

WAGE INEQUALITY AND LABOUR-MARKET PERFORMANCE. A ROLE FOR CORPORATE SOCIAL RESPONSIBILITY?*

1. INTRODUCTION

The current economic and financial crisis has repeatedly brought to the fore the concepts of the moral and social responsibility of business. In this paper we take a longer run perspective to these issues, mainly related to secular developments in the labour market. In the past decades, advanced societies have relied almost exclusively on government to achieve the fulfilment of social and environmental aims. Shrinking government resources, along with a growing distrust of regulations, have led to the development of alternative, voluntary and non-regulatory, initiatives. Among these initiatives, corporate social responsibility (CSR) is taking on a distinctive role. According to the European Commission (2001), CSR is the firms' voluntary integration of social and environmental issues within their business activities and their stakeholder networks. More generally, CSR promotes a vision of business accountability to a wide range of stakeholders. While the traditional firm only has owners and shareholders as its stakeholders, the socially responsible firm recognises a wider set of stakeholders: customers, suppliers, employees, communities, investors, and activist organisations. Key

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areas of concern are the environment, the wellbeing of employees, the community and civil society in general¹.

In this perspective, the ethical conduct of companies is exerting more and more influence on the purchasing decisions of customers. In a recent survey by *Environics International* (see <http://www.environicsinternational.com>) over one in five consumers reported having either rewarded or punished companies because of their perceived ethical conduct. Investors are likewise increasingly including ethical concerns among the criteria used in assessing companies. Again *Environics International* reveals that more than a quarter of share-owning Americans take into account ethical considerations when buying and selling stocks. Finally, the development of the knowledge-based economy prompts firms to align philosophies and operating practices with the principles of their workforce, in order to find and retain an adequate pool of skilled labour.

Yet one may ask whether wage (or, more widely, labour income) inequality should genuinely be among the concerns of a socially responsible firm. Certainly there is evidence that it should be, across a wide range of countries. A survey carried out among North-East Italian employers (Marini and Ferraro, 2004) reveals that fair wealth distribution and low unemployment are among their main social concerns, especially if rank-and-file employers are considered. This evidence is supported in the well-known survey carried out by Boeri *et al.* (2001), according to which citizens from France, Germany, Italy and Spain are, by and large, averse to a shrinking of the safety nets currently provided by their welfare states. Jacoby (2005) reports that Japanese business leaders tend to reject the shareholder value approach that has become the paradigm in the US, because they believe that treating employees well pays off in the long term with better employee training, skill, and effort. The Japanese also reject US-like levels of inequality, prizing an almost-homogeneous society, where the upper middle-class and the working-class still live and commute in relatively close proximity. The Scandinavian bias for income equality is also very well known. Finally, there is at least some evidence that income equality also increasingly matters in the US, where the detrimental impact of increasing income inequality on the social fabric of American society has been forcefully brought

¹ An interesting overview of the CSR concept is provided in Garriga and Mele (2004). The notion of business accountability to a wide range of stakeholders has been first promoted by the influential analysis of Freeman (1984).

to attention (Alesina and La Ferrara, 2000; Putnam, 2000).

It is very well known that the scope for government intervention on income equality (either through taxes or through social safety nets) may be limited, because of the existence of deadweight losses and unintended consequences. This creates room for CSR, and, if firms want to exert an effect on income equality, their primary channel must be wage determination. But is there room for intervention on wage inequality? Or, rather, are firms that are willing to maintain a fair and stable wage structure going to hurt their own workers' labour income by worsening their employment prospects?

During the 1980s, the labour-market performance of most European countries showed clear signs of worsening vis-à-vis the US². This situation was all the more surprising as it went against the experience of the previous two decades, when the US employment rate was consistently lower than that of most European countries (see Table 1).

TABLE 1 - *Employment Rates in the US and Selected European Countries: 1964-2004*

	1964	1974	1984	1994	2004
Austria	0.67	0.64	0.64	0.70	0.68
Belgium	0.58	0.59	0.52	0.54	0.58
Denmark	0.70	0.73	0.73	0.71	0.75
Finland	0.73	0.70	0.72	0.60	0.68
France	0.65	0.64	0.59	0.58	0.63
Germany	0.68	0.66	0.60	0.67	0.69
Italy	0.58	0.55	0.54	0.51	0.57
Netherlands	0.67	0.64	0.54	0.66	0.74
Norway	0.65	0.66	0.73	0.72	0.76
Portugal	0.65	0.68	0.64	0.65	0.71
Spain	0.57	0.58	0.45	0.46	0.61
Sweden	0.72	0.75	0.79	0.70	0.72
<i>Continental Europe (unweighted average)</i>	<i>0.65</i>	<i>0.65</i>	<i>0.62</i>	<i>0.63</i>	<i>0.68</i>
UK	0.69	0.69	0.64	0.67	0.71
US	0.60	0.64	0.67	0.71	0.71

Source: AMECO database.

² Our preferred measure of labour-market performance is the employment rate. However, our conclusions would be substantially unchanged if we considered unemployment rates. As pointed out by Saint-Paul (2004), in recent years countries with high unemployment rates also tended to have low labour-force participation rates.

While some European countries have recently managed to improve their labour-market performance substantially, others appear to be still trapped at low employment rates.

Furthermore, from the 1980s onwards, wage inequality increased markedly in the US (and the UK), while the wage structure remained much more stable in most of continental Europe (see Table 2, where each entry gives the average annual percentage change in the ratio of the average wage in the 9th decile to the average wage in the 1st decile for full-time workers).

