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DOING IT RIGHT? THE US LABOR MARKET RESPONSE TO THE 1980s/1990s

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ABSTRACT

In this paper I examine both the positive and negative aspects of the US labor market response to the economic world of the 1980s/1990s. I review the economic developments that created difficulties in the US and other advanced economies post the first oil shock; consider how a decentralised labor market might be expected to respond to them; and summarise the American response. I conclude by assessing the social welfare consequences of the American response relative to that of Europe.

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Many European analysts and policy-makers view the US labor market as a paradise of neo-classical flexibility. Wages respond rapidly to changes in supply and demand in local labor markets with little institutional intervention. Jobs are readily created for those who seek them. Firms hire and fire at will, with little government or union restrictions. Spells of unemployment are short in duration, and unemployment benefits modest. As a result, the story goes, the US has avoided the long extensive joblessness that has characterised Europe since the early 1980s.

These observations about the American job market are factually correct. There is much about the American response to the economic shocks of the 1980s / 1990s that merits approbation.

Many American analysts and policy-makers, however, view the US job market differently. Wage inequality grew in the 1980s. The real earnings of the less skilled plummeted, to the point where workers in the lower parts of the earnings distribution have living standards below those of comparably situated workers in Europe (Freeman, 1994a, Ch.1). Many young men found crime more attractive than work. Child poverty rose, and the country developed a seemingly permanent underclass of the homeless and beggars.

These observations are also factually correct. There is much about the American job market that merits disapprobation. Americans did not vote George Bush out of office merely because he had never seen a supermarket check-out counter.

1. The Developments

From the early 1970s (roughly post the first oil shock) through the mid-1990s, Western economies had slower economic growth than in the 1950s and 1960s. This made it more difficult to provide rising wages or employment for those seeking jobs than in the previous twenty years or so. The extent to which the post-oil shock slowdown fundamentally breaks with the past is open to debate. Growth rates of real earnings and per capita income vary over extended periods. Since the Industrial Revolution the US and Europe have suffered depressions and periods where living standards deteriorated for many citizens. Perhaps the 1970s-1990s is one of these long cyclic slowdowns. The successful recovery from world war and depression of the 1950s and 1960s may have given us an exalted view of the economic opportunities capitalism normally provides workers. Alternatively, however, the economic performance of advanced countries in this period may represent a particularly unsuccessful adjustment to specific developments.

Many things changed in the 1970s and 1980s from earlier decades, besides the slowdown in growth. The composition of the workforce; the structure of industrial output; the level of foreign trade; the technology of production, all changed. Analysts disagree about the extent to which these changes contributed to the economic ills of the period, but most would concur that along with slow growth the following were important:

•technological change

Although the period was **not** one of rapid productivity growth in the US or other advanced countries,[1] nor of an *accelerating* shift in employment against unskilled labor,[2] there was a clear change in the type of work performed at most workplaces, with evidence that the expanded use of computers shifted labor demand toward more educated workers (Krueger, 1993). Most analysts believe that technological changes contributed to the reduction in the relative earnings of unskilled Americans (US Council of Economic Advisors, 1994).

•the growth of trade

World trade grew from the 1970s through the 1980s, as it had from the 1950s through the 1970s, though with no acceleration of the trend.[3] Beginning in the 1980s a growing proportion of manufacturing imports to the West came from low wage developing countries, such as China. By 1992, in fact, mainland China and Taiwan were together the third largest importer into the US. Some analysts, notably Adrian Wood, argue that the growth of manufacturing imports from third world countries is the main reason for the problems facing less skilled workers in the US and Europe. Others (Borjas, Freeman, and Katz, 1992; Sachs and Shatz, 1994) place a smaller weight on trade, in large part because the vast bulk of less skilled workers are employed outside the traded goods sector; while still others have argued that the trade effects are negligible (Bhagwati; Lawrence and Slaughter, 1993).

