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Conflicting Distributive Interests in a Deepening and Widening Europe: A Challenge to the Emerging Europolity

The recent split in Europe regarding its foreign and security policy and its Constitution distracts from potential conflict in the core arena of European integration where decisions are made concerning the distribution of wealth and income in the deepening and widening Europe. The emerging Europolity will have to manage these conflicts if populism and Euroscepticism are not to endanger the unification of Europe.

European politics and EU policies affecting the distribution of wealth and income in Europe

If there is one sphere where frustration with politics ("Politikverdrossenheit") is stronger than in national politics, it is European politics. European elections are characterised by low voter turn-outs. European affairs have little value in domestic political life. The citizens seem simply to ignore Europe. They apparently think that it does not affect their daily lives in a way that merits deeper involvement. Rather fuzzy issues of national pride and prejudice seem to stir up emotions more than hard economic interests. If further proof were needed, the Iraq crisis provided plenty: Europe is far from unified. However, the cleavage between the "old" and the "new" Europe may be a short-lived, transitory affair. The societies of the EU's present and future member states – let alone their governments – have different preferences, values and interests which may be more fundamental and structural. That this has occurred in the field of foreign policy may be frustrating but should hardly be surprising as foreign and security policy is still a basically national competence.

However, the core of the European integration project is the Internal Market with its framework of regulations and supporting common policies (agricultural, structural, commercial and competition policies), and Economic and Monetary Union, at least for the members of the Eurozone. Even in this core business of Europe, there are conflicting interests, some more obvious than others. Up to now, these conflicts arising from European integration have largely been latent and dormant. Political parties in Europe seldom take up European issues in a serious manner, with the exception of such crucial questions as, for example, EU membership,[1] although most parties have more or less strong programmatic positions on European economic and political integration.[2] Even the election campaigns for the European Parliament are mostly dominated by domestic issues and general assertions of support for Europe.

But the further European integration progresses, the more painful the adjustment pressures and costs are likely to become. The underlying conflicts could become more virulent and require attention from the European political system at all levels, in Brussels, in the member states, and on the regional and local levels. One (dangerous) scenario could be the re-emergence of conflicts between nation-states as opposed to a trans-national cleavage between basic political options for Europe (for example, socialist vs liberal, or federalist vs intergovernmental). Unresolved economic conflicts could also spill over into and fuel traditional national/cultural conflicts.

EU policies affect the behaviour of European states, households and enterprises in various ways. European integration has changed the competencies of states, the structure of markets, people's rights and has even introduced a new currency, albeit not yet in the whole EU. Different EU policies affect different member states, and societal segments within member states, in various ways, sometimes directly, sometimes indirectly,

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1 While some authors (for example, Marks / Wilson 2000) see European issues growing in importance for national parties, others see only a limited impact (for example, Mair 2000). These views can be reconciled if one assumes that party systems shape party attitudes towards Europe rather than the other way round.

2 See for an overview Marks / Wilson / Ray 2002.

by changing the conditions in which they can pursue their interests. Direct effects can also be mitigated when those affected are able to pass on the cost to other segments of their own society or to other member states or third parties. In the end, all distributional conflicts are between individuals and groups of individuals affected in the same way. Even those conflicts that are supposedly between countries are ultimately between segments of different national societies as they usually burden and benefit only some people, and not all citizens of the countries involved (for example, agricultural subsidies may redistribute wealth from tax payers in one member state to farmers in another).

This mixture of direct and indirect effects,[3] effects on whole economies and those that affect only certain sectors or social classes makes the overall impact of European integration on the distribution of wealth and income in Europe less transparent. It is not only difficult to analyse and understand but also difficult to communicate and translate into political action. This basic character of the EU's impact on the lives of European citizens probably largely explains the lack of interest shown by the European public (if it even makes sense to speak of a "European public") in European politics. That does not prevent Europeans from approving or disapproving of the EU and its policies, depending on their perceived effect on the citizens' welfare.[4] In particular, utilitarian evaluations of the costs and benefits of European integration matter while affective attachment to the EU remains moderate.[5] Statistical analysis shows that support for European integration is in fact correlated with perceived benefits that accrue from EU policies. Thus, wealthy and highly skilled people, unskilled workers on relatively low wages and farmers tend to favour European integration more than average as they benefit from market liberalization and the Common Agricultural Policy.[6]

The present paper analyses various European policies with regard to their distributional impact on member states and particular societal groups in Europe in order to assess their implications for the political alignment of interests.

State versus state

Starting point: accession and enlargement

Even if not an EU member, a country might none the less be affected by EU policies (for example, EU trade policy or EU aid), but in the context of this paper we focus on present member states and the candidate countries. Therefore, the starting point for further analysis is the interest of a country (its polity and society) in EU membership. The decision to apply for EU membership and, in the end, to join the EU is one of prime national importance. In many applicant countries, there has been a strong national debate on the issue with conflicting opinions (most recently in Malta) which led in some cases even to a rejection of accession, for example, in Norway. Most candidate countries want to join the EU for general political (or even identity) reasons as well as because they expect substantial welfare gains, including transfer payments which might reach 4% of GDP.

Table 1:
Support for accession in the applicant countries

Country	1993	1996	1997	1998	2001	2002
Estonia	79	76	29	35	33	39
Poland	80	93	70	63	51	61
Czech Rep.	84	79	43	49	46	50
Hungary	83	80	47	56	60	77
Slovenia	92	79	47	57	41	62
Latvia	78	80	34	40	33	54
Lithuania	88	86	35	40	41	53
Slovakia	84	88	46	62	59	69
Bulgaria	76	86	49	57	74	74
Romania	79	97	80	71	80	84
Cyprus					51	58
Malta					39	47
Turkey					59	71
Average CEE	82,3	84,4	48	53		

Source: Eurobarometer.