TABLE 2 - *Wage Inequality in the US and Selected European Countries; Annual Percentage Changes; 1979-2000*

	Men	Women	All
Austria	--	--	--
Belgium	--	--	--
Denmark	--	--	0.1
Finland	0.1	-0.1	-0.2
France	-0.2	-0.1	-0.3
West Germany	0.9	-0.2	0.4
Italy	1.6	-0.6	0.8
Netherlands	0.9	0.2	0.6
Norway	--	--	-0.4
Portugal	--	--	--
Spain	--	--	--
Sweden	0.6	0.7	0.5
UK	1.3	1.2	0.7
US	1.4	1.6	1.0

Source: Glyn (2001).

These diverging labour-market trends captured the attention of citizens and analysts from several countries. A 'unified theory' (Blank, 1997) centred on labour-market rigidities in Europe emerged to explain both the increase in US wage inequality and the rise in European unemployment. Debate in Europe focused on strong unions, restrictive employment protection legislation, generous social-safety nets and large tax wedges (Layard *et al.*, 1991). More specifically, Krugman (1995), argued that technological change and globalization had altered the skill distribution of labour income in favour of relatively skilled workers. Hence, low unemployment rates could only be maintained at the price of a rising skill gap in wages (like in the US and the UK).

Much has been written about these diverging trends, as well as about their recent evolution (Nickell, 2003; Saint-Paul, 2004; Freeman, 2005). A consensus is emerging to the effect that there is no such a thing as a European labour-market problem, much of the unemployment in the EU being concentrated in four large countries: France, Germany, Italy and Spain³. Furthermore, it appears that the improvement of the labour-market situation has not been accompanied in continental Europe by a rise in inequality comparable to that experienced by the US and the UK.

We try below to shed some light on these issues by taking stock of the available literature. First of all, we reassess Krugman's view and find that, by itself, it does not provide a satisfactory explanation of trends in inequality and employment (Section 2). Then we consider some of the factors most often mentioned in the literature as contributing to poor labour-market performance in Europe: strong unions (Section 3), generous social-safety nets and high taxes (Section 4). In Section 5 we turn to one of the major recent new features stylized facts of OECD labour markets, often mentioned as the harbinger of a 'new inequality' in society: the rise of non-standard (part-time and temporary) jobs. In order to fully account for the labour-market trends, in Section 6 we evaluate structural and institutional differences between the US and Europe outside the labour markets as well. In the light of the above analysis, Section 7 assesses the scope for CSR within OECD labour markets. Finally Section 8 provides some concluding remarks.

2. TECHNOLOGICAL CHANGE, GLOBALIZATION AND INEQUALITY

There appears to be considerable evidence in numerous OECD countries that the relative wage of skilled workers has increased, along with a rise in their relative employment levels (OECD, 1997). The magnitude of these changes, however, varies significantly from one country to another. There have been large increases in wage inequality in the US and in the UK, while other countries (especially those in continental Europe) have had more stable wage structures.

Let us consider in greater detail the cross-country evidence on the evolution of wage dispersion. Each entry in Table 3 gives the

³ Until recently, the situation had significantly improved in Spain and, to a lesser extent, in Italy (Garibaldi *et al.*, 2002).

average annual percentage change in the ratio of the average wage in the numerator decile to the average wage in the denominator decile for all full-time workers.

TABLE 3 - *Wage Inequality in Upper and Lower Halves of the Distribution in the US and Selected European Countries; Annual Percentage Changes; 1979-2000*

	9 th decile/ 1 st decile	9 th decile/ 5 st decile	5 th decile/ 1 st decile
Austria	--	--	--
Belgium	--	--	--
Denmark	0.1	0.3	-0.2
Finland	-0.2	0.1	-0.4
France	-0.3	0.0	-0.3
West Germany	0.4	0.6	-0.2
Italy	0.8	1.4	-0.6
Netherlands	0.6	0.4	0.2
Norway	-0.4	0.3	-0.6
Portugal	--	--	--
Spain	--	--	--
Sweden	0.5	0.2	0.3
UK	0.7	0.6	0.1
US	1.0	0.7	0.3

Source: Glyn (2001).

Consider the second and third columns of Table 3, which decompose the change in overall wage dispersion into changes in upper-half (9-5) and lower-half (5-1) dispersion. It turns out that most of the increase in overall wage dispersion arises from changes in its upper half. As pointed out by Atkinson (2003), the unified theory links technical change and globalization with reductions of relative wages in the lower half of wage distribution. We must conclude that there is more to trends in wage structures than implied by the unified theory.

In both the US and the EU, various studies have sought evidence in favour of capital accumulation and technical change as the mainsprings of the skill upgrading that occurred in manufacturing during the 1980s. New technologies, embodied or disembodied in the capital stock, are skill-biased, either because of technological requirements or because of induced internal organizational changes in firms. Many papers (including, for the US, Bound and Johnson,

1992; Berman *et al.*, 1994; and for several developed countries, Berman *et al.*, 1998; Machin and Van Reenen, 1998) document the rising relative employment of skilled workers within industries despite rising relative skilled wages. Various papers (Krueger, 1993; Berman *et al.*, 1994; Autor *et al.*, 1998) document the correlation between skill upgrading and measures of technological change such as computerization and expenditures on research and development. However, cross-country evidence suggests that the demand for skilled workers increased during the last twenty years much more than their supply in the US and the UK, but not in other countries (Layard and Nickell, 1999).

