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A DIFFERENT COURSE FOR EUROPE: WAGES AND COLLECTIVE BARGAINING AS AN ENGINE FOR GROWTH AND STABILITY

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Key Messages

- Europe needs to change course. Europe needs to see wages instead as an engine for demand, growth and jobs and also as an important circuit breaker in the process of deflation and depression.

- The ETUC calls upon policy makers to fully recognise the positive roles of wages in the remaining part of the European Policy Semester. Member States already in deflation urgently need to prevent wage dynamics from falling through the floor. Member States, where real wages have stayed behind productivity, need to trigger a process which closes the gap between wages and productivity. In all of this, the autonomy of social partners to bargain needs to be respected as well as promoted.

- European policy makers appear to be obsessed by the idea of wage competitiveness. All instruments (such as country specific recommendations, Troika adjustment programmes, Euro Plus Pact,…) which are at their disposal, are being used to undermine wages and eliminate all wage bargaining institutions that support wages or keep wages from falling. Labour is increasingly seen as a commodity with wages simply constituting a market price that needs to be flexible so as to restore market equilibrium.

- This obsession is such that there is almost complete denial of what is happening in reality. The facts, and these are based on official numbers from the Commission's AMECO database, are that wages in and across Europe tend to remain behind developments in productivity. This is a long term trend, with the deficits between wage and productivity growth adding up year after year and reaching accumulated real wage gaps as high as 9%, 25% or even 40%. It is also a trend which is, at this very moment, spreading across more and more Member States in Europe.

- This obsession with wage flexibility and wage competitiveness is dangerous for two reasons:

    - Europe is anything but a small open economy. Trying to increase exports, which only make up 17% of European GDP, by depressing internal demand representing 83% of GDP does not make sense and is suicidal for demand and economic activity. Europe cannot steal jobs from itself.

    - Depressing wages in the face of high and nominally rigid debt burdens will deepen and prolong recession. The more wages are depressed, the higher the share the servicing of debt will take up in household and corporate budgets, thereby crowding out consumption and investment demand.

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1. - Wages as the target of the European Policy Semester

We are in the middle of the so-called 2014 European Policy Semester. Over the course of April, Member States have been drawing up their new National Reform Plans. At the end of May, the Commission will respond to these reform plans by publishing the annual country specific recommendations. After endorsement by the Council, Member States are then expected to implement these recommendations during the rest of the year.

Wages are also a part of this process and many Member States will, in the coming months, receive European policy recommendations on the role of wages and the reform of bargaining institutions. This is in line with the trend that can be observed over the past years, a trend by which the Commission is seeking to obtain more competence over national policy making with the aim of building a 'genuine' Economic Union to support Monetary Union.

So what sort of recommendations will the Commission launch this time? We do not know in detail but the 2014 Annual Growth Survey published at the end of last year contains one key phrase that lifts the veil:

> *"Further reform efforts to ensure wage developments in line with productivity, thus supporting competitiveness and aggregate demand".*

The Commission sends two basic messages here:

- Something is going wrong with wages;
- To remedy this, Member States should continue with the policy of structural reforms of wage formation systems.

This is not helpful. The first message is ambiguous since it can also be understood as implying that wages have outpaced productivity. The second message actually backs this latter interpretation by pronouncing support for ongoing reforms, reforms that are in practice heavily biased against wages and systematically seek to weaken systems of collective bargaining.

The ETUC takes issue with these two messages. They misrepresent what is happening in reality, a reality where workers in an increasing number of Member States have seen their wages lag behind productivity. They work to increase inequalities by shifting income from labour to capital. Last but not least, they pose a risk to the economy and jobs since Europe cannot compete with itself and since depressing wages in the face of high debt burdens will deepen and prolong economic depression.

2. - The Commission's wage recommendations are all about pushing wages down and undermining bargaining systems

The Commission calls upon Member States to continue with structural reforms of wage formation systems.

What type of reforms does the Commission have in mind? An analysis of the country specific recommendations issued in June 2013 shows that the Commission is systematically promoting those reforms that weaken wage formation and bargaining systems. In particular, all institutional arrangements which, in one way or another, represent an obstacle to downwards wage flexibility are under fire.

In Belgium, Luxembourg and Italy, this concerns indexation systems linking wages with inflation. In France and Slovenia, the Commission considers the level of minimum wages to be too high, without providing convincing evidence to back this up.

