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Notes on Financial Transformation and Social Citizenship in the EU

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Summary

1. The transformation of financial relations in the EU has been accelerated by monetary union.
2. The transformation has serious implications for both industrial relations and social protection.
3. The current social policies of the EU are too weak to address these new pressures on European social models.
4. The agenda which is being set for the EU continues to give priority to “market-making” over “market-correcting” integration measures.
5. The problem of legitimacy which arises is fundamental to the extent that it takes the form of a challenge to member state participation in European construction.

Notes on Financial Transformation and Social Citizenship in the EU

1. The transformation of financial relations in the EU has been accelerated by monetary union.

The transformation which is taking place can be viewed as a move from “insider” to “outsider” finance. Salient features include:

- the dissolution of established patterns of ownership where concentrated equity holdings were the support of dense relations of reciprocity among enterprises;
- rapid growth of organised equity markets and of the numbers of companies listed on them;
- a move towards less use of bank loans and more use of marketable debt instruments in corporate finance;
- a much more prominent role for collective fund managers in the allocation of capital resources.

Recently produced ECB data (ECB, 2001) put figures to some of these developments. Bank credit continued in 1999 to supply more than half of the net flow of external finance to non-financial Eurozone corporations (329.3 bn euros out of 625.0 bn) and this growth even accelerated in 2000. The corresponding figure for the US (also in euros) is 149.7 bn in a total of 767.0 bn. However, there was at the same time an explosive growth in the issuance of marketable debt by Eurozone companies - up from 18.1 bn in 1998 to 37.3 bn in 1999. This growth, stimulated by monetary union, was even more rapid in 2000 when a further 70 bn was added to totals outstanding by September.

In equity finance, the most notable feature is not the total finance raised, which fell in 1999, but the rapid switch from unquoted to quoted shares. This corresponds to a relative decline in the importance of highly concentrated, “insider”, ownership to a more market-based treatment of equity. While net issuance of the former fell from 88.1 bn in 1998 to 57.9 bn in 1999, the latter rose from 85.8 to 89.3 bn. Since, from the shareholder point of view, equity is seen not only as a means of financing industry, but as a way of controlling and reallocating corporate resources, the gross figures may be more relevant; the finance of one corporation with resources extracted from another is surely a key element in the shareholder paradigm. The gross capital raised by the issue of quoted shares by Eurozone corporations increased threefold between 1995 and 1999 - from 84.1 bn to 240.8 bn euros.

The question arises of how current declines in equity prices will affect patterns of corporate finance in Europe. In the short run it is clearly possible, even probable, that there will be a turn back to the banks and to reliance on the deep pockets of big “insider” shareholders. For at least two reasons, however, the equity crash is unlikely to alter the trend to “outsider”, market-based, finance. Firstly, this trend is not an arbitrary development but one inscribed in the whole process of financial globalisation under US hegemony (it is interesting that, so far, the US slowdown has had no impact on the dollar/euro exchange rate). Of course, as the lessons of the bubble are learned, there may be some changes to financing patterns in the US (where the use of bank credit by corporations has even been rising a little) but the convergence of European practice on the US model is hardly in doubt (Grahl, 2001). Secondly, the financial

transformation is accompanied by a host of institutional reforms - at both EU and member state level - which both assume, and work to guarantee, its permanence.

These changes are necessary for the construction of an integrated capital market in the EU and thus for the efficient functioning of the economic and monetary union. However, they are not taking place according to a clear European strategy, but under the pressure of hegemonic dollar finance. Financial transformation is a unitary process, but in political debate it is represented only in a fragmentary way.

2. The transformation has serious implications for both industrial relations and social protection.

The implications for industrial relations flow from the impact of “outsider” finance on corporate governance. “Stakeholder” concepts of governance are ruined by the reassertion of proprietorial control and the “shareholder value” agenda. This does not mean that the coalitions of interests assembled in European enterprises will be suddenly dismantled. But the coalitions are likely to become narrower and increasingly aligned on shareholder objectives.

One example may be a loss of influence for localities, as new patterns of ownership weaken the links between enterprises and the specific areas in which they have been embedded. Herman Boemer (2000) explores the possible implications for the Ruhr area of the takeover of Mannesmann. “....the control-centre of the telecommunication sector of Mannesmann went to England.....The example of Thyssen-Krupp-Hoesch shows very clearly that the loss of majorities at the end of the day leads to the loss of control and functions by the locations where the former headquarters were sited. This, in turn, means the loss of jobs and future activities.”

The most direct consequence for employees is an increase in job insecurity. This follows from fundholder strategies which seek to substitute diversified portfolios for risk-spreading at the level of the corporation. There would seem to be also pressures towards more wage inequality: incentive systems attempt to reinforce shareholder priorities by rewarding managements and perhaps other core groups in function of profits and share prices. At the same time groups of employees without the ability to obstruct corporate performance may be pushed closer to the reservation wages established on external markets.

