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Committee on Employment and Social Policy

ESP

FOR DEBATE AND GUIDANCE

THIRD ITEM ON THE AGENDA

Global wage trends and wage policy developments in selected countries

Wage policies, productivity growth and employment

Overview

Issues covered

This paper reviews global and regional wage trends during the global economic and financial crisis and the preceding years, and draws linkages to trends in labour productivity and employment. It analyses policy tools – namely collective bargaining, minimum wages and incomes policies – that constituents have at their disposal in working towards a sustainable and broad-based recovery, and discusses the experience gained in selected member countries.

Policy implications

The paper has implications for the debate on wages policies and recovery from the global financial and economic crisis.

Financial implications

None.

Action required

None.

References to other Governing Body documents and ILO instruments

GB.298/ESP/2; GB.298/11(Rev.); GB.303/ESP/1; GB.304/ESP/3.

ILO Declaration on Social Justice for a Fair Globalization.

Global Jobs Pact.

Minimum Wage Fixing Convention, 1970 (No. 131).

Introduction

1. Wage employment and wages are central to the world of work. Living standards of wage earners depend on the level of wages, and on when they are adjusted and paid. Wages are among the foremost subjects of collective bargaining between social partners. They are also a major determinant of aggregate demand and a key factor in the economic performance of countries. In 2008, through the ILO Declaration on Social Justice for a Fair Globalization, the International Labour Conference recognized and declared the commitments of Members and the Organization to the objective of promoting "policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection". [1] In June 2009, the International Labour Conference, attended by tripartite delegations of representatives of governments and employers' and workers' organizations from across the world, adopted the Global Jobs Pact, which involves the principle of avoiding the "damaging consequences of deflationary wage spirals and worsening working conditions" and named social dialogue, collective bargaining and statutory or negotiated minimum wages as the guiding policy options. [2]

2. The Committee on Employment and Social Policy (ESP) has previously debated wage developments and related policy issues, [3] and requested the Office to prepare periodic reports about wage trends and their policy implications. [4] Building on these debates, this paper provides an overview of recent global and regional wage trends and policy developments in selected countries, highlighting interrelationships with labour productivity and employment trends. This paper draws heavily upon the recently released *Global Wage Report 2010–11: Wage policies in times of crisis*. [5] For the production of that report, the Office collaborated with national statistical offices from around the world to compile data on monthly average wages. The database used for the Global Wage Report contains wage data for 115 countries and territories, which account for approximately 94 per cent of the world's wage earners and approximately 98.5 per cent of the global wage bill. [6] Section I of this paper summarizes recent trends in wages, labour productivity and employment. Section II discusses policy instruments and the experience gained with them in some member countries, and section III draws conclusions and suggests some points for debate and guidance.

I. Trends in wages and labour productivity

3. This section presents global and regional wage trends, both in advanced and in emerging and developing economies, and highlights two areas that are of particular concern to many policy-makers, namely developments in the incidence of low pay and the wage share. Trends in wages are examined in the broader context of economic development. While

[1] ILO Declaration on Social Justice for a Fair Globalization, Part I(A)(ii).

[2] Global Jobs Pact, paras 9.6 and 12.3.

[3] GB.298/ESP/2; GB.303/ESP/1; GB.304/ESP/3.

[4] GB.298/11(Rev.).

[5] ILO: *Global Wage Report 2010–11* (Geneva, 2010), available in several languages at http://www.ilo.org/global/publications/ilo-bookstore/order-online/books/WCMS_145265/lang--en/index.htm.

[6] See ILO: *Global Wage Report 2010–11* (Geneva, 2010), Statistical appendix, for the list of collaborating partners and primary sources and for coverage information.

growth of gross domestic product (GDP) provides a first gauge, labour productivity is generally preferred as a reference point for wages. [7] This section discusses the factors that foster labour productivity, and outlines global trends in labour productivity, employment and wages over the past decade.

Global and regional wage trends

4. During the decade preceding the global economic crisis, wage trends were characterized by a decoupling of wage growth from gains in labour productivity in advanced economies, [8] the long-run decline in wage shares, and a widening wage inequality often associated with an increasing incidence of low pay. [9]

5. The global economic and financial crisis cut global wage growth by half, as shown in figure 1. Compared to the pre-crisis growth rates of 2.7 and 2.8 per cent in 2006 and 2007, global wage growth almost halved to 1.5 and 1.6 per cent in 2008 and 2009. [10] The fact that wages did not fare worse can partly be attributed to the influence of China, where wages grew by approximately 12 per cent even at the depth of the crisis. [11] Excluding China, global wage growth declined far more sharply, from 2.1 and 2.2 per cent in 2006 and 2007 to 0.8 and 0.7 per cent in 2008 and 2009. In addition to the substantial job losses during the crisis that pushed the global number of unemployed workers to 205 million in 2010 (27.6 million higher than in 2007), [12] those workers who retained their jobs paid for the crisis through weaker wage growth. Both the loss of employment in the formal sector and the slower growth of wages and hence incomes are important explanations for the persistence of working poverty. The latest ILO estimates show that the number of workers living below the extreme poverty threshold of US$1.25 in purchasing power parities (PPP) per day was about 40 million higher in 2009 than would have been expected on the basis of pre-crisis trends. [13]

[7] In line with these and the new MDG indicator for Target 1.B: "Achieve full and productive employment and decent work for all, including women and young people", the ILO usually defines labour productivity as "GDP per person employed". For a detailed discussion, see also OECD: *Measuring productivity: OECD Manual – Measurement of aggregate and industry-level productivity growth* (Paris, 2001), p. 20.

[8] "Advanced economies" refers to 28 countries as listed in ILO: *Global Wage Report 2010–11*, Technical appendix table A1.

[9] ILO: *Global Wage Report 2008–09* (Geneva, 2008), in particular Chapters 2 and 3.

