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# The Euro crisis and its impact on national and European social policies

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Christophe Degryse, Maria Jepsen and Philippe Pochet

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**Working Paper 2013.05 – advance online publication**

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## **Abstract**

We begin by describing three different models of economic and monetary union and the different policy dynamics underlying them. These dynamics influence the architecture of monetary union which has a huge impact on national industrial relations and welfare state policies.

Our hypothesis is that, in the wake of the financial crisis of 2008, and subsequently of the 'euro crisis', and also due to the fact that the vast majority of governments in the EU responsible for handling this crisis were centre/right-wing, one model of economic and monetary union has been converted into another.

What we describe is a series of political choices, circumstances and windows of opportunity that have enabled this particular vision of the model of monetary union to gain acceptance. In the context of this model, political union is not considered an accessible way to manage the crisis, for the rescue of the euro is regarded as feasible only in a more competitive economy. The social dimension, accordingly, becomes the adjustment variable. In this regard, the statements made by the President of the European Central Bank announcing the death of the European Social Model, are merely the anticipation of a reality that is the outcome of a political choice, based on a set of economic prescriptions and which takes for granted the impossibility of attaining true political union.

We describe the new complex governance system put in place to implement this new model of economic governance of the EMU. It is a system still under construction but already it is putting much more pressure on industrial relations (in terms of wages and decentralization) and welfare states (labour market policy and pensions). It differs from the previous governance system in that, on the one hand, the rules are more rigid and, on the other hand, the changes foreseen relate to the institutions more than the policies.

While we conclude by drawing attention to those aspects that currently cohere and make sense, we are equally well aware of the contradictions, anomalies, power struggles, and possible changes of paradigm that rule out any suggestion of a foregone conclusion.

## Introduction

Since 2010 not a month has gone by without the government of one EU member state or another announcing that it is about to embark on major reform of its welfare legislation, its social protection system, its labour law or the regulations governing collective bargaining. The reasons given to justify these reforms refer unfailingly to the crisis, in particular the crisis of public finances, the fundamental argument being that the increase in public debt causes a slowdown in economic growth.

In the construction of this narrative, the various EU institutions play a role that it is impossible to disregard. For over fifteen years, for one thing, the now standard discourse has been drummed into us that the European social model – a term which actually, as we shall see, should be used in the plural – requires ‘modernization’ if it is to be ‘saved’. This claim has accordingly become so ‘self-evident’ that no one any longer thinks to question it, and the process has meanwhile been accompanied by the creation of various European institutional mechanisms by means of which the national governments undertake to implement the requisite reforms. While initially rather flexible, these mechanisms have recently been made more rigid and complex in the context of the European Semester and its arsenal of multilateral surveillance instruments which include the Euro Plus Pact, the Budgetary Pact, the Country-Specific Recommendations, and so forth.

Since 2010 and the implementation of this ‘new economic governance’, the European social model has been subject to a much more generalized calling into question.

Critical analysis of this process of questioning the social model can be categorized with reference to the famous ‘three Is’: Ideas, Institutions, and Interests.

According to the ‘Ideas’ analysts, the ‘dismantling’ of the European social model is an outcome of the austerity policies that have been introduced throughout the length and breadth of Europe in the wake of mistaken economic analysis that has led to implementation of the wrong policies (see, for example, Blyth 2012).

According to the ‘Institutions’ analysts, the problems suffered by the social model are the consequence of institutional maladjustment, so that the most urgent remedy is to complete Monetary Union by creating new economic and political institutions, i.e. economic government and political union (Pisani-Ferry 2012, De Grauwe 2013).

Finally, we encounter the ‘Interests’ analysts who place the emphasis on the growing divergence of interests between the core and the periphery, between the North and the South, between Western Europe and Central and Eastern Europe, or between France and Germany. Within this approach, it is argued that election results, particularly in Germany and for the European Parliament, are crucial.

It goes without saying that these three explanatory categories are not watertight or mutually exclusive in the manner in which they are summarily presented here. In this paper, however, we will attempt to work out and present some additional forms of explanation that could represent a different approach, one that might be entitled a ‘model-based’ approach.

Regarded from this alternative angle, the crisis of the euro, and hence the calling into question of the European social model, is linked neither to errors of diagnosis, nor to institutional maladjustment, nor to diverging interests. The calling into question is the reflection of a sequence of changes that have come about in keeping with one specific vision of the model of monetary union that is considered desirable. This particular vision – which regards social deregulation as an instrument of adjustment or adaptation – is supported by a group of specific strategic actors (central bankers, certain Commission DGs, Economic and Finance ministers) who feel themselves at ease with the German *ordo-liberalism* approach currently embodied by the beliefs and policies of Mrs. Merkel and which aims at government by rules. To this extent there exists a conjunction of interests, on the basis of partially differing analyses, within the particular group of strategic actors and in keeping with the German policy preferences (which extend beyond the left/right split).

What we will describe is a series of political choices, circumstances and windows of opportunity that have enabled this particular vision of the model of monetary union to find acceptance in a manner that appears to make sense and, in the eyes of its proponents, very good sense.

In the following paragraphs we will begin by describing the alternative policy dynamics underlying the three different models of economic and monetary union. These dynamics influence the architecture of monetary union and, in our view, they also influence the resulting social model.

Secondly, we shall see how these different dynamics have developed – or failed to develop, what political preferences they reflect, and what intrinsic imbalances they potentially harbour. Our hypothesis is that, in the wake of the financial crisis of 2008, the ‘euro crisis’ that ensued represents firm and tangible evidence of the way in which one model of economic and monetary union has been converted into another.

Thirdly, we shall consider the likely consequences of this ‘conversion’ on social models at national and European level. The question indeed arises as to whether these consequences may, in the medium or longer term, cause

European monetary union to become no longer sustainable. However this may be, these consequences are in no way ‘accidental’; even less are they linked to the ‘crisis’; they are inherent in that one particular vision of how economic and monetary union should operate. In this regard, the statements made by the President of the European Central Bank to the *Wall Street Journal* in February 2012 (announcing the death of the European Social Model) are merely the anticipation of a reality that is the outcome of a political choice, based on a set of economic prescriptions and which takes for granted – all the discourse advocating a strengthening of political integration notwithstanding – the impossibility of attaining true political union.

Finally, we will conclude, at least provisionally. Indeed, while we draw attention to those aspects that currently cohere and make sense, we are equally well aware of the contradictions, anomalies, power struggles and possible changes of paradigm that rule out any suggestion of a foregone conclusion.



# **1. Theoretical frameworks and institutional dynamics**

We will begin by presenting the different models – or theoretical reference frameworks – and rationales that have underpinned the institutional dynamics during the period of introduction of EMU, as well as their implications for the social model. As shown by Verdun (2013) and Schelke (2013), it is possible to characterize different institutional dynamics linking economic, political and monetary integration from an economic standpoint. On a basis of free and general reference to the debates among economists, we will elaborate three schematic models of possible modes of interaction, while explicitly incorporating the social dimension into the overall picture (for a more extensive description see Degryse and Pochet 2013).

## **1.1 Monetary union as the natural outcome of political union**

The different sequences in accordance with the first dynamic are as follows. During an initial period, the aim is to achieve real convergence of production structures among those member states wishing to take part in the monetary union; this entails the need for deeper economic integration. Once adequate convergence of policies, including wage and social policies, has been achieved, it is time to move on to a second stage, to make a democratic leap, so to speak, and to create a political union as a means of achieving a greater degree of solidarity among states. Finally, this integration of the real economies that has been sealed by the decision to form a political union enables the last stage of the construction to be completed in the form of a monetary union. In this model, therefore, social convergence constitutes one of the numerous prerequisites for monetary union. Such a monetary union will be federal in type since its prerequisite is a form of integration that is simultaneously political, economic and social.

## **1.2 Monetary union as the trigger for political union**

According to the second dynamic, the political, economic and social integration is also linked to monetary union but in this case it is one of its gradual consequences and not a precondition. Within this scenario, the monetary union is constructed on the basis of formal criteria – in particular, the well-known public deficit and public debt criteria – which allow selection of only those countries that are in a position to endure the constraints inherent in the

process. Governance by indicators is regarded as a means of ‘forcing’ real convergence of the economies. This is a form of convergence that also requires solidarity mechanisms (use of structural funds, creation of a convergence fund, increased community budget) and, *in fine*, political integration (adoption of a European constitution). Within this model, social convergence, while representing an essential component of the project, is not given *a priori* – centralization/decentralization/coordination (there is a huge academic debate on the different performances of the system of wage bargaining see for example Calmfors et al, 1988 and more recently Traxler et Kittel, (2000) and is hence dependent on democratic debate.

