



# **Mutual Learning Programme**

DG Employment, Social Affairs and Inclusion

**Peer Country Comments Paper - Cyprus**

## **Dynamism and dynamite? The MoUs in Cyprus and Portugal**

**Peer Review "Towards a more dynamic collective  
bargaining"**

**Portugal, 23-24 October 2017**



**EUROPEAN COMMISSION**

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## 1 Background to collective bargaining in Cyprus<sup>1</sup>

The first Social Contract (SC) between the unions, employers and the government was signed in 1962. It secured the right to organise, negotiate and sign collective agreements, and the right to strike. The SC was replaced in 1977 by the Industrial Relations Code (IRC). The IRC adopted the main conventions of the ILO and safeguarded the right of freedom of association. The right to strike was also secured except for workers in the security forces, the police, the army, and the fire service. While the IRC does not lead to legally binding agreements, they are generally complied with. The IRC implements tripartitism, recognising that collective bargaining is the most effective way to determine rates of pay and other employment terms, and accepting dispute-resolution procedures including arbitration, mediation and public inquiry.

Collective bargaining at the national level does not exist in Cyprus. The Labour Advisory Board (a tripartite body - consisting of representatives of three unions, two employer federations, and the government) and other *ad hoc* groups of social partners deal with macro issues ('concertation')<sup>2</sup>. Remuneration and other employment issues in the private, semi-private, and local authority sectors are set through collective bargaining between employer and worker organizations, mainly at the industry but also at the enterprise level (e.g. banks); sectoral agreements can be improved at the enterprise level. Wages in the public sector are set by law, following consultations between the unions and the government. Employment protection legislation complements collective agreements. Legislation also governs the minimum wage, hours of work, and annual leave for workers in sectors which are not unionised. The Cyprus Memorandum of Understanding (MoU), in place between March 2013 and 2016, short-circuited normal procedures; nevertheless, private sector collective bargaining facilitated reaching the objectives of the MoU by adjusting wages and increasing the competitiveness of the Cypriot economy.

Two employers' federations represent a large number of associations and enterprises; the percentage of employees who are working in establishments that are affiliated with an employers' organisation is approximately 62%<sup>3</sup>. Seven large and a number of smaller unions represent workers with a coverage rate of approximately 45%<sup>4</sup>.

Because the political system in Cyprus is a so-called "presidential" system, it is important for the Executive Branch to secure sufficient support from the social partners and the political parties for the passage of measures that require legislative approval. Alliances can be fluid, a problem that has become more acute in the last year when Cyprus exited the MoU and when the last parliamentary elections increased political fragmentation. A challenge ahead is charting a course of sound economic policy without the MoU restrictions and with Presidential elections in the near future.

## 2 Assessment of collective bargaining

### 2.1 Collective bargaining in Cyprus and Portugal

There are many similarities in terms of the collective bargaining structures in Cyprus and Portugal:

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<sup>1</sup> Helpful comments and information were received from Marina Ioannou-Hassapi and Xenios Mamas of the Ministry of Labour, Welfare and Social Insurance (MLWSI). The paper does not represent the opinion of the Ministry but is the author's appreciation of the subject.

<sup>2</sup> One such group has just concluded an agreement extending the general terms of a new Cost of Living Allowance (COLA) system for the public to the private sector.

<sup>3</sup> See - European Commission (2016) *Employment and Social Developments in Europe*, p. 214, issued in 2016 but pertaining to 2015 and available at the URL below:

<http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7859&furtherPubs=yes>

<sup>4</sup> Same as Footnote 3 - EC (2016) p. 213

(i) The concept and structure that governs collective bargaining arrangements is common to both countries (the IRC in Cyprus and the Labour Code in Portugal), and the role of the social partners is critical in both countries.

(ii) In both countries, no collective bargaining occurs at the national level but occurs at sector- and enterprise level.

(iii) In both countries, collective bargaining applies to the private and semi-private (state-owned) sector. Agreements are not legally binding in either country.

(iv) Work councils exist but are limited in use in both countries.

(v) There is no strict collective bargaining in the public sector in either country. In Cyprus, the terms of employment in the public sector are determined by statute, following consultation between the government, as an employer, and the relevant union.

(vi) Wage setting was impacted substantially during the MoU years (Cyprus 2013-2016, Portugal 2011-2014) in both countries. A point of contest in Cyprus was the pre-MoU automatic and full indexation of nominal wages (COLA of 100%) to the Consumer Price Index (CPI); the MoU solution for the public sector has now been extended to the private sector through concertation efforts by an ad hoc body of social partners. In Portugal, a difficult point was the extension mechanism relevant to collective bargaining agreements.

