

A triumph of failed ideas

European models of capitalism in the crisis

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How do economic governance reforms and austerity measures affect inclusive growth as formulated in the Europe 2020 Strategy?

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1. Introduction

The financial crisis that broke out in 2008 has turned into an economic and public debt crisis that has been sweeping the EU with a severe impact on the economies and labour markets of member states. Output growth has turned negative in several countries and stagnated elsewhere; unemployment has risen; and public debt and deficits have soared. Partly in response to the crisis and partly within the framework of a longer-term growth and reform agenda, the EU spelled out the Europe 2020 Strategy in 2010, which for the first time puts inclusive growth on an equal footing with smart and sustainable growth – at least on paper. To that end, a headline target of moving 20 million people out of poverty by 2020 has been set. The strategy calls for structural reforms in several areas, as well as for steering the public finances of member states onto a sustainable path as soon as possible.

Moreover, in response to the debt crisis that has been threatening the very existence of the Eurozone and as a complement to the Europe 2020 Strategy, the architecture of the EU's economic governance has come under scrutiny with the aim of introducing reforms that would strengthen it against similar crises in the future. At the same time, the Eurozone member states have been trying to contain the public debt crisis which, at the time of writing (September 2011), has spread to five member states and has become a systemic threat to banking systems in the EU.

National policies in the context of the Europe 2020 Strategy and the new economic governance are to be streamlined and coordinated within what is now called the 'European Semester', which is essentially the annual policymaking cycle in the EU. However, both the economic governance reforms and the austerity measures pursued as a response

to the debt crisis have attracted criticism for their potential to push the European economy into a double-dip recession and strangle growth for several years to come. This would then undermine the objectives of the Europe 2020 Strategy, including that of inclusive growth.

This chapter analyses whether the recent EU economic governance reforms and the austerity measures are likely to affect the prospects of achieving the headline target of lifting 20 million people out of poverty. Fiscal austerity, as planned in several member states, is bound to critically delay output and employment recovery, leading to prolonged and structural unemployment which is associated with detachment from the labour market. According to the Europe 2020 Strategy, the means of achieving inclusive growth are increasing employment, improving skills and fighting poverty. In this chapter, we focus on poverty because employment creation and improved skills actually failed to deliver in terms of reducing poverty in the context of the Lisbon Strategy (Cantillon, 2011). Moreover, in the face of the ongoing creation of substandard employment, with its danger of keeping people in low-wage employment, the development of poverty figures tell us more about inclusion than the mere monitoring of employment rates or developments in skills.

The chapter is structured as follows. In Section 2, we provide an empirical picture of the impact of the crisis on labour market outcomes and public finances in order to get a sense of the problem load and put into context the macroeconomic policy directions that the new economic governance and initiatives to resolve the crisis propose. In Section 3, we present the policy responses to the crisis and critically evaluate their potential to deliver growth. In Section 4, we analyse the Commission recommendations to member states in the context of the European Semester, the medium-term policy plans of member states in terms of – in particular – social spending and the measures already taken as part of the fiscal austerity packages in several member states in order to assess whether fiscal measures undermine and/or override measures for reducing poverty. Section 5 concludes. To support our arguments, we draw on comparative data sources, such as the European Labour Force Survey and national accounts, official EU level and national policy documents and evidence from national experts on austerity programmes (Matsaganis and Leventi, 2011; Theodoropoulou and Watt, 2011).

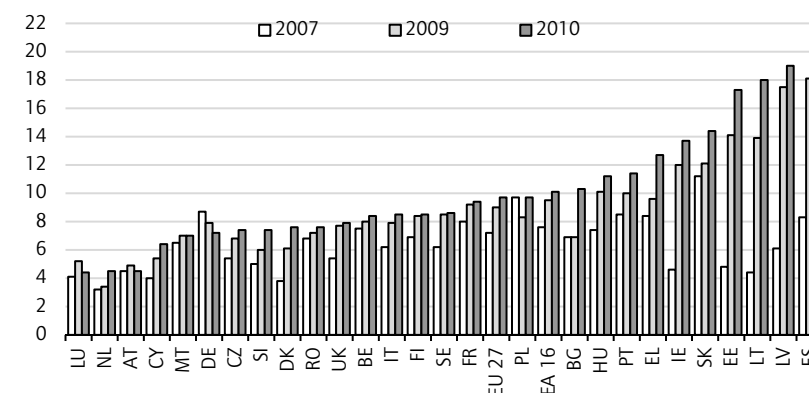
2. The economic crisis in Europe

In this section, we provide an empirical view of the impact of the crisis in Europe with regard to output, employment and unemployment. We also review the evolution of European governments' public debt and their budget balances. All these are crucial parameters for assessing the economic governance reforms and the fiscal austerity measures in terms of their potential to help tackle the current economic crisis and support the Europe 2020 Strategy in delivering its poverty headline target.

2.1 Bleak labour market developments

The EU27 average unemployment stood at 9.7 per cent in 2010, 2.5 percentage points up from 2007 (Figure 1). Employment dropped in the same period on average by 1.3 percentage points. The labour market impact of the large output shocks – average output in the EU dropped by 4.3 per cent in 2009 – was thus considerable. At the same time, as Figure 1 illustrates, there is significant variation in developments in unemployment (and employment) rates in Europe. Particularly Spain, the Baltic countries and Ireland saw huge increases in unemployment and large drops in employment and were among the countries with the highest unemployment rates in 2010 (for details, refer to ETUI/ETUC, 2011).

Figure 1 Developments in unemployment rates, 2007, 2009, 2010



Note: Unemployment rates for population aged 15–64 years.
Source: Eurostat online data base (labour force survey).

The spread has tended to widen these differentials. In the Baltics and Ireland, this was coupled with considerably larger than average drops in output (18 per cent in Latvia, 14.7 per cent in Lithuania, 13.9 per cent in Estonia and 7.6 per cent in Ireland). With 3.7 per cent, however, Spain saw below average drops in output which points to the absence of such things as working time measures, active labour market policies or early retirement and other exit schemes that can act as buffers. The working of such buffers is particularly evident in the case of Germany, one of the few countries that saw unemployment dropping despite a fall in output of 4.7 per cent between 2008 and 2009 (for details on the operation of buffers in the crisis see (Leschke and Watt, 2010).

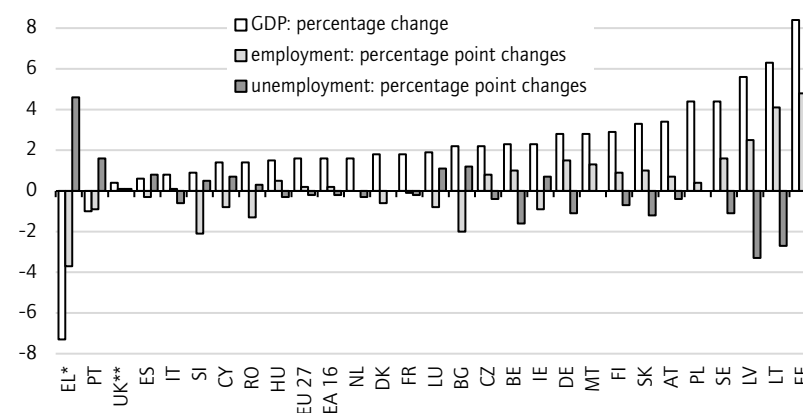
In the second crisis period (2010 compared to 2009) output was on average growing again (1.8 per cent for the EU27 – exceptions were Greece, Romania, Ireland, Latvia and Spain) but employment was still declining and unemployment still rising in the majority of countries. Figure 2 presents the most recent developments in terms of output, employment and unemployment (second quarter of 2011 compared to second quarter of 2010). Output¹ is still declining in Greece and Portugal, whereas some countries are showing major output growth, notably Estonia, Lithuania, Latvia, Sweden and Poland, with output growth surpassing 4 per cent. In line with the large output shock Greece saw employment declining by close to 4 percentage points and unemployment increasing by more than 4 percentage points. Employment in Slovenia and Bulgaria decreased further by around 2 percentage points, despite GDP growth. Portugal, Luxembourg and Bulgaria saw unemployment increasing by more than 1 percentage point. Looking at the five countries that initially experienced the biggest labour market impact of the crisis we see Spain and Ireland still doing relatively badly with output, in the former, growing only at a slow rate and employment still declining and unemployment increasing. This contrasts strongly with the Baltic countries where we see major output growth in the most recent period (following the massive contraction there) and strong

1. It should be noted that, given the ongoing debt crisis, these figures are subject to considerable uncertainty. In several cases of member states that have been receiving financial support from the EU/IMF and of those whose governments have been facing difficulties in the financial markets, their austerity programmes include adjustments being pursued as a condition of financial support and/or in an attempt to avoid having to request financial support. As the experience of Greece, Ireland, Portugal and Latvia has shown so far, such adjustments result in deeper recession than originally forecasted.

increases in employment. Unemployment was also declining strongly in the latter three countries, particularly in Estonia.

