



OECD Economic Outlook 2017 recognises that weak wages produce a weak recovery HAS THE OECD JOINED THE CAMPAIGN FOR HIGHER WAGES?

Trade unions tend to see wages not as a factor of competitiveness but as engine that drives demand, growth and jobs. The [OECD Economic Outlook](#) published today at the start of the Ministerial Council meeting supports this view. It confirms the link between lacklustre economic growth and the stagnation of wage dynamics.

The OECD's point of departure is that the economy still finds itself in a so-called "low growth" trap. Growth is forecast to remain limited to just 2% across the OECD.

The Outlook stresses that the extent to which the recovery can gain sufficient momentum to escape the low-growth trap will be a key issue. It explicitly points to the important role of wages by stating that "*a durable and stronger upturn in household incomes and consumption requires stronger wage growth*".

The OECD acknowledges that the transmission channel from lower unemployment to higher wages is broken. Despite falling unemployment rates, wage growth has been "remarkably stable", in other words very modest. Moreover, the OECD does not expect this to change rapidly in 2017 and 2018 as real wage growth would remain stuck at around 0,5%.

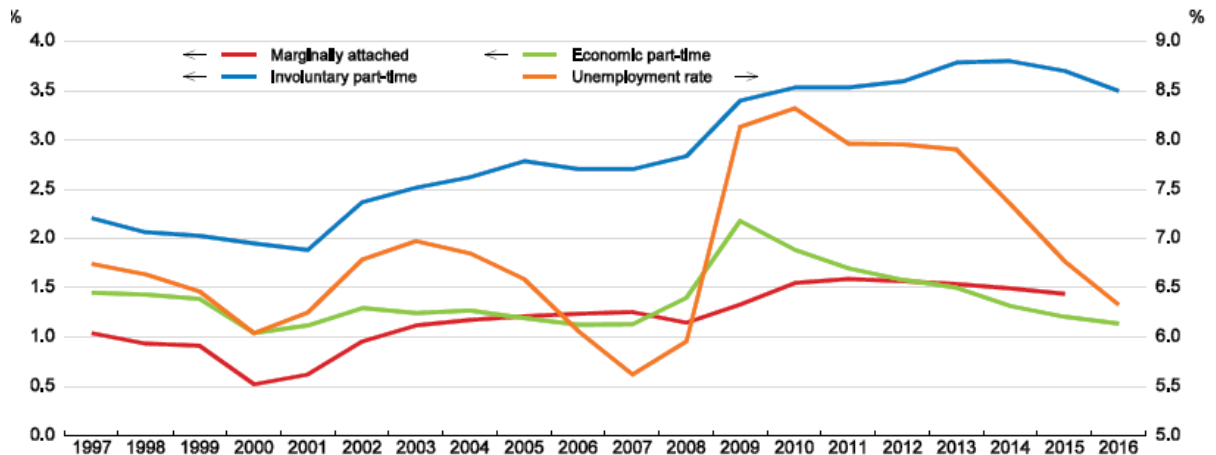
The reasons behind the broken link between unemployment and wages

The OECD identifies three reasons:

- Echoing recent publications from Eurostat and the ECB (see here <https://www.ecb.europa.eu/pub/pdf/ecbu/eb201703.en.pdf?ea7747ab0ef3b038300a8d51a3a95313>), the OECD considers that the traditional statistics on unemployment rates are no longer a correct measure of labour market slack. Indeed, these statistics do not factor in the growing number of involuntary part time and other forms of non-standard work that is much above pre-crisis levels. Combined with the numbers of marginally attached workers (which are also above pre-crisis levels), this makes for a substantial labour market reserve keeping wage dynamics down. As can be seen from the graph below, whereas unemployment and short term working (economic part timers) numbers have come down since the financial crisis, involuntary part time and the number of marginally attached workers have gone up. These are OECD wide numbers but zooming in on individual economies allows to see how dramatic the situation really is. In Italy for example, based on Eurostat, the number of marginally attached workers (3, 2 million) is currently higher than the number of unemployed (3 million), resulting in a broader unemployment rate of 24%. With rates as high as that, it is no wonder that wage dynamics are "down and out".