There is an obvious contradiction between value-based management (VBM) and the principle of codetermination. In fact the number of employees covered by codetermination procedures has been falling in Germany as a consequence of restructuring: disposals, outsourcing and downsizing have increased the proportion of employees in companies below the threshold (500 employees) at which worker representation on supervisory boards is legally required. Over half the private sector workforce is now *mitbestimmungsfrei*.

The German industrial relations system is very stable. Employers are not ready to abandon a model which has “given them substantial reward from organised labour’s collaboration with the productivity coalition at micro-level” (Upchurch, 2000). However, a certain erosion is detected in such phenomena as: falling membership and

weakening discipline in both labour unions and employers' organisations; the failure to transfer the system completely to the East; and doubts about German economic performance, as expressed in the *Standortdebatte*. The survey by Jacobi, Keller and Müller-Jentsch (1998), reversing an earlier, more optimistic, assessment, concludes:

There is little prospect that the post-war German industrial relations system will simply collapse or disintegrate, but its foundations are in some respects being eroded. The system seems to be undergoing a gradual but cumulative change of character; in the new century it is likely to be more decentralized, more fragmented, less legalized, less cohesive, and more internally differentiated. The virtuous circle of stable industrial relations institutions and economic success is no longer the obvious starting point for students of the German model. (p233).

Upchurch explicitly refers to the shareholder value movement as a factor in this process:

....evidence exists that German capital is seeking to integrate itself more into the internationalised world economy by seeking strategic alliances and joint ventures as well as by engaging more vigorously in take-overs (e.g. BMW and Rover). Key players such as Daimler-Benz (now merged with Chrysler) and Siemens have already abandoned features of the 'stakeholder' inheritance by converting to Anglo-Saxon accounting systems and trading on international stock exchanges. The adoption of a shareholder approach is accompanied by more aggressive performance management systems which in turn are likely to upset some of the more 'solidaristic' and equity values of the German organisational culture with a greater emphasis on supply-oriented labour market policy. (p88)

As for the implications of financial transformation in the sphere of social protection, it is clear that the move to fundholder capitalism is central to current projects for reform. The exception which proves the rule is France; since popular resistance has so far blocked direct pension reform, "wage-earners savings" are being used as an alternative channel from wage incomes into the organised capital markets. France is perhaps a key case in the social struggles released by the shareholder drive: on the one hand, collectivist principles are deeply embedded in the mechanisms of income formation, which tend to combine primary distribution and redistribution into a single, highly politicised, process (Friot, 2000); on the other hand, established social protection structures for private sector employees are currently subjected to an astonishing attack by the employers association, MEDEF, which is determined to impose its own social project (*Le Monde*, 3/4/01, supplement *Économie*). This strategic switch comes at the same time as a dramatic transformation of shareholding patterns, made possible by the rapid growth of foreign holdings in the largest French companies (Morin, 2000).

The recent pension reform in Germany may give some indication of the general balance of forces: the drastic move away from private provision which has taken place in Britain is simply not possible in the continental polities where there are so many "veto points" at which change can be blocked. Nevertheless, the German reforms

seem to aim at a certain, phased, reduction in public provision - with the aim of substituting the products of the fund-managers. Changes are to be phased in very slowly, and are in any case quite modest: net income replacement in the existing system falls from 70% to 68% and some state support - subsidies and tax breaks - is offered for contributions of up to 4% of income into private, capitalised, funds (*Le Monde*, 20/3/2001, supplement *Économie*). The direction of change, however, is significant. (This official figure of 68% is convincingly contested by Johannes Steffen (2000) who claims that the true figure, by 2030, will be 64.5% before the operation of the *Ausgleichsfaktor*, 60.5% after it. The *Ausgleichsfaktor* is intended to stabilise state pension contributions by cutting pensions in relation to increased life expectancy. Steffen describes the official figure as based on "*rechnerischen Tricks*" - the definition of net income has been altered by deducting the, voluntary, 4% of gross income which is destined for the fund managers.)

The rejection of the Takeover directive by the European Parliament, to a large extent because of German opposition, means that German policy developments should be specified quite carefully. Both the German tax reform of 2000 and the subsequent pension reform were clear moves towards a shareholder model of the US type: the first permitted the tax-free liquidation of cross-industry equity holdings so that equity could become primarily a marketable asset, rather than the support of close inter-firm alliances; the second will, as mentioned above, channel some 4% of workers gross earnings to pension funds and other fund-holders in return for private pensions. However, hostile takeovers, usually regarded as a key component of the shareholder model have been obstructed by Germany. The key issue was the ability of the targeted enterprise to take defensive action; the final text of the directive would have made such action conditional on the agreement of the target's shareholders - this would normally amount to ruling out the defensive measures as the only group who can be shown to gain almost invariably from a hostile acquisition are the shareholders of the target company. However, it should be remembered that even the US itself introduced some obstacles to takeovers after the excesses of the eighties. The reservations of the German political class seem to concern the procedures and modalities of the shareholder economy rather than its underlying logic. Agreed M&A activity is running at very high levels in Germany and these mergers seem to be increasingly influenced by capital market factors.

