Recensions

Book Reviews

At Home and Abroad: U.S. Labor Market Performance in International Perspective

This is an ambitious book. Blau and Kahn summarize the differences between labour market outcomes in the USA and other OECD countries over the last twenty years, describe the key economic events and labour market institutions that have shaped labour market performance and evaluate the research that has attempted to explain it. They manage (somehow) to do it all in a readable 266 pages, without the crutch of mathematics. The result is an impressive accomplishment that deserves to be widely cited—but it is also not surprising that some important gaps remain.

The book begins with an overview of economic performance in the USA and elsewhere, concentrating on trends in employment, unemployment, working hours, wage levels and wage inequality. In the end, Blau and Kahn will conclude that “institutions matter,” and Chapter 4 is devoted to the conceptual issue of how one might be able to distinguish the influence of institutional structure from the workings of market forces. However, a prior issue is the extent of international institutional differences in collective bargaining, wage setting, minimum wages, employment protection and mandated benefits—and many readers will likely find themselves using the succinct summary of Chapter 3 as an authoritative reference for their own research.

The book then focuses on the impact of labour market institutions on unemployment, relative wages and the gender pay gap. The puzzle is that European labour markets always have been more highly regulated than those in the USA and on average had much less unemployment until the late 1970s. Since about 1980, however, high unemployment has plagued France, Germany and several other countries. The organizing framework for Blau and Kahn’s discussion is the so-called “unified theory,” which explains all this in terms of the interaction of economic shocks and labour market institutions: “The EU experience of rising unemployment, rising real wages, and comparatively stable relative-wage levels and the U.S. experience of falling unemployment, falling to steady real wages, and rapidly rising wage inequality are two sides of the same coin. The United States permitted real and relative wages to adjust, while, in other Western nations, employment took the brunt of the shocks.” (p. 5). A key idea in this approach is the presumption that U.S. labour markets are more “flexible”—although it is notable that “flexibility” is never defined explicitly or tested directly.

Blau and Kahn summarize their own research and that of others with admirable clarity and encyclopaedic thoroughness. In the end, they conclude that although the evidence for institutional impacts on the wage structure is much stronger than for employment effects, the unified theory is a useful framework.
However, the demand side of labour markets is not directly examined. Micro
data on households and individuals is
used extensively, but firm level micro
data is not examined—an issue which is
important since it is the presumed hiring
behaviour of firms in response to wage
(in)flexibility that is assumed to be
responsible for differences in em-
ployment levels. Nor is there any con-
sideration of macro economic demand
management policies—one looks, for
example, in vain for any reference to the
hypothesis of Akerlof, Dickens and
Perry (“Near-Rational Wage and Price
Setting and the Long-Run Phillips
Curve,” Brookings Papers on Economic
Activity 1, 2000, 1-60) that when mon-
etary policy is focussed solely on attain-
ing a very low inflation target (as in the
EMU), a permanently higher unem-
ployment rate is the cost.

However, for this reviewer, the book
also raises the broader issue of how we
should construct, and test, theories. In
economics, one often encounters the
idea that theory is a way of making sense
out of “stylized facts,” i.e. a plausible
explanation of broad empirical generali-
zations. The “unified theory” is just such
a simplified way of thinking about the
many differences between labour mar-
kets in the USA and “elsewhere” and it
has the important policy implication of
a trade-off in social choices about labour
market interventionism or a more “free
market” approach. If a lower unem-
ployment rate (as in the USA in the late
1990s) can only be had by sacrificing the
institutional protections and lower wage
inequality observed “elsewhere,” then
one can perhaps rationalize both stand-
ard economic theories and US policy
choices with a single model.

However, in the natural sciences,
theory is usually thought of in terms of
potentially refutable hypotheses. In this
approach, the blurry idea of “stylized
facts” is avoided and it only takes one
clear counter example to reject a theory.
In, for example, aeronautics a century
ago, because all previous attempts at
flight with heavier than air craft had
failed, the prevailing “unified theory”
held that such flight was impossible—
but the single counter example of the
Wright brothers was enough to disprove
that hypothesis.

Although Blau and Kahn file numer-
ous caveats that the trends they observe
are “not universal,” their general ap-
proach is to contrast outcomes in the
USA with average outcomes “else-
where.” In making broad generalizations
about “stylized facts,” exceptions to the
general rule are ignored or down played.
In particular, the Scandinavians, Swiss
and Austrians often do not fit the “uni-
ified theory” at all well, since they com-
bine extensive labour market regulation,
low inequality and high real wages for
poorer workers with unemployment that
is just as low (or lower) than in the USA
and labour force participation rates that
are equally high. It is only when these
countries are pooled with other “non-
USA” countries that the broad generali-
zation or “stylized fact” appears to
emerge—an aggregation process which
presumes implicitly that the informa-
tion content of these exceptions is nil.

In aeronautics, it was the Wright
brothers’ counter-example that was seen
as having the most information con-
tent—and we have air travel today be-
cause people tried to explain why they
had succeeded, where others had failed,
in manned flight. If Blau and Kahn had
followed this approach, they would have
similarly focussed on explaining the
counter examples to the “unified theory”
and would have asked why some coun-
tries have succeeded in generating both
less wage inequality and less unem-
ployment. This they did not do—which
implies that much remains to be learned
from the international comparison of
labour market outcomes.

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