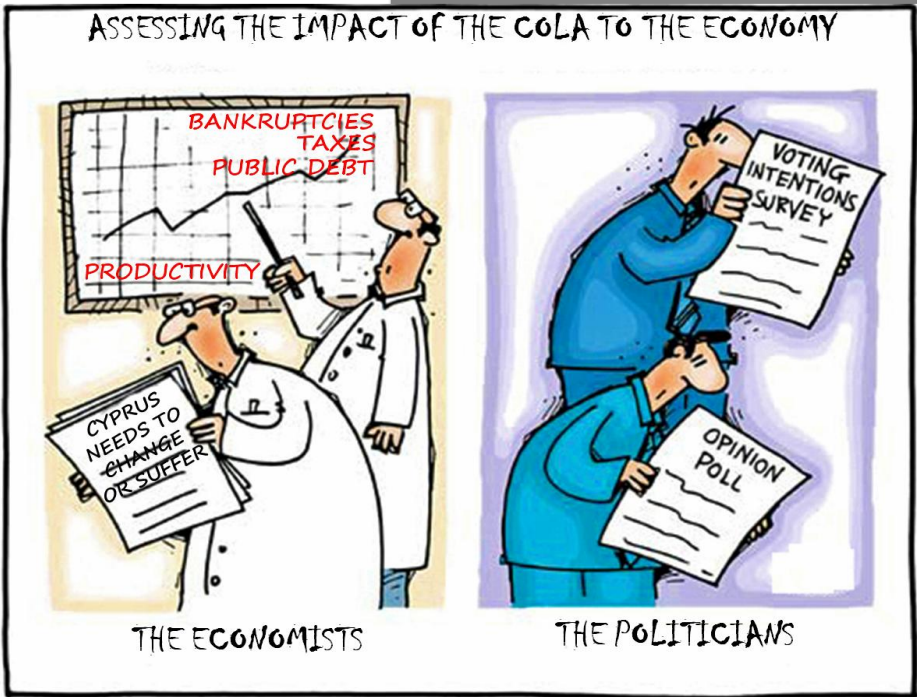


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Cyprus – Why the C.O.L.A. must be abolished immediately!



By Harris A. Samaras



Wage bargaining processes, either through collective bargaining or to an increasing extent through individualized bargaining, determine wages in most EU countries. However, some EU Member States apply a system of “automatic” wage adjustment procedures – also known as “wage indexation”. Systems of wage indexation, where some form of general index prescribes the development of employees’ wages, are currently in place in four EU countries: Belgium, Cyprus, Luxembourg and Malta. Adjustment is based on currency inflation and aims to maintain wage levels, despite long-term increases in the cost of living. Other EU member states that used to have such a system of wage indexation in the past but have now abolished it are Denmark, France, Italy, the Netherlands and Spain.

Wage indexation aims to link wage development to the actual evolution of living costs to ensure that real wages are not overtaken by inflation. Wage indexation is based on regular adjustments of wages in line with general changes in price levels. The index usually used is the Consumer Price Index (CPI). This system is sometimes referred to as the Cost of Living Allowance (COLA) or the cost of living adjustment.

Why is wage indexation, COLA, a catastrophic practice for Cyprus that needs to be abolished immediately?

Wage indexation implies rigidity preventing wages from reflecting actual worker productivity and company performance. This uniform application does not allow wages to mirror productivity differences across economic sectors and geographical areas.

In addition, **wage indexation prohibits greater flexibility concerning pay, for cost and performance reasons** (both within and between companies), flexibility, immensely required to fight pressure from increased competition.

Wage indexation contributes to a self-feeding inflationary spiral and exacerbates inflationary pressures – excessive wage increases could trigger inflationary risks, and high labor costs may indeed be a result of wage indexation in countries where inflation is high or rising at faster than normal pace, impeding the stabilizing role of fiscal policy

Another important reason is the lack of reactivity to economic shock which wage indexation could imply in making downwards wage flexibility impossible. In this context, **wage indexation prevents the necessary adjustments in the case of an adverse economic situation.**

Finally, **wage indexation has a significant impact on public finances** – beyond wages and salaries, the COLA is also an integral feature of pensions, benefits, and other allowances. A marginal increase of the COLA corresponds to tens of millions of Euros in higher expenditure, inducing expenditure overruns.

The trade unions argue that, (a) the very aim of wage indexation systems is to protect real wages against rises in the cost of living – that in the absence of such a mechanism, wage adjustments depend heavily on the trade unions’ bargaining power and that low bargaining coverage may further limit the applications of such bargaining achievements in terms of wage developments, (b) wage indexation is seen to guarantee social fairness in ensuring the redistribution of national income to workers and (c) wage indexation may contribute to peace in industrial relations thus reducing strike levels.

Above arguments are unfounded at least in the 21st century of this planet. Yes, no doubt, when this system was established in 1944 in Cyprus, conditions, social and economic, were immensely different and a lot simpler. Cyprus was also then part of this planet but not part of a Global Economy, and a monetary union (with the loss of the monetary policy tool). A global economy that is interconnected to such extent, that movements in exchange rates, interest rates, stock prices and prices of goods and services are influencing the whole of the globe. No one could have imagined in 1944 or even a few years back that a financial crisis in the U.S. would have threatened the whole planet with bankruptcy, a tsunami in Japan or an uprising in Tunisia would have affected the wallet of each and every Cypriot... How could Cyprus ever dream to even survive within such global economy when it is neither competitive nor



productive? How could Cyprus be productive or competitive when the COLA defeats each and every purpose for competing? How could Cyprus seek for excellence when entrepreneurship and innovation is "massacred" by a system that is not based on merit and performance but instead promotes mediocrity and injustice for those that deserve to be rewarded and one day could have led this country to excellence?

Think about it.

And if politicians, demagogues, populists, colleagues (colleagues that receive a salary and an increase of salary not because they deserve it but because they fall within the protection of this system of 1944) turn around and claim that it is impossible to abolish... as ignorant, weak and opportunists often claim... remember, how fed up you are, for being considered by these very same as ignorant and weak... a victim of opportunists...

Cyprus needs to safeguard competitiveness! Losses in competitiveness in the environment of today will have severe consequences on the real economy of the island to say the least.

References

- ▶ [Cyprus: Immigration, wage indexation and the adjustment in EMU by Polyvios S. Eliofofou](#)
- ▶ [Wage indexation in the European Union by Eurofound](#)
- ▶ [The labour market and the Euro by Christopher A. Pissarides](#)
- ▶ [Supply shocks and monetary policy revisited by Robert J. Gordon](#)
- ▶ [Macroeconomic model of Cyprus economy: The wage-price sector by Louis N. Christofides and Constantinos Vrahimis](#)

See also other publications by Pytheas on Cyprus:

- ▶ [Cyprus must change or suffer! \(February 2011\)](#)
- ▶ [Investing in Cyprus – An EU bridge to the world of business \(February 2011\)](#)
- ▶ [Cyprus – The Economy calls for immediate action! \(December 2010\)](#)
- ▶ [Cyprus – Real estate and construction industries optimistic despite the slowdown \(October 2010\)](#)
- ▶ [The Cyprus real property market contracted... \(October 2009\)](#)
- ▶ [Buying real property in Cyprus \(April 2009\)](#)

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