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FALLING LABOUR'S SHARE OF INCOME

NEHA GUPTA
ASST. PROFESSOR
VIVEKANANDA COLLEGE
DELHI UNIVERSITY
DELHI

ABSTRACT

The labor income share is a key determinant of relevant macroeconomic variables, such as competitiveness, inflation, human capital accumulation, demand and income distribution. Simple economic models predict that the labor income share will fluctuate around a long-run value, thus implying a balanced growth path. However, for over three decades, the share of national income going to labor, in most countries, has been declining. Conversely, capital's share of national income has increased. However this trend of declining labor's share of income has been less noticeable as national income is continually rising. This decline has been secular, other than a small recent temporary reversal in some countries for which various reasons have been given by many economists and institutions. Thus, this paper will examine the trends in this decline in many countries, its causes, and the implications for economic development and the consequences of this shift on economies and societies with few measures which needs to be taken to control it.

KEYWORDS

labour's income, economic development.

1. INTRODUCTION

By Globalization we mean elimination of barriers to trade, cultural exchange and of communication. According to IMF globalization is "the growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, freer international capital flows, and more rapid and widespread diffusion of technology". Globalization has initially started with World War I and then collapsing with the crisis of the gold standard in the late 1920's and early 1930's. Countries involved in this basically prospered due to the immense inequality among them as globalization enables the free flow of goods, capital and labor among them. Globalization in the era since World War II has been driven by trade negotiation rounds like GATT, Uruguay round, bilateral trade agreements like Maastricht treaty and North American free trade agreement etc. In short, Globalization includes greater international movement of commodities, money, information, and people; and the development of technology, organizations, legal systems, and infrastructures to allow this movement. Globalization has different aspects which affects the world economies in several different ways like financially, industrially, economically, politically, culturally, socially, technically, ethically etc. Globalization brings countries closer and improves the quality of life and standard of living. With globalization, the world economies are expanding rapidly day by day and it's not only affecting them positively but also having some harmful effects on some section of the society. It has been seen that over the past 3 decades the share of labor's income from the entire national income is decreasing thoroughly due to various reasons. This is not affecting adversely on the productivity of the labors but also affecting the aggregate demand of the labor in the labor market globally. Although globalization of labor is good for some economies but it proves bad for other economies. In this paper an attempt has been made to explain the various reasons and its effects of the falling share of labor income along with the instances of some other comparative studies.

2. SHRINKING LABOR'S SHARE FROM THE ENTIRE GDP PIE

A striking feature of the current expanding economy is the unusually low share of national income which is earned by labor. According to recent Bureau of Labor Statistics data, labor's share of national income is as low as of post World War II. According to some other study done by the Organization for Economic Co-operation and Development (OECD), labor captured just 62% of all income in the 2000s, down from over 66% in the early 1990s whereas in America, wages used to make up almost 70% of GDP which is 64% now. Some of the biggest declines have been in the egalitarian societies such as Norway (where labor's share has fallen from 64% in 1980 to 55% now) and Sweden (down from 74% in 1980 to 65% now). A drop has also occurred in many emerging markets, particularly in Asia.

FIG. 1

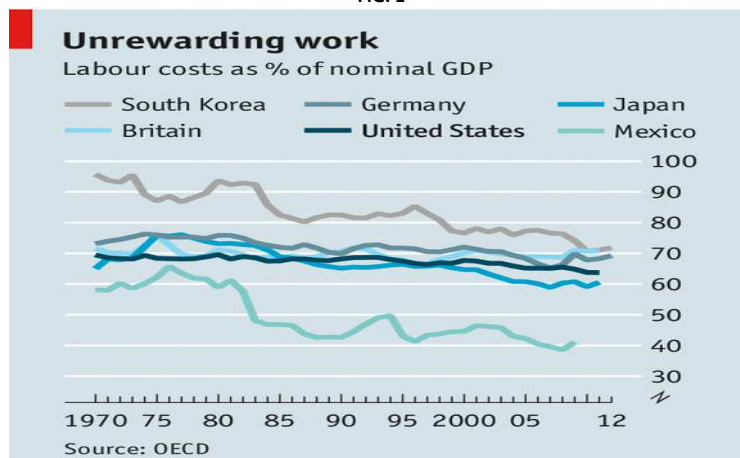
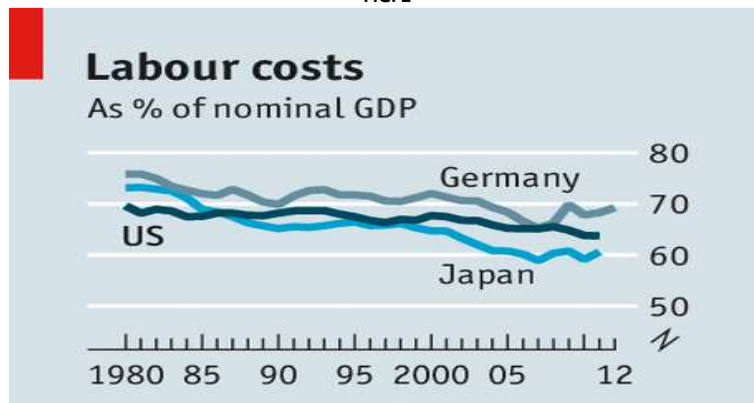


FIG. 2



In terms of the total compensation share of national income, along with the wage share (excluding what employers pay for workers’ pensions, health coverage and social insurance), the following chart shows that the wage share has been coming down faster than the overall compensation share, initially because more workers were getting more of their pay in non wage benefits, but now it is happening because employers have been shedding health and pension benefits (the share of the population with employer-provided health coverage has declined over the last decade from about 73 percent to 63 percent).

