Jobs with Equality

LANE KENWORTHY

OXFORD
UNIVERSITY PRESS

Contents

1

Introduction

THE PROBLEM

From the end of World War II until the mid-1970s, a number of affluent countries achieved a feat that many now look back upon with considerable envy: they combined continuously rising living standards with declining income inequality. Since the mid-1970s these economies have continued to grow, but at a much slower pace. And in many of them, inequality has increased; incomes for those in the middle and at the low end of the distribution have grown less rapidly than for those at the high end.

For policy analysts and policy makers who care about inequality, this poses a challenge. One view is that developments during the postwar "golden age" were a historical fluke and cannot be repeated. In this perspective, countries in the contemporary economic environment must choose between growth and low inequality; they cannot have both. In theoretical terms, the relationship between inequality and growth is ambiguous. There are reasons why low inequality might inhibit growth and other reasons why it might promote growth. The question, therefore, can only be decided empirically. Among the affluent countries, it turns out that there is no association in either direction between income inequality and economic growth since the 1970s (Kenworthy 2004*a*: ch. 4, 2008*a*).

This book does not speak to the question of inequality's impact on economic growth. I assume that if countries with low inequality have been (on average) able to grow just as rapidly as their high-inequality counterparts in recent decades, they may be able to do so over the next few decades as well. The question that motivates the book is: How can affluent countries maintain or move toward low inequality?

By "inequality" I mean posttax-posttransfer income inequality among households. There is good reason to care about inequality in the labor market—that is, inequality of earnings among employed individuals. But earnings typically are pooled within households. Hence, the household is arguably the unit about which we should be most centrally concerned.

Low income inequality is an increasingly difficult goal. Inequality in the market distribution of income—that is, before taxes and government transfers are taken into account—has been rising since the 1970s in many of these countries (Kenworthy 2004*a*; Kenworthy and Pontusson 2005). The first chart in Figure 1.1 shows levels of pretax-pretransfer income inequality among households with working-age heads in twelve countries. The data are for two peak business cycle years, 1979 and 2000. The latter is the most recent year for which reliable comparative data are available. Inequality is measured using the Gini coefficient; it ranges from zero to one, with larger numbers indicating greater inequality. Market inequality rose in eleven of the twelve nations, in some cases quite substantially.

One reason for this is that employment shifts from manufacturing to services, union fragmentation, decentralization of wage setting, globalization, technological change, and other developments have contributed to wage stagnation at the low end of the distribution and growing earnings inequality among employed individuals. The rise in individual earnings inequality began earliest and has been most pronounced in the United States and the United Kingdom, but since the mid-1990s it has occurred in a number of affluent nations (see Chapter 3). This in turn has contributed to rising income inequality among households.

Several other developments have reinforced and accentuated the impact of heightened earnings inequality (Chapter 3). With delayed marriage and more frequent divorce, more households have only a single adult and therefore only one potential earner. At the same time, in households with two adults (whether married or cohabitating), it is increasingly the case that both have paying jobs. These contrasting developments tend to widen the income gap between households. In addition, women and men with high education are increasingly likely to couple with one another, and the same is true for those with low education. This phenomenon, referred to as "marital homogamy," tends to further increase interhousehold income differences.

Declining inequality in the market distribution of earnings and income was key to countries' success in achieving reduced inequality in the distribution of posttax-posttransfer income during the golden age. But redistribution via taxation and government transfers was also an essential element. Given rising market inequality in recent decades, we might expect policy makers with a preference for low inequality to respond by increasing redistribution. The second chart in Figure 1.1 shows that the amount of redistribution achieved via taxes and transfers did indeed rise in most of the countries where market inequality increased. The only exceptions are Italy and the United States.

