CHALLENGE EUROPE

Challenges and new beginnings: Priorities for the EU's new leadership

September 2014

László Andor
Janis A. Emmanouilidis
Malcolm Harbour
Jo Leinen
George Pagoulatos
Daniela Schwarzer
Alexander Stubb
Herman Van Rompuy
Rosa Balfour
Heather Grabbe
Paul Ivan
Cecilia Malmström
Maria João Rodrigues
Radoslaw Sikorski
Pawel Swieboda
Fabian Zuleeg

EUROPEAN POLICY CENTRE

In strategic partnership with the King Baudouin Foundation

EUROPEAN POLICY CENTRE

CHALLENGE EUROPE

Issue 22

Challenges and new beginnings: Priorities for the EU's new leadership

László Andor
Janis A. Emmanouilidis
Malcolm Harbour
Jo Leinen
George Pagoulatos
Daniela Schwarzer
Alexander Stubb
Herman Van Rompuy
Rosa Balfour
Heather Grabbe
Paul Ivan
Cecilia Malmström
Maria João Rodrigues
Radoslaw Sikorski
Pawel Swieboda
Fabian Zuleeg

September 2014

ISSN-1783-2462

Social Europe. Can the EU again improve people's life prospects?

László Andor

Introduction: Unprecedented socio-economic divergence and eroded social mobility in Europe

The European Union has survived the long economic and social crisis, but is weakened by many social fractures that diminish its very ability to act on the challenges it faces.

After years or even decades of socio-economic convergence between Member States, Europe has recently experienced major disparities in economic, employment and social outcomes. In 2010 it agreed a wise socio-economic strategy: "Europe 2020", including clear targets to increase employment and reduce poverty substantially. This Strategy was based on the ambition of sustained convergence between Member States and within societies.

Four years later, it is clear that the EU has not managed to do enough to realise this ambition. The employment rate among 20-64 year olds has dropped from 70.3% in 2008, and 68.5% in 2010, to 68.3% in 2013 instead of rising towards 75%. An initial objective was to lift at least 20 million people out of poverty or social exclusion by 2020, but we have seen that the number of people in or at risk of poverty or social exclusion has risen from 118 million in 2010 to 124 million in 2012. Perhaps most worryingly is that we are far from a situation where every individual has decent opportunities and can rely on the society's support to improve his or her lot.

Citizens' trust in Europe as a force supporting upward social mobility has considerably diminished as the protracted crisis has left millions of people unemployed or trapped in precarious work. This too, can be seen at the national level: the crisis has weakened the ability of many governments to deliver the demands of their citizens: primarily to counteract the economic crisis, provide good-quality public services and ensure good socio-economic opportunities for everyone.

National welfare systems have been substantially weakened as a consequence of the sovereign debt crisis, especially in countries and regions considered as euro zone periphery. Therefore, for the first time since the Second World War, doubt has been cast on the assumption that children are (mostly) going to be better off than their parents.

Socio-economic disparities have grown particularly within the euro zone, chiefly as a consequence of the incomplete design of the Economic and Monetary Union (EMU). Today's set-up of the EMU, on the one hand, severely constrains individual Member States' monetary and fiscal policies, while, on the other hand, lacking sufficient common instruments to mitigate asymmetric economic shocks. The lack of a proper lender of last resort and of a common budget at the EMU level have been the most obvious deficiencies. Europe's monetary union with strict rules for national fiscal policies is today often seen by citizens as a constraint rather than a solution.

Experience since 2008 abundantly confirms that the systemic flaws of the Maastricht design of the EMU have significant real-life consequences during an economic downturn. Adjustment occurs predominantly through 'internal devaluation', resulting in high unemployment, rising poverty and weakening of essential public services like healthcare and education.

While countries deemed insolvent by the financial markets have stayed afloat thanks to drip-fed emergency support from other European countries, the European Central Bank (ECB) and International Monetary Fund (IMF), they had to accept tough fiscal and structural reforms. The latter may have been designed with the best intentions but in many cases had a socially regressive impact, i.e. lower-income groups had to sacrifice the most while upper classes remained relatively protected.

The rise of anti-establishment and often chauvinistic parties in the 2014 elections to the European Parliament reflects the dissatisfaction of many voters with the mainstream parties of the centre-right and to a lesser extent of the centre-left. In most European countries the main explanation for this development is the experience of frontloaded fiscal consolidation combined with 'structural reforms' geared mainly towards internal devaluation, i.e. cost-cutting. These policies have been, in most cases, supported by mainstream parties on both sides of the centre and have been coordinated in Brussels through the EU's reinforced economic governance mechanisms.

