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Comparative Labor Markets

By John Pencavel

At the time of a general election, it is natural to focus on daily or weekly events that might be relevant to the choice presented the electorate: today's movements in the Dow, the Fed's latest interest rate decisions, the month's unemployment figures, changes in indicators of consumer confidence. This concern with recent events results in a tendency to overlook the slow-moving yet inexorable changes that take years or even decades to become evident. From this longer perspective, the labor markets of the United States and those of other relatively wealthy countries have changed considerably over the past 30 years or so. In some countries, unemployment rates have risen to stubbornly higher levels. In other countries, the gap between those toward the top and those toward the bottom of the income distribution has grown to levels not seen for well over 60 years. What forces have operated on these labor markets and how have labor markets been affected? Greater international trade, technological changes, increased capital and labor mobility, and lower transaction costs have played roles in all countries, but the effects of these forces have had different outcomes because of distinct institutional structures. In turn, these distinct institutional labor market structures can be traced to differences in factor endowments, preferences, and starting conditions.

Forces Affecting Labor Markets

The first factor affecting the labor markets of the "rich" economies has been technological change. The effective prices of computing and electronic

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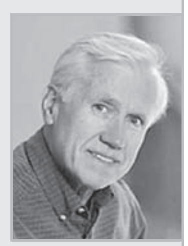
About The Author



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communication have fallen to less than one tenth of their mid-1970s values. This relative price change has encouraged the substitution of some types of labor with computer-assisted technologies. Second, increased trade especially with developing countries of East Asia and Latin America has induced consumers in wealthy nations to switch their consumption patterns. Increasingly, products once made in the wealthy countries have been replaced with cheaper or better products made in developing countries. Third, factors of production have become more mobile across countries. Both labor and capital move in greater quantities and in response to smaller net returns today than they did in the 1970s. Fourth, the cost of transacting in product and factor markets has fallen. This reflects not only the exchanges taking place today on the internet, but more generally the drastic fall in the cost of information has made agents much better informed about their opportunities and, in this sense, has greatly expanded their opportunities.

These forces may interact with one another. The development and the diffusion of the computer chip that have triggered technological changes in labor markets are also closely involved in the drop in transaction costs. Increased product competition from some developing countries may serve as a substitute for the movement of factors: when factors are not completely mobile, trade in products may provide the necessary mobility.

What has been the impact of these four forces on the labor markets of the United States and other relatively rich countries? The pressures of product market competition from the developing countries have induced the owners of firms in the richer countries to seek general cost reductions including reductions in labor costs. The pressures to limit or eliminate practices that raise costs have been evident in, for example, the growth of contingent contracts, the spread of union-free workplaces, and the push toward privatization.

The Consequences

Some types of workers have felt these forces more than others. In particular, low-skill workers in rich countries have suffered relative to those with high skills. In part, this has been because the forces of technological change have not been neutral with respect to different types of labor but have tended to reduce the demand for unskilled workers relative to high-skilled workers. Moreover, the migration of chiefly unskilled workers from developing countries into the richer countries and the movement of goods produced in the developing countries into the richer countries have tended to harm unskilled workers (as workers) relative to the skilled workers in the richer countries. The relative importance of these factors – technological change, trade, immigration, the movement and threat of movement of capital – is an issue of considerable debate, but it suffices here to note that they have tended to work together to put pressure on unskilled relative to skilled workers in the rich countries. How has this pressure affected these labor markets?

Here is where an economy's institutions have mattered. Not merely have labor market and product market institutions affected the forms in which these pressures have been manifested, but in many cases the institutions themselves have been altered, sometimes profoundly. In some instances, the institutions have responded to these forces by changing their operation. In an economy characterized by comprehensive wage-setting by governments or labor unions, these pressures have tended to result in falling labor utilization rates especially among low-skilled workers. This fall in labor utilization rates may take many different forms: a rise in unemployment rates; in slowly growing employment-population ratios; in falling work hours; or in rising rates of early retirement. Many other factors affect these labor utilization rates so it is not straightforward to detect the influence of these common factors operating on them.

