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OECD Economic Outlook 2018

Mixed Findings on the Drivers of Wage - Productivity Decoupling

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Overview

The recent OECD Economic Outlook contains a special chapter stressing the fact that gains in productivity have not been broadly shared with workers in the majority of OECD countries over the last two decades. The OECD also discusses the implications for public policy. While it is interesting to note that the OECD is now openly recognising that improving productivity performance does not automatically trickle down to wages, the report offers less convincing conclusions, in particular with regard to the impact of higher minimum wages.

Decoupling can reflect (i) lower labour share of GDP and/or (ii) greater wage inequality (within and between firms).

The report OECD finds that technological change and integration in global value chains are driving almost two thirds of the decline in the labour share.

However, the report also contends that policy has an important role to play. This is particularly true for enhancing workers' skills, which supports the labour share while containing wage inequalities.

The report finds mixed outcomes for deregulating labour markets or decentralising collective bargaining. Reducing job protection and minimum wages increases wage inequalities between workers, but at the same time *increases* the labour share.

The report makes the counterintuitive claim that higher minimum wages would work to bring the labour share down. Minimum wage hikes would replace (low wage) workers with capital and machinery, the upwards effect of higher wages on the labour share would be more than offset by the number of jobs being destroyed. The negative job effects of minimum wages are however very hard to find in the empirical research on minimum wages.

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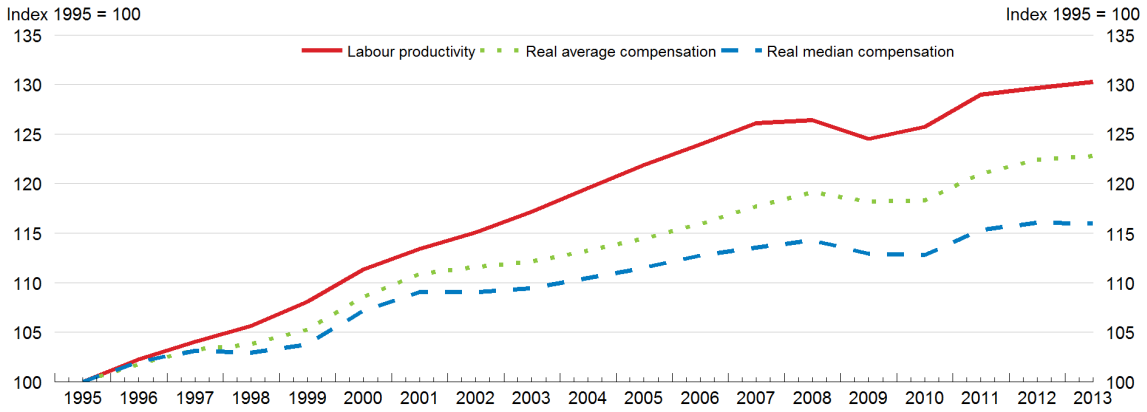
Regarding collective bargaining, the OECD offers language that recognises the value of "some degree" of centralisation: "*Strengthening workers' bargaining positions through reviewing collective bargaining institutions can promote the transmission of productivity gains to wages. On average across countries, some degree of centralisation of collective bargaining does not appear to reduce the labour share and may reduce between-firm wage dispersion*" (page 63).

Wages have stayed behind productivity growth for two decades

The OECD compares productivity improvements since 1995 with the increase in average wages but also with the pace of increase in median wages. While the gap between productivity and average wages describes a falling labour share, the gap between average and median wages indicates to what extent inequality within wage earners has increased, in other words the extent to which high-level professionals and not typical workers have been able to capture a disproportional part of innovation and productivity gains.

The numbers are striking: Out of a 24-country sample, the labour share has been falling over the 1995- 2014 period in 15 OECD economies. In turn, median wages have lagged behind average wage increases in 21 countries. Both trends testify to rising inequalities and to the fact that productivity gains have not been broadly shared with workers.

Using the OECD weighted average and compounding the average annual change (0,6%) over the 20 year period, one arrives at the conclusion that wages for the typical workers (median wage) would have risen twice as fast (by 30% instead of the observed 15%) if productivity gains had been shared more equally (see graph below). The table below also provides country level results.