The other oft-mentioned driver of skill upgrading is the growth in international trade. Trade with countries having a comparative advantage in unskilled-labour-intensive production stimulates specialization in skill-intensive industries (between-industry effect). On the other hand, firms reorganize their activities by outsourcing to foreign countries (where labour is cheaper) the less skill-intensive tasks of production (a within-industry effect). The natural framework for analyzing the impact of trade on labour markets, at least from a maintained assumption of competitive markets, is the Stolper-Samuelson theorem and its various generalizations. Burfisher *et al.* (1994) find small effects for the US of liberalized trade with Mexico as a result of the North American Free Trade Agreement. Krugman *et al.* (1994) conclude that the effect of plausible levels of increased trade with developing countries on unskilled wages in developed nations is small (but negative), and is swamped by other, positive effects. Leamer (1998) and Feenstra and Hanson (1999) extend this framework to incorporate technological change. Leamer concludes that technological change dominated price changes in the 1980s, while the reverse was true for the 1970s. Feenstra and Hanson find that only under assumptions of exogenous commodity prices and exogenous sector-specific wage differentials does outsourcing play a substantial role in generating wage inequality.

The conclusion that the impact of globalization on the rising skill premium is negligible may, however, be sensitive to the competitive-markets assumption. Studies allowing for imperfect competition generally find that increased trade has played some role in the deterioration of the relative wage of unskilled labour (Gaston and Nelson, 2000). Globalization is thought to have reduced union density and the bargaining power of trade unions, leading to higher wage inequality (OECD, 1997). We will come back to this point in Section 3.

Finally, most studies of the effect of immigration on wage inequality have found extremely small effects. Borjas (1994) concludes that there is no evidence that immigrants have had an adverse impact on the earnings and employment of native workers. This conclusion has been subsequently upheld by Borjas *et al.* (1997) and Friedberg (2001).

A further distinctive point of the unified theory is that unemployment remained fairly low for high-skilled workers, while it increased considerably for less-skilled groups. Krugman (1995) points to the rise in relative unemployment rates for unskilled workers in Europe. However, Nickell and Bell (1995) examine trends in relative unemployment rates by quartile in skill distribution, and note that relative unemployment rates by skill show similar trends across industrialized countries and within the OECD. Further light on this issue can be shed by Table 4, where changes in the wage structure are considered in conjunction with changes in the *employment* distribution.

TABLE 4 - *Labour-market Inequality in the US and Selected European Countries; Annual Percentage Changes; 1979-2000*

	9 th decile/1 st decile of the wage distribution		4 th quartile/1 st quartile of the employment distribution	
	1980s	1990s	1980s	1990s
Austria	--	--	--	--
Belgium	--	--	--	--
Denmark	0.1	--	0.6	0.6
Finland	0.8	-1.3	0.5	0.9
France	0.3	-0.8	1.3	-0.4
West Germany	-0.6	0.9	0.6	0.6
Italy	-0.1	1.1	0.9	1.1
Netherlands	0.4	-0.6	0.4	-0.6
Norway	-0.4	--	0.5	0.5
Portugal	--	--	--	--
Spain	--	--	--	--
Sweden	0.3	1.3	-0.1	-0.6
UK	2.2	0.7	1.3	0.3
US	2.1	0.9	0.0	-0.2

Source: Glyn (2000).

If growing wage dispersion truly was the main influence upon the evolution of employment dispersion, there should be a negative

relationship between changes in wage and in employment inequality. However, no significant correlation between these two variables is found, casting considerable doubt on the unified theory argument that rising wage dispersion was the necessary price to pay for a high unskilled employment rate. This evidence is supported by the more detailed comparisons carried out in Card *et al.* (1999) and in Freeman and Schettkat (2001a). Thus, the unified theory does not provide a satisfactory explanation of trends in wage inequality and employment. In the following sections we consider in greater detail some of the factors most often mentioned in the literature as contributing to poor labour-market performance in Europe. We intend in this manner to probe more deeply into the alleged relationship between wage inequality and labour-market performance.

3. UNIONS AND WAGES

A sizeable empirical literature is consistent with the view that unions raise wages and, in most OECD countries, trade unions are highly relevant in wage negotiations. As shown in Layard and Nickell (1999, p. 3041, Table 7), even if union density (the percentage of workers who belong to a trade union) is very low, union coverage (the percentage of workers covered by a collective agreement) can be substantial. For instance, in France and Spain most workers have their wages set by union agreements despite very low union density because, customarily, firms grant to non-union members the same contract terms obtained by union members, or because laws extend union wages to non-unionized firms and workers.

The supply-side-oriented macroeconomic literature of the 1980s and the 1990s (Bruno and Sachs, 1985; Layard *et al.*, 1991) has made clear that a very important aspect of collective wage agreements is the extent to which unions and/or firms coordinate their actions. Coordination is distinct from centralization, which strictly identifies the most dominant level at which wages are negotiated: plant, firm, industry, or economy. Obviously, nationwide wage agreements must be highly coordinated, but highly coordinated bargaining need not be centralized. For example, in Germany and Japan employers' associations are deeply involved in preparing and organizing wage negotiations even when these negotiations ostensibly occur at the firm level. There are well-known and established country rankings of bargaining coordination and centralization (Layard and Nickell, 1999, p. 3041, Table 7, provide various indices of union and

employers' coordination). Clear cross-country patterns do emerge: the Scandinavian countries and Austria have the most coordinated and centralized systems, followed by continental Europe and Japan. By contrast, the Anglo-American system is largely non-coordinated.

There is abundant evidence that the extent of coordination or centralization in bargaining has an impact on the relationship between unions and wages. Wages set nationwide are more responsive to variations in aggregate labour-market conditions if wage agreements are highly coordinated (Layard *et al.*, 1991, Ch. 9, Table 7). Similar evidence can be gleaned from OECD (1997, Ch. 3), Layard and Nickell (1999, pp. 3053, 3067), and Belot and Van Ours (2004). It also turns out that coordinated bargaining tends to be unstable in absence of supporting institutions (such as the local employers' federations in Germany) or strong competitive pressures in the product market. This is substantially in agreement with the results from Stewart (1990), Abowd and Lemieux (1993), and Nickell *et al.* (1994), suggesting that greater competition in the product market lowers the union-wage premium⁴.

