

Centre international de formation européenne  
Institut Européen des Hautes Etudes Internationales  
Paris Nice Berlin Bruxelles Istanbul

# The allegation of social dumping

A case study on Romania

Luisa Maria Bunescu

Coordinating professor: Jean-Claude Vérez

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## ***Foreword***

The **social dumping hypothesis**, referring to the export of goods from a country with weak or poorly enforced labour standards, where enterprises have a consistent competitive advantage given by lower direct and indirect labour costs represents nowadays and ongoing challenge for the big European market. This has been resented especially since the last two waves of the European Enlargement, in 2004 and 2007.

**“The allegation of social dumping. A case study on Romania”** focuses itself on the accusation of social dumping in Romania, a country that became EU member in 2007 and where the GDP per capita, as a measure of economic wealth is 54 % below the EU average, marking thus a striking discrepancy with the founding states. The reader should keep in mind from the beginning that the word “allegation” inside the title was not randomly chosen; “allegation” pinpoints particularly to a statement that someone has done something wrong or illegal, but that has not been proved. The allegation stays an accusation, and without trustworthy and well-grounded evidence it should not turn into a statement.

Starting from the premise that social spending is increasingly dependent upon the availability of resources, we tried to prove that welfare laggards such as Romania would catch up and move up to the trend line, as long as they will find the adequate measures to develop a sustainable economic growth paralleled by redistributive policies.

The specific research question proposed by this paper and based on a case study, aims at analyzing the labour market legislation as the instrument for a rather competitive advantage than that for a social dumping practice. Did the Romanian government change the financing structures of its social security schemes in a manner that would shift the burden from employers and reduce the cost of labour? This is one of the stringent points upon which the authors insist, with the remark explained in Chapter I that social dumping is not to be perceived as synonymous with welfare dumping.

During the 2010-2011 time framework, period when “**The allegation of social dumping. A case study on Romania**” has been written, the accusation of social dumping not only in Romania, but also in other European states that were either employing Romanian workforce or were delocalizing there became widespread. A consensus and an efficient decision-making process at the European level is majorly affected by the industrial/ economic relations inside the Common Market, thus the problem of social dumping needs to be urgently addressed in order for a fruitful cooperation among the European economic partners to be further pursued.

We acknowledge the importance of the previous research done in the field of social dumping, especially the one published in the *Journal of European Social Policy* or by Eurofound. The work done by Hans-Werner Sinn (2001), Paul Krugman and Robert Lawrence (1994) was of a great help in assessing the normative account concerning this practice. The empirical findings developed by Jens Alber and Guy Standing (2000) in respect with the allegation of social dumping in Greece and Spain set the guidelines for our own empirical research in the case of Romania. Due to difficulties in obtaining specific information about the internal practice of companies that were performing social dumping with the explicit/ tacit support of the government, we focused majorly in the analysis of the amended version of the Labour Code in Romania- in order to draw a conclusion about the above-mentioned hypothesis.

In the case of this country, the empirical research regarding this subject is still scarce, being coupled with a continuous institutional changing, national policy debates and official policy justifications. At this, one could add the 2011 Labour Code that brings about a new restructuring of the work-related relations. All this points to this paper as something new in the field, a work that terms the social dumping in the frames of national competitiveness, of political legitimacy and catch-up with welfare states.

The paperwork is divided into three parts, stepping from a general assessment towards a particular/specific approach. Thus, **Chapter I** is concerned entirely with the analytical framework of the social dumping hypothesis, familiarizing the reader with the necessary

terminology that the subject entails. We will refer to the different types of dumping-such as social security one, labour cost dumping, also to the causes that might lead to their use in the business relations and more importantly we will make the case why low wages and social standards do not point to a dumping practice.

**Chapter II** will be concerned with the hypothesis of social dumping inside the Single European Market, with a focus on the labour law and social protection standards. Moving further, we will address the financial dimension of poverty and inequality within the EU, drawing attention upon the existing disparities and different stages of economic development. The last part of this chapter will identify the tendency of the European Court of Justice to rule on the allegations of social dumping, creating thus a precedent for the national courts of each Member State.

**Chapter III** is entirely dedicated to our case study, reflecting the hypothesis of social dumping in Romania after the EU accession. We start by assessing the most important critical reflections concerning the post-1989 Romania, marked by a “stop-and go” series of reforms in order to cope with the transition towards a market democracy undeniably shaped by the NATO and EU admissions. Further on, we will present a brief account of the country’s economic profile, as readers might not be so well acquainted its macroeconomic indicators and we will tackle the state of domestic affairs. The purpose of this subchapter is to turn the allegation of social dumping into a competitive advantage approach. The Romanian Labour Code-2011 version is the specific empirical tool that helps us addressing the social dumping practice, as for the domestic political opposition and trade union representatives it bears within this accusation.

Trying to go deeper than the political discourses, the authors will do their best to shed light upon the contentions’ validity and to draw a substantive conclusion from an experience that is both statistical and at times concerned with the unquantifiable living standards that address the reality of a civilizing process.<sup>1</sup>

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<sup>1</sup> We owe this term to the German sociologist Norbert Elias

***List of Abbreviations***

<b>CFI</b>	<b>Council of Foreign Investors</b>
<b>CFR</b>	<b>Caile Ferate Romane (the Romanian Railways)</b>
<b>CSM</b>	<b>Superior Council of the Magistracy</b>
<b>ECB</b>	<b>European Central Bank</b>
<b>ECJ</b>	<b>European Court of Justice</b>
<b>EEC</b>	<b>European Economic Community</b>
<b>EMU</b>	<b>European Monetary Union</b>
<b>EU</b>	<b>European Union</b>
<b>EU-27</b>	<b>European Union comprising 27 Member States</b>
<b>FDI</b>	<b>Foreign Direct Investment</b>
<b>GDP</b>	<b>Gross Domestic Product</b>
<b>HICPs</b>	<b>Harmonized Indices of Consumer Prices</b>
<b>ILO</b>	<b>International Labour Organization</b>
<b>IMF</b>	<b>International Monetary Fund</b>
<b>IR</b>	<b>International Relations</b>
<b>ISPA</b>	<b>Instrument for Structural Policies for Pre-Accession</b>
<b>MP</b>	<b>Member of Parliament</b>
<b>MS</b>	<b>Member State(s)</b>
<b>NATO</b>	<b>North Atlantic Treaty Organization</b>
<b>OPM</b>	<b>Open Method of Coordination</b>

<b>PC</b>	<b>Partidul Conservativ (The Conservative Party)</b>
<b>Phare</b>	<b>Poland and Hungary: Assistance for Restructuring their Economies</b>
<b>PNL</b>	<b>Partidul National Liberal (The National Liberal Party)</b>
<b>PPP</b>	<b>Purchasing Power Parities</b>
<b>PPS</b>	<b>Purchasing Power Standards</b>
<b>PSD</b>	<b>Partidul Social Democrat (The Social Democratic Party)</b>
<b>QMV</b>	<b>Qualified Majority Voting</b>
<b>Sapard</b>	<b>Special pre- Accession <i>Programme</i> for Agriculture and Rural Development</b>
<b>SEM</b>	<b>Single European Market</b>
<b>TFEU</b>	<b>Treaty on the Functioning of the European Union</b>
<b>VAT</b>	<b>Value Added Tax</b>
<b>WB</b>	<b>World Bank</b>
<b>WTO</b>	<b>World Trade Organization</b>

## CHAPTER I

### Social dumping-an analytical framework

#### Summary

*Business representatives and trade unions in developed and highly industrialized countries often accuse the leadership of less-developed states of making use of social dumping practices in order to increase their competitive advantage, and thus giving birth to an unfair trade. On the other hand, the less-developed countries explain their not so advanced work-place safety legislation, lower wages and other fringe benefits that are rather residual compared to those of economically advanced countries by their endeavor to implement efficient transition strategies that are the premises for a catching-up process and a fruitful convergence.*

#### Résumé

*Les employeurs et les syndicats dans les pays développés et industrialisés accusent souvent les gouvernements des Etats moins économiquement avancés de pratiquer le dumping social afin d'accroître leur avantage compétitif. De l'autre côté, les pays moins développés ou en voie de développement insistent sur le fait que leur législation concernant la sécurité des travailleurs, ainsi que leurs plus bas salaires ou les récompenses adjacentes réduites font partie d'une transition efficiente vers une convergence entre eux et l'avant-garde économique et d'un processus de » catching-up ».*



**Key words**

*catching-up process, competition, direct and indirect wage costs, social dumping*

**1.1. Defining social dumping**

The concept of “social dumping” is highly debatable and there is no single, unanimous definition about it. The theoreticians<sup>2</sup> speak rather about its features and its further implications. It becomes even harder to tackle this term, as in the last two decades the concept acquired a pejorative ring, being used in the same degree by the politicians, economics, IR academics, social science researchers, media and the common people. However, some normative aspects can be drawn in describing an *ad litteram* social dumping practice.

First of all, it implies situations in which standards in one country are lowered compared to those in other states or with what they should have been because of the external pressure stemming from the global economic system. If we are to apply the analogy with the *trade dumping* than we could say that policies in one country or region are employed in order to erode levels or institutions of social protection. In practice, the governments might adopt social dumping policies in the sense of maintaining underdeveloped or residual welfare states, in order to create competitive cost advantages for their own industries or to attract foreign investors.

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

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<sup>2</sup> Hans-Werner Sinn, Robert J.Carbaugh

country, with possible negative consequences for social and labour standards in other countries.<sup>3</sup>

To go even deeper into the complexity of the subject, one could divide cases into *erosion* of already established levels and *arrested development* of forms of social protection and regulation that could have been expected as correlates of economic growth.<sup>4</sup> The distinction between what we called *erosion* and *arrested development* it's similar to the one between *non-decisions* (by which governments refrain themselves from introducing or expanding protective legislation) and *decisions* (by which they dismantle social schemes). In this respect, the above-mentioned distinction can be interpreted as capturing the *degree* of radicalness of social dumping.

Before addressing the core allegation, another criterion has to be considered in tackling this subject: the *forms* or *types* of dumping. Thus, dumping practices can be encountered in *markets*, without state action, or they can be induced by the *government*. The first comprise such business initiatives as the relocation of enterprises to low-cost countries, “capital flight”, and the displacement of high-cost producers by low-cost ones. One might argue that they might be indeed just responsive measures to the *state actions*, but they are taken by private agents (investors, producers, consumers). A second form of dumping requires the *state action* and it is this type which is treated throughout the thesis. Within this dimension, the benchmarks for a well-argued analysis are the fields of *welfare* or *social security*

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<sup>3</sup><http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/SOCIALDUMPING.htm>

<sup>4</sup> Jens Alber; Guy Standing, “Social dumping, catch-up, or convergence? Europe in a comparative global context”, *Journal of European Social Policy*, SAGE Publications, London, 2000, p.99.

*legislation* and of *regulatory labour legislation*, considering the fact that these two might diverge.

*Social security dumping* reflects the extent to which the state is restructuring or reducing the transfers and the social protection schemes by shifting the burden of financing. The main tendencies are the shifts from universalism and social insurance to selectivity, thus to the specific determination of target groups for which the state has to perform those transfers. The problem is of high importance especially in places where the state used to be a welfare one, with large responsibilities in the social protection field. A cut in these transfer payments or social benefits is to be very easily noticed and sanctioned by the citizens. Recent debates on the future of the welfare state treat this topic to a larger extent.

The second approach tied to labour regulations might also be labeled as *labour cost dumping*. In this case, the businesses are enabled to reduce their *non-wage labour costs* by legislation that denies obligations on the part of the employers to pay for social fringe benefits or for a higher protection against injuries, pension schemes, co-determination rights and the like.

A common feature for both types of state-induced dumping is that the cost of performing social protection provisions is shifted from the state and employer onto workers and communities in which they live.

As for developing countries, there are two conflicting hypotheses that should shape thinking about social dumping.<sup>5</sup> One is related to the ambiguous notion of “borrowing” from demonstrations effects of pioneering countries, rather than go through a trial-error process, the other is associated with the “advantage of being backward” stemming from Thorsten Veblen’s work. In this sense, late-comers might aspire to catch-up with institutional innovations such as the welfare state in the advanced countries, saving investment costs and sparing administrative experiments, learning directly from the pioneers. If this was the case, then one would expect to find

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<sup>5</sup> Jens Alber; Guy Standing, *op.cit.* p.102.

that social policy expenditure for a given level of income per habitant is higher than it was for the industrialized countries when they had comparable levels of economic growth. And one would expect legislation and regulations to be more advanced in these developing countries than they were at comparable levels of development and industrialization for the currently advanced states. Satisfying such demands requires the proportional employment of a number of resources. Without these ones, the growth would be an artificial one, with no follow-up. Thus, before accusing a government of practicing social dumping in this globalised international arena, one should think at the *stage of development* that the precise state is traversing.

An alternative version of the “advantage of being backward” argument leads to a divergent hypothesis. It basically states that the late-comers could skip a stage of development that proved to be too costly or wasteful for the pioneers. Hence, if it is right that funded pension schemes are superior to pay-as-you-go schemes, welfare state builders could take a short-cut and directly go for a funded-pension system. Therefore, the late-comers will not catch up, but avoid the path of the pioneers. In this respect, if nowadays the efficiency of the welfare state is put into question by everyone, due to its high costs, then the social spending laggard countries should not be accused of social dumping, but be seen as not embracing an inefficient stage earlier created by those who forged the welfare states in the industrialized world, particularly in Western and Northern Europe.

## **1.2. Causes for potential social dumping**

The most common thesis relating to social dumping is that the pace of change in the international economic systems, the inevitable globalization and economic liberalization have made capital far more mobile as before. This has in turn increased the pressure on governments to ease their regulations and diminish their social protection standards in order to attract more foreign capital in their countries. Not few are those who voice their concerns that the welfare states are being transformed

in this way into *competition states*, whereby the governments are adapting their social and labour policies to some international minimal norms, this global convergence being perceived as having a level well below of the one established by the advanced welfare states in the post-1945 decades. Is this “a race to the bottom”? Based on a relevant case study (see the last chapter) and also on empirical findings the authors of this thesis consider that it is far-fetched to adopt such an approach. Recently, the incidence of government subsidies has been shifted from labour to capital even under the agenda of social democratic political parties whose effective practices tend not to be so much aligned with the traditional political discourse. There is also a coordinated roll-back of socially redistributive policies masterminded by those who represent the capital, the neo-liberal political parties and their supporters; this approach also incorporated the use of the international financial agencies such as the World Trade Organization (WTO), the International Monetary Fund (IMF) or the World Bank (WB).

Underlying the social dumping thesis implies the fact that the international capital mobility is systematically related to cut-backs in social spending, cut-backs in social protection for workers and in the non-wage labour costs as well as restricted labour rights, as the scope of collective bargaining and on the bargaining capacities of trade unions (see Chapter II- Laval case). Thus, in more general terms, social dumping could be interpreted as a global process of “labour recommodification”.<sup>6</sup> This can be considered as a rather pessimistic and biased vision. Arguments do exist in order to contradict the above-mentioned thesis.

