Chapter IV

Inequalities, employment generation and decent work

The subject of inequality is central when examining the challenges of employment-generation and decent work (International Labour Organization, 2007). The evident worsening of economic and social inequality in the past three decades raises an important question on the impact, that such trends have had on the growth of employment and work opportunities. Although well-known economic models have postulated that some inequality promotes investment and economic growth, certain empirical evidence indicates that a high degree of inequality has a negative impact on subsequent economic outcomes. Moreover, better wealth redistribution can indeed promote sustainable economic growth which would generate a relative improvement in work opportunities for lower-income groups and for lower-income countries.

The present chapter begins by reviewing the trends and types of income inequalities. It then focuses on the labour-market and employment consequences of widening income inequality, looking at the direct effects of income inequality on economic outcomes. The chapter goes on to examine how non-economic inequalities affect economic outcomes and employment-generation. It is argued that a high degree of inequality tends to have a negative impact on subsequent economic outcomes and, in turn, on employment-generation and decent work.

Trends and types of economic inequalities

Increasing global economic inequalities and their social and economic consequences have been highlighted in several recent publications, notably *Report on the World Social Situation 2005*. (United Nations, 2005a). The share of the richest 10 per cent of the world's population has increased from 51.6 to 53.4 per cent of total world income (Bourguignon and Morrison, 2002). Also, the income gap between the richest and poorest countries has widened in recent decades (Berry and Serieux, 2006). In fact, the potential contribution of the global market during the 1980s and 1990s to growth and poverty reduction is still seriously under-realized in many developing countries (Osmani, 2003).

Functional distribution of income

Income inequality within many countries has been rising since the 1980s (Atkinson, 2003) after having decreased during the 1950s, 1960s and 1970s. The share of capital in total income has tended to rise while wages and worker benefits have tended to decline. This regressive shift in the functional distribution of income has occurred in both developed and developing countries. For example, one study (Harrison, 2002) found that within poorer countries, labour's share of income has been declining for some time, while the pace of decline has been increasing. In the richer countries too, labour's share of income is also falling; the Bank for International Settlements has shown that wages as a share of national income in the rich G10 countries have been on a downward trend since 1980, having fallen from about 63 to below 59 per cent in 2006.

Low incomes in labour markets do reflect low productivity to some extent, but not always, as can be seen in the divergent trends of productivity and real wages in the United States of America, where productivity has risen, while wages fell between 2001 and 2005. Indeed, policymakers can try to raise productivity and should do so, just as employers can be expected to want to do so; but policymakers can also look more attentively at non-productivity factors that cause workers to have low earnings, such as the pervasive practice of middlemen or landlords, or simply relatives, of taking away part of their incomes, and the practice of using worker indebtedness to induce compliance with dismally low wages.

Above all, policymakers can introduce laws and regulations to facilitate stronger bargaining power of, or on behalf of, workers, so that workers themselves can secure higher wages and benefits that correspond to their productivity. Strengthening of collective bargaining may also be a powerful force for higher productivity. It is too often forgotten that collective bargaining carried out by institutions and groups has a positive effect on dynamic efficiency, especially where those doing the bargaining have a vested interest in the preservation of the productive activity for the longer term. This is a positive externality of trade unions that has been overlooked by critics concentrating on their alleged effect on wages and labour "rigidities".

This regressive shift in the functional distribution of income is also partly a reflection of the forces unleashed by globalization, with a greatly increased abundance of labour supply on the one hand and a greater mobility of capital on the other. The abundant globalized labour supply contributes to keeping down wages: employers can always impose a pay cut merely by threatening to shift production to lower-income countries. This has fuelled the growth of functional income inequality. This global labour supply that is in surplus is acting very much like an unlimited labour surplus holding down real wages as economic growth proceeds. In effect, for many groups of workers in developed countries in particular, real wages have not been rising at all and have even declined in some countries, while the returns to capital have been rising. This is an issue of capital mobility rather than of factor productivity, reflected by a prolonged process of concession bargaining that has reduced real wages and curbed benefits to workers. Several studies have indeed attributed the decline in labour's share in part to financial liberalization (Harrison, 2002; Lee and Jayadev, 2005).

Globalization of financial markets makes it more difficult to tax the relatively mobile factors of production such as capital (Wachtel, 2003). In effect, taxation on capital has been falling, while the effective tax share borne by labour income has been rising, further worsening the functional income distribution.

Governments are advised to consider ways of checking the growth of inequality in order to preserve social cohesion and create a favourable environment for sustained economic growth. One way to accomplish this would be to find ways of redistributing factor incomes, (without undermining the incentive structures excessively) so that the growing functional inequality is not reproduced in personal inequality. Governments must begin by recognizing that there is no prospect of labour markets' adjusting in such a way as to reduce the functional inequalities.

Wage differentials

The growth of overall income inequality has also been attributed to the growth of wage differentials. The real wages of manual workers (unskilled labour) have fallen relative to the wages and salaries of relatively educated and skilled workers.

