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Structural Convergence vs. Systems Competition: Limits to the Diversity of Labour Market Policies in the EMU

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Structural Convergence versus Systems Competition

Limits to the Diversity of Labour Market Policies in the European Economic and Monetary Union

Frank Vandenberg

Abstract and executive summary

Does a monetary union, for it to be successful, impose limits on the diversity of labour market policies and institutions in its member states? I argue that one should not overstretch functionalist arguments in this matter; the problem at hand is political and the challenge is to identify common standards and policy rules that are functionally relevant (taking on board a combination of arguments on what a well-functioning monetary union requires) and legitimate in view of shared aspirations across the member states. What is ‘needed’ and what is ‘imposed’ by monetary unification in Europe, depends on the fundamental aspirations that drive the European project at large.

Already in the 1990s, reform in labour markets was justified by the advent of the monetary union. The European Employment Strategy emphasised supply-side flexibility: an agenda for flexible labour markets was interwoven with an agenda of investment in individual labour market opportunities and the development of ‘enabling’ policies. This essay develops a broader argument: to sustain a well-functioning monetary union that serves the EU’s aspirations, we need a consensus on labour market institutions that support symmetry and stability. Therefore, collective action and ‘protective’ policies are in order. Enabling and protective policies can be mutually reinforcing, in creating resilient social systems.

With regard to symmetry, the member states need labour market institutions that can deliver on wage coordination; this limits the diversity of social systems cohabiting in a monetary union, since it excludes totally decentralised and uncoordinated bargaining. Institutions that monitor competitiveness should be embedded in social dialogue, and distributive concerns should be mainstreamed in the monitoring of competitiveness. Mainstreaming distributive concerns into competitiveness makes the ‘assignment’ for national social partners complex and challenging, but such an encompassing approach may stand a better chance to achieve legitimacy. Simultaneously, EU institutions should avoid interfering in the details of wage bargaining systems. This argument raises an existential question for unions and employers’ organisations in Europe: can they commit themselves to the coordination of wage bargaining, with this dual perspective of competitiveness and fair distribution?

The concern with stability entails a cluster of policy principles to sustain an effective stabilisation capacity in each member state: sufficiently generous unemployment benefits, notably in the short-term; sufficient coverage rates of unemployment benefit schemes; no labour market segmentation that leaves part of the labour force poorly insured against unemployment; no proliferation of employment relations that are not integrated into systems of social insurance; effective activation of unemployed individuals; and the constitution of budgetary buffers in good times, so that the automatic stabilisers can do their work in bad times. These principles become *a fortiori* imperative, as *quid pro quo*, if the Eurozone would be equipped with reinsurance of national unemployment insurance systems; but even without that perspective, they should figure on the Eurozone's agenda. I draw a comparison with the problem of vaccination to make that point.

In addition, the monetary union calls for integrated competitive markets for goods and services and cross-border mobility of labour. This in turn entails a social corollary. Next to reform in the regulation of posting, national minimum wage regimes should be transparent, predictable and universal in coverage. This reinforces the case against total decentralisation of collective bargaining. Also, the legacy of the *Viking* judgment of the European Court of Justice should be clarified.

An upshot of the argument is that one should carefully distinguish between (i) the 'social corollary' of the Economic and Monetary Union and (ii) the 'social corollary' of the Single Market; they partly overlap, but are also different. Moreover, the social policy debate is not exhausted by what we may consider as the logical corollaries of monetary unification and market integration. The *Reflection Paper on the Social Dimension of Europe* of April 2017 is insufficiently clear about this.

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1. CONVERGENCE AND DIVERSITY: BRIDGING FUNCTIONALIST ARGUMENTS AND ASPIRATIONS

We cherish the diversity of our national welfare states: it reflects national preferences, rooted in history and culture; and it allows a healthy dose of ‘systems competition’ and mutual learning. Does a monetary union, for it to be successful, impose limits on the diversity of the social systems in its member states? On the backdrop of that general question, I focus on a specific question: should we agree on *common standards* for labour markets or *common rules for wage policies* across the Economic and Monetary Union? In this essay, the expression ‘common standards’ has a precise meaning; we are not discussing common objectives with regard to policy outcomes, such as employment rates or poverty; common standards set constraints on the level of specific policy *inputs*, such as the generosity of unemployment benefits or the coverage of minimum wages. Common rules would create *procedural* similarities in the development of policies, embedded in labour market institutions. Thus, common standards and rules have a direct impact on the diversity of policies and institutions. They define areas in which evidence-based analysis and past mutual learning yielded sufficient consensus about ‘what works’, and in which systems competition is to be excluded, at least at the level of basic features of policies.

The essay consists of ten sections. This section contextualises the ‘limits-to-diversity’ question and develops some preliminary considerations on how to address it. The argument is not about a monetary union *in abstracto*; it concerns a currency area at the heart of the European project. Therefore, in the second section, I reconnect with the inspiration of the European *founding fathers*. In section 3, I argue that we may have to combine arguments that pull in different directions but that are not incompatible. This sets the scene for the policy proposals developed in sections 4 to 7. Sections 4 and 5 focus on wage bargaining coordination: why it is needed, and how it can be developed. The sixth section considers the consequences of risk-reduction and risk-sharing scenarios for the diversity of labour market institutions that can be accommodated in the monetary union. Section 7 discusses the role of labour market flexibility, next to the need for competitive and integrated markets for goods and services. In section 8, I focus on the necessary balance between freedom of movement of workers and the principle of ‘posting’ of workers: both are needed for the Single Market and the Economic and Monetary Union to be fair and efficient, and both should be well-regulated; this also limits diversity. An upshot of the approach suggested in this essay is that one should carefully distinguish between the ‘social corollary’ of the Economic and Monetary Union and the ‘social corollary’ of the Single Market: they partly overlap, but are also different; some proposals can be limited to the Economic and Monetary Union, but some proposals must be implemented at the level of the Single Market. I briefly address this difficulty in section 9. In section 10, I conclude by summarising the proposals that can be based on the analysis, and I return to the central theme in the first section: arguments about ‘limits to social-model diversity’ cannot be solely functionalist; they are deeply political.

The general question addressed in this essay is not new. The emphasis on labour market flexibility in the European Employment Strategy (launched in 1997), was justified by the perspective of monetary unification.¹ The European Employment Strategy did not call for a harmonisation of labour market institutions. But the aim of the employment guidelines was to achieve convergence across the member states with regard to basic features of labour markets; the common orientation thereby was ‘flexicurity’. Flexicurity would, among other beneficial upshots, guarantee sufficient supply-side flexibility in the labour markets of the monetary union. In the aftermath of the financial crisis, the drive for convergence in the functioning of labour markets gained new momentum in EU policy circles, as part of what is called ‘structural reform’. Thus, convergence and structural reform became pivotal concepts in the Five Presidents’ Report on *Completing Europe’s Economic and Monetary*

¹ See Pochet (2005) and Rhodes (2015).

Union.² They are, moreover, intimately linked in that report: “Sustainable convergence also requires a broader set of policies that come under the heading of ‘structural reforms’, i.e. reforms geared at modernising economies to achieve more growth and jobs. That means both more efficient labour and product markets and stronger public institutions.”

The Five Presidents’ Report sees convergence as a *condition sine qua non* for the development of public risk-sharing via fiscal stabilisers for the euro area. With a view to developing public risk-sharing, the convergence process should also become more binding. The Report is explicit that this entails common standards for labour markets; it is useful to quote it at length: “[A more binding convergence process] would be achieved by agreeing on a set of common high-level standards that would be defined in EU legislation, as sovereignty over policies of common concern would be shared and strong decision-making at euro area level would be established. In some areas, this will need to involve further harmonisation. In other areas, where different policies can lead to similarly good performance, it will mean finding countryspecific solutions. The common standards should focus primarily on labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy (e.g. corporate tax base).” In April 2017, the European Commission presented its proposal for a *European Pillar of Social Rights*: “20 key principles and rights to support fair and well-functioning labour markets and welfare systems (...) designed as a compass for a renewed process of upward convergence towards better working and living conditions in Europe”.³ The fact that the Pillar is “primarily conceived for the euro area but applicable to all EU member states wishing to be part of it” signals the same idea: monetary unification sets a limit to the diversity of national social models.

Some academic scholars argue that the diversity in social systems across the Economic and Monetary Union is simply too large to be accommodated in a beneficial way. The ‘variety of capitalisms’ across countries such as Germany, Finland, Spain and Italy, is such that the Economic and Monetary Union is an intrinsically ill-fated project; the proper solution is to put an end to it.⁴ Hence, there is both a

² European Council (2015)

³ European Commission (2017b); quotations are from the press release accompanying this document on 26 April 2017.

⁴ Among scholars analysing the Economic and Monetary Union as a set of incompatible models of capitalism, Scharpf (2016) is most explicit that the monetary union better be disintegrated. I briefly return to one of Scharpf’s arguments in the conclusion. In section 3, I refer to authors whose analysis is (in various degrees) congenial to the ‘varieties of capitalism’ paradigm, notably Johnston, Hancké, Regan, Carlin and Boltho. The ‘varieties of capitalism’ approach was originally proposed in Hall and Soskice (2001). Space forbids an in-depth discussion of the ‘varieties of capitalism’ literature and its understanding of the Eurozone crisis, as explained by Hall (2012, 2014) and Hassel (2014). Hall (2014, p. 1226) summarises the ‘varieties of capitalism’ understanding of the Eurozone crisis as follows: on one side, there is a set of ‘Coordinated Market Economies’ in ‘northern’ Europe, operating export-led growth models built on high levels of wage coordination, sophisticated systems of vocational training, the inter-firm relations necessary to operate collaborative research and development, and intra-firm relationships that promote continuous innovation and quality control. These include the economies of Germany, the Netherlands, Belgium, Finland, and Austria. Another set of countries in ‘southern’ Europe are described as ‘Mixed Market Economies’ where, apart from periodic ‘social pacts’, wage bargaining is difficult to coordinate because trade unions are relatively strong but vie with one another for the allegiance of the workforce and the right to negotiate wage bargains. Employer associations are sometimes more coordinated, but they were less deeply institutionalised than their northern European counterparts and poorly equipped to operate collaborative vocational training schemes. With variations across sectors and countries, the political economies of Greece, Spain, Portugal, and Italy share these features. Hassel (2014) argues, in the same vein, that “two different kinds of political economies entered a currency union which not only removed the protection of business by national mechanisms vis-à-vis foreign competition via currency depreciation, but also gave governments in mixed market economies access to cheap credit. Because coordination in mixed market economies rested on compensation by the state, governments used these resources to compensate the losers of closer economic integration.” Hassel explains the lack of trust among Eurozone governments on this basis: “Understanding [this] not only helps to explain why the Southern European countries were particularly vulnerable to exploding public debt, but also why (...) policy makers have persistently preferred austerity over the mutualisation of debt. The compensatory role of the state in mixed-market economies thereby undermines the effectiveness of financial bail-outs for economic growth strategies.”

However, Hassel shows that it is hard to find specific indicators for the ‘compensation’ feature of mixed market economies; the data support the idea that there is a cluster of Liberal Market Economies on the one hand, and Coordinated Market Economies and Mixed Market Economies on the other hand; but France displays several features of mixed market economies while Italy displays several features of Coordinated Market Economies. The data also that employment protection has diminished significantly in many countries, including Coordinated Market Economies, since the beginning of the 1990s; cf. Figure 7.2 in section 7, below.

pessimistic version and an optimistic (or, rather, a ‘voluntarist’) version of the same argument: there is a limit to the diversity of welfare states that can be accommodated in a monetary union. I do not subscribe to the pessimistic thesis: it is based on an interpretation of differences in member states’ social institutions that is too static and deterministic (see footnote 4). However, that does not mean that institutional differences cannot constitute important obstacles to a well-functioning monetary union.

Recently, a radically different thesis has been formulated by Schelkle (2017), on the backdrop of theories of international risk sharing: diversity is not a problem, on the contrary it creates opportunities for mutually beneficial risk sharing. Schelkle argues that risk sharing is already an inconspicuous feature of the euro area: it exists, yet the potential for mutually beneficial cooperation it offers is not exploited. Diversity creates a paradox: the more diverse potential member are, the larger the potential economic gains from risk pooling via a monetary union, yet the more difficult it may be to realise these gains politically. I cannot do justice to Schelkle’s subtle analysis in this paper, but I will briefly return to it at the end of section 4 and in section 6 (note 40).⁵

In fact, questions with regard to the limits of welfare state diversity in the European Union date back from long before the run-up to the monetary union. When the Single Market project was launched in the 1980s, many people – including the president of the Commission, Jacques Delors – believed that there had to be a social corollary to the Single Market. Setting social standards or promoting social dialogue, as Delors wanted, inevitably challenges to some extent the diversity of existing regulations and institutions. The social corollary of the Single Market turned out to be more partial and weaker than its proponents had hoped for. This essay therefore is an exercise in soul-searching, with a personal note attached to it: whether or not the European Union should organise a degree of social convergence and how to achieve this, is a problem that exercised me a lot since the end of the 1990s, when I was able to contribute with a colleagues in governments and academia to the implementation of the Open Method of Coordination (a political methodology which was, at the time, seen as an innovative way to accommodate diversity whilst pursuing common social objectives).⁶ Have we been able to formulate a solid doctrine on the conundrum of convergence and diversity, on the basis of the policy experience gathered over all these years? I am a defender of evidence-based policy making, but it seems that the answer to the limits-to-diversity question is not, in the end, a matter of ‘hard science’: evidence-based analysis does not provide policy-makers with answers about ‘limits to diversity’ that are clear-cut, unambiguous, and beyond any reasonable doubt.

An obvious reason why scientific evidence does not yield unambiguous answers is that scientific opinion is divided on the predicament of the Economic and Monetary Union and how it is to be remedied. This forces policy-makers to adopt a degree of (sound) eclecticism: if we think arguments A, B and C all carry some weight and are not incompatible, but we are not able to make a definitive assessment of their relative strength, or we are not able to predict their relative strength in changed

‘Varieties of capitalism’ is criticized (among others) by Crouch, and Herrigel and Zeitlin, both on empirical grounds (the classifications applied are too simple) and on meta-theoretical grounds. Its functionalism produces “models embodying heavily determined logics of action and path dependencies” and precludes the existence of “functional equivalents”, i.e. “alternative ways of producing similar outcomes” (Crouch, 2005, p. 63 and 65). It is too static to develop an account of system change, and too structuralist in its negligence of actor creativity (Herrigel and Zeitlin, 2010). Whilst insights from this literature are helpful in highlighting the ‘institutional assets’ of the Coordinated Market Economies in the monetary union vis-à-vis the institutional weaknesses of southern European countries (see section 3), this should not lead to the deterministic conclusion that institutional path-dependency prevents labour market institutions from evolving. This essay aims to identify key features of social models in which evolution is necessary with a view to constituting a beneficial monetary union, e.g. in the coordination of wage bargaining. There may be different, functionally equivalent institutions that support coordinated wage bargaining, and there are no “institutional complementarities” that preclude their emergence in some European countries (as some ‘varieties of capitalism’ scholars would contend). Also, as explained in the concluding section 10, promoting such an evolution is not necessarily as ‘intrusive’ in terms of micro-governance as Scharpf would have it.

