



REGIONAL INPUT ON THE SOCIAL DIMENSION OF  
EZONEPLUS:  
BELGIUM, THE NETHERLANDS, FRANCE, AUSTRIA  
AND GERMANY

Of reshaping policies, social conflicts, and political consequences

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The Eastward Enlargement of the Eurozone

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This Regional Input is a supplement to Working Paper No. 13 providing data and statistics for Belgium, The Netherlands, France, Austria, and Germany.

Keywords : Regional Input, Belgium, The Netherlands, France, Austria, Germany

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## 1. INITIAL REMARKS: THE SECOND STAGE OF *EZONEPLUS*

Within *Ezoneplus*<sup>1</sup> the *Social Dimension* is a hybrid in the sense that it addresses both the reshaping of certain policies and the socio-political repercussions an Eastward enlargement of the euro-zone may have. Correspondingly, key questions to be answered can be grouped under two headings: Firstly, what kind of external shocks does EU enlargement, and more specifically, the enlargement of EMU produce on national and EU policies? The three policy areas here to be inspected are social security systems, labour market regulation, and EU structural and agricultural policy. Secondly, how do national societies and political systems respond to these new constraints? This implies both potential social conflicts enhanced by the enlargement process, as well as their implications for national policy-making. In order to combine both topics, we suggest an analysis using insights of modern political economy (Kemmerling '02b). In brief, this is to say that rational political actors act in response to *Ezoneplus* in a way predictable once the socio-economic outcomes of the enlargement process have been analysed.

Since the *Social Dimension* is a very broad topic, some basic assumptions derived from previous stages of the project may be helpful in defining the key channels by which Eastward enlargement will affect national societies. For a digest of the major findings of our market reports (cf. the corresponding *Ezoneplus* Working Papers), several points are worth noting: 1) The integration of goods markets has already been accomplished to a considerable extent. Hence, apart from some redistributive problems arising in boarder regions (e.g. Quaisser 2000), trade will not be a major challenge from the perspective of the *Social Dimension*. 2) Similarly, the better part of FDI-flows are enhancing market efficiency and are less of a problem in terms of 'locational' competition between countries. Nevertheless, this topic remains high on the political agenda and anecdotal evidence suggests the opposite (Kittel '01).<sup>2</sup> Integrating FDI-flows in the broader perspective of enlarging financial markets, capital flows may imply new sources of risk for both candidate and member countries. Moreover, integrating capital markets will lead to higher divergence in regional growth and, therefore, constitutes a potential source of social and political discontent in terms of inequality. 3) The analysis of Monetary, Fiscal and Exchange Policy suggests that candidate countries in particular, might (have to) follow a strategy of a hard 'over-commitment' (cf. contributions of Orsi and Fahrholz in Bolle '02) to the EMU-integration process. In order to assure a smooth transit to EMU, governments and central banks in Eastern Europe will probably face incentives to follow strict macroeconomic policies. This, in turn, implies some serious policy constraints for social security systems and labour markets. 4) Not least because of that, labour markets will be a pivotal area of concern for both member and candidate countries.

Negative shocks candidate countries face by joining the currency union may induce an outflow of workers to adjacent member countries. But since most current members are reluctant or unable to integrate a considerable amounts of foreign workforce, labour market issues embody one of the true sources of predicament for the enlargement process. This is particularly the case for the two countries most affected, namely Austria and Germany. Moreover, the devastating performance of Eastern German labour markets and its consequences for the public budget, may serve as a reminder that East-West integration processes may be costly in both social and monetary terms (Sinn '99). This Regional Input compares the socio-economic impact of *Ezoneplus* in Austria and Germany to that of three other Western European EU-countries: France, Belgium and the Netherlands. By this means, it is able to exemplify some of the major social and political issues in the course of enlarging the euro-zone in their current evolution as well as important cross-country differences.

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<sup>1</sup> *Ezoneplus* is a research project funded by the EU commission to investigate the prospective enlargement of the European Monetary Union (EMU). For details see [www.ezoneplus.org](http://www.ezoneplus.org).

<sup>2</sup> Caetano et al. (2002: 42) show that the extent of diversion of FDI-inflows from South East to Eastern Europe will be rather small.

## **2. KEY SOCIO-ECONOMIC PROBLEMS**

### **2.1. Unemployment Rates**

Since we believe that the reshaping of labour markets across Europe is of primordial importance for the whole process of integration, we have chosen to focus on three socio-economic problems closely related to labour market outcomes: unemployment, poverty and inequality. Poverty is arguably less of a political issue in Western Europe, inasmuch as the observable impact of the Eastward enlargement on western European poverty rates is concerned. Moreover, in affluent societies absolute measures of poverty are not very informative. Because of this we have decided to drop this category for our country sample. Unemployment, in turn, is high on the political agenda in many continental European countries, and, in particular, in Germany (Baxandall '01). Hence, we presume it to be a major source of political contest in the wake of enlargement. Inequality, finally, is of societal and political relevance and a cornerstone for modelling the political economy of integration (Persson and Tabellini 2002: 132-140). It is one of the few examples where prosperous efficiency-driven economic trends may have unfavourable social and political consequences, if the 'fruits' of these trends are heavily concentrated on the (old and new) rich.

In contrast to the Regional Inputs on Labour Markets, this RI tackles unemployment from another angle. It focuses on the question in which regions, sectors and age groups unemployment is concentrated. To put it more bluntly: Who are the losers of short-term enlargement costs as far as the labour market is concerned? Table 1 gives a general overview of unemployment in the five countries analysed here. It compares average national unemployment rates to unemployment in those segments of the population that are likely to be affected by enlargement because of their general sensitivity towards shocks (Blundell and MaCurdy '99).

**Table 1 Sensitive segments of labour markets**

Country	standard UR (2001)	UR by education level (2000)			UR by sex (2001)		UR by age (1999) (male/female)	
		low	middle	high	men	women	15-24	50-64
Belgium	6,6	9,3	5,5	2,4	6	7,4	22.7/22.4	7.1/5
Germany	7,9	14	8	4,2	7,7	8,1	9.9/7.7	12.8/11.4
France	8,6	14	2,6	1,9	7,1	10,5	24.9/28.4	9/8.3
Netherlands	2,4	3,4	1,8	1,7	1,9	3	6.6/8.2	4.4/1.6
Austria	3,6	8,2	4	2,4	3	4,3	5.5/6.4	4.4/5.3
Euro-area	7,4	11,2	7,5	5	6,4	8,7	17.1/19.6*	8/7.3*

Source: (Eurostat '02). UR = unemployment rates, Cronos Labour Force Survey<sup>3</sup>, data for EU-15.

Table 1 gives a brief overview of unemployment rates in the five countries. Several key issues are worth noting: As is well-known, standard unemployment rates differ dramatically across countries. Whereas unemployment virtually does not exist in the Netherlands, and is very low in Austria, France, Germany and Belgium have high and persistent unemployment rates. In the table, average unemployment rates are compared to those of particular segments of the labour market. In all countries there is a strong tendency of low-skilled employees to be unemployed. For a French employee with a basic level of education the likelihood of being unemployed is five times higher than for an employee with intermediate qualifications. Low-qualification is the most important determinant of unemployment on the individual level (Commission 02: 29). Next, female employees are somewhat more likely to be unemployed than male. The difference, however, is marginal.<sup>4</sup> This is not the case for unemployment rates in different age categories. Belgian and French youth is strongly affected by unemployment, whereas in Germany older people are more seriously affected by labour market constraints than the rest of the population. Ethnicity, finally, is in all countries a social cleavage segmenting national labour markets. For Germany unemployment rates of people with other citizenships than the German have tripled in the last 25 years (Stat. Bundesamt 01) and are currently about twice as high as the national average. For the other countries unemployment rates of ethnic minorities and non-citizens typically range between two and six times higher than the national averages (Eurostat March 2000).

Another feature of unemployment is its regional variation within countries (Commission '02: 126). Germany here is a prime example: average unemployment rates are more than twice as high in Eastern Germany as in Western Germany (ibid.). Though this is clearly a legacy of the German unification, regional variance is high in Belgium and France as well. These countries mirror the trend of regional diversity in the whole of Europe.<sup>5</sup> Austria and the Netherlands show less of a variation, even controlled for the low national level of unemployment (ibid.).

