NEW SOURCES
of COHESION

Social cohesion
in Europe after the crisis

Knut Dethlefsen, Janis A. Emmanouilidis,
Achilleas Mitsos, Antoinette Primatarova,
Radomír Špok, Paweł Świeboda (ed.)

Social cohesion
in Europe after the crisis

Knut Dethlefsen, Janis A. Emmanouilidis, Achilleas Mitsos, Antoinette Primatarova, Radomír Špok, Paweł Świeboda (ed.)

This report concludes the project on "New Sources of Cohesion" which has been the result of cooperation between Centre for Liberal Strategies, demosEUROPA – Centre for European Strategy, ELIAMEP, European Policy Centre (EPC), Europeum and Friedrich-Ebert-Stiftung. The authors would like to thank numerous experts who offered invaluable advise in the course of the project. Special thanks are expressed to Dr Konrad Niklewicz and Krzysztof Blusz who coordinated work on the public opinion survey. This project was executed with the support of the Europe for Citizens Programme of the European Union.

In the last few years, Europe has been forced to re-think its socio-economic model. Social indicators speak for themselves. Real household income declined significantly between 2008 and 2012, employment rates are lower and the number of people in poverty saw a steady rise with a growing divergence between EU countries.

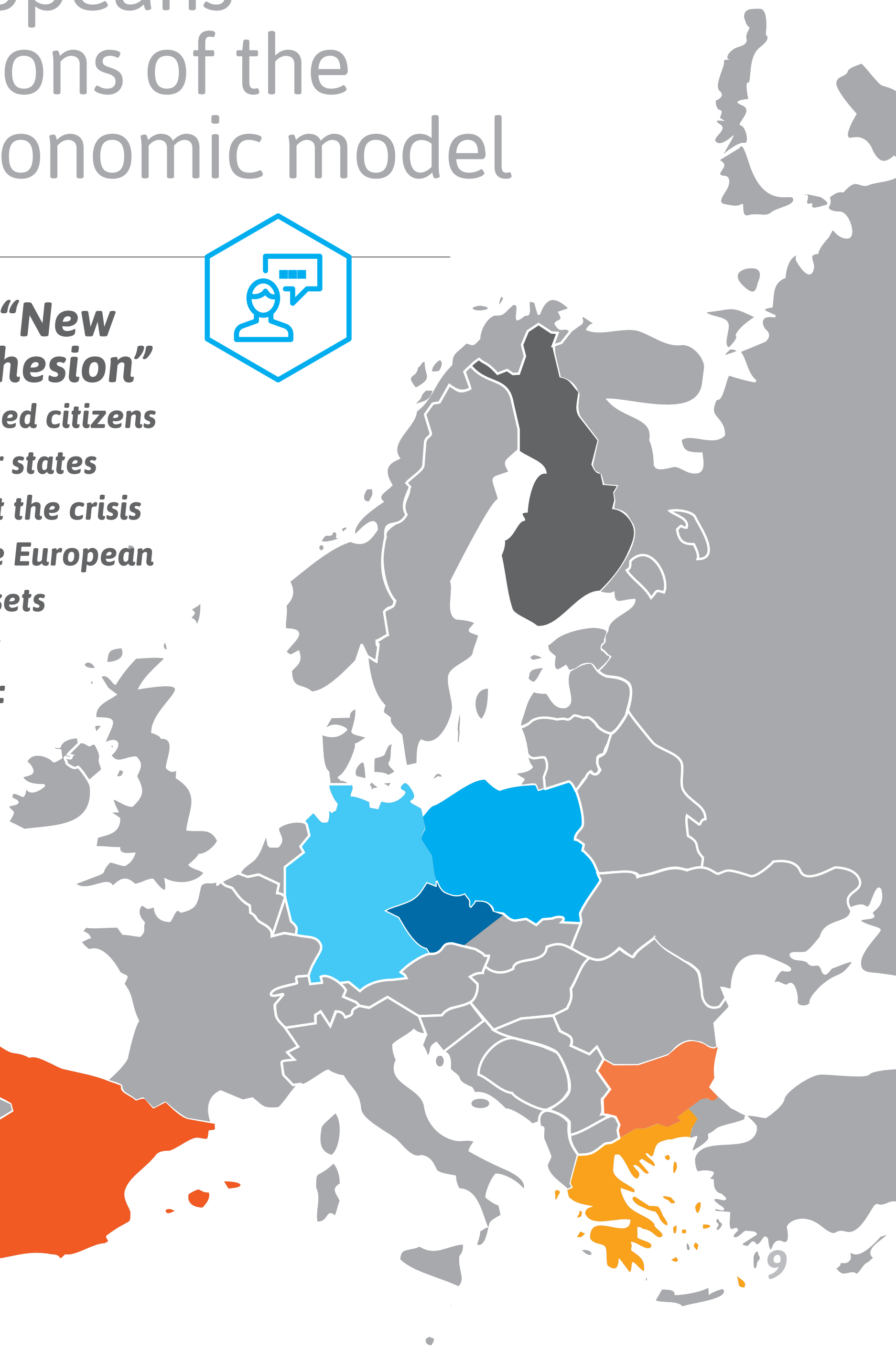
In the eurozone, cuts in public spending and internal devaluation have been the main tools to aim at a correction of unsustainable fiscal positions and a strengthening of competitiveness. It has carried a heavy social price tag. Outside of the eurozone, austerity has also been the prevailing policy, seen as inevitable to avoid economic instability. The crisis has not hit everyone equally. The general losses have been high, but there have also been some quite important redistributive effects. With all the difficulties of defining and measuring 'fairness', it is clear that the adjustment has not been equitable. Apart from issues of market failure, there have been direct increases of inequality within each of the member states. Higher poverty rates have been observed, rises in inequalities between higher and lower income earners as well as intergenerational inequalities between age groups. Long-term consequences are only beginning to surface in the public debate as the most immediate pressures of the crisis are slowly overcome.

In this report, we first of all look at the results of the survey we have carried out in seven European countries and review perceptions of the socio-economic model. Subsequently, we assess the importance of the social dimension in the broader context of the European growth model. We discuss the impact of the structural challenges of globalisation, demography and technological change. We then review the EU's performance in the crisis. Finally, we make a number of recommendations on how to bridge the gap between Europeans' expectations and reality.

The European socio-economic model – *perceptions & realities*

Plus ça change… The Europeans` perceptions of the socio-economic model

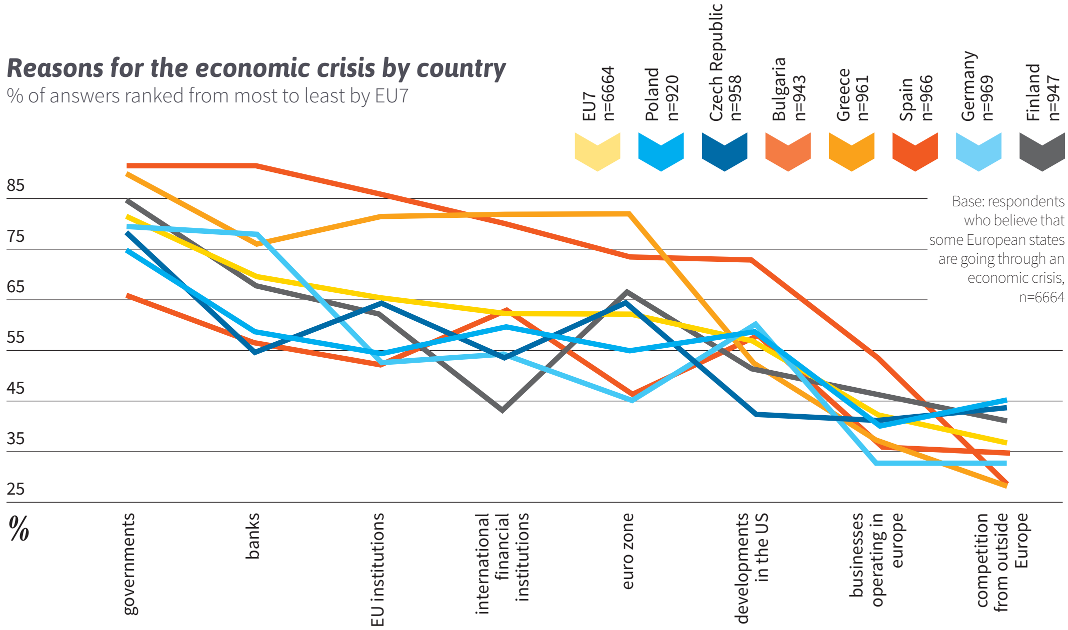
As part of the "New Sources of Cohesion" *project, we have asked citizens in seven EU member states for their views about the crisis and the future of the European social model[1]. Four sets of findings stand out from what we heard:*



1. the crisis is largely seen as a self-inflicted wound. Even though its origins can be traced to massive leveraging engineered by the financial industry in the United States, the Europeans attribute responsibility for the crisis to their national governments, banks and the European Union respectively.

