

Centralised Wage Bargaining: Theoretical Considerations and Some Norwegian Experiences*

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Abstract: Are centralised systems of wage setting good or bad for economic performance? The theoretical literature gives no clear answer. Multiple factors contribute to good economic performance, and different wage bargaining systems may affect each one of these factors differently. While centralised bargaining might be good for unemployment by restraining unions' wage demands and creating better incentives for investment, it may lead to lower work effort and greater conflicts over work organisation compared to a system with local bargaining. Against this background the performance of the Norwegian system of centralised wage bargaining is investigated. It is argued that although this system has performed quite favourably in sustaining low unemployment rates, it is facing major pressure for change as a result of growing internationalisation, and changes in occupational structure and production techniques.

* This is a revised version of a paper originally prepared for the course 'Comparative Perspectives on Work and Organisation', Oslo Summer School in Comparative Social Science. I thank Richard Brooks, Arne L. Kalleberg and Kalle Moene for helpful comments on earlier drafts of the paper.

1. Introduction

Wage-setting practices and institutions differ substantially across countries. In some countries, individual firms and workers determine wages, producing decentralised wage setting. In other countries, employers' federations and unions bargain over wages, producing a more centralised system. What are the impact of different wage-setting institutions on macroeconomic variables such as inflation, unemployment and growth? Are centralised systems of wage setting, like the one we have in Norway, good or bad for economic performance? These are the basic questions raised in this paper.

During the last two decades the comparative study of wage-setting practices and other labour market institutions have attracted increased attention among social scientists and policymakers. One reason for this, is the divergence in macroeconomic performance since the beginning of the 1970s between the United States on the one hand and many European countries on the other. In 1995 Europe's unemployment rate, which had been about half that found in the United States throughout the 1950s and 1960s, had risen to twice of that found in the United States. Between 1970 and 1984, the United States achieved a growth in net employment of 33%, while the EU gained only 1%. In addition, long-term unemployment is more pervasive in the EU than in the United States.

Many analysts and policymakers have attributed the high level of unemployment and low level of job creation in Europe to the way in which wages are determined (see, e.g. OECD (1990) and Lindbeck et al. (1994)). According to these commentators, the problem with the European labour market is that strong unions and collective wage bargaining have raised the wages of the lesser skilled, who have become too expensive. Employers are therefore unwilling to hire them or to invest in sectors or technologies that employ them. It is also claimed that employment protection laws, often introduced at the insistence of strong unions, tend to strengthen the bargaining power of those who already have jobs relative to those who do not have jobs. As a consequence, those who have jobs push up wages without risking losing their jobs. This again makes it even more difficult for the unemployed to get jobs. From this perspective, strong unions not only limit short-term wage adjustments in the face of macroeconomic shocks, they also have harmful effects on the economy in the long run, in turn creating unemployment.

This story, however, does not fit so well if we look back on the employment figures in Norway and Sweden. These two countries managed to hold unemployment rates at under 2.5% at a time when unemployment in many other European countries rose above 10%. At the same time, Sweden and Norway were (and are) characterised by strong unions, relatively centralised wage bargaining and small wage differentials –

the same factors that have been identified as causing unemployment in the rest of Europe. The Scandinavian discrepancy may thus indicate that the effects of different wage-setting systems are more complex than the commentators mentioned above suggest.

The aim of this paper is twofold. *First*, it seeks to compare the performance of different wage bargaining institutions from a theoretical perspective. I begin by analysing effects of wage-setting institutions on union wage demands and unemployment. Then I look at how different wage-bargaining institutions affect decisions regarding variables that are not negotiated over – decisions that may influence unemployment more indirectly. *Second*, by drawing upon the general lessons from the theoretical literature, I try to explain why the Norwegian system of centralised bargaining seems to have performed quite favourably in sustaining low unemployment rates and what problems may threaten the system in the future.¹

