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The Case for a European Social Union

From Muddling through to a Sense of Common purpose

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ABSTRACT

We need a coherent conception of a European Social Union. A Social Union would support national welfare states on a systemic level *in some of their key functions and guide the* substantive development *of national welfare states – via general social standards and objectives, leaving ways and means of social policy to Member States – on the basis of an operational definition of 'the European social model'.*

A Social Union, so conceived, is not only desirable but necessary. To make that analysis is not to say that an operational concept of ESU is already on the table. We are in unchartered territory: important issues have to clarified. First of all, we must be clear about the rationale and motivation for a ESU; that is the subject of the first part of the paper. I discuss arguments applying specifically to the Eurozone (focusing on the need for a 'visible hand', pursuing a symmetric coordination of wage policies), and arguments applying to the EU as a whole (focusing on the 'balancing act' that is needed between international openness, and the pan-European solidarity that this implies, and domestic social cohesion). I briefly sketch the notion of solidarity underpinning a Social Union, and I argue that the idea of ESU marks a return to the inspiration of the founding fathers of the European project.

The second part of the paper links the idea of a Social Union to current debates on social policy. 'Social investment' is a useful unifying policy concept for ESU; if we take it seriously, public investment in education should be higher on the European agenda. I briefly discuss minimum wages and minimum income protection, and I argue that clarification is needed with regard to policy methodologies and tools.

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INTRODUCTION*

The European Union is, as a matter of fact, a union of welfare states. In all member states, whatever their social policy tradition or level of development, there is majority support for core ambitions of a modern welfare state: promoting general prosperity, sustaining social cohesion, protecting vulnerable individuals and supporting education. However different European welfare states are, their national tax and benefit systems have created, to varying degrees and with varying success, a capacity for social and economic stabilization in periods of economic stress; these automatic stabilizers are intrinsically linked with the protection of vulnerable individuals.

The founding fathers of the European integration project were convinced that European economic integration would contribute to the development of prosperous national welfare states, whilst leaving social policy concerns essentially at the national level. History has not proven them wrong, at least until the mid-2000s. Yet, the experience of the crisis forces us to reconsider the question: *how can the EU be a successful union of flourishing welfare states?* Both on the left and the right of the political spectrum, despite conflicting views on the economic policy that is now needed, many would argue that the crux is to restore economic growth by implementing the right kind of economic and monetary governance at EU level. This paper takes a different position: yes, it is essential to restore economic growth, and this is first and foremost a matter of economic and monetary policy; but this short-term urgency cannot be isolated from the imperative to develop a social policy concept for the EU, i.e. a basic consensus on the role the EU should play and the role it should not play in the domain of social policy. The argument is certainly not that the EU should become a welfare state itself. However, restoring the social sovereignty of the member states, with the EU strictly confining its role to economic and monetary policy, is not an option, unless we are ready to trade in illusions. We need to develop a coherent conception of a *European Social Union.*

I use the notion 'social union' deliberately, for three reasons. First, it invites us to propose a clear-cut concept, in contrast to the rather vague notion of 'a social Europe', which often surfaces in discussions on the EU. Second, it signals that we should go beyond the conventional call for 'a social dimension' to the EU. It would be wrong to assert that the EU has no social dimension today. The coordination of social security rights for mobile workers, standards for health and safety in the workplace, some directives on workers' rights… constitute a non-trivial *acquis* of fifty years of piecemeal progress. The EU also developed a solid legal foundation for enforcing non-discrimination among EU citizens. The notion of a 'European Social Union' is not premised on a denial of that positive *acquis*. However, although the next steps we have to take can build on that *acquis*, their nature and rationale respond to a new challenge. We have to understand the novelty of that challenge, which is about more than adding 'a social dimension'. Third, the emphasis on a Social *Union* is not a coincidence. A European Social Union is not a European Welfare State: it is a Union of national Welfare States, with different historical legacies and institutions. As explained below, a

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union of national welfare states may require more tangible solidarity between those welfare states as collective entities. But its purpose is not to organize interpersonal redistribution between individual European citizens across national borders. I will touch upon specific aspects of social policy for which we may have to rethink the practical application of the subsidiarity principle, both within member states and at the level of the EU. Yet, a union of welfare states would apply subsidiarity as a fundamental organizing principle. I will insist on the necessity of convergence, but convergence is not the same as harmonization. More generally, the practice of a Social Union should be far removed from a top-down, 'one size fits all' approach to social policy-making in the member states.

The core idea can be summarized as follows: a Social Union would support national welfare states *on a systemic level* in some of their key functions and guide the *substantive development* of national welfare states – via general social standards and objectives, leaving ways and means of social policy to member states – on the basis of an operational definition of 'the European social model'. In other words, European countries would cooperate in a union with an explicit social purpose – hence, the expression 'European Social Union' (ESU). As I will argue below, in order to clarify the debate, we might distinguish a 'thin' version of this ESU concept from 'thicker' versions. A 'thin' version emphasizes functional corollaries of economic and monetary integration of welfare states, which can be argued for on the basis of economic analysis and evidence. The 'thicker' versions to which I refer below, go beyond pure economic reasoning, and also imply arguments of political legitimacy intrinsic to the European project. I believe these political arguments are compelling and should appeal to people with a variety of political opinions. But it would be intellectually incorrect and politically counterproductive to present arguments on political legitimacy as hard science: some of these arguments are inevitably speculative. We should not deny that we are in the realm of political choices.

This paper should be read as an exercise in conceptual clarification. Rather than a clear-cut set of proposals, it is a 'think piece' about arguments on the social dimension of the European project. Considering social policy as very important is not, by itself, an argument for upscaling certain aspects of social policy to the European level: we need other arguments. The case of a European Social Union rests on a mixture of normative arguments – value judgments on which we may disagree – and empirical arguments. The 'thin version' takes as a *normative* starting point that the integration project is about welfare states with an aspiration to economic and social stabilization, internal cohesion and protection of the most vulnerable, and sees these as common aspirations for all EU member states. The normative underpinning of the 'thicker versions' is more demanding: it considers 'upward convergence', i.e. the combination of growing pan-European and domestic cohesion, as fundamental to the legitimacy of the European project. One may add to the normative ledger of the arguments the idea that the EU should support a set of social rights in a tangible way, e.g. with regard to minimum wages (therefore, I write 'thicker' in plural: there is a plurality of normative options here). One of the *empirical* arguments deployed in this paper refers, for example, to the role of wage bargaining systems in containing divergences in competitiveness within the Eurozone; the argument is that the Eurozone needs a 'visible hand' in the domain of wage bargaining. Obviously, such empirical arguments need scrutiny and debate.

A Social Union, so conceived, is not only desirable but necessary – unless we would drop the idea that the integration project concerns welfare states with at least some shared aspirations. To make that analysis is not to say it leads to only one and definitive version of ESU: depending on the normative judgements that are brought to bear, a Social Union may be a more ambitious ('thicker') or a less ambitious ('thin') project. Nor is it to say that an operational concept of ESU is already on the table. We are in unchartered territory: important issues have to clarified. First of all, we must be clear about the rationale and motivation for a ESU; that is the subject of the first three sections. In section 1, I zoom in on one argument that applies specifically to EMU: EMU needs a 'visible hand' for the symmetric coordination of wage policies. The consequences of monetary unification go beyond wage policies, but I discuss that particular issue to illustrate that EMU forces the member countries to develop a basic consensus on the social order on which it is based. Section 2 presents arguments applying to the EU as a whole: we need a 'balancing' act between international openness, and the pan-European solidarity that this implies, and domestic social cohesion. In section 3, I introduce the notion of solidarity underpinning a Social Union, and I argue that the (thicker) idea of ESU marks a return to the inspiration of the founding fathers of the European project. The next sections of this paper link the idea of a Social Union to current debates on social policy. Section 4 highlights 'social investment' as a unifying policy concept for the EU and underscores the need to put public investment in education higher on the European agenda. Section 5 briefly discusses minimum wages and minimum income protection. Section 6 argues that clarification is needed with regard to policy methodologies and tools (notably : mainstreaming and contractual arrangements). This section shows that the notion of ESU does not point to a parallel and separate social pillar to be added to the existing pillars; this is a misconception to be avoided.

