Rebalance the Lisbon Strategy by strengthening the social pillar

ETUC Resolution to the EU Spring Summit 2004

Resolution adopted by the ETUC Executive Committee in their meeting held in Brussels on 17-18 March 2004

1. In the aftermath of the terrible events of 11th March, the ETUC urges the Irish Presidency to keep the Lisbon Strategy follow-up at the top of its agenda for the Spring Summit on 25 and 26 March. The need to restore confidence by taking concrete measures to support the economy is now greater than ever. Major efforts are required to enable Europe to become, by the year 2010, the most competitive and dynamic knowledge-based economic area in the world – an economic area with sustained growth, more and better jobs and greater social cohesion! It is already apparent that important interim growth and employment targets will not be achieved by 2005. The European Commission, in its report for the Spring Summit, openly admits, among other things, that the goal of raising the employment rate to 67% by 2005 can no longer be achieved.

2. The causes of Europe's weak growth and associated labour market problems are predominantly "made in Europe"! The ETUC has repeatedly called for a balanced macro-economic policy mix and a sensible implementation of the Stability and Growth Pact. The ETUC is also concerned at the one-sided policies conducted by numerous member states which, relying exclusively on narrow structural reforms, conduct what are in essence purely supply-side policies designed to increase flexibility, deregulate labour markets and dismantle welfare services. Such policies erode the confidence of consumers and workers in Europe.

3. The ETUC explicitly welcomed the Lisbon Strategy and has on several occasions called for its effective implementation[1]. But the trade unions reject the one-sided use of the Strategy to legitimise neo-liberal policy approaches. The Lisbon Strategy must be implemented in a manner that is economically, socially and ecologically balanced.

4. Against the background of EU enlargement and in the context of the European Economic Area, we need, more than ever, a

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1 See most recently the resolution adopted by the ETUC Executive Committee on 4 and 5 December 2003 : "Give the recovery of the European economy a chance : relaunching the Lisbon strategy''.

new economic policy direction, one that accords equal weight to the supply and to the demand sides and which puts the social dimension of Europe back in the centre of policy making. Only in this way can the employment rate be raised to 70% by the year 2010, for such progress requires 15 million additional jobs in EU15 and as many as 22 million in EU25. Only a perceptible change of policy direction will restore working men and women's confidence in Europe. Only in this way is it possible to strengthen the consumer confidence so urgently needed for an economic upturn based on the internal market and to allow the huge private savings surplus, amounting to 3.8% of GDP, to be channelled into investment and consumer activity.

Europe must achieve its growth potential

5. Urgent action needs to be taken in order to support sustainable growth. The expected recovery lacks conviction so far and is being threatened by turbulence on the exchange markets. Domestic demand needs to take over and play a leading role in securing the recovery.

6. The policies of the European Central Bank (ECB) must, given low inflation, take account of its obligation to foster growth and employment. The interest rate reductions decided by the ECB came too late and were excessively timid. A further cut in interest rates is required to give the economy a strong and enduring boost.

7. Lisbon will only be reached when the Stability and Growth Pact (SGP) becomes a stability and growth Pact for more and better jobs. A continuing restrictive fiscal policy can only jeopardise the opportunities for economic revival. We need an intelligent and flexible use of the Stability Pact. The Spring Summit should give out a clear signal so that the requisite public investment can be fostered rather than inhibited and the member states can effectively stabilise their economies without imperilling the long-term balance of their national budgets. In its December 2003 resolution, the ETUC's Executive Committee made practical proposals for a sensible reading of the SGP [2]. Moreover, we also need a better coordination and harmonisation of certain tax policies in order to avoid competitive tax dumping on company taxes, savings taxes and green taxes.

8. The ECB also has a primary responsibility in preventing a further acceleration of the value of the Euro. The Commission and the European finance ministers (ECOFIN) must reach

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2 See Resolution of the ETUC Executive Committee : 'The suspension of the Stability and Growth pact : The Stability Pact must become a stability <u>and</u> growth pact'(December 2003).

agreement on exchange rate guidelines designed, among other things, to stabilise the exchange rate between the euro and the dollar. Here too the ECB has a decisive role to play.

9. The ETUC reiterates, in this connection, its support for the European growth initiative, referring once again to the need for significant progress with regard to its financing and for important fields – such as investment in human capital, environmental technologies, and investment in social and ecological town-and-country-planning initiatives – to be taken into account.

10. The ETUC shares the Irish Presidency's view that environmental technologies can make an important contribution to technological innovation and at the same time strengthen competitiveness, open up new markets and create new skilled jobs. In their *Manifesto for sustainable development: investing for a sustainable future*, the ETUC, together with the European Environmental Bureau (EEB) and the Social Platform of NGOs, have presented to the Spring Summit specific proposals for sustainable investment in the fields of housing and transport[3].

Unleashing Social Europe's employment and productivity potential

11. In spite of some progress towards the higher employment rate targets, we are still a long way from the goal of raising the general employment rate to 70% by 2010. Large areas of European employment potential continue to lie fallow. The Commission no longer considers it feasible to raise employment to 65% by next year. Unemployment, meanwhile, has risen once again and is currently over 8% on a European average. Still particularly shocking is the situation of young people, among whom average unemployment in Europe is as high as 17%. Among older workers the employment rate is about 40%. If the 50% target is to be reached by 2010, it requires the creation of 7 million jobs for people aged between 55 and 64. Against this background the discussion in several member states about raising the statutory retirement age is entirely beside the point.

12. Although some progress has been recorded in the efforts to raise the employment rate among women – now at 55.6% – the measures adopted to reduce gender segregation on the labour market are utterly inadequate. The gender pays gap remains as high as ever at 16% – and in the private sector it is

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3 ETUC, EEB, Social Platform : Manifesto for Sustainable Investment : Investing for a Sustainable Future.

as much as 21%! In the view of the ETUC, a specific equality plan needs to be drawn up to combat gender discrimination effectively. Such an action plan must include means to ensure that society and labour markets develop in such a way that women and men have equal possibilities of entering the labour market: i.e. ensuring adequate child care facility, paid parental leave, improved working conditions and working hours.

13. Labour productivity trends are disappointing. Productivity growth has slowed significantly and in 2003 it was only 0.6%. To some extent, of course, this slowdown is the result of weak economic growth; but other factors, such as pay restraint, the decentralisation – not always planned – of collective bargaining, employers' 'flight' from federations, the growth in non-standard forms of employment, and inadequate investment in human capital, are equally responsible for the unsatisfactory productivity developments. Active labour market policies which compel the unemployed to accept jobs that are quite incompatible with their qualifications cannot fail to have adverse effects on productivity.

14. In those cases where the social partners have taken responsibility for further training and lifelong learning, a much better outcome can be observed. In companies with collective agreements more than half of employees take part in training programmes; in companies without a collective agreement, the proportion is less than one third[4]. Firms must find a way out of the vicious circle of insufficient investment in training, if the productivity potential of European employment is to be unleashed. A more systematic implementation of the Framework of Actions for the Lifelong Development of Competencies and Qualifications, agreed at the European level by the social partners, will contribute to bridging the knowledge gap of the workforce and of workplaces.

15. So not only is a new economic policy direction is required, Europe also needs a new, and more positive innovation and structural policy.

Encouraging innovation and social partnership

16. The ETUC welcomes the Irish Presidency's emphasis on innovation and social partnership as vital to successful implementation of the Lisbon Strategy. Innovation in the field of new products and production processes is the key to the future of the European social model. A unilateral focus on strengthening the competitiveness of European businesses is not the way to achieve successful and lasting innovation. In

4 Source: Communication from the Commission on Improving the quality of work – Com(2003)728 final, November 2003

this respect, the ETUC recalls its earlier proposals and demands:

- a significant increase in public and private R&D expenditure to reach the target of 3% by 2010
- adequate investment in human capital in order to achieve the benchmarks set for education, vocational training and lifelong learning
- an innovative industrial policy to be devised on the basis of inter-sectoral and sectoral action plans, involving the social partners.