At least in the short run, enlargement of the Eurozone arguably causes some adjustment costs for labour markets. Though simulation studies still produce some significantly different results (Kiander et al. '02; Boeri et al. '00), the short term problem of higher unemployment rates is one of the most frequent scenarios in these studies. If, therefore, enlargement constitutes such

<sup>3</sup> <http://www.scb.se/internationellt/eu/Unemployment.xls> (date of access 11.03.03).

<sup>4</sup> Needless to say that similar observations don't apply for the case of employment rates, for instance.

<sup>5</sup> In the year 2000 unemployment in the richest regions of the EU was less than half (5.5 %) of that of the poorest regions (12.7) (Commission '02: 132).

a temporary negative shock, the sensitive segments of labour markets should be expected to suffer most from it.

## **2.2. Measures of Inequality**

Reducing inequality is one of the self-declared aims of many European welfare states and, according to some scholars, a basic ‘ingredient’ of the European social model (Kittel '01). It is also frequently mentioned as a potential source for social conflicts across different social strata (Castranova 01; Harms and Zink 02).

In general, income inequality after taxes and transfers is comparatively small in most continental European countries. This becomes obvious if you compare the indices of Table 2 to EU averages. However, the redistributive impact of the welfare state does vary substantially between the five countries. Pre- and after transfer inequality remains almost the same in Germany, whereas it drops substantively for the four other countries. Moreover, inequality is ‘unequal’ across countries, since in Belgium, for example, the spread between top and bottom earners is much larger than for Austria and Germany. Finally, the incidence of low-wage work is – according to Eurostat statistics – highest in Germany and very low in Belgium and the Netherlands. In addition, low-wage work is typically concentrated in certain economic sectors such as agriculture and low productivity jobs in the service sector (Eurostat 2000).

**Table 2 Indicators of Income Inequality**

	AUT	BEL	FRA	GER	NET	EU
GINI/TI (LIS)	0.28 (1995)	0.25 (1997)	0.29 (1994)	0.26 (1994)	0.25 (1994)	0.28*
GINI/PI (Eurostat)	0.31 (1999)	0.32 (1999)	0.34 (1999)	0.30 (1999)	0.33 (1999)	0.35*
GINI/TI (Eurostat)	0.26 (1999)	0.28 (1999)	0.29 (1999)	0.29 (1999)	0.29 (1999)	0.31 (1999)
S80/S20 (Eurostat)	3.7	5.5	4.6	4.4	4.4	5.0
D5/D1	2.1	1.6	2.0	2.4	2.0	2.2**
Low-wage (1996)	8	4	9	11	6	9**

Sources: GINI/TI = Gini-coefficient of Total Income after taxes and transfers (Luxembourg Income Study and Eurostat), GINI/ PI = Gini coefficient of Primary Income before taxes and transfers (Eurostat), S80/S20 (Eurostat), Low-wage (Eurostat and ECHP) = percentage of low-wage employees (60 % of mean income) of all employees, S80/S20 and D5/D1 (Eurostat and ECHP respectively).

\* without Portugal

\*\* without Sweden and Finland

The temporal evolution of inequality shows a rising trend across most European countries. For the five countries the inequality of factor incomes has risen with the exception of the Netherlands, where Gini coefficients of factor income have, in fact, been rising across the 80s and early 90s. Contrary to factor income shares of poor and rich, the inequality of disposable income after taxes and transfers has remained rather stable in all countries (Milanovic 00: 46-49). Rather unsurprisingly, this is not the case for some regions within countries such as Eastern Germany where income inequality in terms of factor income has increased to a considerable extent whereas inequality of disposable income sank throughout the 90s (DIW Wochenbericht 19/00).

All things considered, continental Europe differs less in terms of inequality than in terms of unemployment. The risk of being unemployed varies pronouncedly across countries, and hence enlargement will affect the five countries in very different ways as far as the labour market is concerned. Some segments of the labour seem to be particularly vulnerable to future economic shocks such as enlargement. It is in these segments where social and political concerns about the consequences of *Ezoneplus* should be most visible. Cross-country differences in inequality are shown to be less dramatic between continental European countries. Similar levels of inequality, however, disguise fundamental differences in the causes and social costs of inequality. The quick look at the data is therefore merely a first step in analysing the Social Dimension of *Ezoneplus*.

Whether enlargement has a significant impact on income inequality in Western Europe depends on which of the causal channels of enlargement on inequality is relevant. First, inequality may be increased by additional inflows of low-skilled labour to Western Europe. Since migration, however, in turn, depends on EU unemployment rates this prompts the question how labour market regulation is affected by enlargement. Second, enlargement may constrain national social and redistributive policies such that public means of reducing inequality may be hampered. Third, enlargement will also lead to reallocations of EU-transfers, which may also lead to a change in cross-national inequality in the West if it is not compensated by national policies. It is these three policy areas that are inspected more closely right in the next section.

### **3. THE RESHAPING OF SOCIAL AND LABOUR MARKET POLICY**

#### **3.1. Labour Market Policies and Industrial Relations**

The RI on Labour Markets initiated a discussion on the question whether ‘real rigidities’ are reduced by eastward enlargement (Kemmerling, et al. '02). A preliminary conclusion was that – so far – little impact could be seen in terms of making Western European labour markets more flexible (ibid.: 15). This part of the RI comes back to that issue and delves into the theoretical discussions surrounding the flexibility/ endogenous policy debate. However, it starts with a detour, since most of the relevant literature deals with the question whether EMU has generated more flexibility in European labour markets.

Michael Burda (Burda '01) argues that the Euro will put trade unions and national labour market regulation under pressure. For him, the Euro is a ‘Trojan horse’ (2001: 23) with which politicians introduce deregulation to rigid European labour markets. He bases his claims on the observation that under a unified currency regime the pressure on national collective bargain systems has significantly increased (2001: 17). Though there is some evidence that wage restraint and flexible adjustment paths are more frequent in the last few years (Kemmerling, Pogodda, and Spannbaauer '02), there is also evidence that these forms of new flexibility have been traded-off against new forms of rigidities such as increasing wage compression. Moreover, as Burda explicitly states (Burda '01), increasing pressure depends on the lack of accommodation from social security systems, namely unemployment benefits. Yet structural reforms have been strikingly absent in these areas so far (Kemmerling, Pogodda, and Spannbaauer '02). But even on his own grounds, Burda’s argument is vulnerable as Sibert and Sutherland (Sibert and Sutherland '00) have shown. A monetary union does not automatically induce a higher level of structural reforms in labour markets. To the contrary, the inflation bias of a monetary union may, in fact, be higher than under the previous regime, as policy reform becomes more painful for rational policy-makers. They condition their claims on the extent with which asymmetric output shocks occur in a unified Europe. Even more importantly, these shocks, in turn, are – at least partially – due to different forms of labour market regulation (Kemmerling '02a). Microeconomic theories of labour market regulation indeed suggests that the obstacles to pernicious labour market institutions are large (Saint-Paul 2000). Hence, low levels of reform may be a stable, though not very beneficial equilibrium.

The debate shows that – so far – the channels from monetary union to labour market reform are little understood. This is all the more the case for the eastward enlargement of the euro-zone, since estimates of labour market and output shocks stemming from the enlargement differ considerably. Once more, one has to point out that, although for the whole of the EU such a shock will be comparatively small (Boeri '00), its potential for Germany and Austria must not be understated (Kemmerling, Pogodda, and Spannbaauer '02).<sup>6</sup> The major channel to be investigated here is migration and ‘forfeited’ migration due to high levels of unemployment – at least in Germany – as well as due to postponing the freedom of settlement for CEEC-workers.

This discussion is necessarily linked to a second one dealing with the problem of ‘locational competition’ (Standortwettbewerb) and the claim of wage dumping. We do not want to adopt a normative point of view in this discussion, but we simply state that, empirically, such a claim cannot be entirely rejected. Caetano et al. (2002: 40), for instance, find that differentials in labour costs do play a role in determining the extent of bilateral FDI-flows between Western and Eastern Europe. Of course, these results are of the partial equilibrium type and, hence, have to be treated with outmost delicacy. Brown et al. (Brown, et al. '96) build a theoretical general equilibrium model showing that under particular circumstances, negative partial equilibrium results may also be translated to the general approach. In a similar vein, Casella (Casella '96), claims that a necessary condition for an efficient solution of the problem of different standards is the convergence of income levels across countries. This debate, therefore, mirrors the debate on the Euro and real rigidities. To put it bluntly: if enlargement is a success, it is a self-stabilising success, if it isn't, it isn't!

