

# Decent Work as a coherent policy package

## Introduction

As earlier chapters have demonstrated, the current pattern of growing income inequalities observed in the majority of countries needs to be addressed. Income inequality is partly driven by factors which are not conducive to greater economic efficiency – such as the manner in which financial globalization has developed over the past two decades or so. Observed patterns of growing income inequality also entail considerable risks from the point of view of social cohesion and continued political support for pro-growth policies. As noted in Chapter 1, perceptions that the existing distribution of income is not fair are growing.

Policy action, however, should take into account the need for rewarding work effort, innovation and skills – key drivers of economic growth and prosperity. In this respect, this report sheds light on policies and approaches for addressing income inequality to help ensure that the gains from economic growth are distributed in a more sustainable manner, while also maintaining economic dynamism. This requires action at the international level, notably as regards reform of the financial architecture. But domestic policies can make a major difference as well. Stronger tripartite institutions, well-designed labour regulations and social protection, and respect for basic workers' rights are particularly important, as earlier chapters have shown.

The purpose of this chapter is to show that the domestic policy response is best conducted as a coherent package. This is the essence of the Decent Work Agenda.

## A. Links between Decent Work and income inequality

The Decent Work Agenda provides an ideal framework for examining, collectively, the relationships and potential trade-offs among the various components discussed in this year's World of Work Report. The Decent Work Agenda is captured along four strategic objectives, namely, (i) fundamental principles and rights at work and international labour standards; (ii) employment opportunities for women and men; (iii) social protection and social security; and, (iv) social dialogue and tripartism.

### Box 6.1. Analysing the links between income inequality and Decent Work

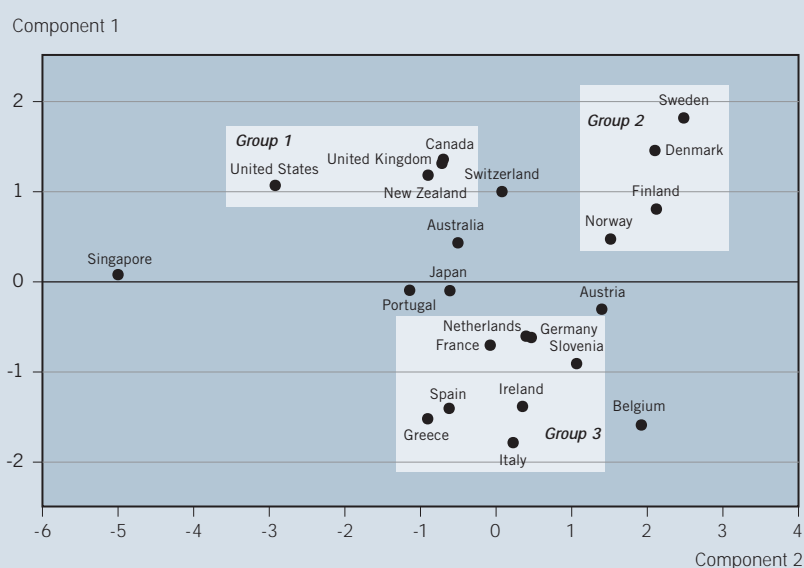
One statistical approach to measuring the relationship between policies and outcomes is the principal component analysis (PCA).<sup>1</sup> This consists of transforming the original data on policies and outcomes into so-called principal components. Each principal component is a linear combination of the original data on policies and outcomes. Principal components are ordered in such a way that the first few retain most of the variation present in all the original data.

For the purposes of this analysis, the PCA has been performed separately on countries with high and with low per-capita GDP.<sup>2</sup>

In high per-capita GDP countries, unionization, welfare state and inequality explain close to half of the variation for the first component while, labour market performance and the coverage of collective agreements explain one fifth of the variation in the second component. The analysis reveals some interesting results vis-à-vis the relationship among the variables (fig. 6.1), which can be broadly categorized into 3 groups, including:

- Group 1: This group includes Canada, New Zealand, the United Kingdom and the United States. These countries have high employment rates but high income inequalities, less regulation and lower unionization;
- Group 2: Comprises the Nordic countries in which the relationship is characterized by more social protection, less income inequality and strong labour market performance;
- Group 3: European countries exhibit more of a balance between protection, rights and income inequality (centred around the mean) but with more regulation and less employment.

