Collective Bargaining And Rising Inequalities: Do The OECD And IMF Get It?

Ronald Janssen 3 February 2016

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In a paper published in spring 2015, the IMF's research department made the case for trade unions and collective bargaining as a powerful tool to keep inequalities in check. Whereas previous literature and statistics were already showing the existence of such a link, the IMF paper went even further by pointing out that trade unions and collective bargaining not only tend to reduce inequalities by pushing up wages at the lower end of the pay scale but also limit the income share captured by the top 10% of income earners. Moreover, the IMF research found that high trade union membership also influences the extent to which the tax system and the welfare state redistribute revenues in a more equal way.

In two recent working papers, the OECD Economics Department also focusses on the theme of inequalities and this in ways one would not necessarily expect.

Inequalities are a lot higher than official OECD data indicate

The first OECD paper starts out by recognising that measures of inequalities based on household surveys are not suited to capture top incomes. This is due to higher than average non-response rates, the unwillingness of top earners to provide accurate data or disclose sensitive information, as well as the censuring of income amounts above a certain threshold in public datasets.

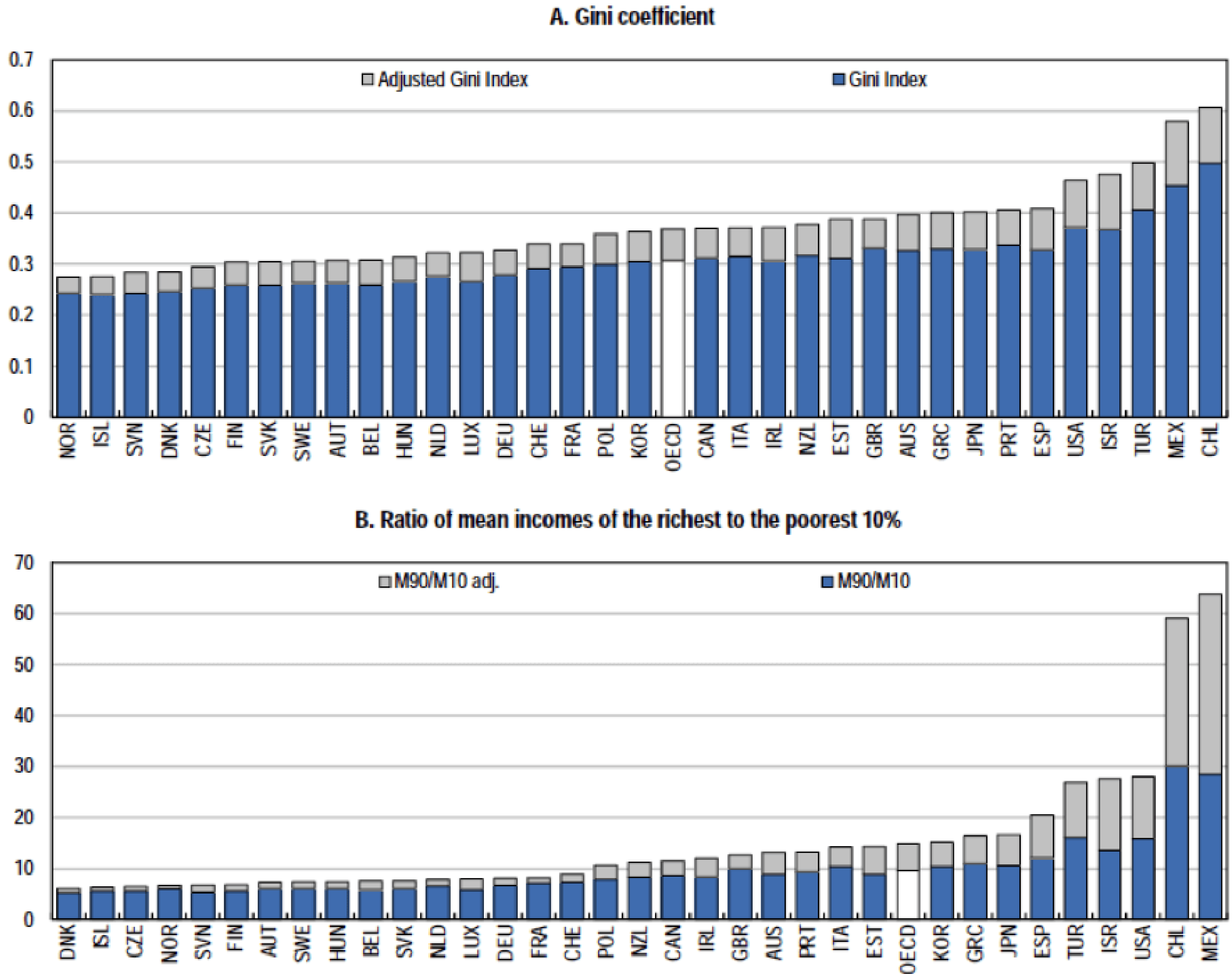
Going on from there, the OECD develops a methodology that combines the incomes of the bottom 90% (as derived from the usual household surveys) with statistics for the richest 10% that are adjusted for the missing top incomes (the "1%") and based on taxation data.

