Gordon Bajnai, Thomas Fischer, Stephanie Hare, Sarah Hoffmann,
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Solidarity: For Sale?

The Social Dimension of the New European Economic Governance

Europe in Dialogue 2012 | 01

Bertelsmann Stiftung

Europe in Dialogue

The Europeans can be proud as they look back on fifty years of peaceful integration. Nowadays many people in the world see the European Union as a model of how states and their citizens can work together in peace and in freedom. However, this achievement does not automatically mean that the EU has the ability to deal with the problems of the future in a rapidly changing world. For this reason the European Union needs to keep developing its unity in diversity in a dynamic way, be it with regard to energy issues, the euro, climate change or new types of conflict. Self-assertion and solidarity are the fundamental concepts which will shape the forthcoming discourse.

"Europe in Dialogue" wishes to make a contribution to this open debate. The analyses in this series subject political concepts, processes and institutions to critical scrutiny and suggest ways of reforming internal and external European policymaking so that it is fit for the future. However, "Europe in Dialogue" is not merely trying to encourage an intra-European debate, and makes a point of including authors from non-EU states. Looking at an issue from a different angle or from a distance often helps to facilitate the crucial change of perspective which in turn makes it possible to continue to develop Europe in a meaningful way and to engage in a critical and yet courteous discourse with other civilizations and continents.

ISSN 1868-5048

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Imprint:

Managing editors:
Joachim Fritz-Vannahme, Armando García Schmidt

Language editing:
Paul Hockenos, Berlin

Copy editor:
Armando García Schmidt

Cover photo:
Photodisc, Hamburg

Print:
Heiden Druck & Medien GmbH, Gütersloh

ISSN:
1868-5048

www.bertelsmann-stiftung.org

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Introduction

Joachim Fritz-Vannahme and Gabriele Schöler

Dear Reader,

This fifth volume of the Bertelsmann Stiftung's Europe in Dialogue series aims to introduce creative, innovative approaches to the pressing issues facing 21st-century Europe. It strives to provide new impetuses to the debate about the future of the European project.

Our previous volume of Europe in Dialogue addressed European economic governance with a focus on crisis prevention and new institutions. This edition, for which contributions were produced in the late summer and early autumn of 2011, examines the social dimensions of the new European policies, issues that have not been as high on the agenda of European leaders and the public.

As *Thomas Fischer* and *Sarah Hoffmann*, both of the Bertelsmann Stiftung, point out in their paper: "There is growing concern that the burgeoning debt crisis in Europe will develop into a massive social crisis." They argue there is a worrying lack of solidarity among member states and their citizenries.

Different concepts of solidarity and their relevance to the European Union and the financial crisis are discussed by the Oxford University scholars *Kalypso Nicolaïdis*, Professor of International Relations, St. Antony's College, and *Juri Viehoff*, Lecturer of International Relations at University College.

Andrew Watt, Senior Researcher at the European Trade Union Institute, has a closer look at Europe's performance prior to and during the financial and economic crisis in terms of cohesion and solidarity, both within and between countries. His is a rather bleak view, namely that “the perceived – but actually misconceived – ‘limits to cross-national solidarity’ threaten to destroy monetary union and perhaps lastingly damage the whole idea of a Europe based on cohesion and solidarity.”

Former Hungarian Prime Minister *Gordon Bajnai* presents more integration as the only solution to overcome the crisis. In his chapter, he deals with the dual challenge political leaders in the European Union face: How to deal with European issues in a manner beneficial both to Europe and the member states’ national electorates.

Vanessa Rossi, Global Advisor with Oxford Analytica, and *Stephanie Hare*, Senior Analyst with Oxford Analytica, present practice-oriented solutions. They argue that a “sharply focussed ‘gold standard’ programme for social investment is not only justifiable and affordable but good value for money.”

These essays are supplemented by *Amalia Khachatryan’s* (Oxford University) annotated selection of current analyses and position papers by leading European think tanks and NGOs. *Paul Hockenos*, an American writer and editor based in Berlin, reviews three recent books on the euro crisis.

We thank all of the authors for their contributions, which provide plenty of fodder for an overdue discussion on the social implications of the crisis and Europe’s response. The views expressed in these contributions, needless to say, are those of the authors not the Bertelsmann Stiftung.

European Economic Governance: What About the Social Dimension?*

Thomas Fischer and Sarah Hoffmann

The outbreak of the Greek crisis has prompted the European Union to design a comprehensive economic governance architecture through which greater coordination of economic and fiscal policy will underpin the eurozone's common monetary policy. The goal is greater fiscal discipline and competitiveness across the EU member states. Yet, in the process, policymakers run the danger of weakening social cohesion in the European Union.

European Economic Governance: Between Public Debt and Social Crisis

In 2010, the European Union's citizens were beginning to think that the economic and financial crisis had been overcome. In some countries, such as Germany, the economy was again beginning to boom. But when the U.S. rating agencies began to cast doubt on the creditworthiness of Greece, and then of Portugal and Ireland, the whole eurozone was plunged into crisis. As a result of growing pressure from the financial markets, the public debt crisis has now reached Spain, Italy and France. 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

* This paper was first published as Spotlight Europe # 2011/04 – September 2011 by the Bertelsmann Stiftung.

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

Yet the new economic governance has more than one blind spot. There is growing concern that the burgeoning debt crisis will develop into a massive social crisis. Many of the people who bore the brunt of the first phase of the global banking crisis were lower middle class. For young people, in particular, the prospects of finding employment have worsened dramatically. In the second phase of the public debt crisis, people affected included 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, it is just this focus on budgetary consolidation and cutting public expenditures that features highest on the political agenda.

The dilemma facing the European Union and its member states is the fact that this is the only way to 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?

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

Graphics: KircherBurkhardt

The EEG Architecture in Brief

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

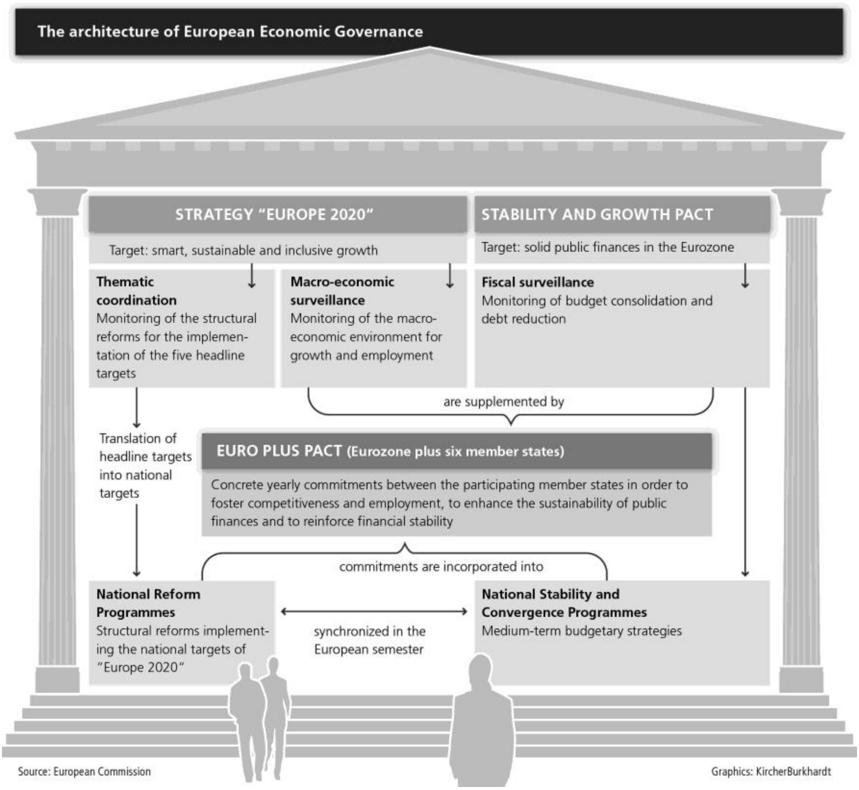
How these goals can be attained, that is, the question of the reforms that national policymakers need to tackle first, is specified in greater detail in seven out of ten ‘Integrated guidelines for the economic and employment policies of the Member States’ (guidelines 4-10). Under the general heading 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 (SGP). The rules of the SGP governing debt reduction and budget consolidation have been tightened further in order to get soaring public indebtedness and enormous budget deficits more efficiently under control.

Within the framework of the newly introduced ‘excessive (macroeconomic) imbalance procedure’, the Commission now uses a scoreboard as an early warning mechanism to identify economic developments threatening the goal of sustainable public finances.

These economic and fiscal policy tools are complemented by the Euro Plus Pact (March 2011), which is open to all EU member states. The 23 EU member states participating so far are committed to coordinating their national economic policies even more closely. They will concentrate on four reform targets: competitiveness, employment, the long-term sustainability of public finances, greater financial stability.



To implement the objectives in the areas of thematic coordination as well as macroeconomic and fiscal surveillance on the national level, member state governments are obliged to submit National Reform Programmes and Stability (for members of the eurozone) and Convergence (for states which are not members of the eurozone) Programmes on an annual basis. As for those countries participating in the Euro Plus Pact, these programmes will also include measures designed to implement the pact.

In addition, the so-called European Semester was introduced in 2011 to avoid contradictory reform requirements in the fields of economic policies, on the one hand, and budgetary policies, on the other. In the first six months of each year this new coordination procedure is applied to make sure that member states' budget planning for the ensuing year pays due attention to the headline targets of the Europe 2020 growth strategy.

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 architecture. Following the conclusions of the euro area heads of State or government, it will enter into force by midst 2012 to replace the European Financial Stability Facility (EFSF), the current temporary European safety net until mid-2013. 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 be 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.

Reality and Fiction

With the EU 2020 Strategy and its three new pillars of smart, sustainable, and inclusive growth, the Commission seeks 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. The financial markets exert strong pressure on the European Union and its member states to stabilize the eurozone as quickly as possible in macroeconomic terms and to reduce high levels of debt. Therefore thematic coordination within the framework of the Europe 2020 Strategy has fallen behind the goals of fiscal policy stability and economic convergence. This also finds expression in the fact that the SGP stipulates targets and rules which are binding for all the member states. Moreover, in the event of non-compliance the SGP sanctions 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.

Even the European Commission feels increasingly uneasy with this structural bias of Europe's new economic governance architecture. In its communication "Concluding the first European semester of economic policy coordination" from June 2011, the Commission warned member states 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 went on to say that the trends visible in many member states demonstrated that there was a growing risk of poverty and marginalization that calls for pro-active countermeasures: "On the basis of the actions described in the national programmes, Member States need to do more to deliver on this target."

At the same time, however, 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 (AGS) published in January 2011, the Commission assigned absolute priority to three main action areas: rigorous fiscal consolidation, labour market reforms for higher employment, and growth-enhancing measures. But now that the second European Semester has started in November 2011, the Commission should slowly begin to place greater emphasis on fighting social exclusion and poverty. In an evaluation of the social impact of the economic crisis jointly published by the European Commission and the EU's Social Protection Committee in January 2011, we find, for example, an interesting point of departure. As this report points out, hitherto only a handful of EU member states have carried out "social impact assessments" of their fiscal consolidation measures. In future the Commission could request member state governments more emphatically to regularly provide for such impact assessments in order to draw up additional country-specific recommendations on how to enhance social cohesion.

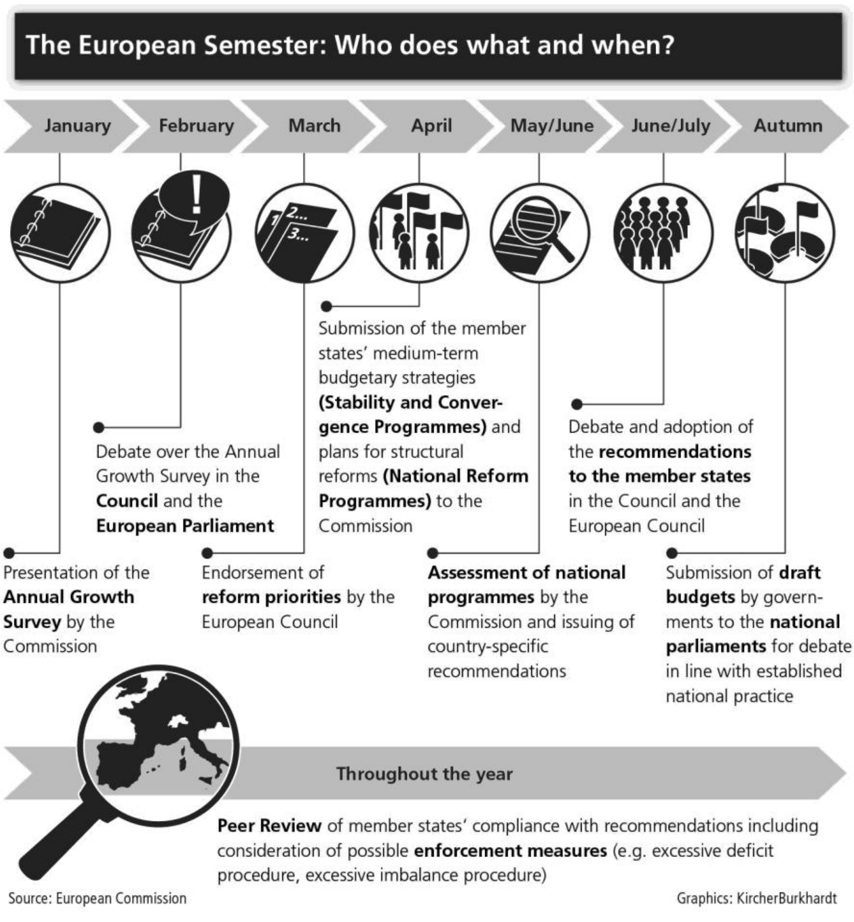
What comes after the spending cuts?

The Commission believes that rigorous fiscal consolidation achieved by concentrating on key public expenditures is the fundamental prerequisite for future growth, and singled this out in its 2011 Annual Growth Survey. There can be no doubt 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 17 EU countries shows that these are primarily cost-cutting exercises (Theodoropoulou/Watt 2011). This strong focus on spending cuts has also been driven by the Commission. It encourages member states to carry out cost-reducing reforms of their national pension, healthcare, and welfare systems, and to slash unemployment benefits.

In the context of the Europe 2020 targets for greater social cohesion and social inclusion, this approach is problematic 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 with sophisticated social security systems, especially when it comes to unemployment benefits, were in a much better position to deal with the economic shocks. 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.

Hence, there are pressing questions with regard to the issue of social cohesion in the European Union. What measures can the member states adopt on the revenue side in order to encourage fiscal consolidation and provide additional financial support for their social security systems and pro-active labour market policies? 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 growth and are particularly dependent on the solidarity of their European partners? And how to make sure that these solidarity claims do not impose on the latter enormous additional financial burdens?



When it comes to additional tax revenue, the introduction of a common financial transaction tax seems an attractive option, though there is as yet no agreement on how the additional revenues should be used. The EU Commission made a proposal to this effect in autumn 2011. 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 – such as for education and vocational training.

On the European level various options are currently being discussed about how to organize joint assistance for member states that 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 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 their introduction, though at the moment they are not politically feasible.

Two other options are more interesting and far more realistic. First, a 'Social Investment Pact' or 'Social Stability 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. For that purpose EU budget expenditures should focus to a greater extent than has hitherto been the case 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. At the same time, the European Commission should put more emphasis on reshaping national budgets along these lines and promoting an older retirement age, the societal integration of migrants, and the introduction of minimum welfare payments (Vandenbroucke/Hemerijck/Palier 2011).

Secondly, in order to mobilize EU financial support at short notice for national reform programmes in crisis-ridden member states, there may well be another way, as the EU Commission has 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 percent from the current 15-25 percent in order to enable them to avail themselves of the subsidies.

Economic and Social Governance is a Necessity

If one looks at the fiscal and social consequences of the crisis for Europeans and at the responses to date, the picture 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 from the recession, and this is paving the way for right-wing populism, as can be seen in the Netherlands, Finland, Sweden, Austria, and France. And the willingness of aid recipients to pursue austerity policies, which involve large-scale reductions in welfare benefits for ever more of the population is reaching a breaking point. The social unrest in Greece and Spain, where youth unemployment has now reached about 50 percent, could be just the beginning.

The cohesion of the eurozone and of the European Union as a whole is being called into question and dissatisfaction with the democratic institutions of Europe has reached a critical level. A social Europe that lives up to the tremendous challenges of the current economic crisis is a difficult and nonetheless necessary balancing act: It has to do justice to the interests of EU member states from which solidarity is expected as well as to the expectations of those dependent upon it.

The work of refining and improving Europe's economic governance should thus be motivated by the insight that functioning, efficient welfare systems on the national level actually make a considerable contribution to social inclusion and macroeconomic stability in the common monetary zone. Particularly in those member states most affected by the crisis, providing sufficient room for manoeuvre for public investment, in areas like education, vocational training and research may be rather difficult in the short term – when rigorous fiscal consolidation is at the top of the agenda. However, in the long term it is precisely these investments that point the way to greater competitiveness, growth, and employment. The provision of such support and the mobilization of the requisite assistance cannot be equated with the indefinite subsidising of fiscal indiscipline. In fact, they point to a Europe in which cohesion is no longer called into question by the advent of ever more safety nets. This is exactly why the new architecture must continue to develop: so that it can combine successful short-term consolidation with a stronger emphasis on the long-term Europe 2020 goals of inclusive growth, social cohesion, and social inclusion.

Or, to put it another way, what we urgently need is a model for the future economic and social governance of the European Union. Against this backdrop, it is rather encouraging that the European Commission seems to have learned first lessons from the first European Semester. In its second Annual Growth Survey, published in November 2011, one out of four priorities is “tackling unemployment and the social consequences of the crisis”.

Further Reading

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The Choice for Sustainable Solidarity in Post-Crisis Europe

Kalypso Nicolaïdis and Juri Viehoff

Who is opposed to *solidarity*? Unsurprisingly, everyone seems to invoke it as the magic bullet that will lead Europe out of its current crisis. It is the existence or absence of solidarity, we are told, that will dictate particular kinds of institutional designs for the European Union. What perhaps is surprising is that solidarity is invoked equally by camps with opposite philosophies. Those who want more redistributive measures between EU states – whether through more integration or increased authority for European institutions – argue that this must follow from the high interdependence we have created through our EU institutions. The other side counters that doing so would undermine the currently existing and precious 'economic solidarity' within member states.

Perhaps our political language is muddled and confused. Perhaps 'solidarity' is nothing more than a political slogan to be backed up by whatever argument commands the public opinion of the day.

We resist such cynicism. Instead, we argue that the lens of political philosophy can help us imbue the 'ideal of solidarity' with a sufficiently distinct moral and political meaning to serve as a useful benchmark for policymaking. Indeed, we believe that under admittedly stringent conditions, solidarity can play a similar role in underpinning European integration in the future as 'peace' played in the foundation years.

We recognise of course that 'solidarity' has been part of the European Union's equation for decades. On the one hand, as the indirect result of spill-over and the impact of free movement on the way in which member states must open their internal solidarity arrangements or welfare states. On the other, 'solidarity' has entered more directly through various channels of inter-state or inter-region aid, including agricultural, regional, and structural funds.[1] But in the wake of the sovereign-debt crisis, the European Union is confronted for the first time with the prospect of direct fiscal transfer of wealth from one group of citizens to another, on a scale that calls for a reappraisal of the ideal and impact of solidarity in this Union.

This essay examines in turn the *what, why*, and *how* of solidarity in the European Union. In conclusion, we advance our own position arguing that for solidarity arrangements to be sustainable in the European Union they must be embedded in *institutions of choice* in both senses – as themselves chosen by all and as frames for continuous policy choices.

What? Towards a Pluralist's Embrace of Solidarity

Of the words in the arsenal of contemporary politics, 'solidarity' may come top as both the most used and the least theorized concept, at least if we are concerned with theories that have achieved some degree of universal acceptance. Scholars have generally come to agree to disagree about the scope, proper usage, and normative significance of the concept of solidarity. Why is solidarity so contested? Arguably because it is used to characterise a whole range of relationships and patterns of behaviour connecting individuals and groups, with a family resemblance rather than a set of clear necessary and sufficient conditions at its core. As a result, those who set out to tackle the issue usually need to start by identifying a set of conditions for 'their' ideal of solidarity, which only partially includes those aspects that other authors deem to be at its core. No wonder then that they end up speaking past one another.

So when there are two conceptions of solidarity, say, blue solidarity and green solidarity, which focus on quite distinctive morally significant aspects

[1] We consider here the issue of economic solidarity, not political variants as in solidarity between member states in the field of foreign policy etc. See de Búrca, 2005.

of the family of solidarity relations, then it might well be the case that authors do not disagree about substantive moral issues at all, but merely talk about separate problems and adopt different labels.[2] There is no obvious remedy for this problem, except for being as precise as possible in presenting the phenomena we are addressing under the heading of solidarity. We start by sketching out some normatively important features of solidarity, with which many writers actually agree, in order to then sharpen our focus on the conceptual space occupied by solidarity without committing to a particular conception within this normative menu.[3] But at least we can point to the core tensions at stake and ask how to manage them.[4]

The Conceptual Features of Solidarity

So what do theorists of solidarity identify as its conceptual features?

First, solidarity is a *hybrid* concept, used to describe both an observable empirical behaviour amongst people and the normative grounds on which there ought to be such behaviour. Thus, we could observe both that there is solidarity between members of a group where there ought to be none and that there ought to be solidarity between individuals where there is none at present. Solidarity in this respect is similar to legitimacy, and thus unsurprisingly gives rise to similar contestations between social scientific empirical and normative philosophical accounts.[5]

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[2] Perhaps the best example for this problem is to be found in debates about whether there can be ‘human solidarity’ with all of humanity. See e.g. the debates created by Richard Rorty’s influential discussion of solidarity and some of his critics (Rorty, 1989; Geras, 1995; Principe, 2000).

[3] We follow here John Rawls’ important distinction between concepts and conceptions. See Rawls, 1999, p. 7.

[4] It should be noted already that the discussion does not ultimately aim to capture *all* contexts in which the language of solidarity is put to use, but it is meant to capture the central usages of the term and to theorise that makes them normatively significant.

[5] For a discussion of this problem in relation to the concept of legitimacy. See Howse & Nicolaïdis, 2001.

Second, solidarity is a *social* concept that describes a relation between agents: one is not in solidarity with oneself. However, the fact that solidarity is ‘social’ still leaves open what it takes to be the proper object or subject of solidarity: Can solidarity only exist between actual persons (whether as individuals or organised in groups) or can it relate to non-human animals or future or past generations? It also begs the question of the kind of relationship that might qualify as such. Some writers – especially those concerned with empirical research – assume that solidarity is necessarily expressed through actual behaviour by agents.[6] Other authors think that solidarity does not require particular kinds of behaviour but is better understood as a disposition to behave in a specific way (Rehg, 2007, p. 8).

Third, therefore, solidarity speaks to *motives*. Behaving (or being disposed to behave) in a specific way is not sufficient to be in solidarity. Such behaviour needs to be accompanied by an appropriate kind of *belief* (Harvey, 2007, p. 22). Thus, acting in ways that benefits somebody else is not sufficient to establish that one is acting *from* solidarity. As we will discuss below, one might be acting only out of pure self-interest in which case we would not normally speak of solidarity. Or one might be acting out of pure selfless or altruistic motives, which would not qualify either. In all cases, our shared beliefs about the kind of relationship that connects ‘us’ need to be compatible with the moral reasons that justify acting *from* solidarity: It is a fundamental to paradigmatic cases of group solidarity – such as the solidarity displayed amongst a minority group fighting against oppression – that members of the group believe that they are united by a *just* cause, such as the eradication of injustice. These appropriate beliefs about morality need not to be true: There can be solidarity between groups that are united in injustice (e.g. between unjust combatants in an unjust war). But it still is the case that those being part of this solidarity group see

[6] See e.g. the discussion in Thome, 1999.

themselves as sharing in 'something morally good' that transcends them as individuals.

