Eurofound

Wage indexation in the European Union

Background paper

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Introduction

The formation of wages in general – and the periodic adjustment of wage levels in particular – are the result of a complex process that is shaped by industrial relations outcomes, as well as considerations such as economic growth, inflation, productivity and labour market developments.

In the majority of countries in the European Union, systems of wage formation are based on collective bargaining between employee representatives – mostly but not exclusively comprising trade unions – as well as employer representatives. Nevertheless, major differences exist as regards the predominant level of bargaining and the links between these levels. One of the main differences in this regard concerns the involvement of either individual employers or an employer association, the latter resulting in so-called 'multi-employer bargaining'.

In many European countries, the collective bargaining system is also dependent on legislation and state intervention. While the state usually acts as an employer in the public sector, involvement in wage setting for the whole economy can result from arbitration processes on wage disputes or the practice of extending collective agreements to whole branches of the economy.

Wage bargaining processes, either through collective bargaining or to an increasing extent through individualised bargaining, determine wages in most EU countries. However, some EU Member States apply a system of 'automatic' wage adjustment procedures – also known as 'wage indexation'. Systems of wage indexation, where some form of general index prescribes the development of employees' wages, are currently in place in four EU countries: Belgium, Cyprus, Luxembourg and Malta. Adjustment is based on currency inflation and aims to maintain wage levels, despite long-term increases in the cost of living. In addition to these four Member States, a number of other EU countries used to have such a system of wage indexation in the past but have now abolished it – as is the case in Denmark, France, Italy, the Netherlands and Spain.

This background paper by the European Foundation for the Improvement of Living and Working Conditions (Eurofound) investigates the different forms of wage indexation that can be found across Europe. It presents the main characteristics of wage indexation, and looks at the legislation and levels of bargaining to this end, as well as the views and positions of the social partners and the role of the state.

The first section describes the functioning and the principle of wage indexation, providing a summary of the main elements of the academic debate on this issue as well as the respective views of the social partners. The second section explores in detail the different systems of wage indexation and wage formation in Belgium, Cyprus, Luxembourg and Malta. The third section completes the picture by looking at various examples of countries that previously had an indexation system and subsequently abolished it, examining the reasons leading to such developments.

This paper draws extensively on research from Eurofound's European Industrial Relations Observatory (EIRO[1]), the European Employment and Industrial Relations Glossaries (EMIRE[2]), as well as journal articles in the field of employment and industrial relations.

[1] **http://www.eurofound.europa.eu/eiro/**.

[2] **http://www.eurofound.europa.eu/emire/emire.htm**.

Functioning of wage indexation

Underlying principle

Wage indexation aims to link wage development to the actual evolution of living costs to ensure that real wages are not overtaken by inflation. While autonomous collective bargaining rounds between employers and trade unions often take into account indicators such as overall inflation rates and price developments, it is still up to the bargaining parties to determine and agree on the outcome of these negotiations. Wage indexation, on the other hand, establishes a floor of wage developments for all wage groups which cannot be undercut by autonomous collective bargaining outcomes or individual agreements – although derogation procedures do exist.

Wage indexation is based on regular adjustments of wages in line with general changes in price levels. The index usually used is the Consumer Price Index (CPI) (Aizenman, 2008). This system is sometimes referred to as the Cost of Living Allowance (COLA) or the cost of living adjustment.

The current existence of a wage indexation system in Europe is not related to other national features of collective bargaining. Belgium and Luxembourg, for instance, are characterised by a centralised level of bargaining, whereas Cyprus and Malta have more decentralised wage bargaining systems.

Although this background paper looks at indexation systems that have a direct impact on wages and salaries, many other European countries use a system of inflation-based indexation. Such a system can be used for the purpose of continuously adjusting minimum wages – as seen in the case of the Czech Republic and Greece – or for calculating welfare benefits and pensions – as observed in Spain and the United Kingdom.

Academic debate on wage indexation

Academic interest in the effects of indexation schemes on the economy goes back as far as the theories of economist Alfred Marshall in the late 19th century. Since then, considerable academic research has been generated on the topic of wage indexation. The research encompasses a wide range of areas from macroeconomic policy to industrial relations research.