Although Britain is obviously an exceptional case, a recent study (Froud et al., 2000) gives some clear examples of the impact of VBM on workers. Labour shedding at BT exemplifies the possibility of a narrowing of coalitions of interest within the firm, as those workers who retained their posts tended to do well; because of buoyant product markets, the big supermarket chains were able to achieve high returns on capital employed without significant disadvantages for their workforces (although losers could obviously be found in the small retail businesses driven out by this growth); in the case of "quietly desperate" firms like GEC (today's Marconi) and Glaxo-Welcome, labour shedding was the essence of the shareholder agenda. "Given the decline of male, manufacturing employment and the expansion of employment in female, part-time and low-paid occupations, transitions from one job to another will now challenge most older male workers....The work on the British Household Panel Surveys at the University of Essex has suggested that, in general, those who are made redundant tend to enter a downward trajectory in terms of employability and earnings, regardless of

the stage in the economic cycle” (p793). Of course, this kind of restructuring can be driven by product market developments; it becomes much more general, however, when financial pressures are the source because in this latter case there are no “sheltered” sectors.

Benefits to shareholders in no way alleviate these social consequences, because only the wealthiest sections of British society own equity, whether directly or through pension funds. In spite of the negative assessment they make of these instances of value-driven restructuring, these writers by no means condemn the process as a whole:

While this paper challenges corporate finance’s general approval of restructuring, it does not aim to substitute generalised disapproval.....so much depends on context, especially the macro context in the broad sense which includes distribution of income as well as the organisation of production. (p795)

It is surely the macro context in this broad sense which would have to be addressed in any attempt to reconcile the financial transformation with the values underlying the European social models.

3. The current social policies of the EU are too weak to address these new pressures on European social models.

The “policy communities” organised around EU social policy continue to expand, but this is not decisive evidence that the structures of “social Europe” are an adequate response to the new pressures on national social models. If globalisation trends are interpreted primarily in terms of trade and FDI, it is possible to dismiss the dangers of competitive deregulation and of a “race to the bottom” in social policy, because only a few sectors are exposed to intense competition from imports and the same applies to the threat of industrial delocalisations. If these sectoral problems are serious enough, in aggregate, to have macroeconomic consequences, then it is always possible to alter macro-economic policy instruments. Thus a recent study of social Europe could suggest that the specific strengths of member state models (social partnership in Germany, the legitimacy of intervention in France and so on) might permit successful adaptation of industrial relations and social protection systems with a minimum of Union-level co-ordination (Maurice, 1999).

To the extent that finance has become the dominant aspect of the globalisation process, such optimism may be out of date. All economic activities, including and especially those of the public sector, have to be financed and if increasingly convergent norms of profitability or cost efficiency are generalised throughout European economies, then the margins of manoeuvre available to “sheltered” or “non-competitive” activities may be narrowed. Meanwhile, the exposure of macro-policy to new constraints - internationalised bond markets, massive global monetary flows - may limit the use of macro-policy instruments to compensate for adverse developments in employment or the distribution of income.

Measured by these more exacting standards, the deficiencies of the EU’s social policies become even more obvious. Since the Maastricht Treaty, the most important component of the “social dimension” has been the labour market legislation enacted under the Treaty’s social protocol. This legislative process has in turn revived the

“social dialogue” between EU level employers’ and labour union organisations, since in the eighties, without the threat of legislation, the employers had been quite unwilling to conclude binding agreements. Both the content of these directives and the manner of their introduction into national legal systems are minimalist. Falkner (2000) writes that in two cases where social dialogue reached agreement (on part-time and fixed-term work) “*low substantive standards* were accepted by labour *in exchange for greater involvement* of the ‘social partners’ at all layers of the European multi-level system” (p715). But this is to say that in countries where unions lack influence over their “partners” the standards imposed will tend to be lower than elsewhere. In fact, this legislation has little impact on employment relations in northern European countries (except Britain) because national regulations or collective agreements are more constraining.

The New Labour government has given up the British derogation from Maastricht social legislation, but the effects of this move are ambiguous. Much of the social chapter legislation requires unanimity in the Council - this applies to issues such as social security, social protection, job creation schemes, codetermination, the representation and collective defence of workers and the treatment of third country nationals. Therefore, by accepting the social protocol, and the dialogue which accompanies it, the Blair government has obtained a veto over a wide range of regulatory issues, and since the British government is still committed to the “flexibility” agenda, it is more than likely that it will block or dilute any ambitious proposals for reform in these fields.

