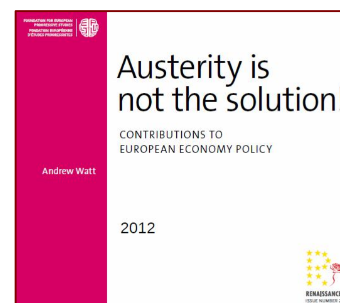
A role for wage setting in a new EU economic governance architecture after the crisis*

Andrew Watt, 2012.



I. Introduction

Important lessons for wage setting in Europe need to be drawn by policymakers, including trade unions, from the economic crisis and the period that preceded it. This is the case particularly within the euro area, where the absence of exchange rates means that the competitive position of domestic firms is determined by relative goods prices of which the most important driver is unit labour costs (ULCs). The existing governance regime has clearly failed. A new institutional architecture is currently being developed in Europe in a process itself driven by political crisis. The outcome of that process is far from clear at the time of writing. This contribution focuses on a possible contribution for wage-setting or 'wage policy' as part of a broader reform of economic governance.

Macroeconomic imbalances have been shown by the crisis to be a serious problem, also within a monetary union. Prior to the crisis some countries ran large and persistent trade and current account deficits, others surpluses. These necessarily require financial transfers from surplus countries to those running deficits. The only question is what form such transfers take. Before the crisis they consisted primarily of a piling up of financial claims on the private and public sectors of deficit countries on the southern and western 'periphery' of the euro area in the banks of countries in the 'North', above all, Germany. The crisis led to doubts as to whether these debts could be repaid, and lending dried up ('sudden stop'). The authorities had to step in, channelling public funds in various forms (ECB support for banks, the European Financial Stability Facility etc.) to the deficit countries.

Unable to devalue to restore price competitiveness, but lacking the benefits of the automatic transfers that normally assist adjustment in monetary unions[1], the 'peripheral' countries faced the major challenge of consolidating their public finances while at the same time needing to improve their competitiveness relative to the core. This relative improvement could be achieved via European investment support (to raise productivity, although this takes time) and expansionary policies on the part of surplus countries (especially Germany). However, lacking leverage over core countries, and increasingly under the political diktat of these countries, they have so far been forced into deflationary policies, condemning them to a long period of recession and stagnation. Moreover, this is also having negative implications for the currently more resilient, but export- dependent, economies in the euro area and beyond. This risks condemning the European economy as a whole to an extended period of fiscal austerity, slow growth and high unemployment. This is precisely the opposite of the vision of smart and inclusive growth set out in the EU 2020 strategy (Leschke/Theodoropoulou/Watt, 2012).

A look at the facts clearly confirms the close empirical link between wage setting (specifically nominal unit labour costs) and current account imbalances.