For Spain, the Commission welcomes the reforms that were introduced by the conservative government at the beginning of 2012. By allowing company bargaining to have priority, these reforms undermine bargaining at the sector level. Even worse, these reforms also give individual employers the right to cancel existing collective agreements and unilaterally impose lower wages. Moreover, by imposing these reforms, the government has gone against the agreement reached by social partners in Spain in January 2012. It does therefore, not come as a surprise that these same reforms have recently been condemned by the ILO as being in contradiction with international labour conventions on the freedom of association.

Meanwhile, Denmark and Finland are being called upon to conclude moderate wage agreements in the future.

In addition to recommending reforms, the Commission is directly prescribing policy action on wage bargaining systems in Member States under financial distress. In these countries, the Commission has, as part of the Troika, imposed cuts in minimum wages (Greece), the freezing of the wage indexation system for the public sector (Cyprus) and a freeze in the minimum wage (Portugal). In Greece, the Troika-led reforms have gone so far as to give 'associations of workers,' which are organised by individual employers themselves, the right to conclude a company agreement setting lower wages than the agreement signed with the representative trade union.

Finally, the European institutions have also been targeting public sector pay. In particular, as stated in the Euro Plus Pact the aim is to: "ensure that wages settlements in the public sector support the competitiveness efforts in the private sector (bearing in mind the important signalling effect of public sector wages)."

Here, the signal that the Commission, together with the European Central Bank, want to send is that the private sector should follow the pay cuts imposed in the public sector (in at least 14 Member States) along with pay freezes stretching over two, three or even four years (in 17 countries). It is of major concern that the European institutions are putting forward the public sector as a model where collective bargaining procedures have been ignored and undermined in order to achieve the widespread pay cuts and pay freezes.

In all of this, there is one exception where the Commission is giving a positive recommendation on wages. However, it is an exception that confirms the general rule. So although the Commission does tell Germany to "sustain the conditions that enable wage growth to support demand," it immediately adds that this should be done by lowering taxes on labour, especially for low wage earners. This implies that the Commission is focussing on fiscal and tax policy as levers to support the purchasing power of workers, meanwhile staying clear from recommendations to strengthen the German wage system itself. This policy will therefore not boost gross wage dynamics as such. If the purchasing power of workers' wages increases, this is because government, not employers, are paying for it. The implication is also that the big gap between real wages and productivity that has developed in Germany itself over the last decade will not be corrected (see further below), nor will the divergence in wage cost dynamics between Germany and much of the rest of the Euro Area be addressed.

Summing up, the Commission's structural reform recommendations contain a systematic bias against workers and wages in favour of business and its profits. They are like a 'mission to destroy', with almost all reform recommendations aimed at weakening bargaining systems to bring wages down, even if this interferes with the autonomy of social partners to bargain.

3. - Workers in Europe have not been living beyond their means

The bias against wages that is present in the country specific recommendations also implies that what the Commission actually means to say when using the phrase “aligning wages with productivity” is that wages have risen out of control and have outpaced trends in productivity. In other words, that workers have been living or earning beyond their ‘means’.

This view is also explicitly adopted by the Employment Committee of the European Council of Employment and Social ministers in its recent ‘Labour Market Reform’ report where it can be read that:

> “*Wages developments unrelated to productivity developments in the years in the run up to the crisis have deteriorated competitiveness, notably in the Euro Area.”*

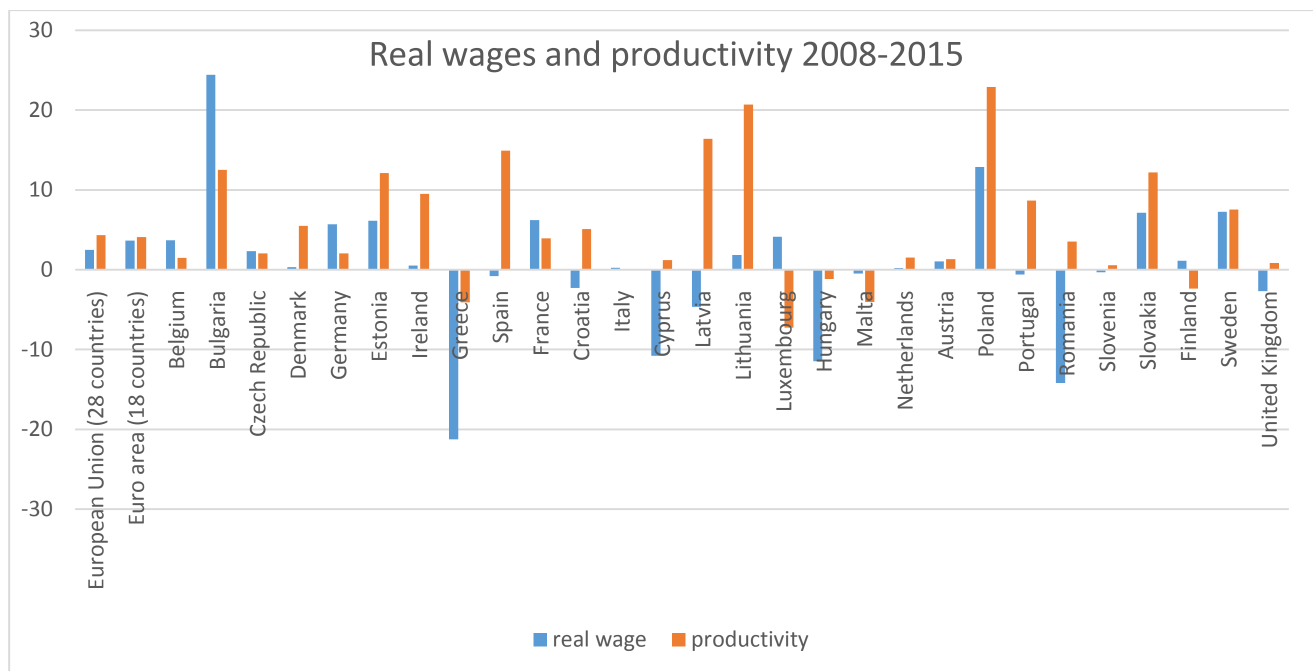
This view, however, is entirely wrong. The reality is the opposite: real wages are systematically lagging behind productivity, not the other way around.

