DOI: 10.1007/s10272-010-0339-2

Vera Glassner and Andrew Watt*

Cutting Wages and Employment in the Public Sector: Smarter Fiscal Consolidation Strategies Needed

This article provides an overview of the impact of public sector pay and employment cutbacks in EU countries and discusses their justification as part of austerity packages. It begins with the outcomes in the countries first hit by the economic crisis before discussing the impact of the crisis and the perceived need for austerity on collective bargaining in the public sector of other EU countries. It then turns to the arguments put forward for focusing on public sector cuts as a means of fiscal consolidation and submits them to critical review. Policy conclusions are drawn regarding collective bargaining, public sector pay issues and pathways to fiscal consolidation in Europe that would be more effective in economic terms and more equitable in social terms.

The economic crisis that hit Europe in September 2008 was characterised by a deep and sudden contraction of output and, as a consequence, by a steep increase in unemployment. A combination of the automatic effects of output losses – not least via rising unemployment – and governments' discretionary anti-crisis packages has also put public budgets under strain. One after another, countries found themselves in the Excessive Deficit Procedure of the Stability and Growth Pact. According to the European Commission's spring economic forecast, government deficits in the EU and the euro area will rise from around 2% in 2008 to more than 6% in 2009 and 7% in 2010. Gross government debt will increase from about 60% to 80% of GDP over the same period.[1]

Beginning in 2009, EU countries began to draft, and some already to implement, "exit strategies" to address rising state deficits. From the spring of 2010, such austerity measures increasingly became the priority of international bodies such as the IMF, the OECD, the G20 and the European Commission in a turnaround from previous recommendations by such organisations that most countries should maintain stimulus until recovery was assured.[2]

One important target of budget consolidation measures are the public sectors of EU countries, a policy also promoted by the European Union in a number of countries. Employment in the public sector was frozen by the stoppage of new hirings in a number of countries, public sector wages have been frozen or cut and services have been outsourced or privatised. In the vast majority of western European EU countries, wages in the public sector are settled via collective bargaining between the government and public sector unions. However, in the exceptional situation of the economic crisis, wages in the public sector are increasingly the outcome of unilateral state decisions rather than collective bargaining. Government decisions to unilaterally cut wages have been accompanied by protest and even strikes in many countries (see Table 1).

Wage Cuts and Freezes in the Public Sector: Where the Crisis Hit First

The Baltic countries have felt the economic downturn most immediately and dramatically. In Latvia and Estonia, GDP started to decline already in the last quarter of 2007[3] with an annual GDP decrease of 18% and 14%, respectively.[4] In order to respond to pressures to consolidate state budgets, wages in the public sector have been the prime adjustment parameter. In *Estonia* a re-

* European Trade Union Institute, Brussels, Belgium. The authors wish to thank Janine Leschke, Richard Pond, Rory O'Farrell and Bela Galgoczi for their helpful comments.

1 European Commission: European Economic Forecast – Spring 2010, Directorate-General for Economic and Financial Affairs, February 2010, pp. 200, 202.

2 European Commission: Commission services issue an analysis of the main innovative financing options, IP/10/405, Brussels, 6 April 2010.