### **1.3 Monetary union without political union: procedural governance and the ‘recalibration’ of social models**

The third model also takes as its starting point the fact that monetary union needs to force economic union, but it regards as impossible – and in all likelihood undesirable – the creation in the medium term of a true political union. Monetary policy therefore has to be immunized against political decision-making (i.e. the outcome of democratic debate) and entrusted to independent experts. In the absence of adjustment instruments achieved through political integration and solidarity, this approach is focused, therefore, on adjustment by means of a flexibilization of social policies at the national level (decentralization of wage bargaining, flexibilization of hire-and-fire arrangements, reduction of replacement income), increased mobility of the labour factor at intra-European level<sup>1</sup>, and governance through the observance of procedures and formal rules devised by experts (‘European Semester’, budgetary discipline, etc.) under threat of automatic sanctions, in other words without, or with only extremely limited, margin for political interpretation. Under this model, the monetary union governed by rules and procedures requires a decentralization and ‘flexibilization’ of the social model which becomes an adjustment variable in the event of idiosyncronic shock.

Even the presentation of these models here is highly schematic and stylized; they give a good framework to understand the global dynamics and logics.

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1. The usual comparison is with the United States where mobility is perceived to be greater.

## 2. From one model to another

The first approach (monetary union as the natural outcome of political union) enjoyed its heyday in the 1970s. It can be found in the draft Werner Plan – Pierre Werner was a former Prime Minister of Luxembourg – which stated that the complete monetary unification of Europe was to be expected only as the outcome of a more protracted process of political union (Werner 1968). Analyses published at the time (Marjolin report 1975 and MacDougall report 1977) presented the main features of the approach that envisaged monetary union as the final stage of an economic, social and political sequence. With the crisis of the euro, this vision has, to some extent, returned into the public debate with some economists – mostly, but not exclusively, Americans (Eichengreen 2012) – arguing that there is a basic fault in the construction of EMU. However, this approach no longer has political currency because EMU has, in its present form, followed a different path. None but those who advocate a dismantling of the current EMU, so as to reconstruct it on totally different foundations, still take this approach seriously.

The two other approaches have been in a state of mutual tension over the last twenty years. In the first of these two approaches, it is possible to recognize the sequence of reforms followed at the level of the European Treaties. After the architecture of economic and monetary union outlined in the Maastricht Treaty (1992) with its model of strong federal governance for the monetary aspect and of weak and procedural inter-governmental coordination for its economic aspect, the Amsterdam Treaty sought to add a coordinated employment dimension (which was generalized later by the open methods of coordination in the social sphere), after which the political dimension was debated between 2000 and 2005 in the framework of the draft constitutional treaty. The aim here was real economic, social and political convergence in the long term but also the construction of a European *demos*, in other words a European identity, by way of a constitution.

Our hypothesis is that this approach to economic and social convergence by way of political integration was deliberately undermined as from 2005 in favour of a model based on market-driven convergence within monetary union; convergence, in other words, without political integration but by way of deregulation and market adjustments. The theoretical underpinnings of this model were in place even back in the 1990s but 2005 represented, as we shall see, a turning point. Strategic actors who supported this approach paradoxically found a way of using the euro crisis to make their mark at the same time as this crisis was revealing the consequences of the failure to achieve stronger political integration within the euro zone. It is the theoretical

underpinnings of these models and their interactions that we set out to describe in the following sections.

## **2.1 Monetary union and socioeconomic convergence by way of political integration**

In the 1990s, and in the context of preparation of monetary union, a series of political, social and trade union actors, aware of the risk of social policies being turned into an adjustment variable in the case of economic shocks in the euro zone, sought to develop a genuine social dimension of economic and monetary integration (Goetschy 2005). This explains the fact that the first ten years of monetary integration gave rise to certain developments in the social sphere that might appear surprising, above all in the light of the substantial weight and influence wielded by the group of experts who supported social policy deregulation (Serrano Pascual 2009).

This period, between 1995 and 2004, that might be described as ‘the social moment’, is the result, on the one hand, of a critique of the Maastricht Treaty which was regarded as unbalanced in the employment and social policy field as compared with the more developed aspects of monetary union and, on the other hand, of the coming to power in the member states, as from 1995, of a majority of centre-left parties (Manow *et al.* 2005). The period in question was characterized by structural reforms (see below) but the difference between then and the way things are being done today is that these reforms were subject to negotiation.

At the European level, this ‘moment’ really began with the Amsterdam Treaty (1997) and the European Employment Strategy initiated by it. The process was taken further with the Lisbon Strategy (2000) and the development of the open methods of coordination in a range of social policy fields (employment, poverty, pensions, etc.) (Pochet 2005).

At the national level, the 1990s also saw the conclusion of numerous national social pacts among political, economic and social actors (Pochet and Fajertag 2000; Pochet *et al.* 2010). In the majority of EMU accession countries a great deal of thought was being given during this period to the new framework of constraints represented by monetary union, particularly in relation to inflation and wage policy (including the national-level structuring of collective bargaining) (Pochet 1999). This process of reflection led to attempts at institutionalization by means of social pacts (in most cases – with the exception of Belgium – for countries outside the DM zone). It is in Belgium, precisely, that this type of institutionalization has developed the furthest, since arrangements there entail a systematic comparison between developments in Belgium and in its three neighboring trading partner countries (Pochet 2004).

In parallel, different forms of wage coordination were emerging at the European level. On the inter-sectoral level, the ETUC set up a working group

on wage coordination based on an explicit mandate received at the Helsinki Congress in 1999. It adopted a first resolution on this subject in 2000 (ETUC 2000). At the sectoral level, the European Metalworkers' Federation (EMF) and the Textile Workers Federation (ETUF) both adopted, towards the end of the 1990s, guidelines for national negotiators (EMF 1998). At a transnational level, the Doorn group, including negotiators from Germany, Belgium, The Netherlands and Luxembourg (subsequently joined by the French) held annual meetings to evaluate the results of their collective bargaining in the light of the previously agreed 'inflation-plus-national-productivity' formula (Pochet 1999; for a general overview Glassner and Pochet 2010). Some authors perceived this development as the emergence of a multi-level industrial relations system (Freyssinet 1996 ; Marginson and Sisson 2004).

The years between 1995 and 1999 also represented the 'golden age' of the European inter-sectoral social dialogue. It is during these years that were negotiated the only three framework agreements on labour market regulation (parental leave, part-time work, fixed-term contracts) that were turned into directives (which became, in other words, legally binding).

Finally, the year 1999 saw the creation of the European macroeconomic dialogue, the purpose of which was to organize a dialogue among the social partners, the ECB and the Commission. Several authors in those years had given consideration to the interactions between monetary policy and labour market institutions and actors (signaling process) (Hall and Franzeze 1998; Martin and Ross 2004; Hancké 2013).

The end of the 1990s also saw the creation of a set of open methods of coordination (OMCs) in the social policy field (health care, pensions and poverty) with a common methodology based on regular reporting, benchmarking and recommendations. These OMCs were overseen by the Employment and Social Affairs DG and brought together a number of different governmental and non-governmental actors in a cluster of specialized committees (EPSCO, EMCO).

As noted by one of the academics best informed about the developments of EMU, Kenneth Dyson, 'the ECB-centric eurozone policy community had to absorb and accommodate the so-called Luxembourg "process" – with its annual employment guidelines and national action plans – and the Cologne "process" – the Employment Pact and the macroeconomic dialogue. These developments opened up the dialogue about EMU by transforming the definition of who was in the policy domain' (Dyson 2002: 101). This same period witnessed also the attempt to enshrine monetary union within a European constitution and a European charter of fundamental rights. In this paper we will not go into detail about the content – which was controversial – of these texts; what interests us here is the general dynamic that underpinned them at the time.

This dynamic of political union and strengthened socio-economic coordination was brought to an end by France's and The Netherlands' rejection – by

referendum – of the draft European constitution. Similarly, the ‘social’ dynamic was halted as from 2005 and the publication of the Kok report entitled ‘Jobs, jobs, jobs’ that had been commissioned by the European Commission and which refocused the whole debate on growth, competitiveness and flexibility. Finally, the crisis of the euro heralded the possibility of a new narrative – focused on excessive public debt, the burden represented by the social model, wage rigidities, etc. – that was to be exploited by the proponents of a market-led monetary union.