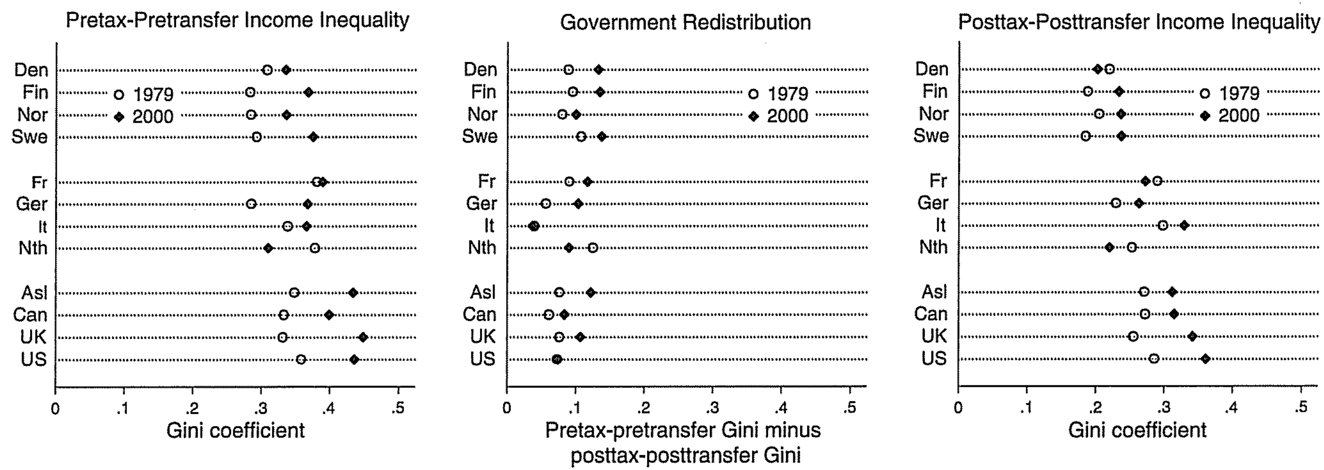

Figure 1.1. Market income inequality, government redistribution, and posttax-posttransfer income inequality, 1979 and 2000.

Note: The countries are ordered alphabetically within each group. The data are for households with working-age heads. Countries for which actual years are not 1979 and 2000: Australia 1981 and 2001, Canada 1981, Denmark 1987, Finland 1987, Germany 1981, Italy 1986, the Netherlands 1983 and 1999, Sweden 1981, United Kingdom 1999. For Italy and the United States, the level of government redistribution was the same in 2000 as in 1979. For data definitions and sources, see the appendix.

However, the third chart in the figure reveals that the rise in redistribution was not sufficient to offset the rise in market inequality. Posttax-posttransfer income inequality increased in nine of the twelve nations.

Countries also face new pressures and constraints on redistribution. One is population aging. Public pension systems in most affluent countries are financed on a "pay-as-you-go" basis: benefits for retirees come directly from current taxes. With low fertility rates and lengthening life spans, the cost of public pensions is rising relative to the tax base from which they are funded. Because pensions typically are the largest category of social expenditure aside from health care, this puts a strain on government finances. Pension systems can be adjusted—by raising the retirement age, reducing benefit levels, and/or taxing back the benefits of well-to-do retirees at steeper rates. But such changes are difficult to implement politically, and they may not yield enough cost savings in any case.

A second constraint is slower rates of productivity growth (growth of output per employed person). This owes to a variety of factors (Baumol, Blackmun, and Wolff 1989; Kenworthy 1995; Maddison 2001). Increased revenues produced by rapid growth of productivity could help to offset the fiscal pressures of population aging. But the past several decades have been characterized by slower, rather than faster, rates of increase in productivity, and there is no convincing evidence to suggest that this pattern will soon reverse.

Given the growing fiscal strain created by population aging and limited productivity growth, policy makers wishing to maintain or increase redistribution might be expected to raise tax rates. But that has been made more difficult by a third constraint: heightened capital mobility. Dire predictions of an all-out race to the bottom in tax rates have not been borne out, but in many countries rates have indeed been reduced, with revenues (as a share of GDP) holding constant only because the tax base has been broadened (Ganghof 2000; Genschel 2002).

A POSSIBLE SOLUTION

An increasingly common view, which I share, is that a key to limiting the growth of inequality in the face of these various pressures and constraints is to increase the employment rate (Esping-Andersen 1999; Ferrera, Hemerijck, and Rhodes 2000; Scharpf and Schmidt 2000; Esping-Andersen et al. 2002; Kok et al. 2003; Kenworthy 2004*a*; OECD 2005*b*, 2006*b*; Institute for Futures Studies 2006; Hemerijck 2007). Doing so is doubly beneficial for redistributive efforts: it yields an increase in tax revenues without an increase in tax rates; and to the extent it moves some current recipients of government benefits into the work force, it reduces welfare state costs.

