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Is Social Europe Fit for Globalisation?

A study of the social impact of globalisation in the European Union

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ABSTRACT

Globalisation is one of the defining phenomena of today's economy, albeit one that is loosely defined and prone to exaggeration. For many, globalisation is an opportunity, affording scope on the supply side for increased specialisation, enhanced diffusion of technology, and a competitive spur to innovation and productivity growth. Yet for others, globalisation is perceived to be a threat to the values, institutions and policies that have underpinned post-war Europe's success and way of life, in short to *social Europe*. This study examines the social impact of globalisation for the EU economies and the policy challenges that arise. It starts by looking at the conceptual background, then provides an extensive empirical analysis of the different facets of globalisation and its social dimension, and moves on to discuss policy issues. The study's key message is that the EU as a whole will gain from globalisation, but that these gains will not be uniformly distributed across individuals, regions and countries. Nor will they accrue automatically, but will instead depend on successful adaptation and well-judged policy responses. In particular, the EU has to balance its efforts to boost competitiveness and to transform its economy by adopting and implementing policies that smooth the adjustment process and offer sufficient protection to those vulnerable to the changes and uncertainties that globalisation will bring.

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EXECUTIVE SUMMARY

Key messages

1. There can be little doubt that globalisation is having, and will continue to have, a pervasive influence on 21st century economic and societal developments. International flows of goods, services and capital have all increased substantially relative to output, especially over the last two decades. Yet, much of the increase in exposure to international competition confronting EU member states is, in fact, the result of European economic integration.
2. An important aspect of globalisation is that the world's two most populous countries – China and India – have reintegrated into the world economy after decades of comparative isolation. Together with the reintegration of former communist countries in Europe, this has meant that the supply of labour available at the global level has greatly expanded, as has the number of global consumers and hence the size and diversity of the potential market for EU exporters.
3. Globalisation has to be seen in perspective, however. As a proportion of GDP, world trade reached a peak before the start of the First World War and it is only in the last decades that it has returned to these levels. As a proportion of the population, international migration is still less extensive than it was a hundred years ago.
4. A distinctive feature of the present wave of globalisation is the intensity of (mostly two-way) capital flows, including foreign direct investment (FDI). Although for most OECD countries FDI still accounts for a relatively small proportion of overall investment, it is a key source of capital and know-how for a number of developing countries and has been significant for some EU member states such as Ireland. Asian investment in the richer countries also deserves to be highlighted.
5. At a deeper level, globalisation can be attributed to underlying drivers of economic, political and social change. These include the long march towards market liberalisation that has characterised the period since the 1950s, the collapse of communism, demographic developments and technological change. Advances in information and communication technologies have had a very pronounced effect on the organisation of economic activity, as have the falling costs of transport, and technologies now flow across borders more readily and more rapidly. To illustrate the point, total freight costs for trade between developed countries are relatively trivial at 4% of the value of trade: two examples are that transport charges represent only 2% of the cost of a television shipped from Asia to Europe and 1.2% of the cost of a kilo of coffee. Similarly, at today's prices, a three-minute telephone call between New York and London would have cost $293 in 1931, $1 in 2001, and is now just a few cents – for a hugely better connection.
6. These trends have been associated with growing prosperity in aggregate, but it is evident that there are losers as well as winners. In particular, rapid advances in technology, coupled with adjustments in some global markets have exerted pressures on the returns to unskilled labour in Europe, with the falling relative wages of unskilled workers contributing to a widening of income inequalities.

Against this backdrop, there have been growing fears that the European social model, rightly seen as a defining feature of the EU and its member states, can no longer be sustained and that it will have to be reined back or even dismantled.

7. A clear conclusion of this report is, however, that these fears are largely unfounded and that there is no compelling evidence that globalisation is leading inexorably to a 'race to the bottom' in social policy or in the capacity of European society to maintain its commitments to solidarity and equality.
8. The contemporary economic environment nevertheless calls for more rapid adaptation to shifting economic currents and fresh thinking about the role of social policy in meeting the challenges of adjustment to new sources of competition – whether owing to technological change or to the different manifestations of globalisation. Social policy has several roles to play in responding to this challenge, notably in facilitating adjustment in labour markets. Education is at the heart of adaptation, but solidarity cannot be neglected.
9. Some of the directions for policy development, such as placing greater weight on flexibility in labour markets and making social protection systems more responsive, are already receiving considerable attention. Others, such as dealing with the consequences of an ageing population are recognised as key issues, but there is less evidence of coherence in policy responses. How to accommodate increased immigration has been less prominent on the policy agenda and has not always been viewed as the most urgent issue in many member states, although it is rapidly becoming so. Consequently, the development of new policy ideas can benefit from the exchange of experience and learning from those member states that have led the way in policy development and innovation.
10. We argue, furthermore, that within the debate on 'flexicurity', it is especially important to look beyond the labour market emphasis of much of the discourse to embrace those wider aspects of the concept that bear most on the economically inactive and the excluded, and not to lose sight of the solidarity function of social protection.

Definitions and overview of the study

11. This study is concerned with the social impact of globalisation in the EU context. Thus, it does not attempt to investigate the wider issues raised in work by, for example, the International Labour Organisation about the costs and benefits for richer and poorer nations and social groups, nor those for governance as raised by Joseph Stiglitz and others with respect to sharing out prosperity at the global level. Instead, the study concentrates on the implications for social policies at the EU and member state levels. The study takes as a given that globalisation has a positive overall economic effect, but also that it has distributive consequences that mean there will be losers as well as winners. It is also acknowledged that the benefits of globalisation do not necessarily accrue automatically to all member states, but need to be nurtured by appropriate policy choices.
12. Globalisation is not an easy concept to pin down, as it has many facets and encompasses a wide range of different processes associated with increased interconnectedness across national borders. A credible definition encompasses the following aspects: the growth in international flows of goods, services and capital;

an increased propensity towards international migration; the spread of technologies and of the multinational companies that play a major role in diffusing them; and the intensification of communication exemplified by the expansion of Internet use. Geographically more dispersed subcontracting, sourcing and division of labour in production processes are also associated with globalisation.

13. The study is in three main parts that draw upon the more detailed work produced by the research team responsible for the study. The first looks at the background, the facts and the figures about globalisation, with the objective of presenting a clear picture of what globalisation is and is not. In the second part, the focus is on the social dimension, including extensive documentation of EU social conditions, together with more specific work on migration (and the regulatory developments affecting it) and trends in inequality. The third part of the study then concentrates on the policy challenges, starting with a discussion of policy issues, what these imply for social policy and the social agenda in the EU, and continuing with a scenario exercise that speculates on the likely evolution of globalisation. A summary and recommendations complete the study.

Main findings on globalisation and its consequences

14. Many contributors to the literature have sought to develop and refine definitions of globalisation, in theoretical and empirical terms. Although the intensity of trade is often used as a proxy for the globalisation process, most authors dealing with the contemporary global economy argue that globalisation should be viewed as a multidimensional phenomenon. Capital and currency flows are just as important as trade in providing quantifiable indicators of globalisation. Certain structural factors, for example the rise of intra-industry trade and the growing salience of multinational enterprises, should be added to the picture.

15. The defining features of the current phase of globalisation include the fact that the global market has expanded to an unprecedented scale, along with the weakening of the traditional core–periphery effects. The volume of world trade quadrupled between 1980 and 2005, while output rose by 250%. In the past, the core provided manufactured goods to the periphery in exchange for raw materials. Today, by contrast, the emerging markets account for a large and growing share of world manufacturing capacity. Even more strikingly, the flow of capital has become bi-directional. While in the 19th century Britain exported financial capital to the periphery, the largest economy of today, the United States, runs a current account deficit substantially financed by emerging-economy nations.

16. In terms of addressing the behaviour of economies in the globalising world, traditional economic theories of trade based on comparative advantage struggle to explain actual developments in the world, particularly the rise of Asian economies, which have created rather than relied on existing, comparative advantages. China doubled its share of world trade in goods to 9% in the decade to 2005, not just by relying on cheap labour; still, the EU has maintained its share, unlike the US and Japan.

17. While globalisation is an uncontested worldwide phenomenon, the rise in the degree of openness to trade in goods and services of the EU member states has

been much less pronounced than frequently argued in the media and in public discourse. The pace of openness to trade has not shown a striking acceleration, with the exception of Germany, the Benelux countries and most of the recently acceded member states, where openness to trade in goods has increased. In the latter case, however, the increase is mainly an effect of elimination of trade barriers within the enlarged internal market.

18. Moreover, the current geographical fragmentation of production processes also has no precedent in history and in today's world countries progressively trade in tasks rather than products. It is also salient that capital markets are much more mature today than at any time during the previous expansions of trade and capital flows. Gross flows of capital are much larger than in the past and they take many more forms. In particular, the flows of FDI are much larger relative to output than at any time before.

19. During the last two decades, financial integration has been by far the most rapidly expanding field of globalisation. Both portfolio and direct investment have increased by a greater order of magnitude relative to GDP. For the 'old' EU member states, volume indicators of international financial integration show a tenfold increase in the 35 years between 1970 and 2004. The stock of external assets and liabilities for the EU as a whole as a proportion of GDP grew from 59% of GDP in 1970, to over 550% in 2004, with strong expansion after 1995. Because of more intense financial integration, the foreign influence on business has grown, including a substantial increase in control by foreign owners through majority-owned foreign affiliates. Although there has been a rise in both outward and inward FDI, there is no indication of an overall increase in foreign (non-EU) ownership of EU business.

20. There has been a considerable relocation of productive activities, in both goods and services. This has resulted in a rapid expansion in two-way trade flows between developed and developing economies. The EU has been among the winners, in particular in the field of business services, notwithstanding a substantial increase in the market share of India.

21. An analysis of the effect of the relocation of activities supports the thesis that the outsourcing of activities during the last 15 years has tended to lead to relative wage losses for unskilled workers and for branches employing a large share of unskilled workers. Yet, other studies reviewed underline sharply that rules and regulations concerning the functioning of the labour market and wage formation exert a strong impact on the degree of outsourcing. There are large disparities between countries with respect to skill levels, which have the arithmetic effect that those countries with low average levels of skills are the most vulnerable. The effects of global competition manifest themselves either in stagnating real wages or (in the case of rigidities with respect to wage formation) in rising unemployment.

22. The 'insourcing' of activities, that is, the expansion (notably of the export of business services and other high value-added service activities) in the world market for service industries have, as could be expected, mainly favoured the branches of activity relying on top-level, highly skilled human resources and has, unavoidably, contributed to the rise in the wedge between highly skilled and low-

skilled labour. At the same time, there is an offsetting trend for certain professional activities to be outsourced to countries like India, with lower cost, but well-educated workers.

23. Despite these various forms of relocation of economic activity, there is little sign that tax yields in EU countries are coming under pressure. Among the old member states (EU-15) only Finland, Ireland and the Netherlands saw a substantial shrinkage of the relative size of their total tax revenues between the periods 1991–95 and 2001–05, comparable periods in the economic cycles. These developments seem to be the results of conscious structural reforms, however, rather than directly reflecting pressures from more mobile tax bases. Most of the EU-15 member states have either maintained the relative size of their tax revenues or even managed to increase them. In addition, several countries have chosen to alter their tax structures to change incentives for business, for reasons beyond just the threat of losing their tax base.

24. Net migration into the EU has been on the increase, rising threefold between the mid-1990s and 2003 to reach some 2 million (although a sizeable share of this is regularisation of illegal immigrants, notably in Spain). The main migratory movement is still (and is likely to remain) immigration into the EU from neighbouring countries, Africa and, increasingly, South America (into Spain). The analysis undertaken within the framework of this study emphasises in particular that, judging from the increasing flow of remittances, links between the migrants and their families in the country of origin are probably more important than often assumed in the conceptual analysis. This conclusion would suggest that the share of migrants coming to work for a certain period in an EU country is increasing and that issues raised by this potential change of the pattern of migration should be studied carefully in addition to issue of social integration.

25. There is convincing evidence that income inequalities have been increasing somewhat in many countries: Gini coefficients have risen over the two decades since the mid-1980s from levels of around 20 (indicating low inequality) in Sweden and Finland to closer to 25, and have grown from already fairly high levels in Italy and Greece. That being said, there is no (or only weak) evidence that this rise in income inequalities is attributable to globalisation. In fact, recent studies and additional examination of available data suggest that the rise in income inequalities is a phenomenon intimately associated with the emergence of the 'knowledge society', which has resulted in an increase in the return on human capital. At the same time, as indicated above, the knowledge society has brought about a widening of the gap between those with a high and those with only a basic endowment of knowledge and skills. It is also noteworthy that over the same period, there was a significant fall to around 30 in the Gini coefficients for Ireland and Spain, showing that the movement is not all one way.

26. The inference to draw is that where there is rising inequality, it is attributable to either explicit political choices or inappropriate responses to the operation of more fundamental socio-economic drivers, such as, notably, the emergence of the knowledge society, increases in educational inequalities or the failure of systems of education to ensure equal opportunities to all. But this process has not followed the same pattern in all countries. In the endeavour to adapt their society and to

find new responses, certain countries have been more successful than others have in adjusting labour and product markets, and especially in actively investing in human capital, including at the lower end of the range of endowment.

27. Examination and assessment of the evidence on the development of the level and structure of social spending suggest that social policy in general has shown a high degree of resilience in the face of globalisation and the rise in inequalities. Social protection expenditure has broadly been stable as a proportion of GDP in the EU since the early 1990s at around 27-28%, contrary to the expectation that it would be squeezed in the interests of bolstering competitiveness. Indeed, its growth over the period 1992–2003 exceeded growth in GDP for the EU-15, with the implication that the European welfare state has become more, not less generous. Moreover, the evidence suggests that globalisation did not even affect the composition of social spending in OECD countries.

28. It is an open question whether an extensive social protection system should be seen as a necessary complement to a more competitive global market or an impediment to successful participation in globalisation. Both arguments are (often too glibly) advanced in crude terms that are at odds with the subtlety of the underlying logic. Some social protection systems, despite being costly in terms of outlays as a proportion of GDP, manifestly manage to strike a successful balance. Others are characterised by problems of inappropriate incentives or burgeoning costs (or both) that appear to be unsustainable.

29. Migration poses a test for the welfare state, not least because of popular perceptions that migrants take advantage of it and give little in return. There is a high risk in this context of setting in motion a vicious circle in which unskilled migration inflames public opinion, resulting in calls for unrealistic restrictions on migration, leading to more illegal and unskilled migration, further inflaming public opinion against migrants and forcing governments to adopt even stricter (and unenforceable) migration restrictions.

30. Overall, however, there is no evidence that migrants are abusing the (politically most sensitive) non-contributory parts of the welfare system, despite survey findings suggesting that 50% of EU citizens believe they do. Furthermore, migration can also contribute towards filling gaps that may emerge for demographic reasons in the capacity of EU member states to fund their social protection systems. This assertion implies that migrants are of working age and are supported sufficiently in the labour market to ensure that they have high enough employment rates. In this respect, migrants have to be seen not as competitors for jobs, undercutting indigenous workers, but as complements: the game is not zero-sum.

31. Globalisation is not – indeed by far – the only factor influencing the socio-economic and cultural fabric and it is often wrongly credited with, or blamed for, much that is happening in EU member states (and elsewhere). Longevity is increasing and the predictability of the life cycle in the sense of a stable career path is reduced for a large number of citizens. There are increasing returns on intellectual capital, that is, on investment in education and knowledge. At the same time, this emergence of the knowledge society entails an increase in

apparent income disparities and – at least in some socio-economic contexts – a change in the patterns and strength of the inclusive forces in society.

Policy issues

32. The core policy issue emanating from the different elements of globalisation is to enable the EU and individual member states to take advantage of the undoubted benefits without undue social costs that might arise from 'winners' being expected to compensate 'losers'. In this regard, the default position is that globalisation is much more an opportunity for added growth than a social menace.
33. In response to the question, Is a social Europe fit for globalisation?, the answer of this report is an emphatic 'yes'. But the benefits of globalisation cannot just be assumed to happen and, with an increased pace of change, it is inevitable that there will be losers as well as winners, with marked social consequences. The European social model is not doomed and the idea that only free market approaches are consistent with sustained prosperity is clearly wrong. Indeed, the success of the smaller open economies testifies to the scope for prospering, even with extensive and generous welfare states.
34. The principal benefits of globalisation arise from the scope it affords on the supply side for increased specialisation, enhanced diffusion of technology, and a competitive spur to innovation and productivity growth. Consumers gain from lower prices and wider choice, while an often-overlooked benefit on the demand side is that emerging markets offer rapidly growing sales opportunities for European companies.
35. It has also to be repeated that globalisation is not a zero-sum game. Nevertheless, in assessing the benefits of globalisation and the social impact, three issues need to be taken into account. First, the gains are not uniformly distributed across individuals, regions and countries. Second, the costs of globalisation are more likely to be concentrated in the short run, while the benefits will take longer to materialise. Third, the gains will not accrue automatically, but will depend instead on success in undertaking adequate competitive, regulatory and social reforms.
36. Critics of globalisation identify a broad range of actual or potential threats from unfettered globalisation. These encompass distributive impacts, such as adverse consequences for specific groups in society, issues of cultural hegemony, concerns about environmental damage and geopolitical disruption (especially now from terrorism). Threats also arise to the stability of public finances and from social tensions associated with migration.
37. Yet it is also important to stress offsetting effects. First, there is a boost to real incomes from the lower prices of imports. Second, the job losses resulting from international competitive effects are small in scale compared with normal 'creative destruction' in product and labour markets. In the same vein, the pressures on social protection budgets from demographic change are much more extensive. Third, the loss of low-value jobs may be less damaging than it sounds: if offshoring means retaining only high-value jobs, it could be seen as a logical answer to a declining labour force.

38. The policy issues surrounding globalisation can be grouped under three main headings. The first is equipping the economy to compete in the globalised age. Second, there are many demands on policy-makers to smooth adjustment. Third, there are issues of governance. One school of thought is that the EU simply has to become more like the US or other parts of the world. This standpoint can be summarised as 'work harder, innovate more and expect less'. The Lisbon strategy is in many ways a response to globalisation, insofar as its primary aims are to reposition the EU in the global economy, but it is important to recall that the strategy also has as key goals creating employment and assuring social cohesion. As such, it is not about emulating the US model.
39. A central policy challenge is to achieve economic flexibility with better social protection in order to create an environment capable of making the best use of the opportunities offered by globalisation. In this context, social policy has a vital role to play, not least in endowing people with capabilities, with a premium on active policies that intervene early rather than passive, reactive policies.
40. Adjusting to globalisation implies policy developments that will, in turn, have social impacts and create uncertainties that need to be managed as social risks. Labour turnover can be expected to grow, putting a premium on the transferability and adaptability of skills, but also on suitable forms of flexibility in the workplace as well as for activating individuals. Active labour market policies are seen as part of the answer, but they are not a panacea and need to be complemented by other policies. Moreover, they are often costly and are prone to inappropriate incentives. An implication is that policy learning and experimentation are needed to find solutions that are effective, as well as attuned to conditions in the different member states.
41. There is an important time dimension to consider, because costs such as higher unemployment and increased income inequality tend to be concentrated in the short term, whereas benefits in the form of lower prices, higher productivity and income will only occur later. Similarly, many reforms will improve the benefits/costs ratio of globalisation in the long term, yet will have a short-term impact – often negative – on social cohesion, which makes them politically awkward to implement. Still, in this context it is important that whatever measures are envisaged to counter negative social repercussions, these should favour, not hamper, the adjustment to changing conditions. Nevertheless, leading commentators (such as Tony Atkinson) have stressed the vital role of social support in smoothing transitions. This stance supports the interpretation of social protection systems as productive factors.
42. It is important to recognise that in the globalised environment, migration is likely to be a permanent feature and thus migration policies have to take a long-term approach. Particular issues include whether to try to stem the increase in low-skilled migration in favour of skills tests or to impose some form of green card (as in the US) or points system to attract specific categories of immigrants.
43. In a long-term perspective, investments in human capital should be expected to deliver not only a higher rate of growth of income and output but also a higher degree of income equality and added labour market flexibility. This view is in line with, notably, the recent argumentation of Gøsta Esping-Andersen in favour of

shifting the emphasis in social and welfare policy towards giving higher priority to childcare and education of the younger generations.

44. To the extent that it is the lower skilled who are most vulnerable to the effects of globalisation, there are grounds for labour market policies aimed specifically at these groups. It has also to be recognised, however, that globalisation does not stand still. The most probable scenario for globalisation is that the main trends will broadly continue over the next 15 years. Therefore, it is reasonable to expect further increases in trade intensity, financial market integration and the spread of technology. Even if the growth of emerging markets slows, it will remain above that of the EU and of most member states, such that the share of global output of the likes of China and India will expand, an implication of which is that globalisation will – as the CIA puts it – acquire a more 'Asian' face.

45. A significant qualitative change in globalisation can nevertheless be expected, as companies rethink their value chains and seek to reduce costs by 'unbundling' tasks, rather than shifting the entire production of products. The much enhanced scope for coordination of production afforded by information and communications technology means that companies can more easily outsource or offshore segments of the production process that were kept in-house in the past. Such unbundling will make it more probable that groups of workers who have hitherto been insulated from globalisation will face new competition, but will equally give increased opportunities to the most qualified and adaptable workers in the EU.

Recommendations

46. A strong conclusion from this study is that many of the fears surrounding globalisation are greatly exaggerated and, even where justified, they tend to rest on an incomplete analysis of the process. Above all, there is no empirical support for the proposition that globalisation is leading to a race to the bottom in social policy. It follows that to view globalisation as an inexorable force is simply unwarranted. Countries can, and do, adjust and there is no great mystery about what is needed. This message has to be repeatedly articulated and 'sold' to citizens.

47. Globalisation reinforces tendencies to diminish 'local solidarity', to pit one welfare system against another and to expose the individual to a higher degree of unpredictability and risk. Yet these processes are not inevitable, especially if a coherent, EU-wide response is put in place. Much can be achieved by using the tools and methodology of the open method of coordination to enable member states to learn from one another and to improve their own policy performance, but it is also important for the social dimension of policy to be fully incorporated in wider policy processes, such as the Lisbon strategy for growth and jobs.

48. Responding to globalisation is only one rationale for 'reinventing the welfare state' and would miss a trick if it meant no more than 'compensating' those who suffer most from more intense international competition. Policy mechanisms and institutions have to be adapted to the changing economic environment, recognising that the ensuing social effects are not always directly attributable to globalisation, but result from the reactions of employment and wage formation.

49. The core of a social policy response is in the following main policy domains: education and training, immigration policy, labour market reforms and the reshaping of social protection. There is, in addition, an international governance dimension to consider, especially in the light of the EU's commitment to international obligations as part of its sustainable development strategy.
50. With regard to training and skills, these can and should be enhanced by due attention to the level of education of vulnerable target groups. It is especially important to extend adult training and learning beyond those who already have a high level of educational attainment.
51. In relation to migration, there is an evident need for new, more comprehensive policies to promote the social integration of different types of migrants into the economy and society of the host country. An active approach to the inclusion of immigrants should therefore be part of solidarity. In addition, national migration policies are bound to have externalities for other member states, so establishing common principles and approaches is a pressing matter.
52. The challenge facing welfare reform is not about defending or opposing levels of social expenditure or casting doubt on specific benefits or rules. Successful welfare states respond to new paradigms and associated risks not by cutting back, but by reconfiguring in ways consistent with values such as those espoused by the European social model. Our fond hope is that the discourse on globalisation can be altered to reflect this analysis.

PART I.

BACKGROUND, KEY CONCEPTS, FACTS AND FIGURES

1. INTRODUCTION

Globalisation evokes strong passions among its supporters and detractors alike. It is also a highly salient political issue that lies behind many of the contemporary debates about policy reform. Often, too, it is perceptions of the threat from globalisation that are to the fore, even as consumers and workers enjoy its benefits. In particular, the viability of the European social model is seen as being at risk, despite much evidence to the contrary. For example, the May 2006 Eurobarometer survey on the Future of Europe (European Commission, 2006d) shows that a growing number of European citizens perceive globalisation as a threat to employment and social conditions. Asked about the increasing globalisation of the economy, 47% of interviewees considered that globalisation was primarily a threat to employment and companies in their country, compared with only 37% who saw it as a good opportunity for firms in their country. Moreover, the latter proportion had fallen by 19 percentage points since October 2003, when 56% of Europeans had viewed globalisation as "a good opportunity". Only 11 of the (then) 25 member states in the May 2006 survey saw globalisation above all as an opportunity for national companies. Danish citizens (77%) and Swedish citizens (54%) were the most positive in their assessment of the consequences of globalisation. On the other hand, the vast majority of French citizens (72%), Greeks (also 72%) and Belgians (64%) seemed to be among the most worried about globalisation.

As a phenomenon of the late 20th and early 21st centuries, there can be little doubt that globalisation is something that resonates widely. Yet in some respects, it is hardly new: trade intensities as a proportion of national output were as high in 1910 as they are today and international migration was extensive. Nevertheless, the growth in research on different facets of globalisation has been extraordinary. Thus, a search of the library catalogue at the London School of Economics produced 1,761 'hits', up from 1,521 in the 15 months since this study had been launched, on the terms *globalisation* or *globalization* in the titles of works it holds, most of them published in the last 20 years, and other data confirm this proliferation in interest. It is also apparent that the salience of globalisation is contested and approaches to coping with it provoke heated debate.

1.1 An interpretation of globalisation

1.1.1 A multifaceted concept

The term 'globalisation' is widely – if usually glibly – used, yet remains ill defined. It is one of those slippery terms that most people understand intuitively but, like the proverbial elephant, find it hard to define or give operational content. The website that accompanies the popular text by Held & McGrew (2003) observes that

> globalization – the 'big idea' of the late twentieth century – lacks precise definition. More than this, it is in danger of becoming, if it has not already become, the cliché of our times. Nonetheless, the term globalization captures elements of a widespread perception that there is a broadening, deepening and speeding up of world-wide interconnectedness in all aspects of life, from the cultural to the

> criminal, the financial to the environmental. At issue appears to be 'a global shift'; that is, a world being moulded, by economic and technological forces, into a shared economic and political arena.

From an economic perspective, Stiglitz (2003, p. 51) gives this definition of the phenomenon:

> The idea of globalization is very simple. The decrease of communication costs, transportation costs, and artificial barriers to goods and factors of production has led to a closer integration of the economies of the world. Globalization implies mobility not only of goods and services but also of capital and knowledge – and to a lesser extent of people. Globalization entails not only the integration of markets, but also the emergence of a global civil society.

A number of facets of globalisation can be distinguished, most of which would be broadly accepted by critics and supporters alike. These include the growth in international flows of goods, services and capital; the increased propensity towards international migration; the spread of technologies and of the multinational companies that play a major role in diffusing them; and the intensification of communication exemplified by the spread of Internet use. Geographically more dispersed subcontracting, sourcing and division of labour in production processes – sometimes seen in more negative terms in the French expression *delocalisation* – are also associated with globalisation. For some of these variables, the relevant indicators may not have changed as much as is sometimes thought and, for variables such as trade flows, it may be that much of what is classed as globalisation is really attributable to forms of regional integration, such as the European Union or the North Atlantic Free Trade Association. Nevertheless, the rise of Chinese exports has dramatically undercut established suppliers and altered supply chains in developed and developing countries alike.

Equally, in areas such as financial markets, there has manifestly been a huge qualitative change insofar as there is instant transmission of information across the world that can trigger rapid flows. There is also a softer dimension to globalisation in the form of global values, global brands, global news and so on – as well as the inevitable backlashes against them. A corollary is that social models and policy approaches will inevitably have to be tempered by these trends. This provokes questions about whether the trends are leading towards an inevitable convergence or whether distinctive social models can be maintained.

1.1.2 Underlying drivers

Although globalisation is a phenomenon much in focus in the public debate and in research endeavours, it is not a *primary* driver of socio-economic developments. To the extent that globalisation exists as a measurable phenomenon, it is the *outcome* of the operation of, and interactions between, such basic drivers as the following:

- the expansion of trade and investment flows, arising partly from the functioning of markets and the organisational choices made by enterprises, and partly from policy choices regarding the liberalisation of trade;
- the integration of capital and money markets resulting in a vastly increased volume of such flows. The free circulation of capital outside government control has led to the transfer of the concept of power, traditionally invested in

governments, to private holders of capital. Capital flows – which were formerly directed towards banks and controlled by governments – are now held by individuals, institutions or private mutual funds and can circulate freely and instantaneously to projects that will yield the maximum profit. Electronic, computerised data transmission now gives them an unprecedented mobility on all the financial markets on the planet;

- demographic developments, notably in the EU context the substantial extent of population ageing underway, which will accelerate over the coming decades. At the same time, the youth populations of many neighbouring global regions, such as North Africa, have been expanding rapidly and these countries may struggle to provide sufficient opportunities for these populations;
- migration. A prominent phenomenon a century ago, but which has been much less in evidence in recent decades, migration is linked to the aforementioned demographic trends. Population movements, both within the EU and from the rest of the world to the EU, are increasing and posing new problems of social integration;
- innovation and R&D, and their impact on the pace of technological change as they affect not just products and processes, but also the options open to enterprises in the management of their activity;
- climate change, energy consumption and pollution; and
- the growing importance of human capital, knowledge and information.

A proper understanding of globalisation calls for an assessment of the respective impacts of these drivers. For example, a key problem facing governments today is how to attract new investment with a view to creating jobs and promoting sustained economic growth. To this end, nations vie with each other through variations in their interest rates or their rates of exchange, and through the competitiveness of their markets. The world has truly become capitalist, and the ever-increasing financial movements can reward savings and productivity, thus strengthening a country's economy. Conversely, foreign capital can abandon an economy or withdraw abruptly if an unfavourable fiscal policy drives it away.

1.2 The policy context

Globalisation poses challenges at all levels of government because of the many ways in which it alters the economic environment, the need for interventions to ensure that economies and support systems adjust and the demands on the state to adapt governance frameworks. From an economic theory standpoint, globalisation can boost growth and increase social welfare through a more efficient allocation of resources. The realisation of the implied social benefits relies on the fulfilment of several conditions, however, such as sufficient flexibility of the labour and product markets, the efficiency of the welfare state and, in the particular case of the EU, on the ability to shift the economic production frontier of the EU economies by a significant level of innovation. Yet, while benefits in the form of lower prices, higher productivity and income will only materialise in the medium term, social costs such as higher unemployment and income inequality are likely to be encountered in the short term. As stated in the Sapir

report to the European Commission, "[t]he key policy issue for Europe is how to enjoy the benefits of globalisation while continuing to mitigate its costs".[1]

The challenges of globalisation inevitably bear on the design and coordination of national labour market and social policies, as well as on the wider question of how the European social model should evolve. In this regard, the new policy framework agreed at the EU level for both economic and social policies needs to be taken into account. On one side of this framework is the partnership for growth and jobs (the relaunched Lisbon strategy), which brings together what were previously separate coordination mechanisms, the Broad Economic Policy Guidelines and the Employment Guidelines. Complementing this framework on the other side is a new approach to the 'open' coordination of social protection and social inclusion policies, agreed in 2006. Within this new 'streamlined' approach, the European Council adopted a Commission proposal, which states that

> [the] overarching objectives of the OMC [open method of coordination] for social protection and social inclusion are to promote:
>
> - social cohesion, equality between men and women and equal opportunities for all through adequate, accessible, financially sustainable, adaptable and efficient social protection systems and social inclusion policies;
> - effective and mutual interaction between the Lisbon objectives of greater economic growth, more and better jobs and greater social cohesion, and with the EU's Sustainable Development Strategy; and
> - good governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy.[2]

These aims suggest some of the contours of an EU response to globalisation. Of particular relevance in exploring the social impact of globalisation is the emphasis on the linkages between the economic and the social. These linkages are captured in the expressions 'feeding-in', meaning the reform of social protection and social inclusion policies to advance Lisbon objectives, and 'feeding-out', which refers to the effects of economic reforms in improving employment and other variables that help lead to greater social cohesion. Feeding-in can be seen as an extension of the notion of social protection as a productive factor, which underpins many recent initiatives to modernise social protection systems. In parallel, the concept of 'active inclusion', which is a central component of the EU's social inclusion strategy, can be seen as a means of enhancing the EU labour force and thus as contributing to the competitiveness that the EU requires to confront globalisation.

That there is considerable policy development underway at present is undeniable, especially around the notion of 'flexicurity'. In relation to the labour market, the European Commission's (2006e) Green Paper on Modernising Labour Law to Meet the Challenges of the 21st Century invites public debate on how labour law can

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[1] See *An Agenda for a Growing Europe: The Sapir Report*, by the High-Level Study Group organised by the President of the European Commission, and chaired by André Sapir, initially published in July 2003 (Sapir et al., 2004).

[2] See the Communication on Working Together, Working Better (European Commission, 2005d).

be rendered more flexible, so as to support the flexibility and adaptability of workers and enterprises alike. It highlights a concern about dual labour markets in which privileged 'insiders' prosper at the expense of 'outsiders'. An important issue raised is how labour law can underpin labour market transitions from one job (or status) to another, rather than protect the individual currently in a job. In this context, the paper invites ideas about how to promote lifelong learning and how to reinforce the inclusiveness of employment policies.

As part of the emerging architecture of economic and social governance in the EU, there is manifestly a strong political push towards defining a way forward for the European social model that embraces a mix of increased labour market flexibility, protection of the individual and wider social aims. Increasingly, this approach is being linked directly to the competitive challenges of globalisation and, within it, the flexicurity debate is crucial, as what the EU is trying to do is to achieve greater flexibility without unduly compromising the much-envied standards of protection that characterise the European social model. An important Communication published by the European Commission (2007b) puts forward an agreed characterisation of flexicurity, which is that it should comprise policies covering labour laws, active labour market measures, lifelong learning and social security reforms. Flexicurity covers both external flexicurity through the labour market and internal flexicurity within individual companies. As a paradigm, it has received the endorsement of the 2007 and 2008 spring European Councils.

1.3 Objectives of the study

The purpose of this study is to investigate the social impact of globalisation from a number of perspectives. The first aim is to develop an inventory of essential features and issues concerning the social impact of globalisation in the EU, to bring out differences in the social consequences for member states and to look for patterns of clustering across the enlarged Union. The assessment of the character and scale of the social impact seeks to highlight groups especially at risk of being disadvantaged by globalisation and to explore whether globalisation merely reinforces existing biases between winners and losers in Europe or whether it also creates new and different divisions. The assessment thus includes the following aspects:

- *The relocation of economic activities*. Under this heading, distributional effects and issues of inequality are considered. How polarised are the distributional outcomes? To what extent do job losses mainly occur in labour-intensive, low-skill processes located in vulnerable areas while job creation takes place in highly skilled sectors in the economic growth centres? How are life chances and living standards affected? What are the resulting patterns of social problems and social decline? Depending on whether they are among the winners or losers, what is the social impact on workers, their families and communities?
- *The relocation of people*. This aspect takes into account socio-cultural implications of global-scale immigration to and asylum-seeking in Europe, particularly
    - the extent to which political conflict and economic and social misery in faraway places have social and political repercussions in Europe;

  - the sharing of the benefits and costs of immigration among the indigenous population; problems of exploitation of migrant workers and trafficking in people;
  - the social ramifications of insufficient economic, social and cultural integration; and
  - the implications of developments towards increasingly multicultural and multi-ethnic societies for social and political cohesion.
- *Opportunities and challenges for the European social model and social protection systems in particular*. Here the focus is first on social policy as a capacity factor: for anticipating and addressing social problems (e.g. sudden mass redundancies, social inequities calling for redistribution, the social exclusion repercussions from local concentrations of long-term unemployment and insufficiently integrated immigrants, etc.) in adequate ways by articulating the synergies between the different elements of the European social model. More specifically, these are active and preventative (employment and) social policies backed by social and civil dialogue. Second, this aspect looks at social policy as a cost factor: social protection (and labour and health & safety standards) as an element in non-wage labour costs. To what extent are EU social protection standards threatened by competition from countries for which a markedly lower level of social protection/labour standards constitutes a major part of their competitive advantage – and what are the social consequences?

The study does not attempt to investigate the wider issues raised in work by, notably, the International Labour Organisation about the costs and benefits for richer and poorer nations and for social groups, nor for governance as raised by Joseph Stiglitz and others with respect to sharing out prosperity at the global level. Instead, the study concentrates on the implications for social policies at the EU and member state levels. The study takes as a given that globalisation has a positive overall economic effect, but also that it has distributive consequences that mean that there will be losers as well as winners. It explores how member states differ in their ability to contain and address the negative social impact of globalisation while seizing the opportunities to benefit. The policy mixes and governance structures that are most effective are highlighted.

Finally, the study tries to assess how the abilities to seize opportunities and absorb the social impact can be improved and considers what can be done to improve Europe's scope for anticipating and handling the dilemmas posed by globalisation in the social field.

1.4 Outline of this report

This report is in three main parts that draw upon the more detailed work produced by the research team responsible for the overall study. This first part, which looks at the phenomenon of globalisation, comprises a synthesis of findings from the extensive literature on the subject and a presentation of relevant empirical material on trade and investment flows and on outsourcing. In the second part, the focus is on the social dimension of globalisation and the way in which it is evolving. A conceptual

discussion is complemented by an extended discussion of social conditions in the EU, together with more specific work on migration (including regulatory developments in the area) and on inequality. The third part of the study then concentrates on the policy issues, drawing out the implications for the social agenda in the EU and continuing with a scenario exercise that speculates on the likely evolution of globalisation. Concluding comments and recommendations complete the study.

2. THE STUDY OF GLOBALISATION: INSIGHTS FROM THE LITERATURE

The body of literature dealing with globalisation is vast and growing exponentially. Specialised databases and studies tell us something about the changing flows of goods and finance. Yet it is the conceptual issues relating to understanding these global changes that provide the most useful background for a study dealing with the impacts of globalisation. Therefore, much of the literature reviewed here not only deals with statistical issues, but also tries to answer some wider questions, most importantly: What is globalisation? How do standard economic and political theories help us to understand it? And what are the potential social impacts of globalisation-related changes?

The term 'globalisation' has caught the attention of the media and academics alike. The sense of profound change in the organisation of the world is often initiated by casual observation. In many shops, most of the products on display have been made or grown in faraway corners of the world. The apples in the shopping trolleys come from South Africa. The shrimps on the plate in the local restaurant were swimming a few days ago in the sea somewhere off the coast of Vietnam. This sense of change is accentuated by some striking statistics. The textile and clothing industry is the most globalised segment of manufacturing. Today, three-fifths of all clothing buttons used in the world are actually produced in one region of China,[3] exemplifying the division of labour on a global scale. It is no wonder that globalisation has become such a popular term, nor that it has come to be used as shorthand for a wide range of economic challenges, seen as an opportunity for some and a threat for others.[4]

The body of literature dealing with globalisation is thus understandably vast. It comprises, first, specialised studies that statistically monitor developments in various economic activities. These indicators demonstrate that something profound is happening in the world and that it is something new. It is true that there was an earlier wave of globalisation associated with the 19th century industrial revolution that swept through Europe and extended to the US. At the end of the 19th century, the volume of

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[3] More specifically, they are produced in and around one town, Qiaotou (see "The tiger's teeth", *Guardian*, 25 May 2005).

[4] Stanley Fischer (2003, p. 2, fn. 2) describes the rise of globalisation and anti-globalisation as follows:

> During the 1970's the word 'globalisation' was never mentioned in the pages of *The New York Times*. In the 1980's the word cropped up less than once a week; in the first half of the 1990's, less than twice a week; and in the latter half of the decade, no more than three times a week. In 2000, there were 514 stories in the paper that made reference to 'globalisation'; there were 364 stories in 2001, and 393 references in 2002. Based on stories in *The New York Times,* the idea of being 'anti-globalisation' was not one that existed before about 1999. Turning from the newspaper to the Internet, 'globalisation' brings up 1.6 million links through the use of the Google search engine, and typing in 'anti-globalisation' brings up 80,000 links.

global trade relative to output was roughly the same as it is today. But today, the world is integrating in a novel way.

The Federal Reserve Board Chairman Ben Bernanke (2006) recently pointed out four defining features of the new developments. First, is the matter of their sheer volume: the global market has expanded to an unprecedented scale, with more countries than ever actively integrated in global markets. Second, is the observed weakening of the traditional core–periphery effects. In the past, the core provided manufactured goods to the periphery in exchange for raw materials. Today, however, the emerging markets account for a large and growing share of world manufacturing capacity and, as China's burgeoning demand for raw materials shows, a significant determinant of commodity prices. Even more strikingly, the flow of capital has become bi-directional. Whereas in the 19th century, Britain exported financial capital to the periphery, the largest economy of today, the US, runs a current account deficit substantially financed by emerging-economy nations. Third, the current geographical fragmentation of production processes has no precedent. Fourth, the capital markets are much more developed and sophisticated today than at any time during the past expansions of trade and capital flows. Gross flows of capital are much larger than in the past, and they take many more forms. In particular, the flows of foreign direct investment are much larger relative to output than at any time before.

Finance is arguably the area in which the world has been transformed into something very close to an idealised global market. With digitisation and the development of communication technologies, the transaction costs of moving money are practically zero. Today, a foreign-exchange dealer in a bank somewhere in Europe follows the movements of currencies in Asia just as closely as those in his or her own country, and interacts continually with counterparts across the globe. Momentous changes in the global organisation of finance and the deepening international division of labour raise questions about their societal implications.

International organisations have responded by organising large-scale research projects. The OECD came up with a programme on "Empowering People to Meet the Challenges of Globalisation". The International Labour Organisation established the World Commission on Globalisation, which gave its report in 2004. The World Bank published, for example, *Poverty in an Age of Globalisation* (2000) and more recently, *Managing the Next Wave of Globalization* (2006d).

Apart from statistical monitoring and impact studies, another layer of literature explores the characteristics of globalisation. This layer is the analytical literature that tries to categorise the phenomena entailed in the global socio-economic processes, looks for drivers of changes and interprets these social and economic processes in terms of larger frameworks of values, preferences and desirable outcomes. It is mostly this body of literature that has been reviewed as a background study for this report.

2.1 What is globalisation?

In 1962, Marshall McLuhan first brought out the term 'global' as something denoting a tectonic shift in social relations into the public domain in his book, *The Gutenberg Galaxy*. The term was more cultural in content than anything else. The concept of a 'global village' describes broadly changing patterns in human perceptions of time and space. Indeed, by now communication technologies and commercial developments

have created a certain global, common cultural code. Two people from different parts of the globe can easily discuss their favourite Hollywood movies, analyse the politics of some of those military conflicts that are heavily covered by news agencies or comment upon the contents of some globally disseminated lifestyle platform, as in the magazine *Cosmopolitan* for example.

Globalisation has progressively come to be referred to in connection with economic challenges, however. References are often negative, as when newspaper headlines describe anti-globalist protesters spoiling international gatherings or the anti-globalisation feelings that ran against the European Constitution (Giddens, 2005, p. 97). Globalisation in this sense denotes the processes of pressure on labour markets to become more flexible and wages to adjust to the rate dictated by the global market. Producers compete not just with other producers in the same country or region, but more and more with almost anyone across the globe, as new technology makes transportation much less of a cost and communication much easier.

2.1.1 Trade

The rise of globalisation is often used as shorthand for the growing prominence of trade in the global economy. In recent years, world trade integration outpaced other sources of growth (World Bank, 2006d, p. xiv). Between 1985 and 2002, trade integration more than tripled (Gunter & van der Hoeven, 2004, p. 3).

But the rise in the volume of trade is not the whole story. It is the composition of trade that tells us more about the nature of the current phase of globalisation. Analyses based on a high level of commodity disaggregation confirm that trade has risen as a consequence of the specialisation of exchanges within the same broad sectors (Gerstenberger, 1990; Storper, 1992, p. 63). Around two-thirds of trade volume today is intra-industry trade (Gunter & van der Hoeven, 2004, p. 10). This trade is largely driven by the activities of multinational enterprises (MNEs). As MNEs build global value chains, each heavily fragmented over a number of countries, global trade increasingly becomes trade in tasks, not entire products or services (Grossman & Rossi-Hansberg, 2006). Indeed, some authors point to the role of MNEs as a uniquely defining feature of globalisation (Strange, 1986). What is more, their role seems likely to grow in the future (Ostry, 1998, p. 86).

The most striking example of globalisation in manufacturing is the textiles, clothing and footwear industry. Here, Asia has plainly come to dominate the global market. It is estimated that Asian mills account for two-thirds of the world's spinning and weaving capacity (Asian Development Bank, 2006). At the same time, trade and production patterns are decisively shaped by distribution companies, which are based in Europe, North America and Japan (Hayashi, 2005).

Outsourcing is clearly one of the drivers of changing patterns of trade. The European Commission recently published a report on outsourcing (Havik & McMorrow, 2006), which showed that EU countries fare well in trade in intermediate goods, producing significant surpluses. Where the EU lags is in trade in information and communications technologies (ICT). Here, the report called the performance "exceptionally poor". Yet concerns arise over whether Europe's relatively good performance in intermediate outputs is simply owing to the fact that the capital stock in traditional industries is high, a product of long historical development. The risk is

that as other countries build up their capital stock – which is growing ever easier – Europe will lose its competitive edge. Another concern is that Europe is becoming more exposed to external price shocks as other countries come to play an important role on the margins of some markets, especially with respect to raw materials.

The rise of China has become a substantial new factor behind the globalisation story. In 2003, China's economy accounted for 55% of Asia's exports. As a percentage of the world economy, China accounted for 7.2% of imports and 16.5% of exports (Reisen, Grandes & Pinaud, 2005, p. 17) and its share keeps on rising. The country is progressively a price-setter in commodity markets (ibid., p. 19). China is the second largest holder of US Treasury bills in the world ($165 billion, 6.5% of total foreign holdings), which makes the cheap labour giant an extremely important player in US and world financial stability (ibid., p. 20).

2.1.2 *Finance*

Some authors focus on financial markets as the key feature of the new economic order (Jessop, 2002, pp. 106–07) and indeed, the rise of various instruments of financial intermediation (if this can still be called 'intermediation') tells an even more dramatic story than the one presented by trade figures. "Between 1963 and 1995, the size of the total funds raised on international markets increased at an annual growth rate of 24.3% compared with 5.5% annual growth rate in world trade and 3.2% growth in global production" (Jessop, 2002, p. 106). These funds are seen, with growing frequency, as 'stateless money', which has a dynamic at odds with the immediate post-war financial regime (Leyshon & Tickell, 1994). Approximately $1.5 trillion is exchanged daily on foreign exchange markets and only 5% of this amount is directly related to payments for traded goods or services (Jessop, 2002, p. 106). The deterritorialisation of money is being reinforced by the development of various derivative instruments.

The Asian crisis of 1997 and the Russian crisis of 1998, as well as the spectacular rise (and sometimes fall) of new financial actors (hedge funds), remind us of a peculiar dynamic of world financial architecture, whereby contagion can spread at a rapid pace from one part of the world to another. Indeed, the nature of such crises is noted by some as a particular characteristic of the present phase of globalisation. Some authors highlight the growing incidence of crises and their pattern – ever more frequently originating in the emerging markets (Pauly, 2005, pp. 183–84).

2.1.3 *Post-industrial economy*

Dealing with new structures of risks would not be complete without taking into consideration the whole conceptual framework that overlaps the theme of globalisation, namely the shift from an industrial to a post-industrial mode of economic growth. In short, an industrial economy is one centred on large-scale manufacturing operations, based on assembly-line or semi-assembly-line work processes. These concentrate a 'massified' workforce, often employed in lifetime jobs, and derive their profit advantage from economies of scale.

As economies become more developed, the technical content of products becomes more easily variable, while growing disposable incomes allow people to make more and more lifestyle choices. 'Flexibility' becomes the key word. On the one hand, products can be quickly modified and innovations can be introduced as production

and the dissemination of knowledge pick up pace with computer and communications technologies. On the other hand, technical and marketing variations also become easier as the market for manufacturing products becomes more global owing to decreases in transportation costs. The ratio of costs based on heavy hardware decreases – again as a result of the emergence of a global competitive market and the widespread standardisation of basic technologies. At the same time, the returns to quick adaptation and innovation increase. 'Economies of scope' and 'economies of networks' become the main sources of profit advantage in the post-industrial component of modern economies. All the while, the service sector grows bigger, generating new tensions and tough policy choices arising from the changes in relative costs in the service and manufacturing sectors (the 'Baumol' or 'cost-disease' effect). Yet it also has to be recognised that the boundary between certain forms of manufacturing and services is becoming more blurred and that for some services the scope for rapid productivity increases is considerable.

2.1.4 Summary of the meaning of globalisation

Thus, globalisation is a multifaceted concept. At the basic level, it refers to changing volumes of trade and investment flows. At the next level of analysis, it refers to a changing quality of these flows. Trade is progressively more intra-firm trade as well as trade in intermediate goods. It is driven by the expansion of MNEs, which have become the typical actor in globalisation processes.

The term 'globalisation' implies new developmental processes emanating from post-industrial organisation, which may then clash in their inherent logic. Bob Jessop speaks of the conflict between the concept of knowledge as intellectual commons and knowledge as intellectual property, and more broadly of the conflict between implications prioritising the information economy and those stressing the need for an information society (Jessop, 2002, p. 110). These conflicts are in line with contradictions sketched out already by Bell (1973) between the economising and sociologising logics of the post-industrial society.

The various dimensions of globalisation can be described as follows (Jessop, 2002, p. 115):

1) the internationalisation of national economic spaces through growing penetration (inward flows) and extraversion (outward flows);
2) the formation of regional economic blocs;
3) the growth of more 'local internationalisation' and 'virtual regions' through the development of economic ties between local and regional authorities in different national economies;
4) the extension and deepening of multinationalisation through MNEs, transnational banks and international producer-service firms;
5) the widening and deepening of international regimes covering economic and economically relevant issues; and
6) the emergence of globalisation proper through the introduction of global norms and standards, the adoption of global benchmarking and the development of globally integrated markets, in which 'deracinated' firms with no evident national base operate.

This list indicates that globalisation is far from producing a homogenised economic space. Rather, it involves a reordering of differences and complementarities in various geographical spaces as well as the global one, and this constant reordering is the basis for creating dynamic competitive advantages (ibid., p. 117).

Depending on which facet of changes sweeping the world they want to stress, different authors come up with different definitions of globalisation (Box 2.1).

Box 2.1 Globalisation – Some definitions

Globalisation is the...

- "integration into the world economy" and increased interdependence "through trade, investment, finance, regional integration, technology, and demographic factors" (Richardson, 1997, p. 50).
- "growing integration of economies and societies around the world as a result of flows of goods and services, capital, people, and ideas" (Dollar, 2001, p. 2).
- external opening and an increased role of markets internally (Robinson, 2001, "Preface").
- process in which "trade grows more rapidly than production" (Storper, 1992, p. 66).
- "closer integration of the countries and peoples of the world which has been brought about by the enormous reductions of costs of transportation and communication, and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) of people across borders" (Stiglitz, 2002, p. 9).
- "reorganisation of production into global production systems, notably global value chains and export processing zones" (Carr & Che, 2004, p. 1).
- "gradual integration of economies and societies driven by new technologies, new economic relationships and the national and international policies of a wide range of actors, including governments, international organisations, business, labour and civil society" (Gunter & van der Hoeven, 2004, p. v).

Despite the prevalence of the economic dimension in the dominant public discourse on globalisation, which revolves around various indicators, it is probably worthwhile to keep in mind that the social reality cannot be simply compressed into a range of numbers. The Bureau of European Policy Advisers has recently published a consultation paper (Liddle & Lerais, 2007) that takes a wide view of the social realities and changes stemming from globalisation. This study is a response to the European Commission's (2006a) Communication on a Citizens' Agenda in which the Commission proposed a 'social reality check' ahead of preparing an agenda to promote access and solidarity in the EU.

2.2 Drivers contributing to the process of globalisation

The **drivers** of globalisation are in part determined by policy factors and in part by technological developments or underlying trends:

- The liberalisation of trade is largely a result of the various waves of lowering of trade barriers within the General Agreement on Tariffs and Trade and its successor the World Trade Organisation, but also of free trade agreements such as the European Free Trade Area and the North American Free Trade Area and a number of bilateral trade agreements across the world.

- In addition to the worldwide liberalisation of trade flows, the successive EU enlargements and the resulting integration have contributed significantly to the boosting of intra-EU trade flows and brought changes in the trade with non-EU countries.
- In recent decades, the rise in trade flows has accelerated through a remarkable reduction of transport costs and technological innovation, notably with the emergence of container handling and movements along with the associated increase in the role of container ships travelling around the world.
- Transport costs have fallen consistently, despite rising oil prices, while cross-border telecommunication costs among the major trading nations have become effectively negligible. Anne Krueger cites evidence that a three-minute telephone call between New York and London would have cost $293 in 1931, $1 in 2001, and is now just a few cents for a better connection.[5] Similarly, key facts cited by the International Shipping Federation shows that between 1980 and 1999, a period when the *annual* increase in the value of world trade was 12%, the costs of shipping rose by just 7% over the whole period.
- Total freight costs for trade between developed countries account for less than 4% of the value of trade, with the implication that it is now other factors (such as regulatory restrictions, tariffs and so on) that limit trade, rather than transport costs. Indeed, transport costs make up only 2% of the cost of a television[6] shipped from Asia to Europe and 1.2% of the cost of a kilo of coffee. Despite the fall in direct transport costs, Anderson & van Wincoop (2004) show that the costs of trading can still be considerable, especially for developing countries. The reasons lie in the costs of border formalities, information and other policy variables that affect distribution and margins at each stage in the chain from the producer to the consumer. They note that for these reasons, barriers to trade remain substantial.
- The rise in world trade has also been favoured by the liberalisation of capital movements, financial markets and payments. All of these developments have represented an imperative complement to the intensification of trade, but they have mainly been implemented within the OECD, by the International Monetary Fund, through EU enlargements or modifications in national policies.
- But again, the process of globalisation would probably not have taken place without the emergence of the Internet, ICT in general and the resulting huge reduction in the costs and increase in the speed of communication across the world.

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[5] See the lecture by A. Kruger given at the Kiel Institute symposium in honour of Herbert Giersch (Kruger, 2006).

[6] See the website of the Roundtable of International Shipping Associations (http://www.marisec.org/shippingfacts/worldtrade/costs.php).

- Rules and regulations concerning immigration and frontier control should also be taken into account as a potential driver of globalisation. Pertinent issues in this field, such as growing demands for political asylum or flows of refuges, are of major importance.
- The genuine internationalisation of many (if not most) multinational companies on the one hand, and the nature of international governance, either absent or in certain areas brought about by intergovernmental cooperation (notably within the OECD) on the other, has contributed to the creation of a world market that is largely unregulated or subject to only partial enforcements of competition rules, for example in transatlantic trade.
- Yet the process of globalisation has also been (and will in the future probably be) even more influenced by the speed of innovation and R&D, the progress of education and of intellectual capital and intangibles, the transfer of technology and the nature of the societal model in different countries. These important aspects only feature tangentially in the present report.

The role and interplay of these and other main drivers have thus contributed to the **process of globalisation**, more specifically,

- huge changes in the size and direction of trade flows, with the share of merchandise trade in world GDP in real terms doubling since 1975 and quadrupling since 1950, but with trade in services only growing by half as much. Services are now starting to catch up, however;
- the outsourcing of production, initially of goods with a high content of low-skilled labour input, but increasingly also of services with a substantial content of highly skilled labour input, including ICT services and certain categories of R&D. According to a recent study by Statistics Canada, 20% of Canadian jobs were exposed to outsourcing, although the study found no indication that industries relatively more exposed to outsourcing had slower growth of employment than less-exposed industries (Morisette & Johnson, 2007). Work by the McKinsey Global Institute has even found that for the US, outsourcing leads to net job creation (Farrell, 2007);
- a certain relocation of people, mainly nationally and associated with the restructuring of production units, yet also to some extent internationally as a complement to the outsourcing and insourcing of production;
- vast changes in the size and patterns of capital movements, both in the field of portfolio investments and in foreign direct investments. The stock of external assets and liabilities for the EU as a whole as a proportion of GDP rose from 59% of GDP in 1970, to over 550% in 2004, with a particularly strong expansion after 1995; and
- the potential influence of the relocation of production on sources of government revenue, creating a need for reordering priorities and reforming taxation.

In view of the very size of the changes in the flows of goods, services and capital movements, and of the ongoing outsourcing and insourcing, the process of globalisation must be expected to have **social consequences**:

- The industrial restructuring in favour of highly skilled branches can be expected to lead not only to a weakening of employment of low-skilled labour but also to

changes in regional employment patterns. A strengthening of employment in regions and branches with a high proportion of highly skilled labour can be anticipated, offset by a negative effect on wages or employment (or both) in low-skilled jobs and branches.

- Since the effects are not symmetrical, nor do they influence the various levels of skill in the same direction or proportions, the process of globalisation may give rise to a tendency for income inequalities. Meanwhile, in countries with a low degree of labour market flexibility, the segmentation of the labour market risks is being accentuated.

Still, the social effects of globalisation are not, as underlined elsewhere in this report, felt in the same way or to the same extent in all EU member states. Depending on the flexibility of the economy, the level of education of the working population, labour market rigidities and the functioning of the system of social protection, globalisation may appear as an opportunity or a danger. Based on the interaction between the economy, the social protection system and the mechanisms of social solidarity, the following effects can be observed:

- In some member states, globalisation is primarily an opportunity to accelerate the process of adaptation to a knowledge society and the growth of productivity, while in others it tends to aggravate existing segmentations and rigidities.
- Globalisation is absorbed with relatively little change in the overall income distribution in some EU countries, even if added segmentation leads to increased disparities of income between 'insiders' and 'outsiders'. But globalisation may be a cause of a general shift in the functional income distribution in favour of capital income.
- Owing to the system of governance and the efficiency of tax collection in some member states, combined with the resilience of their economies, globalisation does not lead to a loss of tax revenue, but to a strengthening of public finance. Yet in other member states with high taxation of labour and rigidities in the system of public revenue, globalisation leads to added pressure on public budgets through a vicious circle of increasing rates of taxation and social security contributions, adding to the direct effects of globalisation on employment.
- In member states with highly adaptable product and labour markets and, especially those with social protection schemes favouring employment and rapid adjustment, the social protection schemes may contribute to accelerating the participation of the economy in the process of globalisation, suggesting that there may be a positive feedback from social protection schemes to the process of globalisation.