The Solidarity Compass: Interest, Community, Altruism, and Obligation

Clearly, the intensity of the bonds that exist between members of the myriads of communities of solidarity we recognise around us, as well as the breadth of the issues to which solidarity applies, varies immensely.[7] Although this need not be the case, the two are usually correlated: the broader the set of issues covered by the solidarity relationship, the greater the intensity of the solidarity bonds amongst its participants. But what unique factors account for the intensity of solidarity bonds in solidarity groups, and does solidarity require a threshold level of intensity or range of issues? Here, there is much disagreement.

With an eye to the EU setting, we make a 'pluralist' case about the nature of solidarity bonds, or the motives and contexts that constitute solidarity. In order to do so in a stylised fashion we offer a 'solidarity compass' which locates solidarity at the intersection of two continuums, namely one between *(self) interest* and *community*, and one between *altruism* and *obligation* (Figure 1). We argue that relationships of solidarity usually entail some degree of each of these features in varying measure as displayed by those participating in them.[8] At the same time, relationships motivated solely by one of these, be it pure self-interest, pure community, pure altruism, or pure obligation, would not qualify as 'solidarity'. Solidarity

[7] E.g. we use the term solidarity both to characterise the close relationship between husband and wife in a marriage, to refer to transnational activist movements focusing on a single political issue or to speak of our feelings about the victims of natural disasters in near and far places.

[8] By 'display' we here mean that these factors would be mentioned by participants when asked for their reasons to participate in the particular solidarity group. Our use of 'reasons' throughout is meant to pick out those subjective reasons that agents think they have for participating in a relationship.

therefore describes a relationship that is motivated to some extent by each of these powerful motives, but irreducible to either one of them. Let us explain in more detail what this means with regards to the European Union today.

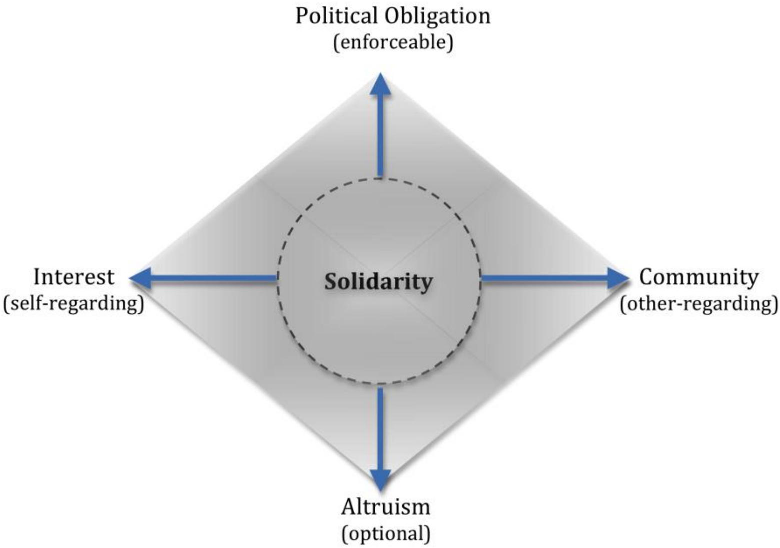

Figure 1: The Conceptual Space of Solidarity

Self-interest vs. *Community* The most often invoked argument in today's EU debates is that 'solidarity is in Germany's (or France's, etc.) interest.' To be sure this is usually qualified as 'enlightened' self-interest or long-term interest, either because it carries expectations of reciprocity or because the positive externalities induced by such solidarity buy a desired outcome (sustaining the European Monetary Union, or EMU). Abstracting from the European Union, we see that for different solidarity groups there can surely be larger or smaller commonality of such baseline interests, which exist independently from the relationship and which do not internalise others' interests. Commonality simply means that each person, group or country stands a better chance of realising its independently given interests by participating in the group. If we take the extreme case where individuals cooperate *only* to each realise their independent interest, then few would speak of solidarity at all (but rather of a cooperation or coalition between agents). So mere commonality of interest is not sufficient for solidarity.

This naturally leads to the thought that acting from solidarity requires that one acts in the belief that there (additionally) exists some form of loyalty, some kind of pre-existing bond with those one is in solidarity with, which in turn would justify some uncertainty on the nature of the 'return on (the solidarity) investment'.[9] At the opposite end of pure self-interest, therefore, there lies what we call the ideal of perfect *community*. Each member identifies with each other member to such an extent that self-interest becomes indistinguishable from common interest: the realisation of each individual's self-interest entails that each other individual's interests are satisfied, i.e. they each see the success of their own life as dependent on the success of the group as a whole.[10] We say that solidarity is located somewhere in between the notion of pure self-interest and ideal community, because surely no such comprehensive loyalty is required to invoke the notion of solidarity between members of a group.[11]

What does this tell us about the existence or absence of solidarity in the European Union? Member states have come to define their interests to ensure long-term stability in their relationship rather than seeking the

[9] Obviously, specifications of what 'loyalty' means here go to the heart of the substantive questions concerning solidarity, which we discuss in the next section.

[10] Feinberg says that the best way to judge different levels of community is by looking at our reactive attitudes: To what extent do I see praise for that person or group as praise *for me*? When that person or group commits a moral wrong – do *I* feel ashamed? (Feinberg, 1990, p. 234).

[11] We leave open here the question whether it is perhaps even false to speak of 'solidarity' within families, precisely for the reason that they realise the perfect ideal of community. The important point is that we can speak of political solidarity where no such strong forms of loyalty exist.

highest possible economic benefit for various powerful national constituencies in the short term. This is consistent with saying that there is nothing more than a commonality of interest. But there are also aspects of the European Union that seem to transcend the realm of self-interest and to come (at least a little) closer to the ideal of community, e.g. the treaty of the European Union speaks of an ‘ever closer union’. This might not be quite the same as a pledge of full-scale economic solidarity, but the implication is that member states see themselves as part-taking in something that is more than a convenient tool to realise self-interest.

Altruism vs. political obligation. Our other continuum is that between (supererogatory) altruism and (enforceable) political obligation. Some think that altruistic behaviour, e.g. charity or the simple generosity displayed by the good Samaritan’s response to the stranger in need, are also possible instances of solidaristic behaviour. If that were true, then it would show that for some instances of solidarity, there does not seem to be any self-interest or reciprocity involved, except perhaps in the form of shared humanity.

Is this true? While we can imagine being in solidarity with others who cannot reciprocate immediately, we are somewhat wary that solidarity can characterise a relationship without any degree of reciprocal link (even if hypothetical). At the very least, a relationship is more rightfully called ‘solidaristic’ the more people have the ability to influence one another’s destiny. So, for instance, a campaigner on behalf of poor, developing-world farmers might ‘only’ have a broad moral interest in seeing their plight diminished; or she might also know the farmers and therefore strongly empathise; or she may be part of the same movement as they are and thus share in a cause whose advancement is her reward. The more we go down this line, the more we can speak of solidarity. Pure charity towards the Greeks or the Irish would not qualify as solidarity. But an active and sustained interest in their future welfare born by a bond of empathy or a sense of community would. Pure selfless or altruistic motives seem atypical cases of solidarity precisely because those acting from solidarity do so while assuming some sort of reciprocity stemming from the bond in question, by which those involved in the relationship collectively advance their interests, e.g. by sharing risks and mutually insuring against disadvantages, even if very well aware that some will benefit disproportionally.

But there is also another important aspect that the discussion of altruism brings to the forefront: altruistic acts are in many instances – e.g. the case of the good Samaritan – supererogatory, i.e. they go beyond what morality strictly requires us to do.[12] By contrast, many things we do in political life we consider obligatory: morality does not make it optional whether we perform them. For example, citizens in a political community owe political obligations to one another such that they mutually uphold one another's rights: they pay taxes, respect the law of the land, serve in times of war.[13] Not only do most people think that such political obligations are non-optional, but they are also such that most people think they are enforceable: If I fail to do my fair share in the communal life of my society, others can force me to do so without wronging me. So when we study the kinds of tasks that morality asks us to do, we see that there is a continuum between optional acts, acts that we are obliged to do (but others may not enforce them against us), and enforceable obligations.

Now our point is that the moral stringency of solidarity duties, including the kind of solidarity that exists at the EU level, straddles the boundaries of strictly supererogatory acts on the one hand and acts that others have a right that we perform them on the other: the European Union may be a polity in the making but not of the kind that entails that the full scope of enforceable political obligations applies to each of its 'citizens'. Nonetheless, it seems far too permissive to assume that all (non-contract-based) demands for burden sharing in the European Union are purely

[12] See the discussion in Seglow & Scott, 2007, pp. 30-31.
[13] See for example Eleftheriadis, forthcoming; see also Klosko, 2005; Simmons, 1979.

optional. Whether solidarity expresses itself in deeds or in thoughts, such expressions include some original element of choice, but cannot be fully reduced to such once a solidarity relationship has come into existence. What solidarity does is introduce a special requirement of justification towards all those one is in solidarity with that falls between a strict obligation and a purely supererogatory act.

Solidarity as Profitable Altruism

To sum up our discussion so far: there are many ways of thinking about the moral relevance of solidarity when it comes to the duties we have towards others. We embrace a pluralist approach whereby solidarity as a moral concept is an intermediary between self-interest and community, as well as between altruism and obligation. And while it exists in tension between these different poles of the moral landscape it can be understood as closer to one or the other according to circumstances and viewpoints. But it cannot be reduced to pure self-interest, community, altruism, or obligation as it needs to entail some degree of connection or bond (even if tenuous), some degree of reciprocity (even if only in theory) and some degree of moral obligation (even if constrained by original choice). How do we capture this in-betweeness?

We can recall Tancredi's recommendation to his uncle, Prince of Salina, to embrace the idea of profitable *altruism* in the Italian Risorgimento so that everything could be allowed to change for everything to remain the same (Lampedusa, 1958). Perhaps this is what we are looking for in the European Union today: a way to weave profitable altruism in the very fabric of the union and make the moral demands on each other progressively stringent.

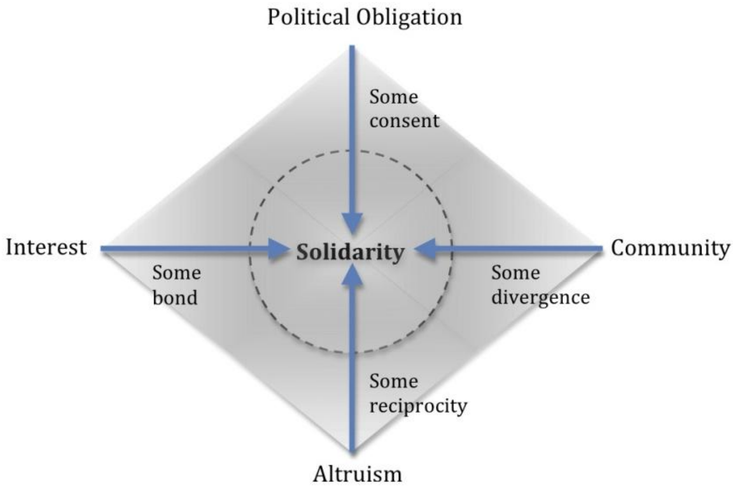

Figure 2: The Requirements of Solidarity

Why? Justifying Solidarity through Institutions of Justice

How then do we get there? How do we reason from these basic characteristics of solidarity to whether and how solidarity in the European Union can and should be enhanced? In other words, does the European Union provide the kind of landscape or context within which citizens (directly or through their states) can or should feel more and more bound by relationships of solidarity?

An obvious starting point is to ask how the European Union differs from the individual nation state when we conceive of the latter as a different kind of 'community of solidarity'. In other words what do national citizens 'owe' – and feel they owe – their co-nationals and what do they owe other EU nationals? Such an account of how we should organise our solidarity duties to share burdens and what kind of institutions we should build and uphold to do so is not simply a theory of solidarity – it is a theory of social justice in general, and distributive justice in particular. Therefore, only a theory of social justice for the European Union can help us combine considerations about 'EU solidarity' with 'national solidarity' as well as other morally relevant facts – such as facts about existing shared institutions, engineered externalities, or reciprocal impact on welfare.

Crucially, solidarity may relate to our theories of justice in two quite fundamentally different ways. There are those for whom national group solidarity (as disposition and behaviour) is a necessary precondition for social justice. In short, 'solidarity restricts justice'. We argue, on the contrary, that because of its intermediate character, 'solidarity' is not a prerequisite but a choice that political community can and must make in certain circumstances through the institutions that they shape collectively. Let us briefly review some of the arguments at play.

The *solidarity as community* argument. Proponents of 'solidarity as precondition' argue that it would be morally wrong to force people to make redistributive sacrifices for others unless they have an inclination to do so based entirely on *community* in the sense discussed in part I (we call *non-instrumentalists* those who believe that even if we could force them we shouldn't't). As they see it, respect for the autonomy of national political communities is paramount considering that nationals feel linked *as persons*. Like individual people, nations should be the authors of their own 'communal life', which requires us to respect the loyalties and special relationships that freely develop between free individuals, and therefore also the duties they accept to owe some and not others. Here we say: sure, what is not to like about autonomy?! But don't we sometimes feel (altruistic) duties of justice towards individuals with whom we share no solidarity except in the most basic sense of common humanity (if this would pass the test of the 'solidarity pre-condition' then of course such a test would be trivial)? And how does the argument translate from the narrow sphere of actual personal relationships into the sphere of institutionally mediated group solidarity within states? Further, if lack of express consent is not a sufficient reason for people to refuse to participate in the large-scale solidarity practices of the welfare state, then autonomy may not be a sufficient reason to rule out a solidaristic European Union either.

The *community of justification* argument. Yet some authors accept the idea of duties of justice towards others with whom we are not in *personal* solidarity but argue that the existing, national bonds of solidarity still limit the scope of distributive justice (we can call them *instrumentalists*). They are pragmatic: for something to be a good theory of redistributive justice, it must be implementable (ought implies can); people must be sufficiently motivated to uphold the institutions and principles that these embed; trying to implement a public institutional system against 'the people' subject to it must necessarily be futile. Individuals will evade taxes where they can, they will cheat and lie, and no administrative and policing process will ever make them comply with the requirements of justice unless they choose to do so freely. Generally speaking, the national level is the only ground where these conditions can be obtained, even if imperfectly. This is why the state is a setting in which people feel the need to justify their behaviour when it comes to social justice or injustice and conversely have the right to demand such justification from state institutions.

But in our view, there are good reasons to see the European Union as a 'structure of justification' in the making (Neyer, 2011). Indeed, the European Union gives effect to the right to justification through multiple networks of policymaking bent on arguing and giving reasons, whether from bureaucrat to bureaucrat, heads of governments to governments, courts to governments, commission to ombudsman, or consultative bodies to policymakers. To be sure, such justification dynamics may often be too legalistic and not democratic enough, non-transparent, lacking in openness to contestation, and pervaded by blame shifting. But the European Union, including at its summits, has also become a highly visible platform for justification and counter-justification including regarding solidarity demands and questions of responsible national policymaking. One only needs to think of the collective censure that states like Greece or Italy received in the context of the sovereign debt crisis for their failure to maintain a financially sound budget. But we are still left with the question: If Europeans mainly remain ‘foreign’ to each other, isn’t it relatively easy to say ‘no’ to the demands of solidarity?

The *sociological* counterargument. The answer will depend in part on whether we believe in the nation-centric story from a sociological standpoint. We know that social justice works (reasonably) well in solidarity groups that have developed out of smaller ones. The existence of national solidarity groups stands at the end of a long process of transformation from more community to less community (i.e. from blood-based loyalty over village-community and feudal-based group solidarity to equal citizenship). So if the necessary bonds of solidarity for the implementation of social justice can ‘survive’ a process of transformation from a few hundred participants to one that involves over 80 million (in the case of Germany), then why not expect that solidarity of the necessary kind could exist amongst an even larger group of people united by the fact that they all live under the dense institutions of the European Union?[14] But if ‘scale-lifting’ of solidarity bonds should not be deemed impossible, we also know from polls that there are huge variations in expressions of we-feeling across states and socio-economic groups.[15] In short, whether it is plausible to lift the scale all the way to ‘institutionalised solidarity’ amongst humankind and short of this among Europeans is ultimately a socio-empirical question.

[14] Moreover, we know that existing national solidarity groups have been intentionally forged by authoritarian rulers and non-democratic administrators.

[15] The most powerful counter-reply here is that policies, which promote certain kinds of supranational solidarity bonds, would be illiberal. We cannot discuss this in more detail here.

The 'other motives' argument. There is indeed empirical evidence that individuals are capable of acting in accordance with (some) principles of distributive justice in the absence of strong solidarity of the national type. Here we are squarely back to our 'solidarity compass'. Citizens may accept institutions that induce solidarity behaviour due to a mix of interest, altruism, and a weak sense of obligation. They are not required to act from a *feeling* of *community* in order to want to live on terms of justice with those citizens from other member states. Ambiguous and mixed motives might be enough: partly self-regarding (something to gain from European solidarity) and partly altruistic (desire to benefit others without immediate reciprocity). This mixed-motive nature of solidarity can sustain an institutional project from which there are many winners. '[Solidarity] is intimately connected to cooperation, that is, to intentional common enterprise, calling for a combined and coordinated action by many people. Unlike natural bonding forces of the kind of family love and care, solidarity is mediated by a commitment to an *idea* or *cause*.' (Heyd, 2007, p. 118; emphasis in original) Can the European Union, or EMU, represent such a cause? Considering that as an institution today it exerts a dramatic influence over life prospects from which nobody can escape without massive costs to self and others – i.e. that all its participants share a *common destiny* – it would be difficult to dismiss the prospect.

The *primacy of justice* argument. The American political philosopher John Rawls famously wrote: "Justice is the first virtue of social institutions, as truth is of systems of thought. A theory however elegant and economical must be rejected or revised if it is untrue; likewise, laws and institutions no matter how efficient and well-arranged must be reformed or abolished if they are unjust" (Rawls, 1999, p. 3). Justice takes priority when it comes to designing and upholding social institutions – or what Rawls calls the basic structure of society – because of the "deep and pervasive nature of its social and psychological effects," its pervasive impact on the way individuals will fare in life “from birth” (Rawls, 1993, p. 260), (Abizadeh, 2007, p. 319). The laws, norms and rules of ‘institutionalised justice’ shape the character and current self-understanding of those living under them as well as individual and collective aspirations for the future[16] – including the choices we make in terms of forming solidarity groups with one set of people rather than another. If that is the case, then how we feel about the European Union as a ‘cause’ that might justify solidarity is itself a function of the European Union as part of the basic structure of our social lives.

In sum, the real disagreement concerning solidarity in the European Union can be traced back to how different thinkers connect it as a prescriptive ideal to their underlying (and often implicit) conceptions of what ‘social justice’ can mean for such a novel institutional form as the EU. If while not a state itself, it is meant to both tame and empower its constituent member states, it must also reinvent the idea of justice and solidarity across borders.

How? Solidarity must be chosen, intrusive and sustained through institutions

This essay is no operational blueprint. But the philosophical debates we have engaged with do suggest some principles for action.

First, the question of solidarity in the European Union should not be apprehended as an ad-hoc remedy, a temporary fix to the sovereign debt crisis. We ought to be in the business of establishing the European project in the long term, of aiming to entrench sustainable integration in Europe, while trying to internalise to the greatest extent possible the interests of future generations (Nicolaïdis, 2010). As we have argued above,

[16] Rawls, 1993, p. 269; This point is also emphasised in Scheffler’s discussion (Scheffler, 2008, p. 74).

sustainable solidarity can only be obtained through institutions of justice within and across states.

Second, the kind of solidarity bonds and behaviours we can wish for the European Union needs to be connected to the kind of polity the European Union actually is and is likely to remain – ours must be a realistic utopia. In this spirit, we see the European Union under the paradigm of *union* rather than communitarian *unity*, a federal union not a federal state, grounded on mutual recognition and justification, not an imaginary ideal of national community.[17] The latter entails the kind of political obligations discussed earlier in this paper and usually associated with nation states, which we do not believe are required to underpin solidarity in the European Union. A supranational union is more than an alliance but it is not a state either – the term ‘union’ may convey an identity bond of *community* – albeit short of national or ethnic connotation – but it may also simply refer to ‘a community of interest’.[18] At its most solidaristic, such a union is one in which each party internalises to a large extent the interests of the others as part of his interest (Feinberg, 1990, p. 234). But we believe that it would be a stretch to call for an extremely stringent ‘one for all, all for one’ stance in all areas of the European Union’s policies. To the extent that there are structural asymmetries between weak and strong, small and big, rich and poor states, or groups of people, such a requirement for solidarity would be too strong and would endanger the unstable balance that the European Union needs to preserve between disintegration and statism writ large. For now, it is enough that each member state (and at least a plurality of citizens) mutually identifies with each other to some degree; that each member be willing to forgo at least some benefit for the sake of realising greater benefit for other members, and that each member thinks that its actions are at least partly

[17] For an early discussion of this contrast see Weiler, 1991. See also Nicolaïdis, 2004.
[18] In truth, the bond that connects citizens of the EU is in the eyes of the beholder, as there exists a mosaic of different European stories each of them (Lacroix & Nicolaïdis, 2010).

grounded in stringent moral and political obligations. This ratio between (small) acceptable cost to oneself and (large) benefit to others becomes the measure of solidarity. Given the basic structure of the European Union as a transnational society, EU institutions can help bolster a kind of structural loyalty to the system and to each other if they are perceived as doing so fairly.

Third, then, in a union that remains mainly a community of foreigners, a community of close strangers bound together by deep interdependence, it is fair enough and indeed a warrant of sustainability that solidarity be part conditional on knowing about the use and misuse of one’s expression of solidarity. Such conditions do not hold in the context of pure charity, nor in the context of family solidarity grounded in blind trust rather than binding trust. And even then, nothing kills the solidarity impulse as the discovery of having been taken for a ride. Habits of solidarity may develop from the existence of institutions that guard against free riding, enforce responsibility upon the recipient and enforce diffuse reciprocity in the *longue durée*. Institutions will not be perceived as just and therefore solidarity not be sustained if some countries or agents benefit unduly, whether because solidarity amounts to mutualising pain and privatizing gain or because solidarity only serves to shield some from adjustment costs that will benefit them in the long run.

We would suggest exploring a kind of *duty to intrude* as an integral part of the institutionalisation of solidarity, or the idea that a country’s or group’s solidarity be grounded on participation in its intended impact, on an active concern in ensuring the fair use of solidaristic behaviour and rules. Such intrusion in term needs to be respectful of differences and autonomy through a spirit of negotiation and mutuality rather than asymmetric domination on the part of the subject of solidarity.

Finally, choice must remain at the core of the European variant of solidarity. In the European Union as we have it today, increasing solidarity will not be an enforceable obligation, delivered through transnational institutions of justice not associated with nation states – it will remain a fragile and contested process in which nation states object and adjust and ultimately determine the institutionalisation of solidarity in the European Union. This was certainly the message expressed by the German Constitutional Court in the summer of 2011, namely that Germans might enter a kind of solidarity contract with their European counterparts but that could not (yet?) amount to endorsing the unpredictable liabilities of others. Solidarity in the European Union must rest on institutions that ensure its constant and renewed fairness to all sides. The choice for sustainable solidarity is at that price.

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Solidarity and Cohesion within and between Countries in a Europe in Crisis

Andrew Watt

This essay considers how Europe has performed prior to and during the on-going financial and economic crisis in terms of cohesion and solidarity, both within and between countries. The linkages between within-country (or 'social'), and between-country (or 'European') cohesion and solidarity are also examined.

For the limited purposes of this essay, the terms solidarity and cohesion are used quite loosely to refer to a situation in which market outcomes are influenced and corrected by means of policies and institutions in a way that reduces the income and other welfare differentials between rich and poor, either at the national or the European level. Cohesion is an outcome of such a process. Solidarity is, if you like, the driving force: the belief that aggregate human welfare is increased if resources are shared more equally and, especially in difficult times, if the strong shoulder a proportionately greater share of the burden. Solidarity and cohesion are considered normatively 'good things', although practical and also ethical limits to such solidarity will be discussed.