FIG. 3



Source: Bureau of Economic Analysis, National Income and Product Accounts Table 1.12 (national income shares of compensation and wages)

2.1 CAUSES OF THIS TREND

The main reason for this declining share is obviously the rising share of capital which is taking over the share of labor; we can also say that today’s productivity growth is largely accrued to capital, not to labor. As a result, growth in real hourly compensation (or real unit labor costs) has lagged behind productivity growth. However, as per some economists the big firms and the weakened workers’ union are responsible for this declining share whereas according to some others the main fault lies with government policies and high taxes.

Let’s look this from an economic model angle. Suppose that some capital is a substitute of labor, rather than a complementary good. If we call this "labor-like" capital "M", the production function goes from $L^a(K^{1-a})$ to $(L+M)^a K^{1-a}$, and the labor share will fall from a to $aL/(L+M)$, while capital's share will increase from $(1-a)$ to $(1-a)+aM/(L+M)$.

Moreover, in macroeconomics we have an equation that explained the wage share and assumed Cobb Douglas production functions (Diminishing marginal returns on production factors). In this model, the wage share was dependent on two things: the level of companies’ market power (ability to set instead of accepts prices) and the importance of capital in production (the exponents in the Cobb-Douglas function). This model shows that both these factors are negatively related to the wage share (A high level of market power for companies will increase the price of sales and increase the profits which will go to the owners of the capital in the form of dividends rather than going to the labor, whereas, if a higher importance is given to the capital in production then the companies will spend more on capital than on labor).

Workers in America blame the availability of cheap labor (increasing population in the developing countries lead to an increase in the labor force which further reduces their wage rates) in the developing economies for this trend. According to a research done by Michael Elsby of the University of Edinburgh, Bart Hobijn of the Federal Reserve Bank of San Francisco and Aysegül Sahin of the Federal Reserve Bank of New York, the labor’s share in many industries in America is falling due to the exposed competition of these industries to imports, which is also leading to a growing wage disparity.

But the main culprit for this is the technology. According to OECD estimates, technology accounts for roughly 80% of the drop in the labor share among its member countries. Day to day improving technology not only provides an advanced way of production and improves the rate of production but also it provides powerful equipments which help the firms to automate an ever larger array of tasks. It also proves cheaper for the firms to take up new technology as against employing more labor for production. Moreover, in recent decade’s jobs requiring middling skills have declined sharply as a share of total employment, while employment in high- and low-skill occupations has increased.

Furthermore, trade and technology’s toll on wages has been abetted by the changes in employment laws. For instance, during late 1970s European workers enjoyed high labor share because of stiff labor-market regulation. But due to privatization and labor and product market liberalization labor share tumbled; this also leads to high unemployment in some countries too. Though, accelerating technological change and rising productivity create the potential for rapid improvements in living standards but if the resulting income gains prove elusive to wage and salary workers, then that promise may not be realized.

One of the reasons for falling wage rate is migration. Since low wage workers are increasingly migrating to the high wage countries thus leading to an increase in the supply of labor and reduction in the wage rate.

It has also been seen from the European spread that especially burdensome insider/outsider labor regulation & payroll taxation (e.g. Spain, Italy, Greece, Romania) reduces labor's share of GDP.

Hence, the usual suspects for this declining trend of labor's income are globalization, technological change, financialization (the growth of the finance sector), and declining workers' bargaining power.

2.2 CONSEQUENCES OF THIS TREND

This trend has very ugly consequences, both politically and economically. It, in turns, worsens inequality as capital tends to be owned by richer households and a rising share of national income is going to capital. For instance, in America, the share of national income going to the bottom 99% of workers has fallen from 60% before the 1980s to 50%. When growth is sluggish, as it is now, these shifts would mean that most workers are getting a smaller morsel of a smaller slice of a slow-growing pie. Within the labor share, the relative incomes of those with education and position rose. The main impact of the decline in the labor share on the economy is reduced demand which in turns adversely affects the economic growth. Thus, inequality is impacting on growth, on social mobility, engendering disillusionment with politics and may affect democracy.

This falling share would also means higher unemployment in the long run. However, According to the report by ILO, this pattern, in many countries, have seems to involve rising dividend payments.

Such trends may force the governments to adopt new protections for workers as a means to support the labor share. But such regulation might lead to more unemployment or to an even faster shift to automation. Moreover, trade's impact could become gentler in future as emerging-market wages rise, but that too could simply hasten automation.