The policy recommendations in chapter 12 of this report argue that there is no empirical evidence of a 'race to the bottom', implying that globalisation is not an inexorable force. Even so, it is recognised that globalisation reinforces tendencies to pit one welfare system against another and to expose individuals to a higher degree of unpredictability and risks. Hence, responding to globalisation requires adapting policies and institutions to a changing economic environment, as discussed in section 12.5.

To the extent that the policy response adopts an active stance, favouring adaptation and maintaining high levels of social justice and solidarity, it can be expected to induce a positive feedback. These not only relate to the social consequences, but also to the very nature of the process of globalisation and the capacity of the EU to exert influence on the international governance of key aspects of this process.

3. EVIDENCE ON THE DEGREE OF OPENNESS

The investigation of globalisation as a new phenomenon that emerged at the end of the 20th century is often puzzling to scholars. One of the reasons is that some substantive aspects of internationalisation, such as massive cross-border trade, foreign direct investment and migration, are not novelties in the history of world economy. Scholars are divided as to whether the most recent wave of internationalisation has demonstrated the scale of quantitative or qualitative change that would justify considering it a paradigm shift (see the overview in Bordo, Eichengreen & Irwin, 1999). Another difficulty is, as discussed in chapter 2, that public perceptions and discourse on globalisation comprise extremely diverse developments starting from various cross-border economic activities through the progress in technology and communication to social and cultural transformations, the interaction of values, etc. An exact and balanced analysis and evaluation of such diverse phenomena summarised under the buzzword ‘globalisation’ is therefore almost impossible.

The heated debates about the causes and effects of globalisation are, however, with us, as is the enthusiasm for, or fear of, those who are convinced of the virtues or the vices of this process. To enhance the analysis of globalisation in the European context, in this overview we focus on ‘economic globalisation’: a basic, historically and theoretically circumscribed side of globalisation relative to the other aspects of the process. We concentrate on *openness* since it is intimately related to economic globalisation and it helps to *measure* the extent of the internationalisation process across countries and time.

This chapter adopts the simple formulation of Brahmbhatt (1998, p. 1) that economic globalisation (or economic integration) is “the increasing freedom and ability of individuals and firms to undertake voluntary economic transactions with residents of other countries, a process entailing a growing contestability of national markets by foreign suppliers”.

Drivers of the process have been both *policy-related* (such as the gradual reduction of official or private obstacles to exchange) and *business*- or *technology-related* (such as the reduction of transaction costs of exchange owing to inventions and technological developments in transport, information technology, communication, etc.). Some analysts attribute the recent wave of globalisation mostly or even solely to the developments in technology (Williamson, 1998; Giddens, 1999). Others, such as Sachs & Warner (1995), focus more on the role of public policy (trade liberalisation, the fall of communism and economic reforms) or even claim that one of the features distinguishing the current wave of globalisation from the earlier one is that current progress in openness relies less on technological developments and more on the abolition of government-erected obstacles to trade and capital flows (Bhagwati, 2004). Finally, some theorists accept both the role of technological developments and public policy, and complement these with further factors. Mussa (2000), for instance, considers the *tastes* of individuals and societies that prefer taking advantage of the opportunities of declining costs of transportation and communication as an equally important driver of globalisation as policy and technology.

Measures of economic openness try to gauge that part of economic integration that can be quantified, and thus analyse the progress (and in some periods, the regression) of globalisation. These measures are also useful because they make it possible to analyse the relationship of openness (or globalisation) with other processes, such as economic growth, inequality or financial volatility.

As the definition of globalisation above reveals, the degree of economic integration or openness is usually related to countries that are defined by their unique geographical location, political system, jurisdiction, language, social history and so forth, or to the residents of these countries. The ease of, or freedom to, conduct transactions across borders refers to various aspects of business:

a) the cross-border trade of goods and services;

b) the ability to carry out financial transactions (portfolio investments as well as lending and borrowing);

c) the establishment, operation and control of business in another country through foreign direct investment;

d) the offer of labour services by residents of another country (labour migration); and

e) the exchange of information, conventions, perceptions and expectations necessary for the smooth and safe conduct of market exchanges.

Based on the current structure of the EU, this chapter centres on past and recent patterns of progress in openness. Both time-related and cross-country comparisons are undertaken, with the aim of establishing which European economies are most open to the rest of the world and which have benefited most from the technological developments of transport and communication of recent decades, as reflected in their openness. How much was economic globalisation enhanced in Europe by the collapse of the communist system and the ensuing broadening of economic freedom? Have the former centrally planned economies caught up with the 'old' EU member states in opening up or are they still following the tracks of their more developed partners? Are there characteristic differences in these patterns when observing trade, portfolio or foreign direct investment (FDI) flows, the exposure to foreign ownership and control, and the exposure to tax competition? In the analysis, we focus on the 15 old EU member states, the 10 new member states that joined the Union in 2004 and the two new countries (Bulgaria and Romania). For cross-country comparisons, we use these 27 countries. The chapter has only a few comparisons with other developed and less developed economies, partly because of brevity considerations and partly because the selection of comparator countries always involves some arbitrariness and would necessitate detailed qualifications in the subsequent analyses of data. In some analyses, however, we also have a look at the development of the 'BRIC' countries (Brazil, Russia, India and China), whose opening up and joining the world market in the past two decades are considered a major part of the current wave of globalisation.

Openness measures provide support to the comparative analysis of openness across countries and time periods. These are either *outcome-based* (showing the actual realisation of openness) or *policy-based* (reflecting the possibility for easy exchange provided by policy instruments). Outcome-based measures are usually associated with de facto liberalisation, while policy-based measures (also called 'rule-based' or

'restriction-based' measures) are associated with *de jure* liberalisation. A number of analysts use both kinds of measures, particularly because the exclusive observation of either measure may be misleading.[7] In this chapter, both outcome- and policy-based measures are used where possible.

Some scholars have found that simple, outcome-based measures can be misleading because they tend to reflect, inter alia, idiosyncratic attributes of countries or transitory developments in certain periods. Thus, indices that are more sophisticated have been proposed for comparative analysis of the level of openness. For instance, since the most common outcome-based index, the trade/GDP ratio, may be influenced by the special geographical location or the size of a given country, it has been suggested that instead of the actual measured level of openness, one should correct actual openness with the country's potential openness (based on the potential trade), which is usually assessed with the help of the so-called 'gravity' model of trade. Others, such as O'Rourke & Williamson (2000), find that the growth in the trade/GDP ratio could reflect growth in import demand or in export supply induced by population growth, the colonisation of empty lands, capital accumulation or technological change – each different from the main drivers of globalisation (the reduction in transaction costs and in the protection provided by policy measures). Consequently, they propose the analysis of the progress in commodity price convergence, which would be "irrefutable evidence that globalisation is taking place" (ibid., p. 4).

For the characterisation of various fields of openness, it is common to use either single measure indicators or multiple measures, or synthesised multiple measures. Most outcome-based measures take values on a continuous scale (usually with no maximum value), while policy-based measures are bound to be qualitative and therefore discrete. The popular synthesised measure of openness of Sachs & Warner (1995), for instance, is binary, i.e. it simply shows whether a country can be considered open or closed at a point in time.

While measures of openness to trade and finance are more or less generally accepted,[8] the openness or liberalisation of services is much more complicated to

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[7] Prasad et al. (2003) give examples of economies that show a high degree of policy-based openness, but achieve little openness in outcomes (remote countries in the case of trade flows and some African countries with respect to financial flows). They also highlight countries that were *de jure* closed to financial flows, but de facto suffered severe capital outflows (some Latin American countries involved in capital flight episodes of the 1970s and 1980s). In this chapter, examples demonstrating the different qualities of the policy-based and outcome-based openness indicators are given.

[8] Although in the various investigations, as many as two dozen alternative indices are used.

gauge. Here, a combination of policy-based measures usually represents the move to a more or less open – or in other words, to a more or less liberal – regime.[9]

In the next sections of this chapter, we analyse various fields in which economic integration is taking place with the help of policy-based and outcome-based indices of openness. Trade in goods and services, financial flows in the form of debt instruments, portfolio and direct investments are discussed, as well as the expansion of foreign control and the effects of the increasing international mobility of the tax bases. The chapter ends with a summary and conclusions. It should be noted that throughout this chapter a grouping of **EU-14** is used to denote the 'old' EU: this aggregate excludes Luxembourg for which it is often difficult to obtain comparable and reliable data. **EU-10** refers to the countries that acceded to the EU in 2004 and **EU-2** represents the newest member states, Bulgaria and Romania.

3.1 Empirical analysis of economic globalisation – Trade

3.1.1 Outcome-based measures

The most common indicator of the evolution of openness is the trade/GDP ratio. The advantages of easy availability of the underlying data and the simple calculation of this index outweigh its conceptual problems.[10] Economic historians have been able to reconstruct the (likely) size of trade and GDP in a number of countries for the past, which shows the acceleration of the opening-up process in the economies around the world since the last decades of the 19th century. Although the evolution has not been without reversals, in the most recent decades and in most of the countries of the world, the extent of openness has reached levels never before experienced (Table 3.1).

Table 3.2 shows the result of the calculations for the evolution of this real openness in the old and new EU member states for five-year periods in the past 30 years as well as in the BRIC countries.[11] Contrary to expectations, the data do not reveal either spectacular or unbroken growth in openness in the individual countries and in the three groups of countries. Nevertheless, we can state that in the EU-14 group the increase of openness since 1981–85 has been sizeable, although the latest level does not seem to be historically high. The country groups EU-10 and EU-2 have also shown considerable growth in their openness since the early 1990s, albeit with large variations

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[9] In the analysis of the *impact of openness* on other phenomena, such as economic growth, employment rates, inequality or financial volatility, a general methodological consideration in choosing the appropriate measure of openness is that it must be exogenous to the phenomena on which openness is supposed to have an impact. Since in this report we analyse openness in itself and not in terms of its impact on other phenomena, we may neglect this – usually difficult – methodological problem.

[10] In addition to the problems associated with actual versus potential trade (discussed above), there are also the problems of inconsistency between trade (which is a gross concept) and GDP (a net concept), with the drawback being that the index has no maximum value. A further consideration is the services bias (analysed below).

[11] Owing to scarce and distorted data, Luxembourg has been left out of most of our calculations.

across the countries.[12] At the end of the period covered in Table 3.2, the most open economies of the old EU member states are those of Belgium, the Netherlands and Ireland; among the new member states the economies of Malta, Estonia and Slovenia are most open.

Table 3.1 Ratio of merchandise exports to GDP, 1870–1998 (in 1990 prices, %)

	1870	**1913**	**1929**	**1950**	**1973**	**1998**
Europe						
France	4.9	7.8	8.6	7.6	15.2	28.7
Germany	9.5	16.1	12.8	6.2	23.8	38.9
Netherlands	17.4	17.3	17.2	12.2	40.7	61.2
UK	12.2	17.5	13.3	11.3	14.0	25.0
Spain	3.8	8.1	5.0	3.0	5.0	23.5
The Americas						
US	2.5	3.7	3.6	3.0	4.9	10.1
Mexico	3.9	9.1	12.5	3.0	1.9	10.7
Brazil	12.2	9.8	6.9	3.9	2.5	5.4
Asia						
China	0.7	1.7	1.8	2.6	1.5	4.9
India	2.6	4.6	3.7	2.9	2.0	2.4
Japan	0.2	2.4	3.5	2.2	7.7	13.4
World	4.6	7.9	9.0	5.5	10.5	17.2

Source: Maddison (2003).

By comparison with the data in Table 3.2, neither the level nor the speed of opening-up in the BRIC countries look as dramatic as the daily news would suggest. Among the four countries, China above all has shown a tendency to increase its trade compared to its GDP: in the most recent years, the index of openness (trade as a share of GDP) for China has increased by 1% each year. This progress is not staggering, however, even if we take into account the size of the Chinese economy. It is not a matter of indifference whether it is a mouse that opens its mouth or a dragon. China is large, but not (yet) that large that this steady opening-up itself should have far-reaching consequences for the EU: in 2004, China's GDP (calculated at international exchange rates) amounted to that of France.

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[12] Data for the former communist economies for the period before 1990 should be considered with caution because of valuation problems and limitations in the reliability of official data at that time.

Table 3.2 Openness to trade in old and new EU member states since 1976 (%, countries in descending order of the values in the period 2001–03)
((merchandise exports+merchandise imports) / 2) / GDP at PPP

	1976–80	1981–85	1986–90	1991–95	1996–2000	2001–03
Belgium	–	45.7	58.1	66.8	72.3	78.5
Netherlands	53.2	38.2	44.0	49.1	53.3	52.1
Ireland	45.2	36.8	47.4	53.3	58.4	49.8
Malta	47.3	33.1	40.4	46.9	39.8	37.3
Austria	24.5	19.2	27.2	30.3	32.6	34.9
Sweden	37.9	28.6	35.3	35.5	39.1	33.8
Denmark	29.7	23.1	29.7	34.3	33.6	33.2
Estonia	–	–	–	19.8	30.3	32.6
Slovenia	–	–	–	31.8	31.3	30.7
Finland	28.5	23.3	27.3	28.0	32.5	30.1
Hungary	16.1	12.1	10.8	13.4	21.0	26.6
Germany	–	20.2	25.1	24.8	25.3	26.1
Czech Rep.	–	–	–	16.1	20.1	26.0
Slovak Rep.	–	–	–	16.3	19.7	24.8
France	20.2	15.7	19.4	21.5	23.0	21.7
UK	18.9	16.5	19.0	20.3	22.3	20.6
Lithuania	–	–	–	12.2	15.8	18.9
Portugal	10.6	9.8	15.4	18.7	19.6	18.4
Cyprus	31.8	25.1	23.0	23.8	21.4	17.7
Spain	8.8	8.3	11.7	14.7	16.7	17.2
Italy	14.7	12.3	15.2	16.3	17.3	17.1
Latvia	–	–	–	10.5	14.5	15.3
Bulgaria	–	36.4	28.6	9.4	10.9	13.1
Poland	–	–	–	7.9	10.5	12.3
Romania	–	–	–	5.6	7.9	11.3
Greece	10.1	8.3	10.0	12.4	12.7	11.0
EU-14	25.2	21.9	27.5	30.4	32.8	31.7
EU-10	–	–	–	19.9	22.5	24.2
EU-2	–	–	–	7.5	9.4	12.2

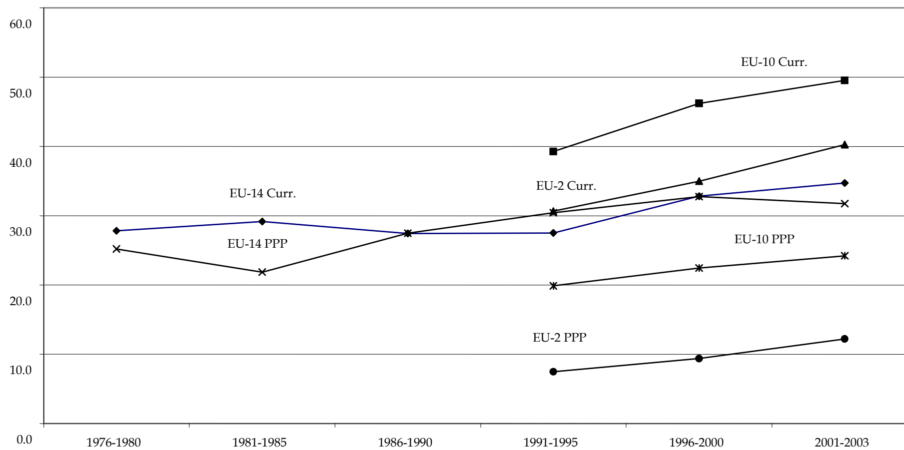
Notes: The group averages are unweighted averages. Owing to scarce and distorted data, Luxembourg has been left out of the EU-14 calculations.

Source: Own calculations based on data from World Bank (WDI) (2005c).

When comparing the positions of the three country groups to each other, we find that the less developed groups (EU-10 and EU-2) that have re-established the principal institutions of a market economy and carried out a policy of opening-up only more recently (i.e. starting with the early 1990s) are still much less open than the developed members of the EU-14. This relative position of the less and more developed countries is critically influenced by the prices used to value the GDP in the denominator of the openness indicator. As Figure 3.1 shows, the ranking of the country groups (and, naturally, of the countries themselves) radically changes if we use the current exchange

rates instead of the PPPs: with the index calculated at current exchange rates the EU-10 group becomes, on average, the most open group followed by the EU-2 and the EU-14.

Figure 3.1 Development of openness to trade in the EU-14, EU-10 and EU-2 country groups (%, calculated on merchandise trade and on GDP at current exchange rates and at PPP)



Source: Own calculations based on data from World Bank (WDI) (2005c).

If we use the broader category in the numerator of the index, i.e. goods and services instead of merchandise goods, we find that with the new numerator the relative position of the countries changes only minimally (Table 3.3). A notable exception is Cyprus, which, being one of the EU member states most dependent on trade in services, has a much more prominent rank in Table 3.3 than in Table 3.2.

Table 3.3 Openness to trade in old and new EU member states since 1976 (%, countries in descending order of the values in the period 2001–03)

((exp. of goods and services+imp. of good and services)/ 2) / GDP at PPP

	1976–80	1981–85	1986–90	1991–95	1996–2000	2001–03
Belgium	67.8	49.5	65.5	74.9	74.8	74.0
Ireland	51.3	41.7	54.8	64.4	76.3	72.3
Netherlands	58.8	46.0	53.0	58.7	58.6	53.3
Malta	66.3	47.6	58.4	64.4	54.9	50.3
Austria	33.8	27.0	38.2	43.6	45.3	47.0
Sweden	45.6	34.9	43.7	44.4	49.7	45.0
Denmark	36.6	28.9	37.3	43.4	43.0	44.8
Cyprus	41.8	35.8	39.2	42.0	39.2	–
Slovenia	–	–	–	37.3	37.0	36.1
Estonia	–	–	–	29.9	33.9	35.1
Finland	32.7	26.8	32.3	34.4	37.7	34.4
Germany	24.1	19.1	25.4	29.8	30.4	31.4
Hungary	16.1	11.9	11.1	15.4	25.5	31.3

Table 3.3 Continued

Czech Rep.	–	–	–	20.6	25.1	30.2
Slovak Rep.	–	–	–	21.3	23.9	28.9
UK	23.6	20.5	23.5	25.8	29.3	28.3
France	23.9	18.6	22.8	25.0	26.0	24.4
Spain	11.6	11.0	15.3	19.0	22.1	23.0
Lithuania	–	–	–	17.5	18.8	22.1
Portugal	13.8	12.4	19.1	24.0	24.4	21.6
Italy	17.1	14.2	18.1	20.5	21.8	21.5
Latvia	–	–	–	22.1	20.7	20.6
Greece	14.0	12.4	14.3	16.6	18.5	17.0
Bulgaria	–	20.6	20.2	10.6	13.3	16.7
Poland	–	–	–	9.1	13.0	15.2
Romania	–	–	–	6.8	9.1	12.5
EU-14	32.5	25.9	33.1	37.5	39.9	38.4
EU-10	–	–	–	28.0	29.2	30.0
EU-2	–	–	–	8.7	11.2	14.6

Notes: The group averages are unweighted averages. Owing to scarce and distorted data, Luxembourg has been left out of the calculations.

Source: Own calculations based on data from World Bank (WDI) (2005c).

At first sight, it is surprising that in the ranking according to the utilisation of trade potential, the new member countries show up only in 13th place (the Czech Republic) and below. The most convincing explanation is that the exercise considers the long period of 1991–2003. Table 3.4 also indicates that there are substantial differences among the countries according to the three rankings of openness. On the one hand, there are countries that are considered very open according to the traditional openness index (calculated using PPP), but at the same time performing much below their potential according to the gravity model (Estonia, Malta and Slovenia). On the other hand, there are others that, when gauged by the traditional indicator, do not look very open but when measured against their potential trade, belong to the very open economies (Italy, Spain and the UK).[13] The last column indicates those countries for which openness levels seem to be robust: they are the most open or least open by a consensus of all three indicators. Again, with due consideration for the long period covered in this calculation, it is no surprise that in the 'consensus ranking' all the economies that are most open are old EU member states, while all but one of the least open ones are new member states. Were there similar calculations for potential trade available for the most recent years, some small new EU member states would probably also show up in the most open economies by consensus of the three openness indices.

[13] Since the first three countries belong to the smallest economies and the second group to the largest economies of the 26 EU member states shown in Table 3.4, it seems that these small economies showed relatively less openness and these large ones relatively more compared with countries of a similar size in the 61-country sample used in the model of Bussière, Fidrmuc & Schnatz (2005).

Table 3.4 Ranking of the countries in terms of openness to trade according to three openness indicators, 1991–2003

	Trade/GDP at current exchange rates	Trade/GDP at PPP rates	Utilisation of trade potential	Consensus level of openness
Germany	20	11	1	M
Netherlands	6	3	2	M
Italy	25	19	3	–
Belgium	2	1	4	M
UK	22	14	5	–
France	23	13	6	–
Sweden	14	5	7	M
Spain	24	21	8	–
Denmark	16	6	9	M
Finland	17	10	10	–
Ireland	5	2	11	M
Austria	13	7	12	M
Czech Rep.	7	16	13	–
Hungary	9	17	14	–
Portugal	19	18	15	–
Poland	21	25	16	L
Greece	26	23	17	L
Bulgaria	11	24	18	L
Slovenia	8	8	19	–
Rumania	15	26	20	L
Slovak Rep.	4	15	21	–
Cyprus	18	12	22	–
Estonia	1	9	23	–
Malta	3	4	24	–
Lithuania	10	20	25	L
Latvia	12	22	26	L

M: Most open economies – based on the three rankings; L: Least open economies – based on the three rankings

Notes: The ranking according to the utilisation of trade potential comes from the results of the gravity model calculation, which assesses a country's trade potential based on its GDP, distance to its trade partners as well as cultural, historical and political factors affecting trade.

Sources: Own calculations based on data from World Bank (WDI) (2005c) and Bussière, Fidrmuc & Schnatz (2005).

3.1.2 Policy-based measures

Another approach to measuring openness is based on the extent of policy-related obstacles to trade. This approach filters out most of the geographical determination of a country's openness. Here, mainly (but not exclusively) those policy instruments of trade are taken into account that *a country itself* applies to ease or hamper trade transactions with the rest of the world. An often-used measure of openness belonging to this category is that developed by Sachs & Warner (1995). This binary indicator of

policy-based openness classifies a country as closed if at least one of five specific characteristics of a closed economy prevails in the country.[14] According to this indicator, the cut-off dates for switching from a closed economy to an open one for an enduring period[15] were different for the various EU member states. Ignoring temporary openness episodes, the first wave of opening-up happened at the end of the 1950s: France, Germany, Greece, Italy, Luxembourg and the Netherlands became open in 1959, while the transition in Austria, Belgium, Cyprus, Denmark, Finland, Portugal, Spain, Sweden and the UK occurred in 1960. Ireland followed suit in 1966. The next wave was stirred by the collapse of central planning and the start of economic transition in Central and Eastern Europe: Hungary and Poland started the process in 1990, followed by Bulgaria, the Czech and Slovak Republics (still as Czechoslovakia), Slovenia (1991), Estonia and Romania (1992), and finally Latvia and Lithuania (1993).[16]

Other, more sophisticated measures for the obstacles to trade are the IMF's Trade Restrictiveness Index (IMF-TRI),[17] and the World Bank's series of indices: the Trade Restrictiveness Index (TRI), the Overall Trade Restrictiveness Index (OTRI) and the Market Access Overall Trade Restrictiveness Index (MA-OTRI). In the following discussion, we analyse the results of the calculation of the World Bank's trade restrictiveness indices based on Kee, Nicita & Olarreaga (2006).[18] The World Bank indices are based on the theoretical approach developed in a series of papers by James Anderson and Peter Neary, starting with their seminal article, Anderson & Neary (1992). All the three indicators attempt to summarise the effects of both tariff and non-tariff barriers reflected in their combined impact on the affected economy. The TRI answers the question of what is the equivalent uniform tariff in a country that would keep *real income* (or welfare) constant. The OTRI answers the question of what is the equivalent uniform tariff in a country that would keep its *imports* at their observed levels. Finally, the MA-OTRI answers the question of what is the equivalent uniform tariff faced by exporters of a given country in the rest of the world that would keep its *exports* at their observed levels.

In their most recent exercise, the experts of the World Bank collected and processed data for 91 counties, mostly for the years 2003–04 (tariffs and trade) and for the late 1990s (non-tariff barriers) – see Kee, Nicita & Olarreaga (2006). The 15 old EU member states were considered a single economy and only their extra-EU trade was taken into account. The new member states (not all of them present in the sample) were handled as separate entities (in practice, what they really were in the period before 2004). Table 3.5 points to some interesting insights that can be drawn from the trade

[14] These characteristics are 1) non-tariff barriers covering 40% or more of trade; 2) average tariff rates of 40% or more; 3) a black market exchange rate that has been depreciated by 20% or more relative to the official exchange rate for a considerable period of time; 4) a socialist system in place; and 5) a state monopoly on major exports (Sachs & Warner, 1995, pp. 22–23).

[15] More specifically, this relates to the date of switching from a closed economy to an open one up to 1994, i.e. the time of writing the study by the authors.

[16] Malta was not rated by the source because of insufficient data on trade policies.

[17] See IMF (2005).

[18] See also the *Global Monitoring Report 2006* published by the World Bank (2006c).

restrictiveness indices. The table contains the ranking of the group of EU-15 and the new member states according to the different trade restrictiveness indices. For each category, there are three indices: a composite index, one calculated for manufacturing products and one for agricultural products.

The first striking result is that the EU-15 is far from being a champion of non-restrictive trade practices with respect to its trade partners. This result is reflected in the EU's positions in the TRI and OTRI rankings. A second interesting finding is that in the relevant period, most of the new member countries were less restrictive vis-à-vis their partners than the EU-15 was vis-à-vis its partners. This is, however, an illusion that can be dispelled with the appropriate interpretation. In the period in question, the basically obstacle-free trade between the new member states and the EU-15 amounted to about 60-70% of the total trade of the new member states, but only about 5-15% of the total trade of the EU-15. This difference is more than sufficient to explain why the new member states may look more open than the old ones, but if we recall that intra-EU trade, which amounts to about 60% of the total trade of the EU-15, is not taken into account in the TRI and OTRI indices, the whole puzzle is solved. With this interpretation in mind, we can assume that in a future edition of TRI and OTRI indices the new member countries (by that time counted as members of the EU) will slip back in the ranking of the countries in terms of openness based on trade restrictiveness. Although we do not have trade restriction indices for all the 27 countries, it is clear that the ranking in Table 3.5 does not match those in Tables 3.2 and 3.3. For instance, Slovenia, a very open economy according to Tables 3.2 and 3.3 (i.e. using outcome-based measures) turns out to be the least open among the Central and Eastern European EU countries in Table 3.5 (i.e. using policy-based measures).

So far, we have presented several measures of openness. Below we continue to do this with the understanding that each index approaches the problem of globalisation from a different angle and can be used to analyse different issues. To show the diverse qualities of the openness indices, here we draw attention to how differently these indices handle the issue of the 'doubling of the global labour force', a recently and sharply formulated line of development of the globalisation process. In his short pamphlet, Richard Freeman states that the fundamental reality of globalisation is that in the past 15 years, the global labour force has doubled.[19]

Workers in China, India and the former Soviet bloc were around and active before the mid-1980s, but only since then have they gradually joined the global workforce pool – effectively doubling the size of the world's connected workforce compared with this pool without them. Transformation, market liberalisation reforms and opening-up in China, India and the former communist countries (as well as progress in the liberal world trading system) have led these countries to join the world's actively and freely trading community. The implications are and will be substantial: more intense global competition, pressure on labour markets around the world, job migration, etc., although offset by more consumer demand.

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[19] See Freeman (2005a and 2005b) and Pisani-Ferry (2005).

Table 3.5 Trade restrictiveness indices: Ranking of current EU member states among 91 countries

	TR Real income-related			OTR Import-related			MA-OTR Export-related		
	All	**Manuf.**	**Agric.**	**All**	**Manuf.**	**Agric.**	**All**	**Manuf.**	**Agric.**
EU-15 (extra-EU trade)	60	57	67	38	34	58	27	33	42
Czech Rep.	5	10	3	3	7	1	11	29	68
Estonia	8	14	4	6	11	3	51	73	50
Hungary	32	46	35	19	28	28	25	36	64
Latvia	41	35	48	27	22	48	54	56	33
Lithuania	14	21	22	8	12	18	72	81	52
Poland	22	31	39	21	26	37	41	53	31
Romania	50	58	53	64	62	64	30	59	22
Slovenia	46	49	70	36	36	70	35	70	86
Memo items									
No. 1	Hong Kong	Hong Kong	Kyrgyzstan	Hong Kong	Hong Kong	Czech Rep.	Gabon	Gabon	Gabon
No. 91	Egypt	Sudan	Egypt	Sudan	Sudan	Tunisia	Nicaragua	Trinidad & Tobago	Thailand*
China's position	52	64	40	39	46	34	5	10	16

* Last in the ranking (in fact no. 88, owing to the lack of data for some countries)

Source: Calculations based on data in Kee, Nicita & Olarreaga (2006).

How does this epochal development in globalisation show up in the openness indicators of the EU-27 analysed so far? From among the indices focusing on policies, the Sachs–Warner index shows a qualitative change for the new member states in the past 15 years, but no change for the 15 old member states. While we do not have a time series for the restriction-based indices of the TRI, OTRI and MA-OTRI, the impression is that the doubling of the global workforce is reflected only to a minor extent in the TRI and OTRI. (Notable exceptions are the Czech Republic, Estonia and Lithuania, which have achieved quite prominent places in these rankings.) The results for the MA-OTRI index (which is to some extent a mirror index of the OTRI) show that China and to a degree Russia have already reached favourable positions among the 91 countries in the ease of access to export markets. In contrast, India can still be found among those countries that have the most difficult access to external markets.

In principle, *outcome-based indicators* (such as trade/GDP) should reflect the effect of the doubling of the global labour force more strongly than policy-based measures. The detected change, however, has so far not been as dramatic as the formulation by Richard Freeman suggests. This result tempts the analyst to contemplate whether the traditional indices of openness are the right tools to reflect appropriately and in a timely manner the most recent developments in the globalisation process.

3.1.3 Trade in services

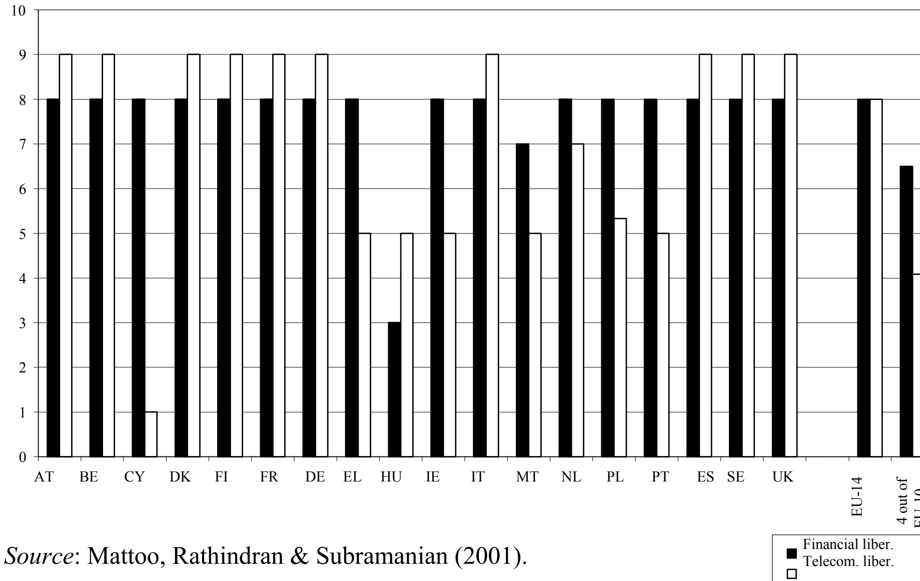
In the literature and public discourse on globalisation, there is a common perception that the liberalisation of services and the expansion of trade in services have made a considerable contribution to the present wave of globalisation. Owing to policies that are more liberal, the global scene of service provision has been reshaped in the past two decades by financial innovations, the development of telecommunication and information technologies, advances in the trade in services as well as the international outsourcing of services.

Services are a diverse package of activities. There are two characteristics distinguishing them from goods with respect to production and trade, with most services having either or both of these. First, because of the simultaneity of production and consumption, trade proper is impossible, and the provision of services by non-residents to residents requires that the factors of production (capital and labour) move to the location of the consumer. Second, barriers to entry are usually maintained not only against foreign suppliers, but also against emerging domestic producers (Mattoo, Rathindran & Subramanian, 2001; UNCTAD, 2004). The implications of these two characteristics are that in many lines of services, FDI (and to a lesser extent, labour migration) on the one hand has to be a prerequisite to and the major mode of penetration of foreign business in domestic services markets. On the other hand, this penetration has to be preceded by the liberalisation of domestic services markets for indigenous business.

The implication of these features for measuring the openness of services markets is that it is necessary to focus on policy-based measures as well as on the evolution of services-related FDI. Because of the diversity of services, different lines of services usually require different indicators of openness. For instance, Eschenbach & François (2002), in their investigation covering 130 countries, use three indicators to characterise the openness of the financial sector in these countries, two of which are policy-related

and one of which is outcome-based.[20] Mattoo, Rathindran & Subramanian (2001) devised even more complex openness indices for two lines of services, the telecommunications sector and the financial services sector. These indicators are based on the degree of competition, the extent of foreign ownership and the nature of regulation in the sector in the given country. The values of these indicators for the EU member states are replicated in Figure 3.2.

Figure 3.2 Financial and telecommunication liberalisation indices (1996–99)



Source: Mattoo, Rathindran & Subramanian (2001).

As the data indicate, in the second half of the 1990s, the old member states of the EU achieved the maximum level of openness in financial services (which, in the classification of the authors, takes the value of 8) and a level quite close to the maximum in telecommunication services (8, while the maximum level is 9). The four new member states in the sample show a reasonable lag behind the old member states in the process of liberalisation.

Table 3.6 gives evidence that in recent years, by utilising the opportunity of increasing openness, service activities have really become an attractive field for foreign investors. Although at the beginning of the 1990s, in the EU member states about half of inward direct investment flows targeted service activities, 10 years later these already made up three-quarters of total FDI inflows. While in this group of countries, the outflow of services-related FDI has not evolved as rapidly as FDI inflows, the reorientation of direct investments from industry (mainly manufacturing) towards services is a clear tendency. Data for the new member states are not complete, but it

[20] These indicators are 1) the estimates of the tariff equivalents for financial services trade, based on GATS (General Agreement of Trade and Services) commitments within the World Trade Organisation; 2) the Heritage Foundation's Bank Freedom Index; and 3) the share of the banking sector accounted for by foreign banks.

seems that these economies are going through the same stages of refocusing FDI flows towards services as the old EU member states did.

Table 3.6 Share of services in total FDI (%)

	Flows				Stock	
	Inward		Outward		Inward	Outward
	Average 1990–94	Average 2000–02	Average 1990–94	Average 2000–02	2001	2001
Austria	–	84.0	40.7	65.7	73.9	–
Belgium	–	–	–	–	–	–
Bulgaria	–	74.1	–	129.0	–	41.4
Cyprus	–	–	–	–	–	–
Czech Rep.	42.8	82.0	–	93.9	60.5	82.0
Denmark	46.6	87.1	49.6	75.2	89.2	78.4
Estonia	41.8	82.0	22.2	87.6	78.2	87.5
Finland	31.9	89.5	24.1	28.9	56.6	27.0
France	69.5	70.8	57.9	81.4	80.2	75.9
Germany	191.4	107.2	46.2	49.5	66.4	68.7
Greece	–	–	–	–	–	–
Hungary	–	62.8	–	30.2	53.3	76.3
Ireland	3.4	50.7	–	26.4	–	–
Italy	61.6	57.0	68.7	43.0	57.0	56.3
Latvia	–	–	–	–	77.2	–
Lithuania	–	85.0	–	–	69.7*	–
Malta	–	–	–	–	–	–
Netherlands	57.8	67.7	53.3	63.7	65.0	58.1
Poland	–	77.3	–	25.9	54.8	86.2
Portugal	45.4	65.6	67.8	58.9	47.9	–
Romania	–	–	–	–	–	–
Slovak Rep.	–	–	–	–	45.8*	60.4
Slovenia	–	–	–	–	52.1	43.7
Spain	40.9	85.5	84.0	88.4	–	–
Sweden	32.1	43.7	43.4	58.8	30.3	39.2
UK	50.4	77.5	46.6	50.5	61.0	62.5
Countries from EU-14	57.4	73.9	52.9	57.5	62.8	58.3
Countries from EU-10	42.3	77.8	22.2	59.4	61.5	72.7
Countries from EU-2	–	74.1	–	129.0	–	41.4

* Data from 2000

Notes: Owing to scarce and distorted data, Luxembourg has been left out of the calculations. Since FDI flows can be both positive and negative (irrespective of whether they are inward or outward), substantial non-service-related negative flows may cause the share of service-related FDI flows to exceed 100%.

Source: UNCTAD (2004).

As regards trade in services, the data presented in Table 3.7 demonstrate that growing openness to services trade (or an expansion in the relative weight of trade in services) is apparent, but its scale is not stunning, and unbroken growth has not been a general characteristic of all the EU member states in the past 10-15 years.

Table 3.7 Openness to services trade in old and new EU member states since 1976 (%, countries in descending order of the values in the period 2001–03)

((exp. of services + imp. of services)/ 2) / GDP at PPP

	1976–80	1981–85	1986–90	1991–95	1996–2000	2001–03
Ireland	6.8	5.2	8.5	11.3	19.8	26.0
Cyprus	12.9	13.1	17.2	20.4	22.5	22.5
Belgium	11.5	8.7	12.7	16.4	15.5	16.7
Denmark	8.5	6.9	9.2	11.1	12.1	15.9
Austria	9.2	8.0	11.4	14.5	14.7	15.4
Malta	21.2	14.9	19.0	18.5	15.4	14.0
Netherlands	11.1	8.5	10.2	12.9	12.4	12.5
Sweden	8.7	6.7	8.7	9.6	10.1	10.9
Estonia	–	–	–	4.4	9.0	9.1
Greece	3.3	2.7	3.3	4.7	6.4	7.8
UK	5.5	4.5	5.0	5.8	7.3	7.8
Spain	2.9	2.7	3.9	4.7	5.3	5.9
Germany	4.5	3.7	4.6	5.3	5.5	5.8
Slovenia	–	–	–	6.2	5.9	5.7
Finland	5.3	4.6	5.8	7.1	6.4	5.6
France	6.1	4.8	5.7	6.6	5.4	5.0
Hungary	–	0.8	1.5	3.5	4.4	4.8
Latvia	–	–	–	3.1	5.7	4.8
Portugal	2.7	2.3	3.4	4.8	4.8	4.6
Czech Rep.	–	–	–	4.4	4.9	4.3
Italy	3.0	2.5	3.6	4.7	4.6	4.2
Slovak Rep.	–	–	–	4.5	3.7	3.9
Bulgaria	–	2.7	1.8	2.3	3.4	4.1
Lithuania	–	–	–	1.6	3.2	3.4
Poland	–	–	–	2.1	2.4	2.4
Romania	–	–	–	0.9	1.3	1.7
EU-14	6.4	5.1	6.9	8.5	9.3	10.3
EU-10	–	–	–	6.9	7.7	7.5
EU-2	–	–	–	1.6	2.3	2.9

Notes: The group averages are unweighted averages. Owing to scarce and distorted data, Luxembourg has been left out of the EU-14 calculations.

Source: Own calculations based on data from World Bank (WDI) (2005c).

Undoubtedly, some economies have traditionally been committed to trade in services because of their specialisation in trading in specific service lines. These countries, such as Cyprus, Malta, Belgium, Austria and the Netherlands, persistently show a high degree of openness. Others have achieved remarkable progress recently, particularly Ireland, but also Denmark, Estonia, Cyprus and Greece. The expansion in the full sample, however, is not staggering. An interesting characteristic emerges (not shown in the table) whereby countries that vigorously expand their export of services also tend to do this in their import of services. Since services are very diverse activities, in some lines of tradable services a real breakthrough has manifestly occurred in recent years, which could go on in the future. Aggregate data, however, do not bring out these developments. This could also be the case for India, the BRIC country for which specific evidence suggests that the cross-border export of services showed spectacular expansion in recent years. Data in Table 3.7 and the underlying export data show that on an aggregate level, service exports from India are still very limited, at less than 1% of GDP.

3.2 Integration of capital and money markets

As noted in a UN training paper, capital markets are in the process of rapid evolution (United Nations, 2001). Capital flows – which were formerly directed towards banks and controlled by governments – are now held by individuals, institutions or private mutual funds and can circulate freely and instantaneously to projects that will yield the maximum profit. Electronic computerised data transmission now gives them an unprecedented mobility on all the financial markets on the planet. Moreover, the volume of such flows has grown – tripling or increasing tenfold in the past few years – mainly as a result of the success of mutual funds, whose assets often exceed those of many governments.

In the past, rivalries between nations were resolved by means of armed conflicts in which empires or ideologies clashed. Nowadays, the wars being waged seem ever more removed from the principal events taking place on the economic and financial front. During the cold war, the superpowers provided assistance in the form of official financial flows or subsidies to centralised economic systems and developing countries whose survival they ensured. Today, these flows and subsidies are considerably reduced or they have even disappeared in some cases. They have given way to the laws of the market place, which govern growth, development, employment and decline.

Today, too, the main problem facing governments is how to attract new investment with a view to creating jobs and promoting sustained economic growth. Governments compete for capital. To this end, nations vie with each other through variations in their interest rates or their rates of exchange, and through the competitiveness of their markets. The world has become capitalist and the ever-increasing financial movements can reward savings and productivity and thus strengthen a country's economy. Conversely, foreign capital can also abandon an economy or withdraw abruptly if an unfavourable fiscal policy drives it away. Speculators may attack a weak currency to weaken it still further. Capital movements may penalise unproductive expenditure and thus help to destroy a country's economy.

Governments and heads of enterprises therefore strive to attract this capital by offering favourable conditions and to utilise capital more productively than their rivals do.

With the end of the cold war, official subsidies and other financial flows dried up in countries such as the Democratic People's Republic of Korea, Myanmar and Cuba, while investors preferred to steer their capital towards countries where the climate was more favourable to them, such as the Republic of Korea, the Taiwan province of China and other emerging countries. Capital has thus become more mobile and more difficult to stabilise and control.

During the 1990s, over 50 developing countries established functioning capital markets. These countries need capital in order to launch their new market economies. In Asia and Latin America, economies are in a state of full expansion; they need to build up infrastructure and find capital to sustain their economic growth. After a period of recession, Europe and Japan also need capital to finance their expansion, create jobs, make good their budget deficits and privatise their state enterprises.

In the face of this increased demand for capital, the competition has become increasingly fierce. In order to attract these financial flows and pay a return on them without over-burdening the costs of production, some countries have had to resort to reducing wages or extending working hours. Moreover, the mounting budget deficits of the US have triggered an additional demand for capital. Prior to the slowdown triggered by the sub-prime crisis in late 2007, the effect of these demands for capital was evident in rising interest rates in Europe despite moderate inflationary pressures. Loans are becoming progressively more expensive and risk breaking the recent cycle of recovery. The countries with economies in transition are also seeking capital. The dearth of capital led to the fall of the Soviet empire, which had been unable either to create sufficient capital or to utilise it effectively.

All these countries are feverishly engaged in establishing a complete capital market infrastructure. The first countries to achieve this will have the benefit of direct and preferential access to international investors. In this context, many countries are also making ever-greater use of derivative markets, including futures markets and options, which will allow improved coverage of risks related to stocks and shares, bonds and exchange rates.

The free circulation of capital outside government control has led to the transfer of the concept of power, traditionally invested in governments, to private holders of capital. This development explains the inability of central banks to curb the speculations that have recently attacked the value of the yen, the dollar and the European currencies. Governments have thus experienced erosion in their ability to control their budgets and their capital. Their fiscal resources appear to be reduced in relation to private capital, no longer enabling them to make the necessary investments. The same applies to the international financial institutions, the World Bank and the International Monetary Fund, which are financed by governments.

In contrast, multinational financiers, managers of private funds and directors of companies or banks have tended to become more powerful. Governments urge them to steer their clients' investments towards their countries: the emergence of private capital as a leading actor on the international scene marks a great turning point in the evolution of world financial management.

After the Second World War, it was generally believed that governments were responsible for the allocation of resources. Today, it is the markets that have taken over this role, thus confirming the decline in state control or 'New Deal' trends. Moreover, until the early 1980s, governments sought to regulate the international monetary system and capital movements for fear of losing their natural capital and control over domestic economic policy. Those countries that have attempted to impose severe restrictions on capital movements have generally had to recognise the fluidity of the financial markets, which have moved towards more welcoming political centres, thus creating an offshore industry that still exists. As a result, governments have been compelled to reduce the barriers to capital movements and, in particular, to reduce the amount of tax deducted at source on foreign investments. From the standpoint of governments responsible for controlling emerging markets, the question of the taxation of capital flows is extremely important. Such taxes can be useful if they are used to build a market infrastructure. Too high a rate of taxation, however, would drive investors away.

3.2.1 Consequences of the globalisation of capital markets

Beneficial economic consequences. The globalisation of capital has beneficial characteristics in many respects. In order to attract the capital necessary for their development, national economies must become or remain open to foreign investment and must adopt responsible fiscal and monetary policies.

The majority of governments have made economic stability one of their highest priorities. Thus, the lowering of customs barriers has introduced competition into previously protected markets. If governments impose excessive regulations or too high a rate of taxation, if public expenditure is too high in relation to revenue and if the central banks destroy too many liquid assets, foreign capital will not be attracted or it will be withdrawn if it is already there. International mutual funds have become a strategic weapon in the arsenal of democracies.

Adverse consequences. The play of market forces may also have adverse consequences. Indeed, the decision-makers and controllers of capital turn away from states that have serious budget deficits or budgets burdened by considerable social expenditure. Deficits and the absence of economic and financial reforms may dissuade the investment of capital in the countries in question. The gap between rich and poor may therefore widen in the face of the exigencies of this social Darwinism and the rigid rules of capitalist disciplines.

Lastly, it is believed that if governments reduce taxes on capital movements, create offshore markets and establish a stable and convertible currency, private capital will flow in.

3.2.2 Domestic savings

Domestic savings are the alternative solution to trying to attract foreign capital. Yet savings have decreased in recent years, since prosperity has placed more consumer goods on the market. Traditionally, national savings supplied the economy with investments that ensured growth and employment. These days, governments have difficulty in keeping these reduced savings within the country. For example, the US is the largest exporter of capital in the world, despite a considerable budget deficit, which

the use of domestic savings would help to clear or reduce; the US deficit, however, is financed mainly by foreign capital. In several countries, governments have established mandatory savings plans. Since the restructuring of pension systems, states have encouraged the development of private pensions, which have increased the rate of savings and which are mostly invested in the stock market.

3.2.3 Effect of the integration of capital markets on globalisation

The globalisation of capital markets and the growth of trade will help create new surpluses, which could meet the world demand for capital. Still, these financial resources, in search of attractive returns, will be invested in countries that achieve a fundamental balance in their public finances and introduce economic and financial measures to reduce budget deficits and current payments, rationalise and privatise public enterprises, develop private savings and the capital market, and liberalise trade.

During the past decade, a growing number of developing countries, emerging countries and economies in transition have introduced the reforms necessary for the restoration of financial equilibrium. Even so, the need to attract external financial flows that could contribute to the creation of jobs and the growth of their economies requires, especially in the context of the globalisation of capital markets, a greater effort in favour of national capital markets. The development of such markets, combined with national capacity-building and the establishment of institutions connected to the international financial centres, would help enhance the effectiveness of financial mediation in the allocation of resources, to channel external flows and to increase and diversify the volume of medium- and long-term financial resources necessary for the economic development of these countries. Finally, these flows, both internal and external, cannot fail to constitute a source for the mobilisation of additional resources through appropriate taxation.

In the past quarter century, governments of industrial and subsequently less developed countries have carried out widespread capital account liberalisation, which has led to the intensification of international financial integration. Appropriately measuring the pace of this progress in openness is perhaps even more important than measuring openness in trade, for two reasons. First, the beneficial nature of financial globalisation is more controversial than the gains achieved as a consequence of unfettered trade. Second, gauging the scope and scale of regulations on a great number of short- and long-term financial instruments and FDI is even more difficult than the extent of tariff and non-tariff barriers to exports and imports.[21]

Owing to the complexity of these regulations, we do not deal with the policy-based measures of financial globalisation here, but focus only on indices that reflect the progress in actual financial openness. This does not mean that the pace and the strategy of the process of financial integration, managed by the governments mostly through adjustments in the relevant regulations, are unimportant. On the contrary, particularly since the financial crises that started in East Asia in 1997, the fine-tuning of financial liberalisation has become a major issue. Experience shows that successful

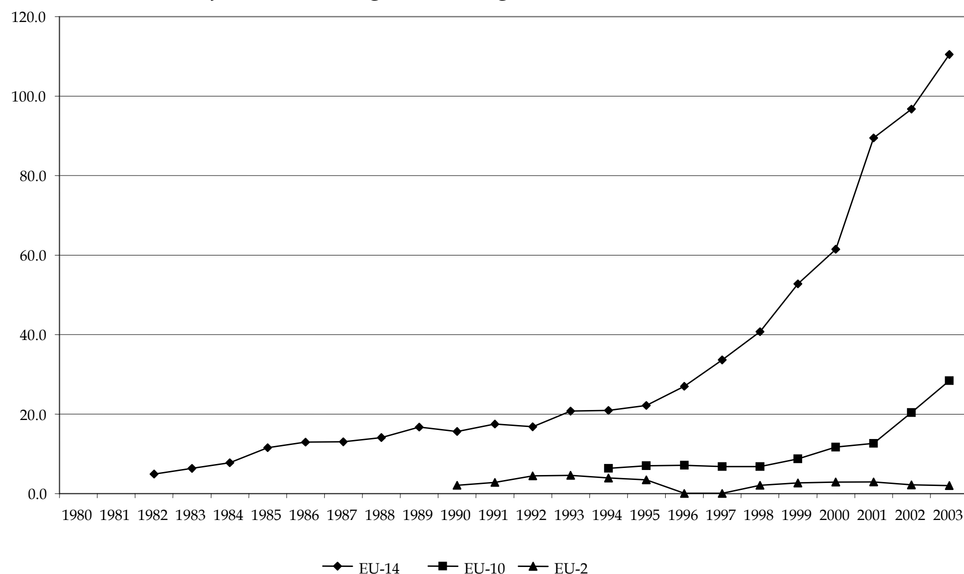
[21] See Chapter IV in IMF (2001), Edison et al. (2002), Prasad et al. (2003), Lane & Milesi-Ferretti (2006) and Gács, Holzmann & Wyzan (1999).

management of financial liberalisation needs, among other things, careful preparation, sound macroeconomic fundamentals, prudent fiscal policies, financial regulations and supervision, and the possible containment of short-term debts, notably those denominated in foreign currencies (see Prasad et al., 2003).

3.2.4 Outcome-based measures

Recently, various attempts have been made to assess the scale of capital mobility (and compare it across countries and time) either through calculating actual, specific capital inflows and outflows as a percentage of GDP, or by calculating composite indices of the main financial flows, also as a percentage of GDP. We have made similar calculations for the EU member countries and their groupings. Figures 3.3 to 3.6 show the results for the development of stocks of different categories of portfolio investments and FDI for the relevant groups of EU member states.

Figure 3.3 Portfolio investments (assets) in groups of EU member states (% of GDP, unweighted average)

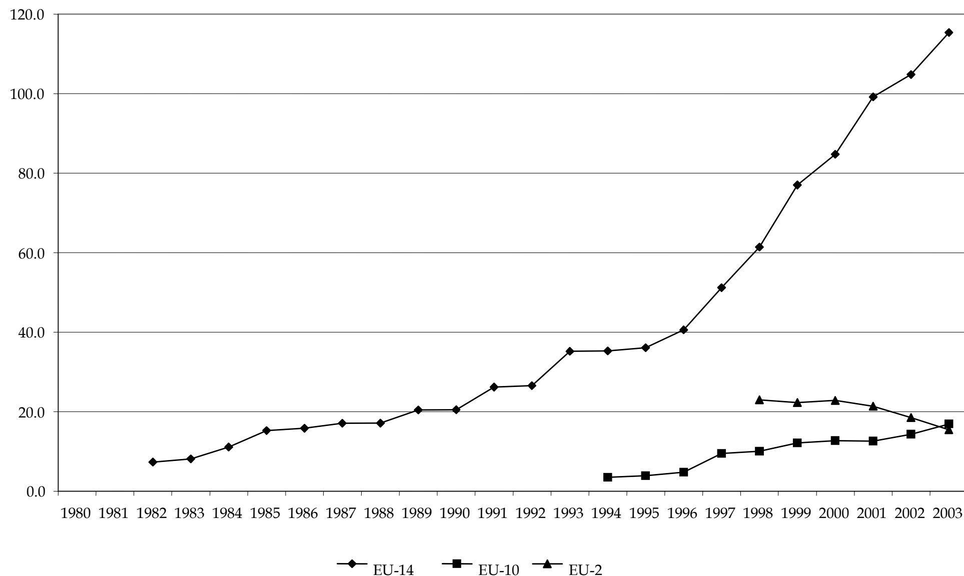


Source: Own calculations based on the IMF International Statistics database.

The figures give evidence of the especially dynamic expansion of capital flows in this part of the world in the past decade. The main drivers of the expansion have been liberalisation and the development of domestic and international capital markets, large-scale privatisation programmes, demographic changes, such as an increasingly ageing population, and the rise in importance of institutional investors in the developed countries.

Figures 3.3 and 3.4 show that the new EU member states (notably the former communist countries) have simply been unable to catch up with the scale of openness to portfolio investments that the old EU member states have achieved despite major institutional transformations and their strong efforts to adopt liberalisation measures in domestic financial markets. The transition countries have been latecomers in establishing solid and open financial markets, and the hectic transformation period of the 1990s had not been attractive to portfolio flows either. Accordingly, it is no surprise that in terms of the accumulated portfolio of liability stocks, they hold the same position now as the old EU member states did 15 years ago.

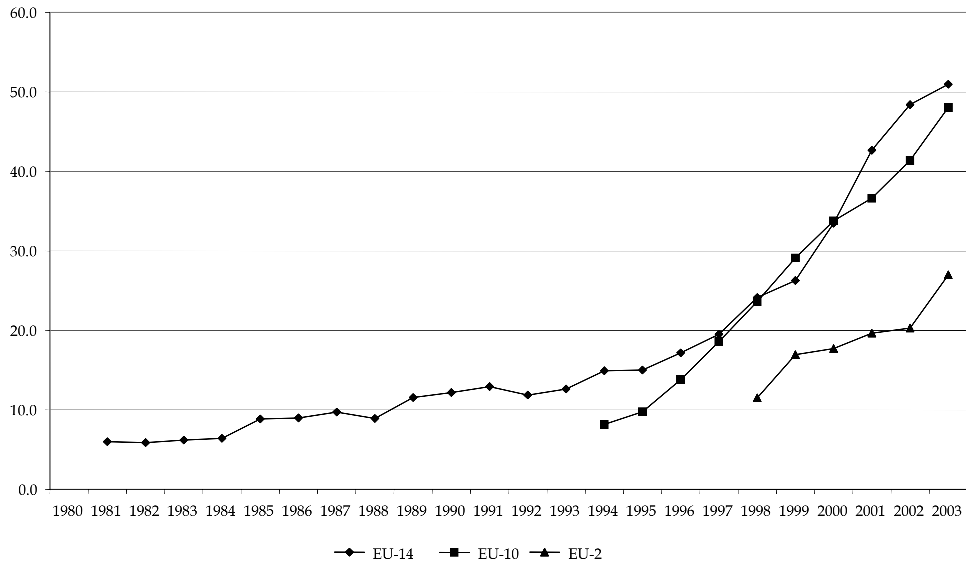
Figure 3.4 Portfolio investments (liabilities) in groups of EU member states (% of GDP, unweighted average)



Source: Own calculations based on the IMF International Financial Statistics database.

