Reconstructing the eurozone: the role of EU social policy

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It is widely recognised that the institutional architecture housing monetary union in Europe is deeply flawed. Although there has been considerable discussion about how these shortcomings can be put right, relatively little has been said about the role EU social policy can play in making the eurozone more stable and sustainable. The purpose of this paper is to address this shortcoming. It is argued that that some form of EU ‘social union’ is urgent, for without it the immediate financial problems facing the members of the eurozone cannot be resolved. The paper seeks to explain what role EU social policies can play in the construction of an adequate federal framework for the monetary union. It is argued that a fully fledged social union is unlikely to emerge that involves massive transfers from the European core to the periphery. At the same time, it is envisaged that EU social policy will need to be strengthened considerably, with interventions focusing on employment creation and on the capacity of national governments to maintain domestic social safety nets.

Key words: Monetary union, Social policy, European integration

JEL classifications: J48, J88, P16

1. Introduction

A wide consensus exists that European monetary union as presently constituted is unsustainable. Most of the internal tensions currently being experienced by the eurozone can be traced back to political errors made when it was first being constructed. At the time, Germany was of the view that a common currency should only be introduced after a very high degree of economic integration and convergence had been achieved. In contrast, France wanted an immediate union, flanked by a strong ‘economic government’. Both positions were coherent enough, but in the horse trading that so characterises EU political decision making an incoherent compromise emerged. In particular, it was decided to create a single currency within a fairly short period without important complementary institutions (Calliess et al., 2011).

The political consequence was to cripple the monetary union. The analytical framework developed over a long period by Michel Aglietta and André Orléan seems...
particularly relevant to assess the debacle, because it links monetary systems to the 
exercise of political sovereignty (see, e.g., Aglietta and Orléan, 1998; see also Grahl, 
2000). In his recent study of the eurozone crisis, Aglietta (2012) argues that there were 
two possible forms of sovereignty that could have provided a political basis for the euro: 
on the one hand, political federation; on the other, German hegemony, if accepted by 
the other member states. Neither was established: the only federal institution was the 
European Central Bank (ECB), yet there is no sovereign body to control its activities 
and situate these in a set of wider economic and social policies for the eurozone area.

At the same time, the hegemony model failed because Germany, as the only possible 
hegemon, could not adapt its own policies to the needs of the eurozone as a whole.

Thus the architecture for European monetary union was incomplete from the very 
start. That the governance of the eurozone has deep-seated fault lines is widely recog-
nised and a huge literature has emerged on how these can be corrected. Yet a matter 
that has received scant attention is the importance of building social foundations to a 
single currency in Europe. Highlighting the importance of a social policy to the long-
term sustainability of European integration is common enough in the political sci-
ence literature, a perspective nicely captured in an eloquent appeal for social Europe: 
‘True, the European financial system faces urgent short-term problems, but these do 
not detract from the fact that, in the longer term, an effective “social union” is indis-
pendable to the Union’s survival’ (Vandenbroucke, 2012, p. 4). In this paper we wish 
to go a step forward and argue that a ‘social union’ is even more urgent: without it the 
financial problems cannot be resolved. The legitimacy problems of the EU, obstacles 
to any project for federation, are closely related to the failures of its social policies. As 
is shown below, the social policies associated with European integration were at first 
ambitious and positive. Then a phase came in which economic integration went ahead 
with fewer social policy developments. In the current century, market-led economic 
integration has been pursued with aggressive moves against member-state social mod-
els and in the sovereign debt crisis itself, austerity policies have virtually made social 
dumping the key instrument with which it is hoped to resolve economic imbalances.

Thus, the first and most important rationale for a renewed and strengthened social 
policy is the need to legitimise the construction of a sovereign authority to govern the 
eurozone. The drastic loss of legitimacy of the European project and the erosion of 
the ‘permissive consensus’ with which it was previously viewed has been undeniable since the 
1990s (Lacroix and Coman, 2007). Although there are many conflicting political inter-
pretations of the EU, we would argue that the erosion of national social models without 
the substitution of effective EU alternatives is a major factor behind increasing resistance 
to the integration process. The democratic deficit of the EU has often been invoked, but 
the social deficit is a closely related issue: the weakness of democratic forces in the EU 
are closely linked to the inadequacy of EU social policies and the related attenuation of 
national social models, particularly since the signing of the Single European Act 1986.

