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A new model for wage formation in Iceland

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A new model for wage formation in Iceland[1][2]

By

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Abstract

Iceland is recovering after a severe crisis, which is an impressive turnaround by any standard. However, the improvement of the economy has led to a rising wage growth, which, if it continues, may lead to another boom-bust cycle. Persistent high wage growth is likely to induce the central bank to raise the interest rate, so as to prevent inflation from exceeding the inflation target. A combination of high wage growth and a monetary tightening would likely lead to appreciation of the Icelandic krona, which would weaken the competitive position of Icelandic firms.

To ensure that wage growth is reduced down to sustainable levels, Iceland would benefit from adopting a wage leadership model, also referred to as a pattern bargaining model, like the Norwegian "frontfag-model". Establishing a wage leadership model requires three steps.

- Develop a common understanding among the labour market parties about the challenges and the need for sustainable wage growth
- Establish a wage leader which negotiates first and thus sets the norm for the wage growth in other parts of the labour market.
- Ensure that the norm for the wage growth is followed elsewhere in the labour market.

Keywords: Collective bargaining, wage leadership model; JEL codes: J5

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[1] This report was written for the Salek group in August 2016. The Salek group is a broad alliance of the social partners in Iceland, see https://rikissattasemjari.is/salek/?lang=en . The report was part of a joint initiative from the Salek group, with the aim "to improve and introduce a new model for conducting wage negotiations in Iceland. In this respect, the social partners have looked for a role model in the other Nordic countries with the view of developing the Icelandic model along the Nordic lines." Due to the turbulent political situation in Iceland, the initiative stopped in 2017. The views and conclusions in the report are the responsibility of the author alone. A version if this report is available in Icelandic on http://rikissattasemjari.is/wp-content/uploads/2017/05/SALEK_Skyrsla_A4_HQ.pdf

[2] The aim of this report is to provide input to the discussion, by (i) Presenting some of the key principles and requirements for a successful wage leadership model; (ii) Describing relevant experience and solutions from Norway and to some extent also Denmark; (iii) Point out some of the specific challenges for Iceland in establishing a wage leadership model.

Introduction

Iceland is doing well after the crisis, which is an impressive turnaround even for a small country of hard-working individuals. However, the booming economy has led to an upsurge in wage growth, which may end up in another boom-bust cycle. In the short run, high wage growth is good for private consumption, as it may stimulate the economy by increasing aggregate demand. However, higher wage growth also weakens competitiveness. This effect is exacerbated by the interaction with monetary policy, because if wage growth is too high, it will lead to inflation being higher than the inflation target. The central bank would then respond by raising the interest rate, which is likely to induce an appreciation of the Icelandic krona.

If wage growth continues to be high, leading to high growth in prices on domestic goods, the inflation target can be only achieved if import prices increase considerably less, or possibly fall. This will require a further strengthening of the krona. Over time, a combination of high nominal wage growth and an inflation target is likely to lead to a significant deterioration of international competiveness. Thus, a continuation of high wage growth involves a considerable risk of a boom-bust cycle, where in the first stage, growth in employment and wages lead to consumption growth involving an overheating of the economy. Over time, this will lead to a situation with higher household debt and a high cost level relative to the trading partners. This is a vulnerable position, which may result in a sharp downturn. Thus, it seems imperative to prevent that the high wage growth persists at a rate which is too high to be consistent with the inflation target.

The key role of moderate wage growth is a conclusion which has been reached in the other Nordic countries with an inflation target, i.e. Norway and Sweden, see e.g. NOU 2013:13 and Gottfries (2010). For example, in NOU 2013:13, page 10, it is stated: "En moderat lønnsvekst vil bidra til bedre konkurranseevne både direkte, og indirekte gjennom lavere rente og svakere kronekurs. Det vil tryggere grunnlag for høy sysselsetting og lav arbeidsledighet framover.»[3] [4] The conclusion is consistent with a large body of evidence documenting that countries with a high degree of co-ordination in the wage setting generally have lower unemployment; 5-6 percentage points is the average finding reported in the survey in Calmfors et al (2001).

The solution in three other Nordic countries, notably Denmark, Norway and Sweden, is some form of wage leadership model - "frontfagsmodellen", using the Norwegian terminology -

[3] Moderate wage growth will contribute to better competitiveness both directly and indirectly via a lower interest rate and a weaker exchange rate. This will provide a more solid foundation for high employment and low unemployment in the future.

[4] Clearly, wage restraint would be equally important with a fixed exchange rate to the Euro, given the low inflation target in the Eurozone. In the short run, a fixed exchange rate might be an advantage, because the effect of high wage growth would not be amplified by appreciation of the exchange rate. However, if the cost level has already increased to a level that is too high, it would be much more difficult to achieve a reduction of the cost level, as one could not benefit from a depreciation of the currency. This effect is illustrated by the recent problems of several countries in the Eurozone after the financial crisis.

where the manufacturing sector (the front fag) bargains first, and the wage outcome in this sector forms a norm for the wage growth that has strong influence on the wage setting in the rest of the economy. Within this general framework there are also differences between the countries, reflecting in part different historical and political development.

A wage leadership models seems a promising choice also in Iceland, because of the high organization rate at both the employer and the employee side of the labour market. However, there would also be considerable challenges in establishing a wage leadership model in Iceland.

