

A European Social Union: Unduly Idealistic or Inevitable?

ABSTRACT

This article summarises a lecture delivered at the EIB on 5 March 2015, on the idea of a European Social Union. The main argument is that a basic consensus on the European social model has become an existential necessity for the EU. A consensus must be reached on the respective roles of EU institutions and national governments in social policy, and on the general objectives and standards of the European social model. The Greek crisis, which is not resolved at the moment of writing, highlights the complexity of the challenge, but also its urgency. To illustrate the potential for such a consensus, reference is made to a report published by the think tank Friends of Europe, 'Unequal Europe: Recommendations for a more caring EU'. Reference is also made to some elements of the recent report 'Towards Economic Union – Convergence, Prosperity and Social Cohesion' by the Presidents of five major EU Institutions – known as the Five Presidents' Report – which shows a growing awareness of the need to incorporate the social dimension in our thinking on the future of the EU. However, the Five Presidents' report underestimates the education agenda that confronts the EU. Finally, it is argued that the Greek drama illustrates first and foremost a 'deficit in common purpose' rather than a democratic deficit in the EU. A sense of common purpose, notably with regard to the European social model, is essential for the Eurozone and the EU to survive.

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The founding fathers of the European project were convinced that economic integration would contribute to the development of prosperous national welfare states, leaving social policy concerns essentially at the national level. History has not proven them wrong, at least until the mid-2000s. However, the experience of the crisis forces us to reconsider the question: *how can the EU be a successful union of flourishing welfare states?* It is obviously necessary to restore economic growth, 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 respective roles of EU Institutions and national governments in social policy and on the general objectives and standards of the European social model. The argument is 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 – a call which can also be heard – is not an option, unless we are ready to trade in illusions. Hence, we need a coherent conception of a *European Social Union*, even if we may not like that expression.

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; it would guide the *substantive development* of national welfare states by indicating general social standards and objectives. The ways and means to implement social policy would be left to Member States, with due respect to their different historical legacies and institutions. The idea of a ‘social union’ does not refer to a separate pillar, to be added to existing pillars. It aims to clarify what is the point and purpose of a social dimension to the European project. One could also say that it describes the ‘social contract’ which the EU needs, between its Member States and between its citizens. Rather than focusing on the terminology – this contribution is not about political communication, let alone political marketing – my aim, here, is to focus on the concept we need.

Although that concept may sound unduly idealistic, it is not: it allows for the piecemeal progress which often characterizes EU politics. To illustrate this, I will relate elements of my argument to the Five Presidents’ Report on *Completing Europe’s Economic and Monetary Union*, which has now been published.¹ I will not discuss the Five Presidents’ Report *in globo*, but only to show how the idea of a European Social Union can serve as a benchmark concept for the direction the EU should take.

The incomplete monetary union

A social union, so conceived, is not only desirable but necessary. This argument is partly based on the *functional* implications of a monetary union. Well-known economic theory explains the benefits and drawbacks of monetary unification in terms of *trade-offs*. Members of a currency area are confronted with a trade-off between symmetry and flexibility. Symmetry refers to movements in

¹ The report was drafted by the Presidents of five major EU Institutions: the European commission, the European Council, the European Central Bank, the Eurogroup and the European Parliament

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 an asymmetric shock. Less symmetry necessitates more flexibility: the less symmetry there is between the countries of a single currency area - e.g. in productivity growth - the greater the required capacity for internal adaptability in order for the monetary union to be beneficial. In this traditional textbook analysis 'adaptability' is understood mainly in terms of labour mobility and/or wage flexibility. There is a second trade-off: if asymmetric shocks can be absorbed through *fiscal transfers* between the member states, then the need for flexibility is reduced. Obviously, fiscal transfers, even if they are not permanent but only temporary and reversible, require a readiness to organise solidarity among the members of the monetary union.

Since 2008, we have learned that the traditional textbook description of these trade-offs is insufficient to understand the Eurozone crisis. Design failures of EMU made it unstable and fragile: it lacked both a banking union and a central bank that was ready to be lender of last resort, if necessary. The Five President's report now adds to this that the Euro area also needs a fiscal stabilisation function. Indeed, both a lender of last resort and a fiscal capacity are indispensable to support Eurozone welfare states in one of their key systemic functions, stabilization in times of economic crisis. The idea of a fiscal stabilisation function, which implies fiscal transfers in one way or other, remains at a very generic level in the Five Presidents' Report. Admittedly, it raises complex political and technical questions, and different options can be pursued. It is therefore urgent to clarify this idea. Fundamentally, both with regard to the completion of banking union (which raises issues of mutual insurance) and fiscal stabilisation (which can also be understood as the organization of a kind of mutual insurance against adverse economic circumstances), the Five Presidents' Report signals an acute awareness that we need to organize more solidarity in the Eurozone.

