

Income Inequality: New Trends and Research Directions

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Abstract

Rising income inequality from the mid-1990s to the present was characterized by rapid income growth among top earners and new patterns of employment and income pooling across families and households. Research on economic inequality expanded from a more narrow focus on wage inequalities and labor markets to other domains including incentive pay, corporate governance, income pooling and family formation, social and economic policy, and political institutions. We review and provide a critical discussion of recent research in these new domains and suggest areas where sociological research may provide new insight into the character and causes of contemporary income inequality.

INTRODUCTION

There is far more scholarly interest in the issue of income inequality today than there was just a decade ago. At that time, earnings and wage inequality were at the center of debates about the new economy, labor markets, and the trade-off between unemployment in Europe and inequality in the United States as alternative responses to technological change and globalization (Blau & Kahn 2002, Katz & Autor 1999, Morris & Western 1999). These debates are still very much alive, but beginning in the early 2000s, new realities and information about income inequality led to a rapid expansion of research in several other domains.

We concentrate our efforts in this review on these newer domains, especially because there are excellent recent reviews of the literature on wage and earnings inequality (e.g., Lemieux 2008). The domains we consider either relate solely to inequality in total incomes (i.e., including all available sources of earned and unearned income) or focus on the earnings component of income inequality. An example of the latter is research that uses income tax records to measure income shares at the top of the distribution and to include high earners with greater representativeness and accuracy than is possible with household surveys (Moore et al. 2000, Weinberg 2004). Including high earners matters because a distinctive feature of contemporary income inequality in English-speaking countries is the large increase in top incomes and the share of top incomes accounted for by earnings rather than capital (Piketty & Saez 2006). In Australia, Canada, the UK, and the United States, earned income is now a majority share of income in the top percentile, whereas it was a minority share earlier in the twentieth century (Leigh 2009). Just as economic sociological studies of internal labor markets have been central to the study of wage and earnings inequality, we believe studies of compensation practices at the very top, and corporate governance institutions more generally, should be of increasing relevance to the study of rising income inequality.

The two other domains that we focus on relate explicitly to total income inequality: family formation practices and social policy and political institutions. Family formation practices are relevant because they determine how individual earnings and other incomes are pooled (or not pooled) into family incomes. How this occurs—who gets married or cohabits and with whom—may have important consequences for the level and structure of income inequality. In the domain of social policy and political institutions, we include the processes by which earnings and income distributions are shaped by social policy, most obviously by the tax structure, income transfer programs, and wage-setting institutions, but also by political parties and general political shocks such as wars.

Although we discuss a wide range of areas of growing interest, the topic of income inequality is a vast one, and thus our review is necessarily limited. Most importantly, we focus our discussion on the U.S. case, both because it is our area of expertise and because a single case allows for a more in-depth analysis of new research frontiers. However, we capture aspects of research on economic inequality of widespread interest, and we refer to cross-national similarities and differences wherever possible.

We begin with a review of the data and measurement issues involved in defining income inequality and assessing its trajectory over time. We briefly review the trends in American income inequality, focusing on points of agreement and disagreement among recent studies and reports (Blank 2010, Gottschalk & Danziger 2005, DeNavas-Walt et al. 2008, U.S. Congressional Budget Office 2008), and compare these trends to those in other industrialized countries. The following sections review each of the three explanations described above in turn: family formation practices, compensation practices and top incomes, and social policy and political institutions. The final section briefly discusses other new and promising areas of research related to income inequality.

DEFINITIONS AND TRENDS

Data

Data limitations are among the biggest constraints to better understanding income inequality. The main sources of data on a country's income distribution are usually household surveys and administrative records. In the United States, household surveys provide the most comprehensive information on a representative sample of individuals in the population but have notable gaps in the coverage of income.

