

Executive summary

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Global Wage Report 2014/15

Wages and income inequality



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Part I. Major trends in wages

The context

Debates about the economic role of wages have intensified in recent years. At the firm level, an increase or decrease in wages affects production costs and has consequences for profitability, sustainability and competitiveness. At the country level, the net effect of higher or lower wages depends on the direction and relative magnitude of the effects of wages on household consumption, investment and net exports. In the Eurozone, concerns over deficits in aggregate demand arising from insufficient household consumption have focused more attention on wages, and many commentators have pointed to the decline or stagnation of wages as increasing the risk of deflation. In some emerging and developing economies, more attention has been devoted to wages as a key component of overall strategies to reduce poverty and inequality.

Global wage growth decelerated in 2013 compared to 2012, and has yet to rebound to pre-crisis rates

Global real wage growth dropped sharply during the crisis in 2008 and 2009, recovered somewhat in 2010 and then decelerated again. Average monthly real wages grew globally by 2.0 per cent in 2013, down from 2.2 per cent in 2012, and have yet to rebound to pre-crisis rates of around 3.0 per cent growth in 2006 and 2007.

Global wage growth driven mostly by emerging and developing economies

Global wage growth in recent years was driven by emerging and developing economies, where real wages have been rising – sometimes rapidly – since 2007. However, there are major regional variations. While real wage growth in 2013 reached 6 per cent in Asia and nearly 6 per cent in Eastern Europe and Central Asia, it amounted to less than 1 per cent in Latin America and the Caribbean (down from 2.3 per cent in 2012). Tentative estimates also show that real wages grew by almost 4 per cent in the Middle East, due to strong reported wage growth in Saudi Arabia, but by less than 1 per cent in Africa. Real wage growth in emerging G20 economies slowed from 6.7 per cent in 2012 to 5.9 per cent in 2013.

Global wage growth cut in half when China is excluded

China accounted for much of global wage growth, because of its large size and high real wage growth. Excluding China cuts global real wage growth almost in half, from 2.0 per cent to 1.1 per cent in 2013, and from 2.2 per cent to 1.3 per cent in 2012.

Flat wages in developed economies

In the group of developed economies, real wages were flat in 2012 and 2013, growing by 0.1 per cent and 0.2 per cent, respectively. In some cases – including Greece, Ireland, Italy, Japan, Spain and the United Kingdom – average real wages in 2013 were below their 2007 level. Composition effects (the effect on the average wage due to the changing composition of workers in paid employment) played a large role in crisis-affected countries.

Between 1999 and 2013, labour productivity growth in developed economies outstripped real wage growth, and labour's share of national income – also a reflection of the link between wages and productivity – fell in the largest developed economies

Overall, in the group of developed economies, real wage growth lagged behind labour productivity growth over the period 1999 to 2013. This was the case before the crisis in 2007 and – after a brief narrowing of the gap during the depth of the crisis – labour productivity has continued to outstrip real wage growth since 2009.

Between 1999 and 2013, labour productivity growth exceeded wage growth in Germany, Japan and the United States. This decoupling of wages and productivity growth is reflected in the decline in the labour income share (the share of GDP going to labour compensation) over the same period in these countries. In other countries, such as France and the United Kingdom, the labour income share remained stable or increased. Among emerging economies, the labour income share increased in recent years in the Russian Federation, and declined in China, Mexico and Turkey. It is important to note, however, that when real wage growth is rapid, the welfare implications of a declining labour income share in emerging and developing economies may be different from those in developed economies.

Average wages in emerging and developing economies are slowly converging towards average wages in developed economies

Average wages are still considerably lower in emerging and developing economies than they are in most developed economies. When measured in purchasing power parity (PPP), the average monthly wage in the United States, for example, is more than triple that in China.

While definitional and methodological differences make precise comparison of wage levels across countries difficult, the average wage in developed economies is estimated at approximately US\$ (PPP) 3,000, as compared to an average wage in emerging and developing economies of about US\$ (PPP) 1,000. The estimated world average monthly wage is about US\$ (PPP) 1,600. However, the gap in real wages between developed and emerging economies has narrowed between 2000 and 2012, based on strong wage growth in the latter, while in many developed countries wages stagnated or contracted.

