



February 2011
AK Position Paper

Legislative proposals of the Commission to strengthen economic governance

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

Herbert Tumpel
President

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Werner Muhm
Director

Executive Summary

The Austrian Federal Chamber of Labour (AK) generally welcomes the discussion to strengthen economic governance within the EU. However, from the point of view of the AK, the concrete proposals of the Commission on the reform of the Stability and Growth Pact (SGP) and the correction of macroeconomic imbalances are not target-oriented in a number of key respects. In par-

ticular the enhanced possibilities of the Commission to impose sanctions - also of a financial nature - are not acceptable. Introducing even tighter surveillance procedures and reporting duties would lead to over-bureaucratism and overburdening of the decision-making bodies, which would weaken the efficiency of economic governance itself. Therefore, the AK argues in favour of bestowing stronger autonomy and independence on the Member States with regard to shaping their budget policy, provided they meet certain requirements.

The AK position in detail

1. Introductory remarks

The global financial and economic crisis has exposed many weaknesses of the European Union. These include for example the growing concentration of wealth and the polarisation of income, a European labour market policy, which is almost exclusively oriented towards flexibilisation of the labour market, a lack of financial market regulation, a lack of qualitative economic coordination at horizontal level - away from the misconstructed Stability and Growth Pact - and divergences in particular within the Eurozone. The draft proposals of the Commission hardly take these difficulties into account and are unilaterally aimed at the problem of national debt. *der Krise mitverantwortlich waren, ohne wachstumshemmend zu wirken.*

The reasons provided in the draft proposals of the Commission ignore the fact that the national debt, which has risen exorbitantly in a very short period of time, is above all the result of the financial crisis. During the recession, the Commission itself had urged the Member States to take measures to counteract the crisis. It is undeniable that medium-term public finance consolidation has now become necessary. And it is undeniable that this can only be successful in a respective growth environment.

Against this background we would like to make the following initial comments:

- In order to prevent the financial markets from once again destabilising the entire economy, a comprehensive regulation of the financial markets is absolutely essential. The reform of financial market regulation is too slow. From our point of view, the measures adopted so far are not nearly as adequate as they should be. The AK emphatically urges the speedy introduction of a Financial Transaction Tax. Its implementation at European level would generate significant tax revenue, thereby contributing to budget consolidation and at the same time curb those speculations, which were jointly responsible for the outbreak of the crisis, without having a growth-inhibiting effect.

- The proposals are strongly influenced by the recent events and do not reflect the fundamental weaknesses of the current macroeconomic policy-mix within the EU. A narrow tightening of the Stability and Growth Pact in accordance with the ideas of the Commission would not only massively hamper future catching up processes of economically weaker countries, but also have a general negative impact on the European Growth due to tightened consolidation regulations. Even EU Budget

The global financial and economic crisis has exposed many weaknesses of the European Union.

It is a fact , that Europe even before the crisis had not been on a course for growth, which is necessary to achieve the objectives of the Lisbon Strategy resp. the new EU-2020-Strategy.

Commissioner Janusz Lewandowski warned some months ago against austerity measures in the Member States that were too strict: "I am worried that a policy of overdrawn consolidation could lead to a deflation. This could bring a new wave of problems."

- It is a fact , that Europe even before the crisis had not been on a course for growth, which is necessary to achieve the objectives of the Lisbon Strategy resp. the new EU-2020-Strategy. What Europe urgently needs is a new growth and distribution model to strengthen domestic demand. In many EU states, the weak development of average incomes, the shift of income distribution to the top and the high tax burden on labour significantly contribute to the fact that domestic demand is weak. Distribution policy issues in connection with economic coordination must no longer be ignored.
- At the same time, the conditions of the SGP must not be an obstacle when it comes to creating the potential for future growth by future public investments in research, education, environment etc. in particular in a difficult economic environment. This requires the reorientation of macroeconomic policy in Europe. Without a reorientation a successful implementation of the EU 2020 Strategy wont be possible.
- Hence, measures against tax dumping and tax evasion are of vital importance. Both represent lost revenue to the states, which is urgently needed for investments and budget consolidation.

