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Income inequality from 1960–2012: a brief time-series history of capital and labour

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Abstract

This commentary examines two principal forms of inequality and their evolution since the 1960s: the division of national income between capital and labour, and the share of total income held by the top 1 per cent of earners. Trends are linked to current discussions of inequality drivers such as financialisation, and a brief time-series analysis of the effects of trade and financial sector growth on top incomes is presented.

Keywords: inequality, labour share, time series, Ireland, top income

Inequality is fast becoming the political buzzword of our time. US democrats have hit on inequality as the focus of their policy programme since Obama's re-election, and Ed Miliband looks set to pin the 2015 electoral hopes of the British Labour party on an agenda of inequality reduction. Talk of inequality in Ireland appears closely tailored to electoral concerns, as the 'squeezed middle' (the traditional centre-right voting bloc of the dominant political parties) take a disproportionate share of policy and media attention, despite the disastrous consequences of austerity on those in lower-income groups. The Irish report of the international 'Growing Inequalities' Impacts' (GINI) project notes strong links between educational attainment and household earnings, and an increase in inequality since the financial crisis (Calvert *et al.* 2013: 29), while the Economic and Social Research Institute's (ESRI) 'Growing up in Ireland' study observed a decline in the reported health of children in low-income families from 2008–11 (O' Toole 2013). Ongoing work at the Centre for Health Geoinformatics is now uncovering strong class gradients in regional premature mortality rates, which appear closely linked to a number of material and social deprivation indicators.

Globally the balance is equally poor despite the movement of countries such as China into middle-income deciles (Lanker and Milanovic 2013), with Oxfam's report on political capture and economic inequality stating that

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over half the world's wealth now resides with the richest 1 per cent (Fuentes-Nivea and Galasso 2014). The Irish experience of the financial crisis has been especially harsh, with rising national and personal debt levels, one of the worst unemployment rates in Europe, and widespread cuts in public spending. Despite the clear class gradient in terms of those who have suffered worst, the Irish policy response has done little to equalise the pain. With enormous transfers of public money to private financial institutions, state-implemented internship schemes and privatisation of utilities, Ireland has been complicit in a substantial upward transfer of wealth. The International Labour Organisation (2013) has also drawn attention to the 'broken link' between wages and productivity since the 1980s, where rising output has not translated into higher shares of wealth for workers. We have every reason to believe that these processes will compound intergenerational inequalities, as well as inequalities between income groups, resulting in greater income capture for the wealthiest.

Inequality: explanations and trends

The political appropriation of inequality is certainly not without precedent – it has become an important part of recent political and research discussion thanks to publications such as Wilkinson and Pickett (2010), and more recently Thomas Piketty (2014a). Within core sociology, Kristal (2010, 2013) has drawn attention to the multiple levels at which inequality operates, from the division of Gross Domestic Product between capital and labour, and wage-share differentials across economic sectors. Others such as Jason Beckfield (2006) have identified key macro-level drivers of inequality such as regional economic and political integration which have tended to drive welfare retrenchment and undermine collective bargaining through international competition. Recently, Basak Kus (2012) has examined the damaging effect of financialisation on income inequality across the OECD since 1995. Together these studies reveal a number of consistencies: 1) that income inequality has grown substantially since the late 1970s, bringing many countries back to levels not recorded since the early twentieth century; 2) that we can identify consistent drivers of inequality that operate with remarkable consistency across countries; 3) that the consequences of rising inequality reach across multiple levels, from our physical and mental health, to the well-being of our communities, and the functioning of our democratic institutions.

