THE FUTURE OF THE EUROPEAN UNION

SEMINAR REPORT HELSINKI - APRIL 22 - 2014

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Foreword

Our seminar *The Future of the Euopean Union* was organized in Helsinki in April 2014. The seminar focused on issues regarding economy and welfare. We tried to open several perspectives: we looked at the general political situation, at expectations of European citizens, at changes in the labour market and at environmental factors affecting the European Union and the future of the member countries.

The first part of the publication handles the future of Europe and EMU, while the second part concentrates on welfare issues.

We want to thank the European Liberal Forum, our co-operating partners Fores and Forum for Greece as well as moderators, speakers and the audience for their contribution to the seminar and this publication.

Karina Jutila
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The Future of Europe: Reform or Decline?

This seminar is held in a historically significant place. It was here, in Ostrobotnia House in Helsinki that

- the Finnish independence movement started a hundred years ago;
- President Urho Kekkonen held his seminal speech in the 1960s that changed Finnish society and economic development. The speech helped to integrate Finnish communists into Finnish society. The Communist Party was an amalgam of doctrinal communism and social populism at the time, but they were successfully integrated in the end;
- here also the True Finns Party celebrated their victory in the Finnish parliamentary elections in March 2011.

What we are doing today is reclaiming this place from populism to focus on the substantive issue of the future of Europe.

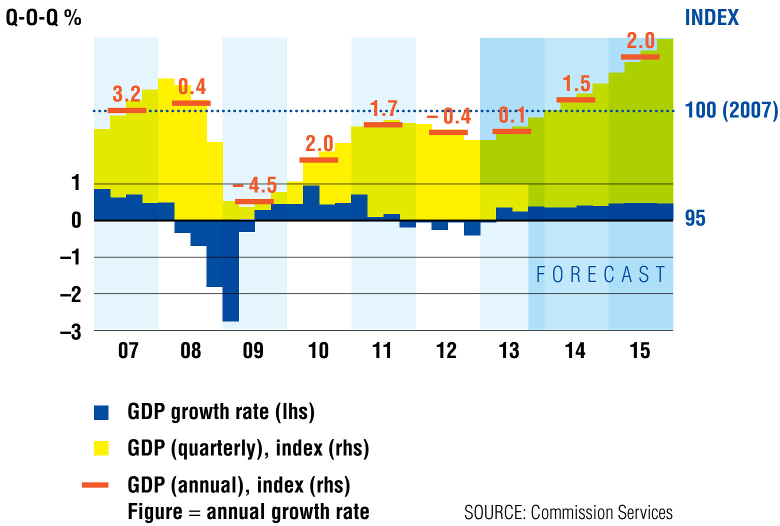
The subject of the day should be narrowed down to discussing the future of the European economic and social model: To me, the right question is not whether Europe will become a federation or not. Instead, Europe could be developed as a community of member states, with relatively deep integration in some areas, while other areas may thrive with less regulation.

I believe that the EU should be developed in such a way that it is big in big things and small in small things: big on peace and security, economic stability and sustainable growth, while refraining from nitty gritty regulation that produces unnecessary bureacracy. The right question is: Are we constructing a Europe that is stagnating and in decline or are we building a reformed, modern and self-confident Europe?

Three challenges for Europe are economic revival, an ecologically sustainable energy union and unity in external action.

These are very much interrelated, and we need to work on all fronts. The current situation is one of economic recovery.

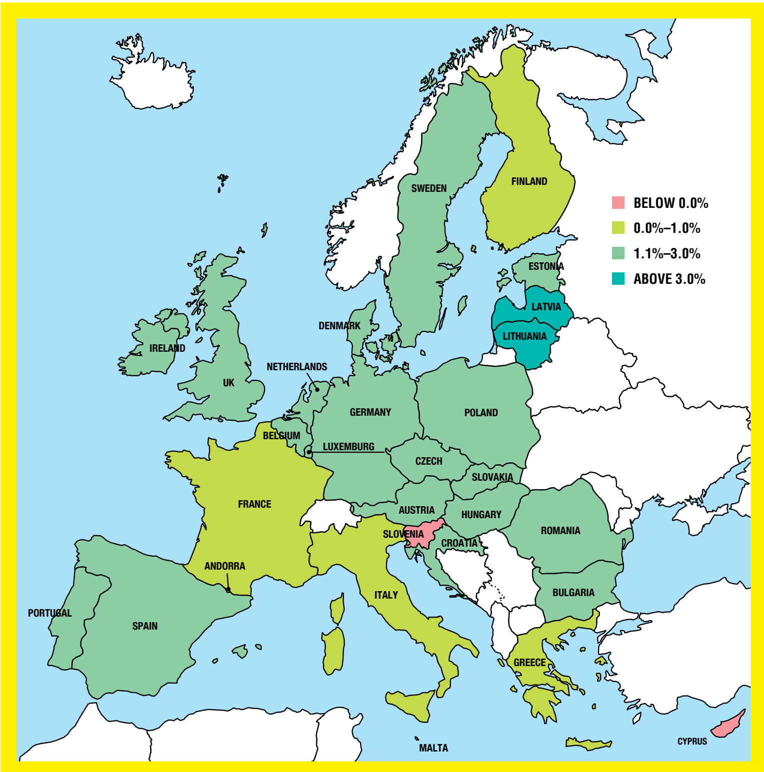
Economic Activity And GDP Growth in the EU 2007–2015



The first financial tsunami came from across the Atlantic in 2008. The rock bottom of the crisis was in the spring and summer of 2012.

I recall a discussion with a US policy maker advising the Europeans during the crisis. In the early days of June 2012 he was ready to concede: *I don't think we have any solutions left, do we?* That moment scared the European decision makers both in the European Council and in the Central Bank.

Since then, the summer of 2012, we have made significant progress, first stabilising and then starting an economic recovery since the summer of 2013.



European growth map 2014.

Core Europe is recovering at a rate of around 2%:

- employment is improving in core Europe
- Britain and Sweden are recovering
- Latvia and Lithuania, with about 3% of economic growth, are currently growing the fastest
- Portugal, Ireland and Spain are now recovering better than we expected at the end of 2013
- Ireland and Spain: both economies are improving.

The biggest challenges in Europe, at the moment, are Italy and France. Both countries need economic reforms to revive competitiveness, employment and growth as well as in maintaining a consistent line of fiscal consolidation. Unfortunately, Finland now belongs in this reference group. Finland, Italy and France face major challenges of economic reform in the coming years.