Source: OECD http://dx.doi.org/10.1787/888933876195

Table 2.1. There are large cross-country differences in macro-level decoupling						
Excluding primary, housing, and non-market sectors, annualised growth rates in percentage points						
	Annualised growth rates			**Contribution to decoupling of**		
	Labour productivity	**Real average wages**	**Real median wages**	**Labour share**	**Wage inequality**	**Total decoupling**
	(1)	**(2)**	**(3)**	**(2) - (1)**	**(3) - (2)**	**(3) - (1)**
Poland	4.2	2.8	2.2	-1.3	-0.6	-2.0
Korea	4.1	3.1	2.7	-1.1	-0.4	-1.5
United States	1.8	1.2	0.5	-0.6	-0.7	-1.3
Hungary	1.9	1.5	0.6	-0.4	-0.9	-1.3
Ireland	2.5	1.4	1.3	-1.1	-0.1	-1.2
Canada	0.9	0.4	0.2	-0.5	-0.2	-0.7
Netherlands	1.8	1.3	1.1	-0.5	-0.2	-0.7
Australia	1.6	1.2	1.0	-0.4	-0.3	-0.7
Israel	1.6	0.7	0.9	-0.9	0.2	-0.7
Japan	0.7	0.3	0.2	-0.5	-0.1	-0.5
Slovak Republic	3.8	3.6	3.3	-0.2	-0.3	-0.5
Belgium	1.4	1.1	1.0	-0.3	-0.1	-0.4
Germany	0.7	0.6	0.5	-0.1	-0.1	-0.2
Austria	1.1	1.0	0.9	-0.1	-0.1	-0.2
Norway	1.5	1.4	1.3	-0.1	-0.1	-0.2
Czech Republic	3.2	3.6	3.2	0.4	-0.4	0.0
New Zealand	1.0	1.4	1.0	0.4	-0.4	0.1
Denmark	1.1	1.4	1.3	0.3	-0.1	0.2
Sweden	2.4	2.7	2.6	0.3	-0.1	0.2
France	1.1	1.4	1.4	0.3	0.0	0.3
United Kingdom	1.2	1.8	1.6	0.6	-0.2	0.4
Finland	1.5	2.0	1.9	0.5	-0.1	0.4
Spain	0.1	0.3	0.6	0.2	0.3	0.5
Italy	-0.3	0.3	0.2	0.5	0.0	0.5
OECD (weighted average)	1.3	1.0	0.7	-0.3	-0.3	-0.6
OECD (unweighted average)	1.7	1.5	1.3	-0.2	-0.2	-0.4

Source OECD http://dx.doi.org/10.1787/888933876271

It is not just about technology, it is also about policy

The OECD research does find that technological change and integration in global value chains are driving almost two thirds of the decline in the labour share: Machines are replacing workers, thus reducing the labour share. In addition, in advanced economies, global value expansion creates more jobs for high skilled workers but displaces jobs for lower skilled workers, thus increasing wage inequality between workers themselves.

However, the OECD also contends that policy has an important role to play. Indeed, whereas technology and globalisation are major trends confronting the whole of the OECD, there is at the same time much divergence. Labour shares are falling and inequality is rising in some economies more than in others. A minority of OECD is even NOT experiencing these dismal outcomes. This indeed points to the fact that public policy can play a key role in ensuring productivity gains are broadly shared.

OECD research, as summarised in the chapter, unveils the links shown in the table below: Enhancing workers' skills supports the labour share while containing wage inequalities. Meanwhile, deregulating labour markets (by reducing job protection, minimum wages or decentralising collective bargaining) increases wage inequalities between workers.

Table 2.2. **Drivers of decoupling**
Average effects across countries, based on recent OECD research

	Ratio of average wages to labour productivity	Ratio of median to average wages or ratio of bottom to top firm-level wages
	Labour share[1]	Inverse measure of wage inequality[2]
Technological change	↘	↘
Trade integration	↘	↘
High skills	↗	↗
Competition-friendly product market reform	↗	↘
Loosening of employment protection	↗	↘
Minimum wage reduction	↗	↘
Collective bargaining decentralisation	⊘	↘
ALMP spending increase	↗	?