In the academic debate, wage indexation desirability is linked to the assessment of the functioning of the labour market. If the labour market is viewed favourably, with wages being continuously adjusted to match the demand and supply of labour, then indexation is considered as an aggravating factor. In contrast, the further one moves away from a market perspective, the more wage indexation appears to have a significant role to play (Aizenman, 2008).

Numerous economists have focused on the role of wage indexation in the inflationary process. For example, according to Ehrenberg (1982), many researchers presented evidence on the impact of wage indexation in the inflationary process, such as Kahn (1981). On the other hand, Aizenman (2008) highlighted that the link between wage indexation and inflation was still undetermined and that wage indexation would not be problematic in countries with stable and low inflation.

Attention has also been directed at the role that wage indexation may play in reducing the level of strike activity in the economy. Kaufman (1981) and Mauro (1982) found evidence that wage indexation reduces the likelihood of strikes. Looking at the cyclical movement of strikes in the manufacturing sector in the United States in the 1970s, Kaufman found evidence that wage indexation contributes to reduced strike activity, as it limits uncertainty over wage revisions, especially when inflation is high and when real wages may be affected.

Researchers also investigated the implications of wage indexation for macroeconomic stabilisation policy, asking whether indexing schemes influence government monetary policies and economic shocks (Gray, 1976).

Further research also discussed indicators other than inflation according to which wages could be indexed, knowing that optimal indexation depends on the availability and cost of information. For instance, Aizenman (1986) investigated other indicators against which wages could be indexed in the case of economic shocks, such as gross national product (GNP).

Social partner views on wage indexation

In the countries with a wage indexation system, heated debates often arise between the social partners about reforming and eventually abolishing these systems of wage adjustment. Employers and their representative organisations are usually highly critical of the established wage indexation systems. From their point of view, wage indexation implies rigidity, preventing wages from reflecting actual worker productivity and company performance. According to employers, this uniform application does not allow wages to mirror productivity differences across economic sectors and geographical areas. A solution often suggested by employers is to keep wage growth in line with productivity rises.

In addition, increased competition has in recent years created pressure for greater flexibility concerning pay, for cost and performance reasons – both within and between companies. As a result, linking wages more closely to performance – be it individual or group-based – is one of the main arguments of employers for abolishing wage indexation measured according to inflation in countries where it is still the case (EIRO, February 2009).

Moreover, employers often mention the potential, self-perpetuating inflationary spiral that wage indexation could create. Excessive wage increases could trigger inflationary risks, and high labour costs may indeed be a result of wage indexation in countries where inflation is high. For these reasons, in France in 1983 and in Italy in 1993, anti-inflation policies have been associated with the abolition of wage indexation systems. Another reason put forward by the employers for abandoning wage indexation is the lack of reactivity to economic shock which this system could imply in making downwards wage flexibility impossible. In this context, wage indexation prevents the necessary adjustments in the case of an adverse economic situation.

Conversely, in countries with wage indexation systems, the trade unions support and defend the maintenance of cost of living adjustments through the automatic indexation of wages based on inflation. Three main arguments of the trade unions can be highlighted. Firstly, the very aim of wage indexation systems is to protect real wages against rises in the cost of living. In the absence of such a mechanism, wage adjustments depend heavily on the trade unions' bargaining power. Moreover, low bargaining coverage may further limit the applications of such bargaining achievements in terms of wage developments. Secondly, wage indexation is seen to guarantee social fairness in ensuring the redistribution of national income to workers. Thirdly, wage indexation may contribute to peace in industrial relations. While collective bargaining remains important within a system of wage indexation, disagreements over wage increases are limited in scope, which in turn may reduce strike levels (Kaufman, 1981; Mauro, 1982)

The trade unions also contend that wage indexation has been associated with moderate demand in pay rises which counteracts the risk of inflationary pressure – one of the main arguments made against wage indexation from a macroeconomic view. In addition, the trade unions highlight that there are possibilities to control wage increases in the event of difficult economic circumstances arising.

From a cross-country perspective, the social partners' involvement in the wage indexation process differs between the countries, as will be shown in the next section of the report. In Malta, for example, the social partners are directly involved in this process through a tripartite body, which establishes the index according to which wages are adjusted. In Luxembourg, the social partners participate in the tripartite body, which is in charge of monitoring the system of wage indexation and has the capacity to temporarily suspend wage indexation if economic difficulties arise.