Trade openness, among several relevant factors, has contributed to the wider wage differential by favouring the wages of workers in export sectors and increasing the earnings of skilled labour relative to unskilled labour (Hoekman and Winters, 2005). Empirical studies have shown that increased trade openness has increased wage inequality in a number of Latin American countries (Milanovic and Squire, 2005; Pavcnik and others, 2002; Beyer, Rojas and Vergara, 1999; Attanasio, Goldberg and Pavcnik, 2003; Harrison and Hanson, 1999). In those cases, the opportunities opened up by the forces of globalization have not reached the poorest groups since the expansion of employment is related to a level of skills that the poor do not possess. Thus, growth has a highly unequal distribution which is increasing; this creates the class of the working poor or perpetuates their existence. However, in other regions, like that of the East Asian countries, the expansion of manufactured exports has brought higher employment and a subsequent increase in real wages, thereby reducing income inequality. For instance, in Malaysia, the demand for unskilled labour created by the process of export-led industrialization has increased considerably and has raised wages for unskilled workers (Jomo, 2006).

Trade liberalization in the absence of other policies will not necessarily lead to higher growth and may even decrease welfare in the shortrun (van der Hoeven and Lubker, 2006). Complementary policy measures have to be in place to counter any short-term negative effect of trade liberalization. For instance, in East Asian countries, greater investment in secondary and tertiary schooling has reduced the negative impact of trade liberalization by preventing a direct translation of educational inequalities into skill-based ones. This observation suggests the need to combine an important social policy with an economic one.

Foreign direct investment (FDI) by multinational enterprises has tended to raise wages in the modern industrial sector in developing countries, but also to widen wage differentials between regions, with strong gains being made by areas in which export-oriented activities are concentrated, leaving other regions behind, and within those local labour markets attracting FDI, with foreign firms paying much more than local firms in the same sectors. Wage differentials between multinational enterprises and local firms may not reflect only skill or productivity differentials. Firm-level data have shown that relatively high wages paid by multinational enterprises may induce a form of labour-market creaming and the emergence of a special labour-market dualism. Spillover benefits have been found to be greater where the multinational enterprises are in a competitive market involving local firms and when the technological and productivity differences between multinational enterprises and local firms are not substantial (Moran, Graham and Blomstrom, 2005).

The offshoring of jobs may also be widening wage differentials, within the countries "losing" jobs and within those "gaining" jobs. The transfer of jobs, and the threat to transfer them, may affect wage differentials as well as labour's share of gross national product (GNP). Traditionally, many of the jobs being transferred from developed to developing countries have been relatively low-wage manual jobs, and the threat to transfer more jobs led to a decline in wages for workers in such jobs in the developed countries. Now, however, the transfer has shifted to services, including a range of professional services, and offshoring has begun to affect wage differentials in developed countries by squeezing the middle-income groups of service workers. Several examples in the United States of America and Germany as well as United Kingdom of Great Britain and Northern Ireland (and almost certainly elsewhere) show that wage differentials between the high-paid and low-paid have grown partly because of the erosion of wage earnings of the middle-income groups (Autor, Katz and Kearney, 2006), precisely those most affected by offshoring and the threat of offshoring of jobs.

There is also the role of economic shocks, which have grown in number and intensity in the recent past. While globalization in itself has been boosting wage inequality between and within countries, economic shocks in themselves also seem to generate increases in wage inequality by disturbing inertias that characterize all labour markets. A case in point was Indonesia's economic crisis of the late 1990s, in the course of which real wages of manual workers had fallen sharply and stayed low when wages of other groups recovered (Dhanani and Islam, 2004).

Casualization, contractualization and wage differentiation

One form of wage inequality, which is made worse when seen in terms of social income (that is to say, when income is measured in terms of wages plus non-wage benefits), is that between those in regular, formal jobs and those in casual, informal jobs. While there has been a growth of casualization and of the number of workers in casual work statuses, there is some evidence that the differentials between the incomes of those in the several work statuses have been wide and are widening.

In developed countries, there has been a shift to more temporary employment, particularly through agency employment. In the United Kingdom of

Great Britain and Northern Ireland, for instance, it has been found that male temporary workers received wages that were 16 per cent lower than those of their male counterparts with similar skills and other personal characteristics who were regular workers, and that female temporaries received 13 per cent less than their equivalents in regular employment (Booth, Francesconi and Frank, 2002). Another study found that agency workers received 9 per cent less pay than other workers with similar characteristics (Forde and Slater, 2005). There and elsewhere in country members of the Organization for Economic Cooperation and Development (OECD), temporary workers do much worse in terms of entitlements and access to benefits such as holidays and pensions (Organization for Economic Cooperation and Development, 2002).

In Australia, where casual employment has risen sharply over the past quarter of a century, casual workers typically receive much lower pay, even though there has been a formal practice of casual loading (providing a premium for workers with casual status). Often the lower pay is due to an absence of bonuses and to the practice of putting casuals on lower classification levels (Campbell, 2004).

In the United States, agency temporary workers earn less than others doing similar jobs, even though their wages may actually be higher than the average for similar labour. The main reason is that the temporaries typically receive entitlement to fewer enterprise benefits and lower-value benefits when they do have entitlement to them. They commonly lack health-care coverage, employment insurance, retirement pay and vacation allowances. The same pattern emerges in Japan (Gottfried, Nishiwara and Aiba, 2006; Weathers, 2001).

