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5 The Changing Structure of Male Earnings in Britain, 1974–1988

John Schmitt

While many of the changes in the U.S. wage structure during the 1970s and 1980s have been well documented (see, e.g., Blackburn, Bloom, and Freeman 1991; Blackburn and Bloom 1987; Bluestone 1990; Bluestone and Harrison 1988; Bound and Johnson 1989; Juhn, Murphy, and Pierce 1989; Katz and Murphy 1992; Katz and Revenga 1989; and Murphy and Welch 1992), little comparable work exists for Britain.[1] This paper uses data on male, full-time employees from the annual General Household Survey (GHS) to examine developments in the British wage structure during the period 1974–88.

The GHS data indicate that the British wage structure was far from stable during the 1970s and 1980s. Earnings inequality fell slightly during the 1970s, only to rise rapidly in the 1980s. Returns to labor market skills such as education and experience declined dramatically in the 1970s and then recovered in

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1. Three other papers address some of the issues discussed here. Moghadam (1990) examines changes in the returns to education in a much broader analysis of wage determination using data from the Family Expenditure Survey for the years 1978–85. Katz, Loveman, and Blanchflower (chap. 1 in this volume) compare changes in the wage structure in four OECD countries using published data from the New Earnings Survey (NES) and micro data from the General Household Survey for their discussion of the United Kingdom. Bell, Rimmer, and Rimmer (1992) examine the role of age in overall wage inequality among full-time male employees using micro data from the NES.

the 1980s, although not always enough to compensate the earlier losses. Meanwhile, earnings for low-skilled workers increased in real terms over the entire period 1974–88.

The increases in earnings inequality and returns to skills during the 1980s parallel developments in the United States. However, the decline in British earnings inequality and skill differentials through the end of the 1970s—particularly the real earnings successes of low-skilled British workers over both decades—stands in strong contrast to the U.S. experience.

This paper documents some of the key developments of the British wage structure sketched above. It also attempts to explain these changes in the context of a simple relative supply and demand framework that takes into account the role of labor market institutions. It seeks to use the similarities and differences between the United States and Britain to shed light on the forces producing the upheavals in the wage structures of both countries.

The main conclusion is that a simple supply and demand analysis can plausibly explain most of the developments in the British wage structure during the 1970s and 1980s. A large rise in the relative supply of skilled labor during the 1970s drove skill differentials down and indirectly contributed to wage compression. In the 1980s, a large rise in the relative demand for skilled labor forced skill differentials and earnings inequality up despite continued strong growth in the supply of skilled labor. The GHS evidence, however, lends little support to the idea that the cause of the increasing relative demand for skills was a decline in the manufacturing sector in favor of services. Instead, it seems that technological or work-organization-related changes *within* industrial sectors were more likely to be driving the increase in demand for skilled workers.

Labor market institutions, which moderate the workings of the market to a much greater degree in Britain than in the United States, may play an important role in explaining the differences between the two countries. In the United States, low-skilled workers saw absolute declines in real earnings with only moderate rises in relative unemployment; in Britain, the low skilled experienced increases in real earnings and much higher unemployment rates. In the context of a supply and demand model, both countries may have faced the same shift in relative demand. The "free market" in the United States led workers to a "low-wage, high-employment" outcome, while British labor market institutions, particularly trade unions, may have allowed workers to "choose" a "high-pay, low-employment" point on the same relative demand curve. The relative strength of British trade unions, wages councils, and incomes policies may also have delayed the onset of the rise in wage inequality in Britain, relative to the United States.

5.1 The Data

The principle source of data is the annual General Household Survey (GHS) for the years 1974–88. The GHS is a survey of between ten and twelve thou-

sand households in England, Scotland, and Wales conducted continuously throughout the year. It provides detailed, nationally representative information on individuals. Throughout this paper, I analyze a subsample of the GHS comprising males aged sixteen (the legal minimum age for leaving school) to sixty-four (the retirement age for males).[2]

The wage variable is the log of weekly earnings for full-time employees deflated using the appropriate monthly retail price index (RPI) with January 1974 as the base. The questions used to calculate weekly earnings underwent some change between the periods 1974–78 and 1979–88. For the years 1974–78, weekly earnings were derived from all earnings including wages, salaries, tips, bonuses, and commissions in all jobs held in the previous twelve months. To calculate weekly earnings, I divided these total earnings by total weeks worked in the previous twelve months. In the 1979–88 surveys, weekly earnings were estimated as the usual gross earnings including tips and bonuses per pay period from the worker's main job, divided by the usual number of weeks covered in each pay period. These changes may affect comparisons of earnings between the two periods, but no discontinuity is evident, and the GHS weekly earnings data appear to be consistent with data from the New Earnings Survey (NES). Unfortunately, no hourly wage series is available owing to substantial changes in work hours information collected after 1983.

The education variables are based on the highest educational qualification earned by the respondent. The use of qualification-based variables offers two advantages over education measures based on years of schooling. First, the qualification variables outperform years variables in standard human capital equations (see Schmitt 1991). Second, the value of different types of qualifications, particularly vocational as opposed to academic qualifications, may shed more light on the workings of the supply and demand for skills than an undifferentiated years variable.

A complete list and brief description of the education variables appears in table 5.1. The large number of categories reflects the relatively complicated structure of British educational qualifications. All British children must attend full-time education until the age of sixteen, at which point a large portion of them leave school.[3] Those who leave school without earning a qualification join the "no qualifications" (NO QUAL) group. This is by far the largest group in the sample, comprising approximately 54 percent of the male labor force in 1974 and 32 percent in 1988.

2. For a detailed description of the GHS, see the annual reports on the GHS published by the Office of Population and Census Surveys. For a detailed description of variables used in this paper, see Schmitt (1992).

3. The school-leaving age was fourteen until 1946 and then fifteen until 1972. This may present some problems with interpretation of the data since the lowest-skilled group does not have a uniform absolute number of years of schooling over time. However, I find no difference in the basic results on skills premiums and earnings dispersion when I conduct the work reported here on a fixed membership subsample defined by year of birth. This cohort approach keeps the composition of absolute years of schooling constant for the group with no qualifications (see Schmitt 1991).

Those who earn qualifications, broadly speaking, follow either a vocational or an academic track. Workers generally earn vocational qualifications while they work, through apprenticeship schemes, part-time study, or relatively short periods of full-time study "sandwiched" between spells of employment, often with the same employer. The vocational qualifications increase in skill from miscellaneous, relatively low-skilled apprenticeships (VOC-OTHER) through incremented, nationally recognized apprenticeships (VOC-LOW, VOC-MIDDLE, and VOC-HIGH). The highest-level vocational qualifications can involve some instruction at what in the United States would be the college level. Some of the qualifications in table 5.1 usually facilitate entry into female-dominated occupations such as teaching, nursing, and clerical jobs (CLERICAL, O-LEV&CLER, NURSING, TEACHING). Few men earn these qualifications.

Schoolchildren following the "academic track" prepare for and take a series of national tests by academic subject. Passing grades on these exams, generally taken at around age sixteen, lead to qualifications that would place individuals in the OTHER, O-LEVEL 1–4, O-LEV&CLER, and O-LEVEL 5+ categories. The "ordinary-level" examination categories distinguish between students who pass between one and four examinations and those who attempt and pass five or more. The distinction is important for some employers and for further study. After "O-levels," some students (usually at around age eighteen) take further national examinations at the "advanced level." For some students, "A-levels" are a terminal qualification; for others, they are only a prerequisite for university admission. The UNIVERSITY category here includes all students who successfully complete the standard three-year university course as well as those who study further. The group with university qualifications represents about 5 percent of the total male labor force in 1974, rising to approximately 11 percent by 1988.

The other principal human capital variable (EXP) measures potential labor market experience, defined in the standard way as age minus age left full-time education.[4] The GHS contains no measure of actual labor market experience, but limiting the sample to males aged sixteen to sixty-four should reduce some of the difficulties associated with using potential rather than actual experience.