On the political front, the European elections of 2004 saw the moderate right-wing group EPP-ED win a sweeping victory over the socialists, who did much more poorly than in the previous elections<sup>2</sup>, while the liberal parties did much better. As from 2005 the Commission was led by the centre-right with the presidency of José Manuel Barroso. In the autumn of 2005 Angela Merkel won the elections in Germany. Silvio Berlusconi was in power in Italy and Jacques Chirac in France, the latter soon to be replaced by Nicolas Sarkozy. More generally, between 2005 and 2012, the balance of power in the member states was very much in favour of the right and centre-right; by the beginning of spring 2012 only three out of 27 member states – Denmark, Austria, Cyprus – were governed by left-wingers while one, Belgium, had a left-right coalition led by a socialist prime minister. Since then the centre left has been making some – slight – progress in countries such as Italy or the Czech Republic. At the end of 2004, by contrast, twelve of these governments had been left-wing or centre-left<sup>3</sup> in orientation.

## **2.2 Political integration abandoned: towards market-driven convergence within monetary union**

It was in this political context that the social developments and achievements of the 1990s and early 2000s came to be unravelled. After a pretty sharp turn in 2005, the social OMCs were weakened in favour of a vision that gradually brought an economic approach back into the centre of European public policies and discourse

From 2004 to 2012 the national social pacts were gradually abandoned, as were the national debates on the constraints represented by EMU. This is an undoubtedly important aspect that, to date, has been subject to little investigation (Pochet *et al.* 2012; Advanic *et al.* 2011). Attention should also be drawn to the case of Greece where EMU entry took place in the absence of a social pact and without giving rise to the development of a strong institution of coordination in the 2000s (Ioannou 2012). This may be a reflection of the

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2. From receiving 34.9% of votes in 1994 their share fell to 27.3% in 2004 and to 25% in 2009. In other words, in a fifteen-year period the European Socialists’ share of the votes fell 10%.

3. See [http://www.europarl.europa.eu/about\\_parliament/fr/004a50d310/Composition-du-Parlement.html](http://www.europarl.europa.eu/about_parliament/fr/004a50d310/Composition-du-Parlement.html) and also <http://www.theguardian.com/world/interactive/2011/jul/28/europe-politics-interactive-map-left-right>

spirit of a period during which EMU appeared as such a success that it did not require, or no longer required, national and/or European institutions. Ireland and its dynamic growth, Spain and its millions of newly created jobs, had become key references in terms of economic and employment successes.

Might it be that, as from 2004-2005, this economic ‘success story’ of the euro zone created the illusion – at least until 2008 and the euro crisis – that market-driven convergence is more efficient than economic and social coordination? It may perhaps be appropriate to describe the proponents of this market-driven convergence as ‘hyper-realists’ – in the sense that they believe that no alternative arrangement will ever work, that the single currency will never lead to an increase in solidarity among member states and even less to any form of political union, and that markets alone can ensure the requisite convergence towards equilibrium within the monetary area.

The proponents of this kind of market-driven convergence<sup>4</sup> have, since Maastricht, advocated a change in the very function to be performed by social policy within the euro zone (Jepsen and Serrano Pascual 2005). This change would, according to them, come about in a virtually mechanical fashion in an EMU that, politically speaking, was incomplete and that it was no doubt impossible to complete. It is highly instructive, in this respect, to consider the work of Amy Verdun who, back in the mid-1990s, conducted interviews of the central bankers, the finance ministers, and the heads of the main employer organisations in three countries, namely, France, the UK and Germany. The few quotes reproduced below serve to summarize these politicians’ and experts’ standpoint and to indicate the nature of their arguments in favour of a socially deregulatory monetary union:

‘Experts’, states Verdun (1996), ‘argued that they favoured EMU exactly because it would lead to a process of harmonization through market forces. EMU would offer legitimacy for restructuring the expensive welfare states’.

Jean-Claude Trichet, who subsequently, in 2001, was to become the ECB President, stated:

‘EMU certainly stimulates structural reform in the labour market. With increased capital mobility and a better functioning single market, firms will become more and more sensitive to overall labour cost differentials and business regulation in choosing a particular location in the Euro-zone. They will therefore exert a considerable pressure for appropriate reforms’.

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4. We will not discuss here the question of whether this groups of ‘experts’ is best described as an epistemic community (Hass 1992), an advocacy coalition (Sabatier 1998) or a policy network (Marsh and Rhodes 1992). The significant point is that it shares the same vision of the place and nature of the social policy to be conducted and that the experts in question are to be found in a variety of centres of power (central banks, national economics and finance ministries, DG Ecfm, Economic policy committee, Brussels think-tanks, etc.).

Daniel Gros and Niels Thygesen, two eminent economists, specialists in monetary issues, summed up the thinking of numerous economists at the time and still today:

‘In sum, labour market flexibility is always useful and if EMU forces labour market reforms that are needed anyway, the economy of EU can only gain’ (1998:288).

The greatest pressure of all, however, was to be exerted on wage bargaining. As indicated already by the Padoa-Schioppa report (1987: 43),

‘The principle of subsidiarity recommends minimal responsibility on the part of the Community for many aspects of social policy, but the question of convergence of labour costs is vital in the context of increasing monetary integration’.

These few references demonstrate, assuming that such demonstration was necessary, that the austerity policies and structural reforms currently underway are not in any way linked to the euro crisis, contrary to the assertions of the great majority of national and European political leaders, but are programmed into the genes of a specific vision of monetary union.

As mentioned above, reforms were not absent from the first phase of monetary union and its ‘social moment’ but these reforms were negotiated (Pochet and Fajertag 2000). At this stage, it would be useful to observe their timing. In this respect, the analysis conducted by Duval and Elmeskov (2005) of the pace of reforms between 1994 and 2004 offers considerable food for thought<sup>5</sup>.

The authors found that, first of all, the euro-zone countries carried out, on average, more reforms than the OECD countries but less than the European non-EMU countries (Denmark, UK and Sweden) and that this was particularly the case during the 1994-1999 period. The manner in which national governments chose to present the challenge of EMU to public opinion is a key variable for understanding each national situation. Even so, the number of reforms seems to have decreased after 1999, though EMU countries remained above the average of OECD countries.

And so, during the first years of the 2000 decade, there was a relative pause in reforms in the eurozone countries. This is the point at which a series of initiatives were to be undertaken by the ECB, the Ecfm DG and the Economic Policy Committee (EPC) (a forum for national experts) in order to consolidate the theoretical framework linking together labour markets, wages and the euro (on wage development the last 3 decades see Visser, 2013)

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5. The reforms observed cover seven areas : a) active labour market policies ; b) taxes and social security contributions ; c) employment protection legislation ; d) unemployment benefits ; e) wage formation and industrial relations ; f) working time flexibility and part-time work; g) old-age pension and early retirement arrangements.

Jean-Claude Trichet (2011) states that in 2005 he set up a working group within the ECB to assess the risks of, in particular, wage divergence<sup>6</sup>. According to Glocker (personal communication), since 2002 the ECB President has been stressing the vital importance of wage issues within the Eurogroup. The ECB also set up a 'Wage dynamic network', the brief of which was described as follows: 'This network has the specific objectives of i) identifying the sources and features of wage and labour cost dynamics that are most relevant for monetary policy and ii) clarifying the relationship between wages, labour costs and prices both at the firm and macro-economic level.'

The network was structured into three working groups, namely, 'macro', 'micro', 'survey'.

Between 2009 and 2011, no less than 51 Working Papers were published by the ECB covering an impressive number of issues relating to the links between labour markets, wages and the euro. These studies dealt with the role of labour markets for monetary policy ('The role of labor markets for euro area monetary policy' n°1035), collective bargaining systems ('Institutional features of wage bargaining in 23 European countries, the UK and Japan', n° 924), automatic pay indexation ('Downward wage rigidity and automatic wage indexation: evidence from monthly micro wage data', n°1269), the flexibility of wage formation systems ('Wages are flexible aren't they? Evidence from micro wage data', n° 1074; 'Wage-setting and wage flexibility in Ireland – results from a firm-level survey', n°1181), etc.

The European Commission's Ecfm DG, meanwhile, has published every year since 2005, in either January or February, a report entitled 'labour market and wage development'. A data base on wage developments, called Ladrev, was also set up in 2005 but discontinued after 2009. The AMECO data base which serves as a reference on wages can now be accessed on the Ecfm DG's website.

As for the Economic Policy Committee (EPC), linked to the Ecfm DG, it has created a working group on labour markets with an extremely broad brief which includes almost all the same areas as the Employment Committee (EMCO) in charge of employment questions. Another EPC sub-group deals with structural reforms linked to the Lisbon Strategy (the 'LIME group') and bases its work on assessment of the impacts of structural reforms on a major data base known as MACMIC. The Employment and Social Affairs DG publishes an annual report on employment and a biennial report on industrial relations, but it was not until 2011 that an official specifically responsible for wages was appointed to this DG.

