

# opinion

Observatoire social européen

# paper

## Europe: The Social Challenge

Defining the Union's social  
objective is a necessity rather  
than a luxury



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**Europe: The Social Challenge. Defining the Union's social objective is a necessity rather than a luxury**

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## Table of contents

Introduction.....	3
1. Why a 'social Europe'?.....	5
Inequality in Europe.....	5
Four arguments in favour of an active social dimension to European policy .....	7
Argument 1: A safeguard against social dumping .....	7
Argument 2: A protective barrier around national social sovereignty .....	9
Argument 3: An inevitability of European Monetary Union.....	11
Argument 4: The social dimension as the core of the political project that is 'Europe'.....	20
Conclusion: Defining the social dimension of the Union is no longer a luxury, but a necessity.....	24
2. Setting the agenda of a social Europe.....	24
The investment agenda: dramatic imbalances in schooling.....	26
The protection agenda: Great variation in social efficiency .....	27
Divergent policy pathways during the boom of 2004/5-2007/8.....	30
3. The 'how' of a social Europe: key issues.....	32
Epilogue. A <i>Catch 22</i> for social democrats?.....	33
References.....	36

## Defining the Union's social objective is a necessity rather than a luxury

*Inaugural lecture by Frank Vandenbroucke on the occasion of his appointment as an Affiliate Professor to the Den Uyl Chair at the University of Amsterdam, 7 June 2012 (1).*

It is a great honour for me to be invited to hold the Den Uyl Chair. Not only was Joop Den Uyl an important social democratic leader in Europe from the 1960s up into the 1980s; his approach to politics also had a profound influence on many, including myself. Jan Pronk wrote a wonderful column on 'Den Uyl as a mentor', in which he summarised Den Uyl's style as a politician in ten lessons. Lesson one went as follows: 'Never stop studying. Never assume that the facts speak for themselves and that the truth has been found. Investigate backgrounds and less obvious associations. Never stop asking questions.' That is precisely what I intend to do.

### Introduction

For over fifty years we have been debating whether European policy requires an active social dimension. This question was already raised in the 1950s, before the establishment of the European Economic Community of six countries, and it is still around today, in a Union of twenty-seven Member States. The number of publications describing the weaknesses of 'social Europe' is now beyond counting. All too often, these writings are merely inconsequential lamentations of the unreachable. The ongoing crisis may present an opportunity to put 'social Europe' firmly on the agenda. Rather than a lamentation, what is needed now is a coherent conception of the reasons behind, the agenda for, and the governance of a European social union. In short, 'social Europe' needs an unequivocal answer to questions of *why*, *what*, and *how*. Remarkably, the question of 'why' European cooperation *ought to* contain – as a matter of principle – an active social dimension has hitherto received relatively little attention (2). I therefore focus first and foremost on this matter. In the first part of my lecture, I briefly scrutinise a number of arguments in favour of a 'social Europe'. I am aware that my approach may strike you as being rather destructive. 'Is this really a time for laying bare the weaknesses in the case for a social Europe?', you may wonder. But bear in mind the 'first lesson of Den Uyl' according to Pronk, and you will see that a social

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1. I would like to thank Rita Baeten, Tuba Bircan, Bea Cantillon, Paul De Grauwe, Ri De Ridder, Steven Engels, Joep Konings, Kim Lievens, Erik Schokkaert, Chris Segaert, Anne Van Lancker, André Van Poeck and Paul Van Rompuy for their detailed comments on and/or assistance with sections of this exposé. Responsibility for the opinions expressed is, however, my own.
  2. This area is not widely developed either in the field of normative political and social philosophy. The few existing sources include the famous appeal by Habermas (2001) and the correspondence between Van Parijs and Rawls (2003). In the literature on 'global justice', however, the EU has hitherto not featured very prominently. Only very recently has a debate been instigated on the normative foundations of a 'social Europe'; see Van Parijs (2011), Sangiovanni (2012), Nicolaïdis and Viehoff (2012), Van Parijs (2011) and the references in these publications.

Europe should not be championed as if it were a self-evidence. In considering the arguments, we must separate the wheat from the chaff. The notion of a social Europe must not be an intellectual hothouse plant that can survive only in the nurturing environment of friendly like-mindedness. The more rigorous you test an idea that you cherish, the stronger it is likely to emerge.

From the first part of my exposé I conclude among other things that, whereas ten years ago the quest for a lucid description of 'the European social model' might have been dismissed as interesting but not strictly necessary, today it is no less than an existential conundrum for the Union. True, the European financial system faces urgent short-term problems, but these do not detract from the fact that, in the longer term, an effective 'social union' is indispensable to the Union's survival. The practical implication is that, in addition to a *fiscal* compact, the Union requires a *social* compact. I argue that a *basic consensus* is required on the meaning of a 'social' dimension for Europe's citizens and on the role the Union might play in it. A common orientation towards social investment policy would appear to me to be an important ingredient. Such a consensus must also cover the issue of Member States' mutual obligations, i.e. what these countries may demand from one another. The question thus arises whether reciprocity can be incorporated into institutional relationships between the Member States, in the same way as social policy within each Member State separately is based on reciprocity between individuals.

All this is not to say that the monetary union can only survive if European policy adequately meets the requirements of social *justice* as I would like to define them. My core argument is more limited in scope: I assert that a basic consensus is required concerning the envisaged social model in order that the monetary union could survive in the long term. Such a basic consensus may assume a variety of shapes, depending on the underlying conception of social justice and the significance attached to it. However, I should at once add to this observation regarding the primacy of a basic consensus that, in order for such a consensus to engender broad political support, it must adhere to the objectives that the European welfare states have in common. It cannot contradict the normative foundations of European welfare states.

In the second part of my lecture, I briefly illustrate the ensuing social agenda. My exposé does not claim to be comprehensive. Important questions are left untouched, for instance whether the European Union should regulate taxation in order to safeguard the funding of welfare states against undue fiscal competition. In the third part of this lecture, I identify some of the urgencies in respect of the *how* – particularly the need to restore the unity between economic and social policy, and between short and long-term objectives – without dwelling on the *governance* agenda.

The Joop Den Uyl Chair refers to social democracy. In the final part of this lecture, I therefore address a question to my fellow European social democrats. The basic consensus – the primacy of which I emphasise – requires a 'historic compromise' between the political families supporting the

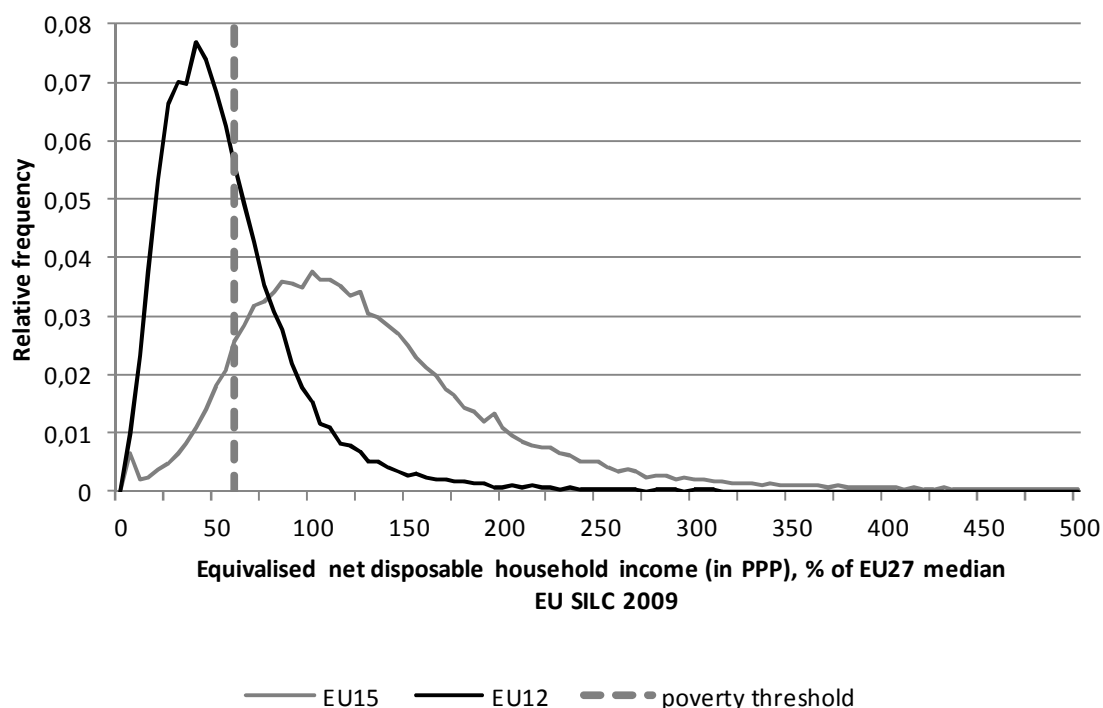
governments of the Member States and that are present in the European parliament. Does such a historic compromise constitute a *catch 22* for social democrats in search of an enhanced identity?

## 1. Why a 'social Europe'?

### *Inequality in Europe*

To put the question of 'why' in context, I start with a factual observation. One of the reasons we wrestle with the issue of a social Europe is the Union's enormous diversity of social systems and their histories. But there is more. Income inequality in the EU is as great as it is in the US; it merely manifests itself in a different way. If you find that hard to believe, consider that the pan-European Gini coefficient (a commonly applied measure of income inequality) is approximately the same as that for the US <sup>(3)</sup>. As long as the European Union was an association of Member States without a common social destiny, we could well afford to overlook that fact. For sure, the extent of income inequality *within* the European Member States is generally much more limited than income inequality within individual US states; but income inequality *between* EU Member States is much greater than that between US states. Leaving aside super rich Luxembourg, per-capita GDP in purchasing power parities (PPPs) in the poorest Member State, Bulgaria, amounts to a third of what it is in the richest Member State, the Netherlands (in euros it amounts to little more than a tenth). A similar exercise for the US reveals that per-capita GDP in the poorest Member State, Mississippi, is about half that in the richest states <sup>(4)</sup>. Minimum wages in the US are low but relatively uniform, cranked up as they are by a Federal hourly minimum wage of USD7.25. By comparison, the Bulgarian minimum monthly wage is estimated by Eurostat to amount to EUR122, which is low even by US standards, and less than 10% of the Dutch minimum wage. Obviously the most recent expansion of the Union has played an important role in this respect. Figure 1 is a visual representation of income distribution in the EU, whereby a distinction is made between the 'old' Europe – the EU15 – and the 'new Europe' – the EU12.

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3. On the basis of EU-SILC 2009, the Gini coefficient for net disposable equivalised household income, expressed in terms of PPPs, amounts to 0.352 for the EU27 (calculation by Tim Goedemé). The latest representative Gini coefficient for the USA provided by the OECD is 0.378; regional price differences are presumably insignificant in the US context. See also Brandolini (2007), Burkhauser and Couch (2010) and Milanovic (2011).
  4. Similarly ignoring some super-rich outliers. Even if impoverished Puerto Rico is included in the American comparison, its relative position (in terms of per-capita GDP, in PPPs) within the US is more favourable than that of Bulgaria within the EU. See Vandenbroucke and al, (2012).

**Figure 1. Income distribution in the EU15 and the EU12**

**Source:** Vandenbroucke, Cantillon, Van Mechelen, Goedemé, Van Lancker (2012).

The horizontal axis of Figure 1 represents net disposable household income of all individual Europeans; amounts are equivalised to take account of household size and composition. All incomes are measured in PPPs and expressed as a proportion of the pan-European median. The dotted line represents a commonly used poverty line – 60% of median income – but defined as a pan-European threshold; it is based on the pan-European median. The areas to the left of the dotted line indicate which proportion of the population has an income below this threshold in respectively the EU15 and the EU12. An analysis in pan-European PPPs reveals that approximately 15% of the population in the EU15 has an income below this pan-European poverty threshold, compared to no less than 70% in the new Member States. The gap between the most and the least affluent countries is quite considerable: expressed in PPPs, 'rich' Romanians (by which I mean: the better-off middle classes) are poor in comparison to 'poor' Dutch citizens (<sup>5</sup>).

