

# **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

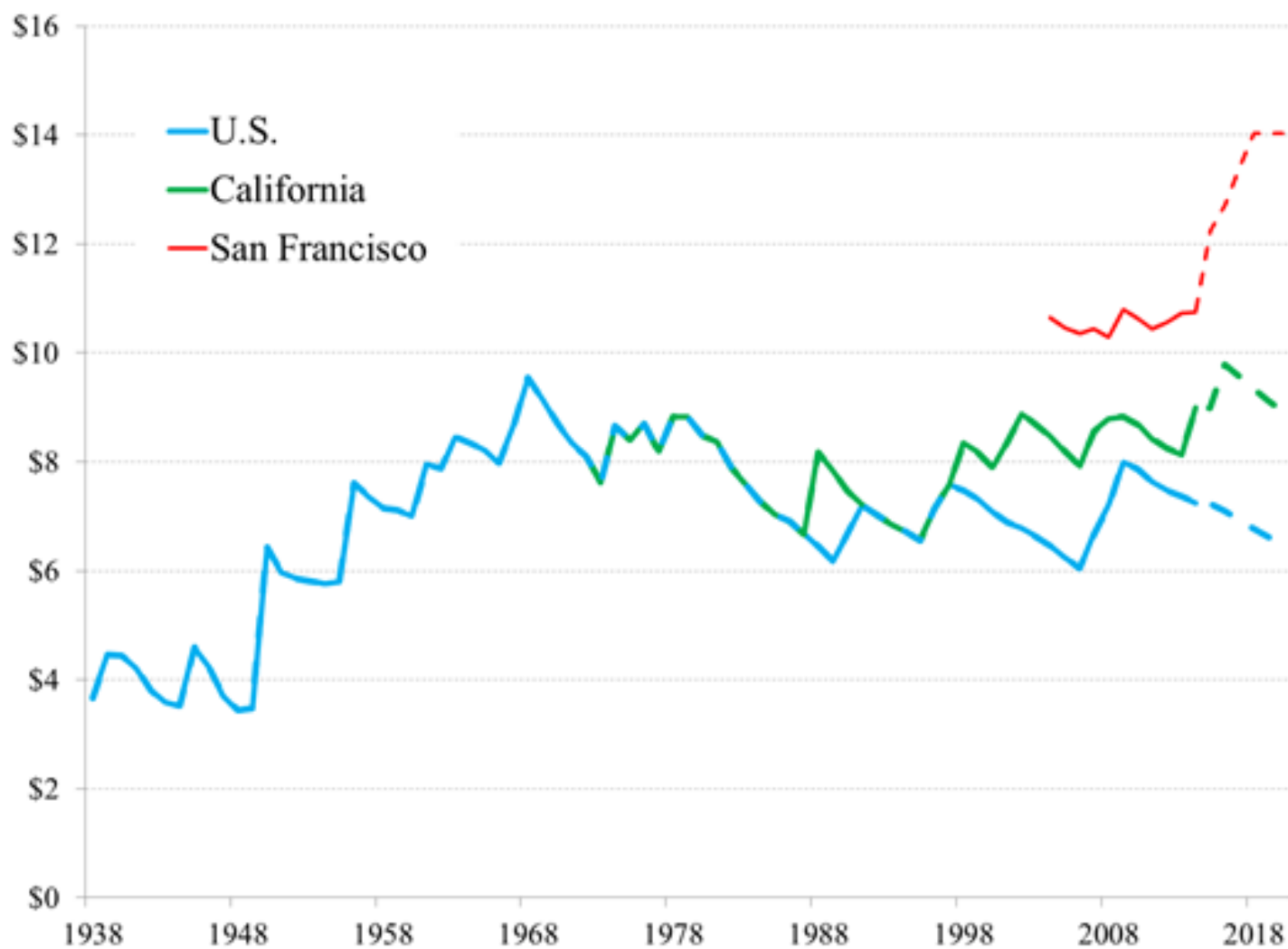
Four main other forces also play a role:

- Changes in minimum wages
- Change in the role and power of unions
- Changes in market power
- Changes in top marginal income tax rates (→ next lecture)

