

# Issues in Regulation Theory

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### EDITORIAL

*The EuroMemorandum Group (European Economists for an Alternative Economic Policy in Europe) has just brought out a book edited by Jorg Hufschmid: Economic Policy for a Social Europe: a critique of neo-liberalism and proposals for alternatives.<sup>1</sup> In the remarks which follow, Jacques Mazier, an active member of the group and author of four of the book's chapters, provides a concise overview of the proposals. Their alternative nature leaves little room for doubt. But whether or not they are realistic remains open to question—not because they are unrealistic, but because they must be sufficiently convincing to encourage the political changes required for their implementation.*

### THEORETICAL NOTE

#### Europe: Some realistic economic policies

Jacques Mazier  
(CEPN-CNRS, Université de Paris-Nord)  
[mazier@seq.univ-paris13.fr](mailto:mazier@seq.univ-paris13.fr)

Errors in the handling of economic policy in Europe appear to be one of the main causes of Europe's flagging growth relative to that of the United States. In the early 1980s, the European Union, which was already caught up in paralysing budget discussions, was incapable of implementing a reflationary policy or promoting a research policy at Community level. The EMS functioned asymmetrically and passed the adjustment cost onto weak-currency countries. In 1985, instead of providing answers to the very real blocking factors which existed, it was decided to stimulate Europe through the market, with the Single Market programme. According to the liberal conception prevailing at the time, the creation of the great internal market and the bolstering of competition were supposed to stimulate growth and innovation. In the early 1990s, financial liberalisation and the increasingly rigid functioning of the EMS necessitated a change in the monetary regime. The single currency plan won out, without anyone drawing the necessary conclusions in terms of economic policy organisation.

The venture seemed shaky from the outset. But the advantages of the single currency were considered determinant and its costs largely underestimated. In addition, the procedures for the introduction of the single currency adopted in Maastricht in December 1991 contributed, along with the repercussions of German reunification, to the freezing of European growth during the long transition period from 1992 to 1998. After the fleeting recovery of 1998-2000, all the blocking factors came back into play once again and the risks of stagnation reappeared. The social protection systems which, with their specific features proper to each country, had been one of the fundamental elements of European societies were gradually called into question. And the enlargement to the countries of Eastern Europe added one more challenge to a European Union with its back to the wall.

Drawing on a critical evaluation of past policies, *Economic Policy for a Social Europe* presents a group of al-

ternative proposals. Although these proposals are far removed from what might reasonably be expected in the European of 25, certain new paths might be explored in the context of a European Community whose member countries function in diverse ways but which is capable of maintaining a cohesion policy and coming together around major development programmes.

#### 1. An alternative framework

The alternative policy is based on the gradual emergence of a European budgetary policy likely both to play a stabilising role and to permit the funding of more active structural policies. Supporting demand should be the priority objective of this policy mix. Its implementation would be facilitated by a reform of a uselessly constraining Stability Pact, an expansion of the ECB's objectives and attention to wage and social policies which would help to redefine the European Social Model. The revision of structural policies at Community level would involve research and industrial policies, in order to back up supply in the medium term, along with agricultural and regional policies, which should be maintained but subject to in-depth reforms.

#### The beginnings of a European budget policy

Setting up a federal budget is theoretically the most appropriate form of response but this is not feasible in practice. At present, the European budget is extremely low (1.04% of the European GDP) and mainly goes for the Common Agricultural Policy (CAP) and regional policy. The majority of public actions take place at national level. Two alternative paths may be explored here. The first would entail a modest, gradual increase of the European budget to about 5 percent of the GDP over the next few years. The Union should generate its own resources through certain taxes well suited to this function: taxes on savings income and business profits (which would limit the effects of tax competition); a tax on financial transactions;

<sup>1</sup> London: Palgrave Macmillan, 2005. These proposals are found in part in the working group's annual Euro-memorandum <[www.memo-europe.uni-bremen.de](http://www.memo-europe.uni-bremen.de)>.

a tax on CO<sub>2</sub> emissions.

The limited size of the EU budget would not, however, allow it to play a stabilising role in case of an asymmetrical crisis affecting a single country.

In order to deal with such crises, we would propose the creation of an Employment Stabilisation Fund on the model of earlier plans elaborated by the Commission itself. In case of a rise in the unemployment rate in one country which is more rapid than the European average, the country concerned would benefit from a transfer (either automatically or following negotiation) from the European budget. According to our estimates, with transfers limited to 2 percent of the GDP, the average annual cost to the European budget would be about 0.23 percent of the GDP.

