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Excessive labour market regulation will not help to combat inequality

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On 28 September 2017, the European Parliament Employment and Social Affairs Committee (EMPL) will vote on an initiative by Spanish MEP Javi Lopez (S&D) on combating inequalities as a lever to boost job creation and growth.

Contrary to what this initiative assumes, income inequality has remained stable in the EU since the 2008-2009 Great Recession. In several Member States, such as Austria, Belgium, France, Latvia, Poland, Portugal, the Netherlands and the UK, the Gini coefficient of disposable income decreased between 2008 and 2015.

The idea that mandatory minimum wage floors can help foster cohesion and reduce poverty is also unsupported by evidence. Increasing labour market regulation tends to act as a barrier to entry, worsens jobs prospects for the young and discourages entrepreneurship.

In light of these incorrect assumptions, we call on the EMPL committee to reject Mr Lopez's own-initiative proposal.

Introduction

On 28 September, the EMPL committee will vote on an own-initiative proposal promoted by Spanish MEP Javi Lopez (S&D) on combating inequalities as a lever to boost job creation and growth (Lopez, 2017). Mr Lopez's report, published on 6 June 2017, tries to address the subject of inequality from both an economic and social perspective and calls on the Commission and the Member States to introduce various income support schemes and to strengthen government regulation. In some areas, the proposal overlaps with another EMPL committee initiative, which aims to tackle poverty through the implementation of minimum income policies (Agea, 2017; EPICENTER, 2017).

In making the case for more state intervention, the report introduces several incorrect assumptions. First, the paper does not acknowledge the fact that income inequality has been either falling or has remained broadly stable in the vast majority of EU Member States. Second, by calling for the establishment, either via legislation or collective bargaining, of national statutory wage floors, the initiative does not recognise the direct costs of these distortionary policies. Third, the idea that the process of collective bargaining decentralisation is associated with higher levels of inequality is misleading.

EU levels of inequality are stable and EU unemployment is down

According to the latest data (Eurofound, 2017; Eurostat, 2017), income inequality has been either falling or has remained broadly stable in the EU in the last decade. As Darvas (2016) explains, in 2015 the Gini coefficient of household disposable income for the EU28 equated to 33.15, a level in line with the 1990 Gini coefficient of 33.21. Looking at these figures, which are based on individual country data, there was a sharp increase in income inequality among the citizens of the EU in 1989-93. By 1994, EU-wide income inequality was 36.08 Gini coefficient points. However, between 1994 and 2008, disposable income inequality declined sharply among European countries to reach a Gini coefficient of disposable income of 33.04. This large fall was mainly due to the convergence of average incomes. Thanks to higher growth, people in poorer regions of the EU increased their income relative to richer regions. Finally, between 2008 and 2015, income inequality has remained stable all across the board.

In some EU countries, the Gini coefficient of equivalised disposable income decreased between 2008 and 2015. It decreased by 1.3 points in Belgium; by 1.4 points in Poland; by 1.5 points in the UK; by 1.8 in Portugal; by 3 points in Latvia (Eurostat, 2017a).

According to Eurofound (2017), EU-wide inequality in final household disposable income as measured by the Gini index was 33.6 in 2014. In 2008, final household disposable income corresponded to 33.7, whilst in 2005 it was 35.5. Thus, contrary to Mr Lopez's argument, it is difficult to suggest that there has been a strong increase in inequality since the 2008-2009 Great Recession and that structural reforms, as well as so-called austerity measures, have intensified this phenomenon. By contrast, as a recent World Bank paper (2016) highlights, levels of inequality between and within countries have actually decreased since the 2008 crisis, with several major industrialised economies such as France, Germany and the UK among the beneficiaries. Moreover, as Eurostat (2017b) shows, in June 2017, the euro area (EA19) seasonally adjusted unemployment rate was 9.1%, down from 10.1% in June 2016. At the same time, the EU28 unemployment rate was 7.7%, down from 8.6% a year earlier. These are the lowest unemployment rates recorded in the EA19 and in the EU28 since February 2009 and December 2008, respectively.

National wage floors distort labour markets and do not help the poor

A key argument put forward by Mr Lopez is that all Member States need to establish national wage floors (e.g. national minimum wage; national living wage) and find a common approach regarding the introduction of a minimum income scheme. The report argues that these policies will help tackle poverty and inequality, will support people with insufficient income and will foster social integration. However, as recent studies show, there is little evidence to support these claims.

