

TRANSCRIPT

The Work Goes On

Guest: Truman Bewley
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Truman Bewley:

So, I talked to quite a few companies that had cut pay and you can do it without people thinking of it as a punishment and without having a disastrous effect on the morale of the employees if it's clear that the pay cut will save a lot of jobs.

Orley Ashenfelter:

Welcome to The Work Goes On, a podcast from the Industrial Relations Section at Princeton University. I'm your host, Orley Ashenfelter, the Joseph Douglas Green 1895 Professor of Economics, emeritus at Princeton University. In this podcast series of conversations with leading thinkers and practitioners, we are creating an oral history of an entire generation of industrial relations experts and labor economists whose contributions to their fields have been absolutely extraordinary. Our guest today is Truman Bewley, who is Alfred C. Cowles Professor Emeritus of Economics at Yale University. He is renowned for his work in pure economic theory, as well as for his work on the institutions and behavior of labor market participants. Truman, welcome to The Work Goes On.

Truman Bewley:

Thank you.

Orley Ashenfelter:

Pleasure to have you here. Let's begin the discussion by talking about your background. Where did you grow up?

Truman Bewley:

Mainly in Boston. In Cambridge, Massachusetts.

Orley Ashenfelter:

Cambridge, Mass. Were your parents professors?

Truman Bewley:

No. My parents divorced when I was three, and my father had a small factory making defense goods in Southport, Connecticut. And my mother was an artist and lived mainly on money given by her father. So, she was the tail end of a rich family. And I'm not rich. I didn't inherit any wealth, but I did not have a deprived childhood.

Orley Ashenfelter:

So, you went to school in Cambridge?

Truman Bewley:

Yes. I went to Brown and Nichols, a prep school in Cambridge.

Orley Ashenfelter:

And from there, I know you went to Cornell, isn't that right?

Truman Bewley:

That's right.

Orley Ashenfelter:

How did that happen?

Truman Bewley:

I don't know. I was a very good student at Brown and Nichols, and I think about half my class went to Harvard, and I just wanted to get away from Cambridge. And my grandfather had, my mother's father had gone to Cornell, and they were from that part of New York, upstate New York. So, it was just a natural thing to do.

Orley Ashenfelter:

Did you do economics at Cornell?

Truman Bewley:

No, not at all. I was interested in physics, but then I got interested in history, and my major was in French history.

Orley Ashenfelter:

I think people will be surprised to hear that, Truman..

Truman Bewley:

Yeah. And then when I got to be a senior, I got in kind of a panic. I didn't want to spend my life looking through a card catalog. I sort of abandoned interest in French history. And I'd enjoyed economics classes because they're analytical. And so, I applied to graduate school in economics. And I applied to Harvard, MIT, and Berkeley. And I was rejected by Harvard and MIT, but I think I offended my advisors in history. So, they wrote bad letters of recommendation for me, but Berkeley didn't ask for letters of recommendation. They went on my GR, well, I guess SAT scores or GRE scores, and they were pretty much perfect. So, I think I got into Berkeley on that basis.

Orley Ashenfelter:

That's wonderful. Of course, you taught at Harvard subsequently, so obviously they realized they made a mistake. That happens, of course. Now, Berkeley, you went to Berkeley.

Truman Bewley:

Yes.

Orley Ashenfelter:

Who did you work with at Berkeley?

Truman Bewley:

Gerard DeBreu.

Orley Ashenfelter:

I had a feeling that must be. He was such a great gentleman too.

Truman Bewley:

Yeah. So, I was attracted by the sort of orderliness of mathematical economics. Same reason I entertained an interest in physics when I was an undergraduate, but life is not so orderly, and somehow I realized that when studying economics. Now, an important part of my background was that my mother, she had a kind of tumultuous private life, but her third husband was a very radical politically, the generation who grew up in the 30s where communism was a good thing. So, his views were like that. And my father, who was running a small business, was very right-wing. So, I found when arguing with both of them that I always wound up arguing about facts, what was true. And that's very hard to know what's true, and you can't make much of an argument about that. The conversation sort of stops. But I got interested and I wanted to know what the facts were. So, that's what I wound up doing.