The second possibility would be to accept a European budget deficit. This deficit, financed by the issuing of securities, would remain modest, on the order of 1 percent of the Community GDP, in order to avoid heavy debt servicing in future. With a 10 percent debt ceiling, the debt servicing would not exceed 0.35 percent of the GDP over the long term. Another solution, easier to implement, would be to broaden the possibilities for borrowing from the European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD).

Last of all, the Stability Pact (where the two indicators of public debt size and weight come into play automatically, without taking into consideration the possible positive effects of certain overspending) should be reformed on the basis of existing proposals (norm for net public debt in % of GDP, tenable current account norm, pragmatism in the approach to surveillance by taking into account the effects of the short-term economic situation).

#### **The independence of the ECB and increased co-ordination**

With regard to monetary policy, the absence of any democratic monitoring, which has no equivalent elsewhere, constitutes a major problem, and one which is difficult to resolve in the absence of a supranational European authority with clearly established legitimacy. It will take a long process of political maturation in order to reach a solution because of opposition to a clearly federal system existing at nation-state level.

The goal chosen by the ECB in the area of price stability (an inflation rate between 0 and 2 %) also poses problems. It runs counter to the objective adopted by the British Chancellor of the Exchequer since the 1990s (between 2.5 and 3.5 %) and the even less constraining positions of the American Federal Reserve. Such a decision should be subject to extensive public debate with the political negotiating partners. As the Japanese example has shown, the overly zealous elimination of inflation can contribute to locking an economy in the 'liquidity trap'.<sup>2</sup>

More fundamentally, expanding the ECB's objectives to include full employment would help to put employment back in the centre of economic policy preoccupations. Such a change would reduce co-ordination problems and align the ECB's objectives with those of other central banks such as the American Federal Reserve.

Instability on the foreign exchange markets brings out another major defect of European monetary institutions: the absence of any clear foreign policy direction. In practice, exchange-rate policy lies entirely in the hands of the ECB; the European Council can only intervene in excep-

tional circumstances. The thorny problem of the international representation of the Euro area only increases the difficulty. It is therefore essential for the Council and the Eurogroup to take back responsibility for exchange-rate policy. The designation of a 'Mister Euro' to represent the Council would symbolise this new distribution of roles. In general terms, exchange-rate policy could have as its objective the establishment of 'flexible target areas' between the main hard currencies with variable margins of fluctuation around benchmark parities. The definition of an exchange-rate policy would also make for a more coherent elaboration of the policy mix.

#### **The reintroduction of wage policy and the defense of a European social model**

Improving the policy mix at European level calls for greater attention to income trends. The co-ordination of wage developments could entail a multi-level negotiation system integrating specific national features and sectoral considerations.

The integration of remunerations into collective bargaining with a Community dimension could take different forms in each country depending on its own traditions (regional occupational branch negotiations in Germany, cross-industry negotiations in Sweden, occupational branch negotiations in The Netherlands, 'social pacts' signed in several European countries). Following a gradual learning process, the 'macro-economic dialogue' introduced in the Cologne process but never implemented might be revived.

In different forms from one country to another, the social protection systems and public services have constituted one of the bases of the European social model which clearly distinguished it from the American or Japanese models. In face of budget constraints, there has been increasing pressure to 'reform' these systems and they are now threatened by the Bolkenstein directive on services in the domestic market.<sup>3</sup>

The European social model should be reasserted around three pillars:

- Full employment, but with jobs corresponding to wage-earners' qualifications and guaranteeing them just remuneration;
- Social protection (old age, sickness, accidents) based on a broad Social Security system;
- Social equity, namely the absence of social discrimination and excessive inequalities in terms of income as well as territorial development and access to quality public services.

These objectives would take different forms depending on the traditions and past experiences of each country. A convergence of national models is not conceivable in the short or medium term. In any case, trends towards the dismantling of social protections should be reversed by showing that these can be preserved on the basis of public systems which are more equitable and just as efficient as the privatised systems.

In addition, certain procedures could be set up at European level:

Minimum levels (defined by country) could be fixed as goals in major areas or, in certain cases, could take the form of more constraining requirements (minimum wage or minimum retirement benefit defined as a percentage of the

<sup>2</sup> A very low interest rate leaves monetary policy with little room for manoeuvre, while the indebted agents are limited by the weight of the real debt.

<sup>3</sup> For one thing, the application of the 'home country principle' encourages social dumping; for another, there is no clear definition of the public-service activities excluded from the field of application.

country's per capita income, social coverage).