For example, the most widely used household survey in the United States, the Annual Social and Economic Supplement of the Current Population Survey (the March CPS), asks respondents for estimates of their market earnings before taxes and deductions from all jobs in the previous calendar year (i.e., cash labor income). Net earnings after expenses from self-employment are also collected (i.e., cash business income). However, in the sequence of questions about earnings, the respondent is specifically asked to include "tips, bonuses, overtime pay or commission" but not "profit-sharing including stock options" (Smeeding & Weinberg 2001, pp. 4, 20). Private pension earnings are collected in a separate item, but employer contributions to fringe benefits are not (e.g., pension and health-care plans). For capital income, the CPS asks for money from dividends, rents, royalties, estates, trusts, bonds, and interest-bearing savings accounts, but not from realized capital gains. And for transfer income, the CPS collects information on some private transfer income (e.g., alimony and child support) and most cash government transfers, but not on in-kind government transfers (e.g., food stamps, Medicaid, subsidized housing, energy assistance). Although the CPS does not include information on taxes, the Luxembourg Income Study (LIS) for the United States (based on the CPS) estimates these.

Users of the CPS and LIS can therefore calculate relatively comprehensive but not perfect measures of earnings inequality (based on cash labor income before taxes), market income

inequality (based on all income before transfers and taxes), gross income inequality (based on all income before taxes), and disposable income inequality (based on all income minus taxes). Disposable cash income, it should be noted, is also referred to as posttax-posttransfer income and is considered the best definition of current economic well-being (Smeeding 2006). Other household surveys, such as the Survey of Income and Program Participation (SIPP), the American Community Survey (ACS), and the Panel Study of Income Dynamics (PSID), overcome some of these limitations (e.g., SIPP collects data on in-kind and near-cash transfers), but have other limitations, and none of these household surveys accurately reflects incomes for the upper part of the right tail of the distribution.

Although lacking in individual detail, administrative records typically suffer less from reporting errors and provide a longer time series of data with more comprehensive information on market income and taxes (Atkinson & Piketty 2007; Piketty & Saez 2003, 2007b). U.S. tax data, for example, contain all reported compensation before taxes and deductions, including returns to employer-provided stocks received in the tax-reporting year. Business and capital incomes are similar to the definitions above, but capital income also includes realized capital gains unrelated to employment compensation. To better capture income components that are often aggregated together in tax records, and to include additional equity-based assets, such as the estimated value of stock or stock options granted per year, scholars have used data on the compensation packages of the top five executives of public corporations as reported to the SEC and compiled in the ExecuComp database of Standard and Poor's (Goolsbee 2000). These administrative data on tax filers and executives are for the full population of these groups, and because historically both tax filers and executives have high incomes, these data are the best sources for measuring the concentration and composition of income in the right and extreme right tail of the distribution.

Trends

Among scholars of income inequality, there is consensus on the main trends of the phenomenon in the United States: (a) Inequality in wages, earnings, and total family incomes in the United States has increased markedly since 1980, with some trends beginning as early as the late 1960s; and (b) the level of inequality today, for both market income and disposable income, is greater than at any point in the past 40 years or longer and may be as high as in the late 1910s or 1920s. There is less agreement on the exact details of these trends, including what has happened in the past decade. Discrepancies arise from three sources: differences in data (discussed in the previous section),¹ measurement, and unit of analysis. In this section, we describe common measures of inequality and units of analysis and then provide a brief overview of trends in income inequality, highlighting the last decade. We conclude this section by comparing the trends and level of inequality in the United States with those in other industrialized countries.

The most common measures of income inequality fall into three categories: shares of income (e.g., the percentage of total income held by the top quartile of the income distribution), percentile ratios (e.g., the ratio of income at the ninetieth percentile to that at the tenth percentile, the 90/10 ratio), and one-number-summary statistics (e.g., the Gini, Theil, Atkinson, and Robin Hood indexes, the coefficient of variation, Shorrocks's coefficient). Measures based on shares of income and percentile ratios each give a picture of income inequality at specific points in the income distribution, whereas one-number-summary statistics measure inequality throughout the distribution and differ somewhat in their sensitivity to changes

¹Measures of income inequality based on household surveys (primarily the March CPS) and IRS tax return data reveal different patterns in inequality growth, which spurred a lively debate as to which data best reflected the true pattern of inequality growth. A recent paper that uses internal CPS data, corrects for topcodes, and uses similar income definitions and similar units of analysis finds largely similar patterns (Burkhauser et al. 2009).

in the tails versus the middle of the distribution. Comparisons of these measures show that most are highly correlated in their estimates for a single point in time (Evans et al. 2004, Leigh 2007) but that estimates of change in inequality over time differ by measure. Evans and colleagues (2004) show that the Gini, Theil, and Robin Hood indexes, as well as the share of income for the top quartile, are highly correlated, whereas the coefficient of variation and 90/10 ratio are less correlated.