The organization of solidarity requires mutual trust. Solidarity on the basis of mutual insurance is a rational option, but even the most rational individuals will not engage in mutual insurance, if they do not trust each other sufficiently. European solidarity requires mutual trust with regard to the quality of the social fabric in the Member States, notably with regard to their capacity to deliver on competitiveness and sound public finances. What we have also learned since 2008 is that exposure to market forces has not in itself produced discipline in the monetary union. On the contrary, monetary integration, as it has been implemented, invited 'lack of discipline' rather than discipline. We witnessed divergence, rather than convergence. Since market forces do not lead to symmetry and convergence, EMU needs a visible hand that pursues symmetry, notably with regard to wage increases. Moreover, Member States need labour market institutions that can coordinate wage increases: the visible hand must be effective.

One should note that arguing that a visible hand is necessary, as I do in my case for a social union, does not mark a departure from current EU *principles*, but rather from current *practice*. The Six-Pack and the Macroeconomic Imbalance Procedure² are deliberate attempts to strengthen the visible

² The Six-Pack is a set of European legislative measures, bundled into a 'six pack' of regulations introduced in 2010-2011, to introduce greater macroeconomic surveillance. The Macroeconomic Imbalance Procedure was part of the Six-Pack; it is a specific surveillance mechanism that aims to identify potential risks early on,

hand of European policy makers. But *current practice* has put a one-sided emphasis on adjustment in Member States with current account deficits and has not addressed the role of Member States with surpluses. Symmetry should be organized instead around a common benchmark, for instance, a 'golden rule' linking national wage increases to national productivity increases. A second desirable departure from current practice is to acknowledge the positive results that come from coordinated wage bargaining within Member States. Instead of encouraging the decentralization of collective bargaining, the EU should take steps to encourage and facilitate bargaining coordination. The Five President's report now tables a proposal which can be linked to the need to revamp systems of collective bargaining: it proposes an Euro area system of national 'Competitiveness Authorities', thereby referring to Belgium as an example of good practice. It so happens that the Belgian competitiveness watchdog is embedded in national collective bargaining institutions, and derives its authority precisely from being part and parcel of the collective bargaining system. Hence, the 'good practice', which the Five Presidents' Report refers to may be broadened to embedding such competitiveness authorities in collective bargaining systems.

Bearing in mind these observations on the importance of coordinated bargaining within Member States and across the Eurozone, we can now return to the long-term trade-off between symmetry and flexibility. Flexibility is a catch-all concept: it includes less regulated labour markets, temporary shock absorbing mechanisms such as *Kurzarbeit* in Germany³ and a highly skilled and versatile labour force. All these features provide different ways and means to achieve labour market flexibility, which can be combined in different ways, according to social preferences. For example, a 'high road' to labour market flexibility, based on skills and work organization, can be opposed to a 'low road', based on mere labour market deregulation. At first sight, one might think that it is irrelevant which of these various labour market flexibility arrangements are adopted as pillars of a sustainable monetary union: i.e. 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, not all systems of labour market regulation deliver equally well with regard to wage coordination. National models of labour market flexibility as much as wage coordination and 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.

Neither flexibility nor fiscal transfers, nor systems of wage coordination, are socially neutral choices. 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. Although its proposals remain rather vague and timid in this respect, the Five President's report illustrates a growing recognition of this fact. The report refers, for instance, to the need for European 'standards

prevent the emergence of harmful macroeconomic imbalances and correct the imbalances that are already in place.

³ *Kurzarbeit* makes it possible for German firms, confronted with a reduction in economic activity, to diminish the regular working hours of their workers on a temporary basis (instead of firing them), with a compensation paid by German social security.

for labour markets', which should combine security and flexibility. The challenge now is to make this proposal operational. Here is some important homework for Marianne Thyssen, the Commissioner for Employment and Social Affairs.

Integration and social regulation in the EU28: a 'balancing act'

Some arguments in favour of an active social dimension apply not only to the Eurozone, but 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. In the past the spectre of large-scale social dumping has never materialized, but in today's enlarged EU blatant cases of illegal working conditions and exploitation do occur, resulting from the interplay of gaps in the domestic implementation of social and employment protection in Member States, their reduced legal sovereignty, and the absence of common social standards in a very heterogeneous group of countries.

A crucial condition for European public opinion to accept labour mobility and migration is that they should fit into a regulated social order; they must not undermine that social order. Whether or not minimum wage standards can be protected in a context of free movement of workers and services is a salient example. 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 one. It requires a 'balancing act', which is feasible: the Friends of Europe report *Unequal Europe - Recommendations for a more caring EU* suggests practical initiatives in this sense. This balancing act is not just between economic and social principles. Both international openness (under certain conditions) and domestic social cohesion can be understood in terms of solidarity. Hence the balancing act is also between different types of solidarity.

