

THE SOCIAL DIMENSION OF THE ECONOMIC AND MONETARY UNION

1. INTRODUCTION

Taking into account the Blueprint of the Commission for a deep and genuine economic and monetary union², the December 2012 European Council requested that possible measures and a time-bound roadmap be elaborated by June 2013 on four issues pertaining to the completion of the EMU, namely the ex ante coordination of major national economic policy reforms; the social dimension of the EMU, including social dialogue; the feasibility and modalities of mutually agreed contracts between Member States and EU institutions for competitiveness and growth; and solidarity mechanisms that can enhance efforts made by Member States that enter into such contractual arrangements. (CC1)

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The present Communication represents another contribution from the Commission to the debate on the deepening of the EMU and, in line with the European Council conclusions, addresses ways to strengthen the social dimension of the EMU, including social dialogue.

The social dimension of the EMU can be understood as an ability of the EU and EMU's governance mechanisms and policy instruments to take into account and address imbalances and challenges related to employment and social policies in the EMU, helping all Member States to realize their growth and employment potential and improve social cohesion.

Since its creation 15 years ago, the European Employment Strategy has created a framework for coordination of policies that aims at creating for employment, as for economic policy, the same resolve to converge towards jointly set, verifiable, regularly updated targets⁴. And, as set out in the Commission's Blueprint, coordination and surveillance of employment and social policies should be reinforced within the EMU governance, and convergence promoted in these areas. Indeed, more and more, employment and social challenges and policies in Member States are a matter of common concern, especially in the euro area. The sovereign debt crisis that started in 2009, together with the impossibility for euro area Member States to unilaterally modify exchange rates and pursue independent monetary policies has reduced individual Member States' ability to mitigate adverse economic developments and their employment and social consequences. Structural reforms supporting employment, productivity and greater socio-economic opportunities are often difficult to undertake in a context of an economic downturn, yet failure to undertake such measures may result in negative spill-over effects and deterioration in economic fundamentals of the currency union as a whole. Therefore it is in the collective interest of the currency union to ensure that employment and social challenges are properly tackled. Without a robust social dimension the EMU will remain incomplete.

The aim of this Communication is to put forward instruments and mechanisms that under the current treaties and in the framework of the European Semester will:

- (i) identify at an early stage major employment and social imbalances that could affect the economic stability of the EMU or undermine its good functioning ;
- (ii) enhance policy coordination and monitoring in the field of employment and social policies in order to pre-empt and act upon major employment and social imbalances and disparities within the EMU before they develop in a disproportionate manner;
- (iii) reinforce the role of the social partners in the governance of the EMU.

2. THE RATIONALE FOR A SOCIAL DIMENSION OF THE EMU

In defining and implementing its policies and activities, the Union is to take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion and a high level of education and

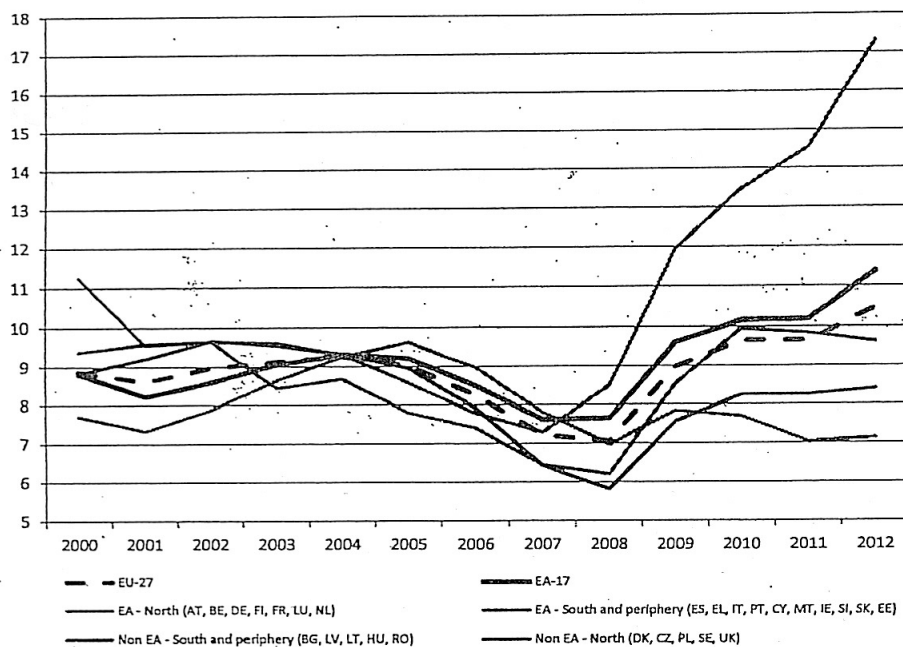
⁴ Communication from the Commission to the European Parliament and the Council: Towards a Deep and Genuine Economic and Monetary Union: The introduction of a Convergence and Competitiveness Instrument. COM(2013) 165

⁵ Cf. Presidency Conclusions of the Extraordinary European Council Meeting on Employment, Luxembourg, 20-21 November 1997, para 3.

training and protection of human health (TFEU Article 9). The Europe 2020 strategy for smart, sustainable and inclusive growth set targets for high employment, higher levels of education and reduced poverty in the EU.

