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Europe's "Winter of Discontent"

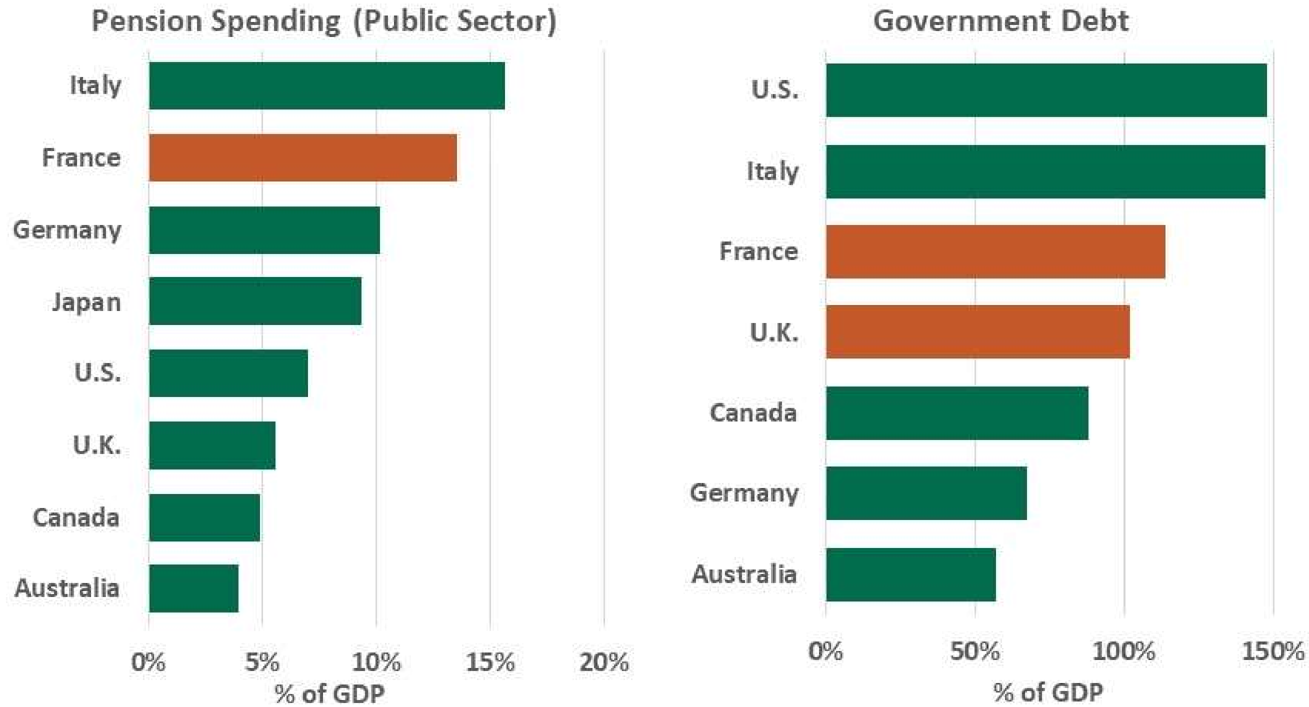
Workers' demands are constrained by fiscal limits.

By Vaibhav Tandon

The 2010s began with the Arab Spring and Occupy Wall Street protests, and ended with demonstrations in India, Hong Kong, Latin America and parts of Europe. In most cases, the unrest was motivated by growing inequality or economic stagnation.

In Europe, the 2020s are not off to great start in this regard. The continent has been grappling with an unprecedented energy shock triggered by Russia’s invasion of Ukraine. This has given rise to a severe cost of living crisis, triggering new waves of protests. The worst of the inflation phase is possibly behind us, but falling real incomes remain grounds for political and socioeconomic turmoil. This may have a negative influence on Europe’s growth outlook.

Just a couple of months ago, France was facing strikes and protests demanding higher wages. Today, the country is staring at another round of disruption prompted by the government's plan to implement unpopular reforms of the state pension system. U.K. workers from the health, postal and rail sectors are staging walkouts, seeking better pay and working conditions.



Sources: OECD, Haver Analytics

France stands out for being in a near-constant state of protest since 2018. The list of grievances includes economic inequality, pension reforms, COVID restrictions and the enduring cost of living crisis. However, the plan to overhaul the social security system has proven to be the hardest pill to swallow for the French public. Unyielding protesters forced administrations to withdraw reforms in 2010 and again in 2020. The third time will almost certainly not end up being the charm.