One key issue where the “social partners” failed to agree was the introduction of European works councils in transnational companies - here the British employers refused to move and the British unions refused to accept an agreement without them (Falkner, 2000). Thus the directive was negotiated, by default, in the Council of Ministers. Streeck (1997) presents a devastating critique of the resulting legislation, which, far from consolidating the German co-determination regime which originally inspired the proposal, actually worked to undermine it. The German regime is part of company law; true to European conceptions of the “social problem” it seeks to compensate for the fundamental asymmetry between workers and employers in the market place. The EU’s surrogate retreats from company law to labour law; instead of a constraint to compensate for the inequalities of the labour market, it promotes agreements on worker consultation “in the shadow of the market”. This case is taken by Streeck to illustrate the decline not only of industrial citizenship but of citizenship as such in an integrated economy with a fragmented polity.

In addition to the continuing programme of EU-level legislation, there has been, since the European Council at Luxembourg in 1997, an interesting attempt to coordinate the labour market policies of member states, and this process was formalised in the Amsterdam Treaty. This is in many ways a promising approach, with the Commission using statistical “benchmarks” to assess the efficacy of national interventions, publishing annually a set of “Employment Guidelines” differentiated by country and putting disputes over competence to the side in order to promote a process of emulation among all the agencies concerned with labour market performance. The recent influence of New Labour over the Luxembourg process has, however, tended to eliminate any potential challenge to employer interests and priorities from this

exercise. The most prominent themes are now “employability” and “enterprise”. “The key point is that these various guidelines largely carry the rhetoric of the modern, UK post-Thatcher, supply-side-driven labour market.” (Mayhew, 2000)

An attempt at a more positive assessment of these developments is made by Jensen et al. (1999). These writers find some tendency toward the emergence of a “European Industrial Relations System”, although they have to redefine this expression to give any plausibility to their argument. Their case is, moreover, so heavily qualified that it almost amounts to a corroboration of the view they wish to challenge:

In other areas, however, there appears to be little justification for maintaining that there is a European system for the regulation of industrial relations functioning parallel with the national IR-systems, or matching them in significance. Firstly, it is still virtually impossible to determine what impact European IR-regulation has had (and will have) – in concrete terms – on relations between workers and employers at national level and at the single workplace. Secondly, there are wide differences between the organisations and procedures established at European level and the corresponding organisations and procedures existing in the national IR-systems. (p119)

This article confirms Falkner’s point that UNICE only bargained under the threat of legislation: the ETUC was given a voice in order to ensure that the European Parliament remained silent.

If Jensen et al. need to redefine the expression, “industrial relations”, Faist (2001) bases his attempt to establish the existence of European social citizenship on an eccentric use of the term, “European.” He claims that social citizenship has become a “nested”, multi-level, structure: which amounts to saying that, since the EU is made up of member states, the French or German social models are already components of EU social citizenship. Obviously this enriches the concept of European social citizenship to a striking degree.

However, if we move from Faist's conceptual innovations to his substantive evidence, there is little to show at the EU level of his multi-story structure. He points out (p 44) that less than 1% of EU expenditure was geared towards social policy in the nineties, but suggests that expenditure on the CAP can be interpreted as having a social purpose. This is quite true; the CAP is an expensive and unsuccessful experiment in transnational social policy which is being wound down as quickly as is politically possible.

Faist argues that interactions among the different levels of his “nested” structure are exhibited in the social compacts used in several smaller member countries to stabilise employment in the EMU. It is an interesting example; these pacts are devices to protect national social models from the adverse consequences of the European macro-regime instituted by Maastricht and the Stability Pact. Since the name of this game is, “export your unemployment to Germany”, it is hard to see how they could represent a step towards a European social structure - these measures succeed to the extent that they are not generalised. For an analysis of the pacts, see Martin (2000):

...if one shifts one's perspective from individual countries to Euroland as a whole, then it is not clear that social pacts have contributed much,

if anything, to reducing the aggregate levels of unemployment in the Euroland economy. They may indeed have succeeded only in redistributing employment, enabling some countries to capture an increased share of the demand to which macroeconomic policy has limited the Euroland economy. (p 7)

When the presidency of Jacques Delors successfully relaunched the integration project through, first, the Single Market Programme and then the EMU project, it was always suggested that the neglect of social construction was tactical - after a phase of market-led integration there would be more scope to build social Europe on firmer economic foundations. Today, the architect himself of the new Europe renounces these hopes: Delors (1997) insists that the social models of Europe must remain national:

Vous connaissez ma conviction: il me semble qu'aujourd'hui comme hier c'est avant tout au niveau national que pourra être efficacement menée la lutte contre le chômage et l'exclusion

Nos États nations doivent s'appuyer sur une cohésion sociale qui renforce le sentiment d'appartenance, grâce à une solidarité renforcée entre tous les citoyens, ce qui implique que les nations conservent leurs compétences en matière de sécurité sociale, d'éducation et de formation, de politique du marché du travail...et aussi de politique des revenus.