First, it is suggested that policymakers in participative democracies need legitimacy to stay in power. This implies that the social costs of any modernization process might be well considered, and cushioned before any step in that domain. As said before, for a more extended welfare state, any cuts in the social spending are visible and unpopular in the short-term, whereas the promised benefits from enhanced competitiveness and economic growth that will arise out of these are diffuse and

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<sup>6</sup> *Ibidem*, p.101.

deferred to the future.<sup>7</sup> Moreover, in the case of incipient or residual welfare states, further cuts in social spending might lead to political instability, on-going protests and illegitimacy of the incumbent government. But again, on economic grounds, the notion that an open economy is positively associated with welfare state growth runs counter to Keynes' beliefs, who envisaged a rather closed economy, and Gunnar Myrdal, a founding father of the welfare state capitalism, who admitted that this type of state depended on protectionism.

Secondly, some have suggested, and the empirical proof seems to confirm it that as more countries become part of an internationally/regionally integrated system, standards agreed upon in leading states are more likely to become reference models for the countries who want to enter close economic partnerships. This could be even interpreted as a convergence process in the form of a "race to the top" or, in terms used within the European Union, as "upward harmonization"<sup>8</sup>. Thus, it can be concluded that the emergence of supranational decision-making bodies has enabled innovative models from states with advanced systems of social protection to be emulated by other countries, through the advice of experts and even through fiscal transfers, as in the case of the European Union. It is possible, however, that the most likely scenario is neither a race to the bottom nor an "upward harmonization", but a "convergence to the mean" in the sense that the leading welfare states limit their duties, while the laggard countries try to catch up and expand public provision.

An international harmonization of social conditions is being postulated by those who fear the social dumping practices and by those who want to put an end to the seemingly unfair competition. International agreements like those of the International Labour Organization (ILO) or the EU Social Charter stand for this tendency as they define a number of social minimum standards which are binding for the contracting parties. For instance, the ILO signatories have agreed to enact a

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<sup>7</sup> P. Pierson, "The New Politics of Welfare", *World Politics* 48 (2), 1996, pp.143-179.

<sup>8</sup> H. Mosley, "The <Social Dumping> Threat of European Integration: a Critique", in B. Hunger and F. Van Waarden (eds), *Convergence or Diversity. Internationalization and Economic Policy Response*, Aldershot, 1995.

system of labour standards<sup>9</sup> regarding minimum wages, maximum working hours per week and minimum rest time, a guaranteed number of holidays with pay and the prohibition of the worst forms of child labour. Unfortunately, there is no single threshold to define the minimum of social protection all over the world. Moreover, the binding effect of the ILO is much less seriously considered than that of the World Trade Organization (WTO) or of the domestic legislation.

As regards the social regulations inside the European Union, we will deal with this subtopic in the next chapter, as it represents one of the departure points for the case study regarding the allegiances for social dumping practices in Romania, after becoming an EU Member State in 2007. The reader should just keep in mind that inside the European framework, conclusive steps were taken by the supranational level to prevent any unfair trade practice and to guarantee an adequate and viable social protection system, not yet harmonized among the 27 Member States, but with clear competition and social policy provisions, especially after the coming into being of the Lisbon Treaty and of the Charter of Fundamental Rights.

### **1.3. The accusation of practicing social dumping**

It has to be acknowledged from the beginning of this subchapter that it is rather difficult to test the hypotheses correlated with the image of social dumping, due to the essential normative haziness of social dumping as a set of tendencies, and because of the lack of relevant and sometimes unreliable data. However, in our case study, discussed in the last chapter, adequate information is available in order to draw a conclusion about the allegation of social dumping in Romania.

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<sup>9</sup> International Labour Organization, <http://www.ilo.org>

**a) Redistribution vs. Payment in Kind<sup>10</sup>**

Analyzing the accusation of social dumping it's not just an irrelevant exercise; in fact it involves two rather intricate phenomena that are quite often referred together in public debates. One is linked to the level of the wages, working conditions and wage related fringe benefits that represent the employers' labour costs; the other refers to the redistribution of resources between different layers of society and type of individuals, such as government transfers. Nevertheless, it is doubtful that the accusations of the business and union leaders from the developed countries have as target the second type of social dumping, even if this one is also ignited by the state action. The core argument would be that the connection between neglecting redistribution and a competitive advantage seems less obvious than the one between bad working conditions and a competitive advantage.<sup>11</sup>

From a theoretical point of view the case is also not clear. Performing tax-cuts for the above-average income earners may reduce the cost of capital and the wage cost for qualified labour; however, there is a reverse: diminishing the social transfers to less qualified labour may lead to emigration and higher wage demands by the low-paid workers, and this, in itself, will tend to raise the wage cost. Thus a vicious circle might take place. What employers and union leaders from the highly-industrialized and economically advanced countries have in mind, therefore seems to be *the working conditions, wages and wage related fringe benefits, which all have a direct impact on the wage cost*. For all the above-mentioned aspects, the central accusation is that the low wage standards are the outcome of a conscious policy of social dumping which is carried out deliberately, or at least tolerated, by the national governments of the developing and less-developed countries. These ones stick to low standards because they are aware of the fact that competitive advantages for the domestic industries result.

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<sup>10</sup> Payment in kind=a way of paying for something with good or services instead of money

<sup>11</sup> Hans-Werner Sinn, "Social Dumping in the Transformation Process?", *NBER Working Paper No.8364, National Bureau of Economic Research, Cambridge, July 2001.*



The social standards meant in this context can be perceived as payments in kind prescribed by the government. Of course, the utility of the workers increases once they receive better safety standards and other wage-related fringe benefits, but in the same time the firms' labour costs go up if they have to pay for these work improvements. The same goes for a financial upturn in the employees' wages. As both the pecuniary salary and the payments in kind are to be paid from the same marginal value product of labour, public legislation on wages in kind does not include a redistribution of resources between different groups of individuals, being instead similar to legislation setting wages itself.<sup>12</sup>

This should demonstrate to the reader that the two potential forms of social dumping should not be treated together. They make a point on two different economic phenomena, and the similarity might arise due to the fact that they can emerge simultaneously as consequences of the policy measures. *Welfare dumping is not social dumping.*

## **b) Direct and Indirect Wage Costs**

The structure and evolution of incomes are salient features of the labour market, illustrating the labour supply from individuals and the labour demand by the enterprises. Moreover, the level and structure of earnings are among the key macro-economic indicators used by policy makers, employers and trade unions in defining their targets and in negotiating collective agreements.

For the time being, there are considerable differences in wage costs inside the European Union, gross hourly wages differing substantially among the member states.

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<sup>12</sup> *Ibidem*

As of January 2007, statutory minimum wages<sup>13</sup> across the various European countries varied between 92 (in Bulgaria) and 1570 (in Luxembourg) euro gross per month.<sup>14</sup> However, differences in the levels of the monthly minimum wages are markedly smaller when expressed in PPS (Purchasing Power Standard) rather than euro.

**Table 1.1** Minimum wages in the EU (Euro/month)<sup>15</sup>

Euro/month	2004	2005	2006	2007	2008	2009	2010	2011
<b>Belgium</b>	1186,31	1210	1234	1259	1309,6	1387,5	1387,5	1415,24
<b>Bulgaria</b>	61,36	76,69	81,79	92,03	112,49	122,71	122,71	122,71
<b>Czech Republic</b>	206,73	235,85	261,03	291,07	300,44	297,67	302,19	319,22
<b>Denmark</b>	-	-	-	-	-	-	-	-
<b>Germany</b>	-	-	-	-	-	-	-	-
<b>Estonia</b>	158,5	171,92	191,73	230,08	278,02	278,02	278,02	278,02
<b>Ireland</b>	1073,15	1183	1292,85	1402,7	1461,85	1461,85	1461,85	1461,85
<b>Greece</b>	630,77	667,68	709,71	730,3	794,02	817,83	862,82	862,82
<b>Spain</b>	537,25	598,5	631,05	665,7	700	728	738,85	748,3
<b>France</b>	1215,11	1286,09	1217,88	1254,28	1280,07	1321,02	1343,77	1365
<b>Italy</b>	-	-	-	-	-	-	-	-
<b>Cyprus</b>	-	-	-	-	-	-	-	-
<b>Latvia</b>	118,96	114,63	129,27	172,12	229,75	254,13	253,77	281,93

<sup>13</sup> In twenty Member States of the European Union (Belgium, Bulgaria, Spain, Estonia, Greece, France, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Czech Republic and the United Kingdom) and one candidate country (Turkey), collective bargaining is subject to a statutory national minimum wage. The other Member States do not have a statutory national minimum wage.

<sup>14</sup> Pierre Regnard, "Population and Social Conditions", *Statistics in Focus, Eurostat*, 71/2007.

<sup>15</sup> The table is partially reproduced; date of extraction- 19 April 2011

[http://epp.eurostat.ec.europa.eu/minimum\\_wage](http://epp.eurostat.ec.europa.eu/minimum_wage)

<b>Lithuania</b>	130,34	144,81	159,29	173,77	231,7	231,7	231,7	231,7
<b>Luxembourg</b>	1402,96	1466,77	1503,42	1570,28	1570,28	1641,74	1682,76	1757,56
<b>Hungary</b>	201,9	231,74	247,16	260,16	271,94	268,09	271,8	280,63
<b>Malta</b>	540,84	555,06	584,24	601,9	617,21	634,88	659,92	664,95
<b>Netherlands</b>	1264,8	1264,8	1272,6	1300,8	1335	1381,2	1407,6	1424,4
<b>Austria</b>	-	-	-	-	-	-	-	-
<b>Poland</b>	175,25	207,86	232,9	244,32	313,34	307,21	320,87	348,68
<b>Portugal</b>	425,95	437,15	449,98	470,17	497	525	554,17	565,83
<b>Romania</b>	<b>68,03</b>	<b>78,7</b>	<b>89,67</b>	<b>115,27</b>	<b>138,59</b>	<b>149,16</b>	<b>141,63</b>	<b>157,2</b>
<b>Slovenia</b>	470,99	490,07	511,9	521,8	538,53	589,19	597,43	748,1
<b>Slovakia</b>	147,68	167,76	182,15	220,71	241,19	295,5	307,7	317
<b>Finland</b>	-	-	-	-	-	-	-	-
<b>Sweden</b>	-	-	-	-	-	-	-	-
<b>United Kingdom</b>	1054,2	1134,67	1212,61	1314,97	1242,24	995,28	1076,46	1138,54

Source: Eurostat

According to the Eurostat definitions, the wage costs are broke down into *direct* and *indirect costs*. The former ones are defined as gross wages per hour, more simply, the official annual pay divided by the number of working hours. They comprise the employees' social security contributions, overtime supplements, shift compensation, regularly paid premia, pay for vacation and national holidays, year-end bonuses and similar items. *Indirect costs* consist of employer social insurance contributions, sick pay schemes, and further social expenses such as those for canteens, medical services, vocational training or sports facilities.<sup>16</sup> These indirect wage costs, according to the Eurostat definitions are part of the costs of social standards; however they do not exhaust this category of labour costs. Safety requirements for machinery, dismissal protection rules, co-determination rights of

<sup>16</sup> These labor costs components and their elements are defined in Commission Regulation (EC) 1737/2005 amending Regulation (EC) No 1726/1999 as regards the definition and transmission of information on labor costs implementing Council Regulation (EC) No 530/1999 concerning structural statistics on earnings and labor costs.

workers represent additional indirect wage costs. These ones can be substantial, highly influencing the competitiveness of the states. Countries with a high direct wage also tend to have a high indirect wage.

The leadership of the business milieu in the European advanced countries argues that such a gap between wages and labour standards is incompatible with a common European market where there are no internal trade restrictions and the four freedoms are granted (freedom of movement, of settlement, of capital and services). In such a market, their argument goes, salaries and working conditions should find each other at almost the same standards in order to ensure a fair competition. The fact that they are so divergent, especially between the founding countries of the EU and the late-comers, indicates social dumping that should be condemned as an unfair trade practice that has to be overcome by extending the scope of common European wage and working standards. If the current binding effect of the European Union Charter of Fundamental Rights that entered into force once with the Lisbon Treaty is to be enough for giving up such grievances, it's left for further discussion in the next chapter.

Nevertheless, the argument of such business and trade union representatives neglects the fact that these differences in wages and social standards are the natural effect of a cumbersome transitional process towards a uniform European economy. This adjustment phase combines elements of the old economic system, even more if this one was impregnated with ideological elements and of the harmonization agreements that force the countries to converge faster in specific areas than they would have done had they been left alone in the decision-making process.

There is little doubt that, in the long run, there will be no economic and social convergence among the European partners. With unrestricted exchange of goods, free movement of capital and services the current differences in overall wage costs due to the adjustment phase certainly cannot be maintained forever. Thus time is needed and adequate political and economic measures. Factor price equalization cannot come

about overnight considering that accumulation of a modern stock of capital in the lagging countries is needed. Despite the fluidity of financial capital that is immersing constantly in countries such as Romania or Bulgaria, the *real capital* faces increased adjustment costs until it gets to a grass roots level. These obstacles include management constraints, the roundabouts of the domestic production chains, learning-by-doing limitations, lack of modern public infrastructure, and, very important, the time consuming process of constructing the economic and political institutional set up which is a *sine qua non* premise for an efficient market economy.

There is a direct correlation between the accumulation of capital and the level of wages; when the former one is slow, wages too lag for a long time behind those in the more developed countries, and workers have strong incentives to migrate and thus to become guest workers in regions where they can receive a higher income. Nevertheless, even when wage differentials are large some people prefer to stay home. The objective as well as the subjective costs of the migration could simply forestall them from maximizing their income. Looked at in this way, substantial differences in pecuniary wages between the advanced and less-advanced economies of Europe seem quite natural for a long-term period.

Social standards are not directly explained by the market forces, they are instead set up by the government or in recent years by supranational decision-making bodies. Nonetheless, they may be explained indirectly, since it is purely irrational for a government to prescribe in kind-payments for workers when they are not proportional to the direct wages agreed to in private labour contracts. That would mean overspending which in the long-run will lead to major domestic financial imbalances. In the light of the empirical information it is expected that governments will plead for social standards in proportion with the direct wages paid, taking into consideration the current internal stage of development. A sluggish adjustment of social standards is quite often a normal consequence of a transition stage which leads to a convergence with the economic conditions in the developed regions only in the very long run.

## **1.4. Why low wages and social standards do not point to social dumping**

Low wages, lagging social standards and high returns on capital are features of a long-term adjustment process. The pioneer countries experienced all these phenomena too, at a time when they built up and extended their industrial sectors. Left to themselves, decentralized choices of households, enterprises and national governments will solve this convergence deficit in the sense that some of the labour force potential will move to the core area as guest workers. This step will then lead to spontaneous increases in wages and improvement of social standards which will reduce the pressure to migrate. As the effective income level will still be well below that of the advanced economies, there will be an influx of capital that will further increase the labour productivity, wages, social standards and reduce unemployment.

A government that acts on behalf of the national interest is aware of the endemic risks stemming from a fast prices harmonization. Wages and work-related fringe benefits must be lower than in the core area during a long transition period before the accumulation of a sufficient stock of real capital. In the long run they will adjust by themselves; the temporary lag in wages and social standards has nothing at all to do with social dumping; it is the outcome of the Invisible Hand in systems competition. Endeavors from the part of the central government or from supranational constructs to push too much for a fast alignment between countries being at different stages of economic and social progress would lead to a short and unsustainable improvement in social standards and wage rises, which would postpone even further a healthy economic set up. Lessons from previous cases could be learnt and mistakes not repeated. The practical example of German unification demonstrates how dangerous such an adjustment policy can be.