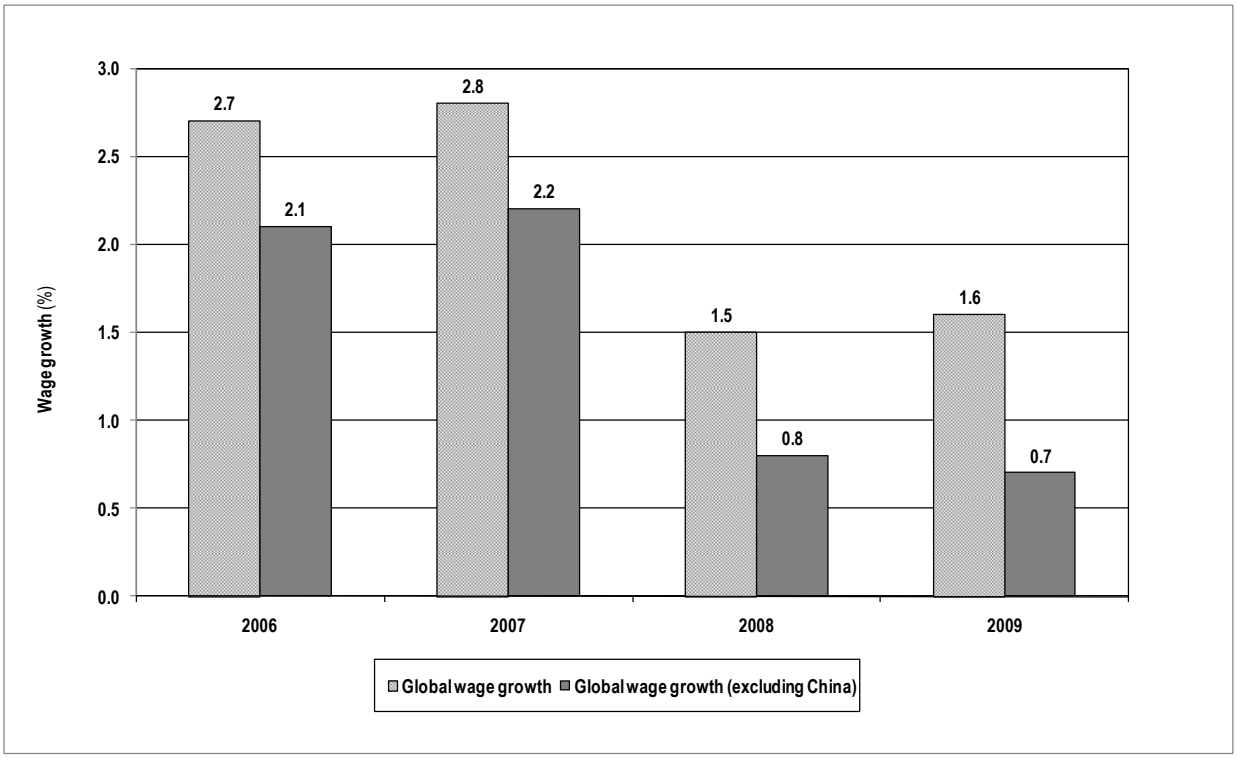
[10] All figures refer to real wage growth, i.e. adjusted for inflation. When interpreting trends in monthly average wages, it is important to note that average wages can alter as a result of changes in either hourly wages or in the number of hours worked, or both.

[11] However, it should be noted that Chinese wage data refer only to "urban units".

[12] See ILO: *Global Employment Trends 2011: The challenge of a jobs recovery* (Geneva, 2011), p. 12 and table A4; available at http://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/@publ/documents/publication/wcms_150440.pdf.

[13] ibid., p. 23f.

Figure 1. Global wage growth, 2006–09 (year-on-year changes, real terms, percentages)



Note: Global wage growth is calculated as the weighted average of national growth rates of real average monthly wages. For coverage and methodology, see ILO: *Global Wage Report 2010–11*, Technical appendix I.

Source: ILO Global Wage Database, based on data from national statistical offices.

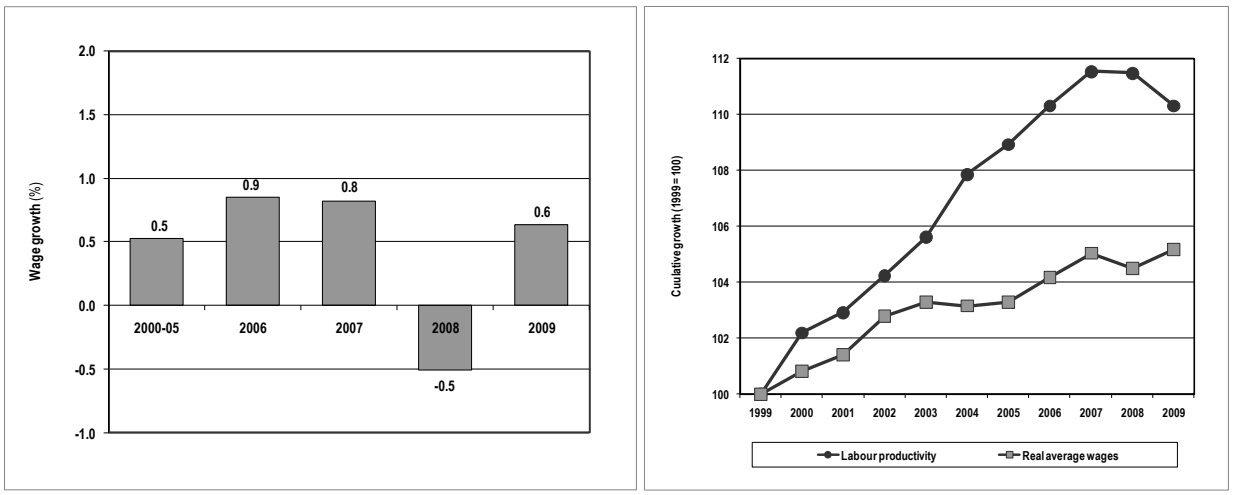
Advanced economies

6. The global estimates reflect large variations in wage growth between regions. One of the weakest performances is seen in the advanced economies, where wage growth was subdued in the pre-crisis years and turned negative in 2008 (-0.5 per cent; see figure 2, panel (a)). Unexpectedly high inflation in 2008 contributed to the decline in the purchasing power of wages during that year, whereas unusually low inflation aided the modest recovery of real wages in 2009 (+0.6 per cent). To the extent that low-paid workers were the first to lose their jobs during the recession, this changed the composition of the population of wage earners towards better paid employees. This composition effect introduces a well-known countercyclical bias that stabilizes average wages during a recession, despite large reductions in monthly pay for individual workers for example, due to the drastic reduction in hours worked that was seen in some countries. [14]

[14] For sources and a detailed discussion see ILO: *Global Wage Report 2010–11*, Chapter 1.

Figure 2. Wage growth and labour productivity growth in advanced countries, 2000–09

(a) Year-on-year wage growth **(b) Cumulative wage and labour productivity growth** (1999 = 100)



Note: Regional wage growth is calculated as the weighted average of national growth rates of real average monthly wages. For coverage and methodology, see ILO: *Global Wage Report 2010–11*, Technical appendix I. To improve comparability, the labour productivity trend is calculated as a weighted average of national growth rates.

Source: ILO Global Wage Database, based on data from national statistical offices.

