# Industry Wage Differentials Rent Sharing and Gender in Belgium

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***Abstract –*** *The main objective of this paper is to present new empirical elements to the debate on sources of wage differentials in Belgium. We investigate issues specifically related to the role of sectoral affiliation in the wage setting process. Hence, there is the empirical investigation of: i) the interaction between inter-industry wage differentials and the gender wage gap in six European countries, ii) how rent sharing interacts with the gender wage gap in the Belgian private sector and iii) the existence of inter-industry wage differentials in Belgium, through the unobserved ability hypothesis. Findings show that combined industry effects explain around 29% of the gender wage gap in Ireland, respectively 14 and 16% in Denmark and Italy, around 7% in the U.K. and almost no share in Belgium and Spain. Our results also suggest that a substantial part of the gender wage gap is due to women's segregation in less profitable firms. Finally, our results show that rent-sharing account for a large fraction of industry wage differentials.*

**Classification JEL –** J16, J31, J71.

***Keywords –*** *industry wage differentials, rent sharing, gender wage gap.*

## 1 INTRODUCTION

Wages are at the core of all economic mechanisms. Workers' revenue and purchasing power derive principally from their wages. Wages are equally central for firms, which pass wages onto the product price. The setting of wages plays an essential role between the product and the labor markets, directly interacting with a country's macroeconomic performance. Analysing the wage-setting process, its structure as well as wage differentials seems therefore fundamental.

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In this perspective, the main objective of this paper is to present new empirical elements to the debate on sources of wage differentials in Belgium. Indeed, we sought to identify the mechanisms that determine wages so that questions as important as those relative to the gender wage gap or to wage inequality may be given the most appropriate policy answers.

In particular, we decided to investigate issues specifically related to the role of sectoral affiliation in the wage setting process. First, questions related to the sectoral effect on wages allow to better understand the mechanisms behind the wage setting process. Their presence indeed implies that the standard competitive model does not fully explain wage variation amongst workers. Secondly, a focus on inter-industry wage differentials allows for an analysis of the role played by firm characteristics in the gender wage gap. More specifically, we can isolate the segregation effect at the sectoral level and amongst firms with different profit levels. Finally, accurate results regarding the presence of sectoral effects allow discriminating amongst the different non-competitive mechanisms suggested by the literature (e.g. rent-sharing or the efficiency wage model).

Hence, this paper focuses on industry wage differentials, rent-sharing and the gender wage gap. There is the empirical investigation of: i) the interaction between inter-industry wage differentials and the gender wage gap in six European countries, ii) how rent sharing interacts with the gender wage gap in the Belgian private sector and iii) the existence of inter-industry wage differentials in Belgium, through the unobserved ability hypothesis [1].

To gain an accurate perspective of the current research, different theories on wage setting are described below. When presenting this research's empirical findings, the review of these different theories allow one to consider their relevance and to place them within the debate over pay determination.

## 2 WAGE SETTING MODELS

The Walrasian (competitive) model is often considered as the starting point and the reference in this debate. It rests on the hypotheses of perfect information and of free entry for all agents. Hence, no player has market power and the determined wage will match all labour demand with all labour supply. The wage that emerges from this process is equal for each worker to the job marginal productivity. In this frame, wage differentials reflect either differences in working conditions (hedonic theory of wages; Rosen, 1974) or variations in individual characteristics of the workers (theory of human capital; Becker, 1964). Hence, each employee contributes differently to the firm's production.

The theory of human capital highlights the link between wages and productivity levels in the competitive model. The theory also provides some possible answers to wage differentials. Moreover, in the long run, it may convincingly explain, through the labor productivity growth, world-level inequalities and the evolution of worker

1. These different questions have been studied within the framework of Tojerow (2008).

incomes overtime. Yet, the 1970s rise in unemployment and wage inequalities puts into question the human capital paradigm. On one hand, despite the hypothesis of a skill-biased technological change, a significant part of the wage inequality increase occurred among workers with identical observable characteristics. On other hand, wages didn't fall as expected when the gap between the labor supply and demand increased sharply in Europe (OECD, 2004). These outcomes from the "field" suggested that the mechanisms described in theory are not necessarily fulfilled in reality.

