

# Social policy in a monetary union: puzzles, paradoxes and perspectives

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## Abstract

All existing monetary unions centralise, to various degrees, specific social policy functions, notably functions that support economic stabilization, like unemployment insurance. The European Monetary Union features as the only exception. Compared to the United States, the European Monetary Union organises more solidarity within its member states, but far less between its member states: this is an untenable paradox of strong but parochial solidarity. Any way out of this paradox leads to a complex puzzle of sovereignty, solidarity and mutual trust.

One should not underestimate the complexity of this puzzle, but not solving it implies a lasting fragility of the European construction. Contrary to what is sometimes argued, we are not facing a 'tragic dilemma' between European integration and maintaining social welfare states, but we need to repair major design flaws in the Monetary Union.

The solution does not point to a European welfare state, but to a true union of welfare states: a European Social Union would support national welfare states on a systemic level in some of their key functions. It presupposes a basic consensus on the European social model. I will briefly refer to the European Commission's initiative to launch a 'European Pillar of Social Rights', since this can contribute to developing such a consensus.

Risk sharing on the basis of mutual insurance – the kind of solidarity I advocate in this contribution – implies 'reciprocity'. Reciprocity is the cement of national welfare states; it can also inspire a European Social Union. For instance, we should apply a principle of reciprocity to current debates on cross-border mobility.

Politically, the arguments presented in this contribution may seem an uphill battle today. However, we should not shy away from the rational argument: in order to 'take back control', Europeans must be ready to share risks and sovereignty in some key domains of their welfare states.

## Introduction: a tragic dilemma?

Developing national welfare states and integrating Europe were the greatest political projects of the 20<sup>th</sup> century. They raised hope: welfare states would 'free the people of fear and need'. European integration was to put an end to a history of bloody wars. Both projects now seem at a standstill, if not in deep trouble. The European Union (EU) faces existential questions about its ultimate goal. There is no questioning the goal of welfare states *per se*, which is to protect people against social risks, but the impression is that they are less and less capable of realising that goal. I will not talk about the succession of crises the Union has been confronted with, nor will I discuss all the challenges our welfare states are facing. Hence, some important issues will not be covered during this lecture. I will zoom in on one particular question: is it the case that the European project and the project of national welfare states are now at odds *with each other*? Are we caught in a tragic dilemma because their objectives (integration and openness by the Union, protection and security by national welfare states) are no longer compatible *qua objectives*?

In the community of EU scholars, that pessimistic assessment is not new. According to Fritz Scharpf, it is impossible for the EU, such as it is conceived, to become a social market economy: the EU consistently pushes its member states towards a liberal market model.<sup>2</sup> The founders of the European project thought rather the opposite: the signatories of the Treaty of Rome were convinced that economic integration would contribute to the development of prosperous and inclusive national welfare states. In retrospect, we can summarize this optimistic belief as follows:

- Economic integration would not only stimulate growth in all participating countries but would also allow for less developed countries to catch up: integration was a convergence machine.
- Social policy could safely be left to the national level, where trade unions and political parties would develop sufficient pressure to redistribute the economic benefits of integration fairly. There was no need to agree on pan-European social standards. Countries that were ahead economically and socially would not be hindered in their social policy: the convergence machine would not affect their internal social cohesion.<sup>3</sup>

In short, the *founding fathers' credo* was based on two articles of faith, which should be clearly distinguished: convergence-through-integration between the member states and cohesion-in-convergence within the member states. I should immediately add that the second article of faith (cohesion-in-convergence) was not undisputed. In the fifties, there was no consensus on whether economic integration was possible without social harmonisation. This question was at the heart of the 1956 Ohlin report, which, together with the Spaak report, prepared the launching of the European Economic Community. Bertil Ohlin<sup>4</sup> believed that differences in wages and related social expenditures between the countries involved were mainly related to differences in productivity; hence, one would not have to fear downward pressure on wages when allowing free trade. However, Ohlin added that, if any divergence in wages would diminish some member states' competitiveness in the common market, such an adverse development would be corrected by adapting exchange rates. Thus, Ohlin was not describing a monetary union, which is not an insignificant caveat. The *founding fathers* followed suit to a large degree.<sup>5</sup>

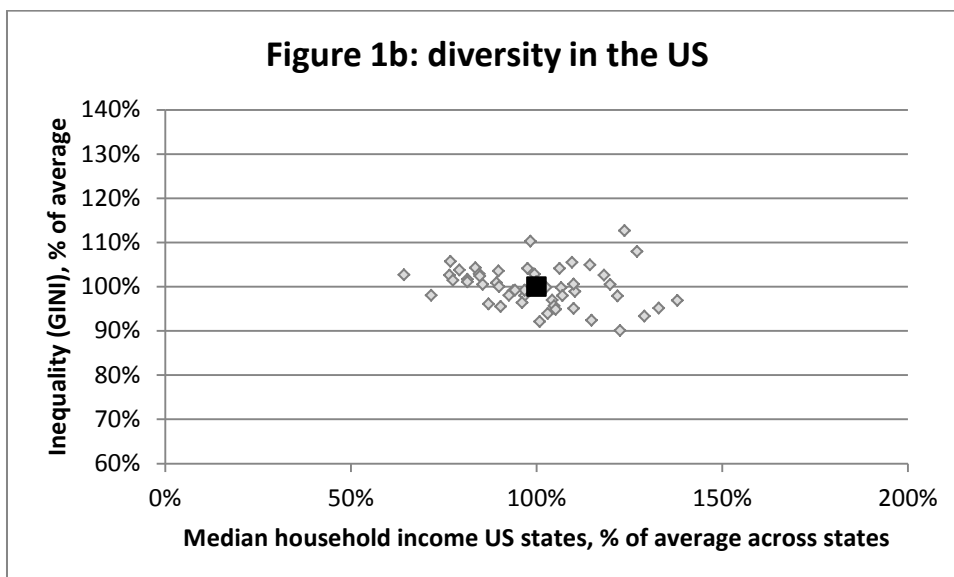
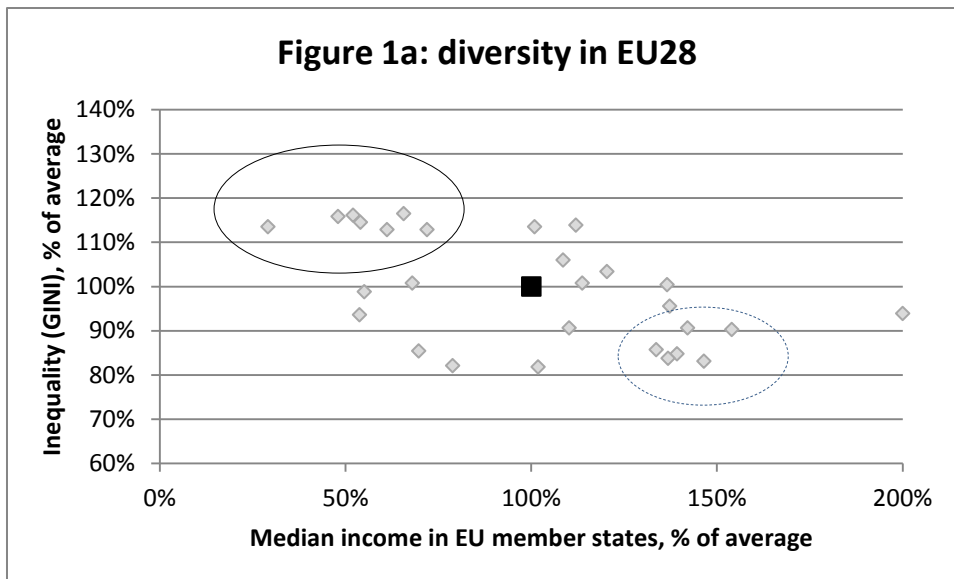
History has not proven Ohlin and the founding fathers wrong, at least not until halfway the first decade of the 21<sup>st</sup> century: integration, economic catching up and the development of national welfare states all went hand in hand. Over the last decade, however, the model started to show

cracks, the first one predating the 2008 crisis. The convergence machine was spinning, but inequality was increasing in several mature European welfare states: 'cohesion-in-convergence' no longer applied. The second crack, or, rather, a spectacular fissure, emerged with the crisis: the convergence machine stopped, with the north and the south of the European Monetary Union tearing apart. Since 2008, inequality has not only been increasing within (a number of) member states but also between member states, particularly in the Eurozone.