In developing countries, where casual labour is almost the norm, as the informal sector tends to be large, one must take note of the fact that it is continuing to spread and that those engaged in casual labour earn much less than those in regular employment and often work without any social benefits. For instance, in the State of Gujarat in India, casual workers were earning much less than those doing regular jobs of a similar nature and less than those nominally self-employed (Unni and Rani, 2002).

The trend of casualization is accompanied by contractualization, as standard collective contracts are being increasingly replaced by individualized contracts based on bargaining between employers and employees. In the process, workers' bargaining power has been eroded, especially for those with lower skill levels. At the same time, an individual worker's ability to bargain becomes more important than before in determining wages, resulting in greater differentiation of wages among workers and worsening income distribution.

In sum, casualization and contractualization have been a means of lowering social income. This trend has further re-enforced wage differentials among workers.

Migrants and the native-born

Growing labour migration will also have strong effects on wage levels, wage differentials and access to social services. Some observers believe the effect of migration on wages in areas of in migration is limited because of labour-market segregation. For example, a study by the World Bank (2006) claimed that in the mid-1990s as many as 70 per cent of recent migrants from developing to developed countries had been in jobs that non-migrants preferred to avoid. Wolf (2006) argues that the notion that immigrants are working at jobs that natives are unwilling to take is erroneous on two counts. First, the supply of labour is dependent on its price. Without immigrants, people would have to spend more on nannies, cleaners, farm workers and so on. Second, most of the workers doing the jobs also performed by immigrants are actually native-born. The obstacle, it seems, is not the absence of native-born workers, but the fact that they would have to be paid higher wages if immigrants were absent.

Clearly, the macroeconomic effects are complex. Raising the supply of labour willing to work for low wages and without non-wage benefits may encourage the growth of production based on labour-intensive technologies using relatively unskilled labour; but this would deter process innovation that would boost productivity, which is what ultimately raises national income, growth and ultimately employment. Thus, while widening wage differentials through the boosting of the labour supply at the lower-skilled end may help individual employers, it could harm economic growth and dynamism.

Minimum wages

Throughout the twentieth century, an important weapon for combating poverty and income insecurity was the statutory minimum wage. With increasing globalization, it has come under attack led by the international financial agencies and some employer organizations. The critics have claimed that minimum wages priced low-productivity workers out of employment and created price distortions that affected the whole wage structure to the detriment of employment-creation and national competitiveness.

The arguments for and against minimum wages have been reviewed extensively (see, for example, Standing, 2002). Perhaps the best argument for them is that they can set a standard for decent work and guide collective and individual bargaining. However, their effectiveness in flexible labour markets characterized by economic openness and widespread non-standard and informal labour relations is limited. Some observers believe a statutory minimum wage does tend to raise "wages" in the informal economy (Devereux, 2005), although enforcement is likely to be very weak in such spheres.

While statutory minimum wages have been eroded by legislative reforms in many countries, a few countries have moved in the other direction. The United Kingdom of Great Britain and Northern Ireland introduced a national minimum wage for the first time in 1997, and the Governments of several countries have extended the coverage of their minimum wage system to groups of workers that were excluded. For example, South Africa extended its coverage to domestics and farm labourers in 2001, China to domestics in 2003, and Bolivia to agricultural workers in 2005. Nevertheless, these are exceptions with respect to the international trend.

The reality in developing countries and in flexible labour markets almost everywhere is that a statutory minimum wage is extremely hard to enforce. Moreover, many Governments have tended to bow to pressures to weaken their universality. Across the world, with a few exceptions, the value of the minimum wage has been allowed to fall relative to average wages and relative to basic subsistence income levels.

Very often, employers have been allowed to pay lower wages to young workers, and often part-time workers and casual workers are excluded from coverage. Frequently, differential minima have been introduced, creating administrative complexity and, paradoxically, leaving the most vulnerable least protected.

This problem is compounded by lack of awareness. Surveys in a large number of developing countries have found that many workers, particularly the poorest and most insecure, are unaware of the existence of a minimum wage, and even when they are aware, do not have the capacity to demand it.

In sum, the minimum wage has been a blunt instrument for providing income security for workers, and this is particularly the case in developing countries. It does have value, but not too much should be expected of it, particularly as a means of combating poverty and economic insecurity owing to exclusion in terms of coverage and difficulties in enforcement.

Impact of inequalities on employment and decent work

Given the global trend of increased inequality, the central question is whether or not the growth in inequality has tended to slow the growth of employment and work opportunities. Although certain economic models have postulated that some inequality promotes investment and economic growth, several empirical studies suggest that inequality lowers subsequent growth. Inequality in income and wealth can indeed reduce the possibilities of overall growth, with negative consequences for employment-creation and decent work. It seems, then, that some income redistribution can have a positive impact on employment outcomes, although the connections between inequality and economic development are still unclear. The argument for reducing inequality is further supported by the linkage between inequality and the perpetuation of poverty, as measured in terms of income and wealth as well as access to productivity — enhancing social services such as education and health (United Nations, 2005a).

