

# Wage coordination in new and old EU member states

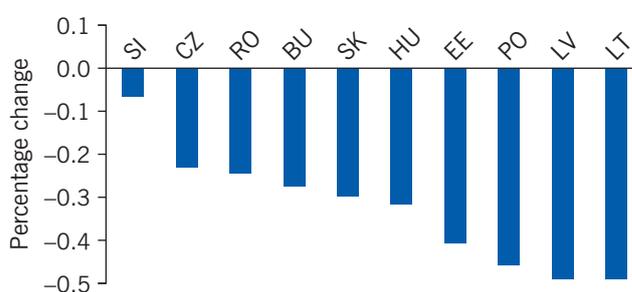
Stronger wage coordination and higher union density are associated with lower unemployment and higher inflation

Keywords: labor market institutions, wage coordination, union density, Phillips curve, exchange rate pass-through

## ELEVATOR PITCH

Aside from employment protection laws, which have been converging, other labor market institutions in new and old EU member states, such as wage bargaining coordination and labor union density, still differ considerably. These labor market institutions also differ among the new EU member states, with the Baltic countries being much more liberal than the others. Research that pools data on old and new EU member states shows that wage coordination mechanisms can improve a country's macroeconomic performance. Stronger wage coordination and higher union density reduce the response of inflation to the business cycle.

Countries with weaker wage coordination face stronger deflationary responses to unemployment



Note: Shows effect on inflation (in the traded sector) of a 1% increase in unemployment in the traded goods sector.

Source: Based on Figure 4.

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## KEY FINDINGS

### Pros

- ⊕ Labor markets are generally perceived to be more flexible in the new EU member states than in the old.
- ⊕ More centralized wage bargaining coordination and higher union density are often associated with lower unemployment.
- ⊕ Wage coordination may result in less sensitivity of inflation to domestic output, thus stabilizing inflation when unemployment is very low.
- ⊕ The benefits of wage coordination may be realized when the lead sectors in wage negotiations are subject to competition through active engagement in international trade.

### Cons

- ⊖ Labor markets in the new EU member states offer much less protection to displaced workers than those in old EU member states.
- ⊖ More centralized wage coordination is associated with higher inflation, especially in the traded sector.
- ⊖ Wage coordination may reduce the inflation-dampening effects of higher unemployment during economic downturns.
- ⊖ When the non-traded sectors (which include many service sectors and the public sector) are the de facto leaders in wage negotiations, a country's competitiveness may suffer.

## AUTHOR'S MAIN MESSAGE

Both formal and informal wage coordination mechanisms can contribute to macroeconomic stability. The traded goods sector rather than the public sector or non-traded services sectors should take the lead in wage coordination so that negotiated wages do not exceed productivity gains. However, in both old and new EU member states, the public sector or the non-traded services sectors are sometimes the de facto leaders—potentially compromising a country's external competitiveness. Policymakers should encourage across-the-board wage settlements that follow productivity gains in traded sectors.