market varieties (as e.g. Estonia tended to adopt) nor state-led development strategies of the East-Asian type are compatible with the *acquis communautaire.*

Twelve years of opening up and transition have already created a highly integrated economy across Europe. The share of the EU in the external trade of the applicant countries is as high as it is within current EU member states. The same is largely true of foreign direct investment. Most analysts do not expect dramatic further increases after accession as gravity models of international trade show that the regional structure has already reached the levels to be expected given the geographical distance and relative income of the economies involved (see Dauderstädt 2000). Further strong increases in FDI are not very probable given the fact that privatisation is almost complete.

Even successful catch-up growth based on EU regional assistance and strong FDI inflows will probably not reduce inequality in Central and Eastern Europe, though it may help to reduce unemployment, on the example of the unique success story of the Republic of Ireland (see O'Hearn 2001). The Irish case shows that you can achieve high growth through foreign investment but that you have to pay a high price. A substantial share of the Irish GDP consists of profits of foreigners thus lowering the share of wages from 77% in 1980 to 53% in 2001 and pushing Ireland in the income per capita league of the EU from rank 5 (GDP/cap) to rank 10 (GNP/Cap). The GNP that measures the income of the Irish is more than 20% lower than the GDP that measures the value added produced in Ireland (or rather accounted for in Ireland because multinational enterprises increase artificially the profits in their Irish subsidiaries through transfer pricing in order to avoid taxes and to benefit from low corporate tax rates in Ireland).

It is hard to imagine for Central and Eastern Europe as a whole to repeat that success. Up to now, only Hungary has shown signs of following that strategy to some extent. If more countries succeeded that would not bode well for the ESM. It could trigger a race to the bottom regarding taxes and wages. Presently, only Hungary has a low rate of corporate taxes (18%) while rates in Poland and the Czech Republic range above 30%. But Poland plans to lower the rate to 22% in 2004 and free market Estonia has a zero rate (Barry 2002: 14). Of course, taxes are only one ingredient of competitiveness and attractiveness to foreign investors. In the end, productivity and unit labour costs are decisive.

The past record of development of poor countries joining the EU is far from promising. Ireland joined the then EEC in 1972 and virtually stagnated for 20 years. Greece became a full member in 1981 and experienced a long-term relative decline in income per capita that it could only reverse in the 1990s. Portugal and Spain benefited basically from the run-up to the Monetary Union and the declining interest rates that triggered a boom in the late 1990s. Otherwise, their income per capita relative to the EU average had not improved substantially. Even worse is the record of poor regions like the Mezzogiorno or Eastern Germany though they benefited not only from EU funds but also from massive national aid. Thus, it is very likely that the income disparities in the enlarged EU will remain big and persistent. (Dauderstädt/Witte 2001)

To summarise: The threat from the East is likely to be on the one hand more persistent, and on the other hand less severe than some people (e.g. Sinn 2002) expect. It will be more persistent because income disparities are bound to remain high because of inefficient national and EU policies. It will be less severe as EU integration and egalitarian preferences in the transition countries will burden the locations with costs that undermine their price competitiveness, at least in the short run, though it might lead to higher levels of welfare in the long run.

2. THE GLOBALISATION OF EUROPE: SCAPEGOAT OR REAL THREAT?

Will the rise of new competitors in the East and their unmitigated access to the markets of the incumbent member states after 2004 really endanger the ESM and produce the dreaded stereotypes of globalisation, i.e. undermine the welfare state, weakening labour, and harming the poor?

As a matter of fact, integration, liberalisation and opening markets ("globalisation") affect employment and income distribution. Let us focus first on different aspects of globalisation and integration that may also function as possible causes of rising unemployment and inequality within the enlarging EU:

- *Trade*: according to classical trade theory, international trade should increase welfare. It does so by fostering specialisation of production, resulting in an increase in productivity. If demand does not increase at the same time, unemployment will increase. Welfare gains can also be distributed differently between the countries participating in the exchange. Moreover, if trade occurs between countries with different endowments of production factors and hence different relations between factor prices (that is, income from utilisation of those factors), trade should increase demand (and hence the price, and so income) for relatively abundant factors and reduce demand for relatively scarcer factors. On the one hand, this would lead to lower wages for unskilled labour in rich countries that have, it is assumed, a greater supply of skilled labour and capital; on the other hand, it would improve the market position and income of highly skilled workers and of capital owners (see Wood 2002). In fact, unemployment and institutional "distortions" of labour market functioning delay and impede these effects.

- *Capital flows:* the impact of "free", that is, more liberalised trade will be reinforced by free movement of capital, in particular foreign direct investment (FDI). Together with international trade, which in any case consists increasingly of the intra-firm trade of multinationals, FDI creates transnational production networks that establish parts of the value-added chain at appropriate locations. Capital will generally look for low-cost and, particularly, low-wage locations with a productivity level which allows for lower unit labour costs. Relocating production to these locations will increase labour demand there and reduce it in the richer (?) investor countries.
- *Migration:* free movement of labour achieves the same effect by means of a "symmetrical" flow of human resources from poor countries with abundant labour to rich countries, also usually with surplus labour but paying higher wages. The increased supply of cheap labour will lead to lower wages, particularly for unskilled workers who have to compete with the immigrants. People may also migrate in order to benefit from better social protection (Sinn 2000). Without controls, such migration may overburden social security systems in the richer host countries and take pressure off systems in the poorer countries of origin until an "equilibrium" level – probably quite low – of social protection is reached (see Wildasin 1991).
- *Tax competition* may also force governments to collect more and more taxes from immobile (or less mobile) sources such as labour, consumption and property, while reducing the rates on mobile sources, particularly capital and corporations. This bias in the tax regime might contribute to a less equitable secondary income distribution (that is, after taxes and transfers), particularly in real terms given the regressive impact of higher indirect taxes (see Genschel 2002 and Wildasin 2001).