The results are rather shocking: inequalities turn out to be a lot higher than previously thought.

When household survey based data are adjusted for the top incomes, the Gini coefficient (which is a measure of the extent of inequalities, the higher the coefficient the higher the inequalities) jumps from 0.31 to 0.37 on average for OECD countries. An even clearer measure is the ratio of the mean income of the richest to the poorest 10%, which increases from 10 to 15. In other words, **the richest 10% in the OECD do not earn 10 times more than the poorest 10% but actually *15* times more**. Graph I show the outliers in this respect: in Chile and Mexico, the number is ridiculously high as the 10% at the top end earn up to 60 times more than the bottom 10%. In Europe, Spain's ratio is striking (20 times more), although inequalities in the US (almost 30 times more) still beat Spanish outcomes.

Graph I

Figure 6. Impact of the adjustment on standard indexes of income inequality
Around 2010



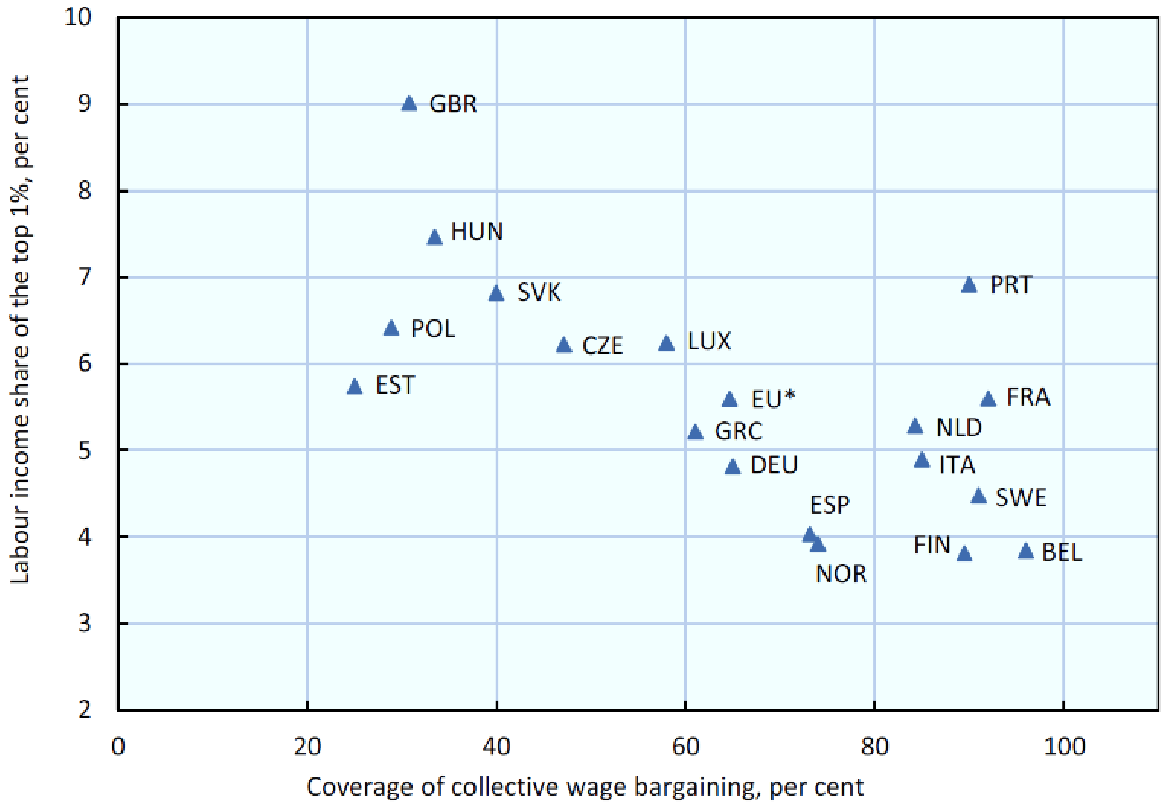
Stronger trade unions and lower wage inequalities indeed go hand in hand

