



# THE REFORM OF THE ECONOMIC AND MONETARY UNION: WHAT SOCIAL DIMENSION?

■ **SOFIA FERNANDES**

FOREWORD BY DAN KERSCH

PREFACE BY NICOLAS SCHMIT

CONCLUSION BY VALDIS DOMBROVSKIS

**#SOCIAL EUROPE**

**#EMU**

# **THE REFORM OF THE ECONOMIC AND MONETARY UNION: WHAT SOCIAL DIMENSION?**

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This report presents a synthesis of the debate on the social dimension of EMU which took place in Luxembourg on 20 June 2018. This expert seminar was jointly organized by the cabinet of the Luxembourg Minister of Labour and the Jacques Delors Institute. The author thanks Sébastien Maillard, Nicolas Schmit and Frank Vandenbroucke for their useful comments on this report.

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## FOREWORD BY DAN KERSCH

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A decade following the beginning of the great recession the European Union might have left its day-to-day crisis management mode, nonetheless we are still confronted with serious social challenges in terms of unemployment and social exclusion. The proclamation of the European Pillar of Social Rights provides us with an important framework to guide actions at national and European level to address these challenges.

Ensuring that we put Europe back on track of social upwards convergence is essential in order to (re)gain citizen's trust in the European project. A lot has already been achieved, for example regarding the fight against youth unemployment through the European-wide youth guarantee, but as ministers of labour and social affairs, we have to further strengthen our efforts to combat unemployment and social exclusion.

The world of work is rapidly changing through digitalisation, new forms of work, and demographic change. We have to adapt the labour markets regulations and our social protection systems to this new reality with the aim of safeguarding citizen's wellbeing and fostering good jobs and good pay for all. Working people have suffered from stagnating wages and the rise of precarious forms of employment. Working poor – a term rarely associated with European labour markets in the past – has become a widespread phenomenon in some Member States of the Union.

We have to create a consensus to align economic and financial policy-making within the European Union and the Economic and Monetary Union with the social and employment objectives of the European Pillar of Social Rights. Only if we rebalance the European integration and pursue ambitious action at European and national level will we be able to ensure that growth improves the lives of the many, not the few.

The present report is the result of a seminar organised in June 2018. The challenges discussed then remain high on the agenda today. As minister of Labour, Employment and the Social and Solidarity Economy of the newly elected government of Luxembourg I will strive for a further strengthening of the social dimension of the European Union.

*Dan Kersch, minister of Labour of Luxembourg*

## PREFACE BY NICOLAS SCHMIT

In June 2015, the incoming Luxembourg Presidency organized a seminar on social Europe. Three years later we can acknowledge that progress has been achieved. The European Pillar of Social Rights defining a set of 20 principles covering equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion was adopted in 2017. A new directive on posting was approved and several important texts are presently discussed, only to mention the Directive on transparent and predictable working conditions.

But despite this obvious progress social Europe is still lagging behind. The economic crisis has left deep scars in the social fabric of many member countries. Inequality is on the rise. More precarious forms of work are expanding. Though unemployment has seriously fallen it remains too high and particularly youth unemployment. Social expectations are high and the digital revolution is rapidly transforming employment and skills requirements.

Unfortunately major decisions on the reform of the Economic and Monetary Union (EMU) have been postponed. The architecture of the Euro area has been seriously shaken and business as usual is really not an option. Bold decisions are needed to make the Euro area more resistant and more resilient and above all to relaunch economic and social upwards convergence. The growing divergences between the “core” and the “periphery” represent a permanent threat for the stability of the Euro area. This has to be seen in a very particular international context characterized by a threatening protectionism and economic nationalism weakening dramatically international cooperation and coordination mechanisms. So the challenge is huge and an ambitious reform agenda is urgently needed. We cannot just permanently rely on the European Central Bank (ECB) to tackle all the problems.

The Franco-German Meseberg declaration adopted in June 2018 shows that there might indeed be a window of opportunity for a more ambitious reform of the EMU, with among others reference to a Euro budget as of 2021, possible change of the Treaty on the European Stability Mechanism (ESM) and even mentioning of a “European stabilization fund for unemployment”. For the time being no decisive progress has been achieved

apart from the strengthening of the Banking Union.

In June 2018, a seminar on the social dimension of the EMU reform was organized in Luxembourg in collaboration with the Jacques Delors Institute. It gathered Labour Ministers of several EU countries, representatives of the social partners, members of the European Parliament and renowned experts on EMU and social Europe. The purpose of this seminar was to better understand the issues around the social dimension of EMU reform. The seminar was divided into two major parts. The first panel was dedicated to the discussion on what social convergence for the euro area we want. The second panel focused on the instruments and governance for social convergence. The main ideas discussed during this seminar are presented in this report.

The fundamental objective of the European Union but equally of the Economic and Monetary Union is to “guarantee economic development and stability as well progress and prosperity for all”. This means upward convergence. It also means that social welfare is a central element of the whole European project, since the beginning but even more so with the single currency. In 2016, Jacques Delors made a clear and useful warning that should be taken very seriously: “If European policy-making jeopardizes cohesion and sacrifices social standards, there is no chance for the European project to gather support from European citizens”.

The past crisis has shown that this support by European citizens has weakened and that we have not only to strengthen the architecture of the monetary union but also restore the trust of citizens. In this respect the social dimension with very tangible results and impacts is key.

A few months before the European elections, clear and ambitious objectives have to be defined. The European Pillar of Social Rights may be very helpful in this respect, but only if a concrete action plan is established. It belongs to the next European Parliament and Commission to take such an initiative. The Social Union should be an integral part of a reform agenda of the European Economic and Monetary Union (EMU). A Social Union would increase the stability of the EMU and improve the necessary solidarity. It should remain open to non EMU members and by no means replace the national welfare systems. But in order to enhance upward social convergence and to improve the stability and efficiency of national welfare systems, a collective standard setting on the basis of the European Pillar of Social Rights as well as a better balance between economic freedoms

and social rights are urgently needed. Developing a Social Union has to go hand in hand with stronger democratic control and participation.

We have to deepen questions like a fiscal capacity, investment strategies and particularly social investments serving the development of human capital. There is certainly a need to improve the European Semester, though some small progress has been achieved recently. Improving the economic and social governance should absolutely put the question of the role of the EPSCO Council (Council formation on Employment, Social Policy, Health and Consumer Affairs). There is a need for strengthening it if the governance has to be rebalanced. Finally, social partners should play a more prominent role.

To conclude, I want to stress a key message that this report should deliver: EMU reform needs a stronger social dimension leading to a Social Union. We all should listen Jacques Delors' warning.

*Nicolas Schmit, former minister of Labour of Luxembourg*

## INTRODUCTION

Significant measures have been taken in recent years to strengthen the Economic and Monetary Union (EMU), though its architecture is as yet incomplete. A set of challenges must still be met in order to **guarantee the prosperity and stability of the common currency area**. The European Commission has identified four complementary areas for the roadmap to complete the EMU reform: the Financial Union, the Fiscal Union, the Economic Union and democratic accountability and strengthened governance<sup>1</sup>. While Jean-Claude Juncker recently stated that “*the Economic and Monetary Union is first and foremost about improving the lives of all Europeans*”<sup>2</sup>, it is crucial that the debate does not neglect the definition of what must be the EMU’s social dimension. The adoption of the **European Pillar of Social Rights (EPSR)** at the end of 2017, and the implementation of the social scoreboard are clearly welcome progress, shining a greater spotlight on Member States’ social development. However, it is still necessary to come up with a better definition of the EMU’s social dimension. This entails clarifying as a priority why the EMU must have a social dimension (Part 1) and what **type of social convergence** is required for the proper functioning and the prosperity of the common currency area and which key focus areas will allow this convergence to be achieved (Part 2). Subsequently, it is essential to define the **instruments and governance** of the EMU’s social dimension (Part 3).

<sup>1</sup> European Commission, [Communication from the Commission](#), “Further steps towards completing Europe’s Economic and Monetary Union: a roadmap”, December 2017.

<sup>2</sup> Jean-Claude Juncker quoted in European Commission, “[EU Budget: A Reform Support Programme and an Investment Stabilisation Function to strengthen Europe’s Economic and Monetary Union](#)”, *Press release*, 31 May 2018.

# 1. WHY MUST THE EMU HAVE A SOCIAL DIMENSION?

In 2013, the European Commission published a communication on the social dimension of the EMU. Since then, several initiatives were adopted to ensure that social concerns are better taken into account in the EMU. The main initiative was the adoption of the European Pillar of Social Rights in November 2017. The EPSR presents twenty principles **to restore convergence in the EU** and in particular in the EMU. However, despite this welcome progress, there is still today a lack of recognition by the main actors of EMU reform (in particular the members of the European Council and the ECOFIN Council) of the need to endow the EMU with a social dimension.