Following unification, Germany learned the tough lesson that the laws of the market cannot be ignored and that in a capitalist system it is the market who decides upon the price of all commodities and returns. Anticipating a wonderful future, the policy of early equalization of wages and social standards was given free hand and the economies of the Eastern Länder were aligned to those of the Western ones.<sup>17</sup> The hourly wage costs in the East German manufacturing jumped to more than 70% of the Western level in only five years, although they were only 7% of this level before unification at by then the exchange rate. The disastrous outcome of this policy was a loss of competitiveness which destroyed nearly 80% of the jobs in manufacturing. Structural unemployment and a westward migration of around 10% of the East German population took place. Also, the automatic increase in wages, which let alone would have occurred as a result of westward migration and a reduction in the East German labour market was not waited for. The rampant unemployment, at least as it was triggered off by a too rapid increase in wages and the immediate implementation of West German labour standards, is an obvious sign of misallocation, thus a huge loss of national output. Germany has had to pay for this economic mistake with massive government transfers to the new Länder.

The European Union cannot allow itself such a policy mistake. Moreover, in the current European context such a decision is very unlikely to be adopted, the policy-making framework being composed not only from national and supranational levels, but also from groups that represent different interests. The German problem was that the Western trade unions and the Western employers negotiated the East German wages among themselves-there were no East German companies at the time (spring 1991). Also, both the negotiating parties had the same interest in increasing the East German wages, avoiding in this way competition stemming from the Eastern side. Similarly, Western employers and trade unions persuaded the government to impose West German work standards and the adjacent social security system from the

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<sup>17</sup> Guillermo de la Dehesa, "Are developing countries engaging in social dumping?", available at <http://www.voxeu.org>

beginning.<sup>18</sup> This is not the case inside the European Union. Despite the strengthened top-down decision-making process, the national governments retain a high degree of sovereignty especially in the domain of social policy, moreover the enterprise culture in all the Member States is very developed and intertwined, with divergent goals that set as a precondition for any regulation a lengthy debate.

### **1.5. Decent work and social dumping**

Work is central to people's well-being and social progress. It strengthens individuals, their families and the social circles in which they live. Such progress, however, is dependent upon a decent work. If we are to talk about social dumping, then the major indicator of such an unfair and immoral practice has to be the working standards.

The International Labour Organization (ILO) has developed an agenda in this respect, having four strategic objectives, with gender equality as a crosscutting one. Thus, creating jobs, guaranteeing rights at work, extending social protection and promoting social dialogue are included in this ambitious approach.<sup>19</sup>

Every day, 6,300 people die as a result of occupational accidents or work-related diseases - more than 2.3 million deaths per year. The human cost of this daily adversity is vast and the economic burden of poor occupational safety and health practices (lost working time and interruption of production, medical expenses and workers' compensation) is estimated at 4 per cent of global GDP/year. The safety and health conditions at work are very different between countries, economic sectors and social groups. Deaths and injuries are higher in developing countries, where a large part of the population is engaged in hazardous activities,

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<sup>18</sup> Hans –Werner Sinn, *op.cit.*, p.33.

<sup>19</sup> Decent Work Agenda, *International Labour Organization*, <http://www.ilo.org/global/about-the-ilo/decent-work-agenda>



such as agriculture, fishing and mining.

The ILO places special importance on developing and applying a preventive safety and health culture in workplaces worldwide. SafeWork, the ILO Programme on Safety and Health at Work and the Environment, aims to create worldwide awareness of the dimensions and consequences of work-related accidents, injuries and diseases. Nonetheless, it has to be mentioned that the ILO Codes of Practice are not legally binding instruments and are not intended to replace the provisions of national laws or regulations, or accepted standards.<sup>20</sup> They aim to serve just as practical guides for public authorities, employers and workers concerned, enterprises and safety and health committees. That's why, in order to assess the existence of social dumping inside the European Union, we should turn our attention towards the binding existing legislation, its uniform applicability or the existing divergences.

At the European level the codification of legislation concerning the minimum safety and health requirements for the use of work equipment by workers took the shape of Directive 2009/104/EC<sup>21</sup>. This directive supersedes the various acts incorporated in it, in the sense that it fully preserves the content of the acts being codified and hence does not more than bring them together with only such formal amendments as are required by the codification exercise itself. Having the statute of a directive, it has to be translated into the national legislation, the methods of its implementation being left to the appreciation of the national layer. In any case, it does have a binding effect and the non-compliance with its provisions attracts the application of sanctions by the EU Commission.

The Directive includes some very precise postulates, starting with general provisions, continuing with employers' obligations and an array of other points.<sup>22</sup> The economic actors inside the European Union are obliged to safeguard this minimum of safety and health requirements. Thus, if cases of non-compliance are to be identified

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<sup>20</sup> Codes of Practice, *International Labour Organization*, <http://www.ilo.org/safework>

<sup>21</sup> <http://www.europarl.europa.eu>

<sup>22</sup> For a full version of the Directive 2009/104/EC please visit [lex.europa.eu/ Directive 2009/104/EC](http://lex.europa.eu/Directive_2009/104/EC)

in any of the Member States, then it is justified to speak about social dumping. Moreover, as we discussed in the first part of this chapter, our focus is on the *state action* as the one that triggers this unfair practice, thus the state should tacitly agree with the social dumping as a form of increasing its competitive advantage.

In 2009, the European Agency for Safety and Health at Work released the results of a European-wide survey on safety and health at work. According to the findings the citizens from all the 27 Member States are concerned about the impact of the economic crisis and recession on their working conditions. On a positive note, the majority of respondents, particularly those coming from the countries that joined the EU prior to the enlargements from 2004 and 2007, consider themselves as well informed about workplace health and safety risks.<sup>23</sup> However, due to a lack of appropriate culture enterprise, also due to asymmetrical information between the employer and the employee, the risks encountered at the workplace seem to be downplayed by both social actors. The survey respondents believe that the need to have a job is such that they would place the salary level (57%) and job security (53%) higher than their health and safety at work (36%) in choosing a job.

## **1.6. Labour standards and the poor workers**

It is an undeniable moral fact that all the social actors should promote the goal of improving the wages and working conditions of workers in developing countries. Nonetheless, it cannot be downsized the fact that forcing these labour standards to be implemented in the countries above-mentioned may only make things worse for the workers, while failing to have the desired effect of keeping more jobs in the developed countries. By definition, raising the cost of labour above its level of productivity is nonsense; workers will become unemployed when their wages are

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<sup>23</sup> Sonia McKay, "How Europeans assess health and safety at work", *Working Lives Research Institute*, March 2010, [http://www.eurofound.europa.eu/health\\_and\\_safety\\_at\\_work](http://www.eurofound.europa.eu/health_and_safety_at_work)

raised above the market value of their productivity. Unemployment will rise and the vicious circle is brought into the macro-economic framework. Furthermore, for the developed countries, imports from developing ones have had a lower impact on employment and on any wage differential than the technical change in the former ones.<sup>24</sup>

The proper response in rich countries to the challenges posed by the lax regulation in the developing ones with manufactured exports should focus on more public sector assistance for workers who must change jobs from declining into growing domains. As regards the countries that are being accused of practicing social dumping, strengthened codes of conduct have to be considered, as for instance those recommended by the International Labour Organization, which until now do not have a binding effect.

The debate continues on whether competition over labour and social costs should be encouraged by the institutional framework of the international economic organizations or whether the social dumping constitutes a real threat. Either way, we do hope that after analyzing this chapter, the reader will recognize the challenges that such an allegation arises and he/she will agree that cautiousness is needed in tackling this topic.

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<sup>24</sup> Paul Krugman, Robert Lawrence, "Trade, jobs and wages", *7NBER Working Paper 4478*, 1994.

## CHAPTER II

### **The Single European Market and the social dumping**

#### Summary

*The purpose of a Single European Market (SEM) had serious implications for employment, industrial relations and for the social systems inside the European Union. Competition between enterprises in different Member States faced with contrasting direct and indirect labour costs and different systems of social and labour regulation poses the problem of social dumping or social regime competition. The result is an ongoing protracted negotiation between the European social partners over the political and legislative strategies to be implemented with respect to the Internal Market. Are economic as well as social harmonization stringently needed for the good functioning of the organization or a loose convergence should suffice?*

#### Résumé

*La création du Marché Commun a mis en question les systèmes sociaux nationaux, le marché du travail, ainsi que les relations industrielles dans l'Union Européenne. La concurrence entre les entreprises implantées dans des Etats-Membres ayant des coûts de travail et de régulations différents pose le problème du dumping social. Le résultat est représenté par une négociation continue entre les partenaires sociaux européens concernant les stratégies politiques et législatives afin de poursuivre le but d'un marché commun. Est-ce que c'est impératif d'avoir une harmonisation économique ainsi qu'une convergence sociale pour un fonctionnement optimal de l'UE ou suffit-il de garder une harmonisation limitée ?*

**Key words**

*European Social Model, income poverty, Internal Market, the Lisbon Treaty, posted workers, working-poor*

**2.1. Features and challenges of/for the Internal Market****2.1.1 Labour law and social protection standards**

The creation of the Single European Market exposes enterprises performing their activity in the framework of a national market to competition with others in different Member States. This means that pressure will be exerted on those companies that have high direct wage costs to constantly improve their productivity in order to compete with those that have lower ones. This aspect of competition, aimed at rewarding productivity was one of the goals of the Single European Market program.

However, national systems of labour law and social protection are diversified among the 27 Member States, imposing different indirect labour costs on enterprises, such as the costs of compliance with the agreed standards, and the costs of contributing to social protection schemes. It is thus argued that a significant competitive edge is created in favor of the enterprises stationed in countries adopting lower indirect labour costs compared to those that perform their activity in Member States with higher labour and social standards.

Social dumping poses two conflicting scenarios for the institutional arrangements of formulating and implementing EU labour law and social policy. One scenario envisages the transfer of social policy jurisdiction to the EU level.

Harmonized or uniform social and labour standards throughout the Community, established through EU legal measures, would secure the objective of greater equalization of indirect labour costs for all enterprises, and reduce, if not eliminate, the threat of unequal standards distorting competition in favor of Member States with lower standards. The second scenario reflects the opposite: retention of national competence over social and labour standards, thus accepting social dumping as a consequence of direct competition between different Member State social regimes.<sup>25</sup> Out of the confrontation of these two perspectives a third scenario could also be envisaged: a limited European convergence in specific policy areas, such as information and consultation of workers or employment policies. This is precisely what has been achieved up to this point, considering the currently binding effect of the Charter of Fundamental Rights of the European Union<sup>26</sup> that is referring more to general provisions, as well as the specific European directives that oblige both the enterprises and the Member States to comply with a minimum of labour, health and security standards at work.

As regards the Charter, it contains several fundamental social rights, such as the Freedom of Association in Article 12, the freedom to choose an occupation and the right to engage in work in Article 15, the principle of non-discrimination in Article 21, the worker's right to information and consultation within an undertaking in Article 27, the right of collective bargaining and action in Article 28 and the protection in the event of unjustified dismissal in Article 30, to mention just a few. Nevertheless, the fundamental employment law in the EU is left to the decision of the states as such. Thus, minimum wages, working hours, social legislation comprising the core welfare elements –such as health benefits, housing and public assistance-all emanate from the national governments. The Member States of the European Union are obliged to comply with the agreements of the International Labour Organization which they have ratified. Nonetheless, the agreements do not have direct effect on the

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<sup>25</sup> [http://www.eurofound.europa.eu/social\\_dumping](http://www.eurofound.europa.eu/social_dumping)

<sup>26</sup> [http://www.europarl.europa.eu/Charter\\_of\\_Fundamental\\_Rights\\_of\\_the\\_European\\_Union](http://www.europarl.europa.eu/Charter_of_Fundamental_Rights_of_the_European_Union)

domestic laws of the countries, but they compel the governments to pay regard to these agreements and to translate them into their national law.

A similar type of legislative translation is applied in the case of directives stemming from the European Union. However, their applicability is much more monitored and judicial sanctions might be taken against social stakeholders that do not obey to them.

The original version of the Treaty establishing the European Economic Community dated from March 25<sup>th</sup>, 1957 already included several salient provisions for the labour market, namely the free movement of workers (Art 48 et seq. EEC), the harmonization of the Member States' social security and cooperation in social issues (Art. 117 et seq., Art. 120 et seq. EEC) as well as on equal pay for men and women. (Art. 119 EEC).<sup>27</sup>

Except the provisions stipulated in the Treaties, as we mentioned above, the secondary law is also important in regard with the degree of economic and social convergence in the European Union. In this respect, the regulations and directives adopted by the European decision-making bodies directly impact the national frameworks. We will briefly refer here to some fields such as *health and safety*, *employee protection in layoffs* and to *the employment contract*.

Competition between the states on the basis of health and safety standards in order to lower costs and attract foreign investment is one of the pivotal fears comprised in the social dumping hypothesis: under conditions of economic integration high-cost countries will be obliged to lower their standards in health and safety in order to remain competitive with low-cost countries. The EU legislation has as central focus the regulation of conditions under which any productive activity can take place in order to create minimum standards beyond which competition should not be present. Nonetheless, the call for social harmonization was a challenging one,

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<sup>27</sup> [http://www.ena.luTreaty Establishing European Economic Community](http://www.ena.luTreaty%20Establishing%20European%20Economic%20Community)

even before the Southern Enlargement. Countries with different social welfare systems were asking for or backing different aspects and this was to be even more divergent with the accession of countries such as Spain, Portugal, Italy and Greece, with rather loose social protection schemes compared to the EU founding countries. Thus, shortly before the Single European Act (SEA), one of the most insightful readers on the EU topics characterized the move towards a social legislative framework as being a “joint decision trap” that would prevent effective policy-making.<sup>28</sup> This deadlock was to be the result of unanimous voting rules under which governments could veto any agreement that did not suit their national interest; and the national interests were divergent. Countries with high-levels of social protection wanted to keep it that way, whereas the new-comers were susceptible to adopt new improvements that were simply unsustainable for their economies.

As a result of the SEA in 1986 a new revival was given to the adoption of legislation in the health and safety sphere by the adoption of the QMV (Qualified Majority Voting) as a voting procedure. The Directive 89/391 on health and safety from June 12, 1989<sup>29</sup> established the legislative foundations in this respect in the European countries. The employers are required to assure the workers’ health and safety in the workplace, including the risk prevention, the provision of necessary training, and the accommodation of technical changes. In the same line of reasoning, the Directive 89/655<sup>30</sup> refers to the minimum safety and health requirements for the use of work equipment. Of course, there are several other regulations, and this subchapter does not aim to exhaust them all. The point that the author wants to bring forward is that there is a framework at the European level as regards these health and safety regulations and as long as the Member States oversee their proportional implementation there can be no case to talk about social dumping practices in the above-mentioned field.

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<sup>28</sup> F Scharpf, “The Joint Decision Trap: Lessons from German Federalism and European Integration”, Wissenschaftszentrum, Berlin, 1985 (Discussion Paper).

