# THE NEW CHALLENGES TO ORTHODOX LABOR-MARKET THEORY—HOW NEW? HOW CHALLENGING?

Glen G. Cain, "The Challenge of Segmented Labor Market Theories to Orthodox Theory," *Journal of Economic Literature* (December 1976). Institute for Research on Poverty Reprint no. 210.

Dennis Aigner and Glen G. Cain, "Statistical Theories of Discrimination in Labor Markets," *Industrial and Labor Relations Review* (January 1977). Institute for Research on Poverty Reprint no. 211.

The 1960s' mood of social reform produced the War on Poverty and the drive for full participation in the economy by minority groups and women. Dissatisfaction with the pace and direction of these efforts helped produce, in turn, the political unrest of the late sixties. It also produced radical challenges within the economics profession to the conventional approaches to labor-market theory.

What is interesting about these challenges is the response, or rather the lack of it, from those in the mainstream of American economics. The recent period has seen the persistence of social problems in the United States that were considered by most economists fifteen years ago as readily solvable within the framework of orthodox economic thinking. It has also seen a moving away from traditional liberal-democratic approaches to social problems—toward the right and toward the left—on the part of many countries in both Europe and Latin America. Yet the economics profession in this country has resisted taking seriously the attempts to reevaluate the basic framework within which they analyze the workings of the economy.

The challengers attack the orthodox descriptions of the workings of the labor market; they question the theories and methods used by conventional labor-market theorists; and, perhaps most important, they advocate economic changes (some of them major) in the direction of the political left.

Conventional (neoclassical) analysts at first ignored the challenge; they have only recently begun to respond. The combatants are grouped by their economic methodologies; but they also largely divide along political and ideological lines—leading on both sides to the raised voices and sometimes faulty logic that often characterize arguments on issues that are deeply felt.

In a stimulating review and synthesis of the extensive literature generated on both sides of the debate (his bibliography runs to 205 items) Glen Cain analyzes the issues, both theoretical and empirical, raised by the challengers. He puts them into the wider perspective of the history of economic thought. And he discusses the strengths and weaknesses of the modern neoclassical response.

Cain's thesis, in a nutshell, is that labor economics since the time of Adam Smith has always presented a target to be challenged—that the recent dissident theories are basically continuations of older debates.

His main message is that (1) more empirical evidence is needed before the verdict can be rendered on the superiority of orthodox economic theory as an explanation for economic reality; but (2) the dissident positions are generally weaker on a priori grounds than the neoclassical one.

Cain's line of argument, and on occasion his tone, betray him to be a neoclassicist. This does not, however, detract from his informative discussion. His exposition of the arguments, his tracing of the connections among them and between them and older schools of thought, and his assessment of where the neoclassical approach is still really vulnerable, provide an enlightening framework for anyone seriously interested in disentangling the issues.

## Orthodox Theory

Neoclassical labor-market theory—to be brief and somewhat simplistic—says that employers act to maximize their profit by paying as low a wage as they can for the worker skills that they need. Workers also want to maximize their gain (in this case their pay) so they accept the highest-paying job for which they have the requisite skills. Jobs demanding higher skills are assumed to be higher paid than less skilled jobs because the amount of training necessary makes that worker more valuable. Particularly unpleasant jobs are also assumed to be more highly paid because workers need more money to be persuaded to do unpleasant rather than pleasant work.

There are many employers and many workers and, in general, all members of both groups act independently. That is, even labor unions and business monopolies are considered relatively ineffective in distorting the operations of the competitive process. This competition (employers trying to keep wages down, workers trying to bid them up) leads to a wage scale such that the number of jobs available at each skill level, or at each degree of unpleasantness, just equals the number of persons able and willing to take those jobs.

As one edition of a well-known economics text states it:

> Never forget that many of the observed differentials in wages have little to do with the imperfections of competition. Equilibrium . . . necessitates tremendous differentials in wages. This is because of the tremendous *qualitative* differentials among people.

Few economic theorists buy neoclassical theory in this simplistic form. They do, however, view this as the appropriate framework within which to analyze the labor market; and they interpret inconsistent evidence as pointing up variations of the basic model rather than the need for a new framework.

