

# Internal Labor Markets and Manpower Analysis

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Heath **Lexington** Books  
D.C. Heath and Company  
Lexington, Massachusetts

## Chapter 1

### Introduction

This volume is the outgrowth of a series of labor market studies conducted over the last six years. These studies reflect the variety of policy concerns of the 1960's—structural unemployment, technological change and automation, inflation, racial discrimination, and the employment and training of **disadvantaged** workers. These problems were initially approached with the traditional analytical tools of economic theory. But, in one way or another, each of the issues strained the conventional framework and required the introduction of a number of institutional or other ad hoc explanations. Reliance upon market imperfections or **nonmarket** institutions to explain deviations from the results predicted by conventional economic theory can be, at best, intellectually unappealing. At worst, it neglects, or even masks, variables significant for policy formation. In this volume, a number of these variables are identified and incorporated into a more comprehensive approach to labor market analysis than that provided by the competitive labor market model.

Internal Labor Market

#### **The Internal Labor Market**

The central concept around which this volume is organized is that of the internal labor market, an administrative unit, such as a manufacturing plant, within which the pricing and allocation of labor is governed by a

set of administrative rules and procedures.<sup>1</sup> The internal labor market, governed by administrative rules, is to be distinguished from *the external labor market* of conventional economic theory where pricing, allocating, and training decisions are controlled directly by economic variables. These two markets are interconnected, however, and movement between them occurs at certain job classifications which constitute *ports of entry and exit* to and from the internal labor market.<sup>2</sup> The remainder of the jobs within the internal market are filled by the promotion or transfer of workers who have already gained entry. Consequently, these jobs are shielded from the direct influences of competitive forces in the external market.

The rules governing internal labor allocation and pricing accord certain rights and privileges to the internal labor force which are not available to workers in the external labor market. The internal labor force, for example, has exclusive rights to jobs filled internally, and continuity of employment, even at entry ports, is protected from direct competition by workers in the external labor market. The phenomenon of internal labor markets is thus closely akin to the problems which other authors have identified as "industrial feudalism," "the balkanization of labor markets," and "property rights" in a job.<sup>3</sup>

The scope and structure of internal labor markets varies considerably among industries and occupations. The production and maintenance units of a steel plant with their limited entry ports and lengthy promotion lines, the garment factory with its many entry ports, the military services, and the exclusive hiring hall in the building trades—each constitutes a type of internal market. However, because the research upon which this volume is based focused primarily upon blue-collar employment in manufacturing, the concepts and applications presented have particular relevance for this sector.

### Enterprise Markets

For blue-collar workers who are in manufacturing, the internal market is generally *synonymous* with the establishment. While several distinct types of internal labor market structures are found in manufacturing establishments, the predominant pattern appears to be one in which *pro-*

*duction* jobs are arranged in seniority districts or lines of progression. Entry job classifications tend to lie at the bottom of these lines and vacancies in other jobs are usually filled by the promotion of workers from the next lowest job classification in the line of progression.

The criteria governing entry to an establishment are fairly responsive to external market conditions. Thus the plant's "hiring standards" vary with the level of unemployment, the wage rates offered by competitors, the characteristics of the local labor supply, and the like. In contrast, layoffs and promotions to *nonentry* jobs are generally determined by relatively fixed standards of seniority and ability. The particular standards, especially the weight given to seniority relative to ability, vary from one plant to another. In any given plant the standards are subject to revision, but they do not change freely with external economic conditions or even in response to variations in the internal supply and demand for labor.

Both the field research and the industrial relations literature indicate that internal markets are by no means limited to blue-collar jobs or to manufacturing enterprises, but occur much more broadly in the economy. The parallel to blue-collar manufacturing markets is strongest for managerial employment, where jobs also tend to be organized in lines of progression. Managerial workers enter large corporations as trainees or lower-level supervisors. From these classifications their internal career ladders stretch to plant manager or to a series of positions in the corporate management hierarchy.

There are, however, significant contrasts between blue-collar manufacturing markets and those for managerial personnel. There is a tendency for managerial markets to span more than one establishment, frequently including all the plants of a corporation. Other contrasts include the stress placed upon ability in the rules determining promotions, often to the exclusion of seniority, and the provision of an implicit employment guarantee in many middle-level management jobs. The latter obviates the need for layoff procedures and *reemployment* rights which characterize blue-collar jobs in manufacturing.