Following the attention Piketty has lately received, some have branded his work as the definitive proof the left has been waiting for. Indeed, for so forceful a critique of liberal capitalism to emerge from within economics is surely an indictment of the inability of neoclassicals to account for the potentially negative consequences of economic growth. Rhetoric is not the sole preserve of political elites however, and Deirdre McCloskey (1988), has been picking at the rhetorical underpinnings of quantitative economics for some time, claiming

that the business of forecasting and formal modelling relies as much on shared assumptions and narrative frames in its claims to scientific rigour. In any event – rhetoric or no – it is difficult to ignore the parsimony of Piketty's model. By distilling inequality to a simple relationship between slow economic growth and high capital returns, he suggests that increases in wealth inequality are the norm (rather than the exception) of a functioning liberal market system. David Harvey (2014) arrives at the same diagnosis in his recent discussion of compound growth, suggesting that capitalism is fast approaching a point where innovation will no longer supply the investment returns needed to forestall crises. The recent finance-driven phase of deregulated capitalism surely underscores the danger of this situation. Unburdened by national regulation or restrictions on international movement, and caught in a rut of low national economic growth since the late 1970s, capital sought its best returns in a system of speculative finance, which came to a spectacular end toward the close of the last decade. What follows is a brief overview of how Ireland fits within these global trends, and how inequality has evolved in the context of key stressors in recent history.

Inequality between capital and labour

Tony Atkinson (2009) suggested that factor shares constituted the 'principal problem' of political economy, claiming we often find it difficult to connect what happens at the level of the macro-economy to the money in our pockets. The concept of 'factor shares' resolves this difficulty somewhat by focusing on the division of national income (GDP) between capital and labour, or by calculating the percentage of income accruing to labour in the form of wages (commonly referred to as 'labour's share'). A renewed emphasis on this classic division has since animated discussions of inequality, not least because of labour share's curious departure from supposed laws of economic growth, which claim this ratio should remain stable over time. Instead the opposite has happened, and labour's share has fallen almost universally in advanced capitalist democracies (Kristal 2010).

Figure 1 graphs Irish labour's share of national income, or compensation of employees as a percentage of gross national income, adjusted for self-employment. Relative to other countries, Ireland's decline from the 1980s to the mid-2000s has been quite strong, with a European Commission report (2007) noting Ireland's rate of decline as the strongest of all EU member states. This decline is evidently not uniform across the entire series however, and Ireland mirrors the experience of many advanced capitalist countries who have experienced alternating phases of growth and loss, with particular losses since the late 1970s.[1] Common explanations of this trend break since the 1980s focus on a shift in collective bargaining power, and in the United States, this pattern is often attributed to the collapse of the post-war capital–labour accord. While unionisation and welfare state growth remained strong in the post-war

Figure 1 Labour's share of national income in Ireland and the OECD, 1960–2012

era, the 1970s ushered in a phase of capital account liberalisation, labour market deregulation, and welfare retrenchment, eroding workers' traditional protections.

The rise of productivity-enhancing and labour saving technologies from the 1970s to 1980s, according to the 'Skill-Biased Technological Change' hypothesis, supposedly introduced a strong class gradient into the labour market, leading to the formation of new inequalities between skilled and unskilled workers. Finally, as the Fordist regime gave way to new forms of globalised flexible production, the balance of bargaining power shifted in favour of mobile capital, now better able to take advantage of cheap material imports, outsourcing, and eventually, relocation to countries with cheap labour costs. Together, these processes eroded the capacity of labour to bargain against capital for greater returns on rising productivity, and its share of economic rewards fell. From the experience of the recent crisis, the prognosis for labour is therefore poor. With the casualisation of wage labour, widespread contractual insecurity, high unemployment and falling, decentralised unionisation, the 'moral hazard' introduced through the public recapitalisation of the private sector has surely signalled that capital has little to fear either from organised labour or the state.

