SOCIAL COHESION AND LABOUR MARKETS

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Summary of discussion

• Winner-takes-all economics has worsened income inequality
• Labour market institutions key for social cohesion
• Need to be complemented by fiscal and other structural policies
WINNER-TAKES-ALL ECONOMICS
Equality-enhancing policies have been de-emphasized...

Top marginal individual income taxes

Trends in spending on social transfers
**Market finance and financial globalization have increased top earners income**

- **Financialization**
  - Market-based finance has pushed up the profit share (Khatiwada, 2010)
  - Stock markets outperform housing over the long-run, which skews wealth distribution upwards
  - Low growth in high interest rate times (especially in the 1980s; Piketty, 2010)

- **Weak corporate governance fosters income spread within firms**
  - Wide-spread evidence for CEO excess pay: The higher the excess the worse share performance (Bebchuk et al. 2010)
  - Weak shareholder rights and inter-locked boards as main hurdle for stronger corporate governance
Other market forces have further exacerbated inequalities

• Strong increase in availability of skilled labour force led to biased technological change
  - Globally mobile labour force has substantially increased effective supply of skilled labour
  - Leads to trade-induced skill-biased technological change (Beaudry, 2005)

• Superstars and intellectual property rights
  - Despite relative success of open-source, IP has made large inroads in service sector innovation (software, creative services).
  - Often IP rights stricter there than in manufacturing, at least when compared to size of sunk costs necessary to generate the underlying intangible asset.
THE LAST DIKES
Trade unions allow to resist further increases in inequalities

Source: IILS estimates.
Transfers and taxes can substantially equalize income

Income inequality before and after taxes

- Income inequality after taxes and transfers vs. Market income inequality

Countries listed from left to right:
- Chile
- Bolivia
- Ireland
- United Kingdom
- Mexico
- Argentina
- Portugal
- Finland
- Peru
- Denmark
- United States
- Italy
- Greece
- Brazil
- Spain
- Belgium
- Australia
- Sweden
- Germany
- Canada
- France
- Luxembourg
- Switzerland
- Netherlands
- Austria
- Norway

Graphical representation showing income inequality before and after taxes for various countries.
More skills are essential for lower inequality
LABOUR MARKET POLICIES: CRISIS LESSONS
Spending on labour market programmes helps create jobs
Internal flexibility improves policy effectiveness

Employment reaction under different wage bargaining schemes

Employment

Deviation from baseline (in %)

With internal flexibility

Without internal flexibility

Months
Labour market segmentation lowers policy effectiveness

Output volatility with labour market segmentation
Coordinate labour and macro policies

Panel A - Government deficit
- Baseline scenario
- Global fiscal consolidation
- Additional stimulus

Panel B - Employment growth
- Baseline scenario
- Global fiscal consolidation
- Additional stimulus
Summary

• **Labour market policies key for social cohesion**
  - Help create employment → the glue of society
  - Improve wage earnings capacity

• **Recent market forces work against them**
  - Winner-takes-all politics and economics
  - Welfare state retrenchment
  - Financialization

• **Labour market policies need to be embedded**
  - Fiscal policies to support sound macroeconomic management
  - Wage bargaining systems supportive of policy effectiveness
  - Product and financial market policies to lower labour market segmentation