However, there are also some important differences in wage setting mechanisms and impact of MoU years on collective bargaining

(i) Both countries have a legal minimum wage<sup>5</sup>. In Cyprus it is occupational, while in Portugal it is national. The motivation for it is also different: In Cyprus, it is used to intervene in occupations with no or low union representation, while in Portugal it seems to be a more explicit tool for income redistribution and the incorporation of productivity gains at the enterprise level.

(ii) Concertation: In Cyprus, the Labour Advisory Board acts as a national concertation body, advising the Minister at MLWSI on important issues. Some concerns can be raised about this body, namely that only three unions participate on a regular basis and that no independent academic experts take part to advise and act as a sounding board. Moreover, labour relations issues are intertwined with macroeconomic issues and this latter expertise does not seem to be well-represented on the Board. Ad hoc bodies also serve an important concertation role. In Portugal, tripartite bodies have a long history<sup>6</sup> of dealing with macro issues and broad human capital issues such as technical and vocational training.

(iii) Wage setting in the two countries appears to have operated in somewhat different ways: In Cyprus, before the MoU, in the semi-public and public sectors but also in some private sector agreements (e.g. banks), nominal wages increased automatically with the CPI (through a 100% COLA clause) and with the passage of time (until pay scale ceilings were reached). Moreover, economy-wide productivity gains were built into wage agreements, regardless of how well a particular sector was growing. As a result, between 2005-2011, the growth in nominal earnings was 27.3 percentage points (pp), and the increase in the CPI was 18.2 pp, implying an increase in real earnings of 9.1 pp, higher than the labour productivity increase of 5.8 pp over this period. That is, in the period prior to the Cyprus crisis, real earnings grew faster than inflation plus labour

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<sup>5</sup> In Cyprus, it ranges between €870-€924 per month (depending on the length of employment), while in Portugal it was fixed at €485 pm during 2011-2014, increasing to €557 pm by 2017. For its coverage in Cyprus, see P. Mitsis (2015) 'Effects of Minimum Wages on Total Employment: Evidence from Cyprus' *Journal of Labor Research* DOI 10.1007/s12122-015-9205-0. He gives a mean value for the period 1960-2011 of 15.1%, while the highest value in this period, attained after the legislative coverage was extended to more occupations, was 29.1% in 2011. For Portugal, the Host Paper (p.5) reports a coverage for 2016 of 23.3%.

<sup>6</sup> See the Host Country Discussion Paper, or Host Paper, pp. 3-4.

productivity, based on data from CYSTAT. In combination with lower interest rates after entry into the EU in 2004 and abundant bank liquidity, these developments encouraged the build-up of considerable private indebtedness. In Portugal, the Host Paper refers (pp. 2-3) to concerted national efforts (1990-1996) to bring the rate of inflation down through wage restraint, as well as to other important concertation initiatives. Table 7 in the Host Paper shows that, over the period 2000-2010, before the Portuguese crisis, Nominal collectively agreed wages increased by 33.7 pp, and Inflation summed to 27.6 pp, implying an increase in real wages of 6.1 pp, much lower than the incredibly large Apparent (see questions) productivity growth of 44.7 pp; this growth was not reflected in real wage growth to any significant extent. It would appear that, prior to the 2011-2014 MoU, the social partners in Portugal managed to restrain wage growth to the point where competitiveness should have been maintained. In section 4, questions to the host country concern whether the MoU measures were appropriate to the causes of the Portuguese crisis.

The MoU froze minimum wages in both countries and, in Cyprus, it introduced a number of net earnings reductions until the end of 2016. In the post-MoU period, a number of new arrangements emerged in Cyprus. As of January 4, 2017, social partner agreement about wage setting in the broader public sector authorised collective bargaining under the IRC with an upper limit equal to the growth in nominal GDP over an earlier reference period. Another important social partner agreement extended a COLA mechanism developed during the MoU for the public sector to the private sector<sup>7</sup>. There is governmental recognition in Cyprus that the runaway nominal and real wage growth in the period prior to 2012 must not be repeated. But it is not clear whether increasing trade union pressures<sup>8</sup> during a pre-election period will be resisted. In Portugal, on the other hand, repeated minimum wage increases have been implemented (14.2 pp over the period 2015-2017, as per Table 8 of the Host Paper) and there appears to be less concern with real wage growth. This may reflect the fact that, in the period prior to the crisis, substantial productivity gains had not been built into real wage increases<sup>9</sup>. In addition, a trend for weakened collective bargaining during the MoU years has been reversed.

