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The new economic governance arrangements and autonomous collective bargaining in the European Union

Dialogue-based macroeconomic coordination

Abstract

The current crisis in the Economic and Monetary Union (EMU) was caused by strong divergences in wages, unit labour costs and prices resulting in member states running large current account surpluses and deficits. The European Council attempted to respond to this governance gap by adopting a regulation on the prevention and correction of macroeconomic imbalances which, however, is asymmetric and hence itself imbalanced. By adopting the regulation, governments committed themselves to safeguarding a balanced development of unit labour costs, and hence of wages, which however are the responsibility of independent social partners, creating a so far unresolved tension. In order to address this shortcoming, this study describes a number of options. The option, which here is considered first best, advocates stronger centralization and coordination of the wage-setting process, underpinned by counter-cyclical fiscal policy and an effective competition policy. As means to implement the greater coordination implied by this option, in addition to the already existing Macroeconomic Dialogue at European level, a special Macroeconomic Dialogue on national level as well as on EMU level is called for.

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The new economic governance arrangements and autonomous collective bargaining in the European Union[1]

Dialogue-based macroeconomic coordination

by

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Executive summary

The current crisis in the euro area has been caused by unsustainable macroeconomic imbalances between Member States. Marked and widening divergences in prices, wages and unit labour costs and in both domestic and export growth have prompted major divergences in current account balances. The crisis has also revealed decisive shortcomings in the economic governance of the euro area. Mainstream economics has failed to recognise the central role played by wage development in securing a cohesive economic and monetary union, a failure reflected in existing economic policy both nationally and at EU level.

From the outset of EMU, and throughout its development so far, there have been clear signals pointing to, and evidence of, this failure. In particular, the Broad Economic Policy Guidelines (BEPG), as the cornerstone of economic policy coordination in the EMU, set out appropriate requirements for the conduct of wage policy under EMU. Eventually, the social partners themselves, and particularly the trade unions, recognised the need for greater coordination of national wage outcomes and took some initial steps in this direction. Ultimately, however, neither the rules set by governments themselves in the form of the BEPG nor the efforts made by the social partners to achieve coordination were sufficient to prevent catastrophic divergences emerging in the growth in unit labour costs.

Towards the end of 2011, in an unprecedented attempt to close the governance gap, the European Council adopted two Regulations on the prevention and correction of macroeconomic imbalances in the euro area. The key Regulation under what is known as the ‘Macroeconomic Imbalances Procedure’ (MIP) identifies nominal unit labour costs and the current account as key indicators to be targeted and monitored, along with other variables. Using a ‘scoreboard’, it defines critical thresholds and sets out in detail a comprehensive procedure for monitoring, correction and sanctions.

However, the Regulation suffers from one severe shortcoming: the procedure for preventing and correcting excessive imbalances is itself imbalanced. It monitors predominantly those indicators that lead to private and public *indebtedness* and current account *deficits*, and the threshold values have been set *asymmetrically*. This gives rise to asymmetric policy recommendations that call for adjustment only in those Member States running current

account deficits, whereas under normal circumstances, a symmetrical approach would be required. Overcoming the current crisis therefore requires, in fact, a reverse asymmetry, with 'surplus countries' adopting expansionary policies while avoiding a deflationary effect on the economies of the 'deficit countries'. Moreover, in adopting the Regulation, governments committed themselves to safeguarding a balanced growth of unit labour costs and, hence, of wages; these, however, are not under their direct control but rather the responsibility of autonomous social partners. Although the Regulation includes several explicit commitments to autonomous collective bargaining, and there is provision (albeit limited) for involving the social partners, neither measure is sufficient to resolve the tension between the new Regulation as an element of economic governance and the existing autonomy enjoyed by collective bargaining.

This study sets out three options for resolving this tension. The first option is to preserve the current wage setting procedures, relying on market forces to correct existing and prospective imbalances. A second option, in line with the Lisbon strategy, is further deregulation of labour markets and decentralisation of wage setting procedures. A third option, which we advocate here, is the exact opposite – stronger centralisation and coordination of the wage-setting process, supported where necessary by a targeted anti-cyclical fiscal policy and competition policy.

Given past shortcomings, considerable improvement is needed in economic thinking and in institutional arrangements, both within the social partners themselves and in their interaction with the other economic policy actors, such as monetary and fiscal policy. It is important that actors' autonomy is coordinated with the greater need for regulation within the euro area and that the national level is coordinated with the EMU level. This study therefore proposes that the institutional framework for closer coordination should include not only the existing Macroeconomic Dialogue at European level but also two special Macroeconomic Dialogues, one adapted to individual Member States and the other to the euro area as a whole. The aims, programme and composition of both bodies should reflect the very diverse wage setting framework in the individual Member States on the one hand and, on the other, the greater need for economic governance within economic and monetary union. More generally, what is required is an over-arching reorientation of economic policy towards promoting coordination and embodying it as part of its overall approach rather than, as at present, frustrating it.

Contents:

List of abbreviations 5

Introduction 6

I. The pivotal role of wage growth within monetary union 10

II. Wage policy and the social partners within economic policy coordination in the past 17

Elements of economic policy coordination 17

Coordination within the trade unions 22

III. The new macroeconomic regime within economic governance 24

The Regulation on the Prevention and Correction of Macroeconomic Imbalances 25

'Scoreboard' elements with relevance to collective bargaining policy 29

The Alert Mechanism Report 31

Involvement of the social partners 34

IV. Options to resolve the tension between the new economic governance arrangements and autonomous collective bargaining 35

Option I: Retention of the current wage-setting structures 36

Option II: Deregulation of the labour market and decentralisation of wage setting 37

Option III: Centralisation and coordination of wage setting 39

Support from an anti-cyclical fiscal policy and competition policy 40

Assessment of the options 41

V. Institutional implementation 44

Closer coordination of wage setting by the trade unions 47

Closer coordination between monetary, fiscal and wage policy in the euro area 51

Macroeconomic Dialogue at National Level 53

Macroeconomic Dialogue at Euro Area Level 55

Summary and conclusions 58

References 61

List of abbreviations

AMR	Alert Mechanism Report
BDA	Bundesvereinigung der Deutschen Arbeitgeberverbände (Confederation of German Employers' Associations)
BDI	Bundesverband der Deutschen Industrie (Federation of German Industries)
BMF	Bundesministerium der Finanzen (German Federal Ministry of Finance)
BMWA/BMWI	Bundesministerium für Wirtschaft und Arbeit/Bundesministerium für Wirtschaft und Technologie (German Federal Ministry of Economics and Labour/Economics and Technology)
BUSINESSEUROPE	Confederation of European Business (successor organisation to UNICE)
CEEP	European Centre of Employers and Enterprises Providing Public Services
DGB	Deutscher Gewerkschaftsbund (Confederation of German Unions)
DIW	Deutsches Institut für Wirtschaftsforschung, Berlin (German Institute for Economic Research)
ECB/ESCB	European Central Bank/European System of Central Banks
EFSF	European Financial Stability Facility
EIF	European Industry Federations
EIP	Excessive Imbalances Procedure
EMF	European Metalworkers' Federation
EMS	European Monetary System
EMU	(European) Economic and Monetary Union
EP	European Parliament
EPC	Economic Policy Committee
ESC	Economic and Social Committee
ESGP	European Stability and Growth Pact
ESM	European Stability Mechanism
ETUC	European Trade Union Confederation
EU	European Union
EUROMED	Macroeconomic Dialogue at euro area Level
GDP	Gross Domestic Product
IGM	Industriegewerkschaft Metall (German metalworkers' union)
LMWG	EPC Working Group on Labour Market Issues
MED	European Macroeconomic Dialogue
MEDNAT	Macroeconomic Dialogue at National Level
MIP	Macroeconomic Imbalances Procedure
NRP	National Reform Programme
OECD	Organisation for Economic Cooperation and Development
SCP	Stability and Convergence Programme
TFEU	Treaty on the Functioning of the European Union
UEAPME	European Association of Craft, Small and Medium-size Enterprises
UNICE	Union of Industrial and Employers' Confederations of Europe
UNCTAD	United Nations Conference on Trade and Development
WGWM	EPC Working Group on Wage Monitoring

Introduction[2]

Researchers and politicians alike now largely agree that the crisis in the euro area can be attributed primarily to macroeconomic imbalances within Economic and Monetary Union, although much more research is needed into the complex factors underlying the crisis. The main factors involved in the emergence of long-term negative macroeconomic trends in the euro area were imbalances in Member States' current accounts and capital accounts and, in some cases, levels of public debt. The current political and institutional structures of the EMU as a whole have proved insufficient to prevent or rapidly to remedy these negative developments, which were evident and recognized at a very early stage. As a result, the crisis has – rightly – been attributed to shortcomings of economic governance across the euro area. The declared aim of European policy is, therefore, to overcome these existing governance shortcomings.

Most of the existing architecture of EMU governance dates from the 1992 Maastricht Treaty, although it has been amended and developed on an ongoing basis since then. Under this Treaty, the euro area is an economic and monetary union with a single, independent monetary policy, a decentralised fiscal policy (albeit subject to supranational rules), and decentralised structural policies supported by a shared monitoring process on the basis of the relatively light-touch 'Open Method of Coordination'. The aim of this monitoring process was primarily to generate political pressure for rapid implementation of the structural reforms needed to strengthen growth factors, on which the EU Member States had agreed as part of the 2000 'Lisbon strategy'.

Against the backdrop of the crisis in the euro area and the complete failure of the Lisbon process and its declared aim to make the European Union "the most competitive and dynamic knowledge-based economy in the world", there is now an intensive debate around developing 'European economic governance' and even political union. There is a desire to coordinate economic policy measures more closely within the EMU and, especially, to improve enforcement. The measures agreed so far represent a fundamental shift in governance, away from gradualist and non-binding undertakings by national governments that previously had

[2] The author would like to thank Volker Hallwirth and Andrew Watt for constructive advice and feedback on this study.

sovereignty in these areas and towards an economic policy governed by supranational rules. A key aim is that it should help stabilise the expectations of all economic players, something that only a rule-governed policy can achieve. The heart of the new economic governance arrangements is the new process for preventing and correcting macroeconomic imbalances. In terms of its force and intensity, this process is comparable to the Stability and Growth Pact (SGP) as demonstrated by the fact that in both Regulations – that on preventing and correcting macroeconomic imbalances and that on implementing the rules – the same 'reverse majority' is applied as in the case of the revised SGP. This means that recommendations made by the Commission can be rejected by the Council only within a very short time frame and subject to a qualified majority.

Closer monitoring of fiscal policy is included in four of the six Regulations comprising the 'Six-Pack'.[3] There is also what is known as a 'Fiscal Compact', which stipulates a reduction in both new and cumulative public debt by means of a 'debt brake' along the lines of the mechanism introduced in Germany.[4] This provision crosses the Rubicon between primarily national sovereignty over fiscal policy and supranational management of fiscal policy; the Treaty itself is intended initially to be the subject of regulation between Member States and will only later be transposed into EU law. The parliamentary hurdles for approval of the Fiscal Compact are, therefore, high.

The two remaining Regulations forming the 'Six-Pack' target the prevention and correction of macroeconomic imbalances (the Macroeconomic Imbalances Procedure, or MIP) and implementation of appropriate measures, including sanctions. They are, in fact, the new element in economic policy coordination. The key factor is that politicians have to sacrifice their primary focus on fiscal balances and structural reform and give the new arrangements the weight they deserve in terms of their relevance to achieving balanced overall economic development, both within the euro area and in the EU Member states as a whole.

The process itself uses a 'scoreboard' with alert thresholds for the external and internal

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[3] A further governance package, the 'Two-Pack', includes a Regulation on closer monitoring of the budgets of all the euro area countries and a further Regulation on monitoring euro area countries that are in economic and financial difficulties.

[4] The Fiscal Compact is the heart of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The aim of this Treaty is to expand coordination of economic policy via a mechanism for 'enhanced cooperation' and, in particular, via the reporting and coordination of major proposed economic policy reforms and to improve governance of the EMU by means of European summits at top level, held as necessary but at least twice a year, and appointment of its own President.

indicators against which each Member State is measured. As set out in detail in the next section, ranking these indicators by cause and impact shows that unit labour costs are not merely a key indicator in themselves but also determine most of the other indicators. Unit labour costs are the result of (labour) productivity and effective earnings. As the most recent economic crisis in particular has demonstrated, short-term growth in productivity is determined by economic growth across the board, whereby labour costs are one of the factors governing macroeconomic growth. By contrast, despite 'wage drift', there is a relatively close relationship between effective earnings and the nominal wage settlements achieved in collective bargaining between trade unions and employers' associations.[5]

This raises the question of whether, in countries where autonomy of collective bargaining is protected by law or even by the Constitution, this protection can be over-ridden by Member States' obligations to carry out macroeconomic monitoring of compliance with the maximum and minimum thresholds for unit labour cost growth. The question is thus whether there is a tension between the new economic governance arrangements and autonomy of collective bargaining and, if so, how this can be resolved.

Another important, but more general issue is the role of wage growth and of the social partners in an economic and monetary union like the euro area and its interaction with other economic policy actors. Here, too, our study is intended to make a contribution. It explicitly avoids tackling fiscal policy reform and the stabilisation and regulation of the financial markets as further elements of EU governance, focusing instead on the macroeconomic imbalances as the major cause of the euro area crisis. The Introduction sets out in brief the central role played by wage policy – and hence by the social partners – within a monetary union. A review covers a number of aspects of current governance that relate to wage policy and the social partners, in particular the Broad Economic Policy Guidelines as a central coordination tool within the EU and EMU. It also summarises previous initiatives on coordination taken by the trade unions.

The second, forward-looking, part of the study begins with a description of the new elements of macroeconomic governance in its radical break with the existing, non-binding method of

[5] The difference between settlement rates laid down by collective agreement and effectiveearnings is the result of what is known as 'wage drift'. When the labour market undergoes major structural change – often as a result of legislation, such as expansion of the low-wage sector or higher levels of part-time working – wage drift per employee can be quite substantial over a given period of time.

coordination. It describes the main Regulation on preventing and correcting macroeconomic imbalances, the components of its central analytical and operational mechanism – the 'scoreboard' – that are relevant to collective bargaining policy, the findings of the first Alert Mechanism Reports, and the provisions within the Regulation for involving the social partners. This section concludes with our finding of a fundamental shortcoming in the Regulation, which treats 'deficit countries' and 'surplus countries' asymmetrically. It also identifies an area of tension between the authoritative status of the new economic governance arrangements and the autonomy of the social partners to conduct collective bargaining.

The second section in this part of the study then sets out options for tackling the tension identified above. It proposes solutions for institutional implementation of our preferred option – greater centralisation and coordination of wage setting, both within individual Member States and between the EMU Member States, while preserving the current autonomy enjoyed by the bargaining parties. It concludes by demonstrating how improved wage-setting arrangements and self-organisation by the social partners can interact more effectively with other macroeconomic actors, such as monetary or fiscal policy.