A key challenge concerns the structure of the wage setting. In Iceland, unions are typically fairly small, and organized along occupational lines. This gives unions a strong position in the wage negotiations, because labour demand is usually less elastic for workers within one occupation (Moene, Wallerstein and Hoel, 1993). The strong position of the unions in the wage setting is exacerbated by the high unionization rate, the fact that the wage in the union contract becomes a binding minimum wage by law, and by the existence of priority clauses giving union workers a priority to jobs in their area. These features are likely to induce strong wage pressure, and they make Iceland an outlier among industrialized countries. Also compared to the other Nordic countries, these features are likely to induce stronger wage pressure in Iceland, making coordinated wage restraint both more challenging and more necessary.

Another challenge concerns the considerable volatility in economic conditions. In part, the volatility reflects that the main export industries are resource dependent, and thus will fluctuate depending on resource prices and the supply of resources. Historically, there has also been considerably volatility in the overall economy, including large fluctuations in the exchange rate.

The problems of achieving coordinated wage moderation in the past may also affect the likelihood of succeeding with a wage leadership model in the future. On the one hand, there appears to be a lack of trust between many of the key decision makers in the Icelandic labour market. A history of leap-frogging, where wage settlements have a strong tendency to exceed the wage outcome of previous settlements, may also make it less tempting for wage setters to agree to new attempts. However, the possible consequences of not trying, of letting the current situation continue, may also provide a strong incentive for labour market partners to try once more.

In the next sections, I will discuss the key issues and challenges that must be dealt with to establish a successful wage leadership model for Iceland.

A wage leadership model for Iceland

Establishing a wage leadership model requires three steps.

- Develop a common understanding among the labour market parties about the challenges and the need for a sustainable wage growth
- Establish a wage leader which negotiates first and thus sets the norm for the wage growth in other parts of the labour market.
- Ensure that the norm for the wage growth is followed elsewhere in the labour market.

1 A common understanding among the labour market parties about the challenges and the need for a sustainable wage growth

Coordinated wage restraint will often be controversial among union members and leaders. After all, the main purpose of unions is to represent the interest of their members, and higher wages is a crucial part of this. Furthermore, most unions usually have several reasonable arguments for why their members in particular deserve higher wages. To make wage restraint feasible in this situation, it is necessary that the wage setters, both employers and union leaders, understand that moderate wage growth is a public good, so that everybody may benefit.[5] There also needs to be a certain amount of trust among the parties, so that all parties can rely on the other parties adhering to their part of the agreement. Finally, there must be sufficient acceptance among union members for wage moderation. Such acceptance is likely to depend among other things on whether members find that the overall outcome is reasonable and just. A sentiment that some groups capture an unreasonable large share of the overall income in the society will make acceptance of wage moderation more difficult. In that sense, also general economic policies and firm behavior are important for the feasibility of wage moderation. Wage moderation leads to higher profits, and it is important that union members see that it also has a clear positive effect on investment and jobs, and not only in higher dividends and increased executive pay.

Several institutional features may contribute to understanding and trust among the labour market parties. In Norway, the cooperation on incomes policy is institutionalized through the Contact Committee (Regjeringens kontaktutvalg for inntektsoppgjørene). This is an informal committee headed by the prime minister, where the government can discuss the economic basis for the wage formation with the main organisations in the labour market, and thus presents its views prior to the actual wage setting.

Of more practical importance is the Technical calculation committee for wage settlements (TBU, Teknisk beregningsutvalg for inntektsoppgjørene), where representatives for the main organisations in the labour market as well as several ministries and Statistics Norway collect and present the relevant statistical material underlying the negotiations. The calculation

[5] In the literature, it is shown that there are several negative external effects in the wage setting (see e.g. Calmfors et al, 2001). Most importantly, higher wages for one group of workers raises costs for the employer, leading to higher product prices and lower purchasing power for other workers. Furthermore, to the extent that members are concerned about relative wages, higher wages for some workers per definition implies a reduction in relative wages of other workers.

committee submits two main reports every year, before and after the wage negotiations. This ensures that the wage setters agree on facts concerning wage levels and wage growth, as well as several indicators for the international competitiveness and the factor shares, i.e. the income sharing between workers and owners. The calculation committee also agrees on a forecast for consumer price inflation, which provides a basis for wage demands related to growth in purchasing power. Following the suggestion by the labour market parties in relation to NOU 2013:13 (the so-called Holden III-report), the committee has also extended its discussion of economic outlook, contributing further to developing a common view on the economic situation

Iceland would also benefit from establishing a Technical calculation committee for the wage settlements, along the lines of the Norwegian counterpart. The main aim would be to ensure reliable and relevant statistical material for the wage setting, both in terms of wage levels and wage growth for various groups and agreement areas. In addition to ensuring that the bargaining parties agree on important numbers and facts, the work in the committee is also an arena for contact and development of trust. These are crucial elements in the development of a wage leadership model.

2 Establish a wage leader ("frontfag") which negotiates first and thus sets the norm for the wage growth in other parts of the labour market.

According to theory, the traded sector should be the wage leader, to ensure that the wage growth is consistent with the competitive position of this sector. In the other Nordic countries, it is usually the manufacturing sector which takes the role as wage leader. There are several reasons for this. One reason is that the manufacturing sector is a large sector, and, partly due to its size, usually fairly representative for the whole traded sector. Thus, the wage norm agreed upon in the manufacturing sector would usually also provide a suitable basis for other parts of the traded sector. Another reason is the competence and responsibility of the organizations in the sector, increasing the likelihood that the organizations which negotiate first take the long run consequences into account when they agree on a norm for the wage growth.

