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THE REFORM OF THE EMU: WHICH SOCIAL DIMENSION?

Introduction

Significant measures have been taken in recent years to strengthen the Economic and Monetary Union (EMU), though its architecture is as yet incomplete. A set of challenges must still be met in order to **guarantee the prosperity and stability of the common monetary area.** During the Euro Summit on 29 June, Heads of State and Government of the euro area countries will have to draft a roadmap to complete the **EMU reform**, for which the Commission has identified four complementary areas: the Financial Union, the Fiscal Union, the Economic Union and democratic accountability and strengthened governance[1]. While Jean-Claude Juncker recently stated that *"the Economic and Monetary Union is first and foremost about improving the lives of all Europeans"*, it is crucial that the debate does not neglect the **definition of what must be the EMU's social dimension**. The adoption of the **European Pillar of Social Rights (EPSR)** at the end of 2017, and the implementation of the social scoreboard are clearly welcome progress, shining a greater spotlight on Member States' social development. However, it is still necessary to come up with a better definition of the EMU's social dimension. This entails clarifying as a priority what **type of social convergence** is required for the proper functioning and the prosperity of the common monetary area and which key focus areas will allow this convergence to be achieved (Part 1). Subsequently, it is essential to define the **instruments and governance** of the EMU's social dimension (Part 2).

1. What social convergence for the euro area?

Debate on the EMU's social dimension is by no means new. Even before the creation of the Euro, academics discussed the **links between national welfare states and a single currency regime**[2]. For instance, as the establishment of EMU was complemented with well-defined rules regarding public spending in the framework of the Stability and Growth Pact, some feared that such fiscal discipline would ultimately cause a drop in social spending and, as a consequence, alter national welfare states. In addition, there were fears that the introduction of the single currency would imply greater flexibility on labour markets and in wage negotiations within Member States, ultimately resulting in a deregulation of labour markets and leading to a "race-to-the-bottom" in social standards across the EMU. Lastly, without the flexibility linked to the exchange rate, social standards ran the risk of acting as adjustment variables in the event of an asymmetric macroeconomic shock.

1. European Commission, Communication from the Commission, "Further steps towards completing Europe's Economic and Monetary Union: a roadmap", December 2017.
2. Begg, I, "The social consequences of Economic and Monetary Union", Final Report, Brussels: European Parliament DG for Research, 1994. Teague, P, "Monetary Union and Social Europe", Journal of European Social Policy 8:117, 1998. Pochet, P, Vanhercke, B. "The Challenges of Economic and Monetary Union to Social Protection", in J Saari (ed), Financing Social Protection in Europe, Helsinki: Ministry of Social Affairs and Health, publications, No. 21, 1999. Martin, A, "The EMU Macroeconomic Policy Regime and the European Social Model", in Martin, A and Ross G (ed), Euros and Europeans: Monetary Integration and the European Model of Society, New York: Cambridge University Press, 2004.

What was envisaged in the initial EMU concept was not, however, a desire to limit the risks that the single currency project could impose on national welfare states, but rather an attempt to ensure that **employment and social policies contribute to the proper functioning of the EMU.** The leading argument in favour of the definition of a social dimension for the EMU is therefore a functional one. In the 1990s, the emergence of the Monetary Union justified the implementation of a European coordination of national employment policies. At that time, labour market flexibility was highlighted in order to strengthen economies' responsiveness when faced with potential asymmetric macroeconomic shocks (as in this case, the ECB's monetary policy, aimed at all euro area countries, is not the appropriate instrument).

The crisis in the euro area has moved along the debate on the EMU's social dimension. During the first years of the crisis, the emphasis was always placed on the need for labour market flexibility, which was reflected in particular in the priorities of the macroeconomic adjustment programmes to which countries which requested financial assistance from the euro area were subject. However, the serious social repercussions of the crisis and the **social divergence between the core and the periphery of the euro area** (see Chart 1 in the Appendix) highlighted that the Monetary Union needed both **labour market institutions which favour *flexibility* and social models that support *stability*.** The combination of adequate flexibility and an effective stabilisation capacity creates a quality of national welfare states which is best captured by the notion of "resilience". Guaranteeing such '*resilience*' is a matter of common concern for all countries in the euro area: the resilience of each individual Member State contributes to the stability of the whole.[3] This implies a degree of convergence, which is not synonymous to harmonisation. Moreover, whilst convergence is needed with regard to some key features of national welfare states, it is not needed in all domains of social policy.

