Wages as the single instrument of adjustment in a monetary union?

Lessons from the Irish case, if any?

Marie Sherlock

SIPTU (Ireland)

13th April, 2010

1) **Overview of the collective bargaining system in Ireland and the current state of play.**
2) **How did we get ourselves to this place?- the background on the need for an adjustment**
3) **The fiscal adjustment**
4) **The economic competitiveness adjustment**
5) **The implications of cutting wages as an instrument for simulating competitive devaluation**

Features of Collective bargaining system in Ireland

Overall, there is a voluntary system of collective bargaining, non binding in law.

4 types of wage determination in Ireland:

- **National wage agreements:** tripartite agreement between Government, Unions and Employers representatives, applied across all sectors.

  Opt out clause? Yes- an inability to pay clause.
- **Registered Employment Agreement (REA):** provision to voluntarily register an enterprise level employment agreement with the Labour Court, agreed by both parties, which binds each to the terms and also applies to other enterprises in that industrial class or geographical areas, where identified, in the REA.

Collective bargaining in Ireland (ii)

- **Registered Employment Agreement :** 4 industries apply nationwide (i) construction, (ii) electrical contractors, (iii) drapery and (iv) printing.

  Opt out clause? No
- **Employment Regulation Order (ERO):** Legally binding sectoral level minimum rates of pay. The rates are proposed by a Joint Labour Committee set up under the auspices of the Labour Court and are made up of employers and unions. Covers 13 economic sectors, of which three are fully traded sectors.

  Opt out clause? no
- **Minimum wage legislation:** rate per hour set by Minister for Enterprise, following on from request for review by Unions or Employers.

  Opt out clauses: inability to pay clause, but not used since its introduction in 2000

Current state of play

- **National Wage Agreement agreed**
  September 2008 committed to 6.1% pay increase over 21months period backdated to March 2008 to January 2010.

	Pay pause	Phase 1: 3.5%	Phase 2: 2.5%
Public	11 month pay pause	Next 9months: not paid	Next 3months: not paid
Private	3month	Next 6months: paid	Next 12months: majority of cases have postponed or renegotiated at local level

National wage agreement

But it was reneged upon by the Government just 4months later

Public sector pay cuts to date:

