

Ways and Means: Harvard's Wage Debate

In partial response to the “living-wage” sit-in at Massachusetts Hall last spring and demands for a \$10.25 hourly minimum wage for the University’s lowest-paid employees, then president Neil L. Rudenstine appointed a Harvard Committee on Employment and Contracting Policies (see “Wage Wrangling,” July-August, page 64, and “Weighing In on Wages,” September-October, page 70). As the committee—faculty members, members of Harvard employee unions, students, and administrators—gathers information, deliberates, and prepares to deliver its final report to President Lawrence H. Summers by December 19, alumni and others can keep abreast of its work at www.hcecp.harvard.edu. A committee-sponsored conversation on wages was held at the Kennedy School’s ARCO Forum on October 22; for details, consult the website.

In the interest of informing readers and involving them in the debate, Harvard Magazine invited three economists and a political theorist to comment briefly on the cases for and against a “living wage,” and on ways of thinking about the issues at stake for the University and for society at large.

~THE EDITORS



Why Not a Living Wage at Harvard?

by RICHARD B. FREEMAN

IN DECEMBER 1929, Massachusetts ordered Harvard to pay its female building cleaners the state minimum wage of 37 cents an hour, two cents above the University’s pay rate. Having ignored the law for eight years, Harvard responded by firing some cleaning women and replacing them with men, whose wages were not covered by the law, and shifting other women to dormitory chambermaid jobs, also not covered by the law. Students and alumni protested and raised enough money to cover the back pay owed to the women.*

The University’s spring 2001 response to student living-wage demands for wage increases to Harvard’s lowest-paid workers was more positive, at least once it became

*As reported in Irving Bernstein, *The Lean Years: A History of the American Worker, 1920-1933*, pages 232-234.

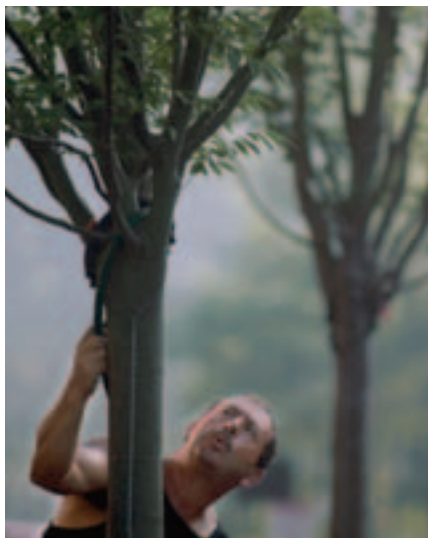


Dining Services workers prepare tens of thousands of campus meals weekly.

clear that the student sit-in struck a chord on the campus and nationwide. In some fashion or other, the University will pay more to its lowest-paid staff members and find a way to include those working for subcontractors in the higher wage—even though market forces allow for lower pay.

Moral progress in addressing an economic problem, or moral turpitude in caving in to irresponsible economic demands?

If Harvard were a business near bankruptcy, one would worry about paying higher wages. If living wages required massive pay increases or covered the bulk of employees, one might dismiss the demands as irrational posturing. But with its huge endowment and successful fund-raising campaign, Harvard has what economists call “economic rent” or surplus that it can spend on raising pay at the bottom of the wage scale if it so desires. Paying the living-wage campaign demands will simply move Harvard’s lowest-paid employees higher in the Boston-area wage scale, not off the scale.



An extensive crew tends Harvard’s grounds.

Declining real wages at the bottom of the skill distribution and a growing earnings disparity are flaws in U.S. economic performance. Paying Harvard’s lowest-paid staff members more will not remedy this national problem. Harvard is not the lowest-paying employer in Boston. Some of the workers whose wages will rise may live in families above the poverty line. Some of the benefits to the least skilled will dissipate over time, as Harvard or its subcontractors reduce employment in these groups and as Harvard attracts and hires better qualified applicants. Still, the preponderance of evidence on “living wages” and minimum

wages suggests that the primary effect of any moderate pay increases for the lowest paid (improving their economic well-being) dominates the adverse secondary effects that trouble economists: loss of employment or the substitution of more skilled workers in their place.

