Vision Europe Summit

Winners and losers of globalisation

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Preface

Launched in January 2015, Vision Europe is a joint project of leading European foundations and think tanks — Bertelsmann Stiftung, Germany; Bruegel, Belgium; Chatham House, UK; CASE, Poland; Compagnia di San Paolo, Italy (in cooperation with its knowledge partner Fondazione Collegio Carlo Alberto); Calouste Gulbenkian Foundation, Portugal; Jacques Delors Institute, France; and the Finnish Innovation Fund Sitra, Finland.

The above organisations work together to investigate, debate and, thus, inform and influence policy makers and public opinion on some of the most pressing public policy challenges Europe faces today. Through research, publications and an annual summit, we aim to be a forum for debate and a source of recommendations to improve policy-making at both a national and EU level and to foster as appropriate European integration.

In 2015, Vision Europe worked together on "the future of the welfare state", creating and developing recommendations for a set of innovative public policies capable of ensuring the long-term sustainability of the national social security systems.

Last year, the Vision Europe partners focused on "improving the responses to the migration and refugee crisis in Europe".

In their Final Declaration, the partners stressed that it is important to control the EU's external borders so that only refugees who have a legitimate right to seek asylum, can enter and potentially remain in the EU; that the EU should develop a system which distributes a much larger number of refugees across the Union, directly from the hotspots in the EU and the neighbouring countries; a third measure should be to improve, standardise and speed up the processes concerning acceptance or rejection of asylum applications. As a fourth measure, the VE partners recommended expanding efforts at the EU level to improve the living conditions of refugees staying in countries close to their countries of origin. The EU and its Member States should work vigorously towards ending the violent conflicts that are the principal causes of the crisis. Action is also required – the partners declared - at the national level, especially in the EU countries where significant numbers of refugees have received or are expected to receive asylum.

For their 2017 common effort, the VE partners chose to address the ghost that in the last few years – at least following the great financial crisis of 2008, – has been haunting Europe, and the whole world: globalisation itself. More precisely, we decided to deal with the all-encompassing question of "winners and losers of globalisation".

Our goal, in tackling such a controversial issue, was to go beyond taking stock of the impact of globalisation on economic, political and social systems around the world, and, consistently with the main aim Vision Europe has pursued since it was launched three years ago, to make policy recommendations based on sound scientific analysis.

The partners' first concern - at we engaged with a problem of historical proportions, that has structurally affected the shape of the world as we used to know it, from the global economy to the social fabric of all countries involved, and the legitimacy and real power of "liberal democracies" and international institutions in governing issues transcending national borders - was to identify a number of main features that have characterised globalisation, and analyse them in separate policy papers.

The decision was made, to divide the research-and-proposal work into three main areas of investigation. Namely: international trade (globalisation "per se", one may argue); the challenges labour and welfare national policies face when confronted with globalisation; the growing difficulty faced by political institutions and governments in "managing" the often-unintended consequences of globalisation.

While we recommend reading each individual paper for detailed analysis and policy proposals, in these introductory lines we outline some of the main conclusions that have been reached through our experts' work.

By increasing cross-border exchange of goods, labour, capital and technologies, the liberalisation of global trade has allowed a better distribution of scarce production factors. This has resulted - as, suggested by the Chapeau Paper prepared by Thieβ Petersen ("Economic globalisation – who is winning, who's losing out") - in growth effects for the economies of all the countries involved. Furthermore, consumers have benefited from lower prices and a larger variety of consumer goods. The other side of the coin, however, consisted of changes in scarcity conditions within the individual economies. This has led to price changes in each country – both for material goods and services, as well as for the production factors of labour and capital. As a result, there are winners and losers of globalisation within each country.

The deciding factor for how globalisation should be shaped in the future is whether the "dividends of globalisation" can be distributed in advanced economies in such a way that globalisation's losers can also benefit from the resulting gains in growth.

This requires policies that reduce income inequality and strengthen social security systems, with the aim of alleviating the citizens' fear of change. In addition to compensating for lost income, it is also important to implement further training for the unemployed, to facilitate their transition into sectors which have benefited from globalisation.

A cross-society consensus must be reached on how exactly those policy instruments should be designed – both in terms of expenditure and income. This consensus must consider unintended effects and reciprocal effects as well. However, in the first instance, the deciding factor will be a fundamental commitment across society to place greater emphasis in policy-making on those who have lost out under globalisation. In the absence of some form of compensation, serious social and political tensions will continue to exist, threatening prosperity across the economy as a whole.

The EU – as Maurizio Ferrera, Manos Matsaganis and Pier Domenico Tortola point out in their paper ("Globalisation, economic inequality and political instability: What future for Europe's welfare?") - is the appropriate sphere in which to devise such solutions, for it works at a scale large enough to preserve the gains from openness while constituting an arena for the legitimate and viable creation of new tools for market corrections.

Based on the above suggestion, it will be interesting to read the paper by Grégory Claeys and André Sapir ("Easing Pain from Trade: the European Globalization Adjustment Fund"), discussing the European Globalisation Adjustment Fund (EGF), established in 2007 to co-fund EU Member States' labour market policies that facilitate the re-integration into employment of workers who have lost their jobs as a result of globalisation, and suggesting ways to improve it and making it more effective at easing the pain from globalisation for EU workers.

The role of institutions in dealing with globalisation and its impact on our economies is discussed in the paper presented by Christopher A. Hartwell ("Do Poor Institutions Create More Losers from Globalisation?"). It studies the conditions under which extra "losers" are generated during the process of liberalisation via an examination of the role of institutions in economic transition.

The impact of globalisation and its role in creating winners and losers within the same national environment on the legitimacy and resilience of Western liberal democracies was examined by Thomas Raines ("Europe, democracy and globalisation: Can the EU counter the illiberal turn?") and by Yves Bertoncini ("Democratic Crises in the EU: Towards 'New Frontiers'"). European societies are increasingly divided by their attitudes to liberal values and their views on the effects of liberalism on society and the economy. In addition, publics and elites are divided over the direction politics should take and the EU, which has important implications for European democracy in the future.

The destabilisation of liberal democracy in Europe is multifaceted: it involves the deep crisis of some of its traditional pillars, namely traditional political parties and workers' organisations, while at the same time citizens tend to identify EU supranational power more with the Troika than with European democratic institutional system: nationalists and populists of all countries tend to blame the citizens' predicament on the lack of democratic legitimacy within EU institutions.

While liberalism is challenged at home, it is also struggling abroad. Challenges include the direction of global trade, the role of China and the political leadership of the United States.

The connections between the international and the domestic challenges to liberalism are important. The increasingly integrated global economy places structural pressures on the Western democratic model. Those countries which are champions of liberal rules-based international order must be able to demonstrate that it can deliver for citizens at home.

For EU policy-makers, the ambition must be to ensure that globalisation works in the interests of a clear majority of citizens. Three approaches which could support this goal are to focus on contesting illiberalism domestically, improving the legitimacy of the EU, and sustaining and nurturing liberalism internationally.

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Economic Globalisation – Who’s Winning, Who’s Losing out?

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Executive summary

There are two main consequences which have arisen from the increasing cross-border exchange of goods, labour, capital and technologies:

- One is a **better distribution of scarce production factors**. This has resulted in **positive growth effects** for the **economies** of all countries involved. Furthermore, consumers benefit from lower prices and a larger variety of consumer goods.
- However, the other is that there have been **changes** in **scarcity conditions** within the individual economies. This leads to price changes in each country – both for material goods and services, as well as for the production factors of labour and capital. As a result, there are **winners** and **losers** of globalisation **within** each country.

In **advanced economies**, the international division of labour and the associated cross-border trade activities lead to an increase in gross domestic product (GDP) in all of the economies involved. If **real per capita gross domestic product** is taken as an indicator for globalisation-driven growth, then it is the advanced economies such as Japan, Switzerland, Finland, Denmark, Ireland and Germany that benefited the most from advancing globalisation between 1990 and 2014. GDP growth attributable to globalisation has been lowest in absolute terms in the **BRIC countries** (Brazil, Russia, India and China). This is due above all to the fact that this indicator was so low for these countries at the beginning of the period under review. **Eastern European economies** occupy a mid-level position in the ranking of globalisation winners, when they are classified in this way.

In **emerging** and **developing countries** too, there has been a positive impact on growth from advancing globalisation. In particular, these effects are reflected in the steep reduction in absolute poverty in Asia, South America and Eastern Europe. By contrast, for the least developed economies in **Africa**, the results are less positive when the pros and cons of globalisation are weighed up. In these countries between 1990 and 2013, the share of the overall population living in poverty decreased from 54 percent to 41 percent only. The gap in per capita GDP is widening between Africa and the rest of the world – not only in absolute terms, but also in relative terms. From this viewpoint, African countries have been **left behind** by globalisation.

At the same time, the market processes of economic globalisation produce **losers** as well as winners **in every country**. In **advanced economies**, it is workers who lose out, in particular the low-qualified and those employed in industries which are competing most intensely with emerging countries (especially China and Eastern European economies). In **emerging economies**, the relative scarce factor (capital) suffers from lower demand.

This means that although the advancing globalisation and international division of labour has boosted growth in advanced economies, over recent years criticism of globalisation has increased considerably in these countries. I believe there are **three main reasons** for this:

1. Up to and including the early 1990s, international trade mostly took place among industrialized countries which all enjoyed relatively high wages. It was only when the Iron Curtain was lifted (**1989**), China joined the World Trade Organization (**2001**) and Eastern European countries acceded to the European Union (**2004**) that competition from low-wage countries increased. As a result, it is only at that time that the employment and wage-reducing effects of the international division of labour have become evident to an appreciable extent.
2. Another main trigger for the growing criticism of globalisation is the **outbreak of the economic and financial crisis** following the Lehman bankruptcy in the autumn of 2008. Three aspects are significant here. First: helplessness in the face of **anonymous, globalised market forces**, which caused the ripples from a local event to quickly escalate into a shockwave across the globe. Second: the fact that after years of cuts in state spending and payments from social security systems, **billions** in cash were **suddenly** available to save the banking and financial systems. Third: the economic slump led to an increase in **unemployment** worldwide, so that the unemployed faced a cut in their income and **downward pressure** on wages arose from the declining demand for labour.
3. In my opinion, the final trigger for growing anti-globalisation was the high number of **refugees** moving into Europe. This has confronted us with the fact that opening up borders – whether for people or trade – changes the scarcity conditions in all the countries involved, automatically creating winners and losers in the process.

The deciding factor for how globalisation should be shaped in the future is whether the **dividends of globalisation** can be distributed in advanced economies in such a way that globalisation's losers can also benefit from the resulting gains in growth. This requires policies that reduce income inequality and strengthen social security systems, in order to alleviate the citizens' fear of change. In addition to compensating for lost income, it is also important to implement further training for the unemployed in order to facilitate their transition into sectors which have benefited from globalisation.

A cross-society consensus has to be reached on how exactly those policy instruments should be designed – both in terms of expenditure and income. This consensus must take into account unintended effects and reciprocal effects as well. However, in the first instance, the deciding factor will be a **fundamental commitment across society** to place greater emphasis in policy-making on **those who have lost out under globalisation**. In the absence of some form of compensation, serious social and political tensions will continue to exist, threatening prosperity across the economy as a whole.

1. Introduction

The aim of this paper is to identify winners and losers of economic globalisation. The focus lies on the income and employment effects in advanced economies and the implications of these effects for the growing criticism of globalisation in these countries.

In this paper, **economic globalisation** is understood as being the economic interconnection with the global economy as a whole, whereby this interdependence relates both to the exchange of **production factors** (labour, capital, technologies, know-how) and the exchange of **products** (material goods and services, finished and unfinished products, consumer and capital goods).

Increasing globalisation of the economy basically means that there is a more intensive **cross-border exchange** of material goods, services, labour, capital and technology. International trade often takes place if the **scarcity conditions** – and therefore the **prices** – **vary** across the countries involved.[1]

- **International trade** takes place if the prices for consumer goods or intermediate products vary across different countries.
- It is worthwhile to **relocate production sites** if the production costs are different in the countries involved.
- **Investments** are made if yields abroad are higher than they are domestically.
- **Migration** takes place if living conditions – particularly earnings opportunities – vary across different countries.

This has two main consequences:

- One is a **better distribution of scarce production factors**. This has resulted – ceteris paribus – in **positive growth effects** for the **economies** of all the countries involved.
- However, the other is that there have been **changes** in **scarcity conditions** within individual economies. For example, if the production of goods which requires low-qualified workers in particular is relocated to low-wage countries, the income and employment opportunities for low-qualified persons decline in industrialized countries, such as Germany. As a result, there will be globalisation **winners** and **losers within** each country.

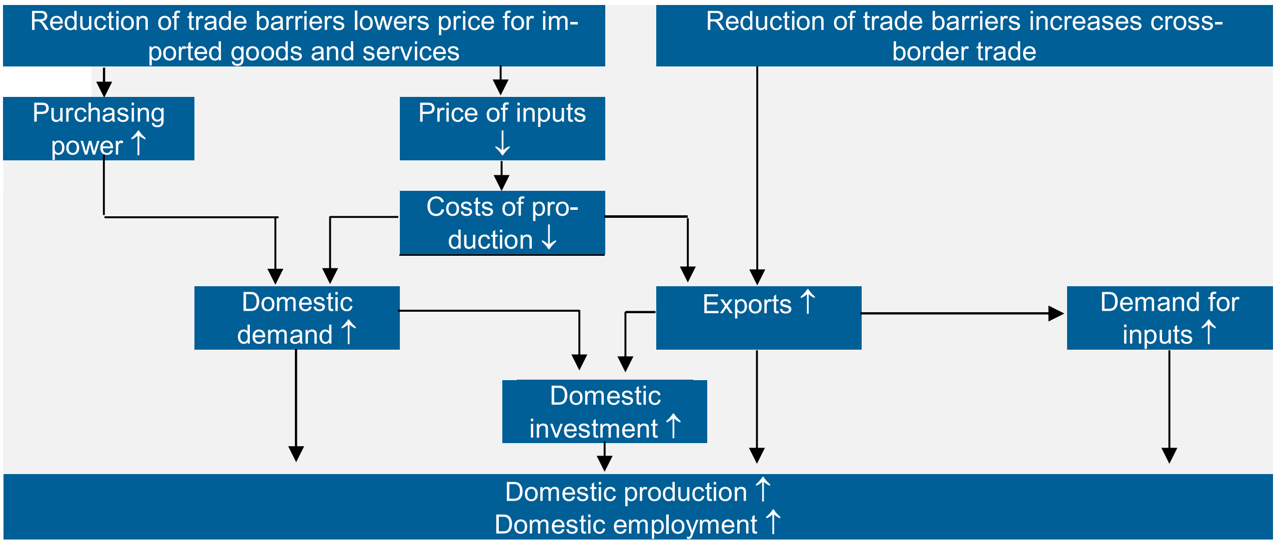
This paper is structured as follows: After a brief description of the most important growth effects of advancing globalisation (**Section 2**), the growth effects attributable to globalisation in industrialized countries and emerging countries are described based on the results of the Bertelsmann Stiftung's Globalisation Report 2016 (**Section 3**). **Section 4** is concerned with the impact of globalisation on those emerging and developing countries which are not included in the Globalisation Report. The income and employment effects that have arisen from globalisation in advanced economies are described in **Section 5**. **Section 6** deals with the role of politics and institutions in shaping globalisation. **Section 7** analyses the significance of income and employment developments for the rise of anti-globalisation in the advanced economies. In **Section 8**, potential future globalisation trends are presented, along with open questions arising therefrom.

[1] Apart from trade due to differences in factor endowment, cross-border trade may also issue from differences in consumer preferences and economies of scale.

2. Growth effects from economic globalisation: Key considerations

Although economic globalisation is much more than just cross-border trade, foreign trade is one core element of globalisation. Hence, an intensification of economic globalisation between two industrialized countries – e.g. Germany and Romania - means a reduction of trade barriers, i.e. tariffs and non-tariff trade restrictions. As a result of the reduction of these barriers, the costs of cross-border trade **fall** and so do the **market prices** for internationally traded goods. This results in positive effects for economic growth and employment in both countries.[2] The growth-generating effects of reducing trade barriers primarily consist of price drops, which increase consumer purchasing power and with that, consumption; they also consist of an increase in exports and investment, which pay off because both consumer demand and exports grow (see Fig. 1).

Figure 1. Diagram of the relationship between reduced trade barriers and economic growth



Source: author's own diagram.

The growth effects described in Fig. 1 result to a great extent from an increase in cross-border trade between the countries involved; in turn, this increase arises from **reductions in the cost of trade** (static growth effects).

In addition, economic integration also leads to an **increase in innovation and productivity,** which in turn generates a reduction in production costs and the price of the goods concerned (dynamic growth effects).

- The reduction of trade barriers in international trade means that companies are able to produce for a larger market. This allows for the **advantages of mass production** to be exploited, leading to lower unit costs and lower prices, so that consumers' purchasing power rises.

[2] Employment effects might be different if we look at cross-border trade between an advanced economy and an emerging economy. I will return to this point in section 5.1.

- Increasing trade between countries increases **competition** between them. Companies are forced to reduce their production costs through innovation and technical advancements, in order to remain competitive on the international stage. When **costs are reduced** via **technical advancements**, this leads to an increase in productivity.[3] This implies that the quantity of goods which can be produced with a given quantity of production factors increases, so the economy grows. At the same time, prices fall due to technical progress, which in turn increases domestic consumer demand for goods.

Where there is far-reaching economic integration, which also allows **production factors** to be exchanged freely across borders, productivity will increase further. A high level of cross-border mobility of labour and capital results in a situation whereby the available production factors can be deployed where they can create the greatest added value. This more targeted deployment of production factors improves productivity and creates an additional driver for growth, via falling prices and higher international competitiveness.

Static and dynamic **growth effects** arising in the course of greater economic integration in the countries involved **mutually reinforce** each other. For example, if production and employment increase in Germany, the demand for goods and services will increase among German citizens. This increasing demand will include products imported from abroad too, leading to increased production, employment and earnings abroad. And the increased economic growth abroad will ultimately lead to an increase in German exports to those countries.

Apart from the growth effects (defined as an increase in GDP) of economic globalisation, it should be emphasized that cross-border trade has positive implications for **consumers**. Due to the import of cheaper products, consumers pay less for these goods and thus obtain gains in terms of purchasing power. In addition, they have access to a larger variety of products (see for example Amiti et al 2017).

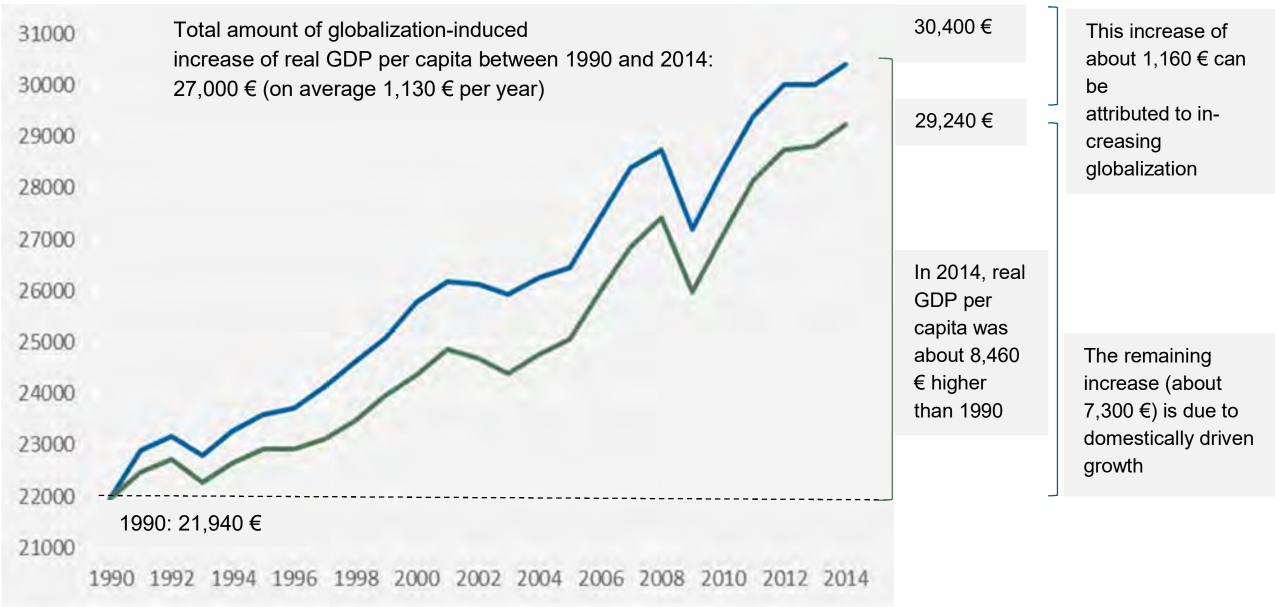
[3] Various studies show that trade openness and increased international competition have a positive effect on productivity – in industrialized countries as well as in emerging countries. See for example Chen, Imds and Scott 2006, Choudhri and Hakura 2000, Nataraj 2011, Wong 2006.

3. Empirical analysis of growth effects from globalisation

3.1 Globalisation and growth

The Bertelsmann Stiftung has demonstrated in the **Globalisation Report 2016** (see Bertelsmann Stiftung 2016a) that the inter-connections described in Section 2 are not merely theories. The economic development of **Germany** provides an **example** of the growth-generating effects of advancing globalisation (for methodological details see box 1). In this case, globalisation-induced growth in GDP per capita amounted to €27,000 between 1990 and 2014. If this gain in GDP is distributed across the 24-year period, then advancing globalisation has increased GDP per capita in Germany on average by €1,130 annually (see Fig. 2).

Figure 2. The development in real GDP per capita in Germany, with and without increasing globalization



Source: Bertelsmann Stiftung 2016a.

This calculation was carried out for all 42 industrialized and emerging countries under review in the report.[4] All of those countries were able to achieve globalisation-induced growth in GDP (see Fig. 3). When these calculations were made, it was found that growth in absolute terms[5] was lowest in the **BRIC countries**. There are two main reasons for these low gains:

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[4] According to the classification of the International Monetary Fund (see IMF 2017: 178), 29 countries are advanced economies (Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Netherlands, New Zealand, Norway, Portugal, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, United Kingdom, United States). The remaining 13 countries are emerging and developing economies (Argentina, Brazil, Bulgaria, Chile, China, Hungary, India, Mexico, Poland, Romania, Russia, South Africa, Turkey). Due to lack of data necessary for the calculations, other countries could not be included, especially no least developed economies.

[5] The Globalisation Report 2016 works with GDP per capita in absolute terms, because this indicator is the standard indicator in economic growth models and because GDP per capita is crucial for material prosperity and living standards.

- Most important is the low initial level of GDP per capita. For example, if GDP per capita starts at a level of €1,000, then a ten percent increase will lead to an extra €100. If GDP per capita is €10,000, even if growth is only two percent, there will be a greater increase in absolute growth of €200.
- Secondly, the level of globalisation expressed by the globalisation index is relatively low in these countries. China, for example, has many restrictions concerning international trade as well as capital controls and other limitations of international economic interconnections. Furthermore, for reasons of international comparison, all indicators of economic cross-border transactions (trade in goods, trade in services, foreign direct investment, portfolio investments) are expressed as percentages of GDP. Therefore China ranks at the bottom of individual indicators such as direct investment, portfolio investments and trade in services (see Bertelsmann Stiftung 2016a: 11). China is thus not making full use of potential gains from globalisation. However it should be noted that large countries such as the United States usually have a lower level of international economic interconnections by virtue of a large domestic market, which decreases dependence on imports and exports. For this reason, China will never achieve index values such as The Netherlands or Ireland.

Box 1: Methodological details of the Globalisation Report 2016

For the purpose of the Globalisation Report, increases in globalisation are measured using the so-called "Globalisation Index", which is closely aligned with the KOF Index of Globalisation created by the Swiss Federal Institute of Technology (ETH) in Zurich (see Dreher 2006). In addition to indicators on economic globalisation, this index also includes aspects of social globalisation (tourism, migration) and political globalisation (institutionalized interconnectedness, foreign relations, etc.). The index used in the Globalisation Report also includes the KOF Index of Globalisation's sub-indexes of social and political aspects of globalisation, but gives them less weight. The economy sub-index takes into account transaction volumes such as trade or investment on the one hand, and transaction limitations such as duties, taxes or capital controls on the other. Based on these data, a globalisation index is drawn up for each country and each year, with scores between 0 and 100. The more points on the index a country has, the more interconnected that country is with others in the world. The "Globalisation Report 2016" examines to what extent 42 advanced economies and emerging countries benefited from increasing globalisation between 1990 and 2014. According to the econometric calculations of the report, an increase of one point on the globalisation index led to an increase of 0.31 percentage points in the growth rate for real GDP per inhabitant.

3.2 Globalisation and growth in Eastern Europe

In 1990, most of the Eastern European countries had a relatively low level of international interconnection. Back then, countries such as Romania and Bulgaria were at the bottom of the ranking of interconnected countries according to the index used by the Globalisation Report 2016. Bulgaria, for example, started with an index value of 28.6 in 1990. Romania scored even lower with 21.4. Until 2007, the year before the Lehman collapse, both countries saw a sharp increase in their globalisation index scores. Bulgaria reached an index value of 66 in 2007, while Romania achieved 60 index points. Hence both countries had more than **doubled** their **globalisation index** scores. The same holds true for almost all Eastern European countries, except Russia. Indeed, it was Eastern European countries that recorded the **largest rises** in the **globalisation ranking** between 1990 and 2014 (see table 1).

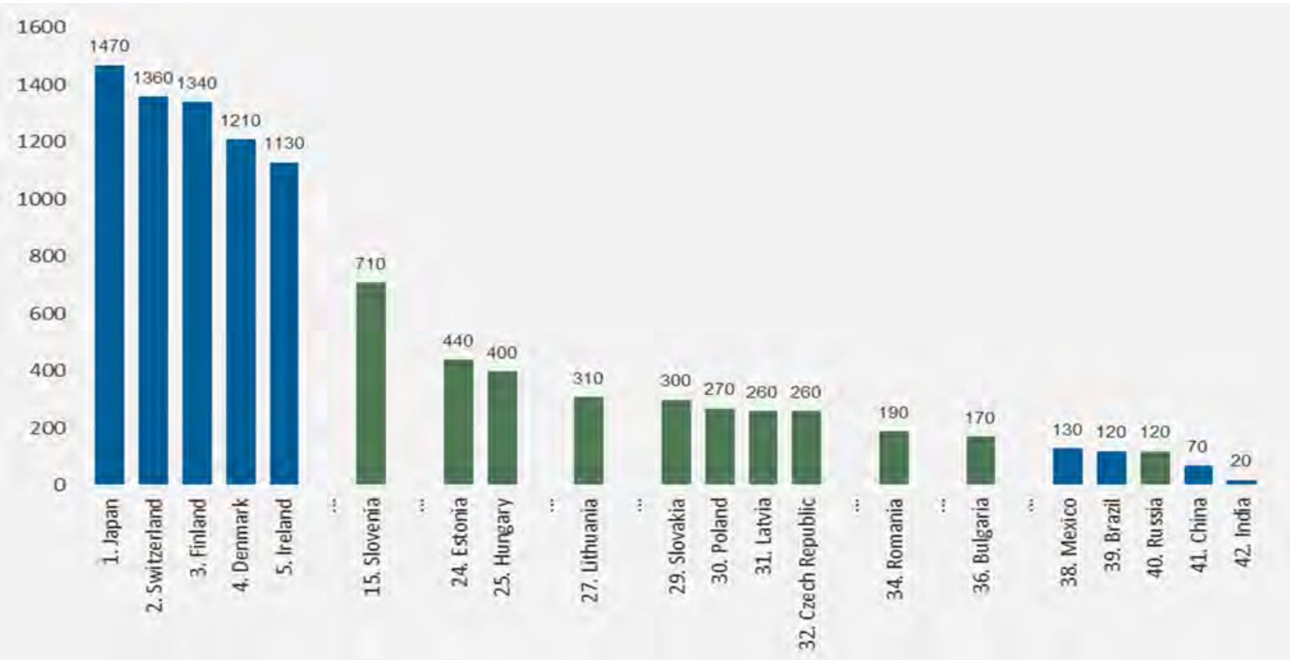
Due to the strong rise in global interconnectedness, all Eastern European countries have shown significant increases in real GDP per capita. Nevertheless, compared to the globalisation-induced GDP increases in advanced economies, their absolute gains are relatively low: for most of the Eastern European countries, the annual gain in real GDP per capita during the period 1990 to 2014 is between €200 and €440. This is much lower than in highly developed countries such as Japan and Switzerland, where these gains are about €1,400 on average per person and year (see Figure 3). Russia has the lowest gains. Apart from the low initial level of GDP per capita in 1990, this result is also due to the stagnant globalisation of Russia since 2002.

Table 1. Countries with the largest increase in the globalization ranking between 1990 and 2014

Country	Ranking 1990	Ranking 2014	Change of rank
Hungary	22	7	+ 15
Bulgaria	36	22	+ 14
Estonia	25	14	+ 11
Romania	41	30	+ 11
Portugal	20	11	+ 9
Slovenia	29	24	+ 5
Finland	14	10	+ 4
Slovakia	21	17	+ 4
Austria	8	5	+ 3
Denmark	9	6	+ 3

Source: Bertelsmann Stiftung 2016a.

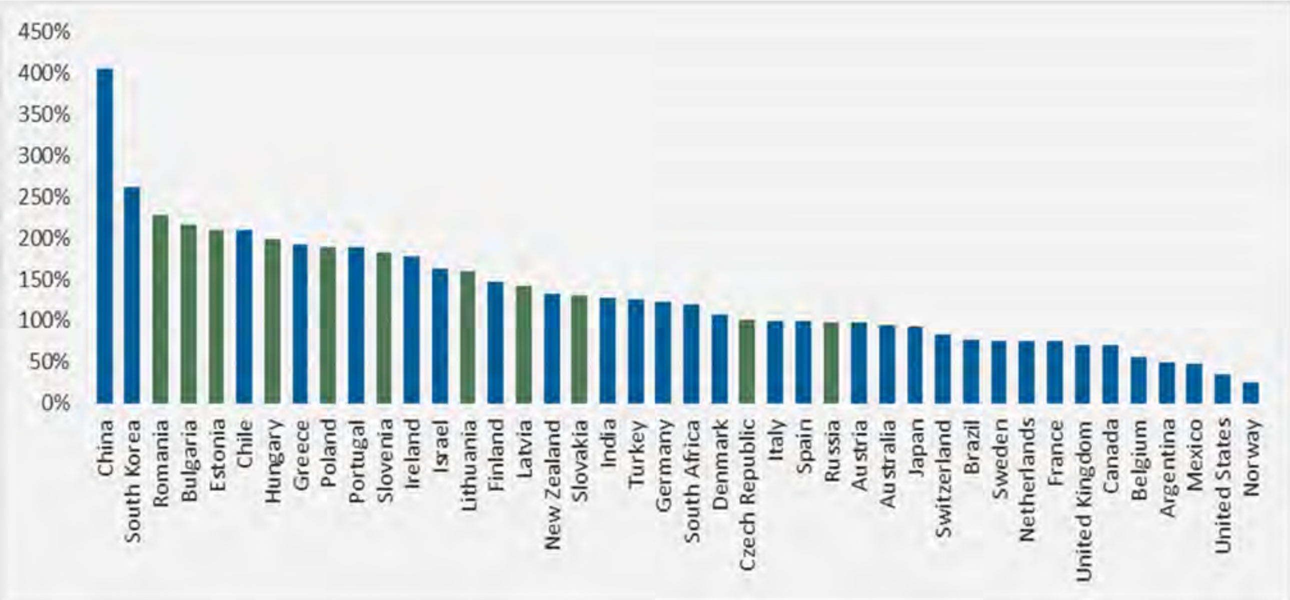
Figure 3. Average gains in real GDP per capita due to increasing globalization during the period 1990 to 2014 in selected countries, in euros (real=Y2000 prices)



Source: Bertelsmann Stiftung 2016a.

The results look quite different when considering the annual gains of increasing globalisation in relation to the initial level of GDP per capita in 1990. Working with the cumulative GDP gains between 1990 and 2014, Romania achieves a per capita GDP increase of € 4,500. This accounts for 230 percent of its GDP per capita in 1990. In Bulgaria and Estonia, cumulative GDP gains amount to 220 and 210 percent of the initial GDP level respectively. This is a much higher value compared to industrialized countries such as Germany (about 120 percent), the United Kingdom (about 70 percent) and the US (37 percent, see Figure 4).

Figure 4. Globalization-induced per capita income gains 1190-2014 compared to per capita GDP in 1990



Source: Bertelsmann Stiftung 2016a.

4. Main impact of economic globalisation on emerging and developing countries

All the countries involved in globalisation – including both emerging and developing countries – are subject to the underlying, growth-generating effects of increasing globalisation. High economic growth is particularly essential for the latter, since such growth contributes to lifting their populations out of poverty. However, economic development in the least developed economies - the African economies in particular - is problematic.

4.1 Globalisation and growth in emerging and developing countries

Participating in the **international division of labour** enables emerging and developing countries – as well as advanced economies – to specialize in manufacturing products for which each country has a cost advantage and to achieve the growth effects described in Section 2.

Furthermore, connections with the global economy provide emerging and developing countries with access to the credits and modern technologies they so urgently need. As a rule, **foreign loans** are necessary because where economic output and the material standard of living are low, domestic savings are usually too low to finance the construction of production facilities and infrastructure. **Direct investment** from advanced economies plays a special role, because alongside financing, it also facilitates access to technologies. This results in positive economic effects for emerging and developing countries (see Petersen 2014 for more information):

- Through foreign direct investment, emerging and developing countries become more **integrated in the global economy**; this means that as a rule, inflows of foreign direct investment are accompanied by an increase in exports from and imports to the country receiving that investment.
- **Overall productivity** and **national income** increase in emerging and developing countries due to the higher capital stock and the technology transfer associated with it. The increase in national income is reflected in the higher GDP per capita.
- In the normal course of events, **competition** in emerging and developing countries will increase, because new providers arrive on the market. This leads to cost pressure, which is reflected in **falling prices** and allows consumer purchasing power in the destination country to increase. However, there are cases in which the entry of multi-national companies onto the market increases the market concentration in the target country. The associated reduction in competition is detrimental to consumers.

Overall, advancing globalisation therefore leads to an increase in growth and employment in emerging and developing countries, as well as in developed ones. This is demonstrated in the case of the emerging economies in the Bertelsmann Stiftung Globalisation Report mentioned above. At the same time, however, it is clear that **globalisation-induced GDP growth as measured in absolute terms** is **considerably greater for industrialized countries** than for emerging countries, at least when looking at development in the period under exam. This means that between 1990 and 2014, the absolute differences in real GDP per capita have grown, e.g. between Germany and China (see Table 2).[6]

[6] As mentioned before, the Globalisation Report focused on the indicator “GDP per capita” instead of absolute or relative GDP values.

Although growth rates of real GDP were much larger in China than in Germany (with regard to both overall GDP and GDP per capita), due to the low initial level of GDP per capita mentioned in section 3.1, China was not able to reduce the gap in real GDP per capita compared to Germany. It is not clear whether Chinese GDP per capita might catch up with German GDP per capita in the long run due to larger growth rates. I have serious doubts that this might happen within the next decades because GDP growth rate for China as well as for India are expected to decline in the long run (see for example PwC 2017: 28).

Nevertheless, globalisation should still be regarded as a positive development from the point of view of emerging and developing countries, since GDP growth generated by globalisation has an important role to play in the fight against poverty for those countries that are on the poverty threshold.

Table 2. Development of real GDP per capita in Germany and China with and without increasing globalization

	Germany	China	Difference in real GDP per capita between Germany and China
Real GDP per capita in 1990	21,940 €	428 €	21,512 €
Real GDP per capita in 2014 without increasing globalization	29,237 €	3,372 €	25,866 €
Real GDP per capita in 2014 with increasing globalization	30,399 €	3,554 €	26,845 €

Source: Berterlsmann Stiftung 2016a.

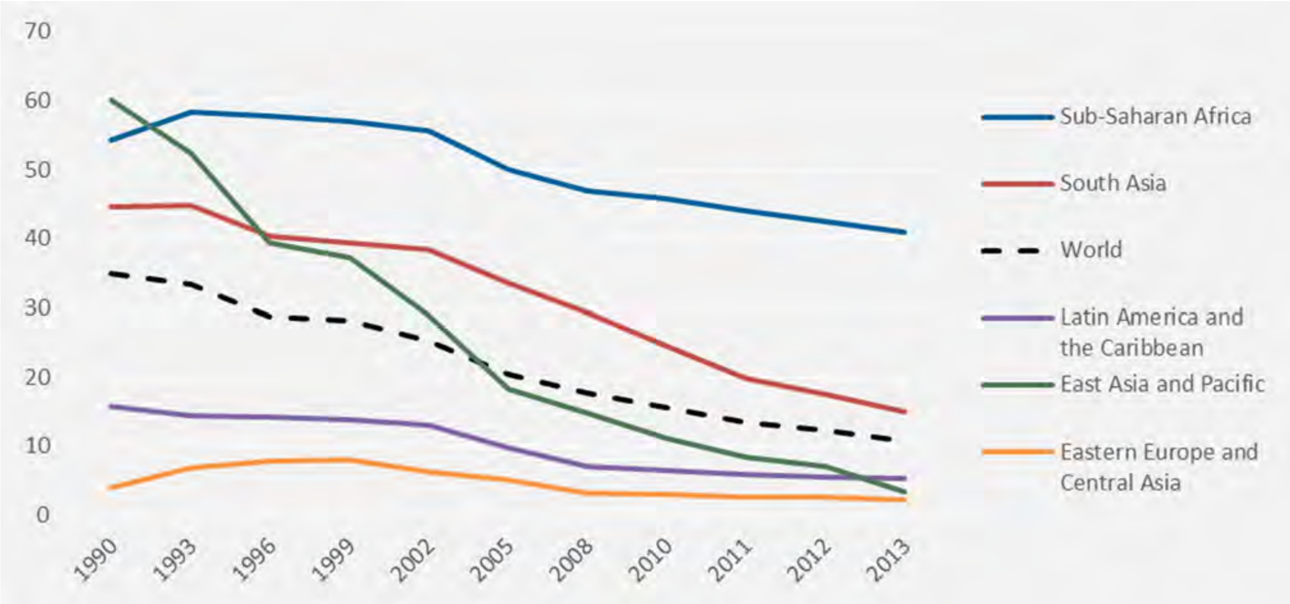
4.2 The fight against poverty

Especially for the less developed countries, the reduction of **poverty** – or, more specifically, the reduction of **absolute poverty** – plays a much more important role than in advanced economies. According to a broadly accepted international definition, a person is poor if he or she has less than USD 1.90 purchasing power parity per day. In 1990, the number of people living in absolute poverty worldwide numbered around 1.85 billion (35 percent of the global population). In 2013, despite a larger population, only just under 767 million people were poor. This is 10.7 percent of the global population.

Additionally, absolute poverty **varies significantly** from **region to region**. In developed industrialized countries there is practically no poverty in absolute terms. Economic growth in South East Asian economies, Eastern Europe and Latin America has led to a situation whereby no more than five percent of the population is considered poor. In Sub-Saharan Africa, however, the picture is quite different (See Fig. 5).

The economic **rise of East Asia**, which is also attributable to greater integration in the global economy, is demonstrated impressively by the vast decrease in the share of people living in poverty in this region. While this share in 1990 was still 60.2 percent, by 2013 it had decreased to only 3.5 percent. In Sub-Saharan Africa, the share decreased only from 54.3 percent to 41 percent during the same period (see Fig. 5). The relatively low reduction in poverty in African economies demonstrates that the least developed economies only benefit from globalisation to a limited extent.

Figure 5. Share of the population living in absolute poverty in selected global regions in the years 1990, 1993, 1996, 1999, 2002, 2005, 2008, 2010 to 2013. Levels for the year 1999 for South East Asia: author's own extrapolation



Source: World Bank Group 2016: 46.

4.3 Problems facing the least developed economies

While emerging economies benefit from economic globalisation – at least at the macro-economic level – there is no guarantee that this will be the case for the least developed countries. For such countries, globalisation can also lead to **negative growth effects**:

- The intensification of international trade leads to a situation whereby there is an increase in the quantity of goods and services that are produced and available to consumers in the countries involved. However, it is also possible that the **increase** in a country's **exports** may lead to a drop in prosperity. If, while international trade grows, a country increases its exports, this raises the supply of goods on the world market. All things being equal, a greater supply of goods leads to a **reduction** in the **global market price** for the goods in question. If the drop in price is steep enough, it may lead to a reduction in export earnings despite the greater quantities being exported. This reduces the earnings available to the exporting country and thus lowers the standard of living in that country. This phenomenon, called immiserizing growth, is a risk for less developed economies in particular because they are more likely to export almost exclusively raw materials rather than any further processed goods (see Bhagwati 1958). As a matter of fact, this phenomenon only occurs if the additional amount of goods provided on the global market is relatively large. Due to growing international markets, this effect seems rather unlikely. Empirical data show that immiserizing growth is a relatively rare phenomenon (see Pyror 2007).
- Where a developing country exporting raw materials suffers falling export revenue, this usually goes hand-in-hand with a **current account deficit**. At present, this phenomenon is affecting countries in Sub-Saharan Africa in particular. The International Monetary Fund (IMF) has reported on the current

accounts of 45 countries in this region. In 2015, 42 of those had a current account **deficit**, the highest of which were 30 percent of GDP or more. At the same time, it is associated with foreign debt. If the current account deficit persists for several years, the developing country's **foreign debt** continues to **rise**. Should international creditors lose confidence at some point and no longer grant additional loans to these countries, it may lead to an economic crisis.

- Opening up borders for products from industrialized countries can lead to industries in the developing countries, which are not yet competitive, being crowded out. This prevents an effective **industrial structure** from being developed in those countries. It is particularly problematic if agriculture in developing countries is confronted by competition from subsidized agricultural enterprises in industrialized countries. These **subsidies** distort competition in favour of the industrialized countries and can lead to a situation whereby farmers in developing countries are no longer competitive even in their own countries (see Giesbert, Pfeiffer und Schotte 2016: 8–9). As a result, this can lead the consumers in developing countries to rely on products supplied by the industrialized countries, i.e. imports. For the developing countries affected, this means a **decline** in domestic **production** and **employment**, as well as the aforementioned current account deficit, together with external debt. In short, paying subsidies to farmers in advanced economies **harms** the **world's poorest**.
- The reduction of import tariffs in the course of advancing globalisation is problematic for developing countries, inasmuch as **import tariffs** are an **important source of revenues** for the government in developing countries which do not yet have a functioning tax system. For example, in Sub-Saharan countries, import tariffs make up between 10 and 30 percent of public revenues (see Giesbert, Pfeiffer and Schotte 2016:9). By way of comparison, tariffs currently amount to less than one percent of public revenues in Germany (see German Federal Ministry of Finance 2016).