3 R. O'Farrell: Wages in the crisis, ETUI Working Paper, 2010.03.

4 European Commission: European Economic Forecast, op. cit.

Table 1

Wage Cuts and Pay Determination Mechanisms in the Public Sector 2009-2010

Country	Cut of nominal wages in %, wage freeze[1]	Sector(s)	Unilateral state decision yes/no	Pay determination mechanism in public sector[2]	Collective action sector[3]
Austria	Wage freezes expected end 2010/2011			CB	D private health service workers, Jan.2009 and 2010
Bulgaria	0% 2010	Ministries and publicly funded bodies	Yes	CB for some public employees excl. civil servants	-
Czech Republic	4% 2010	Senior legal officials, other civil servants	Yes	-	-
Estonia	0% 2009 8% to 10% 2009	General public sector Healthcare sector	Yes	CB in some ministries	-
Finland	Wage freezes expected			CB	D parts of public sector, Feb. 2010
France	Wage freeze 2010-2012 discussed			CB, USD	D public sector, Jan., March, May 2010
Germany	10,000 jobs expected to be cut by 2014			CB	IA warning strikes in local/federal government 2010
Greece	7% 12%-20% 2010 0% 2011-2012	Civil servants	Yes	-	IA public sector strike, Dec. 08 IA public sector strike, Feb.09 IA public & private sector strikes, April 2010 IA general strike, May 2010 D + IA all sectors, June 2010
Hungary	0%	General public sector	No	CB	D Nov. 08 IA strike in parts of public sector, Dec. 09 -Jan. 09
Ireland	5 to 7% as levy inversely related to level of income (2009) 5% to 8% as cuts related to level of income (2010)	All public sector workers	Yes	CB	IA public sector strike, Feb. 09 IA public sector strike, Nov. 09 D public sector strike, Dec. 09 IA incl. strikes in parts of public sector, Jan.- March 2010
Italy	0% (2010) 5% to 10% (2010)	Public sector employees High-wage earners public sector	Yes	CB, USD	IA general strike, June 2010
Latvia	15 to 50% (2009)	Public sector employees	No	CB, USD	D parts public sector, Jan. 09 D parts public & private sector, Oct. 09
Lithuania	8% (2008)	Civil servants	No	-	D parts public & private sector, Jan. 09
Netherlands	Wage freezes expected			CB	IA strike in parts of public sector, May 2010
Portugal	0% (2010-2013)	Civil servants, employees in public companies	Yes	CB, USD	D public sector, Feb. 2010 IA public sector strike, March 2010
Romania	25% (2010)	Public sector employees	Yes	CB, USD	IA public sector strike, Oct. 09 IA public sector strike, Feb. 2010 IA public sector strike May 2010
Slovenia	0% (2009)	Public sector employees (2009 and 2010)	No	CB	-
Spain	5% (2010) 0% (2011)	Civil servants (2010 and 2011)	Yes	CB, USD	IA public sector strike, June 2010 D all sectors, June 2010 IA all sectors, September 2010
UK	0% (2010-2011)	Public sector employees	Yes	CB mainly national and local government, Pay Review Bodies (health, education, prisons)	IA public sector strike, March 2010

In the following countries government packages do not include any cuts in public sector pay: Belgium, Cyprus, Denmark, Luxembourg, Malta, Poland, Slovakia, Sweden.

[1] Measures discussed/proposed by the government refer exclusively to wage freezes/cuts in the public sector, no other measures such as job cuts/stoppages or the reduction of public welfare benefits. [2] If collective bargaining CB; unilateral state decision USD; - = no comparative data available. [3] IA = industrial action, including strike action; D= demonstration, mass rally, picketing; - = no or no information available.

Sources: Eurofound: Capacity building for social dialogue at sectoral and company level in the new Member States, Croatia and Turkey, Dublin 2007; F. Traxler, S. Blaschke, B. Kittel: National labour relations in internationalized markets, Oxford 2001, Oxford University Press; Eurofound EIROnline, consulted between June and July 2010; Planet Labour, database consulted between June and July 2010, www.planetlabor.com; EPSU Epsucob@NEWS database, consulted between June and July 2010, www.epsu.org.

duction of 7% in government expenditure was ratified by the parliament in February 2009, resulting in freezes or cuts in public sector wages.[5]

Social partners and the government in *Lithuania* concluded a national "austerity agreement" in October 2009. This agreement includes wage and job cuts in the civil services sector, deep cuts in pensions and an increase in VAT and social contributions.[6]

The parliament in *Latvia* ratified a tough programme to cut government expenditure in December 2008 as a consequence of the €7.5 billion loan provided by the IMF and the EU. In spring 2009 the government imposed a 15% wage cut across the public sector.[7] Likewise, pensions were cut considerably, e.g. by 10% for old-age pension benefits and 70% for working pensioners.[8] The education sector has been especially affected by savings measures. Teachers' wages were cut by almost one third from September 2009 onwards, and wage cuts have also been implemented in the health sector. Spending on education was reduced by 25% in 2009 compared with 2008. The public school system is subject to reform measures aiming at increasing the cost-efficiency of the education system, as part of which teachers' and civil servants' remuneration system has been changed.[9] For 2010 a 22.5% decrease in the financial support to local and regional governments for the remuneration of teachers is planned. The sector's union has repeatedly – and thus far unsuccessfully – appealed to the government to abstain from these cuts.