The first key question to address is thus to justify the need to endow the EMU with a social dimension. Three main reasons demand a prompt and full strengthening of EMU's social dimension. The first one is **to avoid the negative impact of the monetary union on national welfare states**. This negative impact was put in evidence during the euro area crisis and there is a need to ensure that such a situation will not be reproduced in the future (1.1). The second one is that **a social dimension is needed to contribute to a well-functioning EMU** (1.2). Finally, the third reason is that the EMU must contribute to the **achievement of EU's social objectives**, namely social progress, social cohesion and social justice (1.3.).

## 1.1 Avoiding a negative impact of EMU on national welfare states

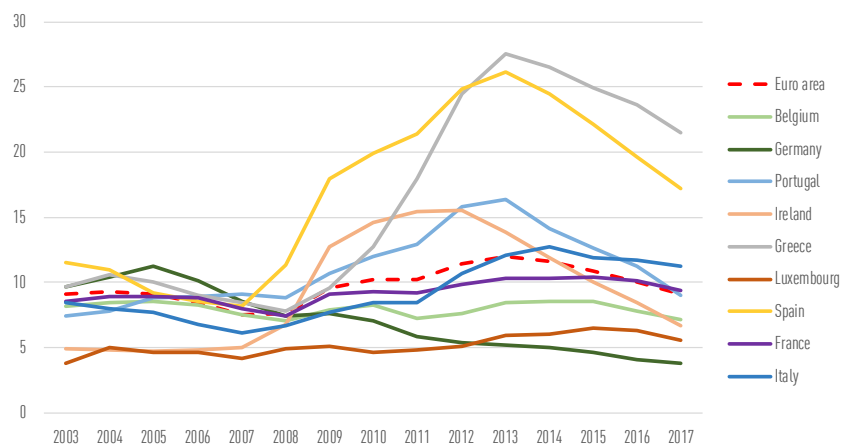
Debate on the EMU's social dimension is by no means new. Even before the creation of the Euro, academics discussed the **links between national welfare states and a single currency regime**<sup>3</sup> and outlined some risks that the common currency could impose on national welfare states. For instance, as the establishment of EMU was complemented with well-de-

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

financed rules regarding public spending in the framework of the Stability and Growth Pact, some feared that such fiscal discipline would ultimately cause a drop in social spending and, as a consequence, alter national welfare states. In addition, there were fears that the introduction of the single currency would imply greater flexibility on labour markets and in wage negotiations within Member States, ultimately resulting in a deregulation of labour markets and leading to a "race-to-the-bottom" in social standards across the EMU. Lastly, there was an acknowledgment that without the flexibility linked to the exchange rate, social standards ran the risk of acting as adjustment variables in the event of an asymmetric macroeconomic shock.

These risks were underestimated and were not reflected in the architecture of the EMU as it was defined in the 1990s. We had to wait until the crisis in the Euro area to see these risks materialise. The divergences in economic performance have been matched by marked differences as regard the social consequences of the crisis. A **widening social gap** between the euro area periphery and the rest of the euro area countries has emerged during the crisis. Figure 1 clearly shows the extent of these divergences in terms of unemployment rates. In the core EMU countries, the unemployment rate has slightly increased in 2009, but has remained stable or decreasing in the subsequent years. In addition, the unemployment rate has been contained under the 10% threshold. In the peripheral countries, the situation has been quite similar to the core in the years preceding the crisis. However, from 2008 until 2013 the unemployment rate has been continuously rising reaching the 25% threshold in Spain and in Greece.

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



Source of data: Eurostat

**The social impact of the crisis has been uneven for three reasons.**

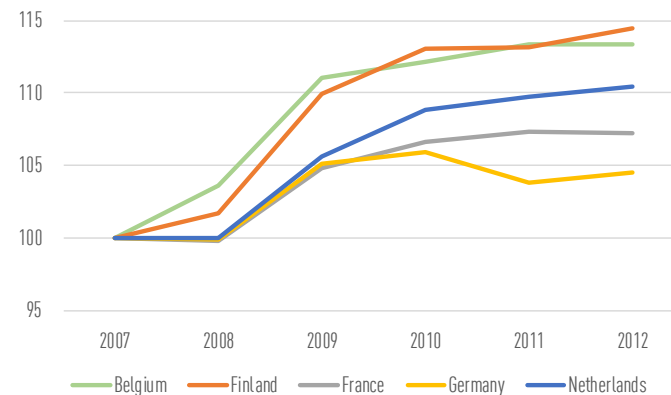
Firstly, the recession in various member states has not hit with the same strength. As a direct consequence, the levels of unemployment have spiked to record levels only in those countries where the economic activity has contracted the most. Secondly, and more importantly, automatic stabilisers have not been functioning in the similar manner in all of the member states. Differences in social models and generosity of welfare benefits imply that, *ceteris paribus*, member states hit by the same shock will have unequal capacity of “cushioning” it. Thirdly, a group of EMU member states have been forced by the markets to apply major fiscal consolidation strategies, which have constrained the normal functioning of these automatic stabilizers even where they were in place.

Data on public social spending illustrates these proposals. According to the estimates of the OECD<sup>4</sup>, in the whole of the EU, aggregate real public social spending has neither increased nor diminished during the crisis years of 2011 and 2012. However, the aggregate trend hides important disparities between the member states. Figure 2 reveals that **core and peripheral EMU countries have displayed contrasted trends in social spending**. Whereas in the core countries real social spending has slightly increased or been maintained between 2007 and 2012, the peripheral EMU countries have experienced a real decline in social spending during this

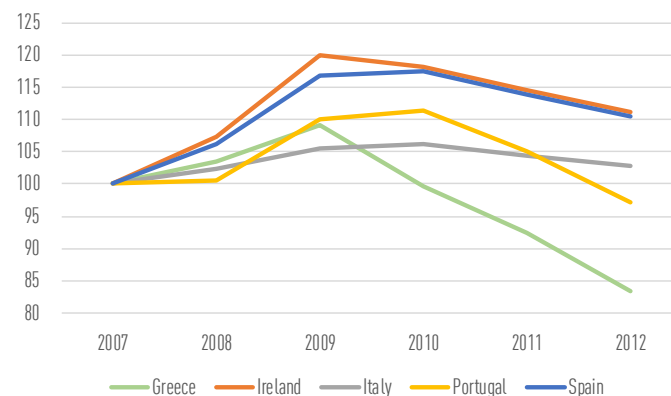
4. OECD social expenditure database (SOEX).

period. The decline has been particularly marked in Greece (where social spending was in 2012 16% lower than in 2007) and in Portugal (3% lower than in 2007). In the other three peripheral EMU countries, welfare cuts have been partly offset by increases in entitlement-based social programs (unemployment, pensions) and it remained still slightly higher in 2012 than in 2007.

**FIGURE 2.a ■ Changes in real public social spending in core EMU countries (index 100 in 2007)**



**FIGURE 2.b ■ Changes in real public social spending in peripheral EMU countries (index 100 in 2007)**



Source: Data from OECD social expenditure database (SOEX).

The peculiarity of the peripheral member states is that they have been forced to implement harsh austerity programmes. Some measures taken such as the reduction of cash benefits and pensions were explicitly aimed



at improving the state of public finances while others such as the reduction of minimum wages have been aimed at boosting national cost competitiveness. Table 1 compares the austerity packages adopted by three peripheral EMU countries most hit by the crisis (Greece, Ireland and Portugal). The aim of this table is to illustrate the extent to which social policies have been used as an adjustment variable in the EMU periphery, yet the list is by no means exhaustive<sup>5</sup>.

**TABLE 1 ■ Main measures to reduce social spending adopted in Greece, Ireland and Portugal during 2009-2013**

	GREECE	IRELAND	PORTUGAL
<b>Minimum wages</b>	<ul style="list-style-type: none"> <li>• approx. 20% cut in all minimum wages.</li> </ul>	<ul style="list-style-type: none"> <li>• reduction by €1 per hour of national minimum wage and abolition of several sector-specific minimum wage.</li> </ul>	<ul style="list-style-type: none"> <li>• freeze of minimum wage.</li> </ul>
<b>Public sector wages</b>	<ul style="list-style-type: none"> <li>• freeze of all public sector salaries;</li> <li>• cut of 13th and 14th monthly salary (for gross salaries above €3000/month);</li> <li>• reduced allowances;</li> <li>• further elimination of seasonal bonuses.</li> </ul>	<ul style="list-style-type: none"> <li>• cut of public sector wages between 5% and 15%;</li> <li>• substantial reduction in staff numbers.</li> </ul>	<ul style="list-style-type: none"> <li>• freeze of public sector wages;</li> <li>• temporary suspension of 13th and 14th monthly salary (wages above €1000);</li> <li>• permanent staff reduced by 2%.</li> </ul>
<b>Pensions</b>	<ul style="list-style-type: none"> <li>• all pensions frozen during 2010-2013;</li> <li>• increase general retirement age to 67;</li> <li>• reduction of overall monthly pension incomes and introduction of a special contribution tax on pensions;</li> <li>• elimination of all seasonal bonuses.</li> </ul>	<ul style="list-style-type: none"> <li>• pension-related deduction with rates ranging from 0% to 10.5%;</li> <li>• progressive increase in state pension age from 65 to 68 by 2028;</li> <li>• raise of number of pension contribution years;</li> <li>• future calculation of pensions on average lifetime income.</li> </ul>	<ul style="list-style-type: none"> <li>• freeze of pensions (except the lowest);</li> <li>• suspension of application of pension indexation rules;</li> <li>• reduction by 10 % in state pensions above €1500 a month.</li> </ul>

5. Fernandes, S. and Maslauskaitė, K., "Deepening EMU: how to maintain and reinforce national welfare states", Report, Jacques Delors Institute, 2013.

