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REPORT: EFFECTS OF THE CRISIS ON COLLECTIVE BARGAINING

**"DEALING WITH THE MELTDOWN OF CASINO CAPITALISM:
WHAT ROLE FOR WAGES AND COLLECTIVE BARGAINING?"**

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I. What has been happening and what are the future perspectives for the economy?

A major negative demand shock

Europe, as well as the world at large, has been hit by a major negative demand shock. The consequence has been a significant fall in economic activity to an extent unseen since the end of the Second World War. Economic activity in Europe is likely to fall by 4% on average in 2009, with industrial production in particular collapsing by some 15 to 20%. Economic collapse certainly accelerated strongly after the US government allowed Lehmann brothers to go bankrupt in September 2008, an event which triggered a world wide credit squeeze immediately dragging down export and investment demand as well as construction sector activity and durable household spending. At the same time, one should not lose sight of the fact that the economic downturn was already developing itself long before the Lehman collapse: Demand dynamics were weakening and the euro area economy already went into recession from the second quarter of 2008. This had to do with a coordinated move of central banks all over the world since mid-2006 to tighten monetary policy rates with the objective of pricking the housing and financial bubbles that had been developing in several regions. Since interest rate hikes tend to impact the economy with a time lag of 1 to 2 years, these showed up in depressed economic performance from 2008 on. In the end, the negative demand effects of past monetary policy restriction coincided with the effects of the world wide credit squeeze, thereby resulting in the collapse of economic activity described above.

A deceptive recovery

Economic performance in the last quarter of 2008 and first quarter of 2009 was horrendous - with quarter on quarter growth figures of around minus 2,5%. In spring 2009 however, policy-makers started to identify what they called 'green shoots of economic recovery': Leading indicators such as the OECD composite indicator started to point to a turnaround in economic activity in the coming

months, while indicators capturing the purchasing intentions of managers were reporting an end to the freefall of activity, both in industry as well as in services. These 'green shoots' indeed turned up in more 'hard' economic data for some countries, with the German and French economy growing slightly in the second quarter of 2009 (compared to the first quarter 2009) and with similar improvement in performance for other major countries such as the UK or Italy. In turn, these better than expected quarterly growth forecasts form the basis to forecast the (euro area) economy returning to a very modest rate of expansion of only 1,1% in 2010.

Unfortunately, the recovery is highly deceptive. It should not be forgotten that the economic forces that have helped to stop the freefall in economic activity and even to stage some expansion in recent quarters are of a temporary nature. On the one hand, the inventory cycle is turning around: Companies have driven down their stock levels to such an extent that they need to start building their inventories once again and this is supporting demand and economic activity for the moment. On the other hand, emergency measures to support the economy taken by a handful of member states (Germany, France, UK and Poland amongst others) have worked by injecting new demand in the economy or by shifting future demand forwards. Car wreckage premiums in particular have resulted in a demand for new cars at a higher level than before the crisis. Some studies estimate that more than half of the economic turnaround observed in the second and third quarter 2009 comes from the sector of car manufacturing. However, these dynamics are not of a permanent nature. Recovery will falter from the moment that companies stop their restocking efforts and when fiscal policy measures have run their course. The latter can be illustrated from the following table, taken from the IMF. Table I summarizes the fiscal stimulus packages Western European member states have adopted with 2007 as a basis. For 2008, the set of European member states reported here adopted a fiscal stimulus package of 0,4% of GDP, with Spain undertaking a major effort. For 2008, the volume of the recovery packages increased to 1% of GDP. This implies that there was a fiscal stimulus to overall economic growth of 0,4% in 2007 and 0,6% (the increase in the value of the recovery package) in 2008. What is scheduled to happen in 2010 however is rather worrying: Recovery packages are indeed made up of temporary support measures to be withdrawn in 2010. With the value of recovery packages in Western Europe programmed to shrink to 0,8% of GDP in the course of 2010, fiscal policy will actually turn contractive and drag economic dynamism down. This is of course a very small fiscal contraction. However, the fact remains that the economy is most likely to be still in need of stimulus in 2010. Moreover, it should be noted that the European average is hiding national differences, with the UK and Spain undertaking a major fiscal contraction of respectively 1,5 and 2% of GDP. Finally, alarmed by deficits rapidly increasing because of automatic stabilizers (unemployment benefits) and the cost of 'bail out' packages for the banking sector, several member states (e.g. Spain and the Netherlands) are already engaging (or planning to engage) in fiscal consolidation, implying a much more powerful fiscal contraction.

**Table 5. Advanced European Economies:
Estimated Cost of Discretionary
Measures, 2008–10 1/**
(Percent of GDP, relative to 2007 baseline)

	2008	2009	2010
Austria	0.3	1.5	1.7
Belgium	0.0	0.8	0.4
Cyprus	0.3	1.7	0.0
Denmark	0.0	0.0	0.0
Finland	0.0	1.7	0.5
France	0.0	0.7	0.8
Germany	0.0	1.6	2.0
Greece	0.0	0.1	0.0
Ireland	0.0	0.0	0.0
Italy	0.0	0.2	0.1
Luxemburg	0.0	3.7	3.6
Malta	0.0	0.6	0.4
Netherlands	0.0	0.8	0.7
Norway	0.0	1.8	1.8
Portugal	0.3	1.0	0.0
Spain	1.9	2.3	0.3
Switzerland	0.0	0.7	0.0
United Kingdom	0.2	1.4	-0.1
Average 2/	0.4	1.0	0.8
Discretionary impulse 3/	0.4	0.6	-0.3

Source: IMF staff estimates.

1/ Figures reflect the budgetary cost of crisis-related discretionary measures in each year compared with 2007, based on measures announced through early March 2009. They do not include (1) "below-the-line" operations that involve acquisition of assets, (2) discretionary measures that were already planned for, and (3) automatic stabilizers. Some figures reflect staff's preliminary analysis.

2/ PPP GDP weights.

