Work Package 2 – Deliverable 2.2

The distributional impact of the inflation crisis in the EU-27

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Deliverable 2.2. – The distributional impact of inflation crisis in the EU-27

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Abstract

This report analyses policy responses to the cost-of-living crisis and the dynamics of conflict and coordination underlying these processes.

The starting point for the analysis is the need to move beyond the explanations and analytical lenses used to explain adjustment to previous inflationary episodes. First, because compared to the 1970s-1980s experience, the recent inflation crisis wasn't caused or intensified by wage demands. Secondly because industrial relations and collective bargaining institutions have over the last three decades undergone deep transformations in key dimensions like trade union strength or collective bargaining structures and coordination.

The report shows the existence of cross-country variation in real wage dynamics, distributional impacts and policies to tackle them. These differences can only be explained through the interaction between government (policy) priorities, collective bargaining institutions and social partner strategies. This interaction no longer takes the form of governments harnessing the capacities of strong and centralized social partner organizations and collective bargaining systems to enforce wage restraint. Rather, the analysis shows how governments' role has not consisted in in coordinating social partners' responses, but framing policy priorities and steering them to either shield competitiveness, support demand or reduce inequalities.

Content

Introduction: managing inflation in the wake of neoliberal transformation

After two decades of low inflation levels and wage moderation, the European Union (EU) has, since 2021, experienced an unprecedented increase in inflation, triggered by a combination of rising energy prices as a consequence of Russia's invasion of Ukraine, disruption in international supply chains following the Covid19 crisis and the effect of climate change on crops and food prices. Price gauging and profit accumulation by firms in systemically significant sectors has then contributed to making matters worse (Weber and Wasner 2023). While inflation developments have not been homogeneous across EU economies, citizens in all countries have been affected.

Inflationary crises bring about three problem loads that must be managed concomitantly: first, ensuring macroeconomic and price stability; second, mitigating the distributional / cost-of living impact on households and workers; third, avoiding the onset of economic stagnation due to declining demand and reduced economic activity. The policy strategies necessary to manage these three faces of the inflation problem load are not necessarily coincident, and balancing these objectives presents governments, unions and employers with dilemmas and trade-offs.

The inflation crisis of 2021-2023 is interesting insofar as its causes have been quite broadly recognized in the policy debate as not being related to wage dynamics or excessively lax fiscal policy. Furthermore, contrary to what happened in the aftermath of the Great Recession, the distributional dimension of the recent inflation crisis has gained centre stage in public and policy debates. In face of a dramatic cost of living crisis, calls have been made by international bodies to sustain real wages and mitigate inflation's greater impact on workers at the bottom of the earnings' distribution (OECD 2022, European Commission 2023). Policymakers have become ever attentive to the negative impact of inflation on society's most vulnerable groups due to the generalized absence of indexation mechanisms in collective bargaining (Koester and Grapow 2021, Checherita-Westphal 2022), the erosion of industrial relations institutions and, as a result, the low risk of an emergence of generalized wage-price spirals. At the same time, however, the macroeconomic management of inflation by central banks, including the European Central Bank, has not deviated significantly from the established doxa underpinning a monetarist understanding of inflation. Hence, the tightening of monetary policy through interest rate hikes has remained an important plank of contemporary inflation management. This has exacerbated cost-of-living pressures, especially for low-income groups; whilst also – by design – intensified overall recessionary dynamics.

This report aims to make sense of the contemporary politics of inflation management and understand how governments and social partners managed the difficult balance of addressing at once the cost-of-living crisis and the macroeconomic dimension of inflation, against a background of weakened coordination capacities and diminished labour power resources after decades of neoliberal erosion of industrial relations. Four broad sets of questions guide this enquiry. First, what policy tools and strategies have been deployed to tackle the inflation crisis of 2021-2023 by governments and social partners, with what objectives and effects? Second, to what extent have state actors and producer groups engaged in coordination and/or conflict in the determination of policy responses to the energy cum inflation crisis? Third, how have developments in wage-setting and collective bargaining interacted with public policy in shaping the distributive and macroeconomic dimensions of the inflationary episode? Finally, in what ways does the contemporary inflation crisis differ from previous inflationary episodes in its macroeconomic and political dynamics?

We depart from the observation that there are different possible roads to tackle the cost-of-living crisis aspect of inflation and achieve the twin goals of sustaining real wages whilst reducing the distributional impact of inflation for the most vulnerable groups in the labour market (OECD, 2023). Governments can rely on a variety of regulatory or social policy instruments, including for example energy price caps and subsidies, income maintenance mechanisms and targeted fringe benefits. Moreover, as public employers and the polity's regulatory authority, most governments have two key incomes policy instruments: public sector wage policy (Di Carlo, 2023; Di Carlo et al, 2024) and minimum wages (Picot, 2023). Finally, they can rely on social dialogue to negotiate incomes policies agreements and orchestrate coordinated responses (Busemeyer et al. 2022). Where collective bargaining exists and covers sufficient parts of the labour market, social partners can play a key role in shaping the impact of the inflation crisis on wages and the wage distribution. These strategies have potential different implications for overall price and wage dynamics – either focusing on mitigation of inflation ex ante or ex post; they might alter more or less deeply (or not at all) the trajectory of wage developments; and might require closer or looser coordination between the state and social partner organisations.

Whilst in the past the coordination between governments and social partners in wage-setting was an important plank of macroeconomic management, after forty years of "neoliberal transformations" which have deeply eroded the overall strength and centralisation of European collective bargaining systems, we expected collective bargaining and social dialogue to play a reduced role in relation to previous inflationary episodes in the 1970s and 1990. Nonetheless, cross-country differences in industrial relations structures and national systems of interest representation continue to matter in Europe. As a result, we expected to observe variation across European countries in the occurrence of state-social partner coordination, and in the capacity of social dialogue to mitigate the negative effects of the cost-of-living crisis on workers while preventing the spread of wage-price spirals (Eurofound et al 2023). Moreover, while one could have expected heightened levels of industrial conflict in an acute inflationary phase as workers and their organizations struggle to defend real wages, against a generalised background of waning union strength we presupposed that the incidence, level and severity of industrial conflict would likely vary across countries, depending on the specific cost-of-living situation, the policies put in place by governments, and union strength and power resources.

We observe, as expected, a stronger role for governments compared to previous inflationary episodes. Not so much in coordinating the social partners' responses, but rather in setting the policy priorities and leading responses to the inflation crisis – either through direct social transfers and tax measures, largely bypassing the wage channel, or through interventions on prices. Moreover, our expectations around the uneven role of social dialogue were also confirmed since patterns of coordination with social partners have emerged in countries such as Germany, Spain and the Nordics; but have been notably absent in contexts as diverse as Italy, France, Greece, Slovenia and Romania. In this regard, institutional legacies, power resources and ideational dynamics all contributed to different extents to shaping different approaches to tackle the inflation crisis. However, one major aspect which stands out across all cases analysed is governments' leading role in steering responses to inflation. The findings also suggest that the incidence of industrial conflict was generally lower than might have been reasonably foreseen given the severity of the inflationary crisis – which might be a symptom either of effectiveness of government interventions to mitigate inflation, or of increased labour weakness and uncertainty, or most likely, of a combination of the two.

Unsurprisingly, wage policy outcomes also varied markedly across European countries. Overall, three broad trajectories can be observed. A first group of countries – the "usual corporatist suspects" – includes Germany, Denmark and Sweden, which display a strategy of overall wage moderation with relatively minimal losses of purchasing power and only minor losses of competitiveness as these countries' Unit labour Costs (ULCs) trajectories remained largely in line with average EMU developments. A second group of countries – the "unexpected revaluators" – includes Romania, Slovenia and to a lesser extent Spain, that display above average real wage developments, with some spillover effects across the wage distribution, but with trade-offs in terms of a possibly worsening competitive position. Finally, a third group of countries – Italy, Greece and to a lesser extent France – are clear cases of "competitive impoverishment", with a labour-unfriendly inflation trajectory across the board – whereby wages continue to stagnate, workers have struggled to keep up with inflation dynamics, the wage share has declined, and competitiveness has maintained at the cost of workers' purchasing power. The implications of these divergent wage developments is the potential long-run entrenchment of different inflation rates within the Eurozone, which spells problematic consequences for the coordination of monetary, fiscal and wage policy within EMU and in the EU more broadly.

