Title
Unemployment and Underemployment in Historical Perspective: Introduction

Author
Eichengreen, Barry

Publication Date
1989-11-01

UNEMPLOYMENT AND UNDEREMPLOYMENT IN HISTORICAL PERSPECTIVE: INTRODUCTION

Barry Eichengreen
University of California at Berkeley

The evolution of modern labor markets currently may be the single most popular research topic among economic historians, almost certainly in North America, quite probably in other parts of the world. And unemployment is, of course, the single most controversial aspect of labor market behavior. The problems involved are fundamentally historical. Labor market outcomes depend on institutions and conventions which have evolved in a fundamentally historical way. The emergence of implicit contracts and internal labor markets was a response to new industrial technologies and organizational forms which attached a growing premium to firm-specific skills and long-term employment relationships (Jacoby, 1985). Together with the rise of organized labor in the final decades of the 19th century, these arrangements transformed the manner in which labor markets responded to disturbances (Eichengreen, 1987a; Friedman, 1988). The realization that the modern labor market produced by these innovations did not function perfectly and could give rise to various problems, not the least of which was involuntary unemployment, prompted public intervention. The new institutional arrangements that resulted -- poor relief, unemployment insurance, and minimum wages prominent among them -- further altered the operation of the market.

Consequently, the structure and performance of labor markets can only be understood historically. They are the product of imperatives and events in the distant past. Equally, the effects of a specific set of labor market structures can only be identified historically. To isolate the impact of a particular labor market arrangement, one must compare the market in which it is embedded with another in which that function is absent or organized differently. The obvious way of doing so is by comparing labor markets over time. Thus, the study of unemployment and labor market dynamics is a fundamentally historical enterprise.

Recent research has revolved around three topics: the changing structure of labor markets, the incidence and effects of unemployment, and the policy response. I consider them in turn, focusing largely but not exclusively on contributions to this volume.

1. The Changing Structure of Labor Markets

Textbook accounts contrast the complex, highly structured labor market of the present with the simple, highly flexible labor market of the past. The transition between eras is usually placed between World Wars I and II to coincide with the spread of science-based industrial technologies, personnel departments, collective bargaining, unemployment insurance and minimum wage laws. The contrast has the following elements.

(a) Nowadays labor contracts negotiated through collective bargaining specify wages and fringe benefits for up to three years in advance. If prices or productivity change, nominal wages may be slow to adjust. In the past employer-employee transactions took place in a setting that more closely resembled spot or auction markets. Workers queued at factory gates and might be hired for a shift, a day or a week at rates of pay that adjusted rapidly to accommodate changing conditions. This minimized the incidence of unemployment attributable to inappropriate real wages.

(b) Nowadays the difficulty of reacquiring skilled employees after layoff and the depreciation of firm-specific knowledge off the job lead employers to retain skilled workers (to hoard labor) when demand falls temporarily. Turnover (movement of workers between firms and through the pool of the unemployed) is low because workers stay where their skills can be put to best use. In the past firm-specific training was less important, and turnover was consequently greater.

(c) Nowadays firms respond to a permanent decline in labor demand by laying off workers. Individuals with the least seniority, least skill and least education are most likely to suffer unemployment. In the past, firms were more inclined to reduce hours of work for all employees and less inclined to lay off workers. Unemployment therefore was less concentrated among certain socioeconomic groups.

Recent research, while supporting elements of this picture, has challenged its generality. Historians have noted that many of the distinctive features of the modern labor market were already evident in the 19th century. The implication may be that the transition to the modern labor market occurred earlier. Another possibility is that the transition never occurred: that labor markets have always been characterized by the kind of structures and relationships present in the 20th century. A third possibility -- the one which most economic historians probably favor -- is that the historical development of labor markets is more complex than suggested by standard accounts. The direction of change has not been from spot markets to long-term relationships, or from fluidity to inertia, but rather from one form of structure to another. Labor markets have developed more gradually and less linearly than commonly supposed, shedding one form of employment relationship for another, with complex implications for labor market outcomes including, notably, unemployment.

