What’s Behind the Increase in Inequality?

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Roadmap for presentation

- Two streams of research on the rise in inequality
  - Monopoly, margins and rents
  - Increasing wage inequality among workers with similar education, occupation and characteristics
- Domestic outsourcing, inter-firm contracting, and production networks
  - Production networks and the link between the increase in rents and the rise in wage inequality among similar workers
Two Streams of Research on Inequality

Increase in monopoly power and rent

- What is economic rent? The case of land
- Decline of anti-trust activity
- Increasing market concentration
- Expansion of patent and copyright protection
- New financial actors and financial engineering
- Rise of platform monopolies
Increase in wage inequality among similar workers

- Early conjectures
- Careful econometric studies
- Explanations
  - Luck of the draw?
  - Sorting of high skill workers into superfirms?
  - High productivity vs. low productivity establishments?

Domestic outsourcing, inter-firm contracting, and production networks
Demise of the vertically integrated firm

- Dominant form of economic organization first two-thirds of 20\textsuperscript{th} century
  - Explained by minimization of transactions costs
- Undermined by
  - Technological innovation
  - Deregulation and trade agreements
  - Shareholder value maximization
  - Focus on core competencies

Domestic Outsourcing & Production Networks

- Advances in technology dramatically reduced monitoring costs
- Firms got advantages of vertical w/o risks
  - Ownership of assets, bureaucratic inflexibility, managerial responsibilities/legal liabilities of employment relationship
- Deregulation, trade agreements
  - Increased pressure to reduce costs
  - Increased opportunities for offshoring
  - Undermined unions
- New financial actors focused on max shareholder value
- Focus on core competencies: Outsource both peripheral and high skill specialized functions
Domestic Outsourcing & Production Networks

- Contracting out for goods and services via business-to-business transactions not new

- But, scale and scope transformed in recent years
  - Changes in the mix of firms’ “make or buy” decisions
  - Described as vertical disintegration of firm or networked production

- More powerful firms capture rents produced by network
  - Set terms and conditions in inter-firm contracts
  - Create competitive bidding process among smaller contractor firms

- Result:
  - Downward pressure on profit margins in contractor firms
  - And, in turn, on wages

Complexity & variety in networked patterns
(modified from Barenberg 2015)
Retail Network (http://www.latimes.com/projects/la-fi-forever-21-factory-workers/)

Low cost clothing for Forever 21, TJ Maxx, Ross, other
- Sewn in factories in LA area – sweatshops paying < min wage
- DOL investigation: workers paid av. $7/hr for 10-hr days sewing
- Contractor gets $1.30 for fast fashion top
  - Pays sewing worker 51 cents
  - 40 cents to iron, pack and ship each garment
  - 39 cents for rent, utilities, workers’ comp, taxes – and meager profit if any
- DOL: Forever 21 would need to pay 50% more for contractors to pay workers fed minimum $7.25, even more for LA min $12
- Retailers force low production costs b/c of their power in the supply chain; ultimately workers bear cost and risk of system
  - Most are undocumented immigrants; Korean owners, Latina workers
- Retailers say they are not involved in manufacturing clothes, don’t employ factory workers, not liable for their wages

Production Networks and Rising Inequality

- Vertical disintegration => jobs along skill ladder leave lead firms
- Takes a network of firms to produce final product
- Capital – capital competition over distribution of a network’s profits and rents
  - Strongest firms capture lion’s share => share rents w/workers
  - Weakest firms struggle to remain viable => squeeze labor
- Two streams of economics research on rising inequality
  - Increase in monopoly power – concentration, patents, platforms
  - Increasing divergence of wages of economically similar workers
- Production networks: Workers’ pay depends on own skills and employer’s position in network
Classic hotel organization chart & employment system

Modern hotel employment system

(Source: Bernhardt et al 2016; Barenberg 2015)
Two Sources of Labor Market Segmentation

<table>
<thead>
<tr>
<th></th>
<th>Primary firm (In-house jobs)</th>
<th>Contractor firm (on-site and off-site)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard jobs</strong></td>
<td>• Permanent employees</td>
<td>• Permanent employees</td>
</tr>
<tr>
<td><strong>Nonstandard jobs</strong></td>
<td>• On-call</td>
<td>• On-demand platform workers</td>
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<td></td>
<td>• Direct-hire temporary</td>
<td>• Temp agency workers</td>
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<td>• Independent contractors</td>
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<td>• Leased workers</td>
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How common is domestic outsourcing?

How many people are in each type of work arrangement?
Conclusion:
Production networks provide the link between increase in rent and rise in wage inequality

Summing up
- Major structural evolution of firms in past 3 decades
  - Vertical disintegration of firms – focus on core competencies, outsource tasks
  - Network forms of production more prominent
- Lead firms capture rents associated with increases in market concentration, expanded patent/copyrights, new financial actors, platform monopolies => can share rents with workers
- Suppliers, subcontractors compete to be lowest bidder on contracts
- Major source of rising inequality in earnings across firms & establishments, differences in pay of similar workers
- Workers’ pay depends on own skills, employers’ position in network
Empirical Evidence

Qualitative studies in Europe and US
- Public and private sector outsourcing → lower pay, job quality; union avoidance
- Study of hotels owned by brand vs franchised (Lak

Quantitative studies: A handful focused on low-skilled jobs
- Substantial wage penalty for outsourced workers doing same job (4% - 24%) (Batt & Nohara 2009; Dube & Kaplan 2010; Goldschmidt & Schmeider 2015)

- US Independent contractors (mainly women, minorities) earn 28% lower wages than standard workers (Katz & Krueger 2016)

- Growth in US inequality last 3 decades due to rise in wage inequality among similar workers across establishments (Barth, Bryson, Davis, Freeman 2016; Song, Jae, Price, Guvenen, Bloom, von Wachter 2015)

Variation in pay & job quality

- Lead firms may share rents with own workers

- Positive context for workers in contractor or supplier firms
  - Production networks based on specialization of skills or inputs
  - Long-term supplier relations may create supplier stability
  - Contractors able to learn and upgrade capabilities over time

- Terms of interfirm contracts depend on relative bargaining power of firms, business strategy of dominant firms

- Cost pressures, stability of weaker firms in network depend on incentive structures in contracts with lead or dominant firms
  - Social movements (fight for $15, paid leave), labor and employment laws (min wage, OSHA), unions protect most vulnerable workers
Directions for Future Research

Research needs

- Complexity of networked organizations has increased

- Multi-level research is needed to capture capital-capital and capital-labor power dynamics, and to link these to pay and inequality

- Need to identify contingencies and contexts that shape outcomes for workers
Research: Need in-depth industry studies

- Multi-method research design
  - Government data where available
  - Proprietary data: Industry trade groups, consulting firms
  - Interview data: industry experts, unions; managers, workers
  - Structured case studies of specific firms, production networks
  - Survey data collection where feasible

- Research design: 3 angles
  - Contracting industries
  - Contractor industries
  - Inter-firm contracting and production networks