# EUROPEAN WAGE RECOMMENDATIONS: THE 2013 GOVERNANCE CYCLE

## General observations

- Like last year, wages are again a central part of the European Semester. Eight member states receive a recommendation on wages and/or wage setting systems. On top of that, there are 4 countries under a Troika program where wage interventions are part and parcel of the adjustment program. In addition, there are Austria and Hungary who are told to reduce the tax burden on low wages. Meanwhile, the UK does not get a specific wage recommendation, however it is stated that its labour market is already flexible (see table attached for an overview per country).This makes a total of 12 member states getting a specific wage recommendation and 14 if Austria and Hungary are counted in as well.

- In almost all cases, the Commission's recommendations are geared towards interventions and reforms that promote downwards wage flexibility.

- The one exception is Germany where there is attention for the role of wages in supporting domestic demand. However, to achieve this aim, the Commission explicitly refers to reducing taxes and social security contributions on low wage earners but not to wage setting as such. Minimum wages do get mentioned but are being downplayed by saying that wage floors would be positive only if they do not lead to significant job losses.

- In this set of country cases receiving negative wage recommendations, the general line is that the Commission is on the one hand satisfied with the reforms of wage formation systems that have already been undertaken but on the other hand is insisting on continuing, deepening or at least 'monitoring' these reforms.

- This concerns wage indexation systems in Belgium and Luxembourg. Also the fact that central agreements in Italy negotiate on a wage increase in line with inflation for all workers in the sector (even if prices of imported energy are now excluded) is being disapproved by the Commission since it prevents individual companies from enjoying downwards wage flexibility.

- In the case of France and Slovenia, minimum wages are the other wage formation institution the Commission is targeting. France is said to have a high minimum wage of 60% of the medium wage, preventing downwards adjustment. In Slovenia, where the minimum wage was hiked substantially in 2010, the Commission's texts also have strict language on the compression of the wage distribution and on the automaticity of regular minimum wage increases.

- Spain, where unit labour costs have turned the corner but are not yet falling as rapidly as the Commission would wish for, the Commission insists on evaluating the reforms by July and present amendments by September if necessary, in other words to go for possibly even more deregulation.

- There are explicit calls to Denmark and Finland to have low and moderate wage developments in future collective bargaining agreements. For Finland, the Commission warns for a repeat of the 2007 coordinated bargaining round where one sector after the other based itself on one central sector agreement.

- We know that the ECB is pushing for a wage standard by which nominal wages are to follow productivity and not compensate for inflation. This narrow wage standard is taken up by the European Semester but there are also contradictions. For example, Belgium is explicitly told to prevent a future decoupling of nominal wage evolutions and productivity developments (which amounts to de facto abolishing indexation). On the other hand, the Finnish CSR refers to aligning real wages with productivity. However, the latter is again in contradiction with the in depth review for Finland itself, condemning the fact that wages are expected to outpace productivity in the next years, thus increasing nominal unit wage costs.

- Another contradiction concerns the Commission's view on the role of wages in supporting innovation and non price competitiveness. The in-depth review on France delivers the message that wages have to be held down in order for profits and profit margins to increase (as they did in Germany over the past decade and as has been happening in Spain recently, in both countries now a gross operating surplus of more than 40% in the non financial business sector compared to only 30 % in France). In the Commission's view, such increase in profit margins, if invested, would enhance innovation and non - price competitiveness and move the economy up on the ladder of added value. In deep contradiction with this is the in-depth review on the Netherlands where it is said that wage moderation could have a potentially negative effect on innovation.

- There is no repeat of the recommendation to increase wage inequalities in Sweden, where the Commission last year had to retreat this sort of recommendation. Instead there's language on 'measures' to improve labour demand for special groups.

**Wages as the main instrument of adjustment: A doubtful approach**

The main idea behind the way wages are being approached in the CSR's and the European Semester in general is that wages are the main instrument of adjustment. Whatever the challenge, whether this concerns addressing current account deficits, rebalancing of the Euro

Area, cost or non-price competitiveness, uneven unemployment rates between regions or categories of workers, skills mismatches between companies, wage flexibility is always the formal policy reply.