Two points are worth noting here. First, the Baltic States were among those countries that recorded very high employment losses/unemployment increases in the wake of the crisis. Therefore, these forecasted improvements would be occurring in labour markets that had deteriorated sharply. Second, at least in the case of Latvia, there is still a lot of uncertainty about the evolution of macroeconomic variables, such as GDP growth (Theodoropoulou and Watt, 2011).

Figure 2 GDP,² employment and unemployment rates, second quarter of 2011 (change compared to second quarter of 2010)



Notes: Employment and unemployment rates for population aged 15–64 years.

* GDP value is provisional. ** GDP refers to first quarter of 2011.

Source: Eurostat online data base (national accounts and labour force survey).

Not all labour market groups were equally affected by labour market developments. Young people (15–24 years) and the low qualified in particular saw their unemployment rates increasing during the crisis. Youth unemployment is now above 20 per cent and is thus more than double the unemployment rate of prime age and older workers, and it has reached 40 per cent in countries such as Spain and Greece. One

2. GDP as used in figure 2 refers to gross domestic product at market prices.

explanation why young people and the low skilled are particularly affected by increasing unemployment and declining unemployment is their disproportionate share of fixed-term and temporary agency work, with temporary workers being the first to lose their jobs during the crisis (for detailed information, see Leschke, forthcoming).

All in all, the picture that emerges from output and labour market developments in the EU from the beginning of the economic crisis until today is a bleak one. The end of the initial downturn did not do much to reverse the initial employment losses. Moreover, over the summer of 2011 signs of a renewed slowdown emerged, alongside evidence of deep-seated problems in the financial sector, against the background of the unresolved sovereign debt crisis. At the time of writing (end of September 2011), a double-dip recession and possibly even a decline into a second major crisis cannot be ruled out. And even optimistic forecasts are for no more than sluggish output growth, insufficient to substantially improve the labour market situation across Europe (although the picture may be brighter in individual countries).

The concern is that there are negative feedback loops between the state of the labour market, the vulnerability of financial institutions and the sovereign debt crisis. In the short term, uncertainty over growth and employment restrains bank lending and firms' recruitment. This also makes it more difficult to consolidate public finances, which creates further uncertainty. On the labour market the concern is that lower employment and higher unemployment rates will become entrenched, as happened for instance in the mid-1990s³. If the appropriate macro-economic demand-side measures are not or cannot be deployed, the use of market-oriented structural policies increases the risks of poverty and social exclusion. We return to this issue in more detail below.

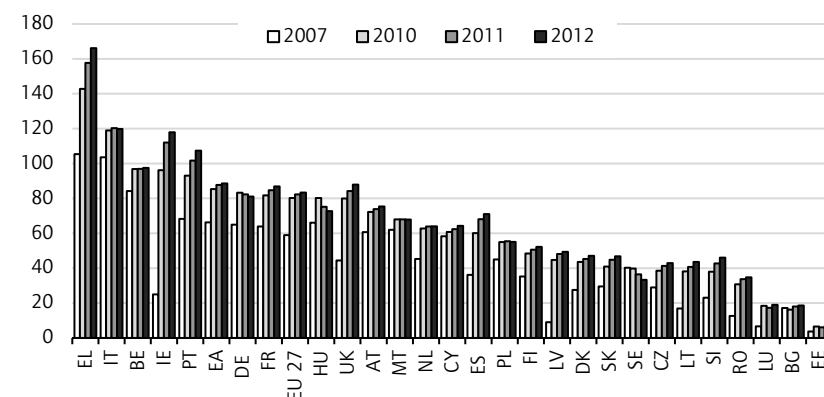
2.2 The crisis and the state of public finances

The economic crisis which began in the last quarter of 2008 has had substantial and varied effects on public finances in European countries

3. See <http://www.social-europe.eu/2011/08/rising-unemployment-please-not-199596-all-over-again/>

(Figures 3 and 4). On average, the gross public debt to GDP ratio in the EU27 rose from 59 per cent in 2007 (66 per cent in the Euro area) to 80 per cent in 2010 (85 per cent in the Euro area), while it is expected to rise further to 83 per cent by 2012 (89 per cent in the Euro area).⁴ Several EU member states saw their public debt to GDP ratios rise to levels that wiped out the fiscal consolidation of the past 25 years or more. Most notably, the debt to GDP ratio of the Irish government rose by 71 percentage points from 25 to 96 per cent between 2007 and 2010 and it is expected to reach 118 per cent of Irish GDP in 2012. Greece, Latvia and the United Kingdom saw rises in their gross debt to GDP ratios of 36–37 percentage points, with the Greek ratio climbing from 105 to 143 per cent between 2007 and 2010 and expected to go up further to 166 per cent of GDP by 2012. In the United Kingdom, the ratio increased from 44 to 80 per cent during the same period and is forecast to reach 88 per cent by 2012. Portugal, Spain and Lithuania also suffered debt to GDP increases of 21 to 25 percentage points between 2007 and 2010, although it is only the Portuguese ratio that has exceeded 100 per cent of GDP, with those of Spain and Lithuania being well below the EU/Euro area averages.

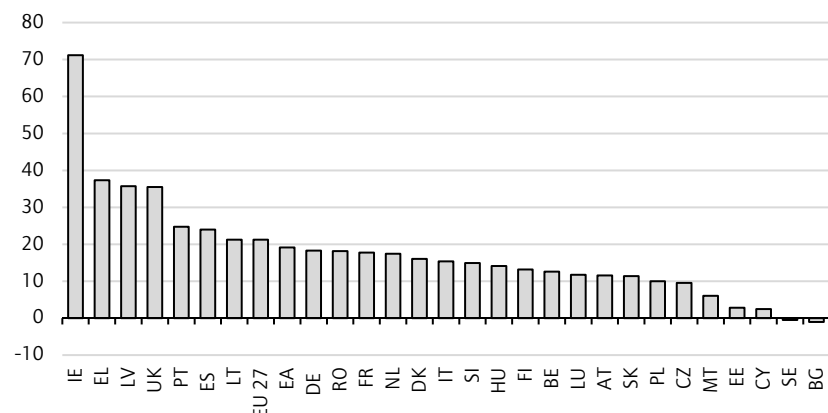
Figure 3 Gross public debt to GDP ratio, EU, 2007, 2010–2012



Source: AMECO data.

4. All figures and forecasts from the AMECO database.

Figure 4 Change in debt/GDP ratio, 2007–2010 (percentage points)



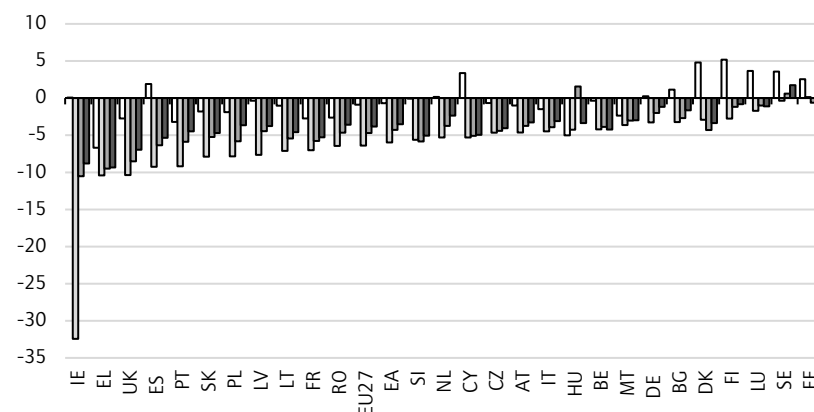
Source: AMECO data.

The increases in the gross debt to GDP ratio reflect two factors: first, the deterioration of government budget balances across Europe due to the crisis, reflecting the operation of the automatic stabilisers (Watt, forthcoming), the discretionary stimulus packages (Watt, 2009) and the measures to bail out the financial sector; second, the contraction of GDP. The average budget deficit rose from 0.9 per cent of GDP in 2007 (0.7 per cent in the Euro area) to 6.4 per cent in 2010 (6 per cent in the Euro area) (Figure 5). Although these average figures conceal a wide variation, only a handful of member states (namely the Nordic countries, Estonia and Luxembourg) still complied with the 3 per cent deficit limit of the Stability and Growth Pact in 2010.

As the credit crunch/financial crisis of 2007–2008 turned into a real-economy crisis, and doubts about the capacity of Greece to pay back its debt arose in the markets, the failure of European leaders to provide a credible and timely guarantee that a member of the Eurozone would not (partly) default on its debt and the refusal of the ECB to undertake the role of lender of last resort for governments sparked contagion and a debt crisis (DeGrauwe, 2011a). It is true that the Greek debt to GDP ratio was relatively high in 2009; however, its sustainability depends not only on this ratio but also on future government balances, the growth rate of the economy and the interest payments the government has to incur in order to keep rolling over its debt. The lack of guarantee

meant that the interest rate required from the Greek government to keep on rolling over its debt started increasing, turning what could have been a liquidity problem into a solvency problem (DeGrauwe, 2011b). This lack of confidence then spread to other Eurozone members with either high debt to GDP ratios or fast increasing government budget deficits. By early 2011, Ireland and Portugal had also sought financial support from the EU and the IMF in order to keep rolling over their public debt, while in the summer of 2011, Spain and Italy also faced very high yield spreads for their government bonds compared to German ones.