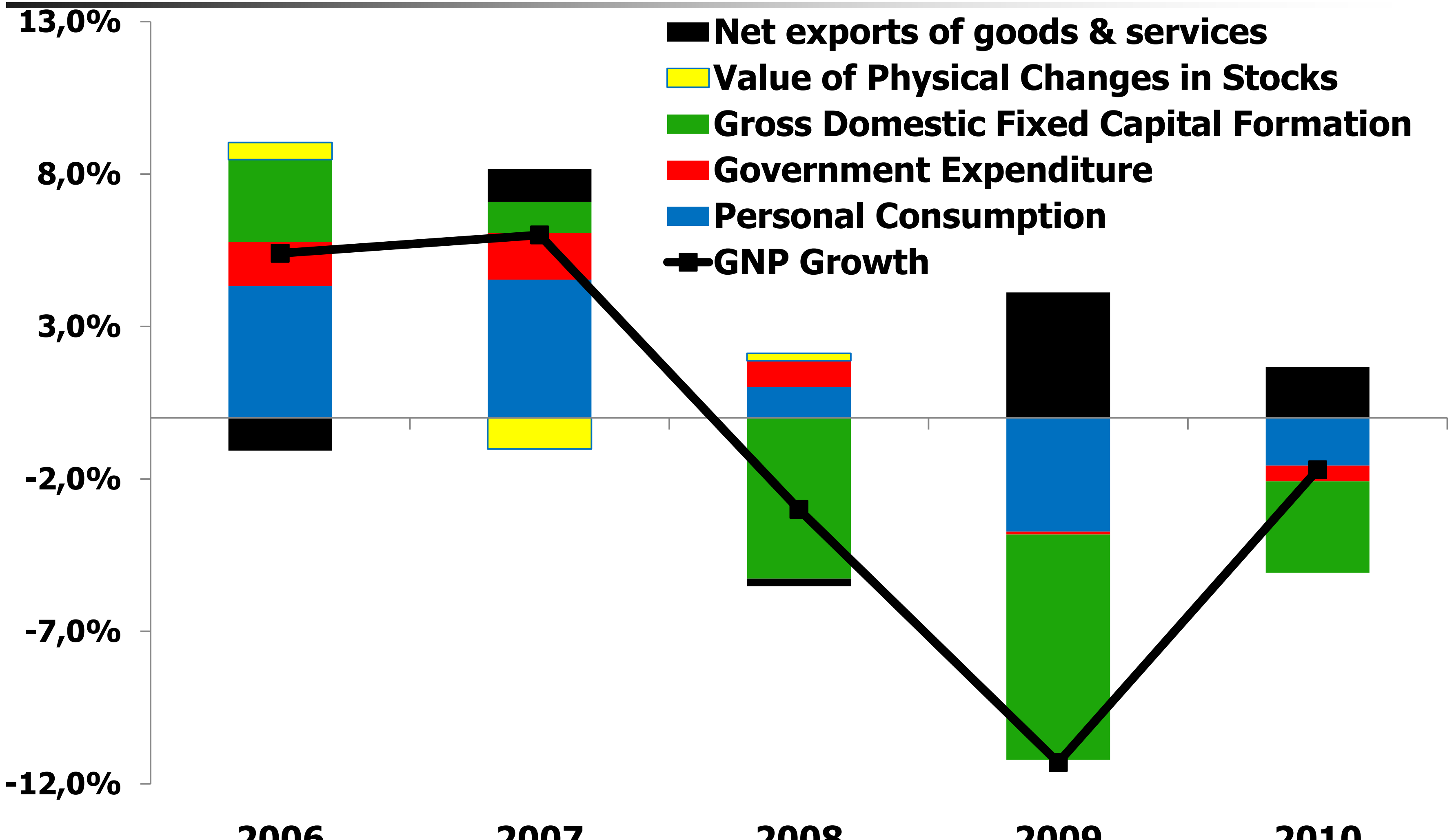
1) **Pension levy introduced February 2009:** was restructured within 2months due to regressive burden on lower paid due to pension contribution tax relief rates. Now: mildly progressive. Ranges from 5% on earnings €15,000-€20,000 to 10% on earnings above €60,000.
2) **Pay cut introduced December 2009:** Very draconian. 5% on first €30,000, 7.5% on next €40,000 and 10% on earnings over €55,000.

Current state of play (ii)

