

Econ 133 – Global Inequality and Growth

Labor income inequality: the role of institutions

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Roadmap

- The limits of the supply-demand framework
- Minimum wage
- Unions
- Market power

1 Limits of the supply-demand framework

The supply/demand framework (“race between education and technology” story) cannot explain key facts:

- Sharper inequality increase in the US than elsewhere
- Rise in inequality concentrated at the top

Four main other forces also play a role:

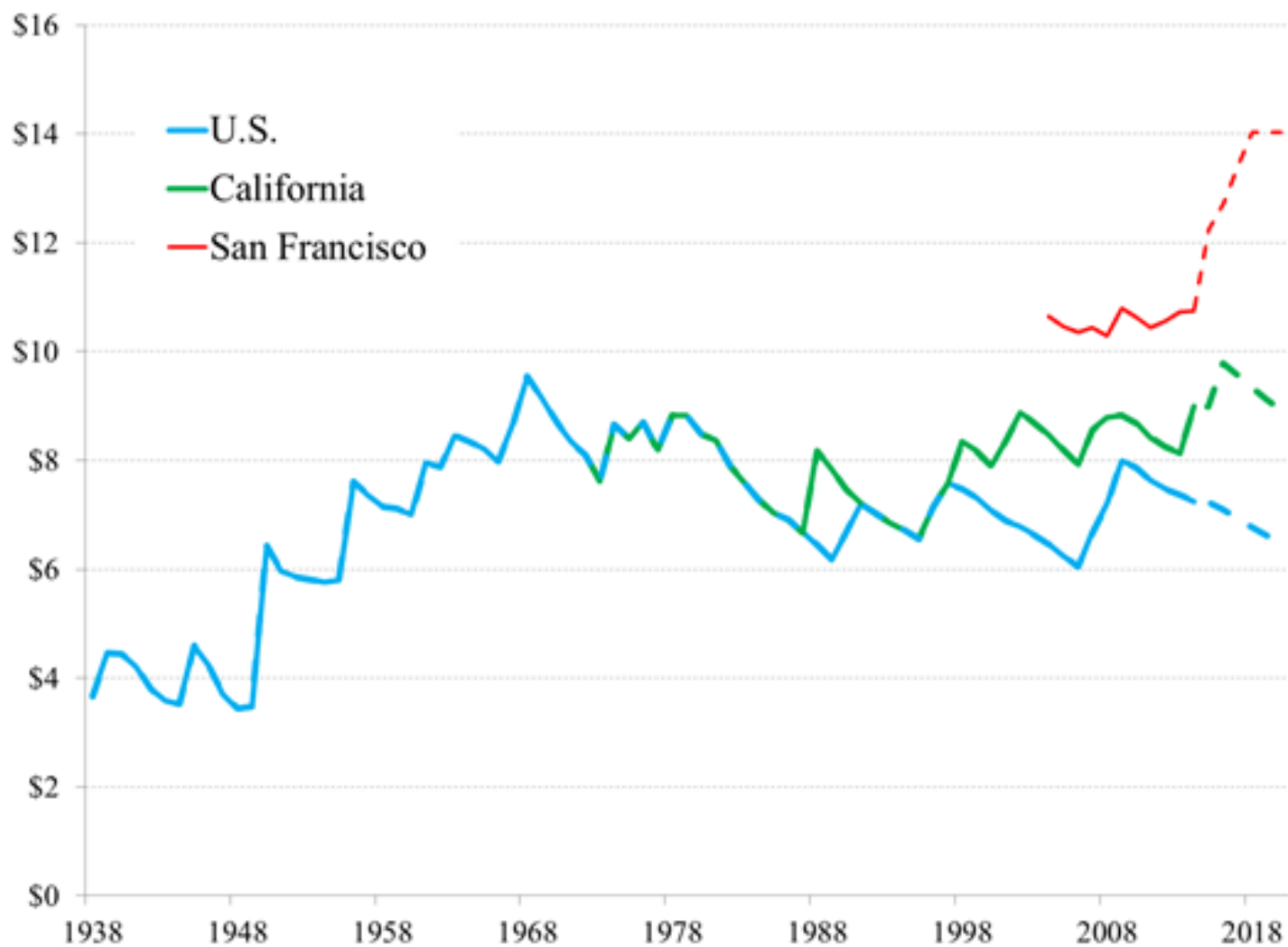
- Changes in minimum wages
- Change in the role and power of unions
- Changes in market power
- Changes in top marginal income tax rates

