

Labor legislation: The United States

Abstract

Labor legislation in the United States has tended to contribute to faster job creation rates than such legislation in most developed economies. Between 1995 and 2010, the average, annual unemployment rate in the United States was 5 percent, about half the eurozone's average of 9.4 percent. Labor participation rates are higher in the United States, anchored by a society that values work, flexibility and competition. Employees can be hired or fired fairly easily—employment protection in the United States is low, as is union density. According to the OECD Employment Protection Legislation index, the overall rate for the United States (0.21) was the lowest among OECD members. Labor taxes are low too: the tax wedge on labor of 30 percent is among the lowest in the advanced world. Unemployment benefits are lower than in most European countries while net replacement rates for the long-term unemployed are the second lowest in the OECD. What are the pros and cons? On the whole, the system succeeded in delivering jobs and productivity growth. Firms and workers have more freedom to negotiate contracts that suit their needs. States and municipalities can add programs that their voters want and their local economies can afford. Countries seeking to promote productive employment would do well to look at the United States for ideas. But the absence of a universal health care system in the United States means that most Americans need a job if they want a good health care.

Americans work on average 4.4 years for one employer and only 1 in 10 employees spends more than 20 years with the same employer.¹ Many depict the US labor market as contestable and dynamic at the price of low safety nets for workers. Much of this description is true. Less stringent regulation makes it easier for employers in the United States to fire and hire. And the unemployed cannot count on benefits as generous as those in Europe. The US system puts some safety nets for the unemployed in place, however. And, above all, the American system has delivered jobs, keeping the unemployment rates lower than those in most of the advanced world.

The focus on jobs

Since the 1980s the US labor market has produced more jobs than most countries in the advanced world (figure 57). Between 1995 and 2010 the average, annual unemployment rate in the United States amounted to about 5 percent, nearly a half of eurozone's average (9.4 percent). The country also has a high level of labor force participation; in 2009 the US participation rate was 74.6 as compared with an OECD weighted average of 70.7. What is more, the estimates of Albagli et al. (2005) indicate that the United States has one of the most flexible labor markets in the advanced world.²

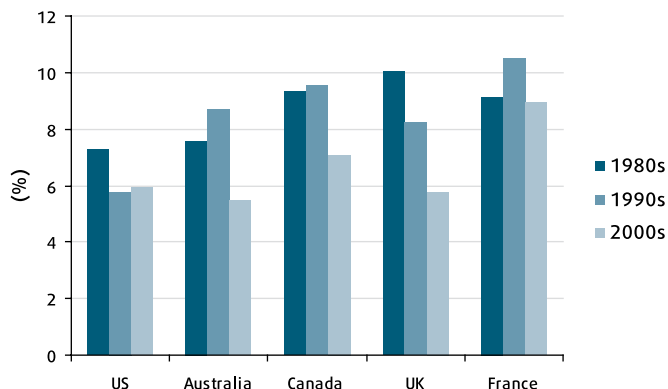
This note investigates how the US labor market legislation contributed to these achievements.

Working in America

First, the US labor market is contestable and dynamic. Employees can be hired or fired easily, giving companies greater freedom than in other parts of the world. The employment protection is low, as is union density. According to the OECD Employment Protection Legislation index, the overall rate for the United States (0.21) was the lowest among OECD members.³ Tax wedges on labor of around 30 percent are one of the most competitive in the advanced world (OECD average: 37 percent).⁴



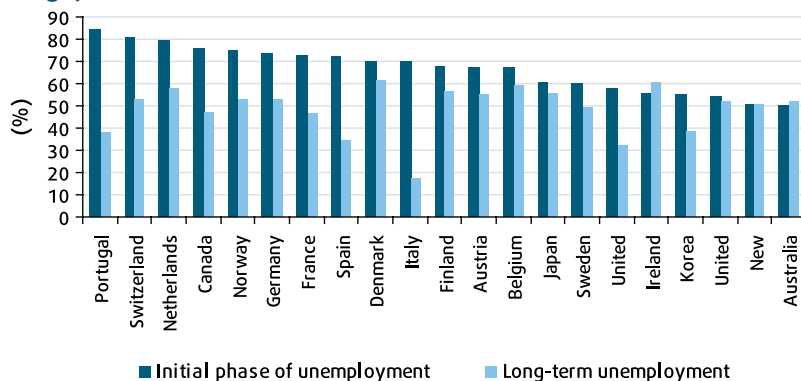
Figure 57: Average annual unemployment rate (%) in the US, Australia, Canada, the UK, and France in the 1980s, 1990s, and 2000s⁵



Source: BLS, ILO and Eurostat.

Second, regulation gives strong incentives for Americans to reenter employment, especially in the long run. In the initial phase of unemployment Americans receive lower benefits than most of their European counterparts, but higher than in Australia, New Zealand, or Britain (figure 58). This changes for the long-term unemployed. Among sample from figure 58, America recorded the second lowest net replacement rates for long-term unemployed, after Italy.⁶

Figure 58: Net replacement rates in 2009 for initial phase of unemployment and long-term unemployment in selected OECD economies (previous earnings equal to an average wage)⁷



Source: OECD.

Third, unemployment insurance (UI) is modest. On average, an unemployed American receives \$309 from UI. Maximum weekly rates of benefits differ across states. In Hawaii an unemployed person will receive more than 50 percent of a weekly wage, while in Mississippi the same person would get only 30 percent. And in most states the unemployment insurance is granted up to 26 weeks a year.

