What influence for European governance?

The Reformed Stability and Growth Pact, the Europe 2020 Strategy and the »European Semester«

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- The financial, economic and currency crises have brought to the attention of the EU just how heterogeneous its socio-economic composition is. Economic asymmetries and inadequate policy coordination threaten both the unity and the success of Economic and Monetary Union.

- The plan is to overcome the current crisis, and avoid others in the future, by means of a new set of reformed and harmonised instruments of political governance within the framework of the »European Semester«.

- The positive approach based on a comprehensive European governance structure, however, assumes a false paradigm, which ties innovation and social progress one-sidedly to the fulfilment of state debt criteria.

- In this way, the EU has taken the liberty of imposing permanent funding restrictions on member state policy projects and, at the same time, of calling for extensive structural reforms of social security systems.

- Instead of this, what is needed is to balance external economic imbalances and the establishment of a Social Stability Pact to enable sustainable European governance which also preserves sovereignty.

Content

Introduction

In areas in which the European Union (EU) lacks legislative powers it gets by with policy coordination. This applies to fiscal policy, as well as employment and social policy. The consequences of the economic crisis in the Eurozone have led, together with the unsatisfactory outcome of the Lisbon Strategy, to calls for more and better coordination processes in Europe.

To this end, in spring 2011, the first so-called »European Semester« will commence. By this means, the coordination of processes pertaining to fiscal supervision within the framework of the Stability and Growth Pact (SGP) – which to date have functioned largely separately – and the policy areas bundled under the Europe 2020 Strategy are to be aligned at European level.

To be sure, some general aims of the Europe 2020 Strategy can be evaluated positively and there has also been progress with regard to economic policy coordination. For example, macroeconomic and, in particular, external economic imbalances are increasingly perceived as a danger to Monetary Union. Overall, however, a politically questionable course has been embarked upon which prioritises increasing competitiveness by means of greater labour market flexibility and structural reforms in social security systems in order to cut public spending. Accordingly, the debate on the need to reform the Stability and Growth Pact is dominated by demands for closer monitoring of the existing deficit criterion and the rapid repayment of government debts which have increased as a consequence of the crisis.

In what follows, we shall first set out the contents of the Europe 2020 Strategy and the debate on the planned tightening up of the Stability and Growth Pact, and also describe the procedural linking together of macroeconomic coordination with the other goals of the Europe 2020 Strategy within the framework of the »European Semester«. In addition, we shall critically examine the prospects of success of this new strategy and outline alternative scenarios for sustainable European governance.

