

Austerity policies and the changing context of collective bargaining in Europe

Introduction

The austerity policies currently pursued by governments throughout Europe in order to resolve the sovereign debt crisis have fundamentally altered the collective bargaining landscape in Europe: they have targeted not only bargaining outcomes, by putting direct pressure on wages, but also bargaining procedures, by pushing for more flexible (i.e. decentralised) wage-setting arrangements. This has been particularly the case in the so-called ‘deficit countries’, in which supranational institutions such as the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF) imposed a policy of cutting wages and decentralizing wage-setting arrangements in return for either financial rescue packages or intervention on sovereign bonds secondary markets. However, the fact that, in 2012, 17 out of 27 EU member states received a country-specific recommendation on wage policy from the European Commission indicates that it is not only deficit countries that are subjected to political pressure to reform their wage-setting arrangements (see Janssen 2012a for an overview of country-specific wage recommendations). The austerity approach pursued by national and supranational policy-makers therefore marks a paradigm shift from the support for (or at least acceptance of) free collective bargaining guaranteed by article 153.5 of the Treaty on the Functioning of the European Union, which explicitly excludes wage-setting and collective bargaining from the realm of EU policies, to direct political intervention in national collective bargaining outcomes and procedures (Schulten 2012a; Schulten and Müller 2013).

This chapter will address the implications of this political interventionism in three distinct spheres. The first part deals with the procedural aspects, illustrating how the austerity-induced political interventionism led to fundamental changes in national wage-setting and collective bargaining institutions; the second part focuses on the implications for the actual outcome of negotiations in terms of wage developments; and the third part traces recent trends in income inequality as a key component of social cohesion.

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Supranational intervention in collective bargaining

Figure 3.1 Forms of supranational intervention in national wage-setting and collective bargaining systems

Form of supranational intervention	Actors applying the measures	Countries affected
New European system of economic governance sanctioning non-compliance of member states with European policy recommendations	European Commission	All EU member states
Memorandums of understanding and stand-by arrangements demanding wage cuts and collective bargaining reforms as a precondition for financial assistance	'Troika': European Commission, European Central Bank and International Monetary Fund International Monetary Fund	Greece, Ireland, Portugal Romania, Latvia and Hungary
ECB intervention on the sovereign bonds secondary market in return for 'voluntary' reforms of collective bargaining systems	European Central Bank	Italy, Spain

Source: authors' compilation.

Growing EU influence on national wage policies

In order to understand the impact of the austerity policies on wages and wage-setting arrangements, it is useful to have a closer look at the underlying rationale of the austerity measures advocated, since the onset of the crisis, by the European Commission's DG ECFIN, the ECB and the IMF. At the heart of the austerity approach lies the belief that the current crisis is essentially a crisis of (cost) competitiveness caused by the asymmetrical development of wages – or more specifically of nominal unit wage costs (as a measure of nominal wages divided by a volume measure of productivity) – in the eurozone (Janssen 2011a: 1). Since the EMU by definition rules out exchange-rate devaluation as a solution to competitiveness problems, wages became policy-makers' key focus as an economic adjustment mechanism. Thus, a policy of internal devaluation was proposed as a 'functional substitute to currency devaluation' (Armingeon and Baccaro 2012: 256) in order to close the

competitive wage gap between 'surplus' and 'deficit' countries. Following this direct link between unit wage costs and competitiveness, the key objective of the internal devaluation approach has been to increase the (downward) flexibility of wages and – in order to achieve this – to decentralize existing collective bargaining arrangements in order to ensure that wages stay in line with productivity developments (Janssen 2011a: 3).

The implementation of the internal devaluation strategy rests on the three pillars of supranational interventionism outlined in Figure 3.1. The first form of interventionism, which potentially applies to all EU member states, is the new European system of economic governance put in place by the EU and its member states towards the end of 2009. With its newly introduced mechanisms for monitoring, sanctions, and increased coordination (Degryse 2012: 6), the new system shifted economic decision-making powers increasingly from the national to the European level. The implications of the various elements of the new system of economic governance will be dealt with in more detail below. The second form of interventionism addresses those crisis-ridden countries which rely on financial assistance from the EU or the IMF. These countries, as a precondition for financial assistance, were required to introduce far-reaching labour market reforms, which were laid down either in so-called

'Memorandums of Understanding' with the Troika (in the case of Greece, Ireland and Portugal) or in 'Stand-by Arrangements' with the IMF (in the case of Hungary, Latvia and Romania). The third form of intervention is the ECB's practice of making the purchase of government bonds conditional on 'voluntary' policy reforms, including reforms of collective bargaining institutions (Meardi 2012a, b). This approach was first pursued unofficially in the cases of Italy and Spain, but became quasi-official in autumn 2012 when the ECB announced that it would buy state bonds without limits if the affected countries agree on certain political reforms (Schulten and Müller 2013).

Despite the differences in method and addressees, the implications of all three forms of interventionism are the same: each of them decreases national actors' discretion over policy choices and, in so doing, creates the framework for imposing the desired austerity measures in the field of wages and collective bargaining.

Supranational intervention in collective bargaining

Figure 3.2 The new European system of economic governance and its impact on wages and wage-setting arrangements

Element of economic governance system	Impact on wages and wage-setting arrangements
European Semester	On the basis of the annual growth survey, European policy-makers propose country-specific policy recommendations on – amongst other things – wage policies and the reform of wage-setting systems.
Euro-Plus Pact	In the context of the broader objective of intensified economic policy coordination, the signatory states commit themselves to promote competitiveness by ensuring that wages stay in line with productivity increases, by way of reviewing wage-setting arrangements and by monitoring public sector wage agreements.
Six Pack	Pressure on wages through: (1) the introduction of asymmetric alert mechanism based on scoreboard of economic indicators which explicitly includes unit wage costs; and (2) the introduction of quasi-automatic sanctions in case of non-compliance with debt and deficit criteria or with country-specific recommendations.
Fiscal Pact	Strengthening of the austerity approach by obliging signatory states to enshrine balanced budget rule (including an automatic correction mechanism) in national law. Strengthening the European policy-makers' competences by obliging countries in excessive deficit procedure to submit their economic and structural reform programme (which potentially also covers the area of wages and collective bargaining) for control and endorsement.

Source: authors' compilation.

