Fissuring of Labor Markets, Wage Stagnation, and Rising Wage Inequality

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- *What is fissuring, what are the different forms that it can take, and how has fissuring led to low wages for workers in regular jobs with standard employment relations?*
- *What policies will it take to get wages rising again?*

What is Fissuring?

For much of the 20th century, a significant part of economic activity took place in vertically integrated corporations that owned the divisions or subsidiaries in which raw materials were processed; components were fabricated; and manufactured products were assembled, marketed, warehoused, and shipped. In service industries, vertically integrated firms were responsible for coordinating all of the activities involved in producing, marketing and delivering the service to households or businesses. A wide range of ancillary activities (e.g., cafeteria, security, or housekeeping) or specialized functions (e.g., human resource management, payroll and IT) were carried out in-house. In these firms, hierarchical forms of organization replaced the market as the primary form of coordinating production.

Large, vertically integrated corporations emerged to minimize firms' costs of managing all activities from the design of products or services to final delivery to consumers. It was economically efficient for firms to employ workers and carry out the full range of production activities in-house when the costs of bureaucratic monitoring and control of employees were less than the costs of specifying, monitoring, and enforcing contracts with independent vendors, contractors, and supplier firms.

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That began to change in the last third of the 20th century. In the 1970s and 1980s, there were numerous technological innovations affecting production, transportation, and monitoring activities. These advances in technology dramatically reduced the costs of monitoring business-to-business contracts and the performance of suppliers and contractors. At the same time, deregulation in many domestic industries and the expansion of trade agreements put downward pressure on prices and increased pressure on US businesses to reduce costs. Vertically integrated firms responded by focusing on their "core competencies" and outsourcing both peripheral tasks and specialized functions to subcontractor firms.

The result is that over the past 50 years, the old bureaucratic, hierarchical firms have largely been disassembled. The old line firms have retained control of such core activities as the brand, research, development, and design, but now they contract for a large number of the activities that are necessary to actually produce a product or service and deliver it to the end user. The firms that retain the core activities dominate a network of smaller and generally more vulnerable companies they contract with to carry out a range of activities - production, logistics, marketing, bill collecting, customer service, and more — required to actually create and deliver goods and services. Consolidation of dominant firms in an industry into a small number of powerful players has been accompanied by fragmentation as activities viewed as non-core functions are outsourced to companies contracted by the dominant firm to carry them out. Dominant firms extract much of the profit and rents jointly created by all of the businesses engaged in producing the final output. Vendors, suppliers and contract companies compete for contracts with the dominant firm that often go to the lowest bidder. Contract companies often end up in a race to the bottom — operating on thin margins, and unable to pay workers fairly.

Consolidation among dominant firms in an industry has reduced market competition and increased the ability of these firms to raise prices for their products — an exercise of monopoly power. This same process of consolidation of dominant firms has reshaped labor markets. Workers hired by dominant firms still have access to internal labor markets and are protected from the effects of labor market competition by administrative rules that establish salary norms, internal equity among job titles, and career ladders for employee advancement. But, a large and growing number of workers are employed by contractor companies subject to sometimes brutal competition to win contracts from dominant firms. Dominant firms exercise a fair amount of control in setting the terms of these contracts — an exercise of monopsony power that translates into lower wages for workers.

A few examples of outsourcing may help.

Many hospitals long ago outsourced food, housekeeping and laundry services and contracted with other firms for these services. Security, landscape, maintenance and facilities management services are often contracted out. Increasingly, bill collecting — euphemistically referred to in health care as revenue cycle management — is being contracted out. At least some hospital nurses may be on the payroll of a nurse staffing agency. Hospitals even contract with physicians' practices or hospitalist companies for radiologists, anesthesiologists, neonatal intensive care physicians, and emergency room doctors. Not only may the ER doctor who saves your life not be employed by the hospital to which the ambulance took you, the doctor may not be in your insurance network even though the hospital is, and you may be stuck for a large medical bill that the revenue cycle company that manages the hospital's billing operations may now hound you to collect.

Welcome to the fissured workplace where the security guard in the hospital lobby, the person who took your insurance information in admissions, the person who brings you your food, the person who cleans your room, the anesthesiologist who assisted your surgeon in the operating room, the person handling your billing questions after you get home all work for different companies — and none of them work for the hospital. Companies providing housekeeping services, to take one example, compete against each other to win the contract. A low bid may win the contract, but the company will be operating on a shoestring, and housekeepers' wages will be squeezed.

While the picture of the fissured workplace is one where employees working side-by-side are on the payrolls of different subcontractors, this is not the only form it takes. Workers in the commercial laundry that washes towels and linens for the hospital are also employed by a subcontractor that competes for the hospital contract by bidding the lowest price and accepting narrow margins. Jobs of workers in the laundry depend on their employer winning these contracts; their pay is constrained by the terms their employers accept.

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Warehouse and logistics operations of a wide array of businesses are often contracted out. Amazon staffs its fulfillment centers with warehouse workers hired by a temporary staffing agency as well as by its own direct hire workers. Deliveries may be handled by trucking companies that utilize independent contractors for this purpose. The final mile — delivery to the customers' door — may be covered by on-demand workers or gig workers. In these cases, fissuring results in precarious jobs for workers employed in nonstandard work arrangements.