It is important to counter from the outset one possible, but serious, misunderstanding. The proposals contained in this study should not be seen as pressure on the unions or as a demand that they make one-sided concessions when they are unsure that the other actors will also play their part. Closer coordination as part of new economic governance arrangements can succeed only where *each actor* makes its own essential contribution. Closer coordination between the Member States in the area of fiscal policy within EMU is equally challenging and has yet to be tackled. The same is true of finding an appropriate role for monetary policy within EMU. Each policy area needs to support the others in making their contribution, especially since no actor can achieve its goals alone and without harming the others. This mutual support has, as we demonstrate, been clearly lacking up to now. The check-list for internal and external coordination by trade unions is relatively long, but this is simply because the requirement for cooperation is considerably higher here than, for example, with monetary policy because individual countries are starting from very different bases. The more successful cooperation within the trade unions is, the more easily they will be able to deal with other actors on the same footing. In the process of give and take between all the actors, the social partners have their part to play in ensuring closer coordination and, thus, leading the euro area out of its

current crisis and restoring the framework for a sustainable economic development oriented to stability, growth and employment. This contribution will be repaid, not least in the form of greater acceptance of, and appreciation for, centralised collective wage setting against the background of bargaining autonomy.

Below, we frequently focus specifically on the trade unions when considering the role of the social partners. However, every collective agreement is signed by two parties. What has been said in relation to the trade unions applies also to the employers' associations, with the caveats that result from the structure and interests of the employers' side (which may be of a very different nature from those of the unions).

I. The pivotal role of wage growth within monetary union

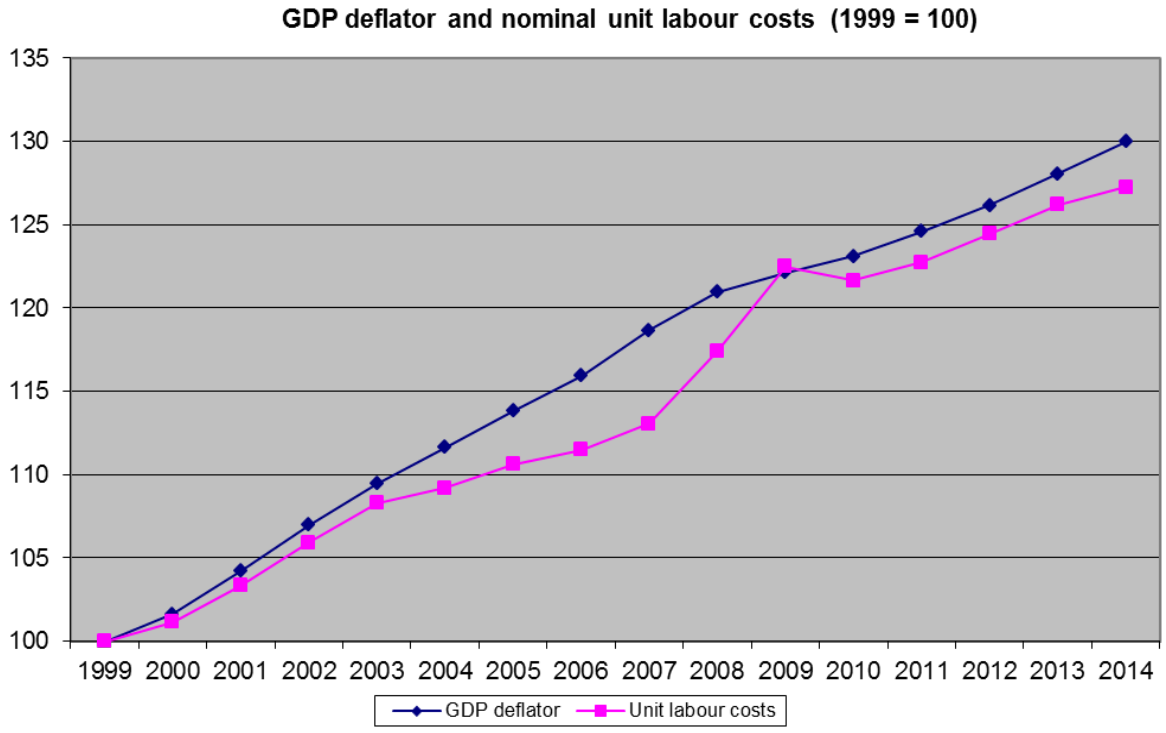
The 'Six-Pack' provided for compulsory coordination to be extended beyond purely fiscal balances to further macroeconomic variables, a step that – given the divergences that were arising – was entirely consistent. In particular, it is essential within monetary union to monitor divergent unit labour costs in the various Member States. Changes in (nominal) unit labour costs are the result of differing rates of change in effective earnings and labour productivity. The wage component of unit labour costs – adjusted for 'wage drift' – is directly determined by nominal wage settlements. The productivity component of unit labour costs is influenced in the short term by, among other things, global economic trends, which in turn are influenced partly by nominal wage settlements. Nominal wage settlements usually have a *direct* effect through macroeconomic *price and volume values*, as we explain below. Through their influence on price growth, nominal wages also have a major influence on the direction of monetary policy and, thus, also an *indirect* but decisive effect on the economic dynamism of the entire monetary area.

The *price effect* is the result of the influence of nominal wages on inflation. Domestic 'home-grown' inflation – that is, GDP deflator – is determined by three values (unit labour costs, business profits, and indirect taxation[6]), with the result that, in some Member States, business

[6] It was particularly striking here that the 2007 rise in VAT in Germany, when combined with a cut in labour costs, functioned de facto like a 'fiscal devaluation'. In the wake of consolidation measures in the

profits have at times had a greater influence than unit labour costs on inflation.[7] However, over the longer term, the closest link has remained that between nominal unit labour costs (and, hence, nominal wages) and GDP deflator (Figure 1).

Figure 1: GDP deflator and nominal unit labour costs in the euro area



Source: AMECO (May 2013); author's own calculations[8]

However, as Figure 1 shows, this convergence repeatedly concealed divergences, representing growth in *real* unit labour costs measured as the difference between the GDP deflator and the change in *nominal* unit labour costs. And the change in real unit labour costs reflects the shift in income distribution between capital income and earned income. Real unit labour costs have

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'programme countries', consumer taxes have been increased drastically in those countries.

7 See European Central Bank (2005), p. 64.

8 History shows that the data for recent years – including those in other Figures and Tables in this study – require frequently radical updating.

risen at very different rates over recent decades.[9] Between 1970 and 1980, they rose modestly (by around 3%) in the Member States of the Twelve, reflecting an improvement in favour of earned income. Over the subsequent decade, they then fell by around 9%. This decline continued in the 1990s, although at a markedly slower rate (6%), and real unit labour costs fell again, by 1%, in the first full decade of the new millennium. In the USA and Japan, by contrast, average income distribution by the same measure remained unchanged throughout the 1990s and then fell relatively markedly, by around 7%, in the following decade.[10]

There are a number of reasons for these trends in income distribution, and it is impossible here to consider in detail the influence each individual causal factor has had. One such factor is the wage restraint that resulted from long-term high unemployment, the weakening of the unions' bargaining power or 'appeals' from government. It is also possible to single out 'wage moderation' resulting from assumed or actual global competition or as a response to technological change – for example, a widening of pay ranges at the bottom end of the scale as a result of increased part-time working and temporary and agency work and of expansion of the low-wage sector. 'Labour market reforms' of other kinds also have a part to play, however, as they cause effective earnings to fall or, at least, to rise less rapidly. A further reason may be the growing importance of non-wage income and capital gains from the financial market sector, with greater 'financialisation' of the economy and the imbalance in distribution reinforcing one another. In the real economy, a growing monopolisation may well have produced a higher mark-up on prices.[11] Increases in consumer taxes have also meant the state helping to drive up prices. However, this left the picture of relative parallel development of unit labour costs and price levels unaffected over the long term.

Through their effect on inflation, nominal unit labour costs and, hence, nominal wages influence two *specific prices* that are fundamental to the creation of divergences within the euro area. First, differing wage and/or price paths produce differing real interest rates both in

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9 See European Economy (2011), pp. 96-97.

10 In the light of the divergences in the euro area, it is interesting that *nominal* unit labour costs in countries such as Germany and Spain changed at markedly different rates between 2000 and 2010 (rising by around 6% and around 30% respectively) yet both countries saw their *real* unit labour costs fall by around the same percentage (around 5% and around 6% respectively). Thus, the proportion accounted for by wage income fell in both countries – that is, it was not determined by whether the economy was in a period of inflation or deflation.

11 See Krämer (2011). For a comprehensive analysis of the causes and effects of increasing imbalances in income distribution, especially for economic growth and for structural and macroeconomic measures to correct imbalances, see, *inter alia*, UNCTAD (2012) and Flassbeck, Spiecker, Meinhardt, and Vesper (2012).

the short term and, until the crisis hit, also in the long term; this is because central bank base rates of interest are the same for all EMU Member States. Differences in real interest rates, however, produce differences in rates of national growth and all macroeconomic values that are sensitive to real interest rates.[12] These include, for example, investment in (private residential) construction. Differences in the dynamics of the real economy generated in this way account for or intensify differences in expectations of further price growth. An expectation that prices will rise further then has a direct reinforcing effect on activity in the real economy, setting in train an upward spiral in prices and volumes.

Alongside this internal effect, nominal wages and, hence, prices (to the extent that they are determined by wages) have an impact on external price competitiveness. In the absence of nominal exchange rates, unit labour costs impact directly on the real exchange rate between Member States via the price of tradable goods. Divergences in the real exchange rate in their turn contribute to divergences in the current account.

As well as the price components – real interest rates and real exchange rates – nominal wages also, by definition, have an influence on growth in real terms. Nominal wages are a key value in the distribution of available income between workers' income and residual corporate and investment income. Assuming that worker households have a lower (marginal) savings rate than entrepreneur households, nominal wages are one of the factors influencing how income across the economy is used – for spending or for saving. Household spending is most important in terms of boosting domestic demand. Saving that is not absorbed by domestic sectors or the state, by contrast, can only be achieved as a current account surplus in relation to other countries and mirrors capital export.

Vital to the formation of divergences between Member States is the fact that the price and volume effects of nominal wages set out above operate in line with, rather than counteracting, each other: both components reinforce divergences in domestic demand and net exports. Thus, when wages and unit labour costs are too low in one Member State, this brings domestic demand down but at the same time improves price competitiveness.[13] The first effect, on

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[12] In a speculative environment, individual assets may form a 'bubble' with price rises in double digits and prices losing any relationship with growth in nominal wages. As a result of soaring prices, the effect of price increases on (negative) real interest rates is higher than that of low or zero nominal rates of interest.

[13] "In the surplus countries, demand grew much more slowly than supply, while at the same time price competitiveness improved markedly. The central driving force behind this has been a policy of wage

volume, weakens imports, while the second, on prices, boosts net exports. This improves the current account from both the import and the export side. If a Member State's unit labour costs are too high, however, the opposite applies. Moreover, the divergence actually widens *from both sides* – that is, the current account is boosted in one country but simultaneously deteriorates in the other.

Figures 2 and 3 illustrate these connections for both 'episodes' of the crisis.[14] The first covers the post-1999 period culminating in 2008 and shows the widening divergence in unit labour costs and, therefore, in current account deficits as the primary cause of the crisis. The second shows the post-crisis adjustment in unit labour costs and – with the exception of Germany – in balance of payments deficits. This is reflected in the fact that the accumulated deficit in the 'deficit countries' no longer grows, stabilizes or even shrinks.[15]

Figure 2 also shows the ECB's inflation target (here assumed to be 2% p.a.) as an orientation value for growth in unit labour costs that will boost stability. This kind of growth in unit labour costs – as in France, for example – is a condition for tension-free growth within the euro area. It is clear that, in line with the forecasts made by the European Commission, all the countries that had markedly over-shot the ECB's price path before the crisis (except Italy) regained or even under-shot it by 2012 – and, in fact, by a large margin for the two subsequent years, according to projections. The major exception is Germany. Until the crisis hit, Germany's unit labour cost growth was lagging increasingly *behind* the ECB target, and since then, the gap has remained virtually unchanged. Germany is not, however, adapting to the norm as the 'deficit countries' are having to do; to achieve this, unit labour costs in Germany would have to rise over a number of years considerably more sharply than the ECB's annual price target.

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moderation..."; Glassner and Watt (2010). See also Horn, Lindner, Tober and Watt (2012), p. 4.

14 "Empirical studies show in this context that relative unit labour costs really are correlated with foreign trade balances (cf. Mongelli und Wyplosz 2009) ... However, it is unclear where the causality lies."; Egger and Etzel (2011), p. 3.

15 Some studies represent divergences in current account balances as a proportion of the annual GDP balance. This is a better expression of the *relationship* for each country. Here, we have instead chosen to represent solely the balances in cumulative form, to illustrate the comparison between *absolute* values.