However, the on-going economic crisis has led to growing divergence in employment and social outcomes between Member States and increasing polarization within societies.⁶ Evidence from the crisis shows that divergence in the employment and social situation between Member States is far more marked among euro area countries (EA17) than in the rest of the EU. The gap that appeared between the weighted aggregate unemployment rates for the north of the EA17 on the one hand, and the south and periphery of the euro area on the other, has been growing at an alarming pace since 2008 (see Chart 1).⁷

Chart 1: Diverging unemployment rates by groups of euro area (EA) and non-EA Member States since 2000



Source: Eurostat, LFS; DG EMPL calculation.

Notes: Weighted average: aggregate unemployment rate = aggregate unemployment level / aggregate labour force.

⁶ More than 26.5 million people are unemployed in the EU27 as of March 2013, of whom over 19 million in the euro area. For an analysis of key employment and social trends, see inter alia the *Employment and Social Developments in Europe 2012* review.

⁷ In the mid-2000s, the currency union produced a convergence in unemployment rates across its Member States, partly because weak financial supervision and lower risk perception stemming from the launch of the currency union resulted in large capital flows into 'peripheral' countries. However, the financial crisis that erupted in 2008 has unleashed divergence at a much larger scale, partly due to the slow deleveraging process and the uncertainty around the recovery prospects of the 'periphery'.

The gap was as high as 7.5 percentage points in 2011, and continued to grow in 2012, when it reached 10.2 pps, the average unemployment rate being 17.3 % in the south and periphery of the EA17, against 7.1 % for the north⁸.

Trends that severely undermine employment, social cohesion and human capital affect competitiveness and sustainable growth of the whole EU. However, socio-economic divergence is of even greater concern within the EMU given the limitations that currency union membership poses to the ability of individual Member States to counteract an economic crisis. Employment and social crises therefore risk developing to a greater extent within a monetary union than among a group of states who do not share the same currency, unless they are addressed within the currency union on a collective basis. Given the high degree of economic interdependence among members of a monetary union, such crises are also likely to have impact beyond national borders.

If national employment and social policies are unable to effectively prevent or address major employment and social disparities *in due time*, these can aggravate imbalances and can result in negative spill-over effects on other Member States and the currency union as a whole, mainly through four channels or transmission mechanisms:

- (i) Unemployment and social problems have a direct effect on aggregate demand through income losses for significant parts of the population or for society as a whole;
- (ii) They increase current and future pressures on public expenditure and reduce revenues, thereby increasing the debt vulnerability of a Member State, undermining the return to fiscal sustainability and compounding internal macroeconomic imbalances;
- (iii) They undermine price and non-price competitiveness and the growth potential of the economies by underutilization and a weakening of human capital now and in the future (hysteresis effects);
- (iv) They can lead to social unrest threatening the stability of governments and their capacity to run sound policies, maintain market confidence in the common currency and borrow with narrow interest rate spreads.

Sustained divergence in employment and social outcomes also threatens to result in a longer-term divergence in the growth potential of (EMU Member States) moving the EMU away from an optimum currency area and undermining its future sustainability, at least in the absence of large compensatory fiscal transfers between Member States. It is therefore important for a currency union to be able to prevent at much earlier stage major employment and social imbalances from developing and to address them in a timely and effective manner where they arise. The ability for such collective action will also have a bearing on the way in which the monetary union contributes to the achievement of Treaty objectives and on its political legitimacy. The proper functioning of the EMU requires that through the strengthening of its social dimension, Member States work jointly towards socio-economic convergence.

⁸ In the rest of the EU, the gap between the north, the south and the periphery of the group formed by non-EA countries was much more limited: after climbing to 1.7 pps in 2010, from 0.4 pp in 2008, it slowed down to 1.6 pps in 2011 and 1.2 pps in 2012.

3. REINFORCED SURVEILLANCE OF EMPLOYMENT AND SOCIAL CHALLENGES AND POLICIES IN THE EMU

The successive waves of crisis (financial, economic, sovereign debt, employment and social) have exposed initial weaknesses in the design of the EMU as well as shortcomings in EU-level policy coordination. The policy response involved strengthening of EU's and EMU's economic governance that intensifies multilateral surveillance, notably in the euro area, within the framework of the European Semester for economic policy coordination.

Titles IX and X TFEU provide the framework and tools for reinforcing multilateral surveillance in the employment and social areas within the European Semester. In particular, the Employment Guidelines proposed by the Commission and approved by the Council present common priorities and targets for national employment and social policies⁹. In the Annual Growth Survey and the enclosed draft Joint Employment Report, the Commission analyses the key employment and social challenges for the EU as well as the policy responses deployed. This serves as a basis for further analysis, surveillance and coordination throughout the European Semester¹⁰. However, this process

HAS SO FAR NOT ALLOWED FOR PROVIDING ANY SPECIFIC FOCUS ON THE EMPLOYMENT AND SOCIAL DYNAMICS WITHIN THE CURRENCY UNION

a) Early detection of key employment and social imbalances (employment and social scoreboard)

As employment and welfare systems are primarily the responsibility of Member States and as fiscal union within the EMU lies beyond the scope of current treaties, building a genuine EMU with a social dimension today (in the short term) requires development or strengthening of employment and social policy instruments and mechanisms within the existing governance framework that would enable to identify and alleviate major employment and social difficulties before they develop at Member State and/or EMU level to such extent that they could threaten the good functioning of the currency union.

The Commission proposes to develop the social dimension of the EMU fully integrated into the currently existing European Semester framework and respecting Member States competences and the principle of subsidiarity (see graph in annex). In this context, it proposes to create a scoreboard of key employment and social indicators that would allow for better and earlier identification of major problems especially those that risk generating negative spill-over effects. This "employment and social imbalances scoreboard" would consist of indicators focusing on employment and social trends that can severely undermine **employment, social cohesion and human capital**, and therefore competitiveness and the well-being of populations, in such a way that they could threaten the stability of the EMU by generating negative spill-over effects.