High levels of involuntary part-time work add to cyclical slack in the OECD area

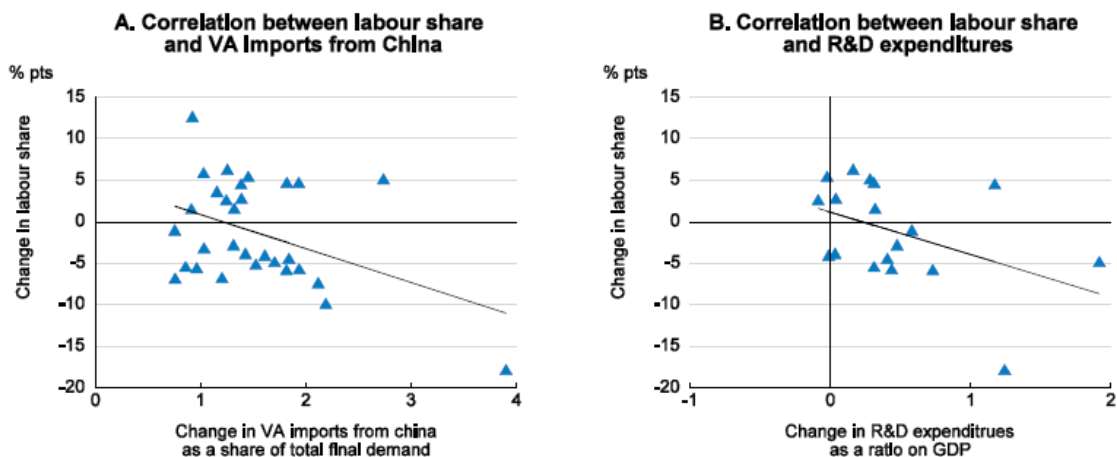
As a percentage of the labour force



- Secondly, additional factors weakening workers’ bargaining power play a decisive role besides labour market slack. For the OECD, the main culprits are technological change that automates routine tasks and the off-shoring of labour intensive activities in global supply chains (see left side graph below). The role of past reforms that weakened wage formation systems by decentralising collective bargaining to the company level or by limiting the possibilities to legally extend collective bargaining is NOT mentioned by the OECD.

Figure 15. Changes in trade and technology are both associated with changes in labour shares in advanced economies

Change between 1995 and 2011, in percentage points



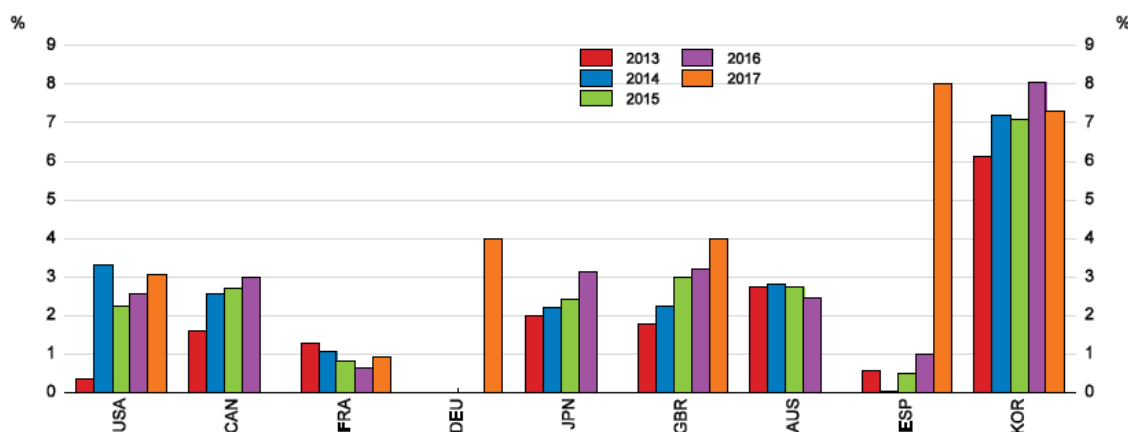
- A third reason goes back to the standard argument that explains low wage growth by dismal productivity performance. Here, the OECD departs from this reasoning by explicitly recognising that “for the typical worker, rising productivity may no longer be sufficient to raise wages”, as productivity growth has decoupled from wage growth over the past two decades, especially in the lower part of the earnings distribution.