The question I table in this lecture is about our European Monetary Union: what does monetary unification mean to social policy? I am not merely asking this question *in abstracto*: I focus on a monetary union serving the European project. I will, therefore, first illustrate how very ambitious the founding fathers' belief was and still is, notably when we apply it to today's enlarged EU. The enlarged Europe is highly unequal, and one should not underestimate the twin challenge of convergence and cohesion. I will be slightly technical in the following section, but readers who don't like graphs and tables can skip this section and move to the following section.

### Unequal Europe

Figure 1a shows the EU member states next to the individual states in the US (Figure 1b). Henceforth, we will simply call all of them 'states'. The grey diamonds represent the individual states. The black square in the middle of both figures represents an imaginary 'representative state', i.e. an imaginary European member state or an imaginary American state in which the residents' income and the distribution of that income correspond to the European, respectively the American average.<sup>6</sup> The horizontal axis shows the median income of each state's residents in relation to the median income of the 'representative state'. The vertical axis represents the state's inequality measure in relation to inequality in the 'representative state'.<sup>7</sup> The inequality measure being the GINI coefficient, we are thus comparing GINI coefficients. When a state (a grey diamond) is situated to the right of the imaginary representative state (the black square), its median income is higher than in the representative state. Conversely, a grey diamond situated to the left of the representative state has a lower income. A grey diamond situated above the representative state is an indication of more inequality than in the representative state, while a grey diamond below the representative state indicates less inequality than in the representative state. The grey dotted circle in Figure 1a holds Sweden, Denmark and four Eurozone countries: Austria, Belgium, Finland and The Netherlands. Compared to the average European member state, these member states are considerably richer (with a median income 34 to 53 percent higher than the average) and have a more equal income distribution (with a GINI coefficient 9 to 17 percent lower than the average). The black circle in Figure 1a holds Rumania and Bulgaria as well as some Eurozone countries: Latvia, Lithuania, Estonia, Greece and Portugal, with a median income of just 29 percent (Rumania) to 72 percent (Portugal) of the European average, and a GINI coefficient 13 to 17 percent higher than the European average. Figure 1a illustrates that the Eurozone is just as heterogeneous as the EU, which, for a monetary union, is quite special.



Source: Eurostat and Bureau of the Census, see endnote 7 for details.

The representative American state in Figure 1b cannot be compared to the representative European member state in Figure 1a as its income is higher but more unequally distributed. When comparing both figures, we see that the American states are less diverse than the European member states when it comes to their income level and income distribution. The large inequality which characterises the US as a country results from large inequality within every state. The situation is different in Europe. If we were to consider Europe as a single country, inequality would also be high. But this is the combined result of (moderate) inequality within most member states and large inequality between member states. Moreover, the poorer European member states often display more internal inequality than the richer ones, as we can see in Figure 1a.

There is even more diversity between European member states when the comparison of income levels is not based on the median income in each of the member states (as in Figure 1a), but when we select a lower rung on the income ladder as a benchmark; Table 1 illustrates this. Table 1 compares the incomes in five member states, situated on four different relative income levels in the

domestic income distribution, with the average of those same income levels in an imaginary 'representative European member state'. For the bottom of the income ladder, we use the income of someone situated at the top of the first quintile in the income distribution of his country; only 20% of his fellow countrymen have an income which is lower. A Rumanian citizen situated at the top of the first quintile in Rumania (i.e. someone who is poor by Rumanian standards) currently has an income equal to 23 percent of the European average of incomes at the top of this quintile. To compare the relatively rich, we use the top of the fourth quintile in each country; 80% of the citizens have an income that is lower than the top of the fourth quintile. A Rumanian citizen whose income is at the top of the fourth quintile in Rumania, has an income equal to 32 percent of the corresponding European average: compared to his fellow Europeans, the 'rich' Rumanian fares relatively better than the poor Rumanian. The opposite observation holds for a country like Denmark: compared to his fellow Europeans, the 'poor' Dane is in a relatively better situation than the rich Dane. Table 1 displays similar comparisons for the top of the second and the third quintile (neither poor nor rich in relative, national terms). The main 'static' observation emerging from Table 1, is that the income gap across European member states is even higher at the bottom of national income ladders than at the top end. However, we also observe change; from a dynamic perspective, Table 1 conveys both positive and negative news: positive in how the Eastern and Central European countries have managed to catch up since 2006, on all rungs of the income ladder; dramatically negative news for Greece, where the opposite occurred, with Greek incomes now even below the Polish level on each quintile of the income distribution!

**Table 1: Income comparison (in relation to the European average) on different rungs of the income ladder**

Benchmark for the comparison	Average of 27 EU member states		Rumania		Denmark		Poland		Germany		Greece	
	2006	2013	2006	2013	2006	2013	2006	2013	2006	2013	2006	2013
Top Quintile 4	100%	100%	26%	32%	123%	133%	48%	70%	138%	138%	100%	65%
Top Quintile 3	100%	100%	24%	30%	132%	140%	45%	67%	138%	138%	93%	62%
Top Quintile 2	100%	100%	21%	28%	139%	145%	45%	67%	139%	138%	88%	58%
Top Quintile 1	100%	100%	18%	23%	144%	152%	43%	67%	140%	136%	82%	53%

Legend: comparison of standardized net disposable household incomes at the top of the national quintiles with the unweighted average of the EU27 member states; the comparison is based on purchasing power parities (PPP) to take into account price differentials between countries

Source: Eurostat: SILC 2007 for the 2006 figures; SILC 2014 for the 2013 figures

This explains why a true pan-European measure of relative income poverty, based on a single common European poverty line, generates a poverty rate much higher than the average of our national poverty rates; and it also explains why such a pan-European measure of poverty improved after 2004.<sup>8</sup> Should we consider Europe as we traditionally consider the US, as one unified country, European poverty rates would be much closer to the American numbers.

At first sight, Table 1 may confirm the impression that the social heterogeneity across the EU is now too large to be beneficial, that is, that we are now caught in a tragic dilemma where progress for some inevitably comes at the price of decline for others. However, the reality is more complex.

### Tragic dilemmas or repairable design flaws?

Welfare states redistribute incomes. This redistributive effort seems to waver in advanced welfare states like Sweden and Germany, which used to serve as a role model and which withstood the recent crisis relatively well. In fact, the economic crisis cannot serve as an explanation in these cases. There are yet other rich welfare states where we have seen, already before the crisis, an increase of relative income poverty (which is measure of income inequality within countries, at the bottom end of their income distribution, rather than a measure of absolute poverty). In most countries, poverty diminished among pensioners, but in a considerable number of countries it increased for people of working age and their children. In these countries, the role played by social benefits in the reduction of poverty diminished; the income gap between households with a high level of participation in the labour market and households with a low level of participation in the labour market widened.<sup>9</sup>

It so happens that we have comparable European information on income distribution mainly for the post-2004 period, when the *European Survey on Income and Living Conditions* (EU SILC) was implemented. Since EU enlargement started in 2004, it is tempting to consider increasing poverty rates since 2004 as proof of the 'tragic dilemma', to which I referred earlier: the decreasing redistributive capacity of advanced European welfare states is perceived as the price to pay for integrating countries with much lower wages and far less social protection. The convergence engine was spinning, for sure, but it also started to erode social cohesion in the most advanced countries. Ohlin's optimism would have worked for countries that were not all that different from one another, but not for a party of 28 very heterogeneous countries. All this sounds plausible – notably on the backdrop of the income data presented in Table 1 –, but is it the true story? I think Ohlin's recipe is no longer adequate today, but are we really confronted with a tragic dilemma?

First of all, we should distinguish between punctual lacunae in the regulation of cross-border mobility on the one hand and fundamental social and economic trends on the other. Lacunae in the regulation of 'posting' create pressure on social standards in some of the most advanced welfare states of the EU (posting means that someone works in, say, The Netherlands, while his employer is based in, say, Poland; posting allows exceptions viz-à-viz rules that normally apply to cross-border mobility of workers). The regulation of posting needs reform; I return to this issue at the end of my lecture. A badly organized system of posting is not a tragic dilemma, it is a repairable design flaw.