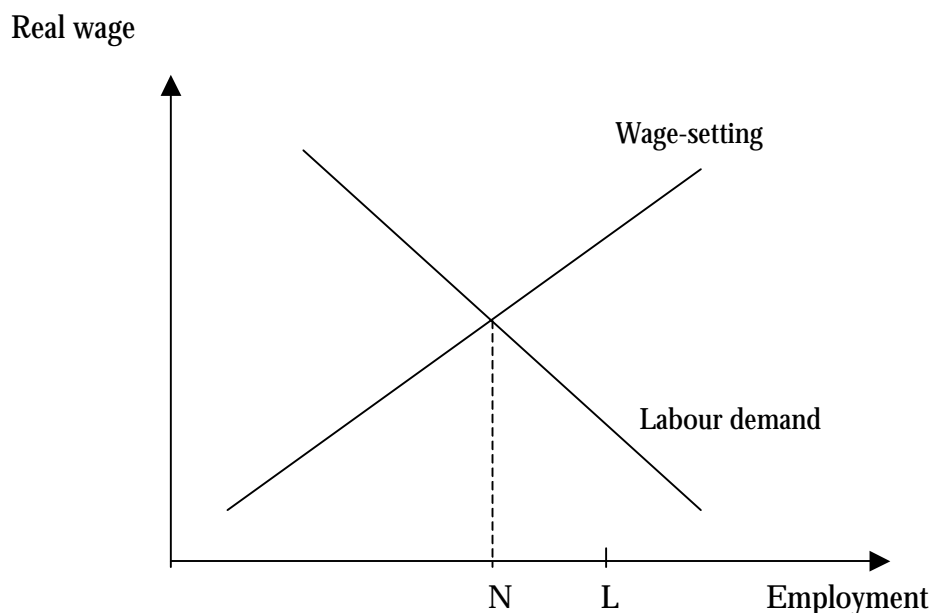
2. Wage Bargaining Institutions Compared

2.1 Wage Setting and Unemployment

A theoretical framework for structural explanations of unemployment, taken from Layard et al. (1991), is illustrated in Figure 1. The upward-sloping wage setting curve illustrates how real wages and unemployment are related. When unemployment is low, workers press for higher wages because employment prospects are good. When unemployment is high, workers are in a weak bargaining position and they moderate their wage demands. The downward-sloping curve is a standard labour demand schedule, which shows that higher real wages lead to lower demand for labour. The two curves are drawn in Figure 1, and their intersection determines unemployment and real wages. This unemployment is often called the equilibrium rate of unemployment or the non-accelerating inflation rate of unemployment (Layard et al., 1991).

¹ The presentation will focus exclusively on the comparative performance of different wage-setting practices. Possible effects of the legal system governing hiring and firing, the tax burden on labour and other labour market institutions such as minimum wages, unemployment benefit systems, and active labour market policy, will therefore not be discussed.

Figure 1 *Equilibrium in the labour market.*



It can be seen from Figure 1 that a wage curve that lies high up in the diagram leads to high real wages and thereby high unemployment. A curve that lies high up in the diagram means that wage pressure is high at a given level of unemployment, and it is here that the system of wage bargaining comes in.

An important goal for trade unions is, of course, that its members receive a high real wage. A high real wage can however lead to a reduction in the number of jobs since the demand for labour among firms is lower the higher real wages are. Unions thus have to trade off the benefits of a nominal wage increase against the associated loss of employment. But this trade off may look very different according to whether one views it from the perspective of a union bargaining at the firm level, the industry level or the national level. Calmors and Driffil (1988) argue that the relationship between union centralisation, wage demands, and employment is U-shaped. Both highly centralised and highly decentralised systems of wage bargaining are likely to produce moderate wage demands and low unemployment. The highest aggregate wage and the highest unemployment are associated with intermediate centralisation in the form of bargaining at the industry level.

Consider first the case of wage setting at the individual firm (complete decentralisation). If the union sets a high nominal wage, the firm's costs will increase. If the firm tries to pass this on in the firm's price, it will price itself out of the market

given the high degree of substitutability between the products of firms in an industry. Instead it will be profitable for the firm to cut back employment. This scenario will probably prevent the union from pushing up wages at firm level. For the economy as a whole, consisting of many unions and firms, the result will moderate wage demands (a wage curve that lies to the right in Figure 1), and thereby produce a low equilibrium rate of unemployment. If wage bargaining takes place at the industry level, a wage increase will have a less direct effect on employment. An increased nominal wage in an industry will lead to increased wage costs for all firms in that industry. Higher wage and price rises at the industry level will, however, result in a relatively limited reduction in demand and employment since the degree of substitutability between the products of different industries is small. The industry union therefore believes it faces a relatively advantageous trade off between higher real wages and employment. The result is the adoption of an aggressive wage policy. When all unions in all industries try to raise nominal wages, however, the result for the economy as a whole is a wage curve that lies high up in Figure 1, and thereby a high equilibrium rate of unemployment. A union that bargains at a national level will have to take this effect into account. It will know that high pay rises may provide increased purchasing power, but also fewer jobs. Hence centralised unions will agree to lower wage levels compared to industry level unions. For the economy as a whole the result will be a low equilibrium rate of unemployment.