2. Specific comments on the legislative proposals of the Commission

2.1 Stability and Growth Pact

The current practice in implementing the Stability and Growth Pact has revealed weaknesses, which should definitely be remedied resp. not intensified during the reform process:

- The implementation of the Pact has not always been handled in the same manner. In 2003, the Commission applied for sanctions to be imposed on Germany and France for comparatively minor exceedances, which, however, did not materialize. In the case of Greece, which significantly deviated from the deficit target (average fresh borrowing before the big recession over 7 % of the GDP 2006-2008), the pressure on the Greek government to change its budget and economic policy was not increased. This would have been in Greece's best interest and could have spared the country some of those more radical measures, which now had to be taken when the country had to draw on the assistance of the other Member States.
- The experiences in the cases of Ireland and Spain have shown that the indicators used within the scope of their surveillance systems were not suitable for recognising in advance a dramatic deterioration of the situation. This also applies to the relevant proposed changes. If the prognoses of the economic development are not able to anticipate turning points in the economy, how can one expect that they foresee the

The AK supports a stronger differentiation with respect to supervising the national states.

complex worsening of the kind of crises, which have occurred in individual EU Member States, in the Eurozone or at a global economic level since 2008?

- The procyclical behaviour of the Stability and Growth Pact was criticised by many and is still waiting for a solution. The application of the potential output concept, on which the calculation of the structural deficit is based, even encourages procyclical behaviour. It is a fact that this projects trends, which lead to incorrect policy recommendations. Countermeasures are taken too late in an economic downturn and austerity measures are applied too early in phases of recovery and boom.

- The crisis situation has also shown that the economic reaction of the Euro Member States is completely different and that therefore the handling of the SGP should be made more flexible and not standardized even more.

However, the reform proposals aim at intensifying the mentioned problems instead of remedying or reducing them. The danger is a "bureaucratic disaster" and complete economic rigidness instead of flexibility. In the light of the financial and economic crisis, which has shown that in particular a quick and flexible reaction is a significant success factor in economic policy, the BAK tries to focus on an effective and manageable reform of the SGP. That is why the AK regards the submitted legislative proposals of the Commission as overdetermination and bureaucratization of the SGP. Their introduction, as well as the proposed automatic

consequences must be rejected because they run counter to the respective economic situations and to the economic constitutions of the states.

On the proposal concerning the extension of economic surveillance and the surveillance and coordination of economic polices

The AK supports a stronger differentiation with respect to supervising the national states. States with solid basic economic data and minor deficits do not require the same surveillance as states that have potential or current problems refinancing their debt portfolio. It is therefore counterproductive to impose the same stricter surveillance measures on all Member States of the Eurozone.

The AK is in favour of granting the Member States more autonomy and independency with regard to shaping their budget policy. States, whose economic situation is good and which orientate their policy on the Maastricht criteria, do not require any "super surveillance". In this case it is adequate for the Commission to examine whether an anticyclical fiscal policy is being pursued and whether the state has a sufficiently large safety margin, enabling it to react to a "normal" crisis situation. As long as debt development and credit rating are satisfactory, any interference in the national budget policy is neither necessary nor sensible.

Only if a significant deviation from the 3 % deficit upper limit (the orientation value for a significant deviation - not as threshold value with automatic effect - could be 5 percent of the GDP)

In accordance with the current 2012 economic forecast of the EU Commission, two large and several small Member States have a debt level of 90 % of GDP or above.

becomes evident, the EU Commission should take measures in accordance with the preventive and corrective arm of the SGP. However, the assessment should also be confirmed by the Council of the Member States and by the European Parliament. It should also be possible to reduce the deficits through revenue and expenditure-side measures. Revenue-side measures are by no means less effective, although this is implied by the Commission's expenditure rule. A comparison of revenue quota and the deficit situation of states show that the former does make a positive contribution to budget consolidation.

The onesided emphasis on the expenditure rule is therefore not justified as a ban on harmful, stricter tax discipline and a coordinated effective fight against tax evasion are of equal importance.