4.4 Summary

The **positive growth effects** of advancing globalisation are evident in emerging countries as well as industrialized countries. In particular, these effects are reflected in the steep **reduction** in **absolute poverty** in Asia, South America and Eastern Europe. By contrast, for the least developed economies in **Africa**, the results are **less positive** when the pros and cons of globalisation are weighed up. In these countries, the share of the overall population living in poverty decreased from 54 percent to only 41 percent between 1990 and 2013. Furthermore, African economies are reporting high current account deficits, which indicates low international competitiveness. In this sense, African countries appear to have been left behind by globalisation.

This development is also reflected in the fact that GDP per capita is growing more slowly in this region than anywhere else in the world. This means that the **gap** in **per capita income** between **Africa** and the **rest of the world** has been **consistently growing** since 1980 – both in absolute and relative terms (see Tab. 3).

Table 3. GDP per capita in USD purchasing power parity, ranked by percentage change

Country Group Name	1980	1990	2000	2010	2015	Change (in percent)
Middle East, North Africa, Afghanistan, and Pakistan	4,575	5,602	7,747	11,533	13,291	+ 191 %
Sub-Saharan Africa	1,173	1,694	1,923	3,220	3,836	+ 227 %
Latin America and the Caribbean	4,583	6,379	8,994	13,463	15,510	+ 238 %
Advanced economies	**10,158**	**19,751**	**29,413**	**40,245**	**46,241**	**+ 355 %**
Emerging and developing Europe	4,433	7,357	10,068	17,527	23,149	+ 411 %
Emerging and developing Asia	560	1,339	2,785	6,914	10,004	+ 1,685 %

Source: IMF, World Economic Outlook Database April 2017. Downloaded on 25.7.2017.

5. Employment and income effects in advanced economies

5.1 Labour market effects from migration and foreign trade

The point of departure for the following analysis is the observation that the factor endowments of countries differ.[7] Factor endowment differences between countries are measured by the capital-to-labour ratio:

- If a country has a large stock of physical capital and only a small number of workers, the capital-to-labour ratio is high. Such a country is rich in capital or **capital-abundant** and **poor in labour**. **Advanced economies** such as Germany are characterized by this kind of endowment of factors of production.
- If the economy has a large number of workers but only a small stock of physical capital, the country is **labour-abundant** and capital-poor. Developing and **emerging countries**, such as China, are examples for labour-abundant economies.

To the extent that the price for the production factor labour is market-based, these scarcity conditions have an impact on market wages. In a country such as Germany, the relatively high scarcity of the factor of labour, in combination with a high standard of living, leads to relatively high wages. In an emerging country such as India, the relative abundance of labour and the low standard of living result in relatively low wages.

To the extent that the international interdependence of countries allows the **migration** of labour at relatively **low costs of transaction** (either due to low legal barriers for immigrants or to low individual costs in terms of removal expenses, costs of finding a job and so on), this **wage disparity** provides an incentive for Chinese workers to move to Germany. On the German labour market, immigration increases the supply of labour. By contrast, in China this kind of labour movement results in a reduction of the supply of labour. These changes to the labour supply change wage levels in both countries. According to economic theory the following labour market reactions are expected:

- In **Germany**, the increase in the supply of labour should cause **wages to fall**, especially for low-skilled workers.
- In China, by contrast, the reduction of labour supply is supposed to cause wages to rise (at least in case of a substantial loss of workers). According to economic textbooks, migration would continue until wages in both countries were the same.

In the face of these wage trends, advanced economies often make efforts to close their borders to foreign workers. However, even if there is no migration between countries at all, the **international division of labour** may lead to wages moving towards identical levels in both countries. Such movement would take place as individual economies specialize in particular products and these products are subsequently traded between countries:

- Due to its abundance of labour and low wages, **China** has an international **competitive advantage** in manufacturing **labour-intensive** goods. This causes the demand for workers to rise. The higher demand for workers in China causes wages to rise.

[7] The statements in Section 5.1 were taken from Petersen 2016a.

- **Germany** has a competitive advantage in manufacturing capital and technology-intensive goods. By contrast, Germany reduces its production of **labour-intensive** products. This leads to the fall of the demand for labour in Germany. The lower demand for workers causes wages to fall. If wages cannot fall below a certain threshold due to social standards, employment also falls.

For developed economies, the international division of labour and foreign trade associated with it prompt **a drop in employment and wages**. This phenomenon has been fairly extensively researched and documented:[8]

- Autor, Dorn and Hanson showed that **Chinese imports** in the **USA** have caused unemployment to increase and wages to fall in local labour markets with high Chinese import pressure. The period under review covered 1990 to 2007 (see Autor, Dorn and Hanson 2013).
- A Bertelsmann Stiftung study examined the impact of imports from China, Eastern Europe and Latin America on wages and employment in **Germany** between 1995 and 2007. Here too, it was confirmed that imports from countries with large workforces and low wages created downward pressure on wages and employment (see Bertelsmann Stiftung 2016b: 12). Current calculations by Südekum, Dauth and Findeisen confirmed these results (see Südekum, Dauth and Findeisen 2017).

The above-mentioned studies have shown that import competition from low-wage countries have a negative impact on wages and employment in **local labour** markets **in advanced** economies with high imports from these countries. Obviously, the **overall labour markets effects** of increasing globalisation can still be positive for advanced economies. Even if advanced economies are specialized in the production of capital-intensive products, the production of export goods needs labour. Hence exports have a positive impact on wages and employment. In general, labour market effects of globalisation are **positive** for an advanced economy if the country has an **export surplus**.

In addition to this general impact of foreign trade on wages and the level of employment in developed industrialized countries, there is another effect which is relevant to the labour market: the international division of labour reinforces **wage disparity** between **highly qualified** and **low qualified workers** in advanced economies.

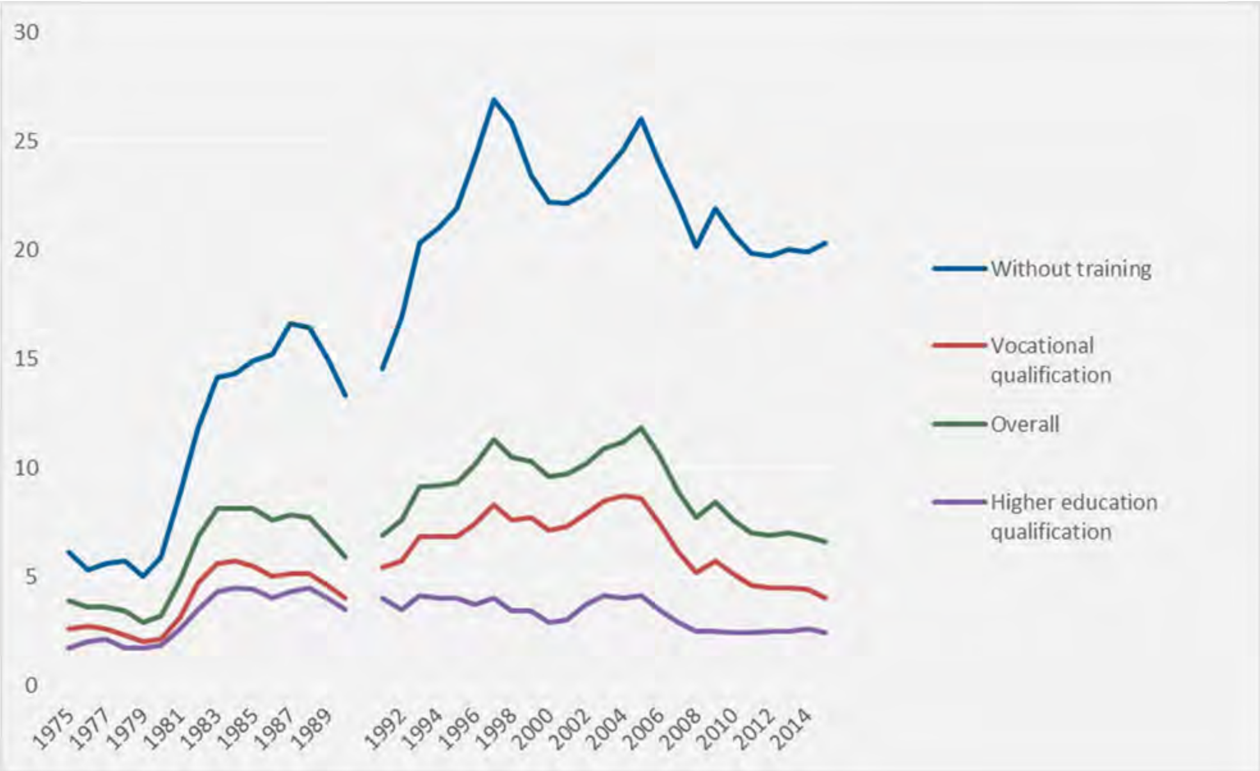
- Advanced economies such as Germany focus upon those production processes which particularly require capital, technology and highly qualified workers. The resulting stronger demand for these three production factors leads to an increase in the price for these factors, i.e. including an **increase** in **wages** for **highly qualified** workers.
- Emerging and developing economies, on the contrary, focus on production processes which require a large human workforce, particularly low-qualified workers. In advanced economies, this results in a drop in demand for workers of this kind.

Therefore, there is a **reduction** in both **employment opportunities** and **wages** for **low-qualified** workers in advanced economies. The poor labour market opportunities for low-qualified workers in developed industrialized countries are reflected in an exemplary manner in the trends for **qualification-specific unemployment rates** in Germany (see Fig. 6).

[8] According to my knowledge, there is no empirical evidence for a negative impact of immigration from China or other low-wage countries on wages and employment in advanced economies. Most likely, this is due to the fact that the number of Chinese immigrants in advanced countries is too low to have any significant labour market effect.

For the **emerging economies**, globalisation has in principle **reverse** income and employment **effects**: the abundant factor (labour) profits from a higher demand (both in terms of higher employment and higher wages) whereas the relative scarce factor (capital) suffers from a lower demand. Especially the higher demand for labour is essential for reducing poverty in these countries.

Figure 6. Qualification-specific unemployment rates in Germany (up until 1990 for West Germany including Berlin, from 1991 for Germany), figures as percentages.



Source: IAB 2016: 2–3.

5.2 Interaction between globalisation and technological advances

The main economic disadvantages of globalisation for advanced economies therefore affect the working population and low-qualified workers in particular. However, the negative income and employment effects for these groups are **by no means solely** the result of increasing **globalisation**. **Technological advances** arising from the pressure to reduce costs in a competitive economy are at least equally significant.

- In a **competitive** market economy, companies are continually being forced to **reduce their production costs** in order to keep up with their competitors and avoid being crowded out of the market.
- **Deploying modern technology** is one effective **instrument** for reducing costs. These technologies increase overall productivity, thus decreasing production costs.
- In highly developed economies such as Germany, it is typical for such technological progress to **replace** the production factor **labour** with the production factor **capital**.

- This **generates a fall in employment**, a tendency of **downward pressure on market wages** and therefore an increase in revenue for the production factor of capital.

These market mechanisms would operate even if an economy were completely isolated from the rest of the world. Nonetheless, globalisation does increase the pressure to cut costs, because it brings with it a considerably higher number of potential competitors. **Economic isolation** would therefore only lower the pressure to reduce costs: it would not prevent it completely. Competition-induced technological advances, which have a tendency to replace the human workforce with machines and digital technologies, **cannot be stopped over the long term** by isolationist economic measures.

5.3 Summary

To summarize, the **international division of labour** and the cross-border trade associated with the international division of labour result in an **increase in GDP** in all the economies involved. At the same time, however, as the economy is globalising in this way, there will be **winners** and **those who lose out** in every country. In advanced economies, it is workers who lose out, in particular the **low-qualified** and those **employed** in industries which are **competing** particularly intensely with **emerging countries** (especially China and Eastern European economies). In **emerging economies**, the relatively scarce factor (capital) suffers from a lower demand. In all countries, consumers benefit from lower prices and a larger variety of consumer goods.

6. The role of politics and institutions

Many of the previous remarks refer to the **pure market processes** of economic globalisation. As a matter of fact, economic processes do not operate in a political or institutional vacuum. Reducing or eliminating barriers to trade in goods, services, labour and capital are **political decisions**. Moreover, differences in **institutions** are main determinants for the economic development of different economies (see Acemoglu and Robinson 2008, Acemoglu and Robinson 2012). Following Douglass North (economist and Nobel Prize winner), institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North 1990: 3).

Concerning the topic of this paper, political decisions and institutional arrangements are essential for the **extent of globalisation** and for the way society is **dealing with** the **market outcomes** of economic globalisation.

The extent of globalisation is shaped by political decisions which promote or impede economic cross-border interconnections. A few examples of the role of political decisions and related institutions are the following:

- The decision of a country to **reduce import tariffs** and non-tariff trade barriers is essential for the size and structure of international trade in goods and services. Lower barriers in trade increase the incentive to trade with other countries. Such decisions are in the hands of national governments and parliaments (in the case of the European Union, these national competences are transferred to the EU). An important global institution which helps to lower trade barriers through negotiations is the World Trade Organization (WTO). Additional trade policy instruments are bilateral or regional free trade agreements which are used in order to reduce or even eliminate tariff and non-tariff barriers to trade. As a matter of fact, the trade policy of many countries goes in the opposite direction. For example: According to the "Global Trade Alert Report" by the Centre for Economic Policy Research (CEPR), **G20 members** implemented about **6,600 protectionist measures** between November 2008 and June 2017 (see CEPR 2017: 31).
- The same applies to the decision to **reduce capital controls** which are used by national governments in order to regulate the inflow and outflow of capital. Closely linked to capital controls are **foreign exchange controls** and the design of foreign exchange markets.
- Finally, **immigration regulations** of individual countries are an important limitation on international migrations flows. The removal of these restrictions, as is the case with the fundamental freedoms of the European internal market, is supposed to increase cross-border migration between EU-countries.

In addition to the shaping of globalisation, political decisions and institutional arrangements are decisive factors for the way a society deals with the results of globalisation, especially how a society wants to **correct** the **market results** produced by globalisation. The described outcomes of globalisation – especially the negative effects for certain groups of persons such as low-skilled workers in advanced economies – can be softened through **public intervention**. For example, if a society does not feel comfortable with the distribution of market income due to globalisation, **taxation** and **transfer payments** can be used to achieve a socially desirable distribution of net income. Other institutions and policy tools that contribute to adjusting market outcomes according to the preferences of society are the education system, labour market policy tools, all areas of the social security system etc.

Therefore, political decisions and institutions determine whether the persons who are negatively impacted by the market processes in a globalised world are eventually to be the losers of globalisation or not. In case of a **strong welfare state** (extensive redistribution policy, high level of protection against dismissal and more), economic and social policies can compensate the income losses of those persons who lose their job due to international competition. In that case, looking at **disposable income** (= market income – taxes – social security contribution + social transfers), these persons might **not be classified** as 'losers of globalisation' **anymore**.

However, it must be pointed out that due to increasing globalisation, national capacities to manage the consequences of a globalised world are limited. An impressive example of this limitation is **Dani Rodrik's trilemma** of the World Economy. He states that the mobility of capital, products and labour cannot be combined with democratic systems and nation states: the disruptive effects (on income and employment) of globalisation require – as I have shown in the preceding sections – government intervention to stabilize this process and make it fair for everyone. In Rodrik's words, national governments need to complement markets. But more and more free trade agreements come at the expenses of national sovereignty and systems as we know them. A truly global economy would require a truly global governance and global decision-making structures, where all countries obey to the same rules – something that is currently not the case and that would probably be opposed by most people (see Rodrik 2011).

7. Reasons for criticism of globalisation in advanced economies

7.1 Key considerations

There are many reasons for the critical view of globalisation held by citizens in advanced economies: declining minimum social standards, increasing social inequality, rising environmental pollution due to more long-distance trade and related energy consumption, the loss of national sovereignty and more are – justifiably or not – frequently being attributed to globalisation.

In my opinion, growing criticism of globalisation is in essence due to the **issue of global distribution** of **income** and wealth. If we open borders for international exchange of goods, services, labour, capital and technologies, we **change** the level of **scarcity** of these resources in all participating countries. And once we change levels of scarcity, we also **change prices**. In a perfect theoretical world with one global market for a certain homogenous product, we are supposed to have one identical price for this product. This principle of **economic convergence** also applies to the prices for production factors, i.e. for wages and interest as the price of the production factor of capital (see Petersen 2016b for more information). Working with the simplifying assumption that labour is a homogenous factor of production, wages in advanced economies (= relatively poor in labour) are supposed to decline.[9] In general, from the point of view of citizens in advanced economies, the trend of economic convergence means that the difference in income compared to less developed economies is becoming smaller.

Advanced economies are still benefiting more from advancing globalisation if GDP per capita is taken as the indicator of the extent to which a country benefits. As shown by Figure 3 in Section 3.2, globalisation-induced growth in **GDP per capita** expressed **in absolute terms** is higher in advanced economies than in emerging countries. One of the reasons for this is that industrialized countries currently have **restrictions in place to stop** the emerging and developing countries from catching up with them:

- There are restrictions in place limiting the **migration** of labour from less developed countries.
- The same is true of competition from **agricultural products** from developing and emerging countries, since as a rule, such agricultural products are burdened with considerably higher import tariffs than industrial products and advanced economies enjoy a far greater competitive advantage for industrial products than for agricultural products (see Table 4).

If economic globalisation were to intensify, this would mean a removal of these restrictions. This would lead to a growing risk of a decline in the income and the material prosperity of citizens in developed economies. This would actually lead to a **new distribution** of **global prosperity** in favour of the emerging and developing countries.

[9] Reasoning is more complicated in case of heterogeneous labor. In that case, wages for high-skilled labor and specialists in advanced economies could rise due to international trade. At the same time, wages for highly qualified specialists in developing countries would decline. However, these changes in wages for high-skilled labor are an incentive for migration: Highly qualified specialists from developing countries would have an incentive to move to advanced economies. If their number is large enough, this increase in labor supply causes a decline of wages for high-skilled labor and specialists in advanced economies.

Table 4. Tariffs on imports for different product groups in selected industrialized countries, simple average

Country	All products	Agricultural products	Non-agricultural products
Switzerland	6.7 %	36.1 %	1.8 %
Canada	4.2 %	16.7 %	2.2 %
Japan	4.0 %	12.9 %	2.5 %
European Union	5.1 %	10.7 %	4.2 %
USA	3.5 %	5.2 %	3.2 %

Source: WTO 2016: 8–24.

7.2 Why is criticism of globalisation boiling over now?

The considerations presented above about different levels of scarcity of labour and capital in advanced economies and developing countries are nothing new. Nevertheless, the strong increase in criticism of globalisation is indeed relatively new. In my view, there are **three** main **reasons** for the fast-growing criticism of globalisation that we are currently observing in advanced economies:

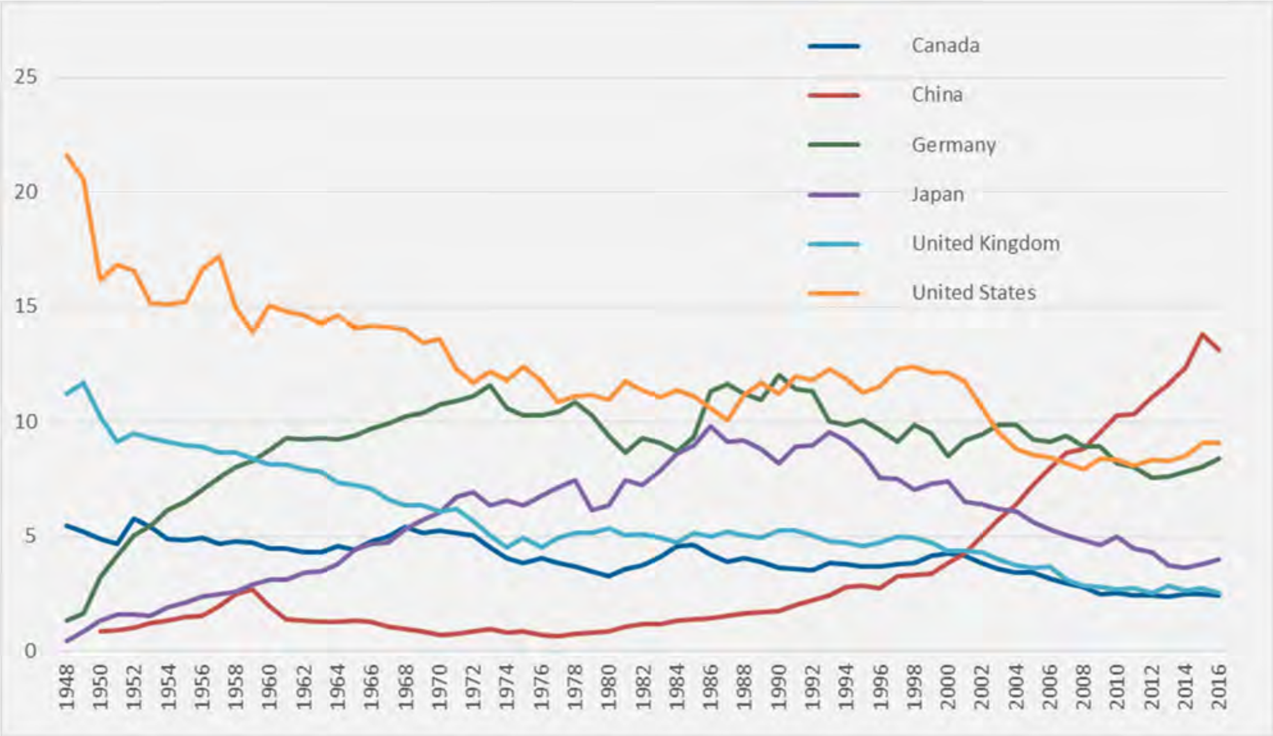
7.2.1 Integration of Eastern Europe and China in the global economy

The distribution effects of advancing globalisation in industrialized countries, as described in Section 5.1, are developments which have, in principle, been observed for decades. However, the full impact of the international division of labour has only made itself felt since the 1990s. Up until the 1990s, advanced economies were still the world's most important exporting countries (see Fig. 7). Trade between industrialized countries brought relatively little pressure on wages and employment, because wages in advanced economies are on a roughly similar level.[10] Since the integration of Eastern Europe (fall of the Iron Curtain) and China (accession to WTO in 2001) into the global division of labour and world trade, the import competition from these countries in the USA and Western Europe has led to a decline in employment and wages in the West. At the same time, social security system payments in many countries have been reduced, meaning that the wage and employment effects of import competition have influenced the standard of living of those affected.

The described impact on wages and employment in the industrialized countries, which arises from competition with emerging countries, is demonstrated in particular by import pressure from **China**. This has increased considerably since the latter's accession to the WTO in 2001. **Since 2009,** China has been the **largest export economy in the world.** In 2015, Chinese exports represented almost 14 percent of all exports worldwide. This means that the negative labour market effects of this kind of globalisation are increasing in industrialized countries.

[10] See previous footnote: In this simple form, the argument applies to homogenous labor. Nevertheless, due to the sheer size of labor force in countries such as China and India – both skilled and unskilled – competition with these countries puts pressure on wages and employment in advanced economies.

Figure 7. Share in global goods exports for selected countries between 1948 and 2016



Source: UNCTADstat, data downloaded on 26/07/2017.

7.2.2 The Lehman bankruptcy

Another main trigger for growing criticism of globalisation is the **outbreak of the economic and financial crisis** following the Lehman bankruptcy in the autumn of 2008. While the previous considerations refer to the **real economy** (markets for goods and factors of production, international trade in goods and services), the financial crisis relates to the financial sector. One aspect of globalisation is the high degree of international financial integration. In combination with ineffective regulation of the global **financial markets** (unregulated derivatives markets, shadow banking, information problems for rating agencies etc.) and the **expansive monetary policy** of many advanced economies during the period 2001 to 2005, financial globalisation facilitates large capital inflows, excessive credit booms and asset price bubbles. The meltdown of housing prices in the United States, Spain, Ireland, Iceland and the United Kingdom triggered a global financial crisis (for details see Stijn et al 2014: XV–XX). Due to the fact that there are many **transmission channels** between the financial and the real sectors of an economy (see BIS 2011), the financial markets crisis caused a recession in many countries – especially in advanced economies. Three aspects of this financial crisis are significant for the growing criticism of globalisation:

1. Helplessness in the face of **anonymous, globalised market forces**, which caused the ripples from a local event to very quickly escalate into a shockwave across the globe that national governments were unable to act upon – except with economic and bank rescue packages which cost billions and were financed through loans.
2. In the 1980s, many governments of advanced economies abandoned the former demand side policy (Keynesian economic policy) and switched to a **supply side policy** (see for example “Reaganomics” and “Thatcherism”) for which globalisation often served as a pretext, for example by politicians arguing

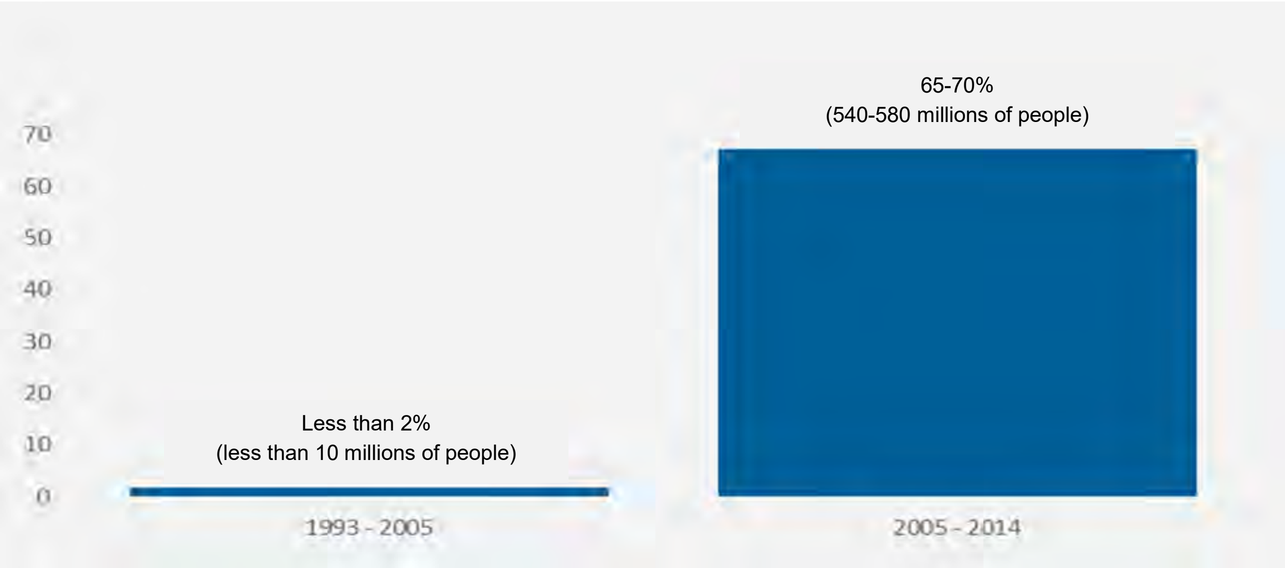
that the country has to become more competitive on the world markets. For the next 30 years, supply side policy was the ruling economic policy paradigm in many advanced economies (see Adam 2014: 106). One element of this policy consists in tax reductions, which translates into lower social transfers. The fact that after years of cuts in public spending and social benefits due to supply side policy, **billions** in cash were **suddenly** available to save the very banking and financial system that was predominantly responsible for the onset of the Lehman bankruptcy, gave rise to criticism of government policies and globalisation.

3 The economic slump led to an increase in **unemployment** worldwide, leading to cuts in income among the unemployed and, additionally, **downward pressure on wages** arising from the reduced demand for labour.

Increasing **competition** with suppliers from **low-wage countries** (in particular from Asia and Eastern Europe), increasing **unemployment** following the **Lehman bankruptcy** and **pressure on wages** associated with these events are the main reasons for the fact that the market income of private households in many developed economies was lower in 2014 than it had been in 2005. The McKinsey Global Institute published a study in July 2016 that focused on changes in market incomes in 25 industrialized countries (for more information on the following see McKinsey Global Institute 2016: 1–3):

- Comparing the **market incomes** of households in 25 industrialized countries in 2005 with the market incomes for the year 1993, less than **two percent** of all people had a market income in **2005** which was **lower** or equal to what it was in 1993. In absolute terms, this affected less than ten million people.
- we compare the figures between **2014** and **2005**, however, some **65 to 70 percent of all people** had a market income in 2014 which was lower than or equal to what it was in 2005. This means that some 540 to 580 million people were affected (see Fig. 8).

Figure 8. Percentage of households with flat or failing market income in the past decade



Note: Population-weighted average of 25 advanced economies(Australia, Austria, Belgium, Canada, Czech-Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Luxembourg, The Netherland, New Zealand, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, the United Kingdom, and the United States).

Source: McKinsey Global Institute 2016:3.

7.2.3 Migration of refugees into Europe

In my opinion, the final trigger for growing anti-globalisation is the large number of **refugees** migrating into Europe. This has confronted us with the fact that opening up borders – whether it be for people or trade – changes the levels of scarcity in all the countries involved, thus automatically creating winners and losers in the process. It also shows that a more even distribution of a given global GDP means a **reduction of GDP per capita** for citizens in industrialized countries.

7.3 Criticism of globalisation and voter behaviour

Voting behaviour depends on **many determinants** (values, historical experiences, social environment, educational and cultural background etc.). The (current) economic situation of a person is one of these determinants. Consequently, the negative employment and income effects in industrialized countries resulting from increasing globalisation have an impact on the citizens' voting behaviour. There is growing empirical evidence for this relationship. Two reports will be discussed briefly below.

7.3.1 Germany: Globalisation strengthens right-wing political parties

A study by Christian Dippel, Robert Gold and Stephan Heblich (see Dippel, Gold and Heblich 2016a for more information on the following) shows that globalisation has a statistically significant influence on voter behaviour in **Germany**. The authors used **German foreign trade** with **China** and **Eastern European countries** as an indicator for globalisation. They studied the influence of this trade on the vote share of the entire political spectrum in Germany. The study covered the period from 1987 to 2009. Analysing the voting behaviour in elections to the German Bundestag at county level ("Landkreise"), the only part of the political spectrum with a significant response to imports from low-wage economies consists of parties of the extreme right. The extreme right-wing parties in Germany during this period included NPD (Nationaldemokratische Partei Deutschlands), *Die Republikaner* and the DVU (Deutsche Volksunion) (see Dippel, Gold and Heblich 2016b: 10). When 408 German counties were analysed, the following correlations could be observed:

- Those **regions** which were **particularly seriously** affected by **import competition** with China and/or Eastern Europe showed a **significantly higher** share of the vote for **right-wing** parties in the German Bundestag elections.
- To the extent that export opportunities improved in a region, the share of the vote for these parties declined.
- A glance at the **individual data** leads to the conclusion that it is low-qualified workers from manufacturing industries that are particularly affected by competition with Chinese and Eastern European competitors who are especially likely to support right-wing parties.

7.3.2 United Kingdom: Globalisation strengthens Brexit supporters

Italo Colatone and Piero Stanig from Bocconi University have analysed the influence of various factors on the **Brexit Referendum** in the United Kingdom (UK) (see Colantone and Stanig 2016 for more information on the following). Among other things, the analysis included trends for **Chinese imports** to the UK. More specifically, import trends in 167 regions between 1990 and 2007 were studied. Econometric calculations were used to examine whether increasing imports from China had a statistically significant impact on voter decisions. The most important results of those calculations can be summarized as follows:

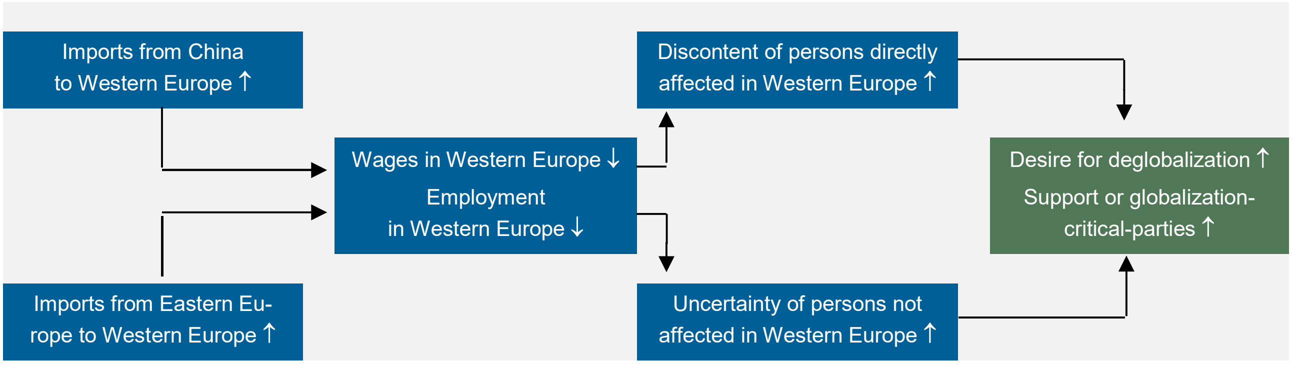
- Those **regions** which were affected to a particularly **great extent** by **Chinese imports systematically** had a **higher share** of **Brexit voters**. Specifically, this was the case for regions which had once had a high proportion of manufacturing companies in the past. A region's **share** of **immigrants** had **no** statistically significant **influence** on the voters' decision of whether to vote for Brexit.

- Calculations based on **individual data** confirmed these results. There was a higher proportion of Brexit voters in regions which were in particularly intense competition with Chinese imports and this was actually independent of the personal employment situation in which those voters found themselves. Even those employed in the **services sector** in regions with high levels of Chinese imports were more likely to be in favour of Brexit, despite the fact that they were not directly affected by goods imports from China. At the end of the day, the proportion of Brexit voters did not depend on whether the voters were unemployed or low-qualified. Therefore, the deciding factor for whether there tends to be greater support for Brexit depends not on the situation of the individual or their household, but rather on the **economic situation of the region in which they live**. Even if people are not actually personally affected by the negative effects of greater competition from Chinese imports, they are more likely to be anti-globalisation and in favour of Brexit, because they are aware of the negative economic impact on their region.

Therefore, Colatone and Stanig state in summary: "Hence, we can claim that globalisation of trade, as captured by our import shock measure, is causally driving support for Brexit. In addition, voters seem to react sociotropically to the globalisation-induced shock" (Colantone und Stanig 2016: 37).

As a result, in my opinion, the interrelationship between globalisation and voter behaviour can be **summarized** as follows: **I believe** that the deciding factor for whether or not citizens in advanced economies are against globalisation is the level of **competition** with **emerging countries** such as China and Eastern European countries. Such countries have a cost advantage in terms of industrially manufactured goods, due to low wage costs. That means that in manufacturing industries in industrialized countries, there has been downward pressure on wages and a decline in employment. This has led to **dissatisfaction** among those affected. At the same time, even among those persons who are not yet affected by import-driven labour market effects, there is increasing **uncertainty** regarding their own economic situation in the future. The wish to tackle the **cause of this dissatisfaction and uncertainty** subsequently leads dissatisfied and uncertain voters to turn towards anti-globalisation parties (see Fig. 9).

Figure 9. Diagram of the relationship between foreign trade with developing countries and voting behaviour in Western European countries



Source: author's own diagram.

An additional reason for growing criticism of globalisation which goes beyond the trade effects is the **loss** of (political) **control**. Due to growing complexities and interdependencies, single local events can have global consequences. Ian Goldin and Mike Mariathasan use the term "**butterfly defect**" to describe growing systematic risks and growing "vulnerability arising from increased connectivity and complexity" (Goldin and Mariathasan 2014: 4). They also observe that we still lack the capacity to manage these complexities and interdependencies (see Goldin and Mariathasan 2014: 3). The loss of control increases individual risks (income, employment and more). Since this loss is due to increasing globalisation, people might wish to reduce the level of globalisation achieved.

7.4 Which counter-measures are needed?

Describing a package of measures intended to stem the criticism of economic globalisation and thus combat criticism would exceed the scope of this paper. However, one fundamental point for such a package is clear: the deciding factor will be the distribution of globalisation's dividends in **Europe** in such a way that those who have lost out under globalisation will also have the opportunity to benefit from gains in income. This requires policies that further **reduce income inequality** and **strengthen social security systems**, in order to mitigate the citizens' fear of change. In addition to compensating for lost income, it is also necessary to advance a more equal distribution of opportunities and capabilities, for example, by providing **further training programs** for the unemployed so as to facilitate their transition to industries which are benefiting from globalisation. Moreover, governments could use special funds in order to support companies or regions to adjust to the structural changes caused by globalisation. Examples for such funds are the U.S. "**Trade Adjustment Assistance** (TAA)" which was first authorized in 1962 (see Hornbeck 2013: 1) and the "**European Globalisation Adjustment Fund** (EGF)" established in 2006 by the European Commission (see Cernat and Mustilli 2017: 2). In turn, this requires a **government** with **sufficient tax revenues** at its disposal.

A cross-society consensus has to be struck on how exactly these policy instruments should be designed. This consensus must take into account unintended effects. However, first it will be crucial to come up with a **fundamental, cross-society commitment** to ensure a more just distribution of the dividends of globalisation and to focus policy more on **those who have lost out under it**. When looking at advanced economies such as Germany, the most important winners and losers of globalisation can be identified in Table 5 below. Since the main negative impacts resulting from globalisation affect **income distribution**, potential winners and losers consist of the **providers** of **factors of production**. The macrosocial gains from globalisation need to be redistributed between these groups. If these persons are not adequately compensated, serious social and political tensions arise which will threaten prosperity across the entire economy (see Heilmann 2017:12).

When considering the **global level**, it is also necessary to take into account the **redistribution** of the gains from globalisation between countries. If resistance to economic globalisation becomes stronger in those regions which have been left behind by the globalisation process (see Section 5), then there is a risk that protectionist measures will lead to a global trade war. The developed industrialized countries would suffer under such a trade war as well. For this reason, it is in the long-term self-interest of the industrialized countries for emerging countries and developing countries in particular to become **better integrated** in the global economy.

This will require that the asymmetrical restrictions on global economic interdependence which currently persist (high capital mobility versus limited migration, high import tariffs on agricultural products versus low import tariffs on industrial goods, see Section 7.1) be **dismantled**. However, in this respect, two stubborn **dilemmas** present themselves:

- If these restrictions are removed, then the income gap between industrialized countries and emerging/developing countries in absolute terms will be reduced. However, this will mean a **decline** in **real GDP per capita** in **industrialized countries**, since it will not be possible to close this gap solely through the growth of per capita income in emerging and developing countries. Such a development could lead anti-globalisation in the USA and Europe to continue increasing.
- If the restrictions referred to are only partially dismantled or left in place entirely, the income gap between industrialized countries and the rest of the world will increase in absolute terms. Globally, this will lead to **growing pressure for redistribution** which may lead to large **migrant flows**. This would likewise further motivate anti-globalisation voices in the USA and Europe.

Table 5. Potential winners and losers of increasing globalization in advanced economies

	Potential winners	Potential losers
Factors of production	Capital, technology and skilled labor	Labor, especially unskilled labor
Products	Capital and technology intensively produced goods and services as well as local services	Labor intensively produced goods
Foreign trade relations	Exports to developed industrialized countries	Intense competition with suppliers from emerging economies (especially Asia and eastern Europe)

Source: author's own diagram.

8. Synthesis and discussion

8.1 Potential future globalisation developments

Three aspects are of central importance for the future development of economic interdependence between all countries: **demographic trends** in the different countries (in particular population growth and size as well as age structure), **technological advances** (in particular information and communication technologies) and **policy decisions**, which create the framework for globalisation:

- **Demographic trends** and **technological advances** are the deciding factors for the **international division of labour** and for the way in which the **international trade** associated with that division is organized. Additionally, both of these influencing factors have an impact on the options for relocating production sites abroad and on levels of **foreign direct investment**. Finally, demographic trends and technological advances have a substantial influence on the material prosperity of societies and are therefore important factors for **migration flows**.
- At the end of the day, whether economically motivated cross-border activity does actually take place or not depends on the **policy framework** in place (see section 6). It is this framework – mainly consisting of **institutions** - which determines whether cross-border activities are facilitated, made more difficult or even completely prohibited.

It is not possible to give a clear-cut answer to the question of how the drivers mentioned here will influence trends in economic globalisation over the coming years:

- **Worldwide demographic trends** show that the global population of around 7.4 billion (as of mid-2016) could grow to over 8.5 billion by 2030 and almost 9.9 billion by 2050. However, this population increase will take place almost exclusively in emerging and developing countries (see Population Reference Bureau 2016: 10). It can therefore be assumed that the demographically-driven **international division of labour** between industrialized countries and the rest of the world will **increase**.
- What is going to make the situation more difficult from the point of view of the developed industrialized countries is the fact that the population in many such countries will age in the coming years. The **aging of the economically active population** is expected to have a negative impact on productivity and economic growth (see Bertelsmann Stiftung 2010). In and of itself, this will have a **negative effect** on the **international competitiveness** of those societies which are aging, in contrast with the young, growing populations of emerging countries.
- Furthermore, **worldwide demographic trends** are influencing **global migration flows**. I believe that the absolute difference in GDP per capita between highly developed industrialized countries and the least developed economies (particular African economies) will continue to widen over the coming decades. In combination with **climate change**, the negative impact of which will be most acute and evident first in Africa, this will mean that developed industrialized countries will have to prepare themselves for **high migration flows** on an ongoing basis.
- At the same time, however, it should be taken into account that the economic upturn in **emerging countries** will cause **wages** to rise in those countries. China is an excellent case in point. In China, the **average wage** in urban areas increased almost **tenfold** between 1995 and 2013 (see Petersen

2016c). This reduces the incentive to relocate the manufacture of goods to China. This development suggests there will tend to be a **drop off** in the **international division of labour**.

- The impact of **technological advances** on economic globalisation is **ambivalent**. On the one hand, further decreases in the costs for communications and transport are to be expected, which will lead to an **increase** in the **international division of labour**. On the other hand, the trend toward greater deployment of capital and technologies will reduce the international division of labour: if it is typical for production processes around the globe to rely less on human workers, then relocation of production processes to emerging and developing countries with large labour forces will no longer make economic sense. Instead, a global **insourcing** trend can be expected. Then it may also be expected that **global trade volumes will decline**, in particular with respect to trade in goods.
- In my opinion, at the end of the day, the **deciding factor** for the future development of economic globalisation will be the **policy frameworks**. If the increase in protectionist measures which has become evident over the last two years continues, this will lead to a step backwards for economic globalisation. Whether this tendency will really persist in the future is **impossible to forecast**, since this is a question of political reactions to preferences expressed by society as a whole. Even if major protectionist measures in the form of import tariffs and non-tariff trade barriers were to be implemented, it would not signal the end of globalisation. If countries such as the USA were to isolate themselves by means of tariffs, there would be a greater incentive for companies from the rest of the world to set up production sites in the USA, so as to circumvent such import tariffs. Globalisation itself would change: less foreign trade, but greater foreign direct investment.