⁵ The heterodox argument – that the monetary union could do with more diversity than allowed for in the dominant EU discourse today – can also be found in Chalmers, Jachtenfuchs and Joerges (2016) and Bronk and Jacoby (2013).

⁶ Vandenbroucke (1999; 2002).

circumstances in the future, the safest bet is to develop a policy that is compatible with both A, B and C. I return to this in section 3.

More fundamentally, we must not overstretch functionalist rationales. The argument developed in this essay has a functionalist flavor: it examines the social policy ‘spill-over’ of monetary unification; the argument is triggered by functional needs, which we try to assess on the basis of evidence. However, we should avoid a discourse framed in precise and irresistible functionalist imperatives. Analytically, the upshot of such a discourse may be an impasse, as it precludes the possibility of different functional equivalents in the realm of social institutions and innovative ‘re-combinations’ of existing institutions. As Crouch (2005, pp. 61-68) explains, there is a kind of functionalism that makes it impossible to understand *change*: rather than applying functionalist models that embody “heavily determined logics of action and path dependences”, we should understand our societies as being constituted by active human agents, with identities and interests that may shift, and power relations and compromises that may change. Politically, ‘there-is-no-alternative’ discourses are counterproductive. My argument in the next section is that we have to reconnect with the original point and purpose of the European project, which is to be a union of welfare states. This is a choice. As Innerarity puts it, ‘Politics is conditional liberty, choices in the midst of constraints. Politics is always freedom in context, even and particularly within frameworks that are as complex as the EU’.⁷ Affirming that a policy is a ‘functional necessity’ dictated by earlier decisions and precluding any alternative solution is politically a weak argument; saying that a policy is both functional and attractive – because it supports our shared aspirations – is politically a strong argument.

Summarising, the challenge is to identify standards and policy rules (limiting social policy diversity in the Economic and Monetary Union) that are functionally relevant (possibly on the basis of a combination of arguments that pull in different directions but are not incompatible) and sufficiently attractive (given our shared aspirations). In yet other words, whilst the limits-to-diversity discussion focusses on the Eurozone, it cannot be dissociated from wider arguments about the social dimension of Europe. Simultaneously, it should be clear that the analysis in this paper does not exhaust the theme of social Europe: there may be sound arguments, unrelated to monetary unification, to develop an active social dimension to the EU. I return to this – with reference to the Commission’s *Reflection Paper on the Social Dimension of Europe*⁸ – in section 9 of the essay.

2. A MONETARY UNION AT THE HEART OF THE EUROPEAN PROJECT

The argument about limits to diversity in the monetary union is not about a monetary union *in abstracto*: it is about a monetary union at the heart of the European project, which should serve the fundamental ambitions of the European project. Therefore, in the next section I will first reconnect with the inspiration of the *founding fathers* of the European integration project, who prepared the Treaty of Rome. The founding fathers were convinced that economic integration would contribute to the development of prosperous national welfare states, whilst leaving social policy concerns essentially at the national level. They optimistically assumed that growing cohesion both between and within countries could be reached by supranational economic cooperation, together with some specific instruments for raising the standard of living across the member states (which were later brought together in the EU’s ‘economic, social and territorial’ cohesion policy). Economic integration was to be organised at the EU level, and would boost economic growth and create upward convergence; domestic social policies were to redistribute the fruits of economic progress, while remaining a

⁷ Innerarity (2016).

⁸ European Commission (2017c).

national prerogative. The specific social dimension of the EU would, in essence, be confined to the coordination of social security rights for mobile citizens and principles of non-discrimination.

The Single European Act of 1986 could have been a game-changer: the deepening of the internal market implied a step change in levels of labour and capital mobility. To prevent a regression in social standards, a pan-European floor of social rights might have been a logical corollary, but an operational and ‘hard’ floor of rights did not emerge in the 1990s, the main exception being the developments of standards for health and safety at the work place. With a view to developing a social dimension to the EU, the European Social Dialogue was launched; opinions on what it delivered diverge, but it is fair to say that European Social Dialogue produced less tangible results than what was hoped for. For sure, after 60 years of piecemeal developments, the European *social acquis* encompasses important policy areas that were shifted from the national to the EU level and an impressive body of anti-discrimination legislation. But redistributive policies, education policies and the development of social security remained – at least in theory – firmly anchored at the national level.

Nevertheless, with hindsight one may say that history has not proven the founding fathers wrong in their optimistic belief, at least until the mid-2000s: market integration led to upward convergence. In the advanced welfare states of the EU, there were no signs of large-scale dumping, despite the absence of pan-European social standards to speak of (admittedly with some exceptions, such as standards on health and safety at work). In other words, there seemed no contradiction between market-driven upward convergence across countries and internal social cohesion within countries. However, since the mid-2000s we witness both growing inequality within a number of the most advanced welfare states of the EU, and – with the outbreak of the financial crisis in 2008 – divergence across member states, notably in the Eurozone. Thus, the experience of the crisis forces us to reconsider the question, both with regard to the Single Market in the enlarged EU, and with regard to the monetary union: how can the Union be a successful *union of flourishing welfare states*?

The emphasis on ‘welfare states’ and ‘union’ in formulating the question is not happenstance. First, the question concerns countries that aspire to be welfare states. In all Member States, whatever their social policy tradition or level of development, there is large support for core ambitions of a modern welfare state: promoting general prosperity, sustaining social cohesion, providing some protection against the potential volatility of market incomes, helping vulnerable individuals and supporting education. However different European welfare states are, their national tax and benefit systems have created, to varying degrees and with varying success, a capacity for social and economic stabilisation in periods of economic stress. These automatic stabilisers are intrinsically linked with the protection of vulnerable individuals: mitigating income volatility and reducing income inequality go hand in hand, not because the goals of income security and poverty alleviation are synonymous or concern the same individuals, but because these goals are served to a large extent by the same types of instruments (progressive taxation and income replacement benefits). If the integration would not concern countries that by and large all share this aspiration, our analysis of the consequences of monetary integration would be different.

Secondly, the question is about a set of countries that will *not* form a federal state in the foreseeable future and that cherish their diversity, for instance with regard to language. Below, I will argue that the Economic and Monetary Union needs a visible hand to prevent wage cost divergences; it cannot only rely on the invisible hand of market adjustment. Such mechanisms do not exist in true federations (which are also currency areas) such as the United States. Why then would they be necessary in Europe? The Euro area needs them because labour mobility is limited and fiscal policy decentralised.⁹ In other words, in Europe monetary unification calls for mechanisms that are intrusive in sensitive national domains (such as wage setting), *because* our attachment to our language and our own country precludes large scale migration as a stabilisation mechanism and because, moreover,

⁹ I owe this argument to Sapir and Wolff (2015), p. 3.

there will never be a federal budget that redistributes resources on a massive scale to depressed areas with high unemployment. Admittedly, with such a constellation, we are in uncharted territory. Can it be constellation a constellation that is not only viable but also beneficial, in light of the aspirations of the European project at large? I believe it can, but it requires both (i) an effective ‘visible hand’ in the form of symmetrical guidance on wage developments, and (ii) a more effective ‘invisible hand’ in the responsiveness of markets to competitive pressures, and (iii) risk-reduction and risk-sharing in (some) sensitive policy-domains, including some domains of social policy. This presupposes a basic consensus on the social model that inspires the union.

In this section, I referred both to the Single Market and the Monetary Union. It is often asserted that a true Single Market needs a monetary union to exclude the possibility of protectionist devaluations, whilst the Economic and Monetary Union needs the Single Market, with its principles of freedom of movement of people, capital, services and goods. I will not elaborate upon these assertions, except to affirm that freedom of movement is a necessary ingredient for the sustainability of a monetary union, alongside an effective Single Market. The social corollary of a Single Market (in essence, the setting of standards in areas where it is necessary to guarantee a level playing field) and the social corollary of a monetary union are qualitatively different; but there is also an overlap: social standards that are necessary for the Single Market to thrive, notably social standards to accommodate the freedom of movement of workers and posting of workers, are part and parcel of the social corollary of the Economic and Monetary Union.

3. FUNDAMENTALS AND MULTIPLE EQUILIBRIA: A COMBINATION OF ARGUMENTS

Mainstream economic analysis explains the benefits and drawbacks of monetary unification in terms of *trade-offs*. The core idea is that members of a currency area are confronted with a trade-off between symmetry and flexibility. Symmetry refers to movements in output, wages and prices. Flexibility relates to wage flexibility and interregional and international labour mobility, which determine a country’s internal adjustment capacity in case of a so-called asymmetric shock. Less symmetry necessitates more flexibility, according to the theory of ‘optimal currency areas’: the less symmetry there is between the countries of a single currency area, the greater the required capacity for internal adaptability in order for the monetary union to be beneficial. There is moreover a second trade-off: if the possibility exists of absorbing asymmetric shocks through *fiscal transfers* between the member states, then the need for flexibility is reduced.

Over the last few years, we learned that this traditional textbook description of these trade-offs is insufficient to understand the Eurozone crisis. Design failures of the Economic and Monetary Union made it inherently unstable and fragile. To understand this, one should not reason about a monetary union *in abstracto*, but examine what went actually wrong in the Euro area during the last decade. The literature on the Eurozone crisis reflects conflicting views on this: a *fundamentalist* view can be distinguished from a *multiple-equilibria* view.¹⁰ The *fundamentalist* view is that widening Eurozone bond yields, as witnessed since 2010, reflect serious deterioration in countries’ macroeconomic fundamentals, notably with regard to competitiveness.¹¹ Against the fundamentalist view, the

¹⁰ Saka et al. (2010).

¹¹ In this fundamentalist camp, one may distinguish those who stress fiscal profligacy in a number of Eurozone countries, and those who stress the emergence of large current accounts deficits and surpluses, linked to diverging competitiveness. On the basis of the evidence, discarding the special case of Greece, the fiscal profligacy thesis is much less compelling than the diverging competitiveness thesis. Many papers have been published on this question since the outbreak of the crisis.

multiple-equilibria view contends that markets may not always function optimally, and therefore countries may find themselves in any one of a set of possible equilibrium conditions, without experiencing any major change in fundamentals. The observation that a monetary union lends itself to the devilish effects of self-fulfilling dynamics is key to De Grauwe's *fragility hypothesis*.¹² Advocates of the multiple-equilibria view do not deny sensitivity to fundamentals: fundamentals matter, but they are not the whole story. Jones' criticism of the competitiveness argument illustrates the latter type of position: Jones argues that divergences in competitiveness cannot explain the root cause of the crisis and why it hit certain countries more than others; the main explanation is grounded in (badly regulated) European financial markets.¹³ In contrast, Boltho and Carlin's argument that the problem of the Eurozone is not so much 'asymmetric shocks' but 'asymmetric behaviour' in the domain of wage formation (as explained in the next section) illustrates the former type of position: the crux of the problem is at the level of fundamentals.¹⁴ Schelkle's analysis, to which I referred in section 1, can be read as a radical emphasis on the multiple-equilibria view (divergences in 'fundamentals', such as competitiveness, do not create financial mayhem, if the monetary union is adequately equipped with macroprudential policies and risk-sharing instruments in the financial and monetary sphere). Schelkle moreover emphasises that diversity makes risk pooling beneficial; I briefly return to her view at the end of section 4 and in section 6 (note 40).

In this essay, I propose to take both the 'fundamentalist' argument and the 'multiple-equilibria argument' on board, whilst acknowledging that their relative weight is debatable; this constitutes the safest point of departure for policy-making and political deliberation. Both the fundamentalist explanation and the multiple-equilibria explanation signal design failures in the monetary union; the combined impact of these design failures is what matters. De Grauwe neatly summarises the Eurozone's predicament as the combination of two design failures: "On the one hand booms and busts continued to occur at the national level. In fact, these were probably intensified by the very existence of a monetary union. On the other hand the stripping away of the lender of last resort support of the member state countries allowed liquidity crises to emerge when booms turned into busts."¹⁵ The divergence in price competitiveness across the Eurozone (the crucial imbalance in the Eurozone at the level of the fundamentals) was closely linked to the first design failure (the persistence and even intensification of booms and busts at the national level).

Sections 4 and 5 elaborate upon the competitiveness argument. Section 6 focusses on stability. Enhancing the Eurozone's stability first of all requires solutions for financial instability, including a fully-fledged Banking Union (Jones exemplifies this position, see also Schelkle); I will not rehearse this argument here, as there is no obvious link with the social dimension; I take it for granted that Banking Union is a first priority. In Section 6, I follow those experts (including the authors of the Five Presidents' Report on *Completing the Economic and Monetary Union*) who argue that Banking Union and solutions in the financial sphere are not sufficient with a view to macro-economic stabilisation.

Johnston, Hancké and Pant (2014) present a succinct survey of the literature, distinguishing a 'fiscal position' and a 'competitiveness position', and provide data supporting the competitiveness position.

¹² De Grauwe (2011).

¹³ Erik Jones (2012, 2014, 2016)

¹⁴ See Boltho and Carlin (2013). Johnston and Regan (2016) combine Jones' financial account of the Eurozone crisis with the competitiveness account; I would consider them as 'fundamentalist', as the crux of their analysis is that the monetary regime of the Eurozone made the different 'varieties of capitalism' incompatible for structural reasons; the policy conclusion they reach is that the different varieties of capitalism can only become compatible in the Economic and Monetary Union if there is a 'co-ordination of more robust wage growth and domestic demand in its northern economies', which 'would require the European Commission and the ECB to directly challenge the policy preferences of northern European countries in the Council. I return to this insight in the concluding section.

¹⁵ De Grauwe (2014).