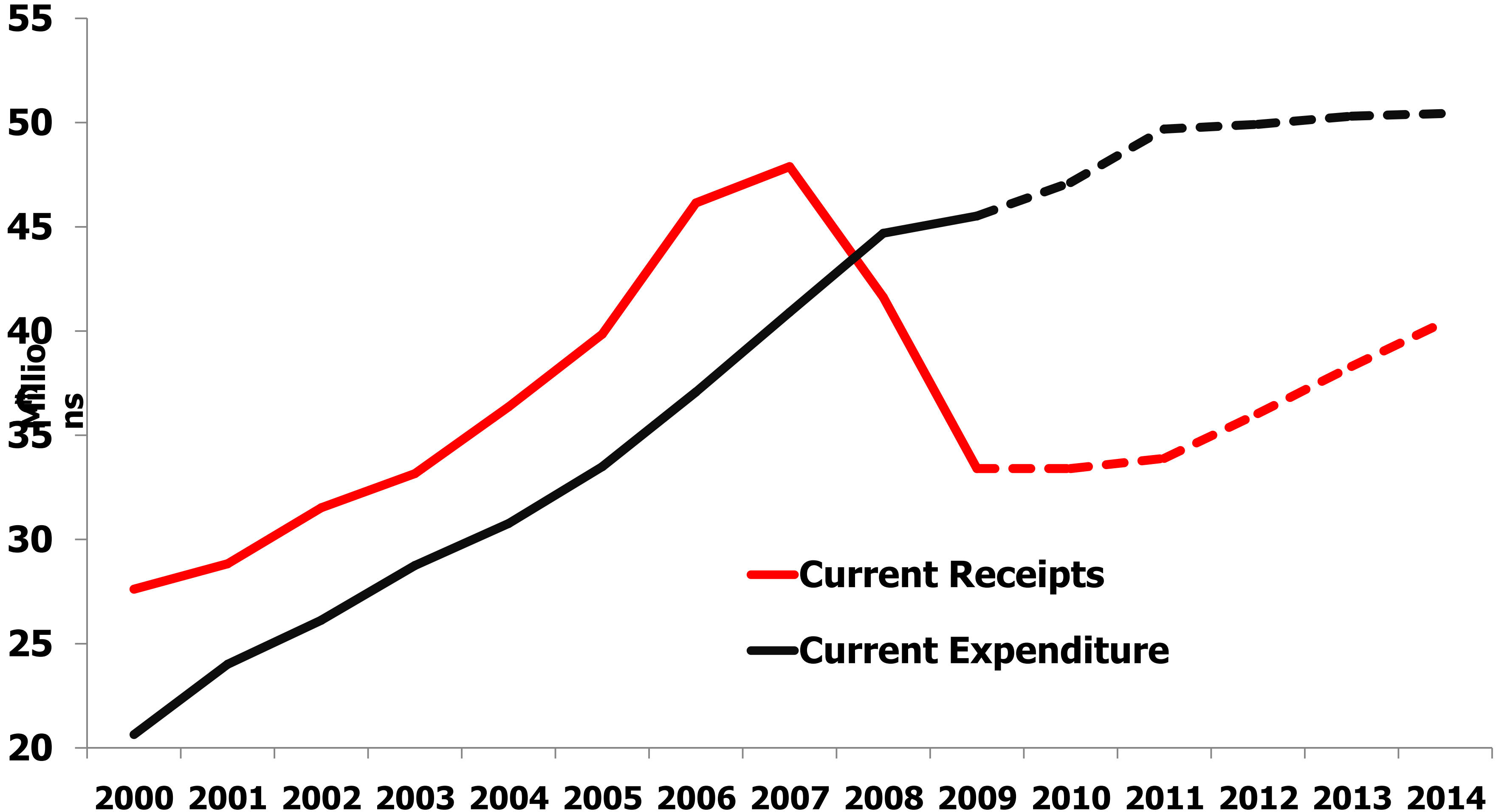
- Draft Public service agreement currently under consideration: no further public sector pay cuts over period to 2012. Review of pay cut to be undertaken in line with progress in public service modernisation programme next year.

- Government proposal to include inability to pay clause for REA, which will expose covered sectors to a race to the bottom in terms of price.