8.2 Open issues

Many challenges are arising from the interplay between globalisation, demographic change and technological advances towards a more capital- and technology-intensive production. The following issues and questions provide food for thought:

- **How should international trade be organized in the future?** Protectionist measures are the wrong approach. Economic isolation means losing out on the static and dynamic growth and productivity effects which have been described in this paper. For consumers, this will result in higher prices, lower purchasing power and a decline in material living standards. Despite this, since the onset of the Lehman bankruptcy, the number of protectionist measures implemented has risen. At the same time, concluding new free trade agreements such as the planned Transatlantic Trade and Investment Partnership (TTIP) is becoming increasingly difficult. Finally, the US protectionist course which the new US government has announced presents a major threat to world trade, because it could prove to be the opening shot in a global trade war. New ways are needed to strengthen sputtering free trade. At the same time it is necessary to weigh the advantages of free trade against the disadvantages. The same holds true for the entire process of globalisation. As long as the advantages of an increase of free trade are larger than the negative effects, increasing free trade makes sense. If, however, the economic, social and ecological costs of more trade are larger than the benefits of increasing free trade, pushing trade forward would no longer make sense. The same holds true for the entire process of globalisation (see Petersen 2017).
- **What contribution could the welfare state make to help those in developed industrialized countries who have lost out under globalisation to share the dividends it brings?** The governments'

conventional approach to redistribution has been the tax-transfer system. Additional options are trade adjustment funds and regional policy instruments. However, redistribution is associated with efficiency losses which have to be taken into consideration. Moreover, against the backdrop of greater capital mobility, the question arises of whether greater compensation can be arranged between globalisation's winners in advanced economies (this means not only highly qualified workers, but in particular those who draw upon capital income) and those who have lost out under globalisation. This presents a serious challenge for precisely those advanced economies that have an aging population: in such countries, the number of people of working age is shrinking, while the number of pensioners is growing. If the trend is for declining government revenues to run up against growing demands for social security payments, then the governments' capacity to redistribute wealth will be limited.

- **What role do technological progress and globalisation play in the distribution of opportunities for income and employment?** The fall in wages and employment opportunities in industrialized countries is not only the result of competition from suppliers in low-wage countries: it is also due to technological change towards more capital- and technology-intensive production processes. Although globalisation does increase the pressure to implement such processes, even in an isolated economy there would be competitive pressure which would lead to work-reducing technological advances.
- **Which additional aspects of globalisation need to be taken into account?** This paper focused on the pure economic effects of globalisation. Clearly, however, globalisation also has profound consequences on many other aspects that are vital for the well-being of individuals: quality of work, social security, environmental conditions, quality of social networks, quality of democracy and institutions and much more. It is far from certain that the impact of economic globalisation is positive on these aspects. In case of a negative impact of globalisation on these issues, society needs to think about how to deal with such trade-offs.
- **How will global financial markets be regulated?** The worldwide reduction of international capital movement restrictions has made a substantial contribution to the considerable increase in the scale of cross-border capital flows. At the same time, however, price volatility for shares, securities and foreign exchange has increased considerably, as has the risk that speculative bubbles will form and burst. Perhaps the current level of financial openness – especially with regard to portfolio investment and speculative capital inflow – is already too high, because financial volatility might result in more economic damage than benefits (see Ostry, Loungani and Furceri 2016: 39). Furthermore, international capital flows are also being used to minimize tax payments on private persons and companies, through tax havens. This means that society loses out on funds which are urgently needed for public tasks (infrastructure, public education, social security etc.).
- **How it is possible to stem CO_2 emissions and the associated climate change arising from advancing globalisation?** The rise in the cross-border exchange of goods is linked to increasing energy consumption and CO_2 emissions. This in turn is intensifying global warming and climate change. It is necessary to internalize these negative external effects, e.g. by way of a carbon tax. However, the deployment of such an instrument has often failed because individual countries would suffer a competitive disadvantage if they were to levy such a tax.
- **What levels (local, regional, national, European or global) are most appropriate to take measures in order to shape globalisation?** In the previous section, in case of required public intervention, there was no differentiation regarding the proper government level. As mentioned above, national governments are overburdened with challenges such as climate change which is at least in

part caused by globalisation-related resource consumption. If global solutions are not possible, regional integration – as is the case with the EU – could be an adequate response to the challenges of increasing globalisation.

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Globalisation, Economic Inequality and Political Instability: What Future for Europe's Welfare?

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Executive summary

The losses of globalisation are concentrated among the lower and middle classes of developed countries, who find themselves in a worse economic and social position due to shifts in geographic and technological production patterns.

The subprime crisis and the euro crisis have exacerbated many of the long-term socio-economic changes of globalisation. This is especially true of the euro crisis, and in particular in the periphery of the Eurozone, where the scenario has deteriorated in terms of inequality, poverty and unemployment.

Meanwhile, the traditional welfare state's capacity to mitigate the adverse effects of globalisation and the Great Recession has declined for a number of reasons, such as the state's exposure to capital flows, endogenous transformations (like ageing), the stickiness of existing policies, and many countries' public debt burden. This weakening of the state is particularly marked within the Eurozone, where state action is further constrained by EMU rules.

The socio-economic effects of globalisation, integration, and the crisis have caused a backlash against openness in many advanced economies. This has, in turn, fuelled an unprecedented wave of populism and Euroscepticism.

While the sovereignist agenda would not be an effective solution to the problems of globalisation and integration, the latter must still be acknowledged, and new forms of social intervention should be devised to help the "losers" of these processes, while retaining their advantages.

The EU is an ideal locus for the development of these new measures as it provides a scale large enough to preserve the advantages of openness but at the same time an arena in which the creation of new social policy tools would be viable and legitimate. Based on these observations, this paper presents ideas for the construction of a European Social Union, composed of five interrelated parts.

(1) ***National Social Spaces****.* This is the ensemble of social protection systems of the EU member states. The EU should intervene in these spaces: 1) to favour the search for joint solutions to the common problems facing member states; 2) to supply resources and incentives to help overcome national policy lock-ins; 3) to limit the system competition based on the logic of (social) comparative advantages.

The EU should be particularly proactive in promoting a reorientation of national spaces towards social investment—a real policy imperative if Europe wishes to reconcile economic competiveness and high prosperity in the context of globalisation.

(2) The EU's ***Mobility Space***. This is the novel membership space inside which all the bearers of EU citizenship enjoy a "title" bestowed upon them by the Union in order to access the services of the place in which they choose to settle.

While freedom of movement must remain a core principle of the Single Market, political conflicts around it cannot be ignored. A new balance between openness and closure is needed. It would be advisable to adopt a more stringent definition of the rights of those who do not work: e.g. relatives remaining in the countries of origin and residents who are not economically active.

(3) ***Transnational Social Spaces***. This is the ensemble of social schemes and policies characterised by a cross-border element, most of which involve regions. Over the last twenty years, the sub-national level has increased its role in social protection: from health to social services, from active labour market policies to inclusion policies.

These novel aggregations can promote interesting forms of coordination and even fusion of social infrastructures, and feed new forms of cross-border solidarity. A similar virtuous circle can result from the ongoing trend of "social transnationalisation", i.e. the creation of cross-border supplementary pension schemes for employees working in different states.

(4) ***EU Social Policy***. These are supranational policies with an explicit social purpose, directly funded by the EU budget and based on either hard or soft law. The strategic priority of the EU social policy should be to increase the profile of pan-European forms of solidarity, calibrating both "reciprocity" and "benevolence". The most effective tool for re-organizing reciprocity is some form of interstate risk-pooling, through measures such as a EU unemployment benefit scheme, or a pan-European pension insurance scheme at the industry or sectoral level.

As to benevolence, the most obvious instrument would be a EU scheme of last resort assistance, based on the "sufficientarian" principle, to make sure that all EU citizens have enough to survive.

(5) The ***European Social Constitution***. This is the set of objectives of a social nature contained in the Treaties. The agenda of the European social constitution must re-start from Lisbon, enabling the full potential of its provisions. The most promising springboard is the social clause (Article 9 TFEU), which should be properly operationalised to redress the balance between the EU's economic and social dimension.

1. Introduction

The expansion of globalisation has generated gains as well as losses. The latter are concentrated among the lower and middle classes of advanced economies, who have seen their conditions worsen due to shifts in geographic and technological production patterns. The situation of these “losers” of globalisation has further deteriorated following the recent financial crisis.

The “great recession” has prompted a number of political and institutional responses, in the first place in Europe. However, these fixes remain insufficient to tackle the structural challenges of globalisation—and, in Europe, economic integration—and to give answers to those left behind by these processes.

The losers of globalisation and integration are caught between a welfare state that is less able to mitigate the markets’ effects, and many political movements proposing an unrealistic return to hard national borders as a panacea for their distress. Clearly, new institutional solutions will have to be found to make globalisation and integration more inclusive and politically viable.

This paper sketches proposals for the transformation of the welfare state in the forthcoming years. In these proposals, and in the underlying analysis, thee focus is primarily on the European Union. European integration has a two-sided relationship with globalisation: on the one hand, the single market reproduces, regionally, the social and economic openness defining globalisation. On the other, the European project includes an important politico-institutional level—located between the equally unsatisfactory national and global arenas—that can be the basis for a more effective system of welfare.

The paper proceeds as follows: the next section examines the main socio-economic effects of globalisation and the crisis, primarily on inequality and social mobility. Section three will look at the political and institutional consequences of globalisation and integration: the state’s decreased ability to mitigate the effects of market forces, and the rise of populism. Building on these analyses, the fourth section presents some ideas on a regional response to the challenges of globalisation and integration, centred on the notion of a European Social Union.

2. The economic and social effects of globalisation

2.1 The decline of north-south inequality, and the rise of inequality in the north

The current wave of globalisation was ushered in by the integration into the world economy of China, India, Russia, its former Soviet satellites in Eastern Europe, India, as well as the rise of Korea, Taiwan, later Brazil, and other developing economies (such as Vietnam, Thailand, and Indonesia).

These transformations have had profound economic effects. To cite just one set of figures, in 1990 3% of world manufacturing was produced in China, compared to 65% in the G7 countries; by 2010, those numbers had changed to 19% and 47% respectively (Figure 2.1).

Soaring growth in rapidly industrialising countries and low growth in the G7 brought about what Baldwin (2016) has called “the great convergence”. Over the last quarter of a century, the share of world income earned by the G7 fell dramatically from two-thirds in 1990 to approximately 40% in 2014 (Figure 2.2).

What are the implications of globalisation for inequality? In a nutshell, inequality between countries has declined in recent decades, while inequality within individual countries has risen. This can be seen in Milanovic’s (2016) “elephant curve”, plotting relative gains in real per-capita incomes by global income level (Figure 2.3).

Between 1988 and 2008, income gains were spectacular around the median of the world income distribution. The persons involved (90% of which lived in China and other emerging Asian economies) were the obvious beneficiaries of globalisation (the “emerging global middle class”). In contrast, income growth was virtually zero around the 80th percentile of the income distribution, where the “lower middle class in the rich world” is located. Finally, the “global plutocracy” saw their incomes soar even higher: the incomes of the top 1% of the distribution grew by over 60% in 1988-2008.

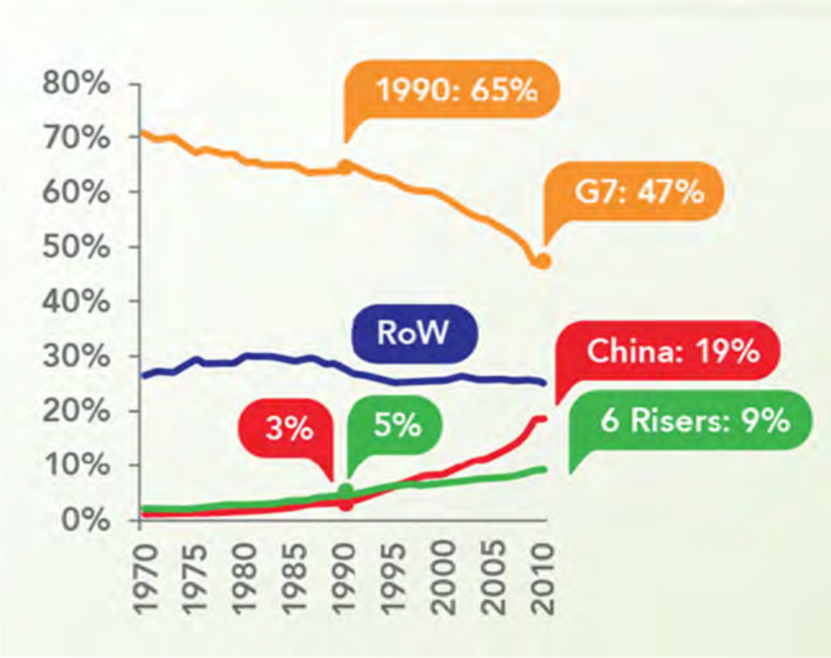
The global financial crisis has accelerated the “great convergence” further. Turmoil in stock exchanges and falling property prices dented the incomes of the “global plutocracy”, while low or no growth in advanced economies caused the incomes of the lower middle class in the rich world to stagnate. At the same time, in 2008-2011 average income in urban China doubled.

While China as a whole remained less prosperous than even the poorest member states of the EU, the gap is fast disappearing. Mean incomes (in power purchasing parities) are already higher in urban areas of China than in Romania and Bulgaria. In the meantime, the hyper-wealthy, i.e. the 735 individuals with a net wealth of over $2 billion in 2013, did better than ever, their combined assets amounting to over 6% of world GDP.

The emergence of a “global plutocracy” points to a broader phenomenon: the recent rise of inequality in almost all advanced industrialised countries. During the three decades from the end of WWII to the 1970s oil shocks, unprecedented growth had gone hand in hand with reductions in income inequality throughout the rich world. In the US, for instance, inequality had peaked in 1933, at the depth of the Great Depression, then fell continuously until 1978, when it started to increase again. In Britain, the levelling of the income distribution began earlier (in 1867), and ended in 1979.

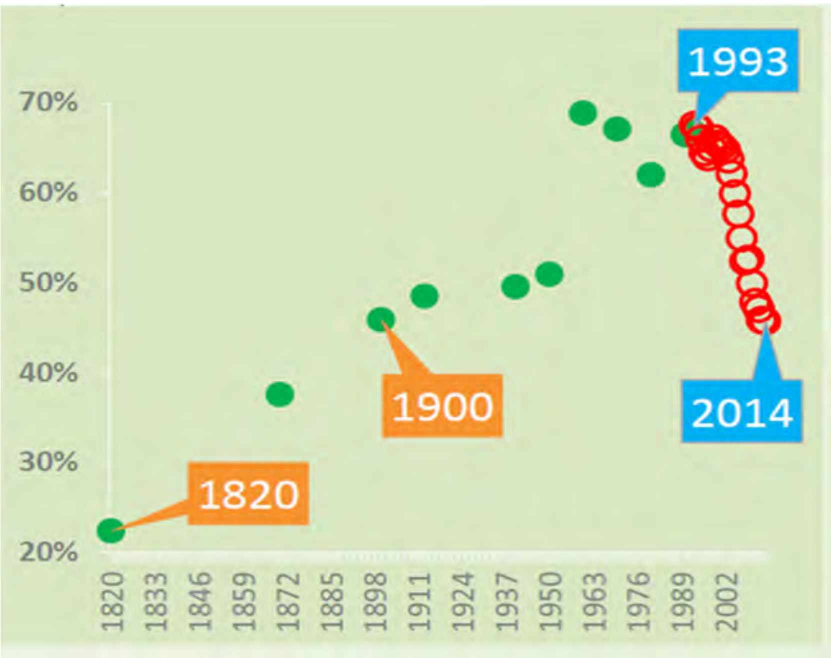
What are the causes of rising inequality in the US and Europe? As successive OECD studies have shown (OECD 2011), greater labour participation and greater earnings disparity among male workers accounted for about 60% of the growth in inequality in household incomes from the mid-1980s to 2008.

Figure 2.1. World manufacturing shares, 1970-2010



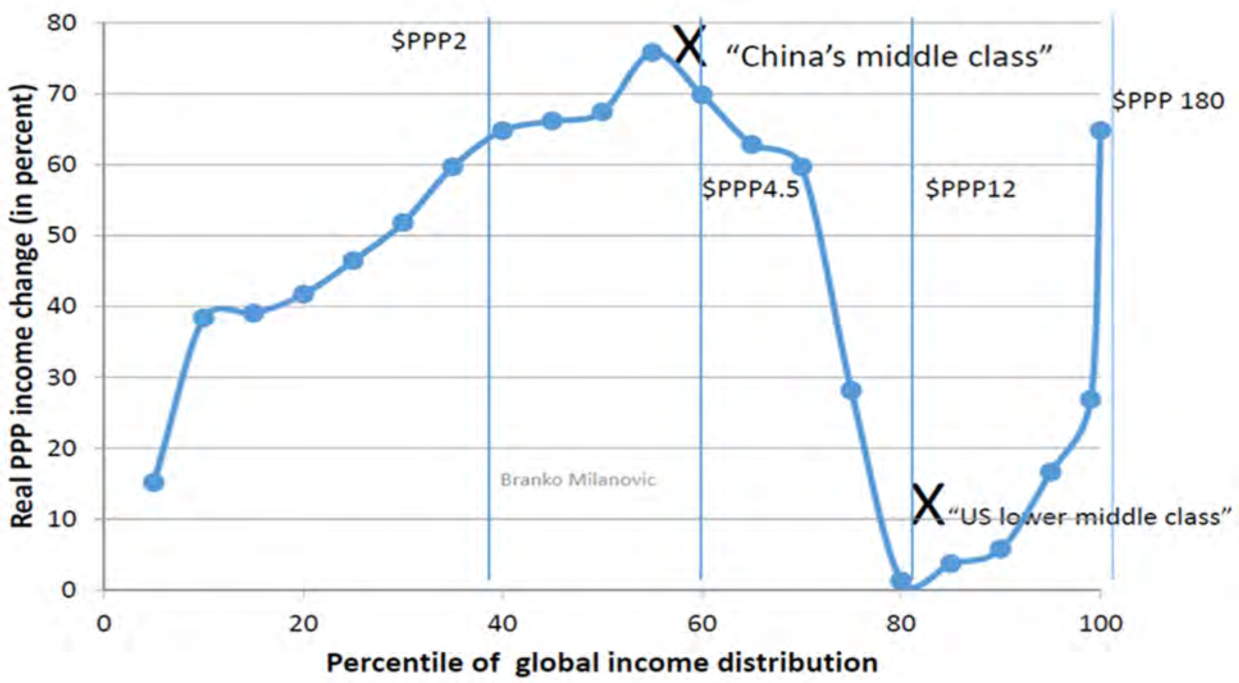
Source: Baldwin (2016).

Figure 2.2. The G7 countries' share of the world GDP, 1820-2014



Source: Baldwin (2016).

Figure 2.3 Real per capita income gains by income level, 1988-2008



Source: Milanovic (2016).

But why has the earnings distribution grown more unequal? For a long time, economists have debated the respective contributions to inequality of technology vs. globalisation. According to proponents of the former, "skill-biased technological change" increased the skills premium, widening the distance between the wages of high-skilled workers relative to those of low-skilled ones.

Those stressing the role of globalisation highlight the disappearance of well-paid jobs in manufacturing in the US and western Europe as firms relocated to lower-wage countries, or were driven out of business by lower-priced imports from emerging economies. As Milanovic (2016, 109-10) has suggested, technology and globalisation may in fact offer complementary explanations:

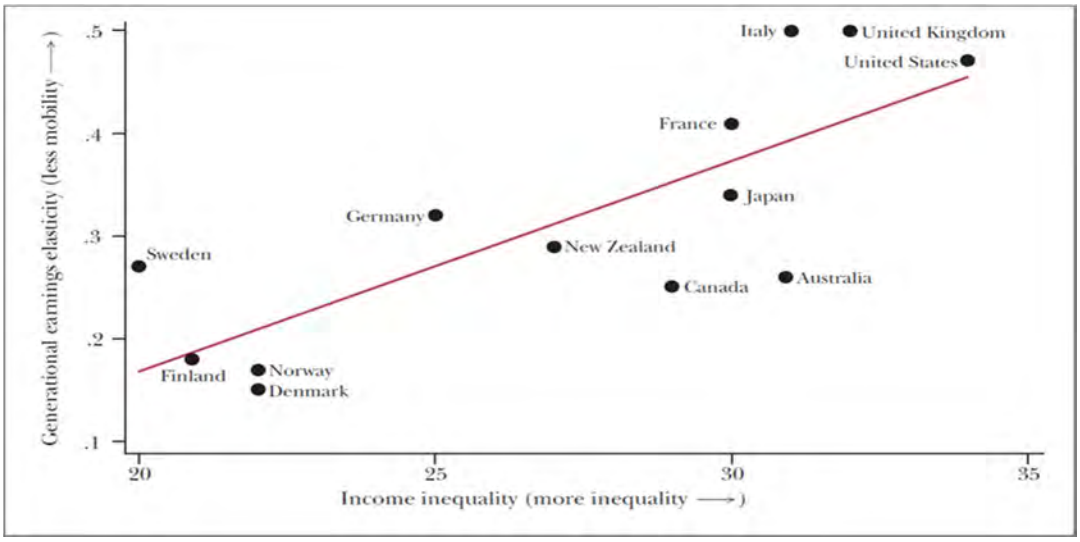
> [T]he lower price of capital goods leading to the replacement of routine labour and greater complementarity between capital and high-skilled workers […] could have occurred only under the conditions of globalisation, where reduced prices of capital goods were made possible thanks to the existence of cheap labour in China and the rest of Asia.

2.2 Declining social mobility

Evidence shows that greater inequality is associated with less mobility across generations, as suggested by "The Great Gatsby curve" (Figure 2.4). The US and the UK are located in the upper right part of the curve, suggesting high inequality as well as high earnings persistence (i.e. low mobility). On the contrary, Finland, Denmark, Norway and Sweden lie in the bottom left of the curve.

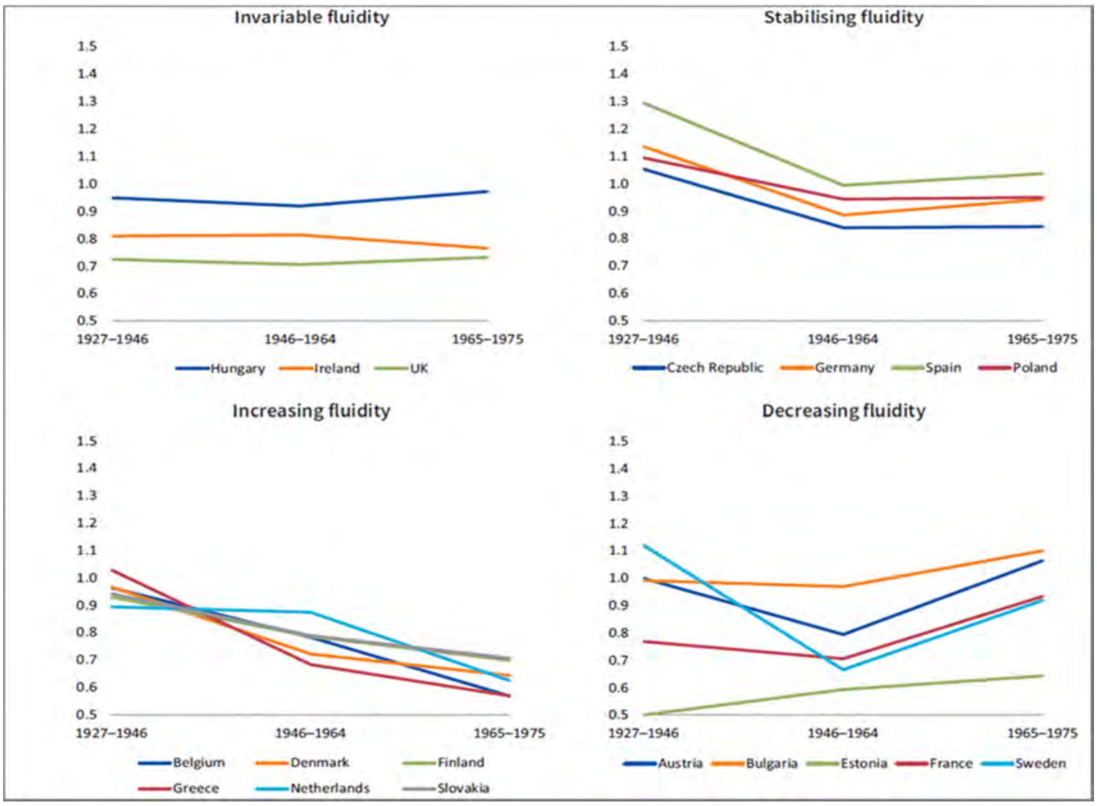
Using data from the European Social Survey 2002-2010, a recent study by Eurofound (2017) has estimated that "social fluidity" among socio-economic classes increased in Finland, Denmark, Belgium, the Netherlands, Slovakia and Greece. In contrast, it was stable in the UK, Ireland and Hungary (and for those born since 1946 in Germany, Poland, Spain and the Czech Republic), and declined (for those born in 1965-1975 relative to earlier cohorts) in Sweden, France, Austria, Estonia and Bulgaria (Figure 2.5).

Figure 2.4. The Great Gatsby curve



Source: Corak (2013).

Figure 2.5. Social fluidity in Europe



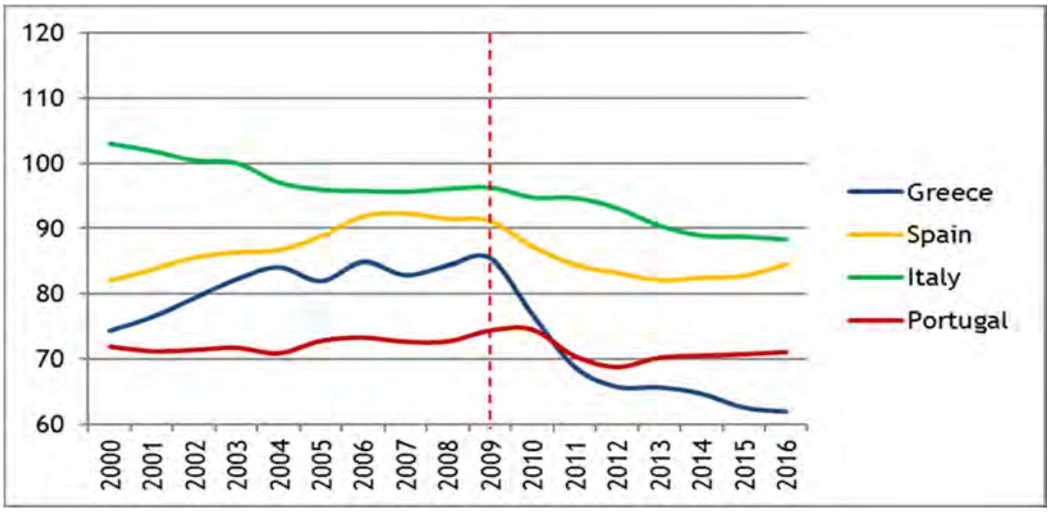
Source: Eurofund (2017).

2.3 Effects of the great recession and EU-induced austerity in southern Europe

On the eve of the Eurozone crisis, average living standards in the southern periphery had converged considerably with the rest of western Europe. In 2009, Spain, Greece and Portugal had come closer to the EU15 average than at any time in the previous quarter century, though Italy had peaked earlier (in 1995). By 2013, all four countries had lost ground relative to the EU15. Relative living standards fell most dramatically in Greece: to 62% of the EU15 average (from 85% in 2009). More recently, the distance seemed to have grown shorter in the case of Portugal and Spain, but not in that of Italy and Greece (Figure 2.6).

Southern European economies have shrunk in recent years: Spain by 8.9% (in 2008-13); Italy by 8.6% (in 2007-13); Portugal by 7.8% (in 2008-13). As for Greece, in 2007-13 GDP contracted by 26.5% in real terms. The trajectory of the Greek economy has so far been L-shaped: real GDP has barely budged (+0.1%) in 2013-16. In contrast, Spain has grown by a cumulative 7.9% over the same period, Portugal by 3.9%, and Italy by 1.8%.

Figure 2.6. Per capita GDP at current market prices - selected countries, 2000-16 (EU15 = 100).



Source: AMECO Eurostat.

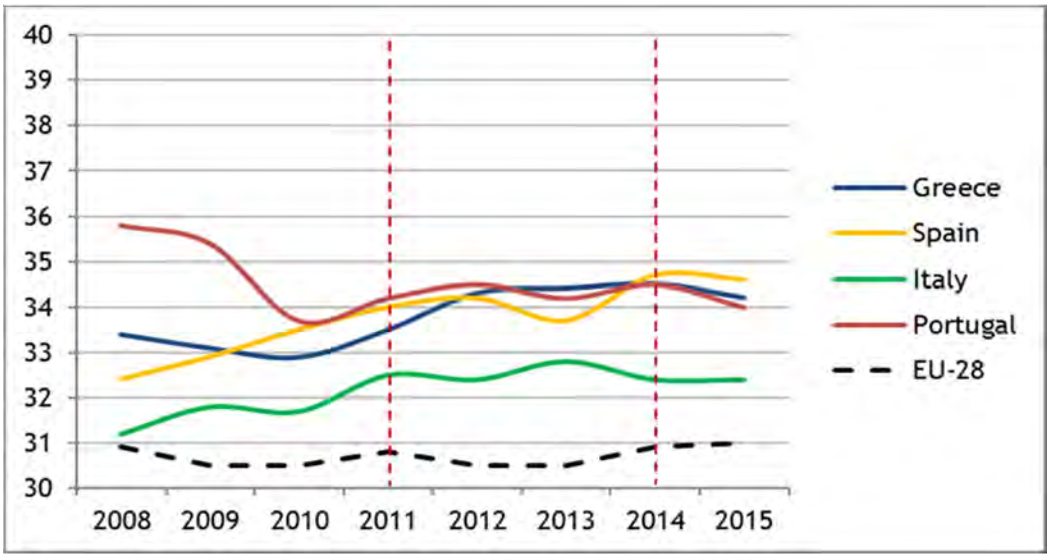
Between 2008 and 2013, the number of workers in jobs decreased significantly in all four countries: by 23.5% in Greece, 16.3% in Spain, 13.1% in Portugal, 4.2% in Italy. Employment rates have fallen dramatically: in Greece by 12.6%, in Spain by 9.7%, in Portugal by 7.4%, in Italy by 3.1% (in 2008-13).

In 2007, the unemployment rate in southern Europe was not far from the average for the EU as a whole, ranging from 6.1% in Italy to 9.1% in Portugal. Thereafter, joblessness rose throughout Europe, but nowhere as much as in Spain and Greece, where in 2013 it peaked at a massive 26.1% and 27.5% respectively. In 2016, against the EU average of 8.5% (10.0% in the euro area), unemployment stood at 23.6% in Greece, 19.6% in Spain, 11.7% in Italy and 11.2% in Portugal.

Real wages experienced zero or negative growth. That was both a result of the recession and of "internal devaluation" (i.e. compression of wages via labour deregulation). A recent study by the ETUI (2017) has estimated that in 2009-16 real wages declined in Greece (by 3.12% per year on average), in Portugal (by 0.74% per year), and also in Italy (-0.28%), while they stagnated in Spain (+0.13%).

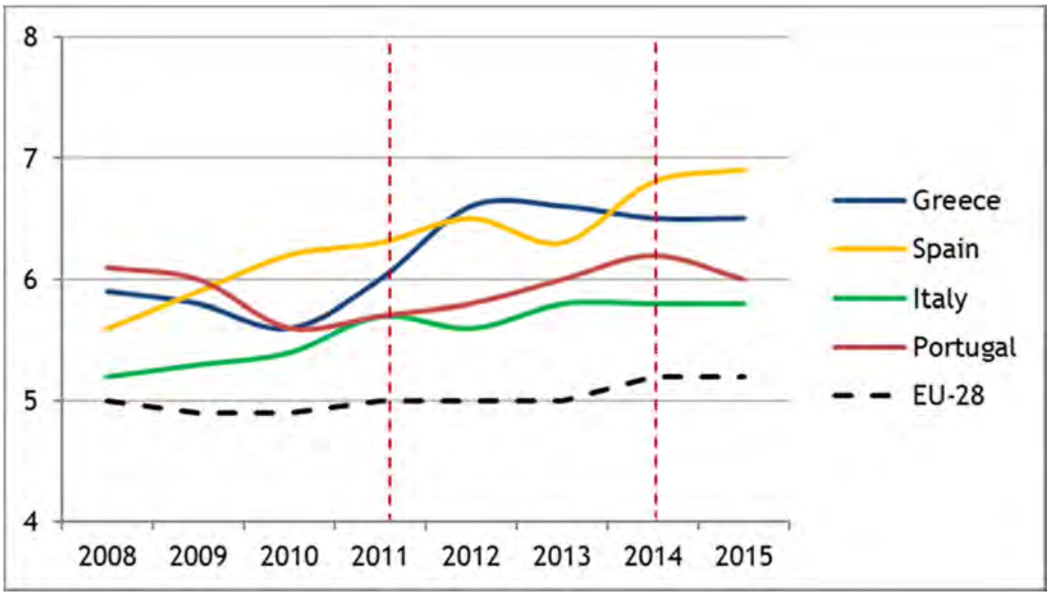
Eurostat figures indicate that income inequality has gone up throughout southern Europe since 2009. (In 2007-09, Portugal and, to a lesser degree, Greece had experienced a drop in inequality). The growth in inequality over the entire period has been greatest in Spain, the country with the highest level in 2014 (Figures 2.7 and 2.8).

Figure 2.7. Gini coefficient - selected countries 2008-15



Source: Eurostat.

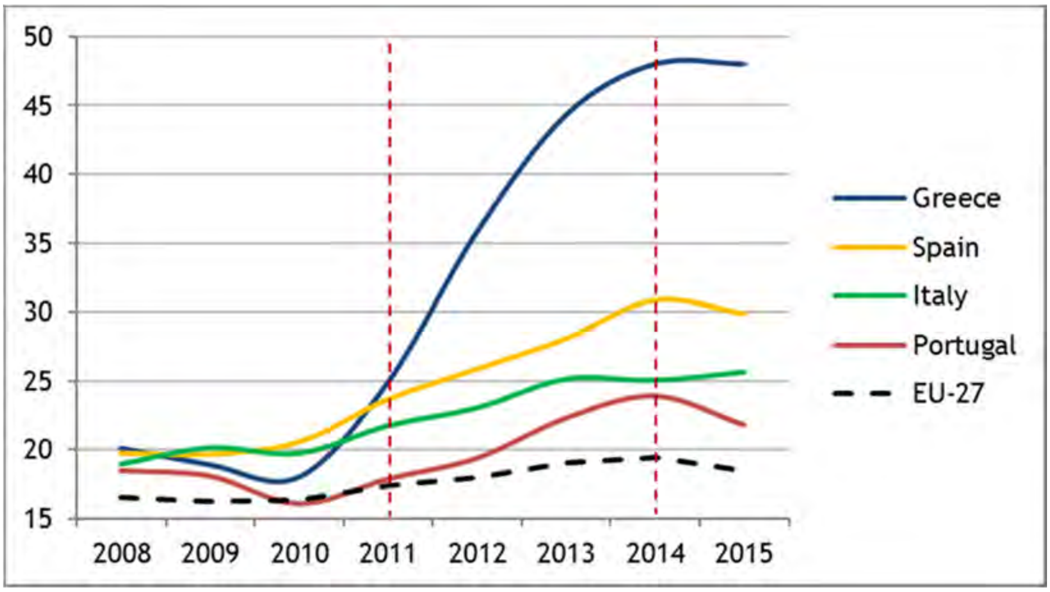
Figure 2.8. Income quintile ratio - selected countries 2008-15



Source: Eurostat.

Relative poverty also increased significantly in 2009-2013 in all countries (in Greece: from 18.0% to as much as 48.0% of the 2007 median, adjusted for inflation - Figure 2.9).

Figure 2.9. Share of population with net equivalent disposable income below 60% of the 2008 median



Source: Eurostat.

3. The political effects of globalisation and integration

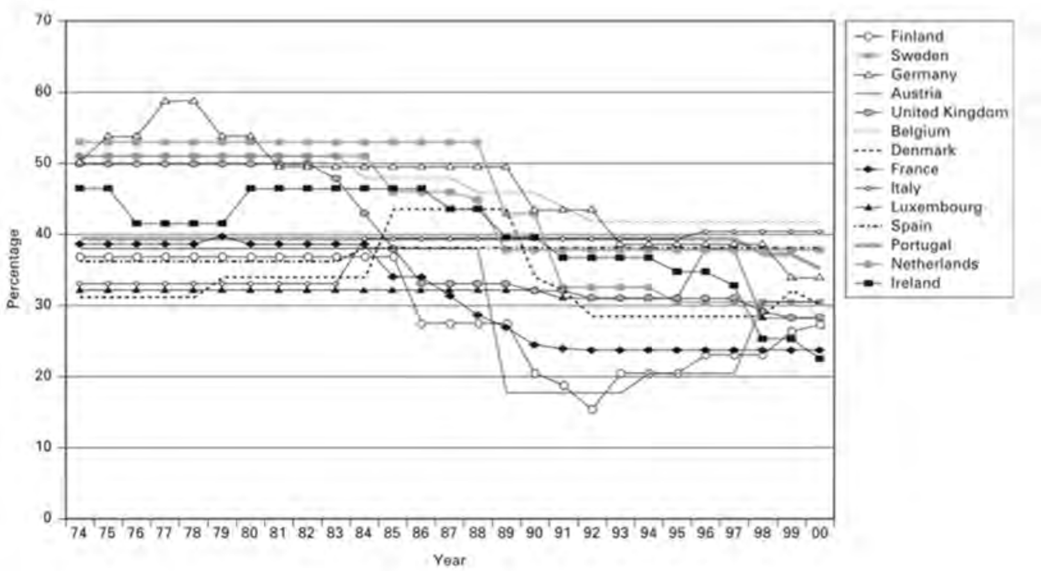
3.1 Globalisation, crisis, and the state

The socio-economic transformations described above have been accompanied by changes in the capacity of the traditional welfare state to correct for inequalities of income and opportunities. Between the end of WWII and the 1970s-80s, the international system was regulated by a regime of "embedded liberalism", in which a fairly high degree of openness in trade was combined with a significant degree of public intervention within state boundaries, aimed at preserving full employment and social welfare. The advent of globalisation altered this compromise by expanding the scope of international free market to capital flows and extending the geographic reach of the liberal system to emerging economies, most notably China.

While globalisation has not generated the neoliberal convergence towards a minimal state that many predicted (e.g. Alesina and Perotti 1994; Strange 1996), it has certainly affected the state in its capacity to set and implement its domestic social goals. This is particularly true wherever state intervention impacts on the return on mobile capital, e.g. through regulations affecting production costs, or through taxation. Figure 3.1 shows this latter mechanism at play by graphing the decrease of corporate taxation in 14 European countries over time. Needless to say, lower corporate taxation means fewer resources to finance social policy initiatives.

At least two additional factors are at play in the weakening of the (welfare) state: the first is the "stickiness" of many social policy instruments, which limits state action whenever the latter implies the partial or total dismantling of existing measures (e.g. Pierson 1993). The second is the size of public debt in many western democracies, which limits their range of social policy intervention.

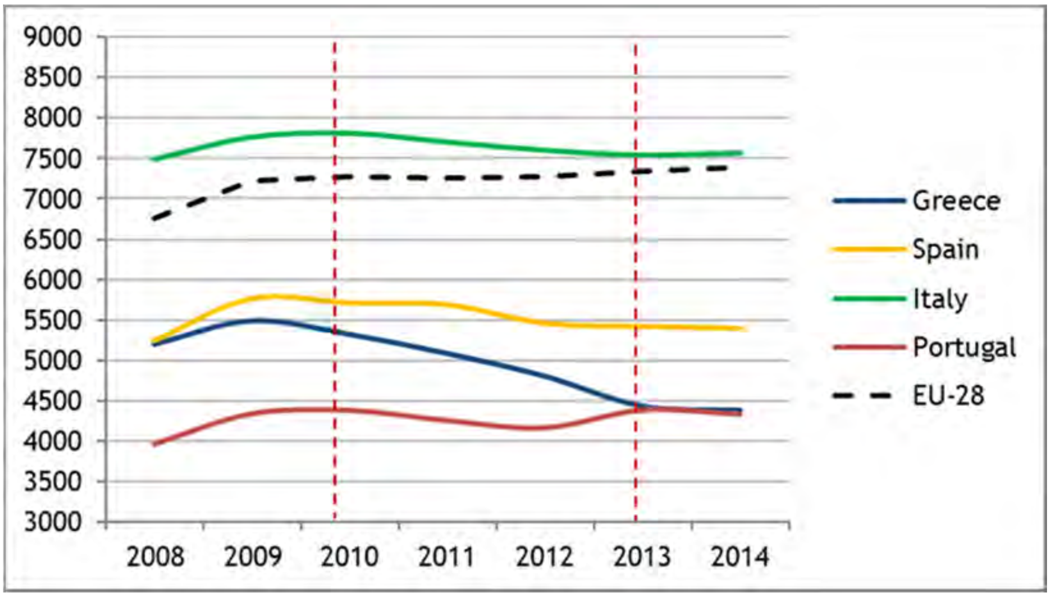
Figure 3.1. Effective tax rates on corporate income - selected countries, 1974-2000



Source: Razin et al. (2005).