<sup>29</sup> [http://eur-lex.europa.eu/Directive\\_89/391](http://eur-lex.europa.eu/Directive_89/391)

<sup>30</sup> [http://eur-lex.europa.eu/Directive\\_89/655](http://eur-lex.europa.eu/Directive_89/655)



Moreover, an unanticipated outcome was the coalescing of health and safety regulations at a high level, instead of a feared low one. As it can be seen, in the Framework Directive, the Commission introduced benchmarks from high-standard countries, such as Sweden. The back-up of high-standard states (Denmark), the isolation of resistant Member States (UK, Ireland) and the passivity of the southern ones in the EU committees ensured that these standards became the EU benchmark.<sup>31</sup>

*The employee protection in layoffs* is also part of the legislative acts coming from the supranational bodies. Employers who intend to reduce their workforce for reasons other than worker performance are demanded to follow a process of collaboration with the trade unions and government authority before they may proceed. Moreover, the employer must provide the employee with a necessary amount of information that has to include the reason for the job loss and the criteria for the selection of the affected workers.

The topic of the *employment contract* inside the European Union is much diversified, due to the fact that the employment contract is freely concluded under private law in every Member State. The general rules of the law of contract-such as the consequences of a breach of a duty, compensation for damages, and cancellation of the contract - are applicable to the employment contract unless the labour law includes special rules.

It is worth to be noted that once with the outbreak of the economic crisis the issue of decentralization of wage bargaining from the (inter)sectoral level to the company one through the use of *derogation clauses* became much more wide spread in a number of European countries.<sup>32</sup> Traditionally, the (inter)sectoral bargaining has had the function of homogenizing wages and working conditions for entire national sectors , in this manner taking them out of the cruel competition for survival in the market place. This type of collective bargaining is also reflected at the European

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<sup>31</sup> Ailish Johnson, *European Welfare States and Supranational Governance of Social Policy*, St Antony's College, Oxford, Palgrave Macmillan, 2005, p.58.

<sup>32</sup> The analyzed countries were Austria, Belgium, France, Germany, Ireland, Italy, and Spain.

level, being associated with a corporatist model in which the employer, the employee and the state—in our case the supranational level—agree to set up rules and binding norms for common reference. This is one of the areas where the creation of the Single European Market in its endeavor to harmonize divergent national social and labour systems brought changes and challenged the sovereignty of the Member States governments and of the local actors. However, as we argued before, an inverse trend can be identified in a number of European countries that are decentralizing their bargaining systems in order to be more flexible and competitive. This is the case, for instance in Germany<sup>33</sup>, and we'll argue the same for Romania in the last chapter.

A specific form of decentralization is the possibility that was given to companies, through various derogation clauses (such as opening clauses, hardship clauses, opt-out clauses, inability to pay clauses), to deviate from pay norms already agreed under intersectoral or sectoral agreements, including minimum wages, when they suffer from temporary economic hardship, as it was the case in the last three years. The rationale behind such deviations is that they are perceived as instruments that enable companies to overcome temporary economic downturn without resorting to mass layoffs. This can be a preventive solution for workers from becoming unemployed, for companies to avoid costly layoff procedures and preserve their human capital. However, they are also seen as controversial practices that challenge some of the principles of the collective labour law and the regulatory capacity of collective bargaining at the national and supranational levels. Furthermore, they can lead to wage declines, increased insecurity for workers and an increase in low pay that can have a spillover effect upon the whole Internal Market.

According to the case studies, it was concluded that, particularly in Germany and in Spain, there is a large number of sectoral agreements that enable the wage derogations at company level in times of serious economic difficulties, and, in the case of Germany, also when the problem of competitiveness is being challenged. In

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<sup>33</sup> Maarten Keune, "Derogation clauses on wages in sectoral collective agreements in seven European countries", [www.eurofound.europa.eu](http://www.eurofound.europa.eu)

Belgium, Italy, Austria and Ireland hardly any sectoral agreements comprise such clauses, while in France there are a number of sectoral agreements that explicitly forbid company-level agreements from undercutting sectoral wage standards. These clauses mainly deal with the non-implementation or alternative use of the sectorally agreed wage increases and additional wage elements such as bonuses. Very rarely do they allow the employer to undercut the sectoral minimum wages, although it is possible in Ireland with the inability-to-pay clauses and also in a number of German agreements.

As for the opinion of social partners, the issue of wage derogation clauses was suggested first by employers. For them, wage flexibility and the indirect wage costs are decisive elements for their survival and profitability in a competitive global economy, and especially in times of economic downturn. Wage derogation clauses also inscribe themselves in the broader attempts by many employer organizations to promote a more generalized decentralization of collective bargaining.<sup>34</sup> However, in some countries such as Austria, Belgium or Italy employer organizations hardly question the main features of existing bargaining systems with which they seem rather satisfied.

Moreover, in a number of cases the national governments also played an important role in the promotion of a decentralization process as regards the collective bargaining. In Germany for instance, the country with the greatest number of open-clause derogations, the various governments of the last decade, as well as the major political parties, have strongly supported this type of decentralization in general and the use of opening clauses in particular. The collective bargaining is a core element for the European social actors. Converging in this respect has been the long-term focus of the supranational decision-making bodies. Nevertheless, as we briefly pointed out before, different ways of doing business are preserved inside the Internal Market. The question that is being raised is, are we to keep a limited convergence model or are we to move further with a deeper harmonization, and if this is the case

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<sup>34</sup> *Ibidem*

what should be the model to be emulated? For the time being, what can be assessed is the fact that a status-quo is being kept and this type of debate is treated with delicacy.

Almost at the opposite spectrum of the approach, trade unions are the social actors who oppose the employer organizations wish for extensive decentralization and derogations from higher-level wage agreements. Their concerns are based on the potential weakening of the worker protection, an increase of wage competition and the downgrading of their collective bargaining power. However, in the case of specific companies that find themselves in serious financial situation, trade unions are often ready to negotiate on measures to maintain employment, even if these might include a temporary undercut of higher-level wage standards. The weight of the trade unions assures an effective check and balances system, due to their traditional concern over the fragmentation of the industrial relations, the increased diversity and inequality concerning working conditions, declining solidarity and downwards wage competition. In Germany, this system is even more questioned, as the trade unions got weaker and weaker in the last decade, once with the increased transfer of the bargaining responsibilities to the company level. In conclusion, the strategy of the trade unions at European level has been characterized as dictated by a “*political-distributive*” logic. This admitted the dangers posed by social dumping in the single market, but also acknowledged the advantages to be reaped by enterprises free to compete without national hindrance. The aim was to achieve a balance between the costs of the social protection necessary to offset the risk of social dumping, and the losses to enterprises created by this necessary degree of regulation.<sup>35</sup>

On the other side, the strategy of employer organizations has been characterized as dictated by an ‘*economic-productive*’ logic. The social dimension of the single market was the achievement of maximum productive and competitive efficiency given the fact that for firms in the European Community, the principal competitive challenge came from outside the EC – mainly from the USA and Japan

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<sup>35</sup> [http://www.eurofound.europa.eu/The Single European Market](http://www.eurofound.europa.eu/The_Single_European_Market)

where there were lower social and labour standards. The social policy of the EC in the new Single European Market should, therefore, aim at reducing this competitive advantage by eliminating those social and labour regulations which were such a burden on the European enterprises.

A special category that is for interest in our study regarding the social dumping is that of the *posted workers* and their subsequent employment contract. The free movement of workers is one of the fundamental freedoms guaranteed by the Treaty of the European Union. An employee becomes a “posted worker” when he is employed in one EU Member State but sent by his employer on a temporary basis to carry out his work in another Member State. For example, a service provider may win a contract in another country and send his employees there to carry out the contract. This trans-national provision of services, where employees are sent to work in a Member State other than the one they usually work in, gives rise to a distinctive category, namely that of "posted workers". This category does not include migrant workers that go to another Member State to seek work and are employed there.<sup>36</sup> The European Community Law established a core of mandatory rules regarding the terms and conditions of employment to be applied in the case of posted workers. The idea behind it was the fear of social dumping where foreign service providers could undercut the local ones, because their labour standards are lower. These rules that were agreed upon at the supranational level reflect the standards of local workers in the host Member State.

The Posting of Workers Directive<sup>37</sup> sets the guidelines in tackling this important aspect of the Internal Market, which raises ongoing concerns among the European businesses. A wide range of issues such as maximum work periods and minimum rest periods, minimum paid annual leave, equal treatment and the conditions of hiring out workers, in particular the supply of workers by temporary

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<sup>36</sup> European Commission, Employment, Social Affairs and Inclusion, <http://ec.europa.eu/postedworkers>

<sup>37</sup> [http://eur-lex.europa.eu/Directive\\_96/71/EC](http://eur-lex.europa.eu/Directive_96/71/EC)

employment undertakings are all regulated. The legislation also tackles issues such as health and safety at work and includes protective measures in the terms and conditions of employment of pregnant women, of children and of young people.

The questions regarding the derogation clauses and those related to the posted workers might very well have a point in the debate referring to the social dumping inside the Single European Market. As we have tackled it above, the former goes hand in hand with a reduction in the social fringe benefits and thus with a potential labour cost dumping (explained in the first chapter), while the latter one refers mainly to the labour standards.

### ***2.1.2. The challenge of divergent welfare systems***

Further challenges for the Internal Market also arise from the different social national systems, which in some European countries have a long tradition, becoming part of the national specificity. Both social security framework, sometimes referred to as the social insurance field (benefit provisions during illness, unemployment, time off due to accidents in the workplace, and old age) and the social regulation (concerning occupational health and safety and other working conditions) are subsets of the social policy. The social security framework is of great importance for our study, as all the benefits that it comprises are built up by the individual during time in employment and is not to be equalized with the social assistance that refers to grants made on the basis of a means test, and includes minimum incomes provided to the long-term unemployed, the disabled and the elderly who may not have worked, or whose social-insurance-provided pension is insufficient. As it has been explained in the first chapter, *welfare dumping is not social dumping*, thus we do exclude from the equation the social assistance aspect. As regards the other two- the social regulation and the social security, even if they fall on the category of the provisions of the welfare state they can be perceived as causes for social dumping, if the government promotes or tacitly agrees on a lax regulation in these domains. In the framework of the European debate they are quite often perceived as that by the social actors coming

from developed welfare states. In order to understand this debate, a brief introduction will be provided to the reader regarding the different types of welfare systems in Europe.

The concept of “welfare state” emerged after World War II, and it was employed in order to describe the complex of social policies enacted under the Labour Government in Great Britain after 1945. From Britain, “the phrase made its way round the world”.<sup>38</sup> The welfare state has a distinct institutional structure for the administration of social policy, and to correlate it with a Weberian terminology it is reflected by an extended and institutionalized bureaucratic authority. “The welfare state might be conceived as a very advanced and developed state apparatus, functioning in a political space that recognized its legitimacy, and in an economic space that provided the means of paying for its outputs.”<sup>39</sup> Again, the problem of resources is being brought into the overall picture when we speak about the existence of the welfare state. Harold Wilensky theorized the fact that such a state would only emerge and expand in tandem with economic development which makes of the latter a precondition for any successful and sustainable implementation of advanced social policies.

While welfare state regimes models give us the general picture of comparing Member States, the policies examined in detail in this paper –health and safety, European social dialogue, wages and employment–could be more specifically perceived as policies relating to the labour market. The interaction between the welfare state and the labour market is however incredibly close and intricate. Policies regulating the labour market are described as social regulation, being the interface between welfare policies legislated and/or provided by the state (health and safety legislation, worker training )and the organization of labour as part of the capitalist

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<sup>38</sup> A. Briggs, “ The Welfare State in Historical Perspective”, *European Journal of Sociology* 2, 1961,p.221, quoted from Ailish Johnson, op.cit., p. 5.

<sup>39</sup> Ailish Johnson, *Ibidem*, p.5.

system of production (working time, worker information, and consultation).<sup>40</sup> What makes from the social regulation field a potential case of government driven social dumping is the fact that the labour market policies comprised under the name of social regulation *involve legislation by governments to improve social welfare but do not require large-scale fiscal transfers to the level of the individual.*

Welfare state regimes types, as identified by Gosta Esping- Andersen and others, display four models of welfare states: liberal, conservative-corporatist, social-democratic, and southern. Each EU Member State may be described as resembling one of the above-mentioned types: Germany, Belgium, France, the Netherlands, Luxembourg and Austria are conservative-corporatist, the UK and Ireland are liberal, Sweden, Denmark and Finland are social-democratic, and Greece, Spain, Italy and Portugal are of the southern welfare state regime. Esping Andersen's work also explains why it is hard to have a convergence for the EU social policy, given such diversity of welfare constructs. Countries with social-democratic and conservative-corporatist welfare states regimes have social and labour market policies that provide the citizens with a wide range of benefits. When it comes to draw a binding European social legislation, they perceive themselves as the leaders in such an action, expecting the other Member States to emulate them. If such policies were to be adopted across the EU, they would no longer represent a competitive disadvantage in the cost of locating production and hiring labour force in the region.

Concomitantly, countries with liberal and southern welfare state regimes that provide fewer services at a lower level of benefit do not want to see their competitive advantage disappear. Moreover, under constraints stemming from the European Monetary Union (EMU), and from the Stability and Growth Pact, Member- States with less developed welfare systems find themselves in the impossibility to expand their spending, if they are not being helped by the EU, which would mean a costly equalization program. Thus countries such as Great Britain, Spain or Greece are

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<sup>40</sup> *Ibidem*, p.7.



expected to resist EU-level cooperation in the social policy field. In addition, the Southern Member States and also the new comers- Bulgaria and Romania also possess weaker administrative cultures, less capable of both raising taxes and funds to pay for expanded social services and their implementation , which would suggest additional resistance to supranational decision-making. In fact, this analysis that takes as criteria the national welfare state histories, the social dumping hypothesis or the preservation of competitive advantage appears to be flawed if we are to consider the reactions of states such as Greece, Spain and in the last post-accession Romania that do not resist supranational convergence measures in the field of social policy, but who become “passive” instead in their adoption. The explanation is rooted in the existence of the EU incentives, including funding, which makes the states to agree to cooperate at the EU level despite their relative lagging.

Member States with a low level of social policy provision also have adjacent grounds for cooperation: the need for the improvement of domestic policy, the desire to catch-up with the more advanced European state partners, and the hand-tying provided by the EU. Thus, the supranational governance is considered to have the greatest impact on states where national policy histories are underdeveloped. Nonetheless, where these states agree with the supranational legislation, their capacity to implement these EU outputs is curtailed by their low level of domestic institutional development. Uneven implementation creates in this manner a doubtful victory for the efficiency of the European policy-making and it endangers the process of constructing a common European social model.

In order to achieve some kind of convergence in the field of social policy, the European Union has adopted an interesting and in the same time intriguing approach known by the name of the “Open Method of Coordination” (OMC).

OMC is related to yardstick competition. (Schleifer, 1985). Yardstick competition is a method to overcome the information problems or the monitoring restrictions of the authority (here the European Commission). It rests on comparative welfare evaluation. Accordingly, each national government would exert more effort in order to enhance their performance relative to their neighbors. The discipline effect of comparative performance evaluation is expected to generate a sort of “yardstick competition” among national governments, with politicians mimicking the behavior of nearby governments.