The introduction is divided into five sections. First, we provide a historical overview of incomes policies and wage-setting strategies in inflationary times. We then analyse wage developments in the EU with a view to map the incidence of inflation on real wages. Next, we offer a comparative discussion of the responses to the inflation crisis, focusing on the role of collective bargaining and government responses.

1. Incomes Policy and Wage Setting in Inflationary Times: A Historical Overview

Building on classic insights from both comparative political economy (CPE) and industrial relations scholarship, the section examines the role played by wage-setting institutions and tripartite incomes policy in the management of inflation, particularly regarding the 1970's Great Inflation and in the run up to the European Economic and Monetary Union (EMU) in the 1990s. As we shall see, these insights remain relevant in today's economic context but also serve as a reference point for evaluating the recent experiences in inflation management.

Neo-corporatism and incomes policies in the Great Inflation of the 1970s

The 1970s Great Inflation brought prolonged high inflation across the U.S. and Europe, driven by demand-side factors such as expansionary fiscal policies and welfare state growth, and by supply-side shocks like the oil crises of 1973 and 1979. This period of "stagflation," characterized by high inflation alongside stagnant growth, led central banks to dramatically hike interest rates in pursuit of price stability, epitomized by the "Volcker shock." These shifts marked the transition to a macroeconomic policy regime increasingly unfavorable to labor (Notermans, 1993).

Industrial relations were pivotal to inflation dynamics, with unions' wage demands intensifying wage-price spirals. While oil price shocks were an exogenous trigger, neoclassical economists attributed inflationary pressures to wage demands exceeding productivity, compelling governments to expand the money supply (Goldthorpe, 1978). Sociologists, however, viewed these demands as rooted in distributional conflicts within capitalism. Workers sought social equity, while employers protected profits by passing costs onto consumers, reinforcing inflation (Panitch, 1977). Goldthorpe (1978) argued that these demands reflected systemic class tensions, with the post-WWII Fordist era empowering organized labor to claim social rights, reduce class inequality, and strengthen labor's position relative to capital; whilst opposing policies that would increase unemployment and threaten the Fordist compromise itself (Goldthorpe, 1978).

While some viewed labor unrest as exacerbating inflation, a rich body of comparative political economy (CPE) and industrial relations scholarship emerged (see Streeck, 2011) emphasizing the stabilizing role of wage-setting institutions and tripartite incomes policies (Aidt and Tzannatos, 2008). Two strands of neo-corporatist literature developed (Streeck and Kenworthy, 2005; Molina and Rhodes, 2002):

1. *Structuralist neo-corporatism*, focusing on the role of centralized and coordinated wage-setting institutions in stabilizing macroeconomic outcomes.

2. *Process-based neo-corporatism*, emphasizing social concertation as an inclusive governance mode where governments shared economic policymaking with social partners.

The structuralist approach analyzed the macroeconomic impact of wage-setting institutions, while the process-based strand explored governments' incomes policies aimed at controlling inflation by managing wages in cooperation with social partners. Though these strands evolved largely in parallel, they occasionally intersected.

The two scholarship streams developed largely in parallel, while at times intersecting. Below, we briefly review the main intellectual developments in both camps, providing a bird's eye view on the evolution of these sets of literature from the 1970s until the turn of the century and conclude by taking stock of these literature, drawing insights relevant for inflation management today.

Neo-corporatist labour market institutions as pre-conditions for macroeconomic stability

The structural variant of neo-corporatist literature examined how countries' wage-setting institutions and systems of interest representation influenced macroeconomic performance. Over time, this scholarship evolved through various phases and different intellectual contributions, eventually coming to form a comprehensive analytical framework by the late 20th century.

Emerging in response to the 1970s inflation crises, early neo-corporatist studies highlighted the advantages of centralized wage-setting systems led by peak-level organizations. Building on Andrew Shonfield's (1969) foundational insights, this literature underscored how countries with centralized wage coordination outperformed others in managing inflation and unemployment during the oil shocks (Bruno and Sachs, 1985; Tarantelli, 1986). Centralized systems, characterized by encompassing and monopolistic organizations for labor and capital, promoted wage moderation due to their collective interest in maintaining macroeconomic stability (Olson, 1986; Crouch, 1990). In contrast, decentralized market-based systems, such as those in Anglo-American economies, were seen as less effective in achieving these outcomes (Streeck, 2010).

Expanding this work, Calmfors and Driffill (1988) argued that both fully centralized and fully decentralized wage-setting systems could achieve low inflation but through distinct mechanisms. Centralized systems relied on collective self-regulation by peak organizations, while decentralized systems depended on competitive pressures forcing wage moderation at the firm level. However, industry-level sectoral wage-setting, lacking these moderating forces, often led to inflationary wage-push dynamics (Flanagan, 1999).

In the 1990s, on the one hand, scholarship shifted toward inter-sectoral wage coordination as an alternative to centralized bargaining. This approach emphasized "pattern bargaining," where export-sector wage setters, often in manufacturing, established wage norms for other sectors (Soskice, 1990; Traxler et al., 2008; Di Carlo, 2020). Pattern bargaining depended on strong cross-class alliances between unions and employer associations, ensuring wages aligned with productivity. However, it also had distributional implications, as wages in low-productivity sectors, like construction and public services, were pegged to higher-productivity manufacturing sectors (Swenson, 1991; Iversen, 1996). The Nordic countries became exemplary of formal and informal pattern bargaining institutionalization (Andersen et al., 2015; Ibsen, 2016). On the other hand, scholars connected wage-setting institutions to monetary policy, particularly as governments delegated monetary policy to independent central banks during the 1980s (McNamara, 2002). The literature explored how interactions between independent central banks and coordinated wage-setters fostered macroeconomic stability. Central bank independence enhanced credibility, while conservative monetary policies discouraged inflationary wage increases (Hall, 1994; Hall and Gingerich, 2009). Export-oriented wage setters moderated demands to avoid triggering central bank interventions that could raise unemployment and harm competitiveness. This strategic interaction ensured low inflation without excessive employment losses, positioning coordinated wage-setting systems as integral to price stability (Iversen, Pontusson, and Soskice).

In all, over several decades, neo-corporatist scholarship established the centrality of centralized and coordinated wage-setting institutions for macroeconomic stability. These institutions came to be viewed as essential prerequisites for effective incomes policy and the integration of labor into economic governance.

Negotiated Incomes Policy in Managing Inflation in the 1970s

During the inflationary 1970s, negotiated incomes policy—cooperation among governments, unions, and employers to limit wage and price increases— played a crucial role in managing inflation, although with mixed results (Marks, 1986). Governments aimed to prevent wage-price spirals by promoting centralized wage-setting to secure unions' wage restraint in exchange for social policy benefits, de facto entering a "social contract" (Crouch, 1978). These responses were negotiated with unions and often also with employers and envisaged a mixture of wage and price controls. Governments sought to centralise the practice of wage-setting to curtail leapfrogging dynamics from different social groups and economics sectors and to contain employers' capacity to defend their profit margins by passing wage increases on to consumers through price increases. Coordination took more or less voluntaristic or institutionalised forms, depending on the national context and period.