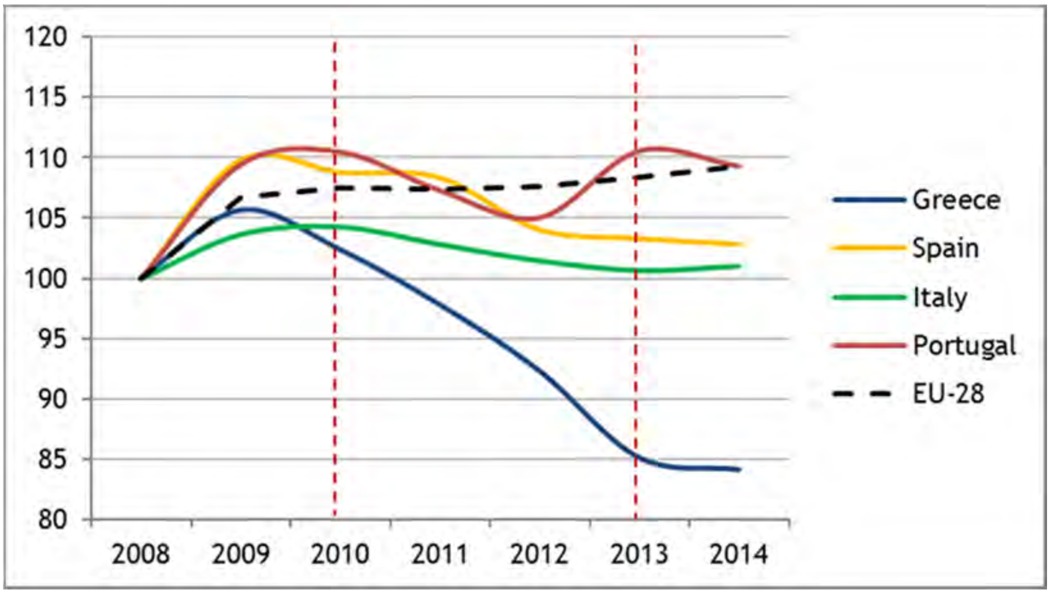
In recent years, the "great recession" has added to and exacerbated trends already at play with globalisation. This is especially true of the Eurozone, and in particular of its peripheral members. As the two figures below show, automatic stabilisers built in the welfare systems of the EU's southern states determined an increase in social spending at the outset of the crisis. However, shortly afterwards and during the worst part of the euro crisis, public spending became pro-cyclical in all four countries shown in the graphs (particularly in Greece), due in large part to the introduction of austerity policies. By Eurostat figures, social expenditure per capita fell by 3% in real terms in Italy (in 2010-13), by 5% in Portugal (2010-12), by 6% in Spain (in 2009-14), and by as much as 20% in Greece (in 2009-14).

Figure 3.2. Per capita spending on social protection - selected countries, 2008-14 (total €)



Source: Eurostat.

Figure 3.3. Total spending on social protection - selected countries, 2008-14 (2008=100)



Source: Eurostat.

The state's declining ability to tackle the social consequences of economic openness and the crisis is further complicated by the international movement of people—which is particularly important within the EU, where free movement is part of the single market. Migration flows exacerbate the above picture in two ways: first, by further undermining the economic position of the host countries' lower and middle classes, with whom immigrants compete in the job market. Second, by feeding the widespread perception of immigrants as undeserving net recipients of welfare measures, thus further strengthening the image of the host state as unable to shield its nationals from the effects of the international economy.

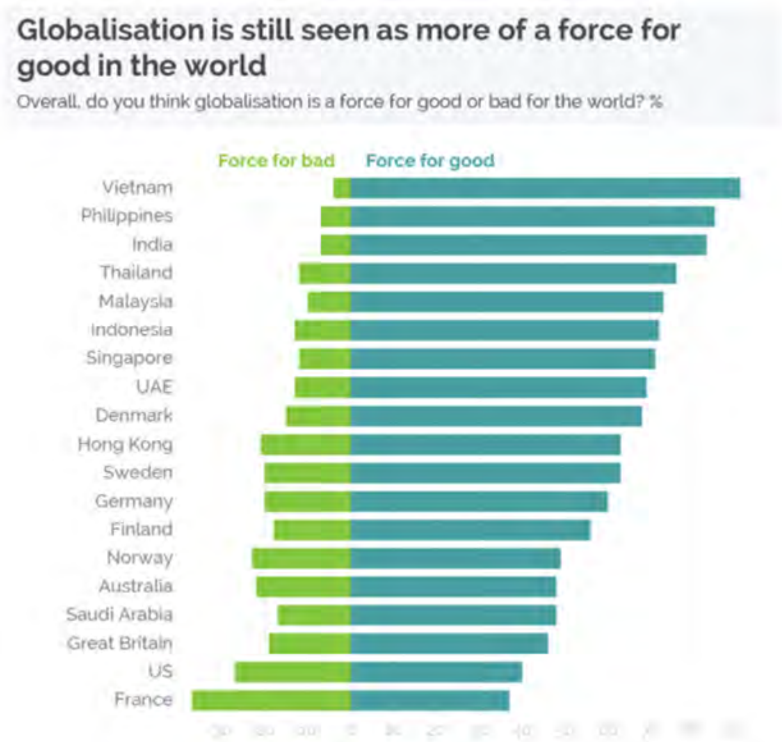
3.2 Political reactions to globalisation and integration

Faced with worsened economic conditions and a weakened state, those sectors of the population that have lost ground as a result of globalisation and integration have turned against these two processes (and the elites that over time have promoted them). Unsurprisingly, opinion against economic openness is distributed unevenly from one country to the next, as shown in Figure 3.4.

While globalisation is seen as a force for good by a majority in all countries—with the exception of France—opinion on globalisation is, on average, more positive in the developing world than in advanced economies. This distribution is consistent with the analysis above, which has shown how the gains from globalisation have been unevenly distributed worldwide. A similar, although not as clear-cut, distribution of public opinion can be observed regarding the human side of globalisation, represented by migration flows (Figure 3.5).

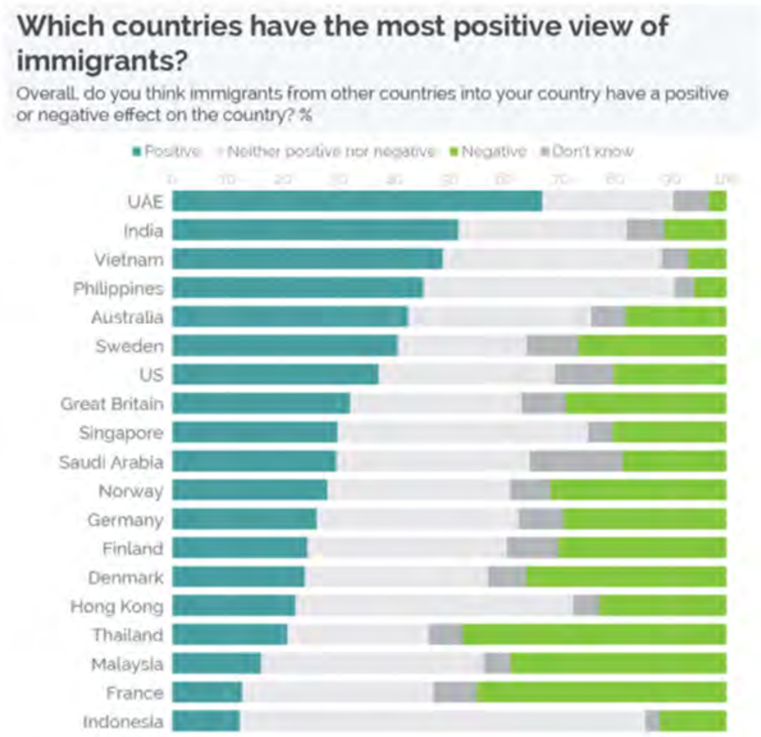
Switching to Europe, in the past decade public opinion trends against openness and transnationalism have had a regional counterpart in the decline of trust in the EU among member states' populations (Figure 3.6).

Figure 3.4. Opinion on globalisation - selected countries, October 2016



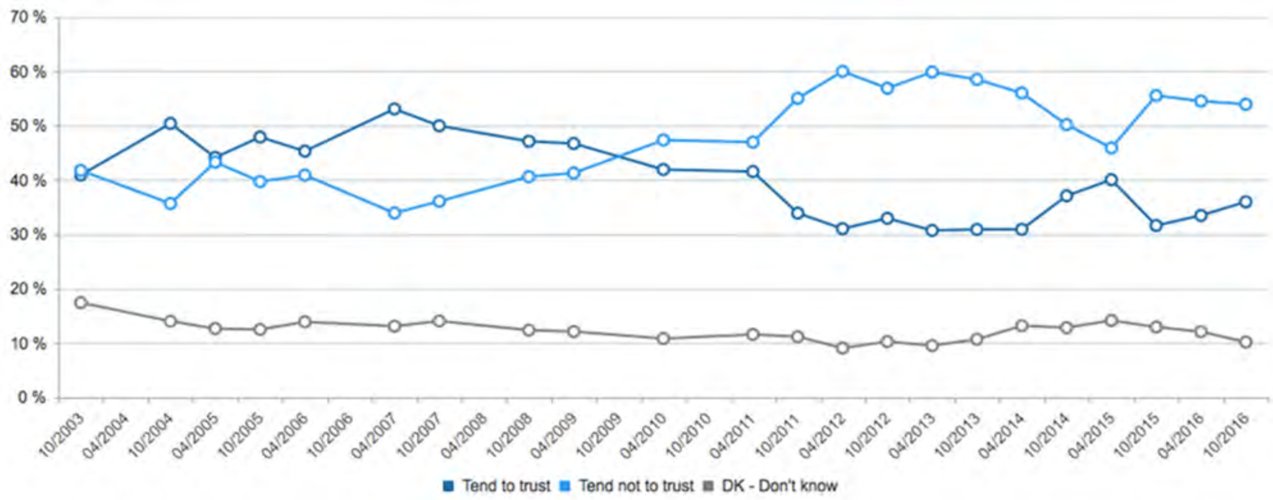
Source: YouGov.

Figure 3.5. Opinion on immigration - selected countries, October 2016



Source: YouGov.

Figure 3.6. Trust in the European Union, 2003-16 (EU average)



Source: Eurobarometer.

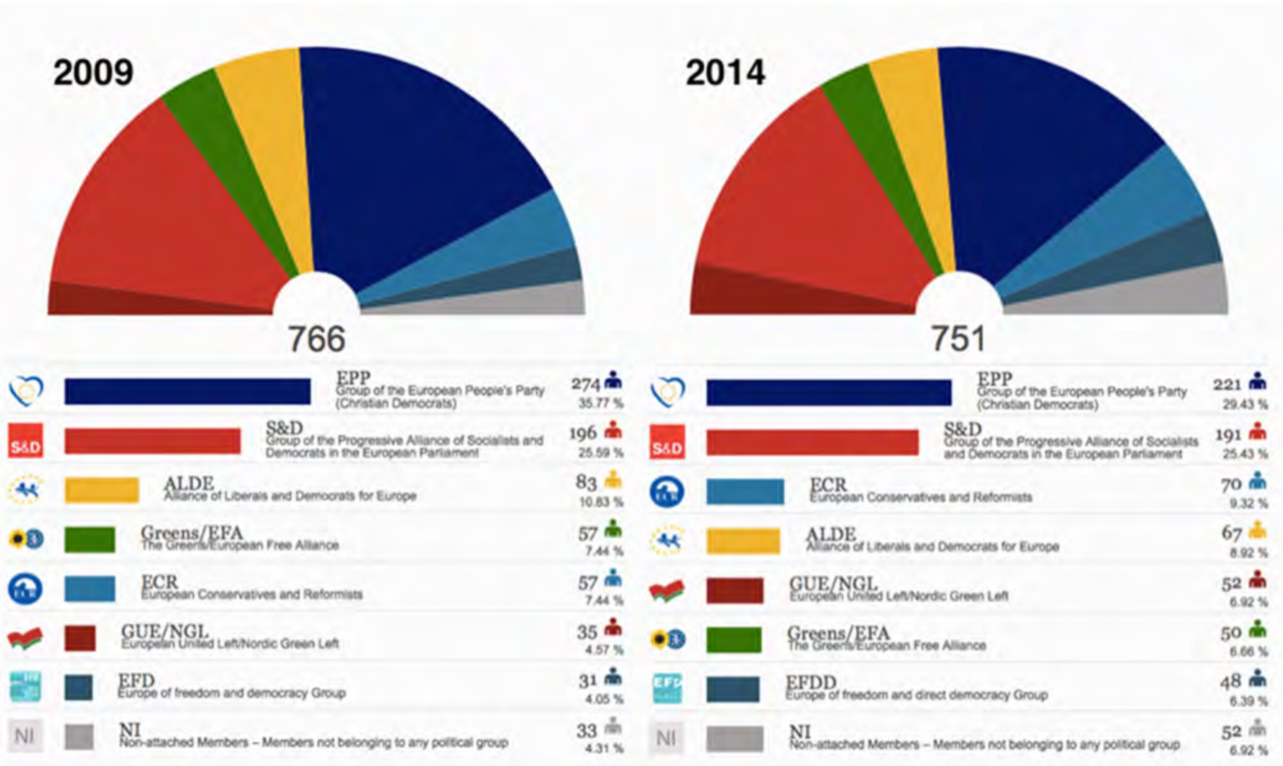
While by no means one and the same, the two phenomena—opposition to globalisation and to European integration—converge in an important respect, namely their being two manifestations of a more general revolt against transnationalism and supranationalism, based on the conviction that re-establishing hard borders and renationalising powers would benefit national communities by giving them back the policy-making capacities lost in recent decades. Given this convergence, it is unsurprising that both phenomena have contributed to the rise of populist political forces in recent years.

Figure 3.7 provides a snapshot of the electoral growth of Europe's populist movements by comparing results of the 2009 and 2014 European Parliament elections in terms of EP seats. As the figure shows, all three groups that have at least a populist/Eurosceptic component—the ECR, the EFD/EFFD and the GUE/NGL—gained in absolute as well as relative terms.

Some scholars have interpreted the rise of populism as the symptom of a deeper transformation in western societies, namely the emergence of a new cleavage structuring social conflict along an integration-demarcation divide (e.g. Kriesi et al. 2012). This new divide is in turn accompanied by a realignment of voter preferences affecting especially the traditional left, which has seen chunks of its working class electorate move towards (often right-wing) populist parties, as the latter are perceived as better defenders of the voters' interests.

Shifting the focus from politics to policy, however, neither side of the integration-demarcation cleavage has a satisfactory answer to the problems generated by globalisation and integration. On the one hand, a return to hard national borders is likely to create more problems than it solves. On the other, globalisation as the mere transcendence of boundaries provides no answer to the need for a correction of transnational market forces. The response, thus, is most likely to be found at an intermediate level: one that is wide enough to safeguard the benefits of openness, but at the same time small enough for the establishment of new social policy tools to be both realistic and justifiable.

Figure 3.7. European Parliamentary groups, 2009 and 2014



Source: European Parliament and authors' elaboration.

4. Social Europe as a possible solution

4.1 Some encouraging trends

Acknowledging the emergence of the integration-demarcation cleavage should not lead to despair about the future of Europe. Some reasons for cautious optimism have emerged lately. In the first place, the performance of EU and Eurozone economies is back to positive. At least in the short run, this is good news for the EU's popularity.

Secondly, and more importantly, there are some signs that public opinion is moving away from populism. One such sign was the June 2017 election of Europhile Emmanuel Macron as French president. More generally, while Euroscepticism remains a strong force in the continent, European public opinion is likely to be better disposed towards the integration project than often thought.

A recent poll conducted by the Pew Research Centre (2017) in ten EU member states—France, Germany, Greece, Hungary, Italy, the Netherlands, Poland, Spain, Sweden and the UK—shows that, while Europeans are on the whole still critical of the way the Union is run, they remain supportive of their countries' EU membership.

The above results support the conclusions of another, more fine-grained survey conducted by the REScEU project in the fall of 2016 in seven European countries: Greece, France, Italy, Sweden, Spain, Poland and the UK (Ferrera and Pellegata 2017). Unlike similar existing studies, the REScEU survey combined general attitudinal questions to a number of more specific ones on the solidarity dimension of the EU. Some of these results are worth reporting here.

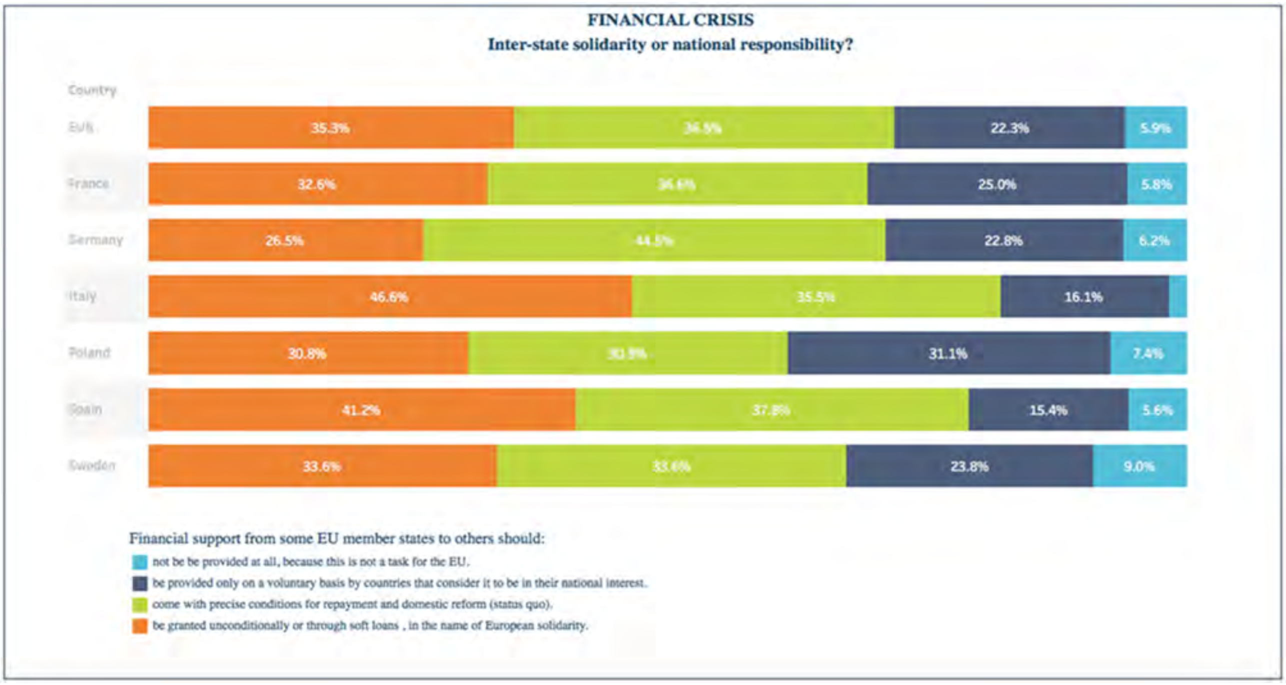
REScEU researchers asked respondents, first, whether the relationship between EU member states should be characterised by international solidarity, or rather by self-help and national responsibility. As Figure 4.1 shows, in all countries the vast majority of respondents support some form of solidarity, whether under precise conditions (the current status quo) or more generously, such as through soft loans or unconditional transfers.

A further step for the social development of the EU would be for it to provide welfare measures for individuals and families. The survey explored this aspect through a battery of questions on whether the EU should provide, respectively, means of subsistence for citizens in case of a crisis (Figure 4.2), poverty relief (Figure 4.3) or insurance against unemployment (Figure 4.4).

Finally, REScEU researchers asked respondents whether EU immigrants should be granted the same welfare protection as host country citizens, or instead some restrictions should be introduced. As shown in Figure 4.5, almost half of the respondents would grant welfare to all EU immigrants, regardless of their work status, while an additional 20% would grant it to all workers from the EU.

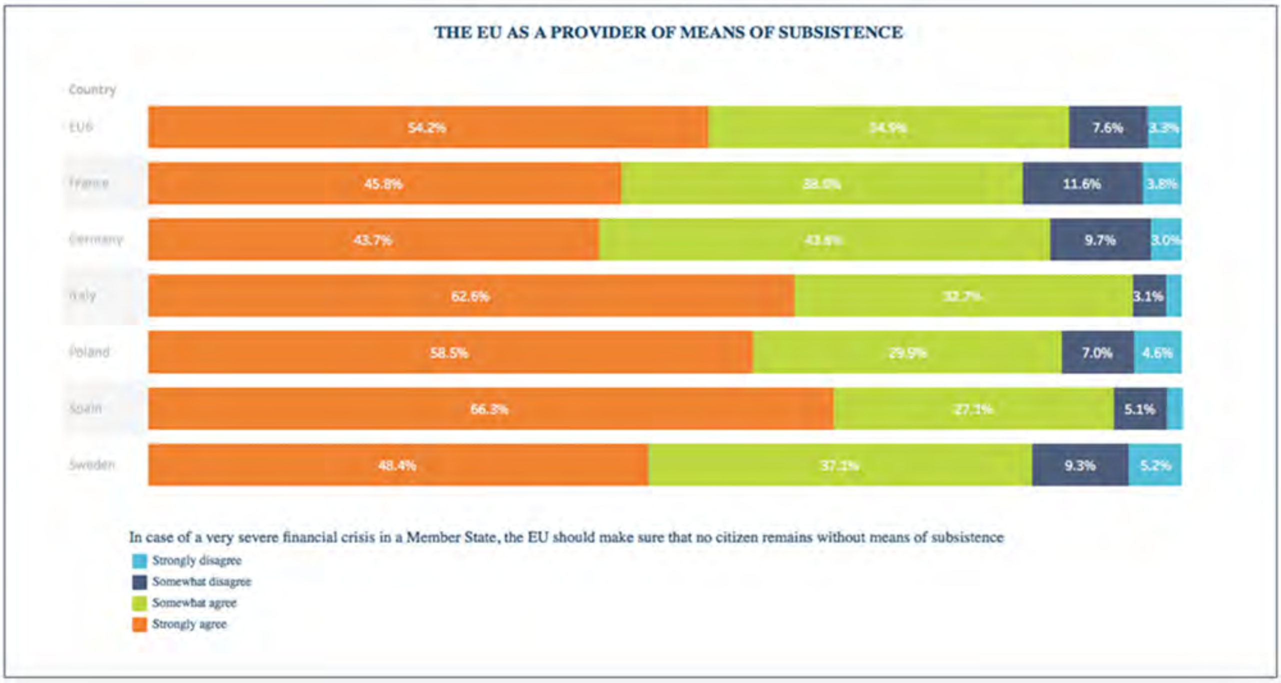
Taken as a whole, this data shows that European citizens are quite open to the idea of the European Union stepping up its efforts in the area of social policy and solidarity. To be sure, social Europe is not the national welfare state writ large. The EU lacks the history, structures and legitimacy to sustain a full welfare state, at least for now. A more realistic scenario is one in which a European system of social protection is built on a variety of levels—supranational, national, local—and instruments, reflecting the multi-layered nature of the Union.

Figure 4.1. Opinion on interstate solidarity in the EU - selected countries, Fall 2016



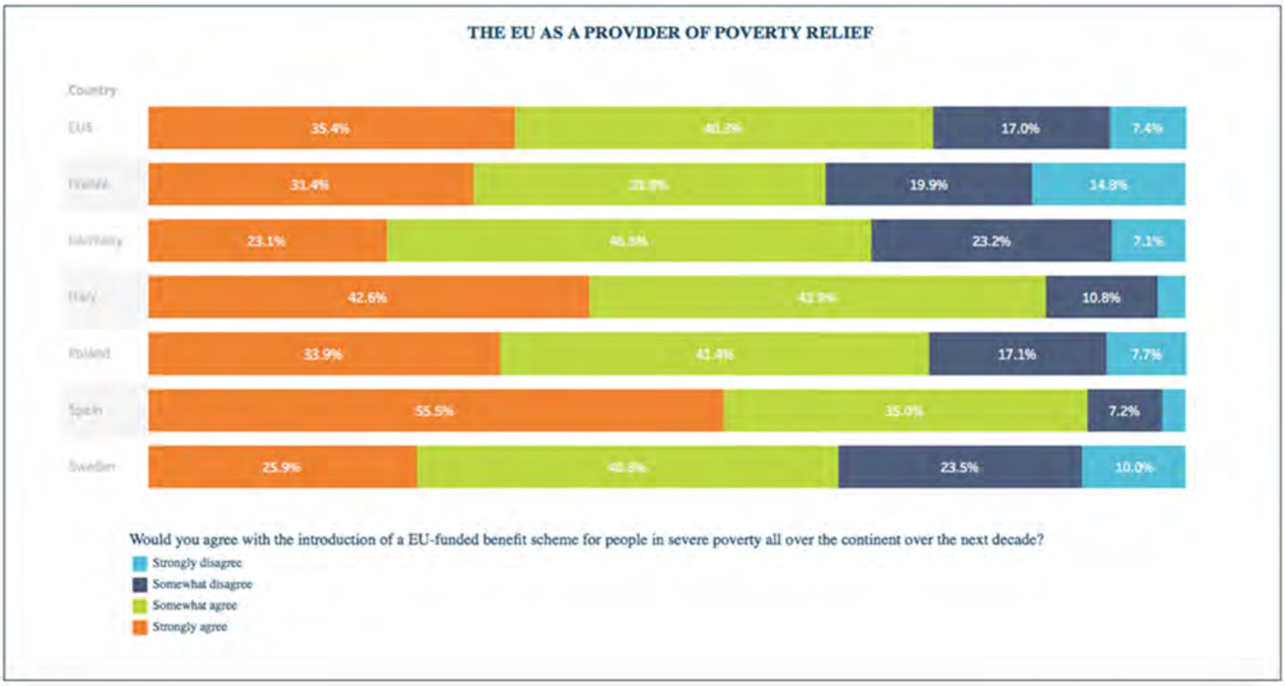
Source: REScEU and EuVisions.

Figure 4.2. Opinion on the EU's provision of means of subsistence - selected countries, Fall 2016



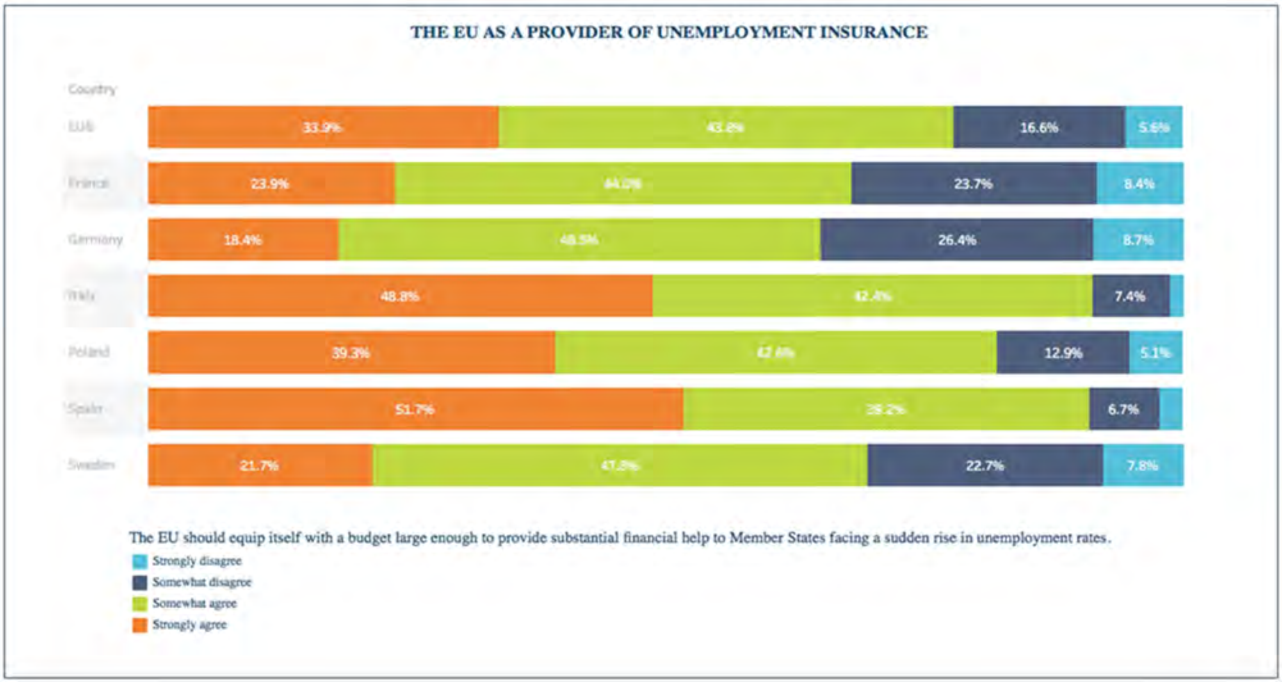
Source: REScEU and EuVisions.

Figure 4.3. Figure 4.3: Opinion on the EU's provision of poverty relief - selected countries, Fall 2016



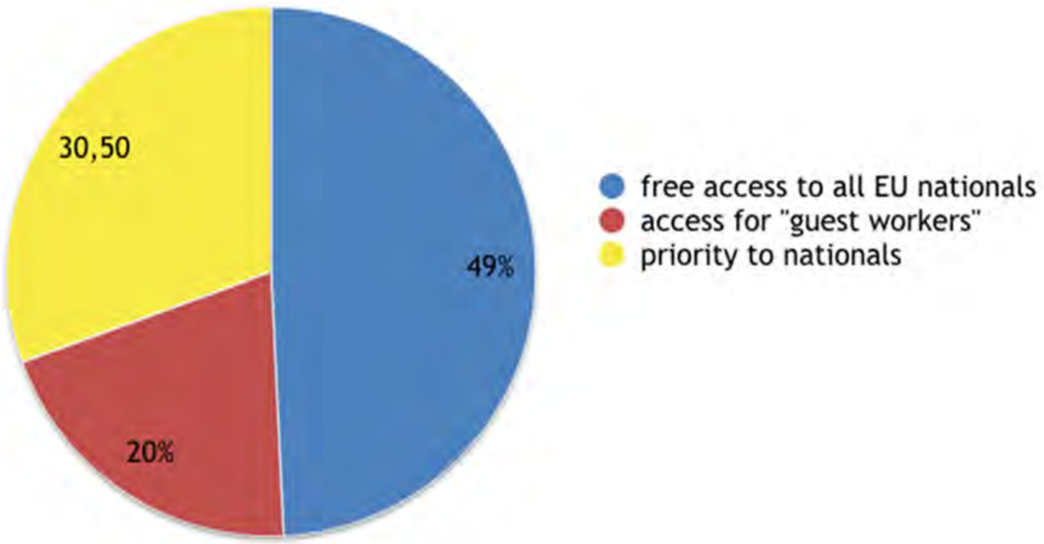
Source: REScEU and EuVisions.

Figure 4.4. Opinion on the EU's provision of unemployment insurance - selected countries, Fall 2016



Source: REScEU and EuVisions.

Figure 4.5. Opinion on the provision of welfare to EU immigrants - selected countries, Fall 2016



Source: REScEU.

4.2 Proposal for a European Social Union

Since the 1987 Single European Act, "social Europe" has been the holy grail for progressive reformers. Alas, it has also become one of the most elusive concepts in debates about the integration process. Ambiguity stems from the tension between the horizontal connotation of the concept—solidaristic goals, policies and achievements at the *national* level—and its vertical connotation — solidaristic or at least socially friendly goals, policies and achievements at the *supranational* level. Instead of ignoring this tension, a heuristically neutral and all-encompassing definition is advisable. The following components can thus be included under the concept of social Europe:

(1) The ensemble of social protection systems of the member states, resting on the common traditions of a "social market economy" and "social dialogue", but characterised by their differences in specific schemes and institutions, logics of market correcting, functional and distributive problems, and degrees of administrative performance. This component can be defined as ***National Social Spaces***.

(2) The novel membership space—coterminous with the EU external borders—inside which all the bearers of EU citizenship enjoy a common "title" bestowed upon them by the Union in order to access the benefits and services of the place in which they choose to settle. Starting from the 1970s, the EU has had an articulated legal framework for the coordination of the social security systems of the member states, and since 2011 a directive regulates the cross-border mobility of patients. This component can be defined as the EU's ***Mobility Space.***

(3) The ensemble of social schemes and policies characterised by a cross-border element. Most of these initiatives involve regions, under the legal umbrella of European territorial cooperation. Another interesting development on this front is the creation (mainly by the social partners) of cross-border occupational insurance schemes for pensions and health care benefits. This component may be called ***Transnational Social Spaces***.

(4) The ensemble of those supranational policies that have an explicit social purpose, be they of a regulative or (re)distributive nature, directly funded by the EU budget (if they imply spending) and based on either hard or soft law. This component is the ***EU Social Policy***.

(5) The set of objectives of a social nature contained in the Treaties, including those that allocate responsibilities between levels of government and define decision-making procedures. Given the supremacy of EU law over national law, such objectives and rules constitute the general framework that guides the other four components. This component can be called the ***European Social Constitution***.

How can the five components be made to work in synch, with mutual reinforcements but also without generating negative externalities for EMU? There is the need to devise an overall framework, that would be known as *European Social Union* (ESU), first proposed by Vandenbroucke (2015). The word choice immediately evokes a system of separate but interdependent elements, subject to common rules and aimed at sustaining different types of solidarity (Figure 4.6): a pan-European solidarity between countries and between individual EU citizens centred on supranational institutions, and the more traditional forms of national solidarity, centred on domestic institutions. The former should limit itself to redistributive goals which are functionally necessary and practically feasible. The latter's goal is the highest possible degree of solidarity—taking into account the preferences expressed democratically by the voters.

Figure 4.6. Types of solidarity within ESU

Component	Type of solidarity
National social spaces	**Horizontal, national**
Cross-border social spaces	**Horizontal, trans/subnational, local**
EU Mobility	**Horizontal/some verticality transnational**
EU social (and cohesion) policy	**Vertical, supranational, pan-European:** **- *Interpersonal*** **- *Interstate***
European Social Constitution	**Vertical, supranational, pan-European**

Source: Authors' elaboration.

Concretely, the institutional mission of ESU should be to guide and support the functioning and modernisation of national welfare states based on common standards and objectives, leaving to the member states wide margins of autonomy in the choice of ways and means. Let us briefly survey the major strategic priorities for each component of the ESU (see Figure 4.7 for a summary).

Figure 4.7. ESU priorities

Component	Challenge/priority
National social spaces	• Stabilisation of social protection • Social investment • Inclusion
Cross-border social spaces	Support and «steer»
EU Mobility	Search for a new balance between «opening» and «closure»
EU social (and cohesion) policy	Expand and strengthen (European Pillar of Social Rights)
European Social Constitution	Operationalize and apply

Source: Authors' elaboration.

National Social Spaces. The current European landscape is characterised by national variations resulting from long-term policy trajectories. A number of factors militate in favour of a more proactive role for the Union at the national level. First, national social spaces are confronting similar problems, in the wake of the rapid endogenous and exogenous transformations illustrated in the previous sections. A joint search for viable and effective solutions can broaden the horizons of national models and provide them with wider policy options. Second, given the weight of policy lock-ins and path dependencies, institutional re-adaptation is a demanding task everywhere. The EU can help by supplying resources and incentives for overcoming organisational stickiness and political blockages to reform. Third, unbridled system competition based on the logic of (social) comparative advantages may lead to a growing "dualisation" between core and periphery (Palier and Rovny 2014) and hinder the formation of that pan-European solidarity which is a necessary political condition for the success of the integration project.

The EU can and should be particularly proactive on one front: promoting a reorientation of national spaces towards social investment. As argued by a rich literature, social investments (and in particular the enhancement of human capital) are a real "policy imperative" if Europe as a whole wishes to reconcile economic competiveness and high prosperity/wellbeing in the context of increasing globalization (Hemerijk 2013; Ferrera 2016a). In the last years the EU has elaborated an articulated agenda on desirable policy responses, underpinned by convincing functional justifications. But more can and needs to be done: the facilitation of social investment should become a key political function of the European Social Union in the future.

EU Mobility Space. Here the priority should be the correct regulation and management of the free movement of persons, and their access to social benefits in the host countries. The ESU could not exist as a *union* of welfare states if did not rest on a common underlying space which guarantees basic social rights in any national system. But as is known this issue has become increasingly contentious after the eastern enlargement. Without an adequate regulatory framework and normative framing, such type of tension is likely to escalate into a fully-fledged conflict with disintegrative implications: Brexit *docet*.

Freedom of movement of workers is a core principle of the European construction. Data shows that the economic balance of intra-EU migration for the receiving countries is positive (Ferrera 2016b). But political conflicts about free movement cannot be ignored. A new balance between openness and closure is needed. To change the rules would require a treaty change, an option fraught with risks. But at the "constitutional" level the rules are very broad. Indeed, the free movement of workers/persons, and especially the access to social benefits are regulated by secondary legislation and Court jurisprudence (Giubboni 2016). It is at this level that solutions must be sought.

What might be done is a more stringent definition of the rights of those who do not work: e.g. the relatives who remain in the countries of origin (for example with regard to family allowances), residents who are not economically active, and to some extent also those who move in search of work. Partly, this can be done by applying more severely the clauses that already exist. But one can also imagine to introduce legislative changes through the ordinary procedure. The freedom of movement of workers and their entitlement to social security benefits should remain a "red line" not to be crossed. On other types of intra-EU migrants, however, it is reasonable to recognise that the pan-European solidarity now politically viable is more limited than that provided for by the regulatory status quo. A redirection in this sense is already detectable in recent ECJ rulings (De Witte 2015).

Transnational Social Spaces. Over the last twenty years, the sub-national level has significantly increased its role and importance in many areas of social protection: from health to social services, from active labour market policies to inclusion policies. There has been extensive cross-border experimentation between regions belonging to different member states (Wassenberg and Reitel 2015). These novel aggregations can promote interesting forms of coordination and even fusion of social infrastructures, feed new forms of cross-border solidarity. A similar virtuous circle can result from a second ongoing trend of "social transnationalisation", i.e. the creation of cross-border pension schemes providing benefits to employees working in different member states (Guardiancich and Natali 2012). However small for the moment, all these developments should be encouraged and supported by the EU, as they work towards a partial de-nationalisation of solidarity by fostering risk sharing along functional and corporate lines.

EU Social Policy. Here the debate is already very extensive and the agenda is crowded. An incomplete inventory should include at least the following objectives:

(1) The introduction of common standards for labour market, wage setting and social inclusion, in order to combat social dumping and facilitate mobility.

(2) A better use and an increase of EU resources for (co-)financing reforms and especially social investment.

(3) Significantly widening the scope of action of the European Fund for Strategic Investment from physical to social infrastructures and policies.

(4) Strengthening cooperation and if possible establishing standards in the field of education, including early childhood education and care.

(5) Strengthening the European social dialogue.

(6) Improving social governance arrangements within the European Semester.

(7) Specifically including modernising social reforms in the list of conditions for obtaining "flexibility" in national budgets.

Box 1 summarises a number of more specific reform proposals at the interface between EU social policy and the EU mobility space. The underlying rationale is that of enhancing the visibility and salience of EU citizenship combining its free movement dimension (now prevalent) with a social dimension.

It will not be easy to make substantial and rapid progress on the front of pan-European solidarity. On the one hand, there are obvious dangers of moral hazard. On the other hand, there is the imperative of upholding the livelihood of the least advantaged, wherever they reside. There is also the need to de-activate the conflict between "movers" and "stayers". Although the technical and political obstacles are major, this is possibly the most urgent "nut to crack" for triggering off an orderly and reasonable Europeanisation of solidarity.

Box 1. Enhancing the social dimension of EU citizenship

Compensating the stayers:

- EU Fund to ease the impact of mobility

Enabling the stayers:

- A system of (transferable) universal vouchers for mobility/upskilling purposes

Autonomising the movers:

- A EU social insurance scheme for mobile workers

Universal empowerment

- A social card for access to a whole range of EU funded facilitating services
- Enhancing the visibility of the Global Adjustment Fund, the Fund for European Aid to the Most Deprived and the various initiatives of the European Social Fund
- EU insurance against the victims of terrorism and persons injured in the line of duty
- Enhancing the external protections linked to the EU passport

European Social Constitution. This component is perhaps the least visible to the general public but it is the most important one. The Lisbon Treaty has already dug the foundation of the ESU in terms of objectives and, in part, instruments (Bruun et al. 2012). Among the most important innovations are the redefinition of the programmatic values and objectives of the Union, the explicit acknowledgement of the links between the internal market and the achievement of full employment and social progress, the formal recognition of the Charter of Fundamental Rights, and—last but not least—the introduction of a transversal "social clause". The crisis has severely weakened the transformative potential of such constitutional changes. Not only have the new rules introduced by the Six Pack, Two Pack and the Fiscal Compact strengthened the paradigm of austerity, but, according to some commentators, such changes are not legally in line with the general provisions of the Treaty concerning, precisely, the social sphere (Kocharov 2012).

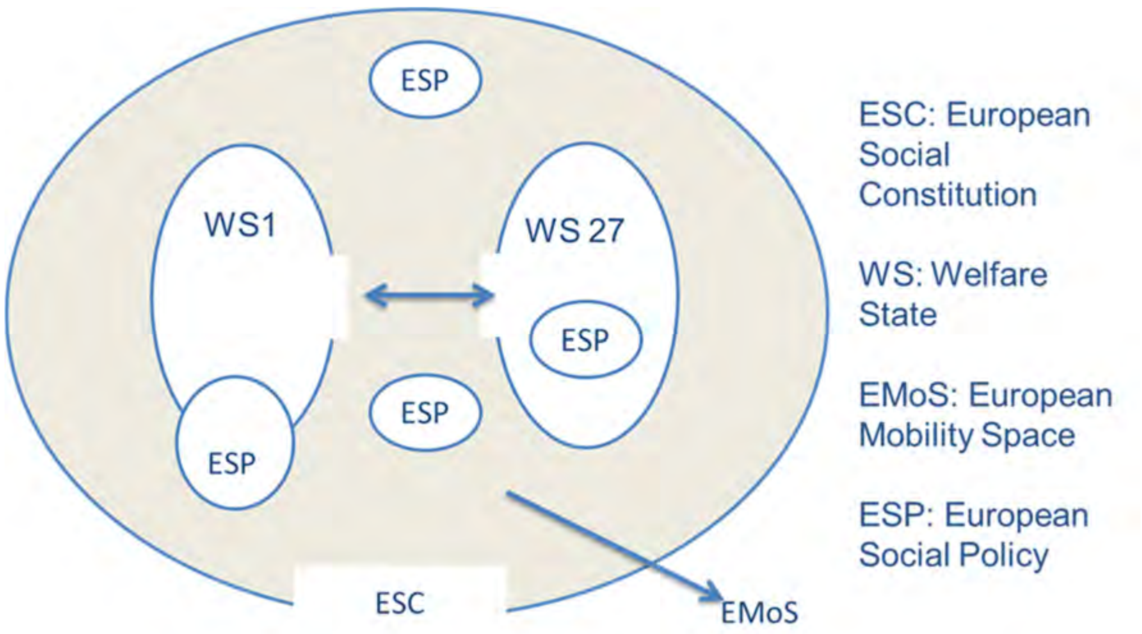
The agenda of the European social constitution must therefore re-start from Lisbon, enabling the full potential of its principles and provisions. The most promising springboard seems to be the social clause (Article 9 TFEU), according to which

> in defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, guarantee of adequate social protection, the fight against social exclusion and a high level of education, training and protection of human health.