Figure 5 General government budget deficit, EU, 2007, 2010–2012 (% of GDP)



Source: AMECO data.

Because of the failure to provide adequate solutions, the Greek, Irish and Portuguese debts continued to rise, because under the financial ‘support’ programmes their governments have been effectively loaded with more debt, carrying relatively high interest rates (which were lowered following the European Council meeting of July 2011). At the same time, the severe austerity programmes that were imposed as a condition for receiving aid plunged the three economies into major recession which worked counter to fiscal consolidation by reducing public revenues, raising benefit expenditure and making spending cuts politically all the more difficult.

Summing up, we can see profound effects on European labour markets and government budgets from the crisis with, at the same time, great

variation between countries. Against this background we now turn to consider the policies implemented in Europe to the extent that they are driven by European policymaking initiatives and processes. First, we describe the main policy initiatives taken at European level since the crisis, before analysing how they have affected – and will continue to affect – national policy choices and also policy outcomes.

3. Policy responses to the quest for growth and the economic crisis: the Europe 2020 Strategy and economic governance reforms

3.1 Europe 2020 Strategy

Partly in response to the crisis, but partly within the framework of a longer-term reform agenda, the European Union has embarked on a complex, multi-layered process of changing the framework within which not only economic but also a wide range of employment-related, social and other policies are designed and implemented by both member states and the European institutions. This process is ongoing. This section summarises some of the key developments, focusing on those particularly relevant for the issue of inclusive growth and the headline target with regard to poverty.

The Europe 2020 Strategy is successor to the Lisbon Strategy, launched in 2000, which formally ended in 2010. Lisbon formulated the strategic goal of becoming ‘the most competitive and dynamic knowledge-based economy in the world, capable of sustainable growth with more and better jobs and greater social cohesion’; this goal was underpinned by a number of EU-level targets. The Europe 2020 priorities and strategy closely resemble those of Lisbon despite the fact that the European Union was not able to deliver on the targets (European Commission, 2010a) and probably would not have done so even in the absence of the economic crisis (for a critical account, see Pochet, 2010).

The Europe 2020 Strategy puts forward three ‘mutually reinforcing’ growth paradigms: smart growth through knowledge and innovation; sustainable growth entailing resource efficiency and a greener and more competitive economy; and inclusive growth, focusing on high employment

and social and territorial cohesion (European Commission, 2010c). Thus, even the social and environmental issues are framed in terms of the growth paradigm. Five headline targets for 2020, covering employment, R&D, climate/energy, education and poverty for the EU as a whole, reflect this strategy.⁵ The Council’s 10 integrated guidelines for the implementation of the Strategy (six focussing on economic policies, three on employment and one on social inclusion and poverty reduction) are supposed to steer and guide reforms in the member states, whereby they are supposed to conform to the fiscal rules of the Stability and Growth Pact (European Commission, 2010d). The so-called seven flagship initiatives spell out the policy measures to be undertaken jointly by EU-level and national actors, which concern the policy areas regarded as most important.

In response to the economic crisis that has revealed the interdependencies and spillovers between different areas the Europe 2020 Strategy seeks to align macroeconomic policy developments and structural reforms within the framework of the so-called ‘European semester’. Stability and Convergence Programmes (which focus on fiscal issues) and National Reform Programmes (which cover a wide range of structural policies) are now to be prepared at the same time in the first half of each year in order to ensure more coherence in reporting, evaluation and recommendations on thematic as well as on economic and budgetary issues, which can then be fed into the finalisation of national budgets (ex ante policy coordination).⁶ The aim is to strengthen budgetary discipline and promote macroeconomic stability and growth in line with the Europe 2020 aims.

As our chapter focuses on ‘inclusive growth’ and, more specifically, the poverty headline target we will look in more detail at this paradigm and its components. The first important thing to note is that, in the social

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5. The targets are as follows: an employment rate of 75 per cent for people aged 20–64; 3 per cent of EU GDP invested in R&D; a longer list of climate/energy targets; reducing the proportion of early school leavers to below 10 per cent and at the same time increasing the share of young people with tertiary education to at least 40 per cent; and reducing the number of people at risk of poverty in the EU by at least 20 million.
 6. This is a further step towards aligning various policy fields. The process started after the mid-term evaluation of the Lisbon Strategy in 2004 when economic, employment and social policies were better integrated by implementing common guidelines and using a common reporting system, the National Reform Programmes.

and employment field, most European coordination takes place through soft law mechanisms, namely, the open method of coordination, (OMC) with little leverage for putting pressure on member states to implement or desist from certain policies. As part of the OMC, recommendations are issued (see below) but there are no sanction mechanisms.

The components of inclusive growth, in the Europe 2020 definition, are increasing employment, improving skills and fighting poverty (European Commission, 2010c, p.16-18). Under the general heading of poverty child poverty in particular, but also the working poor and the exposure of the unemployed to poverty are in focus. It can be considered a step forward that the social dimension has been integrated into the overall Europe 2020 Strategy, but the fact that it is so closely intertwined with employment issues makes it uncertain whether and how member states will address the social inclusion guideline (Zeitlin, 2010, p. 262).

The new Europe 2020 poverty target – to lift 20 million (or one in six) people out of poverty and social exclusion – reflects the need for political compromise (for details, see Mailand, 2011). This is illustrated notably by the fact that the EU27 target is measured on the basis of three combined indicators: at-risk-of-poverty rate,⁷ severe material deprivation rate⁸ and households with very low work intensity.⁹ This combination of monetary (relative income poverty) and non-monetary (material deprivation and exclusion from the labour market) components of poverty is supposed to reflect the multifaceted nature of poverty.¹⁰ A key point is that member states can choose whether they want to use the composite EU definition for monitoring poverty or to set targets on the basis of a subset of the three indicators or on the basis of national indicators reflecting the specific country situation. Most countries have

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7. Persons with an equivalised disposable income below the at-risk-of-poverty threshold, which is defined as 60 per cent of the national median equivalised disposable income after social transfers.
 8. Severe deprivation is defined as experiencing at least four out of nine deprivation items. The deprivation items are as follows: cannot afford to: pay rent or utility bills; keep home adequately warm; face unexpected expenses; eat meat, fish or a protein equivalent every second day; take a week's holiday away from home; or buy a car, a washing machine, a colour TV or a telephone.
 9. Defined as persons aged 0–59 living in households where adults worked less than 20 per cent of their total work potential during the past year.
 10. For detailed information on the social dimension of the Europe 2020 Strategy see Council of the European Union, 18 February 2011.

applied the EU definition but an important subset of countries uses other definitions, the most popular being the ‘at-risk-of-poverty rate’ (for a provisional list, see Council of the European Union, 2011b, p. 3-4).

In what follows, we focus on the poverty headline target as an indicator of inclusive growth. Previous assessments of the Lisbon Strategy that also focused on growth, employment creation and skills upgrading suggest disappointing outcomes with regard to poverty (Cantillon, 2011). Other research has also pointed out that substantial inequalities exist within groups of people with similar skill levels (Franzini, 2011). In other words, employment growth and skills acquisition have been shown to be far from unequivocal paths to more social cohesion, even when macroeconomic conditions were more conducive than currently. Depressed output growth, massive increases in unemployment and pressures to decentralise collective wage bargaining are likely to make these links even weaker. For these reasons, we focus on the poverty headline target.

3.2 Economic governance reforms

The Europe 2020 Strategy was drawn up and launched at a time when the European economy – and especially the Eurozone – was facing the deepest economic crisis since its inception. In the case of the Eurozone, the debt crisis exposed the shortcomings in the economic governance architecture put into place starting in 1992. The European responses to the debt financing crisis that started in Greece were: first, the setting-up of an IMF/EU/EC financial support package for Greece; second, the establishment of the European Financial Support Facility (EFSF) (due to be replaced by a so-called European Financial Support Mechanism ESM) aimed at supporting Eurozone governments facing prohibitively high interest rates for financing their debt in the markets; and third, the launch of the Securities Markets Programme (SMP) under which the ECB began buying Eurozone governments’ bonds.

The spreading of the crisis and its potential implications forced a rethink with regard to the economic governance institutions and procedures that were in place with a view to ensuring that it would not occur again, but also that, if it did occur in future, there would be sufficient resources to tackle it effectively.

Draft legislation¹¹ was proposed by the European Commission and discussed by the European Council. At the time of writing the European Parliament had just adopted these measures, the so-called ‘six-pack’ of economic governance reform proposals.¹² Nonetheless, many details remain to be operationalised.

The thrust of these proposals can be summarised in three points:

- (i) the introduction of a European semester to intensify policy coordination;
- (ii) the introduction of a so-called Excessive Imbalance Procedure to address the issue of external (current account) imbalances; and
- (iii) a strengthening of the fiscal rules under the Stability and Growth Pact (SGP) (for a more detailed discussion of these changes, see also Watt, 2011).

