Two Tales of the Tail of the Distribution of Wages
On the role of changes in institutional, legal and regulatory environment

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Tail inequality: why do we care?

Inter alia, the allocation of talent

- Who does what in the economy affects us all.
- Particularly true for the most talented individuals (general skills).
- Incentives depend on: market size, returns to scale, rents.

Changes in tail inequality mark changes in incentives for talent

- These depend on institutional, legal, regulatory environment.
- Piketty, Bebchuk, et al. for CEOs.
- Philippon and Reshef (2012) for financial sector.
- Today: add lawyers to the picture (ongoing work with Cailin Slattery).
Technology, trade – or something else?

- Broadly speaking, now-developed (post-industrial) countries went through similar exposure to technology and globalization.

- But despite similar structural changes in employment, they exhibit varying changes in the structure of wages.

- Example: job polarization very similar in France and USA; wage inequality increasing in USA, but much less (hardly at all) in France.
  - E.g., Harrigan, Reshef, Toubal (2016).
  - This is much more than minimum wages.
  - Evolution of top 1% income shares differ dramatically, too.

- Changes in institutional, legal, regulatory environment also matter.
Significant increases since 1980.
Weaker or no increases since 1980; compare NLD with GBR.
Finance
Top 1% income share and relative wage in finance, U.S.
Relative wage in finance and deregulation, U.S.
Financial regulation matters

Philippon and Reshef (2012):

1. Deregulation matters—other factors not strongly influential.
2. Excess wages, controlling for composition: only in deregulated periods.
3. Affects all workers, skilled workers and CEOs—to varying degrees.

Boustanifar, Grant and Reshef (2016):

1. Using different (maybe better) panel data econometrics.
2. Corroborate results above, with better causal inference.
3. After controlling for regulation, ICT has no effect.
4. Higher banking concentration also predicts higher wages in finance.
5. Some evidence for effects on cross-border allocation of skill.

Countries that deregulated more saw greater increases in finance relative wages; this coincides with greater increases in top 1% shares.
Lawyers and Legal Services
Why care about lawyers?

Murphy, Shleifer and Vishney (1991), Magee, Brock, Young (1989):

- Countries with proportionately more lawyers grow more slowly
- To some degree, they are rent seekers.

Rent seeking very detrimental to economic activity/growth.

- Landes (1969): *The Unbound Prometheus*
- Baumol (1990)
- Murphy, Shleifer and Vishney (1991, 1993)
Bajika, Cole and Heim (2012), US data:
- Lawyers are 4\textsuperscript{th} largest group within top 1\% income: 7\% in 1979 to 9\% in 1993; around 8.4\% until 2005.
- Top 1\% lawyers’ income share: 0.61\% in 1979 to 1.24\% in 2005.
- Median entry salaries in NY/DC law firms doubled in 1991–2014 to $160,000, and distribution becomes bimodal (NALP data).

Selected literature:
- Pashigian (1977) \textit{J. of Law \& Econ.}:
  - Early analysis; missing the action, important changes post 1970.
- Rosen (1992) \textit{J. of Law \& Econ.}:
- Garicano and Hubbard (2007) \textit{J. of Law \& Econ.}:
  - Extent of mkt. \implies \uparrow specialization, \uparrow associates/partners ratio.

The above lack long run historical perspective, discussion of institutional sources of demand shift—and we argue that this is important.
Relative Wage of Legal Services

- BEA more reliable (no top coding); both underestimate partners.
Relative Wage of Lawyers

- Top coding, especially partners in law firms—but timing coincides.
Secular demand shift in 1970–1990

- Quantity $\uparrow +$ price $\uparrow \implies$ demand outpacing supply.

- This is concentrated on events preceding and during 1970–1990.

- We argue: legal and regulatory environment changed.

- Not the only thing, but many other factors not prime suspects.
  - Patenting activity: timing is off.

(interesting compositional changes within legal service—not today)
Changes in the environment

- Important legislation that resembled constitutional amendments
  - Sweeping, broad—but not particularly specific.
  - With all the best intentions, these increased uncertainty and threat of litigation (Johnson 2009).

- Litigation "explosion" starting in late 1960s, 1970s (Olson 1991)
  - Personal injury, medical malpractice, defective products, etc.
  - 1977 U.S. Supreme Court: litigation no longer an "evil".

- Reform of divorce law in the 1970s: unilateral, "no-fault"

- Links to finance?

- Evolution of political system, rise of lobbying starting in 1970s
Timing of increase strikingly similar to employment, relative wages.
Some suggestive evidence

Barriers to mobility of lawyers (Bar) make states a natural unit of analysis.

- Indeed, decompositions reveal: within-state changes overwhelmingly important (intensities), not changes in states’ sizes (composition).

Using state-level variation and panel data/diff-in-diff techniques, we find

- **Divorce reform** significantly increased demand for legal sv., lawyers.
- States with greater share of African Americans saw greater increases in legal services, lawyers post 1970. **Civil/voting rights acts?**
- States with greater growth of *dirty industries* saw greater increases in employment of lawyers in industry—but not legal services. **NEPA?**
- States with greater growth of *finance* saw greater increases in wages of lawyers in industry—but not legal services, no employment effect.

Identification from within-state variation (control for state-specific trends).
Conclusions

- While "neoclassical" factors (technology, globalization, etc.) certainly play a role in driving top incomes, their effects vary widely.

- Changes in the way that we organize society (institutional, legal and regulatory environment) seem to matter, perhaps even more.

- The interaction of "neoclassical" forces with institutional setup can help explain rise of top income shares, and inequality more broadly.
Bonus Slides
Source: HSUS

NBER series only includes utility patents, HSUS has utility and design

- Not prime candidate explanation. [Demand Shift]
Consistent with increasing returns/span of control for partners.
Census/ACS (also CPS, not shown) aligned with ABA data.