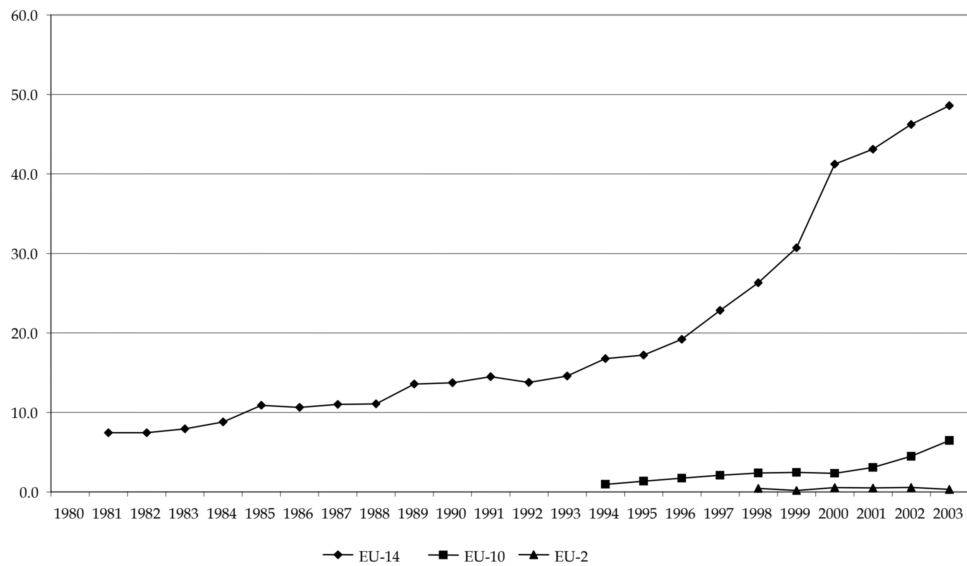
Figures 3.5 and 3.6 indicate, however, that the picture for FDI inflows is completely different. As a result of the unique opportunities afforded by large-scale privatisation and the expected high returns in their markets, in the past decade the 10 (now) new member states experienced massive inflows of FDI, and consequently, by 2003 they showed a similar level of integration in inward investments as the more mature members of the EU. The EU-2 countries, by contrast, seem to lag behind the other two groups by four to five years. Yet in terms of outward FDI, the EU-10 and EU-2 member states have a much lower relative stock than the old member countries. This is no surprise given their low level of development and relative scarcity of indigenous capital.

Figure 3.5 Inward FDI in groups of EU member countries (% of GDP, unweighted average)



Source: Own calculations based on the IMF International Financial Statistics database.

Figure 3.6 Outward FDI in groups of EU member countries (% of GDP, unweighted average)



Source: Own calculations based on the IMF International Financial Statistics database.

Indicators that are more complex, representing the position of individual countries in global financial integration, can be calculated from the data of the IMF's External Wealth of Nations database.[22] This useful source of information has been developed by Lane & Milesi-Ferretti,[23] who took the IMF's concept of 'International Investment Position'[24] as a starting point. The database covers portfolio investments (both equity securities and debt securities), FDI, other investments (including various debt instruments), financial derivatives and reserve assets. Deriving from these raw data the authors offer two main outcome-based (or as they call them, 'volume-based') indicators for measuring the scale of international financial integration of countries. The indicator 'IFIGDP' adds up the *stock of all external assets and liabilities* of a country as a percentage of the country's GDP. A subset of these financial instruments, called 'GEQGDP', focuses on *equity holdings* in portfolio investments and FDI. Tables 3.8 and 3.9 present the results of the calculations of these two indices for the EU countries for every fifth year since 1970. Data in Table 3.8 reflect the extraordinary acceleration of financial integration in the EU-14 since the middle of the 1990s, also experienced worldwide. Beyond this general tendency, we see a wide variation among the economies with Ireland, Belgium, the UK and the Netherlands being on the highly open end, and Greece, Italy, Spain and Germany on the less open end. Clearly, the difference between these groups of countries in international financial integration depends not only on the extent of liberalisation of their capital markets, but also on many other circumstances, such as the differences in how their domestic markets are habitually financed (i.e. by bank loan or equity financing).

Table 3.9 presents similarly dynamic developments in the new member states, naturally starting from (and reaching) a lower level than the old member states of the Union. As expected (for instance after inspecting Figures 3.3 to 3.6), the less developed EU countries have based their integration relatively more on equities versus debt instruments than the more developed EU countries. This corresponds to the tendency that Lane & Milesi-Ferretti (2006) found for two broader categories of countries, the "industrial country group" and the "emerging markets/developing countries" group, not only for all asset and liability instruments but also for liability instruments alone. This finding implies that, through increasing financial integration, these less developed countries are becoming gradually less vulnerable to the more mobile and volatile international financing instruments. As for the variation in terms of financial openness within the EU-10 and the EU-2, we find the traditionally highly open economies of Cyprus and Malta on the one hand, and a more or less balanced development for the rest of the countries on the other. Among this latter group of countries, Estonia stands out with its relatively fast financial integration and Romania is noteworthy for its slow pace.

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[22] See the IMF's website http://www.imf.org/external/pubs/ft/wp/2006/data/wp0669.zip.

[23] See Lane & Milesi-Ferretti (2006), as their latest publication on the database.

[24] Used by the IMF, the methodology of the International Investment Position is described in IMF (1993).

Table 3.8 Volume-based measures of international financial integration (IFIGDP) and its equity part (GEQGDP) in the EU-14 group (% of GDP)

		1970	1975	1980	1985	1990	1995	2000	2004
Austria	IFIGDP	43.5	55.2	96.2	160.7	133	145.7	291.9	393.1
	GEQGDP	7.6	6.2	5.3	8.6	12.5	17.9	62.8	81.9
Belgium	IFIGDP	74.5	90.9	154.6	365.6	394.8	414.6	599.1	819.5
	GEQGDP	8.8	10.6	14.4	42.5	70	96.5	224.6	300.2
Denmark	IFIGDP	49.8	53.3	81.8	158.7	199.9	166.3	329.4	403.1
	GEQGDP	11.2	14.4	15.4	17.1	26.4	41	135.8	136.5
Finland	IFIGDP	64.3	43.6	52.4	83.5	93.9	129.4	397.2	403
	GEQGDP	1.9	2.3	2.7	6.4	13.1	29.9	250.4	155.3
France	IFIGDP	36.9	43.6	67.8	113.3	131.5	176.1	344.7	418.1
	GEQGDP	11.8	8.9	10.4	26.3	35.4	56.9	164.5	164.1
Germany	IFIGDP	43.5	48.5	59.2	100.2	118.6	126.7	267.3	326.2
	GEQGDP	7.6	8.9	8.7	17.5	21.1	24.3	95.7	91.7
Greece	IFIGDP	26.6	35.6	45.6	81.6	81.3	98.4	145.8	207
	GEQGDP	2.6	2.2	5.8	8.6	11.3	14.7	26.7	36.1
Ireland	IFIGDP	111.2	149.7	180.1	191.6	203.2	390.6	1337	1880
	GEQGDP	9.8	16.9	25.8	52.6	47.8	131.1	528.6	692.5
Italy	IFIGDP	60.7	45.2	43.6	64.7	76	116.4	212	229.1
	GEQGDP	7.6	6.3	4.6	11.1	15	23.7	69.9	65.5
Netherlands	IFIGDP	128.7	112	136.9	227.9	260	270.3	624.9	810.9
	GEQGDP	60.7	45.9	45.3	83.1	89.6	122.9	310.4	318.1
Portugal	IFIGDP	0	41	58.6	133.8	88.2	142	300.9	421.8
	GEQGDP	2.5	4.8	5.5	10.6	17.1	26.9	67.9	102.6
Spain	IFIGDP	30.7	29.1	44.5	64.9	63.8	115.3	232.5	300
	GEQGDP	7.9	6.3	6.1	13	20.7	35.2	97	111.7
Sweden	IFIGDP	33.5	43.3	53.5	96.8	149.5	235.4	451.3	436.4
	GEQGDP	8	7.8	7.9	18.8	39.5	86.2	278.5	215.3
UK	IFIGDP	128.4	166.5	195.2	349.1	351.2	423.8	618.2	728
	GEQGDP	38.7	33.3	34.6	58.5	78.3	101	201.9	183.7
EU-14	IFIGDP	59.4	68.4	90.7	156.6	167.5	210.8	439.5	555.4
	GEQGDP	13.3	12.5	13.7	26.8	35.6	57.7	179.6	189.7

Notes: IFIGDP = sum of the stock of external assets and liabilities (% of GDP); GEQGDP = sum of the stock of portfolio equity assets and liabilities and direct investment assets and liabilities (% of GDP); the group average is unweighted.

Sources: Own calculations based on Lane & Milesi-Ferretti (2006) and the IMF's External Wealth of Nations database.

Table 3.9 Volume-based measures of international financial integration (IFIGDP) and its equity part (GEQGDP) in the EU-10 and EU-2 groups (% of GDP)

		1970	1975	1980	1985	1990	1995	2000	2004
Cyprus	IFIGDP	–	108.9	100.4	174.5	239.5	236.2	573.1	513.2
	GEQGDP	–	27.3	22	26.9	21.4	23.1	69.5	110.2
Czech Rep.	IFIGDP	–	–	–	–	–	100.1	146.4	162.6
	GEQGDP	–	–	–	–	–	19.6	50	67.4
Estonia	IFIGDP	–	–	–	–	–	69.9	146.1	251.5
	GEQGDP	–	–	–	–	–	20.1	61.4	121.2
Hungary	IFIGDP	–	–	–	69.4	63.7	123.7	157.7	181
	GEQGDP	–	–	–	0	1.5	27.3	60.1	80.7
Latvia	IFIGDP	–	–	–	–	–	75.7	128.6	190.1
	GEQGDP	–	–	–	–	–	17.9	28.5	36.7
Lithuania	IFIGDP	–	–	–	–	–	48.6	83.4	105
	GEQGDP	–	–	–	–	–	6	22.3	31.7
Malta	IFIGDP	489.8	322.3	190.6	240.8	178.9	226.6	572.8	820.2
	GEQGDP	24.2	21.9	16.3	25.2	22.3	29.1	91.2	114.3
Poland	IFIGDP	–	34.1	54.4	61.5	117.1	65.7	86.5	116.6
	GEQGDP	–	0	0.4	0.6	1.2	6.7	24.5	42.3
Slovak Rep.	IFIGDP	–	–	–	–	–	93.4	126.6	156.5
	GEQGDP	–	–	–	–	–	14.7	32.9	51.8
Slovenia	IFIGDP	–	–	–	–	–	66.9	100.3	150.8
	GEQGDP	–	–	–	–	–	11.8	20.6	36.9
EU-10	IFIGDP	–	–	–	–	–	110.7	212.1	264.8
	GEQGDP	–	–	–	–	–	38.9	96.5	109.6
Bulgaria	IFIGDP	–	–	–	–	–	125.2	175	173.3
	GEQGDP	–	–	–	–	–	4.6	19.7	40.4
Romania	IFIGDP	–	–	–	–	–	41.5	74.6	95.8
	GEQGDP	–	–	–	–	–	1.5	18.3	28.4
EU-2	IFIGDP	–	–	–	–	–	83.3	124.8	134.5
	GEQGDP	–	–	–	–	–	3	19	34.4

Notes: IFIGDP = sum of the stock of external assets and liabilities (% of GDP); GEQGDP = sum of the stock of portfolio equity assets and liabilities and direct investment assets and liabilities (% of GDP); the group averages are unweighted.

Sources: Own calculations based on Lane and Milesi-Ferretti (2006) and the IMF's External Wealth of Nations database.

Openness to financial flows and foreign ownership in different countries can only be incompletely characterised by policy-based indices and the actual aggregate flow and stock values of financial inflows. Based on historical roots, the level of development, the structure of the economy, the economic policies pursued, etc., the same amount of inflows may end up representing more or less *foreign influence* in different countries. For instance, in terms of the indicator of the stock of FDI inflows expressed as a percentage of GDP, by 2003 the new member states (EU-10) had achieved virtually the same level as the old member states (EU-14) (see Figure 3.5 above). Even so, this does not mean that foreign control of business stands at similar levels in the two country groups. Table 3.10 presents data on the extent of foreign control in manufacturing, services and, as part of the latter, in the banking sector in selected countries of our sample. The term 'under foreign control' here means that the local company is an affiliate of a foreign company with majority ownership (more than 50%) by the mother company. Data in the table demonstrate that in most of the new member states foreign control is much stronger than in most of the old member states. An example is Poland: the data underlying Figure 3.5 above show that the relative inward FDI stock of Poland stood at a mere 27.6% in 2003, much lower than the average of the old member states (51%).

Table 3.10 Ratio of business under foreign control in 2000–01 (%)

	Share of affiliates under foreign control [a)]				Bank penetration ratio [b)]
	In manufacturing		In services		
	Turnover 2000	Employment 2000	Turnover 2001	Employment 2001	Assets 2001
Austria	27.1	19.6	16.3	9.7	–
Belgium	47.5*	19.1*	26.6*	18.9*	–
Bulgaria	–	–	–	–	74.6
Cyprus	–	–	–	–	–
Czech Rep.	39.5	24.9	25.6	16.0	–
Denmark	12.0***	10.2***	–	–	0.0
Estonia	–	–	–	–	98.9
Finland	16.2††	17.2††	18.1	11.9	6.2
France	33.6***	28.5***	9.0**	5.3**	–
Germany	5.9	4.2	–	–	–
Greece	–	–	–	–	10.8
Hungary	73.7	47.2	34.0	16.5	88.8
Ireland	78.2	48.1	23.8*	13.6*	–
Italy	22.4***	13.8***	21.0*	7.2*	–
Latvia	–	–	–	–	65.2
Lithuania	–	–	–	–	78.2
Malta	–	–	–	–	–
Netherlands	30.8***	18.9***	16.8*	8.9*	–
Poland	34.7	20.9	23.9	13.4	68.7
Portugal	17.4	10.1	11.9†	4.0†	17.7

Table 3.10 Continued

Romania	–	–	–	–	47.3
Slovak Rep.	–	–	–	–	85.5
Slovenia	–	–	–	–	20.6
Spain	29.7	16.8	–	–	8.5
Sweden	34.3	29.1	18.1*	4.8*	1.8
UK	36.1***	20.4***	17.2*	9.7*	46.0
Countries from EU-14	30.1	19.7	17.9	9.4	10.3
Countries from EU-10	49.3	31.0	27.8	15.3	74.5
Countries from EU-2	–	–	–	–	61.0

* 1997; ** 1998; *** 1999; † 2000; †† 2001

a) Ratio of turnover/employment in majority-owned foreign affiliates to total turnover/employment

b) Ratio of assets of majority-owned foreign affiliates to total banking assets

Sources: OECD (2003) based on OECD AFA and FATS databases, and UNCTAD (2004).

According to Table 3.10, however, in all the categories of foreign control Poland shows the same or higher ratios than the EU-15. The striking difference between aggregate FDI data and ownership patterns can be explained by the pattern of the privatisation process in the transition period of the Central and Eastern European countries. In this process, foreign bidders could obtain stakes in relatively concentrated domestic enterprises easily and cheaply owing to the scarcity of indigenous capital. These stakes could either represent existing majority ownership or be consolidated to shares with majority control shortly after privatisation.

3.3 Tax bases

Globalisation means the lowering of barriers to economic transactions and to the mobility of goods, services, capital and people. The domain of rational decisions of economic agents in pursuing their goals expands from the national market to the global marketplace. Owing to the most recent technical developments – such as communication innovations, more complex and mutable financial instruments, cheap modes of transport and travel – as well as the evolving international tax competition, the bases of various taxes are becoming increasingly mobile. Agents have stepped up their efforts to search and find places around the world with low tax rates or even with possibilities for full tax evasion. Since the early 1990s, the threat of mobile tax bases for the fiscal stability of nations has been discussed with growing angst. The main source of worry has been that shrinking budgets would not be able to finance social protection, the aspect of public spending that, as a result of population ageing and the need for adjustments to the pressure of globalisation, is expected to keep its pivotal role in national budgets.

Tanzi (2001) lists eight “fiscal termites” – elements of the “ecosystem” of globalisation that are gnawing away at the foundations of the tax systems. These are e-commerce and transactions, electronic money, intra-company trade, offshore financial centres, derivatives and hedge funds, the inability or unwillingness of governments to

tax financial capital and the incomes of persons with highly tradable skills, the increased activities of highly skilled individuals outside their country of residence and foreign shopping.

While accepting that the mobility of tax bases has been increasing, most of the evidence reveals that so far, there has been no substantiation of either a race to the bottom in specific forms of taxation or a meltdown of total tax revenues.[25] A realistic historical view suggests that the process of increasing mobility of tax bases evolves in the long term and affects various aspects of the tax structure differently, as shown in Table 3.11 based on Hufbauer's (2000) qualitative assessment of the mobility of tax bases. Indeed, back in the 1970s, when international trade was mostly confined to merchandise trade, multinationals were not yet the main protagonists in the world economy and most individuals consumed and invested in their home country. The world has changed greatly since then; so too has the mobility of tax bases, which nonetheless follows the internationalisation process only gradually. In the next 30 years, it is expected that with a different intensity, tax bases will become progressively footloose.

Table 3.11 Changing mobility of tax bases

		Mobility in	
Tax base item	**1970**	**2000**	**2030**
Wage and salary income	Low	Low	Moderate
Consumption of goods	Low	Moderate	Moderate
Consumption of services	Low	Low	Moderate
Investment income	Low	Moderate	High
Corporate profits	Low	Moderate	High

Source: Hufbauer (2000).

A quantitative comparison of the total tax burden of the EU countries for the past 15 years also indicates that, for the time being, there is no evidence of big losses in the tax system for these economies (Table 3.12). From among the old member states (EU-14) only Finland, Ireland and the Netherlands saw substantial shrinkage in the relative size of their total tax revenues between the periods 1991–95 and 2001–05. These developments, however, seem to be the result of conscious structural reforms, rather than direct implications of the pressure of more mobile tax bases. Most of the old member states have either maintained the relative size of their tax revenues or even managed to increase it.

The new member countries have, on average, lower tax ratios than the old member states, and several of them (such as Estonia, Slovenia and the Slovak Republic) show a tendency towards reducing these ratios further. Most probably, both the perception of growing international tax competition and the desire to prevent the work of the 'fiscal termites' have contributed to the conscious efforts of these governments to cut their tax ratios. Yet, we have to add that the Central and Eastern European

[25] See Tanzi (2000) and Genschel (2001), as well as the literature reviewed in the latter.

economies also battle with a high level of indigenous tax evasion and tax avoidance (reflected in the high ratios of their hidden economies) as well as with excessive corruption. Both of these tend to prompt governments to simplify their tax systems and lower their tax rates (Lackó, 2004; Dreher & Schneider, 2006).

Table 3.12 Total current revenue: General government (% of GDP at current market prices, countries in descending order of the values during 2001–05)

	1986–90	1991–95	1996–2000	2001–05
Sweden	–	57.7	59.2	55.8
Denmark	55.6	55.3	55.7	54.4
Finland	49.6	53.6	52.3	50.0
Belgium	47.2	47.2	49.1	49.1
France	46.5	47.3	49.2	48.4
Austria	48.0	48.8	48.2	48.1
Hungary	–	–	45.1	45.0
Italy	39.3	43.5	45.2	44.0
Slovak Rep.	–	–	53.2	43.5
Germany	42.7	43.7	45.1	43.1
Netherlands	48.9	47.9	44.1	43.1
Czech Rep.	–	42.7	41.5	41.9
Malta	–	–	34.6	40.2
Greece	31.2	35.8	41.0	40.0
Poland	–	44.1	40.5	39.5
Portugal	31.3	35.2	37.2	38.9
UK	40.5	37.9	38.7	38.7
Spain	–	36.6	37.4	38.2
Romania	–	–	–	37.5
Slovenia	–	50.1	42.5	37.4
Estonia	–	46.8	39.9	36.7
Cyprus	–	–	32.2	36.7
Latvia	–	34.9	39.4	34.9
Ireland	39.3	38.6	35.0	32.5
Lithuania	–	34.9	37.2	32.3
Bulgaria	–	–	–	–
Countries from EU-14	43.3	44.9	45.5	44.6
Countries from EU-10	–	42.3	40.6	38.8
Countries from EU-2	–	–	–	37.5

Source: Own calculations based on European Commission (2006i).

3.4 Summary and conclusions on the degree of openness

The analysis of the dynamics of various openness measures shows that in the past one and a half decades, financial integration has been the fastest expanding facet of

globalisation in the EU. Both portfolio and direct investments have increased several-fold relative to GDP. As a result of more intense financial integration, in most countries foreign influence in business has increased, including the substantial control by foreign owners through majority-owned foreign affiliates. Such rapid development has not been detected in the international trade of goods and services: in recent decades, the pace of countries' growing openness to trade has not shown a striking acceleration. Openness to cross-border service activities has increased, but the qualitative change has taken place in the mounting share of FDI devoted to services, rather than in the rising volume of trade in services relative to GDP. The much-discussed increasing mobility of tax bases does not seem to have hit the EU countries so far: on the aggregate level, there is little evidence of a meltdown of aggregate tax revenues and only a few countries show signs of active participation in international tax competition.

The analysis shows wide variation in openness changes across the EU member states, with avant-gardes of economic globalisation and those that are falling behind. Among the old member states, the avant-gardes are Ireland, Belgium and the Netherlands. Among the new member states, there are no apparent avant-gardes: Estonia and the Czech Republic excel in several dimensions, but in a few other areas, they are behind other countries (such as Cyprus and Malta). One can only find out with more sophisticated analysis whether a country has achieved its position because of its special, idiosyncratic conditions or because of deliberate policy decisions. In most dimensions of globalisation, the new member states are gradually catching up with the old ones. Still, contrary to common perceptions, openness to trade in the new member states on average continues to lag behind openness in the old member states. The area in which the new member states have shown the most marked development is the absorption of FDI inflows and the exposure of domestic business to foreign control. When facing international tax competition, it seems that the new member states are more ready to join this practice than the old ones are, although one cannot exclude reversals in the current tendencies.

This chapter has attempted to look at aggregate data on the economic openness of the EU-27 countries in order to analyse the progress of globalisation in a sober way. On the aggregate level and in the analysis of yearly data (sometimes smoothed out for longer periods), we have found clear, but not earth-shattering tendencies in the intensification of global integration. There are many other ways of investigating the process of globalisation, which disclose its more dramatic sides. These include detailed analyses of developments in specific sectors or lines of business, discussion of certain events that take place in periods of less than a year (such as the immediate destabilising impact of particular events or news worldwide) and consideration of the non-economic sides of globalisation – such as its technological, social, political and cultural aspects. Nevertheless, the aim of this overview has been to measure the evolution of the globalisation process in the region with the help of carefully selected and more or less widely accepted indicators, with the aspects listed above lying beyond the scope of this study.

4. EFFECTS OF OUTSOURCING ON LABOUR MARKETS AND WAGES

Outsourcing is seen by many companies as a logical response to cost pressures, since it allows them to optimise their costs by subcontracting parts of their value chain to more efficient subcontractors. A phenomenon that has been strongly advocated by business schools and management consultancies for some time, it has taken on new urgency as options have emerged to outsource across national boundaries. The French term *delocalisation* implies that the search for greater cost efficiency is more a threat, portraying it as competition from low-wage workers. This chapter considers the impact of what has become a politically sensitive issue, yet also one that is prone to many myths.

4.1 The impact of outsourcing on labour markets

Data on the effects of the processes of relocation and outsourcing of jobs as part of restructuring have been collated by the Economic Policy Committee (EPC) (2005, p. 10, chart 2), which show that around 6% of jobs lost in total restructuring resulted from these processes. Yet, in four smaller member states (Greece, Denmark, Finland and Portugal), the share was significantly higher, reaching a third in Greece. By contrast, the EPC analysis finds no reported losses for this reason in four other smaller member states (Slovenia, Estonia, Lithuania and Luxembourg). While these data have to be treated with caution, they suggest that the impact is far from uniform.

Broadly speaking, there is also evidence from the EU and other countries that international outsourcing leads to a shift in the relative demand for labour, and that this can have implications for the wage bill as well as the employment share of highly skilled versus low-skilled labour. What are the policy implications of these findings? First, it is important to stress that the crucial issue for policy-makers is the medium- and long-term effects of international outsourcing. Yet, empirical studies generally deal with partial equilibrium (short-term) effects. Thus, factor movements between sectors or long-term repercussions on competitiveness that stem from outsourcing are not taken into account. Still, the partial equilibrium results give some indication of the direction in which the labour market adjustment seems to go in response to international outsourcing.

A common conclusion of most theoretical contributions is that international outsourcing usually offers the potential for substantial efficiency gains. But only with sufficiently flexible factor prices can potential gains from trade be realised. In addition, adjustment costs can consume a substantial share of these gains if workers experience unemployment or have to be retrained. Hence, policies that mitigate adjustment costs can certainly increase the ability to reap gains from international outsourcing (and trade more generally).

Furthermore, even if international outsourcing does indeed lead to welfare gains, the question remains as to how to strike a balance between collective and individual management of the adjustment. Particularly low-skilled workers feel the pressure from

international outsourcing. As a reaction, it may be essential for workers either to obtain higher qualifications or to find new employment opportunities in other sectors of the economy (or both).

Insurance schemes that partly compensate workers for their potentially lower post-displacement earnings are therefore especially interesting for fostering the transition between economic sectors. The risk that public policy entails crowding out private adjustment or market-based insurance should thus be taken into account when fixing the scope of action for policy-makers.

4.2 The effect of outsourcing on wages

Based on analysis using the German Socio-Economic Household Panel Survey, international outsourcing appears in the German case to raise wages for highly skilled workers, a finding that is in line with the idea that firms outsource the low-skilled, intensive parts of production and, consequently, increase the relative demand for skilled workers. For medium- and low-skilled workers the coefficients on the outsourcing intensity are negative, which is also in line with this reasoning.

The results for those skilled workers whose job requires a defined minimum level of education further support the above findings. International outsourcing has a statistically significant positive impact on workers who report that their job requires college or technical school training. For example, an increase of 1 percentage point in the narrow outsourcing intensity *ceteris paribus* raises wages by about 2%. For workers in jobs requiring lower levels of qualifications there is a statistically significant negative effect of outsourcing, with an increase of 1 percentage point in narrowly defined outsourcing yielding a wage loss of around 1.3%, all other things being equal.

Low-skilled workers are therefore the losers from this form of globalisation of production, while highly skilled workers are, on average, the group liable to gain. This conclusion may have implications for policy-makers, who need to debate whether losers should be compensated or in any other way be the focus of policies aimed at easing the adjustment costs of globalisation.

In order to obtain a better idea of the true impact of international outsourcing, Geischecker & Görg (2006) calculate cumulative marginal effects based on the statistically significant coefficients derived from econometric analysis. These indicate that real wages for workers in the lowest skill categories were reduced by outsourcing by up to 1.5% or 1.3%, depending on whether outsourcing is defined in a narrow or wide sense. By contrast, real wages for highly skilled workers grew by 2.1% in the case of narrowly defined outsourcing, while the coefficient was statistically insignificant for widely defined outsourcing. To calculate numbers that are more economically meaningful, Geischecker & Görg multiply the percentage point changes in the outsourcing intensity starting from the basis year 1991 with the point estimate of the outsourcing variable from the wage regression (i.e. 1.5%, 1.3% and 2.1%, respectively) and the average wage for each respective skill group in 1991.

Overall, the narrowly-defined outsourcing intensity in Germany increased by 3 percentage points between 1991 and 2000. Applying the wide outsourcing definition the increase was about 5 percentage points. As a result, the average hourly wage for low-skilled workers decreased by 4.5% and 6.5%, respectively between 1991 and 2000, while the average hourly wage for highly skilled workers increased by 6.3%.

For low-skilled workers, applying the definition of the International Standard Classification of Education, they calculate that between 1991 and 2000, increased outsourcing accounted for a reduction in hourly earnings by €0.67 and €0.87 for narrowly and widely defined outsourcing respectively. For an average low-skilled worker with, say, 1,600 working hours per year, this amounts to an earnings loss of respectively €1,067 and €1,392 owing to increased outsourcing. On the other hand, highly skilled workers significantly gained from increased outsourcing. On average, their hourly wages increased by about €1.85 in 2000 compared with 1991. Again, with the assumed 1,600 working hours per year this amounts to an earnings gain of €2,960 per annum.[26]

Of course, this average figure hides differences across sectors. Table 4.1 therefore calculates the cumulative wage changes as above, yet instead of an average overall outsourcing intensity, it applies outsourcing intensities by two-digit sector. The implied percentage changes in average wages by sector owing to outsourcing are shown in the table. Based on the narrow definition of outsourcing, highly skilled workers in the transport equipment and leather industries gained most from outsourcing, with percentage increases of over 30%. Skilled workers in the textiles, apparel, office machinery and TV & telephone industries also gained by more than 10%. On the other hand, low-skilled workers in transport equipment, leather and apparel had the highest reductions in their wages attributable to outsourcing, at 20%, 19% and 12%, respectively.

Two interesting questions that these results bring up are i) how important each industry is in the economy and ii) how important skilled and unskilled workers are in each industry. We address the first issue in Table 4.2, which shows the importance of each industry in terms of its employment share in the total manufacturing sector. For example, Table 4.2 shows that the food & beverages industry accounts for 6% of total employment in the manufacturing sector.

A look at Table 4.2 reveals that those industries with the highest gains for skilled workers and the highest losses for unskilled workers (apparel, leather and transport equipment) are also those that are of low importance relative to the total manufacturing sector, jointly accounting for less than 3% of total employment in this sector. By contrast, fabricated metals is the largest industry in the manufacturing sector but also shows among the lowest gains for skilled workers and losses for unskilled workers.

[26] Geischecker & Görg (2006) show similar calculations for our alternative skill definition based on actual data on the job skill requirements. Again, comparing the hourly wages of low-skilled workers in 1991 and 2000, increased international outsourcing accounted for hourly wage reductions of €0.61 and €0.90, respectively. Highly skilled workers, however, gained significantly, with increased outsourcing raising hourly wages by €1.75 to €2.2.

Table 4.1 Cumulated wage effects of international outsourcing by industry (%)

		Narrow outsourcing		Wide outsourcing	
	Industry	**Highly skilled**	**Low-skilled**	**Highly skilled**	**Low-skilled**
15	Food & beverages	0.59	-0.34	2.56	-1.75
17	Textiles	12.92	-7.45	15.04	-10.29
18	Wearing apparel	20.80	-12.00	25.08	-17.16
19	Leather	34.53	-19.92	25.15	-17.21
20	Wood	0.35	-0.20	2.01	-1.38
21	Pulp & paper	6.46	-3.73	8.99	-6.15
22	Publishing & printing	0.04	-0.02	1.05	-0.71
23	Coke & petroleum	-5.53	3.19	-3.17	2.16
24	Chemicals	11.07	-6.39	9.41	-6.44
25	Rubber & plastics	1.09	-0.63	4.51	-3.08
26	Non-metallic minerals	0.46	-0.26	3.88	-2.65
27	Basic metals	7.85	-4.52	13.29	-9.09
28	Fabricated metals	0.78	-0.45	2.29	-1.57
29	Machinery & equipment	2.91	-1.68	4.37	-2.99
30	Office machinery	15.73	-9.07	9.27	-6.34
31	Electrical machinery	9.22	-5.32	10.01	-6.85
32	TV & telephone	13.14	-7.58	9.52	-6.51
33	Medical & optical instruments	1.16	-0.67	4.18	-2.86
34	Motor vehicles	4.97	-2.86	7.14	-4.88
35	Transport equipment	36.20	-20.88	25.96	-17.76
36	Miscellaneous	9.48	-5.47	7.74	-5.29

Sources: Based on own calculations and data in Geischecker & Görg (2006).

To address the second point, i.e. the relative importance of skilled and unskilled workers in each industry, we report the percentage share of skilled, semi-skilled and unskilled workers in Table 4.3.[27] This table shows that in food & beverages, 10% of the workforce is skilled and 68% is low-skilled according to the skill classification used. Except for some high-technology industries such as office and electrical machinery, and TV & telephone, by far the major proportion of the workforce in all other industries is unskilled. At the same time, there is much more heterogeneity in terms of the importance of skilled workers. For example, in wearing apparel, which shows among the highest gains to skilled workers, their employment share is minimal (less than 0.01%). On the other hand, in office machinery, where skilled workers experienced reasonable gains (Table 4.1), their employment share at 60% is also by far the highest.

[27] There are no statistically significant wage effects for medium-skilled workers in any of the industries; hence, they are not included in Table 4.3 (see Geischecker & Görg, 2006).

Table 4.2 Employment shares of industry (%)

Industry	Share
Food & beverages	6.08
Textiles	2.53
Wearing apparel	0.22
Leather	0.47
Wood	1.87
Pulp & paper	1.84
Publishing & printing	2.69
Coke & petroleum	0.55
Chemicals	11.31
Rubber & plastics	3.84
Non-metallic minerals	3.41
Basic metals	3.49
Fabricated metals	21.54
Machinery & equipment	11.67
Office machinery	0.19
Electrical machinery	7.80
TV & telephone	1.40
Medical & optical instruments	3.09
Motor vehicles	12.46
Transport equipment	1.68
Miscellaneous	1.87

Sources: Based on own calculations and data in Geischecker & Görg (2006).

Table 4.3 Employment shares by skill group within industry (%)

Industry	Highly skilled	Medium-skilled	Low-skilled
Food & beverages	10.61	21.22	68.16
Textiles	2.94	11.76	85.29
Wearing apparel	0.00	27.78	72.22
Leather	21.05	0.00	78.95
Wood	0.00	7.28	92.72
Pulp & paper	6.08	7.43	86.49
Publishing & printing	18.89	13.82	67.28
Coke & petroleum	15.91	4.55	79.55
Chemicals	20.75	14.16	65.09
Rubber & plastics	3.24	10.03	86.73
Non-metallic minerals	0.36	15.64	84.00
Basic metals	9.61	9.61	80.78
Fabricated metals	7.72	12.62	79.65
Machinery & equipment	20.96	16.70	62.34
Office machinery	60.00	0.00	40.00
Electrical machinery	29.14	22.45	48.41
TV and telephone	30.97	23.89	45.13
Medical & optical instruments	18.07	31.73	50.20
Motor vehicles	16.63	13.45	69.92
Transport equipment	22.96	15.56	61.48
Miscellaneous	5.96	7.95	86.09

Sources: Based on own calculations and data in Geischecker & Görg (2006).

Munch & Skaksen (2005) report a similar study on the effect of international outsourcing on wages using individual-level data combined with sectoral outsourcing measures for Denmark. In their estimations, they find that real wages for low-skilled workers were reduced, while real wages for highly skilled workers were increased by international outsourcing (narrowly defined). Their data relate to the period 1993–2002. Their point estimates suggest that real hourly wages for low-skilled workers decreased by roughly 10%, while wages for highly skilled workers rose by 13% to 30%, depending on the estimation method. Taking these estimates at face value suggests significantly higher average effects, both negative and positive, in Denmark than in Germany. Yet they are in line with some of the more striking results by industry sector for Germany as discussed in Table 4.1 above. Unfortunately, Munch & Skaksen do not present sufficient data to allow a calculation of 'economic significance' similar to the one undertaken by Geischecker & Görg (2006).

Geischecker et al. (2007) extend this analysis to three European countries, Denmark, Germany and the UK, allowing them to discuss the significance of the social model as well as the impact depending on which class of jobs are predominantly outsourced from the country. The study, again, does not include as many control variables in the empirical model as Geischecker & Görg (2006). Thus, for example, they confirm the negative effect on outsourcing on the wages of low-skilled German workers but find no statistically significant impact on the wages of the high-skilled.

PART II.

THE SOCIAL DIMENSION OF GLOBALISATION

In part I, the reality of globalisation was established. Some of its elements may be more contentious than others are, but the key processes and trends are shown to be both enduring and pervasive. Across the EU, there has been a widespread questioning of whether the social structures and policies that have been at the heart of the European social model can be sustained in the face of globalisation. A 'race to the bottom' is sometimes assumed inevitable. According to Sinn (2004a, p. 16),

> [w]hile the old systems [of] competition took place within closed borders, globalisation has brought about a new type of systems competition that is driven by the mobility of factors of production. The new systems competition will likely imply the erosion of the European welfare state, induce a race to the bottom in the sense that capital will not even pay for the infrastructure it uses and erode national regulatory systems.

Others are much more sanguine about the ability of the European social model to resist dismantlement, however. Even so, one line of argumentation is that there is a systemic problem to address, rather than just a need for ad hoc reforms, an example being the statement from Eichengreen (2006):

> [T]he same institutions of coordinated capitalism that had worked to Europe's advantage in the age of extensive growth now posed obstacles to successful economic performance. In this sense, the continent's very success at exploiting the opportunities for catch-up and convergence after World War II doomed it to difficulties thereafter. And the durability and persistence of institutions, which had worked to Europe's advantage after World War II, were now less positive attributes than impediments to growth.

De la Dehesa (2006) also analyses the challenges the EU has to confront, arguing that especially population ageing should be central to policy thinking, but he is less pessimistic than other contributors are about the EU's scope for reform and ability to prosper under globalisation.

Too often, the debates about social Europe take place in a statistical vacuum, with strong positions being asserted with little firm support. This part of the report therefore aims at redressing the position by presenting a credible account of how the social dimension of globalisation is unfolding in the EU. It starts with a conceptual discussion that builds on the existing academic literature. The first part of chapter 5 concentrates on the interplay between globalisation – notably the openness of markets – and inequality, demonstrating that there is by no means a clear set of theories or predictions. An assessment follows of the various other channels of social impacts, with a focus largely on the circumstances of the EU. Chapter 6 then provides an extended overview of key social indicators. Two of the most politically salient social aspects of globalisation are then examined in more detail in chapter 7. The first, migration, includes a discussion of the issues and a summary of empirical material on trends, before going on to present the findings of an exercise to document policy trends in this area. The last chapter of this section offers a deeper analysis of inequalities in the EU at the country and regional levels, noting that inequality has increased overall in recent decades, raising questions about whether globalisation is the reason.

5. CONCEPTUAL ISSUES

The social repercussions of globalisation come about above all through changes in the distribution of income and assets on the one hand, and through their effects on job opportunities on the other. Re-distribution affects the balance of political power and political changes may accentuate the impact of global changes. In Europe, the picture is complicated by the presence of endogenous social changes: notably ageing populations and the erosion of traditional family structures. Globalisation is a complex phenomenon that overlaps with the shift to a post-industrial type of economy, with the attendant emphasis on flexibility and fast-paced innovation, and the decreasing relative importance, in the most developed economies, of large-scale industrial operations with a workforce employed in lifetime, assembly-line work.

Globalisation is certainly not manifested in the same way across countries. There are countries that trade extensively but do not have substantial inward foreign investment (Japan). There are others where foreigners own more than half the economy, but which are not major players in the manufactured products' global market, with trade largely confined to the immediate neighbourhood (Canada). A third type of country is very open to exports and imports as well as to foreign investment – for example, some new EU member states, where trade openness exceeds 100% and foreign capital owns three-quarters of the economy (Hungary and Slovakia). On other dimensions of globalisation, however, for example the export of capital, these countries are insignificant.

Furthermore, the "distribution of income in a society depends on the distribution of income-generating assets or factors of productions – who owns the land and capital and how human capital is distributed in the labour force" (Robinson, 2001, p. 9), and it also depends on the returns to these assets. Even though there are authors who stress that asset ownership is driven by efficiency (Grossman & Hart, 1986), this is not borne out by empirical evidence. "Different countries might have very different asset distributions, despite identical preferences and technology" (ibid.). In other words, radical redistributions of assets can change patterns of income for good, with the implication that the impact of globalisation on economies depends on how it is handled by domestic institutions. There is nothing to prevent governments from responding (Rodrik, 1997). But the political economy dimension is important (Robinson, 2001, pp. 10–11). In general, Latin American income inequalities have widened in the last decade. In Africa, likewise, governments have mostly failed to respond to globalisation. Social sector spending is usually badly targeted and often regressive (Castro-Leal et al., 1999; Tsikata, 2001, p. 13). Moreover, "[g]lobalisation affects inequality when the distribution of assets is fixed and it can change the rates of return on different assets under an unchanged set of institutions and policies" (Robinson, 2001, p. 10).

5.1 Determinants of changes in inequality: Alternative explanations

The link between globalisation and inequality is at the heart of much of the debate on the social impact of the former. Yet the literature shows that there are considerable

problems in the conceptualisation and measurement of inequalities and even if these problems are resolved, it is not at all evident what to expect from today's more open economic environment. This section documents and assesses the commonly agreed and widely analysed factors that are adjudged to have an effect on the shape of income distribution.

5.1.1 *Trade liberalisation, growth and inequality*

The effects of globalisation on income distribution (defined as reducing transaction costs and the freer movement of goods and services), can be approached through theories of international trade. In a simple version of a Hecksher–Ohlin setting (two economies with two goods and two factors of production – capital and labour or highly skilled and low-skilled labour), country A is characterised by a high ratio of skilled/unskilled work, while country B is characterised by a low ratio of skilled/unskilled work. With no trade, equilibrium wages will be relatively low for the highly skilled in country A and they will be low for the low-skilled in country B. The introduction of trade leads to an increase of skilled wages in country A and higher unskilled wages in country B, leading to increased inequalities in country A and decreasing inequalities in country B. Trade openness would, therefore, lead to benefits first in the low-wage country, especially for the low-skilled. There are, of course, a great number of reasons for the departure of facts from these theoretical predictions. Extreme variations in initial endowments, differential labour-market institutional settings, diverse pay norms and many other factors can cause such departures. [28]

Another departure point for assessing the relationship between globalisation and inequalities is trade liberalisation through reductions of tariffs in international trade. Milanovic & Squire (2005), using occupational wage datasets, find that tariff liberalisation between 1980 and 2000 led to increased inter-occupational wage inequalities (that is, to increased wage premia for higher skills) and increased inter-industry wage differentials in low-income countries (yet depending very much on union density). This type of relationship was also found to operate the other way round, however, for countries with incomes above the world median per capita GDP (around $4,000 at purchasing power parity (PPP)).

Some other empirical papers point to non-linearities with respect to the growth–openness–inequality relationships. Even though the sign and significance of the effects of globalisation on inequality may change depending on the concept of openness deployed (Li, Zou & Squire, 1997), certain types of non-linearities seem to be accepted in the literature. Barro (2000) suggests that there is a positive relationship between openness and inequality in low-income countries and a negative relationship in higher-income countries. Dollar & Kraay (2001 and 2002) argue that trade openness leads to significantly higher growth and this leads to a proportionate increase in the incomes of the poor.

Certain other types of non-linearities may also appear in other dimensions. The differential effects of open markets and of wage premia may affect low-income,

[28] For a recent survey of these failures and refinements of the model for the consequences for income distribution, see Kremer & Maskin (2003) and Milanovic & Squire (2005).

middle-income and higher-income groups differently. Milanovic (2005) finds that for relatively poor countries (below $4,000 PPP per capita), increased openness leads to a top-driven inequality increase. That is, the income shares of the higher deciles increase while lower-income groups lose some ground. But for those countries between $4,000 and $7,000 PPP per capita, the share of the poor and the middle classes begins to be positively affected by openness. "At low income levels, openness is bad for equality; at high income levels it promotes equality" he concludes (ibid.). In an innovative paper, Birdsall et al. (2000) point to an increased middle-class stress during the process of globalisation, meaning that changes in socio-economic settings in the last decades have led to top-driven inequalities at the expense of the middle-income groups.

Economic growth and income inequalities

Simon Kuznets, one of the pioneers of research on growth and inequality in an international context, admitted in his seminal paper that some 5% of empirical information and 95% of speculation led him to his conclusions about the famous inverted U-curve of income growth (Kuznets, 1955). Although since then, there have been spectacular advances in methods, data quality, measurement tools and computing power used for international comparisons, research on income distribution in an international context is still full of noise, non-comparable data and contradictory findings. It is especially so in the research on global inequalities and the potential effects of globalisation on social developments. In addition, theoretical explanations for the now-abundant empirics are needed more than ever.

The growth-inducing effects of openness are widely recognised in the literature, but the links between growth and inequalities are far from clear. As Ravallion (2004a) puts it, empirical findings about the relationship between inequality and economic growth show virtually zero correlation.[29] Growing economies are just as likely to be associated with rising as with falling inequality.[30] The almost complete absence of correlation may stem from measurement error (of inequalities), the inability of Gini coefficients to capture growth-induced inequalities and poverty reduction, the incapacity of cross-section inequality measures to capture 'churning' phenomena and the need to use absolute rather than relative Gini coefficients for inequality measures (Ravallion, 2004a). Nevertheless, when and while growth looks distribution-neutral, the absolute poverty-reducing effects of growth seem proved by many studies (see Ravallion, 2004a and World Bank, 2005a and 2005b for recent accounts). Therefore, globalisation (increased trade openness) may lead to increased (in itself, distribution-neutral) growth and, hence, absolute poverty reduction. The mechanics of it should be

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[29] This view may cast doubt on the appropriateness of Kuznets' curve to describe inequality–growth relationships. A reminder of the dangers of mixing cross-country data with explanations of a longitudinal nature is also warranted. Furthermore, the effect of growth on inequalities is best understood as part of a complex portfolio of relevant explanations with a great number of alternative candidates.

[30] For surveys, see Ravallion & Chen (1997) and Dollar & Kraay (2002), as well as more recent results in Ravallion (2004b).

clarified further, however, with special attention devoted to the role of various institutions channelling growth to societal developments.[31]

There is a substantial body of empirical literature on these issues, which is not repeated here. Still, as both the increase in openness and the poverty-reducing capacities of growth depend very much on endowment effects, one additional factor deserves attention. There is a very complicated relationship between inequality, growth and poverty – although it seems proved that the poverty-reducing ability of economic growth depends very much upon initial inequalities in a country. Therefore, when growth accelerates in a very unequal society, the reduction in poverty is smaller than in a society with more equal endowments, as discussed for example by Cornia & Court (2001). As they put it, there is an "efficient inequality range", that is, very low and very high levels of initial inequalities will impede growth prospects while inequalities in the middle range seem to provide a favourable environment for growth. This inverted U-shape of the growth–inequality relationship deserves attention in future research.

Skill-biased technological change

Skill-biased technological change is another important influence on inequality. Much of the empirical literature (reviewed, for example, by Acemoglu, 2002a and 2002b) shows that increasing college output has been accompanied by an increase in wage premia for more highly educated workers over the past 60 years. On the other hand, sharp rises in education output have not always been followed by a fall in returns to education later and inequalities (mostly of a within-group nature) have widened. Therefore, technological change has proved to be skill-biased and fast (at least relative to education expansion): even increased higher education has been unable to catch up with it. Technological change may have accelerated, and hence, the explanation for the simultaneity of rising college output and wage premia. There is no need here to go into the debate over the nature of this phenomenon (that is, whether explanations should be based on endogenous processes or whether supply reactions should be treated as exogenous facts).

It should be noted that skill-biased technological change would only directly affect wages, while income inequalities in a country also reflect the evolution of incomes of other household members, social benefits and inter-household transfers. Differential labour market institutions on the one hand, and the extent of state

[31] Under certain circumstances, large inequalities may be harmful to growth prospects. Endogenous growth theories allow for heterogeneity in the relative positions of various representative agents in macro models. This makes it possible to analyse the effect of income distribution (the relative positions of representative agents) on growth prospects. Of course, this can go through channels of representative democracy: formation of the fiscal preferences of central budgets, the inducement of rent-seeking behaviour in some subgroups of society and threats of social unrest belong here (Alesina & Perotti, 1994). Some models operate with overlapping-generations assumptions and observe preferences for investment or consumption (Persson & Tabellini, 1994). Others, such as Galor & Zeira (1993) and Bénabou (1996), put forward a more general account of endogenous public policy formation and their effects on growth prospects.

regulations and of the welfare state itself on the other, may affect wage inequalities. In addition, trade (in a Hecksher–Ohlin setting) between a skill-rich and a skill-poor country will increase the demand for skills in the skill-abundant economy, resulting in a prediction of increased wage premia for the highly skilled.

There is a great deal of evidence in support of technology-driven change in wage inequality (see Acemoglu, 2002b for a review). In the income-inequality literature, this line of reasoning is much less prevalent. Nevertheless, many of the decomposition analyses by education levels show a growing share of the between-group components in overall inequalities (Tóth, 2005; Bailey, 1997) in the context of transition countries. Also, as far as the G20 overview is concerned, Smeeding (2002) concludes that there is evidence that both the supply and demand for skills help to explain earned-income changes in the observed country grouping. Acemoglou (2002b) derives differential inequality developments in the US and the UK compared with continental European countries stemming from the differential relative skills supply for these two country groupings.

In terms of overall income-inequality consequences, the second order effects of skill biases should also be analysed. The assumptions of simple models of skill-biased technological change include distinguishing between two levels of skills (high and low) and most of the models do not take explicit account of age heterogeneity in human capital supply. It is clear that assuming low and high skills is an over-simplistic view and at least a medium level should be introduced into the analysis. In addition, as new skill supplies come mostly (depending on the differential dispersion of lifelong learning opportunities) from those leaving the education system, when talking about supply/demand mechanisms for various skills, it should be taken into account that the skill composition of the various cohorts differ. Hujer & Radic (2005) point out that despite the extensive literature on skill-biased technological change, its impact on the age structure is scarcely researched. They find that technological change discriminates against older workers as well as against low-skilled workers. At the same time, they find that the winners of technological change are the highly skilled, regardless of their age. Sabirianova Peter (2006), based on Russian surveys, presents empirical evidence supporting the thesis that transition has been skill-biased. Kertesi & Köllő (2002) and Kézdi (2002), report strong and asymmetric growth in the second half of the 1990s in returns to higher education by age cohort in Hungary. Wage premia increased for younger workers much more than for their older counterparts (among the highly skilled). Tóth (2006a), based on the decomposition of incomes (not wages) of households (not individuals), concludes that transition has been simultaneously age- and skill-biased.

5.1.2 Regional productive factors as determinants of inequality changes

Globalisation means rising trade and increased flows of production factors (capital and labour) among integrating regions or countries. Economic theories suggest that increasing flows of factors among regions might as well promote convergence as well as divergence of regional income levels. In the standard growth model, backward regions are poor because of their lower endowment of capital (physical or human) relative to labour. With immobile factors, the catching-up of poorer regions can occur through investment to increase the capital/labour ratio. If factors are mobile, regional convergence might happen much faster. With decreasing returns, owners of capital

have an incentive to move to poorer regions where capital is less abundant and the marginal product of a unit of capital is higher. In contrast, workers have an incentive to move to richer regions where capital is more abundant, such that labour productivity and wages are higher. If factor prices are free to adjust, the mobility of factors could eliminate regional differences, equilibrating regional differences in the capital/labour ratio.

But decreasing trade costs and factor mobility can also lead to divergence in regional income levels. 'New economic geography' models take into account both the forces that induce dispersion of economic activity among regions and consequently promote regional convergence, and the forces that facilitate concentration of economic activity and regional divergence. An important agglomeration force is increasing returns. Increasing returns might be a result of high fixed costs at the firm level, or fixed costs at the generation of innovations or with the accumulation of a minimum level of physical capital or public infrastructure. Krugman (1991) shows that increasing returns combined with labour mobility across regions might result in two initially identical regions evolving into a core–periphery structure. Suppose there are two identical regions, and one firm[32] (operating in an industry with increasing returns) decides to move to the other region (all else remaining unchanged). Increasing competition on the product and factor markets in the receiving region will put downward pressure on firms' profits, but increasing wages and decreasing product prices will attract workers from the relocating firm's original region. If workers start to migrate, then this action results (in the receiving region) in the growth of the regional market and the decrease of wages, and thus more firms (of the original region) will find it profitable to move as well.

This cumulative mechanism could lead the initially identical regions to evolve into an industrialised core and reindustrialised periphery.[33] Although it is not the only mechanism leading to regional divergence, labour mobility accelerates divergence in these models (Ottaviano & Puga, 2002). In Europe, labour mobility is less important than in the US, and thus other potential mechanisms of this divergence process might dominate. These include input–output costs and demand linkages between firms, factor accumulation or intertemporal linkages (for a survey, see Ottaviano & Puga, 2002). Regional polarisation and convergence are not the only possible outcomes, however. Convergence does not necessarily take place even when agglomeration gains are absent and factor mobility is limited. If distortions on the labour market prevent the adjustment of wages according to productivity, capital will not move to the underdeveloped region, which will result in regional stagnation and unemployment (Faini, 2003).

Decreasing income disparities between countries and increasing regional inequalities within countries might be understood in this theoretical framework.

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[32] The model is a two-sector economy, with a competitive sector and a monopolistically competitive one with increasing returns (labelled 'industry'). The firm that moves is an industrial firm.

[33] Such regional divergence could occur in the absence of labour mobility as well. For an overview of new economic geography models, see Ottaviano & Puga (2002).

Martin (2005) presents a small model of three integrating regions, one rich, one intermediate and one poor region, where the latter two belong to the same country. He argues that increasing integration (lower trade costs) leads to the observed pattern of interregional inequalities if the international cost advantages of the poorer country are higher than the cost advantages of the poorer regions vs. richer regions within the poorer country. Martin (2005) (and see also Puga, 2002) suggests that wage-setting at the national level (and other nationwide labour institutions) resulting in within-country homogeneity and inter-country heterogeneity in labour costs might produce such an effect. If the labour cost advantage of the poorer region within the poor country is not high enough, firms will choose to locate in the richer region of the poor country, which translates into a simultaneous rise in regional inequality in the poorer country and a fall in between-country inequality. Labour market institutions might also account for the divergence in unemployment levels. If, because of national level wage-setting, agglomeration effects on regional productivity are not reflected in regional wage differences, they may instead be reflected in unemployment levels: regions with lower productivity will tend to have higher unemployment rates.

Although migration is less important in the EU than in other economic areas (e.g. the US), according to Faini (2003) there is some evidence that migration favours the convergence of regional income levels. He finds that net outward migration is positive in those initially poor regions that show convergence towards the average but negative for converging rich regions. This finding is consistent with the theory, which would predict that labour migrates from initially poor regions to initially rich regions during the convergence process. Logit analysis of convergence indicators on mobility confirms the same conclusion for the 1980s, but in the 1990s, the relationship was much weaker.

5.1.3 Competing theories, unexplained variance

Arguably, the technology argument (of mostly labour economists) and the globalisation argument (of mostly trade theorists) are, in a sense, competing theories. Among them, the skill-bias argument seems to receive the most empirical support. Analysis in *Employment in Europe 2005* (European Commission, 2005i) reveals that the employment shifts to skill-intensive industries might be too small; therefore, the relevance and explanatory power of 'increased international trade' may not be satisfactory.[34] On the other hand, demand shifts for the educated labour force that are not followed by adequate supply reactions lead to widening wage dispersions. Also, an increase in technology-related indicators seems to correlate positively with increased skills demand and wage dispersion (ibid., p. 198).

After a review of studies on the US experience, Katz & Autor (1999) concluded that trade theory explains no more than some 20% of the inequality increase while some 80% of the rise is accounted for by skill-biased technological change. Yet, it might well be that there are interactions between trade and a shift in the skill bias of production and services. Other papers (Atkinson, 1999; Singh & Dhumale, 2000; Dreher

[34] Also, the de-unionisation hypothesis receives too little empirical support (European Commission, 2005i, p. 198).

& Gaston, 2006) suggest that these two theoretical approaches together still only account for part of the variance in inequality changes.

The elements of the 'transatlantic consensus' (Atkinson, 1999) are that inequality changes observed on both sides of the Atlantic are induced by increased demand for highly skilled work. Whatever the causes assumed (increased trade flows or alternatively, the spread of skill-rewarding technology), increased wage dispersion in the US and higher unemployment in Europe are the results of a common trend. The difference in outcomes can be attributed to institutional differences: rigid labour markets and the welfare state in Europe and flexible labour markets and a minimal welfare state in the US. These arguments are forcefully put by many economists. There are a few interesting questions here, however. First, as both theories leave a great deal of variance unexplained, one should concentrate on those contingencies that may be responsible for the rest. Second, as the institutional setting seems to be a crucial factor, some space should be devoted to the channels and operations of institutional influence.

Candidates for the unexplained variance vary in different parts of the world. Smeeding (2002) (while underlining that studies based on the Luxembourg Income Study do not prove the role of trade liberalisation in increasing inequalities and showing evidence that shifts in skills supply and demand can explain some of the changes in earned incomes across rich nations) calls for further research to find out a fuller list of real causes. As Cornia & Court (2001) point out, there may be 'traditional' and 'new' causes of inequality. Traditional causes include extreme land concentration, the mounting influence of the mineral sector on GDP, changes in access to education and increasing urban–rural divergence. Among the new factors, in addition to technological change and trade liberalisation, various policy measures may also play an important role in increasing inequalities, namely stabilisation packages, financial and labour market liberalisations as well as changes in the tax and transfer schemes. As they warn, care in making generalisations is necessary: country-specific mixes of circumstances and policies drive real changes in inequalities. Singh & Dhumale (2000) point out that the argument behind the transatlantic consensus provides insufficient explanatory power. They imply that some of the inequality increase is owing to a gradual erosion of the efficiency of central welfare-state institutions that were built during the three 'golden age' decades after the Second World War and changing social norms.

Atkinson (1999) warned that there might be at least two different narratives behind empirically observed facts. Changes in inequalities may be associated with technological changes (induced or exacerbated by liberalised trade and increased competition from the developing world) or, on the other hand, with changes in social arrangements. Skill-driven pay reflects social conventions as well as the acceptance of widening inequality (both in terms of micro and macro perspectives) and a shift in social norms and conventions. This (at least as normative as positive) view of pay and income determination obviously draws attention to the operation of the welfare states. He concludes that to the extent that norms (and moreover institutionalised redistributive norms) can be influenced, there is room for political leadership and action (ibid., p. 24).

From a different angle, though, Sapir (2000) also highlights institutional factors. As he stresses, globalisation (the freer flow of capital, labour and services, partial

elimination of trade barriers and the emergence of the information revolution) has led to an unprecedented growth of wealth for the US and the EU. At the same time, declining wages and rising job insecurity in the US and growing unemployment in Europe have accompanied the process on the respective sides of the Atlantic. "Whereas economists continue to argue about whether trade or technological change is the main culprit behind the waning future of labour, ordinary citizens tend to see the two as simply different facets of 'globalisation'" (ibid., p. 31). As for the European regimes, a reform of the welfare state (and within that, labour market regulations and institutions) may be the clue to efficient survival.