Note that there is no necessity in manufacturing taking the role as wage leader, or in having a wage leader at all. In principle, the norm for the wage growth could be set in other ways, e.g. by a group of experts or a joint committee consisting of labour market partners, government representatives and independent experts. For the wage norm to work well, there are two key requirements that must be met. First, the norm for wage growth must be consistent with a satisfying and sustainable evolution of the economy, where the key requirement is that wage growth cannot be too high relative to the inflation target (see box 1). Second, the norm must be accepted by the labour market partners, so that it can have the desired impact on the overall wage growth in the economy. A system where the norm is set by a group of experts or a joint committee is likely to fulfill the first of these requirements. However, it might be more questionable whether it would satisfy the second requirement of providing a norm for wage growth which is accepted by the labour market partners.

In practice it seems that a norm for wage growth which is based on the outcome of a prominent wage negotiation, e.g. the agreement in an important sector of the economy, is more likely to be accepted by the labour market partners. However, using a wage agreement in a sector as the norm may be problematic relative to the first requirement. If the sector is subject to sector-specific shocks, e.g. due to fluctuations in resource prices, the wage outcome from the sector might not be suitable for other parts of the economy. Moreover, there might also be a systematic bias in the sense that the wage growth in the sector tends to be higher or lower than the wage growth in the overall economy, which would also be problematic for the use of the sectoral agreement as the "norm setter".

Box 1 Wage leadership model under an inflation target

The wage leadership model was developed under a fixed exchange rate regime. Under a fixed exchange rate, the norm for wage growth depends on the wage growth among the trading partners, as well as any difference in productivity growth relative to the trading partners. If productivity growth is the same as among the trading partners, wage growth must also be the same as among the trading partners, if international competitiveness is to be maintained.

Under an inflation target with a floating exchange rate, the link between wage growth and competitiveness becomes less clear and direct. In the short run, fluctuations in the exchange rate are likely to dominate the effects from variation in wage or productivity growth. Yet in the medium term, the link between wage growth and competitiveness may be even stronger than under a fixed exchange rate, because the effect is likely to be exacerbated by monetary policy. If wage growth is high, it will have a direct one-for-one effect on the relative cost level, for a given exchange rate. However, high wage growth is also likely to induce a rise in the interest rate, as the central bank tries to dampen the increase in inflation caused by higher wages. An interest rate hike is then likely to induce an appreciation of the exchange rate, further increasing the cost level relative to the trading partners, measured in common currency. While this exacerbating effect via the exchange rate is far from automatic, it may be very strong when it works, making it an important part of the overall relationship between wage growth and competitiveness.

Under an inflation target, the norm for wage growth must thus also be seen in relation to the target for inflation. In the long run, if the inflation target is to be fulfilled, the average wage growth must be equal to the inflation target, plus the average growth in labour productivity in the economy. In periods where one seeks to improve international competitiveness, wage growth must be somewhat lower that the inflation target plus the average growth in labour productivity. Lower wage growth will then push inflation below target, making the central bank set a low interest rate which again weakens the exchange rate, leading to an improvement of the competitive position.

One way to obtain a suitable wage leader is to merge the parties in several sectors, ensuring a larger bargaining entity. In Denmark, mergers on both the union and employer side in the early 1990s ensured that the negotiations now take place between DA and CO-industri.

In Norway, The manufacturing agreement (Industrioverenskomsten) between Federation of Norwegian industries (Norsk Industri) and the metal workers (Fellesforbundet) has the position as frontfag. Thus, this agreement is supposed to provide the basis for the norm for wage growth in other parts of the labour market. However, in a role as a wage leader, this agreement had two important problems. First, the agreement covers only blue collar workers, as wages of white collar workers typically are set in local negotiations. Second, even for blue collar workers the agreement only covers a part of the total wage increase, because many blue collar workers obtain additional wage increments in local negotiations taking place at firm level. Thus, a considerable part of the total wage increase in the manufacturing sector is not determined by the signing of The manufacturing agreement.

The fact that white collar workers are not covered by The manufacturing agreement leads to a potential bias in the norm for the wage growth. Over long time, white collar workers in the manufacturing sector have typically received slightly higher wage growth than blue collar workers, implying that a norm based on wage growth for blue collar workers would result in lower wage growth than what the white collar workers receive. This problem was discussed by the labour market parties in a government commission (NOU 2003: 13), and, following the conclusions in the commission, the Contact Committee in 2003 agreed that the norm for wage increases should be based on the average wage growth in the manufacturing sector, for both blue and white collar workers.

The agreement among the labour market partners that the norm should be based on the average wage growth of all employees in the manufacturing sector removed the potential bias in the system, but it also exacerbated the problem of a noisy signal, as the central wage increase of the blue collar workers constituted an even smaller share of the wage increase for all employees in the manufacturing sector.

Until 2014, this problem was in effect handled by giving the state agreement a key role in the wage setting. The negotiations for the state sector takes place after The manufacturing agreement is concluded, and the state negotiations have thus been based on an estimate for the wage growth in the manufacturing sector that includes the outcome from The manufacturing agreement. However, as the state agreements covers both central and local wage increases in the state sector, it provides a precise number for the total wage increase in the sector. Up till 2014, the state agreement to a large extent worked as an interpreter for the wage leading manufacturing sector, by providing a precise number for the wage growth, based on the wage settlements in the manufacturing sector (NOU 2013: 13, chapter 8).