4. THE NEED FOR AN EFFECTIVE VISIBLE HAND: WAGE BARGAINING COORDINATION

Why would monetary unification *intensify* booms and busts and, thus, intensify divergences in price competitiveness? And why does it need a visible hand? If the invisible hand of market forces is the main driver of adjustment, the effect of wage and price divergence in a monetary union is threefold: one may distinguish three ‘channels of adjustment’: a competitiveness channel (or real exchange rate channel), a real interest channel and an income distribution channel.

First, changes in relative prices determine the competitiveness of an economy vis-à-vis its trading partners. A higher inflation rate reduces competitiveness and leads to a deteriorating trade balance; this, in itself, leads to adjustment, since it dampens economic activity and thus reduces inflationary pressure; this is the classical ‘competitiveness channel’. This channel relies on the invisible hand of the market, and for it to work well, markets have to be fully integrated. This underscores the importance of completing the Single Market. On a more general note, structural reforms that increase the responsiveness of prices and wages to the market enhance the ‘competitiveness channel’, and can therefore be considered important to stabilise the Euro area. I return to this in section 7, below.

There are however two more channels present, which could impede the counter-balancing effect of the competitiveness channel, and may make us think twice about the role of labour market institutions and ‘structural reform’ in that area. The second one is the so-called ‘real interest channel’. Higher inflation rates in a booming country reduce real interest-rates (since the level of nominal interest rates is determined at the Eurozone level) and so stimulate credit-driven domestic consumption and investment: the economic boom is reinforced. Ederer and Reschenhofer identify a third channel, the ‘income distribution channel’, which is more unconventional.¹⁶ Different productivity, wage and price developments may result in divergent patterns in the wage share. If a rising wage share stimulates consumption more than it reduces investment, stronger economic activity will be the result. Thus, a rising wage share would deteriorate trade balances. This channel also counteracts the competitiveness channel and tends to destabilise divergent economic developments in a monetary union; that is at least what one might expect on a theoretical basis.¹⁷

In practice, in the years before the crisis, the ‘real interest channel’ was more effective than the ‘competitiveness channel’. The common monetary policy, in combination with divergent price inflation, stimulated domestic demand and amplified the boom in high-growth and high-inflation countries. This led to rapidly expanding imports and high current account deficits. Contrarily, in low-growth and low-inflation economies real interest rates were higher and restricted domestic demand. This, in combination with solid export growth caused substantial current account surpluses.

Obviously, adjustment is not only brought about by the invisible hand of pure market forces. Wage bargaining institutions make an important difference. Countries like Germany and Finland have unions that have been more conscious of external constraints than countries like Italy or Spain. Hence, the ‘competitiveness channel’ in the former countries is not only more effective (compared to the latter countries) thanks to collective bargaining, but collective bargaining moreover acts in a *preventative way*. The industrial relations literature provides evidence on which wage-setting systems can deliver a real exchange rate that is consistent with sustainable external balance: either so called

¹⁶ Ederer and Reschenhofer (2013).

¹⁷ This argument is more speculative. Before the crisis, the wage share decreased in Germany, Austria and the Netherlands (see Figure 5.1 in section five). This is likely to have restrained private consumption in these countries and consequently weakened domestic demand. It is less clear how important it was as a general explanatory factor for evolutions in the whole set of Eurozone countries over that period. I add it here, because the ‘golden rule’ to which I refer below, would contribute to stabilizing the share of wages and profits in national income.

‘pattern bargaining’, in which the lead in wage negotiations is taken by an exposed sector union, or ‘peak level coordination’ bargaining, in which it is a national all-encompassing union that sets wage aims. Within the Eurozone there would seem to be a split between Germany, the Benelux countries, Austria and Finland on the one hand, all of which benefit from either one or the other of these two wage-setting mechanisms and in which there is a high degree of control over lower-tier wage settlements, and Italy, Portugal, and Spain on the other, in which there is no mechanism to produce wage increases that are consistent with maintaining competitiveness.¹⁸ Pursuing this type of analysis, Hancké *et al.* focus on one key institutional driver of the divergence in competitiveness: a country’s capacity to limit sheltered sector wage growth, relative to wage growth in the manufacturing sector. In the arrangements that preceded the Economic and Monetary Union, national central banks held wages in both the exposed and sheltered sectors in check; the Economic and Monetary Union has become a monetary union that invites these imbalances.¹⁹ On the basis of econometric analysis, they argue that the more ‘rigid’, centralised and coordinated wage bargaining regimes in the Eurozone have best weathered this transition to a monetary union.²⁰ Corporatism emerges as a crucial institutional advantage, which is ironic, given the insistence on decentralisation of wage formation in official EU policies (I return to EU policies at the end of this section).

For sure, research on the performance of labour market institutions with regard to external competitiveness yields nuanced and open-ended conclusions: there is some scope for systems competition, since there is no ‘silver bullet’.²¹ But one negative and one positive conclusion stand out with regard to their capacity to maintain external competitiveness. On the negative count, systems of wage bargaining that are totally decentralised and uncoordinated perform worse, compared to centralised and coordinated structures. On the positive count, resonating an argument developed at length by Crouch: countries with powerful trade unions, but which power has not been used to defy the logic of external competitiveness, have been most successful in social and economic terms.²²

Recent research by Eurofound supports the idea that coordination and centralisation of wage bargaining can be an institutional asset.²³ Eurofound’s approach is interesting, since it makes a distinction between external competitiveness (as measured by nominal unit labour costs) on one hand, and the development of the wage share (for which real unit labour costs are key). Eurofound finds that regimes characterised by higher degrees of coordination and levels of centralisation are associated with significantly lower increases in nominal unit labour costs; in other words, productivity growth exceeds the growth of wage costs in countries with these sorts of bargaining institutions to a greater extent than in countries with uncoordinated bargaining and company- or local-level bargaining. In contrast, real unit labour costs are unaffected by the type of coordination and are positively influenced by levels of bargaining higher than the company level. Hence, if wage moderation was seen as a strategy to increase employment in the medium and long term by mitigating imbalances and improving macroeconomic stability in the Economic and Monetary Union, then the evidence from this study suggests that such a strategy would be favoured by a wage-bargaining system with a high degree of coordination. If keeping wage share high was seen as part of a strategy to promote demand, then the findings of this study suggest that such a strategy would be favoured by any wage-bargaining system other than a pure company-level one.²⁴

¹⁸ Boltho and Carlin (2013), p. 395; see also Traxler and Brandl (2011) on systems of wage formation; and Carlin (2012) on the problem of stabilisation with different systems of collective bargaining.

¹⁹ Johnston and Hancké (2009); Hancké (2013), p. 99.

²⁰ Johnston, Hancké and Pant (2014).

²¹ Brandl (2012).

²² Crouch (2013).

²³ Eurofound (2015).

²⁴ The Eurofound authors are well aware that not all features of a bargaining system can be quantitatively measured. Their analysis “could not shed light on other important factors that could shape the bargaining process and its outcomes: how the various actors understand each other, the more informal dimension, their mutual trust, their convictions and long-term visions, to name but a few.” (Eurofound, 2015, *Executive Summary*, p. 2).

These results signal an important *caveat* viz-à-viz the plea for decentralisation of wage bargaining: uncoordinated bargaining at company level, which does not follow an objective of achieving high levels of employment in the economy at large, results in higher pay outcomes on average. Eurofound concludes that there may be conditions in which “introducing some elements of company-level bargaining could then complement coordinated or higher-level bargaining and result in increasing pay outcomes in very profitable firms, without creating a great risk to an overall objective of wage moderation aimed at increasing aggregate employment.”²⁵ But company-level bargaining cannot be a substitute for higher-level bargaining or bargaining coordination.

Obviously, wage moderation is not an objective *per se*: one would need a policy rule that guarantees true symmetry, preventing both excessive wage moderation in some countries and excessive wage increases in other countries. In fact, it can be argued that one of the main drivers of diverging competitiveness in the Eurozone was the excessive moderation of wage increases in Germany in the first half of the 2000s (see also Figure 5.1 in the next section). The European Commission has come to recognise the importance of symmetry, notably in its *Annual Growth Survey 2017*.²⁶ However, its recommendation, although clear *qua* political message, remains fairly vague in operational terms; earlier Commission recommendations in the same sense vis-à-vis Germany appear to have had little tangible impact. Can we take this approach one step further, and propose more explicit and precise guidance for the coordination of wage developments? Watt proposes a ‘golden rule’ that would guarantee true symmetry in the development of nominal unit labour costs: in all EMU member states, nominal wages should grow at a rate equal to the sum of medium-run national labour productivity growth plus an allowance for the rate of inflation that the monetary authority considers compatible with price stability.²⁷ According to Watt, implementing such a golden rule would require the strengthening of existing coordination instruments, such as the Macroeconomic Dialogue.²⁸ On this basis, Watt envisages a ‘grand bargain’ whereby all actors (trade unions, employers, political decision makers) would reconsider their role and mutual interactions.²⁹

Admittedly, such a ‘golden rule’ raises complex questions with regard to implementation. First, since there is a great variety of wage-bargaining traditions and institutions in the EU, achieving highly coordinated bargaining implies institutional change in many countries: but, simultaneously, there is no single ‘ideal’ template for the coordination of wage bargaining that would suit all countries, given their different histories and cultures. Second, it is not straightforward to define the responsibility of governments with regard to the development of wages; the notion of a ‘rule’ should be clarified with regard to what is expected from governments. Thillaye *et al.* discuss wage coordination and the risks

²⁵ *Ibidem*.

²⁶ “Member States should, together with social partners, and in line with national practices, make sure that their wage-setting systems are effective in delivering both job creation and real income increases, and for that adjust better to changes in productivity over time. In a number of Member States, developments in wages do not sufficiently follow productivity developments. This may lead either to an erosion of competitiveness or, in the case of too modest wage developments, to weaker aggregate demand and growth. This may also discourage productivity gains, research, development and innovation and investment in human capital aimed at improving skills. It may also distort incentives for resource reallocation towards sectors with higher value added and thus hinder further structural change of the EU economies to make them more competitive.” (European Commission, 2016, p. 11).

²⁷ Watt (2012). If the starting point is one of substantial current account imbalances, the rate of nominal wage growth should be lower than indicated by this formula in deficit countries and higher in surplus countries to bring countries back into equilibrium. The ‘golden rule’ of a monetary union would then be: nominal wage growth in each country equals medium term national productivity growth, plus the target inflation rate of the central bank, plus/minus a competitiveness correction in surplus/deficit countries. Watt also points out that it would be sensible to apply a floor to this rule, to avoid negative nominal wage growth (i.e. pay cuts) in deficit countries and the risk of cumulative deflation (as opposed to relative disinflation).

²⁸ Koll (2013) discusses dialogue-based macroeconomic coordination and the experience of the Macroeconomic Dialogue.

²⁹ In Watt’s view, a golden rule would be part of a broader policy package, in which national fiscal policy would also contribute to the correction of external imbalances. The approach to fiscal policy that is associated to Watt’s ‘golden rule’ is different from the approach in the Stability and Growth Pact, since its main focus would be on the external account, rather than on levels of deficits and debt *per se*. Horn, Lindner, Tober and Watt (2012) argue that countries such as Spain and Ireland should have had a more restrictive fiscal policy before the crisis, although they were under no obligation to do so under the SGP coordination mechanisms. At the same time, those economies that were growing sluggishly were for many years prevented by the one-sided approach of the SGP from providing fiscal stimulus to their economies (Horn *et al.*, p. 6).

and difficulties it implies; they suggest different options.³⁰ Wage coordination can be developed as ‘soft guidance’, which requires that the Macroeconomic dialogue be strengthened.³¹ Implementing a golden rule might be easier if limited to minimum wages; however, universal minimum wages do not exist in all EU countries. Thillaye *et al* conclude that a simpler way to tackle imbalances is for the EU to deal with current account deficits and surpluses in a more symmetric way as part of the Macroeconomic Imbalances Procedure. This leaves to national governments and social partners the freedom to adjust the real exchange rate by wages or other means (for instance, by modifying the tax burden). In my opinion, the latter option does not diminish the need for institutions that can deliver on this kind of cooperation. But how can we promote such cooperative institutions? In the next section, I elaborate on that question. But first I briefly return to Schelkle’s alternative analysis.

In a nutshell, Schelkle’s argument boils down to the following: countries in which producers keep on losing out against import competition and that incur persistent current-account deficits will become poor, but they will not risk bankruptcy, unless the accumulating current-account deficits are financed by private capital flows in a way that becomes unsustainable. However, if the monetary union and its member states are equipped with adequate macroprudential policies, financial regulation and a true banking union, the accumulation of current-account deficits does not *per se* lead to financial mayhem across the monetary union. Thus, the problem at hand could be presented as a trade-off between the quality of macroprudential policies, financial regulation and banking union on the one hand, and the need for wage coordination in the euro area on the other hand. To put it bluntly, in this analysis wage coordination may be ‘nice to have’, but it is not ‘necessary’.³² However, even if we would accept that argument, the divergence in prosperity that is a corollary of persistent divergences in competitiveness is fundamentally at odds with the EU’s mission of upward convergence. Hence, my argument in the following section should be understood as motivated not only by a concern with symmetry *per se*, but as motivated also by the ambition to pursue upward convergence in prosperity in combination with domestic cohesion, which is at the heart of the European social model.

5. A POSSIBLE WAY FORWARD: MAINSTREAMING DISTRIBUTIVE CONCERNS IN THE MONITORING OF COMPETITIVENESS

The policies pursued by the EU since the crisis have led to divergence rather than convergence in the practices of collective bargaining across the EU and to divergence in the long-term capacity to deliver on coordination, as shown by Visser.³³ This is illustrated in Figure 4.1. The recommendations of the Euro-Plus Pact of March 2011, the supervisory mechanism in the ‘Six Pack’ of regulations on economic governance adopted by the European Council in October 2011, and the Memoranda of Understanding between the troika of European and international institutions and national governments in countries receiving financial assistance, went invariably in the direction of reforms that weaken multi-employer bargaining and coordination across bargaining units.

