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**Europe 2020: Employment policies  
European Employment Strategy**

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**Wage setting: Institutional features**  
Commission Note

**1. INTRODUCTION**

The 2011 Annual Growth Survey (AGS) states, that "*Member States with large current account deficits and high levels of indebtedness should present concrete corrective measures (these could include strict and sustained wage moderation, including the revision of indexation clauses in bargaining systems)*". The 2011 Joint Employment Report refined the main message concerning wage setting and the recognition of the importance of social partners: "*The policy responses to the crisis are complex and, where relevant, social partners have an important role to play. In particular, cooperation with social partners is necessary to improve the responsiveness of wage setting processes to market developments so that wages properly and promptly reflect labour productivity. At EU level, the link between the national mechanisms of wage determination and the stability of the euro-zone could be analysed*". According to the European Council conclusions, as set out in the Euro Plus Pact, "*while respecting national traditions of social dialogue and industrial relations, measures to ensure costs developments in line with productivity will be given particular attention, such as review(ing) the wage setting arrangements and, where necessary, the degree of centralisation in the bargaining process, and the indexation mechanisms, while maintaining the autonomy of the social partners in the collective bargaining process*".

Agreed wage setting is needed to provide clarity and stability in the relations between firms and workers to stimulate and protect productivity-enhancing, job-specific investments by both employers and employees. At the same time, wage flexibility and adjustment is needed to equalise labour supply and demand in response to changes in economic conditions. Wage setting institutions vary widely between Member States and reflect the diversity of Industrial Relations customs and practices. They reflect a variable balance between stability and flexibility and have to be considered in relation to their effects on the labour market.

The aim of this note is to provide a *mapping* of wage setting mechanisms in Member States. This basis should allow EMCO to gain an understanding of the situation across the EU and help, together with the social partners, to answer to the EPSCO Council's call to "*examine how wage determination at national level can contribute to preventing and rectifying the macro-economic imbalances and enhancing competitiveness*".

## Main Features of Wage Formation

Among the features of a wage setting mechanism that have an influence on wage outcomes, the following ones can be highlighted:

- ***bargaining coverage rate***: an indicator of the extent to which the terms of employment are negotiated by trade unions. Operationally, the coverage rate is defined as the number of employees covered by a collective agreement as a proportion of all wage- and salary-earners in employment. Bargaining coverage measures the real extent to which employees are subject to union negotiated terms and conditions of employment. Bargaining coverage is only weakly correlated to trade union density. It is much more strongly related to the organisation rate of employers, i.e. the degree to which firms are members of employers' organisations that engage in collective bargaining.

- ***employer organisation density***: it can be defined as the proportion of all employers (firms) joining an employers' association. By taking into account the employment size of firms, an employment density rate for employers can be calculated, expressed in terms of the share of employees working in firms joining employers' associations.

- ***trade union density***: is defined as the percentage of workers who are members of a trade union.

- ***degree of centralisation of bargaining***: it is based on the *level* at which bargaining takes place in the economy. Traditionally, there are three main levels of bargaining: national, the (inter)sectoral or industry, and the company level.

- ***coordination of wage formation***: it relates to the extent to which wage negotiations are coordinated across the various wage bargaining levels/actors within an economy. Coordination is "*an attempt to achieve the same or related outcome in separate negotiations*<sup>1</sup>". The relation between coordination and degree of centralization is not given. For example, coordination is still possible in an environment of decentralised wage bargaining if coordination institutions are present. Alternatively, coordination can be difficult to achieve at a centralized level if there are divisions among unions. However, more coordination nearly always goes with more centralisation (see section 2.1)

- ***derogation clauses***: a specific form of decentralisation, opening up possibilities for companies to deviate from pay norms set under intersectoral or sectoral agreements, including minimum wages, when they suffer from temporary economic hardship. Derogation clauses can be of different kinds such as opening clauses, hardship clauses, opt-out clauses or, inability-to-pay clauses. Some agreements also foresee upwards derogations, allowing companies to exceed agreed norms, for example in cases of exceptional performance or for addressing specific labour shortages.

- ***variable pay systems (VPS)***: they increase wage flexibility by linking wages more closely to individual, group or company performance. VPS are frequently expected to

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<sup>1</sup> Sisson-Marginson (2002). Generally, a distinction is made between single-employer and multi-employer coordination (Marginson and Sisson, 2004). Single-employer coordination involves a vertical dimension and covers bargaining units at different levels where there is a dependency relationship and where outcomes at the subordinate level conform to parameters set at higher level. Conversely, multi-employer bargaining involves both a horizontal and a vertical dimension. This means that the coordination covers independent bargaining units at the same level as well as different levels internally within each of the participating organisations. It can also be organised by the trade unions or the works councils and be 'single-union' or 'multi-union', reflecting the coverage, the levels and the patterns of representation.

increase motivation, productivity and innovation. Under VPS, on top of the basic wage, workers receive performance- related variable pay elements that are dependent on the performance of the company as a whole, of the team to which a worker belongs, or of the individual worker.

- **extension** procedures (which are generally administrative or legal) make a collective agreement binding for all employees and employers within its usual field of application, even if some employers or trade unions did not directly sign the agreement.

- **length of agreements**: the average duration of bargained wage agreements.

- **wage indexation**: systems of ‘automatic’ wage adjustment procedures. Wage indexation aims to link wage development to the actual evolution of living costs to ensure that real wages are not overtaken by inflation. Wage indexation establishes a floor of wage developments for all wage groups which cannot be undercut by autonomous collective bargaining outcomes or individual agreements (although derogation procedures do exist here as well).

- **minimum wage**: the minimum wage is relevant to the issue of wage flexibility as it sets limits to wage flexibility by establishing a wage floor in the labour market. However, depending on the level at which the minimum wage is set, it may also play an important role in containing wage inequality and low pay.

## 2. MAPPING OF WAGE SETTING MECHANISMS ACROSS THE EU

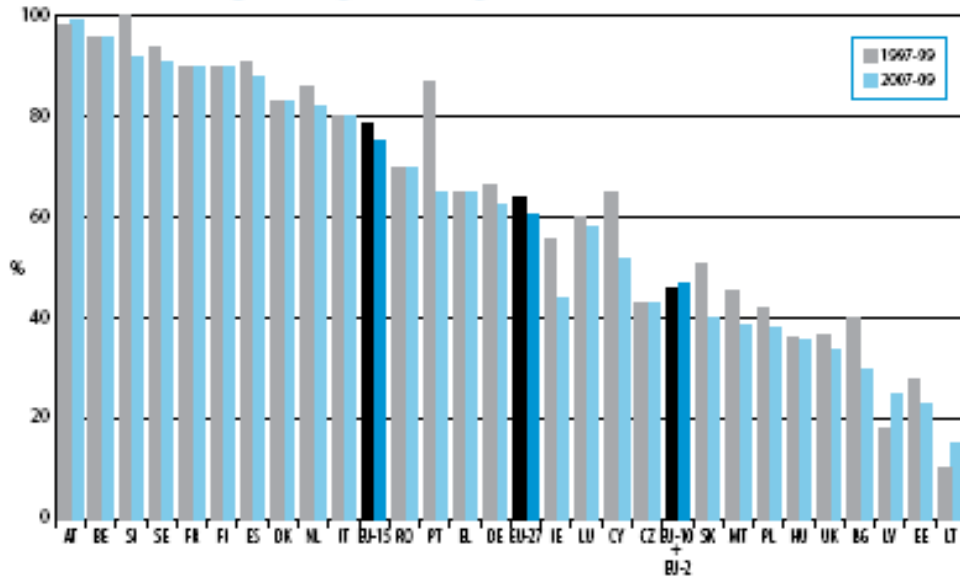
### 2.1. *Bargaining Coverage, Employer Organization and Trade Union Density*

An estimated 121.5 million of the 184 million employees in employment in the EU were covered by a collective agreement in 2008. This translates into a **bargaining coverage rate** of 66%, or two-thirds of all EU employees.