Proposing a European Social Union may seem an idealistic bridge too far, given the state of play of European politics today. However, by linking the idea of ESU to current social policy debates in the EU, I hope to show that it is neither far-fetched nor unduly idealistic. Also, as pointed out in the concluding section 7, a Social Union is not a defensive 'Maginot line' to preserve the social status quo; European welfare states are in a continuous process of reform and many need further reform.

THE INCOMPLETE MONETARY UNION

1.1. THE NEED FOR A SYMMETRIC AND EFFECTIVE VISIBLE HAND

The case for a European Social Union is first and foremost based on a *functional* argument with regard to EMU. Mainstream economic analysis explains the benefits and drawbacks of monetary unification in terms of *trade-offs.* The core idea is that members of a currency area are confronted with a trade-off between symmetry and flexibility. Symmetry refers to movements in output, wages and prices. Flexibility relates to wage flexibility and interregional and international labour mobility, which determine a country's internal adjustment capacity in case of a so-called asymmetric shock. Less symmetry necessitates more flexibility, according to the theory of 'optimal currency areas': the less symmetry there is between the countries of a single currency area, the greater the required capacity for internal adaptability in order for the monetary union to be beneficial. There is moreover a second trade-off: if the possibility exists of absorbing asymmetric shocks through *fiscal transfers* between the member states, then the need for flexibility is reduced.

Over the last few years, we learned that the traditional textbook description of these trade-offs is insufficient to understand the Eurozone crisis. Design failures of the European Monetary Union made it inherently unstable and fragile (De Grauwe, 2011). This insight leads to the conclusion that, apart from a banking union, EMU needs a lender of last resort. Since there was no lender of last resort, individual EMU members were forced to switch off their automatic budgetary stabilizers (De Grauwe, 2014). In other words, a pan-European lender of last resort is indispensable to support welfare states in EMU in one of their key systemic functions, stabilization in times of economic crisis. In this paper, the focus is on two additional conclusions: first, EMU needs a visible hand that deliberately pursues symmetry, notably with regard to pay; second, there are limits to the diversity of social systems that can be accommodated in a monetary union. To understand this, one should not reason about a monetary union *in abstracto*, but examine what went actually wrong in EMU during the last decade. Hence, I start with a minor detour on the analysis of the Eurozone crisis.

The literature on the Eurozone crisis reflects conflicting views on the nature of debt crises; a *fundamentalist* view can be distinguished from a *multiple-equilibria* view (Saka et al., 2010). The *fundamentalist* view is that widening Eurozone bond yields, as witnessed since 2010, reflect serious deterioration in countries macroeconomic fundamentals. In this fundamentalist camp, one may distinguish those who stress fiscal profligacy in a number of Eurozone countries, and those who stress the emergence of large current accounts deficits and surpluses, linked to diverging competitiveness. On the basis of the evidence, discarding the special case of Greece, the fiscal profligacy thesis is much less compelling than the diverging competitiveness thesis.[1] Against the fundamentalist view, the *multiple-equilibria* view contends that markets may not always function optimally, and therefore countries may find themselves in any one of a set of possible equilibrium conditions, without experiencing any major change in fundamentals. The observation that a monetary union lends itself to the devilish effects of self-fulfilling dynamics is key to De Grauwe's *fragility hypothesis*. Advocates of the multiple-equilibria view do not deny sensitivity to fundamentals: fundamentals matter, but they are not the whole story. De Grauwe summarizes the Eurozone's predicament as the combination of *two* design failures: "On the one hand booms and busts continued to occur at the national level. In fact these were probably intensified by the very existence of a monetary union. On the other hand the stripping away of the lender of last resort support of the member state countries allowed liquidity crises to emerge when booms turned into busts." (De Grauwe, 2014). The diverging trends in price competitiveness across the Eurozone (the crucial factor of imbalance in EMU at the level of the fundamentals) were closely linked to the first design failure (the persistence and even intensification of booms and busts at the national level).

Why would monetary unification *intensify* booms and busts and concomitant divergences in price competitiveness? If the invisible hand of market forces is the main driver of adjustment, the effect of wage and price divergence in a monetary union is threefold: one may distinguish three 'channels of adjustment' (Ederer and Reschenhofer, 2013). First, changes in relative prices determine the

[1] Many papers have been published on this question since the outbreak of the crisis. Johnston, Hancké and Pant (2014) present a succinct survey of the literature, distinguishing a 'fiscal position' and a 'competitiveness position', and provide some key data that support the competitiveness position.

competitiveness of an economy vis-à-vis its trading partners. A higher inflation rate reduces competitiveness and leads to a deteriorating trade balance; this, in itself, leads to adjustment, since it dampens economic activity and thus reduces inflationary pressure; this is the classical 'competitiveness channel'. There are however two more channels present, which could impede the counter-balancing effect of the competitiveness channel. The second one is the so-called 'real interest channel'. Higher inflation rates in a booming country reduce real interest-rates (since the level of nominal interest rates is determined at EMU level) and so stimulate credit-driven domestic consumption and investment: the economic boom is reinforced. Ederer and Reschenhofer identify a third channel, the 'income distribution channel', which is more unconventional. Different productivity, wage and price developments may result in divergent patterns in the wage share. If a rising wage share stimulates consumption more than it reduces investment, stronger economic activity will be the result. Thus, a rising wage share would deteriorate trade balances. This channel also counteracts the competitiveness channel and tends to destabilize divergent economic developments in a monetary union; that is at least what one might expect on a theoretical basis.[2]

In practice, in the years before the crisis, the 'real interest channel' was more effective than the 'competitiveness channel'. The common monetary policy, in combination with divergent price inflation, stimulated domestic demand and amplified the boom in high-growth and high-inflation countries. This led to rapidly expanding imports and high current account deficits. Contrarily, in low-growth and low-inflation economies real interest rates were higher and restricted domestic demand. This, in combination with solid export growth caused substantial current account surpluses.

Obviously, adjustment is not only brought about by the invisible hand of pure market forces. Wage bargaining institutions make an important difference. Countries like Germany and Finland have unions that have been much more conscious of external constraints than countries like Italy of Spain. Hence, the 'competitiveness channel' in the former countries is not only more effective (compared to the latter countries) thanks to collective bargaining, but collective bargaining moreover acts in a preventative way. The industrial relations literature provides evidence on which wage-setting systems can deliver a real exchange rate that is consistent with sustainable external balance: either so called 'pattern bargaining', in which the lead in wage negotiations is taken by an exposed sector union, or 'peak level coordination' bargaining, in which it is a national all-encompassing union that sets wage aims. Within the Eurozone there would seem to be a split between Germany, the Benelux countries, Austria and Finland on the one hand, all of which benefit from either one or the other of these two wage-setting mechanisms and in which there is a high degree of control over lower-tier wage settlements, and Italy, Portugal, and Spain on the other, in which there is no mechanism to produce wage increases that are consistent with maintaining competitiveness (Boltho and Carlin,

[2] This argument is more speculative. The wage share decreased significantly in Germany and Austria between 2000 and 2007, but also in the Netherlands and Sweden. This is likely to have restrained private consumption in Germany and the other countries mentioned here, and consequently weakened domestic demand. It is less clear how important it was as a general explanatory factor for evolutions in the whole set of EMU countries over that period. I add it here, because the 'golden rule' to which I refer below, would contribute to stabilizing the share of wages and profits in national income.

2013, p. 395; see also Traxler and Brandl, 2011, on systems of wage formation; and Carlin, 2012, on the problem of stabilisation with different systems of collective bargaining). Pursuing this type of analysis, Hancké *et al.* focus on one key institutional driver of the divergence in competitiveness: a country's capacity to limit sheltered sector wage growth, relative to wage growth in the manufacturing sector. In the arrangements that preceded EMU, national central banks held wages in both the exposed and sheltered sectors in check; EMU has become a monetary union that invites these imbalances (Johnston and Hancké, 2009; Hancké, 2013, p. 99). On the basis of econometric analysis, Johnston, Hancké and Pant (2014) argue that the more 'rigid', centralized and coordinated wage bargaining regimes in the Eurozone have best weathered this transition to a monetary union. Corporatism emerges as a crucial institutional advantage, which is ironic, given the insistence on decentralization of wage formation in the official EU policies. Apart from the recommendations developed in the framework of the European Semester, the Euro Plus Pact of 2011 typifies this insistence on decentralization; although it would be incorrect to describe the Euro Plus Pact as purely deregulatory, it explicitly invited the members states to review the 'degree of centralization of wage bargaining' (Barnard and De Baere, 2014).