Figure 6.1. Principal component analysis for high per-capita GDP countries

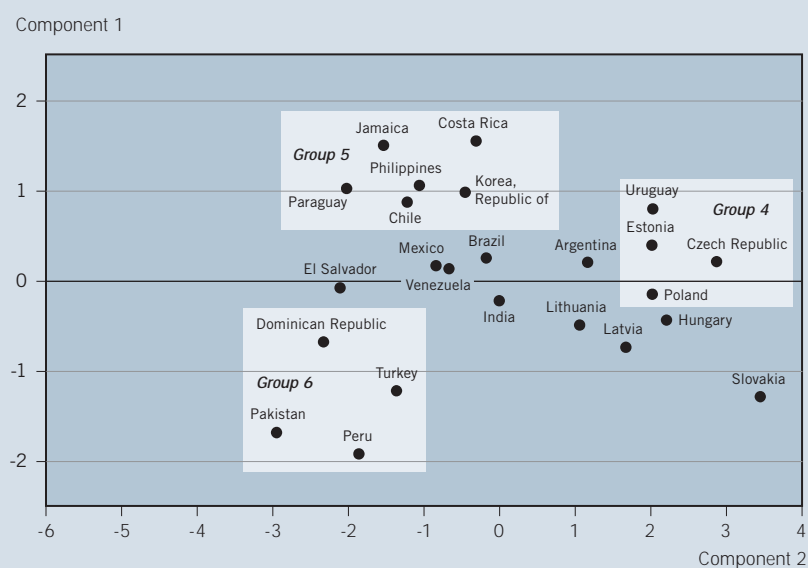


Source: ILS estimates.

In medium and low per-capita GDP countries, labour market regulation, welfare state, democracy and inequality explain over half of the variation for the first component, while for the second, labour market performance, inequality and democracy explain 15 per cent of the variation (fig. 6.2). Once again, the analysis reveals three broad categories:

- Group 4: Principally composed of transition economies of Central and Eastern Europe and Uruguay, with relatively developed welfare states and labour market regulation, together with average labour market performance;
- Group 5: A group of countries composed of Chile, Costa Rica, Jamaica, Paraguay, the Philippines and Republic of Korea that have strong employment performance, little labour market regulation or social protection and higher income inequalities;
- Group 6: A final cluster of countries (Dominican Republic, Pakistan, Peru and Turkey) characterized as having poor employment performance, high income inequalities and limited social protection.

**Figure 6.2. Principal component analysis for medium and low per-capita GDP countries**



Source: ILS estimates.

<sup>1</sup> The PCA gives a dimensionally reduced image of the original data, while retaining as much as possible the variation present in the data. Detailed calculations are available upon request.

<sup>2</sup> High per-capita GDP countries include countries with per-capita GDP above the average, and vice-versa for the medium and low per-capita GDP countries.

Individually, each of the former three issues, or an aspect of them, and their relationship to income inequality has been examined in greater detail in Chapters 3, 4 and 5, respectively. And while each chapter develops key messages and policy considerations around how best to reverse the trend increase in income inequality, the challenge for policy makers is that many of these issues are inter-related. With that in mind, an attempt is made, using the principal component analysis, to measure the relationship among the various components of the Decent Work Agenda and income inequality (box 6.1). To do so, a set of five variables along the lines of the strategic objectives of the Decent Work Agenda is considered:<sup>1</sup>

- income inequality (expressed by the Gini index as elsewhere in the report);
- trade union density and the number of ratified core ILO Conventions;
- the employment rate;
- spending on social protection as a percentage of GDP; and
- respect for political rights, including basic workers' rights.<sup>2</sup>

Some of the main findings of the analysis are illustrated in Table 6.1. In particular, two broad categories are defined as regards high employment rates, i.e. those with relatively high income inequality and those with relatively low income inequality. However, given the complexity of the interactions it is difficult to ascertain the extent to which any one

1. Each variable is expressed as the average over the period 1990-2007 and the data cover 47 countries.

2. As established by Freedom House in 2007.

factor is influencing outcomes related to employment and income inequality. In this regard, it is important to note that the evidence presented here is not intended to be causal in nature but illustrative of the various relationships among the components of the Decent Work Agenda on the one hand, and income inequality on the other.