A significant drawback of the GHS data is the poor information on workers' industry characteristics. From 1974 to 1980, the GHS reports twenty-four consistent industry classifications. From 1981 to 1988, the industry classification

4. The determination of years of full-time education is problematic. The GHS asks respondents their age when they last left full-time education, not the total number of years of full-time education. Each of the fifteen surveys has several hundred (of four to six thousand valid male) respondents who report leaving their last period of full-time education after the age of thirty. The experience definition here assumes that anyone leaving full-time education after twenty-seven has not studied continuously. In these cases, years of schooling is calculated as age minus age left secondary school plus 3.

Table 5.1 Education Qualification Variables

Variable	Description
UNIVERSITY	UNIVERSITY: Higher degree (Census Level A), first degree, university diploma or certificate, qualifications obtained from colleges of further education or from professional institutions of degree standard (Census Level B)
VOC-HIGH	HIGHEST VOCATIONAL: Higher National Certificate (HNC) or Diploma (HND), BEC/TEC Higher Certificate or Higher Diploma, City and Guilds Full Technological Certificate, qualifications obtained from colleges of further education or from professional institutions below degree level but above GCE A-level standard
TEACHING	TEACHING: Nongraduate teaching qualifications (Census Level C)
NURSING	NURSING: Nursing qualifications (e.g., SEN, SRN, SCM)
A-LEVEL	A-LEVEL: GCE A-level, Scottish Leaving Certificate (SLC), Scottish Certificate of Education (SCE), Scottish University Preliminary Examination (SUPE) at Higher Grade, Certificate of Sixth Year Studies
VOC-MIDDLE	MIDDLE VOCATIONAL: City and Guilds Advanced or Final, Ordinary National Certificate (ONC) or Diploma (OND), BEC/TEC National, General, or Ordinary
O-LEVEL 5+	FIVE OR MORE O-LEVELS: Five or more subjects at GCE O-level obtained before 1975 or in grades A–C if obtained later, five or more subjects at SCE Ordinary obtained before 1973 or in bands A–C if obtained later, five or more subjects at CSE grade 1 or at School Certificate, SLC Lower, or SUPE Lower
VOC-LOW	LOWER-MIDDLE VOCATIONAL: City and Guilds Craft or Ordinary
O-LEV&CLER	LESS THAN FIVE O-LEVELS WITH CLERICAL OR COMMERCIAL QUALIFICATION: One to four subjects at GCE O-level or equivalent with clerical or commercial qualification such as typing, shorthand, bookkeeping, commerce
O-LEVEL 1–4	LESS THAN FIVE O-LEVELS WITHOUT A CLERICAL OR COMMERCIAL QUALIFICATION
CLERICAL	CLERICAL OR COMMERCIAL QUALIFICATION WITHOUT O-LEVELS
VOC-OTHER	LOWEST VOCATIONAL: Miscellaneous apprenticeships
OTHER	MISCELLANEOUS, NONVOCATIONAL QUALIFICATIONS: Other qualifications including CSE Grades 2–5, plus all remaining qualifications, which consist mainly of local or regional school-leaving certificates and college or professional awards no regarded as "higher education," i.e., not above GCE A-level standard
NO QUAL	NO QUALIFICATIONS: No qualifications including those with no formal schooling

system is reduced to ten one-digit SIC categories, which cannot be matched consistently with the earlier classification. As a result, I have been forced to reduce the industrial categories to only seven groupings in order to find a definition that is consistent over the fifteen-year sample. The seven categories, however, do allow for a distinction between manufacturing (three categories) and services, the two sectors that have featured prominently in much of the discussion of the changing wage structure in Britain and the United States.

5.2 Changes in the British Wage Structure

5.2.1 Earnings Inequality

Earnings inequality in Britain fell slightly during the 1970s, only to rise rapidly during the 1980s. Meanwhile, in the United States, inequality grew continuously over both decades (see, e.g., Juhn, Murphy, and Pierce 1989, table 1 and fig. 3).

The data in panel A of table 5.2 summarize the British earnings distribution at three periods of the GHS sample, 1974–76, 1978–80, and 1986–88. Following much of the work in the United States, the basic measure of inequality in table 5.2 is the difference between the log earnings of workers in different percentiles of the earnings distribution. Table 5.2 also reports the standard deviation of log earnings, another measure of earnings dispersion.

Both measures of inequality paint the same picture. The 90–10 differential (the difference between the log earnings of workers in the ninetieth and the tenth percentiles of the distribution) and the standard deviation of log earnings show a slight decline (0.01 log points) between 1974–76 and 1978–80. Both measures, however, increased by approximately 20 percent between 1978–80 and 1986–88 (the 90–10 differential by 0.22 log points and the standard deviation of log earnings by 0.11 log points). The rise in dispersion in the 1980s does not appear to be simply a phenomenon of the tails of the distribution since the data also indicate a steep rise in the 75–25 differential during the 1980s.

Figure 5.1 makes the same point more dramatically. The figure shows the log point change, relative to 1974, in real earnings for the tenth, fiftieth, and ninetieth percentiles of the earnings distribution. From 1974 to 1980, earnings

Table 5.2 **Log Real Weekly Earnings Deciles and Quartiles**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Raw earnings:					
90-10	.957	.947	1.170	−.010	.223
90-50	.471	.469	.586	−.003	.117
50-10	.486	.479	.583	−.007	.104
75-25	.468	.476	.615	.008	.139
SD	.422	.412	.524	−.011	.112
B. Residual earnings:					
90-10	.753	.750	.888	−.003	.138
90-50	.379	.388	.446	.009	.057
50-10	.374	.362	.442	−.012	.080
75-25	.388	.378	.445	−.009	.067
SD	.318	.313	.378	−.006	.066

Source: General Household Survey.

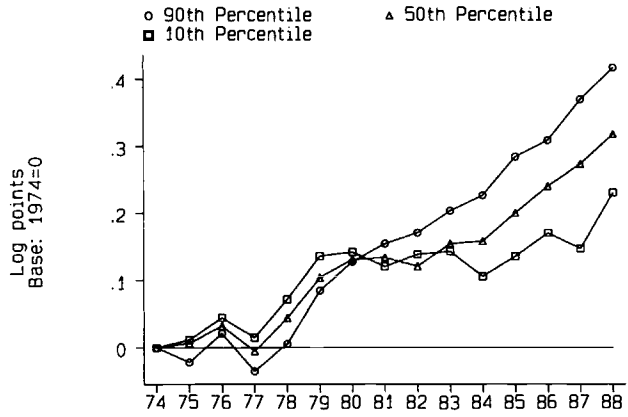

Fig. 5.1 "Indexed" real weekly earnings
Source: General Household Survey data deflated by the retail price index, January 1974 = 100.0

of the tenth percentile grew faster than those of the fiftieth and ninetieth percentiles; the earnings of the ninetieth percentile grew at the slowest rate. After 1980, the growth positions reversed, with tenth-percentile earnings remaining flat over most of the rest of the sample and the ninetieth percentile making large gains.

5.2.2 Education and Experience Differentials

A portion of the changes in overall inequality in Britain during the 1970s and 1980s was due to the decline and subsequent recovery of financial returns to labor market skills. Education and experience differentials fell steeply between the mid- and the late 1970s. By 1986–88, however, education differentials had made a strong recovery, and experience differentials had more than made up for ground lost in the previous decade. In the United States, education differentials reached historic lows in the mid-1970s and grew rapidly through the late 1980s (see Blackburn, Bloom, and Freeman 1991, table 2 and fig. 2). Experience differentials in the United States increased steadily after 1970, especially during the 1980s (see Juhn, Murphy, and Pierce 1989, table 3).

To measure the change in returns to labor market skills in Britain, I have estimated identical human capital weekly earnings equations for fifteen consecutive years of GHS data. Each equation explains the log of real weekly earnings as a function of thirteen education qualification dummy variables, their full interactions with years of potential experience and its square, and nine regional dummies. Owing to the omission of ability, family background, and other variables, the human capital equations may yield biased estimates of the *level* of returns to skills in the individual regressions. However, assuming

that the effects of these biases are constant over time, the difference in estimated returns from one year to the next should provide a consistent estimate of the *change* in the returns.

