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Austerity and the alternatives

Briefing #4: Deregulation is not the answer

NOVEMBER 2014


In nome del popolo italiano, dopo 5 anni di atroci sofferenze
e grandi risultati sulle pratiche civili si è spento
IL LAVORO VERO
in Ministero della Giustizia
e danno il triste annuncio al Popolo Italiano il Presidente del Consiglio,
il Ministro della Giustizia, i Sottosegretari, il MEF
e la Ragioneria Generale, il Parlamento tutto.
La camera ardente sarà allestita presso il
Ministero della Giustizia Via Arenula - Roma
I Tirocinanti Precari della Giustizia ex L. 147/13
si dispensano dalla visita.
NON SPICCIOLI MA
CONTRATTO PER IL 2015
Roma, 29 ottobre 2014

Introduction

This briefing, the fourth in the series[1], is published shortly after the confirmation of a new European Commission and not so long after the new European Parliament has got down to work.

So can we expect the Commission to make a fresh start and present a clean break from the previous policy of austerity and deregulation?

Or is it more likely that the stubborn believers in the virtues of austerity and deregulation now return from the sort of 'holiday' they have taken over the past year, having kept a lower profile in the run-up to the European elections?

Now that a new European Commission and Parliament are elected for the next five years, perhaps they will come back with a vengeance and re-launch an offensive that is even more ambitious and aggressive.

In any case, when observing the ongoing policy discussion in Europe, one is struck by the fact that references to so-called "structural reforms" are everywhere. They are a key theme in the conclusions of every European Council held since June, including in particular the recent Council in Milan on the theme of employment. Along with "contractual arrangements", they feature prominently in Commission President, Jean-Claude Juncker's speech to the European Parliament.

Far more disturbing language comes from the European Central Bank (ECB). It reiterates the so-called need for reforms at every possible occasion and, in its monthly bulletin of July 2014 refers to **radical** reforms that should be **"imposed".** And as ECB president Mario Draghi made clear in his speech to the central banking conference in Jackson Hole in the United States in August, these reforms involve decentralising wage bargaining to company level so as to allow higher wage inequalities between workers as well as to reduce what is being called the "rigidities" embodied in job protection systems.

In all of this, it's as if the implicit deal that has been struck at the highest political levels in Europe is to exchange the degree to which fiscal austerity will be pursued with a policy of structural reforms to deregulate wages and worker rights.

This is a mistake. Exchanging one bad idea for another bad, or even worse idea will get us further into the crisis. It is like trying to get out of a hole by digging an even deeper one.

Workers and trade unions across Europe therefore need to remain extremely vigilant and work to guide the policy process into the right direction and towards a real break with the disastrous policies of the past instead of a return to 'business as usual'.

This briefing aims help this process by debunking the myths about structural reforms.

Since the beginning of the crisis EPSU has been consistent in calling for measures to boost the European economy. It argued for real wage growth to maintain demand and increased public investment to support jobs and the long-term competitiveness of the European economy. For more on EPSU's policy page 20.

[1] Briefings 1-3 are available here: www.epsu.org/a/10808

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Wage cuts don't work

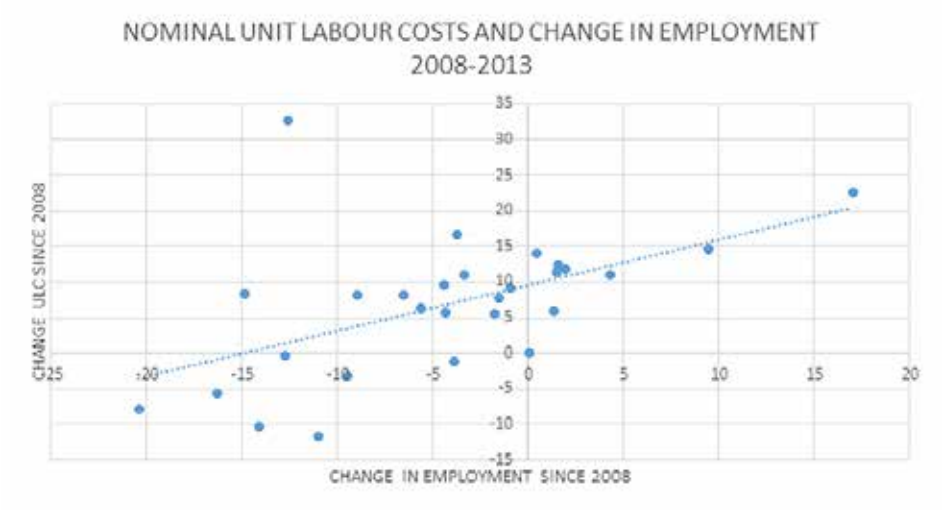
The claim is that, to address mass unemployment in Europe, wages have to go down. In particular, wage cuts are necessary to restore and improve competitiveness, especially for those member states sharing the single currency who can no longer resort to a competitive devaluation of the national currency. Lower wages create new jobs, or so goes the story of the Masters of Wage Deregulation.