Step-by-step tightening the grip on wages

Up until the outbreak of the global economic crisis in 2008, EU-level initiatives in the field of wages and collective bargaining were largely restricted to broad economic policy guidelines, which in practice had little impact on national systems of industrial relations (Busch *et al.* 2013: 8). This situation changed fundamentally with the adoption of the various elements of the new European system of economic governance, which successively tightened the EU's grip on national wage policies (see Figure 3.2). The first step in this process was the adoption, in June 2010, of the 'Europe 2020' strategy which introduced the European Semester as a new EU-level tool of intensified economic policy coordination (European Council 2010: 5). This new mechanism also includes wages and wage-setting arrangements as one policy area to be covered by its staged economic surveillance procedure, leading from the formulation of the annual growth survey to the issuing of country-specific recommendations. However, since the European Semester process still remained at the

level of policy recommendations, European policy-makers saw the need for a more solid legal basis to ensure the implementation of austerity policies. This was swiftly accomplished with the adoption, in March 2011, of the Euro-Plus Pact (also known as the 'Competitiveness Pact') which, in the field of wages and collective bargaining, explicitly committed the 23 signatory countries to foster competitiveness by ensuring that wages develop in line with productivity. For this purpose, the states are obliged to review the degree of centralisation of wage-setting arrangements and the indexation mechanism, as well as to ensure that public sector wage settlements do not undermine competitiveness efforts in the private sector (European Council 2011: 16). The so-called 'Six Pack' adopted in December 2011 represents the next turn of the screw of EU-level interventionism. The most important innovation introduced by the 'Six Pack' with respect to wages and collective bargaining is the establishment of a new system of enhanced fiscal and macroeconomic surveillance, through an alert mechanism for the early detection of macroeconomic imbalances based on a 'scoreboard' of economic indicators that explicitly includes unit wage costs. Since this early warning system only detects unit wage cost developments in excess of the maximum growth rate allowed (9% over a period of three years for Euro-area countries), it entirely ignores the

problem of potential deflationary pressures resulting from stagnating or even falling wages during a period of economic downturn; this new mechanism thus further increases the pressure on wages (Janssen 2011b: 2). In addition, the 'Six Pack' introduces an automatic procedure for imposing financial sanctions on those countries that fail to comply with the deficit and debt criteria or with the recommendations issued on the basis of the alert system. The impact of the 2012 Fiscal Pact on wages and collective bargaining is more indirect but nonetheless far-reaching. Since the Fiscal Pact is an intergovernmental treaty without an exit clause, the obligation to enshrine the rule of balanced budgets in national law can be interpreted as an attempt to make the austerity approach (with its detrimental effects on wages) irreversible (Konecny 2012: 389). The stipulation that every signatory countries subject to an excessive deficit procedure has to submit a structural reform programme for the correction of its excessive deficit to the Council and the European Commission for endorsement and monitoring of the implementation provides the European policy-makers with far-reaching competences which can also be used to attain legal competence over national wage-setting (Janssen 2012b: 2).

Supranational intervention in collective bargaining

Figure 3.3 Decentralization of collective bargaining systems in countries subject to direct supranational intervention

Changes implemented	GR	IE	PT	IT	ES	HU	LV	RO
More restrictive criteria for extension of collective agreements								
Facilitating derogation of firm-level agreements from sectoral agreements or legislative (minimum) provisions								
Suspension of favourability clauses								
Promoting bargaining capacities of company-level actors to negotiate firm-level agreements in addition to or independently from trade unions								
Reducing the period of validity of an agreement after its expiry								

Sources: Clauwaert and Schömann (2012); Schulten (2012a); Szabó (2013); Trif (2013).

Collective bargaining institutions under attack

Although the current economic crisis reinforced the tendencies towards the decentralisation of collective bargaining systems in many EU member states (Glassner *et al.* 2011), this process was most pronounced in those countries subject to direct supranational intervention. Figure 3.3 provides an overview of the measures introduced as part of the national labour market reforms in return for financial support programmes (or, in the cases of Italy and Spain, as a precondition for financial market intervention through the ECB). The figure shows that the 'one-size-fits-all' approach of the supranational institutions led to a convergence of policies, shifting the main focus of collective bargaining from multi-employer towards company-level arrangements. However, within this broader context of converging collective bargaining frameworks, the various decentralisation measures were mixed in a country-specific way. Thus, depending on the degree of centralisation before

the reforms were carried out, and on the country-specific mix of measures applied, it is possible to observe varying outcomes in terms of the magnitude of procedural change.

Against this background, three groups of countries can be distinguished. The first group comprises Ireland and Romania, which before the reforms were characterised by a comparatively high level of bargaining centralisation involving national cross-sectoral agreements which defined the terms of reference for lower-level negotiations (Visser 2011: 41). In these two countries, the austerity-driven changes led to the complete breakdown of multi-employer bargaining. In Ireland this was the result of the government's withdrawal from negotiations over a reform of the public sector in the light of deteriorating public finances in 2009, which after 22 years of cross-sectoral wage determination brought the return of company-level bargaining (O'Kelly 2010; Doherty 2011). In Romania, cross-sectoral bargaining was essentially abolished by the government's unilateral introduction of the Social Dialogue Act in 2011 (Trif 2013). Further pressures towards decentralisation resulted from a tightening of the rules on the extension and application of sectoral agreements, and an increase in the threshold for the representativeness of trade unions as a precondition to negotiate agreements. The second group of countries consists of

Greece, Portugal and Spain, all of which have a long tradition of sectoral bargaining arrangements. Although these multi-employer bargaining structures remained formally intact, their scope and actual operation was increasingly undermined by the various legal changes introduced in response to the demands of supranational institutions (Schulten 2012a: 53). The third group of countries comprises Hungary and Latvia, where the industrial relations system – as in the majority of CEE countries – is characterised by fragmented, single-employer bargaining. Since in these two countries approximately 70% of employees are already covered by local or company-level agreements (Keune 2011: 129), there was not much scope for further decentralisation. While in Latvia the brunt of austerity measures was borne by the public sector in the form of extensive wage cuts (Kallaste and Woolfson 2013: 6-7; see next section), legal changes introduced in Hungary were primarily aimed at weakening the bargaining power of trade unions, for instance by curtailing the right to strike in public services, abolishing the only tripartite national forum for discussing recommendations on wage increases, and allowing works councils to negotiate company-level agreements if no trade union is present at the workplace (Szabó 2013: 11).

Supranational intervention in collective bargaining

Figure 3.4 Wage policies in countries subject to direct supranational intervention

Changes implemented	GR	IE	PT	IT	ES	HU	LV	RO
Minimum wage cuts								
Suspension of automatic wage increases								
Wage freeze or wage cuts in the public sector (incl. bonuses and extra payments)								

Sources: Karnite (2012); Kallaste and Woolfson (2012); Karnite (2012); Schulten (2012a), Szabó (2012); Trif (2012).

Austerity-induced pressure to cut or freeze wages

Procedural changes and modifications to collective bargaining laws, implemented in compliance with the externally-driven rescue programmes, were often accompanied by wage freezes and/or salary cuts. The two main areas of direct political intervention were cuts and/or freezes in public sector pay and in minimum wages. Both areas were easy targets for direct political intervention because in most countries both public sector pay and minimum wages are determined not by collective agreements but by law, thus enabling national governments to impose pay cuts and freezes unilaterally (Schulten and Müller 2013). Further political support for direct intervention in public sector wages was provided by the Euro-Plus Pact, which explicitly requires the EU member states to 'ensure that wage settlements in the public sector support the competitiveness efforts in the private sector' (European Council 2011: 16).