•increased immigration

Most Western countries experienced an increased flow of immigrants from developing countries. The proportion of the population who are foreign born in the US rose from 4.7% in 1970 to 7.9% in 1990. Since the Census fails to count perhaps one-third of illegal immigrants, most of whom work, the proportion who are foreign born in the work force may be as high as 9%. Following the Immigration Act of 1964, the bulk of immigrants were from developing countries, often with little schooling and skills. In 1990 one in five American workers with less than a high school education were foreign born, and one in seven American men in the bottom quintile of the income distribution were foreign born.[4]

•increased supply of women

The proportion of the labor force that is female increased;[5] and many families have come to rely on two earners and or on single female heads. The proportion of `traditional couples' in the US -- man works, wife stays home -- fell from 44% of the total to 23% between 1975 and 1993. The increased role of women as both breadwinners and homemakers challenges traditional work arrangements and raises demands for flexible working hours, job sharing arrangements, child care benefits, and parental leave.

Still, it is important to recognise that the growth of the female share of employment did not accelerate in the 1980s or 1970s. The proportion of females in the work force increased by 30% from 1953 and 1973, and from 1973 and 1993, though the absolute change in the proportion in the work force was bigger in the latter period.

•changed supply of educated workers
The years of schooling attained by the workforce increased greatly. In the US in 1970 12% of the labor force 25-64 years old had more than 12 years of schooling. In 1992 52% had more than 12 years. In the 1970s, with the baby boom entering the job market, the flood of college graduates reduced the pay of college graduates relative to less educated workers (Freeman, 1976). Other advanced countries had a similar experience: increased numbers of graduates reduced educational differentials. In the 1980s, by contrast, the rate of growth in the relative supply of college graduates lessened in the US (it actually fell for 25-29 year old men), contributing to the rise in educational differentials.

•turbulence in other markets
Developments in other markets also `shocked' the US labor market. The US moved from creditor to debtor nation. The US dollar rose in value in the mid-1980s, devastating employment in many export sectors. The government deregulated air transportation and trucking and broke up AT&T, putting downward pressure on wages in those sectors. There was a savings and loan banking crisis; a third world debt crisis; and so on. Following the Reagan tax cuts, the federal budget deficit skyrocketed. Whatever the reason, saving rates were exceptionally low in the US, making investment funds depend on foreign investors, particularly the Japanese. Market reforms, currency fluctuations, and flows of capital also greatly affected labor markets in other advanced countries.

•institutional changes
The major institutional change in the US was the fall in union representation of workers. In part, this reflected the demographic and market developments given above, but to a large extent, it was an independent change, resulting from the US process of determining union representation in an adversarial election where management greatly affects outcomes, in some cases by committing illegal `unfair labor practices'. The fall in union density to 11.4% in the private sector by 1993 meant that most workers had to find means, other than union representation, to give them a voice in company affairs.

Did the economic developments of the 1980s-1990s demand greater structural adjustment in the American job market than was required in earlier decades? The 1994 Economic Report of the President noted that one indicator of turbulence in the job market -- the sum of the absolute value of changes in the proportion of the work force in different industries -- shows no trend since 1945. Abraham and Katz (1986) examined changes in the composition of the labor force across industries and found no evidence of greater turbulence over time. Consistent with this, Steve Allen and I have calculated the amount of shifting among industries since the 1920s and found that the 1980-92 period is not extraordinary in its degree of change (Allen and Freeman, 1994). The most turbulent decade was the 1940s, followed by the 1920s and

1930s. Similarly, we examined the amount of shifting of employment across occupations and found that compared to earlier decades the 1980s to early 1990s was a relatively quiet period in terms of changes in the occupational structure.

In sum, most of the changes in the economy during the 1980s-1990s were not sharp breaks with the past nor marked accelerations of previous trends, but continuations of longer-run developments; and the overall `flux' in the market was not more marked than in earlier decades. What differentiated the troubled times of the 1980s-1990s (or 1970s-1990s) from earlier periods was the direction/bias of changes that put extraordinary pressure on low skill workers and the interaction of the developments outlined above with slow growth.

2. Responses of a Decentralised Labor Market

How might a decentralised labor market respond to weakened demand for labor relative to the supply of labor? In the basic supply-demand model, the wages of workers facing reduced demand for labor should fall, and their employment should drop, but most of those who lose work should find employment quickly elsewhere in the job market. There ought to be no increase in joblessness, beyond some temporary or frictional level.

Consider first the wage side of the story.

Flexible wage adjustments

i. The real hourly compensation of American workers stagnated from 1973-1993 and fell for full-time males -- a development unprecedented in the past 75 years in the country.