Several explanations have been put forward to clarify these "unexpected" outcomes. Some explanations were given within the standard model (e.g. search frictions, short run deviations) while others were based on totally different mechanisms (e.g. bargaining model, efficiency wage models). These theoretical differentiations may have important policy implications. In the first case, once market imperfections are corrected, wages are completely a result of supply and demand forces. In the second case, other factors still play a role once market imperfections are resolved.

The debate revolves around the ability of the standard Walrasian model of the labor market to explain forces that hamper clearing adjustments in the real world. Alternatively, explanations based on non-market forces may be introduced describing the non-adjustment of employment and wages to supply or demand shocks. Over the years, numerous non-competitive models have been formalized to incorporate and explain labor market outcomes.

## 2.1 Issues Concerning the Supply Side

Concerning the supply side, the issues over competitive wage are often linked to the collective bargaining power of trade unions and wage settings. Several models conceptualize this principle i.e. the "right-to-manage" model (Nickell & Andrews, 1983), the "efficient bargaining" model (McDonald & Solow, 1981) and the "general bargaining" model (Manning, 1987).

These trade union models presume that unions represent and therefore bargain for all workers in a firm's given labor pool. Some models question the latter hypothesis and assume instead that union representatives only bargain for employed workers, "the insiders". In this inside-outside theory framework, specific human capital, hiring and firing costs allow the "insiders" to obtain a wage higher than the market clearing wage and higher than the one offered by to the "outsiders" (Lindbeck & Snower, 2001). Furthermore, the existence of mobility costs may allow employees to capture part of the surplus generated by the firm. Hence, workers with identical observable characteristics may be paid differently if the collective bargaining power of their representatives differs.

The rent-sharing hypothesis is often used to explain the wage surplus obtained in bargaining models. In this case, profitable firms pay higher wages to their employees in relation to the parties' relative bargaining powers (Nickell & Andrews, 1983). Hence, the rent-sharing phenomenon implies that increases in a firm's ability to pay lead to improvements in wages not only in the short run but also in the long

term. A general result is that the correlation between workers' wages and firm or industry profitability is stronger in countries with a decentralised wage bargaining system (Holmlund & Zetterberg, 1991). This result might be explained by the fact that the co-ordination of the wage bargaining in the corporatist countries restricts the insider power of the workers i.e. their ability to capture part of the sectoral rents. In sum, studies on rent-sharing offer some evidence for the existence of sectoral effects on wages (Holmlund & Zetterberg, 1991). Nevertheless, other explanations, besides rent-sharing, could explain a positive relation between profits and wages (Blanchflower *et al.*, 1996). For example, in a competitive model with temporary frictions, a positive link between wages and profits may also be possible. A labour contract model where firm and workers share the risk may represent another possibility. Finally, similar correlation may arise in an efficiency wage models, in which firms use higher wage as incentive to enhance employees' efforts.

Parallel to the theories of collective bargaining, there is also a strand of literature that focuses on the labor market's institutional structure as a whole as an explanation for wage dispersions. Collective bargaining is revealed through a string of interactions between workers, employers and governments. Expressed by different indicators, these interactions are often aggregated in the literature to set the corporatist level of a country. The main indicators include the level of centralisation of collective bargaining and the degree of coordination of the wage setting system (Kenworthy, 2003). According to Blau and Kahn (2002), a high index generally implies a low level of wage dispersion. Union density and/or coverage are also evoked to measure the impact of a collective agreement. Again, economic theory indicates a negative impact of union density and bargaining coverage on wage dispersion (OECD, 2004). This negative impact reflects the presence in the unions' utility function of other parameters than the wage level – i.e. wage dispersion, social justice, etc. (Kenworthy, 2003).

## 2.2 Issues Concerning Demand

Alongside models which focus on the imperfections of the labour market supply side, several other models focus on employer behaviour (i.e. demand side) to formalize worker pay policies. A monopsonist firm may for example take advantage of its dominant position to set wages arbitrarily. This situation implies limited mobility and little exportable qualification for the labour supply. The lack of competition generated by these entry costs may also explain how the employer's market power enables the discriminate between workers from different origins.

Other theoretical trends that focus on the demand side introduce the notion of efficiency wages to explain wage dispersion (Shapiro & Stiglitz, 1984). According to these models, firms may have some incentives to spontaneously offer higher wages. These incentives may find their sources in the limited monitoring abilities of the firms or in their willingness to reduce turnover and to attract a better workforce. Again, wage differentials are justified other than through the heterogeneity in human capital or compensating differences.

