TUAC trade union advisory committee to the
OECD organisation for economic cooperation and development
■ CSC commission syndicale consultative auprès de
OCDE l'organisation de coopération et de développement économiques

REASSESSMENT OF THE 1994 OECD JOBS STRATEGY

TUAC COMMENTS ON THE DRAFT POLICY CONCLUSIONS

**"Boosting Jobs and Incomes:
Policy Lessons from Re-Assessing the OECD Jobs Strategy"**

March 2006

I. Introduction

1. The EPC and ELSAC will be aware that TUAC has submitted two sets of written comments to supplement our oral comments in January on the OECD's main report "*OECD Jobs Strategy: Lessons from a decade's experience*" concerning the re-assessment of the 1994 *Jobs Strategy*. TUAC welcomed the serious effort to develop more robust empirical testing of the effects of JS recommendations on employment, whilst having several critical remarks particularly on implications of the tax wedge analysis, the work done on equity and the theoretical and practical basis of the political economy of reform. The present note gives an initial reaction from TUAC and our affiliates on the first draft on the policy lessons and recommendations: "*Boosting Jobs and Incomes: Policy Lessons from Re-Assessing the OECD Jobs Strategy*" – objectives that we clearly share. These are supplemented by additional comments from the European Trade Union Confederation which are annexed focussing on recommendation C3 on collective bargaining that TUAC feels are highly questionable. TUAC would also urge the OECD country representatives to consult trade unions at national level on the JS recommendations given the extremely important implications of this work and to reflect these views in their comments to the OECD.

2. TUAC would not disagree with the "four pillars" of the recommendations, namely:

- Appropriately set macroeconomic policies;
- The removal of alleged impediments to labour market participation and job search;
- Policies tackling labour- and product-market obstacles to labour demand and
- Policies facilitating the development of labour force skills and competencies.

However we would disagree with the overall balance between these items in the recommendations. The draft policy lessons convey four key messages:

- The trend increase in unemployment has been arrested or reversed in many OECD countries (Figure 1);
- Labour and product market reforms in line with the recommendations of the 1994 *Jobs Strategy* have been rewarded by an improved labour market and employment performance. According to the draft policy lessons, "reforming countries have in general done better in reducing unemployment" (§12, p.6);

- There is no single combination of policies and institutions to achieve and maintain good labour market performance.
- Reducing unemployment requires the removal of disincentives to work, less stringent protection of workers, increased flexibility of wages and working time arrangements and more obligations on the unemployed.

3. The recommendations place excessive emphasis upon the labour market alone to reduce unemployment. The approach concentrates upon increasing "incentives" to work by calling for less generous unemployment benefits and time-constrained benefit entitlements. Moreover, it is assumed that the number of employable workers in the economy determines the number of jobs available. Hence, it does not give sufficient attention to the central contributions of both aggregate demand and investment in productive capacity to achieving full employment and rising living standards. By giving more weight to the objective of promoting labour market participation and employment, the draft policy recommendations have been made more specific with regard to areas of policy action. Thus, their number has gone up from previously ten to now twenty major recommendations. Almost two thirds of them, namely 13 out of 20, are focusing on the alleged need to further reform labour market institutions as indicated in the Table below.

Recommendations to "reform" labour market institutions and to promote employment

I.) Proposed actions to reform labour market institutions

- Make work pay by reducing payroll taxes on labour and improved work-incentives:	B7, C2, C9
- Relaxation of EPL and regulations on fixed-term and temporary contracts:	C7, C8
- Provision of sub minimum wages for low productivity workers	C1
- Set unemployment benefit replacement rates to encourage job search	B1
- Enforcement of work availability, job search and compulsion	B1, B2, B4
- Implementation of opt-out clauses in order to limit the scope of sectoral collective bargaining coverage	C3
- Reducing administrative extension of collective bargaining agreements	C3
- Remove all alleged incentives for early labour market exit	B5
- Further flexibilisation of working-time arrangements	B6, C6

II.) Actions to improve the framework for labour-market participation and employment

- Enhance competition in product markets	C4, C5
- Improve labour force skills and facilitate school-to-work-transition	D1, D2
- Improve the performance of employment services	B3
- Appropriately set macroeconomic policies	A1, A2

II. TUAC's Main Comments

4. It is welcome that the draft policy lessons acknowledge that good labour market performance can be achieved and maintained by different policy packages. However, this is not appropriately reflected in the key policy recommendations. They remain tilted in favour of

what are called “liberal regimes”, characterized by low levels of welfare benefits and limited taxation to fund these benefits, little employment protection and a limited role for collective agreements.

