Re-InVEST Policy Brief

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The annual growth survey 2016: opening the door for social policy ?

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Summary

With the publication of the latest Annual Growth Survey (AGS)[1] a new annual cycle of EU economic policy coordination has begun. The AGS is an important step in the European Semester[2]. In this cycle "the European Commission analyses the fiscal and structural reform policies of every Member State, provides recommendations, and monitors their implementation; the Member States implement the commonly agreed policies".

The AGS sets out the European Commission's views on the EU's social and economic priorities and provides the building blocks for the policy recommendations it will put forward in the spring. The European Semester streamlines the macro-economic, the labour market and the fiscal policies. In recent years, the Semester streamlined the austerity and supply-side economic and social policies.

The first AGS based on the reorientations of the new Commission is long-awaited: the new Commission promoted it as a new start for Europe. The AGS is intended to be part of this new start. There are many signs that this Commission wants to take another path. The AGS shows a new discourse. But can we expect more?

The AGS expresses the new priorities of the Commission. As we show in this Policy Brief, the AGS announces a larger sensibility for social accents in EU-policy. We should however note that social policy has always been a matter for member states, the Commission only provides guidelines, which is very different from the strict fiscal and monetary rules under various monetary union projects such as the single currency.

Unfortunately, often discourse is not enough to convince citizens that the European Union will truly work for an effective implementation of its social objectives. We show that a massive ambiguity is blurring the meaning of this discourse. We find a misreading of the signs and a lot of blind spots in the AGS.

Therefore, as shown in this Policy Brief the Commission should go further:

- The Commission must develop a real European social policy. Social policy is of course a core task of the Member States, but this doesn't mean that Europe can't take the lead. As in the discussion surrounding the refugee crisis, the Commission can develop this policy: binding common standards of social protection; an enforceable benchmarking; common standards on social investment, …
- The Commission must re-evaluate the AGS. The AGS is the consequence/result of the macro-economic governance of the Six- and Two-pack. This macro-economic governance is based on a misreading of the signs and contains several blind spots. A new governance can be elaborated, one that reckons with these blind spots and a correct reading of the signs.

[1] http://ec.europa.eu/europe2020/pdf/2016/ags2016_annual_growth_survey.pdf

[2] http://ec.europa.eu/economy_finance/economic_governance/the_european_semester/index_en.htm

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RE-InVEST

REBUILDING AN INCLUSIVE, VALUE-BASED EUROPE OF SOLIDARITY AND TRUST THROUGH SOCIAL INVESTMENTS

A new start for Europe

In the discourse of the European Commission, the new start is concretized in 10 priorities[3]. Three of them are important for RE-InVEST: a new boost for jobs, growth and investment; a deeper and fairer internal market; and a deeper and fairer economic and monetary union.

Our first Policy Brief discussed the objectives of the investment programme[4]. We concluded that there is, firstly, a serious risk that the Juncker Investment Plan (JIP) will result in widening the gap between the countries that perform well and the rest of Europe. Secondly, the proposed plan does not adequately meet the needs of the countries that were most affected by the crisis. And thirdly, the share of social investment in the initial JIP is marginal, suggesting a missed opportunity to enhance the livelihood of vulnerable populations.

With regard to the internal market, the EC aims to combat tax evasion; in relation to the economic and monetary union the EC wants a more democratically legitimate and more accountable structure and proposes that, in the future, any support and reform programme should be subject not only to a fiscal sustainability assessment, but also a social impact assessment.

These issues are inter-related, as democratic governance and a strong and fair fiscal basis are prerequisites for the successful implementation of the social investment package. It is not enough to meet the objectives of Growth and Stability Pact, such as the ratio of budget deficits to GDP, or to find ways of achieving them (increasing tax revenue versus cuts in public expenditure). In order to legitimize EU policies and the European Union project it is important to minimize the adverse social impacts of major EU reforms. It is even more desirable to promote reforms that truly enhance social outcomes; if not, the European concept of social investment, as others in the past, risks to remain empty of any effective content and impact.