The 19th century American labor market has been a leading focus of this research. Susan Carter and Richard Sutch's contribution to this volume reports findings from their project on the late 19th century U.S. labor market. To lay bare the adjustment mechanisms at work, they consider responses to the severe depression of 1893, utilizing survey data for Connecticut. Carter and Sutch report that firms in their sample tended, to a surprising extent, to retain employees on their payrolls when the demand for labor fell. Instead of utilizing layoffs, employers reduced working time. This contrasts with behavior in the 20th century, when firms have tended to adjust employment rather than hours. Carter and Sutch's analysis, together with other studies for the U.S., suggests that the shift from the hours margin to the employment margin took place gradually, rather than discretely at the moment when unemployment insurance or union unemployment benefits were introduced.

It may not be correct to interpret work sharing as evidence of labor hoarding, however. In the presence of labor hoarding, output should fall even more rapidly than labor input. Carter and Sutch find that total worker hours fell by almost 30 per cent, the value of output by only 20 per cent.

Changes in wage behavior are still more complex. Since weekly wage rates fell less than hours, nominal hourly wages rose. Given the collapse of prices, this implied a dramatic rise in the real hourly wage for those fortunate enough to retain employment. The same pattern was evident in prewar Britain, to sophisticated observers at least. (Haim Barkai notes comments by Alfred Marshall to this effect.) Similar behavior is evident during the Great Depression in a variety of countries (Eichengreen and Sachs, 1985). Thus, the rise of real wages in the interwar depression cannot be attributed to solely to U.S. President Hoover's policy of discouraging nominal wage cuts. Rather, it should be seen as the persistence of an adjustment mechanism evident as early as the 1890s.

Post-World War II experience has been very different. Since 1945 there has been no clear tendency for real wages to rise or fall in recessions. This suggests that the acyclical behavior of real wages may be a product of Keynesian stabilization policy or of the increasing indexation of nominal wages in response to persistent inflation, both of which are developments specific to the post-WWII years.

2. Incidence of Unemployment

A common argument among historians is that, prior to the 20th century, the burden of unemployment was much more evenly distributed across socioeconomic groups. The state of trade determined who suffered loss of work. If the demand for coal declined, it was coal miners who suffered unemployment; if the demand for ships declined, it was shipbuilders. Personal characteristics and family circumstances were unimportant as determinants of unemployment, both relative to industry attachment and in comparison with 20th century experience (Keyssar, 1986). Insofar as unemployment was unevenly distributed, its burden fell disproportionately on manual and unskilled workers for whom job attachment was low, labor turnover was high, and unemployment spells were frequent.

Several contributions to this volume reach conclusions consistent with this view. Robert Margo, in his analysis of U.S. unemployment in 1909, finds that personal characteristics account for relatively little unemployment risk. Tim Hatton and Jeffrey Williamson, using data for Michigan in the 1890s, find similarly that while age and ethnicity do help to account for the incidence of unemployment, their explanatory power is low in comparison with that of occupation and industry attachment.

Carter and Sutch's evidence from Connecticut provides additional evidence on the "industrial lottery" model of pre-WWI unemployment. They find that plant shutdowns were one of the principal ways in which firms shed workers, in which case all employees, skilled and unskilled, were equally vulnerable to job loss. Yet they note also that, for firms that did not shut down, nominal wages rose in the 1893 recession, a fact interpreted by contemporary observers as indicating that it was the least skilled (and lowest paid) workers who were laid off. In this respect U.S. experience seems to stand in contrast to that of Edwardian Britain, for which Mark Thomas finds only minor differences in unemployment by skill level.

Why some firms shut down while others remained in operation with reduced staffing is not well understood, as Carter and Sutch observe. Certain technologies heighten the cost of shutting down and starting back up. The fixed costs of firing up a blast furnace are a standard example. But an equally plausible explanation lies in labor management: the danger of losing separated workers with firm-specific skills provides a compelling rationale to avoid shutting down and laying off the entire workforce. Whatever the explanation, the choice of strategy seems to have had major implications for the incidence of unemployment.