Although support for membership has been volatile (see Tables 1 and 2), most candidate countries are likely to vote in favour of accession, to which few po-

3 See also Mair 2000.
4 See Eichenberg / Dalton 1999.
5 See Gabel 1998, Chapter 2. Gabel doubts explanations of public support based on values (for example, Inglehart / Rabier / Reif 1991 and Janssen1991).
6 See Gabel 1998, Chapters 3–5, and Conclusion, p. 110.

litical parties in candidate countries are openly opposed.[7] Voter turnout during the referenda in 2003 has often been low (in particular in Hungary in April 2003). In the end, all countries voted in favour, but the share of supporters in the total electorate remained below 50%, except in Lithuania and Slovenia. This positive attitude and high expectations are seldom based on a thorough knowledge of the EU, its institutions, policies and past record. As knowledge increases and accession gets closer scepticism has often increased, too.[8]

In fact, EU membership as such has rarely led to strong growth, let alone a catching up by poor new members with the older, richer member states. Ireland and Greece remained poor or even became relatively poorer after accession, in 1972 and 1981 respectively. Ireland's economic miracle started only in the mid-1990s. There are even strong risks that membership will make catching-up more difficult by preventing the use of certain potentially successful policies (either radical free market ones or highly interventionist ones of the East Asian type), by infecting the new members with the "Dutch disease" or by offering the wrong incentives. Moreover, accession will affect different groups differently, for example, regions closer to the borders of the present EU are likely to benefit while regions neighbouring on third countries, such as Ukraine, will suffer from less open borders.[9] The interests of other relevant groups, such as labour and capital, will be dealt with below.

Table 2:
Evaluation of EU membership in the candidate countries (autumn 2002) and the results of the referenda in 2003

	BU	**ES**	**LA**	**LI**	**MA**	**PO**	**RU**	**SK**	**SN**	**CR**	**TÜ**	**HU**	**CY**	**CC**
Good thing	74	33	33	41	39	51	80	58	40	46	59	59	51	59
Bad thing	3	14	17	11	31	11	2	5	11	9	14	7	13	10
Neither good nor bad	12	38	39	35	25	27	11	28	42	31	18	23	31	22
Don't know	9	15	11	13	5	12	8	9	7	13	9	10	5	10
Net support	71	19	16	30	8	40	78	53	29	37	45	52	38	49
Referendum														
Yes-vote		67	67	91	54	77		92	90	77		84		
Turn-out		64	72	63	91	59		52	60	55		46		
Yes vote as % of electorate		43	49	58	49	46		48	54	43		38		

Source: Oskar Niedermayer: "Die öffentliche Meinung zur zukünftigen Gestalt der EU. Bevölkerungsorientierungen in Deutschland und den anderen EU-Staaten" (Bonn, 2003), Tabelle A13; referenda: http://www.mdr.de/eu/aktuell/938582.html

Although some of these questions have been addressed in the accession negotiations, the EU has insisted on the adoption of the *acquis communautaire* and the candidates have accepted this. It is none the less possible, if not likely, that some conflicts will re-emerge after accession when the negotiating positions of the new members will be much stronger.

In the present member states, support for enlargement has generally been weaker than in the applicant countries (see Table 3 and 4). Again, few parties openly oppose enlargement. Opposition is strongest in France, probably for political rather than socio-economic reasons. The biggest socio-economic reservations concern the threat of migration, and to a lesser extent low-wage competition and budgetary costs. Related fears are strongest in Germany and Austria and have led to the introduction of transitory regulations that postpone freedom of movement for up to seven years. The strongest supporter of enlargement is

7 See Taggart / Szczerbiak 2001.
8 Ibid., pp. 12–13.
9 For a more detailed analysis of the costs and benefits of accession and enlargement see Dauderstädt 2003.

Greece, again for foreign policy reasons, namely the desire to get Cyprus into the EU.

Table 3: Support for EU enlargement (spring 2002)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EU
For	51	68	43	67	64	40	56	61	55	56	45	57	56	61	38	50
Against	32	23	36	15	14	47	16	19	34	30	36	18	32	27	35	30
Don't know	17	10	22	17	22	13	29	20	11	14	20	25	12	11	28	20
Net support	19	45	7	52	50	-7	40	42	21	26	9	39	24	34	3	20

Source: Oskar Niedermayer: "Die öffentliche Meinung zur zukünftigen Gestalt der EU. Bevölkerungsorientierungen in Deutschland und den anderen EU-Staaten" (Bonn, 2003), Tabelle A14.

Table 4: Support for the accession of 13 candidate countries (autumn 2001)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EU
Malta	18	32	14	55	33	-20	45	38	30	33	20	21	19	54	39	23
Hungary	10	40	28	45	34	-17	29	29	20	22	38	24	37	58	12	20
Cyprus	15	8	3	81	30	-27	41	19	12	18	11	21	11	44	29	13
Poland	8	50	-2	42	34	-12	31	26	14	22	-20	26	18	60	15	13
Czech Rep.	0	40	8	39	35	-25	27	19	23	19	-14	26	15	56	9	11
Slovakia	-6	28	-5	36	28	-31	18	12	10	8	-14	18	7	49	-1	2
Estonia	-3	48	3	29	26	-40	18	3	12	16	-9	13	47	64	-2	2
Latvia	-3	47	3	30	26	-39	19	2	12	15	-8	13	30	63	-2	1
Lithuania	-5	46	-1	30	26	-38	18	1	10	11	-10	15	28	60	-2	1
Bulgaria	-8	7	-22	34	33	-29	21	13	-3	-2	-33	24	-4	36	3	-2
Slovenia	-11	8	-17	33	26	-36	16	8	4	-2	11	15	-10	37	-4	-3
Romania	-14	-1	-32	37	28	-32	15	13	-7	-6	-43	22	-21	30	-4	-7
Turkey	-22	-24	-32	-39	16	-41	22	-11	-30	0	-25	20	-30	2	7	-12

Source: Oskar Niedermayer: "Die öffentliche Meinung zur zukünftigen Gestalt der EU. Bevölkerungsorientierungen in Deutschland und den anderen EU-Staaten" (Bonn, 2003), Tabelle A15.