Orley Ashenfelter:

But let's come back to that. Now you worked at, because you are very famous as a pure theorist, and your contributions in pure theory are not ... Often people think of it as this famous work on how competitive equilibrium is related to the core of an economy, the Pareto efficient core. But you've also done other work in pure economic theory, for example, on the optimum quantity of money, which maybe I'm not sure everybody knows as well. I happen to have read that paper long, long time ago. And then you also wrote a descriptive version of it that is actually even easier for me to read, kind of a critique really of Milton Friedman in a way, but taking him on his own grounds. So, you've worked in many areas of economic theory. So, Debreu was your advisor?

Truman Bewley:

Yes. And see, when I was a graduate student, an outstanding problem that very famous economists had worked on, Debreu and Aumann, Hildenbrand, McFadden, they'd all worked on this problem of trying to prove the existence of equilibrium with different many commodities. And I have an interesting story. Debreu wanted to have a year off in Europe. So, he went to CORE and the University of Louvain in Belgium for a year and packed me along with him. And then I arrived the first day in Belgium. I could read French. I didn't speak French, so I was a little lost. And there was a hotshot mathematical economist at CORE and I met him. We met on the stairs, I remember, in the dark at CORE in this new

building in Louvain and he asked what I wanted to research and I said I wanted to work on this problem of the existence of equilibrium in an infinite number of commodities.

And so, it became clear that he wanted to work on it too. And he started talking about barrelled spaces and all kinds of mathematical jargon, which I didn't understand, but I understood that he was trying to scare me off and that made me very angry. So, I went to my brand new office and 20 minutes I'd figured out how to solve the problem. I had a plan. I didn't have a complete proof, but I think that rage got me going. And then he was very nice. He suggested other ways of doing. We became good friends.

Orley Ashenfelter:

Who was it?

Truman Bewley:

Jean-Francois Mertens, M-E-R-T-E-N-S, a game theorist. And…

Orley Ashenfelter:

Debreu, of course, was French. And probably at that time, French universities might not have been so hospitable to him in a way because of the fact that he did relatively technical economics, not probably what was going on. And I imagine that Brussels, which of course he was at the French speaking school, would have been, and certainly I have loved Brussels as well. They have very good food. Party animals too.

Truman Bewley:

One of the eating capitals of Europe.

Orley Ashenfelter:

Yeah. Good food and not too expensive either. So, you finished at Berkeley, and I already know what you worked on now because you just explained it. What was your first job?

Truman Bewley:

It was at Harvard, and I came there wanting to ... I started my downfall in my life. I wanted to understand macroeconomics and recessions, and why we have unemployment, why we have layoffs rather than pay cuts and things like that. And that was what was on my mind. But when I was at CORE and initially at Harvard, I worked on more technical things, but that was the problem that was bothering me. And I could make no progress. I was very frustrated. I had a very unproductive time at Harvard. It's not Harvard's fault. Just I did not know how to crack that problem and how to formulate it. So, I, of course, later realized that it's an empirical problem, not a theoretical problem. You can't make a model to do these things. You have to know what's going on.

Orley Ashenfelter:

Then you left Harvard, you went to Northwestern?

Truman Bewley:

Yes. I loved Northwestern. It was a kind of free atmosphere. I didn't like Harvard so much, but it wasn't because of anything. It wasn't Harvard's fault. It's because I was frustrated in my own work and that's life, but I kept pushing on at Northwestern. I had ideas I worked out and the problem I was addressing

was why why aren't the price system in a competitive economy, why isn't it stable? Why do we have this example of [Herbert] Scarf of an equilibrium where if you follow the excess demand, you go round and round and round? It never settles down. So, it struck me actually when I was at Harvard, just suddenly hit me when I was sitting in the hallway in the Department of Mathematics there---I taught half math and half econ -- that maybe a solution was to have intertemporal substitution what I called permanent income hypothesis.

And that turned out to give you a theoretical solution, probably not a realistic one. But at Northwestern, I worked on that approach to economics with thinking of people being self-insuring and averaging over time. And so…

Orley Ashenfelter:

What did you teach at Northwestern?

Truman Bewley:

Economics.