Lower wages mean fewer jobs

Their claim is not supported by the facts. On the contrary, the experience from reality shows that the more you cut wages, the more jobs get destroyed. This can be seen from the graph below, setting out the cumulated evolution of wages since 2008 against job performance. There is a positive and not a negative correlation, implying that over this period higher wage growth tends to be associated with relatively better job performance.

Higher wage growth is linked to better job performance

Chart 1: Nominal unit labour costs and change in employment



Source: Eurostat, AMECO database

This can be explained by what happened in two different groupings of Member States. On the one hand, there are Member States such as Germany and Austria that reacted to the crisis by introducing 'short term work schemes'. These schemes upheld wages while at the same time maintaining existing jobs even in the face of depressed demand. The result is rising unit wage costs while at the same time avoiding mass job destruction.

On the other hand, there are those Member States (e.g. Greece, Spain, Portugal…) that resorted to a significant internal wage devaluation. In these countries, wage costs did drop significantly but so did employment. Cutting wages led to a collapse in domestic demand and this collapse was not made up by a sufficient revival of export demand. The end result was to depress overall demand, overall economic activity, hence overall job performance.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Europe can't compete against itself

Real wage increases have been lagging behind productivity

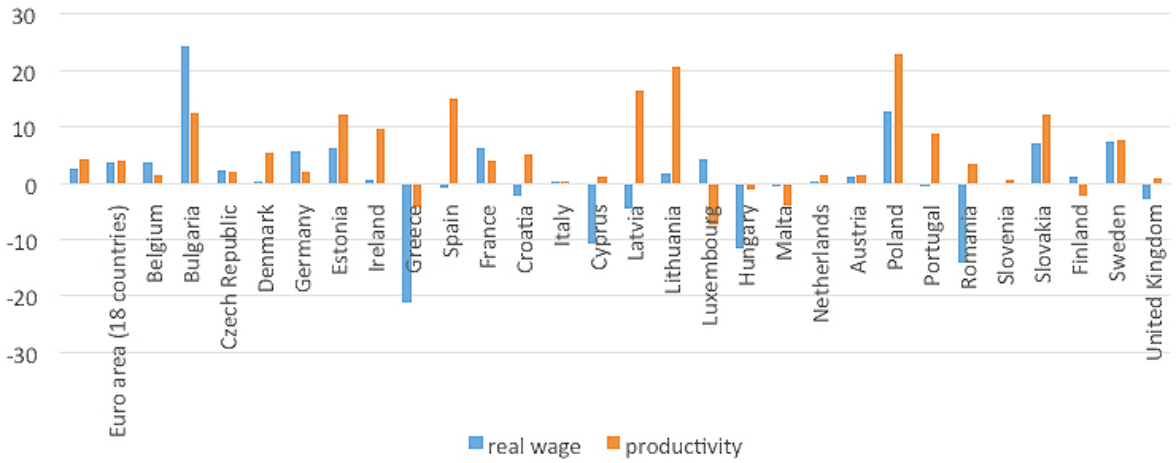
What is described above also points to the important role that wages have in supporting aggregate demand, thereby functioning as a motor for demand, growth and jobs.

This is even more true for Europe as a whole. Indeed, Europe is anything but a small open economy. European member states are mainly exporting and importing to other member states. In the end, the share of exports from European member states to the rest of the world outside Europe is relatively small and limited to no more than 17% of European GDP.

This makes the strategy of squeezing wages to try and trigger a process of export-led growth a strategy that is doomed to fail. Trying to increase exports, which only make up 17% of European GDP, by depressing the pillar of internal demand, a pillar representing 83% of GDP is suicidal for demand and economic activity. In the end, Europe cannot steal jobs from itself.

