

Getting the EU back on course

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The European Union (EU) faces two crises: the economic/financial crisis and the crisis of political legitimacy. These two crises are inter-linked and cannot be solved independently. Economic policies cannot be implemented effectively without the support of the citizens of Europe, and the legitimacy of EU decision-making can only be ensured if it is seen to be concerned with their well-being. This contribution considers two ways in which progress can be made to get the EU back on course.

I. Putting people first in macro-economics

The principal message of this section is that, rather than starting with Gross Domestic Product (GDP) and the instruments of economic policy, and then considering the social consequences, the policy-making process should be turned on its head. The starting point should be the living standards and well-being of individuals and their families. Macro-economic policies, and indeed all policies, are means to an end, not ends in themselves. Their justification should be found in their service to our fellow citizens.

Such a switch in perspective is essential in order to secure democratic support, and this support depends on – among other factors - the impact on individual citizens. We have to know who is gaining and losing from austerity measures in the short-term and from economic growth in the longer-term. This has been stressed by the European Commission itself, “the growth process cannot enjoy sustained democratic support if its fruits are reaped by just a privileged few”.¹ Where macro-economic policies are perceived as unwarranted or unjust, political support will shift towards extremist political parties.

What does this switch mean in concrete terms? Economic growth is only one factor influencing the development of well-being, but it is clearly important,

1 *ECFIN*: Economic growth perspectives for Europe, Issues Note, Brussels, 2012.

since enhanced economic resources can contribute to improving people's lives and the environment in which they live. (The word *can* is used since whether or not they *do* serve these purposes depends on how the resources are used.) For individuals, income is an important determinant of their capacity to lead fulfilling lives. This leads to the proposal that the key macro-economic variable should not be GDP but household disposable income per person, measured in real terms (i.e. taking account of inflation). Rather than the GDP figures that are watched so closely by economic commentators, the numbers featuring in headline announcements should be those for household disposable income per person.

This should not be a particularly shocking proposal. After all, the need for new measures of economic progress was recognized in the Commission publication "GDP and beyond".² There was general acceptance among political leaders in France, Germany and other Member States of the recommendation of the *Stiglitz-Sen-Fitoussi* Commission on the measurement of economic performance and social progress that "while it is informative to track the performance of economies as a whole, trends in citizens' material living standards are better followed through measures of household income and consumption".³

Indeed, figures for real Gross Disposable Household Income (GDHI) are already published by Eurostat and other statistical agencies. But they do not feature prominently in the media coverage or in the political discourse. When politicians talk about the economy "flat-lining", they are referring to GDP. What I am proposing is that Household Income should become the headline indicator – the first number in any news story. In this way, the person in the street can more readily understand the consequences of policies being pursued.

Would this make any difference? Are we not simply replacing one meaningless set of letters (GDP) by another (GDHI)? The short answer is that it *would* make a difference. Certainly this has been true in the recent years of economic crisis and economic austerity. Between 2007 and 2009, real GDP in the Euro area (EU-17) fell by some 4 per cent. Over the same period, the action of automatic stabilizers (notably the welfare state), coupled with discretionary policy measures, protected real household per capita incomes to the extent that they fell by only some 1 per cent. Then, as governments lost their confidence, and austerity programmes were

2 *European Commission*: GDP and beyond: Measuring progress in a changing world, COM(2009) 433, Brussels, 2009.

3 *Stiglitz Commission*: Report on the measurement of economic performance and social progress, www.stiglitz-sen-fitoussi.fr, 2009, paragraph 23.

introduced, real household per capita incomes were no longer protected. In 2011, while GDP is recorded as growing in all EU27 Member States apart from Greece and Portugal, Eurostat figures for real adjusted GDHI per capita fell not only in those countries but also in Ireland, Spain, Cyprus, Romania, and Luxembourg.

By looking at what is happening to household disposable income, we are getting closer to what matters to the individual citizen. But the proposed new headline indicator is still – like GDP – an aggregate measure. Inclusive growth requires that the fruits of economic progress should be shared fairly. In recent decades this has not been the case. In the UK, the top 1 per cent received more than a quarter of the real household income growth between 1990 and 2009. This means that average income is giving a misleading impression of what is happening to the majority of citizens. Some years ago, the author therefore proposed that growth should be measured in terms of the living standards of the median household – the family in the middle of the distribution – a proposal later taken up by the *Stiglitz* Commission. The switch to median income in place of the mean household income would make a big difference. According to the estimates of the U.S. Census Bureau, the median household income in the US has fallen from 89 per cent of the mean in 1967 to 72 per cent in 2011.⁴ This means that the growth rate of median income is much lower: over the 44 years the total increase in real terms was 48 per cent when measured by the mean household income but only 19 per cent when measured in terms of the median.

