National Bank OF BELGIUM
Eurosystem

2008-09-18

PRESS RELEASE

The incomes and financing balance of individuals and companies

(Article published in the Economic Review, September 2008)

This article begins by establishing that the share of wages in GDP has declined quite sharply in Belgium over the past five years, the main counterpart being a growing share for the operating surplus. Next it examines the redistributive income flows between the institutional sectors and the purposes for which individuals and companies use their income. These analyses are based on the national accounts data which offer a systematic description of the various phases in the economic process.

Analysis of the primary incomes arising from domestic production reveals that companies generate the most value added. In 2006 they used 60.6 p.c. of that value added to cover labour costs, whereas during 1995-2002 the average figure was 64.3 p.c. Conversely, general government creates the least value added but pays out most of it in the form of wages, namely 88 p.c. in 2006, compared to 86.1 p.c. in 1995. In the case of the value added of individuals – both self-employed workers and home owners – only 10.6 p.c. was paid out in the form of wages in 2006.

Although there are various definitions of the wage share, which differ considerably in terms of level, they mostly do present a similar picture. Thus, all definitions indicate a fairly stable pattern in the second half of the 1990s, followed by a slight rise and subsequently a somewhat sharper fall during 2003-2005. In the past two years there has been no further significant change in the wage share. Its contraction in 2003-2005 was partly a reflection of the business cycle. In response to the slackening pace of activity in 2001 and 2002, companies tried to reduce their labour costs via corporate restructuring and wage moderation. In addition, the recent pattern can also be regarded as part of the downward trend in the wage share since the early 1980s, just as in most other euro area countries. In the literature, that downward trend is often linked to structural developments such as globalisation which has expanded the labour supply worldwide, technological progress which has made production more capital intensive, and the growing importance of the services sector which features a smaller wage share. Although such developments are inevitable, the policymakers can do a good deal to help, primarily by creating a robust and stable macroeconomic framework supported by efficient labour and product markets.

However, wages are not the only individuals' income category to decline as a percentage of GDP. Since 1995, the rise in the total gross disposable income of individuals has almost continuously lagged behind GDP growth. That is due mainly to the downward trend in net interest income as a percentage of GDP, which in turn reflects falling interest rates. However, the downward trend in individuals' disposable income as a percentage of GDP does not mean that the income itself has also declined in absolute terms. On average, the disposable income of individuals increased by 3 p.c. per annum between 1995 and 2007. Even taking account of inflation as measured by the private final consumption expenditure deflator, disposable income increased in real terms by an average of 1.1 p.c. per annum. Yet this positive average conceals the fact that disposable income did fall in absolute terms in certain years, or for certain population groups.

By analogy with the decline in the gross disposable income of individuals in relation to GDP, their final consumption expenditure displayed a corresponding downward trend, as a percentage of GDP. However, this was far less pronounced, and that was therefore reflected in a downward trend in the savings ratio, from 20 p.c. of disposable income in 1995 to a low of 12.2 p.c. in 2005, after which a gradual recovery set in. That recovery is not, however, evident in the financing balance of individuals, as they do not only consume but also invest, primarily in the form of housing construction and renovation. Since 2004 individuals have recorded a strong rise in their investment expenditure, underpinned by the very low mortgage interest rates and the surge in house prices, and that has been reflected in a further decline in their financing balance which has been below 1 p.c. of GDP in the past three years.

The principal counterpart of the recent contraction of the wage share is the sharp increase in the gross operating surplus of companies, that surplus also being by far their main source of income. However, that increase has not led to a corresponding rise in the financing balance of companies, because the latter have also paid more taxes on income and wealth, and their investment spending has expanded faster than GDP. In comparison with the period 1995-2000, companies have also paid out more in net dividends, as a percentage of GDP, though dividends were even higher in the period 2001-2003. In all, individuals have therefore also benefited from the strong corporate profit growth. Nevertheless, the financing balance of companies has also risen steadily to an average of 2.4 p.c. of GDP in the past three years. Although this rise can be viewed partly as making up lost ground, following the deterioration during the period 1998-2001, the recent improvement still looks significant. It has enabled companies to move gradually towards financing more of their investment out of internal resources, thus further consolidating their balance sheets.