There is, however, more to say on this issue once it is put into the broader perspective of social dumping in general. Sinn (Sinn '00; Sinn '01), for example, strongly argues that even with factor price convergence in the long run, the externalities produced by different standards of social security across Europe, will have detrimental effects on the welfare of Western European economies. Moreover, in the public debate the empirical validity of these claims may matter less than their sheer, ‘apparent’ cogency. Rational political actors may take up these arguments to pursue their own interest-maximising strategies (cf. Box 1).

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<sup>6</sup> In this RI, we refrain from taking into account the potentially detrimental impact of trade and FDIs on southern European economies.

**Box 1 How to explain the bargaining outcome between the EU and Poland – the case of migration**

Economic analyses of the economic impact the Eastward enlargement has overwhelmingly supported the idea that the net value of integration is positive (Baldwin, et al. '97). Even if we restrict the analysis to labour markets only, costs of integration such as rising unemployment should be relatively small compared to the possible gains (Kemmerling, Pogodda, and Spannbaauer '02). How, then, do we account for the fact that most policy-makers in member states are reluctant towards a complete opening of labour markets?

One way to deal with the topic is to suppose that there are powerful interest groups within society that, fearing potential losses for their own clientele, veto an immediate liberalisation of labour markets between East and West. This would be one possibility of explaining why Austria and Germany insisted on delaying the freedom of settlements for CEEC workers during the bilateral negotiations between the EU and Poland. A stylised model for Germany would then ask why trade unions representing such a 'veto-player' managed to convince the government to do so.

In this model there are two players: a trade union (TU) and an employers' association (EA). Both players may propose whether the government should go for an immediate adoption of the social acquis (S), containing all EU-standardised rules that would raise labour costs in CEECs, and an immediate adoption of the freedom of settlements, migration (M) for short. Standard accounts of international trade theory imply the following preference orderings for both actors:

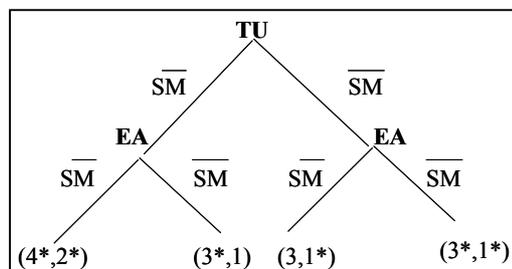
$$EA : SM(4) \succ \overline{SM}(3) \succ \overline{SM}(2) \succ \overline{SM}(1) \rightarrow SM(4) \succ \overline{SM}(2)$$

$$TU : \overline{SM}(4) \succ \overline{SM}(3) \succ SM(2) \succ \overline{SM}(1) \rightarrow \overline{SM}(4) \succ SM(2)$$

where  $\overline{SM}$  is the status quo meaning that accession candidates do not have to apply the acquis and member countries do not have to open their labour markets. For EA the worst option is no migration and no social acquis. This is straightforward, as open product markets mean competition from neighboring countries with lower social standards, whereas German producers cannot benefit from cheaper foreign labour. For obvious reasons SM is then their best option. The other two options are in the middle of the ordering, with migration being somewhat more important than making foreign producers applying EU-standards. This is not a crucial assumption, but might be justified by different production technologies.

The situation for trade unions is very different since no EU-standards but migration would be the worst case for them. To negotiate both EU-standards and migration ranks as worst but one option. Even the status quo is better than that and only beaten by their first preference: no migration (hence no wage pressure), but the export of EU-standards. In this game all strictly dominated strategies may be removed (right hand side of the arrows).

Correspondingly, there seems to be a tie between both actors. However, we have explicitly modelled the status quo as part of the preference ordering. Since both actors are assumed to be veto-players, they have the power to induce the status quo whenever they want to. This turns out to be of crucial advantage for the unions, since they can now propose the following agenda: either postponing migration and exporting social standards or staying with the status quo. The employer association, and hence the government, have to accept this because no other strategy would make them better off. It is subgame perfect Nash equilibrium in the parlance of game theory.



Of the two equilibrium (4\*, 2\*), (3\*, 1\*) only the first one is a stable outcome and resembles the actual (short-term) outcome achieved in the negotiations between the EU and Poland.

The example of Box 1 is only a very stylised attempt to explain why national governments may be reluctant to reap the whole lot of benefits, economic integration would keep in store. Another example is dealt with later on, when we discuss the role of public opinion in the enlargement process (cf. following section). How to deal with potentially powerful short-term losers of the integration process, informs our general hypothesis in this section: governments may be hesitant to make national labour markets ready for enlargement, since the political costs of doing so could be insurmountable. An array of anecdotal evidence should help to bolster this argument empirically. Hence, in the following the RI turns to each country briefly, in order to give a short overview over current reform debates in the areas of labour market policy and regulation as well as the wage bargaining system.<sup>7</sup>

In Austria, labour market conditions are, in general, rather favourable. The unemployment rate, in particular, has never been on alarmingly high levels, and other macroeconomic indicators are also promising. Two problems, however, are frequently mentioned in benchmarking studies. First, the amount of people in early retirement schemes (including those for invalidity retirement) is high. Hence, a part of the good labour market performance is due to increasing the burden of public budgets (see below). Second, most of the unemployed are low-skilled, which implies that competition from CEECs may be particularly harmful for the respective sectors and jobs. Nevertheless, one cornerstone for Austrian stability has been the comparatively flexible and competitive outcomes of collective bargaining. Rather ironically, a well-functioning labour market implies that migration from CEECs is stimulated.<sup>8</sup> Apart from proximity and cultural ties, this is one of the key reasons why migration to Austria is higher than to other EU countries.

Germany differs sharply from the Austrian case. Unemployment is particularly high in neighbour regions to Eastern Europe; the new Länder have an average unemployment rate of 17.5 per cent (excluding eastern Berlin). This fact implies three aspects: First, as mentioned before, the political salience of unemployment is in Germany higher than anywhere else in Europe (Baxandall '01). It remains unclear, however, whether high salience is a response to ongoing problems in the labour market, or whether it is part of the problem, since it possibly increases the political gridlock among political actors (Bolle, et al. '02). Second, one way or the other, high unemployment is at least in part a result of poor labour market institutions.<sup>9</sup> Therefore, eastward enlargement generates other channels of pressure on the German labour market than in the Austrian case. Higher unemployment creates less migration to the official German labour market, since job opportunities for CEEC-workers are low. Illegal forms of migration, however, take place and lead to a booming shadow economy (Schneider '02). Hence, opportunity costs of 'forfeited' migration are higher in Germany, and the balance between the official and the shadow economy is tilted more and more towards the latter.<sup>10</sup>

The result of these processes is a high politicisation of economic integration in as far as labour market issues are concerned. Policy-makers have responded to this trend in an ambivalent way. They have tried to enhance the efficiency gains from enlargement by making the German legal system more liberal in terms of migration and national citizenship (Kemmerling, Pogodda, and Spannauer '02). On the other hand such attempts are limited at best and, frequently, produce political failures, since the political and societal resistance against such policies is fierce. On the other hand, political representatives of sectors bound to loose from integration, try to reform German labour market institutions in a way that would encapsulate their voters from a helter-skelter accession of CEECs.

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<sup>7</sup> This empirical section is meant to be a follow-up of the previous RI on labour markets.

<sup>8</sup> Cf. Kiander (2002: 23); own simple regressions show that average unemployment rates over the last decade, significantly reduced the stock of CEEC-citizens in Western Europe (cf. Annex 1).

<sup>9</sup> For example, Nickell (Nickell '97), Blundell and MaCurdy (1999).

<sup>10</sup> Another, but related mechanism is the likelihood of increasing capital and FDI-outflows due to regulatory differences and their products such as higher non-wage labour costs.