Taken together, these processes should lead to (or even impose) lower real unit labour costs; indeed, the latter have fallen within the EU from an index value of 107 in 1981 to 93 in 2001 (1991=100) (Europäische Kommission 2001).That does not necessarily imply a decline in real wages. Real wages have generally increased, though this increase sometimes conceals substantial sectoral, regional and employment category differences.

However, each of these potentially detrimental causal relations is disputed by a mass of countervailing empirical evidence (Cline 1996; Wood 1994) and theoretical argument (Krugman 1996) exculpating globalisation and integration (see

Dauderstädt 2002b). Officially registered trade, capital and labour flows, particularly net flows, are often relatively small in comparison to the national income of the countries concerned and cannot explain the effects cited. Most of that exchange occurs among rich countries, above all within the EU, whose wages and regulatory standards do not differ that much. Regarding tax competition, empirical surveys (Ganghoff 2000; Genschel 2002) suggest that this has not occurred on a large scale. Tax authorities have combined the targeting of immobile sources with broadening the tax base; furthermore, immobile factors cannot be overburdened without the risk of pushing them into the shadow economy. Given the increasing need to maintain tax revenues due to high unemployment and aging populations, the relative stability of the tax intake might indicate limits imposed by the fear of tax competition.

Assuming ready adjustment by all workers, enterprises and governments, most negative effects would be transitory and small. Lower prices and/or higher investor incomes should lead to additional demand and so new jobs. However, in the meantime those out of work lose some of their purchasing power and deflationary pressures increase. In the real world of information and transaction costs, hysteresis, "ratchet effects", path dependencies, regulated markets, welfare states and slow learning processes, the effects are more lasting and substantial. Nevertheless, the variety of labour market outcomes among EU member states proves that there is no "iron law" of globalisation leading to unemployment. Even the seemingly more probable trade-off between unemployment and wage inequalities cannot be proven, as the examples of the Netherlands and Denmark show. At least as far as industrial earnings between 1970 and 1992 are concerned, unemployment and inequality were positively correlated (Conceição, Ferreira, and Galbraith 1999). There might, however, be a "trilemma" between wage equality, expansion of the service sector, and fiscal restraint (see Hemerijck 2002).

The main cause of unemployment is not international competition but structural change, that is, deindustrialisation. Productivity in agriculture and manufacturing industry has increased much more rapidly than demand for their products, leading to a decline of employment in those sectors. However, this rapid rise in productivity may be partly due to their character as exposed, traded goods sectors. While the surplus rural population of the 1930s–1960s was largely absorbed by the then still expanding manufacturing sector and is now protected by the Common Agricultural Policy, the industrial labour force surplus has to be employed in the service sector, which does not benefit from high productivity increases. Successful countries have, as a rule, either created jobs in public services financed by taxation (typically Sweden) or in a low-wage private service sector (typically the USA). The second option in particular will probably lead to greater inequality and, possibly, poverty if redistributive policies do not intervene.

This leads us to the causes of welfare state retrenchment. Again, contrary to widespread assumptions regarding the "malign workings of globalisation", many studies (Iversen 2001; Kitschelt 1999; Pierson 2001; Schwartz 2001; Swank 2002) consider other causes as more probable, such as deindustrialisation, rising unemployment, an aging population, changing family structures, and, most important, institutional legacies and political priorities. Openness to trade is even regarded by many analysts (Rieger and Leibfried 2001; Rodrik 1997; Rodrik 1998) as a cause of welfare state expansion rather than of retrenchment, though even the positive causal relationship has been disputed (Iversen 2001). The welfare state, which commands between 30 and 50% of national income, is a much more dominant influence on the distribution of income and life chances than foreign economic relations. It creates massive vested interests among a large part of the population. In the relatively affluent democracies of Europe, voters will protect these interests and thus the welfare state. So far, a range of political processes have defended the welfare state against new adjustment pressures. This explains the fact that government expenditure in general, and social spending in particular, has barely decreased, despite some retrenchment (see Tables 7 and 8; see also Pochet and Vanhercke 1999 and Pochet 2002).

In much the same way, income distribution depends less on causes related to the world market than on domestic regulatory and redistributive policies that transform the price system, "distort" competition, protect some industries against new entrants, and limit access to certain skills. The structure of the education system, together with special labour market regulations, determines the skill profile of the labour force. Over time, most developed (knowledge rather than industrial) economies have evolved a symbiotic relationship between specific production and welfare regimes that determines wage and employment patterns (see Estevez-Abe, Iversen, and Soskice 2001 and Freeman and Schettkat 2000).

To summarise: Employment, income distribution, and the welfare state might be affected by economic integration and the increasing exposure of national economies to changes in other economies or the world economy. But these external shocks are translated and mitigated by a wide variety of institutions and policies, in short, by the welfare state. Only where political and institutional constellations allowed for radical change, as a rule in residual-liberal, Anglo-Saxon type welfare states with centralised majoritarian democracies where the number of beneficiaries is relatively small and less powerful, have there been substantial adjustments (see Huber and Stephens 2001 and Swank 2002). Hoewever, the integration of Central and Eastern Europe as such, cannot be expected to cause the dreaded effects. The effects of association and enlargement are relatively weak due to the small size of the applicant economies in comparison to the present member states. The overall share of all applicant countries in the EU's foreign trade is about that of Switzerland. Only particular regions, industries and skill groups in Germany and Austria have been or will be significantly affected (Quaisser 2000).

3. SOCIAL EUROPE AT BAY: THE EVIDENCE SO FAR

Over the last few decades, unemployment, poverty and inequality have generally increased in Europe, although there have been periods (notably the late 1980s) and countries (for example, the Netherlands and Denmark) where social conditions have improved or at least not deteriorated. For many of these problems, the presumed causes are complex and manifold: the decline of global growth rates since 1972; the end of the Bretton-Woods system; the globalisation of international capital markets, investment, and production; the rise of low-wage competitors in the former Third World; deindustrialisation; technological and demographic changes; and – not least – the perverse effects of well developed welfare states themselves. European integration as such and the association of the post-communist applicant countries have arguably contributed to those developments. The introduction of the Single Market and the euro has changed the regulatory and competitive environment of European economies.