5. I leave aside the class of super-rich Romanians, who can be wealthy even by Dutch standards, and refer merely to the better-off middle classes. Expressed in PPPs, the equivalised income of a Romanian on the 80 percentile is below the Dutch poverty threshold, defined as 60% of the national median (Vandenbroucke and *a/*, 2012, Table 3).

### ***Four arguments in favour of an active social dimension to European policy***

Let me begin with a positive observation, counter to the predominantly negative discourse on the social significance of European integration. The European Union plays a progressive role in the development of non-discrimination policy. Starting from the principles of non-discrimination on grounds of nationality (at least for EU citizens) and of equal pay for equal work for men and women, the EU has created a solid legal foundation for enforcing non-discrimination in the fields of gender, age, ethnicity... Stephan Leibfried (2010) suggests that non-discrimination, with an expanding role for courts, may constitute the way forward in further developing Europe's social dimension. In an entity so heterogeneous and so dominated by political vetoing as the EU, it may even constitute the only way forward. Seen in this light, the question may be reformulated as: why does Europe require an active social dimension that goes beyond anti-discrimination? I distinguish between four possible arguments: the envisaged social dimension is...

- i. a safeguard against social dumping;
- ii. a protective barrier around national social sovereignty;
- iii. an inevitability of European Monetary Union;
- iv. the very core of the European project.

The first three arguments are instrumental in nature; the fourth is a matter of principle. Although the proposed arguments do not follow from one another, they are not mutually exclusive either. The question is, therefore, how convincing are they, separately and in conjunction? So let us briefly consider each of the four arguments.

#### ***Argument 1: A safeguard against social dumping***

The first argument is premised on the notion that far-reaching economic integration without social harmonisation induces downward pressure on social development in the most advanced Member States. If such downward pressure becomes aggressive, we speak of dumping. Hence, my (somewhat sloganistic) summary of the first argument as a 'safeguard against social dumping'. The question of whether economic integration without social harmonisation is at all possible was already the subject of the 1956 Ohlin report, which – together with the Spaak report – laid the foundations for the establishment of the European Economic Community. Bertil Ohlin (the Swedish politician and party chairman who would later be awarded the Nobel Prize in Economic Sciences for his work on the *Heckscher-Ohlin Theory*) assumed that differences in labour costs between the countries concerned were so closely related to differences in productivity that free trade would not cause downward pressure on wages. Ohlin did however emphatically assume that any subsequent divergences in the evolution of wages and productivity would be corrected for by adjustments to currency exchange rates (International Labour Organisation, 1956). Given the present context, that is clearly an important caveat.



*Prima facie*, history has not proven Ohlin wrong. In parallel with the process of European integration, the national welfare states have expanded, sometimes spectacularly so. Successive enlargements of the European Community and the EU have invariably resulted in upward convergence; the World Bank has dubbed the EC and the EU a veritable 'convergence machine' (Gill and Raiser, 2012) (6). Social dumping has turned out to be a spectre rather than a reality. Now it can be argued that the European Community – rather in contravention of the Ohlin doctrine – has coupled market integration with high-level social harmonisation in certain areas, more in particular during the 1980s and 90s in relation to health and safety in the workplace (7). It may also be noted that the 'upward' or 'downward' nature of convergence depends on the economic context: in a situation of long-term and widespread unemployment, downward pressure may gain the upper hand, due to, for example, the overall weaker position of the trade unions. The question of whether economic integration occasions upward social convergence more generally depends on the prevailing power balance in society. So I do no justice here to the qualified debate that this issue warrants. Nonetheless, the thesis that lifting obstacles to trade constitutes a barrier to social progress in Europe would appear, *prima facie*, to be exaggerated. The argument for a social Europe premised merely on the functional necessity of preventing social dumping cannot be a strong argument.

To that I would like to add the following consideration. If lifting trade restrictions between countries of unequal economic development puts a brake on social progress, then the Europe of 27 faces an insurmountable problem. The differences between the Member States are so great – as the example of minimum wages shows – that it is impossible to define a *level social playing field* that is economically feasible for the least developed economies yet impactful for the most developed ones (8). That is not to say that to insist Germany should introduce a national minimum wage is not meaningful; on the contrary, there are arguments to the opposite, but their rationale is of a different order than the notion of a pan-European harmonisation of minimum wages (9).

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6. This relates to convergence in national data and says nothing about regional (or subnational) convergence or divergence.
  7. This happened in parallel with the creation of the single market, on the basis of the Single European Act
  8. By 'level playing field', I mean a harmonisation in absolute terms, rather than a harmonisation whereby, say, national minimum wages are set on the basis of average national wages. The latter is by no means self-evident, either, though it is obviously far less of a challenge than an absolute harmonisation.
  9. In what follows, I refer to a plea by Pisani-Ferry for a more expansive wage development in Germany than has been the case in the past decade; an increased minimum wage may fit into such a strategy. I also refer below to a legitimacy argument of a more political nature.

## ***Argument 2: A protective barrier around national social sovereignty***

The first argument – which I have discussed only very briefly – refers to the *de facto* autonomy (i.e. the actual room for policymaking) of national welfare states. The second argument concerns the *legal* sovereignty of those welfare states. It refers to a line of research developed by Fritz Scharpf, Stephan Leibfried, Maurizio Ferrera and others. The underlying notion is that of an intrinsic conflict between the imperatives of, on the one hand, economic integration in a free market and trans-border mobility of citizens and services, and, on the other, the development of national welfare states and communities through nationally conceived reciprocity of rights and duties<sup>(10)</sup>. The latter imperatives presuppose borders and clearly defined membership of national solidarity circles; the former extend beyond such borders and solidarity circles. The fundamental conflict is one between a logic of ‘opening’ and a logic of ‘closure’, to paraphrase Maurizio Ferrera<sup>(11)</sup>. The logic of ‘opening’ implies that a Bulgarian in the Netherlands should enjoy the same right to social assistance as a Dutch national, without attaching excessively strict country-specific conditions; under the logic of ‘closure’, the right to social assistance is earned through adherence to nationally defined social obligations and conceptions of social integration. Taking another example, the logic of ‘opening’ would allow Dutch citizens to shop freely in Belgium for health care services covered by Dutch care insurers, even though this would jeopardize Belgium’s health care planning and rate agreements. The logic of ‘closure’, on the other hand, dictates that national authorities may regard health care provisions as services in a market that is neither open nor free, both to their own citizens and to foreigners. The point that Scharpf (2009), in particular, hammers home is that not only does this conflict exist, but the institutional architecture of the EU is such that it is systematically decided in favour of economic integration and mobility, at the expense of national social sovereignty and national community. Stephan Leibfried (2010) explains that, whereas the European treaties and basic legislation allow for a clear distinction between pure ‘state action’ (or ‘solidarity action’) on the one hand and pure ‘economic action’ on the other (a distinction that provides direction in the jurisprudence of the Court of Justice), the dividing line between the realms of national solidarity and market principles is far less clear in the extensive grey area where social policy and market mechanisms operate concurrently. The latter occurs on a

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10. For a particularly sharp articulation of this pessimism, see Scharpf (2009). Ferrera (2005) is more optimistic.

11. I develop this conflict only partially. A comprehensive analysis would distinguish between (i) the consequences of the free movement of persons for Bismarckian insurance systems, (ii) the consequences of the free movement of persons for citizenship-based Beveridgean systems, (iii) the consequences of the free movement of persons for social assistance schemes, and (iv) the consequences of the free movement of services for social service provisions. In what follows I focus on (iii) and (iv). In the context of Bismarckian social insurance systems, ‘opening’ implies among other things that Member States are not allowed to discriminate on the basis of nationality in the application of such insurance schemes. However, such an anti-discriminatory measure does not preclude a system based on rights *and* duties (‘no rights without contributions’); in other words, ‘opening’ does not rule out the kind of ‘reciprocity’ that is inherent in the Bismarckian insurance model. Nonetheless, flexible rules of access to rights could come under pressure in consequence of cross-border mobility.

grand scale in, for example, European health care. The analyses by Scharpf and Leibfried inspired me ten years ago to propose a 'horizontal social clause', for the purpose of emphasising more strongly the significance of solidarity as an ordering principle and in order to provide clearer guidance in this grey area to all European institutions, including the Court of Justice (Vandenbroucke, 2002c). Anne Van Lancker and other progressive representatives and non-governmental organisations campaigned for this cause in the European Convention. Via the IGC, an adapted version of the text found its way into Article 9 TFEU.

Although I find this an important issue, unlike Scharpf I do not believe that the institutional architecture of the EU today leads systematically and irresistibly to greater liberalisation and unchecked mobility (moreover, perhaps Art 9 TFEU will, with time, contribute towards restoring the balance in this respect) <sup>(12)</sup>. There is room for political initiative aimed at a correction of the balance between free market principles and the principles of social sovereignty: the EU is more receptive to politics than this deterministic analysis suggests. This is apparent from, among other things, the debate on the Services Directive, where the European Parliament amended the far-reaching liberalisation proposed by Bolkestein. It also transpires from the drafting of a 2011 European Directive where the European Parliament and the European Council sought to strike an appropriate balance between patients' rights in cross-border health care and national control over health care systems <sup>(13)</sup>. I do not agree either with the assertion that the EU does not allow the Member States to seek a balance between the granting of rights to social assistance and integration requirements; it seems to me that the problems surrounding this issue are related more to the implementation of policy than to its actual foundations <sup>(14)</sup>. In other words, I disagree with Scharpf – who nonetheless remains one of my intellectual heroes – that the EU has such an asymmetric constitution that it cannot be a social market economy.

That is not to say that the point is irrelevant. In particular, there is a critical interaction between, on the one hand, unequal social and economic development (to which I have already referred in the discussion of the 'first argument') and, on the other, reduced legal sovereignty of the Member States. A tension exists between cross-border mobility and the granting of social rights in every Member State; this could result in downward pressure on social generosity in the more advanced

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12. There is not only Art. 9 TFEU, but also the Charter and the Protocol on Services of General Interest. For a discussion of these elements, see Rhodes (2010), Armstrong (2010), Lenaerts (2011).

13. That is not to say that all problems in the field of health care are resolved. One could in any case argue that, in this matter too, the basic dynamics (including that originating in the Court of Justice) was aimed primarily at liberalisation and mobility, whereby politics was rather forced into the defensive. Nonetheless, the political debate played a role of some significance here. For an evaluation of the impact of the Court on EU law in this domain, see Engels (2012).

14. See Lenaerts (2012) for a brief summary of the viewpoint adopted by the Court of Justice. The implementation of social policy is a determining factor for the actual impact of mobility. An example that comes to mind is that of pseudo 'self-employed' persons entering Belgium to subsequently live off benefits.

of those states. Whether or not the latter actually materialises depends on how the right to mobility and social rights are balanced in principle, as well as on the subsequent implementation of those principles by the Member States, as I have already indicated in respect of the right to social assistance. Another example concerns minimum wages. Are minimum wages in the country of employment applicable to posted workers from another Member State, with a different statutory minimum wage? And what kind of actions can trade unions take when they feel agreements or regulations concerning minimum wages are violated in the posting of workers? A number of notorious judgments by the Court of Justice (*Viking*, *Laval*) have called into question trade unions' scope for action on such matters and seem to give precedence to the liberal principle of free movement. The line of thought developed by the Court in these cases merits a nuanced debate, but it does not diminish the need for a legislative initiative to change the framework the Court has to use. Mario Monti raised this problem in his report on the single market, and in March 2012 the Commission took an initiative to adapt legislation in this area, which should in effect widen the scope for trade union action. Bruun and Bücker (2012), however, feel that the Commission's proposal is inadequate and does not go far enough. They argue that, in this instance, fundamental social rights ought to be given precedence over, or at least receive equal weight as, economic freedoms. This (convincing) plea illustrates that the final word has not yet been spoken on this matter, and that there is scope for policymaking should policymakers so wish.

