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THE REDISCOVERY OF THE BALKANS

ROBERT EVANS, JR.

The concept of dual labor markets was first proposed in order to explain observed economic behavior in developing countries, especially those with an extensive portion of their workforces engaged in traditional agriculture. There the two sectors were agriculture and the advanced technique manufacturing sector. In Japan the concept was also employed to explain wage behavior between large firms and small firms. Here too the distinction has also usually been associated with firms using more traditional and more advanced production techniques. Recently, in the United States Professor Piore has suggested that the concept of a dual labor market may be the most useful way in which to understand the labor market experience of disadvantaged workers. The suggestion has been favorably received by a number of labor economists, and especially by radical economists.² The merits and weaknesses of the concept have been the subject of a mini-debate in the pages of the *Monthly Labor Review*.³

The merits of the concept and its future usefulness can more clearly be understood, I believe, if the concept is considered in its historical context and is compared to similar theories. The objective of this paper is to briefly do both of these. The first section sketches the historical development of the dual labor market concept. The second considers the usefulness of the concept by comparison with situations where such a formulation has found wide acceptance, to Japanese labor markets and developing economies. The final section provides a brief discussion of policy issues.

DIFFERENTIATED LABOR MARKETS

Despite the tendency of early classical writers to write as if labor were a homogeneous commodity, all of them recognized that wage differences would exist at equilibrium for a variety of reasons. John S. Mill even suggested that the lines of demarcation between different labor markets (skill grades) were so strong as

¹ Micheal J. Piore, "On-the-Job Training in the Dual Labor Market" in Arnold Weber, *et al.*, *Public-Private Manpower Policies* (Madison, Wisc.: Industrial Relations Research Association, 1969), pp. 101-132.

² For example, see Howard M. Wachtel, "Capitalism and Poverty in America: Paradox or Contradiction" *Papers and Proceedings, American Economic Review* 62 (May, 1972), pp. 187-194 and material cited therein.

³ Robert E. Klitgaard, "The Dual Labor Market and Manpower Policy," *Monthly Labor Review* 94 (Nov. 1971), pp. 45-48 and Bennett Harrison, "Additional Thoughts on the Dual Labor Market," *Monthly Labor Review* 95 (April, 1972), pp. 37-39.

to be almost equivalent to those separating castes.⁴ Alfred Marshall also believed that there were a number of factors, parents' outlook, time rates of discount, etc, which tended to both divide labor markets and to perpetuate such divisions.⁵ Mostly, however, their emphases were upon forces tending toward equilibrium. Despite observations, concerning barriers, by the middle of the twentieth century there was a standard neo-classical view of the labor market. J. R. Hicks expressed it as follows, "wages in a nation are subject to the equalizing force of movement in search of better wages" but that it is not possible to expect that, "the movement of labor . . . will be very effective . . . in equalizing the net advantages of different occupations."⁶

An alternative view, one which emphasized a more differentiated view of the labor market, based upon local labor market studies, began to appear late in the depression decade of the 1930's. Additional research after the War reinforced by studies of unions and various scholars' wartime association with wage stabilization only strengthened these views. The primary conclusions drawn were that labor markets were increasingly institutional in character and that this tended to create non-competing groups resulting in markets which were more specifically defined and in which movement was more limited than in the neo-classical model. The essence of the view was captured in the title of a paper by Clark Kerr, "The Balkanization of the Labor Market".⁷

The proponents of balkanized labor markets, a group which included many who would subsequently become presidents of the Industrial Relations Research Association, noted a number of different labor market imperfections. The most important imperfections were those affecting informational flows, workers' lack of adequate training, and pure discrimination, the clearest example of which was that practiced against Negroes. Such views of the labor market process led to obvious policy proposals: training, anti-discrimination legislation, and an improved employment service, all of which were proposed and advocated.

Late in the 1950's when the U. S. economy seemed to experience increasing levels of unemployment during non-recessionary periods, it was only natural for the situation to be viewed in the context of balkanized labor markets. Such a view suggested that structural changes in the labor market were the probable cause, hence the view that structural unemployment was a key factor in the unemployment problem.

The structuralist view was challenged by those who argued that the unemployment problem was one which emerged from a lack of adequate aggregate

⁴ John Stuart Mill, *Principles of Political Economy*, II vols. (New York: D. Appleton and Company, 1893) II Vol. I, p. 480.

