

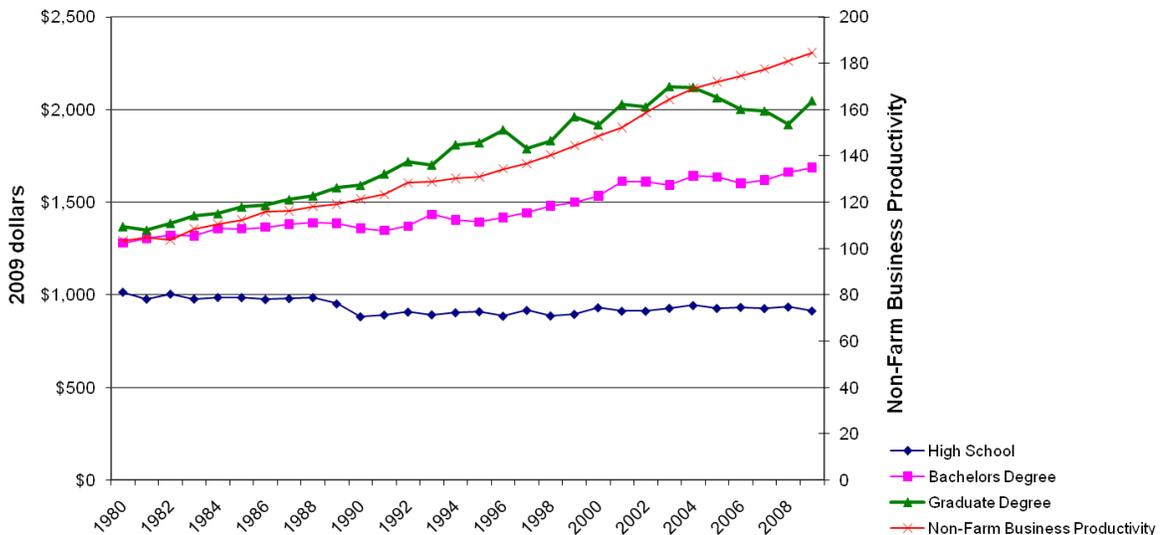
DECENT JOBS FORUM
 A SERIES OF THE NEXT SOCIAL CONTRACT INITIATIVE

NEEDED: A NEW SOCIAL CONTRACT AT WORK^I

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The failure of today’s economy to generate and sustain decent jobs can be traced to the breakdown in the post-World War II social contract that supported a tandem growth in productivity and wages. From 1945 to 1979 productivity and real wages both grew by approximately two to three percent per year. Figure 1 shows that since then, productivity continued to grow steadily while real wages for high school men remained stagnant and the gaps between productivity growth and college graduates expanded, albeit at lower rates. The same basic pattern has persisted over these years for women high school graduates.

Figure 1: Median Compensation of Men Working Full Time, 1980-2008
 Non-Farm Business Productivity on the Right Axis



Source: Levy and Temin, 2009

ⁱ Paper prepared for The New America Foundation forum on Decent Work. This paper draws heavily on a policy brief of the Employment Policy Research Network. See Frank Levy and Thomas Kochan. “Addressing the Problem of Stagnant Wages.” Available Online. <http://www.employmentpolicy.org/topic/12/research/addressing-problem-stagnant-wages>.

The alignment of wage and productivity growth from the mid-1940s through the 1970s resulted from two main factors. Labor markets met the demand for a large number of production workers, and equitable wage norms were supported by government policies and reinforced through collective bargaining and professional personnel/human resource management practices. The good match between these market forces, policies, and institutions set a reasonable floor on wages and sustained real wage growth for all workers, and particularly for those lacking a college education.

Causes of the Breakdown

No single factor explains the breakdown in the social contract and, therefore, no single silver bullet change will reverse the post-1980 trends. Figure 2 illustrates the interrelated factors that contributed to the breakdown, each of which will need to be addressed for the economy to create and sustain decent jobs for the majority of workers in the future.

Figure 2: Causes of the Breakdown in the Social Contract



Globalization

While studies conducted in the 1990s tended to minimize the effects of increased trade on wages¹, more recent studies document that increased exposure to trade with China alone explains 19 percent of the decline in U.S. manufacturing employment between 1991 and 2000 and 32 percent between 2000 and 2007.² Not only were these jobs not replaced with jobs with equivalent wages, but also the threat of outsourcing work to lower wage countries further suppressed the wage demands of all jobs in tradable sectors.

