

The Political Economy of Income Distribution

Alexander Guschanski

*Senior lecturer in Economics,
University of Greenwich*



PEGFA | Institute of Political Economy,
Governance, Finance and Accountability

Outline

- Short-term: The cost of living crisis
- Long-term: Declining bargaining power of labour
 - Decline in the wage share
 - Wage inequality
- Empirical evidence
- What can we do about it?

Short-term: The cost of living crisis

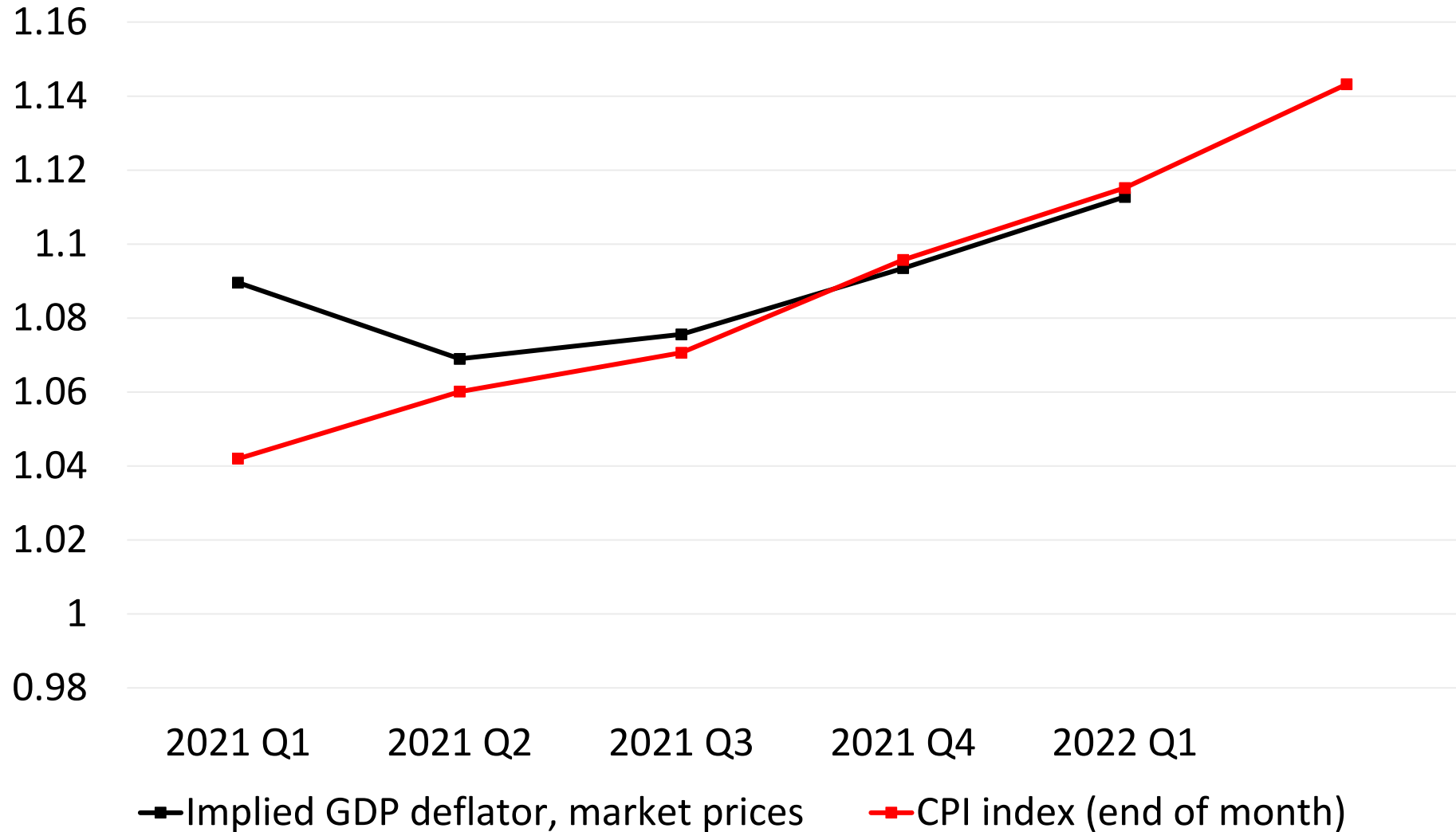
- Consumer Prices Index (CPI) ↑ 9.0% April 2021-22
 - Main contribution: Housing, water, electricity, gas and other fuels, transport & food ([ONS](#))
- Poorest households are hit hardest:
 - 10.9% 1st income decile
 - 7.9% inflation 10th income decile ([IFS](#))
- Wages don't keep up → real wages fall
 - January to March 2022: regular pay ↓ -1.2%
 - March 2021 to March 2022: regular pay ↓ -1.9% ([ONS](#))

Short-term: 1st wave vs 2nd wave inflation

- 1st inflation wave: Q1 2021-Q3 2021
 - Supply chain bottlenecks, increasing oil prices, labour shortages...
 - CPI (including prices of imported goods) increased 2.7%
 - GDP deflator (price of domestic production) declined (-1.28%)
- 2nd inflation wave: Q3 2021-Q1 2022
 - Domestic firms are increasing prices beyond increasing costs of imported intermediate products
 - CPI increased 4.2%
 - GDP deflator increased 3.45%