17. Social partnership, social dialogue and worker participation are not just key elements of the European Social Model but also an important production factor in fostering innovation and implementing a policy of reform attentive to the human factor and geared to the need for social balance. The ETUC has, on numerous occasions, called for a balanced relationship between flexibility and security. At the Spring Summit the Heads of State and Government have once more an opportunity to show that they are not only concerned about flexibility but also about security in the interest of workers.

18. Worker participation, based on effective information and consultation rights, is not an obstacle to, but, on the contrary, a factor operating in the service of, competitiveness. As such the ETUC calls for:

- Prompt revision of the European Works Council (EWC) Directive
- Inclusion of participation rights in the mergers directive on the basis of provisions similar to those contained in the European Company (SE) Directive
- A fundamental revision of the Commission communication on corporate governance
- Amendment of the working time directive to put an end to the opt-out.

19. It is unacceptable for the ETUC that, in the case of the Commission communication on corporate governance and the 10th company law directive, there should have been no prior consultation with the European social partners, according to the Treaty provisions

Conclusion

20. With the enlargement of the European Union on 1 May 2004, the process of European integration will enter a decisively new

phase. In a united Europe economic success must be combined with social justice. Competitiveness, sustainable growth, more and better jobs and social cohesion can be achieved only via the high road of rising productivity, development of appropriate skills and high wages. At the Spring Summit, the Heads of State and Government have the opportunity to embark on a new policy direction and thereby contribute to the success of the Lisbon Strategy. The ETUC and its member organisations are prepared to make their contribution to an economically, socially and ecologically balanced reform strategy.

21. The ETUC has serious doubts about the establishment of a high-level group to carry out a mid-term evaluation of the Lisbon strategy. Such an evaluation should be performed under the auspices of the Commission. The systematic and timely participation of the social partners is indispensable.

22. The proposal for a 'super commissioner' for economic reforms is not acceptable. This would merely accentuate the one-sided orientation towards implementing the Lisbon strategy. Social and ecological progress would be subject to the dictates of competition policy. This runs counter to the balance and the better coordination between economic, social and ecological policies demanded by the ETUC.

    Instead the ETUC welcomes the Irish presidency proposal to have a 'European partnership for change' as a means to promote innovation and productivity through social cohesion and stronger social dialogue and to support macroeconomic demand policies that will finally kick start the recovery.

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Annex:

- ETUC Background Paper for the Spring Council 2004

ETUC Background paper
For the
Spring Council 2004

I. Introduction

Lisbon is off course. The recent joint employment report openly admits that the mid-term objective of an employment rate of 67% by 2005 can no longer be attained.

Moreover, developments concerning growth and labour productivity are worrying. ‘Lisbon’ should be about building a competitive, fast growing and high level of employment economy on the basis of innovation and high productivity. In the Lisbon scenario, realising high growth is essential to combine intensive job creation with high productivity. In reality however, the opposite is happening. The picture that is emerging in reality is one in which Europe is experiencing low levels of growth, as well as low productivity growth. And although this low level of productivity somewhat softens the blow on unemployment rates, this is clearly not compatible with the Lisbon agenda and not the way forward for Europe.

This background paper argues that these disappointing developments on low growth and low productivity outcomes are not a coincidence, but rather the consequence of decisions taken by European policy-makers. Over the past few years, Europe has pursued a narrow agenda of unbalanced policies:

- Europe has pursued the objective of monetary and financial stability while forgetting about the need to support the dynamics of growth.
- Europe has systematically tried to increase competition on as many markets as possible, thereby playing down the need for policies that organise cooperation in certain areas, in particular concerning the building of the social dimension of Europe or the need to protect services of general interest from increasing liberalisation.

The key message of this paper is that a radical overhaul and re-balancing of policies is vital. If Europe really wants to get Lisbon back on track, then a two-tiered policy must be implemented:

- In order to return to high growth, Europe needs supply <u>and</u> demand policies. This requires urgent action in order to secure the recovery in Europe (see part I).
- In order to support labour productivity growth, Europe needs to respect and make use of the productivity and innovation potential that social dialogue, collective bargaining and European social guidelines can offer. The promotion of Social Europe should be placed back at the centre of policy making (see part II).

II. <u>Achieving</u> Europe’s growth potential

THE MAIN POLICY CHALLENGE FACING EUROPE IS TO ACHIEVE ITS GROWTH POTENTIAL

The official European policy discussion over recent years has repeatedly pointed out that Europe needs to raise its growth potential. Potential growth in Europe (in other words the growth rate that is achievable without causing inflationary pressures) is estimated to be about 2 – 2.3%, which is too low to significantly reduce unemployment.

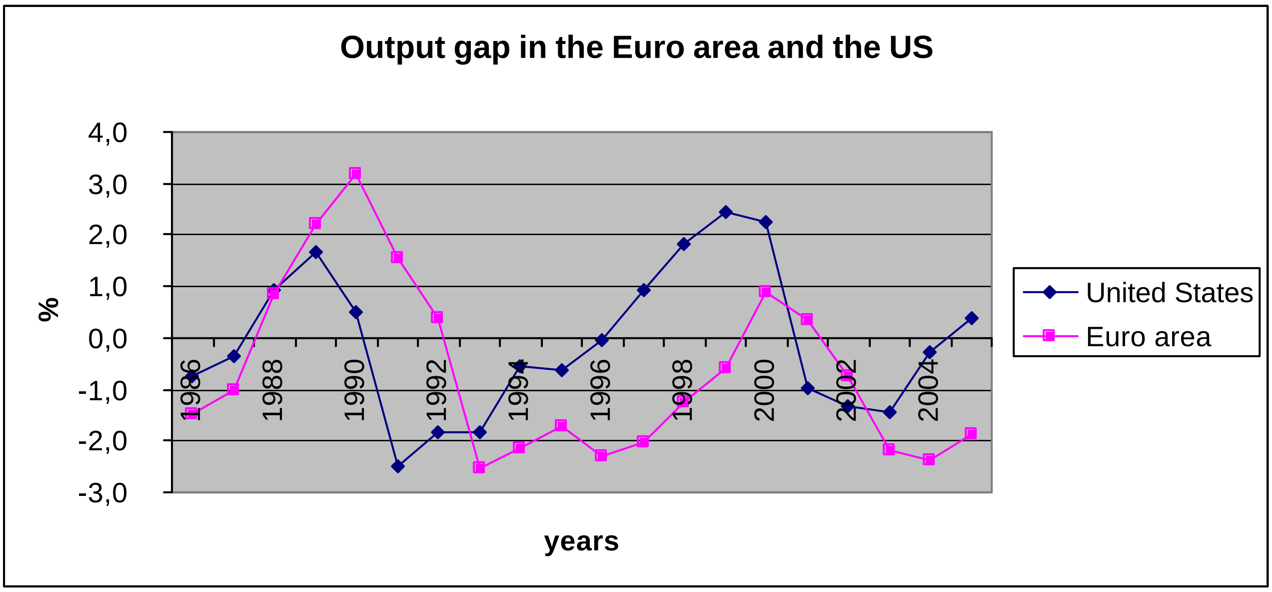
Obviously, a potential growth rate of 2% is an extremely conservative estimate. Indeed, the list of structural reforms that Europe has been implementing over the nineties is rather spectacular: internal market, competition in network industries, structural wage moderation combined with a structural increase in profitability and the introduction of one single currency eliminating currency turmoil within Europe and driving down long term interest rates. Asserting against this background of continuing structural reform that potential growth has actually been falling from 2.8%, over the period 1982-1991, to 2% during the 1990s is incomprehensible!

