European Trade Union Confederation [ETUC]
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COLLECTIVE BARGAINING TRENDS AND OUTCOMES MID – 2006

Part I : Collective bargaining in the euro area

First signs of a turnaround in wage trends…

Wage formation in recent years in the euro area has been weak. Reacting to the slump in economic activity, the growth rate of gross hourly wages has fallen from 3.2% in 2002 to 2.3% in 2005. With inflation running at 2.2% in 2005, real wages are stagnating. Negotiated wages have been showing a similar pattern of weakening growth. Whereas negotiated wages were still growing in 2002 by 2.7%, their growth rate has fallen to 2.1% in 2005.

Contrary to the claim that wage moderation creates sufficient employment to fuel household consumption, the stagnation of real wages has not been offset by substantial job growth. Total wage income of households has been growing very weakly in real terms (around 1%), resulting in low consumption expenditure growth and low overall economic growth.

Workers and trade unions seem to be caught in a vicious circle: Wage moderation is undermining consumption and economic growth. In turn, this is leading to renewed pressures on workers to continue and even intensify wage moderation.

In recent pay deals, several trade unions have been trying to break out of this vicious circle by staging a certain turnaround in collectively bargained wages. Both in Austria as well as in Germany, the metal sector managed to secure a structural increase in pay by around 3%, around 0.5%-0.8% higher compared to 2005. In Spain, agreements concluded in the first quarter of 2006 settle for a 3.07% wage increase.In Italy, the metal sector also managed to conclude a wage increase higher than the price stability target by agreeing on an annual increase of 2.4% over the next 30 months[1](see table).

Table I: Some signs of a turnaround in wage growth

	2005	2006
Germany-metal sector	2.2%	3% (plus a 300 euro lump sum, can vary between 0 and 600 euro subject to local agreement)
Germany –steel sector		3%
Austria – metal (plus banks)	2.5%	3%
Spain		3.07% (excluding revision clause)
France		2.8% (basic pay scales)
Ireland		10% over 27 months (proposal)
Greece		11% over two years in private sector, 3% ceiling in public sector

Source: Eucoba network, New Industrial Relations, INSEE

…. but the overall picture remains one of continuing modest growth in wages

Nevertheless, the fact remains that many other sectors and countries are still moving along the path of low pay increases resulting in falling real wages. This is certainly the case in Germany where the chemicals sector, textiles, construction, public sector have concluded wage deals below 2% in 2007, or even no structural increase in wages at all. But also other countries (Netherlands, Belgium, Finland) show similar limited wage growth.

	2005	2006
German chemicals	2.7% for 19 months from June 2005 (1.7% on annual basis)	One off 1.6% subject to opening clause
German public sector	1% non-recurrent	1% non-recurrent
German textiles	432 euro non recurrent	1.8% (plus opening clause on working time)

[1] In Italy, sectoral agreements negotiate on wage increases that compensate for projected or targeted inflation, with some possibility of additional compensation to correct for past inflation being higher than anticipated.

German construction		1% from April 2006, return to 40 hour week without compensation
Netherlands		2% coordination guideline(with 1.1% in metal)
Belgium		2.25% guideline
Finland		2.1%(national agreement)

Where does this mixed picture put 2006 overall euro area wage growth? A 'back-of-the-envelope' calculation, based on estimates of average country outcomes ranging from 3% in France and Spain to 1.2-1.4% in Germany suggests euro area negotiated wages would increase from 2.1% in 2005 to 2.3% in 2006. Adding some 'wage drift[2]' (0.2%) to negotiated wages results in total wage increases evolving from 2.3% in 2005 to 2.5%. Technically, this is indeed an 'acceleration' but a very limited one from which no sizeable positive effect on household consumption can be expected. Regarding inflation, a 2.5% wage increase is still below the trend increase in hourly productivity of 1.1% over the 2000-2004 period and the 2% price stability target. This means wage formation in the euro area in 2006 will continue to contribute to the process of disinflation in 2006 and keep oil price hikes from spilling over into permanent inflation.

Expectations for wage formation beyond 2006

On the basis of experience over the last years, what can one reasonably expect from wage trends in 2007 and 2008?

For monetary policy makers, the issue seems to be rather straightforward. In the May press conference for example, the ECB insisted on hikes in VAT-rates (Germany) pushing 2007 inflation higher, possibly triggering higher than currently expected wage increases.

However, higher VAT –rates or indirect taxes have a double impact on prices and inflation. On the one hand, they push up inflation in a temporary way. Inflation will only become permanent if the increase in the price level would tempt wage earners to go for higher wage demands.

On the other hand, higher taxes at the same time withdraw aggregate demand from the economy, making it operate at a lower level of activity and pushing unemployment upwards. Wage formation then comes under pressure to react to such economic underperformance by moderating wages.

The fact that inflationary pressures, despite substantial hikes in oil prices, have been contained by very moderate wage trends over the recent years testifies to the potential

[2] Usually, effective wage increases are higher than increases in negotiated wages. However, there sometimes exceptions, as witnessed by Germany in recent years where a sizable negative wage drift has appeared. Wage drift is also depending on the state of the economy. If economic growth is slow and if there is a situation of slack and underutilised labour resources, positive wage drift will be minimal, as has been the case in the euro area over recent years.

strength of this latter mechanism. This leads us to conclude that, despite a temporary blip in inflation in 2007, upwards risks to price stability are unlikely whereas downwards risks to growth performance are a bigger danger. Anecdotical evidence from the bargaining process in the German metal sector illustrates this. In this case, German employers were very reluctant to sign an agreement covering two years, in particular because they were referring to the VAT-hike undermining 2007 growth prospects. This points to the fact that German employers in the 2007 negotiations will take a tough line and use the negative impact of the VAT-hike on the economy as an argument to put trade unions under pressure in the bargaining process.