The first graph below shows this for the period since the financial crisis, from 2008 up until 2015. It makes use of the statistics and the Commission’s winter 2014 economic forecast. It should also be noted that productivity performance over this period has been dismal, and this is because economic production tends to fall faster than the ability of companies to adjust employment when the economy is going through a recession.

However, despite this dismal productivity performance, the compounded increase in real wages over this 7 year period is still below productivity developments in an overwhelming majority of Member States, in 19 to be precise.

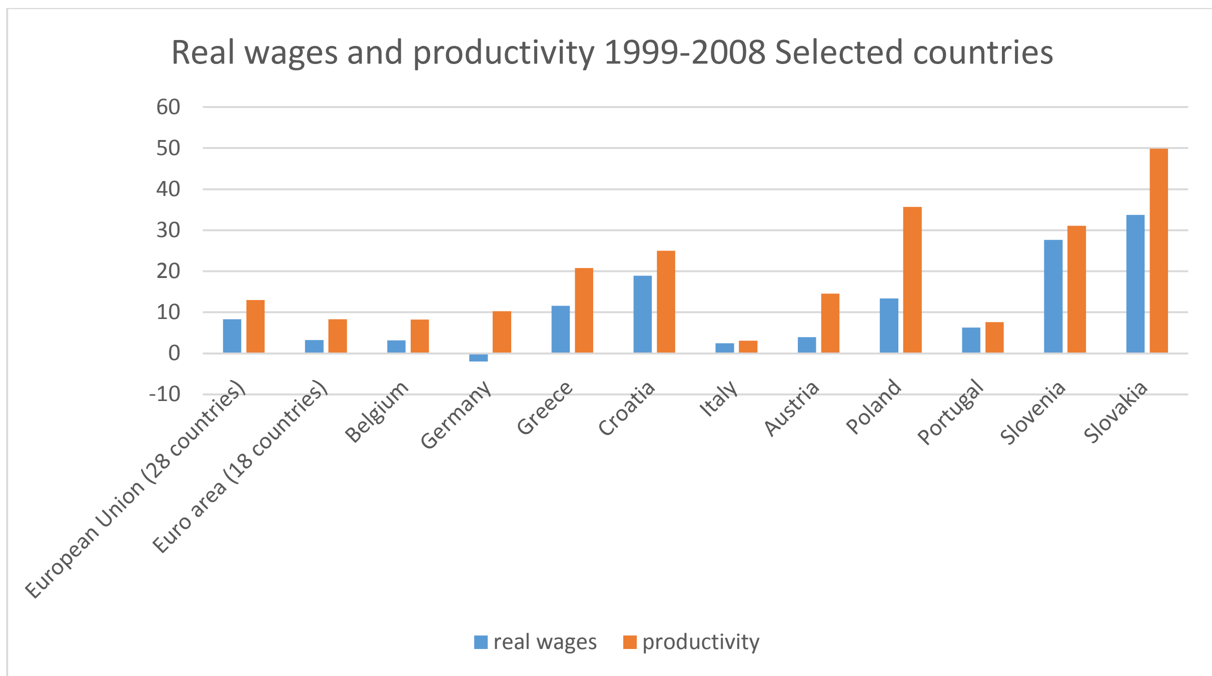
In Greece, Spain, Portugal, Romania and Poland, to name just a few countries, the gap between real wages and soaring productivity rates is actually stunning. Real wage developments in these countries are staying behind productivity and the difference between the increase in percentage of productivity and wages can be as high as 10 to 15 percentage points (pp).