The literature on economic inequality uses various units of analysis including individual hourly wages, individual annual earnings, total household income (unadjusted and adjusted for household size), total family income (unadjusted and adjusted for family size), and total income for tax filing units (a combination of individuals and families). Relatively few studies consider multiple analytic units across the same time periods with the same measures, data source, and treatment of top-coded data, making comparisons less than exact. Additionally, as previously discussed, different types of income may show different patterns, adding another layer of complexity to the summary of inequality trends. However, trends for all units of analysis, measures of inequality, and types of income show that inequality in the United States increased from 1970 through the present.

Several divergencies in trends for the United States by unit of analysis are noteworthy. First, inequality in hourly wages for workers rose at a roughly similar pace for women and men (Gottschalk & Danziger 2005, Lemieux 2008), but inequality in annual earnings shows a different pattern. For the total population of working-age women, inequality in earnings declined as more women entered the labor force and recorded positive earnings. In contrast, inequality in men's earnings and wages track together (Gottschalk & Danziger 2005), and earnings inequality among full-time, year-round workers rose nearly as fast for women as for men (Bryan & Martinez 2008, DeNavas-Walt et al. 2008).

Second, inequality in total income for all households has been higher than that for

families since at least the early 1970s. This pattern is due mostly to the greater variation in the size and number of earners in households than in families, which are defined by the Census Bureau as consisting of two or more individuals related by birth, marriage, or adoption. Adjustments for household or family size tend to show higher levels of inequality because larger families and households are generally poorer than smaller ones. However, the pace of increasing inequality has been similar for households and families.

Third, inequality in incomes for families with children grew at least twice as fast as that of earnings for full-time, year-round workers or wages for men or women (e.g., Western et al. 2008). These divergencies in trends by unit of analysis suggest that growing inequality in wages is not the only trend to be explained and that changes in labor supply and income pooling in households and families are also key components of rising economic inequality.

A neat and brief overview of economic inequality growth in the United States over the past four decades is somewhat elusive, but the consensus is that the 1980s were a period of very rapid inequality growth, whereas the periods before and after are characterized by more complicated trends. Because of space limitations, we focus on key trends from the last decade for which data are available (1996–2006).

Figure 1 shows these trends for the period from 1979 through 2006. What is most striking about the past decade is the tremendous growth in income shares for the top of the income distribution (Piketty & Saez 2006, U.S. Congressional Budget Office 2008). **Figure 1** shows that income shares held by the top 5% of the distribution of tax filers increased by over 50% from 1979 to 2005, with a substantial portion of the increase occurring in just the last decade. Also, pre- and posttax income inequality among top filers grew at nearly the same rate, reflecting the fact that, although the U.S. tax system is progressive, additional taxes were not imposed during the early 2000s to reduce increasing inequality. Growth among the extreme right tail of the income distribution has been

even more exaggerated; income shares held by the top percentile increased by 129% from 1979 to 2006, and 2007 marked the most unequal year since 1917 as measured by the share of income held by the top 0.01% (Piketty & Saez 2006, Saez 2009). Even if the current economic recession reduces top income shares substantially, the concentration of income at the top of the distribution is likely to remain a key feature of modern economic inequality.

Whereas income for top earners has risen rapidly since the mid-1990s, real income for median households has barely budged over the past decade, with all the income growth occurring before 1998. Similarly, although earnings inequality fluctuated somewhat over the past decade, the levels of inequality among all workers and among men were only slightly higher in 2006 than they were in 1996. In contrast, inequality among full-time women workers and among households increased more over this period, but by considerably less than it had during the 1980s. Most accounts hold that inequality between the middle and bottom of the income distribution stabilized or decreased after 1990 (Burtless & Jencks 2003, Daly & Valletta 2006, Western et al. 2008), with almost all the increase in inequality coming from increases at the top of the distribution.