Malta and Hungary get the most support for accession within the EU, Romania and Turkey the least. Concerns about migration and budgetary costs are likely to fuel the reluctance of current member states to accept these applicants. Otherwise, specific and mostly political relations are important. For instance, Germans and Austrians have strongly welcomed the accession of Hungary, while the French, who are generally opposed to enlargement, are less sceptical regarding the accession of Poland (in 2001; after the diplomatic row in 2003 this might have changed) and Romania. Similarly, Finland supports the accession of the Baltic countries.

National budgets and the redistribution of taxes

The European Union as a supra-national entity has only weak redistributive powers compared with true federal governments, as in Germany or the US. Its budget amounts to approximately 1.2 % of European GNP. However, this sum – about 100 billion Euro – is not inconsiderable, and raising it from member states is not easy. Conflicts over the national contribution to the EU budget are notorious – British Prime Minister Margaret Thatcher wanted her money back – and Germany often complains about its role as the largest net contributor.

If one focuses on the net position (net contributor or net beneficiary) of a member state, the perspective changes somewhat as some big contributors are also big recipients. Ultimately, net recipients are interested in sustaining and strengthening redistributive policies – in particular structural and agricultural policies, which make up 80% of the EU budget – while net contributors are interested in reforming these policies. Possible reforms aim at reducing the general level of expenditure and/or increasing the efficiency of the respective policies. The Common Agricultural Policy (CAP) benefits mostly big farmers and thus has little redistributive impact in favour of the poor. Regional and structural funds have hardly been able to reduce the income disparities between the richest and poorest regions in the EU, although some countries (in particular Ireland) have made good use of these funds.

The EU has generally succeeded in achieving a consensus regarding the financing of its budget and the size and design of its redistributive policies. The necessary negotiations have been hard and conflicts during summits could often only be resolved at the last minute. This was the case at the Berlin summit in 1999 when Agenda 2000 was decided upon, or at the Copenhagen summit in 2003 when the financial aspects of enlargement were negotiated. However, it is not only the substantive issues which are the subject of intense conflicts and negotiations, but also the decision-making process. In Nice, for instance, Spain insisted on a unanimous decision on the budget to 2007 to include the next planning–budgeting period of the regional funds that starts in 2006/7. The EU budget is basically decided by the European Council and Parliament, but the latter has no control over the agricultural funds – this indicates the strong interest some governments take in this area.

These distributive conflicts at the EU level are to a large extent conflicts between member states regardless of the party political orientation of their governments. Poorer member states have always argued in favour of "cohesion", and France, with its relatively large agricultural sector, has supported the CAP. The ideological preferences of liberals (less state and thus less redistribution through the state) or social democrats (more social justice and thus less tolerance of a regressive agricultural policy) have had surprisingly little influence on the shaping of these common policies.

Besides indirect transfers via Brussels between national budgets European integration affects the capacity of national governments to raise taxes. Tax competition, in particular regarding corporate taxes and taxes on capital income, is becoming increasingly important, with Luxembourg, Ireland and the UK in opposition to other member states – for example, Germany – which want to harmonise tax rates. Luxembourg, for instance, has sound public finances because it attracts economic activities such as investment which benefit from lower taxes on interest or value added. Through creative accounting and transfer pricing, multinational firms investing in Ireland or Hungary increase their profits at the expense of subsidiaries and tax authorities in countries with higher corporate taxes.

Changing growth opportunities: supply side

At first glance virtually no European policy affects income distribution between member states, if one disregards direct redistribution through the EU budget. In fact, national income depends on the volume and productivity of factors of production, basically labour and capital, employed in the national economy. Clarification is needed here: the factors employed might not belong to the citizens of the respective member state. European integration, in particular the four freedoms of the Common Market, promote the employment of labour and capital from other member states. In fact, intra-European foreign direct investment (FDI) had already reached 7% of GDP in 2000 (European Commission 2002b: 45): the factor income generated belongs to those foreign investors. While the GDP of a given country increases with the domestic use of foreign production factors, its gross national product (GNP) may not, as it reflects the income of the citizens, not of the state or economic territory.

Cross-border flows of capital or labour thus have opposite effects on GDP and GNP. While the capital-exporting country loses GDP because less capital is employed within its borders it will later gain GNP as its capital owners receive a return on their capital from abroad. The same is true for labour migration. Usually, the difference between GDP and GNP is minimal as only a small share of the national capital or labour stock is employed abroad or is owned by foreigners, and inflows and outflows compensate each other. There are exceptions, however, such as Ireland. Small, open economies are in any case more likely to be affected by cross-border investment or migration. A poor open economy is a natural recipient of foreign investment if the productivity level is attractive. EU policies not only alleviate those flows but may also increase attractiveness through regional and structural funds. Ireland has used these funds cleverly to improve the conditions for foreign (and domestic) capital by financing training and infrastructure. As a result, foreign capital now makes up a large share of all capital in Ire-

land and the return on that capital – that is, the profits of foreign investors – make up a substantial share of its GDP. Correspondingly, Ireland's GNP differs strongly – at least in comparison to other advanced economies – from its GDP; more bluntly, Irish citizens (whose income is measured by GNP) are much poorer than the Irish economy (measured in GDP).[10] In a labour-surplus situation (such as Europe has been in for about 30 years) countries compete for capital and investment rather than labour.

