



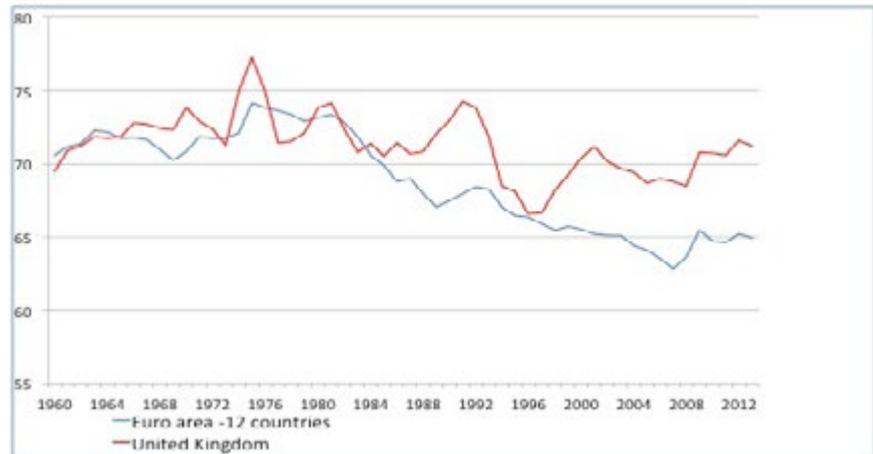
## Europe needs a wage-led recovery

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The new Jobs, Growth and Investment Package of the European Commission (EC) is an attempt to acknowledge the investment deficit in the EU, albeit with insufficient funding; however other tools of economic policy for tackling the jobs and equality deficit is remarkably ignored in the policy debate. In particular the detrimental effects of austerity measures aiming at the fiscal consolidation as well as structural reforms in labour markets, which will continue wage restraint policies, are still seen as part of the solution rather than the problem.

The EC has long encouraged wage moderation for many years, and it has explicitly recommended real wage growth below productivity growth to increase the international competitiveness of the EU. This policy has resulted in three decades of increasing inequality, declining share of wages in national income, and the emergence of a new class of super rich without generating a sustainable growth model for Europe. **Full employment has not been achieved in any of the EU countries, even before the crisis.** The decline in the wage share was associated with a weaker and more volatile growth performance. In countries like the UK, Ireland, Spain, Greece, or Portugal households increased their debt to maintain consumption levels in the absence of decent wage increases. In countries such as Germany, Austria, and the Netherlands an excessive reliance on exports was required to maintain growth in the absence of domestic demand based on a healthy wage growth. The crisis of 2007-9, and the subsequent Great Recession have proven the fragility

**FIGURE 1: WAGE SHARES IN GDP, 1960-2013**  
NOTE: ADJUSTED, RATIO TO GDP AT FACTOR COST (SOURCE: AMECO)



**TABLE 1: AVERAGE GROWTH OF REAL GDP**

	1961-69	1970-79	1980-89	1990-99	2000-07	2008-13
UK	2,90	2,42	2,48	2,18	3,17	-0,28
Euro Area (12 countries)	5,29	3,78	2,27	2,12	2,16	-0,28

- The share of wages in national income in the Eurozone decreased almost 10%-points between 1980 and 2013

- Average growth in GDP fell from 4.5% to 1.7% per year

of both models. However, **wage moderation policies are still part of the crisis management policies** in the national reform and stability programmes as well as the Europe 2020 strategy of the EC.

Rather than more of the same medicine, we argue that Europe needs a fundamental rethinking of its economic policy. Our approach highlights the role of wages as a source of demand. Empirical evidence shows that when the share of wages in national income decreases four things happen.

First, consumption decreases, since workers consume more as a proportion of their income compared to higher income groups who earn profit income; hence

when there is a redistribution from wages to profits, domestic consumption in the national economy unambiguously decreases.