There was a small decrease in coverage rate in many countries, and some larger declines in Portugal, Slovenia, Slovakia, Cyprus, Malta and Poland in recent years. In the UK, bargaining coverage shrank from 54 % in 1990 to 32.3 % in 1998, but has since stabilised and was 33.6 % in 2008. Nonetheless, bargaining coverage in the UK is the lowest amongst the EU-15.

Collective bargaining structures and practices remain fragile in Central and Eastern Europe and coverage is low — the average of 43 % around the end of the decade is 4 percentage points below that in 2000. There was a decline in Estonia, Poland, Slovakia, Slovenia and Bulgaria, and a small rise, from very low levels, in Latvia and Lithuania. The rate was broadly level in Hungary and the Czech Republic. Low coverage rates and weak collective bargaining structures amongst the CEE countries tend to go together with a still considerable role for the state in private sector wage setting, mostly through the mandatory minimum wage.

Figure 1 Bargaining coverage rates in the Member States

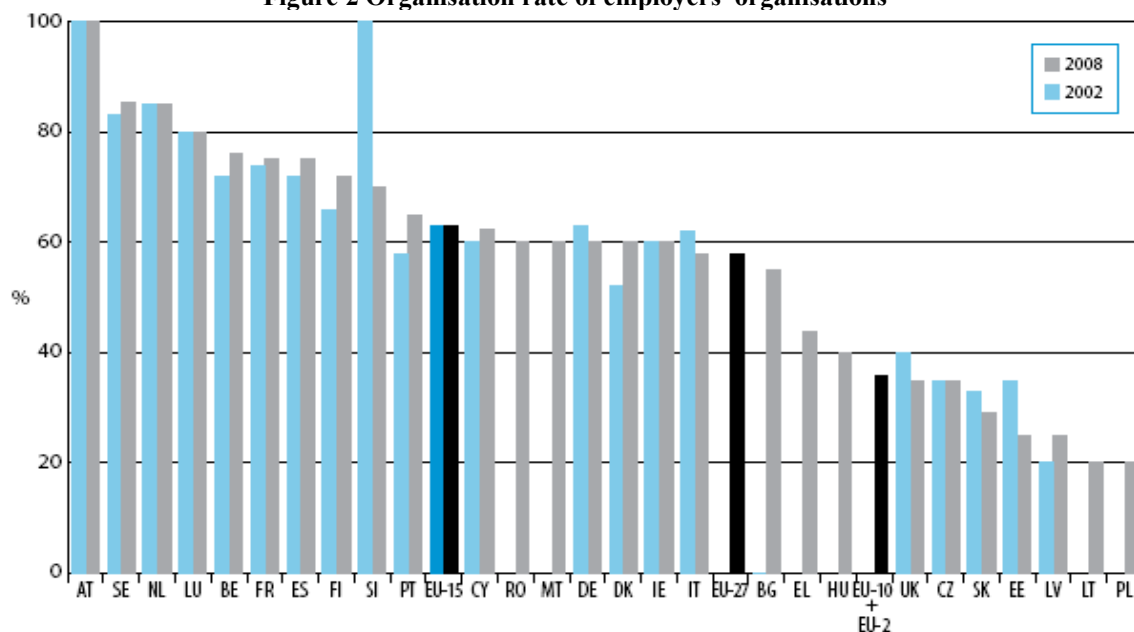


Source: J. Visser, ICTWSS database 3.0, 2010.

In 2008 approximately 106 million employees, or nearly 58 % of the relevant European Union total, worked in firms affiliated with *employers' associations*. This is more than double the level of unionisation, illustrating that maintaining high membership levels seems easier for employers' associations than for trade unions. Compared with 2000 in the EU-15 the organisation rate of employers is stable at 63 %. Within the EU-15 the organisation rate of employees decreased in Germany and the UK, but increased in Sweden, Denmark, Finland, Belgium, France and Spain.

The variation in the level of organisation across countries is considerable, with the 12 new Member States grouped towards the lower end, together with the UK (Figure 2). In central and eastern Europe only about one third of all employees work in firms organised in employers' associations. However, both Romania and Bulgaria appear to have rather high levels of employer organisation, and the same goes for Malta and Cyprus. Employers' organisations in CEE countries, like trade unions, find it hard to gain a foothold in the private sector, either because these firms are exceedingly small and rapidly changing, or because employers, especially in the international large firm sector, are reluctant to join or form associations for the purpose of collective services and representation. In addition, these organisations often lack a mandate from their members and their financial position is often too weak to enable them to provide adequate services to member firms. Frequently, this creates obstacles to social dialogue and collective bargaining.

Figure 2 Organisation rate of employers' organisations



Source: European Commission, *Industrial Relations in Europe 2010*, based on J. Visser, ICTWSS database 3.0, 2010; the averages for EU-27, EU-15 and 12 new Member States are weighted.

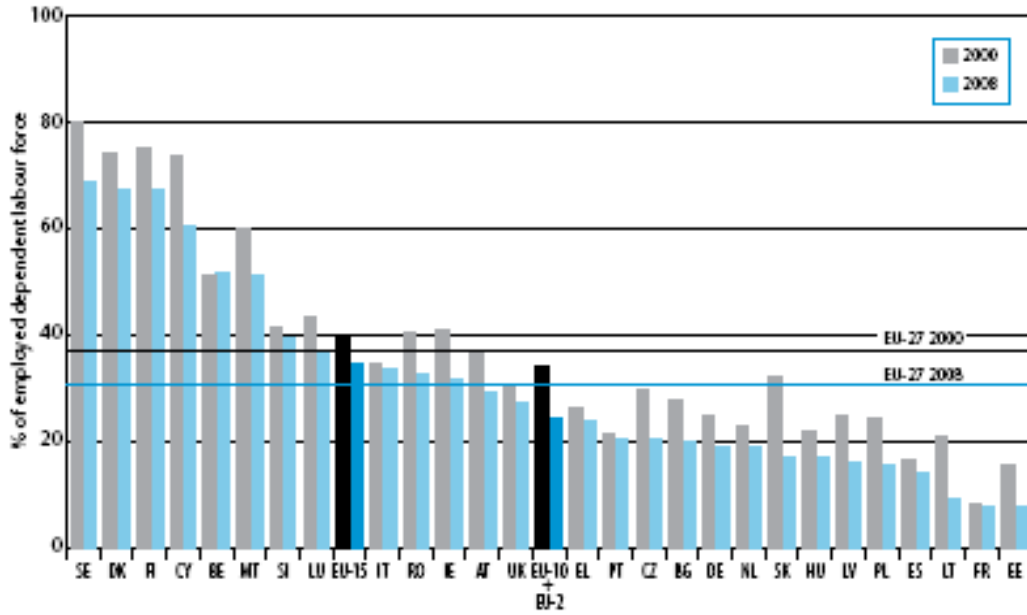
On aggregate, between 2000 and 2008 union membership among the employed salaried workforce in the EU fell by nearly 3 million people, from 46 to 43 million, whereas the number of non-unionised employees increased with more than 20 million from 120 million to 140 million people. As a result, **aggregate union density** — union members with paid employment as a proportion of all employed wage and salary earners — in the EU-27 fell from 27.8 to 23.4%.