It is argued that, prior to the crisis, the growth model adopted by individual European countries, and by the European Union as a whole, was inimical to social cohesion and solidarity, but that there was a general trend towards greater cohesion across national borders (i.e. a convergence of economic welfare indicators) and some limited degree of international solidarity (i.e. in terms of processes, institutions). In the crisis, social cohesion initially increased; this trend was superficial and short-lived, however. The medium-term outlook for social cohesion is bleak because the previous growth model has been largely left intact while the pressures of crisis adjustment have not been distributed according to the principle of solidarity. Inequality within countries is set to rise.

At the same time, as the crisis proceeded the process of convergence between countries largely came to an end, certainly within the euro area, giving way to growing *divergence*. The crisis has been accompanied by what may appear to have been an increase in cross-border solidarity, with the establishment of bail-out funds, the European Financial Stability Facility (ESFS), and a debate about introducing euro bonds. On the other hand, there has been much talk about the supposedly ‘natural’ limits to solidarity between EU countries – essentially the old idea that Europe lacks a *demos* – and there have been clear signs of resistance to ‘helping’ peripheral countries on the part of citizens in ‘core Europe’.

However, it is argued here that the debate has been largely conducted on false premises. The competitiveness (and resultant sovereign debt) problems in the euro area are ‘symmetrical’. Deficits in one country automatically imply surpluses in another. What is needed is not so much what might be called ‘uni-directional conditional solidarity’ (i.e. bail-outs subject to tough conditionality) as *symmetrical* adjustment behaviour by both surplus and deficit countries, plus changes at the European level that are not so much about introducing ‘solidarity’, as is commonly perceived, but rather more about ensuring the efficient functioning of a monetary union.

At the time of writing, this needed shift in policy does not seem likely. And the perceived – but actually misconceived – ‘limits to cross-national solidarity’ threaten to destroy monetary union and perhaps lastingly damage the whole idea of a Europe based on cohesion and solidarity.

Pre-crisis growth model built on growing inequality

As charted by a number of studies, perhaps most comprehensively by the OECD's *Growing Unequal* report (OECD 2008), the growth model characteristic of European countries (and even more so in much of the non-EU OECD) has been based on widening social inequalities since the early 1980s. This was in contrast to the post-war period up until the late 1970s, in which most measures of inequality were declining.

The declining social cohesion was not limited to incomes. While economic growth was employment intensive, there was a hollowing out of middle-class jobs and a rise in the 'precariat': people working on bad jobs and under insecure employment contracts. In Spain around a third of people were employed on fixed-term contracts, the vast majority involuntarily. The opening up of the bottom third of the labour market was particularly pronounced in some countries – in Europe most notably in Germany, which went from being a rather equal country to one that, on some measures, was as unequal as the 'liberal' United Kingdom (on rising inequality in Germany see Horn 2011). In many countries, public services were increasingly also provided on 'market principles', reducing their market-correcting impact.

In most countries, average wage growth failed to keep up with productivity growth so that the share of wages in national income decreased, while that of profits increased. In the twelve founding European Monetary Union (EMU) member countries, for instance, the wage share fell from around more than 68 percent of GDP in the early 1990s to 63 percent when the crisis hit. Moreover, the wage share includes some categories of incomes, notably stock options, which have expanded very rapidly in recent decades and accrue to a small share of the population consisting of CEOs and senior management personnel. These incomes would, in a more intuitive classification of the share of 'wages' and 'profits' in national income, be at least in part classified under profits, implying that the real fall in the wage share is considerably greater than implied by the national accounts (Atkinson 2009, Glyn 2009).

The factors driving this inequality-based growth model are disputed and hard to disentangle. There is some agreement that globalisation (against the background of the higher mobility of capital compared to labour) and so-called 'skill-based' technical change have contributed to rising inequalities, but not about their importance. A shift to greater 'financialisation' of economies (particularly in English-speaking countries) is put forward by a number of authors as an important factor (e.g. Hein 2011). Institutional changes, such as de-unionisation (O'Farrell/Watt 2009) and 'reforms' of welfare states and labour market institutions, are also emphasised to varying degrees (OECD 2011).

It is not necessary here to apportion 'blame' between these factors, merely to note more generally that the decline in social cohesion in the period since 1980 was an expression of a liberal and globalised growth model, based not least on the idea of competition between (welfare) states and wage levels in different countries. This was in marked contrast to the prior social (or Christian) democratic growth model of shared prosperity under which welfare states played primarily a protective and corrective function, and the double function of wages as both cost factor and source of demand was recognised.

Nor will we dwell here on the question whether the growing inequality was, in turn, an important *cause* of the crisis of the global 2007. (On this see among many others: Coats 2011, Horn 2011, Rajan 2010, Watt 2009.) What is certainly clear is that the growth model came to a juddering halt in Europe, and globally, starting in 2007, just as some 80 years earlier the Great Depression ended the turbulent post-1918 growth model that had also been characterised by widening social inequalities (Picketty/Saez 2006).

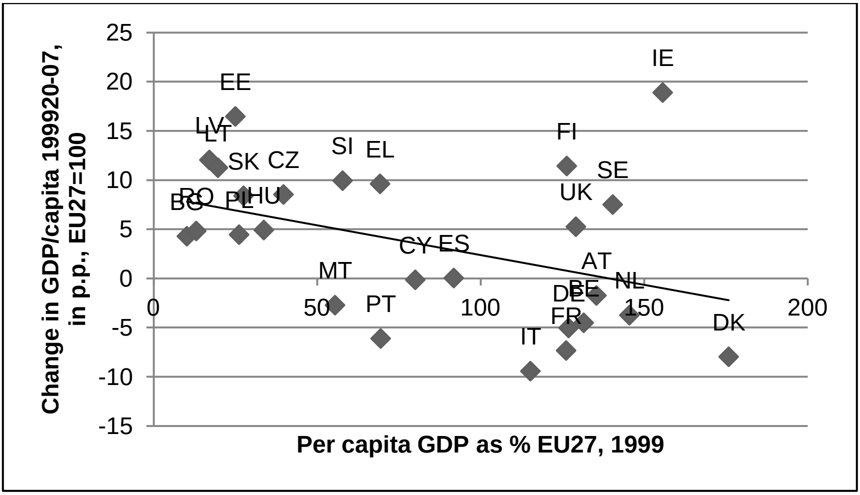

Figure 1: GDP/capita in 1999 and its change 1999-2007; EU27 excl. LU; data source: Eurostat

On the other hand, the years after the founding of the euro in 1999 and after the eastern enlargements in 2004 and 2007 did see an appreciable convergence of income levels *between* European countries (Figure 1). The south and east (and Ireland in the west) – in short the European 'periphery' – grew faster than the northern and central 'core'. Social *divergence* went hand in hand with international *convergence* within Europe. While the latter partly reflected standard economic mechanisms, such as trade and capital and labour mobility, it was also a manifestation of European cross-border solidarity: the cohesion funds and other elements of support made a limited but nonetheless significant contribution to the convergence process. This convergence process can count as an important success for the European integration project, all the more so as it does not appear to have occurred in other regions of the global economy (Gill/Raiser 2011).

However this apparently very successful story of convergence concealed worrying underlying trends that stored up problems for the future. The most important of these was the increase in current account deficits and rising price and wage uncompetitiveness in the peripheral countries, and corresponding current account surpluses and increasing wage and price competitiveness in the core countries, especially Germany.

As a proper understanding of this dynamic is important for the subsequent discussion, it is necessary to dwell for a moment on this issue. We focus on the euro area.

First of all there is a clear correlation between the development of unit labour costs – that is nominal wage growth minus labour productivity growth – and developments in current account balances. This can be seen by comparing Figures 2 and 3 for the EMU countries. In layperson's terms and

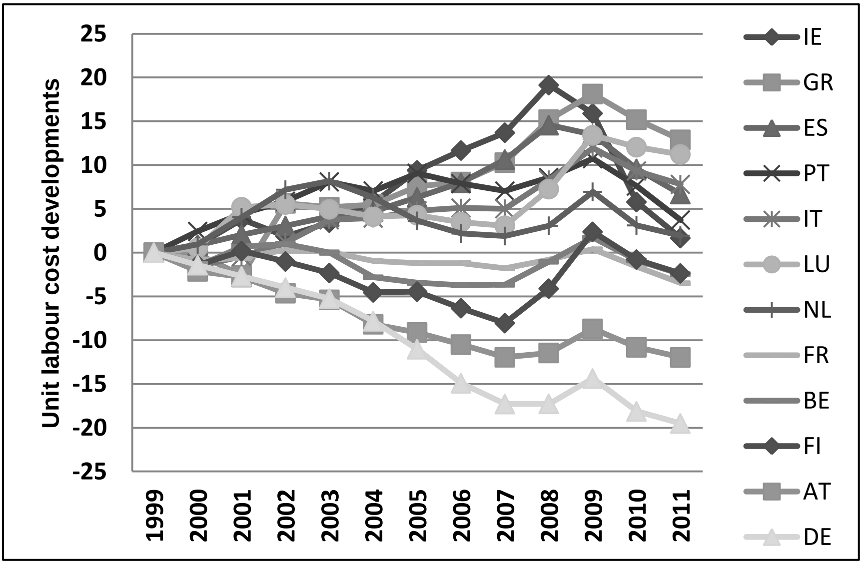

Figure 2: Unit labour cost developments, 1999 = 100 (figures -2% p.a.); data source: AMECO, own calculations

simplifying somewhat: countries in which labour costs rose substantially faster than productivity tended to import more than they exported. Countries in which wages increased more slowly, allowing for their national productivity trends, tended to run export surpluses.

The link between these two developments is complex, however. In particular, the correlation does not permit the conclusion – as many have erroneously claimed[1] – that irresponsible wage policy in the periphery has been at the root of the euro area crisis. In a nutshell the developments can be explained as follows.[2]

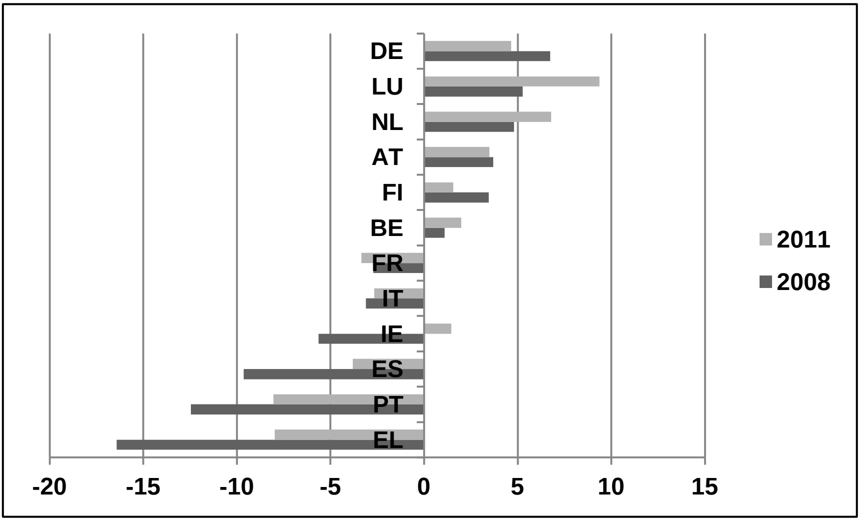

Figure 3: Current account positions, 2008, 2011, % GDP; data source: AMECO

[1] For example by Alan Greenspan in the Financial Times of 7 October 2011. http://blogs.ft.com/the-a-list/2011/10/06/europe%E2%80%99s-crisis-is-all-about-the-north-south-split/.

[2] For a more detailed exposition see Watt (2011a) and the literature cited there.

On joining EMU, previously high-inflation countries, which had had high interest rates, benefited from a sharp fall in borrowing costs, setting off a – seemingly – virtuous circle: these fast-growing, high-inflation economies enjoyed relatively low real interest rates (the common ECB-rate minus their high inflation rates), which stimulated growth further. On the other hand, slow-growing, low-inflation countries were in a vicious circle, suffering from relatively high real interest rates, which were a drag on growth. This dichotomy was exaggerated by the one-sided nature of the Stability and Growth Pact: slow-growing economies were up against or over the 3 percent of GDP deficit limit and prevented from pursuing expansionary fiscal policies, while faster-growing economies were not constrained to run tighter policies.

Asset (especially house) prices rose rapidly in the peripheral countries, thanks to low interest rates, creating wealth and confidence effects that stimulated spending and borrowing. But it wasn't just a financial bubble. Employment growth was strong – Spain created around one third of all the net jobs created in the euro area up to 2007 – and unemployment fell significantly in peripheral countries. By contrast Germany's labour market performance was extremely weak during the pre-crisis EMU period, a fact that is now often overlooked.

This led to a situation of sustained nominal wage/price 'spirals' – where wages and prices chase themselves upwards – that twisted faster in some countries, the periphery, than in others, the core. The combination of faster-rising prices and a stronger dynamic of domestic demand in deficit countries restrained their exports while fuelling import demand; the reverse happened in surplus countries. In Germany domestic demand was essentially stagnant – as were real wages – and such economic growth as it achieved was driven solely by higher net exports.

Because running persistent current account deficits means that a country steadily increases its foreign indebtedness, the seemingly good performance of the periphery was too good to be true. From around 2007 foreign lenders became nervous about debt repayment. Capital inflows stopped. Bubbles burst and growth ground to halt.

One vital point needs to be grasped from Figures 2 and 3. The unit labour cost problem in the euro area is a *symmetrical* one. Some countries exceeded the benchmark rate of unit labour cost growth, which is 2 percent per annum, equal to the inflation target of the European Central Bank (ECB). But others undercut it. (While more countries exceeded than undercut, the size of Germany, representing 30 percent of euro area GDP, relative to Spain, Greece, Ireland and the rest, needs to be borne in mind.) Similarly the current account imbalances more or less netted out. This is unsurprising given that the external trade balance of the euro area as a whole has, for many years, been very close to balance. Thus deficits in one EMU country are a necessary, equal and opposite, corollary of surpluses in other countries.

Direct impact of the crisis on social cohesion and international convergence

The initial effect of the crisis was to narrow social inequality. This was not due to any increase in solidarity, however, but was rather a statistical expression of the fact that top incomes, profits, and not least financial-sector bonuses were hit first and hardest, whereas the wages of those workers who kept their jobs, as contractual income, were initially maintained, while most of those that lost their jobs were initially entitled to some welfare benefits; to a limited extent the latter were stocked up or extended as part of the anti-crisis stimulus packages that, belatedly, were rolled out (Watt

2009a). The share of wages in national income, which had been on a steady downward trend, picked up.

Not only was this ‘improvement’ in social cohesion more of a statistical mirage – incomes at the bottom fell less than at the top as the crisis hit – it was, or, depending on country and indicator, is likely soon to prove, temporary. Rising unemployment increases inequality amongst workers, with big income losses for some, especially as unemployment duration increases and benefit entitlements run out. More generally, higher unemployment weakens the bargaining power of labour presaging a renewed fall in the wage share, especially for those groups with already weak bargaining power (the unskilled, migrants, those in depressed areas with limited mobility).

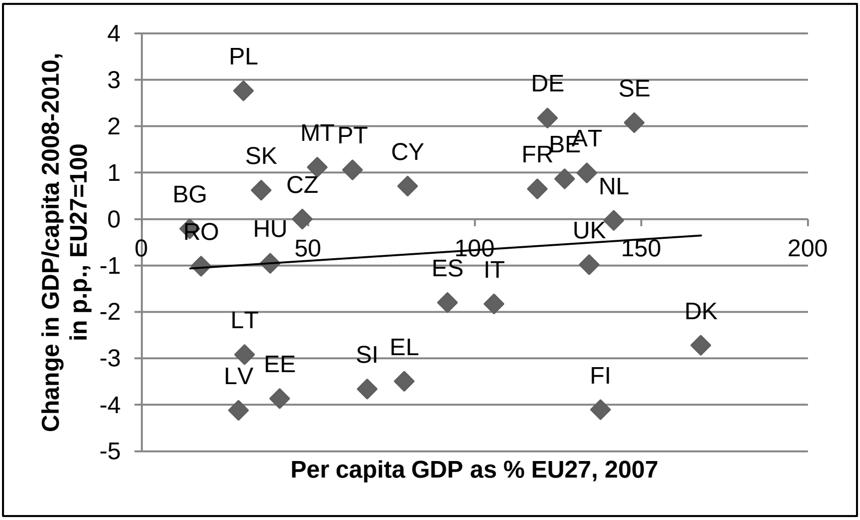

Figure 4: GDP/capita in 2007 and its change 2008-2010; EU27 excl. LU and IE; data source: Eurostat

On top of this, the crisis brought to an abrupt end, and shows signs of reversing, the sustained process of international convergence within Europe. The crisis disproportionately hit the 'peripheral' countries of eastern and southern Europe, and Ireland[3], whereas Germany and most of the core countries around it tended to weather the crisis relatively well (Figure 4). This largely reflected the fact that, as detailed below, the peripheral countries had to cope not only with the fall-out of the global crisis, but also with the need to regain competitiveness.

Impacts of the policy response: economic governance reform, coordinated austerity and the Annual Growth Survey

The crisis did not just have direct effects on social and intra-European cohesion, it also induced policy responses in a number of areas which have already had, and can be expected to continue to have impacts on both cohesion and solidarity, both within and between member states, notably within the context of monetary union.

I will focus here on the fiscal consolidation and austerity programmes, the supply-side agenda of the Annual Growth Survey and its role within the longer-term Europe 2020 strategy, and the attempts to deal with the macroeconomic (current account) imbalances discussed in the previous section.

[3] Ireland fits the broad pattern here – convergence of a peripheral country followed by a reverse in the crisis. However, because its convergence process started earlier and had been spectacularly successful, its GDP per capita had risen to way above the EU27 average. This makes it an outlier in the statistical sense and it is excluded from Figure 4.

Austerity: ill-conceived and poorly coordinated from Brussels

During the course of 2010 government policy across the entire continent progressively shifted from fiscal stimulus to fiscal consolidation (for an overview see Theodoropoulou/Watt 2011). In some countries this shift was undertaken voluntarily, as part of a standard Keynesian approach: reversing a previously expansionary policy once, apparently, growth rates had begun to pick up. In others, though, the shift was forced on them either by pressure from creditors in the framework of external support provided by the European Union and the IMF (initially Latvia, Hungary, Romania; subsequently, Greece, Ireland, Portugal), or out of a fear of the so-called ‘bond vigilantes’ driving up interest rates if radical austerity measures were not swiftly introduced; here Britain led the way, to be followed by most euro area countries. At the latest with the publishing of the Commission’s Annual Growth Survey (AGS) in January 2011, which launched the Europe 2020 strategy, the entire European Union was committed to a clear path of austerity.

It is important to emphasise that fiscal consolidation does not *per se* increase social and economic inequality. It depends how it is done. First there is the issue of timing. Fiscal consolidation that withdraws public demand at the same time as private-sector demand is growing robustly is eminently sensible and poses no social cohesion risk. Second and more importantly, there is the mix of measures. As a general rule, both sides of the government budget are ‘progressive’. In other words, higher public spending and higher revenues (taxes and contributions) tend, respectively, to benefit the poor and lower middle more and hit the upper middle and rich harder. Welfare spending and (progressive) income tax are obvious and important examples. Clearly this is not true of all elements on either side of the ledger, though. Some spending cuts (e.g. mortgage tax relief) would hit higher incomes, while some tax hikes (a prominent case being VAT) hit the poor relatively harder, in the latter case because they consume a greater share of their income.[4]

In short, governments have some considerable discretion both regarding appropriate timing and the distributional impacts of consolidation measures. It has become increasingly clear that the shift to continent-wide austerity was premature and ill-advised. It has been particularly harsh in the already hard-hit peripheral countries. It has worsened the economic and labour market situation, in some cases dramatically so. And, as the analyses brought together in Theodoropoulou and Watt 2011 show, with a few exceptions (France, Austria, Luxembourg) the consolidation packages tended to have regressive distributional effects (cf. Heise and Lierse 2011). In other words, the austerity policies have reduced *both* intra-national cohesion and international convergence within Europe.

The ill-timed and socially regressive form taken by nationally implemented austerity policies was, it must be added, partly driven by a European agenda. In particular, the 2011 AGS sought to whip all EU countries behind the common goal of fiscal consolidation (European Commission 2011; for a critique see Watt 2011b). Amongst other things the AGS raised the previous target of a 0.5 percentage point of GDP yearly improvement in the structural budget balance (the budget position ignoring the effects of the business cycle), which was deemed insufficiently ambitious. The focus was clearly to be put on cutting spending rather than raising revenues, while on the revenue side indirect tax hikes are recommended in a one-size-fits-all fashion, although they tend to be

[4] Even the apparently straightforward case of VAT – a consumption tax, whereas it is well-known that consumption declines as a share of income as one moves up the income distribution – is in practice complex, because various items of spending are typically excluded or are taxed at a lower rate. If these categories are disproportionately important for the budgets of low-income households, the overall impact of a VAT rate hike may not be regressive.

regressive in terms of distribution and have a particularly adverse impact on demand.

Moreover, the crisis and the Europe 2020 strategy and AGS process could also have been taken as an opportunity to promote solutions to the fiscal crisis that would have increased social cohesion, overcoming collective action problems facing member states. For example, a coordinated increase in wealth taxes in the top rate of income tax, and the introduction of a financial transactions tax (FTT) or carbon tax could all have been promoted. Greater efforts could have been made to stop damaging tax competition. In all these areas there are important spill-overs between EU

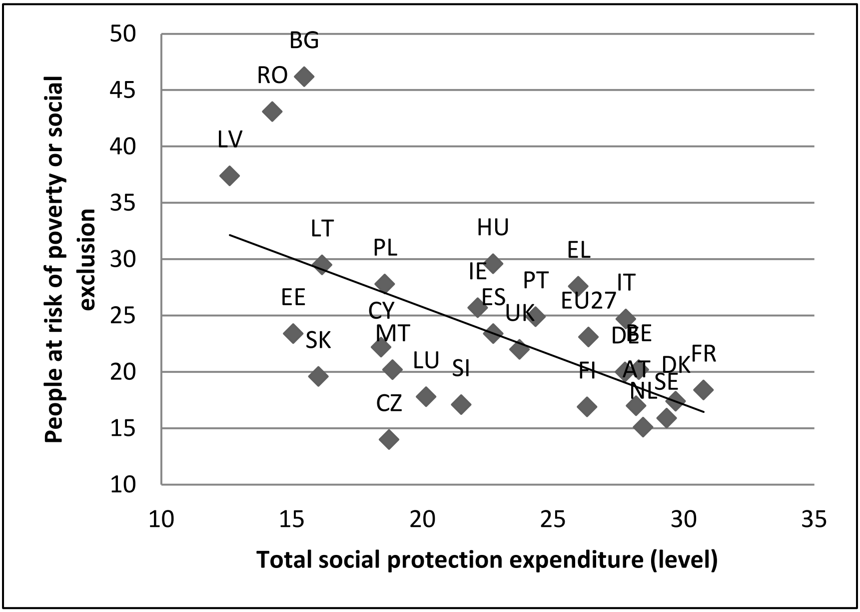

Figure 5: People at risk of poverty or social exclusion and expenditure on social protection

countries. The fact that such measures were not on the agenda while the emphasis was on organising cuts in spending is very telling about the one-sided nature of the policy coordination process in Europe.