The employment and social imbalances scoreboard would provide basis for reinforced multilateral surveillance of employment and social policies with specific attention to developments relevant for the EMU. This scoreboard would also complement indicators

⁹ The White Paper on Pensions, the Employment Package, the Youth Employment Package and the Social Investment Package provide guidance to Member States how to realise the policy aims set out in the aforementioned Guidelines.

¹⁰ Add REF to Regulation 1175/2011.

already used in other surveillance exercises; notably the alert mechanism of the macroeconomic imbalances procedure¹¹. It would help better take employment and social challenges into account in the development of economic policies in the EMU.

The following indicators are proposed to constitute the employment and social imbalances scoreboard:

- (i) high or rising unemployment and labour market precariousness;
- (ii) high or rising youth unemployment, inactivity and exclusion;
- (iii) decline of household disposable income;
- (iv) increases in poverty;
- (v) increasing inequality, particularly in the labour market.

The scoreboard will consist of five headline indicators, each accompanied by a set of auxiliary indicators supporting the analysis of the developments behind each indicator. A full overview is provided in annex.¹²

The headline indicators are associated with two types of thresholds that allow the detection of negative trends at an early stage of emergence or help anticipate further deterioration. The first threshold relates to a Member State's deviation from historical values for the given indicator, while the second marks large deviation from the EMU average. The suggested thresholds are based on a statistical approach and designed to capture rapid deteriorations as well as longer term gradual accumulation of employment and social imbalances (see annex for further detail).

The employment and social imbalances scoreboard will be incorporated in the draft Joint Employment Report¹³ published by the Commission as part of the Annual Growth Survey. It will serve as a mechanism of first warning helping to detect and diagnose key employment and social imbalances and will help anticipating those that would potentially affect the well-functioning of the EMU.

The employment and social imbalances scoreboard will cover all Member States, including those subject to enhanced surveillance under economic adjustment programmes. This is important in order to have a full picture of the social and employment situation across the entire EMU and of convergence or divergence therein. Although covering all EU Member States, the scoreboard will allow assessing dynamics within the EMU.

The construction and filling in of the scoreboard will be conducted by the European Commission; hence there will be no additional reporting obligation on Member States.

b) Stronger coordination and surveillance of employment and social policies (in-depth assessment and benchmarks)

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¹² The proposed indicators in the scoreboard are not meant to replace those used for monitoring the Europe 2020 targets (i.e. employment rate, EU poverty reduction target) nor to anticipate any new ones.

¹³ The Joint Employment Report, provided for in Art 148(1) TFEU, is subject to adoption by the Council and addressed to the European Council. The term 'Joint' refers to an agreement between the Commission and Member States, with the corresponding dataset extensively used in the European Semester.

The scoreboard of employment and social imbalances could provide a basis for earlier identification of policy tools that could help to prevent and *remedy* employment and social imbalances where they arise.

(i) In-depth assessments of major employment and social imbalances...

To analyze the precise nature of an employment or social imbalance apparent from the scoreboard, the Commission will undertake during the European Semester an **in-depth assessment** for countries where headline indicators in the scoreboard of employment and social imbalances are in excess of either the historical thresholds or the thresholds marking large deviations from EMU average. This in-depth assessment will be facilitated by the *auxiliary indicators* of the scoreboard, the vast majority of which are drawn from the Joint Assessment Framework dataset of key labour market and social indicators already used by the Employment Committee and the Social Protection Committee and the Commission during the European Semester.

The in-depth assessment will provide for a reading of the scoreboard that will identify the relevant dimensions of the imbalance and its sources. It will aim at clarifying whether an employment or social imbalance results, besides the general economic situation, also from poor performance of labour market institutions and employment or social policies.

The in-depth assessment will help identify the required policy response, building on the existing policy coordination processes undertaken within the EPSCO Council and its committees on the basis of the EPM and SPPM. The in-depth assessment will make use of *policy benchmarks* developed in this context, while retaining specific focus on measures that are needed for the good functioning of the monetary union, notably by addressing employment and social imbalances with negative spill-over effects.

The in-depth assessment will take the form of Commission Staff Working Documents published during the European Semester in due time in order to be considered by Member States when drafting their National Reform Programmes (and ahead of the ex ante coordination). Reinforced employment and social surveillance and coordination in the EMU is expected to translate into stronger focus on employment policies and social reforms and investments at the national level, building on the National Jobs Plans within the National Reform Programmes.

The in-depth assessment will be taken into account by the Commission in its assessment of NRPs in the context of the adoption of its proposals for country-specific recommendations based on Article 148 TFEU.

(ii) ... Complementing the economic reading provided in the In-depth Reviews of macroeconomic imbalances

Stronger coordination and surveillance of employment and social policies on the basis of the scoreboard of employment and social imbalances and the ensuing in-depth assessment will also make it easier for macroeconomic policy in the monetary union to respond to salient employment and social developments. The in-depth assessment of employment and social imbalances would represent a complementary source of information that would be taken into account as appropriate in the analysis of macroeconomic imbalances and, further, in the formulation of corresponding country-specific recommendations. It would also be

incorporated in the Memoranda of Understanding with Member States subject to enhanced surveillance under economic adjustment programmes.

(iii) ... Supporting the future ex ante coordination of major economic reforms in line with the coordination of policies as provided by art 5 TFEU...

