

World of Work Report 2008
Income Inequalities in the Age of Financial Globalization



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OUTLINE

- **Main message**
- **Trends in Income Distribution**
- **Role of Changing Employment Patterns**
- **Relevance to Indonesia**



MAIN MESSAGE

- **Income inequality has been on the rise, despite strong growth**
- **Partly, this was driven by lack of sufficient employment growth in the formal sector**
- **But policy factors are important as well**
- **Inequality is likely to worsen with the current crisis, in particular through increased labour market vulnerability**



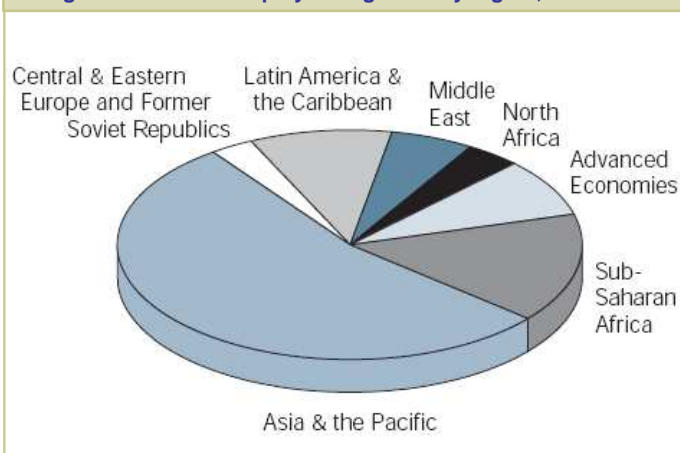
I
Trends in Income Distribution



The previous expansionary period was marked by substantial employment growth...

- **World employment grew more than 30% over the past two decades**
 - Advanced economies share of employment is declining
- **Significant regional variation in employment growth**
 - Average annual growth of 2.8% in Latin America and 2% in Asia and Pacific region compared to less than 1% in advanced economies

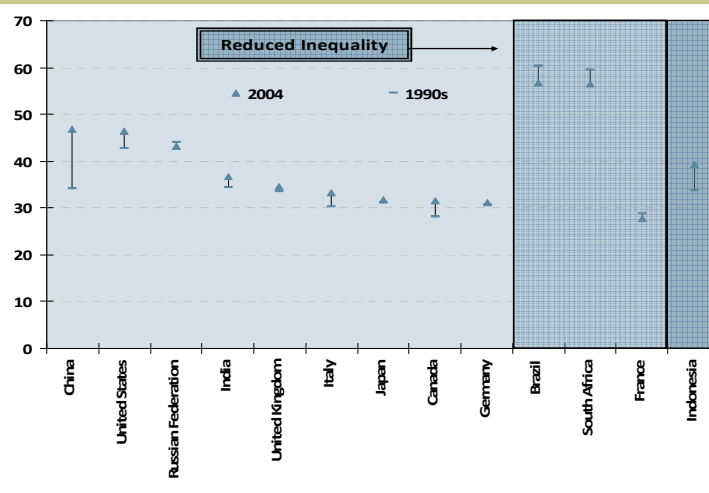
Figure 1. Share of employment growth by region, 2000-2007



...but not all individuals shared equally in the gains.

- Large numbers of women remain excluded from world of work
- Income inequality increased in the majority of countries
 - Between 1990 and 2005, two-thirds of the countries experienced an increase in income inequality as measured by changes in the Gini index.
 - Especially in advanced countries (US, Nordics), but also emerging economies such as Eastern Europe, China and Indonesia

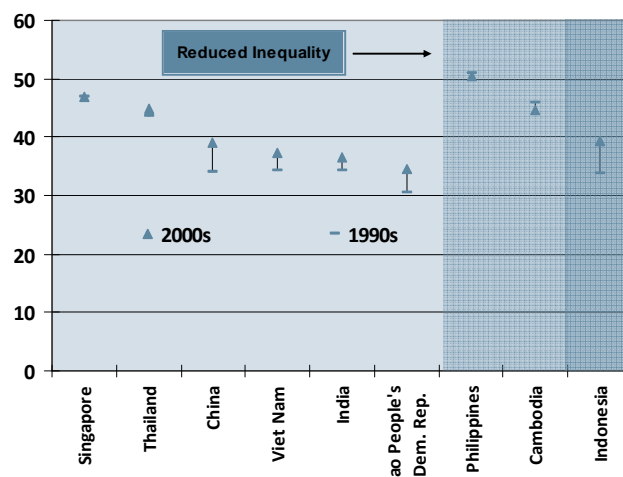
Figure 2. Changes in income inequality, BRIC and G7 countries



...and income inequality remained unequal in Asia and the Pacific.

