29th annual conference on Alternative Economic Policy in Europe
Parthenope University, Naples/Italy, 27 - 28 September 2023

Social divergences between and within EU member states and the reform of EU economic governance framework: what alternatives?

Prof. Maria Karamessini
Panteion University of Social and Political Sciences

Abstract

In the paper we examine social divergences between and within EU member states from the beginning of the 2008 global financial crisis to date, to establish trends in the reinforcement/weakening of social cohesion in the EU. Social divergences are the outcome of economic and (re)distributional processes and policies. Given that the economic and social cohesion of the EU aimed at its 'harmonious development' and the reduction of regional disparities are formally at the core of the European integration project since the Single European Act of 1986, taking stock of existing social divergences is important for assessing if the EC proposals for the reform of the EU fiscal rules and the Economic Governance Framework are "fit for purpose".

On the basis of recent literature and statistical evidence, we have detected the erosion of social cohesion across the EU, including in the countries of its 'core', while social and economic divergences between Member States have gone hand in hand, with contrasting trajectories of the old and new 'periphery' of the EU, southern vs. eastern European 'new' Member States. The proposed reform of the EU economic governance by the European Commission and the new fiscal surveillance procedure cannot allow for a reversal of the situation, since they do not ensure sufficient fiscal space for the most in need and indebted Member States.

Finally, we discuss alternative proposals for the reformed Growth and Stability Pact and European Semester. These include the integration of a Social Imbalances Procedure in the European Semester, the golden rule for public/social investment, the extension of the EU fiscal capacity through the issuing of common EU public debt, an EU pact for employment and investments and enhanced financial support for upward social convergence, targeted to EU Member States with important social problems, lacking own financial means and lagging behind the attainment of common EU social policy goals.

1. Introduction

The global financial crisis, the Covid-19 pandemic and the ongoing cost-of-living crisis have significantly deteriorated the working and living conditions of workers and popular classes across Europe and are still affecting their wellbeing. At the same time, during the 'permacrisis' of the past fifteen years economic and social divergences have increased both within and between EU Member States (MS) undermining social cohesion and the legitimacy of the project of European integration. Rising inequalities

have eroded social cohesion across the EU, including in the countries of its 'core', while economic and social divergences between MS have gone hand in hand, with contrasting trajectories of the old and new 'periphery' of the EU.

The starting point of our paper is that fostering upward social convergence and tackling social inequalities across the EU is not only a fundamental challenge for the future of EU integration and the main way for preventing further escalation of far-/alt-right forces, but it is also a precondition for the success of the ecological and technological/ industrial transformation and restructuring of European economies i.e., the green and digital transitions and strategic investment promoting 'open strategic autonomy'.

We argue that, although the European Pillar of Social Rights constitutes an important basis to reverse the trend towards the erosion of worker and social rights in the EU, it is impossible to build a socially cohesive Europe only through directives defining minimum social standards for MS, however important these may be. Upward social convergence of EU MS lagging behind is strongly associated with their upward economic convergence while tackling social inequalities within Member States requires well-functioning collective bargaining and social dialogue as well as anti-discrimination and redistributive fiscal and social policies at the national level which are costly.

In the following months, the Council and European Parliament will have to agree on the final proposal by the European Commission for the reform of the EU economic governance framework, which provides MS with greater leeway to use their fiscal policies and preserve public investment than they had before under the Fiscal Compact. Although the proposal is clearly a positive development, it falls short of creating a sufficient fiscal space for MS to deal with the great economic, social and environmental challenges they face in the current conjuncture of 'polycrisis', among which social convergence and cohesion in the EU constitutes a fundamental stake. Moreover, sufficient fiscal space at the national level cannot address the problem of the great differences in fiscal and borrowing capacity of MS. It should be thus supplemented by the extension of EU fiscal capacity and its just distribution to MS through the Structural and Investment Funds according to the relative size of the required convergence effort.

We start our analysis by examining social divergences between and within EU Member States from the beginning of the 2008 global financial crisis to date, to establish trends in the reinforcement/weakening of social cohesion in the EU (section 2) We then assess the reform of the EU Economic Governance Framework proposed by the European Commission is "fit for purpose" also from this angle, which is not usually taken on board in most assessments of the Commission's legislative proposals (section 3). Finally, we present alternative proposals for the reform of the EU economic governance framework. Namely, we discuss those in favour of the integration of EU economic and social policy monitoring and coordination under a unitary economic and social governance framework, accompanied by the extension of existing or the establishment of new EU fiscal capacity instruments and enhanced financial support to EU Member States facing important social problems, lacking own financial means to tackle them and lagging behind the attainment of common EU social goals (Section 4).

2. Social convergences/divergences between and within EU Member States: the convergence of the new MS and the uncertain future of Southern Europe

In the EU, the ideas of shared prosperity and economic convergence have gone hand-in-hand with the idea of economic integration for decades, while economic convergence has always been considered the fundamental mechanism and precondition for achieving socio-economic cohesion (Alcidi 2019). Economic and social cohesion became an explicit objective of the EU with the Single European Act of 1986 which established the European Cohesion Policy as the main investment policy of the EU to address disparities between regions in GDP per capita and the unemployment rate. This would be achieved by equipping poorer regions with tools and resources from the European Structural and Investment Funds to realize investment and institutional reforms that improve productivity and boost their potential growth, promote employment and prevent social exclusion. The combination of cohesion policy and the internal market with its four freedoms (freedom of movement of people, goods and capital and of establishing and providing services) was expected to drive economic convergence by allowing the poorer Member States to grow faster and catch up with the richer ones. These promises have only partially been kept.

Social convergences/divergences and social cohesion between and within EU MS is dependent on both real economic convergence/divergence and (re)distributional processes and policies at the national and EU levels. On one hand, fundamental economic variables, such as productivity, employment and GDP per capita levels and growth rates, are basic determinants of the levels and trends in main social indicators, such as real disposable income per capita, wages or the unemployment rate. On the other hand, (re)distributional processes and policies account for levels and trends in the wage share, social expenditure per capita or as percentage of GDP, income and other social inequalities, poverty, material deprivation and social exclusion.

2.1 Literature review

To start with, real economic convergence differs from nominal convergence, which was the prerequisite for joining the EMU on the basis of the criteria of the Stability and Growth Pact. The Maastricht and Lisbon Treaties say very little on the real economy, aside from the fact that growth and employment are an objective of the Union[1].

Research on real convergence within the EU has been the subject of several studies in the past. The findings of individual authors were different, depending on the applied methodology, analyzed period, and selected statistical indicators. GDP/ income per capita is the chief indicator used in the studies of convergence/divergence. Cavenaile and Dubois (2011) evidenced and analyzed an income convergence process within the EU (27 countries) between 1990 and 2007 but also found that the European Union was showing significant heterogeneity. They have cited the differentiation of the European Union as a risk to the effective functioning of the European Union and the Eurozone. Another study by Burian and Brčák (2014) focused on evaluating the convergence

[1] The articles in their monetary chapters all refer to nominal variables, be they monetary policy or inflation, and so does the section that describes the criteria and procedure for the adoption of the euro.

process of the EU membership base in the period 2002–2012. The researchers applied the method of cluster analysis and categorized the 27 Member Countries into four groups: the core of the EU, the old periphery, the new periphery, and a group of non-Member States. They found a reduction in differences between the core of the EU and the new periphery.