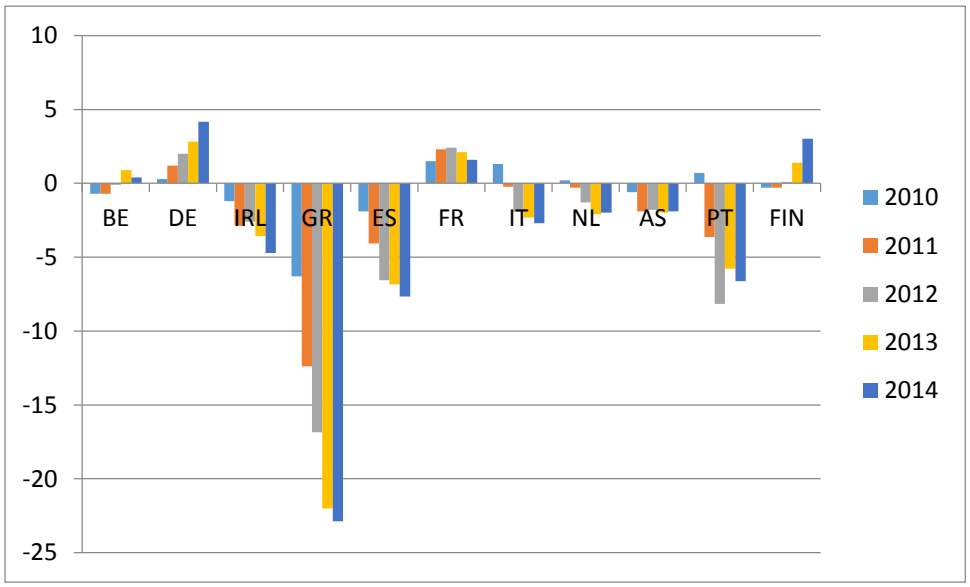
This approach is doubtful. Besides running the danger of promoting higher inequalities, it is having a particular adverse effect on the state and the macro economic performance of the Euro Area economy.

The latter can be illustrated by referring to recent wage trends. According to the Commission's recently released spring forecasts, the growth rate of Euro Area nominal wages took a firm dive below of 2% already from 2009 on. This resulted in a fall of 0.3% in real wages in 2011 and another -0.3% fall in 2012. In 2013 and 2014, the European Commission expects real wages to stay close to stagnation (0.2%).

These are average figures for the Euro Area. Behind these averages is hiding the fact that real wages have fallen quite significantly in a number of member states. In 2012 for example, Greece and Portugal registered a fall of around 5%, whereas real wages are falling by around 2% in Spain and Italy.

Moreover, these falls in real wages add up, year after year. In Greece and Spain real wages have now fallen for five consecutive years. In Italy and Ireland real wages will have been going down over a period of four years. If we start counting from 2009 on and until 2014, real wages per worker will have gone down by 22% in Greece, 7% in Spain and Portugal, 5% in Ireland and 2 to 3% in Austria, the Netherlands and Italy (see graph). In fact, real wage increases in the Euro Area over these past years have been limited to just two countries: Germany and Finland.

