Rich Man, Poor Man

THE OECD forecasts that unemployment in its 24 member countries will rise to a record 36m (8.75% of the labour force) by the end of next year, up from 24.5m in 1990. Europe's jobless rate is expected to hit 12%. The challenge to policy-makers is to prevent this cyclical rise in joblessness becoming permanent. In past recoveries the cyclical increases in unemployment have not been fully reversed because of various labour-market rigidities, and so the jobless rate has ratcheted up.

Economists have long sought ways to make the labour market work better: in particular, to encourage greater wage flexibility, so unemployed workers price themselves back into jobs. Since this implies a fall in pay at the lower end of the labour market, a good sign of an efficient job market (though, possibly, a socially divisive one) is a wide gap between the highest and lowest paid. How does wage inequality vary between countries? And has the labour market been operating more flexibly in the past decade?

The OECD provides some answers in its latest Employment Outlook. The left-hand chart shows the ratio of the wages of the top 10% of earners to the bottom 10%. As might be expected, America has by far the biggest wage differentials, Sweden the smallest. The figures are not strictly comparable between countries, but they provide a broad picture of how wage differentials have moved over time.

In the 1970s wage inequalities fell or were stable in most countries, but in the 1980s the gap widened in 12 of the 17 countries studied. America and Britain saw the biggest widening in wage differentials. In America the highest-paid 10% of workers earned 5.6 times as much as the lowest-paid 10% in 1989 (the latest figure available), up from 4.8 in 1980. In Britain the ratio increased from 2.5 to 3.4 in 1991.

In most countries the wider dispersion of wages was attributable both to gains for high earners relative to median wages and to relative losses for the lower paid. The main exceptions were France and Germany where the wages of the low-paid rose relative to average earnings. In America, Australia and Canada real wages for the bottom 10% of earners fell during the 1980s. In Britain, however, the real pay of the bottom 10% has risen by 11% since 1980--albeit less than the 51% hike for the top 10%.

Why have wage inequalities widened in most countries? One possible explanation is the slew of labour-market reforms, such as decentralisation of wage bargaining, the move to performance-based pay, cuts in minimum wages and the decline in union power. The OECD reckons that such factors help to explain why America and Britain have seen the largest increase in wage inequality but cannot be solely responsible for the recent changes.

Another popular explanation for growing wage inequality, which many Americans fret about, is de-industrial-isation: the replacement of "high quality" jobs in industry by "low quality" jobs in services, including the infamous hamburger-flipping "McJobs". The OECD study concludes, however, that shifts between different sorts of industry, such as between manufacturing and services, are much less influential than the changes within individual industries.

The most important causes of increased wage differentials, says the OECD, are changes in the relative demand and supply of different types of workers, by age and by education. For example, most OECD countries saw a record number of 15 to 24 year olds enter the labour force in the 1980s. This reduced the wages for young workers relative to average wages, and so increased overall dispersion.

Perhaps the most striking increase in wage differentials was between workers with a university degree and those without. In the 1970s this gap narrowed as the supply of workers with a degree increased rapidly. In the 1980s, however, the supply of college-educated workers grew more slowly and their relative rewards rose. For example, in America the number of people with university degrees increased by an annual average of 2.6% in the 1980s, down from 4.4% in the 1970s.

At the same time as the supply-growth of highly educated workers has slowed, the demand for them has accelerated. Technological innovation--in particular, the increased use of computers--has added to the demand for highly educated, skilled workers and reduced the demand for less skilled. Putting these two factors together, the premium earned by American university-educated workers over those who left after high school rose from 37% in the late 1970s to 53% in 1989. The OECD thus rates education as one of the most important explanations for the increase in overall wage differentials.

The more flexible a country's labour market, the more these changes in demand and supply show up in relative wages rather than unemployment. Where countries have a high minimum wage, by contrast, this sets a floor for wages for the less skilled and so prevents the market from clearing. The result: higher unemployment. In France, for instance, the minimum wage rose from 46% of median earnings in 1979 to 53% in 1987. By contrast, America's minimum wage fell from 40% to 30% of average wages over the 1980s. No wonder 23% of French under 25 year olds are unemployed, almost twice as many as in America. Perhaps Bill Clinton should reconsider his plan to raise America's minimum wage.