## **2.2 Extending collective bargaining agreements after expiry (Cyprus and Portugal)**

In Cyprus, a collective bargaining agreement can be extended for one year if two months prior to its expiration neither party has proposed any amendments. Presumably, if amendments are desired but have not been agreed to, business can continue as normal by mutual consent until a new collective bargaining agreement can be achieved. In Portugal, the MoU recommended and the government adopted a reduction of the period during which a cancelled contract would be in effect (Host Paper, Table 5).

In general, the practice of allowing an expired (as distinct from a cancelled) collective bargaining agreement to continue after its expiry constitutes a fall-back option which provides flexibility to the industrial relations system.

## **2.3 Sectoral extension mechanisms of collective bargaining agreements (Cyprus and Portugal)**

Collective bargaining agreements in Cyprus apply to trade union members but, in some cases, employers extend them to non-members as well. No data is available on this matter. In Portugal, a similar common practice exists through 'voluntary internal extensions' to all employees. Except during the MoU period of 2011-2014, the Ministry

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<sup>7</sup> This agreement maintains the institution of COLA clauses in collective bargaining agreements and removes its symmetry, which would have required wage reductions following the deflation that occurred during the Cyprus Crisis. It limits wage indexation to 50% (from 100%), to once (rather than twice) a year, and to years during which prior real GDP growth occurred during a reference period.

<sup>8</sup> See Ergatiki Foni, September 20, 2017.

<sup>9</sup> See Host Paper p. 5 and the analysis on pages 2-3 and Table 7



of Labour would extend collective bargaining agreements by Ordinance if the signatories requested it. This formal step does not exist in Cyprus. Possibly because of its absence, the extension issue was not as prominent in Cyprus during its MoU years as it was in Portugal.

## 2.4 Legislative changes in Cyprus

The efforts to revise the industrial relations system before, during, and after the MoU in Portugal are described in the Host Paper (e.g. Table 5, p. 8). In Cyprus, the MoU<sup>10</sup> did not identify major industrial relations concerns except for the wage indexation issue, where the MoU had a permanent effect on the industrial relations landscape. Other legislative changes that occurred prior to the MoU include (i) strengthening the right to unhindered workplace access by union representatives and broadening the jurisdiction of labour unions (2012), and (ii) spelling out the process for the recognition of trade unions by employers for collective bargaining purposes (2012)<sup>11</sup>.

## 2.5 Changes in employment patterns over time in Cyprus

The study *Social Pillar – Quantifying atypical employment in the EU member states*, available on the ECE web site<sup>12</sup> notes that the Cyprus crisis increased the incidence of atypical forms of employment. Part-time employment as a percentage of total employment increased from 9% in 2011 to 13% in 2015, involuntary part-time work as a percent of total part-time work increased from 49.4% in 2011 to 68.9% in 2015, and the reason for this increase was that a full-time job was not available. The percentage of employees in total employment holding contracts with a limited duration jumped from 11.9% in 2011 to 16% in 2015. Finally, those in temporary work as a percentage of total employees increased from 14.2% in 2011 to 18.5% in 2015. Legislation exists to protect the rights of those in part-time work, but those on short contracts and in temporary work may be less well-protected.

## 3 Assessment of the success factors and transferability

It is difficult to consider the merits of transferring to another country a specific action taken during the complex Portuguese crisis, the resulting MoU years (2011-2014), and the subsequent experience. There is no single programme that resolved a particular difficulty described in the Host Paper that might serve as an example for other Member States; for instance, the increase in the minimum wage in Portugal would not be generally considered an appropriate policy in Cyprus. Yet there are many comparative points of interest and lessons to be learned.

The thesis of the Host Paper is that the system of industrial relations in Portugal worked well prior to the MoU period, while the collective bargaining measures during the period 2011-2014 were not helpful: They did not enhance flexibility, froze the minimum wage rate at €485 per month, lowered the nominal path of collectively agreed wage increases by at least 1 to 1.5 pp (Table 8), created in-work poverty and increased inequality, reduced the effectiveness of a system based on branch/sectoral bargaining which got extended to many more workers, reduced the period during which cancelled collective bargaining agreements could remain in effect, and did not enhance the role and effectiveness of concertation. The post-MoU policy measures reversed some of what was

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<sup>10</sup> Memorandum of Understanding on Specific Economic Policy Conditionality, September 2015, 7<sup>th</sup> version, (referred to as the MoU).