Second, although private investment may partially increase due to higher profits, this increase is insufficient to offset the negative effects on domestic consumption. Third, net exports (exports minus imports) increase due to a fall in unit labour costs, but in the majority of countries, in particular in the large, relatively closed economies, this increase is not enough to offset the negative effect on domestic demand. Finally, in an environment of the global race to the bottom in the wage share, most of the positive effects on net exports are wiped out as labour costs fall simultaneously in

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all countries, and their international competitiveness relative to each other does not change significantly. Thus, in the vast majority of countries a fall in the wage share leads to lower growth; this is what we call a wage-led growth economy. In contrast, mainstream economics, which forms the theoretical basis of the wage restraint policies of the EC, assumes that all our economies and Europe as a whole is profit-led, i.e. they assume that a lower wage share leads to higher growth.

## 'In the vast majority of countries a fall in the wage share leads to lower growth'

The EU as a whole is a typical example of a wage-led economy. Small open economies in the Euro area, such as Ireland, the Netherlands and Austria, may be profit-led, when analysed in isolation, but large economies such as Germany, France, Italy, and the UK are likely to be wage-led. Furthermore the EU is a rather closed economy with low extra-EU trade and high intra-EU trade; hence a fall in the wage share in Europe as a whole is likely to have only moderate positive effects on trade balances, but it will have substantial negative effects on domestic demand. If wages were to change simultaneously in all the EU countries, the net export position of each country would change little because extra-EU trade is comparatively small. Thus, when all EU countries pursue "beggar thy neighbour" policies through wage suppression, the international competitiveness effects will be minor, while the domestic effects will be decisive. Hence not only the wage-led countries but also the profit-led countries in the EU contract as an outcome of wage restraint policies.

**In a wage-led country like the EU as a whole, more egalitarian policies are consistent with growth.** Macroeconomic policy coordination among the EU

Member States (MS), in particular with regards to wage policy, can improve growth and employment. The need for coordination does not exclude the possibility to implement pro-labour policies in a single country in particular in the wage-led economies. However, the impact of these policies on growth and employment are stronger when they are coordinated across countries.

Even the individual profit-led countries can grow if there is a simultaneous increase in the wage share. Indeed, in the majority of profit-led countries, it is not at all possible to grow with policies that result in a decline in the wage share, when this strategy is implemented in many other large economies at the same time.

The concerns regarding the inflationary effects of wage increases are also misplaced in the EU. In particular, as the Eurozone is at the edge of deflation, policies to align wages increases with the historical increases in productivity in the past will only help to reach the inflation target, while at the same time helping to generate a wage-led recovery and decent job creation.

There is a material basis for a wage-led recovery as a path to stable development, social cohesion, and regional convergence in Europe. **Policies to push for a wage-led development strategy can be, and should be, implemented for not only equality but also economic and political stability:** rising income inequality has been one of the root causes of the Great Recession.

A wage-led recovery out of the financial crisis is feasible, but will need political will to be achieved. Globalisation is not an impediment to a wage-led development strategy. The EU as a whole would be an economy that would benefit most from a coordinated boost to the wage share at the global level. As such, Europe should, take a step forward in terms of radically reversing the fall in the wage share.

## 'A wage-led recovery out of the financial crisis is feasible, but will need political will to be achieved'

The fall in the wage share has been a deliberate outcome of policies that led to the fall in the bargaining power of labour, welfare state retrenchment, and financialisation. The solution therefore lies in reversing this process. A strategy of wage-led development requires a policy mix that includes labour market policies aiming at pre-distribution, as well as redistributive policies through progressive taxation.

Labour market policies that aim at increasing the wage share include an improvement in union legislation, increasing the coverage of collective bargaining, increasing the social wage via public goods and social security, and establishing sufficiently high minimum wages. Furthermore we need to overcome the coordination problem that European countries presently face. Europe needs a system of European wage bargaining coordination that aims at wages growing at least with productivity growth and the inflation target in the long term. This requires institution building at the national as well as the European level.

It is also crucial that **policies for wage-led development are complemented by a broad mix of economic policy**, because the effects that can come from a wage-led recovery on growth and hence employment are modest, albeit positive, in magnitude. Wage-led growth is not a magic bullet to solve all the ills of our current economic model. For sustainable and egalitarian development, we need to mobilise all of the tools of economic policy and public spending with an aim to achieve full employment, ecological sustainability, and equality.