## 2.3 Wage Variance and Gender

One should naturally consider gender when examining the issue of differences in earnings. On the one hand, the wage structure mirrors a gender effect and on the other hand, the sources of the gender wage gap partially rely on the wage setting process and structure. Hence, a whole chapter of economic literature focuses on the mechanisms that continuously affect wage differentials between male and female workers.

Common explanations rely on differences in human capital, discriminatory behaviours in the labour market, and occupational or sectoral segregation. Several approaches exist to frame gender relations in the labour market. Some of them fall within a competitive neoclassical framework, other appeal to non-competitive forces to explain gender wage differential [2].

The neoclassical approach determines that years of schooling, experience, job tenure, hours of work and other factors would account for some of the difference in earnings (Mincer & Polachek, 1974). However, measurable factors fail to fully explain the gender wage gap. The remaining unexplained differences could stem from hardly identifiable characteristics or discriminatory behavior towards female workers (Becker, 1971).

Models of “taste discrimination” and “statistical discrimination” focus on this unexplained part of the wage gap. “Taste” models suggest that wage gaps are notably sourced in personal prejudices of employers, fellow employees or customers (Becker, 1971), while “statistical” models result from the rational behaviour of firms confronted with uncertain productivity of an individual (Arrow, 1972).

Several models attempt to explain gender wage gap by also taking into account non-competitive forces, such as the effect of others’ decisions on individuals’ actions. In these cases, the framework generally includes elements of market segregation, as well as institutional and labour market segmentation theories. For example, the monopsonistic discrimination offers an alternative explanation to the one based on differences in individual productivity return. In this case, part of the wage gap results from the overexposure of women to monopsonistic conditions due to their higher family constrains (Barth & Dale-Olsen, 1999).

Beside gender-specific factors, recent constructs also integrate the wage-setting process and institutions into the explanatory schema of the gender wage gap (Blau & Kahn, 2000). For example, a centralised wage bargaining system and minimum wage standards rather tighten wage dispersion. Hence, they may be considered as favourable to gender pay equity.

In general, union priority for wage equity should contribute to the narrowing of the gender wage gap. However, according to Sap (1993), the union effect on the gender wage gap also depends on the relative bargaining power of women and men inside unions.

The different theories presented above offer valuable construct explaining the gender-based wage gap. However, within most of these frameworks, non-economic

2. See the introduction of Tojerow (2008) for an extended theoretical review of the topic.

issues, pre-market choices and forms of behaviour are not always fully incorporated. Moreover, individual rational decisions and larger social institutions may not be precisely articulated in the above mentioned theories to adequately explain gender differences in productivity (Humphries, 1995). Gender theories try to fill this gap by also considering exogenous non-labour market variables. Indeed, gender theories distinguish themselves by attaching greater value to social and legal constraints, which weighs on individual choices.

# 3 EMPIRICAL RESULTS

## 3.1 Inter-Industry Wage Differentials and the Gender Wage Gap: Evidence from European Countries [3]

The aim of this first empirical section is to present how industry effects contribute towards the gender gap in European countries. We examine the interaction between inter-industry wage differentials and the gender wage gap in six European countries, i.e. Belgium, Denmark, Ireland, Italy, Spain, and the U.K. To do so, we rely on harmonised matched employer-employee data set, the 1995 European Structure of Earnings Survey.

We analyse with recent techniques, on a comparable basis, and from a European perspective: i) inter-industry wage differentials by gender, ii) the contribution of industry effects to the overall gender wage gap, and iii) for both sexes, the relationship between collective bargaining characteristics and the dispersion of industry wage differentials.

Empirical findings show that, in all countries and for both sexes, wage differentials exist between workers employed in different sectors, even when controlling for working conditions, individual and firm characteristics. We also find that the hierarchy of sectors in terms of wages is quite similar for male and female workers and across countries. Yet, the apparent similarity between male and female industry wage differentials is challenged by standard statistical tests. Indeed, simple t-tests show that between 43 and 71% of industry wage disparities are significantly different for women and men. Moreover, Chow tests indicate that sectoral wage differentials are significantly different as a group for both sexes in all countries. Regarding the dispersion of industry wage differentials, we find that results vary for men and women, although not systematically nor substantially. Yet, the dispersion of industry wage differentials fluctuates considerably across countries. It is quite large in Ireland, Italy and the U.K., and relatively moderate in Belgium, Denmark and Spain. For both sexes, results point to the existence of a negative and significant relationship

3. A version of this chapter has been published in 2007 in the *Economic and Social Review* (Vol. 38, No. 1). A version that focuses strictly on Belgium was published in 2002 in the *Brussels Economic Review* (Vol. 45, No. 2) and in 2006 in a collective book published by *Palgrave Macmillan* and edited by B. Mahy, R. Plasman and F. Rycx.

between the degree of centralisation of collective bargaining and the dispersion of industry wage differentials.