In the context of a rising European budget, an amount between 0.5 and 1 percent of the EU's GDP could be devoted to a European Social Fund which would finance social transfers helping to attain some of the previously fixed thresholds, notably in the area of pensions or social coverage. Such a fund would be addressed as a priority to the least advanced EU countries, which would thus be gradually integrated into the European Social Model.

Three options may be considered in order to maintain the role of the public services. A first option would grant the public service the status of a national exemption from European competition through directives giving the States the freedom to define their public service missions and methods of accomplishing them in function of their own traditions.

A more ambitious option would be based on the principle of a framework directive defining the bases of 'services of general interest' at Community level and setting up democratic regulatory authorities. A broader notion of 'public service' than the simple 'universal service' would be used. This framework directive would then be adapted to sectoral directives in order to integrate the specific features of each sector. A final option goes still further by defining a European base for 'services of general interest' which would become a common obligation for all Member States with the definition of shared missions and the simultaneous intervention of European and national regulators.

With regard to WTO negotiations for the General Agreement on Trade in Services (GATS), the EU should be given a specific status to pursue a mandate based on a clear conception of the public service at European level. The Bolkenstein directive should be considerably amended and resituated within the framework of a directive on the public services.

### Greater balance among structural policies

#### *A more active research policy*

National policies have been too dispersed and badly co-ordinated, while overall funding levels have been insufficient. At European level, the Framework Programmes for Research and Development (FPRD) have suffered multiple handicaps (inadequate corporate commitment, complex procedures, multiplicity of objectives, quantitative weakness). FPRD procedures should be rationalised with specific rules in function of the operations funded:

- For fundamental research, there should be greater freedom to initiate proposals, with essentially public funding;
- For industrial research, the definition of priorities would be based on an ongoing participation of industry, with a real commitment on the part of the major corporations (which would not, however, have a monopoly on decisions);
- For projects which can be carried out quickly, and in order to support the SMEs in particular, the experience gained from the EUREKA network for market-oriented research and development should be brought into play.

New financial means should be introduced:

- FPRD budgets should be increased (to about 0.4 % of the UE's GDP), which would permit the funding of large-scale actions at European level without dismantling national programmes;
- Long-term budgets and autonomous structures could permit co-operative scientific programmes to be initiated by major fields;

- European technological agencies responsible for the direct promotion and co-ordination of European-level activities in the areas of information technologies and biotechnologies could be created;
- European public research bodies could be set up along similar lines for more fundamental research.
- The creation of a European patent, which is a key issue for the protection of intellectual property in sensitive sectors, would reduce both the costs and the complexity of the present procedure.

#### *Industrial policy and major programmes at European level*

The major public programmes should be reinstated at European level: technological programmes with specific targets, such as the Galileo project for a global satellite navigation system or infrastructural programmes including plans for urban development in the areas of transportation, electricity, gas, telecommunications or postal services. The actual projects would no longer depend on intergovernmental co-ordination but would be carried out by European operators provided with autonomous budgets. Regulatory instruments would also have to be developed at European level: European agencies articulated with their national counterparts; a standardisation policy in order to strengthen the position of European companies; sector-based interventions promoting specific infrastructures or investments.

The policy on competition should be more pragmatic. The community mechanism for monitoring agreements should be less concerned with seeking to maintain sharp competition (held to be a factor of efficiency in and of itself) and should pay greater attention to the economic dimension. The surveillance of concentrations, which has become the prime measure of the policy on competition, should also be made more flexible. The definition of the 'relevant market', which is used to evaluate the risk of a domination position, should be enlarged to world level and not limited to the European dimension alone, much less the national one, as is sometimes the case.

State subsidies are forbidden. Existing control mechanisms should be made both more flexible (by not seeking to promote a unilateral strategy of reducing national subsidies) and more coherent (by creating better linkages between the control of national subsidies and existing Community policies).

#### *A regional policy maintained and extended to the East*

European regional policies have considerable importance because, in spite of the decrease which has been programmed, the Structural Funds and Cohesion Funds still represent an average of 0.4 percent of the annual European GDP for the 2000-2006 period. The effectiveness of the Structural Funds in reducing regional inequalities remains to be seen, however. Between the unwieldiness of the European agendas, the monitoring requirements at national level and the recourse to co-financing, the utilisation of the Structural Funds is often quite slow. Beyond these traditional problems, the enlargement of the EU raises formidable challenges. The entry of the candidate countries considerably lowers per capita income and excludes from the Structural Funds eligibility threshold (under 75 %) a large number of regions presently benefiting from them, without the slightest change in their situations. It is conceivable to raise the threshold to the level, for example, of that of the Cohesion Funds (90 % of the EU's per capita income) but such a change would come up against budget constraints which are difficult to surmount because of the upper limit on the

European budget. For the new member countries, we would limit transfers to 4 percent of the GDP per country in order to take limited absorption capacities into account. This would give rise to an estimated cost between 0.18 percent and 0.38 percent of the EU's GDP (depending on whether the calculations are based on current prices or the PPP).