7. Taking a longer term view, average wages in advanced countries grew by only 5.2 per cent over the entire decade (level in 2009, as compared to 1999). Despite the adverse impact of the crisis in the final years of the decade, labour productivity grew by 10.3 per cent over the same period and thus almost twice as fast as wages. The divergence between wages and productivity finds its main cause in low wage growth during the pre-crisis period. Despite robust economic growth and annual gains in labour productivity between 1.0 and 2.1 per cent during the years from 2002 to 2007 (see section "Labour productivity" below), annual wage growth in advanced countries was less than 1 per cent during the boom period (see figure 2, panel (a)). This long-run deviation has led to a decoupling of wage growth from productivity growth in advanced countries (see figure 2, panel (b)). Since the figures refer to a weighted average, developments in the three largest advanced economies (United States, Japan and Germany) have a particular impact on this outcome. [15] The erosion of workers' bargaining power and the rise of non-standard forms of employment with low monthly wages both contributed to the decoupling of wages from productivity. [16]

[15] For Germany, see the detailed analysis based on data from the Federal Statistical Office, in ILO: *Global Wage Report 2010–11*, *Datenblatt Deutschland* (available in German only at http://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/@publ/documents/publication/wcms_150027.pdf). For the United States and other advanced countries, the US Bureau of Labor Statistics provides useful estimates on productivity in its publication *International comparisons of GDP per capita and per employed person* (2009) (available from http://www.bls.gov/fls/flsgdp.pdf, see table 4) that reflect the same general trends estimated by the Office on the basis of World Bank data.

[16] For a discussion of the role of the latter in the case of Germany, see *Datenblatt Deutschland* (op. cit.).

Emerging and developing economies

8. Overall, wage growth has been substantially higher in emerging and developing economies. [17] For the economies of Central Europe, Eastern Europe and Central Asia, the high wage growth up to the crisis also reflects the depth of wage decline during the transition period in the 1990s, and thus the low basis at the beginning of the 2000s (see figure 3, panels (a) and (b)). While the first half of the past decade was disappointing for wage earners in Latin America and the Caribbean (with annual growth rates of only 0.4 per cent from 2000 to 2005), the region recorded solid real wage growth of 4.2 and 3.3 per cent in 2006 and 2007 (see figure 3, panel (c)). Partly due to the strong performance of China, wage growth in Asia [18] exceeded 7 per cent per year throughout the decade (see figure 3, panel (d)). Again, this trend needs to be seen in the context of still low wage levels and is an outcome predicted by classical development theory when rapid industrialization leads to labour shortages. [19] For both Africa and the Middle East, data constraints do not allow for reliable estimates. However, provisional and tentative estimates indicate that wages in Africa grew during the past decade, while they effectively stagnated in the Middle East (see figure 3, panels (e) and (f)).

9. The largest impact of the global economic and financial crisis on wages can be seen in Central and Eastern Europe (where wages fell by -0.1 per cent in 2009) and in Eastern Europe and Central Asia (with a fall of -2.2 per cent in 2009). [20] This adverse impact on wages comes in addition to a substantial rise in unemployment during the crisis, and helps to explain the rise in working poverty (using the threshold of US$2.00 PPP per day). [21] Wage growth slowed down considerably in Latin America and the Caribbean, but held firm in Asia, whose economies weathered the crisis best. Due to data constraints, no clear findings emerge for Africa and the Middle East. In many countries, the spike in food prices in 2008 also eroded the real purchasing power of wages during that year.

[17] For the purposes of this paper, all countries not grouped under “Advanced countries” are referred to as emerging and developing economies.

[18] Excluding Japan, the Republic of Korea and Singapore, which are grouped as advanced countries (see ILO: *Global Wage Report 2010–11*, Technical appendix I).

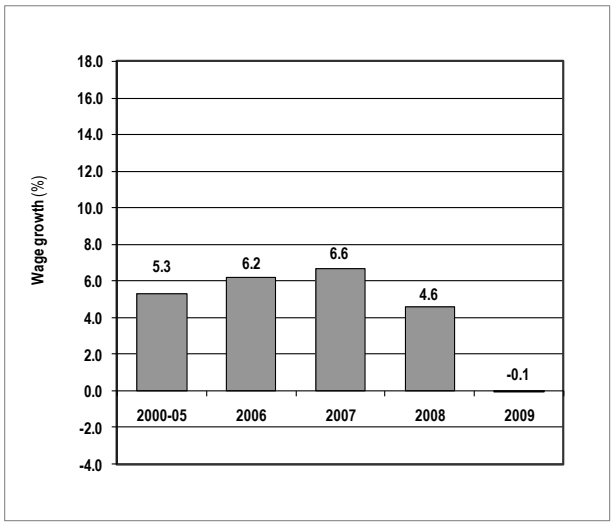
[19] See W.A. Lewis: “Economic development with unlimited supplies of labour”, in *The Manchester School*, Vol. 22 (1954), pp. 139–191, and S. Kuznets: “Economic growth and income inequality”, in *American Economic Review*, Vol. 45, No. 1 (1955), pp. 1–28. However, it should be noted that in many of these Asian countries, including China, wage growth tended to lag behind labour productivity growth.

[20] The regions correspond to the countries covered by the DWT/CO–Budapest (Central and Eastern Europe) and the DWT/CO–Moscow (Eastern Europe and Central Asia).

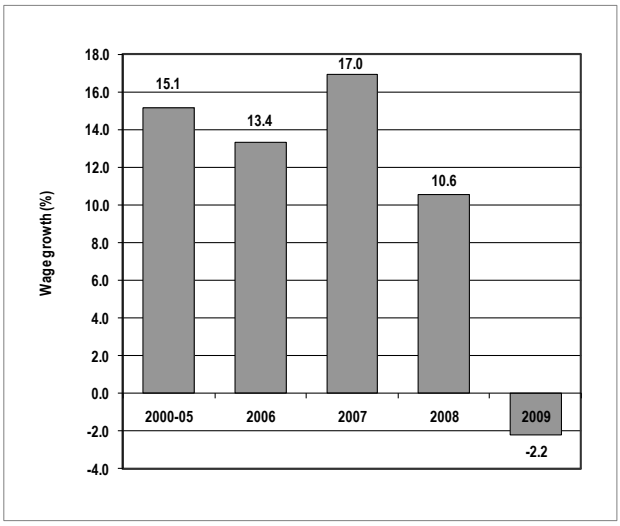
[21] See ILO: *Global Employment Trends 2011*, op. cit.