As Figure 3.4 illustrates, all the countries under economic surveillance by the Troika or the IMF introduced public sector pay cuts and/or freezes in

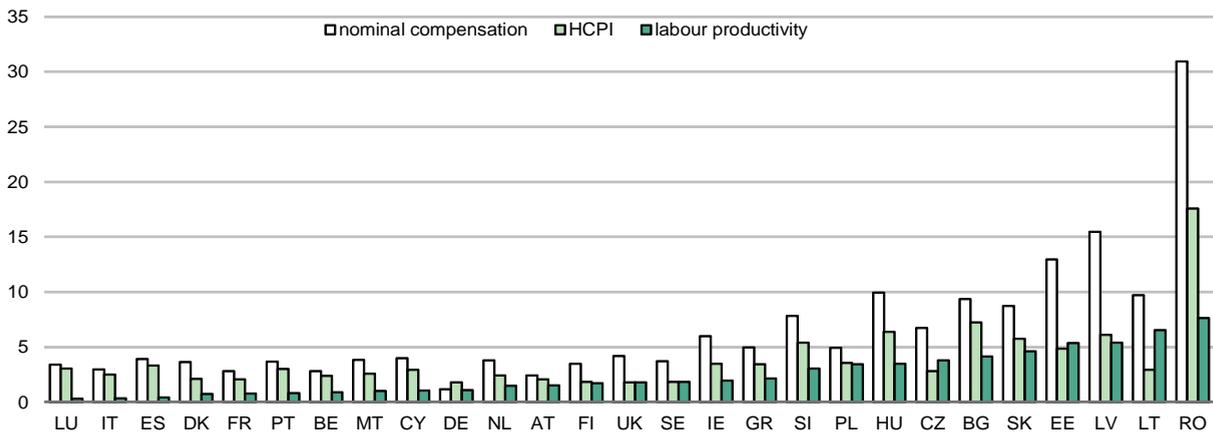
an attempt to reduce public spending in order to stabilize government finances and to reassure bond markets (ILO 2013: 20). The most drastic cuts in public sector pay have been introduced in Romania, Latvia and Greece. In Romania, public sector pay was cut by 25% for the period between June and December 2010. However, since the government simultaneously raised VAT and also introduced cuts in bonuses and additional payments (such as food allowances and rent subsidies), the effective wage decrease of public sector workers was close to 50% (Glassner 2010). In Greece, real wages of many public sector employees are now 40% lower than in 2009 as a result of two successive wage cuts – 14% in 2009 and up to 17% between 2011 and 2013 – in combination with the introduction of a new pay scale (LRD 2012: 16). In Latvia public sector wages were cut by 15% in 2009 followed by a pay freeze between 2010 and 2012 (Schulten and Müller 2013). Direct cuts usually went hand in hand with the cancellation of bonuses and extra payments such as the '13th-month' salary (in Portugal, Romania, and gradually in Hungary), compulsory unpaid leave (in Latvia, Romania, but also in Lithuania and Estonia), and/or the increase in working time without additional compensation (in Spain) (LRD 2012: 16).

The second key area of direct political intervention was minimum wages. Here, three divergent trends are

discernible. Some countries subject to supranational interventionism cut the minimum wage as an integral part of their austerity programmes. Greece went the furthest in this respect, decreasing the minimum wage by as much as 32% for workers below 25 years of age, and by 22% for the rest of the working population. Under pressure from the Troika, Ireland cut its minimum wage by €1 per hour in February 2011, which represented a 12% decrease (Schulten 2012a: 54). However, after a change of government, this cut was retracted and the original rate re-established in July 2011. Other states temporarily froze minimum wage levels. In Latvia, the minimum wage was not raised in 2010 and 2012, while increases in other crisis years remained far below collectively agreed long-term plans (Karnite 2012). In Spain and Portugal, the annual minimum wage increase mechanism was suspended in 2012, with the two countries retaining the 2011 rates (Schulten 2012a: 54).

Wage developments before and during the crisis

Figure 3.5 Nominal wages, prices and labour productivity in the EU, 2000-2008



Source: authors' calculations based on AMECO (2012).
Note: annual %-change, averaged over the 2000-2008 period.

CEE countries catch up before the crisis

Figure 3.5 indicates the averaged changes in nominal compensation (per employee, total economy), prices (measured as the harmonised consumer price index - HCPI) and productivity (measured as GDP at 2005 market prices per person employed) for the period 2000-2008. With regard to the average nominal wage increase, the data shows a clear regional divide between central and eastern European (CEE) countries and the rest of the EU. With the exception of Poland, which just missed the 5% mark, all CEE countries registered an average annual increase in nominal wages of well above 5%, ranging from the Czech Republic (6.71%) to Latvia and Romania (15.47% and 30.94% respectively). Amongst the western European countries, Ireland (6%) and Greece (4.98%) showed the highest average growth rates. All other western European countries stayed at 4% or below. Germany recorded the lowest average growth with 1.16% followed, at some distance, by Austria (2.42%), France (2.81%) and Belgium (2.82%).

Although one could speak of a catching-up process in the CEE countries

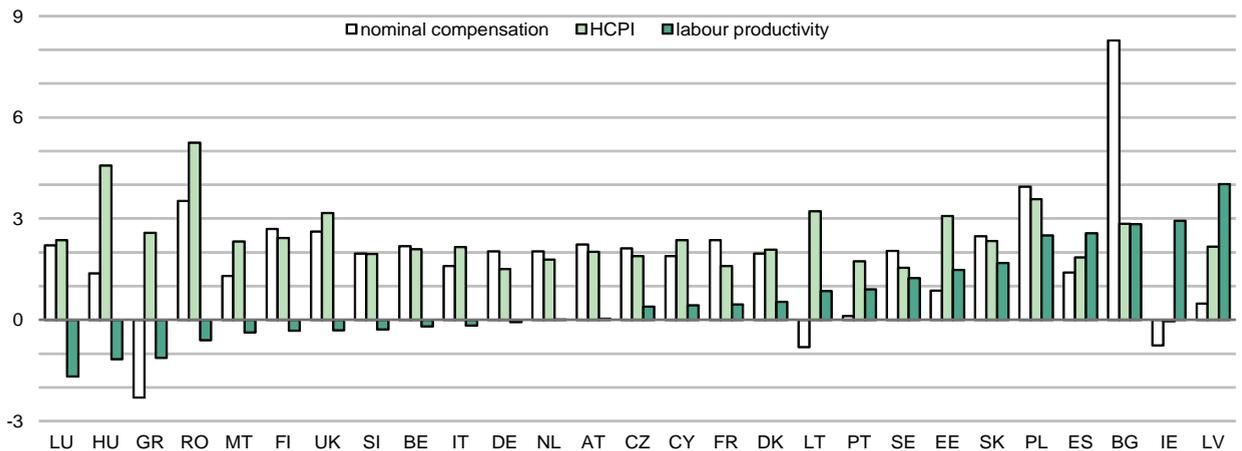
before the onset of the crisis, nominal wage increases are difficult to interpret for two reasons: firstly, nominal wage increases mask the extent of wage differences in absolute terms; i.e. despite the substantial nominal wage increase in most CEE countries, in absolute terms wages in CEE countries are still lagging far behind those in western European countries and even – probably with the exception of Portugal – the Mediterranean countries. Secondly, nominal wage increases are difficult to interpret when not related to other variables. From a supply-side perspective, productivity growth is a relevant variable because the difference between the growth of nominal wages and labour productivity – i.e. nominal unit labour costs – is taken as an indicator of a country's cost competitiveness. In this respect, the data illustrate divergent developments during the pre-crisis period. At one end of the scale are Romania (23.3%), Latvia (10.07%) and Estonia (7.63%), where nominal wages increases heavily outpaced growth in productivity, leading to a strong increase in nominal unit labour costs. At the other end of the scale are Germany (0.06%) and Austria (0.89%), where nominal wage growth more or less remained in line with productivity developments.