This system was, however, not without problems. One weakness was illustrated in the negotiations in the state sector in 2012, where the parties failed to reach an agreement prior to the deadline, to a large extent due to disagreement on what the average wage increase in the manufacturing sector would turn out to be. The consequence was a strike in the state sector, which also led to a strike in the municipality sector, as the negotiations in this sector usually rely heavily on the outcome in the state sector.

To reduce this problem, NOU 2013:13 proposed a novel procedure, in which the NHO, the main employer confederation in the private sector, including the manufacturing sector, in understanding with LO (the Norwegian Confederation of Trade Unions), announces a credible estimate for the average wage growth in the manufacturing sector after The manufacturing agreement has been concluded. A credible estimate for the wage growth in the manufacturing sector will then constitute the norm for wage growth in other parts of the labour market.

The motivation for this procedure is twofold. First, the NHO, in cooperation with LO, is likely in the best position to form an accurate estimate for the wage growth in the manufacturing sector, as they can combine public forecasts of the evolution of the overall economy with input from business and trade union leaders on how they view the situation. Second, having announced an estimate for the wage growth in the manufacturing sector, the NHO has a clear incentive to influence wage setters at the firm level, so as to avoid that the actual wage growth exceeds the estimate. Clearly, if the actual wage growth systematically exceeds the estimate made by the NHO, the estimate would lose its credibility, and it would not be accepted as a norm for wage growth in other parts of the labour market.

This procedure seems to have worked well. In 2014, the NHO announced an estimate for the nominal wage growth of 3.3 percent, and the actual wage growth turned out to be exactly that. In 2015, the NHO announced a wage growth of 2.7 percent, and the actual wage growth turned out to be 2.5 percent. The slightly lower actual wage growth may reflect that the economy turned out to be somewhat weaker than expected, largely due to the falling oil prices. In 2016, the NHO announced an estimate for the annual average wage increase of 2.4 percent (Norsk Industri, 2016).

While this procedure aims to ensure a credible estimate for the wage growth in the manufacturing sector, there may still be considerably disagreement among the bargaining parties in other parts of the labour market whether the estimate is indeed credible. In such cases, NOU 2013: 13 observes on page 142 that "it is possible to agree that a possible incorrect estimate can be taken into account in negotiations in subsequent years." This could be done in various ways, from explicit regulation in the form of a one-for-one compensation of the deviation between the actual wage growth and the estimate, or a much weaker form where the parties agree that a deviation will be taken into account in the subsequent wage negotiations, without specifying how. Formulations of the latter type have been used in the wage agreements in the public sector in Norway.

What would be an appropriate wage leader in Iceland? The role should be given to a sector or part of a sector where the wage settlement will work well as a norm for wage settlements in the rest of the economy. Four main criteria are important. The sector should

- Face a stable economic environment, possibly influenced by fluctuations in the overall economy, but without large, idiosyncratic disturbances leading to fluctuations in the wage growth
- Have competence and understanding in the relevant organisations
- Have an incentive to keep wage growth down because the firms are negatively affected if wage growth is too high

- Be able to reach a wage outcome that can be accepted as a norm for wage growth in other parts of the economy.

Size is in itself not important, but it may still be highly relevant indirectly, as is likely to affect to what extent the sector satisfies the listed criteria.

In Iceland, the choice of a wage leader is made difficult by the fact that much of the traded sector is heavily dependent on natural resources, and thus subject to considerable volatility in prices and possibly also output. This could easily lead to a norm for wage growth that is too high or too low to be suitable for the rest of the economy.

One way to obtain a wage leader that satisfies these criteria might be to ensure coordination among several of the agreements. For example, there could be coordination on the employer side, via SA, ensuring a frontfag consisting of fish processing and/or energy-intensive industries, combined with some other manufacturing. One possibility would then be to have a joint central agreement, with limited scope for firm-specific negotiations afterwards, giving some scope for variation across firms.

If it turns out to be difficult to find a suitable frontfag, an alternative would be to set the norm for wage growth in a two-step procedure, where there first are one or more wage negotiations, and then the norm is set on the basis of these leading settlements. The norm should be an estimate of the wage growth in the manufacturing sector, possibly also including other parts of the traded sector.

The estimate could be set in different ways. One possibility is that SA does it, in "understanding" with ASI, corresponding to the way it is currently done in Norway, where the NHO makes the estimate for the wage growth in the manufacturing sector.

Another possibility is that the norm is set by an expert group, or by the national economic council, still on the basis of the leading settlements.

A third possibility is that the state sector negotiates after one or several leading settlements, following their "lead". The wage growth which is agreed in the state sector would then function as a norm in the rest of the public sector, and perhaps also in related groups in the private sector, while other parts of the private sector more directly could follow the settlements in the leading sector. This would be similar to how the Norwegian system was before 2014.

The advantage of this latter approach is that the state sector could work to make the norm more precise than it is after the leading settlements. Possibly, the agreement in the state sector could also involve an adjustment of the outcome in the leading settlements, if the leading settlements are affected by idiosyncratic features.

Irrespective of how the norm is constructed, it is important that Statistics Iceland, or a new technical calculation committee, afterwards calculate the wage growth for the area that provides the basis for the norm, so that one obtains a correct and precise number for what the wage growth turned out to be.