### ***Argument 3: An inevitability of European Monetary Union***

As I have previously pointed out, the 1956 Ohlin report was premised expressly on the notion that social harmonisation was not necessary, neither at the start of the integration project nor in the longer term, because it assumed that divergent socioeconomic evolutions would be corrected for by exchange rate adjustments. Of course, the establishment of the Monetary Union buried that assumption for the countries of the Eurozone. But with what consequences? Ben Chu, the leader writer with *The Independent*, formulated it as follows on 27 May 2012: 'Europe has to become a 'country' – a new beast – if the euro is to survive'. In arguing his point, he referred to four essential structural flaws in the design of the Monetary Union: the absence of a strong central bank behind the European currency; the absence of strong protection for bank depositors; the absence of a strong centralised government, whose budget forms an automatic buffer in the event of an economic downturn; and the absence of strong 'national' political decision-making. Since 'a country' simply cannot manage without social policy, the conclusion seems straightforward: the Eurozone needs a unified social policy too.

However, I believe that the issue of the euro is not as black and white as that: 'merging into a single state' is not the only way forward. For that matter, since the Eurozone will not become a 'state' in the foreseeable future, the foregoing analysis, if correct, would inevitably imply that the euro is doomed. *On the other hand*, it is not so that stabilising the Eurozone is merely a 'technical'

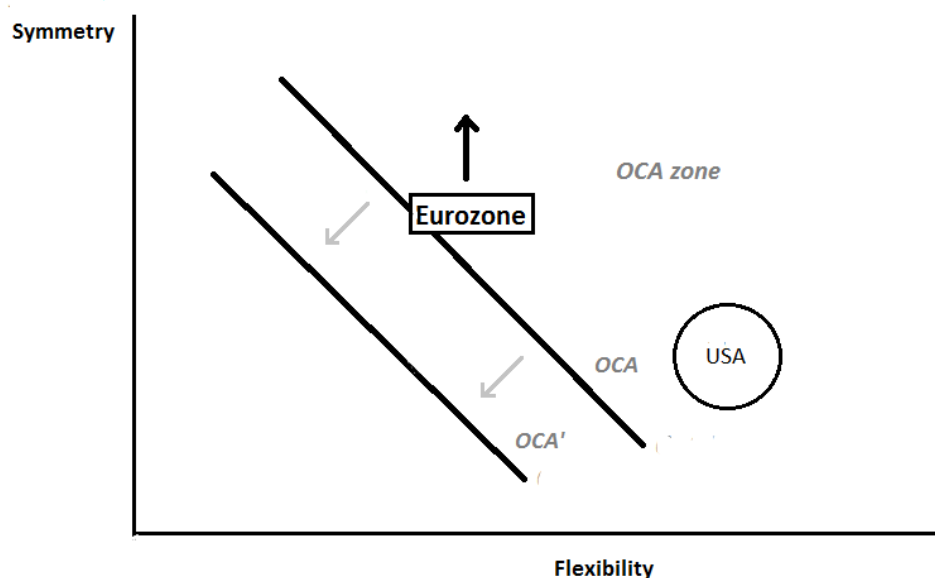
matter of insurance, i.e. it is not just about fine-tuning a system of inter-state insurance against asymmetric economic shocks – a central topic in the theory of optimum currency areas (OCA). Let me illustrate this point using a diagram proposed by Paul De Grauwe (<sup>15</sup>).

The benefits of a currency area relate to the reduction of transaction costs (i.e. the costs associated with currency exchange are eliminated, as is exchange rate variability) and to the fact that price comparability in the participating countries is enhanced. By stimulating cross-border trade it contributes to the creation of wealth. The drawback of joining a currency area is that national governments lose a policy tool, the adjustment of exchange rates. This is a potentially effective policy instrument, when wage and price developments diverge, or, more generally, if one of the countries concerned is affected by an asymmetric shock. In order for the benefits of a currency area to outweigh its drawbacks, the participating countries must display an adequate combination of symmetry and flexibility. Symmetry refers to the degree to which output and employment growth are correlated. Flexibility relates to wage flexibility and interregional and international labour mobility, which determine a country's 'internal' adjustment capacity in case of an asymmetric shock. Less symmetry necessitates more flexibility: 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. Figure 2 measures the degree of symmetry on the vertical axis and the degree of flexibility on the horizontal axis. The trade-off is shown by the declining OCA line. For a group of countries above this line, the benefits of monetary union outweigh the costs: given the degree of symmetry attained, they are sufficiently flexible. In this area of the diagram – the OCA zone – the requirements for an optimum currency area are met. A group of countries situated below the OCA line faces more drawbacks than benefits from

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15. My third argument can be broadened, starting from the premise that European integration not only creates collective goods that are valuable to the Member States, but that it also creates risks for those Member States. An integration project such as that of the European Union therefore implies a specific form of solidarity, inherent in this kind of undertaking; in essence it concerns an equitable insurance against the risks of integration. This notion is developed, for example, by Andrea Sangiovanni (2012), who arrives at a plea for *'reciprocity-based internationalism'*. The appeal of this line of research lies in its distinction between a solidarity concept that is embedded in the EU and one that is embedded in the institutions of the national welfare states. It is all too often taken for granted that a solidarity concept at the European level merely constitutes an *upscaling* of existing, nationally-conceived concepts of solidarity. An approach such as that proposed by Sangiovanni is based from the outset on the assumption that solidarity may be defined differently at a pan-European level than at the national level. However, Sangiovanni's normative approach can be criticised on some points. He uses the term 'risk' to refer to a series of problems and limitations facing the Member States of the EU, which I feel cannot all be rightly categorised as 'risks'; it is therefore not self-evident to apply to them an 'insurance paradigm' like Sangiovanni does. More fundamentally, one might ask whether a conception of social justice in the EU can ever be based solely on (problems in) the present functioning of the EU and on the present mission of the EU: does this not *a priori* limit the perspectives on the requirements of social justice? I further emphasise the notion of *'reciprocity'*, but I do not equate it to fair insurance against the risks of integration (I moreover consider the insurance paradigm to fall short in this respect). The essence of my argument also goes beyond a merely functionalist diversion (cf. argument 4, *infra*). Hence it is different from Sangiovanni's. It is beyond the scope of this lecture, though, to analyse the discrepancies in detail.

monetary union. The states of the US may be regarded to form an OCA; let us assume that the Eurozone is only just above the OCA line – a not so comfortable position to be in.

**Figure 2. Trade-offs in a monetary union**



**Source:** Based on De Grauwe, 2009, p. 110.

There is moreover a second trade-off: if the possibility exists of absorbing asymmetric shocks through *budgetary transfers* between the Member States, then the need for flexibility is reduced. In other words, if budgetary transfers are possible, the OCA line shifts to OCA' (as indicated by the two grey arrows). Economic theory on OCAs does not presuppose a permanent redistribution of income between member countries of the currency area; in principle, such transfer should be regarded as no more than a stabilisation measure. The distinction between 'redistribution' and 'stabilisation' is important, as one may assume the element of *moral hazard* to be more pronounced in instances of 'redistribution' than in cases of 'stabilisation'. *Moral hazard* would occur when a permanent flow of resources from richer to poorer countries would allow the latter to postpone necessary adjustment. Stabilisation can be temporary and cyclical. (By way of theoretical example: a mechanism of European co-funding of unemployment benefits during an initial period of unemployment – i.e. excluding long-term unemployment – that is activated when short-term unemployment in a country rises above a certain level would satisfy the condition of primacy of 'stabilisation' over 'perpetual redistribution').

The position of the Eurozone in Figure 2 is not unchangeable. Member States of a monetary union may put in place surveillance mechanisms to prevent asymmetric socioeconomic trends. That is the purpose of the Sixpack, which the European Union finalised in 2010. If the Eurozone succeeds

in harmonising the socioeconomic evolutions in the participating countries more closely, then the monetary union's position in Figure 2 will move upwards (as indicated by the black arrow). So herein lies an additional *trade-off*: to the extent that socioeconomic surveillance effectively prevents asymmetry, the need for a combination of internal flexibility and stabilising transfers becomes smaller.

This diagram illustrates that the sustainability of the Eurozone does not require a black-and-white choice for or against a budget transfer union, or for or against a particular model of political union. Rather, the sustainability of the monetary union confronts us with interrelated *trade-offs* that restrict our options.

Neither flexibility nor symmetry, nor indeed budgetary transfers, are socially neutral choices. In this context, flexibility refers to adjustment processes that are generally perceived as painful and difficult, like direct nominal pay cuts (rather than real pay erosion through currency depreciation and high inflation) or the facilitation of migration by job-seekers. Often, flexibility is also associated with smooth dismissal procedures and the like. While I am all for job markets that are not excessively rigid, I also feel we would do well to heed the words of the British economist Richard Layard, founder of the *Centre for Economic Performance* and theoretician of the activation policies pursued in the 1990s. Layard asserts that certain forms of flexibility make people unhappy. He refers not so much to wage flexibility – to which he is not opposed, in the context of decentralized wage setting – as to forms of labour market flexibility that induce personal insecurity<sup>(16)</sup>. Clearly, then, flexibility can have many different meanings and hence it, too, is by no means neutral concept.

Budget transfers may be aimed primarily at temporary stabilisation, but in practice it is very difficult to separate the stabilising purpose of public expenditure from its redistributive purposes. Obviously, that is not socially neutral<sup>(17)</sup>.

Is pursuing symmetry, finally, a neutral option? Symmetry essentially refers to budgets, labour cost and labour productivity: the relationship between these parameters must be properly attuned.

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16. Layard sticks to the welfare-to-work argument with which he tried to convince Europe's governments in the 1990s of the benefits of choosing the middle road between the strict US approach and the Franco-German way, which he felt was too lenient. He is opposed to just greater flexibility in the labour market, precisely because flexibility creates uncertainty. Instead, he argues, we should strive for welfare-to-work and secure work, as well as flexible wages, by which he means decentralised wage negotiations and a willingness to trade wage increases for job security (Layard, 2005).

17. Bargain and *a*, (2012) provide an interesting illustration in this respect. The implementation of budgetary transfers through a partial Europeanisation of national tax systems would result in large groups of winners and losers in the Member States. Even if this option is not chosen (a monetary union does not after all necessitate it), it would appear difficult to design a transfer scheme that can avoid a complex debate on the likely structural winners and losers under a pan-European transfer system.

Whether symmetry requires social convergence is a complex matter. Consider the following question: does symmetry imply convergence in retirement ages across the Eurozone? In order to maintain the balance in our social system, in the long run the retirement age should, to an extent at least, be linked to life expectancy. That is my opinion, though I realise all too well that this is easier said than done and do not wishing to be naive about the impact of ageing on individuals. But whether or not that is good policy for an individual welfare state is not the point I wish to discuss. The question under scrutiny here is whether the European Union should ensure, *for the sake of symmetry*, that Member States converge with regard to the link between retirement age and life expectancy. The position that it should is premised on the assumption that a country A that is more generous than other countries insofar as retirement age is concerned will inevitably end up with a relatively larger public debt and/or a relatively higher labour cost per unit of output. In other words, it builds on the notion that such a country will ultimately not be able to organize a trade-off between (greater) generosity of pensions, (lower) net wages, (higher) labour productivity and/or (lower) other public expenditures; a trade-off that would allow the country, despite a relative low retirement age, to continue to meet the requirement of 'symmetry'. The substantiation of this point requires a battery of arguments, including 'political economy' arguments relating to the behaviour of the public authorities, trade unions and employers <sup>(18)</sup>.

