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Policy Brief

The EU directive on fair and adequate minimum wages

Low-pay work, collective bargaining and the prospects for income growth

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#MinimumWageDirective
#EuropeanSocialModel
#CollectiveBargaining

The EU directive on adequate minimum wages marks an important change from previous policies in the field of labour relations. It introduces two novelties. First, by laying the foundations for a common governance of minimum wage-setting mechanisms, the directive could lead to a rise in minimum wages. Second, it lays out guidelines intended to strengthen the role of social actors in wage bargaining. In doing so, the directive differs from previous approaches advocated by the Commission on the need for member states to boost income growth. While post-Euro crisis recommendations were mostly centered on reducing labour costs, this directive reflects a greater concern in policymaking circles for the social role which income growth can play.

Introduction

The directive on fair and adequate minimum wages constitutes, as a report by the European Parliament puts it, a 'watershed moment'. This is not only because it marks the first time that the **Commission is acting concretely on the issue of low-paid work**, but also because its introduction **marks a clear recognition by it of the important role that social actors and collective bargaining institutions play in building social market economies in EU member states**. While the policy recommendations issued after the Eurozone crisis were characterized by fiscal retrenchment and liberalization of the labour market and employee relations, the Juncker Commission presided over a gradual ideological shift, leading to a reassessment of the role of the social dimension in EU policymaking. In addition to famously striving for a 'triple-A rating on social issues' and introducing the European Pillar of Social Rights (EPSR) in 2017, Jean-Claude Juncker also acknowledged the need to introduce a 'minimum salary' in member states. The von der Leyen Commission strives to continue making progress in the field of social affairs and to implement the principles enshrined in the EPSR – including guarantees on decent wages for European workers.

The next few years will not only illustrate how far member states are willing to implement the directive, but, crucially, also define the extent to which they can, where significant discrepancies arise, be challenged in court. These caveats notwithstanding, we will argue in this policy brief that the directive could bring about important changes in European employment relations.

What changes does the directive foresee?

The introduction of a minimum wage directive constituted one of the key legislative proposals set out by President of the European Commission, Ursula von der Leyen, when she presented her college to the European Parliament in 2019. In October 2020, the Commission acted on this pledge by publishing a proposal for a directive on adequate minimum wages in the EU. After two years of negotiations, the European Parliament and Council agreed on its introduction in June 2022. The final text was overwhelmingly approved by MEPs in September 2022 and adopted by the Council the following month.

Although the directive seeks to tackle in-work poverty rates and income differentials in the EU, it has not been greeted enthusiastically by all and sundry. While employers' associations focused on the fact that, as stipulated by the Treaties, the Commission has no competence in matters of pay and on member states' wage-setting mechanisms, Scandinavian trade unions argued for instance that - however well-intentioned - a directive on minimum wages might result in a harmonization of wage-setting standards and practices across member states. This, they found, would jeopardize the autonomous and sector-specific regulation of pay in Scandinavian countries and would result in an undue Commission intervention in well-functioning labour markets. Indeed, evidence shows that the Nordic countries are amongst those with the lowest rates of in-work poverty and low-pay. These preoccupations have led the Commission to clarify that the changes introduced by **the directive only concern those member states which have already introduced statutory minimum wages and that, as stated in its Article 1, the 'full respect of social partners' contractual freedom' remains guaranteed.**

Even with these reassurances, however, Nordic unions are worried that even in countries with extensive collective bargaining, such as Denmark and Sweden, collective bargaining is not universally applied. This could result in demands to set a statutory minimum wage and this could, in turn, lead to a dual wage-setting system where higher collectively bargained pay coexist with minimum wages. The concern, of course, is that employers, in an effort to reduce their labour costs, would seek to bypass pay agreements and opt for statutory regulation of wage-setting. In future, it will be important to assess the way in which the European Court of Justice (ECJ) interprets the directive's clauses and examine the way in which it could deem the directive applicable to Scandinavian countries.