Goldthorpe (1978) saw incomes policy as a response to class-based distributional conflict, and as a major alternative to monetarist economic policymaking, centred on hawkish monetary policy which could provoke social unrest. The longevity of such corporatist arrangements was attributed to the function these fulfilled in supporting the Fordist model of capitalist accumulation and hinged on their capacity to contain inflation (Crouch, 1993: 6; Schmitter, 1974: 111). Corporatist deals were particularly vital in Fordist economies where low inflation and stable employment supported growth by balancing labour and capital interests (Schmitter, 1974; Katzenstein, 1985). Additionally, incomes policy addressed wage inequality, as centralized bargaining helped moderate high wage differentials, benefiting lower-paid workers and sustaining within-class solidarity (Ackers, 2016). By relying on such a practice of political exchange (Pizzorno 1978) between governments and unions, incomes policy deals attempted to smoothen the distributional conflict at the basis of inflation, by connecting policy efforts by government to reduce runaway inflation to distributional issues, and thus offering some degree of accommodation to the working class and unions.

Over time, scholars identified conditions essential for successful negotiated incomes policies, including strong unionization, which pressured governments to negotiate rather than unilaterally impose wage controls (Pizzorno, 1978). Government willingness to share policy-making authority, particularly in left-leaning administrations, further supported incomes policy (Marks, 1986, p. 257). Weaker minority governments also had more incentives to broker deals with trade unions and employers (Baccaro and Simoni 2008; Martin and Swank, 2012). The neo-corporatist literature also emphasized that centralized bargaining systems and encompassing union organisations enabled wage discipline and adherence to incomes policy. This centralization fostered solidarity among workers, who trusted that wage moderation would promote broader working-class welfare, especially in countries with cohesive union structures like Austria, Sweden, and Norway (Marks, 1986). Encompassing unions were more likely to pursue societal, rather than narrow, sectoral interests (Olson, 1982) and would therefore minimize the likelihood that lower-level bargaining units would deviate from the wage guidelines agreed centrally via incomes policies.

Incomes policies without neo-corporatist institutional preconditions

If both literatures had developed somehow in parallel until the 1990s, it was around the turn of the century that these CPE and industrial relations analyses came to intersect when scholars began to make sense of the long season of tripartite social pacts in Europe ahead of EMU accession.

By the mid-1980s, the pressures of globalization, neoliberalism and monetarism, alongside a shift away from Fordist-Keynesian macroeconomic policy, were seen as having signalled the end of neo-corporatist negotiated policymaking (cf. Lash and Urry 1987). However, the 1990s saw a revival of tripartite social concertation, especially in EU countries preparing for accession to the EMU, including those countries that lacked the "institutional pre-requisites" conventionally associated with neo-corporatism, that is centralized or co-ordinated wage setting institutions. During this period, governments, unions, and employer organizations frequently used tripartite agreements, or "social pacts" with the chief objective of securing entry to EMU (Hancke 2002; Rhodes et al. 2011). The key objective of pre-EMU-entry social pacts - lowering inflation rates and institutionalising wage moderation to meeting the Maastricht convergence criteria (Hancke 2002) - was usually linked to other reform efforts – including welfare state restructuring, labour market flexibilization and rationalization of public spending (Regini, 2003). From a tool of redistribution which could facilitate the forging of positive 'class compromises' (cf. Wright, 2000), as it had been the case in the 'golden age' of corporatist deals, concertation became a mechanism to bolster national competitiveness. Competitiveness was to be achieved through the negotiated flexibilization of industrial relations (IR) institutions and labour market policy and fiscal consolidation and wage moderation: what Rhodes (1998) famously described as 'competitive corporatism'.

This experience showed that social concertation could adapt to various economic contexts and power dynamics. However, by the early 2000s, this approach was criticized for facilitating economic liberalization and sometimes worsening inequality by concentrating the costs of liberalization on outsiders and entrenching excessive wage moderation (Baccaro 2014). Furthermore, once EMU entry was achieved, the relevance of negotiated incomes policy for managing inflationary pressures and coordinating inflation rates across EMU member rates largely faded away, as inflation rates declined to historically low levels. At the time, observers (cf. Hancke 2002) argued that lower inflation was related to the leadership of exposed sector's wage setters, signalling a shift toward employers' dominance in wage-setting dynamics.

During this time, many countries began to phase out or limit indexation mechanisms in response to concerns about inflationary spirals and the impact of wage rigidity on economic competitiveness. For instance, in Italy the "scala mobile", an automatic indexation system, was effectively abolished in the early 1990s as part of a tripartite pact aimed at reducing inflation and stabilizing the economy. Spain also experienced a gradual erosion of wage indexation, as collective bargaining agreements increasingly incorporated clauses that adjusted wages based on productivity and firm performance rather than on consumer price indices alone (Regini, 2000). This transition reflected a growing emphasis on productivity-based pay as governments and employers sought to decouple wages from inflation and align them more closely with economic performance.

During the EMU first decade, in some countries wage-push inflation arose from sheltered sectors (cf. Johnston and Hancke 2009), especially in those countries that lacked strong institutions of coordinated collective bargaining or institutionalized pattern bargaining. Yet, diverging wage – and especially ULC – developments went unnoticed to most, even to the European Central Bank (ECB) until the mid-2000s and did not hamper macroeconomic stability until the Eurozone crisis (Braun et al, 2024). When the 2008 financial crisis travelled from the United States and morphed into Europe's sovereign debt crisis, policymakers and scholars began to grapple with macroeconomic instability resulting from the accumulated differentials in ULCs and divergent competitiveness developments across Eurozone countries (Höpner and Lutter 2018).

By interpreting Europe's crises as a competitiveness crisis, European authorities' response aimed at engineering an export-led recovery (Scharpf, 2021) by means of international devaluations to be achieved via wage restraint, labour markets' flexibilization and the decentralization of collective bargaining institutions (Rathgeb and Tassinari 2022; Braun et al, 2024; Erne et al. 2024). Thus, Europe's new economic governance framework has contributed to precisely eroding those "institutional pre-requisites" which scholarly research in CPE and industrial relations had shown to be conducive to wage moderation and successful inflation management – with major implications for countries' capacity to navigate the return of inflation in the 2020s.

