Wage policy in Austria and the Netherlands under EMU

A change in performance or the continuation of the status-quo?

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european trade union institute

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Contents

Introduction *

The introduction of the European Monetary Union (EMU) in 1999 drew wide speculation to the effects of institutional change on microeconomic foundations. The currency union's formation between twelve countries was unprecedented and provided a unique social experiment involving a supranational monetary union's impact on national economic institutions. Labour-market institutions, in particular, were scrutinised in detail. With the disappearance of national monetary policy, and the constraint on fiscal policy by the Stability and Growth Pact (SGP), labour market flexibly was one of the few adjustment mechanisms left to EMU member-states. A mobile labour-force and/or flexible wages could help alleviate the effects of asymmetric shocks. Yet given Europe's low labour mobility, by default, wage policy would become the only short/medium term *labour market policy* for economic adjustment. Labour market reform was another option, but this had the potential to be costly in the short and medium term.

Wage-setting actors (unions and employers, with an emphasis on the former) were subjugated not only to EMU's institutional shifts but also to shifts in macroeconomic constraints. Three major policy shifts took place in 1999. The first involved a shift from national central banks to a pan-European central bank. The second involved the removal of the Maastricht (inflation) criteria, which prompted wage setters in all sectors to limit their wage increases during the 1990s. Both of these shifts prompted political scientists (see Section 1 below) to conjecture that unions in centralised/coordinated labour markets would push for higher wage increases and relax wage restraint once EMU began. (Wage restraint is defined as the difference between nominal wage growth and productivity growth – high values indicate wage excess whereas low values indicate wage restraint[1].) The third major policy shift, the introduction of a common pricing regime, was predicted to promote the continuation of wage restraint in centralised/coordinated bargaining systems, particularly for wage-setters with a substantial member base in the sectors exposed to international (EU) competition.

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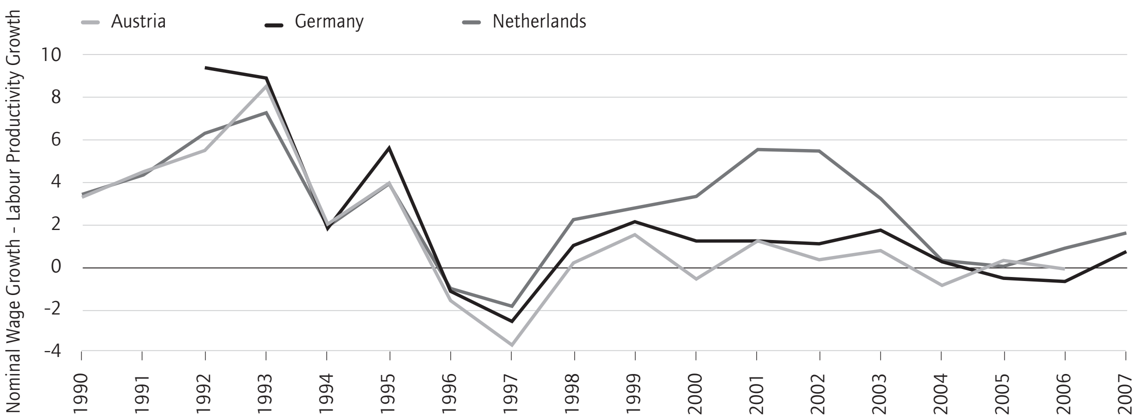
While these three shifts were predicted to have different effects on actors' incentives to exert wage restraint, it was expected that countries with similar economic conditions would exhibit similar wage moderation trends under EMU. Nowhere was this more strongly the case than for small, highly open countries, like Austria and the Netherlands. Both countries had many economic similarities entering EMU; both had high trade openness, long histories of monetary and price stability, similar output growth cycles, both were small (therefore having little prospect of influencing EMU aggregate inflation), operating near full employment, and had strong traditions of corporatism which emphasised wage moderation. Yet despite these similarities and similar incentives for wage setters in exposed sectors to free-ride off of German wage developments, a paradoxical outcome resulted under EMU. Nominal wage restraint trends between Austria and the Netherlands significantly diverged after 1999. Austria, like Germany, continued to exert consistent wage restraint after 1999. The Netherlands, on the other hand, experienced the highest levels of wage excess – aside from Ireland – in EMU until 2004 (see Figure 1).

Figure 1 **Nominal wage restraint (differential in nominal wage growth and labour productivity growth): AT, DE and NL**



Source: Data from AMECO and OECD Databases

1. As this paper seeks to contextualise altered behaviour within Austrian and Dutch wage developments, it requires a measure which gauges wage restraint. Blanchard's (Blanchard and Wolfers 2000; 2006) efficiency wage measurement defines wage restraint as the degree to which real wage growth exceeds, or does not exceed, productivity growth for a given year [Δ(Ln)nominal wages - Δ(Ln)price index - Δ(Ln)labour productivity]. If the difference is equal to or below zero, then wage restraint is achieved. If the difference is positive, then wage excess exists. I use nominal wage restraint instead of real wage restraint, in order to distinguish whether the measurement is driven by productivity versus inflation. Data for nominal wages came from AMECO database (nominal compensation per employee) and the OECD (labour productivity per employee).

This paper addresses two questions. The first is why have nominal wage developments significantly diverged for Austria and the Netherlands, two countries that were predicted to respond to EMU in similar manners? The second question addressed is how did wage setting frameworks affect actors in both countries ability to free-ride around German wage developments? This paper will argue that both countries' wage coordination systems, and how they were indirectly enforced onto unions by employers, shaped national wage restraint's progression over the course of the business cycle. In Austria, pattern bargaining coordination tied wage growth in all sectors to those in the (exposed) manufacturing sector, the sector which had the most to lose employment-wise from high wage growth. As a result, wage restraint was maintained throughout the entire course of the business cycle because a competitiveness check existed at the first stage of each wage bargaining round. Strong employers indirectly enforced this coordination mechanism on shadowing unions. While these unions were allowed to follow manufacturing's trend, employers limited wage growth to sectoral productivity developments. Manufacturing wage growth served as a target, which shadowing unions followed, but due to strong employers, never reached: hence, in Austria, wage trends for more sheltered sectors were consistently below wage trends in the manufacturing sector under EMU. In the Netherlands, no such exposed-sector union check on sheltered sector unions existed. Wage growth in the sheltered sectors increased substantially when favourable economic conditions arose, namely a drop in unemployment and increases in labour demand, because employers could not tie wage demands in these sectors to more competitive sectors. The Netherlands' state-sponsored coordination system failed to keep wage growth in check in good economic times. Only in 2003, during an economic slump were employers able to use a reactive social pact to enforce wage moderation on all sectors. Consequently, wage restraint was a cyclical phenomenon rather than a consistent one like in Austria. *Though their wage restraint performances diverged after 1999, wage developments in Austria and the Netherlands reflected a continuation of the status-quo in their respective coordinated bargaining frameworks. Austria continued to pursue a path of, what I call, preventative corporatism with its wage policy and the Netherlands continued to pursue a path of, what I call, reactive corporatism.*

This paper proceeds as follows. Section 1 presents a literature review of the EMU's predicted influence on wage-setting. Section 2 provides data which tests the literature and establishes the puzzle of diverging wage performance between Austria and the Netherlands under EMU. Section 3 and 4 will discuss the experience of Austria and the Netherlands and outline which sectors contributed most to the divergence in aggregate wage restraint. Section 5 will then discuss how wage bargaining structure, specifically its reaction to EMU, and not EMU by itself, is the key variable which explains the divergence. Section 6 concludes.

1. Wage moderation, small open economies and EMU

Because EMU introduced three significant shifts in macroeconomic governance, it is helpful to analyse each shift with respect to the monetary regime of the Maastricht period (1992-1998). One shift, the move from national central banks to the European Central Bank (ECB), was predicted by political scientists to produce an increase in wage inflation. Under the European Monetary System' Exchange Rate Mechanism (ERM), the Bundesbank was the anchor currency, and therefore, Germany's inflation rate was the *de facto* target for all EMU candidate countries. The German inflation rate later became an explicit target when the Maastricht inflation criteria were established in 1992. In order to ensure that their currencies would stay within the ERM's bands and inflation would stay in line with Germany's, national central banks had to (strictly) impose the Bundesbank's monetary policy on national wage setters. The theory established by the political science literature (see Gnan 1994; Hall 1994; Hochreiter 1995; Hall and Franzese 1998; Iversen 1998; Soskice and Iversen 1998; Iversen 1999; Cukierman and Lippi 2001; Hancke and Soskice 2003; Hochreiter 2004) was that under the Maastricht period, national central banks would act as monitoring agents for inflation by signalling to wage setters their commitment to fulfilling the exchange rate peg. If wage setters pursued an inflationary wage policy which threatened this peg, the central bank would respond with a contractionary monetary policy to ensure the peg was maintained.

However, with the introduction of the European Central Bank (ECB) in 1999, this signalling game disappeared. The exchange rate peg no longer needed to be fulfilled and the enforcer of this peg was transferred to the supranational level. National unions, especially in small countries, were now in a position where their wages would no longer significantly influence monetary policy, and where the central bank would no longer punish excessive wage settlements. Wage bargainers' size with respect to the central bank significantly diminished, and the direct restraining effect of the ECB's monetary policy on national wage decisions was severely limited. Because individual union wage settlements would not influence the EMU-aggregate inflation rate, unions no longer had the incentive to restrain wages on the condition of a retaliatory central bank, and it was predicted that wage restraint would be abandoned. While this literature (with the exception of Cukierman and Lippi, 2001) did not specifically focus on country size, it was implicitly assumed that EMU's impact on wage lapse would be greater for smaller countries, as their wage setters especially had little prospect of influencing the EMU's inflation rate.