Unemployment rates have increased substantially since the 1970s (see Table 4). But while some countries have managed to halt and even reverse the rise (notably the Netherlands, Ireland and the UK), others could only achieve partial success that still leaves unemployment rates much higher than in the 1970s (for example, Sweden, Germany, France and Spain). While employment rates have increased in many countries the share of "normal" work arrangements has decreased in most countries, Greece and Denmark being the exceptions (Hoffmann and Walwei 2002).

Table 4: Unemployment in Europe, 1960–2001 (%)

Year	1960	1961–70	1971–80	1981–90	1991–2000	2001
Belgium	2.3	1.9	4.6	9.7	8.7	6.5
Denmark	1.3	1.1	3.7	7.4	7.1	4.6
Germany	1.0	0.7	2.2	6.0	8.1	7.8
Greece	5.6	5.0	2.2	6.4	9.5	10.5
Spain	2.4	2.5	5.4	18.5	19.6	12.8
France	1.4	1.8	4.1	9.2	11.3	8.5
Ireland	5.8	5.4	7.7	14.7	11.1	3.8
Italy	5.7	4.8	6.1	8.7	10.7	9.8
Luxembourg	0	0	0.6	2.5	2.5	2.0
Netherlands	0.7	0.9	4.4	8.5	5.4	2.6
Austria	2.5	1.9	1.6	3.4	3.9	3.4
Portugal	1.7	2.5	5.1	7.3	5.6	4.6
Finland	1.8	2.4	4.1	4.7	12.5	9.1
Sweden	1.7	1.7	2.1	2.6	7.7	5.2
UK	1.4	1.7	3.8	9.8	8.1	5.3
EU average	2.3	2.2	4.0	9.0	9.9	7.7

Source: Eurostat.

The share of wages in GDP has declined in almost all member states since the first oil shock (see Table 5). The decline was most pronounced in Ireland, strong in the Netherlands and Portugal, and rather modest in Luxembourg and – surprisingly – the UK. That does not mean that real wages declined. With the exception of some years they grew by an average rate of 1% per year.

Table 5: Share of wages in Europe, 1960–2001 (% of GDP)

Year	1960	1961–70	1971–80	1981–90	1991–2000	2001
Belgium	69	69.5	74.8	73.9	72.4	70.5
Denmark	67.7	71.5	74.4	72.7	67.9	65.4
Germany	70.6	71.6	73.7	70.9	67.9	66.0
Greece	101.4	86.1	70.7	74.0	67.3	67.2
Spain	70.7	73.5	75.1	70.5	68.5	67.1
France	74.1	74.2	75.5	74.5	69.5	68.9
Ireland	78.0	77.9	75.9	71.3	62.0	53.9
Italy	76.6	75.0	76.6	74.3	70.3	66.8
Luxembourg	56.3	57.7	65.5	66.5	64.8	62.7
Netherlands	63.4	69.4	74.8	68.1	66.0	65.3
Austria	82.2	82.5	83.4	81.8	76.5	72.5
Portugal	73.7	72.9	87.3	79.6	76.5	72.5
Finland	73.7	73.1	72.5	71.9	66.1	59.8
Sweden	69.4	72.3	74.1	70.5	68.7	71.4
UK	71.7	73,0	73.7	73.2	73.3	73.6
EU average	*72.5*	*73.2*	*74.9*	*72.8*	*69.7*	*68.1*

Source: Eurostat.

Since wage figures include the incomes of both workers and top managers the share of wages does not reflect changes in wage differentials. Without further information on other potential sources of income (for example, from capital or transfers) it is an open question whether the share of the total household income of wage earner households has declined to the same degree. Still, the coincidence observed in several countries of declining wage shares with rising unemployment raises questions concerning the strategy of creating employment through wage restraint (Flassbeck 2000).

It is therefore better to look directly at the development of income distribution. EU Gini coefficients present (Table 6) a small increase in the late 1990s, using the data of the Luxembourg Income Study. However, other empirical data (ECHP) show a decrease between 1994 and 1997. National data covering the period 1984–97 show an increase in inequality (measured by earnings differentials) in some countries (Austria, UK), but also improvements (for example, in Germany, Denmark, Belgium) and some fluctuations, as in Italy and Sweden, that do not confirm any long-term trends (see Scharpf and Schmidt 2000). An older study on the relation between wage differentials and integration shows only inconclusive or weak results with some convergence of wage levels between member states when measured in terms of purchasing power parity (van Mourik 1994).

Table 6: Income distribution in the European Union (Gini coefficients)