For Europe as a whole, the numbers show that productivity over this period increased by 4.3% over this period, whereas the evolution in real wages was limited to just 2.4%. Corresponding numbers for the Euro Area are 4.1% and 2. 4%.



It needs to be stressed that this is not just a recent phenomenon. In the decade before the financial crisis, real wage dynamics were also unable to keep pace with productivity. So, whereas productivity went up by 13% from 1999 to 2008 in Europe, real wage increases were limited to 8%.

Average European numbers were driven especially by big Member States such as Germany and Poland where large gaps between real wages and productivity were allowed to develop. In Germany, real wages in 2008 were actually 2% below their 1999 level. Smaller countries such as Austria, Belgium and Slovakia also form part of this group (see graph below).



What picture do we get when the two periods are taken together?

The next two graphs (the first one for Western European Union countries, the following graph for Central and Eastern European countries) show cumulated developments starting in 1999 and ending in 2015.

The gaps that have opened up over this 15 year period between real wages and productivity are now revealing spectacular numbers. In Poland, real wages are 40 pp behind productivity. In Greece, the gap is 27pp. In Spain, we are talking about a 15pp gap. In Germany, despite more favourable developments in real wages over recent years, the gap is still 9 pp.

For the EU as a whole, the cumulated gap after one and a half decades of wage and productivity developments amounts to 7pp, for the Euro Area it is 5.7 pp.

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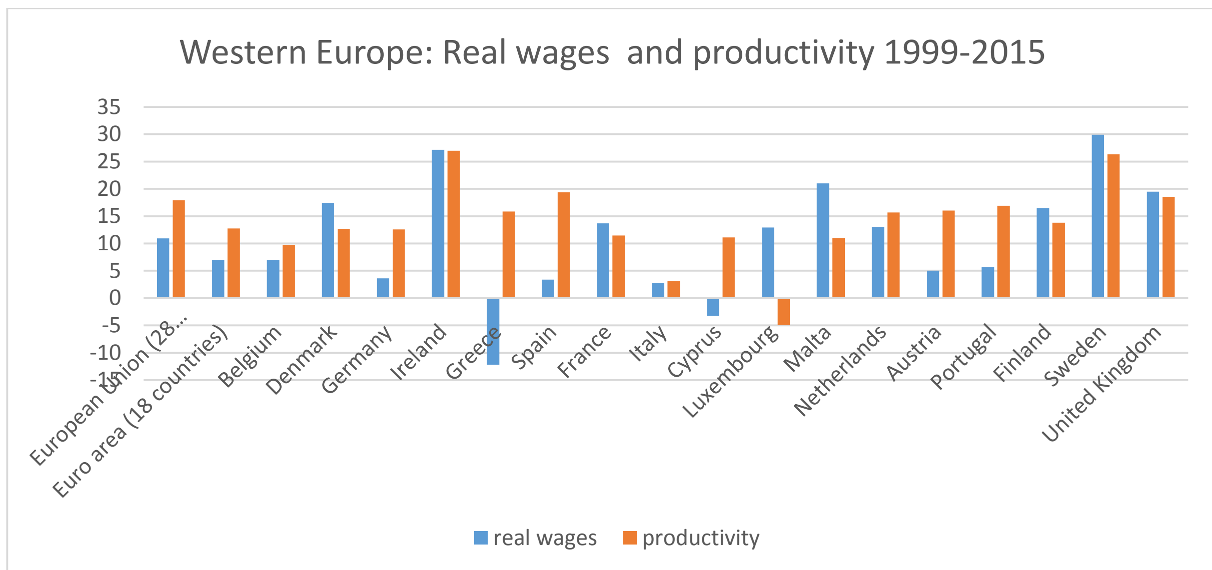
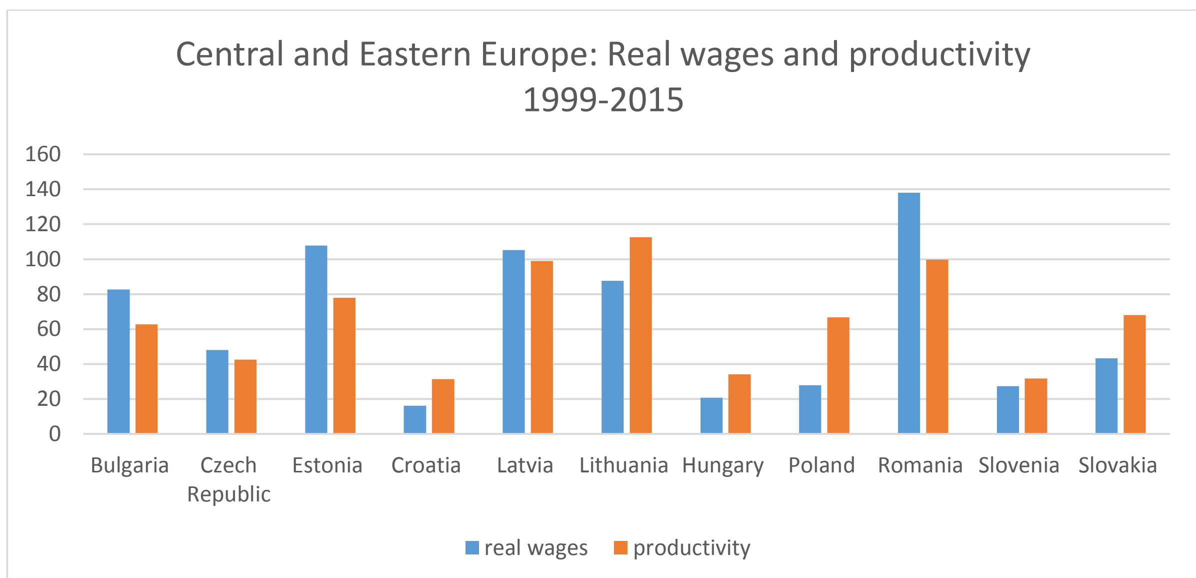




