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# **The Need and Conditions for a Common Socio-Economic Policy in European Union Countries**

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## **1. Introduction**

The realization of European Union's goals, i.e. economic development, peace, democracy and human rights, requires an answer to the fundamental question facing the EU: how to maintain demand for products at the economy's production capacity and at the same time realize the potential of current production technologies.

This problem is very difficult to solve, even for the European Union. It creates a need for a common socio-economic policy in EU countries, including strategic management of vital sectors of the economy as part of European Union's industrial policy.

The term strategic management according to D. Besanko, D. Dranove, M. Stanley, S. Schaefer (who place strategic management in the area of micro-economics, i.e. industrial organization and industrial economics) implies setting long-term goals with associated actions as well as allocating adequate resources to accomplish these goals [1]. Strategic management requires first determining the conditions of economic processes, and then selecting relevant factors to make strategic decisions.

The allocation of essential resources to realize strategic goals requires broad analysis to evaluate economic, ecological and social efficiency in terms of the whole economy as well as its various sectors.

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Recognizing the paramount importance of strategic management in the process of socio-economic integration of European Union countries, this article focuses on the following issues:

1. external conditions on regulating the EU economy taking into account globalization, which creates a need for strategic management of the economy as a system and as individual parts, especially in key areas such as the energy sector,
2. desired internal conditions for the introduction of a unified tax system in EU countries,
3. desired changes in monetary policy of the European Central Bank.

This article does not provide a complete review of all external and internal conditions on economic processes. The focus is on conditions that are contentious and relevant to shaping EU's socio-economic policy, including industrial policy.

European Union's industrial policy encompasses promoting economic activity and a desired production structure which should assure efficient resource use in the economy and limit the structural accommodation costs for EU countries.

## **2. External conditions on management processes stemming from globalization outline a need for strategic management in the EU**

Current determinants of management processes in market economies, including European Union countries, shape three fundamental processes:

1. integration – a deliberate process undertaken in a rational way,
2. globalization – an objective process that weakens the barriers that hinder interaction on a global scale [p. 53],
3. globalism – a grassroots process consisting of an expansion of free markets that manifests itself as an increase in the power of capital markets and international corporations, which gives them autonomy.

According to J.E. Stiglitz [12], globalism implies a market without rulers. It is an introduction of bad *laissez-faire* policies that stem from unofficial activity of the IMF, the WTO and the World Bank. Stiglitz supports this statement as follows: “My economic research had shown the deep underlying flaws in IMF economics – its ‘market fundamentalism’, the belief that markets by themselves lead to economic efficiency. (...) Without proper government regulation and intervention, markets do not lead to economic efficiency. The scandals of the nineties in America and elsewhere brought down ‘finance and capitalism American style’

from the pedestal on which they stood too long. They also proved that the IMF failed in its major mission of ensuring global financial stability” [p. 10–11].

The realities of economic processes show, that economic globalization is ahead of political globalization and it does not support the elimination of the most important flaws in our socio-economic system. As J. M. Keynes pointed out, these flaws are “...its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes” [p. 351]. Global management is currently chaotic and uncoordinated. Consequently, economic growth does not bring the (still expected) benefits to all involved in the management process and even promotes poverty. The main buzz phrase of globalism ‘the winner takes it all’ implies that the existing setup serves only the richest players. Globalism weakens the state, submits it to market forces and erodes its social functions (as evidenced by the reduction of public goods).

Recently, even the IMF noticed and admitted that capital market liberalization in many developing countries further destabilized their markets instead of bringing economic growth [2].

Watching the effects of globalism, it becomes obvious that it comes in conflict with democracy since democracy is based on equality while globalism quickly brings inequality and unequal chances for development. It causes real wages to fall, destroys social accomplishments and institutions that guard the social welfare of inhabitants in affected countries.

Contemporary globalism, as evidenced by its socio-economic effects, does not imply traditional free market mechanisms but rather an overwhelming, predatory market with large monopolies. “Markets by themselves often did not work (...) Unfettered markets, rampant with conflicts of interest, can lead to inefficiency. It was no coincidence that many of the problems of the Roaring Nineties can be traced back to the newly deregulated sectors – electricity, telecommunications, and finance” [p. 52].

Blind faith in market mechanisms results in globalism continuing to undermine state-run social services. W. Szymański is right in pointing out that:

1. “Single countries will find it increasingly difficult to introduce market globalization control mechanisms as market players strongly separate themselves from the general public,
2. A single country is too weak to oppose the exclusion of short-term interests of international corporations from state control and to protect democracy from uncontrolled financial markets and transnational corporations” [16].