Ceci étant dit, l'Union européenne n'en a pas moins un rôle essentiel à jouer pour créer un climat propice à la reprise de l'investissement, à la création d'emplois et au progrès social, pour apporter une valeur ajoutée aux politiques menées au niveau national. (p 95)

This outcome, this insistence on the indispensability of national social models, calls into question the explanatory force of the notion of “neo-liberalism”. Certainly the shock troops of Thatcher and Reagan were indispensable in destabilising the institutions of the postwar compromise. But it might now be suspected that Jospin, Blair and Schröder are more perfect political complements to the current economic and financial transformations than their more doctrinaire predecessors could ever have hoped to be. Capitalist economic systems have to have social policies - people have to live and there is only so much they will take. In today's EU these social policies remain essentially local, particular, traditional, with less and less purchase on the general and systematic market pressures which make them necessary but deprive them of their democratic and emancipatory meaning.

The most alarmist fears of a “race to the bottom” in social policy may be exaggerated: in a world-wide study of the “social dumping” phenomenon Alber and Standing (2000) write:

.....one longer-term theoretical possibility.....is that mainstream representatives of capital have always understood the need for 'embeddedness' in the Polanyian sense. As inequalities widen, and as a sense of relative deprivation and insecurity spreads, there is likely to be growing instability, resistance and other reactions that threaten the sustainability of the process. A race to the bottom is never a realistic possibility, because lowering historically established standards of protection and security will engender growing resistance and a growing

realisation that productivity, wealth creation and investor confidence depend on social and labour market stability. (p117)

Nevertheless, if “race to the bottom” is too colourful an expression, “regime competition” is surely a reality. (It may be most marked not in the sphere of social policy itself but in that of corporate taxation – although big reductions in corporate tax rates then make it more difficult to finance social spending in popularly acceptable ways – see the account of financial pressures on the German system in Manow and Seils (2000). These authors show how growing needs for social protection expenditure and an increasing reluctance of the government to meet it have led to a drastic escalation in employer and employee contributions).

Alber and Standing present data to indicate that European countries in the 80s were already ceasing to display exceptionally high levels of social spending relative to their levels of GDP (“Sweden is the only exception”) and US and British precedents illustrate their own view that the wished-for “resistance” requires that “collective organisations representing and articulating the interests of those threatened by social dumping must exist and be powerful enough to make the expected costs of moving in that direction greater than any expected commercial or economic benefits of doing so” (p117). Europe is surely a long way from “Families Achieving Independence in Montana” or “Wisconsin Works”, but without an ambitious, integrated social policy at the level of the EU, the national social models will tend to remain permanently on the defensive.

4. The agenda which is being set for the EU continues to give priority to “market-making” over “market-correcting” integration measures.

The general direction of European construction at present may be illustrated by the agenda prepared by the Commission for the European Council in Stockholm in March 2001. This is a “new economy” agenda with a vengeance. The ten “priority areas” are as follows (European Commission, 2001):

- Employment; in the weasel language that is becoming depressingly common in Commission documents, member states are enjoined to “develop active employment policies which encourage rather than discourage participation in the workforce.” (Welfare-to-work disciplines are never explicitly called for, but this kind of language certainly does not rule them out.) Targets are to be specified in terms of employment growth rather than unemployment reduction; higher participation rates among older workers are an objective. The social partners are charged with responsibility for “improving employability and adaptability.” “Efficient tax and benefit systems will be a key contributor to Europe’s return to full employment.”
- Open labour markets; it is difficult in general to object to the push on “life-long learning” which is called for, although in practice there is a very big difference between an enhancement of educational rights for all mature citizens and the imposition of stricter retraining obligations on the long-term unemployed. Public authorities are called upon to tackle “barriers resulting from red tape, and from tax and benefit systems, pensions, and recognition of qualifications.” As ever, no examples of such “red tape” or benefit malfunctions are given, but those who know what the Commission is talking about will understand what it means to say.

- Structural economic reform; this is a continuation of the perennial single market drive. Key targets on this occasion are the further liberalisation of rail transport, postal services, gas and electricity. There is some recognition of public service considerations, but not much. “*State aid* in the European Union still accounts for more than 1% [!] of GDP. This must be further reduced.....”
- Integrated financial markets; for this key theme see the discussion of the Lamfalussy report below.
- Regulatory reform; regulation is to be “reviewed”, “simplified”, “modernised.” The aim is a European Union which will be “the *cheapest and easiest place to do business* in the world” [emphasis in original]. “*Formal regulation is not always the answer.*”
- “eEurope”; this embraces digital education, telecoms liberalisation, copyright, distance marketing of financial services and so on.
- IT skills; apart from more educational initiatives, this rubric includes the definition of an EU immigration policy which would take into account the rapid relaxation of immigration controls for certain categories of labour which is already taking place in several member states (usually it is a question of highly qualified IT specialists, although in Britain such immigration is also being used to alleviate the shortage of chronically underpaid public service workers).
- Research, innovation, enterprise; in the background here is the widening gap between EU and US R&D spending (the EU spent 40 billion euros less in 1995, 75 billion less by 1999). In the sole reference to democratic issues in this document it is acknowledged that the public’s voice should be heard “within the on-going debate about science and society.”
- “Frontier technologies”; “despite the progress made – a 70% increase in 1999 – in the supply of risk capital within the EU, it remains barely one third of what is available in the United States.” Recommendations are focussed on intellectual property issues – the adoption of a Community patent and the legal protection of biotechnological inventions.
- Social protection of an ageing population: here at the end one finds the necessity of “improving and modernising” the sacred “*European social model.*” A “*comprehensive approach*” is required “which will involve reversing the trend towards early retirement; faster reduction of public debt in order to use interest savings to support pensions and healthcare; and continuing pension reforms in Member States, including allowing private pension schemes to take full advantage of the internal market.”