This theme emerged strongly at a recent symposium of political scientists. Philippe 
Schmitter (p. 5) writes: ‘The vision of Europe as the site of an alternative form of 
“social capitalism” has been seriously tarnished by the current crisis and the wide-
spread dismantlement of welfare programmes—not to mention the EU’s failure to 
contribute to the coordination of national responses.’ Alan Supiot refers to the influ-
ence of Hayekian thought: ‘it is necessary to put the division of labour and the distribu-
tion of its fruits beyond the reach of the electorate. This is the dream that the European 
institutions have turned into a reality’ (Schmitter et al., 2012, p. 23).
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In this paper we address the question: what role can social policies play in the construction of an adequate federal framework for the monetary union? Their potential role is not confined to their economic function in mitigating the problems of economic divergence in the monetary union; they also have a key political dimension in that they might help to legitimise the new more federal institutions that are needed for a resolution of the eurozone crisis. Without stronger social policies, the very real danger exists that current efforts to bolster the eurozone will have the powerful ‘spill-back’ consequence of weakening even further popular support in the member states for the EU. We adopt a wide definition of social policy, including not only social security but also employment and labour market regulation together with labour market interventions, when these are intended to counter unemployment or to improve the welfare of workers rather than promote purely economic objectives, such as wage flexibility. This would approximately correspond to the policy spheres covered by D.-G V responsible for Employment and Social Affairs, going much beyond the limited fields in which the EU has formal competence. Thus defined, social policy clearly involves some redistributive measures, but we do not include redistributive transfers with essentially macroeconomic or financial objectives, such as public debt write-downs.

Our analysis requires some upfront assumptions to be made about the overall architecture that could be put in place to stabilise the eurozone and the role social policies could play within it. First of all, the eurozone needs to be housed within some type of federal framework, but this is likely to be minimalist in character. It seems to us extremely unlikely that the member states will agree to a fully fledged fiscal union that involves massive transfers from the European core to the periphery. More plausible is a series of fiscal co-insurance institutions along the lines proposed by Martin Wolf (2012), which provide insurance against severe shocks to individual member states and rules to achieve a more functional and symmetric adjustment of imbalances. The thrust of this type of arrangement is to establish economic solidarity inside the eurozone, without large recurrent fiscal transfers occurring from the richer to poorer parts of the EU. Other institutions will almost certainly be required. A banking union seems necessary to remove the problems of banking recapitalisation from member states too small or too weak to handle them. The creation of these types of institutions will inevitably require that the problem of current account imbalances be addressed, at least partially, by deficit countries themselves, as they will not be in receipt of ongoing transfers to offset the domestic gap between income and expenditure. Invariably, this will involve some level of ‘internal devaluation’ taking place in deficit countries. The view taken here is that such adjustment policies are plausible inside the eurozone: a compression of incomes is possible in several of the weaker economies and even desirable if it is concentrated on higher incomes. Portugal and Greece in particular have very high levels of wage inequality and as inequalities are much greater within sectors than across sectors, their reduction could certainly improve the competitiveness of tradeables (European Commission, 2007).

In fact, considerable internal devaluation has already taken place in several of the most severely impacted economies, together with a very welcome internal revaluation in Germany, as Table 1 shows. The problem is that much of this is at the expense of the lowest-paid workers (see, for the Greek case, Karamessini, 2012; pressure on wage-setting mechanisms in low-paid sectors in Ireland is documented in that country’s National Reform Programme, Ireland, 2011, p. 12).
However, this kind of adjustment can hardly succeed without big reductions in the accumulated debt of the countries concerned—either by debt forgiveness or by the assumption of debt at the eurozone level—otherwise, because debts are fixed in money terms, income reductions would serve only to aggravate the difficulties of debt service. The overall point is that a stronger EU social policy, if operating effectively, would encourage internal devaluation efforts to be done in a manner that did not exacerbate social exclusion. In other words, EU social policy would be designed to provide the member states with the economic and political space to keep intact their national systems of social protection. At the moment, the EU centre is virtually requiring member states, particularly in the European periphery, to sacrifice these social systems in defence of the euro.

Second, it seems to us that there is little possibility of strongly centralised or harmonised social policies inside a revamped eurozone. Partly, this is because it is unlikely the member states would agree such measures and, partly and more importantly, because national labour markets and the institutions that govern them continue to lack convergence. It is well known that differing labour market governance structures across the eurozone place a big constraint on the enactment of harmonised EU social policies and this has not been diminished by the current economic crisis. Thus, the social policies needed to support the sustainability of the eurozone will have to be differentiated in character. At the same time they will also have to be very active. In socio-economic terms, they would promote policies primarily focused on the recovery of employment in the eurozone. In political terms, they would promote the legitimacy of the emerging federal institutions.