As in the United States, economic inequality has risen in many industrialized countries since the mid-1970s (Brandolini & Smeeding 2009). Comparing inequality growth across countries is possible using data from the LIS, Cross-National Equivalent File, World Bank, and other sources, but comparisons are inexact because of inconsistencies both within and across countries in data quality, units of analysis, and types of incomes, taxes, and transfers included (see Atkinson & Brandolini 2006). Trends in income inequality growth vary considerably across countries in timing and direction. For example, the English-speaking countries of the United Kingdom, Ireland, Canada, Australia, and the United States all experienced marked increases in both market and disposable income inequality since the 1970s (Brandolini & Smeeding 2009, Kenworthy

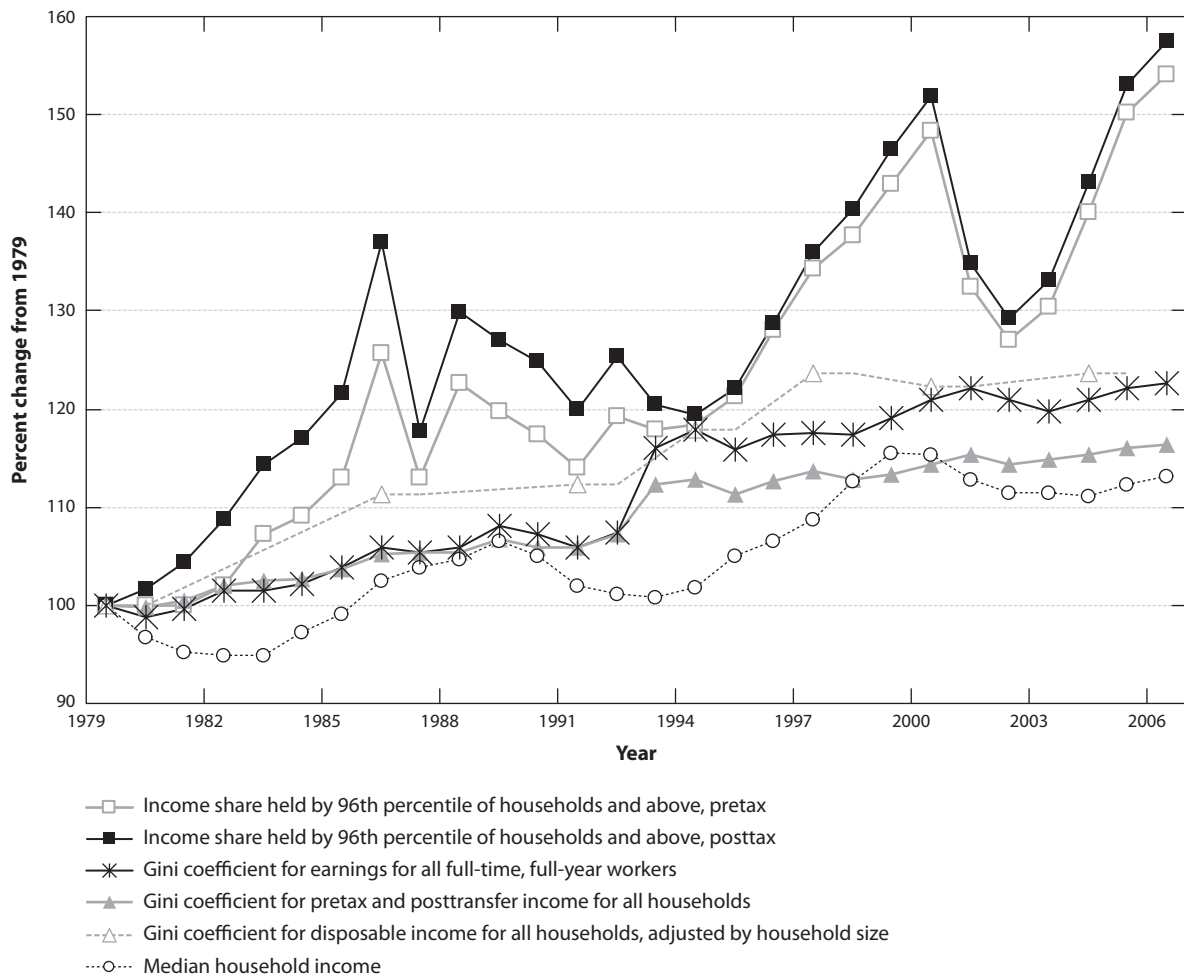


Figure 1

Trends in economic inequality in the United States, 1979 to 2006. The data for the above figure are from the following sources: income shares of the 96th percentile and above, U.S. Congressional Budget Office (table 3); Gini for individual earnings for all full-time, year-round workers, U.S. Census Bureau Historical Income Tables (table IE-2); Gini for all households, unadjusted for household size (pretaxes but including some transfers), DeNavas-Walt et al. 2008 (table A3); Gini for disposable income for all households adjusted by household size, Luxemburg Income Study Key Figures; median household income, DeNavas-Walt et al. 2008 (table A1).