The education differentials in panel A of table 5.3 are calculated as the sum of the coefficient for the qualification-specific dummy variable, plus the value of the qualification-specific experience differential evaluated at twenty years of experience, minus the experience differential for a worker with no qualifications also evaluated at twenty years. This formulation of the differential allows a simple yet flexible representation of the returns to a qualification: qualifications can provide a once-and-for-all boost (through the qualification dummy) and a different earnings profile (through the qualification-specific experience terms). The returns to high- and mid-level qualifications (UNIVERSITY, VOC-HIGH, A-LEVEL, VOC-MIDDLE, and O-LEVEL 5+) in table 5.3 all decline between the first and the second periods. In the 1980s, however, the differentials for these qualifications increase strongly, although generally not enough to offset the declines of the 1970s. The returns to the low-level qualifications (VOC-LOW, O-LEVEL 1–4, and VOC-OTHER) manage modest gains in the 1980s, which exceed losses during the 1970s.

Figure 5.2 plots the estimated returns at twenty years' experience for condensed educational qualifications (UNIV, MIDDLE, and LOW) over all fifteen years in the sample.[5] The returns to university and mid-level qualifications fall through 1979–80, rise again until 1984, and then remain approximately constant through the end of the sample.

Panel B of table 5.3 shows the estimated differentials for years of potential experience. The figures reported are the fixed-weighted averages of the experience differentials for all fourteen education categories evaluated at the number of years indicated in the label. The weights used were the average employment shares of the education categories for the period 1974–88. The experience differentials show declines in the 1970s, followed by strong gains in the 1980s. By the late 1980s, experience premiums were well above the levels prevailing in the mid-1970s.

Similar estimates of changes in education and experience differentials for workers aged sixteen to thirty appear in table 5.4. Since younger workers have shorter tenure with the firms where they work, their earnings are likely to be more responsive to market forces changing the earnings structure. In the United States, for example, increases in experience and education differentials were higher among younger workers than among the population as a whole (Blackburn, Bloom, and Freeman 1991). The regression results summarized in table 5.4 show that the rise in skill differentials was also more marked among young British workers.

5. The condensed qualifications are defined as follows: UNIVERSITY is UNIVERSITY; MIDDLE is VOC-HIGH, TEACHING, NURSING, A-LEVEL, VOC-MIDDLE, and O-LEVEL 5+; LOW is VOC-LOW, O-LEV&CLER, O-LEVEL 1–4, CLERICAL, VOC-OTHER, and OTHER; NO QUAL is NO QUAL.

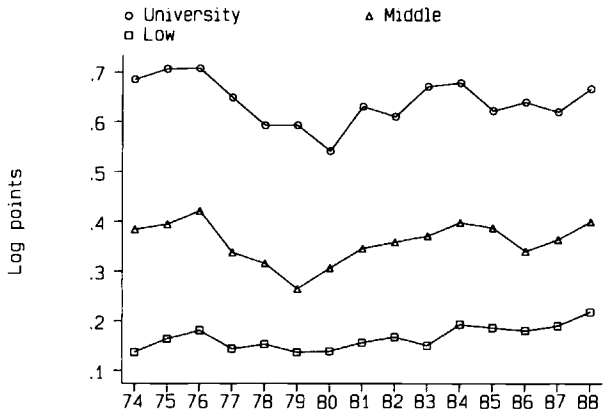

Fig. 5.2 Education differential at 20 years' experience, 16–64-year-olds
Source: General Household Survey using procedure described in notes to table 5.3.

Table 5.3 Skill Differentials: Sixteen- to Sixty-four-Year-Olds

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Educational qualifications (20 years' experience):					
UNIVERSITY	.700	.576	.643	−.124	.067
VOC-HIGH	.400	.306	.382	−.094	.076
A-LEVEL	.529	.395	.494	−.134	.098
VOC-MIDDLE	.266	.193	.282	−.073	.089
O-LEVEL 5+	.471	.312	.351	−.160	.039
VOC-LOW	.199	.153	.202	−.046	.048
O-LEVEL 1–4	.312	.285	.331	−.027	.046
VOC-OTHER	.085	.079	.096	−.006	.017
NO-QUAL	.000	.000	.000	.000	.000
B. Years of potential experience:					
0 YEARS	.000	.000	.000	.000	.000
5 YEARS	.219	.192	.258	−.027	.066
10 YEARS	.396	.346	.468	−.049	.121
20 YEARS	.620	.542	.739	−.078	.196
30 YEARS	.674	.588	.813	−.087	.225
40 YEARS	.558	.483	.690	−.075	.207

Source: General Household Survey.

Note: Average values implied by annual regressions of log real weekly pay against 13 education dummies, experience and its square fully interacted with education dummies, and 9 regional dummies. Education differential is the value of the qualification-specific dummy variable, plus the qualification-specific experience differential evaluated at 20 years, minus the experience differential at 20 years for workers with no qualifiations. Experience differential is the fixed-weighted average over all education groups. Weights are the average employment share for each qualification over the period 1974–88. All underlying qualification dummies and base-level experience variables are significant at at least the 5 percent level.

Table 5.4 **Skill Differentials: Sixteen- to Thirty-Year-Olds**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Educational qualifications (5 years' experience):					
UNIVERSITY	.622	.526	.744	−.096	.218
VOC-HIGH	.447	.375	.578	−.072	.203
A-LEVEL	.237	.333	.405	.096	.072
VOC-MIDDLE	.264	.384	.333	.120	−.052
O-LEVEL 5+	.166	.100	.246	−.066	145
VOC-LOW	.127	.307	.158	.180	−.148
O-LEVEL 1–4	−.002	.051	.116	.054	.065
VOC-OTHER	.353	.336	.365	−.017	.030
NO-QUAL	.000	.000	.000	.000	.000
B. Years of potential experience:					
0 YEARS	.000	.000	.000	.000	.000
5 YEARS	.291	.228	.322	−.063	.094
10 YEARS	.581	.456	.643	.125	.187

Source: General Household Survey.

Note: Average values implied by annual regressions of log real weekly pay against 13 education dummies, years of experience fully interacted with education dummies, and 9 region dummies. Education differential is the value of the qualification-specific dummy variable, plus the qualification-specific experience differential evaluated at 5 years, minus the experience differential at 5 years for workers with no qualifications. Experience differential is fixed-weighted average over all education groups. Weights are the average employment share for each qualification over the period 1974–88. Most underlying qualification dummies and base-level experience variables are significant at at least the 5 percent level.

5.2.3 Residual Inequality

Education and experience differentials can explain only a portion of the change in overall inequality in Britain during the 1970s and 1980s. As earnings differentials rose *between* education and experience groups in the 1980s, earnings dispersion was also increasing *within* these same groups. The same is true for the United States, where changes in education and experience differentials can account for only about half the increase in overall inequality since the mid-1970s (see, e.g., Juhn, Murphy, and Pierce 1989, table 4).

The regression residuals from the earnings equations in the previous section clearly establish that changes in education and experience differentials fail to explain most of the rise in overall inequality. Panel B of table 5.2 above summarizes the distribution of these residuals for the three key time periods. The residuals can be interpreted as individual earnings purged of any systematic differences between "groups" defined by the explanatory variables in the regression (education and experience). Were the increase in overall inequality due solely to rising inequality *between* education-experience groups, we would expect the residual distribution to show no tendency toward greater inequality:

the overall inequality would stem from changing endowments or market valuations of human capital that the earnings regression would "remove" from the data. In fact, residual inequality rises considerably. The 90–10 differential for residual earnings grew 0.138 log points between 1978–80 and 1986–88, as opposed to a 0.223-log-point rise for raw earnings. By this crude measure, changes in returns to education and experience can account for only 40 percent of the rise in British earnings inequality during the 1980s. Approximately 60 percent of the increase occurred *within* education and experience groups.