This makes the reality that is described by the next graph worrying. It shows that, from 2008 to 2015, real wage dynamics have been lagging behind productivity developments in a majority of 18 member states. No wonder that our economies are not recovering but are almost continuously flirting with recession and depression.

Chart 2: Real wages and productivity: compounded evolution since 2008



Source: AMECO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Minimum wages don't destroy jobs

The claim is that by forcing business to pay wages that are higher than workers' productivity, minimum wages destroy jobs.

There is no evidence for this claim. If this were to be the case, then lower skilled workers would especially suffer job losses with higher minimum wages. The reality however is that higher minimum wages tend to be associated with higher employment for lower skilled workers (see graph).

How to explain this? One explanation is that supply effects are more important than demand effects: minimum wages force employers to pay wages at levels at which it is worthwhile to look for and to hold a job. Another explanation is that workers' productivity is not given and that minimum wages force employers to reorganise the work place in a more productive way so that the productivity of workers can be increased.

Higher minimum wages encourage investment in workers

Chart 3: Minimum wage (as % of average wage) and employment rate of low-skilled workers - 2010

Source: DG EMPL calculations on the basis of Eurostat, minimum wage (earn_mw_avgr2) and employment rate (lfsa ergaed)

Source: Commission's Employment and Social Developments Report 2013


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Segmented labour markets: levelling-up is the solution

The claim is that the protection of 'insiders' goes at the expense of 'outsiders' who are being forced into precarious jobs. And that high levels of protection for open-ended contracts forces employers to resort to short-term, insecure labour contracts. The proposed policy is then to reduce significantly the protection embedded in open-ended contracts so that employers will stop using fixed-term or other atypical contracts.

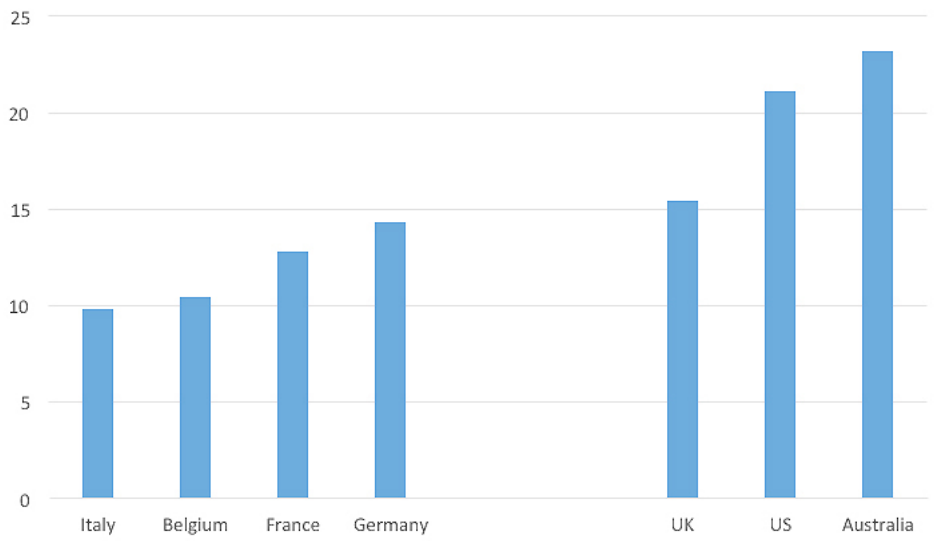
The arguments above are based on the hypothesis that any open-ended contract is by definition stable. This view, however, does not always correspond with the reality on the labour markets.

A closer look at labour markets of the Anglo Saxon world illustrates this vividly. Labour markets in the US, the UK and Australia are indeed characterised by a very low share of temporary contracts, accounting for no more than 6% of all dependent workers. This contrasts with European continental economies such as Germany, France, Italy, Belgium and the Netherlands where the same share of temporary contracts ranges from 10 to 16%. When taking these statistics at face value, it would seem that the Anglo Saxon labour markets score better and have a lower level of labour market segmentation.

However, a completely different picture emerges when looking at the reality behind these temporary contract data and by focussing instead on the number of (dependent) workers that hold short tenure jobs. In other words, the share of workers that are doing the same job with the same employer for no more than a year. The graph below (right hand side) shows that the share of short tenure workers is actually the highest in the UK, US and Australia. The so-called 'segmented' labour markets of Italy, Belgium and France on the other hand have a much lower share of short term jobs.