This **reinforced national stabilisation capacity** is, however, only one of the means of ensuring euro area stability. According to many experts, the EMU must be completed by endowing it with a **common stabilisation instrument**. The creation of this instrument could have an impact on national welfare states (if it took the form of an unemployment insurance or reinsurance), but it would also limit the risk of countries resorting to internal devaluations – which have a negative impact on wages and social standards – in the event of an asymmetric shock.

The need to ensure that national employment and social policies contribute to the EMU's stability is only one aspect of the EMU's social dimension, which **goes beyond the mere "functional requirements" of the EMU *in abstracto***. Against a backdrop in which the single currency is, in some countries, associated with a decline in living standards, a rise in unemployment and a drop in households' disposable income (see Chart 2 in the Appendix), it is essential that **upward convergence in social performance** is promoted in euro area countries. The EMU must serve the fundamental aspiration of the European project, that is, to promote both upward convergence between the Member States and cohesion within the States, so that the single currency brings about a real improvement of living and working conditions of euro area citizens. The adoption of the European Pillar of Social Rights – which was designed for euro area countries, even if it is currently aimed at all EU Member States – is intended to signal the way forward to restore upward convergence.

Such upward convergence in living standards in euro area countries is necessary to **ensure both prosperity and political legitimacy in the euro area**. Given that, from a long-term perspective, employment and social policies – in particular education and lifelong training policies – have an important role to play in improving States' growth prospects (see Chart 3 in the Appendix), these policies should be a matter of common interest.

3. Fernandes, S. and Vandenbroucke, F., "Social Europe: from Slogan to Reality", in the *Schuman Report on Europe 2018*, Robert Schuman Foundation, 2018.

At this time of rising populism and Euroscepticism, this need for convergence is also justified by the necessity of **restoring Europeans' trust** in the EMU project. As Jacques Delors stated, "*if European policy-making jeopardises cohesion and sacrifices social standards, there is no chance for the European project to gather support from European citizens*"[4].

QUESTIONS FOR PANEL 1

- **What are the priority actions in the employment and social fields to guarantee the resilience of national welfare states and thereby contribute to euro area stability?** How can greater flexibility be guaranteed while ensuring stability? In practice, should the emphasis be placed on unemployment benefits, access to social protection, active labour market policies, the coordination of collective bargaining to ensure a certain stability in the development of wages, or other policies?
- **Must upward convergence between Euro area countries be a priority in the reform of the EMU? What are the priority actions in the employment and social fields to contribute to this convergence?** Must a social investment policy aimed at fostering upward convergence in the quality of human capital – which is a key condition for real convergence between countries – be part of the EMU's social dimension, and act as a driving force in this field?
- **Is it necessary/conceivable to have, in the short/medium term, a breakthrough in the debate on automatic stabilisers for the euro area?**

2. What instruments and governance for social convergence in the euro area?

Clarifying the type of convergence required for the sustainability of the common currency project and identifying the priority actions in employment and social fields are only the first step to defining the EMU's social dimension. It is then necessary to **define the instruments –** from those of the EU in this field, i.e. **legislation, the coordination of national employment and social policies and financing – and real initiatives** to achieve the expected results.

In its document dated December 2017 on the reform of the EMU, the Commission did not identify the social dimension as one of the EMU's basic pillars but stressed under the economic pillar the need to **take into consideration the twenty EPSR principles in the European Semester.** The social dimension of the EMU has been strengthened since the start of the Euro area crisis predominantly by the coordination of employment and social policies. Against this backdrop, Zeitlin and Vanhercke (2018) conclude that since 2011, there has been a "**socialisation" of the European Semester**. The researchers suggest that this socialisation includes "*a growing emphasis on social objectives in the Semester's policy orientations and messages, embodied in the Annual Growth Survey and especially the country specific recommendations*"[5]. This trend is set to be heightened with the adoption of the EPSR. Marianne Thyssen recently claimed that "*This year's country specific recommendations have a greater than ever focus on employment, education and social issues*". Moreover, the social scoreboard**,** which includes twelve areas for which it is possible to measure societal progress and a broader set of indicators, is a reference framework used to monitor social developments in the different Member States.