The conclusions are threefold.

- **Contrary to the view suggested by the European Commission's Annual Growth Survey, real wages have not been able to keep pace with progress in productivity.**
- **This is a deep rooted trend that has been ongoing for decades and taking place in periods of recession as well as in periods of growth.**
- **Moreover, the trend is spreading across Europe and contaminating more and more Member States.**

4. - The gods at the ECB must be crazy. How concepts are being twisted.

How is it possible that, in the face of so many official numbers pointing to the opposite, the Commission and many other "serious" policy makers are able to continue claiming that wages have outpaced productivity?

The reply is that in their mission to destroy wages, the 'masters of wage deregulation' are at the same time very efficient at twisting the concepts into something that does not make any sense at all. When they declare that wages have outpaced productivity, the reference is not to '**real**' but to '**nominal**' wages. One perfectly clear example of this is the presentation by the President of the ECB, Mario Draghi, at the March 2013 European Council, lecturing the Heads of State for allowing excessively high wage growth and using graphs where **nominal** (and not real) wage developments are shown in relation to productivity (see here http://www.ecb.europa.eu/press/key/date/2013/html/sp130315.en.pdf?f765ef5a842dd60aabfc98f75e595b45).

This however is a comparison that does not make any sense. It is like comparing 'apples with pears' since a nominal variable (nominal wages) is being compared to a variable from the real sphere of the economy (productivity being calculated on the basis of the increase in real, not nominal economic activity).

Moreover, it is not only theoretically wrong to do so, it is also dangerous for price stability which is ironically the number one objective that is so dear to the heart of the European central bankers.

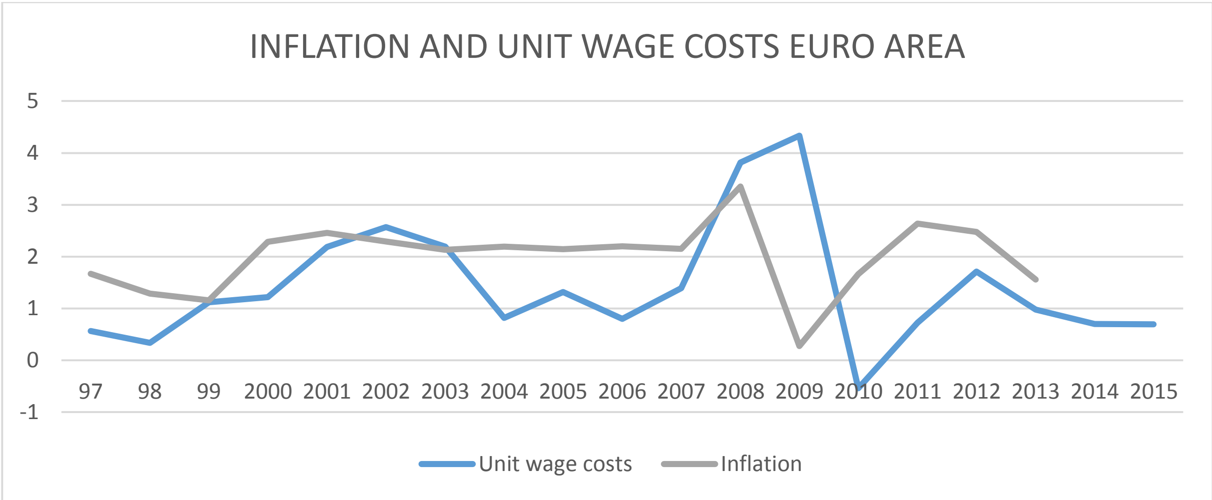
To understand what happens when nominal wages fail to incorporate any increase in the level of inflation and are only following productivity, look at the graph below.

