Automatic stabilizers and the European Pillar of Social Rights: challenges and opportunities

Speech by Frank Vandenbroucke at the High-Level Seminar 'A Euro for convergence and prosperity' organized by the Portuguese government, Lisbon 24 January 2017

Dear Prime Minister,

Dear Ministers,

Distinguished audience,

Let me first of all congratulate you for organizing this High-Level Seminar; it created the opportunity for extremely useful exchanges of views on the completion of the Monetary Union. The importance and the timeliness of your initiative cannot be underrated. We live today, in a world that is beset by uncertainty and fear, politically and economically. The question facing us now, very succinctly put, is the following: how can the European Union, as a beacon of openness in the world, provide its citizens with less uncertainty, more stability and prosperity. How can the Union, open and integrated as it is, be a true union of flourishing welfare states? To be clear, when I use that expression, I am not referring to a monolithic European Welfare State embedded in a federal European super-state; I envisage a union that becomes a holding environment for successful national welfare states. I emphasize this understanding of a 'European Social Union' because we should not become entrapped in the wrong debate about sovereignty. Completing the Monetary Union, so it has become clear during the seminar, is about (a) upward convergence on the basis of common goals and a well-designed investment strategy, which goes beyond the Eurozone proper, and (b) stabilization via risk sharing, which is specific to the Eurozone. I will focus on stabilization, and not return to the investment imperative, although that was very important in our debate this afternoon.

Both banking union and automatic fiscal stabilizers are about risk sharing. Sovereign welfare states that agree to share risks enhance their own domestic capacity to act, they 'take back control' in a *real* sense, thanks to collective action. Analytically, the argument that risk sharing is needed, is compelling; politically it remains an uphill battle. Let me focus on two observations: they point to difficult challenges we have to overcome, but which may, in the end, also be opportunities, as I hope to show.

My first observation is about the complementarity of the solutions that are on offer. With regard to the completion of the monetary union, it is often said that the most urgent task, right now, is completing banking union. Some people moreover argue that if we would have a banking union and a capital market union, with a more integrated capital market that itself functions as a stabilization device when asymmetric shocks occur, automatic fiscal stabilizers become less compelling. Against the latter argument, I would underscore the message to be found in much of the recent work of the IMF on the Eurozone, which is that banking union, capital market union and fiscal stabilizers are complementary devices: the 'private' insurance provided for national economies by well-functioning international credit and capital markets, needs, in support, a 'public' inter-state insurance mechanism based on a fiscal capacity. In the United States, so goes the IMF analysis, it is the complementarity of private insurance against idiosyncratic shocks hitting the individual American states and public insurance provided by the federal tax and benefit system that does the job. Hence, although banking union may in itself be most urgent, banking union, capital market union and

automatic fiscal stabilizers are complementary solutions: 3 x 1 is more than 3 in this case. Hence, even if the design of automatic stabilizers entails a complex discussion, we should not postpone that discussion: one day, preferably sooner rather than later, we need the concurrent existence of a banking union, a capital market union and automatic stabilizers.

Admittedly, the design of automatic stabilizers raises technically complicated questions, which require further thought before decisions can be taken; this adds to my argument that the European Commission and the Council must be expedient in the follow-up of the so-called Five Presidents' Report on Completing the Monetary Union: this is not the moment to lose time: the Commission and the Council should create an intellectual space for sorting out, with an open mind, a number of technical issues.

My second observation is about concerns raised by countries such as Germany – but not only Germany –, that risk sharing leads to moral hazard. Moral hazard occurs when one actor takes more risks because other actors share the costs of those risks. Moral hazard is inevitable in any context of insurance. It can be reduced by a careful design of the insurance policy, but it can never be totally excluded. We should not become totally obsessed with moral hazard: if you're obsessed, and you want to eliminate the faintest possibility of moral hazard, you'll never be able to organize insurance and reap the benefits of collective action. On the other hand, we should not dismissive about moral hazard: we should address it, and find solutions to minimise it.

If automatic stabilizers are triggered, in one way or other, by unemployment, the possibility that member states become 'lax' with regard to the activation of their unemployed generates an obvious risk of moral hazard. Therefore, in such a scheme the quality of national activation policies is a matter of common concern. It so happens that I have been partner in a research consortium, led by the Centre for European Policy Studies, on the feasibility and added value of stabilizers linked to unemployment, either directly, or in a more indirect way. We studied many different variants, and our results have been published a few days ago on the website of the European Commission (see http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7959). The conclusion of this research project emphasizes two conditions, with a view to minimizing moral hazard. First, such a scheme should incorporate financial mechanisms to avoid permanent transfers and minimise the possibility for any country to be, on average, a net beneficiary of the scheme. Second, in addition to such financial mechanisms, Member States should comply with minimum requirements with regard to both the 'activation quality' and the 'stabilisation quality' of their national unemployment benefit system. I should add that, personally, I believe it is easier to meet those conditions and to implement such a scheme, if it takes the form of 're-insurance' of national insurance schemes, rather than being a genuine European unemployment insurance that would create European benefits for individual European citizens. (I, for one, think that re-insurance not only allows more flexibility and offers more scope to mitigate the risk of institutional moral hazard; it also seems the less complicated option. But that is not the main point on which I should elaborate here.[1])