Figure 3. Wage growth in emerging and developing economies, 2000–09

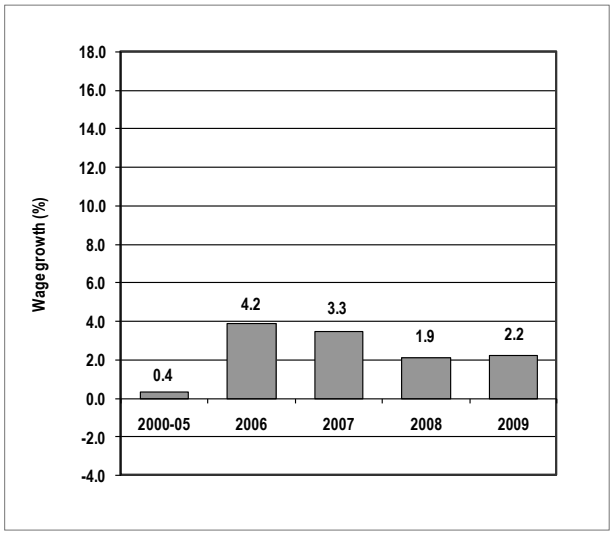
(a) Central and Eastern Europe



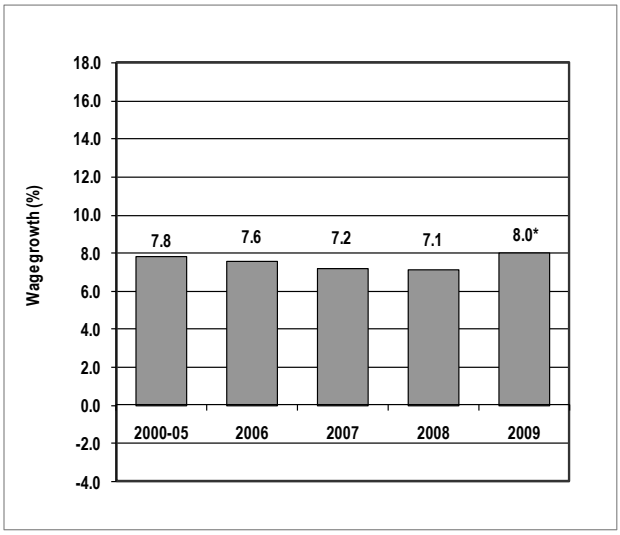
(b) Eastern Europe and Central Asia



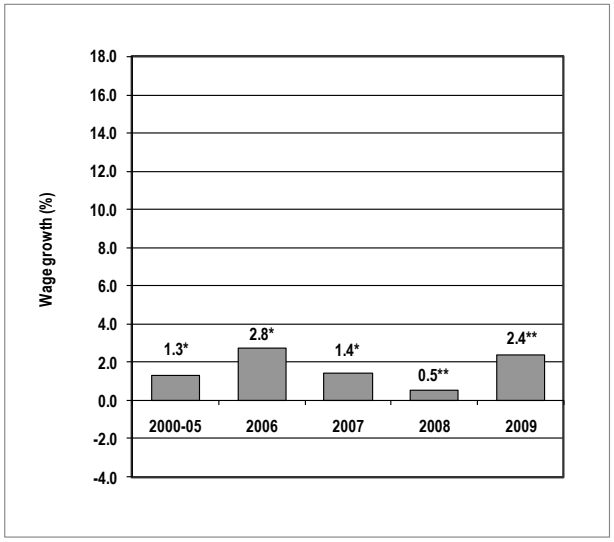
(c) Latin America and the Caribbean



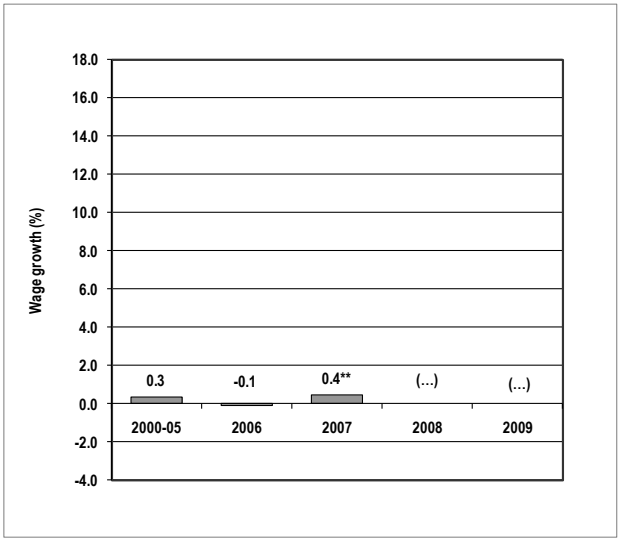
(d) Asia



(e) Africa



(f) Middle East



Notes: * Provisional estimates (based on coverage of ca. 75 per cent). ** Tentative estimates (based on coverage of ca. 40 per cent to ca. 60 per cent). (...) = No estimate available. For technical notes, see figure 4 below.

Source: ILO Global Wage Database, based on data from national statistical offices.

Low-pay incidence

10. As stated earlier, wage inequality widened during the decade prior to the outbreak of the global economic crisis. This was predominantly the result of a "flying top" (rapidly increasing wages at the top), but also of a "collapsing bottom" (a decoupling of the lowest wages from the overall trend) and wage polarization (a combination of both trends). [22] Low-paid workers, defined as those whose hourly wages are less than two-thirds of the median wage across all jobs, [23] acquire special relevance in current times since they are particularly vulnerable to economic crises. Low-wage work, often in conjunction with wage instability and time-related underemployment, increases workers' likelihood of falling into or remaining trapped in poverty. Trends in low-pay work during an economic downturn are thus a good test of the effectiveness of anti-crisis policy responses.

11. The share of low-paid workers increased in a majority of countries with available data between the late 1990s and 2007–09, while wide variations in the incidence of low pay remain between countries, including between advanced economies. [24] Despite generally lower labour market participation, women account for a majority of low-paid workers in virtually all countries with available data. Women's over-representation among low-paid workers has a negative effect on the gender pay gap. The findings also show that youth, those with low levels of education and members of disadvantaged ethnic minorities or immigrant groups are particularly vulnerable to being trapped in low-wage jobs. The types of employment and contract have been also found to increase the risk of low pay: non-regular and short-term jobs are associated with higher incidence of low pay than regular jobs.

Trends in the wage share

12. If average wages do not grow in line with labour productivity, it follows that the share of wages in GDP falls (assuming that the share of employees in total employment stays roughly constant). The functional distribution of national income between labour and capital has hence been of long-standing interest to labour economists, and the Office has collaborated with the Organisation for Economic Co-operation and Development (OECD) to analyse the trends in wage shares for the "real economy" (i.e. excluding the financial sector) of 31 OECD member countries. [25] Since profits fall more sharply during a recession than wages, the wage share displays clear counter-cyclical movements (and increased during the crisis in most countries included in the analysis). However, over the course of several business cycles, there is a predominant long-run downward trend in OECD countries. [26] For instance, out of the 24 countries where the time series goes back to 1980, no fewer than 17 saw a decline in the wage share up to 2007. In a majority of countries, this pattern can also be observed at the sectoral level (and is only to a lesser degree the result of employment shifts between sectors). The manufacturing sector generally suffered

[22] See ILO: *Global Wage Report 2008–09*, section 3.2.

[23] This definition has been adopted for the ILO's decent work indicator for "low pay rate"; see http://www.ilo.org/wcmsp5/groups7public/dgreports/integration/documents/meetingdocument/wcms_115402.pdf.

[24] See ILO: *Global Wage Report 2010–11*, Chapter 3, in particular figure 20. The financial support of the Republic of Korea towards a research project on low pay is acknowledged with gratitude.

[25] For details see ILO: *Global Wage Report 2010–11*, Chapter 2.1 and Technical appendix II. All data refer to unadjusted wage shares. Note that the report still refers to OECD countries and Estonia, which joined the OECD after the report went to press.

