



## **The budgetary dimension of ‘social Europe’; Scenarios and strategies for the future**

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### ***I. The meaning of the exercise***

The goal of this paper is to contribute to the discussion on the reform of the EU budget by defining a set of scenarios and strategies for the budgetary dimension of ‘social Europe’. More specifically, applying a multi-disciplinary perspective, we seek to identify these scenarios and strategies that seem a) more likely than others and b) more acceptable than others in terms of the input- (legitimacy) and the output - dimension (efficiency) of democratic political systems. Following the definitions provided by EU-CONSENT, when using the term “scenarios”, we are referring to possible future paths of development for the European polity; by contrast, when mentioning “strategies”, we are referring to the political behaviour and actions of the relevant political actors (Faber and Wessels, 2006).

To begin with, an operational definition of ‘social Europe’ is needed. For the purpose of this paper, the term social Europe - traditionally associated with social and labour market policies – encompasses also a territorial dimension. In other words, the social character of policies aiming at reducing persistent inefficiency (underutilisation of resources resulting in income below potential in both the short and long-run) and persistent social exclusion (primarily, an excessive number of people below a given standard in terms of income and other features of well-being) *in specific places*<sup>1</sup> should be recognised. Traditional social policies often focus on individuals without taking account of the fact that their well-being and the effectiveness of policy strongly depend on the place where they live. Accordingly, there is tendency to follow what might be described as a *de-contextualised individual approach*, often with a strong non-egalitarian bias. At the same time, place-based policies can make the serious mistake of referring to places almost as if they had a “preference function”, a well-being of their own with the consequences for individuals getting lost.

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<sup>1</sup> This is the definition of cohesion policy adopted by the Barca report (Barca 2009)

The gap between the average well-being of a place and other places is then taken to represent the “inequality” of the people living there; and the policy for reducing the gap is termed “social”. A policy which focuses on places without adequately taking account of the individuals who live there can be described as a *depersonalised place-based approach*. A new combination of the social and the territorial agenda is therefore required. The social agenda needs to be “territorialised”, the territorial agenda “socialised”. The place-based approach to social inclusion should be the result of these two shifts (Barca, 2009; 36).

## II. Taking stock

As we have argued elsewhere, ‘social Europe’ is a two-level government assignment. For a host of social, political and economic reasons, the lower level - the member state – has a much richer and stronger role than the EU level. Changes in the allocation of institutional competencies (Treaty reforms) and effective powers (Treaty reforms and Treaty-based social legislation and policy coordination) since the early days of European integration have been made across policy areas (and, even, sub-areas) in an asymmetric way and have little challenged the national welfare state (Koutsiaras, 2008a). This asymmetry in favour of the national level is clearly reflected in the size and the functions of the EU budget. On the one hand, the EU budget is small compared to the size of national budgets or those of federal governments. In 2008, for instance, it amounted to €129.1 billion, representing 1.03% of the Union’s GNI and 2.5% of EU public spending<sup>2</sup>. On the other hand, both theory and practice militate against fiscal centralization at the EU level.

- Firstly, the revised theory of fiscal federalism exhibits a clear predilection for decentralization: assuming a generalized second-best environment largely associated with political constraints and government failures, the theory concludes that public spending in the EU, be it for redistributive purposes and/or the provision of public goods, should be assigned *in principle* to local (i.e. national) governments. These theoretical models suggest that EU spending should be countenanced where the EU level is manifestly the best one to carry out the task in question. This answer is consistent with the principle of subsidiarity and also reflects a frequently articulated demand, according to which there ought to be a demonstrable benefit (in other words, ‘an added value’) from spending money at the EU level<sup>3</sup> (Begg, 2007; 6).
- Secondly, the size and the role of the EU budget are actually determined by an exceptionally complex structure of institutions, policy-making rules and procedures that facilitate intergovernmental bargaining, but are conspicuously lacking the ingredients of a political community. Divergent national interests and policy preferences mean that competencies and public spending are only hesitantly – and when a Pareto improvement is, at least, within reach<sup>4</sup> - transferred to the EU level. Moreover, in the absence of EU-wide equity considerations, not only does redistribution remain firmly in the hands of the national political institutions, but member states are also reluctant to cede *any* spending authority to the European

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<sup>2</sup> For the sake of comparison, in 2008 the ‘outlays’ (expenditure) of the federal budget of the USA reached the amount of \$ 2.931 billion, representing 20,5% of the country’s GDP.

<sup>3</sup> The question of what actually constitutes ‘added value’ is discussed in the following section.

