ACCOUNTING FOR A LIVING WAGE: A MODEL TO MEASURE PROGRESS ON LIVING WAGES
ACCOUNTING FOR A LIVING WAGE | A MODEL TO MEASURE PROGRESS ON LIVING WAGES

Efforts to tackle growing levels of inequality and poverty around the world are increasingly focused on the payment of a living wage. That’s because realizing the human right to a living wage is essential to raising the living standards of the most vulnerable workers and their families – and to fulfilling a range of other human rights, including rights to food, water, health, adequate housing, education, family life, and fair working hours. Providing living wages can therefore make a significant contribution to the achievement of many of the UN Sustainable Development Goals.

The wider impact on society is also clear. Studies have shown that reductions in poverty and inequality can lead to greater social cohesion1 as well as benefits to business.2 Paying a living wage can deliver not only a more motivated and productive workforce, with lower staff turnover, but also improved revenues and profits and increased value chain resilience and performance.

Yet for all the positive benefits of paying a living wage, current accounting standards, for the most part, still reflect the value of a workforce as a cost to the organization. This creates a perverse incentive for organizations to minimize salaries and benefits in order to increase profits, ignoring the resulting harm to workers’ well-being and risks to longer-term enterprise value.

Our current economic model is underpinned by practices that prioritize short-term financial returns for shareholders over sustainable prosperity within planetary boundaries that benefits all stakeholders. Wealth is increasingly being concentrated into the hands of the already wealthy, with the richest 1% gaining two-thirds of all new wealth created since 2020.3 At the same time, many countries continue to maintain statutory minimum wage levels substantially below a living wage, including due to direct pressures from business.

These practices directly contribute to growing inequality around the world and have negative knock-on impacts on human and social capital and businesses too. The resulting loss of social cohesion and stability, the erosion of trust in democratic institutions and the rule of law, and polarization within societies, represent a fundamental challenge to the achievement of sustainable development and pose a system-level risk to business itself.4

THE COST TO SOCIETY

When workers earn below a living wage, the negative consequences extend beyond workers and their families; the cost of maintaining workers at a decent standard of living is passed from employers onto society. When workers earn too little to sustain themselves and their families, states pick up the bill for providing food stamps and other tax-funded social benefits to bridge the gap. The broader impacts of reduced health and life expectancy, as well as loss of educational attainment and opportunities for workers’ children, are also borne by the state. Current and future tax revenues are decreased, while the demand for social programs increases.

Wages are a key driver of the value of the stock of human capital for workers, for businesses and for society. Human capital refers to an individual’s knowledge, skills, competencies and attributes, including their wellbeing.5 Just as payment of a living wage sustains the stock of human capital, wages below a living wage erode it. For companies, this means they are depleting the stock of human capital upon which they rely to deliver value.

1 Pickett and Wilkinson. The Spirit Level: why more equal societies almost always do better
3 Oxfam. Survival of the Richest: how we must tax the super-rich now to fight inequality
4 The Business Commission to Tackle Inequality. Tackling inequality: the need and opportunity for business action
5 Capitals Coalition. Social & Human Capital Protocol
Recent innovations in human capital accounting have generated approaches to the valuation of aspects of well-being that can be used to estimate and value the consequences for society of paying low wages. While more research is needed to identify the full range of societal impacts of low wages – and to quantify their full effects, it is clear that the further wages fall below the threshold of a living wage, the greater the negative impacts on workers, their families and broader society.  

Reversing the trend towards low wages that drive poverty and inequality may ultimately require that financial accounting rules are adapted to recognize the value of human capital as an asset, and include greater disclosure and more comparable data regarding the payment of living wages. Pending any such change, a more complete accounting in the front end of annual reports for progress towards living wages, and of the value to society of living wages, can offer the more comprehensive picture needed for decision making by managers, investors and other stakeholders. Fundamentally, it can help change the mix of incentives for how companies view the payment of wages.

**REPORTING AS A DRIVER OF CHANGE**

Measuring and reporting on living wage progress is essential to driving better outcomes for workers, businesses, and for society. While there are many initiatives working with business on urgent and groundbreaking programs to implement living wages, there is a long way to go before the major systemic shifts necessary to reaching living wages at scale are achieved.

Investors are increasingly interested in whether companies are taking action on living wages, and if so, whether those actions are having any positive impact on workers’ wages. To be able to make an informed assessment of this aspect of a company’s performance, investors need access to reliable and comparable data.

Yet so far there has not been a generally agreed, straightforward and measurable way for companies to reflect their work to achieve living wages in their public reporting. As a result, investors, civil society and other interested stakeholders lack the information needed to compare companies’ progress, assess which are contributing to the solution and push those sitting on the sidelines to play their part.

Standard setters and data providers have also been constrained to looking at whether companies have made commitments to living wages, without the means to seek more rigorous information on the results achieved. As more countries develop legal instruments on mandatory due diligence, the need for measures that can meaningfully reflect the impacts of a company’s living wage efforts on workers’ incomes becomes ever more critical.

What is needed is a framework that is able to capture a sufficiently accurate and informative picture of the scale and scope of the living wage deficits experienced by workers, together with progress towards living wages, in

---

6 Oxfam America. How low wages hurt families and perpetuate poverty Wills and Linneker. The costs and benefits of the London living wage
7 See for example Fair Labor Association, IDH, Living Wage Foundation, ACT on Living Wages
a company’s operations and first-tier supply chain. A shared and simple methodology to track and report on progress has been a key element of success in similar efforts to embed sustainability goals in business decision-making, for example, to reduce greenhouse gas emissions and close the gender pay gap.

