CANADA-EUROPE TRANSATLANTIC DIALOGUE:
SEEKING TRANSNATIONAL SOLUTIONS TO 21ST CENTURY PROBLEMS

http://www.canada-europe-dialogue
August 2012
Literature Review and Comment

Coordination Through the Crisis: The State of Research on Coordinated Wage-Setting and the Social Partnership

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Introduction

In the current European context, wage-setting remains an underemphasized issue, but an important one. It is with that in mind that this commentary explores the current state of the literature on wage-coordination and the social partnership. Section 1 argues that while it has been largely overlooked throughout the economic crisis, past research has established wage-coordination as a relevant topic in the current political climate. Indeed, the literature has established a strong linkage between the coordination of wage-setting by the social partners, and economic performance. Furthermore, Economic and Monetary Union (EMU) has left fewer tools for macroeconomic management, making wage-levels and the mechanisms by which they are set all the more important.

However, as Section 2 notes, this body of work struggles to address new questions that have come to the fore due to the economic crisis. Specifically, the literature has not fully explored the effects of variations in the institutions which deliver wage-coordination. Similarly

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under explored is the extent to which cross-national and supranational actors are coming to influence wage-setting practices that have hitherto been strictly national in scope. Hence, it concludes that more research is necessary to build upon existing advances and to address these gaps in the literature.

Section 1: Past Research and its Present Relevance

Following Calmfors and Driffill (1988), the literature on wage-setting has compared the performance of economies where wages are set centrally, as in Belgium or the Nordic countries, to countries with highly decentralized systems of wage-setting, as in North America or the UK. Initial work found that wage settlements in highly centralized and highly decentralized systems favoured lower inflation and higher employment. In decentralized systems, atomistic actors responding to market signals are said to produce wage growth that is consistent with low inflation and high employment. The same outcome prevails in centralized systems where encompassing unions gain monopoly power but also bear the brunt of inflationary wage settlements, creating powerful incentives for wage moderation. In intermediate systems, unions command market power but are not encompassing enough to bear all of the costs of inflationary wage settlements, resulting in higher inflation and weaker economic growth.

Subsequent work has found this framework too restrictive. For instance, work by Soskice (1991) finding that intermediate systems that coordinate following settlements in a lead sector, such as Germany behave much like highly centralized systems. Others have pointed to the quality of the relationship between the social partners (Blanchard and Philippon 2006), or the disposition of the central bank towards inflation as other key variables (Guzzo and Velasco 1999). Nonetheless, Driffill's later work (2006) has reiterated the strong independent effect of wage-bargaining institutions in the literature.

Although the issue is treated as a fair-weather one (Pochet 2012; Confidential Interviewee 2012) the effects of different wage-setting practices are, in fact, especially important in the context of EMU. Work in economics on Optimal Currency Area Theory (beginning with Mundell 1961) has stressed the mobility of productive factors as the key to economic health in a large currency area. Indeed, while EMU and the European Union's Single Market do allow for free movement of goods, capital, and labour, several scholars including Parsons and Pochet (2008) have noted that in practice, workers in the Eurozone tend to be highly immobile. Noting that the chief impediment to mobility within the Eurozone is cultural and linguistic, Eichengreen (2012) concludes that it is likely to persist. Similarly, the argument that factor mobility can resolve competitiveness gaps within a currency area assumes a high degree of substitutability among factors, which seems untenable in practice given significant differences between Eurozone economies and the skills that they demand.

Moreover, under EMU, where currency devaluation is impossible, fiscal policy restrained, and factor mobility limited, the coordination of wage-setting remains one of the chief policy instruments for addressing economic shocks and imbalances. Indeed, while fiscal policy remains restricted as a tool for managing aggregate demand, deliberate changes to wages and prices may mimic the effects of currency fluctuations, making wage-setting an important instrument for economic management. Given the present emphasis upon economic imbalances, and diverging competitiveness among Eurozone economies (for example in Natali and Vanhercke 2012), this issue of wage-setting is especially pressing.

However, a common theme in the literature is that EMU may also have substantial feedback effects upon wage-setting regimes. Soskice and Iversen (2001), among others, have noted that a central bank setting rates for the entire Eurozone reduces the pressure on individual countries that fail to control inflation. They have also noted that in a currency area as diverse as the Eurozone, there is a strong possibility of a mismatch between the central bank rate and domestic economic conditions, a dilemma more acute, but not dissimilar, to the one facing central bankers in Canada and the United States, for instance. Similarly, Parsons and Pochet (2008) have found that the mandate of the European Central Bank (ECB) to give economic signals and predictions for the whole of the euro area poses challenges for actors fixing wages at national level, concerned solely with domestic economic conditions.

