PRELIMINARY!!!!	
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# THE NEW SCHOOL The New School for Public Engagement and The New School for Social Research

### The Economics of Inequality and Unemployment

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Office Hours: Wednesdays, 4-6 and by appt.

There are vast differences in the level of income inequality and its change over the last 4 decades among the richest capitalist (OECD) nations. There are also substantial differences in employment performance, as measured by unemployment and employment rates. What explains these differences and are they related? It has been widely accepted in mainstream economics that labor market institutions and policies designed to effectively compress the earnings distribution and reduce the incidence of very low wages will result in job loss and persistent high unemployment. Since employers hire more workers at lower wages, there must be a tradeoff between more equality and more employment (or between inequality and unemployment). Often referred to as the "unified theory," this orthodox perspective is at the root of calls for reforming (weakening) social protection policy to promote job creation and combat unemployment. But is there convincing evidence that more egalitarian wage structures and more generous benefit policies are consistently and strongly associated with lower employment rates and higher unemployment? This course takes a close look at cross-country differences in earnings inequality, the incidence of low wages, the generosity of social protection policies, and employment performance. It concludes with two sessions that focus on the links between aggregate demand, institutions, and work incentives in the Great Recession.

#### **Required Books**

Wiemer Salverda, Brian Nolan and Timothy M. Smeeding, eds. *The Oxford Handbook of Economic Inequality*, (Oxford University Press, 2009). Available in paperback. Jerome Gautie and John Schmitt, eds. *Low-Wage Work in the Wealth World*, (Russell Sage, 2010).

Richard Freeman, *America Works*, (Russell Sage Foundation, 2007). Paper. David R. Howell, *Fighting Unemployment: The Limits of Free Market Orthodoxy* (Oxford, 2005). Paper.

#### Recommended:

- W. Carlin and D. Soskice, *Macroeconomics: Imperfections, Institutions, and Policy* (Oxford, 2006). available in paper
- J. Jacobsen and G. Skillman, *Labor Markets and Employment Relationships*, (Blackwell 2004) Jonas Pontusson, *Inequality and Prosperity: Social Europe vs. Liberal America* (Century Foundation, 2005)

Andrew Glyn, Capitalism Unleashed: Finance, Globalization and Welfare (Oxford, 2006)

#### **Course requirements:**

- 1. Short papers (40%). You are responsible for five short (2-3 page) papers. Each should address a research or policy question closely related the topics covered in the readings for a particular class and must be posted on blackboard the night before the relevant class (before midnight). You should introduce the problem raised by the question, discuss how it is addressed in one or more of the session's readings (you can also reference outside articles/book chapters), and take a position that reflects your views of the evidence and your values (be clear what you mean by terms like equity and efficiency!). You should be prepared to informally (but thoughtfully!) discuss your paper in class.
- 2. The course paper (40%). This is due in the last class session. The paper should address a question of your interest and should be no longer than 12 pages of text (not including references, tables, figures etc). It should **extensively reference relevant course readings** as well as relevant outside readings. Original data work is welcome, but optional. Do not choose a topic that cannot be discussed is considerable depth on the basis of the course readings! It is due in the last class session and you should be prepared to present it.
- 3. <u>Class participation (20%):</u> you are expected to contribute to the discussion in **every** class on the basis of a close reading of at least several of the class readings and your own views. This includes taking a look at the posted short papers by your classmates before class.

#### **Course Outline**

### Session 1: Course Overview; the labor market as a social institution; inequality and the great recession

Robert Solow, "What is Labor Market Flexibility? What's it good for?", Keynes Lecture, 1999. Comments by Charles Bean and Robert Rowthorn (BB)

Wendy Carlin, "Macroeconomic paradigms, policy regimes and global economic crises"

Recommended: Robert Solow, The Labor Market as a Social Institution,

#### **Session 2: Competition and Power in the Labor Market**

Bruce Kaufman, "On the Neoclassical Tradition in Labor Economics" BB R. Freeman, *America Works*:

Chapter 1: "The U.S. Market-Driven Labor System"

Chapter 2: "When Markets Drive Outcomes"

Julia Lane, "Inequality and the Labor Market: Employers", chapter 9 of Salverda et al.

Visser and Checchi, "Inequality and the Labor Market: Unions", in Salverda et al.

Recommended: Alan Manning, "Imperfectly Competitive Labor Markets"...

#### Session 3: Income and Earnings Inequality in Rich Economies: some theory and facts.

Jacobson and Skillman, chapter 17: Earnings Inequality" (BB)

Atkinson, "Introduction", Chapter 1 of Atkinson and Bourguigon eds., Handbook of Income Distribution" BB

Glyn, "Functional Distribution and Inequality," Chapter 5 in Salverda et al.