While its chief benefit with respect to inequality reduction is via redistribution, employment can also reduce inequality in the distribution of market incomes across households. Half a century ago it was normal for many working-age adults to not be in the labor force. They were mainly women, and their husbands were employed. The fact that some adults were employed and others not had little impact on the distribution of earnings among households because inequality of employment occurred mainly within, rather than between, households. That is no longer the case. Women increasingly are in paid work, so inequality of employment occurs more and more between households. In other words, instead of having many households with one (usually male) earner and one (usually female) nonearner, a country with a low or moderate employment rate now is more likely to have many households with two earners and many with no earners (Gregg 1996; OECD 1998). This increases inequality of earnings and incomes between households (Chapter 3; Förster and Pearson 2002). To the extent it reduces the number of zero-earner households, high employment should help to counteract this development and thereby reduce market inequality.

Employment can also be justified on intrinsic grounds (Jahoda 1982; Wilson 1996; Phelps 1997: ch. 1). With heightened geographic mobility, later marriage, and increased divorce, neighborhood and family ties have dissipated somewhat. As a result, work is an increasingly important site of social interaction. Employment imposes regularity and discipline on people's lives. It can be a source of mental stimulation. It helps to fulfill the widespread desire to contribute to, and be integrated with, the larger society. For many individuals, work is inextricably bound up with identity and self-esteem.

What can affluent countries do to secure both low income inequality and high employment? In this book I examine the challenges such countries face, the strategies they have pursued in recent decades, and some options that might help them to do better.

OUTLINE OF THE BOOK

The book consists largely of empirical analysis of the experiences of rich democratic capitalist countries. Due mainly to data limitations but also in part to my desire to understand the institutional configurations and socioeconomic processes in individual countries in some detail, I focus on just twelve nations. Four are "Nordic" European countries: Denmark, Finland, Norway, and Sweden. Four are "continental" European: France, Germany, Italy, and the Netherlands. The other four are "Anglo" (English-speaking): Australia, Canada, the United Kingdom, and the United States. I use this tripartite grouping of the twelve countries throughout the book. Its role, however, is purely heuristic; the aim is to facilitate the display of data and the exposition. I do not argue that membership in a particular group plays a causal role in determining either inequality or employment.

For the most part I concentrate on developments since the late 1970s. This too is due partly to data availability. But there is a substantive rationale as well. The late 1970s mark the beginning of a qualitatively distinct economic environment for these countries—one characterized by, among other things, slower economic growth, globalization, rapid technological change, labor movement fragmentation, and a rightward shift in politics.

In Chapter 2 I consider the question of why citizens and policy makers should want low inequality. Why should we object to inequality? Should we focus on equality of opportunity or equality of outcomes? Why not focus on poverty instead? Why emphasize incomes rather than wealth or material well-being? Do people in fact care about inequality?

In Chapter 3 I argue that in thinking about income inequality, our focus should be on the distribution of posttax-posttransfer income among households, rather than the distribution of earnings among individuals or the distribution of market income among households. I then explore the chief determinants of cross-country and over-time differences in posttax-posttransfer household income inequality. I examine the impact of individual earnings, employment patterns within and across households, household composition and structure, and government redistribution. Each of these has played a role in why some countries have more income inequality than others and in why inequality has increased in many nations. A key finding in Chapter 3 is that for the countries that have been most successful at limiting inequality, redistribution has been especially significant. I suggest that keeping individual earnings inequality in check is likely to be increasingly difficult and that household structure and composition are very difficult for policy makers to influence. Hence, redistribution may be even more important in the future.

Chapter 4 describes the way I conceptualize and measure employment performance. I argue that to assess employment performance since the late 1970s, the most useful measure is employment change. By this I mean change in the employment rate (sometimes referred to as the "employment-to-population ratio"), not change in the number of people employed. It would be helpful to adjust this for work hours, but data limitations prevent that and the best available data suggest that doing so would not change the story much in any event. Part of the cross-country variation in employment change is a product of the degree of job loss in manufacturing and agriculture, and that in turn was due largely to the share of employment in these two sectors at the beginning of the period. In assessing the impact of policies and institutions on employment change, I therefore focus on services.

Chapter 4 also outlines my strategy for analyzing the impact of equality-enhancing institutions and policies on employment performance. Most of the analysis in the book is macrocomparative. Countries are the unit of analysis, and inferences are based on comparison of employment change across countries. For both substantive and methodological reasons, much of the comparative analysis is relatively simple. This imposes some limits but also has some significant advantages. I supplement the macrocomparative analyses with examination of various types of within-country evidence, especially quantitative and qualitative data on over-time developments.