2007), but the timing differed considerably. Inequality rose sharply in the United Kingdom in the 1980s (similar to in the United States), but later and to a lesser extent in Canada (Brandolini & Smeeding 2009). In contrast, disposable income inequality in France declined over the past four decades (Brandolini & Smeeding 2009), and top income shares did not increase (Piketty 2007). Other countries, including some Nordic countries, showed

increases in market income inequality, disposable income inequality, or incomes held by the top shares, with considerable variation in the level and timing of the increases.

Although comparisons of trends in inequality growth between the United States and other countries are hard to generalize, the United States's position in a ranking of the level of inequality is clear. Disposable cash income available to individuals around the turn of the

millennium was more unequal in the United States than in 29 of 32 rich and middle income countries for which comparisons were possible; only Mexico and Russia were more unequal. Americans at the bottom decile were much further from the median than residents of other rich countries; the income ratio of the top decile to the median was also higher for the United States than for many other countries, but it was less of an outlier (Brandolini & Smeeding 2009).

EXPLANATIONS

Family Formation Practices

As described above, for some households and families, such as families with children, inequality in total family incomes adjusted for family size rose much more quickly than inequality in either men's or women's wages or earnings (Daly & Valletta 2006, Martin 2006, Western et al. 2008). A thorough understanding of economic inequality therefore requires looking beyond wage inequalities generated in labor markets to how incomes are pooled and distributed across families. Indeed, scholars such as Esping-Andersen (2007) contend that changes in families are a leading sociological explanation for the rise in economic inequality in the United States and across other industrialized countries (see also McLanahan 2004).

Family formation patterns changed markedly in the United States, as well as in other industrialized countries, over the past four decades (known as the second demographic transition). Changes in American family formation patterns have resulted in more people living in single-person households or with unrelated adults, more cohabiting but unmarried couples, more families consisting of an unmarried mother and her children, and more similarity between spouses among those who marry (for an overview of family changes, see Bianchi & Casper 2000). Decreases in the proportion of those "ever married" (includes those currently married, as well as those widowed, divorced, or separated) and decreases in marital

stability have been more concentrated among economically disadvantaged groups (Bramlett & Mosher 2002, Goldstein & Kenney 2001) and among low earners (McCall 2008), rendering individuals with lower incomes less likely to be living in married couple households. Amid these changes, women's employment was becoming less sensitive to their family characteristics (Cohen & Bianchi 1999, Goldin 2006, Juhn & Murphy 1997), and spouses were becoming increasingly similar in education and, especially, earnings and employment status (Cancian & Reed 1998, 1999; McCall 2008; Schwartz & Mare 2005).² Nonlabor family income also changed, especially after the mid-1990s reforms of welfare and the EITC.

Because these and other changes in families and households have complex implications for income inequality, research in this area has proliferated in recent years. Three questions dominate the literature: (a) How much can changes in family structure—particularly the increase in single mother families—account for the increase in income inequality among families? (b) Did increased wives' employment reduce or increase income inequality among married couples? (c) How have increases in educational homogamy or earnings homogamy affected income inequality among families and across the population? Much of the research addresses two or more of these questions simultaneously, allowing richer understandings of family dynamics but making neat summaries and comparisons between analyses difficult. Below, we review this scholarship and point out future directions for research in this area. Although the literature in this area is not restricted to the American case, we so restrict our discussion because family patterns differ markedly from those of most other countries.

² Among spouses, the correlation of earnings is much lower than the correlation of education (roughly .30 versus .60) but has increased more over time. As in the past, the positive impact of educational homogamy on income inequality is limited by the dominance of men's earnings in family incomes (McCall 2008).