Reasons for the economic crisis by country

% of answers ranked from most to least by EU7



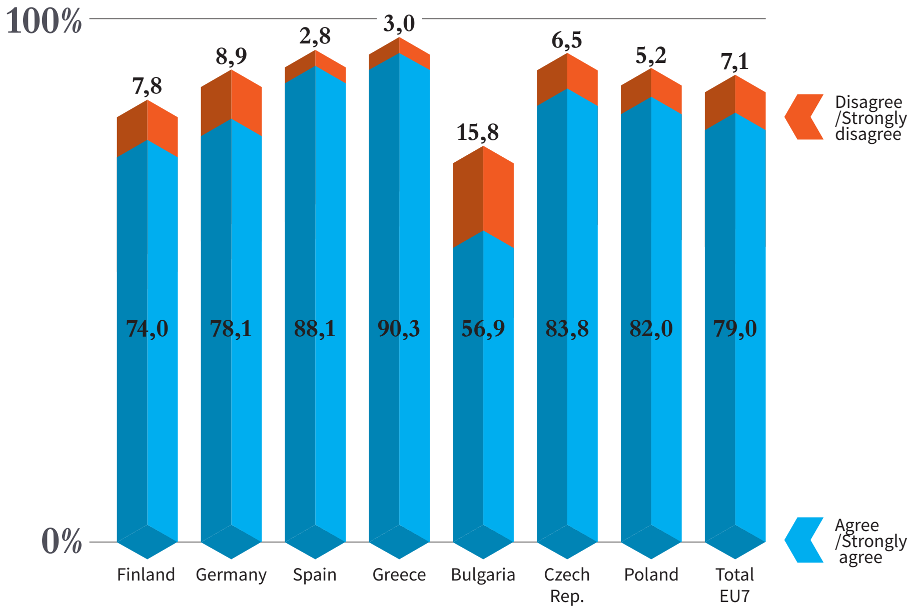
Base: respondents who believe that some European states are going through an economic crisis, n=6664

2. the public has now largely accepted the need for fiscal consolidation, which has been at the heart of the political discourse in the last few years. In our survey, 79 per cent of respondents agree that their countries' public debt is too high and needs to be reduced.

Public debt

Question:
Do you agree with a statement that your country's public debt is currently too high ?

(% of answers)



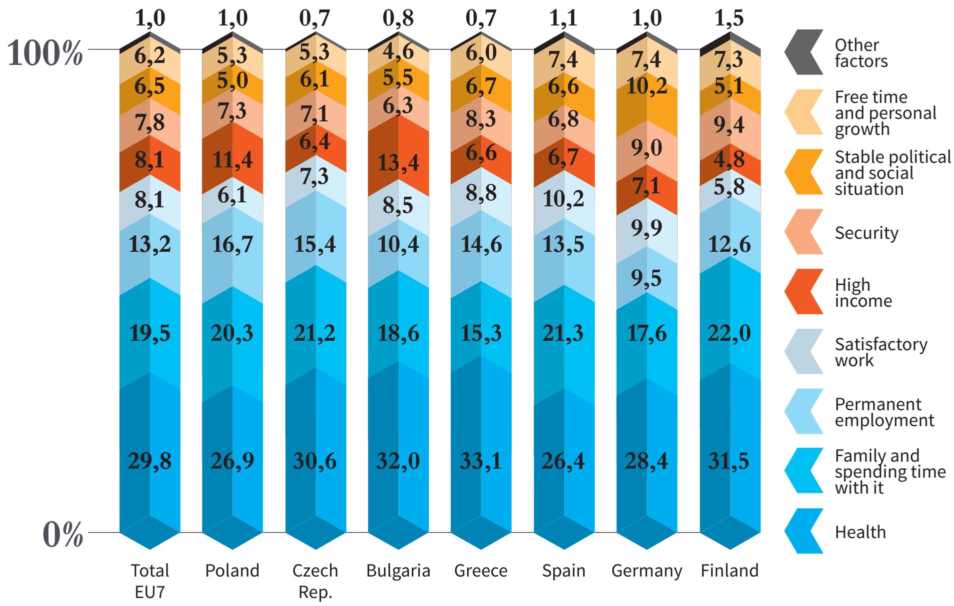
Base: all respondents, n=7000

3 › the Europeans from the seven countries polled declare quality of life, rather than material prosperity, to be their main aspiration, with health referred to as the most important determinant of the former. It follows that, in their view, social services should expand, even if at the expense of cuts in expenditure in other areas, including in public administration.

Importance of factors that influence 'quality of life'

Question: Below is a list of factors that may or may not influence your quality of life. For each factor, please indicate its importance by distributing 100 points among them.

Base: all respondents, n=7000



Finally › there is a yearning for the European Union to become more active in the social dimension, almost as if to compensate for the austerity, which had been prescribed in reaction to the crisis. An active EU role could take the form of a budgetary response such as an EU automatic stabilizer, or some other direct way of delivering (limited) funds to alleviate the most adverse social consequences of the crisis.

The role of the EU

Question: What would you say should be the responsibility of the European Union?

		Total	Poland	Czech Rep.	Bulgaria	Greece	Spain	Germany	Finland
	Base/number of respondents	7000	1000	1000	1000	1000	1000	1000	1000
%	Healthy social security system	64	70	54	75	75	70	47	60
%	Protection of EU member states and the European Union globally	64	66	61	72	70	63	65	51
%	Properly functioning banks	61	49	51	72	71	75	55	53
%	Low unemployment	60	68	51	65	71	72	44	52
%	Financing of scientific research leading to economic and social growth	58	61	54	67	74	68	48	35
%	Low government budget deficit and public debt	51	55	40	48	54	59	54	45
%	European providers offering products and services of higher quality and better price than the companies based outside Europe	45	52	35	58	49	54	31	37
%	Fair regulations in social issues	43	45	26	49	58	45	38	43
%	Other	2	2	2	2	2	4	2	2
%	None of the above/DK	4	2	5	2	2	3	7	8

Statements sorted from most to least by % of answers in the total EU7 column.

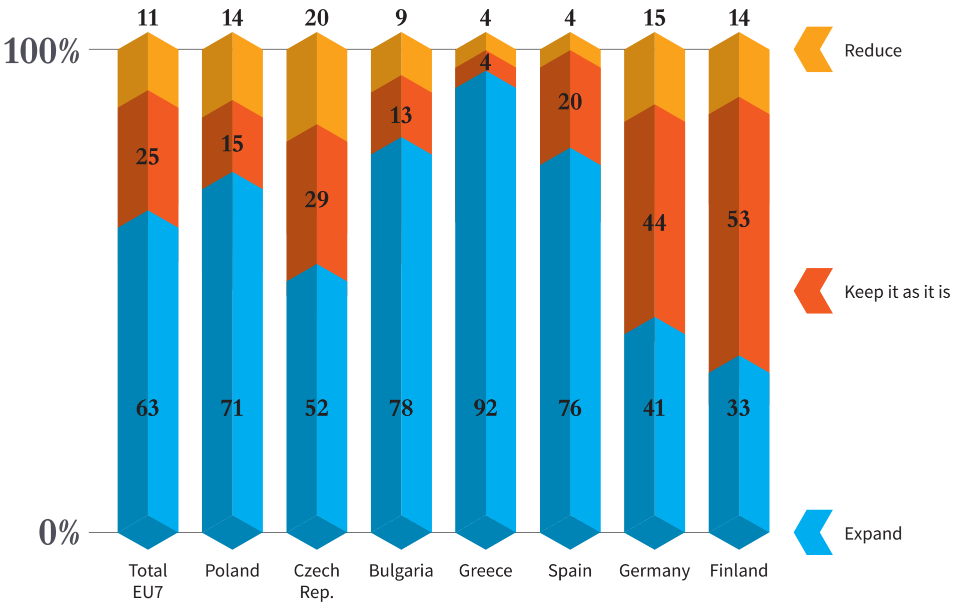
Base: all respondents, n=7000

The survey revealed a surprising degree of convergence on some issues such as the commitment to the consolidation of public finances. However, wide differences remain between the member states, including on their citizens' expectations towards the role of social services.

As many as 92 per cent of respondents in Greece, 78 per cent in Bulgaria and 76 per cent in Spain would like to see an expansion of social services while the figure for Finland was only 33 per cent while for Germany 41 per cent[2].

Social services – expansion or reduction?

Question:
Do you think that the state should expand or reduce the range of social services provided to citizens?



Base: all respondents, n = 7000

One key question, which follows from these results, relates to the role, which the European social model is expected to play in the future. In the past, its main objective has been that of socialising risk and ensuring societal fairness. The instinctive preference for fairness and relative social equality has been at the heart of the idea of a social Europe. However, a number of these assumptions have had to be revisited during the crisis, as objectives of fiscal consolidation and maintaining the welfare model at pre-crisis cost levels would not be compatible without adjusting the tax base for public expenditure.