Despite such progress in strengthening the social dimension of European economic governance, many experts have stressed the **continued imbalance between a monitoring of social developments which remains based on political incentive alone and the restrictive pro-**

4. Rinaldi, D., A new start for social Europe, Report, Jacques Delors Institute, 2016.
5. Zeitlin, J., Vanhercke, B., Socializing the European Semester: EU social and economic policy co-ordination in crisis and beyond, Journal of European Public Policy, 2018.

cedures – together with possible financial sanctions **– to monitor budgetary and macroeconomic imbalances**. In this respect, De la Porte and Heins (2015) state that "*Within the semester, fiscal and budgetary governance instruments have become more precise in terms of objectives, and stricter in terms of surveillance and enforcement, while social and labour market policy instruments remain weaker on these dimensions and thus in their potential impact*" [6].

As regards the second European action instrument in the social field, i.e. **legislation,** apart from the coordination and surveillance of the budgetary policy, there is currently no legal framework on which legislation applicable only to the euro area may be drafted. However, if the euro area countries wished to draft common social or labour standards through legal acts, they could do so through "enhanced cooperation"**,** provided for in the treaties. Admittedly, this instrument is not easy to implement; and yet it could be leveraged to overcome the obstructions that often occur in EU-28 legislative negotiations for employment and social matters. In its paper on the future of the social dimension of Europe (2017), the Commission presented a scenario with a variable geometry social Europe, in which **those who want to go further can do so**, and states that this group of countries should at the very least be made up of the countries of the euro area[7]. This implies that a group of at least nine countries could, as a last resort and only if the 28 Member States agree, adopt legal acts which would only be binding for the participating countries. The common standards could focus mainly on **labour markets, competitiveness, the business environment and public administration, as well as on certain aspects of the fiscal policy** (such as the corporate tax base), according to the Commission's paper. The euro area would be strengthened and its citizens better protected if there were greater convergence of national employment and social policies. Theodoropoulou and Rasnača (2017) add that if the adoption of common standards proves difficult through enhanced cooperation, Member States can use another instrument, intergovernmental cooperation, as was the case for the European Stability Mechanism (ESM) and the Fiscal Compact[8].

The advantage of such a scenario would be primarily the strengthening of convergence within the euro area; yet these initiatives could also serve as a stepping stone to new innovative projects that the EU-28 could link together in time. There is, however, **a risk if social standards are only coordinated for a sub-group of countries within the single market:** countries located outside the euro area could aim to attract companies by deliberately relaxing their standards, to the detriment of social convergence for the EU-28 and of the single market's future cohesion.

With a view to promoting economic and social convergence, European authorities have a third instrument in their arsenal: **financing**. The cohesion policy and structural funds remain the main instruments used for this purpose. The instruments for the EU-28 could be added to with tools aimed at euro area countries.

There appears to be consensus today that the euro area must have a **macroeconomic stabilisation mechanism** (an instrument to improve in particular the absorption of shocks specific to each country in the event that national stabilisation capacities are exhausted). The Five Presidents' Report[9] took the same view. Although the resilience of national welfare states can and must be enhanced in order to curb the scale of crises, the countries of the EMU are still lacking automatic stabilisers for the euro area, and in particular a policy tool in the event of an asymmetric shock. Several proposals have been put forward by researchers in recent years, includ-

6. De la Porte C., Heins E., A new era of European Integration? Governance of labour market and social policy since the sovereign debt crisis, Comparative European Politics, 2015.
7. European Commission, Reflection paper on the social dimension of Europe, 2017.
8. Rasnača, Z., Theodoropoulou, S., Strengthening the EU's social dimension: using the EMU to make the most out of the Social Pillar, European Trade Union Institute (ETUI), 2017.
9. Juncker, J.-C. et al, Completing Europe's Economic and Monetary Union, European Commission, 2015.

ing proposals that present the instrument as an **unemployment insurance (or reinsurance)**[10]. In this context, the German Finance Minister recently proposed a loan-based unemployment reinsurance, to be paid back by the receiving countries in good times[11].