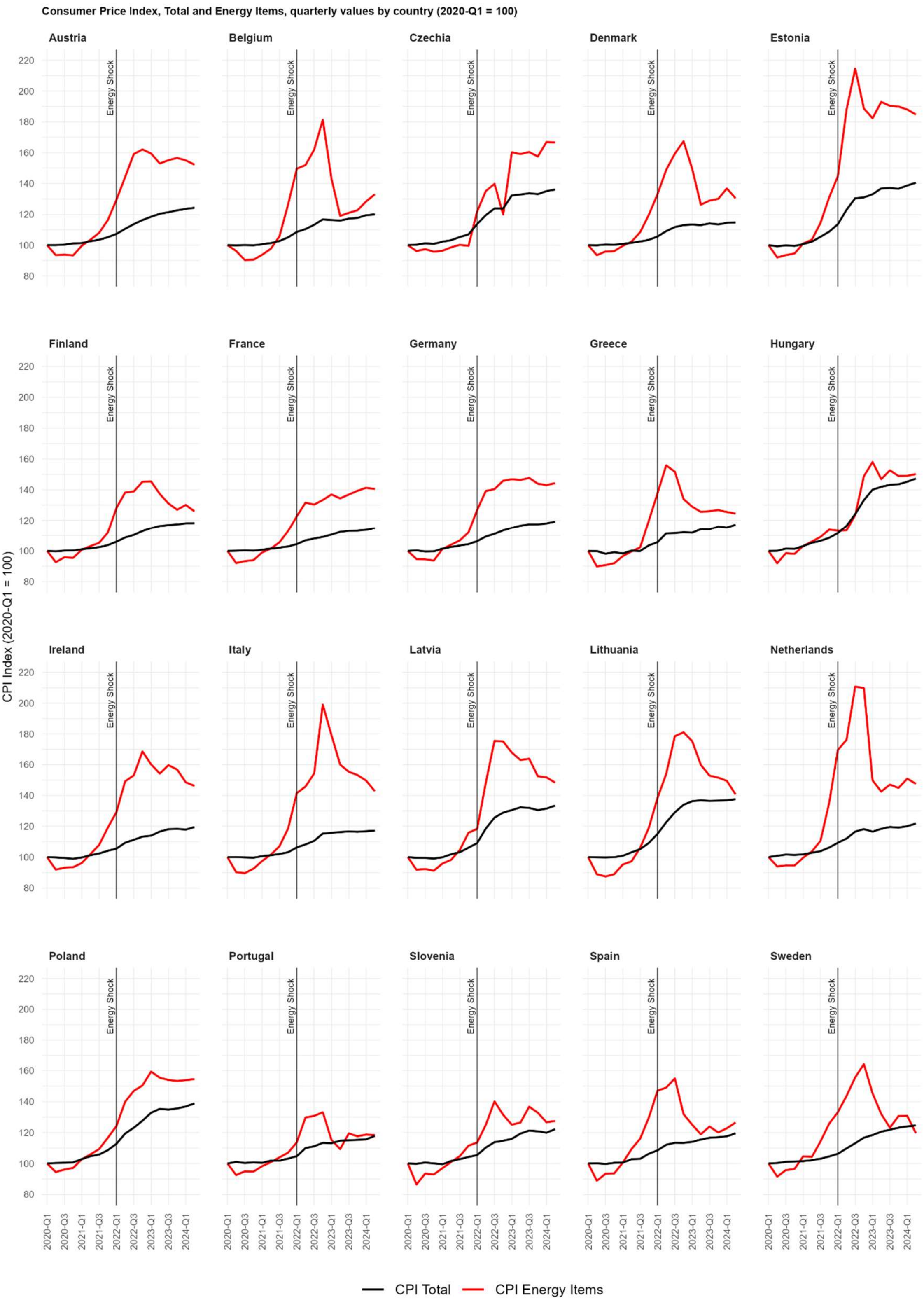
Take-Away Points for the Contemporary Inflationary Phase

The 1970s and 1990s experiences with negotiated incomes policy and bargaining coordination reveal four important considerations for today's inflationary challenges. *First*, the political exchange in the "golden age" of incomes policy rested crucially on the capacity of industrial relations actors to manage the wage-setting process through collective bargaining with some degree of autonomy, and to foster both horizontal and vertical coordination of wage-setting. *Second*, the main reason for the state to enter tripartite negotiations was a recognition of the need to "manage" and, as much as possible, "keep in check" strong unions and class conflict to guarantee the continued conditions for capitalist accumulation and macroeconomic and political stability of the Fordist edifice. It was a process driven by labour's strength, not by weakness. Already by the 1990s, this dynamic had faded away – leaving in place frameworks of wage-setting structurally geared towards wage moderation and employers' dominance. *Third*, there were clear distributional concerns in incomes policy in the 1960s and 1970s. However, these were focused on limiting excessive wage differentials that could emerge from an "excess" of labour bargaining power and thus hurt weaker groups in the labour market, and not so much one of distribution between capital and labour. By the 1990s, such concerns had largely faded away. *Fourth*, alternatives to centralized forms of inflation management have appeared in the form of pattern bargaining where exposed sectors set a wage norm for other sectors to follow. This type of bargaining coordination rests on strong cross-class alliances, typically in the manufacturing sector. However, these arrangements are unevenly present across countries and sectors and have in many contexts become eroded since the Great Financial Crisis. This leaves open the potential for greater need of direct state intervention in distributive dynamics to compensate the weakness of collective bargaining.

2. The 2021 return of inflation and its impact on workers' income

The COVID-19 pandemic produced an intense economic shock worldwide, disrupting supply chains, particularly in the semiconductor industry, and contributing to mounting inflationary pressures from mid-2021 onwards. Reopening economies fueled demand, further increasing prices across multiple sectors (Kemp et al, 2023). In 2022, Russia's invasion of Ukraine furthered the crisis, curtailing Russian energy exports to Europe and disrupting Ukrainian wheat exports - resulting in sharp increases in both energy and food prices. Inflationary impacts, however, were uneven across countries, largely influenced by each nation's dependency on Russian energy and the strategies they implemented to counteract inflation. Energy inflation rose markedly above overall inflation rates (Figure 1), becoming the primary driver of broader inflationary trends. Countries like France, Spain, and Portugal, which introduced energy price caps, were able to contain energy inflation more effectively. In contrast, Nordic countries, which had high exposure to Russian energy, experienced significant spikes in energy costs.

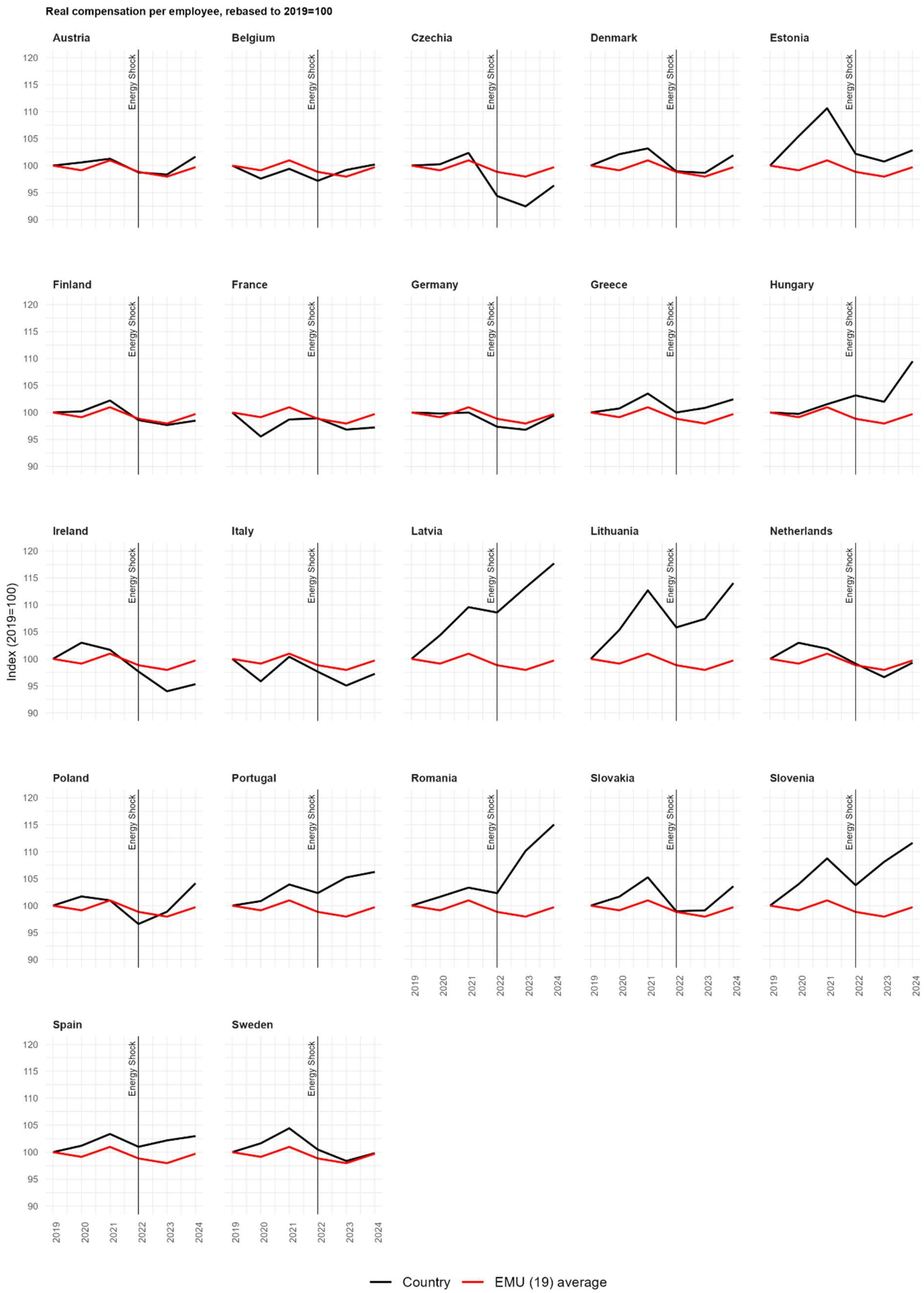
Figure 1: consumer price index, total prices and energy items only, quarterly data (2020-2024)



Source: authors' elaboration from OECD data.