The same has also been confirmed by a study of cross-regional and cross-country income convergence-divergence in the EU during 2000-2015 authored by Alcidi (2019). The study found that during the years 2000-2007 both cross-country and cross-regional differences in GDP per capita in PPS were falling, hence convergence was taking place across the EU. Regarding cross-country differences, income convergence continued until 2009 while the coefficient of variation increased between 2009 and 2015. As for cross-regional differences, variation in GDP per capita growth at the regional level begun to increase in 2008 pointing to regional divergence as a consequence of the global financial crisis while, in 2015, the coefficient was back at the 2000 level. Internal income divergence has been particularly strong in Southeastern and in all new Eastern MS with capital regions having outperformed the rest of the country in a disproportionate manner, driven by strong agglomeration forces around metropolitan areas. Focusing on Eastern MS Andor (2019) has also underlined that in spite of their patent catch-up trajectory since their EU accession in 2004, upward income convergence has not been coupled by a similar social convergence while their strong economic performance has been accompanied by internal socio-economic polarization.

Last but not least, in their study, Abrhám and Vošta (2022) have analysed convergence/ divergence among EU Member States in GDP per capita (measured in purchasing power parity units) and the unemployment rate during the most recent period of 2016-2021, which they have divided in a pre-pandemic period (2016-2019) and the pandemic years (2020-2021). They have found that differences GDP per capita significantly decreased between 2015 and 2019 and increased between 2019 and 2021, pointing to convergence in the first period and to divergence in the second. Divergence during the pandemic was produced by a lower decline in GDP per capita in the developed countries of the EU. The opposite occurred with cross-country differences in the unemployment rate, which increased in the four-year period preceding the pandemic leading to divergence and decreased during the pandemic, implying convergence.

2.2 Convergence/divergence trends between EU MS during the ‘permacrisis’

In what follows, we examine social convergence/divergence trends in the EU during 2008-2022, i.e., over the whole period of the ‘permacrisis’ from the beginning of the global financial crisis, through the Covid-19 pandemic and up to the cost-of-living crisis on the basis of a set of social indicators that depict cross-country trajectories and within-country inequalities. The coverage of the whole period is important in order to realize how EU MS have weathered the three successive crises of the past fifteen years and to assess the varying degree of convergence effort required by the EU MS with the worst social problems and the challenge of EU social cohesion in the coming years.

In this subsection we describe social convergence/divergence between EU countries by studying the variation of the following indicators between 2008 and 2021/22:

a) Gross disposable income of households per capita at constant prices,
b) Employment rate;
c) Real wage/compensation per employee
Our analysis is based on the graphs 1-4 to be found in the Annex of the paper.

Real gross disposable income of households per capita: Between 2008 and 2021, the real per capita gross disposable income of households grew by 10% in the EU on average. The mean dissimulates extremely large country differences in the values of the variable, ranging from -21% in Greece to 46% in Poland, which reflect the legacy of the global financial crisis; the latter hit EU MS in different ways and with varying intensity.

If we measure convergence/divergence in the per capita disposable income of households by comparing dispersion of the values of the variable around the mean in 2008 and 2021, then the coefficient of variation (0.573 in 2008 against 0.568 in 2021) shows that the dispersion was roughly the same in 2021 as in 2008. However, measuring dispersion at the start and end years of the period does not take into account the convergence/divergence trajectories of individual countries or groups of countries towards/from the EU-average trend over the period, as captured by Graph 1.

Graph 1 illustrates that twelve out of the thirteen "new" MS that joined the EU with the 2004, 2007 and 2013 enlargements - all except Cyprus - were those that registered spectacular increases of real per capital household income - between 19% and 46% - thus converging with per capita household income of older MS which displayed as a whole smaller increase. Among the latter, Sweden, Denmark and Germany are the best performers, while most of the southern EU countries (Greece, Italy, Spain and Cyprus) along with Austria registered a reduction in per capita disposable household income.

To a large extent, individual country differences in the variation of the disposable income of households per capita are explained by discrepancies in GDP per capita growth rates. However, in one third of MS the rise in gross disposable income of households per capita outpaced that of GDP per capita, while in the majority of MS the opposite occurred. This means that the income convergence and divergence trajectories of the individual countries around the EU average trend are also accounted for by differences in the evolution of productivity and employment as well as by country-specific distributional factors (state policies, collective bargaining etc.).

Eastern European MS and Malta experienced substantial productivity gains and high real wage and job growth (graph 4), southern European MS productivity and real wage stagnation/decrease. With the exception of Sweden and Germany whose performance was very good, although not as spectacular as that of eastern European MS, the remaining EU MS displayed moderate or negligible productivity gains, low real wage growth rates or even reductions and below average employment performance.[2]

Employment rate: Employment is important for earning market income and for the well-being of workers and their families. Per capita household income rises with the

[2] Ireland is an outlier in all respects. since the skyrocketing of its GDP per capita and the spectacular rise of productivity were followed by a small increase in real wages and a rise in per capita gross disposable income of households equal to the EU average.

number of labour income earners in it. An important effect of the 2008 global financial crisis was the fall of the average employment rate of those aged 20-64 years in the EU from 69.5% in 2008 to 67.5% in 2013. The six-year recovery that followed brought the same rate to 73% in 2019, well above its 2008 level. After its contraction by 1 percentage point in 2020, the strong rebound of the economies after the end of the Covid-19 pandemic crisis, was accompanied by a surge in the number of new jobs while employment also grew during the cost-of-living crisis. In 2022, the EU-average employment rate of those aged 20-64 years was at 75%, 5.5 p.p. above its 2008 level.

Convergence and divergence trajectories took place around the EU average growth trend in the employment rate (Graph 2). With the exception of Portugal, all southern European countries that endured recessions and important net job losses due to the implementation of harsh fiscal consolidation programmes during the sovereign debt crisis years (Greece, Cyprus, Italy, Spain) underperformed as regards job growth over the entire period and diverged from the EU-average change in the employment rate. Similarly, Austria, France, Luxembourg, Denmark and Sweden manifested a restricted job growth and, as a result, their employment rate diverged as well. By contrast, the eastern European MS together with Malta, Portugal and Ireland saw very high rates of job growth and their employment rate increased more than in the EU on average.

Finally, while several countries with lower than EU-average employment rates in 2008, namely Malta, Hungary and Poland succeeded in surpassing the EU-average in 2022 due to their admirable job growth performance, Italy, Greece, Spain, Romania, Croatia and Belgium whose employment rates were also lower than the EU average in 2008 further distanced themselves from the EU-average in 2022 due to their very low job growth rates during the period. France also diverged and became a low-employment rate country, since its employment rate that was equal to the EU average in 2008 stood below the EU-average in 2022.

Real wage/compensation per employee: Between 2009 and 2022 real wages in all eastern European countries except Hungary strongly converged to the EU average and diverged in all southern European ones, except Malta. This is the outcome of the huge differential of wage growth rates between these two groups of countries (Graph 3). In most eastern EU MS (Bulgaria, the Baltic states, Romania, Poland, Czechia, Slovakia), Malta and Slovenia, real wages rose steeply, mainly due to repeated increases in minimum wages by governments and to the contraction of unemployment, which increased the bargaining power of employees. To the contrary, real wages decreased in most southern EU MS (Greece, Portugal, Cyprus, Spain and Italy) during the austerity period of the financial crisis. The initial phase of real wage contraction, was followed by a moderate increase during 2014-2019 period, which yet did not succeed in bringing the purchasing power of wages in these countries to their peak 2009 level. Besides, in Greece, Cyprus and Spain real wages decreased more than in the EU on average in 2022, i.e., during the cost-of-living crisis, adding to the divergence trend of 2009-2021.

For ‘core’ EU MS wage developments have been heterogenous. Real wages in Sweden, Germany and Luxembourg saw a significant increase – from 10 to 15% - between 2009 and 2022, while France, Denmark, Ireland and Portugal witnessed real wage growth rates that ranged from 2% to 7% over the same period. Finally, in Austria, Belgium, the

Netherlands and Finland real wages decreased between 2009 and 2022, but this has not undermined their position among the EU countries with high wages.