Evidence of the impact of the steer given by Europe to national policymaking can be seen from the stability and convergence programmes submitted to the European Commission.[5] Let us start with the initial

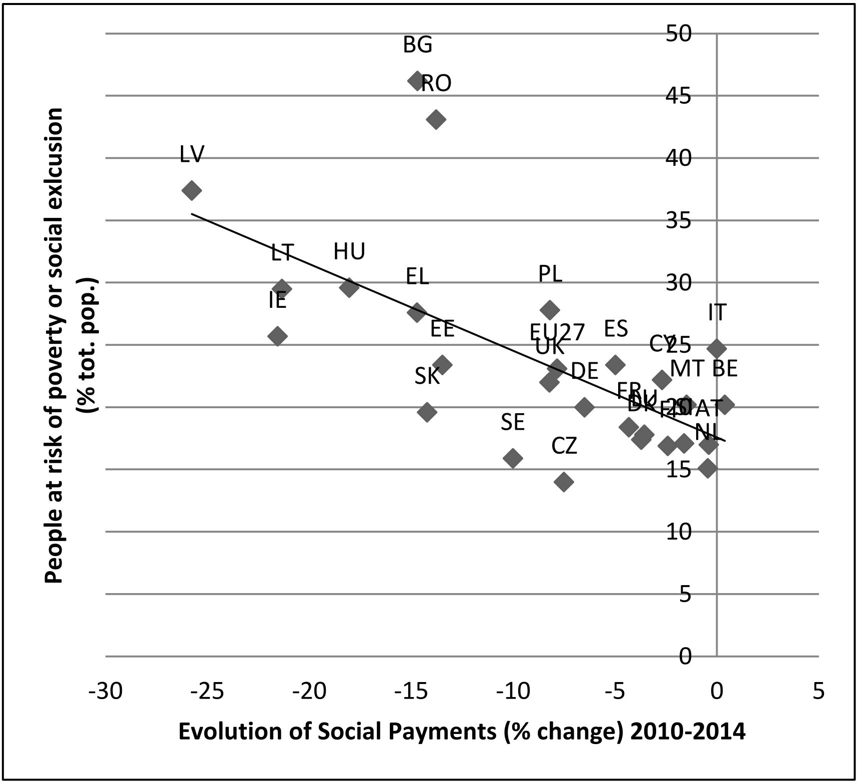

Figure 6: People at risk of poverty or social exclusion and planned changes in social transfers

[5] For more on this see Leschke/Theodoropoulou/Watt forthcoming.

situation. Figure 5 shows that countries with a high ‘risk of poverty’[6] spend less as a proportion of GDP than those countries, in which relative poverty is lower.

What is striking is that, with this starting point in mind, if we plot the risk of poverty against the *planned* changes in social spending as a share of GDP, as announced by national governments in their stability and convergence programmes submitted to the European Commission, we get the picture in Figure 6.

It is evident that those countries in which (relative) poverty affects a comparatively substantial proportion of the population are envisaging the most substantial cuts in social spending as a share of their respective GDP. It seems very likely, therefore, that those countries that can – to use a perhaps inappropriate turn of phrase – least ‘afford’ any further rise in relative poverty are those that are cutting back hardest, generally from already below-average levels, on the sort of social spending that helps attenuate poverty.

We can conclude from this analysis that a combination of the crisis, the real and imagined needs for fiscal consolidation, the political preference of national governments, and the influence exerted by the European policymaking processes and international institutions (EU troika, IMF) on national decision-making is worsening both the intra-national cohesion and solidarity (as expressed by redistributive welfare states) and also international convergence, in terms of a to-be-expected widening of the gap between the performance of countries in limiting relative poverty.

From a more medium-term perspective, and returning to a more macro point of view, the fiscal rules have also been substantially tightened as part of the so-called ‘six pack’ of economic governance reforms that have recently been approved by the European parliament and will come into

[6] Despite the rather misleading phrase, this is a relative poverty concept with a threshold at 60 percent of the country’s median equivalised household income.

force in the course of 2012.[7] A greater focus on government debt (as opposed to deficit) ratios is foreseen. For example, countries are supposed to reduce debt by one twentieth of the gap between the current debt-to-GDP ratio and the 60 percent Maastricht upper limit every year. For a country with debt at 120 percent of GDP, such as Italy, this implies the debt ratio falling by 3 percentage points of GDP every year. Given sluggish economic growth, this can only be achieved (if at all) by an extended period of rigorous austerity. Sanctions have been tightened and, notably, the ability of member states to escape censure from Brussels will be reduced by means of a so-called reverse majority decision rule. In short, looking forward all the signs are that fiscal austerity will continue and indeed intensify, with a focus on measures (public spending cuts, hikes in value-added tax) that will reduce social cohesion.

As if that were not enough, there are longer-term concerns, too. Member states, and in particular France and Germany, have been insisting that all countries institutionalise so-called debt brakes or balanced budget rules in their constitutions, along the lines of the German *Schuldenbremse*. This is seen as a *quid pro quo* for European 'solidarity' in the form of the EFSF and other forms of support. However, putting operational policy rules – which tend to be complex simply because the world is complex, and which are likely to have to be modified as circumstances and our knowledge about the functioning of our economies change – into a hard-to-amend constitution is bad politics. Depending on the way it is implemented it is also bad economics: the crisis teaches us that countries in a monetary union, with a single monetary policy, need to make active use of fiscal policy to address their specific national situations and promote euro area cohesion. Tying the

[7] Details of the six-pack are to be found here: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/647&format=HTML&aged=0&language=EN&guiLanguage=en/.

hands of policymakers with cumbersome, hard-to-change and/or hard to interpret rules is not the way forward.

The EU's poverty reduction target – welcome but irrelevant

Against this background it may seem surprising, but is nevertheless the case, that the Europe 2020 Strategy, into which both the Annual Growth Survey and the fiscal consolidation rules are supposed to fit, is supposed to deliver "smart, sustainable *and inclusive*" growth (emphasis added).[8] On the face of it, then, European policymakers are as concerned with making growth inclusive – i.e. with convergence and solidarity in the sense used in this contribution – as with the goals of raising productivity through innovation (smart) and making growth compatible with ecological constraints (sustainable).

Moreover, under the strategy a specific target has been set: 20 million or one in six people are to be lifted out of poverty and social exclusion by 2020. Yet for the reasons given in the preceding paragraphs, it is almost inconceivable that substantial progress towards achieving the target will be made, at least for the foreseeable future. Economies are mired in post-crisis stagnation, likely to be prolonged by premature fiscal austerity. Moreover the fiscal consolidation methods chosen (and recommended, in some cases insisted upon, by European institutions) are inimical to the goal of inclusive growth. Intra-national cohesion is set to decline, not increase.

[8] An overview of the Europoe2020 strategy is given here: http://ec.europa.eu/europe2020/index_en.htm/.

Divergence between euro-area countries – the need for symmetrical adjustment and a different concept of European solidarity

Let us now turn from the focus on within-country cohesion to look, finally, at the problems of inter-country adjustment after the crisis. In particular we consider the prospects for a return to the pre-crisis convergence trajectory or whether, rather, the current trend towards divergence, especially in the euro area, will continue. This also implies the need to reflect on cross-border solidarity: efforts by wealthier, more fiscally robust and/or faster growing countries, or by the European level as a collective, to help those facing recession and/or fiscal crises. For reasons of space, I will concentrate on the specific issues of the euro area.

As we saw above, the poorer southern periphery of the euro area – Ireland is in a somewhat similar position, although starting from a much higher income level – came out of the crisis in a much worse state than the (wealthier) core. An important reason for this was the prior loss of relative competitiveness of the former against the latter. In fact, the set of conditions faced by these countries after the onset of the crisis put them in an altogether impossible position. Five interlocking elements are crucial:

- Given no exchange rate, and no leverage to resolve competitive differentials via faster wage and price inflation in Germany, and no tolerance on the part of the ECB for higher aggregate inflation in EMU, the countries were forced into 'internal devaluation' – downward pressure on (nominal) wages and prices driven by fiscal contraction;
- These countries faced a substantial need for fiscal consolidation due to the hole blown in public finances by the financial crisis (automatic stabilisers, discretionary fiscal stimulus measures and bank rescue costs). In the case of Greece, and Greece alone, came on top of this serious fiscal mismanagement in the 'fat' years. This required, also,

contractionary fiscal policies (specifically primary surpluses), but, equally, high (nominal) economic growth and relatively low interest rates;[9]

- But nominal growth was weak, even negative, due to the crisis and the need to reverse the loss of competitiveness. Austerity policies aiming to bring about wage and price deflation and consolidate budgets depressed it even further: contractionary fiscal policy is contractionary, especially in the conditions prevailing in monetary union (IMF 2010);
- Worse, nominal interest rates rose sharply. This made an already difficult situation into mission impossible. And why did they increase, whereas rates in the United Kingdom, the United States, and Japan with equally bad, indeed often worse fiscal numbers than the GIIPS, stayed low and even fell? The short answer is: because they are members of a monetary union. They lacked the ability to devalue the exchange rate to restore competitiveness and, more importantly, they lacked the backing of an independent central bank. Such a bank can always 'print money' and ensure that bondholders are repaid. Lacking this, the markets demanded a risk premium. This in turn threatened to turn a potentially manageable situation into a death-spiral of rising interest rates, falling growth, and intensified austerity measures. And this change from a steady state to an exploding trajectory could come about suddenly, by way of nothing more than an initially minor shift in market sentiment, even if that shift itself was unjustified by any change in fundamentals (deGrauwe 2011);
- A final piece completes the dismal mosaic: the public debt is to a considerable extent held as assets by the domestic (and also the

[9] As is well known these – primary budget balance, nominal growth rate and nominal interest rate – are the three decisive variables for fiscal dynamics. See for further explanation Watt (2011c).

foreign) banking sector. If these assets are seen as impaired, the banks, already struggling in many cases after the crisis, are forced to cut back on lending. This dampens the economy, and once again the negative spiral spins.

In a nutshell, the peripheral countries[10] were in an impossible position. It was not – and this is the crucial point – a question of the political will to impose harsh austerity measures. The countries had *no way out – whether or not they imposed austerity*. The only way out was European 'solidarity'.

The negative spirals and cumulative causation mechanisms had to be stopped *ex machina*. And in a monetary union it would seem obvious what *ex machina* means: the other members of the union and its common institutions. They must guarantee that the state debt will be serviced. That's not quite all, but this simple step is a very big part of the solution. Interest rates stay low. Consumers and investors regain confidence. Banks lend. Growth can resume (which is actually normal after a deep recession). Deficit and debt ratios are put on a downward trajectory. In such an environment governments can find the right balance between fiscal stimulus in the short run and fiscal consolidation in the medium run, while maintaining growth-enhancing public investment, without the threat of market panics. In an environment of social trust it may be possible to bring about negotiated and parallel declines in wages and prices – through some form of social pact, as widely practiced in the run-up to EMU in the 1990s – without massive fiscal contraction.

Importantly, provision of such support is not costly to the core members. Firstly, the countries initially hit by the crisis – Greece, Ireland, Portugal – are small, together accounting for just some 6 percent of euro-area GDP.

[10] To get at the 'wood' I have elided some differences at the level of the 'trees'. The Irish case, again, is somewhat different. Given its very large export sector relative to domestic demand, a strategy of internal devaluation may ultimately work, although the short and medium run costs will be high, and the eventual success relies on an improvement in competitiveness that makes success for other countries that much harder.

Secondly, the core countries, especially Germany, could borrow money on capital markets at extremely low interest rates. All that was necessary was to lend this money on with a minimal interest-rate penalty. Despite at times frenzied media reports to the contrary, it was never a question of Germans and the citizens of other core countries ‘tightening their belts’ to help Greeks, all the more so as Germany actually benefited from *lower* interest rates precisely because of the flight to safety out of peripheral-country sovereign bonds (Watt 2011d).

Apart from guaranteeing debt servicing, two other forms of adjustment support would have been extremely helpful. First, investment financed by the structural funds and/or European Investment Bank would have helped sustain demand in peripheral countries in the short run while raising potential output in the longer run (thus easing somewhat the downward pressure on incomes and wages). Secondly, and more importantly, the needed improvement in price competitiveness within the euro area is a *relative* improvement. It would have been vital for the core countries, and particularly Germany and Austria, to support the adjustment process by allowing faster wage (and price) growth. Looking at Figure 2 above, this would imply making a *symmetrical* adjustment in which both countries above and below the benchmark (the 2 percent ULC growth represented by the x-axis) bring ULC growth down and up respectively. This would have been facilitated if the ECB had been prepared to accept, for a limited period, a slightly higher aggregate inflation rate in the euro area. Germany would have benefited from higher real living standards and higher imports. The peripheral countries could have adjusted their relative costs, not without difficulty and pain, certainly, but in a way that kept the economic and social stress to an unavoidable minimum.

As everyone knows, a solidaristic European solution along these lines was not forthcoming. This is not the place to review the economic-policy developments in any detail (see for example Watt 2011e and f). In the context of the issues on which we focus here they can be summarised succinctly as follows.

Some limited European solidarity was provided in the form of the bail-outs and the setting up of the EFSF. However it was provided late, at an inadequate level and at conditions (in terms both of interest rates and the requirements to implement austerity) that did not substantially improve, indeed in many cases actively worsened, the position of the countries concerned. Above all else, adjustment was only sought in the deficit countries. The surplus countries had to 'pay' – as it was foolishly and also incorrectly portrayed to these countries' populations – but they did not have to change their behaviour. The crisis has not been seen as a systemic crisis of the euro area, requiring adjustments on the part of all member states and changes in the institutional architecture of the monetary union. Rather it has been interpreted primarily as a failing by the governments of certain states, specifically, of the peripheral, deficit countries. *They* had to adjust – or, it was made clear, sometimes implicitly, sometimes very explicitly – they had to suffer. The adjustment, in a word, was asymmetric, not symmetric.

And at the time of writing (November 2011) it is clear that this strategy has utterly failed. Social hardship in the periphery has increased enormously. The euro-area countries are now diverging rather than converging. And worst of all, the prospects for improvement in the area as a whole are dismal. The recovery has ground to a halt and a renewed slide into recession seems very likely, with the possibility of a major economic depression.

Conclusion

How much distribution a community of states can organise and under what conditions is an open question. Indeed this same question is unresolved and permanently contested at the national level, too. It is, of course, a normative question whether the degree of European solidarity that was practiced was too little, too much, or just right. What seems to me undisputable, though, is that the policies pursued were completely disastrous from an economic point of view. A rapid solution to the crisis, based on the proposals just discussed, and which can be summed up as generous European solidarity combined with a recognition of mutual responsibility by *all* actors and thus the need for symmetrical adjustment, would have been cheap and effective. It would have halted the contagion that has since spread to all countries sovereign debt markets. It would have established a firm basis for a sustained, even if gradual, recovery of the real economy across the whole of Europe. That would have permitted a stabilisation and effective re-regulation of the financial sector. Against such a background, government budgets could have been consolidated without drastic austerity measures.

Such an approach would have set Europe on a growth trajectory based more on social inclusion, convergence, and solidarity. Every crisis brings opportunities for progressive change. At the current juncture it appears that Europe has let this one slip comprehensively through its grasp. Europe is now on a path of declining social cohesion and probably also between-country cohesion, at least in the euro area.

Worse, the perceived – but actually misconceived – ‘limits to cross-national solidarity’ threaten to destroy monetary union and perhaps lastingly damage the whole idea of a Europe based on cohesion and solidarity and thus destroy the real achievements in terms of international convergence of previous years.

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From Economic to Political Crisis: Challenges Facing a Post-2008 European Union

Gordon Bajnai

The European Union is facing the biggest challenge of its 60-year history. The global financial crisis has highlighted its fragility, a consequence of the half-finished nature of European integration. For the first time in its existence, the European Union has to directly confront the two major forces shaping the world of politics: markets and voters.

The only viable solution to this crisis is to raise integration to the next level. But that will require a transfer of additional sovereign competences from areas most relevant to politics: fiscal, social and economic policies. This inevitable change will, in turn, pose a challenge to European democracy and governance.

The revenge of globalization

The roots of the current crisis in Europe reach back well before 2008. The current fiscal and banking crisis is a consequence of the 'revenge of globalization', or more practically put, a competitiveness trap that has reached the European economy, society, and institutions gradually but with an accelerating speed.

With the progress of globalization, the cost of low-skilled work in the developed economies (especially in high 'fixed-cost' welfare states) has become uncompetitive in the face of a constant challenge from low-income/low-welfare economies. The consequent transfer of capital investments in low-skills/high-manpower industries over to emerging markets has generated gradual technological, know-how, and skills development in those emerging economies. This process is continuously increasing the threshold of ‘value added’ labor that can still be afforded by high wage-cost countries.

In no small part this is a welcome development as more and more people escape poverty and improve wealth in emerging economies, while developing new markets for imported goods and services from the developed economies. Nevertheless, economic transitions on a similar scale always create tensions, and the current global economic realignment may prove to be one of those historic turning points.

However, this process has caused a significant loss of demand for low-skilled jobs in developed countries and in the European Union in particular. Some countries with high quality political institutions and strong economic backgrounds (typically Germany and the Nordic countries) have realized this problem and learned from their mistakes early on. They successfully ‘escaped’ into the knowledge economy where they have reinforced a sustainable competitive edge. After some – largely individual, unrelated – semi-crises these countries have adjusted labor costs to remain competitive. In contrast, those EU countries whose original role in the intra-EU division of work, due to their relative underdevelopment, was to provide the bulk of low-skilled products, have quickly lost their growth potential under the pressure of a relatively expensive euro and quickly increasing unit labor cost. However, these countries have temporarily maintained their growth rate, what was, in fact, a positive output gap. The fuel for this bubble-like growth, based on the increasing share of non-tradable sectors in GDP, was the unreasonably cheap euro denominated funding by financial institutions, which considered eurozone sovereign debt to be risk free.

Furthermore, the EU lags behind in productivity also relative to the U.S. and this gap continues to widen. In 2007 an average U.S. employee produced 42 percent more GDP than his European peer. That gap is – contrary to popular belief – not primarily due to less work but to low growth

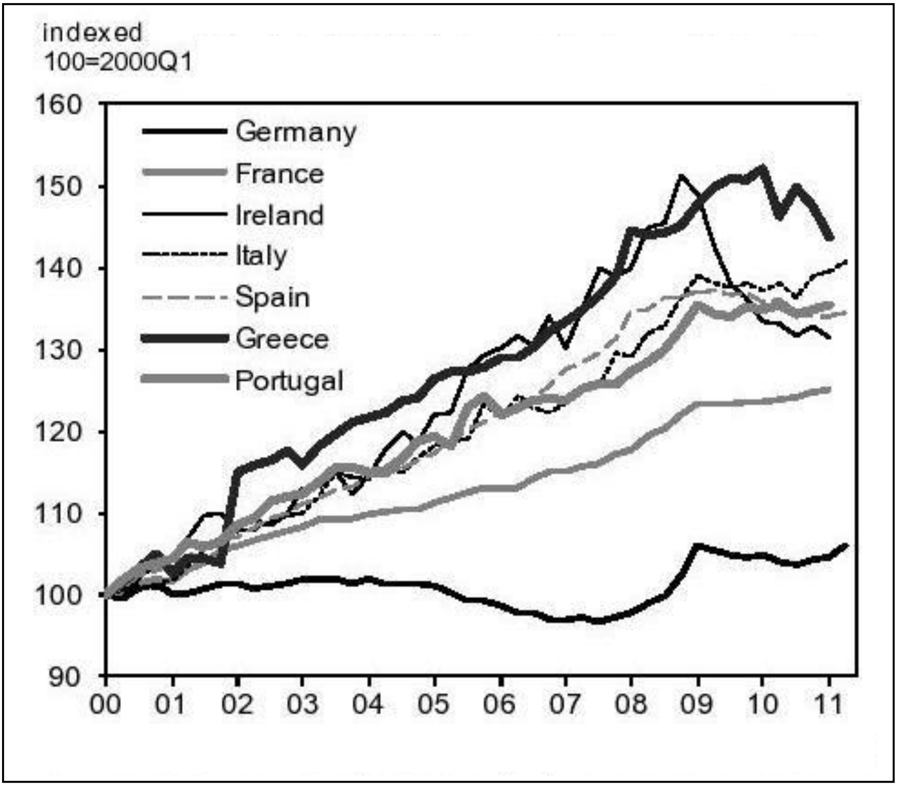

Figure 1: Divergence of Unit labor costs; source: National Statistics, Haver Analytics, GS Global ECS Research

in the total factor productivity (TFP)[1] – that can be ameliorated through efficiency, organizational and technological improvements.

The crisis of 2008 has highlighted the unsustainable nature of the European 'business model' and halted the financing of those economic policies. On the other hand, the crisis of 2008 has not changed the already existing trends of global rebalancing, but has significantly reduced the time available for reaction and correction. It has also made the social and political environment less stable and less manageable before the inevitable structural reforms.

Trends, Risks, Challenges into the Future

There are five key dynamics in the post-2008 environment, the outcome of which will determine the future of Europe and strongly influence the developed world:

- Slower growth. This economic trend will characterize the next ten years in the developed world. This is in particular a consequence of an extended deleveraging process, public and private, which will result in reduced levels of private consumption and investment, and less public spending, a result of austerity programs everywhere. This tendency may substantially increase the long-term natural rate of unemployment compared to pre-crisis levels. There is clearly a mismatch between the low-skilled labor supply that is in abundance available, and the demand for knowledge-economy jobs (the direction most European economies are trying to go in response to the competitive pressures of globalization).

[1] See more in the European Commission's Industrial Competitiveness annual monitoring report: http://ec.europa.eu/enterprise/policies/industrial-competitiveness/industrial-policy/index_en.htm.

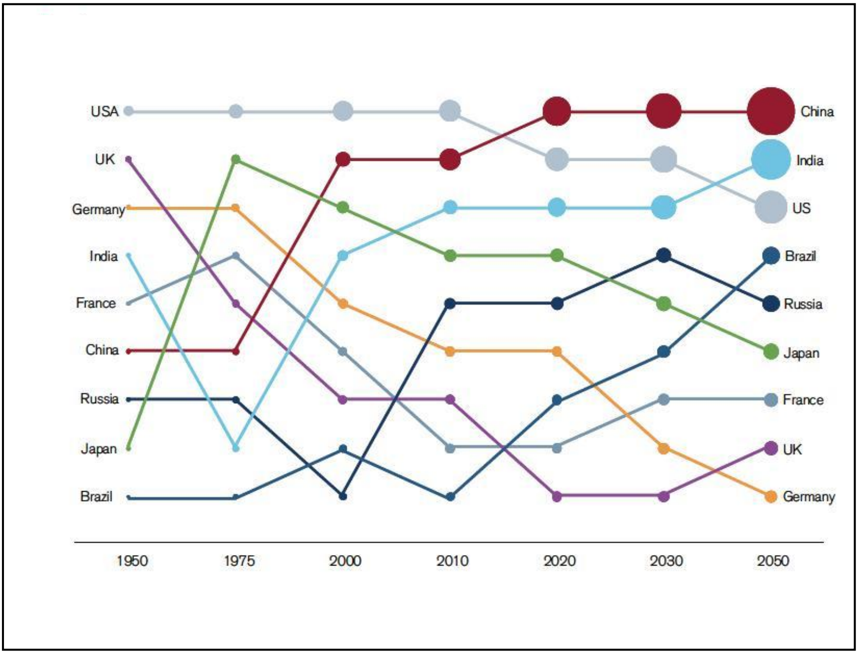

Figure 2: Development and emerging market GDPs, 1950-2050; source: David Hunkar[2]

- Social mobility in reverse. When discussing political stability, an often quoted observation is that revolutions are not made by those who are poor, but by those who become disappointed. This observation is gaining relevance again in the post-2008 world.

  In the first wave of the crisis, the most heavily affected groups in our societies were the lower middle classes. Many of them, tens of millions in Europe over the last 30 to 40 years, have through new jobs and cheap credit emerged from the status of poor to become part of the lower middle classes. Both of these factors of social

2 http://seekingalpha.com/article/192419-can-the-chinese-renminbi-replace-the-dollar-as-the-world-s-reserve-currency.

progress are disappearing in the crisis, pushing these vast groups back to a substantially lower quality of life, and placing additional pressure on already stretched social entitlement budgets and safety nets.

The second phase of the crisis, however, is affecting the traditionally poor because government-led austerity programs typically mean sharp reduction in social, educational, and healthcare schemes. That will increase the number of disappointed people in societies.

