Heritage Lectures

Published by The Heritage Foundation

No. 914
Delivered November 6, 2005

November 28, 2005

Challenges Facing Europe in a World of Globalization

Helle C. Dale

Thank you for inviting me to speak here today at Hanover College. I will be looking at one of the profound problems besetting Europe: the lack of economic liberalization among some of the European Union's biggest countries. Whether the EU has grand ambitions to become a superpower or not, whether it sees itself creating a new international order or wants to enlarge into Asia and North Africa, I think that without the willingness to tackle rigidity and stagnation in the major EU economies, the project will not have much of a chance.

Some of you may have received a surprise gift in the mail, as I did, from the Polish tourism office. As you may know, the French, Germans, and other Europeans have been deeply concerned about the invasion of Polish plumbers and nurses, who have been able to get around restrictions on their right to employment in other EU countries by setting themselves up as independent contractors. The invasion of cheap labor from Eastern and Central Europe as a consequence of EU enlargement earlier this year is, of course, one of the great worries of previously existing EU members. Actual numbers are minuscule compared to the fears they have engendered, as is so often the case.

But let no one accuse the good Poles of lacking a sense of humor. Playing on these fears, the Polish tourism office sent out a poster calling on other Europeans to go to Poland if they don't want Poles to travel to the EU. As you can see, it is quite a remarkable invitation.

The point is that many Europeans suffer great anxiety over the loss of jobs, either due to internal com-

Talking Points

- Without the willingness to tackle rigidity and stagnation in its major economies, any grand EU ambition to become a superpower, to create a new international order, or to enlarge into Asia and North Africa will not have much of a chance.
- The big countries at the heart of the euro zone are stagnating economically and yet seem unable come to grips with the liberalizing changes needed in a world of globalization, competitive labor markets, and mobile capital demands of our economies.
- Flexibility and reform on many levels is key to Europe's success in the future, as it has been with the U.S. economy. That flexibility should continue to allow Europe to develop at different speeds and in different ways.

This paper, in its entirety, can be found at:
www.heritage.org/research/europe/hl914.cfm

Produced by the Douglas and Sarah Allison
Center for Foreign Policy Studies
of the
Kathryn and Shelby Cullom Davis
Institute for International Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

petition in the EU or due to global competition from Asia, from Latin America, and even from the U.S., where some European carmakers have started opening plants. The private sector in Europe has almost stopped producing new jobs since the 1970s, and 20 million Europeans are unemployed, many permanently so. In Italy, 38 percent of respondents to a recent poll told the German market research firm GfK that unemployment was the most pressing social problem. In France, the figure was 58 percent, and in Germany, a soaring 81 percent felt the same way. The big countries at the heart of the euro zone are stagnating economically and yet seem unable come to grips with the liberalizing changes needed in a world of globalization, competitive labor markets, and the mobile capital demands of our economies.

Let's compare the EU with the United States. Total employment in the EU stands at 63 percent. In the U.S. it is 75 percent as measured by 15–64-year-old members of households. Where the United States has 5 percent unemployment, France has 10 percent and Germany has 11 percent. Between 1990 and 2003, the U.S. economy created almost 20 million new jobs. Italy, Germany, and France combined created 3 million. If current trends continue, per capita income will go up in Germany over the next 20 years by 44 percent, while it will double in the United States.

The less regulated U.S. labor market is far better at integrating the workforce at the lower end of the scale, providing economic opportunity and upward mobility that particularly affects immigrants, young people out of high school or college, and women. Immigrants, for instance have about the same unemployment rate in the U.S. as the general population, whereas in Germany and France the unemployment rate for immigrants stands at 25 percent.

Take a look at today's front page about the 10 days of riots among young, disaffected, and unemployed Muslims in France and you see one of the tragic consequences of a rigid and exclusive labor market. Without jobs, integration of immigrants fails, and so does their connection to the rest of society.

Much has been written—among others, by myself—about the issues of EU enlargement and EU integration and what it all means for EU transatlantic relations with the United States. However, I have come to conclude that the biggest question of all is how Europe deals with its comfortable labor force and extensive welfare states, which will need to get into fighting trim to face the challenges of the future.

Europeans love their six-week vacations—who wouldn't?—and they don't mind the fact that their secure job will not pay them enough to aspire to big houses or big cars. High taxes on income and sales give them free health care and free education, state pensions, and unemployment insurance. It is a comfortable life, but it is a life under threat.

If a European loses his job because the company sets up a plant in India, he is highly unlikely to find another one. And generous pension systems are under threat from a declining demographic base. Most countries in Europe are shrinking, failing to sustain their population. By 2050, for instance, the population of Italy will have fallen from 57 million to 45 million. By 2050, more than half of Germany's population will be over 55 years old. Immigration is in Europe a deeply controversial way of expanding the labor force as fear of a rising Muslim population grows.