Orley Ashenfelter:

I ask partly because I have a friend retired now who was a student of yours there. He actually just retired from the engineering school at USC, Jim Moore. And he remembers you as a fantastic teacher.

Truman Bewley:

Really?

Orley Ashenfelter:

Yes. That's quite a compliment from someone coming 50 years after they took the course or 40 years. What did you teach?

Truman Bewley:

I taught mathematical economics and microeconomics and certainly didn't teach macro. I think I taught it. Now that was at Yale. I once taught macro and it was a disaster. I certainly don't think of myself as a great teacher, though I enjoy teaching.

Orley Ashenfelter:

You must have enjoyed it, I guess. Otherwise, most teachers, if they enjoy it, are usually the ones that are good at it. Now, it comes a time when you leave Northwestern and go to Yale.

Truman Bewley:

Yes. Yeah.

Orley Ashenfelter:

Why was that?

Truman Bewley:

Oh, when was that? Somewhere in the 80s. I was only about four years at Northwestern, four or five years at Northwestern. And Northwestern, I liked the atmosphere of the department. It was sort of everybody pulling to improve the department. But they suddenly had a financial crisis and I had three kids and wanted a fourth, so I got scared. And through a friend of mine, Donald Brown, he waived an invitation for me to go to Yale as a guest for a year, a visiting professor, and then they kept me. And that was quite a break because I was the Cowles professor of economics in the Cowles Foundation. And that gave me access to the financial resources, which made possibly the two interview projects I'd done – the one on labor, which was you, and then the one on pricing, which took me 20 years.

Orley Ashenfelter:

I know these took you a lot of time and we should talk about them. I have your book right here called, it's a big one too, by the way, called *Why Wages Don't Fall During a Recession*.

Truman Bewley:

Yeah.

Orley Ashenfelter:

And it is interesting. It's a style of labor economics that actually went out of favor about the time that you started doing it.

Truman Bewley:

Yes, I know.

Orley Ashenfelter:

It was a guy, someone, Lloyd Reynolds at Yale who might have even been there when you were there and probably would have approved. And certainly my teacher, Richard Lester, would have approved of what you were doing. And just to give it, I'm not sure how many people ... It is a formidable book. It's almost 500 pages. So, it is kind of a lot to pick up. The print's pretty small too, by the way, just for…

Truman Bewley:

The quotations are in small print.

Orley Ashenfelter:

And they're in very small print. And so actually, I just wanted to read a couple of those so people could get some idea if they haven't looked at the book. There's probably so many gems in here that others could take advantage of. But these were questions when you were asking people that were involved in human resources. “I have never cut wages. It is like penalizing employees and inviting them to start stealing. They would not look at the business aspect of things. They would think I was hurting them personally.” Another quote is, “it's a personal thing. People can't explain a pay cut at home, so they kind of make it very personal.” And here's a third. “I have never cut anyone's pay. I don't believe it in principle. A pay cut would be interpreted as a punishment, even if it were done across the board. It would be insulting and would lower people's standard of living as well.”

So, that's just some example of very strong comments about wages. And you actually take up, I think it's fair to say, quite a few different theories about why there's downward wage rigidity, which seems to be

with us to this day. What's your take on what happens to wages during a recession or something, maybe it could be not necessarily a recession, but it's something like it?

Truman Bewley:

Well, first of all, that guy said he never cut pay, but some people do. So, I made a point of trying to ferret out companies that had cut pay during the time of my interviews or even earlier, just nosing around being like a detective. You ask people questions and they ask them who else I could ask and so on. And so, I talked to quite a few companies that had cut pay and you can do it without people thinking of it as a punishment and without having a disastrous effect on the morale of the employees if it's clear that the pay cut will save a lot of jobs. Trouble is, from the point of view of the overall economy, that's kind of an unusual circumstance where companies, if you like, get away with pay cuts without harming morale or destroying their company is, well, first of all, companies where you have to bid for work like construction companies or companies producing parts where you have to bid for business.