These are Commission proposals – there is no chance of them all being accepted immediately by the Council – but they are presumably marked by a certain degree of political realism. They are the kind of thing, in the expectation of the Commissioners, that the member states could agree on. It is quite obvious that the whole conception is inspired by the growth pattern of the US economy in the nineties. The response is essentially to replicate the US model as closely as possible – little thought is given to doing things in a different way. The agenda lacks neither ambition nor coherence. It is pertinent to the relaunch of European economic development because, if this relaunch is to be Europe-wide, it will necessitate further integration, especially in the service and financial sectors which are bound to have a central role and in which integration has tended to be more difficult than for tradeable goods. But the agenda is also

completely unbalanced – pension privatisation aside, there are no concrete proposals on social policy and the danger that all these market-creating measures may in themselves intensify social inequalities is simply not addressed.

Since financial integration, facilitated and accelerated by EMU, is central to the official European agenda it is worth looking in a little more detail at the proposals in this sphere, which are largely drawn from the report of the “Wise Men” (Lamfalussy, 2000). Major steps were taken to integrate Europe’s financial sectors in the wake of the Single Act and monetary union itself has removed important obstacles to integration – those arising from the constraints on banks which were previously required to implement national monetary policies and those which were directly linked to the existence of different currencies. However, the ongoing integration process is obstructed by a number of legal, organisational and technical differences among member states and the Lamfalussy report aims to clear this path.

It is notable that the wise men justify their proposals above all in terms of pensions. “Over the period 1984-1988 the average real return on pension funds was 10.5% in the US and 6.3% in those EU countries where funds faced severe investment restrictions” (p5). Thus the individualisation, capitalisation and privatisation of at least a substantial part of EU pension provision is a premise of the whole argument (as is perhaps, although less explicitly, the transfer of pension fund risk to individuals by the substitution of defined contribution for defined benefit pension schemes). As the quotation indicates, the US model of security-based finance is, quite without criticism, adopted as the target of reform:

For large European companies the cost of raising capital in the EU is higher than in the US – even for top blue chip customers. This cost is caused by the complexity of cross-border capital raising in the EU; different rules in each Member State impairing liquidity and efficient pricing; unnecessary costs of establishment plus a higher cost of capital per se. The relative cost may well be higher the smaller the company. At best these are unnecessary, expensive “non-integration” costs – at worst they drive the business out of Europe, usually to the US, with potentially damaging long term consequences for the European economy. (p7)

These judgements are convincing and will not be contested. The consequences of adopting US financial practices for European *societies* are what is missing from the debate.

One of the factors which necessitates a renewal of the single market drive in the financial sphere is the financial transformation itself. The main thrust of reform under the original single market programme, largely enacted by the target date of 1992, was banking, with the second banking directive as the key piece of legislation. As corporate finance moves from being bank-based to security-based, dominated by the issue of marketable debt and equity, the gaps and deficiencies of this first market-making programme become more clear. It is important to recognise that the institutional changes required go well beyond “negative integration” or straightforward liberalisation. This is not analogous to removing a tariff or a quota on commodity trade – deep changes in national structures and policies are required. Lamfalussy mentions, inter alia;

- The need for a common licence to issue securities, itself requiring a common, or at least convergent, definition of securities;
- Common rules against, and definitions of, insider dealing and market manipulation;
- Standardised rules for retail consumer protection in the financial sphere;
- A standardised treatment of collateral;
- A single licence giving the right to offer cross-border financial trading services;
- A unified regulatory structure for security trading, portfolio management, underwriting services etc;
- The need to reduce the existing total of some forty regulatory authorities for securities. (pp 15-17)

These are not small issues. To carry out the market-making agenda in this sphere will require major legislative change, with big impacts on bankruptcy rules, pension fund regulation, accounting standards, company law, corporate taxation and other fields. Although mergers and acquisitions are not considered in the report, it is likely that equity market integration will require some harmonisation of takeover codes. A directive on takeovers is at present blocked between Parliament and Council, a situation which is evidence of the implications of the financial transformation for established systems of industrial relations. Similarly, the new reform agenda is complicated by the failure over more than twenty years to agree on the statutes of a European company, the main obstacle being profound differences in views about the institutionalised place of labour within the enterprise.

