

# Economic and social policy brief: The case for wage led growth

## Executive Summary

This paper summarises global wage developments over the last decades and shows that, overall, there is a trend of wage stagnation in many countries, as wage increases have not kept up to the pace of productivity. At the same time, wage inequality has increased, with the highest-wage earners enjoying a wage rise multiple times faster than the average. The share of labour income in GDP is declining, and profits are not being shared with workers through pay rises. There are a number of drivers influencing such developments, which notably include the decline in trade union density and collective bargaining coverage compounded with the rise in low-paid and precarious work, ineffective labour market regulations, increased power for firms to dictate wages, technological change, weakened labour market institutions, and globalisation. Meanwhile, many workers across the world are not earning sufficient wages to live in dignity – and inadequate social protection systems are further exacerbating high levels of inequality and poverty. Stagnant wage growth, the decline in the labour income share and increasing inequality are having devastating consequences on workers' livelihoods, on the economy and on social cohesion – a fact acknowledged by G20 labour ministers in the past<sup>1</sup>.

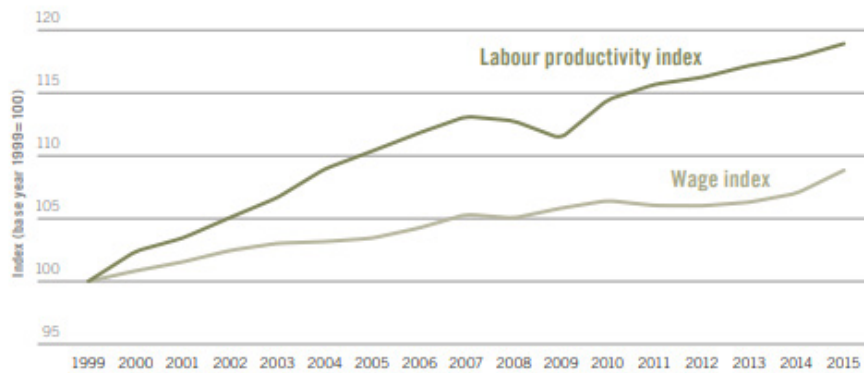
Trade unions insist that these developments should not be taken as inevitable. Governments, together with social partners, have the power to effectively address these challenges, but it will require joint political commitment. Trade unions are calling on governments to set minimum living wages, based on cost of living evidence and with full involvement of social partners. Collective bargaining on wages should be promoted, and agreements should have wide coverage. Permissions for companies to deviate downwards from higher-level collective agreements should also cease, and obstacles to freedom of association need to be effectively addressed. Finally, adequate, comprehensive social protection systems – in line with ILO Convention 102 and Recommendation 202 - need to be put in place in order to guarantee income security for workers and their families, as part of a comprehensive strategy of reducing inequality and promoting adequate living standards for all.

## Wages are stagnating and wage inequality is increasing

In recent decades, wages have stagnated compared to productivity developments. The figure below shows how wages in a selection of developed economies have progressed in relation to productivity between 1999 and 2015. The exception to slow wage growth has been for top earners, who have seen their wages increase much more rapidly than wages in other income groups.

<sup>1</sup> See notably [G20 Policy Priorities on Labour Income Share and Inequalities](#) (Ankara, Turkey 2015)

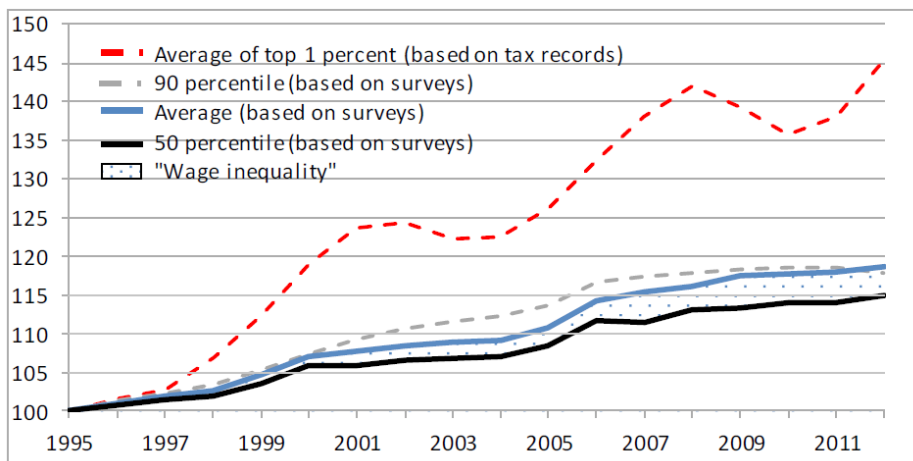
## Trends in growth in average real wages and labour productivity in developed economies, 1999–2015



Source: ILO (2017)

Note: Wage growth is calculated as a weighted average of year-on-year growth in average monthly real wage in 36 economies (for a description of the methodology see Appendix I). The base year is set in 1999 for reasons of data availability.

### Divergence of wages in the top 1% from average and median wages



Source: OECD (2017)

Note: Index: 1995 = 100

The **increased prevalence of precarious work** forms and more low-paid people in work have contributed to this wage stagnation<sup>2</sup>. The ILO has reported that there has been an overall rise in non-standard forms of employment globally, including increases in temporary work, part-time work, temporary agency work and subcontracting, dependent self-employment and disguised employment relationships<sup>3</sup>. These developments have also led to more polarised labour markets, increasingly squeezing the middle class, and contributing to widening wage differentials. These reforms are often driven by regulatory gaps that allow for the proliferation of these work forms as well as recent structural reforms by governments to promote increased labour market flexibility. In some cases, governments and international financial institutions have also directly promoted wage cuts as part of ‘wage moderation policies’— for instance through cuts to public sector wages in the Czech Republic and Ireland and a reduction of the minimum wage level in Greece<sup>4</sup>.

**Declining levels of unionisation** in some countries, often driven by attacks on freedom of association and obstacles imposed to unionisation, as well as the declines in collective bargaining coverage in many countries have also slowed the growth of wages as well as exacerbated wage inequality<sup>5</sup>. In other countries the legal protection provided to unions is being downgraded and criteria for ‘representativeness’ of unions is leading to lower levels of unionisation<sup>6</sup>. Estimations from Visser et al. (2015) have shown that the degree of collective bargaining coverage accounts for 50 per cent of variance in wage inequality<sup>7</sup>.

