

THE ISSUE OF FAIR WAGE

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ABSTRACT

In this paper we examine how the employees' wages can be evaluated as fair or unfair. In the first part we make a distinction between two approaches to the problem: the bargaining-based approach, focused on the process by which wages are set and, the comparison-based approach, focused on the evaluation of the wage differential between two jobs. In the second part, we show the limitations of the second approach. We examine how the employees' wages should be set. Firstly, we show that some factors that are not related to employees' merit can influence the wage level and this is not unfair. Secondly, we argue that the comparison to the prevailing wage in the industry is not a necessary ethical standard. Instead, we argue that wages should be set according to employees' contribution to business objectives. In the end, we discuss in detail this principle.

KEYWORDS: *fair wage, wage differential, merit, salary system*

JEL CLASSIFICATION: *J31, M12*

1. INTRODUCTION

One of the most debated ethical issues in business from a common practice perspective concerns the way in which wages can be evaluated as fair or unfair. Often, in everyday life, people express their ethical views on the relationship between their wages and those of other employees. However, the supporters of a free market view argues that often such views on fair wages are unjustified and based on misunderstanding of how wages are determined in a free economy. In this article, we examine the extent to which wages can be ethically evaluated and compared. In the first part, we will present two approaches of the fair wage problem, which we will call "bargaining-based" and "comparison-based". In the second part we will further analyze the second approach and discuss its difficulties and applicability. We must distinguish between two ethical issues related to salary level. The first of these concerns the relationship between wages and people's basic needs that should be covered by this wage. From this point of view, the main debate regards the right to minimum wage. The second problem concerns the ethical evaluation of wages by the way in which they were set or by comparison to other employees' wages. Often the first issue occurs in the literature under the title of "just wage", while the second under the title of "fair wage".¹ we will be concerned only with the second problem. The discussion in this article is not relevant to the problem of wages in the public sector, which cannot be determined on the free market.

2. TWO APPROACHES TO THE FAIR WAGE PROBLEM

Most of the business ethics issues can be approached from a free-market perspective. In this perspective, any outcome of a transaction freely consented by both parties is ethically acceptable.

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Wages are the outcome of the interplay between demand and supply, and any ethical evaluation of the wage level should start with it. There are three situations in which the outcome of the transaction is unacceptable or at least debatable from an ethical point of view. The first of these relates to the case where one party is constrained to accept the terms of the transaction. However, the concept of constraint has to be understood in a strict sense, including only physical, not psychological pressure, caused, for example, by the urgent need of one of the parties. For example, selling drugs or other vital products at a very high price is not unethical simply because buyers are in an urgent need of drugs. Secondly, transactions are ethically right only to the extent that the market is characterized by fair competition. Prices resulting from transactions on markets affected by competition problems may be incorrect. Since most anti-competitive practices are legally sanctioned, the issue of prices in such markets is primarily a legal, not an ethical problem. However, for the free-market supporters the range of competition matters is not limited to the companies' attempts to destroy competition on the markets in which they operate. Governments, by the regulations that impose, may also adversely affect competition. Third, asymmetry information situations, when one of the parties in a transaction has more information than the other, may raise the ethical question about the outcome of the transaction.

A free-market perspective can be applied to the problem of fair wage. According to this view, any wage resulting from a fair bargaining, characterized by the free and informed consent of both parties is fair. Therefore, in this approach, only the process of bargaining, but not its outcome, can be primarily evaluated as morally correct or incorrect.² we will call such an approach to the problem of fair wage "the bargaining-based approach".³ In this approach, the comparison between the wage rates of different employees is ethically irrelevant. Any theory that supports that a certain wage is too high or too low, but did not take into account the process and the rules that by which the wage was determined, commits a conceptual error (Machan and Chesher, 2002, p. 91).

According to the bargaining-based approach, the wage rates are the result of a negotiation between employers and employees, conducted in a certain economic context, and, if the negotiation is free and correct, the resulting wage is also correct. This approach is in contrast to another one, according to which even in the condition of a fair negotiation, an ethical evaluation of wages is possible and can lead to the conclusion that some wages are unjustifiably high or low. In this approach there are two connected problems: determining the factors that should influence (or justifiably influence) the wage level and how and when two wages can be compared in terms of their levels. Factors such as position (responsibilities), qualifications, skills, abilities, experience, the quantity of work, etc. have a permissible influence on wage rates. The question that we will discuss in the next part of the paper is whether and how these factors can be used for establishing a right wage differential.