If properly operationalised, the activation of this clause might have important effects in terms of the balance between the economic and social dimension. It could in fact serve as a barrier to undue encroachments of the market logic in domestic solidarity spaces. And it could act as a tool to monitor and facilitate the effective implementation of the ambitious social objectives set out in Art. 3 TEU. *Mutatis mutandis*, its effect could be similar to those originated by the clause on gender mainstreaming (i.e. the integration of gender equality in all EU policies) introduced in the 1997 Treaty of Amsterdam (Vieille 2012).

Figure 4.8 provides a summary visualisation of the basic architecture of the European Social Union as a “holding environment” delimited by the Social Constitution and constituted by national social spaces, connected through the mobility space, accompanied by novel experiments of cross-border solidarity and underpinned by EU social policies.

Figure 4.8 .The European Social Union - A visualization



Source: Authors’ elaboration.

5. Conclusion

According to Rodrick's famous "trilemma", globalisation has made it increasingly difficult if not outright impossible to reconcile democracy, sovereignty and economic opening. We can have democratic politics within sovereign nation states only if we restrain opening (as was the case during the European *Trentes Glorieuses*). We can have sovereignty and economic opening, but without the constraints of democratic institutions (the Chinese model?). We might give up sovereignty and create a global democracy aligned with a globalised economy (a modernised version of the Kantian utopia). But for the time being the obstacles to this third scenario seem insurmountable.

In Rodrik's view (shared by many other scholars), the trilemma holds also within Europe. We think, however, that European integration has the potential to overcome the trilemma. National sovereignties have already fused togetherin many key areas, empowering supranational institutions (including the ECJ) as a novel common sovereign representing *de iure* both the member states and EU citizens individually. Economic opening has gone a very long way, but it has not killed domestic democratic institutions. The fact is that the EU member states are not simply democracies, they are *welfare* democracies, or *democratic* welfare states. The challenge today in the EU is how to reconcile economic opening with social protection.

This would require the establishment of a democratic (or even better: a *demoicratic*) European Social Union, along the lines sketched above. The challenge is substantial, not only from an institutional perspective, but also, and especially, from a political perspective. The REScEU survey shows that a "silent majority" of citizens might be available to support such a farsighted agenda. However, the need for brave and responsible political actors capable to connect this potential majority with an ambitious vision remains. Who might those actors be? As of now, unfortunately, there is no one in sight.

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Easing Pain from Trade: the European Globalisation Adjustment Fund

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Executive Summary

- The European Globalisation Adjustment Fund (EGF) was established in 2007 to co-fund EU member states' labour market policies that facilitate the re-integration into employment of workers who have lost their jobs as a result of globalisation.
- The objective of this paper is to describe and analyse the functioning of the EGF and to make suggestions on how to improve it so as to increase its role in dealing with some of the pains from globalisation for EU workers.
- Overall, we think it was important for Europe to create the EGF instrument to assume some financial responsibility for assisting workers displaced by trade liberalisation, since EU trade policy is an exclusive EU competence. We also agree with the overall philosophy of the EGF programme, which is to help improve active labour market measures by national authorities in order to assist displaced workers, rather than provide unemployment benefits.
- However, although the EGF appears to be useful at the micro level (for workers covered by EGF programmes), the essential problem is that it reaches a very small number of workers and involves very small amounts of financing. It is therefore fairly irrelevant from a macro perspective to correct the side effects of globalisation.
- We make three recommendations for improving the EGF programme in the perspective on the next MFF: 1) improve the monitoring and evaluation of the programme by collecting more and better data; 2) revise the eligibility constraints and in particular the high threshold for the minimum number of workers targeted in each case; and 3) enlarge the scope of assistance for adjustment from globalisation to other sources of adjustment, including as a result of intra-EU offshoring and technological change.

1. Introduction

The European Globalisation Adjustment Fund (EGF) was established on January 1st 2007, with the objective to co-fund EU member states' labour market policies that facilitate the re-integration into employment of workers who have lost their jobs as a result of globalisation (defined as increased imports, a decline in market share or of offshoring of jobs). The programme was renewed in 2013 for the duration of the multiannual financial framework (MFF), from 2014 to 2020.

What is the main idea behind such an instrument? It has always been known that although it generates welfare gains on aggregate[1], international trade, by increasing competition and the reallocation of factors of production, also has distributional effects and that not everyone gains from increased trade. Some groups benefit from increased trade while others suffer. In other words, there are both winners and losers from globalisation. This is the reason why the United States created the Trade Adjustment Assistance programme as early as 1962.

Because of these distributional effects, anti-globalisation sentiment has been growing in advanced economies in the recent years. A recent survey[2] has shown that, in Europe, 38% of the population consider that globalisation represents a threat to employment and companies in their country and 63% consider that it leads to an increase in social inequalities.

In reaction to this discontent, policymakers have basically three potential options. First, they can continue to pursue their trade liberalisation agenda, in the hope that the aggregate gains from trade will overwhelm the pains from trade and thus be sufficient to convince their citizens of the merits of globalisation. Second, they can put in place protectionist measures, but at the risk of losing the benefits induced by international trade. More importantly, by adopting an inward-looking strategy, they would run the risk of submitting their economies to a new shock that may eventually be much more painful for workers than increased trade because it could disrupt the "global value chains" put in place by companies over recent decades. Or third, between these two extreme choices, they can try to correct the negative side-effects of globalisation. The US TAA and the EU EGF fit into this third approach.

The assumption behind trade adjustment programmes is that net gains from trade are large enough to finance labour market policies designed to help negatively affected workers to adjust and re-train to find another job in other firms, possibly in other sectors. This type of programme is meant not only to compensate displaced workers, but also increase the benefits from trade by reducing the frictions and by speeding up the adjustment process due to a reallocation of labour.

European countries typically have relatively generous welfare states that are meant to cushion workers against the risk of unemployment, whether they arise from trade liberalisation or other economic shocks that affect them negatively. Why then was the need felt to set a specific instrument from trade adjustment at European level? There were two main reasons. First, it was viewed that since trade is exclusive competence of the EU, trade adjustment should also be an EU responsibility, even if only partly so. Second, the EGF was meant to provide an incentive to EU member states (through co-financing) to put in place, or improve, specific active labour market policies (ALMPs) designed to deal with trade adjustment.

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[1] General-equilibrium analyses by Caliendo, Dvorkin and Parro (2015), Galle Rodriguez-Clare and Yi (2017) show that overall aggregate gains from trade are positive.
[2] See Eurobarometer (2017).

After 10 years of activity, the time is ripe for a review of the EGF programme. This is all the more important given that the next MFF negotiations will start at the beginning of 2018 and determine the fate of the EGF for the budgetary period after 2020. The purpose of this short paper is therefore to describe and analyse the functioning of the EGF and to make suggestions on how to improve the EGF so as to increase its role in addressing some of the pains from globalisation that have been felt by EU workers.

2. The European Globalisation Adjustment Fund

2.1 How was the EGF designed and how has it evolved over the years?

The EGF legislation was defined in 2006 and the fund started on 1 January 2007 at the same time as the MFF for the period 2007-13. The legislation was subsequently revised in 2009 during the global financial crisis, and in 2013 at the occasion of the MFF negotiations for 2014-20.

The original objective of the EGF was to co-finance – with national authorities in charge of implementing programmes at the local level – policies that facilitate the re-integration into employment of workers that have lost their jobs as a result of globalisation. The co-funding rate has evolved several times since the creation of the fund. In the first two years of the program, the co-funding rates were split at 50%. From 2009 to 2011 the EGF share was increased to 65% before returning to 50% in 2012 and 2013. Since 2014, the co-funding EGF share has been set at 60%.

To carry out this task, it was decided in 2007 that, for the period 2007-13, the EGF could use as much €500 million per year from the EU budget. However, given its nature as an instrument destined for emergency measures, the EGF did not receive a proper budget line in the EU budget, but only a cap as it was placed outside of the MFF. This cap was later reduced to €150 million for the MFF 2014-2020. At first, the funds granted by the EGF were transferred from the EU budget reserve to the EGF. In the 2009 report to the European Parliament and the Council, the Commission states that "*the practice followed in 2009 for payment appropriations has been to source them from the ESF budget because of the 'policy proximity', given that the annual requirement for the EGF so far has been only around 1 % of the ESF payment endowment.*"

In terms of procedures[3], to start an application, the interested parties (regions, individuals, employers or representative organisations) should get in contact with the national co-ordinators of the EGF action in their respective countries[4]. Given that the design and implementation of the programme is made at the national level, potential applications are first selected by the Member States. After that, applications have to be submitted to the Commission within 12 weeks of the emergency situation. In the following two weeks, the Commission is expected to respond to the Member State and request additional information to be provided in the coming six to eight weeks. Following the final submission, the Commission then has 12 weeks to make an assessment. Once approved by the Commission, the application is finally submitted to the EU Council and the European Parliament. Indeed, the fact that the EGF is not part of the MFF requires the approval of the Budgetary Authority for each application, which increases the length of the procedure.

To be eligible for EGF co-financing, applications need to fulfil a number of requirements. First in terms of scope, the EGF was originally only considered as a response to globalisation, which was defined as "major structural changes in world trade patterns lead[ing] to serious economic disruption, notably a substantial increase of imports into the EU, or a rapid decline of the EU market share in a given sector or a delocalisation to third countries"[5]. However, in 2009, its scope was broadened to include "workers made redundant as a result of the global financial and economic crisis" [6]. In this period, Member-States could thus also apply for help if they could "establish a direct and demonstrable link between the redundancies and the financial and economic crisis". When the regulation was revised again in 2013, the scope remained open to situations

[3] The current timings and steps of the application are set in Article 8 of the Regulation 1309/2013.
[4] See EC FAQ on the European Globalisation Adjustment Fund, available at http://egf.ie/wp-content/uploads/2012/03/EGF-FAQs.pdf
[5] Article 2 of Regulation (EC) No 1927/2006.
[6] Regulation (EC) No 546/2009.

arising from the “continuation of the global financial and economic crisis […] or as a result of a new global financial and economic crisis”[7].

Second, to be eligible to receive EGF financing, a minimum number of workers have to be affected in a particular case. The original threshold stood at 1,000 redundancies in a firm, in a region, or in two contiguous regions affected, however this criterion was reduced in June 2009 to 500 redundancies. Nevertheless, some exceptions to the minimum threshold apply in case of “a serious impact on employment and the local economy”[8].

Third, EGF applications must finance active labour market policies (ALMP) used to re-train and re-employ workers. These include (a) training, including information and communication technology skills and certification of acquired experience, job-search assistance, occupational guidance, advisory services, mentoring, outplacement assistance, entrepreneurship promotion, aid for self-employment, business start-ups and employee take-overs, and co-operation activities; (b) special time-limited measures, such as job-search allowances, employers' recruitment incentives, mobility allowances, subsistence or training allowances ; and (c) measures to stimulate in particular disadvantaged, older and young unemployed persons to remain in or return to the labour market[9]. In addition, the regulation gave self-employed persons access to EGF support from December 2013 and up until December 2017. This also provided Member States with the ability to include provisions within their applications to co-finance services to young people not in employment, education or training (NEET) from the same local job market but not directly concerned by the layoffs equal to the number of targeted dismissed workers.

Overall, programmes financed by the EGF originally had an implementation period of 12 months during which member states can provide tailor-made services to the unemployed. The maximum duration of the programmes was extended in June 2009 to 24 months. After this period, the Member State has six months to present a final report to the Commission on the implementation of the funds. Once funds are granted, they can be re-allocated between different ALMP. However, a detailed account of the implemented measures should appear in the final reports produced by national authorities for each case, but we do not have access to most of them.

2.2 The EGF from 2007 to 2017: How has it operated?

The EGF had a slow start in its first two years. The Commission received only ten and five applications respectively in 2007 and 2008. The European Commission (2009) explained this low uptake as a result of the uncertainty about eligibility for funding, the high threshold number of redundancies and the short period for implementing measures. Thus, in addition to the changes that were decided upon in 2009, the Commission also decided to establish a network of contact points – the 'Expert group on Contact Persons of the European Globalisation Adjustment Fund' – in order to assist Member States in preparing applications.

Following the first amendment to the EGF Regulation in 2009, the number of applications increased to 30, of which 3 were withdrawn. In that year, 80% of cases were targeted at supporting workers made redundant as a result of the crisis and only 20% for globalisation, highlighting a shift in the purpose of the instrument (see Figure 1).

[7] Regulation (EC) No 1309/2013.
[8] Article 2 of Regulation (EC) No 1927/2006 and of Regulation (EC) No 546/2009 point out that “in small labour markets or in exception circumstances, where duly substantiated by the Member State concerned, an application for a contribution from the EGF may be considered admissible even if the intervention criteria laid down (…) are not entirely met, where redundancies have a serious impact on employment and the local economy”.
[9] See Art. 7 OJ.L 2013 347 01 0855.

Figure 1. Number of EGF cases and total amounts granted by the EGF by year and scope

Note: For the amounts granted, we include only the cases with published financing decisions (excl. 2017).

Source: European Commission.

Overall, a total of 150 applications have been successful since 2007, while the number of applications that have been withdrawn is relatively small overall, with only 18 since 2007[10]. In terms of workers, a total number of 142 434 workers have been targeted since 2007, and the number of workers who actually benefited from EGF-financed policies since 2007 has been 91 505. Out of the 150 applications, there were only 20 applications made by small labour markets or under exceptional circumstances, “in particular with regard to collective applications involving SMEs”[11]. Of these 20 applications, 16 applications concerned less than 500 redundancies – 11 of them trade applications, 5 were crisis-related.

In terms of budget, the annual budget caps set by the regulation have never been fully spent – the maximum annual disbursement granted by the EGF was during the crisis, amounting to 120 million euros in 2009 and 2010. In remaining years, amounts granted by the EGF have been around €40 million on average (in addition these amounts granted might not be fully spent during the implementation of the programme).

In total (and including the share financed by member states), as of mid-2017, €513 million has been spent since 2007, which represents 5607€ per beneficiary of the programme (this amount has varied throughout the years, see Figure 2).

The number of targeted workers varies greatly across EU countries (see Figure 3). In terms of country distribution, EGF cases have mainly been concentrated in Western Europe: Spain has submitted the most applications (22), followed by the Netherlands (17) and Italy (14). There is no north-south divide: Finland (10), Denmark (10) and Belgium (10) are also among the countries with the most applications. On the contrary, applications are predominantly from Western Europe countries (135) while Central and Eastern European Countries have submitted significantly fewer applications (15)[12].

As far as sectors are concerned, automotive and machinery and equipment are dominant in EGF cases (see Figure 4). Logically, most applications come from sectors that have lost significant numbers of jobs in the last

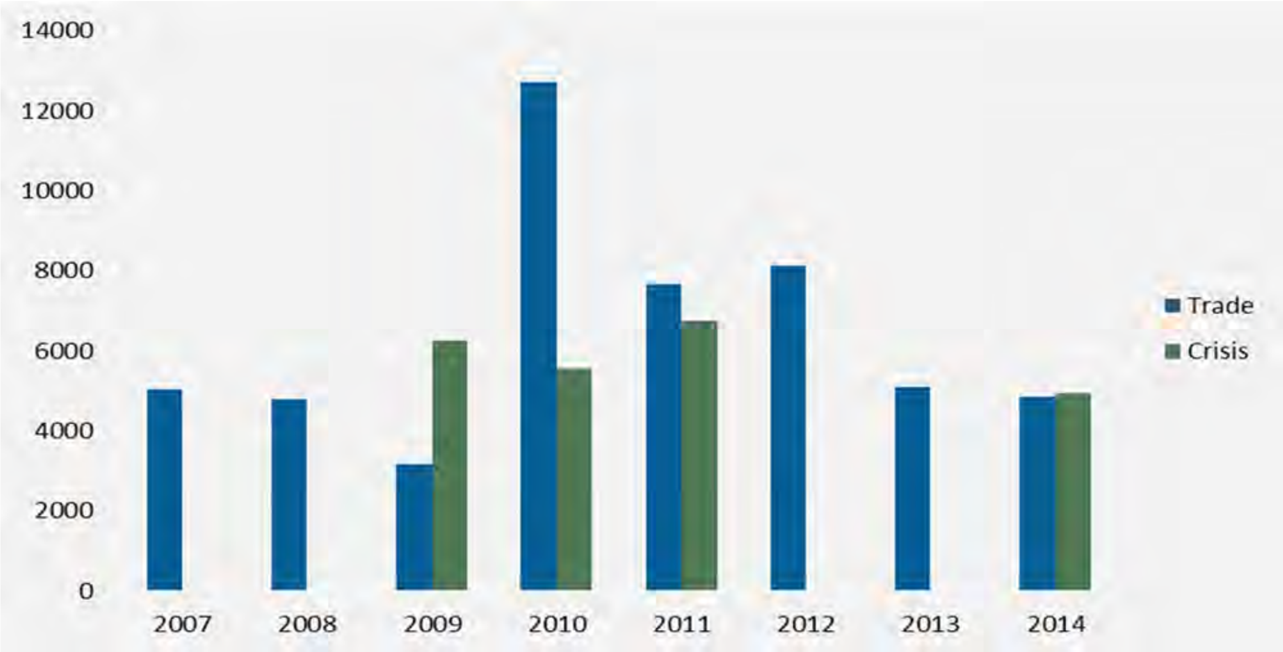
[10] At the time of writing of this paper the Commission has notified the reception of 6 applications made in 2017 (EGF 2017/003, 2017/004, 2017/005, 2017/006, 2017/007 and 2017/008). These applications are still under analysis and therefore are excluded from our study.

[11] In addition to the 20 applications, there is one application submitted by Galicia on the 19th July 2017. This application is still under consideration. Of these applications, 13 were made under Article 2(c) Regulation (EC) No 1927/2006 and 8 were later submitted under Article 4(2) Regulation (EU) 1309/2013.

[12] From Eastern Europe only the Czech Republic, Poland, Romania, Lithuania and Slovenia have participated to the EGF programme. We take as Western Europe countries: Spain, Netherlands, Italy, Belgium, Finland, Denmark, Ireland, Germany, Greece, France, Austria, Sweden, Portugal and Malta.

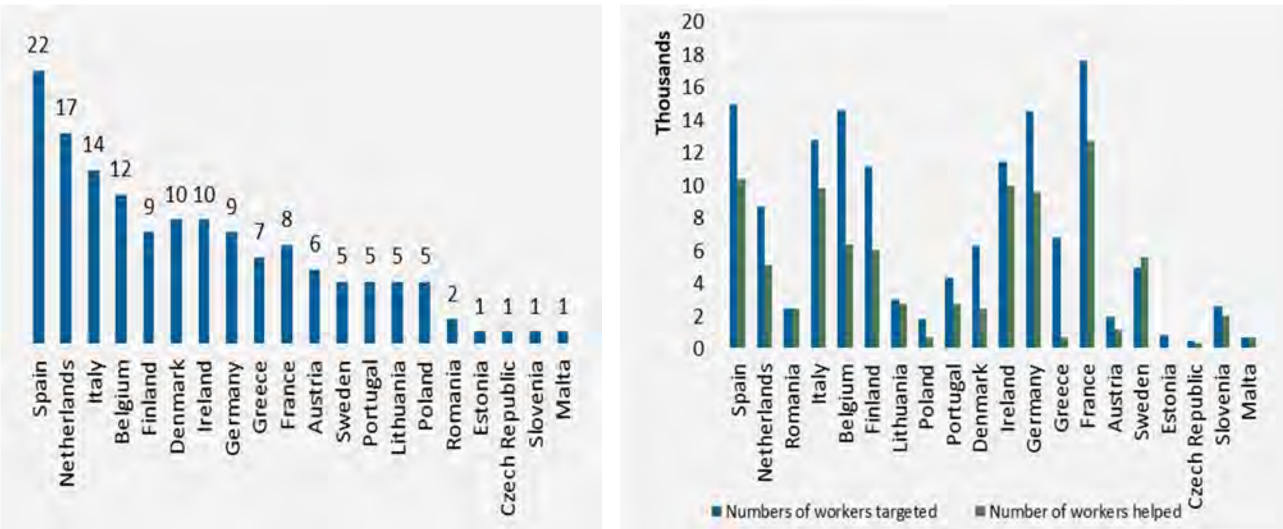
10 years. From 2007-2017, out of 150 applications 115 applications were related to manufacturing, a sector that had a 10% reduction in employment over the last 10 years, while the construction sector, which registered a 20% reduction in employment during the same period, accounted for an additional 9 applications.

Figure 2. Average expenditure per beneficiary (€), by year and type of application



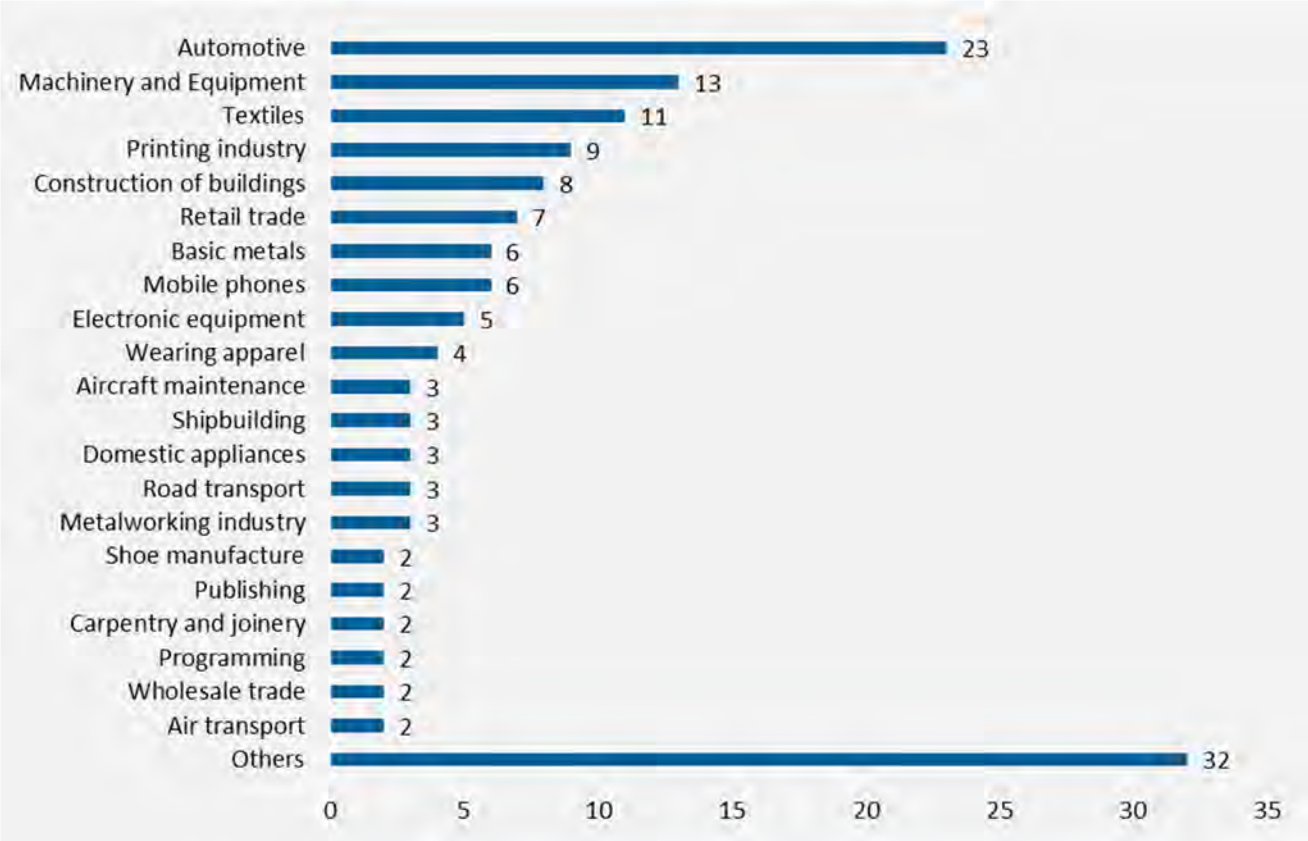
Source: European Commission.

Figure 3. EGF cases and number of workers targeted 2007-2017, by Member-State



Source: European Commission.

Figure 4. EGF Applications by NACE 2 sector and sub-sector

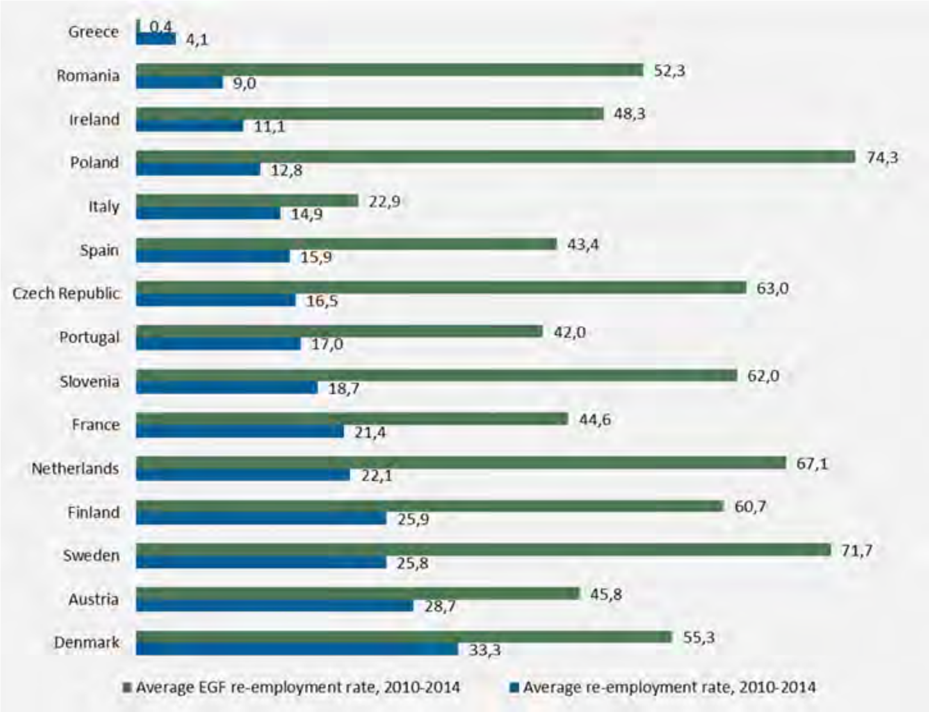


Source: European Commission.

The profile composition of targeted workers is as follows. The gender profile is predominantly male (70% on average), which is slightly higher than the EU average worker (54% in 2016). This is reasonable given the sectors of the cases receiving EGF support. In terms of age, the large majority of targeted workers are aged from 25 to 54 (75%). Workers over 54 are also a significant category (19% on average). This profile is in line with the average EU worker. In terms of educational attainment, on average, 36% of targeted workers have primary or lower secondary level of education and 35% of targeted workers have completed upper secondary education. Compared to EU averages, workers targeted by the EGF-financed programmes are less educated, which is also understandable given the sectors of activity most covered by EGF.

In terms of results, the average re-employment rate after EGF-financed programmes is 49% over all cases for which the data is available. However, it is important to note the great variability across cases, with re-employment rates ranging from 4% to 86%. Compared to the general population, re-employment rates for workers who have benefited from an EGF programme largely exceed the general population average re-employment rates for all countries except in Greece (see Figure 5). Nevertheless, these numbers are not directly comparable because the characteristics of the average worker and of the workers who benefited from EGF differ largely, which should impact their “intrinsic” employability (for instance EGF-financed programme recipients are, on average, older and less educated than average which could make them less re-employable, but work in large companies where they might have acquired relevant skills that can increase their employability). It is thus difficult to attribute the higher re-employment rate to the EGF programmes only.

Figure 5. Transition from unemployment to employment as % of unemployed compared with EGF re-employment rate, 2010-2014 (%)



Source: European Commission, Labour Force Survey (Eurostat). Data is shown for countries where available.

Concerning the length of the procedure, Figure 6 shows that, on average, between the first layoffs of workers and the contribution being granted it takes over a year for Member States to receive funding for EGF-financed programmes.

Figure 6. Average time elapsed between final submission of application, approval and contribution granted (days)

Source: European Commission.

3. Evaluation of the EGF

Overall, the original idea behind the EGF - i.e. to correct the negative side-effects of globalisation by incentivising EU member states to put in place or improve active labour market policies to deal with trade adjustment - was certainly valid in principle since globalisation creates not only gainers but also losers.

In practice, the EGF instrument appears to have been useful and sufficiently flexible to handle very different cases in different countries and sectors, allowing Member States to provide assistance services to displaced workers that they may not have provided otherwise. Unfortunately, a rigorous scientific evaluation of the EGF is not possible at the moment because the data available on the beneficiaries of the EGF programme is not sufficiently detailed. Most of the available data refers to applications for assistance rather than to assistance that was actually granted. The difference between applications and actual assistance granted is typically quite important as close to 6 months may have elapsed between the two periods. As a result, this means that a number of workers covered by the original application may have since found jobs by the time the assistance is actually provided. Therefore, the profile of the original set of workers would typically differ from the profile of those workers who eventually received the assistance. Nonetheless, the fact that the reemployment rate of covered workers (compared to the reemployment of unemployed workers in general) appears to be significantly high is an encouraging element for the potential usefulness of the EGF programme.

Although the EGF appears to be useful at the micro level (for workers covered by applications to the EGF programme), the essential problem is that it reaches a very small number of workers and involves very small amounts of financing. It is therefore fairly irrelevant from a macro perspective to solve the problem it is supposed to solve of correcting the side effects of globalisation.

Compared to the EU budget or the ESF budget line, the EGF financing is insignificant. Even if the whole € 150 million per year were spent it would only represent 1.25% of the ESF budget and 0.1% of the EU budget. Compared to its US equivalent, the Trade Adjustment Assistance (TAA) Programme which had a budget of about $720 million per year on average from 2010 to 2016, its budget is also insignificant (even though the numbers are not easily comparable given that the TAA also include extended income support for redundant workers).

The limited scope of the EGF is even more glaring if one compares the number of workers assisted by the programme to the number of EU workers who might have lost their jobs because of globalisation. This number is not available and is difficult to estimate. However, a rough back of the envelope calculation could be done as follows. Some studies suggest that 5% of job separations in the EU take place because of globalisation[13], which would mean that there are roughly 180 000 job losses per year as a result of globalisation. This compares with 14 000 new workers who have been helped by the EGF programme on average each year during the period from 2007 to 2016.

Besides the fact that the amount of money potentially available for the EGF programme is fairly small, potential reasons for its underutilisation are as follows:

- Eligibility criteria may be too strict: the minimum threshold for the number of workers affected may be too high, especially for small countries and those where SMEs are the main employers.
- Insufficient visibility of the EGF and low awareness by the general public and public authorities.

[13] See Autor et al (2013) or Cernat and Mustilli (2017) who find numbers of that magnitude for the US and Europe in recent years.

- Administrative complexity leading to lengthy procedures and excessively long time for approval of eligible applications.

4. Recommendations to improve the EGF

We agree that it was important for Europe to create the EGF instrument and thereby to assume some financial responsibility for assisting workers displaced by trade liberalisation, since EU trade policy is an exclusive EU competence. We also agree with the overall philosophy of the EGF programme, which is to help improve active labour market measures by national authorities to assist displaced workers rather than provide unemployment benefits. Despite the lack of appropriate data to conduct a thorough analysis of the programme, we found some evidence that the EGF programme has been useful in meeting its objective. We were also particularly struck by the fact that more than 50 percent of the cases that benefitted from EGF assistance and more than 50 percent of the money spent concerned workers made redundant by the economic and financial crisis, rather than by globalisation per se. This suggests that there are important administrative constraints in the operation of the programme and that these constraints were partly lifted during the crisis.

We make three recommendations for improving the EGF programme in the perspective of the next MFF:

1. There is a need to improve the monitoring and evaluation of the programme by collecting more and better data. The present situation is clearly unsatisfactory.
2. There is a need to revise the administration of the programme. There are too many constraints on eligibility. One should envisage having no threshold or at least a much lower threshold than at the moment. Obviously, this would imply that the amount of money available for the programme would increase significantly[14], but it would also mean greater equity in the allocation of funds between workers who work in large establishments and who tend to be eligible and those working in relatively small companies and who tend to be excluded.
3. Finally, one should consider enlarging the scope of assistance for adjustment from globalisation to other sources of adjustment, including intra-EU offshoring, technological change (which might become an even more relevant problem for some workers than globalisation in the future[15]) and the phasing out of activities in order to reduce carbon emissions. The EGF could therefore become the EAF, the European Adjustment Fund, with expanded resources. Ideally these resources should be budgeted in the MFF by the creation of a specific budget line (which would also have to advantage to speed up the procedure). The additional resources for the EAF should come from the budget currently allocated to the European Social Fund.

[14] Coming back to our back-of-the-envelope calculation, if all 180 000 workers affected by globalisation were covered, this would represent a total budget for EGF-financed programmes of 1 billion euro per year (assuming expenditure equal to the average amount spent in the period 2007-16, i.e. 5600€/beneficiary).

[15] See for instance Acemoglu and Restrepo (2017) or Dauth et al (2017) for an estimation of the number of jobs affected by recent technological change in the US and in Germany.

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Do Poor Institutions Create More Losers from Globalisation?

Christopher A. Hartwell, President, CASE – Center for Social and Economic Research, Warsaw

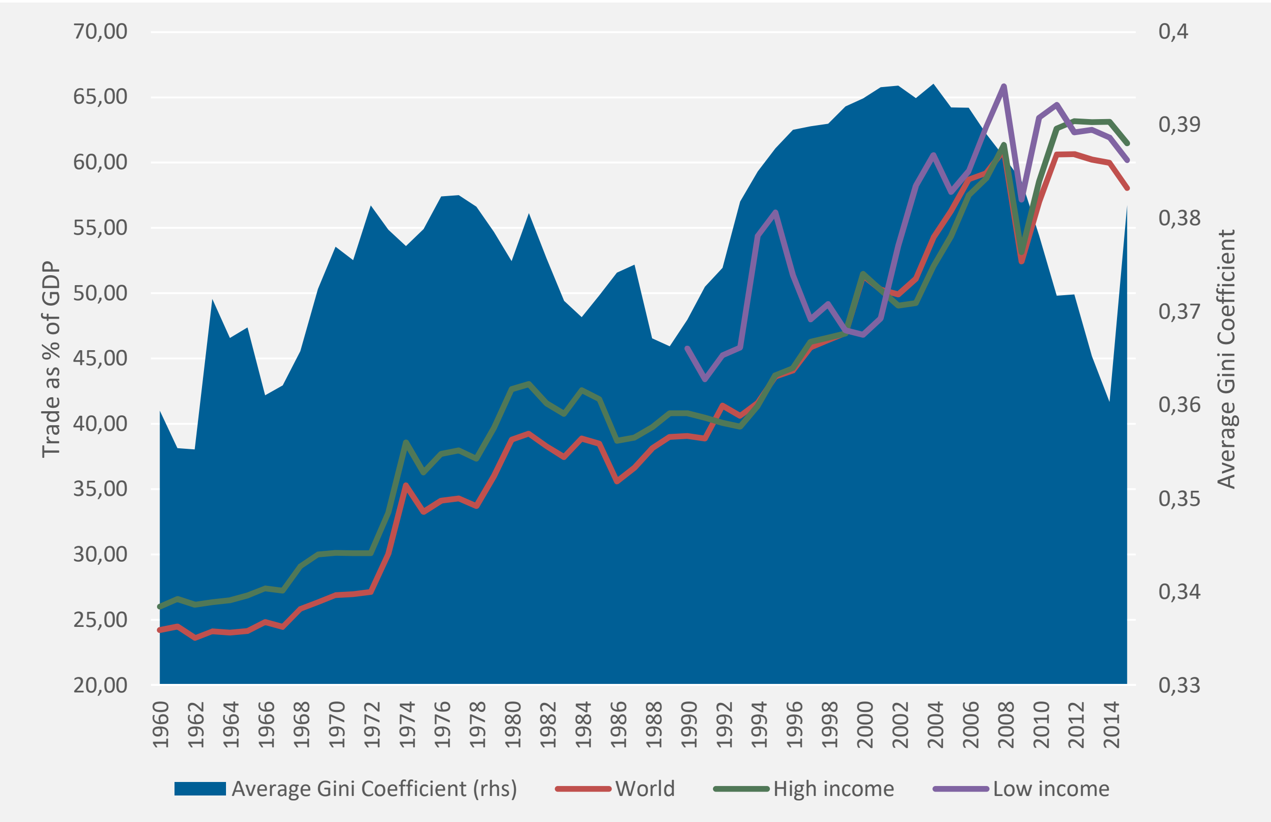
Executive summary

This paper studies the conditions under which extra "losers" are generated during the process of liberalisation via an examination of the role of institutions in economic transition. The hypothesis of this work is that poor institutions can create unnecessary hardship in the transition to greater openness, generating a much higher burden on compensatory policies and making it more difficult to sustain open trade policies. Using a new dataset of trade openness, economic inequality, and institutions, and using 3SLS estimation to account for endogeneity, the analysis finds that this is indeed the case: good institutions mitigate trade-related inequality, with the interaction of globalisation, high property rights, and high levels of democracy performing the best. However, the results are highly sensitive to the choice of property rights indicator, which can alter the effects of democracy. The implications of this work are that basic institutions, especially ones that are effective in their implementation, can help to minimize losses sparked by globalisation, while well-meaning but misguided policies can actually increase the disruption of an economy.

1. Introduction

One of the least-controversial statements in the economics literature is that international trade is beneficial for raising the standards of living of an entire economy. The evidence for this assertion is plentiful, both on an empirical and a moral level, but perhaps the greatest argument for it has been the global trend towards trade openness (Figure 1); if trade is a *prima facie* bad thing, why has most of the world moved in the direction of trade liberalisation over the past forty years? And this trend has not been driven by the richest countries only, as in the 2000s, low-income countries have outpaced the world and high-income averages for trade as a percentage of GDP.

Figure 1. Trade as a % of GDP in the World and High/Low Income Countries



Source: World Development Indicators and Author's Calculations from Solt (2016).

However, the arguments begin (as they tend to do in economics) once one goes deeper than the aggregated country-level unit, as the process of trade liberalisation is also widely acknowledged to create "winners" and "losers." Indeed, the forces which are responsible for the gains of trade - increased competition, reallocation of capital and labour, shifts according to comparative advantage – are precisely those which can cause dislocation and hardship for segments of the population. This has manifested itself in rising Gini coefficients during periods of trade expansion, as shown from approximately 1990 to the start of the global financial crisis in Figure 1.

With freedom to trade regarded as a human right as well as a means to enrich a country, governments have attempted to balance the dispersed gains and concentrated losses of trade liberalisation through various strategies. In particular, to mitigate the political economy effects of the disruption that comes from trade liberalisation, at global level governments have devised schemes to compensate the "losers" via policies funded by the "winners." These programs have ranged from the narrowly-targeted, including trade adjustment assistance and/or employment retraining, to the very broad and somewhat clumsy, including employment protection legislation or tax policy. But no matter which approach is chosen, the overarching goal of such policies is to at least keep a political coalition intact in favour of freer trade and to avoid reform reversals.

Unfortunately, it is entirely possible that compensatory policies may be less effective in convincing the populace of trade's value if the number of losers reaches a substantial portion of the population or some unknown critical mass. In this vein, it may be doubly difficult for compensatory policies to hold together a pro-trade coalition if the country's economic structure itself is contributing to the generation of "losers," creating a pool of losers from trade larger than it needs to be. In other words, if distortions present in an economy generate an artificially large number of losers compared to an economy absent such distortions, fiscal policies could be strained or, in the worst case, unable to cope with the compensation process. Moreover, an economy that generates too many losers from trade will find itself under constant political pressure to reverse its liberalisation, denying the human right of freedom to trade because of distributional effects which could have plausibly been avoided. In this case, even more distortions will be introduced into the country's institutional system, leading to worse economic outcomes.

The purpose of this paper is to study the conditions under which extra "losers" are generated during the process of liberalisation through an examination of the role of institutions in economic transition. The working hypothesis of the research is that poor institutions can create unnecessary hardship in the transition to greater openness, generating a much higher burden on compensatory policies and making it more difficult to sustain open trade policies. Of course, not all institutions have the same effect on individuals facing globalisation: while political institutions (executive constraints, proportional representation) may be concerned with the way in which the spoils of an economy are distributed, poor economic institutions (property rights first and foremost) are more likely to be the culprit for prolonged hardship generated by liberalisation. This is due mainly to the explicit objectives of economic institutions, i.e. the mediation of economic outcomes and oversight of resource reallocation (Hartwell 2013). If economic institutions are dysfunctional in some way, they are then likely to hinder the mobility necessary to emerge from trade-induced dislocation, generating inequalities via institutional hysteresis.

Earlier research has noted the reality of the complex interdependencies between trade, institutions, and inequality, with papers highlighting different facets of the relationship. In the first instance, there is a rich literature on the role of trade in creating losers more generally (Dutt and Mukhopadhyay 2005), with a long history of theory on trade's effects on certain segments of the population (Stolper and Samuelson 1941). In a more political economy vein, and building on Stolper-Samuleson, Mayda and Rodrink (2005) explore how support for trade breaks along the lines of winners and losers. Shifting to institutional influences, seminal work from Acemoglu *et al.* (2005) details how trade influenced institutional development in the 16th through the 19th centuries; on a similar note, other research has documented how good institutions contribute to trade openness itself, creating a virtuous circle (Greif 1993, Dollar and Kraay 2003).

Bringing together these disparate threads is the goal of the examination here and, based on a reading of the literature, this paper is the first attempt to link institutions and losers from globalisation in an explicit manner. If institutions can increase trade, and if trade influences institutions, and if trade may create inequality, then how do pre-existing “good” institutions influence trade-generated inequality? Would “good” institutions decrease the number of losers and thus increase political support for continued trade liberalisation? Or are institutions merely exerting their effects via the trade channel?

The results of the analysis below confirm that poor institutions create a missing link between trade openness (and opening) and the generation of “losers,” especially in the realm of income inequality. Using three-stage least squares (3SLS) techniques on a new dataset of trade, inequality, and institutions, the analysis shows that good institutions do indeed mitigate losses from trade, lowering inequality in the presence of trade liberalisation. This effect is statistically and economically significant and robust to a number of sensitivity analyses. Clearly then, the converse is true: bad institutions do create more losers from globalisation than are necessary.

The rest of the paper proceeds as follows. The next section discusses the previous literature and focuses on the oft-quoted but little-debated definition of “losers” from globalisation, using this derivation to set up the identification strategy. Section 3 builds on this previous research to set up the empirical strategy, while Section 4 is devoted to a discussion of the results and sensitivity analyses. Section 5 offers some concluding thoughts and derives policy recommendations going forward.

2. Literature Review and Theoretical Basis

Who is a "Loser?"

