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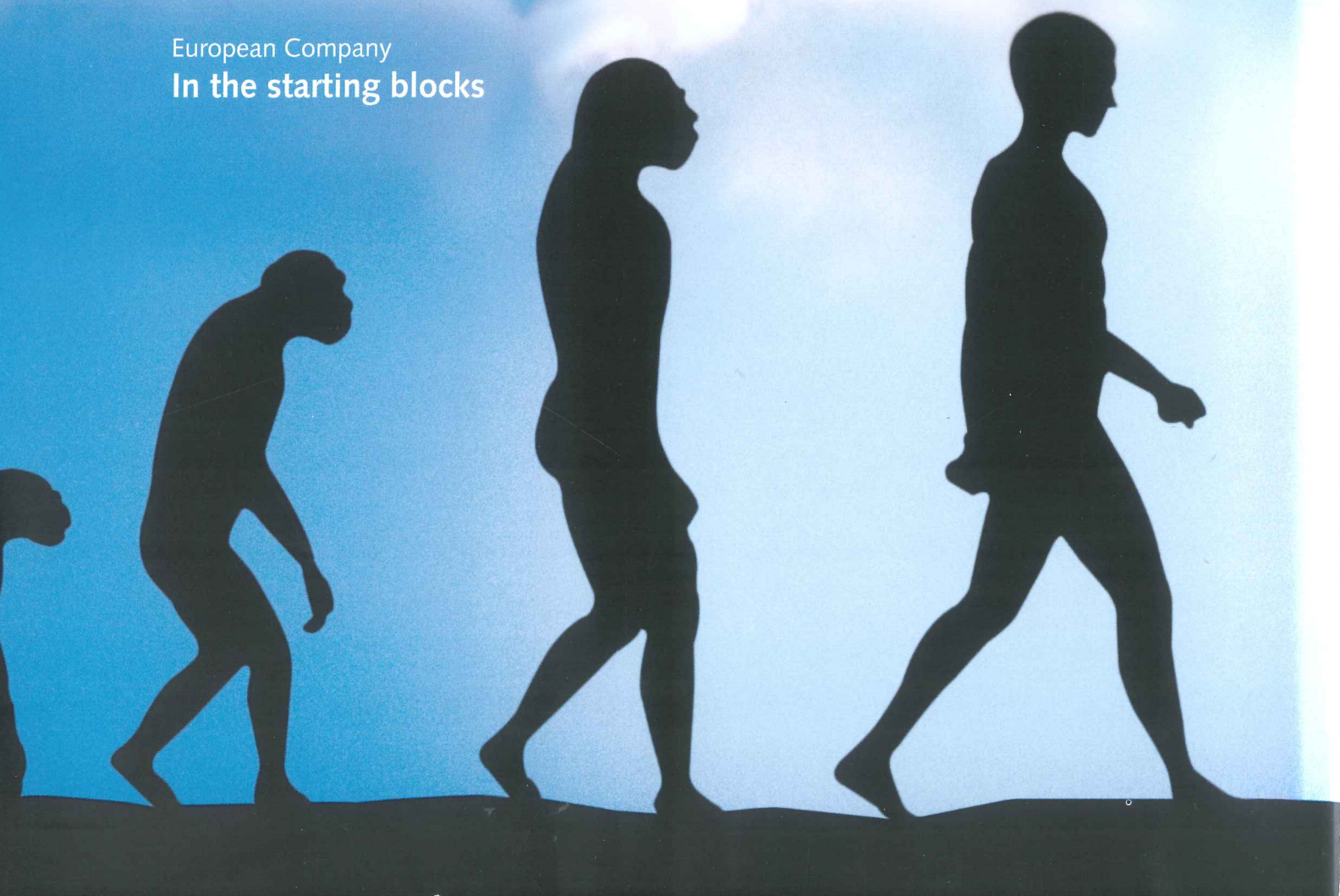
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Towards a civil economy