Figure 2: Nominal unit labour costs

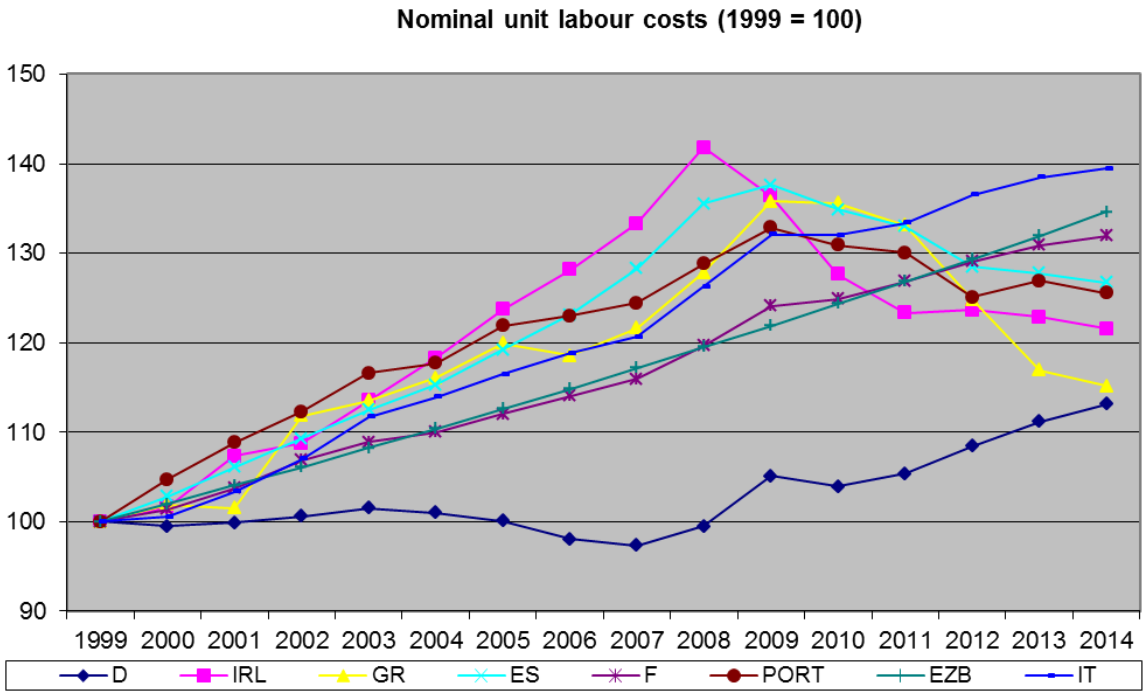
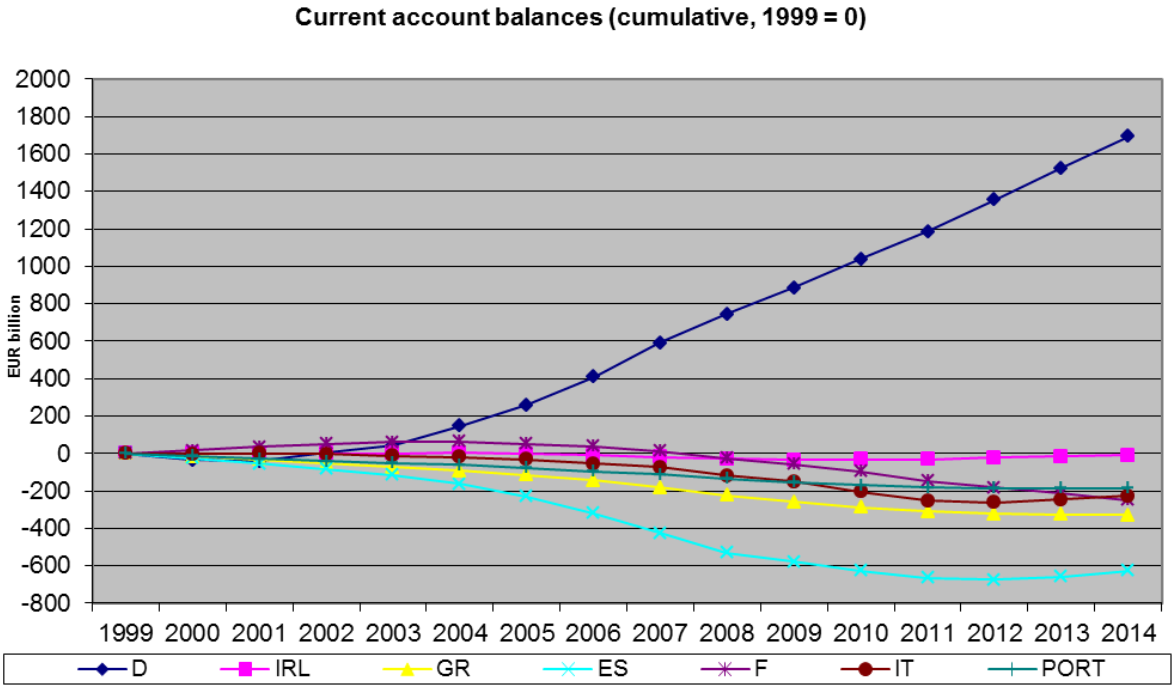


Figure 3: Current account balances



Source: AMECO (May 2013), author's own calculations

Nominal wages are a variable that can be influenced exogenously, where there is centralised or coordinated wage setting, and also have an influence on macroeconomic variables through their effect on prices and volumes, regardless of the fact that – as set out above – it is not wages *alone* that determine prices and that prices are one of the factors influencing wages.[16] This is directly evident where there is wage indexation. However, nominal and real growth are also key factors in wage setting by the social partners. Thus, the Member States entered into economic and monetary union with widely differing levels of macroeconomic growth and, hence, very different scope on the part of businesses to set prices, which was one of the yardsticks for wage setting. Over a period of years, the divergences in macroeconomic price growth between the Member States of the euro area then produced similar divergences in wage setting – under the influence, in some cases, of excessive speculation in the property market – until these culminated in a crisis.[17] Price trends and shifts in wages are determined in addition by an expansive or restrictive approach to national fiscal policy, both as a determining factor and as a corrective.[18]

However, in terms of the steering function of wage policy, it is not important whether wages influence economic growth and, hence, prices or the other way round. There are two key factors in the macroeconomic role of wage setting. The first is that economic growth – that is, the distribution and expenditure of national income – is subject in its volume and price components primarily to collective bargaining where the bargaining strength of the social partners is strong, either directly or because it covers a high proportion of the economy. The second is that, even where there are non-wage influences on prices, wage policy – in those cases in which it can function as a macroeconomic variable thanks to its role in coordinated collective wage bargaining – can help to nudge price development in the right direction where this is intended by the collective bargaining actors.

Ultimately, wage growth oriented to national productivity and the ECB's price target and, where necessary, supported by fiscal and competition policy is a stabilising anchor in the distribution and expenditure of national income, price development and competitiveness –

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16 This latter position is also presented in exclusive terms. See, for example, Morgan Stanley (2004). The European Commission comments, "A simplistic view according to which labour costs move exogenously and cause imbalances should be avoided ..."; European Commission (2011), p. 99.

17 See, *inter alia*, Horn, Lindner, Tober and Watt (2012), p. 3.

18 See, *inter alia*, Horn, Lindner, Tober and Watt (2012), p. 4 and p. 22 ff.

regardless of whether it is pro-active or reactive.[19] If pay growth follows this rule in all Member States, then there is no tension between the Member States and this also helps to maintain price stability across the whole of the euro area. In terms of the global economic embedding of the euro area, this means price growth does not distort price competitiveness in relation to the rest of the world and, hence, does not trigger pressure from the EMU for a change to the structure of the currency markets. The euro area is, then, stable both internally and externally.

II. Wage policy and the social partners within economic policy coordination in the past

Elements of economic policy coordination

The Member States of the EU coordinate their economic policy under Article 121 TFEU and its predecessors. The main instrument they use to do this is the 'Broad Economic Policy Guidelines of the Member States and of the Union'. These Guidelines set out annual recommendations for macroeconomic wage development and the role of the social partners. Consistent emphasis is placed on a wage policy in which nominal wage growth is compatible with the price stability target while, at the same time, real wage growth is closely linked to growth in productivity. However, over more than a decade of these Guidelines, there has been a distinct shift in the respective roles of the social partners and governments in relation to the recommendations in the Guidelines. In the 1998 Guidelines, power and responsibility for wage growth and wage setting systems lay unambiguously with the social partners, while governments had more of a supporting role. However, the Guidelines then increasingly recommended that governments themselves should be active in ensuring the right framework for collective bargaining systems and growth in labour costs. In addition, wage development in the public sector should be used to influence wage outcomes in the private sector too, with the aim of achieving wage restraint throughout the economy and counteracting institutional obstacles to the required flexibility in adapting prices and wages to market conditions.

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[19] Collignon calls here for this rule to be modified in accordance with the efficiency of the relative national capital stock: the greater the rise in its efficiency, the greater the possible increase in unit labour costs without loss of competitiveness. See Collignon (2012), p. 126.

Governments have again and again failed to comply with a central provision of the Guidelines, namely intervening to orient nominal wages to price stability and real pay to productivity *in each Member State*, despite the formal compromises and qualifications with which they have hedged this rule about. The outcome of this discrepancy between the Member States' commitments under the Treaty and the economic policy and economic trends actually in force within the euro area has been many years of divergence within unit labour costs, which eventually assumed crisis dimensions.

As the central tool for coordinating economic policy within the EU, the Broad Economic Policy Guidelines specify, from the perspective of the Council and the Commission, the demands placed on social partners in the macroeconomic policy mix as well as in the structural reform agenda laid down by the Lisbon Strategy and its successors. Other rules and institutions are also of relevance to the role of the social partners within the governance of the EU.

The most important of these is Article 152 TFEU: "The Union recognises and promotes the role of the social partners at its level, taking into account the diversity of national systems. It shall facilitate social dialogue between the social partners, respecting their autonomy." This also includes Article 153 (5), which excludes the Union becoming involved in pay, the right of association, the right to strike and the right to impose lock-outs.

These general provisions can be found in many different forms and in many different bodies, including the *Economic and Social Committee* (ESC; see Articles 301-304 TFEU). The EP, the Council and the Commission consult the ESC in cases laid down in the Treaties, but it can also issue Opinions on its own initiative. In accordance with Article 300 (2), it comprises representatives of employers' and workers' organisations and other representatives of civil society. Since it has a purely advisory function and covers a very wide range of areas, however, the ESC is far from having a role in determining wage policy as part of the economic governance of the EU.[20]

European Social Dialogue, as laid down in Article 151 ff. TFEU, has a different role to play within the governance framework. Workers are represented within European Social Dialogue by the ETUC and employers by CEEP, BUSINESSEUROPE (formerly UNICE) and

[20] "From a body initially limited to representing economic and social interests, the ESC evolved into one representing 'diffuse' general interests"; Bieber, Epiney and Haag (2011), p.155.

UEAPME as representatives of public sector, large, and small and medium-sized companies respectively. The main focus of the bilateral work programmes, which run for several years, is to lay down European social standards. In addition to the consultative role laid down in Article 154 TFEU, the dialogue between the social partners may also, in accordance with Article 155 TFEU, "lead to contractual relations, including agreements." European Social Dialogue has produced many framework agreements, autonomous agreements and frameworks for action, including the framework agreements on part-time work and on fixed-term contracts. However, all these agreements are of a general nature and – more importantly for our purpose – make no explicit provision for a contribution to overall wage development. A macroeconomic working group, set up under the Commission's management, regularly discussed the economic situation and, where appropriate, drew conclusions for economic policy. However, the finance ministers and the ECB were not represented on it, which meant that the actors central to achieving a macroeconomic policy mix were absent.

The *Tripartite Social Summit for Growth and Employment*, provided for in Article 152 TFEU, meets annually before the European Council's spring summit; the social partners, the European Council Troika, and the Commission all attend. Its aim is to facilitate an exchange of views on macroeconomic issues, though these form only part of the agenda, which also includes labour market policy, social policy, and education and training policy; the time available for an exchange of views is, therefore, extremely limited and discussions are not binding in any way.

The involvement of the social partners acquired a qualitatively new dimension with the instigation of the *European Macroeconomic Dialogue* (MED) at the European Council held in Cologne in June 1999, around the time EMU came into being. The participants in MED are: the President of the ECB; a representative of the non-euro area central banks in other EU Member States; a Troika of the Ministers for Economics and Finance and for Employment, Social Affairs and Inclusion, chaired by the current President of the ECOFIN Council; the Commissioners for Economic and Monetary Affairs and for Employment, Social Affairs and Inclusion; and the heads of the European employers' associations CEEP, EUROBUSINESS and UEAPME and of the European Trade Union Confederation (ETUC). MED is, therefore, the sole EU body to bring together round one table *all* the actors involved in the macroeconomic policy mix. The aim of MED is to facilitate an exchange of views on the

current macroeconomic situation and outlook within the EU and on improvements in the interaction of wage development and of monetary and fiscal policy for sustainable, non-inflationary growth. There is no provision for decisions binding on all participants in the sense of *ex ante* coordination. The groundwork for the political MED is carried out at technical level by a body constituted along the same lines.[21]

There were many reasons for setting up MED. Monetary policy is now set at EMU level rather than at national level, whereas fiscal policy and wage policy remain essentially at national Member State level. For there to be a macroeconomic policy mix, it is, therefore, essential to have both fiscal policy and wage policy discussed at EMU level. A policy mix of this kind should be oriented both to stability and to employment. Its primary aim should be to avoid the kind of conflict that arose between monetary policy and wage development in the first half of the 1970s and again of the 1980s in the wake of the two oil price shocks – with disastrous results for prices and employment. Ultimately, the formal hierarchy of objectives and instruments within EMU is such that monetary policy is deemed to determine price stability, while wage development and, hence, the social partners take responsibility for employment. However, this means in practice that the two actors are neither *autonomous* in achieving their own goals – at least without major risks and fall-out – nor *neutral* in relation to the goals of the other, so coordination is needed because of these external effects. Yet because the actors are independent and autonomous, such coordination cannot be the mandatory and binding *ex ante* coordination stipulated in the SGP but is, rather, indicative cooperation based on dialogue. The aim is to prevent misunderstandings and conflicts and to develop a joint perspective on the evolving economic situation and a harmonious, purposeful direction for individual policies with the aim of mutual 'signalling' and trust.[22]

Placing MED at EU level has proved both a strength and a weakness. Against the backdrop of focusing coordination within the EU on structural reform in diverse areas with country-specific recommendations, MED is the only forum in which all the relevant actors involved in macroeconomic policy setting at EU or EMU level are represented. It has, therefore, been important to ensure that this unique macro-level body relating to the EU and the euro area in

[21] On MED, see also Koll (2004) (English version 2005) and the Council documents cited.
[22] On the 'signalling' function, see Watt and Hallwirth (2003), pp. 610-632.

its entirety is not overburdened with the full range of reform agenda issues or with country-specific details. This has also applied to the participants' perception of their own role. The ECB, for example, was initially interested only in trends in inflation at EMU level and considered country-specific price trends to be outside its remit, provided these did not threaten price stability at EMU level or cohesion within the euro area as whole. The social partners, too, focused solely on the European level in their discussions within MED and were represented by their European umbrella associations, whose authority derived primarily from their European 'added value'. They were very concerned to keep debate within MED at European level, knowing also that any country-specific positioning would have attracted criticism from the national umbrella bodies, trade associations and individual trade unions. The Commission representatives, meanwhile, saw MED as an instrument of 'soft coordination' focusing primarily on wage growth; from the outset, their involvement was at EU and/or EMU level.[23] Country-specific trends, by contrast, were dealt with within the structural reform agenda via peer review, peer pressure, best practice and the 'Open Method of Coordination' within other bodies, including the EU's Economic Policy Committee.

The main discussion line within MED was, *de facto*, between monetary policy and wage policy. Monetary policy required the social partners to deliver sustainable wages geared permanently to price stability in terms of the EMU average. The social partners themselves wanted the most favourable possible monetary conditions in terms of interest rates and exchange rates. The trade unions justified this demand by citing higher employment levels. The employers' associations were keen not to impair competitiveness within the euro area (which had been achieved not least through 'wage restraint') by forcing appreciation through rising interest rates. The finance ministers, as president and moderator of MED; for their part, believed the Eurogroup was the key body and were reluctant to become involved in MED until the crisis broke out.[24] In short, the economic policy actors have not made use of the platform represented by MED to achieve a binding improvement in coordination of monetary, fiscal and wage policy. And they have been even less successful in achieving robust results on preventing or correcting country-specific imbalances, especially since these did not explicitly form part of the mandate of MED.

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[23] See European Commission (2002), p. 4.

[24] For an interim assessment of MED 10 years on, see, *inter alia*, Hallwirth and Koll (2009), p. 26 ff. and Koll and Hallwirth (2009), p. 467 ff.