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18. On the basis of a simple economic model, it is strictly speaking not the case that a monetary union requires a harmonisation in the evolution of the retirement age. Imagine that in country A retirement age is not adjusted to life expectancy, while in country B it is. If net wages, relative to labour productivity growth, were to increase less in country A than in country B, due to the rising pensions contributions on gross wages in A, while the gross unit labour cost evolves identically, then there is no divergence insofar as labour cost is concerned. Nor does this give rise to a budgetary difference between the two countries. An alternative unproblematic scenario might be that the citizens of country A are satisfied with a less generous pension. It is also conceivable that the government in A chooses to economise on other public expenditures in order to find additional funding for the pensions system. This reasoning is, however, too simplistic. In comparison with country B, the labour supply in country A will be relatively low. This can generate upward pressure on wages; whether or not supply and demand in the labour market lead to that result depends on the response from workers (and/or their trade unions) to a tighter labour market, and on the possibilities for mitigating any shortages in the labour market through immigration. Under the alternative scenario, it is possible that workers in country A reject less generous pensions than in the other country and/or that the other public expenditures are not sufficiently compressible. This type of argument ventures into the realm of political economy. In this instance, we assume that employers and the government are not able or not willing to draw the consequences of greater generosity w.r.t. the retirement age: the coat is not cut according to the cloth. Ultimately, this will induce an asymmetric development in labour costs and/or public debt. In other words, a difference in pensions policy may result in an asymmetry that compromises cohesion within the monetary union.
- The above scenario is not self-evident: there are many impacting variables. However, if the reasoning holds for the retirement age, then equally so for education. Suppose that country A faces a shortage of skilled workers and a surplus of unskilled workers, unlike country B. One may then expect skilled wages in country A to be relatively high and unskilled wages relatively low (assuming that the imbalance is not resolved through labour migration); alternatively, if there is insufficient wage flexibility, unemployment may ensue. In country A, this will be compensated for with greater expenditures (on unemployment benefits, job schemes for the low-skilled), which will in turn lead to either higher taxes or a budgetary deficit (in comparison to country B). If the trade unions reject the notion of higher taxation leading to lower net wages, then additional upward pressure will be generated on wages. In other words, country A will ultimately 'pay' for the (relative) training deficit in the form of a higher average labour cost and/or



A political economy argument may be, for example, that a relatively generous retirement system in country A will ultimately result in the accumulation of an 'unpaid bill', due to an unwillingness to 'cut one's coat according to one's cloth'; this will increase the public deficit or the relative labour cost. It is not self-evident to prove the universal applicability of such arguments. *If* one chooses to rely on them, one must realise that they may, in the longer term (which is the timeframe contemplated here), also hold for substantial imbalances in education: a comparatively important shortage of skilled workers in country A would eventually also lead to asymmetry in terms of the labour cost per unit of output and/or to greater public debt. The excess supply of unskilled workers and the shortage of skilled workers will prompt responses from the jobs market and policymakers, which will eventually conspire to increase the relative labour cost or public debt in country A (see footnote 18 for an elaboration of this point). Moreover, the applicability of the argument would extend beyond differences in schooling, to other dimensions of social policy. In other words, *if* it is true that divergences in retirement policy pose a long-term problem for the cohesion of a monetary union (that does not wish to rely too much on wage flexibility and immigration), then this may be the case for a whole gamut of parameters of the social model that the Member States pursue domestically. The question then becomes: which areas of social policy leave room for fundamental divergence between the Member States of a monetary union?

Again, there are no cut-and-dried answers to the foregoing issues. The 'ifs' in their phrasing are important 'ifs': there are no hard proofs in these matters. But even if it remains unproven that the tuning of economic strategies presupposes some tuning of social policy, it is certainly a plausible hypothesis. The notion that economic policy is outlined supranationally while social policy is shaped in neatly separated national or regional arenas is most likely naive – a position that Leibfried has since long argued in respect of the EU. For this reason, 'symmetry' is not socially neutral either: the envisaged social convergence presupposes a choice of direction. Furthermore, *if* this argument holds for retirement age, it may also hold in relation to important imbalances in the fields of schooling, and indeed possibly other dimensions of national policy too.

Before I conclude this section, let me briefly return to De Grauwe's diagram. In addition to the described trade-offs, there are other crucial *conditions* for the sustainability of a monetary union. One is particularly topical at the present moment: a banking union. Another is also emphasised strongly by De Grauwe (2011), namely collective action on the sovereign debt of the Member States, in order to prevent Member States from slipping into a 'bad equilibrium', whereby short-term liquidity problems turn into solvability problems. This may be achieved by, for example, the joint issue of eurobonds. As in the case of budgetary transfers, one can object on the basis of *moral hazard*, as the interest rates of 'undisciplined countries' would be kept low at the cost of

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a budgetary shortfall. Lack of flexibility and a failure to cut one's coat according to one's cloth thus give rise to an issue of asymmetry.

higher interest rates in 'disciplined countries'. Mutualisation of debt may be implemented in such a way that these objections are in part resolved, e.g. by a difference in the interest rates applied<sup>(19)</sup>. These additional conditions for the sustainability of the monetary union are rather 'black-and-white': the persuasiveness of joint action (in relation to banks and debt) must surpass a critical threshold in order to be effective. As this lecture focuses on the longer term, I shall not dwell on these burning short-term issues – but obviously the short term presents itself before the long term.

What do the long-term trade-offs, implied by monetary union, entail for the social dimension of the European Union? The analysis, as summarised in De Grauwe's diagram, does not lead to unequivocal normative conclusions about the kind of social model the EU ought to develop. It does, however, show the inevitability of a *basic consensus* on the social dimension of the EU among the Eurozone members, encompassing cognitive as well as normative elements. Let me first summarise the cognitive dimension of the basic consensus necessitated by monetary union:

- What are the costs and benefits of a monetary union, and how can it be stabilised? The foregoing diagram would appear to me to be plausible, yet it remains the subject of debate under economists<sup>(20)</sup>. No other than Robert Mundell, the father of the theory of the optimum currency area, contributed to this debate in 1973 by presenting an alternative to his original analysis of 1961, with which the diagram proposed by De Grauwe ties in more closely (Mundell, 1961, 1973). Monetarists look differently at costs and benefits of monetary union than Keynesians do. At the launch of the Eurozone, the European Commission tended more towards a monetary view of government action than was the case under 'Mundell I'. Much depends on the extent to which one accepts that markets are self-stabilising.
- To what degree does economic symmetry also imply social convergence? What is the political economy of differences in retirement age and, say, schooling?

Scholarly opinions on these issues will never concur entirely. But, in order to arrive at political decisions and coherent policy, at least some analytical agreement is required, even if doubt and uncertainty remains over who is fundamentally right. The European Union is not an institution of science, but a political entity requiring a bedrock of public support among citizens. Some European citizens may entertain doubts about the arguments supporting the proposed connection between economic symmetry and retirement age, and yet believe that the absence of a national system of

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19. Cf. the proposal by Moesen and De Grauwe (De Grauwe and Moesen, 2009), and other proposals. In this sense, a mutualisation of (part) of the sovereign debt might constitute a form of solidarity similar to the kind required for resolving the prisoners' dilemma and to attain a Pareto improvement for all concerned; hence what is at issue is not so much solidarity as calculated self-interest.

20. See for example Fuest and Peichl, (2012) for an overview of types of budgetary unions and alternative proposals.

minimum wages in Germany will eventually put pressure on minimum wages in other Eurozone countries. Scholars should critically analyse *all* these arguments and take nothing for granted. However, for an institution in search of popular legitimacy it may be expedient to acknowledge the first issue (retirement age) as well as the second (minimum wages), as plausible arguments can be developed for both, and to explore ways of fostering public support and realistic policymaking in relation to both.

The normative dimension of the basic consensus that the monetary union demands is also twofold:

- What is our view on flexibility and on pan-European transfers? To what extent is flexibility a price we are willing to pay for possible asymmetric evolutions? What kind of flexibility would this entail? Are we willing to substitute transfers for flexibility, in the knowledge that, in practice, transfers always have a redistributive effect?
- If we agree that economic symmetry also presupposes social convergence, then common benchmarks need to be set as targets for organising such convergence. In the social arena, these tend to have a strong normative connotation. In the case of retirement age, for example, it concerns fundamental questions regarding the meaning of progress and vitality (Vandenbroucke, 2012).

I do not purport that the monetary union will only survive if European policy meets the requirements of *social justice* as I would define it. My claim is more limited; it is that the sustainability of that union requires a consensus on the social dimension. However, in order for such a consensus to be broad-based, it must tie in with the goals that the European welfare states have in common. In the past, it has often been stressed that the European welfare states are so diverse that it is impossible to accurately define *the* European social model. Nonetheless, however diverse the reality of European welfare states, at this time a minimal consensus is needed on common, *normatively charged objectives* of social policy.

Subsequently, a complex question of *reciprocity* in dealing with asymmetric developments needs to be answered. Let me introduce it with a rather technical example. Jean Pisani-Ferry (2012) explains why the adjustments of the economies of Southern Europe cannot be treated as a one-sided process. As a successful adjustment process serves a common interest, all should be prepared to contribute their part. Germany should accept a slightly higher inflation in order to allow the necessary adjustments of wages and prices in Spain (given that price stability in the Eurozone as a whole can be guaranteed and assuming that Spain takes this opportunity to implement structural reforms). The same reasoning applies in the budgetary field (the governments of Northern Europe must, according to Pisani-Ferry, avoid 'overkill') and in relation to

wage development (the governments of Northern Europe must accept a level of wage increases well above that observed in the first decade of the euro). 'Reciprocity', in this particular example, means that you share responsibility for a problem, on the basis of clear agreements and concerted efforts. It implies that the burden of economic adjustment – e.g. with a view to restoring competitiveness – is not placed on the shoulders of a single partner.

At the level of inter-human relationships, I believe strongly in reciprocity as a cohesive agent (Vandenbroucke, 2011). In a previous plea for reciprocity, I contrasted *homo reciprocans* with *homo economicus*: while both are driven by a desire for a 'return on investment' of either money or effort, the former differs from the latter in that he does not apply a shopkeeper mentality. *Homo reciprocans* attaches weight to individual responsibility, but is also capable of compassion if others find themselves in a vulnerable position, even if this position ensues from their own past choices. He is prepared to be (and remain) a net-contributor to society, but on condition that 'his' money is used to effectively tackle social problems such as poverty and unemployment (i.e. rather than being wasted on 'filling bottomless pails'), and provided that, where possible and relevant, those who receive assistance actually make an effort to turn that assistance into something positive. Thus conceived, reciprocity is the fundamental cement of society (Vandenbroucke, 2010). Samuel Bowles (2012) defines 'strong reciprocity' as a 'propensity to cooperate and share with others similarly disposed, even at personal cost' (21). Reciprocity goes beyond 'enlightened self-interest', though it is 'conditional'.

The question (as was neatly summarised in a recent Editorial of the *European Constitutional Law Review*, WTE, DN, 2011) is whether the notion of 'reciprocity' can play a meaningful role in the relationships between members of a union. To be sure, this is complex matter, as it involves various intertwined issues. What is the 'individual' responsibility of Member States in the event of an asymmetric evolution? How are these individual responsibilities attributed to individual Member States, given that an 'asymmetric evolution' is, by definition, a relative notion? At which point does the individual responsibility of Member States end and is collective support required on the basis of jointly organised mechanisms (such as transfers)? Should we adhere to a strict principled morality (whereby 'sinners' must face the punishment that their sins merit) or to a more consequentialist moral framework (taking due account of the fact that excessively strict punishment of sinners will also get saints into trouble)? Can member states of a union enter into an unbreakable mutual

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21. The manner in which Bowles develops this notion, as a realistic concept for human relations on which the welfare state may be founded, is particularly convincing, but it is not readily transposable to the institutional issue at hand. An argument such as that proposed by Pisani-Ferry actually relies on 'considered self-interest'. Bowles also assumes that 'strong reciprocity' finds expression in a willingness to punish failure to comply, even when punishment is personally costly for those imposing it. The institutional reciprocity that the EU requires cannot be based entirely on a 'principled moral reasoning' whereby the transgression of norms leads to sanctions irrespective of their consequences; cf. infra.

commitment with a time horizon that is long enough to allow reciprocity to become a self-sustaining mechanism <sup>(22)</sup>?