Nevertheless, the main finding from the analysis is that it is possible to avoid excessive income inequality while achieving a high employment rate. This is the case for both high and medium/low per-capita GDP countries. For example, among high per-capita GDP countries, Austria, Australia, the Nordics and Switzerland have managed to achieve this. These countries – where employment rates are high and income inequalities relatively low – are characterized by relatively strong, employment-oriented social protection, higher than average coverage of collective agreements and well-respected political rights. Among medium and low per-capita GDP countries, countries like the Czech Republic and Uruguay have managed to achieve relatively high employment and limited income inequalities. They too are associated with relatively developed social protection, stronger tripartite institutions than in other countries, and observance of political rights.

In sum, for policy makers concerned about excessive inequalities while also sustaining employment, the Decent Work Agenda is an important tool and framework to consider.

## B. Policy coherence

The above findings highlight the complementary roles of the different components of the Decent Work Agenda. Indeed, it is likely that these objectives work best as a coherent and mutually-reinforcing package. According to the recently-adopted ILO Declaration on Social Justice for a Fair Globalization, “the four strategic objectives are inseparable, inter-related and mutually supportive (...). To optimize their impact, efforts to promote them should be part of an ILO global and integrated strategy for decent work” (ILO, 2008).

The experience of Argentina provides an example of the important role of policy coherence. Argentina’s economic and social crisis of 2001-2002 was marked by high unemployment, a regressive distribution of income, and increasing poverty. Novick et al. (2007) explain how Argentina emerged from this recessionary context by mounting a systematic effort to integrate policies and also assert that the policy approach was inspired by the concept of decent work.

In particular, in the wake of the 2001 crisis, Argentina embarked on an effort to link economic, labour and social policies, in order to transform production, boost employment, improve incomes and income distribution, and stimulate social mobility. Key steps taken by the State included the following:

- the promotion of decent work was explicitly mentioned as a priority objective of government policies (a first in Latin America);
- an integrated employment plan entitled More and Better Jobs was launched to promote training of unemployed workers and entry into quality jobs;
- labour legislation was restored, and social protection and social dialogue were promoted;
- a National Plan for the Regularization of Work was launched, and increased staff and resources were dedicated to address high levels of unregistered employment;
- emphasis was placed on analysis and monitoring of labour market developments and on the generation of information to support decision making; and,
- active income policies were established, including the reinstatement of a minimum wage, the encouragement of collective bargaining, and a pensions policy.

**Table 6.1. Successful employment performers: two illustrative models**

	Welfare state <sup>1</sup>	Tripartite institutions <sup>2</sup>	Violation of Political rights <sup>3</sup>
<b>High per-capita GDP countries</b>			
High employment/low inequalities (e.g. Austria, Denmark, Finland, Norway, Switzerland and Sweden)	16.2	3.7	1.0
High employment/high inequalities (e.g. New Zealand, United Kingdom and United States)	11.0	1.0	1.0
<b>Medium and low per-capita GDP countries</b>			
High employment/low inequalities (e.g. Czech Republic, Estonia, Hungary and Uruguay)	14.1	2.2	1.6
High employment/high inequalities (e.g. Costa Rica, Jamaica, Mexico, Paraguay and Philippines)	2.1	1.2	2.4
Notes: 1. Welfare state is the average share of social protection expenditure as a percentage of GDP. 2. The measure for tripartite institutions ranges from 1 (few collective Conventions) to 4.7 (many). 3. Violation of political rights ranges from 1 to 7, 1 being low in terms of violating political rights.			
Source: ILS estimates, see box 6.1.			

Since 2001, Argentina has achieved strong economic growth, and has made significant improvements in a number of social and labour indicators. Novick et al. (2007) emphasize that the coherent nature of the reforms was a key reason why the country was able to make a rapid recovery from crisis conditions: policy coherence gave rise to a virtuous circle of demand, employment and investment, which led to a reduction in poverty, lower unemployment, a rise in real wages, and wider coverage of collective bargaining. However, it is important to note that other factors were also likely at play. For example, to a large extent, the economic gains realized by Argentina were due to favourable international conditions and the switch to a floating exchange rate, which allowed the country to produce goods that were competitive in the international market.

In many ways Argentina's strategy reflects the spirit of the Decent Work Agenda, in that government combined efforts to boost employment, reduce poverty, and address distributional concerns. This coherent policy suite promoted job creation and a strengthening of social dialogue, while limiting increases in income inequality.