However, wages are not just a cost factor. They also play an important role in creating or stabilizing internal demand. Against this background, two

relationships are of importance: first, the development of real wages as the difference between nominal wages and inflation (see below), and, second, the comparison between the development of nominal wages and the wage-setting distributive margin, defined as the sum of the changes in inflation and productivity. The latter corresponds to the traditional concept of a 'productivity-oriented' wage policy, according to which nominal wage agreements should cover not only inflation but also productivity increases in order to ensure that workers share proportionally in the general rise in prosperity (Schulten 2002). Figure 3.5 shows that 14 out of the 27 EU member states over-exploited the distributive margin; i.e. nominal wage increases were larger than the sum of inflation and productivity. The best achievers in this respect were those countries which also registered the highest increase in nominal unit labour costs: Romania (5.71%), Latvia (3.95%) and Estonia (2.8%). The most negative distribution balance was seen in Poland (-2.08%) followed by Bulgaria (-2.02%), Slovakia (-1.62%) and the two western European countries Germany (-1.74%) and Austria (-1.16%); in these countries, nominal wage increases remained below the sum of inflation and productivity. In the rest of the countries, the distribution balance stayed within the margins of +/- 1%.

Wage developments before and during the crisis

Figure 3.6 Nominal wages, prices and labour productivity in the EU, 2009-2012



Source: authors' calculations based on AMECO (2012).

Note: annual %-change, averaged over the 2009-2012 period.

Wage moderation throughout crisis-ridden Europe

Since the onset of the crisis, the growth of nominal wages in Europe was much more modest than in the pre-crisis period (see Figure 3.6). In Greece, Lithuania and Ireland the average annual growth was even negative. The decreasing nominal wages in Greece (-2.3%) and Ireland (-0.76%), together with the bare increase in Portugal (0.11%), illustrates the great pressure placed on wages in the crisis-ridden eurozone countries. The main reason for these developments are the substantial wage cuts in the public sector introduced in fulfilment of the Memorandum of Understanding with the 'Troika' which, to a growing extent, influences developments in the private sector (Schulten 2012b: 454; LRD 2012). The only exception to the trend of shrinking nominal wage increases was Germany, where nominal wages grew on average by 2.03%, compared to 1.16% in the pre-crisis period.

The comparison between developments in nominal wages and productivity shows that countries with moderately increasing (or even decreasing) average

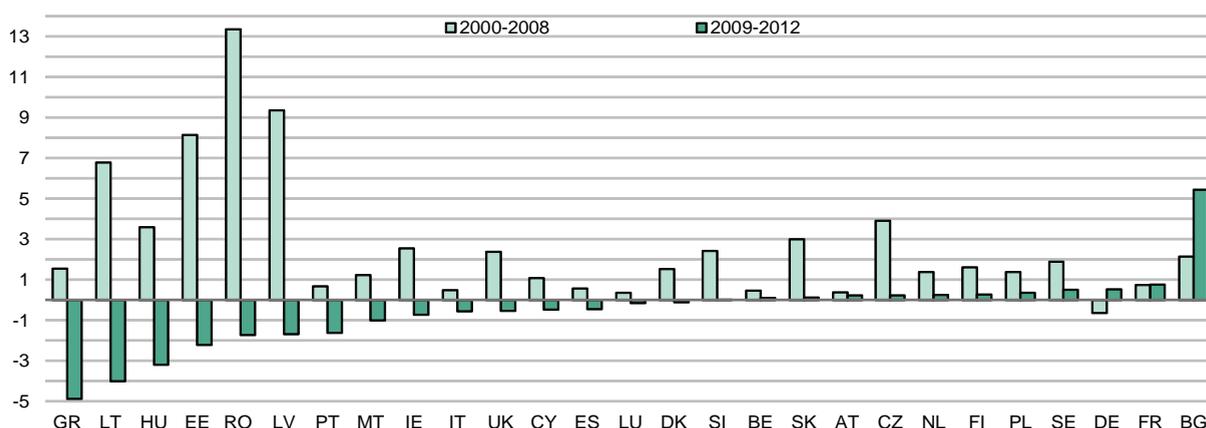
annual growth rates in nominal wages also recorded falling unit labour costs. This applies to all three Baltic states as well as to all GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) with the sole exception of Italy, where the average growth in nominal wages during the crisis-period exceeded that of productivity by 1.77%. Thus, from a supply-side perspective, one might argue that the labour market reforms yielded the desired results: by lowering nominal unit labour costs, they improved cost competitiveness relative to other eurozone countries.

However, neither in the Baltic States nor in the GIIPS countries did nominal wage increases exploit the wage-setting distributive margin. The Baltic States record the most negative distribution balance. Within the eurozone, Greece (-3.75%), Ireland (-3.65%), Spain (-3.02%), and Portugal (-2.52%) show the most negative distribution balance. The exception here is again Italy with an only marginally negative average annual distribution balance of -0.39% during the crisis period. Since a negative development of the distribution balance adversely affects internal demand, these results raise the question of whether the increases in these countries' relative cost competitiveness due to the restrictive wage policy during the crisis period have been (over)compensated by falling internal demand. A recent discussion note

published by DG Employment, Social Affairs and Inclusion points to the risks involved in such a strategy of cutting wages in deficit countries during an economic downturn: 'the scope for restoring competitiveness through wage adjustment is limited by the risk that this may trigger a deflationary wage spiral across the EMU – thereby simultaneously leaving their international competitiveness unchanged and depressing domestic demand in all member states concerned and in the Union as a whole' (European Commission 2012a: 3). This, in turn, means that 'unless surplus countries allow for more wage-based consumption on both domestic and imported goods, the result could be a protracted period of economic stagnation, or even recession' (ILO 2012: 62).

Wage developments before and during the crisis

Figure 3.7 Real wages in EU27, 2000-2008 and 2009-2012



Source: authors' calculations based on AMECO (2012).

Note: annual %-change, averaged over the 2000-2008 and 2009-2012 periods.

Falling real wages in most EU member states

Figure 3.7 illustrates the drastic change in real wage developments from 2000 until now. The pre-crisis period was marked by more or less pronounced real wage increases throughout Europe. The only country which recorded an average annual decrease in real wages during the pre-crisis period is Germany (-0.64%), where, in particular between 2004 and 2008, nominal wages persistently lagged behind inflation. Reflecting the economic catching-up process during the pre-crisis boom period, some CEE countries showed the strongest average annual increases in real wages. The by far strongest performer in this respect was Romania (13.35%) followed by the three Baltic States Latvia (9.35%), Estonia (8.14%), and Lithuania (6.79%). With the two exceptions of Ireland (2.54%) and the UK (2.37%), all western European countries recorded a modest average annual increase below 2%.