In 2008, union density varied from 68.8 % in Sweden to 7.6 % in Estonia. In general, the lowest density rates are currently found in the CEE countries — Slovenia and Romania are the exceptions — and in southern Europe — where Malta and Cyprus are the exceptions. In the EU-15 the highest rates are found in Sweden, Denmark, Finland and Belgium.

Trade unions in Lithuania, Estonia, Slovakia, the Czech Republic and Poland have experienced the largest decline in membership since 2000 in percentage terms, while union membership has increased in Spain, Cyprus, Greece, Belgium and Italy. However, only in Belgium has there been no decrease in the share of union members among all workers.

Another trend is the lower and often decreasing unionisation rates of young people, the difficulty to recruit and retain union members in the expanding services sector, in small firms, and among those with flexible and fixed-term employment contracts

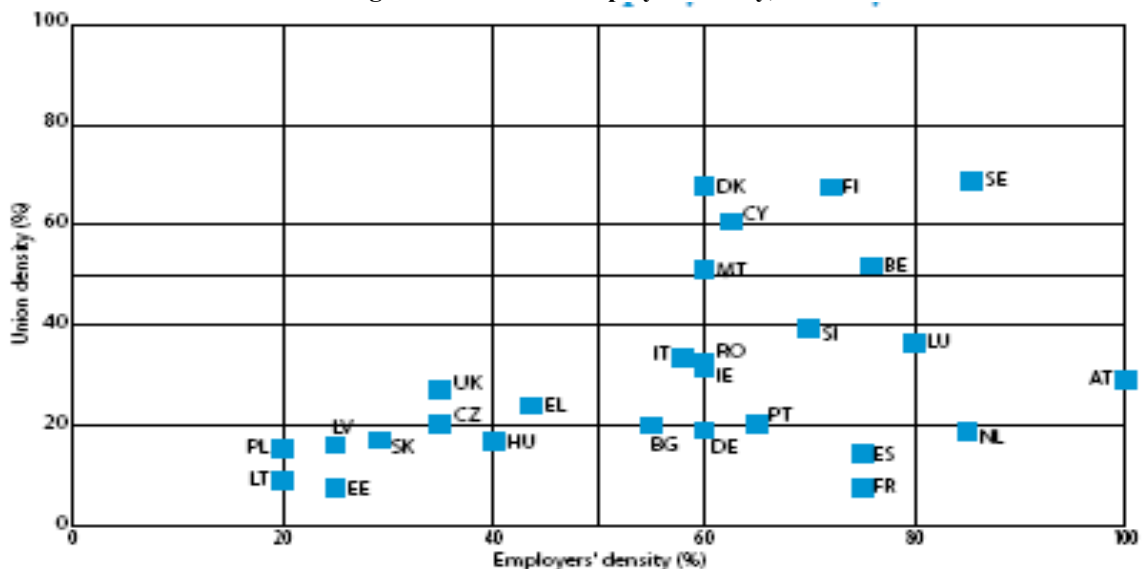
Figure 3 Union density in the Member States in 2000-2008



Source: J. Visser, ICTWSS database 3.0, 2010; the averages for the EU-27, EU-15 and 12 new Member States are weighted.

Finally, looking at the trade union density and employers organizations, three combinations are apparent: (1) high union density and high employer's density: the Nordic countries, Belgium, Malta and Cyprus; (2) low union density and low employer density: the UK and most CEE countries; (3) low union density and high employer density: countries in western and southern Europe.

Figure 4 Union and employer density, 2008.



Source: J. Visser, ICTWSS database 3.0, 2010.

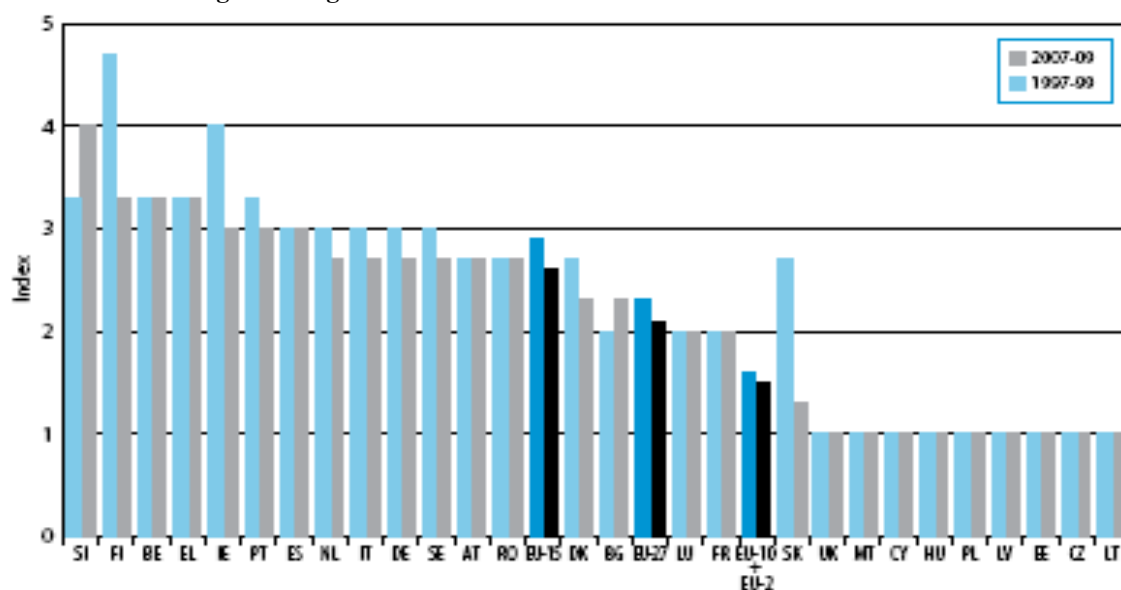
## 2.2. Degree of centralisation and coordination of collective bargaining

There is a great **diversity of situations** across Member States in terms of the degree of centralisation and coordination of collective bargaining.