<sup>2</sup> See for instance OECD (2018) Interim Economic Outlook

<sup>3</sup> ILO (2016) Non-standard employment around the world

<sup>4</sup> See for instance OECD (2012) Public Sector Compensation in Times of Austerity or the [IMF's explanation of the minimum wage reduction in Greece](#)

<sup>5</sup> See for instance International Monetary Fund (2017) World Economic Outlook: [Chapter 3 - Understanding the Downward Trend in Labor Income Shares](#)

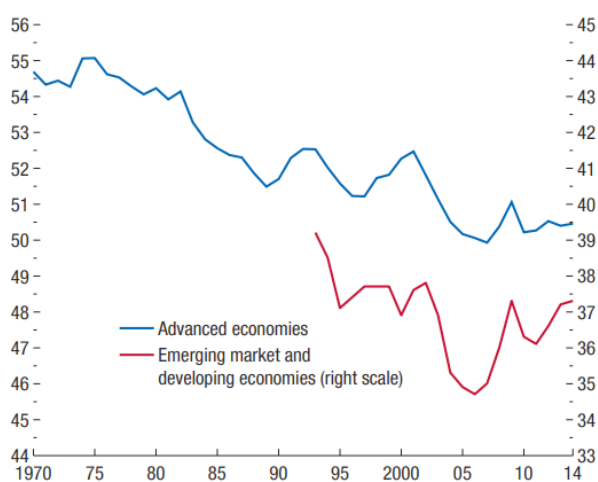
<sup>6</sup> See for instance ITUC Frontlines (2013) [Collective bargaining](#)

<sup>7</sup> Visser J (2015) The Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts. ICTWSS Database. <http://www.aias-uvanet.nl>

In some countries, **reduced competition between firms for labour** has shifted the balance of power to employers to dictate wages and other working conditions - known otherwise as labour market 'monopsony' – leading to the suppression of wages below 'competitive' levels<sup>8</sup>. There are several ways that monopsony can arise. First, product market concentration can lead to monopsony power among firms, since when a limited number of firms in a market exist for a particular type of labour, firms have greater power in setting wages. Collusion among employers to restrict wages can be another source of monopsony power. Within the United States, the practice of including 'non-compete' clauses in employment contracts—thereby restricting workers' employment options when they leave their current firm—is another such means of securing monopsony power<sup>9</sup>. In general, the fact that there are search and mobility costs or that employees may lose the human capital investment they made during their years of service with the company reduces mobility and provides the firm with a degree of power to set wages below worker's productivity.<sup>10</sup>

This general trend of wage stagnation has been accompanied by a dramatic **decline in the labour income share** in most countries— i.e., the percentage of labour income of overall GDP –over recent decades. Globalization, skills-biased technology, the weakening of labour market institutions, the increasing importance of capital income relative to labour income, and growing pressure from financial markets to shift surpluses generated by large businesses towards investors all appear to be contributing factors<sup>11</sup>. Some studies have suggested that part of the decline in the labour income share can be attributed in part to capital substitution for labour through the use of new technology and automated processes, as well as the offshoring of the labour-intensive work in supply chains<sup>12</sup>. It can also be attributed to the increasing importance of the financial sector on the distribution between wages and profits, on the one hand, and retained earnings and financial income in the form of dividends and interests, on the other hand<sup>13</sup>. In other words, profits are not being fairly shared with workers through pay rises. Recent findings also suggest that changes in workers' bargaining power, through declining union density and welfare state retrenchment, have accounted for more than half of the decline in the labour share<sup>14</sup>.

### Evolution of the labour share of income



Source: IMF (2017)

Despite the trend towards a decline in the labour share, top earners have nevertheless overall observed an increase in their labour share as a percentage of GDP over recent decades. That is because **wages for top earners have continued to rise** at a much faster pace than wages throughout the rest of the distribution. The OECD notes that part of this growth appears to be driven by 'winner-takes-most' dynamics within some sectors such as the technology sector<sup>15</sup>. Moreover, as capital ownership is typically concentrated among higher earners, an increase in the share of income accruing to capital tends to raise income inequality<sup>16</sup>. IMF research has also revealed that half of the increase in the 10% income share can be attributed to declining trade unionism.<sup>17</sup>

8 See for instance Rubery and Grimshaw (2009) Gender and the Minimum Wage

9 US Council of Economic Advisors (2016) Labour Market Monopsony: Trends, Consequences and Policy Responses

10 See for instance Card and Krueger (1995) *Myth and measurement: The new economics of the minimum wage*.

11 ILO (2017) [Global Wage Report 2016/2017](#)

12 Elsby et al. (2013) The Decline of the U.S. Labor Share

13 Dühnaupt, P. (2016) Determinants of labour's income share in the era of financialisation

14 Onaran & Guschanski (2018) What drives the four decades-long decline in labour's share of income?

15 OECD (2017) Decoupling wages from productivity

16 For more explanation, see IMF (2017) World Economic Outlook

17 IMF (2015) [Inequality and Labour Market Institutions](#)

## The economic case for increased wages

**Stagnant wages and the declining labour income share are having disastrous social and economic consequences.** G20 ministers acknowledged this fact in the 2015 Ankara Summit, stating that ‘widening inequalities and declining labour income shares not only pose challenges for social and political cohesion, but also have significant economic costs in terms of both the level and sustainability of economic growth’<sup>18</sup>.

It has been widely acknowledged by international organisations **that low wage growth dampens household consumption**, which in turn reduces aggregate demand, particularly when wages stagnated in many economies at the same time<sup>19</sup>. Weak demand can have a detrimental impact on job creation, productivity and overall economic growth. OECD warned in its latest Global Economic Outlook from June 2017 that a durable upturn in consumption and growth requires stronger wage dynamics than the weak pace of wage growth that is currently observed across the OECD<sup>20</sup>. Across the United States and much of Western Europe, for instance, weak demand has been shown to have depressed productivity growth through negative economy of scale effects and downshifts in product and service mix<sup>21</sup>. Moreover, low wage growth can also result in unsustainable borrowing at the lower end of the income distribution. This was the case in the years leading to the recent global economic and financial crisis, where low wage growth compelled many US and European consumers to borrow aggressively in order to maintain their standard of living – leading to an unsustainable situation that fuelled the financial downturn<sup>22</sup>. Moreover, growing income inequality in itself is also carrying significant social and economic risks – including low social mobility, underutilisation of human capital, eroded confidence in institutions, and reduced social cohesion<sup>23</sup>.