1. EU Governance Tools: The Current State of the Reform Debate

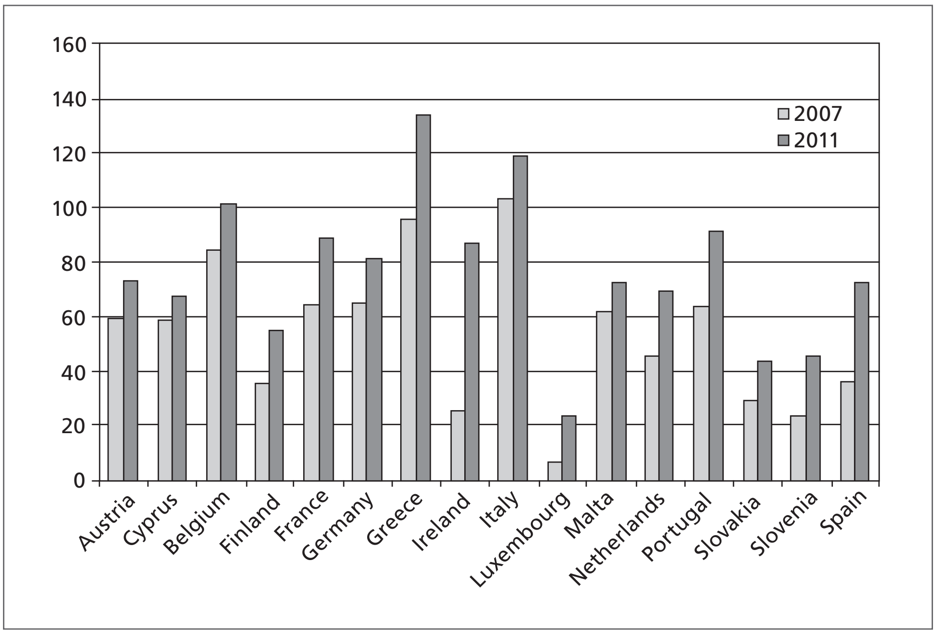
1.1 The Europe 2020 Strategy

In 2010, the Lisbon Strategy expired. However, its overriding goals are largely continued in the new ten-year strategy »Europe 2020«. It is intended to promote Europe's competitiveness, productivity, growth potential, social cohesion and economic convergence. This comes against the background of a heightened need for policy coordination within the EU, based primarily on the Union's structural weaknesses with regard to average growth, employment rates and demographic ageing. In addition, Europe must strengthen the ties between its national economies in the face of global problems and develop its concerted action. The EU must position itself clearly in the global competition for investments, production locations and leading edge technologies. At the same time, it needs to learn lessons from the financial and economic crisis, as well as climate change and resource scarcity in order to focus on the challenges of the coming decade. Permanent loss of prosperity, sluggish growth and uncoordinated reforms which would result in high unemployment, social tensions and Europe's »relative insignificance … on the world stage« (European Commission 2010a: 10) should be averted. To that end, strong growth must be generated which will help the EU to exit from the economic crisis and deal with longer term challenges. This growth is not to be based – and this represents something new in comparison to the old Lisbon Agenda – solely on increasing GDP. Instead, three priority goals are to be pursued simultaneously. Growth in the coming decade is to be:

- »*smart*«, developing an economy based on knowledge and innovation;
- *sustainable,* promoting competitive, but environmentally friendly and resource conserving economies; and
- *inclusive,* promoting high employment and social and international cohesion.

Key instruments for the implementation of the European 2020 Strategy are the so-called Integrated Guidelines for Economic and Employment Policies, which contain the five common objectives of the EU. Accordingly, the EU member states are to coordinate their policy action with regard to:

Figure 1: Public debt/GDP ratios for the Countries of the Eurozone as a Percentage of GDP, 2007 and 2011 (Commission estimates)



Source: Eurostat, authors' calculations (cf. IMK Working Paper 3/2010).

■ promoting employment: by 2020, 75 per cent of the population aged between 20 and 64 should be in employment;

■ improving the conditions for research and development: by 2020, three per cent of GDP should be allocated to this;

■ achieving European climate protection and energy goals: by 2020, greenhouse gas emissions should be reduced by 20 per cent in comparison to 1990 levels, the share of renewable energies in total energy consumption should be increased to 20 per cent and energy efficiency should be raised by 20 per cent;

■ improving levels of education: the school dropout rate should fall below ten per cent by 2020 and the share of higher education graduates among those 30–34 years of age should be increased by at least 40 per cent; reducing poverty and social exclusion: by 2020, at least 20 million fewer people should be at risk of poverty.

These five objectives are detailed in seven flagship initiatives. They include improving the basic conditions for research and development within the framework of an »Innovation Union«; setting a »digital agenda for Europe«; and instituting a »European Platform for Fighting Poverty«. There will also be stronger governance of economic policy through the coordination of the broad outlines of member states' economic policies (European Council 2010a).

Altogether, ten economic and employment policy guidelines have been formulated. The Europe 2020 Strategy thus stands in stark contrast to the Lisbon Strategy's 24 guidelines. However, its legal anchoring in Articles 121 and 148 of the Lisbon Treaty remains the same. Accordingly, the European Council is responsible for directing strategy and adopting the outlines of economic policy and the employment policy guidelines. The member states are required to report regularly on their policies aimed at attaining the common objectives. The European Commission monitors and evaluates, based on a series of indicators, overall progress and discusses policy recommendations with the responsible councils of ministers for the guidance of individual member states.

The undefined position of the European Parliament, national parliaments, regional authorities, the social partners and other civil society actors also remains largely unchanged. At best, they have marginal roles in the allocation of tasks within the framework of the Europe 2020 Strategy. For example, ministerial bureaucracies generally involve the social partners in the preparation of national strategy reports. The European Parliament is permitted to issue a statement on the objectives and developments of the Ten-Year Strategy at the spring European Council (European Commission 2010).

1.2 The Planned Tightening-Up of the Stability and Growth Pact

In the wake of the economic crash during the global economic and financial crisis in 2008, budget deficits in all EU member states soared (see Appendix). In particular, the rather disrespectfully named »PIGS« – Portugal, Ireland, Greece and Spain – have been accused of causing the crisis in the Eurozone by their lack of budgetary discipline. In fact, these states are currently having to combat particularly high budget deficits, rapidly rising public debt/GDP ratios (see Figure 1) and speculative attacks on their government bonds in the financial markets. Before the advent of the crisis, all these countries had macroeconomic imbalances in the form of high current account deficits and rapidly rising private sector debt (see Appendix). These countries' public finances, by contrast, measured in terms of budget deficits and public debt/GDP ratios – with the exception of Greece – were sometimes in much better shape immediately before the outbreak of the crisis than the Eurozone average.

