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SOCIAL COMPETITION IN THE EU: MYTHS AND REALITIES

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Foreword by António Vitorino

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FOREWORD

by António Vitorino

As Kristina Maslauskaitė points out in her Study, social convergence among the European countries was one of the first factors to be evoked at the wake of European construction. The Treaty of Rome states that member countries pledge to promote "equal access to progress" for working conditions and standards of living, and it adds that this "development will ensue not only from the functioning of the common market, which will favour the harmonisation of social systems, but also (...) from the approximation of provisions laid down by law, regulation or administrative action". The debate on competition among the countries "united in diversity" including in the social sphere has been played out between these two dynamics, at once economic and legal. Thus the debate is certainly not new, but it has definitely witnessed a renewed interest since the countries of Central and Eastern Europe joined, as shown, for instance, by the "Polish plumber" row in the French referendum on the European Constitution back in May 2005.

Competition and social convergence in Europe

Salary and social protection levels in European countries logically echo the specific nature of each country's economic and political history. Portugal, for instance, long governed by Salazar, experienced belated economic development and then a revolution with strong social aspirations; bogged down by a crisis in the 1970s, the United Kingdom experienced a marked deregulatory and free-marketeering drive under Margaret Thatcher; the countries of Central and Eastern Europe, for their part, lived under communism which penalised them from an economic and social standpoint; and so forth.

In view of this, we have been able to see how, as the Treaty of Rome stipulates, membership of a "common" then a "single" market has led to the gradual convergence of social standards in these different countries, all of which will have to be reassessed in the light of the current crisis. We may also observe how, despite their differences, the countries of the European Union all share more or less the same kind of "social model", whose distinctive features become very clear when we compare them to the model in force in such countries as, for instance, the United States or China: this European model is distinguished in particular by relatively high average salary levels, a high level of public and welfare spending, and relatively strong labour law.

Just like social measures based on secondary Community law, these common features also have the effect of containing social competition among the European Union's member states. Or, at any rate, they lead to a very different kind of competition from that coming from emerging or developing countries, where social and welfare standards are far weaker than those that we have developed in Europe.

Labour costs and labour law are, of course, only some of the factors among many determining a country's level of competitiveness, and direct foreign investments more often reveal a search for additional demand rather than a search for less costly supply. Thus countries such as Portugal or Spain were able for a long time to benefit from a comparative advantage in terms of salary and thus to stay relatively competitive in certain sectors, while attracting investors who would otherwise have failed to show any spontaneous interest in countries situated beyond the Pyrenees and in the extreme Southeast of Europe. It is partly due to the Central and Eastern European countries' membership of the European Union that the Southern countries have lost their competitive edge and are now facing the need to redefine their comprehensive economic strategy and their position both in Europe and within the globalisation process.

"Social Europe" midway between frustration and distortion

The much-debated Service Directive proposed by Frits Bolkestein naturally foresaw that it would be impossible to work in France or Germany under Polish or Estonian labour laws. Its primary aim was to foster growth and employment

in a sector that accounts for over ⅔ of Europe's GDP but for less than ¼ of intra-EU trade. Even though the directive's aim was to reduce information disclosure requirements and administrative burden to be met before offering such services, it nevertheless raised or "revived" the fear of fostering "social dumping" within the European Union while also pushing forward the process of deregulation in Europe.

This episode has reminded everybody, if indeed there were any need to do so, of the extent to which raising the issue of social competition in Europe can spark a lively reaction throughout the European Union. Such reaction is *de facto* triggered not only in the countries where workers feel that they are the victims of unfair social competition and where they would quite legitimately like to maintain their salary or social welfare at existing levels; it is also to be found in countries which feel that they are being wrongly accused of practising such competition when in fact it merely reflects the current level of their economic and social development level.

In the end, this confrontation leads to frustration and a great deal of tension on both sides of the aisle. It can only hamper European projects for the legal harmonisation of social standards and practices, which is difficult already as the more advanced countries (for example in northern Europe) are reluctant to allow the European Union to intervene in these areas. It is, therefore, crucial to define the real impact of social competition within the European Union in as substantiated a manner as possible to facilitate constructive debate and initiatives in the field of social Europe. The great merit of Kristina Maslauskaitė's Study is precisely that it offers just such a description.

What is the real impact of intra-European social competition?

Putting words and figures to realities too often perceived on a symbolic or nominal basis is the crucial contribution of this Study, which seeks to analyse in accurate detail the principle elements of social competition among the member states of the European Union.

For example, Kristina Maslauskaitė provides an overview of salary differentials among European workers, distinguishing nominal costs from real costs, or, in other words, costs linked to worker productivity. Such a comparison

reveals that the maximum real salary differentials between member states are almost 8 times lower than the nominal ones, which shows that salary competition within the European Union is markedly less acute than is often described.

The other comparisons made by Kristina Maslauskaitė are just as enlightening, addressing respectively non-salary costs (basically linked to social protection), labour law (duration, degree of protection, health and security standards), and factors of an "institutional" nature (worker representation and the existence of a more or less strong parallel economy). All in all, these comparisons provide a rather nuanced picture of intra-European social competition, in which the countries of Central and Eastern Europe occasionally (but not always) show a somewhat setback position related to their "catching-up dynamic", while other countries such as the United Kingdom, Ireland or even Luxembourg also occupy a specific place.

A social agenda based on realities

As stressed in the introduction, Kristina Maslauskaitė's Study does not set out to provide an exhaustive picture of European social competition. Consequentially, the comprehensive overview that she provides does not rule out the existence of a particularly aggressive form of social competition. This, for instance, is the case in certain specific sectors such as farming or transportation, or when protective regulations governing workers' postings are badly implemented or even deliberately circumvented. The comprehensive overview also talks relatively little about the development of differences in unemployment rates between member countries, which has an impact on salary levels and thus also on national economic competitiveness.

The purpose of the Study is not to offer recommendations designed to allay the tension caused by social competition within the European Union. Yet, if I had to formulate one, I would insist on the need to provide for European adjustment spending linked specifically to caring for the victims of intra-European relocation that social competition might cause, even in a limited yet unquestionably spectacular fashion. Portuguese membership of the European Union, for example, prompted the establishment of "Integrated Mediterranean Programmes" for territories and regions in countries that were already members (for instance, the South of France) likely to be impacted by the presence

of these new competitors in an excessively head-on fashion. It is a great pity, both from a social and from a political viewpoint, that such programmes are no longer in force today.

As Jacques Delors so often stresses, the promotion of a European political agenda combining "competition which stimulates, cooperation which strengthens and solidarity which unites" is more necessary than ever and it must lead to the development of the social dimension for both the European Union and the Economic and Monetary Union. Only if this dual challenge is going to be explored on the basis of a lucid and reasoned analysis of the real impact of social competition among European countries, will its promoters find it easier to get heard. Kristina Maslauskaitė's Study will unquestionably offer a valuable contribution in this direction because it will allow the reader to think beyond the myths, and thus to be able to act in the real context.

António Vitorino,
president of Notre Europe - Jacques Delors Institute

EXECUTIVE SUMMARY

The debate on social competition, or social dumping, is as old as the European Union itself, yet it has been getting louder in the recent years marked by economic turmoil and high levels of unemployment in many of the member states. Public opinion and politicians are worried that intense competition in the cost of labour between the member states might result to the "race to the bottom" in terms of social standards.

The aim of the Study is to shed some light on the usually politicised concept and practice of social competition. This Study critically examines the issues related to defining social dumping and provides an overview of existing legal labour standards on both European and global levels. It then proceeds to an in-depth discussion based on statistical data on whether the differences in wages and labour standards leave enough space for regime competition in the EU27. Due to size limitations this Study concentrates on national-level indicators and does not analyse sectorial problems.

The main finding of the Study suggests that, on the whole, social competition within the EU in general, and between the "new" and the "old" member states in particular, is unlikely.

First and foremost, statistical indices of productivity-adjusted labour costs suggest that commonly perceived truths in terms of labour costs might no longer hold. In terms of productivity-adjusted total labour cost, some of the new member states have not only lost their status of the cheap labour destination, but have also become more expensive than the European "core". If ten years ago Central and Eastern European (CEE) member states have been real havens for cheap labour, nowadays the real labour cost in Slovenia and Estonia is in fact higher than in France or Germany. What is more, Ireland, Luxembourg and the UK make it to top five cheapest destinations.

Secondly, even though social policy is still considered a national prerogative, significant progress has been made in harmonising important number of labour standards, including basic health and safety requirements, non-discrimination and labour law relating to part-time work, fixed-term contracts, working hours, employment of young people, employee information and consultation at the European level. These principles set the minimal floor in labour law, which (if enforced) eliminates the possibility of using these rights as factors of labour cost reduction.

Thirdly, the data indicating the respect of various labour standards such as working hours, employment protection and occupational health across the EU does not point towards consistently poor performance by the CEE countries. If some of the countries score low on some of the indices, these differences can often be explained by the socio-economic context rather than governmental policy of labour cost reduction.

Finally, the new member states do have higher shares of "shadow" economy and weaker institutions, all of which could be used for the purposes of driving the labour cost down illegally. Yet, the analysis suggests that it is not obvious that unofficial economic activities can confer a real economic advantage for the new member states. For a producing firm, weak institutions, which often go hand in hand with "shadow" economy, might imply additional costs related to poor infrastructure or inadequate human capital.

Unexpectedly, three member states not belonging to the CEE club, namely the UK, Ireland and to some extent Luxembourg, seem to consistently outperform all the other countries in terms of real labour cost. That combined with low tax rates, flexible labour laws and relatively weak employee participation makes the British Isles the most realistic suspects of social dumping. It does not automatically follow that these countries do engage in social dumping though; it only implies that their economic model is the most efficient in terms of labour cost. As discussed in the Study, disloyal and genuine welfare-enhancing competition might sometimes be difficult to disentangle.

INTRODUCTION

Social dumping, or social competition, is the concept often employed in public debate signifying an undesirable side effect of globalisation in general and of European integration in particular. On the one hand, European Union with its single market is a bastion of globalisation embracing the free movement of goods, services, capital and labour. On the other hand, the EU positions itself as a "social market economy", defending high standards of production and social cohesion. It is often argued that the tensions between free market competition and the European Social Model are eminent in the environment of significant heterogeneity among different member states. Cost competition among member states might put pressure on the social systems leading to the "race to the bottom." Deeply rooted national differences in the field of social policy could thus be menaced once the protective shield of national borders is dropped.

Expectedly, the argument of social competition was first raised after the EU enlargement of 1973 when the UK and Ireland joined in. The two promoters of the "Anglo-Saxon" tradition were seen as a threat to the social status quo in the six founding member states. However, at the time the internal market was far from complete and the Thatcherite reforms were yet to come. In addition, the liberalism of UK and Ireland notwithstanding, their overall labour cost and commitment to high labour standards were comparable to the continental core.