[1] For a short discussion of the differences between a 're-insurance' scheme and a genuine European unemployment insurance scheme, see Frank Vandenbroucke, *Automatic stabilizers for the Euro area and the European social model,* Tribune, Notre Europe Institut Jacques Delors, 22 September 2016 (http://www.institutdelors.eu/media/stabiliserssocialeurope-vandenbroucke-jdi-sept16.pdf?pdf=ok)

I deliberately mention both the activation quality and the 'stabilisation' quality: if the ultimate aim of risk sharing is stabilization, maintaining (and, in some countries, reinforcing) the stabilisation capacity of national systems is the political *quid pro quo* for organising European support. The stabilisation capacity of unemployment benefits depends on their generosity (notably in the short term) and their coverage; countries where the coverage of unemployment insurance is low and patchy, also featured a poor stabilisation capacity.

I am not talking about uniformity of national schemes; I am talking about upward convergence with regard to some basic qualities of national unemployment schemes, both in terms of their activation quality and their stabilisation quality. Is this very far-fetched?

Pursuing convergence in basic qualities of employment and social policies is a well-known challenge in the EU: the European Employment Strategy has been a testing ground, and the European Youth Guarantee can be seen as a good example of 'quality assurance' with regard to national activation policies for young people. (During our debate this afternoon, the example of the European Youth Guarantee has been mentioned several times, as an *acquis* on which one can build.) The European Pillar of Social Rights, launched by the European Commission, is a huge opportunity to revamp and broaden that approach, and to give it more bite. The Commission's outline of the Pillar already includes principles on the regulation of unemployment, both with regard to activation and the quality of the benefits. Hence, there is an intrinsic link between the debate on the European Pillar of Social Rights and the debate on Eurozone stabilizers.

Let me put this in a broader perspective. The Eurozone needs risk sharing, which implies the organization of solidarity. Solidarity requires mutual trust. Solidarity on the basis of mutual insurance is a rational option, but even the most rational individuals will not engage in mutual insurance, if they do not trust each other sufficiently. 'Minimum requirements' – or, 'quality assurance' – in the domain of activation are key to create trust. But European solidarity requires mutual trust with regard to the quality of the social fabric in the Member States in a more general sense: it is also about their capacity to deliver on competitiveness and sound public finances. Time forbids to elaborate upon this, but let me emphasize one point: maintaining wage cost competitiveness is easier in countries with coordinated wage bargaining. Instead of encouraging the decentralisation of collective bargaining, the EU should encourage bargaining coordination; this presupposes a positive stance vis-à-vis social dialogue at large. Again, the Pillar of Social Rights creates interesting perspectives in this respect, as it allows to underscores the importance of collective bargaining and social dialogue.

It is often repeated that a successful monetary union needs a sound combination of symmetry, notably in wage cost developments, and flexibility. Flexibility is a container concept. A 'high road' to labour market flexibility can be placed in opposition to a 'low road' to labour market flexibility. The high road is based on a highly-skilled and versatile labour force, adequate unemployment insurance and activation and training policies that facilitate transitions. The low road is based on mere labour market deregulation and easy hiring and firing. The way in which a high road to labour market flexibility, wage coordination through collective bargaining and unemployment insurance are combined in national labour market institutions is a matter of common concern in a monetary union. That does not mean that the EU should counsel Member States in detail on the organisation of their labour markets; the common concern is about basic features and desirable outcomes. But, neither

flexibility nor fiscal transfers, nor systems of wage coordination, nor unemployment insurance, are socially neutral choices. Hence, completing the monetary union forces upon the member states a consensus on the social order on which that union is based.

In a sense, that observation – that there is a social corollary to monetary unification – is not new. Some of us were also together yesterday, at the conference on the European Pillar of Social Rights, organized by the European Commission. It was a pleasure to listen, yesterday, at that conference to Alan Larsson. Alan Larsson, a former Swedish Minister and civil servant in the European Commission, was the intellectual father of the European Employment Strategy, as it developed in the 1990s. In the 1990s, Alan Larsson justified the emphasis on reform in labour markets in this European Employment Strategy by the advent of the Monetary Union. The argument, then, was mainly about supply-side flexibility and opportunities on labour markets for all. Today, we know that the consensus we need, in order to sustain a well-functioning Monetary Union, should integrate features of labour markets that support stability, such as well-functioning unemployment insurance, and features that support symmetry, such as coordinated wage bargaining. Hence, there is really an intrinsic link between our debate today and the debate on the European Pillar of Social Rights. A few days ago, the European Parliament issued an outstanding report, prepared by Maria-Joao Rodrigues, on the European Pillar of Social Rights. The European Parliament rightly calls for – I quote – "a solid European Pillar of Social Rights that is not limited to a declaration of principles or good intentions but reinforces social rights through concrete and specific tools (legislation, policy-making mechanisms and financial instruments)".

Let me conclude. I emphasized the complementarity of different solutions to the Eurozone's predicament, as discussed today. That complementarity implies that we must not postpone difficult issues on our agenda. Neither should we be dismissive about concerns raised with regard to moral hazard when risks are shared: solutions to that problem do exist. But those solutions necessitate a basic consensus on the social order on which a stable and prosperous monetary union is based. That is, in a nutshell, the challenge of building a European Social Union – a union of flourishing national welfare states.