We have recently seen some stunning consequences of the discontent that besets many Europeans. In France and the Netherlands, voters rejected roundly the European Constitution (for which French politicians had been a driving force). The vote was a vote against an EU that the French consider a threat to their welfare state; for the Dutch, fear of losing their "tolerant" lifestyle under the influx of further Muslim immigration was a big factor. Even the famous French 35-hour workweek is not putting a smile on people's faces. While paychecks are not growing, the shorter workweek gives everybody more free time to shop and spend. The end result, inevitably, is less money to go around.

What France clearly needs is a more flexible job market and lower social costs that would allow for more competition, more labor mobility, and more job creation. But that's not how the majority of French workers see it. They like their job security; according to opinion polls, 70 percent say that their ideal job would be as a civil servant, which offers a job for life. Here the state is still considered the source of all things good and bad. Therefore, the French tend to blame the general economic malaise mainly on politicians simply not doing their jobs well enough.

But they also blame the EU. In particular, resentment focuses on competition (dirty word around here) from the new EU members in Eastern and Central Europe. As a conservative friend of mine notes, "We used to be afraid of invading Warsaw Pact troops. Now we fear an invasion of Polish plumbers!"

Independent contractors from Poland and other points east are setting up shop in France and Germany, everything from plumbers to tile layers to butchers; they offer their services at half the cost of local workers. What will happen to the labor market if and when Turkey eventually joins the EU is enough to send French workers off looking for the pastis bottle.

This fall's German elections were equally a symptom of major problems—as have been the chaotic efforts to cobble together a grand coalition under Chancellor Angela Merkel. Germans intensely dislike uncertainly of any kind, having experienced enormous turbulence in the first half of the 20th century, including the crashing governments of the Weimar period, Nazi dictatorship, and defeat in two world wars.

Part of the problem Germany faces today is a deep and widespread yearning for security in a changing and unpredictable world. This makes German workers unwilling to accept cuts in their pensions and other generous welfare-state provisions and their guarantees of lifelong employment.

Both Gerhard Schroeder and Angela Merkel know these problems have to be tackled—which may be why the German electorate ended up disliking both. Just three days before the election, 30 percent of German voters remained undecided. During his time in office, Mr. Schroeder did attempt much-needed pension and labor-market reforms, and as a consequence become deeply unpopular.

There have been efforts at reform through the European Union. Particularly, the Lisbon agenda adopted at a ministerial summit in 2002 was designed to increase competitiveness. It was in fact meant to make Europe the world leader in industrial and technological innovation—ahead of the U.S. by 2010. It has not been much of a success so far.

In many ways, the current British presidency of the European Union would seem an ideal time to take up the challenge. The British, after all, with the Irish, the Scandinavians, the Spanish (under Prime Minister José Maria Aznar), and the Central and Eastern Europeans, have all understood the need for reforms. As a consequence, Britain, Ireland, and Scandinavia generally enjoy lower unemployment, comparable to that of the United States, as well as higher growth rates. In a number of speeches to the European Parliament, British Prime Minister Tony Blair has identified the need for reform in the areas of unemployment, labor markets, energy dependency, innovation, falling demographics, and the need for balance between work and lifestyle.

In a speech before the European Parliament in June, before taking over the EU presidency, Mr. Blair rejected the idea that reforming the European welfare states would amount to "trampling on the poor and disadvantaged": "What type of social model is it that has 20 million unemployed in Europe? Productivity rates falling behind that of the United States? That, on any relative index of modern economy—skills, R&D, patents, information technology, is going down not up?"

Mr. Blair further deplored that the European Union spends 46 percent of its budget on subsidizing farmers. He urged his fellow European leaders to fight unnecessary red tape: "Send back some of the unnecessary regulation, peel back some of the bureaucracy, and become a champion of a global, outward looking, competitive Europe." For these views, Mr. Blair was immediately attacked by French President Jacques Chirac.

In a nod to President Chirac, Mr. Blair has proposed an EU Globalization Fund. It was proposed at an informal EU conference at Hampton Court,

The French View: "Alternative Globalization"

When historian Samuel Huntington wrote his seminal article about the "Clash of Civilizations," he had in mind not the conflict between the United States and France, but the conflict between Islam and the West. If he is so inclined, however, Mr. Huntington will find much material in the clash of American and French worldviews, the latest example of which was the debacle over the passage in Paris last week of the Treaty on Cultural Diversity in UNESCO's cultural committee.

For Paris and its friends in Ottawa, the problem with globalization is that it allows French and Canadian citizens to watch American movies and buy CDs with American bands, which they do in droves like other consumers the world over.

"Why don't they just make better movies themselves?" one might ask, getting to the crux of the matter. Consumer choice and globalized international trade means competition on a scale with which the French are deeply uncomfortable.