2 Minimum wage

2.1 The evolution of the minimum wage

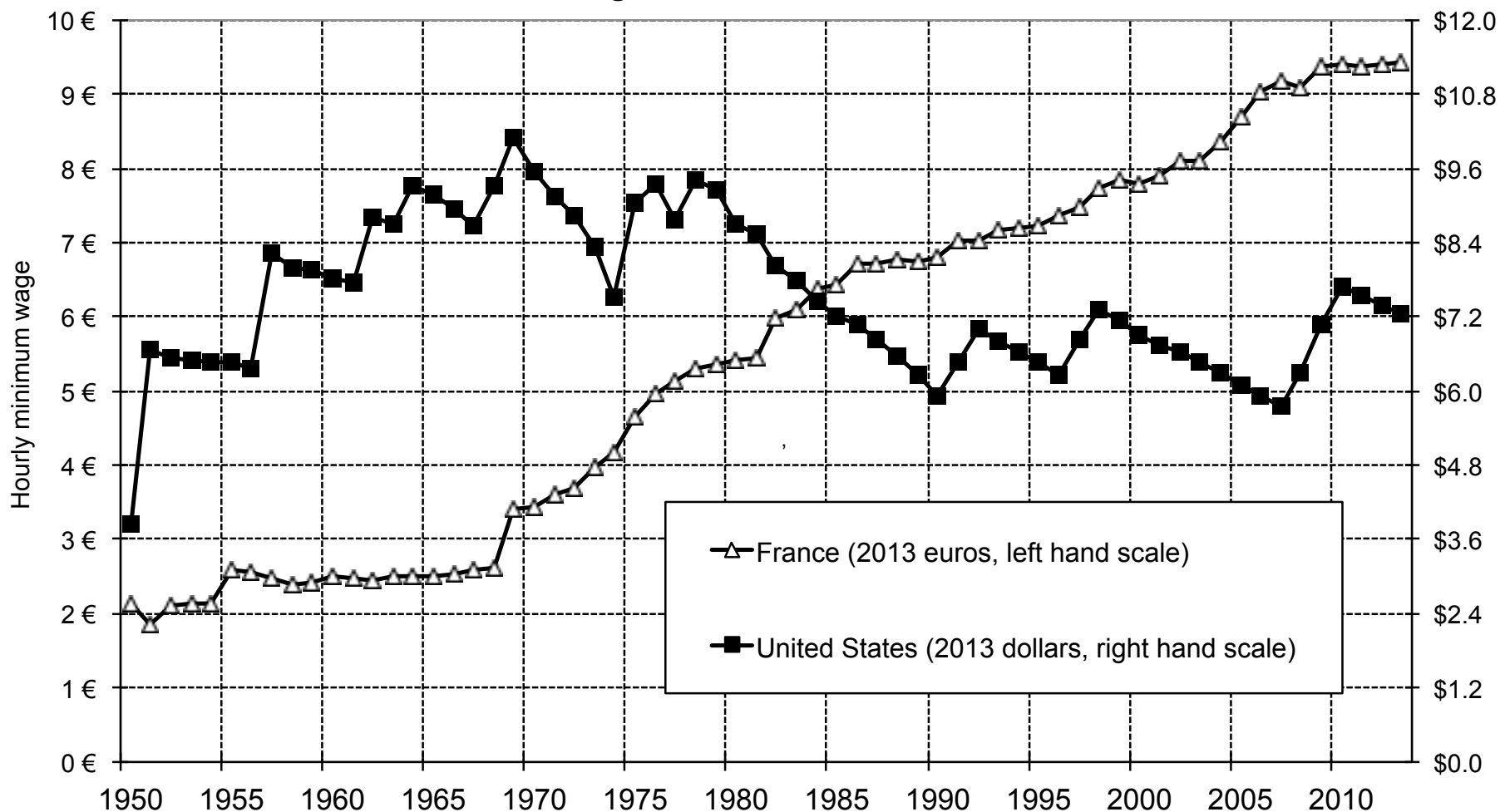
- Federal min. wage introduced in US in 1933; now equal to 7.25\$/h = lower in real terms than in 1960
- Northern and Western States tend to have min. wages $>$ fed. min.
- Different history and evolution of labor market across countries

