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Fiscal redistribution: yes, but inequality starts in the labour market: Findings from the ILO Global Wage Report 2014/2015[1]

by Patrick Belser

The International Labour Organisation (ILO) Global Wage Report, a publication released every two years, has been issued on the 5th of December 2014. The report is titled "Wages and income inequality" and, as usual, it has three parts. The first part analyses the evolution of real wages around the world. The second part, examines the link between wages and household income inequality, and also looks at wage gaps between certain groups: women and men; migrants and nationals; workers in the formal and the informal economy. The last part challenges the reader on what could be appropriate policy responses. The purpose of this column is to therefore highlight and discuss some of the crucial findings of the report.

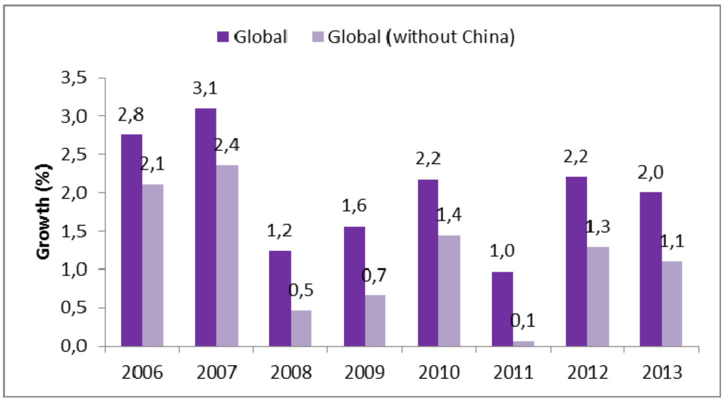
Wage trends: Flat wages in developed economies, growing wages in emerging economies

The most recent global wage growth was driven almost entirely by emerging and developing economies, where real wages have been rising – sometimes rapidly – since 2007. Before the financial crisis, real average wages in developed economies grew by an average of about 1 per cent per year, and global wage growth was about 3 per cent. Such figures have since changed in recent years; wage growth in developed economies almost stands at zero, and global wages are growing by 2 per cent. If you take China out of the equation, the global wage growth is quite simply cut in half (see Figure 1).

So when are workers in developed economies going to ask for more wage increases? Well, the answer, in many countries is: they are asking already. Our traditional chart on the parallel evolution of labour productivity and real wages in developed economies shows that since 2010 – while wages are flat - productivity growth is back on track (see Figure 2). Of course there are differences across countries and the decoupling of wages and productivity does not apply everywhere, and in some countries it goes the opposite way. The report shows that over the last 15 years, the decoupling was most obvious in Germany, Japan, Spain or the United States of America (U.S). Taking a shorter time horizon, the U.K. saw its real average wages fall by a total of 7 per cent since 2007 where, previously, the labour share (i.e. the share of labour compensation in GDP, an indicator of the decoupling) had traditionally been stable. In comparison, the 2.7% increase in real average wages in Germany since 2007, partially reversed the long term decline in the labour share.

As a result of the different trends across the world, average wages in emerging and developing economies are slowly converging towards average wages in developed economies, even if differences remain important. Comparing the purchasing power of their wages, an average American worker is still earning three times as much as a Chinese worker, but the gap is declining fast. If wages continue to stagnate in the U.S., and assuming that Chinese wages growth slows to an average of 5 per cent per year in the future, it would take no longer than about 25 more years for China to catch up.

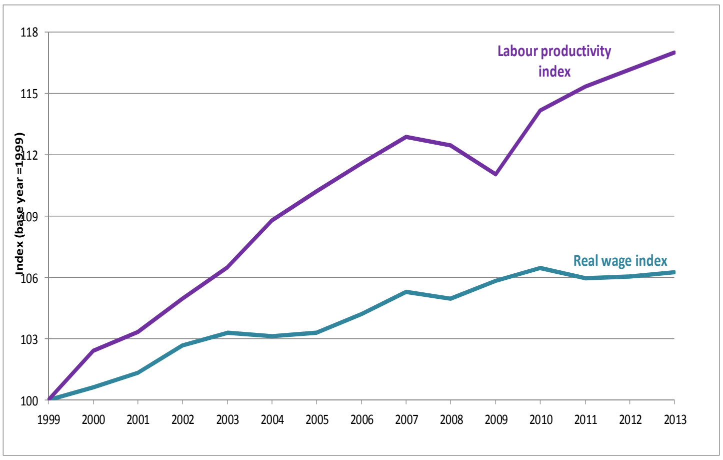
Figure 1: Annual average global real wage growth, 2006–13



Note: Global wage growth is calculated as a weighted average of year-on-year growth in average monthly real wages in 130 countries, covering 95.8% of all employees in the world (for a description of the methodology, see Appendix I).