While in 2007 national budgets, on average, were approximately balanced, in 2009 member state deficits on average exceeded six per cent of GDP. With the exception of Finland and Luxembourg, therefore, the Stability and Growth Pact's target of three per cent of GDP – which still represents the legal basis for fiscal surveillance in the member states – was missed. In the Stability and Convergence Programmes the member states, accordingly, had to explain how they would comply with the three percent criterion once again by 2013 (see Appendix).

With the aim of avoiding possible state bankruptcies or the need for international rescue operations various proposals are currently under discussion for reform of the Stability and Growth Pact. In particular, the German government and the European Commission are pressing, first and foremost, for stricter discipline for Euro-states with regard to austerity and consolidation policies. It is true that there was vocal opposition on the part of some member states to individual proposals for tougher sanctions (for example, the withdrawal of voting rights) in the economic policy Task-Force of EU President Herman van Rompuy and at the summit meeting of the heads of state and government at the European Council on 28–29 October 2010. However, the proposals approved by the European Council at the instigation of the Van Rompuy Task-Force are in large part consistent with the Commission's existing legislative proposals (European Commission 2010b; Van Rompuy 2010; European Council 2010b). In essence, this concerns the following elements of reform:

- Within the framework of the »corrective component« of the Stability and Growth Pact in future the development of government debt will receive the same attention as the development of the budget deficit. Member states whose public debt exceeds 60 per cent of GDP are to be required to reduce it by a certain proportion each year. Breaches of the 60 per cent debt criterion and the three per cent budget deficit criterion should be subjected to sanctions more quickly and to a much greater extent automatically.[1]

- The »preventive component« of the Stability and Growth Pact should be reinforced. In the case of violations of the medium-term goals to be defined in accordance with the – so far still very vague – principle of »prudent budgetary policy« the Council should be able to impose fines.

- Minimum standards should be formulated for the budgetary policy frameworks of individual member states. Also relevant here are explicit fiscal policy rules (for example, on the model of the German »debt brake«), which should ensure the attainment of the medium-term goals.

- An *Excessive Imbalance Procedure* (EIP) should be introduced. By this means the Commission could regularly assess the risk of imbalances with regard to a range of

1. It was above all the proposal of quasi-automatic sanctions – which could be averted only by a qualified majority in the Council (reverse voting) – which encountered resistance among some member states. However, as has been the case hitherto, in future a political decision by the ECOFIN council will be necessary for the imposition of a deficit procedure. Automatic mechanisms are to kick in only in the case of a member state's infringement of the conditions laid down in the deficit procedure (Van Rompuy 2010; Franco-German Declaration 2010).

economic indicators *(Scoreboard),* which to date have not even been accurately defined. Particular emphasis is given to the problem of the higher current account imbalances of some member states in the wake of a loss of competitiveness in recent years. But excessively weak domestic demand in countries running high current account surpluses is also identified as a problem.

■ A permanent crisis management mechanism should be created to supersede the rescue system put in place during the crisis for government bonds, which expires in 2013. The private sector should pay a larger share of the costs arising from the sovereign debt crises and the prohibition on financial assistance for endangered member states (the No Bailout clause) should be retained. The overall goal should be ex ante crisis management to curb incentives for member states to behave recklessly (moral hazard).

1.3 The »European Semester«: De Facto Amalgamation of Policy Coordination Instruments

It was important for many member states that the coordination instruments for fiscal surveillance within the framework of the Stability and Growth Pact and the Europe 2020 Strategy were separated from one another both legally and formally. It was possible to reach agreement on the temporal alignment of coordination cycles, however. This allows the EU to issue its policy recommendations based on the evaluation of a much wider spectrum of individual policies and departments and cross-referencing.

In future, every April the Stability and Convergence Programme of the Stability and Growth Pact is to be submitted to the European Commission at the same time as the national strategy reports of the Europe 2020 Strategy (see Figure 2). Beforehand, from 2011 the annual »European Semester« will start with a growth report by the Commission which sets out the macroeconomic development of the EU and, with reference to the objectives of the ten-year strategy in the previous year, identifies the challenges of the coming year and indicates possible policy options. Briefed by the councils on economic and financial policy (ECOFIN) and on employment, social policy, health and consumer protection (EPSCO) the European Council will issue its first policy recommendations to the member states at its spring summit in March, which should be reflected in the two reports to be submitted to Brussels the following month. The member states are required to establish the first cross-references between the Stability and Convergence Programmes and national reform programmes, for example, by prefacing the presentation of the policy objectives within the framework of the Europe 2020 Strategy with a macroeconomic framework scenario. After the evaluation of these reports, in June the Commission will submit country-specific recommendations and/or – according to the provisions of the treaty – the outlines of statements by the Council. A joint summary report is to be drawn up for all the states in the Eurozone. In the second half of the year, the member states are to transpose the EU's recommendations into national policy (European Commission 2010c; Van Rompuy 2010).