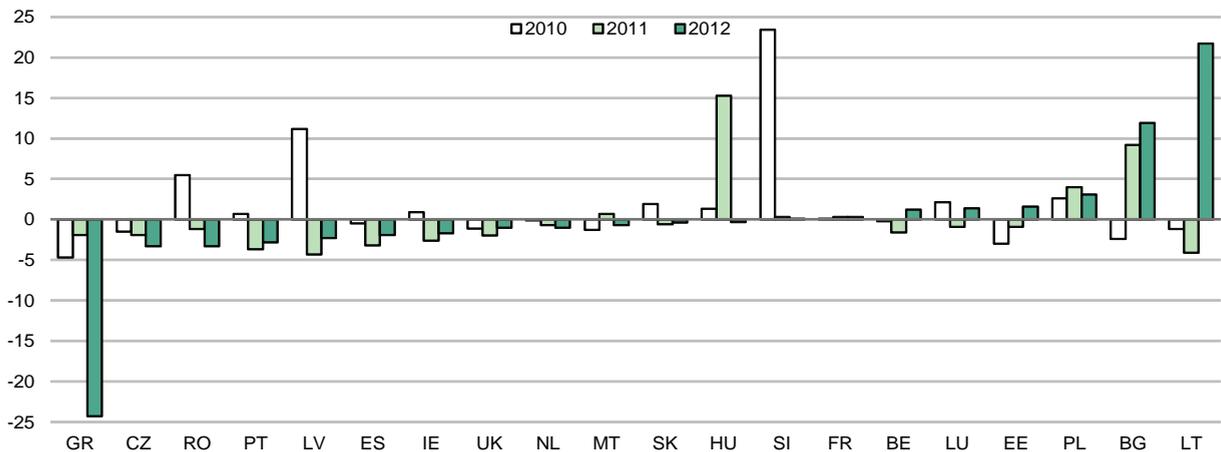
Since the onset of the crisis, this picture has been turned on its head. Between 2009 and 2012, the majority of countries (15 out of 27) recorded falling

real wages. The highest average annual loss in real wages in the crisis period was in Greece (-4.88%) followed by Lithuania (-4.02%), and Hungary (-3.19%). As a matter of fact, all the crisis-ridden countries that were subject to financial bailout programmes suffered falling real wages with potentially detrimental effects for consumption and aggregate demand. The only countries recording average annual growth rates above 0.5% are Germany (0.53%), France (0.76%), the Netherlands (1.25%), the outlier being Bulgaria with 5.43%.

The reasons for the decline in real wages in the majority of countries are manifold. One important explanation is that, in response to the economic crisis, many governments reacted with freezes or even cuts of public sector wages and statutory minimum wages in order to directly cut public expenditure and to set an example for private sector wage developments. Another explanation is that the rising unemployment and the concomitant higher pressure for concession bargaining in order to safeguard employment considerably weakened the bargaining position of trade unions (Schulten 2012b: 455). Last but not least, there is the overarching impact of the direct political intervention in wage-setting as a consequence of the Memorandums of Understanding, which in the crisis-ridden countries led to a sharp decline in real wages.

Wage developments before and during the crisis

Figure 3.8 Changes in real hourly minimum wages in the EU, 2010, 2011 and 2012



Source: WSI Minimum Wage Database (2013).

Note: annual %-change in relation to the previous year. For countries outside the eurozone, calculations are made on the basis of national currencies.

Restrictive minimum wage policy during crisis

Figure 3.8., which charts the development of real hourly minimum wages over the past three years for the 20 EU member states with a statutory minimum wage, shows the direct link between supranational interventionism and a decline in real hourly minimum wages. Greece recorded the most dramatic result with a 24.3% cut in 2012. Romania, Portugal, Latvia, Spain and Ireland have also witnessed drops – albeit less pronounced – in real minimum wages during the last two years. The only exception amongst those countries which were dependent on international financial aid programmes is Hungary, where real minimum wages increased substantially (15.3%) in 2011. This, however, has to be seen as a one-off measure compensating low earners for the introduction of a 16% flat-rate personal income tax from which only top earners benefitted (Szabó 2013).

Figure 3.8 also illustrates the generally weak development of real minimum wages in 2012. The only two countries

with a substantial increase were Lithuania (21.7%) and Bulgaria (11.9%). In absolute terms, however, they still have one of the lowest minimum wages of all European countries with a statutory minimum wage, so that a comparatively small increase in absolute terms makes a fairly big increase in relative terms. According to the most recent figures of the Minimum Wage Database of the Wirtschafts- und Sozialwissenschaftliches Institut (WSI), in January 2013, the hourly minimum wage in Bulgaria was 0.95€ and in Lithuania 1.76€ (Schulten 2013).

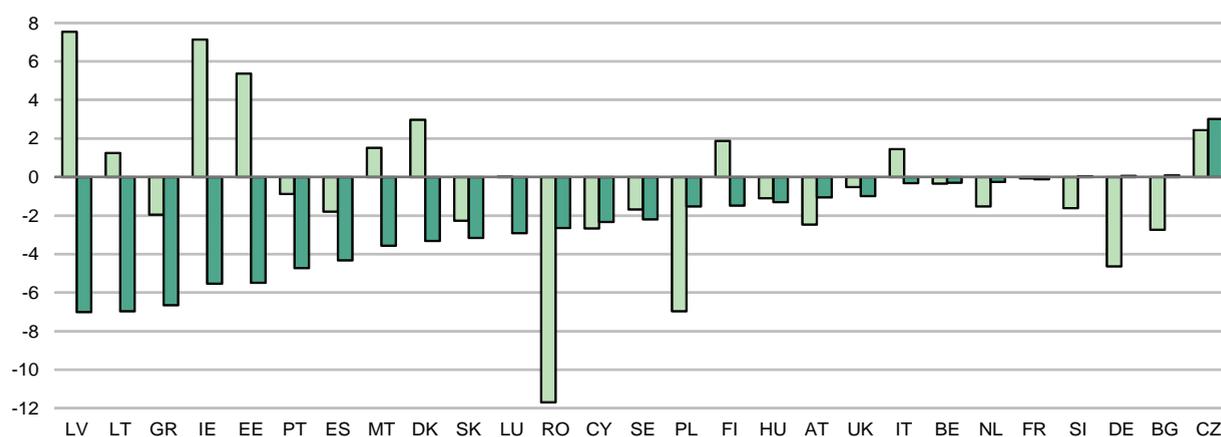
In all other EU countries, the development of nominal minimum wages stayed more or less in line with inflation, resulting in stagnating real minimum wages. Belgium and Luxembourg, for instance, recorded slight increases of 1.2% and 1.4%; this, however, merely made up for the decrease of roughly the same magnitude the year before. Only Poland has persistently recorded slight real minimum wage increases over the last three years.