**Increasing real wages has been, in turn, shown to provide real macroeconomic benefits.** Storm and Naastepad (2011) note in particular the benefits stemming from increased demand, higher labour productivity growth and more rapid technological progress. Raising wages, particularly those at the lower end of the income distribution, would result in shifting income from employers to workers who have a higher propensity to consume. Wage increases, for instance through increasing minimum wages and promoting collective bargaining on wages, therefore can have an economic stimulus effect.

While employers’ organisations and some policymakers often suggest that wages should be kept low in order to maintain competitiveness, **empirical evidence shows that competitiveness can be maintained even during pay rises.** The Economic Policy Institute (2015) has pointed out that Germany has among the highest manufacturing wages in the world and has maintained a relatively stable manufacturing sector, even in the face of competition from China, with lower wages. In 2013, average hourly pay in German manufacturing was \$48.98, more than one-third higher than the United States (\$36.64). However, while employment in US manufacturing declined by 31 per cent between 1997 and 2013, it fell only 4.7 per cent in Germany<sup>24</sup>. There are numerous other factors that can influence competitiveness beyond just wages, such as skill supply, the rule of law, the stability of industrial relations, availability and use of technology and infrastructure, logistics, and trade rules<sup>25</sup>.

Wage increases, particularly for those at the bottom, may also have an **effect on reducing some employment disincentives.** High marginal effective tax rates in some countries may make it financially disadvantageous for workers to enter the (formal) labour market or increase their working hours. A study examining financial disincentives across the European Union found that significant disincentives exist in some countries for second earners to enter into low-wage employment due to increased taxes<sup>26</sup> and the high cost of childcare services<sup>26</sup>.

Measures to counter the slow growth of wages and to boost the labour income share could accordingly have **major macro-economic benefits.** Oneran (2014) estimated for G20 countries that increasing the share of labour income in GDP by 1-5 per cent, depending on the circumstances of the country, could lead to a 1.96 per cent increase in GDP in the G20 as a whole over a horizon of five years. If combining this increase in the labour income share with policies to increase public investment in social and physical infrastructure by 1 per cent of GDP in each country, a GDP increase of up to 5.84 per cent in G20 countries would be observed.

<sup>18</sup> See notably [G20 Policy Priorities on Labour Income Share and Inequalities](#) (Ankara, Turkey 2015)

<sup>19</sup> ILO (2017) [Global Wage Report 2016/2017](#)

<sup>20</sup> OECD (2017) [Global Economic Outlook](#)

<sup>21</sup> McKinsey and Company (2018) Solving the Productivity Puzzle: the role of demand the promise of digitalisation

<sup>22</sup> New America Foundation (2012) [The case for wage-led growth](#)

<sup>23</sup> See for instance IMF (2015) Causes and Consequences of Income Inequality: A Global Perspective; Wilkinson and Pickett (2009) The Spirit Level: Why More Equal Societies Almost Always Do Better

<sup>24</sup> Economic Policy Institute (2015) High wages aren't to blame for the decline of U.S. manufacturing

<sup>25</sup> See for instance, OECD (2008) Skills for Competitiveness: Tackling the low skilled equilibrium conceptual framework; World Bank (2017) Trouble in the Making? The Future of Manufacturing-Led Development

<sup>26</sup> Rastrigina and Verashchagina (2015) [Secondary earners and fiscal policies in Europe](#)

Such an effort would benefit from **international and/or regional coordination**. As globalisation also appears to have exerted downward pressure on wages, wage increases that are coordinated between countries could serve to counter-balance this effect. The ILO has called for global-level policy coordination to avoid either the simultaneous pursuit by too many countries of wage moderation policies, or competitive wage cuts with a view to increasing exports, either of which would risk leading to a fall in regional or global aggregate demand or deflation<sup>27</sup>.

## Role of minimum wages

**Minimum wages have an important function in setting ‘wage floors’** to ensure that formal work guarantees at least a minimum level of income for workers and their families. They have also been shown to be an important tool in reducing wage inequalities by pushing up wages at the bottom of the distribution<sup>28</sup>.

Besides improving the financial situation of the lowest-wage earners, minimum wages have also been shown to have **an important ‘signalling’ effect, raising salaries throughout the income distribution and increasing the average wage**. This is in part because it can serve as an important benchmark, above which workers can negotiate higher wage levels. Estimations in Latin America, for instance, showed that a 10 per cent increase in minimum wages would entail an increase in average wages of between 1 and 6 per cent<sup>29</sup>. Several studies also illustrate how minimum wages can be an important tool in compressing wage differentials and therefore reducing inequality – empirical evidence has demonstrated this to be the case in Brazil and Costa Rica<sup>30</sup>. Evidence also shows that increasing minimum wages can also help to reduce pay disparities between women and men – particularly for low-income workers<sup>31</sup>. As women tend to be overly represented in low-wage work compared to men, increasing the minimum wage can help to push up their wages relative to men’s.

Despite the benefits of minimum wages, **not all countries have them**. While some countries have sought to set wage floors through sectoral collective bargaining, this has been shown only to be effective in preventing in-work poverty within those countries with high collective bargaining coverage (e.g., Denmark, Iceland). For other countries with low collective bargaining coverage and no minimum wages, workers are left without a guarantee to a minimum livelihood through work<sup>32</sup>.

Moreover, when they do exist, **minimum wages are often largely inadequate** to cover the basic needs of workers and their families. The results from the ILO General Survey on Minimum Wage Systems (2014) highlight how minimum wages do not necessarily constitute a living wage, ensuring adequate livelihoods for workers and their families<sup>33</sup>. Results from the 2017 ITUC global poll confirm this, showing that 83 per cent of people in thirteen of the G20 countries believe that the minimum wage is not enough to live on<sup>34</sup>. While **ILO Convention 131 on Minimum Wage Fixing** calls on governments, when determining the level of minimum wages, to take into consideration the needs of workers and their families, minimum wage levels often fall short of what is needed to an adequate standard of living, let alone escape poverty. The chart below shows a comparison between the levels of gross minimum wages and national poverty lines for a selected number of countries. It looks at poverty lines for an individual as well as for a household of four. In nearly all countries covered, the gross monthly minimum wage is insufficient to support the basic expenses of a family, and is barely enough to protect a single individual from falling into poverty. Once taking into account taxes and social contributions (not calculated here), the net wages of a minimum wage earner would likely be even less likely to protect an individual or his/her family from poverty.