- Modest declines in inequality occurred only in Cambodia and the Philippines.
- Income inequality increased in China, Laos and Indonesia over the period 1990 and 2000.

Figure 3. Gini index for 1990 & 2000, Asia and the Pacific



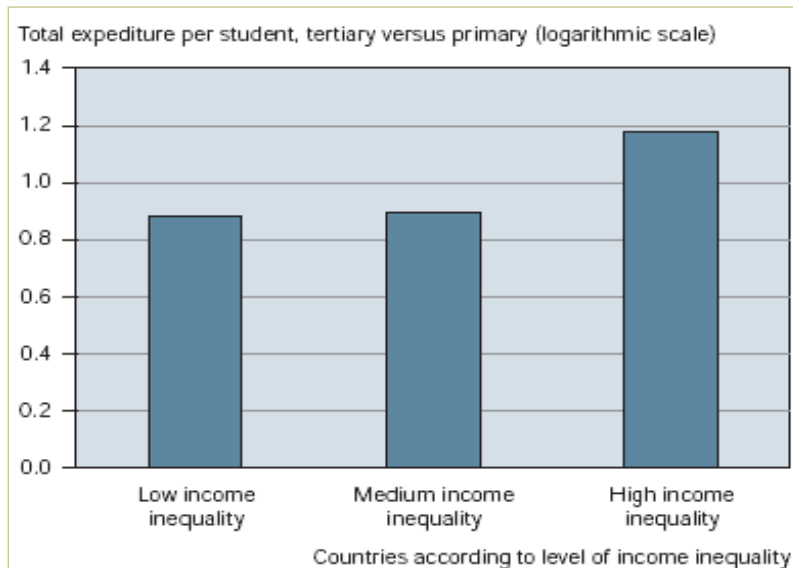
Why income inequality matters

- **Some level of income inequality is necessary**
 - reward work effort and talent
 - encourage innovation
- **But, excessive income inequality brings a number of risks**
 - threatens social stability (corruption, crime, etc.)
 - interferes with economic efficiency
 - resistance to policies promoting pro-growth
- **Much depends on what causes higher inequality and how it is perceived.**



High inequality countries tend to spend relatively more on tertiary vis-à-vis primary education.....

Figure 4. Income Inequality and spending on tertiary education

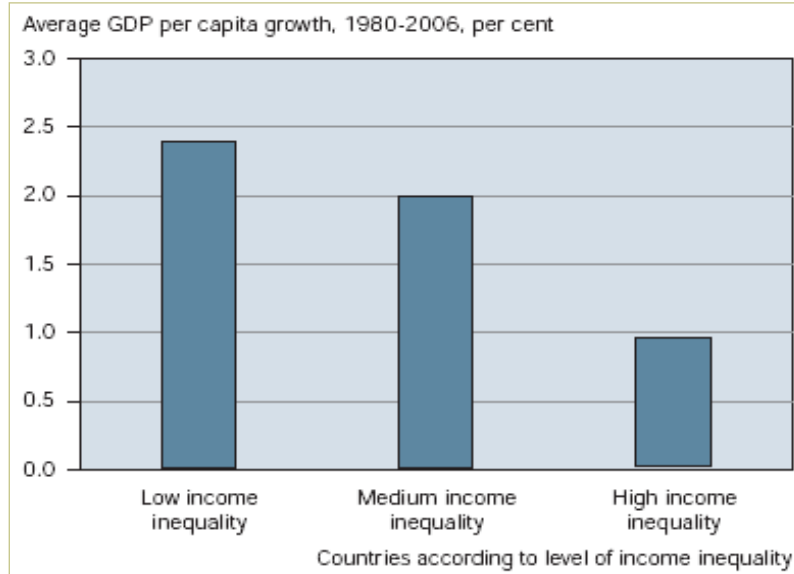


Note: High (low) income inequality countries include the 20 per cent of countries with the highest (lowest) income inequality according to the Gini index. Medium income inequality countries include the other countries.



.....and tend to have more unstable economic growth

Figure 5. Income Inequality and trend per capita GDP growth



Some Causes of Inequality



A number of (competing) factors are said to be driving income inequality.