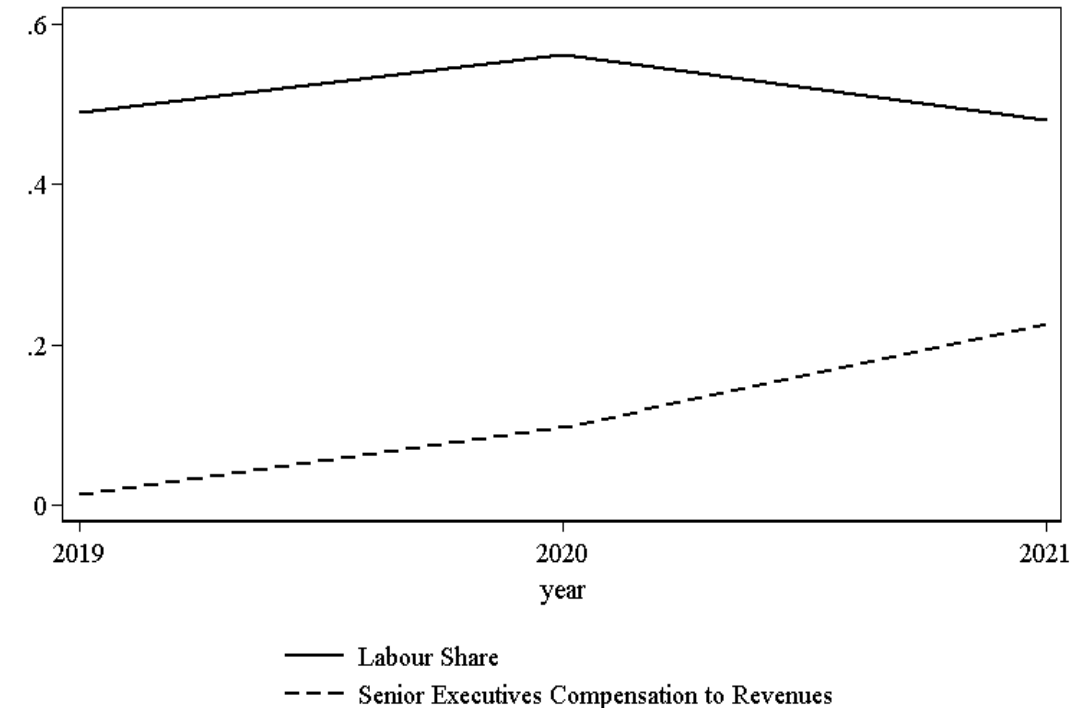
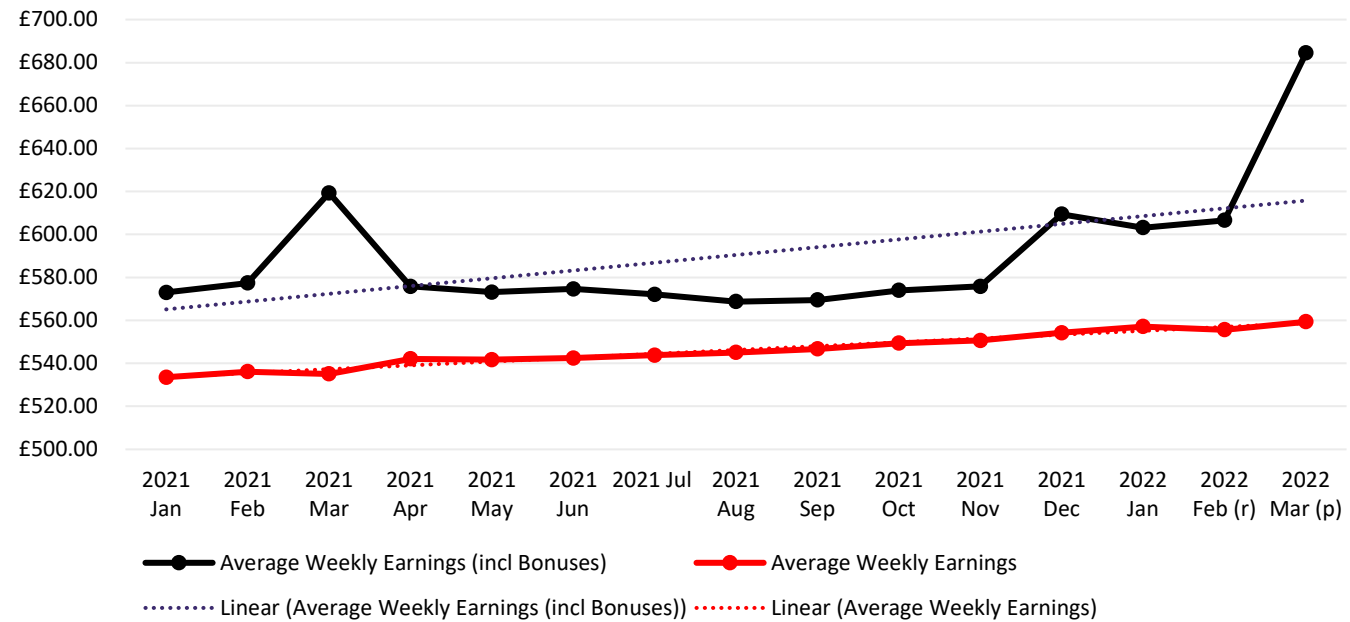
UK: CPI index vs GDP deflator

UK inflation



Why inflation?

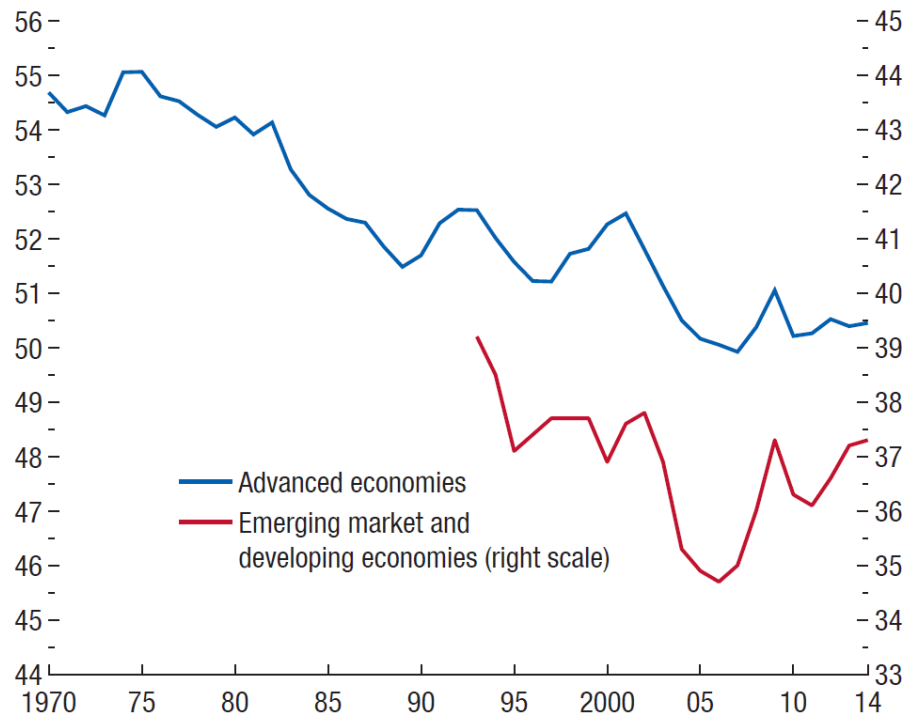
- Oil prices, supply side factors
- Andrew Bailey: Workers should “think and reflect” before asking for pay rises
- Boris Johnson: “We can fix the CoL crisis by increasing wages”
- Yet: No evidence that increasing wages are driving inflation
 - Nominal wage growth low, in line with trend
 - Although...
 - Bonus payments
 - FTSE 350: Executive compensation vs labour share
- We see evidence of
 - Stagnating wages
 - Increasing wage inequality
- Price gauging or supply bottlenecks???