5.1.4 Norms and institutions

Major studies on income distribution in the developed countries refrain from drawing over-simplistic conclusions about the causes of levels or trends in inequalities.[35] It is widely agreed that inequalities in the context of a specific country are the results of a complex of factors (for a comprehensive overview, see Atkinson & Bourguignon, 2000).

The most important direct influences on income inequalities can be associated with various elements of the income package. Probably the most significant, *labour incomes*, are determined by the employment patterns of the various household members, the availability of jobs and the wages earned from selling labour. Still, the distribution of human capital depends on access to education, the functioning of the school system, etc. On top of that, wage dispersion is also determined by the relative demand for skills. In this respect, periods of skill-biased technological change are characterised by growing returns to education and skills. Within the developed world, there are diverging trends in this respect. While there have been increasing wage-inequality trends in, for example, the US, the UK, Denmark, the Netherlands and Poland (and presumably in most of the transition countries), some countries have experienced no change or even a decline in the last decade (European Commission, 2005i). There does not seem to be a consensus about the reasons for these trends. In any case, there is a great deal of variance that cannot even be explained as a combined effect of technological change and trade. Also, to a certain extent, pay norms are social constructs (Atkinson, 1999) and depend on tolerance in society towards high wages. In addition, probably the most important determinant is the institutional setting, broadly defined (including labour legislation, minimum wage rules, active labour market policies, tax/benefit schemes, etc.). It is exactly this feature that leads analysts to say that technological change leads to either higher wage dispersion (in countries with less rigid labour markets such as the US or the UK) or to a growth of unemployment (in countries like France, for example).

Perhaps surprisingly, labour incomes are distributed more unevenly in the EU-10 than in the EU-15 countries in general. Decile ratios of earnings show that the highest inequalities are in the Baltics, Poland and the two recently acceded countries (Bulgaria and Romania), while the most unequal EU-15 country, Ireland, only comes after them.

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[35] See, for example, Atkinson, Rainwater & Smeeding (1995), Gottschalk & Smeeding (2000), Cornia & Court (2001), Förster & Pearson (2002) and Förster & d'Ercole (2005).

The lowest degrees of inequalities can be found in the Scandinavian tier (more specifically in Finland, Norway, Sweden and Denmark).[36]

Other types of incomes from the market (*capital incomes*) and incomes stemming from ownership are probably the least-known area of income inequalities. Although there are interesting studies on this topic, little systematic evidence is available on the effect of capital incomes on cross-country income differentials.

The other large and very important influence on income distribution is the wide array of redistributed incomes (social insurance benefits, public social transfers, and for the sake of simplicity, we also mention benefits in kind under this heading). The relationship between social spending and poverty is generally shown to be negative in the OECD countries (Förster & d'Ercole, 2005; Schwabish, Smeeding & Osberg, 2003) and in the EU (Council of the European Union, 2006), but two important qualifications need to be borne in mind. First, the effect of the welfare state on income inequality (rather than poverty) is not that obvious (Tóth & Gábos, 2006). Furthermore, the relationship between inequality and public social expenditure may be spurious: there is empirical evidence that a high level of inequality may constrain redistribution rather than induce it (Schwabish, Smeeding & Osberg, 2003). Second, the actual effects of welfare states on income distribution depend on the institutional settings in those welfare states.

5.2 Globalisation and European social changes

The sources of pressure for change in European social protection mechanisms fall under three broad headings:

- First, there are the pressures stemming from globalisation and the move to a more post-industrial economy, as described above. Nevertheless, it is difficult to disentangle the effects of globalisation as such and some of the attendant repercussions that affect society at the same time.
- Second, family structures are changing. The nuclear family can be relied upon less and less to help individuals absorb risks. It is particularly the countries belonging to whatever remains of Esping-Andersen's cluster of 'corporatist' welfare states – with their focus on the male breadwinner – that are in the most urgent need of reform (Esping-Andersen, 2002). Incomplete households, unofficial cohabitation and multiple marriages throughout an individual's life – all of these change the landscape of social protection needs. But different life-course practices are also accompanied by different fertility patterns, most notably by postponing the birth of the first child or deciding not to have children at all. More generally, the diversification of life-course practices as opposed to fairly uniform patterns observed in the past adds another dimension to the demand for

[36] This fact is again a confusing one for those searching for imprints of globalisation on wage distribution: clearly, this might be a case for social norm explanations. On top of that, as the results of the most recent 'structure of earnings' show, even the UK wage dispersion is in the middle of the European range, which again is a surprise (European Commission, 2005i).

making social protection systems more 'flexible'. Social protection, if it is to respond to these changes, would need to be more clearly life-course oriented.[37]

- Third, there is the problem of demographic ageing, which is brought about by two factors. People live longer and they are having fewer children. Falling birth rates are a phenomenon observed practically everywhere in the developed and increasingly in the developing world. As countries grow richer, people have fewer children and, as countries undergo major social transformations accompanied by the availability of birth control, birth rates plummet even more dramatically – as recently seen in Central and Eastern Europe (UNIFEM, 2006, Tab. 1.5).

Adverse demographics particularly affect the health care and pension systems. They also affect overall economic performance. European populations will start stagnating between 2010 and 2020; whatever economic growth is to be achieved after the latter date will have to come purely from rises in productivity (European Commission, 2005a, p. 28). That, at least, is the scenario based on observed trends. A recent project sponsored by the European Commission, called DEMWEL[38] (Demographic Uncertainty and the Sustainability of Social Welfare Systems) has addressed the need for basing policies on demographic uncertainty rather than baseline forecasts, by drawing attention to probabilistic projections. Arguably, policies need to be made robust for any change, and not simply tailored to the most pessimistic scenario.

The pressures on the welfare state translate in the public sphere into the debate on reforms to the mechanisms of social protection and those that underpin the welfare state. Sometimes this can result in a string of parametric changes to the system, as seems to be the case with health care, but there are also more fundamental paradigmatic changes motivating reforms to not only the labour market, tax and pension systems but also to childcare and education. Some of the radical reforms debated may not be feasible or warranted, but they deserve consideration. The following sections therefore discuss the reform processes in these areas.

5.2.1 Unemployment

The persistence of high unemployment in a number of European countries is frequently identified as the key issue for the EU, and it increasingly ranks in first place in lists of priorities for social policy across the Union. In 2005, the Lisbon agenda was relaunched with a narrower focus on two areas: economic growth and employment (European Commission, 2005a). Empirical evidence that relates employment rates with labour market institutions is sometimes scarcer than is the host of theoretical arguments (IMF, 2003, p. 129). Nevertheless, empirical studies (Nickell, Ochel & Quintini, 2001) and recent econometric exercises – for example using the IMF's Global

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[37] Consequently, modelling that underpins research on the sustainability of social protection systems needs to look more closely into the transitions in individuals' lives, rather than assuming fairly uniform patterns that are easy to aggregate. Recent examples include the MicMac model (van der Gaag, de Beer & Willekens, 2005).

[38] For further information on DEMWEL, see the ENEPRI website (http://www.enepri.org).

Economy Model (IMF, 2003) – indicate that comprehensive labour market reforms can generate significant gains. At the same time, labour market institutions are a necessary component of market economies, given that labour markets cannot be, by definition, perfectly competitive (ibid., p. 130; Blanchard, 2002). They have an important risk-reducing role (Agell, 1999) and other economic rationales (Blanchard & Giavazzi, 2002).

Indeed, it is important to point out that comparisons of European labour markets with other advanced economies, especially with the US, are often exaggeratedly critical. They produce a lower dispersion of pay within the same narrowly-defined skills groups. Moreover, lower employment among women compared with the US is largely related to the fact that US households rely much more on the marketisation of traditional household activities (Freeman, 2004).

Globalisation contributes to the destruction as well as the creation of jobs. Recent studies on the relocation of production indicate that only 6% of job losses in the EU in the period 2002–05 resulted from the relocation or offshoring of activities (Economic Policy Committee, 2005, p. 10). There is a sense that globalisation contributes to instability in social relationships because of the pressure for fast changes in the labour market. On the other hand, long-term employment relationships, while still dominant, no longer convey a sense of security. It is often the flexibility of the labour market combined with extensive social protection that provides a better sense of security as well as a higher quality of work (Auer, 2005).

Labour market reforms face a number of complications. Almost all net job creation today comes from service sector jobs. Between 1979 and 1993, the OECD countries lost (as an unweighted average) 22% of their manufacturing jobs (ibid.). Yet new jobs are not created fast enough to absorb deindustrialisation job losses in the same way as was done during the pre- and post-war de-ruralisation periods. Three dilemmas can be identified here.

First, the expansion of the tertiary labour market brings about a larger share of low-skilled services. Second, much (although by no means all) of the services sector expansion is subject to the well-known 'Baumol cost-disease effect' (Baumol, 1967). Third, much depends on household consumption choices, since households in principle can often use household work as a substitute for services (Esping-Andersen, 1999, pp. 103–04). Esping-Andersen (1999, pp. 117–19) promotes the idea of a 'new Keynesian household' to deal with job creation problems. The idea here is that policies that facilitate the spread of two-earner households create exactly the type of intensely service-consuming households that we need today.

Deindustrialisation, of course, differs from country to country, with massive losses in some countries with uncompetitive industries such as in the UK or Spain, and much better adaptation in others, as in Germany, Denmark or Italy (ibid., 1999, p. 120). The political economy of reforms is crucial here. Industrial relations models vary in their receptiveness to change. The worst-case scenario, it seems, is where industrial organisations are strong but neither centralised nor capable of coordination, supporting militancy and strong gains for the insiders but neglect for the outsiders. "Economic performance is likely to be superior when either 'markets' or 'neo-corporatism' prevail" (ibid., 1999, p. 121). This view is supported, for example, by the

theoretical studies of Lindbeck & Snower (1988a and 1988b) and the 'hump-shaped curve' hypothesis of macroeconomic performance (Calmfors & Driffill, 1988).

But which way should the reforms generally go? Some diagnose European problems as 'Eurosclerosis' and give the recipe as 'flexibilise!' (Siebert, 1997). Nevertheless, there is a difference here between the continental corporatist systems with rigid labour market policies and the Nordic systems with flexible labour markets but comprehensive social protection. The Swedish Rehn–Meidner model deliberately sought to reduce employment in uncompetitive industries (Esping-Andersen, 1999, p. 123). The Danish and the Dutch 'flexicurity' model (Wilthagen & Tros, 2004) has become the latest buzzword in the world of social protection.

In general, Scandinavia's triple accent on generous income guarantees, active labour market policies and welfare-state employment growth (Esping-Andersen, 1999, p. 123) seems to be a viable alternative to pure-market reforms. Scandinavian successes in employment and growth draw attention and inspire governments of countries that had traditionally been thought of as belonging firmly in the 'liberal' camp (Giddens, 2005, pp. 109-10 and p. 112).

5.2.2 *Pension reforms*

Population ageing puts pressure on existing social protection mechanisms. This tendency is most explicit in the form of the fiscal pressure on pay-as-you-go (PAYG) pension systems. As the ratio of the working-age population to the retired decreases, the lack of economic power to provide for the elderly manifests itself as the need for adjustment – an increase in contributions, less generous pensions or the raising of the retirement age. Shortfalls can be at least partly offset by rising productivity. That is why pension reforms would ideally address the challenge by effecting changes in a combination (or possibly all) of these areas: adjusting the statutory pension age in line with longevity gains, cutting over-generous pensions and making contributions higher, ideally in absolute volume by promoting economic efficiency. Such changes can be accomplished by having a pension system that provides for the efficient allocation of assets (savings of the future retirees) in the economy and provides the right labour market incentives. At the same time, pension reforms involve important issues of fairness and justice. Reforms may be perceived as producing winners and losers, and finding the right social contract might not be easy, although some frameworks have been suggested (Myles, 2002).

The post-communist countries have often opted for a multiple pillar system[39] as recommended by the World Bank (1994) in a report that was later widely criticised for

[39] The first two pillars are mandatory. Of these, one is a publicly organised PAYG scheme; the other consists of individual savings accounts administered by specially licensed pension companies, through which assets are invested in financial markets. The countries that have adopted this system are Hungary, Poland, Latvia, Estonia and the Slovak Republic (in chronological order by the date of starting the reform, from 1998 to 2004). Lithuania has a similar system, but with a fully voluntary option to split contributions between the two tiers. The third pillar should consist of supplementary, voluntary pension savings, but in none of these countries is this component of any significance yet.

unreasonably extolling the virtues of the funded component (Stiglitz & Orszag, 1999, p. 9; Barr, 2001, p. 101; World Bank, 2006a). In Western Europe, the most radical overhaul of a pension system has been undertaken by Sweden, which introduced a notional defined contribution (NDC)[40] system in 1999 (and a small, mandatory funded component). NDC has proved to be a generally popular reform option, also applied in Latvia and Poland for their PAYG pillars and recently adopted in Italy. The World Bank published a study (2006b) that generally looks highly favourably on this type of pension scheme.

5.2.3 *Reforming tax systems*

The wider issues of incentives to work and management of entrepreneurial and labour market risk also embrace taxation. The recent interest in guaranteed minimum income schemes, the growing interest in negative income taxation (one way of boosting the income of low-paid workers), as well as public discussions on the flat-rate income tax should not be overlooked in the social protection debate, since taxation should be seen as a more or less integral part of welfare regimes. A guaranteed minimum income is linked to incentives to work. Under this concept, every individual is entitled to a minimum income, whether s/he is in or out of work, thus avoiding the poverty trap. A standard tax rate is deducted on every source of income (Aglietta, 2000, pp. 444–45). The idea is usually associated with the Belgian economist Philippe Van Parijs, for whom it is directly related to the changing nature of work in the post-industrial age (Aglietta, 2000, p. 445). In this approach, income should be seen as something separate from the nature of the individual job, owing to advances in collective productivity. The same instrument, however, is viewed in a different light by Michel Aglietta, with work as the principal means of social integration. A related concept is that of negative income tax, first put forward by Milton Friedman over 40 years ago (1963). Guaranteeing a certain minimum income as a way of reintegrating individuals into society is today being put on the agenda in countries that combine high unemployment with high labour costs.

This trend in policy-making coincides with the debate on the flat-rate tax, although here the focus of the discussion seems to be on the higher income strata (although in principle a guaranteed minimum income and especially a negative income tax system is basically a flat-rate system). In academic circles, the debates were sparked by the 1985 publication of Hall & Rabushka's book, *The Flat Tax*, republished in 1995. More recently, the flat-rate personal income tax has been introduced in five post-communist member states of the EU – the Baltic States, Romania and Slovakia. The latter is also a member of the OECD, and the only OECD country with this radical tax arrangement on a national scale. This move has helped to bring the issue to wider attention in the European policy scene, surfacing for example during the 2005 German elections (although without being adopted by any party).

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[40] NDC has also been referred to as a "non-financially defined contribution" system in the latest World Bank terminology (2006b).

5.2.4 Poverty and the issue of the underclass

Against the backdrop of discussions on the dismal performance of European labour markets, it is necessary to remember that today's unemployment is associated with much higher participation rates than in the past. "Unlike before, we must now include women in the nation's full employment promise" (Esping-Andersen, 1999, p. 1). Regardless of the widespread discussion about the efficacy of the welfare state, which started right after the post-war boom waned in the early 1970s, social protection has become more, not less, widespread since then. Despite the expansion of social protection, poverty remains a major problem for the European social model(s). Absolute poverty has continued to decline across the EU and generally in the OECD countries in recent years, but relative poverty has been on the rise (Förster & d'Ercole, 2005). This development, again, is very much connected with problems in job creation (European Commission, 2005a, p. 5). Nevertheless, the issue of social exclusion and sometimes the downright creation of an underclass cut across various other aspects of social policy, and especially relevant to it are education policies (Esping-Andersen, 2006).

The problem of the underclass may come from familiar structural causes, but it manifests itself in many new ways. Many social risks are closely correlated with lifestyle habits. Examples include smoking or, in a post-scarcity society, over-eating junk food. In turn, these habits are closely correlated with social divisions (Giddens, 2005, p. 108). Obesity is usually the problem of the low-income strata and has become a serious issue.[41] Lifestyle policies are clearly becoming an important component of state intervention.

5.2.5 Investing in the future – Childcare and education

Childcare is crucial for women's employment. Econometric evidence suggests that if the supply of childcare were to increase by 20 percentage points for countries such as Germany, Italy, Spain or the Netherlands, women's employment could post a gain of as much as 10 percentage points (Esping-Andersen, 1999, p. 59). Yet despite its evident significance, childcare is an often-neglected aspect of social policies, with equally evident adverse effects on women's employment prospects. In the spring of 2003, the Barcelona European Council addressed the issue by setting quantitative targets, for childcare facilities to be available for 90% of children aged between 3 years and the mandatory school age, and for 33% of children under 3 years old. The latter is very far from being attained in most EU countries. Other initiatives suggested include 'daddy days' and 'baby bonds' (Ferrera, 2005, p. 33).

Adequate child benefits and services thus cut across the wider array of employment-cum-growth and social inclusion processes, and they are pertinent to the issue of 'adverse demographics'. The Scandinavian countries and France have relatively high birth rates, and these are precisely the countries that provide comprehensive benefits and services connected with childcare (Giddens, 2005, p. 112).

At the same time, the issue of reforming European education systems (especially at the university level) to make them more globally competitive has also resonated in

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[41] See P. Wintour, "Radical moves to tackle obesity crisis", *Guardian*, 16 June 2006.

the public debate (Lambert & Butler, 2006). Early school-leaving is seen as a specific problem in many member states,[42] albeit with a large diversity. In the EU as a whole, the proportion of the 18-24 age cohort with only lower secondary education and not in further education or training has been falling over recent years – down from 17.7% in 2000 to 14.9% in 2005. Even so, it remains well above the rates in the US or Japan and some way from the benchmark of 10% that the EU has set itself. There is a substantial gender gap in this indicator, with significantly more men than women lacking these qualifications, a difference found in a large majority of member states.

5.2.6 Reconceptualising the welfare state

The prototypical client of the post-war, industrial welfare state was an unskilled or semi-skilled male manufacturing worker, often the sole breadwinner of the family. The main risk for the family was that the breadwinner would lose his job. The accent was therefore on job protection and income maintenance. Risks of poverty were mostly related to children in large families and people in old age. Hence, policies aimed at providing family allowances and pensions. Lone motherhood, the risks associated with labour mobility, retraining needs, youth unemployment and long-term unemployment were never assumed. Life-course risks were mostly a simple question of consumption smoothing, with brief periods of unemployment covered by insurance. Intergenerational risks were deemed overcome by steadily rising productivity.

New risks include de-skilled workers, the new underclass in a 'two-speed society', 'welfare mothers' and so on. The social risks can be formulated as issues of potential traps (Esping-Andersen, 1999, p. 5). One is the 'low-fertility equilibrium' emerging from the pressure on women to combine career and family roles. Another is the potential 'low-wage, low-skill equilibrium' that may arise from extensive labour-market deregulation. Yet so far, it seems that the issue of de-skilling has not been given systematic, EU-wide analysis.

There are two distinctively different strategic responses to the 'equality–jobs trade-off' (Soskice, 1994). In 'uncoordinated economies', wage adjustments and weakened employee protection resulted in rising inequalities. This model seems particularly vulnerable to the low-skills equilibrium. On the other hand, 'coordinated economies' moved in the direction of high-quality, well-remunerated production that privileges the core, stable workforce of highly skilled and highly productive workers. The Nordic countries fall between these two polar opposites. Not so long ago, some commentators were pronouncing the Scandinavian third way as 'stranded' (Esping-Andersen, 1999, p. 152). Today, as we have seen, the Nordic model has become the one to emulate.

How is Europe dealing with the new challenges? Different welfare regimes promote different institutionalised mindsets, which in turn produce different responses to social pressures and difficulties. A simple but insightful story is told by

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[42] See Council of the European Union, Modernising Education and Training: A Vital Contribution to Prosperity, and Social Cohesion in Europe, 2006 Joint Interim Report of the Council and of the Commission on Progress under the 'Education & Training 2010' Work Programme, OJ C79/01, 01.04.2006.

Esping-Andersen, featuring three actors: *Homo liberalismus*, *Homo familius* and *Homo socialdemocraticus* (1999, pp. 170–74). In a similar vein, Held & Koenig-Archibugi (2003) have suggested four classes of respondents to globalisation:

- the *sceptics* (who do not believe any significant changes are needed);
- the *deregulators* (who believe the welfare state needs to be rolled back as a response to globalisation);
- the *reversers* (the anti-globalists who believe there is need to organise resistance to the phenomenon); and
- the *internationalists* (who believe an internationalisation of politics is needed to help deal with the adverse effects of economic liberalisation).

Certain common strands are coming to the fore in the EU, notably around the notion of flexicurity in the context of the relaunched Lisbon strategy (European Commission, 2005i). Key here is the expanding set of governance and meta-governance capacities embodied in the open method of coordination covering social protection and social inclusion, despite the fact that formally the member states retain sovereignty in welfare state policies (Scharpf, 2002). These capacities arose out of the Union's coordinating role for economic policies, and it is therefore perhaps not surprising that some commentators note how "the emergence of social policy at the European level tends to assume a workfare rather than a welfare orientation" (Jessop, 2002, p. 207).

The dominant tone of current policy-making at the European level is seen by some as "not so much social integration but rather the instrumentalisation of policy as a resource for competition oriented structural change" (Deppe, Felder & Titow, 2000). This policy direction seems to be partly the result of analysts and policy-makers being at a loss for solutions and shy about promoting any specific comprehensive policies. Thus, in the view of some commentators, "the social dimension of the Lisbon agenda" for example, "has fallen into the hands of specialised circles of 'insiders'", and social justice is often just being paid lip service (Ferrera, 2005, p. 34). Anthony Giddens has stated this in robust terms:

> Although the Lisbon Agenda, Sapir report, Kok report and other similar contributions all talk about the ESM [European social model], social exclusion and so on, they have little to say about them in a direct way. They lack a systematic discussion of how the innovations they propose can be reconciled with *social justice* and *welfare*. (Giddens, 2005, p. 103, emphasis in the original)

He similarly criticises the Commission's 2005 Communication on the Social Agenda for lack of analysis of "changing patterns of class, inequality and social division".

Giddens goes on to propose a positive welfare programme replacing the negative of Beveridge's 'evils': "In place of Want, personal autonomy; not avoidance of Disease, but active health; instead of Ignorance, education, as a continuing part of life; rather than Squalor, prosperity; and in place of Idleness; initiative" (Giddens, 2005, p. 105). The state he pictures is an agency underpinning paths to prosperity:

> Rather than the 'welfare state', we should speak of a society of positive welfare, in which the state plays a central, but not a dominating, role. The state is primarily a social *investment* and *regulatory* agency. Many over recent years have talked of the welfare state as an enabling force, but it is better to speak of the *ensuring state* in the positive welfare society. An ensuring state is one that enables – one that uses social investment whenever possible to help people to help themselves. (Ibid., p. 106)

Yet the Union undeniably has a social dimension. Despite the differences within the European social model, Begg & Berghman (2002) point out that it still entails shared values that make common approaches feasible. These values couple social norms with economic requirements. As Begg & Berghman (ibid., p. 183) state, the minimum wages and benefits established by EU member states implicitly set minimum productivity requirements. The European social model is alive but needs to deepen the dynamic approach to policies. From a life-course perspective, investing in the health and education of children contains social expenditures later on and creates a good framework for an effectively functioning market. "The focus on capabilities means that the state, as well as the market, must promote the development of each person's capabilities to work in the context of that [which] a person values" (ibid., p. 185).

6. SOCIAL EUROPE AND GLOBALISATION: A RACE TO THE BOTTOM?

One of the most contentious questions surrounding globalisation is whether it leads, inexorably, to retrenchment in social policy and the progressive weakening of the welfare state. The European social model is widely regarded as one of the core values that defines what the EU stands for. It is clear from the orientations of the strategy for growth and employment (the relaunched Lisbon strategy) and the sustainable development strategy that social aims are accorded a prominent, if not always equal, weight in the way Europe moves forward. Consequently, if globalisation were to put at risk the achievements of the European social model, it would give rise to many political challenges.

Previous work (e.g. Bertola, Blau & Kahn, 2001) has shown that closer product market integration and pressures from globalisation are not inducing a uniform, across-the-board tendency towards reducing social welfare provisions in Europe. Some schemes, such as unemployment benefits, are becoming less generous and there is a marked development towards cutting back the system of job guarantees offered in the past to employees. In other fields, the most noticeable being social assistance, the trend goes the other way round: the generosity of provisions has been increasing over time.

Thus, experience does not yet lend support to the view that European social welfare systems are being tested and are at serious risk of being cut back, let alone dismantled because of the competitive pressures associated with globalisation. Instead, the evidence is that such cuts as have occurred have been selective, and more often motivated by internal reassessments within national systems. This may suggest that some rationalisation is going on, but governments retain leverage in deciding which institutional features should be kept in place and which ones should be scaled down. Many governments have even opted, as in the case of income support of the last resort, to make existing provisions more generous over time. These trends in welfare reform are examined in greater detail in section 6.1.

Many of the studies of the social impact of globalisation suggest a plethora of potential effects, yet it is noteworthy that, especially in studies that focus on the contrasts between the richer and poorer parts of the world, there is by no means a consensus. Based on similar evidence, different studies arrive at diametrically opposed – and usually very robustly expressed – conclusions. Part of the problem is that many of the concepts behind the indicators used can be deployed in differing ways.

The subsequent sections of this chapter present information on social trends in the EU that bear on the impact of globalisation. After a brief look at the problems in using social indicators, some major trends are discussed. Section 6.2 considers the methodological issues that arise. Section 6.3 then presents some key trends, while section 6.4 highlights certain poverty and inequality issues, and section 6.5 focuses on gender. The last section discusses the links between the social and the competitive indicators. Underlying the whole chapter is the question of what the evidence reveals about whether or not competitive pressures have affected social policy, and thus whether there are any credible signs of a race to the bottom.

6.1 What kinds of reforms are taking place?

Based on a variety of sources (including country economic reviews carried out by the OECD, the Income Data Source studies, MISSOC reports, etc.), we have taken stock of the reforms undertaken in Europe in the field of non-employment benefits (encompassing not only unemployment benefits, but also the various cash transfers provided to individuals of working age),[43] pensions and employment protection. Details on the inventory of social policy reforms produced by the Fondazione Rodolfo Debenedetti (fRDB) and on the single regulatory changes are explained on the fRDB's website and in publications. The information here summarises the criteria followed in the classification of the various reforms.

The fRDB inventory of reforms is organised along two main lines. On the one hand, reforms are classified based on their broad orientation, that is, whether they tend to reduce or increase the generosity of public pensions and non-employment benefits and make employment protection more or less stringent. It should be stressed that increasing rewards from labour market participation do not necessarily mean phasing out existing cash transfer mechanisms to non-employed individuals. It may simply involve the introduction of wage subsidies, employment-conditional incentives or a switch to activation policies (including sanctions) for beneficiaries of existing schemes.

On the other hand, we distinguish reforms depending on whether they are *marginal* or *radical*. This procedure is done in two stages. Initially, we rely on qualitative assessments, which are based on an evaluation of the scope of the various reforms. In particular, we first classify as radical those reforms that satisfy at least one of the following criteria:

- They reduce replacement rates at the average production-worker level by at least 10%.
- They are comprehensive, that is, do not address just minor features of cash transfer schemes (for example, the minimum employment record required to qualify for unemployment benefits), but rather reform their broader design.
- They involve existing entitlements rather than being simply phased in for the new beneficiaries of the various schemes (thus, reforms of employment protection should also concern workers under permanent contracts).

In the second stage of the classification procedure we look at the actual behaviour of the series that should be most affected by the reforms and only if we observe a change in the underlying trend of these series do we confirm our initial qualitative assessment. The second stage can only be implemented for the reforms carried out before 1993, as we need a minimum number of observations in order to establish whether a change in the underlying trend has occurred. Sometimes, even in the case of reforms undertaken before 1993, the second-stage validation procedure cannot be implemented as some reforms are followed just a few years later by regulatory changes moving in the opposite direction, undoing some of the initial institutional changes. In

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[43] Social assistance to persons of working age, disability pensions and sickness benefits belong to this category.

all the cases where the second stage procedure cannot be implemented, only the first stage assessment is used. The latter was validated in 85% of the cases.

Which series were used in the empirical validation procedures? It obviously depends on the institutional features subject to reforms. On employment protection, we looked at labour market flows, especially unemployment inflows, as previous work has found a strong negative correlation between employment protection and the incidence of unemployment.[44] In any event, the impact of reforms on stocks (of employment and unemployment levels or labour force participation rates) can only be appreciated when working with longer series than are available in the database. On pension reforms, we looked at the dynamics of pension expenditures and revenues earmarked for the public pension funds: we expected radical reforms to affect at least one of the two significantly, thereby altering equilibrium contribution rates (the payroll rates required to clear the public pension budget). Examples of radical reforms are the 1998 Swedish pension reform, as well as the Amato reform carried out in Italy in 1992. Finally, in the case of non-employment benefits, we used proxy outflows from unemployment[45] (or outflows from the live registers to jobs in the countries for which such data are available): we expected radical reforms to affect exit flows from unemployment significantly (unfortunately, we had no data on outflows from non-employment).

The main results of this exercise are summarised in Table 6.1. The table shows that, contrary to popular wisdom and to the belief that labour market and social welfare institutions cannot be modified, many changes have occurred over the observation period (lasting 18 years). We counted some 414 reforms, that is, more than 1.6 per year *and* country. Nevertheless, the changes have often been marginal (388 out of 414 reforms, roughly 95% of the regulatory changes, did not pass our two-stage procedure identifying radical reforms). Moreover, the reforms are almost evenly split between those reducing generosity (increasing rewards from participation) and protection (241 out of 414, that is, about 58%) and those moving in the opposite direction. Nor is it infrequent to find reforms undoing one another over a few years. These inconsistencies and the marginal nature of most reforms have significantly increased the complexity of the European institutional landscape.

In the field of employment protection, for instance, we have seen a multiplication of contractual types, with a number of fixed-term and unstable jobs going hand-in-hand with permanent and still heavily protected positions. To give an example, in Italy 35 different contractual types have been recently counted by the Statistical Office. The number increased to 42 with the 'Biagi' 2003 reform. All this has increased the dualism of European labour markets, making them more segmented, not only between insiders and outsiders, but also among various types of outsiders.

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[44] See Boeri & Jimeno (2003) for a survey of the literature on the effects of employment protection legislation on labour market stocks and flows.

[45] Proxy outflow rates are computed as follows: $O_{t,t+1} = I_{t,t+1} - (U_{t+1} - U_t)$, where O denotes proxy outflows, I inflows and U unemployment levels. All primary data come from the OECD Unemployment Duration database.

Table 6.1 Trends in social reforms

		Decreasing protection and generosity, increasing rewards from participation			Increasing protection and generosity, decreasing rewards from participation				
		1985–90	**1991–96**	**1997–2002**	**1985–90**	**1991–96**	**1997–2002**	**Total per row**	**Of which decreasing (%)**
Employment protection legislation	*Marginal*	6	11	34	6	8	36	101	51
	Radical	0	5	1	0	2	2	10	60
Non-employment benefits	*Marginal*	9	34	92	10	9	27	181	75
	Radical	1	4	1	0	0	0	6	100
Public pensions	*Marginal*	10	10	22	13	27	24	106	39
	Radical	1	0	0	1	5	3	10	10
Total per column		27	64	150	30	51	92	414	–

Source: fRDB.

Table 6.1 also documents an acceleration of reforms in the last six-year period (roughly corresponding to a parliamentary term) covered by the data. Furthermore, in recent years, reforms would seem to have taken an orientation that is better defined in the area of in-work benefits: here they are, for the most part, oriented towards increasing rewards from labour market participation (93 out of 120). In all areas, reforms are still mainly 'marginal' as defined above, and the ratio of marginal to structural reforms has increased since 1990.

It should be stressed that among the reforms that have tightened benefits, increased rewards from participation or reduced employment protection (298, that is, more than 1 per year and country) not a few (12) have been carried out at times of recession (negative GDP growth) and some (59) under slow growth (0–2% of GDP growth). Indeed, Table 6.2 suggests that during recessions or at times of economic stagnation, it is more frequent to carry out these 'politically difficult' reforms than proceeding the other way round, while pressures to increase generosity are strong under buoyant macroeconomic conditions. In particular, when GDP was growing at more than 2% per year, there were 205 difficult reforms, but also 119 reforms doing the popular job of increasing generosity, adding more protections and reducing rewards from participation. That being said, only four of the politically difficult reforms were radical among those carried out when GDP was growing at less than 2% per year. The above findings indicate that reform activity is important, but very much constrained by the need to build up popular consensus, notably at times of relatively strong growth. This suggests that rather than globalisation per se, it is unreformed social welfare systems that are a threat to the survival of the so-called 'social Europe'.

Table 6.2 Reforms of labour markets and the macroeconomic environment

		Politically difficult reforms GDP growth*				**Politically popular reforms GDP growth***			
		Negative	**Stagnant**	**Slow**	**Strong**	**Negative**	**Stagnant**	**Slow**	**Strong**
EPL	*Marginal*	1	–	9	51	–	1	4	52
	Radical	–	1	–	6	2	–	–	2
NEB	*Marginal*	6	3	25	109	–	–	5	54
	Radical	–	1	1	4	–	–	–	4
Pensions	*Marginal*	4	3	10	47	4	–	8	30
	Radical	1	1	–	7	–	–	–	1
Total labour market		12	9	45	224	6	1	17	143
Avg. per year and per country **		(0.86)	(0.60)	(0.32)	(0.69)	(0.67)	(1)	(0.28)	(0.47)

* GDP growth: stagnant implies $0<g<1$, slow implies $1<g<2$, strong implies $g>2$

** In brackets, average number of reforms per year and country

Note: EPL refers to employment protection legislation; NEB refers to non-employment benefits.

Source: fRDB.

6.2 The use of social indicators: Methodological issues

There are numerous difficulties in obtaining accurate, comparable and timely information on poverty, inequality and other aspects of social exclusion that might be affected by globalisation. Many of the relevant data can only be obtained from survey data that rely on large-scale household surveys conducted by the member states. Such surveys employ differing methodologies and they may be carried out at different times, with the results often only available with a substantial lag. As a result, information on recent developments is not readily available, while comparisons across time or among countries are problematic. In addition, seemingly similar figures may be conceptually different, a good example being the calibration of poverty, where the EU standard is to set a 'poverty line' at 60% of median income, whereas the OECD sets the threshold at 50%. Elsewhere, poverty may be measured in absolute terms (for example in terms of basic subsistence) without taking account of the relativities involved. Perhaps surprisingly, the latter is essentially the approach adopted in official US poverty statistics. Statistics for individuals may tell a different story from those for households, and there are diverse techniques for correcting ('equivalence') for household size. Panel data based on surveys may be subject to compositional changes, with some individuals dropping out and not necessarily being replaced by identical individuals or households.

There is an extensive and continuing debate on all these issues,[46] and the point has to be made that there is no single unambiguously 'correct' approach. Many of the concepts and methodologies, moreover, have normative underpinnings that in turn reflect the values embodied in the European social model. Thus, for example, by electing to use a 60% threshold for poverty, Europeans are implicitly setting a tougher target than those countries that adopt 50%. It is important to stress and to repeat these 'health warnings' about much of the social data reported below.

Several sources of data have been used in this chapter. Eurostat compiles a range of indicators relevant to the social inclusion and social protection policy areas. Many relevant data are also presented in the *Joint Report on Social Inclusion and Social Protection* (European Commission, 2006f). The OECD carries out a variety of studies of social conditions among its members (which, it should be noted, exclude some of the smaller, recently acceded EU member states) and these studies have the merit of allowing comparisons with other developed countries. Some use is also made of data from the International Labour Organisation (ILO), which embrace labour market trends and some social conditions; these data allow certain comparisons with emerging competitor nations such as China.

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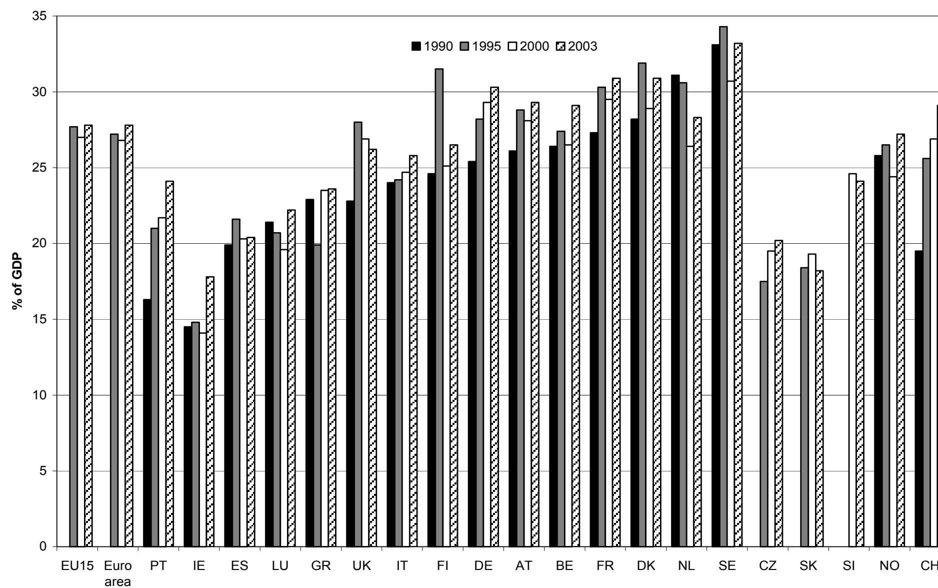
[46] See for example, Atkinson et al. (2002), the special issue of *Politica Economica* (2002) on EU social indicators, Ravallion (2003), and the work of the indicators subgroup of the Social Protection Committee.

6.3 Key trends

Despite these reservations about data quality and definitions, even cursory examination of social statistics at an aggregated level points to some striking conclusions about many of the presumed effects of globalisation, presented below.

- Social protection expenditure has broadly been stable as a share of GDP in the EU since the early 1990s, contrary to the expectation that it would be squeezed in the interests of bolstering competitiveness (Figure 6.1). Indeed, its growth over the period 1992–2003 exceeded GDP growth for the EU-15, with the implication that the European welfare state has become more, not less generous. In fact, the evidence of Dreher et al. (2006) suggests that globalisation has not even affected the composition of social spending in OECD countries.

Figure 6.1 Trends in social protection outlays, 1990–2003 (% of GDP)



Source: Eurostat.

- Nonetheless, at the member state level, wide disparities have persisted (Figure 6.1), although the share of GDP has to be treated with some caution for two main reasons. First, rapid GDP growth increases the denominator of the ratio, such that even if (as in Ireland) per capita spending on social protection has grown quite significantly, the ratio falls. Second, in dynamic economies, the employment rate is bolstered with the result that the number of working-age inactive or unemployed persons tends to diminish, reducing the calls on social protection. In other words, the budget needed to meet a lower demand falls. In such cases, a declining share of social expenditure in GDP may well signify progress rather than retreat of the European social model, although it will be evident that one indicator cannot convincingly answer two such different questions.

- Social protection provided by the state is not the only source of funding for the risks that individuals confront. The US, for example, devotes comfortably the largest share of GDP among advanced countries to health care, at just under 15%, around 50% more than the EU average (although, as a large number of health outcome indicators suggest, this does not translate into better health outcomes for the population as a whole in the case of the US). Even so, much of this is funded privately, with the health-care package constituting a major element in collective bargaining. Similarly, there is a wide range of examples across the developed world of other 'social' expenditure that is partly or wholly financed by the private sector. Such expenditure raises awkward methodological problems: although it typically covers similar risks to social protection (which would vindicate counting it as 'social'), it does not necessarily do so based on need or other social values (which would argue against counting it as like for like).
- Some such private spending is mandatory (for example, paid sick leave or mandatory private pensions), while some is voluntary (third-pillar pensions) as shown in Table 6.3. In addition, countries vary in the degree to which they subsidise private provision or tax benefits. The OECD (2005b) has attempted to bring together all these factors by estimating the aggregate of public and private social spending (Figure 6.2). This shows that the overall social outlays for the EU countries with the highest gross spending on social protection for which comparable data are available (such as Denmark, Sweden, Austria and Belgium, although less so Germany), overstate true social spending. By contrast, the US and the UK are shown to devote significantly more to social spending than is revealed by gross social protection outlays. In fact, the calculations show that the US share (26%) is very close to the shares of Belgium, Denmark, the Netherlands and Austria – countries that might be considered representative of the Nordic or corporatist social models. Germany, on this measure, has the highest overall social spending, followed by Sweden and the UK. In relation to globalisation, the salient point is that the share for the most advanced countries is in a much narrower range than might appear from comparisons of gross public spending on social protection. Still, what tends to be very different is how such expenditure is distributed. Tax breaks, for example, almost inevitably accrue disproportionately to individuals at the upper end of the income distribution.

Table 6.3 Gross private social spending, 2001 (% of GDP)

	OECD highest		**OECD lowest**		**EU highest***		**EU range**
Mandatory	DE/IT	1.4	FI	0.1	DE/IT	1.4	1.3
Voluntary	US	9.9	HU	0.0	NL	5.5	5.5
Total	US	10.3	LU	0.1	NL	6.2	6.1

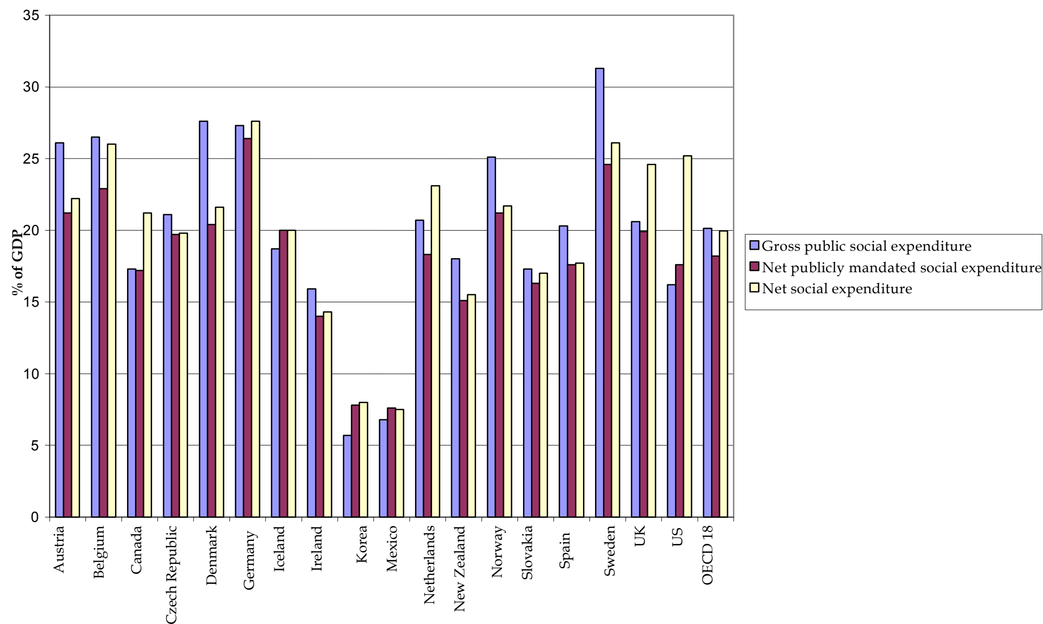
* In several EU member states, there is neither a mandatory nor a voluntary programme.

Source: OECD (2005b).

- Evidence on the generosity of components of social protection presents a mixed picture. Primarily for demographic reasons, old-age pensions, on the whole, have risen significantly in nearly all member states over the medium term, but there have been recent signs of a decline in generosity. For the same reasons, health

care has also tended to increase significantly in nearly all countries, although Germany (with a high base level) has held steady, allowing only very marginal growth in the share of GDP devoted to health-care spending. These trends are well documented in official publications and data are not presented here.

Figure 6.2 Public and private 'social' spending, 2001 (% of GDP)



Note: The public and private components may not be strictly comparable in the risks they insure against, such that comparisons have to be made with caution.

Source: OECD.

- By contrast, the generosity of unemployment benefits has declined in several member states over the medium term, although the economic downturn of the period 2000–03 saw a shorter-term increase. The longer-run trend could be regarded as an indirect consequence of globalisation in pushing member states to restrict benefits as part of policies to liberalise labour markets.
- Even though social inclusion has become a more high-profile objective, data presented in the *Joint Report* (European Commission, 2006f) show that benefits associated with alleviating it have grown at a much lower rate than other elements of social protection.
- Hourly wages and hourly labour costs have also continued to increase in the EU, despite the spectre of low-wage competition, suggesting that there has not been a globalisation-induced squeeze on wages (although it should be noted that in a number of developed countries the share of wages in GDP has declined in recent decades). This contrasts with the position in the US where, according to ILO data, real wages in manufacturing actually fell between 1980 and 2002 (Table 6.4).

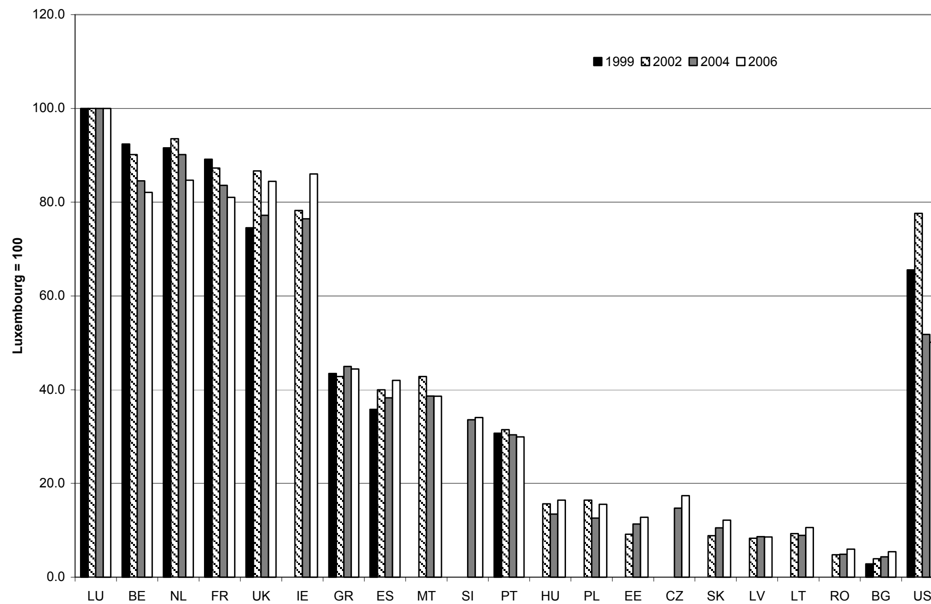
Table 6.4 Real wages in manufacturing, selected countries and years (index, 1995=100)

	1980	1985	1990	1995	2000	2001	2002	2003
Canada	-	94.9	93.9	100.0	102.6	101.5	102.0	100.7
China	-	-	77.4	100.0	155.3	172.2	195.4	-
Cyprus	-	-	-	-	103.3	107.1	109.1	-
Czech Rep.	-	-	-	100.0	116.1	118.6	122.0	-
Denmark	-	-	-	100.0	110.1	113.5	115.3	-
Estonia	-	-	-	100.0	121.9	127.0	135.2	-
Finland	-	-	-	100.0	110.4	110.9	113.2	-
Germany	-	-	-	-	102.4	101.9	102.6	104.1
Hungary	-	-	-	100.0	110.9	116.6	124.5	129.1
India	186.3	151.7	134.3	100.0	73.4	104.4	-	-
Ireland	85.2	86.5	93.7	100.0	141.8	149.2	152.8	155.6
Japan	-	-	-	100.0	103.6	105.9	106.4	106.8
Korea	32.4	42.2	71.0	100.0	117.3	119.8	130.6	137.3
Luxembourg	-	-	102.5	100.0	101.9	99.9	101.6	102.5
Malaysia	-	85.1	80.0	100.0	118.6	129.1	-	-
Malta	-	-	-	-	100.0	100.9	103.3	103.6
Netherlands	79.3	78.2	85.4	100.0	107.1	-	-	-
Portugal	-	-	97.6	100.0	-	-	-	-
Singapore	-	-	73.5	100.0	134.4	136.7	138.8	143.0
Slovakia	-	30.8	30.6	100.0	109.9	112.9	117.2	116.0
Slovenia	-	-	113.1	100.0	117.0	119.5	122.1	124.4
Spain	70.7	78.6	91.9	100.0	104.3	-	-	-
Sweden	94.5	90.8	100.3	100.0	101.7	102.5	103.2	104.6
Taiwan, China	-	-	81.5	100.0	111.1	109.7	109.7	-
UK	-	-	91.4	100.0	111.7	115.8	118.8	121.0
US	108.9	109.5	102.3	100.0	102.7	102.9	105.0	-

Source: ILO Key Indicators of the Labour Market database.

- Minimum wages might have been expected to be especially threatened, as they tend to be paid to the least qualified workers and are most susceptible to competition from unskilled workers in other parts of the world, but here too the evidence is that rates have been maintained (Figure 6.3). Seven EU member states achieve the social aims of minimum wages through collective agreements, rather than by government intervention. ILO data suggest that the rates set are comparable to those of peers with similar levels of GDP per head. Insofar as women are more likely than men are to be paid the minimum wage or just above it, the absence of downward pressure on minimum wages has meant that a possible threat to the incomes of working women has not materialised.

Figure 6.3 Minimum wages compared with the EU highest (PPS index, Luxembourg=100)



* French PPS adjustments appeared to change in 2003, markedly reducing PPS value in the latter two years.

Source: Eurostat.

- Minimum wages are also a feature of most major global competitor nations, including China, the US and India. Table 6.5, derived from information collated by the ILO, sets out the characteristics of minimum wage provisions in a number of these nations. The data suggest that minimum wages are more a feature of domestic policy considerations than pressures of globalisation. Thus, in the US, the minimum wage set at the federal level has remained unchanged for nearly a decade, although individual states are free to set higher (but not lower) minimum wages, which many do, as in Canada. By contrast, China, Australia and many others upgrade the rate – in effect – annually.
- In a number of countries, an explicit social policy choice has been made to increase minimum wages at a faster rate than average earnings. Nevertheless, only in the UK and Poland are minimum wages high enough to take the net income after taxes and benefits of a single-earner family with two children (with one parent working full-time on minimum wages) above the poverty threshold of 60% of median income (European Commission, 2006f, section 3.3 and Figure 3.4).
- Employment rates have been edging up in the EU in recent years, partly reflecting the priority given to raising the rate in the Lisbon strategy. The implication is that despite some of the threats emanating from competition from the rest of the world, notably to unskilled jobs, the dynamic of job creation has been sustained. Employment rates for women, although uniformly lower than those for men, have tended to increase more rapidly than for men in recent years

in most member states, rising by three percentage points in the period 2000–05. The only exceptions in this trend for the period were the Czech Republic, Poland, Slovakia and Sweden, whereas for men the EU-25 employment rate remained virtually unchanged. Half the member states had a fall in the men's employment rate, including the three most populous ones. Yet despite recent increases, there remains a strikingly large gender gap in the employment rates of older workers; indeed, it is only in the Nordic countries that older women have had employment rates close to those of their male peers. Employment growth figures exhibit similar differences both between men and women and across countries. Indicators of lifelong learning suggest that women are more likely than men are to have participated in training. This is true of employed and unemployed women.

Table 6.5 Overview of minimum wage arrangements among key global competitors

	Is there one?	**Nature**	**National?**	**Level**	**Adjustment**
Australia	Yes	Mixed statutory and collective agreement	National rate, but with an option for the state level to also set rate	National $303 per week (2004)	Annual, in practice
Brazil	Yes	Set by law and universal	Uniform, but with scope for higher negotiated levels	$84 per month (2003–04)	Formally, every three years; annual in practice
Canada	Yes	Statutory	Obligation on provinces from federal law	$5 per hour; varies among provinces (2004)	No formal provision; annual revision of three-year deal in Ontario
China	Yes	Responsibility of the state	Set regionally	$23-77 per month, varies by region (2003)	At least every two years
India	Yes	Minimum Wages Act, 1948	Applies mainly to non-unionised labour; otherwise collective agreements	$1.1-2.0 per day for least skilled, varying between rural and urban (2001)	At most every five years
Japan	Yes	Mix of directed and negotiated	Regional and sectoral rates	$5.2-6.1 per hour, varies by prefecture (2003)	No formal rule; annual in practice
Korea	Yes	Set by the ministry, on proposal of wages council	Provision for higher negotiated minimum rate	$2.1 per hour (2004)	Annual
Singapore	No	–	May be set in collective agreements	–	–
Thailand	Yes	Government sets rate on advice of wage committee	National minimum, but provision for higher levels set by provinces	$3.2-4.1 per day, varies by province (2003)	At least annually
US	Yes	Fair Labor Standards Act, 1938	National minimum, but states may set higher rates	$5.15 per hour (1997)	Not stipulated; not changed since 1997

Source: Derived from ILO labour statistics online.

- Since the two oil shocks of the 1970s, the rise in unemployment in the EU as a whole and its persistence has become a notable feature of the EU's social landscape. Still, the aggregate disguises quite marked differences among member states, with some, such as Spain, managing to achieve sizeable reductions in unemployment, while others have struggled to contain it. Table 6.6 presents figures on the long-term unemployment rate, which shows the diversity of experience – possibly as a result of policy initiatives – with the rates having fallen sharply in some countries while rising in others. This suggests that globalisation cannot easily be advanced as a common cause.

Table 6.6 Long-term unemployment rate (total men and women, % of labour force)

	1992	1995	1998	2000	2001	2002	2003	2004	2005
EU-25	n.a.	n.a.	4.4	3.9	3.8	3.9	4.1	4.1	3.9
EU-15	n.a.	4.9	4.4	3.4	3.1	3.1	3.3	3.4	3.3
Euro area	n.a.	5.3	5	3.9	3.6	3.6	3.9	4	3.8
Belgium	4	5.8	5.6	3.7	3.2	3.7	3.7	4.1	4.4
Czech Rep.	n.a.	n.a.	2	4.2	4.2	3.7	3.8	4.2	4.2
Denmark	2.4	2	1.3	0.9	0.9	0.9	1.1	1.2	| | 1.1
Germany	n.a.	3.9	4.5	3.7	3.7	3.9	4.5	5.4	5
Estonia	n.a.	n.a.	4.2	5.9	6	5.4	4.6	5	4.2
Greece	3.8	4.6	5.8	6.2	5.5	5.3	5.3	5.6	5.1
Spain	7.1	10.3	7.5	4.6	3.7	3.7	3.7	3.4	| | 2.2
France	3.4	4.4	4.5	3.5	3	3.1	3.7	3.9	3.9
Ireland	9.2	7.6	3.9	1.6	1.3	1.4	1.6	1.6	1.5
Italy	n.a.	7.1	6.8	6.3	5.7	5.1	4.9	4	3.9
Cyprus	n.a.	n.a.	n.a.	1.2	0.8	0.8	1	1.2	1.2
Latvia	n.a.	n.a.	7.9	7.9	7.2	5.5	4.4	4.6	4.1
Lithuania	n.a.	n.a.	7.5	8	9.3	7.2	6	5.8	4.3
Luxembrg	0.4	0.7	0.9	0.6	0.6	0.7	0.9	1.1	1.2
Hungary	n.a.	n.a.	4.2	3.1	2.6	2.5	2.4	2.7	3.2
Malta	n.a.	n.a.	n.a.	4.4	3.7	3.3	3.2	3.4	3.4
Netherlands	2.5	3.1	1.5	0.8	0.6	0.7	1	1.6	1.9
Austria	n.a.	1	1.3	1	0.9	1.1	1.1	| | 1.3	1.3
Poland	n.a.	n.a.	4.7	7.4	9.2	10.9	11	10.3	10.2
Portugal	1.3	3.1	| | 2.2	1.7	1.5	1.7	2.2	3	3.7
Slovenia	n.a.	n.a.	3.3	4.1	3.7	3.5	3.5	3.2	3.1
Slovakia	n.a.	n.a.	6.5	10.3	11.3	12.2	11.4	11.8	11.7
Finland	n.a.	n.a.	4.1	2.8	2.5	2.3	2.3	2.1	2.2
Sweden	0.5	2.3	2.6	1.4	1	1	1	1.2	1.2
UK	3.5	3.5	1.9	1.4	1.3	1.1	1.1	1	1
US	0.8	0.5	0.4	0.2	0.3	0.5	0.7	0.7	n.a.
Japan	0.3	0.6	0.8	1.2	1.3	1.7	1.8	1.6	n.a.

Notes: | | = break in series; n.a. = not available

Source: Eurostat.

- The disincentive effects of social protection have been declining slightly in nearly all member states in recent years, but are still extremely high. For someone receiving unemployment benefits, in some cases, taking a low-paid job (half of average earnings) results in income *loss* because of benefit withdrawal (European Commission, 2006f, Table 3.1).
- There are similar, although less pronounced disincentives for the inactive, with the difference explained by the relatively higher (often time-limited) benefits paid to recently unemployed persons as opposed to the inactive.

The *Joint Report* (European Commission, 2006f) explores the determinants of demand for social protection and identifies key influences. Pensioners, as one of the main target groups of social protection, receive average per capita transfers more than double those of the population as a whole, so that the well-known problem of population ageing will add to the costs of social protection (assuming no shifts in policy). According to the report (ibid., p. 47), the projected costs of pensions, health care and long-term care will rise by 2.5 percentage points of GDP in the EU as a whole by 2030, from 17.9% to 20.4%. The average disguises large inter-country variations, with Cyprus, Portugal and Belgium all facing rises of more than double the average in pensions (the largest component), whereas the projections show scope for the pensions share in GDP to fall sharply in Poland.