On the other hand, if wage agreements are less coordinated or less centralized, firm or industry wages are more responsive to specific shocks (Layard *et al.*, 1991, Ch. 4, Table 4). It follows that highly coordinated or centralized wage agreements may compress the distribution of wages too much relative to the distribution of skills (OECD, 1997, Ch. 3, Table 3.B.1). In this context, there is little doubt that wages are relatively more compressed in continental Europe, even within education levels. However, as already pointed out in Section 2, there is no convincing evidence that rising unemployment in Europe was brought about by greater wage rigidity in the face of a shift in demand towards skilled labour. A possible answer to this puzzle is that observable measures of education are not appropriate, and that the wage distribution follows the true skill distribution. The available evidence is not however fully consistent with this interpretation (Devroye and Freeman, 2001). It may be that our understanding of the relationships between wage inequality and unemployment is still incomplete. For example, Acemoglu and Pischke (1998) and Agell (1999) suggest that, in the presence of market failures, a more compressed wage structure is conducive to *lower* unemployment.

Summing up the weight of the empirical evidence on these

⁴ See however Checchi and Lucifora (2002) for evidence that deregulation in product markets does not lead to lower union membership across Europe.

matters is not easy. However, a recent and complete survey (Aidt and Tzannatos, 2002, Ch. 5) concludes that, on the whole, coordinated bargaining provides better macroeconomic outcomes than decentralized bargaining. This is consistent with the results from wage equations estimated over recent samples, according to which real-wage flexibility is highest in continental Europe (Cadiou *et al.*, 1999; Peeters and Den Reijer, 2003). In fact these results even suggest that a significant *increase* in the degree of real-wage flexibility has taken place in countries (among which Italy and the Netherlands) where the use of incomes policies contributed to raise bargaining coordination. It thus appears that strong unions, when in conjunction with coordinated bargaining, can achieve a satisfactory labour-market performance with a stable wage structure. In this sense, the spontaneous move toward decentralization that has been characterizing European industrial relations in the last decade (Calmfors, 2001) should be evaluated with care. Channelling this evolution within the bounds of economy-wide coordinated bargaining seems a noteworthy policy priority. Two-tier systems such as the Swedish framework are interesting examples in this respect (Dell’Aringa, 2005).

4. SOCIAL-SAFETY NETS AND TAXES

Welfare states have undergone a thorough reform in most OECD countries. Most countries have reduced the funding of passive labour-market policies. Also, unemployment benefits have been increasingly linked to participation in training programmes and, to a lesser extent, in mechanisms encouraging active job search during the period of benefit erogation. Moreover, the labour supply has been incentivated through fiscal incentives, for instance through the introduction of in-work credits.

Typically, in the US the Temporary Assistance to Needy Families programme replaced the Aid to Families with Dependent Children in 1996, thereby virtually eliminating lifetime entitlements to cash assistance for employable nonworking adults⁵. Other notable changes in the US included the expansion in the early 1990s of the Earned Income Tax Credit, a refundable tax credit operating through the federal tax system subsidising low-wage workers in

⁵ Even before 1996 many welfare reforms (time limitations, work requirements, etc.) that ultimately became part of federal law had already been introduced by a number of individual US states.

low-income families. Following suit, many other OECD countries introduced stricter entitlement tests for unemployment benefits and employment-friendly fiscal incentives, in particular in-work credits. These credits can be linked either to the number of hours worked or to the amount of labour income gained (the latter is especially used if data on working hours are not reliable). The experience of welfare-to-work programmes in Northern European countries, assessed in de Koning *et al.* (2004), is particularly relevant as far as shortening of entitlement periods and stricter entitlement tests are concerned. However, in Nordic countries (as opposed to the UK), this experience has not dented a commitment to income equality, which has been enacted not only through the fiscal system, but also through active labour-market policies and generous unemployment benefits (Fischer and Matthiessen, 2005).

The expenditure on active labour market policies (ALMPs) is considerably greater in Europe than in the US. In Europe this expenditure has actually increased since the early 1990s, reaching on average 1% of GDP (it was around 0.8% previously). In the US, on the other hand, expenditure has been constant at much lower levels (0.2% of GDP). In the field of ALMPs there is also a qualitative difference between Europe and the US. In Europe ALMPs are more geared to the rise of employment, while in the US their main aim is to improve the wage of treated workers (Kluve and Schmidt, 2002).

A key point of the reforms of welfare states relates to the tax system. Following the tax reforms in the UK and the US⁶ in the 1980s a number of OECD countries introduced tax cuts in the corporate income tax on the marginal rates for high-wage income individuals. Particularly incisive reforms of corporate taxes have been adopted in Austria, Belgium, Canada, Finland and Germany. Until the mid-1980s, the highest personal income marginal rate was frequently above 65% in the OECD, while currently it is around 50% (Owens, 2006) for most countries and in any case not above 59% even in countries with a strong welfare state tradition (Denmark, Norway, Sweden, Netherlands). These reductions have also been enacted in very recent years. Thus marginal tax rates for high-wage income

⁶ In the US, the highest personal income marginal rate was lowered to 50 percent (from 70 percent) during the 1980 Reagan administration through the Economic and Recovery Tax Act, then to 28 percent in 1988 through the Tax Reform Act. It went back to 31 percent in 1991 and to 39.6 percent in 1993. The Omnibus Budget Reconciliation Act. In 2003 was lowered again to 35 percent. In the UK the highest rate was lowered in 1979 from 98 to 75 percent. In 1988 it was reduced again (to 40 percent) and has not been changed since then.

individuals were reduced by 2.9 percentage points in the EU15, and by more than 5 percentage points in Belgium, France, Greece, the Netherlands and the US, between 2000 and 2003 (Sweden was the only country where these rates were slightly increased). Similarly, in the OECD area, the average corporate tax rate dropped by almost 7 percentage points between 1997 and 2003 (OECD, 2004).