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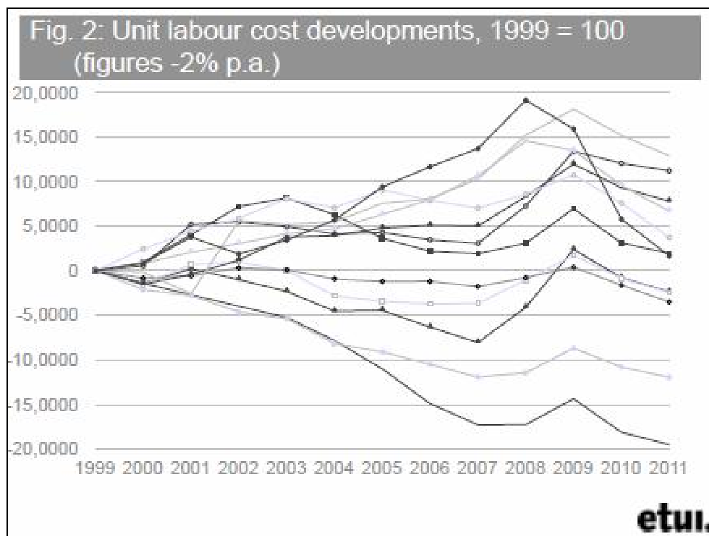
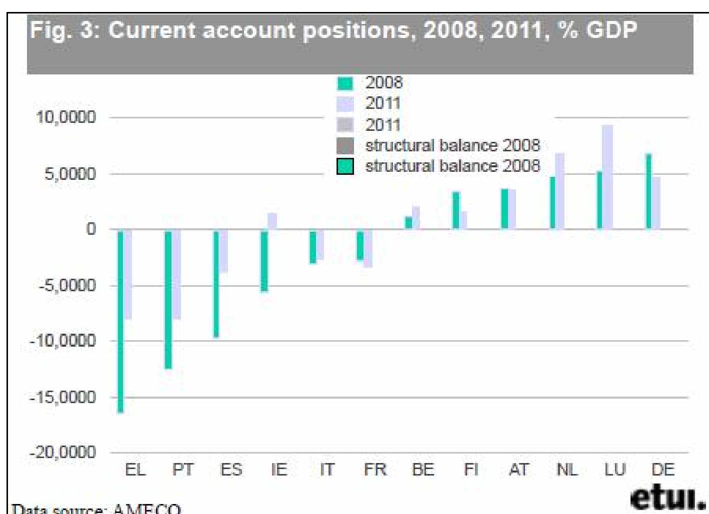
[1] In a monetary union such as the US or UK the national income tax, unemployment benefit and other systems 'invisibly' transfer resources from wealthy regions to poorer ones with high unemployment without the need for an explicit bail-out.





Euro area countries in which unit labour costs -the labour costs in current euros of producing one unit of GDP - rose faster than the average (such as Greece, Ireland, Italy, Portugal Spain - the 'GIIPS') were those countries that had the largest deficits by 2008, when the crisis hit. Conversely Austria and, especially, Germany had below- average unit labour cost growth and large current account surpluses.

II. The causes of macroeconomic imbalances

One must beware of drawing premature conclusions from this correlation, however. It is vital to understand how the imbalances came about and how they can be avoided in the future. Too often the simplistic conclusion is drawn that excessive wage growth has ruined the competitiveness of the southern euro area countries, making it impossible for them to recover from the crisis and service their public debt, and requiring bail-outs by countries that have followed 'prudent' wage policies. The solution, widely considered self-evident, is to cut wages in the Gil PS countries. And the appropriate way to do that is supposedly to decentralise wage bargaining in order for wages to be set at a level closer to 'the market' and thus in a way that is sensitive to competitiveness considerations.

Let us start with unit labour costs. For a given rate of productivity growth the growth of nominal wages determines the pace of growth of nominal unit labour costs. Both empirically and theoretically these are in turn closely linked to the rate of price increases (Watt, 2007). Within a monetary union, that is where there is no possibility of a nominal exchange-rate adjustment, changes in relative nominal unit labour costs are equivalent to changes in the real exchange rate, the measure of a

country's international price competitiveness. Thus the gap in ULCs in figure 1 can be interpreted as a measure of the change in price competitiveness of countries within the euro area since it was established.[2]

Correlation does not necessarily imply causation, however. It is argued here that the problem of macroeconomic imbalances arose as a result of the whole structure, the 'rules of the game', of EMU. Curing such imbalances and preventing them occurring in the future needs a more effective and balanced system of economic governance for EMU, within the framework of which wage-setting also needs to be considered as a 'matter of common concern' across national borders and is coordinated.

How did the institutional structures and economic characteristics of EMU generate imbalances?[3] On joining EMU, previously high- inflation countries which had had high interest rates benefited from a sharp fall in borrowing costs, setting off a seemingly-virtuous circle: these fast-growing, high-inflation economies enjoyed relatively low real interest rates (the common ECB-rate minus their high inflation rates), while slow-growing, low-inflation countries were in a vicious circle (suffering from relatively high real interest rates). This dichotomy was exaggerated by the one-sided nature of the Stability and Growth Pact (SGP): slow-growing economies were up against or over the 3% limit and prevented from pursuing expansionary fiscal policies, while faster-growing economies were not constrained to run tighter policies: Spain and Ireland had no problem sticking to the Pact thanks to their much faster pace of nominal GDP growth.