- In France, min. wage introduced in 1950; now equal to 9.5 euro/h
- Introduced in UK in 1999
- Introduce in Germany in 2015 (8.84 euros per hour)
- No national min. wage in Nordic countries, but binding salary scales negotiated by unions and employers



Note: minimum wage in constant 2014\$. Source: Montialoux and Reich (2016)

Minimum wage in France and the U.S., 1950-2013



Expressed in 2013 purchasing power, the hourly minimum wage rose from \$3.8 to \$7.3 between 1950 and 2013 in the U.S., and from €2.1 to €9.4 in France. Sources and series: see piketty.pse.ens.fr/capital21c.



2.2 Effects of the minimum wage on wage inequality

- Minimum wage reduces lower tail inequality (DiNardo, Fortin and Lemieux 1996; Autor et al. 2016)
- Decline in the real value of the minimum wage explains 30-40% of the rise in P10/P50 wage inequality in the 1980s
- Effect due to spillovers: minimum wage must have raised the wages of workers earning above the minimum

2.3 Effect of minimum wage on employment

- Conventional supply and demand analysis suggests negative effect on employment
- However, in a number of controlled experiments (State minimum wage hikes), little effect found on employment

Variable	Stores by state		
	PA (i)	NJ (ii)	Difference, NJ – PA (iii)
1. FTE employment before, all available observations	23.33 (1.35)	20.44 (0.51)	-2.89 (1.44)
2. FTE employment after, all available observations	21.17 (0.94)	21.03 (0.52)	-0.14 (1.07)
3. Change in mean FTE employment	-2.16 (1.25)	0.59 (0.54)	2.76 (1.36)

Source: Card and Krueger (1994)

- Minimum wage effects are a matter of degree:
 - If high low-wage payroll tax & poor training system for low- skill workers, then cost of high minimum wages can be large
 - If min wage low (such as US today), raising it can actually raise employment by raising labor supply (Card and Krueger 1994)
 - The right level also depends on the tax system and the education system

3 Market power

- Market power: deviation from perfect competition pricing
- Monopoly: producer sets the price of what they sell:
 - Ex: Monsanto = sole supplier of GMO soybeans and corn
 - Ex: Internet access = local monopolies of cable companies
 - In these cases, price $>$ marginal cost