Hiring-related tax credits (wage subsidies) to private employers are in principle a relatively flexible and efficient method to improve the earnings and employment of the less-skilled. Programmes of this kind in the US included the Welfare to Work Tax Credit, the Work Opportunities Tax Credit, and the Targeted Jobs Tax Credit. In contrast to the Earned Income Tax Credit, wage subsidies are often considered to have been a failure because of low take-up rates by firms who viewed the eligible potential workers as unproductive. Katz (1998) concludes that in any case more broadly targeted subsidies are more effective than stand-alone wage subsidies highly targeted on very specific groups. He also finds that policies using an intermediary (e.g. a public employment agency or not-for profit organization) which combine job development, job search assistance, training and wage subsidies appear more successful for targeting specific disadvantaged groups.

Several recent studies (including Prescott, 2004) argue that higher European income and payroll tax rates help explain why hours of work are significantly lower in Europe. However, the bulk of the empirical labour-supply literature suggests that tax rates can explain only a small part of this difference (Alesina *et al.*, 2005). In Europe, an influential study by Daveri and Tabellini (2000) found that virtually all the rise in European equilibrium unemployment rates was to be ascribed to increasing payroll taxes. But according to Layard and Nickell (1999), a reasonable estimate would imply that a 5% reduction in the tax wedge (including income, consumption and payroll taxes) lowers the unemployment rate from 8% to 7%. Nickell (2003) concludes that there is considerable uncertainty about the impact of these taxes on unemployment, as lower taxes (as well as weaker employment protection) are unlikely to bring about sizeable reductions in the unemployment rate, especially if coordinated wage bargaining reduces real-wage resistance.

5. GOOD JOBS AND BAD JOBS?

During the last two decades employment protection legislation has been extensively modified in most European countries. However this is

not so much true within regular employment (see Table 5a) as in the field of temporary employment and fixed-term contracts (see Table 5b). As a consequence, reforms in employment flexibility have mostly consisted in favouring the development of non-standard forms of employment.

TABLE 5A - *Strictness of Employment Protection Legislation:
Regular Employment*

	Late 1980s	Late 1990s	2003
Austria	2.9	2.9	2.4
Belgium	1.7	1.7	1.7
Denmark	1.5	1.5	1.5
Finland	2.8	2.3	2.2
France	2.3	2.3	2.5
Germany	2.6	2.7	2.7
Italy	1.8	1.8	1.8
Netherlands	3.1	3.1	3.1
Norway	2.3	2.3	2.3
Portugal	4.8	4.3	4.3
Spain	3.9	2.6	2.6
Sweden	2.9	2.9	2.9
UK	0.9	0.9	1.1
US	0.2	0.2	0.2

Source: OECD (2002).

TABLE 5B - *Strictness of Employment Protection Legislation:
Temporary Employment*

	Late 1980s	Late 1990s	2003
Austria	1.5	1.5	1.5
Belgium	4.6	2.6	2.6
Denmark	3.1	1.4	1.4
Finland	1.9	1.9	1.9
France	3.1	3.6	3.6
Germany	3.8	2.3	1.8
Italy	5.4	3.6	2.1
Netherlands	2.4	1.2	1.2
Norway	3.5	3.1	2.9
Portugal	3.4	3.0	2.8
Spain	3.8	3.3	3.5
Sweden	4.1	1.6	1.6
UK	0.3	0.3	0.4
US	0.3	0.3	0.3

Source: OECD (2002).

At any rate, while the share of non-standard employment has generally increased, OECD countries still differ considerably in their share of non-standard jobs over total employment. A strong rising trend between 1985 and 2000 was observed for some European countries, such as France, Italy, the Netherlands, Portugal, and Spain. However, many other countries show no clear trend. Non-standard jobs are disproportionately held by younger and less-educated workers, and are more easily found in low-skill occupations, agriculture, and small firms. Women are overrepresented among non-standard workers, but gender differences are seldom large.

Generally speaking, empirical support for an impact of strict labour-market regulations on aggregate labour-market performance appears to be weak. Since employment protection legislation reduces both job destruction and job creation, the relation between protection and unemployment is theoretically ambiguous. The existing evidence (OECD, 2002; 2004) suggests that stricter employment protection does not raise aggregate unemployment, while increasing the duration of unemployment and reducing worker turnover. There is some evidence that employment protection legislation lowers employment rates for young people and women, while increasing them for prime-age men. These relationships however fade away when allowance is made for various control variables. The same reasoning applies for temporary jobs, whose development equally favours both job creation and job destruction (Cahuc and Postel-Vinay, 2002). There is no consistent evidence either of an association between aggregate employment rates and the incidence of part-time work (Garibaldi *et al.*, 2002).

The above considerations cannot exhaust the appraisal of the rise in non-standard employment. To some extent, this trend reflects households' and employers' demand for flexible working patterns. For instance, part-time and temporary jobs give workers better opportunities for combining work with other activities, including education and care-giving. Furthermore, non-standard jobs may allow employers to adjust better to changes in market conditions. On the other hand, the expansion in non-standard jobs has raised concerns about growing labour-market segmentation and dualism (Cahuc and Postel-Vinay, 2002; Destefanis and Fonseca, 2007).