On the other hand, in countries which were not forced to implement pro-cyclical macroeconomic policies and did relatively well during the crisis, the rise of anti-establishment or anti-European parties is mostly explained by a fear of 'having to pay for somebody else's problems', e.g. through cross-country fiscal transfers or by accepting inflows of poorer people from other countries. The interdependence of our countries is not always sufficiently recognised, notably as regards the implications of a one-size-fits-all monetary policy and the economic spill-over effects of prolonged social hardship.

The EU has responded to the employment and social crisis by considerably strengthening the toolbox of employment and social policies. The social dimension of the EMU and the problem of socio-economic divergence have also been explicitly recognised. However, an obvious lesson from the recent crisis is that ambitious employment and social targets and policies can at best partially compensated, but not offset, deficiencies in macroeconomic policy responses and in the architecture of the EMU.

In the following, I will briefly review the main EU policies developed over the past five years in the field of employment and social affairs. I will put these in the context of the macroeconomic policy response during the same period and conclude by reflecting on systemic reforms which Europe needs to strengthen its economic recovery and to at last make progress towards the employment and social inclusion targets of the Europe 2020 Strategy.

Strengthening EU employment and social policies during the long crisis

The *Barroso II* Commission has made a number of proposals to improve the effectiveness of employment and social policies. In 2010, working in the hope of a steady recovery from the economic crisis, we put forward three flagship initiatives aiming to support progress towards the employment and social targets of Europe 2020: The *Agenda for New Skills and Jobs, Youth on the Move* and the *European Platform against Poverty and Social Exclusion*. They contained a number of ideas for structural improvement in the functioning of Europe's labour market and in the social policy field, for instance the idea of a single open-ended employment contract, the concept of a youth guarantee, various measures to boost labour mobility and support for social innovation as the framework for constructive interaction between governments and NGOs in pursuing the objectives of social inclusion and poverty reduction.

However, as the sovereign debt crisis spread across the euro zone periphery and a second recession set in, it became obvious that the intensity of the measures foreseen under the Europe 2020 flagship initiative was insufficient to respond to a worsening employment and social crisis. We therefore had to shift gear and reflect not only on ways to translate an expected economic recovery into improved employment and social situation, but on ways to bring about a job-rich economic recovery in the first place and to improve the efficiency and effectiveness of social policies given the double challenge of fiscal consolidation and a deepening social crisis.

In December 2011 we launched a Youth Opportunities Initiative, which sought to mobilise existing resources, including national allocations from EU Structural Funds that were not yet committed to concrete calls or projects. Many operational programmes were consequently revised in order to enable faster and better drawdown of these resources, targeting in particular support for youth employment and job creation in SMEs.

In April 2012 the Commission put forward an 'Employment Package' which broadened the European Employment Strategy in several ways. It moved beyond the traditional focus on the quantity (participation) and quality (skills) of the labour supply and emphasised the need to boost demand for labour as a prerequisite for higher employment and consequently economic growth. In particular, it advocated lowering the tax wedge on low-paid labour, use of targeted hiring subsidies and arrangements such as short-time work as ways to maintain or increase employment.

These new measures have been recognised as crucial in order to rescue and valorise the productive potential of people otherwise abandoned by the economy due to the double-dip recession. This proactive employment policy agenda, seeking to use labour market levers to stabilise aggregate demand, also included action plans to achieve the job-creation potential of particular sectors such as the green economy, healthcare and information technologies as well as personal and household services. It has been followed up by sectorial initiatives such as the Grand Coalition for Digital Jobs and the 2014 Green Employment Initiative.

In December 2012, the Commission launched a Youth Employment Package whose key element was the proposal for a Council Recommendation on establishing a Youth Guarantee in each country, i.e. a comprehensive scheme ensuring that everyone under 25 receives a good-quality offer of a job, apprenticeship, traineeship or continued education within four months of leaving school or becoming unemployed. The quality of labour market opportunities for young people has been further emphasised throughout a Quality Framework for Traineeships, agreed by Member States in March 2014.

The Youth Guarantee has been conceived as both relief and a structural reform, with some measures helping to immediately alleviate the youth unemployment crisis while others being focused on more structural improvements in school-to-work transitions, e.g. through the development of apprenticeship systems. In 2013 the European Council decided to ring-fence an initial 6 billion within the EU budget to support the Youth Guarantee's implementation in regions with particularly high youth unemployment rates under the new Youth Employment Initiative.

On the social policy side, we have put forward a Social Investment Package in February 2013 which set out ways of further modernising welfare states and improving the efficiency and effectiveness of social policies against the background of growing crisis and shrinking public budgets. We laid emphasis on social services enabling people to actively participate in the economy and society (e.g. childcare or lifelong learning) and on prevention of poverty and exclusion (e.g. through training and employment support) as compared to passive social expenditure that compensates for poor socio-economic outcomes *ex post*.

