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UNCONVENTIONAL VIEWS OF LABOR MARKETS[†]

A Depressed Labor Market as Explained by Participants

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Unemployment is extremely difficult to reconcile with the main body of economic theory. Why is the labor market so different from other markets in that the price of labor does not adjust to clear it? Why do not workers and companies avoid layoffs by having workers continue to work at reduced wages until adverse conditions disappear? Some economists assert that labor markets do clear at all times and that unemployment is not an excess supply of labor, but is withdrawal of supply or a reflection of the normal process by which suppliers and demanders find each other. If labor markets do clear, then why during recessions does one meet or hear of so many very unhappy unemployed people?

Having been perplexed by these questions for years, I took advantage of the recession of 1990–1993 to ask participants in the labor market what they were doing and why. The moment was opportune, for the recession was particularly severe in the New England and New York areas, where the survey was conducted. In doing the survey, I violated many of the implicit rules of economic research, but I believe strongly that it is possible to learn the answers to the questions posed only by violating these rules. The chief interest is in the motives of those making employment and compensation decisions. Most labor-market data have to do with employment and compensation and do not reveal the motives of workers and employers. It is often asserted that peoples claims about their own motives may be misleading, so that motives can be discovered only from behavior. In the context of employment and pay decisions, motives probably could be discovered from actions were it possible to observe the details of everyday business life over an extended period of time, but such an approach seems impracticable. The only feasible approach seems to be to ask key decision-makers or people who observe them about their activities and motives.

I. Methods

A survey of this sort faces one of the fundamental difficulties of economics, which is that many people are reluctant to reveal information about their economic lives. Also, even if people do agree to cooperate with a survey, they may not take it seriously enough to give accurate answers. There is no ideal way to deal with these problems, but after some experimentation and disappointment, I settled on methods which are similar to those used by cultural anthropologists. Low response rates made random sampling impractical. Also, I avoided random sampling because the primary interest was not in the incidence of various practices and attitudes, as it would be in an opinion survey. Rather, my object was to learn about as wide a variety of experience as possible and to solicit the views of well-placed and intelligent observers, for I believed that these would reveal more about the mechanisms of the labor market than would aver-

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age behavior. For instance, I interviewed in companies of all sizes from a wide variety of industries, in companies that were failing or had cut pay, and in companies that were expanding rapidly and giving generous pay increases. I also sought out key decision-makers who had a reputation for being particularly well informed and articulate. Though the resulting sample was not statistically representative, many of the regularities observed were so clear that I believe they are very likely to be truly representative. I hope that future surveys done by others will serve as a check on the validity of the conclusions drawn from this one.

Most of the sample was chosen by a process which is termed "networking" in the business community. Usually, I obtained initial interviews in a type of organization through relatives, friends, acquaintances, or cold calls. During these interviews, I asked about other possible contacts and continued the process in further interviews. Respondents often helped arrange other interviews, and this help was invaluable in overcoming suspicion. About 22 percent of all interviews were arranged through personal contacts, and another 46 percent were arranged with help from intermediaries.

From experience, I found that the best way to learn from interviews was to catch and hold the interest of respondents. Most respondents expressed great interest in the project when I first explained it to them. In order to be sure that they understood the purpose of the interview, I faxed them a letter along with a list of questions. The letter described the project and promised full confidentiality. Without this promise, I believe it would have been impossible to have had any interesting interviews. I also promised to leave respondents in charge of the interview, which in practice I did. I asked few questions and asked for comments on economic theories only rarely and at the end of interviews. I found from experience that too persistent questioning and asking for reactions to economic theories tended to exasperate and confuse respondents and to lead to contradictory answers. A disadvantage of my interviewing style was that not all respondents answered the same questions, which complicates analysis of what was said. An advantage was that respondents gave a great deal of detail and often spoke with what seemed to be astonishing candor.

All but six of the interviews were in-person, taking place in respondents offices or over a meal. The six other interviews were by telephone. Interviews lasted from one to more than five hours, an average one lasting about one and a half hours. Records were kept by taking notes, which were expanded and typed up as soon as possible, while memories were fresh. I did not tape-record interviews, for I thought the recorder might frighten respondents. Also, I did not want to have any record of illegal activities that might be mentioned.