In an international perspective, competing locations attract capital by offering better profits, which result from higher productivity and/or lower wages. In the long run, higher productivity can be achieved through innovation, investment in labour-saving technology, or better management, but in the short run, nominal increases can also be achieved through the externalisation of certain costs (environmental, training, infrastructure), or more directly through lower taxes or more subsidies, and/or less protection of workers (longer hours, less participation, weaker health and safety, shorter holidays, and so on). The EU has laid down a host of rules and regulations that constrain these possibilities in order to prevent "unfair" competition and a "race to the bottom". Different countries are differently affected by these constraints, depending on their mix of industries, education and financial systems, labour market arrangements, and industrial policy "culture" – in short, depending on their "variety of capitalism".[11] Poor countries – such as post-communist accession countries – will prefer a less generous supply of public goods and protection of workers and the environment due to a stronger preference for income growth. In particular, societies might have different preferences regarding the translation of productivity growth into less labour input (that is, earlier retirement, longer holidays, shorter daily or weekly working time).

Changing growth opportunities: demand side

Even when the supply side is working well (sufficient labour and capital are available and used efficiently), growth depends on the demand for potential output. This demand can be managed politically by manipulating state expenditures, monetary growth and external demand, the latter through the exchange rate. All these measures are now constrained – for Eurozone members – by rules set at the European level.

Some member states (for example, Sweden) have relied more than others on nominal devaluations to restore their competitiveness. Nominal devaluations can restore price competitiveness that has been lost through high inflation. Conversely, having a rate of inflation lower than one's trading partners represents a real relative depreciation and allows a nominal appreciation without losing competitiveness (this was typically the case with Germany between 1970 and 1990). Different rates of productivity growth among the member states must lead to different growth rates of income. Lower (or higher) productivity translates into lower (or higher) competitiveness, unless it is compensated for by real appreciation or devaluation of the exchange rate. Within Euroland, exchange rate changes are no longer possible and any differentials in productivity growth and/or inflation rates have to be compensated for by changes in nominal income and/or prices. In particular, poor member states cannot rely on currency appreciation in order to catch up with richer countries. They thus have to rely on a higher rate of inflation (Balassa–Samuelson effect) which the European Central Bank (ECB) will scarcely tolerate.

The Common Monetary Policy of the ECB, together with the accompanying Stability and Growth Pact (SGP), affect economic growth in the member states and ultimately the distribution of income between those countries. As a rule, economies with sluggish growth and high unemployment prefer lower interest rates and higher budget deficits than booming, full-employment economies. Depressed economies usually show lower inflation rates. Given a certain nominal interest rate set by the ECB, real interest rates will thus be higher in these sluggish economies leading them into a vicious circle of recession and deflation. Conversely, fast growing economies with higher inflation rates (for example, Ireland) enjoy lower real interest rates which promote further investment and growth.[12] As long as business cycles are not synchronous in Euroland different economic situations require different policies. Keeping economies in recession in a monetary and fiscal straightjacket will lead to disgruntlement, to say the least.

Popular support for the Euro (see Table 5) reflects these interests. Sweden, Denmark and the UK have not adopted the Euro as they need exchange rate flexibility to maintain competitiveness. In September 2003, the majority of Swedish voters rejected the adoption of the Euro in a referendum. Greece, Spain, Italy and Ireland, which are among the beneficiaries of lower interest rates, show high rates of support.

10 See O´Hearn 2001 and Dauderstädt / Witte 2002.
11 See Hall / Soskice 2001.
12 See Bofinger 2003, pp. 4–7.

Table 5: Support for the Euro (spring 2002)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EZ*	EU
For	82	52	67	80	80	67	78	87	91	75	72	73	64	49	31	75	67
Against	10	43	24	16	12	28	13	9	6	22	19	19	31	42	52	19	25
Don't know	8	5	9	4	7	5	9	4	3	4	10	9	5	8	17	6	8
Net support	72	9	43	64	68	39	65	78	85	53	53	54	33	7	-21	56	42

* EZ = Eurozone.

Source: Oskar Niedermayer: "Die öffentliche Meinung zur zukünftigen Gestalt der EU. Bevölkerungsorientierungen in Deutschland und den anderen EU-Staaten" (Bonn, 2003), Tabelle A17.

Table 6: Evaluation of EU membership (spring 2002)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EU
Good thing	58	60	52	64	66	47	78	69	81	71	37	62	40	38	32	53
Bad thing	4	16	9	5	5	14	4	3	3	6	16	7	18	27	21	11
Neither good nor bad	30	21	31	27	23	35	12	22	14	17	41	24	38	32	32	28
Don't know	7	3	9	4	7	5	6	6	2	6	6	7	4	4	15	8
Net support	54	44	43	59	61	33	74	66	78	65	21	55	22	11	11	42

Source: Oskar Niedermayer: "Die öffentliche Meinung zur zukünftigen Gestalt der EU. Bevölkerungsorientierungen in Deutschland und den anderen EU-Staaten" (Bonn, 2003), Tabelle A12

The fathers of the SGP wanted to make sure that spendthrift governments (or member states) do not get a free ride in the form of relatively low interest rates while those with sound finances are punished by interest rates that are higher than they would be if all governments avoided large deficits. The same is true to some extent regarding wage setting. Since the ECB has a low inflation target it will react to strong wage increases (above productivity growth) with a restrictive monetary policy that dampens economic growth. Responsible social partners in centralised wage bargaining systems might suffer from the behaviour of less responsible unions and employers who neglect the possible ECB reaction and try to "free ride" on the assumption that, in the larger Euroland, their actions will go unnoticed under the cloak of the more responsible behaviour of others.

