Eurodiaconia responds to the 2019 recommendations for the Euro Area as proposed by the European Commission and amended by the Council

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Eurodiaconia is a network of 48 organizations in 32 European countries providing social services and working for social justice. Founded in the Christian tradition we work to ensure that our societies provide opportunities for all people to live in dignity and realize their full potential. Ensuring a social market economy that promotes inclusive growth constitutes a priority for our members and this is demonstrated by their engagement in the provision of work integration and related social services for unemployed persons.

On 21 November 2018, the European Commission published the Autumn Package[1], thereby kick starting the 2019 European Semester cycle. In line with its long-standing awareness that economic and social policies have to be considered together due to their mutual impact on each other, Eurodiaconia has been involved in the European Semester of economic coordination since its beginning in 2011. Eurodiaconia drew out its priorities for the 2019 cycle in October 2018[2], ahead of the Autumn paclage, and was glad to see some of these priorities reflected in the Annual Growth Survey (AGS)[3]. We subsequently sent our comments on the Key Messages of the draft Joint Employment Report[4] to the Employment Committee and the Social Protection Committee.

With this position paper, Eurodiaconia wishes to react to the remaining key document of the package, namely the Euro Area recommendations, proposed as a draft by the Commission on 21 November 2018[5], amended by the Council committees and approved by the ECOFIN Council yesterday[6]. This document sets out recommendations for the 19 countries of the euro area that should in principle be in line with the priorities of the AGS and give directions

[1] European Commission, "European Semester Autumn Package: Bolstering inclusive and sustainable growth", 21 November 2018, available at: http://europa.eu/rapid/press-release_IP-18-6462_en.htm

[2] Eurodiaconia, "Priorities for the upcoming European Semester cycle: input to the Autumn Package", 16 October 2018, available at: https://www.eurodiaconia.org/2018/10/eurodiaconias-priorities-for-the-upcoming-european-semester-cycle-input-to-the-autumn-package/

[3] European Commission, *Annual Growth Survey*, 21 November 2018, available at: https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-annual-growth-survey_en_1.pdf

[4] European Commission, *draft Joint Employment Report*, 21 November 2018, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1547650919951&uri=CELEX%3A52018DC0761

[5] European Commission, *Recommendation for a Council recommendation on the economic policy of the euro area*, 21 November 2018, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1547734022733&uri=CELEX%3A52018DC0759

[6] General Secretariat of the Council Delegations, *Recommenation for a Council recommendation on the economic policy of the euro area*, 11 January 2019, available at: https://data.consilium.europa.eu/doc/document/ST-5097-2019-INIT/en/pdf

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for the upcoming country-specific recommendations this spring and for the completion of the Economic and Monetary Union (EMU).

- The 2019 Euro Area recommendations do not reflect the social ambitions of the Annual Growth Survey

Unlike last year's document[7], the Euro area recommendations for 2019 do not reflect social inclusion among its priorities. This is in contrast with the positive balance between economic and social considerations achieved by the 2019 Annual Growth Survey[8]. This highlights the **need to improve consistency in the various European Semester documents**. This is particularly concerning considering the lack of inclusive economic growth and the depth of inequalities in Europe, as acknowledged in the above-mentioned Annual Growth Survey. The overall emphasis on fiscal stability of the document renders the scope for holistically improving recommendation (3) on active labour market policies and social protection systems quite limited. **The lack of emphasis on social investment is an obstacle to effectively implement the priorities put forward by this year's Annual Growth Survey**. It is especially the case for the objective of fostering investments in quality health and social services to face two of the most challenging trends the European Union is experiencing, namely the ageing of societies and the changing world of work. Europe risks perpetuating the consequences of poverty, social exclusion and inequality, which are not only social but also undermine debt sustainability and growth, as well as the stability of the overall European political system[9]. To counter this trend, **Eurodiaconia recommends to incorporate social inclusion and inequality reduction as clear objectives of the Economic and Monetary Union** (EMU) not only for their social welfare value but also for their inherent long-term economic relevance.