Enhanced policy coordination: the European Semester

The coordination of national policymaking is being streamlined in a new annual procedure known as the European semester, applied from the start of 2011. The process got under way in January with the publication by the European Commission of the Annual Growth Survey (AGS) (Vanhercke, 2011). The Annual Growth Survey 2011 focused on fiscal consolidation and labour market reform: the implicit deal was that this tough neoliberal-inspired package was a quid pro quo for the setting up of the EFSF and the ESM. The 2011 AGS does not contain a single reference to social inclusion or social cohesion – the ‘inclusive growth’ paradigm is in fact reduced to its employment component with no regard to the issue of fighting poverty (European Commission, 2011b). Rigorous fiscal consolidation is put at the centre and strict and sustained wage moderation are suggested as corrective measures for member states with large current account deficits and high levels of indebtedness (European Commission, 2011b, 5); surplus countries, by contrast, are not called upon to accelerate wage growth to bring about symmetrical competitive adjustment (ETUI/ETUC, 2011, ch.1).

11. See http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-09-eu_economic_governance_proposals_en.htm

12. See <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/647&format=HTML&aged=0&language=EN&guiLanguage=en/>

The policy prescriptions with regard to job creation are primarily supply-side, focusing on making work pay by strengthening incentives and conditionality, despite the overwhelmingly demand-side nature of current unemployment problems. Social inclusion/fighting poverty is discussed briefly only in Annex 1 (European Commission, 2011a). Here the focus is clearly on the role of labour market participation (including incentives) in fighting poverty (compare European Commission, 2011a). The potential merits of this approach have already been cast into doubt, however: growth and employment during the Lisbon Strategy era failed to deliver in terms of reducing poverty (Cantillon, 2011).

For the present discussion the key feature of the European semester is that it is serving to increase the pressure on member states to pursue fiscal austerity while at the same time seeking to reduce unemployment by implementing orthodox market-oriented structural reform policies. In a context in which unemployment is high primarily for cyclical (demand-side) not structural (supply-side) reasons, such an approach is likely not only to be ineffectual in reducing unemployment, but also to have negative distributional effects. Both are inimical to the goal of stable and inclusive growth.

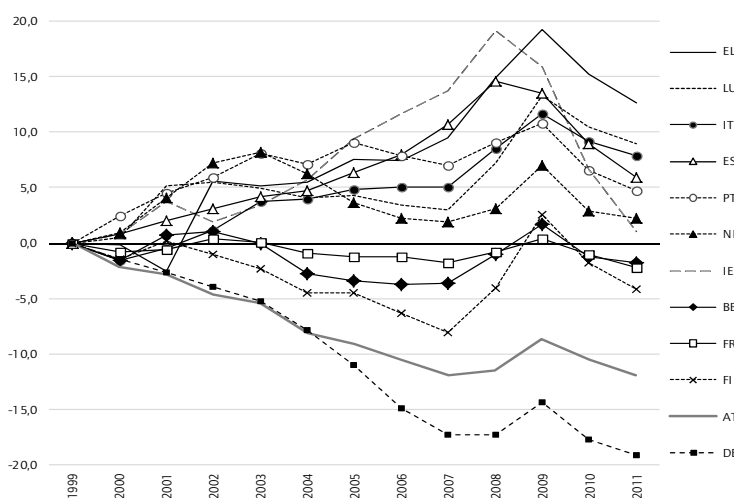
Addressing current account imbalances

The surveillance of Member States is also to be substantially broadened in comparison to the previous emphasis on the fiscal stance. A new, so-called excessive imbalance procedure (EIP) is to be introduced, modelled on the excessive deficit procedure in the SGP. Under the EIP the competitiveness and current account positions (see Box 1) of all member states are to be assessed against a ‘scoreboard’ of relevant indicators (the precise details of which have yet to be decided). The Commission and the Council can make recommendations to member states if the imbalances are held to be excessive and injurious. Like the SGP there is also a corrective arm under which member states (in the Euro area) can be sanctioned for failing to comply with recommendations. A country can be required to deposit up to 0.1 per cent of GDP with the European Commission which, in the case of repeated non-compliance, can be converted into a fine. Decisions on sanctions are taken by the Council, but subject to a new ‘reverse majority’ procedure, whereby the member state threatened by sanctions will have to obtain a qualified majority to overturn the recommendation (as opposed to a qualified majority being necessary in order to endorse the sanction recommendation).

Box 1 Current account imbalances in the Eurozone

One widely drawn lesson of the economic crisis is that current account imbalances are a problem, not only at the global level (for instance, the United States and China), but also between countries that share a common currency.¹³ Such imbalances arose because of the workings of EMU (See Theodoropoulou and Watt, 2011). On joining EMU, previously high-inflation European countries on the southern and western periphery that had had high interest rates benefited from a sharp fall in borrowing costs, setting off a – seemingly – virtuous circle: these fast-growing, high-inflation economies enjoyed relatively low real interest rates (the common ECB-rate minus their high inflation rates). This stoked up economic activity, also by driving up asset – especially house – prices, which in turn stimulated the economy through various wealth effects. Meanwhile, slow-growing, low-inflation countries were mired in a mirror-image vicious circle, facing slow growth and low inflation with relatively high real interest rates.

Figure 6 Nominal unit labour costs minus 2% p.a. (1999 = 100)



Source: AMECO database; authors' calculations.

13. For most purposes it is an acceptable simplification to equate current account (im)balances with trade imbalances. Deficits, then, arise when a country imports more goods and services than it exports; conversely, surpluses are the result of a country exporting more than it imports. Countries running persistent deficits incur net liabilities (foreign debts) vis-à-vis the rest of the world (or run down net asset positions accumulated in the past), while surplus countries build up net asset positions (or pay down past liabilities).

This dichotomy was exaggerated by the one-sided nature of the Stability and Growth Pact: slow-growing economies are prevented from pursuing expansionary fiscal policies, while faster-growing economies are not constrained. This situation led to sustained faster nominal wage/price growth in peripheral countries than in core countries. The combination of faster-rising prices and nominal wages, and stronger domestic demand constrained deficit countries' exports while stoking import demand; the reverse happened in surplus countries. In Germany, domestic demand was essentially stagnant and economic growth was driven solely by higher net exports. The widening competitiveness differentials are shown in Figure 6.

The figure is presented in such a way (subtracting 2 per cent a year from the raw nominal unit labour cost figures) that a country keeping close to the *x*-axis would see domestic prices and unit wage costs growing in line with the ECB inflation target. France and Belgium are in this category. Germany and Austria experienced a marked increase in wage competitiveness (taking 1999 as a starting point) over the period, whereas the 'peripheral' economies, such as Ireland, Greece and Spain, lost competitiveness in the period up to the crisis.

Reinforced fiscal policy surveillance

The surveillance of fiscal policy under the Stability and Growth Pact (SGP) is reinforced considerably under the new proposals. One notable change is an insistence on compliance with the debt criterion (60 per cent of GDP), which had previously essentially been ignored. Countries will be required to achieve rapid downward adjustment towards the threshold (one-twentieth of the gap between the current and target debt-to-GDP ratio per year). The sanctions regime under both the preventive and corrective arm of the Pact is to be tightened, with a more graduated range of sanctions, coupled with the application of the reverse voting mechanism (see above) that makes it harder for member states to block a Commission recommendation to impose sanctions. There is to be particular regard to the expenditure side of the budget, with a norm of linking expenditure to the medium-term rate of economic growth. More attention is also to be paid to fiscal institutions in the member states in order to improve the basis for decision-making and ensuring the provision of correct data.

Assessment

A more detailed critique of this approach is provided by Watt (2011). In brief, while marking progress in some important areas the proposals are a step backward in others and, indeed, raise major concerns. Not least, a number of potential reforms, given the experience of the crisis, are notable by their absence.

In procedural terms the European semester can be welcomed as bringing about much needed policymaking coordination. It is a step in the direction of ‘economic governance’ that many from the outset considered indispensable for the operation of a monetary union. The problem, at least in the first year of its operation, has been (as we have seen) the misguided substantive thrust given by the Annual Growth Survey. One important focus of the reforms is an intensification of a longstanding – but arguably unjustified and unhealthy – European obsession with fiscal deficits and public debt. Not least this raises the danger of a dangerous intensification of fiscal austerity and neglecting cyclical stabilisation. The focus on the expenditure side is likely to have negative distributional implications and thus is inimical to inclusive growth.

The attention to be paid to macroeconomic imbalances is, in principle, justified in light of what has been learned during the crisis (see Box 1). The issue here is more whether the ‘devil lies in the detail’. There are serious concerns about how wage setting at the national level is supposed to be ‘policed’ by policymakers at both EU and national level. Much of the language used by policymakers in the context of the EIP (and also some of the recommendations in the AGS) gives rise to the fear that the focus will be one-sidedly on deficit countries, rather than taking a symmetrical approach to the correction of imbalances. Again, this is both a macro problem and a problem of distributional justice.

