DEAR MEMBERS,

At the joint meeting of the IOE Industrial Relations and Employment Working Groups in October 2013, participants expressed the need for some guidance on the concept of the living wage in order to understand its importance for business organisations and its implications on company operations.

This guidance paper addresses the main issues of the concept and aims to assist employers’ organisations and companies on how best to approach the living wage debate.

We would be pleased to receive additional data from your national contexts to enrich this guidance, as well as your feedback on the paper.

Yours sincerely,

Brent H. Wilton
Secretary-General
Executive Summary

RECENT DEBATE AT INTERNATIONAL AND NATIONAL LEVEL IS BRINGING BACK THE CONCEPT OF THE LIVING WAGE AS A USEFUL TOOL FOR COMPANIES OPERATING GLOBALLY, NOT ONLY IN THE EMPLOYMENT RELATIONSHIP WITH THEIR EMPLOYEES, BUT ALSO IN MANAGING THEIR SUPPLY CHAIN.

It is often presented as a means for effectively tackling wage challenges related to the lack of worker protection in weak governance areas. The concept itself is not new, but the current approach goes to some extent beyond the initial purposes for which it was designed. Some debates on national wage policies also make reference to living wages.

Given that some NGO and multistakeholder initiatives are pushing for the concept to be integrated into CSR strategies, companies and employers’ organisations need to be informed to respond adequately.

Generally, wage policy discussions encompass different concepts, including, among others, minimum wages, prevailing wages, average wages and living wages. When political debates arise on the definition of a minimum to be paid to employees, all concepts raise controversy from different quarters. This demonstrates how wage policies aimed at establishing a minimum wage require employers and employers’ organisations to be able to effectively influence the discussions.

Minimum wages represent the lowest level of pay, established through a minimum wage fixing system, to be paid to a worker by virtue of a contract of employment; prevailing wages are the rate currently paid to workers on the basis of their category and location; average wages are the mean salary paid to workers in a determined area or industry.

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1 Minimum wages can be set by statute; decisions of the competent authority; decisions of wage boards or councils; industrial or labour courts or tribunals; or giving the force of law to provisions of collective agreements.
**Living wages**

**THERE IS NO GENERALLY AGREED DEFINITION OF THE LIVING WAGE.**

The concept presents problems because of its vague nature. As underlined below, its intrinsic lack of specification makes it ultimately difficult to handle and counterproductive in terms of improving worker protection and decreasing informality, as it was not initially designed to influence company wage policies.

The introduction of living wages is supposed to have increasingly positive effects on poverty alleviation, as more basic needs are included in its definition. However, this outcome has often been questioned. For instance, OECD\(^2\) research has found that the poorest households are those where no one is working and therefore neither living nor minimum wages would directly contribute to their poverty alleviation.

There is also abundant literature arguing that minimum wages may in the medium and long term increase poverty and unemployment (particularly among workers with low productivity), and hinder business development\(^3\). This could be said for living wages too, but given the diverse and wide definition of what can be considered as basic needs, living wages could be up to six times higher than minimum wages for low productivity sectors\(^4\). This “excessively high minimum wage” could be even more counterproductive to employment creation and the competitiveness of companies and in the long term adversely affect the economic development of a country. Indeed, referring to living wages has to properly include consideration of national economic factors such as inflation, the cost of living, etc, the fluctuation of which depend on the country’s specific economy.

Beyond that, and although the “livability” concept has been used and developed at international level through Declarations, Conventions and Covenants, it remains highly problematic when applying it to companies. Diverse definitions of living wages consistently refer to them as wages that allow workers to meet their own and their dependents’ basic needs.

Basic needs may include items such as:
- Housing
- Food
- Childcare
- Education
- Transportation
- Healthcare
- Taxes
- Saving for long term purchases and emergencies
- Other basic necessities (social security)

**Living wages and minimum wages**

**GOVERNMENTS, EMPLOYERS, WORKERS AND ACADEMICS HAVE DIFFERENT PERSPECTIVES ON THE CONCEPTS OF THE MINIMUM WAGE AND THE LIVING WAGE.**

Living wages are essentially labour market interventions conceived as instruments of social regulation, without economic connotation, aimed at reducing inequalities and contributing to poverty alleviation. They were designed less to ensure fair compensation to employees, unlike minimum wages. Early attempts to introduce living wages were made in Australia and New Zealand at the beginning of the 20th century.