## The Nature of the Indictment

The source of the indictment of orthodox theory is found in the pervasive hardships and deprivation of large segments of the population, which reveal the inappropriateness of the neoclassical model of how the labor market works. The persistence of poverty; the persistence of income inequality; the failure of education and training programs to improve the lot of those at the bottom; the use by employers of education and training "credentials" to make discriminatory hiring decisions; sustained race and sex discrimination in labor markets; the levels, trends, and structure of unemployment; monopolies, unions, and other sources of protected labor markets; the increasing alienation of the American worker—these constitute the main bill of particulars.

From them flow the new theoretical formulations which veer progressively from orthodox theory.

- The *job competition theory* of Lester Thurow is closest to orthodoxy. The differences are that the number and kind of jobs are determined by technology. Workers' skills and the wages they are willing to work for are, practically speaking, irrelevant. Social custom and institutional considerations determine wage rates, which are rigid; and queues of workers at fixed wages constitute the supply of labor. Decisions concerning job allocation, promotion, and on-the-job training are made within the firm (not affected by the activities of other workers and other firms).

- The *dual labor market theory* of Peter Doeringer and Michael Piore comes next. It depicts two, nonoverlapping labor markets. The primary market is made up of jobs in large firms and/or unionized jobs—leading to higher pay, more chance of promotion, better working conditions, more job stability. The secondary market contains the low-paying jobs, held by workers who suffer discrimination and job instability. This theory places similar emphasis on the allocation of these jobs according to technology and not the relative skills of the workers. It places new emphasis both on employer discrimination and on the mutually reinforcing effects of worker attitudes, motivations, and work habits in assigning (and confining) a worker to the primary or secondary labor market.

- The most removed from the orthodox approach is the *radical theory* of Samuel Bowles, Herbert Gintis and others.[1] This theory expresses a more explicit critique of capitalism as such, acknowledges its ties to Marxian dialectical analysis, and emphasizes class conflicts. The general idea of the dual labor market is sometimes expressed as an analogy with an underdeveloped economy, or even a colony, which is exploited by an imperialist power. Radical theories also draw, as dual market ones do, on sociological analysis of institutional changes and power relations, plus psychological analysis of the attitudes, preferences and motivations of workers and employers.

## Historical Antecedents

Cain sees these challenges as the latest in a long and distinguished history of criticism of classical and neoclassical theory. He also points out that until at least the late 1950s and early 1960s, the neoclassicists did not—among labor economists—constitute the "majority party" as they do today.

John Stuart Mill, as early as 1848, developed the theory of noncompeting groups, when he argued against Adam Smith that the

> more revolting the occupation, the more certain it is to receive the minimum of remuneration, because it devolves upon the most helpless and degraded, on those who are . . . rejected from all other employments.

Marx took up the struggle against the neoclassical position with his theory of the exploitation of labor. Although the radicals argue that there is more to the story than employer exploitation, some adopt his framework and many adopt his rhetoric.

Cain attributes the next challenge on the American scene as coming from the institutionalists like Thorstein Veblen and John R. Commons. The roots of the modern radicals' reaction against abstract theorizing and their incorporation of psychological, sociological, and legal material may be found in the works of these early twentieth century critics of neoclassical economics.

The neoinstitutionalists of the 1940s and 1950s came next—to whom, Cain believes, the new dual and radical labor economists owe their greatest debt. John Dunlop wrote of internal labor markets; Clark Kerr's "Balkanization" concept advanced the idea of labor market segmentation; and many of the dissidents had neoinstitutionalists as teachers. They have gone further than their teachers in the formulation of new and more encompassing theories.

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**Rural experiment**
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The monthly reporting of farm income and expenses proved to be very inaccurate: the average farm family reported only 61 percent of its net farm cash income (as measured against the net income figures derived from interviews, production data, and IRS tax returns). This underreporting arose mainly from the omission of income items rather than from an overreporting of expenses, and could be largely corrected with improved administrative procedures.

The time period over which income was counted in benefit calculation proved to be a very important issue both for equity and for program costs. If income is counted over a very short period (one week is used for Unemployment Compensation and one month for AFDC) benefits respond rapidly to changes in need. But such a system can also distort the timing of income receipts and create inequities between those receiving regular income and those receiving irregular lump sums. Under a one–month accounting period, for example, a wage earner making $1000 a month would not qualify for benefits under feasible levels of generosity, but a farmer clearing $12,000 in crop sales during a three–month period would be eligible for maximum benefits during the rest of the year.

