

A STRAINED EUROPEAN MODEL. IS EASTERN ENLARGEMENT TO BLAME?*

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Abstract. *As anticipated, the recent enlargement has put considerable pressure on the European construction, as most of the EU15 member countries are economically and socially strained and policy-makers have a very hard time in devising proper answers to society's ills. The paper examines various factors which have strained the European Social Model and which, arguably, make this period of Euro-pessimism quite peculiar. It looks at the race for competitiveness in today's world and the economic rise of Asia; it looks at some inner dynamics in the European societies (demographics, the crisis of the welfare state, a sort of decadence) and it tries to explore what lies ahead, including policy options. An underlying thesis herein is that eastern enlargement is not the culprit for the current pains of the EU member countries, though it may have accentuated some.*

Key words: *European Social Model, globalization, competitiveness*

Introduction

Euro-pessimism is not of recent vintage; it has resurfaced from time to time after the Second World War, even at a time of relatively rapid economic growth and low unemployment. I would recall here the famous book by the late French essayist JJ S. Schreiber, "Le Défi Américain" (The American Challenge), in 1968, that triggered a whole debate on the ability of European firms to compete with American (multinational) companies. One can conjecture that this competition has prodded, constantly, top European politicians to push ahead with the EU economic and political project. But there were also bouts of Euro-optimism over decades, which induced fears in reverse,

across the Atlantic. A while ago, some American pundits viewed the *continental model* (M. Albert, 1993) as an interesting alternative to the *Anglo-Saxon model*; this fear was encapsulated in the term of "Fortress Europe".

At the end of the day, however, world competition was viewed within a triangle: USA, EU, and Japan (as an exception to the western world) and nothing more (L. Thurow, 1993). Therefore, one could think that there is nothing new under the sun, for cycles are an unavoidable pattern in economic life¹, in human history. But this reading of modern history and of the type used of forward looking would be misleadingly simplistic and intellectually defective. For there have been deep currents at work in European societies and in the

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¹ I refer to possible cycles in overall productivity dynamics, which can change hierarchies in terms of income per capita. These cycles can be linked with business cycles and longer term/secular cycles.

world in the last couple of decades, that beg for another approach and other policy answers. These currents motivated A. Giddens (1998, 2006) to look beyond conventional theoretical and policy responses. N. Bavarez (2003), A. Sapir (2003, 2005), H. W. Sinn (2004), J. Rifkin (2004), N. Bofinger (2005), J.P. Fitoussi (2005), and others have joined this debate with quite inciting works.

The debate on the European Social Model (ESM) is highly relevant for several reasons. Thus, most of the EU15 member countries are economically and socially strained and policy-makers have a very hard time in devising proper answers to society's ills. Consequently, this debate is destined to help policy become more effective. In addition, the entire project of the Union is meant to give a special social and economic meaning to European societies, which, purportedly, goes beyond the quest of international competitiveness.

This brief paper examines various factors which have strained the ESM and which, arguably, make this period of Euro-pessimism quite peculiar. It looks at the race for competitiveness in today's world and the economic rise of Asia; it looks at some inner dynamics in the European societies (demographics, the crisis of the welfare state, a sort of decadence) and it tries to explore what lies ahead, including policy options. An underlying thesis herein is that eastern enlargement is not the culprit for the current pains of the EU member countries, though it may have accentuated some.

1. The European Social Model and roots of its strain

The claim in favor of the existence a

European model has its own merits, but it is not indisputable. On one hand, one can find traits of capitalism in Europe, which distinguish it of what is generally called the "Anglo-Saxon" variant, or of the type encountered in Asian affluent societies. On the other hand, the welfare state, although in a varied form, is a ubiquitous feature of advanced capitalism worldwide. And some convergence among the patterns of functioning of capitalism has taken place in the last couple of decades under the spell of globalization. Inside Europe there is significant social and economic variety, which makes people differentiate between a Scandinavian model (with its emphasis on social redistribution³), the British model (which is closer to the American model), and a Mediterranean model, which seems to be of a more "disorderly" sort (although the bulging budget deficits in Germany and France have cast some doubt on this view lately). Likewise, some analysts point at the new EU member countries from Central and Eastern Europe, which, seemingly, practice a more liberal (in the European sense) form of capitalism. So where do we stand regarding the "European model"?