5.2.4 Real Earnings of Low-Skilled Workers

While inequality increased substantially in Britain during the 1980s, the real earnings of employed, full-time, low-skilled workers were also growing. In the United States, on the other hand, inequality increased in large measure because the real earnings of low-skilled workers fell. High school dropouts or workers in the tenth percentile of the U.S. earnings distribution, for example, suffered steady and significant reductions in real annual and weekly earnings after the late 1960s (see, e.g., Blackburn, Bloom, and Freeman 1991, table 1; and Juhn, Murphy, and Pierce 1989, fig. 3).

The median real weekly earnings of British workers with no qualifications increased by approximately 0.30 log points between 1974 and 1988. Since this result stands in such contrast with the experience of the United States, I have made several attempts to check the robustness of the result with different ways of defining low-skilled workers and to confirm the GHS results using other data sources.

While those without educational qualification may be a natural choice to represent "low-skilled" workers, they may not be entirely representative of the low skilled. One important reason is that workers with no qualifications tend to be older than those with qualifications. On average, workers without qualifications may have been able to improve their earnings position by capturing some of the rise in returns to experience during the 1980s. One way to reduce the potential for this experience effect is to choose workers in the tenth percentile of the distribution as a proxy for low-skilled workers. As figure 5.1 above shows, real earnings for workers in the tenth percentile increased by approximately 0.20 log points over the sample period.

At between one-third and half of the total sample in each year, the no-qualifications group is also much larger than the natural low-skilled groupings in the United States such as high school dropouts. It could be that, even as *median* real earnings for the no-qualifications group were rising, the earnings of the less skilled among those without qualifications were dropping. However, by 1988, real earnings for the tenth percentile of the no-qualifications group were approximately 0.15 log points above their level in 1974.

The GHS results are also consistent with other publicly available data on British earnings. Published data from the New Earnings Survey (NES), an annual survey of approximately 1 percent of the British labor force collected through their employers, indicate that the weekly and hourly wages of workers

in the tenth percentile of the male earnings distribution both increased by between 10 and 13 percent between 1974 and 1988 (see, e.g., Katz, Loveman, and Blanchflower, chap. 1 in this volume; and Schmitt 1992).[6]

5.2.5 Employment Rates

One of the most striking features of the British wage structure over the period 1974–88 was the large number of people who fell out of it entirely. The unemployment rate quadrupled between the mid-1970s and the mid-1980s—from under 3 percent to over 12 percent. The incidence of unemployment fell much more heavily on the low skilled than on the population as a whole. The unemployment rate for workers with no qualifications exceeded 15 percent in the mid-1980s, with long-term unemployment especially high among those with no qualifications. In the United States, low-skilled workers also bore the brunt of rising unemployment in the 1970s and early 1980s, but the overall and skill-specific unemployment rates there were much lower than in Britain (see, e.g., Blackburn, Bloom, and Freeman 1991, table 3).

To measure the relative unemployment experience of British workers, I have estimated unemployment rates by educational qualification using separate binary probit equations for each of the years of the GHS. Panel A of table 5.5 summarizes the probit-predicted unemployment rates for the three subperiods assuming that all workers were forty years old. The unemployment rates for nearly all qualifications closely track changes in the overall unemployment rate: little change between 1974–76 and 1978–80, followed by large increases through 1986–88. Figure 5.3 graphs the complete unemployment series for the four condensed education categories introduced earlier.

In a world with involuntary unemployment, the return to education has two components—a higher wage while employed and a higher probability of finding and keeping a job. In this simple framework, we can adjust the earlier education differentials to include the differential employment probability associated with a given qualification. Defining the employment probability as one minus the estimated unemployment rate, the relative employment rate for qualification i is then $(1 - u_i)/(1 - u_{\text{NOQUAL}})$. While relative employment rates were low and constant during the 1970s, they rose substantially in the 1980s. Adjusting the changes in education differentials for the changes in relative employment substantially increases the returns to education during the 1980s. Among university graduates, for example, the rise in the education differential

6. Meghir and Whitehouse (1992), however, do find a slight decline in real hourly earnings between 1975 and 1986 for the tenth percentile of the distribution of nonunion, full- and part-time, manual male employees aged twenty-two to fifty-six using data from the Family Expenditure Survey (see their fig. 6). But, even in this fairly disadvantaged segment of the British labor market, the twenty-fifth percentile managed to hold its own between 1975 and 1986. Furthermore, as Meghir and Whitehouse note, the variables that they use to divide their sample into union and nonunion sectors are only indirect measures of union status and may not be completely consistent over time.

Table 5.5 **Unemployment and Relative Employment Rates**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Estimated unemployment rate:					
UNIVERSITY	.014	.013	.027	−.001	.014
VOC-HIGH	.010	.009	.028	−.001	.019
A-LEVEL	.020	.014	.050	−.007	.037
VOC-MIDDLE	.006	.017	.042	.011	.025
O-LEVEL 5+	.011	.016	.040	.005	.024
VOC-LOW	.014	.021	.054	.007	.033
O-LEVEL 1–4	.017	.019	.049	.002	.030
VOC-OTHER	.026	.036	.085	.010	.049
NO QUAL	.041	.055	.131	.014	.077
B. Employment/population ratio:					
UNIVERSITY	.928	.941	.912	.012	−.029
VOC-HIGH	.961	.957	.924	−.004	−.033
A-LEVEL	.786	.752	.779	−.034	−.027
VOC-MIDDLE	.971	.957	.895	−.014	−.063
O-LEVEL 5+	.834	.835	.764	.001	−.071
VOC-LOW	.960	.939	.889	−.021	−.051
O-LEVEL 1–4	.909	.878	.855	−.031	−.023
VOC-OTHER	.942	.908	.796	−.034	−.112
NO QUAL	.886	.845	.704	−.040	−.142

Source: General Household Survey.

Note: Unemployment rates implied by probit regression of employment status against 9 education dummies, age and its square, and 9 region dummies. The 9 qualifications are the 8 here plus an "other" category not shown. Predicted rates evaluated at age 40. Employment/population ratio calculated as GHS sample share of all 16–64-year-old males in full- or part-time employment.

between 1978–80 and 1986–88 increases from 0.067 to 0.113 log points after factoring in the change in employment probabilities over the period.[7]

Given the large drop in labor force participation rates among working-age males during the 1980s, the unemployment rates in panel A of table 5.5 tell only part of the story of the decline in employment rates. Panel B of table 5.5 lists the sample employment/population ratios calculated from the raw GHS data. They show an even sharper drop in relative employment probabilities than implied by the unemployment rates. Except for A-LEVEL and O-LEVEL 5+, employment/population rates in the period 1974–76 clustered around 90

7. To calculate the change in the employment probability–adjusted differential, multiply the average university differential from tables 5.3 and 5.4 for the period 1978–80 by the relative university employment probability $(1 - u_{UNIV})/(1 - u_{NOQUAL})$ for the same period ($1.044 \times 0.576 = 0.601$); do the same for 1986–88 ($1.120 \times 0.643 = 0.720$); and then subtract the first from the second ($0.720 - 0.601 = 0.113$).

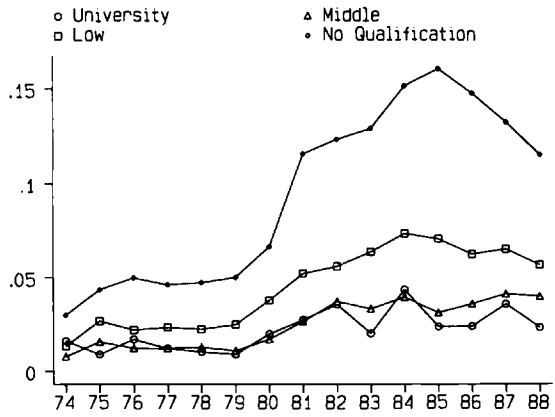

Fig. 5.3 Unemployment rate
Source: General Household Survey using procedure described in notes to table 5.5.

percent.[8] By 1986–88, employment/population rates fell off by a few percentage points for highly skilled workers and plummeted by 14 percentage points for workers with no qualifications.