Wage moderation is not an objective *per se*, as Hancké *et al.* also point out: one would need a policy rule that guarantees true symmetry, preventing both excessive wage moderation in some countries and excessive wage increases in other countries. Watt (2012) presents a compelling case for a 'golden rule' that would guarantee true symmetry in the development of nominal unit labour costs: in all EMU member states, nominal wages should grow at a rate equal to the sum of medium-run national labour productivity growth plus an allowance for the rate of inflation that the monetary authority considers compatible with price stability.[3] Such a golden rule would be part of a broader policy package, in which national fiscal policy would also contribute to the correction of external imbalances.[4] It would not eliminate the need for instruments to prevent shifting market sentiments from destabilizing the monetary union. But it would be a key instrument to prevent unsustainable current account imbalances in the Eurozone. Implementing such a golden rule would require the strengthening of existing coordination instruments, such as the Macroeconomic Dialogue.[5] On this

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[3] If the starting point is one of substantial current account imbalances, the rate of nominal wage growth should be lower than indicated by this formula in deficit countries and higher in surplus countries to bring countries back into equilibrium. The 'golden rule' of a monetary union would then be: nominal wage growth in each country equals medium term national productivity growth, plus the target inflation rate of the central bank, plus/minus a competitiveness correction in surplus/deficit countries. Watt also points out that it would be sensible to apply a floor to this rule, to avoid negative nominal wage growth (i.e. pay cuts) in deficit countries and the risk of cumulative deflation (as opposed to relative disinflation).

[4] The approach to fiscal policy that is associated to Watt' 'golden rule' is different from the approach in the Stability and Growth Pact, since its main focus would be on the external account, rather than on levels of deficits and debt per se. Horn, Lindner, Tober and Watt (2012) argue that countries such as Spain and Ireland should have had a more restrictive fiscal policy before the crisis, although they were under no obligation to do so under the SGP coordination mechanisms. At the same time, those economies that were growing sluggishly were for many years prevented by the one-sided approach of the SGP from providing fiscal stimulus to their economies (Horn *et al.,* p. 6).

[5] Koll (2013) discusses dialogue-based macroeconomic coordination and the experience of the Macroeconomic Dialogue.

basis, Watt envisages a 'grand bargain' whereby all actors (trade unions, employers, political decision makers) would reconsider their role and mutual interactions.[6] Admittedly, although it is compelling on an analytical level, this argument raises complex questions with regard to implementation. First, one can discuss the exact way in which external competitiveness should be measured.[7] Second, it is not straightforward to define the responsibility of governments with regard to the development of wages; the notion of a 'rule' should be clarified with regard to what is expected from governments. Therefore, in the remainder of this paper, I will use the notion 'golden rule' in a somewhat looser generic sense, that is, a system of guidance based on a symmetric approach to competitiveness and involving both governments and collective bargaining, without specifying how it should be made operational and discussing feasibility (Thillaye *et al.*, 2014, discuss the operationalization of this proposal and also suggest an alternative approach.[8] I briefly return to feasibility below). The generic idea can be summarized in two fixed points:

the monetary union needs a visible hand that guides the developments of wage costs (i.e. competitiveness) across the union in a symmetric way;
the monetary union and its member states need labour market institutions that can deliver on this kind of guidance: the visible hand must be effective.

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[6] Horn *et al.* (2012) stress that such coordination should respect the autonomy of collective bargaining in the member states, whilst pursuing coordination. They even assert that '[t]his policy mix of stability-oriented fiscal policy and supporting monetary and wage policy sets out a course that a still largely decentralized monetary union can follow. Within such a framework, it would not be necessary to relocate any substantial powers to an emerging European central state nor to put in place cumbersome and expensive transfer mechanisms to offset current account imbalances.' Preventative wage coordination may diminish the need for fiscal stabilizers, but whether it eliminates it, is less self-evident in my opinion, since asymmetric shocks may occur for other reasons than disparities in wage developments; I do not pursue this argument here.

[7] See, for instance, Collignon (2013) for an alternative approach to the measurement of competitiveness.

[8] Watt's proposal implies that all the relevant actors orient their behavior to – in a nutshell – a golden rule in terms of (nominal) wage outcomes. Clearly wage setting systems do not do this at present; hence, one needs to invest in their capacity to do so, and some pressure needs to be brought to bear by the European authorities. Against the argument that it is extremely difficult to coordinate wage policies, given the heterogeneity of systems of industrial relations and the diverging policy cycles in member states, Watt tables the following counterargument: if one think about all the efforts to constrain national fiscal policy in various ways over the years, it seems at least a reasonable question to ask, what could have been, and what could now be, achieved if we invested in the corporatist institutions at national level that we would need to make some sort of (limited) wage coordination work at least tolerably well (private communication).

Thillaye *et al.* (2014) discuss wage coordination and the risks and difficulties it implies; they suggest different options. Wage coordination can be developed as 'soft guidance', which requires that the Macroeconomic dialogue be strengthened. Implementing a golden rule might be easier if limited to minimum wages; however, universal minimum wages do not exist in all EU countries, hence voluntary member states should first develop a common understanding of what a minimum wage is by using the Open Method of Coordination. They finally say that a simpler way to tackle imbalances is for the EU to deal with current account deficits and surpluses in a more symmetric way as part of MIP. This leaves to national governments and social partners the freedom to adjust the real exchange rate by wages or other means (for instance, by modifying the tax burden). In my opinion, the latter option does not diminish the need for labour market institutions that can deliver on this kind of cooperation.

Obviously, the proposition that a visible hand is necessary does not mark a departure from current policies. The Six-Pack and the Macroeconomic Imbalances Procedure are deliberate attempts to strengthen the visible hand of European policy makers, as experience has shown that exposure to market forces did not in itself produce discipline in the monetary union. The departure from current practice, which has put a one-sided emphasis on adjustment in member states with current account deficits and did not address member states with surpluses, is the proposition that symmetry is organized around a common benchmark, as is the case in Watt's golden rule. One should note that the argument underpinning my first 'fixed point' is empirical, not normative. Opponents might challenge my case for a 'symmetric visible hand' by the following counterargument: in normal times – i.e. in the absence of credit-fuelled speculative bubbles and very exceptional rounds of wage increases –, market forces in each of the member states (yielding an inverse relationship between unemployment and wage inflation, captured by the so-called 'Phillips curve') will produce a satisfactory equilibrium w.r.t. the development of wage cost competitiveness.[9]

My second fixed point also refers to empirical issues. Research on the performance of labour market institutions with regard to external competitiveness yields nuanced and open-ended conclusions: there is no 'silver bullet' (Brandl, 2012). But one negative and one positive conclusion stand out with regard to their capacity to maintain external competitiveness. On the negative count, systems of wage bargaining that are totally decentralized and uncoordinated perform worse, compared to centralized and coordinated structures. On the positive count, resonating an argument developed at length by Crouch (2013): countries with powerful trade unions, but which power has not been used to defy the logic of external competitiveness, have been most successful in social and economic terms.

Admittedly, this argument about the positive role of coordinated bargaining flies against current trends in wage bargaining and current policies: in the domain of collective bargaining, we witness erosion of power and fragmentation of crucial actors. Should we therefore abandon the argument? That conclusion is premature. Although it will be difficult to reverse the present trend in bargaining disintegration (in which sectoral change and the growth of multinational corporations play a role) the first step in achieving such a reversal is to acknowledge the positive results that come from coordination (instead of depicting the erosion of collective bargaining as a positive development to be encouraged). The next step, if one accepts the argument, is to develop an agenda of practical steps that the Commission and other EU institutions can take to encourage and facilitate bargaining coordination wherever they can (cf. footnote 8, supra).

A preventative and symmetric golden rule on wage formation would not diminish the need for a lender of last resort, as proposed by De Grauwe. If a preventative rule is successful, it might diminish, but would not eliminate the need for fiscal stabilizers at the level of the monetary union, if

[9] This is not the point of view taken in this paper, but the objection (and reference to the Phillips curve) formulated by Daniel Gros merits further research.

an asymmetric choc occurs.[10] But that observation does not make a golden rule (in the generic sense in which I now use that expression, cf. supra) less important: stabilizing instruments presuppose a degree of solidarity and mutual trust; mutual trust in turn requires a commitment by member states to prevent excessive imbalances in wage cost developments.