A number of other factors in the wage-setting process have been identified that might induce a central wage-setter to choose differently than unions with only local responsibilities (Moene and Wallerstein, 1993; Calmfors, 1993). For example, firms depend on the labour of workers whom they do not directly employ. An *input price externality* may arise when wage increases in one part of the economy cause price increases for the products used as material inputs by other firms. The consequence may be lower output and employment in other parts of the economy. A *fiscal externality* is imposed on the rest of the economy if wage increases in one sector cause unemployment there to rise. Increased unemployment reduces tax revenues in the affected sector and increases expenses in the form of unemployment benefits. This can lead to the imposition of higher taxes in the rest of the economy. An *unemployment externality* may also arise under decentralised wage setting. If real wages and unemployment rise in one sector, it becomes more difficult for the unemployed everywhere in the economy to find new jobs.

These externalities have all been used to explain why centralised bargaining is likely to produce a lower aggregate real wage and thus lower unemployment. Calmfors (1993) puts it this way: '*The simple idea is that inter-union [...] co-operation implies that the effects on others of wage increases in one part of the economy will be considered. Thus the marginal benefit of a real wage increase is reduced and/or the marginal cost increased. As a consequence, the incentives for real wage restraint ought to be strengthened when bargaining is centralised.*' (p. 164). In

summary, the relationship between centralisation and employment is U-shaped. Both highly decentralised and highly centralised bargaining systems produce greater wage restraint and lower unemployment than bargaining systems in between.

2.3 Wage Bargaining, Work Effort and Productivity

The theory reviewed above emphasises the role of lower wages in bringing about higher employment. The basic question asked was: how do different levels of centralisation affect the optimal wage from the unions' point of view? However, unions do not set wages unilaterally. Rather, the wage contract is the result of a bargaining process between employees and employers, in which both parts must 'give and take'. This leads to an equally important question: how does local versus central bargaining influence the connection between the agreed wage and other economic decisions that may influence unemployment more indirectly? Two variables seem particularly important: work effort and investments.

In most jobs, the individual worker has a great measure of control over his own efforts. This applies in any case to decisions about how efficiently one carries out different work tasks and the quality of the completed work. Other aspects of workers' effort are however decided collectively, as when new work methods and production techniques are introduced. The level at which wage bargaining takes place can be important for efficiency and for conflicts surrounding the organisation of work.

During wage negotiations, a union can threaten with strikes or other actions if its wage demands are not met. To prevent the loss associated with conflict, it may be profitable for employers to give in to wage demands. The higher the firm's profits, the more the union is able to take out in wages. When profits are low, unions must settle for lower wage growth. All types of wage bargaining thus entail a sort of profit-sharing. The profit that is an object for bargaining, however, depends on whether bargaining takes place within an individual firm, in an industry, or at the national level. At the local level, wage bargaining is a form of profit-sharing between the individual firm and its workforce. Hence there will be a more direct relationship between how high work effort is in that particular firm and the wage that the workers can achieve through negotiations. Local bargaining can thus function as an incentive mechanism which rewards high work effort. If wage bargaining takes place at a higher level, the profits to be shared through bargaining are aggregated over an industry or entire economy. Then there is no noticeable connection between how high workers' efforts are in an individual firm and the wage those workers receive as a result of bargaining. The element of high pay as a reward for high effort is, then, weakened in the case of industry-wide or more centralised agreements. Without local bargaining, one should

therefore expect lower production efficiency and greater conflict concerning the organisation of work and new production methods.