Coordination within the trade unions

The ‘Broad Economic Policy Guidelines’, together with other instruments and bodies, determine the role of the social partners in the economic governance of the EU. But how do the social partners themselves define and organise their involvement in the new framework created by the EU and by EMU? This question also has to be seen against a background of a long-term shift in the direction of wage policy that occurred independently of developments within the EU and EMU. The starting point was the ‘solidaristic’ wage policy in place in most (Western) European countries for the 30 years immediately following the Second World War.[25] Wage setting was governed by growth in productivity right across the economy. The ‘solidaristic’ element kept wages in sectors with high productivity from rising too much while at the same time keeping wages in sectors with lower productivity from falling too low. This strategy also incorporated the ‘law of one price’ in individual sectors, which – in contrast to perfect wage differentiation at company level – provided a dynamic incentive for both individual companies and the economy as a whole to pursue structural change. However, since the 1980s, this solidaristic policy has been supplanted by a ‘competition oriented’ wage policy at the level of individual countries – also referred to as ‘national competitive corporatism’.[26] The social partners in each country formed alliances, sometimes at the urging of, or under pressure from, their governments, and Member States began competing with each other, with a marked ‘beggar-my-neighbour’ tendency in the form of driving wage settlements markedly lower than the ‘medium-term productivity growth plus inflation’ formula that had previously been the relatively harmless preserve of small, open economies. In Germany, the example *par excellence* is the 1998 ‘Pact for Employment, Training and Competitiveness’. In the face of this trend there are calls for vertical coordination of wage, fiscal and monetary policy at national level and horizontal coordination of wage and fiscal policy between the national levels, as well as a strengthening of the EU budget to achieve an effective redistribution policy within the EU but specifically “… the development of an autonomous trade union concept for a European economic policy.”[27]

[25] See Schulten (2004), p. 192 ff.
[26] See Schulten (2001), pp. 17-24.
[27] See Schulten (2001), p. 24.

The trade unions attempted to meet these demands and at the same time to counter at EU level the mercantilistic tendencies in which some of them were actually participating at national level. Specific examples here include the 1998 Doorn declaration agreed by the unions in Belgium, Germany, Luxembourg and the Netherlands, the European Metalworkers' Federation's (EMF) acceptance of the European coordination rule, and the ETUC's 2000 coordination guidelines, which formed the basis of the Executive Committee's proposals for coordination of collective wage setting and corresponding Resolutions.[28] The Doorn declaration specified that the unions involved agreed to seek to "achieve collective bargaining settlements that correspond to the sum total of the evolution of prices and the increase in labour productivity." The EMF's resolution, meanwhile, specified that the key reference point and criterion for trade union wage policy in all countries must be to "offset the rate of inflation and to ensure that workers' incomes retain a balanced participation in productivity gains. … The unions keep their full autonomy and take full responsibility in respect of how they use this distribution space for the improvement of wages and measures geared towards fostering employment such as reduction of working time and training." Crucial, because they are constantly being developed, are the Resolutions adopted by the ETUC on coordination of collective bargaining and its coordination guidelines.[29] These stipulate that growth in nominal wages must at least exceed inflation, with the maximum scope given for including productivity in wage claims. This was to achieve three aims:

- "to have *a general indication on wage bargaining* which comes from trade unions at the European level in order to respond to the existing guidelines coming from the Commission (Broad Economic Policy Guidelines) and the ECB, and in order to influence the Macroeconomic Dialogue;
- to *avoid* social and wage dumping and *wage divergence* in Europe, as this could lead to a deterioration of the social climate and could delay the social convergence of the Member States;

[28] In addition to the networks listed here, there are further sectoral and cross-border coordination networks; see Glassner and Watt (2010).
[29] Cf. Janssen (2004), p. 170.

- to *coordinate wage claims in Europe*, particularly in the Single Currency area where pay is now easily comparable and also to encourage an upward convergence of living standards in Europe."[30]

On the basis of reports on coordination of collective bargaining that compared growth in pay at national level with the coordination guidelines, the ETUC's Executive Committee has regularly adopted Resolutions.

In addition to these guidelines, the ETUC resolved at its 1999 Congress in Helsinki to develop European coordination of collective bargaining at both sectoral and cross-sectoral level. The effect of this was to transfer primary responsibility for coordination to the European Industry Federations (EIFs), the sectoral bodies at EU level.[31] In terms of content, this involved a shared understanding of key collective bargaining components, such as adjustment for inflation, labour productivity, and productivity growth. The role of the ETUC itself was to use coordination as a tool to ensure a consistent model, while the employer bodies, UNICE and CEEP, were to be called on to agree to create a framework for autonomous bargaining at European level.[32]

III. The new macroeconomic regime within economic governance

In terms of an interim assessment, it can be concluded that neither government commitments in the form of the Broad Economic Policy Guidelines, nor other institutions and bodies, nor existing coordination within the social partners has been enough to prevent excessive and damaging divergences arising within the EMU.

Indeed, while there were early warning signs that could – had they been taken seriously – have produced corrections in the direction taken by EMU economic policy, attempts to tackle the divergences within the euro area came too late, were too sporadic and failed.[33] Rather than

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[30] See European Trade Union Confederation (2000) (italics added). As is evident, the guidelines include demands that are constitutive of the functioning of a monetary union, although for different reasons.

[31] See Behrens, Hurd, and Waddington, J. (2003), p. 536.

[32] See European Trade Union Confederation (1999).

[33] The same applies to the requirement in the Broad Economic Policy Guidelines 2008-2010, guideline 3, that "... In countries with declining market shares, wage moderation together with reforms boosting productivity are necessary so as to ensure that unit labour costs adjust in order to restore competitiveness. These issues

attending to these divergences and imbalances in country-specific price and wage growth and the endogenous factors fuelling them, those involved took a more hands-off stance, citing ‘catching up’ and the Balassa-Samuelson effect and expecting that the market would correct the imbalances which proved to be permanent, lasting and pro-cyclical.

There was no attempt to amend this course until the crisis on the financial markets brutally laid bare the unsustainable nature of the way things were going. As so often, the parties involved had to engage in ‘pathological learning’ instead of taking preventive action. Economic policy therefore currently faces the simultaneous challenges of correcting the existing divergences, preventing further divergences, and restoring a maximum of growth dynamic across Europe and in individual Member States.

The Regulation on the Prevention and Correction of Macroeconomic Imbalances

The European Council, the Council and the Commission reacted to the crisis with the ‘Europe 2020’ strategy, the ‘European semester’ and the ‘Euro Plus Pact’. They agreed aid packages for Member States particularly severely affected by the crisis, provided support – primarily through the EFSF – and resolved to create a permanent fund in the form of the ESM, supplemented with an intergovernmental Fiscal Compact. In late June 2012, the European Council also agreed a ‘Compact for Jobs and Growth’.

The ‘Euro Plus Pact’ has four aims: to promote competitiveness, to boost employment, to help put public finances on a sound long-term footing, and to strengthen financial stability. As part of the first of these aims, growth in unit labour costs in the economy as a whole, as well as in key sectors, was to be monitored and assessed. In the ‘deficit countries’ in particular, reforms were to be instigated with the aim of keeping costs in line with productivity: the measures proposed include “review[ing] the wage settlement arrangements and, where necessary, the degree of centralisation in the bargaining process, and the indexation mechanisms…” and “ensur[ing] that wage settlements in the public sector support the competitiveness efforts in the private sector ...”. Additionally, the Pact recommends “labour market reforms to promote

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need to be taken into account in the continued dialogue and information exchange between monetary and fiscal authorities and the social partners via the Macroeconomic Dialogue.”

‘flexicurity’”, so as to boost employment. In this context, there is specific reference to “respecting national traditions of social dialogue and industrial relations” while also, in particular, “maintaining the autonomy of the social partners in the collective bargaining process.” The Member States are required to report on the measures taken in these areas in their annual National Reform Programmes.

These few short extracts from the ‘Euro Plus Pact’ suffice to reveal the tension between the Pact and autonomous collective bargaining on the part of the social partners. However, this is truer still of the decisions taken just over six months later by the European Council, when it approved the package of six Regulations known as the ‘Six-Pack’. Four of these six Regulations related to strengthening the existing SGP. The remaining two, however, introduced entirely new elements in the form of a ‘Macroeconomic Imbalances Procedure’ or MIP. The first of these two Regulations governs the prevention and correction of macroeconomic imbalances, while the second sets out the measures to implement these processes. The effect is to extend monitoring of macroeconomic indicators beyond purely fiscal indicators. It is true that the BEPG already did that, but the two new Regulations have taken this monitoring to an entirely new level.

The BEPG were, and remain, the central instrument for coordinating economic policy. However, in accordance with Article 120 TFEU, they represent a framework within which the Member States should design their economic policy. Moreover, inadequate use had been made of the specific scope of Article 121 TFEU for the Commission to issue a warning and for the Council to address specific recommendations to the Member State concerned “where the economic policies of a Member State [were] not consistent with the broad guidelines … or risk[ed] jeopardising the proper functioning of economic and monetary union.” This shortcoming in the multilateral monitoring process was now – according to the Preamble of the Regulation – supplemented “with specific rules for the detection of macroeconomic imbalances as well as for the prevention and correction of excessive macroeconomic imbalances within the Union.” This is more than a ‘quantum leap’ in relation to the status quo in terms of the binding nature and intensity of economic governance, and since it represents an unprecedented degree of commitment by the Member States and precision in the framing of the Regulations, we shall now consider the relationship between governance and autonomy of collective bargaining in relation not to the ‘Euro Plus Pact’ but to this Regulation.

The Regulation begins by defining “imbalances” and “excessive imbalances”. Article 2 specifies that “(1) “imbalances” means any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole; (2) “excessive imbalances” means severe imbalances, including imbalances that jeopardise or risks jeopardising the proper functioning of the economic and monetary union.”

To enable imbalances of this kind to be identified, the Regulation implements an alert mechanism based on a ‘scoreboard’ comprising a set of indicators; the variables for each Member State are set against the threshold for each of these indicators. The Commission publishes an annual report including a qualitative economic and financial assessment for each Member State. When the indicative thresholds are exceeded, the Commission uses this as the basis for deciding whether imbalances are being created. The key point is that this decision may differ depending on whether the Member State concerned has a high current account *deficit* or a high current account *surplus*. The report explicitly names the Member States affected by, or at risk of, imbalances. It is discussed and assessed overall by the Council; where Member States of the euro area are concerned, the Eurogroup discusses the report.

The ‘scoreboard’ on which the report is based includes macroeconomic and macrofinancial indicators. One group includes indicators of external imbalances, while another includes indicators of internal imbalances. The former includes such indicators as the current account and net international investment positions of Member States, real effective exchange rates, export market share, changes in price and cost growth, and non-price competitiveness, “taking into account the different components of productivity.” The second group includes public and private indebtedness, financial and asset market developments, including housing, private sector credit flow, and trends in unemployment. Each indicator has an alert level, in some cases set differently for euro area and non-euro area countries. The Commission’s assessment embeds these indicators within a set of further macroeconomic and sectoral variables. The Commission regularly monitors the appropriateness of the indicators and adjusts them and the thresholds as necessary.

If analysis shows that a Member State is affected by, or at risk of, imbalances, the Commission carries out an “in-depth review” and notifies the EP and the Council of its findings. If the Commission finds that imbalances exist, it informs the EP, the Council and the

Eurogroup of them. The Council may then, on a recommendation from the Commission, act on the basis of Article 121 (2) TFEU to address the necessary recommendations to the Member State in question. If there is an excessive imbalance, then under Article 121 (4) TFEU, the Council combines its notification with the recommendation that the Member State concerned takes corrective measures. This recommendation includes both a deadline and the requirement to submit a "corrective action plan" as provided for in Article 8 of the Regulation. This plan sets out the specific measures the Member State proposes to take to correct the imbalance. The Council assesses the plan and, if it approves it, stipulates a recommendation for a timetable for "surveillance". If it deems the corrective action plan to be inadequate, it will require the Member State to submit a new plan within two months. The proposed monitoring timetable includes regular progress reports by the Member States. In cases of "enhanced surveillance", the Commission may – where necessary in liaison with the ECB – carry out "missions" to monitor implementation of the corrective action plan. In a final stage, the Council assesses whether the Member State has taken the recommended corrective measures. If it has not, the Council, acting on a recommendation from the Commission, adopts a Decision establishing non-compliance and recommending new deadlines for corrective action. This Decision is deemed to have been adopted by the Council unless the Council decides, by a qualified majority, to reject the recommendation within 10 days of its adoption by the Commission (the 'reverse qualified majority' voting procedure).[34] If, however, the Council considers that the Member State has taken the corrective action required, the process is put into abeyance but monitoring continues in line with the original timetable. Where the excessive imbalances are deemed to have been resolved, the Council will confirm this and lift the recommendations previously issued. The European Parliament may request information on the process via its standing committee and is regularly informed of the outcomes.

The Regulation governing implementation of the process lays down a system of sanctions in cases of non-compliance with the Council's recommendations; these range from an interest-bearing deposit to an annual fine equivalent to 0.1% of GDP.

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[34] This process is also applied to the reformed SGP. Previously, the Commission required a qualified majority in the Council to implement its recommendations. This shift has made it much more difficult for the Member State concerned to get round the terms of a recommendation.

‘Scoreboard’ elements with relevance to collective bargaining policy

The scoreboard is the cornerstone of macroeconomic monitoring within the new economic governance arrangements. Here, we shall consider the extent to which the indicators comprising it are influenced by wage setting and, thus, by autonomous collective bargaining. This raises the fundamental question of the relationship between the new economic governance arrangements and autonomous collective bargaining.

Earlier in this study, we set out the central role that wages play in creating cumulative imbalances. The selection of indicators for the scoreboard quantifies and defines the imbalances. The values attached to these indicators are determined, among other things, by exogenous variables. We shall, therefore, here reverse the direction of analysis, tracing the impact chain of individual indicators back to these exogenous variables.

From the perspective of an individual Member State, the *current account balance* (expressed as a percentage of GDP) is the key indicator of *external* imbalances. It is determined by the development of price elements, such as the real effective exchange rate, which we explore below. It is also influenced by volume values and is likely, all other things being equal, to improve in response to lower levels of imports. Imports, for their part, are determined by domestic demand, and domestic demand is likely to grow more slowly when saving levels are high and spending levels are low. Saving and spending levels in turn are determined by income distribution and therefore by effective nominal wages. Thus, effective nominal wages exert a strong influence on the current account balance via domestic demand. The second external indicator, a country’s *net international investment position* or NIIP, expressed as a percentage of GDP, reflects the accumulated current account balance. The same factors therefore apply to it as to the current account balance. The third indicator is the *real effective exchange rate* in relation to 35 industrialised countries, deflated by the (harmonised) consumer price index. Outside EMU, this indicator is determined by the nominal exchange rate and by inflation; within EMU, it is determined solely by inflation. In both cases, unit labour costs and, hence, effective nominal wages are key determinants. (Global) *export market share* is the fourth indicator and is determined by price and non-price variables. Prices are also governed by wage growth. The final external indicator is *nominal unit labour costs.* These are more directly and significantly determined by effective nominal wages than all the

other indicators listed above. As outlined in the Introduction, effective nominal wages are the key determinant of all external indicators.