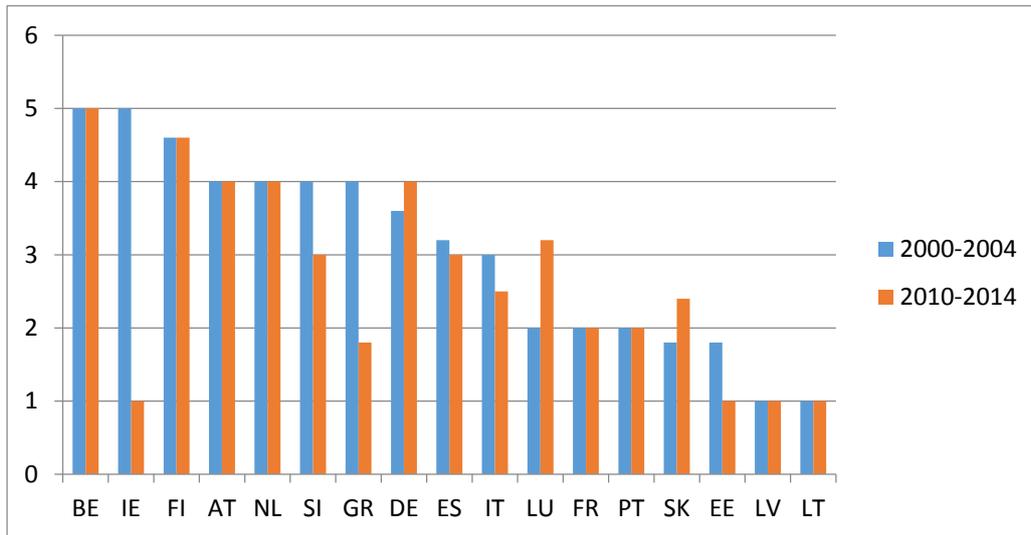
³⁰ Thillaye *et al* (2014).

³¹ Horn *et al.* (2012) stress that such coordination should respect the autonomy of collective bargaining in the member states, whilst pursuing coordination.

³² I thank W. Schelkle for private exchange on this, but the usual disclaimer applies. As indicated in section 1, in this paper I cannot do justice to the richness of the overall analysis in Schelkle (2017).

³³ Visser (2016).

Figure 4.1 Wage bargaining coordination in the Eurozone countries, 2000-2004 and 2010-2014



Source: data selected from Visser (2016), Table 4, p. 24

Note: the extent of wage bargaining coordination is ranked from high (5) to low (1), distinguishing: coordination based on the issuing (by central agreement, government order, or a combination of these) of a binding ceiling or maximum/minimum rate of wage increases (=5); of wage norms, guidelines, patterns or recommendations issued by central organisations or established by a dominant sector, union or employers' association (=4); of negotiation (and conflict mediation) procedures and guidelines issued by central organisations for lower-level bargainers (=3); some form of government coordination through the setting of minimum wage or public sector examples (=2); or none of the above (=1). Averages are calculated over 2000-2004 and 2010-2014, on the basis of the ICTWSS database.

The consequence is that wage bargaining coordination has more or less disappeared in the countries hit hardest during the recession. Thus, the Great Recession has sharpened the divide between a smaller group of countries with more cohesive and coordinated industrial relations and wage bargaining institutions, and lower inequality levels, and a larger group of countries where 'markets make policies', wage bargaining institutions are divisive and uncoordinated, and income inequality levels are higher.

Is it possible to change course, in synergy with the need for symmetric wage cost developments across the Eurozone? More precisely, can we institutionalise a 'golden rule', as sketched in the previous section, and enhance 'delivery', without however imposing uniformity on national wage bargaining institutions? In 2015, Sapir and Wolff formulated a proposal on the coordination of wage policies, inspired by Belgian experience; since it is useful to revisit it, I quote it at length:³⁴

"All euro-area countries should put in place a competitiveness-monitoring framework involving regular assessments and the definition of instruments to prevent problems. An interesting example is the Belgian framework, introduced in 1996 to preserve the country's competitiveness in EMU by keeping the evolution of wages in line with wage developments in the main trading partners. A national body regularly reports on the evolution of Belgian competitiveness relative to its three main trading partners (...). These reports are used by social partners to fix a wage norm for the next round of wage negotiations. Although the norm amounts only to a non-binding guideline, it has generally been respected (...). In case social partners fail to agree a wage norm compatible with the evolution of competitiveness, the

³⁴ Sapir and Wolff (2015), p. 5

government can step in and make the norm legally binding. The system has worked fairly well: it kept untouched the wage formation and bargaining system that existed prior to the euro, but made the behaviour of social partners compatible with membership of the euro area. (...). The Belgian system (...) cannot be exactly copied by other euro-area countries since they typically have different wage formation and bargaining systems. What is important is that all euro-area countries put in place a mechanism to ensure that, although operating within their own system, the behaviour of social partners and the outcome of their wage negotiations is compatible with membership of the euro area in terms of competitiveness and employment. These national mechanisms would constitute national competitiveness councils. We would recommend therefore the creation of a Eurosystem Competitiveness Council (ECC) consisting of both national competitiveness councils and the European Commission. The ECC's primary task would be to coordinate the actions of national competitiveness councils to ensure that no euro-area country fixes a wage norm that implies significant competitiveness problems for itself and/or others. In case this fails, the Commission should have the power to require the relevant competitiveness councils to take corrective action using the MIP and the European Semester instruments.”

This proposal does not deny that wage formation and bargaining systems are deeply rooted and difficult to change; that is exactly the reason why, in Sapir and Wolff's view, deviations in competitiveness must be monitored and corrected before they become too significant and entrenched. The proposal is explicitly symmetric: it also addresses member states in which wage policies entail a significant competitiveness problem for others.

Two features of the Belgian system are important in this respect. First, it is interwoven with social dialogue: competitiveness is assessed by the *Economische Raad voor het Bedrijfsleven/Conseil Central de l'Economie*; this institution represents social partners, and the process is part of their overall bargaining game. Hence, the 'authority' of the procedure is intrinsically related to its being directly embedded in social dialogue.³⁵ Second, the process also operates in the shadow of hierarchy: if the social partners do not deliver on the competitiveness benchmark, as defined by the *Economische Raad voor het Bedrijfsleven/Conseil Central de l'Economie*, the federal Belgian government can step in.

In June 2015, the Five Presidents' Report followed up on this idea and proposed to set up a Euro area system of 'Competitiveness Authorities'. The Report emphasised that the aim of the Competitiveness Authorities should not be to harmonise practices and institutions in charge of wage formation across borders: “Based on a common template, each Member State should decide the exact set-up of its national Competitiveness Authority (...). National actors, such as social partners, should continue to play their role according to the established practices in each Member State, but they should use the opinions of the Authorities as guidance during wage setting negotiations.” As a follow-up to the report, in October 2015 the Council adopted a Recommendation requiring euro area member states to establish national Competitiveness Boards. At the level of each member state, these boards aim to:

- i. monitor competitiveness developments relative to global competitors;
- ii. inform the wage-setting process by providing relevant information;
- iii. monitor policies and formulate policy advice in the field of competitiveness;
- iv. provide advice on the implementation of the Country Specific Recommendations.

Thus, the Council Recommendation was not only softened in comparison to the initial proposal in the Five Presidents' report. It also differs from the initial Sapir-Wolff proposal: putting a strong emphasis on independent experts, it was less embedded in social dialogue and less geared to active

³⁵ At the moment of writing, the Belgian government is legislating on a reform of this system, which (further) constrains the monitoring and negotiation process, against the opposition of the Belgian trade unions. This risks jeopardizing the basic consensus (admittedly with a lot of debate and minor controversies) on the basis of which the system has functioned until now.

coordination. Despite its softer touch (compared to the Five Presidents' Report), the Recommendation was criticised by ETUC: it was seen as instantiating a one-sided view on competitiveness, that would only lead to further attempts to squeeze wages, and as a threat to the autonomy of social partners. The latter fear can also be read in the opinion of the European Economic and Social Committee on the matter.³⁶

The domain of pay is so sensitive that we seem confronted with an intractable policy conundrum. How can we make progress? I suggest three strategic answers. The first is to clearly embed these processes in national collective bargaining, and to strive to create ownership for these processes with social partners. Obviously, in a number of countries collective bargaining is weak or non-existent at the national level; in some countries where it used to be strong, its impact is diminishing. Is it unthinkable to promote national coordination of collective bargaining, in one way or other, where it does not exist, and to reinforce it where it does exist? Looking back at all the efforts to constrain national fiscal policy in various ways since the outbreak of the financial crisis in 2008, it seems a reasonable question to ask: what could have been achieved and what could still be achieved if EU policies invested in the corporatist institutions at national level that are needed to make some sort of (limited) wage coordination work at least tolerably well?

The second strategic answer is that the European Commission and Council should avoid interfering in the details of wage bargaining systems and focus on medium-term outcomes and the credibility of the institutions. The Belgian system has been criticised for the fact that wages are indexed to prices. Whilst the indexing of wages to prices is indeed a debatable feature of collective bargaining systems, with well-known pro's and con's, it is better to leave that sensitive discussion to the Belgian level. Maintaining the indexing of wages to prices implies a 'cost' for the Belgian wage negotiators: sometimes, the system may need long episodes of wage moderation to correct the impact of inflation on wages (notably when inflation is caused by external factors, such as an international increase in oil prices). In the past, the actual implementation of price indexing has sometimes been revised, to address problems of competitiveness. In yet other words, the indexing of wages to prices is an 'insurance mechanism' for trade unions with a premium attached to it. But, if Belgian wage negotiators compromise on such a system and are nevertheless able to maintain competitiveness in the long run, why bother about it at the EU level?

The third strategic answer is to introduce distributive concerns in the process. In a paper on populism and the EU, Buti and Pichelmann argue that we need to "mainstream distributional considerations into EU policy designs"³⁷; the argument certainly applies in this domain. In his list of practical proposals to combat inequality, the late Atkinson included the idea to start a 'national conversation on income distribution':³⁸ Atkinson's proposal goes beyond collective wage bargaining (it also refers to policies on benefits), and it seems particularly motivated by the decline of collective bargaining in the UK, but it would make sense in many countries. Suppose the EU would ask national social partners and governments to keep an eye both on external competitiveness and the wage share, in one and the same process. Admittedly, this is a complex assignment: when inflation rates differ and exchange rates cannot be adjusted, maintaining external competitiveness and keeping the wage share constant are conflicting policy stances, at least in the short run. However, if there is convergence in inflation rates on the basis of the inflation target of the ECB, the 'golden rule' yields both the maintenance of external competitiveness and the maintenance of the wage share. Figure 5.1 illustrates the complexity

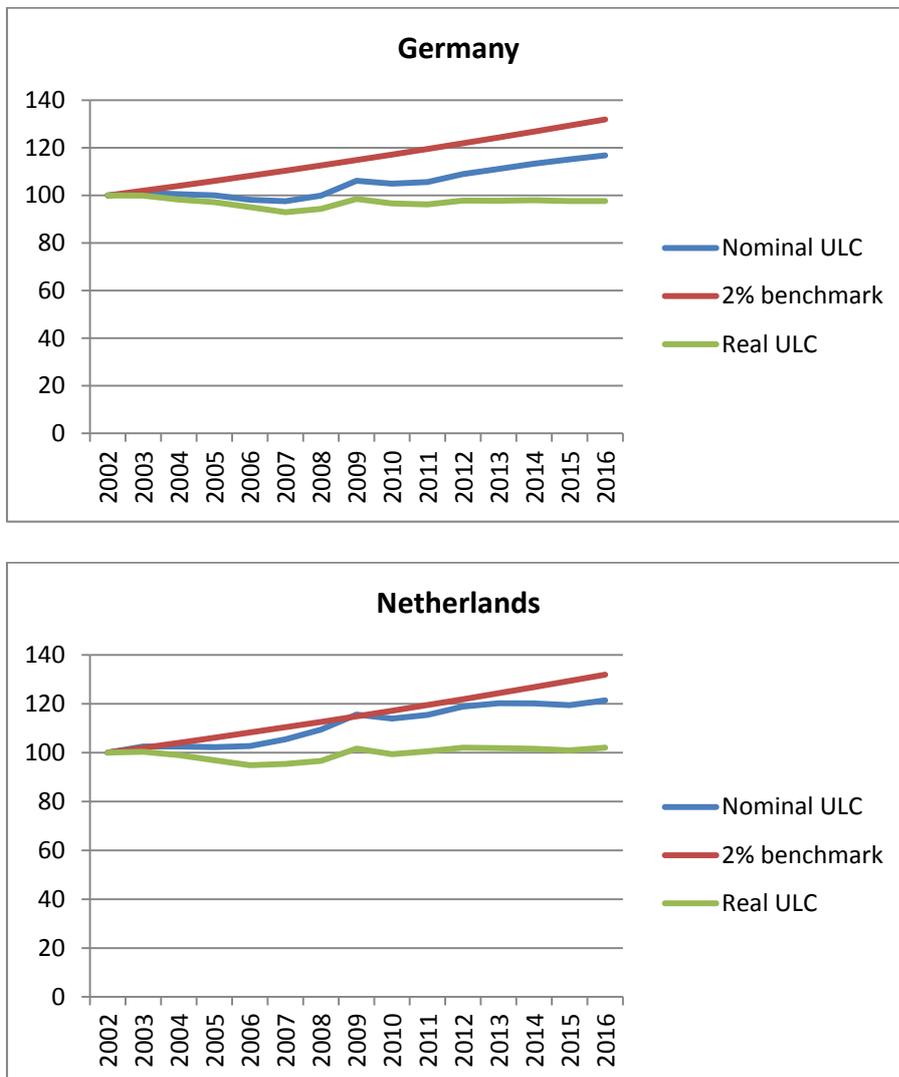
³⁶ "The wage-setting system should be left to the collective bargaining partners, without any interference from outside. Their autonomy has to be fully respected and guaranteed. They have the best understanding of the actual situation in relation to wage setting and labour markets. The collective bargaining partners take into account the fact that changes to wages have effects on both costs and demand. They are well aware that aligning wage increases with medium-term national productivity growth plus the ECB's target inflation rate has a neutral impact in terms of prices, competitiveness, domestic demand and income distribution. The need for strengthening the macroeconomic dialogue is fostered by the fact that this awareness differs from Member State to Member State and sometimes finds no practical expression, thus giving rise to imbalances." (European Economic and Social Committee, 2016)