<sup>4</sup> The most awkward problem that arises in trying to justify EU spending by demonstrating EU added value is that even when there is unambiguous EU added value, it does not follow that it benefits all member states. The result is that there is often a much more onerous test for added value, namely that it is positive for the EU as a whole but does not impose a cost on any member state – known in the trade as Pareto optimality (Begg 2007).

institutions, the reason being that an element of redistribution is inherent in both the allocation and stabilization functions (Koutsiaras, 2004; 2).

That being said, it is worth noting that the main items of EU expenditure are linked – mostly indirectly and, to a lesser extent, directly - to social Europe. Specifically, the largest single EU expenditure item for the period 2007-2013 is the - reformed - Common Agricultural Policy (CAP), representing 42% of total resources, followed by cohesion policy with 35%, while expenditure programmes directly related to the Lisbon objectives account for another 9% of overall spending (Santos and Neheider, 2009; 5). Some brief remarks regarding those policies are thus necessary.

Since 2007, expenditure under CAP has been placed under the heading “*sustainable development and natural resources*”. This category includes both traditional agricultural expenditure of the FEOGA-guarantee (market expenditure and rural development expenditure) as well as FEOGA-orientation expenditure that had previously belonged in the category of structural policy. Not only is the market expenditure subject to a ceiling in real terms and conforming to the 2002 agreement ratified by the fifteen Member States<sup>5</sup>, but also, the entire agricultural budget is stabilized in constant Euros. It thus considerably decreases in relative terms: expenditure set aside for agriculture and rural development will represent slightly more than a third of the total EU budget in 2013, as opposed to half in 2006. The change in name moreover reflects the continuous restructuring of a policy that offers an ever-decreasing amount of support to agricultural productivity and pays increasing attention to environmental preservation and rural development. There is unanimity among economists that reforms in this area should be accelerated and completed, transforming CAP from a price fixing to an income support program for farmers, so as to remove the distorting effects and the inefficiencies of price controls (Tabellini 2003). However, Member states’ views on the CAP can be grouped in two blocks; on the one hand, France, Hungary, Ireland, Latvia, Poland, Portugal, Romania and Spain would like to see the status quo preserved, while the rest supports some type of more rapid transfer of resources from direct aid and market support in agriculture to rural development (Santos and Neheider, 2009: 14).

Cohesion policy is commonly viewed as a means of financial redistribution among Member States and Regions. However, this argument is misleading. The redistribution of resources among places is not a sufficient condition for pursuing either the efficiency or the equity objectives set out in the Treaty when calling for a reduction of disparities. It might be part of the *means* of such a pursuit – some places receiving more from interventions than they contribute through taxation – but the main purpose of cohesion policy is not redistribution but to trigger institutional change and to break inefficiencies and social exclusion traps through the provision of public goods and services. It is certainly the case that cohesion policy has been and is still today entrusted, as are other EU policies, with the side task of “transferring resources between Member States as part

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<sup>5</sup> It foresaw the introduction of a ceiling on intervention expenditure for the common agricultural policy’s budget beginning 2007 (with a margin of a 1% increase per year in value, inferior, in all likelihood, to the annual rate of inflation). This ceiling concerns market expenditure that represents 90% of the common agricultural policy’s budget (FEOGA-guarantee). Rural development expenditure from either the FEOGA-guarantee (second pillar of the common agricultural policy) or the FEOGA orientation (structural action) would be excluded. The direct aid made to Eastern countries would be released gradually, moving from 25% of the Western level in 2004 (impact on the 2005 budget) to 30% in 2005, 35% in 2006, 40% in 2007, and a further 10% per year until achieving 100% in 2013. This gradual release of direct aid to the farmers of the East will ensure a smoothening of agricultural expenditure in the new Member States. But this would also translate into a gradual reduction of the aid handed out to older Member States, and in turn poses the problem of eventual national compensatory measures (Lefebvre 2005; 30) .

of grand bargains”, but if this were its main purpose it would be inappropriate to pursue it through cohesion policy (Barca, 2009).

How effective is cohesion policy? First, one has to take into account that cohesion policy not only suffers from ambiguity at both the conceptual and the organizational levels but is also riddled with goal congestion (Tarschys, 2003; 85)<sup>6</sup>. Secondly, the evidence regarding the impact of structural funds on growth is mixed. The most serious criticism at the conceptual level is that cohesion policy has been following a twin track approach, placing its bet on both the core regions and the lagging regions of the peripheral countries. According to this argument, this effort to promote agglomeration and dispersion simultaneously is bound to be ineffective (Andreou, 2007; 3-6).

