



## The EU's proposals on economic governance

Summary and conclusion:

Claes-Mikael Jonsson, Legal advisor, Department of Working Life

Monika Arvidsson, LO economist, Department of Economic and Labour Market Policy

Johan Danielsson, Research officer, International Department



# The EU's proposals on economic governance

## Summary

In the wake of the euro crisis the European Commission is now launching a far-reaching proposal for economic governance of the Member States' budget policies. Countries outside the eurozone are also affected, fiscal policy is being more stringently controlled from the EU and wage formation is also under pressure.

The Swedish Trade Union Confederation (LO) is concerned about increased control of Swedish economic policy. Despite praise for the Swedish model from all over the world, most recently in Davos, the new EU regulations can lead to the government being forced to take over control of wage formation in the Swedish labour market from the social partners. A clear contravention of the Swedish model and a threat to the role of the trade unions. The proposed new rules also restrict political means to conduct economic policy and the proposals also risk having consequences for wage levels and employment in the public sector.

The EU wants to use the new rules to reduce the differences between the countries' different economic systems. An understandable ambition given the major tensions that have arisen in the eurozone due to different economic situations and major differences in economic policy. The choice of economic policy cannot be regarded as politically neutral. Fiscal policy varies – and must be allowed to do so for democratic reasons – depending on the political colours of governments and the Member States' choice of social model. The regulations proposed by the Commission have a basic liberal outlook, in which the EU makes its own interpretation of the Nordic countries' models for success.

EU membership has many advantages for Sweden. However, there is weak support for increased supranationalism. Particularly if it makes it difficult to safeguard the Swedish model by means of an ambitious welfare policy and strong trade unions. An ideologically neutral framework would instead have had a better chance of gaining legitimacy.

## **The Commission's proposals in brief:**

The proposed EU regulations consist of a package of six legislative proposals. The package can be divided into three areas. The economic framework, surveillance of macroeconomic imbalances and a new framework for budgetary coordination. A short summary of the three areas is given below:

### ***Part 1 – The economic framework***

In the light of the economic crisis the EU now wants to revise the Stability and Growth Pact.

The idea is that new economic rules of play will strengthen economic stability by means of the Member States undertaking to conduct a prudent fiscal policy and combat excessive budget deficits. The basic idea is that economic problems in one country should not be allowed to spread to the eurozone, examples of which we have seen in the case of the PIIGS countries. Excessive economic situations, according to the Commission, are deficits of more than 3 % and a debt to GDP ratio of more than 60 %.

To ensure that the regulations are followed, countries must account for their budget plans. The budgets must be in balance in the medium term and take debt and coming demographic changes into account. Countries that have not achieved the targets must take clear steps towards balance at an annual rate of 0.5 % of GDP. Moreover, the EU wants countries not to increase their expenditure more than the rate of increase as a percentage of GDP. Unforeseen income must be used to write down debt – not to increase expenditure.

To ensure compliance with the new rules, the EU proposes the possibility of fining euro area countries 0.2 % of their GDP. The financial sanctions thus do not apply to Sweden.

### ***Part 2 – Surveillance of macroeconomic imbalances***

The European Commission wants to reduce the risk of macroeconomic imbalances. The ambition is to discover and counteract large differences in Member States' economic development. Imbalances are to be measured and reported on the basis of several different indicators, some of which are assessed in case they are too high or too low. The EU can then exhort a Member State to take measures to rectify the problems. In some areas the EU can restrict national policy by requiring changes in the national budget or in wage trends. Situations can arise here in which the EU pressures countries to reduce wages (via wage cuts) or to reduce the public sector via dismissals.

As examples the Commission mentions that improved competitiveness and external imbalances require major changes in relative prices and costs, as well as a reallocation of demand and supply between the non-tradable (public) sector and the export sector. In plain language the Commission believes that wages need to be adjusted to strengthen competitiveness while the public sector shrinks in favour of private alternatives.

Even in this area it will be possible to impose annual fines on the euro countries. The fines for macroeconomic imbalance are set at 0.1 % of GDP. These financial sanctions do not, however, apply to Sweden.

### ***Part 3 – New rules for budget coordination***

The EU proposal for a new regulatory framework to coordinate the budget processes for the euro countries is intended to increase transparency and in that way give the EU a better chance to control developments in the Member States. The EU believes that it is desirable to have greater predictability and the possibility of discovering and counteracting an unsustainable economic development in good time. New, comparable and clear statistics are

then needed to prevent problems in the national budget being hidden, as was the case for example in Greece.