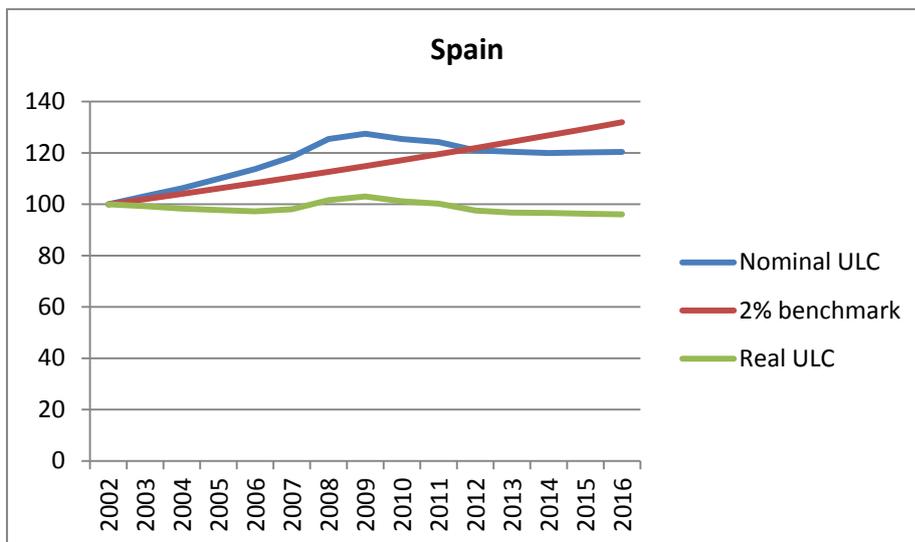
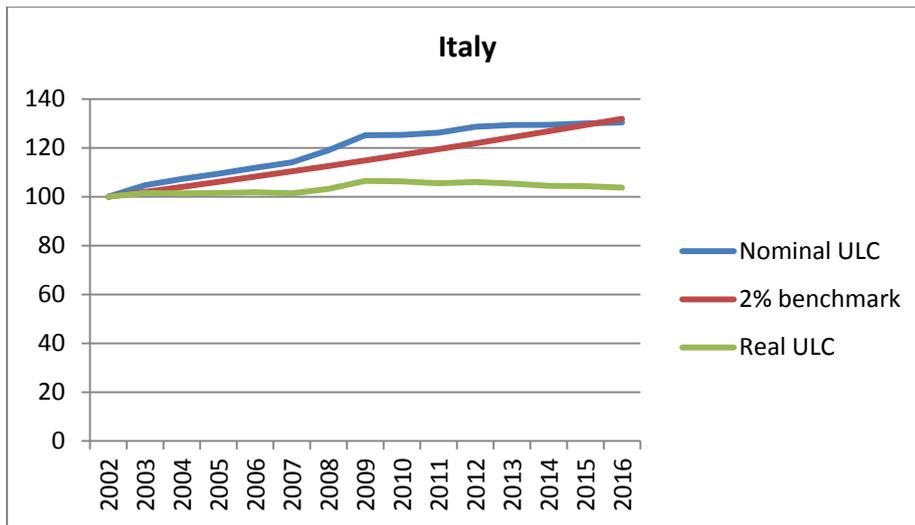
³⁷ Buti and Pichelmann (2017).

³⁸ Atkinson (2015), pp. 153-154.

but also the relevance of such a ‘dual’ assignment: the red line indicates a symmetric benchmark for nominal unit labour costs, based on an increase of 2% per year (the ECB inflation target); the blue line shows the actual development of nominal unit labour costs; the green line shows the development of real unit labour costs, which is a corollary of the (adjusted) wage share. The difference between the evolution of nominal unit labour costs (blue line) and real unit labour costs (green line) is determined by the rate of inflation (more precisely, by the difference between nominal GDP growth and real GDP growth); all indicators are based on an index 100 for the year 2002. The Figure show that the (hypothetical) assignment would have asked for more important wage increases in Germany and the Netherlands prior to the crisis, both because nominal unit labour costs increased with less than the ECB’s inflation target and because the wage share was declining. For Spain and Italy the situation was more complex: whilst nominal unit labour costs were increasing rapidly, the (adjusted) wage share actually was declining before the crisis; the inflationary boom that was developing before the crisis explains this.

Figure 5.1 Nominal unit labour costs and the (adjusted) wage share in Germany, the Netherlands, Spain and Italy





Source: AMECO; the red line defines a Eurozone benchmark for nominal unit labour cost developments.

In short, the ambition should be to engage national social partners in medium-term oriented dialogues in which productivity, wage increases and inflation targets are linked. The primary yardstick applied at EU level, when assessing national wage policies, should be the inflation target of the ECB and the national rate of productivity increase; but keeping the wage share constant should be a ‘distributive’ constraint in the medium term – which requires the avoidance of inflationary developments, such as in Spain and Italy. National social partners and governments should have considerable leeway in their ways and means, as long as there is a credible mid-term commitment to this yardstick. A ‘shadow of hierarchy’ of national governments (in case social partners do not deliver) could be foreseen in the policy architecture in all member states, but the precise way in which it builds upon existing collective bargaining institutions should be left to the member states; the crux is that the national policy architecture that is put in place should be based on a broad consensus. Mainstreaming distributive concerns in the process, may contribute to reaching such a broad consensus.

Admittedly, the experience in Germany and the Netherlands shows that it is easier to obtain ‘moderation’ by wage negotiators in these countries than ‘expansion’ (wage increases), when the

latter is needed from a macro-economic, Eurozone-wide perspective. Whether or not wage increases follow productivity also depends on broader features of the labour market that are influenced by public policies and for which public authorities bear part of the responsibility.³⁹

As explained in the previous section, social partners have been very reluctant to commit themselves to processes they perceive as encroaching on their wage bargaining autonomy. In this respect, trade unions are confronted with an existential question. If they accept to commit themselves to the kind of processes sketched in this section, they have to give up on a notion of ‘unrestrained bargaining autonomy’ that may pay off when their economic and societal position is strong, but they can avoid excessive wage moderation during downturns in particular countries, and they can put the notion of a fair share of wages in national income firmly on the agenda everywhere. This requires a capacity to strike a balance between conflicting tactical and strategic considerations and a capacity to compromise, which – in my mind – will be crucial for the long-term survival of trade unions as relevant European actors and forces for social inclusion.

6. RISK REDUCTION, RISK SHARING AND MORAL HAZARD: A VACCINATION METAPHOR

In this section, I turn to a different strand of arguments about the sustainability of the Economic and Monetary Union, that is, arguments focussing on stability. My point of departure is the case for risk-sharing, as set out in the Five Presidents’ Report on *Completing the Economic and Monetary Union*: next to Banking Union and Capital Market Union, a Fiscal Union is called for, including automatic fiscal stabilisers. In its core, the European Union should become a true ‘insurance union’.⁴⁰ As a matter of fact, all monetary unions but the Eurozone are insurance unions: they not only centralise risk management with regard to banks, they also centralise unemployment insurance. Monetary unions either opt for a downright centralisation of unemployment insurance (like in Canada or in Germany), or they streamline unemployment insurance and provide a degree of reinsurance and centralisation when the need is really high (like in the US, which combine centralisation and decentralisation in unemployment insurance). This is rational behaviour for two well-known reasons. First, risk pooling enhances resilience against idiosyncratic shocks. The second reason also applies when shocks are not idiosyncratic but symmetric across the whole union (and risk *pooling* across member states has no added value *per se*): national insurance systems create an externality; a country that properly insures

³⁹ At the moment of writing, a debate is ongoing in the Netherlands about the call by *De Nederlandsche Bank* (the Dutch central bank) and the *Centraal Planbureau* (the planning office) to accelerate wage increases. In its analysis, the *Financieel Dagblad* remarks that one of the reasons why Dutch unions are probably reluctant to follow this call at this moment, is their fear that even more workers will be shifted to precarious flexible contracts when wage demands increase (FD, 16 June 2017, p.2).

⁴⁰ Schelkle argues that the European Economic and Monetary Union already contains insurance functions, notably via the TARGET2 system. In her analysis, which is based on theories of international risk sharing (in contrast to traditional Optimal Currency Area theory), monetary integration led to instability because it created new interdependencies, which require additional instruments for risk sharing and risk reduction, notably in the financial sphere (and, in a longer term perspective, in housing policies and urban planning). She sees a role for a limited fiscal capacity, to help prevent negative feedback loops between public and private debt, but she warns against further steps in fiscal integration that might generate political tensions due to problems of moral hazard. With proper regulation and insurance, “[t]here is no diversity that cannot, in principle, provide an opportunity for mutually beneficial risk sharing” (Schelkle, 2017, loc. 7427 of the Kindle e-book). However, I think Schelkle’s analysis is not incompatible with the ‘vaccination’ argument I develop in this section. In fact, she recognizes that it is a matter of common concern that some member states raise the effectiveness of automatic stabilizers; she suggests that a more progressive income tax schedule can be a way to achieve this (loc. 2675). I would contend that in that respect, the monetary union is served by convergence (towards effective automatic stabilizers in each of the member states) rather than by diversity. It is unclear to me why ‘diversity’ would be an asset for a monetary union, when that means that some members states have poorly performing social institutions that make them less resilient to shocks.

itself, also helps its neighbours. The problem at hand is comparable to vaccination: vaccines are an archetypal example of externalities: with a vaccine individuals not only protect themselves from infectious diseases but also the people they get in touch with. Hence, it is rational – purely from a view of efficiency – for governments to subsidise vaccination and/or make it compulsory. I will first elaborate upon the analogy with ‘compulsory vaccination’, and then return to its subsidisation.

Prima facie, the vaccination metaphor not only applies to a monetary union but to any highly integrated set of countries, since trade integration suffices to generate externalities of national booms and busts. However, apart from the fact that monetary integration is supposed to promote trade integration, the risk of underprovision of unemployment insurance (our metaphorical vaccine) may be higher in a monetary union. In the short term, unemployment insurance increases the cost of labour. Since exchange rate fluctuations are excluded, nominal wage cost competitiveness is a salient concern in a monetary union. Hence, without some form of coordination, national authorities may be reluctant to provide “costly” unemployment insurance in a monetary union.⁴¹ In short, a monetary union typically features a high risk of cross-border “contagion” on one hand, whilst on the other hand the collective action problem with regard to “vaccination” is salient. Therefore, it is rational for the members of a monetary union to agree on a set of minimum requirements with regard to the stabilisation capacity built into their national social and economic systems.

Which minimum requirements – comparable to mandatory vaccination – should apply? From a preventative perspective, fiscal prudence is a first requirement: member states must not accumulate structural deficits because that reduces their ability to increase public deficits and incur additional debt during a downturn. However, from a stabilisation point of view, fiscal prudence is only a precondition; welfare states must have an endogenous automatic stabilisation capacity to smooth economic shocks. Automatic stabilisation is associated with the size of the public sector and the level of social spending: the public sector wage bill and social transfers create an inertia-effect, that reduces short-term volatility. So conceived, a significant level of pension spending and a large public education sector act as automatic stabilisers. However, in the domain of public spending, the most effective instrument for stabilisation in case of an unemployment shock is unemployment insurance: it kicks in when people lose their income because of unemployment, which makes it crucially different from pension spending (or, from a universal basic income, for that matter). Automatic stabilisation is also associated with the average effective tax rate (notably in case of an ‘income shock’)⁴², which is in turn associated with the size of the public sector and social spending. However, research by Dolls et al. suggests that the *difference* in the stabilisation capacity across EU countries is crucially linked with the shape of the benefit system, and notably with the performance of unemployment insurance. This provides a first reason why one should zoom in on unemployment insurance, if the internal stabilisation capacity of member states is seen as a matter of common concern. The second reason, for focusing on unemployment insurance, is that the level and progressivity of taxation is a sensitive national issue, whilst the need for effective unemployment insurance is widely shared across welfare states of different types.

Therefore, we should focus on the quality of unemployment insurance. The stabilisation capacity of unemployment benefits depends on their generosity (notably for the short-term unemployed) and their coverage. Hence, a ‘compulsory vaccination’ programme against instability would include minimum requirements with regard to the effective coverage and the generosity of (short-term) unemployment benefits in the participating member states. Do they cover all employees or do large groups remain uninsured, as was traditionally the case in Italy (which explains why the stabilising role of unemployment benefits is so limited in that country)?⁴³ Are they generous enough to have a

⁴¹ In the US in the 1930s, federal initiatives to streamline and support state unemployment insurance were motivated by this classical problem of collective action; see Simonetta (2017). For a discussion of the US system and its relevance for the EU, see also Fischer (2017) and the specific US case study referred to in Vandenbroucke and Luigjes (2016).

⁴² See Figure 3 and Figure 4 in Dolls et al (2012b); note that the association with the effective tax rate is stronger in the case of an income shock than in the case of an unemployment shock; see also Dolls et al (2012a).

⁴³ For a comparison of the coverage ratio of unemployment benefits, see below Figure 6.1 in section six; for a systematic discussion of coverage rates, see Esser et al. (2013).

stabilising impact, without creating inactivity traps? For national welfare states, unemployment benefits are the metaphoric camel's nose: whether they generate resilience, i.e. whether they function as an effective shock-absorber without negative side effects, also depends on general features of labour markets and the quality of the activation policies. Labour market segmentation that leaves part of the labour force poorly insured against unemployment, or the proliferation of employment relations which are not integrated into systems of social insurance, reduce the stabilisation capacity of welfare states. Poor activation leads to hysteresis, rather than resilience... In other words, a 'vaccination programme' for resilient national welfare states entails a cluster of principles for labour market policies.

It is important to note that the preceding argument – drawing upon the metaphor of compulsory vaccination – is not premised on the idea that the Eurozone would itself be equipped with automatic stabilisers. However, it is no coincidence that vaccination is being subsidised both in countries where it is mandatory and in countries where it is not. Economic theory indeed learns that goods and services with positive externalities should be subsidised in order to reach an optimal level of consumption. In the Eurozone, it would be rational to associate *reinsurance* of national schemes (granting a European subsidy to national systems when the need is high) with minimum requirements on the stabilisation and activation qualities of these national schemes. In other words, reinsurance (which creates a temporary subsidy to keep the national 'vaccine' against economic volatility affordable) and a compulsory vaccination programme would go hand in hand. Such an insurance device would create a fiscal union of a special kind, which is politically easier to obtain than a fully-fledged budgetary union. It is an illusion to think the EU will develop a federal budget like in the US or in Canada, but a relatively small insurance premium could have the same stabilising impact.