Above all, the reforms represent a missed opportunity to use the crisis to make changes that would enhance growth and employment opportunities in Europe and improve the welfare of European citizens. Notably absent from the reforms is any reference to the role of monetary policy within economic governance. Other matters urgently requiring reform – such as limiting tax competition between EU countries – are not addressed.

As if these initiatives – driven by the standard ‘community method’ involving Commission, Council and Parliament – were not enough, member states have been pushing their own intergovernmentalist

agenda.¹⁴ France and Germany launched an initiative in early 2011 for a so-called ‘Competitiveness Pact’. This led to a more consensual effort within the European Council: renamed ‘Pact for the Euro’ it contained a firm commitment to an effective ESM, alongside a more detailed set of measures to which Euro area member states were to commit themselves.

Measures are to be taken in the following areas: competitiveness, job creation, fiscal consolidation and financial stability. There are no provisions for compulsion or sanctions on member states: peer pressure will be relied upon. Only those actually seeking the support of the EFSF/ESM will be forced to make policy changes. The Pact immediately prompts the question of why we need a (non-binding) intergovernmental Pact for the Euro when the European semester and the Annual Growth Survey constitute a very similar process of policy coordination, albeit with – ultimately – the possibility of imposing sanctions (Watt, 2011). What is explicit in the Pact is the ‘grand bargain’ nature of the deal: European solidarity in the form of the ESM for greater policy constraints. This was only implicit in the AGS. The latest manifestation is the so-called Euro-Plus Pact agreed in March 2011, to which the Euro area members and a number of non-members (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) have signed up.

The latest initiative (August 2011) is another Franco-German plan. Most notable here is the insistence that all countries institutionalise debt brakes/balanced budget rules in their constitutions, along the lines of the German *Schuldenbremse*. Putting operational policy rules into a hard-to-amend constitution is bad politics. Such rules tend to be complex simply because the world is complex and they are likely to have to be modified as circumstances and our knowledge of the functioning of our economies changes. Depending on how it is implemented it is also bad economics: the crisis has taught us that countries in a monetary union, with a single monetary policy, need to use fiscal policy actively to address their specific national situations and promote Euro-

14. An overview of this intergovernmentalist track is to be found here and the links contained within it: <http://www.social-europe.eu/2011/08/another-franco-german-summit-another-mix-of-bad-process-and-ambiguous-outcomes/>

area cohesion. Tying the hands of policymakers with cumbersome, hard to change and/or hard to interpret rules is not the way forward.

Overall, Europe is developing an almost bewildering array of overlapping policy responses in the area of economic governance. Beyond this confusion, none of the measures proposed, singly or jointly, come close to resolving the key problems facing the Euro area.

In the context of the present discussion, which focuses on the prospects for inclusive growth, it can be concluded that the economic governance reforms are based to a considerable extent on a misdiagnosis of the problem ('it's mostly fiscal' and more market-oriented structural reforms are needed). This does not (yet) constitute an adequate response to the crisis and thus threatens, in the short run, to harm any prospect of economic growth and to increase the risk of a renewed downturn. Exacerbating the shift to Continent-wide austerity makes swift recovery of demand and output unlikely. It also promotes policies (expenditure-side forced consolidation, decentralisation of collective bargaining and a 'make work pay' approach to labour market policy) that will tend to make any growth that does occur less 'inclusive' (see also next section). Finally, it risks embedding retrogressive policies in the longer term (such as a debt brake), thereby depressing public investment.

4. Fiscal austerity against inclusive growth?

Having argued that the new economic governance and fiscal austerity in Europe as a response to the debt crisis pose a serious threat to any kind of output growth – and consequently to employment creation and recovery – we shall now take a closer look at the planned national measures for achieving the poverty headline target of the Europe 2020 Strategy. These measures were announced in the context of the European Semester last spring. We ask the following questions: do fiscal consolidation policies overshadow policies aimed at reducing poverty in its various guises? Are the policies planned in the context of the European Semester mutually supportive and likely to increase cohesion across member states? And which objective is the EU's priority: consolidation of public finances or poverty reduction?

To answer these questions, we proceed as follows. Section 4.1 highlights how the EU countries are doing in terms of poverty and social exclusion. Section 4.2 illustrates the extent to which the pressure for fiscal austerity is contradicting the inclusive growth paradigm and particularly its social component. This is done, first, by looking at the planned expenditure cuts – and particularly the cuts in social spending – that the countries report on in their Stability and Convergence Programmes. Second, we look at the emphasis of the Commission's country-specific recommendations as part of the policy cycle of the European Semester. Finally, we present some measures that are likely to have adverse implications for social inclusion and poverty from selected countries.

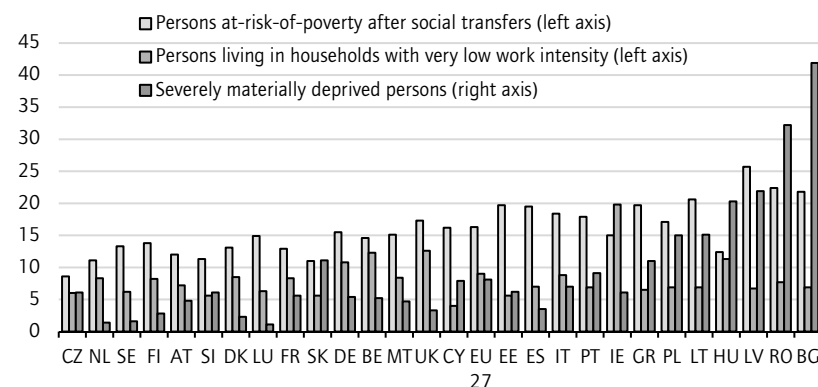
4.1 Poverty and social exclusion in the EU

Figure 7 shows how the EU countries were faring with regard to the overall EU headline target on poverty and social exclusion and its three component sub-indicators in 2009 (latest available data). The overall target is composed of people who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with very low work intensity. The European Council (18 February 2011: 44–46) illustrates for all EU countries how the three groups overlap.¹⁵ In most countries the 'at risk of poverty rate' best accounts for the observed poverty, as measured by the composite indicator. However, in the poorest countries – Bulgaria, Romania, Latvia and Hungary – 'severe material deprivation' is very pronounced, whereas it is of limited importance in most other countries. In Ireland, the most acute dimension of poverty is represented by 'low work intensity households'. The overall indicator capturing people at risk of poverty or social exclusion ranges from 14 per cent of the total population in the Czech Republic to 46 per cent in Bulgaria; the EU average was 23 per cent in 2009. Eight countries had more than one in four people (>25 per cent) in poverty according to the EU definition: (in ascending order) Ireland, Greece,

15. It is important to keep in mind that the EU headline target refers to relative poverty, implying that poverty means very different things when comparing, for example, the Nordic and the Central and Eastern European countries. For comparative purposes and to stick with the European definition we will nevertheless use the EU headline target here.

Poland, Lithuania, Hungary, Latvia, Romania and Bulgaria. The Nordic countries are doing particularly well and the continental European countries all perform above average. The Southern European countries exhibit below EU average performance but, with the exception of Greece, are not among the worst performers. The EU2 countries are by far worst performing and the NMS are spread over the whole distribution, with the Czech Republic being the best performer overall.

Figure 7 The overall EU headline target (people at risk of poverty or exclusion) and its three components, 2009 (share of total population)



Source: Eurostat online database.

All five countries (Greece, Portugal, Ireland, Latvia and Romania)¹⁶ that are currently in receipt of financial assistance (or under precautionary surveillance in the case of Romania) from the EU and the IMF and are thus under particular pressure to engage in rapid fiscal consolidation have poverty and social exclusion rates above the EU average. The