The net effect for increasing flexibility and capacity in the official German labour market and, thereby, for absorbing CEEC migrants is therefore unclear. It mirrors the general debate how to reform German labour market institutions which, currently, comes under the heading of the so-called Hartz-Reform. Initially designed to be a reform of the German public employment agency, its self-declared aim was to resolve the general problem of unemployment in Germany. This claim is overly ambitious in the eyes of most economic research institute monitoring the reform (SVR '02), since substantive reforms, namely the reorganisation of the low-wage sector, have been carefully avoided.<sup>11</sup>

Since labour market shocks will be much smaller for Belgium, the Netherlands and France, the discussion on labour market policies can be brief. The Dutch labour market is hallmarked by a period of considerable success – at least in terms of official unemployment rates. The Netherlands even run the risk of increasing labour shortage. This implies that additional workforce from abroad may be an important asset. Such a positive outlook notwithstanding, the issue of migration ranks high on the political agenda in the Netherlands and has led to a series of restrictions for foreign workers (Vink '02). Belgium struggles with its high unemployment rates. Benchmarking studies (Bertelsmann '02) concede some improvements, namely in form of reduced labour costs, but the general capacity of political institutions to implement substantive reforms seems to be low. France, finally, is another example for a country, where the labour market effects of enlargement have not produced much societal or political disturbance. Moreover, for a couple of years the French government has been experimenting with several, at times, contradictory ways how to combat unemployment. These policies range from a general reduction of maximum working time, to subsidies for the low wage sector, none of which has substantially decreased unemployment so far.

All things considered, theory provides little guidance for forecasting the impact *Exoneplus* has on labour market reforms in Germany. Belgium, the Netherlands and France all are examples for countries where the impact will be small and, hence, the general reform debate follows other concerns. Austria, in contrast, has clearly a high stake in the enlargement process, not least because the Austrian labour market performs relatively well. In Germany the problem is similar but different in tone. High unemployment rates reduce official migration, but probably cause large influxes to the shadow economy. German policy responses have hence been rather ambivalent and do not show clear signals for CEECs labour markets trying to reduce their own national unemployment rates.

### **3.2. National Social Security Systems**

As far as social security systems are concerned, analogous comments apply. Considered as a form of real rigidities, social security systems have only reluctantly been reformed and show a high degree of institutional inertia. Once again, we start the (theory-based) discussion with a brief comment on the impact EMU and 'Maastricht' have had on social policies. Then we deal with the specific effects *Exoneplus* might have. Finally, we contrast this literature to the more general quest for the determinants of social policies, by asking what actually drives the demand for social expenditures.

The 'Stability and Growth Pact' (SGP) as well as the initial 'Maastricht criteria' should have a sizeable impact on the evolution of public deficits and accumulated public debt in Western Europe. Since social expenditures consume a major part of the public budget, fiscal consolidation affects social security systems directly. The regulation of fiscal policy on the EU-level is, however, no *datum* – at least not for larger member countries. The recent discussion on the Pact embodies

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<sup>11</sup> There are, however, a couple of steps towards this direction (e.g. additional tax exemptions for minor jobs), but a significant impact of these measures remains to be seen.

this problem rather drastically.<sup>12</sup> It shows that – although there is some path-dependency within institutions – if opportunity costs of the Pact are too large, rational policy-makers are tempted to dilute these institutions accordingly. In other words, if societal responses to socio-economic hardship are strong enough, the social dimension may have a serious feedback on fiscal policy and market outcomes.

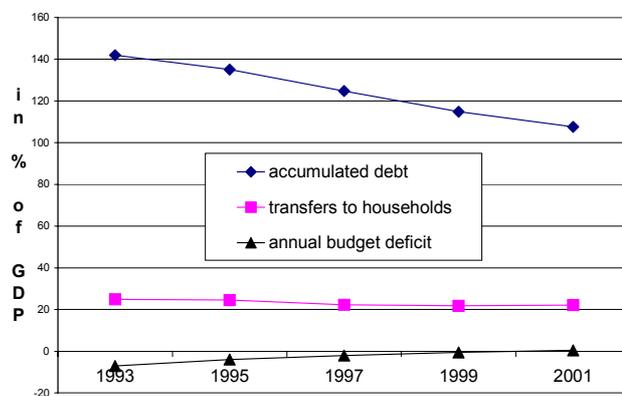
Next, if we assume that the EU and EMU constraints are credible, this prompts the question of consequences for national policy-making. Political economy approaches to fiscal adjustment also try to model the behaviour of national governments exposed to EMU-constraints. According to this literature, an imposition of external constraints such as the Pact, may seriously back-fire, since rational policy-makers will cut budget categories not according to efficiency but according to minimising political and private losses, i.e. rents (Easterly '98). The next Box (no. 2) will show the problems of reducing public deficits for the case of Belgium.

### Box 2 Pitfalls of Fiscal Adjustment – the Case of Belgium

Because of its high initial stock of public debt, Belgium may serve as an example how EMU exerts pressure on national fiscal policies. This may also provide a guideline how to evaluate additional pressure on public budgets coming from structural adjustment in the wake of Eastward enlargement.

As a matter of fact, the Belgian government managed to reduce cumulative debt considerably. Debt-to-GDP ratio peaked in the early '90s at around 140 per cent and has been shrinking since by some 30 percentage points. The annual deficit declined even more drastically from around 10 per cent to a superavit of point five per cent. One major source – apart from endogenous reduction, i.e. debt services – of consolidation is wage constraint exerted by trade unions which affects personal expenditure for public sector workers. The other source is declining public investment (BELFIN '02). The key problem of rising government debt, however, is social transfers to households due to social security systems. These transfers have only been marginally reduced and oscillate currently around the level of 1993 (see graph below).

Fiscal Consolidation in Belgium



Source: own graph on basis of (BELFIN '02).

The evaluation of the fiscal consolidation in Belgium is straightforward. On the one side reducing government debt hinges upon a fragile consensus between social partners. For the government this budget position is difficult to control and even more difficult to plan for the future. On the other side, the government prefers cutting potentially productive investments in public infrastructure to retrenching the welfare state. From a political economy point of view, this is obvious since transfers are direct payments to voters and, hence, highly sensitive to reductions. In that respect, Belgium seems to be a good example why – to paraphrase William Easterly (Easterly '98) – fiscal adjustment is an illusion: in the short term, public protest would simply be too costly to allow for substantial structural reforms.

<sup>12</sup> Cf. recent interviews of Romano Prodi, president of the EU-commission: 'Prodi disowns 'stupid' stability pact' (The Guardian October 18, 2002).

Enlargement of the euro-zone has to be related to the overall context of EMU for current member countries. Potential labour market shocks stemming from Eastward enlargement, will be more difficult to handle than without the restrictions on monetary and fiscal policies. A second potential source of disturbance has already been mentioned as the problem of 'social dumping'. If both problems apply, social security systems will face the double challenge of increasing expenditures vs. declining revenues. A higher inflow of (younger) workers from CEECs could mitigate these consequences, but hinges upon the capacity of western European labour markets to integrate the additional work force. Hence, the total net effect of enlargement remains unclear and depends, we argue, on the determinants that drive the demand for national social policy.

There is an extremely large literature on the determinants of social policy (Cameron '78; Iversen and Cusack '00). Since we focus on political economy we do not touch issues such as demographic and sectoral change as well as 'modernisation' – the 'usual suspects' in this literature –, but look at different political approaches to explain rises in redistribution, social security transfers and the like. A prime avenue to be taken here is the median-voter theorem (Gradstein and Milanovic '00; Meltzer and Richard '91). Simply stated, it argues that the demand for redistributive social policy depends on the relative income of the median voter. The empirical evidence for this thesis is mixed, at best (Milanovic '99). There are several rival theories to explain this shortcoming (Persson and Tabellini '02). Apart from older approaches that focussed on the role of insider-outsider problems, interest groups and/ or the bureaucracy, critiques of this thesis argue that it underestimates the insurance character of social policy (Iversen and Soskice '00). Once again, these debates resemble the case of labour market regulation (Agell '02). This is to say that specific 'social policies' such as unemployment benefits may be explained either along the lines of the rent-seeking or the insurance-seeking literature (Saint-Paul 2000).