Source: OECD

Overall, the OECD concludes that "*Strengthening workers' bargaining positions through reviewing collective bargaining institutions can promote the transmission of productivity gains to wages. On average across countries, some degree of centralisation of collective bargaining does not appear to reduce the labour share and may reduce between-firm wage dispersion*" (page 63).

Minimum wages and the labour share: Unconvincing results

At the same time, the OECD makes the counterintuitive claim that higher minimum wages would work to bring the labour share down, not up. The OECD tries to argue that a minimum wage hikes replace (low wage) workers with capital and machinery so that, in the end, the upwards effect of higher wages on the labour share would be more than offset by the number of jobs being destroyed.

However, for this mechanism to work, it is not sufficient to find a negative effect of minimum wages on jobs. For the labour share to fall because of a minimum wage increase, the negative effect on the number of jobs should be very high if the positive effect of higher wage levels on the labour share is to be more than offset. For example, if the minimum

wage is increased by 10%, then job numbers should go down by more than 10% if the labour share is to go down.

Such highly negative job effects of minimum wages are however very hard to find in the empirical research on minimum wages. In fact, a summary by the OECD[1] itself (2015, page 46) of meta-analysis research showed no or little impact of minimum wages on employment and concluded that 'the impact of minimum wage increases on employment tends to be small - although effects on vulnerable groups may be slightly larger". The table below, taken from the 2015 Employment Outlook, shows no evidence whatsoever that a higher minimum wage would result in a more than proportional decline in the number of jobs, thus pushing down the labour share.

Table 1.3. **The effect of minimum wages on employment: What meta-analyses show**

Study	Number of studies covered	Country coverage	Impact on employment	Impact on youth employment
Doucouliagos and Stanley (2008)	64	United States	Little or no impact	Negative, but small
Boockmann (2010)	55	15 industrial countries	Negative, but varies across countries	
Nataraj et al. (2014)	17	15 low-income countries	Ambiguous	
Leonard, Stanley and Doucouliagos (2014)	16	United Kingdom	No impact	
Belman and Wolfson (2014)	23	Mostly United States	Small negative impact	
Chletsos and Giotis (2015)	77	18 developed and developing countries	No impact	More negative, but not always significant
Broecke, Forti and Vandeweyer (forthcoming)	74	Ten major emerging economies	Little or no impact	More negative, but still very small

StatLink http://dx.doi.org/10.1787/888933240155

How to explain these conflicting views between the OECD's latest economic, research on the one hand and, on the other hand, the OECD's overview of meta-analysis on minimum wages and their job effects? Looking more closely at the analysis underpinning the former, there are a number of problems:

(i) The analysis is what is called a 'difference-in- difference 'approach. It estimates the difference in impact of the minimum wage on the labour share in each sector compared to the sector where the minimum wage is supposed to be 'non-biting' (the latter sector is identified by looking at the US structure of industry as the US is supposed to be the most flexible economy). One can only draw conclusions from this for the entire economy by making the assumption that there is no impact of the minimum wage in that sector where the minimum-wage would be 'non- biting'. If on the other hand, the impact is positive in the latter sector, then negative effects of minimum wages in other sectors where the minimum wage does 'bite' may still result in non-existing or only very small negative effect for the economy as a whole.

(ii) The analysis is also based on the assumption that the causality in the data only runs from minimum wage increases to changes in the labour share. However, causality may also go in the opposite direction, from falling labour shares to minimum wage hikes. Policy makers, when confronted by labour systematically losing out to capital and profits, may decide to intervene and to beef up wages and

[1] http://ifuturo.org/documentacion/Employment%20outlook%202015.pdf

working conditions by increasing the minimum wage. This then gives rise to the negative link that is observed in the OECD's research but the mechanism behind it is that falling labour shares trigger minimum wage hikes and not the other way around. In other words, what the OECD is measuring is to a certain extent, correlation and not causality. This explains the bizarre finding of minimum wages depressing labour shares.