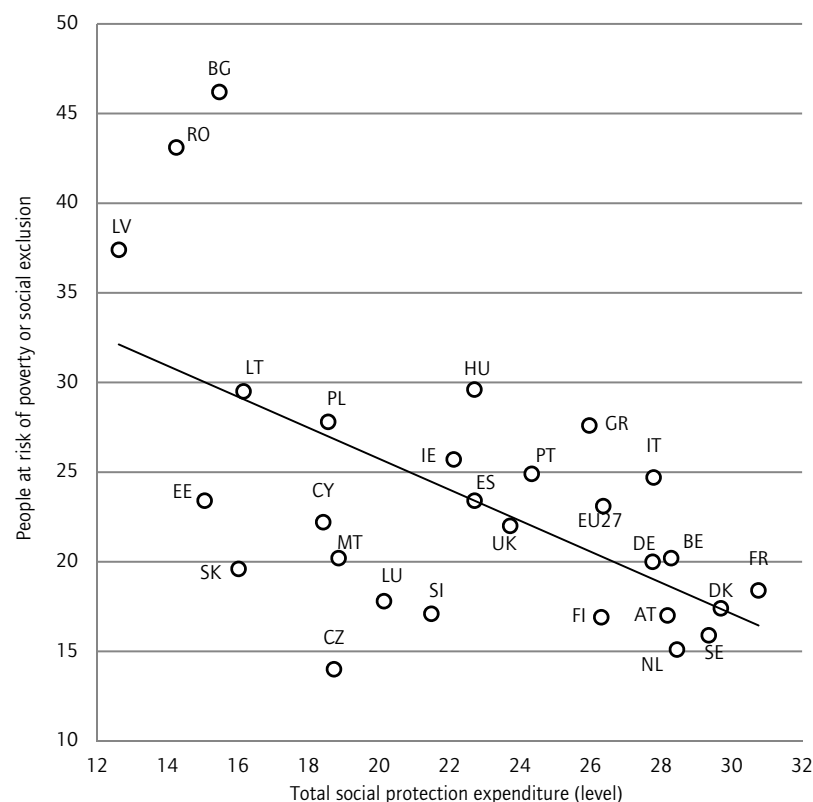
16. Latvia and Romania had to seek multilateral balance-of-payments assistance from, among others, the EU, the IMF, the World Bank and the EBRD in 2008 and 2009, respectively. To that end, they adopted conditionality programmes spelling out the structural reforms they had to undertake. While Romania completed the first programme and is now under a non-activated 'precautionary' programme, Latvia's adjustment is still ongoing. Hungary also received balance-of-payments assistance, although it stopped receiving it before the foreseen end. Greece, Ireland and Portugal had to seek financial assistance from the EU and the IMF in May 2010, December 2010 and May 2011, respectively, as their governments faced prohibitive borrowing costs in the financial markets, following rising concerns that they would not be able to carry on servicing their debt.

following sections will illustrate the negative impact of the pressure for fiscal austerity on the inclusive growth paradigm and point particularly to the danger of countries drifting apart.

4.2 Stability and Convergence programmes against reforms to tackle poverty?

We examine first the plans announced by member states with regard to developments in public expenditure and, particularly, social payments in the context of their Stability and Growth programmes. To put the announced cuts into perspective, Figure 8 illustrates how the different member states are doing in terms of the level of total social expenditure as a share of GDP in 2008 (latest available data from Eurostat) and the share of total population at risk of poverty or social exclusion in 2009 (the reference year for the Europe 2020 headline target). There is substantial variation in levels of social spending and associated risks of poverty and social exclusion. However, we see that in terms of social spending we can roughly distinguish two clusters of member states, namely the old and the new member states. Within these two clusters, there appears to be a negative correlation between social payments and the risk of poverty/social exclusion, which in fact is stronger among the new member states. In other words, the new member states, which are also significantly poorer on average than the old ones, have lower levels of total social spending as a share of GDP, while also presenting a wider variation of poverty risk, with some of the worst performers in the EU (Romania, Bulgaria, Latvia) but also the best performer (Czech Republic). In terms of the Europe 2020 Strategy, one would therefore expect that at least those member states with higher poverty risk rates would be called upon to make relatively more effort to increase social spending as a share of GDP in order to make progress towards their poverty headline target.

Figure 8 Comparison of levels of total social protection expenditure as a percentage of GDP and risk of poverty or social exclusion rate



Source: Eurostat online database.

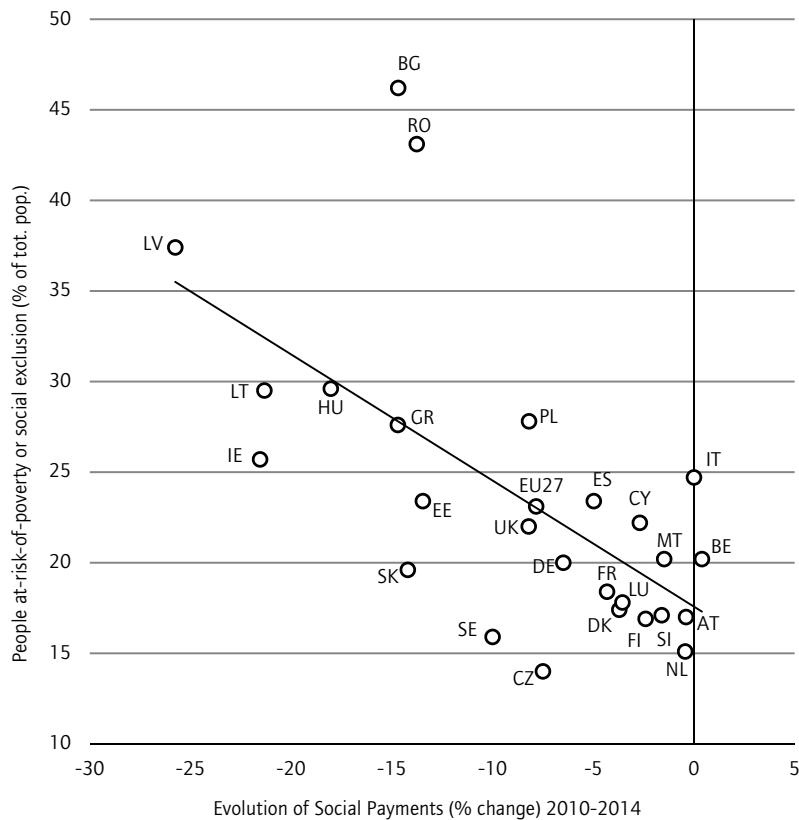
Figure 9 presents the risk of poverty or social exclusion in 2009 and the planned evolution (percentage change) of social payments (including both money transfers and transfers in kind) as a proportion of GDP for 2010–2014, according to the Stability and Growth Programmes which were submitted in spring 2011 in the context of the European Semester (see Annex for complete tables on the development of total public ex-

penditure and social payments).¹⁷ Cuts in social payments are envisaged in the majority of member states, although they are most severe in Ireland, Greece, Latvia, Hungary, Lithuania, Slovakia, Bulgaria, Estonia and Romania, which are also among the countries with the highest proportion of the population at risk of poverty or exclusion. Ireland, Greece, Latvia and Romania have received financial help from the EU and/or the IMF and can thus be considered to have suffered a loss of policymaking autonomy. This is not the case for Lithuania, Estonia, Slovakia and Bulgaria. Estonia was under pressure to demonstrate a commitment to sound public finances as it joined the euro in 2011,¹⁸ however, while Lithuania is in a similar situation as it has been hoping to adopt the euro since 2007. Interestingly, Latvia, Slovakia, Lithuania, Bulgaria, Romania and Estonia have all had and are projected to have public debt to GDP ratios well below the 60 per cent that the Stability and Growth Pact stipulates. This implies that there are few fundamental concerns about the sustainability of their public finances. There are certainly concerns about the social exclusion of particular groups within their populations, however, and the planned cuts in social payments risk aggravating the situation. Overall, the positive correlation between the extent of poverty/social exclusion and the extent of the planned retrenchment of social spending is profoundly worrying and completely at odds with the EU poverty headline target.

¹⁷ These figures are the only ones available for the current period and the near future. It should be noted that the Eurostat definition of social payments as used in Figure 8 is different to the one used for the purposes of Stability and Convergence Programmes (see Figures 9 and 10) in that the former includes all costs associated with a social policy programme (for example, administration costs), whereas the latter measures the payments themselves only. That results in a discrepancy in the size of social payments which is fairly large for some countries (such as Sweden, Denmark and Finland) but not others. However, we think that, given the absence of more recent Eurostat data and forecasts on these payments in the forthcoming years, this discrepancy does not affect the analysis.

¹⁸ Countries giving up their currency and monetary policy tools become vulnerable to financial markets' beliefs about their capacity to carry on servicing their public debt, as they lose control over their central bank. As the current crisis has shown, a market belief that a government cannot carry on servicing its debt can become a self-fulfilling prophecy, once market participants start requiring a higher interest rate in order to continue lending money to the government. See (DeGrauwe, 2011b).

Figure 9 Risk of poverty or social exclusion (2009) and planned evolution of social payments, 2010–2014 (%)

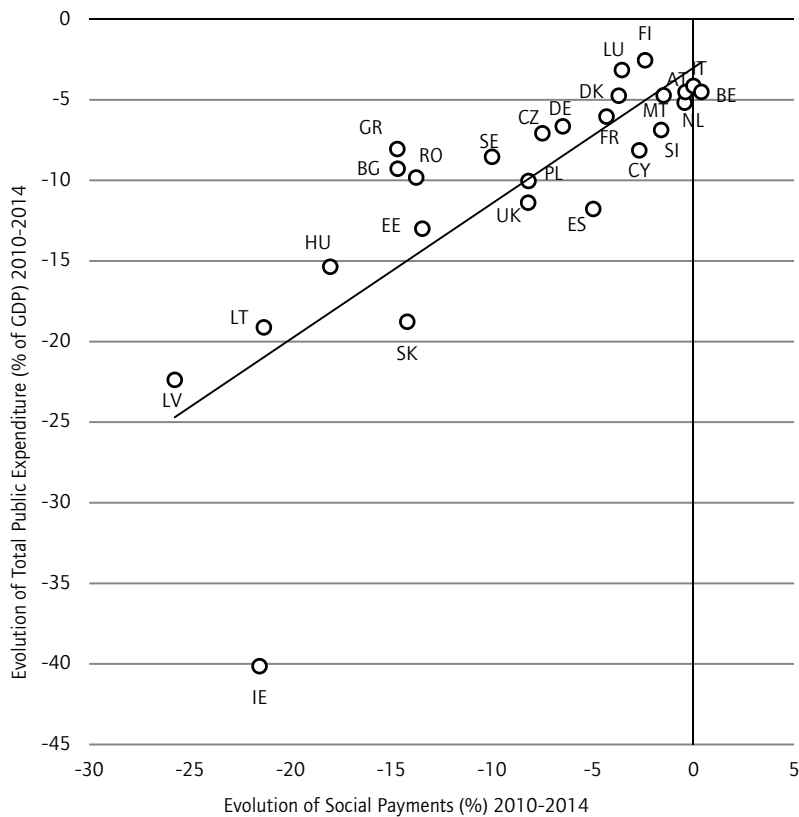


Source: National Stability and Growth Programmes, DG Ecfm and Eurostat online database.