[26] For a similar result, see also IMF: *World Economic Outlook, April 2007* (Washington, DC), Chapter 5.

the largest long-term decline in the share of wages in value added. Globalization and technological change, due both to factor productivity changes favouring capital and to changes in skill structure penalizing low-skilled workers, as well as the weakening of trade unions and collective bargaining, account for this trend. [27]

Labour productivity

Drivers of labour productivity

13. Investments into productive capacity and technological innovation are long-term determinants of productivity, and generate the conditions for a shift towards higher value added activities such as manufacturing. [28] Macroeconomic and industrial policy, and sound management of the financial system, play an equally important role in laying the foundations for productivity growth. At the micro level, workers' skills, and skills development and training, and how efficiently the different factors of production are combined, are crucial determinants of labour productivity. [29] In this regard, the economic literature has highlighted the importance of the productivity of both the employee and the entrepreneur (pointing out the repercussions of management failure), and of management–worker cooperation and social dialogue at the industry and enterprise level as an effective way to improve production processes and raise efficiency. [30]

Trends in labour productivity and employment

14. Increasing labour productivity is one of the main long-term determinants of economic growth. When analysing economic trends, it can be useful to decompose growth into the contribution made by changes in labour productivity and those that are due to an expansion of employment (as shown in figure 4). [31] In the immediate pre-crisis period from 2004 to 2007, the world as a whole achieved both increases in labour productivity (which grew at annual rates of about 3 per cent during this period) and an expansion of employment (at about 2 per cent per year). As a result, output grew at rates close to 5 per cent from 2004 to 2007 (see figure 4, panel (a)). The strongest performance was seen in the emerging and developing economies, [32] where labour productivity grew at rates between 5 and 6 per cent in the immediate pre-crisis period and employment expanded at rates close to 2 per cent. In this group of countries, GDP growth exceeded 7 per cent and reached 8.1 per cent in 2007 (see figure 4, panel (c)). Growth in the advanced countries was still strong and averaged

[27] ILO: *Global Wage Report 2008–09*, p. 22.

[28] For the example of Asia, see A. Amsden: *The rise of "the rest": Challenges to the West from late-industrializing economies* (Oxford, 2001).

[29] The 97th Session of the International Labour Conference (2008) examined in detail the contribution that skills development and training can make to productivity growth. See: Conclusions on skills for improved productivity, employment growth and development, International Labour Conference, 97th Session, Geneva, 2008; available at http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---ifp_skills/documents/publication/wcms_103457.pdf.

[30] R. Freeman and J.L. Medoff: *What do unions do?* (New York, Basic Books, 1984); R. Buchele and J. Christiansen: "Productivity, real wages and worker rights: A cross-national comparison", in *Labour*, Vol. 9, No. 3 (Sept. 1995), pp. 405–422.

[31] See also the chapter on labour productivity in T. Sparreboom and A. Albee (eds): *Towards decent work: Monitoring MDG1B employment indicators in sub-Saharan Africa* (Geneva, ILO, forthcoming 2011).

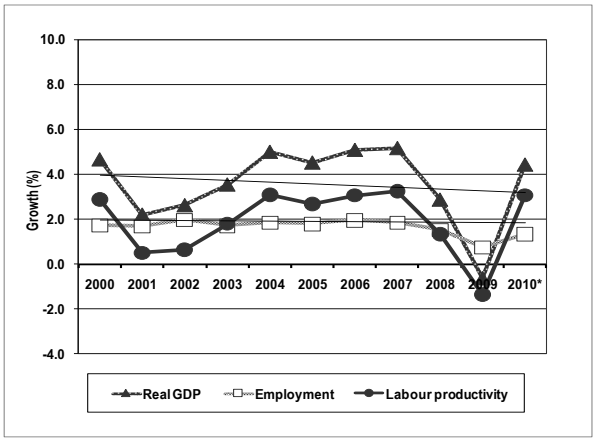
[32] A more detailed breakdown by region is available in ILO: *Global Wage Report 2010–11*, fig. 13.

nearly 3 per cent, accompanied by employment creation and productivity growth (see figure 4, panel (b)).

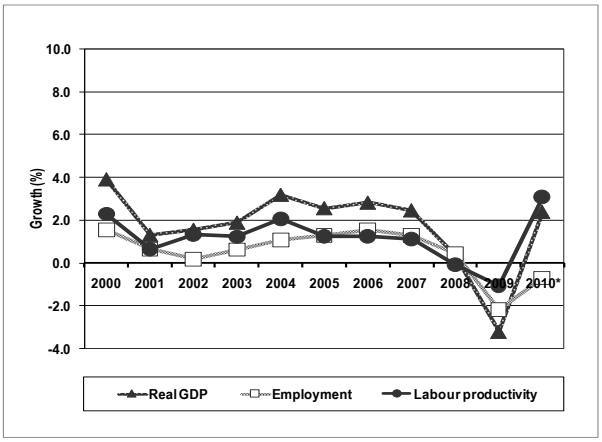
15. The global economic crisis brought this positive trend to an abrupt halt. In the world as a whole, GDP growth turned negative in 2009. The decline in labour productivity was even sharper than the decline of GDP since employment continued to grow modestly in 2009, though the pace was uneven across regions and fell short of the growth of the labour force. [33] The advanced economies experienced the sharpest drop in output (by more than 3 per cent), while employment in advanced economies declined by just over 2 per cent and labour productivity fell. By contrast, in emerging and developing economies both GDP growth and employment growth stayed positive (at about 1.5 per cent), resulting in a stagnation of labour productivity. Labour productivity usually rebounds quickly during the recovery from recessions. Preliminary estimates indicate that this was also the case in 2010, when labour productivity grew by approximately 3.1 per cent in advanced countries and by approximately 4.8 per cent in emerging and developing countries.

Figure 4. Growth in GDP, employment and labour productivity, 2000–10* (percentages)

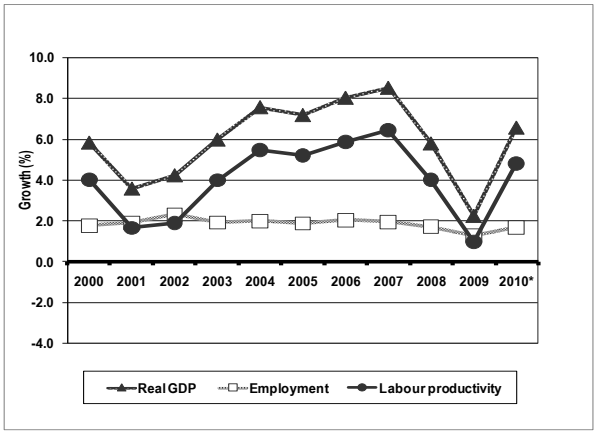
(a) World



(b) Advanced economies



(c) Emerging economies



Notes: * Data for 2010 are provisional estimates. "Advanced economies" refers to 28 advanced countries as listed in ILO: *Global Wage Report 2010–11*, Technical appendix table A1. "Emerging and developing economies" refers to all other economies. Growth rates refer to the year-on-year growth of the world or regional aggregates (GDP and employment) and the world or regional averages (labour productivity).