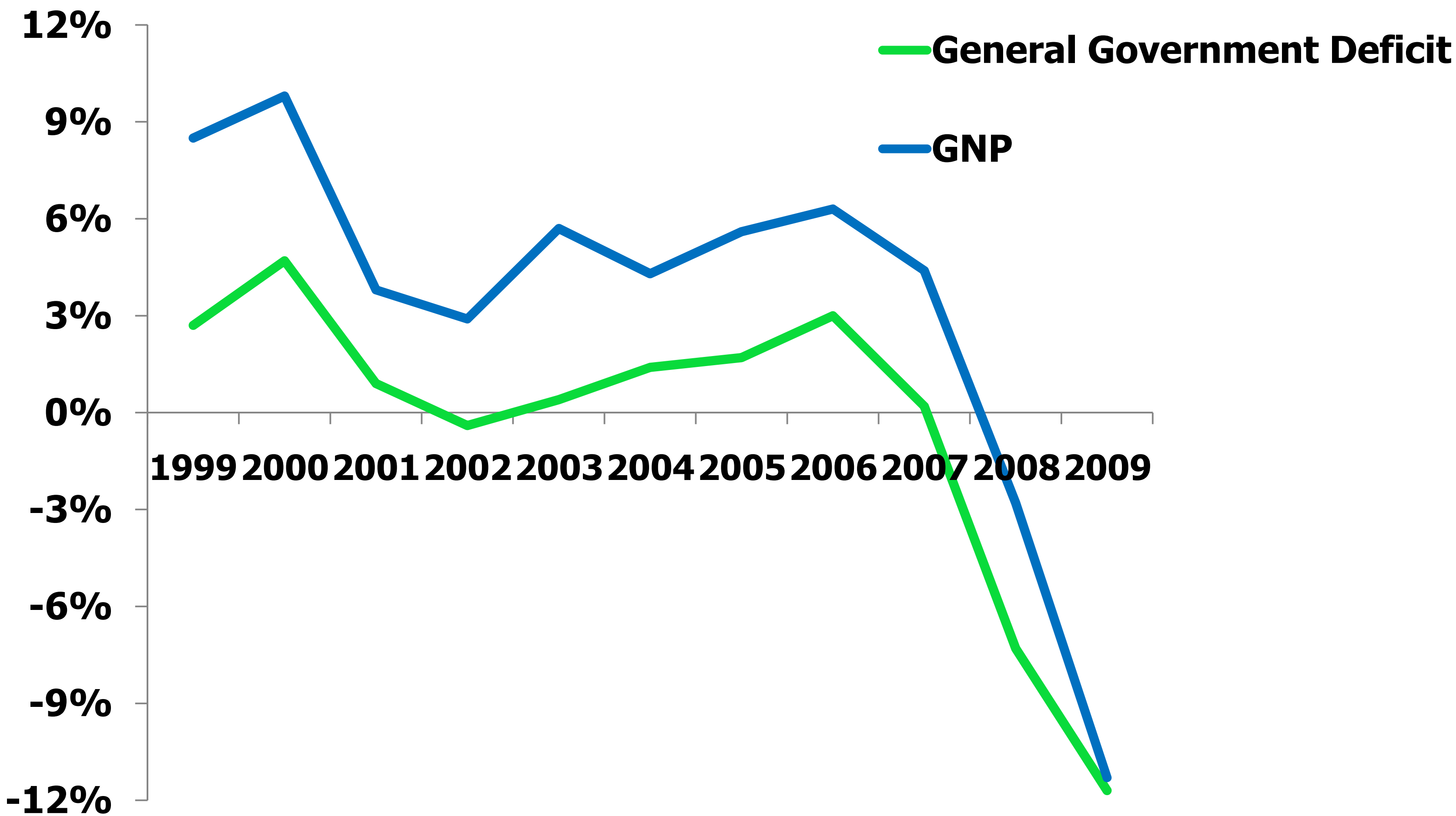
Irish economic growth; an overview



Collapse in tax revenues: 15% of the base in 2006 collapsed and now accounts for only 4% of total tax take.



Irish general Government deficit



Debt to GDP ratio

- Irish Debt to GDP ratio: has jumped by 53% between 2007 and 2010
- Implicit gross debt inclusive of bank recapitalisation scheme and bank asset management programme amounts to 119% of GDP in 2010.

- Debate about scope for further borrowing and offsetting stimulus measures.
- Parallels with Greece in being a non core EU member state at the mercy of international capital markets.

The risk of a prolonged slump from current economic conditions?

- **Annual deflation at 3.1% after 15 months of falling prices. Increased mortgage interest costs and government determined prices likely to push price movement into positive territory at start of 2010 but rest of goods and services prices are likely to remain depressed.**

- **Unemployment rate currently at 13.4%, with over one-third long term unemployed. One in three of men aged 15-24 in the labour force currently unemployed.**

The national response

Notwithstanding the issue that the current Government should be held accountable for contributing to the boom and for failing to instigate counter-cyclical measures, there is a general consensus between Unions and Government on the twin challenges and the need for an "adjustment"

(i) repair public finances

(ii) re-orient private sector economic activity

But fundamental disagreement on

- **a) The scope for offsetting stimulus measures**
- **b) The scale of the adjustment**
- **c) The mechanisms**
- **d) The implications of such an adjustment.**

