Structural Change and Economic Dynamics 30 (2014) 120–131

Contents lists available at ScienceDirect

Structural Change and Economic Dynamics

journal homepage: www.elsevier.com/locate/sced

Capitalists, workers, and managers: Wage inequality and effective demand

Daniele Tavani *, Ramaa Vasudevan

Colorado State University, Fort Collins, CO, United States

ARTICLE INFO

Article history:
Received 13 December 2012
Received in revised form 14 March 2014
Accepted 3 May 2014
Available online 14 May 2014

JEL classification:
B5
E12
E22
E25

Keywords:
Effective demand
Capacity utilization
Wage inequality
Stability

ABSTRACT

We present a simple three-class model in the Kaleckian tradition to investigate the implications of a dominant managerial class for the dynamics of demand and distribution. Managers play a peculiar role in the economy, both because of their supervisory function – which results in surplus extraction and wage inequality – and because of their saving behavior. The adjustment of capacity utilization to accommodate goods market disequilibrium produces two distinct regimes with respect to the responsiveness of investment demand to profitability: a low investment-response regime, where effective demand appears to be both wage-led and *inequality-led*; and a high investment-response regime, where demand looks profit-led. In accordance with recent empirical evidence for the US, we introduce distributional dynamics that hinge on inequality squeezing workers' wage growth. We find that the low investment-responsiveness regime produces a stable demand-distribution equilibrium only if the wage squeeze effect is relatively small. On the other hand, the equilibrium in the high investment-response regime is saddle-path stable. The main distributional implication of the wage squeeze and inequality is that the effect of redistribution toward workers in both the low investment response regime and the high investment response regime leads to declining inequality *and* capacity utilization. Hence, in both regimes, the inequality-led features of the equilibrium dominate the wage-led or profit-led nature of effective demand. These findings imply that distributive dynamics lead to a stronger basis for cohesion in the interests of managers and capitalists compared to workers and managers.

1. Introduction

The recent trajectory of the US economy has been characterized by an increase in income inequality, and in particular the disproportionate and rising share of the top 1% of income earners (Piketty and Saez, 2003, 2006).[1] Duménil and Lévy (2004, 2010) trace the roots of this trend to the rise of the managerial, executive class following what they call the "coup of finance" after the Volcker disinflation of 1980–1984. The rise of the managerial class in the past three decades found fertile soil in the so-called neoliberal revolution, characterized by globalization of goods and factor markets and the growing importance of the financial sector in most advanced economies (Duménil and Lévy, 2004, 2010). Financial and non-financial corporate executives and managers now comprise about two-fifths of the top 1% of the income distribution in the US, together explaining about 60% of the increase in the share of this group (Bakija et al., 2011) in the past two decades. While

* Corresponding author at: 1771 Campus Delivery, Fort Collins, CO 80523-1771, United States. Tel.: +1 970 491 6657.
E-mail addresses: Daniele.Tavani@Colostate.edu (D. Tavani), Ramaa.Vasudevan@Colostate.edu (R. Vasudevan).

[1] Atkinson and Voitchovski (2011) show similar trends occurring in the UK after World War II.

http://dx.doi.org/10.1016/j.strueco.2014.05.001
0954-349X/

wages for the average production worker have remained relatively stagnant, compensations at the upper end of the corporate hierarchy have grown: the ratio between average CEO compensation and average worker wage increased from 40:1 in 1980, to nearly 300:1 in 2000, before declining to 240:1 in 2008 (Economic Policy Institute, 2011). As a result, the share of wage earnings by the top 1% households has increased from about 40% of the overall labor share in the 1950s and 1960s to around 60% in the 1990s (Piketty and Saez, 2003). The widening gap between compensation paid to managerial executives on the one hand, and production workers on the other, is thus a defining feature of the contemporary US (and UK) economy. These facts suggest that a careful analysis of contemporary Western capitalism should take into account the growing importance of the managerial class as an additional dimension of the conflict over the distribution of income, and address the resulting implications for economic growth.