In order to answer the question posed above one should not underestimate the influence of the EU construction as a process of depth and large scope. The European Union (EU) project can be considered from two perspectives. One is the construction itself, which aims at spreading common standards throughout the Union and imposing common rules of policy-making and institutional set-ups. I would mention here the 'Social Charter', which is an attempt to make the social dimension of the Union more uniform. That the EU project mired in the throes and policy dilemmas/trade-offs of enlargement and deepening is

³Which is illustrated by the share of taxes in GDP (above 45%)

another story. The fact remains that the Union assumes a high common denominator, in various social and economic aspects. Another perspective refers to EU's meaning outside its boundaries; the Union, in spite of differences among its member countries, is viewed as a model in the rest of the world, a model that has brought prosperity and peace to its citizens.

What strains the ESM? One big challenge is EU's own growing complexity. This challenge is illustrated by frequent coordination failures among EU member countries with regard to policy-making in various fields. The very institutional set-up is an object for hot debate when it comes to effective economic policy-making; an example is the coherence of macroeconomic policy in a single currency area where fiscal policies stay in the national realm. A line of reasoning, though not uncontested, is that this asymmetry imparts a deflationary bias to macroeconomic policy; and that this bias brings about a bad equilibrium (high unemployment and low growth). The Constitutional Treaty itself has fallen prey to a limited ability to manage a rapidly growing complexity³. Poor leadership in not a few EU countries is more salient under such circumstances.

The Union is strained by an apparent contradiction between its well entrenched social model and the need to make markets more flexible so that economic growth is enhanced and unemployment diminished. Arguably, this contradiction is rooted in several inner dynamics and would not be so acutely felt in the absence of tremendous pressures exerted by globalization, by competition from low wage economies (including eastern European neighboring countries). The inner dynamics relate to a

gradual institutional decay, sclerosis; this process shows that social/institutional structures do not maintain their freshness perpetually, that they can succumb to vested interests⁴. It is not for nothing that some speak of a democratic deficit in the EU that would be detectable at both national and supranational (EU) level. There are areas in society where stalemates are ominous. For instance: the blockage in reforming educational systems, the pension systems, or in enhancing R&D, both in the public and the private sectors. Another inner dynamic relates to aging and demographics which are crippling the social security system (the welfare system). Last but not least the functioning of labor markets opposes "insiders" to "outsiders"; this split is symptomatic for the erosion of social cohesion. A precarious social cohesion refers to the difficulty of integrating, socially and economically, a rising number of immigrants as well.

Globalization and the economic rise of Asia lend a new content to today's world competition. The latter has to be understood against the background of the new information and communication technologies (ICTs), that create a new age of uncertainty (R. Reich, 2000). The ICTs do foster a labor-saving type of growth in many industries and services in industrial countries. This can lead to high economic growth combined with high unemployment and an erosion of social cohesion. When growth is low and unemployment high things get even worse.

2. The Race for Competitiveness

The 2006 State of the Union address touched on competitiveness challenges, voicing concern that the United States risks

³Students of organizational change would tell a lot in this regard and use the EU as a case study.

⁴This brings back to memory M. Olson (1982) and D. North (1981).

falling behind in science and technology. For citizens in the EU, this "wake-up call" may have seemed surprising: from a European perspective, the United States appears to be pretty much ahead. A 2005 report from Conference Board shows that for the period 1995-2005 annual growth in national output for every hour worked in the EU-15 averaged 1.4 per cent, compared with 2.4 per cent in the United States. Likewise, data compiled by the European Commission (EC) in Brussels also suggest the EU lags behind the United States in key areas. Research and Development (R&D), for instance, represented only 1.93 per cent of the bloc's GDP in 2003, as opposed to 2.58 per cent in the United States and 3.15 per cent in Japan. True, there is a broad variety in performance across the EU, with the Nordic countries overtaking the United States in terms of amounts invested in R&D⁵. However, the stark truth is that the heavyweights of the EU do not spend nearly as much in this area as the EC thinks would be adequate – namely, 3 per cent of GDP⁶.