<b>Social transfers</b>	<ul style="list-style-type: none"> <li>• cuts in social transfers such as unemployment benefits;</li> <li>• eligibility conditions for social assistance benefits tightened;</li> <li>• family benefits subject to means-testing.</li> </ul>	<ul style="list-style-type: none"> <li>• cuts in social transfers such as unemployment, sickness, universal child benefits, and working age payments;</li> <li>• penalty measures for beneficiaries not in compliance with job-search.</li> </ul>	<ul style="list-style-type: none"> <li>• cuts in social transfers such as unemployment benefits and family allowances.</li> </ul>
<b>Healthcare expenditure</b>	<ul style="list-style-type: none"> <li>• reduction of operational cost for hospitals;</li> <li>• increased co-payments;</li> <li>• reduction of administrative and physicians staff.</li> </ul>	<ul style="list-style-type: none"> <li>• increased copayments;</li> <li>• tightening eligibility criteria;</li> <li>• provisions to charge all private patients in public hospitals.</li> </ul>	<ul style="list-style-type: none"> <li>• substantial reduction of categories exempted from moderating fees;</li> <li>• increased overall fees;</li> <li>• planned hospital reorganization.</li> </ul>

Source: Fernandes, Sofia and Maslauskaitė, Kristina, "Deepening EMU: how to maintain and reinforce national welfare states", Report, Jacques Delors Institute, 2013.

First of all, the table suggests that **minimum wages and public wages** have not been spared in any of the three countries. Minimum wages have been slashed significantly in Greece (by 20%) and in Ireland (by 1euro/hour) and frozen in Portugal. As minimum wages often concern the most vulnerable part of the labour force, if employment does not increase, such measures can only contribute negatively to levels of poverty recorded in these countries during the first years of the current decade. Similarly, public sector wages have been cut in the three countries. In Ireland the cuts ranged between 5 and 15% whereas in Greece and Portugal the public servants earning above a certain threshold have lost additional months of payment (at least temporarily).

All in all, various **social entitlements** have been reduced or lost altogether in the peripheral member states in the pursuit of austerity and adjustment. The social cost of "internal adjustment" has, therefore, been extremely high for the countries already suffering from a negative economic shock.

Thus, a social dimension for the EMU is first and foremost required because of the constraints enforced by membership of the single currency. In the euro area, member states can no longer make a discretionary use of monetary policy or devaluations so that they are left with no means to address **cyclical shocks**. There is indeed limited room for maneuver for

national states to resort to automatic stabilisers, given that they have to take into account the ceilings imposed by the Stability and Growth Pact. The absence of such adjustment tools has caused painful **internal devaluations** in several countries of the euro area and it should be recognized that equipping the EMU with a macroeconomic stabilisation capacity is a pre-requisite to avoid financial and debt problems to transform into a social crisis. The creation of such an instrument would limit the risk of countries resorting to internal devaluations – which have a negative impact on wages and social standards – in the event of an asymmetric shock.

## 1.2 A social dimension for a better functioning EMU

In the 1990s, what was envisaged in the initial EMU concept was not a desire to limit the risks that the single currency project could impose on national welfare states, but rather an attempt to ensure that **employment and social policies contribute to the proper functioning of the EMU**. When the euro was adopted, the leading argument in favour of the definition of a social dimension for the EMU was therefore a functional one. In this context, the emergence of the Monetary Union justified the implementation of a European coordination of national employment policies (adoption of the European Employment Strategy in 1997). At that time, labour market flexibility was highlighted as a priority in order to strengthen economies' responsiveness when faced with potential asymmetric macroeconomic shocks (as when such shocks occur, the ECB's monetary policy - which targets all euro area countries – is not the appropriate instrument).

During the first years of the euro area crisis, the emphasis was always placed on the need for **labour market flexibility**, which was reflected in particular in the priorities of the macroeconomic adjustment programmes to which countries which requested financial assistance from the euro area were subject. During the first years of the current decade, the majority of EMU countries have introduced structural measures to flexibilise their labour markets. Four main trends can be identified. First, many EU countries have decentralized wage-setting structures or have introduced other changes in the industrial relations structures in order to give firms more flexibility to adjust wages and other labour market conditions. Second, there has been a general trend towards reforming individual and collective redundancy rules, so as to give firms greater autonomy in dismissing workers and/or reducing the costs of lay-off. Third, many EU countries have also introduced reforms in their working time legislation, with the aim

of facilitating overtime or on the contrary, allowing companies in financial difficulty to reduce working time on a temporary basis. Finally, practically all EU countries have eased the rules governing the use of atypical contracts (mostly fixed-term contracts) or have created new types of contracts – in particular for young people – offering less protection than normal contracts<sup>6</sup>.

The crisis in the euro area has moved along the debate on how a reinforced social dimension can contribute to a better functioning EMU. The serious social repercussions of the crisis and the **social divergence between the core and the periphery of the euro area** highlighted that the Monetary Union needed both **labour market institutions which favour flexibility and social models that support stability**. The combination of adequate flexibility and an effective stabilisation capacity creates a quality of national welfare states which is best captured by the notion of “resilience”. Guaranteeing such ‘resilience’ is a matter of common concern for all countries in the euro area: the resilience of each individual member state contributes to the stability of the whole<sup>7</sup>. This implies a degree of convergence, which is not synonymous to harmonisation. Moreover, whilst convergence is needed with regard to some key features of national welfare states, it is not needed in all domains of social policy.

## 1.3 Guaranteeing that EMU contributes to the achievement of EU's social objectives

The need to ensure that national employment and social policies contribute to EMU's stability is only one aspect of the EMU's social dimension, which **goes beyond the mere “functional requirements” of the EMU in abstracto**. As mentioned in point 1.1., we need to guarantee that the EMU doesn't have a negative impact on national welfare states; but this “defensive” approach must be completed with a more positive one.

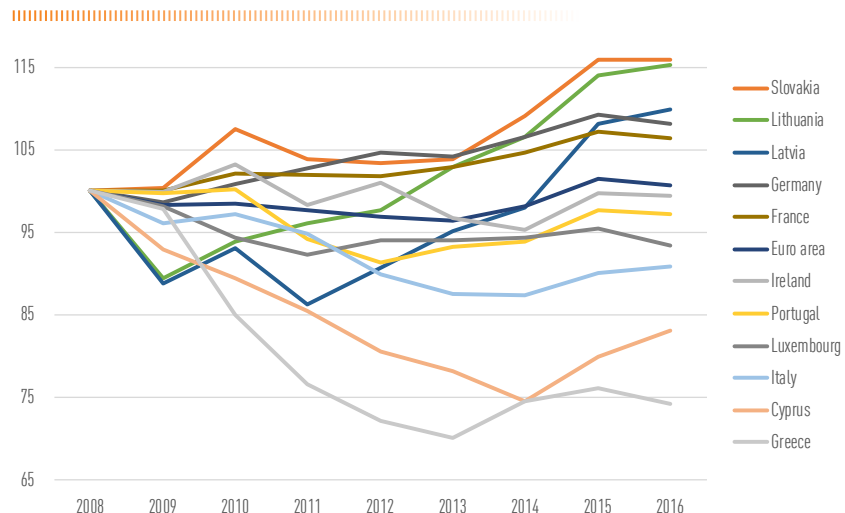
Against a backdrop in which the single currency is, in some countries, associated with a decline in living standards, a rise in unemployment and a drop in households' disposable income (see Figure 3), it is essential that **upward convergence in social performance** is promoted in euro area countries. The EMU must serve the fundamental aspiration of the Euro-

6. Fernandes, S. and Maslauskaitė, K., *op. cit.*

7. Fernandes, S. and Vandembroucke, F., “Social Europe: from Slogan to Reality”, in the *Schuman Report on Europe 2018*, Robert Schuman Foundation, 2018.

pean project, that is, to promote both upward convergence between the Member States and cohesion within the States, so that the single currency brings about a real improvement of living and working conditions of euro area citizens.