The plan of the rest of this article is as follows. First, the past evolution of EU social policies is discussed. It is argued that unresolved issues of sovereignty made for great ambiguity in these policies. Then, the impact of crisis and austerity on social policies is considered: the outcome is complete disorder at both the member-state and eurozone levels. Finally, there is a sketch of the future social policies that could support a positive resolution of the crisis. It is concluded that just as the absence of social content in the monetary union reflects the political failures in its initial design, so the assertion of an ambitious and solidaristic social policy can be a key feature of its renewal.

### 2. Origins and development of EU social policy

Over the years, EU social policy has changed in complexion. In recent times, a model of divided sovereignty emerged in the EU which separated economic policy from social
policy, with the former increasingly controlled by the Union, and the latter largely remaining in the competence of the member states: monetary union tended to destabilise this model, but it collapsed with the eurozone crisis. However, in the heroic phase of European integration, the establishment of full sovereignty was closely linked to an ambitious and well-funded social policy.

Full sovereignty was indispensable to the European Coal and Steel Community (ECSC), the earliest institution of what was to become the EU. The object was to remove heavy industry completely from national control in a context where steel production was critical to both industrial development and military power. Thus, the High Authority could override national decisions within the given sectors. The social policy competence of the ECSC corresponded to this situation: the European Social Fund, established at that time, was intended to compensate those who lost from the integration process. It effectively did so, its main beneficiaries being Belgian miners (Milward, 1992). The ECSC was an experiment in functional integration in European agencies—the notion that national governments surrender control to European functional institutions in specific areas of economic and social life. National governments were prepared to cede sovereignty over social policy in the ECSC because its competence was limited to the coal and steel sectors.

This pattern was not repeated with the formation of the EEC in 1957. Integration had been transformed into an economy-wide project, with the modus operandi being European-level institutions sharing competence with member states. The Treaty of Rome was not particularly coherent on the matter of social policy. Some broad declaratory statements at the beginning hinted that there would be no marked differences between economic and social issues: in both cases an evolution towards greater integration was anticipated. Yet the body of the Treaty contained only a few explicit clauses on social policy, relating to such matters as holiday entitlements, health and safety and equal treatment in employment. At the same time, the Common Agricultural Policy was established by the Treaty, which, although becoming increasingly dysfunctional by the 1970s, was an effective support for the small farmers and rural communities who were one of the most vulnerable groups at a time of generally rising incomes, rapid urbanisation and industrial development.

In terms of employment and labour market policy, the EEC did relatively little until the publication of the 1974 Social Action Programme, which proclaimed that as much importance needed to be attached to the social field as to economic union in European construction. It set out a menu of 30 measures that needed to be adopted in three broad areas: (i) the attainment of full and better employment in the Community; (ii) the improvement of living and working conditions; and (iii) the increased involvement of workers in company-level decisions. The Social Action Programme was commonly viewed by the member states as giving the EEC a human face. But other, more hard-headed, calculations were also at work. At this stage of integration, the big Northern European corporations only had limited multinational interests; German enterprises in particular wanted to discourage competition from other member states simply on the basis of lower standards of social protection and public service provision. A broad German consensus against ‘social dumping’ gave support to active social policy initiatives from the Commission. Whatever the motivation behind its adoption, the Social Action Programme gave rise to considerable legislative activity. During the following decade, a number of important directives were adopted by the member states on equal pay and treatment and workers’ rights in situations such as collective redundancies.
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and transfers of undertakings. Other directives proposed at the time, such as employee information and consultation rights (the infamous Vredeling Directive) and the regulation of working time, had to go through tortuous machinations over a prolonged period of time before being adopted. Those directives that were adopted resulted in the creation of a potted framework of EU social legislation.

Side by side with this increased political activism on EU social legislation were efforts to develop some type of European collective-bargaining structure. European trade unions sought to leave behind years of bitter political rivalry between communist, social democratic and Christian democratic international trade union bodies by creating the ETUC in 1977. Industry trade union federations, such as the European Metalworkers’ Federation, were also revamped. Similarly, European employers reorganised and upgraded their EEC-level representative institutions. Commission-sponsored efforts were launched to start a European-level social dialogue that mostly involved EEC trade unions and employer bodies sitting down to conclude European-wide collective agreements. Nothing of any significance emerged from these discussions, with only one or two weak collective agreements emerging in various parts of the transport sector.