The proposed in-depth assessment will also help (the Commission) in identifying possible spill over effects generated by major employment or social imbalances on other Member States and/or on the euro area and wider EU. In case an employment or social imbalance - or its prevention at an early stage - requires a major economic reform, Member States would be expected to provide information (on their own initiative) in the context of the ex-ante coordination mechanism, by making use of their NRP. Information on the social impact of all major economic reforms would also be submitted by Member States.

The Commission's evaluation of such major plans and reforms would be presented to the EPSCO Council and its Committees as part of the discussion leading to the adoption of CSRs in the context of the European Semester. This could lead on the basis of the relevant country-specific recommendation to an invitation to the Member States concerned to bring forward the necessary measures that could then be set out in a contractual arrangement between the Commission and the Member State concerned, and be accompanied with financial support from the Convergence and Competitiveness Instrument. This would facilitate the implementation of additional reforms and investments, over and above what can be achieved with structural funds support, in particular the European Social Fund, and the Youth Employment Initiative.

(iv) ... And leading to improved policy benchmarking

A well-functioning EMU requires detecting problematic developments at an early stage should lead to preventing them in a more effective way. The in-depth assessment will provide for a qualitative analysis of key factors that would enable to point to the most pressing measures/reforms to be adopted. While ensuring that employment and social policies are sufficiently adaptable and responsive to economic developments and structural challenges, it is in the interest of the EMU, and it is one of the purposes of the EU, to prevent downward cross-national competition on employment and social standards and policies,

Recent developments around the Youth Guarantee [ref] illustrate how a policy benchmark, whereby Member States are required to ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within a period of four months of becoming unemployed or leaving formal education, represents a structural reform of micro- and macro-economic significance which is particularly relevant in the EMU context. Implementing a Youth Guarantee will certainly contribute to avoiding negative spill-over effects on other Member States, both in the short term (demand, implicit fiscal pressure, socio-political unrest) and in the longer term (hysteresis effects leading to a divergence in the growth potential of EMU Member States), by preventing a loss of human capital in a crucial period of life among a generation whose employability and productivity will influence our prosperity for decades to come.

To restore competitiveness and growth in the EMU based on allocation of human capital into productive and sustainable activities, it is important to ensure a reinforced coordination in employment and social areas. Reinforcing the benchmarking of best practices would support

more dynamic labour markets, facilitate a job-rich recovery and socio-economic convergence across the EMU. This includes greater labour mobility, quality of active labour market policies, reforms tackling labour market segmentation, as well as proactive investment in the development of human capital. Good functioning of welfare states, enabling and empowering people to participate in the economy and access social services, is also important to maintain healthy economic fundamentals throughout the currency union.

The current ten-point Integrated Guidelines (Broad economic policy guidelines and Employment guidelines) provide orientation for economic, employment and social policies at Member State level and set quantified headline targets for the Europe 2020 Strategy.

During the past 15 months, the Commission tabled and the European Parliament and Council discussed a set of comprehensive proposals to reinforce employment and social policies in the EU in line with the Europe 2020 objectives and responding to the worsening economic context. These include the White Paper on Pensions¹⁴, the Employment Package¹⁵, the Youth Employment Package¹⁶ and the Social Investment Package¹⁷.

In the context of the forthcoming revision of the **Employment Guidelines** (points 7-10 of the Europe 2020 Integrated Guidelines), the Commission will explore options to enshrine this reinforced employment and social policy agenda into **policy benchmarks** that would represent a reinforced commitment to effective employment and social policies while helping prevent and address employment and social imbalances within the EMU.

c) Institutional setting

The findings of the employment and social imbalances scoreboard and of the in-depth assessment will be available to the European Parliament, the Council, the Eurogroup as well as other institutions, stakeholders and the general public. In particular, the Commission will present the results to the Employment Committee and the Social Protection Committee in the context of their involvement in the European Semester.

Ways to correspondingly enhance the role of the EPSCO Council formation within the EMU context could be explored, for example through regular meetings of employment and social ministers in the framework of the Euro Group. Possibilities should also be sought to intensify exchanges with national and European social partners in the context of addressing employment and social imbalances relevant for the EMU.

The Council, on the basis of discussions in the Employment Committee and the Social Protection Committee, can issue conclusions on how the EMU is affected by imbalances presented in the initial employment and social scoreboard.

5. STRENGTHENING SOCIAL DIALOGUE WITHIN EMU GOVERNANCE

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A consultation of the social partners is ongoing, asking for their views on the social dimension of EMU, in particular social partners' role in governance (the letter and background note are attached).

6. POSSIBLE MEDIUM AND LONG TERM DEVELOPMENTS FOR THE EMPLOYMENT AND SOCIAL GOVERNANCE IN THE EMU¹⁸

Stronger and broader guidelines on employment and social policies: Besides a possible revision of the Employment Guidelines with a view to establishing clear policy benchmarks and facilitating assessment of the effectiveness of national policies in the context of the European Semester, the Commission will further examine how the binding nature and enforcement of such benchmarks could be strengthened, including through incentive and conditionality mechanisms in the context of the Convergence and Competitiveness Instrument.