The social dumping critique resurfaced again with the creation and subsequent consolidation of the European single market, which was later followed by the admission of ten Central and Eastern European Countries (CEECs).[1] Contrary to all of the fifteen existing member states, the CEECs with their low level of economic development and weak post-communist institutions were

1. Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia in 2004; Bulgaria and Romania in 2007.

seen as a far cry from the European Social Model. In the past decade, despite the current economic crisis, the ten CEECs have achieved astonishing progress in terms of GDP growth and Europeanisation of national labour laws. Yet, more often than not they are still accused of dumping their poor labour practices across Europe.

Today in the context of global economic slowdown and growing mistrust with free market ideology, the social dumping argument is back to the public debate. CEECs are no longer the only suspects of the practice. The Southern European countries, namely Greece, Portugal and Spain, are also in the radar[2] let alone the UK and Ireland, which have long been seen as a threat to high protective standards on the continent. Even Germany with its minimum-wage-free slaughterhouses bordering France has been blamed for unfair competition.[3]

This Study critically examines the argument of social dumping and discusses whether the differences in wages and labour standards leave enough space for regime competition in the EU27. Various labour practices across the EU are compared in the attempt to show that, generally speaking, social dumping argument is redundant in the European context. It should be emphasized that this Study concentrates on national-level indicators and does not analyse sectorial problems due to size limitations. Undoubtedly, some sectors such as agriculture, transport and construction are more prone to unfair competition due to the nature of these economic activities. However, the argument of social dumping is often used in a generalised form, or, in other words, against countries as a whole. For this reason a global vision is favoured in the Study.

The Study proceeds as follows: Section 1 sets the scene by over-viewing the evolution of labour standards in the EU and deals with the definitional issues of social dumping. Section 2 analyses the differences of direct costs of labour between the member states. Section 3 complements the analysis by looking at the possible indirect labour costs arising from strict labour market regulation, provisions on occupational health and working time. Section 4 suggests that institutions might also have a role to play in the regime competition on the European level. Final section provides several concluding remarks.

2. Ivora, P. (2010) "Déficit social européen et baisse du dollar à la source de la crise irlandaise" L'Humanite.fr, 19 November 2010.
3. *L'Expansion*, "Abattoirs : l'Allemagne accusée de dumping social" 28 January 2011.

1. European Labour Standards and Social Dumping

Before embarking on the analysis of the current situation of the labour standards in different EU member states, it is useful to see what has been already achieved in terms of labour standard harmonisation on both global and European levels. A clear understanding of the playing field in terms of basic international labour law today is necessary for the analysis of "welfare regime competition". If certain agreed rules of the game are respected by all of the member states, by definition any social competition beyond these standards is rendered impossible. In addition, the definition of social dumping in relation to the existing European labour standards is crucial in the discussion: after all, the answer to whether social dumping exists is very much dependent on what is meant by the question. This section, thus, sets the scene for further discussion by giving a brief review of European labour rights and explaining what the concept of social dumping stands for in the context of the single market.

1.1. EU Labour Rights: Brief Overview

Labour standards, or the fundamental rights at work, are internationally recognised as defined by the eight Conventions of the International Labour Organisation (ILO). The fundamental ILO rights, which are to be respected by all of the EU member states, include elimination of forced and child labour, freedom of association as well as rights to non-discrimination and collective bargaining. These labour standards are the global common denominator, all of the eight Conventions having been ratified by at least 150 countries, including all of the EU countries, regardless of their level of development.

Over the years, labour rights within the EU have been elaborated much further than the ILO minimal standards. One should keep in mind that European social policy was never meant to become a social policy *stricto sensu*. Instead, from the very beginning, it was constructed as a form of social regulation, fixing the

market failure without major resource redistribution.[4] Initially, in the Treaty of Rome, labour was seen as a factor of production needed for the creation of the common market. Therefore, it was granted the same right of free circulation as capital, goods and services. Not surprisingly, the Treaty of Rome has often been called the "economic constitution" because it gave far-reaching rights to economic agents within the common market, but left the social provisions to the discretion of the member states. According to Bercusson, such approach "challenged a fundamental premise of international labour law in the constitution of ILO: that labour is not a commodity".[5]

However, this pragmatic approach was understandable at the time when the founding member states were few in number, and shared common political engagement and constitutional guarantees for the protection of social rights. It was hoped that market forces combined with several clauses for minimal harmonisation, especially in the area of gender equality, would quasi-automatically bring convergence in terms of working and living standards (Art 117 of the Treaty of Rome, Box 1). In addition to that, flexible exchange rates also permitted the countries to overcome asymmetric shocks by devaluing their currencies instead of going through internal devaluations by cutting wages and labour standards. Finally, the European Social Fund was created to compensate workers for job losses resulting from increased competition.

BOX 1 ► Treaty of Rome, Article 117 (now Article 151 TFEU, ex Article 136 TEC)

Member States agree upon the need to promote improved working conditions and an improved standard of living for workers, so as to make possible their harmonisation while the improvement is being maintained.
They believe that such a development will ensue not only from ***the functioning of the common market,*** which ***will favour the harmonisation of social systems***, but also from the ***procedures provided for in this Treaty*** and from the ***approximation of provisions laid down by law, regulation or administrative action.***

4. Majone, G. (1994) "The Rise of the Regulatory State in Europe." West European Politics Vol. 17(03).
5. Bercusson, B. (2009) "European Labour Law." Cambridge University Press, Cambridge, p. 5.

It was not until the adoption of the Single European Act (1986) and the Maastricht Treaty (1992) that a more elaborate social policy found its way into European legislation. The combination of two factors made it impossible to ignore the significance of the social dimension if the European Social Model was to be preserved. Firstly, the three European Union enlargements of 1973, 1981 and 1986 doubled the number of member states and increased the EU diversity in terms of economic development and social regimes. Secondly, the launch of the internal market and a clear commitment to introduce a single currency implied an increased competition within the community. Consequently, Jacques Delors proposed to adopt a balanced approach combining the forces of liberalisation with the clauses of cooperation and solidarity. Three provisions of the Single European Act concerning the institutionalisation of the European social dialogue, the improvement of the working conditions and the pledge for social and economic cohesion laid the legal base for the European social policy.

The Community Charter of Fundamental Social Rights for Workers (1989) was yet another expression of will affirming the right to health and safety at work. With the Treaty of Amsterdam (1997), a new Employment title was introduced and the open method of coordination, consisting of benchmarking and peer-review, was applied in the field of social policy. These developments allowed to set an array of minimal labour standards in health and safety by adopting the Framework Directive 89/391[6] as well as other directives, namely on working time (1993), parental leave (1996), part-time work (1997), fixed-term employment (1999), equal treatment in employment (2000), and information and consultation of employees (2002).[7] The basic approach was to set minimal standards as "social progress clauses" as well as to ensure the respect of "non-regression clauses" by prohibiting the application of the minimum standards if the actual standards of the member state were higher.[8]

6. Framework Directive 89/391 on Health and Safety at Work.
7. Barnard, C. and Deakin, S. (2011) "European labour law after Laval" in Ilasiuk, U. (ed.) *Before and After the Economic Crisis: What Implications for the "European Social Model"?* Cheltenham: Edward Elgar.
8. Deakin, S and Rogowski, R, (2011) "Reflexive labour law, capabilities and the future of social Europe" in Rogowski, R., Salais, R., and Whiteside, N. (eds) *Transforming European Employment Policy - Labour Market Transitions and the Promotion of Capabilities*, Cheltenham: Elgar.

1.2. EU Labour Rights Today

At the moment, European Commission recognises two main areas of rights at work as its competencies: non-discrimination and labour law. The latter covers health and safety, working conditions (relating to part-time work, fixed-term contracts, working hours and posting of workers) as well as information and consultation of employees.[9] Box 2 outlines the Treaty provisions for the labour law on the European level, with all the points, except for (c), (d), (f), and (g), under a qualified majority rule. In addition, the Charter of Fundamental Rights of the European Union proclaims that in the EU civil and political rights share equal standing with economic and social rights.[10] Chapter on Solidarity of the Charter grants all European workers a right of consultation within undertaking (Art. 27), collective action (Art. 28), protection in the event of unjustified dismissal (Art. 30), fair working conditions (Art. 31), social security (Art. 34), and health protection (Art. 35), among others.

BOX 2 ► Article 153 TFEU

1. With a view to achieving the objectives of Article 151, the Union shall support and complement the activities of the Member States in the following fields:
(a) improvement in particular of the working environment to protect workers' health and safety;
(b) working conditions;
(c) social security and social protection of workers;
(d) protection of workers where their employment contract is terminated;
(e) the information and consultation of workers;
(f) representation and collective defence of the interests of workers and employers, including co-determination, subject to paragraph 5;
(g) conditions of employment for third-country nationals legally residing in Union territory;
(h) the integration of persons excluded from the labour market, without prejudice to Article 166;
(i) equality between men and women with regard to labour market opportunities and treatment at work;
(j) the combating of social exclusion;
(k) the modernisation of social protection systems without prejudice to point (c).
5. The provisions of this Article shall not apply to pay, the right of association, the right to strike or the right to impose lock-outs.

9. European Commission, "Rights at Work", viewed on 4 August 2012.
10. Adopted in 2000 and became binding in 2009 with ratification of the Lisbon Treaty.

It should be emphasized, though, that areas of labour law that are not subject to EU legislation are also explicitly mentioned in the Treaty. Article 153(5) states that the provisions of the Treaty "shall not apply to pay, the right of association, the right to strike or the right to impose lock-outs". These provisions are left aside because they mark the main differences between the traditions of industrial relations in the member states. Yet, the question of wages, in particular, is at the heart of the social dumping debate and will therefore be discussed in detail in the following sections.

European Court of Justice (ECJ) has also had a significant role in European social policy, especially through its interpretation of the Posting of Workers Directive (Laval and Viking decisions). Freedom to provide services and the right to strike are both fundamental rights of the EU, enshrined in the TFEU and the Charter of the Fundamental Rights. Nevertheless, in some cases, as in Viking and Laval, these rights can go in opposite directions: the right to strike of one group of workers can interfere with the right to provide services by another. The ECJ has ruled that both rights can coexist if industrial action is legitimate and proportionate in defence of public interest. The fundamental right of collective action is thus not superior, but subject, to the right of free circulation. Yet, this might not necessarily lead to overall deregulation. On the contrary, some evidence suggests that following Viking and Laval certain countries have amended and strengthened their labour laws to fill in previously exploited gaps, whereas some social partners of different countries have managed to reach Europe-wide collective agreements.[11]

1.3. Social Dumping: an Issue of Definition

Viking and Laval cases have often been seen as the expression of social dumping in practice. Indeed, the Laval ruling reads that "the right to take collective action for the protection of the workers of the host state against possible social dumping may constitute an overriding reason of public interest".[12] Social dumping thus provides legitimate grounds for exercising one's right to collective action over someone else's right to provision of services.