If Piketty's prognosis is correct, and the future of capitalism is that of low growth coupled with high capital returns (stagnant growth rates and recent

inflation of local property prices in certain areas suggests as much), the ability for workers to achieve occupational and intergenerational mobility in the labour market is surely limited. In terms of social protection, Irish government consumption as a percentage of GDP dropped from 7 per cent in 1991 to 5 per cent in 2007, while Ireland's growing integration with European financial markets throughout the 1990s heightened its exposure to global economic instability, with almost one-third of Ireland's liabilities residing within the Eurozone immediately prior to the financial crisis (Ó Riain 2012). According to decommodification measures computed by Scruggs and Allen, Ireland's unemployment benefit replacement rates are marginally below average, as are its sick pay and public pensions (Scruggs and Allen 2006: 59). These weak social safety nets underscore the importance of growing structural powerlessness, and labour's share is an important measure relating macro-economic processes and the collective bargaining power of workers to the formation of an economy-wide income pool. It must therefore be considered as a mediator of society-wide personal income inequalities captured through other measures, such as income percentile shares.

Top income shares

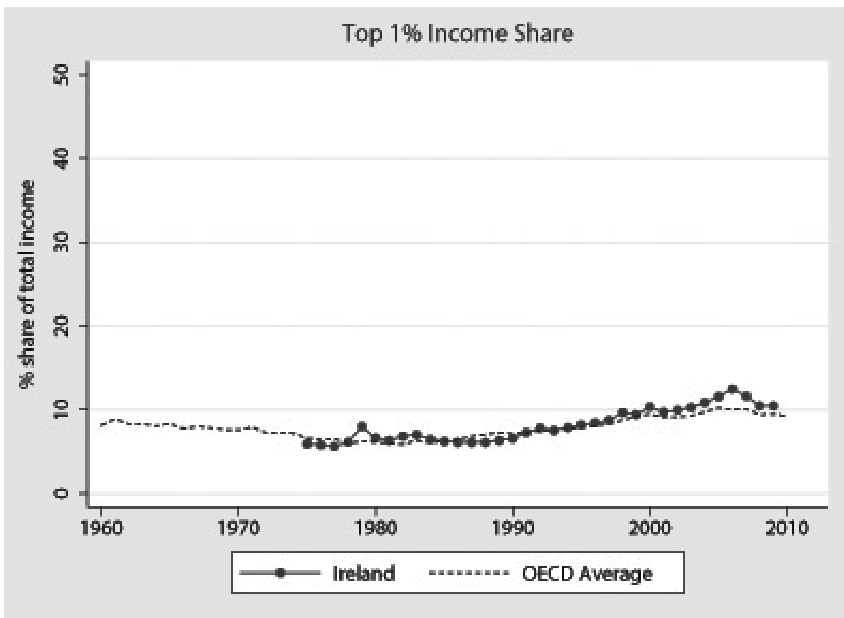

Figure 2 Income shares of the top 1 per cent in Ireland and the OECD, 1960–2012

Note: graph rescaled to illustrate both series

Few figures underscore the uneven impact of financial capitalism as much as the upward trend in top-income shares. In 2003, Paul Thompson drew attention to a number of factors associated with top-income growth such as the de-linking of executive and CEO pay from underlying performance indices, and the rise of shareholder managerialism and equity financing whereby companies were run not for the welfare of their workers, but for their shareholders' dividends (Kus 2012; Thompson 2003). These conditions have lately been incorporated by researchers as a core mechanism of 'financialisation', a process viewed by many as a primary driver of income inequality since the 1980s. Under financialisation, traditional drivers of inequality such as globalisation,[2] the rise of the service sector, and de-unionisation have been compounded by other stressors. These include the stagnation of 'blue collar' wages as real economy activities such as manufacturing decline in importance, stock market profiteering, and the rise of neoliberal fiscal policies targeting inflation reduction instead of social spending (Guttman 2008; Kus 2012). The effect of these stressors is clear in light of recent top-income trends. High-earning hedge fund managers now routinely earn over a billion dollars per year (the top 50 of whom are all male), and a recent Forbes report (2012) shows that CEO earnings have been rising since 2010, hitting an average of $10.5 million in 2012 (including salary, bonuses and stock options).