Source: ILO Global Wage Report 2014/15

Figure 2: Trends in growth in average wages and labour productivity in developed economies (index), 1999–2013



Note: Wage growth is calculated as a weighted average of year-on-year growth in average monthly real wages in 36 economies (for a description of the methodology, see Appendix I). Index is based to 1999 because of data availability.

Source: ILO Global Wage Report 2014/15.

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Inequality often starts in the labour market

The report also looks at the link between wages and household income inequality. We know that since the mid-1980s, income inequality has increased in a majority of advanced economies, and the OECD has singled out growing wage inequality as the single most important reason. The Global Wage Report points to changes in wages and paid employment as key factors underlying more recent inequality trends, covering the years of the crisis. In the two countries where this inequality between the top and bottom 10 per cent increased most over 2006-2010, Spain and the U.S, for example, saw changes in the distribution of wages and job losses account for 90 per cent of the increase in inequality in Spain and 140 per cent of the increase in the U.S. In developed countries where household income inequality increased, other income sources offset about one-third of the increase in inequality due to changes in wages and employment.

This finding is perhaps not too surprising given that, in developed economies, wages usually represent about 70 to 80 per cent of total pre-tax and post-transfers income for households with at least one member of working age. Middle-classes frequently rely more than 80 per cent upon their wage incomes therefore more wage inequality immediately stretches the middle-class. At the bottom end of the distribution, low pay, underemployment or job losses (i.e. lost wages) are the main reason for low-incomes, whereas social transfers can only partly compensate for these problems. With low wages and more unemployment, lower-income groups thus tend to fall further behind. So while the IMF considers that inequality is best corrected through fiscal policies (taxes and transfers), the reality is that increasing inequality in the labour market places a heavier burden on efforts to reduce inequality through taxes and transfers. Furthermore, the past few years have also shown that more redistribution through taxes and transfers politically is not always feasible to say the least. In many countries, taxation systems have become less progressive over recent years.

In emerging and developing economies, the contribution of wages to household income is smaller, ranging from about 50 to 60 per cent in Argentina and Brazil, to about 40 per cent in Peru and 30 per cent in Vietnam. Self-employment income generally comprises a larger share of household income than in developed economies, particularly among low-income groups. But this does not change the fact that where inequality has been reduced, this was mostly due to a more equitable distribution of wages and the creation of paid employment for low-income households. In Argentina and Brazil, where inequality fell considerably over the last ten years or fifteen years, changes in the distribution of wages and paid employment accounted for 87 per cent of the decade-long reduction in top–bottom inequality in Argentina, as they did for 72 per cent in Brazil. Direct employment programmes (as in India and South Africa) and conditional or unconditional cash transfers (as in Brazil and Mexico, among many other countries) have made further contributions to lifting the income of low-income groups.

The challenge of linking wages to productivity growth and reducing inequality

High inequality can lead to a deterioration of social mobility, social cohesion and well-being. High inequality also reduces economic growth. This is particularly the case when inequality has adverse effects on education and heath, on political and economic stability, and on the social consensus necessary for well-functioning societies. In addition, low wage growth holds back household consumption, with possible adverse effects on investment and on overall aggregate demand. So what can be done?

The Global Wage Report suggests combined policy action on at least two fronts. First: redistribution through fiscal policies, with more progressive taxation and some targeted tax-reductions or positive tax-credits to low-income households (such as through in-work benefits), improved tax collection through efforts to formalise informal enterprises and workers, and the development of social protection systems – which in practice account for most of the redistribution through fiscal policies. Secondly: reduced inequality in the labour market through the pursuit of full-employment policies, more and better education for those at the bottom of the distribution, well-enforced minimum wages set at a level that takes into account needs of workers and their families as well as economic factors, and inclusive and encompassing collective bargaining systems. Without strong action in the labour market, current trends in many countries will place a heavy burden on reducing inequality through redistribution mechanisms alone, and the labour income share will probably continue to decline.

The Global Wage Report also shows that there are still persistent wage gaps between men and women as well as between national and migrant workers, or formal and informal economy workers. Extending minimum wages and collective bargaining to low-paid workers will also generally be helpful in reducing these pay gaps, given the over-representation of women, migrants and vulnerable groups in low-paying jobs. However, these policy tools alone will not eliminate all forms of discrimination. A wider range of policies is required to overcome wage gaps across groups that are not explained by human capital and labour market characteristics. For example, achieving equal pay between men and women requires laws and policies aimed at combating discriminatory practices, as well as more effective policies on maternity, paternity, and parental leave.

1 ILO Global Wage Report 2014/15: Wages and income inequality, Geneva (http://www.ilo.org/global/research/global-reports/global-wage-report/2014/lang--en/index.htm)

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