With inflation surging, workers across Europe experienced a significant erosion in their purchasing power, with real wages declining on average by about 2.5% during 2023. However, real wage developments (real compensation per employee) since the pandemic have followed three distinct trajectories (Figure 2).

Figure 2: real compensation per employee, deflator private consumption (2019-2024)



Source: authors' elaboration based on data from AMECO.

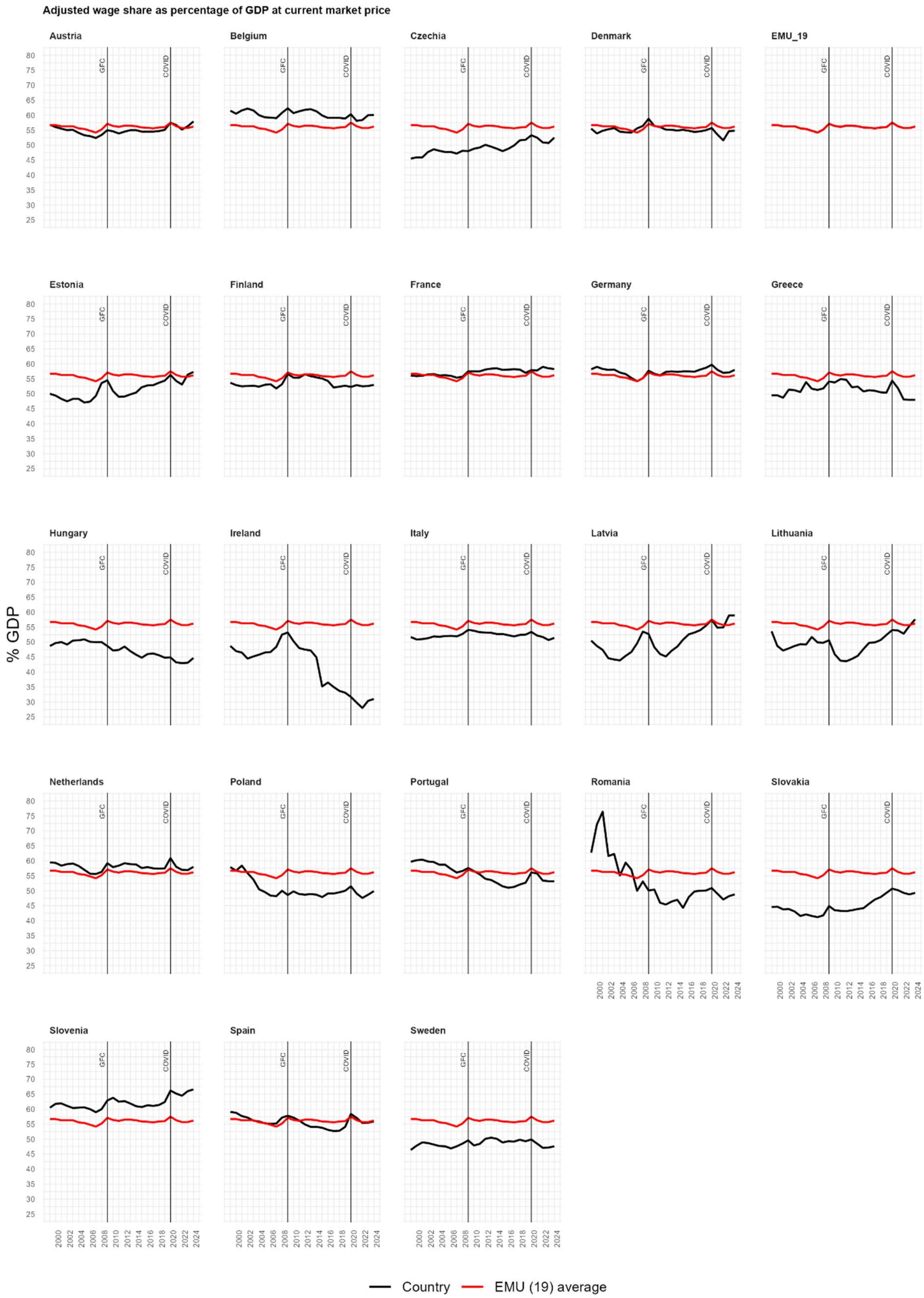
The first group of countries exhibited real wage trends closely aligned with the Euro area average, maintaining moderate levels of decline. This set of countries includes Austria, Belgium, Denmark, Finland, Germany, the Netherlands, Slovakia, and Sweden. Other countries saw a sharp decline in real wages and workers' purchasing power, with real wages declining remarkably in Ireland and Czechia. While not experiencing a decline in real wages comparable to the latter countries, real wages declined steadily also in France and Italy. On the contrary, a few countries reported substantial real wage growth, far exceeding the Euro area average. Estonia, Hungary, Latvia, Lithuania, Portugal, Romania, and Slovenia stand out for achieving real wage gains that defied broader trends. Real wages increased slightly also in Greece and Spain, although to levels not comparable to the real wage growth experience by workers in some Eastern European and Baltic countries.

Developments in the wage share also provide insights about the distribution of national income between capital and labour and, as such, is indicative of the relative economic power of labour versus capital. In periods of economic stability, the wage share tends to fluctuate only moderately. However, during major economic crises, greater fluctuations in the wage share could be indicative of the relative capacity of workers to defend their incomes in the process of macroeconomic stabilisation. In this sense, it becomes interesting to compare developments in countries' wage share in the context of the three major crises which have affected Europe over the last fifteen years: the Global Financial Crisis (GFC), the COVID-19 pandemic, and the recent energy crisis. The comparison allows a tentative assessment as to how the various shocks have influenced income allocation and the degree to which labour or capital has borne the brunt of each crisis.

After the GFC, the wage share saw a marked decline in many European countries (Figure 3), signalling a period in which capital income growth – on average – outpaced that of labour. Unlike the GFC, the COVID-19 pandemic initially led to an increase in the wage share across many – but not all – countries. This unexpected development likely stems from the fact that GDP contracted substantially but extensive government interventions – including wage subsidies, furlough schemes, and other types of support – contributed to stabilize employment and incomes during lockdowns. The 2022 energy crisis affected the wage share negatively across Europe. On average, the wage share fell across Europe from 57.5% in 2020 to 55.7% in 2022. The surge in energy costs increased inflation and reduced real wages, as nominal wage growth could not keep up with the rapid rise in living costs. This shift in income distribution signalled that labour incomes were bearing a disproportionate share of the burden compared to capital incomes. However, the impact varied significantly across Europe, with notable differences in national wage share trends.

Countries can be grouped into three clusters based on wage share developments since the 2022 energy crisis. First, there are countries where the wage share remained relatively constant, such as Austria, Belgium, Denmark, Finland, France, and to some extent also Spain. The second cluster includes countries where the wage share increased despite the energy crisis. Examples include Estonia, Latvia, Lithuania and Slovenia where real wage growth helped preserve labour's share of income. Finally, a third cluster saw significant declines in the wage share, as seen in Ireland, Italy, Romania and Sweden where nominal wage adjustments were insufficient to stabilise labour's income.

Figure 3: adjusted wage share as percentage of GDP in selected European countries (1999-2024)



Source: authors' elaboration based on data from AMECO.

