Policy Brief

What drives the four decades-long decline in labour's share of income?

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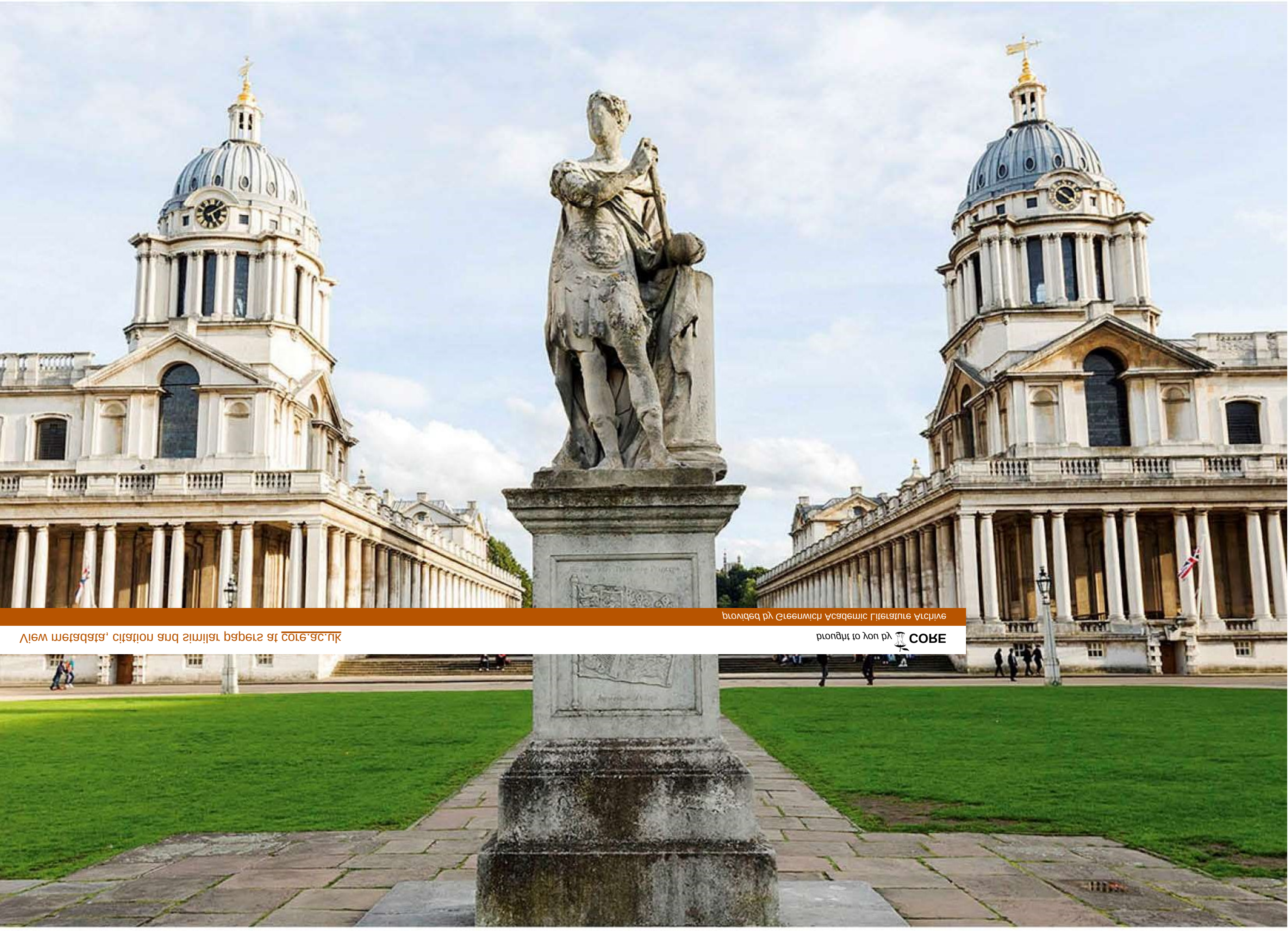

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What drives the four decades-long decline in labour's share of income?

Alexander Guschanski and Ozlem Onaran (2018) of the University of Greenwich Political Economy Research Centre provide evidence that changes in bargaining power, in particular the fall in union density and welfare state retrenchment, lie at the core of rising income inequality between labour and capital. The research challenges the established consensus that inequality is an unavoidable outcome of technological change or globalisation, and shows the importance of labour market institutions and social protection policies. The results of their recent project, funded by the Institute for New Economic Thinking, will be presented at the Royal Economics Society Annual Conference.

The last four decades have been characterised by drastic changes in the distribution of income between wages and profits in both OECD countries and emerging economies. In the UK the wage share in national income has fallen from 74.1% of national income in 1975 to 66.8% in 2017. The Great Recession and Brexit exacerbated these trends, with real pay still lower compared to its peak in early 2008 in the UK, following the longest and most dramatic period of declining real wages since Victorian times.

The Brexit Referendum laid bare the link between people's voting behaviour and their discontent with inequality. Guschanski and Onaran shed light on the causes of rising inequality, with a focus on the wage share in GDP.

There have been dramatic socio-economic changes in the way income is generated and distributed in the past decades, in particular

- technological change, specifically the increasing use of robotics and information and communication technology;
- the rise of global value chains between advanced and emerging economies, accelerated by the entrance of China into the WTO as well as increasing migration; and
- changes in the institutional framework in which bargaining takes place, including a sharp decline in union density and collective bargaining coverage in all OECD countries, with the highest decline taking place in the UK.

Guschanski and Onaran (2018) analyse the impact of these factors on the wage share in different industries in 14 OECD countries for the period of 1970- 2014. The findings suggest that changes in bargaining power explain more than half of the decline in the labour share. This decline is primarily related to a strong deterioration in union density and welfare state retrenchment. The conventional wisdom often focuses on migration as the most important consequence of globalisation for the rise in inequality. In contrast, offshoring, rather than migration, is the most important driver of the negative impact of globalisation according to the researchers. Technological change has a negative effect due to the automation of routine tasks; however, it does not alone explain the strong decline in the wage share, specifically not for low-skilled workers. Instead, the findings suggest that labour has not benefitted as much as capital from the technological advancements due to the decline in workers' bargaining power. The increase in female employment in the absence of strong collective representation of women and enforcement of equal pay legislation also contributes to the fall in the labour share.

Bargaining relations are defined by institutions and policies and can be altered to offset the negative impact of technological change and globalisation on inequality. Tackling income inequality requires a level playing field where the bargaining power of labour is more in balance with that of capital. The impact of globalisation is likely to be significantly moderated or offset by an improvement in union and collective bargaining legislation, increasing minimum wages, improving and enforcing equal pay legislation and increasing the welfare state spending in public services and social security.

References

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