To prevent further spillovers of the banking crisis on the sovereign debt levels of member states, the European Council set out steps towards creating a Banking Union in 2012, consisting of Europeanised banking supervision and mechanisms to deal with banking failures[10]. Moreover, recent proposals to strengthen the EMU linked the goal of economic convergence to concerns about social wellbeing: The *Five Presidents' Report*, which set a roadmap for deepening the EMU in June 2015, stressed improvements in the unemployment and social situation as an economic necessity[11]. The Commissions' *Reflection Paper on the EMU*, published in May 2017, suggested deepening the EMU around principles such as social fairness as well as responsibility and risk sharing. To overcome the lack of economic and social re-convergence, the role of the European

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[7] European Commission, *Recommendation for a Council recommendation on the economic policy of the euro area*, 22 November 2017, available at: https://ec.europa.eu/info/sites/info/files/economy-finance/com-2017-770-en.pdf
[8] European Commission, *Annual Growth Survey*, 21 November 2018, available at: https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-annual-growth-survey_en_1.pdf
[9] See for example Bruegel Policy Brief, "Europe's social problem and its implications for economic growth" , 2014/03.
[10] FEPS Brief, "Finalizing the Banking Union and Eurozone Governance", October 2018
[11] European Commission, *Five President's report: Completing Europe's Economic and Monetary Union*, 2015 p.8.

Semester cycle as a mechanism of coordination was highlighted, with the European Pillar of Social Rights contributing to "better working and living conditions"[12]. Consequently, last year's Euro Area Recommendations prioritised "sustainable and inclusive growth", reforms to "support the creation of quality jobs and reduce inequality" and to "support social protection and inclusion"[13].

- A narrow focus on the economic and fiscal narrative

This broad approach to the design of the EMU is hardly reflected in the Euro Area recommendations for 2019. According to the Commission's summary statement, the document calls for "reforms that increase productivity and growth potential, deepen the Single Market, improve the business environment, promote investment and improve the labour market (…)"[14]. Thus, the five recommendations mainly concern monetary, fiscal and economic policies to counter the expectations of moderate economic growth and to advance the above-mentioned implementation of the EMU. This encompasses deepening the Single Market (recommendation (1)), the Banking Union (recommendation (4)) and completing the EMU (recommendation (5)).

Since Europe is steadily recovering from the economic crisis, it is arguably time to prepare the Euro Area for future economic shocks by deepening its institutions and control mechanisms. At the same time, **the lack of inclusiveness of economic growth remains a pressing challenge for European societies[15] that equally undermines the EMU's resilience**. Indeed, **the fiscal and economic narrative is too narrow and should be balanced with notions of fairness and inequality reductions**. The overall focus on GDP-growth and related aggregate data does not give the full picture in terms of social welfare and inclusive growth, but rather results in blind-spotted economic policy recommendations[16]. **To include the notions of social welfare and citizen's well-being in the Euro area recommendation, the analysis of the economic performance should be better linked to indicators regarding human capital such as educational attainments and the health conditions of citizens**[17]. Indicators that emphasize the distributions of economic growth – such as the OECD's inclusive growth-concept – and inform on outcomes at the individual level would enable a stronger focus on inequality and on social groups who do not benefit

[12] European Commission, *Reflection Paper on the Deepening of the Economic and Monetary Union*, 2017 Section 4, p. 18 – 28.

[13] European Commission, *Recommendation for a Council recommendation on the economic policy of the euro area*, 22 November 2017, available at: https://ec.europa.eu/info/sites/info/files/economy-finance/com-2017-770-en.pdf

[14] European Commission, Press Release Database, "European Semester Autumn Package: Bolstering inclusive and sustainable growth", 2018/11, available at http://europa.eu/rapid/press-release_IP-18-6462_en.htm

[15] European Commission, Social Protection Committee Annual Report 2018, 2018, p. 6, available at https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8151&furtherPubs=yes; European Commission, Annual Growth Survey, 2019, available at https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-annual-growth-survey_en_1.pdf

[16] OECD Report, *Beyond GDP. Measuring What Counts for Economic and Social Performance*, 2018, available at https://read.oecd-ilibrary.org/economics/beyond-gdp_9789264307292-en#page19

[17] Ibid., pp. 43 - 45

from the overall performance of the economy[18]. These metrics are important, since **good structural reform should not only improve productivity[19] but also fairness and inequality reduction**. Hence, both the efficiency and the fairness of public spending and tax systems are crucial for inclusive growth[20]. For instance, the recurring recommendation of shifting the tax burden away from labour should be more consistently balanced with key considerations of ensuring fairness and improving the redistributive impact of taxation systems[21].

- A welcomed emphasis on quality employment

Eurodiaconia welcomes that the recommendation's recitals as well as the staff working document highlight some of those concerns, emphasising high unemployment in some member states and the European Pillar of Social Rights' principles to foster equal opportunities, fair working conditions and social protection and inclusion. Recommendation (3) calls on Euro Area members to "ensure adequate social protection systems across the euro area", "strengthen education systems and investment in skills", "promote quality job creation" and strengthen "the effectiveness of active labour market policies that support transitions". **These aims are important, and Eurodiaconia has directly highlighted some of them as key priorities for the 2019 Semester cycle, such as the promotion of quality employment**[22]. However, they remain too marginal compared to the overall emphasis on economic and fiscal stability, and are very narrowly focused on employment.