In all the alternatives, it would seem reasonable to include an indexation mechanism ensuring that overall, public and private sector wages grow at essentially the same rate. One way to do this is that in each year, wages in the public sector are adjusted according to the deviation between the actual wage growth in the private sector (or in the manufacturing sector) and the norm, so that public sector workers are fully compensated if actual private sector wage growth exceeds the norm, in a symmetric wage, i.e. both up and down.

3 Ensure that the wage norm is followed elsewhere in the labour market

The success of a wage leadership model hinges on whether the wage norm is followed elsewhere in the labour market. The key issue is to prevent wage-wage spirals, where one or several strong groups are able to obtain more than the norm for wage growth, and this leads to other groups following suit. To avoid wage-wage spirals, the best approach is usually to aim for constant relative wages across different sectors or parts of the labour market, i.e. that the wage growth in percent is the same in different parts of the labour market. While there would still be room for flexibility within each part, e.g. allowing for somewhat higher wage growth for workers in some firms or occupations than others, the scope for such differences would be limited.[6]

In principle, one could allow for some flexibility in relative wages also across different parts of the labour market under exceptional circumstances. E.g. one could allow for adjustments based on specific circumstances that necessitate that one group obtain higher wage growth than others. However, such adjustments would put pressure on the system, involving a risk that it breaks down.

As noted, the wage leadership model implies that the wage growth in the leading sector or agreement works as a norm for the percentage wage growth in other sectors of the economy. To some extent, there will be an effect of the first agreement almost by default. As both unions and employers care about relative wages, the wage increase received by one group will affect subsequent negotiations for others workers. To recruit and retain qualified workers, firms will often want to match the wage increase given by other firms who compete for the same type of workers. The first wage round also play a role as measure of comparison, illustrating what is achievable.

However, if the wage leadership model is to succeed, the influence of the wage norm from the wage leader must be much stronger than what would follow by default. If other large worker groups obtain a higher wage growth than the norm, often referred to as “leap-frogging”, it could undermine the role of the wage leader. Furthermore, it could result in higher wage growth for the wage leader in subsequent negotiations.

[6] This does not necessarily prevent adjustment of relative wages between large groups prior to the system starts. However, attempts to realize such adjustments may be risky, as it may cause other groups to try to catch up in subsequent rounds.

In broad terms, there are three main mechanisms that can be used to ensure that the norm from the wage leader is followed elsewhere in the labour market.

- Internal coordination within and among unions/federations and employers' federations
- Mediation officer – measures used to keep wage growth in line with the norm
- Arbitration schemes/compulsory arbitration reducing the possibility of obtaining more than the wage norm by means of industrial action

Below, I will discuss these mechanisms in more detail.

1) Internal coordination within and among unions/federations and employers' federations

As noted above, there is ample empirical evidence across OECD countries suggesting that coordination of wage setting involves considerably lower unemployment. In Denmark and Norway, the coordination has taken place partly through mergers of unions, and partly by strengthened coordination of the actual wage setting. In particular in Denmark, there has been extensive consolidation of the organisations, through a substantial number of mergers on both sides of the labour market. In Denmark, there is also a requirement that the executive committee of DA, the employers' federation, approves of an agreement before it becomes valid.

In Norway, there are also important internal coordinating mechanisms. In the main union confederation, LO, the central level is part to all industry agreements, implying that new agreements and strikes must be approved at the central level. In the main employers' confederation, NHO, the central level exerts a strong authority over the industry federations regarding bargaining and the conclusion of collective agreements, even if the federations negotiate separately with their counterparts (Løken og Stokke, 2009).

In Iceland, the main confederations, SA and ASI, have a fairly dominating role. Combined with a high organization rate on both sides of the labour market, this makes coordination more efficient when it works. However, the structure of the wage setting in Iceland has a number of features that may lead to increased wage pressure. Most importantly, the bargaining rights are vested in small unions organized along occupational lines, giving unions a strong position in the wage setting. Combined with extension rules for collective agreements, and priority clauses giving union members priority to jobs in their area, this makes Iceland an outlier among all industrialized countries. These features imply that small unions generally have a strong bargaining position due to little or no competition from non-unionized workers, combined with weak incentives to take effects on other parts of the labour market into account.

Whether and to what extent one is willing to change or modify institutional features of the wage setting in Iceland is an issue that is up to the affected parties in Iceland. However, it seems clear that the challenging structure of the wage setting in Iceland increases the need for coordination in wage setting

2) Mediation officer – measures used to keep wage growth in line with norm

The mediation officer may also play an important role in contributing to a successful wage leadership model. The influence of the mediation officer may come in several ways. First, with partial exception only in Finland, the mediator will always make proposals that are consistent with the wage leadership model, i.e. the norm for the wage increase implied by the wage settlement for the wage leader. If the bargaining parties in one sector want to deviate, they run the risk of being "named and shamed" by the mediator and other labour market partners (see e.g. Ibsen, 2015).

Second, the mediator may also play the role as a "scapegoat", in particular if unions have to back down on high wage demands they have voiced forcefully before and during the negotiations. An argument that it turned out to be impossible to obtain more than the mediator proposed may make it easier to sell a more moderate agreement to the "rank and file" of the union.

Third, the mediator may interfere more directly with in the negotiations, by requiring a specific negotiation schedule, and possibly also by postponing industrial action. These options are open to the mediators in the other Nordic countries, while the mediation officer in Island can require a negotiation schedule, but not postpone industrial action. Thus, at this point the mediation officer in Iceland has weaker powers than the mediation officers in the other Nordic countries. Postponing industrial action may have an important function by "cooling down" the parties. Moreover, by delaying industrial action in one sector, it may increase the likelihood that others reach an agreement first, which may affect the outcome in the sector where industrial action is postponed.