Participation proves its purpose

European Works Councils
Ten years of growth

European Company
In the starting blocks





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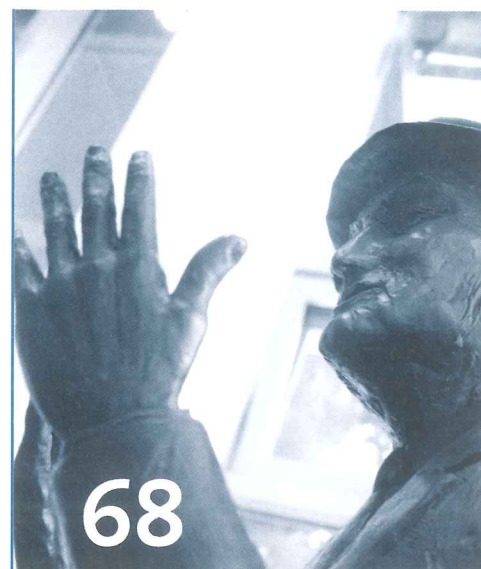
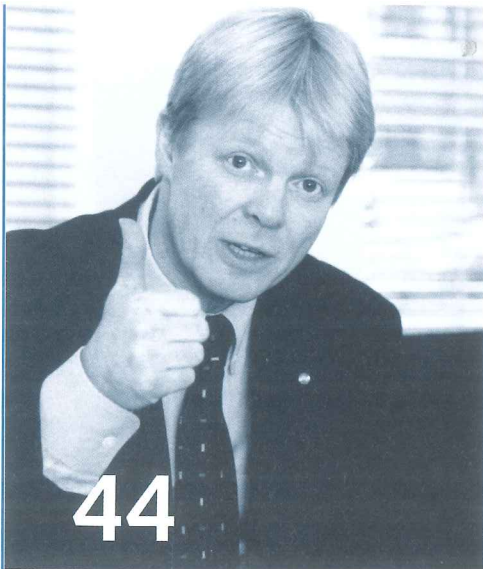
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The Europe of 25

Any prospect of welfare for all?

In the European Union it is still the member states and their national economic and social policies that decide how income is distributed between different groups in society. But the EU is having an increasing impact as it widens and deepens. Is this a good sign for the future of the 'European Social Model'?

By **Michael Dauderstädt**

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■ Increasing the EU's authority within the member states, also described as **deepening**, has recently added monetary policy and the control of fiscal policies to the areas under the jurisdiction of the EU. These powers complement the traditional core of the European integration project, the Internal Market, with its framework of regulations, and a range of common policies, covering agriculture, the structural funds, trade and competition. **Widening**, or enlargement, has increased the diversity of economic structures, in particular income levels and welfare systems, within the EU that are competing on an increasingly level playing field.

The uneven impact of enlargement

For the old EU with 15 members, enlargement, in particular the economic integration since 1990, has reinforced trends that are often referred to under the heading of globalisation. The abolition of barriers to trade and investment, the reduction of communication and transport costs, and industrialisation strategies of poor countries have destroyed millions of jobs in agriculture and

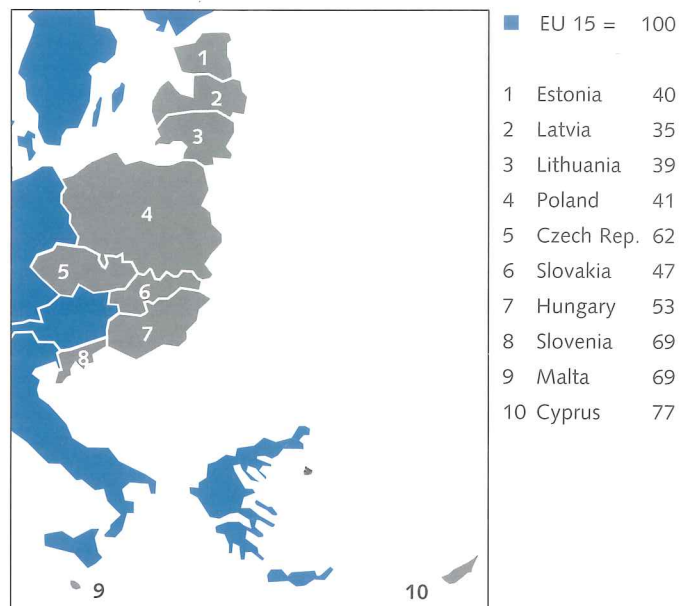
manufacturing in the developed world, mostly in the USA, but also in Europe. The losses have been concentrated in industries using lots of unskilled labour, for example the textile, clothing and leather industry, and those targeted by developing countries' industrial policies such as cars and electronics. But they have occurred in all industries because of lack of demand by the poor countries following the debt crisis. These losses have been offset by new jobs, mostly in services particularly in the USA, less so in Europe.¹ Europe's worse performance is probably due to the fact that it has less of a gap between the highest and lowest paid, and, more importantly, because it has had a less expansionist macro-economic policy that fails to translate higher productivity into increased output. This indicates that better macro-economic management to ensure growth at home and to prevent debt crises in partner countries (as in the Czech Republic and Hungary in the mid-1990s) is a key policy in achieving prosperity for all.

However, the new member states and enlargement continue to play a minor role in this drama. Central and Eastern Europe accounts for less than ten per cent of all EU foreign direct investment and less than five per cent of

Rich Europe - poor Europe

The ten new members

GDP per head, adjusted by purchasing power 2002



Source: Eurostat; DGB einblick

its trade, export or import. There is little evidence that the high level of unemployment in some member states (notably Germany, France, Italy, Spain) is due to foreign competition although employers and liberal politicians try to use that fear or threat to push for lower wages, and/or longer working time. Other causes such as technological change, restrictive macro-economic policies and the unintended side effects of a generous welfare state are probably more important. That is even more the case for the so-called 'crisis of the welfare state'. Apart from the rise of unemployment, it is demographic change and an increasing supply of and demand for ever more sophisticated health services that make the welfare state more expensive and therefore more difficult to pay for.