**Compounded evolution of real wages since 2009**

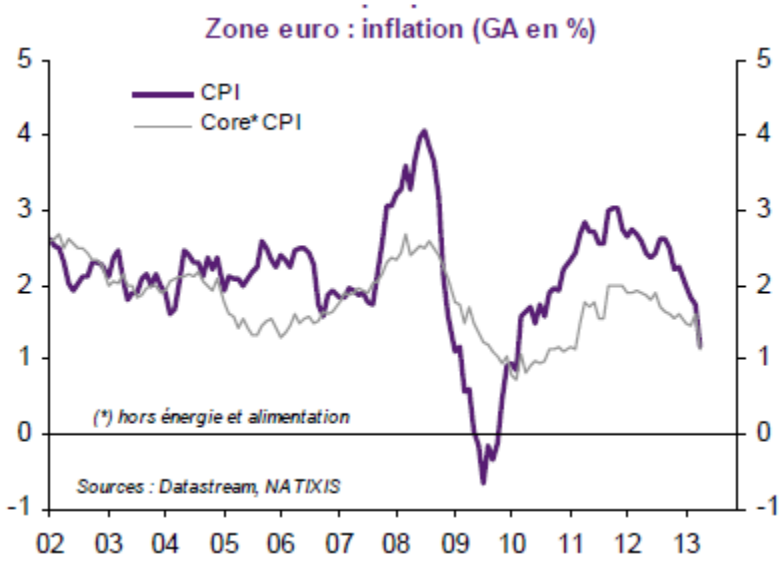



In other words, a policy of competitive wage is now being implemented across a major part of the Euro Area (with the exception of Germany). Such a policy, if pursued simultaneously, will result in a situation in which competitive gains cancel each other out where and the regressive effect of wage cuts on domestic demand would dominate and lead to a worldwide depression.

This is actually already happening in reality: It is no coincidence that the Euro Area's economy is now in recession for six quarters in a row. Europe's obsession with overambitious deficit

targets is certainly to blame for dismal growth performance but another part of the responsibility is to be attributed to this ongoing wage race to the bottom, with real wages in the Euro Area falling or stagnating for four years in a row. The lack of real wage growth implies that one of the pillars of aggregate demand dynamics is simply lacking.

A related concern is the news coming from the inflation front, with headline inflation in the Euro Area falling rapidly from 2% in January down to 1, 2% in April. Such low inflation rate is way below the ECB's official target of price stability ('below but close to 2% inflation') and once again testifies to fact that wage deregulation combined with fiscal austerity have substantially weakened the Euro Area economy. The risk here is that, if a negative shock would arrive or if wage depression were to continue and intensify, low inflation would tip over into outright deflation, generating the dismal picture of a 1930 style deflation and depression.




**To conclude: It is a big disappointment that the European Semester with all of its instruments of monitoring and so called 'economic governance' are simply missing this issue. The whole point of having a European level policy approach should be about checking whether 27/17 different national economic policies are consistent with each other. Instead, the European Semester approaches individual member states in an individual way, presuming that the sum of all the individual parts will be the effective outcome for the whole of Europe. In that way, it is not the Europe of cooperation but the Europe of 'competition state' that is being promoted. (One clear illustration here is that in the French in depth review social partners are warned that, even if they redress competitiveness, more needs to be done because Spain and Italy are meanwhile also reducing labour costs: This is the giving a European blessing to wage race to the bottom). In an integrated economic area with a single currency, stepping into the trap of 'the phallacy of composition' is an unforgivable mistake.**

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| Country | 2013 recommendation | 2012 recommendation | Commission evaluation of 2012 implementation | In depth review Macro imbalances |
|---|---|---|---|---|
| **Austria** | Reduce tax and social burden on labour for low wage earners | | | |
| **Belgium** | Continue with ongoing efforts to reform wage indexation, ensure wage setting responds to productivity developments and reflects local differences in productivity and labour market conditions ,automatic ex post corrections | "All in' indexation, 'ex post' wage corrections, opt out clauses to reflect local productivity) | The effectiveness of several measures addressing labour costs still needs to be established.<br>Decisive reform<br>s are called for, including not just addressing past hikes in unit labour costs but a thorough modernisation of the<br>wage-setting system in order to prevent any future decoupling between nominal wage<br>evolutions and productivity developments. | Idem plus take past wage developments into account in wage norm |
| **Bulgaria** | | | | Unit labour costs under control but without reforms ULC growth may become excessive again |

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|---|---|---|---|---|
| **Cyprus** | Under Troika programm | Reform wage indexation system | Indexation suspended in public sector, negotiations to do this in private sector as well, longer term: limit indexation to 50% of inflation, automatic suspension in economic crisis | |
| **Denmark** | | | | Wage developments need to be moderate<br><br>Correcting accumulate wage competitiveness gap requires low wage growth/high productivity growth for some time to come |
| **Finland** | Align REAL wages with productivity in current low growth environment | Continue to align wage and productivity developments | Agreement between social partners on wages should take due account of competitiveness | Wages expected to outpace productivity in 2013 and 2014, thus increasing nominal unit labour costs<br>Next agreement to aim for lower wage growth in line with productivity.<br>Sectoral agreements instead of one central agreement (No repeat of the 2007 coordinated bargaining round) |