Internal labor markets for other white-collar workers also tend to be structured in a vertical fashion with regard to entry jobs and internal promotion. They may follow either the blue-collar or the managerial variant. Markets for clerical workers and technicians tend to resemble the former, while markets for professionals tend to be more like the latter.

### Craft Markets

In contrast to the predominant patterns of internal market structures I found in manufacturing enterprises are those in the building trades, *longshoring*, and certain services. These tend to center around the local union, and the geographical and occupational jurisdiction of the local

<sup>1</sup> John T. Dunlop, "Job Vacancy Measures and Economic Analysis," *The Measurement and Interpretation of Job Vacancies: A Conference Report*, National Bureau of Economic Research (New York: Columbia University Press, 1966).

<sup>2</sup> See Clark Kerr, "The Balkanization of Labor Markets," in E. Wight Bakke, et al., *Labor Mobility and Economic Opportunity* (Cambridge, Mass.: Technology-Press of MIT, 1954), pp. 92-110.

<sup>3</sup> Arthur M. Ross, "Do We Have a New Industrial Feudalism?" *American Economic Review*, vol. XLVIII, no. 5, December 1958, pp. 914-915, and Frederick Meyers, *Ownership of Jobs: A Comparative Study*, Institute of Industrial Relations, Monograph Series (Los Angeles: University of California Press, 1964), p. 11.

union generally defines the boundaries of the market. The major problems of internal allocation are those of preparing apprentices or trainees to be journeymen and of moving groups of workers of roughly equal skill and rank among jobs of short duration.

The rules governing entry to the craft or occupational type of internal market are more rigid than those found in manufacturing establishments. Those governing internal allocation, however, may be more flexible. They tend to emphasize equality of employment experience among the internal work force somewhat more than the seniority and ability considerations that are dominant in manufacturing. While occupational internal labor markets predominate where the employment relationship is casual, elements of this pattern can even be found in some manufacturing industries, such as printing, where craft traditions are strong.

Because craft markets contain skills that are utilized in many work situations and because they do not generally contain jobs filled exclusively through internal promotion, it could be argued that they are more directly responsive to competitive forces than are enterprise markets. While the evidence presented in this volume is far from complete, this argument does not seem to be warranted. Within many occupational markets, the pricing and allocating of labor are the subjects of administrative rules, just as they are in enterprise markets. These rules create the distinction between the internal and the external labor force which is so important to the definition of an internal labor market. The administrative rules are, of course, different from those found in manufacturing and respond differently to economic variables. But it is not at all clear from the research that they respond any more readily to economic variables. This, as it will be suggested below, is the determining factor in establishing limits to the application of the construct.

#### *Competitive Markets*

Finally, it is useful, when discussing internal labor markets, to have in mind some labor market in which the features of the internal market are absent.<sup>4</sup> In the United States there are some jobs which are not contained within well-defined administrative units and for which the process of allocating and pricing occurs in a more or less competitive fashion. The market for migrant labor in California is the paradigm of such a competitive system, but there are numerous other work situations, some re-

<sup>4</sup> It is conceivable that no such market actually exists and that all jobs in the economy lie within the jurisdiction of some set of administrative rules governing the pricing, entry, and internal allocation of labor. It is also possible that industrial economies evolve in the direction of gradually eliminating jobs outside of internal labor markets. Forces tending to work in this direction are suggested in the next chapter.

quiring considerable skill and others requiring little, in which administrative rules are either absent or so flexible as to argue against the applicability of the internal labor market concept.<sup>5</sup> It is with such competitive unstructured markets that the internal labor market should be contrasted.

#### **The Internal Labor Market as an Analytical Construct**

There is no doubt that internal labor markets, as evidenced by employment situations governed by administrative work rules, are present throughout the economy. Hiring, promotion, and layoff rules which create the distinction between the internal and external labor forces and which govern internal allocation are spelled out in collective bargaining contracts and in management manuals. Similarly, both contracts and manuals contain administrative rules and procedures for the determination of the internal wage structure.

But the utility of the internal labor market as an analytical construct does not depend upon the existence of administrative rules. It depends rather upon the rigidity of the rules which define the boundaries of internal markets and which govern pricing and allocation within them. If these rules are not rigid and respond freely to variations in economic conditions, their independent economic role will be minimal. Under such circumstances a preoccupation with these rules will only serve to obscure the operation of underlying economic forces. If, however, the rules are rigid, they will interrupt or transform economic influences causing the internal labor market to respond to dynamic economic events in a manner not readily predicted from conventional economic theory.

