ANNEX 2 – ETUC’s Priorities for Annual Growth Survey 2015

Stop structural reforms that endanger the role of wages as an anchor for price stability

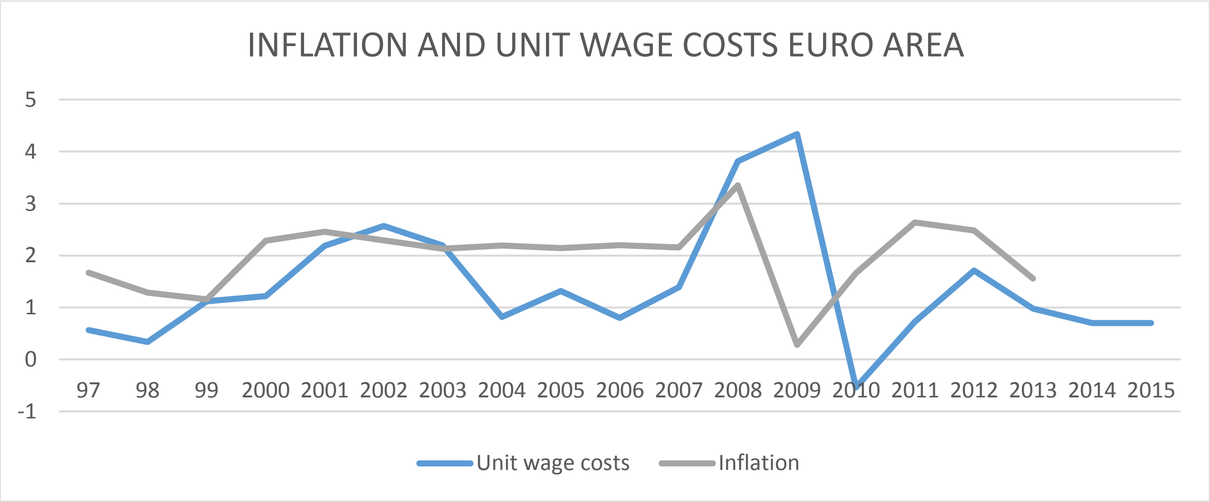
The structural reform agenda pursued across Europe over the past few years has focused on deregulation, and structural weakening of collective bargaining and wage formation systems. The intention it to replace a devaluation of currency with cuts in wags, the so-called ‘internal devaluation’.

It should therefore come as no surprise that this policy of squeezing and cutting wages is now resulting in a Euro Area inflation rate which, at 0.4%, is too low to be comfortable with and too close to the actual threshold of deflation.

The graph below illustrates the link between wages and inflation. It shows the evolution of nominal unit wage costs at the level of the Euro Area, with nominal unit wage costs reflecting the nominal growth of wages as corrected for productivity developments. There is a close relationship between nominal unit wage costs and the rate of inflation: inflation tends to accelerate or decelerate in line with the rate of change in nominal unit wage costs.

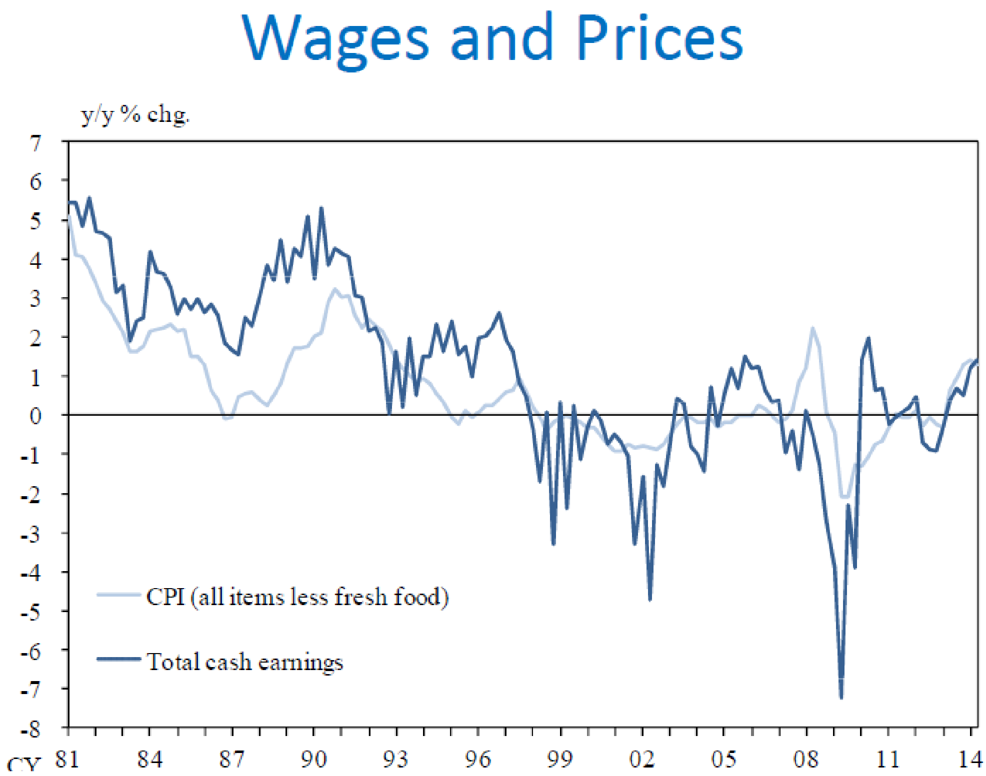
This is perfectly understandable. If wage costs are rising by 2%, business will tend to raise prices by 2% so as to maintain profit margins. If unit wage costs are stagnating, inflation will tend to fall to zero. And if wage costs are falling, business will be able to cut prices without compromising existing profit margins.

With developments in nominal unit wage costs now down to a mere 1% (see graph below), it is unsurprising that Euro Area inflation rates are also down and, at 0,4%, close to zero.



There is also an important precedent here: Japan. In Japan, comparable trends took place from the mid-nineties on. Faced with a lack of aggregate demand, and in the name of 'competitiveness', Japanese business turned to policies aimed at cutting the wage bill such as developing precarious work practices and replacing coordinated wage bargaining in the entire economy (so called "Spring offensive") with company concessional bargaining. The result is that Japan remained trapped in two decades of outright deflation. The following graph also shows the link between wage developments and trends in inflation and deflation, but this time for Japan. The Japanese graph is worryingly similar to the Euro Area graph at this moment in time, and demonstrates what we can expect in Europe if policy-makers continue on this road of structural deregulation of wages.

JAPAN:



If the Euro Area and the ECB are really serious about their objective of price stability (defined as an inflation target of 'below but close to 2%', then policy-makers should stop promoting the deregulation of wages and collective bargaining systems. Instead, they should rediscover the importance of wage formation instruments preventing wage dynamics from 'falling through the floor', thereby triggering price **in**stability or even outright deflation.