The impact on the new member states

The new member states of Central and Eastern Europe have experienced a massive transition since 1990. In economic terms, that transition has produced some growth, neither spectacular nor steady, and a general increase in unemployment, poverty and inequality. Restructuring former state-owned enterprises and foreign direct investment have led to a substantial rise in productivity which has mostly been achieved by cutting jobs but has not resulted in significantly higher wages. Production, employment, and trade of the new member states depend overwhelmingly on investors from and trading partners in the EU.

The welfare states of the new members have also been transformed. Unemployment insurance has had to be introduced and pension systems that had been based on low monetary benefits with a high real value (thanks to fixed low prices for all basic goods and services under socialism) have had to be reformed. Generally, their welfare states are relatively developed given the low level of

income, therefore sometimes called 'pre-mature welfare states' with social spending as a percentage of national income not far below the EU average. At the same time, many transition countries, such as Slovakia, have reformed their tax systems and often substantially lowered their tax rates. It remains to be seen if they can reduce the resulting budget deficits as they are required to do under the Maastricht criteria which apply fully to them.

With the accession, all EU regulations on social standards (in particular the European Charter on Fundamental Social Rights), on social dialogue, workers' rights, health and safety regulation and industrial relations have to be applied and implemented in the new member states. The new members are also subject to the EU competition policy, which will limit their ability to subsidise companies, in particular foreign direct investment for example through lower taxes. They also have to participate in the – relatively weak – EU co-ordination mechanisms on employment and social inclusion.²

Some fear that the adoption of these west-European standards will undermine the competitiveness of the transition economies and lead foreign investors in particular →

Deepening

The decisions on Economic and Monetary Union were taken in the treaties of Maastricht (1991), Amsterdam (1997) and Nice (2000), which also prepared the way for the EU constitution agreed in Brussels in June 2004.

Widening

On 1 May 2004 ten new states joined the EU. They were Poland, the Czech Republic, Slovakia, Hungary, Estonia, Latvia, Lithuania and Slovenia from central and eastern Europe as well as Malta and Cyprus. On joining they accepted all of the EU's existing regulations, the so-called *acquis communautaire*, which run to around 60,000 pages.

→ to shift production to less regulated economies like the Ukraine – with even lower wages. However, the competitive situation will not change dramatically. Wages in the new member states will increase as the general price level approaches the current EU level, although very slowly. But new advantages will appear: access to substantial EU funds (up to 4 per cent of gross domestic product (GDP), still lower risks for investors and traders, and easier migration, at least after a transitional period. However, EU membership in itself has rarely led to strong growth, let alone to catching up with the older richer member states. Ireland and Greece remained poor or even became relatively poorer after accession in 1972 and 1981 respectively. Ireland experienced an economic miracle but it only started in the mid-1990s and it involved an increasing share of GDP going to foreign investors. The share of GDP taken by wages in Ireland fell to the unusually low level of 58 per cent (compared to an EU average of about 78 per cent, although this percentage is also falling). One result is that the income of the Irish citizens, its gross national product (GNP), is about 20 per cent below the output of its economy (GDP). Ireland's success thus remains above all the success of the tax-avoiding foreign investors at the expense of Ireland's employees and taxpayers in Ireland and elsewhere³. New members will have difficulties in following the Irish model, but Hungary and Slovakia are keen to try.

Levelling the playing field

The core of the European integration is 'negative integration' through policies to create a market, dismantling barriers to trade and the movement of capital and labour. In comparison, its policies to correct the impact of the market are weak.⁴ As a supra-national entity the European Union has very limited powers to redistribute income compared with true federal governments like the German or the US government. Its budget amounts to approximately 1.2 per cent of the European GNP. This is mainly used to protect European farmers through the Common

Agricultural Policy (about 40-50 per cent of the EU budget) and, not very successfully, to improve the productivity of the poorer regions through the Regional and Cohesion Funds (about 30-40 per cent of the budget).

The EU has been far more successful in levelling the playing field through the Single Market and Economic and Monetary Union (EMU). However, member states have always been concerned to protect the competitiveness of their companies, and the production and welfare arrangements in which they operate.⁵

On the Single Market, all member states accepted a certain amount of harmonisation, often through EU-wide minimum standards, and the mutual recognition of national standards. However, the increasingly aggressive competition policy of the EU Commission and the judicial activism of the European Court of Justice in the same field are much more contentious, as they expose more and more sectors and entities to Europe-wide competition. Among these are some sectors, such as energy, transport, communication, health, education and social services, which are or were until recently state-owned or state-controlled. Privatisation, the reduction of public support, and competitive pressures usually force the affected sectors to increase productivity and cut jobs. In some senses, the EU is repeating the transition of the planned economies by opening its public sector and parts of the economy providing social services to market forces.