The major element in the list of *internal* imbalance indicators is *deflated house prices.* This indicator is the result of the difference between changes in house prices and changes in consumer prices. Consumer prices are also directly determined by wages. House prices are determined by both cost and demand. When they are growing dynamically, or even speculatively, costs may form the lower threshold, whereas actual prices are determined by price expectations and trends in real interest rates. In EMU, nominal interest rates set by the ECB apply to all Member States, whereas inflation – and, hence, real interest rates – is largely determined by nominal wages except where there is excessive speculation and 'bubbles' form. Further internal indicators are *credit flows and private sector debt* (as a percentage of GDP). Both values are, like *government debt*, determined by structural and cyclical components. In the cyclical component, at least, wage growth plays a part. The same applies also to the final internal indicator, the *rate of unemployment.* The result is that key internal indicators are also influenced by wage setting.[35]

For the scoreboard to be appropriate, it is vital that most of the indicative thresholds are differentiated in terms of direction and extent. Thus, for example, the range of variation in real effective exchange rates (REERs) is set at +/- 5% for euro area countries and +/- 11% for non-euro area countries and is, accordingly, symmetrical in direction and extent. Current account balances are also calculated in terms of both deficit *and* surplus; however, while surpluses are allowed to reach 6%, deficits may not exceed 4%. The net international investment position (NIIP) has only a lower threshold (-35%), as does the change in global export market share (-6%) while variations in nominal unit labour costs have only an upper threshold, set at +9% for euro area Member States and +12% for non-euro area Member States. This asymmetry in the indicators illustrates the asymmetry of the entire approach to balances, divergences and, hence, the requirement for adjustment. There is also a certain contradiction in allowing REERs both an upper and lower threshold (given that within EMU, they are determined largely by unit labour costs) but limiting unit labour costs only by an upper threshold. Much

[35] As the preceding analysis shows, these indicators are not independent of each other. Particularly in EMU, nominal unit labour costs, for example, impact directly on the real exchange rate, which in turn impacts on world market share and the country's current account deficit in its cumulative effect on its net external position.

the same is true of the relationship between the current account (more or less symmetrical) and NIIP or export market share (only a lower threshold).

It is clear that wage setting and wage growth in individual EMU Member States are key determining factors in the development and reduction of both external and internal imbalances as laid down in the Regulations on prevention and correction of macroeconomic imbalances and on measures to implement them. Thus, the social partners, in concluding collective agreements, play a part in determining the success or failure of the measures relating to this area of economic governance, including possible sanctions. However, their scope for decision-making is limited by the framework of the Regulation, which is asymmetrical in design. As in the BEPG, the framework tackles only excessive growth in unit labour costs and a negative international investment position; in the case of the current account, which is particularly important in assessing divergences, the threshold for surpluses is half as high again as that for deficits. This asymmetry weakens and threatens the entire procedure because the burden of adaptation lies primarily with the 'deficit countries' whereas deficits are caused equally by both 'deficit countries' and 'surplus countries' as trading partners. Once they are in this position, however, the 'deficit countries' can take sole responsibility for the necessary adjustments only at the cost of extreme macroeconomic contraction and the accompanying risk of a sustained depression. By contrast, the 'surplus countries' are in a position to achieve the same adjustment through a more expansive approach to their economic policy – and one that will be to the benefit of *all* those involved. In the current crisis, this adjustment through expansion in the 'surplus countries' rather than recession in the 'deficit' countries is, in fact, the only effective and responsible option.

The Alert Mechanism Report

We begin the next section by discussing whether the tension between the new economic governance arrangements and autonomy of bargaining has any practical relevance, using the first Alert Mechanism Report (AMR) published as part of the process of macroeconomic monitoring in February 2012. In this report, the Commission first assessed whether there was any sign of imbalances developing and, if so, in which Member States. It then conducted an

in-depth review where necessary and formulated country-specific recommendations, which were approved by the European Council in late June 2012. The Member States concerned responded in 2013 to the points raised in the AMR and the recommendations with their respective National Reform Programme (NRP) or Stability and Convergence Programme (SCP).

In general terms, the report demonstrates that while current account divergences are now smaller, they have not disappeared with the crisis. In many cases, there is still substantial net foreign debt. Changes in the pre-crisis external positions, it found, reflected divergences in price competitiveness. While the EU as a whole has lost global export market share, some Member States have lost more than others. Moreover, debt is imposing a substantial burden on private households and businesses alike, while the rise in the property prices in many countries is unprecedented. A corrective process is under way, but it is unclear, the report says, how far that process will go and how long it will last. A deleveraging process has also started, but this process will, in fact, make the individual EU economies more vulnerable to cyclical effects. The Report concludes that the adaptation process is ongoing in the real economy. Overall, it sees the EU as confronted with interlinked problems of low growth and high unemployment, the need to restore sustainable and stable public finances, and stabilisation of the financial markets.

Of particular relevance for our purposes are the country-specific findings, which can be broadly summarised as follows:

- A crisis on the financial markets and in the banks, speculative commitments (such as carry-trade or property) and current account deficits are drastically pushing up private and public debt levels.
- Current account deficits, net foreign debt and loss of global export market share can be attributed primarily to a drastic deterioration in price competitiveness.
- The decisive rise in the real effective exchange rate within EMU Member States is based on excessively high growth in nominal unit labour costs. Outside the EMU, an increase in the nominal exchange rate, either by itself or in conjunction with other measures, has produced a higher real effective exchange rate.

On the basis of the country-specific analysis, the Commission began an in-depth review of twelve countries. The ‘programme countries’ (Greece, Ireland, Portugal and Romania) were already being monitored closely and were not, therefore, included in the macroeconomic monitoring measures. However, the Commission also undertook a horizontal analysis of the reasons for the major and long-term current account *surpluses* arising in a number of Member States. It took the view that structural problems, including the operation of the services market, were possible causes for weak consumer and investment demand in these countries.

The in-depth review did not, in this first Report, give rise to any “excessive imbalance” procedures. Countries including France and Italy were found to have “serious” imbalances and Spain to have “very serious” imbalances, but these were deemed “not excessive”. There were also recommendations for Germany, which – as a ‘surplus country’ – had not breached the (asymmetrical) provisions of the Regulation but was being audited for the first time and found to have wages that were not keeping pace with growth in productivity. It was, therefore, recommended that between 2012 and 2013, Germany should “create the conditions to ensure that pay growth keeps pace with growth in productivity.”

The Alert Mechanism Report and the country-specific recommendations confirm:

- that, as suggested by the preceding theoretical analysis, unit labour costs and, hence, wage setting are the key determining factor in the development of major imbalances,
- that the ranges set out in the Regulation are such that, if they had been applied to the whole period since Economic and Monetary Union was launched, there would have been a conflict between wage setting and compliance with the ranges, and thus
- the relevance of the part that wage setting and the social partners play in ensuring compliance with the provisions of the Regulation.

However, these findings are also influenced by the asymmetry described above and that is evident throughout the Regulation. The Regulation targets unit labour costs that *rise* by more than a certain amount but not those that *fall* by more than a certain amount – and, of course, you cannot find what you are not looking for. Independently of this fundamental shortcoming in the Regulation, which also determines further considerations, it is also possible to conclude that the scoreboard that underpins the process contains, within its indicators, a variable – unit labour costs – that differs fundamentally from all the others in that it can be relatively directly

influenced externally. Therefore unit labour costs are both a key value for managing the prevention and correction of excessive macroeconomic imbalances and a key element in autonomous collective bargaining.

The Commission's second Alert Mechanism Report audited for the first time two Member States with "excessive" macroeconomic imbalances identified by an in-depth review – Slovenia and Spain. Both were required to agree 'policy packages' and to submit these to the Commission for scrutiny as part of the 'European semester'. The Commission will decide, on the basis of this scrutiny, whether further review is necessary. Eleven further Member States were also subjected to in-depth review, although none was deemed to have "excessive imbalances". The Commission has now submitted country-specific recommendations for all the Member States with the exception of the 'programme countries'.

Involvement of the social partners

The Regulation makes explicit reference in a number of places to a role for the social partners. Article 1 refers in several places to respect for national wage setting systems and the autonomy of employers and unions in accordance with Article 152 TFEU. It also stipulates that "The recommendations issued under this Regulation shall respect national practices and institutions for wage formation. This Regulation takes into account Article 28 of the Charter of Fundamental Rights of the European Union, and accordingly does not affect the right to negotiate, conclude or enforce collective agreements or to take collective action in accordance with national law and practices."[36] In-depth review is also required to respect national characteristics relating to industrial relations and social dialogue. Where preventive action is required, there is a further explicit reference to full observance of Article 152 TFEU and to account being taken of Article 28 of the Charter of Fundamental Rights of the European Union. Insofar as appropriate, the Commission should involve the social partners and other national-level actors in monitoring preventive action in the form of local "missions". Further

[36] Article 28 of the Charter of Fundamental Rights of the European Union (Right of Collective Bargaining and Action) stipulates "Workers and employers, or their respective organisations, have, in accordance with Community law and national laws and practices, the right to negotiate and conclude collective agreements at the appropriate levels and, in cases of conflicts of interest, to take collective action to defend their interests, including strike action."

optional approaches to involving the social partners could include discussing regular Alert Mechanism Reports, formulating corrective action by the Member State involved in an "excessive imbalance" procedure, or as part of the Economic Dialogue laid down in Article 14 (2). The points set out here, however, reflect only a low level of involvement of the social partners and, in some cases, merely acknowledgement of the status quo. Alongside Article 28 of the Charter and Article 152 TFEU, Article 153 (5) TFEU is also relevant; it explicitly stipulates that the EU may not become involved in Member State activities in relation to pay, the right of association, the right to strike, or the right to impose lock-outs.

IV. Options to resolve the tension between the new economic governance arrangements and autonomous collective bargaining

We now turn to the conclusions that may be drawn from the discussion so far. Is it possible that a *de facto* conflict could arise between the new economic governance arrangements and autonomy of collective bargaining? The answer to this question lies in the operational design of the system in the form of the scoreboard, its indicators, and the threshold values and ranges making up these indicators. Application of the scoreboard to trends since the instigation of EMU but even just limited to the years covered by the Alert Mechanism Report (that is, the three-year period from 2008 to 2010 in the case of unit labour costs, for example) suggests that the answer is a clear 'yes'. Many of the Member States can be shown to have breached a number of the indicators. The reasons for this lie primarily in collective agreements that were never compatible with the Regulation and against which the governments of the relevant Member States were either unable or unwilling to take corrective action. Nonetheless, the Member States had made a commitment to future behaviour that did not reflect past behaviour by the social partners. The social partners for their part might feel restricted by the commitments entered into by their governments in the practical exercise of their rights to autonomy in collective bargaining.[37]

[37] In this context, attention should be drawn to a legal assessment of this tension. This assessment related to the state of negotiations around the MIP (at that point still known as the EIP), but the author took the view that "...the limitations imposed by autonomous collective bargaining together with the limitations under Article 153 TFEU on sovereign management of wages are ensured." However, his assessment was subject to further

For the future, this means either that the bargaining parties set out to agree on wage settlements that comply with the Regulation or that governments attempt to correct settlements, or even the wage setting process, to ensure that unit labour costs and the other scoreboard indicators that they help to determine are in line with the Regulation. We shall now set out and assess a number of options for resolving this tension.

Option I: Retention of the current wage-setting structures

One option is simply to leave things as they are – neglecting self-imposed norms – and to hope that there will never again be conflict between the new economic governance arrangements and autonomous collective bargaining. In fact, the signs are not bad: the crisis has prompted substantial corrective measures in the Member States that have so far over-shot the targets in terms of wage policy.

Table 1: Rates of change in nominal labour costs (in %)[38]

	2008	2009	2010	2011	2012	2013	2014
Greece	3.6	3.5	-2.6	-3.4	-4.2	-7.0	-1.5
Spain	6.9	4.4	0.0	0.7	-0.3	1.4	0.1
Germany	2.1	0.2	2.4	3.0	2.5	2.4	3.1

clarification of the Regulation and subsequent experiences with it. Specifically, he called for "...efforts to be made to ensure that wages and other aspects of employment conditions are not one-sidedly identified as the reason for imbalances"; see Bryde (2011), in particular pp. 36 and 38.

[38] See European Commission (2013), p. 86.

Table 2: Rates of change in nominal unit labour costs (in %)[39]

	2008	2009	2010	2011	2012	2013	2014
Greece	5.1	6.2	-0.1	-1.8	-6.2	-6.3	-1.5
Spain	5.7	1.5	-2.0	-1.4	-3.3	-0.1	-0.1
Germany	2.3	5.6	-1.1	1.4	2.8	2.5	1.8

If the indicators had been formulated symmetrically, then – on the basis of the ECB's price targets – Greece would already have been found to be *under-shooting* the targets quite substantially, including in 2013, as a result of the cumulative change of more than 9% in its unit labour costs over three years. This correction should be seen as part of the adaptation process and as a counter-reaction to the previous over-shoot. In view of the strategically and operationally asymmetrical design of the Regulation – that is, with no *lower* limit on the change in unit labour costs – Greece did not, in fact, breach the provisions of the Regulation, no matter how brutal and damaging the corrective measures were from an economic perspective. In the Member States that have so far under-shot the targets, there has been a relative, though less drastic, correction. In Germany, for example, the annual average rate of change in unit labour costs between 2003 and 2007 was a fall of 0.7%. Since 2011, however, these costs have been rising, although they are nowhere near the upper threshold.[40] There is no suggestion of a rapid upward return to the accumulated price stability path of the ECB that has been the aim since the start of EMU and that is essential to its survival.[41]

Option II: Deregulation of the labour market and decentralisation of wage setting

Labour market reforms, and in particular labour market deregulation and the decentralisation of wage setting, have been on the EU's economic policy agenda since the 2000 Lisbon

[39] See European Commission (2013), p. 94.
[40] During the period between 2008 and 2010, unit labour costs in Germany were affected by short-time working measures prompted by the crisis and are not, therefore, representative.
[41] For an assessment of the current requirements for adjustment, see Horn (2012, 2), p. 28; cf. also Figure 2.

Strategy. However, a further motivation to achieve them may now be the desire within the MIP to prevent wage settlements from over-shooting their targets.

