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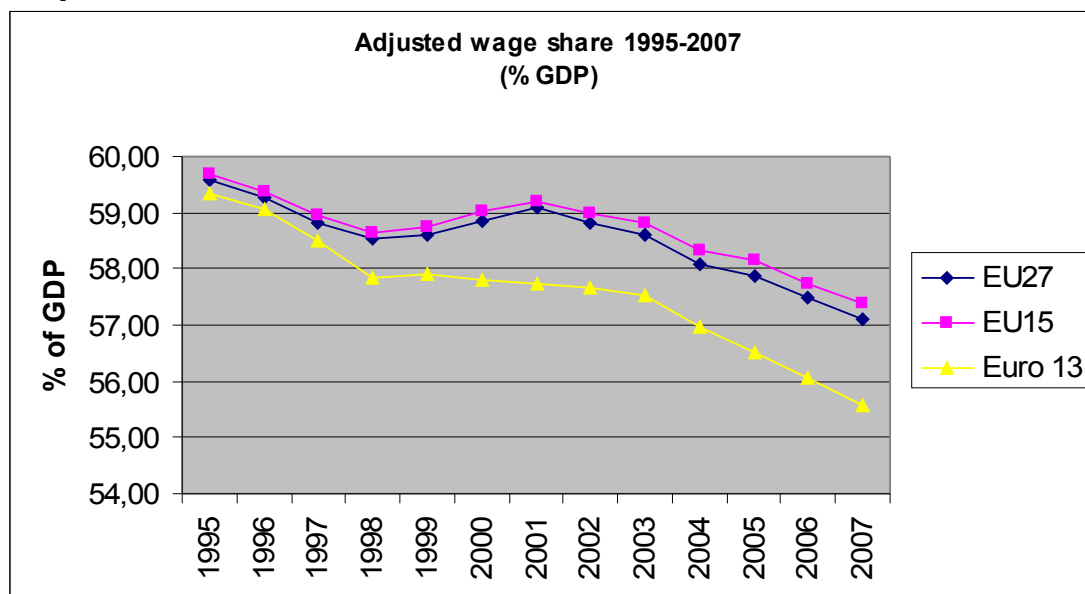
THE REAL FACTS ABOUT WAGES, PROFITS AND JOBS

I. THE FACTS

Over the past decades, wages in Europe have been moderate and in some cases even extremely so.

Real wages have been stagnating in many countries and even falling in some. As a result of this trend, the share of wages in GDP has fallen all over Europe (see graph I below). A massive redistribution from wages to profits has taken place.

Graph I



Business, supported by mainstream economists and official institutions such as the OECD, European Commission and the European Central Bank, argues that this redistribution from workers to capital is necessary to fight mass unemployment in Europe. In their view, wage moderation is beneficial because it would create new jobs. Or, to quote one famous politician: 'the wage moderation of today is the

investment of tomorrow and the jobs of the day after tomorrow'.

