

Wage and Income Inequality in the European Union

European Parliament, EMPL Committee

November 4th 2014

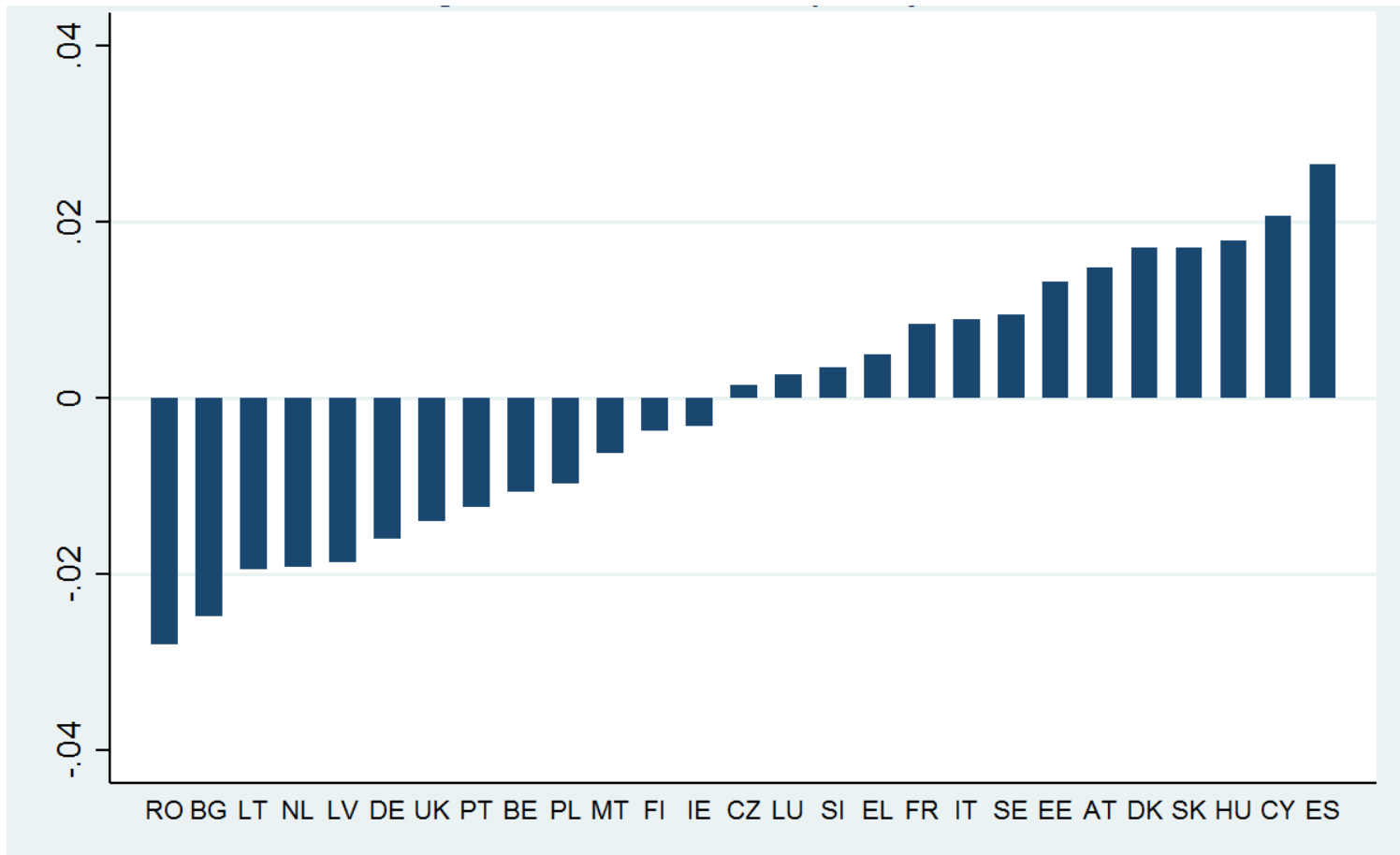
AQR



Motivation

- Income inequality has increased markedly since the mid-1980s.
- The Euro area debt crisis together with fiscal consolidation programmes could have worsened the situation in the recent years.
- How has the Great Recession affected inequality trends?