Finally, in Denmark the mediator also has the power to link the voting in several bargaining areas, with and without prior agreements, into one concatenated decision for all the bargaining areas (Ibsen, 2015). Prior to the ballot, proposed agreements above the norm are rejected by the executive committee in DA, while areas without an agreement are given a wage increase based on the industry norm. The mediator then works together with the bargaining partners, to ensure that several bargaining areas are linked together, increasing the chance of obtaining an overall majority in the ballot in favour of an agreement in line with the norm.

3) Arbitration/compulsory arbitration

In Norway, if an industrial conflict (strike or lock-out) has consequences for life or health, or has other seriously damaging effects on society, the political authorities may interfere by sending the conflict to compulsory arbitration by the National Wages Board (Rikslønnsnemnda) (Ministry of Labour and Social Affairs, 2013). Decisions to stop a work conflict and invoke the National Wages Board are in practice taken by the Government, even if the formal decision is taken by the parliament. The Board consists of three unaffiliated experts as well as two permanent representatives from the main employers' and employees' organisations (NHO and LO), who are all appointed for three years at a time. In addition, there would be one representative from each of the disputing parties.

According to the National Wages Board Act §1 part 4, a decision by the National Wages Board has the same effect as a collective agreement. The Act has no formal regulations for the decision making in the Board, but in the preparatory works, it was assumed that the Board should be an impartial, objective and independent body (Ministry of Labour and Social Affairs, 2013).

A governmental commission, the Committee for the Collective Bargaining System examined the procedure regulations and practice of the Board (NOU 2001:14, the so-called Stabel-utvalget). One guiding principle for the decisions seems to be that the Board only considers questions raised by the parties' claims. Moreover, when a recommended negotiation or mediation proposal is available, this proposal will as a main rule be confirmed by the Board. However, the Board's practice is not invariable, and it can be departed from in situations where this is considered suitable (Ministry of Labour and Social Affairs, 2013).

Stokke, Nergaard and Evju (2013) also find that the Board, with very few exceptions, one of the latest being nurses in the municipality sector in 1998, rules in accordance with the norm from the wage leader. The general idea seems to be that if one of the parties wants an improvement or change in the agreement, over and above the norm from the frontfag, this should be achieved in ordinary negotiations, possibly after a conflict, and not as a ruling from the Wage Board. In NOU 2013:13, it is pointed out that the rulings from the Board generally follow the wage agreements which are already negotiated in the area of the dispute, and that these rulings support that the norm for the wage growth follows from "frontfaget" (page 155).

Compulsory arbitration was used quite frequently in the 1970s and 1980s, but this practice was criticized by ILO for being used in disputes that were not threatening essential services, and its usage violated international conventions (Løkken and Stokke, 2009). Since 2000, the authorities have been more cautious in their use of compulsory arbitration. Yet it still plays an important role in solving difficult conflicts in some sectors.

Conclusions

Iceland is recovering after a severe crisis, which is an impressive turnaround by any standard. However, if the high wage growth continues, it may lead to another boom-bust cycle. Persistent high wage growth is likely to induce the central bank to raise the interest rate, so as to prevent inflation from exceeding the inflation target. A combination of high wage growth and a monetary tightening would likely lead to appreciation of the Icelandic krona, which would weaken the competitive position of Icelandic firms.

To ensure that wage growth is reduced down to sustainable levels, Iceland would benefit from adopting a wage leadership model, also referred to as a pattern bargaining model, similar the Norwegian "frontfag-model". Establishing a wage leadership model requires three steps.

1) Develop a common understanding among the labour market parties about the challenges and the need a sustainable wage growth

To make coordinated wage moderation feasible, the labour market parties must agree on the mutual benefits of ensuring wage growth at sustainable levels. This requires a certain amount of trust among the parties, as well as sufficient acceptance among union members for the wage moderation this entails. As wage moderation leads to higher profits, it is important that union members see that this in fact materializes in a positive effect on investment and jobs, and not only in higher dividends and increased executive pay.

Several institutional features may contribute to understanding and trust among the labour market parties. In particular, Iceland is likely to benefit from establishing a Technical calculation committee for the wage settlements, along the lines of the Norwegian counterpart. The main aim would be to ensure reliable and relevant statistical material for the wage setting, both in terms of wage levels and wage growth for various groups and agreement areas. In addition to ensuring that the bargaining parties agree on important numbers and facts, the work in the committee is also an arena for contact and development of trust. These are crucial elements in the development of a wage leadership model.

2) Establish a wage leader which negotiates first and thus sets the norm for the wage growth in other parts of the labour market.

In Iceland, the choice of a wage leader is made difficult by fact that much of the traded sector is heavily dependent on natural resources, and thus subject to considerable volatility in prices and possibly also output. This could easily lead to a norm for wage growth that is too high or too low to be suitable for the rest of the economy.

One way to obtain a suitable wage leader would be via coordination among several of the agreements. For example, there could be a joint central agreement, with limited scope for firm-specific negotiations afterwards, giving some scope for variation across firms.

If it turns out to be difficult to find a suitable frontfag, an alternative would be to let the norm for wage growth set in a two-step procedure, where the norm is set on the basis of one or several leading wage settlements. The norm should be an estimate of the wage growth in the manufacturing sector, or possibly also including other parts of the traded sector.