An analysis of globalism’s economic effects in the 1990s shows that dogmatic liberalism demanding blind faith in unregulated markets should not be the foundation of European Union’s socio-economic policy. On the contrary, the balancing role of the state should not be lost under globalism. If market

boundaries are not set, international corporations have the power to make markets and countries submit to their will. As a result, political and economic power become integrated in the hands of capital; countries are incapacitated and they submit to capital market anarchy. Transnational corporations become the directors and beneficiaries of globalization. "...rampant economic liberalism creates favorable conditions for new colonization in search of cheap labor" [p. 52, 84, 143].

Globalism renews the need to seek an answer to the questions posed by H. P. Martin and H. Schuman "How much free market can democracy stand considering that politicians in industrialized countries more and more often heed financial markets rather than voters, thereby creating an unceasing conflict between the market and democracy" [p. 233–240].

The above question leads to other more detailed and vital questions in shaping the European Union, namely:

1. what changes in politics, institutions and mentality of decision makers are essential, and can they be put into action for globalization to increase the standards of living in the EU?
2. how to make sure that social effectiveness and justice are taken together, not separately?
3. what set of public goods should be required under democracy?

The criticism of welfare states in Poland does not help in finding positive answers to these questions. It is unfounded and stems from the fact that a welfare state is an obstacle in realizing the goals of globalism. It misinterprets contemporary liberalism and takes into account only microeconomics focusing on an inaccurate analysis of costs and benefits, whereas a long-term macroeconomic perspective is lacking.

An analysis of economic conditions leads to the following expectations from the European Union:

1. Taking into account the goals of the European Community (that is: economic development, peace, democracy and human rights), dogmatic liberalism should not be the foundation of EU's socio-economic policy. It should not be the foundation mainly because, by enhancing market power and limiting the role of the state in the economy, it creates a base for globalism which results in falling real wages and limiting public goods.
2. The European Union should defend countries from negative effects of advancing, unchecked globalism.

In order to fulfill these expectations, the EU should strive to become a group of economically strong countries governed by the same rules, without resorting to wage and tax dumping.

### 3. The need to harmonize tax systems in European Union countries

Differentiation and instability of tax systems in EU countries contributes to tax competition among member states. Numerous, visible negative effects of this competition do not contribute to the goals of the Community and they impede strategic management of the economy (including sectors as important as the energy sector).

Although there are voices in support of harmonizing tax systems in EU countries, the process is progressing too slowly. It started when the Rome Treaty was signed. However, when the Treaty was being introduced, it was decided that harmonizing indirect taxes is sufficient to facilitate the mobility of goods and services. It was thus decided that indirect taxes do not have a significant influence on the functioning of EU's common internal market. This changed following the accession of new countries into the EU. Tax competition based on largely diverse direct and indirect tax rates was detrimental to many countries (including France and Germany). "France and Germany went as far as threatening to stop contributing to the EU budget as a result of substantially lower corporate tax rates in countries such as: Slovakia, Poland, the Czech Republic, Baltic countries to which economic activity was being transferred" [p. 4]. Differences in corporate tax rates are substantial in EU countries as shown in table 1.

**Table 1**  
Corporate tax rates in EU countries in year 2007

Country	Tax rate in year 2007 [%]	Difference in tax rate (country – Poland) [%]
Austria	25	6
Belgium	39,99	20,99
Bulgaria	34	15
Cyprus	10	-9
Czech Republic	24	5
Denmark	28	9
Estonia	22	3
Finland	31	12
France	33,83	14,83

**Table 1 – continue**

<b>Country</b>	<b>Tax rate in year 2007 [%]</b>	<b>Difference in tax rate (country – Poland) [%]</b>
Germany	38,36	19,36
Great Britain	30	11
Greece	25	6
Holland	25	6
Hungary	16	-3
Ireland	12,50	-6,50
Italy	37,25	18,25
Latvia	15	-4
Lithuania	15	-4
Luxemburg	29,63	10,63
Malta	35	16
Poland	19	-
Portugal	25	6
Rumania	16	-3
Slovakia	20	1
Slovenia	19	0
Spain	32,50	13,50
Sweden	28	9

Source: based on [4].