The virtue of living-wage campaigns is that they direct local attention to the national low-

wage problem at places where local decision-makers can address it, albeit in small steps. Harvard faculty and administrators have been in the forefront of public debate on wage disparity in the United States. A positive response by the University to the student action offers an opportunity for Harvard to lead in walking the walk, as well as in talking the talk, in improving conditions at the bottom of the income distribution.

Richard B. Freeman is Ascherman professor of economics.



The Case against the Living Wage

by N. GREGORY MANKIW

WHEN A GROUP OF STUDENTS took over an administration building last spring to protest Harvard's wage policy, many people found it easy to sympathize with them. Without doubt, life is hard for workers getting by on \$8 or \$9 an hour. Moreover, the protest was a welcome relief from the relentless careerism that infects too many students today. The protesters were admirable in their desire to reach beyond their own fortunate cocoons and help those who are less lucky.

Despite the students' good intentions, I cannot support their cause. If any institution should think with its head as well as its heart, it is a university. In my view, there are compelling reasons to reject the students' pleas.

Like most of the prices in our economy, wages move to balance supply and demand. A high minimum wage set by fiat, either through legislation or student pressure, prevents this natural adjustment and hurts some of the people it is designed to help. It is a timeless economic lesson that when the price of something goes up, buyers usually buy less of it. If Harvard has to pay its unskilled workers a higher wage, it will hire fewer of them. Some workers earn

more, but others end up unemployed.

Living-wage advocates say that Harvard with its huge endowment can afford to pay higher wages. That's true, but it misses the point. Like all employers, Harvard faces trade-offs. Should extra money be spent hiring more professors to reduce class sizes, or should it be spent hiring more janitors to vacuum classrooms more often? It's a judgment call. If the cost of unskilled labor rises, Harvard faces a new set of trade-offs. Over time, it will respond by hiring fewer of those workers.

A higher wage would also change the composition of Harvard's work force, for wages play a role in supply as well as demand. If the University posts a job opening at \$10 an hour, it gets a larger and better mix of applicants than if it posts the same opening at \$8 an hour. The person who would have gotten the job at the lower wage is now displaced by a more skilled worker. In the short run, a living wage might benefit those at the bottom of the economic ladder. In the long run, they would be replaced by those who are already a rung or two higher.

Finally, the living-wage protest raises

bridge are rich by world standards.) Harvard needs to pay its workers—janitors and professors alike—enough to attract and motivate them. But it shouldn't pay more than it needs to, given the competitive labor markets in which it hires. To do so would compromise the University's commitment to the creation and dissemination of knowledge.

N. Gregory Mankiw is a professor of economics and author of Principles of Economics, the textbook used in Social Analysis 10, Harvard's introductory economics course.



How Wages Are Set

by ALAN B. KRUEGER

WHAT DETERMINES WAGES? Wages vary with the education and skills needed to perform a job, the agreeableness or disagreeableness of the work, the constancy or inconstancy of employment, and the probability of success in the field—just as Adam Smith said.

Statistical studies suggest, however, that these "competitive" factors account for less than half, and probably only around one-third, of the variability in wages across the full spectrum of workers in different occupations.

Noncompetitive factors also play a role—again, just as Adam Smith said. Indeed, Smith warned that employers are "always and everywhere in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate." Employer bargaining and monopsony power play a role in determining wages. Labor unions play a role. Prejudice and discrimination

play a role, though thankfully less than they used to. Considerations of whether higher pay induces workers to provide more effort, especially in relation to norms of fairness, play a role. Government regulation plays a role. And plain old luck plays a role.



Dining-hall workers have much at stake in the committee's recommendations.

the issue of Harvard's mission in society. The benefactors who give to the University do so to support education, not income redistribution. (And if Harvard were to take up the cause of income redistribution, it would have to acknowledge that even the poorest workers in Cam-

It is a gross oversimplification to say that “wages are set by the competitive forces of supply and demand,” or that there is a unique market-determined wage. The labor market sets bounds on pay, but employers still have a great deal of latitude in choosing wage levels. For example, Harvard’s late Lamont University Professor Sumner Slichter, a noted labor economist, documented large disparities in pay for unskilled workers in different industries, which he attributed to “managerial policy.” There is a wide range of indeterminacy in pay.

