HEADHUNTERS INCREASE WAGE INEQUALITY: Evidence from America and Europe

The rise of professional recruitment companies since the 1970s explains at least 40% of the growth in the share of wages going to the top 1% of employees in the United States. What's more, countries in Europe that have become more exposed to the work of 'headhunters' give a larger share of total wages to their high earners.

These are the central findings of research by Alexey Gorn, to be presented at the annual congress of the European Economic Association in Geneva in August 2016. His study notes that the share of wages going to the top 1% of US employees has increased from 5% to almost 11% between 1970s and 2010s. In large part, this has been due to the use of headhunters for recruitment: by giving firms better knowledge about potential hires and by contacting 'passive' jobseekers who haven't applied for jobs, their work improves matching in the labour market.

The analysis indicates that average productivity increased by 7% due to the rise of headhunters in the United States. The author comments: 'My research has novel implications for optimal top income taxes. Because top wages increase due to efficiency, there are more resources for redistribution. But one must keep in mind that setting taxes too high will discourage workers from considering offers by headhunters and decrease aggregate productivity.'

More...

This study relates the observed increase in the levels and dispersion in top wages to the prominence of headhunters (professional recruiters).

How did the top wages change? The share of wages going to top 1% of US employees increased from 5% to almost 11% between 1970s and 2010s.

How important are headhunters? Fee revenues earned by the top 50 headhunter companies increased from $0.75 billion in 1970s to more than $10 billion in 2010s (illustrated in Figure 1). Now headhunters fill half of the positions paying above $150,000 a year.

Why might headhunters play a role? The headhunters assist firms in hiring new workers, mostly for the top executive and managerial positions. Because headhunters focus on particular positions and industries, they have more information about potential candidates and can provide firms with better hires. On top of this, the headhunters can contact potential candidates directly, without the candidate looking for a job, inducing 'passive' on-the-job search.

These two features of headhunters improve the fit between firms and employees in the very top positions. Because of better fit, the firm-employee match is more productive, so the wage of the employee hired through a headhunter increases.

To assess the contribution of headhunters in the observed increase in top wages, the study develops a theoretical model that incorporates headhunters in the labour market framework of Diamond-Mortensen-Pissarides. In the model, the firms choose whether to hire a worker through a headhunter or post a vacancy, depending on the position.
And when the headhunter calls, the worker chooses whether to accept an offer from the headhunter or to stay with the current employer.

Calibrating the model shows that accounting for the headhunters can explain 40% of the increase in the share of wages that top 1% of US employees earn.

How can we show that headhunters are indeed relevant? Focusing on Europe, the study illustrates that countries that were more exposed to headhunters in 1997 experienced larger growth of top incomes in following years.

As Figure 2 illustrates, the change in the top 10% income share between 1997 and 2010 (vertical axis) is positively correlated with the number of hires by headhunters normalised by population in 1997 (horizontal axis). This evidence illustrates that indeed the headhunters had a contribution in the growth of top incomes in the developed countries.

This research offers a new perspective on the increase in the top wages. This increase in top wages is efficient, in a sense that the model predicts that average productivity increased by 7% due to the rise of headhunters in the United States.

It has novel implications for the studies of optimal top income taxes. Because top wages increase due to efficiency, there are more resources for redistribution – higher taxes on the top will allow for more benefits for lower-income households. So, the model calls for higher top income tax rates.

But one must keep in mind that setting the taxes too high will discourage workers from considering offers by headhunters and decrease aggregate productivity. Incorporating this trade-off in the design of optimal top income taxes is the goal of the future development of this project.

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Contact:
Alexey Gorn
PhD in Economics and Finance
Università Commerciale Luigi Bocconi
Room 5-D2-08
Via Roentgen, 1 20136 Milano (Italia)
Email: alexey.gorn@phd.unibocconi.it
Office: +39 02 5836 5188
Mobile: +39 38 9541 0233
Figure 1: Cumulative change in headhunters’ fee revenues and top 1% wage share

Figure 2: Future growth in top 10% income share and normalised hires by headhunters