In emphasising support for people's active socio-economic participation, the Social Investment Package shared the philosophy of the 2012 White Paper on Pensions, which emphasised the need for active ageing and reduced gender employment gaps as pre-requisites for adequate (effective) and sustainable (efficient) pension systems. The White Paper also promoted longer working lives, notably through alignment of the statutory retirement age to changes in life expectancy, reduction in early retirement options and investment in the employability of older workers.

As part of the Commission's agenda for a job-rich recovery, we have also completed a number of steps towards a *genuine European labour market*, where people can easily seek and take up work in other Member States while having their employment and social rights protected. As part of the effort to facilitate intra-EU labour mobility, the Commission proposed a reform of the European Network of Employment Services (EURES) in order to turn it into a pan-European placement and recruitment service, drawing on improved classifications of skills, qualifications and occupations and using new technological possibilities of automated matching between jobseekers' skills and requirements advertised by employers.

The *Barroso II* Commission also succeeded in removing obstacles to the free movement of workers in several ways. The 'portability' of occupational pensions has been improved through the adoption – after nine years since the original proposal – of a directive improving the acquisition and preservation of supplementary pension rights. This legislation establishes rules on so-called vesting and waiting periods and will make it easier for people to move to a different Member State for work without losing the possibility to accumulate and subsequently enjoy entitlements in occupational pension schemes. Agreement was found also on an enforcement directive on the exercise of the freedom of movement of workers, which requires Member States to establish contact points where mobile EU workers can get information about their rights and redress in case their rights are breached.

In the context of labour mobility, a very important achievement was the adoption in April 2014 of an enforcement directive on the posting of workers in the context of free movement of services. This enforcement directive represents a difficult, if not miraculous compromise between the European Parliament and Council, reconciling a number of very different starting positions. By clarifying how the rules of the 1996 directive on the posting of workers are to be applied and enforced, the enforcement directive will make it easier to ensure that posted workers' rights are protected, that companies have greater legal certainty and that relevant national enforcement bodies work together more efficiently. The enforcement directive will also make it easier to combat the use of 'letterbox companies' and abuses of subcontracting arrangements, particularly in the construction sector, where provisions on joint and several liability for compliance with posting rules were introduced. The enforcement directive can therefore go a long way towards resolving the long-standing political controversy on the conditions of the posting of workers, and should enable policy-makers to move on to other challenges in Europe's single market for services and labour.

Together with strengthening the toolbox of employment and social policies through better analysis, guidance and coordination, and legislative work on a genuine European labour market with good working conditions, we have also ensured that a robust set of financial instruments is available in the EU's Multiannual Financial Framework for 2014-20 to support progress towards the 2020 employment and poverty targets.

The role of the European Social Fund (ESF) has been strengthened through an agreement on its minimum financial share within EU Cohesion Policy (amounting to over 80 billion in current prices for 2014-20) and through close alignment of the ESF's priorities to the Europe 2020 Strategy and country-specific recommendations issued during the European Semester. The European Globalisation Adjustment Fund (EGF) has been maintained and it can now support re-employment of workers affected by mass layoffs not only occurring as a consequence of changing global trade patterns but also those resulting from the on-going economic crisis. A new Fund for European Aid to the Most Deprived (FEAD) has replaced the EU's earlier food aid programme with the explicit objective of strengthening social cohesion through material assistance to severely deprived people and through targeted social inclusion projects. Finally, an EU-level Programme for Employment and Social Innovation (EaSI) will support employment and social analysis, policy-making and mutual learning across Europe, finance the functioning of the EURES job search network, and help to improve the access of micro-entrepreneurs and social entrepreneurs to finance.

Conclusion: Improving the EU's legitimacy through a stronger social dimension of the EMU and its economic policies

Given the complexity of Europe's financial and economic crisis, stronger employment and social policies have been a necessary response but they have clearly not been sufficient to offset the worsening employment and social situation. At the macroeconomic policy level, much of our crisis response has been incremental, largely resulting from the very incomplete design of the EMU. Without any lender of last resort, any euro zone budget or any sort of economic government to begin with, Europe had to respond to the crisis through strengthening the coordination of national fiscal and structural policies and developing emergency macroeconomic stabilisation tools.

Preparations for a more systemic reform of the EMU were started only as a second step in 2012 when the underlying causes of the euro zone crisis became more widely recognised. The key question during the EU's institutional transition in 2014 is whether EMU reform will continue with a sufficient level of ambition or whether complacency will prevail now that GDP growth has turned slightly positive and financial markets are temporarily calm.