As a rough indicator, consider changes in male unemployment rates in the rich countries: "changes" because this allows for country-specific differences in the way that labor markets match unemployed workers with employers; "male" because this avoids the persistent differences across countries in the degree to which societies accommodate women in market work. These proportionate changes in male unemployment rates from 1975 to 2006 for nine major economies are shown in column (1) of Table 1. The largest increase in male unemployment is recorded in Sweden while the United States experienced a small decrease.

In economies where government and labor union wage-setting institutions are less pervasive or where they have been swept aside by competitive and technological forces, these pressures on labor markets are felt less in changes in labor utilization and more in changes in earnings inequality. Column (2) of Table 1 provides a measure of the change in earnings

Table 1

Changes in Male Unemployment Rates and Male Earnings Inequality from the mid-1970s to mid-2000s: Selected Countries

	(1)	(2)
	Proportional changes in male unemployment rates	Proportional changes in male earnings inequality
Australia	0.35	0.45
Canada	0.02	0.14
France	2.00	-0.15
Germany	0.74	0.16
Japan	1.20	0.13
New Zealand	-0.37	0.39
Sweden	4.39	0.11
United Kingdom	0.23	0.47
U.S.A.	-0.41	0.591

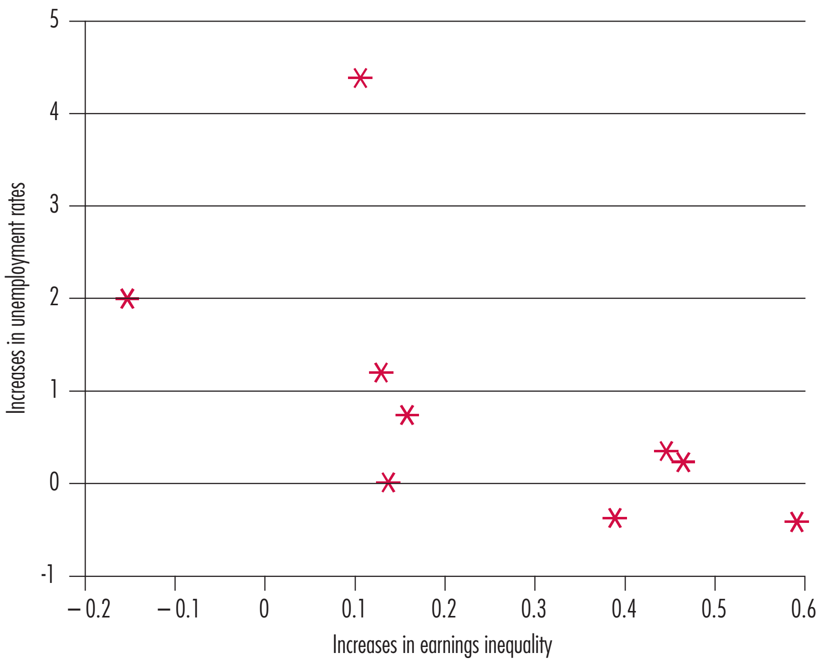
Definitions and Sources

Column (1). Let *U(i, t)* be the male unemployment rate of country *i* in year *t*. Column (1) lists *[U(i,2006) – U(i,1975)]/U(i,2006)*. The data are from the OECD's online data base: *http://stats.oecd.org/wbos/Index.aspx?DatasetCode=LFS_SEXAGE_I_R*

Column (2). Let *D(i,t)* be the ratio in year *t* and in country *i* of the earnings of male workers at the 90th percentile to the earnings of male workers at the 10th percentile. Column (2) lists *[D(i,2006) – D(i,1975)]/D(i,1975)*. The data are from the OECD: *http://www.oecd.org/dataoecd/9/59/39606921.xls*.

The changes are from 1975 to 2006 for Japan, the United Kingdom, and the United States. They are from 1975 to 2005 for Australia, from 1973 to 2006 for Canada, from 1975 to 2005 for France, from 1984 to 2005 for Germany, from 1984 to 2006 for New Zealand, and from 1975 to 2004 for Sweden.