Weakening open-ended contracts is not the answer

Chart 4: Share of workers in their job for less than a year



Source: OECD database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The fact that the former economies have a significantly higher share of workers experiencing short-term, unstable employment relationships does not come as a surprise. It points to the fact that these countries have addressed labour market segmentation by levelling down, by reducing the job protection in open-ended contracts to such an extent that they become as insecure and precarious as temporary/non-standard work arrangements.

This levelling down approach has the effect of cleaning up the statistics but it does not resolve the real problem. Even if workers are employed under a formal open-ended contract, too many of them are in a short-term employment or unstable relationship. This will generate all of the social and economic costs that are usually associated with temporary contracts.

As a consequences we will still have:

Lack of investment in workers' training: if employers can easily fire their workers, at low or no cost, then they have no incentives to look at the alternative of internal or functional flexibility, thereby re-employing workers in other functions when problems in the markets for its products or services arise. The direct consequence of this is that employers are not very interested in training their workforce and maintain and promoting workers' skills levels. If the company is hit by a negative economic shock, the employer will not need a generally skilled workforce since it can fire workers easily instead of having to resort to internal functional flexibility. The simple fact is that easy firing turns workers into a commodity instead of an asset to invest in.

A lack of 'social capital': workers, knowing that they can be fired almost overnight, will not feel committed or loyal to the company. As a result, their productivity will suffer. This, in turn, increases the need (and cost) for business to supervise workers through high layers of management. For example, the density of managers is above 10% in economies with short tenure jobs but only between 2% and 5% in better regulated labour markets.

A lack of innovation: short tenure jobs weaken the 'historic memory' of organisations and also leave companies vulnerable to the problem of having valuable company knowledge leaking away to competitors through high worker turnover, thus reducing the incentive for them to invest in innovation. 'Easy firing' also makes workers reluctant to provide critical but necessary feedback from the shop floor to management. Nor will workers be inclined to suggest or participate in innovation of the workplace since such participation is likely to cost them their job.

To really address the problems caused by labour market segmentation, a policy of levelling up is necessary. Labour law needs to upgrade the protection of temporary contracts and ensure employers do not abuse these contracts (for example by using chains of fixed-term contracts in which the same worker is employed in the same job, with the same employer over long periods of time). Here, the spirit as well as the letter of the European Social Aquis, in particular the principle that fixed-term contracts are the exception and should not become the rule, needs to be rediscovered and become the key principle of an European policy against precarious work practices.

Short-term work leads to loss of skills and productivity


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Another myth – the high corporate tax rate in Europe

The claim is that taxation on corporate profits is too high in Europe and that member states need to cut these taxes so as to attract foreign direct investment from the rest of the world.

This is yet another claim that is contradicted by the facts. Indeed, the extent to which tax competition has already lowered taxes on corporate profits in the European internal market with its freedom of movement for capital is huge.

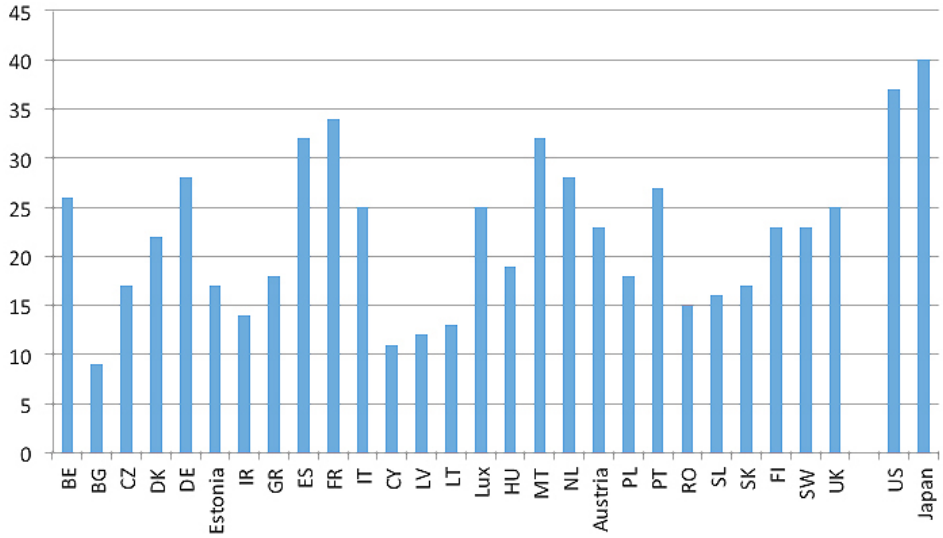
This can be seen from the graph below showing that there is not a single European Member States where the effective tax rate on business profits is higher compared to the tax rate in the US and in Japan.

