ILR Review

Volume 56 | Number 4 Article 83

July 2003

How New Is the "New Employment Contract"?

David I. Levine

Dale Belman

Gary Charness

Erica L. Groshen

K C. O'Shaughnessy

How New Is the "New Employment Contract"?

Divergences: Worldwide Changes in Employment Systems, 2000; Jacques Bélanger, P. K. Edwards, and Larry Haiven, *Workplace Industrial Relations and the Global Challenge*, 1994).

The final synthesis chapter would probably have benefited from more extensive integration of the extant literature on the factors underlying the decline in American private sector unionism with the results derived from the studies in the volume. This would have broadened its scope and relevance as a review piece.

Finally, in their reflections in the summary chapter, the editors suggest that unions as a "social institution [have] to pass the 'market test' for survival" (p. 382). This assessment is probably correct for American unions—functioning, as most of them do, as "business unions." But in exploring the future of American unionism, it might have been useful to consider the long-run possibilities for American unions if they were to evolve more as social and political organizations. If unions cannot do so, then, as the results of the studies in this volume clearly suggest, their prospects are limited. Critically exploring the long-run prospects for an institutionally transformed labor movement would have added an important dimension to the concluding analysis.

These suggestions notwithstanding, a number of the papers in this book make quite useful contributions to the debate over the future of American unions and to our understanding of their decline. The volume is well worth reading.

Richard P. Chaykowski
Associate Professor
School of Industrial Relations
Queen's University

How New Is the "New Employment Contract"? By David I. Levine, Dale Belman, Gary Charness, Erica L. Groshen, and K. C. O'Shaughnessy. Kalamazoo, Mich.: W.E. Upjohn Institute for Employment Research, 2002. 263 pp. ISBN 0-88099-232-8, $40.00 (cloth); 0-88099-231-X, $22.00 (paper).

This timely and provocative book presents an array of evidence on changes in the employment relationship. The research it presents differs in two important ways from previous work on this topic. First, it focuses on the wage side of the employment relationship, in contrast to the duration, stability, or security of employment itself. (For an example of the latter sort of study, see David Neumark, *On the Job: Is Long-Term Employment a Thing of the Past?* 2000.) Second, while earlier research studied general changes in the stability of wages (for example, Peter Gottschalk and Robert Moffitt, "The Growth of Earnings Instability in U.S. Labor Markets," *Brookings Papers on Economic Activity,* No. 2, 1994), Levine and his co-authors link their analysis of wages more strongly to a fundamental behavioral hypothesis regarding changes in the employment relationship that has been offered by researchers in management (for example, Peter Cappelli, *The New Deal at Work,* 1999). Specifically, the book asks whether changes in the wage structure are consistent with the implications of declining importance of internal labor markets.

Among the critical implications of weakening internal labor markets that the authors assess are (1) increasing similarity of mean wages employers pay for similar employees, and increasing similarity of internal wage structures (relative wages by education, tenure, and so on) across employers; (2) declining wage premia for working for large employers, and increasingly similar internal wage structures across large and small employers; (3) increasing correlation of wages of large employers with wages in labor markets in which they are located; (4) more reliance on merit pay and bonuses; and (5) increased acceptance or perception of pay cuts as "fair." In short, the *New Employment Contract* argues that proof that "internal labor markets are in decline" requires evidence that "wages are closer to market wages" (p. 55).

While some of these questions can be assessed using standard household surveys, data are also required on the wage structure of specific employers, and on perceptions of fairness. As such, the authors use an eclectic collection of five data sets: the Current Population Survey, data from the Hay Consulting Group, the Cleveland Salary Survey, a survey of manufacturing establishments in Indiana and Japan, and a survey on perceived fairness in the employment relationship carried out in the United States and Canada.

The answer the book reaches regarding its overriding question is unambiguous. Virtually none of the evidence on the wage side suggests that the employment relationship has changed much. As the authors write, "The basic result of this volume is clear: there is no pattern of declining importance of pay rigidities, or of institutional forces more generally, in determining compensation" (p. 160).