**FIGURE 3 ■ Real adjusted gross household disposable income, per capita in PPS (basis 100 = 2008) in a set of euro area countries**



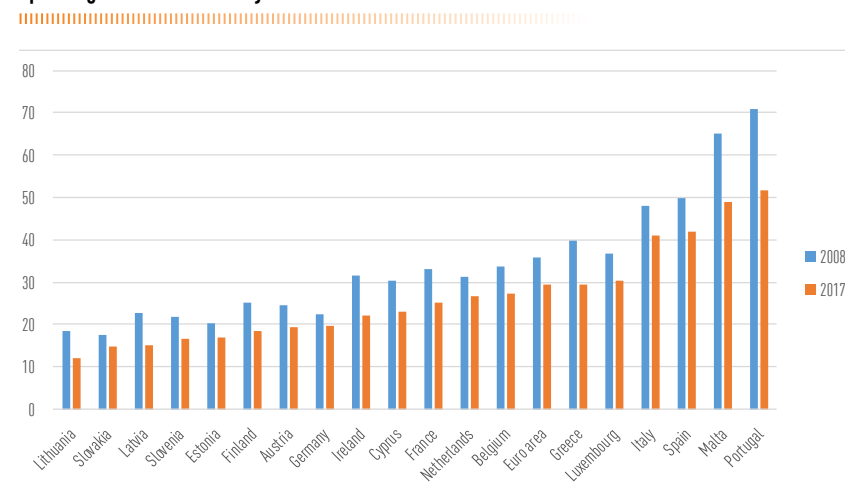
Source of data: Eurostat

Such upward convergence in living standards in euro area countries is necessary to **ensure both prosperity and political legitimacy in the euro area**. Given that, from a long-term perspective, employment and social policies – in particular education and lifelong training policies – have an important role to play in improving States’ growth prospects (see Figure 4), these policies should be a matter of common interest. This means that even though some initiatives in the social field might not be necessary for the good functioning of EMU, they might be needed to guarantee that EMU contributes to better living and working conditions of European citizens.

At this time of rising populism and Euroscepticism, this need for convergence is thus also justified by the necessity of **restoring Europeans’ trust** in the EMU project. As Jacques Delors stated, “if European policy-making jeopardises cohesion and sacrifices social standards, there is no chance for the European project to gather support from European citizens”<sup>8</sup>.

8. Delors J., “Foreword” in Rinaldi, D., *A new start for social Europe*, Report, Jacques Delors Institute, 2016.

**FIGURE 4 ■ Percentage of 15-64-year-olds with a maximum level of educational attainment corresponding to lower secondary level in 2008 and in 2017**



Source of data: Eurostat

## 2. WHAT SOCIAL CONVERGENCE FOR THE EURO AREA?

During the expert seminar in Luxembourg, the panellists and the participants raised three main points concerning the social convergence needed for a well-functioning EMU. The first point highlighted was that “social convergence” means first and foremost **convergence in national social outcomes**; and for this social convergence to be a reality there is a need to rebalance economic and social policies in the EMU (2.1.). Secondly, it was clarified that what is needed is not a fully-fledged convergence of national welfare states of EMU countries, but instead **a convergence in some key features of national welfare states**. The challenge lies in building a consensus on those key features where convergence is needed (2.2.). Finally, a third point was made on the need for **wage convergence in the EMU**. There was, however, no consensus among the participants on this issue. While some participants argued that wage convergence must be a priority for the EMU and this implies some coordination in wage bargaining, others considered that wage convergence is not a pre-requisite for a well-functioning EMU (2.3.).

### 2.1 Rebalancing economic and social policies in the EMU

When discussing about social convergence within the EU and particularly within the euro area, we should bear in mind that **long-term and sustainable social convergence is not possible without economic convergence**. European decision makers tend to dissociate economic discussions from social discussions; this is a mistake. There is a need to break the silos between economic and budgetary policies on the one hand, and employment and social policies on the other. During the first years of the crisis, the crisis management by EU leaders and EMU’s reform were undertaken without considering the possible unwanted side effects that the solutions adopted could have in social terms. This led to the high social costs of the crisis that we highlighted in the previous section.

### BOX 1 ■ The 20 rights and principles of the European Pillar of Social Rights

EQUAL OPPORTUNITIES AND ACCESS TO THE LABOUR MARKET	FAIR WORKING CONDITIONS	ADEQUATE AND SUSTAINABLE SOCIAL PROTECTION
<ul style="list-style-type: none"> <li>• Education, training and life-long learning</li> <li>• Gender equality</li> <li>• Equal opportunities</li> <li>• Active support to employment</li> </ul>	<ul style="list-style-type: none"> <li>• Secure and adaptable employment</li> <li>• Wages</li> <li>• Information about employment conditions and protection in case of dismissals</li> <li>• Social dialogue and involvement of workers</li> <li>• Work-life balance</li> <li>• Healthy, safe and well-adapted work environment</li> </ul>	<ul style="list-style-type: none"> <li>• Childcare and support to children</li> <li>• Social Protection</li> <li>• Unemployment benefits</li> <li>• Minimum income</li> <li>• Old age income and pensions</li> <li>• Health care</li> <li>• Inclusion of people with disabilities</li> <li>• Long-term care</li> <li>• Housing and assistance for the homeless</li> <li>• Access to essential services</li> </ul>

To answer the social consequences of the crisis and restore social convergence, the European Commission proposed a European Pillar of Social Rights (see box 1), which was adopted by the Commission, the European Parliament and the Council at the Social Summit of Gothenburg in November 2017. This is a welcome initiative; however we are still far from putting economic and social issues on equal footing in the EU. To achieve social convergence, there is a need **to change the macroeconomic paradigm in the EU** to make it more sustainable. To this purpose, three main elements need to be considered.

The first one is to **relaunch investment**. The Juncker Plan gave a good impetus in this field to increase public investment and foster private investment, but it is not yet enough. It was not sufficient to mobilize in a proper and meaningful way public and private investment in the EU. Against this backdrop, the European Trade Union Confederation proposes the establishment of a European Treasury for public investment. According to this proposal, “*Under a European Treasury, Member States would decide together the global level of public investment needed across the EU. The treasury would pool future public investment spending in Europe and fund it by European treasury securities. Member states would still retain full control*

over their investments, but funding would come from the European Treasury, in proportion to each Member State's GDP. They could still increase their level of public investment at their own rate of interest. Removing public capital expenditure (financed by the Treasury) from public deficits would allow Member States to increase their budget flexibility while respecting the rules of the SGP (revised to take account of current expenditure and national investment financing only)<sup>9</sup>.

The second element is to address the problem of internal demand in the EU and in particular in the EMU. Internal demand has been depressed. It is composed of investment on the one side but on the other side by the purchasing power of the people. And the only way to **increase internal demand** from this point of view is to increase wages. There is still an important gap between productivity developments and wage developments in the EU. There is a need to fill this gap, making sure that wages can be aligned with productivity developments (see point 2.3).

The third one is to manage the **ongoing transition on the labour market** – e.g. digitalisation, robotisation, energy transition - in a socially fair way. There is a need for anticipation; sufficient resources and the adequate tools need to be put in place in a way that nobody is left behind<sup>10</sup>.

There is a need to make economic governance socially sustainable, making sure that the economic dimension goes together with the social dimension. The Treaties already contain a **horizontal social clause** (article 9 of the TFEU) foreseeing that: *"In defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health"*. This clause deserves greater consideration in Europe's action than it has received in recent years.

## 2.2 Convergence in some key features of national welfare states

As we highlighted in the previous section, having resilient and sustainable welfare states contributes to a well-functioning EMU. The question we need to answer is: what are the priority actions in the employment and

9. ETUC Executive Committee, "A European Treasury for Public Investment", *ETUC Position Paper*, 23 February 2017.

10. Delors J., Fernandes S. and Pellerin-Carlin, T., "Europe needs a Social Pact for the energy transition", *Policy brief*, Jacques Delors Institute, 29 January 2018.

social fields to guarantee the resilience of national welfare states and thus to contribute to euro area stability.

The European Employment Strategy agreed in Luxembourg twenty years ago was very much focused on the flexibility of the labour market, the argument being that for a well-functioning monetary union we need sufficient supply side flexibility. The need to invest in people to enable them and allow them to secure themselves in flexible labour markets was not given sufficient attention.

One of the lessons we learned with the crisis in the euro area is that a well-functioning EMU also depends on **resilient welfare states**, which means welfare states that can guarantee stability. And this stabilisation capacity at the national level needs to be completed with a stabilisation capacity established at the EU level to support member states in the case of asymmetric macroeconomic shocks. And however we organize a stabilization capacity for the monetary union, if it is one way or another linked or triggered by unemployment shocks then inevitably, you will also need to discuss domestic stabilization capacity of the national unemployment benefit systems.

In this context, the concern with the stability of the euro area entails a cluster of policy principles to **sustain an effective stabilization capacity in each member state**. These common principles should include<sup>11</sup>:

- sufficiently generous unemployment benefits, notably in the short-term in order to have this stabilisation capacity;
- sufficient coverage rates of unemployment benefit schemes, avoiding labour market segmentation that leaves part of the labour force poorly insured against unemployment;
- no proliferation of employment relations that are not integrated into social security systems;
- effective activation of unemployed individuals in order to avoid the inactivity traps.