“It is a process where explicit, clear and mutually agreed objectives are defined, after which peer review enables Member States to examine and learn from the best practice in Europe. Commonly agreed upon indicators allow each Member State to find out where it stands, the exchange of information being designed with the aim of institutionalizing policy mimicking”.<sup>41</sup>

The European Employment Strategy (EES), which is but one variation of the OMC, proves that harmonization is not the goal. Rather, a common strategy aids and bolsters national-level reforms and creates a process of ongoing learning and improving in which even the most advanced Member States have their assumptions and policies put to the test.

## **2.2. Income poverty and income inequality within the EU**

This subchapter aims at focusing on the financial dimension of poverty and inequality. The income is an important macroeconomic indicator, as well as a decisive variable for Europe’s households. People are naturally concerned with how much they

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<sup>41</sup> Mathieu Lefebvre, Tim Coelli, Pierre Pestieau, “On the Convergence of Social Protection Performance in the European Union”, *CESifo Economic Studies*, Vol. 56, 2/2010, Oxford University Press

receive each month, be that from employment or self-employment or from state transfers- pensions, unemployment benefits, family benefits or sick pay. By examining the distribution of income inside the EU-27 we could draw a conclusion upon the income differences existing inside and across the countries, an aspect that helps the reader to further clarify the potential allegation of social dumping. Particular attention attaches to those households which, according to the EU definition, are “at-risk-of-poverty”, this being one of the three indicators that form the EU Headline Target on social inclusion in the context of the Europe 2020 Agenda.<sup>42</sup>

The following table reflects the national at-risk-of-poverty thresholds in the EU-27. To make the data more comparable, because the cost of living can vary greatly from one country to the next, these thresholds are expressed in Purchasing Power Standards.<sup>43</sup>

**Table 2.1:** National at-risk-of-poverty thresholds for a household consisting of 2 adults and 2 children below 14 in EU-27 countries (PPS), Survey Year 2008<sup>44</sup>

Belgium	21 307
Bulgaria	5 882
Czech Republic	12 239
Denmark	22 111
Germany	22 317
Estonia	9 769
Ireland	22 993
Greece	15 223
Spain	17 621
France	20 441

<sup>42</sup> The EU headline indicator of (income) poverty/inequality is the proportion of the population living “at-risk-of-poverty”, defined as those living in households whose total equivalised income is below 60 per cent of the median national equivalised household income; it is thus a relative concept.

<sup>43</sup> On the basis of Purchasing Power Parities (PPP), Purchasing Power Standards (PPS) convert amounts expressed in a national currency to an artificial common currency that equalizes the purchasing power of different national currencies (including those countries that share a common currency).

<sup>44</sup> Anthony B. Atkinson, Eric Marlier, Fabienne Montaigne, Anne Reinstadler, “Income poverty and income inequality”, *Income and Living Conditions in Europe*, Eurostat, 2010.

Italy	18 969
Cyprus	23 804
Latvia	9 246
Lithuania	8 812
Luxembourg	34 661
Hungary	8 385
Malta	15 924
Netherlands	23 759
Austria	23 621
Poland	8 222
Portugal	12 113
<b>Romania</b>	<b>4 005</b>
Slovenia	17 630
Slovakia	8 484
Finland	20 227
Sweden	21 792
United Kingdom	24 436

Reading note: in Romania, a family of 2 adults and 2 children below 14 will be considered “at-risk-of-poverty” if it has a total disposable income of less than PPS 4 005; in Denmark, the same family will be considered “at-risk-of-poverty” if it has a total disposable income of less than PPS 22 111.

As it can be deduced from the above table the cross-country differences become striking if we are to compare the EU founding states, or the Northern ones with the last admitted -Romania and Bulgaria. However, this proves nothing else that these states find themselves at different stages of economic development, being characterized by different welfare systems, where the government transfers depend largely on the availability of resources. Moreover, a catch-up process can be perceived as a deliberate practice inside the EU, considering the fact that as of 2007

(the year of Romania's admission to the EU) the annual increase in the minimum wage was of 18%-based on the euro and of 10% based on PPS.<sup>45</sup>

A GDP/capita in PPS would be revealing in order to draw a cross-country comparison and also to observe potential improvements after the EU accession (note: especially for Romania and Bulgaria).

**Table 2.2** GDP per capita in Purchasing Power Standards (PPS) (EU-27=100)<sup>46</sup>

Geo/time	2004	2005	2006	2007	2008	2009
European Union (27 countries)	100	100	100	100	100	100
European Union (25 countries)	104	104	104	104	103	103
Belgium	121	120	118	116	115	116
Bulgaria	35	37	38	40	44	44
Czech Republic	75	76	77	80	80	82
Denmark	126	124	124	123	123	121
Germany	116	117	116	116	116	116
Estonia	57	62	66	69	68	64
Ireland	142	144	145	147	133	127
Greece	94	91	93	92	94	94

<sup>45</sup> Pierre Regnard, *Ibidem*

<sup>46</sup> Gross domestic product (GDP) is a measure for the economic activity. It is defined as the value of all goods and services produced less the value of any goods or services used in their creation. The volume index of GDP per capita in Purchasing Power Standards (PPS) is expressed in relation to the European Union (EU-27) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP per head is higher than the EU average and vice versa. Basic figures are expressed in PPS, i.e. a common currency that eliminates the differences in price levels between countries allowing meaningful volume comparisons of GDP between countries. Please note that the index, calculated from PPS figures and expressed with respect to EU27 = 100, is intended for cross-country comparisons rather than for temporal comparisons.

Spain	101	102	104	105	103	103
France	110	111	109	108	107	108
Italy	107	105	104	104	104	104
Cyprus	90	91	91	93	97	98
Latvia	46	49	52	56	56	52
Lithuania	50	53	55	59	61	55
Luxembourg	253	254	270	275	279	271
Hungary	63	63	63	62	64	65
Malta	77	78	76	76	79	81
Netherlands	129	131	131	132	134	131
Austria	127	124	125	123	124	124
Poland	51	51	52	54	56	61
Portugal	77	79	79	79	78	80
Romania	<b>34</b>	<b>35</b>	<b>38</b>	<b>42</b>	<b>47</b>	<b>46</b>
Slovenia	86	87	88	88	91	88
Slovakia	57	60	63	68	72	73
Finland	116	114	114	117	118	113
Sweden	126	122	123	125	123	119
United Kingdom	124	122	120	116	115	112

Source: Eurostat

Nevertheless, it remains worrisome the fact that in certain EU Members the rate of national at-risk-of-poverty is as high as 25.6 per cent (in Latvia) and 23.4 per cent in Romania (again, with a total disposable income of 4 005 PPS). This goes hand in hand with the above-presented table that reveals the striking difference between the income of a person living in Denmark or Great Britain and one living in Romania, Bulgaria or Latvia.

This is somehow connected to the “working poor” concept, which represents a section of the population that is difficult to define, not only due to a lack of specific data, but also because the terminology combines two levels of analysis: the working

status of individuals and the wages they earn from employment (individual level) and the extent to which they have a poverty-level of income within the household context (collective level).<sup>47</sup> For the purpose of research, the “working-poor” category is defined in the same way as the indicator used by the European Commission to assess and monitor in-work poverty. In this respect, the working-poor are those who are employed and whose disposable income puts them at the risk of poverty. The intricacy of establishing the threshold for the risk of poverty comes also from the measurement of the income. Thus, this one is assessed in relation to the household in which a person lives and covers the income of all the household members, which is shared equally among them after being adjusted for household size and composition. Accordingly, if persons are at risk of poverty, this may not be simply because they have low wages but because their wages are not sufficient to maintain the income of the household in which they live. Equally, a person can earn a very low wage but not be at risk of poverty because the income of other household members is sufficient to raise the overall household income above the poverty threshold.<sup>48</sup>

As an important finding, the EU-SILC data shows that, in 2007, the at-risk-of-poverty rate for employed persons in Romania stood at 4%, compared with the average for the 27 EU Member States of 8%. This might bear a double analysis: on the one hand is another proof that it is far-fetched to speak about social-dumping, 4 being a rather low percentage, especially compared to the EU average; secondly it is of course, harder to pay a monthly income of 1 254 Euro (France, 2007-minimum wage) than one of 114 Euro (Romania, the same year).

Getting closer to our case study, that has as aim the tackling of the social dumping allegation in Romania, in 2008, the minimum wage in this country stood at 10-20% of the equivalent salary in the original 15 EU Member States, while consumer prices stood at over 50% of the average consumer prices for the EU15. Put

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<sup>47</sup> Constantin Ciutacu, “Working poor in Europe-Romania”, Institute of National Economy, Romanian Academy, April, 2010.

<sup>48</sup> *Ibidem*

in other words, in Romania, for a gross minimum wage that is five to ten times lower, one may buy consumer products and services that are only approximately 50% cheaper.

According to the statistics, the number of those who receive the minimum national wage (around 160 euro/month), goes up to 15% of the 4.5 million employees. These people can be considered part of the working poor population. Labour force in Romania is cheap, especially in sectors such as industry, textiles or construction. This should be perceived as a competitive advantage and not as social dumping. One argument in supporting this statement would be that, despite of this low-income, employers do pay increased attention to the working conditions, assuring for their employees adequate standards of health and security.

To this juncture, we have focused on the income poverty. What is the overall extent of inequality? The two main indicators used at the European level are the S80/S20 ratio and the Gini coefficient. In order to ease the evaluation, we will consider just the latter one.

The **Gini coefficient** is a standard economic measure of income inequality, based on Lorenz curve. A society that scores 0 on the Gini scale has perfect equality in income distribution. Higher the number over 0 higher the inequality, and the score of 1.0 (or 100) indicates total inequality where only one person corners all the income. It is used also as a measure of other distributional inequalities such as market share. Named after its inventor, the Italian statistician Corrado Gini (1884-1965). Also called Gini coefficient or index of concentration.

Source: [http://www.businessdictionary.com-Gini\\_index](http://www.businessdictionary.com-Gini_index)

The Gini coefficients vary a lot across countries, from 22, 7 per cent in Slovenia to 37, 4 per cent in Latvia. For the EU-27 as a whole, the average value is 30, 4 per



cent. In Romania the index amounts to 34, 9, becoming higher once with the EU accession.

**Table 2.3** Gini coefficient within the EU<sup>49</sup>

Geo/Time	2003	2004	2005	2006	2007	2008	2009
European Union (27 countries)			30,6	30,2	30,6	30,7	30,4
Belgium	28,3	26,1	28	27,8	26,3	27,5	26,4
Bulgaria	24	26	25	31,2	35,3	35,9	33,4
Czech Republic			26	25,3	25,3	24,7	25,1
Denmark	24,8	23,9	23,9	23,7	25,2	25,1	27
Germany			26,1	26,8	30,4	30,2	29,1
Estonia	34	37,4	34,1	33,1	33,4	30,9	31,4
Ireland	30,6	31,5	31,9	31,9	31,3	29,9	28,8
Greece	34,7	33	33,2	34,3	34,3	33,4	33,1
Spain	31	30,7	31,8	31,2	31,3	31,3	32,3
France	27	28,2	27,7	27,3	26,6	29,2	29,8
Italy		33,2	32,8	32,1	32,3	31	31,5
Cyprus	27		28,7	28,8	29,8	28	28,4
Latvia			36,1	39,2	35,4	37,7	37,4
Lithuania			36,3	35	33,8	34	35,5
Luxembourg	27,6	26,5	26,5	27,8	27,4	27,7	29,2
Hungary	27		27,6	33,3	25,6	25,2	24,7
Malta			26,9	27,3	25,7	26,9	27,8
Netherlands	27		26,9	26,4	27,6	27,6	27,2

<sup>49</sup> Extracted on 19 April 2011; the table is partially reproduced

<b>Austria</b>	27,4	25,8	26,2	25,3	26,2	26,2	25,7
<b>Poland</b>			35,6	33,3	32,2	32	31,4
<b>Portugal</b>		37,8	38,1	37,7	36,8	35,8	35,4
<b>Romania</b>	<b>30</b>	<b>31</b>	<b>31</b>	<b>33</b>	<b>37,8</b>	<b>36</b>	<b>34,9</b>
<b>Slovenia</b>	22		23,8	23,7	23,2	23,4	22,7
<b>Slovakia</b>			26,2	28,1	24,5	23,7	24,8
<b>Finland</b>	26	25,5	26	25,9	26,2	26,4	25,9
<b>Sweden</b>		23	23,4	24	23,4	24	24,8
<b>United Kingdom</b>	34		34,6	32,5	32,8	33,9	32,4

*Source: Eurostat*

The income inequality tends to be addressed simultaneously with the income poverty, a reduction in the latter one influencing positively the former one. However, these cannot be considered *ceteris paribus* cases, for the simple fact that political factors shape the macroeconomic arena, thus social redistribution or economic advantages granted to certain groups rest upon the government's driven policy.

In the next subchapter the authors of this paper aim at focusing on the tendency of the European Court of Justice to rule on the allegations of social dumping inside the Internal Market, creating thus a precedent that sets the benchmarks for the national courts of each Member State.

### **2.3. The ruling of the European Court of Justice in social dumping matters**

In the previous section we have shown that there are large differences within the EU in the composition of labour costs and labour market regulations which might open the path for potential social dumping practices, if no regulatory body is there to oversee the economic activity. Within this framework three rulings of the European

Court of Justice (ECJ) are of extreme importance for the current and future setting of the market relations inside the EU, as well as for the efficiency of the community method in creating judicial precedents.

The purpose of this subchapter is to highlight the tendency of the ECJ in deciding upon the allegation of social dumping practices, thus we will briefly present **The Laval Case-Latvia 2008**<sup>50</sup>, even if two other cases-**The Viking Case-Finland 2007**<sup>51</sup> and **The Ruffert Case-Germany 2008**<sup>52</sup> are very important as well.

On 18 December 2008 the ECJ in the Laval case ruled out that the right to industrial action can sometimes be justified under EU law to protect against social dumping. Nevertheless, the Court also pointed out that “the exercise of that right may be subject to certain restrictions”. The Laval case has its roots in a Latvian company, *Laval un Parteneri* which was awarded a public bid in Sweden to renovate a school. Workers from Latvia were brought thus to work in Sweden. The employees were hired to work through a subsidiary of Laval and negotiations began between this company and the Swedish building and public works trade union. However, these negotiations could not be concluded, and Laval subsequently signed collective agreements with the Latvian building sector trade union, to which 65 per cent of the posted workers were affiliated. The Swedish trade union took collective action and blocked all Laval sites in Sweden. Laval brought proceedings to the Swedish court for a declaration confirming the action of the Swedish trade union as unlawful in that it conflicted with rights established under Art 49 EC (now Article 56 of the Treaty on the Functioning of the European Union –TFEU). The Laval case went to the ECJ along with the interrogation on the freedom to provide cross-border services. The principle of the freedom to provide services enables an economic operator providing services in one Member State to offer services on a temporary basis in another Member State, without having to be established. Furthermore, these Treaty provisions

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<sup>50</sup> <http://eur-lex.europa.eu/the Laval case-PDF>

<sup>51</sup> <http://www.eurofound.europa.eu/The Viking Case>

<sup>52</sup> <http://www.eurofound.europa.eu/ The Ruffert Case>

have direct effect so that Member States must modify national laws that restrict this freedom or otherwise is not compatible with the Treaty's principles.<sup>53</sup>

Directive 96/71<sup>54</sup> on posted workers sets out minimum standards that must apply in the case of workers posted from one Member State to perform activities in another. Article 3 of the directive states that Member States should ensure that terms and conditions established by law, or by universally applicable collective agreements, apply to posted workers, in particular in relation to minimum work periods, breaks, annual holidays and rates of pay.