Income inequality. Changes in Gini coefficient between 2007 and 2011 in EU countries



Source: Eurostat.

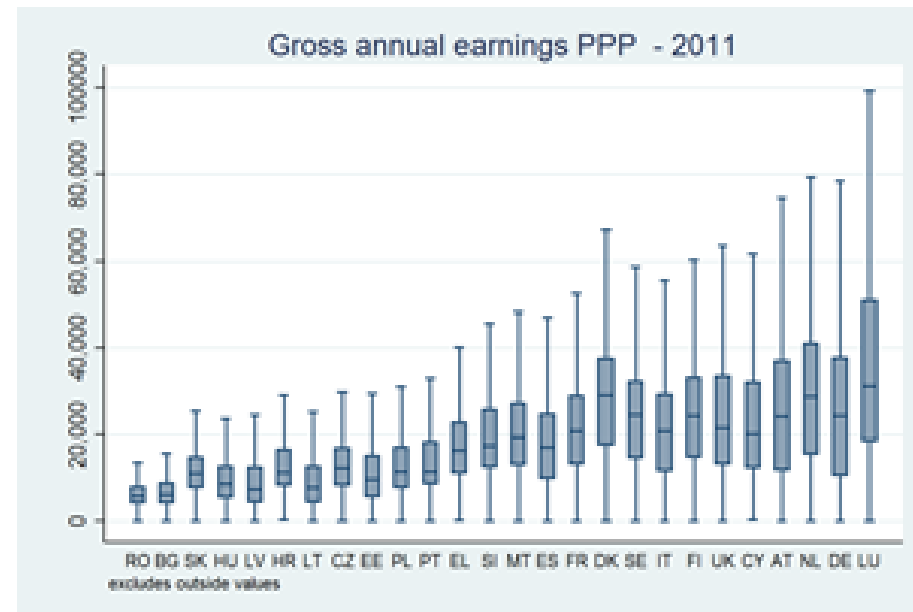
Summary of results

- Wage inequality has not substantially increased in recent years (although our analysis ends in 2011).
- Inequality levels (and changes) are the result of different economic forces with variation in economic conditions and labour market institutions also playing a role.
- Trends in income inequality are not only explained by changes in wage inequality but by falling labour shares and by changes in other income inequality.