Long-term: Declining bargaining power of labour

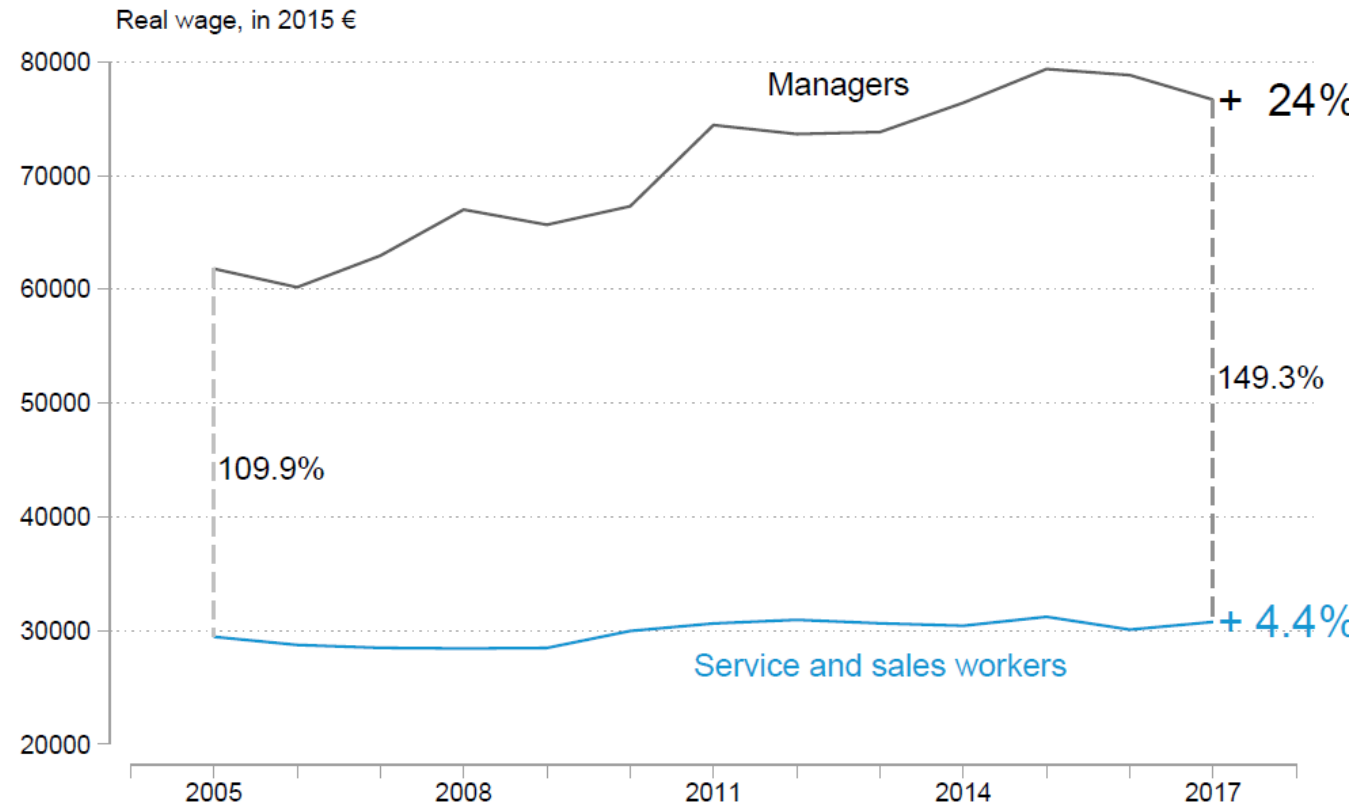
Declining Wage Share

The labor share of income has been on a downward trend in both advanced economies and emerging market and developing economies.