Table 1 documents the stagnation or fall in real earnings for Americans over this period. The compensation series in the table differ in various ways -- the sample covered; inclusion or exclusion of fringe benefit; the particular years covered -- but they tell the same story: that from 1973 or thereabouts to 1993, real pay did not increase at anything like its historic growth rate of 2 or so per cent per year. The real pay in Table 1 deflates earnings by the consumer price index. This is appropriate for comparing living standards but is not the right price index for analyses of labor demand, where a producer price index (PPI) is superior. The bottom lines of the table record rates of change in the consumer price index (CPI) and two measures of output prices, the producer price index and the GDP deflator. Output prices increased less rapidly than the CPI, implying that the decline or stagnation in consumption wages overstates the change in product wages that affect labor demand. OECD data on hourly earnings and producer prices in manufacturing show that from 1979-1989 real product earnings grew by 0.7% per year in the US compared to 1.6% in European Community countries. From this perspective, falling/stagnant real earnings in the US contributed less to the growth of employment than is suggested by the CPI-deflated figures, though it still contributed to the better US employment experience.

ii. The gap in wages between more/less educated and skilled workers rose greatly in the 1980s after falling in the 1970s.

The increased gap in pay between high-skill and low-skill workers is the most widely noted change in the US job market -- documented extensively in Current

Population Survey (CPS) files. The following data show the changes in real earnings from 1972-1990 in the CPS by sex and education (Commission, 1994):

	Men	Women
Less than High School	-23%	-5%
4 Years of High School	-19%	1%
1-3 Years of College	-14%	8%
4 Years of College	-8%	9%

Real earnings fell most for male workers with less than high school education, but they also fell for female workers with less than high school education and for all other groups of men. A group (not shown in these data) that fared particularly poorly in terms of earnings growth was younger men, who also are less likely to have pensions and other fringe benefits than similarly aged men years ago.

Table 2 gives regression coefficients and standard errors for the effect of different levels of education in 1970, 1980, and 1990 from the Census of Population. The estimated coefficients are based on multivariate regressions with hundreds of thousands of observations, so that, with rare exception, all of the coefficients have standard errors below .01. The estimates show a fall in educational differentials in the 1970s followed by a rise in those differentials in the 1980s. This pattern corroborates findings based on CPS data. The changes in educational premium are strong evidence of the flexibility of relative wages to shifts in the demand and supply of labor with different levels of schooling in the US.

iii. The earnings distribution widened greatly from the early 1970s to the 1990s, producing an extraordinarily unequal income distribution.

When Bluestone and Harrison (1986) first reported the `great U-turn' in the American earnings distribution from modest declines (or stability) in inequality to increased inequality, many analysts were suspicious of their claims. Perhaps the results reflected the particular series and measures chosen and the 1980s recession -- the worst since the Great Depression -- rather than a secular change. A decade and a host of studies later, it is common wisdom that the American earnings distribution has undergone an extraordinary widening. The Bureau of the Census reports that in 1992 18% of the nation's year round full-time workers were low wage workers (earning less than $13,091) -- a 50% increase over the 12% of the workforce in the low wage category in 1979.

Measures of the pay gap between workers in the highest decile of earnings and those in the lowest decile show that the US earnings distribution is the most unequal among developed countries (OECD, Employment Outlook, 1993). Male workers in the bottom decile earn 38% of median earnings in the US, whereas the bottom decile of workers earn 68% of median earnings in Western Europe (Freeman, 1994a). In the upper rungs of the distribution, top decile men in the US earn 2.14 times median earnings, whereas top decile men in most European countries earn 1.4 to 1.7 times the median. As a result, the ratio of earnings in the top decile to the lowest decile in the US is 5.63 -- by far the widest among OECD countries. The rise in inequality exceeds, moreover, the rise that would be expected simply given the rising educational or occupational differentials: it has occurred within groups of seemingly similarly skilled workers.

The positive side of the earnings story for the US is that relative and absolute earnings are quite responsive to economic conditions. The negative side is that market conditions demanded falls in real earnings for low paid workers and increases in inequality to levels that trouble even a country with considerable tolerance for inequality.

Job creation and mobility

iv. The US was more successful in generating work for those who seek it in the 1980s and 1990s than European countries.