The restrictive minimum wage policy pursued in most EU member states is part of the overall strategy of internal devaluation which views minimum wages primarily as an obstacle to the (downward) flexibility of wages, which in turn is seen as a central prerequisite of restoring competitiveness (Janssen 2012c). This corresponds with the European Commission's view that minimum

wages should be set at an appropriate level, be sufficiently adjustable to reflect overall economic developments, and be differentiated in order to uphold labour demand (European Commission 2012b: 9). While the Commission refrains from defining what it considers to be an appropriate level, the implicit message is to keep up the pressure on minimum wages. This is confirmed by the fact that, in the Commission's 2012 wage recommendations, France, Slovenia and Hungary were explicitly asked to control or avoid growth in minimum wages in order to improve competitiveness. The ILO, the OECD, the IMF and the World Bank argue in the same direction by suggesting 30 to 40 % of median wages as the appropriate level of minimum wages (ILO *et al.* 2012: 12). However, in a more recent report published by DG Employment, the European Commission also acknowledges the important demand-side function of minimum wages in an economic downturn: by sustaining aggregate demand, by boosting wage equality and by buoying prices, they help to reduce the risk of deflation (European Commission 2012c: 333).

Income distribution and inequality

Figure 3.9 Change (in percentage points) in the adjusted wage share in EU member states, 2000-2008 and 2009-2012



Source: authors' calculations based on AMECO (2012).

Wage share drops as austerity bites

Figure 3.9 presents changes in the adjusted wage share in the period preceding the recent economic downturn (2000-2008), and during the crisis (2009-2012) in 27 EU member states. The adjusted wage share measures compensation per employee (i.e. both wages and employers' social contributions) as a percentage of GDP, and is usually used to assess the distribution of national income between labour and capital. For the pre-crisis period, the data illustrates a divergent development of adjusted wage shares in the European countries. The highest increase was recorded in Latvia (over 7.5%), followed by Ireland (7%), and Estonia (5.3%) where real compensation of employees considerably outpaced the development of labour productivity. However, the experience of Poland and in particular Romania shows that wage growth does not necessarily go hand in hand with an increasing wage share. Between 2000 and 2008, these two countries recorded the highest drop in the adjusted wages share (by 7% in Poland and almost 12% in Romania), despite growing nominal and real wages (see Figures 3.5 and 3.7). In western

Europe, the adjusted wage share fell, in particular in Germany as a consequence of the combined effect of a sustained policy of wage moderation and labour market reforms, which facilitated the extension of a low wage sector based on a marked increase of part-time and other forms of atypical employment, such as the so-called 'mini-jobs' (ILO 2012: 46).

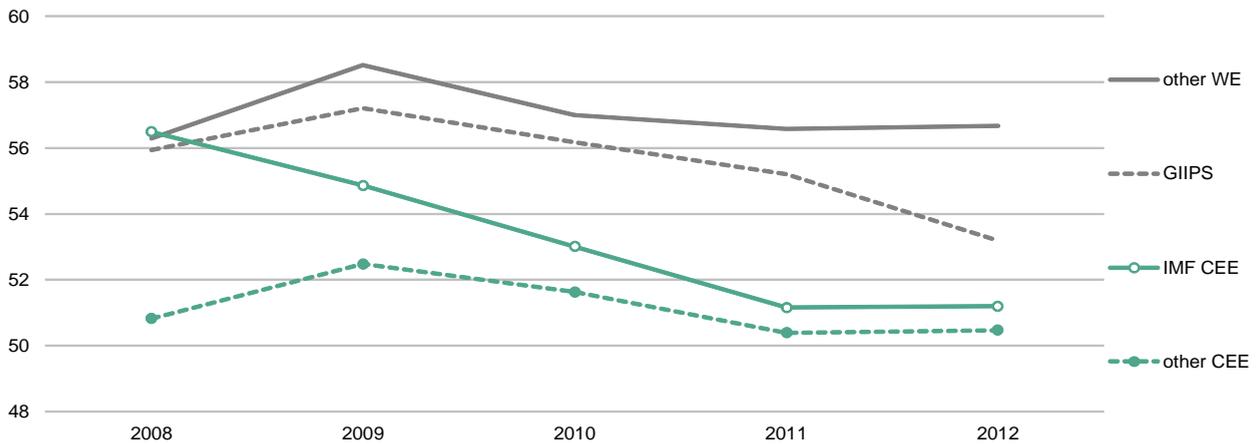
During the recent downturn, the adjusted wage share has been consistently falling in most EU member states. Between 2009 and 2012, many of the previous trends have been reversed: for instance, the Baltic States and Ireland – the champions of wage share growth in the pre-crisis period – have recorded one of the highest wage share decreases in the EU27. Substantial drops in the adjusted wage share also occurred in those countries that were in need of external financial assistance from supranational institutions. These have been the central and eastern European countries that negotiated Stand-by Arrangements with the IMF (Latvia, Romania and Hungary), and those countries making use of European Commission and ECB assistance instruments (Greece, Portugal, Spain and – to a lesser extent – Italy).

The adjusted wage share is a complex variable, which in the medium and long term is influenced by a wide range of factors, such as changes in relative factor prices, the rate of technological progress, relative bargaining power of

capital and labour, and the presence/absence of wage moderation policies (for an overview see Arpaia and Pichelmann 2008). However, despite this complexity, it is fairly safe to conclude that the substantial wage share decreases in these two groups of countries have resulted in large measure from wage restraint in the private sector, as well as from substantial cuts in public sector wages and benefits implemented as part of, or parallel to, the externally-driven assistance programmes (see Figure 3.4).

Income distribution and inequality

Figure 3.10 Adjusted wage share, country group averages, 2008-2012



Source: authors' calculations based on AMECO (2012).

Note: simple average of annual %-change by groups of countries. 'Other WE' encompasses BE, DK, DE, FR, CY, LU, MT, NL, AT, FI, SE and UK. 'Other CEE' refers to BG, CZ, EE, LT, PL, SI and SK. 'IMF CEE' states are RO, LV and HU. 'GIIPS' countries are GR, IE, IT, PT and ES.

Free-falling wage shares in southern Europe

Figure 3.10 presents the development of adjusted wage share between 2008 and 2012 for different groups of countries. It separates IMF-assisted central and eastern European countries (Hungary, Latvia and Romania) from the remaining 'new' EU member states, and the GIIPS countries (Greece, Italy, Ireland, Portugal and Spain) from the rest of western Europe. The graph shows that in most countries, the wage share increased briefly between 2008 and 2009 at the beginning of the economic crisis – following the typical countercyclical character of the wage share because wages tend to be less volatile than profits during an economic downturn. However, what also emerges from Figure 3.10 is that, since then, wage shares in IMF-assisted CEE countries and the GIIPS countries seem to be heading towards a (very low) common denominator set by the remaining CEE states. The adjusted wage shares have remained relatively high and stable only in the rest of western European countries ('other WE').