The estimate that constitutes the norm could be set in different ways. One way that would correspond to the current practice in Norway, would be that SA, in "understanding" with ASI, makes an estimate for the wage growth in the SA-ASI area.

Another possibility is that the norm is set by an expert group, or by the national economic council, still on the basis of the leading settlements.

A third possibility is that the state sector negotiates after one or several leading settlements, following their "lead". The wage growth which is agreed in the state sector would then function as a norm in the rest of the public sector, and perhaps also in related groups in the private sector, while other parts of the private sector more directly follows the settlements in the leading sector.   This would be similar to how the Norwegian system was before 2014.

The advantage of this latter approach is that the state sector could work to make the norm more precise than it is after the leading settlements. Possibly, the agreement in the state sector could also involve an adjustment of the outcome in the leading settlements, if the leading settlements are affected by idiosyncratic features.

Irrespective of how the norm is constructed, Statistics Iceland, or a new technical calculation committee, should afterwards calculate the wage growth for the area that provides the basis for the norm, so that one obtains a correct and precise number for what the wage growth turned out to be.

In all the alternatives, it would seem reasonable to include an indexation mechanism ensuring that overall, public and private sector wages grow at essentially the same rate. One way to do this is that in each year, wages in the public sector are adjusted according to the deviation between the actual wage growth in the private sector (or manufacturing sector) and the norm, so that public sector workers are fully compensated if actual private sector wage growth exceeds the norm, in a symmetric wage, i.e. both up and down.

3) Ensure that the norm for the wage growth is followed elsewhere in the labour market.

In broad terms, there are three main mechanisms that can be used to ensure that the norm from the wage leader is followed elsewhere in the labour market. Given the considerable challenges that are involved when establishing a wage leadership model for Iceland, one should probably pursue all three mechanisms in combination.

- The main organizations should consider the internal coordination within the organization, with the aim of making the organizational structure as well as the bargaining structure more conducive to coordinated solutions.
- The powers and workings of the mediation officer should be reviewed, with the aim of increasing the role of the mediation officer in terms of facilitating wage setting in accordance with a wage leadership model
- A permanent arbitration committee should be considered, along the lines of the National Wage Board in Norway.

How far one can go along each of these lines is difficult to judge, in particular for an outsider. Given the challenges of establishing a wage leadership model, a bold approach might be warranted. However, an initiative like this can only succeed with broad support among the main labour market organizations in Iceland.

The likelihood that a wage leadership model succeeds also depends on the pressure it will face. A volatile economy with large fluctuations in profits and demand for labour will put more pressure on the system, reducing the possibility of success. Monetary and fiscal policy that work to stabilize the economy will therefore also make a wage leadership model more likely to work. Structural policies that stabilize the economy may also contribute in this direction. The management of the natural resources is also of importance. Large fluctuations and unequal distribution of the revenues from the natural resources will increase the strain on the system.

Addendum Brief account of the wage setting in Denmark and Sweden

Wage setting in Denmark[7]

The wage setting in Denmark transformed during the 1980s. In 1982, the Danish government made an explicit policy change towards a low inflation regime. In 1987, the main labour market organisations agreed in the Common Declaration "Felleserklæringen" on wage moderation in exchange for increased employment and increased investments. The wage setting takes place at the industry level, and since the early 1990s, the manufacturing sector negotiates first. About 80-85 percent of the workers in Dansk Arbejdsgiverforening (DA) have minimum wage contracts, which allow bargaining for higher wages at the firm level. Typically, two-thirds of the wage growth takes place at the firm level (Pedersen and Andersen, 2014) The main organization in DA is DI, former Danish Industries, covering 60 percent of the total wages in DA. The bargaining parties in the manufacturing sector are DI and CO-industry, which is a bargaining cartel at the union side, representing both skilled and unskilled workers. Over time, there has been a considerable consolidation at both sides of the labour market, with a substantial number of mergers between unions, and also mergers on the employer side.

In Denmark, the mediation institution ("Forligsinstitutionen") plays a crucial role. In 1934, the mediator was given the right to link several bargaining areas into one joint ballot. Thus, even if the majority of the workers in some unions vote no to the proposed agreement, it would still be valid if there is an overall majority in favour. Such joint proposals are usually carefully negotiated with the confederations, where DA ensures that no area obtains more than the norm, while the counterpart on the union side, LO-D ensures that none of its affiliates get less than the norm (Ibsen, 2015). The mediation institution also has the power to postpone industrial action two times for up to 14 days.

Another element in the coordination is the requirement that the executive committee of DA approves of an agreement before it becomes valid. If the bargaining parties in another industry were to agree to a wage increase exceeding the norm from the manufacturing sector, the executive committee of DA is likely to reject the agreement.

The upshot of the Danish system is very efficient coordination, with no industry defecting from the pattern set by the manufacturing sector in the period after 1991.The government may stop industrial disputes by legal measures, as they did with the conflict for teachers in 2013.

The wage setting in the public sector is linked to private sector wage setting via an automatic regulation. If public sector wage growth exceeds wage growth in the private sector, there will immediately be a downward adjustment to match the public rise to the private one, cf. Aumayr-Pintar (2015). If public sector wage growth is below the wage growth in the private sector, 80 percent of the difference is compensated.

[7] The main sources are Andersen et al (2014) and Ibsen (2015).

