Less to labour, more to capital

By JP Landman

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For half a century, since the Second World War, the division of the spoils of economic growth between labour and capital remained stable. As economies grew, so the total income of labour and capital grew at almost exactly the same rate.

"It seemed as if some unwritten law of economics would ensure that labour and capital would benefit equally from material progress," writes the ILO in Chapter 5 of its Global Wage Report 2012/13.

That "law" no longer holds true. All over the world, the share of the total income going to labour is showing a downward trend. Labour is getting less and capital more.

Global trends are:

- The OECD has found that between 1990 and 2009 the share of labour in national income declined in 26 out of 30 developed economies. It calculated that the median labour share across these countries fell from 66.1% to 61.7% over the period.
- In respect of a different group of countries, namely the US, Euro zone, Japan and the UK, economist Gavyn Davies sums it up succinctly in a blog posted on June11, 2013: "The gross profit share has risen by about 10% of GDP over three decades, and the wage share has fallen by the same amount."
- The ILO World of Work Report 2011 found that the decline was even more pronounced in many emerging and developing countries, with considerable declines in Asia and North Africa and more stable but still declining wage shares in Latin America.
- Even in China, where wages roughly tripled over the last decade, GDP increased at a faster rate than the total wage bill, so that the labour income share went down.
- The global financial crisis seems to have reversed the trend only briefly, after which it resumed.

Productivity doesn't help

A particular feature of the decline in labour's share of income is that it is happening in spite of increased labour productivity.

In the US, for example, hourly labour productivity in the non-farm business sector has increased by around 85% since 1980, while real hourly compensation increased by about 35% (ILO Report, 2013).

In Germany, labour productivity grew by 22.6% over the past two decades, while real monthly wages remained flat. The ILO says that "based on the wage data for 36 countries, we estimate that since 1999 average labour productivity has increased more than twice as much as average wages in developed countries."

Gavyn Davies puts it clearly: " ... real wages in the US have grown much more slowly than output per head, which means that all of the gains from productivity growth have dropped into the hands of shareholders rather than workers." That is true all over, not just in the US.

So the last 20 years or so was a good time to be a shareholder, a bad time to be a worker.

Well, not quite; depends on which worker.

It's skills, stupid (Oh, and share options)

Studies in developed economies have found that wages of low- and medium-skilled workers are driving the decline. Both the International Institute for Labour Studies and the IMF have found that between 1980 and 2005 the labour share of unskilled workers fell, while it increased for skilled workers educated to tertiary level and above. Low-skilled worker stuffed; higher skilled worker doing better.

Even a rise in low-skilled jobs did not benefit low-skilled workers, as these jobs were taken by overqualified workers with intermediary levels of education. A graduate serving as a checkout person - a trend we are beginning to see in SA as well judging by some letters in The New Age newspaper.

Going up the ladder, the higher echelons of workers are even better insulated against the trend. If the compensation of the top 1% of earners was excluded, the drop of the labour share would be even greater.

The ILO report makes the point that "this reflects the sharp increase, especially in English-speaking countries, of the wage and salaries (including bonuses and exercised stock options) of top executives, who now cohabit with capital owners at the top of the income hierarchy".

So although the top 1% are also nominally employees, they had their snouts in the trough of rising company profits and dividends. Not so much skills, as power - in this case the power to allocate (or get allocated) share options.

But not all employees get to the trough. Thus, the pain of a relative decline in compensation as proportion of GDP fell on those employees who did not share in profits or rents. That is the middle classes and lower skilled people.

South African trends

With one possible exception, these trends seem to hold for SA. Going back all the way to 1946 the compensation of employees as a percentage of GDP ranged between 55% and 60%. This held for 53 years. Then, in 2000, the trend started to change decisively. Compensation as a percentage of GDP declined to an all-time low of 49.4% in 2008.

This decline is all the more interesting as labour productivity increased substantially. For about 25 years - from 1970 to 1994 - labour productivity increased by less than 1% a year. Between 1995 and 2012 it increased by more than 3% p.a. But this did not help the workers to stem the decline in their share of national income. Exactly the same trend as experienced globally.

Is there change coming? Maybe.

For the four years since 2008, employees' compensation has increased somewhat to 51.8%. The quantity of the change is not big but the direction is. Labour's share has increased for four years and that is bucking the global trend where labour's share keeps on falling.

Is this change in direction a flash in the pan, or is it something more permanent? We will see over the next few years. If the change is indeed permanent, it will certainly be an exception to global trends. (Or could it be a precursor?)

One must also ask if there is a link between the change in direction and the higher strike action we have seen since 2007. Andrew Levy and Associates' strike data shows a marked increase since 2007 - and labour's share started rising in 2008. Pure coincidence? It seems to me power is not just at work in the remuneration committees in favour of share options, it is also at work on the shop floor.

If correct, this would explain the current wave of strike action and militancy we are seeing in the mines. AMCU president Joseph Mathunjwa condemned company executives who "earn millions of dollars and then lay off workers claiming low platinum prices". COSATU president Sidumo Dlamini warmed to the same theme claiming Lonmin's financial officer is paid "152 times as much as a rock drill operator at the mine".

So what?

These are tectonic shift taking place in the world. What will the consequences be?

First, let's assume labour's share does not keep on falling. For shareholders, the consequences can be painful. The ILO reports that much of the income transferred from labour to capital has been used to pay increased dividends.

Davies calculates that if the 10 percentage points decline in the wage share had not occurred (bullet two above), gross profits in those economies would have been about one-third lower than they are, and nett profits (after depreciation) would have been about two-thirds lower.

As he warns: "Equity markets would indeed be very vulnerable if the decline in the wage share started to reverse on a permanent basis."

Secondly, let's assume the decline continues unchanged. Well, there is a rise in public unrest and dissatisfaction in the world. Are people going out onto the streets because of some change in a GDP ratio? No, 99.99% of people do not know about the ratio, but they have practical experience of the real-life stories that the ratio tells: huge perceived inequalities; inadequate public services; resentment towards those who get bailed out; anger towards those who live on public subsidies. And that is in the developed world.

In developing countries "Unequal distribution and concentration of incomes ... have sparked a multitude of strikes and protests, especially when food and energy price increases have simultaneously eroded the purchasing power of wage earners at the bottom," reports the ILO rather dispassionately.

Thirdly, a decline in the purchasing power of large parts of the population affects demand and, thus, economic growth. The rich may try to make up for it by spending more on cars, private planes and caviar, but it is unlikely to make up for the declining purchasing power of the bulk. Simple mathematics. The point was powerfully made in a reputed interaction between Henry Ford II and union boss Walter Reuther. Ford took Reuther to see his latest plant in Detroit, which contained the first primitive pre-robots, replacing workers in some jobs. Ford asked Reuther: "Tell me Walter, how are you going to get them to join your union?" "I don't know, Henry", Reuther replied. "How are you going to get them to buy your cars?"

As Dr Rupert concluded after the Hiroshima bomb: "We are all scorpions in the same bottle, vulnerable to one another." By the way, he was heavily criticised when he introduced a minimum wage of one pound a day in his factories in SA at a stage when actual wages were much lower. But then he always did see the bigger picture.

ABOUT JP LANDMAN

JP Landman is a political analyst at Nedbank Private Wealth. JP joined BoE Personal Stockbrokers in 2000 as a part-time political analyst. He runs a political and trend analysis consultancy. JP is a highly repsected political commentator and was rated the number one analyst for politics and industrial relations on the JSE in 1998 and again in 1999. During 2010, he was appointed visiting professor at the University of the Free State.