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European Economic Governance. And what is about the Social Dimension?

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The outbreak of the Greek crisis has prompted the European Union to set about designing a comprehensive kind of economic governance architecture in which greater coordination of economic and fiscal policy will underpin and support the common monetary policy of the eurozone. The goal is greater fiscal discipline and competitiveness in all of the EU member states. Yet in the process policymakers are running the danger of weakening social cohesion in the EU.

I

European Economic Governance (EEG). Between Public Debt and Social Crisis

In 2010 people in the EU were beginning to think that the economic and financial crisis had been overcome, and in some countries such as Germany the economy was once again beginning to boom. But when the US rating agencies began to cast doubt on the creditworthiness of Greece, and subsequently of Portugal and Ireland, the whole of the eurozone was plunged into a crisis. As a result of growing pressure from the financial markets, the public debt crisis has now reached Italy and France. In all of this a crucial contributory factor is a serious mistake that was made when the European monetary union came into being. To this day the common monetary policy of the eurozone is not underpinned by a parallel fiscal and economic union. This has contributed to a state of affairs in which economic imbalances between the member states have increased, and national fiscal and economic policies are increasingly unable to regain the confidence of the financial markets (Iain Begg et al. 2011).

European policymakers have certainly done their best to overcome the crisis of confidence. Thus the new European Economic Governance (EEG) architecture envisages a greater degree of coordination and is designed to compel the member states to implement stricter budget discipline and to introduce reforms that will enhance their international competitiveness. Nevertheless, this has not been enough to contain the threat of insolvency in a number of peripheral EU countries. Thus it does not come as a surprise that the attempts to put the economic governance of the EU on a sound footing continue to be dominated by the question of how to deal with the escalating public debt crisis.

Europe 2020: Growth priorities and headline targets

Three growth priorities

Smart growth
Developing an economy based on knowledge and innovation

Sustainable growth
Promoting a more resource efficient, greener and more competitive economy

Inclusive growth
Fostering a high-employment economy delivering social and territorial cohesion

Five headline targets for the EU

Employment
Increasing the employment rate of the population aged 20 to 64 to 75%

Innovation
Investing 3% of the EU's GDP in innovation, research and development

Climate protection and energy
Reducing CO_2 emissions by at least 20% compared to 1990; Increasing the share of renewable energy sources to 20%; Increasing energy efficiency by 20%

Education
Reducing the share of early school leavers below 10%; Increasing the share of the population aged 30 to 34 having completed tertiary education to 40%

Social Inclusion
Reducing the population at risk of poverty or social exclusion by 20 million

Source: European Commission

Yet there are things to which the new economic governance continues to turn a blind eye. There is growing concern that the burgeoning debt crisis in Europe will develop into a massive social crisis. Many of the people who bore the brunt of the first phase of the global banking crisis came from the lower middle classes. For young people in particular the prospects of finding employment have worsened quite dramatically. In the second phase of the public debt crisis people affected by it now include government employees, pensioners, marginalized social groups and those in the lowest income brackets who depend on welfare benefits. They suffer more than anyone else from the stricter fiscal discipline and the drastic government spending cuts. When it comes to Europe's new economic governance, these priorities are right at the top of the bill.

The dilemma facing the EU and its member states is the fact that this is the only way in which can they regain the confidence of the financial markets. But it brings with it the risk of greater social tensions in Europe and decreasing support for its democratic institutions. Can anything be done to defuse the situation?

II

The EEG Architecture in Brief

In its "Europe 2020" growth strategy the EU Commission maps out its vision of a European market economy in the 21st century based on the three pillars of smart, sustainable and inclusive growth, and defines five headline targets.

"How" these goals can be attained, that is, the question of the reforms which national policymakers need to tackle first and foremost, is specified in greater detail in seven out of a total of ten "Integrated guidelines for the economic and employment policies of the Member States" (Guidelines 4-10). Under the general heading of "Thematic Coordination" these guidelines define the common framework for the formulation of national targets, the formulation of national reform programmes, and the monitoring of growth-enhancing reforms by the European Commission.

The three other integrated guidelines (guidelines 1-3) specify which measures should primarily be taken by the member states in order to create a stable macroeconomic environment for the envisaged structural reforms. "Macroeconomic Surveillance" is designed to ensure the quality and sustainability of public finances, the early identification of macroeconomic imbalances and the reduction of imbalances within the eurozone.