Hence, a symmetric guidance with regard to wage cost competitiveness and labour market institutions that can deliver on this kind of guidance should constitute two fixed points in our thinking on what is *needed* for a well-functioning EMU – even if they fly against current practice and policies. With those two fixed points in mind, we can now return to the long-term trade-offs with which the members of a monetary union are confronted: the trade-off between symmetry, flexibility, and the use of fiscal transfers. Flexibility is a container concept: less regulated labour markets, temporary shock absorbing mechanisms such as *Kurzarbeit* in Germany, a highly skilled and versatile labour force… provide different ways and means to labour market flexibility, which can be mixed in different ways, according to social preferences. There might be a 'high road' to labour market flexibility, based predominantly on skills and work organization, as opposed to a 'low road', based predominantly on mere deregulation of labour markets. At first sight, one might think that these varieties of labour market flexibility are irrelevant with a view to sustaining a monetary union, i.e. that they can be seen as functionally equivalent models as long as they yield mobility of workers and responsiveness of wages to constraints of competitiveness. However, the upshot of the two fixed points which we identified, is that not all systems of labour market regulation deliver equally well with regard to the combination of symmetry, which requires the capacity to deliver on a wage policy, and flexibility. So conceived, national models of labour market flexibility as much as national wage policies are a matter of common concern in a monetary union: their choice cannot be relegated totally to the national domain. That does not mean that the EU should counsel member states in detail on the organization of their labour markets. But there is a limit to the social diversity that can be accommodated in a monetary union, not with regard to the details of their organization, but with regard to their fundamental parameters.

A similar argument might be developed with regard to pension systems and member states' long-term fiscal sustainability. In the long run, the financial sustainability of pension systems is a matter of common concern in a monetary union. The insistence of the European Commission that retirement ages be indexed on longevity in all European member states can be interpreted in this sense. Apart from the fact that it may be good policy *per se*, for any welfare state, to establish a (nuanced and realistic) link between retirement ages and longevity, it is plausible to argue that unsustainable pension systems in some member states of the Eurozone would lead to budgetary imbalances that could threaten the Eurozone as such. I will not elaborate upon this 'common concern' argument here, which is admittedly more speculative than the argument on wage coordination.[11]

[10] Whether or not fiscal stabilizers are needed – in addition to the introduction of a banking union and a lender of last resort – and how they would have to be implemented, is an important issue in the context of debates on a European Social Union, but this issue is not developed in this paper.

[11] See Vandenbroucke (2012) for a brief sketch of such an argument.

Neither flexibility nor fiscal transfers, nor indeed symmetry, are socially neutral choices. Flexibility refers to adjustment processes that can be painful, like direct nominal pay cuts (rather than real pay erosion through currency depreciation and high inflation), or imply an important social cost, such as massive migration by job-seekers. Fiscal transfers may be aimed primarily at temporary stabilisation, but *in practice* it is very difficult to separate the stabilising purpose of public expenditure from its redistributive purposes. Obviously, that is not socially neutral. Hence, the long-term trade-offs implied by monetary unification force upon the participating countries a consensus on the social order on which the monetary union is based. Inevitably, such a consensus encompasses cognitive as well as normative elements:

Cognitive: to what degree does economic symmetry also imply social convergence? Which degrees of freedom exist with regard to wage formation and labour market regulation, pension systems and their adjustment to changing longevity…?

Normative: if we agree that economic symmetry presupposes social convergence in some domains, then common benchmarks need to be set as targets for organising such convergence.

Cognitive and normative: are fiscal transfers a necessary ingredient for a successful monetary union?

If different social systems would be functionally equivalent from the point of view of economic symmetry, the principle of *subsidiarity* would imply a return to national social sovereignty, also within a monetary union. If that would be the case, one might question the actual interference of the EU with issues of wage formation and pension sustainability: those who call for a restoration of national social sovereignty (e.g. De Beer, 2014a, 2014b), would have it right. However, there are limits to the diversity in social systems that can be accommodated in a monetary union: there is no escape from the conclusion that a basic consensus on our social model is needed at the level of the monetary union. Only playing the sovereignty card is trading in illusions, as Crouch (2013) explains well in the context of a more general debate on the future of our social model and the role of social and political actors.

1.2. BEYOND ECONOMIC SYMMETRY: CONVERGENCE IN PROSPERITY

Although the argument developed in the previous section marks a significant departure from current practice and is politically demanding, it features a rather ‘thin’ concept of what a European Social Union is about. Watt’s golden rule is premised on the argument that divergence in unit labour costs is a matter of common concern, whilst divergence in the underlying productivity trends is not. Horn *et al.* (2012, p. 5) argue that both productivity levels and growth in productivity are of little importance for membership of a monetary union; what counts for economic symmetry is the relationship between pay increases and productivity increases. That argument is correct for a monetary union *in abstracto*. But for a monetary union that has to serve the European political project, divergent trends in productivity are a matter of common concern, since they contradict the fundamental aspiration of upward convergence that is at the heart of the European project.

The European integration project has been described as a ‘convergence machine’ (Gill and Raiser, 2012). Convergence was not just a result, it was also a pre-condition for continuing European integration: its legitimacy was based on upward convergence in prosperity. Over the last few years, the Eurozone displayed the exact opposite scenario: increasing divergence. Different levels and growth rates of productivity are but part of the puzzle.[12] Elsewhere, I argue that *excessive social imbalances* threaten the monetary union as much as excessive economic imbalances (Vandenbroucke *et al.*, 2013b). The expression 'excessive social imbalances' describes a set of interrelated social problems that affect member states differently (thus creating 'imbalances'). Youth unemployment and child poverty are two examples. In economic terms, current levels of youth unemployment and child poverty in Europe illustrate inadequate investment in human capital on a massive scale. A comparatively high level of youth unemployment and child poverty is synonymous with an investment deficit that may be cause and effect in a vicious circle of underperforming labour markets, child care, education systems and transfer systems. These imbalances should be a matter of common concern for all Eurozone members. If some members of the Eurozone get trapped into a vicious circle of underperforming labour markets and education systems, while other members are on a path of increasing prosperity, the credibility of the European project is at stake. In the previous section, we introduced a 'thin' version of ESU on the basis of sober economic analysis. However, beyond the economic symmetry arguments, there is the aspiration of convergence in prosperity. Convergence does not come about by market forces only, as we now have learned.[13] It requires, among many others factors, investment in human capital.[14] Arguments of political legitimacy call for a 'thicker' version of ESU, in which a common orientation on investment in human capital features prominently. The recently adopted Youth Guarantee and the Social Investment Package can be justified by such a 'thicker' version of ESU. In section 4, I return to the Social Investment Package and the importance of education. The Youth Guarantee, which calls upon member states to prevent young people from staying too long in unemployment, fits well into the development towards ESU; obviously, the proof is in the eating, and the EU and member states must now deliver on this guarantee.

INTEGRATION AND SOCIAL REGULATION IN THE EU28: A 'BALANCING ACT'

Some arguments in favour of an active social dimension to the EU transcend the Eurozone problematic, as they apply to the EU as a whole. A well-known argument holds that economic integration without social harmonisation induces downward pressure on social development in the most advanced member states. Although in the past the spectre of large-scale social dumping has never materialized, in the enlarged EU of today blatant cases of illegal working conditions and exploitation do occur, resulting from the interplay of lacunae in the domestic implementation of

[12] See European Commission (2014, chapter 3) for a survey on convergence and divergence in the EU, and Ederer and Reschenhofer (2013).

[13] If 'convergence' is not just defined in narrow economic terms, this sceptic conclusion applies not only to EMU, but also to some countries that belong to the new member states that entered the EU in the 2000s. See the thematic issue of the *Journal of Common Market Studies* on eastern enlargement and convergence (JCMS, 2014, Vol. 52n nr. 1).

[14] On employment, productivity, models of growth and the role of education, see Marelli and Signorelli (2010). On the role of education (and R&D) in Europe's global competitiveness and the need for a 'high road' to competitiveness (my words), see the ECFIN brief by Bucher and Pichelmann (2013).

social and employment protection in the member states, reduced legal sovereignty of the Member states, and the absence of common social standards in a very heterogeneous entity.

Fears of social dumping, but also welfare tourism, are causing considerable social and political tensions with regard to labour migration. These discussions will not be easily resolved, but a crucial condition for European public opinion to accept migration is that migration and posting of workers should fit into a regulated social order, it must not undermine that social order. Hence the importance of the recent agreement on the new Posting of Workers Enforcement Directive, which is supposed to resolve various legal, administrative and practical forms of abuse, circumvention of regulations and fraudulent practices when workers are temporarily posted in another country.

