

6. Wage and income inequality

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A recent International Labour Organization (ILO) report found that changes in the distribution of wages and paid employment are key factors behind recent inequality trends in both developed and developing countries.

What role have labour markets had in shaping recent trends in household income inequality? This question is little discussed in the literature on the topic. But a recent International Labour Organization (ILO) report, excerpted below, shows that changes in the distribution of wages and paid employment have been key factors behind recent inequality trends in both developed and developing countries.

The report highlights a number of major trends concerning wages, with important consequences for the evolution of income inequality between and within countries. It argues that in many countries, inequality starts in the labour market. This is because wages are a major source of household income, particularly in developed, but also in developing, economies.

Global trends in wages

Changes in wages and paid employment throw some light on recent trends in inequality between countries. Global wage growth in recent years has been mainly driven by developing economies, where real wages have been rising since 2007, in some cases very rapidly. In 2013 real wage growth reached 6 per cent in Asia and nearly 6 per cent in Eastern Europe and Central Asia, but was less than 1 per cent in Latin America and Africa. China accounted for much of the global wage growth, due to both the high rate of real wage growth and its size.

In developed countries, on the other hand, real wages have not increased very much since the financial crisis, rising particularly slowly in 2012 and 2013. As a result, average wages in developing economies are slowly converging toward those in developed economies, even though they remain considerably lower.

Trends in income within countries

Within countries, income inequality is much higher in developing economies than in developed ones. Yet over the period 2006–10 overall inequalities increased very fast in some developed countries. This was mainly owing to a combination of job losses and increasing wage disparities. In Spain and the USA, the two countries where inequality increased most, job losses and changes in the distribution of wages accounted for 90 per cent of the increase in inequality in Spain and 140 per cent of the increase in the USA – meaning that in Spain inequality was further increased by changes to other income sources, while in the USA (as in some other countries) other income sources partially offset the increase in inequality caused by the labour market.

Taken together, the evidence from developed economies shows that the labour market was the largest force contributing to inequality over the period 2006–10. Other income sources, such as transfers, offset some of these increases in some countries. Earlier evidence shows that in the three decades before the 2008 crisis, increases in inequality were also largely driven by changes in the distribution of wages.

The labour market is an important factor in explaining income inequality trends in developing economies too. Although the contribution of wages to household income is smaller, and self-employment income larger, than in developed economies, no country has succeeded in reducing income inequality over the past decade without also reducing inequality in the labour market. Argentina and Brazil are among the countries where inequality fell most. More paid employment and reductions in wage inequality, including through a minimum wage policy, accounted for 87 per cent of the reduction in inequality in Argentina between 2003 and 2012, and for 72 per cent in Brazil between 2001 and 2012.

Conditional or unconditional cash transfers have made further contributions to the incomes of low-income groups. In many other countries, such as India, inequality increased around the same period.

Explaining wage inequality between groups

One element of inequality lies in the wage gaps between different groups of workers. In order to close these wage gaps, it is important to understand why they exist. The ILO report shows that women, migrants and workers in the informal economy sometimes incur 'wage penalties' for multiple and complex reasons which differ from one country to another, and that the penalty occurs at different places in the overall wage distribution. In general, a proportion of the wage gap can be explained by differences in observable individual and labour market characteristics which we would expect to determine wage levels.¹ Unfortunately, the part of the wage gap that cannot be explained by these characteristics remains substantial in many countries, and points towards continued wage discrimination against some categories of workers.

Acknowledgement

This contribution is excerpted from ILO (2015).

Note

1. Differences that are taken into account to explain the wage gap include experience; education; occupational category (managerial, high-skilled, semi-skilled, low-skilled and unskilled); economic activity (about ten categories, including manufacturing, services, and public administration); location (urban, rural); and work intensity (hours worked).

Bibliography

ILO. 2015. *Global Wage Report 2014/15: Wages and Income Inequality*. Geneva, ILO.

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