The third negatively affected social group is young people who are fresh out of school, and without a chance to get a job. The youth unemployment figures in Spain and many other countries are no different than those in North Africa where – despite the overall impressive economic growth – social tensions have recently become uncontrollable. The widely expected increase in retirement age and the perspective of jobless growth in these economies will further reduce the chances of younger generations establishing a proper independent existence.

In light of the tragic experiences of the post-Great Depression era, this sudden reversal in social mobility and lack of positive generational perspective is the greatest risk to the political stability in some of the heavily affected countries in Europe.

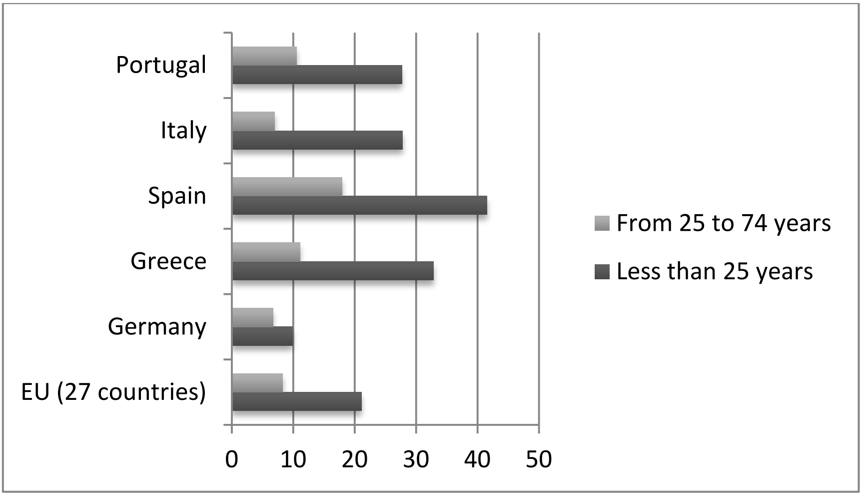

Figure 3: Unemployment rate, by age group (2010, %), source: Eurostat

- Intergenerational conflicts. One of the areas where the crisis has accelerated existing trends is our societies' ageing. Today in Europe roughly 2.5 active adults pay for one retired person, but this number is quickly declining and by 2050 only 1.5 active will have to bear the same burden based on current trends. With the loss of GDP in the crisis and the increased debt burden on governments, the inherent tensions in public finances are quickly escalating. This in turn is putting Europe-wide pressure on governments to demonstrate the sustainability of future pension finance.

  As the natural trends in demography are particularly resistant to government policies, other forms of government action will be needed. The unavoidable increase in retirement age is the most negatively perceived political reform, as demonstrated recently in France and elsewhere, and will not only be resisted by age groups

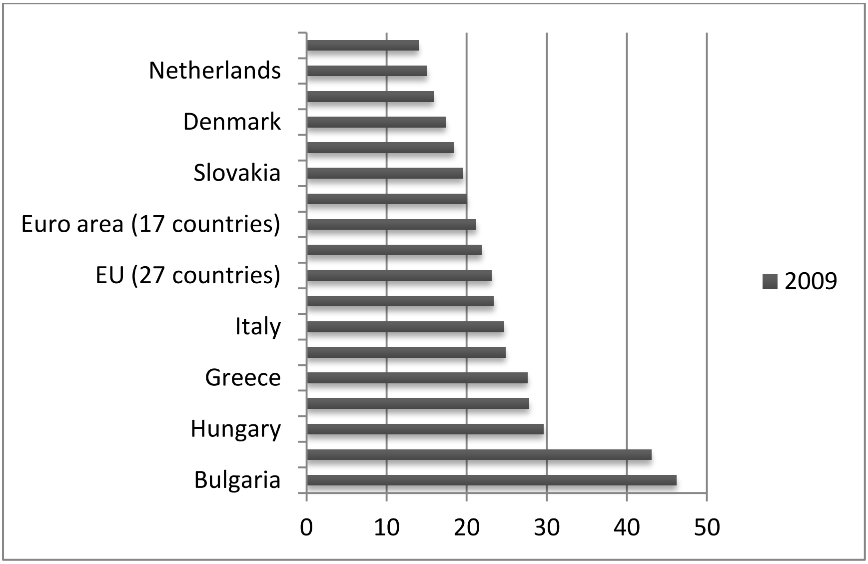

Figure 4: At-risk-of-poverty and social exlusion rate 2009, % of total population, source: Eurostat

closer to retirement but are also seen by young generations as a further impediment for them to access to jobs.

The other logical answer to the problem of ageing, namely immigration, is already an issue that is fundamentally changing the political landscape in most European countries. In some places, it is even putting the stability, identity, and cohesion of our post-industrial societies at risk. Highlighted in a recent study by Daniel Hamilton at Johns Hopkins Center for Transatlantic Relations, the European Union would need to quintuple its net immigration to maintain the current worker/elderly rate at current level. In addition, the current flow of immigration to Europe is defeating the economic rationale: The European Union is by far the largest recipient of unskilled workers. Eighty-five percent of those come to Europe and only 5 percent of them to the United States, whereas 55 percent of skilled migrants aim for the United States and only 5 percent to the European Union.[3]

Should these corrective policies prove unsuccessful in the coming decades, the intergenerational conflicts between active and retired generations can lead to fundamental shifts in the structure and productivity of the welfare state as we know it.

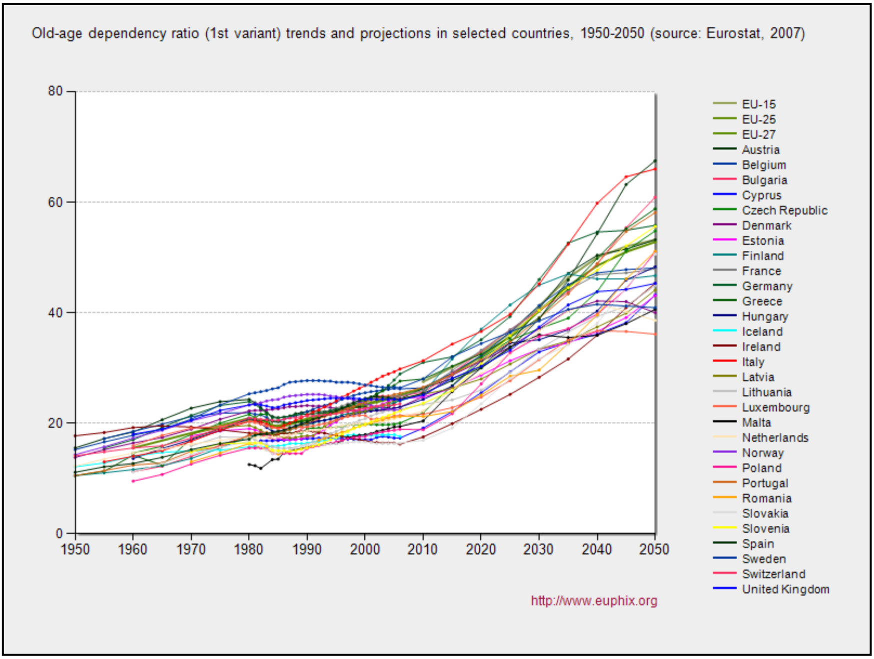

Figure 5: Old-age dependency ratio (1st variant) trends and projections in selected countries, 1950-2050, source: Eurostat

[3] Daniel Hamilton: Europe 2020: Competitive or Complacent, SAIS CTR/Brookings Press, 2010.

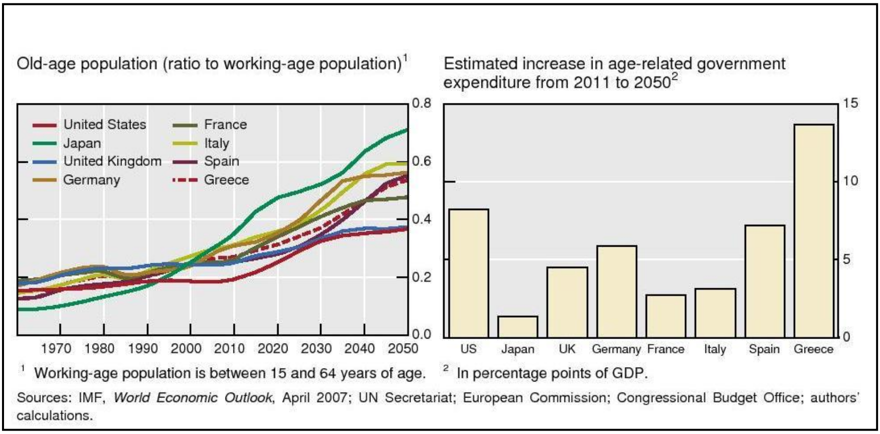

Figure 6: Projected population structure and age-related spending, source: Bank of International Settlements[4]

- Populism, Protectionism, Isolationism, Nationalism. The social and economic tensions exacerbated by the crisis are awakening well-known political reactions of the past. With the decline in consumption and consequent existence of overcapacities in every segment of the economy, the natural instincts of protectionism quickly rise from their grave. With all sorts of international trade regimes in place, the modern form of protectionism is the manipulative currency devaluation. Trade and currency wars are often the anteroom for aggressive nationalism or xenophobia through which political tensions are channeled by opportunistic political players. The recent conflicts around the Roma communities in France, Romanian migrant workers in Spain, the Danish attempt to suspend the Schengen rules in the face of unwanted immigration, the rise of the radical right-wing parties in core European countries, the anti-multinational rhetoric and

[4] http://www.bis.org/publ/othp09.pdf.

measures in Hungary, the historic-nationalistic war-of-words between German and Greek tabloids, all provide a glimpse to the threats that may come further down that road.

All of these movements, prejudices, and actions have political roots that pre-date the crisis, but their political receptivity has grown substantially of late.

- Global rebalancing of power. In terms of global governance, Europe's clout is diminishing. As experienced at the Copenhagen Climate Change Summit, the G20 meetings, energy policy in terms of Russia, trade and exchange rate policy towards China, the European Union and its larger member states are often unable to act as a cohesive and assertive union. This hurts the European Union's ability to deal with the threats and opportunities presented by the ongoing process of globalization.

The crisis after the crisis management

These five key trends are not meant to be Malthusian forecasts. Clearly those risks all can and should be dealt with through a systematic approach over a longer period of time and with the help of sustained high quality governance.

In order to be able to face those challenges, both the member states and the European Union have to find their way out of the current financial crisis. The tailor-made message delivered by the crisis to Europe: it is vulnerable because of a half-hearted, half-considered, half-explained, and, therefore, half-finished integration. Half-hearted, because of the continuous struggle among nation-state realism, idealistic federalism, and mandarin-wise supranationalism. Half-considered, because politically viable options often collide with technocratically optimal solutions. Half-explained to voters because political elites found it cumbersome and risky to involve the electorate. These voters therefore, have shown little interest in the complexities of the European integration process. For all these reasons the project of European integration is half-finished.

Since its inception, the European method of incremental, consensus-seeking decisionmaking based on the ‘lowest common denominator’ principle – makes the European Union an organization that often can develop its structures only under the pressure of a crisis.

The member states at different stages of integration have a tendency to move ahead only on those areas where political consensus can be built and leave behind those unresolved questions, which encounter political difficulties. This method, by nature, leads to incomplete or suboptimal solutions as an output of the amalgam of interests of 27 countries. In fact this method, while the only possible way to achieve and sustain this unprecedented degree of nation-state integration, is also directly responsible for many of the crises that the European Union has been facing in its history.

However the founding fathers in the ongoing creation process of the European integration envisioned a tricky counterbalance to these imperfections: it is practically impossible for any member state to return to a lower level of integration, or to leave the union because the losses suffered would by far outweigh the gains of not pushing through to the next level of integration.

A typical product of this whole process is the European Monetary Union, which was created without a properly functioning fiscal union. Under the historic circumstances at the time, it seemed still a better idea to go forward with a half finished structure than giving up creating something that had so much sense from the political and economic point of view. And the founding fathers of the Maastricht treaty probably thought that while this is as far as they can go at that given point in time, their successors will be there to solve the next issues with a direction to more integration.

The current crisis is developing along the lines of conflict between the increasing pressures of financial markets normally driven by the basic instincts of greed and fear, on the one hand, and the conviction of the dominant players in the European Union that they are already far beyond what is feasible politically in terms of solidarity and common European interest on the other. This tension is best described by the motto, attributed to a highly respected European leader: “We all know what we need to do, what we don’t know is, how to get reelected, if we do what we need to do.”

There is a temptation to translate this sentence as a cynical outburst of the principal-agent problem of elected politicians. Such interpretation is, however, misleading and unfair. An alternative and more realistic translation of this sentence is that the workings of democracy mean that only those technocratically sound solutions can prove to be sustainable for which politicians of a given era are able to obtain a clear majority mandate from voters.

So the question is rather whether those politicians try to swim with the natural wave of public sentiment or more courageously try to build majority support for what they believe is the right thing to do.

The political consequences of economic necessities

The things that we all know we need to do are mostly the logical consequences of the combination of fiscal, financial, and competitiveness factors that are threatening the European Union with a severe loss of its current standing in the world and at home.

1. Survival of the eurozone

All eurozone members (and probably all EU members) need to pay for the mistakes of the past. The creation of an imperfect monetary union was a mistake of everyone around the table, and subsequent short-term compromises have exacerbated the problems. It is also important to note here that there has been no country in the eurozone that has not benefited from the euro – and its potential to breakup could also cause enormous losses.

Therefore the price of the mistakes and omissions of the past have to be paid for – in different forms – by every member of the eurozone. Those who can afford it will pay this price through additional assumption of debt. Those, who cannot take on more debt will pay in the form of extraordinary austerity and painful long term social consequences. However, it would be politically unacceptable to ask the citizens of wealthier countries to sign a blank check without an expiry date. And it would be equally unacceptable to ask the citizens of the down-and-out countries to walk into a tunnel knowing that there is no exit at the end. Only those solutions can prove sustainable that can answer both of these legitimate questions.

2. Step out of the debt spiral

The amount of debt and deficit assumed in the first wave of the crisis by all major European economies directly led to the next wave where they are managing the crisis caused by the crisis management. In their path to return to balanced fiscal policies as quickly as possible, every government in the European Union will have to reduce fiscal expenditure substantially over the coming years.

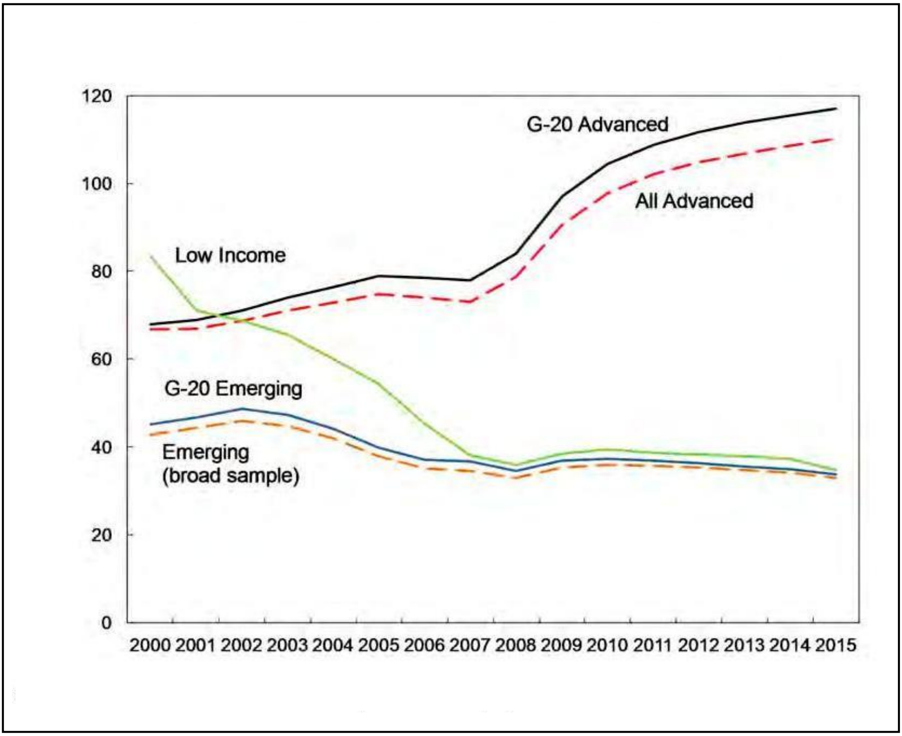

Figure 7: General Government Gross Debt Ratios (in percent of GDP, 2009 PPP-GDP weighted average), source: IMF[5]

3. Reform European welfare systems

In terms of political reforms, we need to differentiate between at least two kinds. Certain reforms are initiated in order to improve the quality of the service to public in a given field. However, more often these days reforms are initiated by governments in order to substantially cut public expenditure.

[5] http://www.imf.org/external/pubs/ft/fm/2010/fm1001.pdf.

In order to restore the sustainability of the European welfare model, which was in question well before the crisis, governments in almost every EU country will need to embark upon major systemic reforms in pension, labor, healthcare, and education sectors. These changes will aim for the creation of a mix of cheaper and more efficient systems, but will not improve the quality of service to the individual citizen. Very often they will have the opposite effect. These reforms, if not tackled wisely, or hurried because of the financial pressures, can have a negative short-term impact on growth-generating demand, a mid-term impact of social cohesion and a long-term impact on the quality of human resources.

4. Resource reallocation for competitiveness

The pressures of external competitiveness on jobs, investment, and innovation will require significant reallocation of resources from traditional interest groups to new actors who offer more competitiveness and growth-potential for the entire society. But it will be at the expense of traditional entitlements. It is reasonable to assume that the relative size of areas like education, higher education, labor market (flexicurity) programs, innovation, research and productive infrastructure will grow in importance, while other areas of classic, less productive welfare entitlements will diminish in their size in the budget. This in practice would mean a deliberate reallocation of funds from the present to the future, obviously at the expense of some important groups of interest or need. That is expected to be extremely tricky, as the debt crisis severely limits member states' ability to compensate these groups and smooth the reform process, constituting a serious impediment to structural reforms.

5. Establish a functioning system of European economic governance

In order to avoid the return of the current crisis, a more integrated European economic governance structure will have to be created. This new degree of integration assumes a previously unseen level of pooling of sovereignty and reduces the political room for manoeuvre by national governments.

The extension of cooperation and coordination to new areas of long-term and core all-European interests will, by necessity, gradually increase the role and importance of the Commission. This should be seen as a positive development. If properly done, this could also be Europe's subconscious answer to the recently much-praised mandarin-style Chinese method of governance of state affairs, in terms of longer-term planning and continuity beyond the individual, short-term political cycles of constituent member states. The critical difference, however, is proper democratic legitimacy, accountability and control.

The European Union and its members, while overrepresented in global institutions, are collectively punching below their weight on strategic interests, value promotion, and issues of global significance. Preserving influence while standing ready for global institutional reform is of fundamental importance also because the European Union could serve both as a useful role model and an experiment for regional and global governance institutions and techniques. Therefore a reassessment of and focus on the international, third party, and global issues, where the European Union should be more than a sum of its parts, is an urgent need to give boost to restore the weight of the external representation of the union.

Ever closer union

European policymaking over most of its 60-year history has only been in detached, indirect contact with the two most important real-life factors of politics: voters and markets. With the current crisis, these actors have discovered that the gradual transfer of powers to the European level means that solutions to their core problems are increasingly to be found in Brussels instead of national capitals. With this realization they will start to demand direct interaction and influence. But while this demand is emerging quickly, to supply a "European political space" with voters able to apply a more direct leverage, with matching functioning institutions and efficient decision-making processes that are transparent, democratic and accountable will be an uphill struggle.

As for the markets, the European Union is in the process of introducing governance structures that will be closer in terms of efficiency to what exists at the national level today. That in fact means a reverse interpretation of the principle of subsidiarity: decisions should be raised up to the level where competence exists to deal with them. With the monetary union as the platform for financial markets, all communication and decisions that have an effect on the euro have to be made with the eurozone perspective.

However, contrary to a federal state, with the EU budget around 1 percent of GDP, this fiscal and competitiveness governance will likely remain to be setting the boundaries and framework of national fiscal decisions. At the same time actions will be worked out and decided at the national level – within the timelines and barriers of the agreed framework.

This however has a direct consequence on the other political actor: the voters. For the electoral base of European political parties, austerity means giving up social entitlements; structural reform means changing the way they used to live; reallocation means sacrificing existing benefits for long-term goals; and more integration means more distanced and less controllable political leadership.

Taken together, the consequences of this long adjustment process is a daunting task for any politician in the coming years. The understandable and recurring disappointment of large groups of politically active citizens will create an unstable political environment in the coming decade. As the democratic political mood keeps shifting, we may expect governing coalitions to collapse, unusual grand coalitions to form, traditional parties to split, unexpected new political forces to rise, street demonstrations to become regular, and more frequent elections to be held in many countries in Europe.

In addition, the inevitable new structures and regulations on enhanced European economic governance mean in practice that democratically elected ‘heads of state and government’ have two lines of accountability instead of one. The first is a traditional reporting line to the home electorate, which is the master of the original mandate and which expects the political leader to represent national interests. But the new rules also establish clear accountability towards the wider all-European interest represented by 26 peers in the Council.

Moreover, the Commission, even more remote from voters, is acting in more and more new functions as an outside controller and regulator of governments, especially in member states with weaker institutions. That process threatens the Commission to slip into the usual role of the IMF as ‘the bad guy’, always delivering the bad news to national audiences. This in turn can easily lead to the alienation of public opinion from the European idea.

With the process of the ‘ever closer union’, many aspects of sovereignty have been pooled step-by-step. But fiscal policy is a jump. Fiscal policy is at the core of the political system. It means wealth redistribution: how much we take from certain groups of citizens, and how much we distribute to certain other groups in our society. And, of course, the approach to fiscal policy is the most obvious differentiating factor between political movements in their constant competition for votes. By giving up a large portion of their room to manoeuvre on these very core issues, governments of member states would significantly reduce their ability to reflect the democratic pressures of their national electorate and thereby create a significant bottleneck in the workings of democracy.

It is thus understandable that there has been such hesitation to take this jump of sovereignty pooling. Yet the already accepted new measures like the European Semester and the Euro Plus Pact are in effect delivering home most of the needed changes. National budgets and reform plans will now be reviewed by the Commission and peer governments before they are discussed in national parliaments. Consequently, any further progress in fiscal integration will push Europe towards political integration and make a shift from the current rather confederative mode of operation towards a more clearly federative system.

Notre Europe, a think tank led by the great European Jacques Delors, called on the European nations to stop defending the illusion of their sovereignty: "The illusion that sovereignty can be maintained in today's world without having limits imposed upon it still persists. This will only change when the right to veto is relinquished and joint sovereignty is fully accepted in situations that require a common solution."[6]

However, European integration is not yet prepared for this inevitable shift. Many symbolic acts and events reflect this, like the decisions of the German Constitutional Court on further expansion of the bailout mechanism, the low (43 percent) turnout at the 2010 European parliamentary elections, the increasing influence of anti-European parties in national parliaments, the polarizing public mood between northern and

[6] http://www.notre-europe.eu/en/axes/europe-and-world-governance/works/publication/reshaping-eu-us-relations-a-concept-paper/ .

southern Europe, and the new doubts around the Schengen zone. These are warning signs that the much-needed and unavoidable process of fiscal (and political) integration faces challenges that could possibly sink the whole boat, if it is not done at the right pace and with the right method.

Many historic examples, most vividly the recent horrors of Yugoslavia, point to the fact that even the most reasonable economic and political unions cannot be sustained if there is no proper democratic legitimacy behind them. So it will not be enough to find an appropriate answer to the crisis of the euro. That solution will inevitably be a new and higher level of political integration at core issues of sovereignty and a mechanism of continuous democratic legitimacy for core decisions at the European level.

Conclusions

The crisis of 2008 has made it clear: Europe needs to step up to the next level of integration, in which it is able to deal with the pressures of markets and the demands of voters. The solution of the euro crisis and the need to regain competitiveness will generate demand for further changes, going well beyond financial stabilization.

The European institutions will need to gain more competence in two aspects: to react faster and more robustly to economic challenges and to ensure continuity in the face of the short political cycles of member states.