---

27 ILO (2017) [Global Wage Report 2016/2017](#)

28 *ibid*

29 Cunningham (2007) *Minimum Wages and Social Policy: Lessons from Developing Countries*

30 World Bank (2015) [Balancing Regulations to Promote Jobs](#)

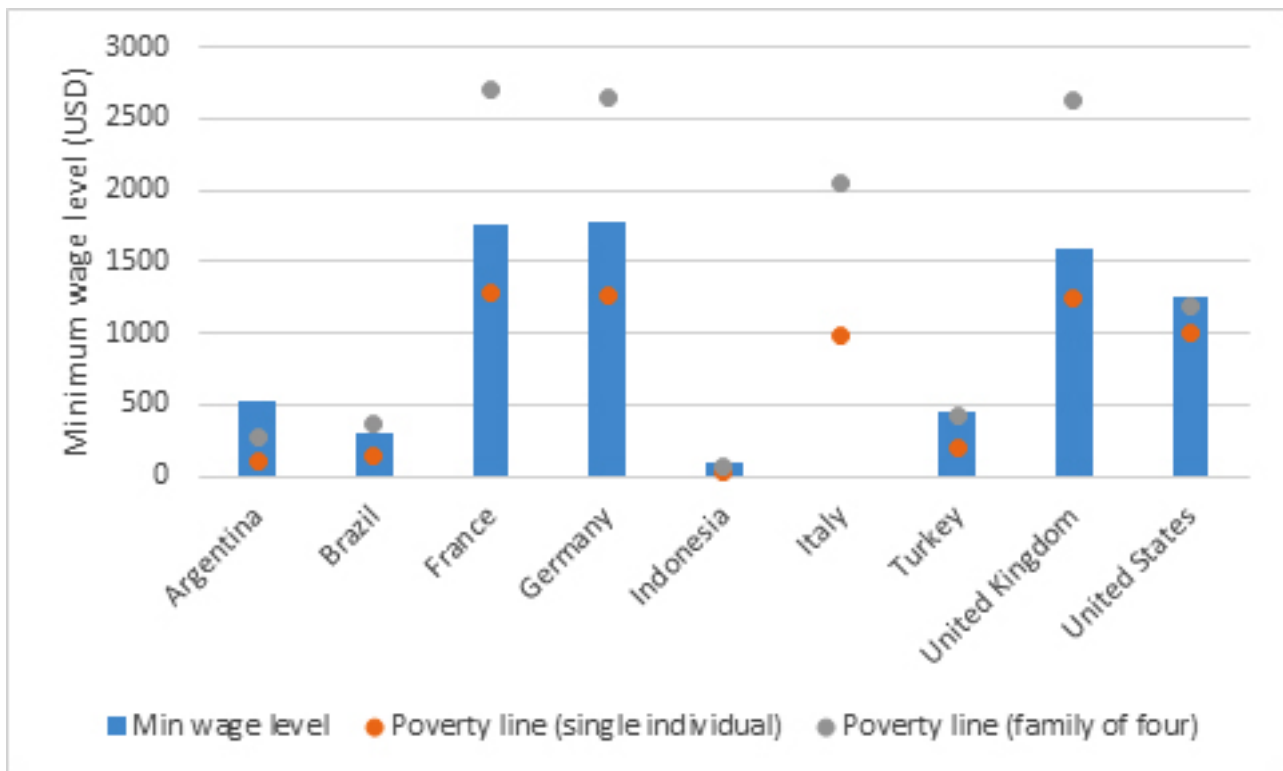
31 See for Instance ILO (2017) [Global Wage Report](#)

32 For more information see for instance the ILO [Minimum Wage Policy Guide](#)

33 ILO (2014) [General Survey Report on Minimum Wage Systems](#)

34 ITUC (2017) [Global Poll](#)

## Minimum wages for selected G20 countries compared to poverty lines



Source: ITUC calculations based on Eurostat database, CEPAL database and union questionnaires.

Note: OECD Equivalency scale applied in order to adjust the poverty line to a family of four (two adults and two children). Note that Italy does not have a statutory minimum wage.

There are various methodologies that can underpin the calculation of a living wage, however most tend to be done through using basic goods baskets that take into account the cost of a basic set of goods and services<sup>35</sup>. Such methodologies do not supplant social dialogue in minimum wage negotiations, but can serve as a useful reference tool to inform discussions. That being said, the structure and composition of such baskets vary significantly between countries – with some countries considering a larger number of goods and services than others. **Trade unions have repeatedly called for the use of basic goods baskets** to inform the level of the minimum wage, and that it should consist, at a minimum the costs of the following goods and services: food; housing; transport; clothing; medical expenses; education expense; household bills and utilities; recreation; essential care costs (child care, elderly care); and contingency for emergencies<sup>36</sup>.

In addition to being set at levels below a basic adequacy standard, the **updating of minimum wages is often not done on a regular basis**. This leads to a loss in the real value of the minimum wage over time after taking into account factors such as inflation and the increased price of consumer goods and services. Within the United States, for example, when adjusting for inflation, the federal minimum wage was worth the most in 1968 at \$8.68/hour (in 2016 dollars). After it was last raised in 2009 to \$7.25/hour, the federal minimum had lost about 9.6 per cent of its purchasing power to inflation by 2017<sup>37</sup>. The figure below shows the evolution of the real minimum wage in a selection of countries using constant prices at 2015 PPP. It shows that while the value of minimum wages has increased in most countries since 2000, the minimum wage had experienced a loss in its value in some countries within recent years, notably the United States, Russia, Greece and Colombia. In other countries, the real value increased dramatically over recent years, for instance in Brazil, where the real value of minimum wages doubled between 2000 and 2012. This increase was largely driven by the government's decision to adjust the minimum wage not just increased inflation, but also changes in GDP, in order to ensure that benefits of economic growth were distributed to those in the lowest income brackets<sup>38</sup>.