During the 1980s, EU social policy had a distinctively Janus-type feel to it. On the one hand, in an important period of judicial activism, the European Court of Justice made a series of rulings that strengthened and widened the legal import of many aspects of EU legislation. The impact was to encourage civic organisations across the member states to use EU legislation to challenge successfully the limits of existing national employment regulations, particularly in the equality field. On the other hand, however, the EU political decision-making process became blocked on social policy, not least due to the actions of Margaret Thatcher as UK Prime Minister. But the obdurateness of Thatcher should not be overstated. Acute economic difficulties led nearly all the member states to become lukewarm about EU social policy. Instead, they became focused upon driving forward the integration process through exclusively economic means, relying completely on ‘negative’ measures to reinforce competition and remove ‘barriers’ to cross-border transactions (Grahl and Teague, 1989). The relegation of social policy involved in the Single European Act and the 1992 agenda were obscured by EU leaders. Jacques Delors, then President of the European Commission, elicited support for the agenda from trade unionists and centre-left parties on the basis of the creative imbalance theory: negative, market-led integration would call forth the necessary social policy corrections. Activism on the part of the Court of Justice gave this argument a veneer of credibility, but in the end the promise was not kept.

Overall, by the 1990s the EU had secured a presence in employment and labour market regulation. It attempted also to extend its influence into social policy fields, such as actions against poverty or ‘active’ employment measures, by making use of the ‘open method of coordination’ (OMC). This established cycles of information exchange and forums for policy debate in the hope that convergence on effective policies could be achieved even where decision making remained with the member states. The OMC, by undertaking research and fostering discussions, promoted the emergence of social policy communities both within and across the member states. At the same time, however, EU social policy could hardly be interpreted as an integrated system of labour market governance—such a regime would have lead to howls of opposition from big corporations, as it would have drastically reduced the scope for regime shopping. In reality, social policy very much less important than was the market completion project. A clear dichotomy emerged in the wake of the triumph of negative integration. On the
one hand, the competition rules of the EU held member-state governments back from most types of economic intervention. In particular, it became very difficult to use public procurement for social purposes. On the other hand, most social policy instruments remained at national level. Member states jealously guarded decision making in social policy, because they could not easily respond to the problems arising from European integration and globalisation with economic measures. Yet the EU could prevent unbridled national autonomy on employment rules, particularly if these carried the danger of circumventing parts of the single-market programme. Thus, the EU had sufficient competence on social matters to prevent defection from negative integration, but not enough to create an institutional exoskeleton for the European labour market.

By the mid-1990s the EU had started once again to adopt social policy directives. Much of this legislative action related primarily to the use of ‘atypical’ employment contracts, such as temporary contracts, agency work, etc. The legislation insisted that workers on such contracts should not be disadvantaged in other respects as compared with workers on ‘standard’, indefinite contracts (but it should be noted that the nature of standard contracts themselves remained in the competence of the member states). To some extent, these directives were about bringing to the statute book proposals that had been in the policy process for some time, albeit in heavily revised form. But their adoption was prescient as flexible forms of working time were on the rise almost everywhere. Yet the enactment of directives on part-time and temporary employment, amongst others, ironically served to highlight important divergences across the member states. On the one hand, they worked to legitimise atypical contracts in many continental European countries: unions in France, Germany and elsewhere resisted the spread of atypical employment, which was seen as threatening the position of workers on ‘standard’ permanent contracts. On the other hand, they afforded new rights to workers in Britain and Ireland, where employment regulation had not previously placed many constraints on employers.

By the early years of the new century, this legislative agenda was effectively exhausted, opening the way to yet another twist in the course of EU social policy. With much fanfare, EU leaders launched the Lisbon Strategy in 2000, which signalled a move away from social policy that sought to develop employment rights towards broader policies aimed at improving employability across the member states. The slogan ‘flexicurity’ figured strongly in these policy efforts. No one can object in principle to a combination of economic security and the flexible use of labour, and the two countries put forward as models of flexicurity—Denmark and the Netherlands—have social models that are more advanced than in most EU member states. In practice, however, flexicurity within the context of EU social policy did not mean the general adoption of the Danish or Dutch social model; the concept was interpreted à la carte and this opened the way to the weakening of standard employment contracts in some member states, so that these would confer fewer social rights and offer less employment protection (Keune and Jepsen, 2006). Although it is justified by the notion that those on standard contracts are labour market ‘insiders’, the flexicurity agenda at the EU level threatened to mimic straightforward labour market flexibility programmes by being harshly egalitarian, with the weakest and most vulnerable ‘insiders’ no doubt being affected the most.

However, since standard employment contracts are in the competence of member states, the EU is not in a position to implement flexicurity reforms—it can only urge national governments to do so (in the French case, Dominique de Villepin and Nicolas Sarkozy were happy to oblige; see Filoche, 2008). Thus, with the adoption of the Lisbon Strategy, the basic dichotomy—economic policies to the EU, social policies to
the member states—was restored. The very aggressive way EU institutions blocked the potential use of social policy to modify the impact of competition rules indicates how this dichotomy has been working out recently. One example was the highly deregulatory Bolkestein Directive seeking the liberalising of service provision across the EU—which was only partially amended by the European Parliament. Another was a series of judgments in the Court of Justice that weakened the position of workers ‘posted’ temporarily to other member states (Ewing and Hendy, 2009).