Understandably, the discussion on the future cohesion policy has revealed diverging views. Most disagreements are related to regional expenditures, in particular, whether funds should go to all regions regardless of the country, only to poor regions or – stricter still – only to poor regions in poor countries. While a majority of member states would like to have a cohesion policy focused exclusively on poor regions – whether in poor or rich countries – the remainder are in favour of the current situation where all regions receive some measure of support (Santos, 2009; 4).

There is overall agreement that the EU should only spend resources in areas where there is added value from doing so at the Community level. However, there is no consensus on what actually constitutes added value (Santos and Neheider, 2009) and, in most cases, as it has been argued previously, added value is equated with Pareto optimality. In any case, economic rationalisation of EU-level intervention traditionally points at market failure – notably economies of scale/scope, externalities and public goods - since they are associated with the under-provision of goods and services in the absence of government intervention. In the case of economies of scale and scope, EU intervention promotes efficiency, as larger scale production leads to decreases in the long-run average unit costs (scale) and as the increase in the number of policies administered at the EU level creates synergies in production and distribution (scope). Similarly, in markets where there are significant externalities, ie benefits or costs that accrue not only to the individuals in a country directly involved in the transaction but also to others in the EU, centralisation can allow for the appropriate distribution of compensation and costs. For instance, significant economies of scale/scope and externalities are thought to be present in R&D and defence policies (Tabellini 2003).

The Lisbon strategy aims at making Europe the most competitive and dynamic knowledge-based economy with sustainable economic growth, more and better jobs and greater social cohesion. However, the negotiations leading to the financial framework 2007–13 have clearly shown that ‘competitiveness’, being a somewhat diffuse goal, does not have a strong lobby inside the EU’s decision-making process<sup>7</sup>. As the group of potential ‘Lisbon budget’ winners is quite large and diffuse and as the potential losers of a shift in priorities are more concentrated and politically more vociferous, the Commission was not able to build a powerful coalition of governments, societal actors and interest

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<sup>6</sup> The partial ‘Lisbonisation’ of cohesion policy for 2007-2013, though useful in principle, is not very helpful in conceptual terms.

<sup>7</sup>The Commission’s proposal for the Financial Framework envisaged increasing the share spent on competitiveness from 7.5% of the budget in 2006 to 13% on average between 2007 and 2013. The final agreement, however, raised this share to an annual average of only 8.6%.

groups to push for a change in spending priorities. The unpredictability of the distributive impact of Lisbon-related expenditures – for example, in the case of research expenditure, where research teams have to apply competitively for EU funding – is another aspect of the explanation. Member states, following a logic of net flows from the budget, were more reluctant to increase this budget heading at the expense of others, where consequences in terms of net flows were more predictable (Schild 2008: 545-546). This may also explain why the issue of funding – providing financial incentives for – comprehensive labour market reform has virtually been left untouched during negotiations for the financial framework 2007-13, though the need for labour market reforms has widely been recognised and politically acknowledged, yet progress has mostly been slow, piecemeal and, from a social point of view, often dubious (e.g. dualism), whilst national governments' reform capacity has, contrary to early predictions, been curtailed following the establishment of EMU (Koutsiaras, 2008b).

### **III. *The budgetary means for social Europe after 2013; the more likely scenarios.***

Mainstream economic thinking, (for example Sapir *et al*, 2003; Tabellini, 2003), has often called into question the allocation of EU spending, asking for a re-orientation of budgetary expenditure towards the promotion of growth and away from the current emphasis on regional cohesion and, especially, farm income support. However, as it has already been argued, while the border between public goods and distributive expenditures is fairly clear conceptually, in practice it is much less so. This applies particularly to cohesion policy, which, despite its numerous shortcomings, represents an appropriate - and one might argue, the only politically feasible - basis for implementing the place-based development approach needed by the Union. On the other hand, much less attention has been paid to the negative impact of the structure and sequence of EU budget negotiations (i.e. that the governance and objectives of cohesion policy are decided *after* the amount of funds and their allocation have been agreed). The present sequence of events tends to decouple the discussion on financial balances from the discussion on the use of the funds, while giving Member States and Regions, as well as the European Parliament, little room to debate policy goals. Moreover, once the financial confrontation is over, the interest of the central decision makers in Member States fades away. Negotiating goals and administrative arrangements is left to the Ministries in charge of implementing the policy, whose mandate is to maximise the room for manoeuvre in the use of funds rather than to maximise the effectiveness with which the funds are used in the other countries. The general interest of the EU in introducing guarantees that funds will be well used is therefore seriously under-represented (Barca, 2009).

