Can competitive labor markets produce social cohesion (or do we need institutions)?

lessons from some advanced and developing countries

Richard B. Freeman, Harvard and NBER, LSE CEP
International conference on social cohesion and development, OECD Paris January 20, 2011
Introduction and Theme

Income inequality has risen in most countries while falling worldwide, which arguably affects social cohesion in countries and internationally. Policies toward inequality have also changed, arguably in response to changed attitudes toward social cohesion.

This talk will review the economic changes and formation of a global market for highly educated workers; speculate on implications for social cohesion; highlight differences in policy responses to inequality; and examine fragmentation/ balkanization of the US as “competitive labor market” to answer the title question.
1. The Changes in Inequality

1- Rapid growth of GDP in large populous developing countries has reduced income inequality among countries in relative terms, not in real absolute differences until now.

<table>
<thead>
<tr>
<th>Year Range</th>
<th>%</th>
<th>Absolute ppp units</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-2006</td>
<td></td>
<td></td>
</tr>
<tr>
<td>US growth</td>
<td>1.9</td>
<td>11,300</td>
</tr>
<tr>
<td>China growth</td>
<td>8.9</td>
<td>5,700</td>
</tr>
</tbody>
</table>

2- But within country inequality increased in most countries due to higher skill differences, rural/urban, geographic differences.

3- Adding the changes together using a variance decomposition, where \( \sigma^2 = a\sigma_1^2 + (1-a)\sigma_2^2 + a(1-a)(M_1-M_2)^2 \), shows global inequality per person fell.

4- Faster DC recovery from recession added to this.
Spread of Higher Education

Mass higher education, once the preserve of the US, and other advanced countries, has spread to the developing countries. China graduates 6-7 million bachelor's per year.

Higher education curriculum similar across countries

The number of international students risen rapidly

Highly skilled immigrants increase from developing countries

Major multinationals recruit internationally

Educated form a more cohesive group, especially scientists, academics, business leaders
### Millions of International Students Worldwide

<table>
<thead>
<tr>
<th>Year</th>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>0.6</td>
</tr>
<tr>
<td>1980</td>
<td>0.8</td>
</tr>
<tr>
<td>1985</td>
<td>0.9</td>
</tr>
<tr>
<td>1990</td>
<td>1.2</td>
</tr>
<tr>
<td>1995</td>
<td>1.3</td>
</tr>
<tr>
<td>2000</td>
<td>1.9</td>
</tr>
<tr>
<td>2005</td>
<td>2.7</td>
</tr>
<tr>
<td>2008 OECD</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Caterpillar China Employment Opportunities
卡特皮勒中国就业机会信息发布会

Richard P. Lavin, Group President, Caterpillar Inc., Peoria, Illinois
11am-1pm, Friday, May 2, 2nd Floor, Levis Faculty Center
(Pizzas, cookies & soft drinks available. Targets: Student/scholars from China)

Caterpillar Team:
Richard Lavin/腊睿智 (JD), Group President
Brian Sun/孙晓波 (PhD), Global R & D Strategy Director
Ulf Lindqwister/林沃福 (PhD), Enterprise Strategy Support Manager
John Balkema/巴强安, Employment Management Manager
Jack Feng/冯常学 (PhD), President, Feng Consulting Inc.

Key facts about Caterpillar Inc.:
World headquarter in Peoria, IL
Fortune 100 US company
Revenue $45 billion in 2007
About 20 facilities in Mainland China
Around 300 facilities in 40 countries
100,000 + employees
Over 180 dealers/105,000 dealer employees
Global leader in construction & mining machines
Global leader in diesel and natural gas engines
Global leader in industrial gas turbines

Agenda:
Jack Feng welcome and introduction of Caterpillar team
UIUC CSSA welcome
UIUC Career Service welcome
Self introduction of each participant (name, major, degree in)
Ulf introduction of Rich Lavin
Rich Lavin presentation “Caterpillar and China: A Shared Future”
Comments by other members of Caterpillar and Q & A
Break up into groups (Business, engineering, marketing, others)

Co-Sponsors:
UIUC Chinese Students & Scholars Association
UIUC Career Services Office
Caterpillar Inc.

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TODAY'S WORK. TOMORROW'S WORLD.™
How does globalization of ideas and education affect social cohesion?

Who do you identify with more? Your intellectual colleagues? Your students and classmates? Or your fellow citizens? Cohesion into interest groups seems to follow similarities and to be greater for intellectual and business elites.

In mid-2000s IBM famously declared it was a global corporation not a multinational.

Labor organizations remain idiosyncratic and local.

From the perspective of Christopher Lasch's 1996 book, Revolt of the Elites, WE are the villains.
2. Different Patterns in Inequality

The US: Inequality risen primarily because inequality has risen within groups. Take any well-defined social-demographic group, including students in a single class in a university. Most of US inequality change occurs within those groups rather than in increased coefficients on measures of labor skills.

China: Inequality risen primarily because of differences among groups. Rural/urban, regional, educational, etc. Work with Wei Chi of Tsinghua shows almost no increase in dispersion of pay within education groups.
Huge Wage Variation Within Skill Groups in US

Figure 3: Wage inequality in Narrow US Score Groups

Source: National Adult Literacy Survey for US; International Adult Literacy Survey for other countries. We break the NALS sample of US workers into groups based on test score. For example, group 260 includes all persons with a score of 258-262. The average number of observations in each group is 286. We compare earnings inequality within each group to earnings inequality of each country. The average standard deviation of log earnings in these twelve groups is .79. The comparable figure for the four countries is Germany .68, Netherlands .67, Sweden .68, and US .86 (in the NALS, or .93 in the IALS).

