



**Wages setting mechanism in the
envisaged unified Cyprus**

The economic impact of MW and CB :

A contested terrain

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Main Points

- The labour and human rights dimension
- The economic arguments
- Minimum wages – rational and systems
- Collective bargaining – rational and systems
- The challenge of a currency union
- The transitional challenge of unification

Article 23 of the Human Rights Declaration



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(3) Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity, and supplemented, if necessary, by other means of social protection.



Social justice and wage setting

- Collective bargaining is a fundamental workers' rights
- It is indispensable for workers dignity, respect and protection at the workplace.
- Minimum wages and collective bargaining avoid a race to the bottom

The economic impact of minimum wages and collective bargaining - a contested terrain

- It enables workers to achieve a fairer distribution of income.
- Protected workers are more motivated and willing to engage for the benefit of the company.
- MW and CB stabilise aggregate demand
- They reward productive and innovative enterprises

- MW and CB reduce flexibility, innovation, competitiveness
- Therefore they result in lower productivity, lower economic growth and lower income even for those it intends to protect.
- They allow for rent seeking of the insider at the expenses of the unemployed and the consumer
- In a currency union national standards are no longer national

What is the relationship between



Productivity



Innovation



Competition



Flexibility



Minimum wage and collective bargaining agreements



Productivity

“Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”

Paul Krugman



Innovation

“Much of the rise in living standards is due to innovation — this has been the case since the Industrial Revolution.”

OECD

Competition



Is Competition the driver for innovation and productivity?



Flexibility



Is flexibility the way to be competitive?

The constant distributional struggle

Employer

State



Worker



MW & CB



Limiting, shifting, and intensifying competition by

- Taking labour out of competition within the sector or the national economy
- Ensuring fairer distribution
- Stimulating greater workplace efficiency
- Forcing uncompetitive companies to improve or close
- Responding to international competition



Minimum wage a basis for a wage system

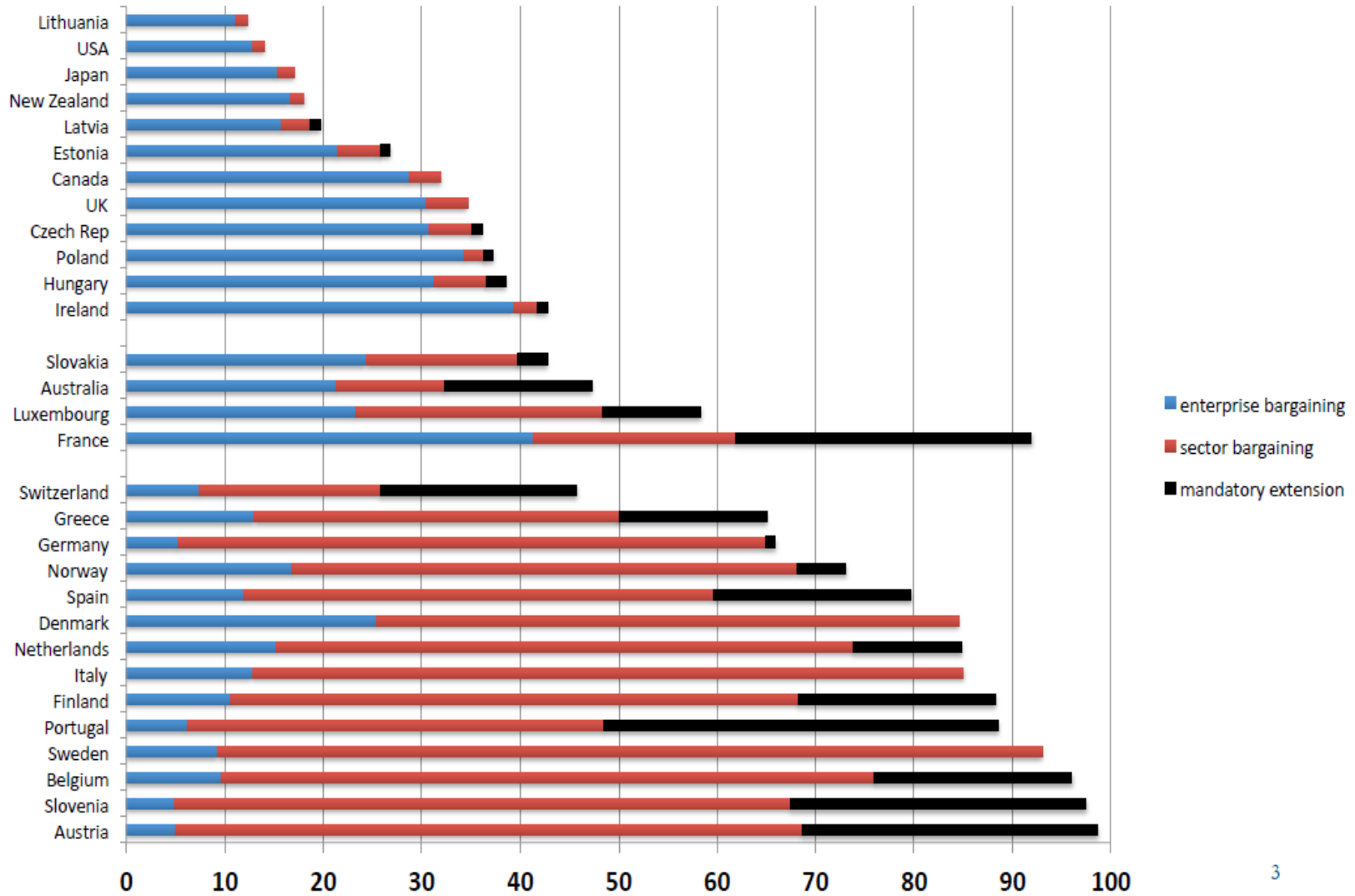
- What is the purpose?
- What is the right level?
- A single or different minimum wage?
- How to set the MW ?
- How to adjust it ?
- What is its impact ?