Another perspective on unemployment incidence can be gleaned from data on flows and durations. An annual average unemployment rate of ten per cent can severely impact the unemployed if one in ten workers is without work for the entire year. Its implications are very different if all labor force participants are unemployed for five weeks. Following work by Mark Thomas (1988) on interwar Britain, a number of contributors to this volume approach the study of unemployment by estimating turnover rates. Thomas himself extends his analysis back to Edwardian Britain. Since Edwardian unemployment rates were so much lower than those of the 1920s and 1930s, it is possible to determine whether Thomas's previous findings, notably of strikingly rapid rates flow through the labor market, are peculiar to periods of high unemployment or are a common feature of earlier eras. Thomas finds for 1913 rates of inflow into the pool of the unemployed comparable to those reached in the depression of the 1930s, and even faster rates of outflow (which is implied by the inflow rates, in combination with the much lower unemployment rate). Thus, the rapid rates of flow through unemployment characteristic of interwar Britain seem to have been even more pronounced before WWI.

Consistent with Thomas's findings for interwar Britain, Robert Margo shows using data from the 1910 U.S. Census that rates of flow through the U.S. labor market were considerably more rapid in the early 20th century than in the 1970s. Evidence presented by other authors for the U.S. (Baily, 1983; Jensen, 1989) suggests that the high rates of flow identified by Margo persisted into the 1930s and only declined after World War II. In both Britain and the U.S., it would appear, then, turnover was much more rapid before World War II than after.

Though turnover was more rapid in both economies before WWI than after WWII, the contrast is especially strong for Britain. The differential in turnover rates as estimated by Margo is around 30 per cent, a substantial sum but still smaller than Thomas's. Consistent with this are the authors' estimates of average unemployment durations: while unemployment rates are not dissimilar in the two countries on the eve of World War I, together their estimates imply that the average duration of an unemployment spell in Britain was only a quarter of the duration of a spell in the U.S. This may not have implications for welfare, however. Thomas notes that individuals suffering short unemployment spells did so repeatedly. For the average unemployed person in Britain, he estimates 3.3 separate spells. Margo's data, which may underestimate the number of separate spells by omitting information on the portion of spells beginning prior to the census year, do not suggest multiple spells within the calendar year. This points to casual labor -- the problem of those especially vulnerable to unemployment moving repeatedly into and out of work -- as a peculiarly British phenomenon.

Margo's application of the methodology to the 1910 U.S. Census is particularly revealing, since it allows him to estimate unemployment dynamics disaggregated by workers' industry of employment and personal characteristics. He finds that white collar workers and service sector employees were far less likely to become unemployed than their counterparts in construction, mining and manufacturing, but that upon losing work they experienced longer unemployment spells. The modern phenomenon of low turnover appeared first, then, in government, services and the professions. Personal characteristics are relatively unimportant as determinants of inflow and outflow rates. One notable exception is race. Contrary to Keyssar's claim that black men were idled less often than whites but experienced more difficulty in obtaining new jobs subsequently, Margo reaches the opposite conclusion on both scores. It is not clear whether this reflects the different industries and occupations in which whites and blacks were concentrated, or whether it is due to other factors, possibly including racial discrimination. Multivariate analysis will be needed to address this question.

3. The Policy Response

The public and private sectors adopted a variety of measures in response to the emergence of high unemployment between the wars. The response was conditioned by contemporary perceptions of the nature of the unemployment problem. The two interwar decades were a period of flux for theories of unemployment, as the contribution by Haim Barkai shows. Before the war, individuals without work had been referred to in Britain as paupers and vagrants, in the U.S. as idlers or loafers, and in France as vagrants and vagabonds, but only rarely as unemployed. The terms used to refer to individuals without work reflected the perception that their plight was largely of their own making. The very fact that the noun "unemployment" was rarely used reflected incomplete appreciation that individuals could be out of work as a result of factors beyond their control, notably the trade cycle (Eichengreen and Hatton, 1988). As Barkai describes, even Alfred Marshall, the dean of English political economists, resisted attributing unemployment to the cycle.