Country	**Gini LIS**												**Gini ECHP**	
Year	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1994**	**1995**	**1997**	**1994**	**1997**
Belgium		**22.7**	22.7	22.7	**23.2**	23.2	23.2	23.2	**22.4**	22.4	22.4	**25.5**	36.0	34.0
Denmark				25.4	25.4	25.4	25.4	25.4	**23.6**	23.6	**26.3**	25.7	23.0	21.0
Germany	**24.9**	24.9	24.9	24.9	24.9	**24.7**	24.7	24.7	24.7	**26.1**	26.1	26.1	31.0	29.0
Greece													37.0	35.0
Spain							**30.3**	30.3	30.3	30.3	30.3	30.3	34.0	35.0
France	**29.8**	29.8	29.8	29.8	29.8	**28.7**	28.7	28.7	28.7	**28.8**	28.8	28.8	29.0	30.0
Ireland				**32.8**	32.8	32.8	32.8	32.8	32.8	32.8	32.8	32.8	33.0	33.0
Italy			**30.6**	30.6	30.6	30.6	30.6	**28.9**	28.9	28.9	**34.2**	34.2	33.0	32.0
Luxembourg		**23.7**	23.7	23.7	23.7	23.7	23.7	**24.0**	24.0	**23.5**	23.5	23.5		
Netherlands				**25.6**	25.6	25.6	25.6	**26.6**	26.6	**25.3**	25.3	25.3	27.0	28.0
Austria				**22.7**	22.7	22.7	22.7	22.7	22.7	22.7	**27.7**	27.7		25.0
Portugal													39.0	38.0
Finland				**20.9**	20.9	20.9	20.9	**21.0**	21.0	21.0	**22.6**	22.6		23.0
Sweden				**21.8**	21.8	21.8	21.8	21.8	**22.9**	22.9	**22.1**	22.1		23.0
UK			**30.3**	30.3	30.3	30.3	30.3	**33.6**	33.6	33.6	**34.4**	34.4	32.0	34.0
EU-Average	*27.4*	*25.3*	*27.0*	*25.9*	*26.0*	*25.9*	*26.2*	*26.4*	*26.3*	*26.3*	*27.4*	*27.6*	*32.2*	*30.0*

Sources: Luxembourg Income Study (bold figures only – other figures are reproduced to obtain estimated EU averages), and EU Commission for ECHP.

Household surveys on social exclusion show that the S80/S20 ratio, indicating the relation between the income of the poorest 20% of the population to that of the richest 20%, ranges from 3.1 (Finland) and 3.2 (Denmark) to 7.2 in Portugal, with an EU average of 5.0 (Eurostat 2000). From 1994 to 1998 the EU average increased from 5 to 5.4 (Eurostat and European Commission 2002). German national data show a steady rise in inequality since 1973. Inequality has also increased in both West and East Germany since unification, although unification led to more equality within the unified Germany between 1993 and 1998 thanks to the convergence of income between East and West Germany (BMAS 2001).

Inequality would be much higher without the correcting influence of redistributive and social policies. Social expenditure as a percentage of GDP increased significantly in most countries between 1960 and 1980, and even between 1980 and 2000, due to aging populations and higher unemployment, it continued to rise, especially in the poorer Southern European countries – including Italy – as well as in France and Finland. As a consequence, the EU average continued to increase as well, in spite of relatively stable or even falling shares in some countries (Germany, Austria, Netherlands) (see Table 7).

Table 7: GDP share of social benefits in Europe, 1960–99 (%)

Year	1960	1969	1979	1989	1999
Austria	7.57	11.21	15.51	14.71	15.71
Belgium	11.35	13.70	20.85	20.62	21.16
Denmark	6.17	8.68	14.96	17.81	16.92
Germany	12.83	13.53	16.95	16.19	16.70
Greece	4.91	7.68	8.57	15.49	15.54
Spain	3.65	6.38	11.70	13.94	15.09
France	12.74	14.82	18.63	21.09	23.55
Ireland	4.07	7.76	11.64	14.62	13.64
Italy	9.50	11.93	14.08	17.61	19.70
Netherlands	7.17	12.92	19.93	18.26	17.75
Portugal	2.26	2.50	7.03	8.25	12.50
Finland	5.08	7.08	9.08	14.36	19.54
Sweden	6.09	8.19	14.28	16.29	15.82
UK	6.06	8.35	10.55	10.47	13.12
EU average	*7.17*	*9.70*	*13.75*	*15.53*	*16.91*

Source: Peter A. Cornelisse and Kees P. Goudswaard, "On the convergence of social protection systems in the European Union", *International Social Security Review*, **55**, No. 3 (2002), p. 10.

Since 1980, in the context of tighter fiscal policies and increasing demands, most governments have wanted to reduce social spending and/or improve its effectiveness. Some – such as Austria, Germany, the Netherlands, Sweden and the UK – succeeded partially and temporarily.

During the 1980s and 1990s, conservative governments in Britain, the United States, and the other Anglo democracies have reduced the generosity of benefits, tightened program eligibility, implemented cost controls on service delivery, and encouraged privatisation of some social insurance and many social services. Neoliberal policy changes have not been confined to these right-of-center governments; Swedish, German, and other Western European governments of all ideological complexions have on occasion reduced pension and other social insurance benefits, limited benefit indexation, and restricted eligibility for unemployment compensation and social assistance. They have also imposed budget caps, user co-payments, and other cost-control measures for health and social services. Moreover, these efforts to restrain the welfare state have occurred at a time of rising need for social protection. (Swank 2002: 1–2)

A look at replacement rates (see Table 8) confirms the retrenchment efforts in Belgium, Germany, the Netherlands, the UK and Sweden, while at the same time reflecting the continuous rise of social protection in the "less developed" welfare states, such as Greece, Italy, Portugal, and Spain, or specific reform approaches, as in Denmark, that have increased replacement rates substantially while reducing job protection, so making labour markets more flexible.

Table 8: Replacement rates of unemployment benefits in Europe*

Year	1979	1989	1997
Austria	29.3	29.3	31.0
Belgium	46.3	42.1	39.8
Denmark	49.8	51.5	66.4
Germany	29.9	27.6	27.1
Greece	6.7	9.2	22.3
Spain	21.4	33.8	31.7
France	24.0	36.9	36.5
Ireland	28.1	26.9	30.0
Italy	1.0	2.7	18.3
Netherlands	47.5	53.2	46.9
Portugal	7.4	31.7	33.4
Finland	26.5	33.9	35.5
Sweden	25.1	28.9	27.6
UK	23.8	17.6	18.8
EU average	*26.2*	*30.4*	*33.2*

* The replacement rate refers to "benefits before tax as a percentage of previous earnings before tax as defined by the legislated entitlements averaged across the circumstances in which the unemployed person may find himself".

Source: Peter A. Cornelisse and Kees P. Goudswaard, "On the convergence of social protection systems in the European Union", *International Social Security Review*, **55**, No. 3 (2002), p. 8.