In his 2015 State of the Union address[5] the president of the EC stressed the importance of the social pillar: "I want to develop a European pillar of social rights, which takes account of the changing realities of Europe's societies and the world of work. And which can serve as a compass for the renewed convergence within the euro area. This European pillar of social rights should complement what we have already jointly achieved when it comes to the protection of workers in the EU. I will expect social partners to play a central role in this process. I believe we do well to start with this initiative within the euro area, while allowing other EU Member States to join in if they want to do so." One cannot but agree to such promises. However again, the president of the EC seems to ignore the scope of the negative impacts on existing social rights that European austerity still produces in many European countries.

This new start is intended to inform the whole text of the AGS.

A new discourse, a new start?

This AGS is different in language if we compare it with the previous survey.

Just counting words already makes a difference. We find the word "social" 38 times, "poverty" 7 times, "employment" 21 times, "social investment" 3 times. In 2015 the word "social' was mentioned only 21 times, "poverty" only twice, "employment" 22 times and "social investment" not at all. The AGS has not only used another vocabulary. It has also changed its contents.

Social investment, investing in human capital is prominent:

- "investment priorities must go beyond traditional infrastructure and extend to human capital and related social investment" (p. 8)
- "it is essential that Member States promote social investment more broadly, including healthcare, childcare, housing support and rehabilitation services to strengthen people's current and future capacities to engage in the labour market and adapt" (p. 10)

[3] http://ec.europa.eu/priorities/index_en.htm
[4] http://www.re-invest.eu/images/docs/policybriefs/policy_brief_1.pdf
[5] http://europa.eu/rapid/press-release_SPEECH-15-5614_en.htm

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- “social investment offers economic and social return, notably in terms of employment prospects, labour incomes and productivity, prevention of poverty and strengthening of social cohesion” (p. 12)

Social protection is promoted:

- “more effective social protection systems are needed to confront poverty and social exclusion, while preserving sustainable public finances and incentives to work” (p. 12)

The Commission declares its intention to promote an upward convergence between the Member States through benchmarking and common standards. The common standards are focused primarily on labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy (p. 9-10). Looking for common standards for an upward convergence is quite challenging.

- “The Commission intends to engage in discussions with Member States and key stakeholders about the challenges faced and the optimal policy responses, by encouraging convergence towards the best performers. Benchmarking, i.e. the cross-examination against a particular benchmark of indicators related to economic and social performance and policies in each Member State” (p. 9)

The AGS recognizes the crucial role of the social partners: “it is important that workers' representation is well ensured and that there is effective coordination of bargaining modalities between and across the various levels”(p. 11).

And there is an important chapter on “the effectiveness and fairness of the tax systems” (p. 13-14).

The AGS expresses the new priorities of the Commission. The AGS opens the door for an EU-wide social policy. We should note that social policy has always been a matter for member states, the Commission only provides guidelines, which is very different from the strict fiscal and monetary rules under various monetary union projects such as the single currency.

However language is not enough to convince that the European Union will truly work for an effective implementing of its social discourse. A massive ambiguity is blurring the meaning of this discourse. For instance, well ensuring workers’ representation, but for what purpose? To have an effective say of reforms that improve social rights and leave room to rising wages, employment security and better purchase power? Or to accept, through “an effective coordination of bargaining modalities”, everlasting wage austerity, social welfare cuts, greater precariousness in the name of maximizing competitiveness, which should boost in turn into growth and employment?

Old wine in new bottles?

If the AGS opens the door for an EU-wide social policy, the question remains, how wide the opening will be in practice? The problem is that the scope for change is constrained by the existing foundations of economic policies.

