

The general real wage decline in the Western Balkans may seriously reduce consumption and accelerate economic slowdown*

Wage institutions and policy suffer a number of structural weaknesses

Real wages slowed significantly in several countries of the Western Balkans in 2008 and real and nominal wages are expected to decline further in 2009, as a consequence of the wage cuts introduced recently. The drop in real and nominal wages may accelerate the reduction in consumption thereby slowing further the economic recovery of these countries – says the new ILO paper prepared for the subregional high-level conference on ‘The Impact of the Financial and Economic Crisis: Wage Fixing and Policy Responses’ which took place in Sarajevo, Bosnia and Herzegovina on 5-6 November 2009. Tripartite delegations from Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Kosovo (within the meaning of UN Security Council Resolution 1244), Montenegro and Serbia attended the conference.

Apart from real wage declines, a resurgence of the non-payment of wages and of wage arrears has also been reported in some countries such as Bosnia Herzegovina and Serbia. The crisis is likely to also increase the reliance on informal cash payments or “envelope” wages thereby underpaying social security contributions and eroding further the already low levels of pensions. All these trends will contribute to curb consumption levels. There are already signs of declining domestic demand in a number of countries in the Western Balkans. In Serbia for instance, aggregate demand in 2008-09 fell by a double-digit percentage.

While there is a need to help companies to preserve employment, wage policies can also play an important role in maintaining much needed demand and restoring confidence. Wage policies can also help mitigate poverty, which is still high in the Western Balkans. Wage levels remain the lowest in Europe and are often below the subsistence minimum. In order to avoid any massive social costs the incidence of low pay in total employment should not be allowed to increase further.

Improve minimum wage fixing

The ILO’s *Global Jobs Pact*¹, which the G20 and other countries have bought into as part of the immediate response to the crisis, warns against the threat of a wage and price deflationary spiral and points to social dialogue, collective bargaining and minimum wages as means to counter deflation. The Pact describes minimum wages as “an important policy tool for social protection” which can help reduce poverty and inequity, increase demand

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¹ *Recovering from the crisis: A global jobs pact* (Geneva, International Labour Office, 2009). http://www.ilo.org/public/libdoc/ilo/2009/109B09_101_engl.pdf

and contribute to economic stability. Countries in the Western Balkans have pursued two opposite routes on minimum wages: some countries, such as Serbia, have decided to raise their minimum wages in real terms, while others have let them freeze. The crisis has further exposed a number of structural weaknesses in wage institutions and wage policy in most countries of the Western Balkans. It would be important to continue reforms to improve minimum wage fixing in the light of the ILO's *Minimum Wage Fixing Convention, 1970 (No. 131)*. The Convention has been ratified by Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro and Serbia.

Aligning wages to productivity

Some national reports prepared for the conference (for instance, on Albania) show how poorly wages have been related to economic performance, already before the crisis. This was reflected in a generally declining wage share since the mid- 1990s. Linking wages to productivity would allow wages to increase as soon as economic recovery takes place, while it would bring some wage flexibility in periods of economic downturn, thus also helping to preserve employment. At the enterprise level, linking a part of wages to performance can be an important tool to stimulate productivity.

Wages and tax reforms

In many countries of the sub-region, the current structure of the labour taxation system (not only personal income tax but also social security contribution rules) seems to be both inequitable and inefficient. The flat-rate tax that dominates in several countries such as Serbia may have adverse effects on net wages and workers' purchasing power.

Tax reforms in relation to personal income tax in Albania, for instance – where there is no progressivity in personal income tax after the introduction of a 10 per cent flat rate – have had a negative effect on the lowest paid workers. It has also increased wage disparity. At the same time, it has led to a substantial decrease in employees' social security contributions, representing a significant revenue loss for the state. There is some evidence that it has also fed an increase in informal employment (72 per cent reported that their wages were informal), as recently reported in a survey carried out by the ILO in the construction sector (ILO, 2008b).²

Any move toward more progressive taxation and reduction in the tax burden for low-wage labour would bring improvements both in terms of efficiency and social justice. At the same time, taxes should be reformed to limit "envelope wage" practices and thus motivate employers to declare the workers' real wage levels rather than only the minimum wage.

Need for more systematic collection of wage statistics

The ILO study has highlighted a serious paradox. Although wages remain the main issue of collective bargaining, wage data remain scarce and inaccurate. Equally lacking are official estimates of subsistence minimum or poverty line. An indispensable condition for effective wage policies is that the government and social partners have equal access to relevant information and data and have the means and capacity to comprehend fully the implications of wage policy decisions on productivity, inflation and employment.

² ILO. 2008b. 'Addressing the Problem of Undeclared Work in the Construction Sector through Social Partnership in Albania', ILO- Albania, September 2008, Tirana.

Social dialogue for better adapting wage policy to the crisis

Generally, most workers in the low-pay sectors are not covered by collective bargaining. The effectiveness of social dialogue should therefore be improved to limit the effects of the crisis on low wage earners. Tripartite discussions may help to find consensual solutions to deal with the sources of the economic and social crisis. Incomes and wage policy could be debated at national level along with other important issues, such as tax reforms and pension reforms, concludes the ILO study.