Measuring growth in terms of what is happening to median household incomes should appeal to politicians who are concerned with the median voter, or with the “squeezed middle”. For this reason it is suggested that the two crises are inter-linked. Changing the way in which we measure economic performance offers the possibility of shifting the political discourse. By explicitly focusing on the concerns of citizens, policy-makers may be able to re-engage with voters. At present, government policies are not tailored to the person in the street, and this is one major reason why people are indeed out on the streets in protest and why people are disaffected with mainstream political parties.

4 U.S. Census Bureau: Income, poverty and health insurance coverage in the US: 2011, Current Population Report P60-243, U.S. Government Printing Office, Washington, DC, 2012.

II. Making growth socially inclusive

We need to change how we measure economic performance, but we need also to change the performance itself. The EU adopted in 2010 the “Europe 2020” goals of achieving growth that is both sustainable and socially inclusive. Europe 2020 has been criticized as mere rhetoric, but the EU leaders arguably were right in identifying the need for a clear statement of the ambitions of the Union and this statement serves to convey a sense of common purpose. Other major political entities, such as the United States, lack any such explicit understanding of where they are headed, and it is hard to imagine that they could reach the degree of agreement achieved in the EU.

The hopes raised by such aspirations do however need to be translated into concrete actions. Otherwise the economic performance – in whatever way reported – will continue to disappoint. In this section, two proposals are made. The first proposal is for an EU-wide unemployment benefit. This is far from a new idea. Indeed, it was early seen as an essential element in the move to a monetary union. Nearly 40 years ago, the *Marjolin* Report on this subject devoted considerable space to the proposal, and it is worth quoting in full their introductory paragraph:

“A Community initiative in the unemployment field is particularly opportune, for it will have beneficial effects on the economy and society as a whole. Without waiting for ambitious programmes of generalized harmonisation to become operative, one definite step in this direction might be to prove before public opinion that Community solidarity is a reality. Moreover the size of the problem posed at present for the Member States by unemployment justify the effort to find appropriate means at Community level to enable the Community to provide assistance in this way.”⁵

The proposal was endorsed by the subsequent *MacDougall* Report:

“Apart from the political attractions of bringing the individual citizen into direct contact with the Community, it would have significant redistributive effects and help to cushion temporary setbacks in particular member countries, thereby going a small part of the way towards creating a situation in which monetary union could be sustained.”⁶

- 5 *Marjolin, R.* et al.: Report of the Study Group “Economic and Monetary Union, 1980”, European Commission, EMU 63, Brussels, 1975, 34.
- 6 *MacDougall, D.* et al.: Report of the Study Group on the role of public finance in European integration, European Commission, Brussels, 1977, 16.

Fast forwarding a third of a century, the proposal has been put back on the table in the report to the December 2012 European Council Meeting on the Roadmap *Towards a Genuine Economic and Monetary Union*.⁷ Under the heading, “Options for the shock absorption function of the euro area fiscal capacity”, it is suggested that at the microeconomic level this could take the form of unemployment insurance:

“In this case, the level of contributions/benefits from/to the fiscal capacity would depend directly on labour market developments. In this scenario, the fiscal capacity would then work as a complement or partial substitute to national unemployment insurance systems.”⁸

What form could such an EU-level unemployment insurance take? What would be the relation with existing national systems of unemployment benefit? (This issue was already discussed in the *Marjolin* Report.) It is assumed that Member States would be expected, as a matter of good faith, to maintain their national benefit systems: i.e. they would not simply reduce their national benefits by the amount of the EU-benefit. But there remain crucial questions concerning the relative roles of the EU and Member State benefits. An EU “supplement” and an EU “basic benefit” are quite different; indeed they may be seen as polar opposites. At one extreme, eligibility for the EU-level scheme could be determined entirely by the existing national unemployment benefit provisions, with the EU-benefit adding x per cent or x EUR to the existing national entitlement. At the other extreme, an EU-level benefit would be paid as a separate benefit under EU-conditions, with Member States acting as the agents of the EU to determine eligibility and make payments. Neither seems satisfactory as an immediate prospect, and an intermediate path seems the best way forward.