- **Domestic**

- Role of tripartite institutions
- Job quality and changing patterns of work
- Redistributive policies and welfare state

- **International**

- Financial globalization
- Foreign direct investment
- Trade liberalisation
- Technological change and increased skills premium

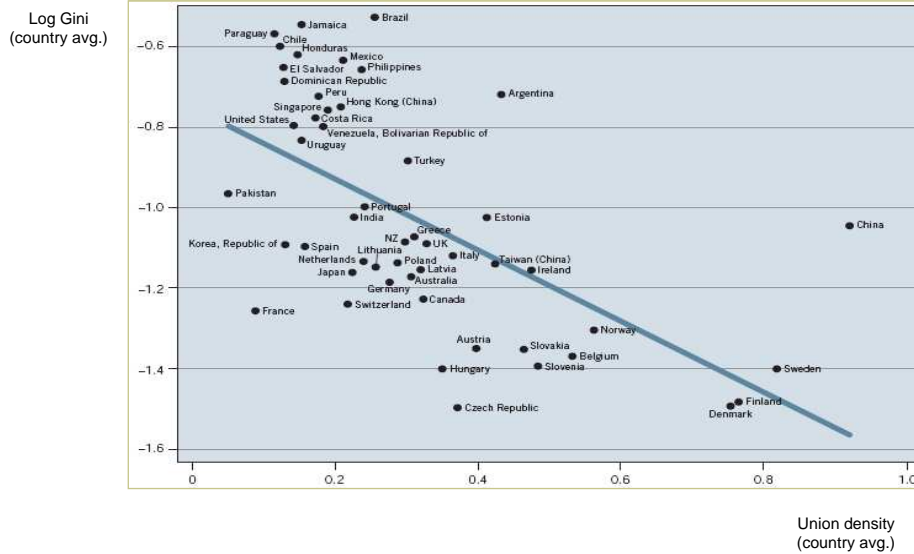
Evidence suggests that both factors have a role to play in mitigating inequality.



Domestic Factors: role of labour market institutions

- Highly unionized countries tend to have lower income-inequality
 - Negative correlation between Gini coefficient and rate of unionization

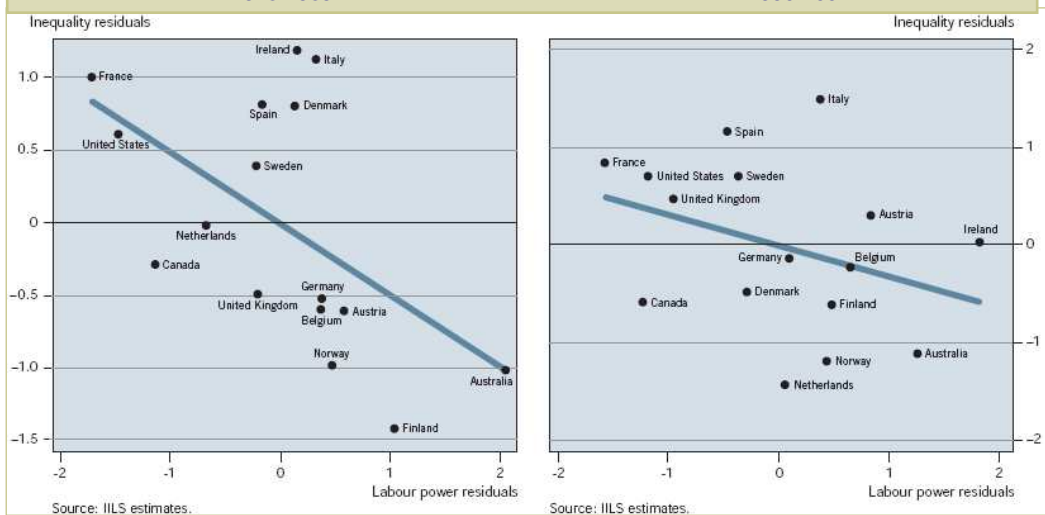
Figure 6. Bivariate correlation between average Gini coefficient and average union density, 1989-2005



Domestic Factors: Role of labour market institutions cont'd

- However, the inequality reducing effect of labour institutions is declining over time