As can be seen, between 2005 and 2010, this group of actors mobilized and developed an extremely sophisticated arsenal of products in order to analyse the likely impact of labour market reforms, wages and monetary union. By contrast, the authors who between 1995 and 2004 had been writing on these

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6. Working group of the monetary policy committee of the SBEC (2005) 'Competitiveness and the export performance of the Euro Area', study no 30.

subjects from a more ‘social’ standpoint (Hall, Soskice, Hancké, Rhodes, Ross, Pochet, etc.) turned their academic focus elsewhere.

When the crisis broke out in 2008, an initial response was to call into question the concept of self-regulating markets. However, the transformation of the crisis of bank debts into a crisis of public debt as from 2009 supplied a new narrative that was exploited by these well prepared strategic actors (ECB, economic and finance ministers, DG Ecfm) in order to put their ideas into practice and alter the function of social policy so that it became the adjustment variable within monetary union. Adjustments in the euro zone (particularly in terms of competitiveness and productivity) were henceforth, according to them, to take place by way of wages, labour law, and social security. This is the principle of internal devaluation, application of which to Greece has achieved the status of an archetype (see Armingeon. et Baccaro, 2012).

At the same time, one actor took on an unprecedentedly central role: the ECB and its two most recent Presidents – Jean-Claude Trichet and Mario Draghi – made creative use of the instruments at their disposal in response to the risk that the euro zone might break apart. This endowed them with an indubitable power of influence. The ECB, the most independent central bank in the world, indicated what structural reforms were required at the national level in return for its intervention on the sovereign debt market. This involvement went as far as the central banker sending, in secret, letters to the Italian and Spanish governments detailing the list of reforms to be adopted. In other words, the ECB took de facto control of the reins of economic policy coordination within the euro zone. It took over the post, left empty by Maastricht and the national governments, of economic governance of the euro zone.

### **3. Financial crisis and dismantling of the social model**

What are the consequences of these changes? The most important change is that the traditional appeal for ‘structural reforms’ in the framework of texts that tended to be non-binding and rather ineffectual (BEPG) has, under the new arrangements, taken on much stronger force. Below we will see, however, that things appear in a very different light depending on whether the state to which injunctions are addressed is a member of the euro zone core and the model of coordinated capitalism, or whether it belongs to the peripheral area, to the set of countries most hard-hit by the financial crisis (Regan, 2013).

Before going into this, however, it will not be a waste of our time to look in more detail at the set of arguments used to link the ‘necessary’ structural reforms to the crisis of public finances. These arguments represent, in our view, a coherent but biased approach that forms the underpinnings of a whole political agenda.

Our next step will be to examine how social and labour market policies are regarded by this strengthened form of economic governance. This we will do by taking a close look at some of the country-specific recommendations or CSRs.

Finally, we will ask a number of questions about the new instruments of governance and the extent to which they are able to contribute to the national reforms.

#### **3.1 Coherent but biased arguments**

The argument went that, insofar as the financial crisis had turned into a crisis of public finances, the situation now ‘required’ that most of the governments adopt a series of budgetary consolidation measures in the form of reforms – frequently radical in nature – of their labour law provisions and social protection arrangements. This argument is far from convincing. The general outline of these structural reforms of the labour market and social security systems had, in actual fact, been advocated well before the outbreak of the crisis, during a period when public debts and deficits were under control (see, *inter alia*, De Grauwe 2011). The EU had already been calling for ‘reform and tightening up of retirement, social security and health care systems’ (Council 2005) during a period when the public debt was well under control at European level (59% of GDP in 2007) and when the average level of budgetary deficit of the 27 EU member states was 0.9% of GDP. Finally, already during a period of

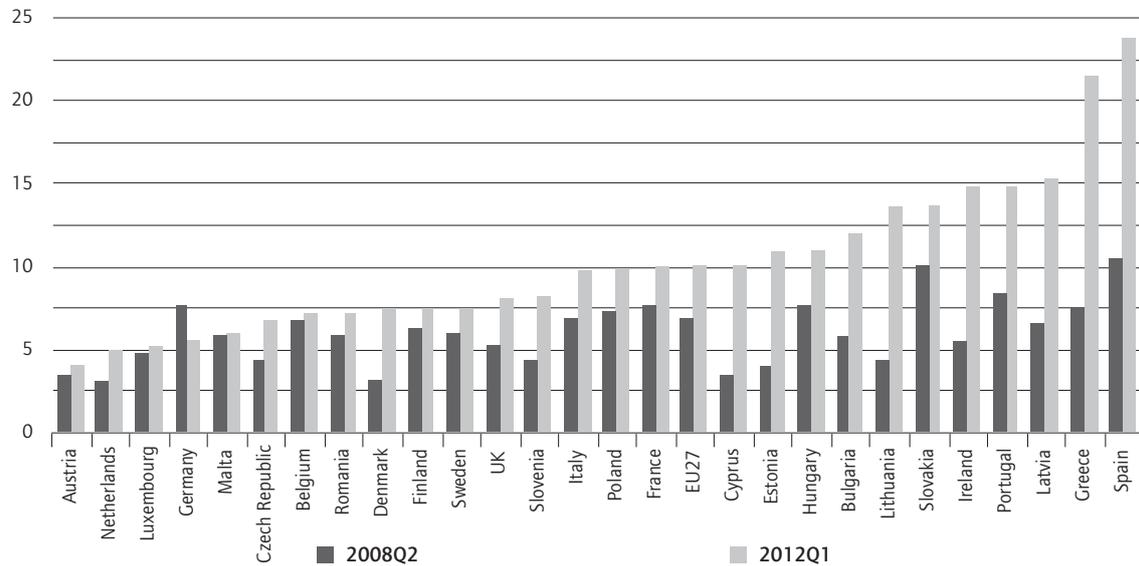
economic growth, the EU had been demanding that wage development in the member states be ‘compatible with a level of profit that would permit investment to boost productivity’. At no moment was there any question as to the nature and general direction of these reforms. What could be questioned was the speed and radical nature of these reforms, the purpose of which was to make social and labour market policy into an adjustment variable. The argument thus became that the earlier reforms had not been adequate or radical enough and that it was important to use the window of opportunity represented by the crisis to ‘force’ governments to take those measures that would yield effects at best in the medium term.

The arguments, for example, on reform of retirement pension systems and the labour market, are to be considered bearing in mind that none of these reforms is likely to produce a positive short-term impact on either public finances or economic growth (see OECD). The time required for the reform to be adopted, and to take effect – such reforms are frequently spread over quite or very long periods – and to exert an impact on the public deficit and economic growth, is such that it is utterly unlikely to make the slightest contribution to solving the current sovereign debt crisis in Europe. By contrast, and this is the focus of the argument, these reforms are supposed to create confidence – beyond the market – and hence entail anticipated effects, for their proponents are convinced of the rational anticipations of economic agents.

This approach totally disregards any consideration concerning which are the countries that best succeeded in getting through the crisis. It is indeed obvious, today, that not only is it the labour markets of the so-called Bismarkian countries that best resisted the financial crisis, the economic crisis, and the crisis of public finances (see below); at the same time, a series of recent studies shows the absence of, or only a very slight, correlation between the deregulation of the labour market institutions and the level of job creation (Advedic and Salardi 2013; Armingeon and Baccaro 2012b). The OECD has also revised its analyses from the 1990s on labour market rigidities and recently adopted a much more cautious position). Even the Commission, in a memo for the EPC, acknowledges that there is no link between employment protection legislation (EPL) and the rate of unemployment (but states that there is an effect on flows and composition) (EC 2012).

On the basis of a very simple criterion which well synthesizes the results of different policies – that of the employment rate – it appears clearly that the countries with a low rate of unemployment are not those which have the most deregulated labour market or the least developed welfare state. Table 1 below shows the unemployment rates from before the crisis and in 2012. The conclusions are the same if we assess the link between public debt (and its development since 2008): there is no link between an increase in the public debt, the degree of labour market regulation or the extent of coverage of social protection systems.

Figure 1 Unemployment in the EU27 (2008Q2-2012Q1(\*)



(\*) Seasonally adjusted data  
Source: Eurostat.