Throughout the crisis years, the *Barroso II* Commission has always paid attention to employment and social developments, although they were not always treated with the same urgency as the financial sector crisis. The Commission has benefitted from very strong analysis in its annual reviews of *Employment and Social Developments in Europe* (ESDE) and from close cooperation with the OECD, ILO and many distinguished experts. Since the European Semester of economic policy coordination was established, the Directorate-General for Employment, Social Affairs and Inclusion has been involved in the preparation of country-specific recommendations as part of the so-called 'core group' alongside the Secretariat General and the Directorate-General for Economic and Financial Affairs and later also the Directorate-General for Taxation.

In October 2013, the Commission also presented proposals to strengthen the social dimension of the EMU, in response to the conclusions of the European Council which identified this in December 2012 as one of the key aspects of EMU reform. A key element of initiative on the social dimension of the EMU has been the creation of a Scoreboard of key employment and social indicators to be used in the European Semester process. This Scoreboard became a tool helping to identify earlier and better major employment and social trends that may affect the good functioning of the EMU.

The Scoreboard, which was approved by the Council as part of the 2014 Joint Employment Report, consists of five key indicators capturing employment and social trends that can severely undermine employment, social cohesion and human capital, and have negative effects on the growth and competitiveness of a Member State and potentially on those of the EMU as a whole:

- the unemployment rate (15-74 age group);
- the NEET rate in conjunction with the youth unemployment rate (15-24 age group);
- real gross household disposable income (GHDI);
- the at-risk-of-poverty rate (18-64 age group); and
- income inequalities (S80/S20 ratio, i.e. the ratio between the incomes of the top and bottom quintiles of the income distribution).

The Scoreboard has been developed with the understanding that given the limited mechanisms of macroeconomic adjustment in the EMU, unemployment and social crises risk developing to a greater extent and last longer within the currency union than outside (or than was the case during earlier instances of monetary cooperation in Europe). Therefore they have to be anticipated and addressed by the currency union on a collective basis. The Scoreboard has been used in preparation of the country-specific recommendations during the 2014 European Semester and could represent a very useful tool also in the coming years when it comes to further strengthening the coordination of economic, employment and social policies.

A good understanding of employment and social dynamics in Europe is very important, because the European integration project can hardly continue to evolve in the right direction unless we find an answer to the question how our Economic and Monetary Union can be made to sustainably work for socio-economic convergence and renewed prosperity across the highly heterogeneous group of countries of which it consists.

In the wake of an economic crisis which was longer and more severe in Europe than in other advanced economies, and which led to socio-economic divergences and inequalities unseen in Europe for decades, we should be grateful that European voters have maintained a majority in the Parliament which wants to further strengthen the European project. However, unless Europe achieves a job-rich and inclusive growth in the second half of this decade and makes visible progress towards the targets originally set for 2020, we can be certain that much fewer voters will give the EU the benefit of the doubt in 2019, if we are still a Union of 28 democratic countries at all by then.

Restoring the capacity to achieve balanced growth and socio-economic convergence in Europe is a key condition for the EU to regain 'output legitimacy'. However, no promising results can yet be shown in this respect, which also means that continuing EMU reform should be seen not only as a key component of the European recovery strategy, but also as a pre-condition of progress towards the Europe 2020 goals.

Our crisis experience shows that achieving durable recovery and restoring convergence will be extremely difficult as long as the EMU remains without a fiscal capacity and continues to rely on austerity and internal devaluation as the main mechanisms of adjustment to economic crises. A more resilient and growth-friendly EMU would require a well-designed mechanism of fiscal transfers between Member States using the euro. Through such a scheme, it should be possible to create a European safety net for the welfare safety nets of individual Member States, strengthening the ability of national governments to support an economic recovery.

The best options for a predictable and rules-based mechanism of countercyclical fiscal transfers appear to be schemes where EMU Member States would share part of the costs of short-term unemployment insurance. One such option is a basic European unemployment insurance scheme, enabling partial pooling of fiscal risks through a common core of national unemployment insurance schemes. Another option is reinsurance of national unemployment insurance schemes that would be activated in cases of severe downturns.

Both such schemes would provide a limited and predictable short-term fiscal stimulus to economies undergoing a downturn in the economic cycle, thus strengthening market confidence in the EMU and helping to mitigate economic contraction. By alleviating the need for abrupt fiscal consolidation in a downturn, such automatic fiscal stabilisers at the EMU level would also create a more favourable environment for structural reforms that bear fruit in the longer term.

Crucially, a countercyclical fiscal capacity at the EMU level would help prevent short-term crises from unleashing longer-lasting divergence within the monetary union. It would provide a good answer to the citizens' question: "How does Europe help us when we need it most?" – an answer which over the past years we have unfortunately struggled to find.

László Andor is European Commissioner for Employment, Social Affairs and Inclusion.