The share of Ireland's top 1 per cent began to move upward from the OECD average during the mid to late 1990s. At Ireland's peak of 12.51 per cent in 2006, Denmark recorded 5.91 per cent, the UK 14.82 per cent, and the US 18.06 per cent. The behaviour of the Irish series appears curiously unresponsive to significant events however, despite a sharp fall and modest recovery following the financial crisis in 2008. Although its upward turn in the early 2000s corresponds to the most profitable phase of the finance-driven boom which preceded the crash, Brian Nolan (2007) has noted that the series appears markedly stable during periods such as the fiscal crisis of the 1980s. More significant still is the continued rise in the share of the top 1 per cent during a time when workers' economy-wide share of national income was falling. This occurred as the amount of domestic credit issued by the banking sector rose from 39 per cent of GDP in 1980, to 207 per cent in 2008. As cheap credit stepped in to shore up stagnant wages and maintain consumption amongst workers, the absorption of financial capital in property yielded large returns to investors. Together, these trends suggest a strong capacity for high earners to weather macroeconomic turmoil with relative ease.

The macroeconomic conditions governing labour's falling share link closely with the rise in top incomes, and studies have already demonstrated the favourable impact of higher labour shares on other measures of the income distribution such as Gini coefficients (Daudey and Garcia-Penalosa 2007). Countries with stronger bargaining capacity (i.e. increasing labour shares), therefore tend to experience a reduction in economy-wide personal income inequality.

Analysis of key drivers

A number of inequality drivers have been identified in the preceding discussion. As we have seen, income inequality assumes a number of primary forms, and as the volume of publicly available data has grown, and the scope of national surveys expanded over the last century, so too has the level of detail and insight we can extract on a given social problem. The following table presents a set of time series regressions of the impact of trade (globalisation) and financial sector profitability (financialisation) on top-income shares since 1970. The effects of variables identified in international literature and other time series studies as protections against rising inequality are also examined, namely welfare spending as a percentage of GDP, and the proportion of wage and salary earners in unions. Although the current sectoral coverage of unionisation is narrow, the series covers a time when union densities were at a recorded high of 64 per cent. This measure thus gives some insight into the net effect of the weakening of organised labour across the last three decades. Owing to shortcomings in available data, the effect of financialisation is estimated from 1995–2009. Models follow a standard error-correction specification, and complete models of the impact of these variables on labour's share of GNI along with complete diagnostics may be found in Flaherty and Ó Riain 2013. Dependent variables are in first differences (Δ), and all predictors are entered both in first differences, and lagged by a period of one year ($ß_{t-1}$). These models give a rough indication of their impact on both short and long-run trends over the series. For supporting illustration, a correlation matrix is provided with the income share of the top 1 per cent entered in levels, and all others in lags of one year.

Although many of the variables in Table 1 are discussed in terms of their impact on labour's share in Flaherty and Ó Riain (2013), the direction of their effect on top-income shares is mirrored in the above analysis. Globalisation is closely implicated in what Alderson and Nielsen (2002) have termed the 'great U-turn', and their analysis shows that factors of globalisation such as foreign investment and southern import volume have had a significant, positive effect on longitudinal inequality within countries. Similar effects are often found in studies of labour's share, where direct investment induces downward wage competition between incumbent firms, and contributes to growth in the service economy, both of which have tended to erode labour's bargaining position. Similar tendencies have defined the Irish experience of globalisation, with trade tending to inflate the share of the top 1 per cent.

Table 1: Drivers of top-income change in Ireland, 1975–2010

	Δ Top 1% Share			
	Regression coefficient		*Standardised coefficient*	
Stressors				
Dependent $_{t-1}$	-.18*	-.51	-.58*	-.95
Δ Trade	.64		.06	
Trade $_{t-1}$	1.96*		.60*	
Δ Finance		.09		.25
Finance $_{t-1}$		.06		.54
Adj R^2	.103	.030	–	–
Protections				
Dependent $_{t-1}$	-.07	-.39*	-.21	
Δ Welfare	-.27		-.31	
Welfare $_{t-1}$	-.13		-.26	
Δ Union		-.10		-.20
Union $_{t-1}$		-.07*		-1.12*
Adj R^2	.103	.117	–	–