Once again, it is not suggested that such reforms are not necessary. For two, linked, reasons, however, they raise acute political difficulties. Firstly, it is more than clear that financial integration is taking the form of an uncritical and indiscriminate adoption of US systems. Although there is no getting away from the fact that competition with the US makes a consolidation of European finance necessary, it is not clear that this consolidation must take the simple form of a European internalisation of US standards. Secondly, European admiration for the dynamism of the US economy rarely extends to its industrial relations and social protection regimes. To carry out a thorough Americanisation of economic relations at EU level while leaving the social questions which are inseparable from these economic relations to the member states may well exacerbate the EU's already acute political problems.

5. The problem of legitimacy which arises is fundamental to the extent that it takes the form of a challenge to member state participation in European construction.

The literature on the EU's democratic deficit is so vast that it is given the ironic acronym, "DemDefLit" by Weiler (1999, p268). Consider, for example, average turnout in elections to the European Parliament, which is like the "average" Soviet harvest: worse than the last, but better than the next.

It is perhaps more useful to begin by looking at the paradoxical strength of the European polity – how can a structure so unloved be so stable? In reality, the European Union is a near perfect Lockean polity; it rests not on allegiance, but on interests. Weiler himself has gone a long way to explaining the source of this strength;

he insists that we take as central, neither the Council nor the Commission, but the Court of Justice. The supremacy of the Court, the acceptance of its verdicts by national judicial systems and hence by other actors in the member states was established at a time when there was an uncodified rule (the “Luxembourg compromise”) which guaranteed unanimity, and thus member state veto power, for all significant decisions. (At this time also, it was common to seek negotiated, political, compromises if member states infringed Community rules.) The two-stage procedure by which EU legislation is enacted reinforces this supremacy; a directive is an instruction to member states to bring their own law into conformity with a central decision. This results in certain ambiguities and inconsistencies because national legal systems are very different; on the other hand, it tends to avoid deep conflicts between EU and member state jurisdictions, because the EU law which national courts are called upon to enforce is usually expressed in national legislation.

The Single European Act involved the decisive abandonment of member state vetos in most questions relating to the EU’s internal market. In theory this should greatly increase the danger of conflict between national and EU politics but the areas in which such conflict is likely are narrowly circumscribed. The EU was given primary competence in the economic field. Having pooled sovereignty in this domain, the member states rushed to assert the principle of subsidiarity in all the rest. Thus European law is essentially economic: European public law subjects all authorities to the rules of the big market; competition law achieves the same result for enterprises. There are the important, but limited, extensions into employment law referred to above.

The “four freedoms” provide the basis, in effect the constitutional core, of the EU jurisdiction. There is to be free movement of goods, services, capital and labour. These freedoms give rise to justiciable rights; if they are violated, remedies may be sought not only in the Court of Justice but in the member state courts which continue to acknowledge its supremacy.

This acceptance of supranationality contrasts sharply with, for example, the international trade treaties entered into by the US. Weiler (1999) writes:

The United States government, for example, is known to exclude, or seriously limit the jurisdictional reach of its own judicial system and courts in relation to some of its trade agreements. The reasons for this US practice are complex, but clearly one aspect is the US government’s wish not to have its hands tied by its own courts. (p200)

Thus, if a US corporation were damaged by a governmental interpretation of the NAFTA, it might not have a clear remedy in the courts. The EU is fundamentally different from the NAFTA in that everyone has justiciable rights.

But if the existence of these rights constitutes the EU as a strong polity, their content abstracts the polity from democratic control. Who, in practice, exercises these four liberties? They map with perfect precision into the classic account in Marx of the circuit of capital. The freedoms embrace every moment of capital - money, commodities, the elements of production and the productive process itself - and ensure that the valorisation process is nowhere impeded by the frontiers of member states. Thus, while it would be a travesty to describe the EU as an economy without a

polity, it is not an extreme exaggeration to assert that the real citizens of this polity are not natural persons but the corporations.

The immense commercial, industrial and financial interests linked to the four freedoms stabilise the EU as a political structure even in the absence, in many member countries, of anything corresponding to the political allegiance found in historic nation states.

It follows that the lack of democratic legitimacy becomes really menacing to the EU structure only when it goes beyond cynicism towards the European Parliament and Commission and starts to call into question the relations between the EU and the governments of member states, since the latter require legitimation in a much stronger sense. Scharpf (1999) writes:

.....democratic legitimacy expands if decisions that were previously compelled by external necessity, or taken by non-accountable authority, become the object of authentic and effective collective choice. Conversely, legitimacy is reduced when policy areas that were previously the object of authentic and effective political choice in democratically constituted polities are pre-empted either by newly arising necessities or by coming under the control of politically non-accountable authorities. This, I suggest, is happening world-wide in the relationship between democracy and the capitalist economy, and it is happening with particular force in the democratic welfare states of Western Europe. (p26)

As regards political processes, one important way in which the EU weakens national polities is by destabilising the balance between executive and legislature. Beetham and Lord (1998):

By applying foreign policy methods to Union activities constructed around a domestic agenda, governments have extended executive privilege to the core of democratic politics and subjected them to a bargaining format that requires secrecy rather than transparency. (p73)