How would integration create a tragic dilemma? Competitive pressure on minimum wages might be a plausible lead. It is a plausible assumption that the integration of countries with far lower minimum wages *per se* limits the margin for increasing minimum wages in the most developed countries – even in the absence of any lacunae in the regulation of cross-border mobility of workers. Hence, in advanced countries the gap between minimum wages and average wages may increase. Minimum wages play a pivotal role in the organisation of minimum income protection: the level of minimum wages constrains the level of unemployment benefits, which in turn constrains the level of residual minimum income assistance. Consequently, the whole edifice of minimum income protection comes under pressure because of 'minimum wage competition'. While this hypothesis sounds plausible, the reality is more complex.

In the group of countries in which minimum wages are set (or affirmed) by public authorities and are recorded by Eurostat<sup>10</sup>, we can indeed see a shift in the relationship between minimum wages and average wages, with a convergence towards the middle. In some countries with a favourable

minimum/average wage ratio before enlargement, the relative ratio displays a downward trend, whereas in countries with a less favourable ratio it often improved. A number of new member states made positive efforts to catch up, resulting in a strong relative and absolute increase of their minimum wages. The same happened in the UK. This suggests that, while the convergence machine was at work in the new member states, pressure was mounting on minimum wages in the most developed welfare states. However, one should not jump to conclusions: minimum wages are important, but they constitute only one component of minimum income protection systems. Over the last 15 years, many governments have amended their tax-and-benefit systems so as to improve the net purchasing power of people working minimum wage jobs: the British 'in-work benefits' for workers on low pay are a well-known example of such a policy. Figure A1 (see the Appendix) illustrates the current importance of those efforts in a number of countries. Hence, one might also say that the integration of low-wage countries has instigated governments to develop stronger *public* efforts to keep net disposable incomes at the bottom end of the labour market high; efforts by the public purse somehow dispensed employers from this responsibility. Now, European integration does not *stop* governments from making such efforts<sup>11</sup>, just like it does not prevent governments from maintaining sufficiently adequate social benefits for people out of work as well. Whether or not such public policies are pursued, is a matter of budgetary priorities. Cantillon, Marchal and Luigjes point out that the evolution of net income protection at the bottom end of the labour market and the evolution of social benefits was all in all more favourable in the 2000s than in the 1990s (i.e. the balance between 'favourable' and 'unfavourable' developments was slightly better in the latter period).<sup>12</sup> That is, at least, a contra-indication for the idea that enlargement made it impossible to continue to support the net income of people working minimum wage jobs. It all depends on political choices that were made (or not made), on the backdrop of social and economic trends that necessitate a greater public effort to protect the incomes of people with relatively little potential in the labour market. Furthermore, in all developed welfare states demographic changes, unrelated to low-wage competition (and unrelated to Europeanisation), create new challenges in the fight against poverty. The growing number of lone parents is an example: in societies where dual-career families have become the norm, a single minimum wage will not suffice to lift a family with children above the poverty threshold, even if that minimum wage is generous. This holds even more for individual social benefits that serve as income replacement: they are inevitably inadequate for lone parents. Governments therefore need to create new tools to fight poverty.<sup>13</sup> This imperative is unrelated to European integration.

The migration wave that started after enlargement contributed to increasing poverty rates in many EU15 countries, where poverty is higher among migrants from the new member states than among EU15 natives. This higher poverty risk is no side effect of 'benefits tourism', it also applies to migrants who have a job. We notice, however, that *non-EU* migrants are most at risk of poverty in the EU. There might be a connection: perhaps new EU-immigrants compete with 'traditional' non-western immigrants, and make it even more difficult for them to move up the social ladder.<sup>14</sup> Next to these direct impacts of migration on social outcomes, there may be an indirect impact, via public attitudes about social policies. Brian Burgoon examined why migration leads to less rather than to more public support for redistribution and social protection. Poor economic integration of migrants seems important in this matter as it heightens public concern that migration jeopardises the welfare states' financial sustainability.<sup>15</sup> In this respect, a vicious circle may be at play, and European integration is present, among other factors, in the causal chain.

To cut a long story short, with regard to increasing poverty in advanced European welfare states,

migration and increased competition at the bottom end of the labour market (not only in regard to wages but also in regard to work quality) provide plausible though complex explanatory factors; but other drivers, unrelated to European integration, are at work too. In a recent synthesis of his life-long research on inequality, Anthony Atkinson emphasizes that many factors contribute to inequality<sup>16</sup>, factors varying from country to country. Countries thus experience very diverse developments. One has to consider both capital markets and labour markets. The analysis should take on board economic and technological developments, which affect wages and employment, but also power relations and codes of conduct, and the way people form households. The story is also about taxes and benefits, in short, about political choices. Increasing inequality does not stem from 'iron laws', whether we are talking about the growing capital stock (which Piketty focuses on), globalisation or Europeanisation. Each country has its own pattern. The key question, however, is whether governments are *willing* to develop and *capable* to develop policies to counter economic and sociological trends that generate inequality and poverty. In other words, the crux is: can governments oppose the forces of inequality and do they want to do that?

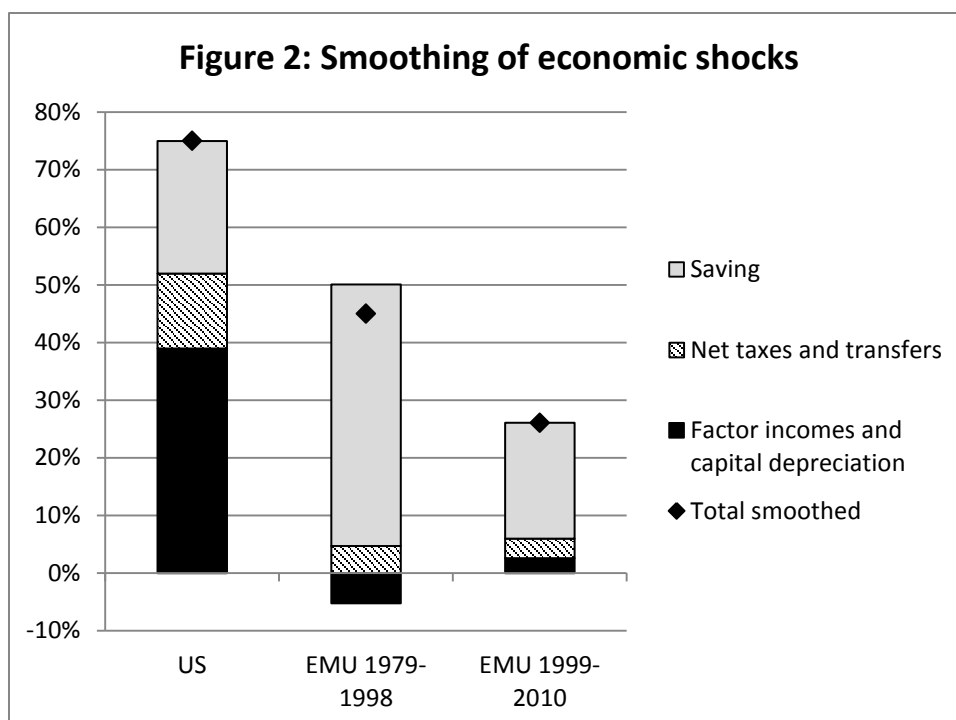
Hence, the relevant question about Europeanisation is what Europeanisation means for the *political support* for social protection and redistribution in EU member states, and what it means for the *effective capacity* of national governments to protect and redistribute, provided there is political support for it. Mind, though, that political support and political capacity do not respond to laws of nature. We are far removed from chemistry or physics, or even objective economic mechanisms: the world of ideas plays a decisive role in the problem at hand. David Cameron's 'Brexit deal', which had everything to do with the net income of minimum wagers, is a clear example. I will return to this when I discuss the issue of posting. But I would first like to focus on some objective facts about the monetary union and the *capacity* of governments to protect and redistribute.

### **A monetary union without a shock-absorber**

The 2008 crisis created a second crack in the founding fathers' *credo*, when the Eurozone north and south started to drift apart: the convergence machine went in reverse gear. Inequality not only grew within but also between member states. The origin was definitely not a tragic dilemma, but a repairable design flaw in the monetary union. Let me zoom in on one aspect, the lack of shock-absorbers.