2.3 WHAT NEEDS TO BE DONE

Many economists says that there are few remedies to this trend as it's a natural process where the market determines the resource allocation and policy making are not so important but since the standing pillars of a good market system is the policies, therefore, it becomes very important to have good policies for improving this trend.

There are many remedies which can be undertaken by the nation whereas may remedies needs international cooperation. The main areas of policy for reform are:-

1. Rebalance labor market institutions,
2. Address taxation progressively, evasion and avoidance,
3. Radical reform of corporate governance and company laws,
4. Improve labor market activation, social welfare and education.

However, much could be done to improve the position of labor without damaging economic efficiency or corporate wellbeing; governments could restore some balance by developing efficient collective bargaining structures which would allow trade unions greater countervailing roles in governance of business, as in Germany with Co-determination. All employers should be licensed in all countries and should adhere to basic human rights and social standards of each country, within ILO parameters.

On the other hand, the international agencies should act on labor standards, on the basis of decent work, promoting respect for human and workers' rights. And for emerging economies, they should insist on:

- freedom of association and the right to collective bargaining;
- the elimination of discrimination in respect of employment and occupation;
- the elimination of all forms of forced or compulsory labor;
- the effective abolition of child labor, especially in its worst forms.

Furthermore, progressive income taxation policies should be used to reduce inequality which is partly due to "an unprecedented rise in top incomes."

The current reforms to curb international tax evasion with action against tax havens, with strengthened International tax agreements are a start. The EU should move against all the tax havens and pursue coordination of corporate tax.

Moreover, corporate governance should become a priority because it was at the heart of the Crash of 2008. There should be far greater financial disclosure, reform of the professions, of company law, of executive pay and of boards. Progress is being made in the regulation of banking.

3. CONCLUSION AND SUGGESTIONS

Since this is a global phenomenon, occurring in most of the countries, labor's share is falling in different places with different politics and different trade policies. It is declining in both trade surplus and trade deficit countries, with high and low unionization rates and varying levels of capital intensiveness.

However, on one hand, there really isn't evidence for the idea that technology is eroding the labor share of GDP. Indeed, if nominal interest rates continue to fall, we are more likely to see capital's share of GDP to fall further (and wages rising) amidst rising investment and increasing capital saturation. But at the other hand, as per the study by Bureau of Labor Statistics, "a fall in labor's share does not necessarily imply a rise in capital's share; indirect taxes and subsidies constitute a wedge between these two series. Consequently, a fall in labor's share *could* be associated with a rise in capital's share, but it *could* also be due to a rise in the share of indirect taxes less subsidies."

Moreover a cyclical pattern to labor's share has been seen over the period i.e., it rises during recessions and falls during expansions and the recent fall in labor's share can be due to the early part of a business cycle expansion. But whether these movements in labor's share have implications for monetary policy or not; that is a bigger question to look upon. The need of the hour for the policymakers is to focus on improving the prospects of low paid and low skilled labor and to spread the capital gains more widely. More work means a stronger labor market, which would bid up employees' slice, as it did in America in the 1990s when unemployment was at record lows. Moreover a greater emphasis should be given on rebooting the current education and training system, more technical subjects should be introduced so that instead of replacing workers by machines, labor would be required to design and operate machines.

Since the current economic and political system has become a system of extraction rather than production, thus it is the need of the hour to favor new economic and resource management models. As more people are no longer needed in the workforce, the only solution is to redistribute and for this taxing the companies on the basis of profit per employee is the fairest way to achieve this redistribution.

An economist has given his thought of providing incentives to the companies that pay higher wages by the government. According to him a company can deduct a larger share of expenses from its tax liabilities if those expenses are due to wages paid to employees and thus help in improving the payment to the factor of production.

However for the past four decades, US payrolls as a portion of GDP are falling while the earnings portion is at record highs. This is because of the reduction in the domestic labor content of goods and services by the rapid and continuing evolution of computer, communication and transportation technology which has enabled automation and outsourcing. Through this all of the labor "savings" have been diverted to the wealthy for short-term earnings improvements. But this has not resulted in lower prices for goods and services because there has also been a concurrent a formation of monopolies through the acquisition of competing firms; since in US, monopolies have cost advantages over smaller competitors with regard to effective tax rate, sales tax, shipping, procurement, per capita healthcare, access and cost of capital and even special municipal subsidies.

Since this deterioration of payrolls is ongoing thus it can only be corrected by the federal intervention by adopting traditional approaches like by strengthening unions and redistributing the taxes. For this government can also impose a punitive excess earnings tax (EET), which will enable the corporations to take the needed internal corrective actions to avoid its burden.

Hence, the economic future is bright only for those who have good technology knowledge and have high skills to augment their productivity and their respective income share. Since we have a global crisis of demand due to increased inequality, it has become very important for any country to emphasize on increasing its

exports and imposing national wealth tax for the richer over and above the income tax and then redistribute this by some other mode like by increasing the salaries of the employees or by structure unemployment insurance so that it smoothes income for all workers, including part-timers and the self-employed. Government can also tax less to labor, by cutting Social Security and Medicare taxes and making up the difference by increasing capital gains taxes because it has been seen that the biggest single inequality creating distortion in the tax code is the preferential treatment for capital gains over income.

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