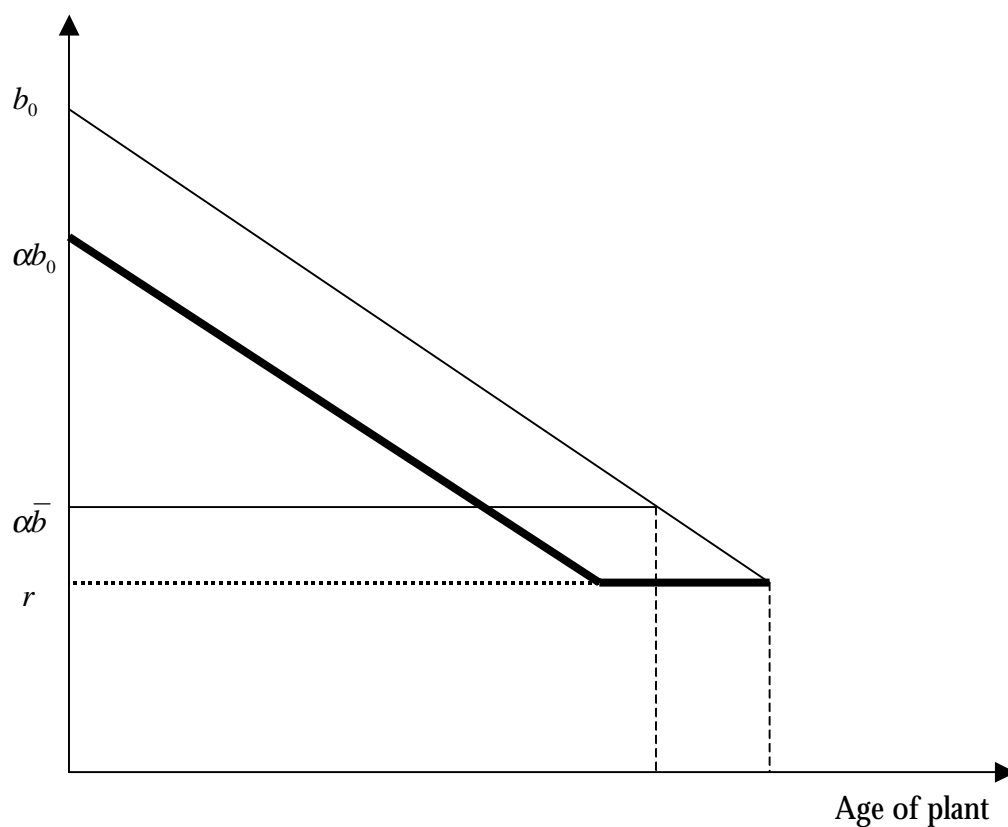
When it comes to encouraging productivity growth that requires investments on the part of the firm, however, centralised wage bargaining provides more appropriate incentives than local bargaining. In local bargaining, workers receive a share of the profits that the investments may bring through the implicit profit-sharing. But this means that the firm only receives a share of the income resulting from the investment at the same time that it must bear all investment costs. It follows that investments are less profitable for firms than they are for society, and the result can be under investment (Grout, 1983). When wages are set at a central level, there is no such direct connection between investment undertaken by an individual firm and the profits that are shared in bargaining. Firms perceive wages as externally decided, and the increased profits from their investments are theirs to keep. Central wage bargaining, then, provides more appropriate incentives for investments.

The level at which wage negotiations take place may not only influence investment and efficiency in already established firms. Types of wage-setting institutions can also influence job creation and employment through the establishment of new firms and the closure of old ones. Schumpeter (1942) regards the closing down of old enterprises and the establishment of new as the fuel of the capitalist economy. This dynamic is to be found in what Schumpeter termed '*the process of creative destruction*'. The process of change takes place when new firms and enterprises establish themselves by applying old techniques in new and more effective ways. Such new enterprises will continuously drive the least efficient entities out of the market and create economic growth and progress.

Traditionally, strong unions and centralised wage bargaining have been seen as hindrances to growth and adjustment to changing market opportunities. Small wage differentials across skill groups create productivity-diminishing distortions of microeconomic incentives. Centralised bargaining also means that the most efficient firms are prevented from attracting labour by offering a wage premium, leading to an inefficient allocation of labour between firms. However, almost a half century ago Gösta Rehn and Rudolf Meidner, two Swedish trade union economists, argued that centralised wage bargaining (or *solidaristic bargaining* as the policy was named) aimed at reducing wage differentials between enterprises within the same industry and between industries can contribute to make an economy more productive by speeding up 'the process of creative destruction'. Following Moene and Wallerstein (1995; 1997), who have formalised the ideas of Rehn and Meidner, this can be explained in the following way: Newly established firms or plants have access to the newest and most productive technology, and are therefore more productive than old plants. This is illustrated in Figure 2, where plants are arranged along the horizontal axis from newest to oldest.

The declining curve that begins at b_0 is the revenue produced by a plant of each age. Since productivity growth is embodied in new plants and equipment, the economy becomes more productive over time as new plants are built and older plants are shut down.