Finally, results indicate that the overall gender wage gap, measured as the difference between the mean log wages of male and female workers, fluctuates between .18 in Denmark and .39 in the U.K. In all countries a significant (at the .01 level) part of this gap can be explained by the segregation of women in lower paying industries. Yet, the relative contribution of this factor to the gender wage gap varies substantially among European countries. It is close to zero in Belgium and Denmark, between 7 and 8% in Ireland, Spain and the U.K., and around 16% in Italy. Differences in industry wage premia for male and female workers significantly (at the .05 level) affect the gender wage gap in Denmark and Ireland only. In these countries, gender differences in industry wage differentials account for respectively 14 and 20% of the gender wage gap. To sum up, findings show that combined industry effects explain around 29% of the gender wage gap in Ireland, respectively 14 and 16% in Denmark and Italy, around 7% in the U.K. and almost no share in Belgium and Spain.

In conclusion, our results emphasize that the size of the gender wage gap as well as its causes vary substantially among European countries. This suggests that no single policy instrument is sufficient to tackle gender pay inequalities in Europe.

## 3.2 Rent sharing and the Gender Wage Gap in Belgium [4]

In this second section we analysis, on the basis of a combination of two large-scale data sets, how rent sharing interacts with the gender wage gap in the Belgian private sector. Empirical findings show that individual gross hourly wages are significantly and positively related to firm profits-per-employee even when controlling for group effects in the residuals, individual and firm characteristics, industry wage differentials and endogeneity of profits. Our instrumented wage-profit elasticity amounts to approximately 6 percentage points and it is not significantly different for men and women. Of the overall gender wage gap (on average women earn 23.7% less than men), results show that around 14% can be explained by the fact that on average women are employed in firms where profits-per-employee are lower. Thus, results suggest that rent-sharing accounts for almost one-third of the overall gender wage gap. A straightforward policy implication is that closing the human capital gap between men and women (in particular, with respect to level of education, training and work experience) is likely to be insufficient to suppress the gender wage gap. Indeed, findings suggest that a substantial part of the gender wage gap is due to women's segregation in less profitable firms.

In the first two chapters we have thus shown the existence of inter-industry wage differentials and rent-sharing. We have also separately shown their role in

4. A version of this chapter has been published in 2004 in the *International Journal of Manpower* (Vol. 25, No. 3/4). An extended version was published in 2006 in a collective book published by Elsevier North-Holland and edited by H. Bunzel, B. Christensen, G. Neumann and J.-M. Robin.

influencing the gender wage gap. These results may have some policy implications. First, our results suggest that an examination of the underlying reasons of dissimilar female and male workers' concentration in different industry and establishment is central to narrowing the gender wage gap. Secondly, the relative importance of female segregation in explaining the gender wage gap probably suggests that equal pay legislation is not sufficient to close the gender pay gap. Equal opportunity policies should most likely come with equal pay legislation to desegregate employment by gender. An element of equal opportunity policy would be "to encourage young girls to consider a wide range of occupational options, and to opt for science and technology, instead of caring, cleaning and catering" (Plantenga & Remery, 2006). Rubery and Smith (2006) have however noticed that raising the relative wage of female-dominated jobs might be more effective. They indeed fear that de-segregation will bring new types of segregation into the labour market (e.g. ethnic segregation). Finally, our results on the existence of a negative correlation between the degree of centralisation of collective bargaining and the dispersion of industry wage differentials suggests that wage policies may also be an appropriate tool to reduce the gender wage gap. For example, the effect of the sectoral segregation on the gender wage gap may be softened in a wage bargaining system that is more centralised.

## 3.3 Industry Wage Differentials, Unobserved Ability, and Rent-Sharing: Evidence from Matched Worker-Firm Data, 1995-2002 [5]

In this last section we try to deepen the understanding of industry wage differentials, rent sharing phenomena and their potential connections.