As in the case of previous enlargements, new Structural Funds could be set up for new member countries, with a maximum budget of 0.4 percent of the EU's GDP. Such a level of funding could be ensured through new instruments issued by the EIB and the EBRD. The present Structural Funds and Cohesion Funds would be divided between the countries of the 15-member EU following a renegotiation of the eligibility threshold and attribution methods. The Structural Funds procedure would be reformed in order to increase its effectiveness.

#### A reformed Common Agricultural Policy (CAP)

The very real problems posed by the Common Agricultural Policy have given rise to four groups of proposals:

- The re-nationalisation of the CAP (i.e., its elimination) is a strong temptation in the United Kingdom and also figures in the Sapir report (2003).

- The Commission proposes a modification in the nature of the subsidies: they would no longer be based on the number of acres or animals but on agricultural practices. The subsidies would thus be 'decoupled' from production and the latter, like prices, would be market driven. This reference to the market, which remains central, is problematic, for history has already demonstrated the market's inability to ensure proper regulation where agriculture is concerned.

- In the context of the enlargement to the East European countries, the ceiling on EC subsidies has been placed at 25 percent of the present amounts per acre or animal with a gradual increase to 100 percent by 2013. This ceiling, which is badly accepted in the new member countries, is not unjustified.<sup>4</sup>

- In the context of the WTO, the Anglo-American countries are trying to protect their interests behind seductive proposals (acceptance of subsidies encouraging 'good practices', gradual reduction of subsidies generation imbalances, the Cairns group's defence of the developing countries). A dismantling of the CAP badly carried out within the WTO would have negative consequences for European farmers without offering remedies for the traditional farming of the developing countries.

Under these circumstances, it seems preferable to come back to the 'Rooseveltian' principles which served as the basis of agricultural policy in the mid 1930s. Agricultural products cannot be governed solely by the laws of international trade. The instability of agricultural markets has extremely negative effects on all agricultural activities and in the medium term, these negative effects largely outnumber the gains resulting from the exploitation of comparative advantages. The pernicious effects of free markets should be corrected through agricultural policy measures. The lessons of the past show that this involves guaranteed price schemes combined with production quotas. Prices should be sufficiently high to incite farmers to produce, while quotas should be individualised and fixed so that the sum of the individual (and national) quotas

remains slightly lower than the EU's total consumption. In this way, overproduction would be avoided and the market left to make the adjustment between European domestic demand and domestic and world supply. Within this framework, imports would thus remain unrestricted. Such a mechanism, set up at EU level, would in turn help to stabilise the world system. Consumer prices would be determined on the basis of world prices and the difference between consumer prices and those guaranteed to farmers would be covered by public subsidies. The guaranteed prices would differ by areas defined in function of development and productivity levels. Production quotas would be interchangeable, but not between different areas, in order to avoid geographic concentration. Last of all, the individual quotas could be used to reduce production, notably in the case of large farms. Production quotas would generate subsidies which could be increased through the variations in quota prices. Regular negotiations would limit an excessive increase in the subsidies.

Within such a framework, the integration of the East European countries could be carried out without imbalances in treatment because the same rules would be applied everywhere. The quotas would be evaluated in each country on the basis of past experience, and the possibilities of future augmentation would be supervised. Guaranteed prices should be sufficiently high to ensure a significant increase in farmers' incomes and permit the modernisation of production methods. At the same time, they should not be too high in order to avoid imbalances relative to non-agricultural incomes.

A more equitable solution could likewise be obtained at the level of *Euro-Mediterranean agreements*. The principle of unlimited imports would open up new possibilities for the farmers in these countries.

## 2. Conditions of implementation

In terms of a simple order of magnitude, the total cost of the policy which has just been sketched out, if it were implemented at full capacity, can be estimated at 2 percent of the average annual GDP of the 15-member EU. This total percentage can be broken down as follows: research subsidies, 0.4 percent; industrial policy and major programmes, 0.4 percent; regional policy for the countries of Central and East Europe, 0.4 percent; Employment Stabilisation Fund, 0.3 percent; Social Fund, 0.5 percent. The CAP and regional policy for the Europe of 15 are assumed to remain at the same overall level.