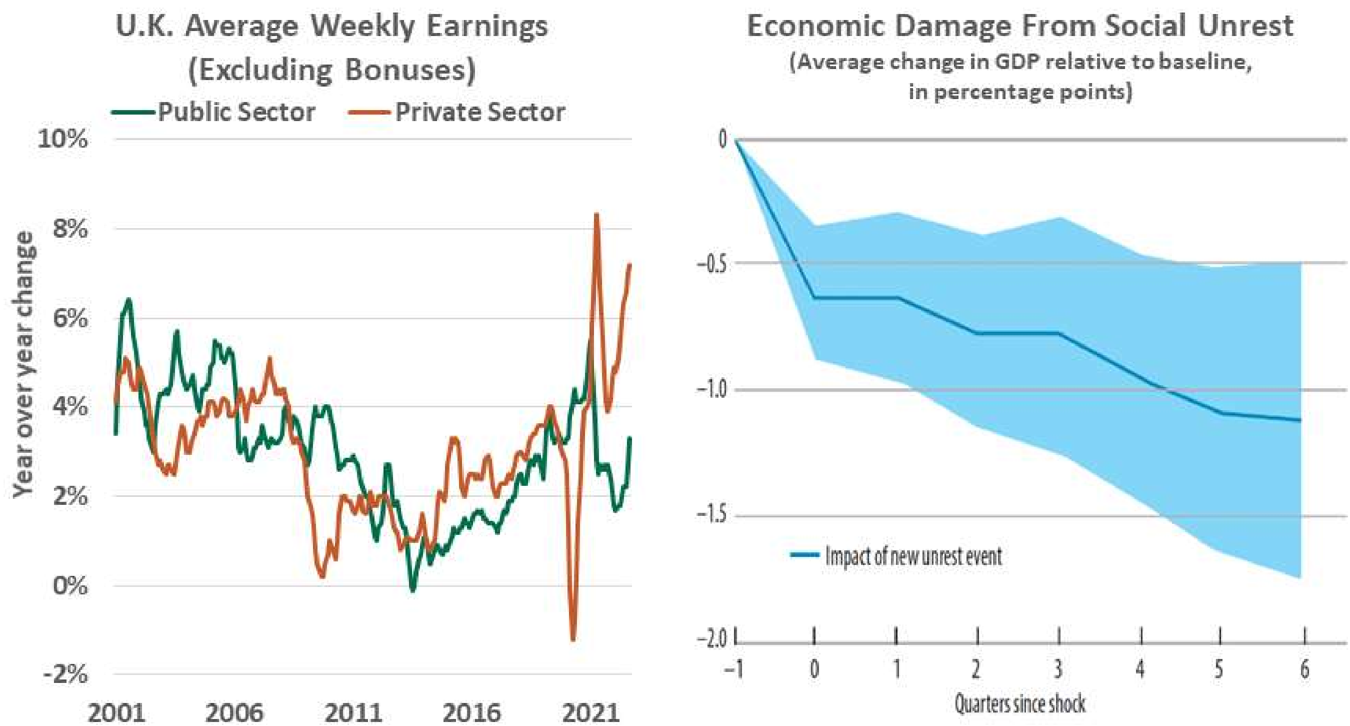
The right to retire at a relatively young age compared to other European peers is profoundly valued in France. As a result, the proposal to raise the legal retirement age from 62 to 64 years by 2030 has not gone down well with unions and workers who are already challenged by the cost of living crisis.

France not only has one of the lowest retirement ages in the industrialized world, but its pension system is also among the most complex and generous. The administration spends nearly 14% of economic output on social security. Unlike in the U.S., the French government plays a major role in the retirement plans of workers, both as a source of funds and as overseer and guarantor of the pension system.

Raising the retirement age would not only bring it closer to the range of 65 to 67 years applicable in neighboring states like Spain and Germany, but would also help to keep the pension budget solvent. The French Pensions Advisory Council estimates a deficit of between 0.3% and 0.4% of gross domestic product (GDP), or over €10 billion a year, until 2032. This would add to the already elevated public debt, the fifth highest among the 27 member states.

According to the Labor Ministry, pushing back the retirement age will save an additional $19 billion a year, allowing the system to break even in four years.

The fiscal room to accommodate workers' demands is limited in many parts of Europe.
Modern day Britain isn't as accustomed to waves of labor unrest, as its unions face harsher rules around strikes than is the case in most European states. However, there are more **strikes** in the U.K. today than there have been in more than a decade. The unrest has been propelled by a cost of living shock due to the war and Brexit-induced bottlenecks, following a decade of austerity to keep national borrowing contained.



Sources: ONS, IMF

According to Capital Economics, 1.5 million days were likely lost in Britain in December 2022 due to protests. Another **analysis** has pegged the cost of ongoing industrial unrest at closer to £7 billion. Acquiescence to strikers' demands of large wage increases could prove to be more expensive, both for markets and government coffers.

The British government's offer of 5% wage gains for public sector workers is the highest increase in two decades. But workers in the private sector are getting increases that are much more generous. Matching the pay gains seen in the private sector could lead to an additional outlay of £12.5 billion this year, as every 1% increase in public sector wage **costs** the Exchequer about £2.5 billion. This would renew concerns over the sustainability of public finances, potentially triggering a fresh bout of volatility in U.K. bond markets.

Lingering strikes, whether over higher pay or against reforms, will exacerbate supply disruptions and staff shortages. Price pressures have proven difficult to relieve thus far, and strikes will only further complicate the inflation challenge for European policymakers.

Unrest is a growing economic concern around the world. The U.S. narrowly avoided a massive rail strike, but some nurses' unions are walking out. Education workers in Canada went on strike last November, while teachers in Portugal have now taken to the streets. Strikes and protests are a means for workers to secure what they consider their fair shares, but they can impede growth. According to the **International Monetary Fund**, on average, major unrest events are followed by a 1 percentage point reduction in GDP six quarters after the occurrence. Strife stirred by socioeconomic influences is associated with even sharper output declines than the ones linked with political causes. Equity markets, on average, decline 1.4 percentage points following an episode of social unrest.

Continued disruptions from protests and strikes can add to inflationary pressures.
European policymakers must act on reforms that not only improve growth, but also benefit the weakest sections of society. Allowing social fault lines to deepen for too long could result in an earthquake of instability.

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