The 2016 AGS categorically states that ‘the economic and social priorities of the 2015 Annual Growth Survey remain valid’ and calls for the need to strengthen policy efforts in order ‘to set the recovery on a sustainable path, unlock investment, strengthen the adjustment capacity of EU Member States, foster productivity and accelerate the process of convergence.’ (p. 4)
To this end, the AGS 2016 focuses on priorities of investment (including human capital and related social investment), pursuing the structural reforms to achieve more coordination among member states, more labour market flexibility whilst focusing on the need to reduce youth and long term unemployment and finally more integrated competition in product and service markets.
And finally, and more importantly, the AGS 2016 is very clear on fiscal policies: ‘responsible fiscal policies - (i) there is a need to continue to support growth- and equity-friendly fiscal consolidation in many countries, (ii) tax systems need to address disincentives to employment creation and be made fairer and still more effective, (iii) social protection systems should be modernized to efficiently respond to risks throughout the lifecycle while remaining fiscally sustainable in view of the upcoming demographic challenges.’ (p. 4)

In short, the AGS 2016 does not offer a change in the fundamentals of the economic model of the Commission which is based on competitive product and service markets and flexible labour markets. The divergent macroeconomic imbalances in the EU (on internal as well external accounts) and increasing inequalities in most

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EU countries are the outcomes of this approach. Despite the emphasis on social investment, the budgetary rules of the single market constrain heavily the Eurozone countries when it comes to their public expenditure and budgets. Therein lies a fundamental contradiction at the heart of the EU approach to welfare and social policy: meeting the needs of people is a national responsibility but the means, i.e. national finances, are directly managed and regulated at EU level (the European Central Bank), together with international financial institutions (such as the IMF), or indirectly through the international financial markets. Financial rules and objectives are enforced by the threat of sanctions, whilst social objectives remain just 'objectives' with very little financial backing provided by the EU to achieve them.

The Commission opens the door for deviation from the SGP-criteria only for the exceptional inflow of refugees: "in applying the Stability and Growth Pact, as confirmed as part of this package, the Commission will take into account the budgetary impact of the exceptional inflow of refugees. The information provided by the Member States will be used when assessing (ex-post) possible temporary deviations from the SGP requirements in 2015 and 2016" (p. 13)
The question remains: does the new discourse reflect a policy reorientation of the Commission or is it just a rhetorical suggestion for the Member States?

