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> Was the twist in the job market against less educated workers [beginning in the 1980s] unique to the United States, or was it part of a general pattern of decline in the well-being of the less skilled in advanced countries?... Have other advanced countries avoided or ameliorated the rise in wage inequality that has characterized the United States? [30]

Earnings inequality grew most rapidly in the 1980s in the United States and the United Kingdom. Other advanced countries generally had modest increases in inequality, and a few apparently had no change. This article argues that the familiar forces of supply and demand are important in wage determination, but had similar effects on all countries, and hence cannot explain most international differences in inequality. Institutional differences, on the other hand, have a clear relationship to the international patterns of inequality.

Changes in the United States and Other Advanced Countries

In the United States, overall wage dispersion grew rapidly in the 1980s, as real earnings rose for high-income workers but fell sharply for those at the bottom. Pay differentials by education, age, and experience increased; the only major differential that decreased was that between men and women. Most of these changes were breaks from the past, contrasting with the trends of the 1970s and earlier decades. In addition, wage dispersion increased within demographic and skill groups, a trend that began earlier and continued through the 1980s.

Did other industrial nations experience similar trends? In the 1970s, educational and skill differentials narrowed substantially in all the countries for which data is available. In the 1980s the same differentials narrowed by a lot in South Korea, and by a little in the Netherlands; other countries ranged from no noticeable change (France, Germany, Italy) to modest increases in inequality (Australia, Canada, Japan, Sweden), and large increases (United States, United Kingdom). However, in Britain real wages increased for all groups; inequality rose because wages rose faster at the top than at the bottom. Only in the United States did low wage workers as a group suffer a serious drop in economic well-being. Women's wages rose relative to men in the 1970s and 1980s in 15 out of 16 major industrial countries (all except Japan).

Explaining the Changes

An analysis of supply and demand factors offers an important but incomplete explanation of the rise in inequality. Supply and demand do not operate in a vacuum; wages must respond to market forces within an existing institutional setting that shapes and constrains the market. Moreover, supply and demand moved in roughly similar ways in all advanced countries. Developed countries operate in the same world markets, using similar technologies in similar industries. Thus the demand for skills should not differ significantly among these countries. Labor supply changes will diverge more, but there is a trend toward a greater proportion of workers obtaining college degrees everywhere. So to understand international differences in labor market outcomes, something beyond supply and demand is needed.

That "something" is the pattern of wage setting, training, and other labor market institutions that varies from one country to another. "The stronger the role of institutions in wage determination, the smaller will be the effect of shifts in supply and demand on relative wages and, as a consequence, the greater will be their effect on relative employment." [44] A greater effort in education and training leads to a more egalitarian distribution of skills, dampening the effects of market shifts. Other institutions such as social insurance and income maintenance programs also affect the wage distribution, by allowing workers to remain unemployed when necessary rather than taking pay cuts to stay employed.

Does the Explanation Fit the United States?

Supply-side changes alone cannot explain the U.S. wage trends of the 1980s. Groups with relative wage increases, such as college graduates and women, also had increases in their relative numbers in the labor force. Declining wages for those at the bottom cannot be explained in terms of the declining quality of education received by young workers, since inequality increased in a similar fashion for all cohorts, including those educated in earlier decades. The surge in immigration explains only part of the decline in relative wages for those at the lowest levels (high school dropouts).

Therefore, there must have been a shift in demand that favored more educated and skilled workers. Part of the demand shift results from the loss of high-wage, blue-collar jobs as goods-producing industries contracted and professions and other services expanded. Most of the change in job structure, however, occurred within narrowly defined industries, as the use of professional, managerial, and technical workers rose and production workers declined almost everywhere. But most of these demand factors also affected European countries, where the resulting trend in inequality was far more muted. Institutional factors, which differ from country to country, also play a role in determining how market forces affect wages. The major institutional factor that affected the U.S. wage structure was the decline of unionism. The precipitous drop in the rate of union membership explains one-fifth of the growth in wage dispersion among male workers.

For young blue-collar men, the proportion who were in unions fell by 15 percentage points in the 1980s. Thus 15 percent of less-skilled young men lost the 20 to 25 percent wage advantage associated with union membership, the lower dispersion of wages in union workplaces, and the better pensions and other fringe benefits under union contracts. The effect may be even greater, since many analysts believe that lower unionization rates reduce the pressure on nonunion employers to pay high wages and benefits.

Why Other Countries Fared Differently

Demand factors, as noted earlier, explain little of the international difference in wage inequality. The same technologies and occupational shifts emerged virtually everywhere; the share of employment in manufacturing declined in all developed countries except Japan. Supply shifts are of greater significance: while the supply of highly educated workers increased rapidly in all developed countries in the 1970s, the rates of growth diverged thereafter. The United States was alone in having a sharp deceleration of growth in the college-educated work force in the 1980s, and had the sharpest increase in the college wage premium as a result. At the other extreme, South Korea had exceptionally fast growth in the college-educated share of its work force, and saw a huge drop in the college wage premium. Most countries fell between these extremes.

Just as in the United States, institutional factors are critical in determining the trends in wage inequality. Wage-setting institutions vary greatly from one country to another. Austria and Sweden have historically had national wage settlements reached between union confederations and employer organizations. National bargaining also determines the rate of wage increases in Japan, though the implementation of the resulting increases is quite decentralized. In Germany, the results of industry or regional collective bargaining are often extended to other workers by the Ministry of Labor. In France, the high minimum wage is important in determining the wage structure, and the Ministry of Labor also extends contracts to other workers. Italy's Scala Mobile, a negotiated nationwide system of wage raises, decreased wage differentials throughout the 1980s.

In several cases these institutions were changed, in ways that weakened or decentralized wage-setting mechanisms, in the 1980s and early 1990s. Sweden, for example, retreated from nationwide wage bargaining in 1983; Italy ultimately dropped the Scala Mobile. However, there remains a clear difference between the United States and other countries. Nowhere else are unions so weak, or is government intervention in wage determination so rare. The only other country that saw a comparable decline in union membership and a simultaneous weakening of other wage-setting institutions was the United Kingdom, the other country where inequality rose sharply. The decline in unionization accounts for about one-fourth of the British increase in inequality, comparable to estimates for the United States. Union membership also fell significantly in the 1980s in France, Austria, and the Netherlands, but other wage-setting institutions remained strong in these countries, so that they did not follow the Anglo-American pattern of rising inequality.

Market forces do appear to be gradually weakening wage-setting institutions and pressing for greater decentralization throughout the world. However, there can be many different responses to this pressure. Few if any countries, other than the United Kingdom, are likely to approach American levels of inequality, given existing institutional structures. The institutions that matter most, in ameliorating trends toward inequality, include both European-style collective bargaining and regulation of wages, and institutions that invest heavily in education and training of non-college-educated workers. German and Japanese do far more to provide on-the-job training than do their American or British counterparts. Such training should be combined with investment in higher education, and with institutions that protect workers' interests in the labor market, to develop a long-term solution to the rise of inequality.