Figure 2 *The distribution of wages with local and industry bargaining*



Source: Moene and Wallerstein (1995)

The impact of different wage-setting institutions on productivity can then be illustrated by using Figure 2. As noted in Section 3, all wage bargaining entails a sort of implicit profit-sharing. At the local level, wage bargaining is a form of profit-sharing between a firm and its workers. Since revenue per worker is highest in the most productive firms, the wage (w) with local bargaining will also be highest in the most productive firms. In Figure 2, locally set wages are assumed to be a fixed proportion (α) of each plant's revenue per worker, until the constraint $w \geq r$ becomes binding. r represents a kind of 'outside option' that can be interpreted as income from other alternatives (self-employment, unemployment benefit, etc.). Wages cannot fall below r . The wage in the least productive plants therefore remains constant until one reaches the plant whose productivity is just high enough to pay $w = r$ and make zero profits.

With centralised bargaining, the profits that are shared are aggregated over the whole industry or the whole economy. As Figure 2 shows, with centralised bargaining the wage is set as a proportion (α) of the average revenue (\bar{b}) per worker. Each firm therefore has to pay the same wage. It can then be seen from Figure 2 that local bargaining raises wages in newer, high productive plants, since workers here are able to capture a share of their above-average productivity. At the same time, it reduces wages in plants with below-average productivity compared to centralised bargaining. When bargaining is centralised, the least efficient plants are prevented from lowering their wages, and as a consequence marginal plants are pushed out of the market much earlier than in the case with local bargaining. This in turn lowers the average age of plants in operation and thereby increases the average productivity of the industry.

Figure 2 captures the essence of Rehn and Meidner's principal argument. Collective wage bargaining and equalisation of wages between enterprises may enhance productive efficiency by encouraging the movement of labour and capital from low to high productivity activities. Holding down wages in the most productive enterprises through central wage negotiations will encourage their expansion and provide employment opportunities for the labour that will be released as the less productive enterprises are forced to close. The less productive enterprises are forced to close because they are not able to cover their (centrally determined) wage costs.² As Moene and Wallerstein (1995) note: *'In fact, the elimination of wage differentials between industries can be understood as a subsidy for new industries and a tax on older ones. [...] The*

² The original arguments put forth by Rehn and Meidner on behalf of centralised bargaining and 'equal pay for equal work' concerned macroeconomic efficiency. An important side effect of this system is, however, that it also promotes the egalitarian ideals of the union movement (Pontusson and Swenson, 1996). As such, the Rehn-Meidner model challenges the conventional (economic) notion of a necessary trade off between efficiency and equality.

consequence is a national economy composed of more modern industries than would be the case with less centralised bargaining' (p. 197).

Having discussed some of the theoretical literature on the comparative performance of different wage-setting institutions, I now turn to some recent Norwegian experiences.

3. Norwegian Experiences

By comparison with other countries, the Norwegian wage bargaining system has been highly centralised.³ While wage negotiations during the 1950s generally took place at the industry level, they became more and more centralised during the 1960s (Dølvik and Stokland, 1992). There was a move towards decentralisation in the early 1980s, but this trend was reversed in the late 1980s. In 1988 to 1990 the wage negotiations were some of the most centralised in the history of Norway (see below).

As Wallerstein (1990) notes: *'The conventional wisdom in economics regarding the labour market is that competition and wage flexibility are good things. Yet centralised, encompassing trade unions are the unions that are least constrained by labour market competition. Moreover, the standardisation of wages in different regions associated with centralised bargaining reduces the sensitivity of wage levels to local labour market conditions.'* (p. 983). According to this perspective Norway should face major problems achieving full employment, but the Norwegian experience runs counter to the view that the stronger the unions, the worse off the economy. As Table 1 shows, Norway managed to hold unemployment down to approximately 2% when it increased dramatically in a number of other European countries.

³ See Calmfors and Driffil (1988), Iversen (1996), OECD (1997), and Wallerstein (1999) for a detailed comparison of wage bargaining institutions across countries. Dølvik and Stokland (1992) give a historical background of the Norwegian wage bargaining system.