However, since 2001, the European economy did not even achieve this low estimate of its potential growth rate. For three years in a row, growth has been systematically below 2%. When corrections are made for the leap–year effect, 2004 may well turn out to be the fourth year with growth that is substantially below potential.

This disappointing growth record has introduced a ‘slack’ in the economy that is now comparable with the non-use of productive capacities that emerged after the deep recession of 1993. The OECD in its December Economic Outlook for example estimates that production in the euro area is 2.5% below its potential level for 2004. Graph I presents these OECD figures on the output gap, comparing the euro area with the developments in the US. It appears that the euro area followed the US in the 2001 downturn but did not succeed in following the US in recovering from the slump. Graph II establishes the output gap for the remaining European countries. During the years 2004-2005, the UK, as well as Denmark and Sweden are also confronted with some under utilisation of productive resources in their economy, but certainly not to the same extent as is the case for the euro area. Also notice the fact that the negative output gap is falling in all countries, except for the euro area.

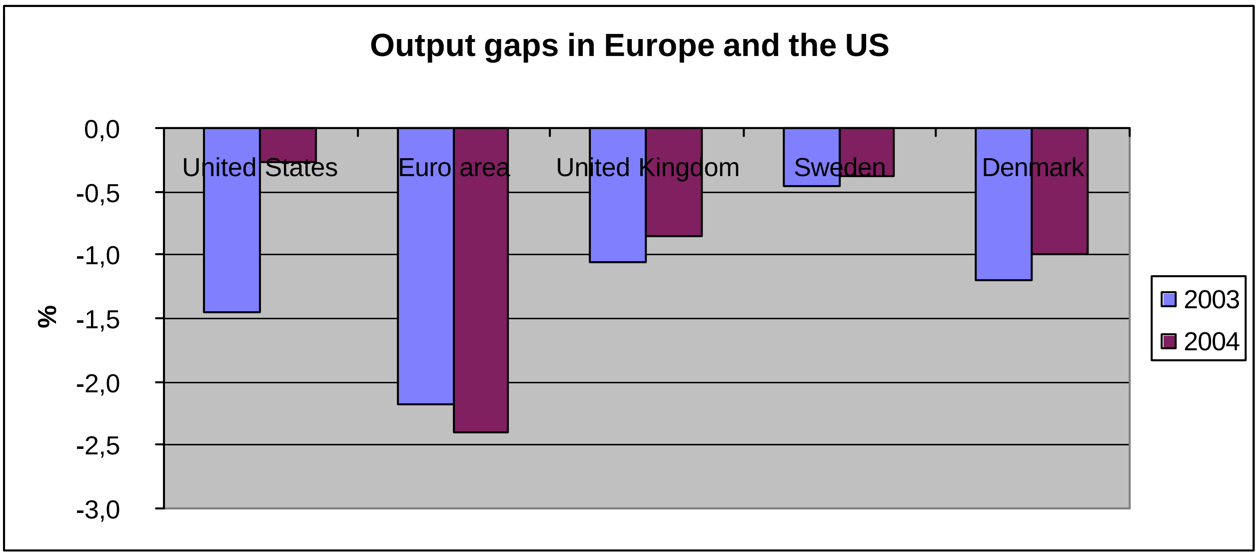
Inside the euro area, important differences also appear (see graph III). The degree of economic slack is not so evident in Spain. Ireland and Greece even appear to have a lack of positive output gap, implying that actual demand and production is in fact exceeding its productive capacities. Germany, and France to a lesser extent, on the other hand are experiencing deeply negative output gaps.

Graph I



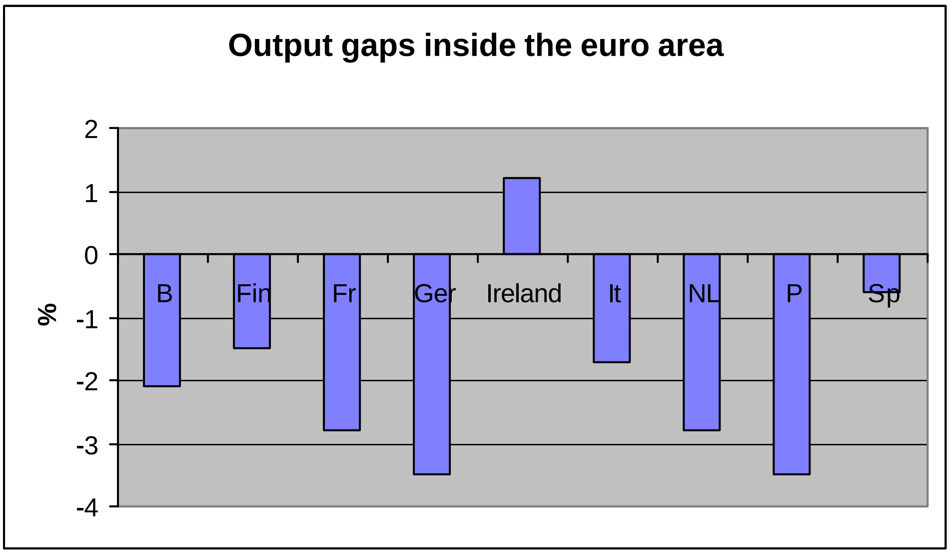
Source: OECD Economic Outlook December 2003

Graph II



Source: OECD Economic Outlook December 2003

Graph III



Source: OECD Economic Outlook December 2003

At the same time, this extraordinary degree of economic slack presents an opportunity. It implies that the European economy is able to grow over the coming three or four years at a growth rate above potential by absorbing the existing slack in the economy. In practical terms, this means that Europe could achieve 3% growth over the coming three to four years, without raising the spectre of inflation and price instability. Europe cannot afford to miss this opportunity. Going further down the path of low growth will:

- result in continuing employment restructuring, faster de-industrialisation and increasing unemployment
- push the euro average deficit over the 3% reference value
- bring us dangerously close to the spectre of deflation
- discourage investments, thereby reducing the capital stock and hence the potential growth rate of the economy itself