Four years ago, when I took on my current portfolio as Economic Affairs Commissioner, European economy was in free fall, facing the crisis in Greece. Our first aim was stability and we achieved it. Our second goal was economic recovery, and we're getting there. Contrary to the predictions of many, the euro did not break up.

Today, Europe's still nascent economic recovery is in danger. The most pressing concern is the way Europe's fragile economy is now haunted by the reborn ghost of old-school geopolitics, and by the scary spectre of deflation.

The conflicts in the Middle East and the fallout from the war in Ukraine – and from Russia's economic stagnation – are weakening investor confidence and so dampening economic activity, thus exacerbating deflationary pressures. These deflationary pressures are in turn further depressing economic activity in Europe and aggravating unemployment.

To bring about recovery in the European economy it will be essential to step up economic reform and forcefully increase the flow of credit to boost productive private and public investment. If not, eurozone policymakers will take a big risk of seeing recovery permanently derailed.

The European centrist and liberal parties now need to stay the course until we make it to economic reform. The last thing we can afford is complacency. We must pursue economic reform, and we must continue to stabilise our public finances.

What is the bottleneck of European reform?

The logjam is very much in the credit conditions of small and medium-sized enterprises (SMEs), especially in Southern Europe.

But while touring Finland, I find that we too have become Southern European: here, too, credit conditions for growth companies seem to be much too tight, and many other parts in Europe are having to tackle similar challenges. The reasons are manifold: New, internationally agreed capital requirements; balance sheet assessment handled by the European banking sector; and fragility of confidence in many issues of the European economy.

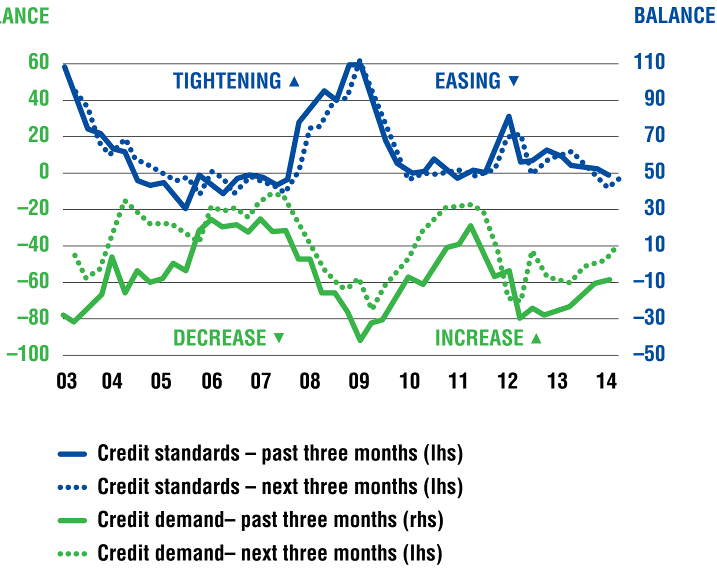
It is crucially important that the European Central Bank, other European institutions and the national authorities strive to remove this bottleneck together.

We need to shift the focus from macroeconomic stabilisation towards microeconomic dynamism and reforms. We should support access to finance for enterprises, especially SMEs, to provide them with better credit conditions and help them to invest and create jobs.

This calls for us to combine European and national forces. The European Investment Bank can do more. I also believe that the European Central Bank is likely to be planning something to this effect, as they are well aware of the tight credit conditions for the European SMEs.

At the same time we have to ensure that the national investment banks and national economic reconstruction/investment funds of the member states can better support the SME sector. This will

Credit Standards And Credit Demand For Loans To Non-Financial Corporations In The Euro Area



SOURCE: ECB Bank Landing Survey

give rise to more growth companies and will genuinely create more sustainable jobs in Europe.

Towards greener energy production

The second of the major challenges is linked to European economic revival. This is the movement from fossil-based energy production to renewables and bioenergy-based greener energy production. The Commission made a first proposal – not the final word – on reforming the climate and energy policy framework by 2030.

Instead of having three specific targets, which is not always the most cost-efficient way, the proposal relies on one major target: reducing greenhouse gas emissions by 40 % and attaining a European-wide target of 27 % renewable energy.

We may have to resort to nationally binding targets on renewable energy in order to get things moving. But this year and the next we must find resource-efficient and cost-efficient ways and means of achieving the targets, while at the same time supporting the shift in energy production to more renewables and greener energy methods, greener technologies.

We now have to engage ourselves in tackling the main challenge of reforming the European social market economy. This does not mean clinging to the status quo, as it would only lead to permanent decline, nor dismantling the European model. We believe in the combination of entrepreneurial drive, culture of stability and social justice. What it does mean is genuinely reforming and modernising the European social model for the sake of generating growth and creating jobs. ■

Sixten Korkman

The Future of EMU: a View from the North

The decision to set up the European Economic and Monetary Union (EMU), inscribed into the treaty of Maastricht, is the boldest step undertaken in the long process of European integration. The first decade of the EMU was widely perceived as successful. However, with the benefit of hindsight we know that growth was unbalanced and that the EMU was heading for great difficulties. Developments in the EMU have for many countries been a prolonged process of boom and bust.

By now, the euro area has for many years been mired in a multidimensional crisis. Governments and banks have been bailed out, output has fallen spectacularly and unemployment has risen to record levels in the worst hit countries. Deep recession and austerity policies have had serious social consequences notably in Southern Europe. European issues give rise to political tensions both within and between the member states.

However, the EMU is no longer facing an “existential crisis” as was the case in the spring of 2012. There is no widespread expectation that one or several member states would exit the euro or that the whole currency union would fall apart. Muddling through is the likely scenario, with crisis countries gradually leaving the worst behind them. While the euro may survive, it can hardly be heralded as a success: overall growth since 2008 has in many member states been weaker than during the Great Depression in the 1930s.

Why the euro?

It is in retrospect remarkable that the Maastricht treaty was agreed upon and subsequently implemented. There certainly was nothing inevitable about this development. According to contemporary observers the EMU was “a gamble”, “a great experiment without precedent”, “a leap into the unknown”, “a cultural revolution, institutionalising monetary orthodoxy and exporting German-style anti-inflationary rigour Europe-wide”. What were the reasons for creating the EMU?

Most European nations have historically preferred a system of fixed but adjustable exchange rates – such as the Gold Standard, the Bretton Woods regime and the European Monetary System (EMS). However, the economic environment changed in the 1980s in ways which made fixed exchange rates increasingly vulnerable to capital flows and speculative pressures. As explained by the famous “impossible trinity”, it is not possible to combine free capital flows with fixed exchange rates and an autonomous monetary policy: one of these has to give.