To do so, it is our aim to shed light on the size, stability and causes of inter-industry wage differentials in Belgium by addressing four central questions: i) Are sectoral differences in pay a temporary phenomenon or do they persist over time?, ii) Do they derive from sectoral differences in the unobserved quality of the labour force?, iii) To what extent are they shaped by sectors' 'ability to pay', i.e. profits?, iii) What is the contribution of rent-sharing to observed industry wage differentials? These questions have been investigated on the basis of a matched employer-employee data set covering the period 1995-2002. This data set derives from the combination of the *Structure of Earnings Survey* and the *Structure of Business Survey*. The former contains detailed information on firm characteristics (e.g. sector of activity, size of the firm, and level of wage bargaining) and on individual workers (e.g. gross hourly wages, bonuses, age, education, sex, and occupation). The latter provides firm- and sector-level information on financial variables (e.g. gross operating surplus).

5. An extended version of this chapter has been submitted in September 2007 in Manchester School. It is currently available as a National Bank of Belgium Working Paper (No. 90, October 2006) and a DULBEA Working Paper (No. 06-14.RS, October 2006). A version that focuses strictly on the role of worker and employer characteristics in Belgium was published in 2007 in the *Brussels Economic Review* (Vol. 50, No. 1).

Our findings show that substantial and persistent wage differentials exist among workers having the same observed characteristics and working conditions, but employed in different sectors. The best paying industry over the period 1995-2002 is the electricity, gas, steam and hot water supply sector. Depending on the period considered, the average worker in this sector earns *ceteris paribus* between 27 and 31 per cent more than the average worker in the whole economy. At the top of the conditional wage distribution, we also find manufacture of coke, refined petroleum products and nuclear fuel (between +20 and 34 per cent), manufacture of chemicals and chemical products (between +11 and 12 per cent), and financial intermediaries (between +6 and 13 per cent). The hotel and restaurant sector is at the very bottom of the wage scale: the average worker's wage in this branch is *ceteris paribus* between 11 and 14 per cent lower than that of the average worker in the economy. At the bottom of the scale, we also find the manufacture of wearing apparel, dressing and dyeing of fur (between -11 and -13 per cent), retail trade (between -7 and -12 per cent), and manufacture of textiles (between -4 and -8 per cent).

Industry wage differentials may of course derive from the fact that the unobserved quality of the labour force is not randomly distributed across sectors. In other words, high-paying industries may simply be those in which the unobserved quality of the labour force is the highest. This potential explanation has been tested with Martins' (2004) methodology. The latter consists in verifying, on the basis of quantile regressions, whether sectors with high average premia have even higher premia amongst high-paid workers. Empirical results show that the unobserved ability hypothesis may not be rejected. However, its contribution to observed industry wage differentials appears to be limited. The role of non-competitive forces can therefore not be neglected.

The most natural non-competitive explanation for the existence of industry wage premia is that they result from inter-sectoral variations in 'ability to pay', i.e. profits. This explanation has been tested using correlation coefficients and cross-sectional regressions. Results show that industry wage premia are significantly and positively correlated with industry profits, in all periods, both at the Nace two- and three digit level. They thus support the hypothesis that industry wage premia derive at least partly from heterogeneity in sectoral profits. Yet, they are consistent with several explanations going beyond the standard competitive model, including the efficiency wage theory and rent-sharing.

The importance of rent-sharing in the Belgian private sector and its contribution to observed industry wage differentials has been examined in the last section of this chapter. Empirical results show first that individual gross hourly wages are significantly and positively related to firm profits-per-employee, even after controlling for group effects in the residuals, individual and firm characteristics, industry wage differentials, and endogeneity of profits. The instrumented wage-profit elasticity estimated at the mean is equal to 0.063. However, workers at the top end of the wage distribution are found to receive a significantly larger share of profits than those at the bottom of the wage distribution. Further results show that substantial wage differentials are recorded between workers employed in different sectors even after controlling for rent-sharing. However, the proportion of significant industry wage premia decreases from around 75 to 50 per cent. We also find that the dispersion

in industry wage differentials drops by almost one-third when profits are taken into account. These findings suggest that rent-sharing accounts for a large fraction of industry wage differentials. Moreover, the presence of rent-sharing may have important policy implications. For example, its existence may affect the way new surpluses are divided between labour and capital. In parallel, it may also prevent an efficient allocation of employment by slowing down the hiring of new workers.

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