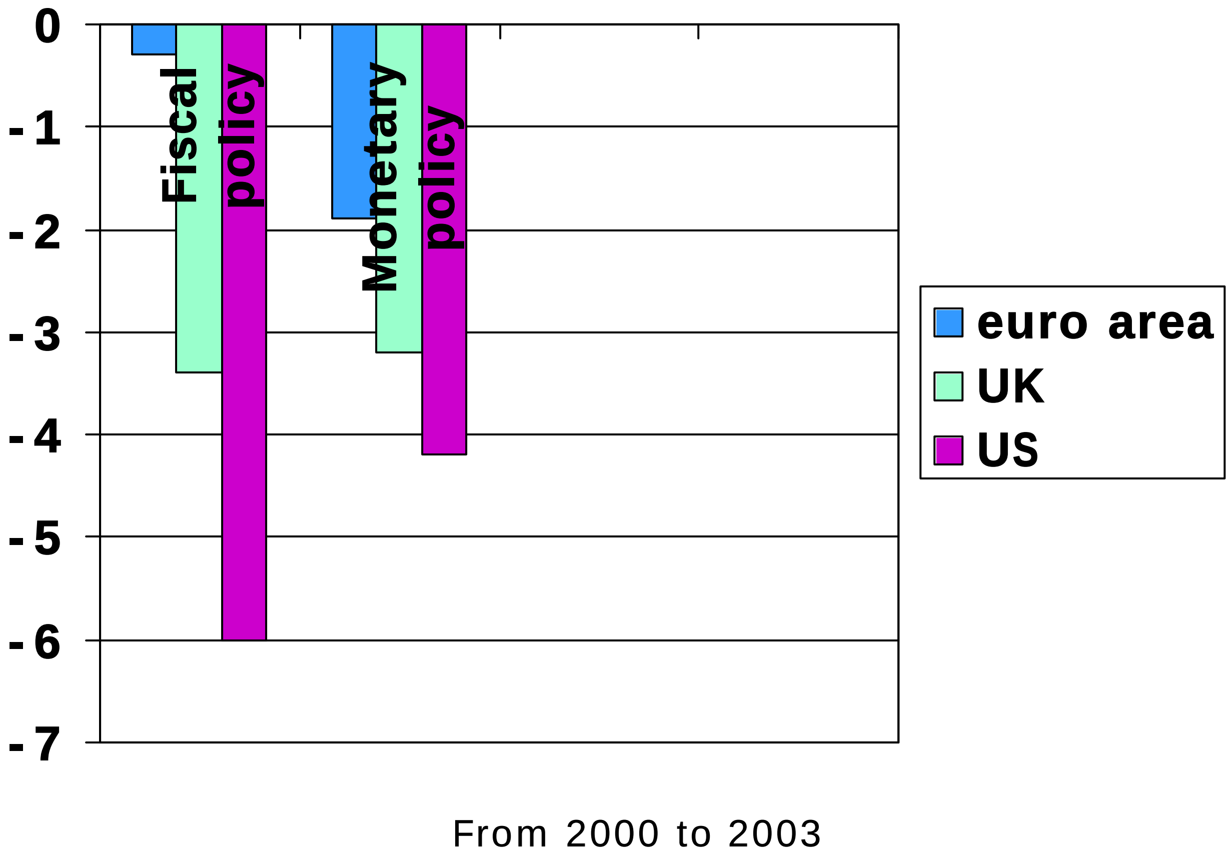
Therefore, Europe urgently needs policies to ensure that the economy will make a sharp recovery from its four-year slump.

…but European policy makers desperately cling to the recipes that got us into this mess in the first place

However, the policy recommendations that have come out of the Lisbon process so far have not been very reassuring. European policy makers, in particular the Ecofin ministers intend to continue to pursue an economic agenda that continues to be focussed completely on the supply side. Price stability, keeping in line with the Stability Pact and structural reform remain the chosen policy options. Responsibility for the demand side of the European recovery is, once again, left into the hands of external demand and the recovery of the world/US economy and in highly uncertain 'confidence' effects that would be triggered by 'structural reform'5.

These are exactly the same policies that have been pursued over the last couple of years and that have failed to shield the European economy from the downturn experienced by the rest of the world. From 2000 to 2003, structural deficits in the euro area have hardly changed, whereas the ECB's interest rate cuts came 'too little, too late'. While both developments do not necessarily point to restrictive policies, they do imply a lack of active support for economic growth. This is clear in graph IV where the fiscal and monetary impulsions that the euro area, the UK and the US have given their economy from the onset of the crisis (2000) up to 2003 are demonstrated. In the UK and the US, both monetary and fiscal policies have been much more supportive of growth than has been the case in the euro area.

Graph IV : Fiscal and monetary policies : change



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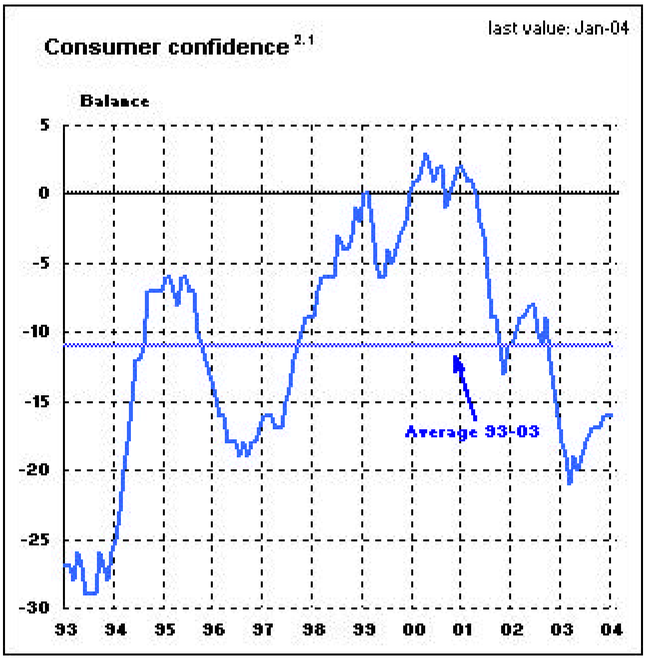
5 Experience in Germany does not confirm this. On the contrary even, the approval of main parts of Agenda 2010 in December 2003 was immediately felt in disappointing consumer purchases.

Continuing on this road in 2004-2005, may well hold back recovery and result in another year of extremely low growth:

- The impact of the recovery in external markets will be dwarfed by the negative impact coming from the appreciation of the euro. First, lagged effects from the appreciation wave that took place from mid 2002 to mid 2003 will continue to exert their negative influence. On top of that comes the recent appreciation (5% since the end of 2003). We estimate (see separate report on the ECB) that this will bring down growth in 2004 to a mere 1.3%. Given the fact that the US core inflation rate keeps on falling and has now reached an all-time low of 1%, a further falling dollar (hence a further appreciation of the euro) may well be a preferred option by the US in order to avoid its economy from tipping into deflation.

- There are already signs that European households are drawing their conclusions from the refusal of policy makers to take responsibility for the management of the recovery. The recovery in consumer confidence, which is still below its long-term average, seems to have come to a stand still see graph V). Most recent figures on retail sales (November 2003) are also disappointing. Workers fear for their jobs and the fact that many governments are pushing through the dismantling of the welfare state does not help.

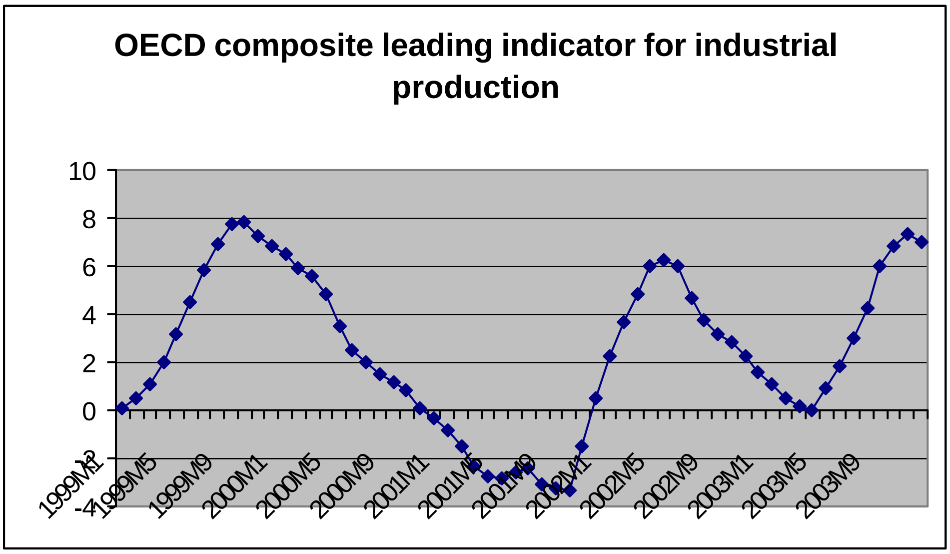
Graph V : Consumer confidence in the euro area