This new level of integration needs to be able to enforce common agreements for the common benefit.

The democratic legitimacy of decisions needs to be strengthened through the amendment of political processes to obtain more direct and obvious support from national electorates.

Charles Darwin noted once: “It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change." Europe, as always, is in transit towards an 'ever closer union'. Every reasonable interest is pointing towards maintaining and strengthening integration.

However, Europe is facing difficulties and looking ahead in ways unparalleled in its short history. There is no guarantee that it will survive. History books are replete with momentary lapses of reason, when public emotions acted against public interest. It is the ultimate responsibility of present and future political leaders to channel emotions and explain the greater interest.

The political leaders of the next decade will have to face up to three major tasks in the process of delivering the inevitable change. First, they need to make sure that the painful period is as short as possible. Second, they need to make sure that the necessity of the sacrifice is accepted, and the burden fairly distributed. This will preserve social stability. Third, and above all, they need to make sure that all this effort will ultimately be worthwhile for the citizens of the European Union.

Social Investment: The EU 'Gold Standard' and the Key to Future Prosperity

Vanessa Rossi and Stephanie Hare

The European Union urgently needs to adopt an EU-level 'gold standard' for social investment in human capital based on a substantial expansion of crossborder education and training schemes. This would guard against the potentially debilitating effects of fiscal austerity by ensuring that opportunities in education, life-long training, and EU job markets would be open to *all* EU citizens. The target would be to create a stronger base for a skilled and mobile continental labour market, benefiting job seekers and employers alike. Furthermore, such a programme would enhance both short and long-run growth prospects and make an important contribution to EU integration and social stability. An annual investment of just 40 to 50 billion euros (about 0.3 percent of EU GDP) could offer as many as four to five million full and part-time crossborder placements each year, generating an 'alumni tsunami' and significant contributions to skills formation, mobility, and reductions in youth underemployment. Such a labour-intensive programme might support as many as a million full and part-time jobs in the education sector and expand the EU economy by more than 0.5 percent over a five-year timeframe, with continuing gains thereafter.

All EU member states are under pressure to ensure that public finances meet agreed-upon prudential guidelines by 2014-15.[1] But such a dash for austerity risks indiscriminate cuts in spending. Popular concerns typically focus on the most immediate impacts, especially the threat to jobs together

[1] Plans for fiscal tightening must aim at meeting the target of stabilising public sector debt (as a share of GDP) by 2014/15. This is also in line with the plan for fiscal consolidation proposed by Germany and the United Kingdom (and agreed) at the Toronto G20 ('Toronto Summit Declaration', 27 June 2010).

with health and welfare programmes, which tempts governments to make heavy cuts in the short-term in areas where negative impacts are less apparent. Public sector investment is therefore particularly vulnerable – reducing expenditure on both physical capital (infrastructure projects) and human capital (education and other social investment) – even though such investments are critical to future productivity, growth, and prosperity, and act to spur private investment.

Various studies have suggested that economies with high levels of public debt typically suffer a negative impact on their long-run trend growth rate: reductions in all forms of public sector investment are likely to be an important contributing factor to this observed weakening in trend growth. Such risks are particularly grave for the most indebted countries, which will have to generate primary budget surpluses over many years in order to reverse the rise in total debt. However, even some of the wealthier EU states (such as Germany, France, and the United Kingdom) are vulnerable given short-term fiscal pressures.

The threat posed by budget cuts to a wide range of social programmes has already been widely discussed, leading many commentators to argue that social spending should be protected on a very broad basis, namely that Europe needs a Social Pact and Solidarity movement, not just fiscal rules. Nevertheless, such discussions often become complicated by the conflation of various aspects of social and economic policies. In addition, it is virtually impossible for fiscally constrained governments to avoid cuts in some of the largest components of public sector spending. Nor can the European Commission take up such a broad role, if only because budgetary resources are extremely limited.

However we believe that a sharply focussed ‘gold standard’ programme for social investment is not only justifiable and affordable but good value for money. It is also readily actionable, for example, through a radical expansion and consolidation of existing successful EU schemes, primarily the European Commission's popular flagship European Region Action Scheme for the Mobility of University Students (ERASMUS), which already assists with exchange programmes for more than 200,000 students every year on a budget of less than 500 million euros. Indeed, this concept could be seen as a bolder version of the recent European Commission proposal "Erasmus For All" (submitted for discussion in November 2011).[2]

A commitment of this type would help safeguard investment in human capital and avoid divisive divergences in education, skill formation, and employment opportunities for EU citizens. Particular aims, within a limited budget, could be to actively encourage:

- Training in sectors and countries where there are labour shortages, or expected shortages. Information and computer technology, and healthcare are often cited, especially in northern Europe;
- Acquisition of skills that help to promote the emergence of a more unified and mobile EU labour market.

Targets could be pursued through differential levels of grants and/or close cooperation with careers and jobs advisory services.

Notably, such developments would at least start to address valid criticisms that, in contrast to the United States, Europe has a fragmented, inappropriately skilled, and insufficiently mobile workforce that generates grossly divergent unemployment rates under monetary union – thus implying that a single currency regime is unsustainable.

We argue that a core programme should be adequately funded and actively pursued at the EU-level because of the important externalities involved in education and training: this would represent a key contribution to the future economic prospects and social stability of the whole European Union and not just to individual recipients of assistance or their home states. EU-wide costs would be containable and relatively low in comparison with

[2] http://ec.europa.eu/education/erasmus-for-all/doc/com_en.pdf.

potential returns from economic and social progress. Additional, if less tangible benefits, such as a more inclusive and resilient society, might follow.

Risks created by high debt levels and fiscal austerity

The financial crash and global recession of 2008-09 created a surge in sovereign debt which, in turn, led to an era of fiscal stringency. Tightening is essential if heavily indebted countries are to avoid:

- Escalating debt crises;
- Persistent vulnerability to future economic shocks (if governments remain policy constrained, with no room for manoeuvre);
- The emergence of an even greater threat to social investment, prosperity, and the future of the welfare state.

Apart from the concerns already expressed about detrimental effects on investment and growth from indiscriminate budget cuts, there is also a risk that the heavy focus on debt management leads to neglect of other issues. Previous EU goals – such as boosting innovation, productivity and growth, encouraging new technologies or supporting European convergence through infrastructure projects – have dropped down the list of priorities not just for cost reasons but because political leaders have been forced to grapple with recurring market turbulence, emergency funding, and the micromanagement of bailouts on a daily basis. Indeed, this highlights one of the important ways in which public sector financial woes impact indirectly on other policies: by absorbing the time and energy of policymakers.

However growth prospects and the divergence in economic trends across member states cannot be ignored. Even before fiscal austerity programmes got underway, the EU economies were displaying divergent recoveries that created tensions over the relatively high growth and falling unemployment rate of the richest states (such as Germany) compared to poor performers overwhelmed by the crisis (chiefly the southern Mediterranean states).

This situation is now being exacerbated as the weakest performers are also the most indebted states, which face even tougher fiscal tightening to curtail the rise in debt in the midst of recession or near recessionary conditions.

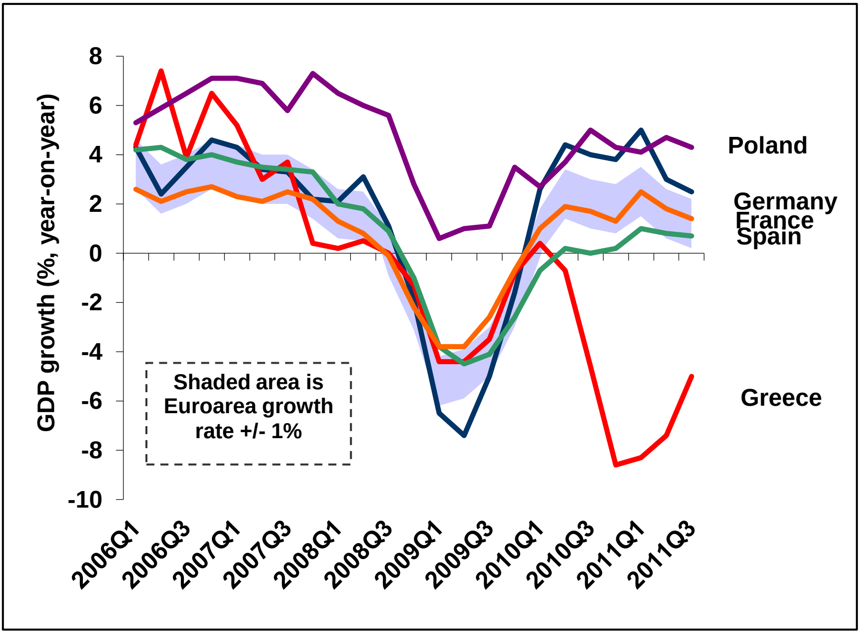

Figure 1: GDP growth across the EU shows divergence with Germany doing well and Greece the worst performer (percent, year-on-year). Source: Eurostat (2011).

This implies that the European Union's divergent (and thus divisive) economic performance looks set to persist for years to come. By extension, the weaker economies will fall even further behind over the long run if they have to cut investment in physical and human capital. Rather than achieving convergence in education, skills, and job opportunities, European labour markets risk becoming even more fragmented with increasing disparities in human capital, wage rates, and social safety nets. This is not a progressive outlook for an integrated European population, labour force, and economy.

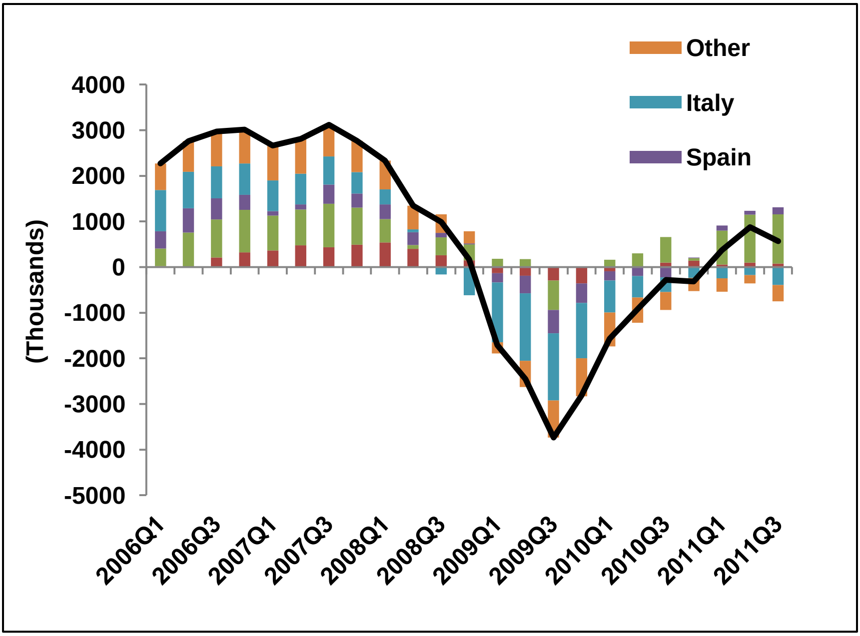

Figure 2: Contributions to eurozone net employment growth by country show improvements chiefly coming from Germany (thousands, four-quarter rolling sum). Source: Eurostat.

Economic prospects also have implications for successful debt management. The better-performing states in terms of both public sector finances and recent growth (such as Germany, Austria, and the

Netherlands) can probably cope with deficit and debt reduction programmes even if these are unpopular, perhaps even emerging from moderately tough austerity programmes after just a few years. A few states (such as Sweden) have finances strong enough that they could even expand spending. However, the combination of very high debts and poor economic performance has already led to bail-outs for the weakest EU economies and ongoing difficulties in meeting deficit reduction targets, a situation that could become worse rather than better.

All of these factors combined imply substantial 'imbalances' in the scale and impacts of fiscal austerity across EU member states. In the worst cases, it is inevitable that there will be cuts in national expenditure on all forms of investment, in the advancement of skills, technology, economic expansion, etc. In effect, not only will the hardest-hit countries face a heavy adjustment burden and recession now, but they will continue to suffer from disadvantages that will weaken their long-run growth prospects.

The risk of a vicious downward spiral in some countries needs to be taken into consideration for the sake of the individuals at risk, for the greater benefit of the European labour force, and for the coherence of the EU economy as a whole. A high priority should be given to EU-wide support for skills formation to improve the future opportunities for vulnerable citizens and to enhance economic growth prospects.

The wealthiest economies must reinforce a positive message

Only a handful of developed economies have escaped the 2008-09 financial crisis and global recession with public finances strong enough to clearly allow substantive progress with funding of pro-growth policies. For example, Sweden, Norway, Australia, and Canada still have potential to enact forward-looking programmes and investments. Within the European Union, the Netherlands (in its 2012 budget statement) has also reinforced its commitment to keep up spending on innovation and research, and member states such as Austria, Denmark, and Finland are likely to do the same. However, there is a real risk that concerns over global stability will cause even these countries to adopt overly cautious policy stances.

To combat the risk of stalled policy initiatives, those countries able to spend more on social investment should be urged to accelerate their efforts and, if possible, offer more assisted places in education and training to people from high unemployment regions. If positive signs of progress and growth were to emerge, even in just a few parts of the developed world, they would enhance confidence and encourage other countries to maintain, or even supplement, their social investment rates.

Evidence of success would also provide important confirmation that the widely assumed model for future growth in the advanced economies can work, in particular that:

- Investment in skills, technology, creativity, and development of modern industries, such as business, IT and leisure services, can be strong drivers of growth;
- Organisational skills, regulatory standards, and application of new technologies can act as key elements of mature economies' comparative advantages and attractiveness compared with fast growing emerging markets;
- Investment in education, training, and labour mobility must be pursued with vigour and supported in Europe through the expansion of current educational exchange programmes.

Forward-looking policies in the midst of fiscal austerity?

Europe must avoid the risk that the debt crisis and short-term expedients dominate the leadership’s agenda to the exclusion of other forward-looking policy initiatives. Clearly many areas of spending are under scrutiny and taxes may also rise to help rapidly reduce unsustainable deficits and debt. Some infrastructure projects will be delayed, in part because co-funding agreements may be delayed. However, it would be particularly damaging to allow human capital investment to fall behind. Even temporary cuts create prolonged and damaging effects.

Many studies cite evidence of permanent effects on the careers and lifetime earnings of young people who find their early working lives disrupted by recessions and economic hardship. A strong commitment to social investment is essential if Europe is to maintain and raise the quality of its human capital and enhance its future growth prospects. This would also directly reach out to those individuals caught up in economic turbulence.

Safeguards could be incorporated into a ‘gold standard’ social investment programme, focusing on:

- Investment in education, including support for the quality of schooling and counselling. EU states generally have high pass rates for secondary education (e.g. 70 percent or more finishing high school), especially for under-30-year-olds, but greater monitoring and cooperation across states might further improve standards. Modest levels of assistance – such as expanding teacher exchange schemes – could reinvigorate poorly performing areas, which may range from remote rural regions to inner city schools with specific needs such as language training;
- Programmes to support lifelong learning and promote labour force skills and mobility through advanced training, work experience, and language skills. These involve cooperation on schemes operated by

the corporate sector and other organisations, including dealing with issues such as EU-wide recognition of qualifications and accreditation of training. Participation in crossborder education and training schemes will also benefit some mid or late-career workers;

- Significant increases in funding for education and training exchanges across the European Union to ensure that this is not just an elitist option for a few, chosen scholars but rather a substantial programme that rapidly creates a large 'alumni' and accelerates the development of an EU-wide skilled and mobile labour force. Particular attention may be paid to so-called Science, Technology, Engineering and Medicine (STEM) subjects, with the aim of keeping the EU economies at the cutting edge of technology and boosting long-run growth potential.

A sizeable financial input is especially critical for the last programme, raising the number of participants in education and training exchange schemes. But the European Union should lend support to all of these proposals in order to boost long-run growth and reduce cross-country 'imbalances' that might otherwise create permanent pockets of low skills and mobility, lack of professional development, technological backwardness, and most probably poverty. However, the rationale for EU-level intervention in social investment programmes – as in many infrastructure projects – is largely based on the existence of important externalities that will accrue:

- There is a collective, EU-wide benefit from national improvements in education, training, mobility of labour, and increased participation rates across all segments of the population, including older age groups. For example, countries facing labour shortages would gain from being able to access an EU-wide labour force provided potential employees could offer the right technical and language skills;
- More precisely, advanced economies with an aging, declining workforce such as Germany and Italy are already bringing in foreign

labour to address specific labour shortages. The situation is likely to become more acute over the next decade: in principle, many jobs could be filled by labour from those EU states with high unemployment rates and few job opportunities. But it is essential that people are not only suitably trained to fill shortages but willing to relocate, thus EU programmes should focus strongly on encouraging those segments of the population most likely to be mobile;

- EU-led initiatives would represent a means of implementing fairer burden sharing in meeting the costs of those elements of social investment that most benefit all states. EU-supervised programmes would aim to reduce inequality of skills and opportunities for EU citizens but they would also ensure that assistance reached the designated targets and results were closely monitored.

The costs of an appropriate social investment could be controlled and kept relatively moderate compared to the risks of not intervening – and the benefits would accrue to the European Union as a whole. Indeed, cross-country effects should be particularly high for well-targeted social investment programmes.

Social investment costs and benefits – affordable proposals?

In view of the concern for social hardship and investment during the ongoing economic crisis in Europe, what type of direct-action programmes might be envisaged? What is the scale of this problem and the possible cost of action?

Perhaps the most obvious measure of increasing social hardship is the rise in unemployment. Since 2008, EU unemployment has risen by seven million people, taking the unemployment rate from around 7 percent to over 10 percent. This rise has not been uniform – some countries have fared far worse than others, with Spain particularly hard hit along with Greece, Ireland, Portugal and the Baltic economies.

One possible target for EU action could be alleviating the effects of the increase in unemployment, particularly the disproportionate increase in hardship in the worst-affected economies. Socio-economic imbalances would be too costly to fully eliminate but an ‘excessive unemployment mechanism’ could introduce forms of burden-sharing that might contain such imbalances within more acceptable bounds.

UNEMPLOYMENT: A KEY INDICATOR OF THE SOCIO-ECONOMIC EFFECTS OF THE CRISIS IN EUROPE

EU unemployment rose by about 40 percent (almost seven million people) from 2008 to a peak in the first half of 2010, when a stronger-than-expected economic recovery halted the uptrend. Now, as growth has stalled and fears of a double-dip recession are escalating, there is justifiable concern that unemployment rates will see further increases, especially in the most indebted countries where fiscal policy is under severe pressure and public sector lay-offs are not likely to be met with new private sector job opportunities.

Until 2008, unemployment rates had been volatile but generally declining from the peaks seen in the mid-to-late 1990s. The average for both the European Union and eurozone converged on a rate of close to 7 percent in 2007, contrasting with the 8-11 percent range seen over the previous two decades. Now the average rate is once more around 10 percent for the European Union (equivalent to around 23.7 million people unemployed) and the eurozone (which reported 16.3 million people out of work in late 2011).

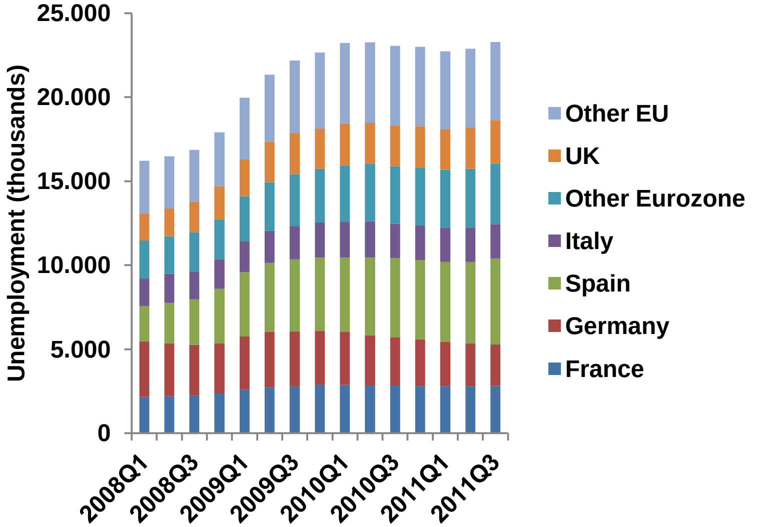

Figure 3: EU unemployment rose by about 40 percent (almost 7 million people) from 2008 to its peak in the first half of 2010, led by Spain and the smaller EU states. Source: Eurostat.

However, impacts have been far from uniform creating parallel divergence in the socio-economic impacts of the crisis. From the beginning of 2008, Spain alone saw an increase of 2.6 million, more than the 1.9 million rise in the United Kingdom, France, and Italy combined. In contrast, Germany's unemployment has actually fallen slightly, by almost 0.7 million, roughly equivalent to the total rise in the number of registered unemployed in Greece, Ireland, and Portugal. Overall, the smaller euro-area states have seen unemployment rise by about 1.2 million while the rest of the rise in unemployment (about 1.5 million) is accounted for by the smaller non-euro EU states.

There are numerous caveats about national variations in measurement methods for labour market statistics. Nevertheless, the homogenised Eurostat definitions are broadly comparable. On this measure, the highest unemployment rates are in:

- Spain (almost 23 percent);
- Latvia, Lithuania, and Greece (15-20 percent);
- Ireland, Portugal, and Slovakia (13-15 percent);
- Estonia and Bulgaria (11-13 percent);
- Hungary, Poland, and France (9-11 percent).

The periphery debtors and almost all of the countries in IMF programmes are above the EU average rate of unemployment, although it is Spain that has the worst performance (as discussed further below). France and Poland represent the EU average. On this measure, Sweden, Slovenia, Cyprus, Italy, and the United Kingdom all have slightly lower-than-average rates (8-9 percent) followed by Denmark, Finland, Belgium, Sweden, and Romania (7-8 percent). The labour markets in Germany, Czech Republic, and Malta are stronger (5-7 percent) while a few of the smaller member states still have unemployment rates below 5 percent (Netherlands, Austria, and Luxembourg).

In addition, the greatest swings in unemployment (about ten percentage points) have been in Spain (after just edging down below 9 percent in 2006-07) and Ireland (pre-crisis 4-5 percent) while Greece has risen from a low of 7-8 percent pre-crisis. In contrast, Portugal's unemployment rate has been relatively subdued historically, cycling in the 4-8 percent range, so the recent rise, although moderate, has pushed the rate up to an unusually high level.

Notably the countries with the highest historic rates of unemployment have also been Spain (rates of 15-25 percent in the 1980s and 1990s), Greece (10-20 percent rates in the period 1985-2005) and Ireland (10-20 percent from the early 1980s to the end of the 1990s). Poland’s rate was previously in the 10-20 percent range from the early 1990s to around 2005 while Slovakia also saw its rate soar into the 15 to 20 percent range from 2000 to around 2005. However, there was typically a cycle at this time among the eastern transition states, Hungary’s being masked by its low labour force participation rate. Interestingly, Italy and Belgium (both with excessively high sovereign debt) also have close-to-average unemployment rates because of relatively low participation rates.

This suggests that the countries that have been hardest hit by the debt crisis and rising unemployment already experienced persistently high unemployment in the past. That is, their relatively recent improvement in employment was built largely on the shaky foundations of cyclical industries (such as construction and other property-related activity) that have rapidly shed labour once the economies began to contract in 2008. Spain and Ireland stand out as being the EU examples of an excessive boom in the labour intensive property sector, which helped create the illusion that high unemployment rates had been turned around when, in fact, this was only a temporary boom phenomenon.

This means that high unemployment could persist even if economic growth returns to a healthy 2-3 percent per annum in these countries, presenting a more entrenched socio-economic challenge within the European Union that warrants greater attention. Policy efforts to address this problem might include increased crossborder training and mobility opportunities.

Some crude indicators of the possible costs and benefits of an EU-level ‘excessive unemployment mechanism’ can be estimated from the figures for the rise in unemployment. For example, an EU-led initiative to support job creation and work experience, which we will call ‘Plan Jobs’, could target places for seven million people, with each country’s share (gross benefit) being proportional to its increase in unemployment since 2007. This programme would be similar to the ‘Georgia Works’ training scheme for the unemployed that was launched in the United States in 2003, which has been rumoured to be a possible template for U.S. President Obama’s drive to reduce unemployment in 2012.