Wage developments can also affect countries' competitiveness positions, that can be gauged by considering the developments in Unit Labour Costs, that reflect shifts in the balance between labour costs and productivity. Rising ULCs indicate that labour costs per unit of output increase, potentially weakening a country's competitive position in international markets. Conversely, when ULCs decline, production becomes relatively cheaper, enhancing competitiveness. In the EMU, where currency devaluations are foregone, adjustments in ULCs serve as a form of "internal devaluation" or "internal revaluation," helping countries manage competitiveness without altering exchange rates.

Examining ULC trajectories during the COVID-19 pandemic and the subsequent energy crisis reveals how European economies adapted to these disruptions, forming distinct clusters based on their ULC trends relative to the EMU average. Beginning in 2020, the pandemic disrupted the balance between labour costs and productivity across Europe as government interventions aimed to stabilize incomes but often led to higher ULCs. However, the effects varied significantly across countries, with three main clusters emerging (Figure 4).

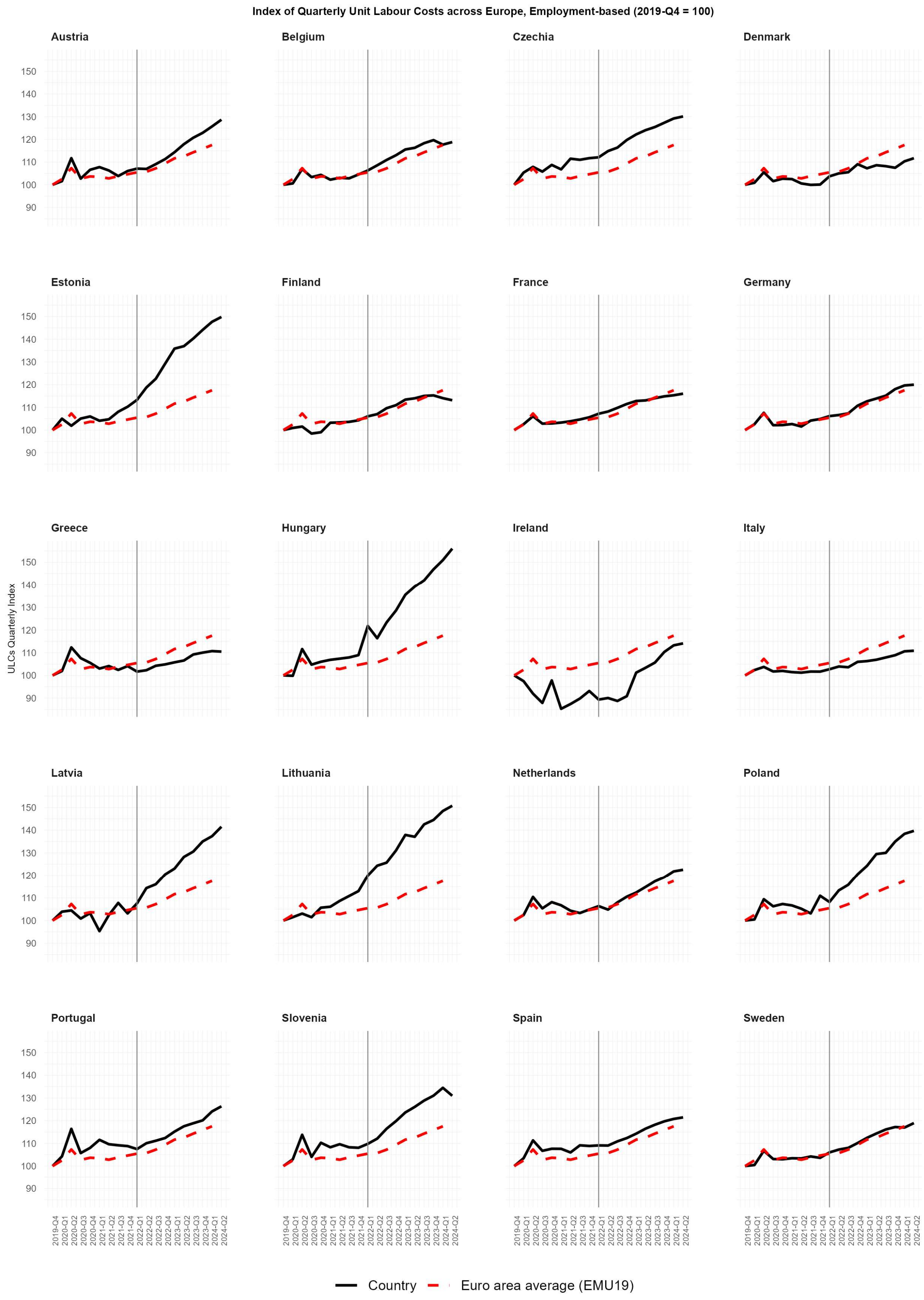
In the first cluster, countries such as Austria, Estonia, Spain, and Sweden experienced ULC growth that exceeded the EMU average, indicating notable rises in labour costs relative to productivity. A second cluster includes countries such as Denmark, Portugal, the Netherlands, and France, which maintained ULC growth in close alignment with the EMU average, staying within a +/-2% range. A third cluster, including Italy, Greece, and Ireland, displayed ULC growth below the EMU average, which suggests an internal devaluation effect.

Following the energy crisis of 2022, additional pressures on labour costs led to mounting divergence in ULC trajectories across Europe. Once again, three clusters emerged based on the relative ULC changes from 2022 onward. The first group, comprising countries such as Estonia, Czechia, Hungary, Latvia, Lithuania and Poland saw high ULC growth, with labour costs rising sharply relative to the EMU average. Ireland stands out as a case where ULCs grew rapidly since 2023, partially recovering the steady decline of the previous years and aligning toward the EMU average. The marked increase in ULCs in these countries indicates a strong internal revaluation, as production costs rose substantially in the context of already relatively higher price inflation, posing challenges to cost competitiveness.

In the second group, which includes Belgium, Finland, France, the Netherlands, Spain and Sweden, ULC growth aligned closely with the EMU average. These countries managed to balance moderate labour cost increases with some level of productivity changes, maintaining ULCs in line with the EMU benchmark, allowing these economies to adjust to the energy crisis without major shifts in competitiveness.

In the third cluster, countries such as Denmark, Greece and Italy saw declining ULCs, pointing to an internal devaluation, where lower-than-average ULC growth supported cost competitiveness despite inflationary pressures, either through productivity increases (as in the case of Denmark) or at the expense of workers' compensation (as in the case of Italy).

Figure 4: quarterly Unit Labour Costs (employment-based) by country (2019-2024)



Source: authors' elaboration based on OECD data.

Overall, both inflation and wage developments varied remarkably across Europe since the outburst of the Covid-19 pandemic, underscoring how different policy choices and economic structures have shaped economic dynamics across Europe. However, challenging developments have occurred especially in the context of the energy shock, with mounting divergence in both wage share and ULCs developments across Europe. To make sense of this diversity in overall wage developments and distributional trajectories, it is necessary to consider how the interaction between public policy responses and collective bargaining developments has played out since 2021.

3. Policy responses to the inflation crisis: New roles for Social Partners and the State

To gauge how the 2021-2023 inflation crisis has been managed across the EU, we need to consider the different contexts in which governments and social partners' have responded. The first element to take into consideration are the characteristics of industrial relations and wage-setting institutions and the power dynamics between capital and labour, which differ deeply from those of past inflationary crises. Second, government objectives and the policies deployed to achieve them have also differed from past inflationary episodes – due both to the different nature of the present inflation crisis, and to the changed institutional and macroeconomic setting. This has implications for the role played by governments' intervention in inflation management, which has increased, and the extent to which they needed to coordinate with social partners to achieve such goals, which has decreased.