In Germany, the introduction of a €8.50 euro/hour national minimum wage has generated a disemployment effect of 1.9%. This means that about 60,000 additional workers could be employed in the absence of the minimum wage (Bossler and Gerner, 2016).

Overall, wage floor policies have negative effects on the economy as a whole. In the UK, for example, the government's own estimates suggest that the implementation of the national living wage will have considerable effects on labour markets, will costs tens of thousands of jobs and 4 million working hours in the next few years (Shackleton, 2017). In the US, recent increases in the minimum wage significantly reduced the employment of low-skilled workers, reduced low-skilled individuals' average monthly incomes and reduced the employment-to-population ratio of working age adults by 0.7 percentage points (Clemens and Wither, 2014). In the city of Seattle, the 2016 increase in the minimum wage to $13 per hour reduced hours worked in low-wage jobs by around 9 percent, whilst hourly wages in such jobs increased by just 3 percent. Consequently, total payroll fell for such jobs, implying that the minimum wage ordinance lowered low-wage employees' earnings by an average of $125 per month (Jardim et al., 2017).

National wage floors such as a minimum wage policy are the wrong tools to tackle poverty. According to the latest ISTAT figures (2017), in Italy there are more than 3.6 million households that are workless. A minimum wage policy would do nothing to help them. Moreover, minimum wages are usually poorly targeted as most of the benefits go to those not in poor households. In the UK, 44 percent of low-paid workers are in households in the top half of the household income distribution (Shackleton, 2017). On top of this, as we highlighted in another recent briefing (EPICENTER, 2017), the introduction of a guaranteed minimum income scheme available to everyone is likely to increase poverty in the vast majority of advanced economies.

Wage setting decentralisation and structural labour market reforms do not give rise to inequality

The Commission's ability to propose employment regulation was limited until the 1990s but today the EU regulates many aspects of national labour markets. By calling on the Commission for more state intervention, Mr Lopez's initiative will introduce new rules in the few remaining labour market areas where there is still no common approach. Consequently, countries such as Austria, Denmark and Sweden, known for their high level of flexicurity and with below EU average unemployment rates and inequality levels, would be forced to introduce new burdensome mandatory rules, such as a statutory minimum wage. It is important to remember that overly stringent rules act as a barrier to entry, shielding incumbents, deterring the foundation of new enterprises and lowering the incentives for firms' growth (Henrekson, 2014; Shackleton, 2017).

More than 80% of employees in Sweden have part of their wages determined by local level negotiations, and 7% have their entire wage determined locally. The number of employees with local agreements has increased in the 1990s and 2000s (Eurofound, 2009).

Labour market reforms that aim to decentralise the process of collective bargaining, can prove to be very effective in reducing unemployment, increasing labour force participation and stimulating productivity. The case of Germany is obvious (Kierkegaard, 2014; Dustmann et al., 2014). During the 1990s employers and workers started using the wage-setting system differently. Over time, this unprecedented decentralisation of wage setting rules led to a marked improvement in Germany's competitive position vis-à-vis the country's main competitors. The transition towards a more decentralised process of wage setting helped prepare the political landscape for additional reforms, which eventually occurred in 2003-2005 under Mr Schröder's left-wing government. The ability of Germany to rely on its decentralised system of industrial relations developed after the reunification process set the foundation for the strong labour market the country still enjoys today. It is interesting to note that between 2008 and 2015 Germany's Gini coefficient of equivalised disposable income remained stable at 30.1, below the EU average of 31.0 (Eurostat, 2017a).

Conclusion

Contrary to Mr Lopez's assumptions, EU levels of inequality have remained broadly stable since the 2008-2009 Great Recession. The idea that mandatory minimum wage floors can help to foster cohesion and to reduce poverty is also not supported by evidence. In fact, excessive labour market regulation tends to act as a barrier to entry, worsens jobs prospects for the young and discourages entrepreneurship. Structural supply-side reforms which aim to decentralise the process of collective bargaining and which stimulate productivity have proved to be successful. Thus, given these misconceptions, we call on the EMPL committee to reject Mr Lopez's proposal.

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