It shows the evolution of nominal unit wage costs at the level of the Euro Area. Since nominal unit wage costs are calculated as the difference between nominal wage growth and productivity growth, the ECB's peculiar standard of aligning nominal wages with productivity boils down to saying that nominal unit wage costs should be around and close to zero.

However, the graph also shows the close relationship that exists between nominal unit wage costs on the one hand, and the rate of inflation on the other. It appears that inflation tends to accelerate (decelerate) in line with the rate of change in nominal unit wage costs going up (going down), even if there is a certain time lag. This is also perfectly understandable. If wage costs are rising by 2%, business will tend to raise prices by 2% so as to maintain profit margins. Vice versa, if wage costs are falling, business will be able to freeze prices or

even cut prices without compromising its profit margins. And if unit wage costs are stagnating, as the ECB would like them to do, inflation will tend to fall to zero, a process that at present is well under way. Indeed, with developments in nominal unit wage costs now down to a mere 1% (see graph), it does not come as a surprise that Euro Area inflation rates are also down and, with 0.5%, close to zero.

In other words, if the ECB is serious about its price stability target of inflation, it should stop promoting the deregulation of wages and instead rediscover the importance of instruments preventing wage dynamics from 'falling through the floor' and triggering price **in**stability or even outright deflation.



5. - Structural reforms: deflation, debt and depression

Why do European institutions deny reality and keep pretending that the problem lies with excessively high wage increases? What explains this obsessive drive for structural reforms to weaken wage bargaining and systems of wage formation?

The simple answer is that, with fiscal austerity undermining domestic demand, policy makers across Europe are pinning all of their hopes on demand coming from the outside. Export-led growth is supposed to take over from weak internal demand, thereby offsetting the cuts in public finances that work to increase unemployment. And to trigger this process of export-led growth, wages need to give. Especially in a monetary union where wage devaluation is to replace the missing instrument of currency devaluation, wages are seen as public enemy number one.

This approach, however, is simplistic and overlooks two basic things: firstly, Europe is not a small open economy but a big and integrated marketplace. Secondly, the combination of deflation and high debt burden is dangerous.

Europe cannot steal jobs from itself

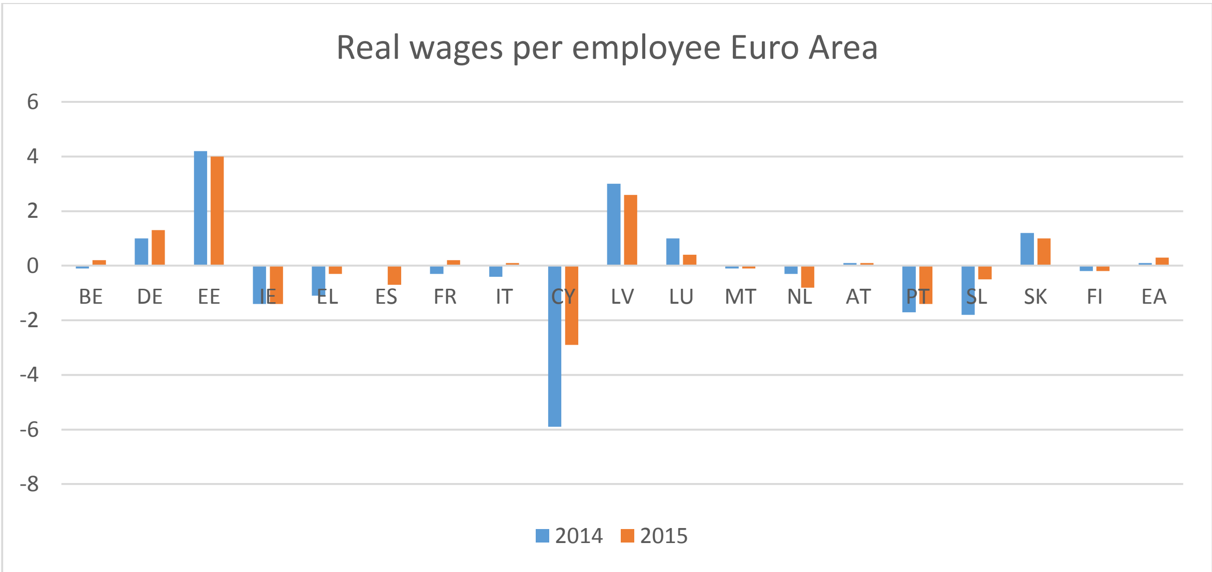
In a small open economy where exports take a major and overwhelming share of all economic activity, a strategy of internal wage devaluation may have some degree of success. Wage depression will tend to hold back household consumption demand but this would then be more than offset by rising export performance, since exports are a big pillar of overall GDP.