The Government's strategy to repair public finances

To date:

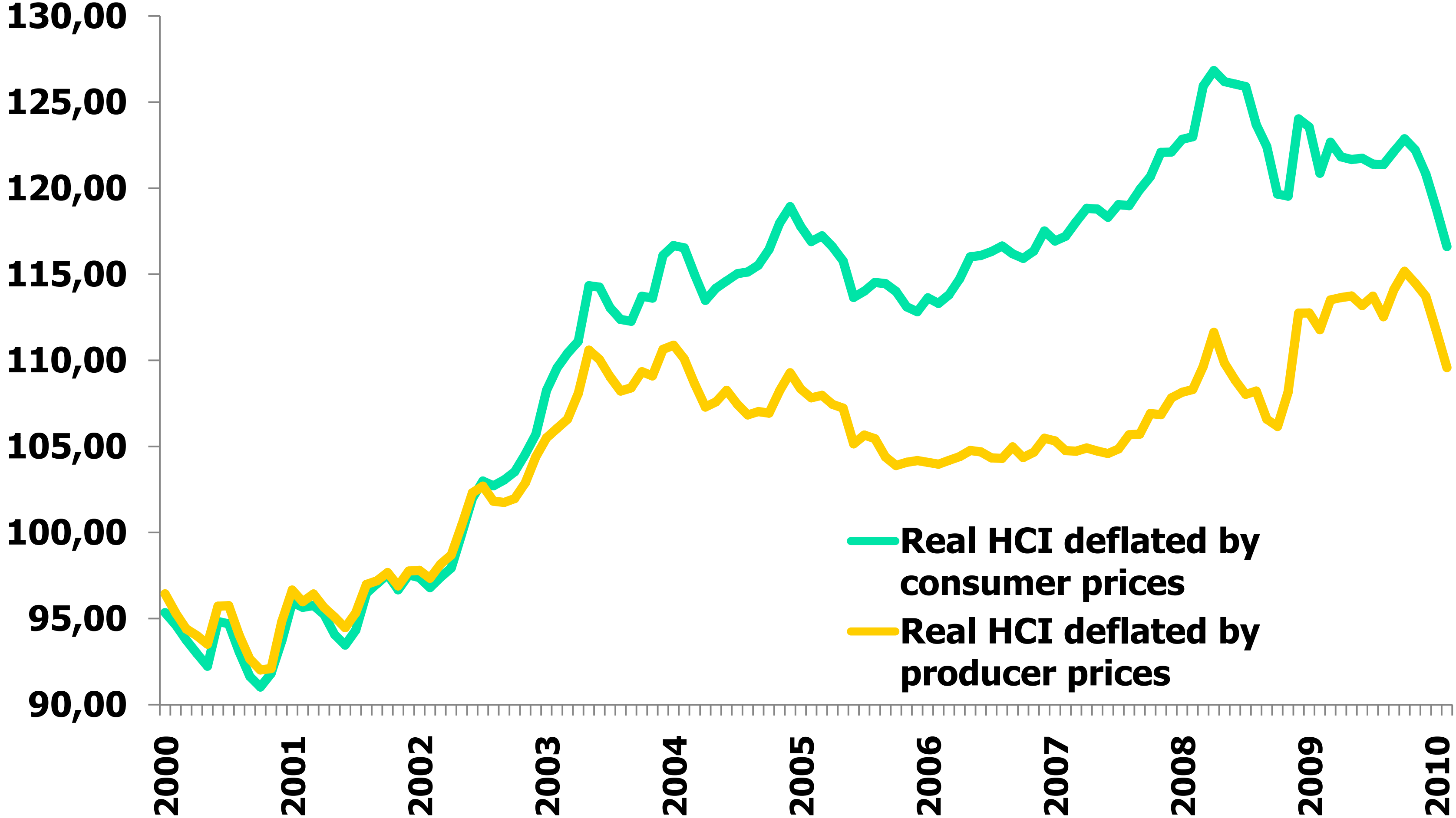
- Pro-cyclical fiscal consolidation worth 8% of GDP over three budgets.
- Government unilaterally opted out of national pay agreement
- Pay cuts as the main stabilisation tool in repairing the public finances. Payroll savings accounted for 45% of total consolidation package between 2009 and 2010.
- Changes to tax system accounted for 28% of overall savings and were mainly limited to income tax increases.

