

# ACCOUNTING FOR JUST WAGES: A PROPOSAL

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## Abstract

Few firms provide corporate social responsibility (CSR) reports, and even fewer report on issues relating to the duty to pay a “just wage” as this duty is understood by the tradition of Catholic Social Thought (see the *Compendium of the Social Doctrine of the Church*, Chapter Six “Human Work,” V. “The Rights of Workers,” §302 “The Right to Fair Remuneration and Income Distribution”). In this paper I address the question of how a firm might implement a system to fulfill a commitment to pay just wages, and make a concrete proposal for reporting standards concerning just wages.

## I. Preliminary Issues

1. Terminology The English translation of the *Compendium* (§302) uses the term “just wage,” and characterizes this in terms found in Vatican II’s *Gaudium et spes*: “Remuneration for labor is to be such that man may be furnished the means to cultivate worthily his own material, social, cultural, and spiritual life and that of his dependents...” Such language is not readily translatable into operational terms, but the description suggests what is often referred to as a “fair wage” or a “living wage,” as well as a “just wage.” While there is no generally accepted definition or methodology of calculating a just wage,<sup>1</sup> one methodology that exemplifies the notion is the formula that grew out of the 1998 International NGO Living Wage Summit: a living wage is equal to “Average family size/average number of adult wage earners x Cost of nutrition + clothing + health care + education + water + child care + transportation + (Housing + Energy/Average number of adult wage earners) + Savings (10% of income).”<sup>2</sup> The calculation of “just wages” should incorporate the value of non-wage benefits such as health care coverage, housing allowances, etc.
2. Is a discrete disclosure on just wages really needed? Yes, it is. Paying a just wage is one of the essential components of CSR, so that any adequate reporting of CSR should include specific disclosures concerning this issue. The language of the *Compendium* makes this clear: “*Remuneration is the most important means for achieving justice in work relationships*” (italics in original) such that “they commit grave injustice who refuse to pay a just wage” (§302).
3. CSR Reporting System Accounting for just wages should take place in the framework of an entity’s integrated CSR reporting system.<sup>3</sup> Only such an integrated approach can fulfill the two important reporting criteria of completeness (which ensures all relevant information is presented) and materiality. The CSR report should be included as an integral part of the firm’s annual report, which traditionally focuses on financial reporting. While a number of firms present CSR reports separately from their financial reports, to do so reinforces the misperception that CSR is of minor importance in

comparison to the firm's financial performance. But this is not correct. If a firm does not integrate CSR information into its annual report, then it provides only an incomplete picture of the firm, a picture that excludes materially important information in evaluating the firm's overall performance.

## II. Steps in the Implementation of Just Wages

1. The firm makes a formal commitment to ensuring just wages for workers. (This might be included in an overall statement of the firm's CSR commitments.)
  - a. An essential issue is the specification of the set of workers to which the firm's commitment currently extends. Does the firm extend its commitment to all its employees, or just some subset, e.g., full-time employees? Does the firm's commitment extend beyond its own employees to include those of wholly- or partially-owned subsidiaries? Or perhaps even beyond these to contractors and suppliers? In theory, the greater the extent of coverage the better. But this area raises a host of knotty issues, e.g., can the firm exercise any control over non-employee wages? Hopefully, the range of this commitment could be extended through time.
  - b. Another essential issue is whether the commitment currently extends to all the labor markets in which the firm operates. It may be that the firm begins acting on its commitment in selected labor markets as prototypes, and then extends its operational commitment over time to other labor markets.
  - c. To ensure the effectiveness of the firm's commitment, this commitment should be reflected in the evaluation and compensation of the relevant managers.
  
2. Definition Since there is no generally-agreed upon definition of a just wage, the firm must determine its own working definition of "just wage." It should document the source of the definition and its justification. As part of its CSR program, the firm should monitor theoretical developments in this area, and change its definition should this be appropriate.
  