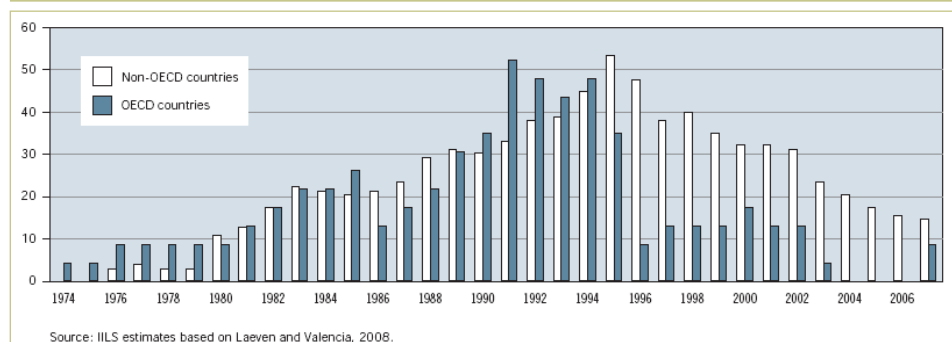
Figure 7. Partial correlation between inequality and labour power controlling for welfare state size
1978-1989 1990-2002



Financial globalization has also contributed to rising inequality due to the growing frequency of crises...

- Banking crises 10 times more likely in 1990s compared to 1970s
- Low-income households are particularly vulnerable in the context of increased instability

Figure 8. Frequency of banking crises, OECD countries and rest of the world (%)



...in addition, financial globalization has reinforced the downward trend in the share of wages accruing to labour.

- **A sizable decrease in the share of wages**
 - This decline in the wage share is over and above any effects resulting from sectoral shifts and changes in labour market regulations and institutions.
 - The uneven distribution of the benefits of financial globalization has led to increased within-country inequality

Figure 9. Financial globalization and the evolution of the wage share



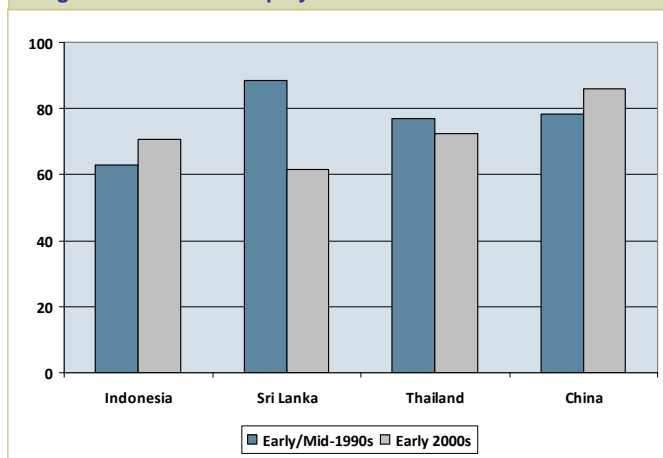
II
Role of Changing Employment Patterns



Duality in the labour market

- **Shift towards non-standard/ informal forms of employment**
 - Increasing incidence of non-standard employment, especially part-time and temporary in majority of advanced economies
 - In Indonesia, the incidence of informal employment remains significant and is on the rise according to measures of self-employment.
- **In Asian economies, the incidence of informal employment has increased or remained high**

Figure 10. Informal employment in Selected Asian countries



...widening wage gaps between various forms of employment

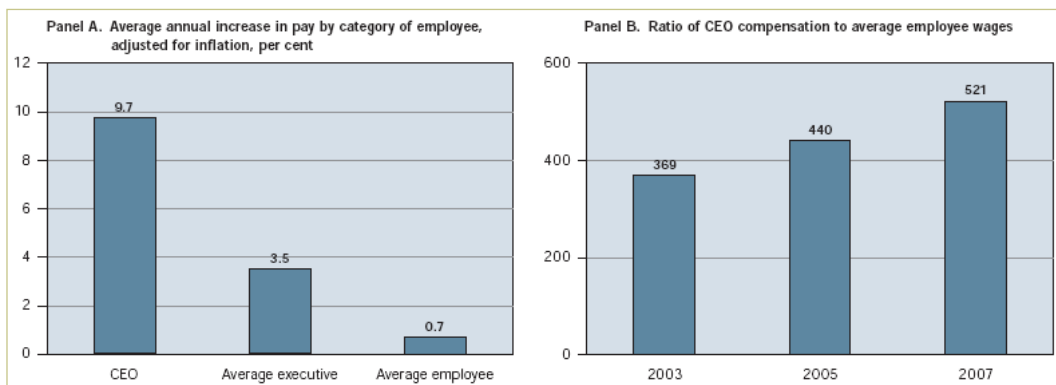
- **Wages in the informal economy are taking a hit:**
 - Wages in the informal economy stood only at 50% of those paid in the formal segment in 2007, down from close to 70% 6 years earlier.
 - Real wage growth in the formal sector has not followed suit productivity growth over the 2000s despite a rapid increase in minimum wages.
- **Duality is further reinforced by strict employment protection**
 - Open unemployment has continuously increased since the Asian crisis.
 - This was mainly a result of the steady increase in the labour force, partly as a result of a reduction in the number of discouraged workers.
 - Employment-to-population ratio has remained constant.
 - Nevertheless, informal employment has increased as formal employment did not grow fast enough.
 - This comes partly as a result of strict firing rules that make formal job creation less attractive to employers.