This is more likely to be achieved if the EU benefit takes the form of unemployment insurance than if the benefit is income-tested, as with unemployment assistance. The aforementioned judgment is based on two main considerations. The first is that the conditions for unemployment insurance are substantially simpler than those involved in a test of means: they are individually based and do not require an income and asset assessments. The second is that we have seen in a number of Member States a move in recent years away from individual-based contributory social insurance to household-based income-tested assistance for the

7 *Van Rompuy, H.A.*: Towards a genuine economic and monetary union, European Council, Brussels, 2012.

8 *Ibid.*, 12.

unemployed. This move was justified by reference to “better targeting”, but the policy contains serious flaws. It weakened the link between social security contributions and potential benefits. People came to view contributions as little different from taxes. The household-based assessment means that the unemployment of one household member reduces the incentive for other earners in the household to take up work or to increase their earnings. The shift to “greater targeting” has had the unintended effect of reducing work incentives. Thirdly, there can be serious problems of “non-take-up” of income-tested benefits. If these drawbacks are now understood, Member States may be more willing to reconsider the role of unemployment insurance, and see the EU scheme as a vehicle for restoring the insurance basis.

Following this line of argument, the most straightforward EU scheme could take the form of extending the duration of unemployment insurance beyond the current national limits. As such, it would closely parallel the federal extended Unemployment Insurance benefits in the United States. When unemployment reaches a threshold level, US states are required by federal law to extend benefits. In 2013, under the Emergency Compensation Program, benefits are paid according to a tiered scale: for example, up to 54 weeks where the state unemployment rate is 6 per cent or higher, reaching a maximum of 73 weeks where the unemployment rate is 9 per cent or higher. The lessons for the EU from the United States have been considered by *Dullien*, who concluded that “the idea of having ‘extended benefits’ with automatic triggers which increase the benefit duration in an economic downturn seems extremely sensible”.⁹

Our aspirations for EU initiatives in the field of social protection should not be limited to unemployment benefits. At the same time, we have to recognise that the scope for action at the EU level is limited by considerations of subsidiarity and by the fact that we are faced with Member States with very different institutions and levels of income. The long-standing nature of this issue suggests that its resolution may have to be found in new forms of social security. Of these, perhaps the most discussed is the idea of a “citizen’s income or a “basic income”, whereby a universal benefit is paid individually to all citizens. Here, the EU should be urged to begin with a basic income for children.

9 *Dullien, S.*: Improving economic stability in Europe: What the Euro Area can learn from the United States Unemployment Insurance, Working Paper FG1, 2007/11, German Institute for Security and International Affairs (SWP), Berlin, 2007, 33.

Some ten years ago, the High-Level Group on the future of social policy in an enlarged European Union made a proposal for a basic income for each child in the EU, as part of a possible “inter-generational pact”.¹⁰ In concrete terms, this could mean a basic income for children, set, say, at 10 per cent of median income per capita in each Member State for each child, administered and financed by the Member State. Such a programme, refined in its details, would allow the EU to invest in its future – children and human capital. Investment in children is a crucial element in economic growth. As noted by the French *Conseil de l’Emploi, des Revenus et de la Cohésion sociale* (CERC) in their 2005 Report, “poverty affects not only the child well-being at the moment when resources are insufficient, but also ... hinders their capacity to develop, to build the required capabilities, including knowledge capital, cultural capital, social capital, health capital”.¹¹

III. Conclusion

To put Europe back on course requires political leadership, but it also requires new thinking. In this paper it has been argued that we need to adopt a new – household income based - approach to the headline economic indicators and to take seriously new ideas for EU action to achieve socially inclusive growth, notably EU extended unemployment insurance, modeled on the US federal system, and an EU basic income for children.

10 *European Commission*: Report of the high-level group on the future of social policy in an enlarged European Union, Office for Official Publications of the European Communities, Luxembourg, 2004.

11 *CERC*: Estimer la pauvreté des enfants, Dossier, Paris, 2005, 6.