A second literature, examining the impact of the Maastricht criteria on wage setters, made similar predictions as the literature discussed above. Prior to 1999, unions in EMU candidate countries had the incentive to keep wage increases low in order to fulfil the Maastricht inflation and exchange rate criteria. This incentive was either chosen (if unions favoured EMU membership) or forced (through the central bank's commitment to a peg). Wage restraint was a promising way of achieving Maastricht's macroeconomic requirements within a short period of time. Once member-states joined EMU, however, the Maastricht inflation criteria was no longer binding, and the chosen or forced incentive to keep inflation low for EMU candidacy disappeared.

Countries still had motivations to keep inflation low, even though the terms of Maastricht no longer existed. However, the elimination of the Maastricht criteria caused speculation about the future of social pacts, especially since their resurgence in the 1990s revolved around wage moderation to achieve low inflation. It was argued by social pact scholars that once EMU entry was guaranteed, these pacts would no longer serve a purpose, and in their different forms, would disappear or become embedded in national wage setting frameworks (Fajertag and Pochet, 2000; Hancké and Rhodes, 2005). There are several problems with this logic, however. Indeed, many EMU member-states introduced social pacts for the sole purpose of fulfilling the Maastricht criteria (Italy, Portugal and Spain most specifically) (Hancké and Rhodes, 2005; Hassel and Ebbinghaus, 2000). However, social pacts have broader agendas than fulfilling club entry requirements, especially for countries with a history of utilising them during economic crisis. Several EMU countries, particularly the Netherlands, have long traditions in addressing employment and competitiveness problems with social pacts (Regini, 2000; Hemerijck and Visser, 2000). Though the Maastricht inflation criterion was eliminated, some EMU member-states, continued to utilise social pacts to maintain wage restraint after 1999.

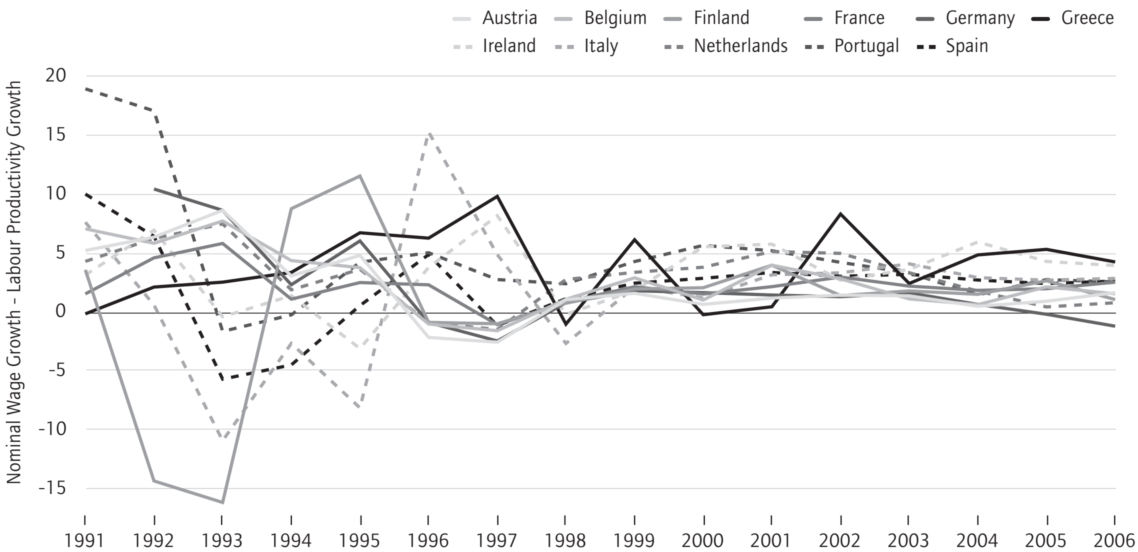
Unlike the political economy and social pact literatures, economic literature examining the shift to a common currency regime predicted that EMU would promote the continuance of wage restraint. The Euro introduced a transparent pricing system, which would reinforce the competitiveness constraint on wage setting actors. Admittedly, product market integration was already high in the E(M)U before 1999. However, a transparent pricing system further underlined the need for competitiveness. The reinforcement of this competitiveness constraint provided a high incentive for the continued exertion of wage restraint, particularly for small states and unions in exposed sectors. Increased competition from abroad restricts the possibility to increase output prices in response to domestic wage increases. Firms in industries with high exposure to foreign competition will not have the same manoeuvrability to raise product prices even if labour costs increase. Instead, firms will prefer to fire workers rather than allow prices to rise and risk a loss in market share. As a result, unions with high membership in tradable goods sectors will have the incentive to pursue wage moderation, in order to guarantee higher employment as well as to prompt higher export growth. This incentive will be greater for small states, as the tradable goods sector carries greater weight in national output. Competitiveness constraints would therefore restrain the ability of wage setters to demand higher wages, not necessarily in the context of EMU, but in the context of a highly integrated product market which EMU was intended to reinforce (Danthine and Hunt 1994, Calmfors et al. 2001, Driffill et al. 1998).

Summing up, the above political science, social pact and economic literatures made conflicting predictions on how EMU would impact wage restraint: the first two predicted an increase in wage excess for all countries across the board, while the later predicted the continuation in wage restraint for all countries. Yet both would prove to be wrong for the experience of Austria and the Netherlands under EMU.

2. National wage developments after 1999

After 1999, wage restraint did not wane as the political economy and social pact literature predicted (see Figure 2). Neither the removal of national central banks and exchange rate pegs nor of Maastricht's nominal criteria placed upward pressure on wages, with respect to labour productivity, in EMU countries. However, much of the ERM experience of D-Mark bloc "late-starters" (Finland, Italy, Spain and Portugal and to some extent Ireland) dominates this picture. Their volatile histories in the run-up to Maastricht make EMU appear much more stable than the previous macroeconomic regime. Consequently, in assessing EMU's impact, it is helpful to distinguish between two groups of countries. For one group, stable monetary ties with Germany were established early (in the late 1970s and early 1980s) and were rigorously enforced by national central banks (Austria, Belgium, France, Germany, and the Netherlands, hereafter called the "core Deutschmark bloc"). For a second group, monetary ties were either established later with Germany (in the late 1980s or the very early 1990s) and/or central banks began their credible enforcement of these hard monetary rules closer to the signing of the Maastricht Treaty (Finland, Ireland, Italy, Spain and Portugal, hereafter called the "peripheral economies").

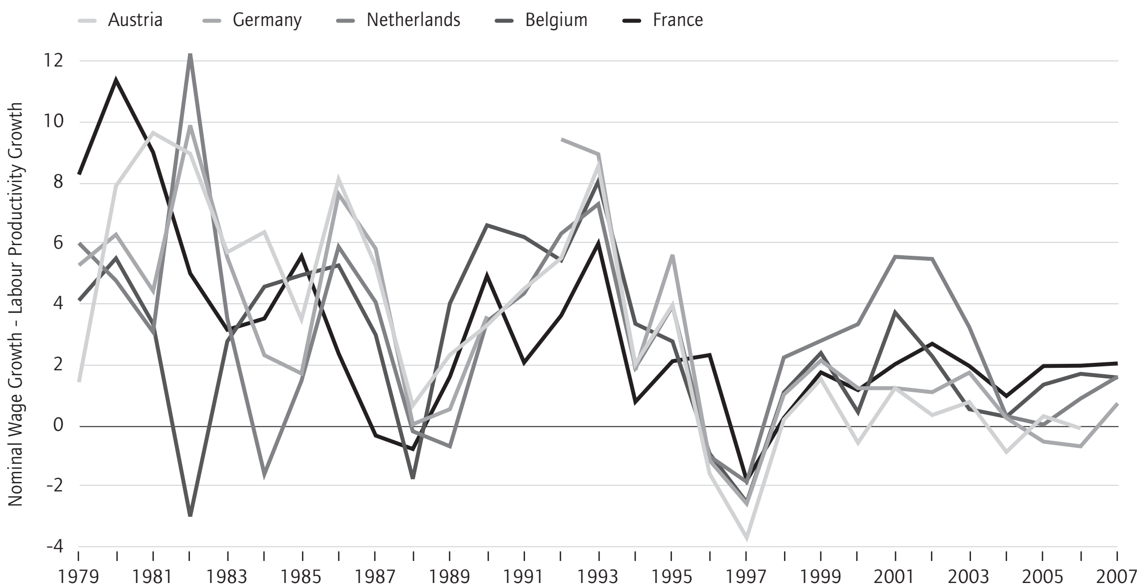
Figure 2 **Nominal wage restraint for EMU9: 1991-2006**



Source: Data from AMECO and OECD Databases

Comparing the periphery with the core is unhelpful in determining the effect of EMU on wages and wage restraint, as the Maastricht years (1992-1998) were pivotal in assisting the periphery with reigning in wage restraint by substantially increasing the credibility of their central banks (see Posen and Gould, 2006). For the core group, central bank credibility was already high at the beginning of the 1990s. In examining the core-group only against each other, for the pre-EMU and EMU regimes, we can obtain a more controlled assessment of how EMU has affected wage bargaining systems. Because this paper focuses on Austria and the Netherlands, it will present the puzzle of wage restraint divergence under EMU with reference to the core Deutschmark bloc countries only (see Figure 3).