To sum up, European policies affect the relative economic fates of member states in various ways. National economic policy debates hardly reflect this. Only with regard to such far-reaching choices as EU accession in general and adoption of the Euro in particular, is dissent noticeable. One can, for instance, assume that the Swedish reluctance to accept the Euro is largely due to Sweden's desire to retain devaluation as part of its economic-policy toolbox. Otherwise, political parties – with the possible exception of some populist ones – have not taken up these questions in their domestic polities. As Table 6 shows, net support for membership is lowest in the UK and Sweden, and, albeit to a lower extent, in Finland and Austria (which also has a strong populist party).

Intra-societal conflicts

Virtually every redistribution between countries affects domestic distribution within the countries concerned. External economic relations interact with the basic distributional mechanism of the societies involved. In the case of the EU, markets determine the primary distribution (section 3.1 and 3.2) which is then massively corrected by public policies, notably the welfare state (section 3.3). EU policies affect both systems of distribution and redistribution.

Labour vs capital

In a market economy, growth resulting from higher factor input and increasing productivity can either be distributed between the producers (labour and capital)

or translated into lower prices, so benefiting consumers. The big traditional conflict in European polities has been between labour and capital, as represented by their organisations (trade unions vs employers' associations), and the related political parties (liberals and conservatives vs social-democrats or communists). The EU has provided a European umbrella for all these organisations: within the European Parliament, the major transnational groups rely on these cleavages, and the civic organisations are well represented in the Economic and Social Committee and their roles defined at the European level within the Treaty of the EU (Art. 138 and 139).

However, the basic features of European integration affect the distribution of income between capital and labour. Liberalising trade, the initial core business of the EU, should, according to classical theory, benefit all participating countries. But in order to benefit from these opportunities and realise their comparative advantages, they have to specialise in those activities in which they are most productive. This, in turn, requires that some producers give up their former business and switch to another. Human and real capital will lose their value in that process. Trade liberalisation is deeper within the EU than generally in the WTO-ruled world economy. With enlargement, it will create a level playing field for very heterogeneous players. Nominal wage levels at exchange rates (less so at purchasing power parities) will differ widely in the enlarged EU.

Trade theory suggests that labour-intensive production will shift to the low-wage locations which specialise in such activities. Unskilled labour in the tradables sector of the richer countries is likely to lose jobs or income while capital owners should benefit from the new division of labour. Conversely, labour in the poorer countries should benefit and local capital lose out as capital becomes less scarce thanks to the inflow from richer countries.[13] The combined effect of trade liberalisation and free movement of capital and labour should equalise factor incomes throughout the EU. This theoretical macro-effect is to some extent mitigated by micro-distortions that sum up to agglomeration advantages that often outweigh the levelling effects of liberalised and integrated markets.

Wage differentials between countries primarily reflect productivity differentials. As explained above, the EU regulates the ways of increasing productivity, for example, by upholding minimum standards regarding health and safety, protecting workers' rights and regulating working time. EU policies support productivity increases, in particular in poor regions, by subsidising investment in infrastructure, training, and so on. In so far as these regulations benefit workers they affect the real distribution between capital and labour, though not by increasing money wages. Wages are to a large extent determined by negotiations between employers and workers, usually by their representative associations and unions. Not all member states have minimum wage legislation, let alone the EU as a whole. However, the outcome of these negotiations depends on the relative scarcity of jobs. It is here that the above described processes of migration and (re-)location of investment become crucial.

Table 7:
GDP share of wages in Europe, 1970–2002 (%)

Year	**1971 -1980**	**1981 -1990**	**1991 -2000**	**2001**	**2002**
Belgium	74.6	73.6	72.2	70.7	70.8
Denmark	74.3	72.6	68.0	67.2	67.1
Germany	73.7	70.9	68.1	67.0	67.0
Greece	70.9	73.5	67.2	66.2	66.1
Spain	75.1	70.5	68.4	66.4	66.1
France	75.5	74.5	69.4	69.0	69.0
Ireland	76.2	71.5	62.6	55.3	56.4
Italy	76.6	74.3	70.3	67.2	67.1
Luxembourg	65.9	66.9	64.1	63.4	63.8
Netherlands	73.4	66.9	65.5	66.3	67.0
Austria	76.3	73.0	69.0	67.1	66.4
Portugal	82.4	75.2	72.9	69.5	69.4
Finland	73.5	71.9	66.2	62.2	62.3
Sweden	74.8	70.8	68.6	72.2	72.2
UK	73.6	73.4	72.9	73.8	73.8
EU average	*74.7*	*72.5*	*69.4*	*68.5*	*68.5*

Source: European Commission, *European Economy* 4 (2002), Table 32, pp. 182–83.

The effects of free trade – that is, the internal market for goods and services – are compounded by the effects of free movement of capital. Although labour is also free to move, it is less likely to do so: consequently, there is an asymmetry between labour and capital. Capital will thus flee locations with lower returns, notably because of higher wages. Ultimately, any investment might require a Europe-wide (if not

13 Gabel, op. cit., has shown that this distribution of advantages is correlated with support for European integration.

global) minimum rate of return while wages have to adjust. Furthermore, strong competition within the large internal market, which is additionally wide open to the global market, exerts a continuous competitive pressure to lower costs and prices. All this is likely to lead to a decline in unit labour costs, which is in fact happening. The share of wages in GDP has on average declined in Europe since the 1970s, from almost 75% to 68% (see Table 7).