The difficulties encountered by the European exchange rate cooperation and the EMS made decision-makers think that a transfer of power over monetary policy to the union level would be the solution. They chose to opt for exchange rate stability and give up national monetary autonomy. The internal market programme added impetus to the single currency project.

A further factor was the development in the 1980s of an economic doctrine stressing the importance of the credibility of monetary policy. Independence of the central bank was seen as a precondition for such credibility. The German central bank (“Buba”) was exceptionally independent and successful, an object of envy in France and other countries. They wanted to benefit from the credibility of a strong and independent central bank. The European Central Bank (ECB), modelled upon the Buba, was by many seen as a shortcut to credibly low inflation and low interest rates.

Political objectives figured prominently on the agenda. Ever since the creation of the European Coal and Steel Community in 1952, there had been the presumption that Europe would step by step develop towards an "ever closer union". The federative dream has since lost much of its appeal, but in the early 1990s the single currency was for many decision-makers a means for furthering political integration.

The world changed dramatically on 9 November 1989, when the Berlin Wall was torn down. One obvious consequence was the prospect of German reunification. In this situation Kohl and Mitterrand agreed that Germany would give up its D-Mark and commit itself to deeper European integration. The agreement took the form of the Maastricht treaty, which contains the main architecture and timetable for the EMU.

What are the lessons?

The causes of the euro area crisis will be an important issue for research for years to come. However, some preliminary lessons may be as follows:

First, the political impetus to deepen integration by monetary unification was strong, and economic considerations were therefore not given sufficient attention. It was well known, and stressed by economists, that a monetary union may face serious strain if its member states are subject to "asymmetric" (idiosyncratic) shocks. This is even more so if there is lack of wage flexibility or labour mobility, and if there is no union-level shock absorber. However, decision-makers resorted to wishful thinking, assuming that member states would converge over time in ways which would reduce the significance of these considerations.

Second, certain "unknown unknowns" emerged. In particular, the risk of sovereign default became a key issue in the aftermath of the global financial crisis. This was notably the case after it had been revealed in December 2009 that the Greek budget figures had been falsified and that the likely government budget deficit for that year was twice as big as had been earlier reported: 12.7 rather than 6.7 per cent of GDP (the final figure was 15.6 per cent). Until then sovereign default had been perceived as something that could happen only in Latin America, Asia or Russia, not in a member state of the EU.

Similarly, the drafters of the Maastricht treaty did not think seriously about the risk of a banking crisis with area-wide repercussions. The risk of an escalating European banking crisis was a key reason for the bailout decisions taken in 2010 and later. Authorities were concerned that a Greek default would trigger consequences similar to those of the collapse of Lehman Brothers. Also, the abovementioned problems tended to create a vicious cycle because of the toxic link between sovereign default risk and banking problems.

Third, it has become obvious that the original institutional setup of the EMU was insufficient and that some of the commitments of the treaty could not be credibly implemented. In particular, the no bailout rule has not been respected, and the fiscal rules (the stability and growth pact) have been repeatedly violated. The euro area authorities have been forced to navigate through unchartered waters without sufficient means of dealing with the difficulties and without a shared vision of how to proceed.

Is the crisis combat over?

Developments in the past six years have been traumatic for the euro area. A number of actions have been undertaken to combat the economic crisis. These actions have been surrounded by many controversies.

First and foremost, a number of bailout packages have been organised to avoid sovereign default. These rescue packages have created political furore among citizens in the creditor countries providing the lending or the guarantees. Also, a rescue mechanism has been set up in the form of the European Stability Mechanism (ESM).

As part of the conditionality of the rescue operations, the crisis countries (notably Greece, Ireland, Portugal and Cyprus, but also Spain and Italy) have been asked to pursue forceful adjustment policies with a view to cutting budget deficits and to undertake structural reforms with a view to restoring growth prospects. Many observers blame excessive “austerity” for the long recession, others see lack of progress on structural reform as preventing a return to growth. Some debt restructurings have been undertaken, notably in Greece.

The most important action has been the commitment of the European Central Bank to undertake OMT (outright monetary transactions) in case of need. The ECB stands ready to buy government bonds (of short maturity) of a country in distress in unlimited amounts provided that the country subjects its policies to the approval and monitoring of the troika (ECB, Commission, International Monetary Fund). This commitment, made originally by the president of the ECB in July 2012, has reduced bond yields of the crisis countries substantially – even though it has not been tested in practice. (It has eliminated the risk of “multiple equilibria” and the risk of a “self-fulfilling” expectation of default.) The constitutionality of OMT has been contested in Germany, notably in the Karlsruhe court, and the issue is now under consideration in the Court of Justice in Luxembourg.

The ECB has recently been remarkably timid in its monetary policy operation. The rate of inflation in the euro area is expected to remain substantially and persistently below the target rate of below but close to two per cent. The crisis countries are suffering from a credit crunch as well as from the strong external value of the euro, which makes it difficult to restore price competitiveness. Yet the ECB has so far not been ready to act with a view to counteracting the risk of the euro area sliding into deflation or too low inflation. One interpretation is that the ECB is trying to put pressure on member states, such as France and Italy, to undertake stronger action to respect the requirements of the stability and growth pact. (Such a political objective would seem incompatible with the technocratic character of the ECB.)

The euro area crisis is far from over. The state of the banking system remains fragile and crisis-prone. Nevertheless, the crisis countries now seem to be recovering – albeit at a painfully slow speed.

What road ahead?

Euro area authorities have taken a number of decisions in order to improve the institutional set-up of the EMU, and alternative visions for future action are the subject of vigorous debate.

The fiscal rules have been substantially rewritten by new or amended regulations and directives ("six-pack", "two-pack") as well as a new intergovernmental agreement (the "fiscal compact"). These changes should tighten fiscal surveillance and broaden the scope of surveillance to include also economic developments other than budgetary positions (the "excessive imbalance procedure"). Macroprudential supervision of financial developments has been initiated.

Work is under way to establish a banking union. This aims at giving euro area authorities more power with regard to banking regulation and supervision. In particular, the ECB has been given responsibility for the supervision of euro area banks, a task that the ECB will assume in the autumn of 2014. Authorities of EU countries are given more power do deal with the banks in trouble by, for example, enforcing "bail-in" of equity holders and certain categories of creditors. A union-level bank resolution authority will be created. It will in the future be in a position to draw upon a common bank resolution fund. There is discussion about the possibility of some form of a common deposit insurance system.