6.4 Poverty and inequality

Within the EU, the latest data on poverty are for 2005 and show that, using a 60% threshold, the range of poverty risks remains substantial and has increased over time in some cases. It is hard to ascribe the changes to globalisation, above all because examination of individual countries shows that the profile can be associated with specific economic developments or policy shifts, rather than there being a general pattern. For example, Finland endured a steep recession in the early 1990s, following the asymmetric shock of losing much of its trade with the former Soviet Union and the parallel banking crisis, and it is no surprise to see significant shifts in indicators. Similarly, the UK implemented a substantial welfare reform programme in the 1980s, also with consequences for indicators. A key concern identified in some of the literature on globalisation is that its impact will fall disproportionately on the poor and the least skilled. A number of general observations are germane:

- Indicators of social cohesion compiled by Eurostat as part of its structural indicators database provide extensive documentation of the incidence of poverty, although breaks in series and incomplete coverage make comparisons over time and across countries difficult. These detailed data show that the risk of poverty is higher among the youth and those aged 65 and over, and in all age groups tends to be higher for women than for men. Thus, the at-risk-of-poverty rate for women, after social transfers, for the EU-25 was 17% of the population in 2005 – a figure that has been stable over recent years – while for men the corresponding rate was 2 percentage points lower. There is substantial variation among member states in both the size of the risk and its trend: rates are highest in southern Europe and lowest in the Nordic countries.
- The data also show that the social protection system makes a pronounced difference. For the EU-25 as a whole, the at-risk-of-poverty rate before social

transfers was 27% and the variation was surprisingly low among the member states; for men the pattern was similar.

- Absolute poverty, although difficult to define in a way that makes cross-country comparisons possible, has continued to fall across the developed world as real income has risen. The OECD notes that the fall in the decade to the mid-1990s was of the order of a third, with a further 25% fall in the following five years. This figure refers to changes in the poverty rate when the *national* poverty line remains constant in real terms to the value of the base year. These lines differ across countries, however.
- The long-run trend reported by the OECD (2005c, p. 32, Figure 2.5) is for the profile of poverty to change, with significant falls in poverty among older age groups, offset by some increases in child poverty.
- An international comparison, albeit one based on a different poverty threshold (50% rather than 60% of median income as is customary in the EU) shows that EU countries – generally – have lower poverty rates and smaller poverty gaps (the difference between the average income of the poor and the poverty line) than most other developed countries. Yet, there is very considerable variation, with the Mediterranean countries and Ireland recording high rates while the Nordic countries, Luxembourg and the Czech Republic have the lowest. Although the picture is not uniform, the majority of member states for which data covering longer periods are available reduced these two rates between the mid-1990s and the year 2000, the last for which comprehensive figures are reported. An obvious problem with these findings is that they are dated and subject to quite substantial problems of heterogeneity in definitions, but the fact that the relevant ratios are fairly stable over time can be interpreted as encouraging evidence that globalisation is not (or at least not so far) having a visible impact on indicators of poverty.
- There is some long-run evidence that inequality has been increasing among the OECD countries since the mid-1970s (Table 6.7 and Figure 6.4), but most of the increase occurred in the 20 years up to the mid-1990s and has since stabilised.

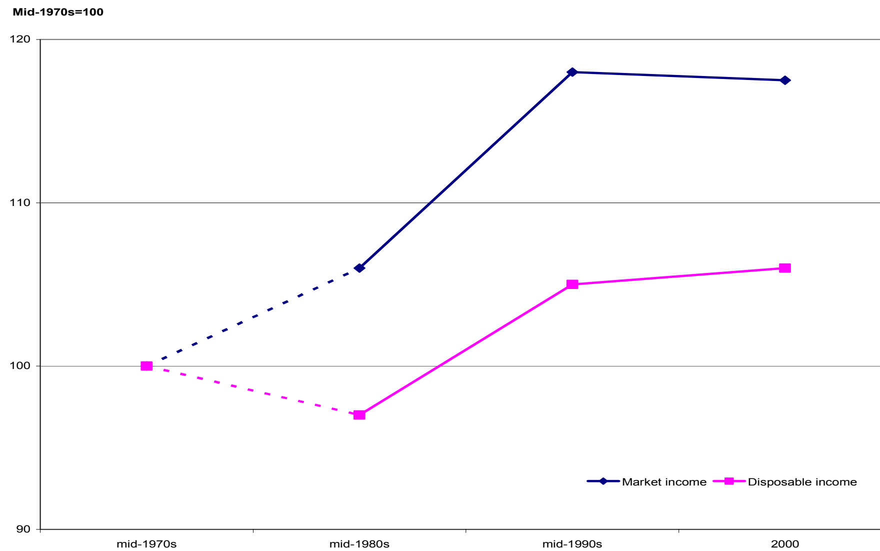
The important role of social protection in reducing the risk of poverty emerges clearly in published data. Including pensions, reductions of between 46% (Ireland) and 80% (Czech Republic) in the numbers at risk of poverty were achieved in 2003 through social protection, according to work by the OECD. Without pensions, the corresponding range is from 13% (Greece) to 64% (Denmark). Nevertheless, as Figure 6.5 shows, there remains a substantial risk of poverty in a number of member states. After social transfers, it is highest in Poland, Lithuania and Portugal, followed by Greece and Spain – all with roughly twice the proportion of persons as in the best-performing member states (the Czech Republic, Slovenia, the Nordic countries and the Netherlands, with a clutch of others not far behind). The Nordic countries are shown to be by far the most effective in reducing the risk of child poverty through social protection, whereas the Mediterranean countries do the least well, although many commentators sound a note of caution about the need to take account of benefits in kind.

Table 6.7 Changes in poverty rates over time

	Poverty rates at 50% of median income					Trend	Poverty rates at 60% of median income					Trend
	Mid-70s	**Mid-80s**	**1990**	**Mid-90s**	**2000**		**Mid-70s**	**Mid-80s**	**1990**	**Mid-90s**	**2000**	
Czech Rep.	–	–	3.2	4.3	4.3	–	–	–	8.1	9.9	9.7	–
Sweden	3.9	3.4	3.7	3.7	5.3	–	9.6	7.5	8.9	7.9	10.8	–
Denmark	–	5.3	–	3.8	4.3	Decreasing	–	12.7	–	10.4	11.6	Decreasing
Netherlands	2.5	3.1	5.2	6.3	6.0	–	5.7	7.1	12.0	13.5	12.4	–
Luxembourg	–	5.4	–	5.5	5.5	Stable	–	11.5	–	12.4	12.9	–
Belgium	–	10.5	–	7.8	*7.2*	Decreasing	–	15.5	–	13.2	*13.1*	Decreasing
France	–	8.0	7.2	7.5	7.0	Decreasing	–	13.7	14.4	13.5	13.4	Stable
Finland	9.9	5.1	–	4.9	6.4	–	15.8	10.7	–	10.8	13.8	–
Germany	–	–	–	8.3	8.9	–	–	–	–	13.8	14.0	–
Hungary	–	–	6.3	7.4	8.2	–	–	–	12.9	14.4	14.4	–
Germany (West)	–	7.4	7.2	8.9	9.5	–	–	13.3	13.1	14.5	14.6	–
Austria	–	6.1	–	7.4	9.3	–	–	11.4	–	13.7	15.6	–
Poland	–	–	–	9.9	9.8	–	–	–	–	16.2	16.3	–
UK	6.4	6.9	14.2	10.9	11.4	–	13.0	17.6	22.2	19.5	19.2	–
Italy	–	10.3	10.7	14.2	12.9	–	–	17.0	19.2	21.6	20.1	–
Spain	–	15.0	11.4	12.6	12.1	Decreasing	–	21.3	17.2	19.6	20.2	Decreasing
Greece	17.8	13.4	–	13.9	13.5	Stable	23.7	19.6	–	21.7	20.5	–
Portugal	16.2	–	13.8	14.6	13.7	–	22.3	–	20.6	22.1	20.6	Stable
Ireland	–	10.6	–	11.0	15.4	–	–	19.5	–	20.7	23.3	–
Norway	–	6.9	–	8.0	6.3	Decreasing	–	12.9	–	14.6	12.1	Decreasing
Canada	14.4	10.7	–	9.5	10.3	Stable	20.1	17.3	–	15.9	17.1	Stable
Australia	–	12.2	–	9.3	11.2	Decreasing	–	21.0	–	18.8	20.2	Decreasing
New Zealand	–	5.8	8.7	7.8	10.4	–	–	14.2	19.3	15.6	20.3	–
US	15.4	17.9	18.1	16.7	17.1	Stable	21.2	23.8	24.2	23.8	23.7	Stable
Japan	–	11.9	–	13.7	15.3	–	–	17.9	–	19.7	21.2	–
Mexico	–	20.7	–	21.7	20.3	Stable	–	27.6	–	27.7	26.9	Stable
Turkey	–	16.4	–	16.2	15.9	Stable	–	24.3	–	23.4	22.7	Decreasing

Source: Förster & d'Ercole (2005).

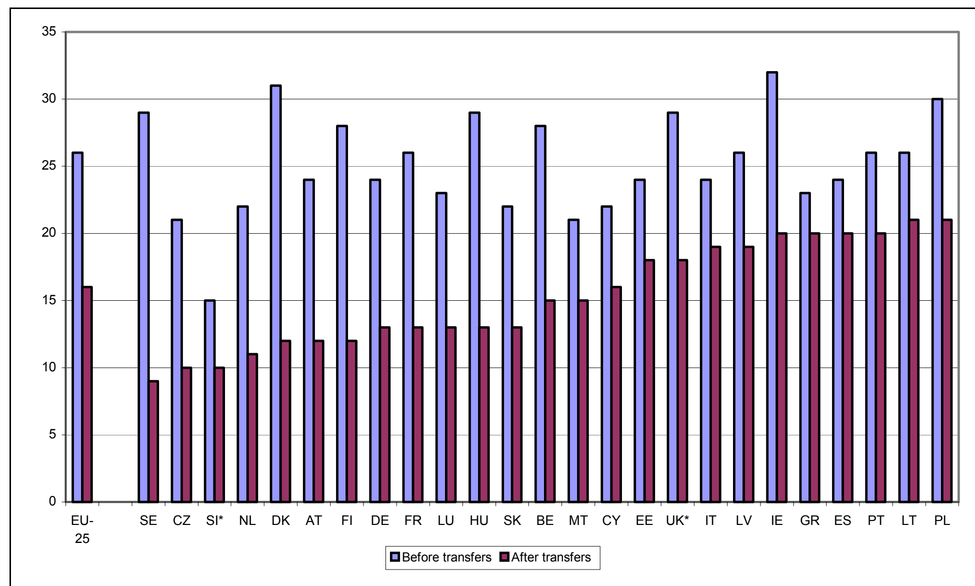
Figure 6.4 Trends in the distribution of equivalised household income (OECD average, index)



Notes: Gini coefficient of income inequality, an average of 17 OECD countries in the mid-1980s, mid-1990s and 2000. Changes over the period from the mid-1970s to the mid-1980s are based on the average values for only 7 OECD countries. The Gini coefficient is defined as the area between the Lorenz curve (which plots cumulative shares of the population, from the poorest to the richest, against the cumulative shares of income that they receive) and the 45 line, taken as a ratio of the whole triangle. Its values range between 0 in the case of 'perfect equality' (each share of the population receives the same share of income) and 100 in the case of 'perfect inequality' (all income goes to the share of the population with the highest income).

Source: Reproduced from OECD (2005c), based on a questionnaire to member countries.

Figure 6.5 At-risk-of-poverty rate for the EU-25, 2005



* = 2003 data for SI and the UK

Note: Data for HU are provisional.

Source: Eurostat.

Many of the foregoing observations assume that social benefits are fully taken up, which is not always a reasonable assumption. For instance, there are systematic differences (resulting from the nature of social protection systems) among member states in the degree to which the unemployed receive benefits they are entitled to as a direct result of job loss, ranging from hardly any in Italy to over 70% in Belgium and Denmark. Some insights into the relative positions of different member states can be obtained by cross-tabulating poverty and inequality indicators, as in Table 6.8 reproduced from the European Commission's (2006f) *Joint Report*.

Table 6.8 Conjunction of poverty gaps and poverty risks

		At-risk-of-poverty headcount		
		Low	**Medium**	**High**
At risk of poverty intensity	*Low*	CZ, SI, DK, LU, FI, SE, HU, NL, AT, FR	CY, LT	UK, IE
	Medium		BE, LV, PL	EE
	High			IT, EL, ES, PT, SK

Notes: Member states are classified as having a medium at-risk-of-poverty headcount (or rate) and at-risk-of-poverty intensity (or gap) if the corresponding figure is respectively within +/- 1 point from the EU average. The highlighted member states are those with a higher than average risk of poverty.

Source: European Commission (2006f), Table 1.1.

Child poverty

Child poverty has recently come to the forefront as a problem of growing concern in the EU, becoming a policy priority for the EU as a whole as well as for most member states. In a majority of member states, the at-risk-of-poverty indicator for children exceeds the national average, the exceptions being the Nordic countries, Slovenia and Cyprus. The intensity of poverty or the poverty gap (which compares the average well-being of those at risk of poverty with the poverty line) follows similar patterns, with the Nordic countries again revealed to have the lowest poverty gaps, along with the Czech Republic and Luxembourg. It is important to recall, however, that these data relate to *country* median incomes and that if an EU median were used, the picture would be very different.

In a recently published study using the Luxembourg Income Survey, Heuveline & Weinshenker (2008) examine whether it is the demography of countries that accounts for differences in child poverty rates (see Table 6.9), but find that it is instead the "anti-poverty effectiveness of tax and transfer policy" that accounts for the differences. They conclude that the high incidence of child poverty, especially in households headed by single women, is amenable to policy action, the implication of which is that globalisation *per se* is not a convincing explanatory factor. Still, it should be noted that these comparisons rely exclusively on monetary incomes, and thus ignore the substantial – and considerably different across countries – role played by transfers in kind (for example, in the case of children, the existence of free childcare services).

Table 6.9 Actual child poverty rates by household type – Selected economies

	Household type					
Country	**All**	**Married couple**	**Co-habiting couple**	**Single male head**	**Single female head, no other adults**	**Single female head and other adults**
US (2000)	22	13.9	29.7	25.6	55.4	36.9
Australia (1994)	16	12.1	*	25.8	51.6	27.2
Belgium (1997)	7.7	7	10.9	19	9.3	12.2
Canada (2000)	14.9	10.4	14.4	13.3	48.3	16.8
Estonia (2000)	13.6	10.2	15.5	10.9	27.3	15.2
Finland (2000)	2.8	1.9	3	2.1	9	0
France (1994)	7.9	5.2	11.7	13.3	27.3	19
Germany (2000)	9	4.1	12	10	42.1	11.3
Netherlands (1999)	9.8	6.6	15.9	11	38.4	16
Norway (2000)	3.4	2.1	1.6	5.4	11.6	8.6
Poland (1999)	12.7	12.2	*	10.5	20.1	15.1
Russia (2000)	23.4	20.7	30.6	16.6	41	24.9
Slovenia (1999)	6.9	5.6	7.4	16.8	28.8	14.4
Sweden (2000)	4.2	2.3	2.3	4.2	13.5	7.1
UK (1999)	15.3	9.2	15	21.4	37.3	9.8

* For Australia and Poland, no distinction is made between married and cohabiting couples.

Source: Heuveline & Weinshenker (2008), using Luxembourg Income Survey data.

Main implications

The implication of the figures presented in this section is that global pressures have not prevented the welfare system from achieving a considerable reduction in poverty and (although the caveat about the reliability and comparability of data over the years needs to be repeated) it is noteworthy that there is no systematic evidence of worsening poverty ratios in recent years. A second inference to draw is that the design of social protection systems has a marked influence on the incidence of poverty, highlighting the importance for the EU of building on the policy diversity among member states to arrive at optimal solutions.

In the discussion of poverty and inequality, it is obvious that the fact that there is little or no sign that globalisation has aggravated the position does not mean that it may not do so in future. Equally, it is reassuring to note that social protection systems have been able to cope with the challenges to date. We return to these questions in a more analytic exercise in chapter 8.

6.5 Gender effects of globalisation in the labour market

In the ILO (2004) study of the social impact of globalisation, a key finding was that women were more affected than men were. Many of the worst social consequences for women, for example in relation to health or basic subsistence, are far removed from the circumstances of the EU. Even so, it might be hypothesised that other aspects of the drive towards gender equality in the EU could be compromised by globalisation, notably in the labour market. A clear example is in unemployment, where in the EU-25 as a whole, unemployment rates have averaged about 2 percentage points higher for

women than for men since 2000. To the extent that some of the unemployment is attributable to global competitive pressures, a tenuous connection between globalisation and gender can by inferred. The gap has been diminishing, however: in 2000, it was 2.6 points, but by 2005, it was down to 1.6 points.

Long-term unemployment for women has generally been higher than for men, although here too the gap is diminishing (Table 6.10). Overall, the long-term unemployment rate for women is consistently higher than the total rate (shown in Table 6.6, above), although the disparity has been edging downwards. The aggregates disguise quite substantial differences, with the three Mediterranean countries (Greece, Italy and Spain) standing out. Women's unemployment in Greece has been some two and a half times that of men in recent years, and in Spain it has tended to be double. But in Spain and Italy the gap has been narrowing, coming down from 10.8 points in Spain in 2000 to 5.2 points in 2005 (a period when unemployment in Spain fell substantially), and in Italy falling from 6.4 points above that of men in 2000 to 3.9 points by 2005.

Table 6.10 Long-term unemployment rates for women (% of labour force)

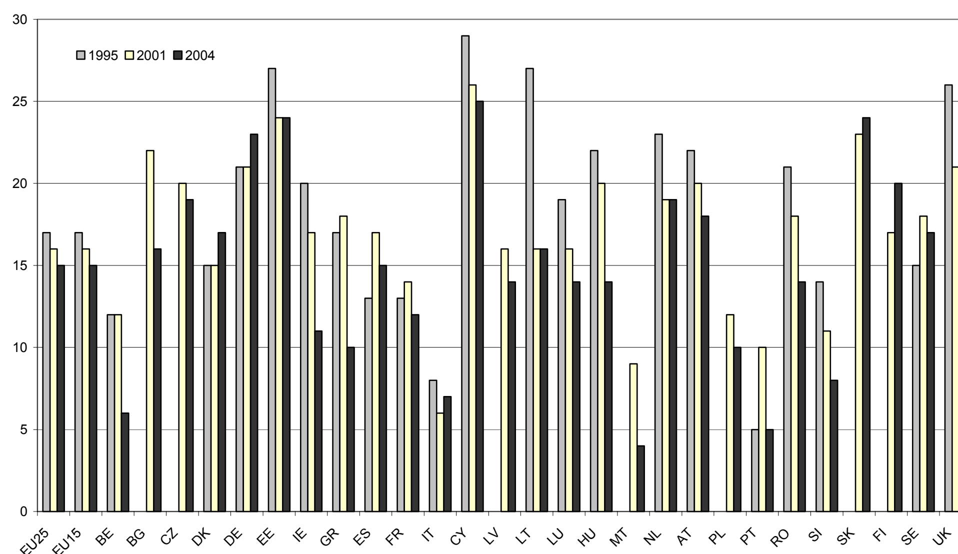
	1992	1995	1998	2000	2001	2002	2003	2004	2005
EU-25	–	–	5.5	4.8	4.6	4.6	4.7	4.7	4.5
EU-15	–	6.1	5.5	4.3	3.8	3.8	3.9	4.0	3.7
Euro area	–	7.3	6.6	5.2	4.6	4.6	4.8	4.9	4.5
Belgium	5.8	7.7	7.1	4.6	3.5	4.3	4.2	4.7	5.0
Czech Rep.	–	–	2.6	5.2	5.1	4.6	5.0	5.3	5.3
Denmark	2.8	2.2	1.7	1.1	1.0	1.0	1.0	1.3	1.2
Germany	–	5.5	6.0	4.6	4.6	4.8	5.2	6.1	|| 5.4
Estonia	–	–	4.1	5.0	5.4	4.4	4.4	4.4	4.2
Greece	7.2	8.1	10.0	10.2	9.1	8.6	8.9	9.4	8.9
Spain	13.3	16.4	11.6	7.4	6.0	5.9	5.7	5.1	|| 3.4
France	4.4	5.3	5.3	4.3	3.6	3.5	4.1	4.3	4.4
Ireland	8.4	6.7	2.8	1.0	0.8	0.8	1.0	1.0	0.8
Italy	–	10.0	9.1	8.4	7.6	6.9	6.6	5.5	5.2
Cyprus	–	–	–	2.2	1.2	1.0	1.3	1.6	1.8
Latvia	–	–	7.5	7.5	6.3	4.6	4.4	4.3	3.7
Lithuania	–	–	7.0	6.5	7.7	6.8	6.0	6.2	4.5
Luxembourg	0.5	1.0	1.1	0.6	0.6	0.9	0.9	1.4	1.2
Hungary	–	–	3.8	2.5	2.1	2.2	2.3	2.6	3.2
Malta	–	–	–	4.2	2.7	2.4	2.4	2.9	3.2
Netherlands	3.3	3.4	1.8	1.0	0.7	0.9	1.1	1.6	1.9
Austria	–	1.5	1.8	1.2	1.1	1.2	1.1	|| 1.4	1.4
Poland	–	–	6.3	9.1	10.8	12.3	11.7	11.0	11.4
Portugal	1.3	3.2	|| 8	2.0	1.9	2.1	2.7	3.4	4.2
Slovenia	–	–	3.3	4.2	4.0	3.6	3.6	3.4	3.3
Slovakia	–	–	7.1	10.2	11.3	12.5	11.7	12.4	12.3
Finland	–	–	3.9	2.7	2.3	2.0	2.0	2.0	1.9
Sweden	0.1	1.0	1.8	1.0	0.8	0.8	0.8	1.0	1.0
UK	2.1	2.0	1.2	0.9	0.8	0.7	0.7	0.6	0.7
US	0.6	0.5	0.3	0.2	0.3	0.5	0.6	0.6	–
Japan	0.2	0.3	0.5	0.8	0.9	1.1	1.2	1.0	–

Note: | | break in series
Source: Eurostat.

The disparities are still disturbing, but an inference might be that globalisation has at least not worsened the gap between men and women and it appears to have coincided with a reduction. It is noteworthy that this relative improvement has been against the backdrop of a significantly more rapid increase in the supply of labour of women than that of men.[47] In nearly all member states, the annual increase in the labour supply of women was consistently above that of men between 2000 and 2005. Part of the explanation may be that women are more likely than men are to work in services, a sector generally less exposed to the competitive pressures of globalisation.

There remain sizeable gender differences in many other relevant gender indicators. In particular, the gender pay gap, shown in Figure 6.6, reveals that there has been some narrowing in pay differences, but that the spread among EU member states is still substantial. Again, however, the pressures of globalisation do not seem to have prevented progress, although the slow pace of change should still be noted in some cases. Data on the risk of poverty in work suggest that there is not much difference between men and women, but that the risk varies hugely from one member state to another. Women are more likely than men are to live in households in which no one works, however: in 2006, the ratio for the EU-25 was 8.8% for men and 10.8% for women. For both men and women, the indicator of jobless households is highest in Belgium and Poland, but is lowest in the Baltic countries for women and in southern European countries for men.

Figure 6.6 Gender pay gap, 1995–2004 (% difference in average hourly earnings, as a percentage of men's earnings, ranked by 2001 gap)



Source: Eurostat.

[47] See the European Commission's database of indicators for monitoring the employment guidelines (retrieved from http://ec.europa.eu/employment_social/employment_strategy/pdf/indicatorsendnov_en.pdf).

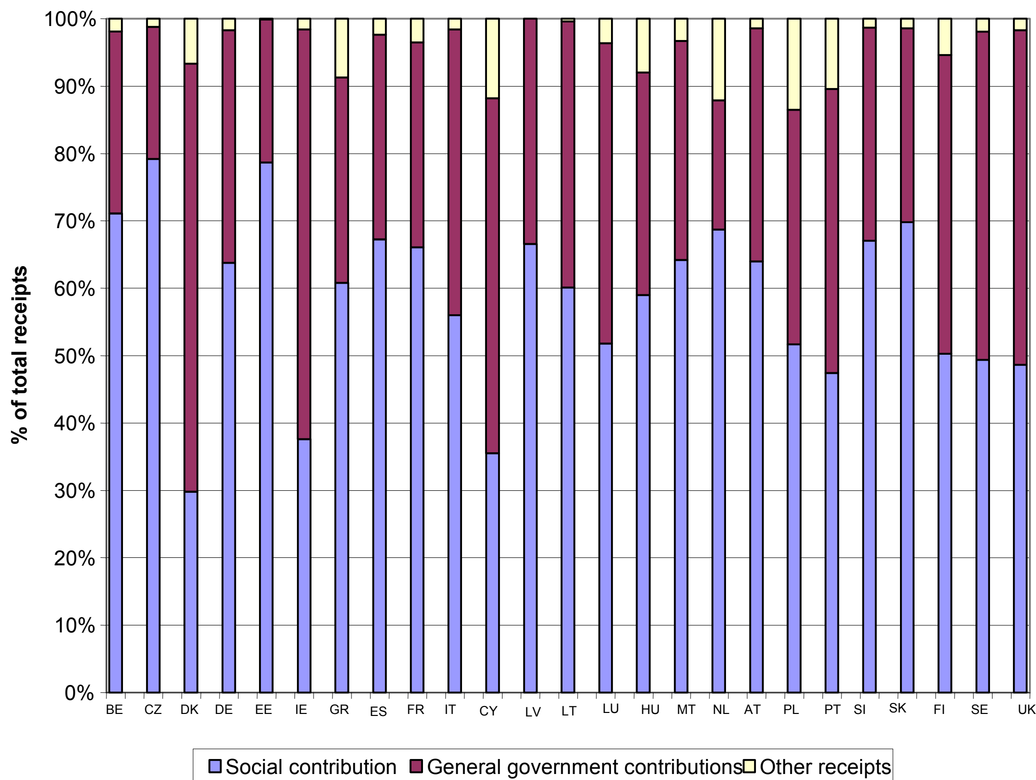
6.6 Social policy and competitiveness

One of the key challenges from globalisation is competitiveness and here the financing of the social protection system is germane. The 2006 *Joint Report* reveals that social charges on employers and employees continue to be the main source of financing for social protection, amounting on average to some 60% of the costs of social protection in 2003 (European Commission, 2006f). Yet, as Figure 6.7 shows, the cross-country variation is enormous.

General taxation is the main source of funding in Denmark, Ireland and Cyprus, with social charges contributing a third or less. The financing is roughly equally split between general taxation and social charges in the UK, Sweden, Poland, Finland, Portugal and Luxembourg. Then, there is a quantum leap to all the other member states, which rely predominantly on social charges.

Moreover, even within the structure of social charges, big differences can be found: Denmark, for example, puts most of the burden on employees, whereas many other countries tend to look more towards employers.

Figure 6.7 Financing of social protection, 2003



Source: Eurostat.

In relation to globalisation, it is also important to note that even where the cost of financing social protection is predominantly met by social charges, it does not inevitably translate into a loss of competitiveness. Given that Danes spend much the same proportion of their GDP on social protection as other richer EU member states, the average Danish taxpayer can be expected to ask for higher nominal wages to compensate for the tax burden that he or she faces to fund social protection. By contrast, for a Belgian or Estonian worker, relatively lower pre-tax wages will be worth more in terms of spending power because the general tax burden is *ceteris paribus* lighter as a result of financing social protection through social charges. In short, the revenue neutrality of different funding approaches needs to be kept in mind.

Equally, the overall choices a country makes about how much public expenditure to undertake will also affect the competitive position, although the effect will depend crucially on how the money is spent. Here again, there is no simple answer, since the evidence shows that countries that devote both high (Sweden) and low (Ireland and several of the recently acceded member states) shares of GDP to public spending fare well.

Nevertheless, microeconomic factors may intrude and it is possible that globalisation pressures may have had an influence for the simple reason that the 'wedge' between wages and labour costs can adversely affect competitiveness in certain markets. To a limited extent, the trend in gross social charges has been towards a reduction, reflecting a combination of financing changes and welfare reform.

Vulnerability to globalisation and opportunities to benefit from it can partly be gauged by the relative specialisation of a member state. Broadly, it would be expected that member states that rely most heavily on segments of economic activity for which the EU is losing its competitive position would face more acute problems than those that are relatively specialised in growth sectors. Starting with the major aggregates, Tables 6.11 and 6.12 show the longer-term trends. Total employment in nearly all the countries included in the OECD's STAN database was substantially higher in 2003 than in 1995, and for those countries for which consistent data are available, it can be seen that the growth over the last three decades has been considerable. Disaggregation into broad sectors shows nonetheless that the tertiary sector has been responsible for most of the job creation. Even high- and medium-high technology industries have seen a decline in share in most OECD countries (Table 6.13).

With respect to job losses, the EPC also reports a mixed story about the resilience of the EU in response. Table 6.14, reproduced from the EPC study, suggests that the US has been better at re-employing workers, whereas the EU-15 manages to provide re-employed workers with a higher income. Table 6.15 shows the overall trends in unemployment benefit replacement rates as computed by the OECD in a complicated exercise to average among different sorts of claimants. These rates vary substantially across EU member states, but they have also been surprisingly stable in most cases, suggesting that they are not a significant consideration in competitiveness. It is, however, noteworthy that there is a big gap between the most generous countries and those OECD members that might be labelled 'Anglo-Saxon'.

Table 6.11 Changes in levels of employment 1995–2003 (total employment headcount, %)

	Agriculture, hunting, forestry and fishing	Total manu.	Textiles, textile prod., leather & footwear	Wood and products of wood & cork	Machinery and equipment	Wholesale & retail	Finance, insurance & real estate	Community, social and personal services	Total services	Business sector services	Total
Austria	-6.8	-7.1	-35.3	-12.4	-2.4	6.5	50.8	11.7	15.4	17.8	6.1
Belgium	-12.6	-9.5	-32.2	-13.3	-13.2	1.2	27.9	15.6	13.6	12.0	7.8
Czech Rep.	-37.7	1.3	-27.1	4.5	7.8	-4.3	16.6	-0.5	0.8	1.5	-5.2
Denmark	-16.3	-11.4	-42.3	-15.4	-5.8	11.8	24.6	9.4	11.5	13.5	5.9
Finland	-24.8	6.3	-21.7	3.0	16.2	23.5	38.6	18.4	21.3	24.3	14.8
France	-9.0	-1.9	n.a.	n.a.	n.a.	15.0	29.8	9.9	17.0	23.4	9.9
Germany	-18.5	-8.3	n.a.	n.a.	n.a.	7.2	36.9	8.5	12.2	14.9	2.5
Greece	-17.9	-9.2	-18.9	-12.9	6.8	12.4	33.2	11.3	13.4	14.7	4.1
Hungary	-27.1	8.9	-15.3	6.3	29.7	20.1	59.2	4.5	12.7	20.3	8.3
Ireland	-19.1	13.6	n.a.	n.a.	n.a.	49.9	82.6	40.9	54.5	65.2	41.2
Italy	-18.7	1.4	-15.3	-2.5	9.3	14.5	43.6	9.5	16.6	22.2	10.4
Luxembourg	-13.3	-1.2	-27.3	n.a.	2.1	21.6	84.2	37.8	48.8	53.7	36.0
Netherlands	-4.8	-3.5	-30.8	10.0	3.5	15.6	33.2	20.6	21.7	22.5	16.1
Poland	1.5	-20.4	n.a.	n.a.	n.a.	19.9	52.4	3.0	12.4	19.2	-0.9
Portugal	-9.3	0.5	-14.3	-4.6	17.9	20.4	20.6	19.6	19.1	18.7	11.7
Spain	-10.8	16.7	n.a.	n.a.	n.a.	23.3	45.8	20.7	25.2	28.7	22.6
Slovak Rep.	-51.8	-10.5	n.a.	n.a.	n.a.	47.6	21.8	-4.4	11.5	26.3	-2.2
UK	-24.7	-17.0	-54.9	-11.2	-21.9	10.5	26.0	13.6	15.7	17.0	9.3
EU-18	-11.0	-5.2	n.a.	n.a.	n.a.	13.2	34.5	11.4	15.9	19.3	8.1
Canada	-19.6	11.2	-0.7	7.4	13.0	19.4	40.3	11.2	19.4	24.6	16.7
US	1.1	-14.5	-48.0	-8.2	-20.3	9.2	16.2	15.5	13.4	11.8	9.6
Japan	-19.0	-17.6	-46.7	-31.7	-15.3	-1.4	-3.3	15.0	5.9	-1.4	-2.5
Korea	-18.9	-12.7	n.a.	n.a.	n.a.	8.1	49.8	45.2	25.8	18.7	8.4

Source: OECD STAN database, 2005 edition.

Table 6.12 Share of manufacturing in total employment, selected OECD countries (headcount, %)

	1980	1985	1990	1995	1998	2000	2001	2002	2003	Change 1995–2003
Austria	22.9	20.9	19.9	17.7	16.5	16.2	16	15.7	15.5	-2.2
Belgium	23.6	21.4	19.7	17.6	16.6	15.9	15.8	15.2	14.7	-2.9
Czech Rep.	n.a.	n.a.	n.a.	28.4	30.8	29.3	30.4	30.6	30.7	2.3
Denmark	20.3	20.2	19.3	18.5	17.0	16.6	16.3	15.8	15.4	-3.1
Finland	24.7	22.5	20.3	20.1	20.1	20.0	19.8	19.3	18.7	-1.4
France	23.6	21.1	19.2	17.1	16.3	15.7	15.6	15.2	n.a.	-1.9*
Germany	31.3	29.2	28.4	22.6	21.6	20.9	20.9	20.5	20.2	-2.4
Greece	n.a.	n.a.	n.a.	16.4	15.8	15.3	15.3	14.8	14.3	-2.1
Hungary	n.a.	n.a.	n.a.	23.5	24.8	24.3	24.8	24.8	23.6	0.1
Ireland	21.1	18.8	19.4	19.4	18.9	17.7	17.2	16.2	15.6	-3.8
Italy	29.1	25.3	24.6	23.4	23.1	22.3	21.9	21.7	21.5	-1.9
Luxembourg	-	22.7	19.2	15.3	13.9	12.5	12.0	11.6	11.1	-4.2
Netherlands	19.6	17.8	17.0	14.9	13.9	13.4	13.0	12.7	12.4	-2.5
Poland	n.a.	n.a.	n.a.	21.1	19.7	18.2	17.7	17.3	n.a.	-3.8*
Portugal	25.3	24.2	23.6	21.8	21.0	20.4	20.2	19.7	19.6	-2.2
Slovak Rep.	-	-	-	27.3	26.6	25.6	25.4	25.3	25.0	-2.3
Spain	23.2	20.5	19.7	18.1	18.6	18.3	18.2	17.9	17.2	-0.9
Sweden	22.8	20.9	19.4	18.2	18.3	17.5	17.3	16.8	16.4	-1.8
UK	26.4	22.1	19.4	17.3	16.8	15.2	14.5	13.6	12.9	-4.4
US	19.3	16.9	15.1	13.8	13.1	12.7	12.1	11.3	10.8	-3.0
Canada	19.1	16.7	15.6	14.2	14.3	14.5	14.2	13.7	13.5	-0.7
Japan	23.1	23.4	23.2	20.6	19.4	18.7	18.4	17.7	17.4	-3.2
Mexico	-	-	12.6	11.2	12.3	12.8	12.2	11.5	11.1	-0.1
Korea	22.7	24.3	27.9	23.6	19.7	20.3	19.8	19.1	19.0	-4.6

* Change up to 2002 for France and Poland

Source: OECD STAN database, 2005 edition.

Table 6.13 Share in total employment of high- and medium-high technology industries

	1990	1995	2001	2002	2003
Austria	6.3	5.5	5.3	5.3	5.2
Belgium	6.9	6.1	5.7	5.4	5.2
Denmark	6.6	6.5	5.9	5.7	5.6
Finland	6.3	7.3	7.6	7.3	7.0
France	6.7	5.9	5.5	5.4	n.a.

Table 6.13 Continued

Germany	13.9	10.3	10.1	9.8	n.a.
Greece	-	2.5	2.4	2.3	2.2
Hungary	-	7.3	8.6	8.5	8.3
Ireland	6.4	7.7	7.8	7	n.a.
Italy	7.5	6.9	6.7	6.6	6.5
Luxembourg	3.1	2.9	2.4	2.3	2.2
Netherlands	5.7	4.6	4.2	4.1	4.0
Portugal	3.6	3.2	3.3	3.1	3.1
Slovak Republic	-	9.2	8.0	-	n.a.
Spain	5.4	4.9	5.1	5.0	n.a.
Sweden	7.7	7.7	7.7	7.5	7.2
UK	7.4	6.3	5.5	5.1	4.8
US	5.6	5.0	4.4	4.1	3.8
Canada	4.6	4.3	4.0	3.9	3.9
Japan	9.1	8.1	7.6	7.4	7.3
Mexico	3.8	3.5	4.2	3.9	3.8
Korea	10.3	10.0	9.2	n.a.	n.a.

Source: OECD STAN database, 2005 edition.

Table 6.14 Labour market responses to displaced workers (%)

	EU-15 1994–2001			**US 1979–99**		
	High competition manu.	**Total manu.**	**Services**	**High competition manu.**	**Total manu.**	**Services**
Share re-employed two years later	52	57	57	63	65	69
Share with no earnings loss or better	44	46	50	36	35	41
Share with earnings loss of 30% or more	5	7	8	25	25	21

Notes: Columns relate to manufacturing with high levels of international competition, total manufacturing and services (including utilities for the US).

Source: Reproduced from EPC (2005).

Moreover, there is evidence that the generosity of unemployment insurance is positively associated with more stable employment prospects after re-employment (Tatsiramos, 2006). Whether these are direct trade-offs is a matter for conjecture, not least because the underlying performance of the economy will tend to have a greater effect on re-employment prospects than the detailed type of unemployment insurance.

Table 6.15 The OECD summary measure of benefit entitlements, 1961–2003

	1961	1971	1975	1981	1985	1987	1991	1993	1995	1997	1999	2001	2003
Netherlands	13	48	48	48	55	57	53	53	52	52	52	53	53
Denmark	20	34	39	54	53	49	52	51	65	62	61	51	50
Belgium	42	41	47	45	43	43	42	40	39	40	39	38	42
Portugal	0	0	5	9	22	31	34	35	35	35	45	41	41
France	25	24	26	31	34	38	38	38	37	37	37	44	39
Ireland	17	17	21	28	28	30	29	31	26	29	29	36	38
Finland	5	8	24	24	34	36	39	38	36	34	34	35	36
Spain	9	12	21	28	34	34	34	32	39	39	38	36	36
Italy	4	2	2	1	0	0	3	17	19	18	34	34	34
Austria	20	23	21	29	29	28	31	27	33	32	33	32	32
Germany	30	29	29	29	28	28	29	28	26	26	27	30	29
Sweden	4	6	22	25	28	30	29	28	27	27	24	24	24
UK	24	25	22	24	21	19	18	19	18	18	17	17	16
Greece	6	6	6	6	7	8	13	13	15	16	17	13	13
Norway	4	5	8	29	39	39	39	39	39	39	41	42	34
Switzerland	2	1	3	13	22	22	22	30	30	34	37	38	33
New Zealand	42	26	28	29	31	33	30	30	27	32	29	28	28
Australia	17	14	22	22	24	25	26	27	27	27	25	25	22
Canada	14	13	20	18	19	19	19	19	19	15	15	15	15
US	7	11	12	15	15	11	11	12	12	14	14	14	14
Japan	12	13	13	9	10	10	10	10	10	11	12	9	8

Note: The OECD summary measure is defined as the average of the gross unemployment-benefit replacement rates for two earnings levels, three family situations and three durations of unemployment.

Source: OECD, Social Expenditure Database.

7. GLOBALISATION AND MIGRATION

In Europe, the coexistence of high unemployment rates, an ageing population and tensions in the social protection systems raises many questions concerning the design of an appropriate immigration policy. Recently, migration has often been considered both a threat and an opportunity. From the latter perspective, it can be seen as an instrument to overcome specific shortages of labour supply in the host country and to counteract population ageing. In this context, migration can contribute to the rescue of the existing social welfare systems, especially of public pension and health insurance schemes.

The evidence suggests that the skills of non-EU immigrants in EU member states are usually complementary to the skills of domestic workers, leading to positive effects on economic activity in the host country (Faini et al., 1999). Yet, immigrants are usually less integrated into society for a number of reasons, such as their cultural differences from the rest of the population, the fact that they are more often subject to racist behaviour and discrimination, and the existence of various legal restrictions that do not apply to EU citizens. In addition, a significant share of non-EU migration is illegal, with important negative consequences both for the social integration of immigrants and for their impact on the social security system. Asylum seekers are a further category that can stretch the resources of some countries. Indeed, in some of the new entry points in the EU (notably the Mediterranean member states), a lack of experience of immigration and limited capacity to deal with it has become a growing social difficulty. Cyprus and Malta are currently very exposed in this regard, but Italy too is under growing pressure (Begg & Marlier, 2007).

In the case of Europe, two types of migration have to be distinguished: cross-border movements within the EU and immigration from non-EU countries. Intra-EU migration is regulated by Art. 39 of the EC Treaty and is among the fundamental freedoms on which the EU is based, although with an extended transition period currently in effect for the recently acceded member states in a majority of EU-15 countries. In contrast to intra-EU migration, immigration from non-EU countries is regulated by national law, which differs among the member states, although the EU member states have agreed to develop a legal framework for a common immigration policy at the EU level in the future. This chapter presents conceptual and empirical information on migration, highlighting the dilemmas it poses. It discusses the perceptions of migrants and provides an inventory of changing policy orientations towards migration, based on new research carried out by the Fondazione Rodolfo Debenedetti (fRDB) to construct a migration reform database.

7.1 Migration: The background

For some years now, net migration has contributed significantly to population changes in the EU. Indeed, according to rough estimates, illegal immigration into the EU amounts to 500,000 persons per year.

The immigrant population is on average younger than the native population. Furthermore, the personal characteristics of a migrant are crucial – not only for his/her motivation to migrate but also for the economic and fiscal effects of migration.

Intra-EU-15 migrants show nearly the same employment rate as natives. The lowest employment rate is reported for the group of non-EU migrants. The employment rates of women are lower than are those of men. With regard to skills, internal migration and migration from non-EU countries are generally not substitutes. The difference stems from the varying skill profiles of EU-10 and non-EU migrants, with both groups offering skill mixes that differ from those of natives. The outcome could be a sound base for future economic growth, since these profiles are complementary.

The eastern enlargement of the EU led to an increase in cross-border migration between the EU-8 and the EU-15. Still, the shares of EU-8 (the new member states from Central and Eastern Europe that acceded to the Union in 2004) and EU-10 nationals in the EU-15 member states remain relatively low. In general, EU-10 migration seems to follow labour market conditions. So far, transitional regulations concerning labour migration have been in place in several countries. Yet, the low degree of mobility can also be the result of favourable factors, such as the understandable preference for living in the home country, as reported in many EU member states.

One important figure in this context is the amount of net migration. Most EU member states not only show considerable migration inflows, but also remarkable outflows, and for some years now net migration has contributed significantly to population changes in the EU.[48] The effects of migration on changes in the total population differ widely among the EU member states – some of them, such as Poland and (for a long time) the Baltic States, have been reporting negative net migration rates. Without migration, several countries such as Germany, Italy and Greece would have reported a decrease in population some years ago. In 2005, nearly 70% of the net migration to the EU stemmed from migration to Spain, Italy and the UK (Table 7.1); net migration to France and Germany accounted for 6% respectively.

In economic theory, it is assumed that migration is mainly determined by the chance to participate in the labour market of the host country. In practice, however, directly work-related migration accounts for a relatively small share of total migration (OECD, 2006b). In France, Sweden, Germany, Austria, the Netherlands, Italy, Finland and the UK, work-related migration amounted to less than 40% of total immigration in 2004. Consequently, economic theory, which focuses on labour migration, can only explain a certain proportion of total immigration.[49]

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[48] By the 1990s, net migration had become the most prominent factor of population growth in many EU member states. (Net migration is the difference between immigration into and emigration from the areas during a given period.) See the European Commission's (2003b) Communication on immigration, integration and employment.

[49] The OECD uses permit data on the reasons for entry. For EU citizens such permits are not necessarily required. The data exclude illegal migrants.

Table 7.1 Net migration, including corrections (in thousands)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
EU-25	1,118.4	826.0	632.5	732.7	658.0	468.5	644.6	905.7	993.2	1,311.5	1,707.3	2,091.5
EU-15	1,216.1	896.9	678.8	765.9	684.2	482.8	665.1	903.2	1,055.6	1,321.8	1,701.2	2,052.1
Eurozone	1,139.9	763.0	533.2	608.6	556.8	377.4	429.3	716.1	852.6	1,096.9	1,534.2	1,755.9
Belgium	25.7	18.3	17.3	1.8	15.1	9.8	11.6	16.7	12.9	35.7	40.5	35.6
Czech Rep.	11.8	5.5	10.0	9.9	10.2	12.0	9.5	8.8	-28.0	-8.5	12.3	25.8
Denmark	11.6	11.4	10.5	28.6	17.5	12.1	11.0	9.4	10.1	12.0	9.6	7.0
Germany	776.3	462.4	315.6	398.3	281.5	93.4	47.0	202.1	167.8	274.8	218.8	142.2
Estonia	-41.5	-28.3	-20.9	-15.6	-13.4	-6.9	-6.7	-1.1	0.2	0.1	0.2	0.0
Greece	94.5	86.5	78.1	77.3	70.9	61.5	54.8	45.1	29.3	37.8	38.0	35.8
Spain	54.2	59.2	54.7	60.4	73.5	83.6	148.8	227.3	378.5	427.8	649.9	738.5
France	36.5	16.5	-3.5	-14.5	-18.5	-13.5	-6.5	45.0	50.1	60.4	65.1	55.0
Ireland	1.7	-3.4	-3.0	6.0	15.9	17.4	16.2	24.3	31.5	38.8	32.7	31.3
Italy	27.8	24.2	25.7	31.5	59.5	55.7	64.1	46.4	55.2	47.6	349.3	600.6*
Cyprus	10.7	8.7	7.0	6.6	6.0	5.5	4.2	4.2	4.0	4.6	6.9	12.4
Latvia	-53.5	-32.4	-22.8	-13.8	-10.1	-9.4	-5.8	-4.1	-5.4	-5.2	-1.8	-0.9
Lithuania	-24.5	-24.0	-24.2	-23.7	-23.4	-22.4	-22.1	-20.7	-20.3	-2.5	-1.9	-6.3
Luxembourg	4.1	3.9	3.8	4.3	3.5	3.6	3.8	4.4	3.5	3.3	2.6	2.1
Hungary	18.5	18.2	18.0	17.8	17.8	17.5	17.3	16.8	16.7	9.8	3.5	15.5
Malta	0.9	1.0	1.0	-0.2	0.7	0.6	0.4	0.5	9.9	2.2	2.0	1.8
Netherlands	43.2	44.5	20.4	15.0	21.3	30.5	44.1	43.9	57.0	56.0	27.6	7.0
Austria	71.5	33.5	3.1	2.1	3.9	1.5	8.5	19.8	17.2	43.5	34.8	38.2
Poland	-11.6	-16.8	-19.0	-18.2	-12.8	-11.7	-13.2	-14.0	-19.6	-16.8	-18.0	-13.8
Portugal	-4.5	8.4	17.3	22.3	26.2	29.4	32.3	38.0	47.1	64.9	70.1	63.5
Slovenia	-5.5	-4.5	0.0	0.8	-3.5	-1.4	-5.5	10.9	2.7	4.9	2.2	3.6
Slovakia	-2.9	1.7	4.7	2.9	2.2	1.8	1.3	1.5	-22.4	1.1	0.9	1.4
Finland	9.1	9.1	3.7	4.2	4.0	4.8	4.5	3.4	2.4	6.1	5.2	5.8
Sweden	19.8	32.1	50.8	11.7	5.8	5.9	11.0	13.6	24.5	28.6	30.9	28.7
UK	44.8	90.2	84.2	117.0	104.0	87.4	213.8	164.2	168.5	184.3	126.4	260.5

* These figures are largely the result of the legalisation of a large number of 'undeclared' immigrants.

Source: Eurostat.

According to the OECD, the most important motivations for migration are family reunification (accompanying the worker) and migration for humanitarian reasons. Because of the Balkan war and other factors, the number of asylum seekers increased tremendously during the 1990s. For the EU-15 as a whole, this development reached its peak in 2000, but some member states, such as the UK, have seen further increases in asylum seekers since then. Recently, many countries have reported a decline in the number of asylum seekers, owing not only to the end of the Balkan war, but also to changes in the legal framework. Family reunification also plays an important role in the case of intra-EU migration. A recent study based on data provided by PIONEUR, a new research project on migration, shows that 30% move because of their partner or family, 24% because they are searching for a better quality of life and 25% for employment.[50] The pull factors differ among the EU member states, however: in France and Spain, it is quality of life; in Italy, it is a partner or family; and in Germany and the UK, it is work and study.

The relatively high share of migration unrelated to employment tends to be reflected in the employment rates of migrants. Table 7.2 distinguishes among natives, migrants from the EU-15, those from the EU-10 and non-EU migrants. Comparing employment rates between EU nationals and non-nationals gives some insights into the relative position of migrants on the labour market. First, intra-EU-15 migrants have much the same employment rate as natives. Second, focusing on the EU-25, the lowest employment rate is reported for the group of non-EU migrants, whose employment rate is 10 percentage points lower than that of EU nationals. But a closer look at this figure reveals that this aggregate number results from the fact that, in the EU-15, the employment rate of non-EU nationals is much lower than that of natives. A comparable effect is not reported for the EU-10, where the employment rate of non-EU nationals is even higher than that of nationals. This outcome might be explained by different types of migration, variations in the design of the selection processes or in the legal frameworks. Still, it is a common feature of migration that the employment rate for migrants is lower than it is for nationals.

About 45% of all migrants entering the EU-15 are women. While most of the member states reported a share of nearly 50% of women, in Germany the immigration of men significantly exceeded that of women (Eurostat, 2003). Women's employment rates are usually lower than employment rates for men. This tendency also holds true for immigrants (Table 7.3). Even so, there exists a gap in women's labour participation between natives and migrants in many European countries. In Austria, Belgium, Germany, Finland, France, the Netherlands and Sweden the participation rate of migrant women is lower than that of native women by about 10 percentage points or more (OECD, 2006b, p. 71). Integrating foreign women into the labour market seems to be a special problem. A gender analysis of unemployment rates shows that migrant women are more likely to be confronted with unemployment than migrant men are. The unemployment rate among migrant women is extraordinarily high in Finland

[50] See the European Commission's website (http://europa.eu/rapid/searchResultAction.do?search=OK&query=social&username=PROF&advanced=0&hits=50&guiLanguage=en).

(31%), France (22%) and Belgium (18%). The comparable figures for migrant men are 21% in Finland, 14% in France and 15% in Belgium.

Table 7.2 Employment rates by nationality, 2005

Country of destination	National	EU-15	EU-10	Non-EU
Belgium	62	60	55	35
Germany	67	68	51	48
Greece	60	53	47	71
Spain	62	64	78	71
France	64	69	62	44
Ireland	67	69	85	57
Netherlands	74	76	64	41
Austria	69	72	66	60
Finland	69	67	55	45
Sweden	74	73	62	45
UK	72	69	75	58
EU-15	67	68	62	55
EU-10	57	59	68	63
EU-25	65	67	62	55

Notes: Italy is excluded, since it does not disaggregate by nationality. Denmark, Luxembourg and Portugal are excluded owing to small sample size.

Source: Eurostat, LFS, European Commission.

Table 7.3 Employment rates of migrants by gender, 2004

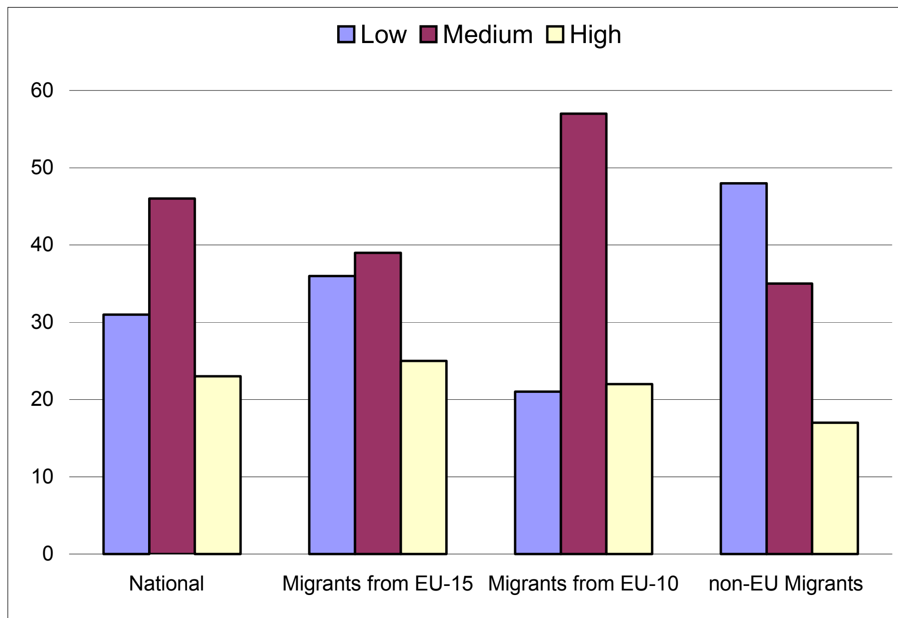
Country of destination	Migrants	Migrant women	Migrant men
Belgium	60	49	71
Germany	64	51	78
Greece	73	57	87
Spain	78	66	89
France	65	52	77
Ireland	65	53	80
Netherlands	60	50	76
Austria	69	57	79
Finland	69	57	83
Sweden	68	65	75
UK	68	60	79

Source: OECD (2006b).

Figure 7.1 presents some insights into the relative skill and education level of immigrants in the EU-15. The question is whether the skill structure of migrants is complementary to that of the EU-15 nationals. Migrants are divided into three subgroups: those from the EU-15, those from the EU-10 and non-EU migrants. The skill composition of the natives can be considered a benchmark. According to the data, 31% are low-skilled workers, and 23% are highly skilled. Important findings are first that the educational and skill profile differs significantly among the subgroups. Second,

migration from non-EU countries as well as migration from the EU-10 has – to a certain degree – a complementary character. Third, the proportion of low-skilled workers is the highest among non-EU nationals (48%) and the lowest among EU-10 nationals (21%).[51] Within this latter subgroup, the proportion of low-skilled workers is much lower than in the subgroup of EU-15 migrants (36%). Therefore, migration induced by the EU enlargement of 2004 seems to be principally migration of persons with a medium educational level (57%).

Figure 7.1 Education levels of migrants and nationals in the EU-15 (among the working-age population), 2005



Note: Education level – low (lower secondary), medium (upper secondary), high (tertiary)

Source: Eurostat, LFS, 2005 Q1, France and Austria, 2005 Q2, European Commission.

In addition, the educational profile of EU-15 migrants and EU-15 nationals is similar; hence, intra-EU-15 migration is not necessarily complementary in character. Nonetheless, the proportion of the highly skilled is highest among EU-15 migrants; here, the share of highly skilled persons is even slightly higher than that of nationals in the EU. Thus, with regard to skills, internal migration and migration from non-EU countries are not direct substitutes. Furthermore, the differences in skill profiles of EU-

[51] Most of the EU-10 migrants work in the retail sector (hotels and restaurants). Their share of 28% is not significantly higher than the 25% share of nationals. This point also holds true for agriculture (in which 4% of nationals work compared with 3% of EU-10 migrants), industry (18%) and financial services (13% and 14%, respectively). By contrast, the share of migrants working in construction is about 15% compared with 8% of the national workforce. The share also differs in public administration, where 32% of residents work compared with 23% of working migrants from the EU-10.

10 and non-EU migrants on the one hand, and natives on the other, could be a sound base for future economic growth, since these profiles are broadly complementary. In addition, the age structure of migrants and natives differs in the EU-25: immigrants are on average younger than natives are, with 41% of all immigrants in the age cohort of 20-39, compared with 28% of natives. Only 9% of migrants are 65 or older compared with 17% of natives (Eurostat database, 2006).

All these types of migration are based on legal migration. Yet, illegal migration is also very substantial in Europe. According to rough estimates, about 500,000 illegal migrants enter the EU each year. Illegal migration from North African countries has become a progressively more important issue for Spain and Italy, and it is a very specific problem for Malta. Calculations based on regularisation data show that in 2004, about 1.4 million illegal immigrants were living in Spain and Italy, representing a 1.2-1.6% share of the total population.[52] But the highest share of illegal or unofficial immigrants in Europe was found in Greece (3.4% of the total population).[53] There, migrants from Albania constitute the large majority of illegal migrants. Usually illegal, unauthorised, undocumented or unofficial immigrants live under hard conditions, and they are forced to participate in informal networks and in the shadow economy.

In summing up the socio-economic characteristics of legal migrants in the EU, it can be said that they are often men, younger than the natives are and show different educational patterns from the natives. In addition, they are much more often confronted with unemployment than the natives are and many of them came for reasons other than work (such as family reunification).

In the case of the EU, the country of origin of a migrant is crucial for formal access to the national social welfare schemes: at the end of the period of transition (in some countries), migrants from other EU member states will be treated on the same terms as natives. Non-EU migrants generally have only limited access to national welfare programmes. The lowest form of protection is given to the illegal and undocumented migrant, while permanent residents as well as conventional refugees have broad access to social welfare. Since social standards differ widely among the EU member states, incentives for 'welfare shopping' could exist. Nevertheless, little support for a 'welfare magnet' hypothesis can be found. Moreover, there seems to be evidence that in many European countries migrants generate at least transitory positive effects on pay-as-you-go pension systems. Net contributions tend to increase with the skills of the foreign workers. Thus, against the background of existing tensions in the welfare schemes, the question of how to select successful migrants is increasingly prominent in public debate.