There are three possible ways of looking at the desired policy intervention in the social field. One is to cushion against the effects of market failure. Another approach is to realise the objective of social equality and fairness. Finally, the third is to equip citizens with better tools of managing their own future in the environment of growing multi-tasking and flexibility.

Over the years, the basic assumption in Europe has been that of a diversity of social models with a varying set of objectives pursued by each one of them, leading to a different set of outcomes. In a number of member states of the South (Greece, Italy, Portugal and Spain) but also the East (Latvia, Lithuania) as well as the United Kingdom, levels of inequality had exceeded significantly the European median. In the past, much of that difference had been attributed to cultural characteristics with the implication that overcoming it would be neither feasible nor desirable. From 2008, the crisis itself and the policies put in place to deal with it have become decisive in accounting for the inter-EU variations.

What is more, the crisis has changed perceptions regarding the diversity of social models in a fundamental manner. It has not only exposed the weakness of a number of them in terms of how they impact on economic growth. It has also demonstrated the models' growing inability to perform their basic function of social protection. Increasing poverty, unemployment, inequality and low growth rates undermine the long-term social contract, which has been crucial for Europe's long-term political and economic stability.

Equality differences in Europe can often be traced to social preferences and choices made by respective societies. Nevertheless, it has proved to be the case that the impact of fiscal instruments on income distribution had greater effect in more unequal countries. In addition, inequality has tended to grow as a result of hampered investment in human capital[3].

The social agenda has tended to be broadly understood in the political discourse of recent years. Forced onto the path of fiscal consolidation, many governments have deliberately avoided opening a thorough discussion about the nature and the functioning of the welfare state, in fear of opening a Pandora's box of claims and grievances. Rarely has prime attention been given to the need for a shift from social protection to social investment. In similar vein, civic protests were aimed at cushioning the impact of spending cuts rather than reinventing the nature of public intervention in the social sphere. Only in the UK has an ideological angle become important with the Conservative government putting forward a powerful set of arguments against

The post-crisis discourse is likely to evolve with the social investment perspective becoming the focal point for efforts to modernise the welfare state. Social investment will be increasingly seen as a pre-condition of economic growth and job creation.

Europe will strive to turn its attachment to social justice into a competitive advantage as a source of greater internal cohesion[4].

---

1 Survey results with full data sets as well as presentation of the methodology can be found on: www.newsocialcohesion.eu

2 There seems to be a clear link between the recent cuts in social services and citizens' preference for an expansion of social services.

3 See "Economic Policy Reforms: Going for Growth", 2012 Edition, chapter 5, OECD 2012.

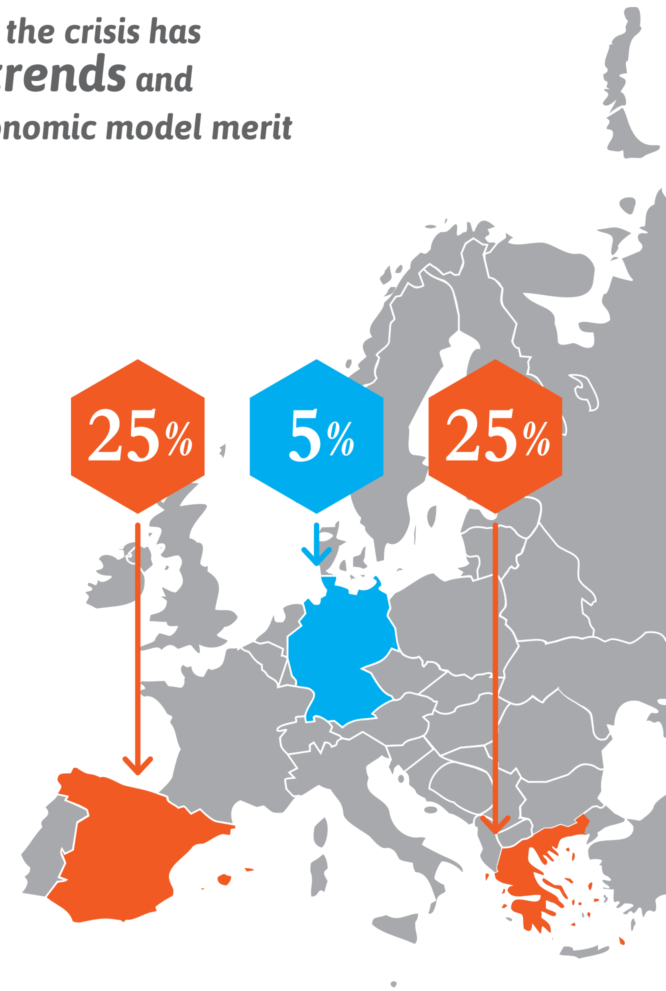
4 "Towards a Social Investment Welfare State?" Nathalie Morel, Bruno Palier and Joakim Palme, Polity Press, 2011

What the crisis has exposed? **The future of the European model of growth**

Absorbing as the immediate effects of the crisis has become, the longer-term trends and parameters of the European socio-economic model merit at least as much attention.

When we look at the productivity performance in the euro area, it becomes clear that it has been lagging behind OECD competitors also before the crisis. Since 2000, total labour productivity per worker grew, in trend, by 0.6 per cent a year, as against 1.2 per cent in the OECD on average, with wide differences within the euro area[5]. However, the dominant paradigm in the crisis has been that of wage restraint and adjustment. The latter and structural reforms have been the main instruments for the most vulnerable countries to regain competitiveness.

Significant differences remain in the performance of the labour market across the EU with the unemployment rate in Germany at a record low of about 5 per cent but its level exceeding 25 per cent in Spain and Greece.



As the OECD points out, unit labour costs have come down substantially in most affected countries except for Italy but prices have adjusted less than wages as a result of slow product market reforms. This has limited the effect of reductions in labour costs on price competitiveness[6]. The structural unemployment rate rose by about 1.5 percentage points in the eurozone between 2007 and 2013[7].

For the reasons, which have to do both with the German macro-economic stability and the perceived efficiency of its labour market, the country's economic model has become a point of reference for many reform efforts around the EU. Much rarely has the observation been made, that the German economic success has come at a price of a growing number of low-paid jobs and increased flexibility of employment. There remains a question as to whether the German export-oriented model can be replicated around the EU and what consequences this would have for the global economy.

As Adam Posen points out, "Germany now has the highest proportion of low-wage workers relative to the national median income in western Europe". The conclusion he draws is unequivocal: "low wages are not the basis on which a rich nation should compete"[8]. Problematically, the conducive situation on the labour market has not led to substantive increases in German private and public investment. Low investment has in turn meant low productivity growth and a vicious cycle of continued dependence on low wages and outsourcing of the production to Central and Eastern Europe. The latter had copied the German wage restraint model much earlier, which had contributed to them becoming a magnet of foreign direct investment. The region's transition from an efficiency-driven model of growth to an innovation-driven one will very much depend on its ability to build other competitive advantages, going beyond inexpensive labour force.

The German approach has also had notable successes, above all in leading to a low unemployment rate and high labour participation. The growth in employment after 2005 has been broad-based across both gender and age groups. It resulted from a comprehensive reform, which covered demand and supply and included reducing long-term unemployment benefits, improving active labour market policies and revamping the national employment agencies. As Jacob Funk Kirkegaard argues, the much-criticised expansion of low-wage "mini jobs" "can largely be explained by evidence that they are used increasingly as second jobs"[9].

The crisis has brought an important redistribution not only within each country but also between EU member states. Convergence trends between richer and poorer countries observed during the last decades have been reversed and further divergence is taking place between countries within the eurozone.

The social imbalances, which emerge as a result of adverse income redistribution, affect the way public opinion perceives the EU. Clearly, even if most people do not consider the EU to be a primary reason for the crisis, they see it as a major actor behind policy decision taken to combat it through the channel of fiscal consolidation. The worsening income distribution is perceived as a negative consequence of the implementation of EU rules. Hence, the impact of the crisis on inequality reduces the EU's legitimacy as the Union – at least in the eyes of citizens in some member states – has become part of the problem rather than part of the solution. This perception became evident in the 2014 European Parliament election, when a considerable proportion of citizens voted in favour of EU-critical political parties and movements. An active public policy response is needed, in particular for the protection of the most vulnerable.

---

5 OECD Economic Surveys: Euro Area 2014, p. 19.

6 OECD Economic Surveys: Euro Area 2014, p. 15.

7 OECD Economic Surveys: Euro Area 2014, p. 20.

8 Adam Posen, "Germany is being crushed by its export obsession", Financial Times, 4 September 2013.

9 Jacob Funk Kirkegaard, "Making Labor Market Reforms Work for Everyone: Lessons from Germany", Policy Brief, Peterson Institute for International Economics, January 2014.

Against the odds. **The changing structural context** for the reform of the socio-economic model

In one of her flagship interviews, Angela Markel said in December 2012 that Europe would have to "work very hard" to maintain one of the most generous welfare systems in the world and remain globally competitive.

