INTRODUCTION

In 1984 the American Economics Association sent a delegation of economists to the Soviet Union for scientific discussion with Soviet economists. It was the final meeting in a series of cultural exchanges at a time when the Cold War was heating up. The trip was made in summer, but in terms of intellectual discourse, Moscow was as cold and dark as Mordor. At lunch the head of the Soviet delegation reminded us that the Soviet Union had enough nuclear weapons to destroy the United States many times over, including President Reagan's Hollywood and Disneyland.

My job was to talk about the U.S. labor market. I criticized the United States for rising inequality; unemployment that had hit double digits in the 1981 recession; declining unionization; reduced company provision of defined-benefit pensions; the stalled advance of black Americans; limited gains in earnings for women; and slow productivity and real wage growth. I saw the United States as losing ground to other advanced economies. Japan, whose labor market and economic institutions were very different from those in the United States, was challenging American firms in automobiles, steel, and high-tech. Advanced Europe, which also had very different institutions, had adjusted better to the 1970s oil shock.

My biggest concern was that the distribution of earnings in the United States was bifurcating. There were more jobs and higher pay at the top of the earnings distribution and also at the bottom of the earnings distribution. The result was fewer middle-class workers. The average hourly earnings of the production and nonsupervisory workers who made up most of the U.S. workforce were trending downward, in a sharp break with U.S. economic history. Crime was high. Social pathologies were destroying inner cities. Homeless people, whom I had always associated with impoverished India or hobos during the Great Depression, were found on the streets of big cities. The Reagan administration's tax cut targeted at the rich was to me the wrong way to solve the country's economic problems. I was tough on the U.S. labor market and economy.

The KGB agent who accompanied the Soviet delegation liked my criticisms. He offered me a piece of Russian chewing gum. Maybe Comrade Konstantin Chernenko, the chairman of the Politburo, would use my statistics the next time he denounced the United States. But Comrade Chernenko was not as sharp as Comrade Yuri Andropov (the previous chairman, who came from the KGB). Was I interested in future trips to Moscow as a friend of the KGB? I could stay in the Friendship Hotel (a decrepit, overcrowded slum dwelling filled with spy cameras and aged babushkas), drink vodka and eat caviar (with bloated Party apparatchiks), and go to Red Square to watch the May Day parade (of weapons designed to destroy me, my family and friends, Hollywood, and Disneyland). I could denounce the Reagan administration to my heart's content.

Shades of Maxwell Smart and KAOS![1] I was critical of the United States because I wanted the country to do better, not because I sympathized with the decaying "Evil Empire." (President Reagan's words rang true to me after that visit.) Wondering if other Russians thought that Andropov was a better leader than Chernenko, I repeated the comment to a Russian economist and watched the man's face turn ash white and his trembling hand spill the vodka as he backed across the room as quickly as he could. Criticize the leader and you just might end up in Moscow's notorious Lubyanka Prison. I was ecstatic when the airplane taking our delegation back to civilization took off from Moscow, leaving behind armed guards at the airport, bookstores filled with Marx and Lenin, and horrid chewing gum. When we landed in Helsinki, I thought it was Paris.

Some of the weaknesses in the U.S. job market and economy that troubled me in Moscow over two decades ago have lessened. In the late 1990s boom, employment rose to unprecedented levels relative to the population of working age, and the rate of productivity advance accelerated. Women made huge gains in the labor market, and crime fell greatly, though that decline may have been the result of the number of persons imprisoned rising to levels unprecedented in any free society.

Other problems, however, got worse. Inequality is now at Third World levels. Real wages have continued to stagnate. The U.S. union movement has weakened and split. And new problems have arisen that I never imagined would plague the United States. While the number of crimes committed by normal citizens has fallen, a wave of crime and amoral greed has engulfed the CEOs of major corporations, harming workers and shareholders alike. The demand for labor has shifted toward highly skilled "superstars" and away from ordinary workers, exacerbating inequality. Most important, globalization is creating a single world labor market in which multinational firms shift jobs from Americans to low-wage workers in developing countries, creating insecurity and uncertainty in the United States about the economic future. Historically, American labor scholars have looked inward to examine U.S. laws and institutions, paying scant regard to the rest of the world, but that traditional approach will not do in the twenty-first century. Globalization has brought the world to the United States—through immigration, trade, capital flows, and the Internet—with huge consequences for American workers and firms.