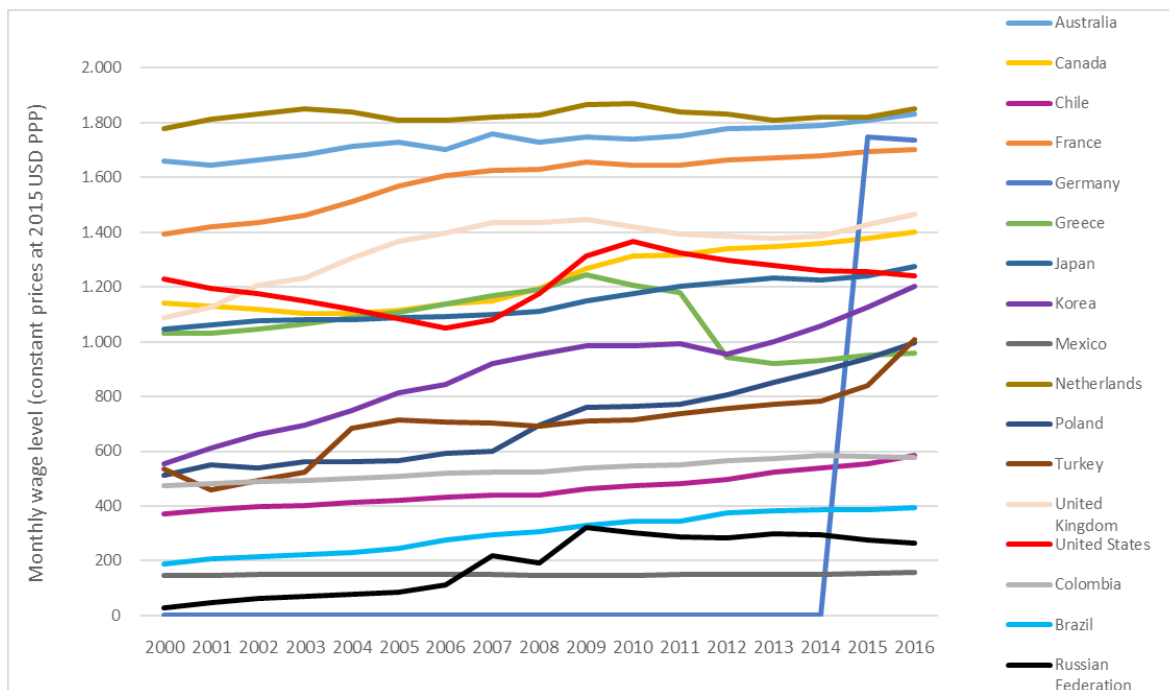
<sup>35</sup> Some approaches using the basic goods baskets include the Anker methodology, MIT living wage calculator and the WageIndicator living wage estimations

<sup>36</sup> For more info see: <https://www.ituc-csi.org/wagescampaign>

<sup>37</sup> Pew Research Centre (2017) [5 Facts about the Minimum Wage](#)

<sup>38</sup> United Nations Economic and Social Committee (2012) [Minimum Wage Policy in Brazil](#) presented as a part of 'Development Strategies That Work. Country experiences presented at the ECOSOC Annual Ministerial Review'

## Evolution of real minimum wage in selected countries (2000-2016)



Source: ITUC calculations based on OECDStat database (extracted 2018)

While employers' organisations often argue that raising the minimum wage would have negative effects on companies' abilities to operate, thereby reducing jobs, **the vast majority of literature has shown that minimum wages have little to no effect on employment**<sup>39</sup>. Studies in emerging economies such as Brazil, Indonesia, India and South Africa, suggest that the minimum wage has either an insignificant or a positive impact on employment and a positive impact on poverty and income inequality<sup>40</sup>. ITUC research has also shown that an increase in the minimum wage in order to ensure a living wage would represent a fraction of the profits made by the major corporations, where the profits for every worker in their supply chain can be as high as \$17,000<sup>41</sup>. In its 2016 Employment Outlook, the OECD highlights the increased skill use and higher productivity that results from higher minimum wages – in addition to the reduction in in-work poverty<sup>42</sup>. An evidence-review by the Ministry of Labour in Ontario, Canada also cited the positive effects of minimum wage increases on the reduction of employee turnover, improved organisational efficiency and increased productivity<sup>43</sup>.

Some governments and employers have also argued that raising the minimum wage can increase the relative size of the informal economy. That being said, the World Bank (2015) has highlighted that there are also **no definitive evidence that higher minimum wages can shift employment from the formal to the informal economy**, and some studies show that they can help to reduce informality<sup>44</sup>. Moreover, minimum wage increases in Costa Rica, Brazil or Indonesia was shown not to have led to increased informality<sup>45</sup>.

Even when minimum wages exist, this does not necessarily mean that it is enforced. **Non-compliance of minimum wages** nevertheless remains a major issue, with estimates showing that over 60 per cent of workers in Honduras and Guatemala, more than one third of wage earners in Ghana, over half of wage earners in Kenya, and a third of garment workers in Indonesia are all paid less than the legal minimum wage<sup>46</sup>. While labour inspectorates are generally tasked to monitor compliance of minimum wage legislation, in some countries they lack the financial and human resource capacity to carry out their necessary work. In addition, while all countries provide fines to employers who do not comply with the legislation, the level of the fines varies significantly, despite the fact that the level of the fines has been shown to be among the key determinants in wage compliance<sup>47</sup>. The complexity of minimum wage systems can further complicate compliance – as having multiple minimum wages according to sector, region, or personal characteristics of the worker can make it more complicated for workers to understand which wage they are entitled to, and makes employers'

39 See for instance the ILO [Minimum Wage Policy Guide](#) or World Bank (2015) [Balancing Regulation to Promote Jobs](#)

40 ITUC Frontlines Report (2014) [Income inequality: Time to deliver an adequate living wage](#)

41 ITUC (2016) [Scandal: Inside the global supply chains of 50 top companies](#)

42 OECD (2016) [Employment Outlook](#)

43 Ontario Ministry of Labour (2015) [The Economic Impact of Minimum Wages](#)

44 World Bank (2015) [Balancing Regulations to Promote Jobs](#)

45 World Bank (2015) [Balancing Regulations to Promote Jobs](#); Hohberg and Lay (2015) [The impact of minimum wages on informal and formal labor market outcomes: evidence from Indonesia](#)

46 ILO (2014) [Incumplimiento con el salario mínimo en América Latina. El peso de los factores económicos e institucionales](#); Bhorat, Kanbur and Stanwix (2015) [Minimum Wages in Sub-Saharan Africa: A Primer](#); ILO (2016) [Weak minimum wage compliance in Asia's garment industry](#);

47 ILO (2014) [Incumplimiento con el salario mínimo en América Latina. El peso de los factores económicos e institucionales](#)

obligations less straightforward<sup>48</sup>. For minimum wage policies to be most effective, they should be as simple as possible, adequately resourced labour inspectorates must be in place and dissuasive sanctions must exist for employers who do not observe the law.