11. Deakin, S., and Rogowski, R., *op.cit.*
12. Laval Un Partneri Ltd v Svenska Byggnadsarbetareförbundet [2008] IRLR 160, paragraph 103.

Interestingly, though, the definitions of social dumping are many. The notion of dumping has its roots in the theory of international trade where it is defined as a form of price discrimination. As explained in the Box 3, it is a problematic concept in the context of trade already; not surprisingly, other forms of dumping, such as social dumping, are even trickier to grasp.

BOX 3 ► Dumping in International Trade

An exporting firm is engaged in dumping when it is charging a higher price for its produce at home than abroad. This strategy can be rational if the firm wants to position itself as a monopolist on the foreign market and, once competition is eliminated, charge higher monopoly prices. The theory of dumping itself is debatable as it requires strong economic assumptions.[13] Nevertheless, most of the governments in the Western world fight against dumping in order to protect their national producers and promote fair competition.[14]
In the case of anti-dumping policies, though, there is a fine line between the promotion of competition and economic protectionism. A dumping strategy and a genuinely competitive behaviour may lead to the same outcome if:

- firms find it profitable to discriminate their prices in different geographical areas due to different elasticities of demand;
- foreign market is much more competitive than the domestic one, which results in lower margins and prices for all the firms on the foreign market;
- lower domestic prices are related to consumer preferences, such as the so-called "home bias". For example, if consumers of all countries have a strong preference for a domestically produced vehicle, firms will be able to sustain a higher margin at home than abroad.

One should note that in all of the cases the foreign consumer wins from the new cheap entry as the prices fall and the competitive situation on the market improves, at least in the short run.

For some, social dumping relates to the behaviour of individual firms as "any practice pursued by an enterprise that [...] takes advantage of differentials in practice and/or legislation in the social field" to become more competitive.[15]

13. Two main theoretical conditions have to be reunited for the dumping theory to hold: imperfect competition and segmentation of the market. For a more comprehensive explanation, see Krugman, P.R. and Obstfeld, M. (2005) "International Trade: Theory and Policy". Addison Wesley, MA Reading.
14. See, for example, Council Regulation (EC) No 1225/2009 of 30 November 2009 on protection against dumped imports from countries not members of the European Community.
15. Vaughan-Whitehead, D. (2003) "EU Enlargement versus Social Europe? The Uncertain Future of the European Social Model", Cheltenham, Edward Elgar, p. 325.

However, this definition is not comprehensive enough as it is only normal to assume that rational profit-maximising firms search for efficiency and lower costs at all times. Indeed, the whole purpose of the single market is to make price arbitration possible at the European level and boost EU-wide productivity. Accusing firms for doing just that would then seem at odds with the founding principles of the common market. Thus, just like with dumping in international trade, it might be difficult to draw a clear line between a "fairly" competitive relocation and "disloyal" social dumping in practice. In addition, the choice of production location is not exclusively dependent on production costs, but also on other factors. As the theory of economic geography suggests, firms tend to locate around the economic "core", which in Europe includes France, Germany and the UK, due to the size of demand, transportation costs, well developed infrastructure, and more efficient institutions.[16]

For others, social dumping can also be seen as a form of state policy rather than a strategy of an individual firm. Alber and Standing, for example, define social dumping as "situations in which standards in one country are lowered relative to what they would have been because of external pressure from all or part of the global economic system".[17] In the similar manner, Sinn classifies social dumping as a deliberate attempt by the poorer countries to maintain "an underdeveloped welfare state to create competitive advantage for their industries".[18] Here social dumping is viewed as a deliberate policy choice, either voluntary or imposed by the global rules of the game, which leads to the actual "race to the bottom".

For others yet, social dumping is often associated with the movement of people rather than relocation of firms. This is particularly the case for the so-called "posted workers", usually illustrated with the infamous example of the "Polish plumber". It is feared that the cheap labour coming from the CEECs to the wealthier member states would accept to work in poorer conditions and it would eventually drive down the labour standards of the host states. Yet, in the EU, the principle of host country control applies, implying that all

16. For more on economic geography see Baldwin, R, Forslid, R., Martin, P., Ottaviano, G. and Robert-Nicoud, F. (2005) "Economic Geography and Public Policy", Princeton University Press.
17. Albert, J. and Standing, G. (2000) "Social Dumping, Catch-up or Convergence? Europe in a Comparative Global Context", Journal of European Social Policy Vol. 10(2), p. 99.
18. Sinn, H-W. (2003) "Social Dumping in the Transformation Process?", NBER Working Paper No. 8364, p. 3.

immigrant workers must comply and be provided with the same standards of labour as domestic workers irrespective of their working contract (see Box 4). For instance, in the countries and in the sectors where minimum wages apply, the immigrants can drive the salaries down only as far.

BOX 4 ► Posting of workers and the "Polish Plumber"

Jacques Pelkmans has outlined four options for a Polish plumber to come and work in France, showing that none of these cases could result in social dumping coming as a consequence of the single market[19]. Firstly, the plumber could come and work as a regular employee having signed a standard French work contract with all the rights it entails. Secondly, the plumber could be posted to France for a temporary assignment; such contracts are currently also under the host country's control. Thirdly, the plumber could come to France as an independent contractor and bid for work contracts, adjusting her own wage as she pleases and assuming the risks. This option has been around long before the creation of the single market and has proven to have little to no cross-border impact. Finally, the plumber could be an illegal immigrant or operating in the shadow economy. This option is naturally problematic, but it is not a consequence of the single market either, as the member states are responsible for the law enforcement on their territory (see section 4 where institutional matters are discussed in detail).

The second option relating to the posting of workers has been one of the most discussed issues in the debate on social dumping. This specific type of cross-border provision of services when the worker is sent to another member state by her employer to carry a specific task has been governed by European legislation since 1996 (The Posting of Workers Directive 96/71/EC). The directive sets a wide array of minimum rights, such as maximum work periods and minimum rest periods, minimum paid holidays and minimum salaries. All these rights reflect the prevailing situation in the country where the employee is working as opposed to her country of origin. In short, the directive aims at limiting the scope of social competition between the member states.

Even though the rules aiming at preventing these temporary forms of social dumping have been adopted 17 years ago, their enforcement has been appalling. As a consequence, posted workers are still often seen as a prime example of the practice of social dumping and the practice of establishing "letter box" companies in the member states with weaker standards has become common. New proposals of the Commission[20] are currently being discussed to ensure compliance, which first and foremost needs to be done on the national level.

19. Pelkmans, J. (2010) "How social is the single market?" Centre for European Policy Studies Commentary, p. 3.
20. European Commission (2012), "Proposal for Directive concerning the enforcement of the provision applicable to the posting of workers in the framework of the provision of services", COM(2012) 131.

Perhaps the most elaborate definition, even if heavily criticised,[21] comes from the European Foundation for the Improvement of Living and Working Conditions, which reads:

> "Social dumping is a practice involving the export of goods from a country with weak or poorly enforced labour standards, where the exporter's costs are *artificially* lower than its competitors in countries with higher standards, hence representing an *unfair* advantage in international trade. It results from differences in direct and indirect labour costs, which constitute a significant competitive advantage for enterprises in one country, with possible negative consequences for social and labour standards in other countries" [emphases added].[22]

This definition supposes that exporting companies are, of course, looking for a competitive advantage in the form of weaker labour standards, but social dumping occurs only when this advantage results from artificially lower costs. On individual firm level, it is impossible to sustain artificially low costs as the workers would simply choose to work for another firm that fairly compensates their effort. It is, thus, the choice of governments, based on the economic development of the country and on preferences of the population, to set and to enforce a certain level of fair labour standards. Consequently, this definition does not presuppose that labour standards must be identical in all of the countries for trade to be considered fair as long as they are not lower artificially.

A word of caution is in order as a second reading of this definition is possible too. Different official labour standards in the member states might not always reflect the reality in practice due to poor enforcement, inefficient institutions and weak governance. Indeed, a country with relatively high labour standards in theory, but poor implementation in practice, could also be accused of social dumping, even if the missing link is outside the direct government control. In countries with large shadow economy, high levels of corruption, or poor transposition of the EU law, for example, official standards might be circumvented for the benefit of the exporting company. This issue will be dealt with in the last section of the Study.

21. Barnaciak, M. (2012) "Social Dumping: Political Catchphrase or Threat to Labour Standards?" ETUI Working Paper, p. 19.
22. Eurofund, "Social Dumping", viewed on 27 July 2012.

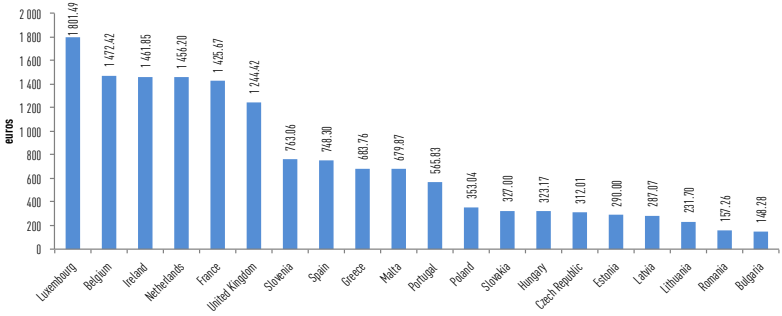
2. Direct Costs of Labour

Different wage levels between countries are probably the most important factor in the discussion on social competition; after all, wages often make up a significant part of production costs. Therefore, it is only natural to start the comparison of labour standards in the EU by looking at salary differentials between the member states. In the following section, direct costs of labour are defined as the salary received by the employee and any labour taxes that the employer and the employee have to pay on a regular basis. Labour cost differences between countries constitute the main incentive for exporting firms to relocate their production. As discussed in the previous section, if these cost differences are artificially created, such relocations could be classified as a practice of social dumping. However, most of the time labour cost differences come from legitimate reasons. This section looks at both wage and labour tax components of labour costs in the EU countries.