The **sector** was the main level at which wage negotiations took place in Austria, Belgium, Denmark, Finland, Germany, Italy, the Netherlands, Portugal, Spain, Sweden and Slovenia. For more than half of all employees covered by collective agreements in these countries, there was no additional firm-level bargaining. In France, Ireland, Greece, Romania and Luxembourg, too, a majority of all employees were covered by agreements that set standards above the level of firms, but in each of these cases the sector plays a less prominent role than in the abovementioned group of countries<sup>2</sup>. Derogations (opting out) are used to some extent in all Member States, with somewhat more frequency in Germany, Ireland, and the Netherlands.

In 10 Member States the main and for most workers the only bargaining activity, if there is bargaining at all, is in the **company**: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and the United Kingdom.

Figure 5 Degree of centralisation in the different Member States<sup>3</sup>



J. Visser, ICTWSS database 3.0, 2010.

<sup>2</sup> In France, sector agreements define minimum standards, however, company bargaining is gaining more and more importance. Ireland braced itself for a return to company bargaining after the crisis broke out. Company negotiations prevail in Luxembourg and cover many employees, but the adjustment of the cost-of-living index, based on consultation with social partners, has remained a very important source of wage regulation. In contrast, in Greece and Romania, for most workers the national agreement, together with the law, is the only source of regulation of wages. (European Commission, Industrial Relations in Europe 2010).

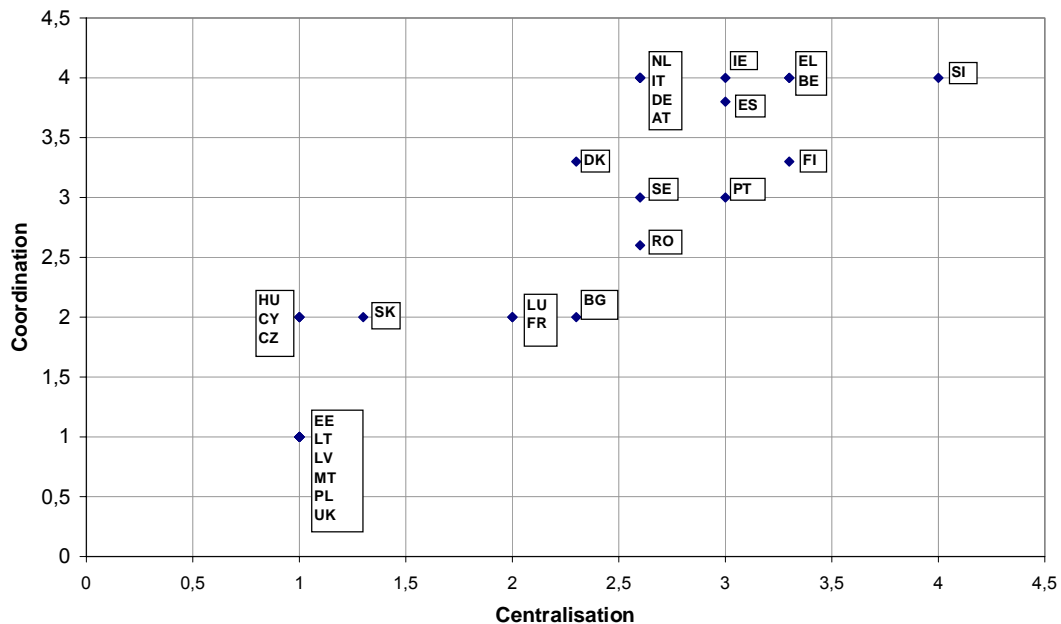
<sup>3</sup> Bargaining centralisation is based on the dominant level at which bargaining takes place. This is scored on a five-point scale: 5 = national (cross-sectoral) bargaining; 4 = national (cross-sectoral) bargaining with derogation and additional sector or company bargaining; 3 = sector- or industry-level bargaining; 2 = sector- or industry-level, with additional local or company bargaining; and 1 = local or company bargaining.

If *coordination* is also taken into consideration (see Fig. 6), there are *two main groups* in the EU:

- On the one hand the economies of Hungary, Czech Republic, Poland, Slovakia, the Baltic countries plus Malta, Cyprus and the UK, where on average decision-making over wages is taking place in the company, with less coordination among bargaining agents or units (lower left corner).
- On the other hand, the continental European countries of north and south Europe, plus Ireland and Slovenia, where decisions over wages are also influenced by bargaining agents above the level of firms and these agents coordinate among themselves (upper right corner).

Within each group, however, there is considerable variation: for instance France scores much lower on coordination than Germany, Italy or Spain, and a more coordinated wage bargaining approach in Romania compared to the rest of the new Member States.

**Figure 6 Bargaining centralisation and coordination in the Member States, 2007-2009<sup>4</sup>**



*Source: European Commission, Industrial Relations 2010.*

<sup>4</sup> The coordination index is derived from Kenworthy (2001) and has the following values: 5 = economy-wide bargaining, based on (a) enforceable agreements between the central organisations of unions and employers affecting the entire economy or entire private sector, or on (b) government imposition of a wage schedule, freeze, or ceiling; 4 = mixed industry and economy-wide bargaining: (a) central organisations negotiate non-enforceable central agreements (guidelines) and/or (b) key unions and employers associations set pattern for the entire economy; 3 = industry bargaining with no or irregular pattern setting, limited involvement of central organisations, and limited freedoms for company bargaining; 2 = mixed or alternating industry- and firm-level bargaining, with weak enforceability of industry agreements; 1 = none of the above, fragmented bargaining, mostly at company level.



The main *trend* in industrial relations of the European Union in the past two or three decades has been towards *decentralisation*. This means that the centre of gravity in decision-making on employment contracting, wages and human resources has moved – to a smaller or larger extent – closer to the firm. More commonly, decentralisation takes the shape of a shift in emphasis between bargaining levels, with the importance of company or local-level collective bargaining gaining at the expense of sectoral collective bargaining, or of sectoral bargaining gaining at the expense of inter-sectoral bargaining.

In terms of the *process* involved, distinction can be made between organised decentralisation<sup>5</sup> — increased scope for company-level bargaining but within the framework of rules and standards set by higher-level agreements — and disorganised decentralisation<sup>6</sup>, that is, the replacement of higher-level bargaining by company bargaining<sup>7</sup>.

### **2.3. Derogations to collective bargaining**

Rather than standard terms, collective agreements at sectoral or inter-sectoral level tend to set *minimum conditions*; or in some cases, the terms set by collective agreements *allow deviation* both above and below the norm, if some procedural conditions — for instance, fair negotiations involving representatives from the group of workers making concessions — have been met.

Derogation allows for more attention to *company-specific conditions* and allows companies to address their specific competitive needs and problems. The reasoning behind such deviations is that they are an instrument that may permit companies to overcome temporary economic difficulties without resorting to (mass) layoffs. This may help to prevent workers from becoming unemployed, avoid costly layoff procedures and preserve human capital for the company.