Table 1

**Percentage Point Change in Revenue Share Earned
by 50 Largest Firms, 1997-2007**

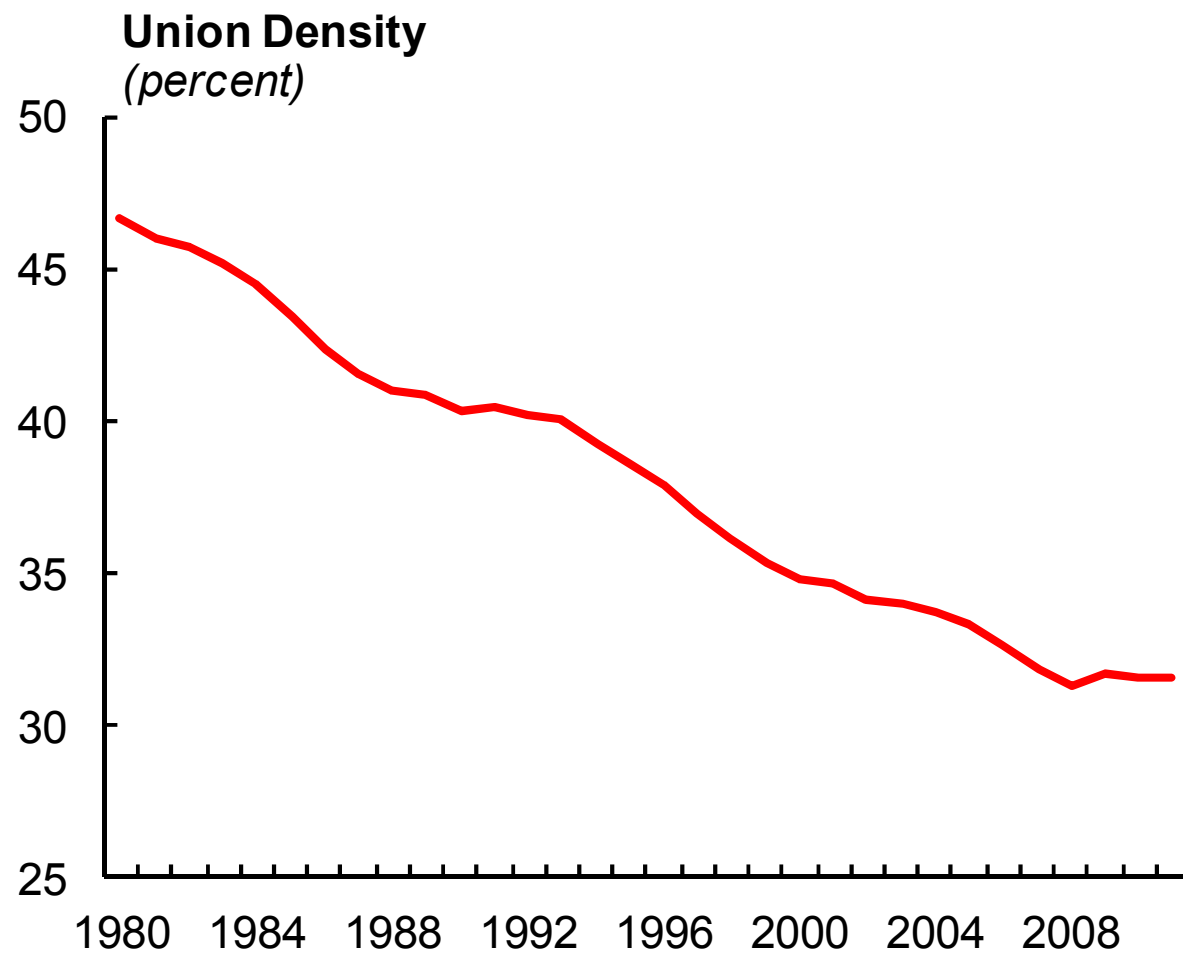
Industry	
Transportation and Warehousing	12.0
Retail Trade	7.6
Finance and Insurance	7.4
Real Estate Rental and Leasing	6.6
Utilities	5.6
Wholesale Trade	4.6
Educational Services	2.7
Accommodation and Food Services	2.6
Professional, Scientific and Technical Services	2.1
Administrative/Support	0.9
Other Services, Non-Public Admin	-1.5
Arts, Entertainment and Recreation	-2.3
Health Care and Social Assistance	-3.7

Source: Furman and Orszag (2015)