Finally, the developments described above might have contributed to an increase in Euroscepticism (see Table 9) since the late 1980s as European citizens started to blame "Brussels" for all major ills, in part because their national politicians were doing the same thing. It is not clear whether the decline in support for the EU is a result of the social "crisis", namely rising unemployment, welfare state retrenchment, and so on. However, it has coincided with the economic recession linked to the fiscal consolidation required by the Maastricht treaty (see Pochet 2002).

Table 9: Support for EU membership

Member states	**1983**	**1990**	**1996**	**2000**
EU membership "a good thing"	54	72	47	50
EU membership benefits my country	52	59	44	47
Applicant countries	-	**1992**	**1997**	**2001**
Support for accession	–	82	48	65

Source: Eurobarometer.

In the applicant countries of Central and Eastern Europe liberalisation and opening up to the world market have played a major role in the overall transition to a market economy. This has been accompanied by a strong increase in unemployment, inequality and poverty, although after 1995 poverty and, in some countries, unemployment fell somewhat (Milanovic 1998). The social crisis largely continued even after the post-transition recession had ended. Of course, there has been significant diversity between the countries of the region, with fast reformers (Central Europe) usually performing better than slow reformers (Bulgaria, Romania). Disappointment with transition and integration led, among other things, to a decline in public approval of EU accession in the late 1990s, although it has recovered recently (see Table 9).

To summarise: Although there has always been much diversity between member states, the general trend has been one of high unemployment, decreasing wage shares, mostly increasing inequality and welfare state retrenchment. And those trends seem to have become more severe during the 1990s when the EU opened its economies towards the associated transition countries. But is not European integration rather than enlargement to be blamed for this dire state of social Europe?

4. THE IMPACT OF EU INTEGRATION ON THE EUROPEAN SOCIAL MODEL

European integration is a complex process that combines market liberalisation (including enlargement) with policy harmonisation. In the first aspect, it resembles "globalisation", with more limited scope (member states plus perhaps the associate members) but with a much more radical liberalisation through the Single Market, that has abolished not only tariffs and quotas, but also non-tariff barriers, fiscal and technical barriers, and similar measures, such as subsidies. In this way the EU is trying to promote freedom of movement of goods and services, workers, and capital. Moreover, monetary union has levelled the playing field even more by abolishing national currencies and exchange rates, so exposing national economies fully to external shocks. These developments have been called "negative integration" – by Fritz Scharpf and Wolfgang Streeck, among others – as they remove obstacles to the free play of markets (that is, for consumers, investors, enterprises, and so on). Regarding the second aspect – which might be called "positive integration" – it, too, constrains national policies by setting minimum standards, requiring compliance with EU rules and regulations, and subjecting national decisions to EU control, peer review, benchmarking, and/or the open method of coordination (OMC). Let us consider first the effect of market integration.

The third major cause to be considered is European integration through common policies rather than the abovementioned international flows and market processes. The EU has adopted a large body of community law, the *acquis communautaire*, which regulates the internal market, monetary union, and a wide range of other policies. Starting from our assumption that domestic institutions and policies rather than international competition determine social outcomes, the impact of integration on these institutions and policies could be of major importance. National economic and social policy-making is substantially constrained by EU membership. Although the EU certainly does not intend to aggravate the social situation in the member states, its structures and policies might well have that effect, at least indirectly.

- *Single market:* many effects discussed above regarding international economic interaction are exacerbated by the Single Market. The Single Market lowers or eliminates the barriers to trade, capital and labour movements and thus intensifies the competition between locations. However, the EU regulations covering the Single Market prohibit seeking particular types of competitive advantage through lower social protection (for example, regarding health and safety at the workplace), lower environmental standards, or poorer product quality.
- *Monetary union:* the common currency prevents the kind of exchange rate manipulation previously used to correct inflation and productivity differentials between member states. A loss of competitiveness cannot now be corrected by devaluation (thus protecting jobs) either, nor can the income level of successful, but poorer countries converge with the rich countries through the appreciation of their currency. Exchange rate changes distribute adjustment costs in a different way from protectionism through tariffs, subsidies or direct income adjust-

ments. They affect other people and allow for some postponement of real adjustment even when, in the end, there is no escape from its painful effects (see Podkaminer 2001 and Orlowsky 2001). The specific policies adopted by the EU through the Maastricht Treaty constrain the fiscal policies of the member states, too (see Genschel 2002). The Stability and Growth Pact limits public deficits and debt, and so prevents or hinders employment policies using Keynesian demand management (see Heise 2002). It may also increase the pressure for budget consolidation, leading to lower social expenditure, as for instance in Germany and France in 2002/2003. According to the statutory bias towards stability, the European Central Bank (ECB) and ECOFIN have already strongly criticised some member states, notably Ireland, because of their above average inflation rate. Such a higher rate of inflation is needed for catch-up growth to reduce income gaps within the currency area (see Dauderstädt and Witte 2001).

- *Competition policy regarding public services:* EU competition policy in general and the Lisbon strategy in particular aim at an EU-wide market for services which – at least in the long run – might include public services that are essential for social welfare. Energy, transport and telecommunications are already affected by stronger domestic and European competition, which has been causing lay-offs in these sectors. Health and education are subject to the most redistributive policies in many countries. The market orientation and privatisation of such services could put low-income users/consumers at a disadvantage (see Jacobi and Kowalski 2002).
- *Economic and social policy coordination and harmonisation:* the EEC Treaty of Rome (1957) required some coordination and cooperation regarding social policy (Art.117-122). Acknowledging the competitive effect of many national policies, the EU has introduced regulations to prevent "unfair" competition. In some cases, such regulation might lead to higher standards in previously less regulated countries; but it could also cause a "race to the bottom", albeit a bottom defined by common minimum standards. Although these standards might be lower than some current national ones, they are high (e.g. four weeks of paid holyday) in comparison to other countries that are not member states of the EU. The Amsterdam Treaty, as well as the last couple of EU summits (in particular Lisbon, but also the Luxembourg, Cardiff and Cologne processes aimed at reforming social and economic policies), strengthened the EU's role in employment and social policy. Although most competences remained national, the EU will use processes such as the "open method of coordination", "bench-marking",

the supervising of national action plans, the setting of targets, and so on, to promote best practice and reforms (see Hemerijk 2002).