Rigorous proof of the rigidity of the internal labor market in the face of economic forces would require (1) the specification of a set of economic variables which should, in principle, govern the pricing and allocation of labor and (2) a demonstration that the rules which actually govern pricing and allocation are inconsistent with this set of variables. To the extent that there is a coherent labor market theory against which an internal market theory must be tested, it is that derived from neoclassical economics. Unfortunately, the requisite measures of neoclassical economic variables are unavailable at the **microeconomic** level, and the administrative rules which control internal labor markets in practice cannot be denned with sufficient precision to permit quantitative testing of their compatibility. As a result, the case for the internal labor market must rest on less satisfactory heuristic evidence.<sup>6</sup>

<sup>5</sup> In particular, see Chapters 3 and 8 of this book.

<sup>6</sup> For one recent attempt at quantitative testing of the internal labor market see **Llad Phillips**, "An Analysis of the Dynamics of Labor Turnover in United States Industry," **unpub.** dissertation (Harvard University, 1969).

There are several factors which indicate a rigidity in the rules of the internal labor market. First, many of the rules governing internal wage determination and allocation have survived over a considerable period of time. Longevity is not, of course, equivalent to rigidity, since a flexible structure may remain unchanged simply because the forces dictating its existence are constant. In many cases, however, the period over which internal markets have survived is long enough to create a strong presumption of variation in the underlying economic and technical contexts. Internal markets in steel, for example, can be traced to the late nineteenth century. For certain typographical, railroad, and construction crafts, the markets extend even further back in time.<sup>7</sup>

Second, a certain degree of rigidity in the rules governing the internal labor market can be inferred from the comments of both labor and management. Management is particularly vocal about the inefficiencies which the rules generate, and both unions and managements frequently speak of particular rules as if they were not only undesirable but sometimes even beyond the control of the parties to renegotiate them. Such comments suggest that the rules are not consistent with the pricing and distribution of labor which would prevail in a competitive market.

Third, the rigidity of the internal labor market appears to be connected with several phenomena at the workplace—investment in enterprise-specific human capital, on-the-job training, and the role of labor as a fixed or quasi-fixed factor of production—which have recently begun to receive attention from economic theorists.<sup>8</sup> These factors have been analyzed in a neoclassical framework, yet their effect is to weaken the assumptions of the competitive model and to interfere with the competitive determination of factor prices. Thus they appear to be highly consistent with the postulates of the internal labor market model.

Finally, there is a series of phenomena connected with the psychological behavior of work groups and the process by which customs are formed at the workplace which contribute to certain rigidities within the internal labor market. Through continuing interpersonal contacts with the internal labor market, workers appear to develop interdependent utility functions, similar to those postulated in the analysis of consumption and saving patterns.<sup>9</sup> These *interdependencies* contribute to the formation of *rela-*

<sup>7</sup> See for example, Lloyd *Ulman*, *The Rise of the National Trade Union* (Cambridge, Mass.: Harvard University Press, 1966).

<sup>8</sup> See Gary S. *Becker*, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (New York: Columbia University Press, 1964) and Walter Y. *Oi*, "Labor as a Quasi-fixed Factor," *The Journal of Political Economy*, vol. LXX, no. 6 (December 1962), pp. 538-555. <sup>9</sup> James S. *Duesenberry*, *Income, Saving, and the Theory of Consumer Behavior* (Cambridge, Mass.: Harvard University Press, 1949).

lively fixed customs and traditions with respect to wage structures, promotion arrangements, and other work rules affecting groups of workers.

### The Internal Labor Market as a Policy Instrument

The internal labor market appears to be a useful analytical device around which to group a series of related precepts which are not comfortably incorporated into conventional models of the labor market. The contrast between the internal labor market and competitive, neoclassical economic theory suggested by the previous discussion, however, should not be overemphasized. Many of the rigidities which impede market forces in the short run are eventually overcome, and there is probably a tendency for the economy to adjust, in time, in a direction consistent with the predictions of competitive theory. Moreover, many of the short-term phenomena associated with internal labor markets could perhaps be incorporated into a suitably modified neoclassical model. For example, even though *monopolylike* behavior is not necessarily characteristic of the internal labor market, the analysis of such markets is conceptually akin to monopolistic, or imperfect, competition and could be described in those terms. Nonetheless, such a presentation is not attempted here for two reasons.