The consensus on trade generating "winners" and "losers" often runs into a key obstacle in measuring this effect, and that is precisely defining what makes a "loser." O'Brien and Leichenko (2003) call attention to this fact, noting that the terms "winners" and "losers" have both political and economic meanings to the term. Indeed, given how trade reforms are usually introduced as part of a broad package of liberalisation (Falvey *et al.* 2012), it is often difficult to disentangle specific trade-related effects on certain segments of a country's workforce. But even if one could entirely isolate the effects of (greater) trade opening on a national economy, there is still little guidance on how to clearly separate the losers from the winners.

The extant literature has coalesced around several metrics to define "losers," based mainly on class, income level, and/or source of income. The most common definitions of losers focus on the effects of trade across income distributions, concentrating either on the very poor of a society (Harrison *et al.* 2003) or on the relative status of some countries in relation to others (Bouët *et al.* 2007). The theory behind this supposed effect encompasses several facets, including the fact that the poorest segments of society are often located in the informal economy and thus are not poised to reap the gains from globalisation (or, alternately, are more exposed to shocks). Another possible channel by which trade could harm the poor involves threatening livelihoods, as poorer workers are generally lower-skilled and unable to compete in a more modern or advanced economy. Ravallion (2006) also notes that trade may not explicitly harm the poor, but given that most of the gains of trade are captured by the non-poor, income gaps may widen and attenuate poverty. Finally, removal of trade taxes may threaten government revenue, causing a cutback in state aid to the poor (Bannister and Thugge 2001).

Despite the intuitive nature of these explanations, the empirical evidence is less uniform on the effects of trade on the poorest, meaning that one cannot simply equate "poor" with "losers from trade." In one of the largest surveys of globalisation-related inequality, Milanovic (2013) finds that the losers from globalisation are those between the 75th and the 90th percentile in income globally, whose incomes grew much more slowly than other percentiles. Interestingly, however, Milanovic also shows that the poorest 5% benefitted much more than those in the 75th to 90th percentiles, meaning that the poorest segments of society were aided by trade. This effect has been echoed by several other studies, which confirm that the poor are also amongst those most aided by trade liberalisation, due to greater consumer choice and lower prices. Empirical evidence from Dollar and Kraay (2004) demonstrates that, on average, there is a great diversity of winners and losers amongst the poor and there is no systematic or automatic loss among the poorest of society due to globalisation, a finding also confirmed by Ravallion (2006). As Topalova (2010) also showed, other factors beyond mere income levels, including institutional arrangements and labour mobility, mattered much more in determining losers in India's trade liberalisation in the early 1990s.

This scenario means that a more precise definition of losers must be sought. Rather than concentrating solely on income levels, the trade literature has instead focused on skill levels (which tend to be correlated with but that do not exclusively overlap with income levels). Davidson and Matusz (2006) are typical of this literature, identifying two groups of losers from liberalisation: "stayers"who are stuck in the low-tech sector and "movers" who go through costly training to switch from the low- to the high-tech sector. However, even here there are anomalies. Rudra (2005) shows that effects of globalisation on workers are conditional on a country's level of development; in particular, workers in high-income countries, while nominally lower-skilled, may have greater bargaining power than low-skilled workers in low-income countries. This theory is supported by the famous work from Lawrence and Slaughter (1993), which found no effect of trade openness on wage levels in the United States. Similarly, Manasse and Turrini (2001) show that trade can actually be beneficial for the lowest-skilled if trade can introduce skill-complementary technology (instead of substitute technology). Barraud and Calfat (2008) also show that sectoral effects are less pronounced under trade liberalisation, as Argentina's globalisation alleviated poverty most markedly in the non-tradables sector.

While the disruptions from trade may be necessarily concentrated in manufacturing and lower-skilled industries due to the ease of movement of goods across borders (and the relatively harder road to trade in services, due to cultural, linguistic, and other "local knowledge" factors), that does not mean that there may not be "losers" in other socio-economic strata. Graham (2001) points out that those who see themselves as losers are not necessarily poor, but rather newly vulnerable members of the middle class who perceive that gains from market reforms have gone disproportionately to the top of the income distribution. Similarly, Kriesi *et al.* (2006) note that individuals who have a strong sense of identity with their national community are also likely to perceive themselves as losers under globalisation, due to the process of "de-nationalisation" which accompanies trade liberalisation.

Given these various issues regarding the understanding of who is a "loser" from globalisation, perhaps the simplest way to encompass all of the various facets of economic loss is to look at the broader idea of within-country income inequality (Bergh and Nilsson 2008). Using this as a rough proxy for overall trade-related losses has many benefits: in the first instance, workers or industries disadvantaged by globalisation will fall behind in wage earnings or profits, creating a widening gap with those who have successfully taken advantage of globalisation. Looking at within-country inequality also may mitigate issues discovered with cross-country analyses, mainly that the development level of an economy matters for determining the impact of trade. By using within-country inequality, the country's benchmark is not against an idealised representative worker, but rather against the country's own income distribution historically. Moreover, as inequality is a relative setting, its use as a metric for losers may also capture the alternative definitions mooted above, including economic insecurity from the middle class. Finally, while there are numerous sources of income inequality, many of these may be controlled for in an econometric setting, leaving much of any widening gap attributable directly to trade. In other words, while all of the channels in which trade may create losers may be visible, the output variable of income inequality after the fact can be observed; by controlling for the other sources of inequality, the residual from this examination could thus plausibly be attributed to globalisation.

How Do Institutions Affect the Number of Losers?

Having chosen a broad metric to understand the "losers" from globalisation, the next step is to understand the theory behind how institutions and trade could interact to mitigate or exacerbate trade-related inequality. Recent work seems to provide evidence for the fact that trade openness *ceteris paribus* increases inequality, albeit not in a linear fashion. In particular, Rojas-Vallejos and Turnovsky (2017) show how tariff reductions can increase short-term inequality, while admitting that the increase in demand and economic activity can offset such losses for the poorest sectors of society in the longer run. In a similar vein but introducing the issue of reverse causality, Katsimi and Moutos (2010) also show a U-shaped relationship between inequality and tariffs, with low levels of inequality associated with higher tariff rates which then decline and eventually rebound; the highest levels of inequality are then associated with the highest tariff rates. The authors note that this is likely a form of redistribution, but it is also plausible that high levels of protectionism are a cause of inequality, rather than a response to it.

Given the reality that losers are indeed created by globalisation, this paper is fashioned around two separate hypotheses, derived from the previous literature and focused on the role of institutions in this relationship. The first hypothesis is:

H1: Countries with poor institutions create more losers from trade than those with good institutions

As noted, a wealth of literature exists relating trade and inequality but a comparatively smaller literature has modelled either the effect of institutions on inequality or the effects of trade on institutions (and vice versa). What research does exist, however, shows a connection between poor institutional quality and inequality globally (Chong and Calderon 2000; Chong and Gradstein 2007; Lin and Fu 2016) while also accounting for the disruptive nature of trade liberalisation. Globalisation can properly be thought of as a process, a temporary event which can reorient an economy's structure but with effects that are often permanent. The challenge in adapting to this longer-term structural disruption comes down to a country's incentive structure; with proper incentives, the disruption occasioned by globalisation can become an opportunity, allowing for resources to shift and adjust to take advantage of the new competitive environment. Where incentives are flawed or blocked in some way, the adjustment is likely to take a much longer time (if at all), leading to unnecessary deadweight losses across an economy.

Institutions enter into this theoretical relationship due to the fact that they are creators, enforcers, and guarantors of various incentive structures in society. Writ large, institutions can then be said to mediate returns to factors of production precisely via the power they exert on incentives, altering relative prices through information dispersion or negatively via transaction costs or cultural and organisational barriers. In fact, if an institution does not perform well at guaranteeing a growth-friendly incentive structure or if the institution is designed explicitly to create barriers (such as in rigid labour markets), institutions can retard the gains from trade (Kapstein 2000). With the gains from trade vitiated, not only do the costs from trade remain but they are often increased, meaning that poorly-functioning institutions not only reduce the number of winners but increase the number of losers.

As already hinted at, "institutions" are not an amorphous lump and, in reality, are highly differentiated by function and form (Hartwell 2013). With regard to the link between institutions and inequality in the presence of globalisation, the most prominent institutional mechanism that has been surveyed is the labour market, including employment protection legislation (EPL), unionisation, minimum wages, and the like. The theoretical link between rigid labour market institutions and inequality is ambiguous: on the one hand, minimum wages and employment protection are meant to mitigate against poverty, providing assistance for lower-skilled professions, thus ensuring employment and lessen income gaps. On the other hand, there is ample theoretical and empirical evidence that such institutions could exacerbate inequality, with minimum wages and unions advantaging insiders to the detriment of outsiders, and EPL could reduce job turnover and labour mobility, trapping individuals in lower-paying positions (as Topalova [2010] notes in the case of India). Jaumotte and Buitron (2015) provide evidence for both sides of this coin, noting that eroding minimum wages can lead to higher inequality, while large-scale collective bargaining increases unemployment and thus inequality.

While labour market institutions are the most obvious link to inequality outcomes, there is a strong case to be made for other institutions having a powerful effect on creating or mitigating losses in society. In particular, property rights, embodied in contracting institutions and the protection of the right of ownership, should theoretically have a mitigating influence on income inequality. Chong and Gradstein (2007) lay out a straightforward case for the relationship, noting that contract enforcement, as embodied by an independent judiciary, allows for the poor to extract rents as well as for the rich. When those rights are missing, rich and particularly powerful elites may expropriate assets from the poor and/or refuse the poor access to the economic system. Similarly, following along the lines of de Soto's (2000) thesis, a lack of property rights may mean that potential assets held by the poor cannot be translated into tangible capital or collateral; thus, income mobility is restricted and inequality widens. There is also a strong feedback effect from inequality to property rights, meaning that inequality can also decrease property rights as elites attempt to cling to their spoils (Glaeser *et al.* 2003, Sonin 2003).

Finally, democratic institutions should also have an impact on income inequality. Part of the way in which democracy would impact inequality is through the choice of labour market institutions, as noted above, but it may also be reflected in fiscal policies, as polities could choose to create programs targeted precisely at compensating the losers (Perotti 1996). Such an approach could quell social tensions while also creating credible commitment for continued redistribution in the future (Acemoglu and Robinson 2000), a fact which would track with the ongoing process of globalisation and perhaps mitigate its effects. Empirical evidence for the effects of democracy are mixed, with Simpson (1990), working before the great wave of globalisation of the 90s, who found that there was also a U-shaped relationship between democracy and inequality: higher levels of democracy corresponded with low inequality, but medium levels of democracy exacerbated it. Other studies, such as Rodrik (1998), show a stronger and linear association between democracy and lessened inequality, while other work advances the idea that inequality may actually be lower in authoritarian regimes (Gradstein and Milanovic 2004). Turning to the idea of democracy in the presence of economic openness, however, Reuveny and Li (2003) clearly show that democracy and economic openness both reduce income inequality over a sample of 69 countries.[1] This result is in line with what is expected by theory and is also part of this supposition.

H2: Countries with more losers from trade have slower trade liberalisation progress

As noted above, the effects of poor institutions are not static unfortunately, and can create a vicious cycle, where increased inequality feeds back into institutional deterioration (Savoia *et al.* 2010). If already-poor institutions are allowed to decline further, it can be expected that inequality in a country would also continue to worsen (along with other economic indicators, as in the case of Venezuela today), creating even more losers (Gradstein 2008). The pressure on institutions could result in a prolonged underdevelopment trap alleviated only by radical institutional reform or economic crisis (or, in many cases, both).

The first set of institutions likely to suffer from increased inequality are political ones, such as democracy or the rule of law. Chong and Gradstein (2007) demonstrate empirically the feedback effects between institutions and inequality, and show that inequality is directly tied to poorer-quality political institutions. Similarly, Licht *et al.* (2007) note that economic inequality (as measured by Gini coefficients) predicts both the rule of law and democratic accountability, with higher levels of inequality associated with a lower rule of law. Seen from a political economy vantage point, this result is not surprising, as one would assume that high pre-existing levels of inequality would persist mainly due to political barriers to entry. To express it another way, inequality remains or even widens due to increasing restrictions placed on the political system, with insiders colluding to keep outsides on the outside. In this manner, already-poor institutions are frozen in place or deteriorate in a way that is beneficial to those at the top of the income ladder.

While the effect of inequality may be most pronounced in political institutions, there is also evidence that economic institutions can also be degraded from prolonged inequality. Keefer and Knack (2002) note that

[1] Despite this result, Reuveny and Li do not include an interaction term for openness and democracy, as is done here.

social polarisation is bad for property rights, showing that inequality leads to a more interventionist government with short time-horizons, willing to expropriate in period 1 for increased revenues with no thought as to the consequences in period 2 (a similar argument, noting that less inequality leads to stronger rights, is made by Gradstein [2007]). Likewise, in countries with a highly stratified income distribution, broader property rights may be opposed by richer elements of society who have invested in their own private rights, a situation that is found in many transition countries of the former Soviet Union (Sonin 2003). In this scenario, politically-earned inequality (a common source of inequality across the globe) creates its own further barriers to entry in the form of weak property rights, ossifying the status quo and reducing income mobility.

This second hypothesis thus takes into account these facts and extends the reasoning further to note that trade itself, a type of economic institution, will likely suffer from inequality. In other terms, if trade may create inequalities, and poor institutions create even more inequality, and inequality creates poor institutions, economic inequality can plausibly be expected to harm further moves towards globalisation. In this sense, one would expect to see significant feedback effects not only from institutions and inequality, as in Chong and Gradstein (2007), but also from inequality to trade.

3. Methodology and Data

In order to examine the relationships between inequality, openness, and institutions, the identification strategy follows from the theory described above, taking into account the high level of endogeneity inherent in the trade/institutions/inequality nexus. In particular, as noted in the previous section, trade shapes institutions (Martin and Steiner 2016), and inequality also shapes institutions, while at the same time institutions influence inequality and vitiate the benefits of trade. To model these effects econometrically, the analysis uses a theoretically-motivated simultaneous equations system based on a three-stage least squares (3SLS estimator) similar to Mustafa *et al.* (2017); the three simultaneous equations utilised are derived from the literature on the determinants of the respective dependent variable, shown below:

- *Inequality*:

As already noted, the main research question of this paper is to tie in trade and institutions to inequality, a task helped by the recent explosion in inequality-related research (as shown in Section III). Building off of this literature review and the large number of significant covariates noted above, the headline equation for inequality is structured as:

$$(1)\quad INEQ_{it} = \alpha TRADE_{it} + \beta INSTITUTIONS_{it} + \gamma TRADE * INSTITUTIONS_{it} + \delta X'_{it} + \mu_t + \epsilon_{it}$$

Where INEQ is income inequality, TRADE is the standard measure of trade openness (exports plus imports as a percentage of GDP), INSTITUTIONS are proxies for specific institutions, TRADE*INSTITUTIONS is an interaction term between the two, *X'* is a vector of controls, μ_t are country-specific effects, and ϵ is an error term specific to each country-year pair.

A key issue will of course be how one measures the dependent variable for "inequality" in Equation 1, and for this examination several metrics are used. The first and most expansive one is derived from Solt (2016), who provides the largest and most complete estimates of Gini Indexes available today. This approach allows for a calculation of within-country income inequality, an indicator which hopefully will capture the proportion of winners and losers after globalisation. Underscoring the uncertainty which comes with obtaining a precise estimate of the Gini coefficient, Solt offers a hundred variables per country-year pair; to simplify the calculations done here, the estimates are averaged to obtain one Gini coefficient per country per year (where available).

In addition, between-country inequality may also proxy for those "left behind" by globalisation, as the increased proportion of losers may actually subsume the winners and manifest itself in lower growth. As in many other papers (and first explored in Sala-i-Martin 1996), the framework of sigma convergence is used to measure between-country inequality, constructing a dispersion metric equal to the standard deviation of a country's log per capita GDP versus all other countries in that year. As Li *et al.* (1998) note, much of variation in inequality does not actually occur within-country, but across countries; in this sense, seeing aggregate losses from trade may be a better metric to understand the role of globalisation and institutions.

The headline equation of inequality shown above also contains the key variable of interest, an interaction term between trade openness and institutions. This variable, in addition to the level effects of trade openness and institutions in isolation on inequality, is intended to capture the relationship between inequality and trade in the presence of good/poor institutional structures (Hypothesis 1 above).

Finishing off the empirical exercise for this equation will be a series of control variables, derived from the literature and following closely in line with Dabla-Norris *et al.* (2015) and Jaumotte and Buitron (2015). To avoid potentially serious misspecification and overidentification errors, the control set is kept parsimonious, but includes: measures of national income (GDP per capita, at its levels and squared, to capture Kuznets-type effects as shown in *inter alia* De Gregorio and Lee 2012); labour market institutions (proxied here by the national unemployment rate); democracy (on the theory that inequality is tolerated less in a democracy, measured here by the ICRG indicator for democratic accountability); government spending (to capture transfer payments and the social safety net); resource endowments (rents as percent of GDP, to capture Dutch Disease and politically-created rents); female mortality (as a proxy for gender inequality); and human capital (proxied by both the initial level of secondary enrolment and the "Human Capital Index" from the World Economic Forum).

- *Institutions*

The second equation of note here determines the forces driving the levels of institutional efficiency in a country, in particular the levels of property rights and democratic accountability. While there is a large literature on the effects of institutions on trade, inequality, and other metrics (notably growth), there are however small clues as to the determinants of institutional levels over a shorter time-span than millennia. Mijiyawa (2013) has laid out an impressive first attempt to understand the determinants of property rights, modelling rights according to several schools of thought, derived from theoretical pieces stretching back hundreds of years. Similarly, Barro (1999) was one of the first economic examinations of the determinants of democracy, finding several similarities to Mijiyawa's analysis in the linkages between development, human capital, and institutions.

Of direct relevance for this research question, Mijiyawa (2013) also notes a strong and significant negative relationship between property rights and a country's Gini coefficient, likely accounting for the use of political (rather than market) power to acquire property, institutionalizing inequality to those not politically-connected. Similarly, in relation to democracy, it is possible that inequality also harms democratic accountability, as the elite seek to stifle access to political levers in order to keep economic power for themselves (Venezuela and Russia are excellent examples of this trend in recent years). In this sense, economic inequality may perpetuate political inequality, as the rule-makers write regulations and pass laws in order to limit political competition (in a classic example of cartel behaviour). Moreover, specific economic policies may also be undertaken in order to stifle political competition, such as loose monetary policies (favouring those first in line to receive cash), while strong property rights may mitigate against deterioration of democracy.

Given this theoretical backing, the equation relating institutions to their determinants is thus:

$$(2)\quad INSTITUTIONS_{it} = \alpha TRADE_{it} + \beta INEQ_{it} + \rho Y'_{it} + \mu_t + \epsilon_{it}$$

Where *INSTITUTIONS* is the institution in question (property rights or democracy), *TRADE* and *INEQ* are as shown in Equation 1 above and *Y'* is a vector of controls. Property rights are measured in this analysis by two separate measures, one objective and one subjective: the objective indicator is contract-intensive money (CIM), introduced by Clague *et al.* (1999) and representing the proportion of money held inside the formal banking sector, while the subjective indicator is the ICRG's measure of investor protection (measuring the risk of expropriation). Each measure has some gaps in its coverage (for CIM the gaps relate to years, while for the ICRG indicator not all countries are covered), but together they help to form a complete picture of property rights. Completing the specification, the controls for the property rights specification are derived from Mijiyawa (2013), and include natural resource rents, latitude, level of democracy, population size, financial market development, labour market efficiency (proxied by the unemployment rate), initial GDP per capita, initial levels of education, and dummies for legal origin (from the database devised by La Porta *et al.* [2008]).

By contrast, democracy is measured by the ICRG measure of democratic accountability, coded from 1 to 6 with higher numbers representing more democracy. For this set of controls, as Mijiyawa (2013) and Hartwell (2014) note, GDP growth, the presence of strong property rights, financial market development, inflation (as a proxy for monetary policy), legal origin, and initial levels of education (as a proxy for demand for democracy) may all correlate with levels of democracy. Thus, they are included here.

- *Trade openness*

The final relationship in the series of equations shown here examines the determinants of trade liberalisation (globalisation) itself. Similar to the equation on institutions, there is also a dearth of research in the extant literature on this topic; although gravity equations remain the workhorse of international trade modelling on a bilateral basis, there is less work on the determinants of aggregate trade flows or a country's overall trade stance. Guttman and Richards (2006) are a notable exception, transposing standard gravity variables (and adding additional plausible covariates) to a model of aggregate trade flows for a large cross-section of countries (170 in total) across six five-year periods. Their examination, once again tracking the gravity literature, finds that country size as proxied by both population and area are the main determinants of trade openness, with smaller landmasses and smaller populations trading much more extensively. Property rights have a small but significant effect, a finding which holds across specifications. In a similar vein, Bleaney and Neaves (2013) find that size matters but has been declining over time (they provide no estimation on the effect of institutions on trade, however).

For this paper, the underlying trade openness equation will rely on both of these papers for its set of covariates. But of particular interest for us is, as noted in Hypothesis 2 above, whether or not inequality harms further trade liberalisation. This equation, the third leg of the triangle, seeks to answer this question via the inclusion of inequality as a right-hand variable, relating inequality to the level of a country's trade openness. Moreover, to capture the dynamic effects of inequality on trade openness, one-, five-, and ten-year lags of the inequality metrics noted above are also included.

The controls utilised in this final equation, derived from the aforementioned literature, posits trade openness as a function of (in addition to inequality and property rights), size, population, and other country-specific traits: these will include democracy (to understand the willingness of the population to open to competition); latitude (to proxy for geography and the effect of the tropics); whether a country is landlocked (to proxy for remoteness); country size (for scale effects); resource endowment (resource rents as a percentage of GDP); human capital (proxied by secondary education enrolment); labour market efficiency; investment potential (initial levels of schooling); government spending (which correlates with higher trade openness, see Adsera and Boix 2002); access to finance and/or financial depth (bank deposits to GDP, to show ability to take advantage of trade opportunities); and the structure of the economy (agriculture as a percentage of GDP). By restricting the analysis to these metrics, it is hoped to capture the vast majority of determinants of trade liberalisation/globalisation without undue white noise. Such an approach, as with the other equations, will also help to alleviate misspecification errors across the 3SLS estimation.

The data for this exercise, comprising these various variables, was compiled from a large number of publicly available sources, including Solt (2016), the World Bank's World Development Indicators (WDI), the International Country Risk Guide (ICRG), the IMF's International Financial Statistics (IFS), previous research, and many other sources. A complete list of variables, definitions, and sources is shown in Table 1 and summary statistics are shown in Table 2.

4. Results

The results of the empirical exercise for both hypotheses are shown in Tables 3 and 4. Given the space constraints involved in showing the results of the three equations, it was decided to display only the "headline" equation (i.e. Equation 1 above) expressing inequality as a function of trade openness and institutional quality.[2] The first specification, shown in Column 1 of Table 3, looks at the effects of property rights on inequality, with property rights proxied by contract-intensive money and inequality proxied by Gini dispersion. The first thing that jumps out immediately is that, across the dataset, it appears that both property rights and trade openness have a statistically significant and positive association with income inequality. However, as predicted by the theory outlined above, property rights and trade openness interacted together do have a mitigating effect (albeit the scale is not as large as the inequality predicted by strong property rights).

Swapping out the CIM indicator with the ICRG investment profile to capture property rights is done in the model shown in Column 2, and the change in variable results in a much larger number of observations but much weaker results. In particular, the relationship between trade openness and inequality disappears, while property rights show a slightly positive correlation with inequality (and the interaction between the two is insignificant). Part of the reason behind this change can be attributed to what the two metrics of property rights are measuring: as Hartwell (2017) notes, the ICRG measure can be thought of as a measure of *potential* property rights, encompassing legislation and the like, while contract-intensive money is a metric of *realised* property rights, including enforcement and expectations. In this sense, what the two sets of results are thus capturing are two different effects, the effect of well-written property rights legislation on inequality and the effect of well-enforced rights on the same. Seen in this light, legislation has little effect on inequality, while good contractual enforcement, by protecting rights, can lead to higher inequality through market-based rewards. Future research calls for a way to involve state capacity in this equation.

Turning to the effects of democracy on inequality in the face of globalisation, democracy was already included in the first two base specifications on property rights, and in both it showed a dampening effect on inequality (as predicted by theory). Including the interaction term between openness and democracy in Columns 3 and 4 (replicating the earlier regressions with two separate proxies for property rights), the influence of democracy turns insignificant by itself in Column 3, but that there is a negative effect on inequality in the face of trade openness and more democracy. On the other hand, using the legislative measure for property rights in Column 4, democracy appears to increase inequality at the 5% level of significance, but in the face of trade openness, it has a marginally negative effect on inequality (with property rights and trade having no effect). This result holds subject to a series of robustness tests (not shown here), including interacting democracy with an executive constraints measure, to see if executive discretion is driving the results, and using an alternate measure of democracy (the polity2 measure from the Polity IV database). Given the radically different number of observations in this specification, as well as issues encountered when including the population and resource measures (which were dropped here), these results must be treated with caution.

As noted earlier, the use of the Gini coefficient as a measure of income inequality may be subject to its own issues, as noted by Li *et al.* (1998), so a metric of between-country inequality should also be utilised to capture net losses attributable to globalisation. This sigma convergence measure, a simple dispersion of standard deviations, would theoretically improve under globalisation, as factor prices and competition spread

[2] Additional results in the system of equations are available from the authors upon request.

the benefits of trade; also, theoretically, the only sticking point to such an adjustment could be the presence of poor institutions not allowing the benefits of trade to accrue.

Table 4 shows the results of using sigma convergence as a dependent variable, and the effect of institutions on this outcome. Trade openness by itself appears to unequivocally reduce between-country inequality, with the same economic significance across specifications. With regard to property rights, it appears that it too has a strong negative association with between-country inequality no matter which metric of rights is used (in distinction to within-country inequality). Interacting property rights and trade openness, however, also returns a consistent result, and that is a divergence in incomes across countries. Given the structure of this analysis, one cannot say which portion of the income distribution is driving these results, but a plausible explanation is that property rights help to make poorer countries richer (decreasing inequality); on the other hand, property rights and trade openness help to make richer countries even richer, increasing inequality.

Turning to the effects of democracy (Columns 3 and 4 of Table 4), they also have somewhat surprising results, in that democracy taken alone has very little effect, but democracy interacted with trade openness appears to slightly widen inequality when using contract-intensive money as a proxy for property rights. Including investor protection and legislative guarantees of property rights, democracy appears to have little correlation with between-country inequality, failing to be significant in the specification shown in Column 4. Property rights continue to behave as earlier.

For the final question, on whether or not inequality can force a slowdown of trade liberalisation, there are several approaches one may utilise to examine this question empirically. The first, and most simple, is the concept of Granger-causality (Granger 1969) which, different from pure causality in the non-economic sense, can enlighten us to the movements of economic statistics and their relations to each other. With lag lengths selected via an unrestricted VAR and where the majority of information criteria was minimized, the Granger-causality tests are shown in Table 5. Perhaps unsurprisingly, there is two-way Granger-causality between trade openness and income inequality taken in the same year (Granger-causality tests the null of no causality; a rejection of the null implies that X Granger-causes Y). But as deeper lags are used, going back to Gini coefficients from five and ten years previously, one can see that the causality is unidirectional, running exclusively from income inequality to trade policies and not the other way around. Again, while this is not true causality in the accepted sense of the word, this examination shows that past values of income inequality contain information that helps predict the level of trade openness above and beyond the information contained in a country's previous experience with trade openness.

Moving back into a multivariate framework, one may better understand the relationship between the two factors via the constituent equations of the previous analyses below the headlines, using trade openness as the dependent variable and inequality as an independent variable. These results are shown in Table 6, Columns 1 and 2, and the results are somewhat surprising – across the two headline specifications, high inequality correlated with trade openness in a statistically and economically significant manner. For example, in the specification examining the relationship of contract-intensive money, trade, and inequality (Column 1), a 1% increase in property rights would correlate with a 61.4% increase in trade openness as a percentage of GDP. This effect is similar across the original models, with substitution of the legal property rights resulting in a statistically significant 26.2% increase in trade openness for each additional point in the ICRG scale. In a theoretical sense, such a result is intuitive, even if the scale is not, as more-advantaged members of the population are likely to be able to take advantage of trade opportunities and agitate to keep trade routes open.

However, these results must be taken with a note of caution: as these numbers are capturing simultaneous effects, there could be other prior factors driving the results apart from the corrected-for endogeneity. Given the simultaneous nature of the system, much as was done with the Granger-causality tests, the analysis also includes lags of up to 10 years for the Gini coefficient, trying to see if previous income disparities in an economy could have generated. Unfortunately for this hypothesis, while the scale of the effect does decay, there is no evidence (Columns 3 through 6) that inequality leads to changes in globalisation or behaviour in trade policy. Much as in the baseline specification, inequality, even at deeper lags, continues to be associated with higher levels of trade openness.

Finally, there is a chance that these specifications are missing something important, namely that income inequality by itself has little effect on trade openness without a method for expressing dissatisfaction, i.e. the democratic process. For this final check, the original and augmented regressions are re-run including an interaction term between the Gini coefficient of a particular year (simultaneous and at 5 and 10-year lags) and democracy. The results, shown in Table 7, confirm this hypothesis, as the interaction between democracy and inequality has a significant and largely negative effect on a country's trade openness. Thus, while democracy may encourage trade openness in general and inequality may be correlated with trade, prolonged inequality is detrimental in the long-run for globalisation. Succinctly stated, too many losers from trade, given a choice at the ballot box, may indeed agitate for less trade in the long term.

5. Conclusions

This paper has taken a new look at the question of trade winners and losers by examining the nexus between trade openness, institutions, and income inequality. The results, while sensitive to choices of metric and still needing further research, show that institutions can indeed mitigate trade-induced losses, even as they provide the needed signals for the reallocation of resources in an economy. Furthermore, while prolonged inequality is no guarantee of protectionist policies, continued losses from trade in a democracy can indeed provide a brake on further globalisation.

From a policy standpoint, the recommendations appear to be rather self-evident, as it would behove a country to ensure its fundamental institutions are sound in order to reap the full benefits of globalisation. As theory would predict, there is necessarily an element of inequality that comes from trade, with winners and losers always present. Additionally, good institutions may actually help to exacerbate this inequality in the short-term via a reallocation of incentives as well as resources; however, as the analysis above has shown, good institutions may help such disruption to be short-lived and mitigate the necessary dislocation of globalisation. Thus, ensuring that property rights and democratic accountability are respected, protected and inviolable should be a priority for any government facing globalisation.

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Tables

Table 1. Variables, Definitions, Sources

Variable	Source	Description
Average Gini Coefficient	Solt (2016)	Average of Solt's 100 annual observations per country of the Gini coefficient
Average Gini Coefficient*Democracy	Author's calculations	Interaction of Gini coefficient and democratic accountability
Bank Deposits as % of GDP	World Bank WDI	Demand, time and saving deposits in deposit money banks as a share of GDP
Democratic Accountability	ICRG	Extent of responsiveness of a government to its people, rated from 1 to 6, with higher number indicating more democracy
Female mortality	World Bank WDI	Female mortality rate, per 1,000 female adults, ages 15-64.
French legal origin dummy	La Porta *et al.* (2008)	Dummy taking the value of 1 if a country had the specific legal origin, 0 if otherwise
Government spending as % of GDP	World Bank WDI	All government current expenditures for purchases of goods and services (including compensation of employees), as % of GDP
Human Capital Index	World Economic Forum	Assesses Learning and Employment outcomes across 5 distinct age groups, on a scale from 0 (worst) to 100 (best),
Initial GDP per capita	Author's calculations from World Bank data	GDP per capita from the first year available
Initial Secondary Enrolment ratio	Author's calculations from World Bank data	Secondary Enrolment ratio from the first year available
Investor Protection	ICRG	Risk of expropriation, contract enforcement, and repatriation of profits, scored on a scale from 0-12 with higher numbers indicating better protection
Land Area	World Bank WDI	Total land area in square kilometres
Landlocked dummy	CEPII GeoDist Database	Dummy taking the value of 1 if a country is landlocked, 0 otherwise

Variable	Source	Description
Latitude	CEPII GeoDist Database	Actual latitude of a country's capital city
Log GDP per capita	World Bank WDI	GDP per capita
Log GDP per capita squared	World Bank WDI	Quadratic term on GDP per capita
Log of population	World Bank WDI	Population in millions, log-linearized
Private Credit as % of GDP	World Bank WDI	Financial resources provided to the private sector by financial corporations, including loans, purchases of non-equity securities, and trade credits and other accounts receivable.
Property Rights (contract-intensive money)	Author's calculations from IMF International Financial Statistics Data	M2 less currency held outside formal banking institutions as a percentage of M2. See also the text.
Resource rents as % of GDP	World Bank WDI	Sum of oil rents, natural gas rents, coal rents (hard and soft), mineral rents, and forest rents as % of GDP
Scandinavian legal origin dummy	La Porta *et al.* (2008)	Dummy taking the value of 1 if a country had the specific legal origin, 0 if otherwise
Sigma Convergence	Author's calculations	Country standard deviation of GDP per capita against the mean GDP of all countries for that year
Trade Openness as % of GDP	World Bank WDI	Sum of exports and imports of goods and services measured as a share of GDP
Trade*contract-intensive money	Author's calculations	Interaction term of trade openness and CIM
Trade*democratic accountability	Author's calculations	Interaction of trade openness and democratic accountability
Trade*investor protection	Author's calculations	Interaction term of trade openness and investor protection
UK legal origin dummy	La Porta *et al.* (2008)	Dummy taking the value of 1 if a country had the specific legal origin, 0 if otherwise
Unemployment rate	International Labour Office	Number of unemployed persons as a percentage of the total number of persons in the labour force

Table 2. Summary Statistics

Variable	N	Mean	SD	Min	Max
Average Gini Coefficient	4,281	0.382	0.089	0.198	0.609
Average Gini Coefficient*Democracy	2,800	1.592	0.560	0.000	3.405
Bank Deposits as % of GDP	7,605	37.980	37.833	0.000	479.670
Democratic Accountability	4,242	3.787	1.666	0.000	6.000
Female mortality, 15-64 years	10,286	197.739	123.834	31.589	799.382
French legal origin dummy	10,864	0.505	0.500	0.000	1.000
Government spending as % of GDP	7,783	15.926	7.605	0.000	156.532
Human Capital Index	6,065	2.102	0.722	1.007	3.734
Initial GDP per capita	10,864	6.318	1.417	3.703	10.316
Initial Secondary Enrolment ratio	10,360	40.842	30.727	0.000	98.983
Investor Protection	3,678	7.404	2.524	0.000	12.000
Land Area (in sq. km)	10,445	680,129	1,854,781	20	16,400,000
Landlocked dummy	10,864	0.180	0.385	0.000	1.000
Latitude	10,528	18.680	24.184	-44.283	64.150
Log GDP per capita	8,584	7.480	1.685	3.548	11.688
Log GDP per capita squared	8,584	58.794	26.005	12.588	136.617
Log of population	10,827	15.158	2.120	9.174	21.039
Private Credit as % of GDP	7,517	35.642	33.256	0.001	312.118
Property Rights (contract-intensive money)	2,862	0.816	0.148	0.139	1.000
Resource rents as % of GDP	7,480	7.136	11.170	0.000	89.166
Scandinavian legal origin dummy	10,864	0.031	0.173	0.000	1.000
Sigma Convergence	8,584	0.180	0.122	0.000	1.557
Trade Openness as % of GDP	8,120	79.290	54.584	0.000	860.800
Trade*contract-intensive money	2,781	71.675	50.811	6.565	441.212
Trade*democratic accountability	4,006	317.560	262.717	0.000	2628.941
Trade*investor protection	3,501	628.279	542.664	0.000	5299.246
UK legal origin dummy	10,864	0.340	0.474	0.000	1.000
Unemployment rate	4,500	9.048	6.338	0.100	37.600

Table 3. Results of Baseline Regressions

	Average Gini Coefficient			
	1	2	3	4
Trade openness	0.02	-0.001	0.005	0.002
	*4.61****	*1.22*	*3.36****	*1.25*
INSTITUTIONAL VARIABLES				
Property rights (contract-intensive money)	0.21		0.05	
	*5.11****		*3.30***	
Property rights (Investor Protection)		0.02		0.02
		*2.10***		*1.46*
Democratic accountability	-0.03	-0.01	-0.01	0.10
	*6.45****	*2.53**	*0.59*	*2.48***
Contract-intensive money*Trade Openness	-0.02		-0.004	
	*4.53****		*2.29***	
Investor Protection*Trade Openness		0.0001		0.0001
		0.53		*0.41*
Democratic Accountability*Trade Openness			-0.0003	-0.0005
			*2.38***	*1.80**
CONTROLS				
GDP per capita	0.12	0.15	0.13	0.14
	*3.17****	*6.25****	*6.75****	*5.45****
GDP per capita^2	-0.01	-0.01	-0.007	-0.01
	*3.96****	*7.44****	*6.53****	*7.90****
Resources to GDP	-0.001	0.0003	-0.0004	
	*2.45***	*0.42*	*1.29*	
Unemployment	0.003	0.003	0.005	0.002
	*4.55****	*6.85****	*9.71****	*4.57****
Initial Secondary Enrolment	-0.001	-0.002	-0.001	-0.002
	*4.51****	*8.14****	*7.94****	*10.67****
Female Mortality	0.0001	0.0001	0.0001	0.0002
	*2.67****	*1.82**	*3.67****	*5.12****
Population	-0.02	-0.003	-0.0006	
	*3.38****	*1.08*	*0.54*	
Human Capital Index	-0.02	0.02	0.00	0.020
	*2.74****	*2.03**	*0.13*	*1.50*
Government Spending	-0.005	-0.002	-0.004	-0.005
	*6.16****	*2.57****	*7.39****	*5.60****
C	-1.27	-0.20	-0.52	-0.55
	*4.23****	*1.84**	*3.51****	*4.63****
n	1105	1932	918	1594
R-squared	*0.22*	*0.18*	*0.57*	*0.38*

Note: absolute value of t-statistics in italics, *, **, and *** denoting significance at 10%, 5%, and 1% levels respectively.

Table 4. Results of Sigma Convergence Regressions

	Sigma convergence			
	1	2	3	4
Trade openness	-0.01	-0.01	-0.01	-0.004
	*5.25****	*2.92****	*4.86****	*3.21****
INSTITUTIONAL VARIABLES				
Property rights (contract-intensive money)	-1.70		-1.20	
	*7.38****		*4.80****	
Property rights (Investor Protection)		-0.07		-0.03
		*2.51***		*2.12***
Democratic accountability	0.02	0.03	-0.05	-0.002
	*5.85****	*3.58****	*1.59*	*0.08*
Contract-intensive money*Trade Openness	0.02		0.01	
	*5.47****		*4.45****	
Investor Protection*Trade Openness		0.0007		0.0003
		*2.78****		*2.17***
Democratic Accountability*Trade Openness			0.0004	0.0001
			*2.18***	*0.39*
CONTROLS				
GDP per capita	-0.60	-0.49	-0.54	-0.50
	*21.32****	*16.42****	*15.27****	*24.76****
GDP per capita^2	0.04	0.03	0.030	0.03
	*22.69****	*16.49****	*16.57****	*26.29****
Resources to GDP	0.001	0.0040	-0.001	0.001
	1.05	*3.22****	*1.67**	*2.37***
Unemployment	-0.002	-0.003	-0.004	-0.004
	*2.67****	*5.19****	*4.61****	*7.92****
Initial Secondary Enrolment	0.0004	0.0003	0.001	0.001
	*1.88**	*0.10*	*5.34****	*4.35****
Female Mortality	-0.00002	-0.00001	-0.00001	0.00004
	0.62	*0.35*	*1.78**	*1.59*
Population	0.01	-0.008	0.002	-0.01
	*4.55****	*2.84****	*0.45*	*3.12****
Human Capital Index	-0.01	0.04	-0.02	-0.005
	1.04	*1.84**	*1.37*	*0.41*
Government Spending	0.003	0.005	0.004	0.003
	*4.25****	*4.68****	*4.41****	*4.73****
C	3.51	2.58	3.41	2.48
	*19.17****	*16.57****	*16.81****	*23.50****
n	1105	1956	918	1594
R-squared	*0.31*	*0.34*	*0.48*	*0.67*

Note: absolute value of t-statistics in italics, *, **, and *** denoting significance at 10%, 5%, and 1% levels respectively.

Table 5. Granger-Causality Tests

Null Hypothesis	Lags	Obs	F-Statistic	Prob.
Trade Openness does not Granger Cause Income Inequality	4	3485	2.87139	0.022
Income Inequality does not Granger Cause Trade Openness			2.02025	0.089
Income Inequality (-5 years) does not Granger Cause Trade Openness	4	3132	3.55478	0.007
Trade Openness does not Granger Cause Income Inequality (-5 years)			0.83373	0.504
Income Inequality (-10 years) does not Granger Cause Trade Openness	4	2549	4.00152	0.003
Trade Openness does not Granger Cause Income Inequality (-10 years)			0.04032	0.997

Lags chosen on the basis of an unrestricted VAR with minimized information criteria. Green squares indicate significance at 10% level.

Table 6. Trade Openness Affected by Inequality?

	Trade Openness					
	1	2	3	4	5	6
Average Gini Coefficient	61.40	26.20				
	*6.16****	*3.46****				
Gini 5-year lag			13.31	14.26		
			*5.71****	*7.19****		
Gini 10-year lag					10.59	11.85
					*5.16****	*6.52****
INSTITUTIONAL VARIABLES						
Property rights (contract-intensive money)	-13.59		-19.40		-0.15	
	*5.24****		*1.37*		*0.01*	
Property rights (Investor Protection)		9.40		0.41		0.45
		*7.73****		*0.63*		*0.82*
Democratic accountability	15.71	27.89	-2.65	1.72	-5.24	-0.41
	*3.32***	*8.18****	*0.83*	*0.72*	*1.97***	*0.19*
CONTROLS						
Initial GDP per capita	7.61	-0.23	9.27	9.02	8.70	9.10
	*4.77****	*0.17*	*6.72****	*6.24****	*6.48****	*6.68****
Resources to GDP	1.26	1.02	1.07	1.08	0.85	0.87
	*4.69****	*4.73****	*5.27****	*6.63****	*4.85****	*5.91****
Unemployment	-3.43	-0.38	-0.87	-0.22	-0.88	-0.31
	*5.60****	*1.07*	*3.63****	*1.31*	*3.75****	*1.71**
Initial Secondary Enrollment	0.22	-0.24	-0.04	-0.22	0.05	-0.21
	*1.67**	*2.33***	*0.50*	*2.55***	*0.89*	*2.53***
Land Area	-0.00004	-0.00006	-0.00005	-0.00006	-0.00005	-0.00005
	*5.98****	*8.02****	*8.55****	*13.47****	*9.28****	*13.63****
Landlocked	14.78	17.75	9.65	13.20	8.43	13..40
	*5.15****	*7.32****	*3.07****	*4.58****	*2.85****	*4.94****
Latitude	0.49	0.26	0.30	0.35	0.30	0.34
	*7.42****	*3.11****	*8.57****	*9.82****	*9.14****	*9.96****
Government Spending	2.92	0.22	1.57	0.90	1.27	0.86
	*7.58****	*0.69*	*6.28****	*4.06****	*4.44****	*3.66****
Bank Deposits	0.28	0.16	0.19	0.47	0.11	0.45
	*4.38****	*2.76****	*3.22****	*10.66****	*2.21***	*10.39****
C	-216.77	-229.74	-36.87	-78.32	-22.37	-57.71
	*5.22****	*5.50****	*2.82****	*5.83****	*1.64*	*4.05****
n	918	1594	884	1522	823	1397
R-squared	*0.28*	*0.35*	*0.41*	*0.42*	*0.57*	*0.42*

Note: absolute value of t-statistics in italics, *, **, and *** denoting significance at 10%, 5%, and 1% levels respectively.