Overall, **a balanced analysis is crucial**, considering the devastating individual and societal consequences of long-term unemployment and youth unemployment. It is thus positive that Recommendation (1) suggests increasing wages and investment in surplus countries, which is in line with a recent recommendation of the International Monetary Fund (IMF) calling particularly on Germany and the Netherlands to foster public investment[23]. Likewise, the OECD employment outlook identifies wage stagnation as an obstacle to the sustainability of the recent economic recovery[24]. While recommendation (3) thus points in the right direction, **a broader approach of balancing economic and social reasoning would be needed to address inequalities and truly foster inclusive growth in the Euro Area**.

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[18] Ibid., p. 105

[19] European Commission, *Analyses of the Euro Area Economy*, 2018, pp.2-3, available at: https://ec.europa.eu/info/sites/info/files/2019-european-semester-recommendation-euro-area-staff-working-document_en.pdf

[20] Ibid., p. 8

[21] Ibid., p.8

[22] Eurodiaconia, "Recommendations ahead of the 2019 Annual Growth Survey" and "Recommendations ahead of the 2019 Draft Joint Employment Report", 2018/10, available on the Eurodiaconia website.

[23] IMF Country Report No. 18/223, p. 13

[24] OECD Employment Outlook 2018, p. 22, available at https://read.oecd-ilibrary.org/employment/oecd-employment-outlook-2018_empl_outlook-2018-en#page1

- What is missing: ensuring social investment in the Euro Area

Recommendation (2) aims at supporting private and public investment, which is expected to increase productivity and innovation in the Euro Area and to strengthen economic, social and territorial cohesion (Recital (3)). In order to successfully achieve this balanced outcome, **the EMU must ensure conditions that allow for the right amount of social investment**. Defined by the Commission as "Spending in human capital which brings lasting positive social and economic returns over time*"*, social investments preemptively prepare citizens for life events such as insufficient income, unemployment or sickness. Social investments can be private or public driven investments that concern at least four areas[25]: early childhood education and care, primary and secondary education, training and active labour market policies and social housing policies. Investment in these areas are productive in the sense that they reduce inequalities and increase labour productivity. Therefore, they have inherent long-term economic returns. This is recognised by the European Commission which states in its staff working document that education and skills are important for productivity. But they are also key for inequality reductions.

The time is ripe to incentivise social investments, considering, firstly, that investment in the EU still lags behind pre-crisis levels – partly because of the ongoing debt consolidation in the public and in private sector[26]. A sustained fall in investment, alongside other factors such as a reduction of the labour force and of consumption might push the EU economy into stagnation[27]. Secondly, the amount of investment in social infrastructure in terms of education, healthcare and housing is estimated to have fallen below the required level[28] to maintain human capital and skills. Thus, **social investment should be part of a general long-term investment strategy of the EU**. This would avoid the further worsening of social infrastructures and help to overcome the lack of investment. By balancing economic reasoning and social needs, it would contribute to the European objective of a social market economy that guarantees social security to its citizens also in times of ongoing global political and economic uncertainties.

The labour market and employment policies in recommendation (3) can be considered as calling for such social investments, as they address training and active labour market policies and the issue of labour market segmentation. However, increased labour market participation should not be regarded as a means to merely increase the "long-run growth potential" of the Euro Area, as it is indicated in recital (2). It ought to be paralleled with a **broader sensitivity to inclusive labour market, ensuring quality employment and addressing the trend of in-work poverty**. Similarly, the recommendation concerning

[25] European Confederation of Independent Trade Unions (CESI), Eurodiaconia, Social Platform, Discussion Paper: *Towards more public social investment in EU economic governance: Which way forward?*, 2016

[26] The Long-term investment task force, *Betting on the long-term. Rebuilding investment for the Europe of tomorrow*, p.19, available at: http://longterminvestment.eu/wp-content/uploads/2018/10/LTI-2018-Betting-on-the-long-term-Rebuilding-investment-for-the-Europe-of-tommorrow.pdf

[27] Ibid., p. 18

[28] Investment in social infrastructure spent by local governments has fallen by 12% between 2008 and 2015, see ibid., p.15

adequate social protection systems is understood as a prerequisite for well-functioning labour markets and for resilient societies and economies. Eurodiaconia welcomes that this positive impact of adequate social protection systems on employment is highlighted, but this is not the sole result of such a system when well-designed. **Better social cohesion and well-being of the citizens is also achieved thanks to adequate social protection systems, and this should come out more strongly in the recommendations**.