Temporary jobs do not imply a wage penalty, at least in continental Europe. There is however evidence that temporary workers receive fewer fringe benefits than permanent workers in countries where these benefits are provided by employers on a voluntary basis (Australia, Canada, and the US). In the UK, there are often waiting periods

before newly hired employees can join an employer-provided pension plan, as well as minimum contribution periods (vesting times) which can be as long as two years.

The evidence for European countries (OECD, 2002) suggests that the majority of temporary workers have considerable continuity in employment, being employed one year earlier and remaining employed one and two years later. Depending on the country considered, between one-third and two-thirds of temporary workers move into a permanent job within a two-year time interval, suggesting considerable upward mobility. Yet, up to one-fourth of temporary workers are unemployed when interviewed one and two years later, and employers provide significantly less training to temporary workers than to permanent workers. Temporary workers who are more educated have a significantly better chance of receiving training and moving into permanent jobs than do less educated temporary workers.

Part-time jobs also elicit concerns of marginalising workers, especially women, in jobs characterized by poor wages and benefits, low tenure, and absence of training opportunities. The wage gap between female part-time and full-time workers is largest in English-speaking countries (Pissarides *et al.*, 2005), and part-time work often entails low social security coverage, especially in Southern European countries and in the UK. Furthermore, O'Reilly and Bothfeld (2002) find that in the UK and Germany only a small number of women are able to use part-time work as a bridge to a full-time job. A substantial percentage drop out of employment, especially mothers of more than one child. On the other hand, Farber (1999) concludes, from evidence on labour-market transitions in the US, that part-time employment is often part of the transition out of unemployment, leading to regular full-time employment in the future. In a number of countries, a large percentage of women work part-time because of family responsibilities, including child- and elder-care. The possibility of finding a part-time job may be crucial to labour-force participation under such circumstances. However, preferences may also be shaped by current policies (Del Boca, 2002). For example, a lack of affordable child-care or subsidized parental leave make full-time work difficult and therefore part-time work is a more attractive option. In these cases, more supportive policies may increase female work participation.

6. BEYOND THE LABOUR MARKET

In order to fully account for diverging labour-market trends, we surmise that structural and institutional differences between the US

and Europe should also be evaluated outside the labour market. This leads us to examine the role of industrial structure and the housing sector.

Job prospects in industries that are more open to international competition, such as manufacturing, are lowered by import penetration and by foreign outsourcing of domestic firms. In contrast, competitive, export-oriented sectors and industries with high national self-reliance have better employment prospects. Services generally are less open to international competition, and this has contributed strongly to their faster employment growth. Moreover, growth opportunities are higher in countries where new, fast-growing sectors in both manufacturing and services are more important (Wood, 1994; Vivarelli and Pianta, 1998).

Naturally, the key question is what has stopped the reallocation of labour from declining to growing industries in EU countries? In this regard, it is interesting to consider the arguments by Hopenhayn and Rogerson (1993), Bertola (1994), and Saint-Paul (2002). According to these authors, strict employment protection laws either slow down labour reallocation from declining to expanding sectors or they encourage specialization in the production of declining-sector goods. Yet, as pointed out by Layard and Nickell (1999, p. 3063), these arguments apply only to the closure of old plants and the opening of new ones since, by merely relying on quits, continuing firms can reduce employment by up to 10% per annum. Moreover, although these arguments may carry some weight, they do not address the structural differences between Europe and the US in the relative growth of the service sector.

An arguably more promising route focuses on economy-wide (screening procedures, tax-related requirements for start-ups) and sectoral (zoning laws or restrictions on shop-opening hours) regulations. The stringency of entry regulations appears to be negatively associated with employment rates (Nicoletti *et al.*, 2001) and entrepreneurial activity (Fonseca *et al.*, 2001) across OECD countries. At the sectoral level, Bertrand and Kramarz (2002) find that entry regulation hinders job creation in the French retail sector.

In the presence of economy-wide entry regulations, the market price of services and rents in the economy increase, triggering a reduction in the labour supply. This provides a rationale for the negative association between product-market regulations and the employment rate found in the literature, and is also consistent with the gap in marketisation of service activities between the US and European economies found by Freeman and Schettkat

(2001b). Accordingly, European households respond to tighter entry regulations by substituting away from the purchase of services in the market (child-care, home repairs and leisure activities) and towards home production while Americans, facing lower service prices, supply more hours of work purchasing equivalent services in the market. The simulations in Messina (2005a) show that economy-wide regulatory barriers to entry obstruct the natural pattern of structural change, hindering the development of those sectors whose demand is income elastic. Thus, countries with tighter restrictions on entry are expected to have a relatively underdeveloped service sector. This negative relationship persists even after controlling for a wide range of factors which might also shape cross-country differences in industrial structure (Messina, 2005b).

It could be asked whether a rise in wage inequality is, effectively, a prerequisite for an increase in service employment. Iversen and Wren (1998) suggest that equality is likely to reduce employment growth in private consumer-oriented services, because productivity in these industries is low and slow-growing. Iversen and Wren find some empirical support for this proposition, but neither Kenworthy (2003) nor Messina (2005b) are able to fully replicate these results. They find either weak or insignificant effects for wage inequality, once other explanatory variables are included in the estimates.

Barriers to geographical mobility are clearly an obstacle to the efficient functioning of the labour market. Layard and Nickell (1999, Table 13, p. 3047) provide convincing *prima facie* evidence that geographical mobility is lowest in southern Europe and highest in the US and the Scandinavian countries. Bover *et al.* (1989) emphasize the importance of regional house-price differentials for labour mobility in the UK. In addition, Jackman and Savouri (1992) provide evidence for an impact of relative house prices on UK inter-regional migration. Focusing on regional migration in Spain, Antolin and Bover (1997) examine house-price differentials as an explanation of mobility choices, apart from demographic characteristics, unemployment status, and wages. Finally, Cannari *et al.* (2000) argue that the cost of housing is likely to represent an important disincentive to move and, to a considerable extent, accounts for the puzzling evidence of falling mobility levels in Italy. Furthermore, the propensity to move may be lower for homeowners, who have to liquidate their housing assets in a given locality to buy a new house elsewhere, thus facing sizeable transaction costs. Oswald (1997) suggests that home ownership is an important barrier to geographical mobility, as rented accommodations involve much lower transactions costs.