A second OECD paper (also from the Economics Department) confirms the insights from the IMF. While the scope of the econometric work done by the OECD is limited in comparison with the work done by the IMF's research department and while the OECD is (necessarily, because of the data set it uses) limiting itself to European countries as well as to wage inequalities (as opposed to inequalities in total revenue), the findings are strikingly similar.

Graph II, taken from the OECD paper, confirms that higher rates of collective bargaining coverage across Europe neatly go hand in hand with a *lower* share of wage income that is captured by the top 1%.

Graph II

Figure 2. Collective wage bargaining and the labour income share of the top 1%



Note: The figure shows a negative, statistically significant at the 1% level, cross-country correlation between the coverage of collective wage bargaining and the labour income share of the top 1%. EU* is the unweighted average across the European countries in the sample.

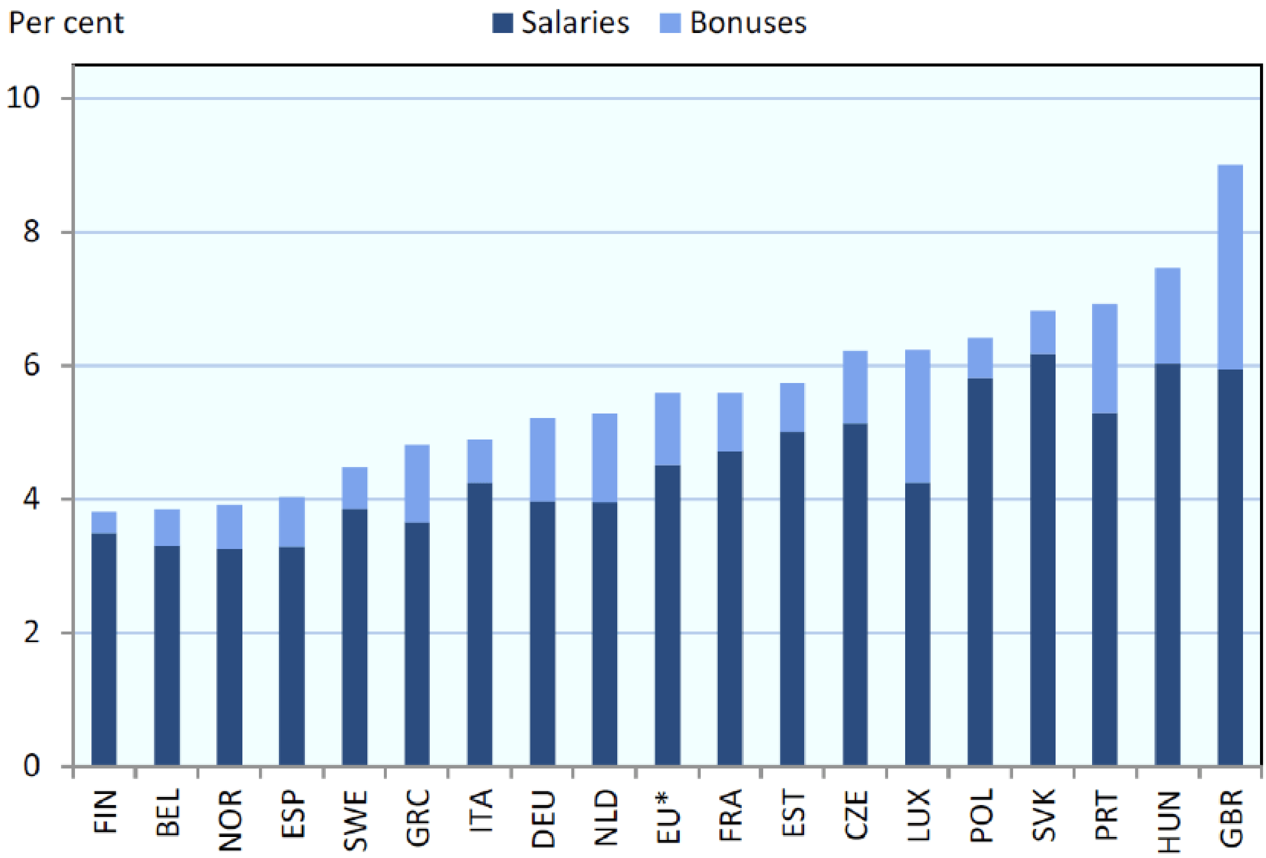
Source: Author calculations using Eurostat Structure of Earnings Survey; ICTWSS.

Finally, graph III drives home the message that the 1% top labour income earners (mostly CEOs, males between 40 and 60, working in finance and industry, getting high bonuses, etc.) are able to capture between 4% and up to almost 9% of all labour income in an economy. The UK, along with Central and Eastern European economies, has the highest income shares for the top 1%.

Graph III

Figure 1. Labour income inequality at the very top

A. Labour income of the top 1% divided by aggregate labour income



Why does high trade union membership reduce inequalities?