2.1. Wages and Productivity

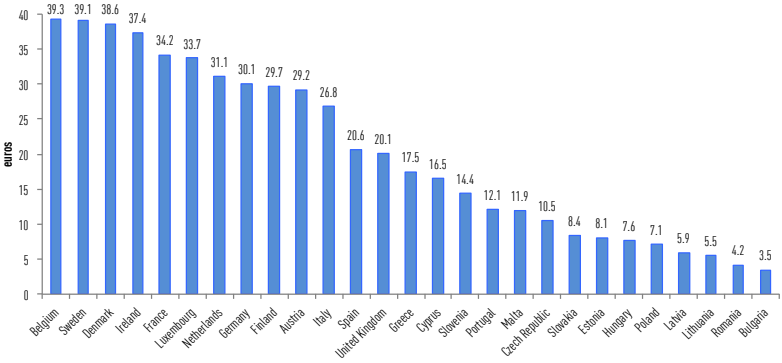
It is useful to start the comparative analysis of salary differentials in the EU27 by looking at some shock statistics that are so frequently escalated in the public debate. For example, nominal minimum wage, which is set at the national level, differs by a factor of 12 between Luxembourg and Bulgaria (Figure 1). In addition to the minimum wage, the estimated average labour costs per hour also differ widely in the EU27. As shown in Figure 2, Bulgarian hourly labour cost is below a 5 euro threshold, whereas Belgian labour cost is approaching 40 euros per hour. It follows then that, in absolute terms, average salary per hour in Belgium is eight times higher than in Bulgaria.

FIGURE 1 ► Minimum Wages in the 20 EU Member States (2012)



Note: statutory minimum wages on national level do not apply in Germany, Italy, Cyprus, Austria and all three Scandinavian member states.
Source: Eurostat, figure by K. Maslauskaitė

FIGURE 2 ► Average Labour Cost per Hour



Source: Eurostat, figure by K. Maslauskaitė

Where do these huge differences come from? They could partly be explained by the units of measurement used. For instance, nominal wages should be adjusted to purchasing power parities (PPP) to allow meaningful cross-country comparisons. For example, once the minimal wages are PPP-adjusted, the difference between Luxemburgish and Bulgarian minimum wages contracts from

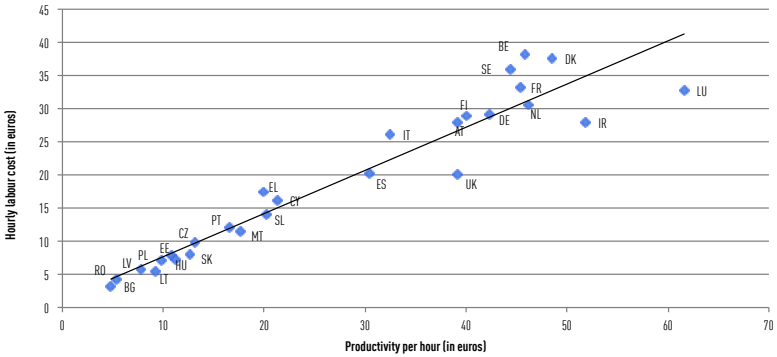
14 to 6 times.[23] Moreover, exchange rates also matter for the countries that do not have a fixed exchange rate regime with the euro (currently UK, Poland, Czech Republic, Hungary and Romania) as exchange rate movements could potentially offset international differences in costs.

However, more importantly, the standard theory of trade suggests that it is the comparative, not absolute, advantage that drives trade; consequently, high-wage countries can very well trade beneficially with low-wage countries on the open markets without depleting their labour norms. Poorer new member states have lower wage levels simply because their physical and human capital is relatively scarcer and their labour productivity is lower. According to the theory, in poorer countries these conditions give rise to a comparative advantage in the labour-intensive sectors, where low wages more than compensate for low productivity. Yet, in capital-intensive sectors, the high wages of the "old" member states are more than compensated by their high productivity stemming from their abundant capital, technology and innovation. Overall, both groups of countries gain from trade when they specialise in what they do best.

Indeed, the proposition that wages are determined by overall productivity level in the country holds when we turn to the data analysis. Figure 3 illustrates a near perfect positive correlation between labour productivity and labour cost per hour in the 27 EU member states. In other words, if Romanians and Bulgarians have the lowest wages, it is because their productivity levels are the lowest too. In fact, Bulgarian workers' productivity is 12.8 times lower than the productivity of the workers in Luxembourg, whereas, as it was noted earlier, the PPP adjusted minimum wage in Bulgaria is only 6 times lower than that of Luxembourg. Figure 3 further suggests that three countries, namely UK, Ireland and Luxembourg, are the only ones that are found significantly under the productivity/labour cost trend; that is, the labour in these countries is the cheapest in the whole of the EU, once the productivity levels are accounted for. Belgium, Sweden, Denmark and Italy, on the contrary, have relatively higher wages given their levels of productivity.

23. Eurostat, "Minimum Wage Statistics", viewed on 30 April 2013.

FIGURE 3 ► Estimated Labour Cost (per hour in euros) Versus Productivity (euros per hour worked) in 2011

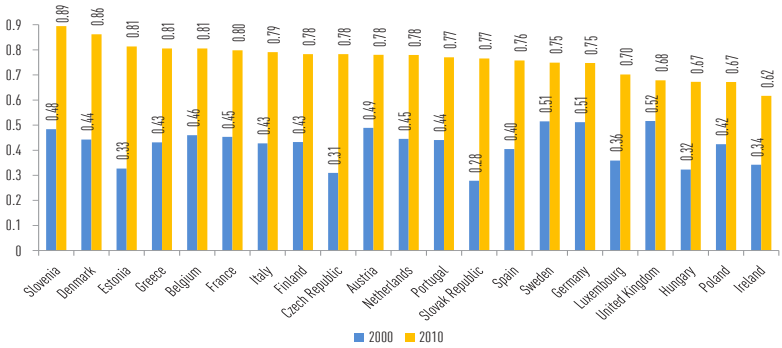


Source: Eurostat, figure by K. Maslauskaitė

Figure 4 further compares all of the countries by their productivity-adjusted cost of labour.[24] In 2000, as expected, unit labour costs were highest in Germany, Austria, the UK and Sweden, whereas the CEECs, Luxembourg and Ireland enjoyed a real cost advantage. For instance, unit labour cost in the Slovak Republic was two times lower than in Germany. Yet, ten years later, the whole picture changed remarkably. In 2010, the real labour cost in Slovenia and Estonia was in fact higher than in France or Germany. Surprisingly, Ireland, Luxembourg and UK made it to top five cheapest destinations. In the remaining two, Poland and Hungary, labour was cheaper by only 10% compared to Germany.[25]

24. Unfortunately, the OECD database consists only of the OECD member states, which excludes Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania, but includes the EU15 and six of the new member states, which should allow establishing a general picture.
25. A word of caution: here the reasoning is based on the average labour costs, and the sectorial differences could be significant. OECD does provide the data on aggregated sectorial developments, but the overall picture in manufacturing and business services, which are the most prone to export, is similar.

FIGURE 4 ► Exchange Rate-Adjusted Unit Labour Costs (ULC) in 2000 and 2010[26]



Source: OECD Statistics, figure by K. Maslauskaitė

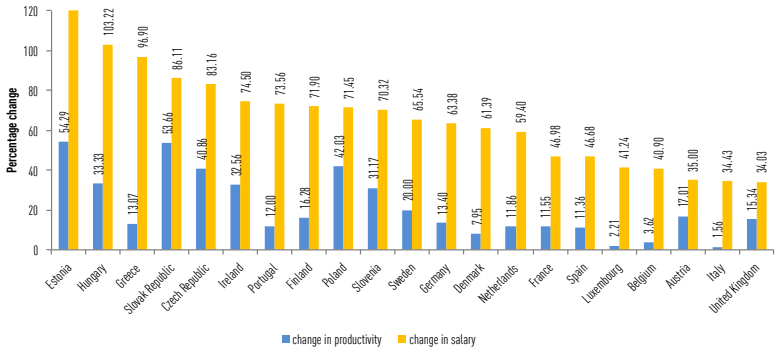
These findings might come as a surprise, but there is a simple explanation behind the convergence of the unit labour costs in the EU. On the one hand, between 2000 and 2011 Estonian and Hungarian wages increased by more than 100%, whereas their productivity grew by only 40% and 20% respectively (Figure 5). On the other hand, in the same period, the UK and Austria have managed to sustain relatively high productivity growth and limit the inflation of salaries. The CEECs, especially those that have adopted the euro or joined the currency board, have thus lost their competitive edge in terms of labour costs. In fact, the developments in the unit labour costs suggest that, on average, the productivity gap between CEECs and the EU15 has become even larger than the wage gap.

Given the significant differences among the CEECs, only an in-depth analysis could further explain why these countries allowed a tottering wage inflation and failed to pick up on productivity growth, which is beyond the reach of this Study. Nevertheless, this section concludes that CEECs suffer from the lack of cost competitiveness in the EU, both as product exporters and as potential

26. The unit labour cost indicator, as defined by the OECD, is a measure of the average total cost of labour per unit of real output. Labour costs here cover wages and salaries, bonuses, payments in kind related to labour services (e.g. food, fuel, housing), severance and termination pay and employers' contributions to pension schemes, casualty and life insurance and workers compensation.

relocation choices for firms in search of low labour cost. Strikingly, labour in real terms in the UK, Ireland and Luxembourg is cheaper than in most of the CEECs; these three countries may then appear the most attractive destinations for exporting firms.

FIGURE 5 ► A Decade of Catching-up: Productivity and Salary Change between 2000 and 2011



Source: Eurostat, figure by K. Maslauskaitė

2.2. Labour Taxes

Previous analysis has looked at the unit labour cost in terms of salaries, which is a rather comprehensive indicator. Yet, the unit labour cost, as calculated by the OECD, does not include some relevant items such as taxes on employment or fringe benefits. Labour taxes make up a solid proportion of the total labour cost: from less than 15% in Malta, Denmark and Luxembourg to more than 30% in Belgium, France and Sweden, with all other member states in between (Eurostat). Therefore, this section complements the previous analysis by looking at the different levels of labour taxes in the EU27.