Table 1 *Standardised unemployment rates in some European countries*

	Average rate of unemployment					
	1974-81	1982-88	1989-92	1993	1995	1999
Belgium	7.8	11.5	7.5	8.6	9.4	9.0
France	5.4	9.6	9.5	11.7	11.6	11.3
Germany	3.5	6.7	4.9	7.9	8.2	8.7
Italy	7.1	9.8	10.4	10.2	12.2	11.4
Netherlands	5.9	10.6	7.4	6.2	6.5	3.3
Norway	1.8	2.7	5.4	6.0	4.9	3.2
Sweden	2.0	2.7	2.6	9.5	9.2	7.2
Switzerland	0.3	0.7	1.3	3.8	3.3	3.8
United Kingdom	6.1	11.0	8.1	10.4	8.7	6.1

Source: OECD

A possible explanation, along the lines suggested in the theoretical literature reviewed above, is that Norway managed to hold unemployment down because centralised encompassing unions had internalised the macroeconomic consequences of their actions and had agreed to lower real wage levels. In addition, by the adoption of the Rehn-Meidner principle of solidaristic wage policies, wages were successfully held back in the most productive enterprises, in turn facilitating high investments and productivity growth.

However, as shown in Table 1, the difference between unemployment in Norway and in the rest of Europe narrowed during the early 1990s. Unemployment in Norway rose from approximately 2% in 1986 to a historical peak of 6% in 1993. If we also include workers enrolled in active labour market programs, the unemployment rate was as high as 9%. But, as can be seen from Table 1, the unemployment rate fell again during the late nineties. Today, Norway is back to almost full employment. What happened?

3.1 The Rise and Fall of Unemployment

The growth in unemployment in the early 1990s was caused primarily by the strong reduction in aggregate demand (Rødseth, 1994). In 1984, Norway's credit market was deregulated. This led to a dramatic growth in private consumption, followed by growth in investments, employment, and prices. Most of the growth in consumption was however financed by loans, and such a loan-financed upswing could not last. After a while, people in the private sector tried to reduce their debt by selling property or paying off their loans in other ways. The result was a great downturn in private consumption that occurred simultaneously with a fall in demand in the rest of Europe as well. 'The boom' ended in a strong recession followed by a significant rise in unemployment from 1987. But, as noted above, the unemployment rate fell gradually during the late 1990s, and Norway is today back to almost full employment. There is no general agreement concerning the causes of the reduction in unemployment, but at least part of the explanation is the labour movement's willingness to moderate wage demands after the sharp rise in unemployment in 1987.

The Social Democratic government (which came to power in 1986) declared 1987 a year of 'emergency incomes policies'. A strong appeal to limit wage increases was sent to the main actors in the Norwegian labour market. As a condition for accepting such limits, however, the Norwegian Confederation of Trade Unions (LO) demanded that wage increases agreed in the national level negotiations should be given the status of law by the Parliament. This was accepted, which meant that LO and the Norwegian Employers' Association (NAF, from 1989 reorganised as the Confederation of Norwegian Business and Industry – NHO) *de facto* controlled the wage growth from 1988 to 1991 (Høgsnes and Longva, 2001). As a consequence, wage growth began to decline and the competitiveness of the Norwegian industry was gradually restored during the early 1990s. In 1992, a new agreement on a tripartite programme was established, the so-called 'Solidarity Alternative', based on a continuation of the strategy of wage moderation from the previous period combined with increased spending on education and training by the government. This alternative has dominated wage negotiations up to the present, and must be given credit for the prosperity of the Norwegian economy and the sharp reduction in unemployment.

3.2 Centralised Wage Bargaining under Pressure

The development described above is, however, just one example of government involvement in the wage bargaining process. Norwegian governments have from the start supported centralised wage bargaining. Low-interest loans have been channelled

to sectors where unions have displayed wage restraint and to firms willing to undertake productive investments, and a legal framework regulating wage negotiations has been provided. Norwegian governments have also intervened more actively. In 1973–76 for example, the government helped the parties to come to a settlement by agreeing to tax cuts and price subsidies. However, most important for the viability of the Norwegian wage bargaining system has probably been that the government has acted as a ‘guarantor’ for full employment through counter-cyclical management of the economy. As such, there is an intimate relationship between macroeconomic policy and wage-setting practices that is not fully captured in the theoretical literature. Take devaluation as an example. There is no doubt that devaluation was important in restoring Norwegian competitiveness through the 1970s and 1980s, in turn facilitating the official policy of full employment. But this strategy clearly depended on centralised co-ordinated bargaining for its effectiveness. Real wage adjustment sufficient to restore competitiveness would have been difficult to obtain without a disciplined labour movement willing to moderate its wage demands after a devaluation. Devaluation in the face of strong and fragmented unions may have no effect whatsoever, because higher prices on imports and increased cost of living will quickly be compensated for by aggressive wage demands. As Cappelen et al. (1992) point out, the wage-setting practices and economic policy that were followed can be characterised as a macro-institutional equilibrium, based on ‘mutual gift exchanges’ between the government and the labour movement: The government traded a full employment policy for permission to govern effectively, while the labour movement traded moderate wage demands for a promise of full employment.⁴