Part II. Wages and income inequality

Mixed trends in household income inequality

Growing inequality in many countries over the last few decades has commanded increasing attention, as high levels of inequality can adversely affect well-being and social cohesion as well as reducing medium- and long-term economic growth. The report shows that recent trends in total household income inequality have been mixed in both developed economies and emerging and developing economies. The level of inequality is generally higher in the latter; however, progress has been made in a number of such countries to reduce it, usually in a context of growing incomes. In developed economies that experienced rising inequality, this has typically occurred in a context of stagnant or declining incomes.

Inequality starts in the labour market

In many countries, inequality starts in the labour market. Changes in the distribution of wages and paid employment have been key factors behind recent inequality trends. In developed economies where inequality increased most, this was frequently due to a combination of more wage inequality and job losses. In Spain and the United States, the two countries where this inequality between the top and bottom 10 per cent increased most, changes in the distribution of wages and job losses accounted for 90 per cent of the increase in inequality in Spain and 140 per cent of the increase in the United States. 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.

A number of emerging and developing economies experienced declines in inequality. In these countries, a more equitable distribution of wages and paid employment was a predominant factor. In Argentina and Brazil, where inequality fell most, 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.

Wages are a major source of household income

The important role of wages in household income inequality can be explained by the fact that wages are a major source of household income in both developed economies and emerging and developing economies. In developed economies, wages represent about 70 to 80 per cent of total pre-tax, post-transfers income for households with at least one member of working age, with substantial variation across countries. In the emerging and developing economies studied in the report, 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 Viet Nam. Self-employment income generally comprises a larger share of household income than in developed economies, particularly among low-income groups.

However, in both types of economies, income sources at both the top and the bottom are more diverse than in the middle, where households rely mostly

on wages. In developed economies, social transfers play an important role in supporting low-income households, whereas in many emerging and developing economies low-income households rely mostly on self-employment. Among the bottom 10 per cent of households, for example, wages represent roughly 50 per cent of household income in the United States, 30 per cent in Italy, 25 per cent in France, 20 per cent in the United Kingdom, 10 per cent in Germany and 5 per cent in Romania. Among the middle- and upper-income groups, wages represent the highest share of household income in almost all countries, reaching about 80 per cent or more in Germany, the United Kingdom and the United States.

For emerging and developing countries, the share of wages among the bottom 10 per cent of households varies from about 50 per cent of household income in the Russian Federation to less than 10 per cent in Viet Nam. In Argentina, Brazil, China and the Russian Federation, the share of wages rises gradually across the middle classes, before declining in the highest income groups.

Some groups suffer from discrimination and wage penalties

The report shows that in almost all countries studied there are wage gaps between men and women as well as between national and migrant workers. These gaps arise for multiple and complex reasons that differ from one country to another and vary at different points of the overall wage distribution. These wage gaps can be divided into an “explained” part, which is accounted for by observed human capital and labour market characteristics, and an “unexplained” part, which captures wage discrimination and includes characteristics (e.g. having children) that should in principle have no effect on wages. The report shows that if this unexplained wage penalty was eliminated, the mean gender wage gap would actually reverse in Brazil, Lithuania, the Russian Federation, Slovenia and Sweden, where the labour market characteristics of the disadvantaged groups should result in higher wages. It would also nearly disappear in about half the countries in the sample of developed economies.

A similar analysis is carried out to compare the wages of migrants with those of national workers, showing that in various countries the mean wage gap would reverse if the unexplained part of the gap was eliminated. Among developed economies, this is the case in Denmark, Germany, Luxembourg, the Netherlands, Norway, Poland and Sweden. In Chile, migrant workers earn more than their national counterparts on average.