It has to be kept in mind that the EU member states have complete independence when deciding on their tax policy issues, so there is little wonder that tax rates on labour are very heterogeneous across Europe. Naturally, unfair tax competition between the countries is undesirable as it could lead to the

"race to the bottom" and hurt the European Social Model. Indeed, the CEECs in particular have often been accused of taxing their labour too lightly. For example, seven of the new member states (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Romania and Slovakia) have adopted flat tax rate on labour income, which usually does not supersede 20%. This triggered the "perception that Eastern Europe loves low taxes".[27]

Do the flat income taxes really confer an unfair advantage to the seven aforementioned CEECs? Obviously, personal income tax is not the only component of the total labour taxes. Social security contributions paid by the employer and the employee must be fractured in, too. The weight attached to each of these three tax components differs highly in the member states: in Denmark, UK and Ireland personal income taxes form a large part of the total tax bill whereas in many of the CEECs the income tax revenues are much less significant.[28]

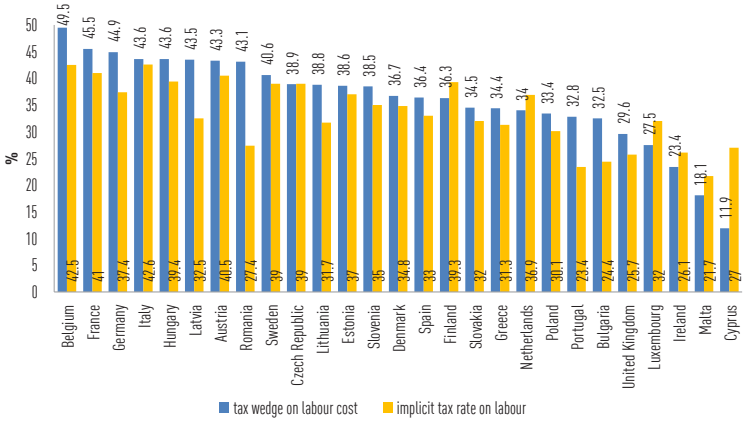
The average of all three contributions that show the effective tax rate on labour can be compared internationally by using the implicit tax rate statistics. Implicit tax rates are calculated backwards dividing the total tax revenues by the aggregate tax base of workers to obtain the average overall tax rate on labour in a given country. Figure 6 shows that the highest average implicit labour tax rates (around 40%) exist in Italy, Belgium, France and Finland. Czech and Hungarian labour is also among the most taxed. The least taxed labour (below 30%) is found in Portugal, UK, Ireland, Malta, Cyprus, Romania and Bulgaria. Other member states including the eight remaining CEECs have the rates between 30% and 40%. The overall picture is thus rather mixed; interestingly though, none of the CEECs that joined the EU in 2004 have a significantly lower tax burden on labour when compared to the "old" member states. In addition, they tend to have higher overall tax rates than those in Ireland and the UK.

However, the implicit tax measure is rather crude as it does not allow discerning the differences of the tax burden between high- and low-income workers. As the cheapest forms of labour most often figure in the social dumping

27. Barysch, K. (2006) "East versus West? The European Economic and Social Model after Enlargement", Centre for European Reform Essays.
28. Eurostat, "Taxation trends in the European Union (2012 Edition)", p. 32.

argument, it is important to identify the tax burden on low income employees. A tax wedge on labour provides a good approximation as it calculates the ratio of total non-salary labour costs over the total labour cost to the firms. Figure 6 provides the tax wedge on the workers with low salaries, here defined as consisting of two-thirds of national average salary. The data shows that the least taxed low-earning labour is to be found in Cyprus and Malta, as well as Ireland, Luxembourg and the UK. Quite strikingly, in almost all of the CEECs low-income labour is taxed at approximately 40%, or at comparable rates to many of "old" continental member states.

FIGURE 6 ► Tax Wedge on Labour Cost and Implicit Tax Rate on Labour (2010)[29]



Source: Eurostat, figure by K. Maslauskaitė

In sum, several preliminary conclusions can be drawn from this section. First of all, taken together, the differences in real salaries and labour taxes do not seem to provide a sufficient incentive for relocation from the "old" to the "new" member states. The real wage and tax levels in the CEECs have been converging, and in most cases have reached or surpassed the EU average; therefore, looking at the evidence, it is hard to prove that the CEECs have been engaging in any kind of social competition. As pointed out by Bernard, instead of

29. Tax wedges are calculated for a single example worker at two-thirds of average earnings. Data for Cyprus is available for 2007 only.

engaging in social dumping themselves, these countries might have actually had socialism dumped onto them.[30] Such convergence is a desirable outcome of European integration in theory, but it leaves these countries, which have much lower demand potential and much less developed infrastructures, in a very vulnerable position for competing on the single market.

Secondly, the most competitive in Europe in terms of labour cost and labour taxes are Ireland, UK and Luxembourg as they are among the cheapest destinations for both components of the total labour cost. This, combined with the fact that they are much closer to the European "core" and have well developed infrastructure, makes them very attractive and competitive. It, of course, does not automatically imply that these three countries are engaging in social competition. For social dumping critique to hold, the labour standards in these countries should also be classified as "weak" or "poorly enforced" and their labour costs as "artificially" lower. Otherwise, the more competitive countries with higher productivity levels are engaging in welfare-increasing fair competition, which is the goal of the single market.

30. Barnard, C. (2008) "Social dumping or dumping socialism?" *The Cambridge Law Journal* Vol. 67(2).

3. Indirect Costs of Labour

If wage costs do not seem to be "artificially low" in most of the EU member states, what about other non-salary costs of labour? Indeed, the advocates of the social dumping argument also focus on other less obvious labour standards as a source for cost minimisation. As a rule, indirect costs are difficult to measure in monetary terms, yet they could potentially constitute a significant cost disadvantage if applied unequally in the different member states. Ensuring high quality working conditions in terms of safety or agreeing to a shorter working week for the same minimal salary could add to the total bill of the employer.

In this Study, following the OCDE the non-wage labour costs are defined as norms, rules and conventions that govern working conditions and industrial relations. The non-wage institutional elements of labour markets such as number of hours worked, employment protection, occupational health and safety standards will now be discussed in turn. This list is far from being exhaustive, yet it should give a flavour of the overall situation in the member states.

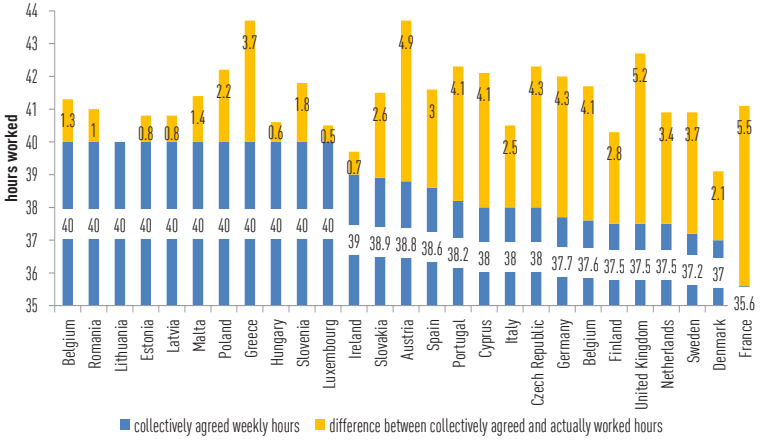
3.1. Working Time

Working time regulation has long been in place in the EU member states for the reasons mostly relating to occupational health, safety, and wellbeing. Working time also matters for economic reasons and in our analysis because wide gaps in weekly working hours among member states could potentially lead to the "race to the bottom" whereby everyone in the EU is obliged to work more to stay competitive. Consequently, a country with no working time regulation could be perceived as engaging in disloyal competition, i.e., creating a comparative advantage at the cost of this particular labour standard. For these reasons, a Working Time Directive has been adopted in 1993 on the European level. Initially the directive included a list of derogations and opt-outs, many of which have been removed in 2003. The directive establishes the maximum week of 48 working hours (including overtime), minimal duration of on-job breaks, weekends and annual leaves in all of the member states.

The factual data suggests that none of the EU member states approach the 48-hour week limit in terms of collectively agreed weekly hours (Figure 7). Eleven member states (most of the CEECs, Greece and Malta) have opted for 40-hour-long working week, whereas France has chosen an average of 35.6 hours. The average bargained working week in the new member states is 39.7 hours while the EU15 average is 37.6 hours. It is interesting to note that the UK has one of the shortest negotiated working weeks with 37.5 hours on average.

Every country has, therefore, a legal margin (set by the aforementioned Directive) of at least 8 hours for the overtime work, giving some flexibility for both the employees and the employers. Indeed, as expected, in all countries, except for Lithuania, actual hours worked are much higher than the collectively agreed standard. Interestingly, even when overtime is accounted for, none of the EU member states approach the average 48 hour limit imposed by the EU legislation. In fact, the EU average for full-time employment is below 42 hours. The two longest-working nations are Austrians and Greeks with more than 43 weekly hours spent at work followed by the UK with 42.5 hours. The CEECs picture is rather mixed, with Czech Republic, Poland, Slovenia and Slovakia approaching the EU average whereas the Lithuanian workers spend even less time at work than collectively agreed. Surprisingly, Ireland, one of the most competitive countries in terms of salary-related costs, has second lowest effective working time after Denmark.

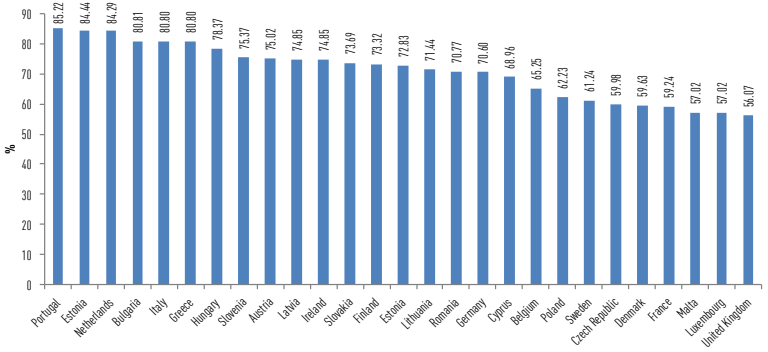
FIGURE 7 ► Average Collectively Agreed Normal Weekly Work Hours and Hours Actually Worked in Full Time Employment in 2010



Remark: Lithuanians, on average, work 0.3h less than collectively agreed.
Source: Office of National Statistics of the UK, figure by K. Maslauskaitė

Finally, it is interesting to see that the majority of Europeans are absolutely happy with the hours they work (Figure 8). In a survey conducted by Eurofund, the majority of people said that even if they had a choice, they would work the same amount of hours as they currently do. It is true that in the UK, Malta, Luxembourg and France 40% of employees would like to work less. In comparison, in the Netherlands, Estonia and Portugal, this figure barely reaches 15%. All in all then, to a large extent, differing working hours reveal national preferences and could not be easily classified as a factor of social dumping used as a tool by national authorities.

FIGURE 8 ► The Proportion of Population that Answered Positively to the Following Question: "If you had a choice, would you prefer to work at least as many hours as you work currently?"



Source: Eurofund, figure by K. Maslauskaitė

3.2. Strictness of Employment Protection

Employment protection consists of various regulations concerning the hiring and firing of workers and is embedded in the labour laws of the member states. Hiring rules include provisions on the temporary employment, simplified procedures on hiring disadvantaged groups of society, and training requirements. Firing rules are made of prescribed notification period, severance payments, and other dismissal procedures. The firing rules especially are considered as an additional charge on the employer because they increase the cost of dismissal. At the EU level, directives on fixed time, part time, temporary agency workers and young people have been adopted to set some minimal standards of employment protection; however, these directives are mostly based on the principle of non-discrimination. For instance, according to the principle, workers who have signed a non-regular job contract should be treated equally with regular workers. Apart from that, employment protection is left as a national competency.