II. The Sample

There were 334 interviews with 372 people, there having been more than one respondent at some interviews. The interviewing was done from April 1, 1992 to April 20, 1994, though only eight interviews were made after July 1993. Of the interviews, 258 were with people in companies, 15 were with headhunters or professional recruiters, 26 were with counselors of the unemployed, 18 were with labor leaders, 4 were with labor lawyers, and 13 were with management consultants. I wanted to interview workers themselves but did not dare request to do so, out of fear that questions about reactions to hypothetical pay cuts would provoke suspicion and unrest within companies.

Most of the interviews took place in Connecticut, though 24 interviews with businesspeople and one with a labor leader took place in nearby states. The people interviewed in companies were usually the owners or presidents of smaller companies, human-resource executives or managers in larger companies, and owners or general managers of stores and restaurants. The counselors of the unemployed included counselors and managers in outplacement companies, in state and local government employment offices, and in privately run employment offices. The counselors also in-

cluded volunteer leaders of support groups for unemployed people. Of the interviews with people in companies, about 45 percent were with manufacturing companies, and the rest were in companies in construction, retail and wholesale trade, transportation, banking, insurance, financial trading companies, publishing, professional services, and miscellaneous other services. The companies or company units studied varied in size from just a few employees to more than 100,000, with 24 percent of the companies having more than 1,000 employees and 30 percent of the companies having fewer than 50 employees.

I am presently writing a book reporting on the survey. What follows is a summary of conclusions.

III. Main Conclusions

In economics, it is normally assumed that people are entirely selfish and must be either coerced or bribed into performing tasks. However, the main causes of downward wage rigidity have to do with employers' belief that other motivators are necessary, which are best thought of as having to do with generosity. Employers want their workers to identify with the objectives of the organization and to cooperate in good spirit with coworkers and supervisors. Good management practice uses punishment largely as a way to weed out bad characters and incompetents and to protect the group from malefactors. Many managers stress that punishment should rarely be used as a way to obtain cooperation. Good practice also offers financial rewards for good performance, when possible, but these rewards and employees' goodwill are thought of as mutually reenforcing. Managers claim that workers have so many opportunities to take advantage of employers that it is not wise to depend on coercion and financial incentives alone as motivators. Also, employers want workers to operate autonomously, show initiative, and use their imagination while working, and workers who are scared or disheartened do not do these things. All these matters of the spirit are referred to as good morale. Employers do not require that workers enjoy their work, it being recognized that many jobs are boring and unpleasant. Good morale implies a willingness to make personal sacrifices for the good of the organization. It is thought to be highly desirable that workers be happy in some broad sense. Happiness is thought to be especially desirable in people who have contact with the public, such as clerks or salespeople.

An explanation of downward wage rigidity must explain why the wages of both existing and new employees do not decline when there is high unemployment. Employers resist cutting pay of existing employees largely out of fear that the shock of a reduced living standard and the insult implied by lower pay would cause workers to lose their allegiance to the organization, which might eventually disintegrate as a result. Most employers did not assert that bad morale would have much immediate impact on productivity in a mechanical sense. They seemed to have in mind the long-run effect on the cohesion of the organization. Employers' concerns about the effects of pay cuts may be exaggerated, for the effects described of actual pay cuts were not very bad in most cases. However, this observation may be the result of selection bias, cuts having been made only when there was reason to believe they would succeed.

When employers do not cut the pay of existing employees, they resist cutting that of new hires mainly because they believe new workers would resent being paid on a lower scale than workers hired earlier, leading to problems of bad morale which could infect the entire organization.

In some types of work, little discontent is caused by cutting the pay of new hires while leaving the pay of existing employees intact. The common features of these types of work are that many of the employees work part-time and turnover is high. In such jobs, workers have relatively little contact with each other and do not think of their jobs as careers, so that internal pay comparisons are not as important as in other jobs, and employers feel comparatively free to reduce hiring pay as the labor market weakens. They do not feel free, however, to reduce

the pay of existing employees. Such high-turnover jobs may be termed the "secondary labor market." It includes the hourly staff of security-guard services and janitorial services and the floor staff of fast-food restaurants and some types of stores, such as supermarkets and low-priced department stores. There also seems to be relatively little resistance to decreases in the pay of workers hired temporarily through agencies.

Most employers do not consider pay cuts or reduced hours to be useful alternatives to layoffs, for they believe that the resulting decrease in workers' living standards would be too harmful to morale. Layoffs also have a bad effect on morale, but this effect is believed to be temporary. The effect of layoffs is to remove the victims of economizing measures from the organization. Those who remain are soon able to carry on in good spirits, if it is believed that there is no short-term danger of further layoffs.