Overall, the directive's reforms can be structured along the following three dimensions:

1) The directive introduces a set of clear and transparent criteria for setting minimum wage rates, and, critically, foresees a greater involvement of social actors in stipulating how these are arrived at. This marks an important difference from previous policy articulations of the Commission as regards industrial relations and wage-setting. In the years of the Euro sovereign debt crisis, the Commission has often been criticized for sidelining the role of social actors and the autonomy of wage-setting institutions, especially in Eurozone member states.

2) The directive specifies that minimum wage rates need to be coupled more closely with the year-on-year development of economic variables such as **the rising cost of living, productivity and overall average wage growth**, so as to ensure that minimum wage growth rates remain in step. Guidelines setting **out the frequency of statutory minimum wage rate updates are specified in the directive**. This is to avert the prospect of 'policy inaction', which could result in negative economic outcomes for low-wage workers such as failing to maintain their purchasing power.

3) The directive further calls on member states to implement, in consultation with social actors, national action plans designed to introduce the target of **a collective bargaining coverage rate of 80%**. These plans should seek to lay down a timeline as well as concrete steps indicating how member states intend to achieve this ambitious objective.

Contrary to earlier recommendations and guidelines set out in employment and social affairs, a **directive has greater 'legal bite', offers member states less leeway and may, in case of discrepancies, result in judicial proceedings at the ECJ.**

Possible consequences and implications of the directive on adequate minimum wages

The implications of the directive for wage levels in Europe

When the European Parliament overwhelmingly approved the minimum wage directive in September 2022, Green MEP, Mounir Satouri, argued that 'thanks to this directive, 25 million workers will see their salary increase by 20%'. This statement, much like other optimistic statements issued by a motley group of Commissioners, parliamentarians, union leaders and academics, plays up the positive consequences that the directive might have.

There is evidence that the directive **does indeed introduce guidelines on policies, which, in the academic literature, have been linked to reductions in in-work poverty rates and to greater social cohesion**. These changes crystallize around two axes for change, that is: 1) the **levels** and **growth rates** of minimum wages and 2) the **governance** of minimum wage-setting mechanisms. Such changes might well lead to an upward convergence in minimum wage rates across member states.

Minimum wages constitute a hotly contested policy electorally and a vibrant topic of research in labour market economics. In particular, the academic literature has examined the question of the employment externalities of minimum wage increases. While recent econometric evidence points to the fact that the employment externalities of moderate minimum wage increases are mostly negligible, the impact of minimum wages on other important socio-economic issues has been also scrutinized empirically. As found in the academic literature, policymakers can reduce in-work poverty rates and the incidence of low-paid work by ensuring that minimum wages are: **1) tied to the development of overall economic growth and 2) relatively generous in ratio to median wages**. The directive addresses this by specifying that the development of minimum wages should be linked to the **year-on-year development of economic indicators such as inflation or average wage growth. This way, policymakers can ensure that the purchasing power of minimum wage earners remains on a par with economic changes**. The directive also suggests that minimum wages should be set at the level of 60% of the country's median wage, a threshold under which workers are commonly considered to be at risk of in-work poverty.