5.3 Supply, Demand, and Labor Market Institutions

Simple models of the relative supply of and demand for workers of different skill levels have been quite successful in explaining changes in skill differentials in the United States (see, e.g., Freeman 1976; Bound and Johnson 1989; Blackburn, Bloom, and Freeman 1991; Katz and Murphy 1992; and Murphy and Welch 1992). A relative supply and demand model also seems a natural benchmark for an analysis of British skill differentials. In this section, I examine the market for skilled labor in Britain, taking into account the evolving role of several British labor market institutions.

5.3.1 Relative Supply of Skills

In Britain, the rise in the supply of workers with educational qualifications during the 1970s and 1980s was dramatic. A breakdown of the male labor force by educational qualifications for the three subperiods of the GHS sample appears in table 5.6. In 1974–76, workers with no qualifications constituted over half the male labor force. By 1986–88, they were less than one-third of the total. Over the same period, workers with university degrees more than doubled from about 5 to 11 percent of the total labor force. Interestingly, the share of workers with the highest levels of vocational qualifications (VOC-

8. A-levels are normally a prerequisite for university admission; students taking A-levels generally have five or more O-levels. Therefore, the large expansion in university education in the 1970s and 1980s probably explains the low employment rates among individuals with these qualifications.

Table 5.6 **Relative Supply of Skills**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Relative supply of males, 16–64:					
UNIVERSITY	.048	.079	.109	.030	.031
VOC-HIGH	.044	.065	.097	.022	.032
A-LEVEL	.030	.021	.045	−.015	.024
VOC-MIDDLE	.042	.043	.076	.001	.033
O-LEVEL 5+	.058	.066	.043	.008	−.023
VOC-LOW	.048	.046	.063	.002	.017
O-LEVEL 1–4	.051	.058	.085	.008	.027
VOC-OTHER	.095	.100	.071	.006	−.029
NO QUAL	.517	.464	.323	−.053	−.141
B. Ratio of females to males, 16–64:					
UNIVERSITY	.272	.314	.455	.041	.142
VOC-HIGH	.107	.139	.172	.032	.033
A-LEVEL	.584	.574	.819	−.010	.245
VOC-MIDDLE	.062	.083	.252	.021	.169
O-LEVEL 5+	.971	1.045	1.446	.074	.401
VOC-LOW	.114	.135	.311	.021	.176
O-LEVEL 1–4	.701	.827	.828	.126	.001
VOC-OTHER	.095	.119	.143	.024	.024
NO QUAL	.812	.852	.857	.040	.005

Source: General Household Survey.

Note: Columns in panel A do not total to one owing to the exclusion of workers with qualifications not shown.

HIGH and VOC-MIDDLE) also doubled over the three periods. Only two of the education groups failed to increase their share of the labor force over the full sample: five or more O-levels (O-LEVEL 5+) and the lowest vocational qualification (VOC-OTHER). Given the fall in workers with no qualifications, these declines probably reflect decisions by individuals not to end their education after achieving these qualifications but instead to use them to gain access to further education.

In a competitive labor market with constant relative demand, an increase in the relative supply of skilled labor would reduce the relative wages of skilled labor. The large increase in the relative supply of skilled labor is consistent with the observed decline in returns to education in Britain during the 1970s but makes a coherent explanation of the recovery of education differentials in the 1980s more difficult. The coincident rise in supplies of and differentials for skilled workers during the 1980s strongly suggests that the relative demand for skilled workers must have grown substantially over the decade.

One of the major developments of the postwar period in both Britain and

the United States was the enormous increase in female participation in the paid workforce. New female workers may have competed disproportionately with low-skilled male workers, thus helping widen skill differentials. Panel B of table 5.6 reports the ratio of females to males by educational qualification for the three subperiods. In 1974–76, there was approximately one female graduate for every four male graduates. By 1986–88, the ratio had doubled to nearly one female graduate for every two male graduates. In comparison, the ratio of females to males among workers with no qualifications increased from 81 to 86 percent in the same period. The rise in female participation, therefore, led to a disproportionate rise in competition for qualified workers.[9] The rise in female participation actually makes it more difficult to explain widening differentials in the 1980s.

The large growth in the relative supply of skilled labor may lie behind the decline in skill differentials and inequality in the 1970s. In the absence of new sources of competition, the declining relative share of male low-skilled workers may also help explain the rise in absolute earnings for low-skilled workers over both decades. However, relative supply movements clearly make the rise in differentials in the 1980s a more puzzling phenomenon.

5.3.2 Relative Demand for Skills

The supply analysis implies an important role for relative demand changes in the 1980s. Most previous research on the U.S. economy has usefully divided relative demand changes into two categories: "between-industry" factors, which affect product demand (and thus labor demand) across industries (e.g., the rise in services as opposed to manufacturing or the rise in foreign as opposed to domestic sources for manufacturing goods), and "within-industry" factors, which affect the valuation of skills independently of changes in product demand (e.g., skills-biased technological innovations or organizational developments favoring skilled workers). While the debate in the United States generally agrees on the importance of demand shifts, no clear conclusions have been reached about these two, not necessarily competing explanations.

Given international trade in goods and production technology, the demand shifts hypothesized in the United States are also likely to have been operating in Britain. The dramatic decline in the share of manufacturing employment in total employment evident in figure 5.4 certainly makes a case for a careful examination of the role of between-industry effects in the growth of inequality during the 1980s. While the relatively poor range of industrial variables makes the GHS data set less than ideal for analyzing relative demand shifts, I have nevertheless conducted some crude tests of the principal demand shift hypotheses. The GHS data do allow us to distinguish workers in three separate manu-

9. Unless females with educational qualifications substituted for males with no qualifications. However, given the employment structure and occupational gender segmentation in Britain during the sample period, this is probably not an important factor.

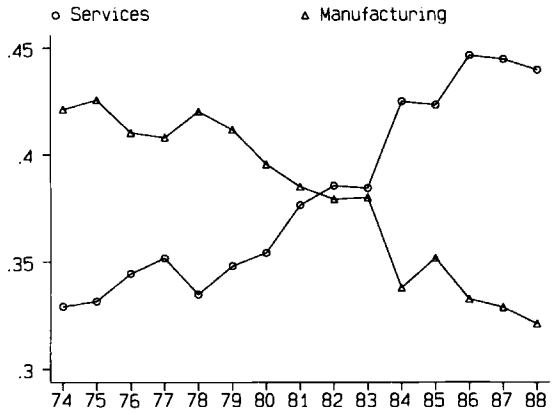

Fig. 5.4 Share in total employment
Source: General Household Survey.

facturing categories from workers in agriculture, services, and two other generally nontraded sectors (transport and communications; construction). I use these simple categories to attempt to estimate the effect of the general decline in domestic manufacturing on skill differentials and overall earnings inequality.

Following Blackburn, Bloom, and Freeman (1991), I use two methods to estimate the role of industrial shifts in the rise in skill differentials between 1978–80 and 1986–88. The first is a shift-share decomposition of the change in education differentials between the two periods. The second is a regression-based decomposition of education and experience differentials.

The shift-share decomposition divides the change in education differentials into three components: (1) the portion due to between-industry changes in the distribution of employment by qualification; (2) the portion due to within-industry changes in the earnings of workers with different qualifications; and (3) the interaction of these two effects.