To this point I have simplified by describing the basic thrust of the book. However, woven through its core analysis is a broader attempt to assess the consistency of the data with alternative theories of wage determination in the labor market, including human capital, sorting, compensating differentials, efficiency wages, and rent-sharing or bargaining models. In one sense, this attempt to consider the implications of alternative theories is crucial, because these alternative theories, coupled with other sources of change in labor markets, could account for some of the same changes in features of the wage structure that are implied by weakening internal labor markets. For example, the decline in unionization may have reduced workers' ability to extract rents. Yet this rent extraction may have been responsible for some of the employer-related variation in wage levels or wage structures, in which case a decline in union strength could have led to increasing similarity of wage levels and wage structures across employers—precisely one of the observable implications of eroding internal labor markets.

However, the discussion of alternative theories on the one hand goes too far, and on the other hand does not go far enough. It goes too far in that it is presented largely as a means of considering other interpretations of evidence consistent with weakening internal labor markets. Yet the book ultimately arrives at the conclusion that there is little evidence that internal labor markets have weakened, obviating the need to try to distinguish among alternative explanations of such evidence. As a consequence, the lengthy treatment of alternative theories of compensation, while commendable, is distracting.

The discussion of alternative theories does not go far enough, however, in considering the implications of multiple theories contributing to the determination of wages and the wage structure. For example, as summarized in Table 2.1 of the book, the human capital model coupled with general rising returns to skill has for the most part precisely the opposite implications of eroding internal labor markets. Focusing on one of the authors' empirical tests, if wage inequality across employers reflects in part differences in human capital, and in part internal labor markets, then eroding internal labor markets would reduce this inequality, while rising returns to skill would have the opposite effect. So if internal labor markets were eroding while returns to skill were rising—both plausible conjectures over the sample period the authors study—the observable implications of eroding internal labor markets could have been masked.

Those who adhere more enthusiastically to the "new employment contracts" perspective on labor markets are also likely to criticize the book's exclusive focus on wages to assess the hypothesis of declining internal labor markets. Internal labor markets—and their hypothesized decline—also have implications regarding ports of entry, career ladders, recruitment, training, job security, and the role of seniority (Peter B. Doeringer and Michael J. Piore, *Internal Labor Markets and Manpower Analysis,* 1971). The authors rely on large surveys covering either workers or employers and their work forces, which are less amenable to studying some of these internal features of labor markets. Moreover, we can hardly fault research on institutions as complex as internal labor markets for not being able to address every dimension of these institutions. Yet one can easily view the hypothesis of declining internal labor markets as having important implications aside from those for wages. As one example, the book presents evidence that pay cuts are not perceived as any more fair in Silicon Valley, a region "frequently associated with the new employment contract" (p. 133). But are the flexible employment relationships frequently ascribed to Silicon Valley characterized primarily by flexibility of wages, or by flexibility along other dimensions? (See, for example, Martin Carnoy, Manuel Castells, and Chris Benner, "Labour Markets and Employment Practices in the Age of Flexibility: A Case Study of Silicon Valley," *International Labour Review,* Vol. 136, No. 1, 1997.)

Echoing this same issue more broadly, Cappelli argues that an "important aspect of the . . . new deal is that it has eliminated many of the human resource practices, based on internal, administrative principles, that essentially buffered both employers and employees from the pressures of the outside labor market" (1999:37). This hypothesis clearly allows for the implications of declining internal labor markets to be reflected in outcomes other than wages. On the other hand, Levine et al. do present cogent arguments linking eroding internal labor markets to the wage outcomes they study. So the ball now lies in the court of the adherents of the "new employment contract" or the "new deal at work" to specify additional testable implications of their perspective on changes in the employment relationship.

David Neumark

Senior Fellow
Public Policy Institute of California