There is a direct link with the "Fiscal Surveillance" of the reformed Stability and Growth Pact. The rules of the Stability and Growth Pact governing debt reduction and budget consolidation have been tightened even further in order to get to grips with the sudden increase in total public indebtedness and the enormous budget deficits.

Within the framework of the newly introduced "excessive (macroeconomic) imbalance procedure" the Commission now uses a scoreboard as an alert mechanism capable of identifying problematical economic developments that may pose a threat to the goal of attaining sustainable public finances.

These economic and fiscal policy provisions are complemented by the Euro Plus Pact which was endorsed in March 2011. It is open to all EU member states. The 23 EU member states which have decided to participate are committed to coordinating their national economic policies even more closely by concentrating on four reform targets: competitiveness, employment, the long-term sustainability of public finances, and greater financial stability.

In order to demonstrate how they are implementing the provisions stipulated in the areas of thematic coordination and macro-economic and fiscal surveillance on the national level, the member states will on a regular basis institute National Reform Programmes and Stability (for members of the eurozone) and Convergence (for states which are not members of the eurozone) Programmes. In the case of states which have decided to participate in the Euro Plus Pact, these will also include the measures designed to implement the latter.

What has been dubbed the "European Semester" in the first six months of each year has been introduced in order to avoid making contradictory demands on the economic and budgetary policies of the member states and to keep track of financial constraints for the implementation of the Europe 2020 goals. This new coordination procedure, which was first used in 2011, is designed to ensure that the EU's headline targets have in fact been incorporated into the national budgetary planning for the ensuing year.

The permanent European Stability Mechanism (ESM), which was set up in order to refinance highly indebted member states on the verge of insolvency, forms the last building block in the new European Economic Governance architecture. In 2013 it will replace the European Financial Stability Facility (EFSF), that is, the current temporary European safety net. The ESM will have at its disposal €500 billion in order to provide assistance for eurozone countries in the event of a crisis. Private investors may get involved in sharing the burden of the ESM assistance packages on a voluntary basis.

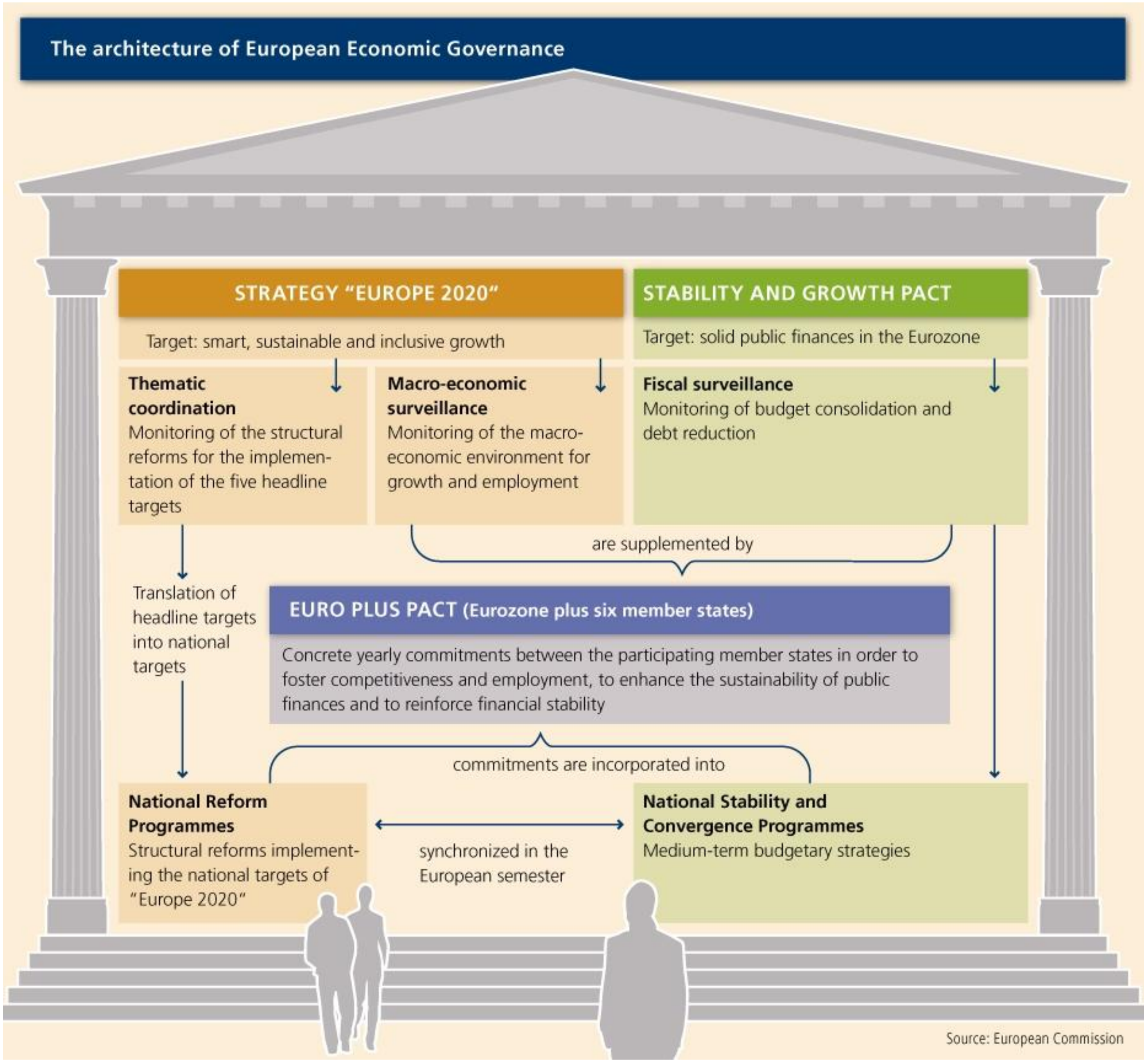
However, ESM assistance will be granted only if the recipients agree to adopt strict reforms and budgetary consolidation measures. Thus if a country avails itself of assistance, it will have to give a commitment to introduce spending cuts and align its policies with EU objectives.