These principles are part and parcel of the Pillar that was adopted by the 28 Member States in Gothenburg in November 2017. As recognised by the European Pillar of Social Rights, well-designed employment protection legislation and unemployment benefit systems are both essential for good labour market functioning. Striking the right balance between flexibility and

11. See Vandenbroucke F., "Structural Convergence vs. Systems Competition: Limits to the Diversity of Labour Market Policies in the EMU", *Discussion paper 65*, DG ECFIN, July 2017.

security may favour economic resilience, by easing adjustment to shocks, while ensuring fairness and securing transitions between different jobs.

As a recent report published by the European Commission highlights<sup>12</sup>, the crisis led to some **reforms of national welfare states** that contributed to the convergence of some of their features. During the first stage of the crisis, as the priority was given to the flexibility of the labour market, we witnessed some convergence in the EU towards a loosening of employment protection for permanent contracts, as measured by the OECD indicator on strictness of employment protection (mainly driven by the component length of notice period and severance payments). This convergence is the result of the reforms conducted in several countries with more stringent legislation, in particular in the Southern member states of the Euro area.

According to the above-mentioned report, the objective of guaranteeing the stability of the national welfare states is also translated into some convergence on some key features of unemployment benefit systems. In line with the objective of broadening their coverage, there is a visible convergence towards lower minimum contribution periods necessary to be eligible for benefits (according to the EC report, eligibility conditions were loosened in eight member states and tightened in only two). Convergence towards a lower maximum duration of benefits was also observed, reflecting the combined need of supporting activation, while finding resources to broaden their coverage. Conversely, differences across countries in the net replacement rates remained mainly unchanged, despite net replacement rates being increased in sixteen member states and reduced in ten.

Finally, in addition to the convergence in some key features of labour markets and national welfare states, several participants outlined the need for **convergence in high levels of quality social investment**. For instance, investing in early childcare services might not be considered a requirement for a well-functioning EMU, but we should not underestimate its benefits to increase women's participation in the labour market and to reduce social inequality. As it contributes to inclusive labour markets and societies, it certainly can be considered as a matter of common interest for euro area countries. The same applies for other social investment, namely quality spending in education and lifelong learning.

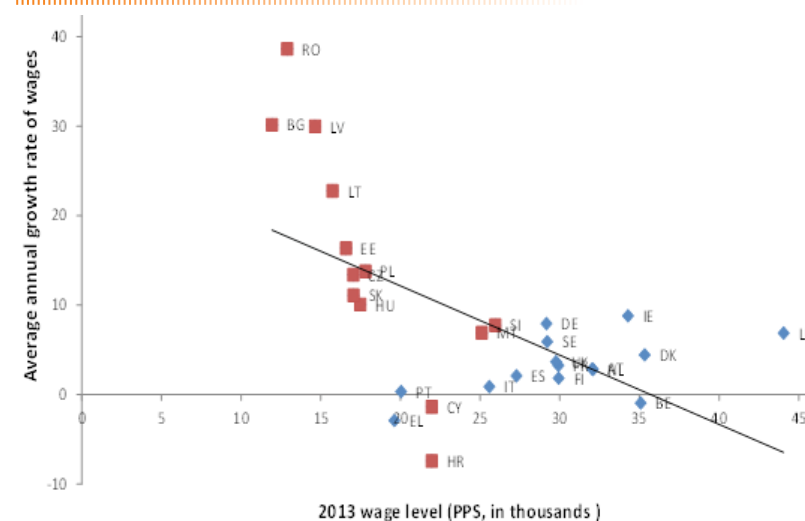
12. European Commission, *Labour market and wage developments in Europe - Annual review 2018*, 25 October 2018, p 4.

## 2.3 Wage convergence and coordination

According to several participants in the seminar, the stability of the euro area also demands a certain stability in the development of wages: in all Member States, **the development of wages should follow the long-term development of productivity**, which also implies that the share of wage in the national revenue is stable.

Since the EU enlargement of 2004, we have always seen **real wage convergence** between Eastern and Western EU countries, even though there has been some slowdown in this convergence with the crisis (see figure 5). This convergence reflects the catching-up process of the productivity level of Eastern countries to that of higher income countries. However, the crisis led to wage divergence or no convergence between Southern and Northern euro area countries. Real wages had to fall to restore competitiveness. This led to a complex situation in the euro area where countries with lower wages were asked to avoid increasing wages (or even to reduce wages) in order to regain competitiveness while other high wages countries – such as Germany and the Netherlands – were requested to increase wages in order to stimulate their internal demand and reduce their current account surplus. This implies **a negative trade-off between convergence and rebalancing**, and is clearly at odds with the aspiration of wage convergence in the euro area.

FIGURE 5 ■ Convergence and divergence in real wages since the recovery



Source: Graph from DG Employment – European Commission with data from AMECO database

The answer to this trade-off is, according to the EC, to undertake structural reforms in Southern member states which will allow for productivity gains and thus allow for wage increases and wage convergence with Northern euro area countries.

However, there is no consensus on the idea that we can achieve higher productivity through structural reforms. According to the European Trade Union Confederation (ETUC), the evidence we had in the last years clearly shows that EU's recommendations concerning the labour market, particularly when they address dismantling centralized coordinated collective bargaining, led to lower productivity and not higher productivity. ETUC highlights that according to the macroeconomic theories, there are only two tools to increase productivity: one is to invest in technology, innovation and quality of products and services; and the second one is to increase wages in line with productivity developments.

In addition, as the European Trade Union Confederation points out, in the last years in the Euro area, wages are lagging behind in comparison to productivity. There is, in a large majority of countries in the EU, **a gap between productivity development and wage development** (and this despite a low level of productivity growth in the last five years). A report from the EC also concludes that *"For the euro area as a whole, real wages in 2017 expanded at a lower rate than productivity"*<sup>13</sup>.

In a few words, wage coordination is needed to avoid excessive wage increases above productivity but also to avoid excessive wage moderation below productivity. In order to be able to do that we need to have some wage coordination within the Member states. What comes out of the literature is that Member states that have coordinated bargaining systems have an advantage; this is not a liability. There is a need to leave behind the one sided plea for decentralisation of wage bargaining. The EU should not advise the member states on the details of their **wage bargaining systems**; but, as Frank Vandenbroucke puts it, member states need to guarantee labour market institutions that can deliver on wage coordination. And he adds that *"this limits the diversity of social systems cohabiting in a monetary union, since it excludes totally decentralised and uncoordinated bargaining. Institutions that monitor competitiveness should be embedded in social dialogue, and distributive concerns should be mainstreamed in the monitoring of competitiveness"*<sup>14</sup>.

<sup>13</sup>. European Commission, *op. cit.*

<sup>14</sup>. Vandenbroucke F., *op. cit.*

### 3 ■ WHAT INSTRUMENTS AND GOVERNANCE FOR SOCIAL CONVERGENCE IN THE EURO AREA?

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

In its document dated December 2017 on the reform of the EMU, the Commission did not identify the social dimension as one of the EMU's basic pillars but stressed under the economic pillar the need to **take into consideration the twenty EPSR principles in the European Semester**.

The Pillar therefore represents a positive step forward, even though, simultaneously, the initiative creates a huge risk. As such, the principles are non-binding for the Member States; if the Union cannot guarantee that they are turned into concrete achievements, the initiative will only increase existing frustrations amongst citizens and have the opposite effect than the one expected.

How can the EU and its member states deliver on the promise contained in the Pillar? Several ideas were discussed during the seminar. There was a broad consensus on the need to **"socialize" the European semester** (3.1.); to adopt **a set of common minimum standards** (3.2.); to equip the EMU with a new budgetary capacity, including for **macroeconomic stabilisation** (3.3.); and to strengthen the **social governance** of the euro area (3.4.). Some experts considered that the country-by-country approach of the European Semester, during which the EC issues country-specific recommendations including for structural reforms of the labour market, is counterproductive as it confines the EC to a role of sermoniser. According to this viewpoint, the EMU would need a new mobilising project to complete the monetary union, the economic union and the banking union. And this project is a **European jobs union** (3.5.).

### 3.1 Socializing the European semester

The social dimension of the EMU has been strengthened since the start of the Euro area crisis predominantly by the coordination of employment and social policies. Against this backdrop, Zeitlin and Vanhercke conclude that since 2011, there has been a **“socialisation” of the European Semester**. The researchers suggest that this socialisation includes *“a growing emphasis on social objectives in the Semester’s policy orientations and messages, embodied in the Annual Growth Survey and especially the country specific recommendations”*<sup>15</sup>. This trend has been heightened with the adoption of the European Pillar of Social Rights. Marianne Thyssen recently claimed that *“This year’s country specific recommendations have a greater than ever focus on employment, education and social issues”*<sup>16</sup>. Moreover, the social scoreboard, which includes twelve areas for which it is possible to measure societal progress and a broader set of indicators, is a reference framework used to monitor social developments in the different Member States.