As part of its proposal for the Multiannual Financial Framework for the 2021-2027 period, the Commission recently proposed the creation of a **European Investment Stabilisation Function** with a view to protecting public investment in the event of large asymmetric shocks and helping the economy rebound quickly. In the event of major asymmetric shocks, this Function would provide up to **€30 billion in loans guaranteed by the EU budget**. Assisting the countries in question to maintain growth-friendly public investments, even in a crisis period, will keep more people in jobs and enable the economy to recover more quickly. This Function will come together with a **Stabilisation Support Fund** which would cover the cost of interest of these loans in full. This Stabilisation Function could be complemented over time by additional resources, in particular from the ESM.

In addition to this Function, the Commission has proposed a second budgetary instrument – the **Reform Support Programme** – which would have an impact on the coordination of economic and social policies, operating as a sort of **financial incentive to implement the reforms** provided for in the country-specific recommendations and which include reforms in employment and social fields. This Programme, with an overall budget of €25 billion, will not only include a **Reform Delivery Tool** but also a Technical Support Instrument and a Convergence Facility for countries which are not part of the euro area. By 2020, the Commission will launch pilot projects to test this instrument. The first pilot project (financed by the European Structural and Investment Funds - ESIF) will be rolled out in Portugal. It is a reform of the vocational education and training system, in a country with the highest rate of unskilled workers within the euro area countries (see Chart 3).

The Commission's proposals appear to be a compromise between the contentions of States which champion the creation of budgetary capacity specific to the euro area in particular with a view to **supporting investment and stimulating growth**, and those of States which place greater emphasis on **supporting reforms to strengthen competitiveness**. Many experts believe that these proposals remain insufficient to meet the stability requirements specific to the euro area. While the notion of maintaining public investment in periods of crisis has been welcomed to an extent, the stabilisation instrument proposed by the Commission appears limited. This instrument **would grant (non-interest-bearing) loans and not subsidies**; and its €30 billion budget is very small, in particular in view of the current lending capacity of the European Financial Stabilisation Mechanism (EFSM) - a facility to be replaced by the new Function – which amounts to €60 billion.

In addition to the matter of concrete initiatives and instruments which can be leveraged to strengthen the EMU's social dimension, the question of the common currency area's **social governance** is raised. Zeitlin and Vanhercke stress that the "socialisation" of the European Semester, which was borne out between 2011 and 2016, comprises "*intensified monitoring, surveillance, and review of national reforms by EU social and employment policy actors and an enhanced role for these actors relative to their economic policy counterparts in drafting, reviewing and amending the CSRs*"[12]. Despite this positive development, **the roles of finance and labour ministers in the governance of the euro area is far from equal.** The challenges of the euro area are still considered to be the responsibility of finance ministers who meet every

10. Frank Vandenbroucke, Risk Reduction, Risk Sharing and Moral Hazard: A Vaccination Metaphor, Intereconomics, Vol. 52, May/June 2017, Number 3, pp. 154-159.

11. Germany's Scholz proposes Europe-wide unemployment insurance scheme, Reuters, 9 June 2018.

12. Zeitlin, J., Vanhercke, B., Socializing the European Semester: EU social and economic policy co-ordination in crisis and beyond, Journal of European Public Policy, 2018.

month (in the ECOFIN and EUROGROUP), compared to labour ministers who meet four times a year. The euro area summits are also prepared by the Eurogroup. In this respect, there are calls for a stronger role for labour ministers, which could involve **greater involvement of the EPSCO Council in the EMU reform** (the euro area summit should, for example, receive a contribution from the EPSCO Council) or through enhanced interaction between the EPSCO and ECOFIN Councils.