III

Reality and Fiction

With the EU 2020 Strategy and its three new pillars of smart, sustainable and inclusive growth the Commission is seeking to lay the foundations for a “new economy.” High employment and productivity levels and strong social cohesion are needed in order to ensure “access and opportunities for all throughout the lifecycle.”

To what extent does the new economic governance meet these demands? The answer is not altogether positive, since it is clear that it is the result of pressure exerted on the member states by the financial markets, which wanted them to stabilize the eurozone as quickly as possible in macroeconomic terms and to reduce the high levels of debt. Thematic coordination within the framework of the Europe 2020 strategy has fallen behind by the goals of fiscal policy stability and economic convergence. This also finds expression in the fact that the Stability and Growth Pact stipulates targets and rules which are binding for all the member states. Moreover, in the event of non-compliance of eurozone countries the Stability and Growth Pact sanctions such violations. On the other hand the five long-term Europe 2020 growth targets first have to be translated into national targets. If a government fails to demonstrate that it is making a serious effort to introduce the requisite reforms, then all that can be done is to bring ‘peer



pressure' to bear on the country concerned.

Meanwhile, even the European Commission suffers from a feeling of unease. It warns the member states in its communication at the conclusion of the first European semester that in "their pursuit of fiscal consolidation and structural reforms, (they) need to find ways of tackling the social impact of the changes now underway." And it goes on to say that the trends visible in many member states demonstrated that there was a growing risk of poverty and marginalization which called for pro-active counter-measures. "On the basis of the actions described in the national programmes, Member States need to do more to deliver on this target."

The Commission fails to mention that it is partly responsible for the almost total omission of the goal of social inclusion. In the recommendations to the governments of the member states in its first Annual Growth Survey published in January 2011 it assigns absolute priority to three main action areas: rigorous fiscal consolidation, labour market reforms for higher employment, and growth-enhancing measures. But now that the first "European semester" has come to an end the Commission should slowly begin to place greater emphasis on the goal of fighting social exclusion and poverty. An interesting point of departure, for example, might be the evaluation of the social consequences of the economic crisis conducted in conjunction with the Social Protection Committee.

This points out that hitherto only a handful of EU member states have carried out "social impact assessments" of their fiscal consolidation measures. The European Commission could in future ask to be given such impact assessments in order to draw up additional country-specific recommendations on how to enhance social cohesion.

IV

What comes after the spending cuts?