Although economists have long believed that there is a trade-off between economic efficiency and social justice, empirical observations show that they are not incompatible and that inequality can have even a negative effect on subsequent economic outcomes. Some recent development theories would even argue that sustainable economic growth and productivity depend on the widest distribution of wealth, health and better education.

There is an important relationship between inequality and the rate of savings that will affect the rate of growth of a closed economy in the long run. Inequalities, moderate or high, in income distribution concentrate money in the hands of those who are willing to save (considering that as income increases, the marginal savings rate increases[1]), accumulate and invest, thereby boosting the growth rate. This consideration has been used to deter government efforts at redistributive taxation.

There are opposing views as well, arguing that under specific circumstances, a certain degree of redistribution can actually enhance savings and push up growth rates. From one perspective, contrary with the standard model of economic growth, savings behaviour is determined not only by income, but by investment and aspirations, and those aspirations are affected by existing inequalities of income and wealth. In an extremely poor country, redistributive policies may bring down the rate of savings and therefore the rate of growth in the medium or even long run. The choice is difficult: an egalitarian policy devised to reduce deprivation and inequality in poor countries is necessary, but at the same time it can bring down the rate of savings and consequently the rate of growth. In medium-income countries, however, the story is different. Redistributive policies may generate more savings at the national level, because they create a middle class with aspirations to a better economic life in the long term. A redistribution policy would give the opportunity to increase their rate of savings to those who could not otherwise afford to do so.

An argument directed against the standard "inequality enables savings, investment and economic growth" model can also be put forth, based on effective demand. If redistribution indeed lowers domestic savings, it increases effective demand in the national market, since the flip side of lower savings is higher consumption. Such inequality-reducing redistributive policies would increase effective demand for goods and services, thus spurring economic growth, especially when domestic investment was not constrained by domestic savings. Furthermore, income determines not only the level of consumption, but also the pattern of composition. At low levels of income, the needs for food, clothing and shelter are more important. Therefore, an income change in favour of the poor and the middle class, through economic growth or redistributive policies, opens up new consumption possibilities that are more likely to be skewed towards labour-intensive and domestically produced goods and services, compared with the consumption pattern of the rich. This shift in consumption structure would be more favourable to economic growth owing to its stimulating effect on the domestic economy. At the same time, this will have further impact on the redistribution of income, as the new demand by consumers will set up derived demand for factors of production and create a relative improvement in work opportunities for lower-income groups, thereby setting in motion a virtuous circle of growth and reduced inequality. Thus, the composition of product demand resulting from a given level of inequality influences both the functional and the personal distribution of income. There is no necessary cause-and-effect relationship between redistributive policy and slower economic growth.

Another macroeconomic implication of inequality is associated with the imperfection of credit markets, a typical characteristic of unequal societies. Although the access to credit by the poorest groups will not affect the creation of employment in a massive way, access to entrepreneurship can alleviate poverty and reduce unemployment. In this way, there will be a change in the supply and demand for labour and, consequently, in the wage rate. The shift of people to an entrepreneurial activity will raise their income and the income of the remaining workers would rise as well, because of the resulting upward pressure on wages. In other words, the market equilibrium is inefficient under high inequality; there are alternative solutions that can improve the situation of some individuals without hurting anyone else. The lack of access to credit creates inefficiency in the economy as a whole. Therefore, less inequality with a more efficient credit market will improve the efficiency of the economy, raising the level of employment and work conditions.

In sum, the long-held preconception that redistributive policies necessarily retard economic growth and thus employment-creation needs to be challenged on many grounds. In the context of securing decent work for all, social and economic policies aimed at reducing inequality have an important role to play, especially under circumstances where inequality is extremely high and in middle-income countries.

Socio-political inequality, economic growth and employment generation

Full employment and decent work require more than just economic inputs: human and social capital is also essential. Income and social inequalities create a deficit in human and social capital detrimental to employment generation. Further, the goal of full employment and decent work cannot be achieved unless equality of opportunity and access to basic social services are ensured. *Report on World Social Situation 2005* (United Nation, 2005a) found that inequalities in education access and outcomes, health status, and other dimensions of human capital are pervasive and growing in many societies. The present section explores the way socio-political factors negatively affect economic growth and employment-generation, primarily through the impact on human and social capital.

Gender inequality undermines growth and employment-creation

As discussed in chapter III, women are overrepresented in the informal economy where jobs are lower-paying and less stable, and the rights of workers less protected. With few exceptions, women earn less than men in all employment categories. Although women's opportunities to participate in the labour force have expanded in recent decades, and there has been a decline in inequality between men and women in many countries, women's access to paid employment remains lower than that of men in most of the developing world, and there is evidence that inequality among women is increasing.