Increasing Wage Inequality

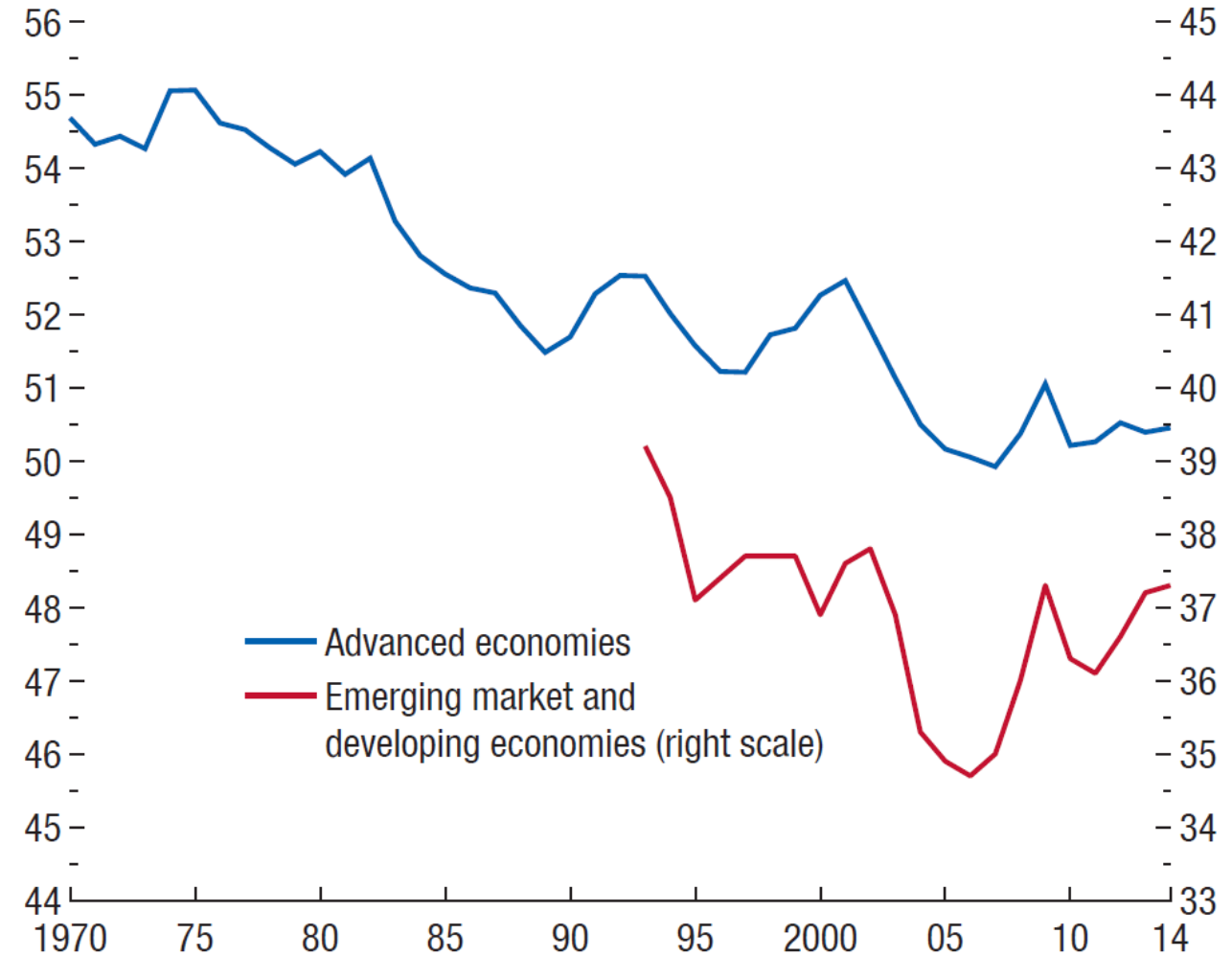
Wage growth diverges across occupations



Sources: CEIC database; Karabarbounis and Neiman (2014); national authorities; Organisation for Economic Co-operation and Development; and IMF staff calculations.

Declining Wage Share

The labor share of income has been on a downward trend in both advanced economies and emerging market and developing economies.



Sources: CEIC database; Karabarbounis and Neiman (2014); national authorities; Organisation for Economic Co-operation and Development; and IMF staff calculations.

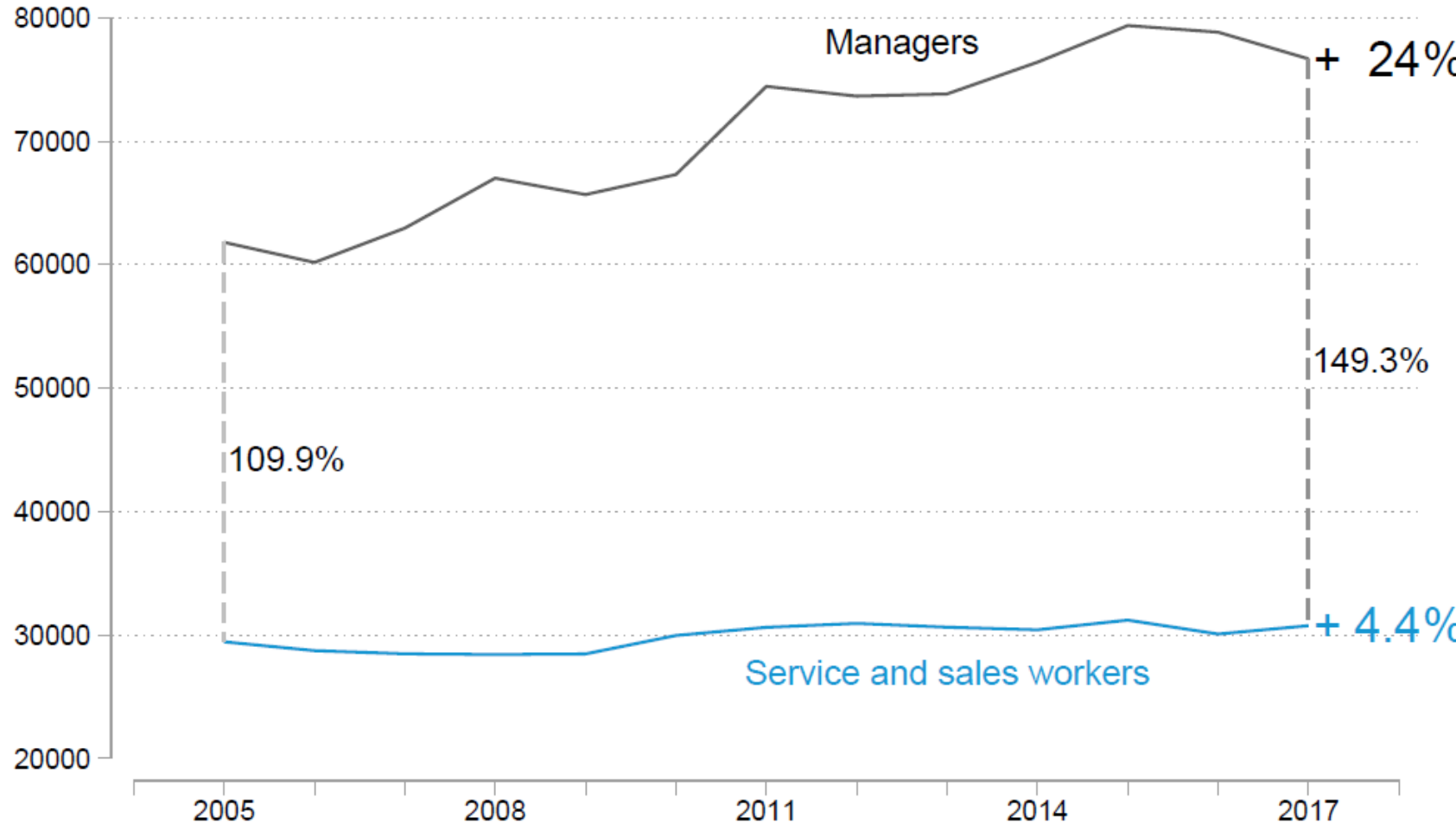
Why did the labour share decline? (with Özlem Onaran)

Two main narratives

1. Human labour is substituted by machines
 - “Inequality is natural consequence of technological progress”
2. Bargaining relations
 - Changes in labour market institution [strike laws – immunities(!), collective bargaining coverage, union density, gender, race]
 - Globalisation – in capital (offshoring) and labour (migration)
 - Financialisation