Thus, member states retained social policy competence, but were highly constrained in their use of such policies: first, by the regime competition implied by the ability of European corporations to regime shop across labour market and welfare systems; and, second, by an increasingly fierce enforcement of the EU’s competition rules.

As high levels of unemployment persisted into the new century, social policy at the member-state level became more restrictive partly because of these competitive pressures. Early responses to higher unemployment had identified a problem of ‘social exclusion’ affecting vulnerable groups who had not acquired the labour market records needed for access to the generous indemnities that prevailed in continental Europe. Expenditures were increased to combat such exclusion. The Hartz IV reforms of employment services and of the unemployment relief system in Germany in 2004 marked a decisive shift away from that approach to a supply-side interpretation of long-term unemployment and a much harsher treatment of the claimants involved, who sometimes suffered drastic reductions in their benefits. Although these and other reforms did lead to a rapid expansion of low-wage sectors in Germany, the outcome has been adverse in many respects: inequalities have widened, particularly at the bottom of the income distribution (for data, see van Treeck and Sturn, 2012, p. 85), and profit shares have continued to rise (Schäfer, 2010); yet there is no significant effect on long-term unemployment (Niemeier, 2010). Overall, some reduction in unemployment has been achieved at the cost of a large increase in the numbers of working poor. Given the key role of the German economy and German influence over current policies throughout the EU, it is a source of concern that labour market polarisation and a decline in the share of jobs with middle incomes is more marked in Germany than elsewhere (Goos et al., 2009).

3. Austerity against sovereignty

To consider the role a revamped EU social policy could play in restoring credibility to monetary union in Europe, it is necessary to relate the political crises of the eurozone to wider problems in the reconciliation of contemporary capitalism and representative democracy. Wolfgang Streeck (2011, p. 13), for example, writes that ‘More than ever, economic power seems today to have become political power, while citizens appear to be almost entirely stripped of their democratic defences and their capacity to impress upon the political economy interests and demands that are incommensurable with those of capital owners.’ Events in the weaker countries of the eurozone give an extreme example of this process. Social policy, as the only remaining instrument governments could use to mitigate external economic pressures, is now being taken out of their hands. However, although this move confirms the effective loss of sovereignty by the member states concerned, it fails to constitute a corresponding power of decision at the eurozone level. This is for two reasons: first, the new constraints on social policy
are completely asymmetric—they apply to the weak, not the strong; and, second, there is no attempt and no ambition to coordinate the outcomes across countries.

The new social regimes are being introduced through a series of measures. Although these are justified in terms of both coordination and surveillance, only the latter is real. The primary focus of the surveillance drive is on fiscal policy, but fiscal targets are accompanied by detailed prescriptions of the measures to be taken to achieve them. Habermas spells out the implications of this approach: governments will be inspected every year to see whether ‘the level of debt, labour market deregulation, the system of social security, the health care system, wages in the public sector, the wage share, the rate of corporation tax and much more correspond to the reckoning of the Council’ (see Calliess et al., 2011, p. 3).

The form of the changes concerned is a drastic tightening of the Growth and Stability Pact through two intergovernmental agreements—the Pact for the Euro in 2011 and the Stability Treaty in 2012—and through the ‘six-pack’ of directives passed by the European Parliament in late 2011. These had the effect of setting more restrictive fiscal targets, controlling the process of budget setting, making litigation against delinquent governments more automatic and less open to political intervention, and introducing new targets on macroeconomic ‘imbalances’ to go along with the previous ones on public sector debt and public sector deficits. The imbalances, to be signalled by one of a short list of macro-variables (the ‘scorecard’) crossing a predetermined threshold, concern essentially external competitiveness. They lock the stable door to the crises in Spain and Ireland, where unsustainable current account deficits developed in the absence of significant public sector borrowing. In addition, there are the separate conditions imposed on those countries that have accepted bailout funds from the Troika1 or the European Financial Stability Facility.