## Role of collective bargaining

**Collective bargaining is associated with higher wages, more security for workers and lower earnings inequality.** A wage premium for workers covered by collective agreements has been observed in many countries. In the United States, for instance, the union wage premium—the percentage-higher wage earned by those covered by a collective bargaining contract, adjusted for workers’ education, age, and other characteristics—is on average 13.6 per cent<sup>49</sup>. In Portugal, when adjusting for firm location, industry and personal characteristics of the worker, the wage premium for unionised workers covered by collective agreements reached up to 34.5 per cent<sup>50</sup>. **While collective bargaining most directly benefits the wages of unionised workers, it can also have a positive effect on non-union workers**, for instance through setting pay standards that workers within another firm or industry can follow, or through extension mechanisms of CBA agreements (see more below)<sup>51</sup>. Collective bargaining has also been shown to boost wages at the bottom of the wage scale more than in the middle or top of the scale, hereby helping to compress the wage distribution and reduce wage inequality<sup>52</sup>.

There are **various ways that collective bargaining is organised**, which can influence the degree to which it can promote higher wages as well as prevent wage inequality. When collective bargaining takes place at national and/or sectoral level, a larger number of workers are covered and wage inequality can be reduced within firms. The extension of collective agreements by governments to all workers in a particular sector or country can further extend coverage and reinforce the positive effects of collective bargaining by extending the provisions of the agreement beyond the members of the signatory organisations<sup>53</sup>. However when collective bargaining takes place only at firm and/or work-place level, the effect of collective bargaining is restricted only to workers within these enterprises; in this case, the coverage, and thereby the benefits, of collective bargaining are far more limited<sup>54</sup>. Moreover, firm-level collective bargaining tends to cover only employees in large or medium-sized enterprises, given that workers in small enterprises might not have the human resource capacity to organise and negotiate working conditions. ILO estimates have shown that among countries where bargaining takes place at the enterprise level, coverage rates tend to vary between 1 per cent and 35 per cent, and the average is 14 per cent. In contrast, for countries dominated by multi-employer bargaining at the sector or national level bargaining, the variation in bargaining coverage ranges from 49 per cent to 98 per cent<sup>55</sup>.

Visser (2016) has reviewed collective bargaining coverage in 38 OECD and EU countries from 1960 to 2013, and found that **coverage has declined significantly in many countries** – especially non-Western European countries. This decline is largely attributed to labour market policy reforms undertaken by governments, and often promoted by international financial institutions. Reforms over recent years to decentralise collective bargaining, shifting it from national/sectoral level to the level of the enterprise, have had a damaging effect on the coverage of collective agreements and has contributed to lower wages of workers. Some governments have also rolled back extension mechanisms of collective agreements, allowed agreements to expire without renewal, as well as allowed companies to deviate from agreements, further reducing coverage and associated wage premiums from collective bargaining<sup>56</sup>. These reforms to weaken and undermine collective bargaining systems have occurred despite the fact that fundamental right set out in **ILO Convention 98 on the Right to Organize and Collective Bargaining**, one of the eight fundamental Conventions of the ILO, which specifically calls on public authorities to take measures to encourage and promote negotiation between employers and unions with a view to developing collective agreements.

---

48 Ibid

49 Economic Policy Institute (2015) The Benefits of Collective Bargaining

50 Portugal and Vilares (2011) [Labour Unions, Union Density and the Union Wage Premium](#)

51 Economic Policy Institute (2003) Union decline lowers wages of nonunion workers

52 Vaughan-Whitehead (2016) Curbing Inequalities in Europe – How Can Social Dialogue and Industrial Relations Help to Close the Gap?

53 Eurwork (2002) Collective bargaining coverage and extension procedures

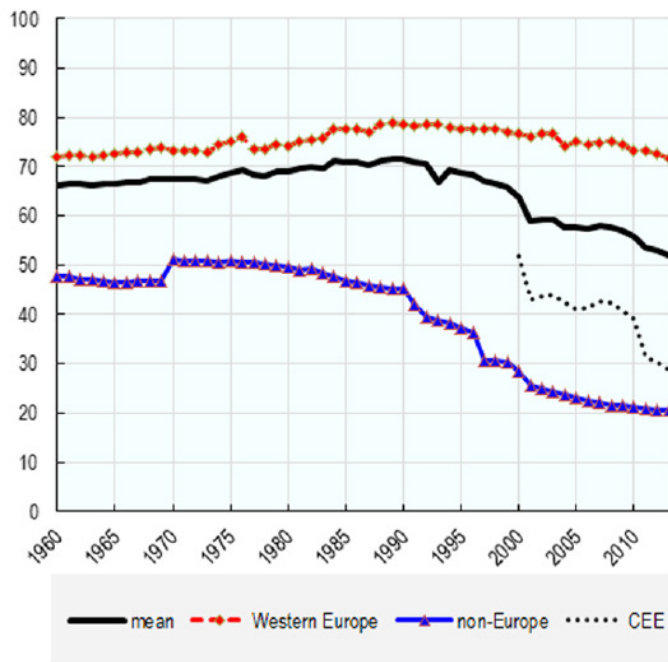
54 ILO (2017) [Global Wage Report 2016-2017](#)

55 ILO (2015) [Collective Bargaining Coverage: Stability, Erosion or Decline?](#)

56 Ibid



## Evolution of collective bargaining coverage in the OECD and EU



Source: Visser (2016)

The reforms taken to reduce collective bargaining coverage were informed, wrongly, by the view that collective bargaining is detrimental to employment, productivity and growth. However, the empirical evidence to support this view is lacking. In fact, **those countries with the highest coverage of collective agreements – such as Austria, Sweden, Denmark and the Netherlands – are among the world’s strongest economies.** They are countries that had been most resilient in the crisis, being least affected by job loss and being able to recover more quickly than their other European counterparts<sup>57</sup>.

## Link between wages and social protection

**Social protection is a key lever in combatting poverty, reducing inequalities, and promoting inclusive growth.** Social protection systems provide essential income support and services to protect people against risks and ensure adequate living standards. They are an important complement to wage policies in terms of preventing poverty and inequality, as well as in supporting aggregate demand and overall economic growth and development.

**ILO Convention 102 on Basic Principles of Social Security** and **Recommendation 202 on Social Protection Floors** together provide a comprehensive framework for states to develop adequate, universally-accessible social protection systems. Convention 102 sets out a framework for the provision of social insurance benefits that provide income replacement for those temporarily or permanently out of work, for instance during spells of unemployment, sickness, maternity, disability or retirement. Recommendation 202 expands the framework to also include social assistance – i.e., non-contributory benefits/services that can help provide financial support to those without sufficient means to live a decent life, including children, the unemployed and working poor, and those in old age, as well as essential services such as healthcare, education and childcare services.