Welfare states have built-in automatic stabilisers: progressive taxes and social benefits support purchasing power in case of an economic downturn, thus smoothing economic shocks. These automatic stabilisers result in – and need – a temporary deterioration of the public budget. The member states of the monetary union that were hit hard by the crisis, had to switch off these automatic stabilisers too quickly because of the reactions on the financial markets and the strict austerity policy agreed upon in the European Council. Analyses by the European Commission show that the evolution of social spending in the member states initially complied with the stabilising pattern one would normally expect, but that this changed during the second phase of the crisis.<sup>17</sup> This discomfoting analysis is well known. It is less known, however, that the Eurozone is the only monetary union in the world where these stabilisers are not partially centralised at the level of the union. The implications of that lacunae can be seen in Figure 2. Figure 2 compares the Eurozone with the US, drawing on work by two IMF economists.<sup>18</sup>





Source: Furceri and Zdzienicka (2013); see note 18 for more details.

Figure 2 shows the impact of idiosyncratic (or ‘asymmetric’) economic shocks, affecting the domestic product of individual American states, on household and government consumption in these states. The bars indicate the extent to which consumption is smoothed during such economic shocks. The US figures relate to the 1963-1990 period: on average 75 per cent of the shocks’ impacts has been smoothed (one might also say that shocks were ‘neutralized’ or ‘absorbed’ at a rate of 75 per cent). The figure distinguishes three smoothing mechanisms:

- Shocks in the states' production can be smoothed because household income is partially based on the revenue of capital invested outside people’s home state. This mechanism is important for the US: it neutralized 39 per cent of idiosyncratic production shocks during the period under consideration. This corresponds to the black part of the bars in Figure 2 (technically, this is the influence of so-called 'factor incomes', to which I have added the impact of capital depreciation, to simplify the presentation). For the American states, this constitutes a cross-border 'insurance mechanism' operating through private capital markets.
- Economic shocks can be smoothed because households and governments save less in order to keep up consumption (or conversely, save more during a production boom). The grey part of the bars in Figure 2 shows that, through this mechanism, on average a share of 23 per cent of shocks was absorbed. Transnational credit markets, allowing for international borrowing and lending, are crucial in this respect: they provide a second cross-border private insurance mechanism.
- The US federal tax and benefit system and social programmes also have a stabilising effect. Moreover, to a certain extent Washington reinsures and tops up the unemployment schemes organised by the states. In itself, this federal umbrella has only a limited impact: it absorbs 13 per cent of the shocks, as we can read from the hatched part of the bars in

Figure 2. What matters is the *complementarity* of these three mechanisms, as explained below.

In the US, states organize unemployment insurance; in other federal nations (like Canada or Germany) the federal level organizes and funds unemployment benefits. The US federal government, however, supports state unemployment insurance schemes with a federal tax credit to help employers pay their contribution to the state schemes, provided the state scheme complies with a set of minimum requirements. State unemployment schemes that incur a deficit can, under certain conditions, borrow money from the federal level. And in times of severe crisis, Washington provides 'extended benefits' and 'emergency benefits', which are partially or entirely financed by the federal budget; the Obama administration applied this system during the financial crisis.<sup>19</sup>

For sure, American unemployment benefits are far less generous than unemployment benefits in mature European welfare states such as Denmark, Sweden, Germany or Belgium. When the US economy is hit by a shock, their role in stabilising incomes is far less important for the US economy than in most European countries (except for Italy, where unemployment benefits have an even less stabilising impact than in the US).<sup>20</sup> That observation does not contradict the analysis on display in Figure 2. Figure 2 shows, first, that risk sharing when idiosyncratic shocks hit the American states is far more important than risk sharing when idiosyncratic shocks hit the individual members of the European Monetary Union, and, second, that federal transfers play a role in explaining this difference. For the European Monetary Union, we distinguish the period prior to monetary unification and the period thereafter. In the eighties and nineties, idiosyncratic shocks in countries that would later shape the monetary union were mainly absorbed by the savings channel and international credit markets, while international capital markets and EU-level transfers hardly played a role. Prior to the creation of the monetary union, shocks were only absorbed for 45 per cent in this group of countries, compared to 75 per cent in the US. Once the monetary union was created, the role of saving and dissaving receded; all mechanisms combined, only 26 per cent of shocks in the monetary union was smoothed.

The authors I gathered these figures from not only indicate that the capacity to smooth shocks has systematically decreased in the Eurozone; they also point out that risk sharing mechanisms provided through private markets are particularly ineffective during severe downturns. At the height of the crisis, southern Eurozone countries were closed off from international credit markets. The fact that in the European Monetary Union national governments are responsible for insuring their own banks (in contrast to the US where banks are reinsured at the federal level) played an important role in this: national banks and national governments held each other in a 'deadly embrace' and the trust of international credit markets collapsed.

This was avoidable; to prevent a repetition of such events, the European Monetary Union needs a set of mechanisms to absorb shocks in its member states. An integrated capital market like the one in the US could contribute to this, but an integrated capital market cannot be achieved in the short run. A banking union, putting an end to the 'deadly embrace', should be a top priority. Banking union is in progress in Europe, but far from achieved. However, an integrated capital market and banking union are only components of what is needed: for international capital and credit markets to fully play their role as private insurers, governments need mutual public insurance. Public insurance is a catalyst and a guarantee for sufficient private insurance. In yet other words, the Eurozone needs automatic fiscal stabilizers: a fiscal union, of a sort, should complement capital market and banking union.<sup>21</sup>

### Why is unemployment insurance centralised?

All monetary unions but the Eurozone centralise unemployment insurance. When they do not opt for a downright centralisation (like in Canada or in Germany), they streamline unemployment insurance and provide a degree of reinsurance and centralisation when the need is really high; that is, they combine centralisation and decentralisation like in the US. This is rational behaviour for two well-known reasons. I already signalled the first one, when describing Figure 2: risk pooling enhances resilience against idiosyncratic shocks. The second reason also applies when shocks are not idiosyncratic but symmetric across the whole union (and risk *pooling* across member states has no added value *per se*); this second reason refers to what economists call 'externalities'. National insurance systems create an externality: a country that properly insures itself, also helps its neighbours. You could compare this to fire insurance: you hope your neighbour subscribes to a proper fire insurance because you would not want him to be unable to pay for damages to your place if a fire in his place spread to yours. That is why fire insurances, just like car insurances, are mandatory in many countries. Vaccines are an archetypal example of externalities: with a vaccine individuals not only protect themselves from infectious diseases but also the people they get in touch with. Hence, it is rational – purely from a view of efficiency – for governments to subsidise vaccination or even make it compulsory. Let me first elaborate upon the analogy with 'compulsory vaccination', and then return to its subsidisation.

A monetary union is at a higher risk of contamination than a mere common market; it runs a higher risk of out-of-control fire.<sup>22</sup> Therefore, it is rational for the members of a monetary union to agree on a set of minimum requirements with regard to the stabilisation capacity built into their national social and economic systems. Which minimum requirements – comparable to mandatory vaccination – should apply? From a preventative perspective, fiscal prudence is a first requirement: member states must not accumulate structural deficits because that reduces their ability to increase public deficits and incur additional debt during a downturn. But I would add that fiscal prudence is not sufficient: the stabilisation capacity of national unemployment insurance systems is important, hence the stabilizing quality of unemployment benefits should be the subject of minimum requirements too. Do they cover all employees or do large groups remain uninsured, as in Italy (which explains why the stabilising role of unemployment benefits is so limited in that country)?<sup>23</sup> Are they generous enough to have a stabilising impact, without creating inactivity traps? For national welfare states, unemployment benefits are the metaphoric camel's nose: whether they function as a good shock-absorber, without negative side effects, also depends on the quality of the activation policies, on the net income that people can make at the bottom end of the labour market, etc. So, our vaccination programme entails a cluster of principles that unemployment and employment policies should coherently comply with.

