

Unions and Wage Inequality

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I. Introduction

How unions affect the distribution of income is a subject that has long intrigued social scientists. The publication of *What Do Unions Do?* and the related papers by Freeman (1980, 1982, 1984) represented a watershed in the evolution of economists' views on this question. Until the 1970s the dominant view was that unions tended to increase wage inequality (Johnson, 1975). Using micro data on individual workers in the union and nonunion sectors, Freeman (1980) presented results that challenged this view. He showed that the inequality-reducing effects of unions were quantitatively larger than the inequality-increasing effects. The equalizing effect of unions became a key chapter in *What Do Unions Do?* and an important component of the authors' overall assessment of the social and economic consequences of unions.

Recently the relationship between unions and inequality has attracted renewed interest as analysts have struggled to explain increases in wage inequality in many industrialized countries. The fact that two of the countries with the largest declines in unionization — the United States and the United Kingdom — also experienced the biggest increases in wage inequality raises the question of whether these two phenomena are linked. If so, how much of the growth in earnings inequality can be attributed to the fall in union coverage?

We make several contributions to this issue. We begin by presenting a simple framework for measuring the effect of unions on wage inequality, based on the potential outcomes framework that is now widely used in program evaluation. Our framework emphasizes three key aspects of collective bargaining: How does the probability of union coverage vary for workers who would earn more or less in the nonunion sector? How much do unions raise average wages for workers in different skill groups? How do unions affect the dispersion of wages within narrow skill groups? Next, we trace the evolution of economists' views on the impacts of unions on the wage distribution. This section places the contributions of Freeman (1980, 1982, 1984) and Freeman and Medoff (1984) in historical context. Third, we present new evidence on the

relationship between unions and wage inequality for three countries — Canada, the United Kingdom, and the United States — during the past three decades. Finally, we assess whether the position put forward in *What Do Unions Do?* regarding unions and wage inequality has held up to the scrutiny of subsequent research, including the new evidence reported herein.

Our analysis of unions and wage inequality in the United States, the United Kingdom, and Canada is motivated by several factors. One is to better understand trends in income inequality. Several previous studies have concluded that falling unionization contributed to the steep increase in wage inequality in the United States and the United Kingdom during the 1980s. Wage inequality did not rise as quickly in these countries in the 1990s. This raises the question of whether the evolution of union coverage and union wage impacts can account for some of the changing trend in wage inequality. More generally, differences across these countries in the timing of changes in unionization and in wage inequality provide an opportunity for further assessing the contribution of institutional change to trends in income inequality.

Our empirical analysis is also motivated by the fact that in these three countries the institutional arrangements governing unionization and collective bargaining provide an environment that is suitable for estimating how unions affect wage inequality. As with other aspects of the economy, collective bargaining institutions in these countries are broadly similar. In particular, negotiations are conducted at the enterprise level, and there is no general mechanism to extend union wage floors beyond the organized sector. The fraction of workers covered by collective agreements in the three countries is also relatively modest — currently under one-third of wage and salary workers. Thus it is possible to compare the structure of wages for workers whose wages are set by union contracts, and those whose wages are not, and potentially infer the effect of unions on overall wage inequality. A similar task is far more difficult in other countries (including the major European countries and Australia) because there is no clear distinction between the union and nonunion sectors. Collective bargaining in these countries is conducted at the industry or sectoral level, and the provisions are formally or informally extended to most of the labor force. Moreover, in many countries, unions exert considerable influence on political decisions (such as minimum wages) that directly affect labor market outcomes.

We also seek to assess whether there are common patterns in the impact of unions on the wage structure in countries with economies and industrial relations systems that are broadly similar. Of particular interest are patterns in union coverage and union wage impacts by gender and skill. To do so, we use micro data samples to compare the incidence and average wage effect of unions by skill level on male and female workers in the three countries, and measure recent trends in union coverage by skill level. Despite some differences in the institutional systems that govern the determination of union status in the three countries, we find remarkable similarity in the overall patterns of union coverage and in the degree to which unions affect wages of different skill groups. Within narrowly defined skill groups, wage inequality is always lower for union workers than nonunion workers. For male workers, union coverage tends to be concentrated at