Source: DG II, web site

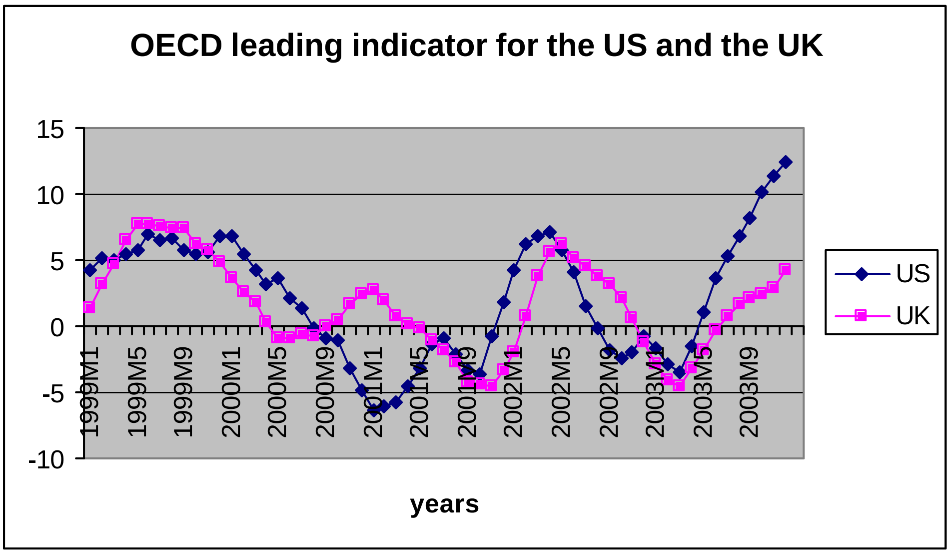
Other recent indicators confirm the fact that the ongoing recovery already seems to be running into difficulties. The OECD leading indicator for the euro area, which foreruns actual industrial production with a time delay of about 6 months, reached a turning point in December 2003. If this trend is confirmed, it means that the recovery may once again have to be postponed in future. This turnaround is not observed in the US or the UK, where the OECD indicator on industrial production continues to strengthen (graph VII).

Graph VI



Source: OECD

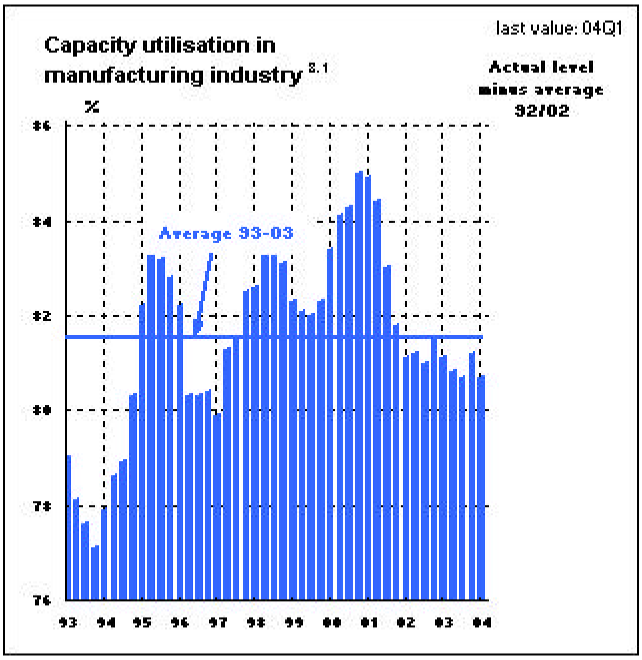
Graph VII



Source: OECD

Finally, capacity utilisation rates in industry in the last quarter of 2003 have fallen back and remain under the long-term average, thereby minimizing the hope that industrial investments would give the recovery a helping hand.

Graph VIII



Source: Web site DGII

WHAT NEEDS TO BE DONE TO SECURE THE RECOVERY?

With no or limited support coming from the external side because of the impact of the euro appreciation, the first line of defence is to make sure that domestic demand takes over.

- There remains scope for monetary policy to support recovery by reducing interest rates. The policy rate in the euro area is still 100 basic points higher when compared to the US. Reducing this interest rate difference would discourage savings and stimulate domestic consumption. It would also discourage speculative flows from low interest bearing dollars into higher interest bearing euros, thereby slowing down somewhat the process of euro appreciation. With the danger of inflation having completely disappeared, there is no reason for the ECB not to pursue its second Treaty mandate, which is to contribute to growth.

- Restrictive fiscal policies would break the already uncertain recovery and must be avoided. The Stability Pact, which in its present form has already proved to be unworkable, must receive an intelligent and flexible reading. The Spring Council should break the deadlock that now exists between European Commission and Finance Ministers on the Stability Pact and should signal the need for ministers to discuss the functioning of the Stability Pact is functioning. In its December 2003 Resolution, the ETUC Executive

Committee made several practical proposals on how the make the Pact a stability and growth pact.

- Avoiding restrictive policies is one thing, having fiscal policies stimulate the recovery in the short run and contribute to the Lisbon's innovation agenda in the medium run is another thing. With a private savings surplus of almost 4% of GDP and an overall savings surplus of 1% of GDP, there is no reason why Europe should not use this savings surplus to invest in its productive base by strengthening research and development efforts and innovation. The Ecofin ministerial council itself claims that an extra investment of 1% of GDP in research and development would add each year an additional growth of ½ % from 2010 onwards. This would mean strong financial return effects in the longer run. In particular, the Spring Council should launch a coordinated and major investment programme of 1% of European GDP in order to make Europe the world leader in the sector of sustainable development by creating a market that promotes innovation and research into sustainable energy sources, clean and safe production techniques, sustainable housing and environmentally friendly transport systems. This investment programme should be excluded from the definition of the public deficit in the Stability Pact.

- In addition, the quick start programme, covering 54 'ready-to-go' cross border investment projects in cooperation with the EIB, should get a 'green light' from the Ecofin council.

The second line of defence is to control and slow down the rate of appreciation of the euro. From its historic low at the end of 2000, the effective exchange rate of the euro has now risen to 28%. Further appreciation in the short run has to be avoided or, at least, slowed down.

- Here again, the ECB plays an important role. The ECB can stabilise the euro/dollar exchange rate by buying up the dollars that are being sold on the exchange markets, thereby increasing its foreign currency reserves. With the ECB 'printing' its own euro money, there are no technical constraints.

- In any case, the ECB should stop its 2003 policy of selling foreign currency reserves, thereby pushing the euro even higher. Over 2003, the ECB has been selling about one fifth of its currency reserves, thereby adding upwards pressure on the euro.

- The management of the euro exchange rate is a shared responsibility. Acting on a proposal from the Commission, the Ecofin Ministerial Council can decide on exchange rate guidelines which, provided there is no threat to price stability, the ECB has to respect. If necessary, the Commission has to exert the responsibility it has been given by the European Treaty.

Unleashing Social Europe’s employment and productivity potential

TRENDS IN LABOUR PRODUCTIVITY ARE DISAPPOINTING…

Part I described how Europe, and the euro area in particular, is grappling with the demand management of its business cycle. But Europe is also doing a poor job on that other issue of the Lisbon agenda, which is the achievement of innovation and high labour productivity outcomes.