Wage inequality

Inequality levels

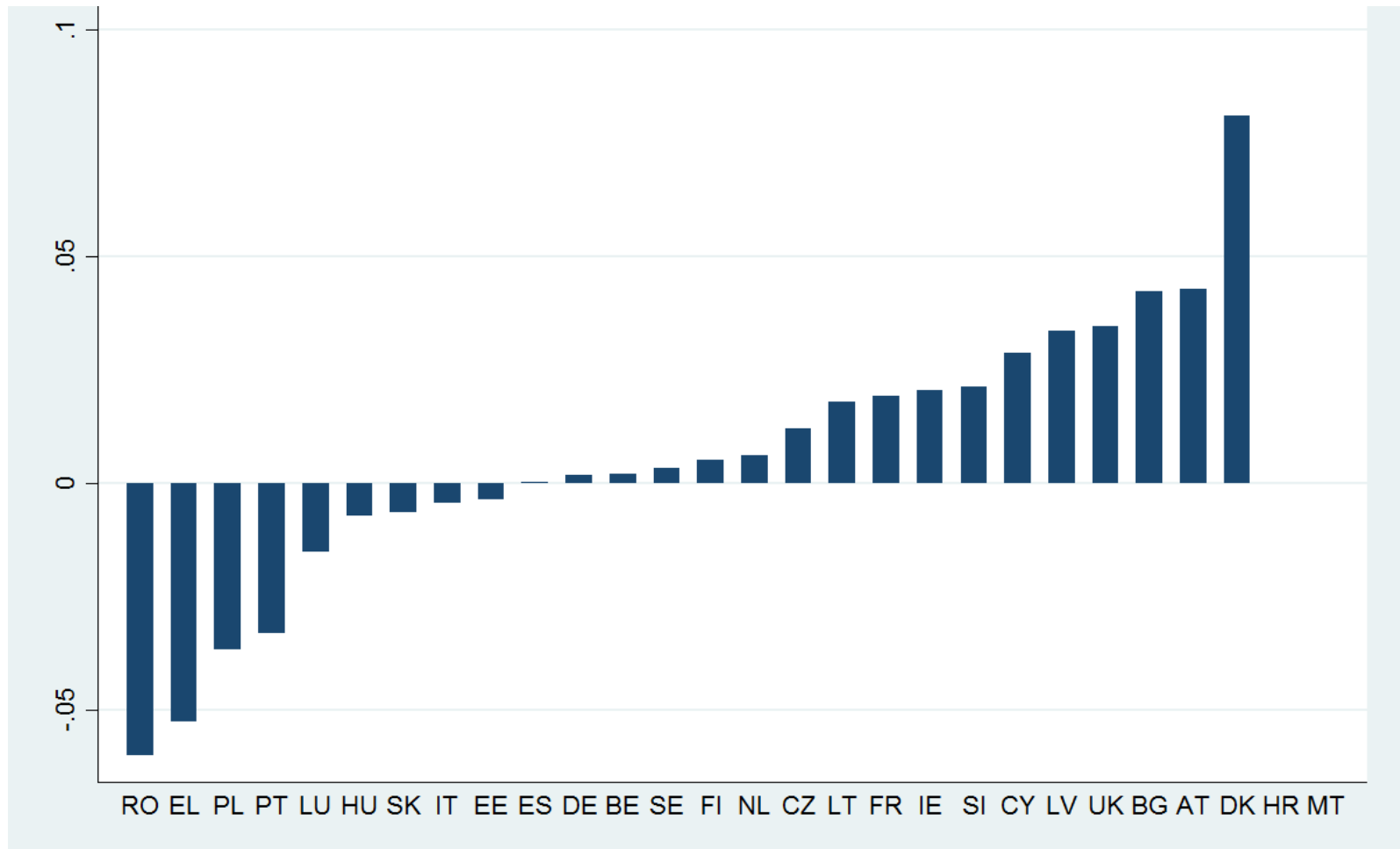
- High level of heterogeneity in wage inequality across EU member states.
- Differences persist along time.



Inequality trends

- Looking at microdata from EU-SILC and SES, wage inequality has increased between 2006 and 2011 in around two thirds of the EU countries considered, while in the rest it has decreased.
- However, variation is only substantial when considering annual earnings due to differences in the number of months worked (while the effect of worked hours is only relevant to a minor extent).

Changes in the Gini index for annual wages between 2006 and 2011 in EU countries

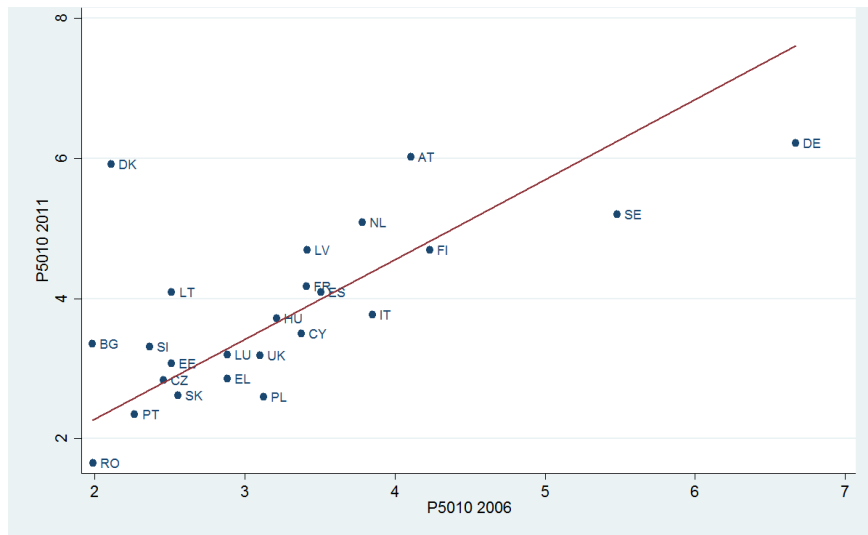


Source: EU-SILC.