Gender inequality and discrimination are incompatible with decent work. In addition, gender inequality impacts economic outcomes ultimately, and employment-generation and decent work in other ways as well. For one, women spend a higher percentage of their income on feeding and educating children (United Nations Children's Fund, 2005). In fact, the effect of mother's income on child survival is nearly 20 times that of the father's (Boeri, del Boca and Pissarides, 2005). Therefore, where gender inequality is high, there are likely to be fewer resources invested in human capital, limiting future growth. Also, income inequality reinforces educational disparities between women and men which, in turn, contribute to continuing inequality. Gender discrimination in employment also results in an inefficient use of human capital: when hiring decisions are made based on factors irrelevant to the task, such as sex of the applicant, women are systematically marginalized and their human capital investment goes to waste, undermining economic growth and thus the goal of decent work for all.

Health as human development

The link is well established between the health status of a population and economic growth and prospects for employment-generation as well as achieving decent work for all. The health of a population can affect the level of productivity; therefore, good health is essential for a productive labour force. There is also evidence that the health of a population affects the level of foreign direct investment (FDI) because foreign firms are less likely to invest in countries where people have poor health. FDI flows are positively correlated with life expectancy and negatively correlated with HIV prevalence (International Labour Organization, 2005).

HIV reduces the quality and quantity of labour through the loss of human capital and through direct losses of the labour force in AIDS-related mortality. In many poor countries, the health and education sectors are losing a large number of personnel owing to AIDS-related deaths, thereby limiting capacity to build future human capital. HIV/AIDS is particularly devastating because it hits the working-age population hardest. High turnover and absenteeism among skilled labour, due to HIV/AIDS-related mortality and illness, cut profit and discourage investment in many countries. This is particularly the case in sub-Saharan Africa.

Hunger prevents development of human capital

Hunger and its manifestations negatively impact the labour force through lowered human capital and productivity. It is also well documented that hungry and malnourished children face particular challenges to learning (World Food Programme, 2006). Hunger affects both an individual's capacity to learn through its effects on brain development and a person's ability to take advantage of learning opportunities in school.

Lack of nutrients during pregnancy and in infancy can lead to irreversible damage to the structure and size of the brain. Low birth weight also has lasting implications for future cognitive ability and academic performance. "Growth faltering" describes the failure of young children to grow to their full potential. In developing countries, as many as one out of three children under age 5 exhibits stunted growth. Stunting can lead to cognitive impairment.

Hungry children have reduced school attendance and enrolment, and they are more likely to drop out. When in school, hungry children have a difficult time concentrating and have shorter attention spans. Hunger also has negative effects on learning for adults, who in addition to suffering the long-term effects of hunger in childhood also experience lower productivity associated with low caloric intake, as well as lower concentration, poorer attendance in work and school and impaired mental functioning (ibid.).

Racial and ethnic minorities and human capital

Racial and ethnic minorities and migrant groups are often subject to social and economic exclusion through labour market discrimination and in terms of access to public goods such as education and health care (Gradstein and Shiff, 2006). Racial/ethnic discrimination commonly results in an unequal distribution of resources across ethnic groups and in some countries ethnicity and income are highly correlated.

Though some argue that ethnic disparities in income are due to human capital differences between ethnic groups, there is significant evidence that suggests that the ethnic differences in occupational attainment and income go well beyond education and skill differentials, and that in fact, ethnic minorities do not receive the same return to education and skills in the labour market as do members of the dominant group owing to discrimination (Frickey, Murdoch and Primon, 2006; Coopersmith, 2006; Berthoud, 2000; Lee, 2004).

The existence of ethnic discrimination and income disparities weakens social cohesion further. In its Declaration, the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance, held in 2001 in Durban, South Africa, affirmed that racism and racial discrimination "are among the root causes of many internal and international conflicts, including armed conflicts, and the consequent forced displacement of populations" (United Nations, 2001). Given that disparities in income can lead to violent conflict, it is not surprising that a large number of the violent conflicts in the world in recent years have had an ethnic component (Gurr, 1993, 2000).

Empirical studies show that ethnic discrimination in the labour market is pervasive and persists despite policies directed against it (Fugazzo, 2003). Discrimination can take the form of negative stereotypes regarding ethnic minorities' work capacities, can be transferred intergenerationally through lower social and human capital, and can occur at the institutional or systematic level. For example, when job opportunities are not advertised, but shared only by word of mouth, ethnic minorities with less social capital are less likely to be aware of such positions and to apply for them. Along similar lines, although the requirements of testing and/or professional certification may appear to treat all applicants equally, in reality qualified ethnic minorities might find it difficult to acquire those credentials owing to remoteness of locations and/or language disadvantages.

When employment decisions are based on irrelevant factors such as race or ethnicity, or the full pool of potential applicants is not considered, not only does discrimination infringe on the human rights of ethnic minorities, but it also constitutes an inefficient use of human capital.

Income inequality is detrimental to human development and social cohesion/trust

Though research results in recent years have been mixed, the latest research based on the best available data finds a consistent relationship between income inequality and health quality (Ram, 2006). It is not just individual income or employment that affects people's health and well-being. Aggregate levels of unemployment and income inequality are also associated with poorer health in the community. There is a strong body of research that links low income to such health indicators as mortality rates, malnutrition and stunted growth, HIV prevalence and general poor health (International Labour Organization, 2005; Ram, 2006; World Food Programme, 2006).