The question of to what extent member states can uphold social standards in a context of free movement is particularly relevant with regard to minimum wages. In member states such as Germany and Sweden, traditionally trade unions resisted state regulation of minimum wages: they considered that to be the domain of collective bargaining and a no-go area for public authorities; thus, they applied a domestic principle of subsidiarity. The *Laval* judgment by the European Court of Justice suggest that that traditional position may be unsustainable: the Court argues that only *predictable* systems of minimum wage protection can be imposed on foreign companies that post workers, i.e. member states must create a legal context in which only generally applicable minimum wage protection has to be respected by foreign service providers. If that argument is accepted, it would mean that social partners should reconsider traditional positions on subsidiarity within welfare states, i.e. they should reconsider the respective roles of social partners and public authorities, or, reconsider the relation between nationwide collective bargaining and local bargaining. The actual responses in Sweden and Denmark to the *Laval* case reaffirm the autonomy of collective bargaining, but introduce conditions for the exercise of collective action: collective agreements can only be enforced through collective action against foreign service providers if they correspond to existing nationwide collective agreements and do not define conditions beyond the hard core of the posted workers directive (Blauberger, 2012). Hence, the Swedish and Danish domestic responses also change the rules of the game in terms of the subsidiarity of the national versus the local level. Politically, this strengthens the case for a pan-European framework with regard to the concept and regulation of minimum wages (to which I return in section 5 below): both at the domestic and the European level, we must reconsider the application of subsidiarity principles.

Together with the *Viking* judgment (which did not concern the freedom of movement, as in *Laval*, but the freedom of establishment), the *Laval* judgment however raises a more fundamental problem than merely the requirement of 'predictability' of minimum provisions, as explained in Barnard and De Baere (2014). Prior to these decisions, the Court had attempted to respect the original settlement contained in the Treaty of Rome that social policy was largely a matter for domestic law. It had deployed a number of techniques to protect national social policy from the application of the (hierarchically superior) economic provisions on the internal market. However, in *Viking* and *Laval* the Court applied its internal market case law with full vigour. The moment collective action was found to be a 'restriction' and thus in breach of EU law, the 'social' interests were on the back-foot, having to defend themselves from the economic rights of free movement. The Court has made it difficult to defend the social interests due to its strict approach to justification and proportionality. Moreover, because the Court applied the freedoms to an area expressly excluded from EU competence (strikes) it created a legislative vacuum. It potentially struck down the national rules but the EU could not deal with the problem given the absence of express competence to act. This is one aspect of the so-called social deficit in the EU, as Barnard and De Baere put it. It is not impossible to solve this problem; Barnard (2013) discusses different solutions, of which a reform of the proportionality principle seems the most promising one.

Fundamentally, even in a 'thin' version of what a Social Union means, the challenge is to preserve the regulatory capacity of national governments and social partners, whilst allowing labour migration and the cross-border delivery of services. Reconciling national regulatory capacity with mobility has also constituted – and still constitutes – a challenge in the domain of health care. The impact of the European legal constellation, notably legislation shaping the internal market, on a sector such as health care shows that a neat separation between 'market issues', belonging to the supranational sphere, and 'social issues', belonging to the national spheres, is unsustainable. This observation inspired me in 2002 to propose a 'horizontal social clause' in the European legal architecture, to provide clearer guidance to all European institutions in the grey area between state and markets (Vandenbroucke, 2002). That idea found its way, via the Lisbon Treaty, into Article 9 TFEU, which formulates the requirement that all EU actions take into account 'the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health'. Will this clause serve as a reference for social impact assessments? Will it play an important role in guiding the Court of Justice and other key actors? The jury is still out, but the horizontal social clause has this potential, as Barnard and De Baere (2014) argue. Admittedly, until now, the horizontal social clause did not play a visible role when designing macroeconomic adjustment programmes – where it should have played a role.

Space forbids to discuss the issue of 'welfare tourism' and the comprehensive analyses by Scharpf (2009) and Höpner and Schäfer (2012a, 2012b) on the impact of the four freedoms and mobility on European welfare states. Unlike these authors, I do not believe that the institutional architecture and the internal heterogeneity of the EU lead systematically and *irresistibly* to greater economic liberalization, unchecked mobility and the erosion of solidarity. Reconciling mobility and the four freedoms on the one hand with the internal cohesion of national welfare states and industrial relations on the other hand is a complex challenge, but it is not an insurmountable challenge. It requires a 'balancing act', which is feasible. In other words, there is room for politics in the EU arena. A less pessimistic assessment of the potential for such a 'balancing act', is probably associated with a different understanding of the social meaning of cross-border mobility. In contrast with Scharpf, Höpner and Schäfer, Caporaso and Tarrow (2009) argue that the Court of Justice attempts to 'embed' the transnational market in Polanyi's terms within its (the Court's) understanding of legitimate social purposes, by acting as a regulatory arbiter between international openness and domestic social cohesion.[15] Both international openness (under certain conditions) and domestic social cohesion can be understood in terms of solidarity. Hence, the balancing act is between types of solidarity. That is not to say that *Viking* and *Laval* are satisfactory examples of such a 'balancing act'; the challenge is to make the balancing act satisfactory. This understanding of what the challenge is about, also underscores the relevance of a broad framework directive on the protection of migrant workers, as proposed by Barnard and De Baere (2014): this would be a prime example of embedding mobility in transnational markets in a social framework.

A SHARED NOTION OF SOLIDARITY

The foregoing discussion shows that we have to combine two perspectives on the meaning of solidarity in Europe: a pan-European notion of solidarity and solidarity within national welfare states. The pan-European notion of solidarity refers to upward economic convergence and cohesion on a European scale. But it also refers to the rights of individuals to improve their own lives by working in a Member State other than the Member State where they were born; the rights of patients to benefit, under certain conditions, from medical care in other member states than their state of residence…. Solidarity within national member states refers to social insurance, income redistribution, the balance of social rights and obligations, which define national welfare states. This dual perspective on solidarity – when used in the European context – makes it inherently complex and multifaceted. There should be no denying that it can imply trade-offs between national solidarity and pan-European solidarity, certainly in the short term. However, the political legitimacy of the European project depends on its capacity to avoid a negative trade-off, or, in other words, to avoid a zero-sum game between national cohesion and pan-European cohesion. In yet other words, the legitimacy of the European project requires a virtuous circle of growing pan-European and national cohesion. Sustaining such a virtuous circle should be the primary objective of a European Social Union.

In fact, this means that we should revisit the fundamental goals that have been part and parcel of the European project since the Treaty of Rome of 1957: the simultaneous pursuit of *economic progress* on the one hand, and of *social progress and cohesion* on the other, both *within* countries (through the gradual development of the welfare states) and *between* countries (through upward convergence across the Union). The founding fathers of the European project optimistically assumed that growing cohesion between and within countries could be reached by supranational economic cooperation, together with some specific instruments for raising the standard of living across the member states (which were later brought together in the EU's 'economic, social and territorial' cohesion policy). Economic integration was to be organized at the EU level, and would boost

[15] Höpner and Schäfer (2012a) explicitly discuss and criticize Caporaso and Tarrow (2009), notably their reference to Polanyi's concept of 'embedding markets'. One should note that Caporaso and Tarrow do not discuss *Viking* and *Laval*, which can be seen as marking a turn in the Court's approach, in favour of liberalization and mobility. On the other hand, the recent judgment by the Court in the *Dano* case, which allows national governments to resist 'benefit tourism' (published on 11 November 2014), illustrates that the Court's logic is not one of unchecked mobility at the cost of domestic social cohesion.