According to the European Federation of Public Service Unions (EPSU), in 2009 the average pay of public administration workers fell by 15.9% in Estonia, 18.1% in Lithuania and 25.1% in Latvia. The average earnings of workers in health and social services declined by a lesser extent, i.e. 6.3% in Estonia, 9.8% in Lithuania and 19% in Latvia.[10]

In *Ireland*, the government withdrew from the national pay agreement settled in November 2008 that foresaw a 6% wage increase over all sectors and unilaterally decided to freeze pay rises of civil servants until at least 2010. This provoked the resistance of the public sector union. In February 2009 talks between the social partners and the government about how to reduce public spending by €1 billion broke down. The main points of conflict were a "pension levy" which is expected to reduce the after-tax income of all public sector employees by 7% on average and a 6% wage cut for employees in the public healthcare and education sectors, as well as workers in local and national administration, the police and armed forces. Renewed negotiations between the social partners and the government collapsed in December 2009 against the background of the largest rise in public deficit in the EU (14.3% in 2009).[11] The government finally presented a new proposal in March 2010 after several weeks of industrial action by the public sector unions. The main changes concern the re-establishment of pay levels for workers earning less than €35,000/year, which will be reviewed in spring 2011, the possibility of the recruitment of new staff in case of specific shortages, and the reversal of pay cuts if efficiency savings in the public sector have been achieved.[12] In spring 2010 the ICTU confederation accepted the government proposal. The members of the public sector CPSU union voted to reject the deal but it will consult its members about another ballot.

In *Hungary*, which received a €20 billion loan from the IMF, the EU and the World Bank in September 2008, public spending cuts have been less draconian than in the Baltics or Ireland. A conflict arose over the government's proposal to cancel the 13th month pension and public sector salary. After a mass rally and an announced strike, an agreement was reached in December 2008. In a "memorandum of understanding" issued by the parties to the negotiation body (i.e. the National Public Service Interest Reconciliation Council), a *de facto* wage freeze for 2009 was agreed on. However, the 13th month salary will be paid to public sector workers earning less than €608/month (as of 5 April 2009) while earners of higher salaries get a reduced bonus.[13]

In *Romania* budget deficit reduction measures were adopted in November 2009 in response to the €20 billion aid provided by the IMF, the EU, the World Bank and the European Bank for Reconstruction in March 2009. Measures for the reorganisation and rationalisation of the public sector, including considerable job cuts, and the possibility of a compulsory unpaid leave of 10 days for public sector employees and reduced working hours

5 Eurofound: EIROonline, consulted between June and July 2010, www.eurofound.europa.eu.
6 Planet Labour: database consulted between June and July 2010, www.planetlabor.com.
7 EPSU: Epsucob@NEWS database, consulted between June and July 2010, www.epsu.org.
8 Eurofound: EIROonline, op.cit.
9 Ibid.
10 EPSU: Cuts will undermine growth says Europe's largest union federation as Council meets, Press release, 15 June 2010, available at: http://www.epsu.org/IMG/pdf/Appendix_2_PR_15_June_2010_-_briefings.pdf.
11 Eurostat, 2010, available at: http://epp.eurostat.ec.europa.eu/.
12 EPSU: Epsucob@NEWS database, op. cit.
13 Eurofound: EIROonline, op.cit.

were introduced. In spring 2010 salaries of public sector employees were cut by 25% from 1 June onwards, and their 13th month bonus will be cancelled. The government plans to cut 100,000 jobs in the public sector. The stated aim of the Romanian government is to avoid having to call on the IMF for another loan. Trade unions strongly oppose the cost saving measures adopted by "emergency" decree.[14]

Collective Bargaining in the Public Sector during the Current "Deficit Crisis"

In spring 2010 growing fears of public debt default by countries such as Greece, Portugal and Spain triggered "emergency" measures at the EU level. Governments throughout Europe responded to the threat of speculative attacks by financial markets and downgrades by rating agencies by announcing and adopting harsh austerity measures.

In *Greece* pressures to cut public spending were particularly strong as the country received a loan of €110 billion from the EU and IMF. In order to reduce the budget deficit from 12.7 to 8.7% of GDP in 2010 and 2.8% by the end of 2013, the government announced, among other measures such as an increase in VAT and pension reforms, a cut in the wages of public sector employees of around 7%, a cut of special bonuses (e.g. holiday and Christmas bonus) by 30%, a reduction of overtime pay and the suspension of new hirings. The choice of measures at least partly reflected the EU's recommendations. Trade unions strongly reject the "emergency package". Six general strikes took place in Greece between December 2009 and May 2010. A 24-hour general strike in the public sector and parts of the private sector organised by the two main union confederations was held on 7 July 2010.