Adjusted wage share: When real wages grow faster than productivity, then the wage share of GDP increases and income redistribution from capital to labour takes place; the opposite happens when productivity grows faster than real wages. Between 2008 and 2022 the adjusted wage share increased in the majority but not in all new MS that displayed the greatest real wage increases (Graph 4). This happened in Bulgaria, Slovakia, Czechia, the Baltic States and Slovenia but not in Romania and Poland where productivity outpaced real wage growth and the wage share dropped significantly. On the opposite, the wage share diminished in all Southern EU countries over the same period; more so in Cyprus and Greece and less so in Portugal, Malta, Spain and Italy. The 'core' EU MS are divided; in some the wage share rose and in the others it reduced. Ireland is an outlier; its wage share plunged between 2008 and 2022 by 28.2 p.p. because real wages increased by 3.2% when productivity almost doubled (90.6% rise). The wage share collapsed in all EU MS in 2022 during the cost-of-living crisis as can been seen on Graph 4. Janssen and Lübker (2023) have placed this fall in a study of income redistribution between capital and labour over a longer period.

2.3 Inequalities/divergences within Member States

In this subsection we analyse inequalities in employment, income and access to basic social services within EU MS, in order to identify those that need more fiscal space at the national level and assistance from the European Structural Funds in order to tackle them. To compare EU countries, we use the following variables/indicators: the gender employment gap, the income quintile share ratio, the at-risk-of poverty or social exclusion rate and the out-of-pocket expenditure on healthcare. Our analysis below is based on the graphs 5-8 to be found in the Annex of the paper.

Inequalities in employment: The gender employment gap, measured as the difference between the male and the female employment rates, is a key indicator of inequalities in employment. The EU-average gender gap shrank from 13.4 pp. in 2009 to 10.7 p.p. in 2022. Up to 2013, this reflected the greater negative effect that the global financial crisis had on male than female employment whereas the narrowing of the gap is negligible from 2014 onward pointing to an almost gender-equal job growth during the subsequent years. Nevertheless, country differences remained huge in 2022, ranging from 21 p.p. in Greece to 0.8 p.p. in Lithuania (Graph 5). All southern European countries, except Portugal, alongside Romania, Poland and Ireland are the MS with the greatest gender inequalities in access to employment in the EU.

Income inequality: The income quintile share ratio S80/S20, measuring the ratio of the total equivalized disposable income received by the 20% of the population with the highest income (top quintile) to that received by the 20 % of the population with the lowest income (lowest quintile) is a key indicator of income inequality in a country. According to this indicator, income inequality in the EU remained stable between 2008 and 2022; after having increased during the global financial crisis it narrowed in the following years and recently returned to its 2008 level. However, there are very large discrepancies in the degree of income inequality between EU MS (Graph 6). Although

half of the eastern European countries (Bulgaria, Romania and the Baltic States) and the largest southern European ones (Greece, Italy, Spain and Portugal) are the most unequal countries in the EU with respect to the income distribution among their citizens, the Visegrád countries and Slovenia are among those with the lowest income inequalities, while Cyprus has lower income inequalities than the EU on average.

Poverty and social exclusion: The at-risk-of poverty or social exclusion rate has decreased in the EU as a whole between 2008 and 2022. The most important reductions in poverty and social exclusion were noted in the new EU MS that joined the EU in 2004, 2007 and 2013 (Graph 7) and are mainly due to the spectacular increases of real per capital household income in these countries in the above period. Smaller reductions were observed in several older member states. As the new MS were also those with the highest rates of poverty and social exclusion, this led convergence between EU MS towards the lower EU-average rate. Notwithstanding convergence, there are still great differences between EU countries re the extent of poverty and social exclusion. The pattern is similar to that described for income inequality. Romania, Bulgaria, and the Baltic States, Greece, Spain and Italy are the countries of the EU with the highest rates of population in poverty or social exclusion. However, eastern and southern European countries are internally divided between the low and high poverty and social exclusion ones, which may be explained by institutional and political/policy differences that shape distributional outcomes in each country. Finally, poverty and social exclusion increased in France, Germany, Luxembourg, Sweden, Denmark and the Netherlands, a sign of erosion of social cohesion in the countries of the ‘core’ of the EU.

Out-of-pocket expenditure on healthcare: Free access to good quality healthcare proved fundamental for European societies to cope with and minimize the number of deaths from the Covid-19 pandemic The latter brought to the fore the importance of public healthcare to ensure basic social rights as well as the vulnerability of citizens and societies from the rampant privatization of the healthcare sector in the past decades. The out-of-pocket expenditure on healthcare is the main indicator measuring the degree of privatization of healthcare services in the different EU MS (Graph 8). According to the most recent available data, the eastern and southern European countries that occupy the top thirteen ranks of the list of the EU MS according to out-of-pocket expenditure as a percentage (%) of total healthcare expenditure. Among the recent EU MS, only Croatia, Czechia and Slovenia appear to have robust public healthcare systems and to keep private healthcare expenditure at low levels.

2.4 Social convergences/divergences and the social cohesion of the EU

Some general conclusions can be drawn from the examination of social convergences/ divergences between and within EU MS in the above paragraphs. First of all, with respect to cross-country differences on the basis of GDP per capita, the literature review points to income convergence of EU MS between 2000 and 2009 (pre-crisis period and first years of financial crisis), divergence between 2009 and 2015 (austerity phase and exit from financial crisis), convergence between 2015 and 2019 (between-two-crises growth period) and divergence between 2019 and 2021 (pandemic crisis). It seems that the crisis periods were detrimental for the social cohesion of the EU.

Second, our analysis of trends over the 2008-2022 period on the basis of main social variables-indicators has proved that all the thirteen "new" MS from the 2004, 2007 and 2013 enlargements of the EU, except Cyprus, have converged towards the older MS as regards the per capita household disposable income while most of the southern EU MS (Greece, Cyprus, Italy and Spain) have diverged, by incurring a reduction in the latter across the same period.

Third, the eastern European MS together with Malta, Portugal and Ireland saw very high rates of job growth and their employment rate increased more than in the EU on average during 2008-2022. Malta, Hungary and Poland who had lower than the EU average employment rates in 2008 succeeded in surpassing the EU average in 2022, while Italy, Greece, Spain, Romania, Croatia and Belgium who had equally lower employment rates in 2008 further distanced themselves from the EU-average in 2022 due to their very low job growth rates over the same period.