Hence, the Eurozone need not constitute 'a country'; but the layered political entity that the Union will be must be underpinned by a sustainable basic consensus in relation to essential cognitive and normative issues <sup>(23)</sup>. The fragility of the Eurozone points to the absence of a 'deep variable', described by De Grauwe as 'a sense of common purpose', as was apparent when monetary union was carried through in the process of German reunification: '(T)his sense of common purpose was the deep variable that made the monetary and political union possible in Germany. Put differently, monetary and political union were endogenous variables that were driven by a common force. The existence of this deep variable made it inconceivable that Germany would have started with a monetary union without having a centralized budget capable of making large transfers between regions, or without a unified social security system. This deep variable is weakly developed at the European Level' (De Grauwe, 2009, p.113). The sense of common purpose in any case presupposes a shared outlook on social progress and on reciprocity in the actions of the Member States.

In the 1999 Den Uyl lecture, speaking as Belgium's Social Affairs Minister, I championed an approach we later coined the 'Open Method of Coordination'. One of the arguments was that the method would make it possible to add substance to the objectives of the 'European social model'. In the years that followed, I came to emphasise that point ever more strongly: in my view, open coordination has both a cognitive and a normative dimension (Vandenbroucke 1999, 2002a, 2002b). What – from a functionalist perspective – may have seemed a somewhat superfluous debate ten years ago has become quite essential in the light of the Eurozone.

#### ***Argument 4: The social dimension as the core of the political project that is 'Europe'***

I now leave aside the monetary union arguments and recommence from a blank slate. The three previously discussed arguments were premised on the EU as a non-social construct. The necessity to develop a social dimension was inferred on functional grounds: with a view to protecting national welfare states against dumping and/or loss of social sovereignty, and for the success of

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22. In addition to these issues, there is a more fundamental, ethical-philosophical question to consider if 'responsibility' is conceived in the context of relationships between countries (or other political entities): must individuals always accept the consequences of decisions taken by their governments? I will not dwell upon this matter further, but clearly any attempt at defining the scope of 'reciprocity' between political entities necessitates an unequivocal answer to that question.

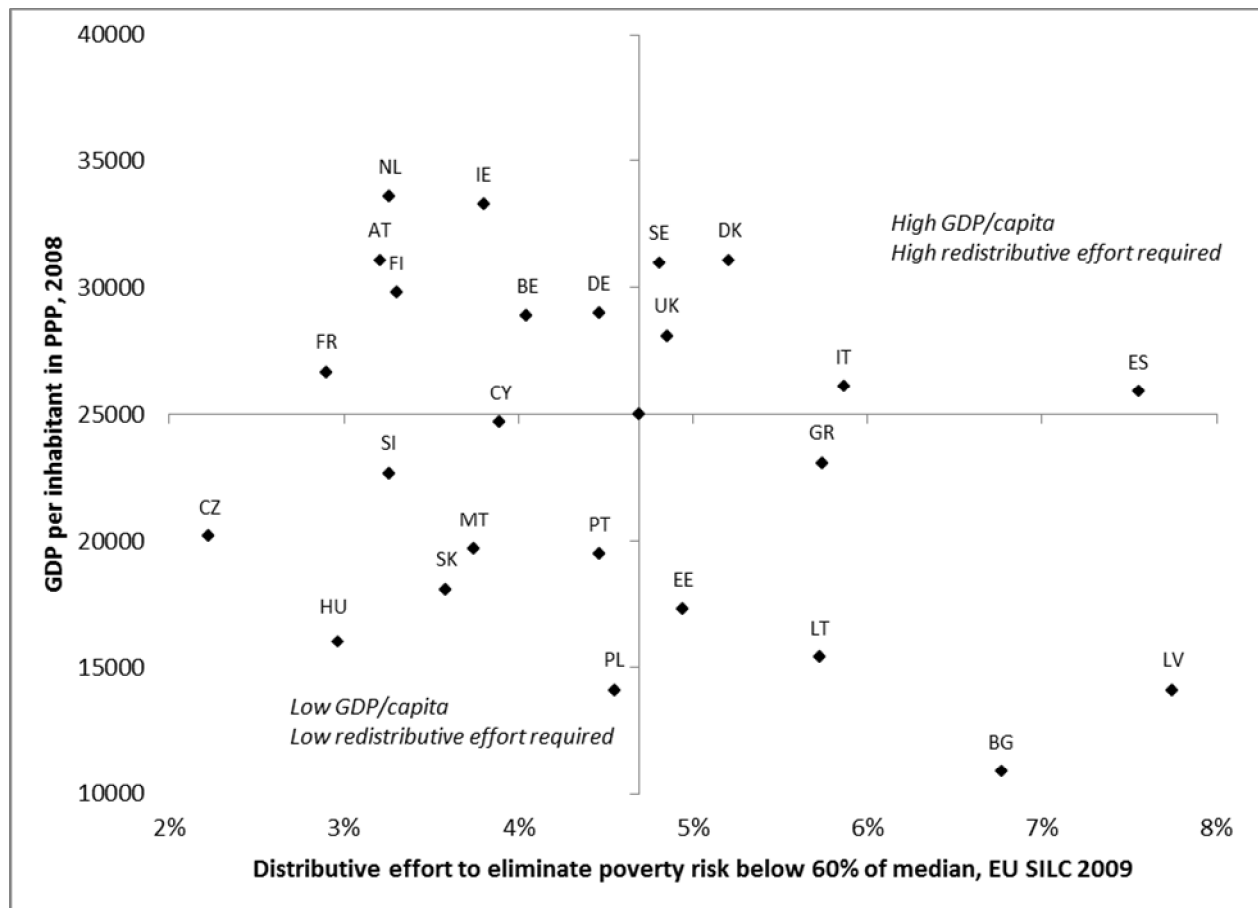
23. A political union is not a black-and-white concept, as De Grauwe emphasises. 'More political union' would in any case (i) facilitate the mutualisation of sovereign debt, and (ii) facilitate budgetary transfers, as arrangements could be made to avoid the moral hazard of persistent budgetary transfers occasioned by 'lax government'. 'More political union' would also make it possible (iii) to step up preventative monitoring with a view to avoiding asymmetric developments.

monetary union ... The fourth argument that I propose is of a different type. In the eyes of Jürgen Habermas, the essence of the European project – and the only remaining project for which political mobilisation is possible – consists in protecting a ‘European way of life’ against the pressures of globalisation. What Habermas means by this phrase, which was inspired by Lionel Jospin, is a way of life characterised by social, political and cultural inclusion and supported by strong welfare states. There is much to say for this interpretation of the European project. A political project that repeatedly intervenes in such a profound manner in the development of the countries of Europe cannot be legitimised for ever on the basis of a historical premise, such as the need to maintain peace. A purely economic rationale similarly fails to encapsulate the scope of such an undertaking and, moreover, fails to acknowledge the many non-economic levers and influences of the Union. Such a broader interpretation can build on degrees of cosmopolitanism that need not go as far as those put forward by Habermas: the essence is rather that what is at stake is a societal model that epitomises the ‘European way of life’. As such, this interpretation does not however induce a precise conception of the role the EU must play in Member States’ social policies in the strict sense. Habermas presupposes that, in a context of globalisation, the national welfare states are increasingly losing room for manoeuvre. His perspective is one whereby the European Union increasingly takes over not just the goals of the constituting national welfare states, but also their roles.

The notion that the European Union should adopt as its own the objectives of the national welfare states, and indeed remind the Member States of those goals (as in the case of poverty reduction), though invariably with due respect for the principles of subsidiarity and diversity, was central to the previously mentioned approach of the ‘Open Method of Coordination’, as launched at the 2000 Lisbon Summit. During the past decade, the criticism has sounded uninterruptedly that this method was too weak, too *soft*. But imagine that the approach were *toughened up* and ask yourself what this might imply for the European project. Bea Cantillon, Tim Goedemé and Anne Van Lancker, Natascha Van Mechelen (2012) and I address this question by simulating a proposal whereby the EU requires all Member States to introduce a system of minimum income protection that would eradicate poverty below a threshold set at 60% of the *national* median income. In other words, we imagine that the EU were to introduce a hard obligation for the Member States in the field of national social policy. The simulation may be regarded as an extreme illustration of the idea that the Union should lay down solid social rights, such as the right to a minimum income in keeping with human dignity <sup>(24)</sup>. So what kind of effort would be required from each of the Member States to meet such an EU requirement? Figure 3 visualises the answer to that question.

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24. The proposal that we simulate draws on Van Lancker and EAPN (2010). An additional argument for such a proposal pertains to an issue touched upon earlier, namely that differences in social assistance combined with cross-border mobility may lead to benefit tourism, generating downward pressure on the most generous systems in Europe. The proposal does not, however, lead to a harmonisation at an absolute level, which implies that ‘competition’ between social benefit systems will not be eliminated, even if the proposal is perfectly implemented. An appropriate balance between the right to mobility and

**Figure 3. Per capita GDP and redistributive effort required to eradicate poverty**

The 'redistributive effort' required in order to fully achieve this goal here and now (which would obviously be a big ask) would be quite variable: expressed as a percentage of the income of the non-poor population (i.e. those above the 60% poverty threshold), the required effort would range from less than 3.5% in the Czech Republic, France and Hungary to 7% or more in Bulgaria, Spain, Lithuania and Romania. The countries that would have to achieve the greatest internal redistribution are all Southern or Eastern European countries. They include the very poorest EU Member States, though it is not the case that 'being poor' necessarily implies a large redistributive effort in order to eliminate relative income poverty.

Romania would face a very substantial redistributive effort. *Prima facie* this is due to the fact that it is a poor and hence socially less developed country. However, Spain would face an equally substantial redistributive effort. In Figure 3, compare Spain's position with that of France: in terms of per capita GDP, the two countries are quite alike, but not so when it comes to the impact of social policy. As will become apparent in due course, Spain's social policy is particularly *inefficient*.

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the right to social benefits presupposes first and foremost an adequate legal delimitation of where the right to benefits begins and ends. Cf. my remark following argument 2, *supra*.

This brings us to a normative matter touched upon in the introduction. Let us assume that the Union were to pursue an explicit social objective in the field of income distribution. Should this objective be expressed in terms of the fairness of pan-European income distribution or in terms of more equitable national income distributions? Should the European Union ensure that 'rich' Romanians transfer sufficiently to 'poor' Romanians or should it ensure that the position of ('rich' as well as 'poor') Romanians improves relative to the position of, say, ('rich' and 'poor') Belgian citizens? This dual perspective cannot be reduced to a single one, as it is premised on conflicting views on the size of the solidarity circle concerned: the 'we' to which solidarity applies is differently defined. There is no simple trade-off between the one and the other perspective, let alone an algorithm whereby national and pan-European poverty indicators may be reduced to a single indicator. The nature of European cooperation is such that it would be highly peculiar to evaluate its results solely on the basis of national poverty indicators; in part, EU cooperation is geared explicitly towards the goal of enhancing pan-European cohesion. However, welfare states also aspire to improving the degree of 'national cohesion'. As European policy has such a considerable impact on national welfare states, its effects in terms of internal cohesion within individual Member States must also be ascertained. In other words, the non-reducible *evaluative dualism*, which compels us to take due account of national as well as pan-European poverty indicators, is intrinsic to the European project. Historically speaking, the European Community has always pursued the goals of enhancing national and pan-European cohesion concurrently. With a view to the latter, it has developed the so-called European cohesion policy. On the other hand, in the debate on 'social Europe', the objective has tended to be situated primarily at the national level: what was supposedly at stake was the safeguarding or improvement of national levels of social cohesion. I think 'social Europe' cannot be reduced to a matter of either national or pan-European cohesion (see also Fahey, 2007).

But that is not the end of the normative debate. If the poorer Member States are required to make a greater effort in order to improve the fairness of their internal income distribution, should they be entitled to more substantial external support from Europe? Or would this amount to an externalisation of policy failure and moral hazard attributable to inefficient government – as exemplified by the previously cited Spanish example? Put differently, *what is the European solidarity that comes with 'a European way of life'?*

My co-authors and I conclude from our simulation of a radical and binding European anti-poverty standard that we face a complex but inevitable problem of institutional reciprocity. On the one hand, the EU should aid the poorest Member States to attain such objectives, while on the other hand Member States are themselves responsible for the effectiveness and efficiency of their anti-poverty policies. Progress can only be achieved in this field if we instigate a virtuous circle of growing pan-European and national cohesion. *That* is the primary objective of a 'social Europe'. In the second part of this lecture I briefly illustrate what this implies in practice.