Brandolini and Smeeding, "Income Inequality in Richer and OECD Countries," Chapter 4 in Salverda et al.

Atkinson, "Income Inequality in OECD Countries: Data and Explanations," *CESifo Economic Studies*, Vol. 49, 2003.

#### Recommended:

Blau and Kahn, "Inequality and Earnings Distribution," Chapter 8 in Salverda et al. Thomas Piketty and Emmanuel Saez, "The Evolution of Top Incomes: A Historical and International Perspective, NBER Working Paper #11955, January 2006.

#### On the World Distribution of Income:

Sudhir Anand and Paul Segal, "What Do We Know about Global Income Inequality", *Journal of Economic Literature* (2008, 46:1).

Bob Sutcliffe, "A more or less unequal world? World income distribution in the 20<sup>th</sup> Century," Political Economy Research Institute Working Paper # 54, 2003.

Dowrick and Akmal, "Contradictory Trends in Global Income Inequality: A Tale of Two Biases," *Review of Income and Wealth*, 51 (2005).

World Bank, "World Development Report 2006: Equity and Development."

J. Roemer, "Review Essay: 2006 World Development Report," *Journal of Economic Inequality*, 4, 2006.

- Sala-i-Martin, "The World Distribution of Income: Falling Poverty and ...Convergence, Period," *Quarterly Journal of Economics*, 121 (2006).
- B. Milanovic, "Global Income Inequality: What it is and Why it Matters," Policy Research, Working Paper No. 3865, World Bank.

IMF, World Economic Outlook chapters (2007, 2008)

OECD, Employment Outlook Chapter (2008)

### Session 4: Productivity and Earnings Inequality: Skills? Education? Behavior? Networks?

Jacobsen and Skillman, Chapter 14: "Education and Ability"

Stephen Machin, "Education and Inequality," chapter 17 of Salverda et al.

- S. Bowles, H. Gintis, and M. Osborne, "The Determinants of Earnings: A Behavioral Approach," *Journal of Economic Literature* (2001)
- Mark Granovetter, "The Impact of Social Structure on Economic Outcomes," *Journal of Economic Perspectives*, winter 2005.

#### Recommended:

David Card, "Estimating the Return to Schooling: Progress on Some Persistent Econometric Problems," *Econometrica* 69(5): 1127-1160.

### Session 5: Rising Earnings Inequality: Measurement? Technology Driven Skill-biased Demand Shifts?

- D. R. Howell and S. Wieler, "Skill-Biased Demand Shifts and the Wage Collapse in the United States: A Critical Perspective," *Eastern Economic Journal*, vol 24, no. 3 (Summer 1998).
- David Card and John DiNardo, "Skill-Biased Technological Change and Rising Wage Inequality: Some Problems and Puzzles," *Journal of Labor Economics* 20(4), 2002.
- Autor, Katz and Kearney, "Trends in U.S. Wage Inequality: Revising the Revisionists," Review of Economics and Statistics 90:2 (May), pp. 300-23, 2008.
- Thomas Lemieux, "The Changing Nature of Wage Inequality," BB
- Robert Gordon, "Misperceptions about the Magnitude and Timing of Changes in American Income Inequality," NBER working paper 15351, September 2009.
- David H. Autor and Lawrence F. Katz, "Grand challenges in the study of employment and technological change: A white paper prepared for the National Science Foundation," September 29, 2010.

#### Recommended

- J. Bound and G. Johnson, "What are the Causes of Rising Wage Inequality in the United States," Federal Reserve Bank of New York Economic Policy Review 1, no. 1 (January 1995).
- D. R. Howell, "The Skills Myth," *The American Prospect*, Summer 1994, pp. 81-90. (Reprinted in *Ticking Time Bombs: The New Conservative Assaults on Democracy*," edited by Robert Kuttner (The New Press): 1996.)
- D. R. Howell, "Collapsing Wages and Rising Inequality: Has Computerization Shifted the Demand for Skills?," *Challenge*, January-February, 1995.

#### Session 6: Rising Inequality: Labor Market Institutions, Social Norms and Ideology?

- D. R. Howell, "Theory-Driven Facts and the Growth in Earnings Inequality," *Review of Radical Political Economics*, 31(1), 1999.
- R. Freeman, America Works, Chapers 5-7.
- N. Fortin and T. Lemieux, "Institutional Changes and Rising Wage Inequality: Is There a Linkage?," *Journal of Economic Perspectives*, (Spring 1997).
- Frank Levy and Peter Temin, "Inequality and Institutions in 20<sup>th</sup> Century America," unpublished paper, (June 2007).

