The role of firms in wage inequality: Policy lessons from a large-scale cross-country study

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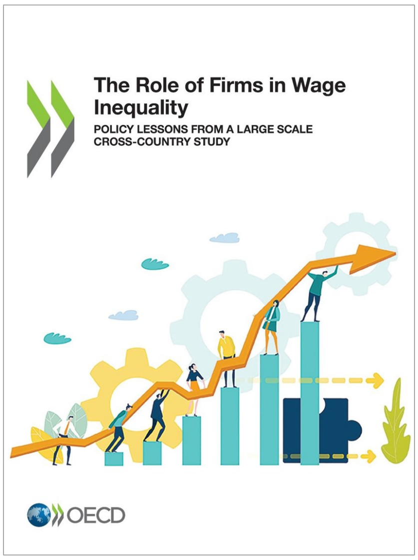


This post provides an overview of the new report The Role of Firms in Wage Inequality: Policy Lessons from a Large Scale Cross-Country Study launched on 9 December.

Policy makers in many OECD countries have been grappling for some time with a number of potentially inter-related trends: low productivity growth, widening gaps in business performance, increasing market concentration and rising income inequality (OECD, 2015; Andrews, Criscuolo and Gal, 2016; Berlingieri, G., P. Blanchenay and C. Criscuolo, 2017). However, little is known about the implications of widening gaps in business performance and increasing market concentration for wage inequality, including wage gaps between men and women.

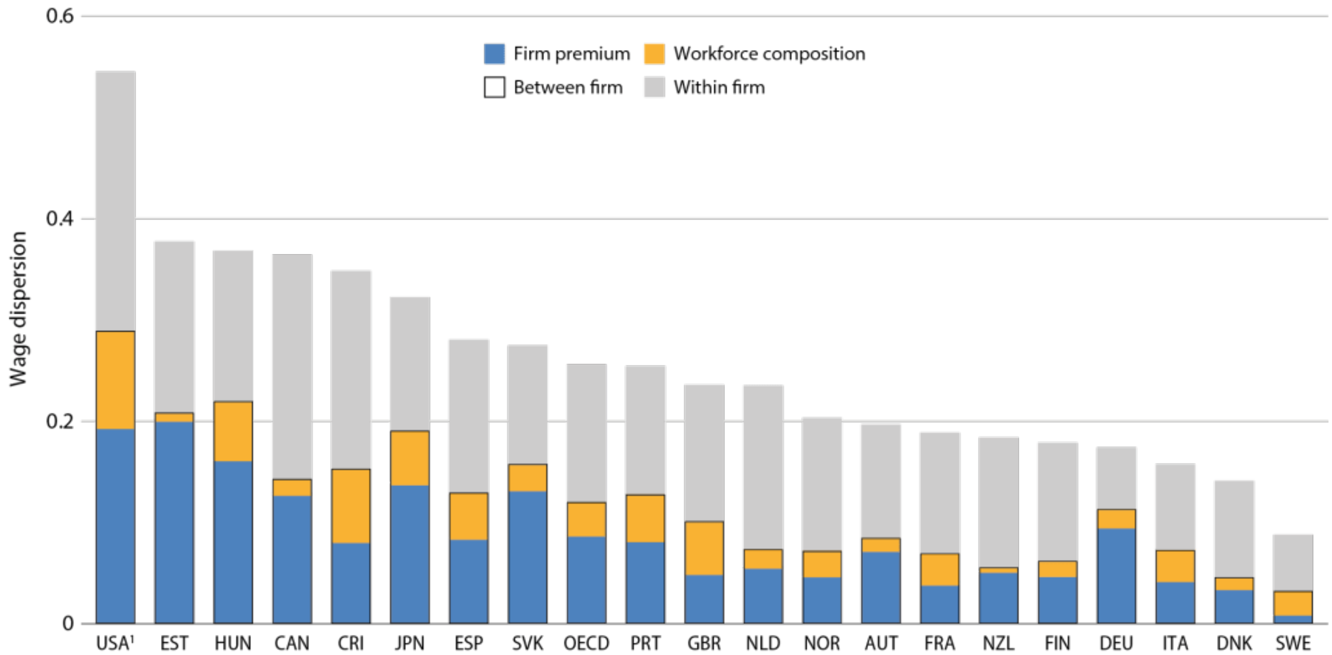
Filling this knowledge gap is the aim of a new OECD report The Role of Firms in Wage Inequality: Policy Lessons from a Large Scale Cross-Country Study, OECD, 2021. As the pandemic has boosted the digitalisation of business models in a way that may favour large tech-savvy firms, this is a critical issue for policy makers seeking to support an inclusive recovery.