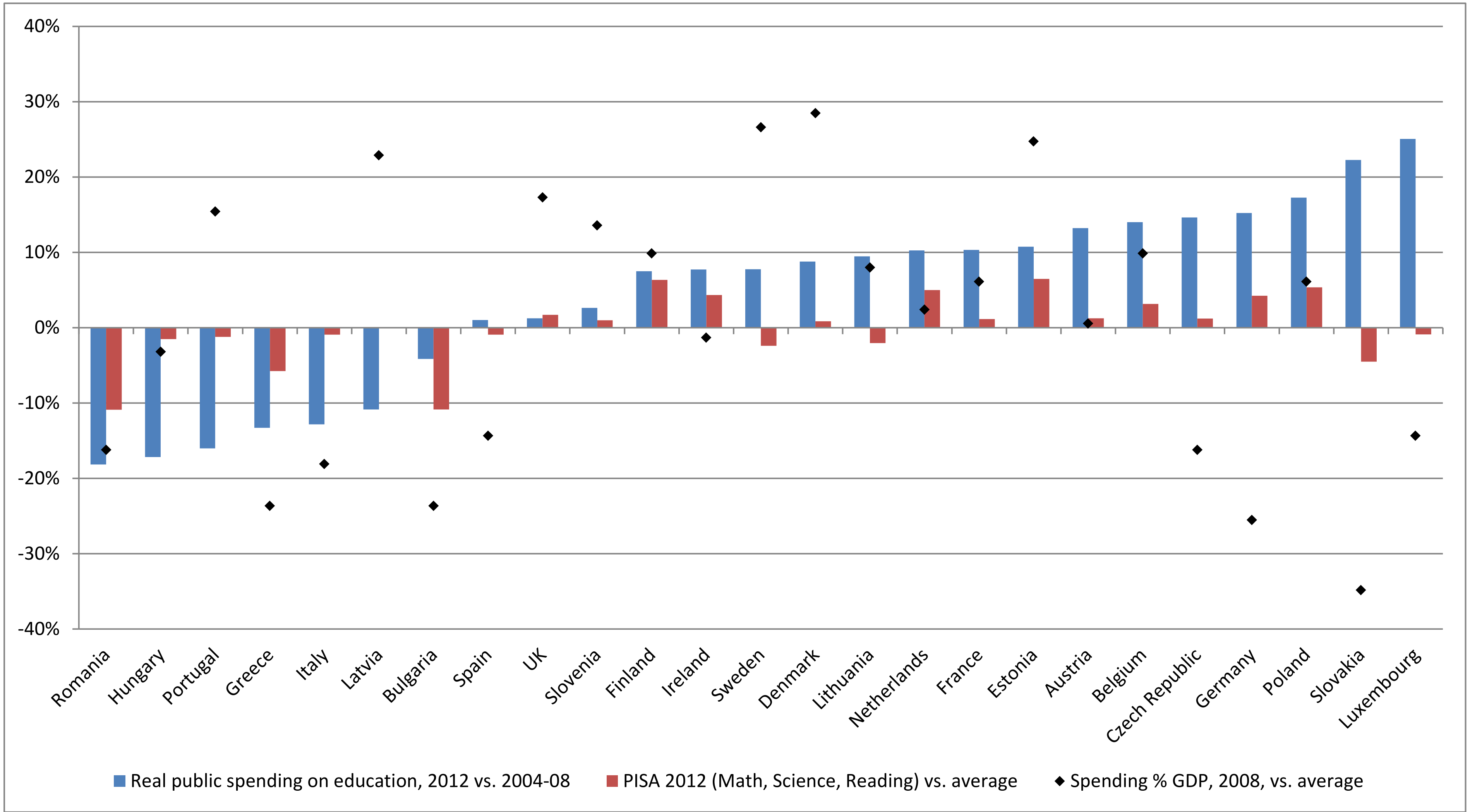
economic growth and create upward convergence; domestic social policies were to redistribute the fruits of economic progress, while remaining a national prerogative. Consecutive enlargements as well as monetary unification made this complex notion of solidarity even more demanding and difficult to handle. Indeed, what is seen by some as 'the dynamics of upward convergence' associated with the enlargement of the EU, is seen as social dumping by others. At the same time, monetary unification necessitates forms of solidarity which were, thus far, a no-go area in European politics. We risk to be caught in a trap: we badly need more European solidarity, whilst it is becoming more difficult to manage. Instead of a virtuous circle, that is a vicious circle.

THE SOCIAL INVESTMENT IMPERATIVE

How can we create a virtuous circle whereby both pan-European cohesion and national cohesion are enhanced? There is a huge disparity in the performance of European welfare states. They also display very different profiles with regard to the formal educational achievement of their population. The southern EU15 member states combine low employment rates with a high share of people with no more than lower secondary education. I do not suggest that there is a simple causal relationship between formal educational attainment and employment: it is the combination of a poor record in employment and education that is so alarming. The OECD PISA programme focuses on real skills acquired, instead of formal levels of education. The most recent PISA tests of the skills of 15-year old students also illustrate the disparity across Europe with regard to investment in human capital in today's younger generation, with weak average scores for countries such as Romania, Bulgaria, Greece, and Slovakia; mediocre scores in Portugal, Italy, Spain and a number of other countries; and relatively high scores in Finland, Ireland, the Netherlands, Estonia, Germany and Poland. These data not only illustrate the particular deficit of Southern Eurozone welfare states – compared to other Eurozone members – with regard to education and employment; they underscore the huge education agenda the whole EU is confronted with. The European Union certainly recognises the challenge: in the *Europe 2020* agenda, reducing the number of early school-leavers is singled out as one of the *headline targets*. The European Commission has developed a comprehensive agenda on education, training and skills, and issued excellent recommendations on the modernization of education systems. However, the question remains as to whether this educational agenda carries sufficient weight at the highest levels of European political decision-making and in the setting of budgetary priorities: the answer seems negative. Real public expenditure on education was lower in 2012 than in 2008 (i.e. before the crisis) in 14 member states, including in member states that badly need to improve their education system. That is not to say that the quality of education systems can be measured in a simplistic way by the level of public spending on education; but it seems very hard to improve education systems significantly whilst disinvesting.

A simple comparison of real public spending on education between 2008 and 2012 might be misleading, since 2008 provides just one snap-shot of the past. Figure 1 displays data on the evolution of public spending on education in real terms, together with the most recent PISA results, and spending as a percentage of GDP. The blue bars compare, for each country, its public education spending in 2012 with its average spending over the years 2004-2008 (deflated with the GDP deflator): in 7 of the 25 countries under review, real spending is now lower than it was, on average, in the five years before the crisis. In Romania the decline is 18%, in Hungary it is 17%, in Portugal 16%, in Greece and Italy 13%, in Latvia 11% and in Bulgaria 4%. Meanwhile, in other countries there

FIGURE 1: SPENDING ON EDUCATION AND PISA RESULTS



Sources: Eurostat (public spending on education, general government), OECD PISA, own calculations.

was a significant increase in real spending, with an increase by 15% or more in the Czech Republic, Germany, Poland, Slovakia and Luxemburg (always comparing 2012 with the average over 2004-2008). The red bars compare the PISA 2012 score (the average scores on mathematics, science and reading) of each country with the average country score across this set of countries. Some of the countries that cut spending drastically (like Romania and Greece) or significantly (like Bulgaria) are also countries with poor PISA scores. Moreover, one cannot say that these countries were 'big spenders' on education, when education spending is compared to GDP: the black dots in Figure 1 highlight this. The graph also illustrates that some of the countries with a spectacular increase in real spending had a relatively low level of spending relative to their GDP in the mid-2000s: they used the produce of economic growth in part to catch up on education spending. Although the graph shows that there is a certain correlation between spending as a percentage of GDP and PISA scores (even as high as 0,62 for 2012), I insist that the message is not that spending guarantees educational performance; but cutting spending is not a recipe for progress either. The take-home message emerging from this graph is a dramatic divergence in the real public effort for education, with drastic cuts in some countries that badly need to improve their educational performance.

The strong record of Northern welfare states, with regard to both employment and poverty, has been linked to their long-term orientation towards 'social investment', i.e. activation, investment in human capital, and capacitating social services such as child care (Hemerijck, 2013). Obviously, investment in education and child care are no panacea; welfare states also differ with regard to the effectiveness of their social protection systems. For instance, Greece does not have a system of minimum income assistance, and minimum income protection in Italy is generally considered to be inadequate. Cash transfer systems are highly fragmented in a number of welfare states. Welfare state performance depends on the complementarity of effective investment in human capital – by means of education, training and child care – and effective protection of human capital – by means of adequate transfer systems and health care. The redistributive role of social protection remains important *per se* (Cantillon and Vandenbroucke, 2014).