Here, the story is about the 'balance of power' with strong trade unions being able to mobilise countervailing forces against market outcomes. Through the process of collective bargaining, trade unions are able to get a better deal for low and middle wage workers and secure fair levels of wages by resisting the managerial prerogative to decide almost unilaterally on wages and working conditions.

This, in turn, makes it more difficult for capital owners and top executives to seize an important or disproportionate share of the total value added by the company. On top of this, strong trade unions are likely to increase workers' influence on corporate policy, thereby affecting decisions on top executive remuneration and dividends.

The principle of 'counter veiling power' exceeds the level of the individual workplaces and also functions at the macro level. Indeed, trade unions also take up the role of a broad political force that is co-shaping tax and benefits systems. By weighing on the political process, unions can prevent already powerful 'insiders' from rigging the redistributive design of the system in their favour as well.

Conclusion

It remains to be seen whether all of this material will be taken into serious account in the practical operations of the IMF (its adjustment programs) and the OECD (its general policy recommendations and its country recommendations). After all, these findings are very far away from the neo-classical theory according to which inequalities simply reflect the unequal distribution of marginal productivity. In other words, if wages are unequal it is because workers at the bottom end of the pay scale are not productive enough, while workers at the other end of the pay scale are “incredibly” productive.

Let’s hope however that these studies, as first steps towards ‘evidence based policy making’, function as an ‘eye opener’, not least for those inside the IMF and the OECD who still adhere to the neo-classical paradigm.