Wage setting in Sweden[8]

During the 1950s, 60s and 70s, wage setting in Sweden was highly centralized. However, during the 1980s, central wage negotiations broke down, ending when Sveriges Arbeidsgiverforbund, SAF, withdraw in 1990. Attempts to ensure coordinated wage moderation succeeded in 1991 but failed in 1995, resulting in wage growth exceeding the wage growth abroad in spite of the high unemployment rate. This was the background for the introduction of the Industry Agreement (Industriavtalet) in 1997. The idea was that international competitiveness should be ensured by moderate wage growth in line with the wage growth abroad. The export industry should set the pace. To avoid wage-wage spirals, there is synchronization of duration and expiration of wage agreements. Impartial mediators ("Opartiska ordförande", OpOs) were supposed to aid the parties in reaching an agreement, and to coordinate across various agreements in the manufacturing sector.

In 2000, the Swedish National Mediation Office, Medlingsinstitutet was established. This is a government agency with three main tasks, which is to mediate in labour disputes, to promote an efficient wage formation process, and to oversee the provision of public statistics on wages and salaries. The Mediation Office appoints mediators in case of a dispute between the parties in the labour market.

The mediators' task of promoting an efficient wage formation process implies that the mediator will never propose an agreement exceeding the norm from the manufacturing sector. However, if the parties themselves agree to a higher outcome, the mediator cannot prevent this, nor can LO or SN (former SAF). Ibsen (2105) argues that the difference in the legal capabilities of the mediation institutions in Denmark and Sweden is the key reason for deviations from the manufacturing sector norm occasionally happening in Sweden, while it does not happen in Denmark.

[8] The main sources are Andersen et al (2014) and Ibsen (2015).

Mediation institutions in the Nordic countries – a comparison with Iceland (preliminary)[9]

1) Duty of the parties to notify the mediator about industrial action

Cover all forms of industrial action in Denmark, Norway and Sweden, but only work stoppages in Finland. Notice period is four working days in Norway, seven working days in Sweden and two weeks in Finland. In Denmark, it varies, and seven days is normal.

In Denmark and Norway, industrial action becomes unlawful if the mediator has not been notified in the correct manner. In Sweden and Finland, this is not the case, but the parties face the risk of being fined by the state.

In Iceland, the notice period is 15 days in the public sector and one week in the private sector. There are no sanctions if the minimum notice period is violated.

2) Duty to take part in mediation

This duty applies in all four countries, and also in Iceland. Primarily this is the case when notice of industrial action has been given, but in principle it also applies if no notice has been given.

3) Temporary peace duty – postpone industrial action.

In Norway, a notice of industrial action can be postponed 14 days (21 days for state employees), Sweden up to 14 days, Finland 7 days, plus up till 7 days for public servants, and Denmark twice, each time up to 14 days (second time only if dispute endanger vital social functions).

In Sweden and Finland, the mediator may vary the duration of the postponement to avoid that parties speculate in postponements to retard negotiations. In Norway, postponement is a routine procedure.

In Iceland, the mediator does not have the opportunity to postpone a work stoppage.

4) If industrial action occurs

In Denmark, the mediator usually withdraws from the conflict, while in the other countries, mediators may be more active if the parties are willing to negotiate.

In Iceland, this depends on the parties to the negotiations. If they are willing to negotiate, the mediator is more active, while if they are not, the mediator is more passive.

5) How do the parties decide over a mediation proposal?

In Norway, unions decide whether to have a ballot, but legislation provides some rules regulating how a ballot shall be conducted. A commission in 2000 proposed that mediators should be allowed to demand a ballot, but this proposal was not followed up in Stortinget.

[9] The main source for the other Nordic countries is Stokke (2009).

In Denmark, the mediator can demand a union ballot, and can treat several proposals for new collective agreements as one entity. If participation is less than 40 percent, at least 25 percent of those entitled to vote must vote against for the proposal to be rejected.

No ballots in Sweden, while ballots may take place in Finland.

In Iceland, several agreements are occasionally linked together in a single ballot, but unless the parties are jointly part to the same dispute, the initiative must come from the unions/federations themselves, and cannot be imposed by the mediator.

6) “Guidelines” for mediator proposals

In Norway, Denmark and Sweden, the mediator does not propose better terms than the outcome from the frontfag/wage leader. In Norway and Sweden, the parties are free to agree on higher or lower wage increase than the norm, but they would have to do this without the help of the mediation officer. In Denmark, such deviations are often prevented by linking of agreements from several sectors.

In Finland, the mediators also keep to the “general guidelines”, although they may propose somewhat more generous terms when a strike has lasted for some time and the strikers have lost income.

In Iceland, the mediator is not obligated to make a proposal. Moreover, according to law, the mediator has to consult with the disputing parties before presenting a mediation proposal. In practice, the tradition is that the mediator needs the approval of all parties in order to make the proposal. The disputing parties review the proposal, and it will only be put forward if the parties agree to it. In this case the proposal is voted on by members of the parties to the dispute.

The state mediator can also propose a solution to disputing negotiation committees but it is subject to the same rules as the mediation proposal, as both committees must agree to its proposal before the mediator can present it.

In Denmark, there is a long tradition of agreeing on “negotiation schedule”, with a fairly detailed plan for the renegotiation of the agreement is laid out. In Sweden, the mediator is supposed to assist parties in agreeing on a negotiation schedule.

In Iceland, the mediator shall present a negotiation schedule, and according to law, the parties must respect this schedule. However, in practice the parties may often violate the schedule, without any sanctions being imposed.

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