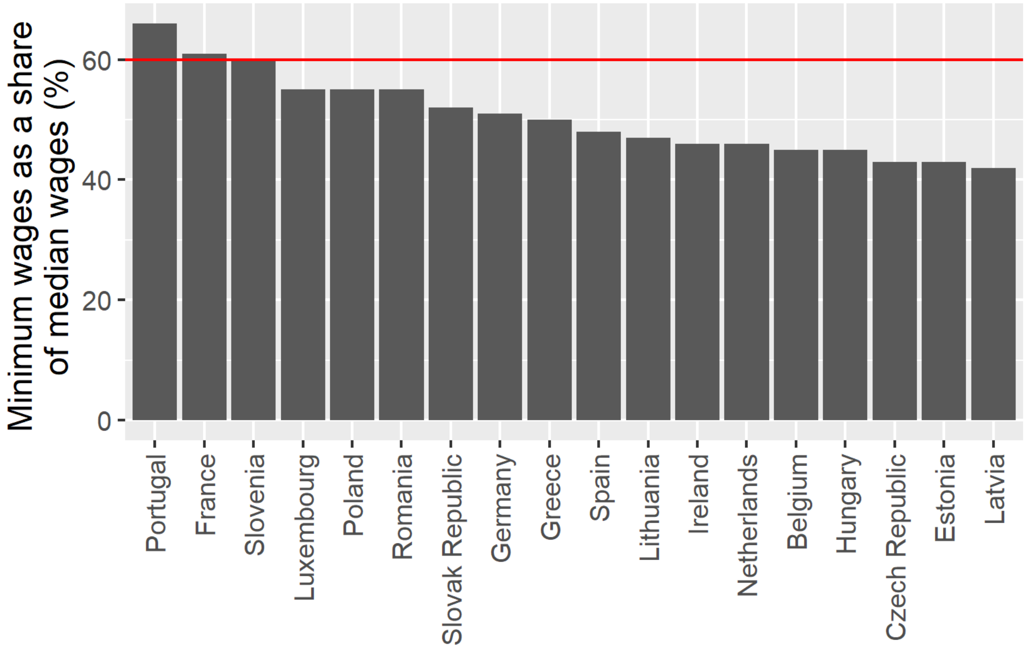

Figure 1: Minimum wages as a share of median wages of select EU member states with statutory minimum wages (2021). Source: OECD

These changes could address the steady loss of purchasing power registered amongst European low-paid workers. This is significant, as recent research from the European Trade Union Confederation has, over the past decade, recorded a real-terms decline in the level of statutory minimum wages. The policy changes introduced by the directive seem particularly important given current soaring inflation rates: low-paid workers are, in fact, disproportionally affected by inflation.

The guidelines on minimum wages are also significant because of the recommendations on the governance of minimum wage-setting mechanisms. As specified above, the **directive seeks to take steps in ensuring that social actors have a greater say here**. This can have consequences for the declared objectives of the directive, namely that of reducing in-work poverty rates and ensuring that low-paid workers earn higher wages. Indeed, empirical research has found **that countries where social actors sit on minimum wage-setting commissions tend to record higher minimum wage levels**.

As there is considerable variety in member states' industrial relations systems, the directive is likely to affect countries in different ways. As illustrated by the charts presented above, the countries which are the **furthest removed from the objectives introduced by the directive are in Central and Eastern Europe (CEE)**. This is true for both the level of minimum wages, and the governance of statutory minimum wage setting-mechanisms. Political actors exercise greater discretion in minimum wage-setting mechanisms in CEE countries compared to Western European ones. Indeed, the growth trajectories of minimum wage rates in most Western European countries are tied to developments in a series of economic indicators: the discretion, which governmental actors have on the growth trajectories of minimum wages is thereby curtailed. By anchoring minimum wage growth to economic indicators, member states can minimize the prospect of 'policy inaction' or of infrequent and unpredictable updates of minimum wage rates (as was the case for Romania and Bulgaria in 2018).