Figure 3 **Nominal wage restraint for the Core-Deutschmark Bloc: 1979-2006**



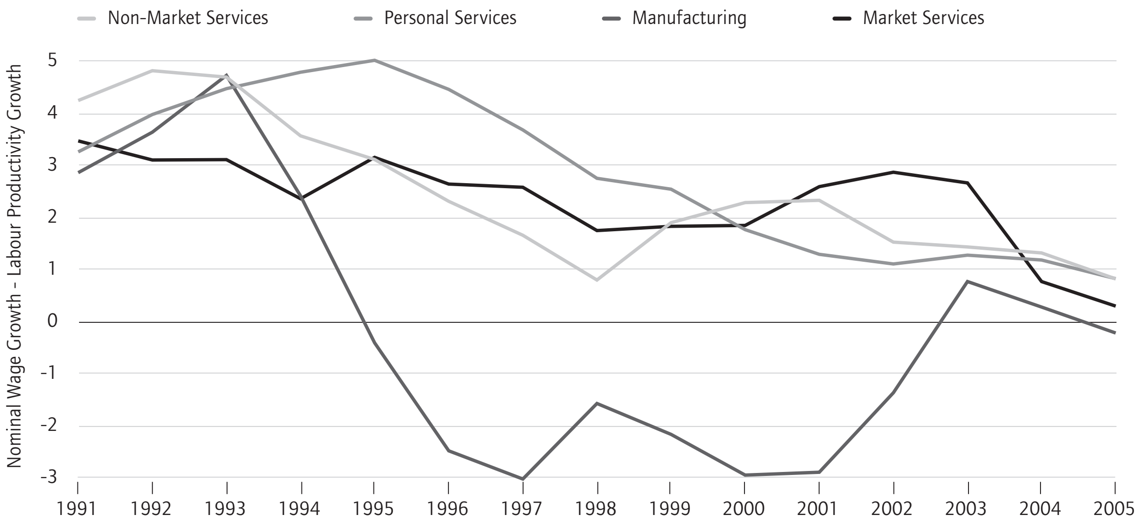
Source: Data from AMECO and OECD Databases

Figure 3 demonstrates that after 1999, what was once a highly synchronous wage restraint regime in the 1990s, began to unravel under EMU, leading to sharp divergence in wage restraint in the DM block. Divergence between Austria, German and Dutch wage restraint reached levels that had not been seen even in the 1980s. Strict harmonisation was an expected outcome of the Maastricht regime. After 1999, with the disappearance of national exchange rate pegs to the D-Mark, wage setters were free, for the first time, to act independently of a national monetary agent. However, countries with similar economic characteristics, according to the literature above, should have behaved similarly with the introduction of the new monetary regime. Wage actors in small, open economies who free-ride off of Germany's trading position should have every incentive to maintain wage restraint under EMU, especially if Germany itself is exerting high levels of wage restraint. Yet Austria and the

Netherlands – two countries of similar economic size, with high export shares and similar growth trends in the 1990s and 2000s, strong corporatist traditions and long histories of monetary credibility, similar union density rates (between 20% and 30%), and similar public sector employment levels – witnessed very different wage developments after the introduction of the Euro. Austria continued to exercise wage restraint, whereas the Netherlands witnessed a period of abnormal wage excess, not seen since the 1980s.

In order to understand the different wage restraint trajectories of both countries after 1999, it is necessary to dissect aggregate performance into sectoral wage restraint performance. Figures 4 and 5 present sectoral wage restraint, three year moving averages[2], for both countries. Figure 6 shows the difference between Dutch and Austrian wage restraint (nominal wage growth which exceeds labour productivity growth); values greater than zero indicate less wage restraint in the Netherlands than in Austria. The sectors examined are manufacturing (ISIC tabulation category D), non-market services (a weighted composite of public administration and defence, education, and health and social work - ISIC tabulation categories L, M and N respectively), personal services (ISIC tabulation category O), and market services (a composite of transport services, post and telecom, financial intermediation, and business activities - ISIC tabulation categories 60-63, 64, J and K respectively).[3] Combined, these four sectors represent 75% of both countries' total employment shares.

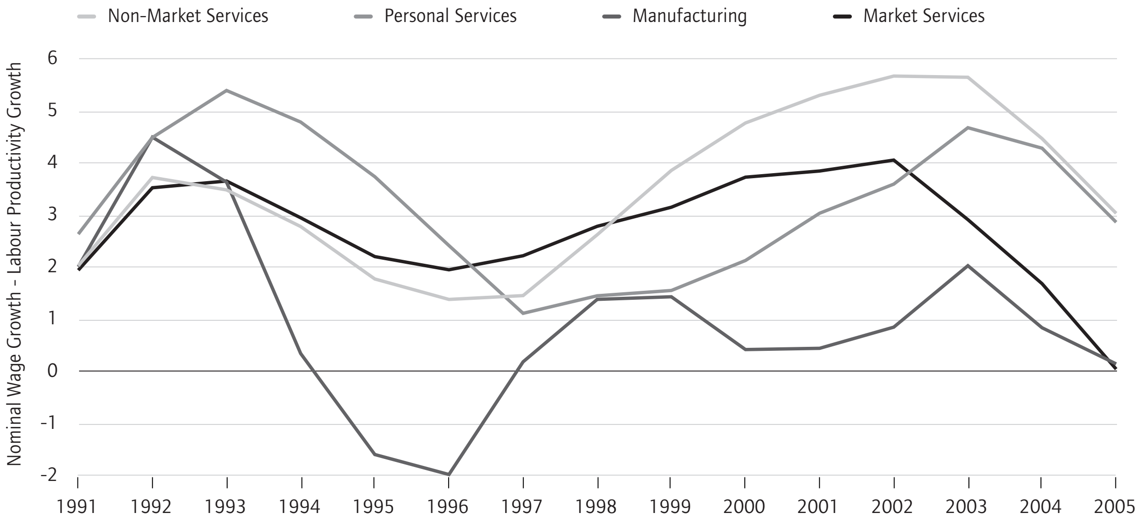
Figure 4 **Sectoral nominal wage restraint for Austria, 3 year moving averages, 1991-2005**



Source: Data from EU KLEMS Database

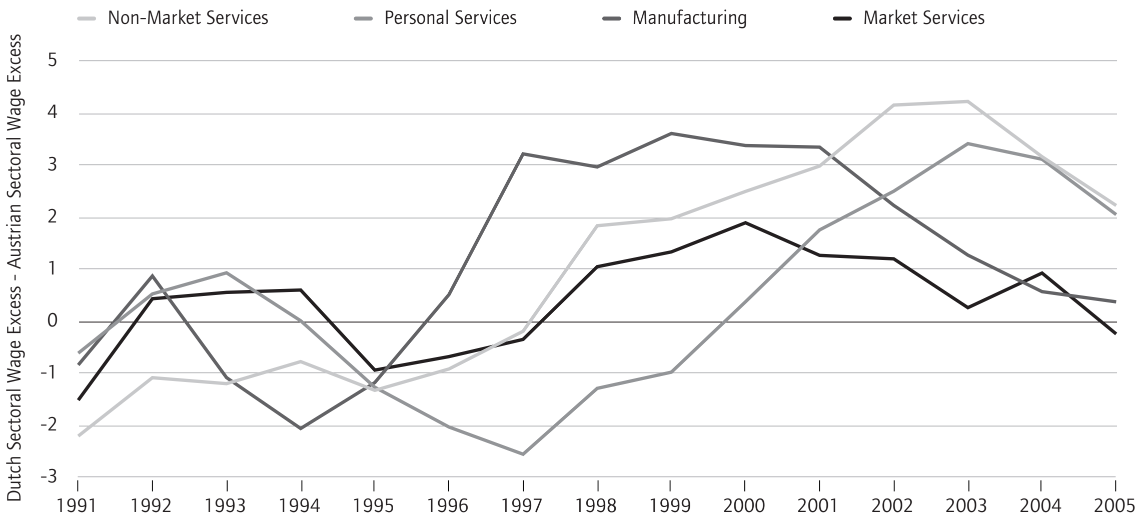
2. Three year moving averages, rather than year-on-year changes, were used as bargaining rounds in Austria and the Netherlands overlap years.
3. Sectoral wage and productivity data came from the EU KLEMS database (accessed October, 2008). The nominal wage was calculated by dividing compensation of employees (COMP) by total hours worked by employees (H_EMPE). Labour productivity growth was calculated from changes in gross value added (LP_I).

Figure 5 **Sectoral nominal wage restraint for the Netherlands, 3 year moving averages, 1991-2005**



Source: Data from EU KLEMS Database

Figure 6 **Difference in wage excess in the Netherlands and Austria, 1991-2005 (3 year moving averages)**



Source: Data from EU KLEMS Database

Figure 6 demonstrates the high degree of wage excess in the Netherlands' manufacturing, non-market and personal services sectors, compared to Austria, in the 1-2 years preceding and after 1999. The Netherlands' market services sector did experience greater wage excess than Austria's, but it was much smaller than the other three sectors. Graphics in Appendix I confirm that, with the exception of the manufacturing sector, both countries did not have substantial differences in sectoral labour productivity performances. The differences lay in wage growth levels. For the manufacturing sector, Austria wage growth was far below productivity growth, while in the Netherlands wage growth remained slightly above productivity increases. For the non-market services sector, wage growth was highly excessive in the Netherlands, exceeding productivity growth by 5% in some years. Understanding why wage restraint/excess differentials were so high in the mid- to late-1990s and 2000s between both countries manufacturing and non-market services sectors can help answer the puzzle as to why there was such high national wage restraint divergence after 1999. What measures were in place in Austria that were successful in containing wage growth at the sectoral level, that were not present in the Netherlands?