To what extent are these planned social cuts in line with more general cuts in public expenditure and how much do they reflect a planned rolling back of the welfare state alone? Figure 10 shows how the planned evolution of social expenditure compares to the planned evolution of public spending between 2010 and 2014 according to the Stability and Growth programmes of 2011. A few points stand out. First, the retreat of the welfare state within the framework of public spending retrenchment is severest in Greece, Bulgaria and Romania. Greece and Latvia have received EU/IMF financial support and have therefore been following

strict conditionality programmes. Second, the retreat of the state and of the welfare state is more pronounced in some of the new member states whose populations are at relatively high risk of poverty, such as Latvia and Lithuania. Third, Ireland has planned by far the biggest cut in public spending (which has to do with the state's guarantees to its banks) and it is therefore difficult to tell whether the rolling back of its social spending is otherwise bigger or smaller than the cuts in public spending as a share of GDP.

Figure 10 Evolution of public and social expenditure, 2010–2014 (%)



Source: National Stability and Growth Programmes, DG Ecfm.

The picture that emerges from these data is that the countries with disproportionate cuts are those that are already doing comparatively badly in terms of poverty and social exclusion. More specifically, especially in those countries in which the EU has had a say in how much the state could spend and what issues it should be focussing on within the framework of financial aid programmes, there has been a rolling back of both public expenditure and social payments.

4.3 EU priorities: predominance of fiscal issues in the country-specific recommendations

Under the impact of the economic crisis on public finances, the alignment of macroeconomic reporting (Stability and Convergence Programmes) and reporting on structural reforms (National Reform Programmes) in the context of the European Semester has to some extent overshadowed the Europe 2020 targets and particularly the inclusive growth agenda. Countries are to give priority to macro-fiscal issues (compare, for example, European Commission, 2010b, 2011b). This is expressed, for example, in the 2011 Annual Growth Survey which, as we have seen, is primarily fiscal in orientation, combined with a neoliberal supply-side reform agenda.

The same predominance of fiscal consolidation is evident when looking at the next step in the European Semester, on which we focus in this section: the drawing up of country-specific recommendations based on the submission of the Stability and Convergence and the National Reform Programmes (NRPs). Interestingly, although the NRPs are now submitted at the same time as the Stability and Convergence Programmes, macroeconomic surveillance is still an important element. On the basis of the Stability and Convergence Programmes and the NRPs, country-specific recommendations are issued by the European Commission and must be approved by the European Council.¹⁹

19. Country-specific recommendations as well as national reform programmes and stability programmes can be found here: http://ec.europa.eu/europe2020/tools/monitoring/recommendations_2011/index_en.htm

What do these recommendations reveal about the relative priority of fiscal consolidation – as pursued in the context of new economic governance and policies to deal with the debt crisis – over policies to tackle poverty? A first interesting point is that the countries in receipt of financial assistance from the EU and the IMF did not receive specific recommendations from the European Commission this year but instead were called upon to implement the measures laid down in their respective memoranda of understanding. At most, these memos contain general clauses stipulating that the most vulnerable segments of the population should be shielded from the impact of the fiscal consolidation measures. However, the specificity of actions to that end does not parallel those of reducing budget deficits, while measures of a more positive nature that could actively help to reduce poverty are not mentioned at all (European Commission, 2011d; Ministry of Finance-Hellenic Republic, 2011; Portuguese Ministry of Finance and Public Administration, 2011). On the contrary, minimum wage cuts have been effected already in Ireland and Greece and have been under consideration in Portugal (Portuguese Ministry of Finance and Public Administration, 2011). Last but not least, in plans for reforming pension and social security systems, ‘sustainability’ clearly takes precedence over adequacy of benefits; in fact, the latter is often simply not considered.

Each of the remaining 22 countries received a recommendation on budgetary discipline (always the first recommendation), whereas the remainder of the recommendations vary considerably in content. As regards the Europe 2020 priority of inclusive growth, labour market inclusion largely predominates over wider poverty prevention goals. Eighteen countries – and among them the three countries with the highest employment rates – received recommendations on improving labour market participation with particular emphasis on strengthening incentives.²⁰ Recommendations on education and training were issued to 16 countries and in the field of pensions to another 16; again, incentives for labour market participation stand centre-stage (for example, abolishing early retirement schemes and increasing effective

20. Recommendation 5 to the Euro area, for example, asks that they ‘pursue further tax reforms which give priority to growth-friendly sources of taxation while preserving overall tax revenues, in particular by lowering taxes on labour to make work pay’. In a similar vein several countries are asked to reduce financial disincentives for second earners or for low (and medium) paid workers.

retirement age). With regard to pensions, adequacy is also mentioned in a number of cases. Eight countries received recommendations on wages (with an emphasis on aligning wage growth and productivity) and seven on public services, in most cases with a focus on improving effectiveness.

A number of these measures may be helpful in fighting poverty and social exclusion, but they are more likely to work when job creation is buoyant and some redistribution policies are in place. Only six countries received recommendations on poverty and social exclusion, namely Bulgaria, Hungary, Estonia, Cyprus, the United Kingdom and the Netherlands.²¹ Interestingly, of the three countries that do particularly badly with regard to the EU poverty headline target (Bulgaria, Romania and Latvia) only Bulgaria received a recommendation on fighting poverty. Member states use different national indicators to report on poverty, and the respective sections in the NRPs thus vary substantially in content and length. This is likely to have rendered the process of giving recommendations with regard to poverty more difficult. Last but not least, four countries received recommendations on health care.

Five of the seven recommendations to the Euro area countries, which receive specific recommendations from the Commission, focus on macro-economic issues (fiscal discipline, stability of financial system, commitment to Euro Plus Pact and enhancing competition in services) (compare Council of the European Union, 2011a). The remaining two recommendations call for reforms to social security systems with an emphasis on fiscal sustainability and adequacy and tax reforms, for example, to make work pay with a focus on growth-friendly sources. The accompanying, more detailed document (European Commission, 2011c) does not contain a single reference to inclusive growth and the detailed table entitled 'labour market and social indicators' provides figures on labour productivity and unit labour cost growth instead of the poverty and social inclusion indicators.

To wrap up, at the level of the country-specific and Euro area recommendations, not only do the outcomes of macroeconomic prescriptions risk

21. The recommendations to Hungary and the Netherlands are only indirectly linked to the poverty headline target, emphasising tailor-made programmes to low skilled and other disadvantaged groups and the labour market integration of vulnerable groups.

running counter to the coordination related to smart, sustainable and inclusive growth, but the inclusive growth paradigm, where it is referenced, seems to be strongly driven by a desire to boost labour force participation, largely based on making-work-pay strategies that are of dubious value in a context of unemployment caused primarily by a shortfall of aggregate demand.

4.4 Evidence from the fiscal austerity packages

To underpin our argument, in this section we have used evidence from national experts (Theodoropoulou and Watt, 2011) and other sources on the austerity programmes adopted by late 2010/early 2011 in 17 EU member states to obtain insights into their effects on poverty and social inclusion (on austerity measures and their social impacts, see also the individual chapters of this volume).

Indirect tax hikes, which tend to disproportionately affect those at the low end of the income distribution, were reported in several countries (Poland, Hungary, Estonia, Cyprus and Latvia), most of them at the higher end of the poverty distribution within the EU. Indeed, the EU recommendations state that tax increases, wherever necessary, should focus more on indirect taxes as these are less likely to interfere with employment creation (European Commission, 2010d). Nonetheless, some countries (France, Austria, Luxembourg and the United Kingdom under the previous Labour administration) increased progressive taxes (income and wealth taxes). Heise and Lierse (2011), who assess the impact of austerity measures on the European social model for seven European countries, also come to the conclusion that in all these countries the economic crisis and the resulting public debt have been used as excuses for social cuts which in most countries disproportionately hit low earners.

Substantially regressive effects for the bottom end of the income distribution have been reported in the United Kingdom as a consequence of the tax and benefit changes pursued by the government there (Browne and Levell, 2010; Horton and Reed, 2010). Moreover, in Denmark, following the measures introduced for 2010, it has been estimated that by 2013 the poorest 10 per cent are likely to lose 0.78 per

cent of their income compared to only 0.03 per cent of the richest 10 per cent (Baadsgaard, 2010).