Indeed, should there have been no economic and financial crisis, Europe would have in any case entered a period of growing structural strains when it comes to the functioning of its welfare state. In the future, the effects of demographic trends will have an increasingly strong bearing on public finances. Half of the EU countries will see their population decrease over the next decades.

In Denmark, for example, the effective economic old-age dependency ratio will rise from close to 40 per cent to close to 60 per cent by 2060. However, in the most profoundly affected EU member state, Romania, it will rise from nearly 40 per cent today to over 110 per cent by 2060[10].

The OECD estimates that because of ageing, employment growth in the eurozone, which had been about 1 per cent per year before the crisis, will fall towards zero while migration flows and pension reforms to increase the effective retirement age "will most likely do little more than stabilise employment in the coming years"[11].

Policy is not helpless in the face of demographic change. Establishing clear linkage between the age of retirement and pension benefits, on the one hand, and future increases in longevity on the other can lead to a significant improvement of both pension adequacy and fiscal sustainability effects. Some simulation results show that the expected increases in public pension expenditures as a share of GDP could almost be halved if retirement ages are fully linked to life expectancy gains in the future[12].

As for the costs, it is important to bear in mind where they are generated and how they can be reduced without sacrificing their impact. As a way of illustration, research shows that, contrary to common sense, demographic factors play a marginal role in explaining the increase of budgetary expenditure on healthcare in recent years[13]. Other factors are more important: increase of income and increase of the relative prices of health services which result from supply limitations as well as technological change and innovation in the healthcare sector. When incorporating these factors in the period of 2010-2060, healthcare costs are projected to rise in the EU by at least 3 per cent of GDP, and in an extreme case, they can be doubled. Findings of our survey concerning importance attached to health are therefore reflected in budgetary trends observed in many member states where expenditure of health is likely to be higher than those on education.

A number of powerful reasons for the growing challenge to the European social fabric have little to do with forces, which the European Union can control. The nature of work and the relationship between work and family life have been undergoing profound changes in the context of globalisation and technological change. Demand for low-skill, routine-based jobs has either migrated to the developing countries or disappeared altogether as a result of growing automation of production processes. The tendency has been for project-based work to replace the traditional patterns of lifetime employment.

This changing context has affected the way in which people have viewed the work-life balance. Research from our project indicates that Europeans from the seven surveyed member states attach enormous importance to family life with outright majorities in Greece, the Czech Republic and Spain claiming to prefer to earn/spend/save less in order to have more time for themselves and their families. Maintaining these priorities will become ever more challenging as the contraction of the labour force caused by population ageing will advance.

Much of the analysis of the problem of inequality has pointed to a disproportional role of technological change and particularly the inroads made by growing automation of the production processes. The latter phenomena tend to impact particularly on the lower-skilled part of the workforce whose roles are directly replaceable. There is no better remedy for this vulnerability than a diffusion of knowledge and skills, together with inclusive educational institutions and continuous social investment[14].

The other powerful driver of inequality has been the fact that the rate of return to capital has tended to exceed the rate of the growth of output. Elaborate mechanisms have been put in place to guard the primacy of this development. In the past three decades, they have placed shareholder value at the heart of the capitalist system in the advanced economies. This has allowed managers to claim flamboyant remuneration as the guardians of that value. Fighting inequality will therefore require a thorough re-examination of the set of incentives which are at work in today's economic model and which lead to the sanctity of profit rather than social cohesion.

There is space for EU-level engagement on both of these dimensions. Although its direct competences in the field of education, training and life-long learning are limited, the EU has long championed an active approach to the social investment agenda. In the second part of this report, we put forward a number of proposals as to how it can be taken forward decisively in the next institutional period. As for the primacy of shareholder value, the reform of the remuneration system has to go beyond the trimming of excessive bonuses and company management needs to become more inclusive.

---

10 "The 2020 Ageing Report", European Commission, p. 31.

11 OECD Economic Surveys: Euro Area 2014, p. 20.

12 Alexander Schwan and Etienne Sail, "Assessing the economic and budgetary impact of linking retirement ages and pension benefits to increases in longevity", Economic papers 512, European Commission, December 2013.

13 Joăo Medeiros, Christoph Schwierz, "Estimating the drivers and projecting long-term public health expenditure in the European Union: Baumol's cost disease revisited", European Commission, Economic Papers 507, October 2013

14 See Eduardo Porter, "Thomas Piketty on the Wealth Divide", Economix blog, 11 March 2014.

Key choices for the reform of the socio-economic model

Experience of the past demonstrates that reductions in public spending have been possible without undermining the core functions of the welfare state, as evidenced by reforms undertaken in Sweden after 1995.

Sweden made cuts in the forms of spending, which would yield an immediate and substantial saving but without encroaching on the capabilities of the government, so as not to harm service delivery.

A more prominent role of public government spending in the GDP does not automatically translate into better public services, e.g. in the area of health or education. What is more, the efficiency of public spending varies widely across the EU.

It tends to be greater in areas where explicit and measurable goals are set such as improvements in relative poverty, healthcare waiting times and university participation. The efficiency of public spending also depends on other factors such as the quality of public administration and corruption. Investing in education is an important case in point. It needs to take place across the life cycle, from early child education and schools through vocational training onto life-long learning. It also has to be inclusive with adequate support provided for students from less affluent families.

Some public spending can be replaced by private spending without adverse social effects[15]. Such is the case when public pensions are replaced by private schemes, especially company funds. More space for the reduction of inefficiencies exists with expenditure, which is meant to address consequences of market inefficiencies. As Jean Pisani-Ferry points out, public programmes in the area of housing, often end up providing "unnecessary support to middle-class households – or, worse, subsidize landlords indirectly by helping tenants pay the rent"[16].

This is not to suggest that public spending can be reduced indefinitely. Nor should it be taken to mean that increases in spending on modernisation of public services, whenever they can be afforded, bring little or no value.

For example, an analysis of the impact of Labour governments' 1997-2009 social programmes in the UK, carried out by the LSE's Centre for Analysis of Social Exclusion, points out that the results were considerable, mostly focused on reinvestment and modernisation of public services, rather than increased cash benefits[17].

The experience of the member states clearly points towards the need for 'smart public spending', optimising policy choices to ensure best value-for-many. The EU-level can both apply this principle to expenditures from the EU budget and make sure that the aggregated wisdom of what goes on in the member states is translated into effective spending patterns, particularly in times of fiscal consolidation.

15 See Jean Pisani-Ferry, "Cut the Spending, Spare the Poor", Project Syndicate, 30 January 20

16 Jean Pisani-Ferry, ibid

17 Among them, a new school buildings programme, saw over 160 schools rebuilt or refurbished between 2004 and 2010 while from 1998 all four-year-olds were given the right to 12.5 hours per week free education, a benefit which was extended to three-year-olds in 2004.

Europe in the crisis – taking stock of the policy response

Taming austerity

The degree to which member states have accepted the principle of austerity has varied both in theory and in practice. In the most astute phase of the crisis, preventing a further deterioration of the fiscal situation was an overarching objective with the implication that cuts were often made in areas where the fiscal effect could have been most pronounced and rapid.

It is not always simple to distinguish between redistributive effects being the results of the crisis itself, the adjustment mechanisms adopted or the recession that followed. For the countries of the eurozone, reducing costs, and, in particular, labour costs, has been the main mechanism of restoring international competitiveness. This so-called "internal devaluation" had triggered recession, which in turn rendered further adjustment measures even more necessary by increasing the need for social benefits and reducing the tax receipts – the "austerity-recession nexus". The adjustment mechanisms reinforce the negative impact of the recession on redistribution of income, and this redistribution limits the effectiveness and the sustainability of the adjustment mechanisms.

Social spending has been at the heart of the fiscal consolidation programmes, which was inevitable given the size of the financial envelope in the area. Only as part of the Second Adjustment Programme, the Greek government committed itself to reducing labour costs in the business economy by 15 per cent in three years, both through cuts in nominal wages as well as through a reduction in non-wage labour costs, elimination of non-core social benefits and reduction in employers' social contributions[18]. In addition, large cuts have also been made in other areas, where the immediacy of the correction of the government's balance sheet could be relatively easily achieved, such as research and development.

The performance of the EU in the crisis confirmed much of the past evidence which showed that in periods of rapid fiscal consolidation the specific parameters of spending cuts and increases in taxation are often at odds with efficiency objectives. The EU, and the eurozone in particular, only slowly came to the realisation that structural reforms can ease the trade-off between consolidation, equity and long-term effects on growth by ensuring a better targeting of public spending and stimulating labour supply. It proved to be particularly difficult to combine fiscal consolidation and structural reform objectives.

Three phases can be singled out in the response to the crisis in the EU. Social policy implications have been different in each one of them, depending on the perceived needs and policy rationale. In the first period of crisis management (2007/2008), attempts to stimulate demand and boost liquidity in the financial system played a dominant role. Automatic stabilisers were allowed to function and short-term labour contracts were either enhanced or introduced in many member states.