Capital market integration and credit market liberalisation during the 1980s have, however, reduced the degree of freedom in economic policies. Devaluation is out of the question, and no longer can Norwegian interest rates or inflation levels differ from world levels. As Fagerberg et al. (1990) have documented, an important instrument for regulating the Norwegian economy after the Second World War was credit.⁵ Credit supply and interest rates were in the hands of the public. Interest rates were deliberately set low to ensure full employment via high stable investment rates. If demand in the main industries fell, or if the housing market began to slump, state loans and credit were used to stimulate production. These instrument are now lost. If unemployment rises, it may therefore be quite difficult to reduce it again through the use of traditional stabilisation policy. The question is then why the unions should co-ordinate their actions and moderate their wage demands in order to increase aggregate employment when unemployment may easily become high anyway. Co-ordinated action on the part of unions will become almost impossible if the individual unions do

⁴ See Garrett and Lange (1991), Pontusson (1992), and Iversen (1998) for similar interpretations of the ‘Scandinavian model’.

⁵ See also Moses (1994).

not see clear advantages to centralised wage setting in the form of low unemployment. If the government does not have the ambition and/or tools available for maintaining full employment, the exchange of wage demand moderation for a guarantee of full employment comes to an end, and the entire institutional equilibrium is in danger. According to Iversen (1996), this is exactly what have happened in Denmark and Sweden: '*[...] since the early 1980s [...] the post World War II centralised bargaining regime, predicated on voluntary wage restraint, redistribution, and full employment, has given way to a more decentralised regime [...]. These institutional changes in the wage formation process have been accompanied by a reordering of economic policy priorities away from full employment [...] towards price stability and balanced budgets.*' (p. 429).

The Norwegian system is also threatened by the steadily growing internationalisation of business. Norwegian workers employed by companies with subsidiaries in several countries have an interest in their wages being on the same level as the wages paid elsewhere in the company. National co-ordination of wages can then conflict with the necessary considerations of conditions within the company. In addition, it is difficult to imagine centralised wage setting without a simultaneous compression of wage differentials among sectors and among worker groups. A lowering of wage differentials means that the wages of the most highly skilled are depressed and the cost of unskilled labour is pushed up. Thus, low-skilled labour is seen as expensive for firms, while highly skilled labour comes to seem inexpensive. Technological developments and the steadily cheaper costs of transportation mean, however, that low-skilled labour becomes more interchangeable across regions. An example is shipbuilding. The hull of a ship can easily be built outside Norway using cheap, low-skilled labour, then be taken back where the production tasks requiring highly skilled (relatively cheap) Norwegian engineers can be performed. This makes a compressed wage structure difficult to maintain over time. As Moene and Wallerstein (1995) note: '*Keeping wages low enough to maintain full employment in the context of declining demand for unskilled labour while rising the relative wage of low-wage workers require increasingly severe wage restraint in the part of workers at higher pay levels.*' (p. 206).

Centralised bargaining and compression of wages may also be incompatible with the introduction of new and more skill-intensive technologies (Pontusson and Swenson (1996); Eichengreen and Iversen (1999)). As more decision making power is delegated to the shop floor it becomes more important for the employers to attract skilled labour and to encourage their continued acquisition of skills through improved wages and employment conditions. But, as discussed in Section 2, this is difficult when wages and working conditions are decided centrally. Increasingly, employers seem to prioritise wage flexibility over wage restraint and to seek more decentralised forms of wage setting. Different types of performance-related and individual pay arrangements have been implemented in some sectors of the Norwegian economy during the 1980s

and 1990s. Over time, such efforts can undermine the traditional union-based channels of wage bargaining and contribute to more individual forms of bargaining.