On the back of low interest rates, asset (especially house) prices rose rapidly in the peripheral countries, creating wealth and confidence effects that further stimulated spending and borrowing. Capital was channelled from the core to the periphery to finance asset purchases and, more generally, to finance the current account deficits. This dynamic spilled over into the labour market. Employment growth was strong - Spain created more than one third of all the net jobs created in the euro area up to 2007 - and unemployment fell significantly, by around 4 percentage points in Greece, Spain and Italy (although this only brought it down from very high to still rather high levels). By contrast - and this fact is now often overlooked - Germany's labour market performance was extremely weak during the pre-crisis EMU period. Unemployment remained broadly constant at an elevated level (above 8%) and German job creation was weak (especially considering the fact that many of the job creations recorded in the statistics consisted of 'mini-jobs' offering very short working hours and low wages).

This situation led to a situation of sustained nominal wage/price 'spirals'-wages and prices chasing themselves upwards-that span faster in some countries than in others. The combination of faster-rising prices and a stronger dynamic of domestic demand in deficit countries restrained their exports while fuelling import demand; current accounts moved inexorably into deficit, by 2008 to more than 10% of GDP in Greece, Portugal and Spain (Figure 2). The reverse happened in surplus countries. In Germany domestic demand was essentially stagnant - as were real wages - and such economic growth as it achieved was driven solely by higher net exports. From 2004 on Germany, the largest economy in the euro area, accounting for almost a third of output, posted a current account surplus of 5% of GDP, steadily rising to peak at almost 8%.

It is worth emphasising that the differentials in the rates of price or unit labour cost inflation between EMU countries in any one year were not very large - typically one or two percentage points. The wage-price 'spirals' cannot be compared with those of the 1970s. The problem was that they were repeated year after year, without correction. Thus the competitive imbalances built up inexorably over time. It is also vital to recognise the symmetrical nature of the imbalance. The deficit countries had ULC growth above the benchmark of 2% p.a., the surplus countries below it (Figure 1

[2] Of course EMU countries also trade with countries outside the monetary union. We focus, though, here on intra-EMU trade. This is not only to simplify the exposition: the overall current account position of the EA has consistently been very close to balance throughout its history. It is the intraarea imbalances that are key.

[3] For an early analysis of this problematic and warning of trouble to come, see Allsopp/Watt 2003.

above).[4] This is why it is incorrect to argue, as so frequently occurs in the public debate, that the deficit countries are the only ones that need to adjust, or, put simply, that everyone must become like Germany.

Competition between Member States on product markets was supposed to act as a brake on this cumulative causation. The dampening effect of higher internal prices on deficit-country exports would weaken overall demand, forcing wages and prices down. Conversely, stronger exports in surplus countries would boost growth and push up wages and prices. This mechanism proved very weak, however, and year after year the same countries posted substantial and indeed growing deficits and surpluses. In sum, over time competitiveness deteriorated in the former group of countries and improved in the latter group. Current account imbalances built up.

Other factors also played a role. Differential demand dynamics on foreign markets have been invoked (Janssen, 2011). Germany, in particular, certainly benefited from dynamic demand in China and other emerging markets for capital goods, in the production of which it has a comparative advantage. Meanwhile, southern European countries, many of whose exports were in competition with emerging economies seeking to move up the value chain, struggled to maintain market share. Given that this trend has to betaken as a 'given', though, this fact does not alter the conclusion that a competitiveness crisis had arisen that requires a correction in relative prices and wages; in fact it strengthens that conclusion. It is also true that the mirror-image deficits and surpluses were readily financed by a liberalised financial sector which exhibited typical 'financial accelerator' properties: the rising price of assets such as Spanish housing led to yet more lending and a steadily inflating bubble.