***Conclusion: Defining the social dimension of the Union is no longer a luxury, but a necessity***

In the first part, I have discussed four arguments for the EU to embrace an active social dimension. I feel those carrying the greatest weight today introduce a solidarity based on reciprocity in the relationships between the Member States. This perspective should go beyond a 'moralistic' framework and also be of help in dealing with the ongoing crisis. Moreover, these arguments do not allow a unilateral focus on either national cohesion or pan-European cohesion as a normative objective. They further presuppose a high degree of consensus on the goals of social policy. The reciprocity referred to is a reciprocity between national democracies. The crucial question is, however, whether reciprocity thus conceived is a workable and solid concept.

The functional requirements for a sustainable monetary union and the principled assertion that, at its core, the European project is a social model point in the same direction: the search for a strong consensus on the content of the European social model is no longer a superfluous luxury, but a necessity. Put differently, the tuning of economic strategies requires a minimal tuning of social policy. The notion that economic policy is designed supranationally while social policymaking happens in neatly separated national or regional arenas is naive. Although this viewpoint for many years dominated thinking on the EU, it is a recipe for a dwindling capacity of the Member States to direct their own social policies, without greater steering capacity on the part of Europe. However, the tuning of social strategies in Europe must not lead to the application of an undifferentiated social policy. Nor is it incompatible with the notion that Member States must retain sovereignty in specific areas (e.g. setting of minimum wages, the organisation of health care): the Member States must be able to effectively assume the responsibilities they bear. How far policy tuning should go, how to organise it democratically, and the extent to which a distinction should be made between countries within and countries outside the Eurozone are by no means simple matters. But the fact remains that the issue of an effective and legitimate European socioeconomic governance is more urgent today than it was ever before.

## **2. Setting the agenda of a social Europe**

How can we create a virtuous circle whereby both pan-European cohesion and national cohesion are enhanced? If there is any area today where the European Union needs a 'pact' for setting long-term goals in a spirit of reciprocity, then it is social investment, so argue Anton Hemerijck, Bruno Palier and myself. Social investment emerged gradually as a social policy perspective in the 1990s in response to fundamental changes in our societies. The focus is on policies that 'prepare' individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the emergence of new social risks and population ageing, rather

than on simply generating responses aimed at ‘repairing’ damage caused by market failure, social misfortune, poor health or prevailing policy inadequacies. The social investment concept is not new, but the fundamental societal trends that necessitated this approach are as relevant and important today as they were ten years ago, perhaps even more so because of adverse demography . It implies a reform-oriented agenda and a dynamic public sector (Vandenbroucke, Hemerijck and Palier, 2011). The agenda involves:

- high-quality childcare;
- investment in training and schooling, at all levels of education;
- support for the combination of paid work and family life;
- later and flexible retirement, in accordance with life expectancy;
- seizing the opportunities presented by migration, through among other things proper integration into education and the labour market;
- minimum income protection and, in general terms, capacitating service provision.

When reconnecting with an existing idea, like social investment, one should first evaluate what that idea has hitherto brought forth in practice. This assessment, which cannot be dissociated from an evaluation of the social chapter of the Lisbon Strategy, must be based on fact rather than perception. I think the conclusion is nuanced and diversified (Vandenbroucke and Vleminckx, 2011; see also Cantillon, 2011, Hemerijck, 2012a and 2012b) <sup>(25)</sup>. In 2008 one painful lesson certainly has been learnt: a robust social policy cannot be built on a shaky economic and financial policy foundation. Much of the progress achieved in the field of employment was wiped out by the financial crisis. This part of the analysis is now generally accepted. However, it has not sunk in sufficiently yet that erroneous economic orientations lead to erroneous orientations in skill formation: how should a country like Spain deal with today’s soaring unemployment rates among construction workers? As policy in the past decade has focused primarily, yet rather inadequately, on budgetary issues, the risks associated with such an economic and educational (non-)policy have not been acknowledged. This observation also underscores that it is too simple just to blame Spain’s policymakers: evidently unforgivable errors have been made by Spanish banks, but Spain’s overall policy stance was also the product of the ECB’s monetary policy.

Where do we stand today in relation to social policy, seen from a social investment perspective? I have often emphasised that we need to develop social investment and social protection as complementary pillars: one cannot replace the other (Vandenbroucke, 1999, 2007). It is beyond

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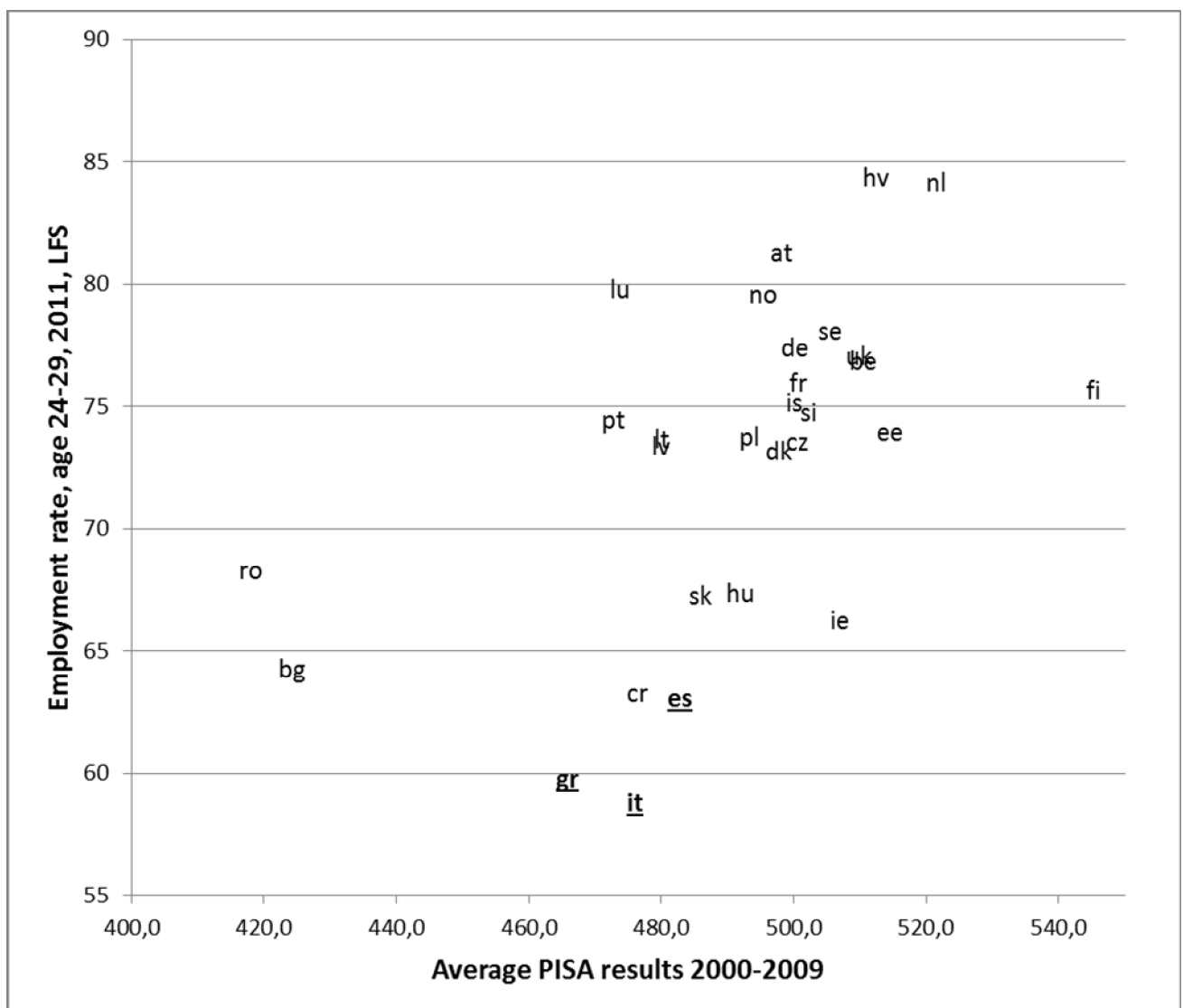
25. There was no single unique recipe that was followed uniformly in all countries of Europe. Given that a social investment strategy is a package, whereby the whole is stronger than the sum of its parts, there was sometimes evidence of policy inconsistencies.

the scope of this lecture to describe what action Member States ought to take in order to meet the requirements of a social investment strategy. I will illustrate how vast the EU's agenda is with regard to 'investment' as well as 'protection'.

### ***The investment agenda: dramatic imbalances in schooling***

Figure 4 combines two series of data: on the one hand, the employment rate of young people (aged 24 to 29) in 2011 and, on the other, the average PISA results attained by 15-year-olds between 2000 and 2009 in the fields of mathematical and scientific literacy, and reading.

**Figure 4. Employment rate among 24-to-29 year-olds and PISA results**



I do not wish to suggest that there is a direct connection between the two variables, let alone any simple causal relationship that explains employment in terms of educational attainment (<sup>26</sup>). But leaving aside outliers such as Bulgaria, Romania and Luxembourg, one cannot but be struck by the apparent correlation. Greece, Italy and Spain, for example, combine low employment rates with very weak PISA scores. Reiterating my previous point: if asymmetry in respect of retirement age is a significant long-term issue facing our monetary union (which I do not refute), then so too is this educational imbalance. Apart from this functionalist argument, this constitutes an exceptionally important societal agenda, at least if youngsters in Italy, Spain and Greece are to be offered the prospect of progress. For that matter, the European Union recognises that challenge: in the *Europe 2020* agenda, reducing the number of early school-leavers (which is high in these countries) is singled out as one of the *headline targets*. However, the question remains whether this educational agenda carries sufficient weight at the highest levels of European decision-making; in my opinion, the answer unfortunately is negative. Now it could of course be argued that this problem in education is one for the Italians, the Spanish, and the Greek to resolve for *themselves*. True, but the same argument holds for other areas of reform – like pensions and the labour market – where these countries are called to account by the European Union. By the same token, it is up to the Union not just to place such educational challenges high on the agenda, but also to make it possible for the countries in question to attain the targets set. An austerity agenda alone will achieve neither the former, nor the latter.

### ***The protection agenda: Great variation in social efficiency***

Figures 5a and 5b illustrate how different European welfare states perform in respect of social protection. The horizontal axis represents total social protection expenditures as a percentage of GDP. These expenditures cover pensions and social benefits, health care and elderly care, housing allowances and various social provisions, as well as before and after school childcare (0-12 years) and active labour market policy, but not education. Represented on the vertical axis of Figure 5a is the proportion of the population with a standardised net household income below 60% of the national median; that is the group described as 'at risk of poverty' in the 2001 Laeken indicators, which were intended to support the 'Open Coordination' of social policy under the Lisbon process (Atkinson and *al*, 2002). The vertical axis of Figure 5b represents an indicator that might be described as the degree of 'relative poverty reduction through transfers', i.e. the difference between pre-transfer and post-transfer poverty, divided by pre-transfer poverty. Pre-transfer poverty represents the proportion of people at risk of poverty if social transfers (including pensions) are not included in household income. Post-transfer poverty is the actually observed

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26. This cannot be proven, either, on the basis of these data, since the generations referred to on the vertical axis (i.e. the generations whose employment rate is measured) and those on the horizontal axis (i.e. generations whose educational attainment is measured) overlap only partially.

proportion of people at risk of poverty (as plotted along the vertical axis of Figure 5a). In what follows, 'relative poverty reduction through transfers' is shortened to 'poverty reduction'.