Whatever the approach to be taken, some consequences remain markedly stable across paradigms. For example, an increase in unemployment, rather unsurprisingly, should lead to a higher demand for social policy as a means of compensation (Greskovits '98). An alternative foundation for this result is delivered by approaches modelling the 'optimal speed of transition' (Aghion and Blanchard '94). In this literature, unemployment is a key variable for government behaviour, namely to initiate and steer privatisation. The term 'transition' should not be seen as exclusively related to CEECs only, but could be also applied to notions of structural change in western European labour markets. The true question of this approach boils down to the idea of explaining policy reform, or of endogenizing policies. In our context, it could determine the level of unemployment benefits as well as the amount of general social transfers.

A second key determinant of the demand for social policy is inequality. *Ceteris paribus*, it raises the demand for social expenditure, since it strengthens the political clout of rent-seekers and it increases the uncertainty of voters.<sup>13</sup> In addition, rising inequality may be viewed as the flip side of rising unemployment, since the sources of unemployment, arguably, are based on some aspects of redistribution caused by modern welfare states.<sup>14</sup>

In short, the demand for social policy responds positively to increasing inequality and unemployment. Increases in social policy may reduce inequality, but the impact on unemployment is ambivalent, since – at least in western Europe – the tax burden of social policy codetermines unemployment (Kemmerling '02a). If unemployment rates escalate (or stagnate on a high level) the process could end up in a bad equilibrium.

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<sup>13</sup> This argument is contested in the literature. Whether inequality determines the level of material insecurity in a society depends on additional factors such as socio-economic mobility (Alesina, et al. '01).

<sup>14</sup> Of course, the link between unemployment and inequality is not easily established. Hence there is a large literature on this cf. (Freeman '95; Hölscher '01). But it suffices to say that continental Europe has a huge employment problem with the so-called low wage sector (Scharpf '97).

### Box 3 Unemployment, Inequality and the Demand for Social Policy – a Stylised Model

A simplified chain of arguments for explaining the impact of *Ezoneplus* on national social policy could be organised around the following punch lines:

- Eastward enlargement of the euro-zone increases either unemployment or inequality or both.
- People affected by unemployment or inequality will ‘voice’ their discomfort
- This, in turn, affects decision-makers and could increase the demand for social policy, i.e. transfers
- If supply of social policy is fixed because of fiscal consolidation  
=> societal unrest (protests etc.)?
- If supply of social policy increases  
=> additional burden may induce new unemployment  
=> whether demand for social policy is reduced remains open  
=> Growth and Stability pact is diluted.

Clearly, Box 3 sketches a very crude version of a model, or chain of arguments, containing lots of empirical and theoretical pitfalls. Nevertheless, it exemplifies some of the fundamental trade-offs between long-term financial sustainability and short-term societal disappointment. To repeat, the overall impact of *Ezoneplus* may be small, but it adds to the general predicament and may toss the scales towards a bad equilibrium. But before coming to the societal responses to these processes, let’s briefly turn to each country for a monitoring of the current reform debates on social security systems.

Most comparative studies state that Germany is the prime example of institutional gridlock (‘Reformstau’) these days (Bertelsmann '02). There have been some cautious attempts to reform the public pension system and to introduce a private supplementary pension system, the Riester-Rente, named after the previous minister for social affairs. However, this pension is voluntary and its acceptance in the population is, so far, low. Hence, pension systems – sooner or later – will be back on the political agenda, since the financing gap of the public insurance system is once again widening (ibid.). In addition, the system of public health is the next major project containing ‘political dynamite’. Problems are similar to pensions and primarily financial in nature.

Whereas Austria shares a relatively high tax burden with Germany, its public budget is nearly balanced. Expenditure for unemployment insurance are markedly lower than in Germany, also because duration of benefits is relatively short for continental European welfare states (Bertelsmann '02). Nevertheless, current debates on tax reforms show that further reforms are much more problematic to achieve. The resignation of the last Austrian government was – at least officially – due to diverging opinions on reducing the tax burden.

As for Belgium, one of the major issues is still how to finance the welfare state (cf. Box 2). Expenditures for pension, health and unemployment benefits are among the highest in Europe (cf. Kemmerling et al. '02). In France, achieving a balanced budget by containing social expenditures is also the major point of political struggles these days. Policies to reduce unemployment have turned out to be rather costly from a budget perspective and the public health system is causing additional troubles. The sole example of little pressure from the public budget are the Netherlands. Mainly because of mixed public and private systems of old-age security and health, the level of social expenditures is rather limited. In addition, net levels of social transfers are surprisingly low for continental European standards (Kemmerling, Pogodda, and Spannauer '02).

Summing this part of the RI up, the trade-off between financial and social stability is probably the most important political problem continental European governments have to face at the

beginning of this century. Reforms seem to be necessary, but highly unpopular, and therefore rarely persecuted in a radical fashion. Because of the ongoing social problems in some member countries, the public opinion and of some politicians have turned their eyes to Brussels in the hope of getting additional transfers.

### **3.3. EU-Policies: Structural Funds and Common Agricultural Policy**

The major results so far were that a) migration may be seriously impeded, above all, by maintaining non-clearing labour markets, and that b) the demand for social policy, if it is affected at all, will increase. Whereas the first is primarily a problem of the accession candidates, the second point also affects current member states. Both issues necessarily prompt the question of how EU-policies may mitigate or deteriorate financing the losers of integration, once enlargement has taken place. The theory of optimal currency areas would imply that – given a low level of mobility and migration – increasing fiscal transfers are necessary. Political economists, however, would doubt that additional West-East transfers are easy to attain, let alone to distribute efficiently.

As a consequence, this part of the RI reviews the impact which *Ezoneplus* has on the two major components of EU-budget: common agricultural policy (CAP) and structural funds (SFs). Once again, it predominantly recurs to the political economy literature and, more specifically, the political economy of fiscal federalism as the third theoretical building block on which the ‘Reshaping of Social and Labour Market Policies’ is based.

A first point of entry into this literature is by simply anticipating which regions, countries and individuals of current member states will loose transfers, and how they will react to this problem. Departing from efficiency considerations of the optimal transfer debate in fiscal federalism (e.g. Oates '99), ‘pork-barrel politics’ is a handy way of how to conceive this process (Cadot, et al. '99; Dixit and Londregan '98). Regions within a country lobby their national governments for support, while these governments determine the absolute level of transfers on the EU-level. Technically speaking, most recent accounts of such models use a menu auction game in the lines of Grossman and Helpman (Grossman and Helpman '94). By this means, the demand for SFs and CAP is primarily explained by concerns within a country. A point of further complication in these models is the problem of multi-level governance, typical for fiscal federalism. Regions may lobby national governments which, in turn, voice their demand in Brussels.

A second point of entry focuses on the set of policy alternatives a national government has to respond to enlargement. As, for example, Casella (Casella '02) has shown, the question of coordinating redistributive policies between countries hinges upon the capacity of national governments to impose barriers to migration. To be sure, these barriers may consist of other tools than simply regulating work permits of foreign workers. An important example is the discretion of government in granting social assistance and other forms of ‘non-tariff’ migration barriers. A more sarcastic, but not totally implausible, way of conceiving this issue is to say that governments try to set national rates of unemployment high enough in order to prevent migration.

A third important issue deals with the political economy approach to anticipate reforms of the EU budget (Weise '01; '02). Since net contributors in the EU such as Germany and the Netherlands, fear substantive additional costs once new countries are accepted, they try to reform the EU household before the enlargement. These attempts experience fierce opposition by countries that benefit from the status quo, namely France and Spain.