In Chapters 5 through 10 I examine a variety of institutions and policies that are likely to influence countries' success in pursuing low inequality with high employment: low-end wage levels, employment protection regulations, government benefits, taxes, skills, and "women-friendly" policies.

Chapters 5–8 examine ways in which institutions and policies at the heart of countries' efforts to reduce inequality—high wage floors, employment protection, generous government benefits, and high taxes—may or may not reduce employment. For the past decade conventional wisdom has held that affluent nations face a choice between two models. The "European model" features high wages, strong employment protection rules, generous benefits, and high taxes. It is thought to produce low inequality but also low employment. The "American model" features low wages, employer flexibility with respect to firing, stingy benefits, and low taxes. It is said to generate high inequality but also high employment. These images are to some degree caricatures of the continents and countries they are said to describe, but many critics of these stylized ideal-types too quickly and cursorily dismiss the possibility that there genuinely are tradeoffs.

In Chapter 5 I look at the effect of wage levels at the low end of the labor market on employment. The key concern here has to do with low-end service jobs. These have been a major source of employment growth in many of the countries that have achieved rising employment rates during the past several decades. Because productivity in these jobs tends to be low and difficult to increase, the question is whether relatively high wages will substantially reduce employer demand for labor. Within the United States, this has been the key question at issue in the recurring debate over whether, and to what degree, the statutory minimum wage should be increased. I focus on cross-country evidence. Are low wages really necessary in low-productivity service jobs? If so, how low do they need to be?

Strict employment protection rules are typically motivated by concern for fairness rather than equality, but they may nevertheless help to reduce inequality in earnings among the employed. The concern is that they may also reduce hiring, thereby inhibiting employment growth. What does the experience of affluent countries in recent decades suggest? I examine this issue in Chapter 6.

In Chapter 7 I turn to government benefits. Generous benefits are necessary for securing low inequality but, depending on the degree of generosity and the conditions of eligibility, they may discourage employment. Has that been the case in affluent countries in recent decades? After examining the comparative evidence, I turn to extended consideration of a particular type of transfer program: employment-conditional earnings subsidies, such as the Earned Income Tax Credit in the United States and the Working Tax Credit in the United Kingdom. This type of benefit has a variety of desirable features. Perhaps most important, it effectively targets transfers to households with low incomes while encouraging employment. What impact have such subsidies had in the countries where they have been tried? How, if at all, might they fit with the policy packages in other countries? What other types of benefits are needed for securing low income inequality in the twenty-first century?

Like benefit programs, tax rates and tax structures differ markedly across the rich countries. And like benefits, taxes play a key role in reducing inequality but may also reduce employment. Do taxes reduce inequality directly, or do they contribute to redistribution chiefly by providing the revenue for transfers? To what extent does globalization constrain governments' ability to maintain large and progressive tax systems? Have countries been moving toward more or less redistributive types of taxation? Do taxes in fact impede employment? If so, does the problem lie chiefly in the overall level of taxation or in the structure of the tax system? What is the magnitude of the effect? I examine these questions in Chapter 8.

Educational attainment is a good predictor of individuals' employment and earnings. In the standard view, this is because education is a useful measure of skills, which in turn are a key determinant of a person's productivity. In theory, equalizing skills could therefore lead to both high employment and a relatively equal distribution of earnings. In Chapter 9 I assess this supposition, drawing on both individual- and country-level data.

In countries that have employment deficits, the problem consists chiefly of a shortage of women in employment. For example, Germany's employment rate among men is almost as high as Sweden's, but the employment rate for women in the two countries differs by more than 10 percentage points. Italy's male employment rate is comparable to that in Finland, but its female employment rate is more than 20 percentage points lower. A critical task for low-employment countries, then, is to increase employment among women. In Chapter 10 I investigate the impact of "women-friendly" policies—funding or provision of childcare, paid maternity/home care leaves, public employment, promotion of part-time work, tax systems that do not penalize a second earner in a household, and antidiscrimination and affirmative action policies—on women's employment. I also consider the relationship between female employment levels and household income inequality.

In the concluding chapter, Chapter 11, I summarize the book's findings, recommend some strategies for combining low inequality with high employment, and consider some potential objections and alternatives.

A word for those who wish to read selectively: Readers concerned mainly with the equality–jobs tradeoff debate will be most interested in Chapters 5–8, but Chapter 4 should be read first. Those whose principal interest is equality and inequality will find Chapters 2 and 3 most directly relevant, but Chapters 5–10 also include useful information and discussion. A summary of the findings and my recommendations are in Chapter 11.