These indicators should be treated with some caution. For one thing, the definition of poverty reduction takes no account of the fact that the behaviour of people is affected by social transfers (without a pensions scheme, many people would be compelled to continue to work) <sup>(27)</sup>. Still, one can make a *prima facie* assessment of the efficiency of social expenditures in terms of a reduction of poverty risks in a given country *A* by applying two criteria. Country *A* may be compared with the other countries in respect of: (i) the 'poverty to social expenditures ratio', and (ii) the 'poverty reduction to social expenditures ratio'. Observed poverty alone (i.e. 'post-transfer poverty') fails to take into account that some welfare states face more extensive primary poverty than others, due to, for example, a larger low-paid labour force or more widespread unemployment. The notion of 'poverty reduction through transfers' provides insight into the extent that social expenditures succeed in remedying primary poverty. On the other hand, looking at poverty reduction alone might hide the fact that a welfare state can actually sustain primary poverty by providing benefits that create inactivity traps. In other words, a welfare state may appear to be effective in reducing poverty, while in fact it is part of the root cause of the primary problem in the first place. Hence the two measures need to be considered together. The test then consists in comparing the position of country *A* with *what one might expect* in terms of poverty and poverty reduction given that country's level of social spending, based on a regression of poverty and poverty reduction for all European countries. That is what we do in Figures 5a and 5b. The regression line in these figures constitutes a measure for the comparative efficiency of European welfare states in dealing with income poverty expressed in terms of the national threshold. A country that finds itself above the regression line in Figure 5a may be regarded as comparatively 'inefficient' insofar as the eventual poverty outcome is concerned. A country that lies below the regression line in Figure 5b may be said to be comparatively 'inefficient' in terms of poverty reduction <sup>(28)</sup>.

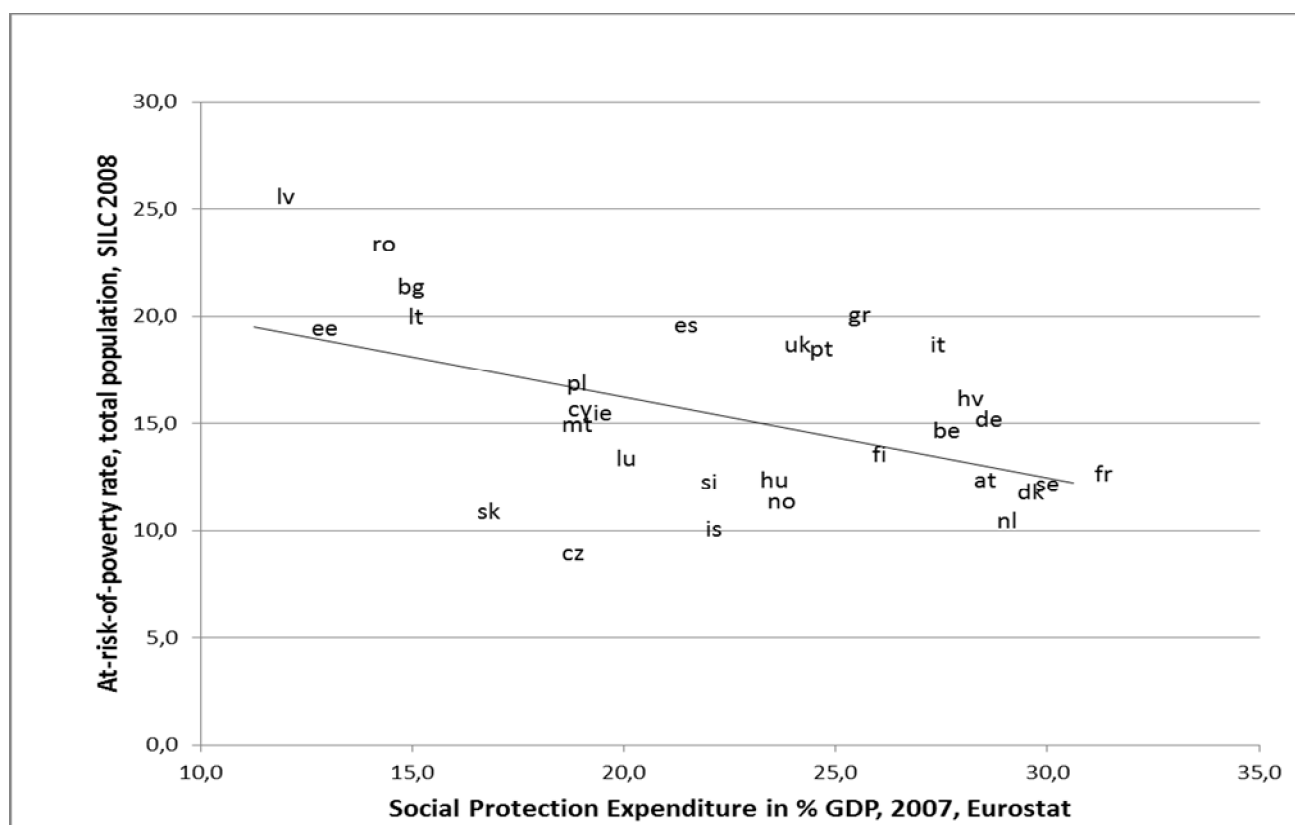
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27. See Vandenbroucke (forthcoming) for a more comprehensive discussion. The underlying data must also be treated with caution. The expenditure data that I use have not been corrected for tax effects. Consequently the expenditure levels for countries such as Sweden and Finland are overestimated and hence their 'efficiency' is underestimated. However, I focus here on 'inefficient' countries; a correction for taxes, to the extent that such a correction is possible, would appear not to significantly affect my observation regarding the relative 'inefficiency' of Spain and Greece. See De Deken (forthcoming).

28. In the interpretation of these tests, due account must be taken of the fact that it concerns a regression technique and estimations. Suppose that we were to apply the following rule of thumb: countries are comparatively 'inefficient' if (i) the estimated poverty rate is at least 1.5 ppt higher than the upper limit of the confidence interval of the regression of poverty on social expenditures, and (ii) the estimated relative poverty reduction is at least 6 ppt lower than the lower limit of the confidence interval of the regression of poverty reduction on social expenditures. Assessed on the basis of this rule, three countries are comparatively inefficient: Latvia, Spain and Greece. If we relax the second criterion, to include countries whose poverty reduction is at least 3 ppt lower than the lower limit of the confidence interval, then the UK, Portugal and Italy are also to be regarded as inefficient. It should be noted that 'inefficiency' is not synonymous with 'policy failure' in relation to social expenditures: there may be other, broader social factors at play on which policy may not have a direct grip.

On the basis of these two criteria, the social expenditures of Spain, Greece, Latvia and – to a lesser degree – Italy, Portugal and the United Kingdom may be regarded as comparatively 'less efficient' in mitigating poverty. To what extent is this attributable to policy? A first, rather obvious, policy-related explanation for the poor performance of the South European welfare states is that, in comparison with the other countries, they spend a lot on pensions. But even if the analysis is restricted to the efficiency of non-pensions-related expenditures on poverty alleviation among non-pensioners, it transpires that social expenditures in Spain, Greece, Portugal and Italy are comparatively less efficient. Surprisingly perhaps, we still lack clear insight into the reasons for this efficiency deficit. One striking characteristic of the systems concerned is their fragmented nature. In comparison with the other countries of the EU15, Portugal, Italy, Spain and Greece also spend relatively little on family support schemes (child benefits, childcare) <sup>(29)</sup>. Both scholarly research and the Open Method of Coordination ought to zoom in on this phenomenon more closely. A recurrent conclusion in scientific analyses (which is further confirmed in Vandembroucke and *a*, 2012) is that the overall quality of a social system, rather than that of a single instrument, is crucial to its poverty record. Again, here the process of Open Coordination should dig deeper.

**Figure 5a. Poverty and social expenditures, 2007/8**



29. However, one cannot conclude on that basis that comparative inefficiency in dealing with poverty can be explained in terms of a comparatively weak budgetary commitment to family policy: the Netherlands likewise spends relatively little on family policy (just slightly more than the countries of Southern Europe), yet it performs well in respect of poverty.

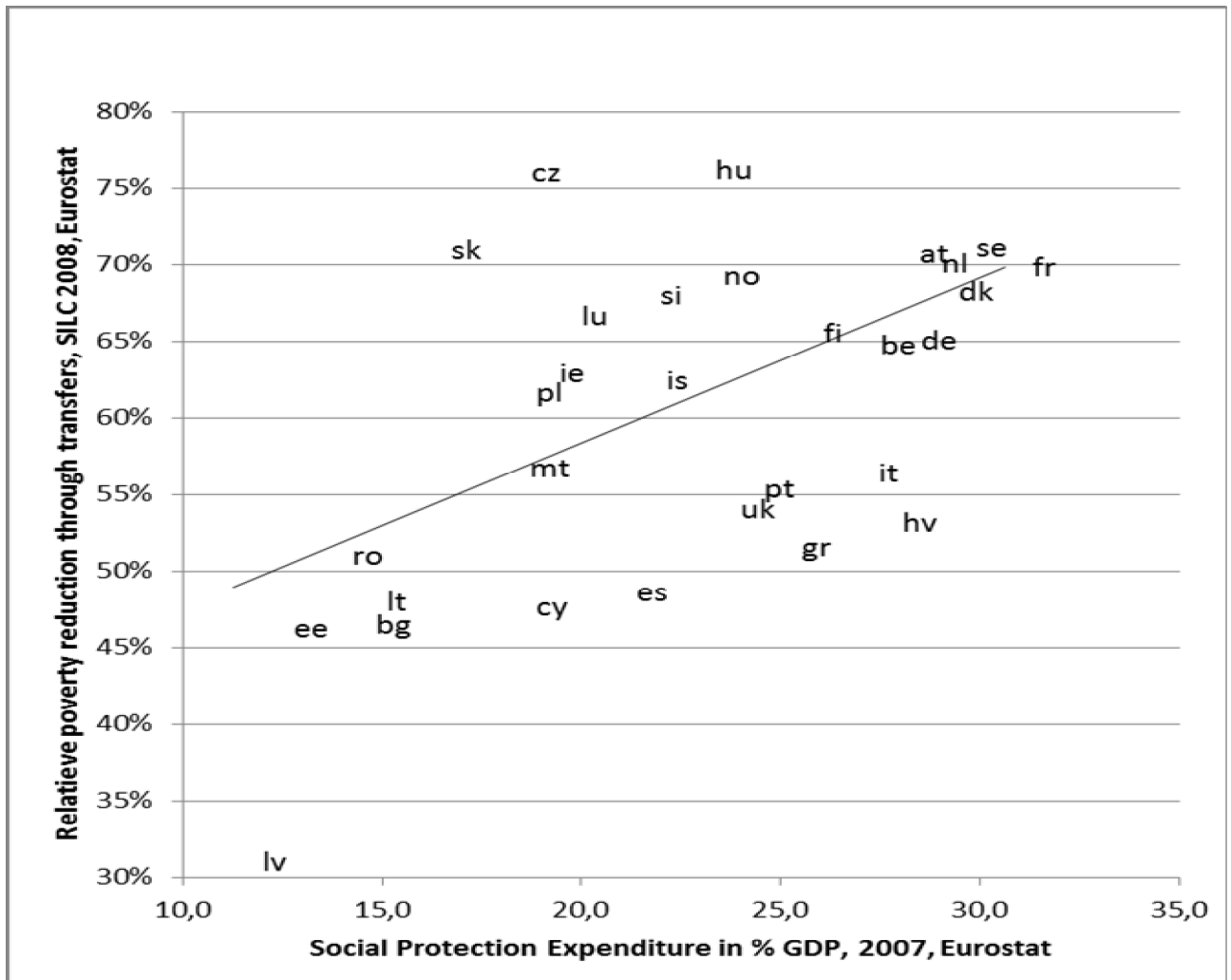
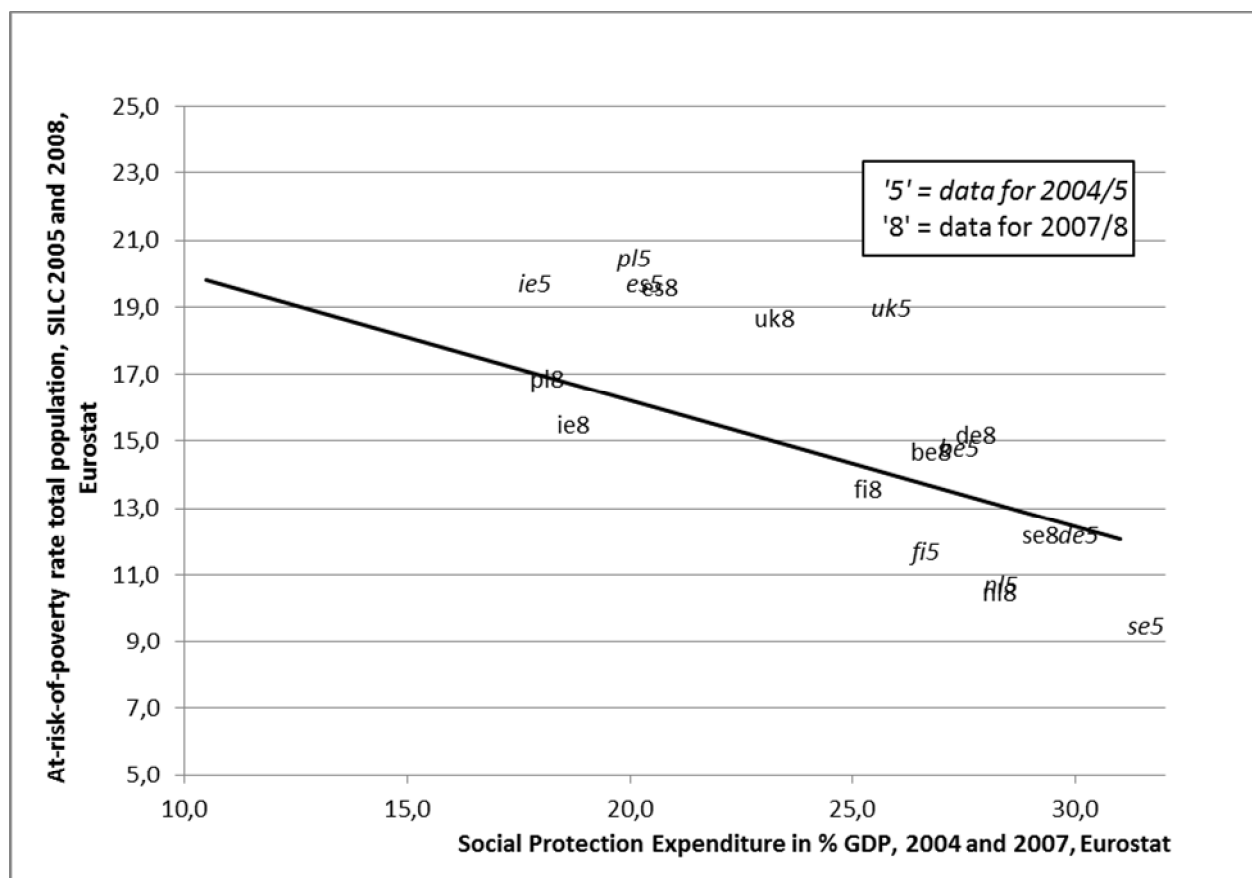
**Figure 5b. Relative poverty reduction and social expenditures, 2007/8*****Divergent policy pathways during the boom of 2004/5-2007/8***