Measured by either employment-population rates or unemployment rates, the US labor market has done a better job than European labor markets in `creating jobs'. In 1974 the ratio of employment to the population aged 15-64 was **the same** in the US and in OECD-Europe: 64.8%. In 1992 the employment to population rate was 71.1% in the US, and 60.1% in OECD-Europe. Prior to the 1980s, the rate of unemployment in the US exceeded the rates in Europe (a fact which led one of my European colleagues to say he could never take seriously the standard neo-classical model of the labor market). After 1983 the rate of unemployment has been considerably higher in Europe. For over a decade the US has produced an unemployment rate roughly 3% points below that in Europe. This change is not, however, the result of the US reducing its unemployment rate. To the contrary, the US unemployment rate has drifted upward decade by decade, as the following decadal average rates of unemployment show: 1950s -- 4.5; 1960s -- 4.8; 1970s -- 6.2; 1980s -- 7.3. In addition, many Americans are involuntarily employed part-time. In 1991, the proportion of the US labor force that was involuntarily part-time was 4.0%, compared to 1.5% for the OECD-Europe countries for which data are available (OECD, Employment Outlook 1993, Table 1.5).

Data on hours worked show that the American employment growth was not fuelled by reduction in hours and work-sharing of the type widely discussed in Europe. Americans put in more hours of work than Europeans, and have increased their work time -- possibly in response to slow growth/decline of earnings. US workers currently work about 200 hours more during a year than workers in Europe. In 1993, the OECD reports that Americans put in 1,743 hours compared to 1,534 hours for Germans, 1,542 hours for the French (1992), and 1,409 hours by the Dutch. A major reason for this difference in working time is the smaller vacations of Americans, who at most take about 2 weeks a year compared to the 4-5 weeks common in Europe. The length of vacation and holiday time in the US has actually declined in the past 20 years. In addition, many Americans hold more than one job. In 1991 over 6% of Americans held a second job. Over 18% of workers reported that they did job-related work at home. With a higher fraction of the work force employed and putting in more hours than Europeans, one might expect that Americans would be eager for time off. Surveys of preferences for work show the opposite: Americans want to work more than Europeans and report themselves working harder and more devoted to work then Europeans (Bell and Freeman, 1994).

The American response to the economic problems of the 1980s was to work more, not to seek to share the available work.

v. Duration of unemployment in the US is shorter than in Europe, so that unemployment is more widely shared among the population.

Unemployment in the US affects many workers. In 1992, 16% of the workforce experienced some joblessness -- nearly three times the proportion unemployed at any time in the year. Spells of unemployment are much shorter in the US than in Europe: 11% of American workers who were unemployed in 1992 were unemployed for more than one year compared to 30-50% in most OECD-European countries (OECD, Employment Outlook 1994, Table P). The movement into and out of joblessness in the US is nearly 10 times as fast as the rate of movement into and out of joblessness in Europe, according to OECD figures. In 1986, 46% of Americans unemployed in one month left that state by the next month; the comparable flow out of unemployment for Europeans was 5%. But, the flip side of this was that 25 of Americans became unemployed in a month compared to 0.4% of Europeans (OECD, Employment Outlook 1990, Table 1.2). In one sense, the flexible US market produces substantial work-sharing over time: workers hold a job for a certain period and are jobless for a certain period in contrast to the insider-outsider distinction between the employed and unemployed in Europe.

Still, this does not mean that the unemployed American does not have a problem. The median spell of reported joblessness in the US of approximately 12 weeks understates the length of completed spells. The amount of time these people will be unemployed is likely to be twice as long -- nearly half a year. This can be quite painful given the low level of US unemployment benefits, potential loss of health insurance between employment spells, and low levels of personal savings. Over time, moreover, the proportion of unemployment that is long run has increased in the US: Murphy and Topel (1987) estimate that 62% of the secular increase in unemployment from 1968-70 to 1980-85 was due to the increase in spells that lasted over six months. Finally, empirical studies of unemployment show that workers displaced from a job into unemployment take large wage cuts when they return to work -- on the order of 23% (Topel, 1994).

vi. Groups whose earnings fell in the 1980s had the worst problems in joblessness.