The Swedish Trade Union Confederation (LO) is positive to making forecasts and public accounting systems comparable. It is important that large deficits are not kept secret. However, at the same time it is extremely important that the comparison figures are not used to keep wages down and reduce the level of welfare in Member States. Using the wage levels in the Member States as an indicator could then be a way of influencing wage formation by the back door and holding down wage increases in those countries.

### **Nordic collective self-regulation**

The predominant features of Nordic labour markets are the autonomy and freedom of the social partners. Labour markets in the Nordic countries are largely regulated by collective agreements which are negotiated by the social partners. The state has, generally in the Nordic countries, no role in fixing the actual price on labour. The individual employment contract will also in most cases be dependent and safeguarded by a collective agreement.

Another distinguishing feature of the Nordic countries, which to a great extent explains the autonomy and strong self-regulation of the social partners, is the high degree of organisation. This applies to trade unions and employers alike. Trade union membership is evenly distributed in all respects. There are e.g. no major differences between men and women, private and public sectors and blue and white collar workers. There are also strong trade unions representing university educated employees in the Nordic countries.

The strong role of the social partners on the collective level does not mean that there is no legislation concerning employment conditions. All Nordic countries have a finely meshed and complex interplay between legislation and collective agreements. Legislation is often kept fairly general. The laws themselves are binding for individual employers and workers, but can to a large extent be derogated from by collective agreements. This means that employment conditions can be tailor-made for different sectors. But as mentioned above there is no legislation on wages. The self-regulation of wages by the social partners is intact.

### **Distribution of responsibility between the government and the social partners**

Industrial relations in the Nordic countries are characterised by a broad support for self-regulation of the social partners. Broadly speaking all political parties in the Nordic countries, both to the left and right, supports the notation of self-regulation on the labour market. Also employers accept collective bargaining and collective agreements as the primary instruments for the regulation of working life.

Self-regulation in the Nordic countries can be described in numerous ways. However, a common denominator seems to be trust. The state trusts the social partners and their abilities to regulate employment relationships through collective agreements. The social partners has been empowered the primary responsibility for the working life.

The empowerment and transfer of labour regulation from the state also entails responsibility for the social partners. Most rights and obligations steaming from the employment

relationship are given to the social partners to carefully handle in their collective relations. Securing the individual position of a worker is generally a responsibility for the social partners. This responsibility for the social partners deviates from continental industrial relation relations where the state generally is the final guarantor of individual rights.

A strong ideological and political consensus that the social partners should have responsibility for wage formation and wage policy in the Nordic countries have given a striking stability to the Nordic industrial relations models. A continuity of self-regulation can be traced back to the first half of the 1900s in most Nordic countries.

### **Calls for the state to enter the Labour Market**

The ideological and political consensus on self-regulation does not necessarily mean that relationships between trade unions and employers' organisations are peaceful. The conflict of interest between the social partners can result in recourse to different strategies to strengthen their respective interests. There are, at least in some Nordic countries, calls for the state to intervene in the self-regulation.

When calls for legislation comes from the employers' organisation, its mostly with the aim of restricting trade union power, in effect certain forms of industrial actions or other elements of laws that strengthen trade union bargaining positions. Calls for legislation from trade unions will mostly be for support of legislative provisions that strengthens a trade union bargaining position or to diminish employers' managerial prerogative (arbetsledningsrätten).

However, recourse by the social partners to the support of legislation that restricts or support collective self-regulation do not change the underlying general consensus that wages and employment conditions should be fixed by the social partners through autonomous collective bargaining.

### **The advantage of self-regulation**

It is the social partners themselves that make the regulatory framework for each and every sector on the labour market. Sweden has over 600 different collective agreements on sector level. There is a great variety as to the methods and structure for wage-setting in these agreements.

The primary advantage of self-regulation is that the social partners take common responsibility for the regulatory framework. They take common responsibility for upholding and enforcing the sector agreement. Thus, sector agreements have legitimacy both for trade unions and employers' organisations.

Self-regulation also means that conflicts of interests between the social partners are solved efficiently on local or sector level. Few disputes has to be settled by the Labour Court in an international comparison.<sup>1</sup>

Another advantage of self-regulation is that wages can be adapted to conditions in each sector. Sector agreements can reflect different variables of interest in the sector. The wage structure will reflect the structure of production, sectors with small production sites will have higher lowest wages and little local wage formation. Sectors with large production sites, where trade unions density is larger, will have lower lowest wages and more local wage-formation.

Sectors where the workers have a stronger individual position on the labour market, often where workers with university degrees and higher officials are frequent, can have sector agreements with local and individual wages, sometimes entirely without any figures in the sector agreement.