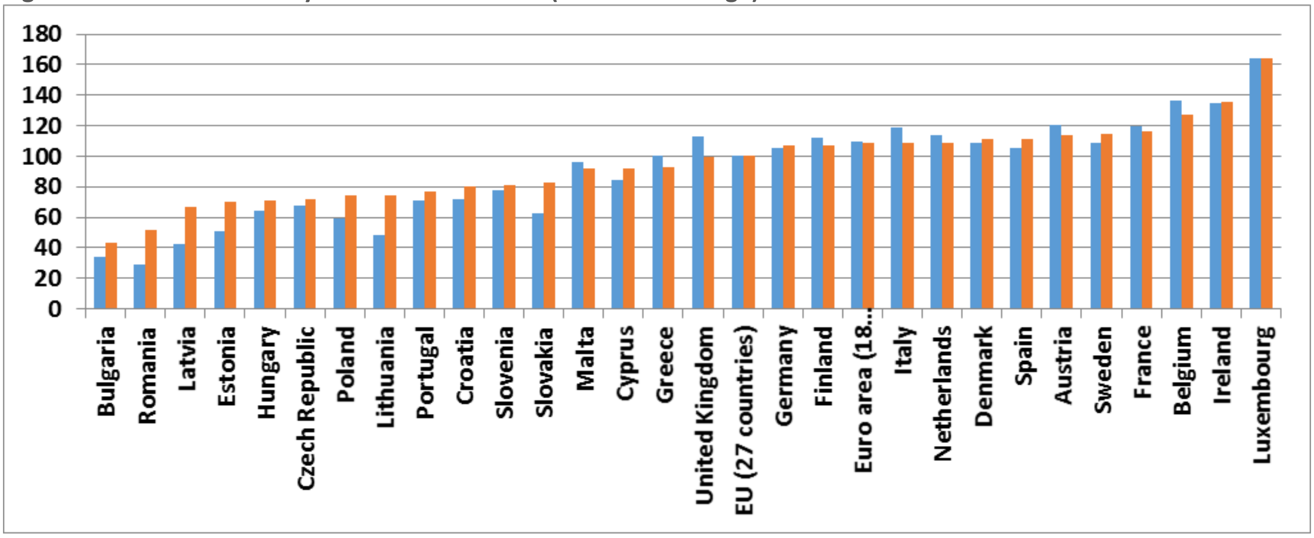
The AGS and the misreading of the signs

The AGS starts with a rather positive evaluation of the economic situation of Europe. This reading seems to ignore the relative underperformance of the region comparing with the United States, and the chronic asymmetries. Even more it endorses the discourse of the ECB and his Chair Mario Draghi. Worrying is the denial of the trend toward deflation which, considering the data, has started as early as 2011 and is now evident.

Apart from underperforming as a region in terms of key indicators – real GDP per capita, investment ratio – and presenting corresponding symptoms of a depression over the medium term, the EU continues to be characterized by severe asymmetries:

- wide disparities of labour productivity per person employed[6]. Convergence policies could contribute to the average growth of EU economy which could partially compensate the negative trend of the productivity growth.

Figure 1 Labour Productivity in the EU 2002-2013 (100 = EU Average)



Data Source: Eurostat

- increasingly weak domestic demand, notably in the Eurozone, where its growth rate averaged 1.23% in the long term (1990-2015), 0.66% since the beginning of this century (2001-2015). Since the financial crisis

[6] Eurostat figures show thirteen member states with labour productivity below the EU-average in 2002 and fifteen in that position in 2013; the lowest performers in 2002 show some improvement http://ec.europa.eu/eurostat/tgm/printTable.do?tab=table&plugin=1&language=en&pcode=tec00116&printPreview=true

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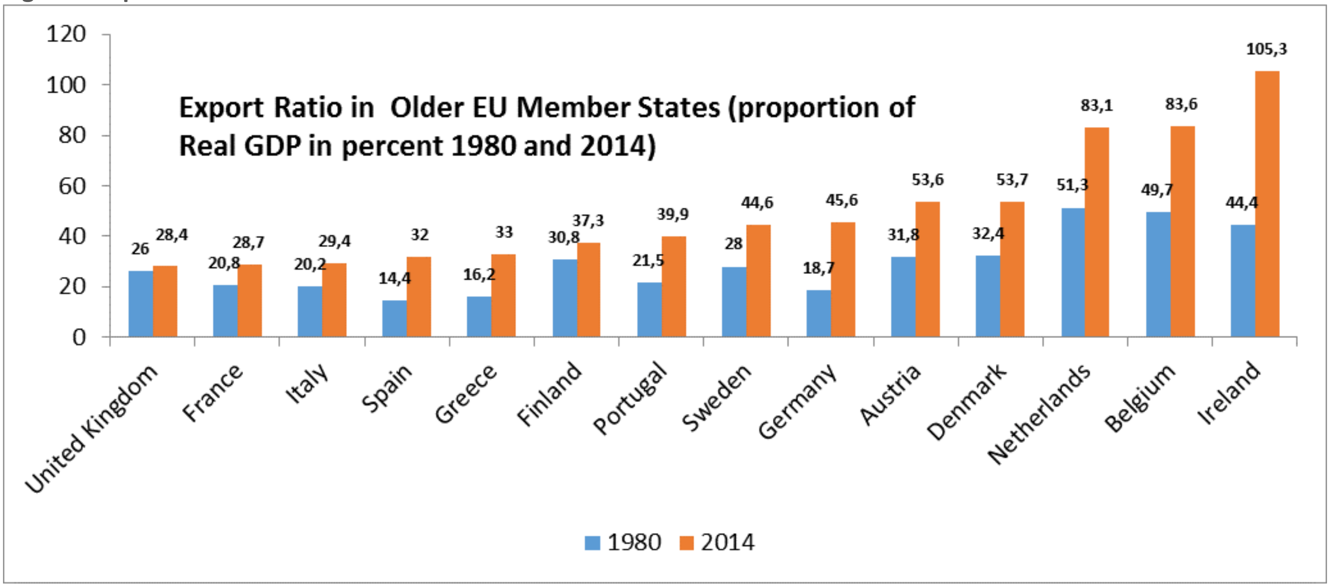
domestic demand growth has even been negative, averaging -0.26%[7]; also in Germany domestic demand growth has been particularly anemic, averaging just 1.18 (1990-2015), 0.66% (2001-2015) and 0.88% since 2008.

