"The Economic and Social Convergence of the European Union: delusion or necessity?"

Translation from original version in French into English –

Recommendations adopted by the Economic and Social Commission on May 22nd 2018 and submitted to the Central Council on June 1st 2018

Some forgotten findings:

- *After a period of clear rapprochement during the first period, from 2000 to 2007 (spreads brought down to almost zero, economic catching up of peripheral countries), diverging trends which were already manifest in term of current account and public budget deficit have become very serious since the crisis of 2008 and 2011 took place; they seem to be on the down side once again, but much too slowly.*
- *Living standards discrepancies within the EU have declined (from 1 to 3 twenty years ago to 1 to 2 nowadays); but they remain important between Northern and Southern or between Western and Eastern Europe. Furthermore, they have in most cases increased within each country.*
- *The single currency (euro) has undeniably played a big role in knitting the eurozone economies more closely together; however the unfinished unification of capital market remains an obstacle on the way. Additionally, it appears that the contribution of structural funds towards more converging economies has been even more significant than that of the single currency.*

Our proposals :

- *Set convergence as the centrepiece of EU recommendations and actions, by monitoring investment, unemployment and living standards indicators on an annual basis.*
- *Reduce the asymmetry between balance of payments indicators and policies.*
- *Pursue the capital market integration as quickly as possible and complete the European Banking Union (notably the bankruptcy resolutions mechanism and deposit guarantees scheme).*
- *Make additional own resources available at EU level, so as to push up the Multiannual Financial Framework to 1.5 % of GDP in order to invest into innovation, digital activities, cross boarder links and productive and competitive activities.*
- *Enforce solidarity between member States by setting up investment guarantee scheme, moving towards better tax harmonization and reacting jointly against attempts to impose extraterritorial sanctions on EU banks and companies.*

Rue Marie-Thérèse 21 - B-1000 Bruxelles - Belgique
info@elec-lece.eu - www.elec-lece.eu

The Economic and Social Commission (ESO) of the European League for Economic Cooperation (ELEC), held in Paris on May 22nd 2018 a debate on the topic of "**The Economic and Social Convergence of the European Union: delusion or necessity?**" with several personalities: Philippe JURGENSEN, Professor of Economics at Sciences Po (Paris), author of "The Euro for Everyone"; Michael HÜTHER, Professor and Director of the Economic Institute IW (Köln), Ilya LINGORSKI, Chief Economist at Bulgarian Development Bank and Sofia KASSIDOVA, Financial Policy and Strategy Advisor to the Bulgarian Development Bank ; and Dario VELO, professor at the Borromeo University (Pavia).

I. The Commission points out the following findings:

1. The economic convergence of the member countries of the European Union - and, within the eurozone, that of the euro area countries - has made significant progress until the 2008-2009 crisis: a sharp reduction in interest rate spreads and inflation; higher growth rates in catching-up countries; widespread reduction in public deficits and public debt. However, the situation was not the same for balances of payments and for public accounts in a few countries, leading to dangerous vulnerabilities.

These vulnerabilities have become evident with the economic and financial crisis of 2008-2009, followed by the sovereign debt crisis of 2011-2012, which led to the return of very strong divergence and an explosion of debt and unemployment in many countries. However, a clear reduction in these differences has begun since 2014, thanks to the efforts of all governments and with the support of the EU.

2. Despite these upward and downward trends, the reduction of differences in living standards between the countries that currently make up the European Union has been considerable thanks to the rapid catching up of Southern countries, and, still more rapidly, Eastern European countries, whose degree of openness to foreign trade has increased considerably: the disparities between the per capita income of the EU's poorest country and the average per capita income of the EU have been reduced from 1 to 3 in 1990 to 1 to 2 currently.

However, in the eurozone, differences in living standards have increased again from 2010 onwards between the countries in the North and those in the South and they hardly stabilize.

3. Since its creation in 1999, the single currency has undeniably been a factor in bringing euro area countries closer together, facilitating and streamlining trade between them and bringing their economic policies closer together. The Stability and Growth Pact and the agreements that have completed it ("six pack," "two pack," etc.) have led to better coordination of budgetary policies. On the other hand, current balance-of-payment situations have remained very divergent while the convergence of social policies has only been very limited, which runs the risk of pushing the Union down the road.

The unification of capital markets has also remained very incomplete; it is insufficient to compensate for the natural trend towards the concentration of productive forces in centrally located countries and which benefit from a long industrial tradition and efficient educational and training systems.

Besides, the effect of the Structural Funds (ERDF, ESF) and the Cohesion Fund, which has contributed in some countries up to 3% of their GDP, seems to have been even more important to facilitate the economic recovery of the countries of Central and Eastern Europe as well as their modernization, with an increase of their per capita income.

4. Whereas if the disparities between European countries have been reduced, income inequality per head within our countries remains important; they have even grown[1], albeit far less than in the United States. In particular, the progress made in the peripheral countries of the European Union has been accompanied by a strong increase in inequalities within each country. It appears that only part of the population in

[1] Measures from Gini Coefficient

these regions benefited from the process of growth and convergence, while the rest of the population remained in great difficulty.

5. All in all, social inequalities remained strong. The introduction of social indicators (unemployment rate, rate of activity, long-term unemployment, youth unemployment, productivity and nominal wages) in the "process on macro-economic imbalances"' (European Scoreboard) should, however, allow further progress to be made in the future.