Table 7. Trade Openness and Inequality Redux

	Dependent Variable: Trade Openness					
	1	2	3	4	5	6
Average Gini Coefficient	168.59	102.01	116.87	68.23	168.59	102.06
	*6.74****	*5.68****	*5.42****	*3.84****	*7.22****	*5.62****
Gini Coefficient*Democracy	-29.49	-17.43				
	*6.21****	*5.11****				
Gini 5-year lag* Democracy			-17.41	-9.59		
			*4.74****	*3.02****		
Gini 10 year lag*Democracy					-29.49	-17.43
					*6.65****	*4.92****
INSTITUTIONAL VARIABLES						
Property rights (contract-intensive money)	-13.27		-11.64		-13.27	
	*4.77****		*4.57****		*5.52****	
Property rights (Investor Protection)		1.36		1.04		1.36
		*2.32***		*1.91**		*2.82****
Democratic accountability	115.43	64.42	68.46	34.63	115.43	64.42
	*5.83****	*4.84****	*4.29****	*2.62****	*6.42****	*4.64****
CONTROLS						
Initial GDP per capita	6.05	8.88	7.78	9.55	6.05	8.88
	*3.22****	*5.61****	*4.02****	*6.03****	*3.53****	*7.07****
Resources to GDP	2.01	1.53	2.27	1.65	2.01	1.53
	*5.70****	*6.47****	*5.65****	*5.40****	*5.82****	*6.14****
Unemployment	-1.04	0.11	-1.72	-0.35	-1.04	0.11
	*2.97****	*0.39*	*4.50****	*1.46*	*2.77****	*0.38*
Initial Secondary Enrollment	0.20	-0.14	0.16	-0.15	0.20	-0.14
	*1.86**	*1.35*	*1.32*	*1.58*	*1.85**	*1.60*
Land Area	-0.00007	-0.00007	-0.00006	-0.00006	-0.00007	-0.00007
	*6.55****	*13.65****	*7.50****	*19.05****	*7.56****	*13.59****
Landlocked	5.93	10.59	13.51	12.17	5.93	10.59
	*1.93**	*3.68****	*3.83****	*4.54****	*1.71**	*3.65****
Latitude	0.39	0.47	0.40	0.47	0.39	0.47
	*10.37****	*10.32****	*8.62****	*9.58****	*9.09****	*9.37****
Government Spending	0.76	0.23	1.85	0.83	0.76	0.23
	*1.90**	*0.91*	*6.49****	*3.14****	*1.75**	*0.74*
Bank Deposits	0.25	0.48	0.24	0.48	0.25	0.48
	*3.88****	*11.83****	*3.53****	*11.20****	*3.61****	*11.98****
C	-556.85	-410.96	-386.57	-286.00	-556.85	-410.96
	*6.62****	*5.72****	*5.18****	*3.93****	*6.94****	*5.60****
n	918	1594	884	1522	918	1594
R-squared	*0.50*	*0.27*	*0.47*	*0.30*	*0.47*	*0.27*

Note: absolute value of t-statistics in italics, *, **, and *** denoting significance at 10%, 5%, and 1% levels respectively.

About the author

Christopher Hartwell (PhD) has over 20 years of experience in research projects and technical assistance throughout Europe, the transition countries of Central and Eastern Europe, the former Soviet Union, and Asia-Pacific. Currently President of CASE – Center for Social and Economic Research in Warsaw, he leads their work in the area of growth and trade, with an emphasis on trade liberalization, free trade agreements, and quantification of non-tariff barriers (NTBs). Through his work with CASE, he has participated in several framework contracts related to trade, including with the European Parliament's INTA Committee and with DG Trade. He helped to design a new methodology for quantifying the costs of NTBs between Ukraine and the EU for a DG Trade project, subsequently published in Applied Economics Letters, and also authored for INTA a study on overlapping free trade agreements in the EU. Dr. Hartwell was also an expert on a recent DG Trade project examining the effects of a revised EU-Chile Association Agreement, contributing to the analysis on trade, investment, and public procurement effects. Prior to joining CASE, he was Head of Global Markets and Institutional Research at the Institute for Emerging Market Studies (IEMS) at the Moscow School of Management – SKOLKOVO, where he advised the Deputy Prime Minister of Kazakhstan on the trade and fiscal aspects of greater Eurasian integration. He continues to work on the trade-related facets of the Eurasian Economic Union, working closely with counterparts in Kazakhstan to help push for greater liberalization. Dr Hartwell also has spent years working on development assistance programs both with USAID and as an employee of the World Bank Group. He holds a PhD from the Warsaw School of Economics and a master's in public policy from Harvard's Kennedy School and is the author of Institutional Barriers in the Transition to Market: Examining Performance and Divergence in Transition Economies (Palgrave Macmillan, 2013) and Two Roads Diverge: The Transition Experience of Poland and Ukraine (Cambridge University Press, 2016). He has also published in prestigious journals such as JCMS – Journal of Common Market Studies, Regional Studies, Journal of Institutional Economics, and Journal of Economic Policy Reform.

Europe, Democracy and Globalisation: Can the EU Counter the Illiberal Turn?

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Executive Summary

- Brexit, Trump, the rise of the radical right in Europe, and the shift in power and influence away from the West are challenging the political stability of many advanced democracies and the integrity of the post-War international order. These challenges are interlinked.
- Democratic politics systems in much of Europe have undergone important structural changes over the last decades: party membership and affiliation have declined, voter turnout at elections is down, support for long-established mainstream parties has fallen, and voters are becoming more volatile. There are also concerns that publics are becoming less committed to democratic principles. The EU is affected by these trends, but European integration has also served as a driver of them.
- Data from a 10-country Chatham House-Kantar survey of both European publics and elites provides fresh evidence about democratic attitudes in the EU. It suggests that despite the political attention attached to the EU's democratic deficit, European citizens tend to think the EU is moderately democratic. At an aggregate level, this is not that different from how Europeans view their own national democracies.
- However, these aggregate figures obscure important national variations, with populations in some countries much less likely to view the EU as democratic. For example, in Austria, fewer than one in five respondents (18%) place the EU at the very democratic end of scale compared with 44% in Poland. The relationship between national democracy and EU democracy also varies by country and by region.
- On a broad level then, attitudes to whether the EU enhances or undermines democracy are not as negative as might be expected. Rather, there is a risk that questions of democracy become intertwined with dissatisfaction on more salient issues.
- European societies are increasingly divided by their attitudes to liberal values and their views on the effects of liberalism on society and the economy. In addition, publics and elites are divided over the future direction of politics and the EU which has important implications for European democracy in the future.
- While liberalism is challenged at home, it is also struggling abroad. Concerns about the stability of this liberal order – and the collection of norms, institutions and alliances which have formed its bedrock – are now widespread. Challenges include the direction of global trade, the role of China and the political leadership of the United States.
- The connections between the international and the domestic challenges to liberalism are important. The increasingly integrated global economy places structural pressures on the Western democratic model. Those countries which are champions of liberal rules based international order must be able to demonstrate that it can deliver for citizens at home.

- For EU policy-makers, the ambition must be to ensure that globalisation works in the interests of a clear majority of citizens. Three approaches which could support this aim are to focus on contesting il-liberalism domestically, improving the legitimacy of the EU, and sustaining and nurturing liberalism internationally.

1. Introduction

It has become increasingly common to declare both democracy and the liberal international order to be in crisis. Brexit, Trump, the rise of the radical right in Europe, and the shift in power and influence away from the West are challenging both the political stability of many advanced democracies and the integrity of the post-War international order. These challenges are closely interlinked. It is Western governments with a liberal orientation which have sought - albeit imperfectly - to build and sustain an international order based on rules and multilateral institutions that can help manage the process of globalisation. At the same time, it is the pressures of the increasingly integrating global economy and the openness of these democracies which have in part contributed to the domestic political backlash against it in the West. There is a risk, in the face of that backlash, that advanced democracies turn to protectionism and unilateralism, undermining international institutions and reducing the capacity of the international system to develop common approaches to global challenges.

The EU has a unique place within this story. Its creation represents an effort by its member states to build a bridge between the global and the national, using the process of integration to try to manage the pressures of globalisation more effectively together than they might do individually. But this process of integration has also become the lightning rod for many political frustrations and economic grievances.

In Europe, the events of the last decade – including the financial crash, sovereign debt crisis, refugee crisis, rise of populist and radical parties and the vote for Brexit – have reinforced the general sense that the EU and even liberalism are under threat. It has become common to speak of Europe's multiple crises or simply *the* crisis: the fear that the EU is incapable of responding to the myriad challenges it faces, which are threatening the integrity and legitimacy of the EU, and the liberal, democratic character of its members states.

But such concerns about the fate of liberal democracy are not new. These are the words of French sociologist Michael Crozier, writing not in 2017, but in 1975:

> "The vague and persistent feeling that democracies have become ungovernable has been growing steadily in Western Europe. The case of Britain has become the most dramatic example of this malaise… Its contemporary troubles seem to announce the collapse of these democratic processes or at least their incapacity to answer the challenges of modern times… These difficulties are compounded by the existence of Europe as a problem. The whirlpool of each national governing system has more and more restrained the margin of freedom on which progress in European unification can be built."[1]

It is striking how much this 42-year-old diagnosis of democratic frailties finds a contemporary echo. Fears about the health of democracy have been its near constant companion throughout history. As David Runciman writes, "the onward march of democracy has been accompanied by a constant drumbeat of intellectual anxiety". But that is not a reason to dismiss such concerns. For many observers, the EU's extended 'polycrisis' has placed the project of European integration in perhaps the gravest position since its foundation.

2017 has, thus far, seen the worst fears recede. Brexit has created an unexpected degree of unity between the EU27, whose governments quickly agreed a negotiating mandate and effectively outsourced the process to the European Commission. So far, the unity has held, and there is some evidence to suggest that support for remaining in the EU has risen since the UK's vote to leave.[2] While elections in Austria, the Netherlands, France and even Germany saw relatively high levels of support for populist, anti-EU parties, none saw a

[1] Crozier, Huntington and Watanuki (1975).
[2] Pew Research Centre (2017).

breakthrough. Meanwhile, pro-EU parties and candidates performed well. President Macron won the French Presidency on an explicitly pro-EU and integrationist platform, while the Euro area has seen a period of sustained economic growth since 2014. In his annual address to the European Parliament on 13 September 2017, European Commission President Jean Claude Juncker's proclaimed that "the wind is back in Europe's sails". Compared with Trump's America and Brexit Britain, the EU seems in comparably decent shape.

But the swing from pessimism to optimism in a relatively short space of time risks obscuring the longer term trends at play, namely the growing internal divide in attitudes within the EU and the associated risk of deterioration of the international order. This essay will explore in greater depth two challenges to European democracy. The first challenge revolves around public attitudes to democracy, and the extent to which they are a driver of negative attitudes toward the EU. Drawing on a unique data set of public and elite attitudes to Europe from ten different countries, this paper will argue that neither publics nor elites in Europe have especially negative views about democracy at the European level, but that they are divided in their attitudes to liberal values and the effects of social change, particularly immigration. It is this challenge to liberalism rather than to democracy which represents the greater challenge to democracy in Europe and European integration. The second dimension that will be explored is the international context in which these domestic democratic contests are taking place, arguing that an illiberal turn within democracies which have championed an international rules-based order risks undermining the strength of that system. The paper then suggests some principles that should guide the response from supporters of liberal principles at home and abroad.

2. A democratic crisis? Public attitudes to democracy in Europe

Political systems in much of Europe have undergone a number of important structural changes over the last decades.

First, party membership and affiliation have declined. Since at least the 1990s, membership of political parties — measured both by total numbers and by the proportion of voters — has fallen across Europe. Although longer-established democracies and smaller countries tend to have proportionately larger party memberships, the pattern of decline is broadly consistent.[3] One scholar has gone as far as declaring ‘the passing of the age of party democracy’.[4] Given the fundamental role that parties have historically played in aggregating popular political attitudes into meaningful movements, developing policy, and providing choice to voters, it is difficult to conceive of current democracies functioning properly without political parties.

Second, voter turnout at elections is falling. Electoral turnout has declined in many advanced democracies since the 1980s and 90s, driven in particular by lower rates of participation among younger voters. This appears to be a result in part of changing political values among younger voting cohorts.[5] Although turnout has not fallen at every election, the overall trend is one of falling participation. At the same time, the effects of decline in turnout are uneven, leading to more skewed electoral participation. In particular, there is a growing gap in voting rates between more and less educated voters, challenging basic notions of how democracies can properly reflect their electorates.[6] Political apathy and indifference are major concerns for the future of European democracy.

Third, support for long-established mainstream parties has fallen. Across Europe, with few exceptions, parties of both the centre-right and centre-left have lost ground to the radical right and left, the Greens, and other alternative, factionalist or issue-based movements. This has happened at a different pace and with different effect across Europe. For example, the severe economic pressures caused by Greece’s sovereign debt crisis and the government’s responses have led to a profound realignment of its political party system. The share of the vote won by Pasok and New Democracy, the established centre-left and centre-right parties, declined precipitously in a very short space of time. In other countries, like Denmark and Sweden, the process has been ongoing for several decades. Europe’s social democratic parties appear particularly vulnerable to electoral decline. Many of Europe’s leading centre-left parties have seen disastrous election results since the financial crisis, including Germany’s SPD, the Netherlands’ PVA, and the French PS.

Britain stands out as an interesting counter-example. Against the broader trend, the British Labour Party achieved a strong showing at the 2017 UK general election (with its highest share of the vote since 1997). But this performance was delivered by its most left-wing leader and manifesto in a generation, rather than a conventional centre-left platform. The combination of the collapse in the UK Independence Party (UKIP) vote following the EU referendum and the Labour Party’s drift to the left resulted in Britain’s two main parties securing an 83% share of the vote at the last election, the highest share since 1970. However, both parties have co-opted or incorporated the positions of the radical left and right, leading to higher vote shares but deep challenges to future party unity and coherence.

[3] Van Biezen, Mair and Poguntke (2012).
[4] Mair (2014).
[5] Blais and Rubenson (2013).
[6] Dassonneville and Hooghe (2017).

Fourth, voters are becoming more volatile. Party loyalty has declined, as many of the sectional bases upon which parties were founded – industrial, religious, social class – have lost their relevance. A growing ideological homogeneity among centrist parties – broadly speaking pro-market, pro-EU, pro-immigration and increasingly socially liberal – reduced much political competition to questions of competence and managerial capability. This has in turn encouraged the rise of alternatives from outside the centre, and radical parties on the populist right in particular. These parties have galvanised support by breaking from the central consensus on issues like the EU, immigration and social integration. They have also reshaped national debates. As a result, more centrist parties have sought to co-opt aspects of their platform or agenda.[7] In the 2017 Dutch election, the incumbent liberal VVD party actively sought to attract voters away from the radical right PVV with rhetoric around preserving Dutch values. A striking example is Britain's UKIP, which, despite only ever having had one MP elected to the House of Commons, had a profound impact on the national debate on immigration, and contributed to Prime Minister David Cameron's promise of a national referendum on EU membership.

2.1 Democracy and the EU

These trends also affect the EU. On the one hand, vulnerable member state governments have shied away from developing European solutions to national problems and have instead adopted a habit of blaming Brussels for their predicament. In addition, domestic political turbulence has undermined the process of electing members of the European Parliament. Turnout is low, pan-European parties are weak and underdeveloped, while many voters seem to use European elections to express their frustrations (perhaps with the expectation of limited consequences), leading to comparatively high levels of representation in the European Parliament of parties from the political fringes, both on the radical left and radical right. While centrist parties still retain a majority, in the 2014 European parliamentary elections, 30.5% of seats were won by anti-establishment parties from a range of different ideological perspectives, including strong showings for the Front National in France, the Five Star movement in Italy, UKIP in Britain, Syriza in Greece, and the Danish People's Party.[8]

But the EU is also a driver of some of these trends. Despite substantial increases in the powers of the European Parliament, the capacity of citizens to shape its political direction or to participate meaningfully in a genuine European democratic process remains limited. While the accession of Central and Eastern Europe states to the EU in 2004 and 2007 was in many ways a triumph for European integration, it also made the EU a less politically and economically coherent bloc, and drove high levels of intra-EU immigration, which has become a source of discontent for voters in some states, most notably Britain.

Criticisms of the EU's democratic deficit have become more pronounced following the eurocrisis, which led to the imposition of unpopular policies of fiscal consolidation and structural reform in a number of EU member states and to technocratic governments in Greece and Italy that were seen not to uphold national sovereignty. The eurocrisis also caused intolerably high levels of unemployment in the EU's south and stagnant or falling incomes for many EU citizens. While the eurocrisis has led to greater economic integration among its members (which promises to go further still), this has not been accompanied by a comparable process of deepening political integration or democratisation.

[7] Wagner and Meyer (2017).
[8] House of Commons Library (2014).

2.2 New data on democracy

The desire to strengthen EU democracy was the motivating factor behind the introduction of 'Spitzenkandidaten' in the 2014 European Parliament elections, whereby the political groupings represented in the European Parliament selected lead candidates for the position of European Commission President. The aim was to create a more genuinely pan-European election campaign, and enhance the legitimacy of the European Commission. However, this innovation had only a limited impact on the campaign.[9] Some federalists, such as Guy Verhofstadt, argue that much deeper political integration is needed to address the challenges to the EU's legitimacy and functionality.[10]

The criticisms of such visions is that they run against the grain of public attitudes in many places, where publics seem cautious about transferring more powers to the European level, and many would like powers returned to member states.[11]

Scholars such as Yacha Mounk have sounded the alarm about the direction of attitudes to democracy more generally. Publics, he argues, are becoming less committed to democratic principles and more open to non-democratic alternatives.[12]

In 2017, Chatham House conducted a unique study of attitudes to European integration. The survey, conducted by Kantar Public, polled two different sample groups. First, a representative sample of more than 10,000 Europeans from 10 different countries — Austria, Belgium, France, Germany, Greece, Hungary, Italy, Poland, Spain and the UK — using gender, age and geographic quotas. Second, a sample of 1,800 European 'elites' – individuals in position of influence in the media, politics, business and civil society.[13] The survey explored their opinions about the EU alongside their broader social and cultural attitudes. This allows us to consider the state of European democracy with fresh data, and to make meaningful comparisons between the views of the public and those in positions of influence. As a result, we can draw the following conclusions.

Despite widespread concerns about a democratic deficit, Europeans citizens tend to think the EU is moderately democratic. Respondents were asked how democratic they thought the EU was, on a scale of 0-10, where a '0' represented "not at all democratic" and a '10' represented "very democratic". In aggregate, Europeans do not view the EU as especially undemocratic. Almost two thirds of Europeans placed the EU at or above the midpoint on the scale (5+). Slightly more (29%) placed the EU at the upper end of the scale (7+) than the 27% who placed it at the lower end (0-3).

At an aggregate level, this is not that different from how Europeans view their own national democracies. Asked about how democratic their own country was, more respondents are likely to place their

[9] Hobolt (2014).
[10] Verhofstadt (2017).
[11] Raines, Goodwin and Cutts (2017).
[12] Foa and Mounk (2016).
[13] The general public survey was conducted between December 2016 and January 2017 among a representative sample of the population in 10 European countries (Austria, Belgium, France, Germany, Greece, Hungary, Italy, Poland, Spain and the UK). At least 1,000 interviews per country were conducted online using Lightspeed Research panels. Quotas were applied on age, gender and region, and deviations were corrected with post-stratification weights. The total sample size was 10,195. The elite survey was conducted between January 2017 and February 2017 in the same 10 countries. The overall number of interviewees was 1,823 (between 160 and 205 per country). The elites interviewed were defined as follows using four broad categories: politicians (local, national, European),32 journalists (news journalists), business leaders (small, medium and large enterprises) and civil society leaders (NGOs, associations, trade unions or universities). The survey was conducted via national research agencies (mostly Kantar agencies), predominantly by telephone. In some countries, some interviews were conducted face to face (Greece and Hungary) or online (Poland). Quotas on each of the four target groups (around 40–50 per category per country) were applied in order to ensure an even spread of respondent profiles across the sample.

national democracy at the upper end of the scale and less likely to place it at the lower end, but the differences are not major (see Fig 2). Overall, 39% placed their national democracy towards the top end of the democratic scale compared with 29% for the EU; 20% placed their country at the bottom end of the scale compared with 29% for the EU.

Figure 1. Ten country aggregate attitudes to EU democracy

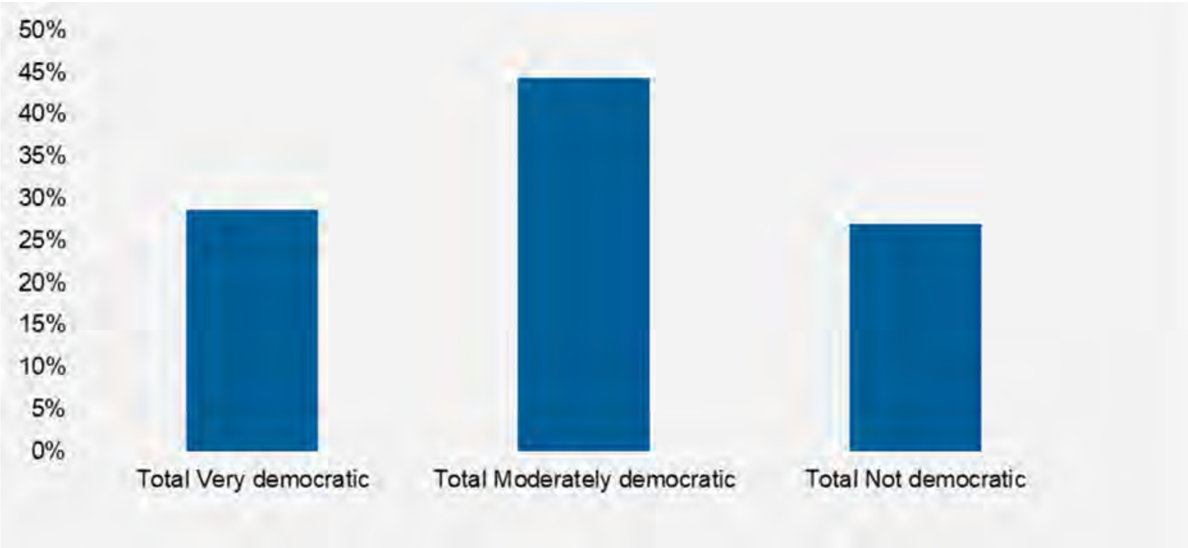
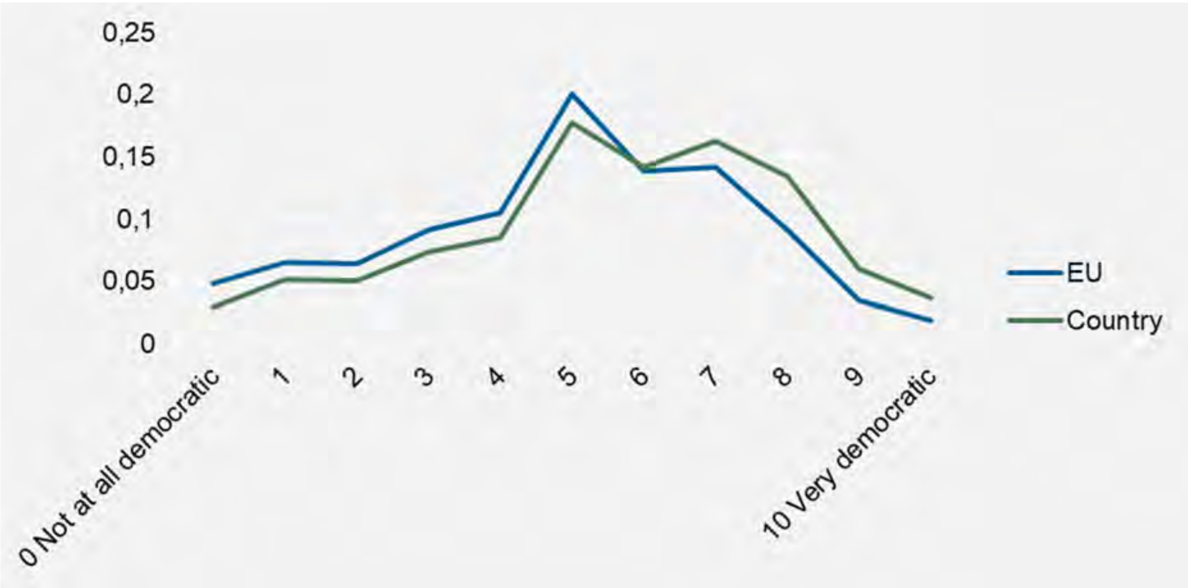


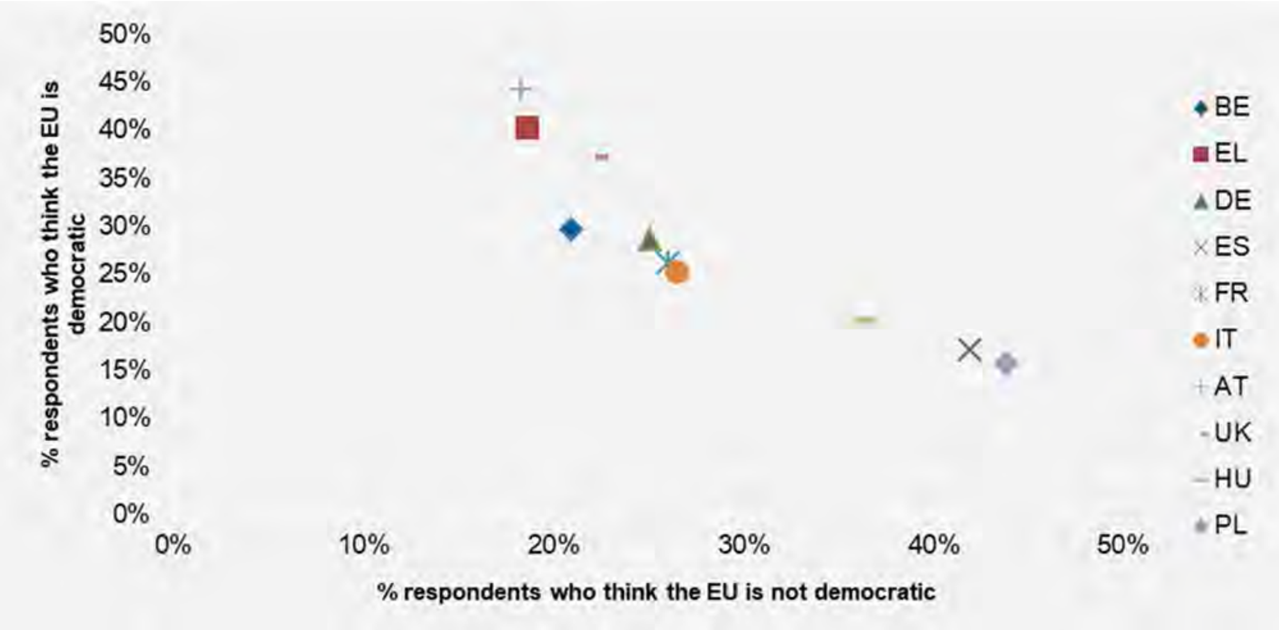
Figure 2. Comparing attitudes to democracy at the EU and the national level (10 country average)



However, these aggregate figures obscure important national variations, with populations in some countries much less likely to view the EU as democratic. To clarify the analysis, results were grouped into three categories of attitudes to EU democracy: 7+ (very), 4-6 (moderately) and 0-3 (not democratic). This helps reveal the considerable variation at a national level. At one extreme lies Austria, where fewer than one in five respondents (18%) placed the EU in the very democratic category and 44% in the not democratic category. At the other is Poland where 44% placed EU democracy in the top category, and just 16% in the 'not' category. In terms of attitudes to EU democracy, the survey suggests the ten countries split into three different groupings.

A positive group, comprising Spain, Poland and Hungary, where many more people think the EU is democratic than not; a middle group, comprising Belgium, France, Germany and Italy, where the two groups are balanced; and the negative group, comprising Austria, Greece and the UK, where many more respondents think the EU is not democratic.

Figure 3. Mapping attitudes to EU democracy

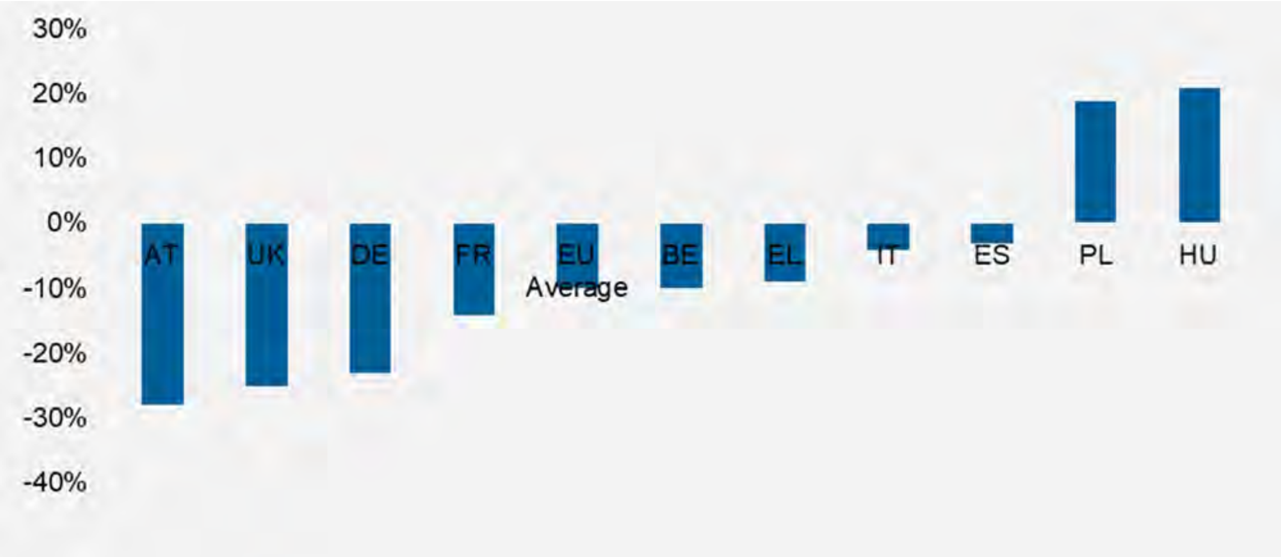


The relationship between national democracy and EU democracy varies by country and by region. Again, here three broad groups emerge: a group of primarily northern European countries that see their country as much more democratic than the EU (Austria, Germany, and the UK in particular, and to a lesser degree France, Belgium, and Greece), a group of Mediterranean countries (Spain and Italy) where the differences are minimal and a group of Central/Eastern European countries (Hungary and Poland) where respondents see the EU as much more democratic than their national democracies.

It is not surprising that Central and Eastern European EU countries hold a strong positive view of EU democracy given their relatively recent transition from authoritarian, communist systems of government and their membership of the EU. It is however an important finding given the concerns about democratic backsliding in some of these countries and the resulting clashes between EU institutions in Brussels and the governments in Warsaw and Budapest. The EU's powers to protect democratic norms in its member states is relatively limited, beyond the drastic step of threatening or actually using Article 7 TEU to suspend a member state's voting rights. But, were the current standoff to escalate, this data suggests there is a strong reservoir of public support in both Hungary and Poland for the view that the EU is a guarantor of national democracy.

At the other end the scale, the UK is emblematic of a country where a large number of people believe that EU integration is corrosive of long-established democratic traditions and institutions, a perception which weighed heavily in the UK referendum debate, particularly for those British Conservatives who take a maximalist and even absolutist view of parliamentary sovereignty. Importantly, however, the negative perception of the EU's democratic deficit is even larger in Austria, a country success for ring-wing and Eurosceptic in October 2017 legislative elections.

Figure 4. EU democracy versus national democracy (% of respondents who view the EU as very democratic minus % who view their country as democratic)



A final interesting aspect of this data is the relative closeness of France and Germany. Much has been made of the potential for a renewed Franco-Germany partnership to regain its role as the engine of European integration following President Macron's election.[14] This data supports the view that French and German citizens see the current state of EU democracy in fairly similar terms. However, German citizens, as much if not more than their French counterparts, are likely to identify a gap between the extent and functioning of national democracy and EU level democracy. This suggests that plans for deeper Eurozone integration may struggle to secure long-lasting public support without addressing other democratic shortcomings; it is possible that publics will at least demand a significant degree of political compromise in this area.

Elites are more positive about EU and national level democracy

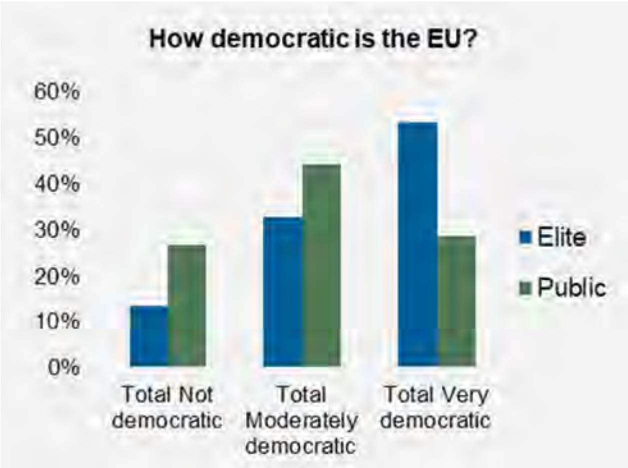
The unique aspect of this survey was to poll elites as well as the general public. On questions of EU democracy, elites tend to see both their own countries and the EU as more democratic than publics do.

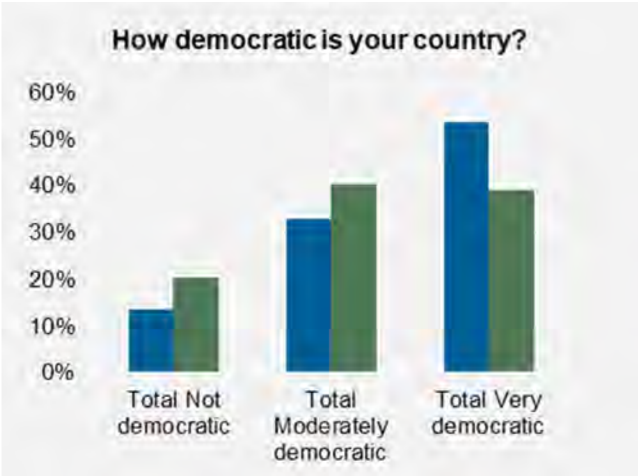
More than half of this sample of European elites view the EU as very democractic, which is almost double the figure for the general public. This may reflect a greater degree of knowledge about democratic compents of the EU institutions (both direct and indirect) – it is notable, for example, that only 62% of Europeans knew that the European Parliament was directly elected (Eurobarometer, 2015). Higher elite perceptions of EU democracy could also be a product of personal or direct involvement with politics, or, alternatively, different standards of judgement. Given a list of words and phrases, both positive and negative, and asked which they most associate with the EU, elites were more likely than the public to select democracy.[15]

[14] See for example, "Restarting the Franco-German engine", *The Economist*, 15 June 2017, https://www.economist.com/news/briefing/21723392-what-emmanuel-marcron-could-mean-paris-berlin-relations-restarting-franco-german-engine.
[15] Full data tables available at https://www.chathamhouse.org/publication/future-europe-comparing-public-and-elite-attitudes.

Differences between the elite and the public are lower in their attitudes to national democracy (see Fig. 5b) than to EU democracy. This reinforces the view that the elite-public gap is greater on issues which relate to European integration and perceptions of the EU than on other aspects of politics. However, democracy is not the area were this elite-public divide was largest. The main divides was evident in attitudes to identity, life experience and political values. This analysis is explored in greater depth in earlier research. [16]

Figure 5a and 5b. Elite vs Public attitudes to EU and national democracy





[16] See Raines, Goodwin and Cutts (2017).

3. From the democratic deficit to the liberalism gap

The ambition to make the EU more democratic and address the so-called democratic deficit has been an important dimension of the EU debate for many years, and explain the considerable growth in the powers of the European Parliament in successive European treaties. As mentioned above, on a broad level, attitudes to whether the EU enhances or undermines democracy are not as negative as might be expected given the challenges that the EU has faced over recent years, particularly around the Eurocrisis. When asked what is the EU's single greatest failure, a lack of democracy is not among the top responses (bureaucracy, immigration and the refugee crisis all get significantly higher responses). At the same time, when asked about the EU's greatest achievements, democratic values come nowhere near the top of the list (free movement, the Schengen area and peace come out top).

But the survey data reveals a different risk for the EU, which is the way that questions of democracy become intertwined with dissatisfaction on more salient issues. As was seen in the UK's referendum on EU membership, concern about immigration can become connected to the EU's inability to control numbers or flows – fusing worries about national sovereignty, anxieties or fear of rising ethno-cultural diversity and democratic control.

3.1 The values divide

Data from the survey reinforces the view that European politics is undergoing a structural transformation. Democratic divides can no longer simply be drawn along a conventional left-right spectrum. Rather, they are shaped by a contest over political values and political identity which cut across traditional divides. In this new contest, the liberalism gap is more important than the democratic deficit.

At one end of this scale are cosmopolitan liberal voters, who value diversity, are open to and embrace social change, and have the mobile assets which allow them to prosper in an increasingly globalised economy. They are often younger and more highly educated. At the other end are more traditionalist, nationalist, and authoritarian-minded voters, who value social order and stability, traditional concepts of community and identity, and are hostile to rising ethno-cultural diversity. European politics is increasingly being fought on issues that lie along this divide, like immigration and EU integration, on which many traditional political parties of the centre left and centre right hold similar views and so struggle to offer clear popular appeal to many voters.

A powerful illustration of this comes from using statistical models to explore how different demographic and political measures correlate to political positions. In this survey, respondents were asked whether they would like the EU to have more powers, the same powers as it does currently, or whether powers should be returned to member states. Using logistic regressions, it is possible to determine the factors driving support for returning powers from the EU. The best predictor of support for this position – with greater predictive power than income, political alignment, age or even level of education – was strong support for the death penalty.[17] This provides evidence that the realignment of European politics is in part a reflection of a contest over liberal values. It also suggests that this divide may outlast a sustained economy recovery in Europe and could become a structural feature of politics for many years to come.

[17] For a full explanation and description of this, see Raines, Goodwin and Cutts (2017). Authoritarian politics are a reliable predictor of support for the death penalty. See Stack (2003).

3.2 Publics and elites disagree on the future direction of politics and the EU

This survey data also demonstrates the existence of a divide between publics and elites over the future direction of politics and the EU which has important implications for European democracy in the future.

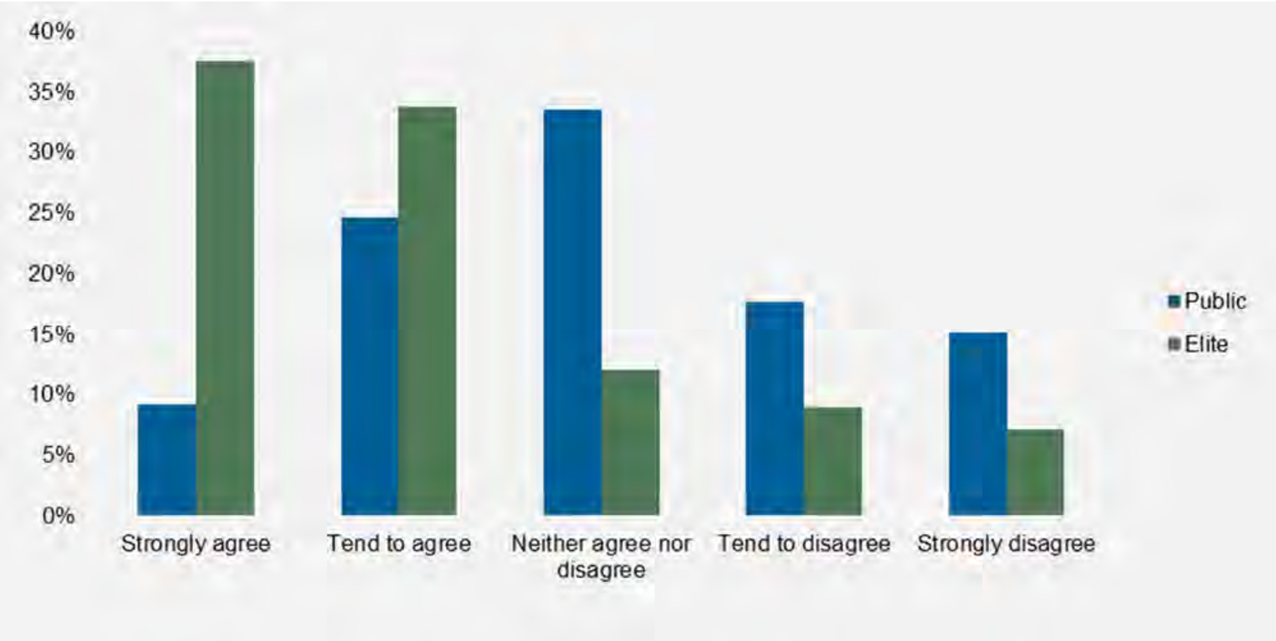
The two groups demonstrate a degree of alignment on a number of issues, including attitudes to financial redistribution within the EU (elites are more supportive but both groups show support); a positive attitude to European identity (with elites especially high); and attitudes to a much more integrated federal Europe (a plurality of both groups oppose this).