<sup>11</sup> For the two legislative changes (in Greek), see respectively the URL addresses:  
[http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/All/78F36847ED99651BC2257A92002C80E8/\\$file/10%CE%99%CE%99%CE%99.pdf?OpenElement](http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/All/78F36847ED99651BC2257A92002C80E8/$file/10%CE%99%CE%99%CE%99.pdf?OpenElement)

[http://www.cylaw.org/nomoi/enop/non-ind/2012\\_1\\_55/index.html](http://www.cylaw.org/nomoi/enop/non-ind/2012_1_55/index.html)

<sup>12</sup> See

<https://europe.icfi.com/ece/admin/countries/documents.aspx?countryid=5&itemtype=1&documentoutput=6&>

done during the MoU, returning the collective bargaining system closer to its original architecture and improving, the Paper argues, outcomes.

The Host Paper offers a lot of arguments to support the view that the system of collective bargaining and social dialogue in Portugal worked well prior to the crisis: At the concertation level, it helped to stop inflation in the 1980s and 1990s, it contributed to effective changes in VET, it introduced the possibility of withdrawing from existing collective bargaining agreements through agreed changes in the Labour Code (2003 and 2009), and it achieved real wage growth which was modest and fell far short of the surprisingly large gains in productivity (44.7 pp) that were achieved during the period 2005-2010. If anything, this record shows the power of employers rather than unions, as the author correctly argues. This seems to be the most convincing line of argument for the Host Paper thesis. If the system isn't broken, why try to fix it? Could Portugal have performed better through the period 2011-2014 without the MoU collective bargaining changes? It is difficult to answer this question without looking more broadly at the causes of the Portuguese crisis and the impact of all the measures taken during this period – a task clearly beyond the Host Paper. Would Portugal have done even better in the period 2015 onwards if the MoU collective bargaining measures had not been reversed? While this is doubtful, it is even harder to determine convincingly.

The MoU period in Portugal, as in Cyprus, involved many painful measures. The Cyprus experiment with the "bail-in" of two systemic banks<sup>13</sup>, the associated capital controls, and the closure of the banking system for two weeks, damaged trust and destroyed the saving of many 'average' people who had saved for health and retirement reasons. It also undermined business confidence, deepened the recession and contributed to the quadrupling of the unemployment rate from 3.7% in 2008 to 16.1% in 2014; the youth unemployment rate reached 38.9% in 2014. No one familiar with this period in Cyprus can call the lending arrangements and conditions as perfect. Yet, a number of measures and advice in the MoU period were helpful. As shown above, wage growth in Cyprus had taken a dangerously high path, in part because of the system of full wage indexation, the awards for productivity growth in sectors which had not earned them, and the automatic wage increases based on years of service rather than performance. The MoU improved one feature of the wage-setting system (the COLA mechanism) permanently. Wage moderation during 2013-2016 has enhanced competitiveness, it has contributed to the recovery which started in 2016, and it has helped decrease the unemployment rate to 10.8% in July 2017. At the same time, the government and the MoU shielded low-income earners from the cuts, the minimum wage was left unchanged, and a Guaranteed Minimum Income system was introduced. Painful measures may correct problems and it is difficult to judge whether the Portuguese MoU changes to the collective bargaining system were necessary without a more complete assessment of the crisis and the policies adopted to resolve it.

This is not the place for assessing the overall merit of the MoUs for Cyprus or Portugal. In the case of the Cyprus crisis, the country was at the brink of bankruptcy and measures such as changes to the collective bargaining system and wage restraint were necessary. Could this also be the case for Portugal as well? This is difficult to answer without a full review of the crisis and all measures taken. One thing is clear: the proposed interventions brought carrots and sticks, dynamism and dynamite to our societies. An important lesson that both countries could take away from this experience is: run your affairs well, so that you never need to go through the MoU experience again.

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<sup>13</sup> This is now official EU policy but has not been imposed on other MSs.

#### **4 Questions to the host country in the Peer Review**

- What were the causes of the Portuguese crisis and the reasons for seeking external support? Were they related to loss of competitiveness and the growth in wage costs, or due to dissaving, internal and external (private and governmental) debt accumulation, structural problems and a banking crisis?<sup>14</sup>
- The reasons for the crisis should affect the remedies put forward by the MoU. Did the public consider the MoU remedies appropriate to the causes? Was the urge to undo the MoU collective bargaining policies after 2014 due to a perceived dissonance between the causes of the crisis and the imposed MoU remedies?
- Did the culture of earlier concertation efforts (1990-1996) to reduce inflation in Portugal also prevent undue real wage growth prior to the Portuguese crisis (2011-2014), as the data in Table 7 suggest? Why did unions fail to appropriate some of the productivity gains?
- How is 'Apparent' productivity growth (Table 7) defined?
- What changes in the form (part-time, limited duration, and temporary) of employment have occurred in Portugal and how were these dealt with in the industrial relations context?