The banking union will face many hurdles before it is up and running. The hope is, however, that it should make it easier to manage cross-border banking problems and also break the fatal link between banks and sovereigns. The view is now widely accepted that a common currency needs to be backed up by a common banking policy with a significant role for authorities at the union level.

All EU member states are invited to join the banking union, including those not participating in the euro area. However, it seems very unlikely that the UK would join. This would have the strange consequence that the City of London, the most important banking site in Europe, would not be part of the banking union. There are also indications that Sweden might choose to stay outside. This threatens to make it more difficult to deal with potential problems of large banks operating in several Nordic countries.

What about a fiscal and political union?

Setting up a banking union involves a significant deepening of integration in a politically sensitive area. It may well be that the banking union will need to be supported by a euro area fiscal backstop to help deal with banking problems of financially weak member states. (Such a backstop already exists in the form of the European Stability Mechanism.)

However, many observers think that more is needed, that the euro area needs to become a fiscal union. One proposal is to introduce a common instrument for borrowing in the form of Eurobonds. Another option for "risk mutualisation" is to create some kind of common shock absorbers to deal with idiosyncratic risks. Also, it has been proposed to draw up a common budget of significant size so as to create "fiscal capacity" for dealing with the problems.

The counterargument is that such solutions would create moral hazard and undermine fiscal discipline. Member states would pursue lax policies in the expectation that the required financing would be at least partly provided by the union as a whole and/or that financing could more easily be arranged.

It has been argued that these risks could be mitigated by combining deeper fiscal integration with stronger centralised power over national budgetary and economic policies. The Commission or the Council should be given the right to veto national policies in case these were felt to be in conflict with the agreed rules and the common interest. The argument is that we need "more Europe" to deal with the problems of the EMU, which is a half-built house.

There are three main reasons why setting up a fiscal union on these lines does not look like a tenable proposition. First, there is a rather limited amount of cross-border solidarity and trust among citizens in Europe. The lack of solidarity may be regretted but should arguably be accepted as a matter of fact – which makes it risky to set up arrangements that may imply significant cross-border transfers.

Second, budgetary sovereignty is deeply ingrained in the political culture of nation states. It is hard to see that euro area member states would in the end be willing to give up power over their budgets and subordinate them to be decided upon by authorities in Brussels. How would, for instance, national compliance be ensured if dissatisfied citizens were to punish an "obedient" government by voting it out of office?

The implication of these two considerations is that a leap into deeper fiscal union, if undertaken, risks becoming a serious source of irritation and conflict between member states. Such a move on the path of integration would easily become a step too far (what the French call *fuite en avant*).

A third consideration is that a fiscal union, in order to be politically legitimate, would need to be backed up by a political union with a strong parliament and some sort of an executive. Such constitutional changes would require a new treaty, not easily achieved, as well as significant modifications to national constitutions, even more difficult to contemplate. Developments along these lines are, for quite some time to come, beyond imagination. Completing the EMU by turning it into a fully-fledged federation is therefore a pipe dream of limited relevance, or a straw man used by anti-European politicians to scare voters and get their attention.

The bottom line is that the future of the EMU will be something like the EMU of Maastricht complemented by a banking union, the purpose of which is to make it possible to respect the no bailout rule. If this is not enough to make the EMU work satisfactorily or sustainably, then EMU will sooner or later fall apart in spite of the problems of its deconstruction. EMU would then become one more item in the already large museum of failed monetary regimes. ■

Andreas Bergström

Welfare In The EU: The Future of the European Social Model

What is welfare? This is a word that can have a very wide meaning. It could be used about welfare services or an economic safety net. We can also talk about the general safety that the state should provide for its citizens – the night watchman state that even libertarians can agree on. And we have, of course, material welfare.

Speaking about the European social model, I will leave material welfare aside. We mostly trust the market to solve that, unless you're sick, old or otherwise incapacitated, which is when the economic safety net should set in.

Varying ambition levels for social services

We can think of different ambition levels for the state's providing or guaranteeing services and economic safety.

I have divided this in two categories. The target groups: who should be supported by the welfare state? And the aim of the welfare state: what is the state trying to achieve?

Ambition levels for social services

		TARGET GROUP	
		Those in need	Everyone
A	Cover basic needs	Classical liberals	
I	Even out possibilities		
M	Even out outcomes		Socialists, left-wing social democrats

The target groups could be those in need or everyone. Historically, most states have moved from the first to the second, and to some extent you can say that many states are somewhere in between.

The aim could be to cover basic needs – which can then be interpreted in different ways, or even out possibilities – a phrase to which most liberals pay at least lip service.

We could also add the question of "how"? States provide different services and insurances, but health care and basic education are always there, usually also pensions and some sort of sickness benefit and disability benefit. Services and insurances are provided in different ways, but we mostly see high ambitions in EU member states in an international comparison.

You can find liberals almost all over these diagrams. You could even add a box for "providing nothing for no-one" where you'd find libertarians. I think we should remember that those who want a more limited role for the state need not be seen as enemies of welfare. They usually believe a welfare society would take the role of the welfare state.

Classical liberals would appear in the upper left-hand corner of this image. This is where we would find even the more socially-minded nineteenth-century liberals. John Stuart Mill, for example, is often seen as a forefather of social liberalism. But even he believed that schooling, for example, should be the responsibility of parents. Only if the parents could not take care of this – for economic reasons or because they were irresponsible – should the state step in and pay for the children's schooling. This is of course quite far from the social liberals of today.

I would argue that most EU member states have the ambition to even out possibilities. But it should be noted that we are far from reaching that. We are often stuck with high levels of socioeconomic glue – children tend to stick to the positions of their parents in spite of the state's high ambitions. We see large inequalities in health and access to good education. We have very different possibilities. And we are of course born as different individuals, with different gifts or handicaps. It is hard to imagine the state somehow evening out possibilities when some people are born with a very good memory, a very quick head and so on. We can try to lift those at the bottom, but we don't want bring down those at the top.

To a large degree, the welfare states of the EU target everyone, not just those in need. We mostly see comprehensive school systems and comprehensive health care, complemented by efforts for those in need. Not everyone needs a wheelchair, for example.

The lower right-hand corner of the diagram may sound typically socialist – to even out outcomes for everyone – but many left-leaning liberals would not be out place here, either. Many liberals believe incomes should be evened out, not completely, but to a smaller or larger extent.

I believe mainstream liberalism in Europe could be placed in the box "Even out possibilities, services targeting everyone". This is where I'll stay for this short introduction, with states trying to promote social mobility and meritocracy. In this regard, education is traditionally seen as one of the most important welfare services.

Future and threats

What is the future for this social model? Is it threatened?