A shared notion of solidarity

The foregoing discussion shows that we have to combine two perspectives on 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, and to the specific solidarity that is needed to sustain the monetary union. But it also refers to the rights of individuals to improve their own lives by working in a Member State other than the one of which they are nationals; or the rights of patients to benefit, under certain conditions, from medical care in other member states than their state of residence. Solidarity within national welfare states refers to social insurance, income redistribution and the balance of social rights and obligations. This dual perspective makes solidarity 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.

As a point 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 hand 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 both 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 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 complex and demanding. 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, so far, a no-go area in European politics, such as a Eurozone stabilisation capacity and fiscal transfers. Over the last few years, the Eurozone has displayed the exact opposite scenario of convergence: increasing divergence. *Excessive social imbalances* threaten the monetary union just as much as excessive economic imbalances. We risk being caught in a trap: we badly need more European solidarity just at a time when it is becoming more difficult to achieve. We are at risk of a vicious rather than a virtuous cycle.

The social investment imperative

How can we create a virtuous circle whereby both pan-European cohesion and national cohesion are enhanced? In the long term, upward convergence among EU Member States (i.e. pan-European cohesion) presupposes convergence in human capital, which is the fundamental long-term driver of economic productivity and prosperity. In a recent analysis of economic divergence in the Eurozone, the ECB (2015) mentioned investing in human capital as one of the key policies to pursue. The OECD PISA tests indeed show a huge disparity in investment in today's youth human capital, with weak average scores for 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. This illustrates not only the particular deficit in education of Southern Eurozone welfare states compared to other Eurozone members but also the huge education agenda that confronts the EU as a whole. The EU certainly recognises the challenge: the *Europe 2020* agenda singles out the reduction of the number of early school-leavers 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, this educational agenda does not carry sufficient weight at the highest levels of European political decision-making and in the setting of budget priorities. Real public expenditure on education was lower in 2013 than before the crisis in 10 Member States, including those that badly need to improve their education system. The divergence in education spending across the EU may lead to more long-term divergence in productivity, instead of the convergence that is so badly needed. 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 while disinvesting.

