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What are governments doing about low-wage employment – and how successful is it?

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Key points

- There are three main approaches across OECD countries to tackling low-wage employment: (i) state support for collective bargaining, (ii) statutory minimum wages, and (iii) substantial in-work benefits in addition to a statutory minimum wage.
- All countries maintain a wage floor in one of two ways: either through a statutory minimum wage or by supporting the organisational conditions for collective bargaining.
- Over time, statutory minimum wages have become increasingly important, while state support for collective bargaining has declined.
- State support for collective bargaining appears most successful in containing low-wage employment.
- If they are high enough, statutory minimum wages can be effective in reducing low-wage employment.
- In-work benefits foster more low-wage employment.

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Introduction

About 16 per cent of workers in the European Union (EU) earn less than two-thirds of their country's median wage, which is the conventional definition of low-wage employment (data from OECD for 2020, the last year with relatively complete data across the EU). This affects women in particular. About 19 per cent of female workers receive low wages, and about 14 per cent of men. In eastern EU Member States the share of workers on low wages is higher than the EU average, reaching up to 29 per cent in Bulgaria. In the Nordic and Southern Member States, it tends to be lower than average and can be as low as 4 per cent in Italy. These figures are for full-time workers, however, and disregard the often poor pay deals of workers on part-time contracts and some other forms of non-standard employment, such as zero-hour contracts and bogus self-employment. Nevertheless, the figures show that low pay is a widespread problem in the EU and varies significantly across countries.

Generally, as unemployment has attenuated, European policy debates have increasingly shifted toward the topic of precarious employment. Debates about poor pay are also driven by growing concern about economic inequality. These debates have focused to a considerable extent on minimum wages. Countries as different as Poland and Spain, among others, have substantially increased the statutory minimum wage. Italy is debating whether to introduce a statutory minimum wage, and in Germany the adequacy of the biannual reviews of minimum wage levels is contested. These are only a few examples. Trade unions point to the importance of collective bargaining in fighting low-wage employment, whereas some policy experts recommend using public benefits to supplement low-wage workers' incomes. The most important EU-level debate concerned the introduction of the directive on adequate minimum wages (Schulten and Müller 2021). Adopted in October 2022, the directive consists of three main elements. First, it instructs Member States to establish robust procedures for setting adequate minimum wage levels. Second, it requires Member States with collective bargaining coverage below 80 per cent to adopt national action plans to increase bargaining coverage. Third, the directive includes measures to improve the enforcement of minimum wages. The cost-of-living crisis since 2021 has created new challenges for the adequacy of minimum wages and collective agreements (Müller 2023).

In this policy brief we contribute to debates on low-wage employment by mapping the comparative policy context. In particular, we ask: Which policies are European states and other developed countries using to address low-wage employment? And which policy approach is most successful in containing low-wage employment (Pedersen and Picot 2023)?

Comparing policy instruments

Generally, states have three main policy tools with which to address low-wage employment: statutory minimum wages, support for collective bargaining, and in-work benefits. Statutory minimum wages are the most straightforward tool, prohibiting wages below a certain level. Of course, the choice of level is crucial, as are the institutions for adjusting it over time.

Support for collective bargaining matters because collective agreements, by defining wage scales, typically define the lowest possible wage and are thus de facto an alternative way of setting minimum wages (Dingeldey et al. 2021; Picot 2023). There are two distinct, but not mutually exclusive ways in which states can support collective bargaining. First, they can foster the organisational conditions for collective bargaining. This often involves backing unions, as they press employers to enter into collective agreements. But wide membership of employers' associations is also important for bargaining coverage (Müller et al. 2019). Strong unions require a regulatory framework that effectively guarantees freedom of association, the right to collective bargaining, and the right to strike. Furthermore, states can enhance union and employer association visibility and legitimacy by actively involving them in public policymaking through corporatist arrangements. States can also incentivise union membership by allowing unions to administer unemployment insurance (so-called Ghent unemployment insurance) or through tax rebates for membership fees.

Second, states can extend the coverage of collective agreements by, for example, mandating all firms in a certain sector to adhere to an agreement, even those that have not signed it. In this case, the state fills the gaps where collective bargaining falls short, rather than by helping the social partners to achieve better coverage from their organizational strength. In several European countries such statutory extensions are applied frequently and are an important tool for propping up bargaining coverage. In the research underlying this policy brief (Pedersen and Picot 2023), however, we have chosen to focus on the first way of supporting collective bargaining: support for organisational conditions. Still, Picot's (2023) analysis of minimum wage regimes, which includes statutory bargaining extensions, is consistent with the results presented here.