How should automatic fiscal stabilisers be organised? Over the last few years, several proposals have been published, some of them linking such stabilisers to the national unemployment systems of the member states.⁴⁴ These proposals typically imply that member states contribute to a common fund that disburses money to member states affected by negative shocks, e.g. a significant increase in unemployment. A research consortium led by the Centre for European Policy Studies (CEPS) examined many different variants of a European Unemployment Benefit Scheme.⁴⁵ The complexity of setting up a genuine European Unemployment Benefit Scheme, even if it only complements existing national schemes, should not be underestimated. Moreover, any European scheme should exclude permanent transfers in favour of certain member states and avoid a structural redistribution of resources between the countries: it should instantiate a pure insurance logic, covering risks that affect all countries participating in the scheme to the same extent. My conclusion from this research is that it is easier to meet these conditions and to implement such a scheme, if it takes the form of 'reinsurance' of national insurance schemes, rather than being a genuine European unemployment benefit scheme, that would create European benefits for individual European citizens. Reinsurance not only allows more flexibility and offers more scope to mitigate the risk of institutional moral hazard (I return to moral hazard below); it also seems the less complicated option.⁴⁶

In a sense, the rationale for reinsurance is simple: prevention is better than cure. Although a degree of solidarity has developed within the Economic and Monetary Union since the crisis, it only came about after difficult intergovernmental negotiations. Solidarity was not *ex ante* rooted in the European fabric, it occurred *ex post*. This has two drawbacks. Organising solidarity *ex post* in an intergovernmental setting implies repeated ad-hoc negotiations about burden sharing and conditionality, which easily leads to conflict and polarisation between governments and their electorates. *Ex post* solidarity is also more expensive than *ex ante* solidarity if the latter has a

⁴⁴ Bablevy et al. (2015) and Oksanen (2016) discuss the rationale of a European insurance scheme, make several suggestions and propose a comprehensive bibliography. For an account of the debate on European unemployment insurance and for an additional bibliography, see Strauss (2016).

⁴⁵ For the results of this research see <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7959>

⁴⁶ For a discussion of the differences between a reinsurance scheme and a genuine European unemployment insurance scheme, see Vandenbroucke (2017, p. 158 and note 14) and Vandenbroucke (2016).

preventative impact. This certainly applies to economic instability: since economic swings are driven by expectations, the expectation of a shock-absorber doing its job is in itself a way of preventing severe shocks. With a view to resilience, risk reduction and risk sharing reinforce each other.

This preventative dimension also explains why 'private insurance mechanisms' through international financial markets need complementary 'public insurance mechanisms' through budget transfers. International markets will be less prone to panics and 'sudden stops', when public insurance mechanisms are expected to cushion the most serious shocks. This is exactly the message to be found in much of the recent work of the IMF on the Eurozone: Banking Union, Capital Market Union and fiscal stabilisers 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.⁴⁷ 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 stabilisers are complementary solutions: 3 x 1 is more than 3 in this case. Hence, even if the design of automatic stabilisers entails a complex discussion, we should not postpone that discussion: one day, the concurrent existence of a Banking Union, a Capital Market union and automatic stabilisers may constitute a formidable institutional asset for the Economic and Monetary Union, and thus for the European project at large.

Solidarity is always intrusive. If the aim of European solidarity is to contribute to stabilisation, a logical corollary is that the stabilisation capacity of the *national* socio-economic systems must be sufficient: maintaining (and, in some countries, reinforcing) the stabilisation capacity of national systems becomes the self-evident political *quid pro quo* for organising European support. Moreover, the possibility for member states that benefit from a European support for their unemployment benefits to become 'lax' with regard to the activation of the unemployed and (re)employment policies at large, generates an obvious risk of institutional moral hazard. We should not become totally obsessed with moral hazard. Moral hazard is unavoidable in any context of insurance. If you're obsessed, and you want to eliminate the faintest possibility of moral hazard, you'll never be able to organise insurance and reap the benefits of collective action. On the other hand, we should not dismissive about moral hazard: we should address it, and find solutions to minimise it. The risk of moral hazard can be reduced through financial mechanisms. A European reinsurance can be based on the degree to which short-term unemployment in member states deviates from its historic (national) profile, so that long-lasting structural differences between countries don't have an impact. High thresholds for intervention can guarantee that the fund only intervenes in case of severe shocks (very significant deviations from a country's historic profile). 'Experience rating' can be introduced, to minimise the risk that a member state becomes a permanent beneficiary of such a scheme.⁴⁸ The more stringent these regulations, the weaker the insurance mechanism, though they can be essential for political support. But, next to financial mechanisms, moral hazard is also reduced by establishing minimum requirements on the quality of the member states' activation and employment policies. If these minimum requirements are effective, more room is created for a powerful insurance mechanism. For solidarity to be effective, it needs to be somewhat intrusive.

Europe is a union of welfare states with no intention to become a federal welfare state; but, in this endeavour, we are considering a well-known problem of federal welfare states, where unemployment benefits and employment policy are managed at different levels. There is an institutional risk of moral hazard when a central government is responsible for unemployment benefits while the states,

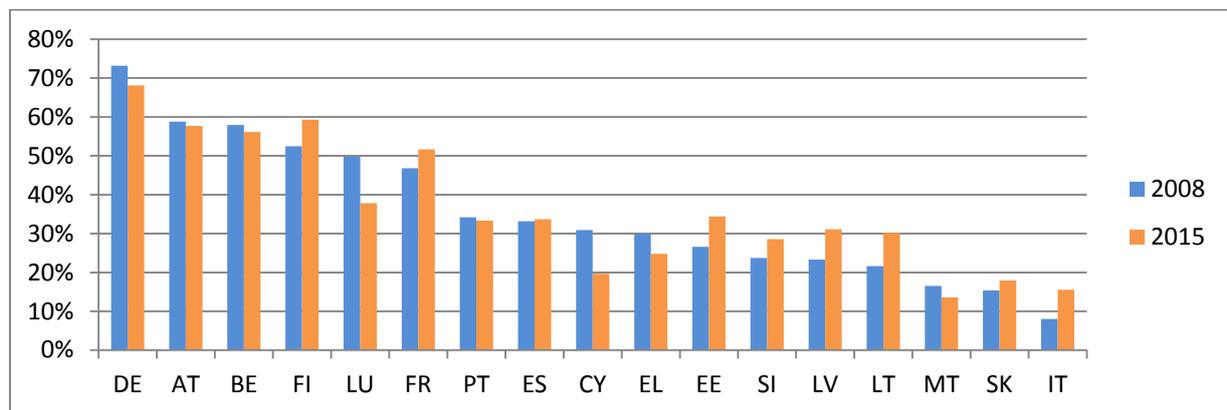
⁴⁷ Allard et al (2015); Furceri, D. and A. Zdziencicka (2013).

⁴⁸ Experience rating ensures that the pay-in that countries or individuals have to contribute to the supranational fund differs depending on their past experience with unemployment. It exists in the US, for employers: the tax due to finance the unemployment insurance scheme is higher for companies that have laid off more workers in the past. In a similar way, in an inter-state insurance scheme, countries with a higher or more volatile short-term unemployment rate may be requested to pay a higher contribution, relative to their GDP, than other countries.

provinces, regions or municipalities are responsible for activation. In this respect, it is interesting to look into countries such as the US, Canada, Germany, Belgium, Austria or Switzerland. A detailed study shows that, in all of these countries, institutional moral hazard, whether implicit or explicit, is an issue of politics and policy. There is a wide range of solutions: minimum requirements on the quality of policies, more or less complex financing models, direct control through coordination mechanisms, etc.⁴⁹ Ever since the European Employment Strategy was launched in 1997, 'coordination' has been part and parcel of the Union. The 2014 Youth Guarantee, which is closely connected with the Employment Strategy, could be seen as a European quality assurance system regarding activation. These mechanisms are too 'soft' to underpin a European reinsurance of national unemployment schemes, but the perspective of a European reinsurance could also be the trigger to make them more ambitious and to give them more bite: in the context of an insurance logic, this would create a legitimate *quid pro quo*. Binding commitments can leave leeway for differentiation in the concrete policies: the essence is that commitments are complied with, not that they are elaborated in detail. There is no need for a homogeneous European social model, but there is need for an agreement on *some* key functions it has to serve.

Hence, there is an intrinsic link between the debate on the *European Pillar of Social Rights* and the debate on Eurozone stabilisers. It is imperative to sort out the priority fields in which convergence is necessary. A priority field for convergence is unemployment insurance: this concerns principles with regard to the generosity and coverage of unemployment benefits, but also principles of activation, and broader principles of labour market regulation that allow universal access to unemployment insurance for all workers. This priority follows from the preceding analysis, but it is also reinforced by the observation that recent trends (since 2009) point to reductions of and dispersion in the quality of unemployment insurance systems across the EU at large, both with regard to benefit generosity, benefit coverage as with regard to the coverage of active labour market policies.⁵⁰ Figures 6.1 and 6.2 display recent trends in the coverage and generosity of short-term unemployment benefits across the Eurozone.

Figure 6.1 Effective coverage of unemployment benefits for the short-term unemployed

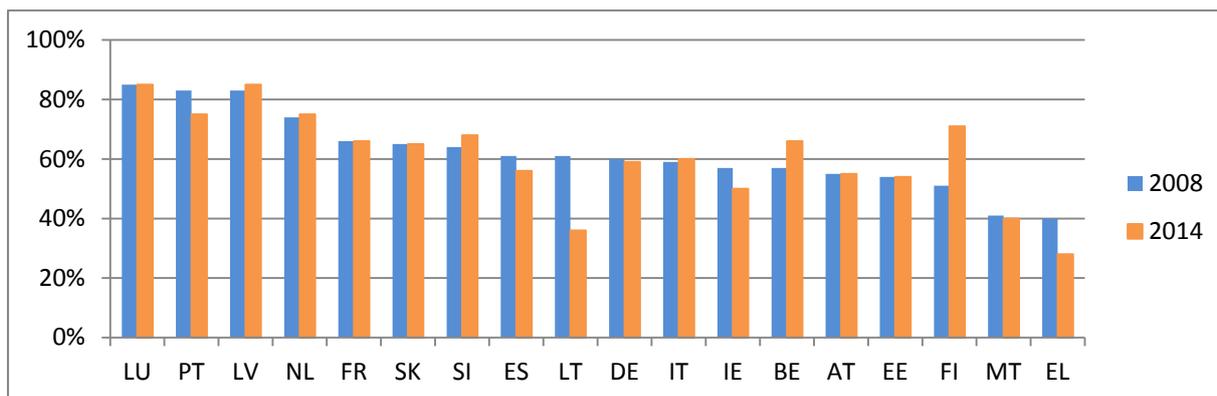


Source: European Commission (2017), Selected data from Chart 1.34, p. 63

Figure 6.2 Net replacement rates of unemployment benefits after 2 months of unemployment

⁴⁹ Vandenbroucke and Luigjes (2016) compare eight countries in which different levels of government are accountable for unemployment benefits and the activation of the unemployed.

⁵⁰ European Commission (2017), p. 63, and 68-69, and Table 1.1.



Source, European Commission (2017), Selected data from Chart 1.39, p. 65

7. ENHANCING THE RESPONSIVENESS OF MARKETS

In section 4, I referred to the classical ‘competitiveness channel’, as one of the channels of adjustment in a monetary union. It relies on the invisible hand of the market, and for it to work well, markets have to be fully integrated. This underscores the importance of completing the Single Market: reforms that facilitate the cross-border integration of product markets such as harmonisation of regulation, opening up sheltered sectors, deregulating closed professions and reductions of red tape, can help to improve the functioning of the euro area.⁵¹ Next to product market reform, labour market reform can enhance the competitiveness channel; in their survey of ‘structural reforms’ needed for the euro area, auf dem Brink and Enderlein refer to “reforms that increase the flexibility of wages and employment such as wage bargaining on plant-level and employment protection legislation reform that allow employers to react to upswings and downturns of the economy, reforms that increase labour mobility such as benefit portability and degree recognition”.⁵² As mentioned in section 3, the need for labour market flexibility is based on the traditional theory of Optimal Currency Areas, which explains that the members of a monetary union are confronted with a trade-off between symmetry and flexibility. However, there is an important qualification to this traditional textbook analysis: the trade-off between what fiscal stabilisers can achieve and what labour market flexibility can achieve depends crucially on the nature of the economic shocks. De Grauwe and Ji argue that when shocks are the result of business cycle movements, the way to deal with them is by stabilisation efforts, not by ‘structural reforms’ for more flexibility.⁵³

Obviously, permanent shocks cannot be excluded. An approach that is deliberately ‘eclectic’, in the sense explained in section 1, should take that possibility on board.⁵⁴ What kind of flexibility is needed in the case of permanent shocks, to facilitate the necessary reallocation of labour and capital? Flexibility is a container concept: there is a ‘high road’ to labour market flexibility, based predominantly on skills and work organisation, as opposed to a ‘low road’, based predominantly on mere deregulation of labour markets. At first sight, one might think that these varieties of labour

⁵¹ This argument is made by auf dem Brinke and Enderlein (2017); see notably p. 8.

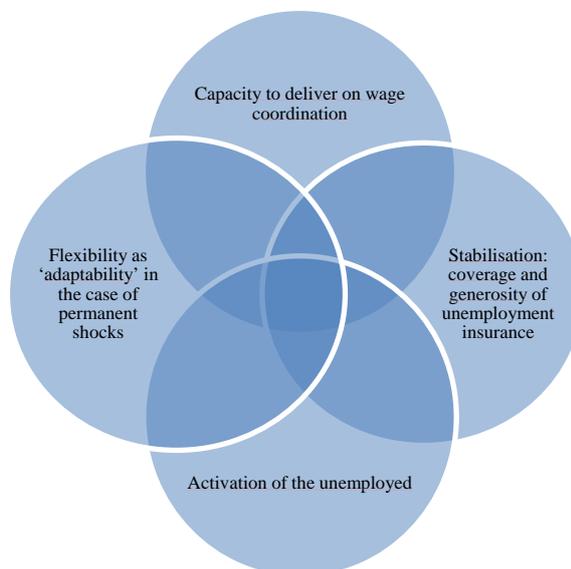
⁵² Ibidem, p. 8.

⁵³ De Grauwe and Ji (2016).