Also unlike the living wage, regulation on the minimum wage is widespread. The vague nature of the “livability” concept makes it difficult for countries to fix their minimum wages by referring exclusively to living wages. **Only a few countries** (for example, Indonesia and Colombia) use a reference to a living wage as part of a minimum wage setting system, together with other economic parameters.

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\(^2\) OECD, 1998

\(^3\) “50 years of Research on the Minimum Wage” (Joint Economic Committee – Congress of the United States” (1995), OECD 1998

Methodologies to measure living wages

THE FOLLOWING METHODOLOGIES HAVE BEEN USED TO DETERMINE THE BASIC NEEDS OF THE WORKER AND HIS FAMILY:

- The **national poverty line level**, set by governments, takes into account regional/sectoral specificities.
- The **full market basket approach** considers a complete basket of goods to meet the basic needs of a family, according to the composition of the household and the number of wage earners. The basket is meant to provide a 2500-3000 calorie diet per person per day.
- The **extrapolated market basket approach** uses as a basis for measurement the food expenditure of an average consumer, multiplied by the number in the household and divided by the number of wage earners. Another (low) percentage is added to this amount for discretionary spending.
- The **relative income measure**, based on the median pay of hourly earnings of a country. Half of the median pay would be considered as low pay. To avoid having to continuously update national hourly earnings, an additional amount of $2 per day (setting the poverty line) has been proposed as an absolute minimum below which half of the median pay cannot fall.\(^5\)

All these methodologies have pros and cons, but none seem to be appropriate in defining basic needs. Irrespective of the methodology, the living wage concept is more a social concept than a mathematical equation. For this reason, it is not suitable for companies to apply to their wage policy, especially for those located in weak governance areas, or in countries with low surveying and statistical capacities.

The ambiguity of the “livability” concept

THE MAIN LIMITATIONS OF THE “LIVABILITY” CONCEPT ARE THE FOLLOWING:

- **The basic needs of workers and their families are diverse** and it is difficult to define and measure them in an objective way (there is no mathematical formula which takes into account the diversities among households);
- **The idea of “livability” often gets confused with similar ideas, such as the subsistence wage, poverty line, and/or relative income.** There is no agreement on these elements, or on other elements that can be considered as the basis for the “living” measurement, such as the household size, the number of wage earners, the level of needs (adequate, medium, low). Moreover, the methodologies outlined do not take into consideration other variations, namely the level of economic and social development of the country, the capacity of employers to pay, the productivity rate, the level of technology, the inflation rate, the unemployment rate; etc.
- **The intrinsic ambiguity of the concept makes it likely to lead to unrealistically high wage levels and to create dilemmas** for companies, incurring negative consequences on job creation and competitiveness. It also affects the capacity of companies to survive in the formal economy. Furthermore, it can reduce the capacity of employers to hire and to pay workers, and therefore can decrease the number of jobs in a given industry.
- **It could lead to unjustified discrimination** among workers, as it is not easy to objectivize the different elements in its definition. Its introduction could also alter perceptions of poverty in certain countries, so considering people not receiving the (higher) living wage poorer than they are in reality;
- It risks **shifting on to companies the responsibility that public authorities should assume in ensuring the basic needs of individuals**

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\(^5\) Anker et al, ILO 2002
by way of national social protection policies, to which employers already directly contribute (for instance national policies providing social insurance for health protection or social assistance covering housing, family care, etc.). Living wages subsidized through public financing would decrease the burden on the private sector, however with possible consequences on increased income taxes, which might in effect diminish the intended benefits.

- Measurement of basic needs may pose greater difficulty along the supply chain, also because of the lack of data in weak governance areas.

Living wages in international law


The principle of the “provision of an adequate living wage” is included in the Preamble to the Constitution of the International Labour Organization, and The Minimum Wage Fixing Convention (No. 131) and Recommendation (No. 135), 1970, deal with living wages.