They have received growing attention and interest in recent years in academic and policy debates in Europe, particularly since the present economic and financial crisis started to put many companies and jobs under pressure.

As seen on fig. 6, higher-level bargaining, with derogation clauses, is dominant in the EU-15 and Slovenia. Although derogation is present in most Member States with industry-wide bargaining, Ireland and Germany have the highest percentage of employees covered by higher-level agreements which contain derogations (see more details in Annex I).

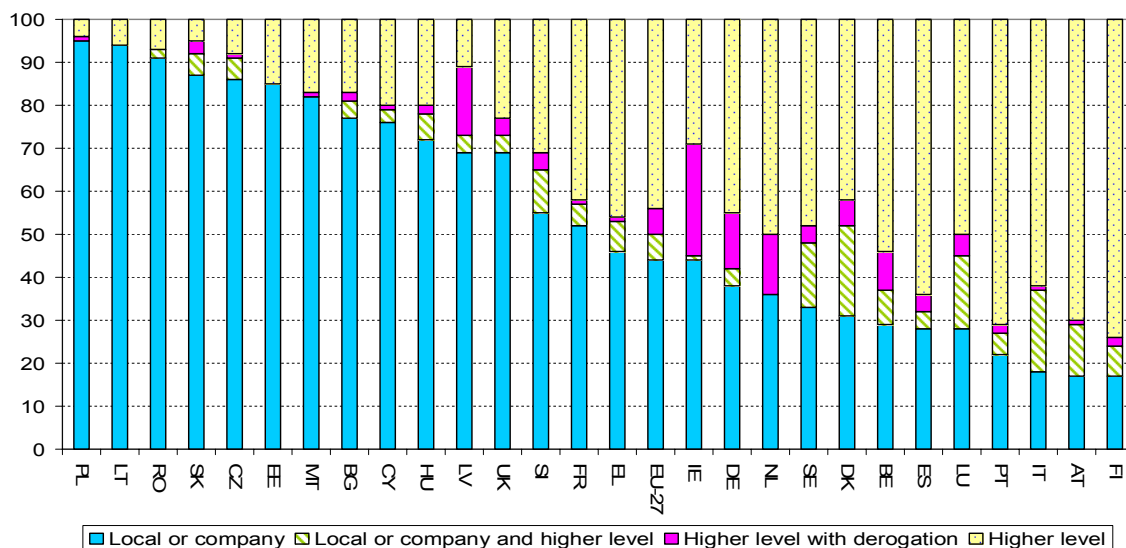
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<sup>5</sup> For example in the Nordic countries from 1990's (EC, 2010)

<sup>6</sup> For example in the UK or in Central Eastern Europe in the 1990's. (EC, 2010)

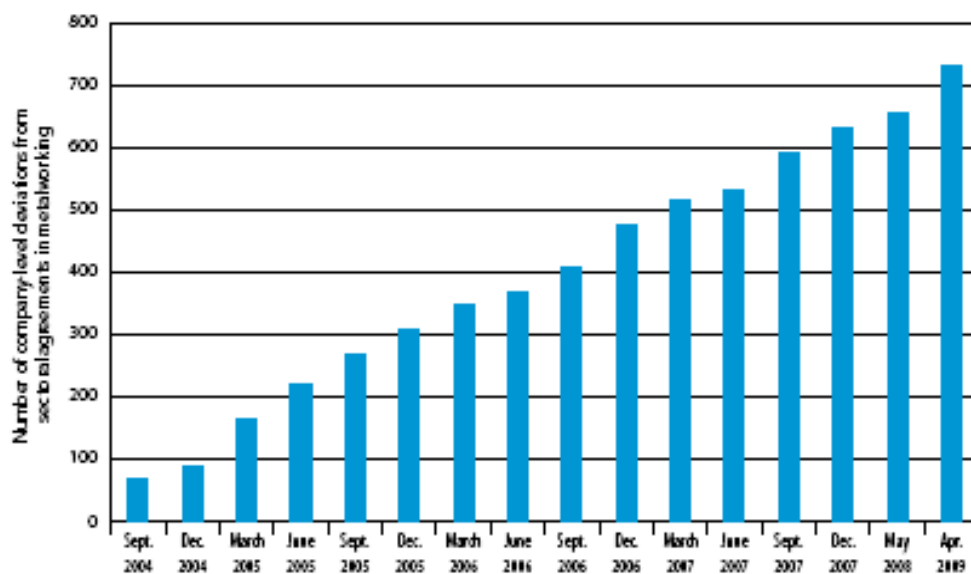
<sup>7</sup> Traxler (1995)

**Figure 7 Employees falling under different levels of collective agreements, private sector, 2009<sup>8</sup>**



Source: J Visser, ICTWSS Database 3.0

**Figure 8 Number of company level deviations from sectoral agreements in metalworking in Germany, 2004-2009**



Source: Bispink and Schulten (forthcoming).

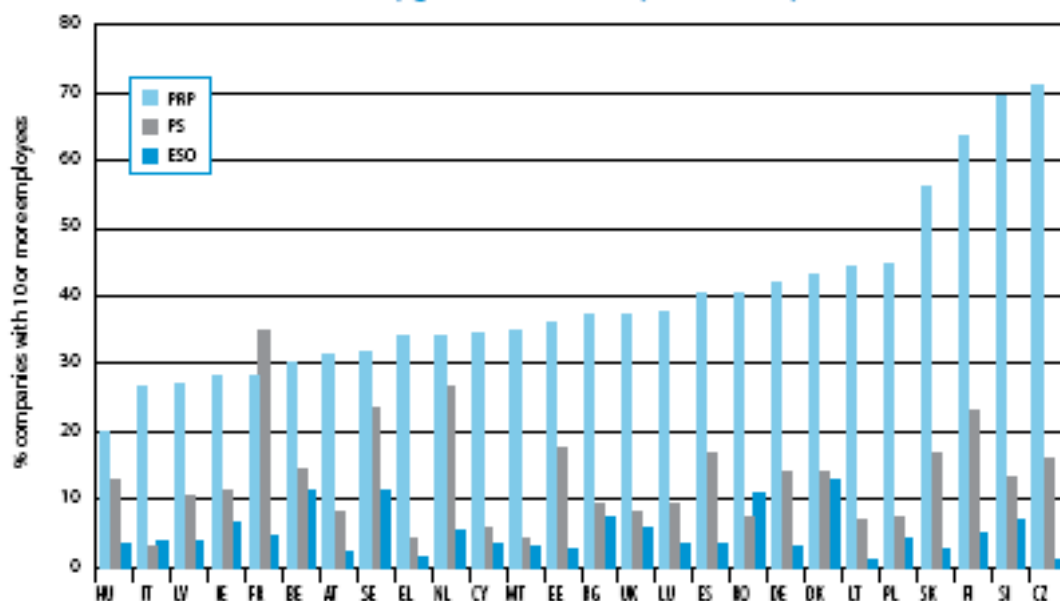
<sup>8</sup> As a per cent of total employees covered by any type of agreement, in establishments with 10 or more employees. Local or company level means single-employer bargaining at establishment or firm level. Higher level means higher than firm level. The two levels can also combine, when the multi-employer agreement sets out a framework that is further developed at company level, or when at company level derogations from higher-level standards are possible, for example in times of economic difficulties.