⁵⁴ An important *caveat* to be mentioned here, is that it is *ex ante* not always easy to distinguish permanent from temporary shocks. In other words, the background institutions of the monetary union must be ‘ready’ for both permanent and temporary shocks, and a reinsurance scheme in support of national unemployment insurance systems should be designed in such a way that permanent transfers are excluded.

market flexibility are irrelevant with a view to sustaining a monetary union, i.e. that they can be seen as functionally equivalent models as long as they yield mobility of workers and responsiveness of wages to constraints of competitiveness. However, in section 4 we noted that not all systems of labour market regulation deliver equally well with regard to the wage policy coordination that is needed in the monetary union: for instance, a one-sided option for decentralisation of wage bargaining may be detrimental for the capacity to deliver on wage discipline. This qualifies the argument by auf den Brink and Enderlein in favour of ‘wage bargaining on plant level’, referred to in the previous paragraph. In the same vein, certain forms of flexibility (such as reliance on non-standard employment relations without adequate social security coverage) may be difficult to reconcile with an adequate system of unemployment insurance, and thus, stabilisation. Moreover, well-organised employment protection also generates economic and social advantages.⁵⁵ What is needed, is a coherent combination of (i) (a high road to) labour market flexibility that facilitates responses to permanent shocks, (ii) a capacity to deliver on wage coordination, (iii) adequately stabilising unemployment insurance, and (iv) adequate activation of the unemployed (given relatively generous unemployment benefits): it is this combination that is a matter of common concern in a monetary union. The intersection of the four circles in the Venn diagram in Figure 7.1 shows the combination that is to be achieved.

Figure 7.1 Fundamental features of labour market institutions for a beneficial Economic and Monetary Union

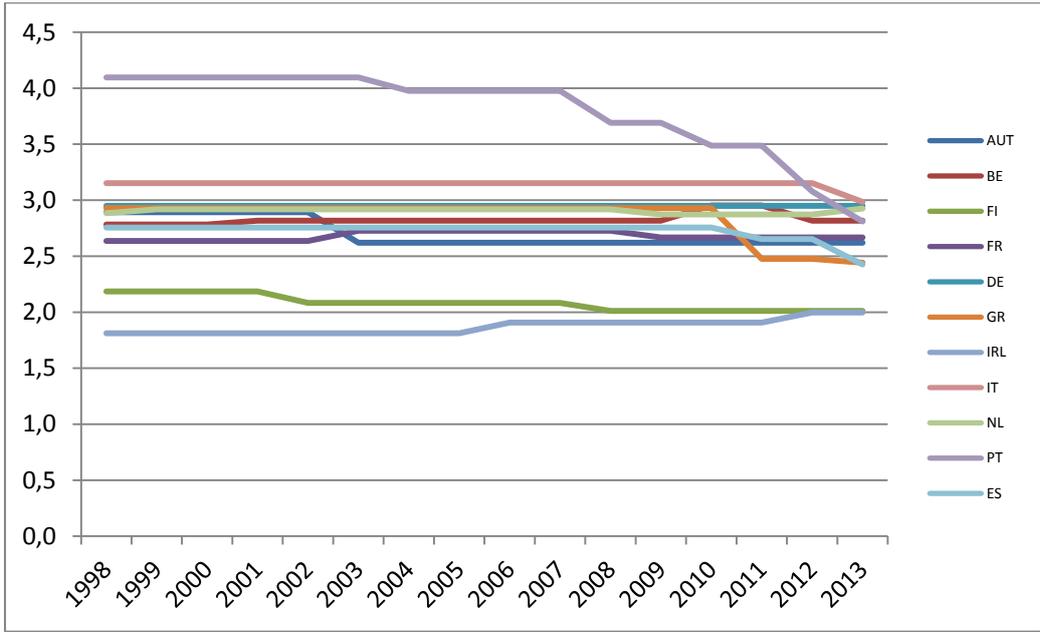


Convergence towards the combination of those features does not mean that the EU should counsel member states in detail on the organisation of their labour markets. There is a limit to the social diversity that can be accommodated in a monetary union, not with regard to the details of their organisation, but with regard to fundamental features that determine their performance. For a system of unemployment insurance to be sufficiently stabilising, some key requirements need to be fulfilled, notably sufficient coverage and short-term generosity. Hence, if one agrees with that argument, in the realm of unemployment insurance the ‘degrees of freedom’ for national policy makers are limited with regard to coverage and generosity; these limitations are also relatively easy to delineate and

⁵⁵ Countouris and Freedland (2013) argue that the need for adequate employment protection and collective bargaining should be reconsidered; for a nuanced assessment of the role of flexibility and protection in economic performance that supports this argument, see the chapter by Crouch in their volume.

assess on the basis of quantitative indicators. In contrast, even in the intersection of the four circles, there remains ample scope for systems competition with regard to flexibility: whether or not labour markets are adaptable when confronted with permanent shocks, depends on many, complex parameters that need national contextualisation to assess them well.⁵⁶ As a matter of fact, on the basis of the available quantitative indicators that are often used in assessments of labour market flexibility, such as the OECD indicators of Employment Protection Legislation (EPL), there has been convergence over the last 15 years. Figure 7.2 illustrates this (with the possible exception of temporary employment regulation in France) on the basis of two key OECD EPL indicators. *Prima facie*, the scope for more convergence *as measured by these EPL indicators* is now more limited than it used to be. With a view to future developments in the EU, a top-down steering of labour market policies on the basis of such (crude) indicators is not very promising.

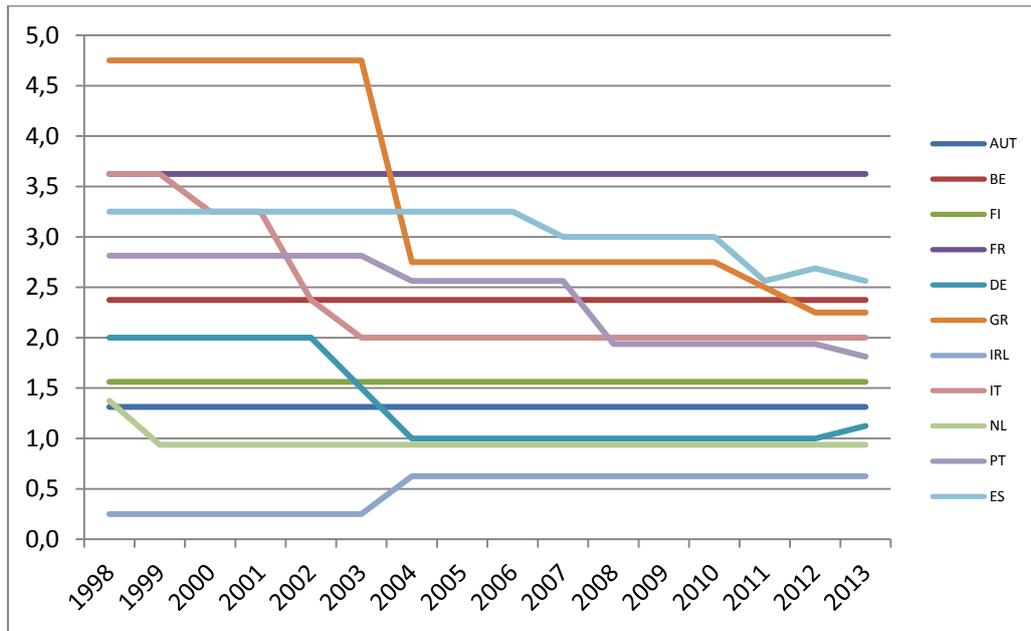
Figure 7.2a Strictness of employment protection, individual and collective dismissals, regular contracts



Source: OECD Employment Protection Database (the indicator shown is eprc_v2)

⁵⁶ In addition, some countries may combine stabilisation instruments in the realm of unemployment insurance with labour market flexibility instruments to cope with cyclical shocks (e.g. *Kurzarbeit* in Germany, ‘economic unemployment’ in Belgium)

Figure 7.2b Strictness of employment protection, temporary employment



Source: OECD Employment Protection Database (the indicator shown is ept_v1)

8. POSTING OF WORKERS AS AN ADJUSTMENT MECHANISM: THE NEED FOR PROPER REGULATION

According to the traditional textbook analysis of monetary integration, mentioned in section 3, cross-border labour mobility is an important flexibility mechanism for monetary unions. The impact of and the existing limits to migration of workers in the EU and the Eurozone have been discussed elsewhere at length.⁵⁷ Although the potential of internal migration in the Eurozone is limited compared to internal migration in the US, free movement of workers is a cornerstone of monetary integration. Free movements implies (amongst other principles) that European citizens are free to reside in any member state of the EU in order to work there, and that national social policies cannot discriminate between workers with a European citizenship, residing in any member state of the EU, on the basis of their nationality. In this section, I argue that the Economic and Monetary Union needs both a regime of free movement of workers and a regime of posting of workers (which supports the freedom of service delivery), and that the two regimes *need each other* and should constitute a well-balanced and sustainable whole.

Posting⁵⁸ has become a controversial issue in the EU, because of widespread feelings that it is difficult to control and that it generates disruptive phenomena of social dumping in particular economic

⁵⁷ For a summary, see European Commission (2015).

⁵⁸ A 'posted worker' is an employee who is sent by his employer to carry out a service in another EU member state on a temporary basis. Posted workers are different from EU mobile workers in that they remain in the host member state temporarily and do not integrate in its labour market, as they maintain an employment contract with an employer in their

sectors. These drawbacks of the current posting regime should be taken at heart and reform is necessary, as recognised by the European Commission; the proposals put forward by Commissioner Thyssen are an important step forward in this respect.⁵⁹ Notwithstanding the need for reform, two arguments militate in favour of having a posting regime; the first is well-known, the second is probably less well-known. The first argument is that posting is necessary for an integrated services market: an integrated services market requires that workers can be sent to other member states for short-term projects, without being employed and affiliated to the social security system of the receiving country. This first argument fits into the broader need for integrated markets and a well-functioning ‘competitiveness channel’, discussed in section 7, above. A second argument can be added to this: if cross-border mobility is to play a role in cushioning asymmetric shocks in the monetary union, then posting may be more effective than traditional channels of mobility in which the worker moves permanently. If country A is hit by an asymmetric unemployment shock, posting of workers (residing in country A) in countries where economic activity and labour demand are stronger, can contribute to cushioning the shock with a maximal positive impact on the budget of country A, since the worker who is posted in other countries immediately generates government revenue in country A. As a short-term stabilising device, posting might be helpful in the context of asymmetric shocks.⁶⁰

Simultaneously, a single market needs a regime of free movement of workers, seeking regular employment contracts in other countries, as a *necessary corollary* to a regime of posting. In yet other words, an integrated, single market for *services*, needs a principle of free movement of *workers* as well. The argument is best explained by a highly stylised theoretical counterfactual for two countries, A and B, with country A being less developed, socially and economically, than country B. Imagine, as a theoretical construct, a situation in which free movement would be limited between country A and country B (say, in specific sectors, or for certain categories of workers, e.g. low-skilled workers), whilst posting would be possible in the context of an integrated, single market of services. This would mean that economic activity in country B (in this sector, or by this type of workers) could only be developed by citizens of country A *on the basis of posting*. Free movement implies a principle of non-discrimination in the application of social and employment policy regimes, which guarantees – at least in principle – a safeguard against practices of social dumping; in contrast, sending workers from country A to country B on the basis of posting allows deviations from the prevailing social and employment policy regime in country B; this is the reason why social dumping can become an issue in the context of posting. Limiting free movement of workers (with the principles of non-discrimination it implies) between A and B whilst allowing posting would, first of all, be unfair from the point of view of workers living in A, since it would make it impossible to work in country B on the basis of the full social and employment policy regime in that country. Moreover, such an imbalance would enhance a dynamic of social dumping: the alternative ‘non-dumping’ option which workers from country A might prefer (compared to the ‘posting’ option), is simply unavailable in this theoretical counterfactual.

The argument developed here not only applies to a monetary union; it applies to the whole single market. *The idea that a single market for services can operate fairly without free movement of workers is ill-guided.* This argument applies *a fortiori* to the monetary union, if posting is seen as a valuable adjustment mechanism, supporting both the competitiveness channel and cyclical stabilisation across a monetary union.

home (‘sending’) country. In contrast to posted workers, EU mobile citizens who work in another member state and have an employment contract with an employer in the latter member state are entitled to full equal treatment with nationals in access to employment, working conditions and all other social and tax conditions.

⁵⁹ See the European Commission’s Press Release of 8 March 2016 (http://europa.eu/rapid/press-release_IP-16-466_en.htm). The proposal led to resistance in a number of member states, leading to an application of the so-called ‘yellow card’ procedure. At the moment of writing, it is unclear how the conflict will be settled.

⁶⁰ The argument is developed by De Wispelaere and Pacolet (2015). There are some limitations to this argument, for instance the fact that *unemployed* persons can never be posted in the context of the provision of services; hence, the argument is based on the possibility that employers confronted with insufficient domestic demand to maintain their workforce can post them to other member states, where there is a demand for their services.

If both free movement and posting are necessary in a monetary union, they should be socially sustainable. The question of to what extent member states can uphold social standards in a context of free movement and posting is particularly relevant with regard to minimum wages. In member states such as Germany and Sweden, trade unions traditionally resisted state regulation of minimum wages: they considered that to be the domain of collective bargaining and a no-go area for public authorities. Thus, they applied a domestic principle of subsidiarity. The *Laval* judgment by the European Court of Justice⁶¹ suggests that that traditional position may be unsustainable: the Court argues that only *predictable* systems of minimum wage protection can be imposed on foreign companies that post workers: member states must create a legal context in which only generally applicable minimum wage protection has to be respected by foreign service providers. This means that social partners should reconsider traditional positions on subsidiarity within welfare states, which means that they should reconsider the respective roles of social partners and public authorities, or, reconsider the relation between nationwide collective bargaining and local bargaining. The actual responses in Sweden and Denmark to the *Laval* case reaffirm the autonomy of collective bargaining, but introduce conditions for the exercise of collective action: collective agreements can be enforced only through collective action against foreign service providers if they correspond to existing nationwide collective agreements and do not define conditions beyond the hard core of the Posting of Workers Directive.⁶² Hence, the Swedish and Danish domestic responses also change the rules of the game in terms of the subsidiarity of the national versus the local level. Politically, the upshot of such developments might be that the case for a pan-European framework with regard to the concept and regulation of minimum wages becomes more plausible too: both at the domestic and the European level, we might have to reconsider the application of subsidiarity principles.⁶³

Together with the *Viking* judgment⁶⁴ (which did not concern the free movement of services, as in *Laval*, but the freedom of establishment), the *Laval* judgment however raises a more fundamental problem than merely the requirement of ‘predictability’ of minimum provisions. Prior to these decisions, the Court had attempted to respect the original settlement contained in the Treaty of Rome that social policy was largely a matter for domestic law. It had deployed a number of techniques to protect national social policy from the application of the (hierarchically superior) economic provisions on the internal market. However, in *Viking* and *Laval* the Court applied its internal market case law with full vigour. The moment collective action was found to be a ‘restriction’ and thus in breach of EU law, the social interests were on the back foot, having to defend themselves from the economic rights of free movement. The Court has made it difficult to defend the social interests due to its strict approach to justification and proportionality. Moreover, because the Court applied the freedoms to an area expressly excluded from EU competence (strikes) it created a legislative vacuum. It potentially struck down the national rules but the EU could not deal with the problem created by the Court given the absence of express competence for the EU to act. This is one aspect of the so-called social deficit in the EU, as Barnard and De Baere put it.⁶⁵ It is not impossible to solve this problem; Barnard discusses different solutions, of which a reform of the proportionality principle seems the most promising one.⁶⁶

Feenstra argues that the *Laval* regulatory conundrum is not as big as some have argued; however, there is one matter that gives pause for concern in Feenstra’s review.⁶⁷ Articles 49 and 56 TFEU are

⁶¹ ECJ, judgment of 18 December 2007 in *Laval un Partneri*, C-341/05, EU:C:2007:809.