First, such an approach tends to be understood as a departure from some optimal set of arrangements and thereby connotes some inefficiency in the operation of the internal market. Many of the forces which encourage the formation of internal labor markets appear to be inescapable elements of the market behavior from which neoclassical theory abstracts, and it is not clear, in the context of these elements, whether the internal labor market is inefficient or *suboptimal*.

Second, adherence to neoclassical forms of analysis when possible can be advocated on the basis of its presumed generality. When, however, enterprise-specific phenomena are widespread, and the circumstances under which they arise easily identified, generality may be obtained only at the expense of relevance and applicability. It is in fact the generality of conventional theory which limits its utility for the analysis of the policy problems noted at the beginning of this chapter. In this sense, the policy problems under examination in this book provide further analytical justification for the concept. For example, the internal labor market plays a critical role in the recruitment and training of the labor force. Partly from necessity and partly from choice it has assumed many of the responsibilities for labor market information and labor force development assumed to be provided by separate systems in many traditional analyses. By internalizing such functions, the internal labor market can select from among a variety of wage and training options in acquiring an internal labor force.

Decisions regarding technological change are also made within the internal market. Many aspects of the relationship between technological change on the one hand and the training and wage costs of the internal labor force on the other can best be understood at the micro level. Technological change, training, and recruitment all affect labor costs and the composition of employment. These factors also play a large role in the process of labor force adjustment to structural change. These adjustment mechanisms in turn affect unemployment and earnings, especially among the less educated and less skilled.

Finally, custom, as a separate force in the internal labor market, has implications for manpower policy. Custom can provide beneficial stabilizing influences; it can be a process for easing labor force adjustments; or it can be a serious impediment to achieving efficiency or equal employment opportunity. The various effects of custom tend to be balanced in the aggregate, yet they are critical to many internal labor market operations.

These problems are largely *microeconomic*, in contrast with the aggregate issues of employment, wage levels, and national income which preoccupied economic policy in the three decades preceding the 1960's. The contrast suggests that the utility of the internal labor market as an analytical construct depends upon the level at which the analysis is conducted. For *macroeconomic* analysis, the administrative features of the internal labor market are treated, in effect, as random events which cancel out in the aggregate. But what is trivial on a macro level can turn out to be central on the micro level, where an understanding of the underlying market machinery is essential.

It is also possible that a recognition of the construct of the internal labor market will point to a new understanding of some of the unsolved macroeconomic problems of the postwar period. For example, it would seem to have particular relevance for understanding the role of the labor market in determining the trade-off between wage stability and full employment subsumed in the "Phillips Curve." Although the potential of the internal labor market for the understanding of aggregate economic problems is not fully explored in this volume, some applications are suggested by the analysis.

### Research Methodology

The concepts developed in this volume are derived primarily from a series of interviews with management and union officials in more than 75 companies during the period 1964 to 1969. Most of the research was done with manufacturing companies, but interviews were also conducted in public and commercial enterprises and in construction and service *indus-*

tries. In most cases, managers from three areas — personnel, industrial engineering, and operations — were interviewed at both the corporate and plant levels. The interviews were open-ended; the majority were two to three hours in length with plant visits lasting one or two days.

Because of the extensive nature of the interviews and the sensitivity of the areas of inquiry, considerable cooperation on the part of managers and union officials was required. Personal contacts and cooperation took precedence over a scientific sampling procedure, but an attempt was made to select a heterogeneous group of plants. A variety of industries and labor markets was represented, but most of the establishments were of medium or large size.

These employer and union interviews have been supplemented by contacts with a variety of civil rights, poverty, and manpower agencies. These contacts provided frequent exposure to the *disadvantaged* labor force and were especially important for the sections of this book dealing with discrimination and low-income labor markets.

In addition to the interview materials, quantitative data on programs and personnel were occasionally collected. Some of this data are presented for illustrative purposes, but, on the whole, they are too fragmented to support any generally valid conclusions. The results, even when statistically significant, suffer from problems of sampling and statistical design which require caution in their interpretation.

### The Plan of the Book

In Part One of this volume the theoretical concept of the internal labor market is developed. Some of the forces determining internal patterns of labor allocation, wage determination, and training are also examined. In Part Two, these analytical materials are applied to a series of topics of concern to manpower policy: adjustments to labor market imbalances, technological change, discrimination, and the disadvantaged labor force. Conclusions for manpower policy are offered in the final chapter.