In several EU states, there is now a debate about welfare tourism, EU migrants adding little but costing a lot. Such voices are now heard especially in Austria, Germany and the United Kingdom. So, is free movement in Europe a threat to the welfare state?

Several studies show the opposite. EU migrants pay more to the states than they get from them. You can find individuals doing the opposite, of course. But as a whole, we mostly see people coming to work, paying taxes and using very little welfare services. The UK has a system with very generous rules in some aspects. But those rules are more generous than EU directives demand, so the issue shouldn't be blamed on the free movement.

Much of the discussion is about Roma, mainly migrating from Romania. They often come to beg or live as street musicians. We see this in Sweden as well, and many people don't like it. But they do not really add up to any considerable cost to the state. They

Threats to the welfare state

Free movement	Race to the bottom	Demographic decline	Ailing economy
No, contributes	Empirically wrong	More immigration	Growth & productivity
Street beggars, etc.	E.g. Sweden, Finland	Longer work-life	Financial crises
		Women	Political failures

come for a few months to beg or to play music, and then they return to Romania. Sweden has had free movement from day one for the new member countries, with no transitional rules. This has not been a big problem, and definitely not a significant burden on welfare systems. These immigrants are not asking for any welfare (and wouldn't be entitled to if they did). Street beggars may be seen as a nuisance, but they're not a threat to the welfare system.

A second possible threat to the welfare state would be a race to the bottom, where states are forced to take out ever-lower taxes to compete for investments and labour. This is an old theory which could probably be put to rest now. Some of the states with the highest welfare ambitions, such as Sweden, Finland, Denmark and the Netherlands, come out on top of the European economy. Companies are happy to invest in countries with high taxes, if the tax money helps build a society where the companies can thrive.

Could the demographic decline be a threat to the European welfare states? An older population means fewer workers providing services and income for more people. There are big differences between EU member states. Some, like Sweden, have increasing populations and quite high birth rates, almost at the level needed to keep the population at status quo. Others have really low birth rates, such as Italy and also several of the newer member states. This is a real problem. But there are possible solutions!

Solutions

One solution is more immigration from third countries. Immigrants are mostly young and willing to work hard. They get older as well, of course, but as long as you have a steady inflow of migrants it keeps the population as a whole younger. So this might help, but right now it is politically hard to increase immigration. We need more liberals to speak well of immigration! Right now, Sweden and Luxembourg are the only member states that want more open borders.

Another solution is longer working lives. Many countries are trying this by making changes to their pension systems. These changes are often met with protests, but they are more or less inevitable. And it can work. The Swedish pension system was reformed in the 1990s, and it is now very profitable to work longer. This has led to the actual retirement age rising quickly. Small changes in the actual retirement age make a big difference economically.

A third solution is more women on the labour market. Europe cannot afford to have the world's best-educated housewives. This is in fact evident in the Europe 2020 targets, where the member states should aim for 75% employment rates for men and women. According to the OECD, if women reached the employment levels of men, the GDP would increase by 12%. This would also solve many of the labour market shortages caused by demographic changes. So how do we do it? It's really no secret, several countries have already done it and some, like Germany, are doing it now. We need daycare for children and good care for the elderly, as it's mostly women who take responsibility for the family. And tax rules shouldn't favour single-earner households, which they still do in many EU countries, where the spouses' incomes are stacked, placing the family's income in a higher tax bracket.

A threat to the welfare state?

Is Europe's ailing economy a threat to the welfare state? It could be. Fores did a lot of work on the economic crisis last year, dissecting the problems in more ways than one.

EU has a problem with low growth and productivity, resulting in lower living standards overall, but it is not necessarily very detrimental to the welfare sector. Lower growth means tax revenue grows slower. But since wage increases in the welfare sector are usually more or less the same as the growth rate, the welfare costs usually grow slower as well. This also applies to the economic safety net.

Slow growth may lead to problems indirectly, however, if it is met with stimuli that decrease the resources available for social spending.

The European Union is clearly vulnerable to financial crises, which leads to acute financial problems for the states, and thereby to a lack of resources for the welfare state. The latest crisis is not really over yet. And the troubles are very likely to come back. We haven't solved the underlying problems; the banking union, which is being built now, is not at all enough to help us in the next downturn.

Which brings us to the last part, political failures. The EU has not handled this crisis well, and we cannot see much happening here. We might see an ever more divided EU, unable to co-operate to build a better economy.

To conclude: On the whole, we should be positive about the future of the European social model. Some of the problems that we hear about are not real. Others are, but so are the available solutions. Nevertheless, there is much to do when it comes to the EU's ability to handle crises. ■

Comments on the introduction speech

Aristides M. Hatzis

I agree with almost everything that Andreas Bergström said [in his speech]. The classical liberal view of the welfare state is also my approach. For economic growth, economic freedom is necessary. Therefore we cannot have alleviation of poverty without economic freedom.

Substantial poverty reduction has been very impressive in developing countries as a result of free trade. Between 1990 and 2010, the number of people living in extreme poverty fell by half as a share of the total population in developing countries, from 43 % to 21 %. This is a reduction of almost one billion people.

Poverty rates started to collapse towards the end of the twentieth century because of the free trade, because of globalisation. It is crucial to understand that this poverty alleviation is even more significant when combined with efficient social policies. Poverty has decreased thanks to two factors: two-thirds are down to free markets, one-third to social policies.

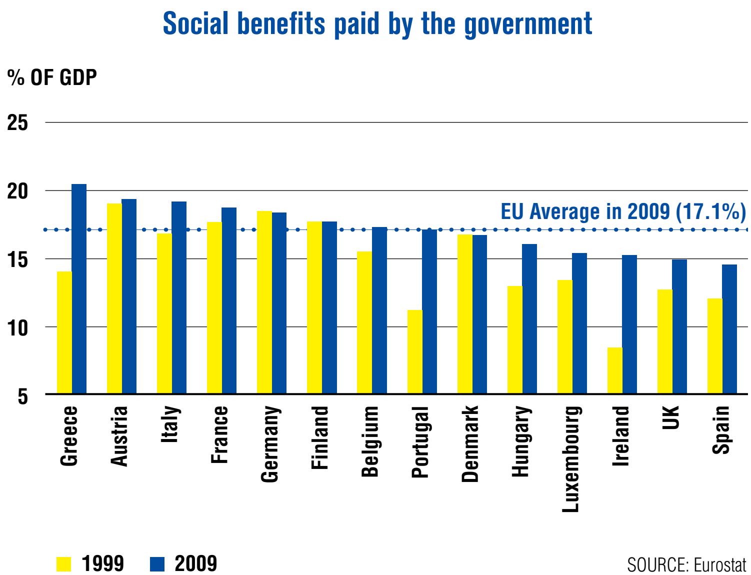
I consider myself a classical liberal in the tradition of John Stuart Mill. I think that the welfare state is a very good idea as long as it provides a safety net to the people in need. It has to be also efficient, to make the best use of limited resources.