If the scale of total funding remains acceptable, the conditions for implementation are admittedly difficult in the present context. Increasing the European budget, even very gradually, hardly seems realistic. The obstacles which emerged within the 15-member EU will only be increased in the enlarged EU. For this reason, a distinction must be made between, on the one hand, what can be envisioned at the level of the Europe of 25 in order to avoid dilution into a kind of United Nations of Europe subject to greater competition and growing inequalities and, on the other, what can be reconstituted on a more limited basis in order to give greater impetus to middle-term growth while offering better responses to short-term steering constraints.

### Ensuring the cohesion of an enlarged Europe

The enlargement of Europe was necessary politically but it will not be easy to preserve the cohesion of the resulting EU. If the effects anticipated for the countries of Central and East Europe (CEE) are positive in the middle term, the risks of a short-term slow-down, greater inequalities and the polarisation of activities are real. From this standpoint, the extension of regional policy and the CAP to the CEE countries seems necessary in order to avoid sudden politi-

<sup>4</sup> Overly large subsidies run the risk of increasing agricultural surpluses and would pose problems of internal redistribution relative to other kinds of income.

cal shifts which could be harmful. Regional policy should be linked with certain of the major technological and infrastructural programmes already envisioned in other contexts. And to increase the margins for manoeuvring in the short term, exchange-rate policy should avoid an overly rapid integration into the Euro area, notwithstanding the temptation of certain CEE countries. In exchange, the Euro area countries should provide assistance for financial stabilisation. All in all, assuming that the budget for the extension of the CAP remains constant because of the reforms undertaken, the increased funding would essentially concern the extension of the regional policy, which could be accomplished through new financial instruments issued by the EIB and the EBRD. In addition, there would be a gradual increase in the European Social Fund.

### Increasing the Euro area's capacities to respond

The Europe of 15 is divided in two – the Euro area and the non-Euro area – for what will probably be a fairly long period. The short-term consequences for regulation procedures are far from negligible. The Euro area's capacities to respond must be improved, and this calls for greater means of action for the Eurogroup, an in-depth reform of the Stability Pact, an expansion of the ECB's objectives and real co-ordination with the Eurogroup, greater attention paid to wage policy and the creation of an Employment Stabilisation Fund to handle asymmetrical crises. Only the last measure would have an impact on the budget. But in the short term it would also be necessary to define a final, non-permanent instrument in order to sustain growth; this could take the form, for example, of a European loan, to be paid back to the member countries, which would finance plans for boosting the economy. It is likely that advances in these different areas will be very uneven, notably because of the heterogeneity of the Euro area countries and their divergent points of view, which may well be a persistent source of difficulties. The question of whether greater advances could be obtained on a more limited scale remains open.

### Concentrating resources on major development programmes

If we draw on the lessons of several positive experiments already underway, the structural politics could generate even greater opportunities for individual programmes in different fields: urban development plans and major programmes for transportation, telecommunications or energy, to be carried out through the creation of European operators with autonomous budgets, or the creation of European technology agencies and European research bodies by large fields. The possibilities of increased co-operative programmes are encouraging but the procedures for their concrete implementation must be simplified. The kind of expenditures (investments supporting middle-term growth) and the volume of funding to be found justify the recourse to loans based on new instruments of the EIB or the EBRD. This approach may turn out to be profitable but past experiences have shown the unwieldiness and slowness of such operations. The impact could thus be quantitatively limited in the middle term unless considerable impetus were given to this process.

(Translated by Miriam Rosen)

## RECENT PUBLICATIONS

*The following publications are signalled by the editors of Issues in Regulation Theory because of their relevance to the research program of the Regulation School.*

- Barbier J.C. et Letablier M.T. (2005), *Politiques sociales. Enjeux méthodologiques et épistémologiques des comparaisons internationales*. P.I.E, lang, Bruxelles, 295 p.
- Cassiers I. et Lendent Ph. (2005), *Politique monétaire et croissance économique en Belgique à l'ère de Bretton Woods (1944-1971)*, Banque Nationale de Belgique, Bruxelles, 224 p. [www.nbb.be](http://www.nbb.be)
- Mouhoud E.M. (ed.) (2005), *Les nouvelles migrations : un enjeu Nord-Sud de la mondialisation*, Paris, Universalis.
- Hugon Ph. et Michalet C.A. (ed.) (2005), *Les nouvelles régulations de l'économie mondiale*, Karthala, Paris, 259 p.
- Tinel B. (2004), *A quoi servent les patrons ? Marglin et les radicaux américains*, ENS Editions, Lyon, 149 p.

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[catherine.bluchetin@cepremap.cnrs.fr](mailto:catherine.bluchetin@cepremap.cnrs.fr)

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