Of the abovementioned processes and policies, enlargement, the Single Market, and, to some extent, Monetary Union work in the same way as the market integration dealt with in section 2. The Single Market has removed trade barriers and thus lowered transaction costs. Monetary Union has also reduced the risk of international transactions, in particular exchange rate risks. The latter might be even more important for transnational investment and production decisions than for trade. Taken together, both arrangements will accelerate the creation and deepening of transeuropean production networks whose internal supply-chains are represented as international trade.

As enlargement and Monetary Union reinforce competitive pressures in Europe, EU supranational policies and policy coordination add further pressure and constrain national reactions and adjustment options. The *Maastricht Treaty and the Stability and Growth Pact* not only level the playing field by removing exchange rate risks, but also limit the capacity of governments to deal with the consequences. But are these constraints really harmful, particularly in relation to social justice? There are at least two different views (for more details see Heise 2002 and Pochet 2002):

- The proponents of the Stability and Growth Pact hope that balanced budgets will lower interest rates and thus induce private investment that, in turn, will lead to stronger growth and employment. They do not believe in employment creation through deficit spending because households and enterprises will increase their savings (and reduce consumption and investment) in anticipation of higher taxes and/or in reaction to higher real interest rates. This conservative, neo-classical view would further expect that wage restraint (wage increases below productivity) would alleviate investment and create new jobs.
- The opponents see a bias towards stability that destroys jobs. They assume a Keynesian overhang of savings that private investment will not absorb. Wage restraint would only reduce demand further. A shift from capital-intensive to labour-intensive production can also not be taken for granted. As lower wages reduce all costs and prices, they do so for capital goods, too. Cheaper investment goods will reduce the expected cost advantage of more labour-intensive types of production.

Actual development over recent years supports the view of the opponents rather than the proponents but interpretation can obviously only be uncertain. The true indicator of success must be long-term growth in output and employment.

The national long-term success stories (Netherlands, Denmark, UK, Sweden, Austria, Ireland, Portugal) are not conclusive. Although it is striking that three of these countries did not join Euroland, others have done so and have managed to achieve low unemployment. Ireland and Portugal might be discounted as high-growth peripheral countries benefiting from special circumstances (large foreign direct investment, falling interest rates, EU funds), but Austria and the Netherlands have adopted different strategies with strong employment growth in the latter and stable employment in the former.

Competition policy will possibly affect the welfare regimes in member states more profoundly. Competition policy determines structures of relative prices in the long run. Falling prices in more competitive sectors usually imply lower incomes, or at least stronger pressure on wages and profits which push productivity growth. In the end, more contested markets might be a source of unemployment and inequality, at least in the short run (see Schwartz 2001). In the long run, higher real incomes can shift demand towards new sectors and spurn growth. Different EU countries rely to different degrees on public services in order to ensure public welfare, particularly as regards insurance, health and education. In all sectors, clients/consumers rely increasingly on complementary private services and products. Those markets are already contested across Europe, as the corresponding public services will be, too, to the extent that they are privatised and deregulated. On the supply side, this can imply poorer working conditions and lower wages; on the user side, temporal and spatial coverage can also suffer with stronger regional inequalities and lacking surge capacities to cope with larger-scale emergencies such as epidemics or terrorist attacks. These "market failures" have to be corrected by regulation which in turn increases costs and puts the providers at a competitive disadvantage. If prices increase, poor clients will no longer be able to enjoy the full range of services.

Since these welfare-related policies are so sensitive they still belong overwhelmingly in the realm of national competences. But some European competences have always been subject to the Single Market. However, the coordination methods used by the EU provide for a strong role for the social partners (Art. 139) and the member states (open method of coordination or OMC). The OMC is theoretically open to civil-society involvement within the member states when targets are determined, quantitative benchmarks defined, National Plans of Action designed, and compliance checked. Generally, the EU has strengthened its role in the field of social and labour market policy, and this EU involvement has promoted social security and the participation of social partners, in particular workers. In the eyes of critics, these measures have increased costs and reduced flexibility. Their extension to the poorer new member states of Central and Eastern Europe is intended to protect the rigid labour markets and production systems of the old EU against competition from the candidate countries (Belke and Hebler 2002). In the eyes of trade unions and other sceptics (Streeck 1995), these policies constitute too low a barrier against the dynamic of a "race to the bottom" promoted by market integration. An additional dimension is the harmonisation of social security systems in the context of the free movement of workers, which should entail transferability of social entitlements.

The most important redistributive EU policies are the Common Agricultural Policy (CAP) and cohesion policy (that is, structural, regional and cohesion funds) that together account for about 80% of the EU budget. In the end, CAP has benefited mostly the richest and biggest farmers, ensured high prices and not prevented poor quality. Cohesion policy has not been able to prevent increasing regional disparities. Less divergence between poor and rich member states, in itself more due to the effects of Monetary Union than EU regional policy, has been accompanied by stronger disparities within member states (Dauderstädt/Witte 2001).

5. DIFFERENT WELFARE STATES FACING ECONOMIC INTEGRATION

National strategies are often less conscious choices between different options than the consequences of past choices, made under different circumstances, which exert a "ratchet effect" (Huber and Stephens 2001) through specific institutional arrangements and political coalitions. Regarding social justice, employment and inequality, the most important past choices concern the type of welfare state and production regimes (see Hall and Soskice 2001; Huber and Stephens 2001). They have led to different exchange rate and monetary policy regimes, distributions of productivity gains, labour market regimes, industrial relations, mixes of public and private supply of social services, and financing models for the welfare state. Add to these differences the more basic ones of structure of trade and production.