The supporters of this approach generally agree that such factors are not helpful to determine the absolute worth of jobs. For many reasons, it is impossible to use some factors, such as those enumerated above, for determining how much a certain employee deserves to be paid. However, according to this approach some comparisons, based on these factors, are relevant from a normative point of view and can lead to some ethical evaluations of wages. These comparisons can be made in two directions. First, two employees whose work activity is similar from all points of view should be paid the same. Secondly, the wage differential between employees should be justified by some ethically relevant factors. Because the second approach of the fair wage problem is based on comparison between employees' work activity, we will call it "the comparison-based approach".

William Shaw is one of the authors that criticize a bargaining-based approach and list some factors and benchmarks that should be taken into account by a business manager who wants to establish fair wages: the prevailing wage in the industry, community wage level, nature of the job, dangers of the job (the unsafe character of the job), employer's financial capabilities, the salaries of employees inside the organization for a comparable work (Shaw, 2011, p. 322).

The well-known principle "Equal pay for equal work", according to which two employees who perform similar works from all relevant points of view should be paid the same, is a good synthesis

of this second approach.⁴ The challenge consists in identifying all relevant factors, which is a necessary condition for applying this principle. The result will be a specification of this principle, as such in the following principle: "Employees who perform jobs that require substantially equal skill, effort and responsibility, and that are performed under similar working conditions within the same establishment" should receive the same salary.⁵

A short example can show the difference between the two approaches. CEOs' compensations (including bonuses, shares, benefits, etc) are generally tens or even hundreds times larger than the employee's average wage. Is this correct? A follower of the comparison-based approach will respond positively or negatively, taking into account the responsibilities of a CEO, his/her skills and qualifications necessary to be a CEO. Another relevant element for an ethical evaluation is the comparison to the CEOs' compensations of similar companies in the same field. From the point of view of a bargaining-based approach such comparisons do not find relevance. If CEO's compensation was established by an adequate procedure, then his/her pay is justified. There is an inclination to consider that the bargaining-based approach would justify any compensation level. This is not necessarily true, because specific methods to establish CEOs' compensations in some companies or even general methods can be debatable from ethical point of view.

In order to clarify the comparison-based approach a remark is necessary. Generally, the wage level depends on a number of factors such as qualifications needed to perform a job, the quality and quantity of work, the possible risks, etc. We must make a distinction between using these factors in a descriptive way, to explain a certain wage level or differential, and using them in a normative way, to justify a wage level or gap. The former problem involves the identification of factors that can explain the wage level, while the latter one involves that these factors have a justified influence. It is important not to confuse the former problem, which has a descriptive character, with the latter one, which has a normative character.⁶ It is obvious that the wage rates depend on some factors that can explain the difference between the wages of two employees, but the problem is which of these explanations are relevant from a moral point of view. If all explanations played the role of ethical justification, the comparison-based approach would lose its normative function.

For this reason, the supporters of this account must distinguish between factors that actually influence wage rates and those that should be taken into account. An example can clarify this distinction. A comparison-based supporter can believe that it is not fair that a good footballer has a much higher salary than a very good writer. Implicitly, he thinks that factors that lead to this great wage differential (for instance greater demand for football) should not influence the wage levels. At the same time, other factors (for instance the instruction and the effort necessary to write a good novel or the importance of literature, by comparison to football, for a good human life) should exert an influence on wage levels.

3. THE COMPARISON-BASED APPROACH: LIMITATIONS AND APPLICABILITY

The comparison-based approach must answer two related problems: determining the factors that justifiably influence the wage rates and the way in which, based on these factors, some comparisons can be made. Next, we will discuss these two problems.

What factors should influence the wage rates? The general idea of the comparison-based approach is that it can be shown that some wages are unfair (too high or too low) by comparison to other employees' wages. This means that some factors should not exert an influence on the wage level and their actual impact leads to unfair wages. The first idea, which we will reject, is that the wages should be set according to what employees deserve, or to their merit. As usually used in ethics and in common language, the concept of deserving is related to what is under one's control (Feldman, 1995, pp. 64-65). In this sense, if someone does everything that is under his/her control he/she deserves something. According to this principle, factors not related to employees' merit should not influence the wages. An important distinction between two categories of factors may be drawn:

factors related to employees' merit, whose influence is permissible, and factors not related to employees' merit (because they are not under their control), whose influence is not permissible.

Factors such as the quality and quantity of work can be included in the first category. It is morally permissible for those who work harder and better to receive a higher salary. Similarly, greater responsibilities are rightly rewarded by a higher wage. From an ethical point of view such wage differentials can easily be justified by at least two elements. First, these differences are related, at least partially, to individuals' merit. The employees who work more and better deserve a higher salary; in a similar way more skilled and qualified employees have made an extra effort in the past and so deserve to be paid better.⁷ Secondly, additional remuneration for such more qualified and better employees is to the advantage of the entire organization, since all employees benefit from their positive contribution and lose if these employees leave the company.