There is no single combination of policies and institutions guaranteeing good labour market performance

5. This bias towards “liberal regimes” appears to be based on the argument that public policy is costly in budgetary terms. However, well-targeted and active public policies that steer the economy and the labour market can increase the employment rate and the economy’s productive performance, thereby generating important return effects for government revenue. For example, those countries that have chosen such a path can achieve sound public finances (e.g. the Nordic countries). Social policy is a force for productive change. High inequality, poverty and social exclusion do not only have social costs, they are also an unsound basis for the OECD countries to raise competitiveness and productivity in a more globally competitive world economy. By investing in social policies, countries can be in a better position to address global competition by way of innovation and productivity instead of competing on the basis of low wages.

Unemployment and deteriorating quality of jobs - remain challenges

6. Despite over a decade of acceleration of structural reforms this has not translated into more jobs. In some countries, job losses during the recession appear to be followed by a jobless recovery. In other countries, in particular the large member countries of the euro area, a real recovery from the slump in growth has simply not materialized. In a number of specific cases, lack of recovery of economic growth has gone hand in hand with a collapse in productivity and the creation of precarious jobs that offer no security and long term prospects for workers and their families. High unemployment across the OECD remains a challenge, as does the integration of young people into labour markets. Structural reforms are no simple ‘magic bullet’. For structural reforms to deliver more and better jobs, they need to be focused on those reforms that improve innovation and productivity and they need to be flanked by active and counter-cyclical aggregate demand policies. Recommendations A1 and A2 focusing on “stability” do not adequately reflect the activist role that macroeconomic policy must play.

A restatement for a *Jobs Strategy* must aim to reduce precariousness and insecurity

7. The ongoing deterioration of the quality of jobs as reflected by increases of in work poverty is noted in passing in the draft main report. However, a reassessed *Jobs Strategy* must aim to reduce precariousness and insecurity. A positive policy initiative is required, introducing labour market and workplace reforms to respond to employee needs and aspirations not weakening protections designed to give security and dignity to employees at the workplace. This agenda of positive reform should recognize that any policy to invest in modern social policies and to help workers face globalization need to unlock the productive potential that is present in many labour market institutions that protect workers from possible abuse by employers. For example, job protection and in particular prior notification of redundancy, should not be seen as rigidity but as a possibility to prepare retrenched workers to find a productive job elsewhere. The recommendations C7 and C8 do not therefore reflect this need nor do they appear based on the empirical findings from the main report.

8. There is an urgent need to reform conventional social security systems in order to enable them to respond appropriately to new forms of systemic risk and uncertainty that are brought about by economic changes within the emerging new global economy. Social security systems need to be strengthened and even broadened so that workers and citizens remain open to the phenomenon of globalization despite the volatility and increased insecurity global markets bring with them. This implies securing a broader financial basis for social security which in turn must lead to measures to fight international tax evasion by the production factors that are the most mobile. In view of the challenges of globalization, ageing and technological developments, social security systems also need to develop new initiatives such as a right to sabbatical social protection, in particular for older workers and lower skilled workers. These elements are missing from the policy recommendations.

Unemployment benefits – not the main causes of unemployment

9. Unemployment benefits provide the unemployed with the financial means to look for another job and a job that matches their skills. OECD research itself has shown that many problems arise from failure of the job-seeker to engage effectively with employment services, in other words they do not point to abuse by the unemployed of the system but to misunderstandings of administrative and bureaucratic processes. We question whether the emphasis on reducing benefit replacement rates as advocated will lead to substantial reductions in unemployment rates. (B1)

Lower tax wedges do not necessarily translate into higher employment

10. With regard to the priority given to reducing tax wedges, possible employment effects, if any, will depend on what element of the tax wedge is being reduced. Decreasing the non-wage contribution of employers may simply lead to wage slides and few new jobs will emerge. Decreasing the tax share of the wage-earner may require a long time until the cut translates into new employment. Cuts of the tax wedge or reductions in the payroll tax are difficult to target and to administer. Moreover, they are costly without boosting sufficiently income and demand. Instead of focusing on policies to reduce merely the tax wedge, TUAC would suggest to pursue a broader approach of policies, aiming to strengthen social security systems and to facilitate a socially sustainability modernization of the economy. (B7; C9) We would also point to inconsistency between the recommendations reducing tax wedges – the recommendation B7 on in-work benefits and the recommendation C1 on limiting minimum wages. A decent minimum wage floor that takes workers out of poverty is needed to stabilize the labour market. As commented on below, in-work benefits have a role of compensating for individual circumstances beyond that. It is significant that the empirical work of the main report recognized that well-set minimum wages are not a barrier to good employment performance;