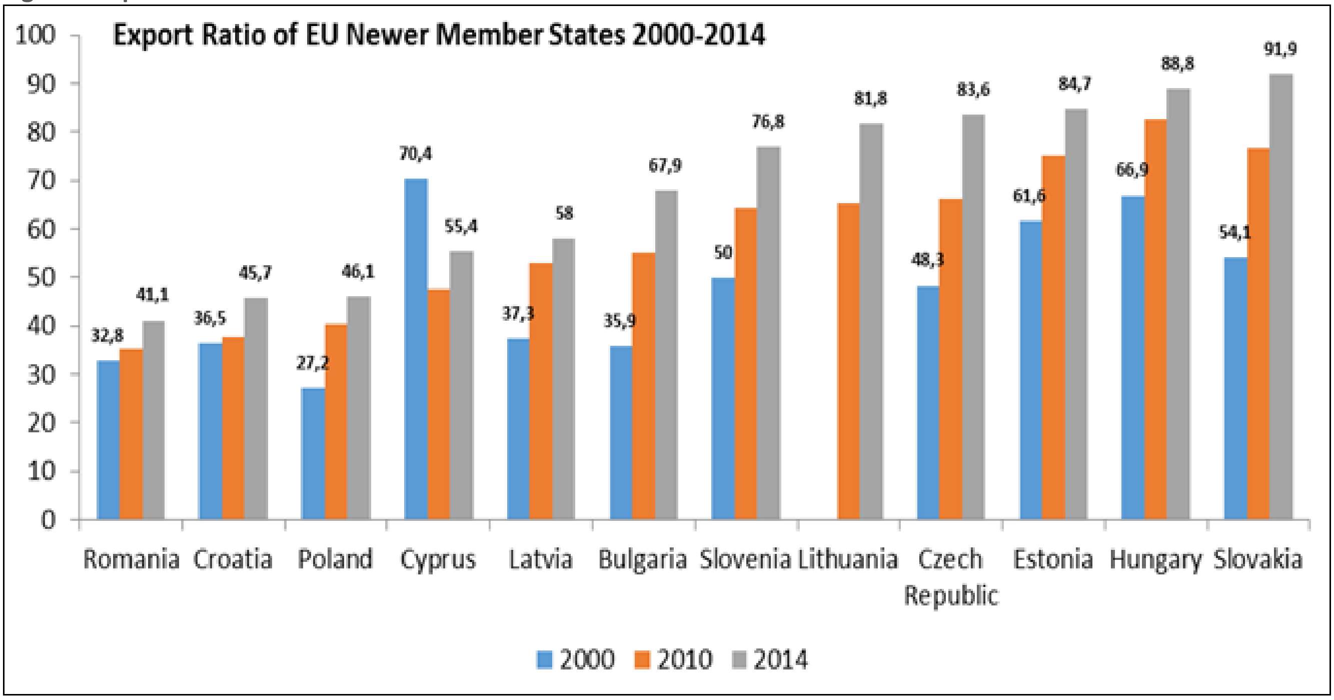
These weaknesses generated a matching dependence on net exports as vehicle of (anaemic) recovery/ growth (particularly in Germany):