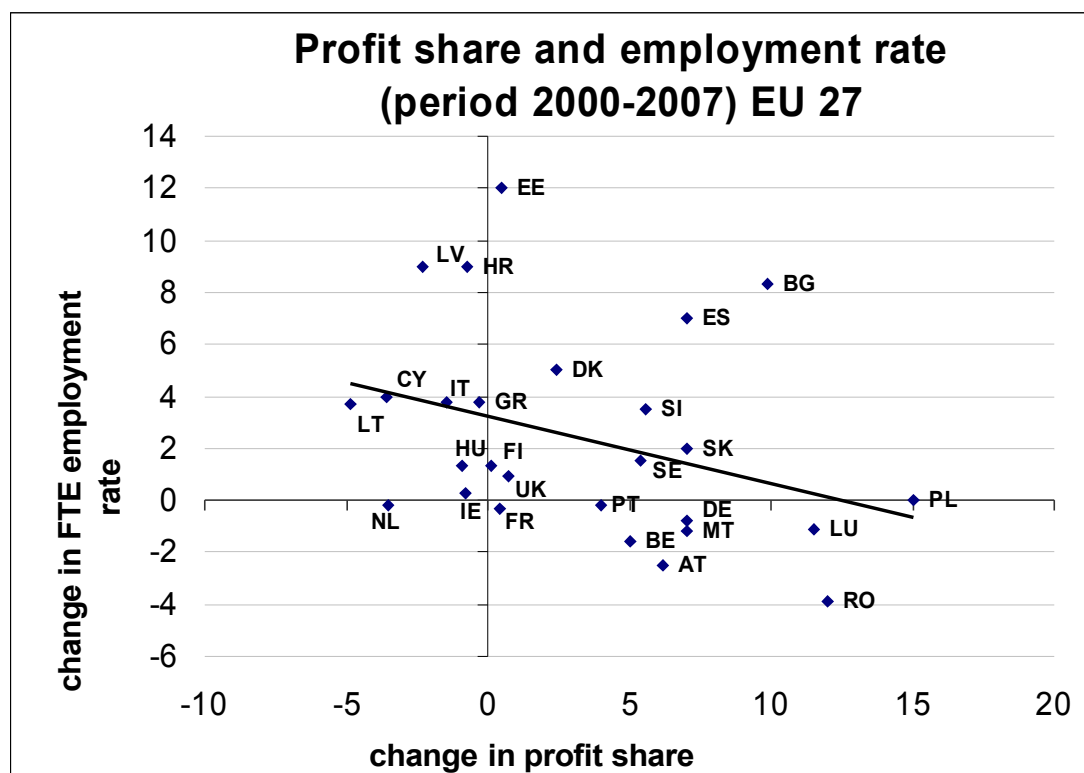
However, what are the facts? After years and years of wage moderation throughout the whole of Europe, is there indeed convincing evidence of moderate wages creating more jobs?

To answer this question, the graph below plots changes in the share of profits in gross domestic product (GDP) against changes in employment rates (measured in

full time equivalents). The presumed logic is that by increasing the profit share in GDP, moderate wage evolutions, would improve employment rates. The graph uses the data of

the 2000-2007 since it is over this period that wage and profit shares have moved the most (see also graph I above).

Graph II



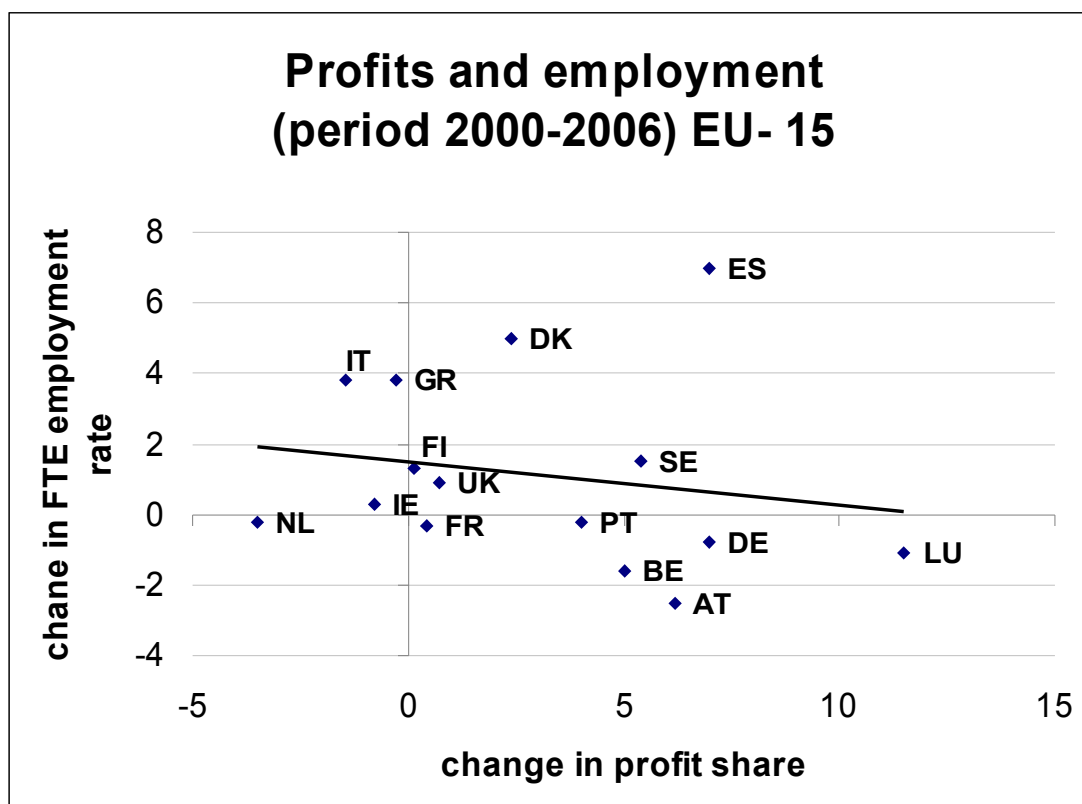
What do we observe? Graph II fully contradicts conventional wisdom. In the Europe of 27 and over the 2000-2007 period, lower wages and higher profits do not systematically tend to lead to improved job performance and higher employment rates. On the contrary, wage moderation tends to lead to reduced job performance. Countries where wage moderation has been extreme (Germany, Austria) have seen stagnating or even falling employment rates. On the other hand, countries where the share of profits has remained stable