In-work benefits are public transfers to workers or households who are working but have low earnings. They can come in many different forms. The best known are the Working Tax Credit in the United Kingdom (currently being merged into the Universal Credit) and the US Earned Income Tax Credit. While policies such as these are explicitly targeted at low earners, other policies can have an equivalent effect: for example, family benefits, housing benefits, or tax allowances. Here, we consider both explicit in-work benefits and the wider generosity of the tax-benefit system for low-wage earners.

Of course, low-wage employment can be affected by other policies, such as regulation of non-standard employment, active labour market policies, vocational training, immigration policies, or out-of-work benefits. We focus on the three abovementioned policies because they shape low-wage employment more directly and specifically. Certainly, support for collective bargaining is rather broad, but low wages are a central issue in collective bargaining, and many unions pay particular attention to them (see, for example, the European Trade Union Confederation's campaign 'Europe needs a pay rise' in 2017–2018).

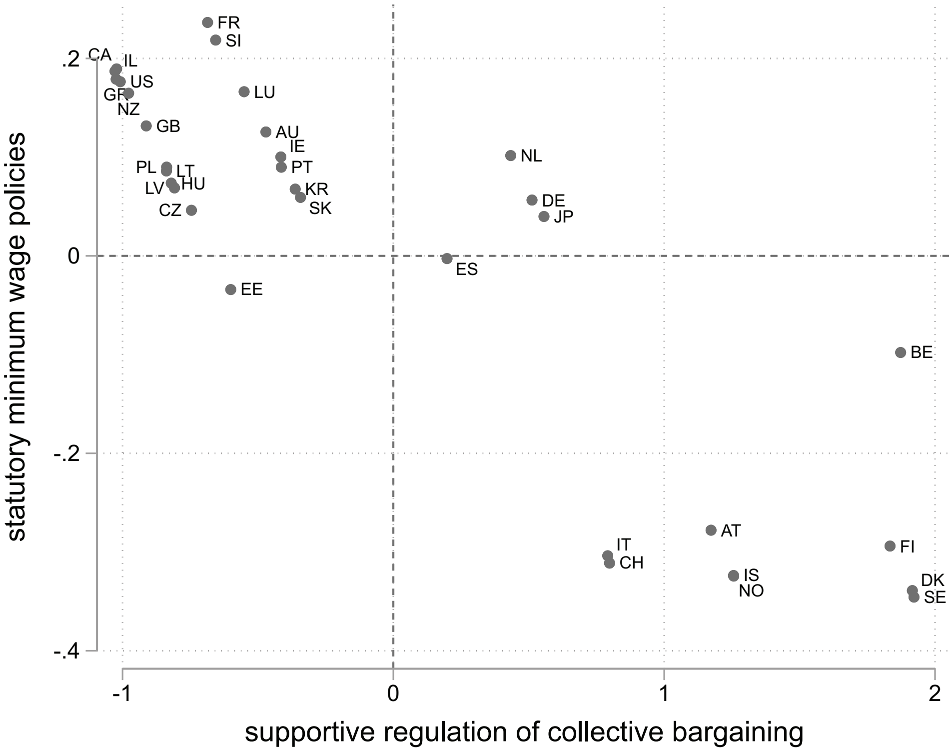
By design, the three policies of interest here have distinct distributive implications. Common to statutory minimum wages and supportive regulation of collective bargaining is that they directly set a wage floor (statutory minimum wage) or contribute to setting one through collective agreements. By contrast, in-work benefits 'accept' low wages and try to improve workers' economic circumstances through additional income from the state. Consequently, the first two policies force higher costs on employers, while the costs of in-work benefits are borne by the public. (Note that the higher costs for employers may lead to productivity investments and increased product demand – they are thus not necessarily a burden.) There are three important differences between statutory minimum wages and support for collective bargaining. First, collective agreements normally define not only the lowest wages but all wage grades. This also protects the wages of workers not at the bottom of the wage scale. Second, while mechanisms for setting the level of statutory minimum wages may differ, they ultimately depend on rules set by elected politicians (Mabbett 2023). This gives workers less control over minimum wages than in collective agreements, with the direct participation of trade unions. On the other hand, and third, a statutory minimum wage has the advantage that it equally applies to all workers (although minimum wage laws can define exceptions, such as for young workers), whereas collective bargaining is differentiated by sectors or firms, and coverage is often limited.