The (marginal) role of industrial relations and wage-setting in the current inflation crisis

When considering the role of industrial relations and wage dynamics in the management of the current inflation crisis, three key aspects demand consideration. First, the current inflation crisis has not been driven by expansionary wage-setting or rigidities in collective bargaining institutions (ILO 2022); but is best understood as a supply-side shock compounded by dynamics of profit accumulation with systemic impacts on prices (cf. Weber). Indeed, real wages have experienced sustained losses in many countries over the last fifteen years, or limited increases at best. Secondly, collective bargaining in many countries has undergone a process of decentralisation over the last two decades. Collective bargaining's coverage rates have declined and research points to a limited role for indexation mechanisms in collective agreements (Koester and Grapow 2021). Consequently, in most countries negotiated wage increases over the last two years have remained far below price increases (Janssen and Lübker 2023). Third, the coordination capacity of social partners in most countries has decreased, not least due to decentralization, union density declines and dwindling collective bargaining coverage. Hence, the immediate impact of the inflation crisis in most EU countries consisted in a generalised decline in real wages – which was only partially recuperated over the following three years.

Compared to the 1970s episodes, this inflation crisis was preceded by a long period of wage stagnation that was particularly intense in those countries that were hit harder by austerity policies after the GFC and where institutional changes in wage-setting systems had been profound. This was most evidently the case in Southern European countries, where labour market reforms post-GFC tried to institutionalise a competitive wage devaluation policy through the decentralization of collective bargaining, real wage cuts in the public sector and the freezing of minimum wages. Even though some of these reforms and policies were relaxed by the late 2010s and early 2020s, their legacy provided an unlikely scenario for a rapid recovery of real wages before a sudden increase in prices, not to mention the risk of experiencing second-round effects.

Some works highlighted the difficulties of negotiated wages to keep up with inflation, paying particular attention to the waning role of wage indexation mechanisms (de Spiegelaere 2023, Molina 2023; Maccarrone 2024), which, as recalled in section 1 above, had been removed in most countries as part of the process of neoliberal restructuring of industrial relations through the 1980s and 1990s. Wage indexation mechanisms survived only in some countries, either in the form of generalised indexation (in this respect, Belgium stands out as an almost sole exception, with positive impacts on workers' purchasing power and internal demand – see Bouquin and Martinez Garcia 2024); or limited to only statutory minimum wages (as in France – see Massimo 2024). Besides the lack of automatic indexation mechanisms, other institutional features of national collective bargaining systems which have become institutionalised over decades of neoliberal reforms have been identified as hindering wage revaluation – such as for instance the common use of inflation indices used to calculate cost-of-living adjustment clauses in collective bargaining that do not include energy items; the weakness of firm-level bargaining in decentralised systems; the rigidities imposed by the duration of collective agreements and their renewal; and the general weakening of unions (Eurofound 2023). In the few cases where wage developments have bucked the trend of wage moderation – in particular, Eastern European and Baltic countries – this seems to have been primarily as a consequence of statutory minimum wage hikes implemented by the state, rather than a result of collective bargaining developments (see Guardiancich and Trif 2024).

However, the overall pattern of wage moderation should not *only* be understood as a consequence of collective bargaining institutional weakness or features. In many cases, unions themselves appear to have internalised the goal of ensuring wage moderation to avoid second-round effects and maintain external competitiveness through a cautious wage-setting policy (especially in EMU countries for which "internal devaluation" or "undervaluation" is the primary tool available to boost competitiveness). This is most clearly the case in export-oriented economies such as Germany and Italy. At the same time, it is important to underscore than in other contexts – such as for instance the Scandinavian countries – the inflation crisis has prompted a revitalisation of wage solidarity in collective bargaining, which might have important transformative effects down the line, highlighting that unions wage-setting strategies are not a frozen landscape and might evolve dynamically in the medium to long run after the dust of the immediate inflationary phase settles.

Inflation and conflict

The difficulties facing collective bargaining systems to adjust to the new inflationary environment and guaranteeing the recovery of purchasing power have put a strong pressure on workers, especially those with lower wages. One could expect that this should have trigger an upsurge in labour conflicts linked to improvements in wages. The lack of homogeneous data makes it difficult to measure the intensity and extension of labour conflicts across the EU. However, some studies have showed no significant increase in labour disputes across the EU (Cojocariu and Sedlakova

2024, Molina 2023). According to data from the ETUI strikes map, those countries reporting the highest increase in the number of disputes in 2022 and 2023 were Austria, Germany and Finland. Other countries experienced a more moderate increase in disputes, including Belgium, Spain, Portugal and the Netherlands. Even though strikes have affected most sectors, health and transport workers have been particularly active in many countries. In a context of limited increase in conflict levels, the UK stands up as a notable exception. Here the strike wave triggered by the inflation crisis has led to more working days lost to strikes in 2022 than in any year since 1989. The strikes have affected almost all sectors of the economy, but have been particularly intense in public services, including health and education. The weakness of collective bargaining institutions can probably explain why UK has experienced this increase in strike levels whilst experiencing similar inflation levels to other EU countries.

But conflict during the inflation crisis has also adopted a political dimension against government responses in managing the inflation crisis. This political dimension has been observed precisely in those countries with stronger mechanisms of wage indexation. In Belgium a general strike was called by trade unions on November 2022 against proposals from right-wing parties and some employer organisations to end with wage indexation in collective agreements. In France too, the CGT and FO confederations organised demonstrations calling for higher pay for all sectors but also asking for updating pensions and social transfers to the new inflation scenario. Overall, however, the landscape across Europe has been one of rather low inflation-related conflict – which may in turn be related to the "mitigating" role played by government policy interventions, which we proceed to analyse next.

The role of government

The changes in the industrial relations landscape that have occurred over the last three decades have had a strong impact on the capacity of collective bargaining institutions and actors to deliver timely responses to protect the most vulnerable groups. The functional need for the state to coordinate its responses with social partners to limit wage militancy and avoid second-round effects has also generally decreased, as only in a few countries and sectors unions conserve sufficient power resources to potentially exert significant cost-push pressures via the wage channel. However, the cost-of-living-crisis aspect of inflation is not one that governments can easily ignore, even if unions are weak – as the social and political consequences of price increases are very acute and generate demands from the public for protective policy interventions that might have disastrous electoral consequences if left unmet. This helps to account for the greater concern paid by policymakers to the distributive aspects of the inflation crisis.

In this context, governments responses have played a central role in the politics of inflation management. Governments' primary role has not been that of hammering incomes policy agreements with trade unions and employers, since the unlikely scenario of second-round effects made these largely unnecessary. Rather, they have played a dominant role in defining the policy priorities and the policy strategies to pursue them. From the comparative analysis, we propose three different (non-mutually exclusive) scenarios which differ with regard to the primary policy objective that governments prioritised when addressing inflation, and the corresponding set of policies they deployed (see table 1).