Labour productivity over recent years has shown a pronounced tendency to slow down. Seen over a longer time period, the rate of increase in labour productivity has been falling in almost all countries, with particularly sharp falls in Italy and Spain. Only Ireland, Sweden and Greece have seen a rising productivity trend. In Germany, Denmark, Austria and Finland, the slowdown in labour productivity growth (compared with the decade of the 1980s) has been more moderate. In some countries (Italy and the Netherlands), hourly labour productivity did not only slow down, *it actually fell in 2003.*

	81-90	91-95	96-2000	2001-2002	2003
Belgium	2.5	1.7	2.6	1.6	0.9
Denmark	1.8	1.9	1.4	1.6	2.3
Germany	1.9	0.7	1.8	1.6	1.2
Greece	0.1	0.6	2.8	3.1	4.2
Spain	2.8	1.9	0.8	0.8	0.7
France	3	1.5	1.4	1.5	0.4
Ireland	4.2	3.6	5.4	5.1	4.6
Italy	2	2.3	1	0.7	-1
Netherlands	2.2	1.5	1.2	1	-0.5
Austria	2.6	3.4	2.7	2.1	1.4
Portugal	3.3	2.9	3.1	2.3	0.3
Finland	3	3	3.1	2.7	1.4
Sweden	1.1	2.5	2.3	2.1	3.1
UK	2.3	3.1	1.7	1.6	1.1
EU 15	2.2	2.4	1.6	1.4	0.6

Source: European Economy Review 2003, Joint Employment Report 2003

… and are also related to policy choices in Europe

To a certain extent, the deceleration of productivity growth is driven by the slowdown of economic activity, which is inducing corporations to maintain their labour force hoping that the recovery might be around the corner. It might also have to do with the fact that the structure of the European economy has changed and that services (where employment restructuring might be less prone to cyclical downturn) now represent a higher share of GDP.

But other factors are also at work. They have to do with explicit policy choices that have been made in Europe:

- Overall wage moderation in Europe over the 1990s has gone very far. Not only did this result in increased investment profitability, it has also made labour relatively cheaper in comparison with capital. Hence, a process of substituting capital by labour has been triggered. With relatively less capital available for workers to work with in the production process, labour productivity has suffered.

  The Commission documents this in two recent studies6. These studies split up the growth in labour productivity in the impact of capital deepening on the one hand, and the way the production factor of labour is used in the production process on the other hand. This last component is called 'total factor productivity' and represents the accumulation of knowledge and the use of innovative concepts of work. Comparing the first half of the nineties with the second half delivers the conclusion that the slowdown in labour productivity in Europe (- 0.8 percentage point) can be mainly explained by the fact that wage moderation has made workers cheaper and has triggered this process of substituting capital with labour. Two thirds (0.6) of the overall productivity slowdown in Europe can be explained by this. The remaining third (-0.2) has to do with a slowdown in the growth of total factor productivity, implying that Europe has lost out somewhat in its capacity to introduce productivity, increasing innovations in the production process.

Table II

	91-95	96-2000	Difference between the two periods
US Labour productivity	1	1.6	+0.6
Of which total factor productivity	0.8	1.2	+0.4
Of which capital deepening	0.2	0.4	+0.2
EU – 15 labour productivity	2.4	1.6	-0.8
Of which total factor productivity	1.4	1.2	- 0.2
Of which capital deepening	1	0.4	- 0.6

Source: European Economy review 2003

6 European Commission (2002). 'Drivers of productivity growth' in the EU European Economy Review 2003 and European Commission (2003), 'Growth, productivity and employment' in the EU Competitiveness report 2003.

Table II allows a comparison with the US. The US has relied on the opposite mechanism of increasing labour productivity by inserting relatively more capital in the production process. But the main contribution to increasing labour productivity in the US comes from total factor productivity, pointing to the possibility that the US somehow has improved its use of new technologies and innovation in the work organisation. Nevertheless, table II also shows a striking convergence between the US and Europe in the second part of the nineties. The US and EU – 15 figures are similar and overlap each other completely! This qualifies somewhat the popular statement that the US, in particular through its flexible (labour) markets, is a more innovative economy….

- Overall wage moderation has been accompanied by a pressure for decentralised bargaining, for example through uncontrolled opening clauses in sectoral bargaining. Saving employment in firms where productivity is relatively low, has accentuated the economy wide process of substitution of capital by labour.

- In addition, several countries have taken the path of building a low wage/low productivity sector by cutting employer's contributions on low wages ('opening the wage distribution by the bottom') or by other means of subsidising low wage/low productive employment ('services cheques' for example). Again, this has changed the structure of the economy, giving low productive sectors a higher share in the overall economy and thereby dragging the average productivity level down.

As a result, growth has indeed been made more labour intensive, thereby providing a certain relief in the face of the poor growth record. Some of these measures remain valid for those workers for which retraining is not a feasible option. But when applied on a massive scale over all the sectors of the economy, the long-term effects of such measures come into question:

- Incentives for investment in education are distorted. Cuts in employers' contributions on overall low pay scales will stimulate employers to review pay scales and keep as many workers as possible into the subsidised low wage category. Workers with qualifications will tend to find themselves more and more within the lower pay scales, thereby seeing the return to schooling reduced. Also, the existence of abundant job opportunities in low productivity sectors may send the perverse signal to young people that there is not much need to invest in education since many (low productive) jobs are readily available.

- With firms knowing that they will be 'bailed out' by workers in case of difficulties, incentives to invest in innovation and productivity are also distorted.

- Ultimately, competition on the basis of a low wage/low productive strategy is doomed to fail in a globalising world.

THE ROLE OF SOCIAL EUROPE IN INCREASING PRODUCTIVITY: CLOSING DOWN THE LOW ROAD

The picture that is emerging is one in which Europe has produced low growth as well as low productivity outcomes, whilst creating enough employment to keep unemployment from rising rapidly. Europe needs to do better. Europe needs high growth, which, combined with high productivity, would result in substantial job creation.

Social Europe is an indispensable part of this agenda. Social Europe does not only have beneficial effects on social inclusion. By limiting perverse competition on the basis of low wages and bad working conditions, social standards force market forces and corporations to compete on the basis of productivity and innovation. The upcoming Spring Council must acknowledge this. The European social agenda can strengthen the productive forces of the economy on the following issues:

Lifelong learning and competition rules

One area where free competition does not function concerns investment in training of workers in order to avoid shortages of qualified labour.

The need for workers to have access to such training is well established. Studies tell us that increasing the number of workers that have access to training by 1%, results in an increase in productivity of 0.3%. At present, 50% of workers do not have access to training. The gap is particularly wide for low skilled and elderly people, where respectively only 2.3% and 3.3% participate in training. Due to their over representation in atypical work, many women are also excluded from training. There are many negative knock-on effects of this, such as reinforcing the gender pay gap, gender segregation at work, as well as under utilisation of skills and competencies.

Unfortunately, there is an important market failure here. As the recent Kok report of the special task force on employment states, '*business has to break out of the vicious circle of systematically underinvesting in training*'. When left to operate freely, individual firms will be victim of the 'prisoner's dilemma'. They will inevitably refrain from investing in workers' training, hoping to 'steal' them away by overbidding wages in order to attract workers from other employers that do invest in training. Of course, when every firm does so, investment in training becomes sub–optimal and shortages of skilled labour make wages and inflation rise when unemployment is still high.

One way to break out of this vicious circle is through collective negotiations on the sectoral/intersectoral level. In a number of European countries (Belgium, the Netherlands and others) social partners negotiate sectoral collective agreements that force all employers to pay into a sectoral fund that provides training for all sectoral workers, but also for lower skilled unemployed. Such schemes correct this typical market failure and contribute to the Lisbon agenda of high productivity and non–inflationary growth. Statistics confirm the positive role that such collective negotiations can play. In 2000, more than half of the workers in firms that are covered by collective agreements, participated in training programmes. In firms that are not covered by collective negotiations, the share of workers having access to training was much lower, only one third. The number of training hours is twice as high in firms that engage in collective bargaining. It is also important to note that collective bargaining provides improved access to training for lower skilled workers.