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<sup>14</sup> See EU (2014), *The Economic Adjustment Programme for Portugal*, Occasional Papers 202.

## Annex 1 Summary table

### Background to collective bargaining in the peer country

- Social dialogue has a long tradition in Cyprus. The 1977 Industrial Relations Code determines how collective bargaining is carried out.
- There is no bargaining at the national level. The Labour Advisory Board advises the minister on general issues. More concertation activity exists in Portugal.
- Bargaining is mainly at the sectoral but, also, at the enterprise level as well; enterprises may improve agreed sectoral terms of employment.
- There are two employer federations and many unions involved. The Ministry is helpful in reaching agreements. It also leads on dispute resolution efforts.
- During the Cyprus MoU, collective bargaining contributed towards economic recovery through agreements involving lower wages.

### Assessment of collective bargaining

- Many similarities between collective bargaining in Cyprus and in Portugal: sectoral and enterprise bargaining, collective bargaining agreement extensions, the public sector arrangements.
- In Cyprus, concertation efforts are weaker. The minimum wage is occupational, not national, as in Portugal, and serves to protect non-unionised workers.
- Prior to the crisis, wage setting in Cyprus reflected an overheated labour market, while in Portugal it appears not to have incorporated productivity gains.
- The MoU identified wage setting in Cyprus as a problem and achieved reductions. In Portugal, the minimum wage rate was frozen but small other nominal wage increases were allowed, increasing inequality.
- In the post-MoU period, trade unions in Cyprus have become very aggressive, while social consensus led to a reversal of MoU policies in Portugal. There, the increase in the minimum wage was greater than the collectively agreed ones.

### Assessment of success factors and transferability

- The measure is the return to pre-MoU collective bargaining procedures, entailing inter alia increases in the national minimum wage, modest agreed real wage increases, and a return to extensions of sectoral agreements.
- Whether the MoU minimum wage freeze and real wage reductions were needed cannot be judged without a more complete analysis of the crisis, its causes, and the labour and other reforms that were undertaken during 2011-2014.
- The Portuguese crisis entailed many other problems, beyond wage costs. In this context, the MoU collective bargaining policies were bound to be questioned.
- In the post-MoU period, the return to consensus building is positive. The increase in the minimum wage (roughly 5% per annum during 2015-2017) was significant but the agreed real wage increases reasonable, reducing inequality.

### Questions to the host country in the Peer Review

- What were the causes of the Portuguese crisis and were the MoU collective bargaining changes essential in resolving these problems?
- What was the public's assessment on this issue and did this create a political momentum for undoing the MoU collective bargaining reforms?
- What explains the wage moderation displayed by unions in the period prior to the Portuguese crisis?

- How is 'Apparent' productivity growth defined?
- Did the crisis bring increased reliance on atypical forms of employment and how are the interests of these workers safeguarded and promoted?

## Annex 2 Example of relevant practice

Name of the practice:	The 2011-2014 Memorandum of Understanding in Portugal (2013-2016 in Cyprus), exit from these, and aspects of the post-exit collective bargaining experience in the two countries.
Year of implementation:	In 2011-2014 in Portugal (and 2013-2016 in Cyprus). Exit from the MoU was achieved in 2014 in Portugal (2016 in Cyprus).
Coordinating authority:	Government of Portugal (and Cyprus) and the international lenders (i.e. the EU, the ECB and the IMF).
Objectives:	Establishing fiscal probity and a path of debt reduction; structural reforms aimed at enhancing growth and returning to more autonomous policies; stabilising the banking sector; re-establishing the ability to access the international borrowing markets. (In the case of Cyprus, the situation in the banking sector was more severe and a more drastic reform ("a bail-in") was also imposed).
Main activities:	During the MoU, responsible fiscal policy was advocated, structural reforms carried out to the extent possible, wage restraint imposed with that in the public sector serving also as a signal to the private sector, and attention given to returning banks and the banking sector generally to a sound footing. In the post-exit period, Portugal reversed some of the MoU CB reforms, while Cyprus maintains the course followed during the MoU, noting, however, that a number of the reforms that had been demanded were not achieved.
Results so far:	In the Peer country, Cyprus, responsible fiscal policy is generally followed. Some but not all indicated structural reforms have been achieved. Wage restraint continues but is threatened by union militancy and a pre-election period. Banking sector reform has proceeded through the bail-in which led to recession-deepening developments; in addition, problems with non-performing loans continue.