Given the general desire to hold down public expenditure, there is no appetite for any large increase in total EU expenditure in real terms. As last time, debate is likely to stay within the range of 1 to 1.5% of GNI, with the so-called 'budget disciplinarians' – the UK, Germany, Sweden, the Netherlands, Denmark and Austria – wanting to keep the limit as low as possible and the Commission, the poorer Member States and the European Parliament wanting to be more expansive. The other two big net contributors, France and Italy are more equivocal<sup>8</sup>.

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<sup>8</sup> The forthcoming review raises also issues about the ways in which the EU is financed. Only 15% of revenue now comes from the original 'own resources' of custom duties and levies on imports, with a further 15% from the rather complex system based on VAT-take. That leaves 70% which is made up by direct contributions from national governments according to the size of their GNI. The best way to simplify the system would be to have the whole of the budget funded by national contribution based on GNI shares, or at least all except the import duties and levies. For some this would not be sufficiently 'communautaire', and there are those at the other end of the spectrum who want to give the

Within this context, and bearing in mind the initial EU-CONSENT scenarios of change (status quo, spill-over, spill-back and 'reinvented' EU) (Faber and Wessels 2006), we think that a 'status quo plus' scenario would be the most appropriate for social Europe in the budgetary field. By this, we are referring to a continuation of the status quo with the addition of some enhancements and some adjustments to externalities. The scenarios of a re-invented EU and spill-back have some limited plausibility, but their realisations seems rather unlikely, albeit for different reasons. The spill-over scenario is not really valid.

- The status quo plus' scenario, which today seems the most probable, is based on a budgetary constraint of 1% of the GNI and on the acquisition of common policies. It ensures a reduction of the CAP accompanied by partial re-nationalisation, maximum preservation of a 'dual' cohesion policy (Andreou 2007) (helping the new member states to 'catch-up' and, simultaneously, devoting resources to promote economic reform in the name of 'Lisbon'), a slight increase in the heading on 'competitiveness', and, most likely, a new but small instrument aiming at stimulating comprehensive labour market reform.
- The realisation of the scenario of a re-invented EU would lead to a EU richer in fiscal means - perhaps in the area of a 1.20% GNI limit - and potentially (more) redistributive. Following the experience of the Globalisation Adjustment Fund, the Union would provide transfers enabling establishment of a common "welfare floor" to deal with immigrants shopping for higher welfare benefits, or funding labour market and social protection reforms, especially providing for the compensation of losers. The resources of CAP would be slightly reduced, without, however, any expenses transferred to national budgets. Finally, in the realm of cohesion policy, an increase in overall spending would be accompanied by new eligibility rules for 'special' and/or 'handicapped' areas; upgrading of the strategic dimension of cohesion (i.e. stronger ties with the Lisbon Strategy), relaxation or abolishment of the 'n+2 rule', increased funds for employment and training measures, less demanding managerial requirements and more emphasis on institution-building. The fulfillment of this scenario, however, is strongly undermined by both the divergence between national interests - and specifically by the determination of the 'net contributors' (UK, Germany, Sweden, the Netherlands, Denmark and Austria to limit) EU expenses not related with the provision of public goods (in their own, restricted sense), as much as possible – and by the existing decision making rules.
- Finally, the spillback scenario would entail a further reduction of EU's own resources as a percentage of GNI, the curtailment of both the CAP and cohesion policies and only a slight increase in the 'competitiveness' heading. The validity of this last scenario would have been great were it for different economic and political circumstances. However, the current economic crisis has greatly contributed to the legitimization of views stressing the merits and the necessity of fiscal activism in social policy. In this context, then, it is reasonable to expect that -

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EU its own tax, with perhaps some flexibility for the budget authorities to decide on the rate. In between lie proposals for hypothecating a share of some EU-wide existing tax (as with VAT) to be paid over to Brussels. This is the approach currently being advocated in the European Parliament. While an intellectual case can be made for such an EU tax, it would be strongly resisted by many Member States, including the UK, and would hardly make the EU any more popular.

most - EU players will adopt a more positive stance towards EU expenditure in the social realm and that additional cuts in the EU budget will be ruled out.