If owning a house reduces geographical mobility, the consequences for the labour market of secularly rising home-ownership could be profound. Could the rise in homeownership be part of the high European unemployment story? Levels of homeownership and unemployment rates are surprisingly highly correlated across countries and throughout time. Moreover, countries with the fastest growth in homeownership had the most rapid growth in unemployment (Oswald, 1997). Most industrialized countries have recently experienced substantial growth in homeownership. Two exceptions are Switzerland and the US. These two countries also have had almost no long-run change in their unemployment rates. Moreover, Greece, and Spain currently have the highest rates of owner-occupied housing in the OECD. They also have very high unemployment rates. This relationship appears to hold in quite different circumstances and for many places. Oswald (1997) reports evidence favourable to this hypothesis for a panel of OECD countries and for the US states, as well as slightly weaker evidence for regions of the Netherlands, Belgium and West Germany. Supportive evidence is also reported by Belot and Van Ours (2004), who carry out an empirical analysis for a panel of OECD countries.

Hence, empirical evidence suggests that rising homeownership and the decline of the private rental housing sector are an important part of the explanation for differences in the industrialized nations' unemployment rates. As a consequence, a rekindling of the private rental housing sector could be an important component of any package of anti-unemployment policies. The US experience also suggests that the development of a secondary mortgage market could be helpful in this ambit.

7. THE ROLE OF CSR

In the early 1990s a theory centred on labour-market rigidities in Europe emerged to explain both the increase in US wage inequality and the rise in European unemployment. After more than ten years, it turns out that matters are not so simple, the trade-off between wage inequality and labour-market performance proving to be rather elusive. Although unions have mattered a lot in the past, their role appears now to have been reduced, which could explain at least some of the cross-country trends in wage inequality. Furthermore, there is evidence that coordinated bargaining helps to achieve a better labour-market performance, partly in conjunction with strong unions

and a stable wage structure. Empirical evidence also reveals that there are strong interactions between labour-market performance and welfare reforms. Properly designed welfare-to-work policies have been able to deliver more jobs without large wage penalties, both in Nordic countries and in the US. On the other hand, the development of non-standard jobs does not appear to have had a significant impact on aggregate labour-market performance, while eliciting some concern in terms of insufficient mobility and the lack of proper pension treatment for non-standard workers⁷. Additionally, part-time work creates some risks of marginalisation and should be complemented by policies encouraging more affordable child-care and less costly parental leave as a means of easing the trade-off between paid employment and family care. On the other hand, industrial composition matters for labour-market performance, and is likely to respond favourably to reduced product-market regulation. Moreover, there is only weak evidence for a positive relationship between pay inequality and size of the service sector. Finally, the structure of the housing market has a strong impact on the geographical mobility of labour, and policies that foster homeownership tendentially lower the mobility of labour and increase unemployment. The US experience suggests however that the development of a secondary mortgage market could help sever the link between home-ownership and low labour mobility.

Given the above discussion, what are the channels through which socially responsible firms are likely to promote a fair and stable wage structure without hurting their own workers' employment prospects? The key point seems that in countries where wage negotiations are decentralized, firms innovate and demand skilled labour by hiring adequately skilled workers on the labour market. Conversely, in centralized or coordinated wage bargaining systems, wages are more compressed and even though firms find it more difficult to attract skilled workers from outside, they gain from training their own workers. In such a situation, it also pays to promote coordination among employers and close inter-firm practices banning worker poaching (Blinder and Krueger, 1996; Casper *et al.*, 1999).

When considering the social advantages of firm-provided training, it is also important to keep in mind the results obtained by Hotz *et al.* (2000) on the long-run links between investment in human capital and

⁷ Anecdotal evidence also suggests that in Europe these workers might find it difficult to get bank loans or mortgages.

workers' employment prospects. Similarly, investment in human capital seems of crucial importance if firms want to contribute to improving the employment prospects of temporary and part-time workers.

Coordination among employers and firm-provided training, while arguably self-financing in the long run, may be a costly short-run option⁸. Citizens and institutions interested in the promotion of these activities may thus be wise to direct some extra resources toward socially responsible firms acting through these channels. In continental Europe, socially responsible investors acting through the stock exchange are not likely to command enough resources. Institutional investors, such as unions or newly developed pension funds, must be brought into the picture, and likewise banking institutions such as the *Banca Etica* in Italy. This raises a delicate problem. While it may be safe to assume that the stock exchange will be committed to ensuring a best-practice screening of projects, support given to firms through other channels may incur problems of low additional impact and efficiency. Third-party rating may be needed at this point. In this sense, the success stories of rating agencies such as the Vigeo Group, providing evaluation of CSR projects to listed and non-listed companies, are indeed a very important development.

A further (perhaps broader) point must still be made. Atkinson (2003), Piketty and Saez (2003), maintain that the evolution of wage inequality in the OECD owes much to a change in the value system prevailing in some countries (in particular the US), that made extremely high executive pay socially acceptable. A paramount role in this respect was taken by corporate governance. Canada, Britain and the US, all countries with shareholder-value models of governance, saw top income shares increase substantially over the past twenty-five years. On the other hand, top income shares have barely changed since 1980 in continental Europe and Japan, which continue to embrace some form of stakeholder governance (Saez, 2006).