⁵ Alfred Marshall, *Principles of Economics*, 8th ed. (New York: Macmillan, 1952), pp. 558, 562-63.

⁶ J. R. Hicks, *The Theory of Wages* (Gloucester, Mass.: Peter Smith, 1957).

⁷ Clark Kerr, "The Balkanization of Labor Markets", in E. Wight Bakke *et al.*, *Labor Mobility and Economic Opportunity* (New York: John Wiley and Sons, 1954), pp. 93-109.

demand in the economy and that unemployment would drop as demand increased. The Aggregate Demand-Structural Unemployment Debate continued for several years and a number of publications. Most would agree that the aggregate demanders won the debate—a fact that was to have great significance for the development of labor market studies. Central to the aggregate demand hypothesis was the concept of a labor market which was segmented, but with rather porous barriers. The explicit model used was that of a queue. The least qualified workers were at the end but were quite employable. All that was required was an adequate general demand for labor.

Subsequently when the Administration undertook manpower programs, it did so anticipating a relatively well-functioning labor market. All that was necessary was to improve the personal characteristics of those at the end of the queue and thereby allow them to move up the line. The approach adopted was one that Adam Smith would have understood for essentially it reduced the cost of obtaining skills.

Unfortunately the mere provision of skills to marginal workers turned out not to have adequately dealt with the central problem, something which the balkanized labor market concept would have suggested, had it been utilized. Since the balkanized concept wasn't used, when the queue failed it was not surprising that there was, in the suggestion of dual labor markets, a halting movement toward the rediecovery of the balkanization concept.

THE MECHANICS OF DUAL LABOR MARKETS

Whether the dual labor market concept is adequate or whether a more fully developed balkanization model needs to be developed depends in part on the usefulness of the dual concept. One test of that usefulness is to compare the concept as applied in the United States with other dual labor market formulations in situations where these concepts have seemed to be worthwhile. One such application has been in the analysis of Japanese labor markets and a second has been in developing countries. In both cases the analysis has been of wage differentials rather than employment.

These Japanese and developing country analyses have several common characteristics.

1) *A Sorting Mechanism*

In Japan the usual basis for division is that of size of firm. As an illustration of the differences involved, in 1969 males aged 40–49 employed in establishments of more than 1,000 workers had average wages 50% higher than did similarly aged males in establishments of 10–29 workers.⁸ In the developing countries

⁸ Robert Evans, Jr., *The Labor Economies of Japan and the United States* (Praeger, 1971), p. 187. Wage differentials by size also exist in the United States, but to a much smaller extent. Wages in size class 500–999 are higher than those in the 10–19 class by only 19% in the United States, compared to 50% in Japan. (p. 192).

the usual division has been between manufacturing or urban employment and agriculture.

2) *Rationality of the Behavior*

The usual rationale for the initial existence of interscale wage differentials in Japan usually has been explained by reference to a firm's need to obtain skilled and committed labor. The continued existence of these differentials has then been explained by the development of worker productivity through training and on-the-job experience. An alternative explanation, which I prefer, is that firms pay higher wages in order to maintain equity between their wage and profit levels. The high profit potential of large firms then can be traced to shortages of capital, government activities, and other imperfections outside the labor market. Similar explanations of rational behavior or imperfections outside of the labor markets have been applied to developing countries. Lloyd Reynolds in discussing Puerto Rico suggested several reasons, a rise in conventional standards of life, increases by capitalists on moral grounds, trade union pressure, or government regulation. The latter, he felt, was particularly important to Puerto Rico.⁹

3) *Maintenance of the Division*

In Japan the maintenance of dual labor markets is rooted in distinctions between permanent employees of large firms and temporary employees, sub-contractor employees and employees of small scale enterprises. The large firms wish to minimize inter-firm mobility. Thus they place their main recruitment efforts upon the attraction of new school graduates. Prior entrants into the labor force are either not employed or, if they are employed, they are paid lower wages. Observed mobility patterns suggest that the system works.¹⁰ In developing countries there does not seem to be a similarly clear selection process. Friends, relatives and chance all appear to be important in deciding who is employed and turnover is not intentionally minimized.