The *Spanish* government presented an austerity programme providing for a reduction in public expenditures of €5 billion in 2010 and €10 billion in 2011. The deficit was to be reduced from 11.2% of GDP in 2009 to 6.5% in 2011. The emergency package included, among other measures, a cut in civil servants' wages of 5% and the freezing of their pay in 2011. Likewise, pensions will be frozen in 2011, and a restrictive reform of partial retirement should be implemented immediately rather than in 2014.[15] The number of new jobs in the public sector will be reduced by 87% compared to the previous year on the basis of a government decree.[16] The public sector unions FSC-CC.OO and FSP-UGT rejected the government's savings plans and decided to call a general strike in September.

Likewise, in *Portugal* the government aims at reducing the public deficit from 9.4 to 7.3% of GDP in 2010 and to 4.6% in 2011 in order to save a total of €3 billion. In order to reach the planned goals in spending reductions, the government announced that it would freeze the wages of civil servants and of employees in public companies.[17] In response, the public sector unions STAL and SINTAP organised a strike of public sector workers in March of this year and called for demonstrations and protest marches.[18]

In *Italy* government debt (as a ratio to GDP) reached the highest level in the EU in 2009, i.e. 117%.[19] In the midst of the euro crisis, the government agreed on an emergency package in spring 2010 that, among other measures, provides for a freeze of wages in the public sector for three years. The pay of the highest income groups in the public sector was cut by 5% (for annual earnings of €90,000 or higher) and 10% (for an annual income of €130,000 or higher). The wages of judges exceeding €80,000/year will be cut by 10%.[20] The CISL and UIL trade unions were partly supportive of the austerity measures that also include tax increases on stock options and managers' bonuses as well as a reduction in income tax and employers' social contributions for low-wage earners. The CGIL trade union called for a general strike in late June 2010.

The public deficit in the *United Kingdom (UK)* was among the highest in the EU in 2009 (-11.5% of GDP).[21] For local government employees, a moderate pay increase of 1% was settled in a one-year agreement in 2009. After the expiry of the agreement, the local government employers' association unilaterally imposed a wage freeze for the forthcoming 12 months.[22] In June 2010 the new government coalition announced an extensive budget consolidation programme, including a VAT increase from 17.5 to 20%, and cutbacks in some social benefits. As a major part of this programme, public pensions will be reformed and the state pension age increased. Wages of public sector employees will be frozen for the forthcoming 2 years for higher wage-earners (i.e. more than £21,000/year). Lower-income earners will receive a flat pay increase of £250 over two years. Recently, the

14 Ibid.
15 Planet Labor, op. cit.
16 Eurofound: EIROonline, op.cit.

17 Planet Labor, op. cit.
18 EPSU: Epsucob@NEWS database, op. cit.
19 Eurostat, op. cit.
20 Planet Labor, op. cit.
21 Eurostat, op. cit.
22 EPSU: Epsucob@NEWS database, op. cit.

government proposed a reform of the public sector pay system in order to allow for lower wage increases in regional public administration and services.

In other countries such as Bulgaria and the Czech Republic, governments adopted austerity programmes including cuts or freezes of public sector pay despite rather low ratios of government debt to GDP (around 15% in Bulgaria and 35% in the Czech Republic in 2009).[23] In Bulgaria the government demanded a 10% reduction of costs in ministries and publicly funded bodies that is expected to result in job cuts and a pay freeze.[24] Likewise, in early 2010 the Czech government decided upon a pay cut of 4% for senior legal officials and other civil servants in 2010.[25] In Slovenia the government and public sector unions already agreed on an austerity pay agreement in early 2009 in order to avoid exceeding a government deficit of 3% of GDP, as stipulated in the Stability and Growth Pact. Measures include a reduction of public sector jobs and the suspension of pay increases during 2009 and 2010 for public sector employees.[26]

In some countries, such as in Germany and Austria, governments' consolidation plans have not *yet* explicitly targeted wage-setting in the public sector. However, bargaining rounds proved to be difficult. For instance, although governments in *Austria* and *Finland* pushed for pay freezes in negotiations at the end of 2009 and the beginning of 2010, unions could secure marginal increases of around 1%. Likewise, in the *Netherlands* a 1.5% pay increase was settled in the municipal sector after several months of targeted industrial action by unions. In *Germany*, a moderate wage increase (2.3% over 26 months) was agreed for public sector employees at the central and communal levels in February 2010 following industrial action by the trade unions. However, in June 2010 the German government presented an austerity package that aims at saving €80 billion by 2014 with cuts concentrated in social services and welfare benefits. In public administration, large-scale job cuts are planned, and the Christmas bonus of public sector employees will not be paid out in 2011.