As noted earlier, the member states of the EU have agreed to develop a legal framework for a common immigration policy at the EU level in the future. Coordination and harmonisation of the legal framework should not be a goal in itself. Rather, it should be used to create an EU-wide legal framework that matches the goals of the Lisbon agenda and reduces transaction costs for migrants. These processes

[52] Many of those making up this share were legalised in 2005.

[53] It is difficult to estimate the number of illegal immigrants; however, various estimate techniques exist (OECD, 2006b, p. 46).

should not necessarily lead to a tightening of migration policies. Indeed, it is well known that with the tightening of immigration rules the number of illegal migrants increases. All in all, the new legal framework should leave enough room for flexibility at the national level.

Stable linkages between the EU as a supranational organisation and the host country on the one side, and the traditional labour-exporting countries on the other could create advantages if they allow clear rules for migration (and for return migration) to be formulated. In the case of developing countries, the implementation of technical and social aid programmes for the labour-exporting countries could be part of the overall agreement. This approach could lead to a reduction of poverty in the home countries of the migrants as well as a decrease of illegal immigration. Box 7.1 provides a case study for Greece.

Box 7.1 A case study: The socio-economic impact of immigration to Greece

Greece witnessed a large inflow of immigrants during the 1990s as a result of social, economic and political changes in communist countries right after the fall of the Soviet Union. The first immigrants came from Poland, but many others followed them; for the most part, they were illegal and they were looking for a job. Yet the key figure in Greece's experience and what made Greece different from other southern European countries such as Italy, Spain and Portugal, was the predominance of immigrants from a single country, namely Albania.

The increasing number of immigrants soon started to attract attention and forced the government to attempt to shape a migration policy, which initially sought to prevent immigrants from entering the country. Owing to the geographical location of Greece and the fact that most immigrants were coming from neighbouring Balkan countries, these efforts quickly proved inadequate. Therefore, the next step was to try to legalise them. Three legalisation schemes were put into practice, but bureaucracy and public sector rigidities have led to unsatisfactory results. Some go as far as accusing Greece of deliberately creating obstacles in order to limit the number of immigrants obtaining a legal work and stay permit, and thus allowing employers to exploit them. Consequently, illegal immigrants have now become undocumented immigrants.

Although many studies attempt to investigate the impact of immigrants on the Greek economy, the lack of statistical data seriously constrains their results. Most of the studies, however, agree that immigrants have positive and negative economic effects. Among the positive effects mentioned are the increase in GDP and its growth rate, support for the agricultural sector and many small to medium-sized firms (at least in the short run), the dampening of inflationary pressures and the increase in foreign direct investment towards mostly Balkan countries. Among the negative effects, immigrants are also thought to have helped the expansion of the informal economy, which was already noticeable, and to have – in some cases – substituted Greek unskilled and semi-skilled workers (according to others, they have freed up the labour force). It is argued that this has led to increased income inequality, unemployment and slow-growing wages, and may have contributed to the slowing down of technological developments (firms find it easier to hire cheap labour than to invest in capital-intensive production techniques) as well as to have drained aggregate demand from Greece by remitting large amounts of money abroad.

With respect to some other issues, such as the impact of immigrants on employment and unemployment overall, a definite answer is yet to be given. Demands on public services (health services included) are not considered to have increased much because of immigrants, except for expenses directed towards public order, which have grown considerably.

Box 7.1 Continued

Still, because of their low income, immigrants do not pay direct taxes, and only contribute to government revenues through indirect taxes. Finally, the impact of immigrants on the social security system is considered positive in the short term, but is expected to become negative in the long term.

The presence of immigrants does not seem to have caused significant demographic changes. Nevertheless, it has given rise to isolated phenomena of xenophobia and racism, which have been fuelled by media and police practices. The increase in criminal activity during the 1990s that was attributed to undocumented immigrants has contributed to such phenomena. The integration of immigrants into Greek society is advancing, but it is doing so at a slow rate since state initiatives are limited and immigrants are left alone to find ways of fitting in.

Greece needs to introduce a more straightforward and clear-cut immigration policy, which will simplify and rationalise the process of legalisation for the different groups of immigrants, attend to their needs and protect their social, political, religious and human rights. In addition, efforts are needed to integrate immigrants into Greek society and to help the indigenous population realise that immigrants are here to stay, in order to create a truly multicultural, multi-ethnic and above all functional society. It is also both necessary and important to collect statistical data that will help researchers form a clearer picture of the situation and to enable better and more efficient actions to be planned and implemented by the government and non-governmental organisations. Finally yet importantly, attention should be given to assisting the integration of second-generation immigrants – an issue not yet fully comprehended by the majority of researchers and politicians.

Migration not only has important consequences for the host nation, but also for the labour-exporting country. One important feature of migration is that the labour migrant might have higher earnings in the host country than in the country of origin. These earnings might at least partially be sent home.[54] Worldwide official remittances amounted to more than $232 billion in 2005 – an amount that is more than double that of international aid programmes (Schiff & Özden, 2005). In addition, large amounts of money are sent through informal channels and are not reported in official statistics.

In the case of a weak official financial sector, intra-family arrangements for remittances offer not only investment possibilities, but also insurance against social risks and income uncertainty, and often contain social as well as intergenerational elements. As a result, remittances are assumed to increase with the educational level of the migrant. A natural interpretation of the linkages between migration, education and remittances is that the prospect of migration makes education a profitable investment. The linkages between migration, education and remittances are often discussed under the heading of 'brain drain–brain gain'.[55]

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[54] For a long time, workers' remittances were widely neglected in economic analysis. Recent studies clearly show that migrants' remittances are an important source of external finance for many low-income countries and can be considered a specific form of development assistance and policy. Nevertheless, the figures on the amount of remittances differ widely. One important data source is the World Development Indicators offered by the World Bank.

[55] Recently, it has become apparent that Europe is also affected by a certain degree of brain

In general, there are at least two linkages between remittances and education: on the one hand, the education of the migrant might affect the size of remittances; on the other, remittances might be spent on the education of the children left at home. Therefore, the impact of remittances on growth in the labour-exporting country depends on migration costs, the availability of education in the home country and the use of remittances for intergenerational transfers for education. Any increase in the access to education, which might also be financed by remittances, can be considered to have a positive impact on economic development. In this context, remittances can be interpreted as compensation for the labour-exporting country's investment in the human capital of the migrant.

7.2 Perceptions of migrants and trends in policy reforms

An overview of the changing perceptions of Europeans about migration and the welfare state is provided by the results from Eurobarometer surveys (Table 7.4 and Figure 7.2). Table 7.4 displays the (unconditional) probability of a respondent agreeing with the statement, "Minority groups exploit the system of social welfare."

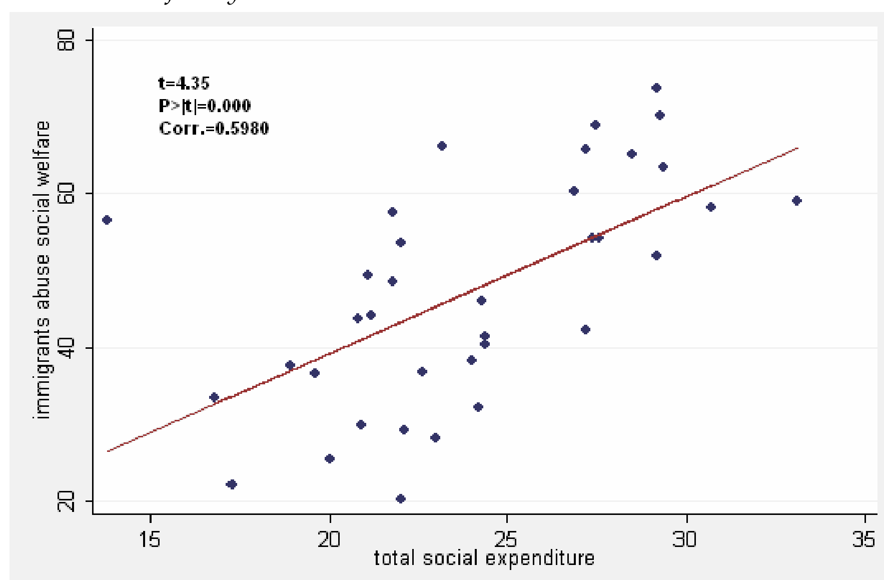
Table 7.4 Do minority groups exploit the system of social welfare? (% of respondents answering in the affirmative)

	1994	1997	2000
Spain	20.2	30	36.7
Northern Ireland	40.98	39.87	40.67
Italy	40.39	32.2	41.5
Luxembourg	28.29	36.85	43.83
Austria	–	48.3	45.87
Greece	44.11	29.21	46.02
Sweden	–	42.64	46.4
Netherlands	42.29	38.33	48.62
Portugal	22.2	37.7	49.5
Denmark	59.1	58.24	51.9
West Germany	60.35	54.11	54.14
Finland	–	50.05	54.95
Ireland	25.6	33.5	56.5
UK	66.05	53.53	57.56
East Germany	64.16	50.29	59.59
France	70.2	63.42	65.17
Belgium	73.68	68.95	65.76
EU-12	46.97	44.73	51.25
EU-15	–	45.13	50.86
St. dev. EU-12	18.57	13.10	9.03

Sources: Eurobarometer 1994, 1997 and 2000.

drain, and is competing with the US for young scientists. While the brain-drain discussion and therefore the linkage between migration and education also affects the EU-15, the linkage between education and remittances is usually only discussed in the context of the catching-up process of low-income countries.

Figure 7.2 Unconditional correlation between perceptions of welfare abuse and the generosity of welfare systems



Sources: Eurobarometer 1994, 1997 and 2000.

These results are in line with a restrictive orientation in immigration policy. The database of social reforms compiled by the fRDB shows increasingly restrictive policies being adopted by national governments to contain immigration flows. In Table 7.5, we describe the evolution of the orientation of reforms during the last 15 years. Corresponding with the '–' sign, we find reforms reducing the generosity of the migration policy, while corresponding with the '+' sign, we find reforms increasing the generosity of the system.

Table 7.5 Orientation of reforms

	AT	DK	FI	FR	DE	GR	IE	IT	NL	PT	SP	UK
1990												
1991						–					–	
1992								+				
1993	–			–								
1994								–				
1995												
1996											+	–
1997				–								
1998	–			+						+		
1999							–	+				–
2000					+		–				+	
2001		–							–		–	
2002		–				+		–				
2003			+	–			–			–	–	
2004			–				–					–
2005					+		–					

Source: fRDB Social Reforms database.

Other results are presented in Tables 7.6 and 7.7. They report the qualitative results of regressions (using European Community Household Panel (ECHP) data covering the period 1994–2001) evaluating the presence of residual dependency from social transfers among non-EU citizens. In other words, we try to isolate whether being a migrant helps to explain the fact of receiving a social transfer *in addition* to the personal characteristics of the individual (such as the number of dependent children) affecting the probability of receiving the transfer. This approximation is the closest possible to the notion of abuse, capturing individuals who *ceteris paribus* receive a social transfer because they are not a citizen of the EU. Put another way, the following question is posed: Would a non-EU citizen be more or less likely to be dependent on social transfers than an EU citizen with similar characteristics?

Table 7.6 Probability of receiving transfers from the social insurance (contributory) parts of the welfare system (pensions and unemployment benefits)

	DE	DK	NL	BE	FR	UK	IR	IT	GR	SP	PT	AT	FI
Age	---	---	---	---	---	---		---	+++	---		---	---
1 Child	---	+++			-			---	---	---	---	---	-
2 Children		+++	---	-	---	---	-		---	---	---	---	---
Medium education		---		---	-	+++	---	---	---	---	---	---	
High education	-	---		---	---	+++	---	---	---	---	---	+++	+++
HH high income	---	---		---	---	---	---		---	---	---	---	---
HH low income	+++		++	---		++	+++	--	+++		---	+++	+++
Partner employed	---	---	+++	---	---	-	-	+++	+++	---	--	---	---
Migrant, non-EU	---	+++		+++	+	---		--	--		+		

Note: HH = household

Source: ECHP (1994–2001).

Table 7.7 Probability of receiving transfers from the social assistance (non-contributory) parts of the welfare system (housing benefits, social assistance and family allowances)

	DE	DK	NL	BE	FR	UK	IR	IT	GR	SP	PT	AT	FI
Age	+++	+++	+++	+++		+++	+++		--	---	+++	+++	+++
1 Child	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++
2 Children	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++	++
Medium education		--	+++	++		+		-	---	--	+++		
High education	+++		+++	+++		+++		---	---	---	++	++	++
HH high income	---	---	---	---	---	---	---	---	---	+	---	---	---
HH low income	+++	+++	+++	+++	+++	+++	+	---	++	+++	---		+++
Partner employed	++	-	+++	---	---	--			--	--	+++	+++	
Migrant, non-EU						---		+	--				+

Note: HH = household

Source: ECHP (1994–2001).

The answer provided by Table 7.6 is that this is not usually the case. Migrants receive proportionally more transfers than natives do (Boeri, Börsch-Supan & Tabellini, 2001) mainly insofar as they have characteristics associated with entitlement to these schemes. There is generally no additional effect of the migrant dummy on the probability of receiving social transfers. Importantly, the exceptions – the cases in which some residual dependency of migrants is observed – mostly relate to the contributory component of social welfare systems, that is, social insurance schemes whereby the individual is entitled to the transfers only to the extent that s/he has contributed to the system in the past (unemployment benefits, sickness benefits and pensions). There is much less evidence of residual welfare dependency (or this is negative, as in the case of the UK and Greece) when the focus is on the non-contributory component, including social assistance, family allowances and housing, which is usually funded through general government revenues.

Overall, there is no evidence that migrants are abusing the welfare state, notably the non-contributory parts of the welfare system. Their over-representation in the stock of benefit recipients can be explained by characteristics such as the presence of many dependent family members and higher exposure to labour market risks, or in any event by past contributions. In effect, migrants are *ceteris paribus* over-represented only among contributory social insurance schemes. We do not observe residual dependency on welfare by migrants.

8. DEEPER ANALYSIS OF INEQUALITIES IN THE EU

As indicated in chapter 6, a trend towards increased inequality has been evident in most EU member states since the 1980s. This trend has many roots and, although it may have been affected by globalisation or the various drivers behind increased internationalisation, this tendency has been influenced by other sources of change. This chapter considers the determinants of inequality in greater detail.

8.1 Accounting for inequalities within the EU

The most recent rounds of enlargement of the EU introduced a further and marked heterogeneity into the EU as a whole. The range of GDP levels in the EU-27 as a result of the entrance of the new member states is much more diverse than in the EU-15. In addition, the new member states from Central and Eastern Europe have undergone large-scale social, economic and political transformations in the last 15-20 years. This process is normally called 'transition', but to a certain extent, it could also be understood as a form of globalisation (because integration into the European Union effectively means lifting trade barriers, the freer flow of economic resources, and so forth).

Income inequalities within countries in the EU-25

An overview of recent trends is provided in Table 8.1 (taken from a recent OECD-wide overview of income distribution trends by Förster & d'Ercole, 2005).

The country coverage includes most current EU member states (shown in bold), but excludes those countries not in the OECD. As benchmarks, several other OECD countries are also presented. What can be inferred from these data?

- There have been all sorts of divergent trends in inequality developments in the period between the mid-1970s and the mid-1980s. Moderate and strong declines were observed in Greece, Finland and Sweden, while a strong increase was registered in the UK.
- The general trend in the period between the mid-1980s and the mid-1990s was characterised by an increase in inequality. Yet this period was the most important one in terms of the economic and social transition of the prospective new member states.
- The period between the mid-1990s and 2000 shows a mixed picture as well. While in Finland and Sweden there was a large increase in the Gini coefficient, indicating growing inequality, for the rest of the countries there was either no change or a very minor change.

Table 8.1 Overall trends in income inequality (mid-1970s to 2000): Summary results for the entire population (based on the Gini coefficient for individuals, equivalised household incomes)

	Strong decline	**Moderate decline**	**Small decline**	**No change**	**Small increase**	**Moderate increase**	**Strong increase**
Mid-1970s to mid-1980s	**Greece**	**Finland, Sweden**	Canada	–	**Netherlands**	US	**UK**
Mid-1980s to mid 1990s	–	**Spain**	Australia, **Denmark**	**Austria,** Canada, **France, Greece, Ireland**	**Belgium, Germany, Luxembourg,** Japan, Sweden	**Czech Rep., Finland, Hungary, Netherlands, Norway, Portugal, UK,** US	**Italy,** Mexico, New Zealand, Turkey
Mid-1990s to 2000	–	Mexico, Turkey	**France, Ireland, Poland**	Australia, **Czech Rep., Germany, Hungary, Italy, Luxembourg, Netherlands,** New Zealand, **Portugal,** US	**Austria,** Canada, **Denmark, Greece,** Japan, **Norway, UK**	–	**Finland, Sweden**

Notes: Strong decline/increase denotes a change in income inequality above +/-12%; moderate decline/increase refers to a change between 7 and 12%; small decline/increase specifies a change between 2 and 7%; and no change means changes between +/- 2%. The results are based on the values of the Gini coefficient in four reference years, which may vary among countries. The variations are presented below.

- Data for 2000 refers to the year 2000 except for Australia, Austria and Greece (1999), Germany, Luxembourg, New Zealand and Switzerland (2001), and the Czech Republic, Mexico and Turkey (2002).
- Mid-1990s data refers to the year 1995 in all countries except for Austria (1993), Australia, Denmark, France, Germany, Greece, Ireland, Japan, Mexico and Turkey (all 1994), and the Czech Republic and New Zealand (1996).
- Mid-1980s data refers to the year 1983 for Austria, Belgium, Denmark and Sweden; to 1984 for Australia, France, Italy and Mexico; to 1985 for Canada, Japan, the Netherlands, Spain and the UK; to 1986 for Finland, Luxembourg, New Zealand and Norway; to 1987 for Ireland and Turkey; to 1988 for Greece; and to 1989 for the US.
- For the Czech Republic, Hungary and Portugal, the period mid-1980s to mid-1990s refers to the early to mid-1990s.

Source: Förster & d'Ercole (2005).

For the first few years of the new decade, more harmonised data are available for the entire EU-27. As a result of efforts to develop indicators (known as the 'Laeken process', see Atkinson et al., 2002 and 2005), new data on income inequalities have become available that are presented in Table 8.2. The conclusions, again, are not very straightforward:

- There are slightly more countries where inequality seems to be increasing than countries experiencing a decline in inequality. The overall picture, however, is not very clear.
- No signs of 'path dependencies' can be observed (in which inequality increased in countries that initially had low inequality and in those that initially had high inequality). Nor can a convergence of inequality measures be discerned: there are no fewer variances in the levels of inequality among the countries at the end of the period than those observed at the beginning.
- Within this period, large differences cannot be traced, even between the EU-15 and EU-10 countries. Furthermore, during this period the transition countries no longer make up the group that produces the most significant changes over a certain period.

*Table 8.2 Overall trends in income inequality in the EU-27 countries, 2000 to 2004 (end-period Gini coefficients in brackets)**

---	**--**	**-**	**0**	**+**	**++**	**+++**
x>12%	**12%<x>7%**	**7%<x>2%**	**0%**	**7%<x>2%**	**12%<x>7%**	**x>12%**
Strong decline	**Moderate decline**	**Small decline**	**No change**	**Small increase**	**Moderate increase**	**Strong increase**
Belgium (26)	–	Estonia (34) Spain (31) Lithuania (29) Netherlands (26)	Greece (33) France(28) Luxembourg (26) Czech Rep. (25) Slovenia (22)	Portugal (38) Latvia (36) UK (34) Ireland (32) Poland (31) Romania (30) Hungary (27) Finland (25) Bulgaria (26) Sweden (23)	Germany (28) Austria (26)	Italy (33) Denmark(24)

* Begin-period data refers to 2000, except for the Czech Rep. (2001) Denmark and Sweden (1999). End-period data refers to 2004, except for the Czech Rep., Estonia, Hungary, Latvia, the Netherlands, Poland, Romania, Slovenia and the UK (2003). Income concepts and equivalence scales differ from the OECD study quoted in Table 8.1. The most important difference is the use of Laeken definitions and concepts in Table 8.2. Cross-country differences in trends over time are not suspected to be large in this respect, however. Alternative estimates (by TÁRKI) for Hungary shows higher Gini values (29 for 2000 and 2005 as well). This result would move Hungary into the 'no-change' cell.

Sources: Tóth (2006b) and data from Eurostat NewCronos database.

Cross-country differences

Recent research on cross-country differences in inequalities (based on the Laeken indicators and produced within the frame of the open method of coordination)[56] presents six different country clusters based on a simultaneous evaluation of economic development and of inequality levels.[57] Splitting the EU-25 into the EU-15 and the EU-10 (since there is so much difference in the mean levels of GDP of the two groups) also implies a classification by the level of development (in this respect, even the two non-transition countries of Cyprus and Malta fit the EU-10 reasonably well), as shown in Table 8.3.

Table 8.3 Country clusters based on inequality and GDP levels in the EU-25 by country group, 2001 (group averages)

Category	Countries	GDP per capita PPS, % EU avg.	Gini coefficient	S80/S20	Poverty rate (60% median threshold)
Unequal EU-10	LV, EE, SK	42	33	5.7	18
Moderately unequal EU-10	CY, MT, HU, PL, LT	60	29	4.5	15
Equal EU-10	CZ, SI	68	24	3.3	10
Unequal EU-15	GR, PT, ES, UK	89	35	5.8	20
Moderately unequal EU-15	IT, DE, BE, NL, IE	117	28	4.3	16
Equal EU-15	FR, FI, SE, DK, AT, LU	136	25	3.6	11

Note: The inequality level is defined by S80/S20, whereby unequal = 5.0 or higher, moderately equal = between 4.0 and 4.9, and equal = below 3.9.

Source: Tóth & Gábos (2005).

The six country groupings are described below.

- The EU-15 countries with relatively equal income distributions are Austria, Denmark, France, Finland, Luxembourg and Sweden.
- The EU-15 countries with a moderate degree of income inequality are Belgium, Germany, Ireland, Italy and the Netherlands.
- The EU-15 countries with a relatively high degree of inequality are Greece, Portugal, Spain and the UK.

[56] For a description and references, see Atkinson et al. (2005) and European Commission (2004a, 2005a and 2006h).

[57] The report has been produced through the frame of the European Observatory on the Social Situation LOT 2, Network on Social Inclusion and Income Distribution. The study was commissioned by the DG for Employment, Social Affairs and Equal Opportunity, and was carried out by the consortium of Applica (Belgium), Essex University (UK), the European Centre for Social Welfare Research (Austria) and TÁRKI (Hungary).

- The EU-10 countries with relatively equal income distributions are the Czech Republic and Slovenia.
- The EU-10 countries with a moderate degree of income inequality are Cyprus, Hungary, Malta, Poland and Lithuania.
- The EU-10 countries with a relatively high degree of inequality are Latvia, Estonia and Slovakia.

There is a considerable degree of heterogeneity, both in the level of GDP and in the inequalities. Nevertheless, and despite the fact that the EU-10 have much lower GDP per head even in terms of purchasing power standards (PPS), there are generally no significant differences between the old and new member states with respect to the variance of overall income inequalities and relative (not absolute!) poverty (Figures 8.1 and 8.2).

In terms of poverty, however, it seems that four groups of countries can be clearly distinguished. Continental European EU-15 countries and the Scandinavian countries belong to the group characterised by high GDP levels and relatively low poverty rates. Anglo-Saxon EU-15 countries and the EU-15 countries of the Mediterranean tier represent a group with lower levels of GDP and higher poverty rates. Those EU-10 countries that are relatively better off constitute the third group, with comparatively low poverty rates, while the other EU-10 member states have the lowest GDP levels and the highest poverty rates. This pattern will obviously correspond to welfare arrangements in the various countries as well as economic factors and historical traditions.

Figure 8.1 GDP per capita and income inequality in European countries

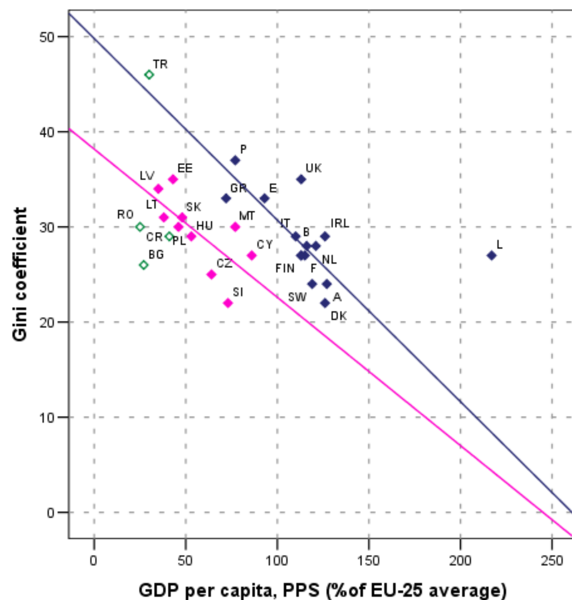
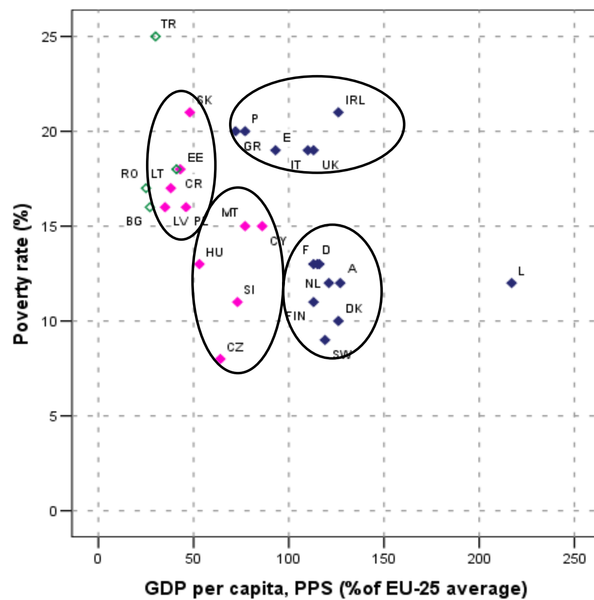


Figure 8.2 GDP per capita and relative income poverty in European countries



8.2 Interregional differences within the EU: Macro data

When analysing the evolution of interregional inequalities in Europe, the main question is whether there is regional convergence, with the poorer regions developing faster than the richer ones or whether, on the contrary, regional development is characterised by divergence (interregional differences, of course, might persist over time without significant convergence or divergence taking place). The results of studies using various methodologies may differ according to the methodology used and the regional and time coverage of the data.

Studies on the evolution of regional GDP per capita reveal that during the period of general economic growth in the 1960s and the early 1970s, regional income differences, measured by such indices as the Theil, Gini or Atkinson, narrowed in the EU (see e.g. De la Fuente & Vives, 1995; Duro, 2004). Regarding evolutions in the 1980s and 1990s, the European Commission's cohesion reports and several other studies trace the evolution of interregional inequalities in Europe. During the 1983–93 period, there was little change in the dispersion of interregional GDP per capita (measured by the standard deviation), but there was a growing dispersion of unemployment among the NUTS II regions.[58] During the 1988–2001 period, GDP per capita[59] dispersion between regions decreased and employment and labour productivity also converged across

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[58] See the European Commission's first report on Economic and Social Cohesion (1996).

[59] There has been a change in the definition of the GDP measure in the European Commission's cohesion reports. The first and second reports use GDP in PPS terms. In the third report, it is argued that using PPS is misleading when considering changes over time and they switch to GDP in real terms.

regions.[60] Regions in which GDP per head was less than 75% of the EU average experienced a higher rate of growth than did other parts of the EU. This was especially true in the case of low-income regions in the 'cohesion' countries (Greece, Ireland, Spain and Portugal), while low-income regions in richer countries seemed to stagnate.

Using different inequality measures (Gini, Atkinson and Theil measures)[61] Duro (2004) finds that regional inequalities in GDP per capita among NUTS II regions[62] generally declined over the period 1982–95. This process was not uniform across the whole period, however. The beginning of the period under study (from the start of the 1980s to the middle of the same decade) was characterised by an increase of interregional inequalities; at the end of the period, a levelling-off or a slight increase in inequalities was detected. Duro presents a Theil decomposition analysis of interregional inequality into within-country and between-country effects.[63] During this period, between-country inequalities fell while inequalities between regions and within countries rose. The between-country component of inequalities showed a cyclical pattern, decreasing in periods of general growth and increasing in periods of recession (in the period 1973 to 1984). Four countries can be characterised by convergent behaviour: initially poor countries (Ireland, Portugal and Spain) grew more rapidly than the EU as a whole, while initially richer-than-average France grew more slowly. Inequality between regions increased most in large countries, with Spain and the UK showing the greatest rises, but with Italy, Germany and France also experiencing significant growth in regional inequalities.

A classic result on regional convergence using regression methods and which also includes data on five European nations during the period 1950–90 is that by Sala-i-Martin (1996), who concludes that regions tend to converge at a speed of 2% per year. Boldrin & Canova (2001) also use regression methods (as well as nonparametric comparisons of regional distributions of income and unemployment) to discover patterns of convergence or divergence among 185 NUTS II regions of the EU during the 1980–96 period. According to their results, no rapid convergence or divergence in income per capita took place in this period. Other researchers use spatial econometric methods to account for similarities among neighbouring regions, which could bias results on convergence in ordinary regression estimations. Arbia & Piras (2005), using data on 125 regions in 10 EU countries, show that allowing for spatial dependence among regions reduces the speed of convergence, but convergence is still detectable.

[60] See the European Commission's Third Report on Economic and Social Cohesion (2004d).

[61] For the definition of these inequality indices, see Cowell (2000).

[62] There are 143 regions in Duro's database, which is based on the REGIO 1999 database.

[63] The Theil index might be decomposed into two parts: one measures that aspect of overall inequality owing to income dispersion within regions; the second measures inequality stemming from inequality between regions. Within-group inequality is a weighted sum of Theil(1) indices of the regions, where weights are income shares of the regions. Between-group inequality is the value of the Theil index of a hypothetical income distribution, where every household has the average income of the region to which it belongs. On the methodology of this decomposition, see Deutsch & Silber (1999).

Using transition matrices, Overman & Puga (2002) show that when changes in regions' relative income situation is considered, there appears to be a high degree of persistence of the positions held between 1986 and 1996. In Table 8.4, transition matrices of relative regional income levels and unemployment rates are displayed. It can be seen that a great majority of the regions (with the exception of the second group) had retained their 1987 relative position in 1996. This stagnation of regions' relative income positions does not mean that regional economies behaved in a similar way. The study also demonstrates that in the same period there was a polarisation of regional unemployment levels. There is a persistence of relative positions among regions with the lowest and the highest unemployment rates, while among regions with intermediate unemployment levels mobility proved much greater.

Table 8.4 Transition probability matrices for GDP per capita and unemployment rates relative to the EU average (150 NUTS II regions)

	1995 GDP per capita relative to the EU average (%)				
1987 relative GDP per capita (%)	**0-60**	**60-75**	**75-100**	**100-130**	**130-**
0-60	0.83	0.17	0.00	0.00	0.00
60-75	0.21	0.47	0.32	0.00	0.00
75-100	0.00	0.18	0.68	0.14	0.00
100-130	0.00	0.00	0.13	0.72	0.15
130-	0.00	0.00	0.00	0.17	0.83
	1996 unemployment rates relative to the EU average (%)				
1986 unemployment rates/ EU avg. (%)	**0-60**	**60-75**	**75-100**	**100-130**	**130-**
0-60	0.81	0.19	0.00	0.00	0.00
60-75	0.52	0.26	0.09	0.09	0.04
75-100	0.24	0.29	0.26	0.21	0.00
100-130	0.06	0.22	0.34	0.19	0.19
130-	0.00	0.00	0.16	0.22	0.62

Source: Overman & Puga (2002).

8.3 Regional income inequalities and poverty in Europe: Microdata

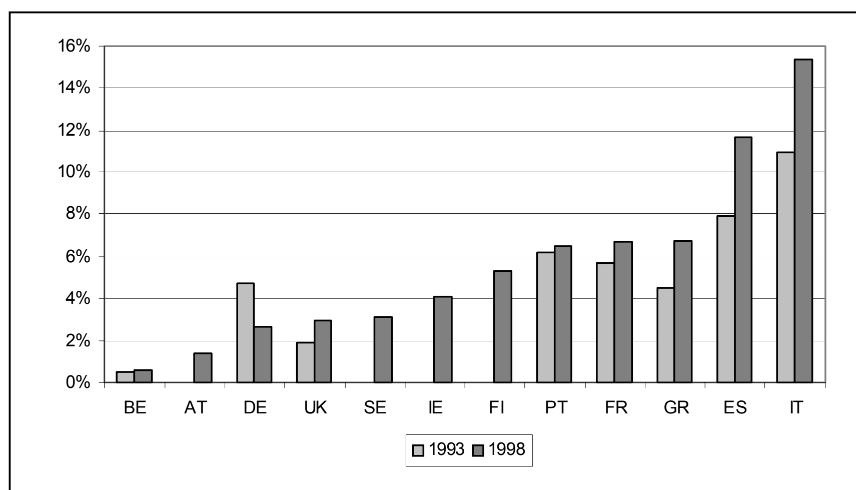
Although aggregate data as used in the studies reviewed in the preceding section are useful for describing broad regional trends, they are not a very good measure of the average well-being of individuals. One major reason for this is that they do not take into account taxes and transfers, which considerably modify the distribution of wages and capital incomes. In order to study regional inequalities in individual well-being, microdata on incomes, household attributes and possibly other sources of well-being are more suitable. The sources of data on inequality of household incomes and regional patterns of poverty in EU countries include such internationally comparable datasets as the European Community Household Panel (ECHP) and the Luxembourg Income Study (LIS).

While individual or household well-being might be better evaluated using microdata on income, these data are not without deficiencies. In some cases, regional sample sizes are small, which results in imprecise estimates, while the temporal coverage is shorter than for GDP data. Patterns of regional (at the NUTS I level) differences in household incomes are described in Stewart (2002) for the beginning and the middle of the 1990s using the LIS data and in Förster (2004) for the years 1993 and 1998 using the ECHP database. The most recent results show two typical pictures of regional disparities (ibid.). The pattern of regional income inequality in a first group of countries is characterised by relatively small differences between the average incomes of regions except that there is one region that has a significantly higher average income than all other regions, which is generally the region with the given country's capital. The London region and the Paris region (Ile de France) are striking examples, while in Greece the region of Attiki, containing the capital Athens, has an average income well above the country's other regions. Yet these differences are exaggerated because of the data problem caused by commuters into the region counting towards its output, but not its population.

In a second group of countries, there is a different pattern with regions clustering in clearly discernible groups. In Italy there seems to be a three-way divide along the north–south dimension. Southern regions (such as Sardegna, Sicilia, Campania and Sud) have the lowest average household incomes; the central regions (including Lazio and Centro) have an intermediate position, while the northern regions, especially Lombardia and Emilia-Romagna, do even better. A similar picture can be detected in Spain. The southern and north-west regions have the lowest average incomes, while the region with the capital Madrid has the highest. But there is evidently a third, intermediate group of regions composed of the eastern and north-eastern regions (for example, Aragon). In Germany, differences in average incomes between the regions are not as large as in Italy or Spain, but there is still an obvious east–west divide. The eastern regions of the former German Democratic Republic have the lowest average incomes, while most of the western regions are noticeably better off. The exceptions are the region composed of Rheinland-Pfalz and Saarland, and the region of Niedersachsen – although here again commuting comes into play. In Sweden and Austria, the regions containing the capital cities have higher average incomes than the other regions, but the overall level of regional inequality is relatively low.

Förster (2004) provides a decomposition of household income inequality into between-region and within-region inequality in European countries, using the decomposability of inequality indices of the Theil index (Figure 8.3). When comparing the extent of interregional inequality between countries, we have to bear in mind that the number of regions differs among countries. A greater number of regions obviously allows for more interregional dispersion. According to the results, five countries have higher interregional income differences than the others: France, Italy, Greece, Spain and Portugal. Italy shows the greatest value of between-region income inequality, during both the middle and the end of the 1990s, with a slight increase during this period (ibid.). Spain shows the largest rise in interregional inequality during the second half of the last decade, almost catching up to the Italian figure from a much lower level. France, Greece and Portugal show somewhat less interregional inequality and only minor changes between 1993 and 1998. In the rest of the countries, income inequality between regions is small.

Figure 8.3 Part of the between-region Theil index in overall Theil



Source: Förster (2004).

The two countries with the highest between-region inequalities (Italy and Spain) also have the highest degree of overall inequality explained by differences between the regions. In this respect, Italy is clearly the leader, with interregional differences accounting for 15% of total inequality as measured by the Theil index. Moreover, this share increased between the first and sixth wave of the ECHP by 4 percentage points. Spain has a somewhat lower proportion of inequality explained by between-region dispersion, but there has been an increase of the same magnitude. The share of interregional inequality in total inequality grew from 8% in 1993 to 12% in 1998. In the cases of Portugal, Greece and France, regional inequalities accounted for 7% of total inequality in 1998. Changes were minor in France and Portugal, but somewhat more considerable in Greece. Inequality between regions in Belgium and Austria accounted for a negligible part of overall dispersion, and it was only slightly higher in Finland, Sweden and Germany.

With regard to regional poverty rates, Stewart (2002) asserts that if a national poverty line is used, the pattern of relative poverty closely mirrors intra-country differences in regional average incomes. In contrast, if a regional poverty line is used the results are different: in most of the cases regions with high average incomes show high poverty rates. This is true of London and the south-east in the UK, Ile de France (the region of Paris), the Vienna region in Austria and the western Netherlands, showing that regions with the highest average incomes can sometimes also be those with the highest levels of inequality.

Stewart (2002) also compared regional differences in average household income to differences in GDP per capita for the middle of the 1990s. The rankings of regions proved to be quite similar for the two indicators but regional differences were much higher in the case of GDP per capita than for household income. This result of course reflects the effect of the tax and transfer system.

8.4 Changes in openness and changes in inequalities in EU countries

A cross-sectional charting of patterns of openness and inequality levels is presented in Tóth & Gabos (2005). This paper gives an overview of poverty and inequality trends in Europe around the year 2001. The paper concludes that at first glance, little correspondence can be shown between inequality levels and the openness of the economy (Figures 8.4 and 8.5).

There was no relationship found between the openness of a country's economy and the actual level of inequalities as measured by Gini levels or poverty rates. As can be seen from the figures, points representing various countries scatter evenly, with no relation to EU membership status, the size of the economy or other characteristics. This outcome may be misleading, however, as globalisation is a process of opening up. To analyse the effects of this process, we need to analyse changes in the observed variables, rather than compare actual levels alone.

To compare the relationship between a change in openness on the one hand, and a change in inequality on the other hand, we identified spells for the various countries, defined by the magnitude of changes in openness and inequalities.[64] For the openness-to-trade indicator[65] (taken from chapter 3), a 10% threshold was defined as significant for rises and falls. That is, if there was a change of more than 10 percentage points in the value of this indicator (as in the case of the UK, taking the ratio of the 1981–85 average value to the 1976–80 average value), it was deemed a significant change in openness. Similarly (using the same thresholds as Förster & d'Ercole, 2005), when a change in the Gini coefficient in roughly the same period exceeded 7%, it was considered a significant change.

The openness-to-trade indicator was calculated for the five-year intervals of 1976–80, 1981–85, 1996–2000 and a shorter period at the end of 2001–03. A difference between these values represents a change in openness for a given country in the given period. We can distinguish three distinct periods with this method: 1976–85, 1986–95 and 1996–2003, with two sub-periods for each spell. A change in a spell should be understood as the difference between the values of the openness indicator representing the first sub-period and the values of the openness indicator representing the second sub-period. A similar method is followed for the Gini coefficients, with the difference that the values for the start of the period and the end of the period are compared.[66]

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[64] The analysis is similar to those carried out by Cornia & Court (2001) and Ravallion (2004b). Rather than concentrating on cross-sectional relationships, longitudinal spells of particular countries are put in the central focus.

[65] The indicator for openness to trade reflects the ratio of the average value of merchandise exports and merchandise imports as a percentage of the GDP at purchasing power parity. The choice of this indicator is quite obvious, since it reflects trade openness and can be interpreted as a matter of degree, it certainly enjoys priority over measures indicating only yes–no relationships (such as the measure offered by Sachs & Warner, 1995, for example).

[66] The source for the Gini coefficient changes for the first two periods is income data from Förster & d'Ercole (2005), who present changes from the mid-1970s to mid-1980s, the mid-1980s to mid-1990s and the mid-1990s to around 2000 (as shown in Table 8.1 above). Data for 2004 are taken from an analysis of different spells by Tóth et al. (2006), also presented in Table 8.2 above.

Figure 8.4 Globalisation index and inequality in Europe, around 2001

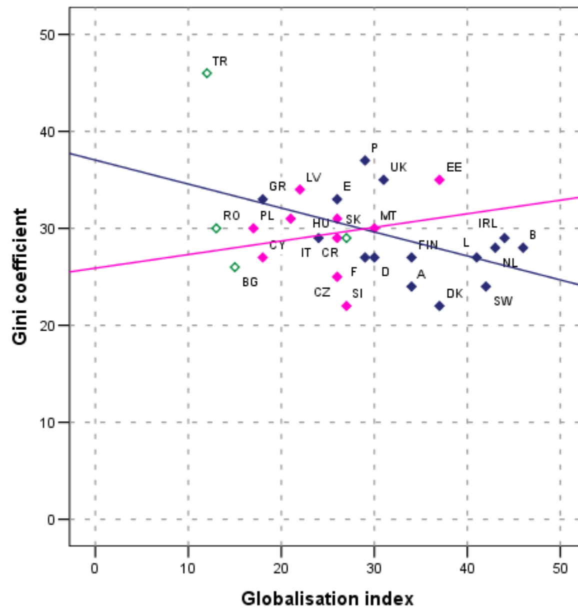
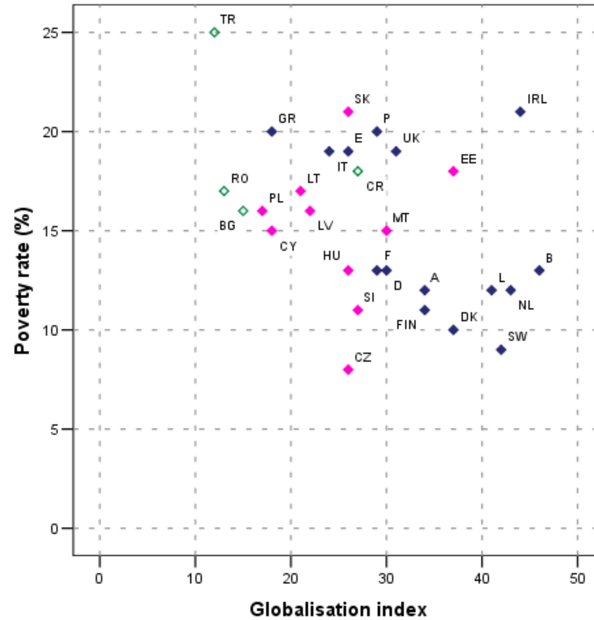


Figure 8.5 Globalisation index and relative poverty in Europe, around 2001



Combinations of these values for the various spells in different countries are shown in Table 8.5. We can conclude from these values that there is no clear tendency in the relationships between a change in openness and a change in inequality. Further points to note are as follows:

- For the period with a general decline in openness (that is, from the mid-1970s to the mid-1980s), there is a serious lack of comparable data on inequalities. Still, periods in which openness declined might be associated with a lower Gini coefficient, implying greater equality (for example in Sweden and Finland in the first periods) or with an increase in the Gini coefficient (as in the UK in the first period and Sweden in the third period), as well as with no change (in the Netherlands in the first and Ireland and Greece in the third periods).
- Most of the spells with inequality increases occurred in periods of no change in openness, mainly in the last periods of observation as in Denmark, Finland, Italy, Austria and Germany. It therefore seems that inequalities may rise in periods with no significant changes in openness.
- A significant increase in openness did not always lead to a change in inequalities as measured by the change in Gini coefficients (out of the 18 such spells in which openness increased only four showed a significant surge in inequality). In fact, when openness grew significantly, Gini coefficients remained stagnant in most of the observed countries (in each of the three periods).
- There were some spells when increases in openness were accompanied by rises in inequality (for instance in the Netherlands, Hungary, Italy and Portugal in the second period), but these were a small proportion of the total number of spells.
- An increase in inequalities might have been preceded by an opening-up period (as in the Netherlands, Italy, Hungary and Portugal in the period 1986–95) and a fall in openness (as in the UK during 1976–85 and Sweden in 1996–2003).

While these are all important messages, two qualifications should be made here. First, all the measures we take into account reflect macro-level aggregated characteristics of the various countries. It may be that certain sectors or population subgroups are affected more than others and this may be masked by the aggregate figures (the problem of 'horizontal inequalities'). Second, it might easily happen that levels of or changes to openness and inequalities are correlated and will only be shown to be so when controlling for a number of background variables.

In a recent study, when attempting to identify the relative strengths of various background factors in explaining inequalities and poverty, Tóth & Gábos (2006) identified no significant effect of openness in an OLS regression controlled for per capita GDP, public social expenditures and EU member status (Table 8.6). All other things being equal, larger GDP showed a negative impact on inequality, while being an EU-10 member state also lowered inequality and poverty levels. Social expenditure has a significant negative effect on income inequality and poverty: the higher its level, the lower the latter tend to be. The overall employment level and the openness of the economy did not show any significant effects. Increased globalisation, therefore, seems to have no effect on inequality or the risk of poverty.[67]

[67] Yet this is not proof either: level-to-level regressions should be replaced by change-to-change regressions at a later stage to study the effects of globalisation as a process, through increments.

Table 8.5 Classification of spells in various countries by the magnitude of changes in openness and inequality indicators

	Gini decline (δx>7%)	**Gini no change (7%<δx>7%)**	**Gini increase (δx>7%)**	**Not known**
Openness decline δx>10%	Sweden 1976-85 Finland 1976-85	Netherlands 1976-85 Ireland 1996-2003 Greece 1996-2003	UK 1976-85 Sweden 1996-2003	Belgium 1976-85 Malta 1976-85 Austria 1976-85 Denmark 1976-85 Hungary 1976-85 Germany 1976-85 France 1976-85 Cyprus 1976-85 Ireland 1976-85 Italy 1976-85 Greece 1976-85 Cyprus 1996-2003
Openness no change (δx <10% change)	Spain 1976-85 Belgium 1996-2003	Germany 1986-95 Netherlands 1996-2003 Slovenia 1996-2003 France 1996-2003 UK 1996-2003 Portugal 1996-2003 Estonia 1996-2003 Spain 1996-2003 Latvia 1996-2003	Finland 1986-95 UK 1986-95 Denmark 1996-2003 Finland 1996-2003 Italy 1996-2003 Austria 1996-2003 Germany 1996-2003	Portugal 1976-85 Sweden 1986-95 Cyprus 1986-95
Openness increase (δx >10%)	Spain 1986-95	Ireland 1976-85 Austria 1986-95 France 1986-95 Denmark 1986-95 Greece 1986-95 Lithuania 1996-2003 Poland 1996-2003 Hungary 1996-2003 Czech Rep. 1996-2003 Bulgaria 1996-2003 Romania 1996-2003	Netherlands 1986-95 Italy 1986-95 Hungary 1986-95 Portugal 1986-95	Belgium 1986-95 Malta 1986-95 Poland 1986-95 Slovakia 1996-2003
Not known	Turkey 1996–2003	Luxembourg 1986-95 Luxembourg 1996-2003	Czech Rep. 1986-95 Turkey 1986-95	–

Notes: The definition of the change-in-openness indicator within a period is the average of the yearly values in the second half of the period as a percentage of the average of the yearly values in the first half. Data for the openness-to-trade indicator comes from chapter 3 in this report. The definition of the Gini change is the percentage change of the Gini of the period end-year to the period start-year (or the closest to it).

Sources: Förster & d'Ercole (2005) and Tóth et al. (2006) based on the Eurostat NewCronos database.

*Table 8.6 Linear regression models for cross-country differences in income inequality and poverty, EU-24**

	Gini index		**S80/S20**		**Income poverty**	
	Regr. coeff. (st. error)	**Standardised coeff.**	**Regr. coeff. (st. error)**	**Standardised coeff.**	**Regr. coeff. (st. error)**	**Standardised coeff.**
GDP per capita, PPS	*-0.071*		**-0.019**		*-0.058*	
	(0.026)	-0.722	(0.006)	-0.795	(0.024)	-0.600
Globalisation index	-0.067		-0.016		-0.074	
	(0.114)	-0.135	(0.026)	-0.132	(0.107)	-0.152
Social expenditures (% of GDP)	**-0.595**		**-0.132**		**-0.556**	
	(0.169)	-0.731	(0.038)	-0.683	(0.154)	-0.698
Employment rate	-0.039		-0.016		-0.154	
	(0.132)	-0.063	(0.029)	-0.110	(0.123)	-0.254
EU member status (0-OMS, 1-NMS)	**-8.135**		**-1.999**		**-8.737**	
	(2.114)	-0.983	(0.473)	-1.016	(1.971)	-1.077
Constant	**64.560**		**13.397**		**56.568**	
	(8.603)	–	(1.925)	–	(8.021)	–
Number of observations	24		24		24	
R-square	0.63		0.67		0.66	

* Lack of data for Cyprus

Note: Regression coefficients are significant at the 1% or 5% levels.

Source: Tóth & Gábos (2006).

One should not forget one of the most important influences on the inequality increase that occurred in one out of three current EU countries: transition. Bearing this point in mind makes those attempts to sort out the inequality effects of globalisation even more complicated. As noted above, the transition from a planned to a market economy constitutes in itself a sort of globalisation. Liberalisation in the direction of other European states (that is, economic integration within the EU) and liberalisation towards other parts of the world (less or more developed countries as well) has meant a two-stage globalisation for the transition countries. It is true, however, that while integration into the EU has entailed technology imports from a more developed part of the world, the current globalisation challenges that transition countries are facing test the competitiveness of their low-cost, low-skill industries.

The implications of the analysis of inequality for social policy are thus mixed. Boeri (2002) suggests that it would be better to "let social policy models compete and Europe will win". Yet, as Sapir (2005) puts it, the combined GDP of countries with inefficient models accounts for some two-thirds of Europe.[68] The key policy message is that the solution lies not so much in trying to slow down or reverse globalisation – even if that were an option – but rather to change the policy approaches of European countries. The next part of the study extends and develops the policy analysis.

[68] This point applies to the EU-15, but this share would be even higher if the EU-10 were taken into account. As for the need for reform, see also European Commission (2005j and 2004b).

PART III.

POLICY ISSUES AND IMPLICATIONS

The empirical analysis and other material presented in part I provides compelling evidence of the steady increase in most of the indicators usually considered to constitute globalisation. On the whole, the trends are gentle, rather than dramatic, implying that there is neither the likelihood of major shifts in the patterns of international exchanges, nor an imminent risk of a crisis affecting the EU. Equally, the landscape has clearly changed, probably irreversibly. Whereas in the past, the US was seen as the leading economy and the principal benchmark against which Europe ought to judge its progress in 'catching up', internationalisation has become much broader in scope and the geographical reach of globalisation has grown much greater.

In particular, China and India are much more than poorly understood competitors that threaten narrow segments of traditional manufacturing, having become major players in the world economy. Their competitive position is evolving rapidly and they represent a huge increase not only in the global labour force, but also in the number of actual and potential global consumers. Both countries, while facing huge unresolved problems of poverty and inequality, as well as environmental degradation, are making determined efforts to develop their presence in the high-technology, knowledge-intensive activities of the future. Moreover, other emerging economies are making substantial strides that offer the prospect of a new international division of economic activity and the extension of international competition into areas hitherto shielded from such forces.

In this multipolar world, Europe can afford neither to stand still nor to delude itself into believing that it can stand apart from these trends. Europe has a social model that, even allowing for all the variants that can be observed across the continent, is the envy of much of the rest of the world, but the model(s) is (are) under pressure from underlying drivers of change, not least demography. Consequently, change is required not just to equip Europe for the evolving competitive challenges of globalisation, but also to modernise the social policy responses to transformations already underway in society. In essence, these are the challenges that the Lisbon strategy (and within it the elaboration of 'flexicurity') seeks to address. While globalisation offers great opportunities for improved economic welfare and job creation, its benefits cannot be taken for granted. It will require adaptation of the European social model, but not its dismantling.

In considering directions for policy responses, misapprehensions about what is and is not happening need to be dispelled, and false dichotomies have to be exposed and contradicted, so as to focus on the sorts of reforms that should be given priority. While some are obvious and reasonably well understood, even if confronted by resistance, others are less so. Migration, for instance, is shown in part II not to be a source of pressure on social protection budgets, despite public perceptions. The fact remains, as noted in the introductory chapter, that Europeans are apprehensive about globalisation and perceive it as a growing threat, yet overall they benefit from it. Nor is there much sign that globalisation *per se* is behind social policy developments. Indeed, one of the most striking aspects of the much-feared 'race to the bottom' is its complete lack of empirical support: as the analysis in part II shows, there have been plenty of changes and more are in the pipeline, but these cannot be ascribed to globalisation easily (and certainly not solely).

Alesina & Giavazzi (2006) are among those who argue that the differences between Europeans and Americans are growing more substantial and becoming more deeply rooted. They cite the fact that "Europeans take longer vacations and retire early" and value job security, while Americans "work long hours" and are prepared to go through bankruptcy and frequent ups and downs in the labour market. Although it can be pointed out that their crude generalisations mask a wide range of behaviours in both continents, a key policy question is whether the European model, especially, is incompatible with retaining competitiveness in increasingly open international markets. Alesina & Giavazzi acknowledge that there are features of the European model that are unambiguously better than its American counterpart, but they also emphatically reject as fuzzy thinking the idea that there is a middle or 'third' way that will allow the best of both worlds. More specifically, they are scathing about the idea that there are 'degrees' of market economy or that concepts such as the social market economy are tenable, stating bluntly that "a market economy is a market economy: qualifications are misleading".

Yet it is far from obvious that a largely market-led vision is the only way forward, not least because of the perceptions in so many EU member states that so-called 'neo-liberal' policies are undermining the fabric of European society. The views of Giddens (2007) and his collaborators in the Policy Network suggest an altogether different response to globalisation, which puts social justice at the forefront of the analysis. While recognising that not all welfare states in Europe are achieving satisfactory outcomes, Giddens is at pains to point out that among the most competitive economies in the EU are the Nordic countries, which retain extensive welfare states. He therefore argues that social justice must be at the heart of the Lisbon strategy, and is critical of "airy statements about reducing social exclusion, as so much of the EU official literature does".

In this part of the report, we concentrate on the policy dimensions of globalisation. Chapter 9 considers, first, how to interpret globalisation from a policy perspective, distinguishing between its advantages and its threats. We then present and assess the main policy-related findings of the study and go on to consider how policy priorities might be affected under different assumptions about the future trajectory of globalisation. A discussion of policy options and methodologies follows, and the report concludes with a series of policy-related recommendations.

9. UNDERSTANDING THE POLICY ISSUES

For the EU, the overarching social dimension of globalisation is what it implies for the future of the European social model in its different guises. Where other global regions may regard income generation and market share as the primary goals, Europe has a more complex objective function that is encapsulated in its sustainable development strategy. This strategy gives considerable weight to competitiveness, but also accords substantial importance to social cohesion and a sustainable environment, which are goals of equal standing in the strategy. Consequently, the EU can be characterised as open and welcoming to globalisation, but concerned to shape it in a manner that is consistent with its wider socio-economic aims. This does not mean retrenchment into outdated policies and practices, despite calls for opposition to globalisation, so much as engaging in modernisations and reforms that reflect the underlying values. The EU has faced mockery for its Lisbon aim to become "the most competitive and dynamic knowledge-based economy in the world", but the second half of this statement is often (unfairly) overlooked, namely, "capable of sustainable economic growth with more and better jobs and greater social cohesion".[69]

Alesina & Giavazzi (2006) succinctly articulate one way forward for Europe:

> Europe does not need more public money in a myriad of programs. Europe needs reforms that create incentives and make its people willing to work hard and longer, take risks, and innovate. Europe needs more competition, not more public infrastructures. European universities need more 'market incentives', not more public money. European firms need lower taxes, less heavily regulated labour markets, and better functioning product markets, not more subsidies and protection. This does not mean that Europe simply needs to adopt the entire US model. Indeed, there are aspects of the European welfare state that are efficient and should be preserved. But too often the benefits to overprotected insiders get precedence over the needs of the general public and, in particular, at a cost to the younger generation.

But theirs is not the only way…

One of the most committed opponents of globalisation is the movement known as ATTAC (Association pour la Taxation des Transactions financières pour l'Aide aux Citoyennes et citoyens). ATTAC argues that globalisation has been dominated by powerful economic interests, big banks, investment funds, transnational groups and other owners of big capital, in what is described as a neo-liberal agenda. ATTAC claims that in this ideology, social problems are most readily solved by being left to the market. Not surprisingly, ATTAC portrays globalisation as a failure in its mission of bringing prosperity to all and calls for a reassertion of social values to counter what it sees as the negative social impact of globalisation in the developed countries as well as the rest of the world. The social effects cited include employment that is more precarious, the use of underpaid or unpaid women's labour to cut costs and cutbacks in social protection, all of which increase inequality and the risk of poverty. At the

[69] See Council of the European Union (2000).

heart of the ATTAC case is the proposition that globalisation in its neo-liberal form results in many losers and only a few winners.