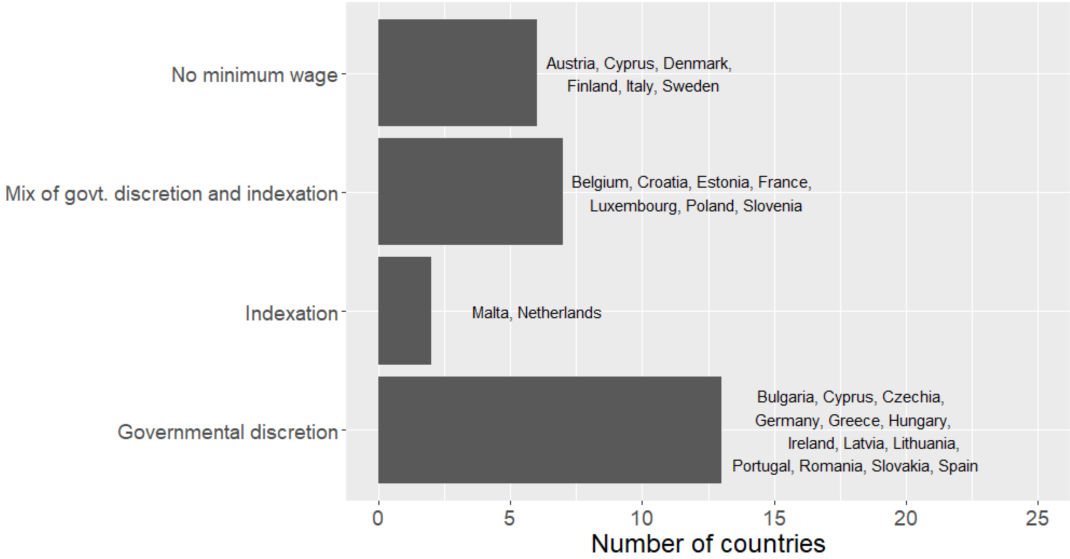

Figure 2: Minimum wage-setting mechanisms. Source: OECD/AIAS.

It is still too early to judge what the impact of the directive will be on countries' industrial relations, but all the above points would indicate that the directive will boost minimum wage growth in EU member states and that the policies called for by the directive can help reduce in-work poverty rates. The implementation of the directive is likely to have the greatest consequences for CEE industrial relations systems: with an increase and upward convergence in minimum wage levels among European countries. This, as clarified by European Commissioner, Nicolas Schmit, should help in ensuring greater upward income convergence between East and West. While the next few years will illustrate the extent to which the directive does benefit low-paid workers in Europe it seems clear that the recommendations are based on evidence-based policies.

Depending upon compliance rates, this policy brief concludes that the guidelines set out for statutory minimum wages do have the *potential* of leading to higher minimum wages across EU member states. Moreover, a recent study conducted by the ECB has found that likely strong minimum wage growth in 2022-2023 can be expected to contribute significantly to overall wages growth in the Eurozone.

Collective bargaining institutions and social actors

The directive on adequate minimum wages also sets out a series of provisions concerning the role of collective bargaining in member states' labour markets. While member states are asked to introduce national plans outlining how they intend to meet the target of **an 80% collective bargaining coverage rate, this objective seems, at least for the foreseeable future, to be more of an aspirational nature**. Collective bargaining coverage rates have been on a steady downward trajectory for most European countries. Moreover, as one can see from Figure 3, most European countries, and especially CEE countries, fall well below the 80% threshold. Reversing this trend would transform countries' industrial relations systems and would require considerable time as well as political effort.

While it is questionable how realistic the target is, especially as countries under economic adjustment programs were asked to downsize collective bargaining coverage rates in the not so recent past, **it remains an important change of direction on the part of the Commission**. This path was paved by the role which the Juncker Commission gave to social policy and the realization of the goals enshrined in the EPSR. What's more, the directive goes on to ascribe greater importance to social actors, who are seen as fundamental in guaranteeing equitable outcomes in labour markets.

Notably, the directive emphasizes that concluding sectoral and pan-industry collective bargaining agreements is important to guarantee adequate wage levels and decent living standards. This is significant, as the EU and the member states' policy response during the Euro crisis was characterized by a **decentralization of existing wage-setting systems. This has weakened social actors as employers, no longer bound by sectoral collective agreements, were allowed to exercise greater discretion in setting wages**. The guidelines set out on the issue of collective bargaining are indicative of a re-orientation of the relationship between EU institutions and social actors. Centralized and sectoral collective bargaining agreements are no longer seen as an impediment to growth, but as an important labour market institution, which can guarantee better living standards for European workers.

The projected increase in collective bargaining rates is likely to be particularly difficult to achieve in CEE countries. First because collective bargaining coverage tends to be on the very low side in CEE countries and, second, because collective bargaining agreements are negotiated bilaterally between employers and unions. This means that the state plays a marginal, if not non-existent role, in such agreements. **Targeting an 80% collective bargaining coverage rate would therefore force the state to relinquish control of the significant influence it wields over CEE countries' labour relations. This is unlikely to happen**, especially if one considers that low-paid work is a highly politicized topic on which the current governments in Poland and Hungary have, for instance, successfully campaigned.

