Policy Brief

Progressive policies for wage-led growth in Europe

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Abstract:
Results of two new projects for FEPS and TASC by Onaran and Obst (2015) and Stockhammer and Wildauer (2015) show that the decline in the wage share was associated with a weaker and more volatile growth performance in the EU as a whole as well as in the vast majority of countries including the UK and Germany; this is what we call a wage-led demand regime. Stimulating wages in the EU would not only improve economic performance but would also help tackle unsustainable growth that is either driven by debt or by an excessive reliance on exports. While a higher wage policy can be implemented in a large single country with a large domestic market such as the UK or Germany, the impact would be stronger if coordinated at the European level. This finding has significant policy implications ahead of the EU referendum in the UK: the UK should see the EU membership as an opportunity and lead high road labour market policies in the EU as opposed to its current position of promoting low road policies, and use every chance to improve the cooperation among the pro-labour forces.

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Europe needs a fundamental rethinking of its economic policy. The crisis in Europe has laid bare the fundament flaws of the European economic policy regime based on the Maastricht Treaty and the Stability and Growth Pact. The EU's policy mix has resulted in a deep economic crisis in southern Europe and a weak recovery in the northern countries, with the Euro area teetering at the brink of deflation. Europe needs a fundamental rethink of fiscal policy, monetary policy, financial regulation and wage policy.

Individual EU Members States (MS) and the European Commission (EC) have long encouraged wage moderation, explicitly recommending real wage growth below productivity growth to increase the international competitiveness of the EU. This policy has resulted in three decades of increasing inequality, declining share of wages in national income, and the emergence of a new class of super rich without generating a sustainable growth model for Europe.

Results of a new project for FEPS and TASC by Onaran and Obst (2015) show that the decline in the wage share was associated with a weaker and more volatile growth performance in the EU as a whole as well as in the vast majority of countries including the UK and Germany; this is what we call a wage-led demand regime. Stockhammer and Wildauer (2015) highlights that in countries like the UK, Ireland, Spain, Greece, or Portugal households increased their debt to maintain consumption levels in the absence of decent wage increases. In countries such as Germany, Austria, and the Netherlands an excessive reliance on exports was required to maintain growth in the absence of domestic demand. The Great Recession 2007-9, and the subsequent Euro Crisis have proven the fragility of both models. However, wage moderation policies are still part of the crisis management policies in the national reform and stability programmes as well as the Europe 2020 strategy of the EC. In particular the detrimental effects of austerity measures aiming at the fiscal consolidation as well as structural reforms in labour markets, which will continue wage restraint policies, are still seen as part of the solution rather than the problem.

Stimulating wages in the EU would not only improve economic performance but would also help tackle unsustainable growth that is either driven by debt or by an excessive reliance on exports. While a higher wage policy can be implemented in a large single country with a large domestic market such as the UK or Germany, the impact would be stronger if coordinated at the European level. This finding has significant policy implications ahead of the EU referendum in the UK: ***the UK should see the EU membership as an opportunity and lead high road labour market policies in the EU as opposed to its current position of promoting low road policies*, *and use every chance to improve the cooperation among the pro-labour forces.***

A strategy of wage-led development requires a policy mix that includes labour market policies aiming at pre-distribution, i.e. the determination of wages as market outcomes, policies targeting the top, middle, and bottom of the wage distribution, as well as redistributive policies through progressive taxes. Furthermore, distribution policies need to be complemented by a macroeconomic and industrial policy mix. Wage policies have to be embedded into broader targets of equality, full employment, and ecological sustainability. In particular, we recommend the following policy measures for sustainable wage-led development to be achieved in Europe:

- **Strengthen the bargaining power of labour** by improving union legislation, and widening collective bargaining coverage,
- **Introduce a European system of minimum wages** which puts in place processes to guarantee that national minimum wages maintain their relation to the median wage of each country and grow incrementally to the level of a living wage,
- Enforce **gender equality** and **close gender pay gaps,**
- **Introduce and enforce pay ratios** to regulate top pay,
- **Strengthen the progressivity of the tax system** through closing tax loop holes in corporation taxes and increasing top rates of income tax, along with more effective taxes on wealth,
- **Strengthen the welfare state** and **re-orientate macroeconomic policies towards ensuring full employment** in order to rebalance both power relations and the wider economy,

- **Reverse the process of financialisation** through regulating finance, including a financial transactions tax and wealth taxes,
- Implement **a substantial public investment programme centred on clean energy and social infrastructure**,
- **Substantially shorten working time** in parallel with the historical growth in productivity,
- As part of a coordinated wage policy, **ensure that nominal wages increase in line with inflation and national productivity**, following an initial gradual correction of the loss in the wage share in the past three decades.

Last but not least, we suggest a system of coordinated national collective bargaining where social partners are also part of tripartite commissions that decide on fiscal and monetary policy. This would require institution building at the national as well as the European level and would effectively try to replicate labour relations systems of the Germanic or Nordic type at the national level and institution building at the European level. As unions would have to give up part of their ability to influence wages, they would have to be compensated by getting a greater say in other policy areas, that is, in fiscal policy and, ultimately, in monetary policy.

We have strong empirical evidence to reject the myth that we cannot have pro-labour policies in Europe in the age of globalisation. The EU as a whole is strong enough to pursue an egalitarian growth strategy and would benefit from a coordinated boost to the wage share. As the main beneficiaries of a global wage-led recovery, Europe could and should take a step forward in terms of radically reversing the fall in the wage share first at home. Even small open economies such as Ireland and Austria can grow if there is a simultaneous increase in the wage share.

A common worry, also among the progressive policy makers on the left is the following question: if the rest of the world does not reverse their low road policies, can the EU implement pro-labour policies unilaterally? Yes, because Europe as whole is a wage-led economy, even after considering the negative effects of a rise in the wage share on international trade, which are relatively minor (Onaran and Obst, 2015). Trade imbalances should be tackled through industrial policy rather than being posed as a barrier to egalitarian policies. The same applies to large economies in the EU such as the UK or Germany, which have the potential to enjoy higher wages without impeding growth even when these policies are applied unilaterally.