As shown above, Cyprus has the lowest (10%) and Germany has the highest (38,36%) corporate tax rate. Taxes are lower than in Poland in: Cyprus (by 10%), Latvia and Lithuania (by 4%), Hungary and Romania (by 3%). Only Slovenia has the same corporate tax rate as Poland (19%). Corporate tax rates in all EU countries with a high GDP per capita (excluding Ireland where the rate is 12,5%) are higher than in Poland. For example, they are 19% higher in Germany and 6% higher in Austria. Lowering tax rates in many countries would require eliminating various forms of tax relief and preferential treatment. This would be a step in the right direction as it would make the entire tax systems more transparent.

Personal income tax rates also vary a lot in EU countries as shown in table 2.

**Table 2**  
Personal income tax rates in EU countries in year 2007

Country	Starting rate	Highest rate	Number of tax brackets	Difference in starting rate (Poland minus given EU country)	Difference in highest rate (Poland minus given EU country)	Difference in number of tax brackets (Poland minus given EU country)
Austria	0	50	4	19	-10	-1
Belgium	25	50	5	-6	-10	-2
Bulgaria	12	32	4	7	8	-1
Cyprus	20	30	3	-1	10	0
Czech Republic	12	32	4	7	8	-1
Denmark	5,48	26,48	3	13,52	13,52	0
Estonia	22	22	1	-3	18	2
Finland	0	32,50	6	19	7,50	-3
France	0	48,09	7	19	-8,09	-4
Germany	0	42	32	19	-2	-29
Greece	15	40	3	4	0	0
Holland	2,45	52	4	16,55	-12	-1
Hungary	18	36	2	1	4	1
Ireland	20	42	2	-1	-2	1
Italy	23	43	4	-4	-3	-1
Latvia	25	25	1	-6	15	2
Lithuania	15	33	2	4	7	1
Luxemburg	0	38	10	19	2	-7
Malta	0	35	6	19	5	-3
Poland	19	40	3	0	0	0
Portugal	10,50	42	7	8,50	-2	-4

**Table 2 – continue**

<b>Country</b>	<b>Starting rate</b>	<b>Highest rate</b>	<b>Number of tax brackets</b>	<b>Difference in starting rate (Poland minus given EU country)</b>	<b>Difference in highest rate (Poland minus given EU country)</b>	<b>Difference in number of tax brackets (Poland minus given EU country)</b>
Rumania	16	16	1	3	-2	2
Slovakia	19	19	1	0	21	2
Slovenia	10	40	3	9	0	0
Spain	9,06	29,16	5	9,94	10,84	-2
Sweden	0	25	3	19	15	0
UK	10	40	3	9	0	0

Source: based on [p. 58].

Based on the data in table 2, the number of tax brackets as well as the starting and highest tax rates are all highly diversified. Only four countries have a linear tax (Estonia, Latvia, Romania and Slovakia) whereas seven countries have a starting tax rate of zero (Austria, Finland, France, Germany, Luxemburg, Malta and Switzerland). This arrangement contributes to labor force mobility and dumping which is even more pronounced in Poland due to relatively low wages for non-management employees compared to most EU countries.

Diversified tax rates currently in place in EU countries lead to tax competition which has a detrimental effect on the economy in the form of ineffective allocation of resources and limited public goods. They also limit the implementation of policies supporting socio-economic development in EU countries, including the ability to strategically manage vital sectors of the economy.

These negative effects are exacerbated by the international transfer of taxes pertaining to all forms of taxation: corporate taxes, capital taxes and income taxes. Research shows that “corporations that take advantage of differences between national tax systems entangled almost all countries in the world in tax system competition” [p. 271].

The elimination of limits on main production factors (work and capital) mobility and the introduction of a monetary union will undoubtedly accelerate the process of harmonizing tax systems and lead to an imminent introduction of a unified tax system in European Union countries.

Taking into account the socio-economic functions that a unified tax system should serve, the process of harmonizing tax systems in EU countries should not take the form of a chaotic convergence. It should be diligently prepared and implemented.

Developing active, prosperous countries build upon the foundation of justice and solidarity stemming from European Union's socio-economic policy requires solid foundations. A unified, optimal tax system should be this foundation for EU countries.

As J. E. Stiglitz correctly states, an optimal tax system "is the set of taxes which maximizes social welfare" [13]. It is not easy to establish such a tax system since the design process of tax solutions is full of vital dilemmas. One has to choose between distribution and efficiency goals (something for something), balancing the benefits of redistribution with costs in the form of lowering efficiency.

The design of a unified, optimal (direct and indirect, corporate and personal) tax system for European Union countries must consider that taxes should serve certain socio-economic functions. Taking into account EU's goals, the structure of the tax systems should:

1. stimulate economic growth (for example, by decreasing the tax burden only for those who invest in the economy, furthermore the tax relief should apply only to increases in investments that meet properly set criteria for economic, ecological and social efficiency),
2. assure an equitable distribution of tax burden (taking into account the ability to pay and not forcing anyone into poverty),
3. contribute to eliminating the most important flaws of our socio-economic system which are "...its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes" [p. 351].