The decision of the ECJ held that the right to take collective action has to be recognized as a fundamental right in the industrial relation. Additionally, the right to take such action against possible social dumping may constitute an overriding reason of public interest. Nevertheless, that does not mean that the Community law is absent from such a ruling. The ECJ noted that industrial action aimed at obtaining terms and conditions which went beyond the minimum established by law made it less attractive for undertakings such as Laval to carry out its business in the Member State and therefore constituted a restriction on the freedom to provide services, guaranteed under the Treaty. The ECJ noted that while Article 3 of the posted workers' directive gave a right to minimum terms and conditions to posted workers, these rights had to have been underpinned either by law or universally applicable collective agreements. In Sweden, there was no statutory minimum wage nor were collective agreements universally applicable. Thus, industrial action to impose terms, in the absence of legally enforceable national provisions, could not be justified under EU law. The court went further than this. It also held that failure to take account of the collective agreement reached between the employer and the Latvian trade union amounted to discrimination against both organizations, given that action to ensure that terms and

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<sup>53</sup> [http://www.eurofound.europa.eu/The Laval case](http://www.eurofound.europa.eu/The_Laval_case)

<sup>54</sup> [http://eur-lex.europa.eu/Directive 96/71](http://eur-lex.europa.eu/Directive_96/71)

conditions were in line with those generally applicable in Sweden did not amount to a public policy, security or health requirement.

As these cases prove, the project of creating a European labour market is quite divergent from the goals associated with national labour market regulation, where the employment protection and the industrial relations are the primary concerns. Labour, and even more-social matters were relatively marginal to the original objectives of the European Economic Community and even for the convergence criteria established by the Maastricht Treaty and designed by a monetarist approach. In terms of their content, the development of labour market regulations during half a century of EU existence has been spasmodic, episodic and unsystematic. Nonetheless, the Community method, where the ECJ overrides the national courts shows again the degree of sovereignty that MS had to give up and the difficulties that might arise of a ruling that is irrespective of the national interest.

It should be also remembered that soon after their EU integration, the welfare arrangements of Greece and Spain led to social dumping allegations.<sup>55</sup> This came in a context where no European Social Model existed (from this point of view no major evolution can be seen nowadays), thus no adequate benchmark in assessing *rudimentary* social systems. Distancing themselves from the Western European rhetoric, researchers like Guilléen and Matsaganis argue that

“<catching up > strategies constituted the common denominator of welfare policies in both [countries], while reforms more often sought to fill coverage gaps and to reduce internal inequalities than to reduce deficits. In any case, as the evidence presented in previous sections shows, both countries quite unambiguously rejected the notion that low labour costs and low standards of social protection might be helpful in a strategy of competitiveness. On the contrary, <convergence with Europe> in terms of income as well as social protection

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<sup>55</sup> Ana M. Guilléen, Manos Matsaganis, “Testing the <social dumping> hypothesis in Southern Europe: welfare policies in Greece and Spain during the last 20 years”, *Journal of European Social Policy*, Vol. 10 (2), SAGE Publications, 2000.

became something of an overriding aim elevated to a national ideal, shared to a large extent by governments and oppositions alike”.<sup>56</sup>

Looking back now, it can be argued that the Southern European welfare states did not fully converge with those prevailing in the continent’s northern countries, but the gap that divided them in the past has closed considerably. Further social convergence appears to be contingent on economic convergence. Nevertheless, as it has been tackled in the first chapter, welfare dumping is not social dumping, even if both have as catalyst the state.

The challenges facing southern European welfare states are now resented by the last European Union Members-Romania and Bulgaria. They are of a more “qualitative” nature bearing on the construction of a set of institutions in tune with democratic values, sensitive, responsive and accountable to a check and balances system.

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<sup>56</sup> *Ibidem*

## CHAPTER III

### The hypothesis of social dumping in Romania

#### Summary

*The allegation of social dumping in Romania became a core problem once with the accession of the country to the European Union. Joining the Internal Market meant that the four freedoms were assured for its citizens, this occurring without an advanced economic and social convergence. In this respect, the labour costs are much cheaper than in the other European Member States, fact that raises the question of social dumping for the foreign competitors whose only advantage remains a continuous increase in productivity. The purpose of this chapter is to check the validity of the social dumping hypothesis in Romania, and to propose to the reader another interpretation for the current industrial relations-that of competitive advantage.*

#### Résumé

*Dès l'adhésion de la Roumanie à l'Union Européenne l'hypothèse du dumping social occupe une place centrale dans les discussions entre les partenaires européens. Même hors d'une convergence économique et sociale, l'appartenance à ce Marché Commun a entraîné l'application des quatre libertés fondamentales inscrites dans le Traité de Rome. Cela pose des problèmes pour les entreprises étrangères car les coûts du travail en Roumanie sont moins chers que dans les autres pays européens, alors le seul avantage de ceux-ci est d'accroître sans cesse leur productivité. Le but de ce chapitre est de vérifier l'hypothèse du dumping social et en*

*même temps de proposer au lecteur une autre interprétation-celle de l'avantage compétitif.*

### **Key words**

*acquis communautaire, Labour Code, macroeconomic indicators, post-1990 Romania*

### **3.1. Post-1989 Romania: critical reflections**

Despite many shortcomings, until 1989 there was a pretty much coherent and universal system of welfare policy in Romania. The old social-welfare contract, between the party-state apparatus, the Communist nomenklatura, and the people, consisted of the provision of highly subsidized prices on food, housing, transport and basic necessities, guaranteed employment, a not very efficient health system and education in conformity with the party ideology, and small differentials between the wages of workers, professionals and managers, in return for political stability.<sup>57</sup> Hidden privileges existed of course, but the important point was that they were hidden from the eyes of the masses, for the simple fact that they breached the essential communist contract.

During the 1990s, at different pace and conviction, the East European countries and, more slowly, those that once formed the USSR were trying to replace their centralized, command economies and their one-party political systems with economies run by the rules of market and by an institutional framework that provided for a degree of democracy. This had an immediate, and quite often, a dramatic impact upon the social conditions across the region. The rates of unemployment amounted, or where made explicit (previously any form of unemployment had been hidden); inflation eroded living standards that were already low; previously inefficient

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<sup>57</sup> Bob Deacon, "Eastern European welfare state: the impact of the politics of globalization", *Journal of European Social Policy*, Vol.10 (2): 146-161, SAGE Publications, 2000.



medical-care establishments were unable to operate in the new cost-accounting frameworks imposed upon them, and some closed.<sup>58</sup>

The above-presented state of affairs characterized Romania too, in the 1990s. The political spectrum, organized by former Communist nomenklatura was paralleled by the economic instability where two major government decisions had and still have far reaching consequences: the privatization of state-owned companies and the re-allocation of land to their former owners, given the nationalization wave practiced during Communism. In a state where the system of checks and balances has been rather primitive, these two processes lacked transparency and were quite often cited in the national newspapers as the source of overnight welfares for the high-level dignitaries.

More than 20 years after the demise of the Communist rule, Romania is still a country in transition, word used rather as a shield against the harsh accusations coming from the foreign partners who argue that Romania is quite a corrupt country with a significant informal economy (the government employs the word “transition” as an excuse for the poor state of affairs). It’s not a shame to be a country in transition, even if this takes more than 20 years, seems to be the rhetoric of the succeeding governments, be that socialist, liberal or liberal-democrat.

Despite this complacent situation, in 1999 Romania was granted “candidate country” statute by the European Union. By 2000 the EU and NATO perspective, as Alina Mungiu- Pippidi , a leading Romanian analyst argues, had become the most credible promises of a stable and prosperous future, guarantees for a political change backed up by the external conditionality, necessary for a society where powerful people still bypassed the law.

Romania’s accession to the EU has to be seen in close connection with the country’s acceptance as a NATO member in 2004. Despite the fact that NATO membership does not mirror the EU one (there are NATO countries that are not EU

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<sup>58</sup> *Ibidem*

Member States and vice versa) , important key players like France, Germany or Great Britain were already part of both structures, their tendency being to see geostrategic actors also as close economic partners, these interdependencies strengthening both organizations. Moreover, the period of economic growth that characterized the years 2003-2007 was also an exogenous factor in the decision to integrate less-developed states like Romania and Bulgaria, a time when the other Member States granted themselves the possibility to close earlier chapters from the *acquis communautaire* on *bona fides* grounds. The author of this paperwork doubts that this would be the case after 2007, once with the economic meltdown and the awareness of the Bruxelles leaders concerning the effective implementation of the Copenhagen convergence criteria. In fact, the 2003 Council decision regarding the Accession Partnership with Romania<sup>59</sup> clearly identifies the principles and the priorities of the state's admission, pinpointing also to the areas where the government has to further strive in order to meet the demands. Community assistance for financing projects through the three preaccession instruments Phare, ISPA and Sapard (all of them for cohesion purposes) was conditional on respect by Romania of its commitments under the Europe Agreement and further steps towards satisfying the Copenhagen criteria. The Accession Partnership also mentioned the *monitoring function* of the European Commission, function that was rather neglected between 2003-2006, and revived just in the last moments before the 2007 membership, when Brussels tried to impose its leverage by all the available instruments. The 2006 Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania<sup>60</sup> it's a comprehensive document in this respect. In the case of Romania, the emphasis continued to be on the reform of the justice system, fight against corruption and the taxation system.

“ A consistent interpretation and application of the law at all levels of courts throughout the country has not yet been fully ensured .Five of the fourteen elected Superior Council of the Magistracy (CSM) members continue to face a potential conflict of interest in inspection

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<sup>59</sup> [http://eur-lex.europa.eu/the\\_2003\\_Accession\\_Partnership\\_with\\_Romania](http://eur-lex.europa.eu/the_2003_Accession_Partnership_with_Romania)

<sup>60</sup> [http://ec.europa.eu/enlargement/Communication\\_from\\_the\\_Commission](http://ec.europa.eu/enlargement/Communication_from_the_Commission)

matters as they hold leading position in courts or prosecution offices. [...] No steps have yet been taken to address the Public Ministry's serious managerial shortcomings such as the very uneven distribution of workloads, lack of relevant ongoing training and inability to collect statistics.[...] There are still cases of institutional violence against and assaulting of Roma, such as police raids and evictions in Roma communities, without proving them with alternative accommodation. Generally, the level of awareness of the Roma situation and of the government strategy for Roma, especially in the local communities which are responsible for the evictions, is low. [...] The operational capacity of the National Agency for Fiscal Administration, whilst increasing slowly, is still in need of significant improvement. Its collection and control capacity remain weak, and whilst the tax collection rate as a percentage of GDP has improved slightly the actual results of the recent actions are mixed. For instance, much of the increase in VAT collection can be attributed to a higher collection rate at import. Romania needs to sustain and further its efforts to ensure an adequate level of tax compliance and collection, in order to improve the administrative capacity of its tax administration if it is to complete preparation in this area.”<sup>61</sup>

These are some excerpts taken from the May 2006 Monitoring Report that refer to the justice chapter, respect and inclusion of minorities and also to the informal economy (that prevents an efficient collection of the taxes). Of course, all these shortcomings could not have been solved out before January 2007, thus the *bona fides* principle was applied.

What is worrisome is the fact that in the current Romanian society the same challenges have to be addressed, 5 years after the accession. The lack of uniform interpretation of the law throughout the country and the ongoing problems with the property restitution and the government misconduct, turn Romania in the third state that is being sued by individuals at the European Court of Human Rights (after Russia and Turkey). As regards the Roma integration, the subject was so much embraced by the European media, that no further argumentation is needed.

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<sup>61</sup> *Ibidem*

The informal economy, with which so many countries in their transition process are being associated, poses further problems for Romania and this comes especially once with the economic meltdown when the taxes on the income were further raised instead of better addressing the collection mechanisms. The economists already established a connection between the tax rates and the amount of tax evasion/ the size of underground economy: the higher the level of taxation, the greater the incentive to participate in underground economic activities and escape taxes. Moreover, moral issues related to the fairness and the asymmetry of the relationship between the individual and the State, and structural flaws in the legislation are also considered as catalysts for economic fraud. According to the different indirect methods used to estimate the size and dynamics of the underground economy (Monetary Approach, Implicit Labour Supply Method, National Accountancy, Energy Consumption Method etc.), the informal economy ranges in Romania between 20% of GDP and more than 45%.<sup>62</sup>

This subchapter aimed at describing the awareness of the other European States in integrating Romania in January 2007. Thanks to exogenous factors, *bona fides* criteria were applied. The current outcries at the European level, asking for further and rapid convergence in an array of domains, ranging from minority rights to justice and economic harmonization need to keep in mind the actual level of development in Romania, the real pace of reforms and the accountability of the incumbent government both in the eyes of the civic population as well as to the European decision-making bodies.

In the next part of the chapter, we will examine the main macroeconomic indicators that characterize the Romanian economic *milieu* in order to get a clearer picture about the existing realities.

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<sup>62</sup> Lucian-Liviu Albu, "A model to estimate informal economy at regional level: theoretical and empirical investigation", Institute for Economic Forecasting, Romanian Academy, 2007 in *Global Forum on Competition*, "Competition Policy and the Informal Economy-Contribution from Romania", OECD, February 2009.

### 3.2. Romania-economic profile

Dependent on the Community's enormous market and banking system, Romania started to feel the effects of the economic crisis as early as 2008. This exogenous factor was paralleled by a poor budgetary management within the country, thus the administration was compelled to ask for a 20 billion Euro financial package (loan) from the IMF, the EU, the World Bank and other international lenders. Even after this loan, the economic status of Romania worsened, as the authorities largely misspent the first transfers on pumping the money in a failed pensions system, instead of wisely investing it. As a countermeasure to a growing budgetary deficit, a fiscal austerity plan was put forward, thus most of the people employed by the state got their salaries reduced by 25% and all the retired people's pensions were cut by 15%. Romania was on the edge of recession, given the fact that the consumer spending dropped sharply as people could not afford most of the things that they were buying before. It is worth to be remembered that, as of 2011 the minimum wage in Romania is of 157, 2 Euro/ month (for a comparative analysis see Table 1.1) and the GDP per capita in PPS amounts to 46 as of 2009 (see Table 2.2.). In a period where the consumer spending is lagging, the government is more than reluctant at investing and the foreign capital is hard to be attracted on the domestic market, recession is a very realistic perspective.

**Table 3.1 Private final consumption expenditure, volumes (percentage changes)**

Geo/time	2010Q3	2010Q4
European Union (27MS)	1.2	1.0
Bulgaria	-1.5	0.7
Germany	1.1	1.4
Ireland	-1.2	-1.4
Greece	-5.6	-8.6
France	2.1	1.7
Poland	4.4	3.1

<b>Romania</b>	<b>-0.9</b>	<b>-1.2</b>
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Source: Eurostat (this table is partially reproduced)

Final consumption expenditure consists of expenditure incurred by resident institutional units on goods or services that are used for the direct satisfaction of individual needs or wants or the collective needs of members of the community. The final consumption expenditure may take place on the domestic territory or abroad and it includes households' and Non Profit Institutions Serving Households final consumption expenditure.