Given the fact that cuts in public sector pay and employment form a key element in fiscal austerity measures, it seems important to subject the arguments behind these cuts to a critical analysis.

23 Eurostat, op. cit.
24 EPSU: Epsucob@NEWS database, op. cit.
25 Ibid.
26 Eurofound: EIROonline, op.cit.

Examining the Arguments for Fiscal Austerity via Public Sector Cutbacks

It is worth emphasising that the analysis of the preferred mix of austerity measures is conceptually separate from the issue of the timing and extent of fiscal consolidation *per se*. While medium-run consolidation is clearly vital, it is too early, given the fragility of the recovery, for most EU countries to embark already on fiscal consolidation at the current juncture, *irrespective of the means used*. Countries with short-run refinancing difficulties and facing speculation against their sovereign debt should receive the necessary European (and if necessary IMF) support, as has to some extent belatedly happened.[27]

Four main arguments, analytically separate but interlinked, have been advanced by key policymakers, notably the European Commission and ECB, for focusing cuts on public sector pay and employment in the current environment. The first is that it is "fair" for public sector workers to take pay cuts because they have much more job security than private sector workers. The second is that it is the most effective way to achieve short-run improvements in the fiscal position.[28] The third is that the underlying problem facing European countries is one of national competitiveness, and public sector wage cuts are the best way to drive down overall wages and prices and thus improve competitiveness.[29] The fourth is that the state sector is simply too big and/or it is in the interests of longer-run efficiency or productivity to shrink the state.[30] We consider these arguments briefly in turn.

- Public sector wage cuts are a *quid pro quo* for job security.

This argument may have been politically effective and was used in countries such as Ireland to divide public and private sector workers. That does not alter the fact

27 E.g. F. Nauschnigg: Growth friendly fiscal consolidation, in: ETUI Policy Brief European Economic and Employment Policy, 4-2010; A. Watt: Europe's Policymakers are rushing towards the Edge of the Cliff, in: Social Europe Journal, 2010, http://www.social-europe.eu/2010/06/europe%E2%80%99s-policymakers-are-rushing-towards-the-edge-of-the-cliff/; A. Watt: A Greek Tragedy or a European Farce? Time to Re-Write the Script, in: Social Europe Journal, 2010, http://www.social-europe.eu/2010/02/a-greek-tragedy-or-a-european-farce-time-to-re-write-the-script/.
28 E.g. European Commission: Public finances in EMU 2010, European Economy 4, 2010, p. 171.
29 E.g. F. Holm-Hadulla, K. Kamath, A. Lamo, J. Pérez, L. Schuknecht: Public wages in the Euro area. Towards securing stability and competitiveness, in: European Central Bank: Occasional Paper Series, No. 112, June 2010; European Commission: Public finances in EMU 2010, op.cit., p. 233.
30 E.g. European Commission: Public finances in EMU 2010, op.cit., p. 22.

that it is specious in economic terms on a number of levels.

Firstly, past reforms have lessened the specificity of public sector employment, making it more precarious in a number of countries.[31] More specifically, in the crisis both private and public sector workers have been suffering a mixture of job losses, reductions in working hours and paycuts. In general, measures were adopted first, and mainly via collective bargaining, in the private and later (often by unilateral state decision) in the public sector.[32] Thus the supposed dichotomy between sectors and, by implication, the "justice" of employment losses in the one versus paycuts in the other, are empirically false. Second, even to the extent that there is a job-security/wage trade-off, it is a medium to longer-run issue: any greater job security in the public sector should in theory be reflected in *generally* lower wages (for a given skill category) than in the private sector.[33] This in no way justifies downward public sector wage flexibility in times of higher unemployment. And lastly, greater job stability reflects more stable demand for services generally in a downturn compared with industrial production or construction. It is not, in that sense, a government-provided privilege.