## 2.4. Variable pay systems and other elements of flexibility

In addition to the trend towards the decentralisation of wage setting, the increasing use of variable pay systems (VPS) is providing another element of flexibility. Among these are performance-related pay, profit sharing and employee share ownership.

VPS are a widespread, although far from universal, feature of contemporary pay systems in the EU. Across the EU-27, one or more types of VPS are found in 44.5 % of companies with 10 or more employees, employing 56.6 % of employees. Conversely, this means that just over half of companies, employing just under half of the relevant workforce, do not use any from of VPS. The growth in the use of VPS reflects the growing interest in variable pay arrangements on the part of employers. It has prompted, and been facilitated by, the decentralisation of pay setting.

Figure 9 Types of VPS in the Member States, 2009



Source: ECS 2009.

Other possible forms of flexibility in the wage setting systems can be also found across the EU:

- In *Italy*, the cost of living related wage increases have been negotiated at the sectoral level while company-level bargaining has dealt with **additional pay** elements linked to productivity, quality and competitiveness improvements, or company economic performance.
- In *Sweden* recent collective agreements in industry have incorporated provisions for local pay review and opportunities for individuals to negotiate their own wages (Granqvist and Regner, 2008).
- In *Denmark*, recent agreements in industry detail general conditions and procedures, as well as minimum, youth and entry wages, and leave the **allocation and division** of pay rises to firm-level negotiations.

- In the *Netherlands*, most sector agreements detail pay increases, but there is now a staggering diversity in types of agreements. In the private sector area of FNV Allies and the employers' federation AOVN, which covers some 700 of the country's 1 000 agreements, 36 % of all agreements are multi-level, 55 % have *à la carte* provisions which allow employees to make a choice between types of working hours arrangements and **between pay and working hours**, and the building up of 'personal budgets' for training, paid leave and early retirement (Zielschot, 2010).

## 2.5. *Extension procedures*

Extension procedures are widespread in many Member States. Usually, extension applies to similar firms in the same sector or branch of economic activity. In some countries the mechanism is used to include all firms under a national agreement, for instance in Belgium with regard to the minimum wage. In a few countries extension mechanisms are used to apply the agreement outside the sector by means of a procedure termed 'enlargement'.

The possibility of *legal extension* of collective agreements exists in 19 out of 27 EU Member States. In eight (Austria, Belgium, Luxembourg, Finland, France, Spain, Portugal and Greece) the practice of extension is widespread and quasi-automatic, and in four of these countries agreements can be applied in other sectors (Austria, Spain, France) or regions (Portugal).

In some countries extension is legally possible but *hardly practiced* because few sector agreements are reached; Poland, Lithuania, Czech Republic, Germany, the Baltic States, the Netherlands and Bulgaria, in recent years also Slovakia and Hungary, are cases in point.

## 2.6. *Length of agreements*

Concerning the *duration* of agreements, European countries with the longest average agreement length of *three* years are Sweden, Denmark and Ireland.

In contrast, average agreement lengths of *one and one and a half year's* duration are found in Austria, Czech Republic, Estonia, France, Hungary, the Netherlands, Portugal, Poland and the United Kingdom.

In Belgium, Cyprus, Finland, Germany, Greece, Italy, Luxembourg, Norway, Slovenia and Spain, agreements frequently last *two years or two years and a half*. In Europe as a whole, very little change in the average agreement length is apparent over the last decade.

*Pre-expiry negotiations* are frequent in the Czech Republic, Estonia, Germany, Luxembourg, the Netherlands, Slovenia, Sweden and can be related at times to cyclical downturns and concerns about competitiveness (Luxembourg) or financial problems at the company level (Netherlands). (DuCaju et al, 2008).

## 2.7. *Wage indexation*

Systems of wage indexation, where some form of general index prescribes the development of employees' wages, are currently in place in four EU countries: Belgium, Cyprus, Luxembourg and Malta. Adjustment is based on price inflation and aims to maintain real wage levels. In

addition to these four Member States, a number of other EU countries used to have such a system of wage indexation in the past but have now abolished it – this is the case for example in Denmark, France, Italy, or the Netherlands and Spain. Spain is an example of a country where wage indexation is in practice present in most collective agreements, although it is no longer prescribed by law.

The effect of such a system on the macro-economic outcomes can vary greatly depending on the coverage (what is indexed), the method of adjustment (is the ex-ante or ex-post inflation, that is the basis, is it the CPI or a refined indicator), derogations (if there is possibility for opting-out), monitoring, and the regularity of adjustments.

In **Belgium**, the system links pay and social security benefits to the health index (*Gezondheidsindex*) in order to prevent the erosion of purchasing power by inflation. Although wage indexation existed in the past, the current health index was introduced in 1994 and established an adjusted core inflation measure that excludes the prices of tobacco, alcohol and transport fuel (Organisation for Economic Co-operation and Development (OECD), 2007). For most workers, the automatic adjustment takes place once a year during the first quarter. Automatic wage indexation also includes the public sector and the minimum wage settlement. The state closely monitors the automatic indexing of wages in order to prevent an upsurge in relative labour costs, which could jeopardise external performance. Two laws were passed in 1989 and 1996, authorising the government to intervene in the wage-setting process. At present, the forecast of increases in foreign hourly labour costs among trading partners (France, Germany and the Netherlands) serves as a maximum wage increase limit at all levels – that is, at cross-sectoral, sectoral and company levels. This means that wage developments can only take place within the range defined by the indexation floor and the wage norm ceiling (Eurofund, EIRO, March 2009a).

In **Luxembourg**, The automatic revaluing of wages and salaries – also called the ‘sliding wage scale’ – was introduced by law in 1975. The adjustment mechanism based on inflation takes place on a retroactive basis once the CPI has risen above 2.5% in the previous six months. In addition, the national minimum wage and social benefits are updated in line with automatic indexation (Schintgen, 1990). The social partners participate in the tripartite body, which is in charge of monitoring the system of wage indexation and has the capacity to temporarily suspend wage indexation if economic difficulties arise. This procedure was used in 2006, for example, when the Tripartite Coordination Committee concluded an important agreement establishing, among other measures, a temporary suspension of automatic wage indexation to slow down wage developments given the difficult economic climate (Eurofund, EIRO, October 2006; OECD, 2008).

In **Malta**, since 1990, the COLA is added to the pay of all workers based on the rate of inflation over the previous 12 months, as calculated by the Retail Price Index (RPI). The RPI is established by a management board comprising a chairperson, the director of the National Statistics Office (NSO), two government representatives, two representatives of industry and two trade union delegates. A derogation procedure is also provided for, which can be invoked by companies facing economic difficulties. However, it requires prior application for authorisation from the country’s Ministry of Education, Employment and the Family.