The ambitious EC blueprint known as the Lisbon Agenda was formulated with an eye to the performance of US companies and the excellence of the American way of blending academic research with high-tech and industrial pursuits. For instance, the EC proposed setting up a European Institute of Technology, modeled after MIT. The idea was criticized as being a "top-down" approach, sucking money and resources from the alternative option of supporting high level research through a European Research Council. Indeed, controversies

have often arisen over specific measures aimed at implementing the Agenda, and much remains in the hands of European national governments. However, it is clear that the United States represents a kind of benchmark for policymakers, and it is also clear that the EU, on average, has been sluggish in achieving its goals in terms of competitiveness. This last sentence needs qualification, however, for there are European companies that have stellar performance in world competition. And the EU, as a whole, and Germany in particular, show excellence in manufacturing trade. But for how long is this going to continue and what about the social implications of labor saving technology and inadequate upgrading of people's skills?

The success of the EU's Nordic fringe has been due not only to major R&D efforts undertaken both by governments and private companies, but also results from flexible product and labor market, as well as a clever overhaul of welfare networks – the so called "flex-security".

The newer EU member countries seem to fare comparatively well in terms of productivity growth⁷; the 2005 report of the Conference Board indicates an increase of over 6 per cent annually in these economies, which have capitalized on their catching up potential. Arguably, however, just catching up isn't enough (see section 4 of this paper). Over the longer run, demographics and an expected sharp rise in wages (according to the Balassa-Samuelson effect) will diminish the growth differential sharply, unless appropriate policies are put into effect.

⁵ Some data would suggest some catching-up lately "More efficient Europe helps hold down rates", *International Herald Tribune*, 16 October 2006, p.16. Other data would indicate, however, the reverse: in 2005 R&D corporate spending rose by 8.2% in the US as compared to 5.8% in the EU ("US widens gap with Europe on R&D", *Financial Times*, 30 October, 2006, p.1)

⁶ A recent Booz Allen Hamilton study finds no solid evidence between R&D expenditure and economic performance ("R&D spending frenzy may be a waste of time", *Financial Times*, 13 November, p.1). But the study is, in my view, conceptually questionable.

⁷ The divisive and acrimonious domestic politics in some of these countries, in the last couple of years, would suggest that things are not as good as they look according to economic growth rates.

If we compare the EU and the United States, then, the latter's concerns might look as unjustified. However, there is another factor to be considered: Asia, China, India and other Asian economies, Brazil, etc. are increasingly a source of competitive pressures in the global economy. These economies are absorbing advanced technologies at a rapid pace and excel in innovation – India's remarkable engineering institutes, like those in Bangalore, can match the best in the Western world. Scientists from Asian nations are becoming an ever more noticeable presence in top scientific journals, illustrating the region's potential to shape the research agenda of the future.

When we introduce Asia into the picture, we can see that the United States and the EU both face competitiveness challenges, although the nature of those challenges is somewhat different. For the United States, they appear to be mainly related to global strategic interests, which in turn are affected by the emergence of new global powers. For the EU, they involve worsening demographics and the crises of the welfare state, together with insufficient resources devoted to R&D and the difficulties in managing its growing complexity. There is a common denominator, however: both the United States and the EU will face stiff competition increasingly from Asian economies.

A couple decades ago, global competition was defined in a triangular formation: US-EU-Japan⁸. The picture today cannot be seen so simply. The evolving global economy brings with it new major competitors and a change of competitive hierarchies. Unless governments and companies are clairvoyant and adjust to trends by investing more in R&D and education, painful corrections will likely be in store.

Those who believe that only non-zero games prevail in the world economy do need a "wake up call" to reality. The dramatic changes under way open up the possibility for co-operative relationships, but also for emerging tensions. Consider, for instance, the growing need for energy and basic commodities in Asia, with China and India as the prime consumers, the unsolved geopolitical crises in various parts of the world (in the Middle East in particular), nuclear proliferation, and the visible and hidden aspects of the struggle against terrorism.