Moreover, in Member States such as Ireland, Cyprus, Slovenia, Slovakia, Bulgaria or Romania, taxes on business profits are ridiculously low.

Here, an initiative to coordinate tax policies on corporate profits across Europe is urgently needed. It will mobilize new and substantial government resources which in turn can be used to co-finance a much needed re-launch of public investment.

Corporate tax rates are lower in the EU than the US or Japan

Chart 5: Effective tax rate on corporate profits 2012



Source: Business Europe 2013 Reform Barometer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Afíliate al Sindicato de Estudiantes
¡Huelga de 72 horas de la comunidad educativa ya!
NO
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VIVOS SE
VIVOS LOS

Social spending and non-wage labour costs: don't compare oranges with peaches

The argument is that Europe is spending too much on social security. Advocates of this view further claim that this is resulting in high non-wage labour costs, thus putting European business at a competitive disadvantage with the rest of the world.

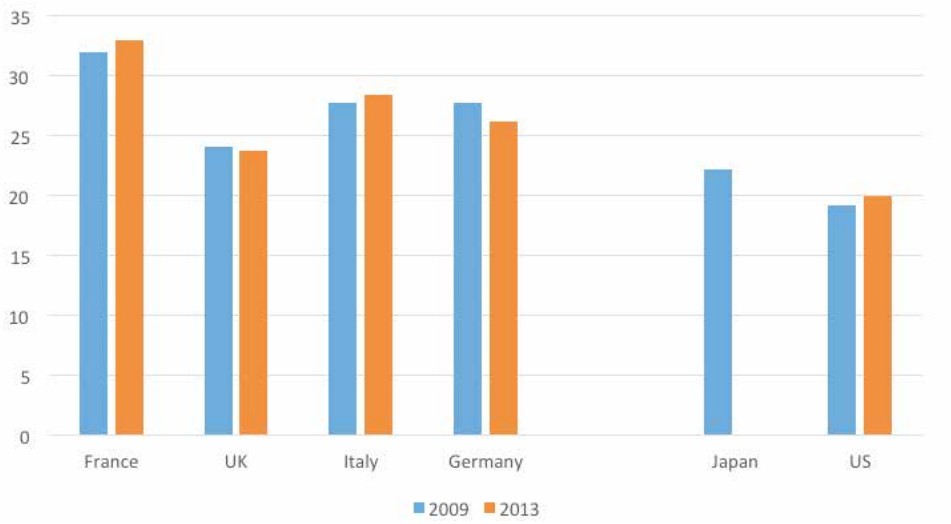
This is a misconception based on the erroneous idea that, by slimming down publicly organised social security systems, employers will be able to push down total wage costs as a result of having to pay much lower employer social security contributions.

However, this line of thinking does not take into account the fact that workers, in the absence of public social security, will want and need to insure themselves privately. Consequently, they will push up wages so as to be able to pay for these private insurance fees. International comparisons whereby the focus is put on public social spending as a % of GDP can therefore be quite misleading. The graphs below, derived from the OECD statistical database on social spending, illustrate this.

The first graph reproduces the typical business' side mantra about public social spending being higher in European countries compared to the US or Japan. In the former the social spending share is between 24% and 30%, in the latter it is only around 20% of GDP.

Lower public social spending means higher private insurance payments

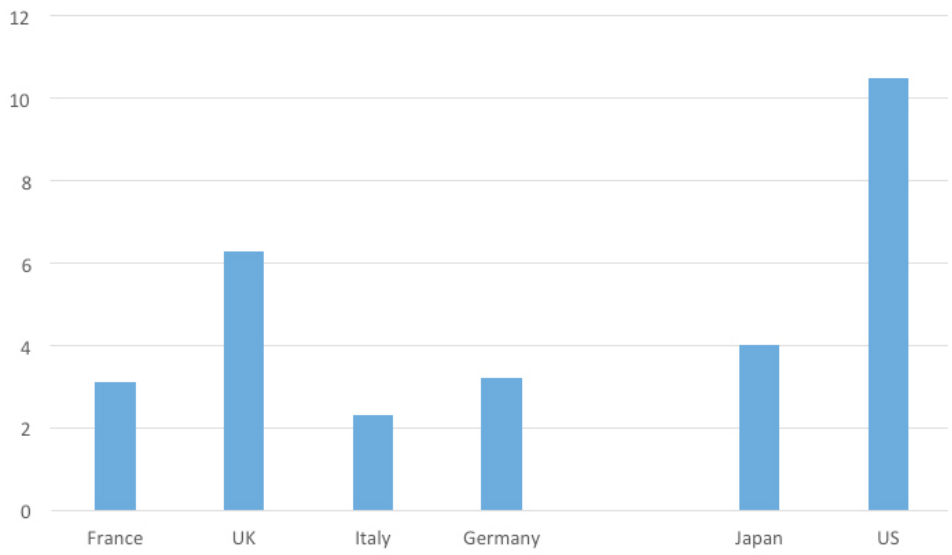
Chart 6: Public social spending as percentage of GDP