In **Cyprus**, the COLA is used as a basis for pay increases. According to the current system for calculating the COLA, every six months (on 1 January and 1 July) the wages of all employees covered by collective agreements are readjusted on the basis of the percentage change in the CPI over the preceding six-month period. Given that wage indexation in Cyprus applies to the outcomes of collective bargaining, in theory it applies only to workers covered by collective

agreements. However, in practice, wage indexation covers all employees, regardless of whether they are a member of a trade union.

In *Spain*, although it is not established as a national practice by law, wage indexation has been widely used. To avoid inflationary pressures, the index used for calculating wage developments is the forecast inflation rate – that is, not the rate of inflation in the previous time span.

**Figure 10 Summary of wage adjustment systems, by country**

	<i>Coverage</i>	<i>Method of adjustment</i>	<i>Regularity of adjustment</i>	<i>Type of collective bargaining</i>	<i>Derogation procedure</i>
<b>Belgium</b>	Pay, minimum wage, social benefits	Health index = CPI excluding the price of tobacco, alcohol and fuel energy	Usually every year during the first term	More centralised. Wage setting is monitored by the state.	Yes, but it is rarely used
<b>Cyprus</b>	Pay	CPI	Every six months	Decentralised	No
<b>Luxembourg</b>	Pay, minimum wage, social benefits	Only applied if CPI rises above 2,5%	Every six months	Rather decentralised	Yes, if the Tripartite Coordination Committee finds it necessary
<b>Malta</b>	Pay, minimum wage, pensions	RPI	Every year	Decentralised	Yes

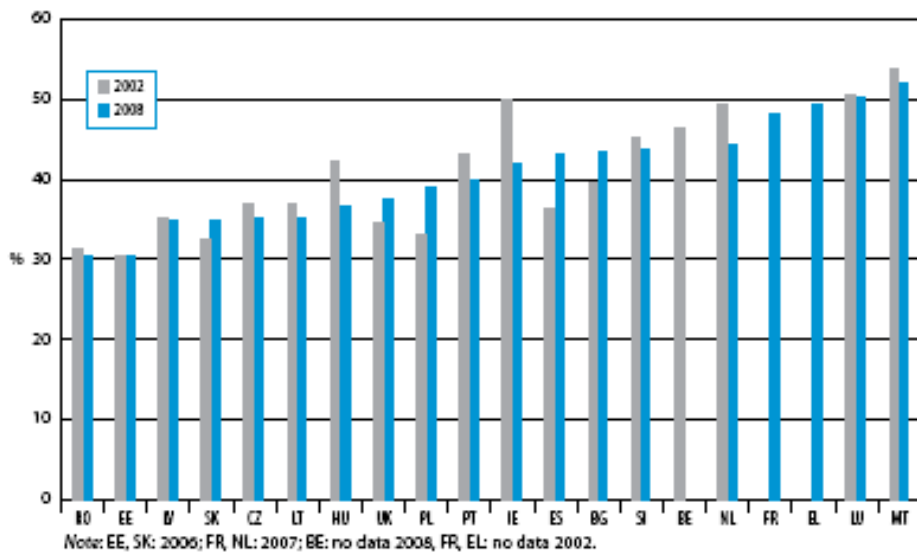
*Source: Eurofund, type of collective bargaining; European Commission, Industrial Relations in Europe 2010*

## **2.8. Minimum wage**

Minimum wages establish a wage floor in the labour market. They can be set by law or by collective agreements. Statutory minimum wages are the most common mechanism. Twenty Member States have a national minimum wage that is set either by law or by a national inter-sectoral agreement. In Germany, Italy, Denmark, Austria, Sweden, Finland and Cyprus however, there is no general statutory minimum wage. In Cyprus, a statutory minimum wage exists for a limited number of occupations only. Elsewhere, the setting of minimum wages has traditionally been left largely to trade unions and employers who define minimum wages in collective agreements, mainly at the sectoral level.

According to Eurostat, in 2008 the level of the statutory minimum wage exceeded 50% of the average wage only in Luxembourg and Malta, whereas in 10 Member States it amounted to less than 40%. Moreover, during the same period the minimum wage lost some terrain to the average wage in 11 countries, most strongly in Ireland and the Netherlands. Conversely it increased by more than the average wage in five countries, in particular in Spain and Poland.

**Figure 11 Monthly minimum wage as a percentage of monthly minimum earnings, industry and services, 2002 and 2008**

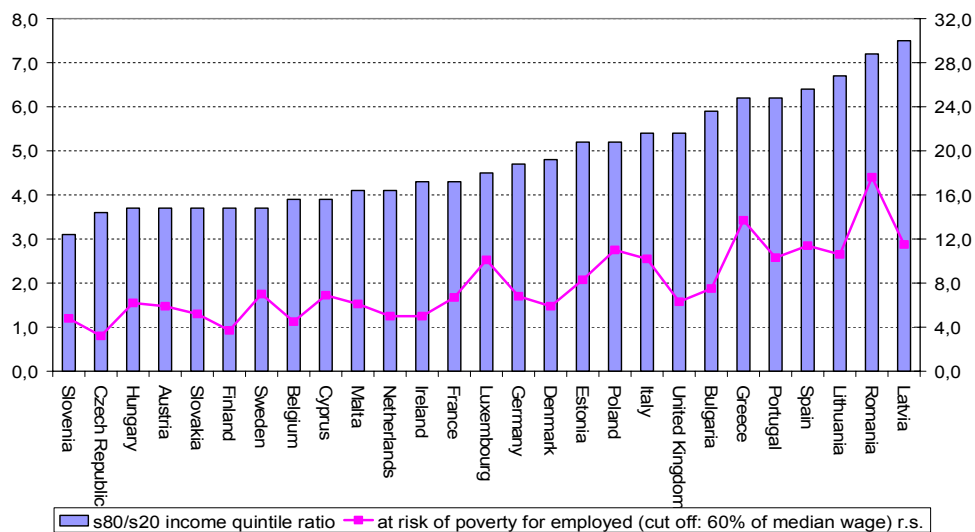


Source: Eurostat.

Depending on the level at which the minimum wage is set, it may play an important role in containing wage inequality and low pay. The generalised decline of trade union density across Europe, combined in some countries with a declining coverage of collective wage bargaining and/or the decentralisation of wage bargaining are factors that are negatively correlated with wage inequality and therefore make the minimum wage more relevant in this respect.

One consequence of collectively agreed instead of statutory minimum wages is that minimum wages may not be uniform, but differ by sector and possibly also by type of job or by region. In sectors where trade unions are weak, collectively agreed minimum wages may be low as compared to similar countries with a statutory minimum. However, the presence of a statutory minimum wage does not necessarily lead to a lower incidence of low pay. As seen on fig. 12, both statutory and collectively agreed minimum wage can go together with higher income inequality and higher incidence of at-risk poverty for employed persons (Latvia and Italy, for example).