Figure 6 provides an overview for selected countries of the road covered during the economically relatively favourable years prior to the 2008 downturn. Strikingly, the pathways were quite divergent.

**Figure 6. Poverty and social expenditures, 2004/5, 2007/8**

The Lisbon summit of 2000 culminated in ambitious statements regarding the fight against poverty in Europe. If one defines the notion of poverty on the basis of a pan-European measure – i.e. the number of Europeans whose income is below 60% of the median income in Europe – then the road travelled by the Union since 2000 is quite satisfactory: so conceived, poverty in the EU has declined significantly (Decancq and *a*, forthcoming). If, however, one measures poverty as intended in the Lisbon Strategy, using national thresholds (i.e. by counting the number of Dutch, Belgian, German... citizens whose income is below 60% of the national median of the Netherlands, Belgium, Germany...), then the inroads made are well below the ambitious target set. In fact, seen from this perspective, there has been no overall decline in poverty, but rather a poverty standstill. Poverty declined in some Member States, including in some with traditionally high poverty rates (e.g. some of the newly acceded countries, such as Poland, which saw a strong poverty decline, but also Ireland); but it also rose in some countries where poverty had been traditionally low (i.e. Finland and Sweden, and – depending on the data used – Germany). In other words, the choice of whether the Union should strive for 'national social cohesion' or 'pan-European social cohesion' makes a substantial difference when it comes to assessing social policy performance over the past decade. From a pan-European point of view, progress has been made. In terms of 'national social cohesion', there was considerable disparity, with an inegalitarian growth model in countries that we traditionally regard as models for emulation when it comes to social policy. Inspired by an



analysis published by Paul De Beer (De Beer, 2007), Vincent Corluy and I have charted this evolution in further detail for the years between 2004-5 and 2007-8. Our approach involved a decomposition of poverty evolutions on the basis of a distinction between 'work-rich' and 'work-poor' households, and the polarisation of jobs across households. Insofar as the latter is concerned, one again observes quite different pathways in the countries of Southern Europe than in the other Member States. By way of illustration, in Poland the proportion of adults in jobless households declined between 2000 and 2008 by 3.6 ppt; in Spain, the decrease amounted to just 1 ppt. On the basis of the evolution of individual employment rates, one would expect a quasi-identical decline in household joblessness in the two aforementioned countries (Corluy and Vandembroucke, 2012, Table 3). That divergence seems due to a deferred modernisation process, for which the Spanish government cannot simply be 'held to account'.

### **3. The 'how' of a social Europe: key issues**

The social investment paradigm is a long-term agenda. It would be naive to think that it can resolve the short-term issues presented by the ongoing economic and financial crisis. The challenge is rather to connect the short-term and the long-term objectives and to link economic and social policy. Two premises would appear to me to be essential:

- The short-term budgetary policy of the Member States should support long-term objectives of social investment policy, rather than to undermine them. In this respect, not only the quantity, but also the quality of expenditures is important.
- The Member States that are compelled today to make serious budgetary efforts in order to reduce their debts (and which often also face the consequences of a weak implementation of the social investment concept from the original Lisbon agenda) must be able to succeed. This success depends crucially on internal reforms, but also on support from other Member States and from the EU. I refer to the call by Pisani-Ferry for a more balanced approach to the macroeconomic adjustment process, and to the need for a collective European response to the banking crisis and the sovereign debt burden. But I also refer to making European funds available to support countries in their efforts to implement an effective social investment policy.

This is not a plea in favour of the social status quo. Quite the contrary, in fact. It is a call for a policy of social reform. However, any European social investment deal must be based on genuine reciprocity.

I ultimately believe that we must persist with 'Open Coordination' as a process whereby the European social model can gradually be better *defined* <sup>(30)</sup>. However, in this process, much greater emphasis needs to be placed on the accountability of the Member States in relation to the general quality of their social protection systems, including with a view to effective and efficient minimum income protection. It is also a good idea to incorporate such 'accountability' more strongly into what at present is the solidarity tool par excellence, namely the European Funds. This can be achieved by devising principles of conditionality, as argued by the European Commission as well as by NGOs such as EAPN <sup>(31)</sup>.

In the present debate, the *Europe 2020* programme offers something to hold on to. The goals of the programme tie in with the notion of social investment: more people in work, more resources for research and development, full commitment to the 20-20-20 targets on energy use, a reduction in school leavers, more youngsters in tertiary education, cutting by 20 million the number of poor in Europe. In the *Annual Growth Survey 2012* (European Commission, 2011), the Commission has drawn up a critical overview on the progress achieved in relation to the 2020 targets. The picture is not encouraging. Based on the plans submitted by the Member States, none of the 2020 targets will be reached. The combined measures aimed at social inclusion are set to reduce the numbers living in poverty by 12 million, well below the envisaged 20 million. A first task for the European Council is to take note of this contradiction and to place the 2020 targets on the agenda equally emphatically as the budgetary objectives.

### **Epilogue. A *Catch 22* for social democrats?**

Politics is neither technocracy nor science. Does the foregoing exposé contain a foundation for an appealing social democratic programme?

The European Union requires a broader objective, including a social aim. A debate that, from a functionalist perspective, may have seemed an incidental luxury only a decade ago is today a necessity for the Eurozone. As I have pointed out, a straightforward economic reasoning suffices to reach that conclusion. But there is more than just the economic argument. A political entity that intervenes profoundly in the daily lives of its citizens, as the European Union does, requires a public objective with a broad legitimacy. Self-evidently the content of that objective is a matter of political decision-making and power balances. I do not pretend that the outcome of the European political debate will always be to our liking; social democracy is after all not a majority movement

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30. Much has been published on Open Coordination as a governance method. See Heidenreich and Zeitlin (2009), Marlier and *al*, (2010), Public Policy and Management Institute (2011), and Zeitlin and Sabel (2010) for a discussion in the broader context of 'experimental governance'.

31. Within the scope of this lecture, I cannot expound on another relevant perspective, namely that of European labour law. However, a Flemish colleague at the University of Tilburg devoted his lecture to this subject (Hendrickx, 2011).

in Europe today. The point that I emphasized in this lecture is that the present goals of the European Union are not only inadequate from a social democratic viewpoint, but that they are intrinsically too narrowly defined to hold any prospect of success.

Social democrats cannot afford to dwell too long on the meaning of the European project and the importance of monetary union. Without resorting to a naive cosmopolitanism, I propose that what is at stake is indeed 'a European way of life'. We will not take charge of our destiny by backtracking. If the Union were to sink deeper into crisis, then the outlook is not bright for social democracy either. Therefore, Europe's social democracy must contribute to the 'basic consensus' that the Union needs to exist. And a 'basic consensus' implies compromise. Although it is a slightly tired phrase, what the European Union needs today is a 'historical compromise' between the dominant political families in Europe's governments and in the European Parliament. At first glance, this challenge may seem a bit of a *catch 22*: political movements exist by the grace of ideological conflict and strife. But if a new basic consensus between the large political factions and governments of Europe can help create hope, then we need not fear it. Obviously social democrats must lay their own accents. The observation that income inequality in the European Union is different yet of the same order as that in the United States should form the core for a social democratic agenda; it calls for a concerted investment in human capital, more specifically through education and training, but also underlines the need for an efficient social protection and 'fairness' in the labour market. As I have previously argued, from a legitimacy perspective, the European Union would do well to focus on a regulatory framework on minimum wages and their adequacy – particularly in Germany – in full acknowledgment of the fact that in this area, too, the architectural diversity between the Member States is considerable (Rycx and Kampelmann, 2012; Marx and *a*, 2012) and pan-European uniformisation a highly complex matter. The margins are therefore narrow. But I daresay that herein, and in the European investment agenda, lies an appealing challenge for social democrats. When I was twenty-two, I read a book in which Joop Den Uyl (1978) asserted that it remains the task of democratic socialists to outline their option for the future and, irrespective of whether the margins are broad or narrow, to gain approval and acquire power. Only then can insight (*inzicht*) yield a new outlook (*uitzicht*), as Den Uyl put it.

Holding the Den Uyl chair, I intend to focus on acquiring insight, but developing an outlook is equally as important. Two issues merit special attention from social democrats, if they aim to combine intellectual insight and political outlook:

- Social democrats across Europe must reassess the content of the social investment agenda that they have helped define – in various shapes – over the past fifteen years. In this context, I condone neither idolatry (the naive notion that 'social investment' always results in win-win) nor unfounded revisionism (the notion that the activation agenda was misguided). Social democrats ought to acknowledge the appeal of a renewed social investment agenda, particularly vis-à-vis

youngsters. They ought to define the role of the public sector in pursuing that agenda and ask themselves how the trade union movement and employers organisations might contribute to that overriding goal.

- Social democrats must mould the notion of reciprocity into a workable political concept, including in the context of the European institutional debate.

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