The Commission believes that rigorous fiscal consolidation achieved by concentrating on key measures is the fundamental prerequisite for growth, and singles this out in its 2011 Annual Growth Survey as the preeminent task of the member states. There can be no doubt about the fact that there is a pressing need to ensure that public finances are sustainable. However, it is questionable whether the national austerity policies adopted hitherto by the member states point in the right direction. A recent European Trade Union Institute study that compares the social consequences of the restructuring programmes being implemented in seventeen EU countries shows that these are primarily cost-cutting exercises (Theodoropoulou/Watt 2011). Thus the Commission encourages the member states to introduce spending cuts in order to reform their national pension, healthcare and welfare systems, and to slash unemployment benefits.

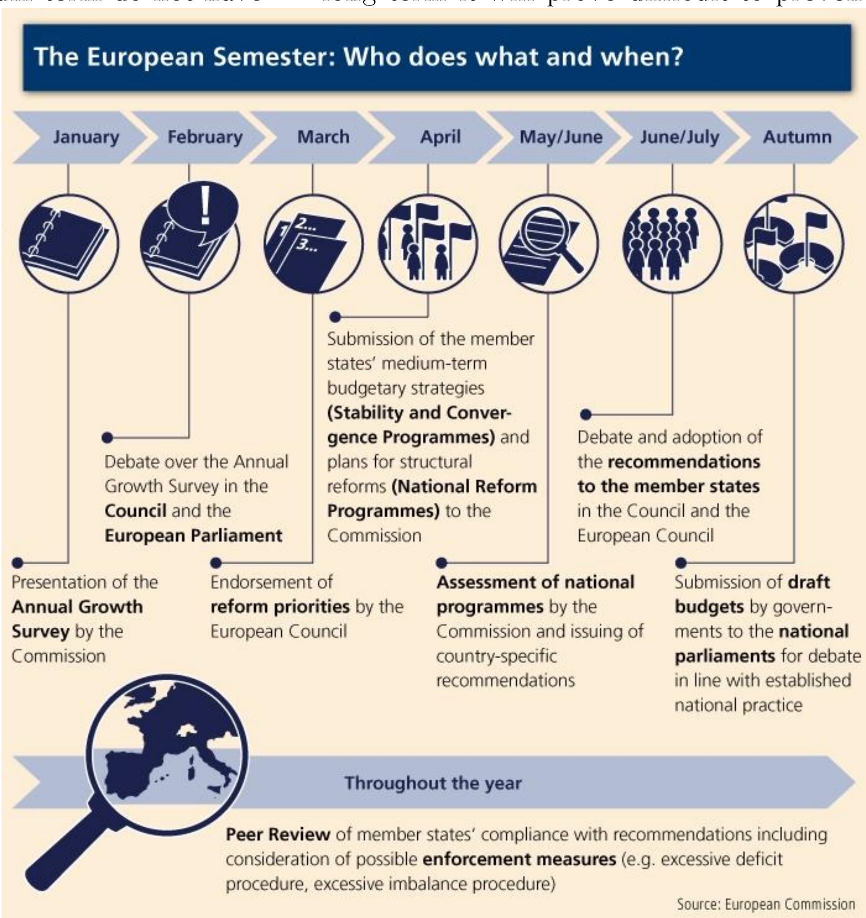
In the context of the Europe 2020 targets of greater social cohesion and social inclusion this approach is decidedly problematical for two reasons. On the one hand constraints on the access to, the level and/or the duration of social benefits, which many member states have now decided to introduce, are an unequal burden for welfare recipients and the unemployed. They increase the risk of living a life below the poverty line, and exacerbate national income distribution differences.

On the other hand, cuts in the welfare systems weaken their function as automatic stabilizers in anti-cyclical fiscal policy. It became apparent in the crisis that states which have sophisticated social security systems, especially when it comes to unemployment benefits, were in a much better position to deal with the economic shock waves. In countries such as Greece, Portugal, Spain, Ireland and the United Kingdom cuts in welfare benefits and the attendant decline in public investment may well accelerate the downward economic spiral.

With regard to the issue of social cohesion in the EU there are now some pressing questions. What measures can the member states adopt on the revenue side in order to encourage fiscal consolidation and to provide additional financial support for their social security systems and a pro-active labour market? And what assistance can the EU level provide for states which in the short and medium term do not have the strength to return unaided to the path of growth and are dependent on the solidarity of their European partners, though without imposing on the latter additional and possibly enormous financial burdens?