EMU-level unemployment benefit scheme acting as short-term automatic stabilizer: As indicated in the Commission's Blueprint, the EMU needs in the long term a central budget with a stabilization function helping address asymmetric shocks within the EMU and preventing short-term crises from unleashing lasting socio-economic divergence. Among such stabilisers, the possibility of establishing an EMU-wide unemployment benefit system (UBS) stands out, as such scheme would be easy to communicate and understand and would stabilise the economy in a timely and effective manner thanks to targeting a population with a high consumption propensity. Initial estimates suggest it is possible to reach large marginal stabilisation in downturns for a reasonable size of the system (0.7% of euro-area GDP). An EMU-wide UBS could ensure basic unemployment benefit provision based on a common standard regarding e.g. duration and jobseeker activation and could, besides its counter-cyclical effect, also help improve the effectiveness of active labour market policies in getting people back to work¹⁹ and further support transnational labour mobility. The Commission intends to launch a consultation on the set-up of such a scheme before mid-2014.

7. CONCLUSION

The recently strengthened EU economic governance aims to reinforce the EMU, addressing some of the initial weaknesses of its design and making it more competitive and able to deliver growth. As a further move towards genuine EMU, the Commission has also proposed ex-ante coordination of plans of major economic reform and a Convergence and Competitiveness Instrument facilitating the implementation of structural reforms.

The development of the social dimension of a genuine EMU relates to the capacity to ensure that economic efficiency and social well-being are pursued at the same time, notably thanks to strong employment and social policies ensuring healthy development of the EMU's human capital base and availability of socio-economic opportunities even in times of crisis and adjustment. While membership of monetary union and the associated fiscal constraints limit

¹⁹ See Employment and Social Developments in Europe 2012, Chapter 1, for analysis of how registration with public employment services and receipt of benefits enhances probability of jobseekers' return to employment.

Member States' ability to unilaterally deal with employment and social consequences of economic shocks, it is the collective interest of the members of the currency union to prevent employment and social crises in any of its parts from deepening and to ensure socio-economic convergence.

There is scope, under the current treaties, to strengthen the social dimension of the EMU by better informing EU economic governance within the European Semester, stepping up surveillance and coordination of employment and social policies and by increasing the role of social dialogue.

To this end, this Communication proposes to monitor employment and social imbalances in the EMU through a limited number of key indicators and analyse them on this basis in depth during the European Semester, triggering collective action where necessary (i.e. country specific recommendations, ex-ante coordination, contractual arrangements and the Convergence and Competitiveness Instrument). The Communication also outlines how corresponding policy tools could be strengthened, notably through the development of policy benchmarks in the context of the Employment Guidelines.

Finally, the place of social dialogue within the European Semester is codified.

TABLE - Scoreboard of employment and social imbalances with key indicators and associated policy tools

INDICATOR	Unemployment rate (%)	NEET (%) (Not in employment, education and training rate)	Change in Real gross disposable income of households (GDHI)	Anchored at risk of poverty rate (%) (threshold fixed at a point in time 2008)	Inequality (S80/S20 ratio)
Target population	Active population	Youth (18-24)	Total population	Total population	Total population
Data source and change	LFS (annual change)	LFS (annual change)	National Accounts	EU-SILC (annual change)	EU-SILC
Indicative threshold for excessive deviation from historical levels	Increase >0.9 pp	Increase >1.3 pp	any decline	Increase >1 pp	Increase >0.3
Period for calculation of threshold	2001-2011	2003-2011	1995-2011	2006-2011	[tbc]
Indicative threshold for excessive divergence from EMU average (much higher levels and rising/declining faster)	Higher level > 1.2 pp Rising faster > 0.6 pp	Higher level > 3.1 pp Rising faster > 0.8 pp	n.a. Declining faster < -1pp	n.a. Rising faster > 0.8 pp	Higher level > 1 Rising faster > 0.3
Rationale for Indicator	General labour market developments; loss of output and productivity; competitiveness; social cohesion	Loss of employability and productivity; skills relevance; performance of education and labour market institutions; competitiveness; social cohesion	Aggregate adequacy of labour market incomes; effectiveness of replacement income schemes	General poverty developments (focus on real incomes of poor people); social cohesion; erosion of human capital	Labour market segmentation and precariousness; equality of opportunity; aggregate demand and social cohesion
Auxiliary indicators (Indicators to be developed in <i>italics</i>)	Long-term unemployment rate Employment rate (m/w, by age) Employment rate (low skilled) Share of unemployed returning to employment within 1 year Involuntary part time / temporary employment Coverage of unemployed by ALMPs Percentage of 25-64s in LLL Job vacancy rate (average over 3 years)	NEETs broken down by age 15-18, 18-19, 20-24 Employment rate of young people Youth unemployment rate Early school leavers Share of NEET subject to intervention (Youth Guarantee) within 4 months Share of low skilled in population aged 18-30	Real unit labour cost Household saving rate Contribution of work income (employees and self-employed) to GDHI change Contribution of benefits and taxes to GDHI change Coverage rates of unemployment benefits	At-risk of poverty gap (to median income) Severe material deprivation AROPE by age (child poverty, working-age poverty, elderly poverty) Aggregate replacement ratio of pensions Gap in unmet need for health care Nowcasts of main income indicators (Euromod)	Involuntary temporary/part-time employment Labour market transitions (by type of contract or pay level) Gender pay gap In-work poverty Jobless households Literacy score gap (PISA) Earnings inequality (excl. people out of work)
EU or national level policy tools that could be mobilised in response to employment or social imbalances identified by the in-depth assessments.	<ul style="list-style-type: none"> Youth Guarantee Minimum content of ALMP; Minimum duration of unemployment benefit with activation conditionality; Target for LLL coverage National minimum income or adequate livelihood; Minimum access to social service Reforms tackling LM segmentation; Minimum wage Minimum standards for consultation of social partners 				

Technical Annex - Selection principles, interpretation and triggers for the employment and social imbalances scoreboard

a. Principles for the choice of indicators

The scoreboard of employment and social imbalances is meant as an initial screening device to identify Member States where developments warrant further in-depth analysis to determine whether social imbalances exist or risk emerging. Five main indicators, reflecting the key outcomes of social imbalances have been selected according to the following principles:

According to the **first principle**, the choice of indicators should focus on social trends that would threaten the stability of the EMU by undermining **employment, social cohesion, and human capital**, and therefore competitiveness and the wellbeing of populations. A particular emphasis should be put on social imbalances that are likely to affect **the sustainability of growth in the medium to long term**. Negative social trends have spill-over effects within the Euro-zone through four channels.