This does not imply that real wages have also declined. In fact, they have increased, albeit slowly, on average by about 1% per year. However, the main beneficiaries of declining real unit labour costs have been consumers, whose income does not primarily depend on wages.

Producers vs consumers

Distributional conflicts between labour and capital are not only affected by shifts in factor demand but also by the size of the "cake" (i.e. value added) available for distribution. As already mentioned, increasing competition in markets for goods, services, capital and labour in the EU has constrained the prices producers can ask. Many niches have been broken up and protective national standards eliminated. Protected markets have permitted high levels of profits and wages at the expense of consumers, an additional income which could be considered as a rent. In highly regulated markets, workers and capitalists seek such rents and defend them against erosion through competition.

Although market integration generally increases competition and reduces the opportunities for rents, the EU has protected certain sectors on a European level, and tolerated national protection of some sectors. Most notoriously, the Common Agricultural Policy (CAP) has protected farmers at the expense of tax payers as well as consumers. To a lesser extent, the same can be said of the coal and steel industry and other sensitive sectors, although their protection has been declining over recent decades. However, services of general interest ("öffentliche Daseinsvorsorge"), either as public or as semi-public sector activities which benefit in many countries from protective legislation, have come under attack from European competition policy.

Returning to the argument made at the beginning of this paper, one might claim that the present European integration set-up, with its combination of market liberalisation, common regulation with minimum standards and competition policy, with the support of an active judicial policy on the part of the European Court, dries up the sources of rents while protecting minimum labour standards. In distributive terms, it makes sure that productivity gains are not kept by the producers, who have to share them between wage- and profit-earners, but translate into lower prices from which all consumers benefit. This disinflationary policy stance is reinforced by the ECB's stability-oriented monetary policy. It benefits everyone with a relatively secure nominal income, such as recipients of transfer payments like pensions and welfare benefits or – to a lesser extent – asset owners.

It is a well established tenet of political economy that producer interests are stronger than consumer interests. Cuts in the (nominal) income of producers lead to stronger political resistance than cuts in the real income of consumers due to price increases, which generally affect only a few products and at a low rate. The successful defence of the CAP by European farmers proves the point. In this perspective, the dismantling of many rent-providing niches by European integration is, on the one hand, surprising, and on the other likely to lead to more discontent among the affected producers in the future. The outcome of these conflicts depends partly on numbers. With the rises in the number of non-producing consumers (for example, pensioners; see also Table 8) there is a chance that present policies might continue. There might also be a backlash from producers, either economically by raising prices or renouncing production, or politically by attacking the policies guaranteeing free markets.

National welfare regimes and their clients

The domestic distributional aspects which we have looked at so far concern primary distribution in the market sphere, albeit through markets regulated by public policies. However, the EU is comprised of welfare states that not only regulate markets but take away a large share of national income through taxes and obligatory social security contributions and redistribute it. The amounts range from 35% in Ireland to 58% in Sweden.[14] Obviously, this gigantic redistribution machinery affects the prosperity of citizens and voters much more than most EU policies and international economic developments. That is probably the reason why national governments have jealously kept these competencies to themselves and refused to surrender decision-making power to the EU.

With many welfare states under stress, and European integration affecting the underlying conditions of

14 See European Commission 2002a, Table 71b "Total revenue; central government", p. 290.

their functioning, this "natural" division of competencies has slowly started to erode, from two sides: Social Democrats have insisted on the EU's engagement in social affairs and added goals such as employment and social inclusion to EU tasks. Liberals, who see supposedly bloated welfare states as prime obstacles to growth in Europe, have put their reform on the EU agenda, for example, in the framework of the Lisbon process, to make Europe the most competitive knowledge-based economy.

Table 8: Major welfare state clienteles (Persons, 1995)

Income groups	Sweden	Germany	USA
Pensions	1 584 304	21 630 000	43 388 000
Disability	408 576	1 180 000	5 876 656
Unemployment	37 734	1 990 000	7 900 000
Social assistance	474 159	2 080 000	4 869 000
Public welfare employment	1 245 800	1 590 000	2 540 000
Total	3 750 573	28 470 000	64 554 656
Electorate	6 551 591	56 090 000	196 089 000
Percentage	57.25	50.76	32.92

Source: Paul Pierson, "Coping with Permanent Austerity. Welfare State Restructuring in Affluent Democracies", in Paul Pierson (ed.), *The New Politics of the Welfare State* (Oxford, 2001), p. 413

Given these contradictory views and the powerful interests involved, the EU has wisely chosen a careful approach that respects national particularities, known as the open method of coordination (OMC). Within the framework of this method, targets and indicators are chosen by consensus, then national governments elaborate National Action Plans to achieve these targets; implementation is then controlled by peer review using the indicators previously agreed upon. This method allows for diversity but still exerts pressure on laggards and offers examples of best practice to poor performers. It is, however, not very democratic. Basically, governments can set targets and choose indicators without (or only selectively) involving national parliaments and/or "civil society" (namely trade unions, employers' associations, welfare organisations, and so on).

Up to now, the impact of the OMC in the field of social policies has been marginal. Outside a group of interested specialist institutions and organisations there has been little debate concerning the EU as an agent that is changing the welfare regimes of its member states. Given the wide diversity of these regimes,[15] any institutional pressure towards equalising the various systems will face substantial opposition from the beneficiaries of current structures.