Despite such progress in strengthening the social dimension of European economic governance, many experts have stressed the **continued imbalance between a monitoring of social developments which remains based on political incentive alone and the restrictive procedures – together with possible financial sanctions – to monitor budgetary and macroeconomic imbalances**. In this respect, De la Porte and Heins state that *“Within the semester, fiscal and budgetary governance instruments have become more precise in terms of objectives, and stricter in terms of surveillance and enforcement, while social and labour market policy instruments remain weaker on these dimensions and thus in their potential impact”*<sup>17</sup>.

How to reconcile budgetary and macroeconomic policy on one side with employment and social policy on the other is likely the greatest challenge facing EU leaders that aim at restoring convergence. As we have separate procedures for budgetary and macroeconomic surveillance, some will argue that it would make sense to have a new separate procedure for the surveillance of social imbalances. Social distress has a strong negative

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

16. Marianne Thyssen quoted in European Commission, *European Semester 2018 Spring Package: Commission issues recommendations for Member States to achieve sustainable, inclusive and long-term growth*, 23 May 2018.

17. De la Porte C., Heins E., *A new era of European Integration? Governance of labour market and social policy since the sovereign debt crisis*, Comparative European Politics, 2015.

impact on the economy and leads to political unrest; so there certainly is a good reason to introduce such a procedure and grant more surveillance powers to the EU in this field. However, while the budgetary and macroeconomic surveillance procedures are based on the possibility to impose financial sanctions to member states that do not respect the commonly defined rules, it is hard to imagine such a sanction based procedure for the surveillance of social imbalances.

Rather than a sanction mechanism, **social imbalances have to be tackled with an incentive mechanism**. Various social indicators relating to the labour market (e.g. unemployment rates) or general wellbeing in the society (e.g. poverty levels) might depend on the business cycle and be outside direct government control, at least in the short run. In addition, the achievement of certain commonly-set target levels might require expensive immediate reforms, which would bear desired outcomes in the longer term only. Therefore, contrary to the Macroeconomic Imbalance Procedure, which includes a sanction mechanism, in the social field member states should adopt an incentive mechanism instead. This mechanism could rest on the “Reform Support Programme” which is currently being debated and which aims at reinforcing the implementation of structural reforms. Nevertheless, rather than a bilateral approach in which the Commission tells each government what it has to do, the member states should define a set of social objectives – or retake the ones from the Europe 2020 strategy – and agree on a financial aid addressed to the countries that are launching initiatives and reforms aiming at achieving these objectives as well as reducing their social imbalances.

### 3.2 EU’s legislation for common minimum social standards

The discussion on the definition of common minimum social standards for the EU and/or the euro area always starts with the identification of the social rules where an EU-wide common standard would be welcome and useful. We tried to identify in section 2.2. the features of national welfare states where some convergence would be needed in order to improve the functioning of the EMU. Not all the principles of the EPSR deserve to be translated in hard law; but some principles would surely need so. As the Commission presented a proposal for a recommendation on the **access for all workers to social protection**, this is clearly one issue where an EU-binding legislation would, at least for the euro area countries, be needed to reinforce the stabilisation capacity of national welfare states and thus the resilience of national economies in bad times.



A second issue to address and which deserves greater attention is whether this set of common social standards could be defined for the EU-28 or not. In its paper on the future of the social dimension of Europe (2017), the Commission presented a scenario with a variable geometry social Europe, in which **those who want to go further can do so**, and states that this group of countries should at the very least be made up of the countries of the euro area<sup>18</sup>. However, apart from the coordination and surveillance of the budgetary policies, there is currently no legal framework on the basis of which legislation applicable only to the euro area may be drafted. But if the euro area countries wished to draft common social or labour standards through legal acts, they could do so through “**enhanced cooperation**”, provided for in the treaties. Admittedly, this instrument is not easy to implement; and yet it could be leveraged to overcome the obstructions that often occur in EU-28 legislative negotiations for social and labour matters. This implies that a group of at least nine countries could, as a last resort and only if the 28 Member States agree, adopt legal acts which would only be binding for the participating countries.

The euro area would be strengthened and its citizens better protected if there were greater convergence of national social and labour policies. In a recent paper on the social dimension of EMU, Theodoropoulou and Rasnača (2017) add that if the adoption of common standards proves difficult through enhanced cooperation, Member States could use another instrument, **intergovernmental cooperation**, as was the case for the European Stability Mechanism (ESM) and the Fiscal Compact<sup>19</sup>.

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

This risk surely exists; yet, EU’s history gives us a good example of a differentiated social integration that led to a strengthening of EU-wide social Europe. In the 1990s, during the negotiations on the Maastricht Treaty, it was possi-

18. European Commission, *Reflection paper on the social dimension of Europe*, 2017.

19. Rasnača, Z., Theodoropoulou, S., *Strengthening the EU’s social dimension: using the EMU to make the most out of the Social Pillar*, European Trade Union Institute (ETUI), 2017.

ble to add a Social Protocol to the EU Treaty because EU countries agreed that the UK could benefit from an “opt-out”. On the basis of this Social Protocol, EU countries signed some new EU legislation in the social field in the 1990s (on European Works Councils and Parental Leave) that was not applicable in the UK. Some years later, after a new British government came to power in 1997, the UK agreed to sign the Social Protocol. As a consequence, this text was incorporated in the Amsterdam Treaty (social chapter)<sup>20</sup>.

### 3.3 New budgetary instruments for the euro area

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

The EC proposal for the multiannual financial framework for the period 2021-2027 includes two new financial instruments directly linked to the common currency (3.3.1). However, despite a growing consensus among experts and within EU institutions on the need for a macroeconomic stabilisation capacity at the euro area level, there is still a lack of support from Member states to create a new macroeconomic stabilisation mechanism at EMU level (3.3.2).

#### 3.3.1 EC proposal for new budgetary instruments for the euro area

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

20. Lourie J., “The Social Chapter”, *Research Paper 97/102*, Business & Transport Section, House of Commons Library, 2 September 1997.

In addition to this Function, the Commission has proposed a second budgetary instrument – the **Reform Support Programme** – which would have an impact on the coordination of economic and social policies, operating as a sort of **financial incentive to implement the reforms** provided for in the country-specific recommendations and which include reforms in social and labour fields. This Programme, with an overall budget of €25 billion, will not only include a **Reform Delivery Tool** but also a Technical Support Instrument and a Convergence Facility for countries which are not part of the euro area. By 2020, the Commission will launch pilot projects to test this instrument. The first pilot project (financed by the European Structural and Investment Funds - ESIF) is being rolled out in Portugal. It is a reform of the vocational education and training system, in a country with the highest rate of unskilled workers within the euro area countries (see Figure 4).

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

Despite the limits of this instrument, the EC proposal is a step forward to recognize the need for a stabilization instrument for the EMU. Maintaining investment through loans in bad times is certainly not the best answer, but it is probably better than nothing. Endowing the EMU with a macroeconomic stabilization capacity is a difficult political issue as it entails the risk of fiscal transfers among countries. A small step approach is probably the only way to succeed.

### 3.3.2 The need for a macroeconomic stabilisation mechanism at EMU level

Creating a budgetary capacity for the Euro area through a small steps approach is not *per se* a bad thing. What we need, however, is to establish a roadmap with short-term initiatives but also longer-term objectives. Although the resilience of national welfare states can and must be enhanced in order to curb the scale of crises, the countries of the EMU are still lacking automatic stabilisers for the euro area, and in particular a policy tool in the event of an asymmetric shock. Thus, endowing the EMU with a solidarity instrument in the form of a macroeconomic stabilisation mechanism should clearly be part of the roadmap.

Although there is no consensus today on this issue at the country level, there appears to be a consensus among EMU experts and at the level of the EU institutions on the need to create such a macroeconomic stabilisation mechanism. Indeed, the Five presidents' report on EMU reform published in 2015 clearly identifies the need to establish in the long-term a macroeconomic stabilisation capacity at the euro area level<sup>21</sup>.

Several proposals have been put forward by researchers in recent years, including proposals that present the instrument as an **unemployment insurance (or reinsurance)**<sup>22</sup>. One of the key questions to address concerning this stabilisation mechanism is whether it should be based on grants or loans. Last June, the German Finance Minister proposed a loan-based unemployment reinsurance, to be paid back by the receiving countries in good times<sup>23</sup>. And in the Meseberg declaration, France and Germany agreed to set up a working group to “*examine the issue of a European Unemployment Stabilization Fund, for the case of severe economic crises, without transfers*”. This means that what is envisaged is a loan-based instrument. As Enderlein and Guttenberg point out, this suggests that “*the instrument comes closer to a cyclical stabilization fund than to a real unemployment insurance*”; but there is an important political message in this joint position, which is that “*France and Germany agree that the cyclical component of unemployment inside EMU is a common challenge of all euro-area countries calling for a reinsurance system*” and this is a major step forward<sup>24</sup>.