The new regimes are concretised in the ‘European Semester’. In the first half of each year, member states are required to submit both a stability programme and a national reform programme, the first dealing with macropolicy in the short to medium term and the second with ‘structural’ reforms—essentially deregulations, privatisations, etc. With the ‘rescue-cum-retrenchment’ regimes (Scharpf, 2011) imposed on the states accepting bailout funds, virtually all social policy autonomy is lost. Detailed prescriptions enforce reforms in pension systems, trade union rights, minimum wage levels and structures, public service provision and much more. For example, consider the recent National Reform Programme for Greece. This includes detailed interventions into the Greek collective-bargaining system that in the past would have been ruled out as contrary to the Treaty of Union but which can now, it seems, be enforced in return for bailout funds and with the flimsy pretence that the reforms represent an initiative of the Greek government itself, merely supervised by the representatives of the Troika. Two examples are chosen here from a long list of such measures: (i) the automatic extension of collective agreements to non-participating employers (a practice still found in Germany and a very necessary defence of collective-bargaining systems

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1 The Troika denotes teams of creditors from the European Commission, the ECB and the IMF: the role of the IMF in public debt and current account crises within the EU began in the Baltic republics in 2008. To involve an external agency in emergency lending in this way could be seen as an admission of the weakness of EU institutions. For the Commission, however, it offered two advantages: it increased the resources available and made it possible to impose conditions on the debtor countries in policy fields outside the competence of the Commission as a purely EU institution.
under pressure) was abolished in 2011; and (ii) unilateral recourse to arbitration was abolished in 2012 (Hellenic Republic, 2012, pp. 6–7).

Note that social protection regimes in the states most affected were underdeveloped prior to the outbreak of the crisis. The COFOG database maintained by Eurostat showed average expenditure on social protection in the EU as 17.6% of GDP in 2007. In Greece the figure was 15.8%, in Portugal 15.3%, in Spain 13.1% and in Ireland 11.5%. Only Italy achieved the EU average. These figures have since risen, because of big increases in unemployment and falling GDP, but remain well below Western European norms.

Even where the Commission does not require specific social policy changes, the intensity of the pressure for rapid fiscal consolidation makes them inevitable. The Irish government was not explicitly enjoined to abandon its antipoverty programmes, but its National Reform Programme makes it clear that this is happening (Ireland, 2011, p. 24). Those weaker states that have not, or not yet, applied for bailout loans are subjected to slightly diluted forms of the same tutelage. They seek to protect the possibility of receiving funds in the future by conforming to the direction of macroeconomic and social policies laid down in Northern Europe and have also to meet the conditions imposed by the ECB to supply liquidity to their banking systems and for inclusion of their government bonds in its security purchase programmes.

However, the dissolution of member-state social policy by no means corresponds to the substitution of social policy at the eurozone level. An elementary problem concerns the macroeconomic framework of the stability programmes. The Commission makes no attempt to aggregate them and to assess their validity as an overall programme for the eurozone as a whole. Three economists at the Hans-Boeckler-Foundation (Semieniuk et al., 2011) carried out this straightforward aggregation exercise for the eurozone states and showed that, taken together, the implications of the stability programmes were wildly implausible because the growth assumptions were in complete contradiction to the ambitious targets for fiscal consolidation: only a massive surge in net exports out of the zone and an equally implausible weakening of private sector balance sheets could make the sums add up.

The eurozone crisis has rendered core social policies at the EU level completely unrealistic. Since no resources were committed by the EU to achieve its social policy targets, since there are no effective levers to influence policy in the stronger states and since the weaker ones have to subordinate social objectives to deficit reduction, the targets are empty aspirations. In the strategy laid down as Europe 2020, the key socio-economic objective is ‘inclusive growth’ (European Commission, 2010). The absence of growth and the exclusion that follows is well illustrated by Greek data (Figure 1). In other countries, the data are a little less dramatic, but their pattern is the same.

Leschke et al. (2012) point out that planned retrenchment in social spending is most severe in just those member states where indicators of poverty and social exclusion are highest. Thus the assault on national social policies, far from inaugurating a coherent regime at the European level, signals both a general deterioration and a dangerous divergence of weaker from stronger member states.

4. Social policy in a sovereign eurozone

It is now widely recognised that the survival of the monetary union requires decisive steps towards federation. The present crisis-ridden surveillance regime may well be unsustainable in economic and financial terms. Politically, it is little more than
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a colonial structure. The minimum steps required in economic terms are discussed elsewhere in this issue of *CJE*. In Aglietta’s notion of monetary systems as based on a sovereign actor, it would be necessary to define a coherent macrostance for the eurozone as a whole, to articulate that stance so as to produce differentiated impacts across member states in very different circumstances and to rely on consistent and unconditional support from the central bank.

A well-defined and adequately funded social policy will be indispensable to the success of such a project, both to establish the legitimacy of the new institutions and to give the most appropriate response to the vast divergence in economic performance currently seen in the monetary union. Federation does not mean complete centralisation, but it requires radical policy departures. Although the annual cycle of national employment policy assessment invented by the Lisbon Strategy is a useful enough procedure, it needs to be given a completely different content: to begin with, it is very necessary to dissolve the humiliating intrusion into the specifics of policy formulation and national practice in the weakest countries—the principle of subsidiarity needs to be reaffirmed.