Similarly, in the late 1990s, structural change, job losses, expanding poverty and worsening income distribution in Brazil brought increased demands for new forms of government intervention (Marshall, 2004). This came in the form of labour market measures to support social protection and employment, including unemployment insurance and training schemes, and assistance to small employers and self employed workers. In 1998, a "package against unemployment" was introduced and while a direct employment creation program was not implemented at the national level, several states and municipalities developed programs on a smaller scale. Widespread social security reform was also undertaken; for example, changes were introduced to create incentives for private-sector workers to postpone retirement, based on the length of their contribution to the social security program. Marshall notes that although funding for many of these measures was fairly limited relative to GDP, the new framework of policies constituted a steady, long-term effort not only aimed at job creation but also concerned with job quality.

Beyond implementation of a coherent package of reforms, ensuring the sustainability and permanence of such reforms is necessary for success, but represents an additional challenge. First, given the nature of the interactions of the various policy planks of the Decent

Work Agenda, measuring progress and isolating impacts of various changes is difficult and is likely to depend considerably on initial conditions in each country (an area for further work – see below).

Second, successfully institutionalizing a coherent policy suite also depends on the availability of funding, notably as regards the financing of suitable social protection schemes and the development of well-functioning institutions, e.g. training systems that respond to labour market requirements. This may mean either a re-allocation of resources or raising new funds.

Finally, the level of political will may well determine the long-run sustainability and success of any coherent policy package as, inevitably, there will be difficult choices to be made.

## C. Areas for further analysis

This report has established a number of facts about income inequality, employment and causal factors. It has also paved the way for policy action in order to address excessive income inequalities, while supporting employment and economic growth.

However, more work needs to be done in order to understand what domestic policies work best, where and under what circumstances. The following areas are particularly relevant for further research:

- A better understanding is needed regarding one of the key factors behind excessive income inequality in some countries, namely employment informality. This calls for an examination of the diverse causes of employment informality and possible policy avenues to promote transitions to formal employment.
- Another domestic policy for which additional research is needed concerns tax policy. There is some agreement – reinforced by analysis in this report - that well-designed social protection can serve both employment and social goals. Yet, little is known about arrangements for funding social protection, especially in the context of developing countries where the tax base is limited and further weakened by the presence of a large informal economy. This year's World of Work Report has also shown that taxes of high incomes have tended to decline, which could be problematic in the context of growing income inequalities, while also weakening the ability of countries to undertake redistribution policies. It would be useful to assess whether there is a risk that international tax competition is putting downward pressure on taxation of incomes of high-income groups.
- Finally, it is important to examine in more detail the role of policy coherence between the different planks of the Decent Work Agenda. This can best be done in the context of country reviews, which is ideal to analyse policy interactions and possible trade-offs.

Further analysis is also needed to follow-up on the report's analyses of financial globalization and corporate governance:

- The current financial system calls for reforms in the regulation of the financial architecture, in particular with respect to prudential regulation and financial supervision. However, no consensus exists as to the optimal regulatory framework and proposals vary from tight regulation for money creation by the banking sector (e.g. through high reserve requirements) to only small modifications to the current supervisory framework (e.g. emphasising macro-prudential regulation to detect systemic risks at an earlier stage). These various proposals come with significantly different implications for

job creation and wage growth. Future work in this area should, therefore, focus on those types of regulation that promise a maximum beneficial impact on Decent Work goals.

- Shedding further light on the design of policies for the development of domestic financial systems is also needed, including the role of monetary policy in promoting employment creation in the medium term. This should help to improve upon distortions in the payment and credit system, allow a better channelling of funds to local entrepreneurs and firms, and help to regulate liquidity growth in line with economic fundamentals, with a view of stimulating sustainable employment creation.
- More work should be devoted to the question of global and regional responses to currency and banking crises. In particular, the setting-up of regional currency areas to allow smaller and more vulnerable countries to benefit from a large, diversified monetary union should be evaluated from the point of view of its labour market implications. Further analysis is needed regarding the conditions that need to be satisfied for currency unions among developing countries to successfully attenuate the risk of external shocks for its members.
- Finally, the issue of executive compensation has attracted considerable attention recently. Some countries have started to take action in this regard, while others are considering several reform options. And, it would be useful to examine the pros and cons of different measures from the point of view of sustainable enterprise development and Decent Work.

## References

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