The relative income hypothesis posits that an individual's health is affected by the distribution of income within a society through inequality's effects on social and human capital. According to this perspective—which has mixed empirical support—in very unequal societies, there tends to be less investment in public goods because they are seen as subsidies from the wealthy to the poor. For example, the fact that there tends to be less investment in public education and health care and a greater use of private services among the wealthy in essence cuts off the poor from opportunities to improve their human capital and stay healthy.

Income inequality also affects economic growth through its effect on education. The relationship between education and income inequality is complex and reciprocal. Limited labour-market opportunities in high-inequality countries influence the decisions of boys and girls on enrolment in school through the associated lack of incentive to stay in school. Moreover high levels of inequality associated with poverty often mean that children, especially girls, are taken out of school to help with household duties or to contribute to household income through paid work. The resultant lower educational attainment, in turn, further fuels income disparities.

Numerous studies link educational enrolment to socio-economic status. Cross-national studies find a large gap in educational attainment achieved by students in the top 20 per cent compared with those in the bottom 40 per cent of the income distribution (Buchmann and Hannum, 2001).

Increasing educational attainment can also increase income inequality. In the United States, there is evidence that increases in income inequality are at least partly attributable to the increasing returns to college degrees, as graduates make more than non-graduates. As the number of college graduates increases, income inequality increases (Lemieux, 2006). At the same time, weakening unions and declining real minimum wages have lowered incomes for non-college graduates. There is also evidence that the education-based wage gap can be reduced through on-the-job training (Hamil-Luker, 2005).

The relationship is complicated further by recent studies showing that returns to primary education in developing countries may be overestimated, particularly when labour-market conditions are not taken into consideration (McKenzie, 2006; Fryer and Vencatachellum, 2005). Where the class structure is rigid, education is likely to have less impact on income inequality. Also, there is some evidence that education is more important in determining occupational attainment for the middle class—which is often small in countries with high income inequality—than for the poor or wealthy. For the poor and the wealthy, intergenerational transfer of occupational status is much more likely. Recent cross-national studies find that public education expenditures reduced the level of income inequality in countries over time (Rudra, 2004; Sylwester, 2000). This relationship was found to be stronger in OECD countries where class structure is arguably less rigid and poverty less extreme. Another study found that economic liberalization may limit the effects of secondary enrolment on income equalization (Wells, 2006).

Social cohesion and political stability are important for economic stability, investment and growth and, ultimately, for the health of the labour market and employment opportunities and conditions. Income inequality can compromise social cohesion, lead to political violence and endanger government stability. In other words, income inequality contributes to a political and social environment that is not conducive to decent work and full employment.

There is also a correlation between income inequality and measures of social capital such as generalized trust. In countries where income inequality is higher, there is less general trust of others. Trust is an important factor in economic growth, as uncertainty is linked to lower investment. Where there is less interpersonal trust, individuals are apt to be less likely to enter into the agreements with each other that are essential for economic development. Where there is a high degree of social cohesion, transaction costs are lowered owing to higher levels of trust and social capital, and lowered transaction costs are conducive to thriving economic activity. Income inequality breaks the bonds of trust and therefore lowers social cohesion. Ultimately, lowered social cohesion strains institutions and impedes growth, which negatively impacts labour-market conditions and is likely to further fuel income inequality (Easterly, Ritzan and Woolcock, 2006).

Income inequality can generate discontent and grievances among the population, particularly when people observe a discrepancy between what they believe is right or fair and the current situation in which they live. When the government is perceived as complicit in the inequality, such grievances may be aimed towards the government and manifest themselves in a variety of ways ranging from conventional political participation (that is to say, in democracies, voting for candidates supportive of redistribution or other policies aimed at addressing the inequality) to protests and, in some cases, even political violence. In fact, cross-national empirical research generally finds that income inequality can lead to political violence (Lichbach, 1989; Schock, 1996). There is evidence that political violence is more likely to result from economic inequality when the State is weak, in other words, when it is unable to maintain order effectively and/or deliver goods and services to the population (Schock, 1996). Therefore, developing countries with weaker State institutions are more susceptible to violence resulting from income inequality.

Finally, democracy and the economic freedom it entails are also important for decent work and full employment. The relationship between income inequality and political violence suggests that democracies may not emerge or may be unable to survive if severe inequalities are not addressed. There is a general consensus that the middle class is important for democracy, and that while there is not a perfect relationship between the two, high income inequality generally means a small middle class. Some research finds a direct relationship between income inequality and democracy, though the findings are disputed (Muller, 1995; Bollen and Jackman, 1995).

Policy directions

Policies and strategies to promote and generate full employment and decent work should take into account the issue of inequality, as there are linkages between inequalities and the achievement of full employment and decent work. Addressing economic, social and political inequalities that underlie labour-market performance as well as the corresponding impact of the labour market on inequalities should underpin policy considerations. Taking these synergies and compensating mechanisms into account is therefore essential in developing policy packages and in shaping political support.

The design and choice of policy strategies directed towards reducing inequalities while promoting job creation will have to take into account, first and foremost, the specific level of development of different countries and the varied motivations for redistribution. Factors that affect the growing inequality and rising unemployment will have to be considered in the policy design, including redistributive policy involving such elements as changes in taxation and benefit systems, labour-market conditions, the changing demographic structure of the population, the changing social structures and human rights.