At the end of 2009, fiscal austerity became the predominant paradigm with stringent limitations imposed on public spending. Contraction of public services and social transfers followed. Steps were taken to deregulate labour markets. Finally, from 2011 onwards, as the macroeconomic pressures began to pose an existential threat to the eurozone, deeper cuts came to be seen as necessary to avoid further market turbulence.

From a political perspective, the primary aim at both the European and the national level was to stop the crisis from spreading. There was a fear that the crisis might spiral out of control and trigger an avalanche with the potential to bury the euro and the European project beneath it. As a consequence, strong emphasis was placed on the issue of public debt and budget deficit, in order not to endanger the access of other indebted governments to capital markets

As an illustration, the Spanish government rushed a constitutional amendment in the autumn of 2011, three months before a general election, to introduce a provision imposing limits on the structural deficit of the federal government and autonomous communities.

There was, especially in the earlier phases, much less emphasis on other aspects of the crisis including (i) the private debt crisis putting strains on the banking sector in many EU countries, (ii) the banking crisis in a highly interwoven European financial system which includes illiquid or even insolvent financial institutions burdened by high levels of public and private debt, (iii) the competitiveness crisis illustrated by current account deficits in some EU countries, especially on Europe's periphery – in Greece, Spain, Portugal and Cyprus[19], or (iv) the institutional crisis of the euro system, not built for bad weather conditions.

Especially in the early phase, there was no strong emphasis on the social dimension of the crisis caused by deep, long-lasting recessions and unbearable levels of unemployment. Nor did the crisis recipe led to much of a thorough reflection in the capitals on the political dimension of the crisis characterised by high levels of volatility and instability as well as the rise of populist anti-establishment, anti-euro and anti-immigration parties and movements. Similarly, the resurgence of distrust among EU countries, leading to high levels of fragmentation, not only between governments but also between national societies, has met with tacit acceptance of the countries' political elites.

The emphasis of crisis management was first and foremost on countering Europe's public debt crisis, which led to rather immediate and substantial cuts in national budgets. In a second step, emphasis was put on a process of internal devaluation and structural reforms aiming to first and foremost increase the economic competitiveness of countries particularly hit by the crisis. In addition, in many EU member states, primarily in those affected by the crisis, spending cuts were accompanied by tax increases in an attempt to re-balance national budgets also on the revenue side. Large parts of the society have therefore been subject of a double squeeze, both through the channel of reduced expenditure as well as higher tax burden.

All the above mentioned measures had severe effects on national social and economic policies resulting in severe social spending cuts and negative economic consequences. Many years of negative growth in the most vulnerable countries have ensued, which in return led to substantially increased levels of (structural) unemployment, including first and foremost youth unemployment. The onset of relative economic stability has created more margin for fiscal adjustment programmes. There is little sign, however, that the additional space, which has been created, will translate into a relaxation of the tight grip on the level of social spending.

The verdict on austerity will remain an intensely contested issue. Having been at the forefront of austerity for much of the crisis, the UK is now boasting of a stronger recovery than its eurozone peers with forecast growth of 2.9 per cent this year, the highest in G7, and an unemployment level of 6.9 per cent. Lack of monetary sovereignty is nevertheless not to be blamed for the costs of internal devaluation.

18 European Economy, Occasional Papers 94, "The Second Adjustment Programme for Greece", European Commission, March 2012.

19 Florence Jaumotte and Piyaporn Sodsriwiboon, "Currency Account Imbalances in the Southern Euro Area", IMF Working Paper, WP/10/139

Nature of the interaction between the member states and the EU level

***Consolidation of public finances,* together with pressure on member states to enhance their relative economic competitiveness through structural reforms became a policy doctrine in the eurozone, and to somewhat lesser extent in the EU at large.**

Although it seemed to be a one-size-fits-all policy, its implementation differed among member states who retained responsibility for defining, formulating and putting in place national consolidation and reform programmes, while adhering to the general rules defined at EU level in the framework of the reformed Stability and Growth Pact and the enhanced rules of fiscal governance enshrined in the so-called fiscal compact treaty (Treaty on Stability, Cooperation and Governance).

Evidence shows that the eurozone responded much more aggressively to the debt problem than the non-eurozone countries, possibly as a result of higher debt ratios. In addition, as Deborah Mabbett (University of London) and Waltraud Schelkle (LSE) argue, non-eurozone countries received more constructive external assistance than those inside, because "the world has learned how to prevent self-fulfilling currency crises". Especially the 1998 IMF intervention has made it clear that "shrinking public finances is not the appropriate response to all macroeconomic instability"[20]. Therefore in assisting Hungary, the IMF designed a monetisation of government debt without expansion of the domestic money supply.

The margins for any national adjustment in the countries of the eurozone have been limited, due to the inability to rely upon devaluation and the practical limits that exist as regards intra-EU mobility. An active EU role is called for through a positive budgetary response, which could take the form of an automatic stabilizer (or even an equalisation mechanism), or some direct way to deliver (limited) funds to alleviate at least the heaviest social impact of the crisis.

If the word "cohesion" has any meaning it would be about reducing disparities and refocusing European budgetary effort to alleviate the adverse social effects of the crisis. Refocusing in terms of countries and regions most severely hit, and, even more importantly, refocusing in order to target substantive sums to combat unemployment and support those public services mostly needed to overcome the present deadlock situation.

Inside the eurozone, special terms applied to the programme countries. After receiving financial support from their eurozone partners (and the IMF), the programme countries (Greece, Ireland, Portugal, and Cyprus) became subject to strict surveillance through the Troika including the European Commission, IMF and the European Central Bank. The financial assistance was combined with a commitment from each programme country to implement detailed Economic Adjustment Programmes (Greece: start of first programme: May 2010; second programme: March 2012; Ireland: start of programme in December 2010, ended in December 2013; Portugal: start in May 2011, due to end in May 2014; Cyprus: start in May 2013, runs until May 2016).

The Economic Adjustment Programmes were designed and agreed between national authorities of the recipient countries and the Troika with the latter being in a relatively strong position to set out the conditionality and the overall set-up and main orientations of the programmes. The precise actions in exchange for financial assistance and guarantees were laid down in a Memorandum of Understanding (MoU) agreed between the member state concerned and the Troika, who was also responsible for reviewing the implementation of the programmes.

The conditions agreed in exchange for financial assistance have varied between the four programme countries. While the level of detail of conditionality was lower and remained rather constant in the case of Ireland and Portugal, it increased and was highest in the case of Greece as the Troika over the course of time came to the conclusion that the implementation of the Greek adjustment programmes was insufficient.[21]

In terms of content and major orientation, the adjustment programmes concentrated mostly on fiscal issues, the financial sector and economic reform issues, while social issues and 'poverty issues' received less attention. The latter is particularly noteworthy as the implementation of the programmes led to serious and unforeseen negative impacts on the quantity and quality of employment, income levels, social protection and health standards, and as a result to severe economic and social hardship.[22]

At the European level, the Euro group bears the ultimate political responsibility for the programmes as it was the one taking final decisions as regards financial assistance and conditionality. At the national level, governments and parliaments in the programme countries were the ones responsible for deciding and implementing the fiscal and economic adjustment programmes. However, national ownership of the programmes was rather low in the four programme countries. The perception lingers as a result of the fact that national governments and parliaments had to rubber-stamp the conditions set by the Troika, faced as there were with the choice between defaulting on their debt or accepting the Memoranda of Understanding negotiated between the Troika and national authorities. In addition, the degree of national ownership was also undermined by the fact that the Troika and EU institutions were used as scapegoats for adverse effects of the adjustment and reform programmes, which in return increased euroscepticism in the countries concerned.

20 Deborah Mabbett and Waltraud Schelkle, "The lack of monetary sovereignty is not the reason Eurozone countries struggled during the crisis", LSE blog EUROPP, 3 April 2014.

21 See André Sapir, Guntram B. Wolff, Carlos de Sousa and Alessio Terzi, The Troika and financial assistance in the euro area, Bruegel 2014, pp. 15-23.

22 See also European Parliament, "Report on the enquiry on the role and operations oft he Troika (ECB, Commission and IMF) with regard tot he euro area programme countries", rapporteur: Othmar Karas and Liem Hoang Ngoc, 28.2.2014.

The 2014-2019 agenda – responding to citizens' concerns & expectations

The European social models are anchored in cultural characteristics of the individual member states, which translates into their lasting diversity.

Some countries search for labour market flexibility and productivity through high skills of the labour force while others look more towards deregulation. In the Sapir report of 2004, four different socio-economic models were singled out in Europe of the then fifteen member states: Anglo-Saxon, Nordic, Mediterranean and Continental ones[23]. The conclusion of the report was that instead of attempting to merge the different models, improvements should be sought in each one of them, drawing on the experience of others. The current economic crisis requires reviewing this assumption. Under the impact of the crisis and in the context of some of the long-term structural challenges, which Europe is facing, the common denominator between them will grow bigger. It will centre on the joint objective of bridging sustainability of the social system as well as inclusiveness and social investment, necessary for competitiveness.

