

Review of European Economic Governance (ETUC position)

Adopted at the ETUC Executive Committee on 2-3 December 2014

The European Commission will review the framework of European economic governance in a communication to be published next month. With this note, the ETUC intends to contribute to this review. The note first provides a short and general evaluation of European economic governance, and then recommends a number of substantive changes and different policy approaches which the ETUC believes are required to deliver an effective European economic governance framework.

I General evaluation of European Economic Governance

A European single market, and even more so a single currency, needs common rules to closely coordinate member states' national economic policies. As shown by the euro crisis, a monetary union where member states go in divergent directions with one part of the union going for competitive wage disinflation while another part is allowing an inflationary boom to take ground, is simply not sustainable. While all of this is indisputable, the ETUC is also of the opinion that the system of European economic governance, as it exists today, is unbalanced and urgently needs to be reformed.

The key problem is that in today's European economic governance, the focus is on fiscal stability (cutting public deficit and public sector debt) and cost competitiveness ('competing against each other by cutting wages'), while the objectives of economic recovery, sustainable growth, more and better jobs, and social cohesion receive far too little attention.

This is resulting in dismal outcomes: Europe, the Euro area in particular, has endured a double dip recession. Its economic recovery is too weak and is in danger of evaporating. Unemployment rates are at a record high and barely falling. Poverty and inequality are on the rise in many member states.

This excessive focus on 'stability' and 'cost competitiveness' generates the opposite of what it intends to achieve: with inflation rates almost touching the bottom line of zero and the IMF recently pointing out that the Euro area is the only region in the world facing a high (30%!) probability of falling into outright deflation, the objective of price stability is now being threatened by this excessively low inflation rate. Here, Europe should learn from the experience of Japan and understand that once an economy falls into deflation, it is extremely difficult to get out of deflation and its associated depression.

Going beyond these considerations and looking at the longer term, it is also clear that a monetary union cannot be run without also effectively running some form of Fiscal and Economic union. Without such fiscal and economic union, the whole burden of adjustment will fall on wages and working conditions and this will end up by seriously weakening workers' support for the European Union.

Finally, any system of economic governance will remain far from complete if the role and the remit of the European Central Bank remains unaddressed. European economic governance will only produce the outcomes that workers and trade unions want if the ECB effectively pursues a double mandate of defending price stability as well as a high level of employment and growth. Amongst other things, this implies that instead of pushing member states into deregulating their economies and labour markets, the ECB should take up the role of shielding euro area governments and sovereign debt from financial market speculation in a more convincing way.

II ETUC proposals for rebalancing Economic Governance

To rebalance European economic governance, the ETUC is putting forward the following proposals.

a) The basic principles must be revised

European Economic Governance needs to take a fully 'symmetrical' approach. The principle should be that countries with a surplus on their external trade have to shoulder their part of the burden of rebalancing the single currency. An economic governance which puts all, or almost all, of the costs of adjustment on the shoulders of the 'debtor' nations is not sustainable.

Adopting this 'fully symmetrical' approach implies, amongst other things, completely changing the formulation in Article 3.2 of the Regulation on the prevention and correction of macroeconomic imbalances stating that "The assessment of Member States showing large current-account deficits may differ from that of Member States that accumulate large current-account surpluses"¹.

Firmly embed the principle of a 'counter-cyclical' macroeconomic policy stance. Despite the claim that the rules on fiscal stability are already flexible, there is still too little consideration given to the state of the business cycle. The consequence is that fiscal austerity is still being imposed on economies that can ill afford it. Instead of outright pro-cyclical policy (trying to cut public deficits when the economy is still in a dismal state), Europe needs to move to a 'counter-cyclical' policy by adopting the principle of 'policy sequencing'. If the economy is in crisis (recession or a weak recovery), the priority should be to invest to get the economy out of the crisis. Once a strong recovery has a firm footing, then the focus can shift towards the objective of public deficit and public debt reduction.