First, the question of how much of the increase in income inequality can be accounted for by the increase in single mother families has garnered considerable research attention. By 2007, four in ten births were to unmarried mothers (Ventura 2009), and although the characteristics of unmarried mothers changed somewhat from the 1980s to the 1990s and 2000s, the nonmarital birth rate climbed at a fairly steady rate over this period, with the 2007 rate about 80% higher than that for 1980. This increase in the share of families headed by single mothers is hypothesized to increase inequality by increasing the number of families with very low incomes, as most single mother families work fewer hours and receive less pay than other families. Studies of the impact of increasing single motherhood on family income inequality vary in their estimates, with a range from 11% to 41%. This wide variance in estimates reflects real differences in effects both by time period and populations as well as by methodological and measurement choices (see McLanahan & Percheski 2008 for a more extensive discussion).

Second, the question of how changes in women's employment affected the income distribution has been the subject of considerable research attention since the 1980s. Wives' and mothers' employment increased dramatically from the early 1960s through the late 1990s, with particularly large increases in employment among married mothers of young children (see Cohen & Bianchi 1999). Increases in women's employment have since slowed down (Goldin 2006).³ Treas's 1987 review of this literature concluded that increases in wives' labor force participation through the mid-1980s reduced income inequality among married couple families but that future increases in wives' employment might have the opposite effect if

they were concentrated among higher earning women or if earnings homogamy in marriage increased. Since that review, Cancian & Reed (1998, 1999), Daly & Valletta (2006), and Pencavel (2006) all have concluded that family income inequality would have been higher by the mid- or late 1990s had women's employment levels and earnings remained constant (cf. Lee 2005). Notably, several studies that simultaneously consider the effects of single motherhood (or female headship) and women's employment on income inequality find that these trends had largely offsetting effects (Albrecht & Albrecht 2007, Nielsen & Alderson 1997, Western et al. 2008).

Third, relatively few published studies have considered how increases in homogamy have affected income inequality. Homogamy on education (Schwartz & Mare 2005), labor supply (Esping-Andersen 2007, Jacobs & Gerson 2004), and especially earnings (Cancian & Reed 1999, McCall 2008) has increased over the past several decades. If family structure, women's employment, and all other factors stayed the same, but individuals were more likely to marry those with more similar earnings or earnings potential (proxied, for example, by education), then this would increase the dispersion of total earnings among married couples. Pencavel (2006) and Cancian & Reed (1999) simultaneously consider the questions of how changes in wives' earnings and the correlation of spouses' earnings have affected family income inequality among married couples; both sets of authors conclude that increasing marital homogamy cannot account for much of the increase in income inequality in the periods that they examined (see also Hyslop 2001). Likewise, Western et al. (2008) find that changes in educational homogamy do not alter their estimates of changes in family income inequality.

However, three recent working papers re-examine this question, and two conclude that increases in homogamy have made the distribution of family incomes substantially more unequal. Focusing only on the effects of earnings homogamy on earnings inequality, Schwartz

³Labor force participation and work hours also declined for men in the bottom part of the education distribution (Jacobs & Gerson 2004). Lee (2001) argues that this contributed substantially to growing family income inequality, particularly in the 1970s.

(2009) estimates that earnings inequality among married couples would be 25–30% lower if the association between spouses' earnings had not increased. She attributes this large gross effect both to declines in the negative relationship between husbands' earnings and wives' odds of working and to increases in the association between spouses' earnings among dual-earner couples. Reed & Cancian's (2009) analysis focuses on income sorting, a concept that captures both the propensity to pool incomes through marriage and the similarity of spouses among the married population. Their simulations find that income sorting accounts for 57% of the Gini coefficient increase in per-person share of family income from 1967 to 2002. The third paper concentrates on educational homogamy, which should have a less direct effect on income inequality, and finds that the correlation between heads' and spouses' education levels does not alter income inequality levels much (Breen & Salazar 2009). The variation in study design, population definition, and time period examined in these studies of homogamy and income sorting makes it hard to reconcile the contradictory findings.

In summary, many scholars are trying to disentangle how changes in family structure, family composition, and women's employment have affected income inequality, but, for some of these questions, the evidence is far from conclusive. There is strong support for the hypothesis that increases in single mother families and decreases in married couple families have increased income inequality and fairly strong evidence that increased women's employment and earnings have reduced inequality, at least through the 1990s. In contrast, there is little consensus about the impact of marital homogamy or income sorting on income inequality, suggesting that more research is needed.