Political realism, however, implies that a federal rescue of the eurozone be minimalist in character, at least initially. Very large international transfers, on a scale to transform the actual pattern of current account imbalances, do not seem possible at present. At the same time, the social dimension to a federal rescue would have to place constraints on the functioning of labour markets. Stockhammer argues that an overall increase in wages is needed to support aggregate demand in the eurozone and that relative wages have to increase in the countries with current account surpluses to reduce present imbalances: ‘Simply put, if Europe wants to avoid crises like the Greek and Irish crises in the future, it needs higher wage growth in Germany’ (*Stockhammer, 2011*, p. 95).

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*Fig. 1.* Greek employment rate (ages 20–64) in the 2000–11 period and national employment rate target for 2020.

*Sources:* Hellenic Statistical Authority (EL.STAT.); Eurostat; *Hellenic Republic, 2012*, p. 24.
Although the German authorities have recently been more sympathetic to the need for higher wages, there are real problems in bringing about a big change—partly because of the power of German multinational enterprises, which are today more concerned with reducing costs in Germany than with Germany as a market (Grahl and Teague, 2004).

Thus, EU social policy would have to grapple in one way or another with the problem of pushing up German wages: on paper, this problem could be addressed in three ways, all of which require national action by Germany or German firms. First, in recognition of the extension of international supply chains by large firms in Germany, wages could be pushed up not in Germany itself but in its industrial suppliers, particularly in Central and Eastern Europe. This would have an equivalent effect on relative costs and would help to narrow the very big income differentials between Western Europe and the CEECs. Second, steps might be taken to reverse some of the harsh labour-market measures of the Schröder administration, which attempted deliberately to promote a low-wage sector in Germany. In consequence, Germany exhibits an unusual pattern of wage distribution, with inequalities widening more at the bottom than at the top (ILO, 2009, p. 26). Third, further reductions in working time might be explored; during the European recession of 2008, Germany made use of its still strong collective-bargaining institutions to cut working time temporarily and this was effective in staving off unemployment increases.

Another correction mechanism, which could be an alternative or a complement to the above and is currently promoted as central to the rescue-cum-retrenchment regimes in the peripheral countries, is ‘internal devaluation’. This corrective mechanism signifies an attempt to restore competitiveness through reductions in incomes and prices. This strategy is currently part of the general drive for fiscal consolidation in the EU as a whole. Although the policy is having a contractionary effect on the countries pursuing fiscal consolidation, it is usually justified on the grounds that internal devaluation allowed the Baltic republics to recover rapidly from a sharp economic downturn. But this justification is spurious as it is not true that the Baltic republics exemplify successful internal devaluation. Their relatively fast, but still incomplete, recovery from drastic recessions is based on support from the EU’s structural fund, on accelerated emigration and on their integration into Polish and Scandinavian supply chains. According to the Commission’s AMECO database, population decline in the three countries since the onset of crisis in 2007 is 513,000, a loss of over 7%; the workforce has declined by 4% over the same period, with unemployment rates in 2012 at 13.7%. Reductions in their real exchange rates have been much too small to produce a general recovery in competitiveness (Kattel and Raudla, 2012). Meanwhile, the European Commission (2012) reports a very severe problem of poverty, especially in Latvia and Lithuania, with the ‘risk of severe material deprivation’ much higher than in the EU as a whole.\footnote{For the case of Latvia, see Hudson and Sommers (2012).}

Thus, a policy of ‘internal devaluation’ runs the danger of simply depressing demand rather than triggering an economic revival. However, we do not completely rule out internal devaluation in the Western periphery. In particular, higher incomes were often outrageously increased during the boom years and this in itself has become a social problem. Even with a change of macroeconomic stance in Northern Europe and the lifting of the austerity requirements imposed by the Troika, these economies will face balance-of-payments constraints on growth in the near future. However, reductions...
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in income should be concentrated at the top, rather than, as at present, on minimum wage earners and other vulnerable groups. Given the difficulties of managing balance-of-payments constraints, bargaining systems need to be strengthened, not fragmented. Finally, reductions in income, although they may slacken current account constraints, are incompatible with the continued service of debts fixed in nominal terms. Debt relief on a large scale is a precondition for any effective approach to divergence in economic performance. The origins of peripheral country debt lie in the massively dysfunctional manner in which the monetary union operated, which makes it doubtful whether it is legitimate to require the populations of the weaker economies to bear this burden (Chesnais, 2011).