At a more general level, even if one accepts the simplistic division of the economy into public and private sectors, the "fairness argument" needs to account for the fact that it was the private sector (and especially finance) that was at the heart of the financial crisis. The financial sector was to a large extent bailed out by the taxpayer. Seen in this light, the "fairness" argument for the public sector "paying the price" also seems to carry little weight in a more political sense.[34]

- The public sector wage bill is the fastest/most effective way to consolidate.

This argument certainly has some force, at least at first glance. Data show that the government wage bill accounts for more than 20% of total public spending in the euro area and over 10% of GDP.[35] In purely mechanical terms (i.e. excluding feedback effects), an across-the-board public sector wage cut of 10% reduces public spending by just over 2%. However, unless the workers affected increase their own borrowing (or reduce their saving), GDP would also fall, by more than 1% in this example, as total spending falls by the same amount as the income losses of those affected. While such a wage-cut strategy is certainly superior to the apparently equivalent approach of cutting an equivalent number of public sector jobs, the desirability of cuts in public sector wages as a consolidation strategy needs to be assessed first against other expenditure-reducing measures and second against revenue-raising measures.

In terms of the former, it is difficult to generalise across European countries regarding the virtues or otherwise of cutting public sector wages versus cutbacks in the other four-fifths of public expenditure. Clearly it depends on the contribution to aggregate welfare of the spending areas under consideration – and this is hard to measure in any objective way. One important argument is that the knock-on effects of wage cuts on aggregate demand are likely to be relatively high: public sector workers tend to be rather concentrated around the middle of the income distribution and can be expected to have a relatively high propensity to consume. The negative demand effects could be reduced, though, by concentrating cuts among the highly paid and exempting the low paid (in some cases this has been done, see above).

In terms of the latter – expenditure cuts versus revenue increases – there are wide-ranging arguments. Expenditure-based approaches are held to be more sustainable.[36] However, both the revenue and the expenditure sides of government budgets are, overall, "progressive" in inequality terms. This means that consolidation via raising revenue is generally better in terms of promoting more equal distributional outcomes than spending cuts. In the context of the crisis, more specific arguments can be made for raising certain kinds of revenue and specifically for calling on the financial sector to contribute more to paying for the cost of cleaning up after the

31 M. Keune, J. Leschke, A. Watt (eds.): Privatisation and liberalisation of public services in Europe. An analysis of economic and labour market impacts, ETUI Brussels 2008.

32 As shown above and see V. Glassner, M. Keune: Negotiating the crisis? Collective bargaining in Europe during the economic downturn, in: DIALOGUE Working Paper, No. 10, Geneva 2010, International Labour Office; J. Leschke, A. Watt: How do institutions affect the labour market adjustment to the economic crisis in different EU countries?, in: ETUI Working Paper 2010.04; R. O'Farrel, op. cit.

33 For an interesting comparison of employment characteristics in the two sectors see J. Leschke, A. Keune: Precarious employment in the public and private sectors: comparing the UK and Germany, in: ETUI Policy Brief European Economic and Employment Policy, 1-2008.

34 See also below and A. Watt: Distributional issues in the context of the economic crisis in Europe, in: Intereconomics, Vol. 44, No. 2, 2009, pp. 82-89.

35 Here and below reference is made to the recent study of public sector wages and employment by the ECB. There are a number of caveats to these data regarding country coverage, definitions, weighting, etc. See footnotes 2 and 3 on p. 8 of the study. The figures given are based on weighted averages rather than the unweighted figures used by the ECB authors. See F. Holm-Hadulla et al., op. cit., p. 8.

36 European Commission: Public finances in EMU 2010, op. cit.

crisis.[37] Looking at historical trends prior to the crisis, there has been a notable reduction in overall taxation in the EU, most notably in the top rate of income tax and in corporate tax.[38]

- Public sector wage cuts are the best way to improve competitiveness.

