IMF research links declining labour share to weakened worker bargaining power

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Change THE RULES

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'Changes in institutions that have weakened worker bargaining power have lowered the labour share'

The IMF has published a paper linking the decline of labour's share in national income in most advanced economies over the past quarter century to labour market deregulation[1]. The paper, prepared by the Fund's research department, examines the impact of reforms in employment protection legislation in 26 advanced economies[2] (mostly European, plus Australia, Canada, Japan, South Korea and US) from 1970 to 2015. It found a decline of labour share in all but four of those countries from the early 1990s. The paper's analysis determines that weakened employment protection legislation (EPL) was a major explanatory factor.

While the paper's conclusions acknowledge, as per IMF orthodoxy, that EPL reforms may have positive impacts on output, they state that the deregulatory reforms' previously unacknowledged (within the Fund) negative impacts on wages and labour share call for "addressing trade-offs between efficiency and equity" in the design of these reforms:

"*... we found a statistically and economically significant negative effect of weaker job protection on labor shares.... Our findings are also robust to a variety of alternative specifications controlling for potential omitted variable bias and reverse causality as well as including different deterministic components. Our results call for more research on the role of labor market deregulation, alongside those of technology and globalization, in the extensive literature on the drivers of the decline in labor shares. On the policy front, they also point to the need for assessing the effects of labor market reform plans on a wide range of macroeconomic outcomes—including productivity, employment and output, but also wages and labor shares—and for addressing trade-offs between efficiency and equity when designing such reforms*."

The paper assesses the impact of job protection deregulation in a sample of 26 advanced economies over the period 1970-2015, using a newly constructed dataset of major reforms to

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[1] IMF Working Paper 'Employment Protection Deregulation and Labor Shares in Advanced Economies' by Gabriele Ciminelli, Romain Duval and Davide Furceri, August 2018

[2] The 26 countries covered are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom and United States

employment protection legislation for regular contracts. They apply the local projection method to estimate the dynamic response of the labor share to reform events at both the country and the country-industry levels.

Job protection deregulation contributed about 15 percent to the average labor share decline in advanced economies

The authors find a statistically significant, economically large and robust negative effect of deregulation on the labor share. In particular, the paper states that 'illustrative back-of-the-envelope calculations suggest that job protection deregulation may have contributed about 15 percent to the average labor share decline in advanced economies'.

Changes in institutions that have weakened worker bargaining power have lowered the labour share

The paper empirically shows that deregulation of the labour market contributed to some of the observed decline in labor shares in many advanced economies

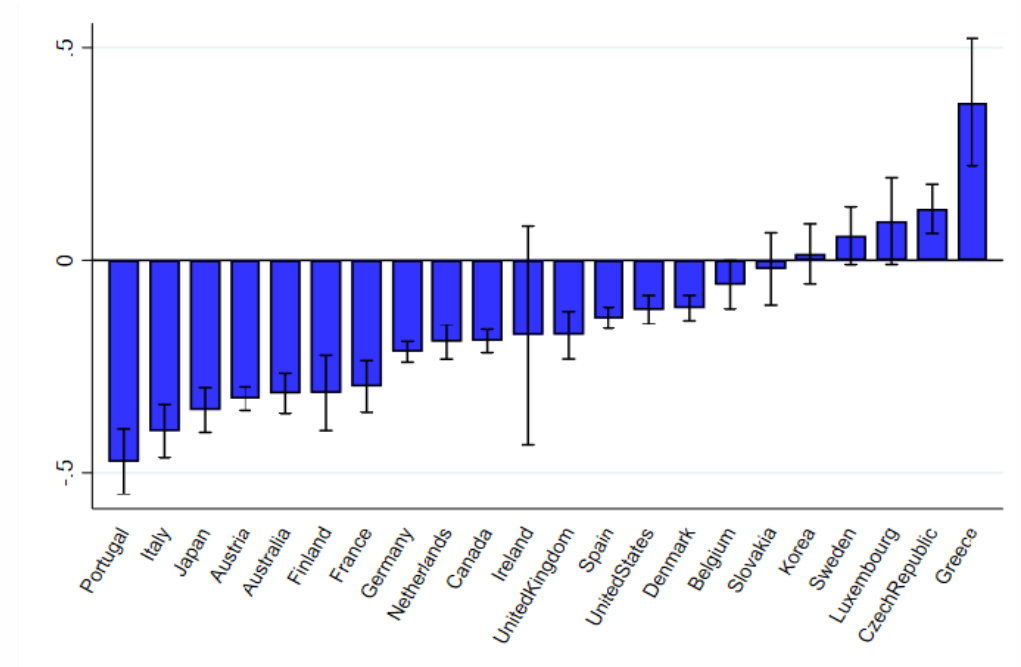
'*these effects to be mainly driven by a decline in the real wage; this further supports our interpretation that weaker bargaining power has been the key channel through which Employment Protection Legislation deregulation has lowered labor shares in reforming advanced economies'*

There is now a growing consensus for a link between labor market deregulation, weaker bargaining power and lower labor shares, Blanchard (1997) and Blanchard and Giavazzi (2003) provide theoretical support for a link.