There are several ways through which the European social project can be realised in the period of the next five years:

Creating a Social Policy Matrix

compatible with the prerogative of fiscal consolidation but ensuring the fulfilment of social goals and drawing on the best practices of the member states.

Codifying and operationalising a Bill of Social Rights

which guarantees basic rights agreed and endorsed at the European level and then implemented as a shared competence or nationally.

Creating a European Pact for Social Investment

to increase and streamline support for the improvement of skills and human capital at both the member state and EU-level.

Re-establishing the case for intra-EU mobility

through both restating its importance for absorbing asymmetric shocks and addressing its abuses.

Reinventing social dialogue

as social cohesion is not only a function of how the terms of the social contract evolve but also of the process through which it is negotiated.

Forging an EU social dimension

through a common EU unemployment scheme, a common EU employment contract, the 29th regime for pension products and completing the monetary union with a social dimension on the basis of an argument that social imbalances threaten the monetary union as much as economic imbalances through underperforming labour markets and high levels of unemployment.

What is needed is not a fully-fledged EU social policy, substituting or even harmonizing, national social policies, but a range of common standards, drawn on the best of our past experience and some minimum social standards accepted by all the member states. Reinforcing the EMU's legitimacy and citizens' support is also a matter of sustainability for the EMU. Indeed, if the common currency is perceived by European citizens as a threat to national welfare states, the political support for the euro will fade away, thus putting at risk the long-term sustainability of the project.

23 The new member states, in particular the transition countries, were still engaged at the time in weaning themselves off the vestiges of the older, socialist-type welfare state.

Social Policy **Matrix**

Even apart from the specificity of each socio-economic model in Europe and its anchoring in cultural characteristics, there is ample space for benefiting from well-tested solutions, particularly in the area of social investment.

Significant employment gains should be expected from cutting the labour tax wedge. The OECD estimates the effect to equal almost 3.5 percentage points over a ten-years period for Greece, although it expects a negligible impact for Portugal[24]. In Southern Europe, shifting the burden of taxation from labour incomes to consumption can also encourage employment. Greece, Italy, Portugal and Spain have some of the lowest implicit tax rates on consumption in the euro area. A European Commission study estimates that long-term effects on employment of a shift from taxation of wages to taxation of financial wealth and transfers would range from 1.8 per cent to 4.7 per cent[25]. Tax credits for low-income earners can also help boost employment in this social group.

The more immediate challenge is how to combine the preservation of social goals and the fiscal consolidation objectives, which will remain valid for much of the forthcoming period. Fiscal consolidation policies can be ranked with respect to their effects on short and long-term growth as well as income distribution. Such rankings naturally need to take into account country-specific circumstances.

As the OECD suggests, "well-designed consolidation packages can avoid severe adverse side effects on growth, equity and current-account imbalances"[26]. This means that for each group of countries, a matrix can be created with a ranking of the most desirable form of intervention from the point of view of social effects. The starting point is to establish fiscal consolidation needs. A gradual effort with a stable but long-term trajectory is clearly preferable, as it comes with the least social costs. The longer the horizon, the more pressing structural adjustments become, given population ageing and the rise in expectations towards the provision of public services. Expenditure on health and long-term care as well as public pension spending will weigh heavily on the means at the disposal of the welfare state.

Evidence shows that the consolidation of public finances can be carried out in a fashion, which avoids adverse effects on equity. Cuts in benefits tend to be regressive with the possible exception of public pensions. Similarly, reduction in the provision of public services contributes to increasing inequality in effective consumption. There are also consolidation instruments which can enhance equity – for example rising inheritance or capital gains tax. Increasing progressive taxation or taxation on capital income also goes in the direction of reducing disposable income inequality[27]. Some of the effects are a function of behavioural patterns in the way individuals react to the various instruments. It is entirely possible that cuts in unemployment insurance can lead to greater labour force participation. Instruments which can be regressive in the short-term, such as consumption taxes, can be neutral in the longer perspective.

In order to establish a hierarchy of instruments, weight needs to be attached to each one of them.

Considering long-term growth and equity effects, the OECD suggests the following **hierarchy of instruments**:

The higher the instruments in the ranking, the better their impact in the process of consolidation from the point of view of long-term growth and equity – subsidies, public pensions and property taxes come top of the list. Instruments at the lower end of the spectrum, including cuts in education, healthcare and family policy are "particularly unfavourable in terms of generating adverse side effects for growth and equity". The importance of the respective elements varies across countries and ought to be taken into account.

---

24 Bouis, R and R. Duval, "Raising potential growth after the crisis: a quantitative assessment of the potential gains from various structural reforms in the OECD area and beyond", OECD Economics Department Working Papers, no. 835, 2011.

25 Janos Varga, Werner Roeger and Jan in't Veld, "Growth Effects of Structural Reforms in Southern Europe: The case of Greece, Italy, Spain and Portugal", European Economy, Economic Papers 511, December 2013.

26 Boris Cournède, Antoine Goujard and Àlvaro Pina, "Reconciling fiscal consolidation with growth and equity", OECD Journal: Economic Studies, vol. 2013, OECD 2014.

27 For the discussion of the effect of fiscal consolidation on equity, see Boris Cournède, Antoine Goujard and Àlvaro Pina, "Reconciling fiscal consolidation with growth and equity", OECD Journal: Economic Studies, vol. 2013, OECD 2014, p. 23-24.

Bill of Social Rights

Social policy has traditionally been implemented through redistribution, regulation or social rights. In a period of financial strain, the scope for an approach based on redistribution is more limited although, as outlined above, there is substantial ground for optimising the fiscal package.

Given the pressures of growing inequality and rising concerns about the effectiveness of social mobility in Europe, more significance should be attached to codifying and operationalising a set of basic social rights of European citizens with emphasis on the need to equip them for the challenges of the future[28]. A focus on rights shifts the span of attention not only to the issue of outcomes but also to the process of achieving them.

The European Union has made numerous forays into this area in the past. The Social Chapter of the Treaty of Maastricht set out broad social policy objectives and gave the mandate for regulation on a range of issues from health and safety, working conditions, consultation of workers, gender equality in job opportunities and treatment at work and protection of pensioners and unemployed. In 2000, the Charter of Fundamental Rights brought together the various fundamental rights protected in the EU under the six title of dignity, freedoms, equality, solidarity, citizens' rights and justice. Most of the rights are spelt out in general fashion. The right to education (article 14 of the Charter) states that "everyone has the right to education and to have access to vocational and continuing training".

In the context of an increasingly competitive global environment with its struggle to nurture human capital, a number of these social rights should be spelt out in greater detail at the European level, even if their implementation would largely be left to the member states. This could take the form of a Bill of Social Rights – a political document drawn out in agreement by the European institutions ratified by all member states.

In our survey, the respondents were asked to distribute 100 points between nine factors that may influence the quality of life: health, permanent employment, high income, stable political and social situation, family and time spent with it, satisfactory work, security, free time and personal growth, other factors.

By a huge margin, health was pointed to as the most important element influencing the quality of life and received 30 out of 100 points in the total sample.

The reading was slightly more elevated in Greece, Bulgaria and Finland and less in Germany, Poland and Spain.

In line with these findings, access to healthcare should feature prominently in the future Bill of Social Rights. This is not simply a matter of adequacy of supply but also relevance and effectiveness of the services provided. Availability of personnel and services, their affordability and acceptability are key dimensions for assessing access to healthcare. The Bill of Social Rights should be used for pushing the boundaries of how an open and accessible healthcare is understood. It should be an instrument for achieving breakthroughs in the development of e-health where a wide disparity exists in the European Union. Only one member state, Luxembourg, authorises e-mail communication between doctors and patients as eligible for refunding by the National Health System. The Bill of Social Rights should be used to make e-health the standard operating procedure in the European Union.

Another crucial area, which should be addressed through this approach, is education.

After decades of assessing educational progress, it is clear that quantitative measures relating to school and university attendance are less indicative of actual attainment than qualitative ones, focuses on improvements in skills.

Top performers in the PISA ranking of educational qualifications often represent different approaches to education. Schooling in Shanghai is very much geared towards obtaining high scores in examinations. In Europe's top-performer, Finland, the education system is student-centred. The national curriculum is broad while teachers are drawn from among the best university graduates. They get maximum autonomy and the system trusts them to be responsible. The focus is on improving teaching and learning. The Bill of Social Rights should codify desirable outcomes, particularly with respect to problem solving.

28 The case for emphasis on social rights is explored in "Strategic options for Europe's Future", New Pact for Europe, pp. 43-44.

European **Pact for Social Investment**

Over the years, the European social model had been centred on the requirements of social protection.