So conceived, a social investment strategy offers an interesting perspective, with regard to both pan-European cohesion and national cohesion (Nicaise and Schepers, 2013). Social investment emerged gradually as a social policy perspective in the 1990s in response to fundamental changes in our societies with a focus on policies that 'prepare' individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the emergence of new social risks and population ageing, rather than on simply generating responses aimed at 'repairing' damage caused by market failure, social misfortune, poor health or prevailing policy inadequacies. Social investment is not an easy panacea. Successful social investment presupposes a well-designed complementarity between 'protecting human capital' by means of traditional instruments of social protection (cash benefits, health care) and 'developing human capital', by means of education, training and activation.

The Social Investment Package, launched by the European Commission (2013a) in February 2013, presents a similar argument and provides an interesting common orientation for EU member states with its focus on early childhood education and care, preventing early school leaving, lifelong learning, affordable child care (as part of an active inclusion strategy), housing support (fighting homelessness), accessible health services and helping people live independently in old age. Together with Hemerijck and Palier, I called for a true 'Social Investment Pact' for the EU (Vandenbroucke, Hemerijck, Palier, 2011). Obviously, a 'Package' is not a 'Pact'; the idea of a 'Pact' underscores the sense of reciprocity that is needed: all member states should be committed to policies that respond to the need for social investment; simultaneously, member states' efforts in this direction – notably efforts by member states who face a difficult budgetary and economic context – should be supported in a tangible way.

MINIMUM WAGES AND MINIMUM INCOME PROTECTION

As already indicated in the previous section, successful social investment presupposes complementarity between 'developing human capital' and 'protecting human capital' by means of traditional instruments of social protection. Minimum income protection, which is one of the functions of social protection, typically has a layered structure, with two types of minimum benefits for inactive individuals (non-means tested minimum social security benefits, means-tested social assistance) and minimum wages for those who are in employment. This layered structure differs markedly across European welfare states, with regard to the relative emphasis on means-tested versus non-means tested benefits, with regard to the difference between incomes based on minimum wages and incomes based on benefits for comparable household types, and with regard to wage-setting institutions. Nevertheless, minimum wages tend to constitute a kind of 'glass ceiling' for the level of minimum benefits, given the need to avoid inactivity traps (Cantillon *et al*, forthcoming). This implies that the level and coverage of minimum wages has, indirectly, an impact on the overall capacity of social protection systems to prevent financial poverty. That observation underscores the importance of maintaining a national regulatory capacity in the domain of minimum wages, a problem we discussed in section 3, above. In a 'thick' version of what a European Social Union is about, motivated by the need for upward convergence across the EU, the argument might go one step further: decent minimum wages can be seen as part and parcel of the social investment strategy underpinning upward convergence, a strategy which we want to see at work everywhere.

Whatever one thinks about it, minimum wages are on the political agenda of the EU. For example, in their joint statement of 29 May 2013, France and Germany proposed '*considering implementing minimum wage floors, defined at national level that would guarantee a high level of employment and fair wages – leaving the choice between legislation and collective-bargaining agreements.*' Interestingly, this joint statement immediately added a consideration on the enhancement of cross-border mobility, '*calling for encouraging cross-border worker mobility by removing obstacles, improving cooperation between employment services (building upon the EURES platform) and facilitating the portability of rights in case of mobility*' (Bundesregierung, 2013). This joint statement lends support to the idea that cross-border mobility is a positive development, if organized with respect to existing social regulation, such as decent minimum wages; moreover, it suggests that minimum wage floors are a natural component of the European social model.

One should be clear about the rationale for a European framework on minimum wages: incorrect arguments for a minimum wage framework will quickly return as a boomerang against the case for minimum wages. Eurofound (2013) published an in-depth investigation of proposals with regard to

European minimum wage coordination. It shows that a European minimum wage threshold at 60% of national median wages would be very demanding in terms of the number of workers affected and the increase in wage levels at the bottom end of the income distribution. A pan-European approach would also encounter huge institutional difficulties, given the differences in wage-setting institutions across the EU. Simultaneously, the report notes a number of arguments in favour of minimum wage coordination at the European level, such as the fact that it would minimise the negative effects on intra-European competitiveness. A gradual approach might therefore be indicated.[16] The report also argues that the main justification for minimum wages is not the reduction of poverty (the direct impact on poverty is rather limited, since household poverty is more related to not working at all than to having low wages). Also, a European framework on minimum wages will not diminish the huge disparities in levels of wages across the EU28. The essential justification for minimum wages is the unambiguous establishment, in each member state, of minimum labour standards below which no employment relationship is considered socially acceptable. That is a matter of principle, which is important per se. Apart from improving equity by raising wages of low-wage earners, adequately set minimum wages encourage inactive people on the margin of the labour market, in particular those with low skills, to actively search for a job (OECD Employment Outlook, 2014). Simultaneously, the level of minimum wages has an indirect impact on the adequacy of social protection systems, as explained above.

Should the EU play a role with regard to minimum income protection as such (apart from minimum wages)? With regard to fighting poverty, the European Anti-Poverty Network (EAPN) proposes a draft directive on adequate minimum income. It would stipulate that 'every Member State shall introduce a minimum income scheme, that guarantees the right to an adequate minimum income to all people living on their territory' (EAPN, 2010). The objective would be to ensure that the combined effect of their minimum income provisions and other policy measures are sufficient for lifting all persons above the poverty threshold (60% of the national median income, in a first stage). The argument is fundamentally political: a European framework with regard to minimum income protection would indeed give substance and political salience to social rights in a 'caring Europe'. But, given the heterogeneity between European member states, any binding agreements on minimum incomes would have to be introduced flexibly and gradually, and implemented in unison with a convergence in activation measures and minimum wages (Vandenbroucke et al, 2013a). Moreover, since such a scheme – even if it is moderate in its initial ambition – requires a significantly greater budgetary effort on behalf of some of the poorer member states in Eastern and Southern Europe, it raises a complex question about the meaning of solidarity within the EU.

In the poorer member states 'the rich' (except the super-rich) are poorer than 'the poor' in the richer member states.[17] Hence, a minimal condition for a 'caring Europe', that attempts to upscale

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[16] See Thillaye *et al.* (2014) for a discussion on the governance aspect, which links minimum wage coordination to wage coordination in general, cf. footnote 8, supra. See Barnard and De Baere (2014) for legal issues and alternative legal solutions.

[17] See Table 11-3 in Vandenbroucke *et al.* (2013), for income data based on EU SILC 2010: in eight new Member States (Romania, Bulgaria, Latvia, Lithuania, Hungary, Poland, Estonia and Slovakia) incomes at the

minimum income protection, is that it should help the poorer member states, not just by opening up markets and implementing successful macro-economic policies at the EU level, but also by putting at their disposal generous Structural Funds for the foreseeable future. Simultaneously, a caring Europe would put positive pressure on poorer and richer member states to gradually improve the overall quality and efficiency of their welfare regimes. Introducing conditionality with regard to aspects of social inclusion policy in the European Social Fund may is one way to develop more leverage.[18] Simultaneously, existing strategies – notably *Europe 2020* – should be taken seriously and given real bite. If this were the overall context, then the prospect of gradually introducing a more binding EU framework on minimum income protection may become realistic and useful, for the political reason indicated above and as a measure to increase the quality and efficiency of domestic social systems. Thus, introducing a European framework for minimum income protection is a matter of political choice (rather than a functional necessity) for the European Union. The bottom-line of the argument is about legitimacy and reciprocity: enhanced solidarity within member states cannot be decoupled from enhanced solidarity among member states – and *vice versa.*

THE NEED TO CLARIFY POLICY METHODS AND TOOLS

In section 1, I wrote that *excessive social imbalances* threaten the monetary union as much as excessive economic imbalances. The first step to restore (upward) convergence, is to fight such excessive social imbalances, notably within the Eurozone. This requires a toolkit, in which three types of instrument are made to work in the same direction: general mainstreaming, contractual approaches, and the European Funds.

Fernandes and Maslauskaite (2013a) rightly argue that the social dimension should be *mainstreamed* into all EU policies, notably into macroeconomic and budgetary surveillance, rather than it being constituted as a separate social pillar. In principle, the *Europe 2020* frame should guarantee such mainstreaming; in practice, the social and education objectives of *Europe 2020* do not carry the same weight as the economic and budgetary objectives. This is, first and foremost, a political problem, which solution presupposes the willingness to take social objectives into account at the highest level of EU decision making. Nevertheless, while the notion of mainstreaming seems straightforward, clarification is needed about the institutional actors that should take the lead in it and how it should exactly be done. Refining the MIP Scoreboard, which is used in the Macroeconomic Imbalances Procedure, was a first step towards such mainstreaming. Social and employment indicators have indeed been added to the set of 'auxiliary indicators' that are used in the economic reading of the MIP Scoreboard. However, some nervousness exists about the

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top of the 4th quintile are *lower* than incomes at the top of the bottom quintile in seven richer countries, namely Luxembourg, the Netherlands, Austria, Cyprus, Sweden, Denmark and France. In Romania, Bulgaria, Latvia, Lithuania and Hungary these 'high incomes' are actually below the poverty threshold in those eight richer countries.

