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Many economists have written about the recent trend toward increased wage inequality, which has occurred in most industrialized countries. Equally important, however, are the large and persistent international differences in the level of inequality. In particular, the distribution of wages is much less equal in the United States than in western Europe. This article presents a detailed comparative analysis of the inequality in the distribution of male wages in the U.S. and nine other developed countries in the 1980s. It finds that the difference between the U.S. and other countries is located almost entirely in the lower half of the wage distribution, and argues that institutional rather than market forces offer the most persuasive explanation of these patterns.

INSTITUTIONS AND INEQUALITY

The mechanism by which market forces affect the distribution of wages is simple and familiar. Greater inequality in one country rather than another could result from either supply or demand factors. That is, there could be international differences either in the distribution of valuable skills in the labor force, or in the patterns of demand for (and hence payment for) particular, scarce skills. However, the empirical analysis discussed below finds that these factors, as best as they can be measured, are of only secondary importance in explaining the actual international variations in inequality.

Institutional factors affecting wage determination have more complex effects. The U.S. has the lowest level of unionization among the major developed countries; this could lead to greater inequality of wages in several ways. First, unions raise their members' wages relative to other workers; the union/non-union wage gap is much larger in the U.S. than elsewhere. Second, union contracts reduce the variation in wages within the unionized sector of the labor force; this sector is smaller in the U.S., and the more variable, non-unionized sector is larger. Third, collective bargaining in the U.S. is more decentralized; thus bargaining does less in the U.S. than in Europe to reduce the variation in wages among unionized workers. Industry-wide collective bargaining agreements in several European countries set nationwide minimum pay standards; in addition, union and government policies in some countries explicitly seek to raise the wages of the lowest-paid workers. Several of these factors suggest that the U.S.-European difference should be particularly evident at the bottom of the wage distribution -- which is exactly what the data show.

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Wage determination is far more centralized in other developed countries than in the U.S. Sweden and Norway have had a single nationwide agreement between the employer association and the major union federation (although there has been some recent movement away from this pattern in Sweden). Austria and Italy have nationwide collective bargaining agreements covering entire industries or groups of industries; Germany has similar agreements on a statewide basis. Australia has government tribunals and compulsory arbitration that set wages for most workers. Switzerland and Britain have less centralized wage determination than many other European countries, but more multi-employer contracts, and a higher degree of unionization, than the U.S. In several European countries, the union movement has pushed explicitly and somewhat successfully for pay scales that raise the relative position of the lowest-paid workers.

DATA AND RESULTS

The heart of the study is an empirical analysis of micro data on individual workers from the U.S. and nine other developed countries, for various years in the 1980s. To increase comparability, the sample is restricted to male wage and salary workers aged 18-65. Other work by the same authors has examined international comparisons of the gender gap in wages, finding similarities in the patterns of male-female inequality and of inequality within the male workforce.

One summary measure of inequality is the standard deviation of wages; it is largest for the U.S., with Australia in second place and the European countries all noticeably more equal. More information about the shape of the wage distribution can be obtained by examining the ratios (or differences in logarithms) between the 10th, 50th, and 90th percentiles of each country's wages.

The ratio of 90th percentile to 50th percentile wages is 1.7 for the U.S. -- and the average 90/50 ratio is also 1.7 for the other nine countries in the study.[1] The 90/50 ratio, in fact, is greater for Switzerland (the highest in the study, at almost 2.2), Britain, and Hungary than it is for the U.S. Thus the pattern of inequality in the upper half of the wage distribution does not distinguish the U.S. from other developed countries.

On the other hand, the distinction is quite clear in the ratio of 50th to 10th percentile wages. This ratio is 2.8 in the U.S., compared to an average of 1.6 for the other nine countries. The 50/10 ratio was 2.1 in Australia, and 1.8 or less in all the European countries. The U.S. has a much greater degree of inequality, therefore, in the lower half of the wage distribution.

How much of the difference between the U.S. and other countries is due to the distribution of skills, or of the rate at which skills are paid? For the standard deviation of wages, only 6% of the difference, on average, is due to a less equal distribution of education and work experience in the U.S., and 15% is attributable to less equal average payment for these skills. Nearly four-fifths of the difference is due to "residual" inequality, i.e. the greater variation in the U.S. in the treatment of people with the same skills. For the 50th/10th percentile ratio, focusing on the lower half of the distribution, 43% of the difference between the U.S. and other countries is due to America's less equal distribution of education and experience, but only 4% is due to difference in the relative payment of these skills; more than half of the difference is still "residual" inequality. (In the upper half of the labor force, the U.S. distribution of education and experience is more equal than that of the other countries.)

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A number of other statistical analyses tell similar stories. For example, a detailed correction for international differences in the distribution of occupations and industries suggests that low-skilled workers should in general fare *worse* relative to the middle in other countries than they do in the U.S. This effect points in the wrong direction, and cannot explain the opposite, observed pattern of smaller low-to-middle skill differentials outside the U.S.

TESTING THE EFFECTS OF INSTITUTIONS

Several authors have produced rankings of countries with respect to the degree of centralization in their wage setting procedures. An average of these published rankings yields an index of centralization; not surprisingly, the index shows the United States to be the least centralized of the ten countries in the study. This index is strongly correlated with both the standard deviation of wages, and with the 50th/10th percentile ratio; it is not, however, significantly related to the 90th/50th percentile ratio. This provides clear statistical evidence of the importance of institutions in explaining the international patterns of inequality.

If centralized wage-setting institutions increase the relative wages of workers at the bottom of the skill and income distribution, those workers may have fewer employment opportunities. With the cost of low-skilled labor raised above its free-market price, the demand for such labor may drop. An examination of the employment/population ratios for low, middle, and high skill groups shows that higher-skilled workers are more likely to be employed in all countries -- but the gap between employment rates for the middle and low skill groups is greater in continental Europe than in the U.S., Britain, and Australia. Europe's more egalitarian wages for low-skilled workers may come at the expense of fewer job opportunities for this group.

It is sometimes suggested that the government is an employer of last resort for unemployed, low-skilled workers. However, in the countries in this study, the government workforce is relatively skilled, and there are no clear patterns of international variation in the skill level of public employees. If European governments attempt to compensate for their relatively greater unemployment of low-skilled workers, it appears that they do so indirectly through policies such as training programs and subsidies for relocation, not through direct public employment.

Notes

1. These are the antilogs of the logarithmic data in the study's Table 1.

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