Ideally, substantial wage reductions for workers facing reduced labor demands will maintain their employment levels. This has not occurred in the US to any noticeable degree. In 1993, the unemployment rate for those with less than a high school education was 12.6%; for those with only a high school education, 7.2%; for those with some college, 5.7%; while for those with a bachelor's degree, it was 3.5%. In the 1980s, unemployment for men aged 25 to 64 steadily increased for high school dropouts and high school graduates relative to those with some college or college graduates; and despite concerns about rising joblessness among white collar workers and an upward trend in the ratio of white collar to blue collar unemployment rates in the 1980s, a blue collar worker still had roughly 3 times the chance of being unemployed as a white collar worker in the early 1990s. Among the young, whose wages have fallen relative to older workers, unemployment rates are also high -- 2-3 times those in Germany, for instance, though less than those in France or Italy.

Employment-population rates for out of school 20-24 year olds were lower in the US than in most advanced OECD-European countries -- a trifle above the rates in France despite much lower relative pay in the US (OECD, Employment Outlook 1994, Table 1.20). For young Blacks, many who are not involved in the workforce at all, joblessness is huge even by European standards. In 1993 just 51% of 16-24 year old Blacks not enrolled in school were employed, compared to 735 of 16-24 year old Whites not enrolled in school. For those in the labor force and not in school, the rate of unemployment was 27% for young Blacks; 11% for young Whites, and 16% for young Hispanics.

Topel (1994) has used the CPS to examine the work activity of adult men according to their position in the wage distribution (which limits the sample to persons who work at least one week in the year). He finds that those with low wages work less than those higher in the income distribution and that joblessness grew more concentrated among the low paid over time, despite their falling wage. For instance between 1967-68 and 1987-89, weeks of joblessness increased by 8.5 weeks among men in the lowest decile of the wage distribution but did not change for those in the upper 4 deciles (Topel, Table 1). My analysis of the annual hours of workers in Census of Population given in Figure 2 reveals a rising inequality in hours worked among Americans: in 1969 the top decile of American men in terms of annual hours, worked .58 ln points more than the bottom decile, whereas in 1989 the top decile worked .94 ln points more than the bottom decile. The rise in hours inequality, however, occurred largely in the 1970s, rather than in the 1980s, when hourly pay inequality grew. Similarly, the variance in the log of annual hours worked doubled from 1969-1979, then rose modestly through 1989. Table 3 shows that the rise in inequality in hours worked was associated with level of pay: in the 1980s hours worked declined most among those with low wages. The covariance between hours worked and wages increased from the 1970 Census to the 1990 Census, implying that the increased inequality in work time contributed to the rise in annual earnings inequality.

A market-clearing interpretation of these results (which does not take seriously measured unemployment) is that falling real wages reduced the work time of the low paid or less skilled along a labor supply curve. The low wages that `solved' the problem of inadequate demand created a supply side incentive problem. A disequilibrium interpretation of these results (which views measured unemployment as real) is that even huge real wage cuts were insufficient to create adequate demand for less skilled young labor. Regardless of which interpretation one prefers, it is clear that massive wage cuts were no panacea for the less skilled.

Problems

vii. The rate of poverty and `extreme poverty' has increased to levels beyond that in other advanced countries.

Every visitor to the US sees some of the downsides of the US economic system: crime-ridden slums in which a large proportion of American children are brought up in poverty and homeless men and the beggars mindful of the worst of Dickens' England. These are not social aberrations in anotherwise neo-classical nirvana, but the tail end of a widening income distribution. With only a modest safety net for citizens who fail in the job market, increased inequality in earnings and time worked translates into increased inequality in family incomes and poverty. The Council of

Economic Advisors reports that mean family income in the lowest quintile declined by 14% from 1973-1992. The child poverty rate rose in the 1980s and shows little sign of falling with economic recovery. For children with single parents, the level of Aid to Families with Dependent Children (AFDC) benefits declined from the mid-1970s through the early 1990s. As a result, despite higher income per head, the rate of child poverty in the US exceeded that in most other advanced countries, even with poverty measured on the same `purchasing power' absolute income scale.

The homeless -- an estimated 500,000 at the outset of the 1990s -- are also partly the result of the widening income inequality. Increased inequality has given the wealthy a greater edge over the poor in competing for land and dwellings, while the hollowing out of the middle class has reduced the number of old dwellings that are available to the poor as middle income earners leave for newer residences (O'Flaherty, 1994). With diminished financial resources, poor families find it difficult to take care of troubled family members, and let them seek respite in shelters or on the street. Social spending for the homeless has been meager. Finally, as the wages of the less skilled have fallen, begging has become more attractive, even for those with normal residences.