These conclusions do not apply if moderate pay cuts could avoid a large number of layoffs. This circumstance arises when a pay cut could keep a company in operation or when the product market is very competitive, so that product price reductions made possible by pay cuts would have a large impact on the quantity of product sold. In such situations, pay cuts are more easily accepted by the work force than otherwise, though employers may nevertheless be reluctant to undertake them.

Most employers and labor leaders interviewed believed that pay cuts would not have a significant impact on their firms employment, at least in the time horizon relevant for layoff decisions. Such employers explained that they had market power in product markets and that production labor costs were a small fraction of total sales, a large fraction being accounted for by materials and supplies. The wages and salaries of overhead workers have no impact on short-run marginal costs and, hence, have no short-term impact on sales.

I asked many employers why they did not take advantage of the recession to reduce labor costs by replacing all or part of their work force with cheaper new hires drawn from the unemployed. The main reason cited for not replacing a part of the work force was that doing so would damage morale. Many employers, however, did take advantage of the recession to lay off less productive workers, with the intention of replacing them later by new hires. The main reason given for not replacing entire work forces was the cost involved in finding and training new workers. Companies do replace work forces when breaking strikes or when they move their facilities to regions or countries with lower labor costs. The savings to be had by replacing workers locally do not seem to have been large enough during the recession to offset the cost of the loss of skills.

It is natural to ask why unemployed workers do not find jobs quickly, even if wages and salaries are downwardly rigid. Cannot workers find jobs almost immediately simply by accepting sufficiently low pay? Perhaps the clearest regularity of the survey was that large classes of unemployed workers find it very difficult to obtain work paying substantially less than what they earned before, unless they take temporary jobs or low-paying jobs in the secondary labor market. Most employers offering good permanent jobs shun workers who earned significantly more previously, significantly meaning 20–30-percent more. Employers label such workers as overqualified and fear that they will be discontent, be a threat to their supervisors, and above all, will leave as soon as they find better jobs. There are some categories of firms or jobs where overqualification is not considered to be a disadvantage. Firms that are growing rapidly can hope soon to promote the overqualified and so welcome them. There is little resistance to hiring overqualified people for jobs where there is rapid turnover, since the turnover is unavoidable in any case. Overqualification is nearly irrelevant in the market for temporary labor and is of reduced importance in the secondary labor market.

Thus, the overqualification phenomenon occurs at all levels of the labor market except among the lowest paid. Because of it, unemployed job-seekers have the choice between joining the queue for jobs for which they are nearly exactly qualified or joining

the somewhat shorter queue for temporary or low-paid work. The disadvantage of the latter choice is that taking a stopgap job distracts from search for a better one, for joining the queue for a type of work means searching intensely for it. It was not clear how many chose the alternative of stopgap work, but it seemed that many did. Many of those who did not do so took a long time to find work, for few jobs were available for which they were nearly exactly qualified.

In many macroeconomic models, it is possible to explain a connection between aggregate demand and employment only if the rigidities in wages and salaries are nominal rather than real. It is not possible to say that downward wage rigidities are either clearly nominal or clearly real. Wages are nominally rigid to some extent, because nominal wage cuts are resented as insults. Real wages are somewhat downwardly flexible in that employees tolerate slow diminution of real wages resulting from nominal wage increases slightly less than inflation. However, real wages seemed to be downwardly rigid in that employers claimed that in the past they had offset rapid inflation through pay increases, because they believed that morale would suffer if real wages were allowed to deteriorate quickly.

IV. Corroboration

Some of the main conclusions are consistent with the findings of other surveys. Roger Kaufman (1984) also found that businesspeople cite worries about morale as the primary reason for not cutting pay. Evidence of these concerns were also found by Richard Lester (1948), Charles Myers and George Schultz (1951), Lloyd Reynolds (1951), and Alan Blinder and Don Choi (1990), though these authors did not focus on the issue of downward pay rigidity. David Levine (1993) found that compensation executives stressed the importance of fairness in pay-setting. Harold Sheppard and Harvey Belitsky (1966), William W. Daniel (1974, 1990), Michael White (1983), and many others have documented the difficulties the unemployed have in finding work. No one, so far as I know, has documented in detail the overqualification phenomenon. I know of only one reference to this phenomenon, this being in Stephen Wood (1986). Nor have I yet found a reference to the greater downward flexibility of pay in the secondary labor market.

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