As of 2011, the consumer spending was still affected by a VAT of 24%-the highest inside the EU area and a flat tax of 16% on all types of income, be that individual or representing the profit of a company. As of March 2011, Romania's Finance Minister, Gheorghe Ialomitianu declared that Romania cannot afford a VAT decrease in the next two years because the VAT brings about 40% of the budgetary revenues.<sup>63</sup>

Moreover, the IMF loan might be interpreted as a short-term salvation, due to the fact that without a sound macroeconomic policy and long-term investment objectives (for the highest possible return), the money coming from the above-mentioned 20 billion Euro loan will be misspent without visible improvement in the economic situation. The burden of this loan is not to be downplayed. For the loan installments transferred this year, Romania will pay the IMF interest worth SDR<sup>64</sup>266

<sup>63</sup> [www.doingbusiness.ro](http://www.doingbusiness.ro) "We cannot afford to cut VAT in 2011 and 2012", 21 March 2011.

<sup>64</sup> SDR=Special Drawing Rights

million (300 million Euro), whereas the repayment of the actual loan is set to start on August 6, 2012.<sup>65</sup>

Jeffrey Franks, the head of IMF delegation for Romania, granted an interview, saying that Romania will register economic growth this year and an upward trend from one quarter to the other. However, economic re-launch or not, the government will keep one promise: to raise the budgetary salaries by the end of the year, at the level prior to the 25% cut. Would the unhealthy budget be an obstacle? It is doubtful, considering the fact that 2012 is an electoral year ...<sup>66</sup>

According to Eurostat, a favorable indicator for the Romanian economy seems to be the industrial production (excluding construction). The output and the activity of the industry sector, measured on a monthly basis it's advancing at a greater pace than the European (EU27) value for the months of January and February 2011, as well as compared to the industry sectors of countries such as Great Britain, France or Germany.<sup>67</sup> Despite this improvement the balance of payments is still in deficit.

**Table 3.2 Balance of payments, current account, quarterly data**

Million EUR

Geo/time	2008Q1	2010Q4
<b>European Union (27 MS)</b>	-59871	-18192
<b>Bulgaria</b>	-1922	-837
<b>Germany</b>	46128	46275
<b>Ireland</b>	-3997	1396
<b>Greece</b>	-9368	-6824
<b>France</b>	-4564	-17379
<b>Poland</b>	-4154	-5274

<sup>65</sup> [www.mediafax.ro](http://www.mediafax.ro) "Romania to pay some EUR 300 Million in IMF loan interest this year", 14 January 2011.

<sup>66</sup> [www.bucharestherald.ro/economics](http://www.bucharestherald.ro/economics) "Should we believe Mr. Franks?", 27 March 2011.

<sup>67</sup> Industrial Production Index, <http://epp.eurostat.ec.europa.eu>

<b>Romania</b>	-3357	<b>-846</b>
<b>United Kingdom</b>	-667	-11453

Source: Eurostat

The current account is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid). The current account is one of the three Balance of Payments sub-balances together with capital account and financial account. The Balance of Payments is the statistical statement that systematically summarises, for a specific time period, the economic transactions of an economy with the rest of the world.

The 2007 admission to the European Union, imposed several convergence criteria, among which the rate of inflation. This one should not be more than 1, 5 points over the average formed by the three countries having the lowest inflation rate.<sup>68</sup> Thus, the Harmonized Indices of Consumer Prices (HICPs) are used for the assessment of the inflation convergence criterion as required under Article 121 of the Treaty of Amsterdam and by the ECB (European Central Bank) for assessing price stability for monetary policy purposes. HICPs are produced and published using a common index reference period (2005=100). As of March 2011 the rate of inflation for EU-27 was 2.4, Germany 1.4, Greece 5.0, whereas Romania had 6.8 (source Eurostat).

The fact that this country did not adopt the euro allows for the Romanian Central Bank a higher degree of monetary autonomy; however common targets-such as price stability (thus inflation) have to be commonly addressed at the European Union. The Romanian authorities made the case on several occasions that the risk for higher inflation needs to be addressed, in order to attract long-term foreign investment that will be benefic not only for the Romanian GDP, but also for the job

<sup>68</sup> Jean-Claude Vézé , *Précis d'économie internationale*, Ellipses Edition, Paris, 2010, p. 173.



creation perspective. However, the two major causes for the inflationary pressures within the country are the VAT increase from 19% to 24% (fact that also diminished the value of the Romanian leu) and the tariffs adopted by the authorities, especially by those at the local level; these tariffs are higher than the national average of the price increase, fact that stimulates inflation. By the time this paper is being written, a consensus has not been yet achieved regarding the efficiency of the administered prices that also increase the rate of inflation in Romania. Prices for gas, electricity and transport went higher in the last year than those practiced in a perfect free market, due to the fact that companies like CFR (Romanian Railways-state owned), or Termoelectrica (electricity-provider-the government also retains big shares) registered major losses that had to be compensated by a price increase. The efficiency of state-owned (managed) companies needs to be urgently addressed, especially when the government explains their existence in the light of social policy.

At a first look, the health of an economy can be best assessed by the value of its currency and by the value of the long term government bond yields. As the value of the Romanian leu is majorly influenced by the value of the Euro, we will further present the second aspect-that of the so-called gilts, or gilt-edged stocks.

Long term government bond yields refer to central government bond yields on the secondary market, gross of tax, with a residual maturity of around 10 years. The bond or the bonds of the basket have to be replaced regularly to avoid any maturity drift. This definition is used in the convergence criteria of the Economic and Monetary Union for long-term interest rates, as required under Article 121 of the Treaty of Amsterdam and the Protocol on the convergence criteria. The interest rate for the long term government bond yields cannot supersede by more than 2% the average value given by the three states that best perform as regards price stability.

**Table 3.3 Long term government bond yields (Monthly average)**

Geo/time	2010M12	2011M03
European Union (27 MS)	4.22	4.45
Germany	2.91	3.21
Ireland	8.45	9.67
Greece	12.01	12.44
Spain	5.38	5.25
France	3.34	3.61
Italy	4.60	4.88
Hungary	7.92	7.29
<b>Romania</b>	<b>7.09</b>	<b>7.31</b>

Source: Eurostat (this table is partially reproduced)

As it can be deduced from this table, since December 2010, the situation for the government bond yields further deteriorated for the EU-27, as well as for Romania. Moreover, as of December 2010, the rate of unemployment in Romania was 7.4, whereas the EU average in March 2011 was 9.5 (Eurostat). The government cannot address this problem (in fact in 2009 and 2010 an increased number of civil servants either lost their job or their salary was cut by 25 % as necessary measures of the austerity budget); the hope remains in foreign companies that consider the Romanian business environment attractive enough in order to come and invest, as a new start-up or as delocalization.

In order to conclude this subchapter, the reader should keep in mind the striking connection between the price levels of food in Romania and the GDP per capita. According to Eurostat, in 2009, for food and non-alcoholic beverages, Romania was 34% cheaper than the EU27 average; the GDP per capita was 54% below the EU average! (see Table 2.2)

Given these macroeconomic indicators, we will move further to the analysis of the new Labour Code in Romania, a very controversial legislative act that for some

bears within the allegation of social dumping, whereas for the others is seen as an instrument for attracting FDI and thus increasing the welfare in Romania. This new legislative framework will shed light upon the hypothesis of social dumping in Romania, being much more relevant than any individual study that might be carried out in order to assess the practice of specific enterprises. Every Labour Code mirrors the intentions of a government regarding the labour market and thus the allegation of implementing a deliberate social dumping practice can be best assessed by analyzing such a document. Of course, this cannot be regarded as an independent variable, considering the fact that politics and the economic environment set up governments.

### **3.3 The Romanian Labour Code-2011 version**

The law 40/ 2011<sup>69</sup> amends the previous Labour Code in Romania, known as the law 53/ 2003. The above-mentioned legislation entered into force as of 1 May 2011 and since its proposition it became the subject of numerous debates between the social actors whose points of view do not converge on several aspects. For a better understanding of the challenges that it implies, we will try to present an overview of the concerned legislation. Afterwards we will put forward the arguments of the government and the opposition as well as those of the employers and trade unions, in order to understand the assumption of social dumping.

One of the main reforms in the actual Labour Code is the modification of the *individual fixed-term labour contract*; thus, if the previous legislation said that this type of contract can be convened upon for a maximum period of 2 years, the amended version states that it can be concluded for a period of maximum 3 years, with the possibility of 3 renewals. Basically, a person employed according to this type of work contract can stay in office for a maximum period of 9 years. This was meant to

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<sup>69</sup> [http://www.rubinian.com/codul\\_muncii\\_13.php](http://www.rubinian.com/codul_muncii_13.php) (The Romanian Labour Code- version in Romanian)

diminish the amount of open-ended individual employment contracts, thus- as the incumbent government often referred to- to make the labour market more *flexible*.

Another amendment is represented by the *prolongation of the probationary stage* within a company or institution, from 30 (as previously agreed) to 45 days for regular employees and from 90 to 120 days for the management positions. Moreover, if before it was forbidden to hire more than 3 persons for the same training position, now that interdiction does not make the object of the actual Code.

The Labour Code enables the employer to establish *individual performance objectives* that will help him/her better assess the quality of his/her employees. The criteria of this assessment are established exclusively by the employer and he/ she can invoke them for a potential lay-off, as a justification that will weigh more than the social background of the employee. This will apply especially in the case of *collective lay-offs* where the performance of every individual will be separately considered. This is one of the matters of concern, considering the fact that the adopted Labour Code minimizes, or one can argue, mentions almost nothing about the collective labour-contracts; all nine articles dealing with this topic in the 2003 version of the legislation were currently suppressed.

Moreover, if an employer was to proceed to collective lay-offs, he was forbidden by law to hire other people during a period of 9 months. During all this time, those who lost their jobs had priority for a possible work reinsertion, if the business was to start again its activity; the case is now that the 9 months turned into 45 days, after which the employer can start to look out for job-seekers, with the mention that the former ones still have priority for reemployment.

Due to economic, technological or other objective reasons, the employer has the right to temporarily reduce the working schedule from 5 to 4 days per week. Until now, this was to be done only if the trade unions agreed upon. Moreover, if the employer has no possibility to pay the overtime hours, the employee can get in turn days off, whenever the employer considers it to be adequate.

The 2011 Labour Code tends to be perceived in Romania as a labour market regulator that favors the foreign investors/ the employers. Due to the fact that the incumbent Liberal-Democratic government assumed responsibility before Parliament for the new legislative version (we will further discuss this in the pages to come) we will treat the government and the employers' position together-as the two major promoters of the bill.

### ***3.3.1 The victorious coalition: Government and employers***

The main argument employed by the Emil Boc government in the defense of the new Labour Code was the fact that it creates an increased amount of *flexibility* in the labour market, leading to the creation of new jobs. The official point of view was backed up by Doina Ciomag, CEO for the Council of Foreign Investors (CFI), who argued that a more flexible labour market will lead to the creation of more than 90.000 jobs in the short-term.

**Table 3.4 The Romanian labour market**

<b>Total active population</b>	<b>10 041 thousand</b>
<b>Total employed persons</b>	9 313 thousand
<b>1)urban</b>	5 115 thousand
<b>2)rural</b>	4 198 thousand
<b>Labour force participation</b>	63,7%
<b>The employment population ratio</b>	58,8%
<b>The rate of unemployment</b>	7,4 % ~ 800 thousand people (Dec. 2010)

Source: The National Institute for Statistics, Romanian Academy; data correspond for the year 2006

In the same line of reasoning, the American Chamber of Commerce and CFI proposed the elimination of positive discrimination rewarded to the trade unions' leaders and to the representatives of the employees within an enterprise, by enabling their potential lay-off.<sup>70</sup> (until now it has been really hard to fire a trade union representative on grounds that are connected with his professional performance, those who were elected kept their positions until the end of their mandate, without a fear of being laid off, so to say).

Not only is the reduction of unemployment addressed by the new Labour Code, but also the *meritocracy* that, according to the Government and the employers was a shadowed criterion within the labour market. Productivity and loyalty will be appreciated- through financial bonuses or simply by the job continuity- laziness and lack of professionalism will be penalized. The individual performance objectives, the much diminished role of the trade unions and the prolonged probationary stages are instruments that are to be used as incentives to attract foreign investors to a much de-regularized and oversimplified labour market. These two social actors also perceive the flexible work schedule as a measure that will better restructure the work load, thus the companies will create in due time the necessary amount of production required by the clients, without the necessity to manage the unsold stocks.

In the eyes of the government and of the investors, the post-1989 period granted an unfair advantage to the trade unions, which were capable to postpone talks with the government and to ask for "unrealistic" demands that did not fit the current realities. Emil Boc further argued that after a consistent analysis, he is firmly convinced that the Romanian labour market is lagging behind the European one as regards its flexibility to adapt to the new economic circumstances; the major cause identified by the Prime-Minister is the huge number of open-ended individual employment contracts that characterize the Romanian internal market which are too

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<sup>70</sup> "Codul Muncii, varianta 2011-Analiza *Gandul*, *Mediafax*, *Ziarul Financiar*", 28 January 2011, [www.gandul.info](http://www.gandul.info)

rigid and which encourage the informal labour, due to their permissive character. The author would be curious to know if the Prime-Minister could also identify a logical link between the fixed-term contracts and the increased rate of unemployment. Romania, marked by contracts agreed upon an undetermined length has a lower rate of unemployment than many European countries with a tradition in fixed-term contracts. Different employers that were interviewed admit that, at least theoretically, it is easier now to fire an employee, but in the same time, he can quit the job easier than before, thanks to the diminished number of legislative constraints.

One must give credit to the incumbent government for having included in the 2011 Labour Code specific measures in the fight against informal labour-market (see the following details). The foreseen fines are pretty strong disincentives for the employers as well as for the employees; the former ones that do hire more than 5 people without legal contracts are bound to be brought to justice and the punishment could be as severe as prison sentence.

Informal employment is one of the key features of Romanian labour market and the main concerns of the Romanian government. A second economy was present in the communist period, and took various forms, ranging from family farming to off-the-books payments and misappropriation in state-owned enterprises.

In nowadays Romania, subsistence agriculture, “envelope” payments, false self-employment and unregistered work are the most common forms of informal employment. For some groups of the population this leads to poverty and exclusion whereas for others it serves as a safety net. It is widely acknowledged that during the harsh years of transition, job losses, unemployment and the resulting poverty were the main reasons behind informality.

Lack of trust in the state and the culture of evasion, high tax wedges as well as complex and time-consuming administrative procedures are the most important reasons why the economic actors opt for an informal employment.