Wage and Income Inequality in the EU

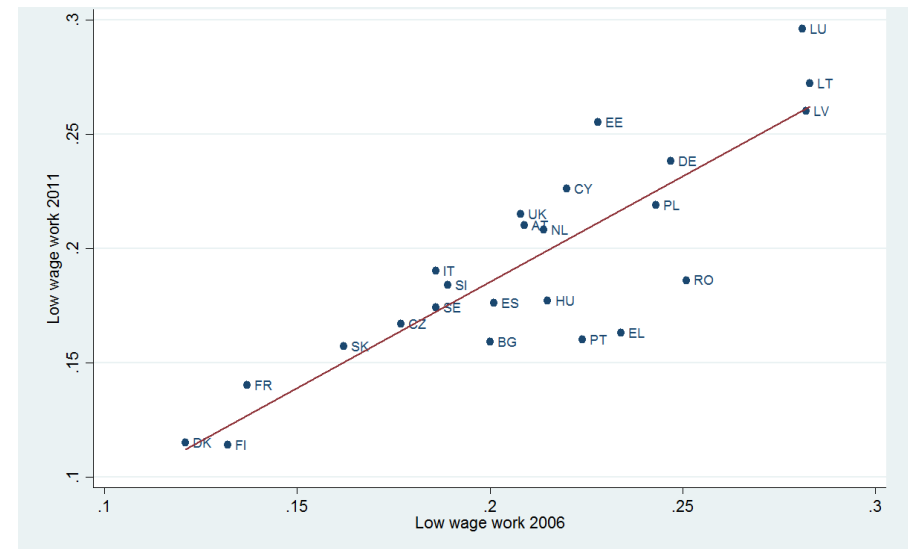
- In most countries, inequality has increased at the bottom of the distribution and not only at the top as predicted in the literature. In these countries, the incidence of low wage work has also increased between 2006 and 2011.

Changes in the P5010 of annual earnings between 2006 and 2011



Source: EU-SILC.

Changes in the incidence of low wage work between 2006 and 2011



Source: EU-SILC.

- Changes in inequality are only partially attributable to changes in the composition of the labour force.
- The analysis of SES microdata also shows that intermediate levels of collective bargaining seem to produce a more compressed wage structure.

The role of institutions

- Union density and bargaining coverage rates have declined between 2004 and 2010 in most EU countries, while the level of wage bargaining has remained mainly stable with predominantly decentralized or intermediate bargaining levels.
- Countries seriously affected by the economic crisis experienced a strong decrease in actual wages, which has resulted in a relative increase of the minimum to average (median) wage ratio - although real purchasing power has, in fact, decreased.

- The basic results of estimating different versions of an econometric model relating wage inequality and labour market institutions show:
 - a significant impact of minimum wages on inequality, being stronger on the lower part of the distribution.
 - the wage bargaining level does not seem to have a robust influence on inequality (high persistence).
 - Union density and the bargaining coverage rate reduce inequality but only when analysing hourly wages.