Therefore, an optimal tax system should contain a set of progressive taxes. It must not be based on linear taxes considering the equity principle dating back to A. Smith and J. S. Mill [7, 11] and socio-economic functions that taxes should serve in European Union's economy.

## **4. Desired changes in monetary policy of the European Central Bank**

It was expected that the new and changed economy, with its advanced technology and enhanced methods of communications, will bring an end to development cycles. This did not happen as shown by the financial crises in the 20-th century (including those in Mexico and Asia).

According to P. Krugman, contemporary financial crises stem from both the speculative character of international capital markets and structural weaknesses of market economies (as shown by the growing capital intensity of production which proves that incomes are declining) [p. 52–57]. J. E. Stiglitz accepts P. Krugman’s reasoning in trying to explain the source of failures and adds that the main mistake was underestimating the equalizing role of the state and blind faith in markets regulating themselves. Stiglitz concludes that not too much, but too little regulation caused the Asian financial crisis and savings and loan crisis in 1989 which cost American taxpayers about 100 billion dollars [p. 84]. According to Stiglitz the following lessons may be learned from the financial crises in the 20-th century:

1. bad accounting frameworks (that are still commonly used) provide bad information and lead to bad economic choices,
2. so-called ‘wizards of the financial market’ are remarkably myopic and put too much trust in modern accounting principles,
3. deficit reduction is normally not a solution to a short-term economic downturn, it may even be bad for long-term economic growth [14],
4. negative effects of capital market liberalization show a need for regulation. In 2003, even the IMF – until recently a major promoter of liberalization – admitted that capital market liberalization, at least in many developing countries, led to economic instability instead of growth [p. 143],
5. the IMF failed in its main mission of providing global financial stability.

Lessons from the analysis of financial crises explicitly show the need for a globalization management system. Currently economic globalization (manifesting itself in globalism) overtook political globalization without solving global problems – instead of bringing widespread prosperity, it increased inequalities. The ‘trickle down’ theory stating that everyone benefits from economic growth was also proven false on multiple occasions.

In the case of chaotic, uncoordinated global management, integration of countries can provide a framework for a global market. Global competition creates new challenges for the EU and at the same time imposes changes that should enhance EU’s economic and political power to realize its main goals.

European Central Bank’s current monetary policy does not help the European Union realize its goals. Curbed inflation and high bond rates, as P. Krugman correctly pointed out, wasted the chance for strong economic development and high employment [p. 52–57].

Promoting economic growth in European Union countries and providing adequate public goods requires looking beyond traditional rules in financial policies (i.e. strict adherence to inflation targets) and searching for new solutions.

Research shows that a reform of the global reserve system can provide additional funds. According to Stiglitz, reserves should not exceed the value of imports over two months. Developing countries currently keep reserves that even exceed the value of imports over eight months. It would be appropriate to keep reserves equal to short-term debt [p. 258]. This is not the case. For example, China's reserves totaled 900 billion USD in year 2006 – that is about 700 USD per capita. The reserves of developing countries amounted to 3350 billion USD in year 2006. These reserves are kept in accounts at interest rates of 1% to 2%. Keeping such high monetary reserves unnecessarily withdraws about 750 billion USD of purchasing power from the global market. This money “is effectively buried in the ground. (...) The global reserve system burdens the economy and makes it difficult to maintain full employment. Money stored in reserves could contribute to global demand if it were used to stimulate the global economy. Instead of spending the money on consumption or investments, governments lock it up” [p. 262]. In 2006, the world's economies held more than 4,5 trillion USD in reserves growing at a rate of 17% per year. As a result, even as the dollar continues to fall against other currencies, the USA supplies the world with Treasury bills that countries need for reserves. This cannot last. Between February 2002 and December 2004, the value of the dollar relative to the euro plummeted by some 37%. The dollar becomes unsuitable for reserves as the USA continues to plunge into greater debt. A quick move away from dollar reserves can cause, at the very least, serious problems on the international monetary market. This situation exposes flaws in IMF's economic rules that should in principle guard the stability of international finances.

This analysis leads to the following general conclusion: without proper regulation and intervention by the European Union, the market does not guarantee economic efficiency in member countries. The current myopic view of markets is an antithesis of development. What is required is the introduction of policy supporting long-term socio-economic development.

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