

Bonn, 05.07.2004

Final report

on the workshop

Wage inequality, technology and institutions

organized by Winfried Koeniger and Marco Leonardi
at IZA, Bonn, 02-03.07.2004

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1. Goal and objectives of the workshop

While inequality increased in Anglo-Saxon economies, there was much less of an increase in many continental European countries. To date, there is no consensus on the reasons of such big differences across otherwise similar economies. Technology and institutions are two possible determinants of the different evolution of wage inequality across countries and time.

The goal of the workshop was to bring together leading international researchers to discuss the most recent theoretical and empirical advances in this research area. In particular, a comparison of Germany and the UK in the last two decades shed further light on the debate. Whereas both economies have been exposed to rather similar technological progress, labor market institutions have changed substantially in the UK since the 1980s and have changed only slightly in Germany.

Below we discuss the main themes of the papers presented at the workshop with a particular focus on the experience in the UK and Germany. For further reference on the specific authors and papers we refer to webpage created for the workshop. This webpage can be found at

<http://www.iza.org/>

clicking on “Events”, “IZA Conferences” and then the workshop hyperlink.

The summary of the workshop themes and main results will appear also in *IZA Compact*, a regular publication of IZA which is distributed to more than 300 IZA fellows. The kind support of the Anglo-German foundation will be acknowledged.

2. Summary of main workshop themes

After the call for papers, a large number of high quality research papers was received out of which 11 were selected for presentation in the workshop. Participants both from European and North-American universities interacted very productively over the course of 2 days. The workshop program included both theoretical and empirical papers. All papers were critically discussed by another researcher after which comments were given from the floor.

The workshop treated the following main themes in separate sessions: unions and wage inequality; institutions, wage inequality and the labor share; institutions and labor demand; technology change and inequality; wage inequality, labor demand and search frictions and skill premiums and firm heterogeneity. In the following we summarize the main findings of each session.

In the session *unions and wage inequality* two papers investigated empirically the effect of deunionization on wage inequality in the UK and the US, respectively. While the decline of the unions did not increase wage inequality in the private sector in the UK during the time period 1983-95, it appears to have had an effect on wage inequality in the public sector. Although unionization declined much more in the private sector rather than in the public sector in the UK, the unions managed to increase wage compression within their members in the private sector but not in the public sector. Using a novel methodology, the second paper finds that unions have become more effective in the US in decreasing wage inequality although overall wage inequality has increased due to deunionization during the 80s.

In the session *institutions, wage inequality and the labor share* a more aggregate perspective was employed to analyze the relationship between labor market institutions and wage inequality or the labor share for a set of OECD countries. The main findings were that labor market institutions can explain a significant share of the different evolution of wage inequality and labor share across countries and over time controlling for other supply and demand factors.

The session *institutions and labor demand* considered the effect of institutions on quantities instead of prices. A simple theoretical argument shows that stronger involvement of unions in wage setting, prices those groups of the population out of the labor market that have a more elastic labor supply. This prediction is borne out for a panel of OECD countries in the time period 1960-96. Young and old relative to prime-aged and prime aged women relative to prime-aged men are found to have lower employment to population ratios.

The next session *technology change and inequality* investigated the demand and supply-side in some detail. On the one hand, empirical evidence shows that technology-driven demand changes seem to have increasingly polarized work in the UK. Many non-routine tasks are not easily substituted by computers. Computers seem to be substitutes to routine tasks in production and complementary to non-routine tasks. Since not only high-paid jobs, but also very low paid jobs like cleaning services or personal care services require non-routine tasks, computerization implies an increase in demand of both high paid jobs and very low paid jobs. This gives raise to job polarization. On the other hand, changes on the supply side are likely to matter, too. From a methodological point of view, correlations between inequality and socio-economic mobility can be used to identify whether changes have occurred on the supply or demand side.

The session on *wage inequality, labor demand and search frictions* modeled labor markets as imperfect with search frictions for firms and workers. The session started with an analysis of the effect of labor taxation on labor demand. It then continued with an analysis of the politico-economic incentives for flexible and rigid wages.

The workshop concluded with a session on *skill premiums and firm heterogeneity*. The session started with estimates on the relationship between skill premia and employment for Germany controlling for cohort effects. The estimates imply that wage cuts of up to 12% are necessary for unskilled workers in order to decrease their unemployment by 50%. The second part of the session used Italian data to analyze whether workers earn unequal wages because they work for unequal firms.

3. Lessons for Germany and the UK

The importance of labor market institutions for wage inequality and employment are of high interest not only for academics but also for policy makers. Currently, the debate about the trade-off between equity and efficiency has resurfaced the policy debate and this is especially so in Germany and the UK. Germany is trying hard to reform its labor market institutions in order to control its persistent unemployment problem which is at the heart of the budgetary problems related to its costly welfare state. Instead, the UK has substantially lower unemployment rates but there are concerns about growing poverty and increasing inequality.