Redistributive policies

Macroeconomic policies designed to address growing income inequality and rising unemployment should weigh the advantages of progressive taxation and government social spending which often serve to supplement income sources of the poor and the working poor. However, grants of tax relief as a means of promoting employment can reduce overall tax revenues and result in lower spending on education, training, health care and other social services needed by the poor. It is important, therefore, that the adverse impact on social spending of tax relief programmes be weighed against the gains in employment-creation.

In addition, the macroeconomic effect of reducing inequalities, which can lead to a shift in demand towards goods and services needed by the poor, should be assessed as a means of opening employment opportunities for lower-income groups.

Wealth redistribution strategies, such as land reform and estate/inheritance taxation, should be more widely implemented and enforced to promote access to land and other productive assets. Success in land reform is often a long-term process and requires mechanisms to support the growth and stability of incomes derived from the land. Otherwise, land recipients can end up utilizing the land as collateral against loans, with failure to repay those loans eventually leading to loss of land ownership.

The deepening of inequality as a result of the various economic crises in the past decades offers important lessons. In particular, the disproportionate costs borne by the poor when economic programmes fail — in terms of hunger, loss of health-care services and reduction in educational opportunities — and the disproportionate benefits gained by the rich when economic programmes succeed should be rectified in policy designs that promote full employment and decent work. Ethical arrangements and fair allocation of risk lead to improved social harmony and socially optimal allocation of resources and minimize perverse risk-taking. In addition, a social risk management perspective needs to be incorporated in policies to ensure that the poor and working poor — who are least capable of absorbing shocks — are provided with appropriate social safety nets.

Labour-intensive initiatives that provide more employment opportunities for the poor should be pursued by Governments. For instance, the employment impact of public infrastructure projects can be enhanced by utilizing labour-intensive production methods and by promoting public works programmes if they are deemed appropriate given limited resources. Another example is the promotion of small and medium-sized enterprises which typically utilize labour-intensive technologies.

Labour- market policies

The policies that promote job creation and entrepreneurship through either tax or customs duties incentives (such as industrial zones) should consider the relative abundance of labour vis-à-vis capital in most of the developing world, that is to say, incentives should be structured consistent with the relative supply of labour and capital.

When seeking to attract foreign investments, Governments together with other countries, should ensure that the intercountry competition does not lead to a "race to the bottom" by compromising domestic standards on living wages and safe working conditions, and the granting of incentives to enterprises that may reduce government revenues and lead to lower spending on social services, health care and education for society at large. Regional cooperation in this regard may serve as an effective countervailing bargaining force vis-à-vis corporations and commercial interests whose size may dwarf those of small developing economies. In addition, the role of trade unions in strengthening collective bargaining can be harnessed in the negotiation process.

Minimum wage policies need to incorporate the minimum cost of living and geographical differences in respect of labour supply, living standards and costs of doing business. Furthermore, government incentives to businesses should take into account various aspects of investment and not solely wages. Other incentives would include government investments in human capital and infrastructure, the streamlining of licensing requirements, good governance and the stability and reliability of legal systems.

The lack of regulatory oversight in the informal economy exposes its workers to greater risk of abuse, poor working conditions and lack of benefits. Policies on work formalization that would provide social security benefits and legal protection to workers need to be carefully balanced against the demand for less formal arrangements often typically associated with start-up and entrepreneurial activities. Conditions for any exception need to be laid out and must ensure that the largest enterprises, well past start-up stages, are required to formalize their workforce. It is therefore imperative that policies weigh the pros and cons of formalization.

The increasing practice of casualization of workers, while indeed allowing for the "distribution" of part-time work among potential workers, does not create an environment conducive to worker advancement, retention of skills and long-term productivity gains.

The design of policies to promote employment and decent work also needs to incorporate the demographic and social changes in society, such as the growth in the number of youth and older people, the growth of households headed by single-women, the displacement of indigenous peoples from their former environments of survival. For example, policies that do not take into account the number of older people as well as the increasing proportion of youth could create biases against these workers, thereby not only generating increasing unemployment in these age cohorts of the population, but also disregarding the higher productivity that older workers may offer to society. Similarly, policies that fail to account for the growing number of household headed by single women, could fail to increase women's employment though, inter alia, not providing childcare and family health benefits.

Low-skilled workers and the working poor would benefit from investments in human capital undertaken to bridge the inequalities in opportunities. Programmes that provide skills development through education and training will help entry-level workers advance. Initiatives towards strengthening entrepreneurial skills and innovative practices could promote the creation of sustainable enterprises and improve job quality.

Political and legal reforms

Policies on employment and decent work should factor in political and legal reforms to ensure that such initiatives do not exacerbate inequalities in society and that they provide employment opportunities for all and protect the rights of workers.