#### **IV. *The budgetary means for social Europe after 2013; the more suitable strategies***

Regarding the CAP, there are essentially three strategic directions. The first is to shift some or all of the burden of agricultural support from the Community budget to national budgets. A second direction for reform is to change the policy itself. The third, more radical strategic approach would be not to have a common policy (Begg, 2007; 19-20). In our view, the second strategic option is both more feasible and desirable. However, the issues raised by the continuation of the 2002 reforms go well beyond the task of this paper<sup>9</sup>.

Cohesion policy offers the appropriate framework to implement the place-based policy model and tackle the challenges facing the Union, but for these challenges to be met several key-components of the policy must be reformed. The reform strategy advocated by the Barca report (2009), articulates a number of – highly commendable - proposals organised on the basis of the following principles:

1. concentrating resources on a few European public goods<sup>10</sup>;
2. developing a genuine and binding strategic dimension of cohesion;
3. promoting experimentalism and mobilisation of local actors;
4. upgrading the Commission<sup>11</sup>; and
5. reinforcing political checks and balances at the EU level

Following the current economic crisis, calls to strengthen the social dimension of Europe are intensifying. Yet there is no obvious common European vision on which to build. Furthermore, finding common ground at the European level may well become even harder because the speed at which member states will recover from the crisis is likely to vary considerably more between countries than did the timing of the initial economic shock of the crisis. On top of that, there is a risk that currency devaluations and sector-specific support measures designed to save jobs in one country at the expense of another country might poison relations within the EU and between the EU and other economies.

As it has been argued, the situation on European labour markets – and in EU treasuries - may readily destroy the most important conceptual pillar of European employment policy beyond pure regional policy: the notion of flexicurity<sup>12</sup>. Against this backdrop, the European partners will be confronted with a major strategic decision: whether actively to promote an ambitious flexicurity strategy, or whether to develop a less controversial

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<sup>9</sup> Should farmers be supported in proportion to the size of their farms, irrespective of their wealth and income, should payments be capped at some level, or should the policy be more of an income support measure for poorer individuals in line with recent reforms? If the rhetoric about supporting the rural economy, preservation of the countryside and sustainable development is to be believed, should CAP spending become increasingly, or even exclusively, rural development, rather than direct payments (Begg, 2007; 19)?

<sup>10</sup> Six candidates for the choice of core priorities are examined: *Innovation* and *Climate change*, with a predominantly efficiency objective; *Migration* and *Children*, with a predominantly social inclusion objective of efficiency and social exclusion; and *Skills* and *Ageing*, where the two objectives are of similar relevance.

<sup>11</sup> In particular, a significant investment in human resources and afar-reaching internal reorganisation are needed.

<sup>12</sup> Not only will the benefits of flexibility be called into question by a public whose trust in conventional economic wisdom has been weakened by the crisis, the promise of security to cushion the adverse effects of greater flexibility will also rapidly lose credibility in view of rapidly mounting public debt, severely curtailing the ability of governments to offer more substantial support and economic security to those who lose their jobs.

agenda based on longer-term challenges that also have a crisis dimension, such as ageing, migration and labour mobility (von Weizsäcker, 2009; pp. 74-77).

An ambitious and intensified flexicurity strategy would have to balance the flexibility and security elements. In addition, it would have to be sufficiently versatile to be meaningful within the great variety of social models present in Europe today. This strategy would have to be backed up not only by the open method of coordination but also by supporting reforms of the ESF and, in general, EU labour market and social expenditure, as well as by significant legislative action to achieve credibility and effectiveness. On the security side, a focus on minimum work income could be an attractive alternative to approaches focused on the contentious issue of the minimum wage. The minimum work income would be defined and mostly financed at the national level. While the mechanics of such schemes will always have to be tailored to the institutional characteristics of national welfare states, the creation of a common framework and a joint social commitment at the European level could go a long way towards balancing the efficiency and equity objectives of the flexicurity agenda in a climate of post-crisis mass unemployment.

Given the reluctance of member states to support greater EU involvement in the flexicurity agenda, an alternative course of action would be to pursue an agenda which would focus on ageing, migration and labour mobility – that is, three areas that have a pressing crisis dimension while also being decisive for the longer-term future of the EU. The budgetary dimension of this more modest strategy would combine the decentralisation of decision-making on the use of ESF funds with the centralisation of the monitoring and evaluation functions. Specifically, ESF spending could move increasingly towards block grants, thereby leaving the geographic distribution of the funds largely untouched while paying heed to the subsidiarity principle. However, such a move should be complemented by a much stronger monitoring and evaluation role for the Commission. Such credible ex-post controls would not only help with joint learning but would also create much better incentives for member states to spend EU taxpayers' money wisely.

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