⁸ A related point is made in Lynch and Nickell (2001), who maintain that firms may refrain from the adoption of new ('Toyotist') workplace practices because of their cost. We note in passing that while there is a close relation between firm-provided training and new workplace organisation, the two phenomena are not the same thing. Lynch and Nickell (2001) argue that, to some extent, the existence of a well trained workforce is propedeutic to the introduction of new workplace practices. It may also be worth pointing out that Black *et al.* (2004) find that new workplace practices have an ambiguous impact on wage equality.

The success of the shareholder-value models of governance has many causes: the slow growth, low competitiveness and profitability, and high-profile bankruptcies of the 1970s; the battles for corporate control that dominated the 1980s; and the activism of institutional investors in the 1990s. Meeting investor demand for higher returns entailed not only resource reallocation but also a redistribution of risk. Over the past twenty years, companies have shifted more of the risk burden that they had carried during the postwar decades onto employees' shoulders. Still, while risk has risen and has been shifted to employees, most of them have not shared in the returns associated with greater risk.

But what has been the actual impact of the shareholder-value model on corporate performance? Already Whitman (1999) argued that, while successful, this model could not be viable in the long run without making health insurance more portable and allocating more resources for job training in new technologies. Assessment of the shareholder-value model has since then become more critical. Take three of its pillars: mergers and acquisitions, downsizing and executive pay. Henry and Jespersen (2002) show that most M&As throughout 1995-2001 resulted in a *reduction* in share prices several years after the acquisition. As for downsizing, Baumol *et al.* (2003) find that in the 1980s and 1990s it boosted profits – and executive pay – but not productivity. Finally, Daily and Dalton (1998), Bebchuk and Fried (2004) show that the other basic elements of shareholder-value governance – independent boards, small boards of directors, use of stock options – are not associated with better corporate performance.

Following these considerations, many investors, including the influential CalPERS, are now beginning to think that the shareholder-value model's virtues were oversold. Accordingly, they are taking a stance against cronyism on corporate boards, emphasis on stock options and quarterly results, and in favour of socially responsible investing. This change of approach could push shareholder-value oriented corporate governance towards a more balanced system, fully recognising that stakeholders do not include only shareholders but also employees and other categories. Favouring this change of orientation is likely to have an important impact on wage equality, perhaps as important as the diffusion of firm-provided training schemes.

8. CONCLUDING REMARKS

In the Introduction we noted that more intervention through CSR on income inequality may be desirable, as the typical public

interventions in this sphere (redistributive taxation or income transfers) are likely to incur in deadweight losses or produce unintended consequences. We conclude by pointing out that our survey has revealed various areas in which there may be more intervention on labour income inequality either by government or by a combination of government and other actors, without the consequences singled out above. These areas obviously include education, training, and the design of appropriate welfare-to-work policies. However, they also include reducing product-market regulation, encouraging more affordable child-care and less costly parental leave, fostering territorial mobility through the development of a secondary mortgage market. Especially in the last two areas, socially responsible firms may collaborate with government and other institutions and help to achieve a better employment performance alongside with a stable wage structure.

The role of CSR with respect to wages and employment must always be seen, however, within the field of 'socially responsible business' and not be limited to some policies of cooperation with institutions and local or national governments. This is so both because CSR is a business strategy regarding the involvement of all stakeholders (with their legitimate expectations), and because a 'work-responsible' policy also includes actions and choices that go beyond the issue of wages and employment in its strictest sense (think of the climate of workplace relations and the role of human values in it).

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ABSTRACT

In this paper we assess the scope for corporate social responsibility (CSR) within the area of wage inequality. We begin by noting that the salient trends in wage structures and employment across European and US labour markets are more complicated than implied by the so-called 'unified theory'. This leads us to examine in detail the factors mentioned in the literature as contributing to poor labour-market performance in Europe. We find that (a) strong unions, a factor often believed to bring about wage compression and poor labour-market performance, are not necessarily associated with the latter when bargaining is sufficiently coordinated; (b) successful welfare reforms can bring about considerable improvements in performance without significant impact on inequality; (c) territorial mobility and child-care policies may considerably increase work participation, especially among women. We conclude that there is room for CSR to affect wage inequality, especially through firm-provided training.

Keywords: Wage Inequality, Labour-market Institutions, Corporate Social Responsibility

JEL Classification: C24, J64, J69

RIASSUNTO

*Disuguaglianza salariale e performance del mercato del lavoro.
Un ruolo per la responsabilità sociale di impresa?*

In questo lavoro si valuta il possibile ruolo della responsabilità sociale di impresa nell'ambito delle disuguaglianze salariali. Dopo aver rilevato che le tendenze salienti di salari e occupazione in Europa e Stati Uniti sono più complesse di quelle implicite nella cosiddetta 'teoria unificata', vengono esaminati in dettaglio i fattori a cui la letteratura attribuisce la cattiva performance del mercato del lavoro in Europa. Da questa disamina scaturisce che (a) il potere sindacale, spesso ritenuto fonte di compressione salariale e cattiva performance del mercato del lavoro, non è necessariamente connesso con quest'ultima, in presenza di contrattazione salariale sufficientemente coordinata; (b) appropriate riforme del sistema di welfare possono portare a migliori performance del mercato del lavoro senza un impatto significativo sulla disuguaglianza; (c) le politiche per l'infanzia, nonché una maggiore mobilità territoriale, aumentano notevolmente il tasso di attività, soprattutto tra le donne.

Si conclude che vi è spazio per la responsabilità sociale di impresa nella riduzione delle disuguaglianze salariali, in particolare attraverso una maggiore formazione professionale fornita dalle imprese.