Some sector agreements includes two levels for wage bargaining - the sector level and the company level. This two-tier system for wage formation also has a purpose to create competitive neutrality between companies. The sector agreement will fix the lowest price on labour where there should be no competitive scope between companies, while bargaining at the local/company level can adapt to company conditions.

### **Consequences for Member States' fiscal policy**

The European Commission's proposed new regulations will have clear consequences. Changes to the economic framework involve restricting each Member State's freedom of action. A tight fiscal policy risks being the framework for all 27 EU Member States.

The proposal that has now been made means that the scope for conducting an expansive fiscal policy is severely restricted. The Member States are to save their way out of recessions and pay off national debt when the economy allows. Being able to invest a country out of a recession, or conduct an ambitious welfare policy, may become very difficult. Millions of workers risk being affected in the form of higher unemployment and poorer welfare systems.

The fines the EU can impose only apply to the eurozone and hence not to Sweden. But the moral obligation to follow the rules, which applies to the entire EU, will very probably also bind the Swedish government, regardless of party colour.

Among the further negative effects of the proposal we see that a policy of restraint in an already difficult situation gives fewer opportunities to invest in new jobs and growth stimulus. The effect may rather be that a country is dragged deeper into recession as private investment is also reduced when demand is choked off. In the crisis of the 1990s Sweden managed to remove "bad loans" from the financial system instead of reducing interest rates and subsidising the financial sector. There are no initiatives described in the Commission proposal to support financial markets in the respective countries to avoid bubbles. There is a great difference between deficits arising from bookkeeping irregularities, purely opportunistic fiscal

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<sup>1</sup> The Swedish Labour Court have about 400 disputes to handle each year. Compared to approximately 200 000-300 000 in the United Kingdom

policy or disruptions in the financial market in the form of “financial bubbles”. Unhappily the Commission makes no distinction between market failures and political failures.

Only a few EU countries today have resources for implementing vigorous fiscal policy measures to mitigate economic downturns. What remains is expenditure cuts and lower taxes, which can in turn reduce investment and increase income differentials. With the new rules even minor downturns in the economy can be deepened when scope for investments is restricted. Member States and citizens then lose power over economic policy in favour of the European Commission.

Neither does the Commission take into account that the proposals also reduce the opportunities of democracy at national level, when politicians and the electorate cannot recommend a particular policy, since they are restricted at EU level. Coordination gains in fiscal policy must instead be made through consensus on stimulus or regulation – not through curtailed opportunities for politicians and citizens at national level.

### **Economic policy needs according to the Swedish Trade Union Confederation**

An important challenge is the financial markets’ share of the economy and increasingly rapid globalisation. The EU needs strong rules for financial markets and better control of imbalances within them. The EU Member States must give priority to more ambitious social insurance schemes that function as automatic stabilisers in times of economic downturn and that level out cyclical fluctuations. This is absolutely the most important policy for stabilising future cyclical fluctuations and thereby also employment. But the tendency is the opposite; decreased automatic stabilisers.

Fiscal policy thus becomes more important when fluctuations are on the increase and at the same time it has greater impact on employment and output.

At present there is consensus among political economists that changes in demand affect output – at least in the short term. The Swedish Trade Union Confederation believes it is necessary for politicians where necessary to allow budget deficits to grow in order to stimulate the economy and strengthen employment.

Today a lot of attention is being given to countries’ budget deficits. Unfortunately, the positive correlation between an expansive policy and employment is discussed far too seldom. Nor is the correlation between expansive policy and increased public revenue discussed.

The effect of using tight fiscal policy, such as tax reductions, leads to increased private savings instead of increased consumption. An efficient fiscal policy must strengthen households’ expectations of employment growth. It is quite simply difficult for the policy to be effective if households are negative towards developments in the near future. A demand crisis will arise when the situation on the labour market is gloomy and safety nets are weak. Hence, weak unemployment insurance leads to increased saving for security, having a dampening effect on consumption and employment.

In other words, resources are needed to counteract unemployment in recessions. Few politicians today dare to refrain from action when a major crisis becomes apparent. On the other hand, tax cuts are unfortunately being used to an increasing extent despite the fact that

the most effective weapon is increased public spending through such things as government grants to municipalities and county councils. A responsible policy over electoral periods would be a form of the funds used in states in the USA; “Rainy-day funds”, where money is saved in good times to be used in bad times. This leads to a credible fiscal policy with a contract between generations. No such proposals can be found in the European Commission’s legislative proposal.

### **How binding are the regulations on Sweden?**

The proposals put forward by the Commission are regulations that bind Member States directly. Sweden and other Member States have a loyalty obligation towards the EU that is expressly laid down in the EU Treaty. It has been maintained that the recommendations proposed by the Commission (and that can be overturned by a qualified majority of Member States) should be regarded as non-binding guidelines. Such a view conflicts, however, with experience of current and previous Swedish governments’ actions in relation to the requirements of the Stability and Growth Pact.