Be that as it may, the developments in current account imbalances were clearly unsustainable. A persistent deficit has to be financed by borrowing from abroad while countries running surpluses pile up financial claims year after year on deficit countries. In the crisis these capital flows came to a sudden stop. At the end of the day the imbalances manifest themselves as a competitiveness crisis. The competitiveness constraint then suddenly became binding as the internal dynamic reverses: virtuous circles turn vicious. Private lenders are no longer willing to finance deficits. Deficit countries are forced to cut domestic consumption and relocate production in favour of tradable goods (i.e. raise net exports). Meanwhile the financial institutions in the surplus countries face substantial losses on their foreign loans. This dynamic was a key element in the unfolding of the economic and financial crisis in Europe from the second half of 2008. It is a process that, at the time of writing, has not ended.

In short we see that, on the one hand, wage-setting was inextricably tied up with the emergence of current account imbalances. However, the relationship is not a simple line of causation from wage policy to competitiveness differentials to current account imbalances and then crisis. Rather the whole design of EMU was such that it gave rise, given the starting conditions, to both the imbalances and the wage and price differentials. This strongly suggests that wage policy was one factor behind the imbalances, but that given the other failings of the economic governance regime, it could not in the past, and in future also will not be able to, resolve the competitiveness issues and current account imbalances on its own. "Cut southern wages" is a specious policy response to the competitiveness crisis.

We now consider the implications of this analysis for wage-setting in a monetary union in more detail. We first take a theoretical and subsequently a more practical approach to this question.

[4] The reason that 2% is taken as the ULC benchmark is that this is the rate of inflation targeted by the ECB. As noted before price inflation and ULC developments are very tightly correlated. Thus ULC growth at this benchmark rate stabilises inflation at the rate targeted by the central bank. We return to this important point in the next section.

III. A role for wage setting in a policy mix for growth and jobs

Improving and deteriorating international competitiveness is actually a matter of prices (and especially those of traded goods). Even so, the pace of aggregate *nominal* wage increases is a decisive factor for macroeconomic imbalances because nominal wage and price increases tend to move together, as the one drives and justifies the other: faster price increases feed higher nominal wage demands, while faster wage growth pushes up domestic firms' costs, while at the same time creating scope on the demand side for higher prices. And it is not just wage developments in the tradable sector (often approximated by manufacturing) that are crucial. This is because manufacturing buys in many domestic services that therefore influence its cost base (Horn et al., 2007). And even in the sheltered sector the pace of wage growth is important for import dynamics.[5]

It is important to emphasise a related point in this context. The fact that *nominal* wage and price increases are closely correlated also means that *real* wage increases - which is what workers and the unions that represent them are ultimately interested in - are not closely linked to the pace of nominal wage growth; decisive for real wage increases is, rather, the rate of productivity growth. These theoretical interlinkages (and their limitations) can be seen in the figures for the euro area countries collated in Table 1.

Table 1. Wage, price and productivity variables, %-change 2000-2008

	NW	RW	Pdty	ULC	P
BE	25.6	5.8	6.4	18.0	18.7
DE	8.9	0.5	8.9	0.0	8.3
IE	56.4	25.7	10.4	41.6	24.4
EL	52.1	16.7	18.7	28.2	30.4
ES	35.9	0.4	3.9	30.8	35.4
FR	25.0	5.6	6.0	18.0	18.4
IT	27.2	4.4	1.3	25.7	21.9
LU	26.7	-4.9	1.8	24.5	33.2
NL	33.1	9.3	11.7	19.1	21.8
AT	21.0	5.7	11.8	8.2	14.5
PT	30.0	3.8	5.7	23.1	25.3
FI	30.7	17.7	13.7	14.9	11.1
EA-12	22.2	3.3	6.7	15.7	18.2