What European and other developed countries are doing about low-wage employment

When analysing the variation of the three low-wage policies across countries, we combined several measures into one index per policy, using confirmatory factors analysis (Pedersen and Picot 2023). For statutory minimum wages, we took their level (measured in relation to a country's median wage) and information on the extent to which the government or social partners control level-setting. For supportive regulation of collective bargaining, we initially used a wide range of measures: effective right to collective bargaining, effective right to strike, legal provisions for works councils, the extent to which wage bargaining is coordinated between sectors and levels (which we use as a proxy for corporatism), and union-administered unemployment insurance (known as the 'Ghent system'). The first three proved not to add substantial information. Thus, the final measure combines wage coordination and Ghent unemployment insurance. For in-work benefits, we measured the generosity of the tax-benefit system for two different types of households with low earnings, as well as an indicator of whether there is a dedicated benefit for low earners.

A first striking finding was that statutory minimum wages and state support for collective bargaining are closely and negatively correlated. This means that states always use one of the two policies. It makes perfect sense that governments do not introduce a statutory minimum wage when they successfully support collective bargaining. It is more surprising, given the recent strength of neoliberal politics and business interests (Baccaro and Howell 2017), that all developed democracies do one or the other: they either support collective bargaining or have a statutory minimum wage. States in the bottom right of Figure 1 exhibit strong support for collective bargaining. None of them, except Belgium, have a national minimum wage. States in the top left of Figure 1 have well-established legislation on minimum wages and offer notably less support for collective bargaining. As mentioned, we focus on support for the organisational conditions of collective bargaining and do not consider statutory extensions of collective agreements. Statutory extensions would not substantially alter the distribution, however (Picot 2023). A few countries in the top left frequently use this instrument (France, Portugal and Spain), but most of the others make little or no use of it. Conversely, the two countries furthest to the bottom-right (Denmark and Sweden) do not apply statutory extensions at all, but the others apply them widely (Belgium, Finland and Iceland), have functional equivalents (Austria and Italy), or apply them to some extent (Norway and Switzerland).

Figure 1 **Scatterplot of statutory minimum wage policies and supportive regulation of collective bargaining**

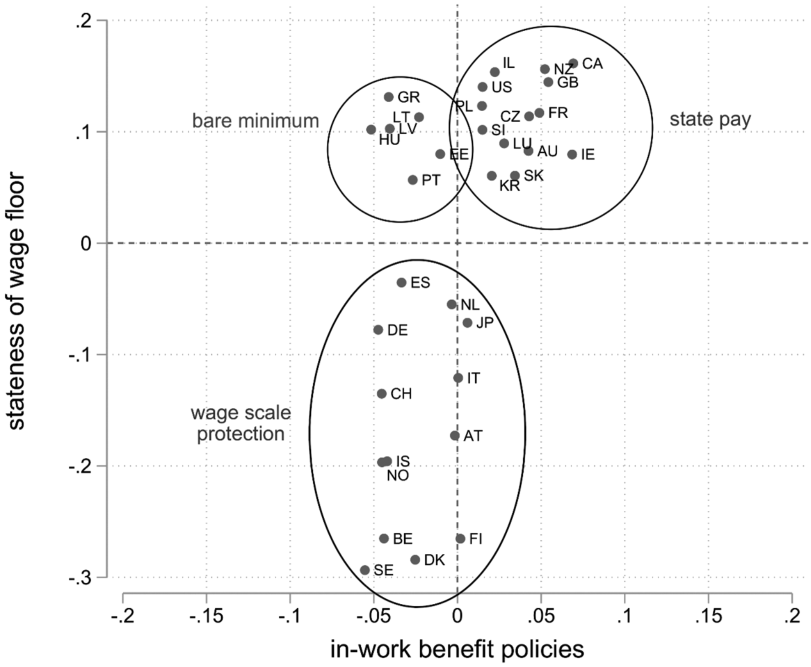


Note: the figure is based on confirmatory factor analysis. The value of 0 corresponds to the mean. The data is from 2017. Country acronyms: Australia (AU), Austria (AT), Belgium (BE), Canada (CA), Czech Republic (CZ), Denmark (DK), Estonia (EE), Finland (FI), France (FR), Germany (DE), Greece (GR), Hungary (HU), Iceland (IS), Ireland (IE), Israel (IL), Italy (IT), Japan (JP), Latvia (LV), Lithuania (LT), Luxemburg (LU), Netherlands (NL), New Zealand (NZ), Norway (NO), Poland (PL), Portugal (PT), Slovak Republic (SK), Slovenia (SI), South Korea (KR), Spain (ES), Sweden (SE), Switzerland (CH), United Kingdom (GB), and United States (US).