Comparing the wording between articles which deal with changes on collective bargaining and those on minimum wages is also telling. **While changes on minimum wages are more prescriptive, the wording for the proposed changes on collective bargaining is much more vague**. Policy reform here is to be articulated via national action plans outlining how member states intend to increase coverage rates. The EU seems to be well aware of the ambitious nature of the proposed changes in this area. In fact, the text of the directive states that when assessing the progress that member states make towards the collective bargaining coverage objective, reviews should be grounded in their industrial relations systems' 'national tradition and practice'.

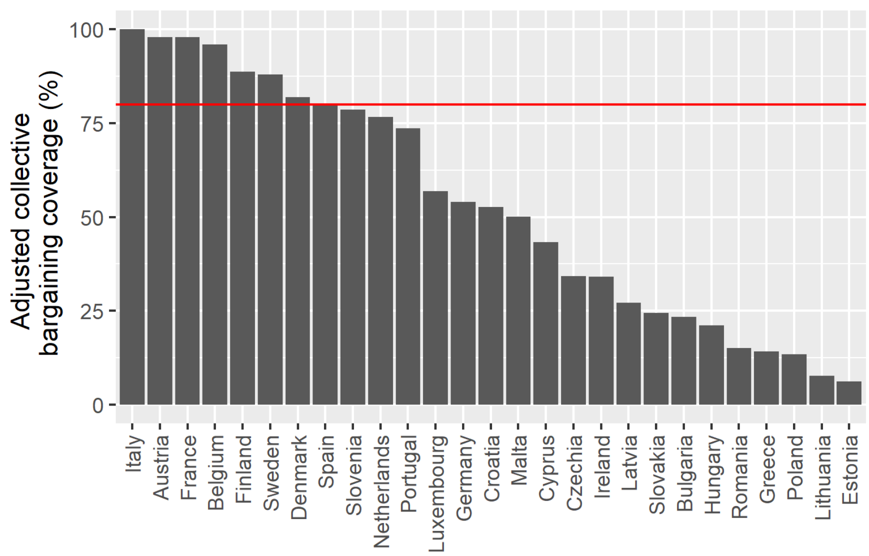

Figure 3: Adjusted collective bargaining coverage (2019). Source: OECD/AIAS.

This directive is not the first time that the Commission has engaged with member states' minimum wage policies. Under the European Semester, the Commission issues a series of country-specific recommendations (CSRs) to member states, including on the regulation of the labour market and on wage growth more generally. **Past CSRs on member states' minimum wage increases tied developments in minimum wage rates to competitiveness indicators, such as labour costs**. As competitiveness was often seen by EU policymakers as a cause of - and a cure for - the Euro crisis, the **Commission frequently recommended overall wage as well as minimum wage growth to be kept in line with developments in labour costs**. This is represented graphically in Figure 4, where one can observe that the **number of CSRs on minimum wages, urging a greater alignment to competitiveness indicators, had been particularly high during and immediately after the crisis**. With time, however, the nature of the recommendations on minimum wages has changed, as **the focus is now on increasing minimum wages and ensuring that the governance mechanisms in place are transparent and reliably implemented**.

This policy re-orientation ties in with the direction of EU policymaking towards member states' labour markets. Unlike immediately after the crisis, **more recent policies have been distinguished by a greater emphasis on the social dimension**. Similarly, in the proposed directive on improving conditions in platform work, the Commission seems to be **serious in its commitment to deliver on the policy aims of the European Pillar of Social Rights by enhancing employment protection for low-paid workers and those engaged in non-standard forms of employment**. In general, these initiatives point to the increasingly social thrust in EU policymaking. Beside the implications for minimum wages and collective bargaining coverage, the directive's biggest import is the attempt to harmonize industrial relations standards and prompt member states to recognise the normative importance of ensuring that minimum wage growth acts as a safeguard against in-work poverty.