<table>
<thead>
<tr>
<th></th>
<th>Informal</th>
<th>Formal</th>
<th>Informal</th>
<th>Formal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hrs/Week</td>
<td>53.4</td>
<td>42.4</td>
<td>72.1</td>
<td>52.2</td>
</tr>
<tr>
<td>Monthly yuan earnings</td>
<td>1094</td>
<td>1387</td>
<td>976</td>
<td>1247</td>
</tr>
<tr>
<td>Pension</td>
<td>54.80%</td>
<td>82.10%</td>
<td>2.1</td>
<td>29</td>
</tr>
<tr>
<td>UI</td>
<td>12.6</td>
<td>39.7</td>
<td>0.4</td>
<td>17.8</td>
</tr>
<tr>
<td>Work Injury Ins.</td>
<td>6</td>
<td>29.1</td>
<td>1.2</td>
<td>31.7</td>
</tr>
<tr>
<td>Health Ins.</td>
<td>32.6</td>
<td>71.4</td>
<td>1.3</td>
<td>29.7</td>
</tr>
</tbody>
</table>
Does this imply different patterns of social cohesion?

Speculative hypothesis 1: Higher within group inequality reduces within group cohesion along economic dimension?

Speculative hypothesis 2: Greater cross group inequality creates potential for social disorder, which leads leadership to act in ways to preserve social cohesion?
3. Policy Responses

China: From Deng Xiaping, "Let some people get rich first" to Jiang Zemin "if certain social and economic problems are not tackled without delay, the overall stability of the country could be threatened"

Concern of leaders over social stability reflected in set of labor laws enacted over the opposition of many economists, new wealthy class, US Chamber of Commerce in China, others.
Policy Reforms Have Been Pro-Labor

Union/CB Reforms – to strengthen ability of ACFTU to organize workplaces, bargain collectively

Large increases in minimum wages, city/province

Contract Labor law (took effect January 2008)– to give migrant workers/ other informal market workers contract protection

Other reforms: introduction of national social security, pensions etc.
Honda Workers in Strike Summer 2010

Government responds by allowing strike. ACFTU seeks to try to become representative. Regional variation in strategy to reform worker official organizations.
Democratic regimes in Latin America have also changed policies.

Left-of-center regimes elected in the wake of the failed Washington Consensus policies such as Lula (and even some conservative Latin American governments) adopt pro-labor policies.

The result is that Latin America has combined falling income inequality with growth – which few if any analysts expected ten or so years ago.

Does Tunisian political upheaval --> push-back against the inequalities of past several decades' laissez-faire policies will spread in the developing world?
Substantial country differences in advanced country adjustments in 2008-10 recession

Adjustment largely through employment – US, Spain, Ireland, Latvia

Adjustment largely through hours --- Germany, Czech, Slovakia, Greece

Adjustment largely through hourly productivity -- Netherlands, Japan, UK, Romania.

Source: EU, Employment in Europe 2010, chart 12b
BLS Mfg data show declining productivity per hour as job-saving mode of response.
The Variation is immense

The United States had the largest productivity increase, 7.7%, and huge reduction in total hours worked.

Japan had the steepest productivity decline, -11.4%.

Within EU, Belgium 1.2% vs Germany -9.3%
   - France, -7.2%;

Even among Scandinavians, Denmark -1.4%, Sweden, -7.3%, Norway, 0.8%
What caused such massive differences?

EU: concern over workers → Short-term work initiatives: work-sharing either by government or collective bargaining, wage freezes. UI coverage more extensive, with some limits. Conservative and business commitment to social system

US: battle over extending UI, major coming cuts in public sector employment; NO INSTITUTIONS to press for policies beneficial to workers. Return of Wall Street and continued belief in WC policie
III. A Real World Competitive Labor Market in Action: fragmentation of US earnings

How should a competitive labor market respond to major recession?

With price/wage adjustments. Big loss of jobs and rapid jobs recovery when recession ends.

In industries, Salter model most appropriate, with firms as wage-takers so that demand increases produces big gains in employment. Market sets similar wage changes to similarly skilled workers.
## Big rising wage diffs between establishments

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Change variance, all workers</td>
<td>.048</td>
<td>.041</td>
<td>.102</td>
<td>.140</td>
</tr>
<tr>
<td>Between establishments</td>
<td>.036</td>
<td>.033</td>
<td>.114</td>
<td>--</td>
</tr>
<tr>
<td>Within establishments</td>
<td>.013</td>
<td>----</td>
<td>----</td>
<td>---</td>
</tr>
<tr>
<td>% to between establishments</td>
<td>74</td>
<td>80 (71a)</td>
<td>100+</td>
<td>Most</td>
</tr>
</tbody>
</table>
Increased dispersion, 1977 to 2007

1- Rising dispersion of ln wages associated with greater increase in productivity dispersion:
   
   \[
   \text{increase V ln wages} = 0.14 \text{ points}
   \]
   
   \[
   \text{increase Vln Output/E} = 0.34 \text{ points!}
   \]

2- Rise in dispersion of ln wages is in multi-establishment firms (which have greater choice and may be less market-constrained):

\[
\begin{array}{ccc}
1977 & 2002 & 2007 \\
\text{Single establishment firms} & 0.34 & 0.39 & 0.40 \\
\text{Multi establishment firms} & 0.29 & 0.47 & 0.51 \\
\end{array}
\]
What explains divergence between US labor outcomes and competitive model?

H1: The Invisible Hand is more mysterious than naïve economists think. Mysterious dark matter – unmeasured skill differences, economic conditions, technological change – account for patterns.

H2: US is not competitive market at all. Too much regulation and Obama health care and anti-business attitude has delayed recovery

H3: The Invisible Hand needs help to establish socially desirable outcomes. Model requires social institutions.