However, these pressures are arguably increasing. Clients (that is, consumers of public services and recipients of public transfer payments) will move from country to country. Providers located or registered in one country will start to offer their services to potential clients in other member states. Let's consider some basic features of welfare states:

- Health: Provision of health services is organised in very different ways across the EU, ranging from a single National Health Service in the UK to mixes of private and public provision with a variety of voluntary and obligatory insurance schemes. In an open European market, insurance as well as the supply of health services should be free to all suppliers from member states. There are already certain areas supplementing the core health systems, such as the "market" for pharmaceuticals or non-prescription treatments (for example, "wellness") which are relatively free. The more access to health products and services is left to the market (that is, the decision of consumers to buy and of suppliers to sell) the more they will be open on a European scale. This will lower costs as cheaper suppliers enter the market (for example, health services from or in Central and Eastern Europe, such as dental treatment, massage, spas). It is also likely to reduce the income of certain still sheltered suppliers in richer old member states. Insurance that has redistributive elements (same entitlements, different premiums) cannot compete with insurance schemes that are less burdened with solidarity requirements. More generally, the entitlement of residents and citizens to health care will eventually have to be regulated at the European level, corresponding to the free movement of people. This is also likely to involve a degree of solidarity or public subsidy in the case of people who are not – or not sufficiently – insured and too poor to pay market or cost prices.
- Education: The problems arising in health care arise in education, too. There is already a market for such services alongside the public system. The mix varies across Europe. Conditions for establishing institutions offering education are required as well as rules that regulate the access of residents and citizens to educational services (including fees or prices).

15 See Gösta Esping-Andersen 1990.

- Pensions: Different member states have different systems, ranging from pay-as-you-go (PAYG) to funded systems. While PAYG systems provide better benefits when economies (and wages) grow rapidly, the return of funded systems depends on growing asset prices, high real interest rates and profits. The monetary policy of the ECB crucially affects this choice. In many countries mixed systems offer public minimum pensions that can be supplemented by private insurance which is either obligatory or voluntary. Life insurance is basically a service with a Europe-wide market. The return on capital of funded schemes depends to a substantial degree on the regulations constraining investment opportunities. In many countries pension funds are required by law to invest a certain proportion of their capital in bonds (public debt) and stocks, as well as in domestic and foreign instruments. Within an internal market for financial services, some of these requirements cannot be upheld. As pressures on pension systems increase with the ageing of Europe, all policies affecting the chances of securing a relatively prosperous retirement will be hotly contested.

Similar problems arise in a wider range of social services and services of general interest that are less directly related to welfare in the narrow sense (for example, placement services, transport, communication, low-cost housing, water, energy, waste disposal, and so on). The more these services are provided through the market by private business and the more clients are required to pay for these services, the more will risk be privatised and individualised, and poorer people are likely to have less access to these services. To avoid social exclusion, poorer people will need more cash benefits as in-kind redistribution through free services erodes. Of course, many of these changes can and do take place through domestic reforms that have no intrinsic relation to the EU. However, the more some member states switch to the market the more will European regulations be needed, since the domestic market cannot be separated from the internal market.

In most member states, there are domestic rules about the minimum entitlements ("social rights") possessed by every citizen (and to a lesser extent every resident) in relation to the national welfare system. Often these rights are enshrined in the national constitution. With the emerging European constitution presently being elaborated by the Convention social rights might be established on a European scale. Their level is likely to be set at the level of the least generous member state (minimum standard) while leaving it open to national law to be more generous. That still leaves the possibility of social welfare migration triggered by high levels of protection and generalised entitlements for all EU citizens (residents?) feared by some observers.[16]

To sum up, European regulation affects the relative strength of societal groups in distributive struggles within their respective societies. The EU defines rights, sets standards for industrial relations and, probably most important, changes market opportunities by exposing firms to more competition. The latter process will increasingly infringe upon basic features of national welfare regimes. National parties are forced to fight for their preferences in both the European and the national arena, and have to decide whether to opt for the preservation of national regulation or the adoption of European regulation.

Responses of the emerging Europolity

As we have seen, European integration has substantially affected – and this is only likely to increase – the risks to and opportunities for prosperity of different member states and specific groups or people within member states. In many cases, deepening and widening Europe has changed and will continue to change the functioning of distribution and redistribution rather than the eventual outcome. As business, households and governments learn and adjust, the effects of the new integrated economy will become bigger. To give an example: instead of devaluing the national currency a country might now be forced to cut costs (including wages) directly and in nominal terms to become competitive again. In both cases, real wages will eventually suffer but the ways in which prices and nominal income change are different and affect different groups partially and temporarily.

From the political perspective, this should be sufficient for the emergence of political conflicts as the affected groups will want to shape European policies. In fact, even on economic issues conflicts between member states still dominate the European political system. These conflicts primarily concern basic questions of accession, enlargement, adoption of the Euro and direct redistributive policies (budget, CAP, structural and regional funds). Conflicts along party lines are observed much less often.

Important national groups and parties that are strongly either pro- or anti-European can be observed[17] in those member states whose political-economic insti-

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16 See Sinn 2000.