On the proposal concerning the acceleration and clarification of the procedure in case of excessive deficit

A differentiation should be made with regard to applying the debt criterion. In view of the scope of the debt quota (7.2 % - 126.8 %) in the Eurozone, a uniform numeric debt rule has to be rejected. In particular states that have significantly exceeded the debt criterion are realistically not in a position to reduce their debt to the extent proposed. In accordance with the current 2012 economic forecast of the EU Commission, two large and several small Member States have a debt level of 90 % of GDP or above. Realistically, a reduction to 60 % will take more than a decade, in some cases several decades. During this long period it is important that countries

raise sufficient tax revenue to enable them to cover interest payments.

On the proposal concerning the effective implementation of budgetary surveillance in the Eurozone

The proposed financial sanctions both in the preventive and in the corrective implementation component of the SGP have to be rejected, as they worsen the economic situation of a state even further. It has to increase borrowing to pay the imposed fine; however, occasionally all states come to the aid with their rescue system. The logic of sanctions is based on the misapprehension that a state could react to incentives in the same way as an individual. Hence, it would almost be counterproductive to sanction a government that has just come into office to remedy the mistakes of the preceding government. The intended preventive impact is essentially dependent on the quality of the prognoses used. However, in view of the current quality of the prognoses, the risk of automated mistakes, for which nobody is responsible, is increasing enormously.

A rulebased procedure, as proposed in the "reverse voting" mechanism, leads to bureaucratisation and an increasing lack of transparency of the process and suggests that the budgetary policy of the Euro states could be fully brought under common control. In view of the actual existing differences of the national budgetary situation and the economic power within the Euro states, this is a misleading assumption. In view of the possible economic consequences of this austerity policy, the planned measures cannot be regarded as proportional.

On the proposal concerning the requirements on the budgetary framework of the Member States

The intended and in some cases even necessary improvement in reporting should not lead to an unmanageable overkill of data and reports. Here too the principle of quality before quantity applies. As a rule, national growth prognoses form a better basis for assessing the economic and fiscal situation than EU prognoses. A complete duplication of national prognosis structures is neither sensible nor necessary.

In conclusion, we would like to summarize our main concerns and reform proposals on budgetary surveillance as follows:

- In respect of the treatment of the Member States in the surveillance system there is a need for stronger differentiation between households, where targets have only been exceeded to a minor degree and those where targets were significantly exceeded. In particular, the same has to be practiced in the deficit procedure, when the targets have been exceeded.
- The approach that any possible and different crises in any of the 17 Euro countries and those who might join later can be anticipated by the same permanent detailed bureaucratic surveillance system should be abandoned. It appears to be more important to introduce a flexible system to deal with actual crises.
- The proposed financial sanctions both in the preventive and in the corrective implementation com-

ponent of the SGP have to be rejected, as they worsen the economic situation of a state even further.

- Only the relaxed and country-specific application of the SGP can provide an adequate answer to a crisis. This equally applies to the special situation after the Big Recession 2008/09 and to future phases of the economic development with a "normalised" economic trend. A synchronised reduction of the deficits carries the risk that the negative spillovers of national policies endanger or stifle any economic upturn across Europe.
- It is extremely doubtful whether the proposed reforms on economic governance can prevent any future European crises. This would require a - non-enforceable - political will towards stronger political integration and serious efforts to consequently tackle the causes of crises in the financial sector. To force all Member States into a uniform corset, which further limits their economic room for manoeuvre, only makes the situation worse. In view of the possible economic consequences of this austerity policy the planned measures have to be regarded as disproportionate.
- The proposals of the Commission still ignore the fiscal problems, which are caused by the harmful race to reduce taxes, tax oases and a lack of tax discipline and rely mainly on supply-side measures, which put the creation of a growthfriendly climate at risk. The demand side must be equally included in the policy recommendations.

- With regarding to tackling crises, the EU should not neglect its primary targets, which have been determined in the basic treaties of the Union. This includes in particular the adaption of living conditions within the Union.
- The AK is in favour of accelerating the recovery by a growth-friendly European environment, to grant the states catching-up processes and to involve creditors in the costs of the crisis.