## 2 Minimum wage

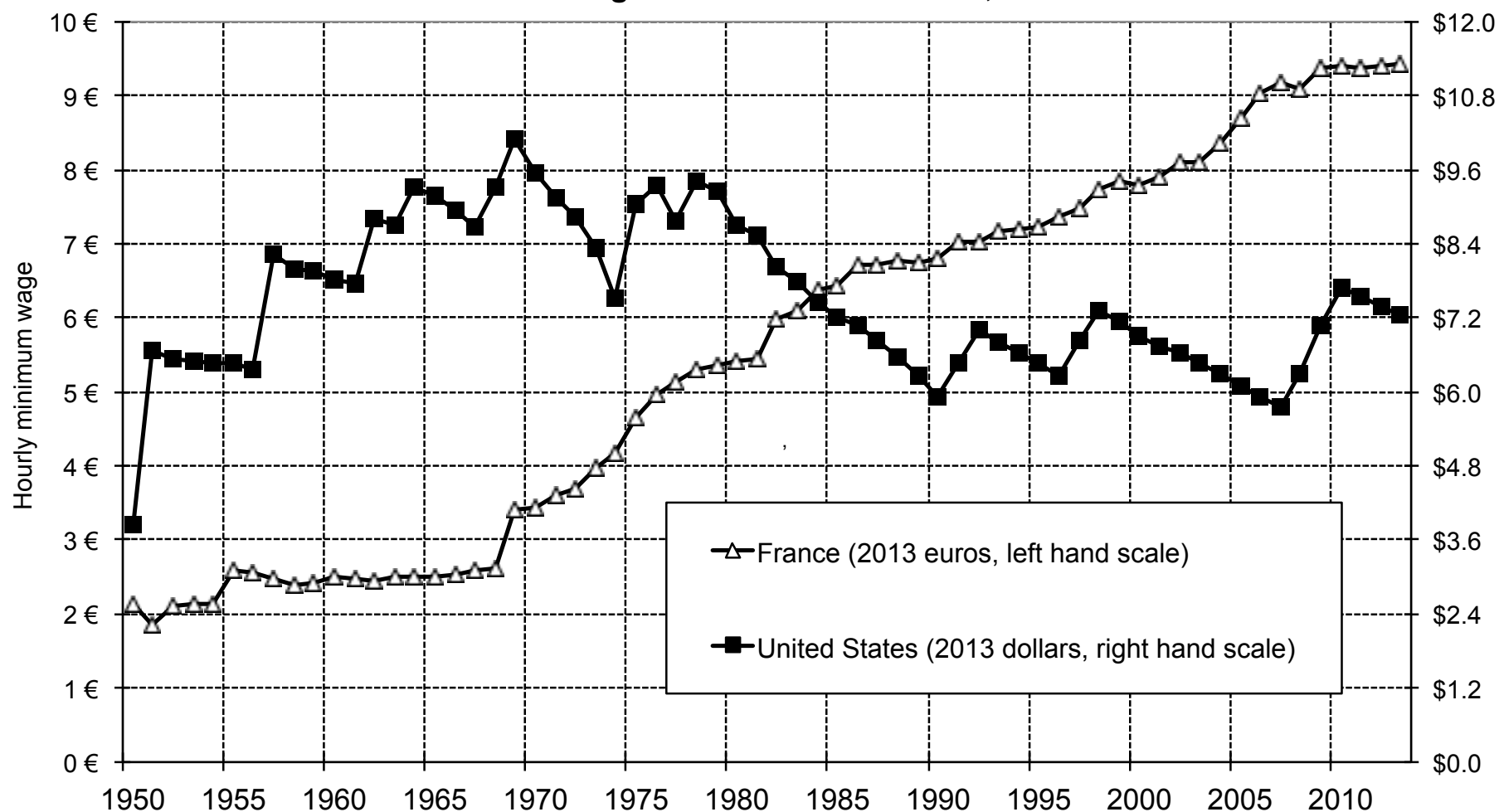
### 2.1 The evolution of the minimum wage

- 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



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](http://piketty.pse.ens.fr/capital21c).