Increasing Wage Inequality

Wage growth diverges across occupations
Real wage, in 2015 €



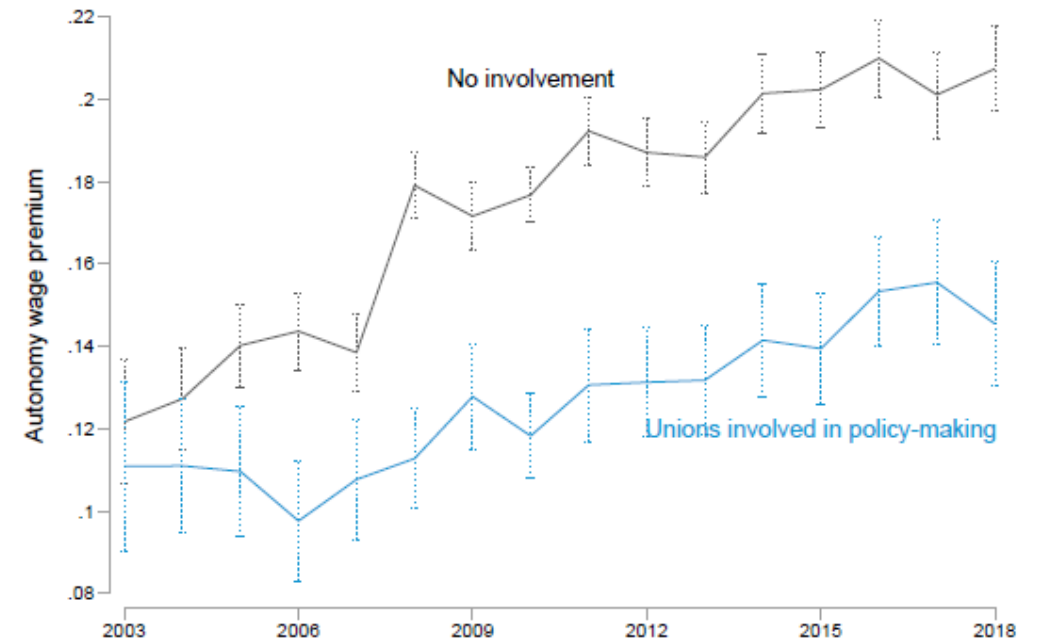
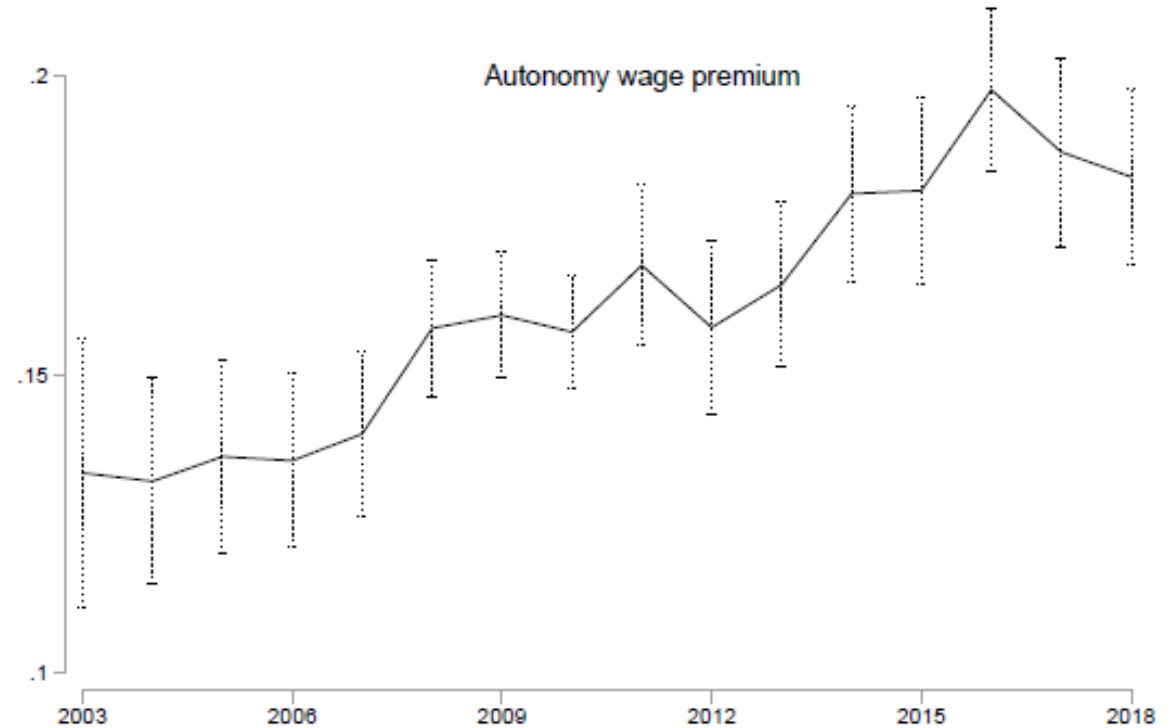
Why did wage inequality increase?

(with Thomas Rabensteiner, work in progress)

- Job-polarization → decline of the middle-class
 1. Routinisation (Autor et al. 2003, Acemoglu and Autor 2011)
 2. Offshoring (Firpo et al. 2011)
- Rising wage inequality natural consequence of technological progress?
- But what about low-wage workers whose jobs cannot be offshored or automated?
 - Cleaners
 - Customer facing activities
 - ...

Empirical evidence

- European Union Survey of Income and Living Conditions (EU SILC), 800k observations
- Offshoring and routinisation do not predict wage *divergence*
- Neither does education
 - Education premium declining
- Worker autonomy: strong predictor of wage growth
- Mediated by collective bargaining



Conclusion

- Short-term
 - Wages not a driver of recent inflation
 - Workers have been losing out: regular pay↓, executive pay/ bonuses↑ → wage inequality ↑
- Long-term
 - Declining wage share, increasing wage inequality
 - Declining bargaining power of labour → important, yet underappreciated
- Solution
 - Short-term: increase wages (minimum wage↑) and income (benefits), introduce price controls
 - Medium-term: regain bargaining power
 - Union density, collective bargaining coverage can increase wage share & reduce wage inequality

References

- Guschanski, A. and Onaran, Ö. (2021) 'The decline in the wage share: falling bargaining power of labour or technological progress? Industry-level evidence from the OECD', *Socio-Economic Review*, <https://doi.org/10.1093/ser/mwaa031>
- Guschanski, Alexander and Onaran, Özlem (2021), "[The effect of global value chain participation on the labour share – Industry level evidence from emerging economies](#)", #GPERC82
- Guschanski, A. and Onaran, Ö. (2018), '[Determinants of the wage share: a cross-country comparison using sectoral data](#)', CESifo Forum
- Guschanski, A. and Onaran, Ö. (2018), "The labour share and financialisation: Evidence from publicly listed firms", *Greenwich Papers in Political Economy*, University of Greenwich, [#GPERC59](#)
- Kohler, K., Guschanski, A., and Stockhammer, E. (2019) The impact of financialisation on the wage share: a theoretical clarification and empirical test, *Cambridge Journal of Economics*, vol. 43, no. 4, 937–974
- Onaran, Özlem and Guschanski, Alexander (2018), [Reverting Inequality: a win-win for people and economic performance](#). *Raising the Bar*. pp. 45-54 (doi: <https://fabians.org.uk/publication/raising-the-bar/>).