This option offers politicians a range of instruments of varying degrees of interventionism under the general heading of 'labour market reforms'.[42] These instruments range from limited action, such as requiring public sector wage setting to comply with the Regulation, specifying statutory minimum wages and changing the contribution rates to social security schemes, via scrapping wage indexation and cutting benefits, to reducing protection against dismissal and decentralising wage setting "so that wages and salaries and working conditions can be tailored to the specific needs of businesses."[43] More radical demands relate to restricting the general applicability of collective agreements and even to abolishing autonomous collective bargaining itself. For Member States with current account deficits, there is a call for "...structural reforms to enhance the flexibility of the labour and product markets", because "...a real effective exchange rate depreciation generally requires adjustments in prices and wages.".[44] The upshot may take the form of dramatic (de)regulation – amongst other things in the wake of the crisis and the requirements imposed on the 'deficit countries' – or of a gradual process of erosion.[45] Both would result in wage setting being decentralised to company level, atomising 'wage policy' and creating wages that grew pro-cyclically, possibly with a time lag and some variation, depending on the state of the labour market. The cycle itself would be determined by the shape of national fiscal and labour market policy. In that case, politicians alone would be responsible for complying with the target set as part of the economic governance arrangements.

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42 See, for example, European Commission (2011), p. 91.

43 See European Central Bank (2012, 2), p. 93.

44 See European Central Bank (2012, 1), p. 47. The ECB itself uses the example of Japan to confirm that this requirement in particular may involve substantial risks: "Labour market adjustment centred on wages: the unemployment rate rose slightly but nominal wages fell rapidly, which seems to have contributed to Japan entering a phase of deflation from the late 1990s onwards."; European Central Bank (2012, 2), p. 97.

45 "There is clear evidence of a 'deconstruction' of labour law under the guise of the economic crisis"; Clauwaert and Schömann (2012), p. 17.

Option III: Centralisation and coordination of wage setting

A third option takes the opposite approach. It is based on active support for, rather than simply tolerance of, autonomous collective bargaining as laid down in Article 152 TFEU. Centralised collective wage setting via sectoral agreements, agreements that are declared 'generally binding' across sectors, and minimum wages would not, in this option, be discredited as a 'monopoly' on wage setting that needs to be smashed. These elements would, rather, be supported by a high level of coordination.[46] Centralisation and coordination of wage setting would be recognised for what they are within an economic and monetary union: a significant, exogenous macroeconomic control variable in achieving the economic policy goals of the European Union and EMU.[47]

Operationally, wage setting is geared in this option to an inflation-neutral margin of distribution, that is, to changes in medium-term national labour productivity and the ECB's price target. Orientation to this wage formula does not reduce collective bargaining to an automatic mechanism but, as with the current system, enables the full scope for distribution to be used in the form of a variety of quantitative and qualitative bargaining elements. In the short term, and until the crisis was resolved, the existing 'surplus countries' would be required to over-shoot this norm without fuelling inflation, while the 'deficit countries' would be required to under-shoot it without fuelling deflation.[48] As demonstrated above, this process is, in fact, already well under way or even complete in the 'deficit countries'. It is now up to the 'surplus countries' to make their essential contribution to adjustment.

National governments with wage settlements that over-shoot have so far tolerated this state of affairs; in countries with excessively low wage settlements, by contrast, they have actively contributed to this situation through repeated appeals for 'wage restraint' and 'wage moderation' and through political measures. Now they should explicitly encourage and support the social partners in *all* Member States in concluding wage agreements that – once

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46 "For a given degree of centralisation, more effective coordination helps in achieving macroeconomic goals (stabilising inflation, tackling unemployment, correcting external imbalances)"; European Commission (2011), p. 94.

47 For a detailed weighing-up of the advantages and disadvantages of both centralised and decentralised wage setting, with a concluding appeal for sectoral agreements, see, for example, Hallwirth (1998), p. 164 ff.

48 On this requirement, see, most recently, Horn (2012, p. 1).

the crisis is over – will enable the full inflation-neutral scope for distribution, but no more and no less, to be used.

Support from an anti-cyclical fiscal policy and competition policy

Against the backdrop of experience so far and the diversity of framework conditions in individual Member States, it is possible that wage policy alone will not be enough – or should not even be aiming – to ensure compliance with the provision of the Regulation. As past experience has regularly shown (often dramatically through stabilising recessions) in a regime of national monetary policies, monetary policy may seek to use threats to avoid growth in wages and unit labour costs that are deemed under the Regulation to be exceeding the upper threshold, or to correct it with restrictions. In EMU, this instrument is simply not available. What remains is fiscal policy. Fiscal policy can, in fact or even simply in prospect, act anti-cyclically in the short term.

When wage settlements over-shoot the thresholds, politicians can take counter-action with a restrictive fiscal policy. A similar result can be achieved with fiscal containment of domestic growth and devaluation of the real exchange rate by means of a simultaneous increase in consumer taxes and reduction in additional labour costs. ‘Surplus countries’, by contrast, would have to use an expansive fiscal policy to stimulate aggregated demand and also act expansively on wage and price growth. With a view to the debt brake, this can also be tackled through a combination of tax increases, where savings and assets are high, and of an increase of expenditures with a high multiplier effect. An overall expansive effect of fiscal policy can, in particular, support an upward correction in unit labour costs that have for a long period under-shot the ECB’s price targets.

As well as an anti-cyclical fiscal policy, there is a need for adequately intense competition between the Member States. An appropriate competition policy must create and sustain the necessary conditions that a rise in labour costs that is geared to the inflation target of ECB and productivity growth, will be translated in a similar rise in the price level.. As we have shown above, there is no guarantee that unit labour costs and prices move in the same direction. Thus, in the first ten years of EMU, prices rose markedly more rapidly than unit labour costs,

both in ‘surplus countries’, such as Germany, and in ‘deficit countries’, such as Spain. The same phenomenon – in reverse – can be observed in the most recent adjustment process: even when increases in indirect taxation are excluded, the macroeconomic price level in Greece has not fallen since 2010, yet unit labour costs have fallen by a double-digit figure over the same period.[49] A *temporary* lag between profits and wages can act as a microeconomic incentive for entrepreneurial action and a macroeconomic indicator of an incipient upturn. However, if it becomes *chronic*, this lag becomes pathological and points to distortions in competition.

To sum up, fiscal policy may well be constrained by the Fiscal Compact, but it can use automatic stabilisers, the shape of what is known as the ‘tax wedge’, and discreet, revenue-neutral expenditure policy to correct what the Regulation would deem inadequate pay growth in either expansive or restrictive terms where the aim is to achieve compliance with the Regulation. Competition policy must help ensure that wage development in line with the targets is also matched by a similar price development at macroeconomic level: the key to complying with the price target within monetary union or to ensuring (price) competitiveness is, ultimately, prices, even where wages are a major determining factor in price trends.

Assessment of the options

Below, we assess which of these options best suits the requirements of monetary union in general and, in particular, of the conditions laid down by the Regulation on preventing and correcting macroeconomic imbalances. Support for the option involving retaining the current wage setting structures is offered by the fact that both over-shoots and, to a lesser extent, under-shoots in wages have been reversed by the crisis. Formal compliance with the ranges set out in the Regulation is also promoted by the Fiscal Compact, given the asymmetry evident in the Regulation. If the Fiscal Compact were to be introduced in the euro area Member States, it would by itself produce a *downward* effect on unit labour costs, where, however, there is no lower threshold to be breached – unless, of course, the consolidation measures stifle economic growth so sustainably that the budget deficit continues to widen rather than narrowing.

[49] See iAGS Report (2013), p. 72.

Expectations of a 'no change' approach are based primarily on the assumption that the market will drive correction of labour costs. Where economic growth has slowed down in a particular Member State, the expectation is that pressure on wages will gradually ease and price competitiveness will grow, producing an improvement in the current account and a positive impact on macroeconomic development from foreign trade. However, this causal chain reflects only a partial view. The overall picture should also include the repercussions of wage moderation on consumer spending, investment and the budget deficit and their impact on the current account.[50] As explained above, current account deficits are always the result of both price *and* volume trends – in this case, of both price competitiveness *and* demand conditions.[51]

This means that the most recent improvements in the current account deficits in the 'deficit countries' are attributable more to the weakening of domestic demand and, hence, to the fall in imports, than to an improvement in price competitiveness.[52] As history has shown, a *laissez-faire* approach, even in relation to wages, is more likely to produce a pro-cyclical continuation of under- or over-shooting than self-correction by the market once the crisis is over and 'normal' conditions return. This, therefore, argues against Option I.[53]

Decentralisation of the labour market and deregulation of wage setting (Option II) represent one extreme on the spectrum of feasible alternatives to the *status quo* and represent the most interventionist option. Many economists have called for this option and continue to do so as the condition for boosting employment, frequently with reference to the example of the USA and the 'employment miracle' seen in that country prior to the crisis, which is attributed to flexible and decentralised wage setting.[54] Influenced by mainstream economics, politicians seem tempted to follow this line of thinking, as is evident from the clear change in the emphasis in the wording of the BEPG, as noted above. Also symptomatic was the unilateral

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50 "In addition to the mechanic partial equilibrium effect of price competitiveness on the trade balance and, therefore, the current account, it should be borne in mind that these policies affect consumption, investment and the budget balance with non-trivial and possibly relevant implications for the current account." European Commission (2011), p. 93.

51 See European Commission (2011), p. 85.

52 See Sachverständigenrat (2012), no. 119.

53 "The dynamics of labour costs within monetary union is driven by a complex set of factors, and an automatic adjustment to external imbalances via the market mechanism is not granted." European Commission (2011), p. 84.

54 No mention is made of the fact that – as in other countries with spectacular successes in employment terms in the immediate wake of structural reforms – there was also a new expansionary focus in monetary, fiscal and/or currency policy.

narrowing of the original Lisbon strategy, when it was renegotiated in 2005, to merely a 'reform strategy' – that is, a strategy without a macroeconomic component. A further recent example is not least the labour market deregulation provisions demanded of the 'programme countries' as a precondition for financial assistance. There is certainly no guarantee of a positive relationship between decentralised wage setting and employment.[55] What is certain, however, is that any attempt to do away with key elements of autonomous collective bargaining or, indeed, autonomous bargaining itself would provoke vehement resistance from the trade unions, and possibly from employers' associations too, and is likely to be thrown out by the labour courts. Against the backdrop of a lack of consensus among economists, but also of the near-certainty of massive conflict within the political world, this option should be discounted.

Option III, which aims at greater centralisation and coordination of wage setting, represents the other end of the spectrum of possible alternatives to the 'no change' option. In marked contrast with the option to atomise wage setting, the social partners function under this option as macroeconomic actors within the rules of monetary union, making them explicit participants in economic governance with a direct role to play in ensuring compliance with the new procedures for preventing excessive imbalances. They therefore do everything already listed in connection with the key role that wages have in a monetary union: they ensure price stability as a condition for long-term favourable monetary policy, they achieve neutrality in (primary) distribution and, hence, a stable relationship between consumer spending and saving and between domestic demand and foreign trade, and, not least, they preserve fair international price competitiveness and stability of the value of the euro in relation to the rest of the world. A normative approach of this kind is also supported by economists and political consultants, including, for example, the OECD[56] and ultimately, albeit with reservations, by the German Ministry of Economics and Technology's Advisory Board.[57] The advantages of this option, particularly under monetary union, and given the

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55 "There is broad agreement that research so far has managed only to a certain extent to demonstrate a strong and robust pattern of relations between bargaining characteristics and wage outcomes ... For instance, empirical evidence on aggregate data shows that the degree of centralisation matters for the distribution of wages..., while the impact on aggregate developments is less clear-cut ..." European Commission (2011), p. 96. See also, for example, Schettkat (2003), p. 634 ff.

56 See OECD (1997)

57 "For example, wage rigidity tends to be higher in countries with high levels of protection against dismissal and high minimum wages in relation to general pay levels. It tends to be lower where there is greater

objectives of the Regulation, are obvious and should provide motivation to implement this option. We shall, therefore, give it greater consideration below.

However, the conditions for centralisation and coordination of wage setting differ widely from one Member State to another. In Member States in which the necessary preconditions do not prevail, wage setting alone cannot achieve the desired outcome. In such cases, an anti-cyclical fiscal policy must also be put in place as a supporting measure, since it can both complement the weak contribution made by wage setting to meeting the objectives of the Regulation and correct wage setting that is running counter to those objectives. Depending on the specific conditions in a particular country, the mix between wage setting and fiscal policy may differ. Nonetheless, wage policy remains the instrument of choice as it is capable of targeting the price target more directly, and with less fall-out, than fiscal policy.[58] Competition policy also plays a supporting role in this option.

V. Institutional implementation

Sustainable implementation of the strategy outlined above would be subject to a number of conceptual conditions and institutional guarantees. For example, the new framework for economic governance remains incomplete. One area where this is the case is fiscal policy. We shall not attempt here to answer the question of whether, and how, the Fiscal Compact can achieve what it was intended to do or whether it also requires some form of fiscal union. What we shall seek to do is to clarify the question of whether, and how, wage setting can proceed in a way that meets the requirements of an economic and monetary union.

The precondition for this is acknowledgement that the norms of a monetary union must be complied with symmetrically. In this case, symmetry does not mean downward harmonisation of above-average growth in productivity in one Member State with the average of the euro area Member States. Growth in productivity – where it is desirable, for example to boost growth or reduce working time – is a long-term project. The same is true of any kind of

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coverage of centralised wage bargaining and a high union density rate."; BMWI (2012,2), p.16

[58] See also Horn, Lindner, Tober and Watt (2102), p. 23:"Wage policy, like competition policy, is upstream of fiscal policy."

structural reform provided it is the right kind of reform and being implemented in the right way.

The decisive factor is that changes in nominal wages should make full use of the medium-term change in national productivity (regardless of the level this reaches) plus the ECB's price target. This includes the possibility of 'surplus countries' over-shooting the target and 'deficit countries' under-shooting it until the current crisis has been resolved. The design of the scoreboard must take account of this principle: only then will country-specific recommendations be symmetrical. Much the same is true of the preventive and corrective actions taken by Member States and their economic policy actors. If, however, the existing asymmetry is not corrected, then the entire approach taken by the Regulation and the specific process of macroeconomic monitoring of economic governance it embodies is fundamentally wrong, not to say dangerous: this one-sidedness shifts the entire burden of adjustment on to the 'deficit countries', forcing them into a long-term recession, while the 'surplus countries' are exempted from making their own contribution.[59] A recessionary trend towards austerity would, moreover, produce a serious conflict with the rights of the social partners to autonomous collective bargaining, which – even if not formalised – would be material.[60] As with a stabilising recession prompted by restrictive monetary policy, austerity may involve massive cuts in spending and in wages, leading to "... a situation that forces the trade unions to accept wage cuts for economic reasons."[61] This is a trend that must be resisted, not least to show that the procedure for preventing and correcting macroeconomic imbalances, while focused on macroeconomic growth, does not merely become a vehicle for driving forward the structural reform agenda of the Lisbon Strategy under another name.

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[59] It is more than striking that Germany's Council of Economic Experts lent its support to this asymmetry in its assessment of macroeconomic developments: "However, it is precisely this indicator [author's note: the current account balance] that should be viewed critically as it identifies as a threat not only deficits but also the very strong surpluses that can, for example, arise when competitiveness increases, even though the threshold values have been set asymmetrically."; Sachverständigenrat (2012), no. 225.