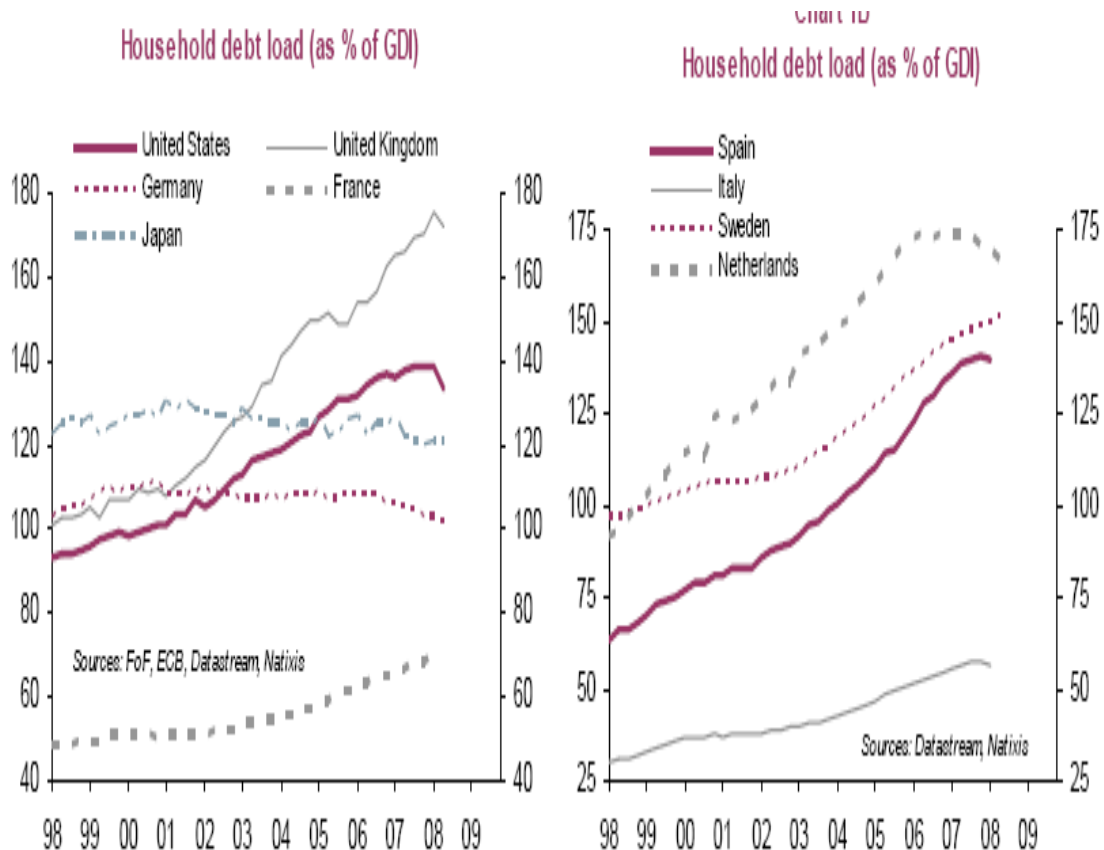
3/ Change from previous year.

Looking beyond the short term: The bankruptcy of the model of growth of 'casino capitalism'

The withdrawal of fiscal stimulus in 2010 would not be a problem if the economy would be able to rely on its own dynamics forces to grow and expand. Unfortunately, it is the opposite that is the case and this has to do with the fact that the model of 'casino capitalism' has been pushed way beyond its limits. Over the past decade, the US and major parts of Europe (Spain, UK, Ireland but also Sweden, Denmark and the Netherlands) have relied on speculative debt and asset price bubbles in order to drive demand dynamics and economic growth forwards: The impact of weak wage growth and rising inequalities on aggregate demand was offset by inducing households to take out more debt so that consumption could keep on growing. In doing so, these countries did not only boost (artificially) their own growth performance, they also provided dynamic export markets for those countries that were following the path of an 'export-led' and 'competitive disinflation-based' expansion instead of 'bubble-based growth'. The latter countries (Germany and Japan) have been 'free riding' on the US, UK and Spanish asset booms, which were powerful enough to drive forward their own domestic demand as well as export demand for 'free riders'.

It should be strongly stressed that this model of 'casino capitalism' has reached its limits and has now shifted into reverse gear. In those countries that used to rely on speculative bubbles to drive demand dynamics, private sector debt loads and asset prices have now become excessively high (see graphs below) and the speculative boom has now turned into a speculative bust. Private sector agents

now focus on driving their debt burdens down and on increasing their savings rates. Debt deflation however is a drawn out process that takes a lot of time. During this prolonged period aggregate demand will be seriously suffering. Put simply, debt deflation means that the private sector will not be able to trigger growth dynamics for several years to come. If the public sector does not step in to help the private sector in its efforts to de-leverage its debt load, the result will be a prolonged period of economic weakness during which a renewed slide into recession cannot be excluded.



