ECONOMIC SCENE

Americanized Labor Policy Is Spreading in Europe

Francisco Seco/Associated Press

Union protesters in Lisbon last month hold signs reading “Government Out.” By **EDUARDO PORTER**

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In 2008, 1.9 million Portuguese workers in the private sector were covered by collective bargaining agreements. Last year, the number was down to 300,000.

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Kay Nietfeld/Deutsche Presse-Agentur, via Associated Press

Angela Merkel, center, was forced to approve Germany’s first minimum wage law to form a government.

Spain has eased restrictions on collective layoffs and unfair dismissal, and softened limits on extending temporary work, allowing workers to be kept on fixed-term contracts for up to four years. Ireland and Portugal have frozen the minimum wage, while Greece has cut it by nearly a fourth. This is what is known in Europe as “internal devaluation.”

Tethered to the euro and thus unable to devalue their currency to help make their goods less expensive in export markets, many European countries — especially those along the Continent's southern rim that have been hammered by the financial crisis — have been furiously dismantling workplace protections in a bid to reduce the cost of labor.

The rationale — forcefully articulated by the German government of Angela Merkel, the European Commission and somewhat less enthusiastically by the International Monetary Fund — is that this is the only strategy available to restore competitiveness, increase employment and recover solvency.

These policy moves are radically changing the nature of Europe's society.

"The speed of change has certainly been very fast," said Raymond Torres, the chief economist of the International Labor Organization in Geneva. "As far as I can tell, these are the most significant changes since World War II."

While most of the debate over Europe's response to the financial crisis has focused on the budget austerity enveloping the Continent, the comparatively unheralded erosion of worker protection is likely to have at least as big and lasting an impact on Europe's social contract.

"It has a disastrous effect on social cohesion and a tremendous effect on inequality," argued Jean-Paul Fitoussi, an economics professor at the Institut d'Études Politiques de Paris. "Well-being has fallen all across Europe. One symptom is the rise of extremist political parties."

Europe's strategy offers a test of the role played by labor market institutions — from unions to the minimum wage — in moderating the soaring income inequality that has become one of the hallmarks of our era.

Inequality across much of Europe has widened, but it is still quite modest when compared with the vast income gap in the United States.

The question is whether relative equity can hold as workplace institutions that for decades protected European employees' standard of living give way to a more lightly regulated, American-style approach, where the government hardly interferes in the job market and organized labor has little say.

The evidence so far suggests the answer is no. The drop in unionization in Portugal "is going to blow the wage distribution apart," David Card, a labor economist at the University of California, Berkeley, said.

Perhaps the most compelling evidence that Europe's tentative new path will lead to deepening inequality comes from the country that adopted the strategy earliest and came out at the other end a paragon of success: Germany.

The overhaul of the labor market started after German unification in the early 1990s, when factories in the less-productive Eastern part of the country found they could not compete at the pay scales provided in the West, and defected en masse from the sector agreements negotiated between industry associations and large unions. West German firms soon took up the strategy. The share of workers covered by collective labor agreements fell.

In the early 2000s — when a hobbled Germany won the moniker "sick man of Europe" — efforts to improve competitiveness and employment further eroded worker protections, fueling a boom in low-paid, short-term "mini-jobs" that today account for more than a fifth of German employment.

Today, Germany is seen as a shining example of the virtues of such reform efforts. It is an exporting powerhouse with an unemployment rate, according to the European statistical agency Eurostat, of 5.2 percent: the envy of the Western world. But on closer inspection it becomes apparent that not all Germans have benefited from Germany's success.

In 1991, the richest 10 percent of Germans took in 26 percent of the nation's income before taxes and transfers, according to a report by Kai Daniel Schmid and Ulrike Stein of the Macroeconomic Policy Institute in Düsseldorf, which is closely linked to the German Confederation of Trade Unions. By 2010 they took in 31 percent.

Over the same period, the slice of the nation's income taken by the bottom half of the population fell to 17 percent, from 22 percent.

As Professor Card has noted, the widening of the wage gap among German men from 1996 through 2009 roughly matches that in the United States during the 1980s — one of the periods of fastest-growing income inequality since the Gilded Age.

And though inequality in Germany has abated somewhat over the last two years as the number of part-time, low-wage jobs has stabilized, it remains much higher than a decade ago.

Whether Germany's strategy will be of any use to distressed European countries today ishotly debated. German exports did take off, but domestic demand sagged, a direct consequence, critics say, of lower pay. So it took a long time for the efforts to produce jobs.

What's more, the German rebound relied on a fast-growing global economy that was hungry for its exports. The world is very different today. "Demand from Asia was much more important than mini-jobs," Mr. Torres of the I.L.O. argues.

But there is another issue at play. Even if the strategy were to eventually increase employment, what else will it do to Europe?

Andrew Watt, an economist who heads the Macroeconomic Policy Institute in Germany, worries that the push for labor market deregulation will cascade from one weak country to the next, as all engage in a futile race to create jobs by gaining market share from one another in a world of insufficient demand. "Whichever country is weakest at the time is forced into major cutbacks. First Germany, now Spain, next France," he said.

"I am concerned about the longer-run costs," Mr. Watt added. "It is hard to rebuild collective bargaining and welfare-state structures once they have been destroyed."

Lowell Turner, who heads the Worker Institute at Cornell University, argues that there has always been a tension between the European Union's economic project — centered on creating a vast single market — and the Continent's deep-rooted commitment to social equity. The crisis put a thumb on the scales. "For a year or two governments protected their workers," he said. But "the balance has tipped away from social Europe."

There are signs of change, though. German elections earlier this year forced the Christian Democratic Union of Chancellor Merkel into a governing coalition with the Social Democratic Party. Part of the deal to form a government included introducing Germany's first minimum wage, at 8.5 euros an hour, or about $11.50.