Smaller benefits are not the only reason why Americans work. Because there is no universal health care system, employers provide health care coverage to around 55 percent of Americans.⁸ Thus, access to affordable health care is conditional on remaining in the workforce. However,

those that just lost their jobs are not left without options. Under the Consolidated Omnibus Budget Reconciliation Act of 1986, workers with employer-sponsored health insurance, who just lost their jobs, can continue in the existing coverage for the next 18 to 36 months.⁹ The only difference is that the employer stops paying his share and the unemployed person needs to pay the total premium.

Fourth, though not so generous, the unemployment insurance system seems to be well managed. In most states, unemployment insurance is granted up to 26 weeks a year, but it can be extended by the president in times of economic distress. Finally, labor market policies are also very flexible depending on the economic situation. In 2008 the United States spent three times less on labor market programs than did OECD members on average.¹⁰ When the crisis of 2008 hit the job market, the spending doubled from 0.43 percent of GDP in 2008 to 0.98 percent in 2009.

Fifth, American workers may be well less protected from being fired, but it seems to be applied equally across most professions. Because labor turnover costs are low and cannot be influenced by those already in the employment, the issue of being insider or outsider seems to be less of a problem. This benefits the employers, who in most cases can get the best for a job. And although this may lead to greater within-skill wage inequality (see next section), it also pushes employees to work longer (Michelacci 2008).¹¹ The logic behind this is that if within certain profession incomes are more diversified, employees will work longer to get incomes from the upper side of the scale. Working longer helps also workers to acquire new skills and improve existing ones.

Risk, reward, and the price

By granting greater freedom for employers and employees, the American system undoubtedly delivered jobs. But it may also be the case that labor legislation did not contribute so much to lower jobless figures as it is assumed. Katz and Krueger (1999) point out that some factors behind the lower unemployment rate in the late 1990s and restrained wage growth had less to do with labor regulation and more with other factors, e.g., demographic changes in age structure and an increase in incarceration rates among men.¹²

It may also be that the system that successfully kept the unemployment low also contributed to greater inequality on the labor market. The findings of Autor et al. (2006) imply that since 1980s, US employment has started to polarize into low-wage and high-wage jobs, squeezing the middle out of the picture.

Keeping all the above-mentioned reservations in mind, the US labor market fulfills its fundamental function and provides people with jobs. American solution cannot easily be replicated in other countries, due to many differences among advanced countries, including different understandings of government's role in the labor market. Yet the American experience suggests, above all, that for employment to grow, labor markets need to be contestable.



Sources

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Notes

- 1 US Labor Department estimates for 2010. The first figure corresponds to median job tenure.
- 2 The authors assess the flexibility of labor markets to structural shocks by building an index of labor market rigidity (the higher the index, the more rigid the labor market) using quarterly data on unemployment 1980:Q1–2000:Q4. The United States was ranked fifth (1st=least rigid, last=most rigid) after Hong Kong, Korea, Chile, and Mexico. The sample includes Hong Kong, Korea, Chile, Mexico, the United States, Canada, Netherlands, the United Kingdom, Australia, France, Belgium, Italy, Denmark, Austria, Germany, Spain, Sweden, and Colombia.
- 3 The higher the index's value, the stronger is the employment protection in a country. In 2008 the highest ratios were observed in Turkey (3.72), Luxembourg (3.25), and Portugal (3.15).
- 4 Reference year: 2008.
- 5 The average for France in the 1980s corresponds to period 1983–89.
- 6 The low ratio for Italy derives partly from discrepancies in benefits for different family models, according to OECD. For example, long-term unemployed in married couple with one earner (average wage) and no children will get a net replacement rate of about 1 percent, while the same couple with two earners and no children receives a net replacement rate of 46 percent.
- 7 Net replacement rate includes unemployment benefits, social assistance, and family and housing benefits in the 60th month of benefit receipt, all after tax. The computed values are averages of net replacement rates for six types of households earning an average wage: (1) single, no children; (2) married couple, one earner, no children; (3) married couple, two earners, no children; (4) single parent, two children; (5) married couple, one earner, two children; and (6) married couple, two earners, two children. For married couples, the percentage of average wage relates to one spouse only; the second spouse is assumed to be "inactive" with no earnings in a one-earner couple and to have full-time earnings equal to 67 percent of average wage in a two-earner couple. Children are aged four and six and neither childcare benefits nor childcare costs are considered.
- 8 Data for 2010.
- 9 This applies for workers in the following situations: (1) they lose their job; (2) their hours are cut; (3) their employed spouse dies or divorces them; or (4) they are a student who graduates and losses parental plan coverage.
- 10 The OECD unweighted average in 2008 was 1.36 percent of GDP as compared to 0.43 percent of GDP in the United States. The US data is for 2007–8, as the fiscal year starts on October 1.
- 11 The authors assess the impact of within-skill wage inequality and unemployment in explaining the diverging evolution of hours per worker in the United States and the EU from 1970 to 2002. Results indicate that different labor market conditions contributed to divergence in working hours in the United States and the EU.
- 12 According to the authors' estimates, changes in the age structure (due to maturity of baby boomers) accounted for a 0.4 percentage point decline in overall unemployment since 1985. Growth in incarceration rates contributed to a decline of the male unemployment rate of 0.3 percentage points since 1985.