The case of Austria and the Netherlands provides a convenient microcosm in the study of EMU's effects on wage-setting behaviour. Both witnessed similar economic conditions upon entering the EMU. Even more perplexing, the Netherlands total trade, as a percentage of GDP, is 1.5 times that of Austria's, suggesting that Dutch wage bargainers possessed *more* of an incentive to maintain wage restraint. Eventually the Dutch did harness wage excess, through overlapping national social pacts, introduced in 2003 and 2004, which were responses to heavy losses in international competitiveness. Austria and the Netherlands demonstrate that, while competitiveness and labour market conditions have substantial weight in wage-setting, they are incomplete in explaining the progression of wages: they are necessary conditions for understanding wage moderation for these two countries, but not *sufficient* ones.

3. Wage bargaining systems and wage responsiveness

Much of the political science and economic literature discussing wage restraint under EMU lacks a crucial institutional component. EMU member-states have different collective bargaining frameworks in which wages are set. Under the ERM period, different wage actors within these frameworks were more-or-less forced to follow the same wage policy, due to pressures from national, non-accommodating central banks. Under EMU, however, this hard monetary constraint was lifted and wage actors within national bargaining frameworks were able to pursue different sectoral wage policies. The dynamic between wage setting actors in sheltered sectors and wage setting actors in exposed sectors was altered, and wage-setting institutions inherited an even more important role under the absence of a national monetary authority. These institutions, and the actors within them, react differently to losses in price (wage) competitiveness. Industrial organisation scholars have acknowledged that institutional structure plays a key role in wage responsiveness to market pressures. Traxler (2002) notes that institutional setting significantly predetermines wage actors' behaviour, in that only a limited number of options is available in response to a shock, under a certain institutional context. Moreover, bargainers significantly differ in their capacity for wage moderation given macroeconomic constraints. Hassel (2006) claims that wage formation processes are equally influenced by market developments and institutional factors, and when collective bargaining is conducted by wage bargaining institutions, the design of these institutions, specifically their coordination mechanisms, has a strong impact on the progression of wages. Therefore, in order to understand why wage policy pursued such different paths after 1999, countries' wage-bargaining institutional structure must be brought into the fold.

A wealth of literature has quantified or qualitatively codified wage bargaining structures in developed economies. Calmfors and Driffill (1988) examined the performance of OECD countries based upon the centralisation of their wage bargaining systems, discovering that extremes (highly centralised or decentralised) perform best. The authors' measure of centralisation was based upon an ordinal rather than a cardinal system, making it possible to compare national wage-bargaining institutions. Soskice (1990), however, noted that it is not *centralisation* of wage systems which is the indicator of economic success, but rather *coordination* within these systems. Since these two influential papers, numerous academics have constructed quantitative indicators of corporatism, attempting to measure both wage bargaining centralisation and coordination (see Kenworthy, 2003 for analysis on 42 time-variant and time invariant indictors). Most indicators analysed wage-setting institutions along general lines, examining centralised verses decentralised systems, and/or coordinated verses uncoordinated systems. Despite the abundance of literature that categorises wage bargaining systems, little of the corporatist literature attempted to predict or explain how different *frameworks* of macroeconomic wage coordination would perform or have performed under EMU. One of the more qualitative categorical systems of wage bargaining coordination, developed in Traxler et al's *National Labour Relations in Internationalised Markets* (2001), provides a pivotal insight into wage bargaining frameworks, and offers clues as to how responses to competitiveness are ingrained in each specific bargaining structure. Traxler identified six different structures of wage coordination: state-imposed coordination, state-sponsored coordination (which often involve some variant of social pacts), inter-associational coordination, intra-associational coordination, pattern bargaining coordination (where one sector, usually the metal industry, is the trend-setter for all other industries), and no coordination. Each structure's reaction to different phases of the business cycle provides the explanation for Austrian and Dutch wage restraint divergence under EMU.

The following section will briefly outline the similar economic conditions which Austria and the Netherlands were confronted with upon EMU entry and will discuss in greater detail their wage coordination systems. Using Mill's Method of Difference, Section IV will then discuss how including these different structures in the analysis of competitiveness' effects on wage policy best explains wage trends in Austria and the Netherlands after 1999.

4. Similar entry conditions yet different outcomes

Austria and the Netherlands entered the EMU with similar macroeconomic conditions and institutional objectives. Both states were small and highly exposed to trade; Austria entered the EMU with the fifth highest level of openness (total trade was 83.6% of Austria's GDP), and the Netherlands entered with the fourth highest level of openness (total trade amounting to 121.9% of GDP) (AMECO Database). Both countries also witnessed similar increases in trade since 1999. In addition to their high level of openness, Austria and the Netherlands traded substantially with Germany. In 1999, Austria and the Netherlands' total trade with Germany was 34% and 27% of their national GDP, respectively, higher than any other EU countries with the exception of Luxembourg (IMF DOTS and AMECO databases). Given Germany's high exertion of wage restraint since 1996, both countries had the incentive to pursue a policy of wage moderation in order to remain competitive against their largest trading partner.

Austria and the Netherlands also had similar monetary and exchange rate policy histories. Monetary links with the Deutschmark had been established in the 1970s. Hard currency stances no longer left room for doubt that the national central bank would uphold a policy of price stability. Throughout the 1970s and 1980s, the Netherlands adamantly followed Germany's price stability policies, and was considered one of the best performers in the EMS class (McNamara, 1998). Austria established its own (formal) exchange rate peg with Germany in 1981, despite remaining outside the European Community until 1995. After several appreciations of the schilling between 1979 and 1981, Austria abided by its hard-currency policy and maintained a stability-oriented monetary policy in order to check wage growth over the long term (Hochreiter 1995). Once the ECB came into operation, the enforcement of price stability and non-inflationary wage increases had been embedded in Austria's and the Netherlands' wage bargaining systems for over two decades.

In addition to their monetary histories, Austria and the Netherlands wage bargaining systems shared the objective of wage moderation, and their economic success in the late 1980s and 1990s has been partially attributed to this objective. The primary goal of the Österreichischer Gewerkschaftbund (ÖGB), Austria's monopoly Trade Union Federation, has been to preserve employment by promoting economic growth. Employment always has priority over wages (Traxler, 1998). Moreover, ÖGB's cooperation with employers and the state has resulted in a strong orientation towards quantitative, macroeconomic goals, while qualitative goals (workplace related issues) hold secondary importance (Traxler, 1998).

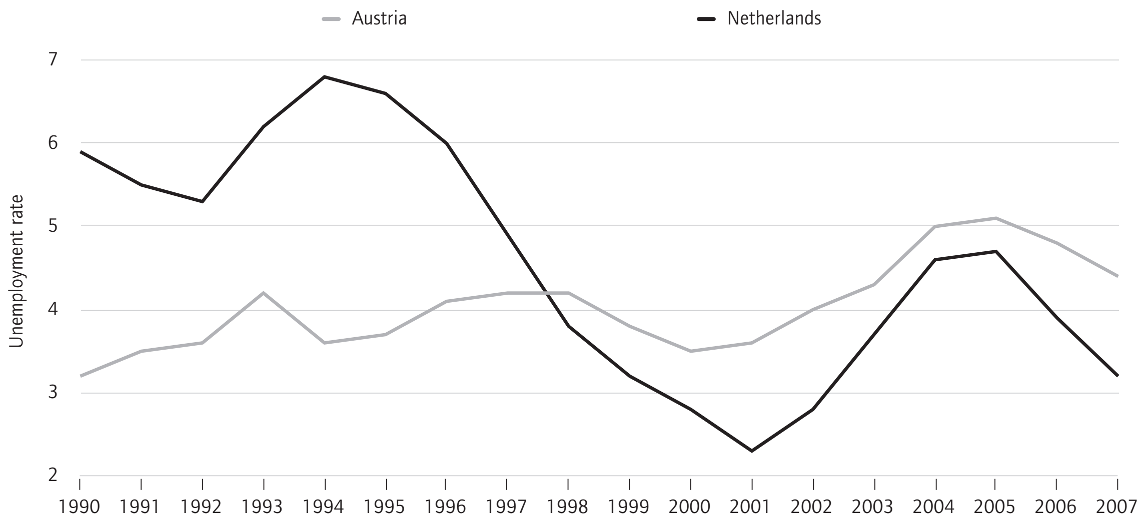
Wage moderation became a predominant policy in the Dutch wage bargaining system with the signing of the Wassenaar Accord in 1982. In the face of economic decline, Dutch unions and employers adopted a 'jobs before income' policy similar to that pursued in Austria. Since then, wage moderation has been the core target of all sequential social pacts in the Netherlands. The Netherlands' 'New Course' agreement in 1993 revolved around the exchange of wage moderation for working time reduction, while its 'Agenda 2002' signed in 1997, stressed the need for 'responsible wage-setting' in the face of decentralisation and the implementation of flexible/motivating pay policies (Hemerijck et al, 2000). Like Austria, the Netherlands has witnessed economic benefits due to wage moderation. After the Wassenaar Accord, average real wages fell by 9%, resulting in the restoration of profit levels and investment growth over the course of the 1980s. Such wage moderation has contributed to the surge in job creation over the 1980s and 1990s. Netherlands' Bureau for Economic Policy Analysis (CPB) estimated that over the 1980s, 265,000 jobs had been created by wage moderation alone. Like Austria, wage moderation has been a dominant policy in Dutch labour relations – it was adopted and endorsed by the Netherlands two largest unions, the Federation of Dutch Trade Unions (FNV) and the Christian National Union Federation (CNV) – and it has provided a pivotal contribution to Dutch economic success and the maintenance of Dutch competitiveness.