However, Plan Jobs might require funding of as much as 175 billion euros (close to 1.5 percent of EU GDP) for provision of one-year job guarantees at an average of 25,000 euro (total cost) per participant for up to seven million people. Based on each country’s unemployment increase, Spain might receive as much as 65 billion euros (6 to 7 percent of its national GDP), Greece about ten billion euros (4 to 5 percent of its GDP) and Ireland five billion euros (roughly 3 percent of its GDP). Such sums would provide a significant boost to the respective economies (other net beneficiaries would be the Baltic states, Portugal, and some of the smaller eastern European members). However, this plan would be costly, not fundable from the EU budget and probably not acceptable to contributing member states. Even if Plan Jobs were to halve costs by offering shorter term or less well paid work experience, it would probably remain too expensive to be adopted.

An effective and acceptable way forward could be through an extensive education and training exchange programme. This would combine the task of social investment with that of rapidly reducing underemployment, thus stimulating both short and long-term economic growth potential. The scheme would cater largely (not necessarily solely) to mobile, younger people in the 20 to 30-year age range. Benefits would be more widespread across member states than Plan Jobs. Although large numbers of participants in such schemes come from regions with exceptionally high youth unemployment rates (such as Spain, the Baltics, and the periphery debtors, namely Greece, Ireland, and Portugal), exchanges imply that training takes place outside home states, creating jobs and economic growth across the European Union.

This programme could be operated as a bold expansion of existing successful EU initiatives, primarily the European Commission's flagship ERASMUS academic exchange scheme. Indeed, following discussions in the European Parliament in mid-2011 about boosting this flagship, the European Commission has proposed a more substantive 'Erasmus For All' programme (November 2011), costing almost 20 billion euro for 2014-2020, but this is relatively timid compared with the concept outlined here. Currently ERASMUS assists over 200,000 students a year with short and long-stay exchanges at more than 4,000 participating higher education institutions within an annual cost of less than 500 million euro. The numbers of students are large in relation to the cost, although low compared with the European Union's total number of university students (around 12 million out of some 35 million under-25s in full-time education) and the number of under-25s out of work (approximately five million out of a registered workforce of about 25 million).

The new plan, which we could call ERASMUS-PLUS should take a far more ambitious approach to achieving a marked impact on the EU education and labour markets, aiming to raise annual funding to 40 to 50 billion euro (0.3-0.4 percent of EU GDP), some of which might be found by redeploying EU structural funds that some analysts[3] and press reports suggest are currently under-utilised, in part due to the impact of the crisis on the principle of 'matching funds' (this appears to be a particularly important factor behind funding cuts to Greece).

[3] For example, the Brussels think tank, Bruegel.

Compared with the existing ERASMUS scheme, the proposed ‘plus’ plan would need to allocate more funds per participant in order to encourage wider and longer duration participation, to alleviate the hardship constraints in some countries, and to meet the expansion costs of the universities, colleges, and training centres involved. Some of these extra costs might be donated by employers keen to fill skill shortages. However funding of 40 to 50 billion euros would be one hundred times greater than the current ERASMUS budget. Thus even if the average cost per participant were to rise significantly to around 10,000 to 15,000 euro (compared with the present ERASMUS average of less than 2500 euro), the extended programme might reach as many as four to five million full and part-time participants each year versus an estimated 5 million over 7 years for “ERASMUS For All”. This number of participants would have a considerable impact in a relatively short space of time, cutting youth unemployment, and creating a massive ‘ERASMUS alumni tsunami’ across Europe.

ERASMUS-PLUS could also add as many as a million new full and part-time posts. Expansion of the education and training sector would be particularly welcome as this is a labour-intensive, skilled-services industry creating the type of jobs that Europe wants in a sector in which it has comparative advantage and future ‘export’ potential.

Total direct and indirect economic gains could boost EU GDP by as much as 0.5 to 0.6 percent over a five-year time frame with further increments over the long run from the investment in skills and mobility.

To summarize, ERASMUS-PLUS should have a three-point impact:

- On raising social investment and mitigating the potential losses in long-term trend growth due to fiscal austerity;
- On reducing unemployment, especially youth unemployment in the countries worst affected by the crisis but also through job creation in one of Europe’s strongest ‘industries’, the education and training sector;

- On improving the prospects for a better skilled, more mobile, and integrated European labour force in the future for the benefit of all member states and citizens.

Conclusions

Education and training should help level the playing field for EU citizens and boost both their individual lifetime earnings prospects and the EU economy's growth capacity. It is not about subsidising member states but supporting EU-wide development of an appropriately skilled and mobile workforce. Such programmes represent good-value investment if the costs are compared with the potential returns to the economy as well as to individual programme participants.

Social investment of this kind also addresses modern economy problems such as:

- Social exclusion, which will become an even greater threat in regions facing a prolonged period of high unemployment;
- Shortages of skilled workers in specific sectors and countries and the related problem of career guidance for young school leavers;
- The future need for greater labour mobility and increased participation in the labour force to offset the impacts of population ageing.

Given the nature of these problems, it is important that a well-designed and targeted social investment agenda is pursued vigorously across all EU states in order to gain the maximum benefits and stimulate future growth in the region as a whole. Yet if poorer countries maintain spending on education and devote a relatively high proportion of their budget to this, only to see many of their most talented young people leave for higher level education and jobs in the wealthier states, this would not represent fair burden sharing. Neither would it be helpful if these countries slashed spending to meet fiscal targets, damaging the potential for their young people to participate in the wider EU labour market and reducing the growth in the EU labour force.

Externalities, as well as concerns over the differential impact of fiscal austerity, imply that EU-level funding is a fair and appropriate mechanism for shouldering at least some of the costs of training, particularly where this is targeted at exchange programmes, enhancement of portable skills and mobility across the European Union.

The European Union cannot possibly provide guarantees of equality in economic performance and living standards across the member states. Indeed, as we demonstrate here, massive employment support programmes would be costly and unlikely to gain support. But the European Union can do more to safeguard skills formation and foster mobility in the EU workforce of the future.

For Further Reading

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What the Think Tanks are Thinking: Social Europe

Amalia Khachatryan

While the deepening euro-area debt crisis has dominated the news headlines over the last year, the policy debate in Europe has focused primarily on the implementation of austerity measures to curb debt as well as the financial assistance brokered to avoid a sovereign default. In contrast, at the European level, the social consequences of the crisis and the policies implemented have received little attention. Yet the effects of the debt crisis have the potential to undermine social cohesion and political trust in the European Union and threaten the project of European integration.

The discussion about social Europe among the major think tanks addresses issues such as integration and solidarity in the European Union in times of crisis, political legitimacy, and conflicting interests at the national and the EU level, as well as social investment as the key to future prosperity. Moreover, their publications address the reform of the Stability and Growth Pact (SGP), the implementation of the Europe 2020 Strategy, and the consequences of economic policies for the labour market and migration patterns.

As analyst Daniela Schwarzer of the Berlin-based **Stiftung Wissenschaft und Politik / German Institute for International and Security Affairs (SWP)** highlights in her article "Economic Governance: Governing the EU out of the Economic Crisis", while economic governance will continue to remain high on the European Union's agenda, it may not be sufficient on its own. She argues: "With less support for integration in the public opinion and falling trust in the European Union and national institutions, on the one hand, and increasing expectations for provisions of economic wellbeing and social security by the European Union, on the other hand, it has already become important to explain why the currency union may need further steps of integration and how prospects for growth and employment can be improved."

European integration and solidarity

At a September 2011 conference addressing transatlantic economic challenges, hosted by the Brussels-based **Bruegel** think tank, Wolfgang Schäuble, Germany's Federal Minister of Finance, pointed out that "a common currency cannot survive without solidarity between its members. But such solidarity has its limits. It can only accompany a country's reform efforts, not replace them: A member state has to be willing to deal with the root causes of its problems itself. European solidarity cannot replace a governments resolve." Obviously not only highly indebted countries need to change; bureaucracy has to become more effective and less self-absorbed for Europe and its members to become more efficient.

In his short piece "Brussels Summit: The Long War Ahead", published by the **Carnegie Endowment for International Peace**, Uri Dadush, Senior Associate and Director of Carnegie's International Economics Program, points to a "change in mood as the eurozone countries realize that they can no longer go it alone on key policies." Analysing the latest European deal for Greece, he highlights the commitments to "embed structural budget balance in legislation, to base government budgets on independent forecasts, and to submit to much tighter peer review of both fiscal and structural policies. Most emblematic of the big European ship slowly shifting direction is the decision to open the door to "limited" treaty changes to enhance economic coordination.

In the June 2011 **European Policy Centre (EPC)** strategy paper, "Stronger after the Crisis - Strategic Choices for Europe's Way ahead", Janis A. Emmanouilidis and Josef Janning (with Hans Martens, Rosa Balfour, Yves Pascouau and Fabian Zuleeg) also argue that if European leaders do not succeed in re-energising European integration, the European Union will lose relevance for its citizens and become marginal as the principal instrument shaping their future. Hence, “it will not suffice to merely follow a reactive approach aimed at papering over the cracks. Once the sovereign debt crisis is contained, the European Union will be in dire need of proactive projects that could reignite integration, rebuild consensus, and attract and tie the leadership ambitions of its key actors on both the national and European level. For Europe to remain relevant, leaders could choose among four potential strategic projects: (1) the completion of a truly integrated internal market; (2) the establishment of a common migration and asylum policy; (3) the revitalisation of the European social model through a common vision of a ‘Social Europe’; (4) the establishment of a Defence Union.” Nevertheless, the broadness of these suggested alternatives is indicative of the lack of clarity over the priorities that might emerge post-crisis.

Thomas Klau, Head of the Paris Office and Senior Policy Fellow at the **European Council on Foreign Relations (ECFR)**, in a November 2011 commentary for the London-based ECFR entitled “A Deepening Crisis Requires Further Integration” is more specific. He highlights that “establishing a eurozone treasury as part of a European executive body controlled by European parliamentarians” may become a longer-term solution for stability in Europe. He argues that “the current fragmentation of executive, legislative and judicial power in the eurozone has led to enormous uncertainty among investors who are often quite clueless about the real distribution of power in the European Union. And if national policymaking finds itself subjected to new jointly agreed eurozone constraints or new obligations to exercise eurozone solidarity, then that shrinking of the democratic space at national level must be counterbalanced by an expansion of the scope for democracy at the European level of policymaking."

The journal ***Social Europe***, in collaboration with Germany's **Friedrich Ebert Stiftung**, underscores the view that "the continued soul-searching of European social democracy remains high on Europe's agenda." In the winter/spring 2011 issue of the journal entitled "A New Age of Global Responsibility" Pierre Moscovici, Member of the French Parliament, takes stock of the European left and suggests new policy directions to build the "Good Society" while Paul Collier of Oxford University looks at alternative development models and examines European democracy versus Asian autocracy.

Political power, democratic legitimacy, and conflicting interests

The challenges in institutional terms are also significant. In strengthening the governance of the eurozone, there must be clear democratic legitimacy for any measures introduced. The **European Trade Union Institute (ETUI)** policy brief by Christophe Degryse and Philippe Pochet entitled "Monetary Union, Economic Coordination and Democratic Legitimacy", argues that the legitimacy question will determine the acceptability of emergency measures among European populations and thus account for the long-term sustainability of the solutions proposed for dealing with the crisis.

Financial constraints also feature in think tank policy analysis. For example, in "Europe Must Unchain Itself to Save Itself", Jean Pisani-Ferry, Director of **Bruegel** and Professor of Economics at Université Paris-Dauphine, argues that Europe "has enough resources to resolve its current crisis but an extraordinary series of constraints means it has to turn to emerging economies for help." The paper examines ways in which Europe could unlock these constraints.

Andrew Watt and Sotiria Theodoropoulou of the **ETUI** highlight their view of the consequences of austerity measures in a paper entitled "Withdrawal Symptoms: An Assessment of the Austerity Packages in Europe". Based on a survey of national experts, the paper evaluates the austerity packages that the EU member states' governments have devised in response to the financial crisis and recession. This study raises doubts about the drive for austerity. The authors seem convinced that austerity will be counterproductive: while it is widely believed in policymaking circles that "austerity is necessary for consolidation, and consolidation necessary for growth and jobs, Europe needs to grow out of its public-sector deficits and debts, which resulted from the failings of an unregulated private sector, especially in finance. To do that it needs to invest without delay. The Europe 2020 goals are highly unlikely to be achievable in a context of persistently sluggish growth and regressive distributional tax-and-spend policies and cutbacks in areas such as public investment, education and active labour market policy."

In the working paper "How Effective and Legitimate is the European Semester? Increasing Role of the European Parliament", Benedicta Marzinotto, Guntram B. Wolff, and Mark Hallerberg of **Bruegel** conclude that "member states are only slowly internalising the new procedure. The Semester has so far lacked legitimacy due to the minor role assigned to the European Parliament, the marginal involvement of national parliaments, and the lack of transparency of the process at some stages. Finally, there remains room to clarify the implications from a unified legal text." They argue that the role of the European Parliament is important to hold the Commission and the Council accountable.

In the October 2011 **Centre for European Policy Studies (CEPS)** policy brief "A Call to Members of the European Parliament: Take Transparency Seriously and Enact the 'Legislative Footprint'," Lukas Obholzer of the London School of Economics and Political Science and

Centre for European Policy Studies (CEPS) also argues that in the light of recent events and closed-door meetings, the European Parliament fails in its role as “a guarantor of legitimacy in EU decision-making”.

Indeed, a number of references are made to the fact that members of national parliaments feel that they have little control over decisions taken in Europe although they need to defend these decisions with the same vigour as they adopt for national laws they vote for themselves. In a **Centre for European Reform (CER)** guest essay, Denis MacShane, a Labour MP from Rotherham, argues that “this gap is now a major part of the growing deficit in democratic confidence in Europe. MEPs need to be in tune with the democratically elected governments of the countries they represent, or the legitimacy of European Union institutions will be called into question. Popular confidence in the European Union will erode unless national parliaments are treated as partners rather than afterthoughts”, he concludes.

Looking ahead to Europe 2020

Discussions about the Europe 2020 Strategy as part of the EU economic governance package and the successor of the Lisbon Strategy have also attracted considerable attention. In the lead-up to this year’s spring European Summit, the **European Trade Union Confederation (ETUC)** and **ETUI** published the 112-page “Benchmarking Working Europe 2011”, which critically assesses the foundation of the strategy with its strong emphasis on fiscal consolidation but neglect of the need for economic growth and quality jobs. Several of the contributions to this collection of essays suggest that it is by raising social and environmental standards, and thus wellbeing, that Europe might succeed in achieving a sustainable growth pattern and a healthier and more cohesive society for the future. The authors emphasise the danger that if the (macro) economic policies pursued are wrong, other targets in the Europe 2020 strategy, such as raising education standards, increasing R&D spending and reducing poverty, may prove illusory and will further undermine the credibility of Europe. Proposed plans should be technically correct and internally coherent to avoid a very basic loss in confidence: preferably they should be able to deliver at least a marked improvement in performance according to the targets set.

The **Lisbon Council for Economic Competitiveness and Social Renewal**, a think tank and policy network, also kept the Europe 2020 Strategy as the focus of research. “An Action Plan for Europe 2020: Strategic Advice for the Post-Crisis World”, the policy brief produced in March 2011, reflects upon the challenges ahead, and offers strategic advice on how to attain Europe's key targets and goals. It includes contributions from international scholars and experts such as Enrico Giovannini, Parag Khanna, Wim Kok, Alessandro Leipold, Ann Mettler, Geoff Mulgan, Andreas Schleicher, Martin Schuurmans, Mark Spelman, Sören Stamer, Žiga Turk, and Harry Verhaar.

In the May 2011 working paper “Have the Euro Area and EU Economic Governance Worked? Just the Facts”, Demosthenes Ioannou and Livio Stracca of the **European Central Bank (ECB)** examine two key elements of the European Union and euro-area economic governance framework, namely the SGP and the Lisbon Strategy. Their findings indicate that economic governance in the European Union and the euro area has had limited or no success. It concludes that the SGP has had no overall effect on the behaviour of the primary balance. While it has increased the counter-cyclicality of fiscal policy, it has also increased its sensitivity to the political business cycle. The authors also conclude that the Lisbon Strategy has had no impact on the behaviour of real per capita GDP growth, employment growth, or labour productivity trends.

Christophe Degryse (Observatoire Social Européen, OSE) and David Natali (University of Bologna-Forlí) in the **ETUI/OSE**-published book *Social*

Developments in the European Union 2010 also examine the ways in which the European Union has tackled the fiscal crisis, the first steps towards implementation of the Lisbon Treaty, and the launch of the EU2020 Strategy. This twelfth annual report examines a number of aspects including the risks for the European social model and European integration project, the state of the debate on revision of the SGP, the impact of the economic and financial crisis on pensions, the new ‘EU employment policy roadmap’ and, more generally, the tensions, risks, and opportunities generated by Europe 2020.

The **Lisbon Council** policy brief on “Human Capital Leading Indicators: How Europe's Regions and Cities can Drive Growth and Foster Social Inclusion”, produced by Peer Ederer, Philipp Schuller and Stephan Willms in February 2011, concluded that while human capital is a key component of European development, the Europe 2020 strategy should “contain more precise targets and recommendations for regions and regional policymakers if it hopes to be effective.” The study evaluates human-capital endowment, utilisation and productivity in detailed case studies of seven European cities and regions, namely Bratislava, Emilia-Romagna, Helsinki, Navarra, Sofia, Stockholm, and the West Midlands area in the UK. Based on the assessment of the important role played by local decision-making in the success of human-capital policies, it recommends that “cities and regions should appoint regional human capital managers to coordinate, evangelise and implement better human-capital creation and deployment.”

Growth, social policy, and well-being in Europe

A task force comprised of the **ETUI, ITUC, Global Union Research Network (GURN),** and **Trade Union Advisory Committee (TUAC)** was established to define the parameters of a new growth model. With a preface by U.S. economist and Nobel Prize laureate Joseph Stiglitz, the initial results have been published in the book *Exiting from the Crisis: Towards a Model of more Equitable and Sustainable Growth,* edited by David Coats of The Smith Institute, London. It includes contributions from more than 30 authors, who take up the challenge of developing progressive alternatives to the failed neoliberal model that has dominated economic policy for over three decades.

"Inequality, Poverty and the Crisis in Greece", a policy brief by Manos Matsaganis and Chrysa Leventi of the **Athens University of Economics and Business**, calls for "a concerted effort to tighten the social safety net and shield the weakest groups from its adverse effects to prevent the economic crisis from turning into a social catastrophe." The paper looks into the distributional and social consequences of the austerity packages for the Greek population. It concludes that as a result of austerity and the wider recession, 5 percent of the Greek population saw their 2010 incomes fall below the 2009 poverty line, swelling the ranks of those who were already in poverty (another 20 percent of population).

Similarly, the "Well-being 2030: A New Vision for Social Europe" issue paper produced by Claire Dhéret and Fabian Zuleeg together with Serban Chiorean-Sime and Elisa Molino of the **EPC**, encourages policymakers at both the national and EU levels to ensure that "social policy both contributes to increasing people's resilience to cope with social risks and has a positive impact on the key determinants of well-being, without compromising the sustainability of European welfare models." This final paper summarises the key findings of Well-being 2030, a two-year research project co-funded by the European Commission and the European Policy Centre, an independent, not-for-profit think tank committed to European integration.

Published within the same framework of the Well-being 2030 project, the new issue of **EPC**'s *Challenge Europe* entitled "Growth, Well-being and Social Policy in Europe: Trade-off or Synergy?", addresses the question of how social policy can be converted into an effective productive factor to foster economic growth and advance the well-being of Europeans. Based on the argument that social policy can contribute to long-term sustainable growth, this multi-author publication focuses on those policies, that might bring the most added value to a citizens' lives. It explores possible synergies between growth, social policy and well-being, as well as policy areas where intervention can be most effective such as employment, education, healthcare, and others. The authors of the publication also look at the EU's room for manoeuvre and propose policy recommendations.

Social investment in Europe

Linked to the growth and well-being of European citizens, social investment is another key element in the European dialogue on social consequences of EU economic governance. **EPC**'s "Growth, Well-being and Social Policy in Europe: Trade-off or Synergy?" highlights that "investments into areas such as education, health or housing should not be seen as a drain on the public purse but as factors which can contribute to future economic performance – in other words, there is a real return for society from investing in people both in economic and financial terms. Investing in human capital is the only way to mobilise the productive potential of citizens, to make them more resilient to social risks such as long-term unemployment and become therefore an asset for the economic development of a country. If these social returns are taken into account, more investments will lead to better outcomes for society as a whole and will be financially sustainable as they will increase the number of taxpayers and reduce the need for future corrective interventions."

In "Towards a Social Investment Welfare State? Ideas, Policies and Challenges", published in November 2011, authors Nathalie Morel (**Sciences Po**), Bruno Palier (**Sciences Po**), and Joakim Palme (**Uppsala University and Institute for Futures Studies, Stockholm**) also scrutinise the question of social investment looking at the recently promoted European 'social investment' strategy and its potential to regenerate welfare state, promote social inclusion, create more and better jobs, and help address the challenges posed by the economic crisis, globalisation, ageing, and climate change. To assess the diversity, achievements, shortcomings and potentials of social investment policies, the book brings together leading social-policy scholars and well-known policy experts, connecting academic and policy debates around the future of the welfare state.

Migration and open borders in the EU

Discussion of the social consequences of EU economic governance and the current crisis has also included the issue of migration and open borders, especially in the aftermath of the May 2011 Danish initiative. Since then, the new government in Denmark has repealed the move to install permanent controls, including customs houses and video surveillance. However, this initiative alarmed not just Brussels but also travellers and business associations EU-wide. A paper by Peter Hobbing, former official of the European Commission and an Associate Senior Research Fellow at **CEPS**, argues that the reintroduction of internal border controls violates EU treaty legislation, no matter whether the measures are based on Schengen or customs provisions. In addition, such border-based checks are highly inefficient compared with modern cross-border cooperation among law enforcement authorities.

The **EPC's Task Force on Temporary and Circular Migration** investigated whether temporary and circular migration policies are part of the solution to sustaining Europe's economic and social models. The March 2011 working paper "Temporary and Circular Migration: Opportunities and Challenges", by Sheena McLoughlin and Rainer Münz with contributions from Rudolf Bünte, Göran Hultin, Wolfgang Müller, and Ronald Skeldon, presented both the challenges of migration (e.g. the need to prevent exploitation of migrants and incentivise return to countries of origin) and the opportunities (e.g. the potential for development in countries of origin).

In the commentary “Internal Border Controls in the Schengen Area: Much Ado about Nothing?” Yves Pascouau (EPC, June 2011) analyses the conclusions of the European Council on this specific issue. The author concludes that while strong conditions were indeed put forward by the European Council, there is no assurance that the recommended mechanisms will be adopted and implemented.

Ten years ago, the Lisbon Treaty promised to enhance the Union’s institutional and legal framework. But despite the provision of new instruments it became increasingly evident that the means available at the European level are insufficient for the European Union to confront its current challenges. While the European Union has recently made references to 'Social Europe' in some of its major strategic frameworks including the Europe 2020 Strategy, its leaders, however, focused more on restoring economic recovery and budget consolidation without notable effort to provision for measures to cushion their impact on social issues.

Will Europe be able to sustain continuing economic integration – and can it do this without further political integration? Is the treaty-based integration process flexible enough to cope with rapidly emerging global challenges? Will the EU governments succeed in restoring mutual trust and can they narrow the gap between national capitals and ‘Brussels’? Will the member states be prepared to set aside national interests and transfer more power to the European level? Which social and economic model would make Europe more competitive, and more resilient? Germany’s social-market, export-led model fared well and rebounded with even lower unemployment rate than before the crisis. The Nordic economic model has also proven its stability in times of the global crisis, as underscored by Anders Borg, Minister for Finance of Sweden, at the 10th Munich Economic

Summit in 2011, organized by the **BMW Stiftung Herbert Quandt** and the **CESifo Group**.