3. Who fears globalization?

Usually, the less benign side of global free trade is ascribed to effects on countries that either cannot make good use of their comparative advantages, or face stiff protectionism from wealthy economies in certain domains –as in the case of farm products. In general, such economies are to be found in the developing world, which are afflicted by poor governance and inability to absorb new technologies.

Recent years, however, have witnessed a rising choir of disquiet in advanced countries as to the impact of global trade on their economies. In the USA, leading politicians have voiced their concerns over what they perceive as multiplying runaway jobs due to outsourcing/off-shoring. This feeling is even more acute in Western Europe, where top national policy makers have not demurred from making public their worries about industrial relocation. And they have not refrained from blaming new EU member countries for, allegedly, practicing unfair competition via lower taxes; fiscal competition would, it is argued, further entice jobs to the less affluent East of Europe.

⁸The composition of the Trilateral Commission is quite telling in this regard.

How does it come that advanced economies, which have traditionally been staunch supporters of free trade, seem to have second thoughts about it and resurrect a new brand of economic nationalism (some would call it patriotism)?

There are both theoretical and more down to earth reasons for this apparent partial turnaround in the public rhetoric displayed in rich economies. Economics-wise, the arguments which stress the virtues of free trade form the basics for rationalizing commercial exchanges among countries; nonetheless, these arguments lose some of their appeal when the distribution of gains is largely asymmetric and dynamic competitive advantages dominate. Brander and Spencer (1983), Krugman and Helpman (1985), respectively, wrote seminal pieces on what they called “strategic trade”. One can posit that the economic rise of Asian economies (and most impressively of China, in the last couple of decades) is to be judged through such policy lenses; namely, strategic trade policy, which was embedded into a development industrial policy by using market forces in a smart way⁹.

Nowadays, the new information and communication technologies (ICTs), bring about great opportunities for those developing economies which benefit on well educated populations. Again, Asian countries fare quite well in this respect. “India unbound”, of the last decade, is the outcome of market-oriented reforms against the background of a vast pool of English-speaking engineers and computer/ software specialists. Although one has to admit that only parts of India have been touched by rapid economic progress, and much of it is still mired in abject poverty.

What matters in the global economic game, and which drives industrial

relocation, is the existence of substantial wage differentials among countries and regions; these differentials induce globally oriented companies to shift operations in areas which combine cheap labour with adequate technologies. The intensity of this process depends on wage differentials, the quality of other production factors and the emergence of industrial clusters. Leading mainstream trade economists (like J. Bhagwati) would argue that advanced economies have not much to fear since they are increasingly specializing in higher value added products and services; and that all countries will be better off in the end. This train of thought was counteracted by the Nobel prize winner P. Samuelson, from MIT. He says that “sometimes a productivity gain in one country can benefit that country alone, while permanently hurting the other country by reducing the gains from trade that are possible between the two countries (2004, pp.142). He further says that “post-2000 outsourcing is just what ought to have been predictable as far back as 1950”, in the sense of other economies in the world assimilating advanced technologies and catching-up with the US economy, more or less.

Samuelson's argument finds solid underpinning in empirical research done by L. Freeman from Harvard. Professor Freeman estimates that the entry of China, India and countries from the former Soviet bloc into the world economy resulted in a doubling of the number of workers, to almost 3 Bn. Consequently, the ratio of capital to labour fell to 60% of what would otherwise have been. Moreover, the newcomers have good technical skills and much lower wages than their western counterparts. This exerts a strong downward pressure on wages in western economies¹⁰.

⁹D. Rodrik is, probably, the most articulate and sophisticated development economist, in this regard (1996, 1998)

¹⁰S.Brittan (2006, p.13).