The Commission intends to draw up its recommendations on the basis of all the information available within the framework of the »European Semester« on the economic, employment and social policies of the member states:

»Together with fiscal surveillance under the Stability and Growth Pact, country surveillance aims at ensuring a stable macroeconomic environment conducive to growth and employment creation, taking full account of the interdependence between Member States' economies, particularly in the euro area. This will ensure consistency within Europe 2020, in particular by identifying the macro/fiscal constraints within which Member States are to implement structural reforms and can invest in the growth-enhancing policies of Europe 2020« (European Commission 2010d: 4).

In this way, the coordination within the framework of the Stability and Growth Pact would merge with the coordination aimed at achieving the objectives of Europe 2020. In addition, the already existing Open Method of Coordination (OMC) will be integrated in the areas of social protection and social inclusion through the ten-year strategy, probably in the »European Semester« (Social Protection Committee 2010). In that way, for example, the Commission and the Council could voice their objections with regard to the unsuitable or insufficiently stringent budgetary policies being implemented by a member state with reference to particular employment and social policies and call for alternative policies in these areas.

2. Consequences for Policy Management

2.1 Against the Background of the Lisbon Process

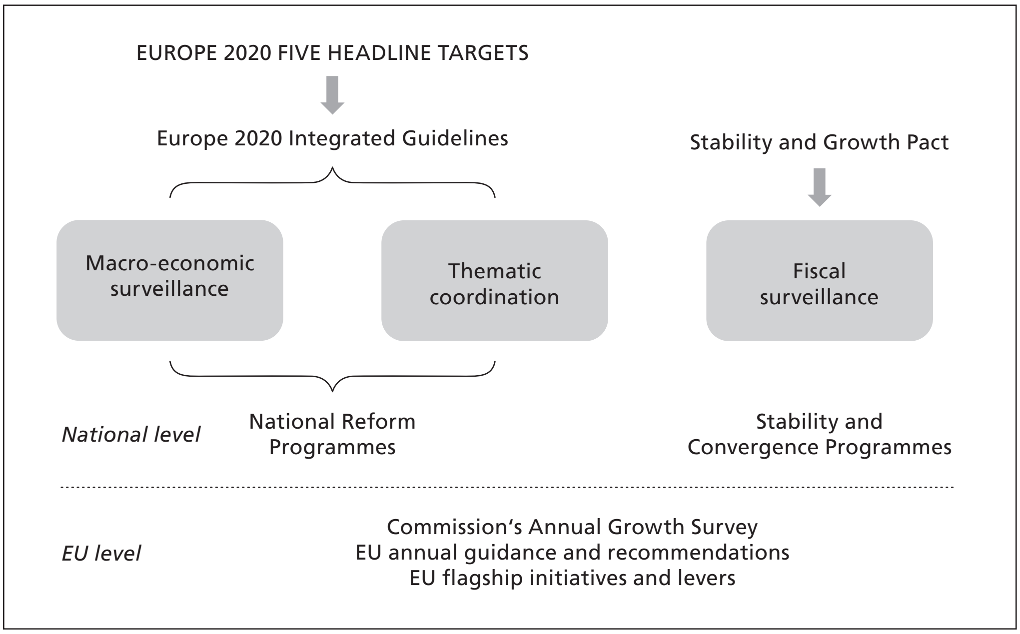
In principle, it is to be welcomed that budgetary aspects of the Stability and Growth Pact do not stand alone but, together with the »European Semester«, for the first time form an integrated approach which is moving in the direction of a comprehensive policy mix. In particular in a unified currency area economic, employment and social policies play an important role in the establishment of macroeconomic control instruments.

However, it is a moot point whether this new governance structure is based on principles which are too one-sidedly supply-side and market oriented. Because even the positive elements of the Europe 2020 Strategy appear to be dominated by the demand for budget policy consolidation and boosting member state competitiveness.