Technological Change

The lack of wage growth of high school graduates has been reinforced by the computerization of many production and clerical jobs that repetitively process information using standard operating procedures or rules. These jobs lie in the lower-middle of the earnings distribution and are often held by high school graduates or persons with some college.³

Decline of Unions and Collective Bargaining

The long-term decline in union membership accelerated in the 1980s and 1990s, and now stands at 6.9 percent of the private sector workforce and 12.9 percent of the overall workforce. As unions declined, so did worker bargaining power and the innovative capacity of collective bargaining. By the mid-1980s union coverage had declined sufficiently so that unions could no longer rely on strike threats as a source of bargaining power or use pattern bargaining to spread wage increases beyond their specific bargaining units. Innovative labor management relationships that were competitive with the best of non-union models emerged in a number of industries, but without labor law reforms needed to support and endorse them, the innovations failed to diffuse broadly enough to become the new norm.⁴ The result was a downward spiral: It was easier for firms to avoid unions than to work with them to transform relationships and work practices. The threat effects of unions on new operations evaporated, and the pressure to match union wages and benefits eroded. Collective bargaining has never recovered its pre-1980s momentum.

The Rise of Finance Capitalism.

Under the forms of managerial capitalism that emerged out of the New Deal and were sustained in the social contract decades following WWII, corporations made money through investments in productive enterprises and the creation and realization of value through the management of labor. Shareholder claims were important, but were held in check by pressures from unions. Union pressure, in turn, increased the leverage of corporate labor relations managers in making the case with their CEOs and board members for wage formulas and internal wage structures that kept intra-firm and inter-occupational wage inequality in check.

The 1980s witnessed the rise in financial capitalism, in which productive enterprises are viewed as bundles of assets to be reconfigured with the goal of maximizing financial returns. As this new financial business model ascended and unions declined, power within corporations shifted from labor relations and human resource executives to finance and other top executives who serve as agents of increasingly demanding financial markets.⁵

Deregulation and Passive Government

Deregulation of financial markets supported the new financial business model. Large institutional investors emerged as the result of pension reforms which allowed pension funds and insurance companies to hold shares of stock and risky bonds in their portfolios. Saving and Loan banks (S&Ls) were allowed to hold junk bonds and invest in risky activities under the Garn-St. Germain Act of 1982. Reagan-era tax law reforms provided incentives for debt-financing over the use of retained earnings for investment, leading many to use retained earnings for stock buybacks to inflate the value of stocks and reward shareholders.⁶

A series of banking-law reforms – culminating in the 1999 Gramm-Leach-Bliley Act that repealed the Glass-Steagall Act of 1933 – allowed banks and insurance companies to consolidate into financial institutions that held less capital in reserve and further increased the role of leverage in trading activities. New financial instruments (such as credit default swaps) and new financial actors (hedge funds and private equity funds) emerged and were explicitly exempted from regulation under the 2000 Commodity Futures Modernization Act.

Deregulation of trucking, airlines, and telecommunications industries led to new entrants that labor did not or could not organize, which further weakened the ability of collective bargaining to take wages out of competition. Many of these firms also made more extensive use of contracting firms for clerical, maintenance, food service, and other lower skilled work: jobs that had

enjoyed a wage premium under the wage distribution norms enforced in large firms through collective bargaining and professional personnel practices.

Finally, government support for wage norms through incomes policies of the 1960s and 1970s (wage-price guidelines and their progeny) was replaced with a laissez-faire philosophy, weaker enforcement of labor and employment laws, and tax reforms that dramatically lowered marginal rates on high income.

Building a New Social Contract

The old social contract worked because there was a good match between the production driven economy and the policies and institutions that supported it. Our challenge is to build institutions capable of supporting an innovation-knowledge based economy. Increased quality and levels of education are clearly necessary starting points, but not sufficient solutions.

Transformed Labor Management Relationships

Creating and sustaining a new social contract will require a new labor management relations system that fits and supports the innovation-knowledge based economy. Union pressure and collective bargaining were driving forces in generating and sustaining the wage-productivity norms in the post World War II social contract. However, efforts to return to the arms-length labor management relations of the past will not generate the productivity and service quality levels needed to fund and sustain wage improvements today. Adherence to those practices was part of the reason for increased managerial opposition to unions and to the growth of domestic non-union and international competition. The good news is that alternative, so-called “transformed” models of labor management relations that incorporate knowledge based work systems and support business strategies focused on innovation, growth, productivity, and service quality have demonstrated their ability to compete at levels comparable to the most advanced non-union firms. The bad news is that these models never diffused beyond a minority of firms, even in the more highly unionized industries. Diffusion of these transformed models will require fundamental reforms and modernization of labor law and related policies.⁷

Fixing the documented failings of labor law is important in its own right to give voice and bargaining power workers need to gradually upgrade low wage jobs. But actively endorsing and supporting transformed labor management relations would also serve as a catalyst for the changes in corporate practices discussed below. Thus, labor law reform and modernization have to be at the core of any effort to build a new social contract.