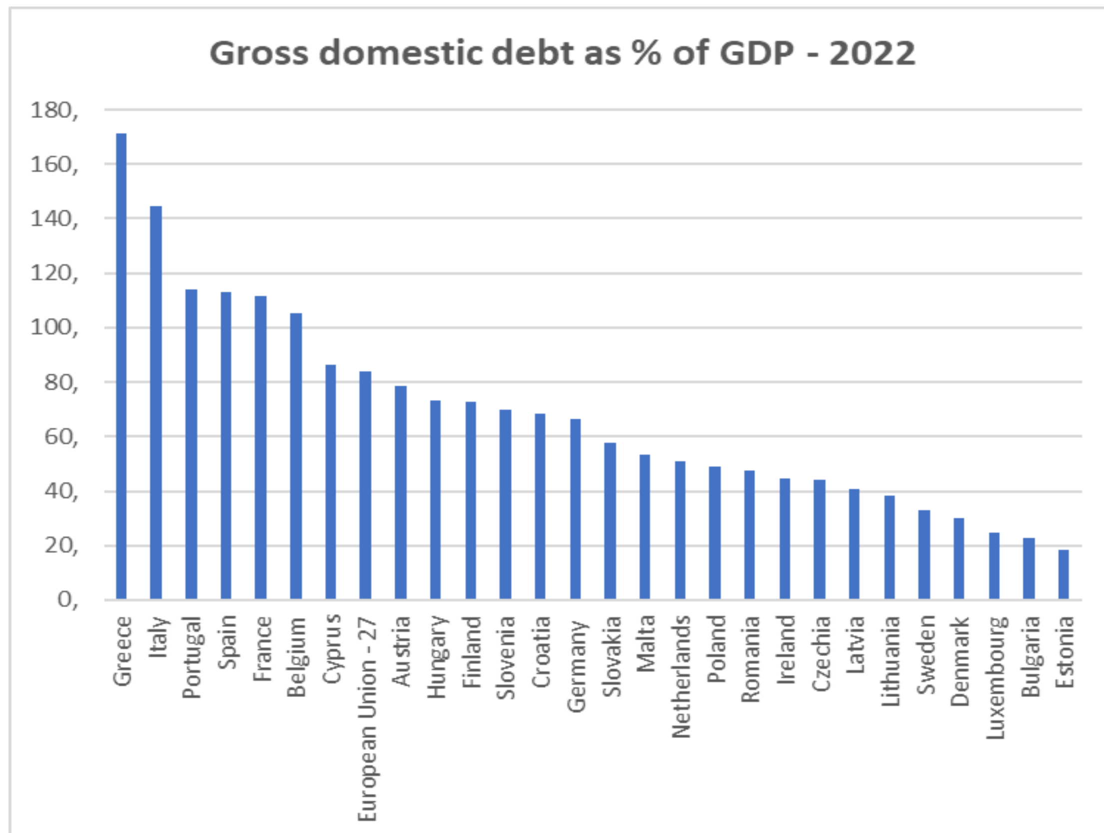
Fourth, real wages in eastern European countries strongly converged to the EU average and diverged in southern European ones because of the huge differential of wage growth rates between these two groups of countries. Strong real wage growth outpaced productivity in some Eastern countries leading to an increase in the wage share, while it fell short of productivity gains in others producing a fall in the wage share. Conversely, the wage share diminished in all southern European countries.

Fifth, southern and eastern EU MS are heterogenous groups when it comes to within-country income inequalities and poverty/social exclusion rates, but most of the southern European countries and half of the eastern European ones are those with the highest scores in income inequality and poverty/social exclusion rates in the EU. Southern Europe is also much more homogenous than Eastern Europe and 'new' MS as regards gender inequalities in access to employment – southern European countries figure among the EU MS with the lowest female employment rates and the largest gender employment gaps, while most of the eastern European countries have above EU average female employment rates and below EU average gender employment gaps. However, southern and eastern European countries are 'united' and internally homogenous in having the more privatized healthcare systems in the EU.

All in all, southern Europe is diverging while 'new' MS and eastern Europe in particular are converging towards EU-average trends in all main indicators of social well-being and cohesion, though from a low starting point and with great challenges ahead as regards the sustainability of their socio-economic development path. At the same time, old EU MS of the 'core' and Scandinavian countries follow diverging trajectories. Most of them display rising income inequality and poverty and social exclusion rates. Moreover, with the exception of Germany and Sweden, they are stuck in low productivity and real wage growth or even reductions. This means that social cohesion is a big stake for both the EU and the Member States, while social divergences between MS over the past fifteen years are associated with economic divergences triggered by the successive crises and the pre-2008 pattern of EU economic integration.

From this point of view, the future of Southern Europe is uncertain and the reform of EU economic governance should take this problem seriously into account given that the

Greek, Italian, Portuguese and Spanish states are the most overindebted in the EU (the sovereign debt ratio of Cyprus is also above the EU average but not as high) and will have to implement restrictive fiscal policies from 2024 onwards.



The economic and social divergence of the European South, the increase in income inequalities and poverty in many 'old' MS and the great social inequalities and welfare state weaknesses in most eastern European MS are big challenges that should be taken into account by the pending reform of the EU economic governance. In the next section we assess whether the proposals by the European Commission are 'fit for purpose'.

3. New EU fiscal rules and economic governance: More but insufficient fiscal space to face major challenges in exchange of tighter control of compliance

Last April the European Commission presented legislative proposals for a comprehensive reform of the EU economic governance framework (European Commission 2023). The European Parliament and the Council will have to agree on the legislative proposals for the new framework to start being implemented in 2024 and fully from 2025 onwards. Hereafter we explain the reasons for the reform

The debate on how to reform the EU framework of economic policy coordination and surveillance was initiated in 2015, as a response to the global financial crisis and the euro area sovereign debt crisis and gained momentum with the launch of the European Green Deal and the Covid-19 pandemic. For the proponents of the reform of the Stability and Growth Pact, more leeway in fiscal policies was needed to allow EU MS address two challenges (a) stabilise their economies, preserve public investment and

their production capacity and protect the society in the face of shocks, long-lasting economic crises and major health crises, and (b) finance the necessary investment for the green and digital transitions without leaving anyone behind. The above debate evolved in parallel with the one on whether and in what form a common fiscal capacity should be established in the euro area and possibly in the EU (Theodoropoulou 2023).

3.1 The Commission's reform proposals

The Commission's proposed reform seeks to respond to the significantly higher levels of public debt in the aftermath of the pandemic by taking on board the lessons from the EU policy response to COVID-19. The key objective of the reform of EU fiscal rules and economic governance is to offer to the MS with high public debt the opportunity for a **smooth fiscal adjustment** that will allow them to **promote growth** through public investment and reforms and, at the same time, **improve debt sustainability**.

The legislative proposals introduce a **new fiscal surveillance process** for the coordination of MS economic policies, to be integrated in the European Semester. The new process makes EU economic governance simpler, places greater emphasis on the medium-term but also strengthens the power of the Council and the Commission to enforce compliance of MS with EU criteria for structural reforms and investment.

In the new process, MS will have to bring together their fiscal, reform and investment commitments into a **single medium-term fiscal-structural plan** setting out their fiscal, reform and investment policies over the course of four years. Fiscal surveillance under the European Semester will now focus on a **single operational indicator**, namely the MS's multi-year **net expenditure targets**, as endorsed by the Council, that will serve as a basis for carrying out annual fiscal surveillance over the lifetime of the MS's medium-term fiscal-structural plan.

The fiscal surveillance of MS with a government deficit above 3% or public debt above 60% of GDP will be based on fiscal policy commitments under their national fiscal adjustment paths i.e., on their net expenditure paths, spreading over four to seven years. For each one of these MS, the **Commission** will issue a country-specific "**technical trajectory**" to ensure that debt is put on a plausibly downward path or stays at prudent levels at the end of the adjustment period, and that the deficit remains or is brought and maintained below 3% of GDP in the medium term.

The **European Semester** will remain the key channel for the Council to endorse the set of reform and investment commitments proposed by MS after an assessment by the Commission against clear common criteria set out in EU legislation (growth-enhancement, debt sustainability, common EU priorities and targets, CSRs); and for the Commission to monitor the delivery of investment and reform commitments contained in MS recovery and resilience and medium-term fiscal-structural plans. The reforms and investments of the medium-term fiscal-structural plans should prevent or correct imbalances detected under the **Macroeconomic Imbalances Procedure**.

3.2 Assessment of the proposed reform

The proposals help to move towards a **more risk-based surveillance framework** that puts debt sustainability at its core and differentiates more between countries by taking into account their degree of public debt challenges. The new fiscal surveillance process, with differentiated medium-term fiscal adjustment paths for MS, provides the most indebted EU MS, among which all the southern European ones, with greater leeway to use their fiscal policies and preserve public investment than they had before.

However, in reality,

a) The reform offers to indebted MS very **little additional room for manoeuvre** in exchange of a **tighter control** by the Commission and the Council **of their compliance** with **EU criteria for investment and reforms** in the framework of the European Semester.[3] For Member States that face substantial public debt challenges, departures from the agreed fiscal adjustment path will by default lead to the opening of an excessive deficit procedure and **stricter sanctions**.
b) The **extent of fiscal leeway** will depend on **the debt sustainability analysis**, with 'guidance' by the Commission; the assumptions for the analysis cannot avoid **political assessments** without intervention/control by democratic bodies.
c) The reform **does not guarantee a sufficient**, or sufficiently even, **fiscal space** across MS to support the green and digital transitions and industrial policy, provide quality public services and tackle social inequalities;
d) The reform is **not coupled with** the extension of existing or the establishment of new **European fiscal capacity instruments** to assist MS to deal with the common challenges lying ahead and more so the MS with limited fiscal space and the greatest need for **economic** and **social** convergence.
e) The reform does not provide for an **integrated governance framework** that puts the attainment of economic, social and environmental policy goals on an equal footing.