Firm pay policies account for around one-third of overall wage inequality

Wages are not only determined by workers’ skills but also by the productivity and pay policies of the firms they work for. The new report finds that average pay differentials across firms account for a sizeable part of overall wage inequality and that this predominantly reflects between-firm differences in pay for workers with similar levels of skills rather than differences in the composition of workers (Figure 1). Differences in wage premia across firms, i.e. pay differences after taking account of differences in workforce composition, account for around one-third of overall wage inequality.

Figure 1. Firm wage premia account for about one third of overall wage inequality

Contributions to overall wage dispersion, latest available year



Note: The height of the bars denotes the level of overall wage inequality in the latest available year, with the shaded parts denoting the contributions of firm premia, sorting and within-firm inequality. OECD refers to the average of the 20 countries shown.
Figures for the United States are based on Barth et al., 2016.
Source: OECD, 2021.

Between-firm pay gaps are not necessarily a bad thing, since they allow high-productivity firms to attract workers and grow their businesses by offering high wages.

But cross-firm pay gaps can also be excessive if they reflect barriers to mobility that trap a large share of workers in low-wage firms. This is particularly important for women who, on average, are more likely to work in low-wage firms.

For instance, a fast-food worker whose contract prevents her/him from moving to a higher-paying competing restaurant by a so-called non-compete clause remains trapped in her/his low-pay job, and prevents the high-pay restaurant from expanding. This raises wage inequality and reduces aggregate productivity.

Complementing worker-centred policies with firm-centred policies would promote an inclusive recovery

To promote an inclusive recovery from the COVID-19 crisis, policy makers need to update their toolkit and complement worker-centred policies with firm-centred policies. This involves:

- First, enabling firms to adopt new technologies, digital business models and high-performance management practices would promote the productivity catch-up of low-performing firms and allow them to pay higher wages.
- Second, ensuring effective competition between firms on both product and labour markets would limit the risk of excessive wage-setting power. This includes accounting for the labour market consequences of mergers and combating mobility-restricting agreements (e.g. non-compete clauses, some professional licencing requirements). According to the new report, strengthening competition between firms in local labour markets could significantly boost wages of workers in highly-concentrated markets who typically face a wage penalty of 7% relative to similar workers in markets with low concentration.
- Third, boosting job mobility through active labour market policies (e.g. via re-skilling) and support for geographical mobility (e.g. via transport and housing policies) would allow workers currently trapped in low-performing firms to unlock their potential by moving to high-performing ones. The new report suggests that this could have significant effects on wages and inequality, as high-performing firms typically pay about twice as much as low-performing ones for comparable workers.
- Fourth, promoting worker representation in the workplace and collective bargaining would further help counter-balance the disproportionate wage-setting power of some employers, including large digital platforms that resort to non-standard forms of work (e.g. self-employed workers).

The new OECD report puts firms squarely at the centre of our thinking on the nexus between growth and inclusiveness by providing comprehensive new evidence on the links between firm performance, wage setting practices and wage inequality.

Action is needed now to avoid the risk of a two-speed economy in which activity and employment are highly concentrated, and high-productivity firms and their workers increasingly pull away from the rest.

References

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