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Economic News

PUBLIC SECTOR WAGE AGREEMENT

Costly wage agreement for local governments and consumers

The collective bargaining agreement in the public sector (federal and local governments) is much higher than the offers proposed by mediators. All in all, the wage agreement will put considerable pressure on local governments to raise the rates for community services. This in turn will increase the ECB's concerns regarding inflation.

- Both parties (employers and unions) in the public sector for federal and local governments today reached an understanding on a collective wage agreement. Accordingly, some 1.3 million employees will receive a salary increase of 3.1%, retroactive to 1 January. Moreover, a basic monthly increase of €50 is to be paid this year, which will be permanently added to base salaries. This brings the volume of the **collective wage agreement to over 5%**. It was further agreed that, in the second phase, an additional salary increase of 2.9% will go into effect as of 1 January 2009. However, employees were also required to make concessions, i.e. the working week was extended to 39 hours on average.
- The pay agreement averted a threatened all-out strike in the public sector. From the employees' perspective, it is clearly positive that, following years of wage restraint, public sector employees will also be able to benefit from the economic upturn. To this extent, the agreed collective wage increase represents a form of compensation for years past.
- The cost burden resulting from the pay agreement should weigh more heavily on the local governments, where the share of personnel costs is considerably higher, than on the federal government. Although the budget situation of cities and municipalities is very positive, it is foreseeable that, due to the financial market crisis and weaker growth, tax revenues will not be so plentiful in future as in the past. There are two ways local governments can respond to the rising personnel costs.
- First, they can **reduce expenditures** by either reducing staff – which would be more of a medium-term option at best – or scale back investment. This would particularly affect the construction industry, as local governments account for two-thirds of all public construction investment.
- Second, local governments could **increase the rates for their services**. As consumers of public services are generally not in a position to avoid such rate hikes, as exemplified by refuse collection, the rate adjustments would further feed inflation, which in turn would substantiate the ECB's concerns regarding spiralling inflation. Economic data from this morning show that the inflation rate in the Eurozone rose by 3.5% in March, a new high since the introduction of the euro. Against this backdrop, policy rate cuts by the ECB will probably not be on the agenda for the time being

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