**Table 3 EU budget positions of current member countries**  
(Simulation of expenditures of the EU-15 budget in 2007)

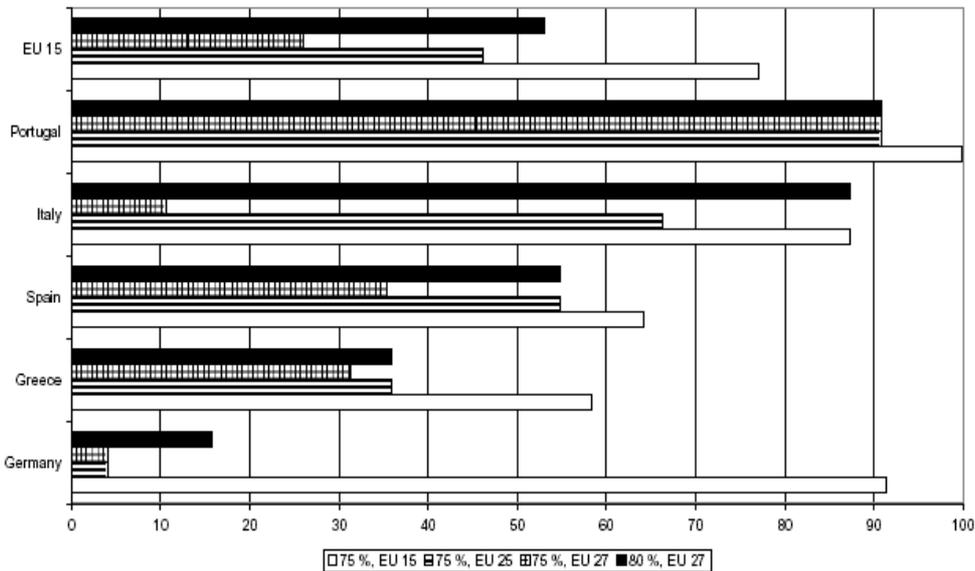
	All expenditures	Of which		All Contributions	Net position
		SFs	CAP		
Austria	1550	216	1217	1856	-306
Belgium	1367	160	1060	2202	-835
France	12451	1816	9773	12771	-320
Germany	11446	3536	6737	18917	-7472
Netherlands	2211	359	1625	3442	-1232
EU-15	74792	27395	42025	74792	
EU-15 (% of GDP)	0.81	0.30	0.45	0.81	

Source: own graph on basis of (Weise '01). Million Euros in prices of 1999.

Table 3 shows this problem for a simulation of future budget positions of current EU member states. Note in this calculation enlargement will not have taken place yet. Accepting 12 new member countries would imply, for instance, that Germany's net position would deteriorate by some five billion Euro (Weise '01).

But worse a budget position is not only due to increasing contributions. EU regional transfers (SFs) will be redistributed, since many regions of current member countries will be pushed above certain thresholds, namely the 75 percentage level in relative income that is attached to the so-called Objective 1 (Weise '02). For Germany this implies that six out of seven regions won't be entitled to get SFs in an enlarged Europe. In France three regions, and in Belgium and Austria one region will also be dropped.

**Figure 1 Objective 1 Population post 2007, alternative criteria (in % of current objective 1 population)**



Source: (Weise '02)

Figure 1 shows this problem in terms of the population affected by enlargement. The bars represent the share of the future population entitled to Objective 1 funds relative to the current Objective 1 population. The shares differ for a set of criteria. If the status quo without enlargement applies, 90 percent of the Objective 1 population will maintain their entitlements in 2007. With enlargement, the share is reduced to around five percent. Figure 1 also shows that next to Germany the southern European countries are most affected by the diversion of SFs to CEECs.

The problem of CAP is similar in nature, only that Belgium and France are the main beneficiaries of the current situation. However, the logic of reform is inverted. Whereas the major criteria for SFs are relative in nature, thus holding absolute levels of SFs more or less constant, CAP hinges upon absolute levels of production. In other words, shifting the status quo of EU-15 to EU-27 is mainly a zero-sum game, whereas CAP directly affects the absolute size of the EU budget. For SFs a reform would be interesting for Germany in order to maintain their population within the criteria of entitlement. A reform of CAP would mean the opposite, i.e. down-sizing the entire budget. Assuming fierce opposition of farmers in most countries, reforming CAP is politically dangerous. The compromise currently emerging out of EU negotiations on CAP is thus biased against the future members. At least for a grace period, new members will not be entitled to the same proportion of CAP-cash the old members are.

All things considered, the outcome of pork-barrelling about EU-transfers is yet to be seen. As in the areas of national policy, there seems to be a high extent of inertia in both EU policies. In opposite ways, this will lead to pronounced redistributive effects for CAP and SFs. The national willingness to pay or renounce of transfers will depend, as in the previous cases of policy reform, on internal political processes. It is these to which the RI now proceeds.

## 4. THE POLITICS OF *EZONEPLUS*

So far, we have merely assumed that societies are reluctant to policy changes in the realms of social security and employment. This sort of societal unrest and its political manifestations have been treated as unobservable variables. This is quite natural since hard empirical evidence is difficult to attain and evaluate. Nevertheless, this part of the RI tries to nail down some of the strategies individuals and interest groups have to make this unrest visible.

Talking about both the winners and losers of the enlargement process generates a major question arises: What kinds of strategies do individuals and corporate actors have to complain about their losses or promote their benefits in a politically meaningful way? Two distinctions may help to organise the argument. First, there is the distinction between ‘voice’ and ‘exit’ strategies (Alt, et al. '99). Political actors can either choose to make their complaints observable within the political institutions, or they stop their cooperation within these institutions and look for alternatives outside. A second distinction deals with the capability of organising the voice strategy. Some segments within the population are more apt to form a (unified) political platform and to coordinate strategies than others. Hence this difference is best captured by the notion of ‘organised groups vs. dispersed individuals’. The following 2x2 matrix shows a couple of relevant strategies in the enlargement process.

**Figure 2 Matrix of political reaction towards enlargement**

	Voice	Exit	
Organised	Interest Group Lobbying	FDI, Capital Transfers	
Dispersed	Voting, Strikes, Protests	Shadow economy, tax evasion etc.	Doing nothing Not voting

Some of these strategies have already been mentioned in previous parts. This time, however, we will look more closely at the empirical evidence for the politics of *Ezoneplus*. The section contains three parts: The first entails a set of issues and indicators dealing with the question how general interest in the form of public opinion is affected by enlargement. The next will shed light into the question whether and how these anti-enlargement attitudes may be transformed into a political position (usually in the form of Eurosceptic parties). The third part concentrates on interest groups such as trade unions and farmers’ associations and their capacity to ‘voice’ their scepticism towards enlargement.

### **4.1. Individual Scepticism towards Enlargement**

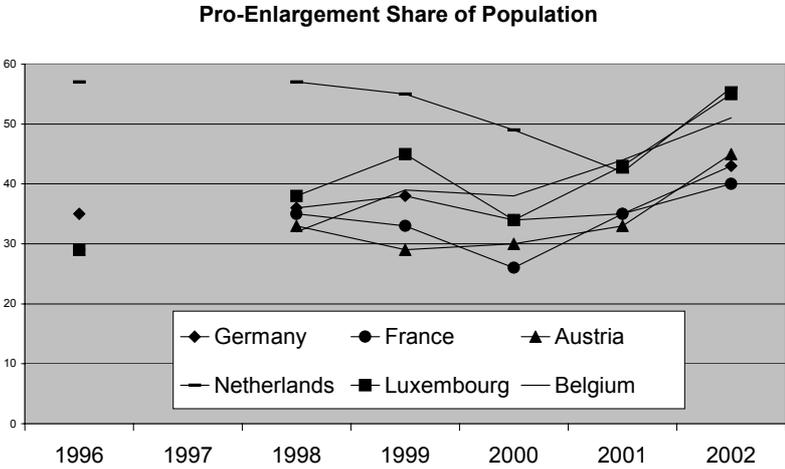
To begin with, public opinion is a major concern for EU policy makers. Since democratic legitimacy of EU decision-making is – at best limited – and *Ezoneplus* entails a set of problematic socio-economic ‘side effects’, taxing the amount of euroscepticism prevalent in the European public(s) is an important way of estimating the political problem of the Social Dimension.

In general terms, the role of public opinion in the political system has been likened to the role of prices in market economies (Luhmann 2000: 292). To be elected, politicians have to

monitor public opinion polls, and adapt their policies in a similar fashion in which enterprises use prices to make their decisions to invest and produce. This is not to say that politicians always follow or adhere to the public opinion, but open violations to such behaviour will seriously challenge their future prospects. Hence, analysing public opinion not only gives some taste of how reluctant societies might be to the problems *Ezoneplus* generates – however distorted this information may be – it also should be seen as a causes for the previously mentioned lack of policy reforms and the delay with which policies are being reshaped.

The empirical evidence suggests that public agreement on Eastward enlargement is, in some countries, ‘a close race’. Figure 3 shows the share of the population that agrees with the enlargement of the European Union. Apart from the Netherlands, in none of the six countries the pro-enlargement group is above 50 percent of the population. Though there are some signs of an ascending trend, volatility of public opinion is typically high as may be seen in the case of the Dutch population.

**Figure 3 Public Opinion on EU enlargement**



Source: Eurobarometer, various years.