Notes: NW ('nominal wage') = nominal compensation per employee
RW('real wage') = real compensation per employee, GDP deflator[6]
Pdty ('productivity') = GDP per person employed, constant prices
ULC ('nominal unit labour costs') = Ratio of compensation per employee to real GDP per person employed
P ('prices/inflation') = GDP deflator Source: AMECO

Looking first at the EA-12 aggregate we seethe roughly parallel increase in prices and unit labour costs. Real wage growth was much closer to productivity gains (although still lower) than to nominal wage growth. With some exceptions these patterns hold broadly across the countries. Picking out some examples we see that despite the fact that nominal wage growth in Spain was about four times the rate in Germany, the rate of real wage increases in the two countries was almost identical. Germany differs from the rest- and given its weight this affects the euro area average - in having a substantial difference between productivity and real wages and between nominal unit labour costs and prices. We will return to this below: suffice it to say here that this reflected a major shift in national income away from labour and in favour of capital in this period.

[5] It is surprising how many commentators focus solely on exports, forgetting that imports are just as important in determining the current account position.

[6] The GDP deflator is used to measure prices and calculate real wages. Unlike the consumer price index this measure focuses on the prices and costs of domestic production. (See earlier footnote.) The period 2000-2008 was characterised by rising energy prices: consumer price inflation was rather higher.

Summing up two important findings for nominal wages, these interlinkages imply that faster nominal wage growth to the extent that it is associated with faster price inflation does not raise real wages. Conversely, nominal wage moderation does not reduce the pace of real wage growth provided and to the extent that it is reflected in slower price inflation. If we now recall that wage bargains are always struck in nominal (cash) terms, we can draw some stylised conclusions for wage policy in a monetary union.

Let us first consider a situation where national economies within a monetary union are 'in balance', implying that each has low unemployment, stable inflation, and small current account deficits and surpluses. Then suppose that nominal wages grow at a rate equal tithe sum of medium-run national labour productivity growth plus an allowance for the rate of inflation that the monetary authority considers compatible with price stability." In such a situation all countries experience the same rate of growth of unit labour costs and this rate is close to what the monetary authority considers compatible with 'price stability'. If, furthermore, there is no shift in national income between profits and wages, then domestic price inflation will increase at the same rate as ULCs.

For as long as these conditions hold the central bank can allow the economy to grow vigorously and keep unemployment low or drive it down. Indeed, in the case of the ECB, it would be obliged to do so by its secondary mandate (to support the goals set out in the Treaty), given that its primary mandate (price stability) would be assured. This remains true for all that the ECB has sought to downplay this obligation. Meanwhile, real wages in each country grow in line with the medium term rate of productivity in that country and workers' share of national income is stable.

Taking medium term productivity growth helps to smooth out cyclical fluctuations. Using the central bank inflation target as a guideline, rather than current price inflation, does the same, and, crucially in the light of the above discussion, prevents nominal wage and price developments in member countries diverging over time. Taking national productivity growth promotes social and regional cohesion within countries. Yes, in a physical sense the rate of productivity growth differs between sectors.

But the outcome outlined here - uniform increases across sectors - is compatible with that due to changes in the relative prices of goods produced by different sectors. Indeed, this is what we see in practice: the price of, say, haircuts, rises relative to those of mass-produced widgets, while substitution between, say semi-skilled hairdressers and widget makers tends to balance their wages. Meanwhile individual producers have an incentive to raise their productivity: if they beat (underperform) the sectoral average they earn higher (lower) profits. This is not the case in a stylised 'superflexible' wage-setting system idealised by some liberal economists and policymakers: if workers' wages responded immediately and completely to the productivity of the individual plant there would be no incentive at all to raise productivity.