Historically, universities have chosen to set pay in the bottom half of the range because they were struggling to build endowments and educate large waves of students in the aftermath of the GI Bill and the baby boom.

In the private sector, more profitable companies routinely pay higher wages than less profitable ones. Workers frequently evaluate the adequacy of their pay, and adjust their work effort, in relation to their employers’ ability to pay. As university endowments have grown, it is natural to expect their workers to demand higher pay as well. Indeed, more protests over worker pay have arisen at better-endowed colleges than at less well-endowed colleges.

Can universities now afford to pay higher wages to low-level staff workers? Most can. Harvard will not go out of business or relocate if it pays higher salaries. In the long run, the higher pay will probably come from lower student subsidies, faculty compensation, and growth in the endowment—and employee performance may improve, partially or even fully offsetting the higher costs. I doubt that Harvard’s staffing levels would be drastically cut if pay increased, although there may be some adjustment. But workers’ opinions on this issue should matter more than economists’: workers might prefer higher pay and shorter hours, even with the risk of lower employment. Broad representation on the University’s current Committee on Employment and Contracting Policies thus makes sense.

Like it or not, elite universities are engaged in the business of redistribution. Harvard’s undergraduate tuition probably

covers less than half of the University’s true costs of education, even for non-scholarship students. By subsidizing tuition, universities redistribute income to students who overwhelmingly come from, and will return to, *middle- and upper-income* classes.

What then should Harvard do? Harvard should do what is best for Harvard. In the process, Harvard will implicitly define its mission. Is it to narrowly educate students in academic disciplines? Is it also to educate students in the values of modern society? Is it to serve as a model employer for society as a whole?

I would humbly recommend that the Harvard administration adopt Adam Smith’s outlook: “No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, clothe and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed and lodged.”

Alan B. Krueger, Ph.D. ’87, is Bendheim professor of economics and public affairs at Princeton University; he specializes in labor economics and the economics of education. He is also an “Economic Scene” columnist for the New York Times.



The Work That Makes Harvard Possible

by RUSSELL MUIRHEAD

THE LIVING-WAGE CONTROVERSY points to the core of what Harvard is about. On one side is the view that teaching and research are the exclusive purposes of the University. In contrast, I would like to endorse a more expansive view, which affirms the University as an inclusive community.

The narrow conception, which I re-



Transportation Services staff members handle parking, passenger shuttles, and mail delivery.

spect but ultimately reject, comes in the “Dissenting View” offered by a minority of the Mills committee, which was charged by President Neil L. Rudenstine in 1999-2000 to recommend policies for low-wage workers at Harvard [for the report, see www.provost.harvard.edu/adhoc/]. While the majority rejected a living wage in favor of benefits such as healthcare for part-time workers and subsidized language lessons for non-native speakers, the minority offered a more restricted view: that “the University has an obligation to society to support its core teaching resources and research mission in the most efficient way possible.”

Given the scarcity and utility of these core missions in the larger society, the University, on the minority’s argument, has a *moral* obligation to do everything within the bounds of the law in order to maximize those activities. Thus it is not merely permissible, but also morally commendable, for the University to refrain from paying any premium above the market wage. To do otherwise is to misdirect feelings of “guilt and remorse.”

One might extend this argument (although the authors of a “Dissenting View” did not) to say that those who teach and do research, along with those who study and learn, *are* the University. On this argument, the others who make possible teaching and research—administrators, police, cleaners, cooks, office

staff—occupy a lesser part of the place. These people represent only overhead, in this view; they are to be seen as market workers and paid as little as the market permits.

Rudenstine, the living-wage protesters, and the Mills committee majority had one fundamental point in common: they rejected this narrow conception of the University community. Further, the motivation they share—to offer Harvard workers more than the market minimum—is based in something more respectable than misplaced guilt.