Well, you can bid a little lower if you have a pay cut. So, that kind of setting. Most of the companies I found that had cut pay were companies that were in construction and where they're bidding for business in that sense. Now, another circumstance where you can cut pay is sort of the three categories is where a company has acquired a lot of debt often with management buyouts. They call it MBOs where the new owners borrow a lot of money. Then they find that the profits of the company they bought don't support the debt. They can't keep up with the debt payments, the interests on the debt. And so, then the workers understand or the employees understand that if the company goes under, they'll probably all lose their jobs. The company, the building, the machinery would be sold off and there'd be no more company.

So that's another circumstance where a number of the companies I visited that had cut pay were in that setting. And a third, which I only remember… There probably were others that I interviewed, but was where you have a company which was a branch of a great big company. I don't want to give the names of companies, but this is an example, the General Motors or General Electric or something like that. Branch of a big company which has unionized employees and hence fairly high pay rates. And because of that, the company that was, the branch that was sold off has high pay rates. Well, the owners of the company of this branch, if you like, subsidiary of the major company, don't want to pay those higher wages. So, they just ruthlessly cut pay and say, "Heck with morale, we're not here to make people happy. We're here to make money." And they take that ruthless attitude and go right ahead and cut pay and let people be unhappy and feel punished and try to sabotage the company or whatever.

So, they take the consequences. So those are the kind of three settings in which ... But all those three settings, that doesn't add up to a big fraction of the economy, even though construction is a fairly big sector of the economy. Not all construction companies would be able to be in the setting where they think they can cut pay and get more work that way. That would be more for the small, medium-sized construction companies. So, my feeling is that pay cutting happens just in a small section of the economy. Now they get lots of publicity. In the 2008 recession, there's a lot of publicity of pay cuts that happened, but it didn't have much of an impact on the average pay rates you can read about. And the government statistics just was affected a limited number of people.

Orley Ashenfelter:

And I guess my takeaway from what you wrote actually, I understand… Actually, it's very good way to put this, that there are some places where there will be wage cuts, but it's not in the vast majority of places. And my impression is that you came to the conclusion that wage cuts are not normal because they cause more damage than benefit. Is that a fair…

Truman Bewley:

That's very often the case, yes. But if the workers ... I mean, there are two cases I gave you there. The workers feel, their employees, I should say, feel that the pay cut is reducing their chances of losing their job. They may go along with it and think that it's a positive thing. In fact, sometimes I remember a few companies where the management said, the people I was talking to, the owners said that some of the employees said during a recession that time that they, “Why don't you cut pay rather than laying us off?” And they refused to do it because they thought that after the pay cut, there'd be so much resentment in spite of the demands. They didn't want to do it, but it's a decision to be made. And then people have to feel what would be the managers or owners have to feel what would be the impact.

Like all human things, all decisions make, there's no pat answers. One of the things I regret about the book is the title. It sounds like nobody ever cuts pay and that's not true. If you read the book, you find that's not what I'm saying, but it's an editor's choice.

Orley Ashenfelter:

You're quite careful about methods in the book too. I was impressed by that. Just as you mentioned, for example, that you sought out firms that had made pay cuts so you could understand why they did it. That's a form of selection, but it's a form of selection that is guaranteed to give you some additional information. And by being blunt about that, I think it's a very useful way to talk about your methods. There are a couple of things I do want to ask. And the first is, you spent a long time doing this work, and I gather the Cowles Foundation was helpful in providing finance. What made you start on such a big project? This is a very large project. Most economists don't take such a giant step. They do little steps, and that's not what you did. You more or less did a complete career change by going into this line of work.

Do you have an explanation for why you suddenly did that?

Truman Bewley:

Frustration. I was just determined. You live only once. I was determined to get to the bottom of this question, and I didn't know that it would take so long when I started. And one of the interesting things about a study like this, in both the pricing study I've done more recently and this labor study, the very first interview was in a way the most revealing in the sense that the basic themes were established. And the labor study, I remember asking naively, “Well, why don't you cut pay rather than lay all these people off?” And the guy said, “To get the misery out the door.” And I was completely new.

Orley Ashenfelter:

That’s very well put, isn't it?

Truman Bewley:

Very well put. I remembered, but it happened almost right away in the beginning of the interview, and I was completely naive. I didn't have any way of recording. I didn't even bring a pad of paper. So, the guy handed me a pad of paper and a pencil and I furiously took notes. So, I don't think I ever wrote down to get the misery out the door because that was like a wet washcloth being thrown in my face. Wow.