Overall, this is a policy mix, with wage-setting at the centre that not only avoids macroeconomic imbalances but also maximises growth and employment opportunities and real incomes, while maintaining price stability. It does not ignore differentials of productivity levels or growth, nor country's different production and export specialisations. All countries should indeed strive to raise productivity and adapt their specialisations. To the extent that productivity- enhancing policies are successful, the pace of both nominal and real wage growth can and should increase. Productivity is the cloth from which the cloak of real living standards is cut.[7]

[7] Clearly, it is a highly stylised model. Among other things it assumes high mobility of labour within a country (which to some extent in Europe is an arbitrary geographical area from an economic point of view), and limited labour mobility between countries.

Now let us consider the case where the starting point is one of substantial current account imbalances. If these are to be corrected[8], the rate of nominal wage growth should be lower than indicated by the above formula in deficit countries and higher in surplus countries to bring countries back into equilibrium. This wage norm - nominal wage growth in each country equals medium term national productivity growth, plus the target inflation rate of the central bank, plus/minus a competitiveness correction in surplus/deficit countries -can be seen as the "Golden Rule" of a monetary union (Watt 2010).

It would be sensible to apply a cut-off point or floor to this rule, such that negative nominal wage growth (i.e. pay cuts) in deficit countries should be avoided in order to avoid the risk of cumulative deflation (as opposed to relative disinflation). To put it another way, a nominal wage freeze would be the most severe adjustment path envisaged under such a rebalancing strategy. A SOMEWHAT HIGHER OVERALL INFLATION TARGET WOULD FACILITATE INTER-COUNTRY ADJUSTMENT WHILE AVOIDING COSTLY DEFLATION, BY PERMITTING FASTER WAGE AND PRICE INCREASES IN SURPLUS COUNTRIES (Allsopp/Watt 2003, Blanchard 2010).

We have thus outlined a model under which, if its conditions are met"[9], current account imbalances can be reduced while, in the short-term, maintaining output and employment as far as possible in both deficit and surplus countries. Moreover, in the medium and longer term it would avoid the creation of imbalances between countries and keep the whole currency area on a balanced growth path with low inflation and high employment.

So much for theory.

IV. Wage setting in practice

Wage-setting, as is well known, is decentralised within the monetary union, while it is centralised and/or coordinated at national level, but to varying degrees. There is a very limited set of institutions and procedures all of them extremely weak, to monitor and guide wage setting in the Member States at transnational level (see Schulten 2005 and Glassner/Watt, 2010 for an overview). Examples include: the ETUC Coordination of Collective Bargaining (CCB) Committee and the CCB Committees of some sectoral European Trade Union Federations, the Doom process bringing together the metal sector unions of Germany and the Benelux countries, and formal or informal 'benchmarking' by some countries against, in particular, German ULC developments. At the EU level there are a number of relevant institutions and processes: the Macroeconomic Dialogue (Koll, 2005 and Watt, 2006), which brings together the European Commission, the ECB the social partners and a number of Council committees, statistical monitoring of wage developments by Eurostat and the ECB, and wage monitoring within the Economic Policy Committee of the ECOFIN Council. Most recently the Excessive Imbalance Procedure has been initiated as part of the so-called 'six-pack' of economic governance reforms. Under it nominal unit labour cost developments (and thus implicitly nominal wage growth) are to be monitored (Watt, 2010b and Janssen, 2011b).

A sober analysis and the experience of the years leading up to the crisis show that none of these weak coordination instruments, neither those within European trade unionism, nor the existing external technical and political bodies, has been able to exert a significant influence on nominal wage setting in the face of those forces within EMU (asymmetrical fiscal policy, free capital flows), which create the pressure for diverging nominal wage (and price) trends. This strongly suggests that

[8] The existence of small current account imbalances even in the long term may well be considered an 'equilibrium' feature of economies in a monetary union, reflecting economic catch-up, demographic factors etc. I do not enter the debate here as to exactly when an imbalance should be considered excessive.