The socio-economic outcome is the result of a complex interaction of integration processes and these national adjustment regimes. The external causes (globalisation, European integration, enlargement) create challenges that are different in the various countries because of different economic and social structures, policy legacies and power constellations. Oil price shocks affect Austria quite differently from oil-producing UK or nuclear France. The challenge of low-wage competition affects the countries with substantial tradable sectors if they are not exclusively focused on high-tech, high-price segments. Disinflationary policies are harder to swallow in countries like Greece or Italy than in traditionally hard-currency, tight-money countries such as Germany and Austria. Some problems are exacerbated by domestic developments as in the case of German unification which upset traditional West German policies completely.

Regarding social justice and inclusion, the most important structural differences between EU member states are their different welfare states. Following Esping-Andersen and others (Esping-Andersen 1990; Merkel 2001; Scharpf and Schmidt 2000), one usually differentiates between three types of welfare state: the Scandinavian or universalistic, the continental, and the Anglo-Saxon or marginal. They have different traditions of coverage, entitlement, funding and organisation. In the Scandinavian system, all citizens are entitled to coverage, social protection is financed by taxation, social services are run by the state and the participation of women in the labour market is high. In the continental system, benefits are linked to employment and families, and financed by contributions based on wages. The Anglo-Saxon system provides protection only for the poor and expects the rest to look after themselves by using market-oriented services. These systems have been variously affected by the challenges of globalisation and integration (see Scharpf and Schmidt 2000).

- *Employment and labour market policy:* hardly any member state was able to break the decline in employment in the exposed tradable sector, although the rates of decline varied – with the Netherlands and Denmark in relatively favourable positions (see Hoffmann and Walwei 2002; Walwei and Werner 2002). The Netherlands managed to reduce unemployment to a large extent by keeping wage rises under control (Wassenaar agreement) and by expanding part-time work. In common with Germany and France, it also resorted to early retirement in order to reduce the labour supply. France additionally reduced the working week to 35 hours. High employment in public services helped to keep unemployment relatively low in Sweden and Denmark. Making labour markets flexible fostered the creation of new jobs in the service sector, particularly in the UK. Unemployment benefits are tied to readiness to enter additional training schemes and/or accept jobs which are less well paid or located further away. There are trade-offs between income and employment and between employment and social protection. Getting people out of the labour market by means of generous social policies makes it possible for the remaining active workers to demand high wages. High wages require high productivity but the number of such jobs might be low. Inversely, efforts to get more people from welfare to work might entail slower productivity growth.

- *Social policy:* Most countries tightened eligibility criteria and reduced benefit levels for welfare payments. By doing this, they intended also to increase the gap between low wages and welfare benefits and create stronger incentives to accept low-paid jobs. Germany subsidised the pension system in order to limit social security contributions and thus non-wage labour costs. Pension reforms started to tighten rules on eligibility for disability pensions, as well as on early retirement. The retirement age for women has been increased with a view to equalisation with the male retirement age. Germany introduced a second pillar of state-subsidised capital-funded insurance. Most countries introduced measures to control health expenditure.
- *Tax and fiscal policy:* Tax systems still vary substantially in Europe. Total tax revenue (as a percentage of GDP) has remained relatively stable although total state expenditure declined from 51.4% in 1995 to 45.8% in 2000. This reflects lower budget deficits in preparation for Monetary Union. Some countries introduced energy taxes, for example, Germany. Top rates on personal income and statutory corporate tax rates were lowered in many countries. The tax systems of Central and Eastern Europe add still more diversity, although the composition of their revenue sources is already relatively similar to that of the EU (see Table 10).

Table 10: Structure of state revenues, 2000 (% of GDP)

Country (EU-15)	Current revenues	Indirect taxes	Direct taxes	Social security contri-butions	Other current revenue
Belgium	49.0	13.0	17.5	15.9	2.7
Denmark	56.2	**17.3**	**29.6**	**3.5**	**5.8**
Germany	45.8	12.3	12.0	18.5	3.0
Greece	41.1	14.8	**8.7**	13.8	4.1
Spain	38.8	**11.9**	10.3	13.1	3.5
France	48.9	15.5	11.9	**18.4**	3.7
Ireland	**34.7**	13.9	13.3	5.7	2.5
Italy	45.4	15.3	14.6	12.6	3.2
Luxemburg	45.3	13.3	16.4	11.5	4.9
Netherlands	43.4	12.2	11.8	16.9	4.7
Austria	47.6	15.4	12.7	16.9	3.4
Portugal	44.3	16.0	10.8	12.6	4.5
Finland	50.9	14.0	18.8	13.0	5.7
Sweden	**57.5**	14.8	21.3	16.6	5.6
Great Britain	39.2	13.7	16.2	7.5	2.0
EU-15	**44.6**	**13.8**	**13.8**	**14.4**	**3.3**
Country (Central and Eastern Europe)	**Total current revenue and grants**	**Indirect taxes and customs duties**	**Taxes on income, profits and capital gains**	**Social security con-tributions**	**Non-tax revenue**
Bulgaria	42.1	13.8	6.9	11.2	**8.2**
Czech Republic	39.4	12.6	8.9	**14.7**	2.5
Estonia	35.4	13.0	8.7	9.9	3.3
Hungary	**45.0**	15.7	**9.4**	12.8	5.6
Latvia	35.0	11.9	7.7	10.7	3.0
Lithuania*	**31.5**	12.5	9.3	**6.8**	**1.7**
Poland*	40.3	13.2	7.9	11.3	6.5
Romania	31.4	**11.4**	**5.9**	10.9	1.9
Slovakia	36.2	13.0	7.6	11.2	3.7
Slovenia	42.5	**15.9**	7.7	13.7	2.4
CEE-10	**37.9**	**13.3**	**8,0**	**11.3**	**3.9**

* 1999; bold figures indicate max and min values in each column.