Wage indexation systems in the EU

Across the EU, wage indexation is implemented in various ways and at different levels. In Belgium, Cyprus, Luxembourg and Malta, for example, it applies to all employees. Spain is an example of a country where wage indexation is in practice present in most collective agreements, although it is not prescribed by law. A further example of wage indexation can be found in the public service at EU level, where the wages of EU employees are linked to overall wage development at national level and cost of living developments at the place of employment. The following sections describe in more detail how these wage indexation systems operate; a summary of the different systems is also shown in the table at the end of this chapter.

Belgium

In Belgium, collective bargaining and wage indexation play a central role in wage setting. In addition, the state plays a major role in monitoring wage growth. Wage bargaining is highly structured at three interlinked levels in this country: the central cross-sectoral level covering the entire economy; the intermediate level covering specific industrial sectors; and the company level. At macro level, wage bargaining takes place every two years and results in national cross-sectoral agreements scheduling pay increases for the two following years. In principle, a lower-level agreement should respect what has been reached in the higher-level agreement and can only improve what has been agreed upon. For that reason, wage bargaining is considered to be highly centralised in Belgium.

The country has an extensive automatic index-linking system in setting wages which constitutes upper and lower bounds to wage growth. The system links pay and social security benefits to the health index (*Gezondheidsindex*) in order to prevent the erosion of purchasing power by inflation. Although wage indexation existed in the past, the current health index was introduced in 1994 and established an adjusted core inflation measure that excludes the prices of tobacco, alcohol and transport fuel (Organisation for Economic Co-operation and Development (OECD), 2007). For most workers, the automatic adjustment takes place once a year during the first quarter. Automatic wage indexation also includes the public sector and the minimum wage settlement.

On the whole, indexing means that for every 2% rise in the cost of living, there is an automatic increase of 2% in pay. However, each sectoral collective agreement implements the indexation in a different manner, leading to a rather complex indexing system. The state closely monitors the automatic indexing of wages in order to prevent an upsurge in relative labour costs, which could jeopardise external performance. Two laws were passed in 1989 and 1996, authorising the government to intervene in the wage-setting process. At present, the forecast of increases in foreign hourly labour costs among trading partners (France, Germany and the Netherlands) serves as a maximum wage increase limit at all levels – that is, at cross-sectoral, sectoral and company levels. This means that wage developments can only take place within the range defined by the indexation floor and the wage norm ceiling (EIRO, March 2009a).

It is mandatory for all employers to adjust wages according to the index. While opt-out clauses in sectoral agreements exist, these are rarely used. Employers in Belgium have criticised the country's wage formation framework for not being flexible enough to withstand economic shocks and for not sufficiently reflecting changes in regional employment. They also believe that the system leads to increases in wage costs and thus threatens the competitiveness of the economy and employment. As living costs in Belgium have risen significantly over the past two years, the Federation of Belgian Enterprises (*Fédération des Entreprises de Belgique/Verbond van Belgische Ondernemingen*, FEB/VBO) fears negative consequences for the competitiveness of the Belgian economy if the automatic wage indexation is maintained in its current form.

However, the trade unions consider this proposition to be unacceptable, especially in the context of the current economic crisis. In particular, the trade unions are concerned about the potential loss in workers' purchasing power and consider that wage indexation should be protected (EIRO, January 2009).

Cyprus

In Cyprus, wage developments are mainly settled at sectoral and company levels through bipartite collective bargaining negotiations held between the employer and the most representative trade unions. Collective bargaining does not exist at national level for the setting of minimum terms and conditions of employment binding for all workers.

In this country, the company and the sectoral levels are both considered to be important. Whereas company-level agreements are the most common, sectoral agreements cover a larger proportion of the workforce. For example, the sectoral agreement in the construction sector covers about 25,000 employees and the accord in the hotels and restaurants sector about 16,000 workers.