The bulk of European legislation in the social area has also aimed at ensuring binding minimal standards in the area of employment, equal opportunity or rights of the disabled and disprivileged. Even though the case for expanding social protection remains valid as the nature of work evolves, there is an urgent need for a European social investment agenda. The European Union is particularly well positioned to engage in this area, given its efforts to prioritise development of human capital in both the Lisbon Strategy and Europe 2020. An approach which puts emphasis on social investment goes beyond the traditional policies aimed at boosting human capital, focused not only on shaping it up, including through education and training, but also how to make most effective use of it.

Human capital formation plays a key role in generating economic growth. In one influential study[29], educational gains from improving educational standards have been shown to lead to average increases of GDP in the range of 4.5 – 16.8 per cent, with the highest number being reached when all EU member states are brought up to the level of top-performer, Finland. The study makes the observation that economic cohesion within the EU appears to be highly dependent on fostering more equality of achievement across countries. South European countries have the largest share of the low-skilled workers among the euro area countries. Increasing the share of medium and high-skilled labour forces can also have most significant effect on increasing the long-run employment rate.

Schooling only shows its effect over time and can only become meaningful over the medium-term given that cohort effects take time to be fully reflected in the labour force. However, its impact is significant and persistent. Structural reforms in this area have particularly high effects for Italy and Portugal with around 23 per cent and 34 per cent long-run GDP increase respectively[30]. The earlier these reforms are undertaken, the better for reaping long-run benefits. These areas could be among those financially supported by a new fiscal capacity currently discussed between member states (see also below).

In order to support national efforts at improving educational attainment, a European Pact for Social Investment should be launched with cohesion policy resources and reserves of unspent funds being designated for the purpose of co-financing schooling, university instruction and retraining efforts in the area of "Skills of the Future". The emphasis would be placed not only on learning but also on the effective application of knowledge and skills. While decisions with respect to the curricula would remain national ones, key parameters of the "Skills of the Future" programme would be agreed and implemented at the European level.

29 Eric A. Hanushek and Ludger Woessmann, "The Economic Benefit of Educational Reform in the European Union", CESifo Economic Studies, vol. 58, 1/2012.

30 Janos Varga, Werner Roeger and Jan in't Veld, "Growth Effects of Structural Reforms in Southern Europe: The case of Greece, Italy, Spain and Portugal", European Economy, Economic Papers 511, December 2013, p. 21.

Renewing the case for **intra-EU mobility**

***Free movement of persons is one of the foundations of the single market.** One of the advantages of labour mobility lies in absorbing asymmetric market shocks – workers move from regions of high pressure in the labour markets to those where opportunities exist and where demand for skills is highest.*

Labour mobility in the EU lags considerably behind that of the United States, even though it has increased in the crisis. The share of recent migrants in the total population has increased from 0.17 to 0.21 per cent between 2005-2006 and 2011-2012 in the EU-27 while the same ratio for the United States fell from 2.92 to 2.72 per cent. Migrants benefiting from free movement of persons in the EU are on average much younger and more highly educated than the non-mobile population[31].

Our survey of seven EU member states has shown that only 30 per cent of respondents blame unemployment on immigrants, with higher numbers observed in Greece, the Czech Republic and Spain (40 per cent and more) and lower ones in Finland, Poland and Bulgaria (27, 21 and 12 per cent respectively). In spite of this and regardless of studies showing that migrants make a net contribution to the receiving countries' social insurance system, the desire to curtail free movement of persons has become one of the dominant political projects in a number of countries. Equal access to social benefits, a phenomenon referred to as "welfare tourism", has faced particularly strong criticism. Concerns have also been raised for the contractors to be held accountable for the correct payment of employees they hire. "If we allow the pillar of free movement to degenerate, it will ultimately undermine the legitimacy of the EU", Lodewijk Asscher, Deputy Prime Minister of the Netherlands argues[32].

The case for intra-EU mobility should therefore be re-established with action on three accounts.

Firstly

the benefits of mobility need to be presented more widely through an EU-wide information campaign. The view needs to be countered that mobility is an asymmetrical right which draws on the resources of the receiving countries. An EU-wide assessment of the value added of mobility should be made with a balance sheet of the effect on the social insurance systems of the member states. The costs of human capital formation on the part of sending countries should also be taken into account and brought into the discussion.

Secondly

efforts should be made to improve the functioning of the European labour market with the establishment of European labour offices as antenna organisations located in the member states to ensure better information about opportunities available in the different regions. In addition, barriers to mobility such as the limitations in the portability of public pensions should be addressed.

Thirdly

claims of improper displacement and unfair competition should be addressed openly. This should lead to ensuring that the principle of equal pay for equal work would extend to all terms of employment. It would also curtail the phenomenon of letterbox companies, which pretend to move abroad but continue to operate in the sending country. Many concerns have already been addressed through the revision of the posting of workers directive. Compromise on the issue was achieved in a constructive and mutually satisfactory manner. There is no reason why further sensitivities could not be resolved provided that no outcomes are predetermined in advance in contravention of the treaty. One possible solution would also be to introduce relative minimum wages, which would create a level-playing field in the EU while reflecting the different levels of development.

Prospects for finding workable solutions reflecting the interests of all EU countries will be helped by the growing policy convergence between the poorer and the more advanced member states. At the same time, low labour costs remain the source of Central Europe's competitive advantage which means that what is at stake is economic remodelling and the much more demanding task of moving to a higher value-added which can only be done through a transfer to innovation-driven growth.

31 Jauer, J. et al. (2014), "Migration as an Adjustment Mechanism in the Crisis? A Comparison of Europe and the United States", OECD Social, Employment and Migration Working Papers, No. 155, OECD Publishing; http://dx.doi.org/10.1787/5jzb8p51gvhl-en, p. 15

32 "Orange alert remains over free movement in EU", letter to the FT, 9 May 2014.

Reinventing social dialogue

Social cohesion is not only a function of how the terms of the social contract evolve but also of the process through which it is negotiated. One study of trade unions and nationwide sector agreements has concluded that "wage setting institutions are in a state of turmoil, change or outright crisis"[33].

Industry level agreements have also changed beyond recognition. Much greater role is now assigned to company and individual bargaining across the EU with the Southern members converging fast in the course of the recession. It is not clear whether the trend towards decentralisation and prioritising of enterprise over sector bargaining will bring the end to all multiemployer bargaining and coordination. Decline of union membership has also been accompanied by the concentration of union representation in large firms, the public sector and employees in stable jobs with employment protection.

The crisis saw a further deterioration of social dialogue in Europe. In Greece, no satisfactory result was achieved in negotiations between the employers and employees in the critical periods of the country's socio-economic re-footing. As part of the adjustment programme, the Greek government committed to facilitate collective bargaining and ensure wage flexibility. Subsequent reforms included a reduction in minimum wages in the private sector and amendment of a number of wage-setting mechanisms. The latter included the rules on the expiration of collective agreements and the arbitration of wage disputes.

33 Jelle Viser, "Wage Bargaining Institutions – from crisis to crisis", Economic Papers no. 488, April 2013, European Commission

34 See Kate Pickett, Richard Wilkinson and Roberto de Vogli, "Equality, Sustainability and Wellbeing", The Francqui International Conference, Brussels, 8 May 2014.

35 Stephen J. Silvia, "Holding the Shop Together: German Industrial Relations in the Post-War Era", 2013.

Recalibrating social dialogue is an important way towards addressing the issue of social imbalances. The phenomenon of growing inequality tends to be linked to the weakening of the trade union membership with the indication that a higher employee representation on company boards would contribute to reducing inequality[34]. A number of principles would need to be agreed before greater inclusiveness can be brought about. One of them has to do with the need for reforms of the wage-setting frameworks, so that they better align wages to productivity. Social dialogue will in the future need to be seen as an integral part of the macro-economic strategy, rather than a growing liability for it.

Much of the reform needs to be driven by the unions and other social actors themselves. Experience of the German IG Metall trade union shows that internal renewal and organisational reform can bring tangible results. In IG Metall, responsibility and resources have been devolved to local members who were tasked with focusing on advice and service to existing members and recruitment. It became a common theme in the workplace discussions that the social partners, work councils and the government would need to "hold the shop together"[35]. As a result, the German trade union movement has experienced a remarkable comeback.

In the end, a successful social dialogue requires that both trade unions and employer associations mutually recognize each other as fully-fledged social partners with the well-being of the respective company and the economy at large as a common goal. Of course, this makes necessary a minimum of solidarity between employer and employee when it comes to fair distribution of profits and losses as well as responsibility.

Social dimension of the eurozone

In the course of the crisis, social imbalances in the EMU have emerged as a clear threat to the future of the common currency. As a result, the social dimension became one of the four pillars of EMU reform at the December 2012 European Council.

Its main tenet has been to reinforce social coordination and surveillance through a scoreboard of employment and social indicators. The latter have extended to minimum social standards such as a minimum duration and minimum replacement rates of unemployment benefits, a minimum income and minimum wage.