There are two strands of economic literature that justify the need for employment protection and show that more protection does not actually affect the cost competitiveness of the country. First argument developed by Pissarides emphasizes the workers' need for insurance in the uncertain economic environment.[31] Severance payments and notice periods smooth out workers' consumption over time if they get fired. Firms agree to incorporate the costs of insurance in their balance sheets if workers accept lower wages. Another strand of theory sees a job as a public good, i.e. job's social value is higher than its private value because the government needs to support the unemployed through taxes. The firm then needs to be given an incentive to internalise these additional social costs, keeping its hiring behaviour unchanged. Consequently, the firm pays lower wages than it would have done in the absence of employment protection. Both these theories suggest that higher employment protection results in risk sharing between the employer and the employee, but it does not change the labour cost in the country.

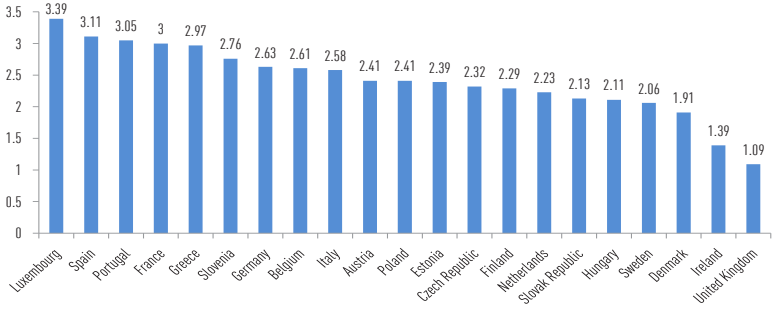
In practice, however, high employment protection is not always compensated with lower wages. Then, all things being equal, the firms would rather relocate their production to a country with a more flexible labour market to minimise their losses in case of restructuring. It should be noted that employment protection, as opposed to many other labour standards, is not seen as a factor of the negative "race to the bottom". Quite the contrary - for many years to date, the Commission has been advocating "flexisecurity", which includes labour market liberalisation. The member states have been encouraged "to review and, where appropriate, reform overly restrictive elements of employment legislation".[32]

However, despite the general trends towards more labour market liberalisation, substantial differences can still be observed among the member states. The OECD has developed synthesized indicators of employment protection for regular workers, temporary employees, collective dismissals, and the average of all three of them (the data is only available for the EU member states

31. Petrongolo, B. and Pissarides, C.A. (2001) "Looking into the Black Box: A Survey of the Matching Function", *Journal of Economic Literature*, American Economic Association, vol. 39(2), pages 390-431
32. *Council Decision of 22 July 2003 on guidelines for the employment policies of the Member States*, 2003/578/EC; more recently, European Commission, *Towards Common Principles of Flexicurity: More and better jobs through flexibility and security*, COM(2007) 359 final, 27.06.2007.

that belong to the OECD).[33] The average indicator shows that Luxembourg, Portugal, France and Spain have the strictest employment protection whereas Ireland and the UK are the most flexible (Figure 9). These findings are somewhat in contradiction with the theoretical predictions: the lowest real wage countries, UK and Ireland, tend to have lower employment protection further improving their competitiveness. The CEECs picture is rather mixed. Slovenia, Estonia and the Czech Republic belong to the 10 most regulated labour markets, in contrast with Slovak Republic and Hungary that are among the least regulated.

FIGURE 9 ► Overall Strictness of Employment Protection



Source: OECD, figure by K. Maslauskaitė

Obviously, this indicator is a very crude measure of the actual situation in the member states. It is also difficult to measure the monetary value of these differences among the countries for the businesses. Yet, some preliminary conclusions can be drawn. Firstly, the CEECs, often described as champions of liberalism, generally have strictness of employment protection comparable to that of Germany and the Scandinavian countries. It would thus be difficult to argue that the governments of these countries use particularly lax employment protection policy to gain "unfair" competitive edge. Secondly, Ireland and the UK (but not Luxembourg) yet again appear to be the most competitive countries for production.

33. The OECD database consists only of the OECD member states, which excludes Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania, but includes the EU15 and six new member states.

3.3. Health and Safety at Work

High health and safety standards can be considered an additional non-labour cost for the employers. If some countries had weaker health and safety regulations, employers could potentially benefit from lower production costs by, for example, cutting down on security equipment or using cheaper and more dangerous technologies. In the context of the European internal market, this could lead to social dumping between the member states, even if such short-sighted strategy would be destructive for human capital in the long run.

Health and safety at work is still a relevant issue both at European and at national levels despite the technological progress and historical shift from manufacturing to service economies. It has been estimated that in 2007 Europeans have taken 367 million days of sick leave due to work-related health problems.[34] Traditionally, occupational accidents have been seen as the most obvious consequence of poor safety regulation at work. One would expect more occupational accidents to happen in the countries with poorer regulation and enforcement or higher proportion of potentially "dangerous" economic activity.

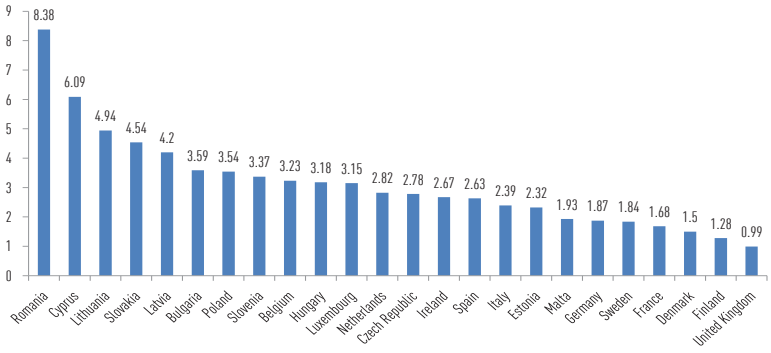
Consequently, European legislation is rather vast in the area of health and safety at work. In fact, the Commission considers that it is one of the spheres where European regulation has had the most impact.[35] The legal basis of the EU health and safety legislation is found in Article 153 (TFEU) as well as the directive on measures to improve health and safety at work (Directive 89/391/89). The directive sets out the basic responsibilities of the employers in terms of protecting their workers' health in all sectors of economy. In addition, two EU agencies have been established for the purpose, namely the European Agency for Safety and Health at Work in Bilbao, Spain, and the European Foundation for the Improvement of Living and Working Conditions in Dublin, Ireland.

Even though all member states have to follow the minimal standards set at the EU level, the countries can unilaterally impose higher standards at the national level. This is why a significant heterogeneity is observed among the member states. It is hard to compare the actual enforcement of the labour

34. Eurostat, "Health and Safety at Work", viewed on 16 July 2012.
35. European Commission, "Health and Safety at Work", viewed on 20 July 2012.

standards in the member states, yet a comparison of the "outcomes" of poor regulation (fatality rates or the number of sick leave days) is possible thanks to the Eurostat and the 2007 *ad hoc* module of the Labour Force Survey (LFS). Figure 10 shows that the new member states have the highest fatality rates resulting from accidents at work.[36] For example, in Lithuania the number of workers who died from a work-related injury (5 fatalities for 100,000 workers) is a triple of that of Finland (1.5 fatalities).

FIGURE 10 ► Fatal Accidents at Work (per 100,000 employees)[37]



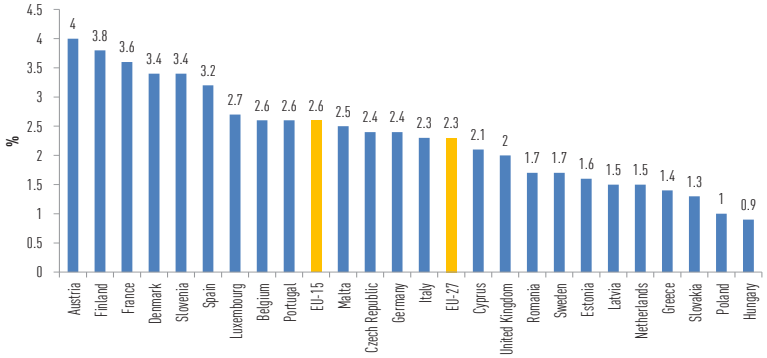
Source: Eurostat, figure by K. Maslauskaitė

Other factors not necessarily related to the health and safety standards, such as the proportion of "dangerous" industries in the national economy, might also influence the rates of fatalities. The Labour Force Survey might give a flavour of the extent of these "other" factors. Figure 11 reports the proportion of workers who have taken a sick leave due to a work-related accident. Normally, this measure should be closely correlated to the fatal accidents at work if poor working conditions were the main explanation behind the differences between countries. Yet, the most accidents resulting in a sick leave have been reported in Austria, Finland and France (more than 3.5% of the labour force), not in

36. Rates are based on fatalities occurring across 12 sectors, including agriculture, manufacturing, and construction, the transport sector is excluded.
37. Data for Austria and Portugal not available.

the countries with highest fatality rates. In comparison, the rates in Hungary, Poland and Slovakia were approximately three times lower. All in all, the evidence on occupational health and safety is mixed. More fatalities happen in the CEECs, but the rates of accidents resulting in a sick leave are much higher in the EU15. UK seems to be the safest country to work with the lowest fatality rates and below average proportion of workers having taken a sick leave, implying that the health and safety standards are well in place despite the country's competitiveness.

FIGURE 11 ► Workers Reporting an Accident at Work in the Last 12 Months Resulting in a Sick Leave (%)



Source: Eurostat, figure by K. Maslauskaitė

4. Institutional Factors

The previous analysis focuses on various labour cost factors in the EU member states showing that the indirect and direct cost differences are often rather limited. Overall, the UK, Ireland and, to some extent, Luxembourg seem to be the most competitive economies for labour with no overwhelming labour cost advantage found in the new member states. These conclusions might raise some eyebrows since they suggest that even the domestic exporting firms of the Central and Eastern European countries would potentially benefit from relocating their production towards the British Isles.

This section elaborates on other potential underlying reasons, which could further affect the cost of labour in the EU. For example, institutional factors such as the structure of industrial relations could also affect the setting of national labour standards and their efficient implementation. Similarly, shadow economy is obviously relevant for the present discussion as all the previous figures were drawn on the data representing the official economy. Yet, the existence of shadow (or "black") economy, which does not necessarily enter in the national and European statistical databases, could be polluting the figures, making them difficult to compare across countries.

4.1. Workers' Representation

A relevant institutional factor for the present analysis is the national structure of industrial relations. Worker participation is directly related to the hypothesis of social dumping as countries with stronger worker participation are expected to have both higher labour standards and better compliance. Therefore, the indirect labour costs are higher when the workers can defend their rights directly.