They also find that labor shares have generally been on a declining trend since the mid-1970s, with the decline accelerating in the 1990s but there exist significant heterogeneities both across countries and industries.

Over the period 1970-2015, the IMF estimated the average yearly change in labour's share of national income relative to the other advanced countries. Australia had the fifth largest average yearly change of the 22 countries analysed.

Graph: IMF estimates of average yearly change in country labor shares 1970-2015

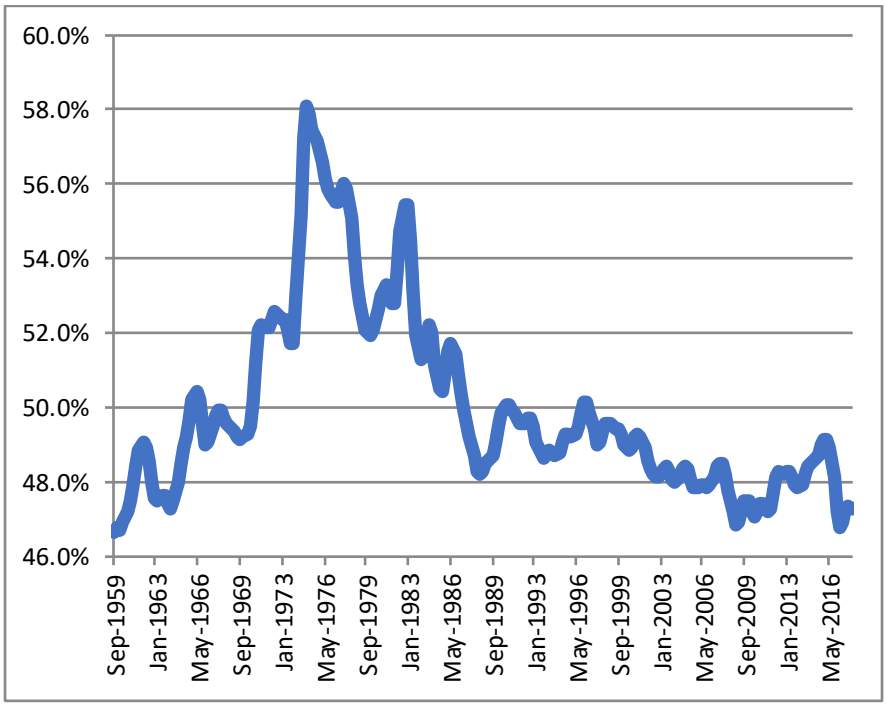


Notes: Replicated from IMF: The Figure shows estimated linear trends in industry labor shares (y-axis) for each country. Trends are estimated from the following regressions: $LStj=\alpha j+\tau tj+\varepsilon tj$, where the subscript t and the superscript j denote respectively year and country. LS is the labor share, α is a constant term, τ is the linear trend, and ε is the error term. Capped spikes denote 90% confidence intervals. Estimates should be interpreted as the average yearly change in country labor shares over the period considered. The period considered is country-specific and depends on the availability of labor income data in the EU KLEMS database, but is 1970-2015 in most cases.

The labour share of Australia's GDP is now around 11 percentage points lower than during the mid-1970s. Dr. Jim Stanford, from the Centre for Future Work estimates that if the proportion of national economic output being paid to wages was at the same level as in 1975, Australian workers would have received more than $200 billion in extra compensation last year – or $16,750 extra income, on average, for each employed worker[3].

[3] https://www.smh.com.au/business/the-economy/australia-needs-a-raise-wage-earners-have-rarely-collected-a-smaller-share-of-the-economy-20180803-p4zvcz.html
For additional information Australia's labour share please see: '*The Declining Labour Share in Australia: Definition, Measurement and International Comparisons*' Stanford J, Journal of Political Economy, Issue No 81, Winter, 2018

Graph: Labour Compensation as a share of GDP 1959-2018



Source: ACTU's calculations from ABS Catalogue 5206.0.

If Australia is to reverse the decline in labour share policy reforms to strengthen workers bargaining power will be crucial

The empirical evidence presented in this recent IMF paper between the negative effects of weaker job protections is strong and statically significant[4].