How the EU will develop in the long term is still an open political question, which cannot be answered at the present time. With regard to the next foreseeable steps, the AK is in favour of adopting a pragmatic approach, which has been proven to be the way forward in the financial and economic crisis.

2.2 Procedure to correct macroeconomic imbalances

The consequences of the financial crisis clearly show that better economic coordination within the European Union and above all within the Eurozone is absolutely necessary. The current proposal of the Commission to prevent macroeconomic imbalances therefore addresses an important economic and political problem.

However, in its present form it is influenced too much by the latest events and therefore shows serious deficiencies and gaps from a democratic, economic and technical point of view.

The proposals of the Commission raise serious concerns that the European Union, following a long political phase, which had been marked by deregulation of the financial markets, based on excessive control reduction and increasing social imbalance, now, in respect of the task to avoid macroeconomic imbalances, tends to favour extreme over-bureaucratization and thereby runs the risk of abandoning its own principles and targets, which have also been formulated in the treaties.

The proposal of the Commission gives cause for concern for the following reasons and should therefore be revised urgently:

- The proposed sanction mechanism is highly problematic from a democratic point of view, as it is the ultimate responsibility of the voters in a democracy to sanction bad and to reward good policies. The idea of a national „Joe Bloggs“, who can be encouraged to conduct himself in conformity with the rules through sanctions, for example sanctions imposed through fines, is a feeble construction. It cannot be in the interest of the Union to strengthen nationalistic forces through a bureaucratic “sanction mechanism” and to weaken constructive governments through additional burdens. Any agreement on such measures - if at all - can only be reached by institutions that have been given a democratic mandate by the citizens, in the case of the Union at best by the European Parliament.

The consequences of the financial crisis clearly show that better economic coordination within the European Union and above all within the Eurozone is absolutely necessary.

- From an economic point of view, the planned procedure to correct macroeconomic imbalances in its current conception is based on the unrealistic and often refuted idea that it is possible to predict complex aggravations of crises, as they have occurred since 2008 in individual EU Member States, in the Eurozone or at a global level with such precision that they provide a sound basis for automatic or mandatory consequences. There is a fundamental difference between a purely empirical and theoretical analysis of an economic situation and a necessarily bureaucratically formalised determination of economic facts, which are linked to legal consequences. One should not underestimate the danger of manipulated or falsified statistics in this context, in particular concerning parts of the economy where there is practically no precise primary information available (e.g. travel expenses abroad). In view of the long historic run-up periods in case of macroeconomic imbalances and of the expected lengthy proceedings, the risk is great that the consequences of a failed economic policy will only then be sanctioned when corrective measures have already been initiated and possibly weaken those forces which endeavour to realign the policy. Another risk is a “false alarm”, which might worsen the situation of a country. The experiences of the Stability and Growth Pact demonstrate the inadequacy of bureaucratic mechanisms for such problems and should be understood as a warning, not to repeat the mistakes of this Pact in respect to the materially even more complex area of macroeconomic imbalances.

- Although from an economic point of view the draft addresses some of the main problems, which are linked to the monetary union without relevant political coordination, however important causes are being ignored. There is for example no reference to the weak increase in wages in some core countries, which, in association with the weak domestic demand has significantly contributed to the rise in imbalances. Current account surpluses can be linked both to a strong rise in exports and to a weak growth in imports. During the crisis, it was not least the weak growth in some core countries of the Eurozone, which helped to cause this development.

We demand a symmetric approach to reduce macroeconomic imbalances

Concerning deflationary coordination in the sense of an asymmetric reduction of the current account deficits, it is the deficit countries that have to bear the entire direct burden. The consequence would be that the growth rates in Europe would lean towards the rates of the slowest growing economies. Such a strategy would contradict the EU objective of increasing wealth for all Europeans.

The reduction of the current account imbalances, which have continued almost unchanged in the wake of the Big Recession, can only be achieved gradually, moreover as the countries producing surpluses through real wage rises, which correspond to the overall economic growth, must contribute to this in the same way as the deficit countries do through wage moderation, which,

however, does not lead to real wage reductions. There is something like a minimum consensus among the divergent economic directions, according to which deflation must be avoided. On this basis, the EU instances should recognise that it should not be the aim to remove current account imbalances by imposing wage reduction on the trade unions in the deficit countries.