The return of the spectre of mass unemployment

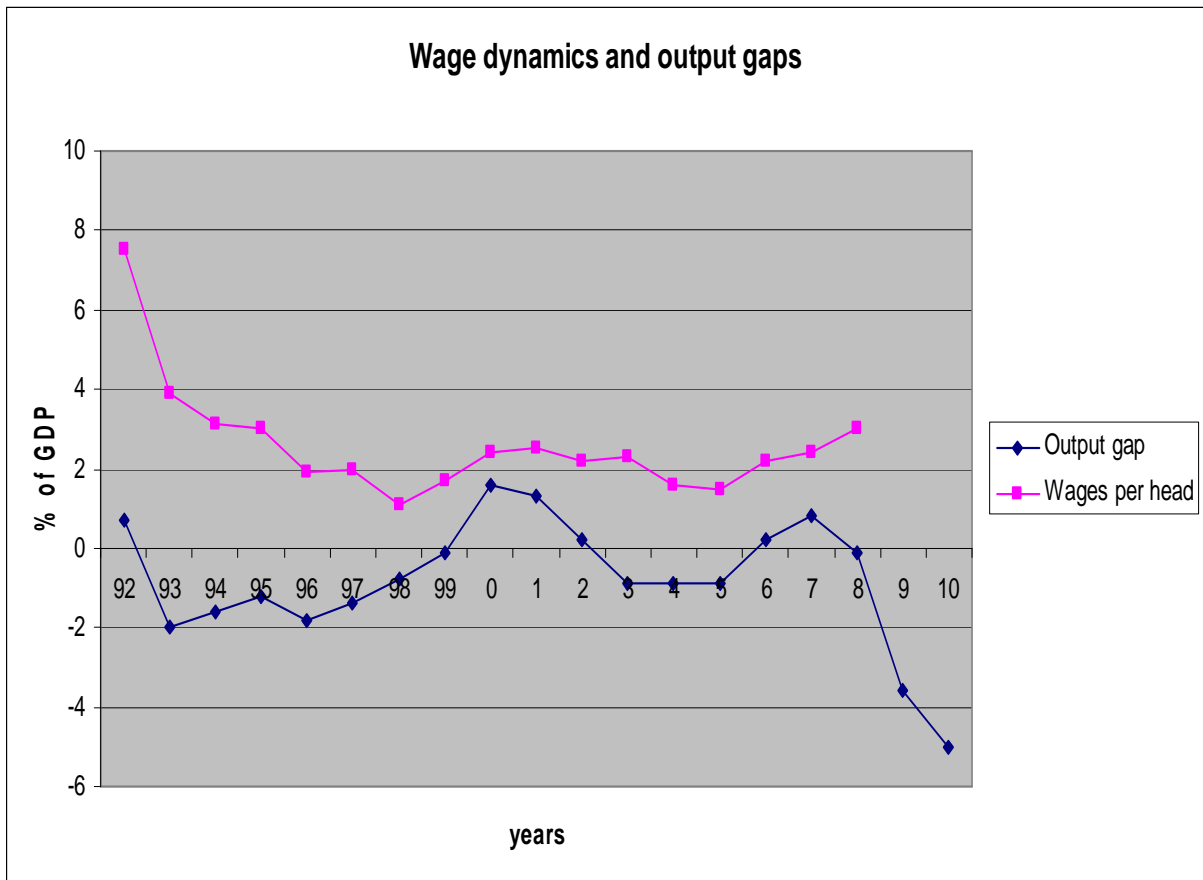
Rising unemployment is another dark cloud hanging over the European economy. Companies reacted to the economic meltdown at the beginning of 2009 by hoarding labour, hoping to avoid problems with finding skilled labour when economic recovery would be back on the agenda. However, business cannot indefinitely hold on to labour. If economic recovery does not come soon, companies will shift from hoarding labour to shedding jobs. Major employment restructuring will be taking place now and in the coming quarters. Unemployment is rising rapidly and is expected to reach 12,5% for the euro area and 11,5% for Europe as a whole by the end of 2012. This will trigger another downwards spiral with the potential of destabilising the recovery: Higher unemployment means a reduced mass of wages, which means lower household consumption and a further weakening of economic activity, which in turn means an additional rise in unemployment.

II. The impact on wages and collective bargaining

High and rising unemployment, a deceptive recovery and sluggish medium-term growth prospects because of aggregate demand being dragged down by a too high private sector debt load paints a grim outlook. To which extent will this influence the bargaining position of workers and trade unions?

What happened to wage dynamics in crisis situations in the past?

A first answer to this question can be given by looking at what happened to wage dynamics in the economic downturns of the past. Graph II explores this link between wages and the business cycle by using the macro-economic concept of the 'output gap'. This concept is a proxy measure for the intensity of the crisis and estimates how far economic activity has fallen below 'potential' activity, which is basically the level of economic activity that can be sustained without causing inflationary pressures. It appears that each time a gap opens up between economic activity and potential activity (beginning of the nineties, or after 2001), wage dynamics suffer as well: Visually, a 1% negative output gap can be linked to a deceleration of wage growth of around 1%. At the beginning of the nineties for example, a gap in output developed of around minus 2% of GDP and the rate of wage growth started to decline from 4% to 2%.



Applying this 'rule of thumb' for the coming years sends out a strong warning signal. Indeed, the intensity of the past downturns pale when compared to the present. The economy is now estimated to dive some 6 to 8% below its

potential. This is huge. This enormous slack in economic activity can be expected to have an important effect on wage dynamics. Moreover, wage dynamics are already starting out from a rather modest rate of growth. Both factors taken together may well result in average wage dynamics moving down close to zero or even turning negative.

Most recent collective bargaining outcomes

Let us move from macro-economic analysis to the reality of collective bargaining. Can we already observe some of this weakening of wage dynamics in the collective bargaining outcomes of 2009? Table II, which is based on the annual collective bargaining questionnaire of the ETUC, reports the collectively bargained wage increases of 2009 and compares these with the two previous years. The final column of the table reports the total wage increase per hour that is expected for 2009. This final column is to cross-check the data on collectively bargained wage increases, in particular since collective bargaining coverage rates and flexible bonus systems are not always comparable between the different countries.

The key conclusion to be drawn is that collectively bargaining, only one year into the crisis, is already being influenced in a negative way. And this is despite the fact that 2009 wage agreements were mostly based on bargaining strategies which were developed in the previous year - at which time trade unions were looking for robust wage increases in order to compensate for the hike in (oil) prices that occurred in the first half of 2008.

In the Eastern European member states reported here (with the exception of Poland), this process of wage dynamics adjusting downwards is quite outspoken, even spectacular: Here, nominal wage cuts, or at best wage freezes, have become the standard practice. With inflation still running in positive numbers, this implies an even bigger cut in real wages.

Even if wage freezes or wage cuts are not (yet?) generalised in Western European countries, one can nevertheless already observe a certain weakening of wage dynamics as well: Collectively bargained wage increases are coming down from growth rates of around 3 to 4% to growth rates between 2 and 2.6%, with wage dynamics from the Belgian inter-sector agreement falling close to zero. Nordic countries take a somewhat special position: Collectively bargained wage dynamics are also weakening but this weakening starts from somewhat higher levels of growth so that these countries still record around 3% (collectively bargained) wage growth in 2009.