Thanks to concerted efforts over a number of years, several initiatives now have tools that enable companies to identify where wages are being paid below the level of a living wage in their own operations and supply chains. These include living wage benchmarks and wage data collection tools that companies can use to assess by how much current wages deviate from a living wage estimate in a particular location. These are all positive steps forward. However, in order to be able to measure and report on progress in a way that is both meaningful and understandable, there needs to be a means of revealing how efforts to close living wage gaps are positively impacting wage outcomes for workers.

AN ACCOUNTING MODEL FOR LIVING WAGE PROGRESS

The Living Wage Accounting Model provides organizations with the means to measure and articulate progress towards payment of a living wage for their own employees, contractors, and workers in the first tier of their supply chain, by demonstrating the year-on-year movement of workers towards living wages.

Companies can use the Model to show the proportion of workers in any one category (e.g., employees, contractors or supply chain workers) being paid below a living wage and by how far: the Living Wage Deficit. With such a measure, progress over time will be revealed through a diminishing proportion of workers below a living wage and a reduction in the Living Wage Deficit as a proportion of the Living Wage Threshold (the measure of when all workers receive a living wage). These metrics enable a good degree of comparability between companies, while allowing for some variation in the benchmarks, data collection, and wage measurement methodologies that companies may use within the boundaries of the model.

<table>
<thead>
<tr>
<th>ACCOUNTING FOR A LIVING WAGE-Key Metrics</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIVING WAGE THRESHOLD ($) = Total no. of workers x Living Wage for their location</td>
</tr>
<tr>
<td>LIVING WAGE DEFICIT AS A PROPORTION OF WORKFORCE</td>
</tr>
<tr>
<td>= Total no. of workers below a LW ÷Total no. of workers</td>
</tr>
<tr>
<td>IN $ = Total no. of workers below a LW x distance to LW for those workers</td>
</tr>
<tr>
<td>LIVING WAGE PROGRESS Year-on-Year change in Living Wage Deficit ($) as a proportion of Living Wage Threshold ($)</td>
</tr>
<tr>
<td>HUMAN CAPITAL EROSION IN PHYSICAL UNITS</td>
</tr>
<tr>
<td>= Living Wage Deficit ($) x Utility of Income Factor (e.g., Health)</td>
</tr>
<tr>
<td>IN $ = Human Capital Erosion (in physical units) x value of physical welfare component</td>
</tr>
</tbody>
</table>

ABOUT THE MODEL

The Living Wage Accounting Model is the product of a two-year iterative process of research, development, consultation and testing of ideas with a wide array of experts, as well as piloting and adjusting of the final Model. At every stage of development, the process has benefited from the expert contributions of representatives of living wage benchmark methodologies and initiatives, accounting experts, companies, and investors through a series of bilateral and group consultations. The Model itself builds upon the work of a range of existing initiatives, including those developing or assessing living wage methodologies and benchmarks, those

8 While the most severe impacts on workers from low wages may occur beyond the first tier, for now there are challenges to acquiring the necessary quantitative data. The model’s supporting narrative indicators ask for information about efforts to address living wages at deeper tiers of the supply chain.
collaborating with companies in different sectors on practical ways to advance towards living wages, and those that take an accounting lens to the question of living wages.

The piloting phase ran from July-December 2022 and involved a select group of both small and large companies that applied the Model either to their own workforce or to their first tier supply chain in order to test its practical application and to identify any barriers to its usage. Their feedback helped to refine the Model, as well as to identify where further collaborative efforts will be needed to support companies in obtaining sufficiently accurate and reliable wage data from business partners in their supply chain.

The result is an accounting model that can be used by companies in both internal management and public reporting to express in simple and comparable terms the progress toward living wages in their own operations and supply chains. It enables standardized disclosures in a company’s annual report, much like those for greenhouse gas emissions or the gender pay gap. These metrics are ready to be integrated into accounting and reporting standards, and are already contributing to sustainability disclosures. In addition, the metrics relating to human capital erosion can provide valuable insights to companies on how their living wage deficit, and progress in reducing it, is impacting society more broadly. This can support better business decision-making based on a fuller understanding of the company’s overall impacts.

With widespread adoption, this Living Wage Accounting Model has the potential to play a catalytic role in delivering greater transparency, informing new standards and creating incentives for improving wages and reducing inequalities. This is essential to rebuilding economies that advance human dignity across the world. To learn more about the Model, and how to use it, please visit our webpage.

9 See for example the Johannesburg Stock Exchange Sustainability Disclosure Guidance and the draft European Sustainability Reporting Standards for own workforce.
ABOUT SHIFT

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. Shift’s global team of experts works across all continents and sectors to challenge assumptions, push boundaries and redefine corporate practice in order to build a world where business gets done with respect for people’s dignity. We are a non-profit, mission-driven organization headquartered in New York City.

shiftproject.org
@shiftproject

ABOUT CAPITALS COALITION

Capitals Coalition is a global collaboration redefining value to transform decision making. It sits at the heart of an extensive global network which has united to advance the capitals approach to decision-making. The ambition of the Coalition is that by 2030 the majority of businesses, financial institutions and governments will include the value of natural capital, social capital and human capital in their decision making and that this will deliver a fairer, just and more sustainable world.

ABOUT THE LIVING WAGE PROJECT

The Living Wage Accounting Model provides organizations with the means to measure and articulate progress towards payment of a living wage for their own employees, contractors, and workers in the first tier of their supply chain, by demonstrating the year-on-year movement of workers towards living wages.