Active labour market policy must be maintained, the "mutual obligations" approach must be rebalanced

11. In discussing *activation strategies* the draft focuses on the supply side of the labour market. The fact that jobs must be available in order to make *activation strategies* work by bringing unemployed workers and benefit recipients back into work, is not taken into account. The underlying "mutual obligations" approach appears to be one-sided. A reassessed *Jobs Strategy*, claiming to be a restatement for the future, needs to call for a better balance of rights and obligations. (B1)

12. A reassessed *Jobs Strategy* must go beyond calling for the conduct of regular assessments of active labour market policies. Besides the fact that active labour market policies will have little effect in periods of low growth and low job creation, assessments of active labour market policies also need to take the special position of disadvantaged groups into consideration. For these groups, training and job creation schemes are often successful and these policy measures should not be discarded on the basis of a too general analysis. So, instead of calling for a termination of inefficient programmes it must call for an ongoing redesign of labour market programmes. A future oriented *Jobs Strategy* must also call upon governments to ensure appropriate financing of active labour market policies. (B3)

Lifelong learning policies cannot be limited to the creation of a well-functioning training market

13. It is welcome that the draft policy lessons give particular attention to the need to strengthen lifelong learning and ensure worker training. TUAC welcomes in particular the call upon governments to facilitate the development of skills jointly with the social partners. However, the language used in this respect (recommendation D1) needs to be revised. Moreover, the recommendations need also to address more specifically major barriers preventing workers from undergoing training (lack of time, lack of access, the ongoing discrimination of women and older workers as well as the fact that continuing training tends to reinforce existing skill differences resulting from unequal access to and participation in education in all countries). (D1)

14. The policy lessons suggested in order to raise the level of enterprise-based training are limited in scope; they are primarily concerned with the creation of training markets. They should rather aim to strengthen the role of employers in the provision of training with full social partner involvement. (D2)

Macroeconomic strategy –a visible hand of demand management is needed

15. The macroeconomic strategy advocated by the restated *Jobs Strategy* remains along the same lines as advocated in 1994. However, macroeconomic policy, in particular institutional coordination and the structures of economic policy governance are of key importance for strategies successfully reducing unemployment and promoting employment. Case studies also highlight that maintaining strong aggregate demand can be particularly effective if financial and monetary policies are closely coordinated with collective bargaining, based on social dialogue and consensus building. (A1 und A2)

New working time arrangements must be based on joint agreements between workers' representatives and employers

16. Because quality of working life and work-life balance issues are of primary importance for workers and their families, trade unions are increasingly advocating for the introduction of new and innovative working time arrangements. However, in order to benefit both employees and employers, the implementation of flexible working time arrangements cannot be left simply to agreements between the individual employee and the employer as advocated by the policy recommendations. The implementation of new working time arrangements must be based upon joint negotiations and agreements between workers' representatives and employers. (C6)

Wage setting institutions: Sectoral wage bargaining no impediment to employment success

17. We are deeply concerned at the intrusive recommendation C3 aimed at undermining collective bargaining at sectoral level. This has no foundation in the empirical work of the Main Report that noted the value of coordinated bargaining systems. Institutional changes in national bargaining systems should be left primarily to their key actors, trade unions and employers. In many countries they have started already a process of institutional transformation without abandoning collective bargaining at the sectoral level. They have recognized that bargaining agreements at the sectoral level can provide a framework for conditions of work and pay, while the actual terms and conditions for both individual firms and workers, agreed upon on firm level, can vary in accordance with competitiveness and productivity of the firm. However, in order to prevent a cost-cutting race to the bottom and to protect workers, a wage floor provided by sectoral agreements is indispensable. (C3)

18. Sectoral wage bargaining is not an impediment to good labour market performance. The call to move away from sectoral wage bargaining and phase out extension mechanisms is based on a simplistic view of labour market functioning and is not supported by the evidence provided in the OECD's own main report. The outcome of sectoral wage bargaining and its determinants show that economic survival and competitiveness of firms is a key precondition for the security of jobs, regardless of the level of negotiations. Furthermore, globalization implies competitive pressures have intensified also at the sectoral level. The issue is not so much the level of negotiations but the extent to which bargaining is coordinated so that macro–economic objectives can be taken into account in wage formation, thereby avoiding costly conflicts with policy actors such as the central bank.