Get in touch

Alexander Guschanski

- Email: alexander.guschanski@gre.ac.uk
- Twitter: [@AGuschanski](https://twitter.com/AGuschanski)



PEGFA | Institute of Political Economy,
Governance, Finance and Accountability

Conclusion

- Short-term
 - First wave of inflation driven by external costs & supply bottlenecks
 - Still relevant, but now also domestic sources → But NOT wages
- Long-term
 - Declining wage share, increasing wage inequality
 - Declining bargaining power of labour → important, yet underappreciated
- Solution
 - Short-term: increase wages (minimum wage↑) and income (benefits), introduce price controls
 - Medium-term: regain bargaining power
 - Union density, collective bargaining coverage can increase wage share & reduce wage inequality

Short-term: The cost of living crisis

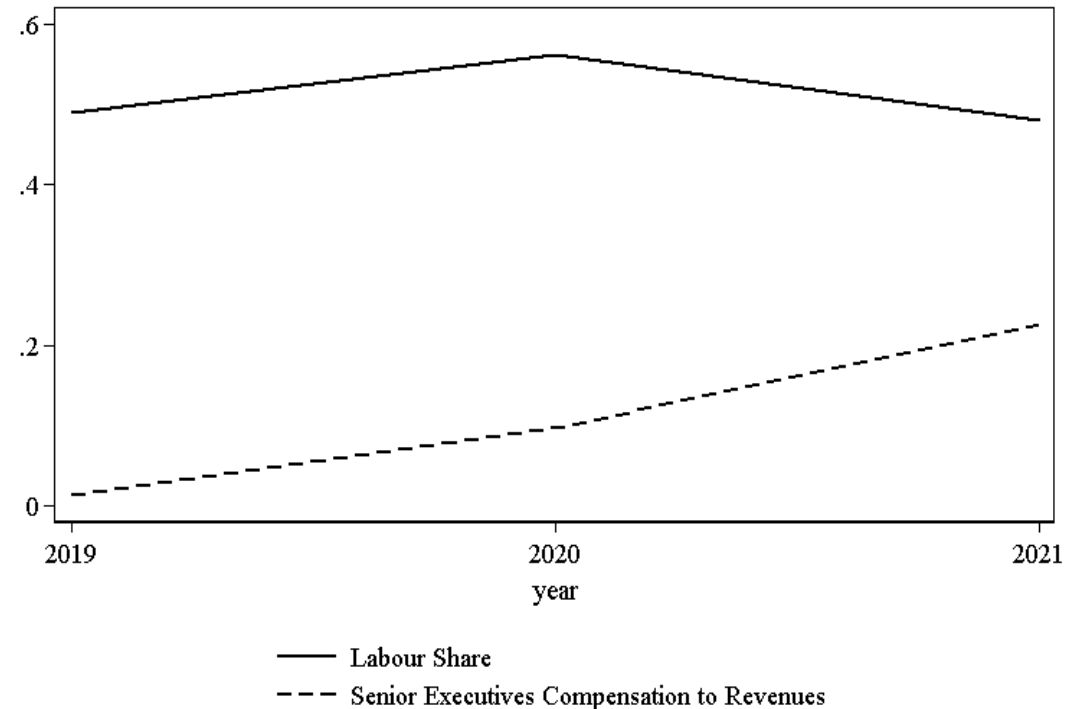
- Consumer Prices Index (CPI) ↑ 9.0% April 2021-22
 - Main contribution: Housing, water, electricity, gas and other fuels, transport & food (ONS)
- Poorest households are hit hardest: 10.9% vs 7.9% inflation between 1st and 10th decile (IFS)
- Wages don't keep up → real wages fall
 - In real terms (adjusted for inflation) in January to March 2022, growth in total pay was 1.4% and regular pay fell on the year at negative 1.2%.
 - Strong bonus payments have kept real total pay growth positive, and real regular pay growth last fell on the year to more than negative 1.2% in September to November 2013

1st wave vs 2nd wave inflation

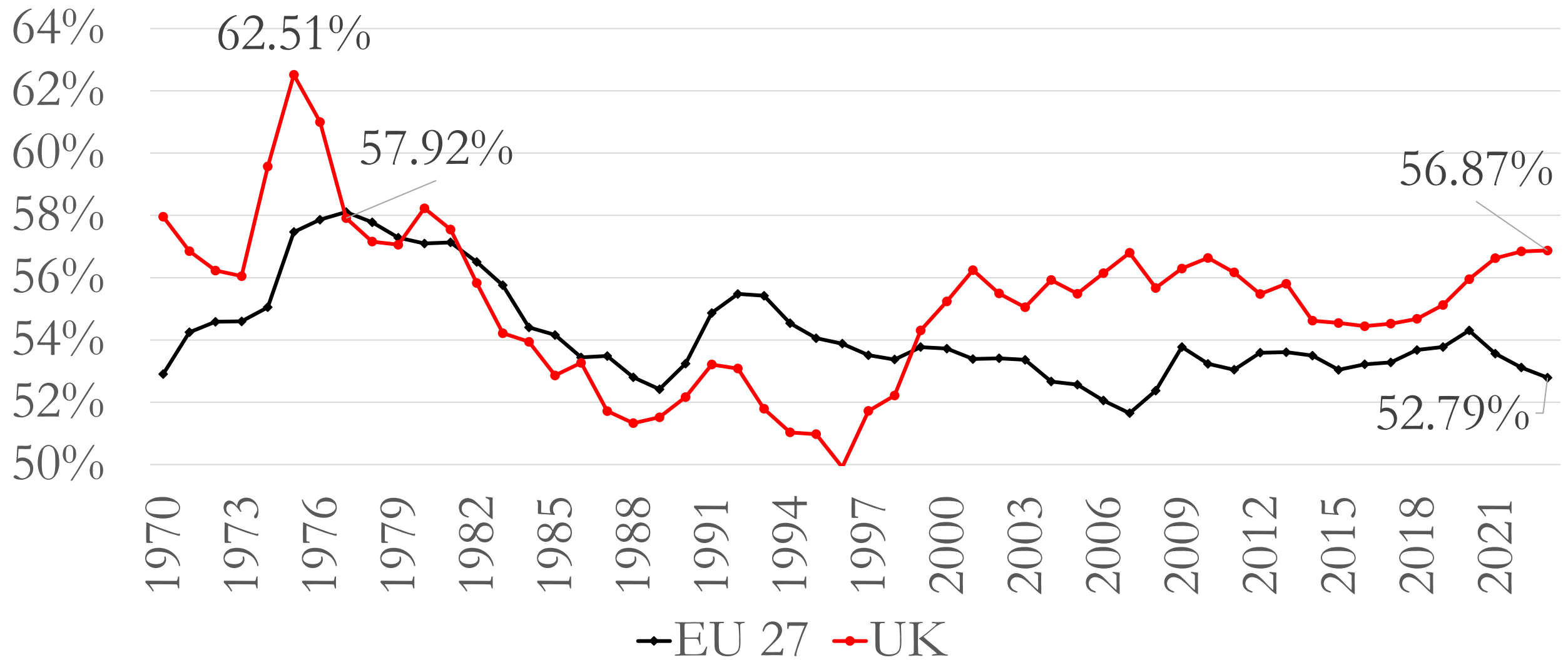
- We can think of inflation as driven by external and internal factors
- One way to look at this is to compare the CPI and the GDP deflator
- Inflation (CPI):
 - 2020,Q1-2021,Q1: 0.71%
 - 2021,Q1-2022,Q1: 7.02%
- → 1st wave driven by: supply chain bottlenecks, increasing oil prices, Russia's attack on Ukraine, ...
- CPI = 'felt' inflation vs GDP deflator = 'domestic production' inflation
- CPI increases slightly in 2020; strong rise since Q2 2021: 7.02% between Q1 2021 – Q1 2022
- GDP deflator spikes during Covid (Q2 2020) but since then declines... until Q3 2021 (-1.28% between Q1 2021 – Q3 2021)
- Since Q3 2021: 2nd wave of inflation (domestically driven): 3.45% Q3,21-Q1,22
- When GDP deflator increases, this goes either into ULC or unit profits
- Recent analysis by Unite the Union suggests that 59% goes into profits, while 8% went into wages