#### Recommended

- R. Freeman, "Labor Market Institutions and Earnings Inequality, *New England Economic Review*, (May/June 1996).
- J. DiNardo, N. Fortin and T. Lemieux, "Labor Market Institutions and the Distribution of Wages, 1973-1992: A Semi-parametric Approach," *Econometrica* 64, no. 3 (September 1996).
- David S. Lee, "Wage Inequality in the United States During the 1980s: Rising Dispersion or Falling Minimum Wage?," *The Quarterly Journal of Economics*, 114, no 3 (1999).

#### **Session 7: Low Wages in Rich Economies: dimensions and explanations**

Lucifora and Salverda, "Low Pay," in Salverda et al.

Mason and Salverda, "Low Pay, Working Conditions, and Living Standards", Chapter 2 in Gautie and Schmitt.

Howell and Okatenko, "By What Measure? A Comparison of French and U.S. Labor Market Performance With New Indicators of Employment Adequacy," *International Review of Applied Economics*," 2010 (BB).

Bosch, Mayhew, and Gautie, "Industiral Relations, Legal Regulations, and Wage Setting," Chapter 3 in Gautie and Schmitt.

Gautie et al., The Impact of Institutions on the Supply Side of the Low-Wage Labor Market," Chapter 4 of Gautie and Schmitt.

#### Session 8: The Consequences of High Inequality and Low Wages

Finis Welch, "In Defense of Inequality," Richard T. Ely Lecture, AEA Papers and Proceedings, *American Economic Review*, May 1999.

R. Freeman, America Works,

Chapter 3: "Distribution Matters"

Chapter 4: "Why Americans Work and Work."

Nolan and Marx, "Economic Inequality, Poverty, and Social Exclusion," in Salverda et al.

Van Praag and Ferrer-I-Carbonell, "Inequality and Happiness," in Salverda et al.

Nancy Folbre, "Inequality and Time Use in the Household," in Salverda et al.

#### Recommended:

Alesina, Di Tella, and MacCulloch, "Inequality and Happiness: Are Europeans and Americans Different?" *Journal of Public Economics* 88 (2004).

Christopher Jencks, "Does Inequality Matter?" *Daedalus* (Winter 2002).

Robert Frank, Falling Behind: How Rising Inequality Harms

the Middle Class (University of California Press, 2007).

E. Glaeser, "Inequality" October 2005, Kennedy School Faculty Research Working Papers Series (RWP05-056)

## Session 9: Does Wage Rigidity (Compression) Explain High Unemployment? Perspectives on the Relationship between Wages and Employment

Jacobsen and Skillman, Labor Markets and Employment Relationships,

Chapter 18: "Unemployment" (pp. 489-517);

Chapter 19: "Labor Market Dynamics" (pp.518-542).

Arthur Okun, Prices and Quantities: A Macroeconomic Analysis (Brookings, 1981):

Chapter 2:

Chapter 3:

Peter Diamond, "Unemployment, Vacancies, Wages," *American Economic Review* 101, June 2011. (see also the nobel lectures by Mortensen and Pissarides in the same issue).

#### Recommended:

Carlin and Soskice, Macroeconomics: Imperfections, Institutions and Policy,

Chapter 2: Aggregate Demand, aggregate Supply, and Business Cycles (pp. 27-66);

Chapter 4: "Labour Markets and Supply-Side Policies," (pp. 103-125)

E. Stockhammer, "The Macroeconomics of Unemployment," in Hein and Stockhammer, *A Modern Guide to Keynesian Macroeconomics and Economic Policies* (Edward Elgar, 2011).

### Session 10: The Persistence of High Unemployment in the OECD: Evolution of The Orthodox Account

Siebert, Horst. 1997. "Labor market rigidities: At the root of unemployment in Europe," *Journal of Economic Perspectives* 11, no. 3 (Summer): 37-54.

Nickell, Stephen. 1997. "Unemployment and Labor Market Rigidities: Europe versus North America," *Journal of Economic Perspectives*, Summer, Vol. 11, No. 3, pp. 55-74.

Nickell, Stephen, Luca Nunziata and W. Ochel. 2005. "Unemployment in the OECD Since the 1960s. What do We Know?", *The Economic Journal*, vol. 115 no. 500, pp. 1-27.