* $p \leq .05$

Table 2: Pearson correlations (Ireland, 1975–2010)

	Top 1%	*Trade*	*Finance*	*Welfare*
Trade	.806***			
Finance	.764**	-.486		
Welfare	-.577**	-.319*	.272	
Union	-.928***	-.767***	-.890***	.223

*$p \leq .05$; **$p \leq .01$; ***$p \leq .001$

Note: Top 1% entered in levels, all others in lags of 1 year

In their analysis of the rise of the American super-rich, Volscho and Kelly (2012) found that higher capital gains taxation rates, coupled with higher union membership and democratic congressional control tended to reduce the share of the top 1 per cent. Conversely, trade openness and stock market valuation

had a positive effect, where higher imports of labour-intensive goods tended to weaken bargaining power. The shareholder value movement – a core feature of financialisation – also shifted managerial compensation from fixed salaries to performance benchmarking and stock options, and according to Forbes (2012), core salary and bonuses now account for only one-third of CEO annual income. The financialisation of the Irish economy followed a somewhat different path, albeit one closely tied to the fortunes of foreign financial markets. With cuts in capital gains tax, and deregulation of the financial sector in the 1990s, capital increasingly favoured investment in property over technology. As the investment strategies of the core banking sector switched toward property, construction and pricing became detached from underlying supply and demand, leading to a disastrous property bubble (Ó Riain 2012, 2014). The uneven distribution of the rewards of such a financialised economy is reflected in Kus's finding of a positive association between the income shares of the top 5 per cent, and a composite index of stock market valuation, bank profitability, and securitisation (2012: 492).

Similar effects are found in the above models, with trade and financial sector profitability both exerting positive influence on top incomes. As for traditional promoters of redistribution, both welfare and unionisation appear to pull down the shares of the top 1 per cent in the long run, consistent with existing research on other countries. Ireland's welfare intensity (spending as a percentage of GDP) is comparatively low, yet its status as a 'small open economy' suggests that strong welfare should be a central policy aim, given the instabilities globalisation supposedly induces in outward-focused economies. Proportional welfare spending fell sharply in the 1990s as GDP grew and the economy moved toward full employment. Similarly, government consumption's share of GDP – Stockhammer's (2012) measure of welfare state retrenchment – fell consistently from the early 1990s to the financial crisis.

Post-crisis welfare reforms have been particularly punitive with cuts in welfare rates, greater restraints on young claimants, and a series of 'workfare' measures in the vein of corporate welfare. Similarly the capacities of unions to effect economy-wide redistribution since the 1970s have been limited by falling membership, and the concentration of agreements in specific sectors under social partnership. This contrasts with bargaining systems such as Denmark's where centralised wage agreements enjoy broader sectoral coverage (Ebbinghaus, Gobel and Koos 2011). In light of the weight of cross-national evidence demonstrating the downward effect of these institutions on top incomes, and the comparatively weaker impact of these variables relative to financialisation and trade in the above models, it seems that any further weakening will merely enhance top-income growth. In light of the fact that both unionisation and welfare have been substantially weakened in their capacity to

effect national protection, serious discussion is needed about alternative ways to sustain equality.

Controversies and conclusions

Debate continues regarding the relationship between inequality and population well-being. Some have challenged Piketty's findings on the basis of data inaccuracies (Giles 2014), although his published response indicates that proposed adjustments do little to alter fundamental underlying trends (Piketty 2014b). Contrary evidence to Wilkinson and Pickett's thesis detailed in *The Spirit Level* is also found in the work of Deaton (2001). Beckfield (2004) raises similar concerns regarding the within-country impact of inequality, noting that fixed-effects models tend to nullify the impact of inequality on health outcomes. More recent research from Kondo *et al.* (2009) shows a stronger association in random effects specifications which better capture the effect of between-country inequalities. In short, the observed relationship appears to depend very much on model specifications, authors' choice of country groupings, and selection of independent variables. This merely underscores the need for assessing individual countries more closely, in order to tease out the ways in which different combinations of social institutions may offset or enhance top-income accumulation.