Not coincidentally, vaccination is being subsidised both in countries where it is mandatory and in countries where it is not. Economic theory indeed learns that goods and services with positive externalities should be subsidised in order to reach an optimal level of consumption. In the Eurozone, national unemployment systems are not subsidised, although it would be rational to do that to some extent, or better, it would be rational to associate *reinsurance* of national schemes (granting a European subsidy to national systems when the need is high) with minimum requirements on the stabilisation and activation qualities of these national schemes. In other words, reinsurance (which creates a temporary subsidy to keep the national 'vaccine' against economic volatility affordable) and a compulsory vaccination programme would go hand in hand. Such an insurance device may answer

the need for a fiscal union to underpin the monetary union. It would create a fiscal union of a special kind, which is politically easier to obtain. It is an illusion to think the EU will develop a federal budget like in the US or in Canada, but a relatively small insurance premium could have the same stabilizing impact.

What would a Eurozone interstate insurance look like? Over the last few years, several proposals have been published, some of them linking an interstate insurance to the national unemployment systems of the member states.<sup>24</sup> These proposals typically imply that member states contribute to a common fund that disburses money to member states affected by negative shocks, e.g. a significant increase in unemployment. I have been partner to a large-scale study led by the Centre for European Policy Studies (CEPS) on this topic; we examined many different variants of a European Unemployment Benefit Scheme, and our results have now been published by the European Commission.<sup>25</sup> The complexity of setting up a genuine European Unemployment Benefit Scheme, even if it only complements existing national schemes, should not be underestimated. Moreover, any European scheme should exclude permanent transfers in favour of certain member states and avoid a structural redistribution of resources between the countries: it should really respond to a pure insurance logic, covering risks that affect any country participating in the scheme to the same extent. My own conclusion from this research is that it is easier to meet these conditions and to implement such a scheme, if it takes the form of 'reinsurance' of national insurance schemes, rather than being a genuine European unemployment benefit scheme, that would create European benefits for individual European citizens. Reinsurance not only allows more flexibility and offers more scope to mitigate the risk of institutional moral hazard (I return to moral hazard below); it also seems the less complicated option. But that is not the main point on which I want to elaborate here.<sup>26</sup> Instead of going into technical details, I would like to emphasize the rationale for a reinsurance approach and the trade-off it implies between solidarity and (formal) sovereignty.

In a sense, the rationale is simple: prevention is better than cure. Although a degree of solidarity has developed within the European Monetary Union since the crisis, it only came about after difficult intergovernmental negotiations. Solidarity was not *ex ante* rooted in the European fabric, it occurred *ex post*. This has two drawbacks. Organising solidarity *ex post* in an intergovernmental setting implies repeated ad-hoc negotiations about burden sharing and conditionality, which easily leads to conflict and polarisation between governments and their electorates. *Ex post* solidarity is also more expensive than *ex ante* solidarity if the latter has a preventative impact. This certainly applies to economic instability: since economic swings are driven by expectations, the expectation of a shock-absorber doing its job is in itself a way of preventing severe shocks.<sup>27</sup> This preventative dimension also explains why 'private insurance mechanisms' through international financial markets need complementary 'public insurance mechanisms' through budget transfers. International markets will be less prone to panics and 'sudden stops', when public insurance mechanisms are expected to cushion the most serious shocks.

### **A puzzle of solidarity and sovereignty**

You will probably argue that no matter how rational this argument is, it is doomed to remain political fiction. Mutual distrust is deeply rooted in Europe, any proposal to share resources on a European level meets strong resistance, and the dominant concern in political debates about proposals for solidarity in the Eurozone is that solidarity generates moral hazard. (Moral hazard occurs when one

actor takes more risks because other actors share the costs of those risks.) We are indeed facing a paradox. The US consolidate weak solidarity mechanisms in the states (*in casu*, relatively ungenerous unemployment insurance) with federal *ex ante* solidarity mechanisms, which makes their monetary union 'complete'. The Eurozone fails to support existing strong solidarity mechanisms within its member states with *ex ante* solidarity on the European level: solidarity is well-developed but parochial, and therefore the European Monetary Union is incomplete.

Is there a way out, that allows to complete the European Monetary Union? Admittedly, the political puzzle is very difficult: any scheme for a more stable monetary union relies on the simultaneous pooling of risks and sovereignty – not across the board, but in specific yet sensitive domains of policy. Everybody has to 'cross the street at the same time', when it comes to sharing sovereignty and risks. How can this be done when there is no mutual trust? Allow me once more to list all the pieces of this classical prisoners' dilemma.

A solidary insurance mechanism for temporary shocks cannot remedy structural imbalances between member states: the member states' structural fiscal position and their competitiveness need to be guarded, as a backdrop to such insurance device. We know that the best way to handle imbalances is symmetric, i.e. by sharing the burden of adjustment in a spirit of reciprocity – which has, alas, not been the case in the EU.<sup>28</sup> But a symmetric and fair approach to mutual adjustment does not diminish the inconvenient truth that effective collective action means reducing national sovereignty, at least in a formal sense. However, the upshot of sovereignty pooling – in the context of a mutually beneficial 'insurance contract' – can be a gain in legitimacy. An inclusive insurance against shocks can enhance the political acceptability of strict rules on structural fiscal positions and competitiveness with which member states have to comply. Fiscal rules may also become more simple and transparent when the need for 'flexibility' in fiscal governance – to accommodate shocks – is catered for by an insurance device.

Yet, solidarity is always intrusive. I already touched upon this observation in a previous section, let me elaborate upon it a little. If the aim of European solidarity is to contribute to stabilisation, a logical corollary is that the stabilisation capacity of the *national* unemployment benefit schemes must be sufficient: maintaining (and, in some countries, reinforcing) the stabilisation capacity of national systems is the political *quid pro quo* for organising European support. The stabilisation capacity of unemployment benefits depends on their generosity (notably for the short-term unemployed) and their coverage. Hence, minimum requirements with regard to the effective coverage and the generosity of (short-term) unemployment benefits in the participating member states, are part and parcel of such an approach. Trade unions and social movements may welcome such requirements as a positive social agenda for the EU, but it makes us tread on the sensitive turf of social security. Next, there is the problem of moral hazard. The possibility for member states that benefit from a European support for their unemployment benefits to become 'lax' with regard to the activation of the unemployed and (re)employment policies at large, generates an obvious risk of institutional moral hazard.

We should not become totally obsessed with moral hazard. Moral hazard is unavoidable in any context of insurance. If you're obsessed, and you want to eliminate the faintest possibility of moral hazard, you'll never be able to organize insurance and reap the benefits of collective action. On the other hand, we should not dismissive about moral hazard: we should address it, and find solutions to minimise it. The risk of moral hazard can be reduced through financial mechanisms. A European reinsurance can be based on the degree to which short-term unemployment in member states

deviates from its historic (national) profile, so that long-lasting structural differences between countries don't have an impact. High thresholds for intervention can guarantee that the fund only intervenes in case of severe shocks (very significant deviations from a country's historic profile). A 'claw back' mechanism might even stipulate when a member state is no longer entitled to transfers and by when collected transfers have to be reimbursed. The more stringent these regulations, the weaker the insurance mechanism, though they can be essential for political support. But, next to financial mechanisms, moral hazard can also be reduced by establishing minimum requirements on the quality of the member states' activation and employment policies. If these minimum requirements are effective, more room is created for a powerful insurance mechanism. For solidarity to be effective, it needs to be somewhat intrusive.

Europe is a union of welfare states with no intention to become a federal welfare state; but, in this endeavour, we are considering a well-known problem of federal welfare states, where unemployment benefits and employment policy are managed at different levels. There is an institutional risk of moral hazard when a central government is responsible for unemployment benefits while the states, provinces, regions or municipalities are responsible for activation. In this respect, it is interesting to look into countries such as the US, Canada, Germany, Belgium, Austria, Switzerland, etc.<sup>29</sup> A detailed study shows that, in all of these countries, institutional moral hazard, whether implicit or explicit, is an issue of politics and policy. There is a wide range of solutions: minimum requirements on the quality of policies, more or less complex financing models, direct control through coordination mechanisms, etc. Ever since the European Employment Strategy was launched in 1997, 'coordination' has been part and parcel of the Union. The 2014 Youth Guarantee, which is closely connected with the Employment Strategy, could be seen as a European quality assurance system regarding activation. These mechanisms are too 'soft' to underpin a European reinsurance of national unemployment schemes, but the perspective of a European reinsurance could also be the trigger to make them more ambitious and to give them more bite: in the context of an insurance logic, this would create a legitimate *quid pro quo*. Binding commitments can leave leeway for differentiation in the concrete policies: the essence is that commitments are complied with, not that they are elaborated in detail. There is no need for a homogeneous European social model, but there is need for an agreement on *some* key functions it has to serve.