In terms of the development of unemployment rates, the four countries that stand out are Luxembourg, Austria, the Netherlands, Germany (and to a lesser extent Belgium). In spite of their creditable performance, three of these five countries received ‘specific recommendations’<sup>7</sup> in 2012 aimed at their wage formation systems (Luxembourg and Belgium – to which should be added Cyprus, in sixth position – for their wage indexation system, and Germany for better taking account of productivity in wage development). According to Palier (2010), it is precisely these countries that have been most criticized by the EU for their supposed absence of reforms, but this runs counter to the facts. In terms of varieties of capitalism, these are also all countries regarded as ‘coordinated’ (in the image of Germany)(Hall and Soskice 2001, Regan, 2013).

### 3.2 Social policy and specific recommendations country by country

This section analyses how the ‘new economic governance’ interacts with social policies, and presents a first assessment of the potential impact of an economic framework approach on the ‘recalibration’ and redefinition of the national social models.

As will be shown in more detail in section 3.3, the CSRs are the result of a complex process that begins with the Annual Growth Survey (AGS), which

7. Recent literature also shows that ever greater differences exist within each country (Jackson and Deeg 2012).

presents the challenges and priorities for the EU, including the national reform programmes and the evaluation by the European Commission of the performance of each member state.

The CSRs focus on the structural reforms likely to strengthen growth and competitiveness and the member states are supposed to incorporate the recommendations issued into their national reform programme. The CSRs are drawn up by the European Commission, discussed with the member states, and adopted by the European Council.

Formally, the CSRs are opinions but the expectation is nonetheless that they will be heeded. They become more binding for countries of the euro zone insofar as they are linked to the risk of sanctions under the excessive deficits procedure or the excessive imbalances procedure.

Accordingly, in specific circumstances, the CSRs have made policy coordination and the soft approach to social policy more rigid, virtually compulsory, minor changes in the treaties in relation to social aspects notwithstanding. This potentially radical change in how social policy is dealt with at European level was introduced by the earlier agreement to better coordinate economic policies including those relating to the labour market and social protection (Jepsen and Serrano Pascual 2011).

Stefan Clauwaert (2013) has carried out an assessment of the number of social recommendations included in the total CSRs received by each country.

An immediately striking feature in this table is the high number of social CSRs, amounting to some 40% of the total.

A more careful analysis of what recommendations fall under the CSR and how they relate to particular problems of the various member states displays a somewhat puzzling picture.

Recommendations linked to increasing labour market participation (especially for women and older workers) and to raising both the actual and the statutory retirement age are given to most member states; on the hand, very few member states are recommended to ensure the provision of encompassing and adequate social protection for their citizens, despite the fact that poverty is increasing and social protection is losing some of its effectiveness as the crisis drags on (European Commission 2013). Hence the CSRs define the nature of the common challenges entailed by the social models and recommend how they should be tackled. This is not in itself new, for it is an approach that started at the end of 2000 when emphasis was placed on how to define common problems and how they could be solved (Jepsen 2009). What is new, however, is the instrument and the process by which this approach is currently being furthered.

The CSRs convey ideas associated with a particular ‘model’ of the EU insofar as they are focused on growth and competitiveness, while totally neglecting

Table 1 Overview of the total number of CSRs per country compared to the social CSRs for 2011-2012, 2012-2013 and 2013-2014

Country	CSRs 2011–2012		CSRs 2012–2013		CSRs 2013–2014	
	Total	'Social'	Total	'Social'	Total	'Social'
AT	5	2	7	2	7	3
BE	6	3	7	2	7	4
BG	6	3	7	2	7	3
CY	7	3	7	3	–	–
CZ	6	3	6	3	7	3
DE	4	1	4	1	4	1
DK	5	2	5	2	3	1
EE	4	1	5	2	5	2
ES	7	4	8	5	9	4
FI	5	2	5	2	5	2
FR	5	4	5	3	6	4
HU	5	2	7	3	7	3
IT	6	2	6	3	6	2
LT	6	2	6	3	6	3
LUX	4	3	5	2	6	3
LV	–	–	7	3	7	3
MT	5	3	6	3	5	2
NL	4	2	5	2	4	2
PL	7	3	6	2	7	2
RO	–	–	–	–	8	3
SE	3	1	4	1	4	1
SI	6	3	7	4	9	2
SK	6	3	7	5	6	2
UK	5	2	6	2	6	2
	<b>117</b>	<b>54</b>	<b>137</b>	<b>61</b>	<b>142</b>	<b>57</b>

Source : Clauwaert (2013)

what constitutes the principal role of social policies, namely, to ensure social cohesion and some degree of redistribution (Jepsen, 2009).

A careful reading of the CSRs on pensions, labour market and labour law leaves no doubt as to the intended direction of the reforms advocated, even though the formulations in 2013 are less rigid than was the case in 2012. The following paragraphs present an analysis of the formulation of certain CSRs and identify more precisely the overall sense of the reforms proposed.

Table 2 European Commission country specific recommendations 2013-2014 (social field only)

		AT	BE	BG	CZ	DE	DK	EE	ES	FI	FR	HU	IT	LT	LU	LV	MT	NL	PL	RO	SE	SI	SK	UK
<b>Wages</b>	reviewing wage indexation		●												●									
	reviewing wage-setting system - align with productivity developments		●			●			●	●	●		●		●								●	
<b>EPL</b>	adjusting employment protection legislation										●		●					●	●					
<b>Labour Market participation</b>	enhancing participation of women	●									●	●					●		●					
	enhancing participation of older workers, promoting active ageing, LLL	●	●	●	●						●			●	●		●	●	●	●			●	
	reducing tax disincentives for second earners						●						●					●						
<b>Youth employment</b>	youth guarantee			●					●	●	●	●	●		●				●	●			●	●
	facilitating transition school to work by incentives for companies to hire young people																		●	●	●		●	●
	facilitating transition school to work through apprenticeships and work-based learning		●								●			●	●		●	●	●		●			●
	reducing school/education 'drop outs'																							
<b>Pensions</b>	explicit link between pensionable age and life expectancy	●					●		●				●				●		●					
	reducing early retirement	●	●	●	●			●	●	●	●			●	●			●					●	
<b>Vulnerable</b>	ensuring the adequacy and coverage of social protection systems	●	●	●	●			●	●					●	●		●		●					
	(access to) quality social services			●									●						●	●			●	
	better targeting social assistance			●					●															
<b>Child poverty</b>	making child support more effective													●						●			●	
	access to and quality of childcare services			●								●												
<b>Tax</b>	shift away from tax on labour (incl. attention for low income earners)				●	●						●	●				●		●	●			●	●

Source : Clauwaert (2013)<sup>8</sup>

Most of the recommendations on pensions establish a link between statutory retirement age and life expectancy, seeking thereby to create automatic rules that would reduce the political risks entailed by pension reforms. The European Union – and, in particular, the Ecfm Council – has for almost 20 years been sensitive to the sustainability of public finances and to the risks entailed by

8. Similar tables can be found for 2011 and 2012 in Clauwaert (2013).

spending on pensions; raising of the statutory pension age is a recommendation that has been repeated time and time again (Natali 2009).

This recommendation has given rise to controversy in some countries where alignment of the actual retirement age with the statutory retirement age was the main aim or where the low employment rate of the over 55s constituted a real problem.

While these concerns are still raised in the CSRs, there is a clear and unified recommendation to increase the statutory retirement age with life expectancy, a recommendation that appears at odds with the chronically difficult labour market situation experienced by older workers. The strategy would thus appear to be focused exclusively on cost containment, in other words on the need to for public finance controls<sup>9</sup>.

Labour market participation is the second major subject of concern encountered in the CSRs. Most countries have received a recommendation concerning activation, whether in general or in relation to measures geared to specific groups such as, for example, the long-term unemployed.

In general, these recommendations are concentrated on strengthening the capacity of the public employment services to supply adequate levels of service and also on the links between social benefits and the social assistance system and the activation measures.

The emphasis is also placed on increasing incentives to labour market participation by means of reform of the tax and benefits system, in particular as it applies to low wages. This question of activation and of the disincentives stemming from the tax/benefit system is yet another topic that has been on the European agenda for a long time. A consensus is emerging from the research in relation to the fact that, in spite of a rather inconclusive direct impact of OMCs on national reforms (Lelie and Vanhercke 2013), the European level has been invoked for the implementation of activation measures in the various member states whose governments have used the coordination processes placed at their disposal by EU-level recommendations. With regard to the CSRs and their follow-up, it seems that the 2013 crop of recommendations is more diversified, more sensitive to local contexts and less unidirectional than in the two previous years.

What is lacking is consideration of the demand side. The recommendations are completely focused on the supply side, sometimes going so far as to urge a reduction in public sector employment.