It is founded rather in the understanding that the central goals of teaching and research can include all who serve them, however indirectly. The rarity and usefulness—even the nobility—of these goals lend a certain kind of dignity and purpose to the many activities that make them possible. This understanding can be represented in different ways, some material



A mechanic maintains office equipment.

and some symbolic. The little things matter: language lessons, library cards, athletic passes. But so do the big things, like healthcare and wages.

Inclusion of this sort involves a more demanding concept of reciprocity than free markets normally embody. The University should not pretend to be an essentially strategic institution, taking

all it can get while giving as little as it legally can. Teaching and research themselves are served by a University community that exemplifies decency and generosity. The lecture hall and the lab are not places of exchange, where students might pick up a valuable credential while professors butter their bread. They are, rather, sites where individuals relate to each other in a common mission. The transformative potential of liberal learning requires suspending, if only in moments, the strategic orientation so necessary in other parts of life.

For these reasons, the University as a whole stands to gain when attitudes, practices, and pay recognize a central fact: the work that makes Harvard possible makes workers part of Harvard.

Russell Muirhead is assistant professor of government; his book Just Work is forthcoming from Harvard University Press.

The Law of Gravity

What goes up indeed comes down. Following the breathtaking 32.2 percent return on investments for the fiscal year ended June 30, 2000, Harvard Management Company (HMC) reported this September that endowment performance for the succeeding 12 months, after all expenses, was -2.7 percent. Perhaps a second law, about history repeating itself, is at work as well: the only prior year in which investment return was negative was 1984—following HMC's record performance in 1983.

The change in direction could hardly surprise anyone who paid attention to an environment that HMC president Jack R. Meyer, M.B.A. '69, characterized as "harsh" during the fiscal year, with "sharply negative" returns for "all the major equity markets, including private equity." The latter category includes venture capital, which propelled the outsized gains in the prior year (see "Rocketing Returns," November-December 2000, page 78).

What may be surprising—and reassuring—is how well HMC's fund managers did under adverse conditions. The -2.7 percent endowment return exceeded the aggregate performance of HMC's "policy portfolio" (the weighted mix of different kinds of assets used to guide its investment decisions) by 7.1 percentage points, the second-largest margin in HMC's history. Had the endowment declined in line with the -9.8 percent return of its market benchmarks, Harvard would be \$1.4 billion poorer.

In fact, the endowment's value declined to approximately \$18.3 billion at the end of June from \$19.1 billion a year earlier. The negative investment return accounted for about \$500 million of the decline in value. A larger factor was the roughly \$615 million in endowment income disbursed to support the University's operations in fiscal 2001, offset in part by \$300 million of

new endowment gifts. Fiscal year 2001 concludes a decade of HMC operations in their current form. During that time, annualized investment return has averaged 16.5 percent—3.5 percentage points better than benchmark returns, and 4.6 percentage points above the median return for comparable large institutional investment funds. That performance, Meyer observed, produced an endowment \$7.4 billion larger than if HMC had earned only median returns.

Although he characterized the negative investment return as "disappointing," Meyer said he was "very pleased that we managed to outperform our benchmarks by a large margin—otherwise, this would have been a pretty serious down year."

As noted, benchmark returns were negative for all categories of equity investments, but HMC's large domestic and foreign equity portfolios—accounting, in total, for more than one-third of assets—avoided the worst damage, returning, respectively, -4.6 percent (versus a market return of -10.9 percent) and -16.9 percent (-23.3 percent for the market). Emerging-market assets actually had a positive return of 3 percent, 17.2 percentage points better than the market, as a strategy involving discounted closed-end funds proved highly successful.

Private equities, where Harvard's 155.2 percent return in fiscal 2000 exceeded the market by more than 100 percentage points, this year underperformed a sharply declining market by a small margin. Over the course of an astonishing three-year venture-capital cycle, Meyer said, HMC's private-equity investments paid off enormously; even with the recent losses, he noted, HMC's inability to invest as much as it wanted to in this asset class early in the cycle reduced returns by a significant amount.