- The Stability and Growth Pact still guides the Euro Area recommendations

The question is whether the current EMU's narrative is capable of putting social inclusion at its core. According to the European Commission's own data, social policy, healthcare and education represent on average 65% of public expenditure in Europe[29]. **Social investments therefore still rely heavily on public spending and this is something that has to be acknowledged by the EMU if it is to have a sustainable long-term investment strategy**. The Stability and Growth Pact (SGP) sets out rules to ensure sound public finances and to coordinate the fiscal policies of the member states, such as the deficit and debt criteria. Especially in time of crises, it has been limiting governments' abilities to use fiscal policies to support economic upturn and to engage in social investment. In fact, it is investments in human capital and housing as well as in social, health and education services that often constitute a breach of the SGP's deficit rules[30]. The so-called investment clause[31] that allows member states to deviate temporarily from their medium-term objectives (MTO), has not effectively impacted social investment, partly due to its strict restrictions. Thus, the current governance framework puts member states pursuing social investments through public spending at risk of not complying with EU rules[32].

The 2019 Euro Area recommendations call on the member states to comply with the SGP and, consequently, **the recommendations prioritise the creation of fiscally resilient over fair and inclusive economies**. They are expected to have positive social spillovers at some point, such as "significant and long-lasting effects on income and labour supply" (recital 6). This is concerning since **it leaves little scope for timely responses to the needs of vulnerable groups**, particularly in countries with high public (and private) debt(s), that are expected to tighten their fiscal policies according to recommendation (2). Regarding the long-run resilience of economies, it should be considered, that **not only countries with**

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[29] According to data presented by DG EMPL representatives at an event in the European Parliament on 16 October 2018.
[30] Jansen, Ronald, "OECD Meets Piketty: An Alternative Economic Narrative", 2018, available at: https://www.socialeurope.eu/oecd-meets-picketty-an-alternative-economic-narrative and Pekanov, Atanas, "The Case For A Proper Macroeconomic Stabilisation Function For The EU", 2018 available at: https://www.socialeurope.eu/the-case-for-a-proper-macroeconomic-stabilisation-function-for-the-eu
[31] The investment clause to the SGP is set out in point 2.2 of the European Commission's Communication COM(2015) of 13 January 2015 "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact", based on Article 5 of Regulation 1666/97. It allows member states to deviate from their medium-term objective (MTO) only if a number of conditions are met. For instance, the Member State's GDP growth must be negative or its GDP below its potential.
[32] Fabian Zuleeg/Jan David Schneider, "What role for social investment in the new economic governance of the Eurozone?", EPC Policy Brief 10 November 2015, p. 2.

fiscal buffers tend to be more resilient to economic turndowns, as the recommendations emphasise, but also those that have adequately resourced social protection systems which function as automatic stabilisers with positive effects on demand in times of economic turndown[33]. Against this backdrop, **the positive correlation of social cohesion, productive capacities and ultimately economic growth[34] should be better reflected in the recommendations**. **This in turn, requires a revision of the SGP towards a fiscal policy framework that not only supports investment, as outlined in the recommendations, but incentivises investment in human capital, housing, care and education services**.

- Conclusion: towards an EMU that fosters social convergence

As a step in this direction, Eurodiaconia suggests **linking the European Pillar of Social Rights more closely to the long-term objective of completing the EMU**. This implies putting social standards at the heart of the Euro Area and its economic ambitions. As the improvements in last year's cycle as well as the 2019 Annual Growth Survey have demonstrated, the European Semester can steer the process of deepening European social convergence in terms of high living standards and better incomes for all citizens. This is needed to contribute to an EMU that is more than an economic end in itself[35] but also delivers on the EU treaties' objectives of economic and social cohesion[36].

For further details about Eurodiaconia's work on the European Semester, social investments, and the Economic and Monetary Union, please contact our Secretary General Heather Roy at heather.roy@eurodiaconia.org or our Economic and Social Policy Officer Laure Drege at laure.drege@eurodiaconia.org.

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[33] European Commission, *Employment and social developments in Europe 2014*, 2014, section 4.4, available at: http://ec.europa.eu/social/BlobServlet?docId=13404&

[34] OECD, *Income inequality and labour income share in G20 countries: Trends, impacts and causes, 2015*, pp.2-3, available at: https://www.oecd.org/g20/topics/employment-and-social-policy/Income-inequality-labour-income-share.pdf. And European Commission, *Towards social investment for growth and cohesion – including implementing the European Social Fund 2014-2020*, pp.1-2, available at: http://ec.europa.eu/social/BlobServlet?docId=9761&langId=en

[35] European Commission, *Five Presidents Report*, 2015, p. 2

[36] European Commission, *Reflection Paper on the deepening of the EMU*, 2017, p.23