

Comment on Giuseppe Bertola: Social and labor market policies in a growing EU

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This is a thoughtful paper on social and labor market policies in Europe. The bottom line is that there is a need for more coordination in the field of social and labor market policies (although the paper is not very specific about what should be done). A main argument is that economic integration without attention paid to social aspects is deemed to cause resentment against further economic integration. This possibility is illustrated by means of a simple model where economic integration absent social interventions *may* cause lower welfare relative to the pre-integration situation.

The outline of my comments is as follows. First, I will by means of a few examples concretize what the EU is doing in the area of labor market policies. These examples illustrate that the EU as of 2005 is far from passive when it comes to social and labor market policies. Second, I will very briefly discuss some pros and cons of policy coordination in this area.

1. What does the EU do?

The EU as of 2005 is actively involved in, inter alia, regulations of working time and active labor market policies. The EU is also interfering with national labor market laws concerning collective agreements.

The EU directive on *working time* in its most recent form dates back to 2003. It stipulates in great detail how working time and rest periods should be scheduled. These rules include:

- a minimum daily rest period of 11 consecutive hours per 24-hour period;
- a rest break, where the working day is longer than six hours;
- a minimum uninterrupted rest period of 24 hours for each seven-day period, which is added to the 11 hours' daily rest;
- maximum weekly working time of 48 hours, including overtime;

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- paid annual leave of at least four weeks.

Sweden has typically been keen to follow EU directives. In this case, we were a bit slow, however, a fact that prompted the EU commission to bring an action against Sweden at the European Court of Justice in 2004. This action triggered changes in Swedish working time legislation in February 2005, changes that came into force on the 1st of July 2005.

The European Social Fund (ESF) is the EU's main tool for *active labor market policies*. Over the period 2000-2006, the ESF spends some 70 billion Euros on projects in the member states. Keywords for the activities are employability, entrepreneurship, adaptability, and equal opportunities between men and women. Sweden is on the boat with a Swedish section of the ESF (Svenska ESF-rådet), spending some 6 billion SEK over the same period on the so-called Objective 3 program (Mål 3), plus a roughly equal amount through government co-financing. From the available ESF-documents, ESF Sweden seems to have affected a fairly large number of people (some 15 percent of the labor force over a five-year period).

EU-interventions in the area of *labor law* involve, among other things, the directive on posted workers. Which rules should apply when a firm, a construction firm, say, posts workers in a foreign country? Should it be the collective agreement in the origin country or the host country? The rules are stated in the EU directive on posted workers from 1999.¹ The directive states that it is the rules prevailing in the host country that apply.

These rules may not always be easy to interpret in practice, however, as we know from a recent Swedish labor conflict (Vaxholmskonflikten) where a Latvian construction firm and the Swedish construction workers' union failed to reach a wage agreement. The details of the conflict are somewhat murky for outsiders. Roughly, it seems as if the Latvian firm was willing to pay the minimum wage as given by the collective agreement, whereas the Swedish union asked for something above the minimum wage. The Swedish labor court has asked the European Court of Justice for a preliminary ruling. In the meantime, a discussion has been initiated on how to deal with the directive in practice. One alternative would be legislation on minimum wages. Another alternative, adopted in other Nordic countries,

¹ The Swedish term is "utstationeringsdirektivet".

would be to extend by law the collective agreements. Both routes would be new elements in Swedish labor law.

2. What should the EU do?

When economies are open to trade and factor mobility, policymaking in one country is typically bound to have some repercussion on some other countries. In theory, there is generally a case for policy coordination so as to improve welfare by offsetting the externalities. In practice, the case for coordination is often much weaker since we have limited understanding of all the relevant externalities. A few examples can illustrate this claim.

2.1. Unemployment insurance and active labor market policy

In theory, spillover effects across countries driven by UI policies can certainly be identified. According to standard theory, benefits affect wages, employment and output in the domestic country. This may trigger changes in relative prices between goods produced at home and goods produced abroad, thus affecting foreign countries. Benefits may also affect firms' location decision via the effects on wage pressure. Similar arguments can be made for active labor market policies. There would thus seem to be a case for coordination, provided that we can agree on the correct model.

But UI systems have many parameters that are substitutes, including replacement rates and the duration of benefit receipt. Focusing on just one parameter would be insufficient, as countries could offset the prescribed policies by changing a parameter that is not subject to coordination. Coordination may therefore be ineffective unless it becomes *comprehensive*, i.e., including a host of relevant parameters of the system. But countries may have chosen different UI schemes for good reasons. Wage bargaining systems may differ (and this has implications for how benefits affect employment). And preferences may differ (different preferred tradeoffs between income protection and employment).

Regarding active labor market policies, there remains considerable uncertainty about what works and what does not work. Given this state of knowledge, it would be unwise to promote coordination of policies. Diversity in policy choices may help inform researchers and policy makers so that they learn about successful as well as unsuccessful programs.

My conclusion is that the case for coordination in this area is weak.

2.2 Working time

One might ask if there is a case for regulating working time at all. I do not think that the answer is obvious. In a highly unionized labor market, such as the Swedish one, one might argue that a reasonable tradeoff between flexibility and security can be achieved through collective bargaining.

Be that as it may, it takes more to argue that there is a case for *supranational* working time regulations than to argue in favor of national regulations. Externalities are certainly conceivable and may well be of some practical importance. They work through firms' labor costs and may therefore affect firms' location decisions; the recent German experience of negotiated working time increases is a case in point. But if there is a case for supranational regulations on working time, there is an equally strong case for a supranational wages policy, perhaps an EU wide minimum wage. Such a policy would in all likelihood be a disaster if it is given any bite; and without bite it would be meaningless. There is a sharp difference between a nationwide minimum wage and a European level minimum wage. Mobility is reasonably high *within* countries, but very low *across* countries. Wages must be allowed to reflect productivity differences *across* countries, even if they are not allowed to reflect productivity differences across *industries* within countries.

My conclusion is that the case for supranational legislation on working time is weak.

2.3. Labor law and collective agreements

It is easy to see a case for *some* EU level regulations regarding labor law, in particular laws that concern the operation of collective agreements. The presence of country interdependencies is obvious when it comes to workers posted by one firm in another country. To facilitate trade in services, it is important to offer firms and workers clear and predictable rules upon which they can base their decisions. Firms should be able to figure out what wages they should pay in a prospective host country. This calls for some supranational rules. The details of the directive on posted workers can be discussed, but it is clearly important to reduce uncertainty and increase transparency.

3. Conclusions

Economic integration requires some degree of coordination so as to facilitate the mobility of goods and people. As is well known, country-specific regulations may well be driven by protectionism. It is important that workers contemplating to migrate can make reasonably accurate predictions about wages and transfer incomes in a prospective destination country. It is equally important that a firm that contemplates operations in a foreign country can roughly predict what the wage costs would be. These considerations motivate some supranational agreements on “rules of the game”.

Current EU operations extend beyond ambitions to facilitate economic integration. I find it difficult to rationalize supranational regulations on working time (as long as a supranational wages policy is not on the table, and so for good reasons). It is also difficult to identify externalities that motivate supranational activities in the area of active labor market policies.

Since the externalities that could motivate supranational coordination are so evasive, it is better to rely on diversity and experimentation than on a common supranational policy. Different policy preferences should be allowed to result in different policy outcomes.