Despite sharing similar incentives to maintain wage restraint, Austria and the Netherlands pursued very different wage trends under the EMU. Wage-setters in both countries should have pursued similar wage behaviour with the introduction of the Euro and the ECB. That wage behaviour differed for both countries is not likely attributable to this identical institutional change alone. However, different wage restraint performance under EMU could be caused by different *reactions* to this similar change by different wage setting institutions.

Borghans and Kriechel (2007) attribute the relatively high wage growth in the Netherlands to shortages of highly-educated workers. In 1998, firms encountered problems recruiting highly-educated workers, as vacancy rates increased and employment decreased. By late-1999, the strong economic growth of the late 1990s reached a plateau for the Netherlands; however, unions, especially in the public sector, remained adamant in demanding high pay increases in order to 'taste the fruits of recent economic growth' (EIRO, 1999b; para. 7). Unions and employers had trapped themselves in a wage-price spiral and Dutch competitiveness steadily declined. Union officials were placed under intense pressure from their rank-and-file over wage demands, as employers offered salary increases of 14% per year to retain managers and executives. Though the FNV and CNV had encountered substantial pressure from the government to reduce wage demands, wage growth per year between 2000 and 2002 remained above 5%, despite negligible productivity growth.

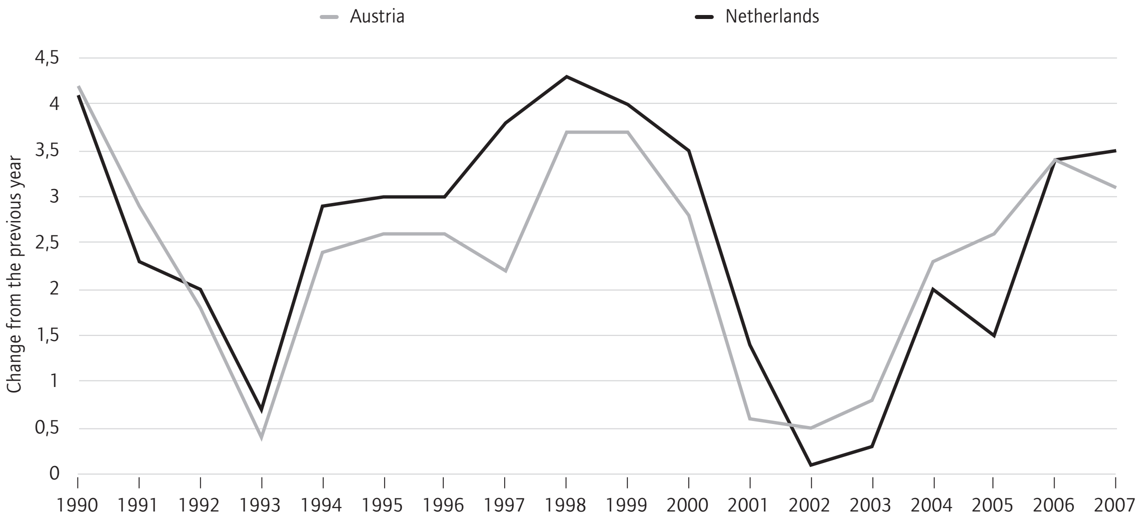
While the Netherlands' rapidly declining unemployment in the late 1990s presented Dutch labour unions with slightly different labour market conditions than Austrian unions, Austrian unemployment was also low and near Dutch unemployment levels. Moreover, both countries shared similar business cycles throughout the 1990s and 2000s (see Figures 7 and 8). Even amidst labour shortages, Dutch unions and employers were under equal, if not greater pressure from the government to maintain wage restraint after 1999. Government pressure and significant losses in competitiveness eventually forced Dutch social partners to sign two social agreements in late-2002, and 2003, mandating a pay freeze of 2.5% in 2003, and freezes in collectively-agreed wages during 2004 and 2005 (EIRO, 2005a). In the meantime, when Austrian social partners were presented with generous GDP growth and labour productivity forecasts - increases of over 3% in 2006 - collective agreements only pushed for a 3.1% wage increase for the following year. Being the highest pay increase negotiated since 2000, the bargaining round was quick (the agreement was reach within a few days), and social partners agreed to leave working time debates out of consideration (EIRO, 2005b; para. 2). During the period of high growth in the late 1990s and 2000, Austrian unions did not press for high wage increases to capture economic rents. Changes in the business cycle filtered throughout the Austrian and Dutch wage bargaining systems differently. While Austria maintained wage moderation in both the boom of the late 1990s *and* the bust of the early 2000s, the Netherlands lost control of it completely during and immediately after the boom and finally managed to regain it in the midst of the bust.

Figure 7 **Unemployment in Austria and the Netherlands, 1990-2007**



Source: OECD

Figure 8 **Real GDP growth in Austria and the Netherlands, 1990-2007**



Source: IMF World Economic Outlook

Under EMU, Austrian and Dutch social partners utilised different strategies to incorporate competitiveness into wage policy. Austrian unions and employers pursued a path of *preventative corporatism* and avoided wage excesses *before* they manifested themselves on Austrian competitiveness. The Netherlands, on the other hand, pursued a path of *responsive corporatism* and responded to wage excesses only *after* they had led to a major loss in competitiveness. Were these different wage progressions unexpected? Once different structures of wage coordination are taken into account these two different wage policies are understandable. Because Austrian wage coordination operated via pattern bargaining, competitiveness constraints were ingrained in the first stage of bargaining. If pattern bargaining revolves around a highly-exposed leading sector (in Austria's case the manufacturing sector), which has much to gain from wage restraint, wage moderation becomes the norm throughout the entire business cycle. If wage bargaining coordination is state-sponsored and reliant on overlapping social pacts, on the other hand, wage restraint will not be consistent, even if wage moderation is a primary objective of social partners. Social pacts are formulated in reaction to a perceived or real threat. If wage moderation is a core target of social pacts, as in the Netherlands, then intuitively, the creation of the social pact implies that wage moderation has been abandoned. With the implementation of the pact, wage restraint intensifies, and a more favourable economic condition is restored. Since wage bargaining in the Netherlands operates through state-sponsored coordination (with social pacts) wage moderation should follow a cyclical pattern; it will be least intense during booms and slightly thereafter, when union actors seek to capture rents from high economic growth, and it will be most intense during busts, when social pacts are created to enhance competitiveness and economic performance.

5. The influence of wage bargaining structure on wage restraint

Competition concerns and market constraints provide a first justification for why the elimination of national central banks and Maastricht criteria did not lead to rampant wage growth after 1999. Yet, the competitiveness argument does not offer a complete explanation of wage trends as it lacks an institutional component. While highly open countries have similar incentive to sustain wage moderation in order to maintain a competitive real exchange rate (RER), these countries are presented with different wage coordination mechanisms that permit different types of wage responsiveness.

5.1. Austria: a pattern bargaining approach

Austria's wage bargaining system is Europe's most centralised. The ÖGB holds a complete monopoly on union power, encompassing the country's entire union membership. All union members belong to ÖGB, individual unions are subdivisions of ÖGB, and no union exists outside the ÖGB umbrella (Traxler and Pernicka 2007). Negotiations proceed in annual intervals, with two wage rounds in the fall and spring. Bargaining is undertaken at the sectoral and enterprise level; individual unions bargain their own settlements, while the ÖGB formulate wage guidelines before major wage settlements. Thus, the ÖGB determines the timing and objectives of all wage negotiations. Due to the ÖGB's de facto monopoly on worker representation, the costs of inflationary wage settlements on unemployment are completely internalised. Since union competition is absent, there is no other party which the ÖGB can transfer the costs of excessive wage increases. Consequently, the ÖGB has a record of high unemployment sensitivity in nominal wage developments. In an empirical study of the responsiveness of nominal wages among the EU13 (Luxembourg and Greece excluded) between 1970 and 1999, Austrian nominal wages were most sensitive towards changes in unemployment levels (Hassel, 2006).

Since 1983, wage bargaining coordination in Austria has occurred via a pattern bargaining coordination method. The miners and metalworkers union, Gewerkschaft Metall-Bergbau-Energie (GMBE[4]), establishes its wage settlements first. After wage agreements are established in the manufacturing

4. In 2006, the GMBE merged with the textiles union to form GMT (Traxler and Pernicka, 2007). As this paper is focusing especially on the years 1999 to 2005/6, it will refer to the union as GMBE.

sector, all remaining sectors implicitly use GMBE's wage increase as a target. Given the strength of employers (represented by WKO, Austria's monopoly employers' federation), who have an organisation density near 100%, unions for more sheltered sectors are rarely able to meet this target, but rather have to settle for a lower wage increase based on their (lower) sectoral productivity trends. Pace-setting by GMBE follows a macroeconomic approach to wage setting; the union bases its wage demands on overall productivity increases rather than the metal industry's (higher) productivity growth. In 1983, GMBE proposed that macroeconomic growth and inflation should be the main criteria for wage policy, and that the exposed sector be recognised as the trend-setter for the sheltered sectors. To keep inter-union balance, GMBE was granted its leading role in relation to other unions only if it refrained from fully exploiting the metal industry's higher productivity increases (Traxler 1998).