4. Social convergence and cohesion between and within MS: alternative proposals for the new EU economic governance framework

Social convergence and cohesion between and within MS in the EU are traditionally attempted through the EU social policy agenda, which includes Directives and Council Recommendations and policy initiatives financed through the European Structural Funds. Since its adoption in 2017, the European Pillar of Social Rights has triggered an ambitious social policy agenda at the EU level which has been reinforced during the Covid-19 pandemic crisis by initiatives to protect the jobs and the income of employees and the self-employed such as SURE. After the adoption of important Directives on

---

[3] According to the Commissions' proposals, the set of reform and investment commitments will be endorsed by the Council after an assessment by the Commission against **clear common criteria** set out in the legislation. These criteria include whether the **reform and investment commitments**:

- are growth-enhancing;
- support debt sustainability; and
- respond to common EU priorities and targets and relevant country-specific recommendations addressed to the Member State in the context of the European Semester.

The set of reform and investment commitments could include reforms agreed in the context of NextGenerationEU's Recovery and Resilience Facility. Failure to deliver on the commitments justifying the extension would trigger enforcement actions.

Work-life Balance, Transparent and Predictable Working Conditions, Women on Boards and Adequate Minimum Wages from 2019 to 2022, two Directives have/will enter(ed) into force in 2023: on Pay Transparency and Platform Work. At the same time, several other EU social policy initiatives have been developed: the Employment Policy Guidelines, the EU Skills Strategy, the Child and Youth Guarantees and, recently, the EU Care Strategy, the Council Recommendation on minimum income etc., and a new financial instrument has been created: the Just Transition Fund, to prevent/tackle the social problems produced by the transition to climate-neutrality in particular territories.

However, we cannot build a socially cohesive Europe only through EU social policy without adapting the EU economic governance framework because:
A) Social convergence between EU MS is impossible without economic convergence;
B) Tackling social inequalities within Member States does not only require well-functioning social dialogue but also redistributive fiscal and social policies which need sufficient funding, especially in the countries with the greatest inequalities;
C) It is impossible to deal with the social dimension of the green and digital transitions without massive public spending.

For all the above reasons, EU MS need sufficient fiscal space and this will be impossible in the next years without a reform of the EU economic governance framework. Three amendments to the Commission's proposals have been publicly debated:

First, comes the idea of an **integrated governance framework** that puts the attainment of economic, social and environmental policy goals on an equal footing. In order to strengthen the social dimension of the European Semester, to promote upward social convergence and reduce inequalities, the Belgian and Spanish governments have proposed at the Porto Summit in 2021 to integrate into the European Semester a '**Social Imbalances Procedure' (SIP)** that would identify, prevent and address the social imbalances that negatively affect the working and living conditions in EU countries and reflect the divergences in all Member States from the common targets and the overarching objectives of the upward social convergence. The procedure would include an alert mechanism and the issuing of Country Specific Recommendation for social imbalances in a critical situation. Fiscal and macroeconomic recommendations should not hamper the correction of social imbalances identified. On the contrary, they should support it by adequate investments and appropriate financial resources for policy response. However, there was no mention to the provision of additional EU funds to MS with critical imbalances to help them correct them. Recently, the Spanish presidency asked the opinion of the European Economic and Social Committee (EESC) on the SIP, which was favourable. The EESC (2023) also recommended that existing rules for funds allocation (ESIF, RRF and others) should become more flexible after negotiations so that they are quickly adapted to correct the social imbalances of countries in critical situation, identified through the SIP. However, the EESC did not recommend enhanced targeted EU financial support to the countries in need and with great divergence.

Another proposal is that **'social investments' should be discounted from the deficit and debt rules** (Hemerijck and Huguenot-Noël 2022)[4], while the ETUC (2022) proposes that net public investments in general – not only social investment - should be financed by debt and excluded from balanced-budget rules (golden rule). However, these proposals are useless for heavily indebted countries.

ETUC (2023) has recently proposed a more comprehensive alternative:

- An **EU sovereignty fund for just socio-ecological transition** to finance important projects of common European interest;
- A **European pact for employment and investments** which would include (a) a benchmark for public investments that keeps Europe ahead of key global competitors (b) minimum quantitative benchmarks on public investment growth and net investment levels (c) a golden rule for investments (d) an EU-debt financed budget for investments;
- **A social convergence procedure** that detects and removes **social imbalances** (SIP) with the possibility for social partners to submit negotiated CSRs;
- A permanent **instrument for stabilizing employment** on a revised SURE model.

It is worth stressing that the golden rule for (social) investment is useless for heavily indebted countries which, on the contrary, benefit from the creation of additional EU fiscal capacity distributed to MS according to convergence needs and financed either from the fiscal base of EU MS or through the issuing of common EU pubic debt. Last but not least, without additional and targeted financial support of MS with critical social imbalances, a Social Imbalances Procedure may become a disciplinary mechanism for EU MS that do not comply to neoliberal policies recommended by EU institutions.

REFERENCES

Abrhám J. and M. Vošta (2022), 'Impact of the COVID-19 Pandemic on EU Convergence', *Journal of Risk and Financial Management*, 15: 384. https://doi.org/10.3390/jrfm15090384

Alcidi C. (2019), Economic Integration and Income Convergence in the EU, *Intereconomics,* Vol. 54, 2019/1, pp. 5–11.

Andor (2019), 'Fifteen Years of Convergence: East-West Imbalance and What the EU Should Do About it', *Intereconomics,* Vol. 54, 2019/1, pp. 18–23.

Burian, S. and J. Brčák (2014), 'Convergence process in the European region—Cluster analysis', *International Advances in Economic Research* 20: 459–60.

Cavenaile, L., and D. Dubois (2011), 'An empirical analysis of income convergence in the European Union', *Applied Economics Letters* 18: 1705–08.

[4] Hemerijck and Huguenot-Noël show that expansive European welfare states investing in their citizens, from early childhood education and care to active ageing, have engendered virtuous circles of employment and productivity enlarging the revenues on which they depend while the social-investment paradigm, they argue, proved the 'unsung hero' of the Great Recession, cushioning the big welfare states in particular through the credit crunch and the eurozone crisis. They also maintain that the climate crisis should not now imply a turn away to 'hard', infrastructural investment since 'resilient welfare states are the *sine qua non* for a "just transition".'

EESC (2023), Opinion of the European Economic and Social Committee on the Social Imbalances Procedure (exploratory opinion at the request of the Spanish Presidency) (2023/C 228/07), Official Journal of the European Union 29.6.2023.

European Commission (2023), Proposal for a Regulation of the European Parliament and of the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, COM(2023) 240 final, Brussels 26.4.2023.

ETUC (2022), *ETUC Resolution on the Social Imbalances Procedure for the EU*, adopted at the virtual Executive Committee Meeting of 16-17 March 2022.

ETUC (2023), *ETUC Position on the Reform of the economic governance (toward an EU pact for employment and investments)*, position adopted at the Executive Committee Meeting of 30-31 March 2023.

Hemerijck A and R. Huguenot-Noël (2022), *Resilient Welfare States in the European Union*, Agenda Publishing.