Worker participation has been a hot topic in the EU legislation, especially after the adoption of the Single European Act and the Eastern enlargements. It has been widely documented that labour in the CEECs is much more quiescent due to social and political context and therefore some harmonisation was seen

as necessary.[38] Consequently, European legislation on the "social acquis" has emerged. It consists of three major directives, namely the European Works Council Directive (94/45 EC and 2009/38/EC), Employee Involvement in the European Company Directive (2001/86/EC and 2003/72/EC) and European Framework Directive on Information and Consultation (2002/14/EC).

The first two directives concern worker participation in international companies operating in several member states. The number of companies concerned is rather limited and the overall impact of these directives is not well established. For instance, the Directive on the European Company concerns only the Societas Europea (SE), the number of which reached 1286 in 2012.[39] This number is inflated as it is known that many of these SEs are void and have been created purely for administrative purposes.[40]

Similarly, the European Works Council Directive has been adopted by 995 international companies[41], all of which established representative workers' councils by 2011. Nevertheless, the functioning of these councils remains heterogeneous due to the differences in the laws and business practices of the country of origin.[42]

Contrary to the first two directives, the European Framework Directive on Information and Consultation aims at harmonising domestic provisions on worker participation among the member states. The directive obliges the companies to provide information on the developments in the organisation, economic situation, and probable change in terms of the employment conditions in the company. It represents a minimal standard at European level and as such is an important development in harmonising industrial relations across the member states. The impact of the Directive was significant, particularly in several EU countries. For example, before the adoption of the directive, the UK and Ireland had never legally regulated employee consultation;

38. Kubicek, P. (2004) "Organized Labour in Postcommunist States: From Solidarity to Infirmity", Pittsburg University Press, Pittsburg.
39. ETUI, website of worker-participation.eu, "Facts and Figures".
40. European Trade Union Institute, "European Companies (SE) – News from the SE Factsheet Database (March 2009)", viewed on 10 July 2012.
41. ETUI, website of worker-participation.eu, "Facts and Figures".
42. Cressey, P. (2009) "Employee Participation" in Gold, M. (ed.) *Employment Policy in the European Union: Origins Themes and Prospects*. Palgrave, London.

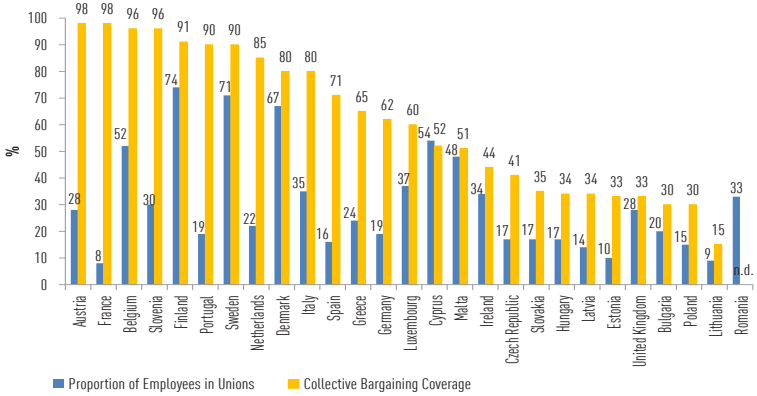
consequently, their long-rooted structure of labour relations had to be fundamentally transformed.[43]

Nonetheless, most of the structure of industrial relations remains a national competence. Over the decades, the countries have developed their own "models" of employee representation. In eight of the member states (Cyprus, Denmark, Finland, Italy, Lithuania, Malta, Romania and Sweden) workers are represented mostly by the trade unions, in four member states (Austria, Germany, Luxembourg and the Netherlands) the elected work councils prevail, whereas in the remaining fifteen countries a mixed regime has emerged over time. On top of these differences, the representative bodies in 27 member states differ significantly in terms of their negotiating power, budget and other prerogatives.

In this context, it is not straightforward to quantify and compare worker representation across European countries. Collective bargaining coverage measure (Figure 12) gives a good starting point and shows that the percentage of the workforce covered by collective agreements is large in Austria, France, Scandinavian countries, Portugal and Slovenia. In most of the CEECs (except for Slovenia), in the UK and Ireland collective bargaining coverage is around 40% or lower. It is interesting to note that collective bargaining coverage and trade union membership do not necessarily go hand in hand. For example, in France, trade union membership is lower than 10%, whereas collective agreements cover virtually the entire workforce.

43. Hall, M.J. (2005) "Assessing the Information and Consultation of Employees Regulations", *Industrial Law Journal* Vol. 34, p. 104.

FIGURE 12 ► Employee Participation in the EU[44]



Source: ETUI, figure by K. Maslauskaitė

Yet, as mentioned earlier, many countries have preferred a participation model built on company-level negotiation. For example, while trade unions are still often associated with their Soviet predecessors in the CEECs and thus trade union density is low, the workers in Hungary, Slovakia, Slovenia and Czech Republic have "widespread participation rights" on the board level (as defined in Box 5). To reconcile this heterogeneity of representation models, the European Trade Union Institute has gone a step further and developed a European Participation Index (EPI, Figure 13). EPI averages three measures of participation: board level, establishment (plant) level and collective bargaining.

BOX 5 ► The EPI consists of three equally weighted components:

1. **Board-level participation** – measures the strength of legal rights in each country for employee representation in the company's highest decision-making body. This classification was developed by the SE Europe network of ETUI and classifies countries in three groups: "widespread participation rights", "limited participation rights" and "no (or very limited) participation rights".

44. For Romania the collective bargaining coverage is unknown following the change of national laws in 2011.

2. **Establishment-level participation** – measures the strength of worker participation at the plant level. This is based on an analysis of Eurofound's 2009 European Company Survey, which includes data on the presence or absence of formal employee representation in more than 27,000 companies in the EU27 and other European countries.
3. **Collective bargaining participation** – measures union influence on company industrial-relations policies, including an average of i) union density (i.e. percentage of workforce belonging to unions) and ii) collective bargaining coverage (i.e. percentage of the workforce covered by collective agreements).

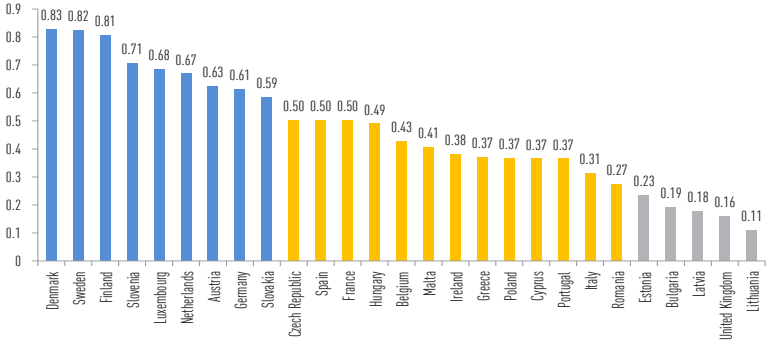
Source: www.workers-participation.eu

As both trade union membership and collective bargaining coverage enter into the calculation of EPI, unsurprisingly, the index shows similar trends as in Figure 12. The Scandinavian countries, Slovenia, Luxembourg, Germany, the Netherlands and Austria top the table. Interestingly, however, Slovakia, Hungary and the Czech Republic score very highly as well. In fact, the workers of these countries are as well represented as those in France and better represented than in Belgium.

The evidence points to the well documented fact that workers are poorly represented in several of the new member states, namely the Baltic countries, Bulgaria and Romania. More surprisingly, worker participation in the UK is second weakest to that of Lithuania, implying that British firms would not have an interest to relocate eastwards as far as worker participation is concerned. It is noteworthy that Spain, France and Belgium do not score particularly high.

All in all, significant differences in European worker participation index do exist; yet, there is no clear cut "East-West" or "North-South" distinction. For Scandinavian firms, relocating towards the east or towards the west could potentially be a cost-cutting strategy in terms of compliance with labour standards. For the firms in France and Belgium, it is much less obvious as their own employee participation reaches average levels at most.

FIGURE 13 ► European Participation Index (2010)



Source: ETUI (the index is constructed as defined in the Box 5), figure by K. Maslauskaitė

4.2. Shadow Economy in the EU

"Shadow" economy, such as defined in the Box 6, might distort the numerical analysis of Sections 2 and 3 because the "black" part of economy is not reflected in the official figures. Yet, the firms that choose to enter into "shadow" labour relations by employing the workers outside the official contracts, can potentially circumvent labour taxation, provide worse working conditions or pay lower wages altogether. In addition, the unofficial workers do not have legal protection; consequently their bargaining power is reduced to bare minimum. Such practices can be qualified as unfair competition among the firms in different member states because the cost of work becomes "artificially" low.

BOX 6 ► Definition of Shadow Economy

Shadow economy consists of the "economic activities and the income derived thereof that circumvent or avoid government regulation or taxation. The major component (about two thirds) is undeclared work, which refers to the wages that workers and business don't declare to avoid taxes".[45] Shadow economy

45. Schneider, F. (2011) "Size and development of the Shadow Economy from 2003 to 2012: some new facts" IZA Discussion Paper No. 5769.

does not include criminal activities such as burglary, but rather "focuses on productive economic activities that would normally be included in the national accounts but which remain underground due to tax or regulatory burdens".[46]

It is commonly agreed that shadow economy plays a non-negligible role in the EU in general and in several member states in particular. Various authors have attempted to estimate the extent of the shadow economy in the EU using rather comprehensive techniques.[47] The most recent estimate of the black economy in the EU reaches the average 20% of the overall GDP.[48] Yet, the average level, enormous as it is, hides a large variation between the member states. For example, in most of the CEECs more than a quarter of the economic activity is performed on the black market whereas in Austria, Luxembourg, the Netherlands, UK and France the proportion barely reaches 10% (see Figure 15 for individual estimations). The Southern member states, namely Greece, Italy, Spain and Portugal, are somewhere in between.

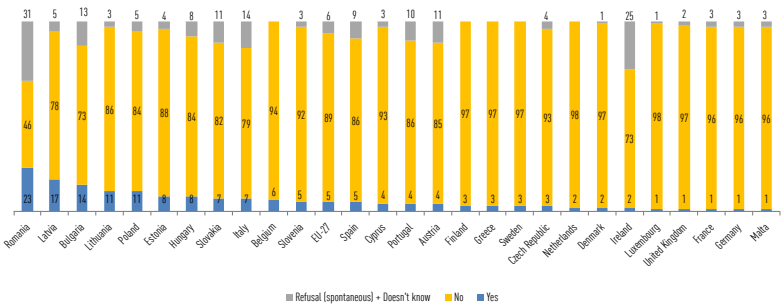
Shadow employment can take many forms. The most basic practice is the employer's refusal to sign any legal work contract with the employee. In this case, the employee officially remains either unemployed or outside the working force. Obviously, this is the most complicated situation for the employees as they are left with no social rights whatsoever vis-à-vis their employer. Another, more sophisticated example of law-evasion is the so-called "envelope wages". It is a tax avoidance technique whereby the employee is declared as earning a low or minimum wage. This salary is later complemented by an undeclared, and thus untaxed, additional "under-the-table" payment.