## 2.2 Economic effects of the minimum wage

- Why do countries have minimum wages? To protect low-wage workers from lack of negotiating power
- 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,  $\text{price} > \text{marginal cost}$

**Table 1**

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

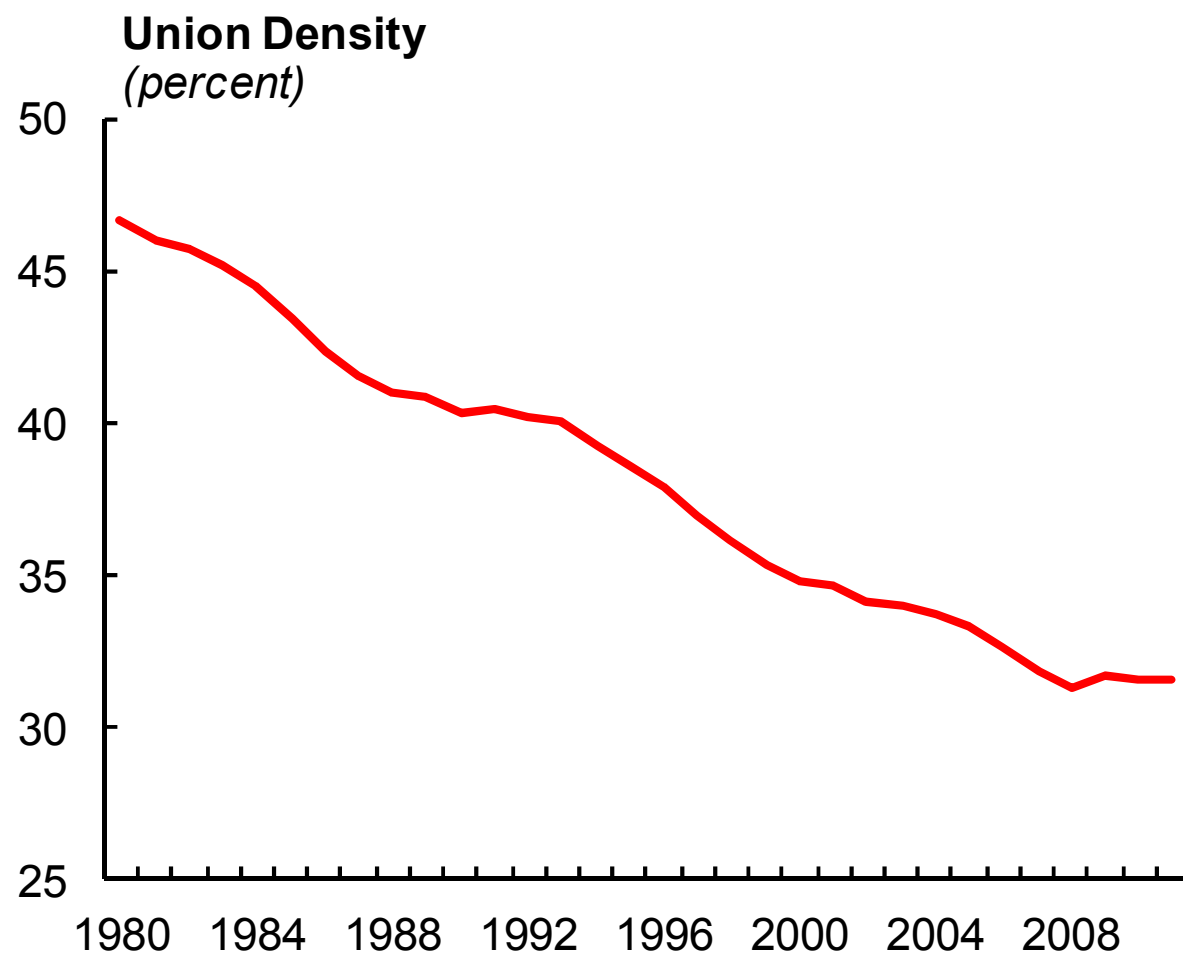
<b>Industry</b>	
Transportation and Warehousing	<b>12.0</b>
Retail Trade	<b>7.6</b>
Finance and Insurance	<b>7.4</b>
Real Estate Rental and Leasing	<b>6.6</b>
Utilities	<b>5.6</b>
Wholesale Trade	<b>4.6</b>
Educational Services	<b>2.7</b>
Accommodation and Food Services	<b>2.6</b>
Professional, Scientific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

Source: Furman and Orszag (2015)