While collective bargaining and pay setting are framed by overall economic developments, in particular the development of labour productivity, a system of pay indexation operates in Cyprus – that is, the COLA, which is used as a basis for pay increases. The CPI is calculated by the Statistical Service of Cyprus (*Στατιστική Υπηρεσία της Κυπριακής Δημοκρατίας*, CYSTAT) on the basis of a basket of goods (EIRO, April 2009). According to the current system for calculating the COLA, every six months (on 1 January and 1 July) the wages of all employees covered by collective agreements are readjusted on the basis of the percentage change in the CPI over the preceding six-month period. Given that wage indexation in Cyprus applies to the outcomes of collective bargaining, in theory it applies only to workers covered by collective agreements. However, in practice, wage indexation covers all employees, regardless of whether they are a member of a trade union.

Clauses that provide for derogations from the wage norms stipulated in sectoral agreements are not found in Cyprus. However, under special circumstances – that is, achieving the macroeconomic convergence criteria for Cyprus's successful inclusion in the European Economic and Monetary Union (EMU) in January 2008 – collective bargaining has been characterised by wage moderation. An example of this was seen in the case of the sectoral agreement in the semi-public sector in 2005, which did not provide for any pay increases for 2004 and 2005 (EIRO, February 2005).

This system of pay indexation has been in use since 1944. It is considered to be one of the most important achievements of the Cypriot trade union movement, which strongly supports the system as a fair means of preserving employees' real earnings. However, the country's employer organisations have been more disparaging, making frequent criticisms against both the wage indexation system and the present method of calculation.

Employer organisations would prefer the system of wage indexation based on inflation to be abolished and replaced by an alignment of wages with increases in average productivity, as calculated by CYSTAT. The issue of changing the system of wage indexation has been seriously at stake in the social dialogue agenda between 1995 and 1997. More recently, the Governor of the Central Bank of Cyprus, Athanasios Orphanides, indirectly mentioned the need to reform the wage indexation system on the basis that it aggravates inflation. Shortly after this, the Employers' and Industrialists' Federation (*Ομοσπονδία Εργοδοτών και Βιομηχάνων*, OEB) supported the governor's opinion. However, on the trade union side, the Democratic Labour Federation of Cyprus (*Δημοκρατική Εργατική Ομοσπονδία Κύπρου*, DEOK), the Cyprus Workers' Confederation (*Συνομοσπονδία Εργαζομένων Κύπρου*, SEK) and the Pancyprian Federation of Labour (*Παγκύπρια Εργατική Ομοσπονδία*, PEO) expressed their disagreement with the governor's position. The trade unions stated that the indexation system protects workers' real wages from inflationary pressures and that it has contributed to industrial relations peace (EIRO, March 2009b).

For its part, the Cypriot government contends that the collective bargaining outcomes regarding wage determination should be respected and that the government only plays a secondary role in this respect. However, successive Cypriot governments have continued to support the wage indexation system on the basis that constant improvement of workers' living standards should be respected in a context of increased labour productivity.

Luxembourg

In Luxembourg, wage setting is either based on legislation (for the public sector and the minimum wage) or on collective bargaining. The wage can also be individually negotiated between the two parties in an employment contract. In any case, the wage setting should take into account the automatic wage indexation system that exists in Luxembourg. This means that pay levels are automatically adjusted to compensate for changes in the cost of living (EIRO, March 2009c).

The automatic revaluing of wages and salaries – also called the 'sliding wage scale' – was introduced by law in 1975. The adjustment mechanism based on inflation takes place on a retroactive basis once the CPI has risen above 2.5% in the previous six months. In addition, the national minimum wage and social benefits are updated in line with automatic indexation (Schintgen, 1990). The law of 1975 provides for sanctions on employers that do not respect the sliding scale of wages and salaries. However, in the case of a worsening economic situation, monitored through economic indicators related to the country's competitive economic situation, it is established that the government should resort to the Tripartite Coordination Committee (*Comité de coordination tripartite*).

The Tripartite Coordination Committee consists of four members of the government, four employer representatives and four employee delegates. This body is in charge of assessing the economic and social situation relative to its four neighbouring countries – Belgium, France, Germany and the Netherlands; it also gives advice on labour market policies (Schintgen, 1990). With regard to wage indexation, the committee may recommend temporarily suspending indexation. This procedure was used in 2006, for example, when the Tripartite Coordination Committee concluded an important agreement establishing, among other measures, a temporary suspension of automatic wage indexation to slow down wage developments given the difficult economic climate (EIRO, October 2006; OECD, 2008).