It pays to note, in this regard, that some German workers have accepted cuts in their wages. Like Freeman reasons L. Summers, too: “middle-class workers and their employers whether they live in the American Midwest, the Ruhr valley, Latin America, or Eastern Europe are left out” in a global competition that rewards the combination of low wages and diffusible technologies, and the ability to access global product and financial markets.¹¹

Against the backdrop of the new ICTs and considerable wage differentials among economies in the world, important shifts in the global distribution of industrial and services activities looks unavoidable. At the same time, public budgets are increasingly under strain due to population ageing¹². Thence comes out the fear of outsourcing/off-shoring. One can easily understand this fear in western European countries, where wages are a high multiple of what well educated workers in Eastern and central Europe earn. The Lisbon Agenda sprang out of this fear, albeit the perspective was framed in global (and not continental) terms. The big EU member countries fear Asian countries and the US economy mostly and regard the Lisbon Agenda as a competitiveness policy response¹³. The EU Commission updating of the Agenda has scaled down the super-ambitious ultimate goal, but the policy thrust is unaltered.

The fear of outsourcing/off-shoring can be examined analogously with the anguish surrounding the transformation depression of the last decade in post-communist economies. The latter went through a dramatic fall of output because resource reallocation at the newly market clearing prices could not happen rapidly enough. Similar pains can be detected

nowadays among some groups of workers in rich economies, who cannot compete in the new global economy.

The theoretical explanation presented above can be complemented by the reality of protectionist measures in various countries, which makes the picture fuzzier. The bottom line is that countries which have skilled people, which invest in education and have forward looking public policies, are more likely to enjoy the fruits of technology dissemination on a global scale.

4. High growth rates are not enough. The case of Central Europe

What has happened in Hungary, Slovakia, the Czech Republic, Poland, in the last couple of years, has raised eyebrows among observers worldwide. How does it come that after EU accession domestic politics have stumbled in such a disturbing manner in these countries; fragile and stalemated governments, coalitions that bring together strange bedfellows (with political philosophies quite apart), have puzzled those who have expected a consolidation of democratic politics.

It pays to remember that these economies are part of the dynamic area of Europe, with annual economic growth rates that have been a multiple of those registered in the hard core of the EU (5-6% vs. 1-2%). Moreover, their economies seem to be well embedded in higher value-added European industrial networks, as against other transition economies. These networks, therefore, should provide more optimism regarding the chances of these countries to sustain rapid economic growth over the longer term.

¹¹ L. Summers, 2006, p.13

¹² D. Gros (2005);

¹³ E. Maincent and L. Navarro (2006)

Conventional wisdom, that blends politics and economics, says that wherever economic growth is pretty high social stability and sound politics have a better chance to ensue, or consolidate. To be more specific, in the case of Central Europe, a logical inference would be that, owing to significant economic growth in this decade, a large part of the population would enjoy tangible economic fruits and, therefore, support the ruling coalitions. Moreover, EU accession was presumed to ascertain the solid underpinning of these young liberal democracies and enhance, further, democratic politics. And there is another factor to consider. As against the citizens of most of the EU 15 (I put Spain and Portugal aside due to the decades of authoritarian rule under Franco and Salazar) most of the post-communist countries' citizens have an own lived experience with the command (communist) system. Therefore, a fair assumption would be that they are immune to the erosion of basic coordinates of orderly democratic life, and be better able to detect fake democrats and cheap populism, be it on the right or the left.

I would try to elaborate on these explanatory variables were they accepted as such. When it comes to economic growth post-communist Mitteleuropa shows, glaringly, that high growth rates are not sufficient for securing tranquility in social and political life. Among economists there is an ongoing debate on the fundamentals of economic growth, on the relationship between democracy and prosperity. Some would argue that what matters most and foremost is economic growth, even if that may incur substantial inequities among social partners. Another line of reasoning submits that sustainable economic growth should not impair social cohesion, which it has to be accompanied by an adequate

production of public goods. The debate involves the importance of good practices in both the public and the private sector and how corruption can be combated effectively. Arguably, wherever in Central and Eastern Europe numerous citizens have lost in the economic race, or have been marginalized (excluded from the fruits of economic growth) their frustration is likely to be captured by extremist parties and centrist parties lose political ground.