Clearly, these visions of globalisation, and thus of what the policy directions and prescriptions ought to be, are incompatible. It is therefore useful to preface a policy discussion by reviewing the main sources of costs and benefits, which is the subject of the next section. We then develop an inventory of the central policy issues that have to be confronted in responding to globalisation.

9.1 The costs and benefits

Processes often referred to as 'globalisation', especially the deepening international division of labour affected through growing trade and investment flows, can overall be adjudged to have undeniable benefits. The exchange of products makes trading parties better off. Flows of products and investment increase productive capacity by facilitating the transfer of knowledge and technology. International investment flows often help create capital dramatically faster than used to be the case with relatively closed economies, while improving returns for savers. Openness to trade usually helps heterogeneous economies to improve their governance patterns. But even in more mono-sectoral economies, where rent-seeking and monopoly practices may temporarily be sustained by intensified trade, openness tends subsequently to accentuate political pressures for change. Equally, analysts and ultimately policy-makers need to be aware that the impact of globalisation depends very much on the distribution of endowments in the economy and in society. Appropriate policy decisions based on the knowledge of linkages between globalisation-related effects and the impact on welfare will help create public or market-based mechanisms that should aid the management of risks emanating from globalisation, and contribute to robust economic performance. Hence, the 'creative destruction' resulting from globalisation will not only affect the economy, but will almost unavoidably introduce new and possibly unanticipated changes in the distribution of income. Globalisation may thus disturb and disrupt the mechanisms of social 'justice' in the sense of John Rawls (1973).

A common concern of European policy-makers is the mediocre growth performance of the European countries over the last three decades, which is apt to be seen as empirical evidence that globalisation is not working for Europe. Despite the positive impact of European economic integration on economic growth, Europe's performance has deteriorated, both absolutely in comparison with earlier decades and relatively in comparison with the US, let alone the dynamic emerging economies such as China. In the post-war period, Europe enjoyed a combination of high growth rates and a high level of social protection. This successful economic performance lasting from 1945 to 1975 was based on factor accumulation, imitation of technologies and large-scale production. This process led Europe closer to the technology frontier, however. At the same time, the new technological revolutions in communications and information made leading European industries susceptible to offshore production in middle-income, newly industrialised countries with educated workforces and lower labour costs. In this new environment, imitation has lost its power in creating production structures capable of coping with international competition, and innovation at the frontier has become the main engine of growth. It is easy in these circumstances to blame globalisation for the malaise of the EU economies and to decry

délocalisations, but it is very often misleading to do so. In practice, as many authors have shown, globalisation brings a variety of threats and opportunities.

9.1.1 The advantages of globalisation

The rapid changes in the world economy owing to the acceleration of the globalisation process are expected to yield significant gains to EU countries, as well as to other global regions, through more efficient allocation of world resources. This more efficient allocation of resources will boost growth with potentially positive effects on social welfare by offering the prospect, and very often the reality, of greater aggregate prosperity. The economic benefits of globalisation partly reflect the large body of theory and empirical evidence on the gains from increased specialisation. They also flow from the access to knowledge and the reorganisation taking place in value chains. The principal benefits of globalisation can be summarised under a number of key headings:

- The diffusion of technology combined with larger markets should stimulate economic growth by facilitating productivity growth.
- A spur to innovation as a competitive factor can also lead to higher productivity and improved living standards.
- A better configuration of the value chain, in which comparative advantage and specialisation gain according to economic geography characteristics, translates into a higher aggregate output.
- More responsive capital markets can allocate resources to where they can attain the highest return, with knock-on benefits for the EU's savers.
- Foreign direct investment (FDI) flows can achieve a better matching of savings and investment flows across the world, including the fact that such flows continue to provide capital and opportunities for richer countries such as the EU member states.
- Demand from emerging markets is the flip side of the rapid expansion of new competitors. Fears expressed in the EU-15 about competition from the recently acceded member states have proved to be unfounded, as these dynamic economies have greatly increased their imports from the former. Similar increases in demand can be expected from the new global competitors, including China and India. The upshot is that new sources of demand tend to offset losses in selected markets, including the domestic one.
- Consumers gain from obtaining access to cheaper sources of goods and services. Yet the fall in prices relies on the level of competition in the product markets. If markets are characterised by an oligopolistic structure, the positive price effect of globalisation may be more limited. Here, many authors point to the rising saliency of the multinational enterprise as a feature of globalisation, but also as the driver of trade, investment and technological changes.
- With all the world population growth in the coming decades forecasted to be in developing countries, there is a potential labour supply for 'ageing' Europe.

The macroeconomic position

What is important to note is that many of the gains are pervasive, but often not very visible or readily calculable, with the result that there is no easily quantifiable figure for the overall benefits. Jaumotte & Tytell (2007) estimate, for example, that falling prices for traded goods have increased output and real labour incomes in the 'advanced' economies by about 6% over the last quarter of a century. This gain has been accompanied by substantial increases in real terms in the labour incomes of emerging market economies, yet it is also probable that the competitive pressures have been one factor behind the general decline in inflation. There has nonetheless been a tendency for the labour share of income to fall, a trend that has appeared in most advanced economies in recent years (although the supposedly Anglo-Saxon economy of the UK is a notable exception). 'Labour globalisation' may be a factor in this shift, but Jaumotte & Tytell (2007) argue that technological change has had a bigger impact, above all on the levels of unskilled wages, and also notes that despite the fall in share, real labour incomes have "grown robustly in advanced economies", especially in the Anglo-Saxon ones.

The degree to which real wages in the most dynamic emerging markets converge with richer countries is striking. According to Jaumotte & Tytell (2007), real manufacturing wages in China (adjusted for purchasing power) caught up from 7.4% of the US level in 1992 to 16.1% 10 years later in 2002. Over the same period, Korean wages went from 48.8% to 70.2%. By and large, such relative changes reflect growth rates, and it is noteworthy that economically less successful emerging economies have not seen similar rates of catching-up. The policy implication, however, is that the economies that do expand significantly will follow a well-trodden path of seeing rising wages and growing consumer demand.

9.1.2 Presumed threats and challenges

Critics of globalisation identify a broad range of actual or potential threats from unfettered globalisation. These encompass distributive impacts, such as adverse consequences for specific groups in society, issues of cultural hegemony, concerns about environmental damage and geopolitical disruption, nowadays especially from terrorism.

The main threats identified from globalisation arise from the intensification of competition, pressures on public finances and the repercussions of migration. The existence of a number of restrictions on trade and on labour flows provides the EU member states with relatively more insulation from the more pernicious effects of globalisation than other countries around the world. Nevertheless, they still face a number of potentially serious social costs that are associated with the process of globalisation. Torres (2001, p. 1) makes the point that the sheer complexity of globalisation and its many dimensions means that "identifying a simple relationship between globalisation and social progress is impossible". The range of effects can be grouped under five main headings.

Social dumping and tax competition

Social dumping results from the rising competition of countries for the attraction of investment through the lowering of labour regulations and standards (Adnett, 1995).

This competitive deregulation is complemented by the impact of tax competition on the welfare state (Bretschger & Hettich, 2002; Winner, 2005). The free mobility of factors of production stemming from globalisation can tempt countries to embark on tax competition aimed at attracting the tax bases of relatively more mobile factors of production (e.g. capital). In equilibrium, this process lowers tax rates to suboptimal levels, leaving tax bases unaltered with a negative impact on government revenue, at least in the short run. This process restricts the ability of countries to preserve a strong welfare state and increases the relative tax burden of less mobile production factors (e.g. labour). In contrast to this process, the need for a strong welfare state may increase with globalisation for at least three reasons. First, many of the arguments supporting the existence of the welfare state (the presence of uncertainty that could otherwise reduce innovation and investment) become more significant in a globalised environment. Second, gains from globalisation may spread unevenly across individuals. Third, exploiting the efficiency gains from globalisation depends crucially on the existence of the welfare state and its role in preserving a suitable economic and regulatory environment.

A rise in unemployment

For developed countries in general and EU countries in particular, globalisation can have a negative effect on employment, at least in the short term. Yet, this effect is not uniformly distributed across the population, but has hitherto had a disproportionate effect on low-skilled workers. Skill-biased technological change reduces the demand for unskilled labour, leading to higher long-term unemployment among unskilled workers in Europe. The magnitude of this effect depends on the ability of workers to be successfully retrained. At the same time, international outsourcing leads to a shift in relative demand for labour and increases the employment share of highly skilled versus low-skilled labour. As shown in chapter 4 of this report, firms outsource the low-skilled, intensive parts of production and hence increase the relative demand for skilled labour. Empirical work examining the effects of outward FDI on home employment provides mixed evidence, however, while at the same time showing that at least some of the short-term costs are reversed in the longer term (Brainard & Riker, 1997; Blomstrom et al., 1997; Mariotti et al., 2003).

A rise in income inequality and poverty

Trade increases the efficiency of production and affects the income of factor prices in a way that is rarely beneficial for all individuals. If economies are endowed with different capital/labour ratios, in theory free factor mobility will induce capital (labour) to move from the economies with a high (low) capital/labour ratio to those in which capital (labour) is relatively scarce. This process in turn affects the distribution of income since it increases the relative income of capital (labour) in the countries endowed with a high (low) capital/labour ratio. Moreover, trade arising from differences in technologies can have a positive impact on all workers only in the unrealistic scenario that all workers are identical and fully mobile across industries. Otherwise, technological innovation will tend to raise the relative demand for skilled labour. As a result, the relative income of skilled versus unskilled labour will tend to increase. Outsourcing will have a similar effect on wages. *Ceteris paribus*, these effects

are likely to lead to increased levels of inequality and (relative) poverty. Yet as chapter 8 showed, the empirical picture is decidedly mixed and inconclusive.

A rise in international migration

Increased international migration entails both costs and benefits for all countries involved. From the perspective of economic benefits, migration has two important effects. First, it can facilitate economic growth by raising labour supply or by affecting the skill composition of the workforce. Second, it may partly tackle the financial burden imposed on the social welfare systems of industrialised countries by the ageing of their populations. The evidence presented in chapter 7 suggests that in many European countries migrants generate at least transitory positive effects on existing pay-as-you-go pension systems. On the cost side, migration may reduce wages and increase unemployment in the host country, especially if migrants' skills are similar to those of workers in the host country.

The European Commission's *Second Annual Report on Migration and Integration* (European Commission, 2006b) notes that net migration, which has grown significantly in recent years, continues to be the main source of population growth, with some member states such as Spain and Cyprus experiencing exceptional increases. Yet the report also notes that national policies are becoming more diverse, although a general trend is towards policies that are more restrictive. Moreover, it is clear that the integration of migrants remains problematic, even in those countries that appear to have adapted social policies well in relation to the complexities of globalisation (see Begg & Marlier, 2007). For example, the employment rate of migrants in Denmark – the country that tops the table for employment rates in several segments of the working population – is significantly below that of the indigenous population. In several member states, the extent of participation of immigrants in civic society is low and there are specific problems among target groups, notably women and dependent migrants.

A rise in regional inequality

In theory, in a frictionless world the process of globalisation should gradually eliminate regional inequality. The free mobility of goods and factors of production should enforce a more efficient allocation of resources internationally through the equation of marginal productivity and income across different regions. Low-income regions should grow faster than high-income regions as they will attract more capital and be able to exploit their comparative advantage. In the real world, however, production often concentrates in relatively advanced regions in order to exploit agglomeration effects and increasing returns to scale, such that the catch-up process of backward regions becomes very difficult. EU countries are partly protected from the effects of globalisation because of the existing restrictions to trade with the rest of the world (especially trade in agricultural products) – although these restrictions have declined substantially in recent decades. Still, the EU countries remain exposed to free capital mobility. Furthermore, European economic integration is a form of globalisation on a smaller scale. According to the Sapir et al. (2004) report, in the 1980–2000 period, one can observe a tendency of per-capita GDP towards convergence

across the EU member states, while within most countries one can observe a divergence of GDP levels across regions.

Plainly, there will always be localised impacts of structural change and these impacts may be long-lasting ones. Many regions and localities largely dependent on traditional industries in decline – such as coal mining, steel-making, ship-building and textiles – faced severe economic problems during the latter half of the 20th century. Among the new member states of Central and Eastern Europe, the decline of state-owned enterprises had a similar, although often even more pronounced effect during the 1990s. It is moreover safe to predict that further localities will be affected in this way from new forms of restructuring that themselves cannot readily be predicted. Two observations are nonetheless germane. First, in the contemporary economy, dominated as it is by relatively smaller and more diversified companies or branches of larger companies, the sheer number of large production units at risk has declined. Second, the understanding of economic development needs and of the contribution of different policies in this arena has improved considerably over the years.

Other distributive effects

It has to be recognised, however, that adjustment can be slow and that the consequences can be acute for affected groups. Adjustments to job losses and job gains, whether at the level of localities or among different occupational groups, take various forms and create a variety of social pressures. In boom areas, the social infrastructure can be become overrun and congested, while migrants drawn to the area often face poor housing conditions and varied forms of discrimination.

The typical social repercussions of changing patterns of activity that result in economic decline include

- immediate job losses that raise the unemployment rate, with knock-on effects on other jobs in the local economy through depression of local demand;
- a decline in the employment rate and a rise in inactivity as displaced workers fall victim to invalidity or become detached from the labour market (Alcock et al., 2003), sometimes also associated with an increase in social exclusion or mental health problems;
- migration away from the area, which can diminish local communities by leaving a more dependent population; and
- a loss of social capital for communities as a whole and the undermining of the human capital of the individual.

All of these effects pose challenges for the European social model and social protection systems, which have simultaneously to meet expectations that they will contribute to adjustment trajectories, while offering solidarity. The next section considers what is at stake.

9.2 Policy questions: What is at stake?

Three issues are most central regarding the benefits from globalisation. First, globalisation gains are not uniformly distributed across individuals, regions or countries. Second, although the costs of globalisation are likely to be concentrated in the short run, the benefits will take longer to materialise. Finally, the gains from

globalisation will depend on whether EU countries can succeed in combining high growth with a reformed model of social protection.

Many of the prospective social advantages of globalisation flow from the anticipated increases in output afforded by the division of labour and the dynamism imparted by economic integration. It is also important to recognise that some of the underlying processes can also be beneficial and not to take a purely static view of current trends. Thus, in the medium to long term, benefits such as the diffusion of technology and the competitive stimulus that may initially destroy jobs should translate into improved productivity gains for the EU. In short, it is misleading to portray international competition as a zero-sum game.

Critics continue to claim that the EU model has to change. Thus, Alesina & Giavazzi (2006) hold that the growing welfare state in Europe was paid for by inflation in the 1970s and growing public debt in the 1980s, prompting them to assert that "the very institutions that had been responsible for the success of the 1960s became an obstacle for growth after the 1970s". The thrust of their critique is encapsulated in their statement that "you can't grow very fast if you work fewer and fewer hours per week, unless your productivity grows at extraordinary rates". Yet the evidence is that countries that have implemented appropriate reforms have been able to promote equality and maintain social provision while prospering in international markets. Part of the answer is to adopt strict criteria for assessing the quality of social spending – moving away from the idea that aggregate social spending is the measure of social provision. Rather, the focus should be on whether social justice is being advanced and whether there is a 'productive' orientation to the system.

Globalisation as a process calls for a variety of means of adjustment. It entails assisting workers to adapt to the new economic environment and offering sufficient protections to those in transition. The diverse welfare states in the EU have differing performances in this regard, suggesting that there is considerable room for learning and experimentation in facilitating adjustment. It is in addition relevant that all EU countries face similar core issues for the future, but have to respond on the back of past structures and approaches that reflect preferences that have been forged over decades. Solutions therefore have to be customised.

A commonly held view, despite the lack of hard evidence that it is happening, is that globalisation is bound to threaten established welfare states because of competitive pressures. The argument runs as follows:

- offshored or outsourced work leads to unemployment;
- payments of social charges fall;
- demands for social protection rise;
- generosity therefore has to diminish; *or*
- taxes have to increase, which raises costs and which in turn accelerates offshoring, and so forth.

Yet it is also important to stress offsetting effects. First, there is a boost to real incomes from the lower prices of imports. Second, the job losses resulting from international competitive effects are small in scale compared with normal 'creative destruction' in the labour market. In the same vein, the pressures on social protection budgets from demographic changes are much more extensive. Third, the loss of low-

value jobs may be less damaging than it sounds: if offshoring means retaining only high-value jobs, it could be seen as a logical answer to a declining labour force.

Additionally, if 'social protection as a productive factor' is to be realised as an objective, there manifestly have to be changes in the nature of regimes, implying a need to reconcile the protective, productive and solidarity elements of social protection. Incentives are critical. The tension in social safety nets, according to an OECD study by van den Noord et al. (2006), is that their presence may help overcome resistance to globalisation, "but they can also weaken the incentives to work and save". The authors show that safety nets, in certain circumstances, prolong adverse shocks and have a negative impact on employment. Insofar as safety nets favour insiders, they can offset resistance to globalisation, yet may also harden the opposition of outsiders. Their research is ambivalent, however, about the effect on business investment.

The trend towards increased inequality is partly attributable to lower taxation on high incomes. Still, it is not evident whether the latter is a consequence of tax competition induced by globalisation or is instead a microeconomic shift – which first emerged as 'Reaganomics' – aimed at increasing incentives in the interests of enterprise. The policy question is whether inequality is damaging to social cohesion, and here it has to be emphasised that inequality and poverty are not (necessarily) two faces of the same phenomenon.[70]

It would be disingenuous to dismiss claims that globalisation has costs. As report after report stresses, the benefits of globalisation do not accrue automatically to all. Workers do lose jobs and they are not redeployed instantly. Some categories of workers will face systematic downgrading of their earning capacity. By contrast, the gains may be very substantial for other groups. What this adds up to is that globalisation may have aggregate gains, but has distributive consequences, and it is predictable that those who lose will shout louder than those who gain.

Much of the discourse around globalisation, however, is still centred on a 'manufacturist' view of the world. In this regard, it is an open question how different the 'knowledge' economy is from the economic structures that preceded it, wherein mass manufacturing was perceived as the driving force of prosperity, notwithstanding the progressive decline of the manufacturing share. Today, private services of various kinds and publicly-funded services account for the bulk of jobs. Many of these jobs are low-skilled, poorly paid and often subject to greater precarity, albeit not directly in competition with the rest of the world: a care assistant employed in Lyon at the minimum wage does not compete with a hospital cleaner in Bangalore. But in manufacturing, low-skilled jobs are increasingly disappearing because of new technologies and it is in this domain that the threat of outsourcing or imports from China and India may be contributing to the insecurity of the worst-off. Even so, it is in business services that some of the main contemporary challenges of globalisation may become most acute, as the discussion in part I demonstrates.

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[70] Giddens (2007) does make the telling point that if poverty is defined as only relative to a median income line, then poverty and inequality become synonymous.

10. IMPLICATIONS FOR THE EU SOCIAL AGENDA AND THE SOCIAL POLICY STRATEGIES OF MEMBER STATES

This chapter explores the main policy implications of globalisation for the EU and its member states. It should be noted that several aspects of globalisation are closely linked with features of European integration, making it difficult to identify which one is the principal cause or at what level the policy response should be envisaged. Nevertheless, some attempt is made to disentangle the corresponding effects and to focus on policies dealing with the socio-economic consequences of globalisation that are not directly related to the process of European integration.

As EU Trade Commissioner Peter Mandelson put it recently, "there are real challenges. Rapid change means opportunity for many, threats for some and uncertainty for most" (Mandelson, 2007, p. 12). Yet he also makes clear that "the politics of globalisation are the politics of change", and it can be argued that the real focus of attention should be around the adaptation of social protection systems. Tony Atkinson (2004) has drawn attention to the role that social protection systems play in responding to globalisation, pointing out that in the early 20th century, when the previous wave of globalisation reached its peak, social protection systems were already well established even if their outlays were small. Atkinson disagrees with others (he cites Tanzi, 2004) who date modern welfare states to the inter-war (and thus protectionist) period. He asserts instead that they arose as a direct complement to the prosperity that was being generated by increased international exchanges, precisely because it afforded the means of countering trends towards unacceptable levels of inequality: "[S]ocial insurance was a response to the perceived shortcomings of the industrialised market economy."

The differences among EU member states debunk the idea that it is only lightly taxed economies that rein back their welfare states that can prosper in an increasingly competitive, globalised world. Rodrik (1997) has shown that economies that are more open tend to have larger governments, demonstrating that the reason is to cushion segments of the economy from shocks and to facilitate efficient labour-market adjustment. The Nordic economies illustrate this conjunction and the Nordic experience shows it is possible to have a flexible labour market, high trade intensity, balanced budgets, high growth *and* a strong welfare state with low levels of poverty and few structural social problems such as long-term unemployment. Still, this does not mean that social policy in general and social protection in particular can avoid scrutiny and eventual reform, not just to contend with globalisation, but also the many other dilemmas facing the welfare state, such as those associated with population ageing. In essence, this is the backdrop to much of the debate around the concept of flexicurity.

Today, social policy aims at being both more extensive and complex, embracing the many different EU social priorities (as articulated by the European Commission in its 2005 relaunch of the social agenda). The headline goals are, first, employment, and

second, fighting poverty and promoting equal opportunities. Compared with the early 20th century responses to globalisation, the agenda now embraces gender, equality and social inclusion, as well as the protection of those at risk and countering poverty. Demography (identified as one of the underlying drivers of globalisation) is also recognised in the social agenda as one of the issues that policy has to confront. The press release accompanying the European Commission's (2005d) Communication states that by "modernising labour markets and social protection systems, it will help people seize the opportunities created by international competition, technological advances and changing population patterns while protecting the most vulnerable in society".

10.1 Strategic social choices

There are several directions that policy can take in responding to globalisation. At one extreme is opting out, following the prescription of non-governmental organisations such as ATTAC[71] and the associated protest movements that now tend to congregate around meetings of the G8 and similar events. At the other extreme would be full market liberalisation, in all its dimensions, as sometimes advocated by the most radical economists. Somewhere in the middle is the mainstream European view captured in the Lisbon strategy (vintage 2000), which calls for extensive supply-side reforms, tempered by policies to assure social cohesion. It is a middle way that lies between what Mandelson (2007) has called the standpoint of the hyper-globalists and that of the protectionists. He identifies – and rejects – "hyper-globalism", which portrays globalisation as an irresistible economic force in which global capital imposes neo-liberal economic policies on all governments, with the implication that the EU cannot muster the political capability to shape this change. But the mainstream European view is not one that espouses protectionism either.

The core policy package, reiterated in many a communication or policy statement, comprises fiscal consolidation, labour market reforms aimed at raising employment rates (especially for target groups), much-increased effort on research and innovation, an intensification of competition and better regulation. This mix has been referred to as the Brussels–Frankfurt consensus, in parallel with (but not slavishly following) the well-known Washington equivalent long advocated by the International Monetary Fund and the World Bank. Adjusting to globalisation implies a number of adaptations, many of which will have social ramifications that need to be managed. As the European Policy Committee (EPC) notes in a recent report (EPC, 2005), it is imperative that Europe's economies are able to move labour and capital swiftly and with ease "to take advantage of new opportunities and potential income gains, and minimise adjustment costs". Particular concerns are to avoid concentrations of displaced workers. Much of the analysis in this report is consistent with the middle way. Even so, it is also important to stress that there are many areas in which choices still need to be made, some difficult, others harsh. What is meant by structural reform

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[71] ATTAC refers to the Association pour la Taxation des Transactions financières pour l'Aide aux Citoyennes et citoyens.

is not always agreed, although the main elements tend to be variations on the same lists; for example, Trichet (2006) has suggested four priorities:

- moving more people into work,
- increasing competition,
- unlocking business potential, and
- supporting an innovative environment.

A three-pronged policy approach is advocated by Jaumotte & Tytell (2007), which calls for adverse distributive impacts to be addressed by the following orientations:

> – **Improve the functioning of labor markets**. Policies that reduce labor costs and increase the ease with which workers move from declining to expanding areas of the economy would help the adjustment. In some countries, making health care less dependent on continued employment and increasing the portability of pension benefits would also contribute.
>
> – **Increase access to education and training**. Workers in skilled sectors have been better able to adapt to changing conditions caused by the ICT revolution than workers in unskilled sectors. Improved education and training will help workers compete with the growing pool of skilled workers in emerging market countries, especially in Asia.
>
> – **Ensure adequate safety nets during the adjustment period**. Adequate income support should be available to cushion, but not obstruct, the process of change.

Other topics might be included, but the underlying messages are now sufficiently familiar that they do not require repetition. At the same time, there is an open question about where social policy fits into the structural reform agenda. The crude view that social protection is a drag on competitiveness has given way to a more nuanced discussion of how different approaches to social protection can feed into reform. The High-Level Group report on the future of social policy in the enlarged EU (European Commission, 2004b) is particularly emphatic in this regard, noting the need for lifelong learning, the modernisation of work organisation and reform of social protection systems. The High-Level Group also calls for a new intergenerational pact "focused on the young and based on confidence" and, in its discussion of opportunities, stresses that societal change creates new job opportunities in a range of areas for which knowledge is key. 'New' jobs call especially for competences in areas such as information technology and interpersonal communications.

The High-Level Group points to the requirement for specific adaptations induced by globalisation, noting that three "compromises can be detected within the social model: between the state and the market; between labour and capital, requiring concerted action and a role for nationwide agreements; and between the welfare state and individual responsibility". Key areas for action are

- the method of financing social protection, and especially the link to competitiveness;
- social dialogue, not least as a means of mediating change;
- efforts to counter the tendency towards the social exclusion of marginalised groups most affected by globalisation; and

- new forms of security that go beyond income, notably lifelong learning and 'capital ownership', especially through the activities of pension funds.

In a similar vein, the 'social stock-taking' exercise currently being conducted by the European Commission (see the discussion paper by Liddle & Lerais, 2007), while arguing that it is internal social dynamics rather than globalisation that are having the greatest effects on social trends, identifies fairness between the generations as a major social issue. The balance between protection of the vulnerable and solidarity on the one hand, and dependency and weakened incentives to seize opportunities on the other, is stressed. The paper also draws attention to the balance between rights and responsibilities, noting a trend towards greater 'individualisation' as a phenomenon of recent years. At the same time, the paper notes the multiple social challenges of increased migration, with the many cultural and economic benefits attributable to immigrants being offset by problems of inadequate integration and the perception, if not necessarily the reality, that immigrants are a competitive threat to the indigenous population in diverse ways.

A Communication from the Commission (2007b) builds on ideas in the *Joint Employment Report* (Council of the European Union, 2007a) to spell out what is meant by flexicurity. The Communication makes the link to globalisation very explicit. It stresses that flexicurity is about transitions between the different stages of working life and also that in combining the flexibility and security elements, a balance is being struck between competitive imperatives and the need to offer adequate social protection and income security. A further element is that the Communication recognises that those most at risk may be relatively more detached from the labour market and that there will be a need to offer more than conventional active labour market policies in a more comprehensive inclusion strategy. The latter can be defined to mean not only inclusion in the labour market, but also social empowerment, access to social services and adequate minimum incomes.

The four components of flexicurity set out in the Communication are as follows:

- **flexible contractual arrangements** (from the perspective of both the employer and the employee) through modern labour laws allowing for sufficiently flexible work arrangements and reducing labour market segmentation and undeclared work. The link between productivity and wages is part of such arrangements;
- **reliable and responsive lifelong learning systems** to ensure the continual adaptability and employability of workers. Financial and other incentives should be reviewed to achieve a breakthrough. EU funding should strongly support these enhanced efforts;
- **active labour market policies**, which effectively help people to cope with rapid change, unemployment spells and transitions to new jobs; and
- **modern social security systems**, which combine the provision of adequate income support with the need to facilitate labour market mobility. The removal of restrictions and obstacles for the mobility of workers within the EU, and measures to support work–life balance (including enhanced childcare) are part of this component of the strategy.

There is also an important strand within social inclusion policy that seeks to promote active inclusion, defined to mean not only inclusion in the labour market, but also social empowerment, access to social services and adequate minimum incomes.

It is worth examining whether and how these orientations accord with the likely demands on policy emanating from globalisation and perhaps more importantly, where rhetoric stops and real policy momentum can be found. Immigration is a good example, since it can be anticipated that the integration of immigrants will require much more than just labour market policies. The 2007 *Joint Report on Social Protection and Social Inclusion* (European Commission, 2007a) notes that most member states have active labour market policies that reach out to disadvantaged workers, but there are shortcomings in minimum income provision and access to quality social services. The report calls specific attention to flexible working arrangements for older workers.

A clear policy conclusion from reviewing the socio-economic costs and benefits of globalisation is that there is an urgent need for policy reforms aimed at mitigating costs and increasing gains to the greatest possible extent. Several policies seeking to maximise the advantages of globalisation will at the same time reduce its costs (for instance, policies promoting education), while enabling EU economies to achieve optimal positions in the new, emerging international division of labour. Yet reforms may differ significantly in their distributional impact and in the time needed for the full realisation of their effects. In general, reforms that will improve the benefits/costs ratio of globalisation in the long term while they are accompanied by a strong short-term impact on social cohesion are more difficult to implement. Several policies belonging to this category, such as those aimed at reforming the welfare state and the labour market, are vital to enable the benefits from globalisation to be attained at the lowest possible cost. The next sections describe the principal policy actors and areas involved.

10.2 The dimensions of a policy response

Prospective responses to globalisation can come from all levels of government and they can be expected to engage a wide range of actors. Which aspects of the social dimension of globalisation are most relevant in the EU context? On the one hand, these include the different effects on target groups and on indicators of well-being and its distribution, all of which shape societal change. On the other hand, responses to what is perceived as globalisation embrace both economic and social policies, the social models that countries try to develop and the policy strategies, designs and instruments. The scope is considerable, covering inter alia labour market trends (employment, unemployment and remuneration); labour standards and rights to protection; the quality of work; and more overtly social objectives such as gender, social inclusion or cohesion, family policy and solidarity. Globalisation also entails looking at complementary policy areas that affect capacities to adjust, encompassing education, innovation and many other facets of the supply side.

Consequently, the challenges that globalisation imposes on policy are grouped under three main headings. The first is that of equipping the economy to compete in the globalised age. The second involves the many demands on policy-makers to smooth adjustment. The third concerns the issues of governance. In all of these respects, there will be an interplay between what the EU level does and the policies

adopted by member states, while the approach of other actors (such as the social partners) will also be influential.

10.2.1 EU policies

EU policies that bear extensively on globalisation have evolved in the areas of competitiveness, external relations and the social agenda. In responding to globalisation, several EU policies are relevant. Most obviously, the relaunched Lisbon strategy – the partnership for growth and jobs (PGJ) – is central, but it has to dovetail with other policy measures and instruments in providing both effective governance and real policy momentum. The social fund, for instance, has a role to play.

A recent paper by two UK government ministers (Blunkett & Johnson, 2005) puts forward a (surprisingly?) persuasive case for EU policy:

> The European Union has a key role as a catalyst for change – identifying the challenges and promoting solutions. We have much to learn from each other and Europe should provide more opportunities to share experience and identify and share good practice, agreeing strategic targets and reviewing progress. It can also provide a forum for bringing together key actors, not only government but business, trade unions and other stakeholders. Ultimately, what happens in one nation state affects the potential for success in others.

The areas in which the EU level can make the most impact – in the absence of more extensive funding (assuming no significant growth in the EU budget overall or in the 'envelope' for growth-related policies) – are partly regulatory and partly to do with the coordination of national policies. It is in the latter context that the evolution of the open method of coordination (OMC) will be critical.

The partnership for growth and jobs

The PGJ is in many ways a response to globalisation insofar as its primary aim is to reposition the EU in the global economy, while respecting social cohesion. In essence, it is a broad reform agenda, although in focusing especially on innovation and employment rates, it addresses two of the perceived weaknesses of the EU identified in many recent studies. The PGJ is both a policy framework, characterised by the integrated guidelines that map out the agenda for reform, and a policy methodology in which the emphasis is on policy coherence, learning from others and using good practices such as setting targets – in other words, the aims usually ascribed to the OMC.

In social policy terms, perhaps the key issue is how employment evolves. Raising the employment rates is clearly identified as a core target of the PGJ. Yet while it is necessary, it can be argued that it is not sufficient to address fully the question of how to deal with the social dimension of the Lisbon strategy. Active inclusion, as a policy approach, is critical since it confronts employability, but social protection systems also have to be able to offer assistance to those who lose their connections with the labour market. Therefore, there is a need to enhance the links between the social protection and social inclusion strategies at the EU level and the PGJ.

An important feature of the relaunch of the Lisbon agenda is that it is intended to offer a framework within which other policies both contribute and benefit. Trade is a good example: according to a background paper on the Commission's global Europe

strategy (European Commission, 2006g), various internal policies, including "social and cohesion policy exert a strong influence on the capacity of EU companies to compete internationally". The paper notes the importance of economic openness, but also highlights that while "the costs of change are limited at an aggregate level they are strongly felt in the specific areas they occur". It also notes that benefits are "more diffuse and longer-term". The implication is that a political economy problem exists and has to be managed. Along with a redefinition of the EU's approach to external policy, the global Europe action plan stresses the need for complementary policies to support adaptation and education.

Following the application, in 2006, of the OMC to social protection and social inclusion, member states have prepared national strategies in these policy areas. They are intended to complement and feed into the Lisbon strategy as part of the overall response to globalisation. In these domains, the importance of active inclusion policies has been emphasised (for an independent overview, see Begg, Berghman & Marlier, 2006). Active inclusion has three overlapping elements: promoting inclusion in the labour market, assuring minimum incomes and empowering excluded individuals, notably by guaranteeing their access to public services. It is a policy approach that tries to reach out not just to unemployed individuals who are already economically active, but also to those more distant from the labour market.

Cohesion

Cohesion policy is another domain in which EU-level interventions can influence social impacts. Since EU economies differ in several aspects, such as their level of innovation or their capacity to engage in R&D, globalisation may widen income disparities across countries. Although EU cohesion policy is based on principles (the multi-annual programming of the expenditure, national co-financing of the EU transfers and the additionality of EU financing to national funds) that address such dilemmas, it is largely focused on regions (through structural funds) rather than on countries (through cohesion funds). While the 2007–13 programming period has seen an increased prominence accorded to Lisbon objectives, there are still doubts about whether enough attention is paid to the challenges of globalisation. Influential studies, such as the Sapir report, argue that EU convergence policy should concentrate on low-income countries rather than on low-income regions, and eligibility should be reviewed at the end of each programming period, even if such a move were to face political obstacles. Moreover, there is a need to revisit some of the policy instruments and to tailor them more closely to the circumstances of individual regions: for example, institution-building may be more salient in some cases than investment in human and physical capital.

Education

Since the turn of the century, there have also been several initiatives at the EU level in the area of education policy.[72] The principle is to advance policy in this area through

[72] For an inventory, see the European Commission's website (http://ec.europa.eu/education/policies/2010/doc/compendium05_en.pdf).

the OMC, emphasising policy learning and the exchange of experience. It is noted in the most recent Joint Interim Report of the Council and the Commission[73] that the objectives of the approach in the context of the Lisbon strategy are both social and economic: the social aims include not only employment, but also a means of countering social exclusion, while the economic rationale is to boost "excellence, innovation and competitiveness". This dual role of education is central in offering a constructive response to globalisation and is also regarded by the EU institutions as highly relevant to the future of the European social model. The report welcomes the higher priority given by most member states to education and training, but also notes that there are still large differences among them in the extent of commitments to lifelong learning and other elements of policy in the Lisbon agenda.

In higher education, the Bologna process, through which the comparability of degrees and quality standards are meant to be assured, is a key measure. Yet the report notes that the EU as a whole lags well behind in its spending (private as well as public) on higher education, spending 1.2% of GDP in 2001. EU spending is below half that of notable competitors such as the US (3.2%) and Canada (2.5%), although the Nordic member states are well ahead of the EU average in this regard, with Sweden at 2.3% and Denmark at 2.8%. The report notes that to attain the US ratio, the EU member states in aggregate would need to spend an additional €180 billion per annum, a sum achievable only by mobilising more private funding. The funding of higher education is thus an area in which the EU needs to think afresh in responding to globalisation.

Sustainable development

A revised EU sustainable development strategy (SDS) was agreed in 2006, although its relationship with the PGJ is subject to some ambiguity. The overall aim of the SDS is to achieve continuous improvements in the quality of life for both current and future generations and to this end, the strategy sets out seven key challenges and corresponding overall objectives and targets. While the SDS tends to be associated most with environmental aims (being seen by some as 'only' the 'environmental pillar' of Lisbon), it has broader ambitions. In particular, the sixth of its seven objectives concerns social inclusion, demography and migration. A politically sensitive issue around the SDS is how potential clashes of objectives are resolved.

Other policy areas

The ability of countries to use exchange rate policies to stabilise their economies in the light of adverse economic events is limited by the openness of their economies. As emphasised by De Grauwe (2003), the higher the degree of an economy's openness, the more rapidly the real effects of a currency's realignment will disappear. Devaluation will increase inflation directly through a rise in import prices. The rise in inflation will boost wage demands, putting an upward pressure on production costs. Furthermore,

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[73] For further details, see Council of European Union, Modernising Education and Training: A Vital Contribution to Prosperity, and Social Cohesion in Europe, 2006 Joint Interim Report of the Council and of the Commission on Progress under the 'Education & Training 2010' Work Programme, OJ C79/01, 01.04.2006.

the rise in the price of imported intermediate products and inputs will also stimulate a rise in the price of domestic products. As domestic products become more expensive, the impact of exchange rate devaluation on the competitiveness of the economy will disappear, leaving countries with an unaffected level of output but at the cost of a higher level of prices. Hence, the globalisation process implies the steady weakening of exchange rate policy as an effective instrument for economic stabilisation.

The resulting implication is that in order to stabilise the EU after a symmetric shock and to avoid an EU-wide recession, alternative aggregate stabilisation policies (for example, monetary policy) should be used. On the other hand, at the national level the openness of the member states' economies owing to globalisation reduces the cost of adopting the euro. Plainly, the cost of abandoning independent exchange rate policy in order to join a common currency area decreases as exchange-rate policy becomes less effective in a more open, globalised economic environment.

In an increasingly open international economy, it becomes more likely that direct tax bases (personal and corporate incomes) will react elastically to tax rates. In the context of this new reality, achieving the desired level of redistribution becomes progressively more difficult. Moreover, since capital is significantly more mobile than labour, tax competition may shift the tax burden from capital to labour, adding some extra burden to the already high level of European unemployment. Indeed, with capital liberalisation, some member states have experienced an erosion of tax revenues coming from direct taxation of personal savings and of companies. Although proposals to harmonise several aspects of tax policy have been discussed for decades in the EU, only some very limited measures have been adopted because most proposals have been blocked by the requirement of unanimity in the Council. As recognised by the Sapir et al. report (2004), national decision-making, desired redistribution and integrated markets for goods and products form an inconsistent trinity.

Furthermore, despite the steps taken at the EU level for deeper economic integration, the rapid pace of globalisation may gradually remove the option of imperfect economic integration. Thus, retaining a level of redistribution that would allow both the offsetting of the social costs of redistribution and the creation of conditions facilitating the growth process would require at least some form of coordinated decision-making.

10.2.2 Member state policies

Given that the EU level has scarcely any budgetary capacity in relation to social policy, with the corollary that its actions must necessarily be in the regulatory domain or in coordinating member state policies, it is at the member state level that the principal responses have to be funded and implemented. Joseph Stiglitz (2004), a member of the International Labour Organisation's World Commission on Globalisation that produced that organisation's study of the social impact of globalisation, explained that in the thinking of the World Commission and contrary to those who worry that globalisation has become a reason to criticise "excessive government intervention in the economy" the opposite is true. He asserts, "[T]the state has a role to play in cushioning individuals and society from the impact of rapid economic change. The way that globalisation has been managed, however, has eroded the ability of the state

to play its proper role." The question that then arises is where the member states should concentrate their efforts.

Disparities in long-term unemployment rates reveal the differences among member states, but according to the EPC (2005) they do not provide firm evidence of the 'best' social model. Rather, the onus should be on member states to find solutions that reflect good practice (and hence draw on EU-level comparisons) in five areas, all of which concern the labour market:

- tax and benefit reforms that make work pay;
- improvements in the skills and employability of workers;
- active labour market policies that reach disadvantaged groups in the labour market;
- better-designed employment protection legislation; and
- flexibility at the regional and sectoral levels, not least in wages.

Nevertheless, the labour market cannot be seen as the only arena in which member-state policy choices are critical in relation to social policy. Other key areas also merit focus by the member states:

- education systems;
- the reform of social protection, rather than its attrition, together with a more inclusive approach to immigrants;
- attention to labour standards; and
- a better appreciation of transitions to and from the world of work.

Taking into account the heterogeneity of EU member states, not all policies are equally suitable or urgent. At the same time, enhancement of the capacity of government, public administration and legislatures to implement reforms and to ensure a high degree of efficiency in the delivery of social protection is fundamental to success. It is in many of these domains that the OMC is supposed to offer ways of achieving advances through policy transfer and learning. The success or failure of the OMC crucially depends on the efforts of national governments (especially in the implementation phase), the extent and quality of public scrutiny, and the ability to identify best practices. Hence, benchmarking along with the definition of indicators plays an important role. Benchmarks are the basis for well-founded evaluation, public scrutiny and peer review. Consequently, the definition and use of credible and accurate indicators is a *sine qua non* for a successful benchmarking exercise.

Yet, in the absence of adequate and firm data and sufficient proof of a clear causal relationship between OMC processes/initiatives and social policy modifications, the successes and failures of the OMC are still debatable. On the one hand, it is reported that the OMC has generated noticeable change over the last few years (Pochet & Zeitlin, 2005). The main contributions of the OMC include the increased awareness being given to enhancing social inclusion by national governments, a better understanding of the main features and causes of poverty and social exclusion, and greater ambitions and enriched aspirations in social policy-making. The OMC has allowed progress in social policy areas where the traditional regulation methods have confronted a lack of any consensus over priorities and an anti-Brussels reaction.

On the other hand, hard-law proponents claim that opportunities for the necessary hard legislation may be crowded out unless the soft option is radically restricted. Soft coordination through the vague guidance of the European authorities may have occurred at the expense of top-down harmonisation of minimum legal standards, a fact that jeopardises the European social policy influence on national legal systems and turns any impact into something that is 'illusory rather than actual'. In fact, for all its rhetoric, the ability of the OMC to coordinate national social policies towards convergence on best practice models has yet to prove its worth in the presence of a dominant European market law. The OMC is also evidently insufficient in areas of social and employment policy characterised by strong negative externalities.

Against this backdrop, it is worth exploring how different policy areas can be expected to evolve at the national level. Prospective reforms can be explored under a number of headings.

10.2.3 Welfare state reforms – Fleshing out flexicurity

Global competition is related to higher uncertainty, and thus presents new difficulties for the management of social risks. One of the main justifications for government intervention in economic life, as well as for the establishment of the welfare state, is the presence of uncertainty and uninsurable risk. Globalisation tends to intensify this uncertainty, in turn strengthening the role of the welfare state. In fact, the existence of a safety net will encourage entrepreneurial risk-taking with a positive effect on growth. Nevertheless, social policy should aim at helping individuals to manage the steadily mounting risks by endowing them with the capabilities to do so rather than relying on mechanisms of insurance, redistribution and consumption smoothing. Enhancing these capabilities implies shifting social insurance from passive measures to those promoting education, lifelong learning and labour market participation (for example, through the provision of childcare facilities, maternity and paternity allowances, etc.). Such policies are likely to combat poverty and social exclusion among younger cohorts of the population (Muffels et al., 2002). At the same time, social protection systems in EU countries have to find innovative ways to cope with rising health care and retirement costs while avoiding the resurgence of elderly poverty.

The goal of any welfare state reform should be to combine greater economic flexibility with better social protection in order to create an environment capable of making the best use of the opportunities offered by globalisation. This is the basic idea behind the concept of 'flexicurity' discussed above. Many member states currently face a potentially unfavourable conjunction of a heavily burdened welfare state and low economic growth. Insufficiently high growth rates and rising unemployment combined with a rapidly ageing population have increased the costs of the European social model since the mid-1970s. But improving the growth rates and cutting unemployment requires adapting the welfare state to the new socio-economic environment.

Prior to the last two stages of expansion, the EU welfare state was characterised by the presence of four distinct social models (Esping-Andersen, 1990; Ferrera, 1996): the Nordic (Denmark, Finland, Sweden and, to a large extent, the Netherlands), the Continental (Austria, Belgium, France, Germany and Luxemburg), the Anglo-Saxon (Ireland and the UK) and the Mediterranean (Greece, Italy, Portugal and Spain). Naturally, differences can be observed between these four models as well as within

each of them. By comparing the four models in terms of i) the reduction of income inequality and poverty, and ii) the rewards for labour market participation, Boeri (2002) concludes that the Nordic model performs better on both criteria whereas the Anglo-Saxon model does almost equally well according to the second criterion. Similar conclusions are also reached by Sapir (2006). The addition of the 12 new member states has increased cross-country heterogeneity and introduced at least one more type of social model. Giddens (2007) is critical, however, of the continuing portrayal of four distinct types of social models in the EU-15, arguing that even if they are seen as ideal types rather than accurate descriptions, they no longer reflect the many changes that have resulted in 'hybrids'. He also expresses doubts about "according too much primacy to jobs", noting that there are wider social problems to confront than unemployment.

Insofar as the Lisbon strategy is at the heart of the EU response to globalisation, the insistence by Giddens on social justice and on the fact that "reform promotes social justice" rather than undermining it is central to new thinking, which he labels "positive welfare". Giddens associates social injustice above all with poverty and stresses its dynamic character. He notes that flexicurity is about transitions between jobs and recognises that a job is still the best way out of poverty. But he holds that a preventative approach is needed as well to counter episodes of poverty that may be unrelated to the labour market. He reserves the term 'social exclusion' for multiple deprivations.

These trends, together with the fact that diverse welfare states face common dilemmas, are critical to developing a new understanding of social justice and of the policy interventions that will be needed to promote it. In a recent statement, the Policy Network (2006) observes that

> while the defence of the welfare status quo may seem electorally attractive in the short term, it is a political dead end. Failure to advocate progressive reforms leads to blockages in our societies: certain versions of the European social model can confer competitive advantages, but a poorly functioning social model can, on the contrary, become an economic handicap.

This statement highlights a critical "paradox that defence of an existing social model may in crucial respects not serve the cause of social justice, while reform that superficially tests traditional conceptions of social justice may actually fulfil the long-term demands of social justice more effectively" (ibid.).

If the benefits of globalisation are to be reconciled with social justice, new strategies are plainly needed, as the adverse effects of misguided policies are becoming more evident in the disparate performances of EU economies.

10.2.4 Labour market reforms

As noted earlier, both the costs and benefits of globalisation depend crucially on the flexibility of the labour market. The existing evidence suggests that most European labour markets were substantially more rigid by the turn of the century than they had been in the mid-1960s (Nickell, 2003), indicating that labour market inflexibility is partly to blame for inadequate growth in Europe. The process of globalisation has increased the cost of labour market rigidities by making producers more sensitive to increases in labour costs. A greater pace of technological progress requires a higher

labour turnover. With the rising importance of innovation and the quickening speed of restructuring, labour market flexibility has become an important factor for economic growth. This implies that globalisation has grown costly for countries that impose significant costs on turnover. Modern European welfare states nonetheless often protect the status quo at an increasing opportunity cost (Heckman, 2003).

Labour market reforms frequently meet strong political opposition. Consequently, when such reforms are actually implemented they are so heavily shaped by political constraints that they can often be counterproductive. According to Saint-Paul (2000), the following conditions may ease the political constraints faced by reformers:

- the existence of an unfavourable economic climate in which incumbent workers face a higher risk of lob losses;
- the design of reforms in a two-tier fashion so that they apply to new labour contracts without affecting employed workers; and
- the existence of a lag between the decision date and the implementation date.

Given that the impact of globalisation on the EU labour markets satisfies the first condition, political constraints to labour market reforms are likely to loosen. As noted by EEAG (2004), this is rather unfortunate and paradoxical since the adverse effects of these reforms are more bearable in economic booms when economic conditions are favourable.

Employment protection

Strict employment-protection provisions are a form of labour market inflexibility that, although the significance is disputed, is widely seen as a constraint to economic growth, insofar as it inhibits an effective matching of skills and abilities with specific tasks, as well as a better adjustment of employment to output levels. That being said, diminished employment protection comes at a significant cost in terms of less stable employment paths and lower human capital investment, and the costs of change to an alternative model are not always appreciated. More specifically, the uncertainty regarding the workers' future employment prospects may discourage investment in both general skills by the employer and in firm-specific human capital by the worker.

The overall picture of developments in the EU labour markets suggests that countries that have managed to decrease unemployment have all liberalised their labour markets along at least some lines, whereas none of those who did not liberalise have managed to reduce unemployment (EEAG, 2004). It should be noted, however, that this may come at a social cost, since the experience of at least the US and the UK shows that labour market liberalisation has led to greater wage inequality both between and within groups of workers (Gosling & Lemieux, 2004; Tsakloglou & Cholezas, 2006). That being said, recent OECD research by Bassanini & Duval (2006) shows that there are systematic differences between countries in labour market performances. They hold that "high and long-lasting unemployment benefits, high tax wedges and stringent anti-competitive product market regulation are found to increase aggregate unemployment", while coordinated or centralised wage-bargaining systems have a positive effect. In addition, employment rates are higher where the tax wedge is lower and, unsurprisingly, unemployment benefits are less generous.

Regarding protection against uninsurable labour-market risks, the four European social models mentioned earlier behave very differently in the sense that they offer a different combination of employment protection legislation (EPL) and unemployment benefits. The Mediterranean model offers very strict EPL with a rather low coverage of unemployment benefits. On the opposite side lies the Nordic model. Both the Anglo-Saxon and the Continental models offer generous unemployment benefits, but they differ in their level of EPL, since the Anglo-Saxon model provides comparatively less protection than all other systems. Furthermore, Sapir (2006) finds a strong connection between the employment rate generated by a social system and the instrument the system uses for protecting workers against uninsurable labour market risks. He reports that the stricter the EPL is, the lower the employment rate. The generosity of unemployment benefits plays only a secondary role. This view implies that changing the instruments for workers' protection from stricter EPL to higher unemployment insurance is potentially useful for raising the rate of employment.

Moreover, a large proportion of the dismissal costs in most countries (especially in southern Europe) takes the form of highly uncertain legal procedures. Therefore, there is a need for reducing uncertainty by simplifying the EPL. EEAG (2004) advocate "the elimination of the current system of legal procedures in many countries, especially the Southern European ones and its replacement by a simple 'firing tax' which would be paid to [the] worker as [a] severance payment".

Active labour market policies

The consensus view among both policy-makers and economists is that a push towards training and redeployment is a more productive way of using public revenue and the unemployed workers' time than passive policies of compensation. Yet, active labour market policies can prove costly and inefficient if they fail to create the appropriate incentives. In order to decrease the equilibrium rate of unemployment, these policies should improve the competitiveness of the unemployed workers and their search intensity. This approach, however, may not be politically desirable or easy if it puts competitive pressures on incumbent employees. For example, the French *emploi jeunes* programme in 1997 directed young unemployed workers towards exclusively low-skilled public sector jobs despite the fact that many programme participants had a rich educational background. Restricting the programme to the public sector removed competition for private sector jobs but its medium-term effect on employability has been questionable (EEAG, 2004).

Reforms that affect the incentives of unemployed and employed workers

Cutting the benefits on offer to the unemployed if job search activity proves insufficient may have a positive employment effect, as shown by the Swedish and Dutch experiences. This type of reform increases labour market efficiency without reducing the level of social insurance. In addition, it is likely that work incentives will increase if means-tested welfare payments are replaced by in-work benefits like tax credits for earned income. Such a reform may have a strong positive impact on employment while being politically more acceptable than alternative reforms (such as a reduction in employment protection). Finally, profit sharing or the promotion of stock ownership may decrease the rate of equilibrium unemployment and stimulate growth.

Under such schemes, incumbent workers may be more willing to accept policies that improve firms' profitability (e.g. wage moderation) even though they would strongly oppose such policies outside these schemes.

Labour mobility and migration policies

Labour mobility is an important aspect of labour market flexibility since it allows European economies to adjust to the changing market conditions brought about by the globalisation process. The role of labour mobility in the EU countries is twofold: first, labour mobility contributes to the flexible environment required by economic growth while, second, in a monetary union the role of mobility becomes more significant as an important adjustment mechanism in the presence of asymmetric shocks. One can distinguish between regional mobility within individual countries, intra-EU mobility and that between the EU and non-EU countries.

The degree of cross-border labour mobility within the EU and indeed within many member states is manifestly limited (Vandamme, 2000), especially compared with federal countries such as the US or Germany. As a result, the social impact of the creative destruction process implied by globalisation increases and individual EU countries rely on national budgets to stabilise adverse regional shocks (Obstfeld et al., 1998). It should be noted that intra-EU mobility is an important component of the single market and existing obstacles in terms of the non-transferability or incompatibility of acquired rights for health, pensions and unemployment benefits should be removed. Improving labour mobility across eurozone countries will significantly reduce the cost of a single currency, since labour mobility is an important characteristic of an optimal currency area. This is especially so given that other characteristics of an optimal currency area, such as wage flexibility or the existence of a central fiscal budget, are very limited in the euro area.

Migration from non-EU countries could contribute to additional economic activities that otherwise would not take place. The positive impact of migration on growth accentuates when the skill structure of migrants and natives is complementary. As noted earlier, although the skill structure of intra-EU migrants is comparable to that of natives, non-EU labour migration seems to be complementary to the skill structure of natives. Migration is also often considered a tool to counteract the demographic problems arising from the ageing of society and to support the very survival of the existing social welfare systems. The policy implications are explored in greater depth in section 10.3

10.2.5 Product market liberalisation and competition policy

Deregulating product markets as well as labour markets may boost employment and improve the growth prospects of an economy in a progressively globalised environment. Especially where growth is innovation-driven, the importance of contestable markets with the entry and exit of firms has grown. New entrants may make innovations at the frontier more easily since established firms face the cost of losing their current markets. Market liberalisation can prove beneficial for both consumption and growth, since on the one hand, it leads to lower prices owing to intensified competition, and on the other hand, it stimulates innovations. A successful example of this type of market liberalisation has been observed in telecommunications.

At the same time, active competition policy is important for successful market liberalisation. It is essential that market liberalisation be supported by an appropriate regulatory framework that protects new entrants from anti-competitive behaviour by existing firms. Thus, better coordination between competition and regulatory policies is important for encouraging new entrants. It should be noted that harmonising the present regulations may often protect incumbent firms instead of stimulating entry and exit. Moreover, complex regulatory environments that increase the time and administrative costs of establishing a firm may reduce the returns from innovation and limit the entry of new firms.

Research and development are clearly a prerequisite for technological progress and innovation. The European Council has set the target for R&D expenditure at 3% of GDP. The EU is investing substantially less in R&D than the US is, but this average picture mainly reflects the low levels of R&D expenditure by the Mediterranean EU countries and on the part of business. Paradoxically, technological progress based on the development of new technologies requires the imposition of limits in the diffusion of these new technologies, which in turn may delay such progress. In other words, innovation is possible as long as mechanisms such as patents are in place, thus ensuring the returns from innovations to the innovator. Still, in 2000 the EU produced only a quarter of the number of patents produced in the US. Tax credits are also important for encouraging private research investments. Tax credits have the advantage of lowering administration costs. In addition, they reward success since only profitable firms can use the credit and they avoid all the problems related to the ability of bureaucrats to pick winners or their possible sensitivity to special interests.

Regional policies

At the member state level, the interplay between spatially targeted economic-development policies and competition engenders some tensions. Regional income inequality may refer to income disparities across EU countries or within EU countries. In theory, only the first type of regional inequality should be tackled by EU policies, whereas the latter type should be a concern of national policies. Several political and economic arguments support this allocation of responsibilities: subsidiarity, coherence with fiscal policy, equal treatment of equally prosperous countries, etc. As globalisation accelerates, economic change and the need for dealing with significant regional inequalities within individual EU countries may emerge, at least in the short run. This phenomenon may be mitigated by national regional policies, complemented by a combination of policies mentioned in previous sections (labour market and migration policies). Still, it is essential that these policies are compatible with EU rules (for instance, state aid to industries may violate EU competition policy).

10.3 Migration, welfare and globalisation

In many respects, migration is the policy area that has been the least coherently approached in adapting to globalisation. Migration is, in any case, a particularly daunting dilemma for the welfare state. This view is extensively held by Europeans and, significantly, it tends to be stronger in countries with the most developed welfare states. Indeed, even within the EU, labour mobility has long been a problematic issue, with conflicting perspectives on its merits and consequences, especially after the 2004

enlargement. Although the 2005 social agenda is explicit about the need for policy innovation in relation to immigrants, a recent assessment of member state policies in this domain points to a range of shortcomings (Begg & Marlier, 2007). The differences among member states and among immigrants of different origins have to be stressed, but immigrants typically have worse housing conditions, lower educational attainment and inferior access to social services. Ethnic minorities such as the Roma often face equivalent marginalisation, although the reasons differ. Regarding the appropriate design of migration policies, the following factors should be taken into account.

Migration is not a temporary development

It is important that EU countries perceive that, in a globalised environment, migration is likely to be a permanent development and thus migration policies should be designed to reflect a long-term perspective. This was not the case with early national migration policies, which tended to have a much shorter perspective. For example, in Italy, migration only began to be considered a stable phenomenon in the 1990s with the Martelli Law, aimed at regulating the entry and residence of non-EU citizens (Kosic & Tryandafyllidou, 2005).