Figure 2 Export Ratio in Older Member States



Data Source: World Bank

Figure 3 Export Ratio of EU Newer Member States 2004-2014



Data Source: World Bank

- With the exception of Cyprus, the export ratios of all EU member states have grown (see above two charts), in some cases markedly; while the smaller EU states unsurprisingly display a very high dependency on exports (Ireland, Belgium, The Netherlands, Slovakia, Estonia, Czech Republic, Lithuania etc), and the larger, sectorally more diverse states (UK, France, Italy, Spain) lower but rising export ratios. The 144% rise in Germany's ER (1980: 18.7 percent; 2014: 45.6 percent) underscores the

[7] Figures from OECD *Economic Outlook*, November 2014, Paris; 2014-15 figures are estimates

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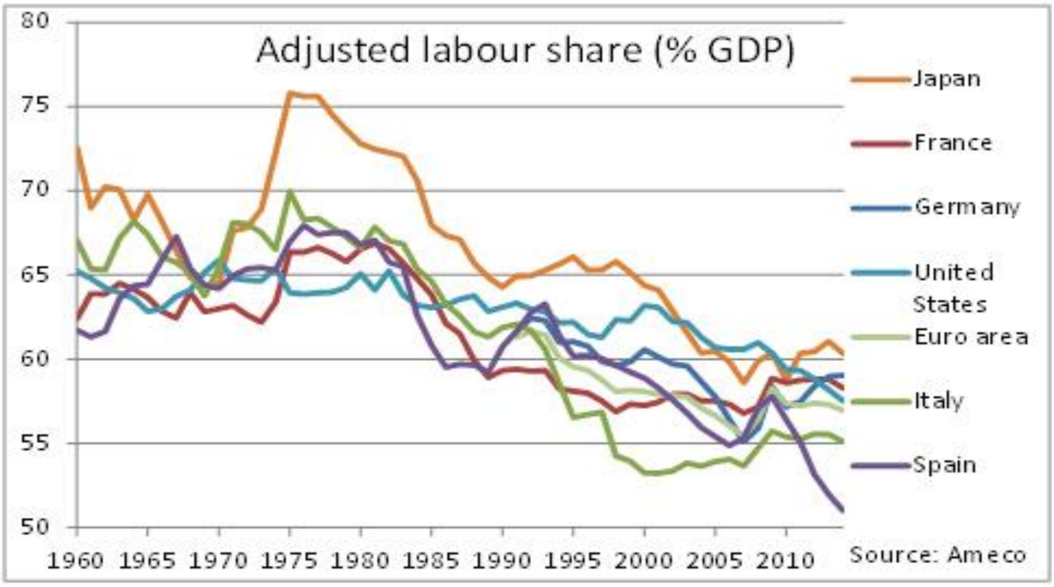
'chronic' export dependency of Europe's core industrial economy and the corresponding weakness of Germany's domestic demand factors and overall growth record (above).

- A critical determinant of stagnating domestic demand across the EU is the chronic widening of income and wealth disparities, along with the declining share of wages in national income:

Figure 4 Adjusted labour share



- In a region, where private consumption accounts for 56.9 percent of EU28 GDP[8], it is unsurprising that the dramatic decline in the share of wages and salaries in national income weakens aggregate demand and increases the importance of other demand factors as vehicles of growth, notably exports. It is also unsurprising that, with the EU's (pro-cyclical) imperative of budgetary consolidation reducing the share of public consumption from 21.8 percent of GDP in 2009 to 20.9 percent in 2014, businesses which are heavily dependent on domestic demand are reluctant to increase productive investment expenditures, despite enjoying a higher profit share in national income (profits ratio).

The AGS points correctly to the link between wages and productivity: "to ensure high employment levels throughout the EU and to advance convergence, real wages must continue to move in line with productivity over the medium term" (p. 11). Higher wages are necessary to boost the aggregate domestic demand. The Commission gives the responsibility for the adjustment of the wages in the hands of the Member States and the social partners.