This should be done by increasing the degree of flexibility in the Stability Pact by:

- adopting the rule that if an economy is in crisis and clearly operating below its full capacity, the rules of the Stability Pact should no longer impose cutting the structural deficit by 'at least' 0.5% of the GDP but instead allow the postponement of structural fiscal adjustment until the economy is in better shape and closer to a more normal level of economic activity.
- reviewing the way the Commission is calculating structural deficits. At this moment, increases in unemployment are being almost fully reflected in the Commission's estimates of structural unemployment. This is resulting in overly pessimistic estimates of structural deficits which, in turn, increases the pressure to continue with fiscal consolidation policy, even in the midst of a serious depression.
- adopting, if necessary, longer transition periods when trying to adhere to the rule that debt over 60% of GDP needs to be reduced to that level within a period of 20 years.

End the bias against public investment. It is widely accepted that private sector agents (corporations, households) can finance investment by taking on more debt. However, the rules of the Stability and Growth Pact² governing public finances make it very hard, if not impossible, for member states to finance their public investments through debt issuance. This introduces a bias against public investment that is weakening our economies, both in the short run (lack of aggregate demand) as well as in the longer run (lower growth potential due to insufficient public infrastructure and networks). It also works to push public services and public investment into Private - Public - Partnerships (PPP's) with the associated danger of increasing the costs for the public sector over the long term while privatising the benefits of such projects by installing private monopolies.

¹ Regulation (EU) No 1176/2011

² Structural deficit of no more than 0.5% of GDP, public deficit below 3% of GDP, annual reduction of public debt rate

The ETUC therefore recommends the adoption of a 'Golden Rule' excluding public investment from the calculation of the deficits that are taken into account by European Economic governance. In this respect, national co-financing of investment expenditure done under the European Structural Funds should be taken out of the public deficit or debt statistics when evaluating conformity to the fiscal rules of European Economic governance.

b) Look at the Euro Area as a whole

The European economic governance system currently publishes a specific in-depth study on the Euro area, as well as specific Euro area recommendations. These, unfortunately, largely reflect the sum of policy advice given to individual Euro area member states and comprise little more than a call for each country to respect its deficit target and engage in more structural reforms.

However, the sum of policies pursued by individual member states does not necessarily equal the outcome for the whole of the Euro area. If one member state applies austerity and/or wage squeezes, then that member state can hope to rely on exports for keeping up its growth and job dynamics. However, if all member states do so at the same time, they will be making things much worse by undermining each other's exports. This approach is known in economic terminology as 'the fallacy of composition', and should be avoided. To assess the outcomes for the Euro area as a whole, attention should be paid to:

Avoiding a bias in favour of 'deflation', caused by national wage formation processes that lead to a unit labour cost development for the whole of the Euro area that is below the ECB's target for price stability ('inflation below but close to 2%').

The stance of fiscal policy for the Euro area as a whole.

The impact of the overall Euro area current account surplus on the exchange rate of the single currency and the risk of the latter being systematically overvalued.

c) Put the social dimension at the heart of European Economic Governance

The European Treaties, together with the Charter of Fundamental Rights, contain a number of important social principles that require the European Union to promote employment and to improve and harmonise living and working conditions (TFEU article 151), and to promote social justice and protection (TEU Article 3). There is also a horizontal social clause which requires the Union to take into account the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, a high level of education and protection of human health (Article 9 TFEU) as well as the Protocol on Services of General Interest (nr 26) when defining and implementing its policies.

The current system of economic governance does not take into account the social principles described above. It is a 'stand-alone' system that focusses solely on economic objectives such as public deficit and debt targets or external trade deficits without recognising in any way the social principles described above. As such, it is also seriously delinked from the EU 2020 strategy and its goals of more and better jobs and lower poverty. The result is that the new competences obtained by the system of economic governance infringe on the EU's social objectives and fundamental rights. To correct this, clear limits and boundaries need to be set to the system of economic governance by exploring ways to force economic governance to strictly respect the social principles within the Treaties and the Charter.