The decomposition involves several stages of calculations. First, the raw earnings data are used to calculate education differentials, d_{qst}, for each qualification (q) within each industrial sector (s) in each year (t):

$$d_{qst} = \overline{\ln w_{qst}} - \overline{\ln w_{0st}}, \tag{1}$$

where w refers to real wages, 0 is the base group with no qualifications, and a bar indicates a sample mean. Second, the qualification differentials in each sector are used to produce an economy-wide "raw differential," d_{qt}, for each qualification as a weighted average of the qualification differential in each of the sectors:

$$d_{qt} = \sum_{s} d_{qst} \cdot x_{qst}, \tag{2}$$

where x is the proportion of all workers with qualification q working in industry s at time t. Third, the between-industry effect is removed from the differential by reestimating d_{qt} using the average employment share for the period 1974–88:

$$\hat{d}_{qt} = \sum_s d_{qst} \cdot \bar{x}_{qs}. \tag{3}$$

Fourth, in a similar way, the within-industry effect is removed from the differential by reestimating d_{qt} using the average industry-specific differential for each qualification over the full sample:

$$\hat{d}_{qt} = \sum_s \bar{d}_{qs} \cdot x_{qst}. \tag{4}$$

Finally, the changes in the three differentials are calculated for the three subperiods. The interaction of the between- and within-industry effects is defined as the signed difference between the change in the raw differential and the sum of the changes of the two "controlled" differentials.

The results of this shift-share decomposition for the 1980s appear in panel B of table 5.7. The first column shows the actual change in the education differentials. Note that these estimates differ slightly from earlier ones since the differentials here are calculated using the raw data without controlling for compositional effects. The shifts in employment from manufacturing to the other sectors make only a negligible contribution toward the rise in differentials during the 1980s (see col. 2 of panel B). The within-industry component of the change in differentials (col. 3 of panel B) accounts for nearly all the rise in the overall education differentials.

The second decomposition technique attempts to measure the effect of manufacturing-to-service employment changes using a modified human capital earnings equation. To implement this decomposition, I pooled the GHS samples for 1978–80 and 1986–88 (and, separately, 1974–76 and 1978–80) and used the data to estimate an equation of the form

$$\ln w_i = a + \boldsymbol{b}_1 \boldsymbol{S}_i + \boldsymbol{b}_2 \boldsymbol{Q}_i + \boldsymbol{b}_3 (D_i \boldsymbol{Q}_i) + \boldsymbol{b}_4 \boldsymbol{R}_i + \boldsymbol{b}_5 (D_i \boldsymbol{R}_i) + e_i, \tag{5}$$

where $\boldsymbol{S}$ is a vector of six industrial sector dummy variables; $\boldsymbol{Q}$ is a vector of educational qualification dummy variables and their complete interactions with experience and experience squared; $\boldsymbol{R}$ is a vector of nine region dummies; D is a dummy variable equal to one if the observation belongs to the later subperiod; e is an error term; and a and $\boldsymbol{b}$ are parameters to be estimated. In this specification, the coefficients, $\boldsymbol{b}_3$, represent the change between the first and the second periods in the differential associated with each of the educational qualifications. We can measure the effect of between-industry employment changes by comparing the estimates of $\boldsymbol{b}_3$ in a regression like (5) with estimates of $\boldsymbol{b}_3$ in an identical regression that excludes the industry-sector dummies.[10] If the decline in relative earnings for the low skilled is due to their

10. The qualification differentials are constructed exactly as in tables 5.3 and 5.4.

Table 5.7 **Industry-Based Shift-Share Decomposition**

	Change in Raw Differential	Change in Differential Due To: Between Industry Shifts	Within Industry Shifts	Interaction
A. 1974–76 to 1978–80:				
UNIVERSITY	−.074	.006	−.078	−.002
VOC-HIGH	−.109	−.003	−.105	−.001
A-LEVEL	.161	.004	.166	−.008
VOC-MIDDLE	.040	.000	.040	−.001
O-LEVEL 5+	−.194	−.022	−.174	.001
VOC-LOW	.128	.001	.128	−.001
O-LEVEL 1–4	.004	.006	.003	−.005
VOC-OTHER	−.003	−.001	−.003	.001
B. 1978–80 to 1986–88:				
UNIVERSITY	.080	.001	.074	.004
VOC-HIGH	.048	.004	.042	.002
A-LEVEL	−.068	.005	−.075	.003
VOC-MIDDLE	−.053	.004	−.061	.004
O-LEVEL 5+	.161	.036	.128	−.003
VOC-LOW	−.139	−.003	−.132	−.004
O-LEVEL 1–4	.016	.007	.005	.004
VOC-OTHER	.008	−.002	.009	.001

Source: General Household Survey.

increasing concentration outside the manufacturing sector, then the estimated change in differentials ($\boldsymbol{b}_3$) should be smaller in the regression that controls for industrial sector. The difference between the $\boldsymbol{b}_3$ coefficients in the regressions with and without the industry controls, therefore, should give an estimate of the importance of industry shifts.

Panel B of table 5.8 reports results of the regression decomposition of the industry shift for the 1980s. Column 1 presents the estimated increase in the differential in a regression like (5) that excludes industrial sector controls. These differentials are nearly identical to those in column 2, estimated using six industry dummies. The resulting estimated cross-industry effects in column 3 are tiny, reinforcing the conclusions from the shift-share analysis.[11]

The evidence from both decompositions suggests that the decline in the manufacturing employment share was probably not the main source of widening skill differentials. This is not entirely surprising given that the manufactur-

11. While the two decompositions are related, it is important to be clear about how they differ. The shift-share decomposition does not control for compositional effects due to experience or region, but it does allow for education differentials to vary across sectors. The regression decomposition controls for compositional effects but imposes the restriction that education differentials are identical across industries.

Table 5.8 **Industry-Based Regression Decomposition**

	Change in Regression Estimated Differential		Estimated Industry Effect
	No Industry Controls	6 Industry Controls	
A. 1974–76 to 1978–80:			
UNIVERSITY	−.121	−.113	−.008
VOC-HIGH	−.090	−.098	−.008
A-LEVEL	−.142	−.138	−.004
VOC-MIDDLE	−.071	−.064	−.007
O-LEVEL 5+	−.168	−.174	.006
VOC-LOW	−.052	−.052	.001
O-LEVEL 1–4	−.025	−.020	−.005
VOC-OTHER	−.009	−.012	.003
B. 1978–80 to 1986–88:			
UNIVERSITY	.066	.063	−.003
VOC-HIGH	.077	.075	.002
A-LEVEL	.106	.099	.007
VOC-MIDDLE	.084	.083	−.001
O-LEVEL 5+	.046	.050	−.004
VOC-LOW	.052	.053	−.002
O-LEVEL 1–4	.050	.041	.010
VOC-OTHER	.013	.018	−.005

Source: General Household Survey.

ing employment share was falling in the 1970s as skill differentials and earnings inequality were also dropping.

The decomposition results point strongly toward within-industry factors. Data on the breakdown of skill-group employment by industrial sector in tables 5.9 and 5.10 indicate that the pattern of labor demand within industries including manufacturing changed significantly over the sample period. The share of manufacturing employees with a university degree (see panel A of table 5.9) almost tripled from 3.0 to 8.6 percent between 1974–76 and 1986–88. The share of university graduates in services (see panel B) did not quite double over the same period. These numbers suggest a sharp rise in demand for skilled workers *within* manufacturing, one that in relative terms was actually greater than in services.

The employment share of university graduates, however, may not reflect a rise in demand so much as the greater abundance of university graduates by the end of the sample. Jobs that had been filled by workers with less than a university education in 1974–76 may have been filled by university graduates in 1986–88 simply because more workers had university degrees. In this respect, the occupational employment shares in table 5.10 argue more persua-

sively that production methods changed within manufacturing in ways that favored highly skilled workers. Nonmanual employment (defined by job classification, not a worker's personal characteristics) increased from approximately 26 percent of total manufacturing employment in 1974–76 to 36 percent in 1986–88—with all the increase stemming from a higher share of professional employees.

A comparison of the 90–10 differentials in manufacturing and services provides a final piece of evidence supporting the importance of within-industry effects. Over the entire period 1974–88, the 90–10 differential for services was on average about 0.30 log points larger than in manufacturing. All else constant, the shift in employment from manufacturing to services would have contributed to a rise in inequality. However, the 90–10 differential for manufacturing grew faster than in services over the 1980s—a 0.200-log-point rise versus 0.178—a phenomenon that the between-industry hypothesis cannot explain.