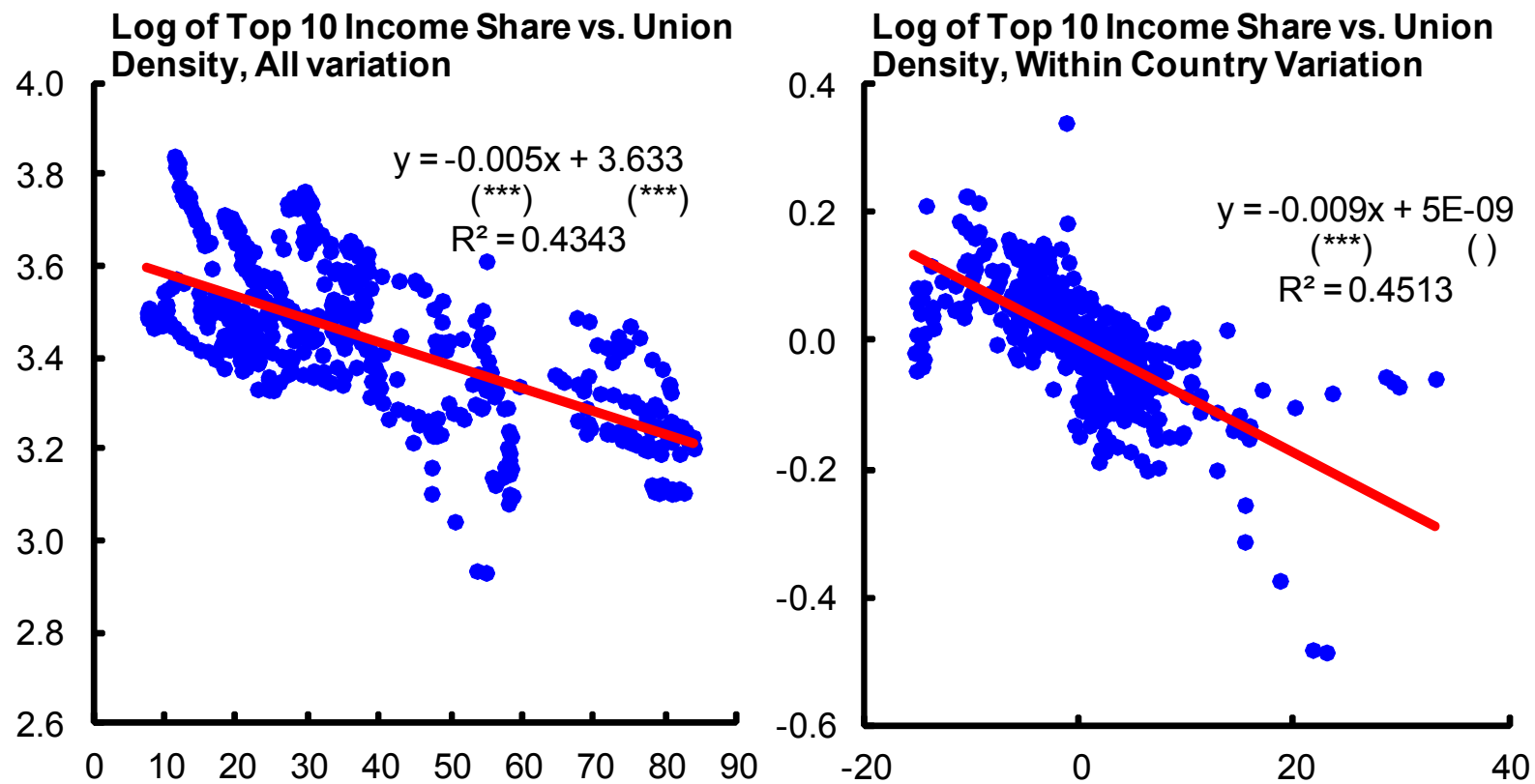
- Monopsony: purchasers set the price of what they buy:
 - Ex: Walmart = main purchaser of products for retail
 - Ex: fast-food chains = main employer in small towns
 - Consequences on labor market: $wage < \text{marginal product}$; can explain worsening of inequality
 - Strong rationale for min. wage (protect low-wage workers from lack of negotiating power)

4 Unions

- Big decline in unionization in advanced economies
- But with different trends: US vs. Canada
- Strong correlation btw ↘ union and ↗ of top 10% income share



Source: Jaumotte and Buitron (2015)



Source: Jaumotte and Buitron (2015)

5 Policy implications

- Market power largely determined by political decisions → antitrust laws, laws on revolving door & lobbying, campaign finance laws
- Minimum wage: key local policy issue
- Change in labor law and contract law can empower workers to take action against employers and to assert their interests

6 Conclusion

- The supply/demand is not enough to understand the rise of labor income inequality in the US
- Labor market institutions matter
- Stagnation of minimum wage combined with ↗ market power of producer and ↘ power of unions have contributed to ↗ inequality

References

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Montialoux Claire, and Robert Reich, “Local minimum wages”, IRLE Policy brief 2016