Source: Pedersen and Picot (2023).

Because the two policies – statutory minimum wages and supportive regulation of collective bargaining – are so closely related, we can merge the two measures into one, which then represents the degree to which the wage floor is determined directly by the state rather than by social partners (which one may refer to as the ‘stateness’ of the wage floor). Figure 2 presents this new measure together with our measure of in-work benefit policies.

Figure 2 **Developed countries' approach to low-wage employment on two dimensions: state determination of the wage floor and in-work benefit policies**



Note: the figure is based on a confirmatory factor analysis. The value of 0 corresponds to the mean. The data is from 2017. The three ellipses indicate groups of countries with substantively and statistically distinct policy approaches. For country acronyms, see note under Figure 1.

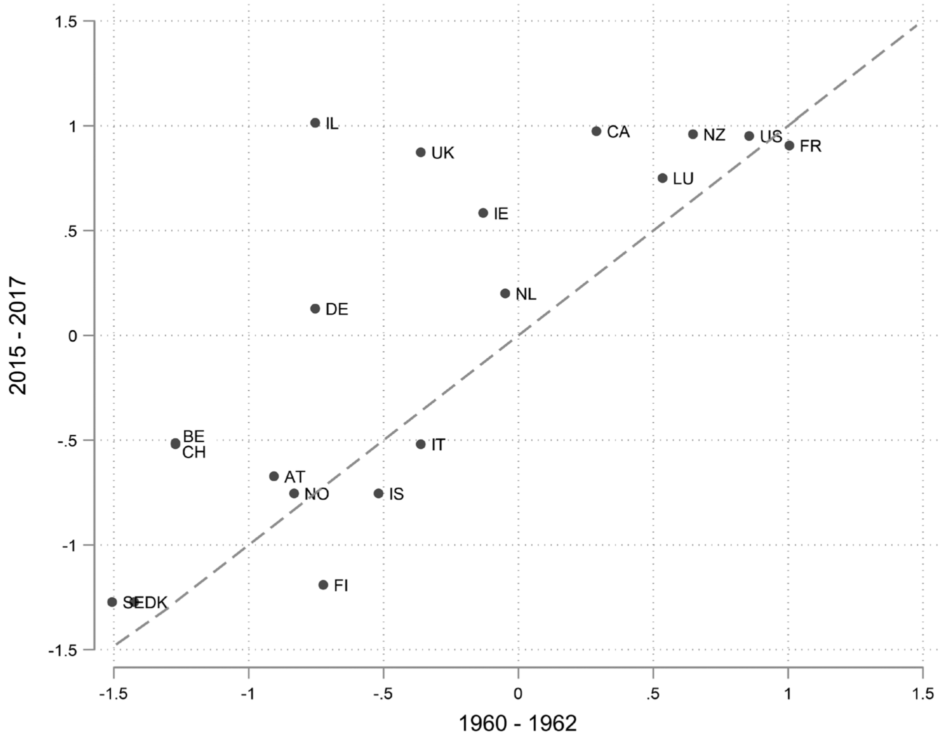
Source: Pedersen and Picot (2023).

In Figure 2 we identify three distinct state approaches to low-wage employment. First, in countries in the bottom left, state policy regarding the wage floor emphasises support for collective bargaining, while doing little in terms of in-work benefits. We call this approach 'wage scale protection' because its most important implication is that workers above the wage floor are also protected from sliding down the wage scale. In this group we find the Nordic countries, most Continental European countries, as well as Italy, Spain and Japan. Second, the countries in the top left have well-established statutory minimum wages, but little support for collective bargaining, and no generous in-work benefit policies. Accordingly, we call this approach 'bare minimum'. Here, we find several Eastern and Southern European states. Third, in the top right of the figure countries supplement their statutory minimum wages with generous in-work benefit policies. We dub this approach 'state pay' because it entails that a substantial share of low-wage workers' incomes comes from the state. In this group we find the familiar countries of liberal capitalism, as well as France and Luxembourg, some Eastern European countries, and South Korea.

