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Why we should care about wages

by Patrick Belser

A labour market view of the crisis

The past two years have witnessed the worst global economic recession since 1929. The financial crisis, which started in the US and was triggered by a speculative bubble in the housing market, sent a shock wave through the real economy and labour markets around the world. The most immediate impact on labour markets has been the explosion of unemployment rates. In the US, unemployment figures have exceeded the 10% threshold in October 2009. The Euro area is not far behind, with an average unemployment rate of 9.7% in September 2009. In some European countries, the proportion of people looking for a job has reached dramatic proportions, with figures close to 20% in both Spain and Latvia.

But that is not all there is. Focusing on unemployment rates alone understates the true extent of the deterioration of employment and conditions of work in labour markets. Everywhere, the crisis has led to cuts in working time, which has damaged the living standards of workers and their families. In the 27 member states of the European Union, full-time employees work about three-quarters of an hour less every week than they did before the crisis. In the US, weekly working time for production and nonsupervisory workers has fallen by about half an hour. These average changes may seem relatively small because not everyone was affected, however, for those who were hit, the cuts in hours have often been severe. Similar trends have been observed elsewhere and, globally, the number of involuntary part-time workers appears to have increased.

The result, in most cases, has been a fall in take-home pay for workers at the end of the month. Figures collected at the ILO for 53 countries show that in 2008 real monthly wages (i.e. wages adjusted for inflation) fell in one quarter of all countries. In most other countries, particularly developing countries, wages continued to grow but at a much slower pace than before the crisis. The situation is likely to have been even worse in 2009, given the quarterly figures already available and the increase in the supply of unemployed people looking for jobs. Another worrying problem is the increase in the late-payment or non-payment of wages, particularly in transition economies such as Russia and Ukraine.

Wages and the recovery

Why should we care about wages, and not just unemployment? There are at least three reasons. The first has to do with social justice and the hardships that lower wages inflict on workers and their families, particularly at the lower end of the income distribution. In the US, 7.5 million people work for earnings that fall below the poverty level and in Europe 8% of workers can be called "working poor". For these workers even small changes in wages can represent large differences in living standards. Furthermore, the crisis comes after years of wage moderation and increasing inequality. Before the crisis, the wages of median and low-paid workers have remained largely flat despite considerable increases in economy-wide productivity. So one question is: where has the money gone? Research shows that high earners have benefited most, and that a large share of the rest has gone into corporate profits and investment.

The second reason why we should care is that a continued deterioration in wages is bad news for the economic recovery. The pace of the recovery depends largely on the extent to which people are able to consume whatever the global economy produces. And consumption, in turn, depends on the level of wages. In fact, in some advanced economies, almost 80% of household income comes from wages and salaries. Although GDP figures in the course of 2009 provided indications of a possible economic rebound, the trends in real wages observed during the past few quarters raise serious questions about the true extent of a global economic recovery and also highlight the risks of phasing out government rescue packages too early. As the experience of Japan during the past decade has cruelly shown, wage deflation deprives national economies of much needed demand and can result in lengthy periods of economic stagnation.

Finally, we should already be thinking about the post-crisis world. Before the crisis, in the period from 1995-2007, the share of wages in GDP had declined in a majority of countries for which data is available. This may have been due to a combination of weaker trade unions, labour-saving technology, openness to trade and the pressures arising from the financial of markets. Whatever the cause, the imbalance between increasing profits and stagnating wages has contributed to the crisis by creating an explosive mixture of high liquidity on financial markets, low rates of interest, and huge household debts. A system of bonuses which distorted incentives towards short-term risk provided the additional dynamite. For a more stable future, we should identify policies which ensure

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that productivity growth - when it is back - translates into adequate increases in wages for a majority, and not just higher bonuses for a few. Only this way can advanced economies achieve more sustainable patterns of consumption and investment.

Where to start?

The first immediate priority for governments in advanced economies has been to provide support to economic activity through large fiscal stimulus packages. Through this channel governments have provided some much needed demand for goods and services, which in turn has prevented a further decline in labour demand, employment and wages. Thanks to these measures, a social catastrophe has been avoided. For a sample of 19 OECD countries, the ILO estimates that fiscal stimulus packages have prevented between 3.2 million and 5.5 million additional jobs losses.

A majority of governments in OECD countries have taken additional measures to limit the damage inflicted by the crisis on employment and wages. One effective method has been the use of work-sharing arrangements, which have often combined shorter working times (to avoid layoffs) with wage subsidies. The latter have been provided through partial unemployment compensation or from general government revenues. According to the OECD, 22 out of 29 countries surveyed have put in place such a system. The most publicized example has been the case of Germany's "Kurzarbeit" (short work) which has benefitted up to one and a half million workers. Companies have also benefitted from being able to keep their skilled workers on the payroll. Given the severity of the employment crisis, these temporary measures should not be phased out to early.

Worldwide, a considerable number of countries have also increased the purchasing power of low paid workers through minimum wages. Figures collected by the ILO show that in 2008 half of 86 countries sampled have increased the minimum wage in real terms. A number of countries, including major economies such as Brazil, the US, Japan and Russia have pursued this policy in 2009. Minimum wages can have negative impacts on employment if they are set too high. However, the more recent literature shows that when set at a level which takes into account the situation of workers and their families as well as productivity and other economic factors (as recommended in ILO Convention 131), minimum wages can increase the living standards of low-paid workers at little or no cost to aggregate employment. And for individual companies that are in such severe economic difficulties that they cannot even afford to pay minimum wages, there is always to possibility to provide smart exemptions or tax incentives, as is done in Indonesia for example.

But the deeper, more challenging need is to strengthen collective bargaining over wages. The ILO's Global Wage Report in 2008/09 showed that when a large share of workers is covered by collective bargaining agreements the transmission mechanism between productivity and wages works pretty well: over the period 1995-2007 a 1% increase in GDP per capita (an indicator of productivity growth) translated into an almost equal increase in wages. But where the coverage of collective bargaining is weak, the report calculated that each additional 1% growth in GDP per capita only led to a 0.65% increase in average wages. Thus, governments and social partners would be well advised to start consultations on how to strengthen constructive collective bargaining as part of a wider set of economic and industrial policies that can contribute to a fairer and more sustainable global economic recovery.

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