These changes significantly alter the incentives for actors responsible for wage-setting. For instance, Johnston and Hancke (2009) have noted divergences within Eurozone economies on wage-setting between export-oriented sectors, which face stiff pressure for competitive wages, and sheltered sectors, which now face less discipline from the central bank on wages. Cukierman and Lippi (2001), for example, also note that EMU should make unions more aggressive on wages, while Enderlein (2006) is not alone in observing significant changes in the behavior of domestic actors as a result of the mismatch between domestic economic conditions and central bank rates.

Section 2: Emerging Gaps in the Literature

While existing work does speak to a number of important issues in the current context, the economic crisis has highlighted a number of important gaps in the literature that demand further research. Indeed, Crouch (2000) has found that under EMU, coordinated systems should respond more quickly to market signals and outperform uncoordinated ones. Similarly, Hancké and Rhodes (2005) found that the effects of EMU vary significantly between systems, but very little detailed analysis has been done to examine these dynamics in individual systems. For instance, while Belgium, France, Germany, and the Netherlands are all grouped as ‘coordinated systems’, their means for coordinating wage-setting are very different, and little work has been done to examine firstly, how effectively they respond to conditions under the euro and secondly, how the response strategies of the social partners have affected their functioning. Two important exceptions, however, are Pochet, Keune, and Natali (2010) — although it does not cover Belgium and Germany — and Hermann (2005). Furthermore, while the literature on wage-bargaining has examined extensively the behaviour of the labour movement under EMU, much of this literature has left under explored the role of the employers (Pochet 2012).

Under explored, as well, has been the role of European influences in national wage-bargaining. Indeed, Soskice and Iversen (2001) are correct that centralized European Union (EU) wide collective bargaining is impractical, but to overlook the issue entirely as much of the literature does is deeply problematic. Certainly, while wage-setting is still largely a national affair, as Glassner and Watt (2010), as well as Glassner and Pochet (2011) note, there has already been coordinating activity on wages between the metalworking sectors of Germany, Belgium, and the Netherlands. Nonetheless, the literature is unclear on what the potential for greater coordination at sector level, and on the possible implications of coordination at this level might be for economic governance in the Eurozone more broadly, although Traxler, Brandl, Glassner, and Ludvig (2008) and Traxler and Brandl (2009) are notable exceptions.

Furthermore, at the European level, the labour movement is attempting to build capacity for closer coordination among member unions (Visentini 2012) and has proposed an EU-level campaign on minimum wages (Visentini 2012, Confidential Interviewee 2012), while the Commission has called for a tripartite body at European level to monitor wage-setting (Visentini 2012). This is not to overstate the role of European influences upon wage-setting, but the literature is equally remiss in ignoring them. Other under explored subtleties include mechanisms within national systems to coordinate across borders, where the Belgian and Dutch systems are particularly attuned to changes in wages in Germany, for instance.

Concluding Thoughts

In conclusion, coordinated wage-setting is an under-appreciated topic in the current economic context. However, the connections in the literature drawn between wage-setting practices and economic competitiveness, as well as macroeconomic stability under the euro are extremely pertinent. Furthermore, demands for restructuring of labour market policies in peripheral Eurozone countries means that detailed research on wage-setting regimes is not merely a question of academic interest. Nonetheless, the literature has yet to explore fully the effects of different institutional choices in various Eurozone countries, despite suggesting that these differences may be highly consequential. It also has yet to examine in depth the role and the consequences of cross-national and supranational influences upon wage-bargaining, as well as the role of the employers in the process. Hence further research is needed to address these gaps in the literature and to ensure that they speak more forcefully to questions currently being posed about economic governance in the Eurozone.

ACKNOWLEDGEMENTS

This commentary has benefited from interviews with three key informants held between July 17 and 19 2012 in Brussels. The author would like to thank these interviewees for their time and insight. The author also wishes to thank Bart Vanhercke and the European Social Observatory (OSE) for their help and support, and, of course, Dr Amy Verdun at the University of Victoria for her comments and feedback.

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