A Welfare State is a good idea as long as it:

- provides a safety net for those in need
- exploits positive externalities (health, education)

• provides opportunities (more positive externalities) – in this way people can also give back to society
• exploits economies of scale (insurance system)
• is efficient! (it alleviates poverty, etc.)

It is now time to assess the quality of welfare systems, not in northern Europe but in the southern European countries.



The 3 + Ireland have invested a rising share of their GDP in "social benefits" in the past decade. Within the EU as a whole, the average was 17.1 % in 2009.

The financial crisis stemmed from structural problems in the Eurozone. There is always a temptation to use the southern European nations – Greece in particular – as a scapegoat, but I do believe that the biggest factor in the crisis was what I call the "institutional deficit of Greece".

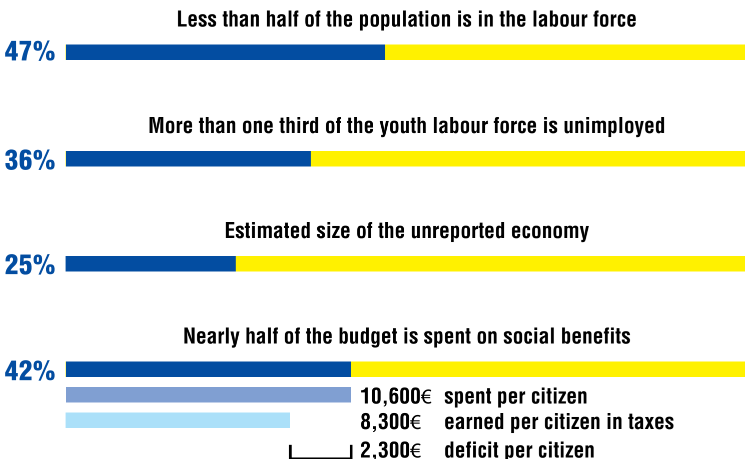
Greece was, and in many ways still is, a textbook example of many institutional deficiencies – esp. overregulation and corruption. At the same time Greece had to support an inefficient and distorted welfare state.

As we can see, in 2009 the Greek government spent nearly half of its budget on social benefits. It spent around €10,600 per person, while taxes per person amounted to €8,800. A bloated welfare state indeed, leaving a deficit of around €2,000 per person.

This led to “borrowed happiness” based on subsidies and loans. The average per capita income in 2008 was $31,700. Greece ranked as the 25th richest country in the world with an income equal to 95% of the EU per capita income average. In 2009, before the crisis, private spending in Greece was 12% higher than the EU average. Human development and quality of life indices in 2010 ranked Greece at the 22nd place in the list of the 42 "very high human development" countries.

Greece was part of every exclusive group in Europe, from the European economic and monetary union to OECD and NATO.

Greek tragedy: a look at Greece's economic crisis



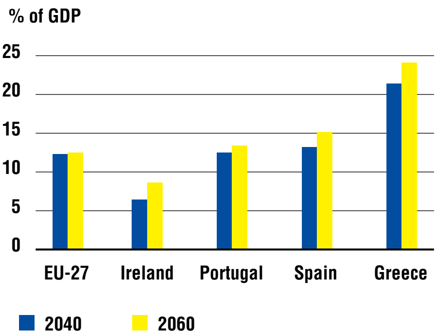
However, the people lived in a very unequal society, the most unequal of all in the EU.

A bloated Welfare State

Social benefits to households (as a percentage of GDP) rose from 22 % (2004) to 26.4 % (2008) and to 29 % (2009) while the conservatives ruled Greece. Half of this money was spent on pensions and "social transfers" (subsidies to the pension funds of powerful professional groups made up 52 % of this half – 6.34 % of GDP in 2008). In addition to this, Greece had an inefficient welfare state. The indicator which shows the efficiency of social benefits in alleviating poverty was the lowest in Europe at 13 %. The average EU figure was 35 %, while some Scandinavian countries were as efficient as 70 %. In 2002 the indicator showed a poor 4 % with an EU average of 31 %.

What does this mean? Quite simply, money that was meant for those in need went to the middle and the upper middle classes. These were not benefits, nor should they be called benefits. Rather,

EC pension projections (2009)



Greece will be spending
nearly a quarter of its GDP on pensions.

they were "spoils" for those with political power to grab them. This led to some very strange and distorted phenomena.

An inefficient welfare state

- **Greek families paid 45 % of the "free" health care costs, mostly by bribing doctors and nurses to do their job**
- **2.5 % of Greek households went bankrupt every year due to high medical expenses**
- **Greek households spent more on the "free" education of their children than any other households in the EU**
- **Greeks also have to pay for private tutorship in order to enter public university**

I call this "welfare populism" and it is exactly the type of welfare state that should be avoided.

We would probably all agree that a welfare state is a very good idea and something that we should try to protect as much as we can. The case of Greece shows all too well what the deficiencies and problems can be of an inefficient system.

People in Greece realise the need for structural reforms. They see the inefficient and deficient system and the overregulation, while also acknowledging that we need to do as much as we can to protect our uniqueness, our national character. There is a minority, a strong minority of Greek intellectuals who have recognised the inefficiencies and who are ready to fight to change the situation. Let's end with this optimistic perspective. ■

Comments on the introduction speech

Essi Rentola

My talk will be more closely linked to what **Andreas Bergström** said about free movement threatening the European welfare state. As a lawyer working with fundamental freedoms I ask: Is the fear of benefit tourism jeopardising the legitimacy of the fundamental freedoms in the EU?

As Andreas Bergstöm reminded us, each member state decides for themselves on matters of social security. Also, many of us may be aware that Finns are concerned over child benefits, for example, being paid to Estonia to people working in Finland and their children residing in Estonia. This relates to EU regulations. It is something that has existed in the European community for the past 55 years: if you work in one EU country and your children live in another EU country, you are entitled to the child benefits of your country of employment.

I will discuss some of the challenges on the EU level and in the member states, and then look at what should be done.

Challenges for regulation and legislation

Originally the rules were intended for economically active persons, but more recently, after the Lissabon Treaty, more rights have been available also for non-economically active persons.

They were brought into the personal scope of social security co-ordination as of 1 May 2010.