Giving voice to all members of society, including workers and the unemployed, women, migrants and other marginalized groups, should ensure that their views on matters affecting their lives are heard. Democratic societies, with their laws and legislation already in place, often fall short in terms of those laws' implementation and this problem should be addressed. In other countries where such laws are absent, taking into account the views and opinions of workers, the unemployed and the marginalized can lead to a more effective design and implementation of strategies; and allowing for public reviews of proposed policies and programmes, wherein views and conflicting perspectives could be solicited and better addressed, would be a concrete step in this regard.

As deepening inequalities and the continued downward pressure on wages of workers and reduction of work benefits are inconsistent with social harmony and can potentially lead to social conflicts, they would need to be addressed.

Political reforms and legal provisions for recognizing greater equality as regards race, gender and age are also essential to raising awareness and consciousness among businesses of these objectives. Protecting immigrants' workplace rights and civil rights should be embedded in immigration laws and enforcement of equal employment opportunity protections. In fact, the introduction of anti-discrimination laws is needed to ensure that employment growth and decent work do not disproportionately benefit the more privileged members of society.

Emerging challenges for policy interventions

Changes in the labour market brought on by increasing globalization have resulted in new policy challenges whose impact on inequality will require further studies.

Migrant and overseas employment, which has increased significantly in a globalized world, constitutes one such challenge. It is increasingly recognized that migrant workers come from families of relatively higher income in their home countries. With foreign remittances increasing, a direct income effect has been the increase in wage and income inequality in the sending country. In addition, as these workers are generally better educated and productive, their migration contributes to brain drain, disrupting the supply of important services including medical and health-care services and education, and resulting in higher prices or the reduction of social services for those left in the sending country. Careful consideration needs to be given to the potentially adverse effects of the growth of overseas employment and of foreign remittances on income distribution, particularly as developing countries encourage and promote overseas work as an important tool with which to address unemployment and foreign exchange deficits. These considerations need to be balanced against benefits such as higher incomes and gains in skills, productivity and work experience that are reaped upon the return of migrant workers.

Another emerging challenge is the growing rollback of enterprise non-wage benefits (for example, pension and health insurance). While this is perceived as helpful in generating employment and maintaining a competitive business environment, it has potential long-term implications. The competition among countries to attract businesses can lead to the establishment of a global standard that relies on the privatization and commercialization of benefit schemes. This privatization process in societies with poor consumer protection capabilities can potentially expose workers and their families to fraudulent business practices. In addition, under voluntary schemes, there may not be sufficient voluntary participation to create viable insurance programmes (whether privately or publicly operated). The efficiency benefits from the rollback in enterprise non-wage benefits should be balanced against the long-term overall impact on society and against their potential adverse long-term implications for health care and income security of workers as well as retirees.

Concluding remarks

Global economic inequalities have increased during the past two decades and income inequality within many countries has been rising since the 1980s. This chapter has shown that a high degree of inequality has a negative impact on subsequent economic outcomes and that better income and wealth redistribution can indeed promote sustainable economic growth that would generate a relative improvement in work opportunities. Though classical economic models suggest that wealth inequality is supportive of economic growth, based on the empirical evidence presented there is little doubt that reducing wealth inequality does not have a negative effect on economic growth. In fact, a high level of economic inequalities can retard economic growth by creating political demands for redistribution. Evidence suggests that economic growth and productivity are better supported by an equitable distribution of wealth and better healthcare and education. Also, the lack of access to credit for many in very unequal societies creates market inefficiencies. In these countries, increased equality would increase credit access and improve the efficiency of the economy, thereby raising the level of employment and work conditions for the poor.

Income inequality also hurts economic outcomes and, in turn, employment-generation through its impact on social inequalities such as those related to gender, health and education, among others. Where gender inequality is high, fewer resources are invested in human capital and ultimately in the future labour market. In addition, discrimination based on gender, ethnicity, age or other factors irrelevant to job performance introduces serious inefficiencies (not to mention injustices) into the labour market.

Good health is essential for a productive labour force, and low income is one of the major factors associated with poor health. The HIV/AIDS epidemic in Africa is one example of how population health can have seriously negative consequences for economic growth and employment generation, owing to the loss not only of human capital, but also of FDI.

Income inequality also affects the labour market by reinforcing educational disparities and breaking down social cohesion, hindering economic growth and employment-creation.

Finally, there are policies and strategies that Governments can pursue to promote and generate full employment and decent work, taking into account the issue of income inequality. Redistributive policies should be more widely implemented. Trade unions in their role of strengthening the position of workers in collective bargaining and promoting productivity growth represent another means of improving economic outcome by reducing inequality. Policies on employment and decent work should factor in political and legal reforms to ensure that such initiatives do not exacerbate inequalities in society and that they provide employment opportunities for all and protect the rights of workers.

The fact that deepening inequalities and declining wages and benefits reduce social cohesion and can lead to overt conflict should be confronted directly.

This chapter has also examined some emerging challenges for policy interventions owing to changes in the labour market resulting from increasing globalization. The impact on inequality of migrants and overseas employment, as well as of the increasing rollback of non-wage benefits such as pensions and health insurance, warrants further studies.

Notes

1 It is important to consider that the behaviour of individual savings as income changes might be influenced by several factors, and it is therefore difficult to accept a priori the idea that marginal savings will increase with income.