Lifting German wages at the bottom end should help other European countries to some extent, expanding German demand for their products. It is perhaps overly optimistic, though, to assume Berlin would welcome similar policies among its poorer, weaker neighbors.

Rather, labor markets in Southern Europe seem destined to increasingly follow the American way. "This is a way to, indeed, make Europe very much more like the U.S.," Mr. Watt said. "With respect, that is not what most Europeans want."

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ECONOMIC VIEW

The Business of the Minimum Wage

By CHRISTINA D. ROMER Published: March 2, 2013

RAISING the minimum wage, as President Obama proposed in his State of the Union address, tends to be more popular with the general public than with economists.

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Mark Allen Miller

I don't believe that's because economists care less about the plight of the poor — many economists are perfectly nice people who care deeply about poverty and income inequality. Rather, economic analysis raises questions about whether a higher minimum wage will achieve better outcomes for the economy and reduce poverty.

First, what's the argument for having a minimum wage at all? Many of my students assume that government protection is the only thing ensuring decent wages for most American workers. But basic economics shows that competition between employers for workers can be very effective at preventing businesses from misbehaving. If every other store in town is paying workers $9 an hour, one offering $8 will find it hard to hire anyone — perhaps not when unemployment is high, but certainly in normal times. Robust competition is a powerful force helping to ensure that workers are paid what they contribute to their employers' bottom lines.

One argument for a minimum wage is that there sometimes isn't enough competition among employers. In our nation's history, there have been company towns where one employer truly dominated the local economy. As a result, that employer could affect the going wage for the entire area. In such a situation, a minimum wage can not only make workers better off but can also lead to more efficient levels of production and employment.

But I suspect that few people, including economists, find this argument compelling today. Company towns are largely a thing of the past in this country; even Wal-Mart Stores, the nation's largest employer, faces substantial competition for workers in most places. And many employers paying the minimum wage are small businesses that clearly face strong competition for workers.

Instead, most arguments for instituting or raising a minimum wage are based on fairness and redistribution. Even if workers are getting a competitive wage, many of us are deeply disturbed that some hard-working families still have very little. Though a desire to help the poor is largely a moral issue, economics can help us think about how successful a higher minimum wage would be at reducing poverty.

An important issue is who benefits. When the minimum wage rises, is income redistributed primarily to poor families, or do many families higher up the income ladder benefit as well?

It is true, as conservative commentators often point out, that some minimum-wage workers are middle-class teenagers or secondary earners in fairly well-off households. But the available data suggest that roughly half the workers likely to be affected by the $9-an-hour level proposed by the president are in families earning less than $40,000 a year. So while raising the minimum wage from the current $7.25 an hour may not be particularly well targeted as an anti-poverty proposal, it's not badly targeted, either.

A related issue is whether some low-income workers will lose their jobs when businesses have to pay a higher minimum wage. There's been a tremendous amount of research on this topic, and the bulk of the empirical analysis finds that the overall adverse employment effects are small.

Some evidence suggests that employment doesn't fall much because the higher minimum wage lowers labor turnover, which raises productivity and labor demand. But it's possible that productivity also rises because the higher minimum attracts more efficient workers to the labor pool. If these new workers are typically more affluent — perhaps middle-income spouses or retirees — and end up taking some jobs held by poorer workers, a higher minimum could harm the truly disadvantaged.

Another reason that employment may not fall is that businesses pass along some of the cost of a higher minimum wage to consumers through higher prices. Often, the customers paying those prices — including some of the diners at McDonald's and the shoppers at Walmart — have very low family incomes. Thus this price effect may harm the very people whom a minimum wage is supposed to help.

It's precisely because the redistributive effects of a minimum wage are complicated that most economists prefer other ways to help low-income families. For example, the current tax system already subsidizes work by the poor via an earned-income tax credit. A low-income family with earned income gets a payment from the government that supplements its wages. This approach is very well targeted — the subsidy goes only to poor families — and could easily be made more generous.

By raising the reward for working, this tax credit also tends to increase the supply of labor. And that puts downward pressure on wages. As a result, some of the benefits go to businesses, as would be the case with any wage subsidy. Though this mutes some of the direct redistributive value of the program — particularly if there's no constraining minimum wage — it also tends to increase employment. And a job may ultimately be the most valuable thing for a family struggling to escape poverty.

What about the macroeconomic argument that is sometimes made for raising the minimum wage? Poorer people typically spend a larger fraction of their income than more affluent people. So if an increase in the minimum wage successfully redistributed some income to the poor, it could increase overall consumer spending — which could stimulate employment and output growth.

All of this is true, but the effects would probably be small. The president's proposal would raise annual income by $3,500 for a full-time minimum-wage worker. A recent analysis found that 13 million workers earn less than $9 an hour. If they were all working full time at the current minimum — and a majority are not — the income increase from the higher minimum wage would be only about $50 billion. Even assuming that all of that higher income was redistributed from the wealthiest families, the difference in spending behavior between low-income and high-income consumers is likely to translate into only about an additional $10 billion to $20 billion in consumer purchases. That's not much in a $15 trillion economy.

SO where does all of this leave us? The economics of the minimum wage are complicated, and it's far from obvious what an increase would accomplish. If a higher minimum wage were the only anti-poverty initiative available, I would support it. It helps some low-income workers, and the costs in terms of employment and inefficiency are likely small.

But we could do so much better if we were willing to spend some money. A more generous earned-income tax credit would provide more support for the working poor and would be pro-business at the same time. And pre-kindergarten education, which the president proposes to make universal, has been shown in rigorous studies to strengthen families and reduce poverty and crime. Why settle for half-measures when such truly first-rate policies are well understood and ready to go?

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