EU expansion in 2004 obviously had a significant impact on Finland, for example. When Estonia joined the EU, we began to see people migrating to Finland to work here – for the first time in our history.

What makes this more difficult in practice is that regulations on social security co-ordination are no longer the only legal instruments in EU law affecting social security. We have the directive on patient mobility and directives on free movement for EU nationals but also third country nationals coming into EU. Directives give rights to equal treatment also in relation to social benefits.

There are also the external EU relations (Association Agreements) which have an increasing impact. There are association agreements with practically every nation in the world.

Also, the dynamic case law of the European Court of Justice creates plenty of challenges for the realisation of rights in the EU, as primary law often precedes secondary law. The European Court of Justice has also forged a new notion of European Solidarity within the case law that concerns social security.

National challenges

At least in Finland, the discussion tends to go like this: *We are so different, we have a residence-based system and we are alone in this.* Each country has a notion of being different and unique. It is true to a degree: we come from different historical traditions and our systems are built in a different way, but when it comes to the challenges within the EU, the challenges are not so very different.

One of the common challenges for Member States, based on a study, is globalization and increased migration, characterized by new patterns, including more temporary migrant workers and migration by persons other than traditional economically active migrants. Therefore, new approaches to the inclusion of people in the solidarity circle are necessary. Residence is a growing connecting factor in all national legislation in the EU. This means that rights are created for non-active persons on the basis if residence.

Although Finns claim to be alone in practicing a residence-based system, health care and benefits are inscribed in the national legislation of many member states. All member states therefore face the same problem of non-active migrants receiving more rights. The growing gap in benefit levels between Member States is a crucial factor. Therefore, new ways of looking at the prevention and compensation of social security risks (inclusion of activation measures, benefits such as long-term care insurance benefits, new forms of statutory pension insurance) are being considered. Individualization of Social Security rights (effect on derived rights)… The lack of synchronization between Social Security, taxation and labour law makes it difficult.

Benefit tourism

The main problem is how to combate "benefit tourism". Is this fear justified?

The "benefit tourism" referred to in the media and in political debates contains the idea that mobile EU citizens move to another state to benefit from more generous welfare systems. Studies do not confirm this, quite the opposite. Those EU citizens who move pay more into the system than they get out of it.
What studies do confirm is that the main reason for EU citizens to move to another state is work-related, and that mobile EU citizens are generally more likely to be economically active and less likely to benefit from social benefits than nationals of host states. Yet, public opinion considers benefit tourism to be a real threat. This makes it a real threat for the EU. I have two very basic questions on this.

What is social security fraud? What is not social security fraud? An Estonian father works in Helsinki as a bus driver, resides with his family in Tallinn (wife not working) and receives

National Challenges because of EU-level Development

- **Economically non-active persons within the personal scope of social security coordination 1 May 2010**
- **Enlargement of the EU 1 May 2004**
- **Regulations on Coordination of Social Security are no longer the only legal instruments in EU law affecting Social Security**
  - **Directive on patient mobility**
  - **Directives on free movement**
  - **External relations of EU (Association agreements)**
- **Dynamic case law of the European Court of Justice**
  - **Primary law precedes secondary law**
  - **European Solidarity**

child benefit from Finland. Many Finns consider this is wrong and a fraud or at least social tourism.

It is not, these are EU rules that date from the 1950s. Maybe they should be changed but that's the way they are.

A second example: a Finnish national resides in Spain or Thailand and receives child benefit from Finland. If we asked this person, he/she might respond that yes, I am a Finnish national and therefore have the right to a Finnish child benefit. But if you are residing in another country, you have permanently moved and are not entitled to residence-based benefits. That's fraud.

The main thing is that it is not possible to define "social shopping" or "social tourism", whereas you can define what social security fraud is in legal terms.

- **Threat of social tourism can endanger the whole European idea, as there is a considerable risk that the public opinion regards these aspects of social tourism as a negative aspect of free movement, which is a fundamental pillar of the European structure.**
- **If Europe does not address this highly political question, the legitimacy of the whole European idea is endangered**

One of the ways to solve this question is to introduce into EU law a requirement of a closer link of the persons concerned to a Member State before a State has to grant benefits, especially tax-financed benefits which are not linked to income from previous gainful work.

Also, as a reminder: while you have the right to move freely in the EU, you do not have an unconditional right even as an EU national to stay in that country after three months if you do not have sufficient means to support yourself. You should not become an unreasonable burden for the social assistance system in the host member state.

Such definitions and drawing of lines between the different definitions is perhaps the true challenge at least for lawyers in the EU in the future. ■

Comments on the introduction speech

Kari Välimäki

Thank you for inviting me to comment on **Andreas Bergström's** introduction.

To my mind the main problem is unbalanced decision making. It used to be possible to take all the decisions on the same level whether they were about economics, social policy, education and so on. Balanced development was possible. The European Union has changed this: we have to balance between European and national powers.

European social policy?

What is European social policy? There is no European social policy. There are at least four different kinds of models coming from different directions. We cannot speak about one model only. The problem is that when we speak about the future of these models, the politicians lack a single vision. As we noticed, it was hard for Andreas to place the liberals on the map, to show what they really want from European social policy. The same applies to almost all the political parties, whether left or right. They don't have a defined European social policy. That's the problem. As far as I understand the challenges, we have to make joined-up decisions where the economic sector, the social policy sector, the education sector and so on speak to each other. Only then will there be balanced development.

Greece created some kind of welfare system but at the same time economics went down. This was clearly an unbalanced situation. Similar conditions now prevail in many countries, and that is the major problem. This is why I am in favour of a stronger social dimension in the European Union but the basic conditions must be there for such a dimension to be built. Here, I will refer to the ideas advocated by the International Labour Organization of the United Nation. To have a social policy model we need:

- Democracy. While slightly different democratic regimes exist in the European system, the main thing is a democratic system of freely elected powers exists.
- Respect for human rights. This means that while it is not an easy task, solidarity across borders is important.
- Rule of Law.

These tools are available to us on the national level; they should also be available on the European union level, but they are not – not like on the national level. In order to implement a social policy model, you need economic guidance on, for example, the means and opportunity of reallocating resources in accordance with social principles.

Second, you need legislation, and once again, there is a problem: we need to balance between national and EU legislation. As **Essi Rentola** said, the legislation varies from one member country to another, and the only way today is to have some kind of "coordination" instead of common principles in how we organise the different kinds of benefits and services.

The Europe we want to create

What is the Europe like that we want to create? What kind of society are we seeking? And what are the principles behind this creation?