**Figure 12 Income inequality and at-risk of poverty rates in 2009**



Source: Eurostat

### **3. CONCLUDING REMARKS**

The wage-setting systems vary greatly across the European Union. The level of bargaining, the coordination, the use of indexation mechanisms, the coverage of collective agreements, the degree of employer organisation, the density of unions and the possible derogations and other flexibility elements provide a complex picture of wage setting mechanisms.

Wage flexibility and the role of wage setting institutions in fostering or limiting such flexibility, just as the trade off between job/employment flexibility and stability, have been at the core of the European economic and labour market debate for some time.

Research focusing on either aspect of wage formation systems is inconclusive, with the results depending on the methodology and time-frame used. Furthermore, complementarities and the interactions between each aspect are important for the impact of collective bargaining on economic performance, and it can therefore be misleading to focus on one particular aspect in isolation. Any kind of "optimum" between flexibility and stability is difficult to define, thus even more difficult to achieve, and putting the issue in the context of macro-economic imbalances, the picture becomes even more complex. This would point to the need to assess each system according to its own individual advantages and disadvantages.



## **Annex I**

### **Possible derogations<sup>9</sup>**

- In **Austria**, no derogations are foreseen by law. Sectoral agreements can include opening clauses which under certain conditions allow companies to undercut standards set by sectoral agreements.

The most prominent example of flexibility is the "*distributive option*" (*Verteilungsoption*), according to which a part of the agreed increase of actual wages should be distributed not to all employees within the company but only to specific groups, including vulnerable groups – such as low-paid employees, younger workers and women – but also the more productive employees. For example, in 2007, 0.3 % of the actual wage increase could be distributed flexibly, in line with certain criteria (e.g. compensation for especially low incomes or high performance, reduction of the gender-related pay gap, etc.) to be agreed upon by the parties to the works agreement

- In **Belgium**, labour legislation does not explicitly provide for the possibility of company-level deviations. Opening clauses however exist in sectoral agreements, which allow companies in economic difficulties not to implement the wage increases determined in the respective sectoral agreement (in some cases this includes the increases of the sectoral minimum wages), or deal with additional wage and labour cost elements such as premiums.

In practice, in the period from 2005 until today, opening clauses dealing with wages appeared in sectoral agreements covering six (sub)sectors: engineering; metal manufacturing; food manufacturing; retail of food products; large retail stores; department stores. These sectors together cover only a small part of the Belgium economy and labour market. Also, they are hardly ever applied at company level and the total number of companies using these clauses is likely to be fewer than 10 a year.

- Similarly, in **Germany**, the law does not regulate derogations to the detriment of employees. According to the "favourability principle" (*Günstigkeitsprinzip*), company-level departures from sectoral agreements are usually possible only when these favour employees. However, the bargaining parties may include *opening clauses* in sectoral collective agreements that allow, under certain conditions, a divergence from collectively agreed standards, even if this changes employment conditions for the worse.

In Germany, all important sectoral agreements now contain some opening clauses. However, their content can vary widely. The wage issues they affect range from basic pay to bonuses, they can concern absolute reductions or rather derogations from agreed wage increases. Also, they sometimes involve postponement of the payment of the wage elements in question, a reduction or even a complete annulment – in the case of bonuses, for example. Sometimes the use of an opening clause is restricted to a situation when a company is in serious economic difficulties; in other cases it can be used for improving competitiveness. In exchange, employees may be offered enhanced *job security*, such as a commitment by employers not to resort to compulsory redundancies over a defined period

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<sup>9</sup> This section follows the Eurofund issue on Derogation clauses which examined 7 Member States (AT, BE, FR, DE, IE, IT, ES), 2010. <http://www.eurofound.europa.eu/pubdocs/2010/87/en/2/EF1087EN.pdf>

of time. Where the use at company level is concerned, according to the Institute of Economic and Social Research (WSI) works council survey, in 2010: 16% of establishments used opening clauses to set lower pay rates for job starters; 14% reduced or suspended annual bonus payments; 13% deferred agreed pay increases; 9% cut basic pay.

- In **France**, traditionally, there was no general mechanism providing for derogations and lower-level agreements. This partially changed with the 2004 Fillon law. Now, a lower-level agreement may *deviate* from the provisions of a higher-level agreement unless such derogation is expressly forbidden. Four major issues are exempted from any derogation at company level: minimum wages; job classifications; supplementary social protection measures; multi-company and cross-sector vocational training funds. However, although systematic data are lacking, no noticeable increase can be observed in the use of company agreements and industrial relations actors rather continue to follow traditional bargaining practices, not undercutting sectoral wage agreements at company level.
- In **Spain**, since 1994, the Workers' Statute contains a mandate to include an opt-out clause in collective agreements at sectoral or intersectoral level allowing companies to adopt lower wages than those agreed at higher level when they temporarily undergo economic difficulties. Most recently, the Royal Law Decree 10/2010 of 16 June, on urgent measures on the reform of the labour market, modifies the legal framework for the use of wage opt-out clauses aiming to make it easier to use them (however, the ratification of this Decree by the Spanish Senate is still pending at the time of finalising this report).

According to the new law, following a consultation procedure, a company agreement between the employer and the employee representatives *might depart* from the wages fixed by a collective agreement negotiated at a higher level, when, as a result of the application of those wages, the economic situation and prospects of the company could be damaged and affect jobs. This agreement, which can only apply while the collective agreement at a higher level has not exceeded its term or, in any case, for a maximum period of three years, must clearly determine the new remuneration to be paid and a schedule of gradual convergence towards the previously applicable wages.

In practice, wage opt-out clauses were included in 51% of sectoral agreements, covering 74% of workers in 2009. However, from the (scarce) data available it emerges that there are not many companies using the opt-out clauses to achieve a reduction of wages or labour costs. A report from the Bank of Spain shows that when facing economic difficulties, only 4.6% of undertakings decide on using the opt-out clause to reduce wages, while 70% choose to dismiss workers.

- Finally, in **Ireland**, the National Minimum Wage Act includes an "*inability-to-pay*" clause. When an employer cannot afford to pay the minimum wage due to financial difficulties, an application may be made to the Labour Court which can, following an inquiry, exempt the employer from paying the minimum rate for three to 12 months. The employer must be able to demonstrate that the proposed exemption would be needed to preserve jobs and has the consent of a majority of the employees, who must also agree to be bound by the Labour Court decision.

In Ireland, since 2003, the national social pacts have included an inability-to-pay clause. The clause concerns employers that can prove that they are in difficult financial circumstances in which full payment of nationally agreed wage increases would mean

serious loss of competitiveness and employment. If their application is successful, they can refrain from paying all or some of the pay increases due in a wage agreement. There is no precise administration of all cases in which this clause was used but between the introduction of the 'inability-to-pay' clause in the national wage agreement and the end of 2008, 339 related cases have been notified to the LRC, and 175 or 52% completed by the Labour Court. The earlier-mentioned inability-to-pay clause of the National Minimum Wage Act, under which companies in economic difficulties can be exempted from paying the full statutory minimum wage for a period between three and 12 months, is used much less.