The questionable and ultimately not particularly meaningful concept of »competitiveness« links the new ten-year strategy substantively to the Lisbon Strategy. The latter, at the latest since its revision after a sobering mid-term review in 2005, prioritised the objectives of further deregulation and economic revitalisation by cutting back regulatory intervention in the functioning of the market. Even if the Europe 2020 Strategy cites »smart, sustainable and inclusive growth« as its aim (European Council 2010a), the clear identification of a need for structural reform in employment and social policies points towards the continuation of a market-based understanding of growth.

The policies recommended for attaining these objectives are largely based on familiar notions about increasing competitiveness and marketisation. As far as reinforcing the EU's social dimension is concerned, they lack ambition and are primarily a continuation of the policies of the previous Lisbon Strategy, focused on structural reform, flexibilisation and boosting competitiveness. For example, tax and social contribution systems are to be reformed in order to boost incentives to seek employment. Public spending on older people in the areas of pensions and health care is to be cut and retirement ages raised in order to safeguard the sustainability of the financial system. The active labour market policies advocated are aimed, first and foremost, at establishing an obligation on the unemployed to reintegrate themselves in the labour market. Education is viewed functionally and in economic terms, primarily as a means of obtaining qualifications to enable participation in the labour market; in other

Figure 2: Components of the »European Semester«



Source: European Commission 2010c: 2.

words, as an investment in human resources (ECOFIN 2010; European Commission 2010e).

Crucial considerations which are indispensible for an optimal policy mix remain excluded from the »European Semester«, such as stricter wage coordination in Europe and mechanisms to balance out external economic asymmetries. The objectives of greater social cohesion and the elimination of economic policy heterogeneities are being pursued only at the margins. The Europe 2020 Strategy lacks, among other things, qualitative considerations to complement its quantitative employment goals, such as »decent work«, the target criterion of full employment and an account of the relevance of agreed objectives for other areas of social security than just combating poverty, not to mention ambitious environmental and energy goals which go beyond what has already been agreed at the European level.

In addition, coordination processes have been tightened up and the parallel reporting on economic, employment and social policy topics could raise public awareness with regard to the Europe 2020 Strategy to a much greater extent than with regard to the Lisbon Strategy. However, even a public debate as strong as the discussions on the violations of the criteria of the Stability and Growth Pact cannot eliminate the familiar shortcomings of the coordination procedures. These include shallow democratic roots and a lack of transparency and of participation by social and political actors. Experiences with OMC also show that the establishment of subordinate aims and indicators can have a considerable influence on the evaluation of individual policies. As a result, there is a danger of a one-sided orientation focusing on financial inputs, leading to demands for flexibilisation and recommodification.

2.2 Against the Background of Experiences of the Stability and Growth Pact

It is obvious that the current crisis of the Eurozone was not caused by the laxness of the »corrective component« in the old Stability and Growth Pact. The examples of Ireland and Spain illustrate this particularly clearly. The two countries were abruptly tied together with Portugal and Greece as the so-called »PIGS« and brought within the sights of financial market speculators, even though from the founding of the Monetary Union until immediately before the outbreak of the global economic crisis they had never contravened the »corrective« components of the Stability and Growth Pact. Nor, in the run up to the crisis, would they have been affected by the tightened up »corrective component« of the Stability and Growth Pact currently being discussed by the German government and the European Commission:

- Spain did not breach the three per cent criterion of the Stability and Growth Pact even once between 1999 and 2007. Its public debt/GDP ratio fell from 62 per cent to 36 per cent. Between 2005 and 2007 Spain even ran budget surpluses which at times reached two per cent of GDP.

- In Ireland, the public debt/GDP ratio fell from just under 49 per cent to 25 per cent and the budget was almost always in surplus (sometimes reaching around five per cent of GDP).

- By comparison, Germany ran a budget deficit between 2001 and 2006 and exceeded the three per cent deficit limit from 2002 to 2005. As a result, between 1999 and 2007 the public debt/GDP ratio rose from 61 per cent to 65 per cent.

These examples show why the planned extension of the Stability and Growth Pact to encompass the problem of external economic imbalances is overdue. The susceptibility of the PIGS to speculative attacks can be explained, first and foremost, by the skyrocketing of – principally private – external indebtedness in the years leading up to the crisis. These countries' high current account deficits largely reflected the credit-financed consumption boom in the private sector, combined with a loss of price competitiveness. When the private credit bubbles burst in the wake of the crisis and private demand plunged overnight the state had to »assume«, within the framework of bank bailouts and economic stimulus measures, a considerable part of private debt (see Appendix and Figure 1). In contrast, Germany's violation of the »corrective« part of the Stability and Growth Pact never entailed a heightened risk of speculative attacks on the government bond market. This is because in Germany private surpluses, which at times reached almost nine per cent of GDP, were always higher than new government borrowings, so that Germany systematically ran current account surpluses, which up to 2007 rose to almost eight per cent of GDP. As a result, Germany is a net creditor vis-à-vis other countries and is perceived as particularly competitive.