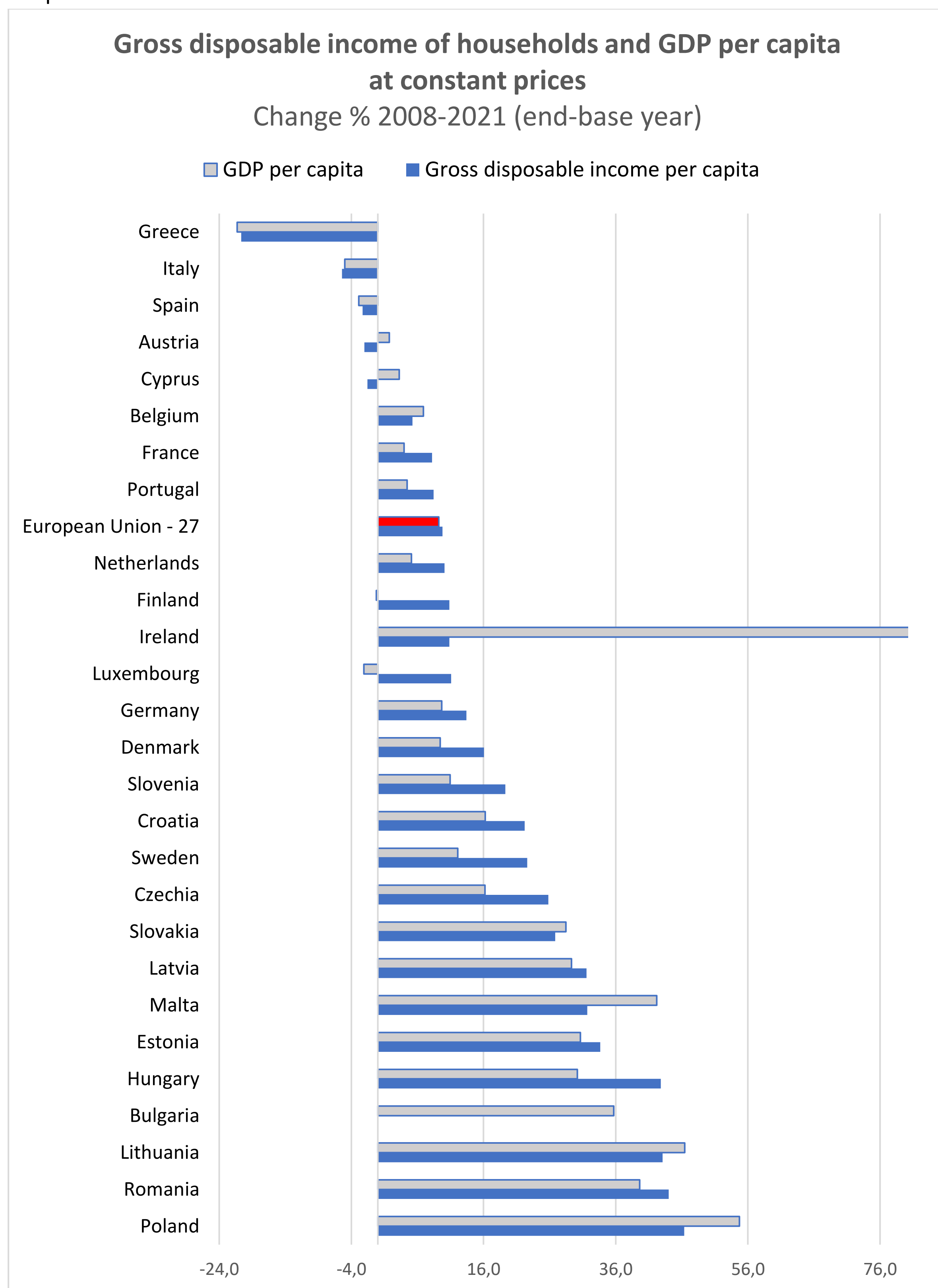
Lynch E., N. Countouris, P. Pochet (2023), 'Foreword. A crisis of crisis', in Countouris N., Piasna A. and Theodoropoulou S. (eds.) (2023), *Benchmarking Working Europe 2023*, ETUI and ETUC.

Theodoropoulou S. (2023), 'Economic developments and policies in Europe in the shadow of the geopolitical and green transitions', in Countouris N., Piasna A. and Theodoropoulou S. (eds.) (2023), *Benchmarking Working Europe 2023*, ETUI and ETUC.

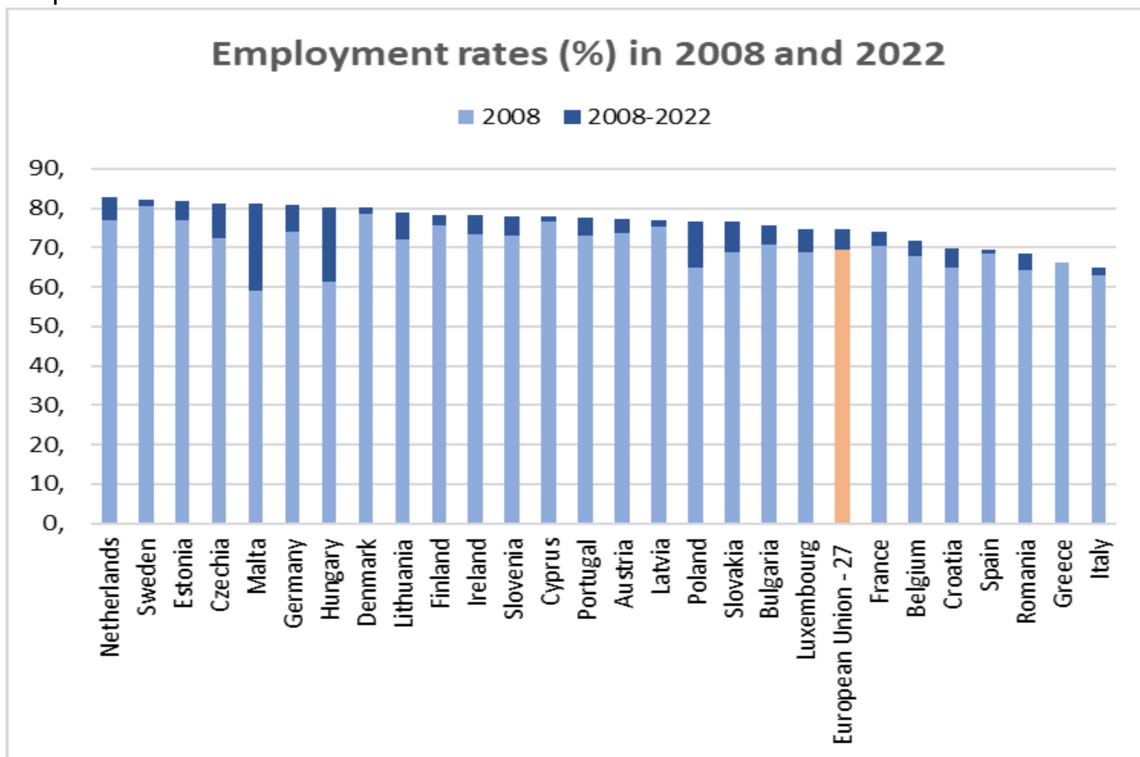
Janssen T., M. Lübker (2023), *Real Wages Collapse across Europe due to Inflation Shock,* WSI European Collective Bargaining 2022/2023.