The Commission’s recommendations cannot be placed on a level with the OECD’s economic guidelines, for example. The procedural system for recommendations now being proposed differs considerably from the more voluntary Open Method of Coordination found for the EU2020 strategy, for example. In the Open Method of Coordination a number of different indicators and objectives can be assumed, but the implementation is left entirely to four Member States. With the system of recommendation now proposed, implementation of the recommendations will be mandatory.

Even if the system of sanctions through fines does not include Sweden, as mentioned before, there is no reason to believe that the present or future Swedish governments would not follow the Commission’s recommendations. In this context it should also be mentioned that a Swedish government wishing Sweden to join the eurozone must follow the Commission’s recommendations unconditionally.

### **Consequences for wage formation**

The proposed new EU regulations mean that the EU will be able to interfere in national wage formation. This could be in future wage negotiations or even directly in present day wage levels.

Concerning future wage formation, the European Commission will be given a mandate to override both national legislation and collective agreements. In Sweden the government has no tools to control wage formation. The National Mediation Office has two tasks: to mediate in disputes and to promote efficient wage formation. At present the National Mediation Office has no real tools for controlling and steering wage formation. That is how the Swedish model hangs together. If the government is to strengthen control of wages in Sweden, then the role of the National Mediation Office must be strengthened. The trade unions risk being reduced to being “the plaintiff” in a state wage formation process.

As regards any requirements to reduce wage levels in Sweden, the government must take other measures. In practice this will probably be done by cutting wages in the public sector. A

unilateral decision by the government, however, would probably require legislative amendments. Wage terms in collective agreements cannot be unilaterally changed while the collective agreement is binding. It is difficult to predict how such legislation could be formulated.

The Swedish Trade Union Confederation strongly opposes such supranational interference in wage formation. It would tear up the Swedish model by its roots. It would also mean our abandoning a historically successful model of strong trade unions and stable wage formation.

### **Other consequences of the new regulations**

The full consequence of the Commission's proposal for the trade union movement is difficult to predict. However, it is certain that the proposal put forward seriously damages the relationship between the social partners. If the wage formation framework is determined by the European Commission the foundations of wage formation will be affected. Even if negotiations can be carried out, the standard is set by the EU. In addition, it seems as though changes in the wage margin between groups will be impossible to demand.

As is known, specific initiatives to increase low wages or improve women's wages require pay increases there to be greater than in other sectors.

If the rules are introduced as they appear at present, this would conflict with current ILO Conventions on collective bargaining and freedom of association. The question of highest relevance is then if Sweden and other EU countries can continue to be members of the ILO and the EU at the same time.

The Commission's proposal also raises the issue of discussing the premises of democracy. The Commission's proposal restricts the right of association and the right of negotiation. The proposal should also be assessed on the basis of the freedom of action politics can and should have at national level. If economic policy is controlled and restricted by the Commission this will have direct consequences for the ability to conduct a policy of reform in all policy areas.

Finally, there is reason to wonder if some parts of the proposals conflict with the EU Treaty. Article 153 states that "The provisions of this Article shall not apply to pay, the right of association, the right to strike or the right to impose lock-outs." The Member States have not given the EU the right to regulate wage conditions. Here too the far-reaching proposals can be questioned.

### **The process forward and choice of strategy**

The Commission's legislative proposals were presented at the end of September 2010. The process is being pursued intensively by the Commission and several of the major Member States. The hope seems to be that an informal agreement will be in place for the spring Council summit at the end of March. Stopping the entire package will be difficult. In the wake of the crisis there is great willingness to compromise. Despite the political situation, the Swedish Trade Union Confederation and the trade union movement must stand up for the Swedish labour market model.

The social partners' autonomy must be protected from the Commission's attempts to gain influence over wage formation in the Member States. Ultimately this is about defending Sweden's independence and self-regulation of the labour market parties.

The legislative proposals do not need to be adopted in any great hurry. Introducing a new system of surveillance and control of macroeconomic imbalances is not a crisis measure but an economic framework that must be put in place after the crisis and help the Member States to avoid future crises. Creating scope for a thorough and objective debate in which the proposals are discussed in depth in the Member States will increase the chances of dealing sensibly with the proposals. The crisis must not be allowed to stress people into making bad decisions with far-reaching consequences.

In summary, the trade union movement needs to oppose the Commission's proposals on "Economic Governance". Measures are needed to stop any damage to wage formation and the possibility of conducting economic policy.

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