21. Juncker, J.-C. et al, [Completing Europe's Economic and Monetary Union](#), European Commission, 2015.

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

23. [Germany's Scholz proposes Europe-wide unemployment insurance scheme](#), *Reuters*, 9 June 2018.

24. Enderlein H. and Guttenberg L., [Why Meseberg matters – A short explainer](#), *Brief*, Jacques Delors Institute, 20 June 2018.

### 3.4 The social governance of the euro area

In addition to the matter of concrete initiatives and instruments which can be leveraged to strengthen the EMU's social dimension, the question of the common currency area's **social governance** is raised. Zeitlin and Vanhercke stress that the "socialisation" of the European Semester, which was borne out between 2011 and 2016, comprises "*intensified monitoring, surveillance, and review of national reforms by EU social and employment policy actors and an enhanced role for these actors relative to their economic policy counterparts in drafting, reviewing and amending the CSRs*"<sup>25</sup>. Despite this positive development, **the roles of finance and labour ministers in the governance of the euro area is far from equal**. The challenges of the euro area are still considered to be the responsibility of finance ministers who meet every month (in the ECOFIN and EUROGROUP), compared to labour ministers who meet four times a year. The euro area summits are also prepared by the Eurogroup. In this respect, there are calls for a stronger role for labour ministers, which could involve **greater involvement of the EPSCO Council in the EMU reform** (the euro area summit should, for example, receive a contribution from the EPSCO Council) or through enhanced interaction between the EPSCO and ECOFIN Councils.

Last but by no means least: the **role of social partners in euro area governance**. Social partners are involved in the **European semester** – they are in particular consulted by the Commission when drafting the Annual Growth Survey – yet their involvement could be enhanced. In this respect, Parker and Pye (2017) propose, for example, that "*national social partners should also be incorporated into the series of bilateral meetings held between the Commission and national governments throughout the European Semester. The active involvement of social partners would help to bolster the attention given to rights assessments*"<sup>26</sup>. While the Commission wishes to grant financial incentives for the implementation of structural reforms – some of which would be in employment and social fields, as is the case for the pilot project in Portugal – the role that social partners must play in these reform proposals between the Commission and national governments must be defined.

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

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

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

### 3.5 A new mobilising project: a jobs union

During the seminar, it was proposed to launch a new mobilising project at the EMU level: a jobs union that would complete the existing monetary, economic and banking unions<sup>27</sup>. The implementation of this project would follow the logic of other EU projects; as for the setting up of the single market or the monetary union, the **jobs union** would need a roadmap with the identification of criteria to join it and different stages to be implemented. It would imply the setting up of long-term objectives. According to the viewpoints expressed during the seminar, such an ambitious project would rely on **three pillars**.

The first pillar would include the **convergence in some key features of national welfare states** linked to the labour market and the social security systems – as presented in point 2.2 – in order to increase their resilience. The starting point of this convergence would naturally be the EPSR, with some of its principles being translated into common standards established through EU law and applicable at least to Euro area countries (see point 3.2).

The convergence foreseen in this first pillar would create the necessary conditions for the establishment of new solidarity instruments for the euro area (or the review and reinforcement of existing ones at EU level, such as the European Globalisation Adjustment Fund which scope and magnitude could be enlarged). Such **solidarity mechanisms** would constitute the second pillar of the jobs union. It should include a budgetary stabilisation tool at EMU level in order to limit the risk that member states need to undertake an internal devaluation process when hit by an asymmetric shock (see point 3.3).

27. See Bénassy-Quéré A., *A European Jobs union*, Les rencontres économiques, 2017.

Finally, the third pillar of the jobs union would consist in the strengthening of the **single European Labour market**, as a way to reinforce the cyclical adjustment capacity of the euro area countries through labour mobility and to tackle the structural geographic mismatch between job offer and demand. This single European labour market requires a set of initiatives to guarantee a fair labour mobility in the EU/euro area. These initiatives range from the *de jure* and *de facto* recognition of diplomas and qualifications, to the reinforcement of the portability of workers' rights (including training, unemployment benefits and pensions) and better fight against abuses and fraud. This last objective can be achieved through the creation in 2019 of a European Labour Authority, as proposed by the European Commission in March 2018<sup>28</sup>.

As French economist Agnès Bénassy-Quéré puts it, this jobs union would be a concrete project, *"likely to change the lives of workers, as Erasmus has achieved for the students. In a services economy where skills and mobility are more important than ever, such a project would also contribute to restoring robust growth"*<sup>29</sup>.

<sup>28</sup>. See Fernandes S., *"What ambition for the European Labour Authority"*, Policy paper, Jacques Delors Institute, March 2018.

<sup>29</sup>. Bénassy-Quéré A., *op. cit.*

## CONCLUSION BY VALDIS DOMBROVSKIS, VICE-PRESIDENT OF THE EUROPEAN COMMISSION

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According to Eurobarometer polls, 6 in 10 Europeans want more decision-making at the European level on social security and health issues. Only half of them believe that, currently, everyone has a chance to succeed.

Europe's social model is particularly highly valued. Despite different histories and traditions, we all share a belief that a more social Europe is necessary. This was the main message voiced at the Gothenburg Social Summit of November 2017, on which we shall build. Equality of opportunities and more equitable outcomes, we realise, lead not just to social improvements but also to economically and politically strengthened societies. Making our economies and social systems converge is therefore not just a priority, but also a necessity.

We have an opportunity to do so: if we look at the economic outlook across Europe, we now see a steady and broad-based economic expansion. Growth rates are the highest in a decade, with 2.3% growth expected this year.

Investment is picking up, employment is at record levels and the unemployment rate is back to where it was before the crisis. The share of people at risk of poverty or social exclusion has also fallen to pre-crisis levels. Public finances are improving. And our banking sector is better shaped and well capitalised.

There is no room for complacency. Economic growth does not automatically lead to social improvements. Since the crisis, convergence between regions is faltering, social trends are uneven at best, and inequality among generations is rising.

Global developments, driven by a combination of technology and globalisation, put additional pressure on our social security systems.

The World Bank once dubbed the EU 'the convergence machine'. Our social model clearly needs updating to meet people's expectations, to make our economies more resilient to crisis and to changes that we are facing; in short: to keep the convergence machine going. That is what EMU reform is all about.

It is important to highlight why social convergence in the EU, and in particular the euro area, is a must:

- First, the crisis **laid bare the existing weaknesses** in our economies and social systems. Its legacy persists in the form of high public and private debt, insufficient public investment, and high risks of poverty among some segments in society. And despite clear improvements in overall employment figures, half of all unemployed people are currently long-term unemployed.
- The crisis also further added to **budgetary pressure resulting from demographic trends**. There are already more people over 65 years old than under 14. Going forward, higher costs for pensions, healthcare and long-term care will have to be borne by fewer people. By 2060, there will be only 2 people of working age for every elderly person. Ten years ago, that ratio was 4 to 1.
- On top of that, the crisis shed new light on the **inequality of parts of our social security systems and little labour markets**, which proved very focused on insiders and provided legal protection for outsiders.

At the same time, a number of **new challenges** are coming our way:

- Robotisation and digitisation make **new forms of work** possible. This implies more choice in people's careers: maybe from one or two jobs over a career span, more than 10 job changes might be the new normal. It also allows independent ways of working. But there are clear risks of increasing insecurity and inequality, as social protection and social dialogue lag behind in those new forms of work.
- **Job polarisation** is another risk: global competition and new types of jobs – created mainly in the services sector – demand new types of skills, and those who lack them could lose out from competition both from abroad and from technology. Beyond Europe's well-known productivity challenges, a new breach threatens to open up along what the OECD calls the 'Productivity-Inclusiveness Nexus', with more inequality growing *between* companies in different sectors - according to their productivity growth - and *within* companies, between high-skill and lower-skilled jobs.
- Finally, we also see advanced societies also raising the bar on **people's expectations when it comes to social rights**, wanting for instance to combine a career with a high quality of life.

At the same time, let's think and act positively. However great the challenges, let's not forget that the basic evolutions are good news: people lead longer and live healthier lives, have more opportunities and more options in their lives and careers. There are also aspects on globalisation and technology which both are a spur to our economy.

In a digitised, innovative and open world, economic and social progress is more than ever **two sides of the same coin**. This is the kind of convergence we should invest in: one that looks at economic and social considerations together.

The push to make our growth more inclusive has gathered support in recent years. The EU is developing the necessary **instruments and governance** framework to make this happen.

Let me highlight some key steps in this direction.

With the proclamation of the **European Pillar of Social Rights**, we have agreed on a path towards upward social convergence based on a rights-based approach. This is an approach that builds on high-level social standards that are applicable in order to modernise our labour and social protection systems.

Of course, the real test lies in its implementation; which is a joint responsibility of EU institutions, Member States, social partners and other stakeholders.

Another instrument in our hands to boost upward social convergence is the European Semester.