- They have a direct effect on aggregate demand through income losses for significant parts of the population or for society as a whole (unemployment, NEET, GHDI);
- they increase current and future pressures on public budgets expenditure and reduce revenues (unemployment, NEET, poverty), thereby increasing the debt vulnerability of a country, undermining the return to fiscal sustainability and compounding internal macro-economic imbalances;
- they undermine price and non-price competitiveness by under-utilisation and weakening of human capital, now and in the future through hysteresis (NEET, poverty, income inequalities);
- and finally they can lead to social unrest threatening the stability of governments and their capacity to run sound policies, and maintain market confidence in the common currency and narrow interest rates spreads (unemployment, NEET, rising inequalities, GHDI and poverty).

According to the **second principle**, the indicators should both measure the most important dimensions of employment and social developments at a society-level, and monitor the labour market performance and position of particular groups at risk. Three indicators concern society as a whole (GHDI, inequalities, anchored risk-of-poverty) and two focus on specific groups (unemployment, NEETs).

According to the **third principle**, the indicators and related thresholds should allow the detection of negative trends at an early stage of their emergence, and help to anticipate further deterioration. This means that indicators need to be able to capture both rapid deteriorations as well as the longer term gradual accumulation of imbalances. Moreover, indicative thresholds need to be set at prudent levels, which on the one hand avoid excessive numbers of 'false alarms' but which on the other hand are not set so stringently that they only identify problems once they are entrenched. To this end, thresholds have generally been established via a statistical approach based on the distributions of the indicators' values, by identifying the thresholds as the lower and/or upper quintiles of the distributions.

According to the **fourth principle** the scoreboard has an important communication role. For this purpose, the scoreboard consists of a limited number of indicators. Moreover, the choice of indicators and transformations is kept as simple and straightforward as possible. Data transformations are transparent and tractable so that they can be replicated by third parties. The choice of indicators complements indicators/targets used in other EU surveillance exercises.

According to the **fifth principle**, indicators should be of high statistical quality in terms of timeliness and comparability across countries. To this end, they are derived from data compiled according to the principles of the European Statistics Code of Practice of the European Statistical System (ESS). Where available, Eurostat sources are used so that the data comparability and statistical quality can be ensured. Otherwise, when Eurostat data are not available, the highest quality alternative data sources are chosen (e.g. the OECD).

b. Rationale and interpretation

For each of five headline indicators proposed, we present the rationale leading to its selection and guidelines for its interpretation on the basis of the above five principles:

1. Unemployment levels and change (disproportionate levels, disproportionate increase).

- **Rationale:** Fast rising or high levels of unemployment rates reflect a worsening labour market and social situation. They require immediate action to prevent more people from losing their job, help the unemployed back to work and thereby prevent long-term unemployment. High or fast rising unemployment can have adverse and long-lasting effects on human capital, leading to losses of productivity and competitiveness. Furthermore, it increases pressure on social budgets and leads to direct income losses, which depresses aggregate demand, especially if the coverage and adequacy of safety nets is insufficient.
- **Interpretation and auxiliary indicators:** Unemployment rates should be interpreted together with the long-term unemployment rate, which tends to be further lagged but captures the negative consequences of high and persistent levels of unemployment. Information on job vacancy rates (demand side) and access to LLL and ALMP (supply side) would allow the evaluation of the risks of high levels of unemployment turning structural. Structural unemployment is a manifest sign of inefficient labour market resource allocation. Information on labour market segmentation by type of contracts (permanent/temporary, full-time/part-time), and on transitions between them sheds light on (poor) labour market performance, including underemployment. The level and change of the employment rate of men and women at different ages will complement the picture.
- **Format and quality:** Level and year-on-year change of the unemployment rate. The unemployment rate is a timely and robust indicator produced by the European Statistical System (Source: Eurostat – LFS)

2. Young people (18-25 years) not in employment, education or training – NEET (disproportionate levels, disproportionate increase):

- **Rationale:** Rising or high levels of NEETs point to substantial costs both for young people (lack of income and skills now and foregone earnings in the future) and the economy and society as a whole (cost of support and underutilisation of potential workforce now²⁰, and foregone future competitiveness and revenues). The risk of permanent scarring is well documented (by the OECD and others): even if they do find jobs in the future, NEETs face substantially lower employability and productivity. Early intervention is necessary to avoid a serious and permanent loss of human capital.

- **Interpretation and auxiliary indicators:** The NEETs rate should be broken down by age groups and complemented by the youth unemployment rate and the share of early school leavers. Early school leaving (without any qualifications) is a major contributing factor to youth unemployment and inactivity as low-skilled young people are much more likely to be unemployed than the medium and high skilled. Intervention within four months of being without a job or not in education and training, in line with the Youth Guarantee, substantially increases the chances of avoiding lower employability and loss of human capital.