Figures 9, 10 and 11 demonstrate the high correlation of (3 year moving average) wage growth in the manufacturing sector and various sheltered sectors, for Austria and the Netherlands. The most surprising correlations are those for market services and personal services, traditionally under-represented sectors, union-wise. Austria's high bargaining coverage, around 99%, ensures that wage growth in the least unionised sectors fall into the pattern bargaining fold. Comparing scatter plot diagrams of manufacturing sector wage growth and various sheltered sector wage growth in both countries, Austria's high R^2 values (in some cases more than 4 times as high as for the Dutch diagrams) indicate that wage growth in both the manufacturing and personal-services/non-market-services/market-services are almost perfectly, linearly correlated, unlike in the Netherlands.

Austria's pattern bargaining system is a wage bargaining structure that sustains consistent wage moderation. In assigning the role of trend-setter to the most exposed sector, Austrian wage bargaining actors entrench competitiveness checks into the first stage of wage negotiations. Wage growth targets are established by the sector most sensitive to competitiveness pressures and developments in international markets. Other unions, in turn, mimic these developments, indirectly including competitiveness concerns in their own wage settlements. While the public sector does not have formal bargaining rights, their wages are negotiated informally via ÖGB. Yet Austria's strongly united employers' association is an important mechanism which helps to facilitate sheltered sector unions' adoption of manufacturing wage increases as an upper bound. Wage increases in the non-market, personal and market services sectors have been consistently below wage increases in the manufacturing sector for the past ten years. Though sheltered sector unions would prefer higher wage increases, or at least wage increases nearer to those in manufacturing, employers have been able to keep wage increases in these sectors in-line with their own productivity increases. Therefore, Austria's consistent wage moderation policy is the result of two factors tied to its pattern bargaining framework. One factor, is the establishment of the exposed sector union, one which has the most to lose employment-wise from excessive wage settlements, as the trend-setter for wage increase. The second factor is a strong employer actor who ensures this coordination method is enforced among all

Figure 9 **Scatter plot of wage growth (3 year moving average) in the manufacturing and non-market services sectors**

Austria

Best Fit Line: y = 1.104x – 0.905; **R^2 = 0.7844**

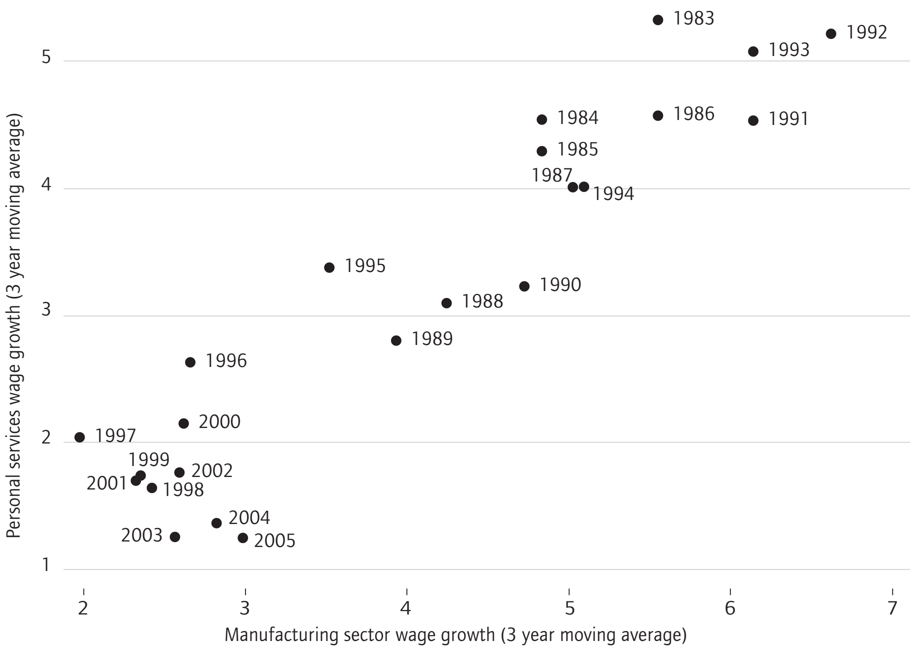
Netherlands

Best Fit Line: y = 0.982x – 1.302; **R^2 = 0.3551**

Source: All wage data come from the EU KLEMS database

Figure 10 **Scatter plot of wage growth (3 year moving average) in the manufacturing and personal services sectors**

Austria



Best Fit Line: y = 0.943x – 0.607; R^2 = **0.9105**

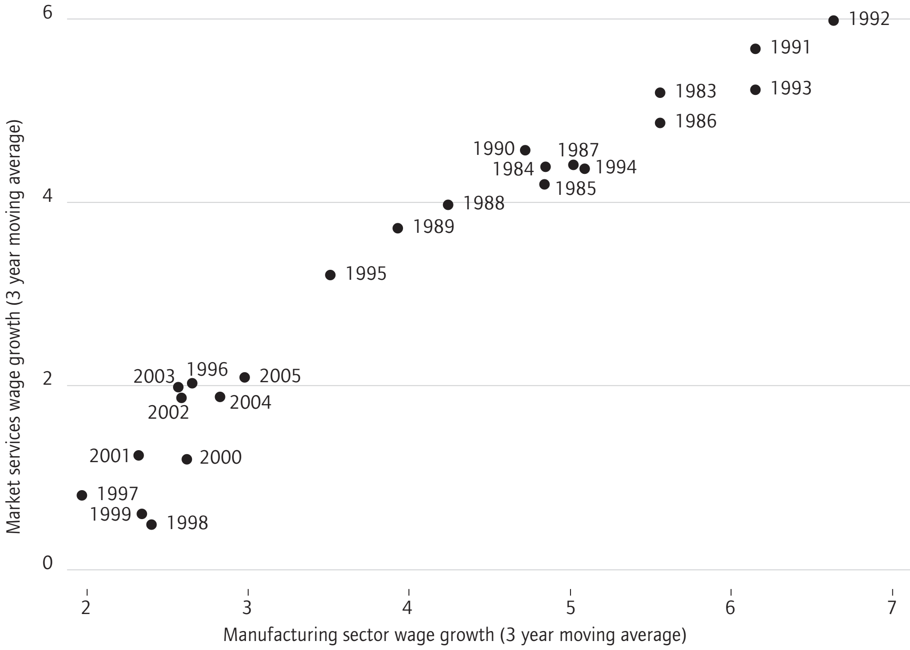
Netherlands

Best Fit Line: y = 1.028x – 1.988; R^2 = **0.2986**

Source: All wage data come from the EU KLEMS database

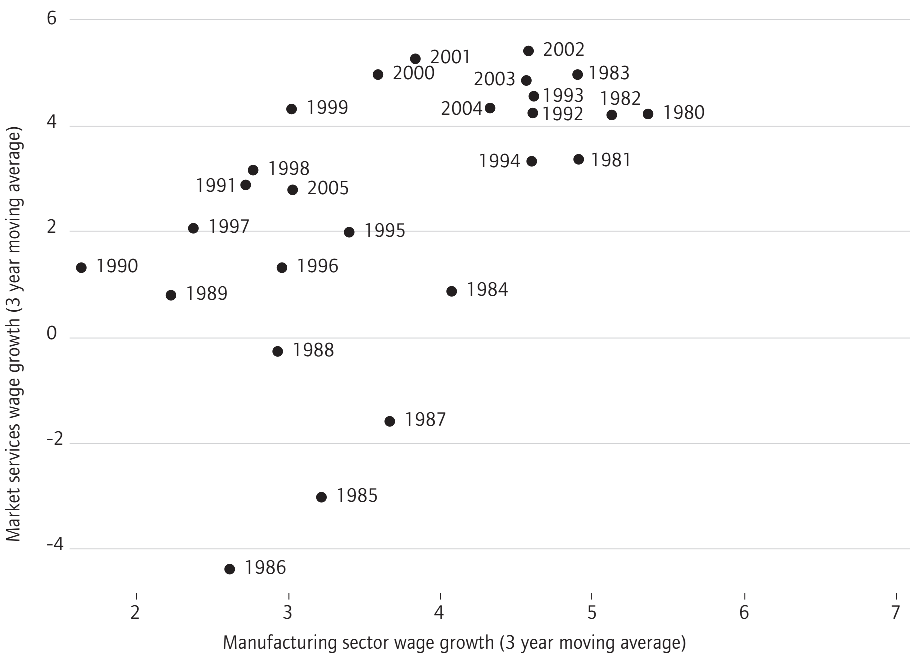
Figure 11 **Scatter plot of wage growth (3 year moving average) in the manufacturing and market services sectors**

Austria



Best Fit Line: y = 1.159x – 1.424; R^2 = **0.9642**

Netherlands



Best Fit Line: y = 1.372x – 2.527; R^2 = **0.2912**

Source: All wage data come from the EU KLEMS database

remaining unions. Strong employers and an exposed-leader, sheltered-follower dynamic not only provide the means to implement a consistent wage moderation policy throughout the entire Austrian economy, but also the method for aggregate wages to respond to, or outright avoid, losses in competitiveness most quickly.

5.2. The Netherlands: a social pact approach

Since the Wassenaar Accord in 1982, corporatism in the Netherlands has involved high state participation, yet the state does not claim a direct role in negotiations. Wage bargaining coordination, in this respect, is state-sponsored rather than state-imposed; unions and employers associations conduct all negotiations and agreements, while the state is an advisor, and during extreme circumstances, present threats of intervention.