Another new global development is the executive pay

- Increasing gap in pay between CEOs and employees (including other executives).
- Variable compensation accounts for a significant, and growing share of this difference.

Figure 11. Evolution of executive pay versus average employee wages in the United States, 2003-2007



III
Relevance to Indonesia



The impact of financial crisis is so far limited in Indonesia

- **Indonesia is expected to grow rapidly in coming years**
 - Growth accelerated to more than 6% in 2007.
 - Only modest slowdown expected to around 5% in 2009.
 - Growth rests firmly anchored on domestic demand, resulting from both strong private consumption and investment.
- **The corporate sector has experienced de-leveraging, making it less vulnerable than in the past.**
- **It remains, however, heavily exposed to foreign capital flows**
 - Potential transmission mechanism from the global financial crisis via external financing conditions.
 - Positive effects to be expected from lower energy and commodity prices.



...but there has been a long-term trend towards rising income inequality and increase labour market vulnerability...

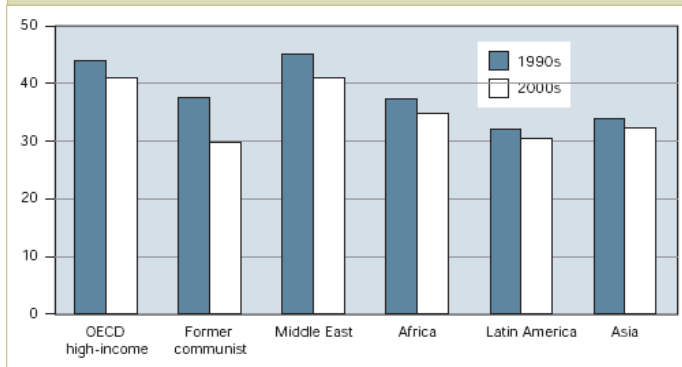
- Level of income inequality in Indonesia has been on the rise during the 1990s, but still below levels seen among BRICS countries.
- Employment growth has been strong, mainly in the informal sector, increasing the number of vulnerable jobs.
- Despite economic dynamism, real wage remained stagnant throughout the 2000s, leading the share of labour income in GDP to fall.
- Increasing food and energy prices are likely to have a negative effect on the purchasing power, in particular for the poorer households.



...amidst less Distributive Policy

- **Taxes have become less progressive**
 - Direct taxes contribute 48% of total tax revenue, while most of the remaining 52% comes from indirect taxes.
 - Indirect taxes hurt the poor much more than the rich.
- **Social transfers have not kept pace**
 - Redistribution effort through employment guarantee schemes and subsidised food has not been able to keep pace with rising inequality
 - Social transfers to richer households through energy subsidies.

Figure 12. Top marginal individual income taxes, worldwide (%)



A Way Forward...



Policies need to maintain employment dynamism while mitigating income inequality...

- **Promote involvement of employers and workers**
 - Emphasise social dialogue with tripartite institutions; involvement of social partners in reforms & skill development policies
- **Consideration of both quantity and quality of jobs**
 - In the course of employment regulations reforms, wage formation and social protection systems
- **Tax and social policy to support employment and equity**
 - Remove tax measures that distort labour market participation
 - Phase-out obstacles to formal sector employment growth
 - Increase progressivity in the tax system (role for multilateral action)
- **Cautious approach to financial globalization**
 - Consideration of social impacts
 - Reinforced prudential regulation
 - Coordinated action



...and need to put more emphasis on improving human capital

Figure 13. PISA scores, G7, selected BRICS and Indonesia, 2006