However, the influence of other factors is not as easily acceptable from a moral perspective. For instance, the demand for the product provided by the company is not under control of an individual employee and he cannot be blamed if the demand is low. Nevertheless, the low demand is a factor which negatively affects the employees' wages. In a market economy, however, this is permissible, since the wage rates are directly related to the company's revenues determined by sales. It can be made a distinction between deserving something (a higher wage in this case) and having the right to claim something (the other having a moral duty to provide). Although an employee who does quality work in an unsuccessful company deserves, in a sense of the term, a higher wage, the employer doesn't have a duty to provide it, if its limited revenues do not allow it. Other factors not related to merit and debatable from an ethical point of view influence the wage rates. For instance, studies show that the strength of trade unions or the negotiation power of an employee can give a wage premium. Anyway, it is ethically permissible for parties in negotiation to try to defend their interests (in a right manner), even more so as both parties have the same moral rights. These two examples show that some factors that are not related to merit rightly influence employees' wages.

On a more general level, the free market does not always reward the deserving ones, but only those whose skills and talents are demanded (Meadowcroft, 2002, p. 105), regardless of the effort necessary to acquire the skills. Returning to a previous example a good writer has generally a lower income than a footballer. This feature of the free market system is sometimes considered objectionable from an ethical point of view.⁸ However, irrespective to the answer to this problem, a distinction should be made between the issue of fairness of an economic system and the issue of permissible conduct of an individual in this system. The discussion on fair wages falls under the second issue, while the first one does not belong to the field of business ethics.

Therefore, the employer does not have the moral duty to pay employees according to their merit. A more adequate principle is that the wage system should be designed according to employees' contribution to the objectives of the organization (Shaw, 2011, p. 322; Vallance, 1995, p. 71). So, the employer should take into account only the factors related to organization's objectives. This principle eliminates the relevance of the factors not related to employees' performance, such as gender, race, their personal relationship to companies' executives or other influential people in the company, etc. So, the salary system of a company should not promote discrimination and partiality. Designing a fair salary system, centered on employees' contribution to the company, benefit the whole organization. However, personal interests can prevail upon company's interests and this leads to an unfair wage systems.

Concluding the discussion above, in a fair salary system employees should be paid according to their contribution to business objectives and should not advantage or disadvantage some employees for personal reasons. This general principle can be applied when the wages of two employees in the same position are compared.⁹ The problem is whether other valid comparisons can be made. In this regard, the discussion in the literature is focused mainly on three areas: the wage differential between employees of the subsidiaries of the same multinational company in countries with very different development level, the wage differential between employees with different positions or

performing different jobs in the same company, the wage differential between employees in similar positions or occupations in different companies (Agalgatti and Krishna, 2007, p. 270). We will focus on the last two points.

Can we compare in an ethically relevant way the wages of two employees with different occupations in the same company? we have already shown that factors related to the nature of job influence the wage levels. But does lead this to relevant comparisons? Let's suppose that we have a list of ethically relevant factors. But what is their weight in deciding a fair wage? For instance, a certain job can be dangerous and this would mean that the employees hired to perform it should be paid more. But what is the fair increase? It is impossible to decide this in an objective manner, because different people have different levels of aversion to danger. The decision regarding the wage premium for which a certain employee would be willing to perform a dangerous job depends on his/her psychological makeup. In the same way, people agree that managerial jobs requiring responsibility, experience and leading skills should be paid better, but have different opinions regarding the fair differential. The problem of comparison is even more difficult when two jobs differ from two points of view, leading the wage rates in different directions. For instance, many unqualified jobs are more dangerous than qualified jobs. It cannot be decided in an objective way which of the two jobs should be paid more: the unqualified and more dangerous job or the other one (O'Neill 1993, p. 694). These irresolvable difficulties will keep their relevance when two jobs in the same company are compared.

Another comparison often used in common ethical arguments is that between the wages of employees performing similar jobs in different companies, in the same industry.¹⁰ Is this a valid comparison? Firstly, in some cases, companies can justify the practice of giving wages lower than the other companies by the fact that this is a necessary mean for offering low prices. Providing low wages becomes a strategic choice of some companies, essential for their business model. Of course, one can argue that by using this business model employees will be poorly motivated or that the company will select low-skilled employees and so the company will lose money. Nevertheless, this is a choice that may be inadequate from a strategic perspective, but not necessarily an unethical practice. Secondly, low paid employees have the right and opportunity to move to another company if they are better qualified than its employees. This argument is part of a general approach to the free-market advocates, who show that the invisible hand of the market can solve problems considered as having an ethical dimension. These two arguments lead to the idea that giving wages below industry average is not necessarily unethical. However, a bargaining-based view can also show, in some cases, that providing low wages is unethical. For example, low wages may be the result of the fact that companies do not respect employees' unions and collective bargaining rights.