The social benefits of migration depend on migrants' integration

For migration to be a successful long-term process, the integration of migrants is a necessary condition. The effective integration of different types of migrants into the economy and society of the host country is important for maximising the social benefits of migration. In this respect, facilitating the access of migrants and especially that of their children to education would be a promising approach. Allowing migrants to participate in the decision-making process regarding migration policies is another. Moreover, providing political rights to long-term migrants may be an effective way of promoting their integration.

In addition, migrants (at least those who anticipate long-term residence in the host country) should be actively encouraged to learn the language of the host country and thus to take part more fully in social and economic life. A good example of a migration reform that follows this direction is the new Nationality Law that came into force in Germany in 2000. A child born in Germany to non-German parents automatically acquires German citizenship at birth, but then has to choose between the citizenship of his/her parents or German citizenship by the age of 23. Along the same lines but in a less generous way, in 1998 France reintroduced (with Law 98/170 – *loi* Guigou) the automatic right to French citizenship for children born in France of foreign parents. They become French at the age of 18, unless they decide to renounce French nationality, while the parents may ask for French nationality for their children at the age of 13. It should be noted that the mass media also have an important role to play in the successful integration of immigrants in the social life of the host country by discouraging the promotion of xenophobic stereotypes and thinly veiled racist behaviour.

Combining a general EU policy framework that allows national flexibility

In an integrated Europe, national migration policies are bound to have externalities for other member states. EU member states agreed to develop a legal framework for a

common immigration policy at the EU level in the future. Yet, different types of migration (e.g. permanent or temporary) can match different demand structures in the labour market of the host country of the potential migrant. For example, Greece is a country in which labour demand exhibits strong seasonal patterns because of the importance of summer tourism and agriculture in the economy. For this reason, in 2001 Greece allowed seasonal workers to work in the country even without a settlement permit. The needs of the local labour market are known best at the local level, and hence future EU rules on migration should allow enough scope for flexibility at the national and local levels.

Encouraging migration to benefit growth

The migration decision is greatly influenced by economic considerations. Therefore, creating favourable economic conditions will work as a pull factor. Many of the non-EU immigrants are low-skilled workers. Given the shift of demand towards skilled labour brought about in the EU by globalisation, to make migration an effective a long-term strategy it is necessary for these migrants and their families to be integrated into programmes for lifelong learning. Moreover, countries can provide incentives for migration in areas where there is a shortage of domestic labour supply. Since higher education is a long-term investment, in the short term the supply of highly educated workers is inflexible and migration can fill some of the excess demand.

Several countries have implemented migration policies aimed at attracting highly skilled labour. In 2000, Germany introduced a residence permit for highly qualified foreign workers in the information and communication technology industries (a green card system). Similarly, in 2002 Denmark introduced a job card scheme to ease the entry of highly skilled foreign workers into areas experiencing a shortage of Danish labour. More recently, in 2005 the German Immigration Act provided more incentives for the migration of highly skilled workers by granting an immediate permanent residence permit to highly qualified persons as well as the possibility for non-EU students to remain in Germany for one year after their studies to seek employment. The same Act includes some further growth-stimulating measures such as the settlement of self-employed persons, who receive a residence permit if they invest at least €1 million and create a minimum of 10 jobs.

Contributions of migration to funding the welfare system

Migration can partially contribute to the sustainability of existing welfare systems or at least provide them with the breathing space to reform. Labour market shortages and financial distress in the social security systems caused by the shrinking number of contributors can be counteracted by a higher supply in the official labour market. In this respect, the imposition of measures that weaken the incentives for illegal migration is essential. Applying measures to limit the black market for migrants *ex post* (with respect to their transportation, employment, accommodation, trafficking, etc.), such as those taken in Greece and Spain in the early 2000s, is only a second-best policy. One policy broadly implemented in the EU that tends to provoke illegal migration with negative consequences for pension systems is the requirement of a job contract in order to be allowed entry into the country. Tackling this issue was partly the aim of the Italian 1999 reform that introduced a special settlement permit to search for work (a

sponsor mechanism): foreign citizens are allowed to enter Italy even without an employment contract in order to establish themselves in the work environment. The precondition is that an Italian citizen or a foreign citizen legally resident in Italy guarantees the support of the foreigner for one year.

In 2002, a similar measure was introduced in the UK for highly skilled labour in the framework of the Highly Skilled Migrant Programme, which seeks to attract individuals with a high stock of human capital in terms of the qualifications and skills required by UK businesses to compete in the global marketplace. This scheme provides migrants leave to enter the UK to seek work instead of requiring them to demonstrate a pre-existing offer of employment.

There is only weak evidence that the specific design of a given welfare system operates as a welfare magnet. At any rate, there is no doubt that introducing basic common features to the social protection systems of the member states would cut the transaction and information costs of potential migrants. In this framework, the cross-border portability of claims against pension systems is desirable and it should be facilitated.

Cooperating with labour-exporting countries

Migration also has important consequences for the labour-exporting countries. Stable linkages between the EU and individual host member states on the one hand, and the traditional labour-exporting countries on the other, could have benefits. In this context, clear rules for migration, outbound as well as return, should be formulated. In the case of developing countries, the implementation of technical and social aid programmes for the labour-exporting countries could be part of the overall agreement. This approach could lead not only to a reduction of poverty in the home country of the migrant, but also to a decline in illegal migration.

Policy options on migration

Although the actual impact of migration on public finances is probably very limited, the issue of migrant demands on the welfare state is nevertheless perceived as a salient one by citizens and their governments. Against this background, there is a high risk of setting in motion a vicious circle in which unskilled migration inflames public opinion, resulting in calls for unrealistic (or needless) restrictions on migration. These restrictions in turn lead to more illegal and unskilled migration, further inflaming public opinion against migrants and forcing governments to adopt even stricter (and unenforceable) migration policies. Three strategies for addressing this potential vicious circle are

1) closing the welfare door to migrants,
2) introducing a ‘points system’ rewarding skilled migration, and
3) harmonising safety nets at the EU level.

Closing the welfare door? A number of scholars, including Hans-Werner Sinn (2004b and 2004c) advocate the temporary closing of the welfare door to migrants. Closing the welfare door would reduce migration flows, while mildly increasing the proportion (although not necessarily the absolute number) of skilled workers in migration inflows. Such a policy, however, would postpone the assimilation of migrants who are already

in the country or who would come in any event. Thus, it may – paradoxically – increase the negative externalities on the native population from immigration to rigid labour markets, by pushing many migrants into illegal activities.

Adopting a points system? A points system is a method for ranking applications for residence and work permits. It has been adopted by Australia, Canada, New Zealand and, in Europe, by Switzerland. Each applicant is allocated a score based on explicit criteria that typically reward educational attainment, experience and language abilities. 'Bonus' points can also be given for employment in occupations and regions where there is a shortage of workers. A points system adopted by Europe vis-à-vis non-EU nationals would encourage more skilled migration not only in relative, but also in absolute terms, enhancing the growth potential of migration and reducing negative externalities through unemployment. An additional advantage of a points system is that it could simplify migration regulations, notably by removing the need for ad hoc policies for highly skilled migrants and by integrating asylum policies into a broader framework through, for example, granting 'humanitarian' points.

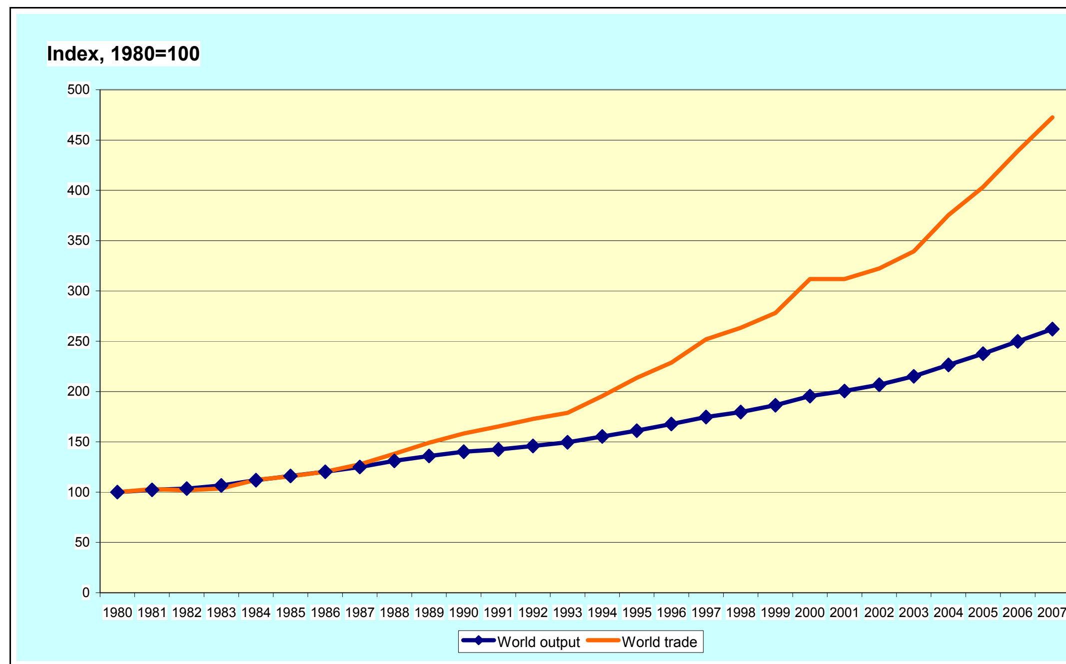
Harmonising minimum welfare across jurisdictions. The above policy options have to do with migration policy or the treatment provided to migrants rather than the design of social policies. Another option involves the harmonisation of minimum welfare standards (Bean et al., 1998; Bertola et al., 2000) or an EU-wide minimum welfare floor (see Atkinson, 2002). The rationale for this policy is that it would prevent welfare shopping and a potential race to the bottom in social welfare provision fostered by concerns of fiscal spillovers across jurisdictions. Although, as explained in the last part of chapter 6, there is no evidence that social assistance provisions are being dismantled, many countries have some safety net in place, and hence it seems reasonable to coordinate these schemes for a minimum guaranteed income.

11. SCENARIOS

In view of the many influences on globalisation, it is evident that it is not a static concept and that changes can be expected. As globalisation itself evolves, it is useful to develop a plausible scenario for what can be expected over the next 15 to 20 years and to examine the factors that might result in deviations from the more likely trends. Useful background material that focuses extensively on globalisation is provided in weighty scenario-building exercises by the CIA (National Intelligence Council, 2004), with a 2020 perspective, and by the pioneers of scenario-building, Shell, in an exercise that looks out to 2025 (Shell, 2006). The futurology industry is, in addition, very extensive and ideas and analyses from a wide variety of sources have been incorporated in what is presented in this chapter.

Globalisation, as Richard Baldwin rather pointedly puts it, "is a new and important phenomenon – and has been since the introduction of steamships, railroads and the telegraph" (Baldwin, 2006, p. 1). A first era of globalisation extended from the mid-19th century (and could be dated from considerably earlier) until World War I. It saw not only a great opening of trade and investment flows, but also large-scale population movements (Atkinson, 2004). In the last 40 years and more especially in the last quarter of a century, it is the expansion of trade and investment that has been the main visible manifestation of globalisation, while international labour flows have been much less extensive, certainly compared with the phase from the mid-19th century to World War I. Figure 11.1 shows the degree to which international trade has outpaced output over the last quarter of a century, underlining what is a key trend.

Figure 11.1 Growth of world output and trade

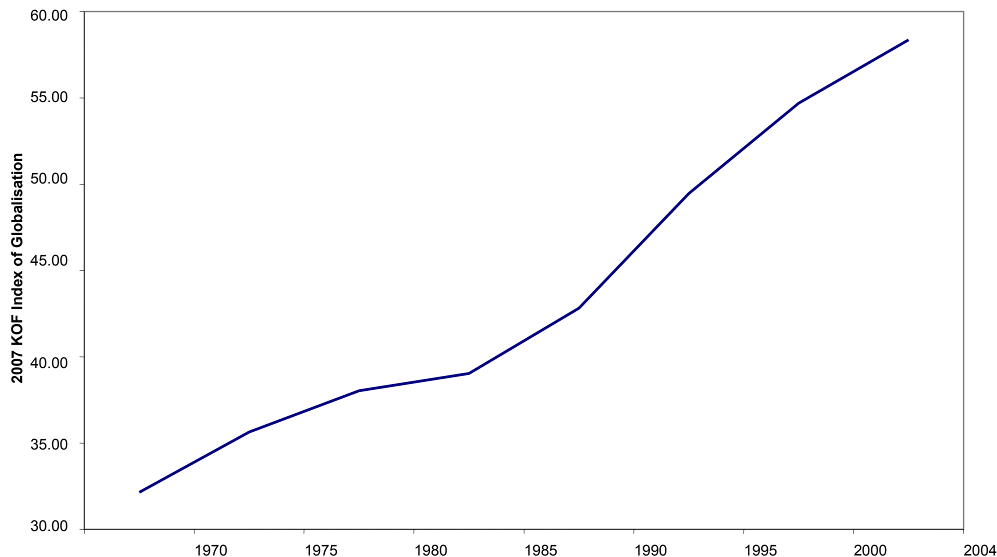


Source: IMF World Economic Outlook database, September 2006.

11.1 Influences on future developments

The CIA's 2020 project suggests several ways in which major global developments could take shape and be buffeted or bolstered by the forces of change over the next 15 years. In a sense, the most likely evolution is a continuation – in some cases an intensification – of many of the trends discussed in earlier chapters. Indices that try to measure the extent of globalisation typically combine information on flows of trade and investment, along with measures of social interactions and political convergence. They are inevitably somewhat arbitrary, both in the choice of indicators and in how they are weighted together, but nonetheless provide some measure of the long-run trend. For example, the 'KOF' index, compiled by the Swiss Institute for Business Cycle Research, demonstrates that globalisation has been on an interrupted upward trend since 1970 (Figure 11.2) and shows no sign of abating.

Figure 11.2 The unrelenting rise of globalisation



Source: Swiss Institute for Business Cycle Research website (2007) (retrieved from http://globalization.kof.ethz.ch/).

Nevertheless, by considering factors that might alter a base scenario, differing perspectives on future developments can be adduced. Such exercises underline the wide range of factors, discontinuities and uncertainties shaping a new global order. Those explored by the CIA include, in addition to economic factors, the security role played by the US, the role of social and religious identity, and the breakdown of the international order because of growing insecurity. The CIA analysis highlights various 'switching points' that could shift developments in different directions. The most important such points include the impact of robust economic growth and the spread of technology; the nature and extent of terrorism; the resiliency or weakness of states, particularly in the Middle East, Central Asia and Africa; and the potential spread of

conflict, including between states. In addition, according to the CIA, anti-Americanism is presently at a peak and is likely to abate, especially if globalisation takes on new, more nuanced characteristics.

11.2 Sources of variation

Various currents of political and social change can be expected to interact with the economic variables that have until now shaped globalisation in determining likely trends. Some will continue to be underlying drivers, while others may exert an inhibiting effect on current trends, possibly leading to reversal. It is also important to recognise uncertainties.

Drivers

Bearing in mind the ideas set out in part I, it is worth speculating on how some of the key drivers identified will evolve.

- Multilateral trade negotiations may have run out of steam, but internal liberalisation in emerging markets can be expected to continue and, moreover, to have marked effects on the trends in markets. There will be both risks and opportunities for the EU from these developments.
- Further advances in information and communications technology (ICT) and perhaps more importantly, in the interplay between technology and regulation, will be a critical driver, especially in enabling individual functions to be outsourced and in opening up markets for services.
- Market opportunities are shifting to reflect the new global distribution of prosperity.
- An internationalisation of savings and investment decisions is underway, such that countries will come under more intensive scrutiny from investors and savers.
- Societal changes are prompting further reassessments of welfare states in ways that can be expected to bear on the capacity to respond to globalisation.

Inhibitors

Frieden (2007) argues that the first era of globalisation collapsed above all because "there was no effective political and policy response to changing economic and social conditions", with social orders facing new demands that were not satisfied. Possible triggers for a similar reaction today include

- reform fatigue;
- anti-immigrant sentiment, including resentment of highly skilled professionals competing for what have hitherto been jobs reserved for indigenous workers;
- even a potential backlash from Euro-scepticism; this could be described as the 'José Bové' phenomenon or could be characterised by the emergence of a polarised ideological choice between radical right solutions and populism on the left (witness the 2007 French presidential election?); and
- at the political level, an additional source of opposition to globalisation is security concerns, most obviously post-9/11.

All of these factors point to the challenge of dealing with the concern of those who lose or perceive themselves as losing.

Switching points

Any base scenario relies on there being stability and predictability in underlying relationships, but there can plainly be developments that alter such relationships, causing reassessments. Possible interruptions could come from

- a pandemic of some sort (today's candidate being avian flu, while yesterday's was SARS and the previous day's was AIDS – the key message being that there is always a risk);
- much-increased terrorist activity or an upsurge of tensions that could deteriorate into armed conflicts;
- concerns about economic or physical security, whether from threats to ICT security or from terrorism, that lead governments to close the doors and re-impose harsher restrictions on movement;
- a backlash against outsourcing, especially if it reaches deeper into white-collar jobs;
- financial instability as a source of extensive disruption;
- a rapid acceleration of climate change that undermines established productive structures;
- effects of growing energy demand as the world's two most populous nations continue to expand, restoring the link between energy demand and global GDP growth that had arguably been broken after the oil crises of the 1970s; and
- access to water, which can be viewed similarly.

Even within the base scenario, factors with the potential to cause change include

- terrorism proving to have a disruptive impact on global connections;
- the way in which the next stages of China's and India's integration into the world economy proceed. Interdependencies will be created, but there may also be attempts by these new competitors to enter previously protected markets in the EU and the US;
- oil price changes and the success of efforts to diversify to new sources of supply on the one hand, and to reduce demand on the other; and
- the potential impact of new entrants to the EU, notably the most populous (Turkey and Ukraine).

Possible positive 'surprises' could come from

- breakthroughs in relevant technologies, such as energy;
- price mechanisms ensuring better use of scarce primary materials;
- a more far-reaching and consensual multilateral trade deal;
- an acceleration in incremental improvements in energy saving;
- health advances that lead to more productive older workers; and
- the abatement of geopolitical tensions.

11.3 The most likely evolution

At the heart of any scenario is the question of inevitability. Shell has long espoused a contrast between a 'TINA' (there is no alternative) approach and what might be labelled the 'ATTAC'[74] approach of curbing market power in favour of community, environmental and social objectives. In its latest scenario exercise, however, Shell notes that today populations expect more of their states in providing security, as a result of which there is now a three-way interaction, and not just a form of efficiency–equity trade-off. Moreover, none will be optimal. The CIA similarly puts forward a 'Davos world' scenario along with various security-related ones in which non-economic imperatives become more important. In this exercise, the favourable Davos world scenario is one of robust economic growth and a continuation of many of the globalisation trends. Although the sudden reversal of 1914 serves as a warning that a continuation of globalisation cannot be taken for granted, it is hard not to make an extension of these trends a central projection of a scenario up to 2020. Such a scenario would have a number of elements to it:

- trade volumes continuing to grow as a share of GDP (as in Figure 11.1 above);
- further increases in the flows of FDI, again relative to income;
- more jobs being associated in some way with international exchanges; and
- deeper embedding through the various social interactions, increasing Internet access and further developments in ICT that allow greater volumes of digital flows at falling costs.

What can be drawn from this is that for a base scenario, a continuation of the trends is probable, but with a possible new twist. In a recent contribution, Baldwin (2006) offers some important and original insights into the evolving economics of globalisation and the implications of emerging trends for EU policy. He argues that there have been two economic processes behind globalisation, which he labels "unbundlings". The first enabled separation between the location in which goods (initially) and services (subsequently) were produced and their place of consumption, giving rise to vastly increased international trade. He notes, however, that the finest level of competition was firms and that, because firms tended to cluster in particular locations, the skilled labour that those firms used most intensively tended to prosper or not, along with the sectors to which the firms belonged.

A second unbundling has arisen much more recently, driven by rapidly falling communication and coordination costs. According to Baldwin, this results in competition among workers to carry out particular tasks, enabling factories and offices to be "unpacked" and implying that certain conventional assumptions about the consequences of globalisation have to be revisited. In particular, the widely accepted notion that it is skilled workers in the richer countries who benefit while the unskilled lose may cease to be valid. If correct, this would have profound implications for a policy approach that emphasises skills and knowledge intensity as the way forward for the EU.

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[74] ATTAC refers to the non-governmental organisation, Association pour la Taxation des Transactions financières pour l'Aide aux Citoyennes et citoyens.

Nevertheless, there is no certainty that globalisation will either continue apace or remain – at least in some eyes – a predominantly American-led and neo-liberal phenomenon. For the CIA, one of the likely changes is that globalisation will acquire more of an 'Asian face', as the countries currently expanding at high rates evolve from low-cost competitors in mass markets to become major consumer markets, while also enhancing their contributions to innovation and the development of new technologies. These trends would be expected to translate into a reconfiguration of economic roles, but also to lead to shifts in the balance of political power, including the shaping of rules. China, India and other emerging countries can be expected to increase their influence not only in economic terms, but also in global governance. The potential for a backlash cannot be ignored.

Using Baldwin's notion of unbundling, it is evident that globalisation is entering a phase wherein there is a difference in the manner in which markets are opening. This can be characterised as a fragmentation of the production process, involving opportunities driven by ICT to 'outsource' and 'offshore'. An OECD (2006a) Issues Paper has described this trend as follows: "[T]he globalisation of value chains has resulted in a greater use of intermediates by companies, with a decline in the 'production depth'." Still, certain aspects of globalisation are likely to prove irreversible and thus become axiomatic in any scenario. In particular, the interconnectedness that has arisen because of communication advances of different sorts will be a core feature of globalisation that will have not just economic impacts, but also (as the CIA puts it) shake up the status quo and lead to political and cultural convulsions. It is also salient that even with some moderation of growth rates in the most dynamic economies, global per-capita GDP could be some 50% higher in 2020 than it was in 2000.

Table 11.1 provides a summary of the CIA's exploration of factors that will bear on the future direction of global relations. The table offers a useful contrast between those developments that can be regarded as reasonably probable and those for which much greater uncertainty can be identified. For example, there are bound to be reservations about the ability of European countries to recast their welfare states, especially as they are faced with the problems of population ageing.

Drawing on these and other interpretations, a number of points arise.

- Contrary to the expectations of some business gurus, according to Shell the state will not wither away, but will shift from a nation-state conception to a market-state one with more emphasis on enabling than on providing (see also Mandelson, 2007).
- Technological progress will depend on cooperation and on regulation of intellectual property rights, while migration is expected to accelerate but will be increasingly subject to political backlashes. Nationalism could impose a brake on both.
- Energy is widely seen as both a constraint and a challenge. Three decades of de-linking between GDP growth and energy consumption, with the latter no longer directly correlated with the former as in the past, have been overtaken by the growing demand from China and India, which re-links energy demand to GDP.

Table 11.1 The 2020 global landscape, according to the CIA

Relative certainties	**Key uncertainties**
Globalisation largely irreversible and likely to become less Westernised	Whether globalisation will pull in lagging economies; the degree to which Asian countries set new rules of the game
World economy substantially larger	Extent of gaps between the 'haves' and 'have nots'; backsliding by fragile democracies; managing or containing financial crises
Increasing number of global firms facilitate the spread of new technologies	Extent to which connectivity challenges governments
Rise of Asia and the advent of possible new economic middle-weights	Whether the rise of China/India occurs smoothly
Ageing populations in established powers	Ability of the EU and Japan to adapt workforces, welfare systems and integrate migrant populations; whether the EU becomes a superpower
Energy supplies 'in the ground' sufficient to meet global demand	Political instability in producer countries; supply disruptions
Growing power of non-state actors	Willingness and ability of states and international institutions to accommodate these actors
Political Islam remains a potent force	Impact of religiosity on the unity of states and the potential for conflict; the growth of jihadist ideology
Improved weapons-of-mass- destruction capabilities of some states	More or fewer nuclear powers; the ability of terrorists to acquire biological, chemical, radiological or nuclear weapons
Arc of instability spanning the Middle East, Asia and Africa	Precipitating events leading to the overthrow of regimes
Unlikelihood of great-power conflict escalating into total war	Ability to manage flashpoints and competition for resources
Environmental and ethical issues even more to the fore	Extent to which new technologies create or resolve ethical dilemmas
US will remain the single most powerful actor economically, technologically and militarily	Whether other countries will more openly challenge Washington; whether the US loses its science & technology edge

Source: National Intelligence Council (2004).

A key point is that some tasks lend themselves to unbundling to a much greater degree than others, because they do not all respond similarly to lower costs. This tendency has a number of immediate ramifications:

- It makes it much less predictable who will win or lose from globalisation.
- Change may grow more sudden. For example, the solution to a computer security problem may overnight facilitate, say, the offshoring of an invoicing function. What Baldwin (2006) calls the "tipping point" may occur when a

number of technological advances come together to alter relative costs so substantially that companies have to adapt swiftly.

- The effects will often be at the level of the individual, so that responses also need to be at that level. By the same token, a response at the level of the sector may prove to be seriously misconceived: as Baldwin puts it, "policies designed to help sectors may miss globalisation's losers entirely". Central to his line of argument is the element of coordination costs.
- Routine, but not necessarily low-technology jobs have become more mobile. The sorts of tasks that can most easily be offshored are (van Welsum & Reif, 2006a and 2006b) those that are
  - IT intensive,
  - readily transmittable through IT,
  - codifiable, and
  - do not require face-to-face interaction.

11.4 The risks and opportunities

Looking forward, the influences on the evolution of globalisation will lead to a range of risks and opportunities. Globally, it is to be anticipated that there will be significant power shifts (sectorally as well as geographically) that in turn will affect the range of risks and opportunities emanating from globalisation. Many of the opportunities follow from the well-established analysis of the effects of enhanced international specialisation, while risks arise from failures to anticipate or adjust. At the same time, new vulnerabilities have to be foreseen and accommodated.

One of the most likely developments over the coming years is that a higher proportion of workers will be affected positively or negatively by globalisation, instead of the old distinction between the traded and non-traded sectors. Labour turnover will tend to be higher with the corollary that income and employment security cannot be as high as in the past. Overall, this is perceived as a threat (especially in the EU), but can just as readily be viewed as an opportunity. In the 'second unbundling' approach, a different profile of worker is on the front line and the risks are intensified for workers with poorly transferable skills. Additional features are that

- the balance between security and openness is critical,
- shifts in governance are essential, and
- 'Asianisation' implies faster adjustment in the EU.

What facilitates adaptation?

Globalisation is, as has been stressed in many parts of this report, essentially always about adjustment. As Baldwin (2006) puts it, "gains from trade almost always come with pains-from-trade", which make it incumbent on governments to facilitate adjustment through a combination of labour market and supply-side policies on the one hand, and social protection on the other. Unpredictability may be the most awkward facet of 'new' globalisation to deal with. Analytical skills that are not currently traded may become subject to new competition. The premium may be on knowing how to learn (which is one step back from lifelong learning) rather than learning alone – fostering lifetime employability rather than lifetime employment.

Adjustment will also be shaped by the degree to which governments are prepared to cooperate, both within the EU and in wider fora. Here, Shell sees a number of options. If there is little trust, institutional discontinuities will make further integration more difficult and could lead to regulatory competition, including giving oxygen to the famous race to the bottom. Equally, nationalist sentiment could be expected to lead to regulatory fragmentation and the dominance of national regulatory regimes in what could become a zero- or negative-sum game. It can therefore be anticipated that the costs of adjustment will depend on the following factors:

- political and administrative structures that are geared towards success and reward it;
- high levels of educational attainment;
- open economies reinforced by competition;
- a capacity to 'work smart rather than work hard';
- an emphasis on taking individual responsibility as well as having access;
- but also some coercion from the state to make sure things happen; and
- the revisiting of mechanisms of governance for the contemporary challenges.

As an example of the dilemmas, Artus, Cohen & Pisani-Ferry (2006) have voiced their concerns about the trends visible in France, noting the 'mainstreaming' of protectionist rhetoric (admittedly in the context of the 2007 election campaign). While their analysis is confined to France, many of the points they raise may have resonance for other member states:

- First, they stress that the underlying trends cannot be reversed, notably the desire for greater well-being in China, India and other emerging economies.
- Second, they assert that "all Maginot lines suffer from the same defect: by offering the illusion of safety, they delay an effective response".
- Third, they emphasise that France's economic woes cannot really be blamed on import competition, misguided euro-area economic policies or high labour costs, but on "the narrowness of our export supply-base: too few French companies are able to compete on quantity or quality, and they have been too timid in reaching out to the new areas of growth in the world".
- They also implicitly criticise the French propensity to pander to the short-term victims of globalisation, while recognising the importance of helping the individual to deal with the consequences through retraining and income support.

12. OVERVIEW, POLICY RESPONSES AND POLICY PROCESSES

A key argument in the present report and indeed in the vast majority of studies and reports consulted is that globalisation is a major factor influencing 'creative destruction', to use the renowned terminology of Joseph Schumpeter. The evidence suggests that over the long term and across the economy as a whole, globalisation is favourable to employment. What is evident, however, is that the benefits of globalisation cannot just be assumed to happen and, with an increased pace of change, it is inevitable that there will be losers as well as winners, with marked social consequences. Yet this does not mean that the European social model is doomed and that only free market approaches will prosper. Indeed, the success of the smaller open economies testifies to the scope for prospering, even where the welfare state is extensive and consumes a high proportion of GDP (as is the case in the Nordic countries). It also has to be stressed that much of the increase in exposure to international competition confronting EU member states is in fact the result of European economic integration.

An important conclusion is therefore that costly welfare states cannot convincingly be blamed for slow growth, but that economic problems commonly associated with globalisation are more often the result of failures to invest sufficiently in growth-promoting policies. In this vein, Aiginger (2005) notes that the four European countries that have enjoyed the greatest success (Denmark, Finland, the Netherlands and Sweden) have all invested heavily in education, the diffusion of new technologies and research. It is also striking that these countries have succeeded in attaining progressive social aims, including promoting gender equality, limiting poverty and inequality, fostering high rates of (family-friendly) employment and investing in children. At the same time, indicators of openness show that all four are among the most open economies in the world and can thus be adjudged to have fully embraced globalisation.

A strong conclusion is that many of the fears surrounding globalisation are greatly exaggerated and even where justified they tend to rest on an incomplete analysis of the process. It follows that to view globalisation as an inexorable and threatening force is simply unwarranted. This message has to be repeatedly articulated and 'sold' to citizens. Nevertheless, it is plain that globalisation will be a bumpy ride and that it cannot be ignored as a major determinant of the well-being of Europeans, but also that adjustment to it is necessary. It calls for imaginative and well-conceived policy responses. The EU's Economic Policy Committee (2005) identifies a twin challenge for EU policy-makers:

- to communicate clearly that globalisation has tangible benefits and affords many opportunities to Europeans, and

- to formulate and deliver policies that deal with the concerns Europeans have about globalisation and equip the economy to adapt to change.

12.1 What is at issue?

Globalisation is not – indeed by far – the only factor influencing the socio-economic and cultural fabric and is often wrongly credited with or blamed for much that is happening in EU member states (and elsewhere). Longevity is increasing and the predictability of the life cycle is reducing for a large number of citizens. There are increasing returns on intellectual capital, that is, on investment in education and knowledge. Still, this emergence of the knowledge society entails an increase in apparent income disparities and – at least in some socio-economic contexts – a change in the patterns and strength of the inclusive forces in society.

12.1.1 Opportunities and drawbacks

The issue of opportunities is too often overlooked and has to be approached from differing perspectives. Turnover in the labour market is critical. As noted in part II, evidence presented by the EPC (2005) shows that in only four member states (Denmark, Greece, Finland and Portugal) could more than 10% of job losses be explained by relocation and offshoring over the period 2002–05. Yet these countries have also been able to create jobs successfully, thereby keeping unemployment in check. Instead, it is in the area of adjustment of employment that some of the main policy issues arise. These concern, first, the speed with which workers are redeployed and second, the options that are open to such workers in terms of location and quality of jobs, retraining and other policy actions to underpin their employability.

To some extent, the EU economy is stuck with mass production, large firms, outdated technologies and rigid employment patterns that inhibit adjustment to the new international environment, so that in the absence of any reforms globalisation could present more of a threat than an opportunity. But it need not be so. The impact of rapid technological change and strong global competition on economic growth will depend on various factors such as the flexibility of production structures and the labour market. A more flexible economic environment combined with policies promoting the formation of high-quality human capital and R&D will allow EU economies to adjust quickly to the rapid change in the global economy, thereby reaping the benefits of globalisation. At the same time, reforms of the social protection systems aiming at supporting and reinserting into the labour market those affected negatively from these changes can promote a more equal spreading of the benefits of globalisation.

Many claims about the social impact of globalisation are bandied around, often on the flimsiest of evidence. Above all, there is no empirical support for the proposition that globalisation is leading to a race to the bottom in social policy. Spending on social protection has been remarkably stable as a proportion of GDP and, although many member states are engaging in extensive reform of their welfare systems, this is more because of a need to react to population ageing than to competition from the rest of the world. Similarly, progress on gender issues such as equality of pay has continued – if not as rapidly as some might hope.

Manifestly, an important aspect of globalisation is that the world's two most populous countries – China and India – have reintegrated into the world economy after decades of comparative isolation. Together with the reintegration of former communist countries in Europe, this has meant that the supply of labour available at the global level has greatly expanded. Debunking is nonetheless needed on economic threats. For example, the idea that India's production of engineers and China's emerging R&D focus will swamp the EU has, at worst, only limited credibility. While there are legitimate fears about the propensity of some emerging economies to adopt mercantilist policies that result in growing trade surpluses and an apparent exodus of jobs from developed countries, an important lesson from European integration is that new member states boost demand. In other words, the huge increase in the global labour pool is also a huge increase in the number of global consumers. Moreover, China cannot continue indefinitely to rely on export growth, if only for straightforward arithmetic reasons; it must then turn to domestic demand, especially as before long China will have to provide for its own ageing population, implying some unwinding of its foreign reserves. Already, China is engaged in a profound debate on how to instil better labour standards and how to build its own forms of social protection.

A distinctive feature of the present wave of globalisation is the intensity of (mostly two-way) capital flows, including foreign direct investment (FDI). Although, for most OECD countries, FDI still accounts for a relatively small proportion of overall investment, it is a key source of capital and know-how for a number of developing countries, and also has been significant for some EU member states such as Ireland. Asian investment in the richer countries also deserves to be highlighted. Nor is offshoring certain to be an inexorable or one-way trend. Some companies have brought call-centre jobs back from India to the UK. The relationship between wage relativities and the benefits of offshoring is complex (de la Dehesa, 2007) and unpredictable as technology evolves.

While the overall impact of globalisation offers the potential for increased prosperity and often the reality of it, it would be disingenuous to claim that there are not drawbacks. Certainly, there have been changes that run counter to the tenets of some social models, especially the overall observation that inequality has tended to increase (as discussed below). Still, the trends and the possible causalities involved need to be examined with considerable care.

12.1.2 Growing inequality?

Over the last few decades, and thus the period associated with globalisation, there has been some evidence that inequality has increased in EU member states, although the trends have been far from stable. The period between the mid-1980s and the mid-1990s was characterised by inequality increases. At the same time, this period coincided with the most intensive economic and social transformations of the countries of Central and Eastern Europe that have recently acceded to the EU. The period between the mid-1990s and 2000 showed a mixed picture again. In some traditionally low inequality (Nordic) countries a large increase in the Gini coefficient was observed, signalling greater inequality, but for the rest of the countries either no change or a very minor change was visible. Analytic work (see chapter 8) suggests that the relationship between the trend of openness and inequality is inconclusive. Most of the spells in which inequality grew were periods of no change in openness, showing that

globalisation is not a necessary precondition for an increase in inequalities. Nor did a significant gain in openness always lead to a change in inequalities as measured by the change in Gini coefficients (out of the 18 such spells of openness increase only 4 showed a significant rise in inequality). There were some spells when increased openness coincided with increased inequality, but this was not a consistent result.

There has been no evident overall tendency towards an increase in interregional income inequalities in Europe in the past two decades. Overall, inequality between regions has stagnated or decreased, with a marked fall of between-country inequalities and a rise of within-country regional disparities.

It is also demonstrable that skill-biased technological development explains more of the variance in inequality changes than the rival trade theories. Even so, an important part of the observed phenomena remains unexplained by any of these theories. Among the alternative explanations, a plausible one is that institutional settings (actual patterns of welfare state activities) play an important role in shaping inequalities. It is not the welfare state in general, but the type and efficiency of the welfare state that matters, and it is conceivable that some welfare states will be more vulnerable than others will to the tides of globalisation. Equally, the evidence suggests that the most efficient and adaptable social and economic policy regimes can readily accommodate globalisation.

12.2 Effects on public finances and the pressures on social protection systems

It can be argued that the many forms of globalisation, together with trends in demography, have gradually sucked Europe into a spiral of low growth and high public expenditure. A driving force behind this spiral is the difficulty of reforming social policy in Europe in a way that stimulates growth while preserving social cohesion. Low growth rates and high unemployment rates put a heavy burden on public finances, curbing the scope for fiscal policy to be used to support the growth process. It is evident that implementing policies promoting growth is a necessary condition for being able to finance policies aimed at improving social cohesion. As globalisation accelerates further, both costs and benefits will tend to rise, with costs such as higher unemployment and increased inequality concentrated in the short run while benefits in the form of lower prices, higher productivity and income will only occur later on. Hence, the main challenge for Europe is to promote policies that maximise the benefits while reducing the costs of globalisation and optimising the sequencing of policy interventions. The following key messages arise:

- Weakening the welfare state and thereby undermining social cohesion is not a prerequisite for reaping the benefits of globalisation in terms of economic growth. Moreover, the introduction of measures that may threaten social cohesion even in the short run, such as reducing employment protection, is only one possible way of arriving at a more flexible economic environment. An alternative 'high route' would include more investment in training and product market liberalisation.
- In contrast, a strong welfare state is a prerequisite for coping with the social cost of globalisation. In addition, a strong welfare state may stimulate growth by diminishing the level of uncertainty related to the process of globalisation.

- Nevertheless, the majority of social systems in Europe are under significant strain owing to the social impact of globalisation combined with the effects of factors unrelated to the globalisation process, such as the low efficiency of welfare systems and population ageing.
- Therefore, it is conceivable that at some point welfare systems may not be able to safeguard social cohesion in Europe. Clearly, this outcome is not politically acceptable in Europe.
- To avoid a damaging breakdown in social cohesion it is urgent to reform social systems in a timely yet well-sequenced way that combines social protection with endowing individuals with the necessary abilities to manage steadily increasing risks.
- Reforming the social system may entail short-run costs in order to achieve medium-term benefits. Thus, policy-makers may be reluctant to introduce reforms if the horizon for reaping the benefits exceeds the policy-makers' expected terms in office.
- Some form of central EU policy or policy coordination at the EU level may hence be required for two reasons. First, intensified international competition, desired redistribution and local decision-making form an inconsistent trinity. Second, applying reforms decided at the EU level can reduce (although not in all circumstances) the political cost of these reforms for national policy-makers.
- Still, preserving national flexibility is important since the needs and characteristics of individual economies and societies are best known at the national level. Future EU policies need to be flexible enough to meet needs at the national level.

A sense of perspective moreover has to be maintained in discussing globalisation, even if the trend on all the relevant indicators of internationalisation tends to be upwards. Not all jobs are subject to international competition, even indirectly, and this will remain the case. On the contrary, a substantial share of jobs in personal services (both publicly and privately produced), local production of goods, construction and public administration are largely immune to external competition. Plainly, overall prosperity and thus the demand for non-traded goods is correlated with competitiveness, but EU 'domestic' demand will always be a significant influence. New technologies can be expected to increase the proportion of currently non-traded jobs (notably in services) that can be traded, but they will still constitute a low proportion. Some such jobs will face competition from immigrants, but even this phenomenon will be subject to controls imposed on the number and characteristics of immigrants. In any case, migrants boost domestic demand in host countries.

12.3 Policy responses

Countries can, and do, adjust to globalisation and there is no great mystery about what is needed. It can be argued that the core of a social policy response is in the following main policy domains: education and training, immigration policy, labour market reforms and the reshaping of social protection. These policy domains are inevitably interconnected and these connections have to be stressed, while also being linked to economic developments. Responding to globalisation needs a concerted approach, not

a Balkanised one. In this regard, the breadth of the EU's post-2005 Lisbon and sustainable development approaches has to be commended, with the former now becoming a much broader economic governance framework. The trouble is that delivery has lagged behind.

Policy needs to be integrated, not least because change is not confined to the economic sphere, where the large manufacturing operations based on a relatively homogeneous workforce employed in assembly-line work are becoming less and less significant. The social sphere is changing too. People no longer live mainly in nuclear families, having children at a fairly predictable age and facing only transient problems with employment that are easily dealt with through unemployment insurance. In a society where a bad mix of skills can lead to lifelong poverty, the premium on good education and lifelong learning opportunities is increasing.

12.3.1 Flexicurity and beyond in the reform of social protection

A common feature of the European social models is that it is considered a key task for public policy to provide a certain degree of collective protection of the citizens against the risks that are not 'insurable' in the market. These aspects of public policy could perhaps be called 'collective risk management', but are increasingly analysed in terms of 'social risk management'. This concept of social risk management is closely related to the notion of social protection as a productive factor and a key argument is that the more effectively a society lets the individual manage his or her risks, the higher the welfare gains for all. The implication for policy is that the welfare of individuals is enhanced by the right mix of market and state-based risk-management mechanisms that go beyond the narrowly defined social protection that dominated policy-making for most of the post-war era. In the view of some observers, the era of classical social policy has in fact come to an end and is being supplanted by a policy approach aimed at providing appropriate tools to enable the citizen to face up to the complexities of a life cycle lasting almost a century. The state, in other words, is altering its role from that of 'provider' to that of 'enabler'.

From this perspective, we argue that in the 21st century, we cannot collectively protect the individual against all risks nor offer comprehensive social security, but that as a minimum we must offer a policy framework within which the individual can plan the life cycle and benefit from a collective management of uninsurable risks. We see no contradiction between adopting such a basic principle for social policy and pursuing the fundamental objectives of the Lisbon agenda. Yet, the principles of empowerment and social risk management would seem to us to go far beyond the labour market emphasis that is at the heart of today's conception of flexicurity.

Reinventing the welfare state requires much more than and indeed something beyond just combining flexibility and security. The security element of flexicurity tends to be portrayed as an assurance to the worker that his or her income will be protected in return for agreeing to more flexibility in the work environment, with the focus on protection of the worker rather than the job. This shift appears to work well in some settings, but the degree to which the approach is transferable is open to question. It also tends to leave out of the equation the protection of those more distant from the labour market either because of social exclusion or because of their stage in the life cycle.

Hence, further thinking about the nature of flexicurity is needed, perhaps restoring solidarity more to the equation than is sometimes the case when flexicurity is (and is certainly perceived to be) portrayed almost exclusively as a labour-market policy concept. At the same time, it is also important to recognise the salience of the many transitions in the labour market, as well as to and from work. The relationship between work and non-work is becoming more complex (Policy Network, 2006), and its features include both passive and active aspects, rights and obligations, and incentives alongside benefits. Protection is needed, but of an appropriate kind.

Reform of social protection also has to exhibit sensitivity to new demands, a good example being migration. The empirical studies reported in chapter 7 show that migration has had little discernible impact on indigenous labour. Nonetheless, all the indications are that the extent of migration will increase and this will require a concerted policy response, from the perspectives of both labour supply and human capital. Skilled migrants can be a source not just of filling gaps in the labour market, but also of a competitiveness-enhancing increase in labour supply. As such, they constitute an element in the wider strategy to boost human capital. Social protection systems consequently need to evolve to ensure the better integration of immigrants. In parallel, there is a political challenge to be confronted to convince indigenous populations that immigrants should not be seen as competitors for scarce jobs and social benefits (and thus a threat), but as contributors.

12.3.2 The primary role of enhancing human capital

In a long-term perspective, investments in human capital should be expected to deliver a higher rate of growth as well as a higher degree of income equality and added labour market flexibility. This view is in line with notably the recent argumentation of Esping-Andersen (2006), in favour of shifting the emphasis in social and welfare policy towards childcare and education of the younger generations, a standpoint echoed by Giddens (2007). Returning to its role as a basic driver of socio-economic developments discussed in the introduction, a number of conclusions about human capital can be derived.

- The frequently discussed employment gap between the EU and the US seems to be largely an education gap: for given levels of human capital endowment, the rates of employment are not very different in the EU and the US, but the share of low-skilled labour in the total labour force is much higher in the EU than in the US.
- Differences in skill levels also stem from a strong age gradient in the EU countries. On average, the human capital endowment of the elderly in the EU is significantly lower than that of the younger generations, while in the US there is much less of a difference between the different cohorts in this respect.
- The strictness of employment regulation appears to be negatively associated with the endowment of human capital – high levels of employment regulation are mainly found in countries with a relatively low level of human capital.
- Income inequalities, even after transfers, also appear to be negatively associated with human capital endowment, with high levels of income inequality mostly found in countries with a relatively low level of human capital.

- OECD countries appear, nevertheless, to be split into two groups: corporatist and liberal, with the latter associated with higher degrees of income inequality and higher levels of employment protection than the remaining countries.

These correlations should not be interpreted as time-invariant causal relationships. The explanation may perhaps be found in the functioning of the political system and the civil society: a workforce with a low level of educational attainment may appear less capable of adjusting to rapid structural changes and of adapting to innovation and new technology. Social groups and countries with low levels of educational attainment may therefore press more strongly for protection and offer more resistance to change than groups and countries with higher levels of human capital endowment.

12.4 The policy process

In the last few years, the EU has progressively put in place a system for economic governance that can be seen in part as a response to different facets of globalisation. From a governance perspective, one of the most contentious issues was (and remains) the ability of the European social model and the policies that lie behind it to provide significant 'added value' to national policies. The sustainable development strategy highlights social and environmental dimensions, while also acknowledging the responsibilities of the EU towards developing countries. The Lisbon partnership for growth and jobs lays considerable stress on the competitive dimension, and can be regarded as setting the agenda for reforms consistent with intensifying competition, while the different forms of the open method of coordination applied to social policy serve to keep social cohesion as a policy objective prominent in policy thinking.

Two concepts are central to the political and academic discourse: the modernisation of the European social model and the synchronisation of employment, social and economic policy coordination processes. In these processes, a key orchestrating role is played by the European Council, while the methodological paradigm for social policy has become the open method of coordination. To achieve policy coherence, an important linkage is that between the economic and the social, captured in the expressions 'feeding-in' (the reform of social protection and social inclusion policies to advance Lisbon objectives) and 'feeding-out' (the effects of economic reforms in improving employment and other variables that help lead to greater social cohesion). Feeding-in can be seen as an extension of the notion of social protection as a productive factor that underpins many recent initiatives to modernise social protection systems. In parallel, the concept of 'active inclusion' that is a central component of the EU's social inclusion strategy can be seen as a means of enhancing the EU labour force, and thus as contributing to the competitiveness that the EU requires to confront globalisation. In a way, the feeding-in/feeding-out concepts amount to a refinement of social justice: contrary to the basic argument of John Rawls, the task of public policy is not to ensure social cohesion by paying off the poorest member of society but to provide the tools and endowments to teach him/her to fish!

Is the policy structure adequate? Clearly, one of the main shortcomings has been delivery rather than strategic aims, but the aims also have to be looked at afresh in constructing a social policy for the future. There is plainly unfinished business, not just around external dossiers such as the Doha round, but also in domestic reforms, for

example the links between competition policy and the propensity to innovate. Here the open method of coordination can help, but it needs to go beyond ritualised reporting and more intensive efforts are necessary to exploit the opportunities for policy learning, experimentation and innovation.

In the labour market, a nuanced approach to flexibility is needed so as to be capable of assisting those outside the reach of conventional policies. In particular, some differentiation of labour market policies according to the level of education of the various age groups as well as by gender is desirable. As the discussion in chapter 11 indicates, there is likely to be a spread of employment effects of globalisation into previously unaffected occupations. Consequently, what has to be confronted is the fundamental issue of empowering the individual and ensuring collective management of the risks that cannot be insured by the single person. It could be argued, perhaps, that we are here facing a subject that would be ideal as a governing issue for coordination at the level of the EU. But then the question of forms of coordination arises. Notably, there is an uncertainty about whether the open method of coordination goes far enough or has appropriate incentives (and sanctions).

More generally, there is an increasing need to consider how childcare, education, family policy, labour market policy, unemployment allowances, maternity and paternity allowances, lifelong learning, health and long-term care and retirement schemes can contribute to enhancing the empowerment of the individual during the life cycle while ensuring an efficient management of the uninsurable risks. Furthermore, it is not possible to draw strong distinctions between the social impacts of globalisation and those caused by other factors, especially the emergence of the knowledge society.

Thus, globalisation is only one argument for reinventing the welfare state and we see little or no support for arguments in favour of taking measures only to 'compensate' those who suffer most from globalisation. An underlying thesis about globalisation is that it must ultimately lead to the EU becoming more like the US in social terms. We argue instead that welfare systems respond to new paradigms and associated risks, not by cutting back, but by reconfiguring in ways consistent with values. It is these values that continue to be the heart of the European social model and not the levels of expenditure or the preservation of specific benefits or rules.

12.5 Recommendations

This section recapitulates the foregoing discussion and puts forward policy recommendations. As noted earlier, the fears about globalisation tend to be overstated and distorted by flawed analysis and political grandstanding. It is therefore important to stress the benefits and opportunities as well as being realistic about the risks. At the same time, the risks cannot be ignored and need to be soberly assessed if they are to result in well-conceived policy choices.

The process of globalisation, including its drivers and social consequences, is summarised and illustrated in Figure 12.1 at the end of the chapter. The main drivers (enablers) are on the left-hand side, various aspects of the globalisation process are in the middle part and the (potential) social consequences and the policy recommendations in this report are on the right-hand side.

Globalisation reinforces tendencies to diminish 'local solidarity', to pit one welfare system against another and to expose the individual to a higher degree of unpredictability and risk. Yet these processes are not inexorable, especially if a coherent, EU-wide response is put in place. Much can be achieved by using the tools and methodology of the open method of coordination to enable member states to learn from one another and to improve their own policy performance, but it is also crucial for the social dimension of policy to be fully incorporated in wider policy processes, such as the partnership for growth and jobs.

Responding to globalisation is only one rationale for reinventing the welfare state and would miss a trick if it meant no more than compensating those who suffer most from more intense international competition. Policy mechanisms and institutions have to be adapted to the changing economic environment, recognising that ensuing social effects are not always directly attributable to globalisation, but result from the reactions of employment and wage formation.

As previously mentioned, the core of a social policy response is in the following main policy domains: education and training, immigration policy, labour market reforms and the reshaping of social protection. This list implies that policy needs to go beyond the largely labour market focus of much of the flexicurity agenda. As the discussion in the 2007 *Joint Employment Report* (Council of the European Union, 2007a) shows, flexicurity is seen as being about activating workers by providing pathways into employment, lifelong learning and the reform of labour laws. Social protection reform is on the list, but still with a bias towards the labour market, such that there is a risk of neglecting the social impact on the economically inactive or those segments of the population that do not fit into neat labour market categories, including immigrants. While many of the transitions induced by globalisation are within the labour market, allowance has to be made for transitions to and from the world of work. Although the scope of flexicurity as most recently defined extends to all transitions, the key will be whether it does so in practice. Social justice, as articulated by Anthony Giddens and his colleagues in the Policy Network, implies more than jobs.

Thus, the combination of flexibility and security should be brought about by a rethinking and reshaping of social protection, while having sufficient regard to solidarity. New ways should be found to manage social and individual risks so as to stimulate adaptation to the new patterns of social change.

With regard to education, training and skills, these can and should be enhanced by due attention to the level of education of vulnerable target groups. It is especially important to extend adult training and learning beyond those who already have a high level of educational attainment, particularly low-skilled workers and those most distant from the labour market.

Labour market adaptability should be enhanced, but within a context of solidarity and a framework addressing the individual endowments of workers.

In relation to migration, there is an evident need for new, more comprehensive policies to promote the social integration of different types of migrants into the economy and society of the host country. Hence, an active approach to the inclusion of immigrants should be part of solidarity as well as labour market integration. Moreover, national migration policies are bound to have externalities for other member states, and thus establishing common EU principles and approaches is a pressing matter.

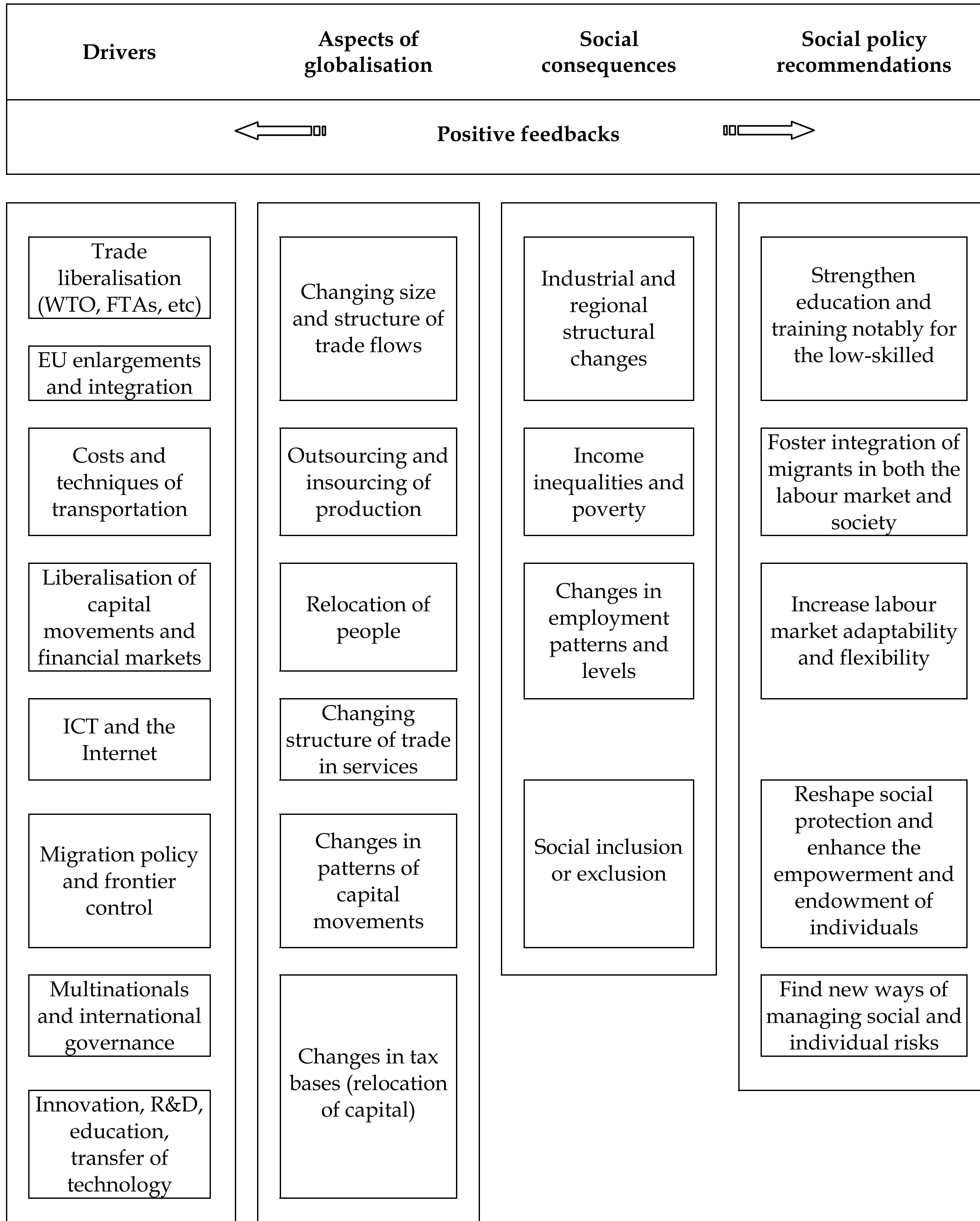
Aiginger (2005) presents a table in which he contrasts the attributes of the 'old' and 'reformed' models of the welfare state in Europe. Although his focus is on the "ability to create welfare" (his definition of competitiveness), his table can also be interpreted to address some of the issues posed by globalisation. In Table 12.1, a similar exercise is presented, drawing partly on Aiginger's insights, but bringing in additional elements. Manifestly, no country exhibits all the attributes in the right-hand column or none of those in the left-hand one, but some EU member states can be characterised as being more 'column one' than 'column two' and vice versa.

Table 12.1 Synthesis of the changing focus of social policies in response to globalisation

Outdated or increasingly less effective approaches	**Approaches consistent with benefiting from globalisation**
The different components of flexicurity	
Strong protection of existing jobs	Support for the individual to redeploy
Passive income support for the unemployed	Active labour market policies
Easy access to early retirement	Encouragement of older workers
Rights to a range of social services and benefits	Conditions for eligibility
Protections linked to employment	New interpretations of social justice
The economic activity model	
Male, full-time breadwinner	Gender mix with flexible working hours
Industrial policy that promotes 'champions'	Small and medium-sized enterprises and new sectors
Manufacturing as a core activity	A knowledge economy
Regulated labour and product markets	'Better' regulation; flexibility in managing companies
Stability	Growth
Physical capital	Human capital and research
Marginalisation of migrant workers	Economic and social integration of migrants

The challenge facing welfare reform is not about defending or opposing levels of social expenditure or casting doubt on specific benefits or rules. Successful welfare states respond to new paradigms and associated risks, not by cutting back, but by reconfiguring in ways consistent with values such as those espoused by the European social model. Our fond hope is that the discourse on globalisation can be altered to reflect this analysis.

Figure 12.1 Schematic overview of the process of globalisation



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