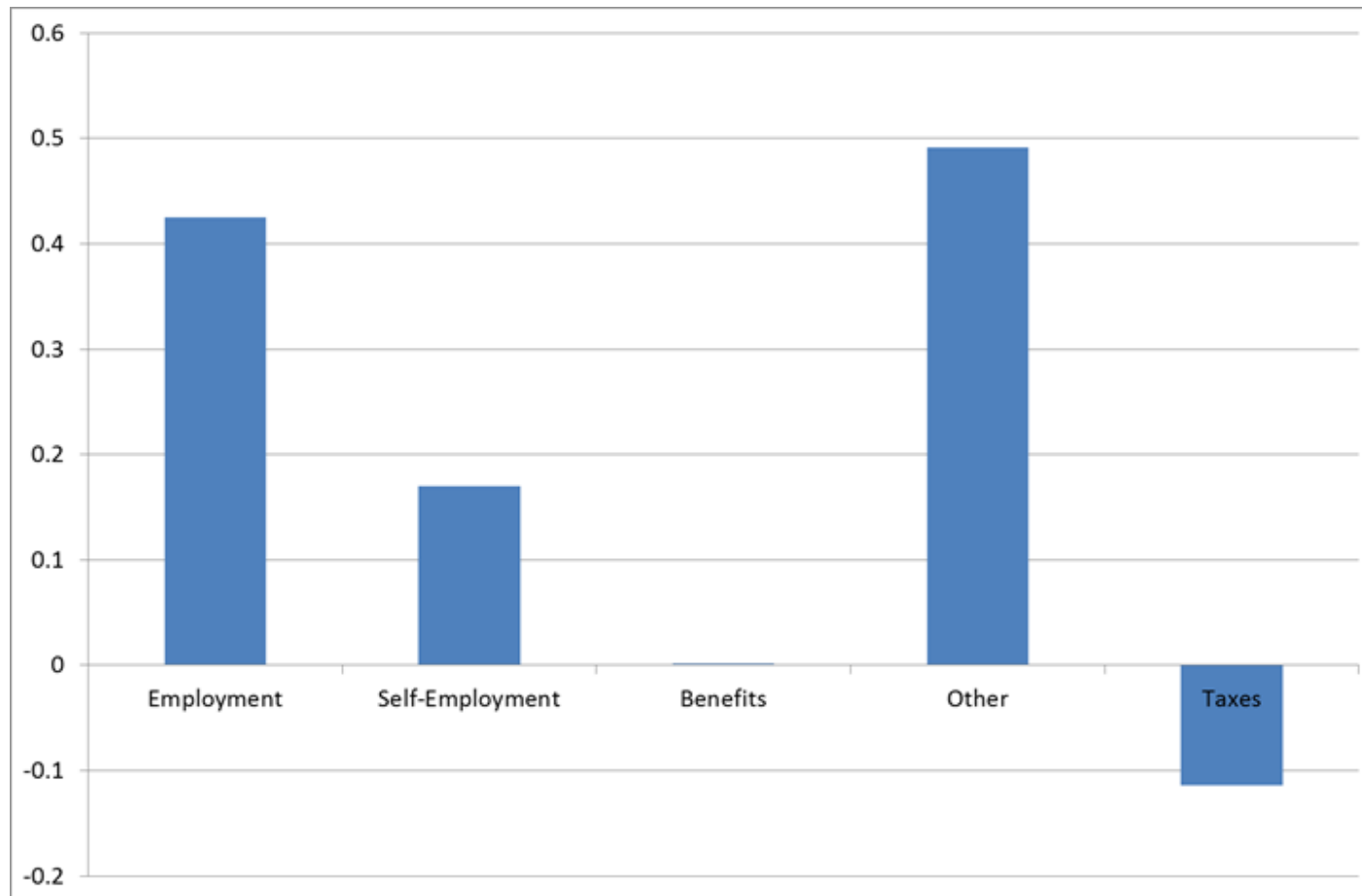
- The econometric model includes additional controls in line with previous literature summarized in the report:
 - Large impact of globalization and technological change.
 - Wage inequality increases in recessions and decreases during expansions, and it is also related to the industry mix.
 - Improving competition in regulated network sectors also has a robust influence in reducing wage inequality.

Income inequality

- We have decomposed the variation in the Gini index of household annual income from 2006 to 2011 using microdata from EU-SILC into the relative contribution of changes in inequality by income from paid employment, income from self-employment, transfers, other income (mainly capital), and taxes.
- The contribution of these components to income inequality depends on two factors: inequality trends of individual components and shares of total income.

- Although the most important component of income inequality is wage inequality, the obtained evidence shows that the income source that has contributed most to the increase in overall income inequality is capital income, while taxes have contributed to decreasing income inequality and transfers have been neutral.
- The contribution of wage inequality has been less relevant than in previous studies due to decreasing wage shares in most EU countries—a factor that is clearly related to the fall in employment rates due to the economic crisis.

Correlation coefficient between changes in the Gini index for income and changes in the contribution to inequality of the different income sources (2006-2011)



Source: EU-SILC.

Wage and Income Inequality in the European Union

European Parliament, EMPL Committee

November 4th 2014

AQR

U
B
Universitat de Barcelona

DIW BERLIN