Social protection can have a **significant impact on reducing inequality** because it can function as an income distribution tool, boosting household incomes at the bottom of the income distribution. They are also crucial in supporting greater equality of opportunity. The provision of social protection benefits and services to children from poor households has been shown to have a positive effect on their health, cognitive development and educational attainment, health, and overall employment later on in life and is an effective tool in reducing intergenerational transmissions of disadvantage<sup>58</sup>. The provision of unemployment and income support, effectively combined with active labour market measures such as job-search assistance and skill training, has been shown to also improve skills and employability and can reduce unemployment, improve skill matching and support higher and more quality employment<sup>59</sup>.

<sup>57</sup> Vaughan-Whitehead (2018) Reducing Inequalities in Europe : How Industrial Relations and Labour Policies Can Close the Gap

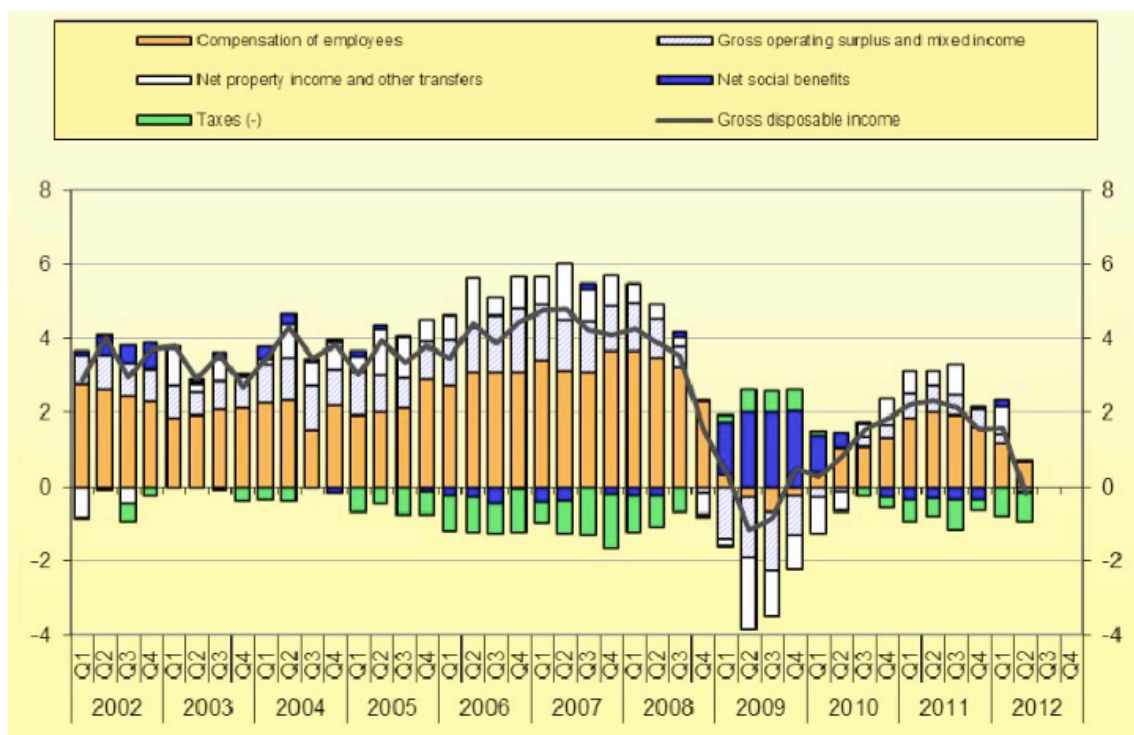
<sup>58</sup> OECD (2017) Preventing Ageing Unequally

<sup>59</sup> European Commission (2013) Evidence of Demographic and Social Trends: Social policies' contribution to inclusion, employment and the economy

Social protection also has a crucial role in supporting the **formalisation of the informal economy**. Experiences in Uruguay, Brazil, Argentina and Ecuador show how the extension of social protection to individual independent workers and/or entrepreneurs provided a strong incentive for many of these workers, who were previously in the informal economy, to formalise<sup>60</sup>. Second, as poverty is one of the key drivers of informality, by providing low-income people a 'legitimate' form of income support, they are less compelled to accept insecure work in the informal economy in order to get by<sup>61</sup>. To encourage formalisation, social protection is of course best complemented with other measures to improve the attractiveness of the formal sector, such as through ensuring decent wages, occupational health and safety, and other measures to improve the working environment.

Like wages, social protection is also important in creating and maintaining aggregate demand. As low-income households have a higher propensity to consume their incomes, social assistance benefits providing financial support to those at the bottom of the income distribution can stimulate consumption and raise aggregate demand. Social insurance benefits can also stimulate demand, since by providing income replacement during periods out of work, such as unemployment or retirement, they allow households to maintain their consumption patterns. During economic downturns and periods of high or structural unemployment, they also serve as **important automatic stabilisers**, maintaining aggregate demand by allowing households to continue to consume despite a loss of their work incomes, thereby cushioning economic shocks and preventing downturns from further intensifying<sup>62</sup>. The below chart shows how social protection expenditures helped to buffer the effects of the economic crisis on Eurozone member states in its early phase (late 2008 and 2009). However in the second phase of the crisis, the positive effect of social protection benefits were weakened – which may be in part to the exhaustion of unemployment benefits as well as the austerity measures taken to scale back social protection systems (more explanation below)<sup>63</sup>.

**Contributions of components to the growth of nominal gross disposable income of households (Eurozone)**



Source: European Commission (2013)

Despite all of the benefits of social protection, the International Labour Organisation (ILO) estimates that **only 28 per cent of the world's population enjoy a comprehensive level of social protection**<sup>64</sup>. Governments have committed to extending social protection coverage through the **Agenda 2030 Sustainable Development Goals**, committing to Target 1.3 to 'Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable'. However, while this global commitment has been made, a worrying trend of retrenchment to social protection that has been observed in several countries over recent years. Reforms to reduce social protection coverage and adequacy have been done as a response to the recent economic and financial crisis as well as demographic

60 ILO (2014) Monotax: Promoting formalization and protection of independent workers

61 ILO (2011) Decent Work and the Informal Economy

62 See for instance European Commission (2013) Evidence on Demographic and Social Trends: Social Policies' contribution to Inclusion, Employment and the Economy

63 European Commission (2013) Evidence on Demographic and Social Trends: Social policies' contribution to inclusion, employment and the economy

64 ILO (2014) World Social Protection Report 2014-2015

ageing in some countries. Such reforms included the tightening of eligibility criteria for social protection, the increase in required contributory periods, and in some cases, the introduction of extreme-targeting of benefits. Other measures included the reduction in the duration and/or generosity of benefits in some cases. Numerous studies have shown that such reforms have weakened the capacity for social protection systems to operate effectively and have increased poverty and widened gap between the wealthy and the poor<sup>65</sup>. Finally, the rise of non-standard and precarious forms of work is also compromising social protection coverage, as many workers on irregular contracts are excluded from benefits available to workers on standard contracts<sup>66</sup>.