experience the highest increases in employment rates.

We know that, over this period, 12 new member states have prepared for EU-entry and have gone to an extraordinary process of structural adjustment. Could this explain why we do not find a positive relationship between profits and employment? Unfortunately for the business lobby and for mainstream economics, this is not the case. Even if we limit our focus to the EU-15, the negative relationship between wage moderation,

increased profits and job performance remains (see graph II). Wage concessions still constitute the profits of today and tomorrow but it can not be claimed they are the new jobs of the future.

Graph III



II. THE GAP BETWEEN PRACTICE AND THEORY

Why do the facts contradict the conventional wisdom so strongly? How to explain this gap between standard economic theory and reality?

The answer is that business is extremely efficient in the practice of 'cherry-picking'. Those parts of economic theory that fit business' vested interests are selected and forcefully injected into public

opinion while remaining oblivious to the conditions that need to be fulfilled if wage moderation is ever to work.

According to economic theory, wage moderation may indeed create jobs ***if and only if the*** economy finds itself in very specific situations. Occasions may arise for moderate wages to lead to improved job performance if profits are so low that they discourage investment, or if the country is so dependant on exports so that export led growth

can compensate for the fall in domestic demand coming from wage moderation, or if the central bank is willing and able to compensate for wage moderation and its negative demand effects.

However, none of these conditions is valid at present:

- Profits in Europe and the euro area have never been as high as they are now.
- Europe as a whole is a relatively closed economy, depending for 85 to 90% on domestic demand and only for 15% on exports to third countries. Generalising the model of 'export led growth' by proposing wage moderation does not make any sense for the whole of Europe. On the contrary, such a strategy will lead to economic warfare ('guerre économique') undermining domestic demand and overall growth.
- The European Central Bank is highly reluctant to engage in activist monetary policy. It does not want to play the role of stabilising the 'real' economy and compensate for the negative impact of wage moderation on domestic demand. Instead, the ECB prefers to see its

mandate as being limited to stabilise inflation and inflationary expectations at the lowest possible level. In such a context, it is extremely difficult, if not impossible, for wage moderation to transform itself into more jobs.

III. CONCLUSION: WHAT THE EUROPEAN ECONOMY NEEDS RIGHT NOW

The previous has underlined that policy makers should not follow (one part of) economic theory blindly. Instead, they need to look at the reality of the economy. And the reality right now is that the European economy is in urgent need of a new driver for economic growth. All traditional drivers of economic growth (exports to the US, business investments, construction led by household debt and asset price bubbles) have disappeared or are in the process of doing so. The only driver remaining that could take over is private consumption. But for this to take place, more robust wage growth ending the decade long process of redistribution from wages to profits is indispensable.

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25th February 2008