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|---|---|---|---|---|
| **France** | Take further action to reduce employer social security contributions.<br><br>Ensure developments in the minimum wage support job creation and competitiveness, taking wage supports schemes and social contributions exemptions into account | Ensure that any development in the minimum wage supports jobs and competitiveness | Substantial increase in labour costs over last ten years including a real increase in the minimum wage of 16%.<br><br>Tax credit on payroll will influence competitiveness in a limited way (manufacturing will not benefit primarily, firms will first restore their financial situation) | High minimum wage (60% of median) prevents downwards adjustments while its indexation formulae may led to average wage pressure.<br><br>Profitability of firms among the lowest in Europe, hinders non price competitiveness. Wage developments need to be looked at closely to avoid further erosion.<br><br>January 2013 social partner agreements positive but needs to be complemented to enable firms to redress their competitive edge, in particular over Spain and Italy where labour costs have been reduced and significant reforms undertaken. |

| Country | 2013 recommendation | 2012 recommendation | Commission evaluation of 2012 implementation | In depth review Macro imbalances |
|---|---|---|---|---|
| **Germany** | Sustain conditions that enable wage growth to support domestic demand. To this purpose, reduce high taxes and social security contributions, especially for low wage earners | Create the conditions for wages to grow in line with productivity | Real wages have increased stronger than productivity since the crisis.<br><br>Wage floors would have a positive impact on overall income of workers pronly if they do not lead to significant job losses. | |
| **Greece** | Under Troika programm | | Extensive labour market reforms introduced in 2012 are delivering results in terms of wage flexibility an d improved competitiveness but need to<br>be complemented with measures to promote employment, including by making Greece a better place to invest. | |
| **Hungary** | Alleviate tax burden on low wage earners | | | |
| **Ireland** | Under Troika program | | Earlier loss of competitiveness has been erased by a mix of wage moderation and productivity increases | |
| **Italy** | Ensure implementation of wage setting reforms to allow better alignment of wages with productivity | | Lacklustre productivity not reflected in wages over past ten years; adjustment in wage setting along lines of social partner agreement are thus required | Wages still not sufficiently responsive to productivity developments, promote shift in wage bargaining towards company level. Low share of company level agreements, especially in the South |

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|---|---|---|---|---|
| **Luxembourg** | Beyond the current freeze, take further structural measures, to reform the wage setting system, including wage indexation, to improve its responsiveness to productivity and sectoral developments and labour market conditions and foster competitiveness. | Reform indexation by indexing only one a year and reduce impact of energy prices | Nominal unit wage costs increased by 16% between 2008 and 2012, tow times faster than neighbouring countries | |
| **Malta** | | Further reforms of wage indexation and limit impact of import prices | Malta's wage indexation mechanism could still pose a challenge to the flexibility of real wages in the event of a very adverse economic situation. | |
| **Netherlands** | | | | Although wage moderation could create jobs in the trade sector, it could also depress domestic demand and have a potentially negative effect on innovation. |
| **Portugal** | Under Troika program | | | |

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|---|---|---|---|---|
| **Spain** | Finalise evaluation of 2012 reform by July, present amendments if necessary by September | Implement labour market reform including bargaining system | Reform agenda goes in right direction, implement reforms so they can start generating positive effects | Monitor whether labour market reform is attaining its objectives (align wages with economic conditions, greater use of permanent contracts) |
| **Slovenia** | Ensure wage developments including minimum wages support jobs | Wage growth, including minimum wages to support jobs | Public sector wage bill has been reduced but minimum wages have continued to rise | Adaptation of minimum wage setting (2010 hike compresses wage distribution, annual automatic increases magnify tensions) |
| **Sweden** | Measures to improve labour demand for young low skilled and migrant background | "Encourage increased wage flexibility at the lower end of the wags scale ' (scrapped by Council) | | |
| **UK** | | | | Flexible with regards to labour markets |