Extend 'wage safeguard clauses'. One practical way to do this is to apply more broadly the so-called 'wage safeguard' clauses. These exist in two regulations (Regulation on

macroeconomic excessive imbalances, Regulation on the surveillance of the budgetary cycle - the so-called 'Two Pack'). These clauses reflect key principles from the European Treaties by stating that the regulation 'shall not impact on the right to bargain and the right to undertake action' and shall 'respect the diversity of national systems of industrial relations'. To make sure that all the regulations that make up the system of European economic governance conform to the Treaties, these wage safeguard clauses should be extended to all existing instruments of European economic regulation.

d) Better indicators are necessary

Identify shortages in public investment. Falling rates of public investment are one of the dismal effects of austerity. Public investment in the Euro area now stands at only 2.1% of GDP, having fallen from 2.8% of GDP before the crisis. As stated above, this is negative both from a short-term as well as from a long-term perspective. New indicators aimed at detecting and preventing systematic shortfalls in public investment need to be developed.

Define thresholds for current account balances that are symmetric. 'Surplus' countries should not enjoy different and favourable treatment through a maximum surplus threshold of 6% of GDP whereas at the same time 'deficit' countries are subject to a much stricter follow-up with a threshold of 4% of GDP for their current account deficits.

Draw attention to 'lowflation' and 'deflation' risks. With deflation being much harder to fight than excessive inflation because nominal interest rates cannot be cut below zero, European economic governance urgently needs to develop a system for preventing the risk of sliding into a situation of deflation.

Besides a special indicator tracking the risk of price deflation as such, specific indicators and analysis of the implications of the process of debt deflation on the sustainability of debt (including public as well as private sector debt) need to be developed.

Introduce an indicator that reflects the fact that 'wages are an anchor of price stability'. In the same vein, the benefit of robust wages as an anchor for price stability and as an instrument to keep the economy away from deflationary territory needs to be explicitly recognised. This can be done in practice by using a lower minimum threshold for unit labour costs in the scoreboard of economic indicators to detect any unit labour cost evolution falling below 2% in any given member state and analysing such evolution as a cause for concern.

Introduce more and improved labour market related social indicators. Improved and more refined indicators demonstrating/tracking the social impact of European economic governance are needed. To identify negative social developments feeding back into negative economic performance, we need an indicator on decent work referring in particular to, amongst others, the incidence, evolution and numbers of low wage jobs (defined by the OECD as workers earning a wage below two thirds of the median wage), indicators on the incidence of unstable job relationships with very short job tenure, and indicators on the incidence of jobs with a small number of hours (on-call contracts, zero-hour contracts and related forms of precarious contracts).

Indeed, such phenomena do not only cause concern through a worsening of the social situation. They also constitute an obstacle to a strong economic recovery. By paying out very low, and in effect poverty wages and placing workers in employment situations characterised by excessive forms of insecurity, precarious jobs prevent the process of recovery from developing into a self-sustaining process of rising job numbers, rising demand, and hence rising investment and additional jobs. In short, precarious jobs make for a precarious recovery.

Monitor profits. Current economic governance only sees wages as a cost and assumes that lower wages will lead to higher profits, which would then automatically spill over into higher innovation and investment. This assumption is far from correct as the response of private investment depends on a variety of factors, not least the factor of demand perspectives. The latter, however, is itself being negatively influenced when wages are being squeezed.

What is therefore necessary are indicators that focus on the level, the evolution and the share of profits and profitability while also tracking what use is being made of (increased) profits. The latter refers to indicators on the investment rates of non-financial companies, on dividend policy and related policies (share buy-backs and CEO pay) and also whether companies are hoarding profits and cash reserves.

e) A greater role for social partners in the system both at national and European level

The question of rebalancing current economic governance is closely associated with the question of who is deciding on the management of the system. If decisions on indicators, analysis and policy is left to the finance establishment (finance ministers, central bankers, and DG ECFIN), then the outcome will be biased in favour of the financial view of the world.

The European social partners in their joint declaration on the involvement of social partners in the management of European economic governance have proposed that the macroeconomic dialogue should be used as the forum to consult the social partners on the Excessive Macroeconomic Imbalance procedure, thus allowing for a systematic discussion of the Commission's in-depth analysis of member states.

The ETUC invites the Commission, DG ECFIN in particular, to take the initiative in restructuring the Macro Economic Dialogue along the lines suggested above, and to support, strengthen and enlarge the social partners' participation.

The ETUC also invites the Commission as well as the Council to upgrade the role of the Tripartite Social Summit by making it the forum where social partners can influence in depth European Economic Governance in the context of the European Semester and the EU 2020 strategy.