This workshop has tried to shed light on whether these two problems are indeed just the different side of the same coin. The analyses in this workshop suggest that this might indeed be the case. Although the details on the micro level are more complicated (for example, deunionization in the UK did not have dramatic effects on inequality in the private sector), the evidence suggests that by and large the same institutions that compress wages on the one hand, decrease employment on the other hand. In particular, the wage cuts necessary to control the unemployment problem are substantial as suggested by the empirical analysis on Germany. However, changes in the economic environment such as the introduction of new technologies, will continue to increase wage inequality if market forces rule as suggested by the British experience.

Thus, institutions should be updated to the current environment to minimize the adverse employment consequences while there is scope for them to limit market forces if the implied inequality is considered too high. Countries such as the UK and Germany will continue to have different institutions and thus also labor market outcomes. However, for a given taste for equity, both countries should continue to learn from other countries' experiences in order to contain the efficiency losses associated with their labor market policies.



Anglo-German Foundation
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IZA Workshop
Wage Inequality, Technology and Institutions

July, 2 - 3, 2004
IZA, Bonn, Germany

+++ We wish to thank the Anglo-German Foundation for financial support +++

Program

+++ 45 minutes presentation +++ 10 minutes discussion +++ 5 minutes general discussion +++

Friday, July 2:

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| 12:20 - 13:20 | Lunch |
| 13:20 - 13:30 | Welcome |
| | <i>Session 1: Unions and Wage Inequality</i> |
| 13:30 - 14:30 | W. Stanley Siebert (University of Birmingham, UK and IZA), John T. Addison (University of South Carolina and IZA) and Ralph W. Bailey (University of Birmingham)
"The Impact of Deunionization on Earnings Dispersion Revisited"

Discussant: Chinhui Juhn (University of Houston and IZA) |
| 14:30 - 15:30 | Björn Brügemann (MIT)
"Unions, Deunionization and Changing Wage Inequality"

Discussant: W. Stanley Siebert (University of Birmingham, UK and IZA) |
| 15:30 - 16:00 | Coffee / Tea Break |
| | <i>Session 2: Institutions, Wage Inequality and the Labor Share</i> |
| 16:00 - 17:00 | Winfried Koeniger (IZA), Marco Leonardi (University of Milan and IZA) and Luca Nunziata (University of Milan and IZA)
"Labor Market Institutions and Wage Inequality"

Discussant: Francine Blau (Cornell University and IZA) |
| 17:00 - 18:00 | Daniele Checchi (University of Milan and IZA) and Cecilia Garcia Penalosa (CNRS and GREQAM)
"Labor Shares and the Personal Distribution of Income in the OECD"

Discussant: Sebastian Kessing (Wissenschaftszentrum Berlin für Sozialforschung WZB) |
| 20:00 | Dinner |

Saturday, July 3:

Session 3: Institutions and Labor Demand

9:30 - 10:30

Lawrence M. Kahn (Cornell University and IZA), Guiseppa Bertola (Universita di Torino) and Francine Blau (Cornell University)
"Labor Market Institutions and Demographic Employment Patterns"

Discussant: **Stephen Machin** (University College London and IZA)

10:30 - 10:45

Coffee / Tea Break

Session 4: Technology Change and Inequality

10:45 - 11:45

Alan Manning (London School of Economics) and Maarten Goos (London School of Economics)
"Lousy and Lovely Jobs: The Rising Polarization of Work in Britain"

Discussant: **Marco Leonardi** (University of Milan and IZA)

11:45 - 12:45

José V. Rodriguez Mora (Universitat Pompeu Fabra), John Hassler (Stockholm University and IZA) and Joseph Zeira (Hebrew University)
"Inequality and Mobility"

Discussant: **Winfried Koeniger** (IZA)

12:45 - 14:00

Lunch

Session 5: Wage Inequality, Labor Demand and Search Frictions

14:00 - 15:00

Olivier Pierrard (Catholic University of Louvain)
"Impacts of Selective Reductions in Labor Taxation"

Discussant: **José V. Rodriguez Mora** (Universitat Pompeu Fabra)

15:00 - 16:00

Tito Boeri (Bocconi University and IZA) and Michael C. Burda (Humboldt University, Berlin and IZA)
"Preferences for Rigid versus Individualized Wage Setting in Search Economies with Frictions"

Discussant: **Björn Brügemann** (MIT)

16:00 - 16:30

Coffee / Tea Break

Session 6: Skill Premiums and Firm Heterogeneity

16:30 - 17:30

Bernd Fitzenberger (University of Frankfurt) and Karsten Kohn (University of Frankfurt)
"Skill Premia, Employment, and Cohort Effects in a Model of German Labor Demand"

Discussant: **David A. Jaeger** (College of William and Mary and IZA)

17:30 - 18:30

Alfonso Rosolia (Bank of Italy), Andrea Brandolini (Bank of Italy) and Piero Cipollone (Bank of Italy)
"Unequal Workers or Unequal Firms"

Discussant: **Alexandru Voicu** (IZA)