Source: EU: Eurostat; CEE: UN-ECE, *Economic Survey of Europe*, No. 1 (2002), p. 61.

In the end, the various member states weathered the challenges of the 1990s, but with very different outcomes. Even an apparent failure with regard to unemployment, such as Germany, looks quite different if one focuses on equality, which is quite high in Germany thanks to low wage differentials. In the 1990s, low unemployment seemed to be more difficult to achieve without sacrificing equality, although redistributive measures such as earned income tax credits, negative income tax, lower rates of social security contributions or wage subsidies can improve the lot of the "working poor". Politically, however, the search for scapegoats is now on. Governments unable to implement reforms tend to blame globalisation, global recession or Brussels for negative developments. While there is always at least an element of truth in this, the "whole truth" must include national public policies, not to mention societal attitudes, preferences and blocking tactics.

Very often, the real and basic distributional conflicts are quite simple. Higher social or environmental standards, earlier or easier retirement, generous leave rules and other "social goodies" reduce real national income by reducing either productivity or total labour input. These losses can be compensated by productivity growth due to the same processes (for example, firing or retiring the least productive workers) or other factors. But, all things being equal, somebody has to accept the loss. These losses can be allocated through inflationary processes, devaluation, public distribution of subsidies and taxes or direct nominal income changes. European integration prevents some of these types of adjustment. Within Euroland, inflation, devaluation and subsidies to producers are no longer an option. The remaining adjustment mechanisms are direct changes in nominal income, usually mitigated by redistributive policies (progressive tax regimes and social transfers).

6. PROSPECTS: A TRIPLE TRANSFORMATION OF THE EUROPEAN SOCIAL MODEL

The currency union in combination with the Single Market has created a "level playing field" within Europe that will be extended to Central and Eastern Europe. But on this level playing field very different national players meet with different levels of income, endowments, preferences and strategies. With the accession of post-communist countries, these differences will substantially increase. Their per-capita income is lower, their social aspirations have been formed by decades of imposed egalitarianism (Delhey 2001), and their social and tax systems have only recently been reformed to cope with the new market economy, transition and integration. The resulting competition can be healthy for the purpose of improving national solutions and finding innovative responses to common challenges. But it could also turn out to be political dynamite when important social groups perceive that their interests are being endangered by European policies or rules. The rise of right-wing populism in some elections in Europe (Austria, the Netherlands, Denmark), with its attendant Euroscepticism, is one example of such a trend that is even more worrying because it has affected countries with relatively successful employment and social policies (see Ehrke 2002).

On the national level, the result of a more competitive environment and limited national sovereignty could be a convergence of economic and social policies. Up to now, convergence of social protection levels has been weak and mainly due to the expansion of social security in the poorer countries (Cornelisse and Goudswaard 2002). The traditional diversity of European welfare states may no longer be viable. The continental system could be forced to shift to tax-based social security in order to reduce labour costs. Scandinavian systems might be forced to lower the share of the state or at least to open up the system of public services to competition. Harmonising social policies would also ease the free movement of labour while at the same time discouraging migration in search of the best welfare-benefit deal. Pension systems will increasingly be integrated in euro capital markets. Obviously, such adjustments will be strongly rejected by national constituencies which fear (possibly with justification) income or entitlement losses. The political economy of social policy reform in welfare democracies makes radical changes very difficult, although they might be easier in some politico-institutional environments (for example, Westminster-style systems) than in others.

Given the fact that social justice is a highly contentious concept, particularly in an international context where winners and losers in the same game might be distributed across different nations – at least in appearance – politics play a decisive role. The current constitutional debate (Convention) in the EU is to a large extent concerned with the power and legitimacy of the institutions, procedures and decisions that affect the distribution of wealth, income and life chances within the enlarged union. The new members of Central and Eastern Europe will add a new dimension to the already complicated mix of welfare and production regimes in the EU. As already mentioned, they are at the same time more egalitarian in their aspirations (Delhey 1999) and economically and administratively less able to fulfil the expectations of their people. Hopes and fears in the applicant countries regarding the impact of EU membership on welfare and distribution are running high.

The EU is trying to ensure the compliance of the applicant countries by using involvement (political dialogue, participation in the Convention) and aid to build capacities (PHARE and other programmes), as well as monitoring (screening) and sanctions (aid cuts, delayed accession).

In the end, politics will be decisive. There will not only be real winners and losers, but also those who consider themselves as belonging to one group or the other. Parties, media, and societal organisations shape those perceptions and organise the respective interests. The structure of political systems (electoral law, division of powers, centralism, and so on) will then determine which interests eventually shape political decisions and the design and outcome of policies. As past policies have already created powerful vested interests within the different types of welfare state, it is not probable that a common model will emerge through convergence (see Ebbinghaus 1999; Swank 2002). Continued and increasing diversity requires flexible institutions and procedures of integration in order to avoid widespread discontent and the revival of nationalism.

The ESM will face a triple transformation: The first transformation is already well under way. It is the "Self-Transformation of the European Social Model(s)" as Anton Hemerijck (2002) calls it. It is a reaction to deindustrialisation, ageing and changing gender roles. The second transformation has already been provoked by the challenges of European integration, in particular Monetary Union. It is co-ordinated on the European level, mostly though the open method of coordination that allows a substantial degree of national diversity. The third transformation is the one brought about by enlargement. It will reinforce the first two transformations by increasing, though but slightly, the pressures driving them. More important, it will extend the ESM to the East where it will be adapted to the specific problems and political preferences of transition economies and societies. Enlargement should also cause some serious evaluation and redesign of the redistributive policies on the European level such as agricultural and cohesion policy. To give an answer to our original question: Enlargement will be the extension rather than the end of the ESM, but of a transformed ESM.

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