Table II: Collectively bargained wage increases**Note: Figures between brackets are taken from similar series in Consensus Forecasts**

Collectively bargained wages	2009	2008	2007	PM: Wage cost per hour 2009
Belgium	Lump sum of 125 euro	4.2%	3.5%	2.3%
Estonia	Wage cuts			-5.7%
France	n.a. (2.2%)	3.4%	2.9%	0.8%
Germany	3% (2.4%)	2.9%	2.2%	2.4%
Hungary	3.9%	5 to 7%	8%	1.3%
Lithuania	3	6	4.1	-0.9%
Netherlands	3	3.25	1.8%	4.25
Norway	4	6	5.4%	
Poland				5
Portugal	2.9	3	3.4%	
Spain	2.7	3.6	4.2%	3.1
Sweden	3	3	2.6%	3.5
UK	3.1	3.3	3.5%	(1.5% average earnings)
Czech Republic	Many wage freezes in companies			2
Italy	4.1% (2.6%)	3.5%	2.1%	
Switzerland	2.6%	2.2%	2%	

Source: ETUC collective bargaining questionnaire, Consensus Forecasts October 2009

However, one can go into deeper detail. Instead of looking at the 2009 average bargained wage increases, one can also look at the rate of wage increase concluded in those agreements which were bargained from the start of 2009 itself, thereby excluding those wage increases paid out in 2009 but on the basis of agreements that were signed before 2009. Unfortunately, such information is only available for Germany and Spain. Germany in particular signals a significant weakening of wage dynamics: In the first half of 2009, collectively bargained agreements at sector level in Germany contain a wage increase of 2.8% for an average duration of 23 months, bringing the annual (collectively bargained) wage increase to a mere 1.5%. In Spain, wage agreements concluded in the first five months of 2009 arrive at a wage increase of 2.7%, compared with a bargained wage increase of 3.5% over the same period in the previous year.

Table III: The reality of bargaining under the threat of recession in Germany

	Agreed wage increase	More details	Possibilities to deviate
Insurance	2,5%	Concluded autumn 2008, running over 16 months	
Textiles	1,5%	From March 2009	Yes, in return for job security
Metal	2,1% wage increase of May 2009	Autumn 2008 agreement	Possibility to postpone wage increase used in half of cases

Vulnerability to the economic crisis of collective bargaining systems

Another way to gauge the impact of this crisis on the future developments in collective bargaining is to look in depth at some of the qualitative reporting that was done in the ETUC 2009 collective bargaining questionnaire. Indeed, the 2009 ETUC questionnaire asked affiliates which impact they were expecting from the recession on collective bargaining in 2010. Another question raised was whether this crisis would cause a shift to a lower level of bargaining with 'decentralised bargaining' possibly weakening the bargaining position of trade unions.

To a large extent, ETUC affiliates replied to the first question that the employers' offensive to bring down or even to crush wage dynamics is already there:

- In France, the law governing the adjustment mechanism of the minimum wage is now being applied to the letter: The minimum wage is adjusted for (low) inflation and half of the wage increase enjoyed by a basic blue-collar worker without any further effort. Moreover, a low wage commission installed by the government is criticising the high level of the minimum wage in France. Finally, the crisis is revealing the extent to which wage formation in France is based on flexible pay. Due to the crisis, 'side' wages (overtime payment, bonuses and all sorts of premiums) have been heavily reduced to such an extent that a fall of 0.4% of the average wage per head is now expected for 2009.
- In Spain, the crisis has made employers become rather aggressive in their collective bargaining strategies. Spanish employers have refused wage increases higher than 1% whilst also asking for opening clauses at company level so that the agreed pay increase can be refused in the event that the company is recording losses. As a result, and for the first time in many years, it was not possible to decide on a national social partner agreement setting a recommendation for wage bargaining at the sector level. Moreover, there was a blockade and almost a standstill in collective bargaining itself. Of the 1,685 agreements that came up for renewal during the first half of 2009, only 190 agreements have been signed. Fortunately, labour courts intervening after trade unions launched social conflicts have decided in favour of the trade union recommendation of a wage increase of at least 2%.

- In Germany, employers are preparing their offensive and have now started to talk openly about wage cuts and a 40-hour working week.
- In Estonia, minimum wages have not been increased for the first time in many years: public sector wages have been cut by 8% whereas private sector wages have been cut by 'individual agreement' by 10 to 30%. In Latvia meanwhile, public sector wages have been cut by 35% and teachers' wages even by 50%. In Lithuania, the cut in the wages of public sector employees is 10%. Meanwhile, Bulgaria also expects employers to be aggressive on the issue of wage cuts and wage freezes.
- Surprisingly, even Luxembourg, which has a reputation of having a socially corrected market economy, is reporting the employers' intention to go for 'zero' wage agreements, with the government setting the bad example by cutting wages. The Irish report is similar (although Ireland is of course suffering from high external imbalances and Luxembourg is not): Irish employers want (nominal) wages to be cut and report a 2% across the board wage cut in the private sector, with wage cuts running up to 12% in companies experiencing major difficulties. Irish employers completely adhere to the logic of downwards economic and social spirals by asking for similar cuts in unemployment benefits (to prevent work disincentives coming from wage cuts) and a cut in the minimum wage (so that there is no floor to wage cuts).
- In Belgium, wage moderation will continue because of the indexation mechanism, translating low inflation into low wages growth. In parallel, in the Netherlands, a wage increase limited to 1,5% seems to be on the cards, possibly in exchange for some more positive social measures from government or employers.

The second question provided a somewhat more balanced reply from affiliates. Several were confident there would be no shift to company level bargaining because of the crisis (Belgium, Portugal, Norway and Cyprus). Others indicated that the crisis would be, on the contrary, an opportunity to shift to higher levels of bargaining with central level agreements providing social and employment measures, sometimes in exchange for moderate wage increases (Bulgaria, Iceland, Netherlands and Poland). However, there are also those member states where bargaining is already decentralised and where company management has considerable leeway over workers to press for wage cuts under the motto 'your wage or your job'(Estonia, Lithuania and the UK). Germany reports the continuation of company level opening clauses in sector agreements (metal and chemicals), even if there are supposed to be strict limits to using such opening clauses in the form of 'counter efforts' from the employers. In Italy, two trade unions signed an agreement at the beginning of 2009 to allow company level bargaining to deviate from wage sector level in a downwards direction. Finally, in Spain, some sector agreements also contain opening clauses in return for the wage indexation clause, although they do not seem to be used much at the moment.