Compared to these standards of sorting, rationality, and maintenance, the American concept, as developed to date, appears to be quite disembodied, merely some odds and ends of facts all in search of a theory. No consistent basis for a division between the two markets has been proposed. Those that have been suggested tend to stress high wages and stability of employment in one sector and their opposites in the other. As description these may be realistic, but they provide no base from which to proceed to explain why.¹¹ Secondly, no real rationale for employer behavior in setting up the two markets has been provided. Some attempt has been made to talk of exploitation, or an attempt to save money by paying lower wages, but these fly in the face of the known association of low profits

⁹ Lloyd G. Reynolds, "Wages and Employment in a Labor Surplus Economy," *American Economic Review* 55 (March, 1965), p. 21.

¹⁰ Evans, pp. 77, 171, 183.

¹¹ This point is well made by Jerry E. Pohlman, "Discussion," *Proceedings, Twenty-fourth Industrial Relations Research Association Meetings*, (May, 1972), pp. 315-317.

with low wages¹² and do not suggest why most employers choose to pay high wages. The only place where the American model appears to have any structure is in its explanation of maintenance, where it states that employers for good business reasons choose not to take a chance with persons experienced in unstable employment. Even here it stands in marked contrast with the foreign country models, for both of them would argue that most of the excluded employees would be equally as productive. Taken as a whole then, I can only conclude that the dual labor concept is not a useful analytical construct for the United States Labor Economy.

DUAL MARKETS AND POLICY

Labor Economics as it developed in the 1950's was rooted in the micro-analysis of empirically observed labor markets. It emphasized the division of markets, the importance of past practices, and adjustments toward new equilibriums via employment opportunities and labor mobility rather than through movements of relative wages. The initial development of manpower policy in the United States was rooted in these concepts. This may easily be seen in the Area Redevelopment Act. This Balkin concept also underlay the structuralist view of the level of unemployment. When this view lost the great Structuralist-Aggregate Demand Debate, its influence upon the development of manpower policy was also lost. It was then replaced by concepts which stressed the ease of labor transfer, especially under conditions of high demand. This was also the period of the development of the human capital school of labor market analysis and this served only to strengthen the kind of manpower emphasis upon training alone which was developing.

The rise of the dual labor market concept in the United States is essentially a reaction to the inability of many manpower programs to achieve the success which had been anticipated. A case can be made that by focussing attention upon the deficiencies in manpower programs, it has served a useful purpose. Its emphasis upon the importance of good job opportunities and its enlistment of the contribution of other social sciences may also be useful in pointing back toward earlier and more fruitful directions in labor economics. The danger is that the concept may be used as a basis for new labor market policies and since it is a false concept, there would be a high probability that policies based upon the dual labor market concept would be no more successful than have many earlier policies and programs.

The wage differences between high and low wage sectors represent very real productivity differences and the mere removal of in-tray-labor market boundaries is not apt to improve income distribution. It may make initial access to the

¹² Evans, pp. 225-227. Low wages and low profits go together. Nor does the possibility of gains to primary employers from being able to purchase the output of low wage labor appear to be very promising, for surely directly paying lower wages would be even more advantageous.

high wage sectors more equal and could be defended upon that value alone. Similarly, the extension of the minimum wage or an increase in its level, or the provision of subsidized employment are equally incapable of improving the situation. The one policy of a negative character which could improve the situation would be one which required productivity gains to be shared via price decreases rather than as at present through wage increases. Such a policy would be difficult to draft, enact, or enforce. What are required are positive policies which can extend the area encompassed by the high wage sectors.

In searching for such positive policies, the experience of Japan may provide some useful insights, for in recent years there have been significant shifts in the proportions within the high and low wage sectors of her economy. The basic lessons are three in number. It is not an easy or a swift task. Hardwork is required. Most importantly, it is only by introducing high productivity techniques into low wage sectors that they are able to increase their absolute productivity and consequently the wages of their employees. The exact method of transfer which is applicable and the potential role of government policy will require careful study and will probably be different in the various sectors of the low wage economy.

CONCLUSION

The discussion of the dual labor market concept in the United States in the 1970's represents a turn back toward earlier directions. Analytically it must be rejected because of its structural weaknesses and its inability to provide testible hypotheses. In spite of this rejection, it is possible that out of the discussion which it has provoked will emerge a combination of the insights and practical understanding embodied in the concept of Balkanization with the more sophisticated analytical and computation techniques which have been developed in recent years.

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