Box 2

RECENT DEVELOPMENTS IN THE WAGE DRIFT IN THE EURO AREA

The adjustment of labour costs to changes in the economic situation can be gauged via different indicators. One such indicator is the wage drift, which measures the difference between the growth in the actual wages received by workers and that in negotiated wages. Since negotiated wages are typically fixed for some time ahead, short-run changes in economic conditions are most likely reflected in movements in the wage drift, driven by flexible wage elements, such as bonuses. This box presents an estimate of the wage drift in the euro area and explores its evolution since 2008.

Wage drift as a component of compensation per employee

The most frequently used indicator of labour cost developments at the aggregate level is growth in compensation per employee. In addition to growth in wages and salaries, it reflects changes in the employer part of social security contributions. Growth in compensation per employee can thus be broken down into negotiated wage growth, the wage drift and the impact of changes in employers' social security contributions. Chart A shows this breakdown, defining the social security contribution component as the difference between the annual rate of growth in compensation per employee and that in gross wages and salaries per employee, and the wage drift as the difference between the annual rate of growth in gross wages and salaries per employee and that in negotiated wages.[1] Using this approach, social security contributions will only have an

1 The wage drift is measured as the difference between the annual rate of growth in wages and salaries and that in negotiated wages rather than as the contribution that negotiated wages make to overall wage growth, owing to the data limitations applying to negotiated wages. In particular, this series is typically not available in levels, but only as the growth rate resulting from the wage bargaining process.

impact on growth in compensation per employee if they grow at a different rate to gross wages, and wage drift components will only have an impact if they grow at a different rate to negotiated wages.

The impact of changes in employers' social security contributions has been relatively limited. Over the period since 1999 it has been neutral with regard to the annual average growth rate of compensation per employee of 2.1%. Measured in absolute terms, it has amounted to an average of 0.15 percentage point. Changes in social security contributions tend to be driven mainly by regulatory reforms and therefore do not normally exhibit a clear cyclical pattern.[2] Hence, the longer the period for which wages are negotiated and the sharper the movements in the cyclical position of the economy, the greater a role wage drift should play in explaining the movements in overall labour cost growth over the economic cycle.

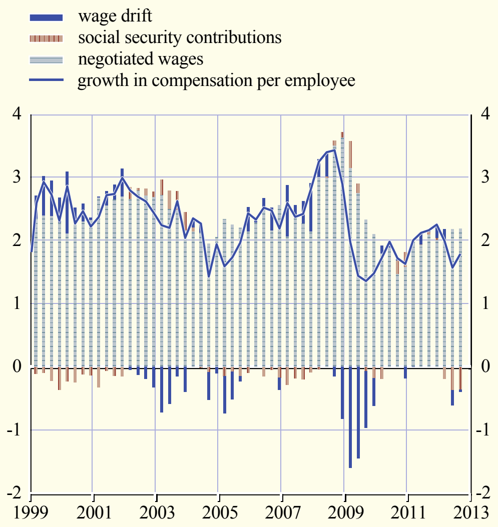
Assessing movements in the wage drift

The wage drift in the euro area, as shown in Chart A, is an aggregate measure, and its use as an indicator of cyclical adjustment is subject to a number of caveats. One caveat relates to the statistical and conceptual properties of the euro area indicator of negotiated wages, which, by contrast with compensation per employee, is aggregated from non-harmonised national data and does not cover all euro area countries. Moreover, wage indexation clauses that provide for adjustments to actual wage growth on the basis of past inflation outcomes are typically not reflected in negotiated wages and thus appear in the wage drift as a factor that is independent from the economic situation at the time.

2 A counter-cyclical impact of social security contributions on growth in compensation per employee can be explained by the fact that contribution rates are raised (lowered) in bad (good) times as revenues fall (rise) relative to expenditure. There may also be pro-cyclical effects if, for instance, employers' social security contributions are reduced as a deliberate measure to lower labour costs in bad times.

Chart A Compensation per employee and wage drift in the euro area

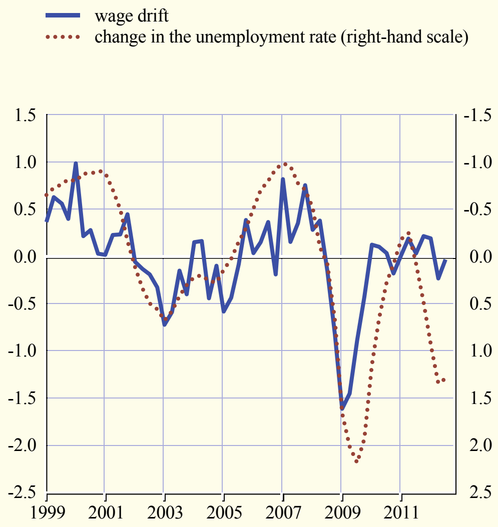
(annual percentage changes; percentage points)



Sources: Eurostat and ECB calculations.

Chart B Wage drift and change in the unemployment rate in the euro area

(annual percentage changes; percentage points)



Sources: Eurostat and ECB calculations.
Note: The right-hand scale is inverted.

A second caveat relates to the influence associated with changes in the composition of employment: for example, if employment shifts (i) between sectors that have different degrees of coverage of collective wage bargaining and thus different weights in the negotiated wage indicator and the actual wage indicator; (ii) within a sector between groups with different wage levels but the same negotiated wage increase; or (iii) between full-time and part-time work where the negotiated wage increase makes no distinction between the two. Such composition effects tend to evolve gradually and do not normally conceal the cyclical movement of the wage drift. However, in the case of sudden and strong changes, such as in the aftermath of the 2008 recession, the cyclical adjustment of the wage drift can be blurred. For instance, the rise in the proportion of part-time employment has clearly accelerated since 2008, driving the wage drift down, and the incidence of unemployment has largely been among workers on low wages, such as young workers, which has driven the wage drift up.[3]

Bearing these factors in mind, Chart B suggests a clear co-movement of the wage drift with the economic cycle, as measured by the change in the unemployment rate. In particular, the wage drift had a downward impact on developments in compensation per employee during the period of subdued growth between 2003 and 2005. In the period of buoyant growth in the run-up to the economic and financial crisis in 2008, the wage drift had an upward impact. This is in line with the notion that tightening labour markets make wage components such as overtime and bonus payments increase more quickly than basic pay. During the recession, the impact of the wage drift once again turned strongly to the downside, amounting to around -1 percentage point of growth in compensation per employee. However, over the last three years the role of the wage drift in explaining overall labour cost developments has, on balance, been relatively limited. This may to a large extent reflect the fact that labour markets have developed in opposite directions across the euro area countries. In this respect, a negative wage drift in countries that are subject to macroeconomic adjustment pressures has been counterbalanced by a positive wage drift in other countries. However, looking ahead, the renewed decline in output and sharp increase in unemployment since the end of 2011 are expected to result in a downward impact on the wage drift.

Overall, estimates of the wage drift in the euro area confirm a clear cyclical pattern around the recession in 2008, while, in its aftermath, the heterogeneous adjustment and rebalancing processes across countries have blurred this pattern at the euro area-wide level.

3 For more detailed information on (un)employment composition effects, see "Euro area labour markets and the crisis", Structural Issues Report, ECB, Frankfurt am Main, October 2012.