Proponents of this argument point to the relationship between private-sector and public-sector wage setting and outcomes and the isolation of the public sector from market competition driving up wages in the private sector.[39] The close correlation over time between wage outcomes in the two sectors is of little surprise given that they constitute two (unequal) halves of a single national labour market, with public and private employers competing for the same pool of labour and unions in both sectors using the other as a benchmark. The second argument relies merely on a statistical analysis (Granger-causality) without reference to the institutional economics and industrial relations studies showing that the coordination of collective bargaining positively influences macroeconomic performance in terms of inflation, employment, etc.[40]

The coincidence of a decline in competitiveness, faster growing wages in the public and private sectors *and* faster growth of overall nominal wages in some countries of the euro area, i.e. Ireland, Greece, Spain, Italy and Portugal, that the authors have observed[41] requires detailed analysis. More fundamental dynamics are almost certainly at work behind the widening competitive imbalances[42] than the influence of the public sector wage trajectory. Nevertheless, there remains a *prima facie* case that in *such countries,* the public sector should take a leading role in reducing overall unit labour costs and prices.

However, firstly this needs to be part of a broad-based strategy involving negotiated wage policy responses also in the private sector and, not least, steps to reduce oligopolistic price setting on product markets. The well-known Wassenaar agreement in the Netherlands, agreed between the social partners and the Dutch government in 1982 when costs and prices had also got out of line and the Netherlands was part of the hard-currency bloc, offers a historical precedent for broad-based reform with the involvement of the social partners. In contrast, swingeing cuts in public sector pay (especially in the absence of other measures), in the hope of setting off a deflationary wage and price spiral, is a costly and risky strategy that runs the acute danger of entrenching negative expectations and economic stagnation (as happened in Japan, for instance). And secondly, it is vital to emphasise that the competitive imbalances have two sides. Surplus countries such as Germany, Austria and the Netherlands need to have *faster* wage growth, in both their public and private sectors. Raising "competitiveness" via public sector wage-induced deflation is a beggar-thy-neighbour strategy that cannot work for Europe as a whole.

The policy conclusions drawn from the analysis by the ECB authors (and previously by other institutions, e.g. OECD[43]) give cause for concern. They call, among other things, for "less coordinated and more decentralised wage bargaining" and "a smaller public sector workforce", as well as for "decoupling public sector wages from private sector benchmarks" and for wage expenditure rules that make public sector wages counter-cyclical or at least less pro-cyclical.[44] The first proposal ignores the vast literature on the advantages and superior economic performance of coordinated pay bargaining. The proposed decoupling of public sector wage-setting from wage bargaining in the private sector is odd given that a closer tying of pay outcomes in the two sectors is surely in line with standard economic theory (competition for labour on a single labour market). The final argument appears bizarre. It is well-known that wages

37 On this see A. Watt: Distributional issues in the context …, op. cit.; P. Schulmeister: A general financial transaction tax: enhancing stability and fiscal consolidation, in: A. Watt, A. Botsch (eds.): After the crisis: towards a sustainable growth model, Brussels 2010, ETUI, pp. 45-49; for an opposing view European Commission: Public finances in EMU 2010, op. cit.

38 European Union: Taxation trends in the European Union. Main results, 2010 edition, http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-EU-10-001/EN/KS-EU-10-001-EN.PDF/, pp. 5-10.

39 F. Holm-Hadulla et al., op. cit.

40 See e.g. D. Soskice: Wage Determination: The changing role of institutions in advanced industrialized countries, in: Oxford Review of Economic Policy, Vol. 6, 1990, pp. 36-61; D.C. North: Institutions, Institutional Change and Economic Performance, Cambridge 1990, Cambridge Univ. Press; F. J. Flanagan: Macroeconomic Performance and Collective Bargaining: An International Perspective, in: Journal of Economic Literature, Vol. 37, No. 3, 1999, pp. 1150-1175; F. Traxler, B. Kittel: The Bargaining System and Performance: A Comparison of 18 OECD countries, in: Comparative Political Studies, Vol. 33, 2000, pp. 1154-1190; F. Traxler, S. Blaschke, B. Kittel: National labour relations in internationalized markets, Oxford 2001, Oxford University Press; F. Traxler: Bargaining (De)centralization, Macroeconomic Performance and Control over the Employment Relationship, in: British Journal of Industrial Relations, Vol. 41, No. 1, 2003, pp. 1-27.

41 F. Holm-Hadulla et al., op. cit., p. 29.

42 A. Watt: Imbalances in Europe: What caused them? What role did they play in the crisis? What is the right political response? What are the implications for trade unions?, Background paper for Congress of UNI-Europa, in: ETUI discussion paper, forthcoming 2010.