The European Commission's 2013 Non-paper on the social dimension of the eurozone makes a plea for contractual arrangements to be equipped with a social chapter. An automatic eurozone stabiliser financed from the fiscal capacity was meant to follow. Herman Van Rompuy's report about the implementation of the idea of the Genuine Economic and Monetary Union suggested in June 2013[36] the strengthening of analytical tools by identifying common benchmarks, broadening of the macroeconomic imbalances procedure with complement social indicators, supplementing the existing economic surveillance with a social and employment scoreboard in the European Semester and adoption of more systematic approach to education and training by the member states. No specific objectives or minimum standards were envisaged.

The new scoreboard of key employment and social indicators to be published shortly by the European Commission in the framework of the European Semester is likely to confirm the existence of high income inequalities in some member states as well as growing divergence across the EU, as measured by the differences in income inequalities between individual member states. Clearly, there is now no disagreement that enduring and growing socio-economic divergence is a challenge for the monetary union.

The Commission's assessment of five "key social indicators" in the framework of the strengthened European Semester covers areas including poverty, inequality, household income, employment rates and youth joblessness. Critics have considered this development to be mostly about communication given that the social criteria, which are to be monitored, remain non-binding. The key issue will be to have country-specific recommendations on how to reduce inequalities. They would then need to be taken up in the national political discourse. Much depends as well on the approach the Commission would undertake in assessing how its recommendations have been implemented. There is an open question to what extent addressing the social imbalances would require the Commission to adapt its traditional policy of appealing for increased flexibility of the labour market and reduction of labour costs.

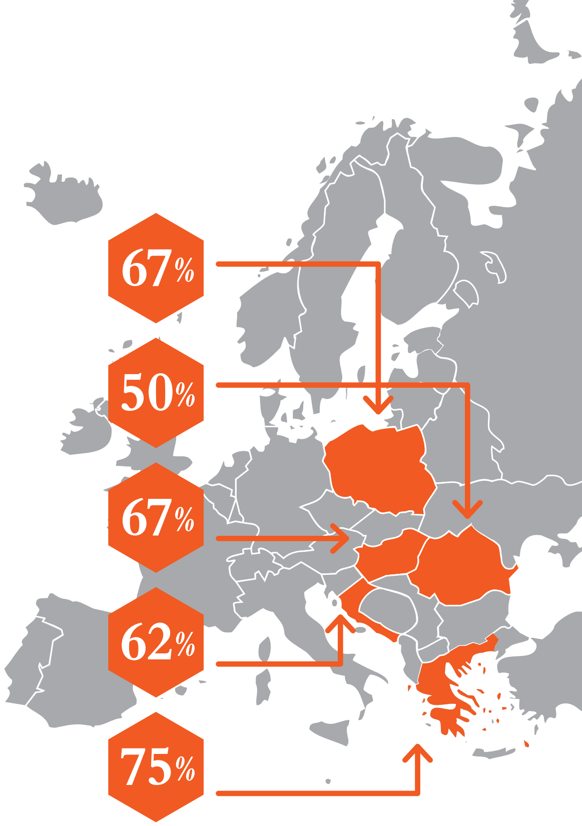
36 Herman Van Rompuy, "Towards a genuine Economic and Monetary Union. Towards an integrated economic policy framework: state of play of consultations", 28 June 2013.

Keeping the **non-eurozone countries on board**

The June 2013 Van Rompuy report touches also upon the fact that competitiveness, growth and jobs are issues that have to be high on the agenda of member states that have not yet adopted the Euro (Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania have no clear target dates for adopting the euro) and does not exclude them from the process of concluding contracts for competitiveness, growth and jobs.

These agreements should be inclusive, differentiated and tailor-made and "could also support reform efforts in member states not yet having adopted the currency of the Union and contribute to making their economies fit for its adoption by improving their ability to adjust to economic fluctuations in the absence of exchange rate adjustment possibilities"[37]. However, in the discussion of the solidarity mechanisms that should help to tackle "short-term impact of reforms on certain segments of society" the non-eurozone countries are not mentioned. The social pillar of the EMU is supposed to counterbalance the negative impact of the crisis-driven austerity on cohesion within member states but does not focus on the continued need to enhance cohesion between member states. Apart for the Czech Republic, all the other Central European states continue to be poorer than the crisis-hit Greece.

Greece's GDP in PPP in 2004 was at 94% of the EU average and is down to 75% in 2012 but remains above the respective GDP in PPP of Bulgaria (47%), Croatia (62%), Hungary (67%), Poland (67%) and Romania (50%)[38]. Moreover, there is a sizeable difference between the latter and countries with a derogation to join the euro like Denmark and the UK. "The 10% richest living in Romania would be among the 10% poorest in the United Kingdom..."[39]



At the start of the transition, all post-communist countries had to implement very ambitious reform agendas. Whereas austerity has become the catchword for the measures to tackle the crisis of the eurozone, in the early nineties the catchword for the reforms in the transition countries was "shock therapy", and it brought with it a very high social price. Countries that were late to adopt "shock therapy" measures (like Bulgaria) paid an even higher social price. Compared to the protests against austerity policies today it seems surprising that "shock therapy" did not meet much opposition at the time. The simple explanation for this is that the reform agenda in the transition countries was driven by the hope for a better future and membership in the EU, or simply for a change of the status quo. In contrast, today's reform agendas that go under the austerity label are driven predominantly by fear.

Proposals on the creation of a social dimension of the eurozone come as an attempt to accommodate the concerns of citizens in the eurozone countries about lowering social standards, changing the status quo. These fears should no doubt be addressed. At the same time, a social pillar of the EMU should not be designed in a way that neglects the aspirations of the still poorer younger member states. As the eurozone consolidates and extends its ranks, it should be remembered that the implementation of similar measures could lead to different outcomes, depending on the economic and political environment. Different wealth levels and differently functioning institutions are two factors that have a big impact on the outcomes of both fiscal prudence and labour market reforms. As argued by Ivan Krastev and Georgi Ganev: "To wealthy Germans, fiscal conservatism in their institutionally functional country promises that tomorrow won't be too different from today – their lifestyle will be protected. In poor, dysfunctional Bulgaria, the same policies make people angry that tomorrow will be too much like today".[40] Thus, a social pillar of the EMU should be designed in a way that not only protects the existing social models but also allows to improve the dysfunctional ones.

---

37 Ibid

38 Eurostat at: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00114

39 Inequalitywatch at http://www.inequalitywatch.eu/spip.php?article99

40 Krastev, Ivan and Georgi Ganev. Why making Europe German won't fix the crisis. At: http://www.bloombergview.com/articles/2013-04-07/why-making-europe-german-won-t-fix-the-crisis

Conclusion

The current crisis has posed a challenge to the social fabric of many communities and regions in Europe. It has come in parallel with growing awareness about the structural challenges for social Europe, which have to do with globalisation, demography and technological change. Consolidation of public finances and deleveraging will continue to slow down growth in the medium term leading to further income divergence. As our survey and national debates have shown, a new consensus on the socio-economic model will need to be embedded in the formative experience of the crisis.

There are several channels through which the impact of the social crisis has been felt. Politics has become less consensual and more adversarial. Some countries political scenes have been rebuilt entirely and this process is set to continue. For many intents and purposes, this has amounted to a redefinition of the social contract with far-reaching political implications. Social policy has traditionally been about finding the right equilibrium between a concern for equity and social justice as well as the prerogative of economic growth. Its role in this area is only bound to grow in the post-crisis environment.

Citizens expect Europe to develop a meaningful social dimension. In spite of the limitations of the established practice, the European Union should make the 2014-2019 institutional cycle one devoted to social enablement. Rather than being seen as a liability, social Europe needs to once more come to be seen as a competitive asset of the European Union.

The new European leadership, which will emerge after the recently concluded European Parliament elections, should be given the task to define the pillars of a "more social Europe". No illusion should be created that the shortcomings of the EU's division of competences can be overcome. At the same time, the EU has shown on many occasions in the past that once genuinely committed, it can achieve impressive results. We have outlined in this report six components of a new approach, which should be considered as a matter of priority. They have to do with designing a Social Policy Matrix aimed at optimising the fulfilment of social goals within existing fiscal constraints, formulating a Bill of Social Rights with guarantees of basic rights, creating a European Pact for Social Investment aimed at the improvement of skills and human capital, re-establishing the case for intra-EU mobility, reconstituting social dialogue and finally, forging an EU social dimension. It is once this set of instruments is put to good use that the EU can claim to have leapfrogged in building its much-needed social dimension. The next institutional term is the most conducive period for this type of transformation.

Cover and design: Bakalie Branding Studio

First published in Poland, Warsaw 2014 by:

demosEUROPA
– Centre for European Strategy Foundation
23 Mokotowska Street Apt. 8
00-560 Warsaw, Poland
phone: +48 22 401 70 26
demoseuropa@demoseuropa.eu
http: www.demoseuropa.eu

Co-funded by

Consortium

Project`s partner

Supported by