- **Format and quality:** Level and year-on-year change of the share of NEETs. The NEETs rate is a timely and robust indicator produced by the European Statistical System (Source: Eurostat – LFS).

3. Changes in real gross disposable income of households – GDHI (decline)

- **Rationale:** A persistent decline in the real gross disposable income of households signals that declines in labour market incomes are not being offset by replacement income schemes (primarily unemployment benefits and pensions), with direct negative impacts on aggregate demand, and the general living standards of populations.

- **Interpretation and auxiliary indicators:** The evolution of gross disposable income of households should be interpreted together with data on the contribution of labour market earnings (for employees and self-employed) to the change in household incomes. Analysing the contribution of taxes and benefits would also allow assessing the capacity of the tax and benefiting system to compensate the fall in market incomes. In the current crisis, this capacity has weakened over time and notably in the Eurozone. It should also be interpreted together with changes in real unit labour costs (important factor behind labour market income) and household saving rates (which help assess to what extent household budgets are under stress and what developments in aggregate demand can be expected in the near future).

- **Format and quality:** Year-on-year change of in the real gross disposable income of households. The GHDI is a timely and robust indicator produced by the European Statistical System (Source: Eurostat – National Accounts).

4. Changes in the anchored at-risk-of-poverty rate - deflated (disproportionate increase)

- **Rationale:** Increases in the at-risk-of-poverty rate anchored at a point in time (2008) reflect the deterioration of the real income of the poor and the lack of effectiveness of

²⁰ An October 2012 2011 Eurofound study estimated the economic cost of the labour market disengagement of young people who are not in employment, education or training. The total cost for the year 2011 amounts to approximately €153 billion (i.e. ~ 1.2% of Europe's GDP), comprising foregone earnings as well as excess transfers. See (<http://www.eurofound.europa.eu/emcc/labourmarket/youth.htm> for further detail.

social inclusion policies. The anchored risk-of-poverty is especially suited to capture the effects of worsening economic conditions on the living standards of the poorest segment of the population²¹.

- **Interpretation and auxiliary indicators:** The anchored at-risk-of-poverty rate should be looked at together with the **poverty gap** which reflects the relative deterioration of the living standards of the poor compared to median income, even when overall incomes increase. Information on the risks of poverty for specific group of the population (children, working age, elderly) would allow to identify the groups most affected. Information on the relative income of the elderly and on the gap in unmet need for health care (income gradient) provides rough information on the effectiveness of pensions and health expenditure.
- **Format and quality:** Year-on-year change of the at-risk-of poverty anchored at fixed point in time (2008) - *also called semi-absolute poverty rate*. The anchored at-risk of poverty rate is a robust indicator produced by the European Statistical System (Source: Eurostat – EU-SILC). It lacks timeliness, but current investments in micro-simulation models would allow to produce "nowcasts" (values for current year) of this income based indicator.

5. Inequalities (S80/S20 ratio) (disproportionate levels, disproportionate increase)

- **Rationale:** High and increasing levels of income inequalities can undermine sustainable growth by depressing aggregate demand or leading to unsustainable borrowing at the lower end of the income distribution where the propensity to consume is the greatest. High or rising inequalities also show that the benefits of growth are not widely shared and that too many people are not able to fulfil their potential to contribute to the economy and society. Specific attention should be paid to trends in **earnings inequality** (see below) which put a strain on public budgets by increasing the need for redistribution.
- **Interpretation:** The analysis of income inequalities should be complemented by a focus unsustainable increases in labour market inequalities (e.g. earnings inequality), resulting from both wage polarisation and unequal distribution in the quantity of work (i.e. due to segmentation and job precariousness). This requires looking at indicators of in-work poverty, gender pay gap, involuntary temporary employment, involuntary part time work, as well as indicators reflecting labour market transitions towards better quality jobs (by type of contract or pay level). Information on jobless households illustrates the polarisation of jobs between job-rich and job-poor households, which has detrimental impacts on social cohesion and human capital both in the short and the long term (children living in jobless households). Inequality of opportunity to develop one's socio-economic potential, with its adverse impact on employability, productivity and competitiveness, can be compounded also by low performance of the education system, which can be gauged from data on the gaps in literacy scores (PISA).

²¹ In times of crisis, the anchored risk of poverty reacts more strongly than the at-risk of poverty rate, which is based on the current threshold (and may decrease if median income drops). In growth times, a stagnating or increasing poverty rate would signal a growth pattern not benefiting to the poor, i.e. a lack of inclusive growth.

- **Format and quality:** Level and year-on-year change of the S80/S20 (alternatively gini coefficient – *but more difficult to communicate*). The S80/S20 is a robust indicator produced by the European Statistical System (Source: Eurostat – EU-SILC). It lacks timeliness, but current investments in micro-simulation models would allow to produce "nowcasts" (values for current year) of this income based indicator.