A symmetric adjustment process instead of an asymmetric reduction of discrepancies in international competitive positions and trade balances requires that incomes in those countries where the overall economic productivity is significantly increasing must again begin to follow the development of productivity more closely. However, the wage rate is not a direct policy variable.

The fixing of wages resp. the wage level is a matter for the parties to collective bargaining and must be the result of a free agreement. Wage guidelines and directives of the government are in contrast to the principle of collective bargaining autonomy and must therefore be rejected for regulatory reasons. The implicit call on governments, to intervene in the tariff autonomy, is democratically completely unacceptable. A cross-border coordination of national wage policies at European level can make an important contribution to a symmetric reduction of imbalances. It should therefore be promoted by suitable framework conditions, for example as part of the European macroeconomic dialogue.

The concrete structure of indicators is decisive

The proposals concerning the indicators to be included in the scoreboard show a strong asymmetric distortion. The unilateral fixation on the development of unit labour costs means that the share of wages in national income, which has been declining in most Member States for decades, is ignored. The same applies to the development of profits, which is indispensable as an indicator for the effectiveness of market forces and intensity of competition.

From a technical-administrative point of view, the proposed procedure via a scoreboard and relevant warning thresholds shows significant weaknesses. However, it has to be regarded as a move in the right direction that a comprehensive analysis is planned before further steps are taken; however, in view of the complexity and the time required for such analyses, one has to assume that an abbreviated schematic scoreboard analysis dominates both the public debate and the assessment of the financial markets. This entails the risk of wrong analyses being more effective in the medium term, a fact, which can be hardly balanced by detailed interpretation and comments.

The Commission already regularly examines the development of the Member States in various contexts (such as the Stability and Growth Pact), applying very high, hardly justifiable bureaucratic efforts. However, the complexity of

the examinations provided for in the planned proceedings for correcting macroeconomic imbalances would even exceed these efforts and result in enormous over-bureaucratisation. The problems of time series breaks alone, the comparability of statistic indicators, which even in the ideal case of a uniform collection in different institutional scopes of the individual states have a different information value, as well as the evident problems of changing the content of this information as soon as it is linked to economic consequences, by far outweigh the alleged advantages of rule-based procedures. Instead of schematic coordination processes burdened by bureaucracy, one should aim at developing a genuine cooperation between the major economic players in the Member States and at a European level. This includes the development of social dialogue, the greater involvement of the ECB in the economic coordination and an orientation towards the European target of generally increasing welfare and social cohesion.

Should the Union, in spite of these massive concerns, select a schematised scoreboard approach, it has to support the consideration of all Union targets. Price stability, stable public finance and foreign trade balance are instrumental targets, whose overall aim it is to achieve primary objectives such as a high level of prosperity, fair contribution of income and social cohesion. An appropriate consideration of this target hierarchy is absolutely essential for the political stability of the EU.

Finally we would like to underline again that basically and above all a sustainable improvement of the medium and long-term economic development in Europe requires a balanced development on the supply and demand side, supported by an expansive macroeconomic policy, instead of the unilateral emphasis on improving competitiveness through reducing costs.

Should you have any further questions
please do not hesitate to contact

Norbert Templ

T + 43 (0) 1 501 65 2158
norbert.templ@akwien.at

as well as

Amir Goreishi

(in unserem Brüsseler Büro)
T +32 (0) 2 230 62 54
amir.goreishi@akeuropa.eu

Bundesarbeitskammer Österreich

Prinz-Eugen-Strasse, 20-22
A-1040 Wien, Österreich
T +43 (0) 1 501 65-0
F +43 (0) 1 501 65-0

AK EUROPA

Ständige Vertretung Österreichs bei
der EU
Avenue de Cortenbergh, 30
B-1040 Brüssel, Belgien
T +32 (0) 2 230 62 54
F +32 (0) 2 230 29 73