By the 1920s the noun had come into common usage. Unemployment was seen as a "problem of industry" rather than of the individual's making (Beveridge, 1910). Unemployment insurance was a direct response to the perception that involuntary unemployment was intrinsic to the operation of modern labor markets. Its provision once again transformed the structure and operation of the labor market. The effects of unemployment benefits on the behavior of the unemployed, and specifically on their incentive to seek work, has been a subject of great controversy over the last decade. Daniel Benjamin and Levis Kochin (1979) argued that a third to a half of interwar unemployment in Great Britain was induced by the provision of generous unemployment benefits. Benjamin and Kochin's analysis was conducted at a high level of aggregation. Subsequent research seeking to get closer to the operation of the interwar labor market has not been kind to their hypothesis. My own work (1987) using a sample of several thousand workers in the early years of the Depression found some evidence of benefit-induced unemployment, but only among young, single men without families to support. The impact on the aggregate unemployment rate was small. Tim Hatton (1985) looked at vacancy and unemployment stocks, the relationship between which should have been directly affected if insurance benefits discouraged search, and found no evidence that the unemployment/vacancy ratio shifted with changes in the generosity of benefits.

If the induced-unemployment hypothesis has any validity, it should apply equally to other countries in which unemployment insurance schemes had been adopted. David Corbett's study of Germany is one of the first analyses of the effects of unemployment benefits in other countries. Corbett shows that, as in Britain, there is a strong time-series correlation between the benefit/wage ratio and the unemployment rate. Yet, as Hatton found for Britain, Corbett shows for Germany that the correlation is largely spurious. There was at most a modest role for relief benefits in inducing search unemployment. This finding is buttressed by its consistency with the qualitative literature, as summarized in Evans and Geary (1987).

Alan Green and Mary MacKinnon take a similar approach to analyzing the impact of New Deal programs in the U.S. These schemes are alleged to have raised wages, reduced labor market flexibility, and limited willingness to seek work, thereby delaying the recovery of employment from the Depression. If NRA codes and WPA programs actually had these effects, recovery should have proceeded more rapidly in countries where economic conditions were otherwise similar but comparable programs were absent. Canada is one such country. Green and MacKinnon analyze matched pairs of U.S. regions and Canadian provinces and, after controlling for other economic characteristics, find that recovery was no more rapid in Canada despite the absence of the NRA and WPA. In addition to its substantive conclusions, their work underscores the methodological advantages of the comparative approach.

A regrettable limitation of the literature on unemployment insurance is that it has been analyzed in isolation from complementary policies like welfare benefits and private charity. Bernard Harris describes attempts to coordinate public policy with charitable initiative, as when for example the British Government matched contributions to the Lord Mayors' Fund or provided finance for privately-initiated self-help schemes. Harris is appropriately cautious about drawing implications for policy, given the preliminary state of his research. But to this U.S. reader, mindful of President Bush's "thousand points of light," Harris's findings point toward the conclusion that private initiatives, even when publicly subsidized, were inadequate to make significant inroads into the unemployment problem.

When their entitlement to unemployment benefits was exhausted, the long-term unemployed were forced to resort to traditional forms of aid such as poor relief and public assistance. In contrast to unemployment benefits, these were administered at the local level. Anne Digby's study of County Durham describes the highly politicized nature of unemployment policy and the difficulty of generalizing about its effects. Contemporary commentary reflects some concern that the provision of relief discouraged search, mainly by young, single males. But in the view of many contemporaries, and in the view of Digby herself, as important as attitudes toward work were attitudes toward welfare. What mattered was not so much the level of welfare benefits as the fact that the unemployed were no longer stigmatized by the receipt of public assistance. Acceptance of the fact that unemployment could be involuntary made drawing benefits socially acceptable.

This account of unemployment policy at the local level provides a striking contrast to W. R. Garside's account of policy from the perspective of Whitehall. Whereas the local authorities were concerned to maintain minimal acceptable living standards for the unemployed, the central government was concerned to control and restrict local expenditure so as to limit welfare dependency and reduce the burden of rates. Limiting the burden of taxation and the level of public expenditure was designed initially to arrest Britain's loss of industrial and financial preeminence and subsequently to buttress currency stability and avoid crowding out productive investment. Yet governments which went too far down the road of austerity courted loss of support from the working class. Compromise involved mastering "The Art of Expediency" to which the title of Garside's article alludes.