In Luxembourg, the employers' focus has largely been on trying to limit the effects of the country's wage scale, which makes adjustments in line with the cost of living index. The country's main employer organisation, the Union of Luxembourg Enterprises (*Union des Entreprises Luxembourgeoises*, UEL), contends that the system of automatic wage increases should be reformed. The main point of conflict is the employers' wish to replace linear pay increases with more flexible, individualised elements. Employers condemn the fact that the payment of automatic index-linked increases ignores the competitive situation or the individual financial situation of enterprises. They claim that the automatic indexation system endangers the competitiveness of the Luxembourg economy, which faces foreign competitors that do not have this 'burden' (EIRO, June 2002). Furthermore, employers believe that the automatic indexing of pay has major secondary psychological effects. According to employers, many employees think that an index-linked increase is not a real pay rise, but an increase to which they have a right (EIRO, November 1999). More recently, in February 2009, UEL indicated in a **position paper (in French, 210Kb PDF)**[3] that the wage indexation should only be applied to low wages of up to 1.5 times the minimum wage, in order to protect low-paid workers without imposing too heavy a burden on companies.

In contrast, the trade unions claim that this indexation of wages according to price levels does not lead to uncontrolled pay growth, which has been confirmed by the moderate pay rises agreed. Furthermore, the trade unions endorse the preservation of a system that 'provides an absolute minimum, and does not undermine the competitiveness of enterprises because of the contribution it makes to industrial peace' (EIRO, June 2002).

[3] **http://www.uel.lu/fr/upload/doc1451/Crise-mesures-UEL-vers_def_02-06.pdf**.

Malta

In Malta, the system of wage formation is regulated by legislation and collective bargaining. Wages are predominantly regulated by collective agreements at company level. It is mandatory for companies in Malta to increase wages according to a statutory COLA every year. The national minimum wage is set by law but is also updated each year in accordance with the country's COLA (EIRO, March 2009d).

This system dates back to 1990 when an agreement on national income policy introduced the cost of living adjustment. The agreement was initially planned for a three-year period and, although it has never been formally extended, the system is still in use today. The agreement is said to be the main outcome of the Malta Council for Economic and Social Development (MCESD), the national tripartite institution for social dialogue, which was launched in 1988 and which formally organises social dialogue between the social partners. This income policy agreement proved the feasibility of social dialogue in the context of the polarised political context of Malta and brought stability and peace in the industrial relations climate (Zammit and Brincat, 2006).

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

In Malta, as in other countries using such a system, debate is ongoing about the status of automatic wage indexation through the COLA, with employers arguing for its abolition but the trade unions supporting it. Due to the high level of inflation in 2009, the wage increase is expected to be substantial in 2010. Employers have expressed their discontent and fears that this could in turn fuel inflation, jeopardise the competitiveness of Maltese companies and eventually threaten employment. As a consequence, the Malta Employers' Association (MEA) has suggested that the government should subsidise the COLA increase. It also advocates that wage increases in the future should be determined by collective bargaining using productivity as a reference, highlighting that the COLA should be restricted to the lowest wage earners only.

However, the Maltese government rejected the MEA proposition of subsidising the COLA and limiting its scope. It highlighted the positive role that the COLA has played in easing industrial tensions in Malta and in leading to moderate demands for wage increases. In an interview published in a local newspaper, the Maltese Minister of Finance, Tonio Fenech, stated that 'we should move away from the mentality that to become competitive we must have the lowest wages in the world' (EIRO, December 2009).

The trade unions have endorsed the government's position. They strongly support the use of wage indexation, oppose the employers' suggestion of abandoning the COLA and insist that it should be granted to all workers. However, the General Secretary of the General Workers' Union (GWU), Tony Zarb, has proposed a revision of the RPI weighting mechanism, taking into account changes in the consumption patterns of Maltese society (EIRO, December 2009).

Wage indexation and collective bargaining in Spain

Although it is not established as a national practice by law, wage indexation has been widely used in Spain. Most collective agreements include clauses specifying wage increases based on inflation. To avoid inflationary pressures, the index used for calculating wage developments is the forecast inflation rate – that is, not the rate of inflation in the previous time span. In Spain, pay rises are thus settled according to three criteria: the inflation rate forecast by the government, the increase in productivity and a wage revision clause in cases where the real inflation rate exceeds the government forecast (EIRO, February 2006; EIRO, March 2009e).