Conspicuously absent: Policies to strengthen wages

The recognition that low wage dynamics are holding back economic growth and that this also has to do with the weaker bargaining position of labour and with the fact that wages for the typical worker are systematically lagging behind productivity should logically lead to suggest policies and reforms that support wages by (re)strengthening wage bargaining systems.

That is unfortunately not the case. The OECD in its Outlook remains silent on this issue, perhaps with the exception of a very implicit reference to the role of minimum wages. The statement that the “*subdued nature of economy-wide wage growth contrasts with the pick-up in the annual growth of minimum wages in some major economies*”, may be read as a careful suggestion to consider stronger minimum wages. In other recent publications such as the 2017 “Going for Growth” report and the EDRC review of Japan, the OECD already recommended to the US, South-Korea and Japan to increase their minimum wages.

Figure 13. Minimum wage growth is picking up in some countries



Macro - economic policy to the rescue?

Instead, the OECD focusses on the first factor of labour market slack, arguing that wage pressure should eventually show up as labour markets continue to tighten. To fully eliminate existing labour market slack, the OECD is calling for a policy mix where a gradual reduction of monetary policy support is to be offset by a more active use of fiscal policy with the latter to be complemented by more ambitious structural reforms. This raises serious questions.

Why take the risk of withdrawing monetary policy support if labour market slack is still pervasive while core inflation is stuck substantially below price stability targets? What will be the implications of “tapering” of quantitative easing (QE) in the euro area? What if this substantially weakens the monetary policy lifeline for distressed euro area members such as Italy or Spain that QE represents? What if fiscal policy does not step in, with the euro area sticking to the Stability

Pact or is employed in the wrong way with a “trickle up” strategy where the rich in the US get tax cuts while all others get welfare cuts?

And, more importantly, what is meant by “more ambitious structural reforms”? This turns out to be about getting displaced workers into a job by shifting funds towards active labour market programs and this within a given budgetary line. In other words, this is about financing active labour market spending by reducing unemployment benefits (see also this OECD paper <https://www.oecd.org/eco/Coping-with-creative-destruction-reducing-the-costs-of-firm-exit.pdf>).

Let’s also keep in mind the other flagship OECD publication ‘Going for Growth’ released earlier this year (http://www.oecd-ilibrary.org/economics/economic-policy-reforms-2017_growth-2017-en). It recommends traditional structural reforms that reduce job protection, unemployment benefits, sector level bargaining and mechanisms of legal extension of collective bargaining (see table below).

OECD recommendations in Going for Growth 2017:

Avoid a too high minimum wage	Promote firm level bargaining, reduce extension	Restructure benefits to increase work incentives	Reform job protection
Colombia, Turkey	Belgium, France, Italy, South Africa	Finland, Iceland, Ireland, Latvia, Luxembourg, Netherlands, Slovenia, Lithuania	Chile, France, Japan, Korea, Netherlands, Spain, Turkey, Colombia, India, Indonesia

To conclude, the OECD’s Outlook is not consistent. While the positive role wages play in supporting economic recovery is being recognised, the OECD fails to draw the proper conclusions from this. Instead of arguing in favour of reforms that strengthen labour’s bargaining position, the OECD in the end does the opposite by again insisting on reforms that weaken the bargaining position of workers. If policy makers were indeed to follow this, the recovery will not be made stronger but weaker.