To summarize the importance of relative supply and demand factors, I have regressed the log of the university differential against the log of the relative supply of university graduates and a quadratic trend term (to proxy shifts in

Table 5.9 **Skills Distribution by Industry: Education**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Manufacturing:					
UNIVERSITY	.030	.051	.086	.021	.035
VOC-HIGH	.043	.068	.128	.026	.059
A-LEVEL	.016	.009	.028	−.007	.019
VOC-MIDDLE	.056	.046	.090	−.010	.044
O-LEVEL 5+	.039	.056	.029	.016	−.027
VOC-LOW	.052	.046	.070	−.006	.023
O-LEVEL 1–4	.044	.049	.079	.005	.030
VOC-OTHER	.120	.130	.093	.010	−.037
NO QUAL	.546	.483	.324	−.063	−.160
B. Services:					
UNIVERSITY	.096	.154	.179	.058	.025
VOC-HIGH	.058	.078	.097	.021	.019
A-LEVEL	.056	.028	.071	−.028	.044
VOC-MIDDLE	.030	.029	.067	−.001	.038
O-LEVEL 5+	.100	.090	.065	−.010	−.025
VOC-LOW	.034	.030	.047	−.004	.018
O-LEVEL 1–4	.068	.079	.095	.011	.017
VOC-OTHER	.057	.061	.043	.004	−.018
NO QUAL	.404	.358	.238	−.046	−.120

Source: General Household Survey.

Note: Skills shares within each industry grouping do not total to one owing to exlusion of workers with qualifications not listed.

Table 5.10 **Skills Distribution by Industry: Occupation**

	1974–76 (1)	1978–80 (2)	1986–88 (3)	Change, (2) − (1)	Change, (3) − (2)
A. Manufacturing:					
Nonmanual:					
Professional	.136	.150	.243	.013	.093
Other	.119	.114	.112	−.004	−.003
Manual:					
Skilled	.519	.518	.459	−.002	−.058
Semiskilled	.191	.185	.159	−.007	−.026
Unskilled	.033	.033	.027	−.000	−.006
B. Services					
Nonmanual:					
Professional	.337	.328	.378	−.009	.050
Other	.325	.329	.287	.004	−.042
Manual:					
Skilled	.203	.208	.206	.006	−.002
Semiskilled	.083	.077	.071	−.006	−.006
Unskilled	.035	.038	.034	.004	−.004

Source: General Household Survey.

Note: Skills shares within each industry grouping do not total to one owing to exclusion of workers in "personal services" occupation.

relative demand and other factors affecting the differential). Estimating the equation using ordinary least squares on the sample period 1974–88 gives an estimate of −0.29 for the elasticity of the university differential with respect to the relative supply of university graduates.[12] This supply elasticity can help predict what might have happened to differentials during the 1980s in the absence of a continued expansion of supply. Restricting relative supplies of university graduates to their average level over the period 1974–88, and using the estimated supply elasticity, yields an estimate of the differential under the assumption that relative supplies were constant through the 1980s. Under these assumptions, the differential would have increased by 0.207 log points (vs. 0.067) between 1978–80 and 1986–88. An alternative interpretation is, of course, that relative demand shifts during the 1980s must have been very large to make their effects felt despite large increases in relative supplies.

5.3.3 Labor Market Institutions

Labor supply and demand shifts can explain many of the similarities in the development of the U.S. and British wage structures. However, supply and demand are less illuminating when it comes to explaining differences. Labor

12. The standard error of the supply elasticity is 0.093, making it significant at the 1 percent level; the R^2 is 0.456; and the Durbin-Watson statistic is 1.64 (critical value $d^L = 0.95$ and $d^U = 1.54$), providing no indication of serial correlation.

market institutions may be in a better position to account for the divergences, especially in the experiences of low-skilled workers and the timing of the rise in inequality. I therefore now examine the role of several British labor market institutions: the extensive use of incomes policies in Britain during the 1970s; the industry- and occupation-specific minimum wages set by national wages councils; the unemployment benefit system; and trade unions.

Incomes Policies of the 1970s

Five incomes policies were in effect during the first five years of the GHS sample. Two of these limited pay increases to a uniform nominal amount (the same, fixed pounds-per-week ceiling applicable to workers at all pay levels); a third policy prescribed proportional increases that may have impeded any underlying tendency toward wage dispersion. In an analysis that pays particular attention to wage differentials, Ashenfelter and Layard (1983) conclude that the incomes policies of the 1970s achieved some of their implicit wage compression targets and probably prevented dispersion from increasing as fast as it would have in the absence of such policies. The effects, however, are difficult to quantify, and incomes policies in the 1970s probably tell us little about the period of widening inequality in the 1980s.

Wage Councils

Britain did not have a statutory national minimum wage in force at any time during the period 1974–88. However, approximately 10 percent of the national labor force worked in industries covered by wages councils, which set minimum pay rates by occupation for workers under their jurisdiction. Anecdotal evidence suggests that a serious erosion in the scope, enforcement, and "bite" of wages council minimums took place after the election of the Conservative government in 1979. By the time the Wage Act of 1986 restricted councils to setting a single minimum for all occupations within a covered industry and removed workers under the age of twenty-one from councils' jurisdiction, wages councils had lost a great deal of their previous influence on wages.

In a broader study of the effects of minimum pay rates on employment, Machin and Manning (1992) examined the effect of wages councils on hourly wage dispersion. Their estimates suggest that the decline in wages council minimums relative to industry averages resulted in an 8 percent increase in the coefficient of variation of wages for covered workers.[13] Since this estimate excludes the effects of reduction in coverage and enforcement, it is probably an underestimate of the effect of the decline in councils on dispersion.

The demise of wages councils during the 1980s may have played an important role in rising inequality during the 1980s. Nevertheless, the disman-

13. For the decline in the industry minimum relative to the industry average, see their fig. 4. For wage dispersion, see their fig. 5. The dispersion-to-elasticity figure is based on their table 2, cols. 3 and 4.

tling of wages councils, which disproportionately protect the wages of low earners, makes it more difficult to explain the rise in real earnings for low-skilled workers.

Unemployment Benefits

Real earnings for the low skilled may have increased in Britain over the sample because the benefit system placed an ever-rising floor on earnings. A rise in the real value of benefits could account for the simultaneous increase in low-skilled earnings and unemployment.

A careful analysis of the effect of the complex British benefit system on low-skilled workers over the fifteen-year period of the sample is well beyond the scope of this paper. As a quick check on the possible effects of benefits on low-skilled earnings, I have graphed the indexed value of real unemployment benefits and the real earnings of workers in the tenth percentile over the sample years in figure 5.5. Unemployment benefit is an unemployment insurance program covering most unemployed workers in the first year of unemployment. The benefit data graphed in figure 5.5 are the log of the real statutory level of unemployment benefits for a single man with no children (see Department of Social Security 1992, table C1.01). Figure 5.5 suggests that the absolute value of unemployment benefits grew slightly over the sample period. However, unemployment benefits failed to keep pace with rises in earnings of workers in the tenth percentile of the full-time earnings distribution.

In absolute terms, the unemployment benefit system was not much more generous in 1988 than it was in 1974. However, in relative terms, it was actu-

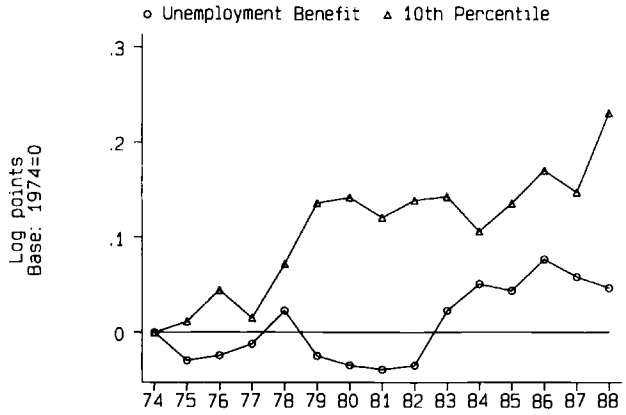

Fig. 5.5 "Indexed" unemployment benefit and earnings

Sources: Weekly unemployment benefit for single male with no children from Department of Social Security (1992, table C1.01, pp. 133–34). Weekly earnings for the tenth percentile of full-time male employees from the General Household Survey. Both series deflated using the retail price index, January 1974 = 100.0.