19. Sectoral wage bargaining is especially appropriate for economies where small companies prevail. Negotiation costs become 'centralised' and harmful 'demonstration' effects or situations in which firms are bidding up wages against each other are avoided by sectoral wage increases that provide the function of constituting a 'fair' wage increase. Sectoral wage bargaining systems imply also a "peace-keeping" function by transferring wage conflicts between management and the workforce to a level above the firm. There are good reasons for leaving institutional changes in national bargaining systems primarily to their key actors, trade unions and employers rather than dictating a particular direction of reform that is not supported by empirical evidence. This is treated further in the annexed note from the European Trade Union Confederation.

Minimum wages don't cause unemployment

20. Those working families relying on minimum wages are struggling to make ends meet. The reality is that many households depend on minimum-wage workers. In order to have a decent living, they need not only appropriately set minimum wages but also access to affordable goods and services.

21. With regard to the importance of wage floors, the draft policy lessons are overly critical on the role and importance of minimum wages. Thus, it is important to emphasize that in the analytical work of the reassessment no significant impact of the minimum wage on the aggregate unemployment rate was found. In line with that finding, the outgoing chairman of the *UK Low Pay Commission,* Adair Turner, reported that "since its introduction in 1999 the

minimum wage has been a major success. It has significantly improved the wages of many low earners; it has helped improve the earnings of many low-income families; and it has played a major role in narrowing the gender pay gap. But it has achieved this without significant adverse effects on business or employment creation." Similar evidence has also been reported with regard to other countries. (C1)

22. Concerns, causing the OECD to call for sub-minimum wages for youth, need to compare to the example of the labour market outcome of a recent youth minimum wage reform in New Zealand. The reform lowered the eligible age for the adult minimum wage from 20 to 18 years and resulted in a 69 percent increase in the minimum wage for the 18 and 19 year olds. Further steps of the reform increased also the minimum wage for 16 and 17 years-olds by 41 percent over a period of two years. A study, analyzing the effects of a large reform of the youth minimum wage did not find "robust evidence of any adverse effect of the minimum wage change on youth employment or hours worked." Thus, the claim for youth sub-minimum wages is disputable.

Enhanced product market competition: a challenge for active labour market policy

23. The policy recommendations assert that increased competition in product markets is likely to be good for employment. The underlying assumption is based on the interplay between increased productivity, lower prices, higher real wages and thus an increase in demand and output which will in turn increase aggregate employment. However evidence from sectoral studies suggests that subsequent to deregulation employment at sectoral level tends to decrease, which means in the short run almost always layoffs. Thus, policy makers and governments cannot ignore that enhanced competition in product markets requires far more intensive efforts to establish policies designed to manage change, in particular for active labour market policies. (C4; C6)

ANNEX

WHY AVOID EXCESSIVE FLEXIBILITY IN WAGE FORMATION

A view from the European Trade Union Confederation

In comparison with the 1994 OECD job recommendation on 'flexible wage formation', the formulation of the 2006 draft recommendation is quite unbalanced. The call for stronger opening clauses and for a reform of the system of administrative extension of collective agreements is to be seen as an attempt to undermine the system of sectoral bargaining, a system that is already under pressure in a number of EU-countries.

There are many reasons to be very careful with that kind of recommendations, certainly from a European (Monetary) Union perspective. Here is an overview.

<u>**Efficiency and innovation reasons**</u>

The 'law of one price' holds for labour markets as well. It is apparently fashionable to argue that wages should react to the conditions and problems of each individual firm in each different locality.

However, the basic rule of classical economics is that an efficient market is characterised by one price. If prices for comparable products differ from each other, then there is inefficiency and imperfect competition. The same is also true for labour markets. If workers with comparable skills are paid different wages in different firms, then efficiency gains can be realised. These gains can be realised, either by having workers move to those firms where wages and productivity are higher, either by forcing low productive firms to reorganise and increase productivity so a higher wage can be paid. 'Same pay for equal work' is not only a rightful social concern, it also plays a role in enhancing labour market efficiency. It can hardly be the OECD's intention to promote social segregation and economic inefficiency by defending unequal pay for comparable work…

Especially European labour markets need to ensure that the 'law of one price' is respected. In the US, high mobility of workers is a force working in the direction of a certain (but far from complete!) reduction of wage differentials. If firms are offering unproductive jobs with low wages, workers can 'vote with their feet' by moving to another state where job offers are better. In doing so, wages for identical skills become somewhat compressed, even if research (Freeman) finds that wage differentials even inside similar industries in the US are still quite large.