Eurobarometer Data (Eurobarometer '02) also cautiously suggests that issue salience of enlargement varies across Europe. If people are directly asked how important enlargement maybe for themselves or their respective country, differences in average national responses are small (ibid.: 10). If, however, questions are issued that try to tax the knowledge of people about enlargement, proximity plays an important role in explaining national differences (ibid.: 31).

Unfortunately, Eurobarometer Data does not reveal much information about potential determinants of attitudes. The few categories that are inquired (cf. Annex 2) suggest three pro- vs. contra-enlargement cleavages: young vs. old, workers vs. other employees, urban vs. rural areas. Apart from the first one, these differences are easy to explain by using standard theory of international economic integration (Kemmerling '02b). According to the previous parts of this RI, workers may fear the detrimental impact on their wage and social transfer levels, whereas rural areas are afraid of a potential diversion of CAP- and SF-cash.

### **3.2. Consequences of Individual Euroscepticism: Voice or Exit?**

How is Euroscepticism transformed into party politics? Unfortunately, so far there has little research been done on the direct impact enlargement may have.<sup>15</sup> A trick, which has figured prominently in previous parts of this RI, is to use general information about the EU and EMU and put this into the context of enlargement. Annex 3 contains information of recent study about the extent of general Euroscepticism in both national public opinion and national party systems. According to the authors (Taggart and Szczerbiak '02), parties may be classified into three groups: hard euroscepticism, soft euroscepticism and no (open) euroscepticism.<sup>16</sup> They maintain that there is no perfect fit between the level of Euroscepticism in the public opinion and the size of anti-European parties in national parliaments. Country studies show that the reasons for the success or failure of anti-European parties differ profoundly from country to country (ibid.).

**Table 4 Euroscepticism in the public opinion and the party system compared**

	Austria	Belgium	France	Germany	Netherlands
	Euroscepticism in Public Opinion				
	0.21	0.08	0.12	0.11	0.09
	Parties' Euroscepticism				
Hard	0.00	0.09	0.27	0.03	0.00
Soft	0.27	0.00	0.04	0.05	0.16

Source: Taggart and Szczerbiak '02.

Notes: Euroscepticism is measured as the percentage of people disagreeing with enlargement in the 1998 Eurobarometer survey (third line), or the percentage of parties strongly or weakly rejecting enlargement (fifth and sixth line).

Hardliners, in particular, are not members of any government in Europe (ibid.: 16). The political clout of anti-enlargement parties is therefore clearly limited. Most interestingly, Germany has shown a marked resilience against Euroscepticism and anti-enlargement parties, a fact that has been related to its federalist political system (Lees '02). The one exception, where Euroscepticism features prominently in the political system, is France. However, enlargement has, so far, never been made to a major issue during recent election campaigns.<sup>17</sup> Soft euroscepticism, frequently related to enlargement issues such as the alleged explosion of the EU budget, is strong in Austria and the Netherlands. In both countries, parties with an outspoken, but not extremist scepticism towards enlargement are or have been in national governments.

<sup>15</sup> For western Europe, at least, enlargement has, so far, not featured as a significant political issue along which party systems could be arranged (Gabel and Anderson '02; Sitter '02).

<sup>16</sup> The distinction between 'hard' and 'soft' notions of Euroscepticism is drawn on the question whether European integration is generally rejected or only some aspects of it such as the monetary union.

<sup>17</sup> Cf. RIIA/OERN Election Briefing No. 4

(<http://www.sussex.ac.uk/Units/SEI/oern/ElectionBriefings/index.html>, 10.11.02).

All things considered, party politics does not seem to be a major ‘avenue’ for societal discontent against enlargement. However, for some parties it seems to be a handy ‘tool’ for mobilising critical and, at times, extremist voters as the following box suggests.

#### **Box 4 Temelin – Austria’s Referendum Against Enlargement**

From the 14<sup>th</sup> to the 21<sup>st</sup> of January 2001 the Austrian electorate was called for a public referendum initiated by the FPÖ (Freiheitliche Partei Österreichs). The official title of the “Volksbegehren” was ‘veto against Temelin’, a Czech nuclear power plant in the boarder region to Austria. Though the trigger of this referendum were (allegedly) poor safety standards of the power plant, parties leaders of the FPÖ openly admitted that the referendum should be seen as a protest against the way how enlargement takes place (Plasser and Ulram '02).

Roughly 900 000 people, about 15 percent of the electorate, voted against Temelin. An analysis of the voters shows that the referendum had little to do with environmental concerns (Plasser and Ulram '02). Only 8 per cent of green voters signed the referendum, whereas more than 40 per cent of FPÖ supporters. More importantly, around a quarter of those who signed the referendum are openly against enlargement.

The referendum against Temelin was closely related to two other dominant issues in the Austrian public related to enlargement: labour market issues and the so-called Benes decrees. Whereas labour market issues are relatively easy explained given the results of previous section, the Benes decrees constitute an entirely different issue area related to the historical legacy of Austria. In 1945 the first President of Czechoslovakia, Edvard Benes, sanctioned all acts that had happened in the course of the eviction of German and Austrian inhabitants of the Czech territory. Since the decrees are still part of the corpus of national legislation in the Czech Republic, they are a major source of disturbance in the bilateral diplomatic relations with Austria. Especially among older people and supports of right-wing positions, these decrees are an indignity. The example also shows that – whereas general Euroscepticism cannot be attached to the traditional left-right divide in the political spectrum, anti-enlargement opinions are frequently correlated with extremist attitudes in terms of xenophobia.

The Box on Temelin has shown that there is some, though weakly to be established relationship between criticism against enlargement and populist or sometimes even xenophobic tendencies. Especially because of issues concerning labour markets and social security systems, the political discussion on enlargement is, now and then fused with explicitly nationalistic positions (Kemmerling and Bolle '02).

Next to these different aspects of voicing political protests, the Social Dimension also has to deal with the phenomena of exit strategies for individuals in response to enlargement. One of these strategies has also been discussed: the rising share of informal and illegal market transactions, i.e. the shadow economy, which may be seen as an indication for such an effect induced by enlargement.<sup>18</sup> Another way, though clearly more passive, is political alienation. A larger European Union and a larger monetary union in particular, may foster this process to significantly higher levels. An example is the notoriously low voter turnout for elections of the European Parliament. Most interestingly for our context, one of the determinants for turnout figures is the amount of subsidies granted to a country (Mattila '01). Abstention as well as other exit strategies may not endanger enlargement directly, but arguably produce a negative feedback loop to the integration process in the long run.

### **4.3. Specific Interest Groups, Public Protests and other ‘Veto-Points’**

To be sure, data on public opinion, Euroscepticism or voter turnout is prone to well-known critique. Is public opinion really important in modern political systems? How reliable or noise is the information propelled by opinion polls? However, rather than to discard this

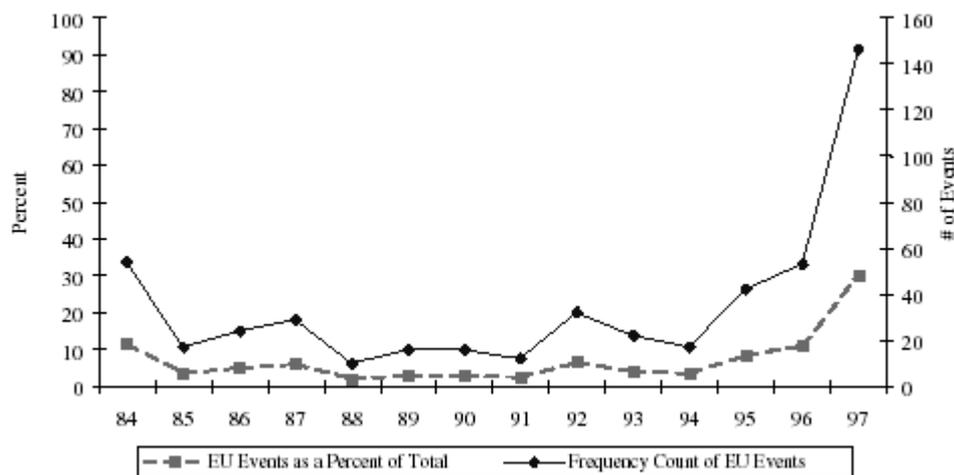
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<sup>18</sup> We believe that enlargement will significantly increase the shadow economy since the black-market demand for low-wage jobs is high whereas the supply of it, due to high reservation wages, is low for national citizens, but not for illegal immigrants.

information, we try to find complementary measures for societal discontent with enlargement. One of the alternative to polls is to look at the evidence for manifest political protests. The politics of Brussels is haunted by frequently occurring manifestations and blockades. But not only Brussels is a place to express dissatisfaction, national protests and manifestations may also have a linkage to the EU and enlargement.