Other references to living wages are to be found in the 1977 ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy and in the 1976 OECD Guidelines for Multinational Enterprises.

Nevertheless:

1. All these provisions have to be properly interpreted in their context and framework; none were conceived to create an international legal obligation on States or companies for a living wage.

2. Even if this concept appears to be a legitimate reference as a goal for public policies, none of these organizations, or UN Member States, have developed them in a concrete way, mainly due to the uncertainty and lack of practical approach that this concept lends itself to.

3. These references were initially introduced as objectives of public policies, as well as globally legitimate aspirations, rather than concrete obligations for companies within an employment relationship.

However, further pressure for engagement at international level can be seen in the OECD Guidelines which include a reference to “best possible wages” or, alternatively, wages covering “basic needs of the workers and their families”. They also state that “Enterprises should seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship. This is not intended to shift responsibility from the entity causing an adverse impact to the enterprise” [...]. Therefore it can be argued that this reference to wages applies beyond the direct relationship of multinational companies with their own employees in the country.

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6 Article 23, paragraph 3 states: “Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity, and supplemented, if necessary, by other means of social protection”

7 Article 7 recognises that the right to “Remuneration which provides all workers, as a minimum, with: … (ii) A decent living for themselves and their families in accordance with the provisions of the present Covenant”.

8 ILO Convention 131 established the level of minimum wage as the combination of both social (living) factors and economic ones (“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” and “the requirement of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment”).

9 Paragraph 34 reads as follows: “When multinational enterprises operate in developing countries [...] they should provide the best possible wages, benefits and conditions of work, within the framework of government policies. These should be related to the economic position of the enterprise, but should be at least adequate to satisfy the basic needs of the workers and their families. Where they provide workers with basic amenities such as housing, medical care or food, these amenities should be of a good standard”.

10 This does not prevent companies’ action to “encourage, where practicable, business partners, including suppliers and subcontractors, to apply principles of responsible business conduct compatible with the Guidelines”.
Best approach for companies

WHILE REFERENCES TO LIVING WAGES ARE BEING USED BY SOME NGO AND MULTISTAKEHOLDER INITIATIVES IN MONITORING LABOUR STANDARDS IN COMPANIES, BUSINESSES SHOULD TAKE PARTICULAR NOTE OF THE DRAWBACKS OF SUCH A CONCEPT.

Doing so would prevent them from having to ensure that suppliers compensate with wages that, depending on the elements used to define basic needs, could be two to three times prevailing wage rates in a given industry. As mentioned above, the concept lacks clarity and there is no consensus at national or international level. Attempted application of the concept could also create discrimination among workers, and, instead of being effective in resolving reputational or non-compliance risks in the supply chain, it could create additional difficulties for companies in weak governance areas.

The same could be said for SMEs striving to remain competitive and for whom an obligation to pay too high minimum wages would mean closing down, or shifting into the informal economy.

Therefore, it is highly recommended that companies look at more efficient alternatives as part of human rights/CSR, human resources, or wage policy strategies. In order to minimise reputational risk in supply chains or as a result of human resources policies for instance, more concrete references could be useful: national minimum wages where they exist, minimum wages as set up in collective agreements, or a general legal compliance approach.

Additionally, a multistakeholder approach to wage policies will be much more effective, with positive effects on the whole business environment and SMEs’ capacity to remain competitive. Indeed, it is important to bear in mind that challenges over compliance in the supply chain affect not just companies acting globally, but also other actors (international organisations, UN and non-UN agencies, NGOs and Trade Unions, regional organisations, consumers, business organisations, etc.) and this has to do with other factors such as the inefficiency and/or weakness of public institutions, including judicial systems; lack of appropriate adaptable legal frameworks; the absence of an attractive business environment; absence of a compliance culture; intensive migration phenomena; significant demographic change; lack of appropriate competences and qualifications; and widespread corruption, among others.

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The IOE is the largest network of the private sector in the world. With 150 business and employer organisation members in 143 countries, it is the global voice of business.