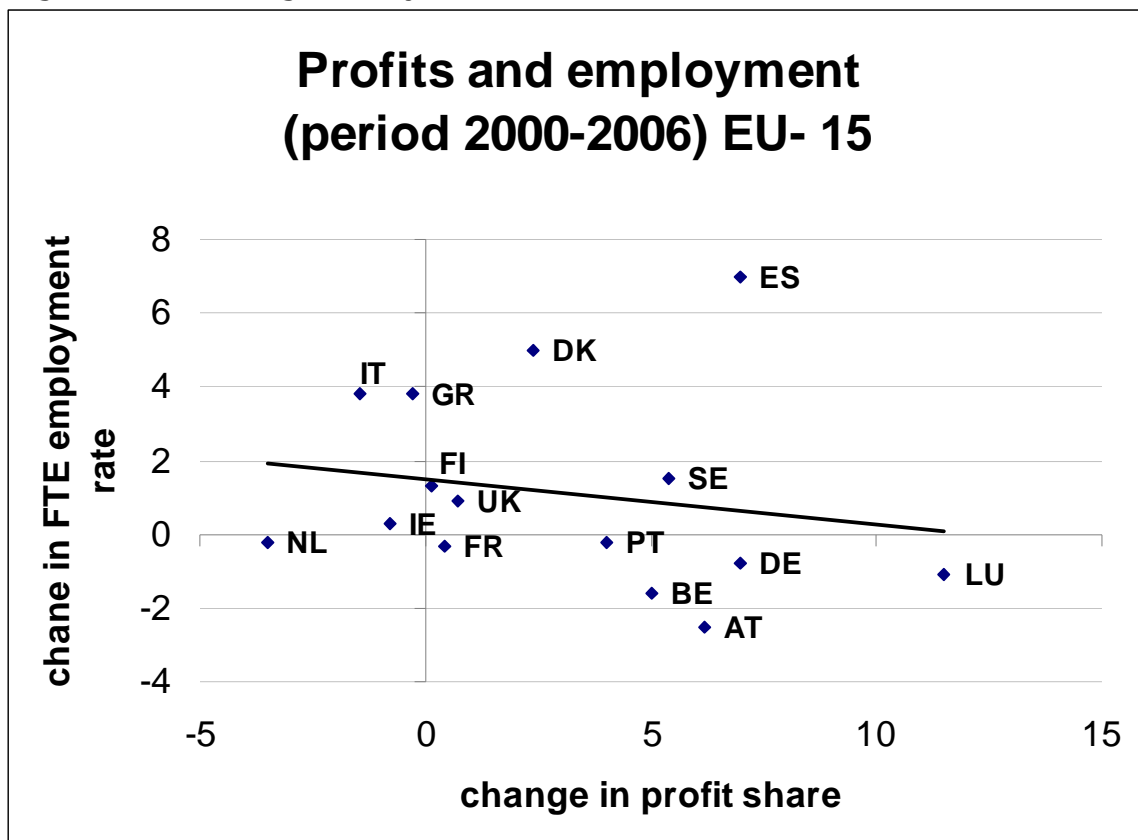
Nevertheless, the above implies that opening clauses allowing individual companies to go below the sector level agreement now exist in three major members of the monetary union. The following question thus needs to be raised: If, in the past, this instrument allowed Germany to freeze real average wages for several years and drag down the euro area average, what would be the impact if these three countries were to go down this road?

III. Collective bargaining, wages and jobs in Europe : Overcoming the fallacy of composition

High and rising unemployment and a weak bargaining position, together with an offensive from the employers' side - How should trade unions in Europe react to all of this? Should trade unions 'buy' into the mainstream economists' argument of 'lower wages, more jobs' and cooperate in organising wage moderation, even wage cuts in some cases? Or should trade unions join up so as to construct and coordinate collective bargaining strategies throughout Europe which do contribute to jobs recovery without however sacrificing wages?

Lower wages, more jobs?

Let us start by taking a look at the empirical evidence. Can we observe in economic reality a positive relationship between wages and jobs? The following graph provides a sobering view on the mainstream economists' argument that wage moderation is good for jobs.



The graph relates the change in the share of profits in GDP from 2000 to 2006 in Western Europe¹ with the change in the employment rate, with employment expressed in full time equivalents. Here, the change in the profit share is used as a proxy for wage moderation, with an increase in profit share indicating a fall in the wage share. It turns out that, in reality, the relationship between wages,

¹ Repeating this exercise for the whole of Europe delivers an even stronger negative relationship. This might perhaps have something to do with the fact that Central and Eastern European countries are still somewhat digesting the negative jobs effects from transition from a planned economy. Nevertheless, the fact remains that over a seven year period rising profits are not associated with rising employment rates.

profits and employment is the opposite of what mainstream economic theory so forcefully claims: Wage moderation does lead to higher profits but an increase in the profit share tends to lower, not increase employment. Individual country cases are also interesting to observe: Germany, Belgium and Austria fit the general conclusion that wage moderation led to a deteriorating and not an increasing employment rate. In Spain, and Sweden to a lesser extent, rising profits did go hand in hand with more jobs.

Three reasons why wage moderation will certainly not work now....

If the empirical evidence does not show a straightforward link between lower wages and jobs in general, the nature of the crisis we are going through at present is such that the presumed job benefits of wage moderation policies are even more doubtful. Indeed, this crisis is particular in several respects:

- Firstly, all countries are now in the same boat. Whereas, in the past, countries and sub regions inside Europe could pursue a strategy of competitive wage moderation in order to freeload on the growth and import demand dynamics in other parts of Europe, this is no longer the case right now. All countries in Europe are now severely hit by the crisis, in particular those countries which in the past functioned as a certain locomotive for the whole of Europe (UK and Spain in particular). Trying to improve the competitive (cost) position at a moment when export markets are weak will not do much good -it will in fact worsen things (see below).
- Secondly, this is a 'demand' crisis and not a 'supply' side crisis. This makes an important difference. A supply shock increases production costs and unemployment increases because companies cut employment in order to restore profits. In this case, wage moderation works in the right way: It brings production costs back down, thereby restoring profits as well as labour demand. The following scheme describes this mechanism

