PART III | Implications for equitable growth

7 Internal and external imbalances

The *Global Wage Report* is a contribution to a wider literature on the changes in the distribution and levels of wages within and across countries, as well as on the economic and social implications of these trends. Some stylized facts emerge from this literature. One of the key findings is the downward trend in the labour share and the growing inequality in personal income distribution.

7.1 Functional and personal income distribution

A smaller share for workers

In terms of functional income distribution, which concerns how national income has been distributed between labour and capital, the present report has shown that there is a long-term trend towards a falling share of labour compensation and a rising share of profits in many countries. This confirms the findings of the *Global Wage Report 2010/11* (2010a), which identified a declining trend in the labour share in 17 out of 24 developed economies since the 1980s, and of the OECD's *Employment Outlook 2012* (2012b) which described a similar trend in 26 out of 30 countries since 1990. This indicates that there have been discrepancies between wages and labour productivity growth in a large number of countries.

A growing gap between top and bottom earners

The personal distribution of wages has also become more unequal. The distance between the top 10 per cent and the bottom 10 per cent of wage earners has increased in 23 out of 31 countries since 1995–97 (ILO, 2008a), and the proportion of those with low pay (defined as less than two-thirds of the median wage) has also increased in 25 out of 37 countries (ILO, 2010a). Such trends towards growing inequality remain strong when other income sources, taxation, and income transfer are considered.

7.2 Wage-based consumption is down, affecting the recovery

These internal imbalances have tended to create or exacerbate external imbalances. The skewed distribution in favour of capital income has tended to suppress consumption demand. In some countries, consumption kept growing mostly as a result of a phenomenal increase in household debts. Other countries have looked for solutions outside, with export surpluses compensating for weak domestic demand. But, ultimately, relying on easy credit turned out to be unsustainable, and export-led growth strategies based on trade surpluses were also often only possible in combination with the debt-driven consumption in deficit countries.

These imbalances all appeared before the Great Recession. While the full impact of the crisis on these external and internal imbalances is not yet clear, there are few reasons for excessive optimism. Average wages have declined in developed economies in 2008 and 2011. Cuts in labour costs in crisis countries with current account deficits involve economic risks: unless surplus countries allow for more wage-based consumption on both domestic and imported goods, the result could be a protracted period of economic stagnation, or even recession.

The risks of austerity and recession

As for internal imbalances, austerity policies and a prolonged period of economic downturn are unlikely to reverse trends in the personal distribution of wages and incomes. Although the labour share briefly bounced back at the beginning of the crisis it began to decline again after 2009. At the same time there are indications that the crisis may have further increased inequality. In the United States the increase in income inequality between 2010 and 2011 was the largest on record since 1993 and the number of "working poor" has now reached 7.2 per cent of all workers in 2011, up from 5.7 per cent in 2007 (US Census Bureau, various years). In Europe, over 8 per cent of people with a job are at risk of poverty and can be qualified as "working poor" according to the European Commission's *Employment and Social Developments in Europe 2011* (2012c).

These developments not only have consequences on economic stability and growth, but they also challenged the notion of social justice and undermine social cohesion. Unequal distribution and concentration of incomes among top earners and the owners of capital have been the cause of public dissatisfaction across the world, increasing the risk of social unrest and social instability. In developed economies, they have reduced the acceptance of austerity and fiscal consolidation measures. In developing countries, they have sparked a multitude of strikes and protests, especially when food and energy price increases have simultaneously eroded the purchasing power of wage earners at the bottom.

8 Reconnecting wages and productivity

8.1 Coordinated policy action

What should be done? Our analysis suggests that policy actions towards "rebalancing" should be taken at both national and global levels. In doing so, a simplistic view that countries can just "cut" their way out of the recession needs to be avoided, and more emphasis should be placed on policies that promote a close connection between the growth of labour productivity and the growth of workers' compensation. The existence of a large current-account surplus in some countries indicates that there is room to stimulate domestic demand, notably by better linking wage and productivity increases. Great care should be taken not to promote a "race to the bottom" in labour shares in deficit countries or throughout the Eurozone. Unrestrained pursuit of labour cost advantage in securing economic competitiveness is likely to discourage economic innovation and upgrading which have constituted key dynamics of the market economy. Austerity measures that are imposed from the outside, bypassing social partners, will also harm effective labour relations. Thus, global-level policy coordination which can prevent the "low-road" option is strongly recommended to create favourable environments for "internal rebalancing".