The report also finds a wage gap between workers in the formal and the informal economy; this is shown in the report, for example, in wage gaps affecting workers in the informal economy for selected Latin American countries. As with gender and migrant wage gaps, the wage gap for workers in the informal economy is generally lowest in the bottom deciles and increases for higher wage earners. In addition, the observable labour market characteristics of informal economy workers differ from workers in the formal economy across all points of the wage distribution and for all countries (i.e. there is an explained gap across the entire distribution). At the same time, however, the unexplained part of the wage gap remains significant.

Part III. Policy responses to address wages and inequality

The policy challenge

Inequality can be addressed through policies that affect wage distribution directly or indirectly and through fiscal policies that redistribute income through taxation and transfers. However, increasing inequality in the labour market places a heavier burden on efforts to reduce inequality through taxes and transfers, which is not always possible or desirable. This suggests that inequality that arises within the labour market should also be addressed through policies that have a direct effect on the distribution of wages.

Minimum wages and collective bargaining

Recent research suggests that governments have considerable space for using minimum wages as a policy tool. On the one hand, research shows that there is either no trade-off between increased minimum wages and employment levels or that such increases have very limited effects on employment, which can be either positive or negative. On the other, it shows that minimum wages do contribute effectively to reducing wage inequality. Minimum wage policies have been used as effective policy tools by an increasing number of governments in recent years, in both developed economies and emerging and developing economies. Importantly, minimum wages should be set in a way that balances the needs of workers and their families with economic factors.

Collective bargaining is another labour market institution that has long been recognized as a key instrument for addressing inequality in general and wage inequality in particular. The extent to which collective bargaining can compress overall wage inequality depends on the proportion of workers covered by collective agreements and on the position of these workers in the wage distribution.

Promoting job creation

Job creation is a priority in all countries, and the report shows that access to, or loss of, paid employment is a key determinant of income inequality. In developed economies, job losses that disproportionately affected low-income workers contributed to increasing inequality. In emerging and developing economies, the creation of paid employment for those at the bottom contributed to reducing inequality in a number of countries. These findings confirm that the pursuit of full-employment policies is an important aspect of reducing inequality. The promotion of sustainable enterprises is key in this regard. This involves establishing an environment favourable to the creation and development of enterprises, as well as to innovation and enhanced productivity. The resulting benefits can be shared equitably within enterprises and in society more broadly.

Special attention to disadvantaged groups of workers

Extending minimum wages and collective bargaining to low-paid workers will generally be helpful in reducing inequality among women, migrants and vulnerable groups, who are over-represented among these workers. However, these policy tools alone will not eliminate all forms of discrimination or wage gaps, which constitute a significant source of inequality. 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 policies aimed at combating discriminatory practices and gender-based stereotypes about the value of women's work, effective policies on maternity, paternity and parental leave, as well as advocacy for better sharing of family responsibilities.

Fiscal redistribution through taxes and social protection systems

Fiscal policies can compensate to some extent for inequality in the labour market, through both progressive taxation systems and transfers that tend to equalize household incomes. Such policies are used more frequently by governments in developed economies to address their income distribution objectives than in emerging and developing economies, although there may be some convergence under way. In emerging and developing economies, there appears to be space for increased tax revenues through a variety of measures, including by broadening the tax base through the transition of workers and enterprises from the informal to the formal economy as well as by improving tax collection. Increased revenues would in turn allow for the extension and upgrading of social protection systems, which are often not fully developed in such economies.

The need for combined policy action

Wages constitute the largest single source of income for households in developed and emerging economies alike, with only a few exceptions. At the same time, wages make a smaller contribution to household income for the lowest income groups. In developed economies, where social transfers are more important sources of income for these groups, this calls for a combination of policies that help individuals in these households move into employment and measures that raise the quality and compensation of the work they find. In some emerging and developing economies, raising the income of low-income groups has been achieved through direct employment programmes (as in India and South Africa) and cash transfers (as in Brazil and Mexico, among many other countries). In the end, the most effective and sustainable route out of poverty for the working-age population is a productive, fairly paid job. Policies should be geared towards this objective.