Empirical data on the incidence of genuinely European protests (i.e. protests about EU-related issues) shows an ascending trend in the nineties (cf. Figure 4).

**Figure 4 Frequency and percentage of Western European contentious events provoked by European Union policies and institutions, 1984 to 1997.**



Source: (Imig '02).

On the national level, strike is still the most common form of political protest, compared to other forms of public protest. For the case of Brussels politics the ‘tone of the discourse’ seems to be markedly more confrontational (ibid.: 926). Moreover, EU policies may play a role in causing national political predicaments (see above). Hence national waves of protests such as general strikes are indirectly related to EU issues. Anecdotal evidence suggests that the occurrence of general and mass strikes is related to the attempts of national governments to retrench and reform their welfare states, labour markets included.<sup>19</sup>

Most manifest and regularly occurring forms of political protest presuppose political agents endowed with the necessary capabilities and resources to organise these protests. Two likely candidates that potentially provide political agency of Euroscepticism are trade unions and sectoral interest groups, namely farmers’ associations.

All things considered, the way societal reactions are transformed into political concerns depends on the specific policy area, but also on nationally idiosyncratic facts. Labour market regulation and CAP will affect major national veto players, i.e. special interest groups. Social security systems are rather a problem of ‘general interest politics’ (Persson and Tabellini '02). No matter what transmission channel is argued for, societies will react towards enlargement and lead to a reshaping of policy areas which is different from pure market outcomes.

<sup>19</sup> Note, for instance, the recent general strikes in Italy and Portugal, the latter being directly related to attempts of the government to obey to the EMU-rules for fiscal policy.

## 5. CONCLUSIONS

This RI showed some of the social and political problems arising from the eastward enlargement of the eurozone in Western European countries. At least in the short run, *Ergoneplus* may affect some segments of the population negatively. These social conflicts are a major reason why the policy areas analysed here are reacting rather sluggishly to the enlargement process and do not neatly fit into to broad picture of the reshaping of policies sketched for the areas of monetary, fiscal and exchange rate policies. Rational governments and other politically relevant actors take up these fears and transform them into national policies.

Synopsis 1 summarises the major problem areas of enlargement. Austria seems to be mainly affected by the inflow of additional workforce. Though this may stimulate additional growth and efficiency gains, it may also demand additional reforms in terms of labour market regulation. In that respect the Austrian situation resembles the Dutch one. Germany is probably most seriously affected by enlargement. It may not only loose in terms of structural funds, but high social standards are attractive to foreign workers, and difficult to maintain because of exploding budgets. The German welfare state could arguably need an inflow of migration from CEECs, the potential, however, is seriously limited by high unemployment rates. Like the Netherlands, Belgium and France are little affected by enlargement. The exception may be French farmers, showing a considerable of political clout. In an enlarged Europe, high costs of the social security system are still a major area of political discontent in both Belgium and Germany.

**Table 5 Synopsis I – Key policy areas of discontent**

	Social Policy	Labour Market SFs Regulation	CAP
Austria		x	
Germany	x	x	x (East)
Belgium	x		
Netherlands		x	
France			x

Socio-economic conditions are not always directly transformed into political conflicts. To the contrary, in some cases resistance against enlargement may be related as much with fears and a lack of information as with true material hardship. Synopsis II summarises the major transmission mechanisms analysed in this input. Public opinion plays a major role in Austria and, to a somewhat lesser extent, in Germany, since both countries share borders with CEECs and a history overshadowed by bad memories. Anti-enlargement sentiments do not feature prominently in Germany, whereas in Austria and the Netherlands they do. Given the relative un-affectedness of the Netherlands this may come as a surprise and clearly alludes to the aforementioned aspects of fear and ignorance. Enlargement-sceptic interest groups exert influence in Germany (mainly trade unions) and France and Belgium (farmers' associations). Alienation, in terms of low electoral turnout, though not a direct threat to enlargement, seems to play a role in both Germany and the Netherlands, for distinct reasons though, since, for example, party and interest group politics are differently organised in both countries.

**Table 6 Synopsis II – Key political responses of discontent**

	Public Opinion	Parties	Interest Groups	Alienation
Austria	x	x		
Germany	x		x	x
Belgium			x	
Netherlands		x		x
France			x	

Taken these main points together, they show that enlargement exerts a strong influence on the policy areas inspected here. The lack of policy adjustment is mainly due to countervailing trends in society that produce an impact on national policy-making. The discussion shows that there are no automatic stabilisers that can guarantee a smooth and profound reshaping and that simultaneously induce optimal gains in efficiency. Most likely, enlargement costs, and those of CEECs in particular, are not easily absorbed by markets in the short run. To the contrary, political bargains on the national and EU-level will arise, and force the EU itself to dedicate more money 'than necessary' to the enlargement process. Since the only political alternative would be to open up and deregulate labour markets, and the German one in particular, net contributors will 'gladly' pay that price instead of facing the political costs of national social conflicts.

## Annex 1: Unemployment and the Size of Migration to Western Europe

	Size of Migration in 1999 (CEEC-citizen/national population)	
Avg. unemployment rate (90-99)	-0.05	(0.02) *
Dummy for neighbouring country	0.43	(0.14) *
Intercept	0.54	0,21 *
Nobs.	15	
Adjusted R <sup>2</sup> (SE of Estimate)	0.47	(0.26)
F-Test		6.71 *
White-Test		4.07

Own calculations; standard errors in parentheses; level of significance \*\* < .5

## Annex 2: Eurobarometer 2002: 23.

2) Vous personnellement, êtes-vous tout à fait favorable, plutôt favorable, plutôt opposé ou tout à fait opposé à l'élargissement de l'Union européenne?

2) Are you, personally, totally in favour, rather in favour, rather opposed or totally opposed to the enlargement of the European Union ?

	+++ FAVORABLE IN FAVOUR	--/ OPPOSE OPPOSED	Tout à fav le Totally in favour	Plutôt f le Rather in	Plutôt o Rather	Tout à opposé Totally opposed	[cela dépend [It depends countr(y)(ies)]	[nsp/sr] [dk/na]	BASE
UE 15	68%	18%	24%	44%	11%	7%	3%	11%	15088
<b>SEXE - SEX</b>									
Hommes - Men	70%	19%	27%	43%	11%	8%	3%	8%	7095
Femmes - Women	65%	17%	20%	45%	12%	5%	3%	14%	7993
<b>AGE</b>									
15-24	77%	10%	23%	54%	7%	2%	3%	11%	2232
25-39	70%	16%	22%	49%	11%	5%	3%	11%	4333
40-54	66%	20%	24%	43%	13%	7%	3%	10%	3746
55 & +	62%	22%	26%	37%	12%	10%	3%	12%	4760
<b>EDUCATION</b>									
15 & moins	63%	19%	24%	39%	10%	9%	3%	14%	3781
16-20	67%	19%	22%	45%	12%	6%	3%	11%	6601
21 & plus	74%	15%	26%	48%	11%	4%	3%	8%	4706
<b>PROFESSION - OCCUPATION</b>									
Indépendant – Self-employed.	68%	21%	26%	42%	13%	8%	2%	9%	1410
Employé – Employee	71%	17%	24%	48%	12%	5%	3%	9%	4775
Ouvrier – Manual worker.	63%	21%	21%	42%	13%	8%	2%	14%	1948
Sans act.prof. – No prof.activ.	67%	17%	24%	43%	11%	7%	3%	12%	6882
<b>HABITAT - LOCALITY TYPE</b>									
Métropoles - Metropolitan	70%	17%	22%	48%	11%	5%	3%	10%	3953
Centres urbains - Urban zone	70%	17%	28%	42%	10%	7%	3%	11%	6079
Zone rurale - Rural zone	63%	21%	20%	44%	13%	7%	3%	13%	5055

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