The Government’s strategy to lift economy out of recession

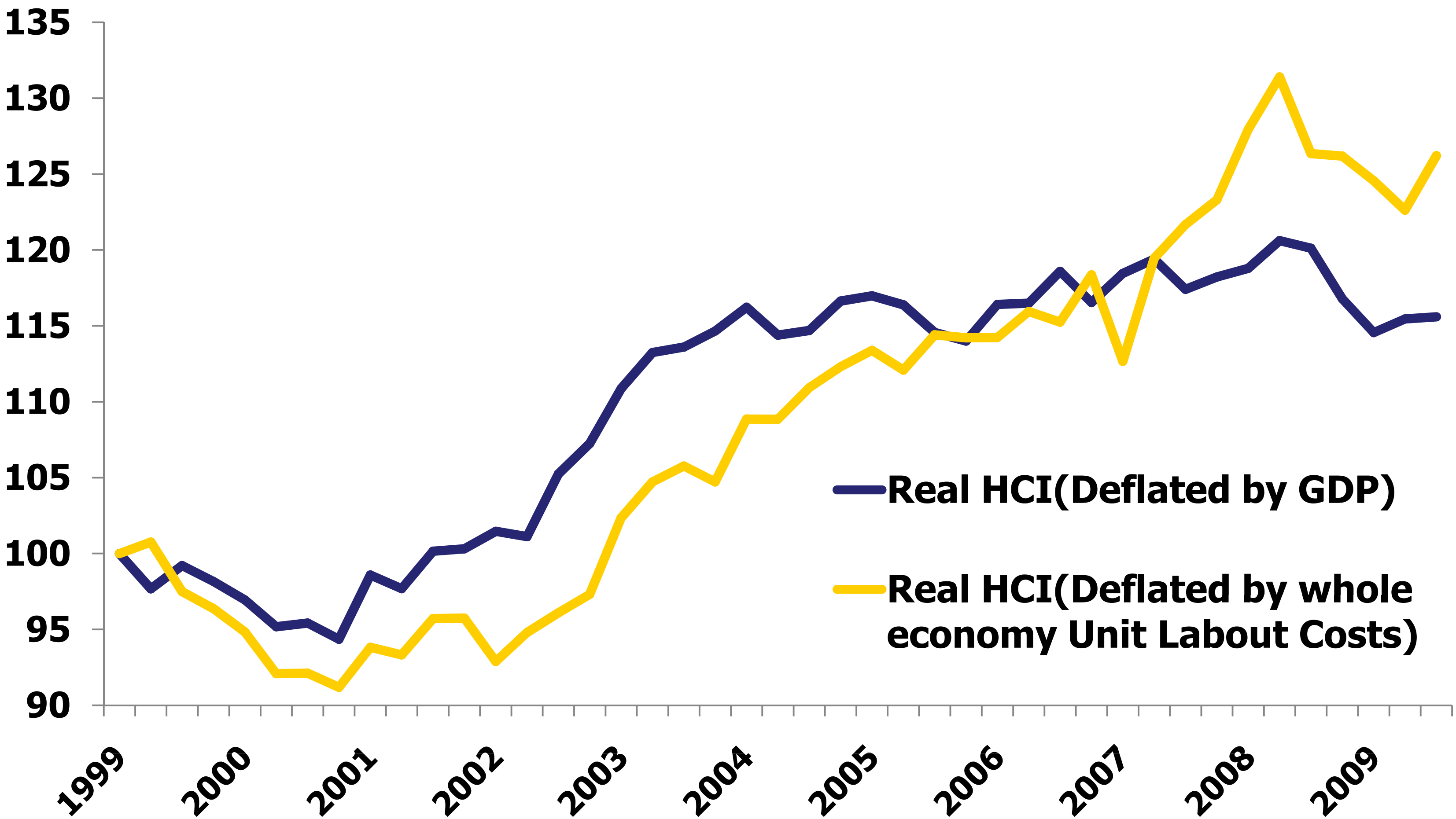
- **In contrast to other Euro area member states, Ireland’s current account will move from deficit to surplus in 2010, driven by plunge in import demand.**
- **Irish exports of goods and services broadly held up in 2009, recording only 2% slippage, due to strength of pharmaceuticals and organic chemicals trade.**
- **But gap widening between traditional and modern manufacturing during the global downturn. 14% drop in traditional manufacturing output was almost offset by rise in modern manufacturing output.**