### **A basic consensus on the European social model has become an existential necessity**

In the past, attempts to develop a consensus on 'the European social model' were seen as useful, though not essential for the European project: 'nice to have' but not indispensable. Today, finding a basic consensus on key functions of social policy has become an existential necessity for the Union. This observation does not only apply to the members of the monetary union, but here I focus on arguments that are specific to the monetary union.<sup>30</sup>

Well-known economic theory explains the benefits and drawbacks of monetary unification in terms of trade-offs. Members of a currency area are confronted with a trade-off between symmetry and flexibility. Symmetry refers to movements in output, wages and prices. Flexibility relates to wage flexibility and interregional and international labour mobility, which determine a country's internal adjustment capacity in case of an asymmetric shock. Less symmetry necessitates more flexibility: the less symmetry there is between the economic development of countries in a single currency area, the greater the required capacity for internal adaptability in order for the monetary union to be beneficial. In this traditional textbook analysis 'adaptability' is understood mainly in terms of labour

mobility and/or wage flexibility. There is a second trade-off, explained in those textbooks: if asymmetric shocks can be absorbed through fiscal transfers between the member states, then the need for internal flexibility is reduced. Fiscal transfers make it possible to alleviate the plight of countries hit by a negative shock. Obviously, fiscal transfers, even if they are not permanent but only temporary and reversible, require a readiness to organise solidarity among the members of the monetary union.

The organisation of solidarity requires mutual trust. Solidarity on the basis of mutual insurance is a rational option, but even the most rational individuals will not engage in mutual insurance, if they do not trust each other sufficiently. In the context of a European reinsurance of national unemployment benefit schemes, the 'minimum requirements' mentioned in the previous paragraph are key to create trust. But European solidarity requires mutual trust with regard to the quality of the social fabric in the member states in a more general sense, including with regard to their capacity to deliver on competitiveness and sound public finances. Exposure to market forces has not in itself produced 'discipline' in the monetary union with respect to competitiveness and public finance. On the contrary, we witnessed asymmetrical developments and divergence, rather than symmetry and convergence. Relative competitiveness deteriorated significantly in some countries and improved in other countries, thus creating huge economic imbalances in the Eurozone. Since the invisible hand of the market does not deliver, the European Monetary Union needs a visible hand that pursues symmetry, notably with regard to wage increases. Moreover, member states need labour market institutions that can coordinate wage increases: the visible hand must be effective.<sup>31</sup>

Flexibility is a container concept. A 'high road' to labour market flexibility can be placed in opposition to a 'low road' to labour market flexibility. The high road is based on a highly-skilled and versatile labour force, adequate unemployment insurance and activation and training policies that facilitate transitions. The low road is based on mere labour market deregulation and easy hiring and firing. At first sight, it might be thought irrelevant which of these flexibility models are adopted as pillars of a sustainable monetary union: i.e. they can be seen as functionally equivalent models as long as the outcome is economic adaptability. However, apart from the social costs that are attached to certain types of flexibility, not all systems of labour market regulation deliver equally well with regard to wage coordination and the quality of unemployment insurance. The members of the monetary union should perform well in *each* of these dimensions of labour market regulation. The way in which labour market flexibility, wage coordination and unemployment insurance are combined in national labour market institutions is a matter of common concern in a monetary union: these choices cannot be relegated totally to the national domain. That does not mean that the EU should counsel member states in detail on the organisation of their labour markets. But there is a limit to the social diversity that can be accommodated in a monetary union, not with regard to the institutional details of labour markets, but with regard to some basic features.<sup>32</sup> Whatever the governance method, neither flexibility nor fiscal transfers, nor systems of wage coordination or unemployment insurance, are socially neutral choices. Hence, the long-term trade-offs implied by monetary unification force upon the participating countries a consensus on the social order on which the monetary union is based.

### **A European pillar of social rights**

Can we start working on such a consensus? In March 2016, the European Commission launched a wide consultation on a 'European Pillar of Social Rights'.<sup>33</sup> The Commission's initiative focusses on the Eurozone, but other member states are welcome to adhere. The term 'rights' is somehow confusing

since the Pillar is presented in essence as a tool for benchmarking national policies; it is a set of principles that does not replace or change existing rights, as the Commission itself indicates: "The Pillar has been conceived as a reference framework to screen the employment and social performance of participating Member States, to drive reforms at national level and, more specifically, to serve as a compass for the renewed process of convergence across Europe." The policy areas are grouped into three main themes: equal opportunities and access to the labour market; fair working conditions; adequate and sustainable social protection and access to high quality essential services.

A large debate on such a set of principles can contribute to building the consensus that is needed. But it is also a high-risk initiative. If it is perceived as merely repackaging the existing European coordination strategies, such as the European Employment strategy and the Open Method of Coordination for Social Protection and Social Inclusion, it will not create a new momentum. On the contrary, it will then only enhance the prevailing scepticism on the Union's social significance. For this initiative to be successful, three conditions have to be met. First, the debate about the pillar of social rights has to be concluded by political leaders and social partners at the highest level, so that there is a firm commitment at the highest political level. (Think about the 'Fiscal Compact': a 'Social Compact' should have the same political salience.) Second, one should distinguish between areas in which the EU is competent to establish effective rights in the legal sense of the term (as in the domain of working conditions), and areas in which the Union has less competences. In those areas where the Union has legislative power, the legislative initiative should not be curbed but supported. In other areas, a thorough and incisive benchmarking of instruments and results that surpasses the various current coordination processes is to be organised.<sup>34</sup> Third, this initiative should be linked to 'harder' initiatives such as designing automatic stabilisers for the Eurozone: this link is not only analytically compelling, as explained in this lecture, but it would significantly increase the political salience of the Pillar initiative.

### **Reciprocity and cross-border mobility**

My argument about risk sharing is based on reciprocity. Mutual insurance presupposes a European *quid pro quo*, hence, a sense of reciprocity. But reciprocity means more than merely bargaining a *quid pro quo*. Samuel Bowles defines 'strong reciprocity' as a "propensity to cooperate and share with others similarly disposed, even at personal cost."<sup>35</sup> Reciprocity goes beyond 'enlightened self-interest', though it is 'conditional'. *Quid pro quo* should not become a ruthless mantra that neglects the need for compassion in particular contexts; it should not lead to an obsession with moral hazard, which makes us overlook the benefit of mutual insurance. So conceived, reciprocity is the cement of national welfare states. In the same spirit, it should be a guiding normative principle for the EU. Reciprocity should also be applied to current debates on cross-border mobility. Let me briefly explain what I mean.

The EU is built on the basis of a principle of non-discrimination among EU citizens: Belgian social policy cannot be different for a Polish citizen in Belgium and a Belgian citizen in Belgium. For sure, this does not mean that a European citizen can enter Belgium without means of existence and immediately apply for social assistance: European legislation does not impose such an immediate and unconditional generosity, at least not for those who are economically inactive. But a Polish citizen working in Belgium (to take that simple example) enjoys the same social rights as the Belgian citizen working in Belgium: he is integrated into the Belgian solidarity circle, with everything that it



entails. What is the rationale for that principle? First of all, it facilitates cross-border mobility. Second, it makes tangible an ideal of European citizenship, based on non-discriminatory access to national solidarity circles. Third, it justifies the fact that the Polish worker's employer pays the same social security contributions to Belgian social security as the Belgian worker's employer. In other words, non-discrimination in terms of social rights, justifies and so sustains the principle that we do not tolerate competition between the Polish and the Belgian social security system on Belgian territory.

Competition between the Polish and the Belgian social security system is exactly what happens in the context of 'posting' of workers: a Polish worker who is 'posted' in Belgium remains integrated in Polish social security. Thus, posting is an exception to a foundational principle of the European project. In order to accommodate work in other countries on short-term projects, such an exception is needed, *a fortiori* if one wants to develop an integrated market for services. Admittedly, the scope for this exception has become too large, and there are important problems of inspection and control. That is the reason why a number of member states, notably the Netherlands but also Belgium, ask for reform. Commissioner Marianne Thyssen launched a reform proposal in March 2016, which has, however, been rejected by a large number of new member states (and by Denmark). At this very moment, we seem to be in a stalemate. Is it still possible to find common ground in the search for a compromise? I believe this is possible, on the basis of a sense of reciprocity.