The great danger for overall economic development in the Eurozone in the next few years is that the »corrective component« of the – as the case may be, reformed and tightened up – Stability and Growth Pact alone is being given priority, aimed at rapidly and uncompromisingly consolidating budgets in all member states. As it is, within the framework of the 2010 to 2013 Stability Programme the member states are obliged, in accordance with the previous Stability and Growth Pact, to reduce their budget deficits to three per cent (that means reducing them by more than half in comparison to 2009). Unless there is a rapid recovery in private demand a new economic downturn looms.

Particularly alarming in this context is the fact that the (optimistic) growth targets laid down in the national stability programmes of Eurozone countries rely substantially on the hope of benefitting from strong demand from the rest of the world and thereby an improvement in the current account balance. The countries in the Eurozone running the largest surpluses, Germany and the Netherlands, expect an increase in current account balances by 2013 of around six per cent of GDP (see Appendix). Only in this way can these countries realise the ambitious goal of reducing their budget deficits to three per cent in the context of relatively weak demand in the private sector which is expected to continue. Current deficit countries, such as Greece, Portugal and Spain, by contrast, expect renewed falls in household savings, which are supposed to make possible, in the context of continuing high current account deficits, the required reduction of the budget deficit below the three per cent mark (see Appendix). It is highly questionable, however, whether the strong development of private demand which this assumes is realistic or sustainable, given the existing problems of over-indebtedness in these countries. However, this is what needs to happen if the export-oriented growth strategies envisaged by Germany and the Netherlands are to succeed. Even the hope of a strong surge in demand in the rest of the world appears very doubtful in light of the equally uncertain developments in China, Japan and the USA.

Implementation of the provisions of the old Stability and Growth Pact already threatened to provoke an economic relapse in the Eurozone. If all member states with public debt/GDP ratios above 60 per cent were now obliged, due to a tightening-up of the Stability and Growth Pact, to make additional (expenditure side) consolidation efforts, the Eurozone might even be facing an entire »lost decade« with relentless deflationary tendencies. In such a case, the social and environmental objectives of the Europe 2020 Strategy would become a distant prospect.

3. Alternative Scenarios for Sustainable European Governance

Since any attempt to transfer a high degree of economic policymaking competence to the EU would founder on the resistance of the member states, instead European economic governance will have to be organised in a more constructive way. Closer harmonisation and coordination of member state policies in the EU is unavoidable in the already established common economic and monetary area and must extend far beyond the management and control of budget policies laid down in the Stability and Growth Pact. This is why the basic approach of closer convergence of economic, employment and social policy coordination instruments within the framework of the »European Semester« is clearly correct. However, the de facto combination of fiscal surveillance by means of the Stability and Growth Pact with the Europe 2020 Strategy is pursuing a substantially false paradigm.

3.1 External Economic Stability Pact and Macroeconomic Dialogue

In the public debate, especially in Germany, the impression is often given that the crisis can be traced back to a lack of budgetary discipline on the part of a small number of countries. As we have already explained, this perception is mistaken. Susceptibility to speculative attacks depends much more on the balance of payments than on the budget deficit. A new Stability Pact should therefore address current account balances. Since high Eurozone export surpluses with regard to the rest of the world are neither realistic nor desirable over the long term, a co-operative approach is needed to avoid external economic imbalances in the Eurozone.

A new Stability Pact should therefore oblige countries with high current account deficits to limit growth in unit wage costs and, if necessary, apply a restrictive fiscal policy. Countries with high surpluses, by contrast, should be obliged to implement a more expansive fiscal policy or to abandon wage restraint and generally to boost domestic demand. Social policy and distributive goals could also help to reinforce domestic demand. For this purpose, on the one hand, macroeconomic dialogue involving the social partners must be intensified. At the same time, there needs to be closer coordination of national fiscal policies beyond the previous attempts at reform in the domain of the »corrective« and »preventive« arm of the Stability and Growth Pact. As long as the member states, in their fiscal policymaking, abide by the measures laid down to limit external economic imbalances the Community must guarantee the government bonds issued for this purpose. What is really needed here is the establishment of a permanent crisis management mechanism or a European Monetary Fund whose financing structure should also include incentives to avoid high current account imbalances. However, the setting up of such a permanent crisis management mechanism and a stricter interpretation of the no-bailout clause demanded by the German government would not, on their own, be sufficient incentive to prevent external economic imbalances, in particular on the part of countries running surpluses.