Strategy is to achieve competitiveness gain by pushing down wage rates in traditional manufacturing and commercial services sectors.

Real effective exchange rate deflated by consumer and producer prices 2000-2010 (Feb.)



Harmonised competitiveness index 1999- Q3 2009



Irish cost competitiveness position 2010

- Adjustment already in train for industry sector unit labour costs but increase in unit labour costs market services points to issues of regulation.
- Contrary to widespread perception, private sector hourly wages recorded an annual increase of marginal 0.2% up to mid 2009. Employer and agency surveys suggest only 15% of companies have cut pay over 2009.
- Other non pay costs: regulated non traded services costs such as waste, accountancy, legal fees are consistently higher than competitor countries.

Irish cost competitiveness (ii)

Ireland has largest share of export trade outside the euro-area. Over 60% of Irish export trade is outside of euro-area, with approximately a quarter of merchandise and services exports going to the UK.

- **Sterling: 16% depreciation since first half of 2008.**

Wages as only tool for adjustment? The current Government strategy

- Cut public sector pay by average 14%- not clear what the transmission effect to private sector, if at all.
- Social welfare payment changes designed to force unemployed out into workplace- medium term effect: drive down wages.

  -4.1% social welfare cuts applied to all, but particular targeting of under 25's through the halving of payment 20-21year old, and payment of 75% for those aged 22-24.

  -Conditionality of full social welfare payment on participation in activation measures; designed to force unemployed into workplace, regardless of skills base.

The Government's simulated devaluation strategy

- **Threatened cut of minimum wage down from €8.65 per hour**
- **Attempts to undermine system of collective bargaining by including inability to pay clause.**

But…

- **Minimum wage only covers less than 3% of full time workers in the country.**
- **Blunt cut in wages assumes automatic pick up in export competitiveness. But major unresolved question is competitive at what?**
- **Major skills mismatch between current excess labour supply and jobs due to be created in future.**

The rationale for cutting pay

Government's argument is that we have all paid ourselves too much and that with falling prices are better off in real terms even after pay cut.

But…

- **Economy wide labour costs have increased by 39% between 2000 and 2009. However, in terms of labour cost per hour, Ireland was ranked 10th in 2008.**
- **Labour share of national income was 58% in 2008, below EU 15 average of 65.3%.**
- **When mortgage interest is excluded from consumer price, price fall in 2009 was only 1.2%. Broad based benefit of falling prices disputed by trade unions.**

Implications of strategy to simulate devaluation

Still too early to tell the impact of the current Government Strategy, but there are a number of risks:

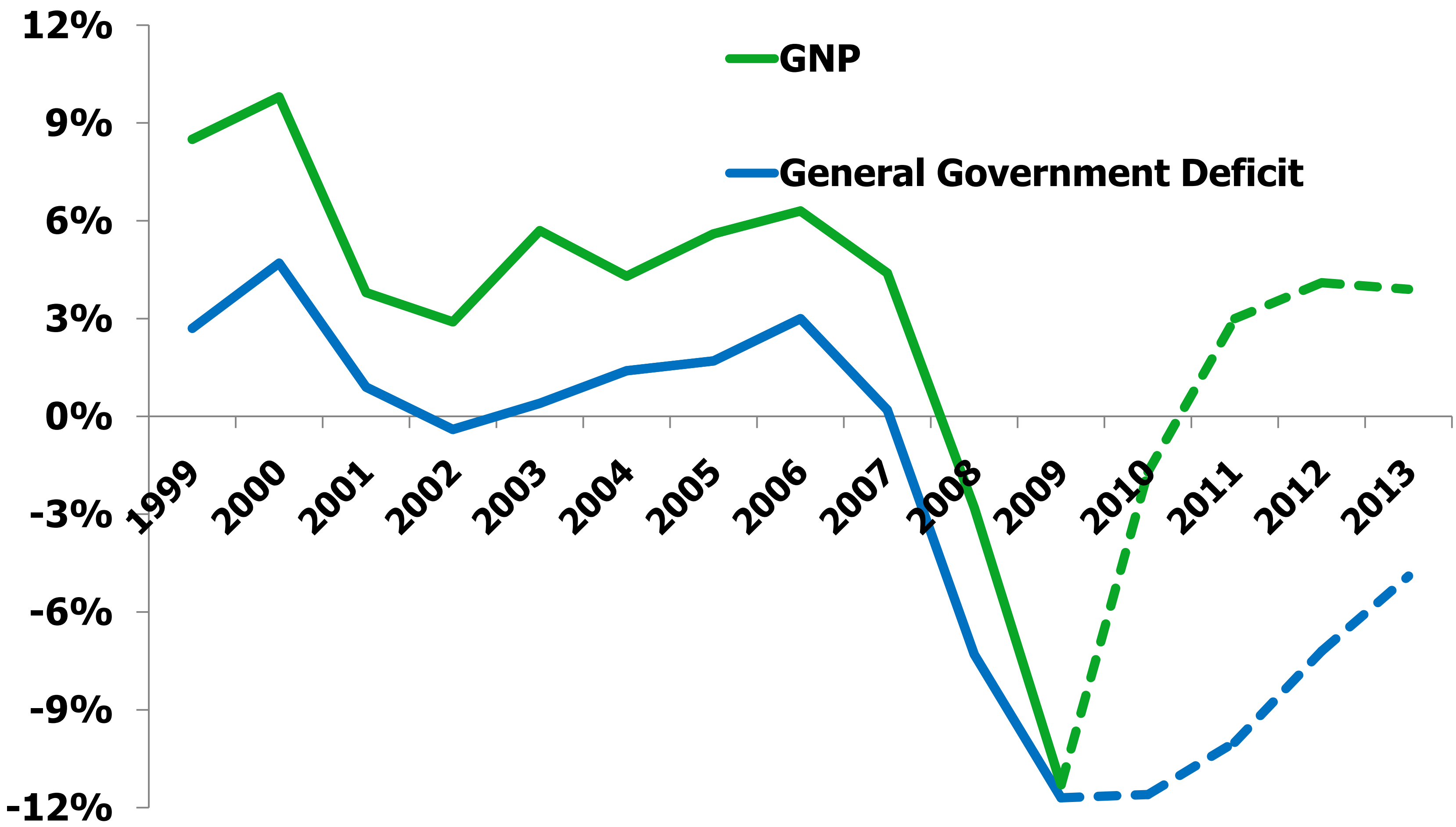
Persistent deflation:

- **Retail sales trend still in decline. Cautiousness borne out by pessimistic consumer confidence indicators with expectation of further deterioration in household finances. Prospects of property tax and water charge introduction at end of year.**

Weaker pick up in global export demand than expected:

- **Pick in world merchandise trade of 7% by mid 2010 now seems to be pushed out end of year, because of German and US performance.**

Government's optimistic growth projection 2011-2014



Lessons from Ireland?

- **Success of Government strategy predicated on Ireland being a small open economy capable of transmitting wage cuts into enhanced competitive global market position rather than deflating economic activity.**

- **But over 50% of economic activity is derived from domestic consumption. The fear is that medium term growth will be largely jobless.**