

A Bold Approach to Equity: Making Salary Indexation Social Again

In Luxembourg, the preservation of purchasing power for all citizens is a vital aspect of the social fabric. The obligation is enshrined in Luxembourg's public order law, illustrating a shared understanding of social peace. However, there is a growing concern that the principle is increasingly at odds with the country's competitiveness, potentially undermining its longer-term economic attractiveness. Acknowledging the greater value to society of a protected purchasing power, this analysis rather suggests that the current system of indexation has become somewhat anti-social and requires thoughtful re-evaluation to restore its original foundational concern: ensuring continued equitable affordability of essential goods and services. The proposed solution pragmatically contributes to the safeguarding of Luxembourg's attractiveness, and ought to be agreeable to policymakers across the political spectrum bar the extremes.

Addressing the Flaws of Uniform Indexation

The traditional method of indexation, which applies a uniform percentage increase across all salary levels, has inadvertently favoured higher earners. This practice has resulted in an imbalance reminiscent of adverse selection in insurance, where benefits disproportionately accrue to those in more privileged positions. Furthermore, this uniform approach may create a moral hazard, whereby higher earners feel less compelled to enhance their performance, knowing that their wealth will increase with certainty regardless of their productivity. Given the complexities of today's economic landscape, it is essential to reassess how the indexation mechanism effectively addresses the loss of purchasing power for all citizens equally, in accordance with its foundational purpose.

To tackle these disparities, a shift in the indexation paradigm is proposed, prioritising a clearly defined basket of essential goods and services. Much like tailored insurance policies, this new index would monitor the prices of necessities—such as water, food, shelter, clothing, energy, transport, medical care, access to IT and communication, and education. Importantly, this index must be weighted according to the respective budget shares typically allocated to these items by the median salary earner, ensuring that it accurately reflects the true evolution of purchasing power for basic needs for a representative employee across the spectrum of salary earners.

The median salary, defined as the amount at which half of employees earn less and half earn more, represents the central point in the range of salaries, providing a clear picture of typical earnings. According to the latest analysis by Luxembourg's statistical office, half of the employees working full-time earn less than €58,126 gross annually. That includes all remuneration received (such as all kinds of bonuses, overtime, 13th month and end-of-year bonuses), and thus amounts to approximately a gross pay of €4,845 per month.

From Per-Cent to Euro-Cent

Once it hits the trigger of an accumulated 2,5% threshold currently deployed in Luxembourg, the new index could be applied directly to the medium salary, thus resulting in a fixed additional euro amount that would meaningfully assist the 50% lowest earners in coping with rising prices of essential goods and services. However, if this amount suffices to compensate for a loss in purchasing power for the 50% lowest earners, it logically follows that the same amount should also be adequate for those 50% earning more. By implementing an absolute euro adjustment instead of a blanket percentage increase, equitable support could be ensured across all income levels!

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Transitioning from a "per-cent" to a "euro-cent" based approach would not only streamline the indexation system but thus also foster a sense of fairness similar to a well-structured insurance pool, where all members benefit from collective support, irrespective of their income—much like how coverage under the CNS applies uniformly for the same medical intervention, for instance. This mechanism would ensure that all workers, regardless of their earnings, receive equal absolute protection against the erosion of purchasing power for essential goods and services. It shifts the focus back to where these corrections matter most: the lower tail of the earnings distribution.

Enhancing Financial Flexibility for a More Cohesive Society

A collective step toward a fair sustainable future is essential—and it is a journey that must be taken together. If social partners, employers, and political leaders are genuinely committed to protecting purchasing power and social cohesion in a meaningful way, they must strike a careful balance. It is crucial to prioritise the most vulnerable to ensure that no one is left behind, while also having the courage to reassess unwarranted windfalls. By focusing on uniform euro adjustments rather than uniform percentage increases, a more equitable and sustainable economic environment can be cultivated.

As a beneficial side effect, this framework would provide employers in Luxembourg with increased financial flexibility and breathing space. By prioritising the affordability of essential needs for everyone, companies would be better equipped to complement the necessary foundational adjustments with discretionary, investments in their employees across all levels. This flexibility would enable them to cultivate a more engaged and motivated workforce, ultimately enhancing overall productivity. Furthermore, if a fixed euro adjustment were applied in the future to the pension ceiling (currently €10,393), it could help manage the sustainability of the growth in pension liabilities, an issue recently highlighted by the IMF.

Safeguarding Luxembourg as a destination of choice

This revised approach not only safeguards the purchasing power of all citizens but also reinforces Luxembourg's social foundation. It presents a true "win-win-win" opportunity. As salary indexation reflects an anticipated adjustment rather than accrued income, modifying the mechanism does not reduce anyone's current wealth; instead, it reshapes the basis for future increases. By prioritising social equity and stability, this targeted reform promotes a broad sense of enhanced welfare. In economic terms, it exemplifies a pragmatic form of Pareto efficiency, integrating shared social objectives. This focus aligns with the legislator's original intent in elevating the protection against purchasing power loss to a matter of public order.

Employers stand to benefit from a secure, valued workforce, and trade unions can support a system that truly addresses the aspirations and social values of their members. Ultimately, policymakers can take credit for bolstering Luxembourg's appeal as a destination of choice, both for employees and employers, ensuring a cohesive and competitive society. Let's make salary indexation social again!

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The views expressed are his own.

References :

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