Because of reasons geography (limited space for housing), but also cultural differences and language barriers inside EU member states themselves, it is unrealistic to think of European countries to achieve a similar degree of workers' mobility as in the US. Therefore, the instrument of sectoral wage agreements is to be seen as a means to put in place wages reflecting more efficient market outcomes that otherwise would not be arrived at by an imperfect market with low workers' mobility. (As with the minimum wage, the caveat is of course to set wage levels in a range that is not too high, nor too low).

Enterprise based bargaining systems can be detrimental to incentives for innovation. Wage bargaining systems that are completely based on enterprise level run the danger of installing perverse incentives to innovation. Firms investing in innovation and/or raising productivity may well be confronted with additional wage demands. In this way, innovation rents will be 'captured'.

Incentives for innovation can also be captured by competing firms that do not innovate. If (sectoral) wage floors are lacking, competing firms will respond to a competitors' innovation by cutting wages. In that case, innovation does not pay off either because the competitive advantage innovation brings with it is almost immediately absorbed by competitors cutting their wage levels.

Sectoral wage bargaining prevents firms from taking the 'easy-way out'. Ultimately, the mechanisms described previously may end up in a situation of 'moral hazard'. If firms realise that they can count on wage earners to 'bail them out' every time when there is a competitive challenge, then the incentive to look for other and better ways to face competitive or globalisation challenges is destroyed.

Preventing firms from taking each other 'hostage' in a low cost / low productivity equilibrium. Firms taking 'the easy way out' by cutting wages and introducing precarious jobs lead to a 'fallacy of composition'. For the individual firm it may seem obvious to do so. But if other firms are forced by cut-throat competition to follow the same example, this will lead to creating an underclass of workers holding second-tier jobs paying poverty wages under uncertain working conditions.

However, the price of inequality and social exclusion is high, not only in social but also in economic terms. They are a serious obstacle standing in the way of a skilled and well-educated work force that is able to confront the challenge of competition from low wage economies by going for innovation and higher productivity solutions.

Bringing sectoral level real wages in line with average productivity promotes productivity and innovation

Aligning wages on average (national/sectoral) productivity through sectoral collective bargaining has a double effect:

- Firms that succeed in exceeding this average rate of productivity improvement will get a bonus. Profits and returns on investment will be high, thereby triggering more investment in these particular firms. As a result, more job opportunities will be created in those firms that realise high productivity outcomes, implying that the process of structural change is in this case accompanied by large creation of productive jobs.

- Firms that do not tend to engage in innovation and productivity increase are penalized and forced to do improve their performance. Having to pay wage increases that are in line with average productivity, these firms are obliged to follow the 'leaders in productivity'. If they do not, they will go bankrupt, thereby freeing up resources that can be used more productively by other corporations.

The caveat here is that this process of 'creative destruction' through sectoral wage bargaining needs to be supported by workers moving from low to higher productive firms. This implies access to training and lifelong learning as well as other active labour market policies to help retrenched workers find another (and productive) job. To be noted here is that sectoral collective bargaining agreements also play part in this by taking investment in workers' training out of competition through sectoral training funds that are financed by all firms of the sector.

Macro – economic policy concerns

Coordination of wage bargaining to avoid costly macro-economic conflicts and to sustain high but non-inflationary growth. In the economists' ideal situation, wages and productivity at the margin should be equal and in line with each other. In the real world however, 'productivity' is notoriously difficult to measure and workers' attitude to wages is based on comparisons with the wages other workers are getting. This opens the way for 'demonstration' effects and negative externalities to take hold. If some groups of workers (be it management or similar workers in other firms) are being perceived by other workers as being seriously overpaid, a 'catching-up' process may follow that does not take economic reality into account. If such 'demonstration' effects spread through the economy, the end result is a monetary policy intervention to abort economic growth even when unemployment is still high.

By defining a range (not necessarily a single figure!) for wage increases that can be considered as appropriate, coordination of wage bargaining helps to avoid such negative contamination effects. It also allows to 'internalize' macro-economic objectives such as price stability, job creation or restoring competitiveness into the process of wage formation. In this way, growth can continue much longer and more and better jobs can be created compared to the 'free market' case in which the risk of wage formation spiralling out of control and ignoring the macro-economic environment and objectives is much higher.