In some cases, moreover, an increase in the numbers of child-minders is recommended as a means of raising women's labour market participation. This

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9. The European Commission classifies the recommendations on pensions and health care as linked to public finances and not to the labour market or to social policy.

policy approach is not new but is a follow-up to earlier recommendations along similar lines.

The last field analysed is that of labour law. Without going into detail, recent research has shown a definite link between recommendations and reforms in the industrial relations sphere and labour law generally (Clauwaert and Schömann 2012; Laulom et al. 2012; Herman 2013, Degryse et Pochet, 2012, for Italy see Sacchi, 2013). This is particularly the case for countries experiencing major economic difficulties (World Bank model) or those subject to a Memorandum of Understanding (IMF model).

This influence exerted by CSRs is not the only reason for reforms which have also involved other actors but the CSRs have been urging reforms of this type (it is not methodologically possible to establish any unequivocal distinction between the European influence and other forms of influence; what is important is to analyze the ‘meaning’ of the reforms and to consider it as exerting an impact alongside all the other forms of pressure applied in the same direction (see, on this subject, Pochet 2012).

To what extent this affects a country like Belgium which has no need of financial aid but has a public debt of approximately 100% of GDP and is required to reduce it rapidly under the terms of the new stability treaty is a question that will be examined in greater detail in the following section.

Although it is difficult to undertake an overall assessment of extent to which the CSRs are binding in relation to their impact on national social models, one unequivocal indication is available in relation to their influence on labour market reforms (see above). This instrument does, however, have the potential to be much more effective than the social and employment OMCs; the changes in formulation show us also that a great deal will depend on the capacity of the different actors to confer legitimacy upon their own particular definition of what a European social model ought to be.

Lelie and Vanhercke (2013) and Vanhercke (2013) analysed the actors in the social policy field to evaluate the instruments and the influence they are (still) in a position to exert in this field. Without being able to make a complete evaluation, it seems at this stage that they had more influence in relation to the reformulation of certain recommendations linked to labour market participation than to those concerning pensions or wages and wage formation systems.

This finding can be interpreted in two ways. Either the European actors of the more socially inclined coalition do not have a fundamentally different interpretation from the economic coalition (for example, the trade unions are wondering whether DG employment really does have a different discourse when it comes to wages) or, according to a second hypothesis, they are not strong enough to impose a more balanced formulation of the recommendations on pensions and wages.

Numerous questions remain and no final answer can be offered concerning the real influence of this new economic governance on the definition of national social models; what is clear, however, is that social questions are right at the top of the political agenda and have a central role in the CSRs and that these instruments adopt a consistent approach as to the function of social policy; however, the three consecutive years show also that this is a system in the making and that there are ongoing struggles among actors and conceptions even if there is no doubt as to who are the winners and which are the dominant messages for the moment.

The central question is really that of knowing to what extent these recommendations are binding and impossible for the national governments to elude or disregard. How do these recommendations affect and interact with the national reforms associated with and dependent on domestic dynamics? While there is indeed a good deal of uncertainty on this score, it is impossible to deny that the CSRs do potentially open up a road to more radical reforms and to a form of social interventionism – inevitably deregulatory in its general thrust – in a manner that is more binding than was the case previously and with a stronger normative dimension aimed at increasing the sensitivity of social policies to market forces.

### **3.3 The instruments of the new governance**

As the previous section has shown, social and labour market policy constitute a significant component of the CSRs. This is the case in spite of the subsidiarity principle and the few amendments contained in the Lisbon Treaty that relate to social policy (in particular, the horizontal social clause in Article 9). The formulation, meaning and constraints of the CSRs have been amended and harmonized (so that there is less possibility for differing interpretations than was previously the case). They have become not only more binding but also less differentiated in content: ‘one size fits all’.

This section will contain an attempt to understand the instruments and the actors that have enabled reforms to be more forcefully urged, or even imposed, upon member states in the framework of a reinforced economic governance.

These reforms are ‘recommended’ by the European Union, or the ‘troika’ (Commission, ECB and IMF) for those countries that are in receipt of financial assistance from the EU, by way of a set of new procedures put in place between 2010 and 2012. These procedures include the European Semester and the strengthening of the stability and growth pact, procedures to be implemented in the event of macroeconomic imbalances, the country-specific recommendations, the ex-ante surveillance of national budgets, the requirement to enshrine the ‘golden rule’ of budgetary balance in the national constitutions or equivalent texts, etc. (Degryse 2012). They are also embedded in the EU 2020 strategy (for a critique see Pochet, 2010).

The academic literature of the last ten years took an interest in the new forms of governance potentially offered by the introduction of the open methods of

coordination. The authors in question examined the possible impacts, with a broad consensus claiming that the impact was likely to be relatively weak but differentiated according to country and OMC and above all in terms of overall ideas (cognitive frameworks). Emphasis was in most cases laid on the differences between the so-called soft law and classic Community law, though it was also shown that the distinctions between the two were not as rigid as frequently claimed.

At the level of actors, interest was focused in the first instance on the balances between the actors and social objectives and the actors and economic objectives. Interest came subsequently to be focused on the internal developments of the different processes, although surprisingly little has been written on the instruments that were tantamount to economic OMCs, namely, the Broad economic policy guidelines, and the micro reforms. These soft forms of coordination were, generally speaking, ignored by the economic literature which focused principally upon convergence via the markets or via classic Community law.

The point to be made, then, is that earlier academic analysis failed to anticipate the current dynamics. On the one hand, we have been witnessing a series of radical and rather similar reforms in a number of countries, though not in all. Countries that, at least for the time being, are much less affected by the structural reforms of collective bargaining are Benelux, Austria, Germany, and the Scandinavian countries, in other words, those countries that constituted the heart of the DM zone in the 1980s and 1990s. The reforms in the area of social protection, by contrast, affect all countries, one reason for this being that their introduction is generally associated with national domestic dynamics of population ageing.

The soft instruments, meanwhile, have become more rigid. It is difficult, at the present stage, to gain any clear idea of exactly how binding their effects are to become, for this is a form of governance 'in progress' that employs a set of wide-ranging instruments and procedures (see below). What is already quite clear, however, is that the strengthening of the system of economic governance has served to herald the arrival of new forms of interrelationship between the EU and the member states (De la Porte and Heins, forthcoming).

Bertoncini (2013) supplies an interpretative framework that enables an assessment to be made of how these complex relationships evolve over time. From our own standpoint, there would appear to be a need for a preliminary and basic distinction to be established between rules and institutions on the one hand and the content of the prescriptions on the other.

Historically, the Maastricht Treaty (1992), and then the Stability and Growth Pact (1997)<sup>10</sup>, provided the basis of the common rules. The requirement for

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**10.** Council Regulation (EC) n°1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Official Journal L209 of 2.8.1997

reduction of the budget deficit to below 3% of GDP was accompanied by no indication of how this was to be achieved, whether by a reduction in expenditure or by an increase in taxes. The Stability Pact did, however, refer to the need for the member states' economic policies to be in line with the BEPG (Article 5).

In parallel with this requirement, there was a development of instruments of a 'hyper-OECD' type (BEPG, EES, Cardiff, social OMCs). Such instruments were much more normative; their purpose was to indicate what the features of 'good' reforms were likely to be (for example, the reading of the BEPG in 1997, the year of the pact, stressed a preference for reduction in expenditure over increase in revenue).

However, like the OECD instruments on which they seem to have been modeled, these new instruments had a tendency to contradict one another, even though their general direction was unequivocal (on the OECD see the book by Armingeon and Beyeler (2004) which traces the development of the OECD discourse and analyses its recommendations over 40 years in some ten countries). The adoption of the 'principal/agent approach' is a feature taken from the OECD; here the 'principals' are the member states, while the 'agent' is the Commission. The agent cannot move too far away from the interests of the 'principals', on pain of receiving a dressing down. The agent, in this case the Commission, seeks to maximize its position by having rules that are as rigid as possible (automatic sanctions, for example).

That this twofold structure (general rules and normative prescriptions enshrined in other less binding instruments) had started to become problematic even before the crisis is indicated by the reform in 2005 of both the stability pact and the open methods of coordination.

Under these types of arrangement, the ECB is an external agent taking part in the debates but above all creating the conditions for its 'independence' from the political power and its credibility vis-à-vis the markets (Buiter 2008).

The crisis was to alter this initial twofold structure. At the level of actors, the financial markets became a fully-fledged actor which would differentiate the risks displayed by each country and become sensitive to any signs of instability.