Scheme I: Supply Shock: Wage moderation rebalances labour market equilibrium

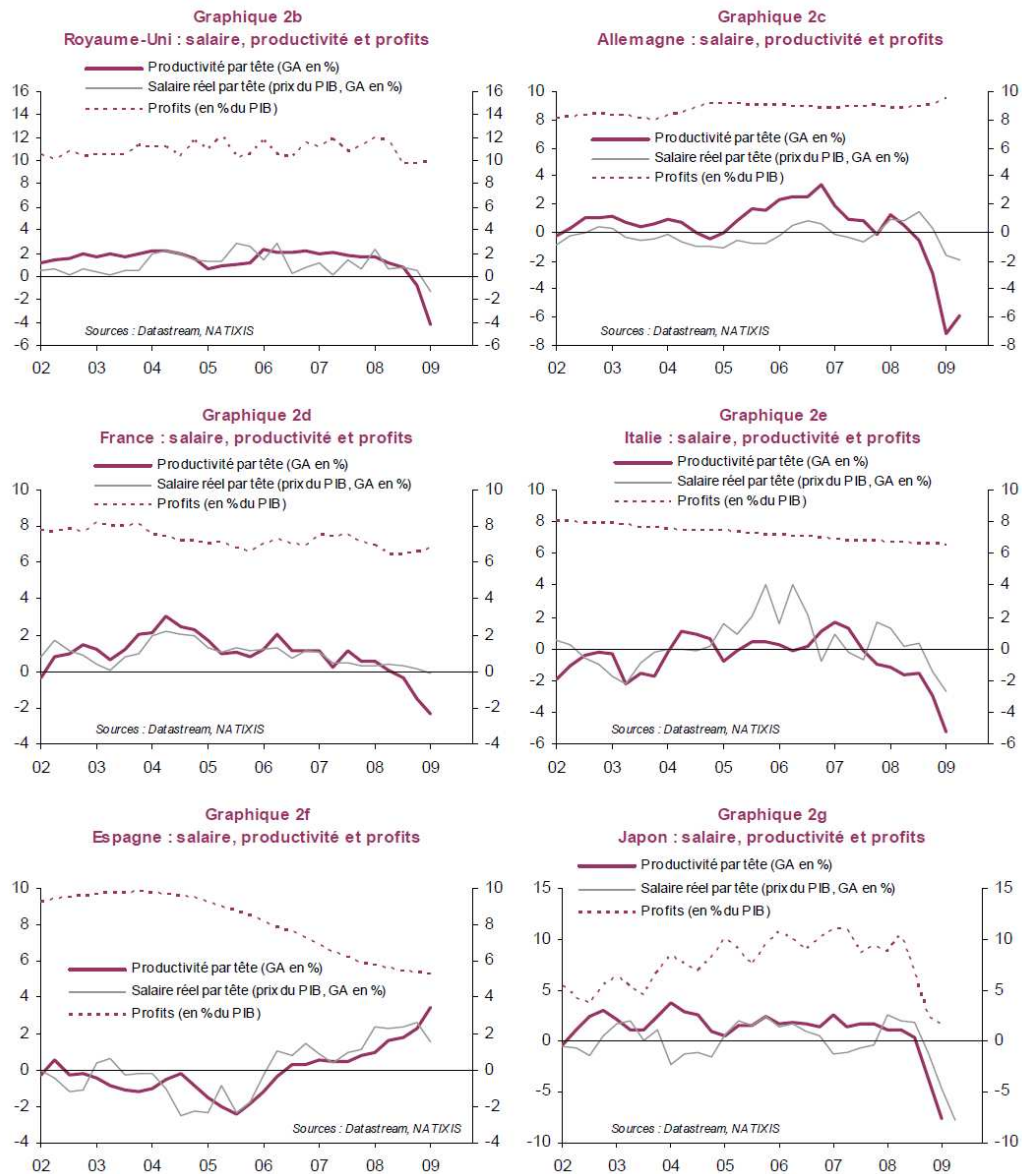
Supply shock increasing production costs Jobs are cut and unemployment increases... Wage flexibility reduces production costs..... Labour demand increases again

A demand shock however is a completely different matter. Unemployment rises because the demand for the products and services that companies produce falls away. In this situation, wage moderation has the opposite effect of depressing aggregate demand and jobs perspectives even further. In a situation of demand shocks, wage moderation does not rebalance the economy but pushes the labour market further away from equilibrium.

Scheme II: Demand shock: Wage moderation produces more disequilibrium and more unemployment

Demand shock....Jobs are cut and unemployment increase....Wage flexibility weakens demand further...More jobs are cut.

As described above, the shock the economy is going through is a 'demand' shock. And this conclusion is even reinforced by looking at what is happening to profits. Indeed, a negative demand shock is also expected to drive down profits because firms cut prices in response to the excess supply on the goods and services market. In practice however, profits as a % of GDP until now appear to be resilient to the recession, and this despite the fact that output prices (core inflation) as well as labour productivity have been falling. However, temporary public transfers ('Kurzarbeit' schemes) may be one of the reasons for this. The following graphs illustrate the resilience of profits for some major economies up to the end of 2008, with Spain being the exception to this.



- Thirdly, the credit channel can no longer be counted upon to get the economy out of the slump. In previous downturns, demand dynamics were restored by expansionary monetary policy. Central banks cut interest rates and triggered new asset price bubbles. Households responded to these by taking out more loans and more credit. This allowed household

spending to continue and recover despite weak wage dynamics. Demand shocks and wage moderation were overcome by resorting to households borrowing money and creating the illusion of rising household wealth through asset price inflation. However, as described above, debt loads have now become excessive and the consequence is that monetary policy is now 'pushing on a string'. Given excessive debt loads, households are very reluctant to take on even more debt, making it much more difficult for economies to thrive and expand on the basis of credit and debts. This means that the economy is now much more vulnerable to the negative demand effects of weak wage dynamics. It also means wage moderation and rising profits will not be used by business to increase investment. This in turn could strengthen the balance sheet of companies; it could however also be used to pay out more dividends with the aim of restoring the company stock values.