According to the French conspiracy mill, the U.S. government is forcing French consumers to eat hamburgers at thousands of McDonald's outlets that dot the country. This causes McDonald's restaurants to be the object of occasional violent attacks by French radicals. And according to fevered French media reports of the last few days, the post–World War II U.S. Marshall Plan for France was conditioned on the import of American movies, which in turn made French consumers buy American blue jeans. And on and on it goes.

Though the real purpose of the Treaty on Cultural Diversity is political, it may well have consequences for the Doha Round of the World Trade Organization. Protecting "cultural expression," in the treaty's vague formulation, could mean protecting anything from Brazilian coffee beans to French wine. Paris is already jeopardizing the entire Doha Round by bitterly opposing the cuts in EU agricultural tariffs necessary to keep the round afloat—in order to "save" the protectionist Common Agricultural Policy.

The French political elite have now come up with the idea of "alternative globalization." *Le Monde* put it this way: "Cultural Diversity—a manifesto for another kind of globalization." The French way of globalization involves global governance, global taxes, global environmental regulation, and regimes like the Treaty on Cultural Diversity. What it does not imply is global free trade.

London, and the idea is to set up a fund within the EU to mitigate the consequences of globalization, a proposal that has been unenthusiastically received by the countries that would be paying for it, primarily Germany.

The problem is, however, as noted in the *Financial Times* by Wolfgang Munchau, that "the EU is the wrong institutional platform to deal with globalization. It has become too large and divided. The appropriate levels are the national governments and the eurozone." In a number of important areas, such as economic and labor market reform, there is no EU-wide policy. These are matters for the member states. And even if there were implementation, it rests with the individual governments. It is, for instance, far harder to fire someone in France than it is in England. It is also far easier to set up a company. As a consequence, Britain has far less unemployment than does France.

This accounts for the fact that members of the European Union have made uneven progress in adapting in the 21st century. The countries at the heart of the European Union—France, Germany, and Italy—have made little progress. Let me quote from what French President Jacques Chirac said this spring after a heated debate over the modernization of regulations on services in the internal market: "Ultra-liberalism is as great a menace as communism in its day." He was joined by Luxembourg Prime Minister Jean-Claude Juncker, who said, "It's the first time that, in an almost solemn manner, the viewpoint of those who say stop to unlimited liberal free market principles has prevailed. In this view, it was a good day for Europe."

As it happens, the American model, so often raised as a specter by European scaremongers, is not the only workable model, and it is probably not realistic to think that Europe and the United States will ever converge, given our very different political traditions and historical origins.

In a new paper published by the Bruegel Institute, a Brussels-based think tank, Belgian economist André Sapir argues that there is not one single European model. The notion of a "European social model" is misleading. There really are "different European social models, with different performance in terms of 'efficiency' and 'equity'. Models that are not efficient are by definition not sustainable and must be reformed." The combined GDP of countries with inefficient models "accounts for two-thirds of the entire EU-25 and 90 percent of the 12-member eurozone."[1]

Professor Sapir identifies four distinct models, and some perform better than others:

- **The Nordic model**—Sweden, Denmark, Finland, and the Netherlands—has the highest spending on social protection and public welfare. Labor markets, on the other hand, are relatively unregulated, but there are strong labor unions, which means high wages.
- **The Anglo-Saxon model**—exemplified by Ireland and the United Kingdom—has social assistance of last resort, mainly focusing on people of working age, weak unions, and a relatively unregulated labor market.
- **The Rhineland model**—Austria, Belgium, France, Germany, and Luxembourg—relies on social insurance for the unemployed and strong employment protection. They also have powerful unions and collective bargaining.
- **The Mediterranean model**—Greece, Italy, Portugal, and Spain—have high levels of benefits for seniors, early retirement ages, and heavy labor market regulations.

In particular, it is clear that there is an inverse relationship between employment protection and unemployment levels, a problem that particularly besets the Rhineland and Mediterranean models. The Scandinavian model shows that where social solidarity is high, poverty alleviation is not contrary to job growth or productivity.

All of which suggests that flexibility and reform on many levels is key to Europe's success in the future, as it has been with the U.S. economy. That flexibility should continue to allow Europe to develop at different speeds and in different ways. Whatever Europe's destiny as a global power or a free trade area, Europe's future will depend on its ability to face up the challenge of globalization and a world that changes at a dizzying speed.

—Helle C. Dale is Deputy Director of the Kathryn and Shelby Cullom Davis Institute for International Studies and Director of the Douglas and Sarah Allison Center for Foreign Policy Studies, a division of the Davis Institute, at The Heritage Foundation. These remarks were delivered at Hanover College in Hanover, Indiana.

1. See André Sapir, "Globalisation and the Reform of European Social Models," Bruegel *Policy Brief*, Issue 2005/01, November 2005.