Economic research falling within non-mainstream traditions has made a great deal of progress in understanding the linkages between income distribution and macroeconomic outcomes.[2] Post-Keynesian (PK) macro-models concerned with effective demand stemming from the work of Kaldor and Kalecki have been conventionally set up in terms of two classes: the capitalist class and the working class, thus dealing with the so-called *functional* income distribution. This tradition has its roots in the surplus-based approach of Classical–Marxian analyses, and incorporates Keynesian elements through the inclusion of an independent investment function, as well as the role played by capacity utilization in determining macroeconomic adjustments in the goods market. Studying the impact of redistribution on effective demand (a commonly utilized proxy for which is the rate of capacity utilization) allows the characterization of capitalist economies as either wage-led – where redistribution toward wages stimulates demand – or profit-led – where redistribution toward wages dampens effective demand (Bhaduri and Marglin, 1990a).[3] The analysis in terms of two classes has also been fruitful in investigating the cyclical dynamics of distributive shares and employment growth: although not dealing with effective demand problems, the cyclical growth model of the class struggle by Goodwin (1967) is still a solid foundation of most analyses on growth and distribution that broadly fall within heterodox traditions. With employment being procyclical, similarities can be found between PK models and the Goodwin cyclical growth framework, a recent example being the contribution by Barbosa-Filho and Taylor (2006). However, since the managerial class is subsumed under the broader label ‘labor’, neither the PK literature nor the literature falling within the Goodwin tradition are suited to address changes in the *size*, or *personal* distribution of income, and the macroeconomic effect of the additional dimension of distributional conflict generated by growing wage inequality coupled with a growing importance of executive and managerial labor. An exception is a recent paper by Carvalho and Rezai (2012), in which a role for the size distribution of income is introduced in the Kaleckian model. They look at an overall measure of inequality (the Gini coefficient) as influencing the propensity to save of different percentiles of wage earners, while keeping the traditional two-class distinction that is typical in the literature.

This paper also deals with the size income distribution, in that it focuses on income inequality among wage-earners. Differently from Carvalho and Rezai (2012), however, we treat managerial labor as a separate class characterized by: (i) a distinct function in the production process – that of disciplining workers and coordinating activities on behalf of the capitalists, and (ii) a different saving behavior relative to both workers and capitalists.[4] We then investigate the impact of the rise of the managerial class for macroeconomic adjustment and its linkages to income distribution.

As a first pass at unraveling the implications of this added dimension of class conflict, the schematic model developed here abstracts from financial flows. Certainly, a more complete understanding of the implications of a three class structure would require addressing the impact of growth of the financial sector and the financial orientation of managerial behavior.[5] Yet, we argue that the present analysis has some interestingly insights to offer into the relation between growing inequality and macroeconomic outcomes. Our focus is on the interplay between wage inequality – defined as the ratio of managerial wages to workers' wages – and the rate of capacity utilization, in a simple Kaleckian-type model of demand and distribution. On the one hand, adjustments in aggregate demand are affected by wage inequality, because of its effect on both the demand for investment and the supply of savings. Accordingly, the demand side of the economy is represented by a dynamic equation in which changes in utilization depend on wage inequality. On the other hand, effective demand affects the evolution of wage inequality: in his recent book, Galbraith (2012) documents a strong, positive correlation between levels of inequality and unemployment. In Kaleckian models, employment is demand-determined and proxied by the rate of capacity utilization. Accordingly, the distribution side of the economy is represented by a dynamic equation linking changes in wage inequality to the rate of utilization. In particular, higher rates of capacity utilization signal a tightening of the labor market and thus lead to a slowdown in the pace of growth of inequality.

[2] An excellent summary of the many issues analyzed in the literature can be found in Setterfield (2010).

[3] Bhaduri and Marglin (1990a) also look at the effect of redistribution on the growth rate of capital stock, classifying economies as either *stagnationist* – if redistribution toward wages induces higher accumulation – or *exhilarationist* – if the opposite is true.

[4] Carvalho and Rezai (2012) document that the propensity to save of different income groups correlates positively with earned income. Our framework, in which workers do not save, managers save a fraction of their income, and capitalists save all of their profits, is consistent with their findings.

[5] Galbraith (2012), for instance, shows the remarkable correlation between wage inequality and stock-market price indices, suggesting that stock market trends are an important determinant of the compensation paid to the top managers. The rise of shareholder value ideology also reoriented managerial goals with perverse effects for investment behavior (Lazonick, 2000).