Last but by no means least: the **role of social partners in euro area governance.** Social partners are involved in the **European semester** – they are in particular consulted by the Commission when drafting the Annual Growth Survey – yet their involvement could be enhanced. In this respect, Parker and Pye (2017) propose, for example, that "*national social partners should also be incorporated into the series of bilateral meetings held between the Commission and national governments throughout the European Semester*. *The active involvement of social partners would help to bolster the attention given to rights assessments*"[13]. While the Commission wishes to grant financial incentives for the implementation of structural reforms – some of which would be in employment and social fields, as is the case for the pilot project in Portugal – the role that social partners must play in these reform proposals between the Commission and national governments must be defined.

In addition to their role in euro area governance, social partners have a natural part to play on a **legislative level**. Since the Commission presented the EPSR, it has submitted several points for approval by social partners but was forced to legislate due to their inability to come to an agreement (on the work-life balance, the revision of the Written Statement Directive and access to social protection for workers and the self-employed). While the notion of drafting **social standards** through enhanced cooperation, at least for euro area countries, raises challenges, one of the main issues is definitely that of **safeguarding the role of social partners in the definition of these standards.**

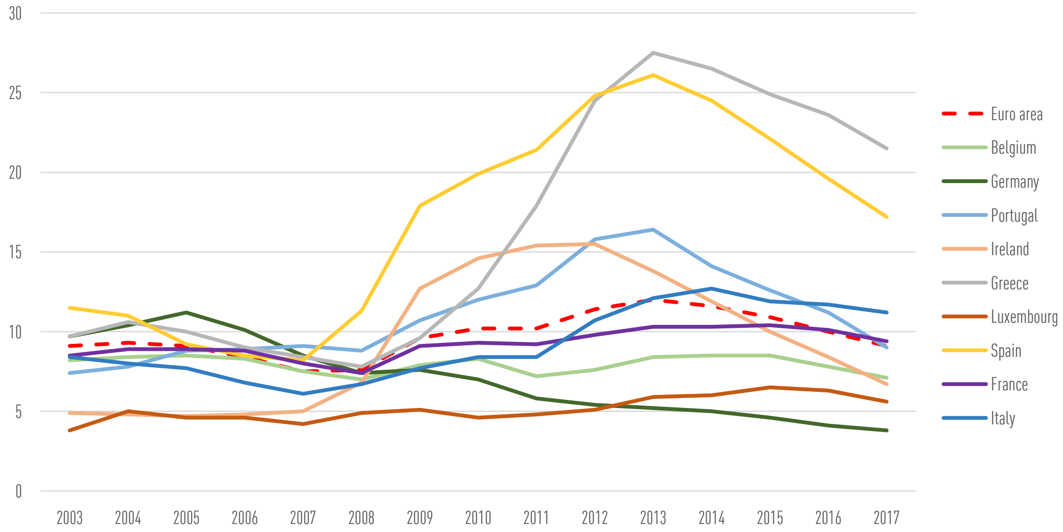
QUESTIONS FOR PANEL 2

- **In the priority action areas for employment and social policies in the euro area, is it sufficient to have a procedure based on political incentive, benchmarking and the sharing of best practices, given the limited impact of the open method of coordination since 1999?** How can the effectiveness of political incentive be stepped up?
- **Should social standards established by legislation be considered for the euro area countries through enhanced cooperations and, if so, for which points?** For example, the Commission has just presented a proposal for a recommendation on access to social protection for workers and the self-employed. Given the interdependence between euro area countries and the greater need to make welfare states more resilient, should it be considered that euro area countries may go further than a simple recommendation (and thereby request that the Commission submits a proposal for a directive)? Should other principles of the EPSR be put into practice through this instrument, for example those concerning adequate minimum wages and income?
- **Are the budgetary instruments proposed by the Commission sufficient to ensure the euro area's stability and prosperity?**
- **How can social governance be enhanced in the euro area, and in particular the role of the EPSCO Council (including in the EMU reform) and of social partners?**

13. Parker O., Pye R., Mobilising social rights in EU economic convergence: a pragmatic challenge to neoliberal Europe, Comparative European Politics, 2017.