Changes that have occurred inside Norwegian society represent additional threats to the wage bargaining system. As already noted, centralised wage setting means that the wages of the highly skilled are depressed and the wages of the unskilled are pushed up. At the same time centralised wage bargaining prevents workers in the most efficient industries from earning higher wages. As a consequence, the cost competitiveness of the most efficient and dynamic firms is enhanced. The principal beneficiaries of the centralised wage bargaining system have thus been the low-paid wage earners – whose relative wages have increased rapidly – and employers, particularly employers with modern efficient enterprises. The losers have been the high-skilled/well-educated segment of the labour force. In part, the Norwegian wage bargaining system is based on an ‘exploitation’ of the middle class (Swenson (1991); Moene (1999)). But this implicit cross-class coalition between employers and low-wage workers may not be stable as the number of highly skilled and well-educated workers grows. Resistance to the reduction of wage differentials has grown, and the traditional blue-collar unions are losing ground relative to unions of white-collar and professional workers dedicated to restoring traditional wage differentials. At the same time, the increasing use of different types of performance-related wages, as noted above, primarily benefits the highly skilled workers. A new coalition between employers seeking more flexible wage systems and an increasing number of privileged employees who seek to escape the constraints of centralised wage bargaining is therefore developing.

On top of this is the fact that long-term changes in the structure of employment have altered the dynamics of centralised wage bargaining by increasing the influence of parties sheltered from international competition. Norway is a small open economy – more dependent than ever on exports. Productivity gains have, however, reduced the share of the workforce employed in the traded goods sector, while employment in the sheltered public sector has increased. This threatens the stability of the centralised wage bargaining system. As Swenson (1991) and Bowman (2001) have documented, the system of centralised wage bargaining in Sweden and Norway was originally established as a result of a close co-operation between labour and capital. In particular it was important for employers in export-orientated sectors to restrain the wage demand of unions in the sheltered sectors of the economy. Not subject to international competition, employers in the sheltered sectors of the economy could more easily pass on the costs of high wages to consumers. Unions in the sheltered sectors thus enjoyed an advantage in wage bargaining compared to workers in the traded goods sectors. To gain control of the sector pay structure, the employers therefore aggressively encouraged unions to centralise authority across industries. The prime motive was to help maintain the competitiveness of the export sectors.

However, as an increasing number of union members work within the sheltered sector of the economy, the policy of general wage restraint on behalf of the traded goods sector is a much more complex issue for the labour movement today compared with the 1950s and 1960s. The outcome of central bargaining is today heavily influenced by union demands in sheltered sectors. As a consequence, many employers no longer view centralised bargaining as a good instrument for the control of wage costs and maintenance of competitiveness of the export sector.⁶

Although the Norwegian system of centralised bargaining has come under pressure from different but interconnected directions, it is too early to say whether fundamental changes will occur. The Norwegian system is based on a coalition of diverse and conflicting interests. On the one hand, increased international competition speaks for the maintenance of centralised bargaining. Strong encompassing unions may be to the employers' advantage by restricting wage demands and securing national competitiveness. On the other hand, changes in the macroeconomic policy regime, changes in technology and industrial structure speak for more decentralised wage setting. Until now, however, both union and employer support for centralised wage bargaining seems to remain strong in Norway.

4. Concluding Remarks

Are centralised systems of wage setting like the one we have in Norway good or bad for economic performance? This is the basic question raised in this paper. The discussion does not provide any unambiguous conclusions. The main reason for this is that there are multiple inputs that contribute to good economic performance and different wage-setting institutions may affect each differently. One main virtue of a centralised wage-setting system, however, is that central negotiators have to consider the effects of wage settlements on the entire economy. For a number of reasons, wage increases for one group may have negative consequences for others, and such externalities will be considered under centralised bargaining. As a consequence, the incentives for real wage restraint ought to be strengthened when bargaining is centralised, in turn holding unemployment down.

In the end it should be emphasised that the central issue should not be the identification of a particular wage-setting institution that 'works best'. Centralised wage bargaining systems are found primarily in small countries. It is not evident that

⁶ In this connection it is interesting to note that in Sweden, export-orientated employers already took initiatives to break with the system of centralised wage bargaining in 1983. Since then, there has been a gradual shift away from the original system until the Swedish employers' organisation openly abandoned centralised wage bargaining in 1992. After 1992, all wage negotiations have taken place at the industry and sector level (Iversen, 1996; Pontusson and Swenson, 1996).

labour market institutions developed in one country, or in a group of more or less similar countries, can be 'exported' to another. The central issue for future research should therefore be to try to identify specific institutions and policies that can succeed in particular environments. As argued in this paper, although the Norwegian system of wage bargaining seems to have performed quite favourably in sustaining low unemployment rates, it is not certain that it will survive. How the system develops will be decided primarily by the conditions characterising the environment of the parties involved, conditions which neither party alone can control.

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