Due to the recent economic crisis, inflation rates have been lower than those foreseen by the government, a development that led to tensions in collective bargaining processes. The government forecast an inflation rate of 2% for 2009, but in June 2009 the actual rate was -1%. As a consequence, pay rises below 2% were being applied in some sectors and companies. The trade unions opposed these practices on the basis that, in a period of economic downturn, it is necessary to support demand and not to reduce pay and thereby workers' purchasing power. This has led to several industrial disputes. In the case of labour relations court cases, the labour courts have often supported the employees (Días-Arias, 2009).

Wage indexation for employees of EU institutions

The remuneration of employees and officials of European institutions is subject to a combined form of wage indexation, as laid down in the **Staff Regulations of EU officials and other employees (1.28Mb PDF)**[4] in place since 1 May 2004. Following a decision by the European Council based on Eurostat data, the salaries of EU employees are adjusted annually. The adjustment takes account of both the average salary developments of national civil servants in a sample of eight Member States – namely, Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain and the UK – and of the cost of living at the place of employment. As this measure is applied retrospectively, wage developments in the national public services apply to EU employees, with a time lag of one year.

This first step of adjustment aims to ensure that wage developments at EU level reflect the developments at national level. A second step of adjustment takes into account the geographical differences in the cost of living between Brussels and any other place of employment in an EU institution, as well as the differences over time. Adjustment is based on the so-called 'correction coefficient', which reflects the differences in purchasing power between Brussels and the place of employment, with Brussels as the reference city. However, the indicator does not necessarily follow the general evolution of consumer prices in a given country, because it takes into account the consumption patterns of EU employees at their place of employment. Consumption patterns are established by means of a survey – namely, the Family Budget Survey (FBS) – which is conducted every five to seven years among employees in EU institutions located outside of Brussels.

As a result of this adjustment procedure, wages for the same position in an EU institution may vary extensively across Europe. For instance, an employee working in an EU institution in Bulgaria would receive 62% of the wage paid for the same position in Brussels, while an employee working in Denmark would receive 138% of this wage – in accordance with the **Council Regulation of 21 December 2009 (168Kb PDF)**[5] on remuneration and pensions of EU officials and other employees.

4 **http://ec.europa.eu/civil_service/docs/toc100_en.pdf**.

5 **http://register.consilium.europa.eu/pdf/en/09/st16/st16488-re03.en09.pdf**.

Table 1: *Summary of wage adjustment systems, by country*

	Coverage	Method of adjustment	Regularity of adjustment	Type of collective bargaining	Derogation procedure
Belgium	Pay Minimum wage Social benefits	Health index = CPI excluding the price of tobacco, alcohol and fuel energy	Usually every year during the first term	Centralised collective bargaining Wage setting is monitored by the state	Yes, but it is rarely used
Cyprus	Pay	CPI	Every six months	Company and sectoral levels (in term of coverage) No formal coordination between the two levels	No
Luxembourg	Pay Minimum wage Social benefits	Only applied if the CPI rises above 2.5%	Every six months	Rather centralised	Yes, if the Tripartite Coordination Committee finds it necessary
Malta	Pay Minimum wage Pensions	RPI	Every year	Company level	Yes

Source: *Authors' own overview*

Examples of earlier wage indexation systems

In addition to Belgium, Cyprus, Luxembourg and Malta, where wage indexation systems are currently in place, a number of European countries changed the practice of wage formation and abolished general wage indexation systems – mostly in the 1980s and early 1990s. The countries in question are Denmark, France, Italy and the Netherlands.

Denmark

A system of wage indexation, or cost of living adjustment (*dyrtidsregulering*), was previously in place in Denmark. The system was based on a price index representing the price of selected goods. Industry-wide and sectoral agreements in Denmark contained clauses mentioning a detailed system of automatic pay adjustment in accordance with changes in the price index (EMIRE, 2003a). This system had been reformed several times to control pay growth – that is, in 1963, 1978 and 1979. In 1982, the automatic cost of living wage indexation was finally abolished (Hasselbalch, 2005).