Rebalancing Corporate Governance, Strategies, and Practices

In a global economy with low wage options available in other countries, the economy needs to build capacity to innovate and use technologies and human capital as key sources of competitive advantage. This requires enterprises with long time horizons, where human resource strategies play a central role and are well integrated with financial, technological, and other key strategies, and where the workforce is committed and engaged in driving the innovation, productivity and service improvement processes. All of these points are well known and have been documented repeatedly in the business strategy and employment relations literatures using terms such as “high road” competitive strategies, and “high performance” or “knowledge based” work systems. Again, the good news is there is considerable experience and evidence of the payoffs to firms that adopt and sustain these strategies and associated work systems.⁸

The difficult question is how to expand the circle of such firms within different industries so that they set the competitive benchmarks for other firms. The Alfred P. Sloan Foundation has had considerable success in generating and disseminating

research on these organizational strategies and work systems through the industry, academic, and labor study centers it created in recent years. The Hitachi Foundation is likewise identifying enterprises that adopt sustainable business and employment strategies and building learning networks among executives from these and other interested firms. Combining these information-sharing and network-building strategies with strong and flexible enforcement of employment laws (see below) and transformed unions and labor management relationships would serve as a powerful, mixed carrot-and-stick approach to matching market forces and institutions in support an innovation-knowledge based economy.

Modern Enforcement Regimes and Promotion of New Wage Norms

Not all firms will adopt high road or knowledge based work strategies. A large number of workplaces continue to violate wage, labor, safety, and/or equal employment laws, illustrating the need for new, more rigorous coalition based enforcement regimes. Targeting strict and more effective enforcement of employment standards on the most egregious violators and focusing on performance based enforcement strategies for high standard/high road enterprises would raise the floor for all workers, level the playing field for high standard employers, and create incentives for firms in the middle of the strategy and work system distribution to move in the higher road direction. Making the data on compliance of all employment laws transparent and available to the public would add more pressure for firms to comply and to use their good records in recruitment and other reputation-building, marketing campaigns.

None of the actions called for here will garner initial or sustained political support unless America embarks on a new national dialogue over wage norms and related fair employment practices. The public should be educated about both the magnitude and the costs of allowing the majority of income gains go to the top ten percent of the labor force, as has been the case in the years since the old social contract began breaking down. While it is typical and appropriate to call for the President to initiate national dialogue on issues such as this, he cannot sustain it alone and is not likely to take on this issue unless he senses the public is calling for or receptive to it. Thus, we all have to take up the challenge of developing a new narrative that makes the case for both a national dialogue on decent work and for the systemic actions suggested here aimed at building a new social contract that is fitted to the needs of an innovation-knowledge based economy. This forum is therefore a step in the right direction.

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- ¹ See for example, Robert E. Lawrence and Michael J. Slaughter. "Trade and U.S. Wages: Giant Sucking Sound or Small Hiccup?" *Brookings Papers on Economic Activity*. 1993 (2): 161-210.
- ² David Autor, David Dorn, and Gordon H. Hanson. "The China Syndrome: Local Labor Market Effects of Import Competition in the U.S." Working Paper. MIT Department of Economics. 2011.
- ³ See David Autor, Frank Levy, and Richard J. Murnane. "The Skill Content of Recent Technological Change." *Quarterly Journal of Economics*. 118(4):1279-1333. 2003.
- ⁴ See Thomas A. Kochan, Harry C. Katz, and Robert B. McKersie. The Transformation of American Industrial Relations. New York: Basic Books. 1986.
- ⁵ See Sanford Jacoby. The Embedded Corporation. Princeton: Princeton University Press. 2005.
- ⁶ William Lazonick. Sustainable Prosperity in the New Economy. Kalamazoo: W.E. Upjohn Institute. 2009.
Gerald Davis. Managed by the Markets. New York: Oxford University Press. 2009.
- ⁷ For evidence on the effects of transformed labor management relations see See Thomas A. Kochan, Harry C. Katz, and Robert B. McKersie. The Transformation of American Industrial Relations. New York: Basic Books. 1986. and Eileen Appelbaum, Jody Hoffer Gittel, and Carrie Leana. "High Performance Work Practices and Sustainable Economic Growth." Employment Policy Research Network. April 2011. Available Online. <http://www.employmentpolicy.org/topic/23/research/high-performance-work-practices-and-sustainable-economic-growth-o>. For evidence on the need for labor law reform and options for modernizing labor law see, Richard B. Freeman. "What Can we learn from NLRA to Create Labor Law for the 21st Century." Forthcoming in *ABA Journal on Labor and Employment*. and Thomas A. Kochan. "Rethinking and Reframing U.S. Policy on Worker Voice and Representation." Forthcoming in *ABA Journal on Labor and Employment*.
- ⁸ Michael Porter. Competitive Strategy. New York: The Free Press. 1980. and Eileen Appelbaum, Jody Hoffer Gittel, and Carrie Leana. "High Performance Work Practices and Sustainable Economic Growth." Employment Policy Research Network. April 2011. Available Online.



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