Since the same economic developments that led to a crisis of public debt also saw a vast accumulation of private wealth, the most appropriate way to clear public sector debt is by a Europe-wide wealth tax:

In Europe there are 3.1 million individuals considered as ‘high net worth individuals’ (HNWI), which is defined as owning investible assets of at least US$1 million. They account for 0.6% of the EU’s population, which stands at 502.5 million. In 2010, their wealth totalled US$ 10.2 trillion, which is equal to 24% of the global wealth of HNWIs, while it grew by 7.2% in relation to 2009. (World Wealth Report, 2011, cited in EuroMemo Group, 2012)

The imposition of such a tax certainly presupposes that the effort to legitimise a sovereign eurozone would succeed; otherwise, the issue of taxation without representation could arise. However, the political popularity of the financial transactions tax proposed by the Commission to obtain some compensation for the misdeeds of the financial sector indicates that taxes clearly compatible with social justice could actually work to reinforce support for a federating project.

The new integration measures to reconstruct the eurozone will only be acceptable if the reconstruction promotes the interests of the populations of the zone, rather than those of dominant financial elites. Only clear and ambitious social policies can meet this condition. But social policies are also necessary to secure effective convergence of economic performance within the monetary union. Contrary to the prevailing view among EU leaders, market integration as such does not promote convergence, but rather polarisation. During the first decade of the twenty-first century there seemed to be a movement of employment out to the periphery. The Commission’s AMECO database gives the growth of employment in the original eurozone (the first 11 countries plus Greece) between 1999 and 2007 as 13.7 million. Of this total, two-thirds, or 8.9 million, took place in the ‘periphery’—in Ireland, Greece, Spain, Italy and Portugal. However, this was not a consequence of successful convergence. It reflected unsustainable capital flows often of a highly speculative nature and all the periphery’s gains in employment were subsequently reversed.

The EU has already launched an industrial policy initiative, using the European Investment Bank to stimulate investment across the EU as a whole. Although the sum involved, around 1% of EU GDP, is not yet enough, if this kind of initiative is concentrated on the states most affected by the crisis, it could start to have a significant effect. Social policies, again with most expenditure concentrated on the weakest member-state economies, are needed both for immediate recovery and convergence of economic performance. The content of renewed social policies is subject to political constraints: the nature of the expenditures involved will affect the willingness of electorates in the stronger member states to accept the necessary transfers. Stockhammer (2012) has argued that a full
European welfare state would be economically viable and would contribute to the reduction of imbalances. If some benefits, say a European component in retirement pensions, were paid at the same nominal level across the EU, they would tend to have more purchasing power in the lower-income countries where non-tradable goods and services are cheaper. Galbraith (2009, p. 19) has advocated this policy: ‘The European Union should start a European Pension Union, levelling up pensions payments in the poorer member states until a common minimum standard for Europe as a whole has been reached. This would have good effects on employment, and help to ease the mortgage crisis.’

Such a leap towards federalism may be more than is politically possible. A more modest, but still effective, strategy would be a Europe-wide employment programme that concentrates resources on those countries where unemployment is highest and focuses especially on the prevention of long-term unemployment. A condition for success in this kind of intervention would be to break with the dogma, contradicted by three decades of experience but still prevalent among EU policy makers, that the private sector would be capable of providing enough jobs if only the workforce could be rendered sufficiently ‘employable’. Froud et al. (2011) have shown that government expenditures continue to be the indispensable core of actual employment systems, even if the activities involved are outsourced. There is a very close correspondence between unemployment rates and the imbalances within the eurozone, so that a forceful and well-resourced employment strategy would address both problems. Since the unemployment crisis is the direct outcome of serious malfunctions in the eurozone and of a catastrophic breakdown in the financial system enthusiastically promoted by EU leaderships (Grahl, 2011), there is a clear European responsibility to contribute to its resolution.

5. Conclusion

The argument developed in this paper is that successful reconstruction of the eurozone requires a major transfer of sovereignty to federal institutions, so that the monetary system is protected and sustained by a sovereign polity. In macroeconomic terms this requires an economic government of the eurozone with the capacity to formulate a functional fiscal policy differentiated across member states and the subordination of the ECB to this government. In political terms it requires that the new federal structures are legitimate. Given the drastic loss of popular support for European integration, legitimacy can only be obtained through a complete reorientation of the EU which would relegate the rules of competition and the reinforcement of the single market from the status of ends to that of means. The new purpose of European construction must become the welfare of European populations and this purpose could be effectively signalled by the adoption of an ambitious and solidaristic social policy. Although a full European welfare state might in time be the best expression of such a policy, in the immediate future a large-scale employment programme, led by the public sector, offers the best prospect for success.

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