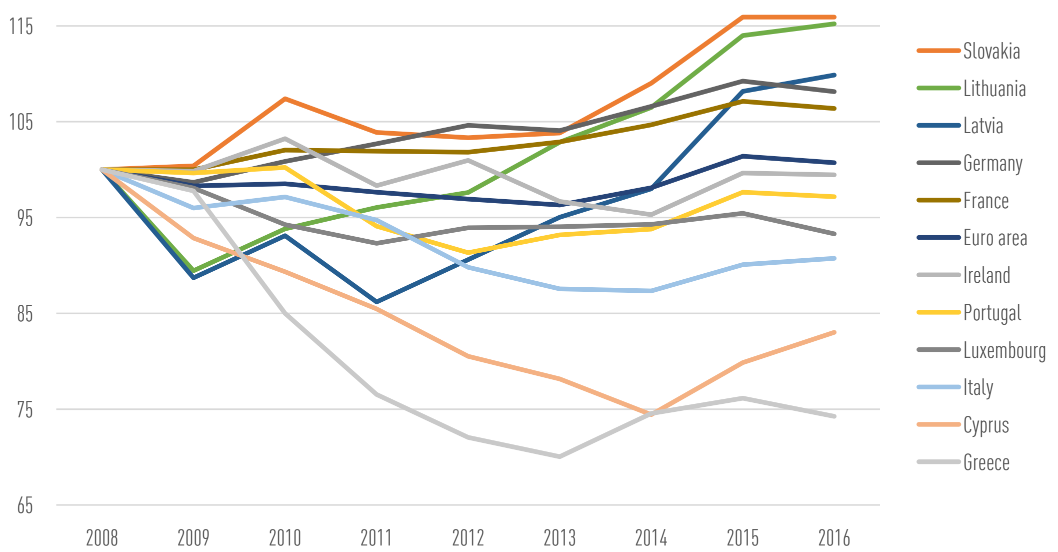
Appendix

CHART 1 ■ Unemployment rate trends in a set of euro area countries (2003- 2017).



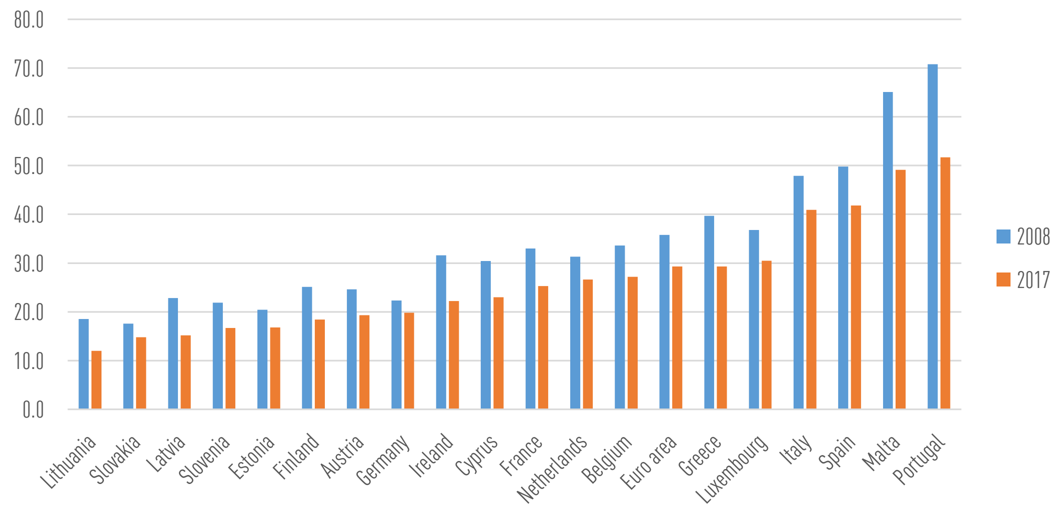
Source of data: Eurostat

CHART 2 ■ Real adjusted gross household disposable income, per capita in PPS (basis 100 = 2008) in a set of euro area countries.



Source of data: Eurostat

CHART 3 ▪ Percentage of 15-64-year-olds with a maximum level of educational attainment corresponding to lower secondary level in 2008 and in 2017.



Source of data: Eurostat

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