Coordination of collective bargaining can also be implemented through enterprise bargaining, provided this happens against the background of a more centralised or sectoral framework. The danger however is that when opening clauses in sectoral agreements become the rule instead of the exception, the credibility of the entire bargaining system may be under threat. And if negotiating structures at sectoral level weaken, so does the possibility of coordination and internalisation of broader objectives into wage formation. The result of this may well be that when the economy moves into the next cyclical upturn, wage inflation starts to accelerate sooner and more quickly than would have been the case if coordinated bargaining structures would have been maintained.

Avoiding to take unnecessary risks with deflation. Calls for (even more) flexible wage setting need to take into account that the ghost of high inflation has now been convincingly defeated. Inflation is now at historical lows, especially in the euro area. In such a situation, increasing wage flexibility by weakening trade unions' negotiating positions is dangerous. The risk is that the additional disinflationary forces are unleashed and that these tip low inflation over into deflation, thereby rendering monetary policy powerless because of the zero bound on interest rates. This is not what we want to see happening.

Competitive moderation or how euro area members continue to drag each other back down in the hole. Trend growth in the euro area has tended to go down over the last decade. One basic explanation for this is that the growth potential of the entire area has been systematically dragged down by member states attempts to stage a recovery at the expense of others by going for competitive wage moderation. In the latter half of the nineties for example, Italian workers suffered cuts in real and nominal wages in order to see their country qualify for monetary union. From '99-2000 on, Germany reacted and restored its competitiveness by almost freezing nominal wages and cutting real wages. In both cases, the loss of purchasing power resulting from wage moderation or even wage cuts dragged down the growth performance of these economies but also for the euro area as well.

Weakening existing bargaining systems further by the general use of opening clauses would be like an open invitation for even more competitive wage moderation in Europe, resulting in a serious loss of economic dynamics of the internal market itself.

Will competitive divergence mean the end of the euro area? The lesson from history is that internal markets and single currencies run into much difficulty when they are perceived as non-beneficial for the individual country. If the spiral of competitive wage moderation is in full unleashed onto Europe, there is a certain danger that some member states will no longer want to abide by the rules of the internal market or the single currency….Protectionism and nationalism are the almost unavoidable end result of generalised competitive wage moderation.

Limits to monetary policy action. Those who advocate even more wage flexibility implicitly rely on the central bank to take up the responsibility of 'demander of last resort'. Unfortunately for the euro area, the ECB has locked itself in a policy framework that makes it very difficult to react to wage moderation in an appropriate way and transform wage moderation into more and better jobs.

One problem is the point estimate the ECB uses to define its price stability target. With an explicit target of 1,9% inflation ('below but close to 2%'), the ECB has the tendency to react to economic shocks such as the oil price by increasing output variability in order to respect absolute price stability. Higher output variability however reduces longer term potential growth.

Moreover, the ECB's 'point estimate' definition of price stability is compounded by the fact that a vicious circle is operating in the euro area:

- To reduce the deficit, governments raise indirect taxes…
- … thereby pushing headline inflation up and over the 1,9% inflation target…
- …to which the ECB reacts by hiking interest rates…
- …which provides a setback to the recovery…
- …as well as a setback to the public deficit…
- …which pushes governments to raise indirect taxes and/or administered prices again…

In other words, the euro area is inflicting stagflation on itself....

The ECB has also bound its hands to react to far going wage moderation in other ways:

- Inflation is already low, implying the zero bound in interest rates is rather close
- The ECB has implicitly set an even higher downward bound for interest rates. Experience over the recent years points to the fact that the ECB is very reluctant to allow negative real interest rates to materialise. With inflationary expectations around 2%, this implies that the ECB could be extremely reluctant to reduce nominal interest rates below the 2% bound.
- Finally, in case deflation would indeed hit the euro area, it should be noted that the European Treaty rules out monetary financing of government debt. In other words, the mechanism Japan used to get out of its liquidity trap (print money for the government to spend) is unconstitutional in Europe. This is an extra reason not to take risks with deflation in Europe.

A look at the real world

Finally, it needs to be underlined that the view that sectoral bargaining is per definition rigid because it involves one identical pay increase for all firms in the sector is severely outdated. Reality is much more balanced. In many cases, sectoral agreements only represent a general framework for further negotiations at enterprise level. Such a framework then stipulates the minimum and maximum range in which wage increases can be negotiated. In other cases, it is left to enterprise negotiations to pay the wage increase out or to negotiate an alternative arrangement (more training, additional hiring of workers…). All of this needs to be taken into account when evaluating sectoral wage bargaining in Europe.