Despite the wide consensus on the positive role that collective negotiations can play, the Commission's competition rules target such sectoral bargained outcomes. In particular, the Commission Competition directorate argues that employer contributions, which result from a legally extended sectoral collective agreement, constitute public funds, which are to be considered as illegal state aid when these fund are recycled in the specific sector. The Spring Council has to provide a political signal that the objective of investing in workers' training and lifelong learning takes precedence over competition rules. Instead, such schemes must be supported, for example by providing support from the European Social Fund for such bargaining agreements.

Flexicurity

Competition between the unemployed may also result in excessive flexibility in the form of atypical labour contracts. Although part time, fixed term and temporary agency work provide firms with flexibility and may presented as a 'spring board' to better working conditions, these contracts may also constitute 'low productivity' or 'inactivity' traps, hereby affecting female workers in a disproportionate way :

- Workers with these contracts have a lower probability of getting a full time job and a higher probability of becoming unemployed. 39% of workers on a fixed term contract remain in the same situation after one year, whereas 22% of these workers regress to a state of inactivity.

- Access to training is limited for these workers, thereby preventing upwards job mobility.

- Temporary agency work is concentrated in sectors with a high record of work accidents. Adequate control of agency permits or even exclusion of selected high-risk sectors from temporary agency work is therefore necessary.

- Different forms of discrimination, e.g. social security systems, human resource management, make a – typical contracts less attractive, inciting workers to remain in or to go back to a state of inactivity.

- The artificial promotion of part time work (for example by awarding cuts in employers' contributions irrespective of the number of hours worked) results in a situation in which these workers are systematically refused any access to full-time jobs. Obviously, this is a waste of human capital that eventually may worsen the problem of shortages for skilled workers. It is also a way of cultivating the working poor culture. Again, there is an important gender aspect here with female workers being more at risk. Instead, part time work can be made attractive for workers on the basis of an equal rights approach that strengthens and reinforces the rights and working conditions of these workers.

- In general, employment security is a key determinant of job satisfaction and of a productive work force. Introducing flexibility as such while neglecting security, may well turn out to be counterproductive for the productivity of the workforce.

In order to avoid these perverse effects, flexibility must be accompanied by security. This implies the following 'checks and balances':

- Broadening security to themes such as decent pay, quality of work and access to lifelong learning but also protection against discrimination and unfair dismissal.

- Paying attention to the interplay with social protection and active labour market measures. Denmark for example has no strong employment protection legislation but does have high unemployment benefits. Denmark is also characterised by the fact that corporations do not spend much resources on workers' training. Instead, the government has to step in and provide training and other active labour market measures.

- Involvement of and negotiation by the Social Partners on the balance between flexibility and security.

- Avoiding a dual labour market where 'excessive flexibility' rules in the disadvantaged segment by giving all workers equivalent rights (social protection, access to training, and access to promotion).

- Flexibility in terms of reconciling work and family life may also be beneficial to workers. This involves an agenda of better (child) care facilities as well as paid parental leave in order to allow both men and women to combine professional and family life.It also means curbing long working hours.

The European Council has to respect this approach and cannot simply call for removing obstacles on flexible forms of work organisation without paying full and complete attention to the proper implementation of security dimension. Likewise, with the aim of providing agency workers with a set of guaranteed rights, the directive on temporary agency work must be put back on the political agenda.

Raising the voice of workers: Workers' information and participation rights

'Enronitis' is not limited to the US. European companies are contaminated with the same disease. The recent scandals in Europe have shown that it is working people and savers who pay the price of poor and dishonest management. Therefore, it is unacceptable that all the last-generation Directives of the European Commission are seriously weakening the rights of participation of workers and their representatives.

Experience shows that companies with solid participation structures are able to manage effectively any negative social and economic consequences triggered off by restructuring. Moreover, and in contrast to the short-term interests of financial markets, workers and their trade unions have long-term expectations, which represent an added value due to an increase in company policy stability. Participation represents a factor for competitivity and not a burden to the company.

Therefore, we call for a profound revision of the present Communication on Corporate Governance. In this communication it appears that workers do not exist and that instruments for information and consultation are superfluous in order to ensure that a company is being well governed.

Moreover, the 10^{th} Directive on mergers is even more dangerous as it cancels out the European Company Statute (SE) provisions. This proposal in fact contains a provision that severely undermines the result reached with the SE Directive by allowing negotiations only in cases where no participation exists at all. Taking into account the very different systems of participation in the EU Member States, this means that the lowest level could be chosen for the merger of companies. Reducing the level of workers' participation clearly contradicts the fundamental EC Treaty provision calling for improved working conditions, in order to make possible their harmonisation, whilst also maintaining improvements. Consequently, the ETUC demands that the provisions in the SE Directive be maintained in cases of cross-border mergers.

For the same reasons, the ETUC is calling urgently for the revision of the European Works Council (EWC) Directive, already delayed for five years by the Commission, which is aimed at improving information and consultation rights at international level.

Finally, the ETUC stresses that these proposals, both for the 10^{th} Directive and the Communication on Corporate Governance, have been carried out without any prior consultation with the Social Partners. Consequently, not only workers' rights are weakened, but also the role of the Social Partners and the provisions of Article 137-138 of the Treaty are seriously undermined.

Working time

Working time is another area where common social standards can lead to a better social and economic outcome. Having workers compete on the basis of long working hours will lead in the longer run to an abused and exhausted labour force, undermining the concept of active ageing. There is also a more short-term relationship between working hours and productivity. Experience with labour time shortening, for example in France and Germany, shows that shorter working hours does boost productivity. In fact, France (35 hour week) is one of the few countries that did not experience a fall in hourly labour productivity over the 1990s.

Therefore, Europe should seriously the directive on working time and bring an end to the opt–out regime.

Industrial policy and social restructuring

Europe is confronted with a significant trend of de–industrialisation. This trend needs to be addressed. A core of industrial activity needs to be retained in Europe. Industrial production, even if it is capital intensive and no longer directly creates massive industrial employment, remains important for its links with the rest of the economy, in particular for the sector that is delivering services to industry. One job in industry represents a multifold of jobs in other parts of the economy.

At the same time, industry in Europe must choose the road of quality and innovation. Low labour costs and low social/environmental standards are not a (long term) solution. To push through this agenda of innovation and industrial policy, workers and trade unions must be consulted. The Commission, in cooperation with social partners must develop sectoral reconversion plans with the aim of safeguarding the most important industrial activities in Europe. This is linked to the major investment plan in sustainable development (see above).

The wave of employment restructuring that is hitting Europe must also be dealt with. Here, the Social Partners at the European level need to start discussions on industrial restructuring. These discussions have to be supported by the Commission and the Council, for example by setting up a European Restructuring Fund that provides financial input to collective agreements on employment restructuring that provide training and active labour market measures for retrenched workers.

Innovation, the knowledge society and social dialogue: Social capital instead of an economic supervisor

Several Heads of State are making a plea for a 'super-Commissioner', responsible for economic reform, who would coordinate and 'have a voice' in the work of other Commissioners. At the same time, proposals are made to assess legislation, including social and environmental, on its impact on competitiveness.

Such an approach threatens to turn things upside down. Again, we repeat that Lisbon has several and equally important pillars: growth and competitiveness, but also good quality jobs/high productivity as well as social inclusion. And while growth might provide more means to increase social inclusion, the opposite is also true, for example through training and adequate social benefits, increased social inclusion can provide the basis for higher growth. Creating a 'super economic reform' Commissioner does not respect the equilibrium in the Lisbon strategy. Making employment and environmental initiatives dependent on the dictate of 'economic reform' will block the social, as well as the sustainability, dimension of Europe.