Some governments and international organisations have repeatedly cited cost concerns as the main motivation for retrenching social protection and/or not expanding it, arguing that social protection schemes are unaffordable, however **there are variety of means to develop fiscal space for social protection**. This can be done in a variety of ways, for instance through more redistributive tax systems, tackling illicit financial flows and tax evasion, re-allocating public expenditures, and taking measures to increase tax and social security contributions by supporting formal employment<sup>67</sup>. Moreover, many of the cost concerns that governments have might be greatly overstated. The ILO Social Protection Cost Calculator estimates, for instance, that the provision of basic social assistance benefits would cost only around 3.2% of GDP in South Africa, 1.4% in Malaysia and 3.8% in India<sup>68</sup>.

## Conclusions – effective measures to raise wages and reduce inequality

**Governments must take action to break the cycle of low and stagnant wages, wage inequality and the decline in the labour income share.** These trends are having devastating consequences on workers' livelihoods, on social cohesion and on the economy as a whole.

**Minimum living wages should be ensured.** Minimum wages are a crucial tool to improve the financial situation for the lowest paid workers, and can have an important 'ripple' effect in boosting wages across the distribution. However for minimum wages to be adequate and effective in meeting the basic needs of workers and their families, governments must ensure that they are based on evidence of the cost of living. Moreover, many workers are currently left out from minimum wages, signalling the need to reform minimum wage systems to ensure a wage floor for all workers. Minimum wages should also be regularly updated to take into account changes in inflation and the cost of living, and should be done with the full involvement of social partners – such as within tripartite wage committees or councils. Finally, enforcement of the minimum wage is essential, and governments should deploy adequate labour inspectorates as well as dissuasive sanctions.

**Governments must also ensure and promote collective bargaining rights** in order to achieve fair wages above the minimum wage level. Accordingly, workers should have the right to organise, join trade unions, and negotiate appropriate wages and compensation for their work with their employers. National collective bargaining systems are essential tools to narrow wage differentials and reduce overall inequality. Collective bargaining arrangements should have wide coverage (i.e., through national, sectoral and/or multi-employer bargaining) and States can reinforce the positive effects of collective bargaining through the use of extension mechanisms. Recent reforms to weaken collective bargaining and reduce its coverage, for instance through the decentralisation of collective bargaining and the use of exemptions for companies to adhere to these agreements, cannot be justified and should be immediately reconsidered.

**Social protection must also be part of the package**, as raising wages cannot be seen in isolation from a more comprehensive strategy for reducing inequality and ensuring decent living standards for all. Social protection systems play an important role in preventing and reducing poverty, fostering skills development and employability, providing crucial automatic stabilisers and supporting overall economic growth and development. Governments should work to expand coverage of social protection systems, in line with ILO standards and the Agenda 2030 target to expand social protection coverage. Recent reforms to retrench social protection systems have had devastating consequences, and governments should instead work to create sufficient fiscal space to ensure adequate, comprehensive social protection systems.

**Decent work must be promoted**, and the expansion of precarious, low-paid work must be effectively addressed. The rise in non-standard forms of employment has contributed to the trend of stagnant wage growth and increasing wage inequality, and is also compromising workers' ability to access social protection. The rise in these jobs has been driven in part by regulatory loopholes that have allowed such workforms to proliferate, as well as recent reforms taken by governments to enhance labour market flexibility. Governments must take

65 Office of the High Commissioner for Human Rights (2013) [Report on austerity measures and economic and social rights](#)

66 European (2018) Access to social protection for all forms of employment

67 Ortiz et al (2017) [Fiscal Space for Social Protection and the SDGs: Options to Expand Social Investments in 187 Countries](#)

68 See link to the ILO social protection cost calculator [here](#)

measures to enhance workers' job security, as well as ensure that workers under atypical contracts are entitled to equivalent social protection rights as workers on standard, full-time contracts.

Finally, **international and regional coordination for wages and social protection** is important in order to avoid the risk of downward competition between countries as well as regional or global falls in aggregate demand. Such coordination would benefit from governments jointly making concrete and time-bound commitments to raise minimum wages, expand collective bargaining and enhance social protection. G20 Labour Ministers acknowledged in 2017 that 'minimum wage legislation and collective bargaining in particular can set income floors to reduce income inequality, eliminate poverty wages, and achieve sustainable wage growth<sup>69</sup>'. Governments should now follow up this acknowledgement with a concrete plan for action. They should also commit to implementing and expanding upon their previous commitments, including those within the 2015 G20 Policy Priorities on the Labour Income Share on reducing wage inequality through minimum wages, promoting the coverage of collective agreements, making work pay, enhancing job quality and reducing labour market segmentation<sup>70</sup>.

## Key references and further reading

OECD (2017) [Decoupling of Wages from Productivity: Macro-Level Facts](#). Economic Department Working Paper No. 1373

International Monetary Fund (2017) World Economic Outlook: [Chapter 3 - Understanding the Downward Trend in Labor Income Shares](#)

International Labour Organisation (2015) [Collective Bargaining Coverage: Stability, Erosion or Decline?](#)

International Labour Organisation (2017) [Global Wage Report 2016/2017](#)

International Labour Organisation (2018) [World Social Protection Report 2017-2019](#)

International Trade Union Confederation (2014) [Social protection: A Key to a fair society](#)

International Trade Union Confederation (2014) [Income inequality: Time to deliver an adequate living wage](#)

International Trade Union Confederation (2013) [Collective bargaining](#)

Onaran and Guschanski (2018) [What drives the four decades-long decline in labour's share of income?](#)

Oneran (2014) [The Case for a Coordinated Policy Mix of Wage-led Recovery and Public Investment in the G20](#)

Onaran and Galanis (2012) [Is aggregate demand wage-led or profit-led? National and global effects](#)

Storm and Naastepad (2011) [Wage-led or Profit-led Supply: Wages, Productivity and Investment](#)

Visser (2016) [What happened to collective bargaining coverage during the great recession?](#)

World Bank (2015) [Balancing Regulations to Promote Jobs](#)

69 [G20 Labour Ministerial Declaration](#) (Hamburg, Germany 2017)

70 [G20 Policy Priorities on Labour Income Share and Inequalities](#) (Ankara, Turkey 2015)