The ideas and views expressed by the Commission were very close to the kind of Europe and social policy promoted by the Nordic countries. The problem is that there are so many different kinds of circumstances in the member states. The starting points are totally different, and it's therefore extremely hard to have a common approach. In any case, I feel that we need to create a more social Europe.

As **Sixten Korkman** claimed, we need to be ready to develop a common vision of the European model. I would also stress a more universal approach.

How do we see the role of social policy? Some politicians regard this as more or less public spending, while others stress productive value. We have to invest in social policy to be able to balance these. They have to go hand in hand.

What we need are visionary politicians who recognise that Europe is diverse and who want to create a new social policy model based on the four different models. We cannot give up.

To me, the starting point should be the following: economic decisions, social policy decisions, employment policy decisions are interrelated. This is the way to create a template for decision making at the national and EU levels.

What should be done now? Structural change is essential, because our pensions policy has been too generous. ■

Comments on the introduction speech

Leila Kostiainen

My roots are in the trade union movement, and I cannot avoid representing the trade unions in this context, too.

I have also been a political person and would like to say something about welfare in the EU. So far we have discussed European social models, which I feel is somewhat restrictive. Instead, I would like to emphasise welfare and well-being.

I agree that there is no one European social model at the moment; there are at least four models in use. What we have is a coordinated combination of several models.

The basic factor in the welfare of Europeans is peace. The events of Ukraine have been very frightening. Peace is the primary requirement if we are to feel safe and build our lives feeling safe.

I agree wholeheartedly with **Aristides Hatzis**: when it comes to decreasing poverty, the key is economic growth. Peace first, then economy. It's impossible to build a welfare state or a welfare model without enough money. This makes money and economic growth so important: we need them to be able to help the people who need it.

Andreas Bergström argued that the market takes care of material welfare. I also think that the best economic system is the market economy. It requires state regulation, however; we therefore must include material welfare in this discussion. ■

Jörn Donner

Hard times for Europe
Dinner speech

We live in hard times. As we seem to be able to handle only one crisis at any one time, the disaster of Syria, the Palestine-Israeli conflict and murder in parts of Africa have been superseded by Mr. **Putin**'s actions and turmoil in Ukraine. Considering the participants in this seminar, I probably do not need to convince any of you about the importance of liberal values, especially now that there is an ongoing conflict between liberal, western openness and some very different ideas about how a society should look like.

It might be, to quote a book by **V. S. Naipaul**, that I am among the believers. In that case I need not repeat views about the advantages and disadvantages of the European Union. In this country, like in many others, opinions abound about its shortcomings. If we are convinced about the value of liberal ideas, this fight has to be fought on many fronts, within the Union, in the East as well as in the West. Many people in the United States claim that liberalism is another word for socialism. Living in hard times means facing a situation that brings to mind 1961 and the building of the Berlin Wall. *"Ich bin ein Berliner"*, **John F. Kennedy** famously claimed, making it known that NATO and his country would guarantee that the Soviets could only advance to a point without bloodshed. It took almost 30 years for the Cold War to abate. Agreement on Germany was achieved in 1990 between **Gorbachev** and **Kohl**.

Many countries in Europe chose freedom.

One of the consequences of Mr. Putin's recent activities has been an increased interest in joining the NATO in Sweden and Finland. Vladimir Putin argues that there was an agreement of not enlarging the NATO to the former Warsaw pact countries. No such agreement exists. Lacking membership in the NATO, both Finland and Sweden have shown interest in different EU military projects. Let me say that the EU is a military paper tiger, and that the whole problem would easily disappear if Finland and Sweden joined the alliance.

There are many obstacles to this.

Politicians in different parties – in Finland in particular – wish to continue a long tradition, dating to the end of the Second World War, to keep us non-aligned, despite the well-known fact that during the Cold War we were protected by NATO's nuclear umbrella.

Sweden has remained formally neutral since 1812, keeping a fragile tactical balance even during WW2, delivering iron ore to the Nazis while doing business with the west at the same time. Today, many decades later, Sweden has lots of military hardware but very few soldiers on the ground. Sweden has 897 colonels, but only eight battalions to be commanded.

You may ask why I am dwelling on these matters today. A lot of attention has been paid in Finland to the economic problems facing the Union and to our own home-grown problems. In the words of **John Donne**, we have to remind people that *"no man is an island"*, and that the developments in Ukraine and Russia will be with us for a good while yet.

And here I might return to the question of liberalism. Russia has never enjoyed any sort of liberal society, except maybe for a brief turbulent period under Yeltsin. There is, as we know, a growing middle class, but at the same time a surge of nationalist hype, orchestrated by Putin and his henchmen.

Russia is lost as a liberal prospect for a long time to come. ■

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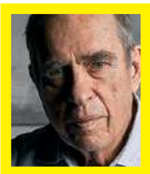

Jörn Donner
MP, writer, film director, actor, producer, politician, founder of Finnish Film Archive. Member of Swedish Parliamentary Group.

"The Nordic model may have been a success, and it may have been the best for us, but I am not sure whether it would be the best model elsewhere, too. It's impossible to copy and every model has its own history, having gradually developed over time."

“The Nordic countries have done very well in terms of their economic performance, employment and social protection systems. It's easy to forget this, as we have recently been through very bad economic times, bringing to mind the 1990s.”

“We should define the main principles of the Nordic model. I would argue that one of the main principles is high employment.”

“The free movement of people leads to a better allocation of resources. It is the only liberal way of treating matters. In the EU, we have free movement of services, goods and capital – and of people.”

“It is perfectly fine that the member states decide what kind of systems they have, because we come from different histories and traditions; why should we have the same systems?”

"Why should we restrict the movement of people? It's the free markets that are behind this, and we have to accept that. It doesn't cause any structural problems for the national systems."

"We should bear in mind that all the decisions taken on the EU level have some social consequences in member states. You should take into account at the European level that they are not just economic decisions, they are also social decisions."

"In the long run, if we have to harmonise something in the European Union, it is this dimension of the welfare state. The welfare state is an investment device."

"After spending some time in a Nordic country one realises that the welfare state has a very strong investment dimension in the Nordic countries. In the Nordic countries, they are tied to very high levels of social capital."

With the support of of Think Tank e2 and Magma, ELF organised the seminar "The Future of the European Union" in Helsinki on 22 April 2014. The seminar took up for discussion the future matters from the perspective of economy and welfare. We looked into how the general political situation, expectations of the European citizens, changes in the labour market and environmental factors affect the European Union and the future of the member countries.

The first part of the publication handles the future of Europe and EMU, and the second part concentrates on the welfare issues.

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