The reform proposals of the European Commission and the Van Rompuy Task Force, with their emphasis on the problem of excessive imbalances, are to some extent a step in the right direction. However, there is a risk that, in the event, there will continue to be a one-sided focus on countries with current account deficits. It is unclear to what extent sanctions to be imposed – by a majority decision of the Council – on countries running significant surpluses, such as Germany and the Netherlands, are politically realistic. Furthermore, the »preventive component« of the Stability and Growth Pact called for by the Commission is apparently still not seen as related to the problem of excessive current account surpluses. Rather it is supposed to encourage member states to »follow prudent fiscal policies in good times to build up the necessary buffer for bad times« (European Commission 2010f). This could mean that countries with high current account deficits and high growth – such as Ireland and Spain over the past decade – should in future strive for even higher surpluses in order to counter private sector tendencies to run up excessive debt. In that case, however, countries with excessive current account surpluses and below average growth – such as Germany over the past decade – should be obliged to follow a »preventive and more expansive« fiscal policy. At times, this may also call for budget deficits well above three per cent. Otherwise, the reduction of external economic imbalances risks failure once again; also, the Eurozone as a whole will again be threatened by tendencies towards stagnation, even deflation.

3.2 Social Stability Pact and a Redesign of OMC

Against the background of experiences with the Lisbon Strategy the new Europe 2020 Strategy is disappointing. Many of the above-described challenges and aims with regard to the EU's social, employment and environmental policy development must, given the dominance of the deficit criteria, be subject to fundamental funding restrictions. A concentration, already present in the integrated Guidelines, on a few flagship projects and recommendations about opportunities to implement cuts at the very core of welfare state social policies is foreseeable. Thus, on the one hand, a »European platform against poverty and social exclusion« has been set up, and on the other hand, the Commission recommends in its Green Paper on pensions (European Commission 2010g) the stronger marketisation of old age pensions and a higher degree of individualisation of risk, which will only serve to exacerbate the problem of old age poverty. Both initiatives refer to the Europe 2020 Strategy. These inherent contradictions will prevent Europe from developing a consistent strategy by means of which macroeconomically and socially sustainable growth can be generated.

It seems highly questionable to implement the consolidation policies made necessary by large-scale government rescue and economic stimulus packages at the expense of social security. The socially vulnerable and the poor will suffer most from the stricter and longer-term austerity policies which have already been launched in many countries. A consistent European coordination strategy, however, should also take into account possibilities of reform on the revenue side in order to ensure that those responsible for the financial crisis pay their fair share of the ensuing costs. Higher taxes on high incomes and wealth, together with the introduction of a financial transactions tax and a comprehensive bank levy would both contribute to budget consolidation and proactively boost Europe's social and environmental renewal.

The social objectives of the Europe 2020 Strategy can be attained only if they do not further accentuate the one-sided orientation of economic policy governance towards budgetary considerations. Decent jobs, social progress and environmental sustainability should, as target criteria, be on the same footing as competitiveness and single market freedoms. Instead of using tax and social contribution levels and wage costs as bargaining chips in a system of market states, mechanisms should be introduced which restore social cohesion as the focus of European coordination efforts. If the emphasis continues to be on structural reforms of the welfare state in terms of recommodification and risk individualisation in parallel with a procyclical fiscal policy no balancing out of the EU's socioeconomic heterogeneities can be expected. In order to check intra-European competition for investments, jobs and production locations competition-driven harmonisation should be replaced by a »Social Stability Pact«. On this basis, member states' minimum wages, corporate taxes and social spending would be coordinated in accordance with their respective economic capacities.

As in the case of economic policy, what is called for is an intelligent balance of policies agreed on between the member states and implemented in decentralised fashion, on the one hand, and a central European framework, on the other. The Social Stability Pact could be put into effect within the framework of the European 2020 Strategy by means of a redesigned OMC, with the member states reaching agreement on common European target criteria, formulae and development corridors which they would either adhere to or work towards in the coming years. To be sure, this would require renouncing the previously predominant non-specific one-size-fits-all approach of the OMC, which took no account of different welfare state arrangements and social policy traditions. In addition, the basis for the utilisation of qualitative indicators as against the already well developed quantitative ones should be extended. In general, the democratic control and transparency of OMC should be improved by means of the close and institutionalised participation of the social partners and other civil society actors, as well as of the European Parliament and member state parliaments. In a Communication on reinforcing the social dimension of the EU in 2008 the European Commission itself proposed measures pointing in this direction, although so far they have not been taken up in the Europe 2020 Strategy (see European Commission 2008).