[9] An obvious question is whether (domestic) price rises above the rise in ULCs (and thus a shift in national income from wages to profits) can be avoided. As we have seen, this trend was prominent in Germany during the 2000s. Briefly, in conditions of close-to full employment this should not occur over an extended period. Specific flanking policies (touched on below) might be advisable to limit firms' pricing power and/or to stabilise and strengthen collective wage bargaining systems. For a more detailed and technical exposition of this section see Watt 2007.

additional efforts would be needed to strengthen existing coordination instruments, and possibly establish new ones, as part of a broader-based move towards more coordinated economic policy setting in a post-crisis euro area. Clearly wage coordination cannot sensibly be pursued on its own and will certainly fail if, for example, national fiscal policy is not similarly constrained to reduce divergences in the pace of demand growth with respect to domestic supply and financial flows between countries are allowed to be driven untrammelled by shifting market sentiments.

V. The challenges of the economic and political context

For European trade unions the current constellation represents a serious threat. The question is whether it can also be grasped as an opportunity.

The threat is very real. It is what we have seen unfolding across the euro area in the past two to three years. The public authorities are seeking a deflationary solution. They are attacking collective wage setting against the background of high unemployment and fiscal austerity. This is particularly the case in countries in need of external support: Greece, Ireland, Italy, Spain and Portugal. Essentially these countries are being blackmailed into 'reforms' under the pretext that this is necessary (indeed: the only way) to correct imbalances and re-launch growth. The surveillance of macro-imbalances under the Excessive Deficit Procedure promises to be applied in a one-sided and thus deflationary way and without representation from the side of workers. Adjustment will be sought through wage (moderation) policies without due regard to the need for other policies (especially national fiscal policy) to ensure balanced development across the euro area.

It is, admittedly, hard to see at present, but the situation could give trade unions an opportunity to put themselves forward as key, indeed indispensable, macroeconomic actors to ensure the smooth functioning of the monetary union, which in turn would increase their ability to realise trade union goals of more and better jobs, ensuring rising living standards for working people and avoiding beggar-thy-neighbour strategies. If they can deliver wage outcomes that approximate to the 'Golden Wage Rule' they have something with which to bargain with other actors. Ultimately this requires changes in the political leadership of key Member States and the European institutions. Assuming that a major break-up of the euro area can be averted in the meantime, there are signs that this may be occurring. The complete failure of the dominant centre-right parties to resolve the crisis is becoming every day more and more apparent, which can be expected to open up avenues for progressive change and reform.

If European trade unions want to journey down this road they would, as a precondition for playing that role, need to 'invest' more than has previously been the case in their own autonomous cross-border wage-coordination activities. At the same time they would need to campaign effectively and alongside political allies for institutional changes in order to strengthen the effectiveness and inclusiveness of national bargaining systems and move towards a coordinated economic governance framework. Such a framework must be one in which appropriate fiscal and other policies are combined with appropriate (in the sense of the Golden Rule) nominal wage setting to deliver balanced and growth-friendly overall outcomes.

Even if it is unclear how feasible obtaining such a conductive political environment in the EU might be, it is useful to envisage the contours of a possible progressive consensus about a new economic governance structure emerging in which wage-setting would play an important role. What could such a structure look like?

VI. A 'grand bargain' for greater economic policy coordination centered on a golden wage rule

Based on the lessons from the crisis, the empirical and theoretical insights described above and in the light of the current economic and political constellation in Europe, a 'grand bargain' could be envisaged in which greater economic policy coordination goes hand in hand with a strengthening of wage policy coordination with the aim of ensuring regionally and socially balanced, job-rich growth throughout the euro area. Cornerstones of such an approach can be set out as follows.

• All policymakers recognise that macroeconomic imbalances have arisen in the euro area as a result of design faults within economic governance that need to be rectified symmetrically in the direction of greater policy coordination. Within that framework greater coordination of wage-setting is a necessary but far from sufficient component.