If Piketty has indeed put to rest Kuznet's prediction of a secular return to equality as economic development weakens the income divide between industrial and agricultural workers, focus must shift to the institutional underpinnings of inequality and its status as an inherent, rather than transient consequence of 'functioning' capitalism. If a return to compound growth is to remain a core policy agenda of states, then inequality and capital accumulation is a necessary precondition of renewed investment. Given the punitive turn in welfare provision since the crisis, and the sustained drive toward further retrenchment, it is clear that the existing institutions of the state cannot be relied upon to supply an appropriate income security foundation. The narrow coverage of existing (effectively bilateral) union pacts, coupled with stagnant membership rates suggests a task of mammoth reform in order to achieve similar levels of income equalisation enjoyed by the Nordics. Extensive casualisations of labour across both public and private sector have further eroded collective bargaining power, with the constant threat of redundancy and short-term contracting acting as an effective hedge against organisation. International comparison offers little encouragement, and the number of employees on zero-hours contracts has now reached 1.4 million in the UK, despite their better weathering of the crash, and comparatively lower unemployment rates (Inman and Monaghan 2014).

Recent figures published by the OECD (2014)[3] offer further cause for concern. Irish market income inequality rose 5 per cent from 2007–11, and the

share of individuals with less than 50 per cent median income rose 8 percentage points during the same period. The OECD (2014) warns that this serves merely to undermine gains in equality achieved during times of strong growth. Calvert *et al*. (2013) note that in the early stages of the Celtic Tiger, economic growth benefited low-income groups by extending labour market participation. As the economy reached full employment in the 2000s, the effect of top-income growth took over, and these incomes were hit harder in the early years of the crisis leading to a temporary reduction in overall inequality (Calvert *et al.* 2013: 29). The last recorded observations for Ireland in the World Top Incomes Database shows the top 1 per cent share at 10.48 per cent in 2008, and 10.5 per cent in 2009. Furthermore, Labour's share has levelled off at 64 per cent since 2010, following an upsurge in the pre-crisis years driven by growth in labour-intensive construction, and further 'growth' following the collapse of Ireland's GDP during the financial crisis. These figures inspire little confidence in any real transfer of power to labour, and the weight of international evidence on both the trend decline and institutional drivers of labour's share, is substantial.

The future of top earners thus appears secure; unscathed by an austerity programme that has leaned heavily on regressive fixed charges and a transfer of public wealth into private hands, the fortunes of the wealthiest look set to continue relatively undisturbed.

Data sources

Labour share: compensation of employees and nominal compensation of self-employed divided by gross national income (source: European Commission AMECO database).

Top 1 per cent: share in total national income of the top 1 per cent of earners (source: World Top Incomes Database; Nolan 2007).

Trade: percentage global share of combined imports and exports (source: European Commission AMECO database).

Finance: financial sector (FIRE) gross operating surplus as percentage of all sectors (source: OECD structural analysis database).

Welfare: welfare spending as percentage of gross domestic product (source: European Commission AMECO database).

Union: net union membership as proportion of wage and salary earners in employment (source: Visser 2011).

Notes

1 The recent upswing in labour's share since the financial crisis is attributable to the post-crisis collapse in national income (GDP), a situation borne out by its post-2010

drop and levelling as unemployment grew. Full commentary on the nuances of this series and an extended analysis are available in Flaherty and Ó Riain 2013.

2 The negative impact of globalisation and international trade on labour's share has been studied by Decreuse and Maarek (2008), Diwan (2001), and Harrison (2005), who have shown that the ability of multinationals to relocate with ease has tended to undermine the capacity of unions to negotiate terms of tenure and pay. Harrison's (2005) results show particularly strong effects in poor countries where trade shares, foreign investment, and capital controls tend to weaken labour's share.

3 Direct link to data: www.oecd.org/els/soc/OECD2014-Inequality-Update-Figures.xlsx.

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