Some Europeans might wonder if the problem of increased poverty and incumbent social ills is peculiarly American, due to the US's minority population or immigrants, rather than part-and-parcel of a response to the American reliance on market forces, to determine incomes. While Americans differ in some ways from Europeans, I would not downplay the effect of labor market and economic institutions on behavior. In joint work with Anders Björklund, I examined the income distribution of Americans of Swedish descent and found that this distribution was as unequal as that of other Americans, producing US style poverty among Swedish-Americans leagues greater than that of their Swedish brethren in Sweden, despite a sizeable American advantage in GDP per head (Björklund and Freeman, 1995). The European country whose labor market most resembles the American, the UK, has seen rising inequality, increased homelessness and crime.

viii. A large number of American men, particularly less educated young minority men, have been involved in crimes that have led to incarceration.

Most visitors to the US are aware of another downside of American society -- the high level of crime. Few realise that the high crime rate has occurred despite the nation incarcerating extraordinary numbers. In 1993 roughly 2% of the American male work force was in jail or prison. The 2% does not refer to minority men or to young men, but to **all men**. An additional 5% of men were on probation or parole, so that approximately 7% of American men were under supervision of the criminal justice system. Most of these men have relatively little schooling and limited work skills. Among subgroups 3% of men aged 18-34 are incarcerated; 9% of all black men are incarcerated; and 13% of lack men aged 18-34 are incarcerated (Freeman, 1994b). These extraordinary levels are the result of an 8.5% growth in the prison and jail population in the 1980s that shows no sign of levelling off.

The US has avoided the heavy expense of a welfare state and dole for the longterm jobless, but has developed something comparable through its jails and prisons. The 2% incarcerated are in for long periods of time at an average annual cost of $25,000 or so. While no one can say for certain what proportion of the crime problem results from income inequality, a growing body of studies find that inequality and low wages are important economic factors in maintaining the rate of crime, despite massive incarceration (Freeman, 1994b). At the minimum, arrest and prison records show that the criminal population has the same characteristics as the population doing poorly in the job market. Many inner city youths report that they can earn more from crime than from legitimate employment and have substantial opportunities for illegal earnings.

ix. Government regulations of the labor market, and individual court suits over worker rights, have increased greatly.

The image of the US labor market as the least regulated among major Western countries is true in four respects: collective bargaining is limited to 11% of the private sector; most collective agreements are between local unions and establishments; national regulation of wages, fringe benefits, or hiring and firing is minimal; and there are few barriers to exit and entry of firms. But talk to an American business person about labor market regulations and you will hear bitter complaints about government policies and court actions. The reason for these complaints is that the US gives individuals many rights at workplaces that can be enforced through court actions. The number of federal statutes covering the workplace increased since the 1970s under the administrations of both political parties. The enactment of laws regarding occupational health and safety, pension plans, employment of immigrants, family and medical leaves, and various amendments to the equal opportunity statutes, including acts giving the disabled the right to sue if they believe an employer has discriminated against them by not adjusting the job they are seeking to take account of their disability, are illustrative of major regulatory developments.

While American workers are more protected at their workplace with statutory rights than in the past and firms more restricted in what they can do to workers, appropriations for organisation and staff to enforce legal rights have not increased. Given limited regulatory staff, and absent works councils or other local groups of employees to work with management to monitor local work conditions, American workers have flooded agencies and courts with suits on employment issues (Commission, 1994). Between 1971 and 1991 the number of court cases filed in federal district courts on individual employment issues increased by 430%. In 1971 employment law cases were 6% of all cases in these courts. In 1991, they were 16% of all cases. EEOC complaints rose by 56% between 1981 and 1993, and the number of discrimination suits before state agencies also skyrocketed. The American Civil Liberties Union, which is hardly a union grievance committee, receives hundreds of calls per day asking for legal assistance on workplace issues, as do a variety of other civil rights type organisations.

This court-based system of workplace justice adds to the inequality in the American labor market, since only those with enough gumption and/or income are likely to take an employer to court over violations of workplace rights. Ms Jones may sue her employer for alleged sexual harassment or discrimination, while Ms Smith does not do so because she cannot afford a lawyer. Ms Jones may convince a jury to give her hundreds of thousands of dollars in settlement while Mr Jones may fail to do so. A company that sells consumer products may settle a workers' complaint out of court to avoid bad publicity while one that sells producer products may decide to go to court with the same case. And so on. Most labor relations experts regard the system as a costly inequitable `lottery'.