3.3 The Dual Pact as Macroeconomic and Normative Connecting Link between Sovereign States

Inevitably, in an increasingly integrated space European governance has at its disposal a number of instruments which are becoming more and more important. The financial and economic crisis has demonstrated to the EU and its member states in no uncertain terms how heterogeneous the union of states remains and that harmonisation, coordination and joint policy planning is indispensible. From now on new instruments must be freed from the encumbrance of an agenda predominantly focused on debt criteria, to which all other aspects of economic, employment, social and environmental policy are subordinated.

What is needed instead is a bold move which breaks with dysfunctional convictions and practices. Europe must hastily equip itself with appropriate institutional instruments in order to achieve strong and stable growth »by its own efforts«, and also to be able to avert the abovementioned fears of »relative insignificance on the world stage« (European Commission 2010a: 10). European governance should be distinguished by a fundamentally transformed economic stability pact focusing on the correction of external economic imbalances between the member states. It should be complemented by a Social Stability Pact on an equal footing which makes social progress a condition of improving economic performance.

This approach would »preserve sovereignty« since the EU would provide only a political framework aimed at linking social progress and economic performance and avoiding external economic imbalances, leaving individual policy emphases to the member states. Respective economic policy capacities and current account balances are the central concern. In this way, no member state would be led by the hand – as might be the case with the centralisation of fiscal policy competences – and also neither overburdened nor insufficiently challenged (as might be the case with social minimum standards). The dual pact proposed here would not curtail member states' sovereignty and room to manoeuvre any more than the proposals currently under discussion at the European level for a reformed Stability and Growth Pact. Instead, it would provide, even during periods of increased government debt, sufficient room for an ambitious tax and financial policy which would not have to abandon innovation and the social dimension to uncontrolled consolidation policies.

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Appendix

Sectoral net lending/net borrowing for the countries of the Eurozone as a percentage of GDP

	2007			2009			2013 (according to stability programmes)		
	Public sector balance	**Private sector balance**	**External balance**	**Public sector balance**	**Private sector balance**	**External balance**	**Public sector balance**	**Private sector balance**	**External balance**
Austria	–0.55	3.90	–3.36	–3.45	5.93	–2.48	–2.70	5.60	–2.90
Belgium	–0.24	3.95	–3.71	–6.06	8.09	–2.03	–3.00	5.00	–2.00
Cyprus	3.40	–15.14	11.74	–6.07	–2.47	8.54	–2.50	–10.40	12.90
Finland	5.19	–0.90	–4.29	–2.41	3.89	–1.48	–1.90	3.90	–2.00
France	–2.73	0.46	2.27	–7.57	4.64	2.93	–3.00	0.30	2.70
Germany	0.19	7.72	–7.91	–3.30	8.28	–4.99	–3.00	8.50	–5.50
Greece	–5.37	–9.30	14.67	–13.52	0.39	13.13	–2.00	–2.00	4.00
Ireland	0.14	–5.47	5.34	–14.28	11.33	2.94	–4.90	3.30	1.60
Italy	–1.48	–0.34	1.82	–5.24	2.08	3.16	–2.70	1.40	1.30
Luxembourg	3.63	6.08	–9.71	–0.74	6.38	–5.64	–1.10	8.10	–7.00
Malta	–2.15	–4.04	6.19	–3.82	–0.07	3.89	–2.80	1.40	1.40
Netherlands	0.17	8.37	–8.54	–5.28	9.15	–3.87	–3.00	9.25	–6.25
Portugal	–2.65	–7.13	9.78	–9.43	–1.08	10.51	–2.80	–5.50	8.30
Slovakia	–1.66	–3.44	5.10	–6.77	3.64	3.13	–3.00	1.10	1.90
Slovenia	0.02	–4.52	4.50	–5.49	4.58	0.91	–1.60	1.90	–0.30
Spain	1.91	–11.92	10.02	–11.19	6.09	5.09	–3.00	–0.50	3.50
Average (unweighted)	–0.14	–1.98	2.12	–6.54	4.43	2.11	–2.69	1.96	0.73
Average (weighted)	–0.64	0.98	–0.34	–6.29	5.68	0.61	–2.91	3.41	–0.50

Note: The net borrowing/net lending of the state, the private sector and foreign countries add up, by definition, to zero (discrepencies in the table due to rounding). External net borrowing/net lending corresponds, in the opposite direction, to the domestic current account balance. A »structurally« balanced budget means, therefore, that the »structural« net savings of the private sector must fund external new borrowings in their entirety.

Source: Eurostat, authors' calculations (cf. IMK Working Paper 3/2010).

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