43 OECD: Employment Outlook, Paris 1994, Organisation for Economic Co-operation and Development.

44 F. Holm-Hadulla et al., op. cit., pp. 29 ff.

in general are "pro-cyclical" in the sense of rising faster (usually with a lag) in economic good times than bad. Moreover, it is to be expected that the pro-cyclicality of wage movements would be enhanced further if wage-setting were decentralised. And the obvious implication in the current context – public sector pay should now be rising *faster* in the recession – appears to elude the authors.

- The state sector is too big and/or must shrink in the interests of longer-run efficiency.

Except for brief periods in recessions, private sector employment in the euro area has grown faster than that in the public sector since the late 1980s, and the share of the latter in total employment has fallen by almost 2 percentage points.[45] Recent decades have not seen a "bloating" of the public sector; on the contrary, it is generally accepted that the crisis, and its huge losses, are the result of excessive and irrational developments in the private sector, especially in finance. To the extent that the public sector was to blame, it is in the area of liberalisation and inadequate oversight and supervision (again, especially in finance). Certainly it is hard to make the case that the large, labour-intensive parts of the public sector (health care, education, security services) are in any way responsible for the huge costs generated by the crisis.

Conclusions

Workers in Europe, in both the public and private sectors, are already feeling the effects of pay cuts and losses in income and purchasing power. While the consolidation of public budgets requires a balanced and well-timed mix of both revenue and expenditure side measures, the harsh austerity programmes launched by many European governments are in many cases precipitous and disproportionately based on cuts in social transfers as well as pay and employment cuts in the public sectors. This places an additional burden on workers and their families that is not justified in either economic or "ethical" terms.

As shown above, the various arguments that public sector wage cuts should be used as a prime means of reducing deficits are at best partial and in many cases unconvincing. In particular the "competitiveness" argument disregards the diverging developments of the external trade balances of EU countries. While public wage restraint in deficit countries would contribute to a reduction of unit labour costs, a more dynamic wage development is needed in surplus countries in order to strengthen internal demand and permit a balanced and sustainable recovery. Unless concentrated on high income earners, public sector pay cuts are likely to have serious negative repercussions for aggregate demand and thus, ultimately, for the success of the consolidation effort.

In the medium run, budget consolidation is clearly necessary in Europe. The means chosen should limit negative demand effects and, where possible, stimulate investment and growth. If fiscal consolidation is to succeed, the measures selected also need to be perceived as "fair" by citizens. It is not clear that focusing cuts on public sector wages meets these criteria.

Turning to implications for collective bargaining, the announcement of cuts in pay or pay freezes via unilateral state decision marks a break with the previous tradition of settling wages in the public sector. Beyond the issue of the wage outcomes, government unilateralism in pay-setting and/or the recommendation of a far-reaching decentralisation of pay bargaining are of great concern. First, wage bargaining coordination across sectors and between employee groups, as practised across much of continental Europe, is a means of ensuring that pay rises are in line with productivity growth and inflation. Secondly, a system where public sector pay is subject to strict budgetary restraints and wage determination in the private sector is completely uncoordinated would imply a worrying increase in the pro-cyclicality of wage movements and risk unsustainable divergences between pay in the two sectors. Third, and more broadly, this unilateralism is incompatible with the European social model and high quality industrial relations based (amongst other things) on the right to collective bargaining and strong employee participation.

It is vital for European unions, in *both* the private and public sectors, to pursue a wage policy orientated towards medium-run productivity increases and moderate inflation. This prevents downward pressures on wages and maintains workers' purchasing power. It also contributes to stable and balanced economic development within the eurozone and across the business cycle and thereby helps to avoid imbalances in international competitiveness with their potentially disastrous consequences.[46]

45 See F. Holm-Hadulla et al., op. cit.; see also D. Soskice, op. cit.; D.C. North, op. cit.; F. J. Flanagan, op. cit.; F. Traxler, B. Kittel: The Bargaining System …, op. cit.; F. Traxler, S. Blaschke, B. Kittel: National labour relations …, op. cit.; F. Traxler: Bargaining (De)centralization …, op. cit.

46 See also V. Glassner, A. Watt: The current Crisis reveals both: The Importance and the Limitations of the transnational Coordination of Collective Bargaining Policies, in: Social Europe Journal, 2010, www.social-europe.eu/2010/07/the-current-crisis-reveals-both-the-importance-and-the-limitations-of-the-transnational-coordination-of-collective-bargaining-policies/.