3. Methodology Since there is no generally-agreed upon methodology of determining a just wage, the firm must specify its methodology (including how frequently a fair wage is recalculated). There appear to be two broad approaches, one purely quantitative, one qualitative.<sup>4</sup> Perhaps the most important aspect of a qualitative approach is that it usually involves consultation with workers and other stakeholders. This is desirable in itself as it provides the workers more participation in the firm (see *Compendium* §281, "Work, the right to participate"). As part of its CSR program, the firm should monitor theoretical developments in this area, and change the methodology should this be appropriate.
  
4. Incorporation into a firm's payroll system, and thence budgeting, performance evaluation, and planning "Just wage" reporting must be incorporated into a firm's payroll system. In addition to the normal information in the system, (including, of course, the actual wage paid) two additional pieces of information should be added in order to track information related to just wages: a) the current market wage for each

job classification (and thus each individual), and b) the current just wage prevailing in the labor market. This information will allow the firm to calculate a) the additional labor cost attributable to paying actual wages over the market wage due to the firm's commitment to pay just wages, and b) for workers whose wages fall short of a just wage, how much in additional wages would need to be paid to these workers in order to bring them to the level of a just wage. These amounts are required for both budgetary purposes and for tracking the performance of the firm relative to fulfilling its commitment to pay just wages.

5. Audit procedures Adequate audit procedures must be in place to ensure that the system is functioning properly, proper documentation and internal controls are maintained, and that information is accurately recorded and processed. Besides the normal internal audits, the firm should hire an independent third-party of recognized competence and integrity in the field of CSR auditing to provide an opinion on the firm's CSR operations, systems, and reports.<sup>5</sup>

### III. Reporting Proposal

In the CSR portion of the firm's annual report would be a section labeled: "**Just Wages.**" This section would include the following information.

1. The firm's definition of just wages
2. Methodology
  - a A general description of the methodology used to determine the just wage and the market wage within labor markets.
  - b If different methodologies are used in different markets, an explanation for this.
  - c A statement of how frequently the just wage is recalculated
  - d A specification of the set of workers to which the firm's commitment and reporting relating to just wages extends.
3. Performance This information is intended to provide a two-year summary of the performance of the firm relating to just wages. I have included in this summary 1) information on the number of labor markets and workers for which the just wage is higher than the market wage, and 2) the value of additional resources (not including administrative costs) related to fulfilling the firm's commitment to pay just wages. The information in this section probably would best be presented in tabular form, so I present an example on below. Furthermore, a longer-term trend analysis could be very useful, especially when it is taken together with the management Commentary (see 4 below).
  - a Relevant Markets and Employees Disclose:
    - i The ratio of (the number of labor markets in which just wages monitoring takes place) to (the total number of the firm's total labor markets).
    - ii the number of labor markets in which the firm does business in which the just wage for the firm's labor was higher than the market wage;
    - iii the number of workers for whom the just wage was higher than the market wage.

- b Full just wages: Markets, workers, amounts Disclose:
- i of those markets falling under 3a<sub>ii</sub>, the number of markets in which all workers were paid full just wages;
  - ii of the workers falling under 3a<sub>iii</sub>, the number of these who were paid a full just wage.
  - iii for the workers included in 3b<sub>ii</sub> ("full just wage workers"):
    - 3.b.iii.1. the total "just wage differential," i.e., the total amount of the wages paid over and above the prevailing market wages for these workers,
    - 3.b.iii.2. the ratio of the "just wage differential" to total prevailing market wages for these workers
- c Below Just wages: Markets, workers, amounts Disclose:
- i of those markets falling under 3a<sub>ii</sub>, the number of markets in which workers were not paid full just wages;
  - ii of the workers falling under 3a<sub>iii</sub>, the number not paid a full just wage,
  - iii for the workers included in 3c<sub>ii</sub> ("below just wage workers"):
    - 3.c.iii.1. the total "partial just wage differential," i.e., the total amount of wages paid over and above the prevailing market wages;
    - 3.c.iii.2. the ratio of "partial just wage differential" to total prevailing market wages for these workers;
    - 3.c.iii.3. the total "just wage deficit" i.e., the total additional amount of wages the firm would have had to pay these workers to bring their wages to the just wage level;
    - 3.c.iii.4. the ratio of the "just wage differential deficit" to total prevailing market wages for these workers.