Instead of following a model that is based on 'systematic distrust' by those actors that are responsible for economic reform, policy makers should defend and promote the building of 'social capital'. Indeed, the ability to work with and trust each other is crucial for a 'knowledge society'. Learning from others and competence building is difficult, if not impossible, when groups of workers are extremely divided or where rigid hierarchical structures and corruption are present. For example, workers that are insecure about their job and regard their fellow workers as competitors for their job place will not share their 'knowledge' about the production process and the firm's products, but will guard it for themselves. Also, structural dialogue between social partners on reforms and their social implications will increase the perception that costs and benefits are more equally shared, thereby increasing the willingness for change.

Therefore, combating social segmentation, preventing the widening of income inequalities and social dialogue are essential conditions for stimulating innovation processes. This is the right innovation agenda that should be pursued by policy makers.

A special action plan on gender

Achieving the Lisbon objectives will depend to an important extent on the success of a strategy that seeks to increase the employment rate of women. Therefore, a special gender action plan is needed, that combines different policy axis:

- The reconciliation of work and family life, for both male and female workers, in areas such as child and elderly care, paid parental leave, maintained social security rights and improved working conditions and working organisation, such as reasonable working hours.

- Special attention to the implementation of the existing directives on equal treatment and initiating new proposals for directives.

- Increasing access to training for workers in atypical statutes (where women are over-represented and which has detrimental effects on the gender wage gap.

- An action programme with objectives, targets, timetable to tackle the gender wage gap

- Negotiations on a framework of action for gender equality

- Special focus on improving the quality of work and on multiple discrimination (young,old,migrant,ethnic female workers).

Tax competition and the savings directive

Building a competitive and innovative economy implies a key role for government, but government cannot function without resources. When confronting the enormous range of challenges raised by the Lisbon agenda, European governments just cannot afford another round of competitive tax dumping. The savings taxation directive, which offers Europe the opportunity to shift some of the tax burden from workers to the factor of capital, should not be allowed to become blocked on the issue of some small third countries that refuse to cooperate. In the field of company taxation, a minimum tax tariff on profits has to be decided upon in order to avoid that different governments would be played out against each other by the interests of international capital.

Enlargement

On 1st May 2004, 10 new member states will enter the European Union. This will increase the relevance of this paper's proposals even more:

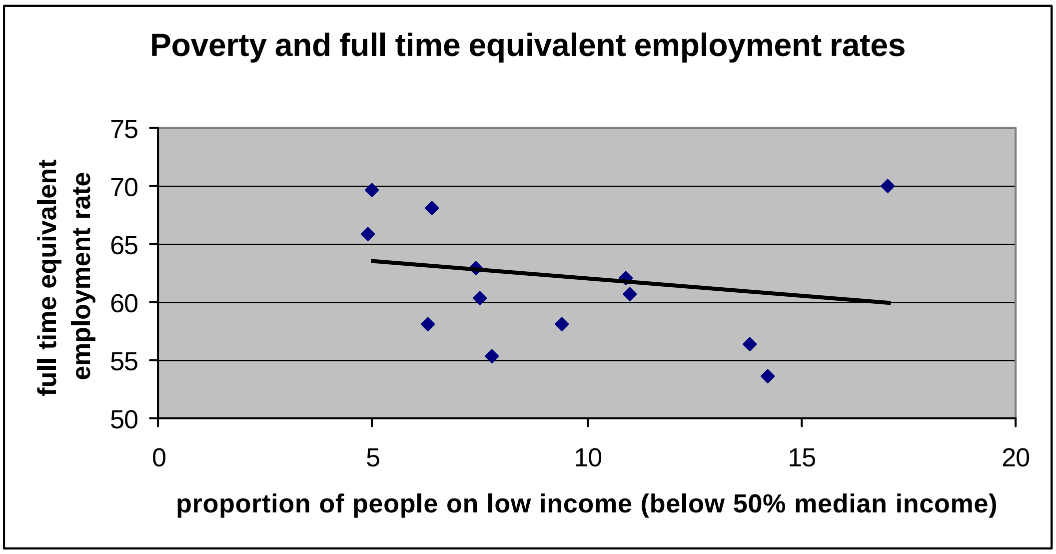
- The making of an enlarged European market will increase productivity, adding to disinflationary forces and stressing even more the need for expansionary aggregate demand policies. If workers lose their jobs due to the relocation of production, then macro policies have to make sure that the rest of the economy is sufficiently dynamic to take displaced workers back on board.

- The absence of social Europe will lead to competition, not only between the EU – 15 and the accession countries but also and importantly between the accession countries themselves.

- Rules to limit tax competition on capital income and business profits will be particularly necessary to prevent accession countries from being drawn in a downwards spiral that ends in a 'tax-free lunch' for business and high taxes/low social protection for workers.

Social cohesion

Employment is important to combat social exclusion and poverty. But the link between job creation and reducing poverty is not always guaranteed. The following graph (which includes EU countries except Spain and Portugal and includes US) illustrates this clearly. Poverty at work does exist and narrow 'making work pay' policies may well reduce 'poverty traps' while at the same time resulting in higher poverty rates.



Source: EC, OECD

Social Europe can certainly reinforce the Lisbon's employment and productivity agenda. But if the goal of social cohesion is to be reached, specific social policies are needed. Economic policies are no substitute for social policies.

III. In which direction is the March Spring Council going? (Summary of draft conclusions of the Spring Council)

The central message is to 'speed up significantly the pace of reform' and 'to pursue reform across all areas'. At the same time, the Spring Council selects 'sustainable growth' and 'more and better jobs' as the two priorities that need special attention.

On 'growth', the draft conclusions acknowledge that the main challenge facing Europe is to realise its growth potential. This is indeed a radical change from previous messages that systematically considered the issue of raising the growth potential of Europe and stayed rather quite on effective growth itself. Unfortunately, the measures being considered (budgetary consolidation in line with the Stability Pact, structural reforms to boost confidence), will not be effective and may even be counterproductive in supporting effective growth in the short term.

On ‘jobs’, obstacles on ‘flexible’ work are to be eliminated (while ‘ensuring adequate security’), tax/benefits to be reconsidered in order to make work pay and gender pay gaps to be addressed. The process of employment guidelines should be tightened by making country specific recommendations. Disturbing is the fact that the paper assumes that there is a strong, automatic link between higher employment rates and social inclusion.

However, the draft also puts forward a third issue. In fact, ‘competitiveness is receiving more attention than growth or jobs.

- Strengthen the structure and the role of the Competitiveness Council in the next Commission.
- More competition in services. General agreement on the services package by the 2005 Spring Council.
- Political agreement on the mutual recognition of professional qualifications by June 2004 (!)
- Compliment the ‘regulation’ letter of the four presidencies with a follow-up programme.
- Increase business investment in research and development by providing specific incentives and secure a greater leverage of private funds in public sector investment.

Finally, countries should build national Reform Partnerships (with social partners and civil society), to be complimented by a ‘European Partnership for Change’ (a commitment <u>by</u> the European social partners!). Another high-level group must identify measures to strengthen the Lisbon agenda (in the context of the mid-term review).

Comparing the Council draft with the Commission’s initial Spring Council Report reveals that a number of proposals have disappeared into the background:

- The reinforcement of training and life long learning by the private sector and the reference to the Social Partners’ framework for action on lifelong learning.
- The call on Social Partners to discuss an agreement on industrial restructuring.
- Access to training for all and improving the quality of work.

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