... and will produce the 'Double D' of Depression and Deflation

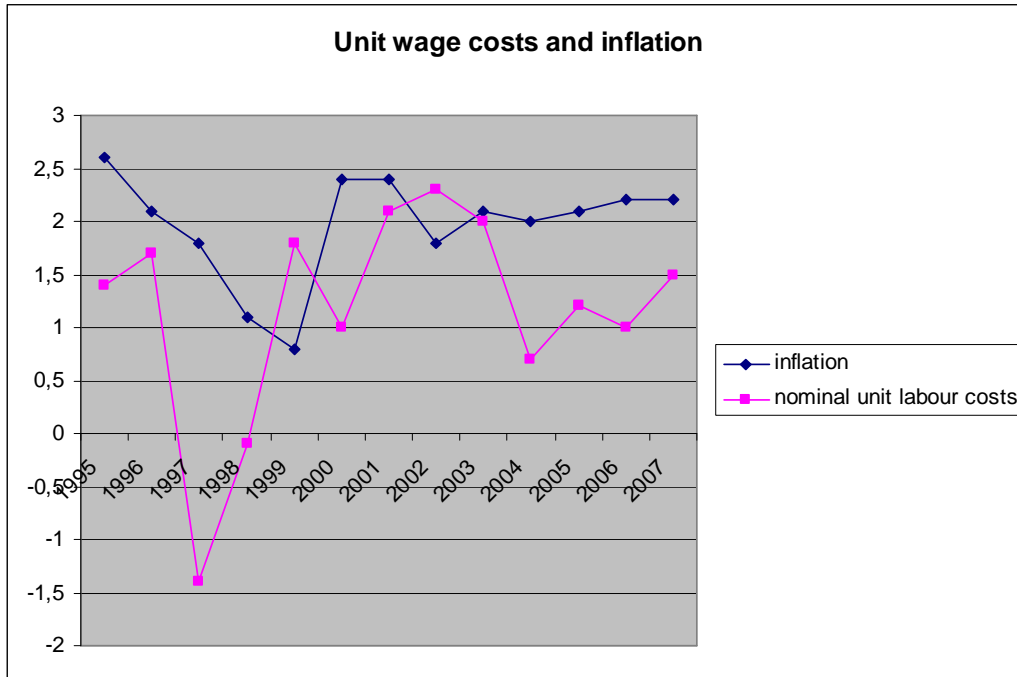
Circumstances are such that one should go further, and not limit oneself to simply questioning the presumed employment benefits of wage moderation. As things stand right now, squeezing wages risks inflicting serious damage on jobs by pushing the economy into a prolonged depression and deflation.

At the moment, this risk is masked by several factors. Wage dynamics are still in positive terrain, while the collapse in demand has also shocked productivity with companies postponing job restructuring and holding on to their staff. Positive wage dynamics combined with falling productivity rates combine forces to produce a substantial increase in unit wage costs of around 3 to 3.5% in 2008 and 2009. This actually implies that unit wage costs are growing at a rate which is above the medium-term 2% price stability target. Nevertheless, despite this cost 'explosion', inflation and core inflation in particular are edging downwards and this again illustrates the lack of demand and the degree of slack on the supply side of the economy.

However, looking forward, things are completely different. We know labour markets react to a crisis with a time lag: Companies will not keep staff indefinitely on their pay roll, implying that massive jobs restructuring is in the pipeline or already happening: Some 5% of employment is expected to be scrapped between 2008 and 2010. This will turn around the 2008 and 2009 collapse in productivity into a major hike. Massive jobs restructuring is also expected to hike unemployment to rates of 11.5 (EU -27) or even 12.5% (Euro Area), which will drag the trade unions' bargaining position and wage dynamics downwards.

A scenario in which average wage growth, dragged down by wage cuts at company level in several countries, falls to close to zero, combined with productivity improving at a rate of 2 to 2.5% (the result of productivity returning to its trend growth plus catching up for past cuts) can not be excluded. Such a scenario would lead to unit wage costs starting to fall by 2 to 3% from 2010 on, thereby opening a major gap with unit wage cost development (plus 2%) which would be in line with the objective of price stability.

In the recent past, such a situation did already occur when unit wage costs fell by 1.5% for several years in a row at the end of the Nineties. This produced a disinflationary pressure and inflation came down from 2.5% in 1996 to go below 1% in '99 (see graph).

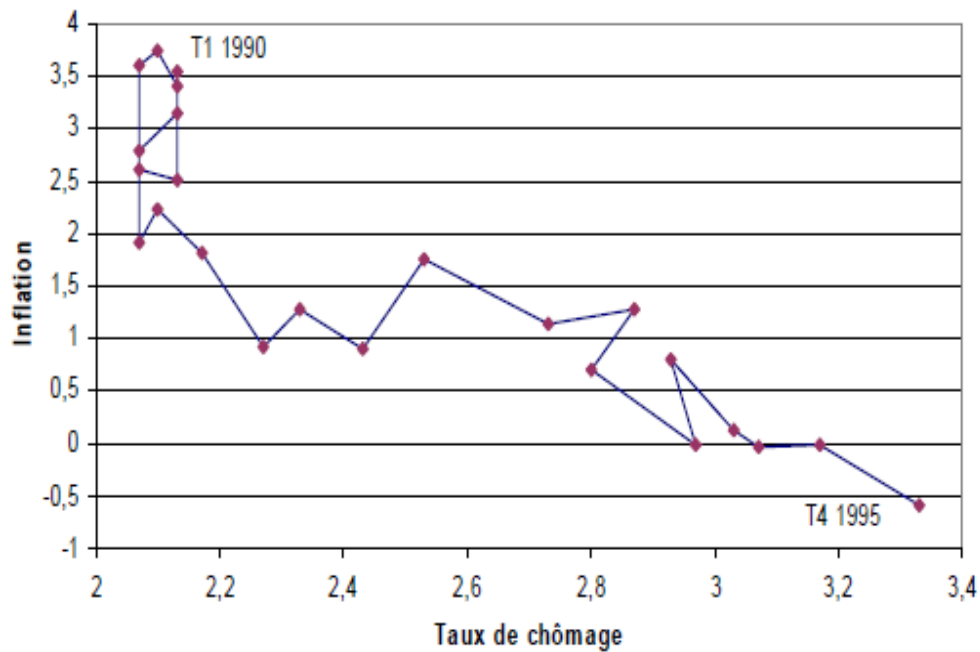


Now, however, (core) inflation is already low and close to 1% and the disinflationary pressure that is expected to come from this crisis may well turn 1% inflation into deflation, in other words into a situation of falling prices.

If such a situation of deflation is allowed to produce and entrench itself, the economy will be in for even more trouble. Deflation has the perverse effect of immediately producing additional monetary contraction (real interest rates increase without monetary policy able to do much about this given the fact that nominal interest rates cannot become negative, the so-called zero bound on nominal interest rates). Deflation also encourages households and firms to postpone spending and investment decisions since prices are expected to become cheaper, thereby seriously weakening demand dynamics. And for countries with high private sector indebtedness, deflation is a disaster since nominal debt levels are rigid whereas the annual revenue flows from which debt is expected to be paid back are shrinking because nominal revenues are falling.