For a start, it is useful to refer to David Cameron's argument when he was negotiating a deal with the EU to avoid Brexit. Cameron's argument was about EU workers in the UK who are *not* posted; he wanted a derogation of the principle of non-discrimination. This was motivated by the British government's huge efforts to support the purchasing power of people working at low wages, on top of the wages paid by the employers. Cameron argued that the British system attracts people from all over Europe at the expense of the British taxpayer. Figure A1 (see the Appendix) shows that the efforts made by the British government are indeed important, but also that the disposable income of people working at minimum wages in the UK is not higher than in other countries. Other countries develop similar efforts with public resources, on top of the employers' efforts. In this sense, Cameron's argument is not entirely convincing. The Brexit discussion mainly illustrated how the *idea* of the Brits being too generous for European immigrants can lead the debate. As I said before, the influence of Europeanisation on political support for redistribution in welfare states does not arise from the laws of nature and objective facts; ideas and perceptions are crucial in determining political support. Cameron obtained a derogation from the non-discrimination principle in his deal with the EU, but – with Brexit voted – that deal is now off the table. Hence, we can return to sound principles.

Why is the debate on posting so difficult and divisive in the EU? New member states such as Poland typically want as little limitations as possible on posting of workers (since a liberal posting regime is economically beneficial for them); simultaneously, they want as little limitations as possible on the principle of non-discrimination in social policy (since such limitations imply a social relapse for Polish citizens). Thus, they apply two principles that are, in terms of rationale and justification, fundamentally at odds with each other, but that seem to serve their short-term interests best. The Dutch government has launched a campaign against what it considers to be excessive and uncontrolled freedom in the realm of posting, and urges the EU to take initiatives in this domain. Simultaneously, major parties in the Dutch government (and opposition) have voiced some sympathy with parts of Cameron's agenda.<sup>36</sup> Just as the Polish, they apply two contradictory rationales (or, they are at least attracted by two contradictory rationales), motivated by what they think is their short-

term interest. But is this really their interest?

In fact, in a European negotiation on these matters, the Dutch government should address the Polish government in the following way: “We will never discriminate Polish citizens who work in the Netherlands: we can assure you that the Cameron agenda is definitely off the table. But, please, understand that we do not want to see our social system undermined by excesses in the application of posting.” This is, in a sense, again a matter of sound reciprocity. If such reciprocity would inspire the representatives of mature EU welfare states, they may strike a better deal with representatives of less developed EU welfare states on both issues (posting, non-discrimination), compared to a situation in which deviations from the non-discrimination principle and uncontrollable posting would proliferate. If deviations from the non-discrimination principle and uncontrollable posting thrive, we will ultimately settle for an equilibrium with less social protection than in the opposite case. Everybody would lose in the end.

### **A European Social Union**

The founding fathers of the European project were convinced that European economic integration would contribute to the development of prosperous national welfare states, whilst leaving social policy concerns essentially at the national level. History did not prove them wrong, at least until the mid-2000s. Yet, the experience of the protracted crisis that has hit Europe forces us to reconsider the question: how can the EU be a successful union of flourishing welfare states? Both on the left and the right of the political spectrum, despite conflicting views on the exact policy mix that is needed, many would argue that the crux is to implement the right kind of economic, financial and monetary governance at EU level. My lecture is inspired by a different position: yes, economic, financial and monetary policies are crucial, but they cannot be isolated from the longer-term imperative to develop a social policy concept for the EU, that is, a basic consensus on the role the EU should play and the role it should not play in the domain of social policy. The argument is not that the EU should become a welfare state itself. However, restoring the social sovereignty of the Member States, with the EU strictly confining its role to economic, financial and monetary policy, is also not an option. We need a coherent conception of a ‘European Social Union’.

I use the notion ‘Social Union’ deliberately, for three reasons. First, it invites us to propose a clear-cut concept, in contrast to the rather vague notion of ‘a Social Europe’, which often surfaces in discussions on the EU. Second, it indicates that we should go beyond the conventional call for ‘a social dimension’ to the EU. It would be wrong to assert that the EU has no social dimension today. The coordination of social security rights for mobile workers, standards for health and safety in the workplace, and some directives on workers’ rights, constitute a non-trivial *acquis* of fifty years of piecemeal progress. The EU also developed a solid legal foundation for enforcing non-discrimination among EU citizens. The notion of a European Social Union is not premised on a denial of that positive *acquis*. The next steps can build on that *acquis*. However, the next stage of development must respond to a new challenge, which is about more than ‘adding a social dimension’. Third, the emphasis on a Social *Union* is not a coincidence. A European Social Union is not a European Welfare State: it is a union of national welfare states, with different historical legacies and institutions. As explained in this lecture, a union of national welfare states requires more tangible solidarity between those welfare states as collective entities. But its primary purpose is not to organise interpersonal redistribution between individual European citizens across national borders; the main mechanisms of solidarity which the EU now needs to develop are between member states; they should refer to insurance logics rather than to redistribution (and to support for social investment strategies, an

argument I did not develop in this lecture)<sup>37</sup>. In some domains of policy, we may have to rethink the practical application of the subsidiarity principle, both within member states and at the level of the EU. Yet, a 'union of welfare states' would apply subsidiarity as a fundamental organising principle. Solidarity between member states necessitates a degree of convergence, but convergence is not the same as harmonisation. More generally, the practice of a Social Union should be far removed from a top-down, one-size-fits-all approach to social policy-making in the member states.<sup>38</sup>

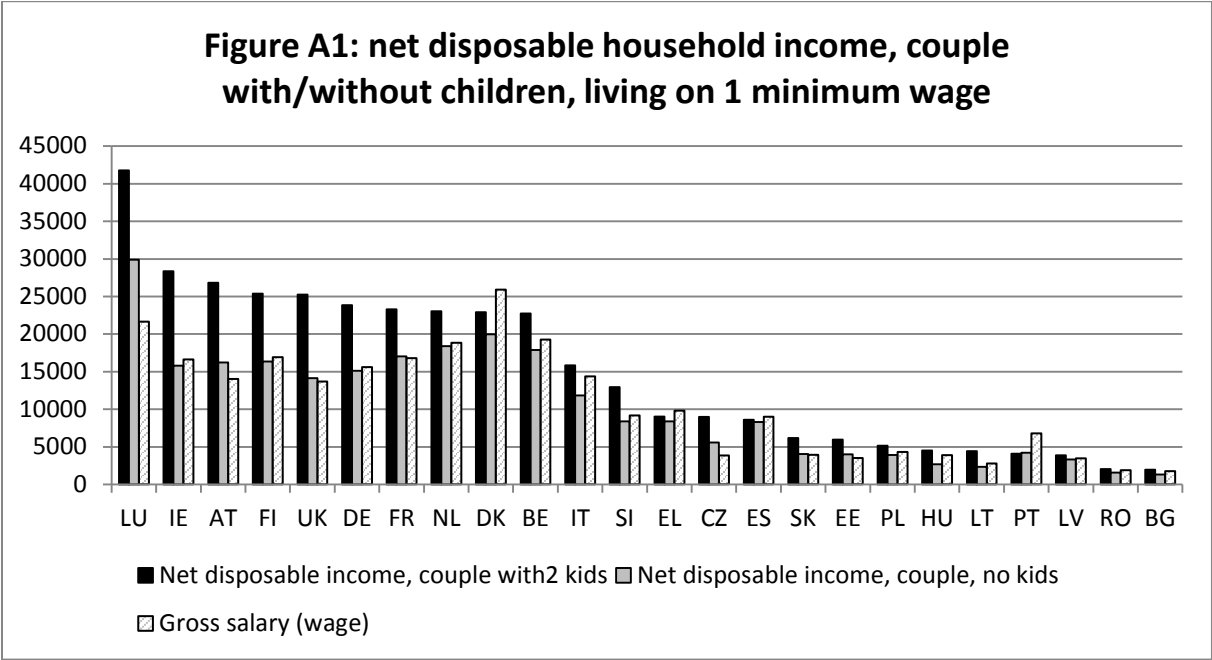
The core idea can be summarised as follows: a Social Union would support national welfare states *on a systemic level* in some of their key functions and guide the *substantive development* of national welfare states – via general social standards and objectives, leaving ways and means of social policy to the Member States – on the basis of an operational definition of 'the European Social Model'. In other words, European countries would cooperate in a union with an explicit social purpose – hence, the expression European Social Union.