Another explanation is the very disappearance of the EU anchor. This anchor has allowed politicians, irrespective of their political persuasions, to rally citizens behind the banner of EU accession as a "return to Europe". For not a few of these citizens "return to Europe" has been assumed to bring them into a Nirvana sort of society, with immediate considerable economic benefits. And these people have seen that nothing has changed dramatically after May 2004. On the contrary, some additional pains have been brought about by the rigors of complying with the regulations of the EU. A confrontation with reality was thus unavoidable. This confrontation concerns the resurrection of "economic patriotism" in major EU member countries (like France, Germany, Spain, etc) as well. In order to join the EU eastern European countries have observed most diligently the intellectual and operational matrix of the Union; for instance, the total opening of markets (for the sake of single markets), including those for financial services and public utilities. As a matter of fact, in these sectors, Eastern Europeans have been more liberal (in the European sense) than their western counterparts. It is easy then to comprehend the frustration in some political circles in central Europe when EU heavyweights preach what they do not practice. And thence one gets an

explanation (among others) for the revival of economic nationalism in the East as well, a tendency that can be amplified by other issues (for example, Poland's fear of Germany and Russia, both of which are working together in the very sensitive field of energy procurement).

As to collective memory it does not seem to be an effective protective tool because of its selectivity. There seems to be an asymmetry at play here: people do enjoy political liberties and like to voice their satisfaction/frustration; but, at the same time, they seem to have forgotten the period when those liberties were non-existent and what it implied in their lives. Likewise, cohorts of young people, who do not have a lived experience with communism, heighten this asymmetry. However far fetched the analogy may be, the mentioned asymmetry is, arguably, similar to the disconnection that some people in Western countries reveal with the ravages of the Second World War and its atrocities (including the Holocaust).

An additional explanatory argument can be used: actual democracy is quite distant from textbook democracy. The former means, essentially, the functioning, for better or worse, of checks and balances; it refers to the morality and the sense of accountability of political rulers, which might be quite dismaying under certain conditions. The actual state of democracy does have an impact on the mythology created after the fall of communism; not a few myths and clichés are fading away in the "New Europe" and individual and group psychologies react one way or another.

Eastern European societies are much less prosperous than their western EU partners. At the same time, they are facing similar structural challenges: aging, the crisis of the welfare system, social (income)

polarization, identity-related confusion, and a rising pressure of immigration. High economic growth is not a panacea where governments are incapable to deal with the social challenges that accompany modernization, against the background of globalization; and high economic growth may not be durable if wages keep rising rapidly because of catching up dynamics inside the Union. There are no easy solutions in this regard. What is certain, nonetheless, is that national politicians will be severely tested in the years to come; what they do will influence domestic politics and their countries' economies greatly. What is happening in central Europe is a lesson and a harbinger to other post-communist countries as well.

5. The future of the ESM

How would the "European model" evolve in the future hinges on the interplay of a myriad of factors? I would mention some of them. One factor is the challenge of managing the increasing complexity in the Union. Students of organizational change know how difficult is to make ever larger and complex organizations function efficiently. For the sake of economic and social functionality the EU has to find more appropriate institutional and policy constructs; the Constitutional Treaty is part of this endeavor. For this to happen, better leadership, actual statesmanship, has to come to the fore. But this political commodity is pretty scarce in Europe nowadays.

It may be that rising variable geometry is inescapable in the Union, but this would not simplify the challenge of managing increasing complexity; the latter would have to deal with issues like: tax competition (whether to make fiscal policies

more convergent and avoid a race to the bottom; whom/what to tax when factors of production are increasingly mobile, etc), creating genuine single markets, the reform of the Common Agricultural Policy, and, not least, the reform of the functioning of the European Commission, of its links with other EU governing bodies.

The clash of paradigms and ideas would shape things as well. For instance, the big failures in financial and energy markets have ushered into a new period of market regulation, which reshaped public policy accordingly (The Oxley-Sarbanes Act in the USA is a clear example, which has had reverberations in Europe as well). Public policy is forced to reconsider older times theses (ex: the state has to provide essential public goods) in order to regain the moral ground, which was partially lost owing to major scandals in the corporate world.