The initiatives of the Commission to give the European Union a "social triple A rating", the development of a "European social rights Pilar" and its adoption at the European Social Summit for Fair Jobs and Growth in Gothenburg (November 17th 2017) will considerably increase the attention given to safeguarding the "European social model" and help deter the race towards the lowest social level. However, Social Europe remains a work in progress, and projects such as a common European unemployment insurance scheme are still in limbo.

II. Willing to contribute to the development of policies so that Europe can cope with this multifaceted challenge, our Commission formulates the following recommendations:

1. Convergence **-** specifically addressed by Article 3 of the Treaty of the European Union must be placed more at the center of the recommendations and actions of the European Union. The Scoreboard indicators should be more detailed, on an annual bases and not only on average triennial; their access should be facilitated and their distribution systematized and expanded.

In particular, close monitoring must be insured, beyond the criteria for budget, indebtedness and structural reforms, on issues of growth, innovation and investment, unemployment, in assessing the policies of Member States and at the level of each region. A precise analysis of changes in income per capita disparities and standard of living between countries and within them should be made annually and accompanied by incentivizing measures. Similarly, the Union budget and, if necessary, the euro area budget should contribute to all these priorities.

2. Monitoring the balance of payments must receive more attention and the criteria must no longer be unbalanced. It is inappropriate, in particular, for unbalances in balance of payments considered acceptable to be higher when it comes to surpluses than those retained when it comes to deficit (6% of GDP against - 3%, recently modified into a figure of - 4%). That is to forget the common sense observation that surpluses of countries are the deficits of others, at least worldwide. Reducing the asymmetry of adjustment policies between eurozone countries requires a better combination between the need for the fight against moral hazard and the required risk sharing.

Some observe, however, that these figures are not significant enough and that capital flows must also be taken into account; the main progress would therefore be to move towards more integrated capital markets, in order to encourage investment in the European countries in need from overabundant saving countries. The "Brexit" is another reason to push this integration into the capital markets.

All in all, in order to ensure a sustainable co-existence of balance of payment deficits in some euro area countries and surplus in other countries, these imbalances must, on the one hand, be maintained in reasonable proportions and dynamics and, on the other hand, the intra-zone capital market must become once again fluid, as it was before the eurozone crisis, so that the financing capacity of certain nations can cover the need for financing of others, particularly in the form of direct investment. This integration of the financial markets will only be recovered if each country conducts a sustainable policy and if intra-zone solidarity is affirmed, commensurate with the sustainability efforts of the economic policies of each individual.

We also recommend that the current payments indicator of each EU Member State be detailed by providing its balance of payments with the euro area as a whole and, more specifically, with each of the other euro area Member States in particular. It is also important to monitor very closely developments in productivity, annual salaries and the sharing of added value within each EU Member State.

3. At the same time, the European Banking Union must be completed with the setup of the deposit guarantee insurance scheme, as well as with the common 'final backstop' on public funds provided by the European Commission, so as to prevent a widespread contagion effect triggered by community resources, in the event of insufficient safety net at lower levels (guarantee of deposits and resolution mechanisms). Besides, work must continue for further development of the Capital Market Union.

4. The Multiannual Financial Framework (MFF) for 2021-2027, which has just been presented by the European Commission, provides - alongside entirely justified new expenditures on European security and defense, control of migration and support for reforms and investments **-** a significant reduction (5 %) in allocations altogether to the common agricultural policy and cohesion policy. This reduction could damage the necessary convergence efforts between our economies, although there is leeway to make these policies more efficient through more retributive schemes. This situation is aggravated by the heavy budgetary consequences of the British withdrawal.

It is only possible to come out of this situation "on top", i.e. by increasing the amount of this forecast budget. The amounts currently proposed for the MFF 2021-2027 represent 1,135 billion commitment appropriations (at 2018 prices), representing 1.11 per cent of the gross national income of the member countries. This percentage, even though it is slightly higher than the current MFF 2014-2020 (1.00%), must be improved, by further developing common resources, as announced in the MFF 2021-2027 (ecologic fees for instance). A ratio of 1.5% of national income would be a minimum for community action to have real impact. A revision of sources of income in EU budget could also be considered.

5. Part of this essential budgetary effort should take the form of investment guarantees to encourage the private sector to engage in the construction and renovation of infrastructure, as well as other projects in energy, digital (broadband Internet), cross-border connections and productive and competitive activities, particularly in the least developed countries, in order to facilitate their catching up.

This would be a logical extension and an amplification of the 'Juncker Plan' Investment, the effects of which were positive but too limited, especially given the fact that the most advanced countries in the EU have absorbed the majority of it. Funding could be partially provided in the form of project bonds issued by project companies; these bonds would benefit in whole or in part from the above guarantees.

6. Convergence, in other words the gradual rapprochement of our societies, requires a long-term vision. A specialized entity should be established with the Commission and the European Council to draw the medium-term perspective and follow it concretely year by year; an alternative course of action would be to entrust this function to an existing entity or a network of recognized institutes.

7. Greater economic, social and territorial convergence, being the fundamental objective of the EU, also requires the implementation of our previous recommendations*;* particularly in the area of tax harmonization[2] (June 5th 2015), to ensure transparency and to avoid fiscal dumping or the social lowest bidder; or in relation to "the future of international trade, investments and trade negotiations" (June 17th 2016), in order to avoid distortions of competition triggered by social inequalities and to combat tax havens and more broadly tax evasion. These need to be completed by the necessary measures to combat attempts to impose external monetary sovereignty and/or extraterritorial sanctions.

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[2] It means a reduction of differences - but not a unification – of public tax bases.