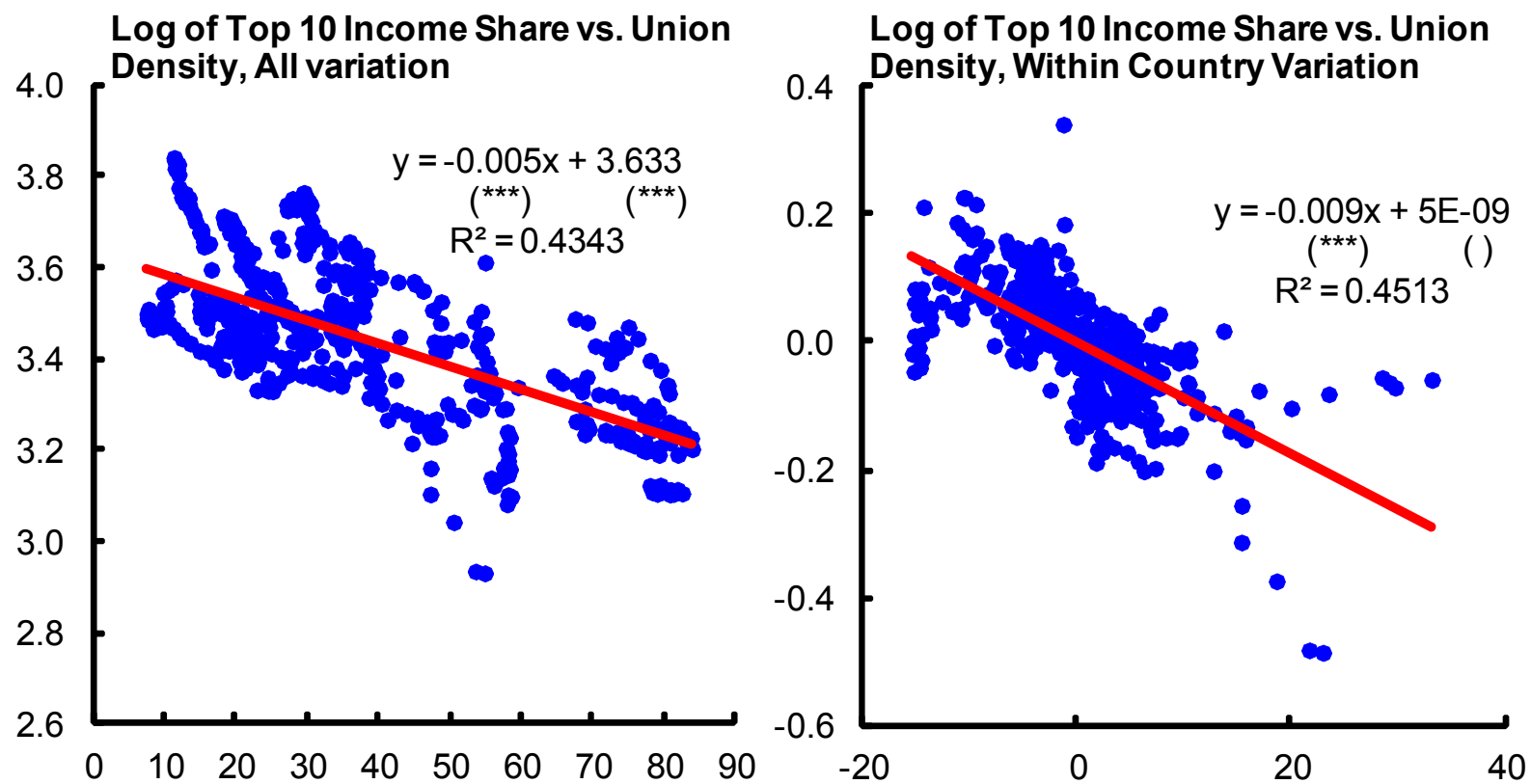
- Monopsony: purchasers set the price of what they buy:
  - Ex: Walmart = main purchaser of products for retail
  - Ex: fast-food chains = main employer in small towns
  - Consequences on labor market:  $\text{wage} < \text{marginal product}$ ; can explain worsening of inequality and low employment effect of min. wage increases

## 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
- Changer 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

Card, David and Alan B. Krueger, “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania”, *American Economic Review* 1994 (web)

Furman, Jason and Peter Orszag, “A Firm-Level Perspective on the Role of Rents in the Rise in Inequality”, 2015 (web)

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