Figure 1: A worrying divergence in spending on education

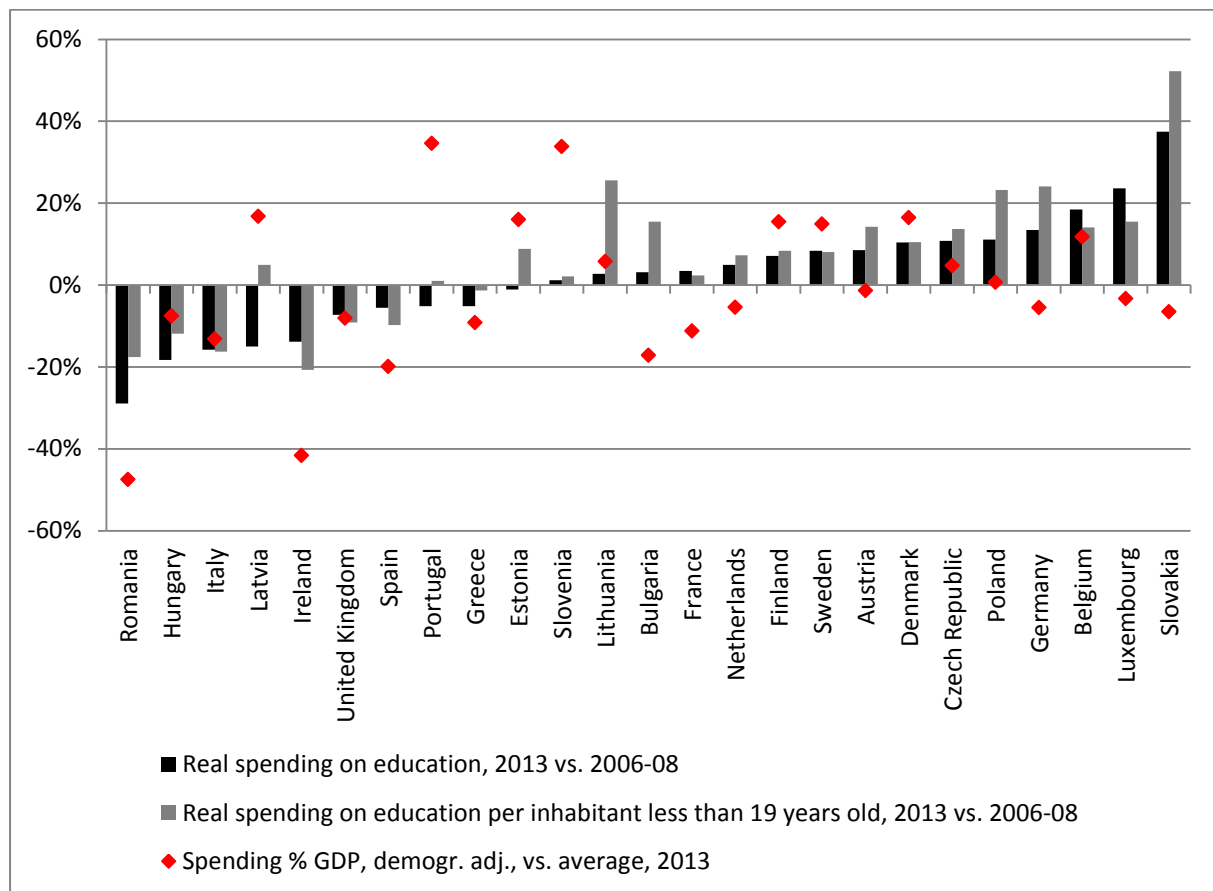


Figure 1 displays data on the evolution of public spending on education in real terms. The black bars compare, for each country, its public education spending in 2013 with its average spending over the years 2006-2008 (deflated with the GDP deflator): in 10 of the 25 countries under review, real spending is now lower than it was, on average, in the years before the crisis. In Romania the decline is 29%, in Hungary it is 18%, in Italy 16%, in Latvia 15% and in Ireland 14%. Meanwhile, there was a significant increase in real spending, with an increase in education spending of 10% or more in Denmark, the Czech Republic, Germany, Poland, Belgium, Luxemburg and Slovakia (always comparing 2013 with the average over 2006-2008). Obviously, demography plays a role: the grey bars in Figure 1 take demographic change into account, by calculating real public spending on education per inhabitant younger than 19 years old. Per young inhabitant, real spending diminished ‘only’ by 18% in Romania and 12% in Hungary; by contrast, in Ireland real spending per young inhabitant diminished by 21%. The effort in public education spending is spectacular in Germany and Poland, when taking demography in account. With regard to human capital, we are generating further divergence in the EU.

Data retrieved from Eurostat website; author’s own calculations

Successful welfare states need a well-designed complementarity between ‘developing human capital’, by means of education, training and activation and ‘protecting human capital’ by means of traditional instruments of social protection (cash benefits, health care) and protection of employment conditions (notably minimum wages). Based on these arguments, Vandenbroucke, Hemerijck and Palier (2011) called for an EU-wide ‘Social Investment Pact’. The Social Investment Package, launched by the European Commission in February 2013, presents a similar argument and thus provides the common orientation EU Member States do need in my opinion. Obviously, a ‘package’ is not a ‘pact’. The idea of a pact underscores the sense of reciprocity that is required: all

Member States should be committed to policies that respond to the need for social investment. Simultaneously, efforts of Member States in this direction – notably by those experiencing budgetary problems – should be supported in a tangible way. When difficult reforms are necessary, there must also be solidarity for reform. Alas, the dramatic divergence in spending on education, mentioned earlier, shows that we are far removed from such a common orientation today. Surprisingly, the idea of social investment, as a useful unifying policy concept for all European welfare states, is barely mentioned in the Five Presidents’ Report: adequate education is mentioned in passing, child care is not mentioned. This is an important gap.

The democratic construction of a sense of common purpose

I have argued here that we need a clear-cut concept with regard to the social dimension of the EU. The idea of a European Social Union, as outlined here, aims to clarify what is the point and purpose of a social dimension to the European project. Admittedly, there is one crucial precondition: to build a social union, we need a stronger sense of common purpose and, as a corollary, a real sense of reciprocity. The *politics* of reciprocity amongst democratically elected governments is inevitably complex. The protracted negotiations between Greece and the other Eurozone members that are going on at the moment of writing illustrate how extremely difficult it can be to find a compromise between democracies in a spirit of reciprocity. A union of national welfare states is a union of democracies; but even if these democracies maintain their sovereignty on the ways and means of social policy, they must agree on the common objectives of the union, on the burden sharing the commonly agreed objectives may imply, and on the extent to which in specific domains sovereignty has to be pooled. In itself, that constitutes a huge democratic challenge, which is not to be underestimated. The Greek drama clearly shows that we have to rethink the political institutions: the way in which the EU organizes its crisis management invites political polarisation among governments and, thus, escalation rather than rational compromise. More effective political processes must go hand in hand with stronger democratic legitimacy. However, it is my contention that the problem at hand is not, first and foremost, one of a ‘democratic deficit’ in the existing EU Institutions; the problem is a ‘deficit in common purpose’.

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