As regards political outcomes, many critical commentators focus exactly on the EU's "social dimension"; the lack of powers, of ambitions, of effective interventions in the spheres of industrial relations and social protection prevents any compensation at EU level, for a decline in the problem-solving capacities of member states. Schmitter (2000) links processes to outcomes in the following way:

From its origins, the integration process tended to privilege two sets of interests: first and formally, those of the governments of member states (with their so-called "national interests") and, second and informally, those of the business sectors most directly affected by its functional policy domains. This left out many citizens of Europe whose individual and collective well-being was indirectly, gradually, and often surreptitiously affected by EU policies: (1) large and diffuse quasi-groups of "policy takers" within each member state such as wage earners, unemployed persons, women, consumers, pensioners, youth and so on; (2) intense and compact movements committed to some specific cause or the provision of some particular public good such as

environmental protection, abortion rights, conscientious objection, and international solidarity; (3) inhabitants of subnational political units – regions, provinces, communes, municipalities – who do not feel adequately represented by their respective national governments; and (4), most importantly for the future of the integration process, transnational or cross-border coalitions of any of the preceding three categories. (p 54)

Schmitter also takes the position that the core of the democratic problem is in the relationship of the EU to the member states. The two main reasons he gives for concern (p 116) are the increasing contestation of the rules and practices of democracy at national level (evidenced by many particular phenomena and by “most generally, a widespread impression that European democracies are not working well to protect their citizens”); and that “Europeans feel themselves, rightly or wrongly, at the mercy of a process of integration that they do not understand and certainly do not control – however much they may enjoy its material benefits”.

To pursue the analysis of these political problems and their possible resolution would be well beyond the purpose of these notes. (It is interesting, perhaps disturbing, that the three main politicologues who have been consulted – Scharpf, Weiler, Schmitter – converge only on important elements of their diagnosis; their prescriptions are radically divergent).

The present notes can close with the insistence that both the ongoing financial transformation and the EU’s response can seriously aggravate the political problems of the EU. Both political processes and political outcomes are involved.

Firstly, the context is one of vast, global, transformations – in markets for currency, bonds and equity – in the face of which member states are already almost totally disarmed (Grahl, 2001). To use the menacing language of New Labour, “the status quo is not an option”. Given the openness of their financial systems, member state governments can do little more than adapt domestic systems – financial, industrial and social – by patterns of accommodation which seek to avoid intensified pressure on corporate and public finance.

It follows that any coherent response is bound to be at EU level, and that it must be predicated on an effective consolidation of European financial processes, and on a continuing drive for integration. But at this point the limits of the European constitution dictate that both the procedures and the content of financial consolidation will be deprived of democratic significance. The Lamfalussy report, to be sure, makes all the right noises: unification of securities markets “must respect democratic processes at both national and Union levels” (p 24). But the report also makes clear that parliaments will only be called upon to enact the broadest, most procedural, enabling measures; the substance of unification will be determined and implemented by the players themselves – by the regulators and their corporate interlocutors - the exchanges, the dealers, the big issuers and the big fundholders. “.....there should be arrangements whereby market practitioners could systematically and regularly provide input to this Regulators Committee and the European Commission” (p 25). An exercise in European comitology at its worst, in the “infranational integration”

(Weiler, p 272) where technical debate between officials and interested parties short circuits the mechanisms of democratic control, is pre-programmed into the EU's new financial agenda.

What is worse, such parliamentary supervision as does take place will be constitutionally confined to the market-making objectives which are now being promulgated by Council and Commission. To qualify and reorder these objectives for market-correcting social purposes or to impose social constraints on the outcomes of financial integration would be to exceed the competencies of EU instances and to trespass onto the holy ground of subsidiarity.

To take the key example of pensions; it is clear that the whole thrust of both the general and the financial agendas now being prepared in the Commission *presuppose* a major substitution of private for public provision and this in a context where *nothing* is presupposed as to the distributional impact of this switch or its effects on the income security of employees. Yet it is also clear that in the country where this substitution has gone furthest, Britain, it is a comprehensive failure, not only in broad terms of social justice but in terms of the narrow objectives set by the New Labour administration itself – New Labour pension reforms multiply and perpetuate the “welfare dependence” they were supposed to eradicate.

It may be too much to ask that the contestation of such developments take a clean, functionally integrative, form, to ask that opposition not only try to block these new threats to democracy and social justice, but that it do so in ways which provide the EU with a clear alternative line of political development. It seems that actual revolts, as in the Danish referendum, are likely to draw on specifically national forces and to be markedly dysfunctional from the point of view of European construction. Both financial globalisation, as an economic development, and the EU response, confined to market-making and the replication of US models, present serious threats to social achievements in European countries; no effective resistance will be criticised here. But effectiveness is an important issue; it may not be compatible with the minimalism towards the EU and the reassertion of national and local identities which at present characterise the constituencies of opposition.

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