Short-term: Crises and income distribution

- $GDP = Wages + Profits \rightarrow GDP \text{ deflator} = \text{unit labour costs} + \text{unit profits}$
- When GDP deflator increases, this goes either into ULC or unit profits ($GDP = Wages + Profits$)
- 2nd inflation wave (Q3 2021-Q1 2022): 59% goes into profits, while 8% went into wages (Unite the Union, 2022)
- No evidence that increasing wages are driving inflation
 - Andrew Bailey: “Workers should “*think and reflect*” on whether to ask for *pay* rises”
 - FTSE 350: Executive compensation vs labour share
- Who will win?

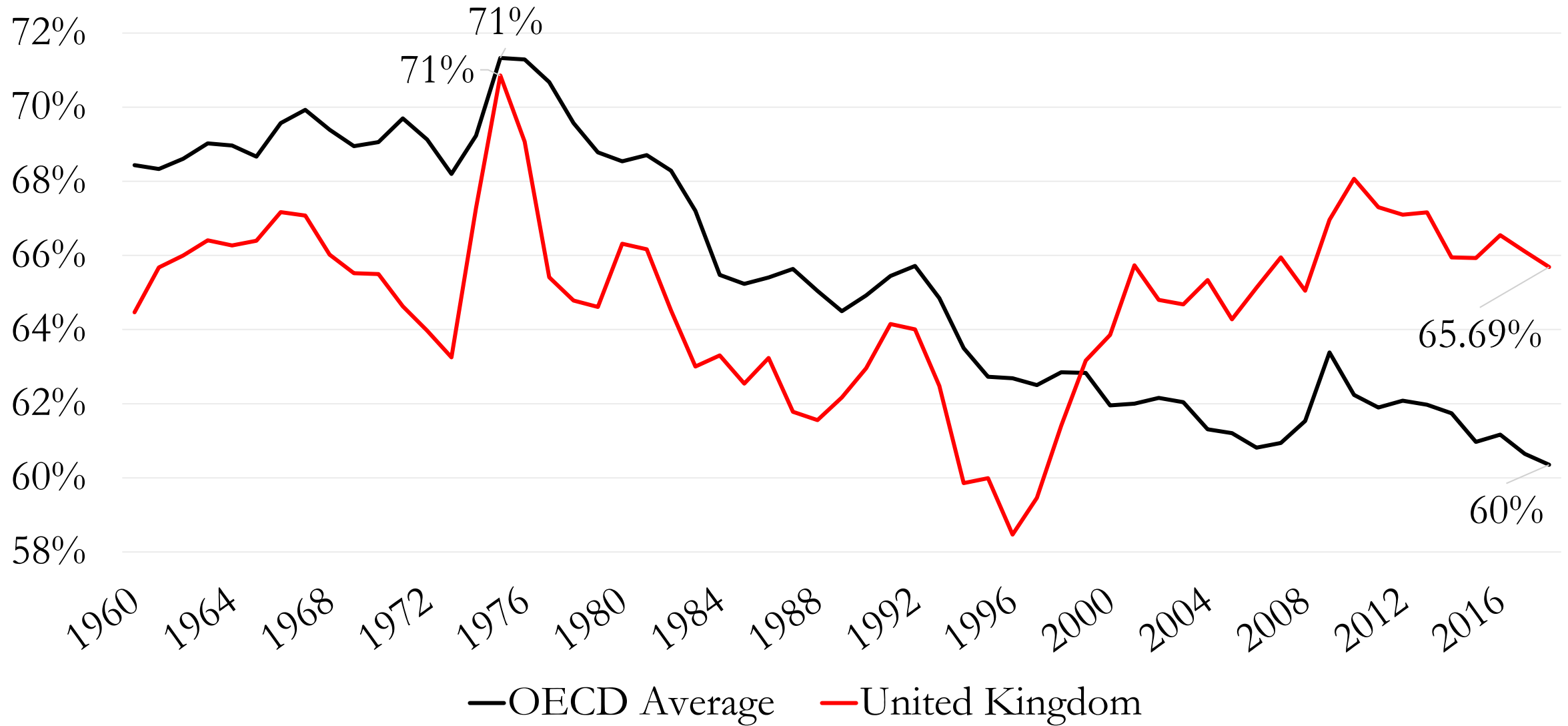


Wage Share in Europe and the UK



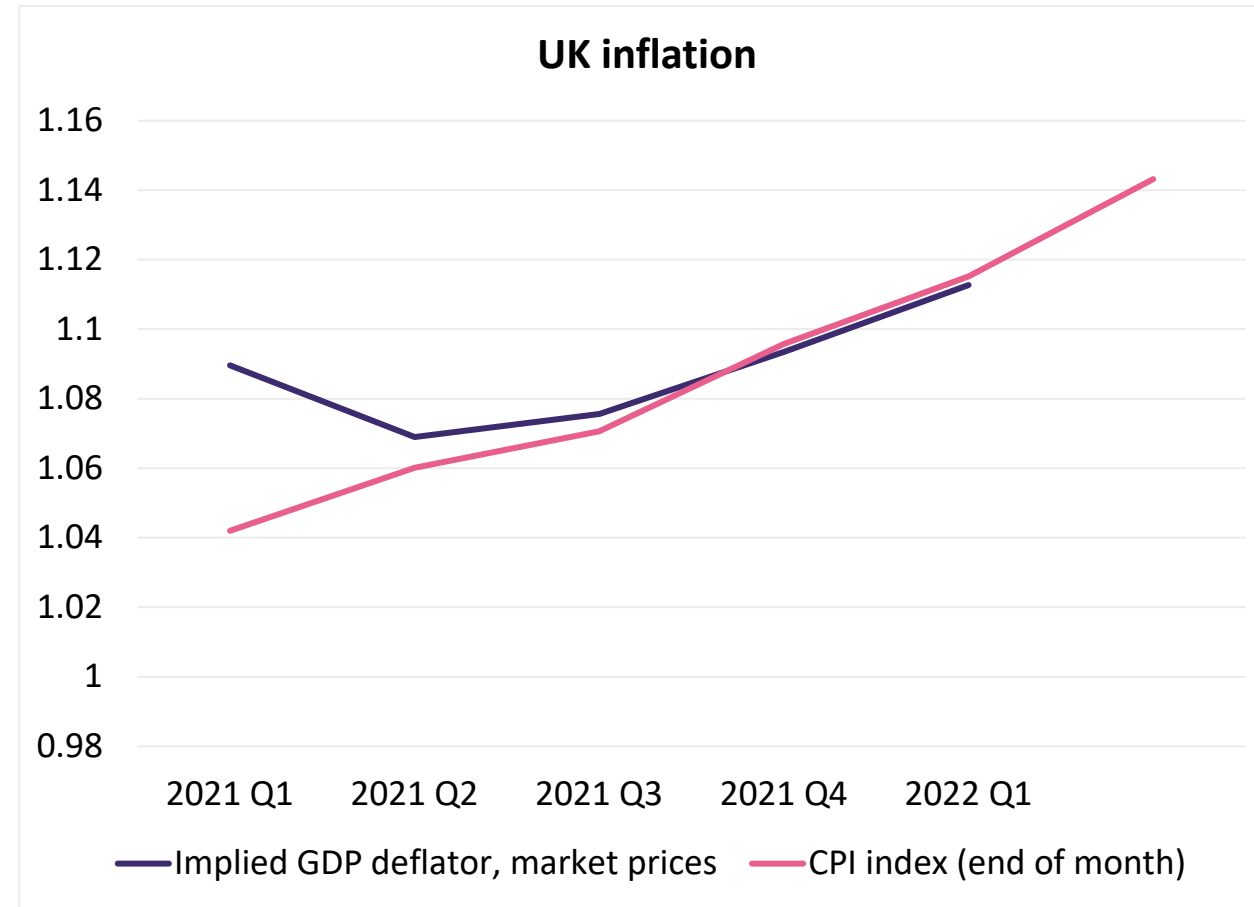
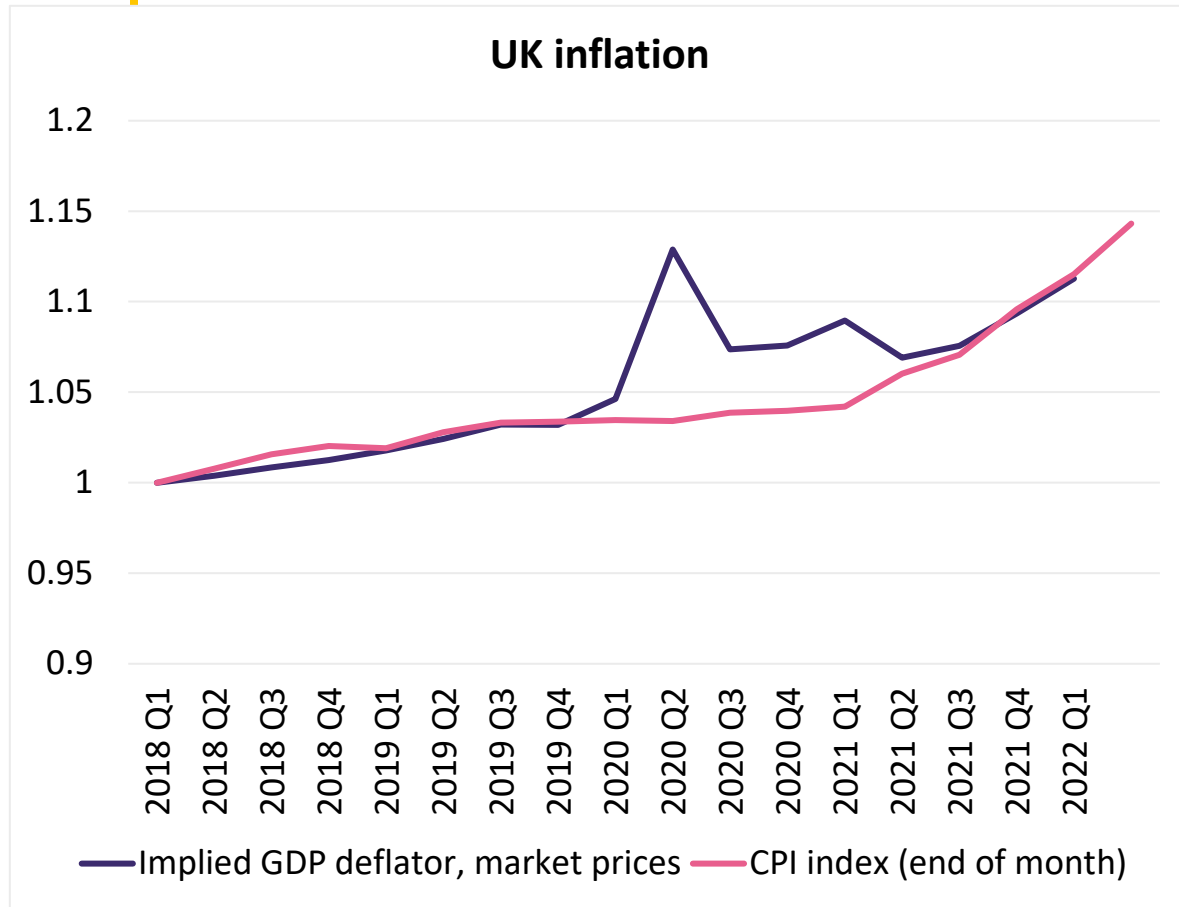
Source: Ameco database (http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm)

Average Wage Share in OECD countries & The UK



Source: Ameco database (http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm)

UK: CPI index vs GDP deflator



UK: CPI index vs GDP deflator