Some might object that such a detailed presentation is not necessary, but every piece of information contributes to a full picture of the firm's performance in the area of satisfying its commitment to pay just wages. Without the information on the monitored labor markets relative to total labor markets, one cannot gauge accurately how fully the firm's commitment to just wages has become operational. Without the information on the labor markets and workers, the extent of the firm's challenge in this area is not known. The distinction between a) markets in which just wages are fully paid and b) markets in which just wages are not fully paid, is one vital measure of how completely the firm has satisfied its commitment, and what is left to be done. Similarly, providing the actual monetary values of what I call the "wage differentials" and the "wage deficits" and the corresponding percentages relative to market wages are vital measures of the resources the firm has employed already to satisfy its commitment, and the amount of additional resources the firm needs to satisfy its commitment fully. Such information is useful. For instance, in the example I provide below the firm is paying 10.6% above market wages on average to pay full just wages in certain labor markets, but it is failing to pay full just wages in other markets even though it is paying a premium of 20% over market wages in those markets. This suggests that the gaps between just wages and market wages can vary dramatically from labor market to labor market, and sometimes the resources of the firm can be strained to fill this gap. Indeed, the very viability of operations in such markets can be a challenge to firms: the difference between paying the

market wage and paying a just wage may, in such markets, be the difference between a profit and loss, between long-term value-added to the company and a long-term drain on company assets. That is important information for the firm as a whole, and for assessing the performance of the firm in the area of just wages in particular. Such information provides the background to meaningful stakeholder analysis, especially when the information is seen in the context of both the firm's financial statements and the firm's performance with respect other elements of corporate social responsibility.

4. Management Discussion This might be included elsewhere in the CSR report, e.g., in an overall statement of the firm's performance relative to its CSR commitments, but it should merit its own paragraph or section. This discussion would address the firm's commitment, performance, and plans in this area, including:
  - a An affirmation of the firm's commitment to pay just wages, and when this was adopted.
  - b A brief discussion of any recent changes in the firm's definition of "just wages," or in its methodology for calculating them.
  - c A brief discussion of what workers and what labor markets are covered by this commitment, recent changes in either of these, and any plans to change these in the near future.
  - d A brief analysis of the reported data, including year-to-year changes.
  - e The obstacles to paying full fair wages to all workers, and what steps, if any, the firm is taking to overcome those obstacles;
  - f A general specification of what reasonable audit procedures are performed to ensure the integrity of the above information;
  - g Any analysis of longer-term trends in this area, beyond the two-year period presented.

**EXAMPLE OF TABULAR PRESENTATION OF**  
**“III.3. ENVIRONMENT AND PERFORMANCE”**

I. Just Wages: Markets, Workers	2006	2005
[Monitored Labor Markets/ Total Labor Markets] <sup>1</sup>	75%	65%
Labor Markets: just wage>market wage <sup>2</sup>	50	45
% of Total Labor Markets	36%	30%
Workers: just wage>market wage <sup>3</sup>	56,000	51,500
% of Total Workers	25%	24%

II. FULL Just Wages	2006	2005
Labor Markets <sup>4</sup>	42	38
Workers <sup>5</sup>	51,300	47,200
Just Wage Differential <sup>6</sup> (€thousands)	10,260	7,316
Just Wage Differential <sup>6</sup> /Market Wages <sup>7</sup>	10.5%	8.6%

III. BELOW Just Wages	2006	2005
Labor Markets <sup>8</sup>	8	7
Number of Workers <sup>9</sup>	4,700	4,300
Partial Just Wage Differential <sup>10</sup> (€thousands)	1,410	1,182
Partial Just Wage Differential <sup>10</sup> / Market Wages <sup>7</sup>	20.0%	18.6%
(Just Wage Deficit) <sup>11</sup> (€thousands)	(470)	(408)
(Just Wage Deficit) <sup>11</sup> / Market Wages <sup>7</sup>	(6.7%)	(6.4%)