[60] See Bryde (2011), p. 40: "The much greater danger of the new instruments, as far as workers' interests and the freedom of collective bargaining are concerned, is their one-sided use solely as part of an austerity policy."

[61] See Bryde (2011), p. 41.

The definition of an appropriate, and more particularly symmetrical, norm is, however, merely a necessary requirement: it will become a sufficient requirement only if it is both achievable and actually achieved. We therefore recall here the tension within which wage policy and fiscal policy operate at national level:

- Through over- or under-shooting the scoreboard ranges, wage policy may breach the obligation on the government to comply with the norm.
- Fiscal policy can help counter this breach but, in doing so, influences the macroeconomic outcome of autonomous collective agreements.

There is, therefore, the possibility of external effects similar to those that may be produced at another level between monetary, fiscal and wage policy. In both cases, coordination is needed if the aims are to be achieved under the best possible conditions. The intention so far was for that to be achieved at EMU and/or EU level through the EU's Macroeconomic Dialogue.[62] The existing need for coordination at national level can be achieved in much the same way, though this requires in particular a number of improvements to coordination, first within and between national unions, second between the unions of different Member States, and third between the social partners, fiscal policy and monetary policy in the macroeconomic policy mix at EU and EMU level.

Greater coordination does not mean a change in the distribution of powers between national and European levels, either in the case of the unions or of macroeconomic policy. The autonomy and independence of all actors are preserved. Coordination can only be cooperation on a voluntary basis – dialogue-based macroeconomic coordination, as the sub-title of this study puts it. For the same reason, there is no need for formal bureaucratic arrangements to be put in place; existing bodies can be used, with a new forum for dialogue being created only where necessary.

[62] The design and composition of MED is not responsible for the fact that the 'offer' of European MED has not so far been used more effectively by the economic policy actors.

Closer coordination of wage setting by the trade unions

The trade unions claim authority to "strengthen wage policy coordination across the euro area."[63] This demand is merely the logical consequence of their demand for autonomy in collective bargaining. However, the unions must then make good on this claim. The current divergences in the growth of unit labour costs demonstrate that existing procedures for 'voluntary self-monitoring' by the unions of growth in wages within the euro area are inadequate.[64] Wage policy needs to be 'Europeanised'.[65]

In reality, this demand presupposes a number of very different preconditions. For example, different Member States differ in their union membership levels, the extent of coordination, and the level of coverage of collective bargaining.[66] This is particularly true of union membership, which varies among the EMU countries from about 8% in France to about 75% in Finland. The extent of coordination of wage setting also varies markedly between the larger Member States. These differences make it difficult to see whether the necessary minimum level of coordination could, in fact, be achieved. By contrast, it is clear that in the larger Member States, the level of coverage of collective bargaining – which determines the impact of wage settlements – ranges between around 66% in Germany and around 95% in France.[67] The rate of coverage in the new accession countries from the former Eastern bloc is, by contrast, generally much lower.

The European dimension of collective bargaining is relatively underdeveloped within individual Member States, and action in this area is not primarily guided by concerns about the economic policy requirements of monetary union. Major differences persist between

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63 "To prevent unit labour costs in different Member States from drifting apart, a system of closer economic policy coordination should strengthen wage policy coordination within the euro area alongside fiscal and monetary policy, *something that only the trade unions can organise and achieve.*"; DGB (2011), p.17 (author's italics) The text continues: "Autonomy of collective bargaining must be respected – state targets for collective bargaining or government instructions to cut pay would be unacceptable in this context and are to be rejected." See also Janssen (2013): "European economic governance can only work if it is balanced and it can only be balanced if the autonomy of social dialogue and collective bargaining are fully respected."

64 "...Imbalances may need to be corrected by coordinated wage policy ... Europe needs more coordination of wage-setting strategies"; Collignon (2012), p. 126.

65 See Schulten (2004), p. 203.

66 The following figures are taken from the table in European Commission (2011), p. 95.

67 It is striking that France achieves this level of coverage of collective bargaining with a trade union density of just 8%, while Finland's similar level of coverage (around 87%) is achieved with a trade union density of 75%.

Member States in the relationship between umbrella organisations and their member unions but also between member unions themselves. There are further differences within each individual union between the bargaining experts, who conduct collective bargaining, and the economic policy experts, whose focus is more on national and European macroeconomic interactions. Nor is it possible to reduce the self-perception of the actors simply to responsibility to implement some abstract wage norm handed down by EMU. Each bargaining situation includes the specific local power relationship and the full range of tools available for labour disputes. The internationalisation of businesses and the globalisation of competition are also opening up a new flexibility that will transcend the euro area.[68] Finally, there will always be other elements than merely wage settlements at stake in any set of negotiations.

The need for Europeanisation of wage policy confronts the obstacle that in reality, there is, therefore, a patchwork of trade union structures, with major differences at national and sectoral level. Against the backdrop of this diversity, how can Europeanisation be achieved, and how can the parties behave in a way that is in line with the needs of EMU? In the Introduction, we described cross-border initiatives and supranational institutions, both before the launch of EMU and in its earliest days. However, as we have also shown, these arrangements and institutions did not prevent damaging divergences opening up between the Member States of the euro area. This indicates substantial room for improvement within the internal governance of trade unions, too. These improvements must pursue a number of aims at the same time, must be supported by the other economic policy actors, and must be capable of being measured by the criteria set out below.

The first of these is the unions' claim, cited above, to autonomy in managing wage policy coordination within the EMU.[69] Against the backdrop of the central role that wages play within economic and monetary union, it is vital that wage policy functions as a macroeconomic actor in the euro area and takes its share of responsibility for growth, employment and price stability. The key priority is compliance with the wage policy rules of EMU. This is, not least, about the role of the trade unions in helping to resolve the current crisis, because much of the cost of the crisis is taking the form of unemployment, wage cuts

[68] Reflecting the global dimension of coordination, trade unions from a range of sectors and different countries have recently joined forces in the new union IndustriALL Global Union.

[69] On the issue of whether Europe needs coordination of national wage policies, see, for example, ifo schnelldienst (2011), pp. 3-15.

and additional burdens on taxpayers and is, therefore, being borne largely by workers, especially if the guarantees and risks of the aid programmes are actually to materialise.

These new requirements for trade union governance are both internal and external. Internally, there is a need for unions to reconfigure, with the aim of equipping themselves better to coordinate within EMU; this relates to the relationship of individual unions both with their national and European umbrella associations and with the Europe-wide sectoral umbrella bodies. In the most general terms, the permeability and networking of previous national bottom-up structures must be widened by an EMU-level top-down structure. The European dimension must be capable of acting and negotiating locally along with national bodies.[70]

Once again, it is important to stress that the balance of powers between individual union and umbrella association, or between national and European level, is not affected by this. In purely practical terms, it also means no additional burden on unions. On the contrary, there is a broad overlap between what the EMU is demanding and what national bargaining policy is seeking. In both cases, the aim is to "return to a productivity-oriented wage policy that makes full use of the scope for distribution in accordance with national price and productivity targets."[71] In terms of productivity, it is the medium-term trend that is important: it acts as a built-in stabiliser by avoiding a focus on pro-cyclical wage growth as a reference point. However, the rules of the EMU demand fundamental adjustment: rather than national price growth, the ECB's inflation target applies to all EMU Member States as a wage component. However, if the existing divergences in unit labour costs are not reduced, there is a need for temporary flexibility: in the 'surplus countries', unit labour costs must grow more rapidly than indicated in the EMU-wide price target, while the reverse is true of the 'deficit countries'.[72] Some substantial adjustment has already been achieved along these lines, albeit with the wrong weighting: it has been too brutal for the 'deficit countries', causing serious damage to domestic growth in those countries, while for the 'surplus countries', including Germany, it has not gone far enough in the other direction. The adjustment process must continue, but the main burden of adjustment can and must be borne by the 'surplus countries', albeit without harming domestic growth in the 'deficit countries' or, indeed, across the euro area as a whole.

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70 "...The effectiveness of cross-border wage coordination is limited for the reason that wage policy goals set by European unions are voluntary in nature and tend to be perceived by national union bargainers as 'political' declarations that do not constrain national bargaining practices."; Glassner and Watt (2010)

71 See Schulten (2004), p. 205.

72 Cf. here the 'golden wage rule' in a monetary union (Watt, 2007, p. 109).

The trade unions have responded to the new challenges represented by unsatisfactory growth over the past ten years or so, by the latest crisis and, most particularly, by the new economic governance arrangements.[73] For example, the ETUC's Collective Bargaining Committee has proposed a new form of coordination geared explicitly to the scoreboard that underpins the Regulation on macroeconomic imbalances. As well as aspects relevant to collective bargaining, tax and employment measures should, the ETUC suggests, also be included, while Macroeconomic Dialogue and Social Dialogue should be strengthened at European level. Its Resolution lists four 'main priorities'; we shall focus here on priority 1, "Strengthening collective bargaining". This relates to defending the autonomy of collective bargaining and combatting "the unwanted decentralisation of bargaining". The Resolution explicitly reproduces the formulation on wages included in the 2000 coordination guidelines: "Wages should rise according to annual rates reflecting – among other developments – increases in inflation and gains in productivity."[74] Specifically, the Collective Bargaining Committee and, where appropriate, a Steering Committee yet to be constituted, should coordinate positions on the outcome of the scoreboard as a response to the Commission's 'external coordination'. Further concrete measures include enhanced networking among members, involvement in the coordination process of "the most relevant people in charge of collective bargaining" in member unions, and ensuring that "the European dimension is taken into account when affiliates pursue their collective bargaining aims". The ETUC's Resolution makes no claims to be a 'one size fits all' solution; instead, it seeks to reflect differences, for example in levels of coverage of collective bargaining both within and between Member States. This plurality in wage setting systems should not, however, be an obstacle to implementing the general aims set out above. Even implicit coordination, by means of regular interaction between individual unions to assist wage leadership or 'pattern bargaining', could be enough. This is, for example, happening within Germany in the form of what are known as 'pioneer agreements', collective agreements concluded within some EMU Member States that are explicitly or implicitly modelled on settlements reached in Germany. At the opposite end of the spectrum of possible coordination, it is also possible to envisage collective bargaining and collective agreements for more than one country. A lack of will and, possibly, expertise on the part of the

[73] See European Trade Union Confederation (2012).

[74] In an economic and monetary union, the normal position should – as already outlined – be national productivity growth in each individual country, with the ECB price target applying to the price component across EMU, however.

unions and uncertainty about the statutory basis mean, however, that for the moment, this solution is not seen as realistic.[75] In all the cases in which the desired macroeconomic outcome cannot be achieved solely through wage setting, fiscal policy must also be involved, as set out above.

As far as the content and conduct of coordination is concerned, it makes sense to base processes on the 'European semester' and to synchronise procedures with it. At the start of coordination, for example, the unions could use the Report and recommendations of the ETUC's Coordination Committee to identify specific EMU wage policy requirements. These could be used in national collective bargaining as *indicative* – and emphatically not as *imperative* – safeguards. The outcome would be subject to an EU-level assessment at the end of each year. Since national trade unions are autonomous, the process should follow the 'open method of coordination', which relies on voluntarism and uses benchmarking, best practice and peer review.[76] The findings could be submitted at an appropriate time in the EMU 'European semester' reporting sequence: in the Commission's Annual Growth Survey as an initial assessment of the coming year, the European Council's formulation of guidelines, or the submission of National Reform Programmes (NRPs) by the Member States and their assessment at EU level, with the outcome of country-specific recommendations in the 'European' first half-year and implementation of these recommendations in the 'national' second half-year.

Closer coordination between monetary, fiscal and wage policy in the euro area

National Reform Programmes are designated as the forum in which to apply the new economic governance arrangements, and in particular the Macroeconomic Imbalances Procedure, at Member State level. Scrutiny of the existing NRPs, with Germany's as a case study, shows that there is substantial room for improvement, given the importance of wage settlements in the new economic governance arrangements. The text of the NRPs makes no mention whatsoever of the social partners; they are mentioned in the Preface, along with

[75] See Boni (2012), p. 7 and Schömann (2012), p. 230.
[76] See Schulten (2004), p. 211.

many other organisations, but their specific contribution is not made explicit.[77] That is both paradoxical and consistent: the Council's country-specific recommendations for Germany make no mention of wage growth that *under-shoots* the ECB's price target, let alone criticise it, and it is not, therefore, surprising that the German government fails to respond to wage policy recommendations that have not, in fact, been made. The government is, though, well aware of the importance of this issue. It relates to both the emergence and the management of divergences, yet in the now familiar asymmetrical way that exempts 'surplus countries' from all criticism and, therefore, from any need to take action.[78] However, if wage setting in Germany is also to have the importance it deserves in the Commission's and the Council's monitoring, then it is difficult to see how the country's NRP can be the sole forum for considering wage setting and wage growth. On the one hand, the NRP is a report on behalf of the government, and the social partners have no influence on the thrust of it, and on the other hand, the social partners cannot afford to let themselves be subsumed within a government document so easily.

Experience with NRPs prompts questions about the trade unions' general relationship to their respective national governments. Government attitudes to trade unions have often been, and remain, very volatile. Sometimes, governments will seek to convince the unions to help protect national industry through wage restraint or wage moderation, demanding this even at the cost of nationalistic mercantilism and in breach of the rules of engagement of the EMU. At other times, the trade unions are directly confronted with efforts by government to

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[77] See BMWI (2012, 1).

[78] It may be interesting to reproduce the position of EMU's largest Member State and 'surplus country' in context: "The lack of competitiveness in individual Member States was a key factor in the loss of confidence in stable economic and financial development in these countries. This is why a new procedure for preventing and correcting macroeconomic imbalances was instigated at European level alongside the existing fiscal policy monitoring under the Stability and Growth Pact.

The new procedure focuses primarily on countries with weak competitiveness that may manifest itself as increasing indebtedness, rising unit labour costs, falling export market shares or a high current account deficit. There is a far greater danger that other Member States will end up also being affected than there is with competitive countries with current account surpluses. Second, high current account deficits usually go hand in hand with rising levels of foreign debt, with the result that the solvency of the Member States concerned is impaired and, with it, the viability of the euro area as a whole. The German government therefore welcomes the statement by the European Commission that current account surpluses will not be considered as triggering penalties in this procedure. Such surpluses are justified where – as in Germany – they are the result of competitive companies operating in functional markets and are based on structural factors that influence savings and investment behaviour. The country's current account balance is not a target indicator for its government.

The European Commission has recently noted a reduction in macroeconomic imbalances, though it is unclear to what extend this trend will be sustainable and not merely the outcome of cyclical factors. The most important thing from the perspective of the German government is that corrective action against problematic imbalances follows market economy adjustment processes or is the outcome of structural reforms to improve competitiveness." BMWI (2012, 1)

decentralise the labour market and reform it in ways that will reduce their power. This ambivalence and unpredictability on the part of governments must be replaced by a clear, sustainable and mutual support between government and trade unions as both seek to shape policy in a way that complies with the requirements of EMU.