EMU has been the main reason for such convergence between rich and poor countries as has occurred since about 1994. During the preparatory phase it brought lower interest rates and so boosted consumption and investment in the states at the periphery of the EU. And it continues to give these countries low real interest rates as their inflation rates are higher than the EU average, while the European Central Bank (ECB) sets the same interest rate for the whole Eurozone.⁶ But the UK, Sweden, and Denmark refused to join the EMU because their systems and the long-term competitiveness of their companies depended much more than those of the continental member states on the possibility of devaluing their currencies and running huge budget deficits during recessions.

The future of social Europe

Enlargement as such will not endanger the 'European Social Model'. Instead it will extend it to the East, although probably in a reformed way.⁷ But the continued deindustrialisation and relocation of those production processes that primarily use unskilled labour will reinforce structural trends in the European economy that lead to higher unemployment on the one hand and lower unit labour costs on the other. The second increases everyone's real incomes, but in Europe it has not been possible to convert this into new demand and new jobs.

At present Europe and the ECB are following an essentially deflationary policy. This benefits people with fixed incomes like pensioners and those receiving unemployment benefits, because their income is not eroded by inflation. These groups make up an increasing proportion of the electorate, if they are not already the majority, so there is a chance that present policies will continue. On the other hand there could be a backlash from producers. This could either be economic, in that they increase prices or cease production, or political in that they attack the policies that liberalise and 'create' markets.

The redistribution from those who pay taxes and social security contributions (mostly wage earners) to non-working citizens hardly stimulates demand. But it has contributed to a continuous rise of the shadow economy in the EU (from 14,1 per cent of the GDP in 1989/90 to 18,6 per cent in 2001/02) further undermining both the tax base and social security system. In particular, continental Europe is trapped between tight budgets (a consequence of the Stability and Growth Pact) that prevent the expansion of public employment, and policy to limit pay inequalities that prevents the growth of private jobs in the service sector.⁸

Basically, that leaves two alternatives for those who want to preserve social justice in Europe. Either, to protect their national regimes and limit the role of the EU to the management of 'policy externalities resulting from cross-border economic activity'⁹, or, to try to establish a truly European production and welfare

regime. The first will run into conflicts as more and more of these policy externalities (unintended consequences of economic decisions) concern core elements of national varieties of capitalism. The latter will have to choose between two options. The first is a tax-based universal welfare state of the Scandinavian type (hardly acceptable to the UK and difficult for continental Europe). The second is an economically liberal model that relies on the market mechanism eventually leading to a trickle-down of the benefits of integration – the productivity gains and low cost – to all strata of the society. The continental model of contribution-based insurance schemes seems to be the least viable on a European scale. ■

- 1 See André Sapir, 'An Agenda for a Growing Europe – The Sapir Report', Oxford 2004
- 2 See Daniel C. Vaughan-Whitehead, 'EU Enlargement versus Social Europe? The Uncertain Future of the European Social Model', Cheltenham/Northampton 2003
- 3 See Michael Dauderstädt und Lothar Witte (eds.), 'Cohesive Growth in the Enlarging Euroland', Friedrich Ebert Stiftung, Bonn 2001
- 4 See Fritz W. Scharpf: The European Social Model: Coping with the Challenges of Diversity. In: J.H.H. Weiler et al. (eds.), *Integration in an Expanding European Union: Assessing the Fundamentals*, Oxford/Malden 2004
- 5 See Peter A Hall and David Soskice (eds.): *Varieties of Capitalism – The Institutional Foundations of Comparative Advantage*. Oxford, 2001
- 6 See Peter Bofinger: The Stability and Growth Pact Neglects the Policy Mix between Fiscal and Monetary Policy. In: *Intereconomics Review of European Economic Policy* 1, 2003
- 7 See Michael Dauderstädt 'EU Eastern Enlargement: Extension or End of the European Social Model?' in Reiner Hoffmann et al. (eds.) 'European Integration as a Social experiment in a Globalized World' Düsseldorf (HBS) 2003
- 8 See Anton Hemmerick: The Self-Transformation of the European Social Model. In: *Internationale Politik und Gesellschaft*, 4/2002
- 9 Andrew Moravcsik: In Defence of the 'Democratic Deficit' – Reassessing Legitimacy in the European Union. In: J.H.H. Weiler et al. (eds.), *Integration in an Expanding European Union: Assessing the Fundamentals*, Oxford/Malden 2004, p.81.