The one key function of welfare states on which I focused in this lecture is stabilisation, but I could also have given other examples of welfare state functions that should be supported by a Social Union. Think, for instance, of defining European rules for corporate taxation, which would enable national governments to maintain a balanced tax system. I referred to the US during this lecture, because that comparison highlights fundamental flaws in the design of the Eurozone, and the paradox of parochial solidarity. However, I do not consider the US an 'example to be followed', not in terms of political institutions, nor in terms of social model. We, Europeans, are in uncharted territory: in the entire world, there is not a single example of a 'union of welfare states' like the one the EU is supposed to be.

Politically, this creates a very complicated puzzle: it should be to everyone's benefit to 'cross over at the same time' when it comes to sharing sovereignty and sharing risks. But how do you make this happen when there is no mutual trust and when you think you are increasingly losing control on your own national situation? The latter is what is at the core of the debate: the EU has become synonymous with 'losing control'. If we are not willing to share risk and sovereignty, we will not be able to 'take back control'. Politically, the arguments presented in this contribution may seem an uphill battle today. However, we should not shy away from the rational argument: in order to 'take back control', Europeans must be ready to share risks and sovereignty in some key domains of their welfare states.

**Appendix: The role of minimum wages, taxes, contributions and benefits in households' purchasing power**

Figure A1 shows the net disposable household income of a couple with a single income: one partner is working a minimum wage job. Their net disposable income is influenced by the level of the minimum wage, taxes and social security contributions they have to pay, and benefits they receive. We distinguish between a childless couple and a couple with two children.



Source: CSB MIPI Databank Version 3/2013; see Van Mechelen et al. (2011)

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<sup>1</sup> This contribution is based on my inaugural address as full professor at the University of Amsterdam, 1 June 2016, with some short-cuts and updates.

<sup>2</sup> See Scharpf (2009) for a synthesis of his view. For the relationship between Scharpf and related authors and arguments for 'social Europe', see Vandenbroucke (2012).

<sup>3</sup> I borrow the term 'convergence machine' from Gill and Raiser (2012).

<sup>4</sup> Ohlin, recipient of the *Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel* and Swedish politician and party leader, is mainly known for his research on international trade, which is summarised in the *Heckscher-Ohlin theorem*. The report was published by the International Labour Organisation (ILO, 1956).

<sup>5</sup> I write 'to a large degree' since the developing European Economic Community did link market integration to social harmonisation in specific areas, notably safety and health at work since the 1980s. For an overview of the social policy the Union developed, see Vandenbroucke and Vanhercke (2014), Anderson (2015), Leibfried (2015) and Rhodes (2015).

<sup>6</sup> This refers to the unweighted average of the (member) states' numbers, i.e. without taking into account the differences in size of the (member) states.

<sup>7</sup> The EU figures are based on EU SILC 2014 (Eurostat); the US numbers are based on information from the *Bureau of the Census*. The underlying EU and US figures are not fully comparable. The EU figures render the median available household income per individual, standardised so that it can take into account differences in household size and household composition; the amounts are rendered in purchasing power parities; for most countries they cover 2013, except for the UK and Ireland where they cover 2014. The US figures render incomes in dollars, on a household basis, and cover 2014.

<sup>8</sup> See Goedemé and Collado (2016) for a comprehensive analysis of pan-European versus national standards for inequality and poverty.

<sup>9</sup> Cantillon and Vandenbroucke (2014) examine why poverty increased in mature welfare states even before the crisis. See also Vandenbroucke and Rinaldi (2015) for a summary of the convergence-cohesion challenge in Europe.

<sup>10</sup> The Eurostat data this rough statement is based on cover the 1999-2008 period and do not concern Germany, Sweden, Denmark, Austria, Finland and Italy.

<sup>11</sup> The existing institutional configuration of some countries may be less suited to making such modifications; therefore, EU-integration might entail asymmetric effects.

<sup>12</sup> See Cantillon and Marchal (2016) and Cantillon, Marchal and Luigjes (2015).

<sup>13</sup> See Vandenbroucke and Vinck (2015).

<sup>14</sup> For such an analysis concerning the Netherlands, see SEO (2014).

<sup>15</sup> Burgoon (2014); for a broader discussion, see Burgoon (2013).

<sup>16</sup> Atkinson (2015); see also Salverda et al. (2014).

<sup>17</sup> See chapter III.2 pages 276-278, in European Council (2016).

<sup>18</sup> Based on Furceri and Zdzienicka (2013), I combined the following series: column IV from Table 3 (numbers they borrowed from Asdrubali) and columns (II) and (III) from Table A1.

<sup>19</sup> This sophisticated system is explained in Vandenbroucke and Luigjes (2016).

<sup>20</sup> See Figure 1 in Vandenbroucke and Luigjes (2016), based on Dolls, Fuest and Peichl (2012).

<sup>21</sup> This argument was also used by Allard et al. (2015, p. 239).

<sup>22</sup> Teulings (2014, p. 34).

<sup>23</sup> For a comparison of the coverage ratio of unemployment benefits, see Esser et al. (2013).

<sup>24</sup> Bablevy et al. (2015) and Oksanen (2016) discuss the rationale of a European insurance scheme, make several suggestions and propose a comprehensive bibliography. For an account of the debate on European



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unemployment insurance and for an additional bibliography, see Strauss (2016).

<sup>25</sup> The publication of this research can be found via <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7959>

<sup>26</sup> For a short discussion of the differences between a 're-insurance' scheme and a genuine European unemployment insurance scheme, see Vandenbroucke (2016b).

<sup>27</sup> This argument is similar to the one used by De Grauwe and others authors who plead for collective action on public debt of Eurozone countries, e.g. via Eurobonds.

<sup>28</sup> This means, for instance, that, in case of diverging competitiveness, countries with large current account surpluses should also initiate corrective actions.

<sup>29</sup> Vandenbroucke and Luigjes (2016) compare eight countries in which different levels of government are accountable for unemployment benefits and the activation of the unemployed.

<sup>30</sup> For arguments regarding the EU28 and for a more detailed reflection on a 'European Social Union', see Vandenbroucke (2015).

<sup>31</sup> Arguing that a visible hand is necessary, does not mark a departure from current EU *principles*, but rather from current *practice*. The Six-Pack and the Macroeconomic Imbalance Procedure are deliberate attempts to strengthen the visible hand of European policy makers. But current practice has put a one-sided emphasis on adjustment in Member States with current account deficits and has not addressed the role of Member States with surpluses. Symmetry should be organised instead around a common benchmark, for instance, a 'golden rule' linking national wage increases to national productivity increases. Such a golden rule would avoid both excessive wage moderation in some countries and excessive pay increases in other countries (Vandenbroucke, 2015).

<sup>32</sup> A congenial argument may also be applied to pension schemes and long term fiscal sustainability.

<sup>33</sup> This initiative is part of the Commission's work on deepening the monetary union, further to the Report of the Five Presidents of the European Institutions on completing the European Monetary Union. See European Council (2015).

<sup>34</sup> This implies new challenges for comparative policy analysis; see Vandenbroucke (2016c).

<sup>35</sup> See Bowles (2012).

<sup>36</sup> In fact, the main point of sympathy (in the Dutch government) with Cameron's agenda concerned his position on the exportability of child benefits, which entails a more nuanced debate than the debate on in-work benefits for non-UK citizens, as explained in Vandenbroucke (2016a). However, the underlying political driver is the same.

<sup>37</sup> See Vandenbroucke and Rinaldi (2015).

<sup>38</sup> Subsidiarity is often wrongly considered in one direction; organising macroeconomic shock-absorbers on the supra-national level is also an example of subsidiarity. Vandenbroucke (2015) explains why the European reality, from a European Social Union perspective, can justify rethinking the application of the subsidiarity principle *within* member states in some specific areas, such as the setting of minimum wages.