ANNEX

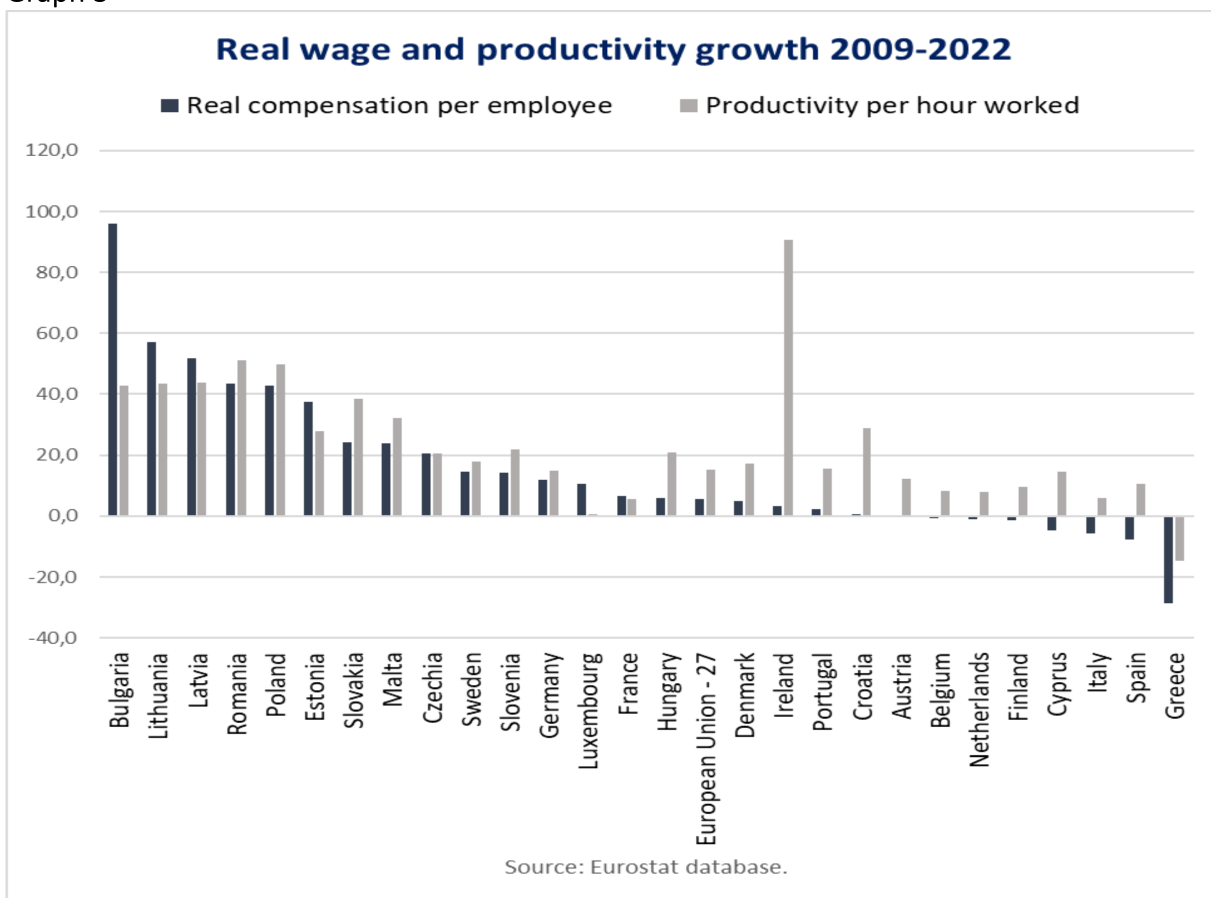
Graph1



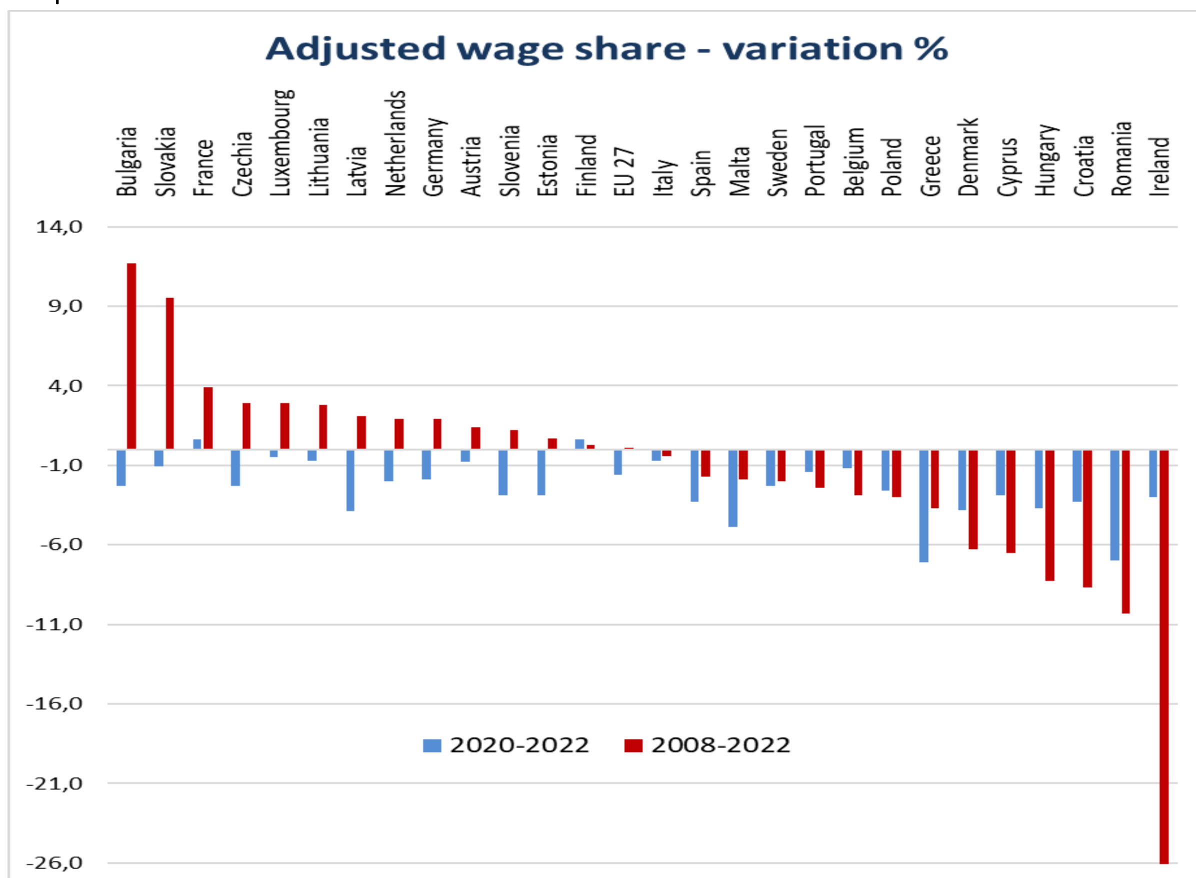
Graph 2



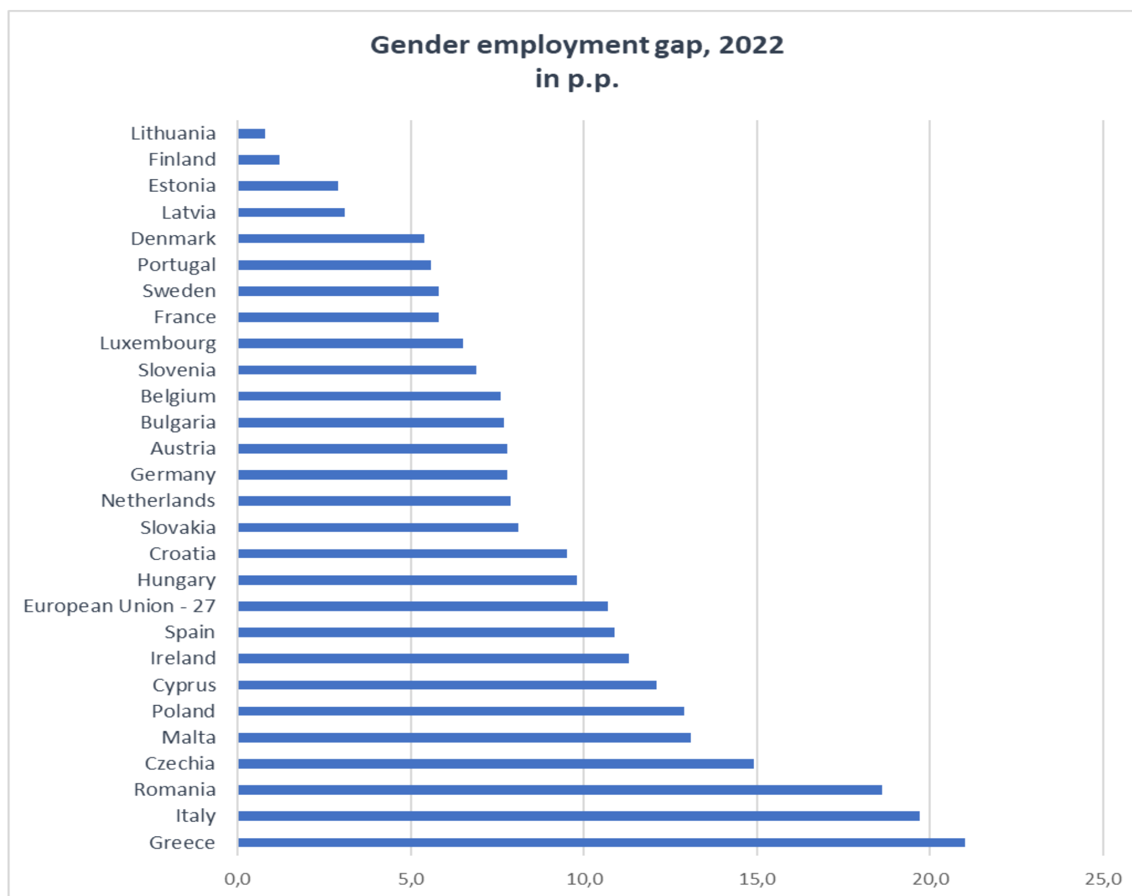