3. Evaluating the American Response

To judge the response of the American labor market to the developments of the past several decades requires two things: a welfare function to assess the level and the distribution of economic outcomes; and a counter-factual measuring rod for comparison. I am not so bold as to write down either `**the**' social welfare function or `**the**' counterfactual, and so will limit my concluding comments to some observations about the positive and negative aspects of the US response; and the possible lessons of this experience for Europe.

By any plausible metric, the US has done well in the level of unemployment and in its distribution among workers compared to Europe. Given two ways of producing a 10% unemployment rate -- having 10% of the workforce unemployed for a year and 90% employed versus having all workers unemployed 10% of the time and employed 90% of the time -- the latter, which comes closer to the US than to Europe, would get higher marks. If Europe could import US unemployment patterns and maintain (most of) its wage distribution, it would benefit. At the same time, the US has done poorly in the level of income for those in the bottom rungs of the distribution, compared to Europe. Analysts can weigh increased inequality differently when the `rising tide raises all boats', but few would give high grades to an income distribution where increased inequality means falling real incomes for the low paid. If the US could import a European earnings distribution without (much) cost in jobs or changes in the distribution of joblessness, most welfare functions would rate this a gain.

These considerations do not, however, take us very far, for if lower unemployment comes at the expense of lower wages for the less skilled and, conversely, we are left with debating whether a better response on unemployment is socially superior or inferior to a better response on earnings. Many Europeans seeing first hand the unemployment problem -- believe that a better level and distribution of unemployment is more important; while many Americans -- seeing first hand the social and economic effects of a worsened income distribution -- cast wishful eyes at the European welfare state. And both may be right, given their starting points. The US could arguably benefit from a bit more redistribution of income and a stronger social safety net (*vide* the Clinton Administration effort to enact national health insurance). And Europe could arguably benefit from a bit less redistribution and lower social safety net (*vide* the efforts of most European governments).

But there is more that we can say about the US and European responses to the economic problems of the past two decades. A key issue in assessing these responses is their viability or lack thereof over the long run. The European response of maintaining a reasonably constant earnings distribution in the face of market trends toward inequality faces problems of fiscal feasibility at high levels of unemployment. Regardless of how highly one values the preservation of real incomes in the bottom rungs of the distribution, it is difficult to see how a welfare state developed in a world of 2-3% joblessness can prosper over the long run in a world of 6-10% unemployment and slow economic growth.

But the US response also has problems of viability. The American job market serves well the best firms and the skilled workers, and generates self-correcting forces, in the form of increased investment by young persons in education and training in response to educational differentials. But it does a poor job in preparing less skilled Americans for the modern world of work and has shortchanged the children brought up in poverty and surrounded by crime. The economic and social conditions that produce crime burdens the US with a huge criminal justice system.

Recent economic theorising about growth suggests, moreover, that a large population of poorly skilled persons can detract from the productivity of the highly skilled through spillovers. Even if one does not accept this argument and believes, as I am inclined to do, that an economy can succeed with a highly unequal distribution of income -- a dual economy of the sort usually associated with third world countries -- few would laud such an outcome. In its May 1994 Fact-Finding Report, the Commission on the Future of Worker-Management Relations wrote: "A healthy society cannot long continue along the path the US is moving, with rising bifurcation of the labor market". This assessment was widely cited and accepted in public discussion of the Report.

There are thus dangers in the American response to the economic developments of the 1980s-1990s that Europeans and others who look admiringly at the US experience should bear in mind. If OECD-Europe were to copy the US wholehog, it would find itself facing many of the same problems that bedevil the US today; just as the US would likely face European problems if it expanded its welfare state and adopted European modes of labor market operations. But such stark transformations are not realistic. Labor markets in Europe differ in so many ways from the US labor market that even with substantial changes, I would not expect the European labor situation or problems to mirror those in the US in the foreseeable future.

The real issue is less far-reaching but also more difficult to answer given our current state of knowledge. This is determining which, if any, US practices could be crafted or designed to `fit' with the other parts of European economic systems, to create better outcomes and, conversely which, if any, European practices could be designed to fit with the US labor relations system, in ways that would avoid simply trading one set of ills for another. If we knew the answer to this dual question -- to how to combine the best of American flexibility and reliance on market forces with the best of European social protections -- we'd turn discussions of labor market reforms, flexibility, and the like from alchemy and ideology to science. It is, in my opinion, finding the right combination that is the economic challenge of the 1990s.