Source: ILO calculations based on GDP data from the World Bank (GDP in constant 2005 PPP US$) and employment data from the ILO's *Global Employment Trends* model.

[33] The sharp decline in worldwide labour productivity is partly the result of a composition effect, since employment fell in advanced economies (with high productivity), but continued to grow in emerging and developing economies (with lower productivity). Employment in emerging and developing economies thus accounted for a larger proportion of the global total in 2009 than in 2008, depressing average productivity.

Labour productivity and wages

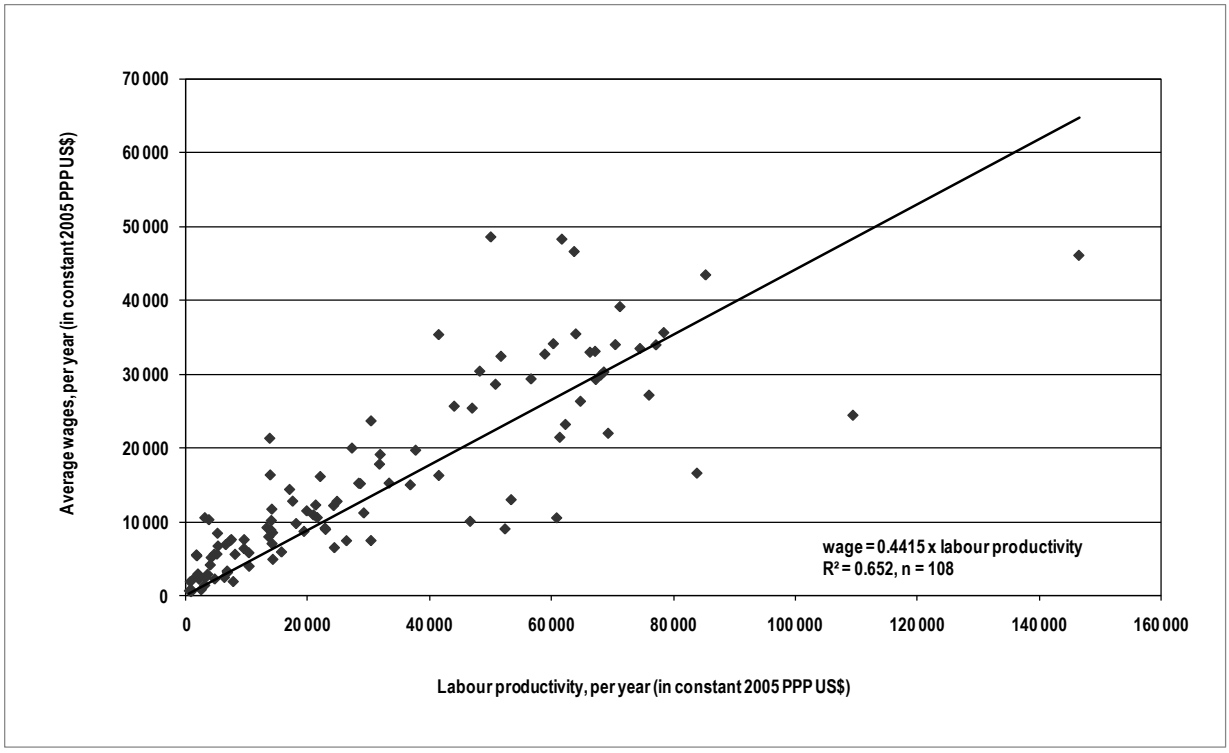
16. While productivity growth is universally recognized as one of the drivers of development, it is not an end in itself but a means to improve workers' lives by providing the foundations for sustainable wage increases. [34] If wage growth consistently exceeds productivity gains, this can undermine the sustainability of enterprises and harm their competitiveness. If wage growth lags behind productivity growth, workers do not fully participate in the fruits of progress and productivity gains do not fully translate into better living standards for workers. Whereas profits tend to be volatile along the business cycle, a long-term alignment of wages and labour productivity also stabilizes the share of operating surplus in total value added (which, in turn, can be re-invested by enterprises). Wages are also an important source of domestic demand, which in turn is an important determinant of growth. For these reasons, labour productivity is widely accepted as a reference point for wages, in particular in advanced countries where the large majority of workers are wage earners. While short-run deviations between productivity and wages can often be explained by cyclical effects, a long-run divergence has more profound implications.

17. For a cross-section of 108 countries and territories with available data from the ILO's Global Wage Database, figure 5 shows a positive association between productivity and wages across countries. When comparing between countries, wages are estimated to be higher by about US$0.44 for every US$1.00 difference in labour productivity (expressed in PPP). While differences in labour productivity explain about two-thirds of differences in wages, there is a considerable variation and some countries have considerably lower wages than one would expect given their productivity level. Moreover, the observed cross-section relationship is in part due to an identity in the OECD System of National Accounts since the compensation of employees (and hence wages) is itself an major component of GDP. [35] Further, the finding of an association in a cross-section of countries does not imply that wages grow in line with productivity over time in any given country (see above for a discussion of the decoupling of wages and labour productivity in advanced countries).

[34] See also Conclusions concerning skills for improved productivity, employment growth and development, International Labour Conference, 97th Session, Geneva, 2008, in particular para. 7ff.

[35] See EC–IMF–OECD–UN–World Bank: System of National Accounts (1993), Primary Distribution of Income Account (Chapter VII), available at http://unstats.un.org/unsd/sna1993/toctop.asp.

Figure 5. Labour productivity levels and wage levels, 2009 or latest available year (cross-section)



Note: "Labour productivity" refers to GDP in 2005 PPP US$ per person employed; data are for 2009 or the latest available observation from any given country that is included in the ILO's Global Wage Database. Yearly wages are estimated as 12 x average monthly wages (the main indicator collected in the database). For most countries, wage data refer to the formal sector only.

Source: ILO Global Wage Database 2010–11, ILO calculations based on GDP data from the World Bank (GDP in constant 2005 PPP US$) and employment data from the ILO's *Global Employment Trends* model.

II. Wage policies

18. The trends discussed above have important implications for policy-making towards a broad-based recovery. Why should policy-makers care about wage policies during the crisis and the recovery process? One reason concerns social justice and the hardship that inequality and low wages impose on households, particularly at the lower end of the wage distribution. Another reason, however, which has recently re-emerged in policy debates, is the macroeconomic effects of wages. While wages that are low relative to productivity may help boost a country's exports, it is important to keep in mind that not all countries can improve their competitiveness simultaneously and that low wages depress household consumption and hence aggregate demand. [36] Investment in productive capacity itself depends at least partly on the extent to which households are able to consume what enterprises produce. This suggests that the quality and pace of the recovery and the resumption of economic growth will, in part, depend on the recovery of wages and household income.