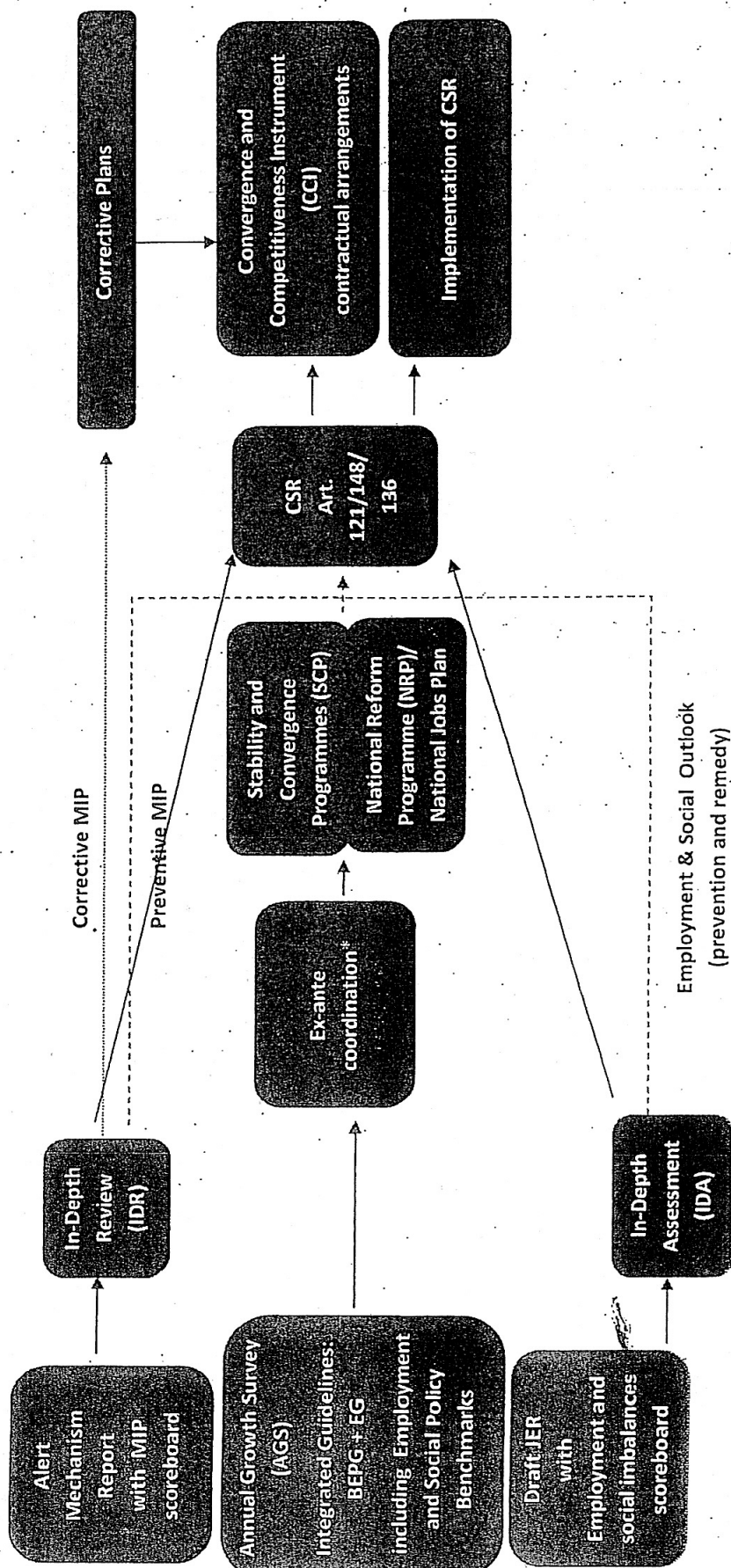
c. Triggers

The indicators should be associated to indicative thresholds to serve as alert levels (triggers) for the review of the situation of the Member State. The reading of the indicators should not be mechanical; they should be interpreted together with the full set of auxiliary indicators complemented by a broader assessment of the economic and social situation as well as of policy developments. The thresholds should trigger alerts in cases of substantial deviations from historical levels, but also in case of substantial divergence from the EMU average or from best-performing states.

The scoreboard suggests, for the time being, indicative thresholds for these two types of excessive deviations. They have been established by a statistical approach based on the distribution of year on year changes/difference to EMU average of the indicators over a long period of time (taking account of pre-crisis developments, as far as possible). Both for temporal developments and for deviations from EMU average, the threshold corresponds to the upper (or lower) quintile. However, for the EU-SILC variables (anchored poverty and S80/S20) the triggers refer to the top 15% of the distribution of changes/differences. This is to ensure that the changes are significant given the value of the confidence intervals attached to the EU-SILC aggregates of the distribution. These thresholds will need to be further reviewed and tested.

GRAPH - European Semester in a genuine EMU with a social dimension

Art. 121 - ECOFIN



Art. 148 - EPSCO

November: publication of
MIP, AGS, JER and EQ

March: Spring European Council
Tripartite Social Summit

June: adoption of the CSRs

* Ex-ante coordination could also take place closer to the adoption of the CSRs or of the Contracts

- Surveillance of employment/social policies in EMU: The agreed strengthening of focus on employment and social developments and policies within the MIP (selection of indicators has to be decided between Cabinets Rehn and Andor) plus a descriptive/factual assessment of these policies in the MIP in-depth reports is maintained; furthermore:
- Scoreboard of key employment and social indicators will be developed by building on and integrating the existing tools (Employment Performance Monitor and Social Protection Performance Monitor) and will be attached to the draft Joint Employment Report (JER). There will be no new separate follow-up process as regards in-depth assessment reviews and /or trigger subsequent actions (so-called IDA in the graph attached to the draft Communication), instead this scoreboard will feed-in in the EPSCO and social dialogue assessment of the Europe 2020 / CSRs (e.g.: TSS, Social Dialogue Committee);
- Strengthen the Open Method of Coordination in the area of employment and social governance and in the context of Europe 2020 (including the assessment of the headline targets).
- EMU-level unemployment benefit scheme: The Communication to reaffirm the long-term vision of the Blueprint, therefore to be repeated the possibility of some EMU stabilisation tool to support adjustment to asymmetric shocks in the long-term.