17 The most often quoted empirical survey has been done by Leonard Ray (1999).

tutions ("variety of capitalism")[18] are less compatible with the hybrid European system, such as the UK, Denmark, and Sweden. They are either more fragmented, "free-market", and less coordinated than the EU as a whole (the British case) or more coordinated, interventionist, and centralised (the Scandinavian case). In the remaining member states, usually of the triple-C variety (continental–Catholic–corporatist), European integration remains largely unquestioned. Political cleavages regarding Europe are usually stronger before accession than afterwards. In old member states, most big parties have accepted EU membership and its main consequences as an unalterable fact of life.[19] In the transition/candidate countries, there are large minorities against accession but few opposed political parties, with the exception of a few populist ones (for example, in Poland), whose motivation in opposing accession is usually nationalist–cultural rather than socio-economic. As Paul Taggart and Aleks Szczerbiak (2001) show, there is little correlation between public- and party-based Euroscepticism; and even in the party systems they consider highly Eurosceptic the "hard" opponent parties are not very strong (the strongest being the Czech and Moravian Communist Party with 11% of the vote). Probably, a strong party with a good chance of forming a government will avoid a hardline anti-EU position (Taggart/Szcerbiak 2001: 11-12). A special case is Malta where one major party, the Labour Party, has been opposed to EU membership.

In this regard, there seems to be some convergence between old member states (not necessarily "old Europe") and candidates, namely in so far as populists are the most important Eurosceptic forces. When in power – usually in coalition with centre-right parties – they have dampened their criticism of European integration somewhat. Their basic instincts are parochial, racist or nationalistic; none the less, populism has social and economic roots.[20] Losers from modernisation also see their access to public goods and services endangered by neo-liberal retrenchment policies as well as competition from immigrants. Although their values differ dramatically, populists might join forces with the anti-globalisation movement which also abhors the more open trans-national markets entailed by European integration and fears negative effects on equality and ecology.

The two underdeveloped cleavages in the Europolity are the federalist–intergovernmental and the left–right (that is, social-democratic vs liberal-conservative) cleavages. Both exist in a nascent and/or distorted form.

- The first exists as the more radical pro- vs anti-European cleavage we have discussed above. In its purest form, it emerges during national debates before accession. As such it is not a "Euro-loyal" cleavage that would find a constructive role in the EU political system, of the kind played by similar cleavages (Hamilton vs Madison/Jefferson) in early US history. It is distorted as a government attitude (for example, the UK; see above) or as a populist-right or hard left position elsewhere.[21] Moderate eurosceptic parties should favour intergovernmentalism in order to preserve national capacities to shape policies.
- The second exists in a formal way as the two big party families have European umbrella organisations, the "Party of European Socialists" and the "European Peoples Party". But they hardly differ in their programmes for Europe. The differences are nuances rather than full-fledged alternatives. While the social democrats favour equality and cohesion, the conservatives stress cultural identity, family values, law and order but are less clear regarding free markets. Ultimately, they tend to converge on the median voters' positions, as their national component parties usually do.

The classical picture of the European party landscape as elaborated by Hix,[22] where parties are positioned in a two-dimensional system with a vertical sovereignty–integration axis and a horizontal left–right axis, shows a concentration of major parties in the upper (namely pro-integration) centre. Except for extremist and strictly anti-European parties, there is hardly any substantial choice regarding the core questions of integration. Following Marks and Wilson (2002), it seems plausible that social democrats would support deepening in order to establish a market-correcting force at the European level as the internal market has become irreversible. Liberals should support the establishment of an internal market and a single currency (that is, "negative integration") while opposing any further strengthening of supra-national governance of these integrated markets. They would prefer a regime competition that exerts pressure on national regimes which would become even stronger with the widening of

18 See Brinegar / Jolly / Kitschelt 2002.
19 For instance, social democratic parties in EFTA countries have been more or less eurosceptic before accession, both in the first enlargement (UK and Denmark) and in the most recent one (Finland, Norway, Sweden, Austria); see Marks / Wilson, op. cit., p. 445.
20 See Cuperus 2003.
21 See Mair, op. cit., p. 34.
22 See Hix / Lord 1997, Figure 2.1, p. 50. Similarly Hooghe / Wilson 2001, p. 124 and pp. 163–86.

Europe. Given the present depth of integration, that could lead to an alignment of cleavages with social democratic "deepeners" against liberal "flatteners/wideners".

This situation reflects the still embryonic state of the Europolity, including the notorious "democracy deficit". Of the two ways the electorate can influence European decisions (directly through the European Parliament or indirectly via national elections and governments) the indirect way is more important. From that still dominant national perspective, EU decision making remains in the realm of foreign policy whose democratic control is traditionally weaker than core domestic issues such as fiscal or social policy. Although most EU regulation has to be translated into national law and actually makes up an increasing part of national legislation, it is hardly seen as a Europe-wide issue.

The Europolity does not yet show features known from the German federal system, where the voting behaviour of federal states (*Bundesländer*) in the chamber of states (*Bundesrat*) is often subordinated to party positions. There are no fully developed and mutually opposing social-democratic and liberal-conservative strategies of European integration that would lead to coordinated voting behaviour by, for instance, social democrats in the European Parliament and member-state governments led by social democrats in the Council. Moreover, even the selection of the European Commission, its president and the Commissioners is far from fully politicised. Bigger member states have even sent two Commissioners of different party affiliations to the Commission (for example, the UK).

To sum up, all this gives European voters little say in European affairs. With no choice of strategic alternatives they are overwhelmed by a plethora of technocratic choices. Lobbying groups with strong preferences regarding specific regulations take over the field. Seemingly national preferences mingle with group preferences (workers, employers, farmers, consumers, pensioners). European umbrella parties are not (yet?) able to amalgamate such a variety of positions across various cleavages and to resolve the inherent conflicts. As the effects of European integration on political parties are to a large extent indirect they threaten to depoliticise European affairs.23 This seeming unaccountability of European politics could undermine the legitimacy of both (traditional) political parties and European integration. In this perspective, the very complexity of European integration provokes a populist reaction that offers simplistic pseudo-choices.

23 See Mair, op. cit., pp. 48-49.

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