Table 1

Government priorities vis-à-vis inflation crisis *(not necessarily mutually exclusive)*	**Possible policy tools**	**Growth model features**	**Coordination with social partners needed (functionally?)**	**Coordination with social partners wanted (expressively)?**	***Exemplary cases***
Shielding competitiveness	Indirect price controls (Mostly untargeted) subsidies to producers for increased costs (esp. energy) Encouragement of wage restraint/moderation One-off social bonuses to compensate business & households	Export led	YES – if unions strong enough to advance strategically important high wage demands NO - if unions weak	YES - if unions strong enough to delegitimate wage restraint unless negotiated NO – if unions weak or delegitimised	Germany (informal coordination with social partners for wage restraint) Italy (no coordination) Greece (no coordination)
Supporting domestic demand	Wage revaluation *across* the pay scale (via support for collective bargaining / indexation) (Mostly untargeted) social bonuses Tax reductions	Demand led	YES – if automatic/statutory means of wage revaluation are absent OR if unions are too weak and collective bargaining very eroded NO - if institutionalised / statutory mechanisms of wage revaluation are present OR social partners can take care of wage-revaluation autonomously	YES – if cabinet wants legitimation from union side (for ideological/partisan purposes) NO – if cabinet does not desire legitimation from unions or their cooperation is not forthcoming	Spain (coordination for expressive purposes alongside state intervention via statutory minimum wage to compensate for weakness of collective bargaining) Norway (consensual policy-making without explicit coordination; generous and universalistic bonuses; solidaristic wage-setting in CB) Belgium (no coordination; wage revaluation across the board through automatic indexation)

Mitigating inequality in impacts	Direct price controls Taxation on extra-profits Wage re-evaluation *at bottom* of pay scale Targeted support measures for vulnerable groups	Either	YES – if automatic/statutory means of wage re-evaluation are absent, or if unions are too weak and collective bargaining too eroded	YES – if cabinet wants legitimation from union side (for ideological/partisan purposes)	Spain (as above)
			NO - if institutional mechanisms of wage revaluation/indexation are present OR social partners can take care of wage-revaluation autonomously	NO – if cabinet does not desire legitimation from unions or their cooperation is not forthcoming	France (no coordination; automatic indexation of minimum wage at bottom of pay scale) Denmark (consensual policymaking without explicit coordination; targeted support measures for vulnerable groups) Romania (no coordination; statutory increases in minimum wage and targeted support for vulnerable groups) Slovenia (no coordination; statutory minimum wage increases)

In export-led economies like Germany, Italy and to some extent Sweden, governments have first and mostly aimed at shielding firms' competitiveness. The type of policies used to achieve these goals have varied, but these include subsidies to producers for increased energy costs or indirect price controls. In order to ensure wage restraint, these countries may rely on existing forms of wage-setting coordination like in Germany. Real wages in these countries may accordingly fall during the inflationary phase and workers will mostly be compensated though one-time payments or social transfers financed through general taxation to avoid any form of second-round effects into collective bargaining.

In a second scenario, generally more marginal, governments' responses have been oriented to supporting domestic demand as part of a wage-led macroeconomic strategy to avoid recession and support households' purchasing power. Spain and Belgium would fall into this second group. In this case there is also great variance in the variety of policies implemented, but they may include expansionary public sector wage-setting or wage re-evaluation across the pay scale, for instance by ensuring some indexation of wages in collective bargaining. In Belgium, where forms of indexation in collective bargaining are still in place, this has contributed to maintain purchasing power of wages. Moreover, governments in this case may play a more active role in promoting coordinated responses with social partners to ensure some real wage recovery in negotiated wages. This has been the case in Spain, where the government has (unsuccessfully) tried to involve social partners into a tripartite incomes policy agreement to the aim of drawing a path for wage recovery compatible with competitive requirements. Beyond wage-setting, other policy tools have been used by governments in these countries, including direct transfers to families and / or individuals or tax reductions like reduced VAT for basic goods.

Finally, in a third scenario governments (and social partners) have placed the mitigation of the negative distributional impact of inflation as a key goal in their responses to the inflationary crisis. Some of the policy responses sketched out before under the supporting domestic demand scenario are also applicable when governments aim to reduce inequalities provoked by inflation. These include the use of direct transfers to families or rebates on some indirect taxes like VAT that have a proportionally larger impact on low-income groups. Resources necessary to follow this route can be raised through new taxes on extra-profits in sectors like banking or energy. Price controls to limit the increase in energy costs may also play an important role in this case. For instance, the so-called Iberian exception introduced in 2022 in Spain and Portugal was a temporary measure aimed at stabilizing energy prices through putting a cap on natural gas and effectively decoupling their electricity markets from rising global gas prices. This measure sought to reduce energy costs for households and businesses, alleviate inflationary pressures, and ultimately help reduce socioeconomic inequalities exacerbated by the crisis. When it comes to wage-setting, governments may rely primarily on minimum wage increases aligned with inflation to compress the wage structure at the bottom of the wage scale. In those countries without a statutory minimum wage, social partners may also look for ways to set higher negotiated minimum wages that help compress the wage structure at the bottom.

What is common across the board is that, in all these different scenarios, direct state intervention to compensate households and/or increase the social acceptability of wage moderation with alternative forms of compensation financed through fiscal policy has increased, whilst the occurrence of explicit coordination with social partners to achieve these objectives has waned.

4. Conclusions and future research trajectories

The contemporary politics of inflation management in the aftermath of neoliberal transformation are complex and multifaceted. To conclude, we want to highlight **three** main take-away points, and some avenues for future research.

First, in a context of general union weakness and eroded collective bargaining structures, the role of the state as the chief actor in managing both the macroeconomic *and* the distributive aspects of inflation has increased compared to the past. Whilst governments did not need to mitigate the wage militancy of strong unions, they needed nonetheless to address the adverse distributional effects of inflation on household, which, if left, are sure harbingers of electoral backlash and possible social unrest. Hence, in most cases, the main "referent" constituencies for governments when crafting policy responses to the current inflation phases have been households in their primary role as *consumers* and *voters,* rather than union members; alongside firms hit hard by increased energy and production costs and interest rate hikes. In a context of union weakness and generally subdued industrial conflict, it appears that the combined use of fiscal policy, price controls and statutory wage interventions has been temporarily effective in ensuring social peace, even in the context of repeated interest rate hikes. Future research shall investigate the extent to which governments' efforts to minimise the political costs of inflation have actually paid off in the medium run. Furthermore, as many countries face constrained fiscal space coming out of the acute inflation crisis, the sustainability of this response strategy might not necessarily be ensured in the long run, potentially casting trouble if inflation was to pick up again in the near future.

Second, and consequently from the preceding point, governments have prioritised policy tools at their direct disposal – either fiscal policy interventions, price controls, or statutory wage interventions – to mitigate the adverse implications of inflations on firms and workers and coordinating this mitigation effort with the pursuit of their broader macroeconomic management objectives. As the deployment of "visible" policies that directly impact households purchasing power – either direct social transfer, tax cuts, price controls or statutory minimum wage hikes – helps to secure legitimation from the public, the consensus-generating (or "expressive") functions of coordination with unions becomes even less relevant. Thus, coordination in wage-setting with unions and employers has only remained relevant in those few countries and sectors that retain "competitive corporatist" features geared towards preserving competitiveness in export-led economies (e.g. Germany and Sweden); or in those rare cases, such as Spain, where left governments were interested in maintaining close political links with unions as part of a broader wage-led growth strategy (cf. Bondy et al. 2024); but these are the exception rather than the rule. Future research should investigate more systematically the links between growth strategies and the role of wage policy, in both inflationary and non inflationary times.

Third, we observe that the accumulated impacts of forty years of neoliberal transformation appear to have had their "desired" effect on the relationship between industrial relations and inflation – which, as we recalled, was indeed one of the primary objectives that the neoliberal-monetarist assault of the 1980s on industrial relations aimed to achieve. Union strength is no longer a serious problem for macroeconomic stability (cf. Cova 2024), and the institutional set up of collective bargaining in most countries has largely internalised the imperative of wage moderation. However, union strategy is not necessarily a frozen landscape, even in the presence of strong institutional constraints. The extent to which unions in the wake of the Great Inflation of 2021-2023 will either continue to internalise and comply with an institutional framework geared towards wage moderation and price stability, or will seek to alter it by bringing back to the fore demands around wage solidarity, indexation and broader labour-capital redistribution is an open ended question that future research should address.

Future research should also investigate more systematically the broader inter-relation between monetary policy, especially for EMU countries, wage-setting dynamics and fiscal policy. To what extent did policymakers and unions adapt their strategies, wage demands and fiscal policy responses to the ECB interest rate setting behaviour? To what extent was there explicit coordination across Eurozone governments and unions in this regard? And, if this was absent or limited, what are the long-run effects for EMU? Only a renewed dialogue between industrial relations and comparative political economy, in the spirit of 1970s scholarship, can help to address these questions. This is an avenue of enquiry that future work should address as a priority.

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