When it comes to additional tax revenue, the introduction of a common financial transaction tax currently seems to be an attractive option, though there is as yet no agreement on how the additional revenues generated in this way should be used. The EU Commission will probably make a proposal to this effect in autumn, and German Chancellor Merkel and French President Sarkozy have come out in favour of it. A common tax of this kind could be collected on a national level and used primarily for the consolidation of national budgets and for public investment designed to enhance competitiveness, that is, for specific areas such as education and vocational training.

On the European level various options are currently being discussed on how to organize joint assistance for member states which are either running out of cash or on the verge of insolvency. None of the proposals have been so hotly debated as the creation of eurobonds, primarily because they mean that Germany will have to shoulder an additional interest burden. Although there are certainly good reasons for the debate, the estimated additional costs would in fact not be excessive. In the long term it will prove difficult to prevent the introduction of such bonds, though at the moment they are not (as yet) feasible in political terms.



Two other action options would seem to be more interesting and far more realistic. First, a "social investment pact" could be introduced to complement the competition-based Euro Plus Pact, which is focused on unit labour costs and productivity increases. The purpose of such a pact would be to achieve a more balanced relationship between short-term fiscal consolidation on the one hand and long-term social investment requirements on the other. Thus the EU budget would pool expenditure to a greater extent than has hitherto been the case and focus on providing support for member states in areas such as early childhood education, the transition from school to employment, life-long learning, flexible working conditions, striking a balance between family life and work, training and enhancing the employability of older employees and at the same time raising the retirement age, the societal integration of migrants, and the introduction of minimum welfare payments (Vandenbroucke/Hemerijck/Palier 2011).

Secondly, in order to be able to mobilize EU financial support at short notice for such national reform programmes in the member states particularly affected by the crisis, there may well be another way, as the EU Commission has already pointed out. For a limited period at least these countries could be allowed to receive subsidies from the European Structural Funds for projects within the framework of the investment pact, and at the same time the national co-financing rate could be lowered to 5% from the current 15% to 25% in order to enable them to avail themselves of the subsidies.

V

Though Difficult, Economic and Social Governance is a Necessity

If one looks at the fiscal and social consequences of the crisis for the Europeans and at their responses to date, the picture that emerges is a gloomy one. A growing sense of "assistance fatigue" is taking hold of the general public in states which have managed to weather the storm. People are increasingly unwilling to give a helping hand to partners smarting under the recession, and this is paving the way for right-wing populism, as can be seen in the case of the Netherlands, Finland, Sweden, Austria and France. And the willingness of aid recipients to pursue a policy of austerity which involves large-scale reductions in welfare benefits for more and more sections of the population is reaching breaking point. The social unrest in Greece and the young protesters in Spain, where youth unemployment has now reached about 50%, could be just the beginning.

A point has now been reached where the cohesion of the eurozone and that of the EU as a whole is being called into question and dissatisfaction with the democratic institutions of Europe has reached a critical level. A social Europe which does justice to the interests of EU member states from which solidarity can be expected and of those which are dependent on it thus becomes a difficult and nonetheless necessary balancing act.

The work of refining and improving Europe's economic governance should thus be motivated by the insight that functioning and efficient welfare systems on the national level actually make a considerable contribution to social inclusion and macroeconomic stability in the common monetary zone. Providing sufficient room for manoeuvre for public investment in the future, especially in the areas of education, vocational training and research, and in particular in the EU member states most affected by the crisis, may in the short term be rather difficult when rigorous fiscal consolidation is at the top of the agenda. However, in the long term it is precisely these investments which point the way to greater competitiveness, growth and employment in the countries concerned. The provision of such support and the mobilization of the requisite assistance cannot be compared to a willingness to subsidize fiscal indiscipline on an indefinite basis. In fact, they point to a Europe where cohesion is no longer called into question by the advent of more and more safety nets. But this is the precise reason why the new EEG architecture must continue to develop so that it can combine successful short-term consolidation and the enhanced long-term Europe 2020 goals of inclusive growth, social cohesion and social inclusion. Or, to put it another way, what is needed is a model for the future Economic and Social Governance of the EU.

For Further Reading

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Responsible

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