ENDNOTES

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1. In the US from 1973-1992 the rate of growth of GDP per employee was 0.5% a year, compared to 2.5% per year from 1950- 1973. In manufacturing the growth of productivity fell in the 1970s but recovered in the late 1980s and 1990s to its historic level of approximately 2.5% per year. Measured by GDP per employee or manufacturing output per hour, the US had slower growth of productivity than other advanced countries.

2. Employment shifted toward the skilled within industries no faster than in earlier decades. In manufacturing, the ratio of non-production to production workers rose from .264 in 1973, to .318 in 1993 but the ratio had risen proportionately faster in the preceding two decades from .199 in 1953. The Economic Policy Institute estimates that occupational upgrading raised compensation by .18% per year from 1972-1979, and by .19% per year from 1979-1993, implying no change in the rate of acceleration of skill upgrading.

3. In the US the most commonly used measure of the magnitude of trade in the economy, the ratio of exports and imports to GDP rose by 3.3% per year from 1959-1973 and increased thereafter by 2.9% per year.

4. This is based on tabulations from the 1990 Census public use dataset.

5. In 1953 34.4% of women of working age were in the labor force. In 1973 44.7% were in the labor force. In 1993 57.9% were in the labor force.

TABLE 1

Compound Annual Growth of Real Earnings and Prices in the US, 1973-1993

	Rate Per Year
Establishment Survey Data	
Average Hourly Earnings, Private Non-Agriculture	
Production and Non-supervisory Workers	-0.8
Hourly Compensation, Business Sector	0.4
Total Compensation, Employment Cost Index (1979-1993)	0.1
National Income and Products Account, 1975-1993	
Wages and Salaries of Full-Time Equivalent Workers	-0.1
Compensation of Full-Time Equivalent Workers	0.2
Household Survey Data	
Median Weekly Earnings of Full-Time Workers, 1979-93	
All	-0.2
Male	-0.8
Female	0.5
Median Annual Income, Full-Time Workers, 1973-1992	
Male	-0.5
Female	0.7
Price Indices, 1973-1993	
Consumer Price Index	5.9
Producer Price Index	5.0
GDP Deflator	5.5

Source and Note overleaf

Source: Updated and adapted from Commission on the Future of Worker-Management Relations, Fact Finding Report, May 1994.

Note: Figures for median weekly earnings differ slightly from those in the Commission report because different government documents report different medians for 1979.

TABLE 2

Estimates of the Effect of Education on Ln Hourly Earnings of American Men Aged 18-64, 1970-1990

Education	1969	1979	1989
8 years or less	-.44	-.48	-.41
Some High School (9-11 years)	-.20	-.25	-.24
High School (12 years)	--	--	--
Some College (13-15 years)	.11	.10	.17
College (16 years)	.43	.34	.49
College Plus (>16 years)	.65	.41	.63
Other Controls			
9 experience dummies	x	x	x
2 race/ethnic dummies	x	x	x
Number of Observations	335,423	373,139	406,931
R^2			

Source: Tabulated from US Census of Population public use data files, 1970,1980, 1990.

Note: Because of the large sample sizes all of the standard errors on the coefficients are less than .01 except for the following:
(1) 1969: College Plus (>16 years) = .18
(2) 1989: 8 years or less = .01

TABLE 3

Mean Annual Hours Worked, by Wage Decile, Male Workers, 1970-1990

Wage Decile	1970	1980	1990	Percentage Change, 1970-90
0-10	2133	1754	1693	-21%
10-20	2268	1921	1940	-14%
20-30	2293	2008	2026	-12%
30-40	2192	2064	2076	-5%
40-50	2204	2070	2096	-5%
50-60	2170	2091	2132	-2%
60-70	2146	2074	2100	-4%
70-80	2085	2074	2085	0%
80-90	2011	2032	2066	3%
90-100	1742	1656	1776	2%

Source: Tabulated from US Census of Population public use data files, 1970, 1980, and 1990. The number of observations for the 1970 sample was 121,078; for the 1980 sample was 174,443; for the 1990 sample was 135,434.

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