19. There is now a broad-based debate on how far the wage trends prior to the global economic crisis mentioned in paragraph 4 above have contributed to global imbalances by depressing domestic demand, causing increasing reliance on exports and contributing to

[36] See also ILO: *Setting policy directions for job creation and poverty reduction*, technical paper submitted to the Asian Employment Forum (Beijing, 2007).

the build-up of unsustainable household debt. [37] Wage policies can play an important role in addressing imbalances and in fostering sustainable economic growth in the post-crisis period. A recent IMF paper argues that a "restoration of workers' earnings – for example, by strengthening collective bargaining rights – [allows workers] to work their way out of debt over time", therefore reducing leverage and the risk of future financial crises. [38] This section will discuss some of the instruments available to constituents, namely collective bargaining, minimum wages and income policies aimed at low-income policies, and report on the experience gained in some ILO member countries.

Collective bargaining: Strengthening the linkage between wages and productivity

20. Collective bargaining remains the single most important institution through which social partners can directly bargain over the share of value added which goes into wages. Market forces alone do not deliver the best outcomes with respect to decent work. Indeed, a stable wage share is often the result of institutional settings and practices that are able to strike a balance between wages that are high enough to sustain consumption consistent with overall economic growth and adequate returns to investment. Engaging in collective bargaining and worker information, consultation and participation are also distinctive features of any sustainable enterprise. [39] Despite its beneficial role in wage-fixing, collective bargaining coverage has, nonetheless, been declining in some settings, and this is a matter of concern. A number of recent country examples may provide valuable insights on how to reverse this trend, in view also of economic recovery. These country experiences show how collective bargaining can help adapt to economic uncertainties and downturns through short-term adjustments and concessions on wages and other working conditions, while permitting a more expeditious alignment of wages with productivity gains when the economy recovers.

21. Uruguay, for example, reintroduced the wage council system in March 2005 to determine wages by sector of activity. During the period from 2005 to 2009, the wage councils operated as a strongly coordinated sectoral bargaining system. At the time of the reintroduction of the wage council system, Uruguay was coming out of the deepest recession in its recent history. The new system ensured that the strong economic recovery translated not only into an increase in the employment rate from 51.5 per cent in 2004 to 58.6 per cent in 2009 and a drop in unemployment from a peak of 18 per cent in 2003 to 7.6 per cent in 2009, but also into strong real wage growth of around 5 per cent per year. [40] These results were reached while maintaining both fiscal and price stability. This experience challenges the view that policy-makers should first aim to increase growth, followed by employment creation and only then aim at improving wages. In fact, the simultaneous recovery of wages and employment in Uruguay appears to have played a key role in sustaining significant economic growth.

22. Recent examples show that the role of trade unions in linking wages to labour productivity also remains strong in periods of crisis. It is interesting to see, for example, that Germany's response to the crisis has reinforced its core institutions and the willingness of major

[37] See also IMF–ILO: *The challenges of growth, employment and social cohesion*, Discussion document for the Joint ILO–IMF conference in cooperation with the office of the Prime Minister of Norway (Oslo, 2010).

[38] Cited from the IMF journal *Finance & Development* (Dec. 2010).

[39] See Conclusions concerning the promotion of sustainable enterprises, International Labour Conference, 96th Session, Geneva, 2007, in particular para. 13.

[40] See ILO: *Global Wage Report 2010–11*, box 8.

stakeholders to work together. With the help of state subsidies, employers kept their long-term commitments to core workers and, in return, trade unions and work councils agreed to make concessions in terms of pay and working conditions. Industry-wide collective bargaining also brought about considerable real wage cuts, and made the timing of wage increases contingent on economic recovery. [41] The model of close cooperation explains, at least in part, the low number of job losses during the crisis, in spite of a sharp economic contraction. The German experience contrasts with countries with weak collective bargaining institutions, including countries in Central and Eastern Europe. There, enterprises responded to the crisis by sharply reducing employment, and adjustments in hours that helped to stabilize employment elsewhere played only a marginal role. [42]

Minimum wages: Protecting low-paid workers

23. In light of the limited coverage of collective bargaining in some countries and the challenges confronting trade unions to organize low-paid workers, minimum wages can play an important complementary role. They can protect the purchasing power of low-paid workers, strengthen aggregate demand, promote stability and avoid sections of society feeling left behind during periods of economic recovery and growth. [43] Even during the crisis year of 2009, a majority of countries with available data adjusted the (nominal) minimum wage upwards. [44] This shows continuity with a more "active" use of minimum wage policies by countries across the world in the decade prior to the current global economic crisis. It also presents a departure from the experience during previous crises, and is in line with the recommendation of the Global Jobs Pact that governments should consider minimum wages as an option to avoid deflationary wage spirals. [45]

24. Room for increasing minimum wages depends not only on the overall economic context, but also on their initial level. The Minimum Wage Fixing Convention, 1970 (No. 131), which considers that minimum wage systems are necessary to protect wage earners against unduly low wages, calls for setting levels that take into consideration: (a) the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits, and the relative living standards of other social groups; as well as (b) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment.

25. The United Kingdom seems to be one country that succeeded in striking such a balance. In 2010, a survey of British political experts identified the minimum wage as the most successful government policy of the past 30 years. [46] The criteria used to define the success of a policy were successful implementation, positive social and economic impacts, and sustainability over time. In the United Kingdom, the minimum wage was introduced in 1999, after the reforms of the 1980s had eroded collective bargaining in many industries

[41] The industry-level agreements often included clauses which allowed the actual implementation of the wage agreements at the industry level to be negotiated at an enterprise level, providing additional flexibility to firms and workers in distress ("opening clauses").

[42] See ILO: *Global Wage Report 2010–11*, Chapter 5.1.

[43] See also Global Jobs Pact, para. 23.

[44] See ILO: *Global Wage Report 2010–11*, table 5.

[45] Global Jobs Pact, para. 12(3).

[46] Institute for Government: "What makes a 'successful policy'?", Analysis of Political Studies Association survey data (London, November 2010), available at http://www.instituteforgovernment.org.uk/pdfs/PSA_survey_results.pdf.

and abolished wage councils. Contrary to widespread fears at the time, the minimum wage had no apparent negative impact either on employment or wage inflation over its first ten years. [47]

26. A carefully designed minimum wage can also have a positive impact in developing countries and has increasingly been revitalized by policy-makers. In Latin America, 18 out of 22 countries adjusted their minimum wages in 2009 slightly above or close to past inflation figures. However, as the actual inflation rate was lower than expected, these adjustments resulted in real minimum wage increases that helped avoid deflationary pressures without jeopardizing employment. In Brazil, a country with a large informal economy, the national minimum wage is among the policies that are most frequently credited for the sharp reduction in inequality and the decline of working poverty over the past decade, without seemingly slowing employment growth. [48] The minimum wage in Brazil has been raised consistently from 33 per cent of median wages in 2002 to more than 42 per cent of median wages, according to the most recent data. [49] Even during the crisis, the minimum wage was raised in real terms by 6 per cent two months earlier than originally scheduled. This, along with assuring liquidity to the financial sector, continued implementation of an ambitious infrastructure investment programme and reinforced social protection, was central to the government's anti-crisis response. This "active" minimum wage policy has been also a core element in Brazil's strategy to build up a middle class and support the emergence of a domestic market supported by domestic household consumption.