1. The ratio of (the number of labor markets in which just wage monitoring takes place) to (the total number of the firm's labor markets).
2. Number of relevant labor markets in which the just wage was higher than the market wage.
3. Number of relevant workers for whom the just wage was higher than the market wage.
4. Of the labor markets in Table I, the number in which all workers were paid just wages.
5. Of the workers in Table I, the number paid just wages or higher.
6. **Just Wage Differential** The total wages to workers over the market wage for these same workers.
7. Estimated market wages for the relevant workers.
8. Of the labor markets in Table I, the number in which some workers were paid below just wages.
9. Of the workers in Table I, the number paid below just wages.
10. **Partial Just Wage Differential** The total wages to workers over the market wage for these same workers. (NOTE: these are corrected from the five-page summary.)
11. **Just Wage (Deficit)** The additional amount of wages that would need to be paid to workers receiving below just wages to bring them to full just wages.

**APPENDIX 1:****Calculations for Presentation Table**

(NOTE: This is a purely hypothetical example for purposes of illustration)

	<b>2006</b>	<b>2005</b>
<b>FULL JUST WAGES (Just wage&gt;market wage)</b>		
Workers	51,300	47,200
Market Wage per worker	€ 1,900	€ 1,800
Actual Wages (=just wage) per worker	€ 2,100	€ 1,955
Actual Wages (=just wages)	€ 107,730,000	€92,276,000
Market Wages	€ 97,470,000	€84,960,000
<b>Just Wage Differential</b>	<b>€ 10,260,000</b>	<b>€ 7,316,000</b>
<b>Just Wage Differential/Market Wages</b>	<b>10.5%</b>	<b>8.6%</b>
<b>PARTIAL JUST WAGES (Just wage&gt;market wage)</b>		
Workers	4,700	4,300
Market Wage per worker	€ 1,500	€ 1,480
Actual wages per worker	€ 1,800	€ 1,755
Just Wage per worker	€ 1,900	€ 1,850
Actual Wages	€ 8,460,000	€ 7,546,500
Market Wages	€ 7,050,000	€ 6,364,000
<b>Partial just wage differential</b>	<b>€ 1,410,000</b>	<b>€ 1,182,500</b>
<b>Partial Just Wage Differential/ Market wages</b>	<b>20.0%</b>	<b>18.6%</b>
Just wages	€ 8,930,000	€ 7,955,000
Actual Wages	€ 8,460,000	€ 7,546,500
<b>Just Wage Deficit</b>	<b>€ 470,000</b>	<b>€ 408,500</b>
<b>Just Wage Deficit/Market Wages</b>	<b>6.7%</b>	<b>6.4%</b>

## **ADDENDUM:**

### **A hypothetical example of a socially committed firm paying below just wages**

A reader of this proposal commented that he doubted that any firm would report failing to pay just wages once it had committed to do so. He may be correct, but I think there are some interesting cases in which firms might. Here is a hypothetical example.

Consider a struggling firm that is committed both to the principles of Catholic Social Thought, including paying a just wage, and to a vigorous program of corporate social reporting. The firm's products are sold in a highly competitive market so they have little upward price flexibility, it cannot improve its product mix, and there are no viable new products on the horizon. The company's financial performance is break-even, and its cash flow is just barely adequate even though it runs a lean operation with no superfluous assets or expenses. It cannot significantly change the efficiency of its operations by changing its asset mix. These factors suggest the company has little capacity to take on new debt.