Orley Ashenfelter:

That's a very good way to put it.

Truman Bewley:

I didn't expect that.

Orley Ashenfelter:

Kind of sadly amusing in a way.

Truman Bewley:

It's amazing. Yeah. But it's also the way people talk. They're very down-to-earth.

Orley Ashenfelter:

The last thing I would like to ask you about, the book about prices… I guess you did more or less the same thing in discussions of pricing with various businesses. And that book is quite recent. I don't have a copy of that yet. So, that's a follow on. Someone wrote that it was a bookend to this book although this book is big enough, so it's a bookend by itself. Can you give us a brief, quick summary of what you did with the pricing book?

Truman Bewley:

It was stimulated by open question in the labor book because when I asked people, "why don't you cut pay, reduce price, then you can sell more." And that got people talking about pricing, though I was talking to the wrong people in the company that didn't know about pricing, let's say we're the owner. And by the way, the owners often don't know much, but they would just say, scoff at that, lower the price and sell more. That's not the way the world works. Well, it does work. If you run a construction company, you're bidding for business or you're running a parts, making parts for automobile companies, you bid for work, you can sell more. So, there are a lot of companies like that, but it's not a huge number. But I wanted to know how do they set prices? People would talk in the labor study when they talked about pricing, they talk about, well, the competitors will reduce their price too.

So, that sounded like a familiar model. So, I wanted to know, just get to the bottom of that. And so, I really thought of the pricing study, as you say, as a bookend to the labor study, but I sort of lost track of that idea because there's a lot to know about pricing. And so, I wound up contrasting in the pricing study the prices of differentiated goods from the pricing of commodities. Commodities are using a language of business where commodity is an undifferentiated good sold on a very competitive market. So, of course, not all the economy falls in those two categories, but there are an awful lot of companies that do. And what I found was that, and of course in the competitive commodity, using the business terminology, in the commodity markets, they're just what you expect. It's price is decided on the market, and the price changes every five minutes maybe, depends on how the market's run, but it's just being [inaudible].

And in the differentiated goods, they don't want to change price. They spend a lot of time thinking about what the price should be. And then they don't want to dicker about price or bargain about price. They set a price and stick with it and don't want anybody to think that the price can change. The reason for that is they want to compete on the quality, the performance of the product. And so that's a different world. And getting back to the labor study, you can see that if you're a company that's producing a commodity, usually the price is the price. You're not going to reduce pay and reduce the price. That's a separate issue. And with the differentiated good, you're not going to reduce the price. You don't want to mess with the price. You may have to if there's a big increase in cost or something like that, but generally they don't think that way.

And they also think that reducing the price will not increase sales. And they really understood that, except they are competing on the basis of quality rather, or the performance characteristics of the product rather than on the price.

Orley Ashenfelter:

I missed… One last thought. Actually, the way labor economists have thought more about people's compensation is what's become heavily important is the influence of the firm, who you work for, as opposed to what you bring to who you work for. And in some ways, I think the texture of the two books you've done, they're both consistent really with that focus, even though the focus now is very technical, econometric issues and how to actually estimate these effects separately for persons as well as for firms. Anyway, just a last comment and thank you so much. That was a wonderful way to describe what you've done. I appreciate so much you're coming on with us. And also, I happen to be a big fan of your book, including its many quotes that are incredibly difficult to read because they're so small, such small print. Thank you for being with us.

Truman Bewley:

Well, thank you for inviting me. Like everybody, I like talking about myself and that's the advantage you have as an interviewer interviewing businessmen. If you get them to talk about themselves, they're very willing, as long as you don't touch on the confidential matters.

Orley Ashenfelter:

Our guest today has been Truman Bewley, the Alfred C. Cowles Professor of Economics Emeritus at Yale University. Please join us again for the next episode of "The Work Goes On: an Oral History of Industrial Relations and Labor Economics" from the Industrial Relations Section at Princeton University. I'm your host, Orley Ashenfelter. Thanks for listening.

Announcer:

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