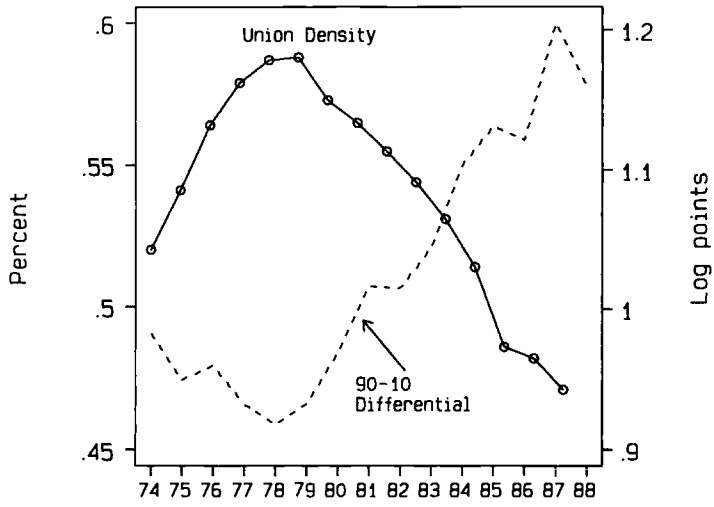

Fig. 5.6 Union density and earnings dispersion
Sources: For union density, see notes to table 5.11. Log weekly earnings differential for full-time male employees from General Household Survey as in table 5.2.

ally less generous. While the analysis is far from complete, the idea that the benefit system pushed the real earnings of low-skilled workers up in absolute terms over the 1970s and 1980s does not appear to be consistent with evidence on unemployment benefit.

Trade Unions

Perhaps the most striking institutional difference between Britain and the United States is the much higher degree of unionization in Britain. In Britain, union membership grew rapidly during the 1970s to a historic peak of just under 60 percent of the workforce in 1979. Union density in the United States, on the other hand, declined steadily in the 1970s, falling below 20 percent by the end of the decade. In the 1980s, both countries experienced drops of about 10 percentage points in union density.

Figure 5.6 shows a strong inverse relation between trade union density and overall earnings dispersion in Britain. While the figure cannot establish causation, the striking association suggests that the decline in unionization played a crucial role in the development of the British wage structure during the 1980s. In this respect, it may be telling that the continuous decline in union density in the United States coincided with a continuous rise in earnings inequality there.

Following Freeman (1991, table 2), table 5.11 estimates the contribution of the decline in union membership to the change in skill differentials from 1978–80 to 1986–88 using micro data from the GHS. Column 1 presents cross-sectional estimates of the union differential from the GHS data for 1983 (the only year where the GHS asks workers about their union affiliation). As in the

Table 5.11 Unions and Skill Differentials, 1978–80 to 1986–88

	Union Differential (1983)	Change Union Membership	Effect on Earnings	Change Skill Differential	Share of Change Explained
A. Education differentials:					
UNIV	.031	−.103	−.003		
NO QUAL	.170	−.103	−.018		
Total			.014	.067	.21
B. Occupational differentials:					
Nonmanual	.078	−.103	−.008		
Manual	.227	−.103	−.023		
Total			.014	.110	.13

Note: Union differentials for 1983 estimated using GHS data with the model from table 5.3, augmented by a trade union membership dummy variable and its interaction with relevant skill categories. The change in union membership is the change in overall union membership. For membership data for 1974–78, see Central Statistical Office (CSO), *Social Trends* 18 (1988), table 11.8, p. 172; and for 1979–88, see Bird, Stevens, and Yates (1991, 337). The working population is employees in employment in June of each year from the *Department of Employment Gazette.* Change in university differential from table 5.3. Change in nonmanual differential from OLS regressions of natural log of real pay against a dummy variable for nonmanual job, experience and experience squared and their interactions with the nonmanual dummy, and 9 region dummies.

United States, union differentials are small for skilled workers and much larger for less skilled workers. Since no estimates of British union membership by education or occupation exist for the skill groups and time period in table 5.11, column 2 uses the change in union membership in the whole economy (−10.3 percentage points) to estimate the decline in union membership in each skill group. Multiplying the change in membership by the union differential for each skill group gives an estimate of the effect of union decline on the earnings of each skill group. A comparison of these union earnings effects across complementary skill groups yields an estimate of the total effect of union decline on the corresponding skill differential. On this basis, union membership losses account for about 21 percent of the rise in the university differential and 13 percent of the rise in the nonmanual differential during the 1980s.[14]

As with wages councils, the decline in union membership does not make it any easier to account for the rise in low-skilled earnings. However, it may be that the divergent earnings experiences of low-skilled workers in the United

14. These estimates lie very close to the 25 percent figure for the United States given by Freeman (1991). Table 5.11 makes two assumptions that bias the estimates in different directions. The assumption that declines in membership were uniform across skill groups probably significantly reduces the union effect. Declines in membership were almost certainly much greater among low-skilled workers. In the United States, e.g., unionization rates among college graduates fell 3 percentage points between 1978 and 1988, while those for high school graduates dropped 12 percentage points (Freeman 1991, table 2). On the other hand, the assumption of a constant union markup probably inflates the union effect, given some evidence that the union differential fell slightly in Britain during the 1980s. Using plausible values for both missing numbers suggests that table 5.11 probably underestimates the union effect on differentials.

States and Britain have less to do with *changes* in institutions within the two countries over time and more to do with cross-country differences in the *levels* of influence of the institutions. Skill differentials and overall inequality may have increased in Britain because of the weakening of some labor market institutions, but low-skilled workers may have been able to protect absolute earnings more effectively in Britain than in the United States owing to the much greater level of influence exerted by the British institutions. Freeman (1991) finds some evidence for this institutional "levels" effect in cross sections of OECD countries. Countries with high union density have lower variances of earnings. They also experienced smaller changes in earnings differentials between 1978 and 1987 (Freeman 1991, tables 8 and 9, pp. 36–37).

5.4 Some Conclusions

The 1970s and 1980s were tumultuous times for the British earnings structure. The GHS data indicate that skill differentials and overall earnings inequality fell slightly during the 1970s and then rose sharply in the 1980s.

A simple relative supply and demand framework can explain many of these developments. Large increases in supplies of skilled labor helped narrow skill differentials during the 1970s. During the 1980s, a strong rise in the demand for skilled labor led to widening skill differentials despite a continued expansion in the relative supply of skilled labor. The GHS data provide little support for the hypothesis that the decline in British manufacturing employment lies behind changing relative demand for labor or the increase in inequality. The GHS data, however, do support the view that a rise in demand for skills within industries—including manufacturing—has made an important contribution to the rise in inequality.

Labor market institutions also appear to have played an important role in the changing earnings structure. Incomes policies may have checked an underlying tendency toward wage dispersion during the mid-1970s and delayed the onset of rising inequality until the late 1970s. The declining importance of wages councils, and especially trade unions, also probably allowed for greater inequality during the 1980s.

What does the evidence from the 1970s and 1980s say about the 1990s? Despite a British institutional framework that attenuates the effects of supply and demand changes to a much greater degree than in the United States, the same market forces that led to widening differentials during the 1980s could act to close them in the 1990s. The rising differentials are providing a strong financial incentive for individuals to acquire formal education and skills training. The number of new graduates, for example, increased steadily from approximately 95,000 in 1980 to over 120,000 in 1988 (*Highly Qualified People* 1990). Particularly if wages councils and unions avoid further declines in influence, continuing supply responses could conceivably undo many of the developments of the 1980s.

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