However, Europe and the Euro Area are anything but ‘a small open economy’. Europe is an integrated marketplace where European Member States are mainly exporting to each other. The share of exports going to the rest of the world is relatively small and limited to 17% of GDP. This figure also implies that internal demand, coming from households, companies and governments across Europe itself, represents 83% of European GDP.

Therefore, the strategy of internal wage devaluation now being set up across major parts of Europe and, ironically, with the blessing of European institutions, is doomed to fail. It does not make sense to depress internal demand representing 83% of total economic activity in order to increase extra European exports only worth 17% of GDP. The share of exports outside Europe in GDP is simply too small for this strategy to be able to work. *The basic fact is that Europe cannot steal jobs from itself.*

The problem is especially acute in the Euro Area where the strategy of internal devaluation has been pursued most aggressively. The result is that the Euro Area is facing absolute wage depression. Since 2011, growth in Euro Area average real wages has been zero and this stagnation of real wages is expected to continue in 2014. Moreover, this Euro Area average hides the fact that in 2014 real wages will continue to fall in 11 Euro Area Member States.

In the end, only Germany (to a modest extent) and small members from Central and Eastern Europe are still enjoying real wage increases, whereas real wages remain depressed or are falling in the rest. This does not bode well for the strength or the duration of the ongoing economic recovery.



Deflation and debt: a dangerous twin

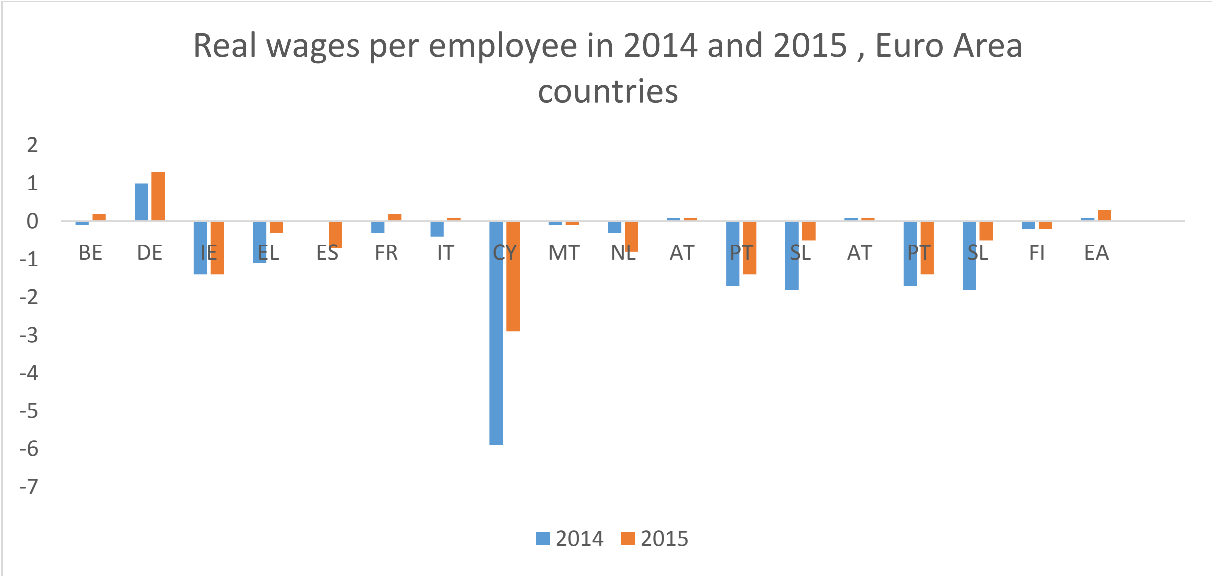
Policy makers in Europe are obsessed with wage competitiveness and this obsession makes them turn a blind eye to the second danger - the risk that their declared war on wages interacts with debt dynamics, thereby pushing the economy into the trap of a prolonged depression of activity.