In view of the crisis and its implications, these questions need urgent answers. If we fail to address and effectively respond to these issues and fundamental challenges, the whole process of European integration will be thrown into question. Perhaps the most common ground across studies can be found in the view that growth and employment strategies will require specific emphasis on investment in skills and policies to increase labour market participation and citizens' mobility – and that without growth and jobs, there is little chance of progress in terms of other agendas.

From Beauty to Beast: The Euro and the Future of the Old Continent

Paul Hockenos

David Marsh, *The Euro: The Battle for the New Global Currency* (Yale University Press, New Haven and London) 2011, 384 pages.

Johan Van Overtveldt *The End of the Euro: The Uneasy Future of the European Union* (Agate Publishing, Chicago) 2011, 223 pages.

Matthew Lynn, *Bust: Greece, The Euro, and the Sovereign Debt Crisis* (John Wiley & Sons, Hoboken, NJ) 2011, 282 pages.

For an informed layman trying to get one's head around the euro crisis, it seems that no matter how conscientiously one struggles to keep up with the flood of articles, op-eds, and news reports, an intellectually satisfying bigger picture of the community's worst moment can be elusive. The whole remains frustratingly less than the sum of its parts for mortal non-economists. One doesn't have to be an economist however to grasp that Europe's currency and debt crises are existential to the fate of the European Union, and even the stability of the global economy. We're all in on this, and one desperately wants to be the wiser about it.

Thus we can be grateful for a first round of new books about the crisis, fresh off the press and penned by economic journalists who know the field as experts and write in language that non-experts can comprehend – and even relish. The London-based David Marsh has written for *The Economist* for years and lectures across the world on Europe's economy (His *The Euro* is a revised and updated edition of his classic work, first published in 2009.); Matthew Lynn, also a Brit, is a witty, erudite commentator for Bloomberg with years of experience, and even several novels to his name; Johan Van Overtveldt is editor-in-chief of Belgium's leading weekly on business and economics. Their prose is lively, their portraits' of the players – from *Bild-Zeitung* to the Papandreou family – are rich, and most critically, they start at the beginning of the whole story, providing key historical background rather than picking up at the latest new turn in the crisis. One reservation, though, is that they all come to much the same conclusions, especially in terms of the euro being a mission that was bound to fail and the sooner tossed into history's dustbin the better.

Of course, it's always easier in hindsight to detect the inherent flaws and acquired deformities of a policy when its consequences are wreaking havoc across the globe. Many observers were party to the initial euphoria around the launch of the single currency in 1999 – and it is instructive to examine, as do Marsh and Van Overtveldt in some detail – the tempting advantages that its advocates, which included many highly respected economists, saw in the project at the time. These perks of monetary union remain valid today, which is why the zone members aren't willing to pitch the whole kit-and-caboodle just yet. The question is whether they can get it to work to realize these virtues without bringing down the entire project of European integration.

Indeed, there are a host of undeniable benefits that currency union brings like-minded states that regularly do business with one another (just look at the United States). In the case of the European Union, advocates underscored that the euro would break down the last barriers to the free movement of people, goods, and capital among its cohorts, facilitating even further business within the common market, the world's largest trading bloc. The elimination of costly and time-consuming currency conversion boosts economic efficiency and makes prices readily transparent, which lowers prices and thus ameliorates inflation.

Critically, replacing national currencies with one money eradicates fluctuating exchange rates, which had in the past proved easy pickings for currency speculators – and hurt most those economies with weaker, vacillating currencies like the southern Europeans. Thus exchange rate risks and national currency crises would be banished forever. Moreover, the creation of a single, autonomous central bank, the European Central Bank (ECB), promised to eliminate competition between states and reduce uncertainty. No longer would sound economic policy be subject to fleeting political whims. Its model would be Germany's hard-nosed Bundesbank, the rock upon which the country's economic *wunders* had been built.

Moreover, since its earliest days in postwar Europe, integration has always been about more than money. Many figures, like the europhile heavyweights German Chancellor Helmut Kohl and French presidents François Mitterrand and Jacques Chirac, saw the euro as the final brick in the postwar edifice that had brought unprecedented peace to its members. The single currency was to be the pinnacle of Franco-German reconciliation and pave the way to a political union. Among other bonuses, this would bind mighty Germany once and for all. Europe also envisaged the euro as a rival force to the dollar, lending the eurozone states more gravitas on the world stage.

The three-stage creation of the European Monetary Union (EMU) was agreed upon in 1992 at Maastricht, a Dutch city in the border regions of the Netherlands, Germany, and Belgium. The treaty set budgetary, debt, inflation, interest rate, and other convergence criteria as goals to narrow differences between the future eurozone members. According to the treaty, only countries that met these criteria could be part of the euro. In order to encourage budgetary discipline – an essential safeguard, everyone agreed – countries would be fined for annual deficits larger than three percent of

GDP. Yet these essential conditions would fall by the wayside en route to the present mess.

On January 1,1999, exchange rates of the original “euro-eleven” were locked in place, kicking off the EMU. As Lynn describes in detail, Greece was not one of the initial eleven because it did not meet the EMU criteria. In fact, its economy – reliant on agriculture, shipping, and tourism – wasn’t close on a number of the preconditions, such as budget health, outstanding debt, and inflation, to name three biggies. The Germans and other northern Europeans were fiercely adamant that the Greeks not join. And, indeed, because of these inadequacies, Greece was turned down for the EMU in 1999. As Lynn argues: “Greece didn’t just fail by a little. It failed by a mile.”

Three years later the EMU’s crown jewel, the euro itself, was introduced as a freely circulating physical currency, namely as euro notes and coins. (Greece was one of the 12 there to celebrate, having ostensibly made up so much ground so quickly that it was accepted into the EMU one year before the euro’s launch). This grand experiment called the euro, Marsh describes as an incredible “bloodless, noiseless, bureaucratic revolution. But it was a revolution all the same: an unprecedented, self-willed abrogation of state prerogative.”

And the euro jumped off to a superlative start. In bolstering the internal market for European commerce, the euro fortified European firms’ competitiveness worldwide – and exports as well as imports to and from non-euro states soared between 1999 and 2010. Inflation was low across the entire zone and capital markets functioned more smoothly. The euro expanded the size and liquidity of the continent’s financial markets: investors from around the world channelled excess savings into the euro, argues Marsh, which “contributed to a sizeable fall in borrowing costs for the poorer-performing euro states.” Those countries that in the past had endured high inflation and instability, like the southern Europeans, enjoyed access to previously unthinkable interest rates, which enabled the likes of Ireland and Spain to bankroll enormous housing booms.

And the euro sheltered its members from wild fluctuations in the dollar, which in the past had sent shock waves through European economies. The eurozone weathered nearly a decade of crises, from the after effects of 9/11 to the financial meltdowns of 2007 and 2008, with flying colours. The euro shielded the smaller countries from global turmoil, something that non-euro countries like Hungary lacked, and was ravaged as a result. Cyprus, Estonia, Greece, Malta, Slovakia, and Slovenia, eagerly joined the euro club in the course of the decade.

“It is one of the greatest success stories in the history of the European community”, gushed Germany’s finance minister, Peer Steinbrück, in 2008. Just months before the crisis broke in Europe in 2009, the European Commission was unqualified in praise for its precocious creation: The euro “has clearly become the second most important currency in the world; it has brought economic stability; it has promoted economic and financial integration, and generated trade and growth among its members; and its framework for sound and sustainable public finances helps ensure that future generations can continue to benefit from the social systems that Europe is justly famous for.” As Lynn puts in a typical piece of his wonderfully off-the-cuff prose: “If it was possible for a currency to pull on a cozy pair of slippers, make a cup of hot chocolate, pull itself up by the fire, and start reading the gardening supplement in the newspaper, then that is what the euro would be doing.”

So good did things look, safeguards such as keeping to yearly budget deficits of less than three per cent of GDP were completely ignored – and broken – by almost every country, not least and early on by Germany and France.

The euro’s early smooth sailing whisked away the resounding criticism that an array of experts had previously levied against monetary union.

Critically, a single monetary policy conducted by an independent, supranational central bank, like the ECB, takes key levers out of the hands of national policymakers. This relieves them of the ability to set interest rates and devaluate currency, which had in the past been used in very different ways by the countries joining the monetary union, who had different growth and spending patterns, and dissimilar business cycles.

As much sense as a single monetary policy can make, experts warned, it can only succeed among nations with like-minded monetary *and* fiscal policies. This was basic economics that was recognised in the (mostly unheeded) Maastricht conditions. Otherwise, a “one-size-fits-all” monetary regime may be just right at one time for one set of countries, while handcuffing and imperilling others at just the wrong time. The ECB set a single monetary policy in an economic area that had diverse economic, budgetary, and regulatory policies, which were determined by 17 independent national governments.

In the past, for example, Germany, notorious for its tight money policies and historic fears of inflation, pursued conservative monetary and fiscal policies, which produced low and stable inflation, and higher personal income. The guardian of these policies in Germany was the politically independent Bundesbank, Germany’s central bank. On the other hand, the southern Europeans tended to fight economic slowdown by liberal government spending and increasing deficits – and in crises devaluing the currency in order to sink production costs and thus prime exports. Their lower-growth economies lived with high inflation and currency fluctuations, as well as politically managed central banks.

Economists understood from the beginning that imbalances between countries could doom the whole project. The Maastricht treaty indeed set some significant, if minimal criteria. But with bookkeeping slights-of-hand nearly every country had fudged the EMU’s convergence criteria, including for deficit levels, assets, and expected revenue.

Greece was a blatant offender. Between 1999, when it was turned down, and 2001, when it qualified for the euro, “something very mysterious happened”, writes Lynn. “The Greek economy completely transformed itself. Just like that.” The budget deficit fell to 1 percent of GDP while inflation plunged to just 5 percent. In fact, desperate to super-charge its economy into Scandinavian-style prosperity, the Greeks cooked the books. It “cheated and lied its way into the single currency”, writes Lynn. Brussels wilfully closed its eyes.

Not everybody was so accommodating. In Germany, 155 university professors issued a public letter pleading for the EMU’s postponement. They argued vigorously for an even higher bar that included standards for a strong political union with automatic fiscal transfers and flexible, mobile labour markets. Britain opted out of the euro, among other reasons, over concern about these omissions.

Critics charged that a functional monetary union required common trade, finance and budget, and social and wage policies. And this high degree of economic coordination was in effect possible only in a full-scale political union – a tightly knit federation of some sort. But it was no secret that the vast majority of EU Europeans had no appetite for a political union, that bit even further into national sovereignty. Pro-EU politicos knew this very well, but gambled that putting the cart before a non-existent horse, namely monetary before political union, would produce a horse.

Van Overtveldt piles the blame on the euro’s political architects, who either knew well – or should have known – that a single currency under flawed conditions could blow up in their faces, be it sooner or later. The political elite, he claims, “paid elaborate lip service to these warnings, insisting that these conditions were unnecessary. Showing persistence and unity, they claimed, would automatically turn the EMU into a strong monetary union – and further more, the political cooperation required to operate the EMU project efficiently would lead to political unification.”

As of 1999, the fixed exchange rate was valid for every eurozone country. But this rate – and ECB policy in general – ended up basically that of the Germans, the euro's undisputed anchor. The eurozone's tight, low-inflation monetary policy resembled the Bundesbank's postwar policies closer than the French or anyone else had ever imagined possible. As both Marsh and Van Overtveldt argue, the French in particular saw the euro as a way to undermine the powerful Bundesbank's conservative ways. Thus for the eurozone's peripheral countries, like Ireland, Portugal, Spain, and Greece – and France and Italy, too – the exchange rate was much too high. In effect, the D-mark had replaced the drachma.

This priced many of their goods and services out of business on the international market. Damaging their competitiveness even further was the failure to reform labour markets. Greece and Portugal, for example, thus lost out to the Central Europeans who had lower labour costs and just as much human capital.

But these countries had access to money at virtually the same, for them, rock-bottom prices that the Germans could borrow at, regardless of their financial circumstances. The Europe-wide fall in market interest rates and risk premiums to German levels, argues Marsh, that accompanied the start of the single currency "was used in the more inflation-prone peripheral countries not to build up productive capacity and prepare economies for the challenges of technological change and foreign competition, but to fuel wasteful consumption and speculative purchases of financial assets and real estate whose values subsequently plummeted."

The euro, explains Lynn, was in effect "a massive scheme for recycling money from the core of Europe to its periphery. … The euro turned half the continent into creditors, the other half into speculators. The banks were playing middlemen, collecting extravagant fees, and racking up enormous debts on their balance sheets that were sustained only by the absurd valuations put onto property assets at the height of the bubble.” As it happened, it was first in Athens where debts started falling due.

Yet, while they were riding high, the eurozone “success stories” of Ireland and Spain made headlines everywhere. These countries (the so-called Club Med countries) experienced credit booms during the first eight years of the century that enabled unusually high growth rates and higher inflation, which sparked off increasing balance of payments deficits. Since internal transfers in such cases weren’t part of the Maastricht blueprint (every nation for itself when it came to budgets), these had to be paid off by foreign borrowing. The bond markets had always assumed that a bailout was in the offing, should worse come to worse, even if everybody had sworn the very opposite. That’s why the markets bought up Greek debt without thinking twice about it. Across the south, budget deficits soared, financed by foreign banks and other institutions that saw no currency risk.

Meanwhile, the Germans were sitting pretty. They experienced lower growth and inflation rates, which resulted in greater competitiveness and enormous surpluses. Between 1999 and 2010, for example, Germany’s exports to Greece, Ireland, Portugal, and Spain nearly doubled. Exports to China increased tenfold. The surpluses were channelled back to the poorer states in the form of credit. This argues Marsh effectively poured “oil on a slow-burning monetary fire”.

Even as early as 2006 the writing was on the wall: Greece, Portugal, and Spain ran up some of the world’s largest balance of payments imbalances. Domestic spending was rapidly outpacing domestic production. As Van Overtveldt puts it: “excessive credit creation fuelled inflation, which in turn contributed to wage increases that hurt competitiveness. Combined with mounting government deficits, these developments jacked up current account deficits.” The fiction that the eurozone was on its way to becoming one big economy was never openly challenged, even though the economic upheaval raging elsewhere was aggravating the underlying imbalances within the euro area.

When the great recession finally reached Europe's shores, the eurozone's dirty laundry was suddenly open to public viewing and the crisis escalated at warp speed. It opened in Greece with Athens's admission that its 2009 budget deficit would at least quadruple the Maastricht stipulations. But "let there be no mistake", argues Van Overtveldt. "If Papandreou hadn't confessed … something else would have sparked the sovereign debt crisis in Europe. The situation had become untenable, and Greece was just the tip of the iceberg. The discovery of Greece's chicanery drew almost immediate attention to a host of major problems within the euro area, from huge imbalances in current accounts to the fragility of Europe's banking sector."

Lynn agrees whole-heartedly with Van Overtveldt on this point and makes the case strongly (and several times over): "It was a crisis that was hitting most of the eurozone, and indeed most of the developed world. They had all been borrowing far more than they could really afford. And, like a new, virulent virus, the crisis was about to hop from one nation to the next." The euro countries' financial systems had become so interconnected that should one or two go down the tubes, the others would go with them – or at least pay an extremely high price. Although Lynn's book focuses on Greece, he does an equally good job with the problems in the other southern countries and Ireland, too.

When Papandreou let the cat out of the bag, the prices of its government bonds, the chief means to cover deficits, soared. The markets, by isolating and attacking Greece, quickly pushed its debt costs beyond Athens's reach. This is exactly what happened to the other Club Med countries and what's happening to Italy today – the bond spread increases made their financing costs unbearable. The single currency didn't abolish national credit risk, as everybody thought it would, but shifted it to another venue: from currencies to national debt. The financial markets saw these countries' solvency in jeopardy and the days of easy credit skidded to an end. One bailout followed another: Greece, then Ireland, then Portugal, and then Greece again.

The peripheral countries, argues Van Overtveldt, were trapped by policies that “focused solely on lending money against promises of austerity and structural reforms. The contradictions inherent in this approach turned this precarious situation into a highly destructive cycle.” Lynn is of the same opinion: “The Greeks are now stuck in an inflationary trap from which there is unlikely to be any escape.” The same goes for Spain, Portugal, Ireland, and Italy: “Their economies were shrinking, there was little prospect of any return to growth, and governments were struggling to keep under control deficits that were already too big…. When prices start falling, then the debt problems become even more acute, because of course while the total amount you owe remains the same, wages and prices, which provide the money to repay the debt, start to fall. Even if you keep up the payments, your debt mountain keeps growing every year. You have to run faster and faster just to stay where you are.”

Both Van Overtveldt and Marsh bring the euro saga up to summer 2011 (Lynn to mid-2010), and even though much has happened since then – like the trillion-euro bailout package, debt relief, and new fiscal coordination and crisis resolution mechanisms – their dire conclusions remain valid.

Marsh is the more pessimistic of the three, although not by much. He believes that economic policies need nation states, especially when things go awry. “The battle to maintain the euro as it was originally conceived has been lost”, he argues. “The repercussions of the financial crisis on Europe – even though it started elsewhere – will prove longer-lasting and more pernicious than on America.”

The euro’s structural flaws made the present crisis inevitable and the nature of the EMU makes them irresoluble, Marsh concludes. The major creditor nations and those who have profited most from the strong-currency policies – Germany, above all, as well as the Netherlands, Finland, Austria, and Belgium – are unlikely either to relinquish the one-size monetary policies that fit *their* economies. And although they might dig deeper into their pockets to bail out the peripheral countries, these loans simply sink them further into debt and render them unable to restart their economies. The hundreds of billions provided by the European Financial Stability Facility (EFSF) heaps debt upon debt and traps them “in a vicious circle of economic decline and growing financial market suspicion that loans will not be repaid, generating self-fulfilling consequences.”

The other possibility, namely to buckle down and create a political union capable of transferring taxpayers’ money between the zone’s have and have-nots, is simply not on the cards. Perhaps a bit too hastily, Marsh writes off real economic governance as a mirage. Rather, the upshot will be a Germany-led Europe in which the area’s most muscular economy sets policy for the rest of the eurozone – or those who opt to remain in it. This is the exact opposite of what the French and others envisioned when they originally pushed the idea of monetary union.

Van Overtveldt agrees that the present course of loading debt on the fringe countries will bury them for many years to come. The harder they try to meet the demands imposed upon them, the more debt will escalate and the deeper into recession will they fall. Thus the odds increase that these countries sink into chaos and the EU with them. But Van Overtveldt outlines a way forward that he calls “back to square one”. He believes that completing the EMU – fulfilling those criteria that many experts deemed essential ten years ago, and a few additional ones as well – can lay the foundations for a sound monetary union. These conditions include political union, fiscal integration, labour mobility, and price and wage flexibility.

He sees the initiatives taken in this direction in spring and summer 2011 as encouraging, even if too meek. And the monumental task of pushing through tighter political and fiscal union lies ahead of them in an atmosphere of ever greater national acrimony. Above all he's worried about Germany, where a change in popular support for the European project as a whole could derail the entire enterprise.

That would seem unlikely, particularly in light of Merkel's new-found resolve since *The End of the Euro* was published. Germany probably won't withdraw from the eurozone, as Van Overtveldt suggests possible, but rather its bull-headedness could drive other countries out. Many experts today are suggesting this would be best for Greece for this very reason; it desperately needs back the monetary levers it lost to the EMU to address its crisis. Merkel's recent initiatives, like forcing banks and other creditors to slash the Greeks' debt in half, indicate a commitment to the European Union that all three authors underestimate.

But Merkel has been at least one step behind the careening crisis from the beginning, and has displayed little aptitude for the kind of innovative thinking or tough-minded decision-making required. Merkel and her European peers have done next to nothing about providing the over-indebted euro countries with a road map to get their economies back on their feet and address the skewed monetary policies that landed everybody in this mess. This means formulating a convincing strategic vision for the future and not just half-measures to patch up the blunders of the past.

As for Lynn, he thinks the sooner the euro is trashed, the sooner the Europeans can begin to move forward again. There are no insuperable challenges to breaking up the eurozone, he claims. Can Greece recover within the confines of the euro? No, he concludes. Greece, he argues, "is locked into a currency union with northern Europe, with which its economy is fundamentally uncompetitive. Although it could theoretically fix that by savagely cutting wages, that doesn't appear realistic. … There was nothing in the country's history, economy or political system to suggest it was willing to endure the kind of grinding austerity for a generation or more that would be necessary to make its industry competitive with Germany and France within a credit union."

Lynn outlines some different scenarios for the euro, short of trashing it, that he thinks the euro ideologues might try before dismantling it. One is creation of north and south eurozones, namely two euros. The southern euro, comprised of the Club Meds plus maybe Cyprus and Malta, would be called the *medi*. The *medi*, he suggests "would depreciate sharply against the northern, but otherwise all the advantages of having a currency that straddles several countries could be maintained." The southern currency would be weaker than the euro but far stronger than a third-league, little national currency. Likewise, the northern countries would be relived of responsibility for subsidizing their poorer member states. The idea is not so crazy.

This crisis has already Europe's prestigious confederation: The bloc's power centre has shifted irreversibly (to Germany), newly created institutions and regulations further centralise policymaking (opposed by most Europeans), and loud anti-EU voices in its own ranks (some belonging to ugly populists) have been immeasurably bolstered. A dark irony, the historic experiment in supranational cooperation seems to have triggered not greater harmony and European loyalty, as intended, but rather it has amplified their antitheses, namely dissidence and strident nationalism.

There is no end in sight to this Wagnerian drama, no matter how many billions more Nicolas Sarkozy and Angela Merkel throw in the direction of Greece or Ireland, or now even Italy. In fact, as three of these excellent new books agree, their austerity prescriptions for these reeling nations may well even exacerbate the crisis. The authors blame the euro's fall not on speculators or bond markets, who they let off the hook a bit too easily, but on fundamental structural flaws in the monetary union itself, deficiencies that must be addressed at their source if the currency has any chance to make a comeback.

Europe’s beautiful project, the quintessentially civilised mission of uniting a peaceful and prosperous continent, is on the rocks, a debacle ultimately brought on by its most ardent enthusiasts. Neither the unambiguous warnings of whole teams of top-flight international economists nor the elementary laws of macroeconomics deterred them from forging a monetary union and common currency among 17 extremely disparate economies, from the Levantine island of Cyprus to oil-rich Norway. The ancient Greeks called it hubris, and thus perhaps it is fitting that the tragedy of the euro opened in Greece, even if it isn’t the culprit for bringing the Old Continent’s grandest success story to the brink – and maybe even to ruin.

Abbreviations

AGS	Annual Growth Survey
AMECO	Annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs
CEO	Chief executive officer
CEPS	Centre for European Policy Studies
CER	Centre for European Reform
ECB	European Central Bank
ECFR	European Council on Foreign Relations
EEG	European economic governance
EFSF	European Financial Stability Facility
EMU	European Monetary Union
EPC	European Policy Centre
ERASMUS	European Region Action Scheme for the Mobility of University Students
ESM	European Stability Mechanism
ETUC	European Trade Union Confederation
ETUI	European Trade Union Institute
EU	European Union
FTT	financial transactions tax

GDP	Gross domestic product
GIIPS	Greece, Italy, Ireland, Portugal, Spain
GURN	Global Union Research Network
IMF	International Monetary Fund
NGO	Non-Governmental Organization
OECD	Organisation for Economic Co-operation and Development
OSE	Observatoire Social Européen
MEP	Member of the European Parliament
PPP	Purchasing power parity
SGP	Stability and Growth Pact
STEM	Science, Technology, Engineering and Medicine
SWP	Stiftung Wissenschaft und Politik / German Institute for International and Security Affairs
TFP	Total factor productivity
TUAC	Trade Union Advisory Committee
ULC	Unit labour costs
U.S.	United States of America
VAT	Value added tax

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