The effect of falling labour income shares on economic growth very much

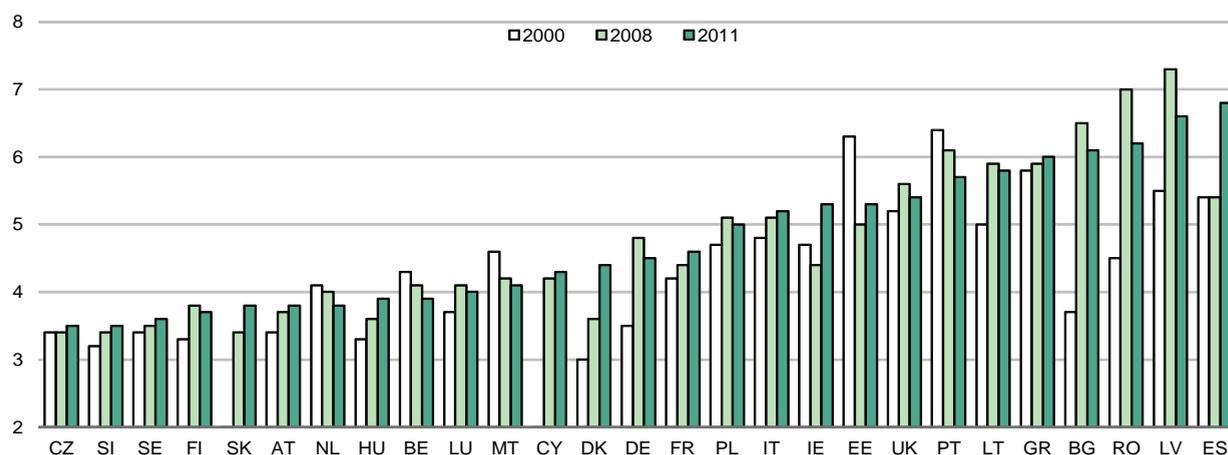
depends on the specific economic conditions of the country under investigation. A recent ILO analysis shows that from a demand-side perspective, falling labour wage shares are associated with lower private consumption and hence lower internal demand (ILO 2012: 55). However, the same study also showed that, from a supply-side perspective, falling labour income shares are associated with a higher share of net exports – i.e. an increase in international competitiveness. Which effect in the end prevails – the negative impact of decreasing internal demand or the positive impact of increasing competitiveness – very much depends on the growth strategy pursued in the country in question. In countries with an export-driven growth strategy, the positive effect of a falling labour share in terms of a strong export growth may (over)compensate the negative effect of falling labour income shares on internal demand. The question remains whether such a model is sustainable in the long run because, as the ILO points out, 'export-led growth strategies based on trade surpluses are often only possible in combination with the debt-driven consumption in deficit countries' (ILO 2012: 62).

However, in countries with a less export-oriented growth strategy (such as the GIIPS countries) and in which internal demand plays a much stronger role for growth, the impact of the austerity

measures in terms of falling real wages and labour income shares actually inhibits economic growth. An important lesson to be learned from these developments should be that the 'one-size-fits-all' austerity approach currently pursued by national governments under pressure from international institutions might work in one country but have the exactly opposite effect in another country. In its recent global wage report, the ILO highlights the risks of such a 'one-size-fits-all' approach by carefully suggesting that 'a presumption that wage moderation is always beneficial for economic activity would be misguided' (ILO 2012: 56).

Income distribution and inequality

Figure 3.11 Inequality of income distribution (80/20 income quintile share ratio) in the EU, 2000, 2008 and 2011



Source: Eurostat (2012).

Note: for CZ, DK and SE, figures refer to 2001 data. For SK and CY, no data is available for 2000 and 2001.

Divergent trends in income inequality across EU27

Wage share trends discussed in the previous section tell us little about the (absolute) levels of income inequality within EU member states. To assess developments in this respect, it might be instructive to look at changes in the income quintile share ratio. Also known as the S80/S20 ratio, it is calculated as the ratio of total income obtained by the 20% of the population with the highest income to that obtained by the 20% of the population with the lowest income. The higher the ratio, the larger the income discrepancy between the richest and the poorest quintile.

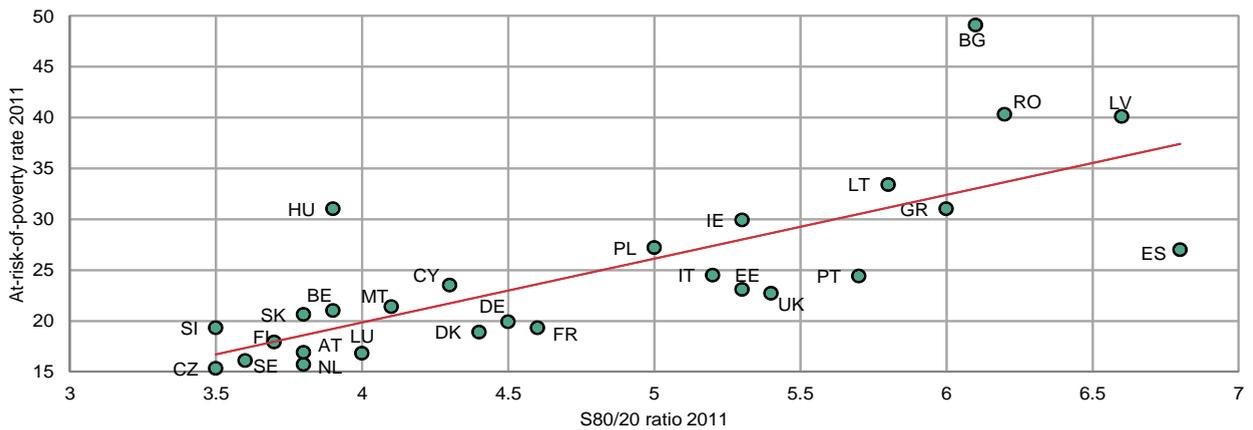
Figure 3.11 shows that the extent of income inequality varies significantly across the EU. In 2011, incomes were most equally distributed in the Czech Republic and Slovenia (both countries with the S80/20 ratio of 3.5). Among old EU member states, the three Scandinavian countries Denmark, Sweden and Finland, together with Austria and the Netherlands, traditionally display the lowest income inequality rates (in all these countries, S80/20 ratio remains

below 4.0). At the other end of the scale, Spain and Latvia were the most unequal countries in 2011 (with, respectively, 6.8 and 6.6 values of the S80/20 ratio), followed by Romania (6.2), Bulgaria (6.1) and Greece (6.0).

It is noteworthy that the most egalitarian west European countries are also characterised by inclusive wage-setting systems and high collective bargaining coverage rates. This would suggest that comprehensive collective bargaining systems, which cover substantial parts of the workforce and spread productivity increase premia among different occupational groups and/ or sectors, contribute to a more equal distribution of income within the population (ETUC and ETUI 2012: 68). However, relatively low levels of income inequality rates in some central and eastern European countries, in which collective bargaining does not play a prominent role, suggest that other variables are also important for mitigating income inequality. In the case of the so-called Visegrád countries (Poland, the Czech Republic, Slovakia and Hungary) and in Slovenia, social transfers and benefits have been an important income-equalising factor (Bohle and Greskovits 2012).

Income distribution and inequality

Figure 3.12 At-risk-of-poverty rates and S80/20 ratios per country in the EU, 2011



Source: authors' calculations based on Eurostat (2012), following Atkinson *et al.* (2010).
Note: S80/20 figures for CZ, DK and SE refer to 2001 data. For SK and CY, no data is available for 2000 and 2001.