Policy pragmatism is in much higher demand albeit hard-nosed “ideologues” walk through the corridors of power. But a big irony is present here. There are a growing number of signs that market fundamentalists are on the retreat and that pragmatic considerations, social and environmental concerns would and should find easier way into mainstream policy-making. On the other hand, the pressures of globalization make it quite hard for western governments (in the EU) to strike the right balance between social concerns (dealing with the “underdogs”/“les exclus”) and environmental issues, on one hand, and reforming/streamlining the welfare state, on the other hand. This is because coordination failures exist not only within the EU, but in the world economy as well. Missing, or ineffective institutions for global governance are to be mentioned in this regard.

¹⁴See C. Bebear, (2003)

¹⁵ “Trust and similar values, loyalty, truth-telling...have real, practical, economic value; they increase the efficiency of the system, enable you to produce more goods or more of whatever you hold in high esteem. But they are not commodities for which trade on the open market is technically possible or even meaningful” (Arrow, 1974, p.23)

Education has to be tackled much more effectively by national governments. People have to rediscover the merits of engineering, mathematics, physical sciences. This would help create competitive edges based on technological advance, higher value-added products and services. The economic battles of the future, in an expanding global economy – wherein China and India will play an ever bigger role – cannot be won by armies made up of lawyers and MBA graduates exclusively.

Can a *new social contract* be entered into by social partners? If wage earners would accept a slower rise in their incomes (a freeze, or a cut), would capital accept lower profits/dividends for the sake of more public and private productive investment? It is public knowledge that recent years have witnessed an astonishing rise in the incomes of CEOs at a time of modest, or even stagnant wages, that income polarization has increased in almost all western societies, that the middle class has been frequently a loser. If this dynamic is judged by considering the myriad of corporate scandals one has to question the morality and social responsibility of numerous corporate leaders¹⁴. Can we ask wage earners to accept cuts in their incomes when CEOs gain ever more? This is why ethics and morality are part of the equation when trying to address society's ills.

Ethical and moral considerations suggest that we need “to go back to roots”, to regain our moral values: honesty and trustworthiness, honor and respect, loyalty, hard work, education, family, community, altruism and compassion, the love of one's country¹⁵. In order to strengthen the social cement of society guilt and shame need to

be recovered as socializing emotions¹⁶. Cynicism, the lust for power and money, hypocrisy, disregard for fellow citizens have been spreading; they point to a decadence that has to be fought against tenaciously. It is dismaying to see top notch politicians who reveal themselves as villains, who use the intricate ways of democratic procedures to enrich themselves and their cronies, to grab and hold on power. This behavior is undermining democracy and crippling the effectiveness of public policy. One could argue that virtue and vice have accompanied human history from the very beginning, that actual democracies are not textbook, ideal creatures. Nonetheless, I would argue that in times of duress lofty ideals and moral values can make the difference and turn the boat in the right direction.

The role of religion is to be highlighted when examining the role of moral values. For Church, as an institution, is facing its own challenges, including a credibility issue. At the same time, inter-religious dialogue is a must in a Europe that has to show that the clash of civilizations can be averted on its own turf.

The moral ground relates to international politics as well. Issues such as environment protection (dealing with global warming), containing and combating diseases in the poor world, securing

drinkable water and fighting poverty, resuming the Doha trade Round, etc. make up an urgent agenda; this agenda would help deal with international terrorism, too.

When highlighting the moral ground, the EU (especially the heavyweights) has to undergo its own soul-searching; it has to practice more what it preaches in its dealings with emerging economies, with developing countries in general. Just keep in mind how and why the Doha trade round has failed.

On all the accounts mentioned above the "European model" has something relevant to say. Its progress would make a significant contribution to how the world evolves in the years, decades, to come – economically, socially, and politically. This progress, however, were it to happen, would not be, in my view, spectacular. There are many more uncertainties around, and the world has been changing considerably as against a few decades ago, when the EU project included less than a dozen European countries. The economic rise of Asia is quite momentous historically and it produces tectonic shifts in the balance of power in the world; it also changes the flow of pressures worldwide, sometimes dramatically. Rather a muddling through period is more likely to follow for the European Union.

¹⁶ See D. Lal for insightful observations on the cultural dimension of development, differences between Europe and Asia (1999)

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