[18] Schoukens and Beke Smets (2014) discuss the potential to give inclusion recommendations more legal bite.

ownership and control of the process in which they will be used. As a matter of fact, there is more than one 'scoreboard'. Next to the auxiliary indicators in the MIP, a scoreboard of (a few) employment and social indicators was adopted by the EPSCO Council in December 2013, to inform macroeconomic and fiscal policies, both at EU and national levels, in the context of the European Semester. In itself, that can be seen as promising. However, the European Council's confirmation of "the relevance of the use of a scoreboard of key employment and social indicators" (European Council, 2013: §38) and especially that "The use of this wider range of indicators will have the sole purpose of allowing a broader understanding of social developments" (Ibid: §39) is unsatisfactory. The precise role of this new scoreboard vis-à-vis the strong analytical tools developed recently by the EPSCO Council – the Employment Performance Monitor and Social Protection Performance Monitor – should be further defined. Finally, mainstreaming should include monitoring the impact of social and labour market reforms in member states having signed a Memorandum of Understanding. In short, if mainstreaming social policy objectives is deemed necessary, the content, the process and the role of the different policy strands have to be clarified, in order to make such mainstreaming effective and legitimate in the perception of all the actors involved.

In section 4, I concluded that a pan-European social investment strategy requires a sense of reciprocity: all member states should be committed to policies that respond to the need for social investment; simultaneously, member states' efforts in this direction – notably efforts by member states who face a difficult budgetary and economic context – should be supported in a tangible way. Organizing reciprocity implies a *contractual approach*, in one way or other. Here too, there is a need for clarification. In 2013 the European Commission proposed formal 'contractual arrangements' between the EU and the member states as part of a 'convergence and competitiveness instrument' (European Commission, 2012, 2013b). The idea of contractual arrangements raised many issues, as explained Van den Bosch (2013).[19] With hindsight, the key question that comes out of this discussion, is whether such contracts envisage a bilateral top-down approach with the Council and the Commission dictating policies to specific countries (a 'principal-agent model' with financial incentives), or, alternatively, solidarity in commonly agreed structural welfare state reform. In the run-up to the December 2013 Council, many governments have taken a defensive approach in the discussion about the proposed contractual arrangements, and the discussion got stalled. In a sense, this is understandable given the impression that these contracts would simply reinforce a top-down implementation model of policies that are controversial in member states. However, a less defensive approach in this debate would have been better, at least if one wanted to turn the proposal into 'solidarity in structural welfare reform' – which is necessary.

So conceived, the questions with regard to 'contracts' echo questions raised with regard to the *European funds*. Cohesion policy is supporting 'inclusive growth' more effectively than it did before, mainly thanks to concentration of efforts. The case could be made that not only the ESF, but also the ERDF and other funds should support the employment and social policy thematic objectives, and have corresponding social investment priorities. There is a risk that contractual arrangements, as

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[19] Barnard and De Baere (2014) discuss legal possibilities.

proposed in 2013, would overlap with existing cohesion policy programmes with a clear social commitment. Contractual arrangements and cohesion policy operational programmes should be made consistent and complementary policy tools, in order to increase – instead of merely substitute – efforts at EU level in employment and social policies (Vandenbroucke and Vanhercke, 2014).

Rubio (2014) argues that structural reforms in EU Member States should be stimulated by other mechanisms than the contractual arrangements proposed in 2013; for instance, the Commission and the Council may apply the flexibility clause in the Stability and Growth Pact so as to explicitly allow member states to implement structural reforms that are costly (in budgetary terms) in the short run. Space forbids to pursue this argument here. *The take-home message is that we need to organize reciprocity in a legitimate and practical way.*

7. CONCLUSION: FROM A SENSE OF SURVIVAL TO A SENSE OF COMMON PURPOSE

The Eurozone must be complemented with a genuine social dimension for it to be sustainable in the long term, as a monetary union of welfare states. A Social Union would support national welfare states *on a systemic level* in some of their key functions (such as macroeconomic stabilisation) and guide the *substantive development* of national welfare states – via general social standards and objectives, leaving ways and means of social policy to member states – on the basis of an operational definition of 'the European social model'. In other words, European countries would cooperate in a union with an explicit social purpose – hence, the expression 'European Social Union'. ESU, so conceived, is not only desirable, but necessary.

Our arguments with regard to EMU are premised on the idea that the tuning of economic strategies requires a minimal tuning of social policy, even if this should not lead to the application of an undifferentiated social policy: member states should retain sovereignty in specific areas (e.g. the organisation of health care), and they must be able to effectively assume the responsibilities they bear. That is one of the reasons why the idea of a Social Union is not confined to the Eurozone, although some specific arguments only apply to the Eurozone. At the level of the EU28, we must deepen our mutual understanding of the social goals to be achieved by market integration and the mobility of people, services, goods and capital; and it must be possible to maintain principles of social regulation that serve those goals.

The practice of a Social Union should be far removed from a top-down, 'one size fits all' approach to social policy-making in the member states. What is needed today, is a more balanced approach to macroeconomic coordination, i.e. a combination of greater room for manoeuvre and tangible support for member states that opt for a social investment strategy, and policy guidance based on clear and sufficiently stringent and constraining objectives with regard to well-defined social outcomes on the one hand, and genuine scope for exploration and mutual learning on the ways and means to achieve those outcomes on the other hand.

A Social Union is not a defensive Maginot Line, to fight the previous war: we need reform, not a status quo. In policy terms, the challenge is to make *long-term* social investments and *medium-term* fiscal consolidation mutually supportive and sustainable, under improved financial and economic governance. In political terms, European citizens need a reformist perspective that gives the *social* *acquis* they cherish a credible future. A European Social Union should build on that *acquis*; simultaneously, building on that *acquis* requires reform. That is the quintessence of the call for a social investment pact.

The case for a Social Union is not a blueprint for a one-off, revolutionary 'big bang' in the EU. The aim of this paper is to clarify a benchmark concept; politics in the EU is inevitably piecemeal and step-by-step, but it needs orientation on the basis of a clear concept. This paper presented a generic concept (whilst making a distinction between a 'thin' and 'thicker' version of arguments), without developing a precise list of proposals. Depending on the normative judgements that are brought to bear, a Social Union may be a more ambitious or a less ambitious project. Sections 4 to 6 of the paper intended to show that current debates on social policy in the EU can be interpreted and oriented on the basis of such a 'Social Union' concept. The final question, obviously, is: can we mobilize public support, and on the basis of which arguments? The survey of normative arguments for a Social Union presented in Vandevelde (2014) and the empirical examination of its legitimacy by Hooghe and Verhaegen (2014) point in the same direction: a *well-functioning* union of welfare states would provide a 'public good' for citizens in all the constituent welfare states. If it functions well, a virtuous circle of increasing trust in the institution and support for ambitious normative aims is possible.

Some of the issues I discussed in the preceding sections are already well-rehearsed in debates on 'social Europe'; others are rather new. Some proposals are analytically compelling, but raise complex questions of governance (such as symmetric coordination of wage cost competitiveness, possibly associated with minimum wage coordination…). Developing a coherent conception of a European Social Union, in which old and new proposals fit together to make a consistent whole, and translating it in operational political proposals, leads us into unchartered territory (Vandenbroucke and Vanhercke, 2014, list no less than '10 tough nuts to crack' in the discussion on European Social Union).

At the moment of writing, we may hope that the actions of the EU and its member states will no longer be guided by day-to-day crisis management, as was the case since 2009. However, without a sense of common purpose, it will not be possible to overcome the legacy of the crisis; it will not be possible to avoid the spectre of sluggish economic growth for many years; and it will not be possible to fight the mounting euroscepticism[20]. Moving from a 'sense of survival' to a 'sense of common purpose' is a basic condition for building a Social Union.

[20] Fernandes and Maslauskaite (2013b), who's Scenario C also inspired the subtitle of this section.

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