The United States has an exceptional labor market. With less institutional regulation than is found in any other major advanced country, it relies on decentralized wage setting to determine pay and provides workers with lower safety nets to deal with unemployment, disability, and health problems. It gives managers great rewards and power. Historians and political scientists often write about "American exceptionalism"—the extent to which the frontier, openness to immigration, high religiosity, and rejection of European-style class politics has made the United States different from other advanced capitalist countries.[2] Economists examine how the U.S. labor market produces different outcomes than those in Europe or Japan.[3] Some see the U.S. market as the nearest thing to the "invisible hand" market of economic theory, and a main reason for U.S. economic success.

This book does not join in this sanguine view of the U.S. economic model. I take a more critical view of the performance of the U.S. labor market. The triumph of market capitalism and the collapse of the Soviet bloc have not blunted my belief that the U.S. labor system can do better. I am critical of the U.S. model, as I was in Moscow, because it has weaknesses that harm workers but can be remedied, I believe, without reducing growth and productivity. I recognize that there are powerful market and nonmarket forces that act to increase inequality in the United States, from technological change that favors the more skilled to globalization, which places U.S. workers in competition with lower-wage workers elsewhere in the world. But these forces are not all-powerful. The country can strengthen the market forces and institutions that favor ordinary workers. It can adjust to globalization in ways that will yield better outcomes for working citizens. My critical view of the U.S. labor market is not one of doom and gloom but one that sees the opportunity to do better.

Part of the historic success of the United States comes from its reliance on markets. But part of its success also has to do with how government and institutions operate and the ways in which the country has historically supplemented or amended market outcomes. The United States was the first country to develop mass higher education. The federal government's investments in research and development have produced innovations such as the Internet that have spurred the private economy as well as advances in medicine that elongate lives. The government has battled against discrimination in the job market, used tax and transfer policies to provide social security for the elderly, enacted laws and rules that reduce occupational injuries and deaths, and set up a legal system for workers to unionize through secret ballot elections. Some of these policies have worked well. Some have not. But the same is true of markets. Sometimes markets work well. Sometimes they do not. The most sophisticated market in capitalism, the financial market, fluctuates wildly for reasons no one understands, not even Warren Buffett or George Soros. Without a powerful Securities and Exchange Commission regulating financial transactions, Wall Street would turn into a fraudulent casino. The differences between the ways in which stock and currency markets work in reality and abstract models of perfectly efficient markets have led financial economists to devote more resources to "behavioral economics," studies that seek to understand the flaws and foibles of real markets. Labor economics has always been behavioral economics.

The first eight chapters of this book are about the functioning of U.S. labor markets and the resulting successes and failures. These chapters are based on the scientific analyses of economists with widely different perspectives and ideologies. In the lingo of social science, they are "positive economics." In the lingo of Joe Friday from the old *Dragnet* TV show, these chapters are about the facts, m'am, just the facts.[4] Where economists and other social scientists disagree about the processes that have generated the facts, I give you both sides—my (hopefully) correct view and the alternative view.

The last chapter moves to normative issues. I lay out how I believe the country can restructure the labor market and supplement market solutions to improve the well-being of ordinary workers. In contrast to recent policy debate, in which politicians and policy analysts often claim that whatever policies they favor—tax cuts for the rich, lower trade barriers, greater spending on education—make the economy better for everyone, I do not sell my policy prescriptions as "win-win" solutions. Almost all policies benefit some people—tax cuts for the rich benefit the rich, and reduced trade barriers benefit consumers of goods with lower tariffs—but those benefits may or may not trickle down or across to the rest of society. Most policies also create losers, usually indirectly—the tax cut to the rich may come at the expense of greater spending on social programs, reduced trade barriers often harm manufacturing firms and their workers—and it is disingenuous to claim otherwise. Even with the rare win-win policies, there are huge distributional issues: does the extra output go primarily to lower-income workers and their families or primarily to well-heeled professionals and executives?

My prescriptions are designed to make it easier for ordinary workers to advance their interests in the labor market. Given the extraordinary inequality in the U.S. job market, this must be done by shifting some national output from the super-wealthy to regular employees and reducing the control over the U.S. economy exerted by the super-wealthy. Sorry, Bill, Warren, George, and the rest of the billionaires on the *Forbes* "400 Richest Americans" list.[5] But more than anyone else, you know that a bit less for you and a bit more for the average American will do the country good—and will not inhibit your efforts to make your firms and investments succeed.