

Andersen, Torben

Article

The European Labour Markets - Wage Norms in Europe - A Curse or Blessing?

CESifo Forum

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Andersen, Torben (2004) : The European Labour Markets - Wage Norms in Europe - A Curse or Blessing?, CESifo Forum, ISSN 2190-717X, ifo Institut für Wirtschaftsforschung an der Universität München, München, Vol. 05, Iss. 1, pp. 31-33

This Version is available at:

<https://hdl.handle.net/10419/166175>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

WAGE NORMS IN EUROPE – A CURSE OR BLESSING?

TORBEN M. ANDERSEN*

The characteristics of European labour markets are centre stage to many policy issues. Structural problems causing impediments in the adjustment process are widely perceived to be a key reason for persistent unemployment problems in a number of European countries. Furthermore, the formation of the European Monetary Union is often taken to put further demands on the flexibility of wages to compensate for lack of (national) instruments to deal with country specific shocks. In the absence of sufficient flexibility it follows that asymmetries and differences in labour market performance across European countries may not only persist but increase. However, labour market structures and institutions may adapt as a response to the integration process, and therefore it is necessary to evaluate the mechanisms through which labour markets could be affected by integration before any conclusions on the need for structural labour market reforms can be made.

The process of wage formation in Europe is affected by integration through two main mechanisms. First, the ongoing integration process, in particular of financial and product markets, implies that production and thus employment can be more easily relocated across countries and thus labour markets. This occurs via changes in market shares and relocation of production via outsourcing, foreign direct investment etc.. The effects of product market integration on labour markets can roughly be summarized as implying that the elasticity of employment with respect to wages increases. Accordingly, wage setters face a steeper trade-off between wages and employment, and this would in general tend to induce wage moderation. This may have beneficial effects on the level of employment, and therefore it is often hypothesized that product market integration is like a structural reform making labour markets more flexible. More sensitivity of employment to relative

wages also means that wage interdependencies become stronger, that is, the consequences of having wage developments out of line with that of competitors become more severe.

Second, the common monetary policy implies that an increased adjustment burden is put on wages to cope with asymmetric or country specific shocks; not least in cases where no leverage is left for fiscal policy. Much focus in the debate has therefore been on the need to ensure that wage formation is consistent with the inflation target pursued by the European Central Bank.

It is therefore quite common to encounter statements to the effect that the key issue is to have wage developments in Europe be in accordance with the monetary policy objective of low and stable inflation. This is, however, a very imprecise yardstick by which to evaluate the importance of labour market structures. First, to the extent that the monetary policy objective is pursued rigorously, the issue is not to make wage development consistent with low and stable inflation, but rather at what level of unemployment wage formation is consistent with the inflation target. Second, informal coordination on wage setting via e.g. strong norm building in wage setting (like the formula or norm calling for wage increases to equal inflation plus productivity growth) may be detrimental to more smoothly working labour markets, since it reinforces wage interdependencies in wage setting and therefore leads to large sensitivity of employment to country-specific or asymmetric shocks. Such norms may thus be conducive to nominal convergence but come at the cost of less real convergence.

The development in the level and dispersion (measured by its standard deviation) of aggregate nominal wage increases for all EU-countries (except Portugal) for the period 1971 to 2001 is given in the Figure.

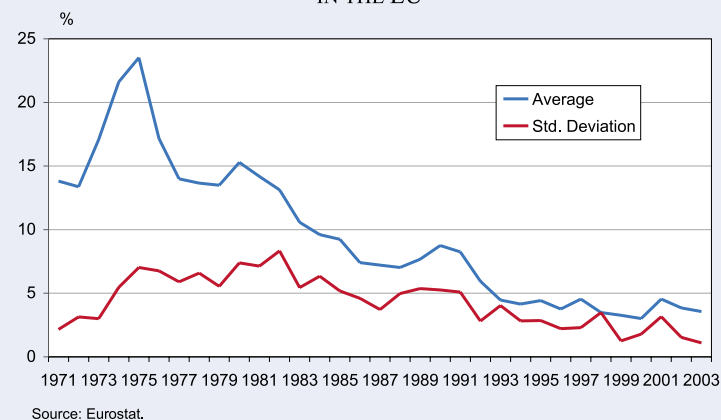
It can be seen that average nominal wage increases have come down, particularly in the 1990s during the



How does economic integration affect the labour markets?

* Department of Economics, University of Aarhus.