Unlike Austria, the Netherlands has four major unions federations. The two largest, and most powerful, are the Federation of Dutch Trade Unions (FNV) and the Christian-National Union Federation (CNV), claiming over 1.4 million members (Visser, 1998). Dutch employers' associations are well organised, more so than unions, and their member firms employ between 60% and 70% of all private sector workers. However, their organisational strength, while higher than unions, is not as high as in Austria. Like in Austria, negotiations are undertaken at the sectoral level, but bargaining round objectives are established at the central level. At the beginning of each bargaining round, a group of central union experts (the Stichting van de Arbeid – STAR) establishes an appropriate level of wage growth for contract negotiations. Wages are then negotiated at the sectoral and firm levels. Benchmarks for wages are labour productivity and producer prices, yet there is secondary emphasis on inflation, unemployment and corporate profitability (Hancké, 2002).

Like Austria, the Netherlands has a high collective bargaining coverage rate despite relatively low trade union density. According to the 2004 OECD Employment Outlook, the Netherlands' trade union density rate was 23% in 2000, the 20th highest in the OECD; collective bargaining coverage, however, was over 80%, the 6th highest. Excess coverage results from collective bargaining legislation, notably the 1927 Law on Collective Agreements stipulating that an employer who signs a collective agreement must apply its conditions to all relevant employees, not only union members. In nearly all sectors and companies, there are two or more unions involved in a single bargaining table. Inter-union coordination is high and frequent because the 1927 law mandates that agreements signed by one union must be extended to members in others, (Visser, 1998).

The success of each bargaining round and how well the government and social partners work together depends as much on institutions as on the preferences, strategic goals, and power positions of each actor. Such preferences, goals and positions change over the course of the business cycle. Due to this constant flux of preferences, social pacts have become an integral feature of wage negotiations in the Netherlands. The incentives to enter social pacts generally differ between actors. The government prefers them if they are a substitute for lost policy instruments (i.e. monetary policy and fiscal policy constraints under EMU) and are useful tool to accomplish economic recovery. Though decentralisation should be their first preference as this will minimise union economic rent capture, employers acknowledge the benefits of social pacts in achieving wage moderation through quick cooperation rather than drawn out labour-market reforms. Union preferences to participate in social pacts result during periods of lost ground and credibility (Visser, 2002). Given these three actors' interests, the incentives to utilise social pacts are most harmonised in situations of economic decline. Unsurprisingly, since the early 1980s, social pacts surfaced in the Netherlands each time poor economic conditions arose.

Since the Wassenaar Accord, social partners in the Netherlands have utilised social pacts to restore wage restraint during periods of economic decline. Most recently, under the ERM and EMU periods, two major pacts – 'A New Course' in 1993 and the Employment Terms Policy in 2003 – were created during deteriorating economic climates in order to restore employment and competitiveness levels. 'A New Course' was drafted when the Dutch economy was in the midst of recession, and nominal wage growth exceeded productivity increases by 8%. Limited wage increases were the agreement's primary objective, and wage growth declined from over 8% in 1993, to 4% in 1995 to less than 0% in 1996 (ILO, 2007; para. 4-6). An economic boom followed the agreement, yet a deteriorating economic climate returned to the Netherlands in the early 2000s. Competitiveness was lost, as high inflation prompted a heavy appreciation of the real exchange rate (RER), and corporate profitability declined significantly. The substantial loss in competitiveness and profitability, via excessive wage growth during the 1998-2002 period, forced Dutch social partners to sign another social pact in 2003, the Employment Terms Policy, with a wage ceiling in 2003 of 2.5% and wage freezes for 2004 and 2005 (STAR, 2002; para. 8). As with the 1993 agreement, nominal wage growth declined quickly from over 5% in 2002, to 1.5% in 2005.

The contrast in the Netherlands' state-sponsored wage coordination with Austria's pattern bargaining system is an important one, as the role of employers as an enforcer of wage moderation becomes cyclical rather than consistent. Unions' and employers' motivations to exert wage moderation are most aligned during times of economic crisis. It is easier for employers to demand wage moderation from unions if unemployment is rising and international competitiveness is falling. Social pacts, therefore, are a logical outcome of such aligned preferences. However, during boom periods when corporate profitability is high, it becomes more difficult for employers to enforce wage moderation onto unions, particularly those in the sheltered sectors. Employers cannot use exposed sector unions as a check on sheltered sector wages if there is no union coordination mechanism in place which ties these two unions together. Social pacts provide a temporary means for employers to constrain wages in sheltered sectors, but these instruments make aggregate wage restraint a cyclical phenomenon rather than a consistent one.

5.3. Bargaining systems and Austrian and Dutch wage policy under EMU

The case of Austrian and Dutch wage policy provides a clear example of how the impact of competitiveness on wages is influenced by institutional constraints. Wages in both countries followed very different trajectories after 1999, yet by 2005, both countries had nominal wage growth levels on par with productivity increases. Competitiveness constraints, *only when combined with effective wage bargaining coordination mechanisms* provides a full explanation of why wage developments undertook these different trajectories. Ultimately, exercised wage restraint is dependent upon on the responsiveness of nominal wages to changes in competitiveness. To gauge the degree of such responsiveness, one must understand how wage moderation fits into different collective bargaining systems.

In Austria, a pattern bargaining system established the sector with the most sensitivity to RER appreciation as the trend-setter for the country's collective agreements. With GMBE's leading position, competitiveness concerns are ingrained in the first stage of wage negotiations, and permeate throughout wage developments in all other sectors. Because it is not in the GMBE's interest to establish wage demands that deter a competitive RER, a moderate wage increase in line with national productivity – and not the manufacturing sector's higher labour productivity – is set in each bargaining round. Unions in other sectors use this wage increase as a target, but rarely reach it in their own negotiations due to the strong bargaining position of employers. Rather, wage increases are set around sectoral productivity increases. Competitiveness is a constraint which is built into the Austrian bargaining system. Austrian wage-setting, by design, will pursue a *proactive* rather than a reactive approach to wage moderation since this constraint is firmly embedded at the first stage of negotiations, and enforced by employers through all subsequent stages. Therefore, Austria's wage policy performance in the EMU that of continued wage moderation, is expected given how the competitiveness objectives are embodied in its institutional framework.

Wage policy in the Netherlands under EMU was also an expected outcome, given its institutional framework. The Netherlands' wage bargaining system relies heavily on social pacts. Yet, despite the fact that wage moderation was a core target for social pacts in the Netherlands, these pacts in themselves are reactionary. Social pacts present a means of solving collective action problems which result from perceived external threats – not meeting the EMU criteria, for example – or from real external threats – a declining competitiveness, high unemployment, etc. For the Netherlands, social pacts arose after the real external threat manifested. These pacts, though reactive, corrected problems resulting from excessive wage growth, and helped Dutch social partners restore competitiveness via decreasing labour costs. Therefore, the ultimate objective, wage moderation, was achieved, yet due to social pact's *reactive* nature, it was cyclically rather than consistently maintained. During periods of high growth, wage moderation was abandoned by unions who sought to capture economic rents (higher wages) for their members. Yet, when high wages became inflationary and prompted a RER appreciation, wage moderation was restored to correct for losses in corporate profitability. This is precisely what happened with Dutch wage policy under the EMU. Wage growth ballooned because employers were unable to enforce wage moderation among unions; high growth and labour scarcity warranted higher wages. Yet after a sharp deterioration in the economic climate, employers and unions both agreed to sign the 2003 social pact which suppressed wage growth and reinstated wage restraint.

6. Conclusions

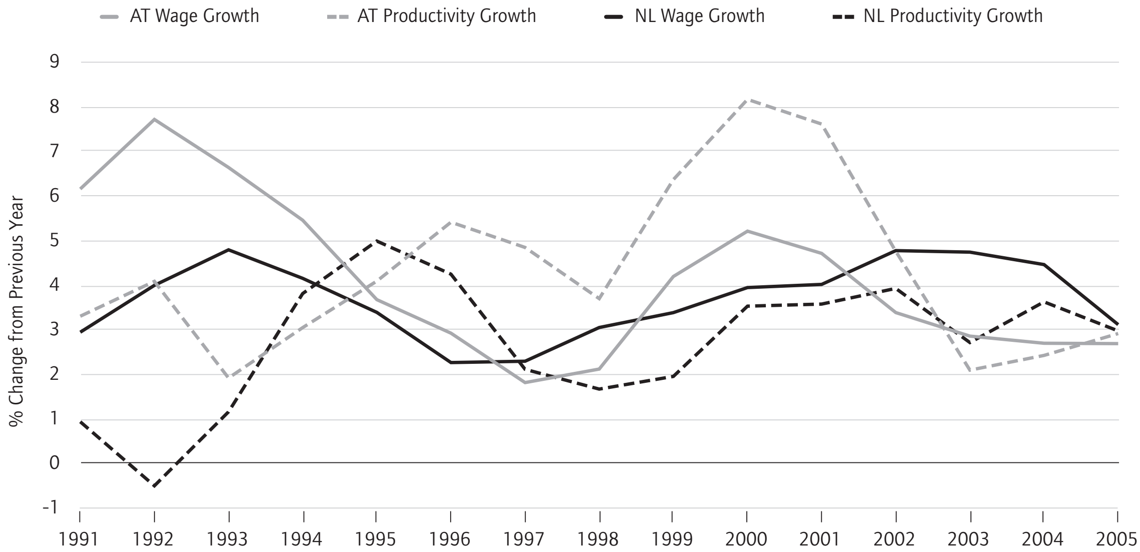
This paper has demonstrated that despite forecasts from political science and economic literature, the EMU and macroeconomic shifts resulting from it, have had little influence on wage-setting activity in Austria and the Netherlands. The EMU's new macroeconomic order has not changed these two countries' microeconomic wage institutions. The reason why these countries' wage policies reacted differently to EMU was due to differences in their wage systems, not due to EMU itself. Wage restraint undertook very different paths in both countries after EMU's inception. Yet the method in which their wage bargaining systems prevented/reacted to wage excess did not alter considerably, compared to their pre-1999 performance. Austria continued to exercise wage moderation under the EMU, not due to the EMU's possible enhancement of competitiveness, but due to its pattern bargaining system which established a preventative check on excessive wage growth in other sheltered sectors. Likewise, wage restraint in the Netherlands followed a more cyclical trend under EMU. Austria's and the Netherlands' labour market institutions were highly rooted and well accustomed to assisting both countries in adjusting to major macroeconomic shocks; EMU does not appear to have changed this.