4. Directions for Research

The traditional preoccupation with interwar unemployment has already been superceded by a longer-term perspective in which the Depression of the 1930s is treated as but one of many episodes of high unemployment. The recent flurry of research on the U.S. labor market in the late 19th century is the leading indicator of this trend. Just as the literature on interwar unemployment was greatly enriched by the proliferation of national case studies, so too would be that on the late 19th century. Only then can the generality of conclusions and the explanation for international variations in unemployment experience be adequately understood.

Local and regional studies offer many of the same advantages. The characteristics of unemployment differ markedly across regions. Only through the accumulation of case studies can we begin to understand how the economic history and industrial structure of a region generate a particular pattern of unemployment. The contributions of Digby, Harris, and Green and MacKinnon, as well as other recent studies like that of Nicholas (1986), illustrate the insight to be gained from local studies.

Finally, the nature of unemployment and the policy response must be analyzed in an integrated fashion. That recent work by economists on interwar unemployment has generated more heat than light is attributable to their failure to approach the question in this fashion, preferring to superimpose modern perceptions of the unemployment problem on historical data and to criticize policy responses from that perspective. To appreciate why governments responded as they did and to move from there to an assessment of the effects of their policies, it is essential to ground the analysis in the structure of the labor markets of the era and thereby in the nature of the unemployment problem.

REFERENCES

Beveridge, William, Unemployment: A Problem of Industry, London: Longmans, Green, 1910.

Baily, Martin Neil, "The Labor Market in the 1930s," in James Tobin (ed.), Macroeconomics, Prices and Quantities, Washington, D.C.: The Brookings Institution, 1983, pp. 21-61.

Benjamin, Daniel and Levis Kochin, "Searching for an Explanation for Unemployment in Interwar Britain," Journal of Political Economy 87, 1979, pp. 441-478.

Eichengreen, Barry, "The Impact of Late-Nineteenth Century Unions on Labor Earnings and Hours: Iowa in 1894," Industrial Relations and Labor Review 40, 1987a, pp. 501-515.

Eichengreen, Barry, "Unemployment in Interwar Britain: Dole or Doldrums?" Oxford Economic Papers 39, 1987b, pp. 597-623.

Eichengreen, Barry and Jeffrey Sachs, "Exchange Rates and Economic Recovery in the 1930s," Journal of Economic History 45, 1985, pp. 925-946.

Eichengreen, Barry and T.J. Hatton, "Interwar Unemployment in International Perspective: An Overview," in Barry Eichengreen and T.J. Hatton (eds.), Interwar Unemployment in International Perspective, Dordrecht: Kluwer, 1988, pp. 1-50.

Evans, Richard J. and Dick Geary, The German Unemployed, London: Croom Helm, 1987.

Friedman, Gerald, "Strike Success and Union Ideology: The United States and France, 1880-1914," Journal of Economic History XLVIII, 1988, pp. 1-26.

Hatton, T.J., "The British Labor Market in the 1920s: A Test of the Search-Turnover Approach," Explorations in Economic History 22, 1985, pp. 257-270.

Jacoby, Sanford, Employing Bureaucracy, New York: Columbia University Press, 1985.

Jensen, Richard J., "The Causes and Cures of Unemployment in the Great Depression," Journal of Interdisciplinary History 19, 1989, pp. 553-583.

Keyssar, Alexander, Out of Work: The First Century of Unemployment in Massachusetts, Cambridge: Cambridge University Press, 1986.

Nicholas, Katherine, The Social Effects of Unemployment in Teeside, Manchester: Manchester University Press, 1986.

Thomas, Mark, "Labour Market Structure and the Nature of Unemployment in Interwar Britain," in Barry Eichengreen and T.J. Hatton (eds.), Interwar Unemployment in International Perspective, Dordrecht: Kluwer, 1988, pp. 97-148.

UNEMPLOYMENT AND UNDEREMPLOYMENT IN HISTORICAL PERSPECTIVE

Edited by

Barry Eichengreen
University of California at Berkeley

for the
1990 International Economic History Association Congress

CONTENTS