Chapter 4


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Abstract: This chapter analyses the macroeconomic consequences of a “social pact” among the government, trade unions and employers’ associations aimed at keeping the growth in domestic wages and prices in line with the government’s inflation target in a country belonging to a monetary union. We demonstrate that an outward-looking social pact which targets union-wide inflation can lead employment at the competitive level and eliminating the inflationary (or deflationary) bias in the economy.

Key words: Employment, inflation, social pacts, EMU.

1. INTRODUCTION

The social consensus over macroeconomic goals is a key feature of recent social pacts as those observed in several European countries in the run-up to the European monetary union, EMU, where social parties and eventually the government have agreed to set guidelines for nominal wage growth in accordance with domestic inflation and output targets. It is widely recognized that such social pacts have played a relevant role in the policy for EMU membership and have contributed in a significant way to reduce the costs of disinflation. It is not clear as well, however, how they actually perform and
should be designed once monetary policy is delegated to the European central bank.

The social pact works by coordinating the expectations of price- and wage-setters towards the government’s macroeconomic objectives. As far as the inflation target is concerned, the pact functions properly whenever the government can exercise a significant control over domestic prices, either directly, by adjusting tariffs and administered prices, or indirectly, via the threat of a monetary reaction in the event actual inflation is above the target. Both channels are clearly weakened in the EMU. The harmonization of indirect taxation and many anti-trust competences have been delegated at the European level, thereby reducing the government’s ability to affect tariffs and prices. On the other hand, the common monetary policy may not respond to a pressure on local prices and wages unless it endangers union-wide monetary stability. A climate of social consensus over macroeconomic objectives can nevertheless play a significant role in promoting wage and price strategies consistent with the macroeconomic developments and policy goals in the monetary union. In what follows, we will argue in favor of an outward-looking inflation target for the social pact adopted in a member country, namely one which appropriately takes into account the inflationary developments throughout the monetary union.

The optimal design of domestic macroeconomic targets occupies a central role in the current debate on the future of the income policy agreements introduced in Italy during the Nineties. The first step is made in July 1992 with the abolition of the wage indexation mechanism (the so-called “scala mobile”) which had been in place since the mid-Seventies. The previous system, based on a backward-looking mechanism where nominal wage growth is automatically linked to realized inflation, had come under increasing pressure in the Eighties, as the exchange rate policy of the Bank of Italy turned less accommodative. As long as the exchange rate was fixed, in fact, higher nominal wage growth relative to the trading partners translated into a loss of competitiveness for Italian products, thereby reducing employment prospects.

The current system of wage setting is introduced one year later, with the agreement on labor costs signed between the social parties and the Government. The pact involves a double level of wage bargaining, where minimum wages are negotiated in a cooperative way by means of national contracts while wage hikes above the minimum are demanded to local contracts at the firm level. The national branch of the wage bargaining system is intended to pursue macroeconomic goals, by reducing social conflict and fostering wage moderation. Microeconomic objectives, as

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1 The agreement in July 1992 freezes wage renewals for the next 18 months and accords a uniform wage increase (equal to 7 percent) to workers in all sectors of the economy.