LEVEL AND DISPERSION OF AGGREGATE NOMINAL WAGE INCREASES IN THE EU



preparation phase up to and after the establishment of the European Monetary Union. Nominal wage increases have thus fairly quickly adapted to the low inflation environment, which may be taken as a sign that this process quickly established credibility. The dispersion in wage increases has also been reduced over this period, partly reflecting the lower average level of nominal wage increases

Looking at recent developments, there are reasons for concern. Although wage formation has adapted fairly smoothly to the new monetary regime in the sense of more moderate nominal wage increases and less dispersion in nominal wage increases among member countries, there is a risk that nominal convergence is achieved at the cost of real divergence. This is suggested by the fact that the dispersion in wage increases across European countries does not seem to reflect that business cycles are asymmetric. If so, one should expect to find a positive relationship between the dispersion of e.g. GDP growth rates and the dispersion of nominal wage changes. However, the correlation between nominal wage changes and GDP growth is falling, since the correlation was 0.74 over the period 1971–80, 0.62 over the period 1981–1990 and 0.56 over the period 1991–2002. This suggests that nominal wage changes to a lesser extent than previously reflect differences in business cycle developments.

Accordingly, the empirical evidence suggests that there has been some strengthening of wage interdependencies with some convergence of nominal wage increases across European countries, but also that wages to a lesser extent respond to domestic labour market conditions, that is, the nominal convergence does not necessarily reflect real convergence.

Wage formation in European countries remains largely a national matter. Although there are theoretical arguments that the incentive for unions to cooperate across borders increases with further integration, no formal cooperation has been seen. However, the importance of the “European” element in wage formation, that is, the increased focus on competitiveness following from intensified integration, is visible in all EU labour markets. In various countries a “European norm” has played

either an explicit or an implicit role in wage formation. An interesting example is the Belgian “law on competitiveness” of 1996 which explicitly linked wage increases to wage increases of its main competitors (Germany, the Netherlands and France). This prompted the so-called “Doorn initiative”, which involves unions in Germany, France, Belgium, the Netherlands and Luxembourg. The “Doorn initiative” is not an attempt at establishing transnational wage bargaining, but rather an initiative which, through exchange of information and peer pressure, aims at avoiding a process of “competitive” wage cuts, or competition between different national collective bargaining systems. The initiative has launched a “wage coordination formula” which defines the scope for nominal wage increases as the sum of inflation and productivity growth. The intention is to have a norm “protecting” the labour share, and to ensure a level playing field to avoid undercutting. In recent years the norm has also been interpreted more flexibly to take into account qualitative aspects like work environment, flexible working hours, training etc.

Thus more focus has been put on wage norms, and in some cases there are even explicit recommendations that wages should be set according to such norms to protect the “wage share”. The appealing idea underlying this is that there is room for wage increases equal to the sum of productivity increases and inflation. While this may sound appealing, there are several caveats attached to these norms, and widespread adoption of these norms may therefore be problematic.

In the first place, application of the norm is not trivial. What measure of productivity or inflation to use? Is it observed or expected values which should be incorporated in the norm? Is it firm-specific, nation-

Wage formation has adapted to a low inflation environment

al or European-wide measures which should be applied?

The wage norm tends to have a self-fulfilling property for a very basic reason. At any given wage, firms will tend to adjust the workforce to match the value of the productivity (marginal product) of labour. Hence if wages are set at a high level, the ex-post observed productivity would be high since firms had to adapt to wages, and therefore the norm would seem vindicated. The point is, of course, that it is uninteresting whether the wage norm is met, unless it is seen relative to the level of employment.

Widespread application of the wage norm will also strengthen wage interdependencies in Europe in the sense that wage formation would tend to be more alike if the same measures of productivity and inflation are applied. In particular the latter is likely to the extent that the inflation target of the ECB is credible. This may thus imply that it in some sense becomes easier to attain the inflation target. However, it is problematic since it also implies that wage formation in local or national labour markets comes to depend less on local conditions and more on aggregate or currency-wide conditions. This implies that wages would take less of a burden in adjusting to asymmetric or country specific shocks and therefore more of a burden would necessarily fall on employment and output. Therefore nominal convergence may come at the cost of increased real divergence. This is an example of wage formation in contrast to the usual condition for a currency union that nominal wages should be more flexible.

There is no such thing as a common wage norm which can be applied across European countries. To ensure sufficient adaptability wages have to adjust to local conditions.