8.2 Strengthening existing institutions

"Internal rebalancing" can begin by strengthening institutions for wage determination. This report highlights that the weakening of such institutions and hence workers' bargaining position has contributed to the deterioration in both functional and personal income distribution. Thus, policies are needed to "rebalance" bargaining power for economic efficiency and social stability. Given the difficulty with organizing workers, particularly in the context of increasing labour market segmentation and rapid technological changes, more supporting and enabling environments need to be created for collective bargaining and to enable workers to demand a fair share of economic output. At the same time, it should be noted that these workers, particularly low-paid workers, have shouldered a greater burden of the widening inequality and need more protection when it comes to wage determination. Minimum wages, if properly designed, have proved an effective policy tool which can provide a decent wage floor and thus secure a minimum living standard for these workers and their families. As the latest *World Development Report 2013: Jobs* (World Bank, 2012) has shown, the potential negative impacts of collective bargaining arrangements and minimum wages on employment and other labour market outcomes have been rather over-stated in the past, while some care needs to be taken in designing them to improve their effectiveness.

8.3 Beyond labour markets

Financial regulation

The findings of our report make it clear that it will not be enough to "rebalance" income redistribution solely through labour market policies. As others have indicated (OECD, 2011 and 2012a; IILS, 2011 and 2012), one important contributing factor to the widening inequality is the policies that have led to unconstrained "financial globalization". Financialization has created incentives for diverting corporations' internal means of finance from real investment into risky speculative financial investments aimed at generating maximum short-run profits. Unregulated financial markets have not only exacerbated inequality but also tended to produce suboptimal and unstable economic outcomes. Therefore, "rebalancing" requires better regulation of the financial sector and restoring their role in channelling resources into productive and sustainable investments.

Taxation and social security

There are other critical dimensions of "rebalancing" which deserve a more detailed analysis. Taxation, the subject of intense debates, is one of them. In various countries, the current taxation scheme tends to be relatively generous to capital incomes when compared to labour incomes, which increases pressure on both labour costs to employers and the take-home pay of workers. Another important area which deserves emphasis is social security and income policies. Our analysis of the labour income share indicates that changes in social security system have impacts not just on income redistribution but also on the primary income distribution such as the labour share. The latter can take place in various channels, including by weakening workers' bargaining position through reducing their fall-back position (e.g. unemployment benefits) or what economists call "reservation wages". Therefore, adequate social security benefits can contribute to creating more favorable institutional environments for effective wage bargaining and to secure basic income for workers in need. At the same time, it is essential that a balance is found between the costs and benefits of social security systems for society and different groups of financers and beneficiaries.

8.4 Specificities of developing countries

The above policies apply to both developed and developing countries. The latter group of countries however faces some specific challenges.

Reaching other earners

First, it must be recognized that only about half of all workers in developing and emerging countries are wage earners – most of the others are self-employed or family helpers. This does not mean that minimum wages and collective bargaining are irrelevant. This report has shown that in a sample of 32 developing countries taken at different points in time in the period 1997–2006 no less than 64 million wage workers were earning less than PPP$2 per day. Minimum wages and collective bargaining can be ways for these workers and their families to achieve higher living standards. But additional measures are needed to create more wage jobs and to raise the productivity and earnings of those in self-employment. Employment guarantee schemes that pay minimum wages are also ways to create incentives for private firms to comply with the minimum wage in order not to lose their workforce.

Improving labour productivity

Additionally, wages are generally much lower in developing and emerging countries, with average wages – even though increasing faster than in developed economies – typically ranging from anywhere between PPP$150 and PPP$1,000 per month. In this context, raising average labour productivity remains a key challenge which must involve efforts to raise the level of education and the capabilities that are required for productive transformation and economic development, combined with a policy environment that is conducive to growth and job creation.

Implementing social protection schemes

Finally, a key challenge for developing and emerging economies is the development of well-designed social protection systems. These will allow workers and their families to invest in the education of their children, to reduce the amounts of precautionary savings and to develop middle-class consumption patterns. The ILO has shown that effective social protection floors are not beyond what countries can afford, whatever their level of economic development (ILO, 2010e).