The young working under precarious employment contracts are particularly hard hit in Italy due to the limited coverage of unemployment insurance. The unemployment rate for those under 25 in Italy stood at 27.8 per cent in 2010 (Eurostat LFS data), more than three times higher than the average which was 8.4 per cent (Theodoropoulou and Watt, 2011). This implies a concentration of social exclusion in this group.

In a similar vein, in Greece (for details, see Matsaganis and Leventi, 2011), because of their very low coverage by unemployment insurance, the unemployed have been particularly affected by the fiscal austerity programme that is a condition of the financial support the country receives from the EU and the IMF. Pensioners have also been targeted. Indirect tax increases have been regressive. Some measures, however, such as some elements of public sector retrenchment, have tended to narrow the income distribution (Matsaganis and Leventi, 2011). Overall, as a result of the austerity and the wider recession, 5 per cent of the Greek population saw their 2010 incomes fall below the 2009 poverty line, swelling the ranks of those who were already in poverty (another 20 per cent of the population). However, while the crisis has raised demand for social protection, the supply of social benefits has been reduced rather than increased.

Social benefit recipients are ill-affected following cuts in Latvia, Romania, Germany, the United Kingdom, Spain and Ireland (Heise and Lierse, 2011, p.24-26). In Portugal, the recipients of non-contributory benefits (social assistance, which is more likely to be received by people at the margins of the labour market) are likely to suffer most following measures to reduce expenditure on these benefits within the framework of the programme imposed as a quid pro quo for financial support from the EU and the IMF (Portuguese Ministry of Finance and Public Administration, 2011). Again, it is worth noting that the majority of these countries are at the upper end of poverty distribution in the EU, and have also been finding it hard to finance their public debt in the markets.

5. Conclusion

Europe is currently going through the worst economic crisis of the post-War era. Unemployment has increased dramatically in several countries, especially among young people, and the prospects for output growth recovery appear gloomy for the next few years. Due to the economic interdependence of EU member states, these developments are likely to spread across the Union and especially within the Eurozone. Past experience shows that this combination of high unemployment and prolonged weak output growth is bound to lead to persistently high unemployment, the depreciation of skills and the labour market detachment of unemployed people. The social consequences of these developments will be grave as social exclusion is likely to increase.

Against this background, we have sought to evaluate the coherence of the policy responses promoted at the EU level in response to the crisis and the quest for growth. We have investigated whether the pursuit of fiscal austerity as dictated in the context of the European Semester runs counter to the pursuit of inclusive growth through reducing poverty, which is one of the priorities of the Europe 2020 Strategy. Our answer is affirmative and our argument is spelled out along two axes.

First, the underlying principles of the proposed new economic governance structures are bound to impose a fiscal austerity bias which, under the current circumstances, will inevitably lead to depressed demand and no output growth in the short, medium and, due to hysteresis mechanisms, eventually the long term. This is inimical to growth as such, but is also expected to make any growth that is achieved less inclusive.

Second, a closer look at the recommendations to member states and their declared stability and convergence programmes suggests that all policy considerations with regard to tackling poverty and social exclusion are subjugated to fiscal consolidation and other goals. It is not the first time that inclusive growth has been subordinated to other issues, such as macroeconomic concerns, productivity and employment growth, but the crisis and the subsequent austerity measures have further emphasised these tendencies. This predominance of public finance concerns over inclusive growth is particularly striking in the cases of member states that have been performing below the average in terms of poverty and social exclusion, but have no particular problems in terms of the

sustainability of their public finances. To that end, we have also provided some evidence from austerity packages already adopted in selected member states (as available) and how they have been adversely affecting vulnerable groups or doing little to improve their position. The crisis could and should have been used as an opportunity to introduce corrections to the previous growth model, of which rising inequality was a prominent feature (Watt 2009). However, the evidence suggests not only that this has not happened, but that current policies are tending to exacerbate the direct negative effects on distribution and poverty/exclusion arising from the crisis itself.

Annex

Table A1 Evolution of total public expenditure 2010–2015, according to Stability and Growth Programmes 2011 (% of GDP)

	2010	2011	2012	2013	2014	2015	2014–2010 (p.p.)	2014–2010 (%)
LV	42.9	42.8	39.4	36.3	33.3		–9.6	–22.4
IE	67.0	45.5	43.7	42.4	40.1	37.8	–26.9	–40.1
LT	41.3	39.2	40.2	35.7	33.4		–7.9	–19.1
HU	48.8	49.7	44.1	42.5	41.3	40.3	–7.5	–15.4
EL	49.6	49.5	49.1	47.6	45.6		–4.0	–8.1
BG	37.7	37.2	36.8	36.4	34.2		–3.5	–9.3
SK	41.0	37.9	35.6	34.7	33.3		–7.7	–18.8
RO	40.7	39.2	37.6	37.2	36.7		–4.0	–9.8
EE	40.0	40.3	40.4	36.8	34.8	33.3	–5.2	–13.0
SE	52.7	51.3	50.0	49.0	48.2		–4.5	–8.5
UK	47.4	46.5	45.4	43.8	42.0		–5.4	–11.4
PL	45.8	45.7	43.7	42.2	41.2		–4.6	–10.0
CZ	45.2	46.2	45.7	44.0	42.0		–3.2	–7.1
DE	46.6	45.5	44.5	44.0	43.5	43	–3.1	–6.7
ES	45.0	42.7	41.4	40.5	39.7		–5.3	–11.8
FR	56.2	55.7	54.9	53.8	52.8		–3.4	–6.0
DK	56.8	55.8	56.6	54.2	54.1	53.3	–2.7	–4.8
LU	41.2	40.7	40.9	40.5	39.9		–1.3	–3.2
CY	46.7	46.1	44.4	43.4	42.9		–3.8	–8.1
FI	54.8	53.8	53.5	53.6	53.4	53.4	–1.4	–2.6
SI	48.0	48.0	48.2	46.0	44.7	43.1	–3.3	–6.9
MT	42.3	42.9	42.0	41.4	40.3		–2.0	–4.7
NL	50.2	49.0	48.3	47.7	47.6	47.6	–2.6	–5.2
AT	53.0	52.0	51.6	51.0	50.6		–2.4	–4.5
IT	50.6	49.7	48.9	48.7	48.5		–2.1	–4.2
BE	53.1	53.4	52.4	51.7	50.7		–2.4	–4.5
PT								

Source: National Stability and Growth Programmes, DG Ecfm.

Table 2 Evolution of social payments 2010–2015, according to Stability and Growth Programmes 2011 (% of GDP)

	2010	2011	2012	2013	2014	2015	2014–2010 (p.p.)	2014–2010 (%)
LV	13.2	12.4	11.2	10.5	9.8		–3.4	–25.8
IE	18.1	17.2	16.3	15.3	14.2	13.3	–3.9	–21.5
LT	15.0	13.9	13.7	12.6	11.8		–3.2	–21.3
HU	18.3	17.7	16.2	15.5	15.0	14.6	–3.3	–18.0
EL	23.8	23.3	22.5	21.4	20.3		–3.5	–14.7
BG	14.3	13.6	12.8	12.3	12.2		–2.1	–14.7
SK	19.0	18.1	17.6	17.0	16.3		–2.7	–14.2
RO	13.8	13.1	12.7	12.2	11.9		–1.9	–13.8
EE	15.6	14.6	13.9	13.7	13.5	13.3	–2.1	–13.5
SE	19.0	18.2	17.9	17.4	17.1		–1.9	–10.0
UK	13.4	13.2	13.2	12.9	12.3		–1.1	–8.2
PL	17.1	16.5	16.2	15.9	15.7		–1.4	–8.2
CZ	20.0	20.1	19.6	19.3	18.5		–1.5	–7.5
DE	26.2	25.5	25.0	25.0	24.5	24.5	–1.7	–6.5
ES	18.1	17.9	17.6	17.3	17.2		–0.9	–5.0
FR	25.5	25.4	25.1	24.7	24.4		–1.1	–4.3
DK	18.9	18.9	18.5	18.4	18.2	17.9	–0.7	–3.7
LU	19.7	19.4	19.5	19.4	19.0		–0.7	–3.6
CY	14.9	14.8	14.9	14.7	14.5		–0.4	–2.7
FI	20.8	20.2	20.3	20.3	20.3	20.3	–0.5	–2.4
SI	18.7	19.1	19.4	18.5	18.4	18.3	–0.3	–1.6
MT	13.5	13.5	13.6	13.5	13.3		–0.2	–1.5
NL	22.8	22.7	22.8	22.5	22.7	23.1	–0.1	–0.4
AT	25.5	25.3	25.3	25.4	25.4		–0.1	–0.4
IT	22.2	22.2	22.2	22.1	22.2		0.0	0.0
BE	25.3	25.4	25.4	25.4	25.4		0.1	0.4

Source: National Stability and Growth Programmes, DG Ecfm.

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