What the IMF is referring to when they discuss weaker job protections and employment market deregulation is the neoliberal attack on unions and labour legislation over the last 30 years in advanced economies. The natural conclusion of this paper is that if Australia is to reverse the decline in labour share then policy reforms to strengthen workers' bargaining power will be crucial.

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[4] The IMF paper *"found a statistically and economically significant negative effect of weaker job protection on labor shares. In line with theory, this effect is concentrated in industries with a higher propensity to regularly adjust the workforce and a lower elasticity of substitution between capital and labor, and it is likely driven by a reduction in wage rents"*

In addition to the empirical evidence on weaker job protections and the labour share of income discussed by the IMF, the OECD has also recently assessed different collective bargaining systems on the economy. We discuss this below.

Wage stagnation and the need for bargaining with multiple employers and across industries

The international economic consensus on the role of labour market institutions and labour market outcomes appears to be changing. In July 2018 the OECD released their flagship publication the "Employment Outlook". A key chapter of this new publication reports on the results of a comprehensive study examining how different collective bargaining systems impact on the economy.

Based on new economic evidence the OECD has abandoned its previous support for enterprise level collective bargaining and individual contracts. Instead the OECD is now strongly supporting coordinated industry and multi-employer collective bargaining and measures to ensure the maximum number of workers are covered by a collective agreement that is negotiated with a trade union.

The OECD concluded that widening income inequality is a serious economic and political challenge. They have advanced a number of policy recommendations to boost wages and prevent further increases in inequality. Industry and sector level collective bargaining and stronger trade unions are among their key recommendations.

Industry and sector level collective bargaining reduces wage inequality and produces better labour market outcomes

The OECD examined the impact of collective bargaining systems in 35 advanced economies over the period 1980 to 2015. They found that industry level bargaining systems, that allow trade unions and employers to coordinate outcomes across a sector, significantly out-perform countries with either enterprise only level bargaining or no collective bargaining. According to the OECD, countries with these types of bargaining arrangements:

> "*... are shown to be associated with higher employment, lower unemployment, a better integration of vulnerable groups and less wage inequality than fully decentralized systems.*"

Countries that had industry level and coordinated bargaining systems in 2015 include Austria, Denmark, Germany, the Netherlands, Norway, Sweden, Belgium and Finland.

Countries that are classified as having "fully decentralized collective bargaining systems" include the USA, United Kingdom and New Zealand. Countries in this category performed worse than the three categories of countries that had variations of industry or sector level bargaining in terms of the employment rate; unemployment rate; youth unemployment; gender equality in the labour market; the integration of low skilled workers into jobs; and, in respect of wage inequality.

Australia was grouped in the category that had the second worst economic performance (described by the OECD as "largely decentralized collective bargaining systems"). The group that contains Australia performed significantly worse in terms of employment and unemployment than the three groups of countries that use variations of industry or sector level bargaining. The group containing Australia also performed worse than all three industry or sector level bargaining groups when it came to integrating youth, women and low skilled workers into employment.

Wage inequality in the group containing Australia is greater than in the groups of countries that have access to industry level collective bargaining. The OECD did not include Australia in the same category as the USA and the UK largely because of the existence of the system of Modern Awards in Australia. To realise the potential for economic improvements through coordinated bargaining systems will require the repeal of laws that currently inhibit and prevent industry or multi-employer bargaining and restoring various powers that the industrial umpire had prior to the 1990s.

The OECD supports measures to boost wages

Another key finding of the Employment Outlook 2018 is that despite rising employment rates, advanced economies are facing "unprecedented wage stagnation". OECD research suggested that with unemployment falling to current levels, wage growth should be roughly double what is being experienced. Wage stagnation is primarily affecting low-paid workers, part-time workers and those in other forms of precarious work. The OECD has voiced strong concerns about the implications of wage stagnation for economic, social and political stability. These concerns are particularly relevant in Australia where wage stagnation is now presenting an unprecedented challenge.

The OECD strongly supported enterprise level collective bargaining in the 1990s. In the past, its recommendations were often cited by conservative Australian Governments who wanted to abolish trade unions, introduce individual contracts and weaken the industrial umpire. Now the OECD has thoroughly reviewed the economic evidence and acknowledged that the attack on collective bargaining and labour market institutions is misconceived.

Conclusions

It is time to revise our labour laws and strengthen our institutions to support industry and sector level bargaining and stronger trade unions. The OECD has argued that this makes economic sense. It is also the sound social and political strategy at this time.

Workers have rarely collected a smaller share of Australia's economy. Australia has experienced a decline in labour's share of income since the 1970's. With the IMF publishing strong empirical evidence showing that changes in institutions have weakened worker bargaining power and have lowered the labour share, it is clear we need stronger labour market institutions in order to reverse the decline.

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