Another factor that affects domestic demand is the growing inequality in some of the EU countries. The following figure reveals the rising inequality measured by the share of the top 1% of earners in total taxable income. In comparing 1980 with 2008 it is clear there is a marked increase in the share of top 1% earners in several Member States (e.g. Finland, France, Britain and Italy). The disparity among the EU members is another cause for concern that undermines the convergence of the EU and the European integration process. It is notable that the income per capita in the richest Member States is three times that of the poorest; that has been combined, since the onset of the crisis, with a process of concentration of capital, production and investment in the euro area – about 49 per cent of the euro area research and development in 2012 was concentrated in Germany, the Netherlands and Austria, compared with 46 per cent in 2007[9].

"If the integration process is to represent social progress then the well-being of EU citizens, rather than the functioning of national institutional structures must become the target of EU social policies. Moreover, tax-based transfer payments are, in the long run, more likely to be politically acceptable if they are seen as support for disadvantaged EU citizens rather than for specific member states."[10]

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[8] Figure for 2014; c.f. http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Expenditure_components_of_GDP,_EU-28,_2014_(%25_share_of_GDP)_YB15.png

[9] Euromemorandum, 2015, p. 27

[10] Ibid, p. 27

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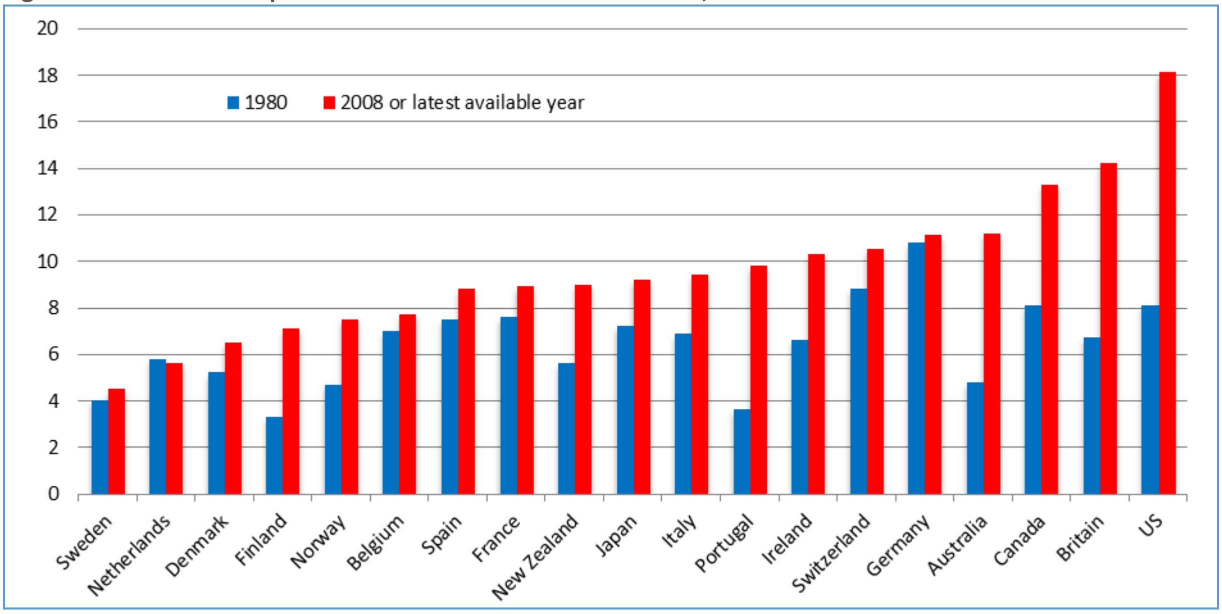
Figure 5: Share of the top 1% of earners in total taxable income, 1980 and 2008



Source: OECD, Statlink http://dx.doi.org/10.1787/888932566554 (as presented in the Euromemorandum, 2015)

The misreading of the signs is problematic. It undermines arriving at a clear and well-articulated solution that could also undermine the trust of people in Europe. Next to the misreading we also find blind spots in the AGS.