Graph 3



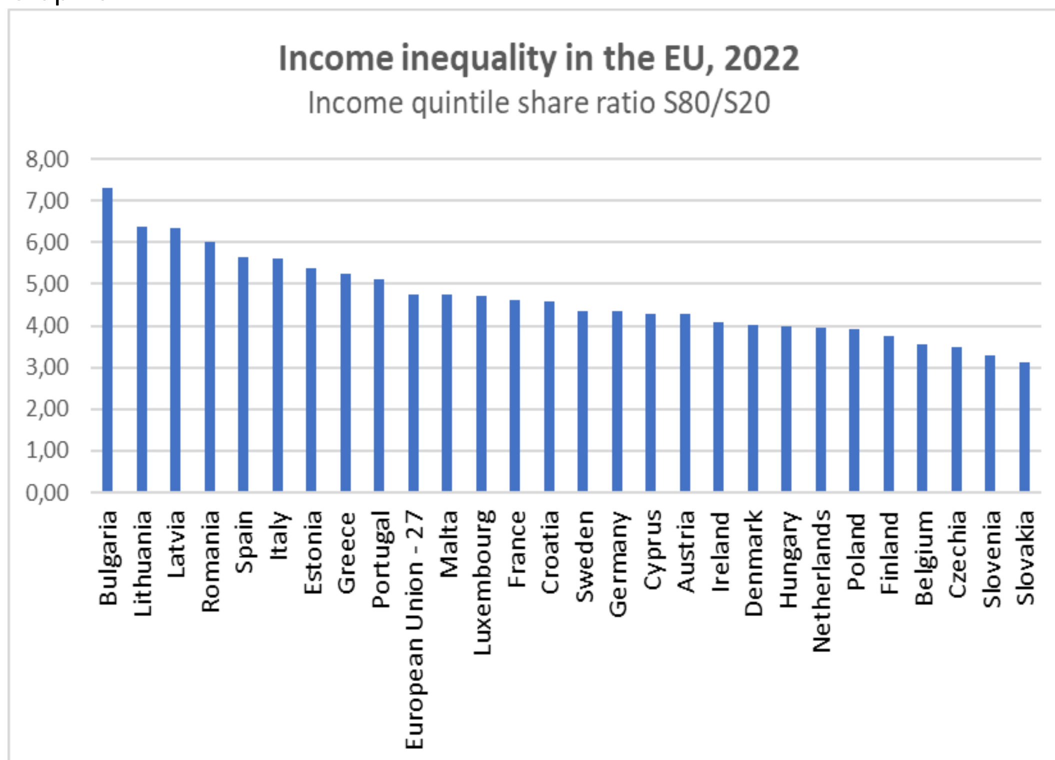
Graph 4



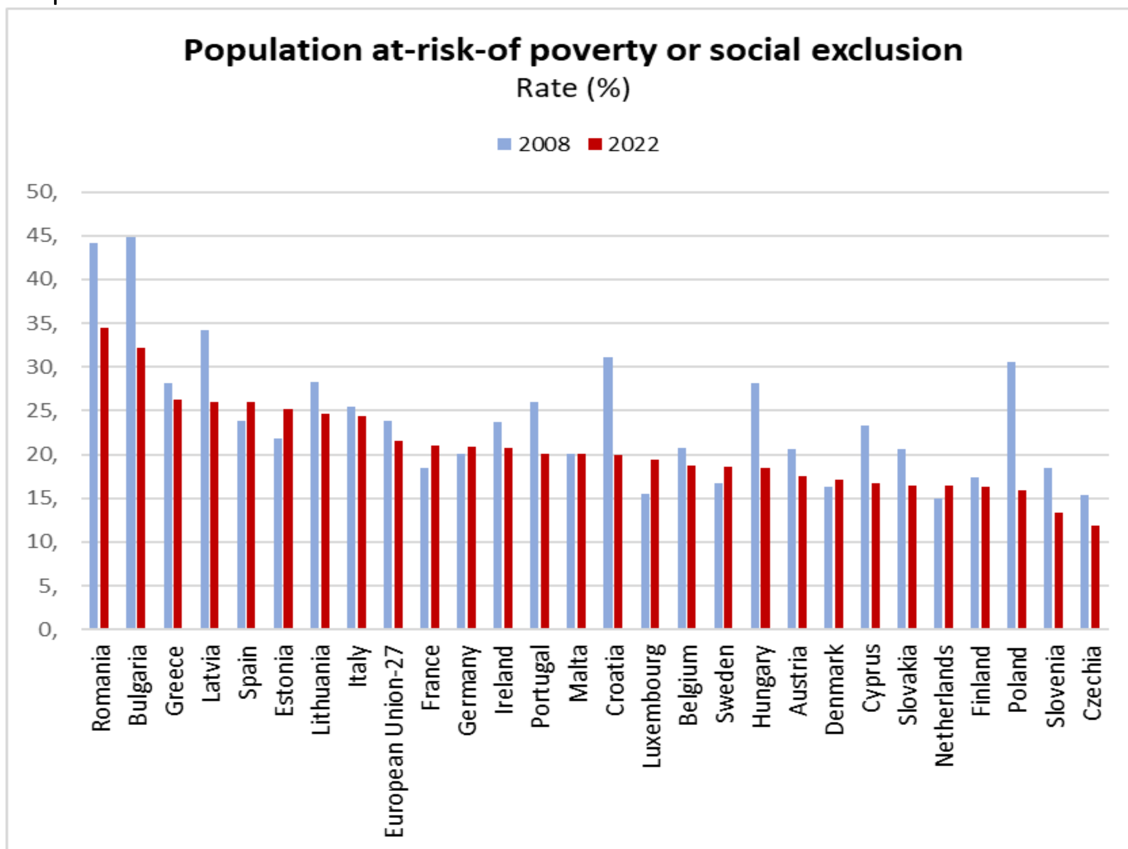
Graph 5



Graph 6



Graph 7



Graph 8