The experience of Austria and the Netherlands offers an important insight into the possible future of wage relations in the EMU. Political economists have speculated about the future of collective bargaining institutions in the EMU. Hancké (2002) and Thelen (2000) claim that labour markets will not undergo a dramatic deregulation and coordination will likely persist, as wage bargaining institutions benefit employers. To deregulate them is an irrational strategy on the employers' behalf. Dufresene (2002) suggests that European-wide coordination, and possibly cross-border unions, will emerge as typified by the attempts of the Doorn Group. Martin (1998) and Calmfors (2001) project that national bargaining coordination in the EMU will represent a transitional phase (for the next 10 to 15 years), and will ultimately become deregulated long-run, as national coordination attempts become less effective.
Yet, the last literature predicting deregulation neglects an important feature of wage bargaining systems. Wage bargaining coordination institutions are not created equally; these institutions can be, and have been, an asset for enforcing wage moderation, particularly among small, highly exposed countries. More importantly, different systems can attain similar objectives in different manners. While there may be market pressure for the convergence of wage restraint under EMU, this does not imply that wage bargaining coordination systems themselves will converge to one model. In speculating the effects of

the EMU on wage bargaining systems, one must distinguish between convergence in wage restraint and convergence in wage *systems*. Wage restraint outcomes between the peripheral economies (Finland, Ireland, Italy, Portugal and Spain) and core Deutschmark bloc (Austria, Belgium, France, Germany and the Netherlands) have converged prior to EMU, yet most of these countries have not witnessed substantial change in the structure of wage coordination. These structures are deeply embedded in national labour markets, and though diverse, have helped (particularly small, open) states adapt to changes in the international economic environment. These wage bargaining institutions are likely to be sustained for years to come, especially in countries where they are crucial tools for economic adaptation.

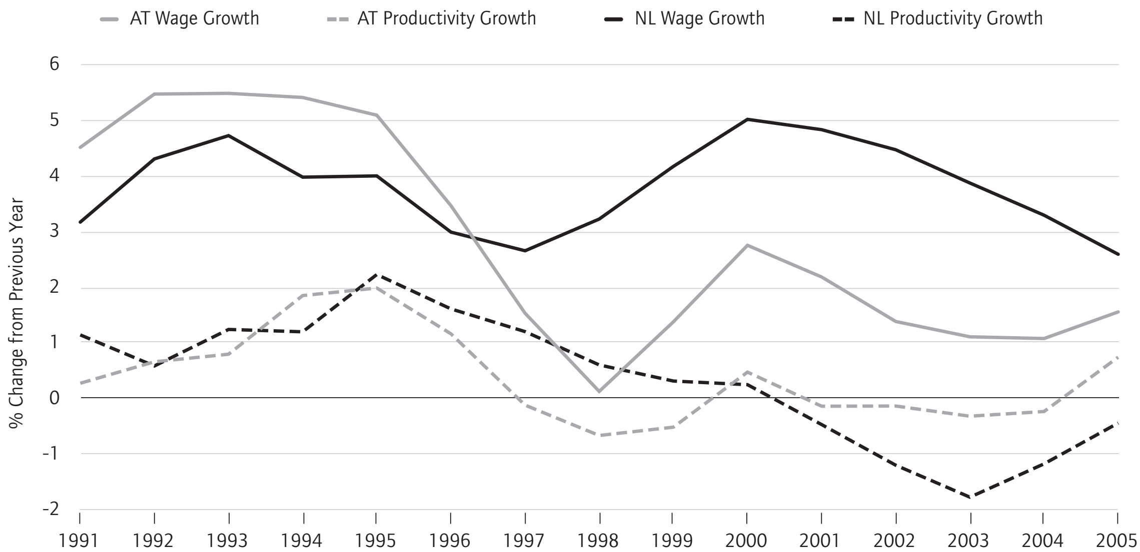
Appendix I
Sectoral wage growth and labour productivity trends

Figure A.1 **Nominal wage growth and labour productivity growth (3 year moving average), manufacturing**



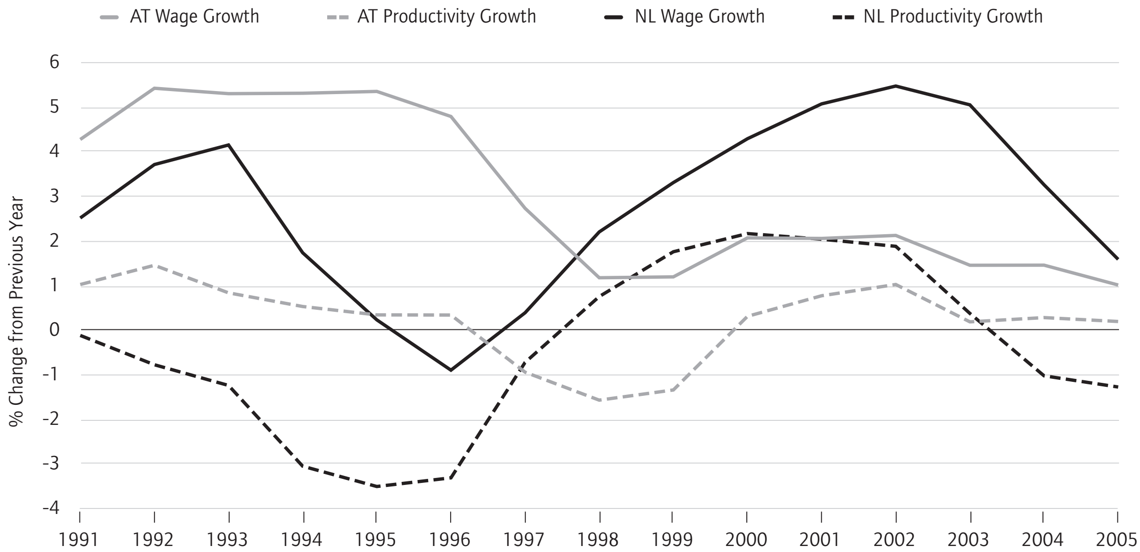
Source: Data from EU KLEMS Database

Figure A.2 **Nominal wage growth and labour productivity growth (3 year moving average), non-market services**



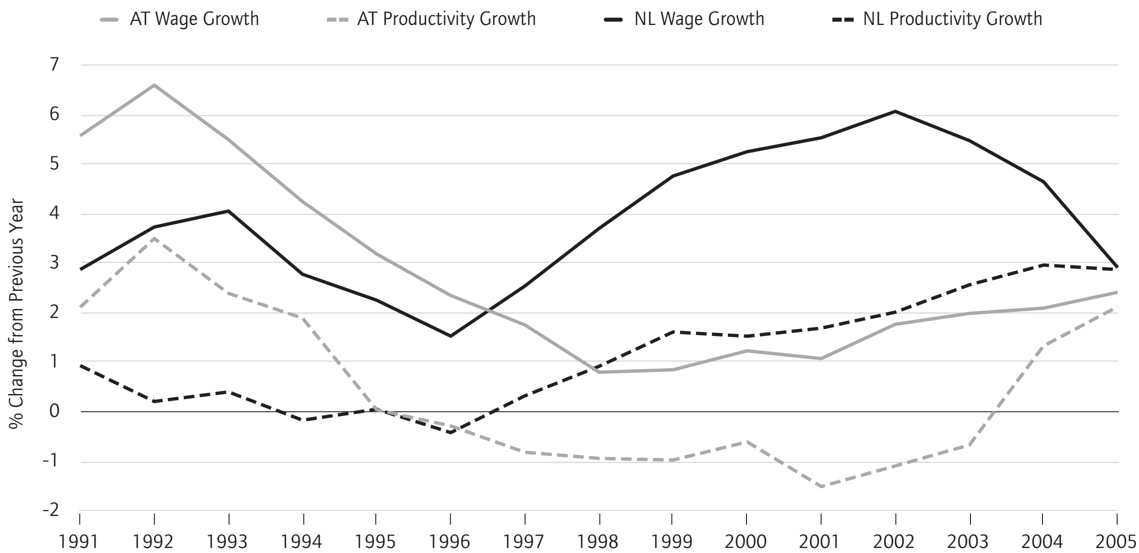
Source: Data from EU KLEMS Database

Figure A.3 **Nominal wage growth and labour productivity growth (3 year moving average), personal services**



Source: Data from EU KLEMS Database

Figure A.4 **Nominal wage growth and labour productivity growth (3 year moving average), market services**



Source: Data from EU KLEMS Database

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