Bassanini, Andrea and Romain Duval. 2006. "Employment Patterns in OECD Countries: reassessing the role of policies and institutions," OECD Social, Employment and Migration Working Paper No. 35, and OECD Economics Department Working Paper No. 486, Paris. [A somewhat less technical version appears in the *OECD Employment Outlook*, 2006].

Layard, Richard, Stephen Nickell and Richard Jackman. "Introduction" to the 2<sup>nd</sup> edition of *Unemployment: Macroeconomic Performance and the Labour Market* (Oxford: Oxford University Press).

#### Recommended:

Carlin and Soskice, chapter 18: "Unemployment: Institutions, Shocks and Policies"

# Session 11: The Critical Assessment of the empirical evidence on Institutions, labor market rigidities, and unemployment (4/27)

- Baker et al., Chapter 3 in Howell, Fighting Unemployment.
- Baccaro, Lucio and Diego Rei. 2005. "Institutional determinants of unemployment in OECD countries: A time series cross-section analysis," International Institute for Labour Studies Discussion Paper, DP/160/2005, International Institute for Labour Studies, Geneva.
- Howell et al., "Are Protective Labor Market Institutions at the Root of Unemployment?," *Capitalism and Society*, 2007.
- Howell, "Institutions, aggregate demand, and cross-country employment performance: alternative theoretical perspectives and the evidence," in Hein and Stockhammer, *A Modern Guide to Keynesian Macroeconomics and Economic Policies* (Edward Elgar, 2011).

#### Recommended:

- D. R. Howell and Miriam Rehm, "Unemployment Compensation and High European Unemployment: a reassessment with new benefit indicators," *Oxford Review of Economic Policy*, vol 25, no 1, 2009.
- J. Schmitt and J. Wadsworth, "Is the OECD Jobs Strategy behind U.S. and British Employment and Unemployment Success in the 1990s?" Chapter 5 in Howell, ed., *Fighting Unemployment*.
- Andrew Glyn, "Labor Market Success and Labor Market Reform: Lessons from Ireland and New Zealand," chapter 6 in Howell, ed., *Fighting Unemployment*.

#### Session 12: Inequality, Efficiency and Employment: Tradeoffs and the Role of the State?

Jonas Agell, "Efficiency and Equality in the Labour Market," mimeo, August 25, 2003.

- D. R. Howell and F. Huebler, "Wage Compression and the Unemployment Crisis: Labor Market Institutions, Skills, and Inequality-Unemployment Tradeoffs," chapter 2 in Howell, ed., *Fighting Unemployment*.
- Esping-Andersen and Myles, "Economic inequality and the Welfare State," chapter 25 of Salverda et al.
- McCarty and Pontusson, "The Political Economy of Inequality and Redistribution," chapter 26 of Salverda et al.

### Session 13: Institutions and Work Incentives in the Great Recession: Research using labor flow data

- Davis, Faberman and Haltiwanger, "The Flow Approach to Labor Markets: New Data Sources and Micro-Macro Links," *Journal of Economic Perspectives*, vol 20, no 3, summer 2006.
- Elsby, Michaels and Solon, "The Ins and Outs of Cyclical Unemployment," *American Economic Journal: Macroeconomics* 2009, 1:1, 84-110.
- Elsby, Hobijn and Sahin, "The Labor Market in the Great Recession," *Brookings Papers on Economic Activity*, 2010.
- Daly, Hobijn and Valletta, "The Recent Evolution of the Natural Rate of Unemployment,"

- Federal Reserve Bank of San Francisco, Working Paper 2011-05, January 2011.
- D. R. Howell and B. Azizoglu, "Unemployment benefits and work incentives: the US labour market in the great recession," *Oxford Review of Economic Policy*, 2011.

### Session 14: The Translation of Aggregate Demand into Employment: What's Happened to Okun's Law? Problems of Measurement? Institutional Changes?

- IMF, "Unemployment Dynamics During Recessions and Recoveries: Okun's Law and Beyond," chapter 3, *World Economic Outlook*, April 2010.
- Robert J. Gordon, "The Demise of Okun's Law and of Procyclical fluctuations in Conventional and Unconventional Measures of Productivity," NBER presentation, July 21, 2010.
- Basu and Foley, "Dynamics of Output and Employment in the U.S. Economy," SCEPA working paper 2011-4.
- Duncan Foley, "The Political Economy of U.S. Output and Employment 2001-2010. Bretton Woods manuscript.
- Michael Burda and Jennifer Hunt, "What Explains the German Labor Market Miracle in the Great Recession?", IZA discussion paper, no 5800, June 2011 (also published in the Brookings Papers).

#### **Session 15: Student Presentations**