Analyses of this data over time show a secular trend away from support for collective bargaining towards statutory minimum wages. In Figure 3, all countries above the diagonal line moved towards higher state-determination of the wage floor between 1960 and 2017. The main reason for higher scores for state influence here is that countries introduced statutory minimum wages.

This trend has to be interpreted in light of the well-known decline in industrial relations and collective bargaining in many countries over recent decades (for example, Baccaro and Howell 2017). Indeed, research shows that erosion of collective bargaining coverage goes a long way towards explaining why countries introduce a statutory minimum wage (Kozák and Picot 2023; Meyer 2016).

Figure 3 **Change over time in state determination of the wage floor, 1960 to 2017**



Note: values averaged over three years on each axis to even out noise in the data.

Source: Pedersen and Picot (2023).

For in-work benefits we have data only since 2001. Here, we do not observe a clear-cut trend, but on average in-work benefit policies have been rising rather than declining in importance.

What works in tackling low-wage employment?

We also investigated the levels of low-wage employment associated with the three low-wage policies. First, we simply looked at the shares of low-wage employment within each policy approach (see Table 1). Low-wage employment is lowest where the wage scale protection approach is taken. The bare minimum approach has substantially more low-wage employment and the state pay approach has most. The same pattern holds for wage inequality between low earners (bottom decile) and median earners.

Table 1 **Policy outcomes by policy approach to low pay, 2017**

Policy approach	Average low-wage employment share	Average 10^{th}–50^{th} wage inequality
Wage scale protection	9.57	1.520
Bare minimum	15.97	1.745
State pay	17.66	1.754

Note: the policy approaches are explained above and identified in Figure 2.

Source: Pedersen and Picot (2023).

We further investigate the findings presented in Table 1 by making sure they are not driven by other differences between the groups of countries with different policy approaches, such as differences in unemployment, share of service employment, or size of international trade. We did this with a dataset that stretches back in time (from 2001 to 2017) and we focussed on the effect of individual policies (Pedersen and Picot 2023). Statistical regressions showed that strong collective bargaining, especially high bargaining coverage, is the best way to contain low-wage employment, although statutory minimum wages, when set at a high level, are also effective.

Our regression results for in-work benefits (measured broadly as the generosity of the tax-benefit system for low earners) revealed that they are associated with more low-wage employment. This is in line with our theoretical consideration above: that in-work benefits make it easier for employers to pay lower wages. We also show that this result holds for the combination of in-work benefit policies and statutory minimum wages. This supports our argument that wage scale protection matters. In countries with in-work benefits, many workers are pushed down to the statutory minimum wage, which is often not high enough, so that they fall below two-thirds of the median wage (the statistical definition of low pay).

Conclusion

In European and other developed countries there are three distinct policy approaches to low-wage employment: (i) wage scale protection, where governments focus on supporting collective bargaining; (ii) bare minimum, where there is a statutory minimum wage but little else; and (iii) state pay, where in-work benefits are combined with a statutory minimum wage. According to our results, the first approach, wage scale protection, is most effective in containing low-wage employment, while the third, state pay, is least effective or even counter-productive. In the second, bare minimum, much depends on the level of the statutory minimum wage.

The policy trend in recent decades has been away from support for collective bargaining and towards statutory minimum wages. However, to fight low pay it is essential to protect not just workers at the bottom of the wage distribution, but also to prevent the decline of wages towards the bottom. Accordingly, we need more political focus on state support of collective bargaining. Some support measures, such as corporatism and the Ghent unemployment insurance system, are of course hard to copy in countries where unions and employer organisations are weak and fragmented. Other tools include effective legal rights for unions (in particular, right of association, right to collective bargaining, right to access the workplace, right to strike), tax rebates for membership fees, and public procurement conditional on collective agreements.

While support for collective bargaining should be preferred in tackling low-wage employment, many states, for example in central and eastern Europe, have such low bargaining coverage that collective bargaining will not resolve their problems in the short run. Hence, statutory minimum wages remain an important tool, but they must be set sufficiently high. The cost-of-living crisis has only increased the urgency of adjusting statutory minimum wages swiftly to adequate levels (Müller 2023).

Our research therefore supports the general thrust of the EU minimum wage directive because it shows that both state support for collective bargaining and adequately high minimum wages are important for countering low-wage employment (see also Haapanala et al. 2023).

In-work benefits can help low paid workers financially by propping up their overall income from state resources. However, this does not address the root of the problem: low work earnings. Rather, it exacerbates the problem by facilitating more low-wage employment.

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