Coherence between collective bargaining and minimum-wage setting

27. While the importance of both minimum wages and collective bargaining has long been recognized, their effectiveness and macroeconomic contribution has attracted increasing attention from policy-makers. First, more efforts have been made to implement wage policies better and to make them more effective. In this respect, securing policy coherence is often considered critical. For instance, creating a complementary relationship between minimum wages and collective bargaining is a daunting task in many developing countries. Minimum wages are mainly intended to protect unorganized, unskilled low-paid workers. When their level is set too high, this increases the risk that they fail to protect low-paid workers effectively and, at the same time, minimum wage-setting runs the danger of effectively replacing collective bargaining. For this reason, developing countries such as the Philippines are in the process of improving the current tripartite wage commissions to secure better policy coherence between minimum wages and collective bargaining by introducing a two-tier system with statutory minimum wages for lowest paid workers and non-binding wage guidelines for collective bargaining.

28. Second, in light of the experiences of the global economic crisis, these wage policies are being considered in terms of their potentially positive contributions to economic growth and macroeconomic stability. An increasing number of economists and policy-makers argue that, in order to address the imbalances that contributed to the global financial and economic crisis, a new strategy is needed to maintain stable consumption demand through

[47] Low Pay Commission Report (2009), *National Minimum Wage* (Norwich, The Stationery Office, 2009), p. ix.

[48] *The Economist* ("Lula's legacy", 30 Sep. 2010) points out for example that "median earnings are rising and, despite a minimum wage at its highest in real terms since 1979, so is employment".

[49] See ILO: *Global Wage Report 2010–11*, figure 31.

solid income growth. [50] Effective wage policies, if well-designed and properly implemented, can strengthen the long-run linkage between wages and productivity, thereby sustaining consumption demand. This view, for instance, appears to be reflected in China's 12th Five Year Plan which emphasizes the need for increasing workers' disposable income and domestic consumption in line with labour productivity.

Broadening wage policies to ensure minimum income for vulnerable workers and their families

29. Even with effective collective bargaining and minimum wages, some workers with low levels of education and productivity may be at risk of poverty. In such cases, "in-work benefits" – which take the form of tax credits, wage-related transfers or other lump-sum payments [51] to low-paid workers – can be a complementary instrument to increase the disposable incomes of such workers. As these schemes tend to include an element of work incentive, the amount of the benefits is typically a function of gross earnings with phase-in and phase-out elements. In other words, total benefits tend to increase as earnings increase and, beyond a certain threshold, remain flat, and then begin to fall. This design encourages low-paid workers to stay in the labour market.

30. Examples include the earned income tax credit in the United States, the working tax credit in the United Kingdom, or the "prime pour l'emploi" (PPE) in France. In France, the group of experts that has reviewed the national minimum wage since 2009 considers that the most important determinant of poverty is the insufficient number of hours worked, before the low level of hourly wages. It therefore considers that minimum wage alone cannot solve the problem of poverty and that it must be complemented by so-called in-work benefits and other measures of social protection. [52] The experience of the United Kingdom prior to 1999 shows however that in the absence of a minimum wage, in-work benefits may turn into some kind of wage subsidy when companies feel that they can shift some labour costs to tax credits. [53] Both measures are therefore complementary.

31. Finally, the introduction of in-work benefit schemes may be challenging for developing countries, especially during the crisis, given the massive size of the informal economy and the existing budgetary constraints. Yet, despite the obvious constraints, recent experiences in developing countries show that their implementation may be possible. [54] In the Philippines, for instance, non-wage benefits packages were introduced during the economic crisis to improve income for low-paid workers. One of these packages is the exemption from income tax payment, which was estimated to add about 37 to 61 pesos per day (slightly more than 10 per cent of the minimum wage) to the disposable income of

[50] See J-P. Fitoussi and J. Stiglitz: *The ways out of the crisis and the building of a more cohesive world*, The Shadow GN, Chair's summary (Rome, LUISS Guido Carli, 2009). See also M. Kumhof and R. Ranciere: *Inequality, leverage and crises*, IMF Working Paper No. 10/268 (Washington, DC, 2010).

[51] For a review of policies in industrialized countries, see H. Immervoll and M. Pearson: *A good time for making work pay? Taking stock of in-work benefits and related measures across the OECD*, IZA Policy Paper No. 3 (Bonn, Institute for the Study of Labour, 2009).

[52] P. Champsaur: *Salaire minimum interprofessionnel de croissance : Rapport du groupe d'experts* (Paris, Ministère du travail, des relations sociales, de la famille de la solidarité et de la ville, 2009), p. 6, available at http://www.ladocumentationfrancaise.fr/rapports-publics/094000572/index.shtml.

[53] D. Metcalf: "Nothing new under the sun: The prescience of W.S. Sanders' 1906 Fabian Tract", in *British Journal of Industrial Relations*, Vol. 47, No. 2 (2009), pp. 289–305.

[54] For a review, see T. Peralta and E. Guirao: *Low-paid workers in the Philippines*, National technical report prepared for the ILO *Global Wage Report 2010–11*.

minimum-wage earners. [55] At the same time, when in-work benefits remain a difficult policy option, broader income-transfer schemes, which are not related to employment and earning status, can be used. Examples include the *Bolsa Familia* in Brazil or *Child support grants* in South Africa.

III. Conclusions and points for debate

32. This paper has presented data on recent trends in wages that show a sharp slow down of global wage growth during the global economic and financial crisis. This short-run development can be placed in a context of subdued global wage growth in the long run, especially in the advanced countries where wages have become increasingly decoupled from gains in labour productivity. It has also discussed the role wage policies can play in addressing these imbalances towards a sustainable and broad-based recovery from the crisis. In the light of the above, the ESP may wish to shed further light on the experience gained with policy instruments, in particular:

(a) how collective bargaining can help to strengthen links between labour productivity and wages and create an environment that supports a virtuous circle of productivity gains and wage growth and thus employment and economic growth and development;

(b) the role of minimum wages in setting a wage floor, protecting low-paid workers, and ensuring that economic recovery translates into rising living standards for all;

(c) the experience with a broader income policy, including in-work benefits and cash transfers, in addressing working poverty and contributing to domestic demand;

(d) issues regarding the coherence between the above policy tools, and ways to ensure their complementarity; and

(e) how skills development and small enterprise development can contribute to enhanced labour productivity in small and medium-sized enterprises, thereby allowing a stronger and better distributed wage growth.

33. The Committee may also wish to provide further guidance to the Office for its future work on wage policies.

Geneva, 2 February 2011

Submitted for debate and guidance

[55] ibid.