What about prospects for 2008 and beyond? Even if the euro area economy would succeed in reducing slack and (cyclical) unemployment in coming years,(something which is not so likely if the ECB continues with hiking interest rates to fight the imaginery danger of inflation) there remains a certain buffer fund in wage formation against inflationary dangers. As noted above, wages are now increasing at a rate around 2.5% which is below the sum of the price stability target and potential productivity growth (1 -1.5%). This means that wages in the euro area could accelerate from 2.5 to 3.5% before they would even start to cause inflationary pressures. Moreover, with business profits haven risen recently, stronger wage growth beyond this point also could be handled by bringing profit margins back to more reasonable levels.

To be noted here is the entirely different attitude of central bankers towards wage formation. Whereas the ECB seems to think that any acceleration of wages, even a limited one from a very low level, is dangerous and warranting a change in monetary policy, the Fed chairmen is much more balanced in his opinions. For example, in a recent interview in the Financial Times, Bernanke declared that stronger wage growth does not automatically lead to higher inflation but that much depends on developments in productivity and profit margins.

<u>In any case, the ultimate conclusion is that the risk of inflationary threats coming from the wage formation process in the euro area is very limited in coming years.</u>

Longer working hours

Since the well-known Siemens agreement from mid-2003, there also appears to be a turnaround in the trend of working hours. Whereas there was a trend for working hours for full-timers to fall, this trend has been reversed in several countries of the euro area. In Germany, Spain, Italy and Austria the previous trend of a steady fall in hours worked has been halted and reversed into an increasing trend. Given the fact that unemployment is high and firms in the euro area are experiencing no difficulty whatsoever to find skilled labour, this comes as a surprise. Irrespective of the fact whether longer working hours are effectively paid or not, it does mean that fewer jobs have been created than otherwise would have been the case. It also means that potential growth rates, as used by the ECB, are being underestimated and that the economy could use sustained monetary policy injection to grow faster without endangering price stability.

Annual number of hours worked by workers having a full time job

	2000	2003	2005
Germany	1457	1429	1450
France	1508	1527	1534
Italy	1603	1599	1631
Austria	1575	1563	1661

Source : Eurostat,OECD

Correcting excessive flexibility on labour markets

Concerning excessive flexibility leading to an insecure work force and low innovation, there are some positive developments :

- To fight the problem of false self employed, the Dutch FNV is seeking to include minimum wage rates for self employed into collective agreements.
- In Spain, a draft law to improve paternity leave and negotiate equality plans in firms is in the process of being considered.
- The outgoing Berlusconi government has put some limits to 'continuous collaboration contracts' but a wider and more convincing correction of the very flexible Italian labour market is expected from the new Prodi government.
- In Sweden, with about 200 000 permanent jobs being replaced by temporary jobs, draft legislation is now being considered to give temporary staff priority after 6 months and to limit employers' use of temporary work to 14 months in five year period.

Part II: Collective bargaining outside the euro area

Trends in wages

Outside the euro area, collective bargaining and wage trends seem to evolve around a stable trend that is substantially higher.

For the new member states, this does not come as a surprise as they have an important catching-up process to do. Wage increases in the order of 10-11% (Lithuania, Estonia) or 5-6% (Slovakia) are being mentioned. In addition, statutory minimum wages in these countries continue to be increased. One notable exception is Poland where high unemployment (18%) is keeping wage growth down.

Noteworthy is a report from the World Bank, urging employers in Lithuania to hike wages in order to be able to prevent skilled labour from leaving the country. Reflecting further on this, this indicates that labour market forces may run behind what is needed in wage formation, for example because Lithuanian employers are holding each other ransom by competing against each other pressing on the basis of too low wages. In this case, the market needs to be corrected or helped by institutional arrangements such as collective bargaining and/or statutory minimum wages.

For Western European countries outside the euro area, nominal wage increases are evidently lower compared to Eastern Europe but quite robust compared to most euro are countries. In the UK and Nordic countries, nominal pay is evolving around a trend of about 4%UK) or 3.5% (Sweden), representing real gains in purchasing power of wage earners.

Systems of wage formation in Eastern Europe

Some Eastern European countries are in the process of trying to strengthen collective bargaining practices. In the Czech Republic, a draft labour code would introduce the instrument of a legal extension of collective bargaining. However, with a new government in place, it remains to be seen how things will develop. In Hungary, the construction sector is the first sector where a legal extension of a sectoral agreement has been implemented.

On the other hand, labour law seems to be toughened up in Poland where a revision of the labour code makes it clear that firms can cancel the existing collective agreement and are no longer bound by it after a waiting period. This introduces an element of US labour law where it is the firm and not the worker that is holding the job and where the assumption is that workers showing up at work implicitly agree with new working conditions as defined unilaterally by the firm. A similar system was introduced a couple of years ago in Portugal by the Barrosso government, although the later government did introduce a mechanism of 'arbritrage' before giving the firm the possibility to cancel collective agreements.

Re-regulation of the UK labour market is continuing

The UK has recently taken several measures to strengthen the position of workers on the UK labour market:

- The cap on redundancy pay has been additionally raised.
- Workers receive a new right to claim unfair dismissal if they suffer a material deterioration in working conditions in case of the transfer of an enterprise.
- Draft legislation to end current practice of counting public holidays as part of annual vacation. Note that the annual hours worked by full times is falling steadily in the UK, approaching the level of 1665 hours a year in 2005 – close to for example the Austrian figure.
- Tougher action to enforce minimum wage, together with extra hikes in youngsters' minimum wage (10%).

Ronald Janssen
ETUC
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