It supports the achievement of common goals by targeting the most pressing reforms needed at national level. By **integrating the European Pillar of social rights into this process**, we focus Member States' minds and efforts on the social issues that matter most, such as possible shortfalls in skill levels, underperformance in active labour market policies or education systems, and social exclusion of weaker segments in society.

The analysis of the new **social scoreboard** shows, naturally, a great variation in social situations. That is precisely the point: it allows for a targeted approach, aimed at specific needs and possibilities of the country in question, while pushing the social reform efforts of all in the right direction.

This also allows us to **identify EMU specific challenges and successes**. We see, for instance, an overall improved performance on employment

and childcare in the EMU countries – despite the obvious setbacks of the crisis – while the impact of social transfers seems to be weakening and income inequality had worsened.

Beyond targeted national reforms, EU-level action can also help create job opportunities and improve social standards across the EU.

This is why, on top of the work throughout the European Semester, we have updated the EU rules on **labour mobility**, revised the system of **Social Security Coordination**, and proposed the creation of a **European Labour Authority**, which will support national authorities, individuals and employers to manage cross-border labour situations more effectively.

Other EU legislation, such as on **Work-Life Balance**, on **Transparent and predictable working conditions**, and the Recommendation on **Access to social protection for workers and the self-employed**, can help us keep the social convergence momentum going too.

We can also support convergence efforts through appropriate funding. This is the focus of the latest **Multiannual Financial Framework** proposals, which the Commission has outlined over the past few weeks.

- Specifically, the proposed **European Social Fund Plus** is the way to put our money where our mouth is – to the tune of up to €101 billion for the next MFF. The ESF+ merges existing funds and programmes, and this integration should allow us provide additional focus on areas where that is necessary. We are securing funding to certain key groups, such as youth, and earmarking resources to promote social inclusion and tackling poverty. To make our European Social Funding more effective, the link with European Semester priorities and CSRs is also tightened.
- This allows for complementarity with our **Reform Support Programme**, which will provide technical and financial assistance to Member States implementing reforms. There will be three tools under the Reform Support Programme with a total budget of €25 billion. (i) First, there is the Reform Delivery Tool, which offers financial support to the Member State upon implementation of agreed reforms. (ii) Second, the Programme will continue to provide technical support for the design and implementation of reforms in Member States, and we see a great demand from Member States for that - hence our proposal to increase the funding. (iii) And third, we also propose a dedicated Convergence Facility to offer support for those non-euro Member States

that take concrete steps to join the euro area.

- The revised **European Globalisation Adjustment Fund** will allow us to react to profound social changes brought about by shifts and shocks in the global economy, with a proposed budget of €1.6 billion. By simplifying the procedure and lowering the threshold - the current 500 redundancies will be halved, the EGF will be more efficient and allow more companies to benefit, especially SMEs.
- And in the context of EMU reform, we have also outlined our proposal for a **European Investment Stabilisation Function**. Public investment is often the first to get cut in times of stress on public budgets, with large and potentially long-term economic and social consequences. An investment Stabilisation Function would help stabilise investment levels and facilitate rapid economic recovery, complementing the role of existing national automatic stabilisers. Our proposal is aimed at euro area countries as well as those participating in the European Exchange Rate Mechanism II exactly as Mr. Minister outlined that those countries do not have exchange rate as a policy tool. Loans of up to €30 billion would be mobilised, together with an interest rate subsidy to cover their cost. There will be also strict criteria of sound macroeconomic and fiscal policies to provide incentives for responsible budgets as well as then to provide a buffer for external shock.

Last but not least, I would like to outline the emphasis we have put on **social dialogue** throughout the structural reforms process. We have committed to engage with social partners whenever key decisions are taken, not only on traditionally 'social' issues but across the board. And I hope we are delivering on this promise.

Social partners' engagement is crucial to get the best sense of which reforms are needed and their feasibility, and to increase ownership in implementing them. So, we consistently bring this message to national and even regional governments, and do what we can to support building social partners' capacity in practice.

It is also true that even the best proposals on paper still risk remaining dead letter, if there is no broad base to carry them out in practice. Social dialogue is a key element of a vibrant social dimension to our EU and, more specifically, to the EMU.

Before concluding, let me say a few words on governance, by quoting the recent OECD report 'Opportunities for All'. The report describes the social

challenges highly developed economies face, and underlines this point in particular. It says: 'The complexity of the inclusive growth agenda raises important challenges in terms of governance, as policy fragmentation needs to be reduced and institutional mechanisms integrated in order to design coherent policy packages and deliver them more effectively.' This is precisely what EMU completion sets out to achieve: to allow better governance, stronger policy coordination, and more support to make sure reforms are effectively delivered.

Over the years, we have reinforced our economic governance system. We have streamlined the European Semester, with fewer recommendations, to make them more effective. We have taken the euro area dimension fully on board. And we especially put more emphasis on the social performance of countries. And this is the direction I think we need to continue to work.

There is a lot of economic and social potential in Europe. Our economies' openness and competitiveness continue to attract investors and partners from across the globe. Our stability and social coherence are part of our attraction.

What we need to do is concentrate minds and efforts at all levels on making that growth more inclusive, and use the current window of opportunity to double down on efforts to prepare for tomorrow's challenges, it also concerns completing the EMU agenda.

*Valdis Dombrovskis, Vice-President of the European Commission*

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# THE REFORME OF THE EMU: WHICH SOCIAL DIMENSION?

20 June 2018, 15:00 - 19:00

Senningen Castle,  
Luxembourg

The reform of the Economic and Monetary Union (EMU) will be at the heart of the European agenda in the coming months. This reflection on the deepening of EMU should not be limited to economic, budgetary or financial stakes. EMU also has a social dimension that needs to be clarified. What social convergence is necessary for the proper functioning of EMU? What are the instruments to put in place or strengthen to achieve this social convergence? How to improve the social governance of EMU? It is during a high-level seminar that the Luxembourg government, in partnership with the Jacques Delors Institute, seeks to answer these questions in order to contribute to the debate on the deepening of EMU.

**15:00 - 15:10 Introduction by Nicolas Schmit**, Minister for Labour, Employment and the Social and Solidarity Economy, Luxembourg

**15:10 - 15:20 Keynote speech by Luca Visentini**, General Secretary of the European Trade Union Confederation

**15:20 - 16:45 Panel 1: What social convergence for the euro area?**

**Agnès Bénassy-Quéré**, Professor at the Paris School of Economics

**Barbara Kauffmann**, Director for Employment and Social Governance at the European Commission

**Frank Vandenbroucke**, Professor at the University of Amsterdam

**Chair: Sébastien Maillard**, Director of the Jacques Delors Institute

**16:45 - 16:55 Speech by Maxime Cerutti**, Director of the Social Affairs department at Business Europe

**16:55 - 17:10 Coffee Break**

**17:10 - 17:20 Speech by Kris Peeters**, Vice Prime Minister of Belgium and Minister for Work, Economic Affairs and Consumer Affairs, responsible for Foreign Trade

**17:20 - 18:45 Panel 2: What instruments and governance for social convergence in the euro area?**

**László Andor**, former Commissioner for Employment, Social Affairs and Inclusion

**Lucas Guttenberg**, Deputy Head of Research at the Jacques Delors Institut - Berlin

**Maria João Rodrigues**, Member of the European Parliament, rapporteur of the report on the European Pillar of Social Rights

**Chair: Sonja Bekker**, Associate Professor at the Tilburg Law School

**18:45 - 19:00 Conclusion by Valdis Dombrovskis**, European Commission Vice-President for the Euro and Social Dialogue

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## THE REFORM OF THE ECONOMIC AND MONETARY UNION: WHAT SOCIAL DIMENSION?

Significant measures have been taken in recent years to strengthen the Economic and Monetary Union (EMU), though its architecture is as yet incomplete. A set of challenges must still be met in order to guarantee the prosperity and stability of the common currency area.

While Jean-Claude Juncker recently stated that “the Economic and Monetary Union is first and foremost about improving the lives of all Europeans”, it is crucial that the debate on EMU’s reform does not neglect the definition of what must be the EMU’s social dimension. As Nicolas Schmit underlines in the preface of this publication, EMU’s reform must include the definition of a “social union” that would enhance upward social convergence and improve the stability and efficiency of national welfare systems.

This report, commissioned by the Ministry of Labour, Employment and the Social and Solidarity Economy of Luxembourg, focuses on three key questions for the definition of EMU’s social dimension: 1. Why the EMU must have a social dimension?; 2. What type of social convergence is required for the proper functioning and the prosperity of the common currency area?; 3. What instruments need to be put in place or reinforced and what social governance is needed in the euro area ?

This publication builds on the debate, visions and proposals shared by experts and policy-makers who gathered in Luxembourg in 2018 for the seminar on “The Reform of the Economic and Monetary Union: Which Social Dimension?” jointly organized by the Jacques Delors Institute and the Ministry of Labour of Luxembourg. It aims at fostering debate on the reinforcement of EMU’s social dimension and presents policy recommendations to rebalance the economic and social dimensions of the European project.