FIGURE 1
Changes in Earnings Inequality and in Unemployment Rates: Selected Countries



inequality of male workers in recent decades. Using the ratio of earnings at the 90th percentile to earnings at the 10th percentile as an indicator of inequality, it shows inequality to have increased most in the United States, Britain, and Australia while earnings inequality fell in France.

The tendency for increases in earnings inequality to substitute for growth in unemployment across these nine countries is evident in Figure 1 which graphs the data in columns (1) and (2) from Table 1. This negative association is not a strong one, but this should not be surprising given the different ways in which changes in labor utilization might be manifested and given measurement problems.

It is not only a matter of the level of unemployment, but also of its character: in North American labor markets, the probability of an individual entering unemployment is much greater than it is in Continental Europe; however, once unemployed, the European worker remains in that state very much longer than the North American.[1] Cross-country differences in unemployment durations are quite remarkable: in 2007, 11 percent of the male unemployed in the United States and 8 percent of the male unemployed in Canada had been unemployed for a year or more; the corresponding percentages were 43 in France, 58 in Germany, and 47 in Italy.[2] Some of these differences can be explained by the greater propensity of the unemployed in North America to drop out of the labor force entirely, but this is not the entire story. In general, there is greater turnover, more movement, in North American labor markets.

Unionism and Collective Bargaining

Labor unionism is relevant to where countries have positioned themselves on this trade-off between changes in earnings inequality and changes in unemployment. The fraction of workers covered by collective bargaining contracts has fallen substantially over the last 30 years in Britain, the United

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1 Britain, Australia, Sweden, and Japan tend to lie between Continental Europe and North America.

2 The figure for France is for the year 2006.

States, and Japan. By contrast, the coverage of collective bargaining contracts has actually expanded in France and Sweden, and it has changed relatively little Germany. Where the reach of collective bargaining contracts has increased or fallen little (as in France, Sweden, and Germany), earnings inequality has tended to grow least or not at all; where unionism has shrunk most (Britain, the United States, and New Zealand), earnings inequality has increased the most.

It is not merely the extent of unionism that has changed in different degrees across countries, but also its character. Within the union sector, multi-employer and multi-sector agreements have become less common and more issues are determined at the level of the single employer or even the single workplace. This is the case not only in economies where the scope of collective bargaining contracts has shrunk, but also in countries where the reach of collective bargaining contracts remains extensive (such as Australia and Sweden). Features other than unionism are at work. Performance-related pay has grown in all countries and workplace procedures have become more informal. The hierarchy of management structures has become flatter and work teams more common especially in unionized establishments.

The consequence is that, even though social scientists have often been attracted to the notion that countries are "converging" on a similar set of institutions, processes, and outcomes, the evidence for it from labor markets is really lacking. Indeed, divergence seems to be a better characterization of the last 30 years or so. Is this surprising? Not at all. Notwithstanding increased international trade and greater factor mobility, relative factor prices are quite different across countries which means that, even if all countries had access to the same technology, they would select different factor combinations. And one important factor – land – is inherently immobile and the imperatives of geography result in differences in factor proportions across countries even when other input prices are similar. This means that, even if they were to produce the same combination of goods, countries will invoke different technologies to produce these goods and the different technologies will tend to beget different institutions and outcomes. This argument is reinforced by the recognition that countries will exploit their specific endowments by producing different goods and this represents another force contributing to country differences in institutions and outcomes.

Furthermore, the preferences and values of people are by no means the same across countries (at least beyond the most rudimentary and basic of needs) and they have not become manifestly more similar. Americans remain more tolerant of wide disparities of consumption and income, more dedicated to long work hours, and less concerned about whether workers have mechanisms for representation at their workplaces compared with, say, Continental Europeans. With such country-specific values and principles, it is hardly surprising that different economies cling to specific institutions and processes and that countries are not converging on a similar set of labor market institutions and processes.

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