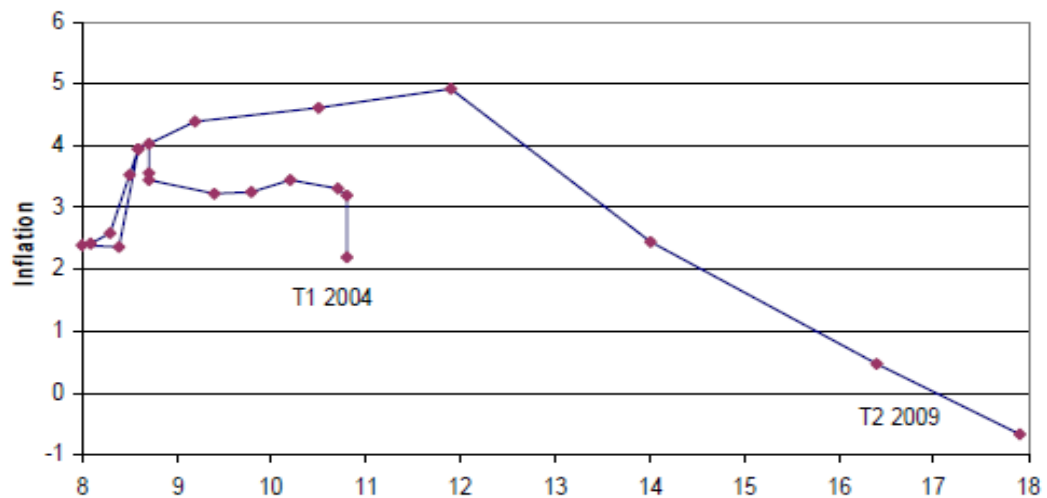
Is all of this far-fetched? The following series of graphs shows how Japan arrived at deflation and its 'lost decade'. In Japan, things started with inflation falling and unemployment rising steadily in the first half of the nineties. Policy did not stop this movement and even encouraged it by allowing negative wage growth and precarious work practices to develop (all in order to improve the 'competitiveness' of business). As a result, the Japanese economy moved continuously to the southeast in this Philips curb graph to finally end up in deflation and depression (or very weak growth), a situation in which it stayed for more than ten years.

Graphique 10 : courbe de Phillips : Japon (T1 90 - T4 95)

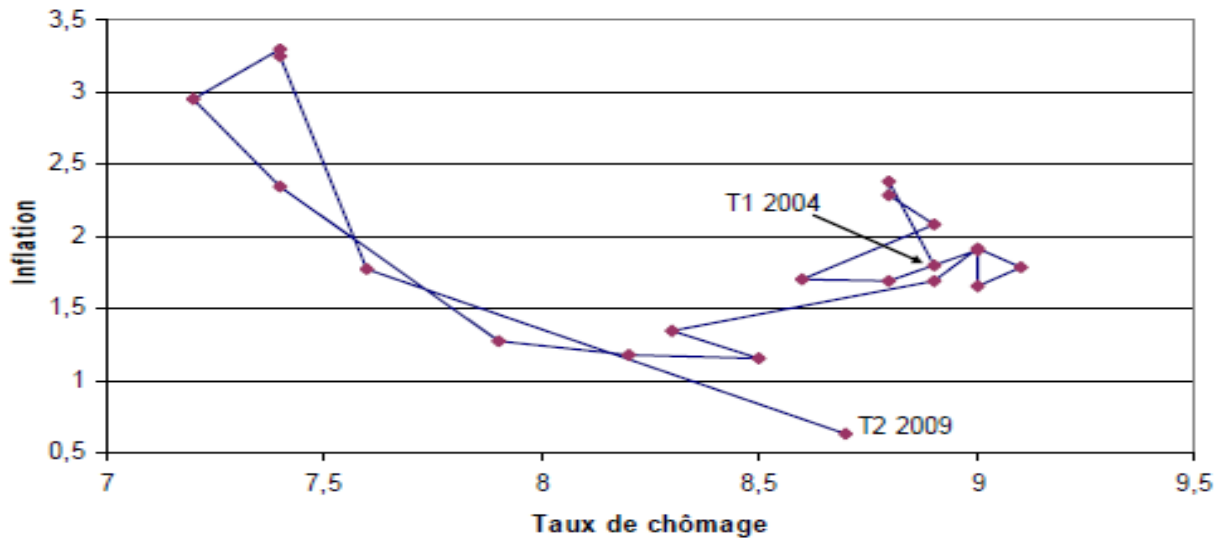


It is worrying to observe that several European countries are now moving along the same pattern. Inflation is falling from low levels to even lower levels while unemployment is ratcheting upwards. The similarity with Japan in the first half of the Nineties is striking.

Graphique 9 : courbe de Phillips : Espagne (T1 2004 - T2 2009)



Graphique 8 : courbe de Phillips : France (T1 2004 - T2 2009)



Conclusion: Collective bargaining in Europe must overcome the fallacy of composition

In all of this, trade unions and collective bargainers find themselves faced with an intense paradox. On the one hand, there is the pressure from the shop-floor of workers willing to accept a wage squeeze in order to save their jobs or have some kind of a job guarantee from their employer. This pressure is perfectly understandable, certainly at company level where workers are much more vulnerable to the blackmail of 'your wage or your job'. At the same time, it is exactly this kind of wage policy that will destroy jobs by adding to the weakness of aggregate demand in the European internal market place if it becomes widespread throughout the economy and Europe. Some 80 years ago, J.M. Keynes called this the 'fallacy of composition': What may be or seem perfectly rational from an individual point of view, may prove to be a disaster if all individuals adopt the same behaviour. In other words, to avoid 'market failure', individual market players' decisions need to be coordinated in order to internalise the general interest.

To state things more clearly: to avoid deflation and depression, trade unions in Europe face the challenge of having to stick together and join up forces in order to avoid a situation in which European workers undercut each other. Coordination of collective bargaining on a European scale, with clear guidelines for national, sector and company trade unions to reject wage cuts and defend positive wage cost increases in order to ward off the danger of deflation, is more necessary than ever.

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