• Europe's trade unions recognise the centrality of wage-setting within the EU and especially within the monetary union in order to ensure balanced economic development and promote high levels of employment and rising living standards.

• Trade unions have the competence and the responsibility for nominal wage setting, a role cannot be played by other actors. It is recognised that attempts to weaken existing collective bargaining institutions are not the way forward. On the contrary such institutions need to be strengthened if nominal wage setting is to fulfil its needed function within EMU and nominal wage outcomes are to be in line with the above "Golden Wage Rule".

• Consequently Policymakers refrain from attempts to impose one-sided and top-down constraints on wage setting. Labour must be adequately represented on all technical and political decision-making and advisory bodies at both the European and national level dealing with wage-setting.

What would be the implications of such an approach for the different actors and policy areas? Within such a framework the ETUC would commit itself to working both with other European actors and in its autonomous actions with affiliates towards strengthening the coordination of wage policy in Europe in pursuit of the above goals. Within a more coordinated policy framework it would seek wage developments in which real wages move in line with medium term productivity and nominal wages are set responsibly such as to contribute to avoiding imbalances and rectifying existing imbalances and underpinning price stability from the wages side ("Golden Rule"). In this context it insists on the need for such wage norms to be respected in a symmetrical way and for other actors to avoid beggar-thy-neighbour strategies and policy recommendations.

National fiscal policy needs to be considered within the macro- economic imbalances framework. Guidelines for and constraints on national fiscal policy must be symmetrical, decisively breaking with the tradition of obsessively focusing on current (or even structurally adjusted) deficits. A country's current account should be an important determinant of its appropriate fiscal stance. A mechanism must be introduced that excludes public spending that raises future potential output from consideration in the analysis of the current budget position.

The Macroeconomic Dialogue (MED) needs to be brought out of the shadows and decisively strengthened in the direction of a permanent secretariat. It should be mentioned explicitly as an actor as part of the process of enhanced European policy coordination foreseen under EU2020 and the proposed economic governance reforms and be in a position to contribute as an institution to the public debate. A specific MED for the euro area should be established. MEDs could be established at national level, organised in different ways depending on the national traditions and ensuring a real dialogue. Appropriate articulation between the national and European levels is needed.

The social partners should be given observer status at euro group meetings and on all technical committees (EPC etc.) addressing wage issues. A social partner advisory board to the ECB should be established, as exists in a number of EU Member States' central banks. Trade unions require support from public authorities in their efforts to rebuild collective bargaining institutions at national level and governments and EU policymakers must desist from enacting and recommending policies that serve to weaken them.

Alongside wages it is vital that EU policymaking bodies and technical committees also address issues of price setting and take distributional matters into account- both functional and personal distribution - when setting policy. Underpinning the concern with distributional fairness, *EUROPE SHOULD COMMIT TO AN OPEN METHOD OF COORDINATION TO RENDER EFFECTIVE A EUROPEAN WAGE NORM SO THAT THE LOWEST WAGES IN EACH EU COUNTRY SHOULD BE AT LEAST 50% OF THE NATIONAL AVERAGE.*

VII. Conclusion

The ideas underpinning this paper have been developed over a long period with a view to making the 'actually existing' monetary union work better overall, and especially to make it work better for ordinary workers from all the member countries. Yet now the very future of the monetary union is at stake. Only a further integration of policy offers lasting answers to Europe's challenges and can generate higher living standards and employment opportunities for Europe's workers. Constructing a grand bargain along the lines proposed here is difficult. It requires cooperation from a variety of actors. The fundamental threat to the existence of the monetary union we now face seemingly makes a move to a progressive alternative more difficult. Unfortunately recent proposals coming from European-level authorities and conservative-run Member States seem to suggest that they continue to favour an approach that is top-down and asymmetrical. Such an approach clearly will not work.

There is a window of opportunity, at least, to try a more constructive path forward. It would be a tragedy if the monetary union would first have to fail for Europe to change course.

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