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Labor market rigidity, social policies and the labor share: Empirical evidence before and after the big crisis

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Highlights

- Labor market institutions and policies are shown to affect the labor income share.
- Continental Southern Europe mostly sustains income with welfare expenditures.
- Active and passive measures are particularly sensitive to the 2007 structural break.
- Minimum wage affects the re-distributional impact of social policies.
- EPL is strongly positively correlated to the labor share in minimum wage countries.

Abstract

This paper provides evidence of the impact of three important and general policies shaping the degree of labor market rigidity on the labor share: welfare expenditures, government expenditures on active labor market programs, and passive labor market measures. It analyzes the impact of regulation, such as the intensity of employment protection, and evaluates whether trade unions and minimum wage institutions play a role in the relationship between all measures and the labor share. The labor income share has experienced a declining trend since the mid-1970s in most advanced economies, and the existing literature found little if no correlation of this decline to general labor market characteristics. However, the present paper finds that some institutions are correlated to the downward trend, depending on the welfare system adopted, and that welfare and employment protection counteract the decline. Moreover, many countries saw an upsurge in their labor share after the burst of the financial crisis. Evidence of whether the effect of the policies weakened or reinforced the labor share after 2007 is reported.

JEL classification: E02, E25, H53