High income inequality increases risk of poverty

As far as changes in income inequality over time are concerned, Figure 3.11 displays divergent developments across the EU27 with regard to the risk of poverty. Three broad tendencies are discernible:

- 1) Countries featuring very dynamic increases in income inequality in the period preceding the recent downturn, in particular Romania, Latvia and Bulgaria, recorded a drop in the S80/20 ratio between 2009 and 2011 – i.e. they became slightly more equal in respect of income levels.
- 2) States where income inequalities have risen during the crisis, in line with a steady increase trend already identifiable before the downturn. This group comprises the Czech Republic, France, Italy, Hungary and Austria. A special case here is Spain, where income inequality was relatively stable before the crisis but skyrocketed between 2009 and 2011 (see below).
- 3) EU member states in which income inequality decreased during the crisis,

in line with a pre-crisis decreasing trend: Belgium, Malta, the Netherlands and Portugal.

The absence of a unified trend in income inequality among EU27 indicates that the impact of crisis on income distribution is not clear-cut. The developments may vary depending on the main channel through which the crisis affects the less-skilled part of the workforce: if the low-skilled suffer predominantly from job cuts and declining employment opportunities, the reduction of the pool of less qualified, less-paid workers might lead to the decrease in the extent of income inequality (de Beer 2012). In addition, the crisis might have an equalising effect if the profits of the richest fall faster than wages and social entitlements of less affluent parts of the population (Dauderstädt and Keltek 2012: 2); this might have been the case in the Baltic and southeast European states following the burst of the construction and/or financial markets' bubble. To the contrary, if the low-skilled retain employment, but their wages are cut, income dispersion might further widen. Finally, there is a general consensus that a growing unemployment rate across all societal groups results in increasing income inequality (de Beer 2012). The Spanish story best illustrates the latter trend; as a result of rapidly growing unemployment, the country has surpassed CEE states and is currently characterised by the most unequal income structure in the EU.

Figure 3.12 illustrates the relationship between income inequality and the proportion of poverty risks in individual EU member states. The latter is assessed on the basis of the at-risk-of-poverty rate, defined as a share of the population whose income after social transfers lies below 60% of the median equalised disposable income. Figure 3.12 above shows that, in 2011, the two variables were closely correlated (with S80/20 ratio explaining 76% of variation in the poverty rate). This means that in EU member states featuring high levels of income inequality poverty risks tend to be high as well (cf. Atkinson *et al.* 2011: 112-113). Importantly, all crisis-ridden countries that had recourse to supra-national assistance can be located at the upper end of the income inequality/poverty risk scale. The only exception is Hungary, which scores relatively low on the income inequality scale thanks to its relatively dense social safety net (Bohle and Greskovits 2012).

Conclusions

The failure of internal devaluation and austerity

The economic crisis and the concomitant austerity measures reinforced the already existing dominance of competitiveness as the central frame of reference for wage policies. The result was the convergence of policies in the field of wages and collective bargaining towards an approach of internal devaluation aimed at an increased (downward) flexibility of wages as a means to close the competitiveness gap between ‘surplus’ and ‘deficit’ countries. However, our analysis suggests that, rather than creating a more level playing field, the austerity measures introduced in the ‘deficit’ countries reinforced the already existing divergent trends in the field of wages and collective bargaining in the EU. Specifically, one can observe the emergence of three distinct trends that cut across traditional typologies of national industrial relations systems established, for example, by Ebbinghaus and Visser (1997) or Kohl and Platzer (2004).

The first trend concerns the Nordic states and the central west European countries (France, Germany, Austria and the BeNeLux countries) which were not that severely affected by the economic and financial crisis and where, as a consequence, wage levels and collective bargaining institutions remained relatively stable. If anything, the crisis seemed to have accelerated already existing processes of a more or less controlled decentralization of bargaining arrangements without, however, endangering the dominant role of sectoral-level bargaining arrangements (Keune 2011: 143/144).

The second trend concerns the new EU member states which were not in need of financial aid programmes by the EU and/or the IMF. In these countries, wage developments were very uneven; some countries, like Poland and Bulgaria,

experienced relatively high real wage increases while others, such as Lithuania and Estonia, recorded a substantial fall in real wages. Even though in most of the countries the crisis was used as a pretext for an increased flexibilization of the labour market, often without the involvement of the social partners, the changes tended to be path-dependent without major disruptions of existing already highly decentralized and fragmented bargaining arrangements (Glassner 2013).

The third trend can be observed in the GIIPS states and the CEE countries that concluded Stand-by Arrangements with the IMF. In these countries, the direct political intervention from the supranational and national levels led to a decline in wages but also to a ‘frontal assault on articulated, multi-employer bargaining’ (Marginson 2012: 9). In countries characterized by a comparatively high level of bargaining centralization, the austerity-induced reforms led to a dismantling of existing wage-setting arrangements, either by completely abolishing institutions of cross-sectoral wage coordination, such as in Ireland or Romania, or by continuously hollowing out existing sectoral bargaining arrangements, which is what happened in Greece, Spain and Portugal. The exception in this respect is Italy, where wage developments – at least compared to the other GIIPS countries – remained relatively stable, and where the trade unions (so far) have been able to fend off the most radical procedural reforms of the traditional system of co-ordinated bargaining (Meardi 2012b).

Overall, our analysis shows that the austerity-driven reforms have contributed to the growing diversity of social standards in Europe. In particular, they have made the southern European countries move closer towards new EU member states’ standards in terms of incomes, wage-setting arrangements and social cohesion, thus widening the gap between the ‘core’ and the ‘periphery’ of the eurozone and the EU.

Looking beyond the direct implications in the field of wages and collective bargaining, this chapter demonstrates the need for a critical reassessment of the internal devaluation approach currently

pursued jointly by supranational institutions and national governments. There is, however, a growing consensus about the negative impact of austerity measures on economic growth during an economic downturn. Several more recent studies show that not only was internal devaluation ineffective in addressing the problem of macro-economic imbalances but it actually aggravated the debt problems of deficit countries (Holland 2012; Horn *et al.* 2013). Even the IMF recently admitted that large and rapid fiscal consolidation may lead to unintended economic consequences for growth and employment (Blanchard and Leigh 2013; IMF 2012). However, as Armingeon and Baccaro point out, ‘this emerging consensus has so far had little impact on European policymakers, who continue to emphasize the need for the GIIPS countries to implement austerity and structural adjustment programmes’ (2012: 263).

The problem of this one-sided fixation on austerity and improving cost competitiveness through (downward) wage flexibility is that it a priori precludes any thinking in political alternatives. Such an alternative could be the establishment of a European structural investment programme in order to help deficit countries to upgrade their economic and industrial structure, which would enable them to specialize in certain sectors and niche markets in order to produce new goods to generate revenue, jobs and wages to repay existing debts (for instance in the field of sustainable energies). This would also reflect the real lesson to be learned from the German case, which is often portrayed by European policymakers as the example to be followed. The real foundation of Germany’s strong competitive position is not wage moderation but its specialization in high-technology and high-quality niche markets in which German companies enjoy high pricing power (Felipe and Kumar 2011; Janssen 2012d). The subordinated role of wage moderation for Germany’s competitive position can be seen in the fact that German industry did not use the reduction of unit labour costs and the productivity efforts extracted from its workers to lower the prices of manufacturing, but instead turned them into higher profit margins.