This one represents today between 20 and 50 per cent of total employment, depending on the definition used.<sup>71</sup>

According to the International Finance Corporation and the World Bank data, in 2011 “Doing Business” report it was acknowledged the fact that Romania ranks 56 out of 183 economies after neighbors such as Bulgaria or Hungary.<sup>72</sup> Giving credit to the quoted source, the major setbacks for this country seem to be registering property, paying taxes and closing a business. Moreover, the employers and foreign investors complained about the fact that the Romania labour market is more rigid than its neighbors’ markets; according to World Bank’s rigidity of employment index (consisting of hiring and firing of workers and the rigidity of working hours) Romania ranked 46, while Bulgaria 19, Hungary 20, Poland 25, and Germany 42.<sup>73</sup>

Nonetheless, it was expected that after the announced reforms, the grade given to this country by the 2011 Doing Business report will improve compared to the 2010 one; this is not the case; in 2010 Romania ranked 54 among the world economies, today it ranks 56. According to the available data, the only things that were improved are dealing with construction permits and trading across borders, whereas aspects such as starting and closing a business and protecting the investors deteriorated. The author of this paper believes that a sluggish business environment has to do not only with the repercussions of the economic meltdown, but also with a degrading domestic political milieu whose “license to govern”/ to represent the Romanian electorate has been much contested in the last two years.

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<sup>71</sup> “Report on Informal Employment in Romania”, *OECD Development Centre*, Working Paper No.271, July 2008

<sup>72</sup> <http://www.doingbusiness.org/data/exploreconomies/romania>

<sup>73</sup> [www.worldbank.com](http://www.worldbank.com) (the ranking is from 0 to 100; a lower score indicates a more flexible labor market)



### ***3.3.2 The counterbalance: political opposition and trade unions***

The response of the political opposition triggered by the 2011 Labour Code amassed an array of Romanian MPs coming from three main political groupings: PSD (The Social-Democratic Party), PNL (The National-Liberal Party) and PC (The Conservative Party). Victor Ponta, the president of PSD argued that this is [was] a decisive crossroad for the Romanian political framework due to the fact that the major opposition parties found support in the trade unions and vice versa.

Despite the fact that this furthers us from our topic regarding the assumption of social dumping as economic practice inside the Romanian market, the reader must be aware of the intricate political milieu that sets the stage for fervent debates as it was the case with the amended Labour Code. Trade union representatives and MPs coming from the governing coalition as well as from the opposition parties submitted over 140 amendments to the project to change the Labour Code. The Government approved only 8 amendments which did not make the central object of discussions- collective lay-offs stipulated by the new version, the extended probationary stage for a new employee and the discretionary schedule set up by the employer. The Emil Boc government, decided to urge the whole procedure by *assuming responsibility before Parliament* for the new bill, meaning that the normative act which is pushed this way is considered adopted and no longer has to be debated in Parliament, unless a censure motion is submitted within three days. If a censure motion is adopted, the Government steps down. The censure motion was put forward by the MPs of the opposition parties, but it was not adopted. The New Labour Code became a law, having a binding effect for all social actors. The reader might ask himself if the act of the Government is a democratic one- assuming responsibility in front of the Parliament- in this way bypassing the legislative power; the opposition referred precisely to this aspect, more than that, to the abuse practiced by the incumbent Boc government that used 11 times within 2 years this procedure to pass legislation. According to the Romanian Constitution, this was supposed to be an exceptional

measure, not a customary one, precisely due to the fact that it avoids any Parliamentary debate or any form of vote.

We will further refer to their points of concern (shared by both political opposition and trade unions). First of all, they opposed the deliberate policy meant to reduce the widespread use of open-ended individual employment contracts; both the employee representatives, as well as Parliamentary spokesmen argued that fixed-term contracts will increase the instability of the workforce. Secondly, the signatories considered the prolonged probationary stage for a new employee, and the on-going possibility to make use of this prerogative as prone to give birth to abuses by becoming a routine inside an enterprise, also increasing the incertitude for the workforce.

A much contested issue introduced once with the new Labour Code was the art. 49 paragraph 5, which states that the employment contract can be annulled by the employer at any time during a period of suspension. In the eyes of the social actors that we're referring to in this subchapter this represents a serious discretionary bill that might lead to conflicts at the workplace, that do not come at all under the auspices of the new Code. Article 249 just mentions that "conflicts that occur at the workplace will be addressed by a special law".

The last point that the political opposition and the trade unions drew attention upon is the mere existence of one of the latter's strategic roles- negotiator of the collective employment contract at the national level. The present Labour Code states that the collective negotiations are not obligatory anymore (between trade unions and the employers' representatives, also the state), but that it suffices to have collective agreements at the unity level, if the enterprise is to have more than 21 employees. The other articles from the 2003 version of the Labour Code regarding the national labour agreements were abrogated.

As a last resort 112 MPs, coming from PSD (Social Democratic Party) and PNL (National Liberal Party) submitted a formal complaint to the Constitutional

Court, arguing that the 2011 Labour Code is not constitutional. Their accusation was based on the fact that during the previous censure motion (when the Government assumed responsibility before the Parliament for the normative act) just 216 out of 470 MPs were present, moreover, that art. 141 from the Romanian Constitution was not respected, given the fact that the Economic and Social Council was not consulted regarding the revised version of the legislative act, and the fact that they identified aspects from it as being connected with the social dumping. Except all these remarks, the Constitutional Court rejected their accusations and validated the new Labour Code.<sup>74</sup>

### ***3.3.3 Is it social dumping?***

After the Government sought the confidence vote in the Parliament for passing the New Labour Code hundreds of unionists protested outside prefects' offices and headquarters of the ruling Democratic Liberal Party. The protesters fulminated not as much against the legislation per se, but against the government led by Emil Boc under the guidelines of Traian Basescu, the incumbent President. As the legitimacy of the leadership has been highly contested and as none of the members of the executive-especially the Prime-Minister was willing to resign, the people deeply affected by the economic crisis and the austerity measures, used the 2011 Labour Code more as an opportunity to voice up their discontent.

The populist and moreover demagogic discourse of the opposition parties (discourse not centered necessarily on the Labour Code, but on the poor performance of the Prime-Minister that is governing an alliance made out of "thieves and stupid people", MPs that do not represent the Romanian citizens and who are paid just to sit

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<sup>74</sup> "Codul Muncii 2011 este constitutional. Curtea Constitutionala a respins sesizarea Parlamentarilor PNL si PSD", [www.legislatiamuncii.manger.ro](http://www.legislatiamuncii.manger.ro)

on their benches etc.)<sup>75</sup> and trade unions consisted majorly of the indirect accusation of social dumping, by stating that the Romanian workers are becoming 21<sup>st</sup> century slaves, as the new legislation empowers much more the employers than the employees. A proof in their argument is the fact that the employer has from now on at his/her disposal the legal grounds to realize what they name as being an exploitation of the work force, with the sole aim of maximizing the profit. Adopting an empirical reasoning, this might mean for instance, that an employee could work just four days one week, and the next one, due to an increased demand in production be compelled to work 5 days and also overtime. Moreover, the first part of the legal vacation was reduced from fifteen to ten days, measure that gave birth to further accusations, given the fact that some consider that this period is insufficient for a worker to properly rest and be able to restart performing his/her activity optimally.

On behalf of what was labeled as *flexibility*, the employer has now the adjacent possibility to reject one worker's demand for unpaid holiday, having as purpose a professional training; the approval/ rejection of the concerned trade union is not necessary anymore; also the employer can decide, *without* the accord of the trade union (only formal consultation is needed) upon the reduction of the working hours paralleled by the reduction of the employee's monthly income.

As the reader could notice again from the previous examples, the importance of the trade unions at a national level is highly diminished, these ones being considered as blockers of effective legislation, and as social actors that rend the economic framework sluggish.

Nonetheless, as it is the case for Germany too, an increased transfer of the bargaining responsibilities to the company level should not be equalized with social dumping, but with a reinterpretation of the traditional fragmentation of the industrial relations. On the other side, as we mentioned in the second chapter of this paper, if we are to consider the strategy of employer organizations as dictated by an

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<sup>75</sup> <http://victorponta.ro/node/1770>

“economic-productive” logic and that of the trade unions as characterized by a “political-distributive” one then we might ask into question the balance between the costs of the social protection necessary to offset the risk of social dumping and the losses of the companies given a higher threshold for regulation.

It becomes more and more clear that the corporatist model of doing business is being challenged. For instance, in other European countries (Spain, Germany) wage derogations at company level are possible in times of serious economic difficulties, also when the problem of competitiveness is being addressed (Germany). In Romania, the 2011 Labour Code is not a short-term measure that tries to solve the economic crisis, but one that endeavors to make the country more attractive to foreign investors. This is the logic of the market. Is this the same for all the European Member States? It would be far-fetched to affirm that, given the fact that in countries such as France, Austria or Belgium wage derogations or open clauses are not being addressed, despite the economic downturn.

The first lesson that the New Labour Code in Romania teaches us, is the fact that there is no such thing as “upward harmonization” (discussed in Chapter I), among the new comers and the founding fathers. Germany, as well as Romania decided to adopt a much more *decentralized* and *derogatory* framework for the industrial relations in order to increase their competitiveness. These attributes are far from being synonymous with convergence and corporatism.

Secondly, exogenous factors, as the pace of capitalism, the mobility of capital and the increased interdependence, make the states dependent upon increasing their comparative/competitive advantage in order to survive on the market place. As there is no single threshold for social protection jointly agreed upon, a lax regulation is perceived as an instrument in order to stay competitive.

In our normative account regarding the allegation of social dumping, we referred to the labour cost dumping and also to the safety and health conditions. As regards the former, the central accusation would be that low wage standards are the

outcome of a deliberate policy of social dumping carried out by the national governments. In Romania's case, it is clear that the New Labour Code touched on the employer's labour costs, especially on the direct ones (gross wages per hour, overtime supplements, regularly paid premia etc.). For instance, if the production conditions ask for it, the employer might reduce unilaterally the number of working days and in the same time the amount of the monthly income, as well as it can compensate the employee for his/her overtime hours with days off instead of money. The indirect costs were not addressed by the new legislation, meaning that the employer's social insurance contributions, sick pay schemes, and further social expenses such as those for medical services stay as they were before. The same goes for the *safety and health conditions* that are the object of a set of convergence criteria at the European level, enshrined in the Directive 2009/104/EC. From this point of view it can be clearly assessed that there is no case of social dumping as a deliberate practice triggered by the Romanian leadership.

In order to emphasize again the difficulty in assessing the social dumping we will further refer to a recent event within the European Market, which made itself heard up to the highest decision-making level. In January 2011, Germany was accused of practicing social dumping by hiring underpaid Romanian, Polish and Hungarian butchers. What does being underpaid mean? That is a very tricky question, given the fact that in Germany there is no such thing as statutory minimum wage. The French and the Danish trade unions' representatives as well as the work force directly concerned (the butchers) are pointing to a distortion of the competition inside the Internal Market. It has been assessed that the price difference for the beef, induced by this situation is of 5 cents per kilogram between France and Germany. This is not a derisory amount. Also in Germany, there were grievances concerning this state of affairs, with the German Trade Union for Food and Restaurants asking for a minimum wage for the whole branch. It is well known the fact that part of the German competitive advantage and exporting power is due to its Central and East-European subcontractors, as it is the case in the current allegation. At present, just 10

to 50 % of the employees working for the German butcher's stalls are directly hired by German companies that have a collective agreement with specific national trade unions.<sup>76</sup> The others are being subcontracted.

As this empirical example points out, it is highly delicate to admit a practice of social dumping regarding not the safety and health conditions, but the costs of labour as long as there is no benchmark. Which is the international standard? What is the national one, especially for countries such as Germany where there is no minimum wage?

As regards the Romanian Labour Code-the 2011 amended version, the author would like to point out that despite all the strong remarks put forward by the opposition and the trade unions, the major bone of contention was the absence from the new Code of collective agreements at national and sectoral levels. If such collective agreements are eliminated, the trade union and employer organization representatives at national level will lose their roles as negotiators, and a large number of employees (particularly in the public sector and in small and medium sized enterprises) will no longer be protected by collective bargaining.<sup>77</sup>

We consider that a diminished influence of the collective bargaining does not point to social dumping, or the reduced bargaining power of the trade unions, even though these tendencies mark a clear contrast with the traditional view of a corporate state. Despite the demagogic discourse of leaders that have as sole purpose to be (re)elected, the Romanian workers are not being transformed into modern slaves, though the current economic downturn makes it more difficult to have a stable job if people are not being competitive and flexible enough.

Moreover, as we argued before, wages and work-related fringe benefits must be lower in states engaged in a "catching-up" process than those in core areas, before the

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<sup>76</sup> Mara Matei, "Germania acuzata de dumping social in angajarea masiva de macelari est europeni", *Romania Libera*, 28 January 2011.

<sup>77</sup> Constantin Ciutacu, "Government and Trade Unions clash on new Labour Code", *Institute of National Economy, Romanian Academy*, 29 April 2011.

accumulation of a sufficient stock of real capital; this is the result of the Invisible Hand, if we keep in mind the premise that welfare dumping is not social dumping. In the current business framework in Romania, it would be unsustainable to continue with the 18% increase in wages (see Chapter II), which is not being paralleled by a similar increase in productivity.

Addressing the decent work concept it is a duty of the entirety of the social actors, especially of the government. The debate remains open whether this should be defined in a neo-liberal terminology (as it is the case nowadays) or in a rather socialist one (terms employed both in their economic and political dimensions), that would include not only health and security measures, but also a sufficient/ decent income that would point to living standards and in the long run to the societal inequalities.



## ***Conclusion***

**“The allegation of social dumping. A case study on Romania”** aimed at explaining the implications of a social dumping hypothesis within the big European market, with a relevant case study comprising the economic and labour *milieux* in Romania. Taking as premise the fact that welfare dumping is not synonymous with social dumping, we proved that the current industrial relations within the EU should be interpreted in the light of the competitive advantage theory, which states that lower direct and indirect labour costs are instruments that in the long run secure a sustainable economic growth, thus promoting a catching up process.

A note of caution must be added to our statistical exercise. It should be acknowledged that it is difficult to test the hypothesis correlated with the image of social dumping, due to the essential conceptual haziness of social dumping as a set of tendencies, and because of the lack of relevant data, especially in the case of Romania. To obtain a more valid picture, more substantiated accounts of our regional research have to be referred to, as field studies on specific companies that bypass the labour market regulations; moreover, the one that formulated such a hypothesis has to also prove that the state is aware of such practices within its territory and that it decided to turn a blind eye on them. This is not an easy or a short-term exercise.

Our empirical findings focused majorly on the legislation that makes the object of the Labour Code in Romania, and also on the decisions stemming from the European Court of Justice with regard to the allegation of social dumping. Different political points of view have been expressed throughout the paper, coupled with changes in the institutional setting. This was meant to provide the reader with a broader understanding of the work-related processes, and also to create an overall framework that integrates our particular point of concern.

While substantive research addressed the issue of the competitive advantage theory, not much has been written about the allegation of social dumping perceived in the light of the former. Thus, we hope that this one will serve as a reference point for further studies on the subject, and also as an analysis for those interested in the European market and in the impact that the last two waves of enlargement had upon the industrial relations inside it.

As a last point, this thesis does not aim to exhaust the subject; on the contrary, it hopes that it will trigger academics, practitioners as well as students to write more on this topic, especially in nowadays' Europe where nationalistic policies make of the social dumping *hypothesis* a point of their election campaigns. (for instance, the right wing parties in Western Europe, which point to the delocalization process as being social dumping).

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