However, as argued above, workers in countries where public social spending is low will turn to private insurance. The next graph shows the cost of private social spending according to the same OECD statistical database. It appears that private social spending and public spending are like two communicating barrels. The lower the public social spending, the higher the private social spending and in countries with well developed public social security systems, private social insurance is almost non-existent.

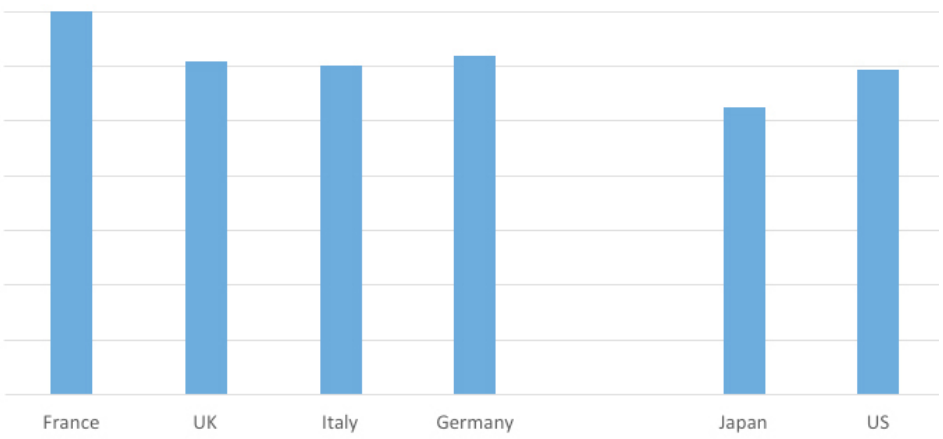

LA EDUCACIÓN
NO ES UN
GASTO, ES UNA
INVERSIÓN
SURF PRO
Surfers Paradise

Chart 7: Private social spending as a percentage of GDP 2009



Adding private and public social spending then results in the third graph. It can then be seen that total social spending in key European Member States is not really out of line with such spending in the US or Japan. When the correct international comparison is used, the case that employers are paying too much for social spending in Europe and that this is pushing up total wage costs more than in our major competitors is a non starter.

Chart 8: Total gross social spending as a percentage of GDP 2009



EPSU POLICY

EPSU has been challenging austerity policies since the beginning of the crisis, when countries like Latvia, Hungary and Romania were among the first to suffer from the requirements of the European Union and International Monetary Fund to cut public spending.

Since then we have seen the introduction of the European Semester and establishment of the system of economic governance which have been used as a transmission belt for austerity.

EPSU has criticised the Semester for its lack of democracy, with its limited roles for the European Parliament as well as national parliaments and the even more limited openings for contributions from trade unions and civil society.

At its Congress in Toulouse in May 2014, EPSU reaffirmed its calls for alternatives to austerity and the urgent need to promote social and public investment to create quality employment. The resolution on economic policy said that EPSU would:

Support the ETUC in its efforts to achieve major reforms in the system of economic governance at European level to ensure a greater role for European and national social partners, national parliaments and the European Parliament at all stages of the European Semester.

Furthermore, it argued that:

Social and environmental issues must take precedence over the economic policies and targets set by the European institutions and there needs to be a move away from the narrow focus on budgetary discipline and maintaining a low inflation rate. The European Central Bank remit should take account of employment to the same extent as price stability.

EPSU supports the ETUC's proposed investment plan, *A New Path for Europe*, and has been active along with the ETUC in calling for a major increase in public investment to underpin a sustainable economic recovery.

WORK PLACES

AGAINST AUSTERITY

For another Europe

There are alternatives!

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