Hotels are a classic example of a fissured workplace, where the desk clerks, concierges, and doormen that share responsibilities in the hotel lobby may all work for different employers. The hotel itself may be part of a large chain; one among many chains owned by a parent company in this highly concentrated industry.

Fast food restaurant chains are often franchised operations. The dominant company — say, the headquarters operation of a McDonald's — is the franchisor. It contracts with a franchisee who owns an individual restaurant location. The contract specifies many things — how much the franchisee will have to pay to use the restaurant chain's brand name, how much they will have to invest in building the restaurant facility, what it will cost to use the company's point-of-sale proprietary inventory control software, and so on. It will also specify the standards the franchisor expects franchisees to meet in terms of things like staffing, menus, and cleanliness. For many franchisees, there is not much left for the proprietor once these mandatory expenses have been met. The franchisee may struggle to cover other expenses and to make payroll; fast-food workers find that wages are squeezed.

It's not just low-skill workers whose jobs and pay are affected by outsourcing, however. Document mills hire young lawyers to do the basic legal research that first- and second-year associates at law firms used to do. While they are not low-paid compared to other workers, they earn a fraction of what law associates are paid and have no possibility of upward mobility. IT customer support staff housed in call centers remote from the company whose products they support similarly face relatively low pay and lack of opportunity for upward mobility.

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The increase in domestic outsourcing and the resulting fragmentation or "fissuring" of production among companies in a production ecosystem has been a game changer for how labor markets function and how wages are determined. Dominant firms exercise market power and capture economic value-added. Unions (and in some cases, internal equity norms) enable workers employed by these firms to capture a share of the value they have helped create. Workers with similar skills and productivity characteristics employed by weaker or more vulnerable contractor companies in the production ecosystem may be paid lower wages even when their skills, productivity, and demographic characteristics are similar to those employed in dominant firms. The result is an increase in wage inequality among similar workers employed in different establishments. The monopsony power of dominant firms in establishing the parameters of contracts with vendors, suppliers, and contract companies translates into lower wages for workers employed by those companies.

While some workers utilized by subcontractors may be temp workers, on-demand workers, gig workers or independent contractors (as in the warehousing and logistics example), most have a standard employment relationship. They have a regular job with a single employer — a landscape company, food service company, commercial laundry, document mill, hospitalist company, and so on. Yet, because they work for companies that depend on contracting with a dominant firm, they have low wages and few benefits. Alternative work arrangements or contingent jobs are often low-paid and precarious. However, they cannot account for the increase in wage inequality and economic insecurity in recent years because their share of total employment has largely held steady since nonstandard work arrangements were first tracked 22 years ago in 1995. Rather, it is the increase in the number of workers employed in standard work arrangements by companies that contract with dominant firms that are at the root of the increasingly severe low pay crisis in the United States.

The power imbalance between capital and labor has reached extreme proportions. Fissuring has left many employers that contract with dominant firms unable to pay workers a living wage. Employer-by-employer solutions are not viable in these circumstances. Even where a union represents workers, density in many private sector industries is too low to enable unions to bargain effectively vis-á-vis individual employers. Still, much can be done. Unions remain one of the largest membership organizations in the United States and have extensive experience working in alliance with other labor and community organizations to win policies at the state and national level that support working families. Recent minimum wage gains in states and major cities and the spate of impressive victories for paid family leave and paid sick days in cities and states across the country are a testament to what worker movements can accomplish, especially with the active support of local unions and state labor federations.

What Policies Can Get Wages Rising?

- *Establish minimum employment standards that benefit all workers and protect the most vulnerable*
    - Establish a minimum wage that is a living wage and index it to the average wage
    - Require employers to provide all workers with a minimum of two weeks paid vacation
    - Assure that employers allow all workers to earn a minimum of seven paid sick days a year and to carry over unused paid sick days up to twice the annual number

- *Share the prosperity that workers create through federal programs that guarantee*
    - Twelve weeks of paid family and medical leave
    - Access to affordable, quality child care
    - Tuition-free undergraduate education at public colleges and universities
    - Single payer (Medicare for All) health care system

- *Hold remote entities such as dominant firms and franchisors accountable*
    - Develop definitions of "joint employer" for pension regulations (ERISA) and multi-employer pension funds and for employment laws (e.g., the WARN Act) that recognize the new realities of networks of firms jointly engaged in production
    - Also for issues of wage theft and OSHA violations

- *Address the effects of industry consolidation on monopsony — employers' ability to hold down wages*
    - Examine mergers for negative effects on labor markets as well as consumer markets
    - Ban non-compete and non-poaching agreements for low-wage workers

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- *Respect workers' right to organize and to participate in corporate decision making*
    - Require card check recognition in union organizing drives
    - Provide a reasonable time frame to reach a first contract
    - Require that a certain proportion of seats on corporate boards of directors go to representatives elected by employees

- *Renew the national commitment to full employment*
    - Urge the Federal Reserve to embrace monetary policies that fulfill its dual mandate for full employment as well as price stability
    - Adopt a federal jobs guarantee that assures that everyone who wants to work can have a job that pays $15 an hour (indexed to average wage) and health benefits