France

In France, wage indexation based on price levels was abolished in 1983 in order to contain inflationary pressures. From then on, wages as a proportion of gross domestic product (GDP) declined. Although numerous automatic index-linking practices existed in France, they are much less common today. However, the national guaranteed minimum wage (*salaire minimum interprofessionnel de croissance*, SMIC) is still partially automatically linked to changes in the cost of living (EMIRE, 2003b). Nevertheless, in order to preserve the public order, the country's Labour Code explicitly mentions that it is forbidden to include in collective agreements clauses indexing wages on the SMIC.

Italy

In Italy, the COLA was introduced by collective bargaining after the Second World War. The way in which it operated underwent various changes over time. The system in operation from the mid 1970s was based on the automatic payment of equal amounts to all employees, regardless of individual pay levels. This system came under criticism as it was seen as aggravating the inflationary tendencies present in the Italian economy and because it was a source of compression of pay differentials (Casadio, 2003). This combination of factors led to substantial inflation rates and increased the need for reforms (EIRO, June 1998). In 1992, the national multi-industry agreement abolished the system of automatic pay adjustment, the so-called ‘scala mobile’. In the following year, the 1993 tripartite agreement confirmed the abolition of the former sliding-scale mechanism and introduced the forecast rate of inflation as a new parameter to which pay increases should refer (EMIRE, 2003c; EMIRE, 2003d). The forecast rate of inflation is anticipated by the national budget report. Since then, the trade unions have been asserting that this indicator is unreliable and that compensatory mechanisms in the case of inflationary differentials should be foreseen (EIRO, September 2008).

Netherlands

Prior to 1969, automatic cost of living adjustment clauses were part of lower-level collective agreements (EMIRE, 2003e). In 1969, the Netherlands instituted a national automatic cost of living adjustment system, as recommended by the Social and Economic Council (*Sociaal-Economische Raad*, SER). Trade unions and individual employees saw this cost of living adjustment as a means of counteracting a decline in gross real earnings due to price rises. On several occasions, the abolition of automatic cost of living adjustment clauses in collective agreements provoked conflict and even strikes. Eventually, as a result of an economic crisis, this system was abolished in 1982 through the historic agreement on pay moderation – the so-called ‘Wassenaar Accord’. This agreement provided for the abolition of automatic cost of living adjustments, in exchange for a reduction in working time (EMIRE, 2003f; EIRO, October 1997).

Conclusions

Systems of wage indexation and ‘automatic’ wage adjustments covering the whole workforce are currently in operation in Belgium, Cyprus, Luxembourg and Malta. In Spain, wage indexation plays an important role in collective agreements, although it is not provided for by law, while a form of indexation is also in place for employees in the European public service. These systems constitute a supplementary instrument of wage adjustment in a European context that is characterised by collective bargaining at various levels.

In contrast to autonomous collective bargaining, wage indexation allows for employees’ current purchasing power levels to be maintained, regardless of the outcomes of industrial relations processes. Wage indexation thus warrants that wages are adjusted – and usually increased – on a regular basis, according to an agreed indicator that reflects general price developments.

Where they exist, wage indexation systems are subject to debate among the social partners as well as academics in the field of economics and industrial relations. As a major point of concern, wage indexation has been held responsible for fuelling inflationary pressures. In countries with high levels of inflation, wage indexation is perceived as encouraging a self-perpetuating inflationary spiral. These views have consequently led to the abrogation of indexation as a means of controlling inflation in a number of European countries during the 1980s and 1990s.

However, according to past experience, it seems that wage indexation systems can be sustainable and profitable in the long term in countries where inflation levels are rather low and steady (Aizenman, 2008). Proponents of wage indexation also highlight that it can often foster wage moderation, therefore avoiding inflationary tendencies. This is supported by the example of Belgium, where inflation rates have been comparatively low over the last decade. Furthermore, wage indexation is seen as a measure for ensuring industrial relations peace, as it potentially reduces the number of strikes related to wage negotiations.

Finally, existing derogation practices in current indexation systems – either on a national basis, as seen in Luxembourg where indexation applies only above a certain inflation threshold, or on a case-by-case basis, as observed in Malta – provide employers with the flexibility needed in times of economic downturn. In such instances, companies in difficulty need to adjust labour costs to a changing economic context.

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