The firm's policy is to locate its manufacturing operations in economically-depressed areas in an attempt to provide employment and stimulate the local economy. Although it is committed to paying just wages, to do so in some of these locales would push these operations into the red and result in a significant drain on the cash reserves of the company. That is not a viable option. An alternative would be to close these operations, but the company refuses to do so because it would hurt its current workers by thrusting them into the ranks of the unemployed in a severely depressed labor market. Instead, it chooses a third option: it pays the highest wage it can while maintaining a break-even situation with respect to both income and cash flow. The firm was able to pay a premium over the market wage of 18.6% in 2005 and 20.0% in 2006 (as in the example in the table above), but such wages still fall short of a just wage. It appears that this sort of situation is envisioned by *Quadragesimo anno* §72: "In determining the amount of the wage, the condition of a business and of the one carrying it on must also be taken into account; for it would be unjust to demand excessive wages which a business cannot stand without its ruin and consequent calamity to the workers."

I believe such a company might well wish to report their just wage information in the format I suggest above. When this information is taken in conjunction with the firm's financial statements, other social responsibility disclosures, and management discussions stakeholders are presented with a picture of the firm that includes all the materially important information in evaluating the firm's overall performance. And presumably that is the picture such a firm wishes to provide.

Let me add one last remark. While I suspect that there will be for-profit firms that fit the above description to a large degree, I suspect there will be even more non-profit service providers who do so *mutatis mutandis*. When such organizations consider the wages they are able to pay, they must take into account not only the welfare of their current workers (as in the above example), but also the welfare of those who receive their services. Will the organization shut down operations in an area when it cannot pay just wages, even though workers and service recipients

will both be hurt? In these cases, the just wage disclosures proposed above can be an integral part of explaining the organization and its operations to its stakeholders.

## Endnotes

<sup>1</sup> See *Business for Social Responsibility* “Issue Brief: Living Wage” (<http://www.bsr.org/CSRResources/IssueBriefDetail.cfm?DocumentID=50678>). SA8000 includes a standard for remuneration (8.1) that states: “The company shall ensure that wages paid for a standard working week shall always meet at least legal or minimum industry standards and shall be sufficient to meet basic needs of personnel and to provide some discretionary income.” (<http://www.sa-intl.org/index.cfm?fuseaction=document.showDocumentByID&nodeID=1&DocumentID=136>). The *Ethical Trading Initiative: “The ‘Living Wage’ Clause in the ETI Code- How to Implement It?”* describes a similar standard as follows: “Wages and benefits paid for a standard working week meet, at a minimum, national legal standards or industry benchmark standards, whichever is higher. In any event wages should always be enough to meet basic needs and to provide some discretionary income.” This, as well as a good discussion of the whole issue of living wage, is at <http://www.ethicaltrade.org/Z/lib/2000/06/livwage/index.shtml#liv-fair>.

<sup>2</sup> See *Business for Social Responsibility* “Issue Brief: Living Wage” at <http://www.bsr.org/CSRResources/IssueBriefDetail.cfm?DocumentID=50678>. The Council on Economic Priorities Accreditation Agency 38 (now SAI), *Guidance Document for Social Accountability 8000*, 23 April 1999, p. 38 formula is [(Half average household size X cost of food per person X total:food expenditure ratio)+ savings] quoted in *Ethical Trading Initiative: “The ‘Living Wage’ Clause in the ETI Code- How to Implement It?”* (see above).

<sup>3</sup> For approaches to overall corporate social responsibility reporting systems see: *Global Reporting Initiative Sustainability Reporting Guidelines 2002* (<http://www.globalreporting.org/guidelines/2002.asp>; a new version is to be published in 2006); *AccountAbility 1000 (AA1000) Framework* (<http://www.accountability.org.uk/uploadstore/cms/docs/AA1000%20Framework%201999.pdf>); *Social Accountability International: Social Accountability 8000 (SA8000)* (<http://www.sa-intl.org/index.cfm?fuseaction=document.showDocumentByID&nodeID=1&DocumentID=136>).

<sup>4</sup> See the above citation for the *Ethical Trading Initiative: “The ‘Living Wage’ Clause in the ETI Code- How to Implement It?”*

<sup>5</sup> Some of the organizations listed in note 3 above provide such services.