⁶² Blauburger (2012).

⁶³ The argument developed in this section is not specific to the Economic and Monetary Union; it holds for the Single Market at large. As a matter of fact, most Eurozone countries have a statutory minimum wage, which means that their system complies with the requirements of transparency, predictability and universal coverage emphasized here; the exceptions are Austria, Finland and Italy, where there is no statutory minimum wage. In Finland, minimum wages are determined in (sectoral) collective agreements, and a public commission under the Ministry of Social Affairs and Health formally decides whether collective agreements are generally binding (Eurofound, 2016).

⁶⁴ ECJ, judgment of 11 December 2007 in *International Transport Workers' Federation and Finnish Seamen's Union* (‘*Viking Line*’), C-438/05, EU:C:2007:772.

⁶⁵ Barnard and De Baere (2014).

⁶⁶ Barnard (2013).

⁶⁷ Feenstra (2017, forthcoming).

directly effective and apply both to member states and trade unions, but the Posting of Workers Directive leaves considerable regulatory margin to the Member States on matters concerning public policy provisions. Trade unions cannot avail themselves of that same public policy derogation. According to Feenstra, “[t]he approach of the Court imposing on trade unions the same limits the Court imposes on Member States’ authorities while refusing to entrust trade unions with the task of determining the nature of the public social order appears at odds with the different regulatory instruments (including the implementation of Directives by social partners) used in Member States to attain public policy objectives”. Unlike *Laval*’s regulatory conundrum, the question how to balance economic freedoms and fundamental social rights (the *Viking* conundrum), appears far from resolved. Feenstra argues that the proportionality principle is, in principle, an appropriate tool to balance between the economic and social rights of the EU, provided the EU follows a different, alternative approach than the very strict application of proportionality in *Viking*.

9. THE ECONOMIC AND MONETARY UNION, THE SINGLE MARKET, AND THE WIDER DEBATE ON THE SOCIAL DIMENSION OF THE EUROPEAN UNION

On 26 April 2017, the European Commission published its proposal for a *European Pillar of Social Rights* and a *Reflection Paper on the Social Dimension of Europe*.⁶⁸ The Pillar and the parallel initiatives announced by the Commission respond to some of the stability-related challenges identified in this essay, such as the need to avoid a proliferation of precarious employment relations which are not integrated into systems of social insurance and the need to assure a certain quality of unemployment insurance in the Eurozone countries. The Pillar initiative is obviously only at a stage of agenda-setting, but it may create an important momentum.

The Commission indicates that the Pillar of Social Rights is “primarily conceived for the euro area but applicable to all EU Member States wishing to be part of it.” The argument is that the principles set out in the Pillar create resilient welfare states, which we definitely need most urgently in the Eurozone, but not only there. In contrast, the *Reflection Paper on the Social Dimension of Europe* sketches two possible options to strengthen the EU’s social dimension: one option would confine the *whole* social dimension to the Eurozone countries; another option would develop the *whole* social dimension for the EU27. The way in which these options are introduced in the *Reflection Paper* is not very satisfactory, as it lacks analytical clarity.

An upshot of the approach suggested in this essay is that one should carefully distinguish between the ‘social corollary’ of the Economic and Monetary Union and the ‘social corollary’ of the Single Market: they partly overlap, they partly differ. However, if there is an overlap, solutions cannot be confined to the Eurozone. Three examples can illustrate this:

- i. An example of ‘overlap’ is the regulation of freedom of movement and posting: this is a social corollary of both the Economic and Monetary Union and the Single Market, for reasons explained in section 8 (moreover, freedom of movement and posting are mutually interdependent principles); but this also means that such regulation cannot be confined to the Eurozone, even if there are some particular ‘Eurozone’-arguments involved; that would distort the necessary level-playing field in the Single Market.

⁶⁸ European Commission (2017b and 2017c).

- ii. The creation of a level playing-field in health and safety at work is a different example: this is a corollary to the Single Market and not of the Monetary Union *per se*; again, developing a specific policy on health and safety at work in the Eurozone would distort the level playing-field in the Single Market.
- iii. Common standards with regard to the quality of unemployment insurance and activation are a corollary of the Monetary Union, for reasons explained in section 6. Specific standards on the quality of unemployment insurance and activation for the Eurozone would *not* be problematic for the Single Market (even if one might consider it legitimate to develop such standards for all EU27 member states).

In yet other words, it is rational and feasible to develop a Eurozone framework for some specific functions of welfare states (such as unemployment insurance), but for some other dimensions one needs the scope of the Single Market.

Finally, it should be clear that analyses starting from the functional prerequisites of the Monetary Union and the Single Market do not exhaust the theme of social Europe. There may be legitimate political arguments, unrelated to monetary unification *per se* and unrelated to the Single Market *per se*, to develop an active social dimension to the EU. The aspiration of upward convergence across the member states and social cohesion within the member states was at the heart of European cooperation, long before the monetary union and the Single Market were launched. In this essay I did not elaborate on social investment: I consider social investment an important concept to guide social policies in the European Union at large, with a view to upward convergence in prosperity and social cohesion. Social investment advocates certainly concur with the idea that the combination of ‘enabling’ and ‘protective’ social policies creates resilient social systems, and would emphasise that social investment adds to this.⁶⁹ But the argument in favour of social investment it is not a functional corollary of the monetary union as such; neither is it tied in specifically with the Single Market. On an abstract, analytical level, there is no *a priori* reason preventing a particular subset of European Member States, different from both the Eurozone and the Single Market countries, to set up enhanced cooperation in the domain of social investment. Politically, it may be an ill-guided choice to create such a subset of countries; there may be positive political argument to associate cooperation on social investment with either the Eurozone or the Single Market. But this is a matter of political choice, within a variegated range of available options.

10. CONCLUSION: POLICY POINTERS FOR A FUNDAMENTALLY POLITICAL QUESTION

Does a monetary union, for it to be successful, impose limits on the diversity of social systems in its member states? The observation that there is a social corollary to monetary unification is not new. Already in the 1990s, the emphasis on reform in labour markets in the European Employment Strategy was justified by the advent of the monetary union. The argument, then, was mainly about supply-side *flexibility*; an agenda for more flexible labour markets was interwoven with an agenda of investment in labour market opportunities for all and the development of ‘enabling’ policies. The argument developed in this essay is broader: in order to sustain a well-functioning monetary union that serves the EU’s fundamental aspirations, we need a consensus on labour market institutions that support *symmetry* and *stability*. In addition, the monetary union calls for integrated competitive

⁶⁹ On the role of social investment in the EU, see Hemerijck (2017). See my argument that the EU should support ‘dual use packages’ according to a social investment logic, with a view to promote upward convergence and social cohesion, in Vandenbroucke and Rinaldi (2015).

markets for goods and services and cross-border mobility of labour, which in turn entail a social corollary: well-balanced and socially sustainable principles of free movement of workers and posting. In making this analysis, we should however avoid the overstretching of functionalist arguments: what is 'needed' and what is 'called for' by monetary unification in Europe, depends on the fundamental aspirations that drive the European project at large. This is the way in which expressions such as 'need' and 'necessity' are to be understood.

With a view to symmetry, the monetary union needs a visible hand to guide the developments of wage costs across the union in a truly symmetric way. The monetary union and its Member States need labour market institutions that can deliver on this kind of guidance; this limits the diversity of social systems cohabiting in a monetary union, since it excludes totally decentralised and uncoordinated bargaining. I argued that institutions that monitor competitiveness should be embedded in social dialogue, and that distributive concerns should be mainstreamed in the monitoring of competitiveness: mainstreaming distributive concerns into competitiveness makes the 'assignment' for national social partners more complex and challenging, but such an encompassing approach may stand a better chance to achieve legitimacy. From this perspective, the decentralisation of wage bargaining can be a complementary strategy but not a substitute for coordinated wage. EU guidance should not be bothered by details of wage bargaining systems (such as the presence or absence of price indexation mechanisms); it should focus on the medium term and on the credibility of institutions that coordinate national actors with regard to wage increases, productivity, and inflation targets. Admittedly, this argument raises an existential question for unions and employers' organisations in Europe: can they commit themselves to the coordination of wage bargaining, with this dual perspective of competitiveness and fair distribution?

With a view to stability, the stabilisation capacity of national systems is a matter of common concern in a monetary union. Stabilisation capacity entails a cluster of principles with which member states should comply:

- i. sufficiently generous unemployment benefits, notably in the short-term;
- ii. sufficient coverage rates of unemployment benefit schemes;
- iii. no labour market segmentation that leaves part of the labour force poorly insured against unemployment;
- iv. no proliferation of 'new' employment relations which are not integrated into systems of social insurance;
- v. effective activation of unemployed individuals (to fight moral hazard, associated with unemployment insurance);
- vi. and, last but not least, on the level of macro-economic surveillance, the need for countries to constitute budgetary buffers in good times, so that they can let the automatic stabilisers work in bad times.

These principles are important *per se* (they constitute a 'compulsory vaccination programme'); they become truly imperative, as a *quid pro quo*, if a European re-insurance would be introduced (a scenario in which this vaccination programme would be subsidised).

The foregoing features of social systems all refer to the need for 'visible hands', supporting an correcting market outcomes. A well-functioning monetary union also needs the 'invisible hand' of integrated and competitive product markets; it needs labour markets with a capacity for adaptation, (notably in coping with permanent asymmetric shocks) and cross-border mobility of workers. In this respect, the agenda of the monetary union and the Single Market coincide; its social corollary is the

need for a well-balanced and socially sustainable regime of free movement and posting. Next to reform in the regulation of posting, the upshot is that national minimum wage regimes should be transparent, predictable and universal in coverage, in all the member states; also, the question of how to balance economic and social rights (following on the *Viking* judgment) is still lingering on the agenda and needs further clarification.

The requirement of transparency, predictability and universality of minimum wage regimes also militates against a one-sided decentralisation in the regulation of labour markets: coordinating key features of labour markets, such as minimum wages, at the level of the nation states participating in the single market (and, therefore, the monetary union) contributes to the functioning and the social sustainability of the Single Market. There is scope for ‘systems competition’ in the way in which minimum wages are regulated in the member states; however, there is no scope for systems competition when it comes to their transparency, predictability and the need for universal coverage. Flexibility that is needed in labour markets when they are confronted with shocks of a more permanent nature. However, labour market flexibility must be compatible with coordinated bargaining and adequate unemployment insurance for all workers. *Within these limitations*, there is scope for systems competition with regard to labour market flexibility. Unlimited flexibility is not good *per se*: well-organised employment protection also generates social and economic advantages. In this regard, mutual learning processes are more productive than the imposition of any blueprint.

Hence, there is indeed a limit to the social diversity that can be accommodated in a monetary union that has to serve the EU’s fundamental aspirations, not ‘across the board’, and certainly not with regard to the details of labour market institutions, but with regard to some fundamental parameters. Is it possible for a set of diverse welfare states, often perceived as fundamentally different ‘varieties of capitalism’, to constitute a healthy monetary union, so conceived? Can a monetary union be ‘a union of welfare states’, or should it become a welfare super-state? Resonating pessimistic assessments of the monetary union based on the presumption that ‘varieties of capitalism’ are highly path dependent and therefore very difficult to change, Scharpf argues that the variety in the *European Economic and Monetary Union* is simply too large. Solutions for the survival of the Economic and Monetary Union have to be so intrusive that they are both confronted with a problem of democratic legitimacy and that they are not effective. According to Scharpf, after the Great Depression and the Second World War liberal democracies “had learned to protect themselves against the recurrent crises of capitalist economies through strategies of ‘global steering’ that avoided the need for state interventions in the market at the micro level.” What all strategies to solve the Eurozone predicament would have in common, however, is “a radical turn in economic governance – away from the liberal paradigm of macroeconomic ‘global steering’ and toward *dirigiste* strategies of potentially very intrusive state interventions in market transactions at the micro or meso levels of the economy.”⁷⁰

Admittedly, the policies imposed on the Southern Eurozone were intrusive. However, that is not the way the monetary union should normally function and our assessment should be forward-looking: a real Banking Union should prevent the deadly embrace of banks and sovereigns which exacerbated the crisis in Europe, and a preventative approach to the monitoring of cost competitiveness should avoid a return to the huge macro-economic imbalances that existed by 2008 (and, finally, setting up automatic stabilisers may further reduce, *ex ante*, the amplitude of shocks). In a monetary union that is equipped with these policies, ‘steering’ of labour market policies on the basis of a selective and limited set of well-identifiable and measurable features, such as the ones listed in this conclusion, should be sufficient. The main problem is not the fact that ‘steering’ needs to become detailed and intrusive; the main problem is that belief systems about which socio-economic policies are adequate, differ across the monetary union.⁷¹ Therefore, the problem of developing a basic consensus on the kind of social order – the essential features of labour markets – that is compatible with a well-

⁷⁰ Scharpf (2016), p. 31 and 42; see footnote 4 for references to the ‘varieties of capitalism’ literature.

⁷¹ Hassel (2014) and Johnston and Regan (2016) associate the ‘varieties of capitalism’ with differences in belief systems: see notes 4 and 14. This is an interesting insight; however, one should not draw overly static and deterministic conclusions from it.

functioning monetary union is fundamentally political. Finding a political consensus may be easier if we realise that the common concern is not only about flexibility and individual opportunity, which calls upon the resilience of the individual and is to be supported by ‘enabling’ policies; the common concern is also about symmetry and stability, which calls for collective action and is supported by protective policies. Enabling and protective policies can be mutually reinforcing, in creating resilient *social systems*. Such a balanced message may resonate better with the European population than previous discourses.

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