THE EFFECT OF NETWORKS ON THE SHARE OF WAGES IN THE NATIONAL INCOME

Introductory thoughts on the current situation

During the last two decades earnings, in relation to the national income, the so-called share of wages in the national income, have tended to fall[1]. Respectively, the percentage of income upon investments has risen. It should not be forgotten that the figures forming this share of wages include the salaries of top earners, for example company directors; if they were to be removed, the discrepancy would be considerably greater.

The explanation given for falling share of wages is often unemployment, which is, in industrialised countries, caused primarily by digitalisation and technological progress. These two factors increasingly provide industries with the possibility to replace manpower with machines, thereby reducing costs. To the same aim, production can be removed to parts of the world where wages are lower, thus further reducing costs. (Outsourcing) Problems in the job market and increasing pressure on the share of wages are also a result of competition from emerging markets, which due to low production costs are pushing inland produce out of the market. Basically, unemployment is the main explanation for the reduction in the share of wages in the national income. There is no concrete proof that liberalisation of the job market regulations, which make it more difficult for trade unions to counter a reduction of wage ratios with demands for higher wages, is a cause.

An economic sciences research group[2] has, based on micro panel data from the US, census results up to 1982 and international sources and documents, found a further possible cause for sinking wage ratios. According to this group, during the last two decades, in most branches, businesses have succeeded in achieving network effects[3], by increasing their range of products and through effective marketing, thereby increasing their share in the market and building up a dominant position in the market. This applies to the beginning of the digital age, the so-called Industrial Revolution[4], as well as increasingly cross-linked economic units, particularly the 'Internet Giants',

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[1] One example is the Republic of Germany, where the wage ratio has sunk from 72.9% in 1993 to 68.2% in 2013 and 2015. (Statista: National Account, Hamburg 2017, p. 57 and following)

[2] Christina Patterson/David Autor/John van Reenen (Massachusetts Institute of Technology IT)/David Dorn (University of Zurich)/Lawrence Katz (Harvard University): *The Fall of the Labor Share and the Rise of Superstar Firms,* NBER Working Paper No. 23396, May 2017, NBER Programm(s): LS PR

[3] These so-called network effects (network externalities) mean that the use of a product for the consumer increases according to its acceptance on the market and, therefore, increase in production levels. This applies to businesses intending to employ the product in their production processes, as well as consumers who consider the product more useful – often without realising it, the more popular it becomes. On the other hand, network effects enable the provider (network owner) to set the product's price at a level bringing maximum profit.

[4] However, one wishes to name this revolution: historically Industry 2.0, or Industry 4.0. (see: Hennies, M. O. E./Raudjärv, M., Industry 4.0 – Thoughts on the present situation, in: Estonian Discussions of Economic Policy, Berlin/Tallinn 2015, p.9-23).

such as Apple, Alphabet (Google), Microsoft, Amazon and Facebook, which procure exorbitantly high profits per work force member. In other branches, network effects lead to accumulation of business and extremely high profits in so-called Superstar-Companies.

Increasing concentration on the markets leads to sinking wage ratios in the economic sector concerned. The research team attributes that to the fact that businesses whose labour costs are relatively low achieve a higher share of the market than those with higher labour costs. These escalating developments are stated as a further reason for a reduction in the share of wages in the national income.

On the other hand, one could argue that in branches of industry and companies in which the profit per work force member is above average, experience shows that higher than average wages are earned. In fact, this counteracts the afore mentioned tangential reduction in the share of wages in the national income.

In the research findings quoted the authors have discovered that businesses which dominate the market are increasingly outsourcing labour intensive production areas to subcontractors. Furthermore, through service contracts affiliated companies, are being entrusted with production of wage intensive products or are employing temporary workers. Therefore, profit orientated fringe benefits remain largely within the circle of the core workforce of these Superstar-Companies and have very little compensatory influence on the development of the share of wages in the national income.

The falling share of wages in the national income and the trend towards an increase in inequality of income distribution, in the States, should not be thoughtlessly counteracted by progressively staggered taxation. This could lead, in an increasingly globalised world economy, to highly qualified workers leaving the country and taking their innovation potential and motivation abroad. This would result in a loss of growth potential through taxation for the country in question.

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