The ECB also stepped out of its isolation and became explicitly part of the new structures. This was the counterpart of the fact that the ECB (in the absence of any credible coordinated political response) became the only body capable of exerting a firm influence on the financial markets. It agreed to take on this role in exchange for the guarantee that the EU would oversee developments in those countries that had run adrift. The ECB's new position was therefore right at the centre of gravity of the normative apparatus, located mid-way between the markets and the political sphere. As pointed out by Torres (2013: 293-4),

'For the ECB, this "invasion of other policy domains" – by calling for sound economic policy management, in particular in the fiscal domain, for

structural reforms and for reinforced economic governance in general – is motivated by the fact that the euro area is at the epicenter of sovereign debt crisis’.

A twofold movement ensued.

On the one hand, there was the strengthening of rules and structures that was achieved by the Six Pack<sup>11</sup>, the Euro-Plus Pact and the treaty on stability, coordination and governance. The mechanisms for financial support and the procedures on macro-economic imbalances contributed to a move in the same direction. A key point here is the strengthening of sanctions (reverse majority). It is to be noted that, by and large, the governments that abide by the rules are not threatened by sanctions (for example, the Scandinavian countries, Germany, Austria, Luxembourg or the Netherlands). The texts in question contain no stipulations concerning the nature of the reforms to be undertaken; it is a matter of fixing thresholds, setting rules, creating and strengthening institutions (for example, the euro zone summit).

On the other hand, in the context of implementation of this strengthening of the rules (by way of the European Semester which includes, among other things, the Annual Growth Survey<sup>12</sup>, the stability and convergence programmes, the national reform programmes and, above all, the country-specific recommendations<sup>13</sup>), an attempt is made to strengthen the binding nature of the normative recommendations. For example, the balances between the social and the financial aspects of retirement pension systems disappear and are replaced by a lengthening of working life and a later statutory retirement age, the sustainability of public finances having now been accorded priority over the social aims and goals (see below). This reinforcement is accompanied by a change in the main actors and in the channels of

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- 11.** This refers to the six pieces of legislation that together reformed and fleshed out the Stability and Growth Pact:
- Regulation (EU) n° 1175/2011 of the European Parliament and the Council of 16 November 2011 amending Council Regulation (EC) n° 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Official Journal, L306, 23 November 2011, pp. 12-24
  - Council Regulation (EU) n°1177/2011 of 8 November 2011 amending Regulation (EC) n° 1467/97 on speeding up and clarifying the implementation of the excessive debt procedures, Official Journal, L306, 23 November 2011, pp. 33-40
  - Regulation (EU) n°1173/2011 of the European Parliament and the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, Official Journal, L306, 23 November 2011, pp. 1-7
  - Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, Official Journal, L306, 23 November 2011, pp. 41-47
  - Regulation (EU) n° 1176/2011 of the European Parliament and the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, Official Journal, L 306, 23 November 2011, pp. 25-32
  - Regulation (EU) no 1174/2011 of the European Parliament and the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, Official Journal, L306,23 November 2011, pp. 8-11
- 12.** See European Commission, Annual Growth Survey 2013, COM(2012) 750 final, 28.11.2012.
- 13.** See : [http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)

dissemination. As we have seen, the ECS and Ecfm have increased their knowledge of labour markets (and the national reforms on this score) and are in a position to exert much stronger and more precisely targeted pressure than was previously the case, partly because of their greater expertise but above all because the crisis has placed the ECB at the centre of the stage, mid-way between the markets which it has managed to reassure and the political actors whom it tells what they must do so as to ensure that the markets remain calm and that the ECB will take action to stabilize the system in the event of crisis.

This normative strengthening also has its limits. The member states are not prepared to leave the whole of the initiative to their 'agent'. One clear example of such refusal was provided when French President François Hollande put his foot down by stating that he would embark on a reform of pensions but that it was not up to the Commission to stipulate either the principles he was to follow or the details of their implementation.

The comparison with the OECD is useful here again. At the beginning of the 1990s this body undertook an ultra-liberal analysis (the 'Jobs Study'), in part because the 1980s had seen the demise of the neo-Keynesian consensus and the rise of social deregulation policies. Yet this development had been subject to varying implementation from one member state to another, with instances of domestic resistance more visible in some cases than others. Fifteen years later, the OECD's general diagnoses are much less strident and the internal tensions between different approaches much more obvious.

The European Commission is at the same stage of adopting a radical posture as was the OECD at the beginning of the 1990s, but inner tensions are still present (as are differing developments in member states' preferences). It is to be noted that within this principal/agent model the ECB is able to act as an extremely free agent because the conditions required for a change of its status are virtually impossible to fulfill (unanimity).

As the reader will by this stage have understood, our purpose in this paper is to emphasize underlying motives and rationales and not to describe in any detail instances of resistance, inconsistency, or alternatives of which we do not deny the existence.

In this new architecture the Memoranda of Understanding (MoU) for the countries in receipt of European and IMF assistance have become the most binding of instruments because the countries subject to their introduction have very limited room for manoeuvre. In such cases, therefore, the rules and the policy prescriptions tend to merge. The ECB, in such cases, has stepped out of its role as external actor and become a fully-fledged member of the Troika.

The following stage (not yet completed) is that of the 'contractual arrangements' by means of which the states formally undertake, vis-à-vis the Commission and in exchange for financial assistance, to implement the structural reforms on pain of sanction, hence the creation of the 'World Bank model'. This idea is taken from the document of the four presidencies

(Commission, European Council, ECB and Eurogroup) which signifies, here again, a more direct commitment on the part of the ECB in more binding solutions (a situation that is confirmed in, for example, the ECB's working paper with the evocative title *Just Facts* written by two of its economists, Ioannou and Stracca (2011), on the failure of the stability and growth pact and the Lisbon Strategy (even though the disclaimer states that the opinions expressed are not necessarily those of the Bank).

Another form of intrusion, but one of which it is difficult to uncover precise traces, is that of the ECB which had taken on the role of lending support – at the level of words by reassuring the markets and at the level of acts by repurchasing the debt – to countries in difficulty. The letters – written in secret! – to Italy and Spain are the visible tip of this iceberg. While this type of excessively direct intrusion was quickly brought to a halt, having fallen prey to criticism of the ECB for exceeding its role (Bertoncini, 2013; for a more general argument see Buiters 2008), it no doubt continues to take place in some more subtle manner.

The two examples that follow enable us to gain an idea of the difficulty of putting in place a more binding form of governance.

The first relates to the ex- ante coordination of reforms. This would represent a very important step because the EU would be in a position to oversee reforms even in advance of their formal adoption. A non-paper issued by the Commission (June 2013) proposes a voluntary consultation for one experimental year, after which stock would be taken of the lessons to be learned, before generalizing the approach. This cautious approach represents a clear sign of the difficulties entailed in moving on from a discourse about anticipating reforms to formalized practices.

The other example is provided by the scoreboard of macro-economic imbalances. This instrument was intended to become one of the strong links of a form of governance that took into account a broader number of factors (wages, housing, and so on). After two years during each of which more than ten countries were subjected to in-depth analysis, it is difficult to claim that this instrument has so far exerted any real influence. This does not necessarily mean that it will not do so in the future but it does show, once again, the difficulties entailed in making this type of intrusion into national policies operational (and politically acceptable).

It is thus still a case of a more rigid form of government being introduced involving distinct groups of countries where those that observe the norms and those subject to MoU are located at the two extremes. The remaining countries are somewhere in the middle, and this position can be well illustrated by the case of Belgium.

This case is an interesting one because it is a limit case. The country's performances during the crisis have been pretty good (at least so far) in relation to the European average, but it is undoubtedly the most centralized/coordinated

country characterized by the presence of strong and influential trade union actors. Belgium's Achilles heel is a debt that has risen to 100% of GDP after having fallen below 90% before the crisis of 2008.

Belgium received a total of six recommendations in 2011-2012, three of which were linked to social policy. For 2012-2013 the total number received was seven, including two social ones; among the most recent recommendations received in 2013-2014, four out of a total of seven were linked to social policy (Clauwaert 2013: 4). A preliminary assessment of the social recommendations prompts three observations: first of all, Belgium is among the countries in receipt of the most recommendations relating to social policy; secondly, it has been receiving recommendations in certain fields (older workers, pensions, labour costs) similar to the other member states; finally, although wage developments have, overall, remained in line with the inflation-and-productivity-neutral aim of the last ten years, Belgium has received recommendations to revise its wage formation system.

The main controversial issues have been the indexation system and the retirement age. The second of these topics will be examined in more detail below.