Macroeconomic Dialogue at National Level

A forum must, therefore, be found that facilitates cooperation but also ensures the sovereignty of governments and the autonomy of the social partners – which, in this case, also means coordination through dialogue. One such forum could be Macroeconomic Dialogue at National Level (MEDNAT), which has been described in greater detail elsewhere.[79,80] We shall attempt below to update its design in the light of more recent developments and the new requirements imposed by the new economic governance arrangements.

The composition of MEDNAT would be determined by responsibilities at national level. The example of Germany will serve as an illustration. As far as the Federal Government is concerned, representatives of the Chancellor's Office and the Ministries of Finance, Economics and Employment would be involved. On the social partner side, the BDA, BDI and other national-level bodies would represent employers, with the DGB and representatives of individual trade unions on the union side. The DGB, Germany's main union confederation, has long indicated that it would be willing to do this.[81] A representative of the German Bundesbank as a member of the ESCB should also be present, although without any direct powers over the national policy mix, to pass on national signals to the European body responsible for setting monetary policy and/or to represent that body's position in national discussions.[82] Consideration would also have to be given to the direct contribution to

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[79] The 1998 Guidelines were the first to endorse cooperation between macroeconomic actors at national level: "At the national level, governments may have to take a stronger interest in fostering social dialogue and in promoting understanding of the policy line developed in the Broad Guidelines."

[80] See Koll (2011), p. 27 ff.

[81] "Beyond this, setting up national Macroeconomic Dialogues at both technical and political level is an appropriate way of embedding the European dimension more firmly in national policy and developing macroeconomic policy approaches to tackle the ongoing crisis in growth and employment"; see DGB (2005), p. 69.

[82] This composition is in line with the existing national Macroeconomic Dialogue that has been operating at technical level in Germany since the earliest days of EUROMED. At political level, the closest idea to a

MEDNAT of representatives of the Council of Economic Experts in terms of economic expertise to support assessment of the macroeconomic situation.

Setting goals for MEDNAT would derive from the requirements of the new economic governance arrangements. In general terms, the priority would be to implement the Council's country-specific macroeconomic recommendations and, more specifically, to comply with the scoreboard ranges as part of the process for preventing and correcting economic imbalances. This issue can be tackled only as part of a discussion of macroeconomic trends in Germany and across the euro area and of the macroeconomic policy mix as a whole. The MEDNAT agenda could, therefore, include the following items:

- exchange of views on the current economic situation and outlook both in Germany and in the euro area based on projections and alternative quantitative scenarios,
- economic policy requirements for achieving or maintaining long-term, smooth, growth- and stability-oriented economic growth in Germany as part of EMU,
- compliance with the SGP and Fiscal Compact target and with the procedure for preventing and correcting economic imbalances, in particular the scoreboard and the country-specific recommendations, sub-divided as follows:
    - notification by the German Bundesbank as a member of the ESCB of its planned monetary policy,
    - the cyclical and structural stance of fiscal policy within the framework of the debt brake and the SGP,
    - exchange of views on developments in wage policy,
    - assessment of the intensity of competition in the business sector,
    - the consequences of monetary, fiscal, wage and competition policy for macroeconomic growth, in particular on (real net) incomes and their distribution and use and, hence, on domestic demand and foreign trade and on the current account.[83]

MEDNAT is the exchange of views between government representatives and employers' associations and unions in the run-up to adopting the Annual Economic Report. However, talks with employers and unions take place separately and the German Bundesbank is not involved.

[83] The substantial increase in publications dealing with issues of distribution in particular demonstrates how

In the current situation, there must also be agreement on how the gaps that have developed between euro area Member States can be narrowed without impairing the functioning of the economic cycle. Targets for reducing these divergences and road maps to achieving these reductions could be outlined and could help boost confidence like in the case of the SGP. MEDNAT meetings should adopt a timescale that fits in with both the European and the subsequent national 'semester'. An initial meeting could be held during the first half of the year by way of preparing the national NRP, with a further meeting around mid-year following submission of the Alert Mechanism Report and country-specific recommendations, with a view to putting these into implementation. Both meetings should be at top level and be preceded by technical preparation.

It should also be noted that the priority for the trade unions would not merely be 'compliance' with the new requirements of economic governance, even though that alone should be adequate motivation.[84] Another priority would be for them to find a forum in which to bring their legitimate demands to the other economic policy actors with the aim of establishing a stability- and employment-oriented macroeconomic policy mix. The internal dimension of union coordination referred to above would, in this case, be supplemented with an external dimension.

Macroeconomic Dialogue at Euro Area Level

At national level, fiscal policy and wage policy determine what happens at macroeconomic level: monetary policy is laid down by the ECB and has a more observational and indicative role in the national context. The situation is reversed at euro area level, where monetary policy is the only actor that interacts with all national fiscal policy and wage policy initiatives and measures. To that extent, there is also a need for coordination at euro area level: the Eurogroup has, therefore, long existed alongside the Council, but the social partners are not

central issues of income and capital distribution are to the emergence, development and resolution not just of the crisis on the financial markets but also to the crisis besetting the euro area.

84 "The prejudices common within some trade unions against 'integrating' wage policy in a broader model of economic policy coordination are, ultimately, unconvincing. They completely fail to acknowledge that without a coordinated economic policy, wage policy would come under even greater pressure to adjust and/or the national pacts that would be concluded instead would increase competition between the national part-regions of economic monetary union"; Welzmüller (2004), p. 127.

yet represented on it. Because it plays a key role in EMU wage policy, however, it is essential that they are involved. This could be done within a Macroeconomic Dialogue at euro area level (EUROMED). EUROMED would then comprise the following participants: the President of the ECB; the ministers of finance of the euro area countries; the Commissioners for Economic and Monetary Affairs and for Employment, Social Affairs and Inclusion; and representatives of European-level employers' associations and trade unions. In purely practical terms, and without additional bureaucracy, EUROMED could be achieved by the Eurogroup meeting regularly twice a year or as required in its existing form but with the additional participation of the social partners. Beyond the standing role to ensure an appropriate macroeconomic policy mix within the euro area as part of the global economy, EUROMED should also gear its timing and its agenda to the requirements of the 'European semester' and, in particular, the country-specific issues. The groundwork for both meetings could be laid at technical level also with the involvement of the social partners: appropriate forum could be the EU's Economic and Financial Committee or its Economic Policy Committee. At euro area level, consideration needs to be given to whether a newly created European Council of Economic Experts with responsibility for assessing macroeconomic trends right across the euro area could improve the discussions within, and outcomes of, EUROMED.

The role of EUROMED would be initially be the same as MED assumes at pan-EU level:

- discussion of the macroeconomic situation and outlook across the euro area,
- identification of the need for economic policy action to achieve and maintain a sustainable and smooth growth- and stability-oriented policy mix of monetary, fiscal and wage policy across the euro area,
- identification of its own contribution and that of other macroeconomic actors to achieving these goals.

New responsibilities for EUROMED also arise from the new economic governance arrangements and, in particular, from the system of country-specific monitoring, to which little, if any, attention has so far been paid. The main source of new responsibilities is the need to implement the Regulation on the prevention and correction of macroeconomic imbalances:

- discussion of the Commission's Alert Mechanism Report where it refers to Member States using the single currency,
- discussion of the Member States that, in the view of the Commission, manifest such imbalances,
- discussion of further elements of Regulation that, though they are properly the preserve of the Council, also need to be discussed by euro area social partners because these social partners have a special role. These include, for example, recommendations to the Member States and their scrutiny, recommendations based on the assumption that there is an excessive imbalance, assessment of the corrective action plan, and monitoring of this plan.[85]

Beyond these specific points, the *modus operandi* of the new EUROMED, as well as that of the existing MED at EU level, needs the following improvements in relation to its current operation:

- greater obligation to have *ex ante* coordination,
- greater account of the fiscal policy direction and its impact at EMU level as part of an adequate macroeconomic policy mix,
- greater recognition of trends in exchange rates and exchange rate policy,
- making discussions more objective by using quantitative scenarios with alternative assumptions,
- better visibility and information for the (financial) markets through publication of non-controversial results of talks,

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85 Moreover the social partners should also be involved in the 'economic policy dialogue' between the institutions of the European Union, in particular the EP, the Council and the Commission, as provided for in the Regulation. Such involvement would include discussion of the Broad Economic Policy Guidelines, the general guidelines issued by the Commission to the Member States at the beginning of each annual monitoring cycle, the European Council's conclusions on the guidelines for economic policy as part of the 'European semester', the findings of multilateral monitoring, and the European Council's conclusions on them in accordance with Article 14 (1) of the Regulation. The Member State concerned may be invited to these discussions under Article 14 (2), and this should also be possible for the social partners at national level.

- Involvement of the European Parliament, in particular by improving explicit briefing.[86]

Summary and conclusions

The current crisis in the euro area was the result of unsustainable macroeconomic imbalances. It has mercilessly exposed serious defects in the governance of the euro area. The key cause of the explosive divergences in current account deficits was the drift in macroeconomic price levels and in growth of domestic demand and exports between Member States. Persistent and permanent divergences in wage growth played a key role here. The cardinal error made by mainstream economics and economists at EU and national level was their failure to acknowledge the central role of wage setting in ensuring cohesion within economic and monetary union.

In the early stages of EMU and throughout its existence to date, there have been clear signs and signals of this shortcoming. The central coordination instrument – the Broad Economic Policy Guidelines – also laid down necessary and sufficient requirements for wage setting. Finally, the social partners themselves had recognised the need for greater coordination of national pay setting within EMU and formulated approaches to achieving this. Ultimately, however, governments failed to comply with the rules that they had themselves set and the social partners' attempts at coordination were inadequate to prevent the catastrophic divergence in unit labour costs. Misleading academic paradigms and a failure by politicians to follow through, combined with mercantilist tendencies in the 'surplus countries' and blithe complacency in the 'deficit countries', ensured that the outcome was very different from what was hoped – and what had been possible.

In late 2011, the European Council sought to close the gap in EMU governance with a Regulation on preventing and correcting macroeconomic imbalances as part of the 'Six-Pack' of measures on governance. Among other things, this Regulation specifies a country's nominal unit labour costs and current account balance as the key control and target variables; it defines ranges and key thresholds and makes compliance subject to a detailed process of

[86] See Koll (2011), p. 25 f.

monitoring, correction and sanction. The first Alert Mechanism Reports set out the outcome of the process so far.

Unfortunately, the Regulation is designed asymmetrically as far as both prevention and correction are concerned. Specifically, the trends for whose monitoring it provides are primarily those influenced by *over-shoots* in unit labour costs that may generate current account *deficits*, with the result that correction is imposed only on the 'deficit countries'. This in turn generates a risk of a downward spiral that becomes self-reinforcing in a crisis. This asymmetry is, therefore, not merely a shortcoming but also seriously and dangerously misleading where the causes of, and action in relation to, imbalances are concerned. It is, therefore, important that this asymmetry is removed. While the crisis persists, indeed, a kind of 'reverse' asymmetry is required, with the 'surplus countries' shouldering the brunt of adjustment because they are the only Member States with capacity to do so.

Another dimension is that governments commit to monitoring their unit labour costs via the 'scoreboard' using a variable that is not within their direct control but is the subject of autonomous behaviour on the part of employers and unions to the extent that it involves a wage component. The new rules make several references to freedom of collective bargaining and also provide for the social partners to be involved in the process. However, neither provision has so far been adequate to resolve the tension between the new economic governance arrangements and autonomous collective bargaining.

Options are explored that could resolve this tension: retention of the current wage setting structure, trusting the market to correct current and future divergences; further deregulation of the labour market and decentralisation of wage setting; and its exact opposite, greater centralisation and coordination of wage setting, the option endorsed here. Wage policy and wage setting may, where necessary, be made more effective with the support of an anti-cyclical fiscal policy and an effective competition policy.

In the light of past shortcomings, however, there is also a need for substantial conceptual improvement and institutional support, both within the social partners themselves and in their interaction with other macroeconomic actors, such as monetary and fiscal policy. What is important here is, first, to combine the autonomy of the various actors with greater regulation at euro area level and, second, to ensure coordination of the national level with the euro area level. A suitable institutional framework for greater coordination could, therefore, be a

Macroeconomic Dialogue at both national and euro area level in addition to the existing Macroeconomic Dialogue at EU level. The organisation of these Dialogues could build on existing bodies and approaches and would not involve any additional bureaucracy. Both bodies would need to be adapted to the prevailing situation in the Member States in terms of their goals, their programme and their composition or design, to enable them to meet the increased demands on economic policy governance in an economic and monetary union.

The analysis above demonstrates that, even when EMU was launched, it already had many of the necessary rules and appropriate institutions on which it could have drawn to ensure its smooth operation. Yet economic imbalances reached acute levels and eventually spilled over into a full-blown crisis. Why, then, be optimistic that things will be different in the future?

One key difference compared with the launch of EMU is the brutal experience of the current crisis, which is threatening the entire project not only economically but also socially and politically. The extremely thorny nature of the problems is a further difference. If there is anything good at all to be said of the current crisis, it is that it offers lessons for the future, albeit – as so often – in the form of 'pathological learning'. It is extremely hard, particularly for those directly affected, to see that once again it takes substantial damage – a persistent recession, massive pay cuts, especially among the lowest-paid, and a rapid and dramatic rise in unemployment, particularly youth unemployment – for mainstream economics and economic policies to hopefully learn some lessons. Our previous obsession with fiscal balances and structural reform has distorted our perception of the conditions for an adequate growth- and stability-oriented macroeconomic policy mix with a high level of employment, full participation by workers in the fruits of higher productivity, favourable investment conditions for businesses, and economic prosperity for the whole of society.[87] Realisation has now dawned as to what neglecting the macroeconomic dimension of EMU actually means: crisis-level divergences between Member States, drastic remedial measures in specific

[87] "…Drawing lessons from the crisis, we need to broaden the focus of our surveillance beyond fiscal policy to include relevant developments of macroeconomic imbalances…"; European Commission (2010), p. 6 (see also p. 38, Resolution of the Eurogroup; "It was a mistake on our part to have focused on state finances. We should have been monitoring a broader range of macroeconomic parameters ... growth in unit labour costs, current account deficits, property bubbles. The Commission would have benefited from a mandate to take action against these imbalances in the same way as it was acting against excessive public debt."; Regling (2010), p. 2).

Member States, contractionary tends in the euro area as a whole, and a dramatic loss of community spirit and acceptance of the ‘European project’. Realising this is one thing; a major reorientation of economic policy is quite another. Economic policy cannot, as has been the case in the past, be allowed to frustrate stronger coordination but must promote it and embody it as part of its overall approach. However, above all, it urgently needs further conceptual safeguards and institutional strengthening, as described above, so that the crisis can be resolved and the lessons learned are not rapidly forgotten again as soon as signs of improvement start to appear.

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