Executive Summary

International Labour Organization

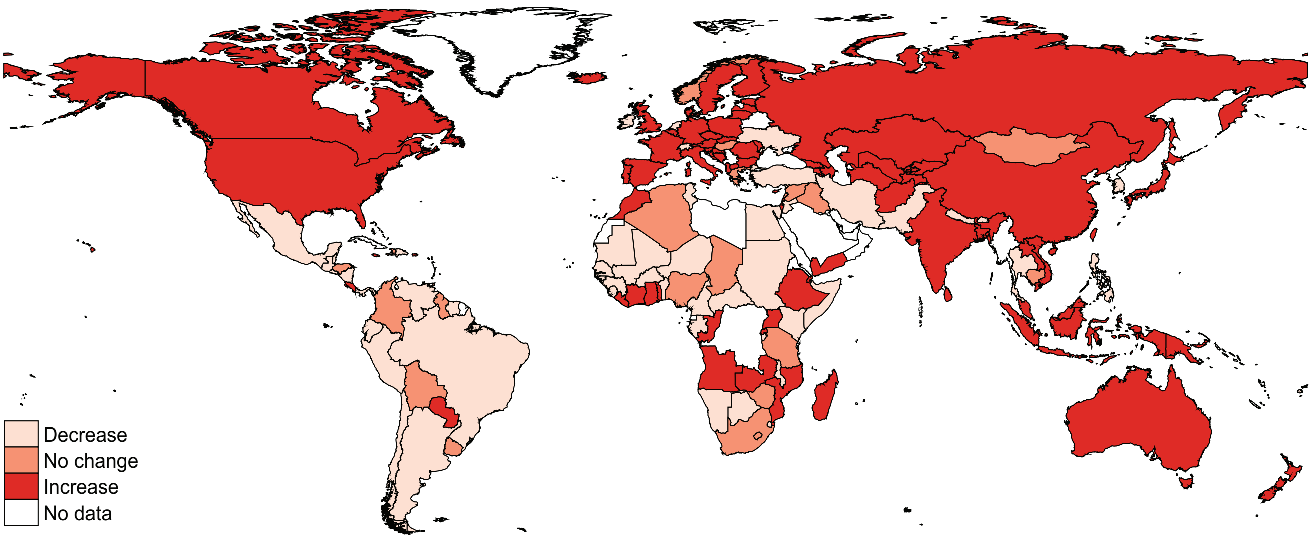
Labour Markets, Institutions and Inequality

Building just societies in the 21st century

Edited by Janine Berg

Over the past several decades, in most industrialized countries – Canada, the United States, most of Europe, and Australia and New Zealand – income inequality as measured by the Gini coefficient has increased. Inequality also increased in Asia, including in India and China, as well as in parts of Africa. In contrast, inequality fell in most of Latin America and in a handful of African countries (see figure). Nevertheless, Latin America remains the most unequal region of the world, slightly below southern Africa.

Figure. Changes in income inequality, early 1990s–early 2010s



Source: Standardized World Income Inequality Database, version 4.1

The rise in inequality, which has affected both the distribution of income between capital and labour, and among families and individuals, has prompted debates on the causes and possible remedies. This new edited volume, based on the findings of ILO experts, is about remedies.

It argues that to reduce inequality, countries must strengthen their labour market institutions, defined broadly to include the more familiar institutions that regulate the workplace – collective bargaining, minimum wages, the type of employment contract and working-time regulations – as well as institutions that redistribute income, such as pensions, income support for the unemployed and the poor, and public social services. Because work is by far the most important source of household income for non-retired households, the book also considers full employment policies in its analysis.

Chapters in the volume examine how specific labour market institutions affect income inequality as well as how these institutions interact with one another to influence how labour markets function. It considers both industrialized and developing countries and recognizes that there is no “one-size-fits-all” model for reducing inequality; rather, policies should be designed to reflect the economic, social and institutional characteristics of given countries. The authors argue that countries can, despite pressures from globalization, curb inequality, and show how governments can use a range of different policies, which work together, to achieve this goal.

Labour market institutions affect workers’ access to the labour market

At the most immediate level, policies aimed at promoting full employment help to ensure opportunities in the labour market. Lowering the cost of labour will not solve problems of unemployment; rather, macroeconomic, trade and investment policies need to be designed with the explicit goal of supporting job creation.