Economists refer to this as the process of rising real burdens of debt. Here is how it works:

- the burden of outstanding debt depends not only on the interest that needs to be paid each year but also on the flow of income that debtors receive and expect to receive in future (irrespective of whether the debtor is a household, a government or a private business).
- When nominal wages are being squeezed debtors need to service debt from a lower income basis. A wage cut does not change the value of nominal debt in any way. Debt remains the same and, together with interest rate charges, needs to be repaid in full even when debtors' nominal income flows go down.
- This 'rigidity of nominal debt' crowds out aggregate demand. If households have to spend an increasing share of their income to service their debts, they will have no other choice but to cut spending on goods and services. Aggregate demand will get seriously squeezed and so will economic activity. As long as the economy finds itself in this trap of high and rising debt burdens, prospects for growth and jobs will be dismal.
- One other channel of depression works through debtors defaulting on their loans, thereby shifting the losses to the banking sector. This in turn destroys the capital and finance basis of the banks, forcing them to cut off the flow of credit to the real economy. The credit squeeze drags down investment and the economy again finds itself facing depressed growth prospects.
- The cycle of income deflation and rising real debt burdens is complete when wages and prices react to the ongoing depression of economic activity by going down even further, thereby giving an additional twist to the wheel of wage deflation. The real burden of debt rises further and even more demand is squeezed out of the economy. In other words, once this cycle of rising real debt burdens is unleashed, the economy finds itself trapped in a hole that simply gets deeper and deeper by itself.

In the end, even if Member States manage to achieve some small gains in wage competitiveness, the potential positive effects of this will be swept away by the systemic increase in the real burden of debt.

All of this can be easily recognised in the Euro Area over the past few years. Euro Area nominal wage dynamics have come down to the pace of an annual increase of not even 2% (see graph below). In particular, in financially distressed Euro Area Member States, nominal wages are, at best, stagnating (Spain) and, at worst, falling (Greece, Ireland, Portugal, Cyprus). At the same time, the countries mentioned are exactly those countries already carrying high public and private debt loads, making this process of rising real debt burdens particularly problematic. It does not come as a surprise that the economy has been most depressed in exactly these countries, despite sometimes spectacular improvements in so-called wage competitiveness. These are also the countries where defaults on loans have soared, thereby putting into motion the mechanism whereby banks lose part of their capital and in turn squeeze credit to the real economy. All these developments fit the picture of debt and deflation quite well.



To summarize - the mission to weaken and destroy wage formation and bargaining which many European policy makers have embarked upon over the last few years is deepening the crisis. It is risky to go for radical wage flexibility and it is especially a very bad idea to do so when total debt loads are already high.

6. - A different course for Europe: wages as a source of growth and stability

Europe needs to change course, not just on fiscal austerity but also on reforms and wage flexibility. The Commission, the ECB and the European Council(s) are wrong to see wages as a negative adjustment mechanism for competitiveness and jobs. Labour is not like a commodity.

Wages are not simply a price to 'clear the market'. Stable and robust wages that cannot be cut overnight at the pure discretion of the employer provide essential security for workers and their families. Wages, by strengthening general demand dynamics, are also an engine of growth and job creation. Last but not least, stable wages also function as a circuit breaker against the three vicious D's: Deflation, Debt and Depression.

The ETUC therefore calls upon the Commission, the Council and Member States to recognise this fundamentally different role of wages and to take this into full account in the so-called "European Policy Semester". National reform plans and the upcoming country specific recommendations need to shift direction and seek ways to strengthen wage formation systems and respect for the autonomy of collective bargaining.

In particular, Member States that are already in deflation or under threat of deflation, urgently need to prevent nominal wages from 'falling through the floor'. Meanwhile, in Member States where real wages have been lagging behind productivity, the focus should be for real wages to catch up significantly.

To achieve this, respect and the promotion of autonomous collective bargaining is the best instrument, thereby also ensuring that workers get a fairer share of economic progress while supporting productivity and investments and fighting poverty.

Here, the ETUC also insists that the Commission, the Council, and national governments strictly adhere to the principles of the European Treaty by respecting the autonomy of social partners and the diversity of national systems of industrial relations, thereby considering the decision on how to organise wage bargaining as a national competence. Reforms to strengthen wage formation and bargaining systems can only be undertaken through negotiations with social partners and after in-depth social dialogue at a national level. Such reforms can then take different forms, depending on the national situation and the national tradition of wage formation.