We have shown that the comparisons between wage levels have a very limited ethical relevance, and they are useful especially when wages of the employees with similar jobs in the same company are compared. So, the main subject of interest is the fairness of the salary system used by companies. Such a system should satisfy three conditions.

Firstly, it should be based on clear, objective and publicly available criteria (Shaw, 2011, p. 322). Secondly, these criteria should be equitable and impartial. Equity is especially important when employees in the same position work in different circumstances and the same rule can apply differently to them. For instance, the same rules applied to store managers in different location can be inequitable for the managers of poorly located stores. An impartial system is one that does not disadvantage or favor some categories of employees. For example, a wage system that rewards excessively experienced workers is not impartial. The problem of equity can be raised also between employees in different positions, but, as we have shown, the range of available valid arguments is severely limited. Thirdly, these criteria should be related to company's objectives. A salary system should reward achievements according to how much they ultimately benefit the company.

4. CONCLUSIONS

In the first part of the paper, we have distinguished two approaches to the fair wage problem, or in other words two ways in which a certain wage should be judged as fair or unfair. According to the first one, a fair wage level is one resulting from a correct process of bargaining between employer and employee. According to the second approach, some comparisons between different wage levels may be ethically relevant for the issue of wage fairness. Generally, in the literature, one of two extreme positions is adopted. Some authors consider that wage comparisons are completely irrelevant from a normative point of view and the issue of fair wage should be settled only by evaluating the process of salary negotiation. Other authors consider that such an evaluation is completely insufficient, and the main element of wage ethical evaluation consists in comparisons between the wage of levels of different employees. We have tried to find a way between these two extreme positions. On the one side, many ways to compare wage rates of employees are irrelevant. On the other side, the wage comparison at the level of a company, especially between employees in the same positions, is significant and important from an ethical point of view. In the end, we have enumerated three criteria that should be respected by a fair salary system. These are only some general criteria that can be discussed in more detail in specific contexts, in some industries or companies.

A final remark is needed. Designing a fair salary system has not only an ethical, but also a professional dimension. An unfair salary system would give wrong incentives or would reward excessively some types of conduct or some people. From this reason, a fair wage system is desirable not only from an ethical point of view, but also from a profit point of view. Designing a fair wage system, that give right incentives, requires not only ethical conduct, but also managerial professional expertise.

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Endnotes

- 1 We will generally use the term “wage”, often used in the literature, but any job benefits are included. At the same time, we do not take into account the difference between wage and salary.
- 2 The most well-known exposition of a process-based, or procedural, account of justice is in (Nozick, 1974, pp. 160-164). In this fragment, Nozick does not discuss the problem of fair wage, but that of distribution of wealth. Of course, the two problems are tightly related, but not identical.
- 3 We have chosen to use the syntagm “bargaining-based approach” in order to stress the distinction between a process-based and an outcome-based approach. Anyway, most supporters of such an approach are also defenders of a free-market view, although the two elements of their conception – the process-based character and the free-market view – are conceptually distinct. The supporters of a bargaining-based approach can significantly differ in respect to the criteria of a fair bargaining. For this article, we will ignore these differences.
- 4 This principle is included in The Universal Declaration of Human Rights and in other international legal documents (Article 23). Despite of its formulation, in most cases this principle is a condition against discrimination (“equal pay for equal work regardless of the gender”). As we will develop later, the principle is completely justified in this sense. Next we will refer to the general interpretation of the principle, which is independent of the issue of discrimination and closer to the letter of the principle. This principle has legal relevance, but we are interested only in its ethical dimension.
- 5 <http://www.eeoc.gov/eeoc/publications/fs-epa.cfm>. The original quotation refers to a comparison between women and men who perform the same quantity and quality of work. Here we are interested only in the enumeration of the relevant factors.
- 6 Of course, the supporters of the bargaining-based approach do not deny that many factors are considered in the negotiation between employer and employee, but they consider these factors as not having moral relevance (Machan and Chesher, 2002, p. 99).
- 7 In a sense of the term “to deserve”, better qualified people do not necessarily deserve more. For instance, people from disadvantaged families must make greater effort than other people to achieve a certain qualification level and so they can deserve more even if they are less qualified.
- 8 Many free market supporters bring many cogent arguments for the fact that the free market does not necessarily reward merit, and this is not a negative, but rather a desirable feature of it (Meadowcroft, 2002, pp. 67-70). Anyway, my main point is that this general discussion is not directly related to the problem of fair wage.
- 9 We will return at this point in the end of the paper.
- 10 Walmart is a company often criticized for its business model based on low wages, significantly below retail industry average.