The Eurobarometer survey in 2007 found that 5% of dependent workers in the EU have received at least a part of their salary "in the shadow" with great variation between the member states. In Malta, UK, Luxembourg, France and Germany, only 1% of workers admitted to be subjected to this practice whereas in Romania, Bulgaria and Latvia, the proportion amounted to at least 14% (Figure 14). The same survey suggests that in the ten CEECs, 10% of

46. Schneider, F., *op. cit.*
47. A good description of various techniques used may be found in Schneider, F., *op. cit.*
48. Schneider, F., *op. cit.*

officially declared employees received an average of two fifths of their salary "in the envelope", which amounts to a total of 8 million workers in the region.[49] These numbers are probably underestimated still as during the surveys many workers might have not revealed the truth due to the negative social stigma attached to the practice. The high numbers of workers who refused to answer the question (gray bars in Figure 14) point towards the potential extent of such misreporting.

FIGURE 14 ► Share of Employees Receiving an Envelope Wage[50]



Source: Eurobarometer (2007)

4.3. Shadow Economy: a Factor of Cost Advantage?

Even though shadow economy constitutes a rather large part of GDP in many member states, it does not necessarily produce a real competitive advantage in terms of labour cost. It could be irrelevant if, as preliminarily shown by the same Eurobarometer survey, the largest part of undeclared EU-wide work is carried out in the non-exporting sectors of construction, hospitality, household and personal services. More importantly yet and depending on its origins, shadow economy, if it is a result of poor institutional quality, may also be harmful for countries trying to attract foreign investment.

49. Williams, C.C. (2008) "The commonality of envelope wages in Eastern European economies", Eastern European Economics Vol. 47(2).
50. Eurobarometer (2007) "Undeclared Work in the European Union". The question asked was "Sometimes employers prefer to pay all or part of the regular salary or the remuneration for the extra work or overtime hours cash-in-hand and without declaring it to the tax or social security authorities. Did your employer pay you all or part of your income in the last 12 months in this way?".

Overall, there are three broad causes that could explain law evasion in the labour relations.

First of all, some scholars seem to argue that shadow economy emerges with increasing income tax and social contribution levels. The argument goes that higher taxes provide a stronger incentive to operate in the shadow economy.[51] Nevertheless, France, Belgium and the Scandinavian countries have relatively high taxes and relatively small shadow economies, which shows that the relationship is not that straightforward.

Another reason might be linked to deterrence. Economists have developed mathematical models showing that strong deterrence is needed if people are to abide the law. According to these models, compliance increases when sanctions and/or the probability of getting caught are high enough. Yet, the empirical proof of this mechanism is rather ambiguous too.[52]

The third explanation, which is often emphasized by international organisations, is that shadow economy is only a symptom of ineffective institutions. Poor institutional quality results in reduced capacity of tax collection and enforcement of law, which in turn leads to a "bad equilibrium": regulatory discretion and burden on the firm is high, the rule of law is weak, and there is a high incidence of bribery and a relatively high share of activities in the unofficial economy".[53] Moreover, ineffective institutions cannot ensure an efficient provision of public goods. It discourages the workers and the employers from declaring their economic activities because they do not feel that they get their tax money's worth of public services.

The crude data indices seem to confirm the importance of this last argument in explaining the origins of shadow economy. Institutional quality is tricky to measure, but following the common practice in literature, it is approximated by the corruption perception index in Figure 15. It seems that a higher level of corruption perception (where 1 represents high and 10 represents low degree

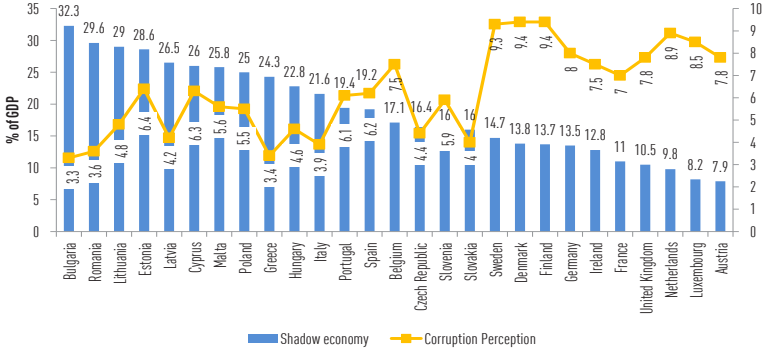
51. Such an argument may be found in Mummert, A. and Schneider, F. (2001) "The German shadow economy: Parted in a united Germany?" Finanzarchiv, Vol. 58/3 and Del'Anno, R. (2003) "Estimating the shadow economy in Italy: A structural equation approach", Discussion Paper, Department of Economics and Statistics, University of Salerno.
52. Schneider, F. (2011), p. 11, *op. cit.*
53. Johnson, S., Kaufmann, D. and Zoido-Lobaton, P. (1998). "Regulatory Discretion and the Unofficial Economy," American Economic Review Vol. 88(2).

of corruption) is positively correlated with the size of the shadow economy. The worst corruption perception combined with the highest shares of shadow economy is observed in Bulgaria, Romania, Greece, and Italy. Top performers are all of the Scandinavian countries, Austria, the Netherlands, Luxembourg and the UK.

It follows then that for a company relocating from Austria, Luxembourg or the Netherlands to Bulgaria, Romania, Greece or Italy, and hoping to circumvent labour laws by operating "in the shadow", additional costs might be due. For example, in a country with weak institutions, transport infrastructure or quality of education of potential employees might be much lower. Consequently, the employer will need to adapt the production line accordingly. In addition, high levels of corruption could create unanticipated obstacles for setting up and operating the business. All of these unforeseen costs could eventually supersede the cost savings derived from employing personnel illegally.

In sum, the above observations point to the fact that shadow economy might be polluting the official figures and indeed be a factor of social dumping on its own right by artificially lowering the cost of labour. Yet, even though clear data on both the extent and the origins of shadow economy are still lacking, it should be kept in mind that shadow economy can come at a price of its own. It is not obvious that the cost savings derived from evading labour laws outweigh the cost of operating within an environment of poor institutional quality.

FIGURE 15 ► Shadow Economy and Corruption Perception[54]



Sources: Schneider, F. (2011) and Transparency International, figure by K. Maslauskaitė

54. Corruption Perception is an index constructed by Transparency International, which goes from high corruption perception (1) to low (10).

CONCLUSION

Lately many EU countries have been accused of disloyal competition forcing other member states to engage in the social "race to the bottom". This Study has attempted to provide a preliminary analysis of various labour standards in the 27 EU member states in order to see whether their differences leave enough space for social dumping. Due to the size limitations, only the general trends on the national level have been observed using the most relevant, even if sometimes imperfect and incomplete, empirical data.

Overall, the analysis has revealed some intriguing developments and shown that, generally speaking, there is little space for regime competition between the European "core" and the "new" member states. There are four main reasons why the gap in terms of cost competitiveness between the old member states and the CEECs has virtually been closed:

First of all, CEECs have lost their cost competitiveness over the past decade. As shown by the data, the real productivity-adjusted salaries the CEECs are in line with those in the EU15. Even if wages in the region remain very low in absolute values, so does labour productivity. In terms of productivity-adjusted total labour cost, some of the new member states have not only lost their status of the cheap labour destination, but have also become more expensive than the European core. This is a result of a very fast wage convergence in the period from 2000 to 2010, which was not accompanied by a similarly high productivity growth.

Secondly, current ILO and European legislation in labour law have set minimal standards in all of the member states, including the new adherents. Even though social policy is still considered a national prerogative, significant progress has been made in harmonising basic health and safety requirements, non-discrimination and labour law relating to part-time work, fixed-term

contracts, working hours, employment of young people, employee information and consultation.

Thirdly, other labour standards such as working hours, employment protection and occupational health in the new member states as a group seem to be comparable to the other countries of the European core. Even though quantitative measurement is not easy to perform in most of these cases, no evidence of consistently poor labour standards in the CEECs has been found. Moreover, if some of the countries score low on some of the indices, these differences can often be explained by the socio-economic context rather than governmental policy of labour cost reduction.

Fourthly, the new member states do have higher shares of "shadow" economy. Yet, it is not obvious that unofficial activities can confer a real economic advantage. Weak institutions, which often go hand in hand with "shadow" economy, might imply additional costs for a producing firm.

If anything, there are three member states, namely the UK, Ireland and to some extent Luxembourg, that seem to consistently outperform all the other countries in terms of real labour cost. That combined with low tax rates, flexible labour laws and relatively weak employee participation makes the British Isles the most realistic suspects of social dumping. It does not automatically follow that these countries do engage in social dumping though; it only implies that their economic model is the most efficient in terms of labour cost. As discussed in the Study, disloyal and genuine welfare-enhancing competition might be sometimes difficult to disentangle.

These are, of course, just the general trends on national level. Some sectors, especially construction, agriculture and transport, might be experiencing different dynamics in terms of disloyal competition. Further research, especially in these sectors of economic activity, would be welcome to shed more light on the complex issue of social dumping.

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SOCIAL COMPETITION IN THE EU: MYTHS AND REALITY

The debate on social competition, or social dumping, is as old as the European Union itself, yet it has been getting louder in the recent years marked by economic turmoil and high levels of unemployment in many of the member states. Public opinion and politicians are worried that intense competition in the cost of labour between the member states might result in the "race to the bottom" in terms of social standards.

This Study aims at providing a preliminary analysis of various labour standards in the 27 EU member states in order to see whether the cross-country differences leave enough space for engaging in "social dumping". Due to the size limitations, only the general trends on the national level have been observed using the most relevant empirical data.

Overall, the analysis reveals some intriguing developments and shows that, generally speaking, there is little space for regime competition between the European "core" and the "new" member states. For example, in terms of productivity-adjusted total labour cost, some of the new member states have not only lost their status of the cheap labour destination, but have also become more expensive than the European core.

Unexpectedly, three member states not belonging to the Central and Easter European club, namely the UK, Ireland and to some extent Luxembourg, seem to consistently outperform all the other countries in terms of real labour cost both in direct and indirect terms. In this sense, these countries could be considered as the most realistic suspects of "social dumping". It does not automatically follow that these member states do engage in social dumping though; it only implies that their economic model is the most efficient in terms of labour cost. After all, as discussed in the Study, disloyal and genuine welfare-enhancing competition might be sometimes difficult to disentangle, which makes the argument of "social dumping" difficult to prove.

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