

## **A New Approach to Policy Coordination in the EU**

*CEPS Commentary*

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**6 March 2007**

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Politicians and business leaders in the industrially advanced world are realising that the fears and insecurity generated amongst the public by globalisation and technological change may pose a threat to open markets by fuelling protectionist sentiments and hostility to the free movement of people. The problem is especially acute in the continental member states of the European Union, where widespread antipathy to integration and immigration have already produced massive political fallout, leading to the failed referenda in France and the Netherlands and a de facto moratorium on accession negotiations with Turkey. The European Council and the European Commission have been watching helplessly, as if the matter was not in their hands. We argue that, on the contrary, there is a lot they could do, if only they followed the right approach.

Conventional wisdom maintains that the Union can do little to allay those fears, since the inability to meet the challenges of integration is due to rigid economic structures and inadequate human capital – structural weaknesses that can only be tackled effectively by policies at the national level, where the Union has little role to play. This view overlooks the existence of substantial policy spill-over across the member states of the Union that well justifies strengthened policy coordination for labour market and welfare reform.

Outdated labour market rules are the main reason why the full benefits of the internal market and monetary union have failed to materialise and productivity and innovation stagnate in Europe. Labour market rigidities – above all in France, Germany and Italy – impede adjustment in response to competitive market forces generated by integrating markets. Those losing their jobs cannot find a new occupation because barriers to entry, notably in services, keep them out of new activities taking advantage of new technologies. Those who still have a job feel threatened because they know that once they lose it, their chances of finding a new one are slim given the high incidence of long-term unemployment. Both view immigrants as a threat to their livelihood and integration within the internal market as a threat to their ‘societal model’. They turn against Europe because they feel incapable of meeting the challenge.

Thus, rigid labour markets pose a serious threat to the core of the Union, namely the internal market: if they cannot reform, eventually, France or Italy would be tempted to renege on free circulation for goods services and labour, maybe even abandon the euro, with disruptive consequences for all member states. Therefore, there is a common interest in fostering national policies that are consistent with integration in the internal market.

The benefits of coordination are likely to be reinforced by ‘learning’ spillovers in reform policies, as confirmed by evidence that reforms tend to spread in waves and follow similar patterns within homogeneous regions. This makes sense. Structural reforms are resisted, among other things, due to the uncertainty about adjustment costs and their distribution. One way to weaken this resistance would be to involve not only ministers and heads of government in the exchange of information on policy design, but also those who resist change at all levels of society, notably trade unions. A clear policy message by the European Council would have a much stronger effect if it were not only an expression of the wish of heads of governments; the reforms must be accepted broadly at all levels of society or they will not be implemented. Only then can one hope for the virtuous circle of improved expectations and economic performance that was supposed to have been set in motion by the European Council of Lisbon seven years ago.

The experience of successful reform in Anglo-Saxon and Nordic European countries shows that we need not be condemned to stagnation, provided we are ready to renounce rigid employment protection. The key to overcoming resistance is to give affected workers credible grounds to hope that they can find a new job. They must be accompanied by a combination of retraining and employment promotion, with generous

income support – of course, for a limited time and contingent on demonstrated efforts to find a new occupation by displaced workers. Together with strong unambiguous endorsement of this approach, the European Council might also recommend its member states to accompany the relaxation of employment protection with the establishment of a minimum wage – determined as an agreed proportion of the statutory wage for regular long-term employment. Most member states have in any event set a de facto floor to wages by the minimum income support available to all unemployed.

With such a comprehensive policy package, resistance to change would in all likelihood diminish. Together with efficiency, the gradual elimination of dual labour-market arrangements would also boost equity in our societies, which at present is badly damaged by the unsustainable protection accorded to those who have a stable job in the public sector and in protected private activities.

Immigration poses even greater policy challenges, since immigrants are broadly perceived as a direct source of economic insecurity, threatening jobs as well as crowding out natives from social services. The Union dimension of the issue is determined by substantial policy spillovers across the member states. There is ample evidence that restrictions to immigration in one country divert migrants' flows to other countries in the Union; that migration is attracted by generous welfare entitlements and their redistribution components; and that well-functioning labour markets attract migrants with higher qualifications, while countries with rigid employment protection are mainly targeted by the low-skilled and those willing to work illegally. Labour migration also presents challenges for source countries, which may see their pool of young and educated substantially diminished.

Policy coordination is useful if it contributes effective remedies to those negative spillovers resulting from uncoordinated policies. Two measures would appear useful in this regard. First, the old member states should immediately lift the remaining restrictions on the freedom of movement for workers from the new member countries. Any minimum wage would automatically also apply to immigrant workers, mitigating 'unfair' competition for low-skilled jobs. Second, the Union should enact a common scheme for admission of immigrant workers from outside the EU, as already suggested by the Commission with its Policy Plan on Legal Migration. In addition, the scheme should also include a 'point system' for the selection of applicants for residence and work permits. A point system would assign each applicant a score based on objective criteria, typically including language abilities (in the language of the target country), education and work experience. This approach has been successfully implemented in Australia, New Zealand and Switzerland; Germany and the UK are following suit.

In sum, by establishing a common 'welfare floor' throughout the Union, providing an effective safety net to native workers whose jobs are felt to be threatened by integration, and adopting a coordinated policy on immigration, the European Council would be able to reassure its citizens, hopefully reducing their hostility to migrant workers, and at the same time offer those migrants an equitable and fair legal framework.

These policies for the labour market and immigration should become the focus of policy coordination within the European Council. By concentrating on appropriate policies to sustain the integration process while at the same preserving the European social model, the European Council would again become a relevant policy forum where the real needs and hopes of Union citizens could find effective responses.

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