Workers are better able to access these jobs if there are supportive labour market institutions. For instance, the provision of public care services can facilitate women’s ability to enter or remain in paid work, with consequences for both gender and income inequality. When care services are not publicly provided, workers either are not able to enter the labour market, or have less flexibility – and thus less choice and bargaining power – when they do enter. If they do enter, they may relegate their domestic responsibilities to other, usually female, members of the household, which explains in part the higher share of young female NEETs (not in education, training or work) in lower-income families. Other institutions can also affect participation in the labour market, ensuring that groups outside of working age (e.g. adolescents, the elderly) have the option of not participating. For example, there is a significant negative relationship between the coverage and benefit levels of pensions and the labour force participation of the elderly.

Labour market institutions affect earnings in the labour market

Collective bargaining and minimum wages are two institutions that directly affect workers’ earnings, compressing overall wage distribution by propping up wages at the bottom of the wage pyramid. Unions’ influence on wage distribution in an economy can come from their role as actors representing labour in broader economic and social policy debates, but also as parties to collective bargaining agreements negotiated at either the firm or sectoral level. The influence of collective bargaining will differ depending on whether the system is “narrow”, as in limited to the parties or bargaining unit, or an “encompassing system”, whereby collective bargaining agreements are extended to workers in the broader economic sector who are not members of a union.

Minimum wages, by ensuring a minimum level of earnings for those at the bottom of the pay scale, are also an effective tool for compressing wage distribution, and they serve to lessen the incidence of low pay in both developed and developing countries. More than 90 per cent of ILO member States have a minimum wage system in place, and even in developing countries where enforcement mechanisms are weak, minimum wages help to reduce inequality.

The types of employment contracts people work under also influence their pay and working conditions. The rise in temporary employment contracts and part-time work can contribute to inequality depending on how it is regulated in national markets. For example, for part-time work, where national regulation embodies the principle of equal treatment of part-time workers, wages and benefits will be on a pro-rata basis and the worker will be less penalized for working part-time hours. Moreover, policies that grant employees the right to switch into and out of part-time work mitigate the risk of these jobs becoming a career trap.

As *Labour Markets, Institutions and Inequality* is concerned with overall equity in a society, it includes chapters devoted to analysing how labour market institutions affect the outcomes of women, youth and migrant workers in the labour market. The authors find that minimum wages, collective bargaining and policies that protect part-time and temporary workers help increase the earnings of these workers, while limiting the overall dispersion of income in the labour market – calling into question the assumption that labour market regulations hurt these groups.

Redistributive policies affect income both in and out of the labour market

Redistributive social policies are the principal means that governments have to alter the distribution of income. These policies help to smooth income over the different stages of life as well as help people prepare for possible contingencies. But besides directly affecting family incomes, social policies can also indirectly affect incomes, through their influence on the labour market. Social assistance programmes can lessen workers' desperation and thus their likelihood of falling victim to forced labour or other forms of exploitative work. Unemployment benefits can improve matching in the labour market as well as workers' ability to bargain for higher wages; employment guarantee programmes can improve compliance with the minimum wage. In-work benefits, on the other hand, can risk acting as a subsidy to low wages provided by employers, unless they are complemented by other policies such as minimum wages.

Governments vary in their commitment to redistribution, with tax systems and social security systems – the two main vehicles for fiscal redistribution – differing greatly in their scope and size across countries. The book provides data that shows, for example, how in Latin America and East Asia taxes and transfers have little impact on reducing the Gini coefficient (a reduction of a mere 0.02 percentage points), indicating that this is an underdeveloped policy tool. Europe and North America rely more heavily on taxes and transfers, but the design and redistributive impact of their systems differ. Europe relies more heavily on transfers, whereas the United States and Canada rely more on taxes to reduce inequality; the overall redistributive outcome is much greater in Europe, resulting in a reduction of the Gini coefficient of 0.20 percentage points or more in some countries.

The redistributive potential of social policies is also affected by design, including the mix between public and private forms of protection, and whether there are minimum guarantees for all. Many developing countries have recently expanded their social assistance programmes, which is a welcome development, given their effectiveness at reducing poverty. But because of the low level of benefits, these policies need to be complemented with other social protection measures that can provide expanded support to workers and have a greater redistributive effect.

The need for political will

There is a wide range of distributive and redistributive policies that countries can adapt if they want to build just societies. Selecting the right set of policies is an important first step, one which this book seeks to help policy-makers achieve. Putting the right mix into action, however, requires the political will and commitment to enact or strengthen laws and policies that can raise earnings at work as well as protect those who are out of the labour market. Only then can just societies be assured.

Department of Communication and Public Information
International Labour Organization
4 route des Morillons, 1211 Geneva 22, Switzerland
For more information, visit our website www.ilo.org