The blind spots of the AGS

Strikingly, the AGS uses the word 'demand' once in its 16 pages and only in relation to the labour market.

'Investment' on the other hand, as a factor of domestic demand, is mentioned 75 times. However, the predominant focus in the document is on improving the supply-side incentives for mobilising business investment.

The very first mention of the term sets the tone for the rest of the document: 'High private and public debt levels contribute to holding back investment' (p. 3). The much boasted Juncker Investment Plan has to be understood accordingly as a supply-side measure, inasmuch as the €21 billion EU funding for the programme, which was officially launched in July 2015, represents public insurance support for private risk-taking, rather than targeted public investment for the direct stimulation of aggregate demand in the European economy. The assumed multiplier-effects of such guarantees (€21 billion of public money generating €315 billion in additional investments, or 15 times the capital outlay) bear no resemblance to the much more modest macroeconomic returns assumed by the literature on fiscal multipliers – between 1.3 and 1.7.

The text then advocates the removal of administrative and regulatory 'barriers' to investment (p.6-7), improving the investment environment, completing the proposed Banking Union and Capital Markets Union, and pursuing 'structural reforms', above all in national labour markets.

Another persistent analytical blind spot concerns the fiscal policy of EU member states. The document makes repeated reference to 'responsible fiscal policies' and the need to respect the rules of the SGP governing fiscal consolidation. Notwithstanding the failure of current EU/ ECB policy to prevent the continuing rise of the aggregate debt-to-GDP ratio (92.9% in 2015/ QI), the emphasis on negative fiscal harmonisation ignores entirely the ongoing erosion of European fiscal cultures. This erosion is represented by inter-state tax competition and the resulting weakening of their vital fiscal resilience.

The progress that has been achieved by the draft directive on a Common Consolidated Corporate Tax Base[11] and the recent acceptance of the OECD's taxation recommendations concerning Base Erosion and Profit

[11] http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm

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Shifting (BEPS)[12] is critically undermined by the toleration of fundamentally disparate tax cultures within the EU28: the abolition of progressive income tax in the majority of newer member states, the progressive and competitive reduction of standard rates of Corporation Tax over the last two decades and the weakening of public tax administrations across the region have rendered the member states of the EU fatally vulnerable to the tax and regulatory arbitrage of highly mobile Trans National Corporations, reducing their ability to compensate for increasingly evident market failures (long-term, structural youth unemployment, poverty in working households).
The wide disparity in the ratio of tax revenues to GDP across the EU28 (EU19) is a fundamental obstacle to any ambition to promote 'convergence' to European best practice; it is absolutely no coincidence that the member states with the better ratios (in terms of tax revenue) have consistently better records of expenditure on Research and Development, key components of both the Lisbon Agenda and Europe 2020.

Conclusion

The Commission faces the big challenge of re-balancing the economy while restoring the social damage of harsh neoliberal policies from the past. There are many signs that this Commission wants to take another path. The AGS shows a new discourse. But this is not enough. As shown in this Policy Brief the Commission must go further:

- it must develop a real European social policy. Social policy is of course a core task of the Member States, but this doesn't mean that Europe cannot take the lead. As in the discussion about the refugee crisis, the Commission can develop this policy: through binding common standards of social protection; an enforceable benchmarking; common standards on social investment, …
- The Commission must re-evaluate the AGS. Like the entire macro-economic governance framework, it is based on crippled supply-side economics and an unbalanced diagnosis of the economic and social trends, with several blind spots. A new governance framework should be elaborated, one that reckons with these blind spots and a correct reading.

[12] http://www.oecd.org/ctp/beps.htm

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