The recommendations on an end to indexation or, in any case, the demand for substantial changes in Belgium, have developed as follows:

In 2011 the recommendation was rather general:

‘Take steps to reform, in consultation with the social partners and in accordance with national practice, the system of wage bargaining and wage indexation, to ensure that wage growth better reflects developments in labour productivity and competitiveness.’

In 2012, by contrast, the wording became extremely precise and was accompanied by a call for a more radical change in the Belgian collective bargaining system.

‘To boost job creation and competitiveness, take steps to reform, in consultation with the social partners and in accordance with national practice, the system of wage bargaining and wage indexation. As a first step, ensure that wage growth better reflects developments in labour productivity and competitiveness, by (i) ensuring the implementation of ex post correction mechanisms foreseen in the “wage norm” and promoting all-in agreements to improve cost-competitiveness and (ii) facilitating the use of opt-out clauses from sectoral collective agreements to better align wage growth and labour productivity developments at local level.’

Finally, in 2013, the recommendation became once again less prescriptive, while remaining more precise than in 2011:

‘To restore competitiveness, pursue the on-going efforts to reform the wage setting system, including wage indexation; in particular, by taking structural measures, in consultation with the social partners and in accordance with national practice, to ensure that wage setting is responsive to productivity developments, reflects local differences in productivity and labour market conditions, and provides automatic corrections when wage evolutions undermines cost-competitiveness.’

Pay developments in Belgium have been under discussion for quite some time and there have been differing interpretations of actual wage developments. The Eurostat figures show that pay developments in Belgium have been aligned with inflation more than with productivity, which is what can be expected of a neutral development. In spite of this, the wage formation system has been called into question because there are those who regard it as insufficiently flexible and not sensitive enough to market signals. This is evidence of the narrow view of the role of wages as influencing prices alone while leaving aside aspects linked to demand and productivity.

A similar type of development can be observed in the recommendations linked to pensions.

In 2011 the recommendation was rather general and stated:

‘Take steps to improve the long-term sustainability of public finances. In line with the framework of the three-pronged EU strategy, the focus should be put on curbing age-related expenditure, notably by preventing early exit from the labour market in order to markedly increase the effective retirement age. Measures such as linking the statutory retirement age to life expectancy could be considered.’

By contrast, in 2012 the tone of the recommendation became more strident and precise:

‘Continue to improve the long-term sustainability of public finances by curbing age-related expenditure, including health expenditure. In particular, implement the reform of pre-retirement and pension schemes and take further steps to ensure an increase in the effective retirement age, including through linking the statutory retirement age to life expectancy.’

The same type of recommendation was adopted in 2013 but this time the angle of attack was different. The main point made related to the need to curb costs in an ageing society:

‘Step up efforts to close the gap between the effective and statutory retirement age, including by quickly including by pursuing the on-going reforms to reduce the early-exit possibilities. Underpin reforms of the old-age social security systems with employment-support measures and labour-market reforms conducive to active ageing. Accelerate the adoption of a decision to link the statutory retirement age to life expectancy.’

Continue to improve the cost-efficiency of public spending on long term institutional care.’

One observation emerges from the reading of these three recommendations: whereas their aim is identical, namely, to contain the public deficits linked to ageing of the population, the focus on the means of achieving this aim has been altered, to some extent at least. Starting out from a focus on a reform of early retirement and retirement systems, in particular, linking the statutory retirement age to life expectancy (basing this reform on pre-defined rules) (2012 and 2013), the recommendation of 2013 adopts a different angle (without abandoning the ideas about reform of the pensions system) by focusing on the possibility of raising the retirement age by labour market reforms aimed at active ageing and thereby tackling the heart of the Belgian problem.

An aspect we have not examined here is the role of the different actors responsible for preparing these recommendations which is normally a responsibility shared (for both pensions and wages) between the EcFin and Employment DGs. To fully understand the changes in focus and expression, a more in-depth analysis of the interactions among these actors would have been required. However, we may observe that the CSRs are still in a state of evolution even though the general direction remains – to link statutory age and life expectancy, to reform the indexation system – and there seems to be in 2013 a more diversified approach to the question of ‘how’ these recommendations can/must be achieved.

Only the future will tell how Belgium will react and will heed – or fail to heed – these recommendations. They are quite obviously controversial and the conclusion may be drawn that if these reforms do indeed come to be implemented in Belgium then the recommendations are de facto binding in character not only for the countries under MoU or subject to the pressure of financial market but in actual fact for all member states. If this turns out to be the case, then Europe will have entered a new era as regards the coordination of social policies.

## Conclusions

The imbalances in the institutional structure of economic and monetary union as adopted under the Maastricht Treaty (and which is the result of a political choice ‘by default’) were able to be redressed in the 1990s and early 2000s by the conclusion of social pacts in the member states, but also by social strategies put in place at the European level and which included the development of the European social dialogue, the European employment strategy, the Lisbon strategy, the open methods of coordination in the fields of pensions, health care, etc. The economic and monetary union thus had, to a certain extent, its social dimension, even if this was weak, contradictory and fragile.

As from the middle of the decade of the 2000s, this dimension was subjected to a first phase of dismantling with the arrival in power in most of the European capitals of governments of the centre-right and right, as well as the arrival of Mr Barroso as President of the European Commission. The open methods of coordination were gradually voided of their substance, the European social dialogue was no longer fed, the social goals of the Lisbon Strategy were neglected, while few new European legislative initiatives were taken in the social policy field (the pretext for this lack of activity being that the new EU member states had to be allowed time to digest the *acquis communautaire*).

In the wake of the financial crisis that exploded in 2008, what little remained of the social dimension of the economic and monetary union, and of the European Union as a whole, underwent a second phase of weakening. After first of all tackling the onset of crisis in 2008-2009 with measures to boost economic activity and employment, the member states subsequently embarked upon major programmes to reduce public expenditure and introduce structural reforms.

The reforms in question related principally to labour law and social protection. At the level of content, they pretty much resembled the usual precepts advocated by mainstream economists who generally regard the European social model as the main reason for the deterioration in the member states’ public finances. If the content of these reforms was therefore not new, the political and socio-economic context opened up, by contrast, an unexpected window of opportunity for the proponents of draconian reforms.

While justified in official discourse by ‘the crisis’, these reforms are in fact quite unrelated to the economic cycle. They are actually aimed at reconfiguring whole areas of the European social model – labour law, collective bargaining, social dialogue, wage formation systems, the two sides of industry, the

foundations of social protection, and so forth – even though the best components of this model had proved efficacious in the crisis for avoiding a serious deterioration of the situation in the economy and on the labour market. The countries that experienced the lowest unemployment rates in the wake of the crisis are in actual fact those which have the strongest social institutions and collective bargaining partnerships.

These reforms have been undertaken in the framework of strengthened economic governance. As these processes are still in the process of construction (IMF versus hyper-OECD) and there exists little serious and reliably documented research on the real or imagined impacts on the national social models, it is not at this stage possible to draw any definitive conclusions.

What is perfectly clear, however, is that the social policy recommendations are developing a new message containing specific ideas about how a national social model should operate and that this message is being communicated to all the member states, albeit with some slight variations. The tenets of this message are as follows: the costs of health care and pension systems should be pegged or even reduced; the wage formation systems should be brought within the realm of competition; the social benefit systems create disincentives to labour market participation; labour costs must be reduced. This message contains nothing or very little about how social models are intended to reduce inequality, to supply assistance and protection, nor about the ways in which they could contribute to the operation of a regulated market economy.

All will depend on the real force that the CSRs prove able to wield and on the capacity/determination of the governments to make use of them or to modify their content (see principal/agent approach); it is, at any rate, highly possible that the system of strengthened governance will become an extremely effective instrument for changing the bases of a European social model.

Because of a failure to commit to a real economic union, that is to say, a voluntary process of convergence of the economic performance and social cohesion of the euro zone member states (see ETUC, 2013 for proposals on a social dimension of EMU and EU), social policies – in the broad sense – have today been designated as the main adjustment variables of monetary union. What the dominant discourse states is that internal devaluations – which will affect wages, labour law and social protection – must from now on replace the practice of currency devaluation as it was practiced in the past.

The impact of this discourse has already weighed heavily upon the balance of power between the constellation of social actors and that of economic actors, all the more so in that the institutional adjustment underway, the ‘new economic governance’, serves to strengthen, by its definition and nature, the hand of the economic actors.

The only means of reversing this dynamic is to place social issues back on the political agenda at both the national and the European levels (Vandenbroucke 2013; Rodrigues 2013, ); to complete economic and monetary union and endow

it with genuine instruments of adjustment and stabilization; and to change the direction of economic policies to place them in the service of a sustainable and shared prosperity. But this will be the topic of a next publication.

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