To permit short–term responsiveness and still ensure equal treatment of wage earners and self–employed farmers, the Rural Experiment developed a system of accounting whereby income was counted for the most recent month but both excess income and losses were carried over and included in income for a twelve–month period.

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Write to the Institute for Research on Poverty for a list of the Technical Papers from the Rural Experiment, which are available at cost.

**New challenges**
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The most recent challenge came from Charles Killingsworth and the structuralists of the 1950s. They questioned the orthodox view that full employment could be restored without inflation—arguing that technology, population shifts and other "structural shocks" were the root causes of pervasive unemployment and were beyond the easy remedy of economic stimulation through the "free market." This concept of structural unemployment of the unskilled due to the faults of the free market is closely allied to the modern dissidents' depiction of the depressed secondary labor market.

## Defense of the Neoclassical Approach

A defense of neoclassical research must rest on (1) adherence to the view that positive economic analysis can be separated from normative issues; (2) a denial that neoclassical models assume away conflict among various economic groups in society; (3) a belief that it is useful to construct economic models which assume that tastes and institutional factors are determined *outside* the economic system, while at the same time (4) claiming that neoclassical theory is capable of analyzing a variety of "noneconomic" variables and "disequilibrium" conditions.

## Cain's Assessment of the Debate

Cain's conclusion is that the theoretical contributions of the newest challenge to orthodoxy can be best formulated as modifications and additions to orthodox theory. (1) The new theorists have focussed "on a major gap in neoclassical models of labor market behavior," which make no allowance for the possibility that *attitudes may be a result of one's labor market achievement.* "The effects of discrimination, other systematic factors or even random factors that start workers off in the secondary sector (that is, in "bad" jobs), can shape tastes in an antiwork direction and thereby reinforce the disadvantageous position of low–wage workers." Neoclassicists need now to concentrate on building into their framework the possibility that these factors themselves affect and are affected by the working of the labor market.

(2) The new theorists have also reinforced the charge that neoclassical economics does not provide a very complete or convincing theory of *discrimination.* Neoclassical theories of discrimination have developed along three lines: competitive models which predict a long–run disappearance of wage (or job) discrimination; noncompetitive

theories, which are downplayed as being empirically unimportant; and models of the unreliability of the information channels operating in the labor market.

These are not, for Cain, convincing explanations for the extent of discrimination that we observe, and he suggests

> that we not lose sight of the substantial differences in the level of white and black earnings (10 to 20 percent)[2] even for recent data and even after available productivity variables have been held constant.

(3) The new theorists' emphasis on the *occupational structure* highlights our lack of empirical evidence on the questions of occupational choice and occupational mobility. According to Cain, labor-market economists should devote more serious effort to studying the institutional dimensions of operations *within* companies and firms (internal labor markets) to enrich our understanding of the economics of bureaucratic organizations. More evidence is also needed before we know whether workers with specific attributes are confined to one segment of the labor market and, if so, how substantial the incidence is.

(4) The new theorists' highlighting of *unemployment and job instability* points up, according to Cain, both theoretical and empirical gaps in the neoclassical approach, particularly the inadequacy of current efforts at explanation in terms of job search behavior. It also raises a basic issue, as yet unresolved, concerning the extent to which low education and training levels are *causal* to the observed instability of employment (as the neoclassical approach conventionally assumes), and the extent to which they are an *effect* of that instability.

(5) The alledged failure of *training and educational training programs,* according to Cain, involves the still messy issue of evaluating the evaluations of social action programs. Evaluations of government programs reveal the difficulties in applied economic research but also illustrate "the opportunities to test hypotheses in concrete situations where questions of bias and misspecification are not floating in abstraction, which is the bane of our current attempts to assess economic research."

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As Cain rather eloquently sums it up:

> In the areas of empirical research and policy prescriptions, the dual and radical school represents an important voice. Although their research suffers, in my view, because it is not anchored to as tight and consistent a theory as neoclassical theory, this fault is compensated by their new ideas and their discovery of empirical anomalies in the orthodox paradigm.[3]

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[1]For example, Samuel Bowles and Herbert Gintis, *Schooling in Capitalist America.* New York: Basic Books, 1975.

[2]Other estimates put the unexplained difference in the neighborhood of 30 percent.

[3]Glen G. Cain, "The Challenge of Dual and Radical Theories of the Labor Market to Orthodox Theory," *American Economic Review* 65 (May 1975):16–22.


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