However, in a number of areas, there are pronounced differences. These include:

- Only a third of the public believe they have benefited from EU membership, compared with 71% of the elite sample;
- A plurality of elites think the EU should have more powers, while a plurality of the public wants them returned to member states;
- 57% of elites think immigration has been good for their country;
- A majority of the public (53%) think their country was a better place to live 20 years ago, while a plurality of the elite think their country is better today.

The risk is that populists, who present themselves as authentic representatives of people's concerns against an elite portrayed as corrupt and out of touch, will be able to utilise this divide in order to increase their power but may not be able to resolve the popular frustrations that animate their supporters.

Figure 6. "People like you have benefited from membership of the European Union"



4. The Illiberal Challenge

European societies are increasingly divided by their attitudes to liberal values and their views on the effects of liberalism on society and the economy. The data suggests, therefore, that the present weakness of European politics is driven more by challenges to liberal values than by attitudes to democracy per se.

And while liberalism is challenged at home, it is also struggling abroad. The democracies of post-war Western Europe, and allied nations, prospered securely within the context of a new international liberal order of open trade and investment that was promoted by the US and underwritten by its security guarantees. But concerns about the stability of this liberal order – and the collection of norms, institutions and alliances which have formed its bedrock – are now widespread.

Three challenges are worth highlighting, in particular:

- **The direction of global trade:** After three decades in which global trade grew faster than global GDP growth, since 2009 trade growth has never fully recovered. While a serious slide into protectionism was avoided in the wake of the financial crash, the World Trade Organization (WTO) has declared that "such a long, uninterrupted spell of slow but positive trade growth is unprecedented".[18] This is matched by a rise in anti-trade sentiment in many major economies, expressed though the mercantilist rhetoric of populist politicians or public hostility to new trade deals. The Transatlantic Trade and Investment Partnership (TTIP), the ambitious proposed transatlantic trade deal, has stalled, facing public opposition in Europe and political antipathy in the US. The EU-Canada trade deal was almost sunk by objections from the Walloon Parliament in Belgium. And while Britain's government preaches the gospel of free trade, it is currently struggling to negotiate its withdrawal from the world's largest market while the first serious mention of a UK-US trade deal created a firestorm about the potential arrival of US chlorine washed chicken in British supermarkets. The perception of many on both the left and right is that such trade deals primarily serve the interests of large corporations rather than consumers. This fits broader critiques of liberalism and economic integration; markets were poorly regulated in the run up to the 2008 crash and have in many cases delivered uneven benefits: great wealth for some and stagnating wages for many.
- **The future role of China:** The growth of China is the defining economic facet of the early 21st century. The remarkable growth of the Chinese economy has lifted millions out of poverty and returned China to its historic position as one of the world's largest economies. But exactly what the Chinese vision of globalisation is remains unclear. China has sought to present itself as the champion of the economic liberalism of which it has been such a huge beneficiary. But its rhetoric of economic openness contrasts with the perception of unfair trade practices, closed aspects of its domestic market and a growing regional assertiveness, particularly over territorial claims in the South China Sea. In addition, the positive messages of President Xi on the international stage are at odds with the growing repression of political dissent at home. China's model of state capitalism may appeal to some leaders of developing economies, but it does not seem to offer an appealing alternative to democratic liberalism for developed democracies. Whatever direction the international order may take, China will be central to shaping it.
- **The political direction of United States**: More than any other country, the US built and sustained the post-War international liberal order. The election of President Trump and his 'America first' rhetoric is a

[18] WTO, 7 April 2016, https://www.wto.org/english/news_e/pres16_e/pr768_e.htm

direct rebuttal of the system which all modern former incumbents of that office have seen as the best guarantor of America's international interests. At times in the past, the US has taken a unilateral approach, and underlined aspects of that same order. The US never ratified the Kyoto Treaty, the Com-Comprehensive Test Ban Treaty, or the International Criminal Court and has a decidedly mixed record of interventions abroad. But there has never been a modern US President who was opposed to or even contemptuous of basic aspects of the international order. President Trump's decision to withdraw from the Paris climate accord, his lukewarm attitude to NATO, his rhetoric around the the Joint Comprehensive Plan of Action (JCOPA) with Iran and his bullish and protectionist approach to international trade risk taking international liberal order into uncharted territory.

With the centre of gravity shifting, with opponents and spoilers emboldened and with its champions lacking confidence or conviction, the liberal order appears to be in trouble.

4.1 Liberalism: Trouble at home, trouble abroad

The connections between the international and the domestic challenges to liberalism are important. The increasingly integrated global economy which the liberal order has supported places structural pressures on the Western democratic model. Transnational challenges, such as climate change and financial stability, require cooperation and regulation at the international level, challenging traditional concepts of state sovereignty and creating greater distance between governments and citizens. These pressures will only intensify in the future. To be sustainable, democracy requires at least two things: a political 'community of fate'—to make accountable self-government a reality— and an 'imagined community', in which a sense of solidarity and cohesion exists amongst the populace, thereby enabling the pluralistic and discursive components of democracy. Both seem under threat at present. Indeed, some scholars like Dani Rodrik, believe that only two of the three prongs of democracy, integrated global markets and nation states can coexist.

Many of the challengers to liberal democracies at home are critics of liberalism abroad. They reject the benefits of open societies, open trade and the cultural ethos of globalisation. Opposition to international issues, like promoting global trade, fighting climate change, or delivering overseas aid, have served as rallying points for illiberal domestic politics.

Those countries which are champions of liberal rules based international order must be able to demonstrate that it can deliver for citizens at home. If not, there is a risk of a downward spiral: publics will continue to seek solutions from populists, who have been adept at articulating the worries and fears of many but whose solutions offer little promise of addressing the root causes. Where nationalist populists do gain power, they may through unilateralism and mercantilism further undermine the capacity of the international liberal order to deliver, risking its further decline and setting back the goal of global progress.

5. Principles to move forward

For EU policy-makers, the ambition must be to ensure that globalisation works in the interests of a clear majority of citizens. Three approaches which could support this aim are contesting illiberalism; improving the democratic legitimacy of the EU; and sustaining and nurturing liberalism internationally.

Contest illiberalism

The key challenge facing Europe's established parties is how to contest this illiberal turn. This is not a straightforward task. But some starting points could include:

- **Reframing debates about immigration:** There is some evidence to suggest that anxieties about immigration can be combatted by using factual information in well framed campaigns. Emphasising the way that migrants become part of and contribute to local communities can be more effective than narratives which champion the abstract benefits of diversity.
- **Target the sceptical middle:** A forthcoming Chatham House research paper identifies the roughly third of the European population who are moderately sceptical about migration and European integration as the key swing group to be won over. If their concerns are not addressed, many of these voters may drift towards more hard-line sceptical groups.
- **Challenge the actions of illiberal leaders within Europe:** European leaders must hold firm in their critical response and opposition to democratic backsliding in some countries within the EU – particularly when it runs counter to the fundamental principles of EU membership as enshrined in the EU treaties and Copenhagen criteria.
- **Foster inclusive growth at home:** Although income is not a strong predictor of positioning on the liberal-authoritarian values spectrum described above, there is evidence that poverty, and inequality of opportunity, particularly in education, remain important factors.[19] A recent commission in the UK examining inclusive growth concluded that it was necessary to 'move from an economic model based on growing now and distributing later to one that sees growth and social reform as two sides of the same coin'.[20] This could involve placing a heightened premium on investment in social infrastructure such as education, workforce skills and employment services, which can contribute to improving productivity and support adjustments to the effects of trade-driven and technological disruptions. There is also a growing momentum around the importance of using additional measures such as well-being to evaluate economic progress. The OECD has developed a framework to approach this.[21]

Improve democratic legitimacy in the EU

There is no magic wand which will fix the challenges to the democratic legitimacy of the EU. The European Parliament cannot be the only answer as the difficulties are mostly structural. However, some points stand out:

- **Eurozone reform should be a democratic process**: The creation of the single currency was rooted not only in an attempt to improve the economic efficiency of a deepening single market, but also in a grand political vision, which sought to bind together the peoples of Europe and the interests of member states through a shared currency. The shortcomings in the design of the monetary union which were revealed during the crisis seem to argue for deeper monetary integration. However, if this is do-

[19] https://www.jrf.org.uk/report/brexit-vote-explained-poverty-low-skills-and-lack-opportunities.
[20] https://www.thersa.org/globalassets/pdfs/reports/rsa_inclusive-growth-commission-final-report-march-2017.pdf.
[21] http://www.oecd.org/statistics/measuring-well-being-and-progress.htm#framework.

ne in a way that bypasses public consent, it will create further legitimacy challenges for the EU. Therefore, both in the manner that it is negotiated and in reforms it enacts, the democratic legitimacy of deepening the Eurozone should be a focus at each stage.

- **Recognise the diversity of attitudes in Europe**: It is clear from the survey data that the varieties of attitudes to the EU across Europe do not fit neatly onto a linear pro or anti-EU spectrum. Many in Europe feel positive towards the EU but do not necessarily support deeper integration, and some who value the EU would like it to do less. A narrow binary debate risks closing down the space available for a productive democratic discussion, delegitimizing reasonable dissent and serving the interests of those on the extremes who build support by attacking a stifling consensus which does not appear to address high salience issues.
- **Avoid undue pessimism**: As the data above suggests, views of democracy in the EU are more positive than might be expected, including in Central and Eastern Europe. This gives a platform to build on and the potential to address long term issues.

Sustain and nurture a rule-based liberal order

Despite their relatively weak position at present, the EU and its neighbours, including the UK, should continue to do all they can to sustain to sustain a liberal international order, a rules-based system which offers the best chance of addressing global challenges. Even if aspects of the open international economy have driven political backlashes, the consequences of abandoning that openness are likely to be worse than trying to manage its effects. In particular:

- **Ensure Britain and the EU remain regional and international partners:** The complex disentangling of Britain from the EU has not got off to a good start. There are many issues to be resolved, both in settling the terms of Britain's withdrawal and of the two sides' future relations. But it should be a clear priority for both parties to create a framework which supports deep and close cooperation internationally. Britain and the EU will remain obvious partners in terms of their values, interests and geographic proximity. In the long run, both will benefit from partnering to tackle challenges to the international liberal order.
- **Maintain the pilot light of transatlantic relations:** It is difficult to see in the current climate how it will be possible for the US, EU and UK to cooperate strategically and effectively, given that many US administration positions run counter to those in Europe, as well as to previous US governments. On climate change, NATO, the Middle East, Russia and trade it may be hard to find common ground. However, it is important that the transatlantic relationship outlasts the vicissitudes of a single administration, and that links are maintained across the broad spectrum of institutions.
- **Engage constructively with China:** It is sensible for the EU to approach China's flagship strategic infrastructure initiative on the 'Belt and Road' positively. The EU should also try to negotiate an investment treaty with China in the near future, as well as aim for an FTA over the longer term.[22] The EU should aim to support China's active participation in sustaining the international economic order of which it has been one of the chief beneficiaries. Where China is seen to be operating unfairly, there may also be opportunities to work with the US where assessments are closer to the European position than on many other issues.

[22] García-Herrero et al. (2017).

6. Conclusion

For decades, political leaders of advanced democracies have broadly supported an increasingly integrated global economy, and in Europe, the deepening political and economic integration of the EU. Meanwhile, Europe has seen a structural transformation of party systems and is now facing a backlash against economic and political openness. Chatham House data suggests that while attitudes to national and EU democracy are not especially negative, there is a divide over liberal values both among the public, and between the public and political elites, and this divide is empowering those who reject both open societies domestically and a liberal rules-based system internationally.

Those countries which are champions of liberal rules-based international order must be able to demonstrate that it can deliver for citizens at home. These pressures are only likely to intensify in the years to come, as technological change brings greater disruption to established economic and business models. The task of ensuring that globalisation works in the interests of a clear majority of citizens is an urgent one.

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Democratic Crises in The EU: Towards "New Frontiers"

Yves Bertoncini, European Affairs Consultant and President of the Mouvement Européen - France

Executive Summary

1. National democracies disrupted by a triple legitimacy crisis

- The rise in protest votes within the EU is the result of a reaction to the economic and financial crisis but also a more structural development related to Europe's fate in globalisation (winners vs losers but also an identity crisis),
- The democratic crisis is also heightened by the decline of traditional parties which have structured national politics, by the citizen predilection for forms of participative and direct democracy and by the effects of the spectacular rise of social networks,
- The financial crisis has had a role in weakening the legitimacy of European political systems, fuelling the distrust of traditional elites, perceived as being at the root of the crisis or as incapable of dealing with it.
- This threefold destabilisation has affected many democracies in the EU, but has not, however, disputed their foundations and operation.

2. The European Union after the "Troika": the democratic deficit, a never ending debate?

- The intervention of the Troika was marked by relationships of conditionality between States and an operation characterised by opacity: it must be acknowledged as an aside, at a democratic and political cost, which must be brought to a close.
- A reinforcement of the transparency of EU decision-making is a more classic democratic challenge, that must be tackled within the EMU, but also for trade negotiations and "comitology" procedures,
- A reduction of the EU's "electoral deficit" would imply in particular extending the dynamic introduced by the "spitzenkandidaten" system launched in 2014, which would involve, for example, all candidates for the presidency of the Commission taking part in the European elections and the appointment of the members of the Commission by the elected President.

3. Democratic conflicts between EU citizens: how can we become more united in diversity?

- The political conflicts caused by the successive crises which have hit the EU actually reveal the existence of considerable divides between EU citizens. These divides are much more of a danger for the EU's cohesion than yet another demonstration of its democratic deficit,
- Promoting European unity must involve highlighting how peoples of the EU can both come together, by

sharing their sovereignty, and be similar, by gaining awareness of their common identity with regard to the rest of the world,

- A differentiated Europe may be a last resort to breathe life into Europeans' "unity in diversity" in a democratic framework, while ensuring the proposal of a positive agenda on all levels/for all citizens (Eurozone, Schengen and EU).

1. Introduction

The crises hitting many European democracies take root in causes that are both cyclical and structural, national and international. These causes must be analysed in detail so that informed diagnostics and recommendations may be drafted. Not all European democracies are affected in the same way, the democratisation of the European Union (EU) is making constant progress, and yet the economic and financial crisis, the advance of globalisation and the rise in new communication networks have put European political systems to the test.

Since it is based on national democracies to a great extent, the EU is also affected by the current trend of destabilisation, in addition to the challenges related to its specific nature and its operating method. A phenomenon such as the intervention of the "Troika" in Greece and in other countries has radicalised the conventional debate on the "democratic deficit" of the European construction, which has also been subject to a popular demand for increased transparency and participation. It is important to stress the difference between a popularity deficit and a democratic deficit, but also to highlight the divisions between European peoples as an element of a political crisis, rather than a democratic crisis.

2. National democracies disrupted by a triple legitimacy crisis

European, and even western, democracies have been disrupted for the last decade by the calling into question of the three foundations of their legitimacy:

- their efficiency in adopting decisions and political choices which benefit the greatest number ("output legitimacy");
- their ability to enable their citizens to make their voices heard and influence public decisions ("input legitimacy");
- and lastly the acknowledgement of public decision-makers as the representatives of the citizens they are intended to serve ("inner legitimacy").

This threefold destabilisation has affected many democracies in the EU, but has not, however, questioned their foundations and functioning.

2.1 The rise in protest votes: a reaction to the crises or a structural development?

The financial crisis that began in 2007 has been described as the most serious since the crisis of 1929. Its major economic and social repercussions have triggered intense waves of anger and resentment. However, the popular reactions expressed throughout the crisis have not had the same political outlets as those observed in the 1930s, in particular owing to the activation of sophisticated social protection mechanisms that barely existed at the time. Such reactions have generated a feeling of dissatisfaction that more or less radical protest parties have been able to harness[1]. The rise of such parties has been furthered by two, more structural phenomena related to Europe's fate in globalisation.

The first phenomenon is the increasing economic and social polarisation between the winners and losers of the opening of international trade, the "generally positive" impact of which is felt by Europeans to very different degrees according to their level of education, profession and region of origin. The same can be said for the opening up of immigration channels in European and western countries: this causes different responses which are often negative, heightened by the "refugee crisis" for citizens who are wary of a multicultural model of society.

The conjunction of these two phenomena fuels a kind of identity crisis, which further exacerbates the feeling of loss of control with regard to the development of the world with Europe no longer at its centre: it may foster a preference for authoritarian powers claiming to be the protectors of the old order.

Responses of rejection are stronger in countries which were particularly hit by the financial crisis, with broadly open economies, unsophisticated social protection systems, and in addition home to high levels of immigration due to their attractiveness. Based on these three reasons, is it so surprising that the United Kingdom and the USA have suffered such disruptive and striking political shocks as the victory of the Brexit vote and the election of Donald Trump, even if both of them were obtained with a narrow margin? Is it not logical that other EU democracies were

[1] On this subject, see for example Stijn Van Kessel, Populist Parties in Europe - Agents of Discontent? Palgrave Macmillan, 2015.

able to channel the expression of dissenting forces without exposing themselves to particularly harmful political or institutional consequences?[2]

In any case, it is important to make a clear distinction between two recent political developments in Europe:

- the first, which results from the rise of parties championing radical positions, winning seats in Parliament, where applicable taking part in forming the government of their country – without undermining in any way the normal functioning of democracy, and even seeking the direct intervention of the people (as was the case with the holding of a referendum in Greece by Alexis Tsipras);
- the second development is part of the shift whereby parties claim more or less directly to be a model of "illiberal democracy" (in Poland and in Hungary), specifically because they place democracy and "the people" above the principles of the rule of law – without undermining in any way the conventional election procedures, and even attempting to use them to their advantage (as was the case in Hungary with the holding of a referendum on the resettlement of refugees).[3]

2.2 The (r)evolution of democratic debate

The negative repercussions of the economic and financial crisis seem to have occurred alongside a more structural transformation of the conditions under which democratic debate is organised in Europe, in terms of partisan "infrastructures" and intellectual "superstructures".

The traditional parties which have structured national political life since the end of World War II are for the most part facing a historic weakened position.

This is true for social democrats and socialists, which are struggling to reform the redistribution system against a backdrop of globalisation and an ageing population. It is also true to a lesser extent for Christian democrats, facing both the secularisation of Europeans but also political forces which are more radical champions of religion in the political arena. This double weakening has been beneficial to new political parties, often taking up an anti-system position, and which have been able to do well from a decisive political line (radical left such as Syriza or far-right such as AFD) or on the basis of a catch-all approach (for example, the Five Star Movement or, in a completely different manner, En Marche).

This upheaval in partisan politics was fostered by the citizens' predilection for forms of participative and direct democracy, against the backdrop of the continued increase in level of education and degree of information.

The increasing number of rolling news channels and the spectacular rise of social networks have heightened the intensity and transparency of democratic debate, but have also caused a number of adverse effects. The segmentation of information channels therefore appears to be highly ambivalent: we are first of all informed by those with whom we form a community, whether real or virtual, in which there is an element of trust, to the detriment of broader interaction with fellow citizens. The discrediting of conventional media outlets, treated as representatives of the "system", has resulted in the spread of "alternative facts" and "fake news", sometimes disseminated as part of propaganda campaigns[4].

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[2] As stated by Thomas Raines, it is the "challenge to liberalism rather than to democracy which represents the greater threat to Europe and European integration", in Thomas Raines, "The twin liberal challenge", Chatham House, October 2017.

[3] On Hungary and the concept of illiberal democracy, see András L. Pap, D*emocratic Decline in Hungary - Law and Society in an Illiberal Democracy*, Routledge, 2017.

[4] See Thierry De Montbrial, Dominique David, Ramses 2018: La guerre de l'information aura-t-elle lieu ? Institut Français des relations internationales, Dunod, September 2017.

These major changes to the framework of national political debate have not called into question democratic principles – at least not to this day. It is a difficult challenge for traditional parties and political powers, encouraged to change their means of operating and communicating. The same applies to government authorities, that can choose whether or not to take on board the concerns and even the solutions voiced by parties claiming to be "anti-establishment". In any case, it appears more correct to speak about partisan crises and information crises to describe the political situation over the last decade rather than a deep-rooted crisis affecting traditional democracies, in Europe and elsewhere.

2.3 Is there a divide between citizens and political elites?

The financial and economic crisis has also played a role in weakening the legitimacy of European political systems by fuelling the distrust of traditional elites: economic and banking elites, thought to have devised the practices which had disastrous repercussions in terms of growth and employment; and political elites, accused of failing to prevent the crisis or of having taken contested or painful decisions to tackle it.[5]

This rejection of elites was more keenly felt in countries in which a collusion between politics and finance has been perceived (for example in Spain or in Ireland). The rejection of traditional political elites was also encouraged by the development of coalition or "national unity" governments (see Table 1), made necessary by the wide spread of votes in legislative elections (for example in Greece and Italy). These multi-party governments have led voters wishing to express their desire for change and interplay to give credit to the political powers on the margins of the political chessboard (radical left and far right) or those claiming to be new arrivals (for example Podemos and Ciudadanos in Spain).

Table 1. Selection of "grand coalition" or national unity governments in the EU (2007-2017)

COUNTRY	PARTIS INVOLVED	PERIOD
Austria	OVP (EPP) & SPO (S&D)	2007-2017
Czech Republic	CCSD (S&D) & KDU-CSL (EPP) & ANO	2013-2017
Germany	CDU-CSU (EPP) & SPD (S&D)	2013-2017
Greece	ND (EPP) & PASOK (S&D)	2011-2015
Italy	Forza Italia (EPP) & Democratic Party (S&D) & alii	2011-2014
The Netherlands	VVD (ALDE) & NPVA (S&D)	2012-2017

Source: Author's own compilation.

The widening of the gap between citizens and political elites was exploited by so-called "populist" leaders or movements, a term selected almost invariably in juxtaposition to "the people", deemed an undefined entity, and its representatives deemed discredited and even illegitimate.[6] The rise in these movements or leaders does not appear to be simply due to substantive reasons (anger aimed at "those at the top") but is also due to formal reasons, and in particular the inclination to use a simple and emotional communication method more likely to have an impact on a greater number than the rational and legal language often preferred by traditional political elites.

[5] On the mass-elites divide cause by the crises, see in particular Hanspeter Kriesi and S. Pappas Takis eds. *European Populism in the Shadow of the Great Recession*. Colchester: ECPR press, 2015.

[6] On the anti-establishment divide as a consequence of the lack of representation of mainstream parties, see Peter Mair, *Ruling the Void: The Hollowing Of Western Democracy*, Verso, 2013.

The ability to offer clear-cut and even simplistic political options instead of the culture of compromise and gradualism used by the elites in power has also contributed to the rise of these protest parties, even if they failed to attain power within the EU with a few recent exceptions (participation in the coalition governments in Bulgaria, Finland, Greece and Portugal).

The rise in protest parties has come in conjunction with the major traditional parties holding up quite well (such as the CDU-CSU in Germany, the People's Party in Spain, etc.). Similarly, the prospect of a possible victory of political powers with radical positions (such as the departure of their country from the Eurozone) has led to an erosion of popular support, as was seen in France when the National Front reached the second round of the presidential election. It emerged that parties calling for a "return to order" were actually promoting a change likened to a "leap into the unknown", in total contradiction with their political position and the aspirations of many voters.

3. The European Union after the “Troika”: the democratic deficit, a never-ending debate?

Launched after World War II on the basis of an enlightened despotism approach[7], the European construction has since undergone a movement of constant democratisation, as the European institutions gained increasing competence and powers. This progressive democratisation was in particular marked by the rise of Members of the European Parliament elected by direct universal suffrage and further heightened by the recent entry into force of the Treaty of Lisbon. It has, however, come up against the new political order caused by the Eurozone crisis, and which symbolised the arrival of the Troika in Greece, Ireland, Portugal and Cyprus. The exceptional and costly nature of this political aside must be stressed and the main political challenges that the European institutions face must be identified in order to understand the almost-permanent “democratic crisis” afflicting the EU.

3.1 “Europe-IMF”: a political aside that must come to an end

The Eurozone crisis radicalised criticism of the EU’s democratic deficit, in particular by granting a decisive role to the pool of eminent experts commonly known as the “Troika”, made up of officials from the European Central Bank, the European Commission and representatives of the International Monetary Fund. The emergence of the “Troika” appeared to echo the denunciation of “nationless technocrats” blasted by General de Gaulle and has revived criticism of the European construction which is deemed insufficiently democratic.

This criticism originally focused on the EU’s ability to weigh in on the collective decisions made in national democracies[8], on the basis of a relationship of conditionality similar to that established by the IMF with the countries it funds (see Table 2). Four EU Member States lost part of their sovereignty because they lost their solvency: as they could no longer obtain financing at reasonable rates on the financial markets, these four countries were obliged to resort to loans and guarantees from public creditors (EU Member States, the ECB and the IMF). When describing the resulting “creditocracy”, Mario Monti rightly referred to the creation of an exorbitant political relationship under ordinary European and international law, based on formal equality between States. Once the countries in question restored a sufficient level of credibility on the markets, they were once again able to collect the financing they required, while removing themselves from a relationship of political dependence with “Europe-IMF”[9], which was only an aside.

Criticism of the “democratic deficit” of “Europe-IMF” and the governance of the Eurozone also targeted the opacity with which crucial decisions have been taken, in particular at meetings of the “Eurogroup”, within the “Troika”, or even during Eurozone summits. The co-existence of different players within the “Troika” has made it difficult to identify who exactly made common decisions, which have often been subject to conflicting interpretations and communication – the same can even be said of the conclusions of several European Council “crisis” meetings. While the sensitive nature of the decisions to be made with regard to the reactions of the financial markets sometimes called for a degree of discretion on the part of the decision-makers, this discretion has proved to be very counterproductive from the European citizens’ perspective. Similarly, the shortcomings of the parliamentary control conducted on a European level has revealed democratic imperfections with regard to the often-strict

[7] On this subject, see Yves Bertoncini, *Europe, le temps des fils fondateurs*, Essai, Michalon, 2005.

[8] This criticism also concerns, to a lesser extent, the European mechanisms to monitor the budgetary, economic and social policies of Member States, via the Stability Pact and the adoption of the “Treaty on Stability, Coordination and Governance” (TSCG).

[9] On the concept of Europe-IMF, see Yves Bertoncini, “Eurozone and democracy(ies): a misleading debate”. Policy paper No. 94, Jacques Delors Institute, July 2013.

parliamentary control conducted in many national democracies (for example in Germany). Once again, if the Europe-IMF aside has now ended to a great extent, it will leave quite a profound impact[10] since the criticism voiced about this new political order directly echoes the recurring criticism of the EU.

Table 2. The way in which powers are exercised within the EMU

PURPOSE	TOOLS	KEYWORD	EUROPEAN ACTORS	COMPARABLE ACTORS
Bailout	ESM Memorandum of Understanding	Condition	Commission / BECB European Council	IMF
Supervision of budgetary excesses	Stability and Growth Pact TSCG	Sanction	Commission Council	UN
Monitoring economic and social policies	Europe 2020 TSCG/Euro Plus Pact	Political incentive	Commission Council	OECD
Assistance for structural reforms	Reform financial aid	Financial incentive	Commission Council	World Bank

Source: Yves Bertoncini, and Antonio Vitorino, "Reforming Europe's governance", Study No.105, Jacques Delors Institute, September 2014.

3.2 A classic challenge: how to reinforce the transparency of EU decision-making?

The creation of a "Euro summit" in 2008, at the height of the financial crisis, helped to make use of faces familiar to European citizens at a time when key decisions were being made. This identification of the main decision-makers was useful in the succession of summits presented as "last-chance" meetings: although these summits often gave rise to the voicing of fierce disagreements, they did highlight the natural antagonism between representatives of different parties and citizens.

This need for visibility should now result in the creation of a permanent president of the "Eurogroup", who is not playing a bit part, hastened to return to his/her national capital once the meetings are over: this president should be the constant embodiment of the Eurozone's management, not only for other decision-makers, but also for citizens and their European and national representatives. Entrusting the role of permanent president of the Eurogroup to the Commissioner responsible for economic affairs and finance, based on the existing model of the High Representative for Foreign Affairs, would make the governance of the Eurozone simpler and more readily identifiable. The President of the Eurogroup must also act under the supervision of the Members of the European Parliament in a Eurozone sub-committee – that could easily act as a "Eurozone parliament", which could be recognised by citizens in the relevant Member State[11]. Together with the integration of the European Stability Mechanism within the community system, all these adjustments would improve the democratic clarity of Eurozone governance (see Table 3) and allow the EU to find a successful way out of the "crisis" in its strictest sense, i.e. a temporary phenomenon.

[10] The Europe-IMF aside will be brought to a full close in the summer of 2018, when Greece will return fully to the financial markets (even though some ex-post monitoring mechanisms may remain in place, as is the case with Cyprus, Ireland and Portugal.

[11] For further information about the democratisation of the Eurozone and the EU, see Yves Bertoncini & Antonio Vitorino, Reforming Europe's governance, Studies & Reports No. 105, Jacques Delors Institute, September 2014.

Table 3. A clearer institutional architecture for the Eurozone

THE "GOVERNMENT" OF THE EUROZONE	
Presidential level	Regular Eurozone summits with a permanent president and contribution of the President of the Commission
Ministerial level	Eurogroup with a full-time President and contribution of the Commission
THE PARLIAMENTARY DIMENSION OF THE EUROZONE	
European Parliament	Eurozone sub-committee (open to all Members of the European Parliament, up to 60 members)
National parliaments – European level	Interparliamentary conference of the EMU(open to representatives of the 25national parliaments that have ratified the TSCG, upto150). Participation of Members of the European Parliament(up to 30 MEPs).
National parliaments – national level	Reinforcement of ex-ante and ex-post monitoring of their government when debating and voting on issues related to the Eurozone

Source: Yves Bertoncini, and Antonio Vitorino, "Reforming Europe's governance", Study No.105, Jacques Delors Institute, September 2014.

There is scope to step up the transparency of the EU's decisions well beyond the management of the Eurozone. The Treaty of Lisbon sought to satisfy this requirement by stating the open court principle for Council debates when meeting in "legislative formation". Results must then be produced to make more visible the documents stating each country's voting outcome during the adoption of Council decision, and also when these decisions are not adopted due to an unattained required majority.

Increased transparency on a European level is also required for non-legislative decisions:

- Firstly, for international trade negotiations, which have an impact on collective interests and preferences that are so important that they can no longer be conducted exclusively via diplomacy. Even though negotiators should not show their hand to their international partners, considerable progress must be made in this area: this is what Jean-Claude Juncker meant when he announced his intention to make public the trade negotiation mandates proposed by the Commission, while inviting the Council to do the same when these mandates are adopted.
- Secondly, for the directives and regulations adopted by the committees which meet under the presidency of the Commission, and which are in greater numbers than the legislative texts adopted by the Council and the European Parliament. As demonstrated by the controversy surrounding the abolition of roaming fees or the authorisation of glyphosates, it is politically inconsistent not to apply the same transparency and supervision requirements to these comitology decisions, on the grounds that they concern less sensitive subjects on an infra-legislative level.

It is also in terms of the progress achieved regarding the transparency of trade negotiations and comitology proceedings that the EU can show that it has learnt from the Eurozone crisis, as well as from the development of public debate on Europe.

3.3 An endless debate: the European Union's electoral deficit

The incursion of the Troika further fuelled criticism of the importance of non-elected bodies on a European level. Responsibility must be taken in part for this situation, since it is logical that the members of an institution such as the European Central Bank are not elected: it is precisely to remove the management of money as a public commodity from political pressures that central bankers are appointed and act independently, across the globe.

However, a reinforcement of the electoral foundations of European institutions would be welcome, in particular extending the dynamic introduced by the *spitzenkandidaten* (top candidates) system launched in 2014 on the basis of the Treaty of Lisbon, which would suppose in particular:

- The nomination of candidates for the Presidency of the Commission put forward by European political parties on the basis of a primary election which is as open as possible: competition between several candidates[12] and election by party members, or even European citizens[13],
- The participation in European elections of all candidates for the Presidency of the European Commission[14], or even of all candidates for a European Commissioner position[15],
- The appointment of members of the Commission by the President elected on the basis of the outcome of the European elections[16], once again to reinforce the link between their appointment and the popular vote;
- The establishment of a voting method close to the citizens, on the basis of constituencies that are as regionalised as possible — the additional option of transnational lists to be used to add a pool of pan-European office holders[17].

All or part of these political and institutional reforms could help to reduce the EU's electoral deficit, which will remain structural due to size effects: the members of a European Parliament limited to 751 seats cannot by nature enjoy such intense and close relations with their fellow citizens (roughly 500 million) as national MPs. These reforms do confirm, however, the EU's constant progress to reach a democratic horizon that is still to be conquered.

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[12] In 2014, Martin Schulz did not have any competition when he was nominated as the candidate for the European social democrats.

[13] The European Greens were the only party in 2014 to use a primary election open to European citizens, and not simply the delegates appointed by the national political parties.

[14] In 2014, Jean-Claude Juncker was not a candidate in the European elections, although he was nominated by the EPP to be its candidate for the presidency of the Commission.

[15] On the basis of the system in force in countries such as the United Kingdom or Germany, where there is a requirement to be an elected national MP to be appointed Minister.

[16] The members of the Commission are currently appointed by the Council of Ministers, and de facto by the Heads of State and Government.

[17] In the short term, these transnational lists could be created in the spring of 2019 thanks to the reallocation of the 73 British seats made possible by Brexit.

4. Democratic conflicts between EU citizens: how can we become more united in diversity?

The political conflicts caused by the successive crises that have hit the EU over the last decade have sometimes been described as the demonstration of a divide between “Brussels” and European citizens. They actually reveal considerable divides between EU citizens which can only be overcome by highlighting what unites them, or failing this, by promoting a European construction of variable geometry.

4.1 A striking political divide: not Brussels against the citizens but citizens against citizens

The recent intensification of criticism against “Brussels despotism” has occurred alongside an unprecedented heightening of public debate caused by the Eurozone crisis and the refugee crisis, across the EU. The contrast is striking between the denunciation of a “Europe” which is said to be cut off from its citizens and the incredible number of parliamentary votes and national elections which have placed European decisions at the forefront. The debates resulting from the recent crises have in fact played a part rarely seen before in the democratic way in which decisions are made at EU level (“input legitimacy”).

The EU has admittedly become much less popular with its citizens during the Eurozone crisis, and subsequently during the refugee crisis. The EU’s image, the trust placed in it and the direction it is taking have been assessed to be in sharp decline among citizens in most EU Member States[18]. This drop in popularity, which was curbed over the last period from 2015 to 2017, was all the more striking as it was fuelled by criticism from diametrically opposed positions: criticism of the financial assistance granted to some Eurozone countries voiced in creditor countries such as Germany, Finland and Slovakia, alongside criticism of austerity expressed in countries such as Greece, Ireland and Portugal in return for EU and IMF financial assistance. The same dynamic of diametrically opposed criticism was revived when the refugee crisis hit, with public opinion denouncing the lack of control in some border countries (Greece, Italy, etc.), the lack of solidarity between European countries (Germany, Sweden, etc.), or on the contrary the solidarity organised by the EU (Poland, Hungary, etc.).

This twofold criticism is naturally harmful to the European construction, but above all it reveals “horizontal” divides between European citizens, much more than a “vertical” divide between the EU and its citizens. Such horizontal divides have made the adoption of decisions more complex for national and European authorities; and were sometimes accompanied by the prevalence of hackneyed stereotypes (Greeks = lazy; Germans = Nazis, etc.), stereotypes which are often conveyed by the political elites as much as by the citizens. They have resulted in the adoption of decisions based on compromises deemed to be unsatisfactory by all. Yet these divides have reflected or continue to reflect the heterogeneous nature of the interests and perceptions of citizens of EU Member States, “united in diversity”: these are much more of a danger to the EU’s cohesion than yet another demonstration of its democratic deficit.

[18] See for example Daniel Debomy, “EU no, euro yes? European public opinions facing the crisis (2007-2012)”, Policy Paper No. 90, Jacques Delors Institute, March 2013.

4.2 An imperative necessity: "united in adversity"

The divisions (centre/periphery, north/south, east/west, etc.) between national democracies exacerbated by the recent crises call for more emphasis on unity among Europeans. Promoting this unity has less to do with exalting the existence of an unidentifiable European people, and more to do with highlighting how peoples of the EU can both come together and be similar – which is easier to do if the outlook is global[19], as the French president Emmanuel Macron did in his addresses in Athens and at the Sorbonne.

First of all, it is possible to state the reasons why Europeans are called upon to share their sovereignty in order to defend their interests and values more effectively in a world in which Europe is no longer at the centre and accounts for barely 6% of the total population. The advantages of shared sovereignty can then be promoted as a response to challenges as varied as climate change, energy dependency, financial deregulation, the fight against terrorism, the emergence of continental superpowers, uncontrolled migrant flows, etc. "Strength through unity" or the EU as a protection from threats may be a useful mantra to stitch together the cohesion between European citizens against a backdrop which is both unstable and adverse.

In addition to these operational prospects, it is just as important to invest in Identity Politics, stressing how similar Europeans are compared to the rest of the world. This does not simply involve highlighting our shared past and heritage, but also the principles on which the European model is based, separate from Asian or American models. We are, for example, European because we share democracy, the rule of law, gender equality, the protection of minorities, and the rejection of the death penalty, principles which are rarely applied with such intensity elsewhere in the world. We are also European because we are connected by a development model capable of generating around one quarter of the global wealth, based on a "social market economy" which strives to reconcile efficiency and cohesion like no other region of the world, while attempting to limit its CO_2 emissions. We are European because our long history of war has taught us to prefer the pacific settlement of disputes, without sending uniformed soldiers to die in neighbouring countries or young people to blow themselves up in public spaces[20]. Without a doubt, Russian aggressiveness, the uniqueness of the Chinese model and the inability of Donald Trump to embody the values of the western world create favourable conditions for the promotion of such a European identity by the EU's political and intellectual elites.

4.3 A hypothetical imperative: a differentiated Europe as a last resort?

Breathing life into Europeans' "unity in diversity" in a democratic framework must be an impetus for the reinforcement of their involvement in public debate on the EU's decisions, in particular around European Parliament elections or initiatives such as the "Conventions" held in the first half of 2018. While such public consultations could result in the continued striking divisions between the EU and the inability of national political leaders to overcome them, the promotion of differentiated integration may appear to be the last resort for today's Europe.

This differentiated integration is naturally already a political reality, in particular through the existence of the Schengen Area including 22 of the 28 EU Member States and the Eurozone bringing together 19 Member States. This must not, however, be promoted further without proposing several positive agendas involving all EU Member States, to ensure that some are not left with the impression of being side-lined. Above all, it is important to avoid

[19] Some more "inward looking" motives should naturally be promoted as well, such as the importance of the solidarity principle and the need to reduce economic and social asymmetries in order to increase unity within Europe.

[20] On this subject, see "Yes, we are European!", Jacques Delors, Enrico Letta, Pascal Lamy, Yves Bertoncini & Alii, Tribune, Jacques Delors Institute, December 2016.

using the concept of a “multi-speed Europe”, especially as it is necessary to make quicker progress on several levels (Eurozone, Schengen and EU).

Differentiated integration could also be perceived as legitimate in the event of heterogeneous national desires or capacities. It can easily be presented as a tool aimed at serving the interests of EU citizens and Member States, while ensuring full compliance with their wishes and sovereignty. A national abstention may be legitimate in the EU today, in which many Member States or citizens are reacting negatively to what they perceive to be “restrictions” coming from Brussels. Differentiation may also result from heterogeneous national capacities, which must be assessed on the basis of criteria that are fully acknowledged to be legitimate (for example as regards entry in the Eurozone and the Schengen Area).

Differentiated integration must be based on legitimate procedures and mechanisms. Its implementation within the EU is the best option in terms of legitimacy (see Table 4), as it requires the involvement of well identified community institutions, on the basis of several options (enhanced cooperation, permanent structured cooperation, etc.). Differentiated integration outside of the EU could continue to develop, particularly in the field of external relations and defence (Eurocorps, Athena, etc.) and for research and development (CERN, Eureka, etc.). Formal and informal coordination and communication mechanisms must be developed between participating and non-participating countries under all circumstances.

It is under these conditions that differentiated integration could prove to be a good way of combining Europe’s democratic unity in diversity, rather than as a means to aggravate intra-European political fragmentation, from which external countries such as Russia, China, the USA and soon the United Kingdom may stand to gain, a development which would ultimately endanger the proper functioning and even the long-term continuation of the EU.

Table 4. Main EU mechanisms of “internal” differentiated integration

EU MECHANISMS	EXAMPLES
Opting out	Euro, defence, citizenship, asylum, Charter of fundamental rights, etc.
Enhanced cooperation (at least 9 out of 28 countries)	Divorce law, financial transaction tax, EU patent, etc.
Permanent structured cooperation	Defence (not used yet)
Constructive abstention (1/3 MS and 1/3 of the EU population)	Common Foreign and Security Policy
Intergovernmental agreement finally/to be integrated in the EU framework	Schengen agreement; Fiscal Compact (to be integrated by the end of 2017)

Source : Yves Bertoncini, “Differentiated Integration in the EU: A Variable Geometry Legitimacy”, Jacques Delors Institute, March 2017.

5. Conclusion

The new democratic order created by the external and internal crises experienced by EU Member States is even more unsettling as it is also a result of a more structural transformation of the technological and cultural backdrop against which political debate is held. This new order must be understood in detail in order to properly distinguish that which is part of national democratic confrontation, within EU Member States and between EU citizens, from what is actually an infringement of the foundations of national and European democracies. Political developments as wide-ranging as the rise to power of Syriza in Greece, the Brexit outcome in the United Kingdom and the advance of radical parties can naturally be subject to more or less negative assessments, but they are the expression of democratic choices rather than any questioning of national or European democratic life.

Once this distinction is made, several types of recommendations may be put forward based on the brief observations discussed in this Policy Paper. These recommendations can be organised into three categories.

First of all, to stabilise national democracies:

- Promote a controlled openness to trade and migration, together with mechanisms to cover the costs incurred due to this openness,
- Ensure that political, economic and financial elites act in an exemplary manner,
- Avoid leaving the monopoly of targeting emotions, hearts and souls to so-called "populist" parties.

Then, to democratise the EU's operations:

- Put a permanent end to the Troika aside,
- Draw all the political conclusions of the application of the "*spitzenkandidaten*" system for the European elections in the spring of 2019,
- Increase transparency for EU decisions on Eurozone governance, trade negotiations and comitology procedures.

Lastly, for a more effective organisation of democratic unity in diversity within the EU:

- Promote the joint exercise of sovereignty to tackle common challenges such as climate change, energy dependency, terrorist threats, etc.,
- Highlight the elements of a common European identity in relation to the rest of the world (rule of law, respect of minorities, economic and social model, etc.),
- Promote a Europe of variable geometry as a last resort.

The "new frontiers" of democracy in Europe could be outlined in such a manner, for a democracy that remains a constant requirement and a promise.

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