Collective bargaining



- Enterprise - **limits individual workplace competition**
- Sectoral - **avoids wage competition between enterprises**
- Regional - **recognises differences in costs and productivity**
- National - **distributes productivity gains across sectors**

Coverage rates by dominant level





The role of wage policies in addressing trade imbalances and lack of competitiveness in a currency union



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- For a national government with currency sovereignty a growing trade deficit can be addressed by lowering real wages through devaluation of the currency if there is a viable export industry and potential for substituting imports
- In a currency union national agreements become regional and the tradable sector directly competes with enterprises not covered by the collective bargaining agreements. If the tradable sector is predominately in a price competition wage moderation can restore competitiveness.
- To avoid «beggar thy neighbour» policies macro-economically a common commitment to wage growth in line with national productivity and target inflation rate of the central bank becomes desirable.



Option for wage setting in a currency union from a macroeconomic point of view

- **Option 1:** Ignoring the realities of a currency union and the growing trade deficit and declining competitiveness
- **Option 2:** Participate in the race to the bottom
- **Option 3:** Using tax policies reduce non wage costs and increase the cost for imports
- **Option 4:** Create a system of continues transfers either through agreed transfers or through highly disruptive “indebttness and default” crises
- **Option 5:** Progressive penalty taxes where wages overshoot the wage norm and progressive penalty taxes on enterprise profits with wage increases below the wage norm

The challenge for a small country with only a few dominant sectors – a sectoral approach might be more important than a macro-economic approach



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- Wage as a competitiveness factor for the financial sector?
- Wages as a competitiveness factor for the tourist sector?
- Wages as a competitiveness factor of other industry (light industry, agriculture)



The challenge of unification

- Different levels of wages and productivity
- Level of labour and capital mobility
- Rapid increase of wages will be an economic shock for low productivity enterprises
- Rapid integration into EU and EU price and wage level could destroy industry in northern part of the island
- High wage gap will trigger strong migration from low wage region
- This will create strong wage pressure in particular in the low skill sectors like tourism



Wage policy needs institutional prerequisites

- Do both regions have labour market institutions that allow for wage policies and are they compatible or contradictory?
 - Legal Minimum wage
 - other minimum standards like working time
 - Social security system
 - sectoral bargaining agreement
 - legal extension mechanisms
 - trade union bargaining power



What can be done

- Free movement of workers politically central for the unification process
- Wage policy can only work as an overall concept of managed unification (public investment and special incentives for private investment in the poorer region, similar standard of public services)
- Setting binding minimum wage floor and extending collective bargaining coverage separately for both regions reflecting the different levels of productivity
- Setting a mechanisms for arriving at a joint floor over a ten to twenty year period. May be temporary wage subsidies
- Creating joint unemployment and health insurance