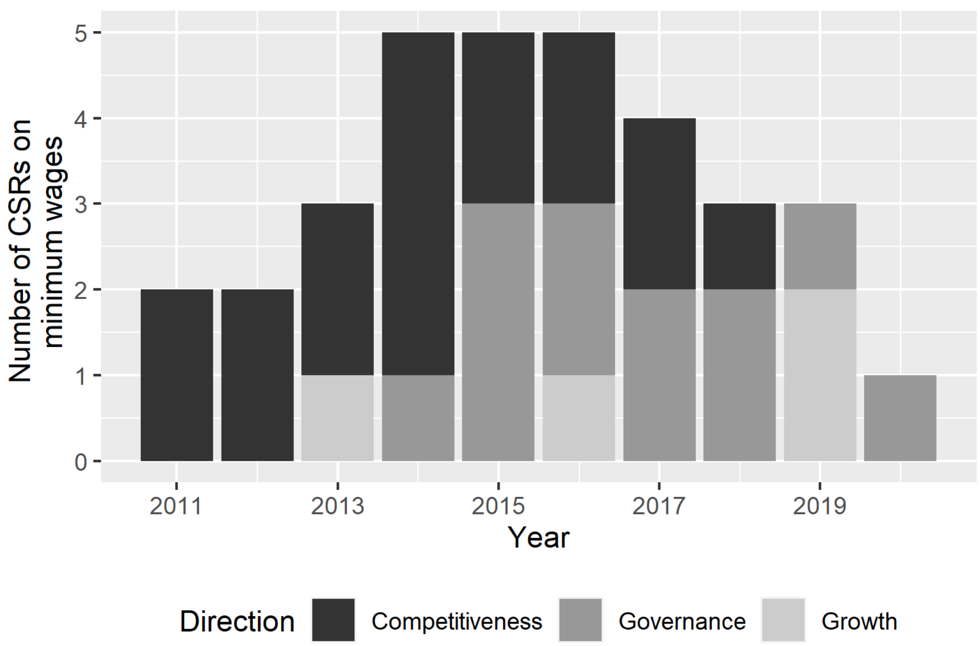

Figure 4: Number of CSRs on minimum wages (2011-2020). ***Competitiveness****: CSRs on minimum wages, which focus on aligning minimum wage growth to competitiveness targets.* ***Governance****: CSRs which call for a reform of the governance of minimum wage-setting mechanisms (e.g. increase transparency and include social actors).* ***Growth****: CSRs which encourage or discuss minimum wage growth positively. Source: Author's analysis.*

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Conclusion

The directive on adequate minimum wages points to a significant change of direction in EU policymaking in employment and social affairs. **With wide-ranging provisions on the governance of minimum wages, it marks an important step towards the realization of the goals set out in the principles of the European Pillar of Social Rights, notably a more socially resilient Europe**. While time will tell whether the wished-for convergence among minimum wages will take place or not, the directive does set out important guidelines on the governance of minimum wages, strengthens the role of social actors and, more generally, defines important normative notions of what the role of social actors should be in a well-functioning and equitable European social market economy. From a policy perspective, the changes introduced by the directive follow solid empirical evidence, which identifies adjustment of minimum wage rates to a series of economic indicators as an important tool to reduce inequality rates and foster equitable labour market outcomes. Similarly, regular and timely updates of minimum wage rates as well as the inclusion of social actors in minimum wage-setting mechanisms have, as discussed, also been linked with positive outcomes on income inequality and in-work poverty.

Beyond the regulation of minimum wages, the **directive is also noteworthy for the more important role it assigns to social actors:** seen as key players in implementing reforms which can improve working conditions for European low-paid workers. **This policy brief has argued that the directive is more likely to have an impact on the governance of minimum wage-setting mechanisms, which might, in turn, lead to higher minimum wages across the Union, than on the extension of collective bargaining agreements**. The well-intentioned objective of a collective bargaining coverage rate of 80% seems overly ambitious, if not unrealistic, and unlikely to introduce systematic change, in particular in CEE countries' industrial relations. Critically, however, **the EU no longer sees widespread collective bargaining coverage and agreements as an obstacle to growth, but rather as an important strategy designed to ensure that European workers attain (and keep) decent living standards**.

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