In addition to these questions that have dominated the literature, several other questions call out for investigation. As many have pointed out, incomes may not be as equally distributed within families and households as many of our models assume (e.g., Lundberg et al.

1997). Thus, future research should more carefully examine the intrahousehold distribution of income, as well as how cohabitators and other nonfamily household members share incomes (e.g., Kenney 2006). More generally, the rise in cohabitation has complicated the classification of households as either nonfamily or family households (Smock 2000), with little uniformity in how scholars treat cohabitor income in analyses of family income inequality. Indeed, most American household surveys, including the CPS, have not consistently identified cohabitators over time (the decennial census first included an "unmarried partner" category in 1990; CPS added it in 1995) (Casper & Cohen 2000). Additionally, as we mentioned above, some incomes that transfer between households are recorded in household surveys, but others are not. Monetary gifts to children are missed, for example, and research shows that these types of income transfers are common and sometimes substantial in size (Berry 2008, Schoeni 1997). Finally, more work is needed on how the EITC, which affects both incentives for employment and government transfers to families, has affected income inequality among households and families.

Top Incomes and Compensation Practices

The lion's share of income inequality still comes from earnings inequality, a significant portion of which in recent years is due to disproportionate gains at the top. This is especially but not exclusively the case in the United States; growing top incomes and the corporate governance institutions that support them are found in other Anglo-Saxon countries, and Continental European countries have emulated the Anglo-Saxon model to varying degrees (Beckfield 2006, Cernat 2004, Leigh 2009). In a novel recent study of 15 OECD countries, for example, Sjöberg (2009) found a reasonable range of variation across countries in indicators of corporate governance structures, and these indicators were more strongly associated with the

90/10 ratio of earnings than were other institutional factors.⁴ Still, American CEO pay is unquestionably an outlier. Based on recent unpublished estimates using matching methods across countries, median CEO pay in the United States is 23% greater than in the UK and 55% greater than in Continental Europe (Conyon et al. 2009).

Economic explanations of rising top-end pay fall into two main categories and one residual category: changes in corporate governance, changes in the market for talent, and changes in social norms, respectively. Perhaps the most extensive debate thus far concerns the relationship between corporate governance and executive compensation. If, according to prevailing economic theory, corporate governance in the Anglo-American model is defined as the rules and institutions that maximize ownership value, the central question is how to use compensation practices to align the interests of executives (nonowner agents) with those of value-maximizing owners (dispersed principals) (Davis 2005, Jensen et al. 2004). This principal-agent dilemma applies less directly to Europe and Japan, where ownership is more concentrated and other stakeholders are more powerful (such as families, banks, and labor) (for a review, see Aguilera & Jackson 2003). In the United States, concerns about shareholder value became an issue in the 1970s when stock market values and other economic indicators were down, and mismanagement was one of the factors singled out for blame (Jensen et al. 2004).

One solution at the forefront of current research on executive compensation is the granting of share options to executives as an incentive to increase shareholder value. Jensen et al. (2004, p. 25) report that base

salary and bonus compensation to American executives increased threefold from 1970 to 2000 but that the average value of options increased from virtually nothing to \$7 million, accounting for half of average total executive compensation in 2000. Critics contend that pay did not reflect performance and that executives favored options and persuaded friendly boards to ratify them because options are less transparent and more susceptible to rent-seeking than is cash salary (Bebchuk & Fried 2003). Others counter that the rising power of financial markets in the 1980s ought to have reined in executives vis-à-vis large and predatory investors and that it was accounting and tax rules that made options attractive (Hall & Murphy 2003, Kaplan & Rauh 2010). Consistent with this, historical evidence suggests that options were common during earlier periods of relatively low executive compensation and inequality (Frydman & Saks 2008). Thus, options per se do not appear to be the underlying reason executive pay soared when it did in the United States.

A second set of explanations for changes in pay at the top is a transformation in the markets for top-end jobs. Rising executive compensation in public corporations is considered just one example of a more general shift in compensation practices affecting those with exceptional talents in high demand and in lucrative fields (e.g., hedge fund managers, specialist surgeons, athletes, etc.) (Kaplan & Rauh 2010, Rosen 1981). Seeking a versatile explanation of top pay, then, some scholars seize on the well-known correlation between firm size and earnings to show a strong association between rising market capitalization and executive pay, although only in the period after 1970 (Gabaix & Landier 2008). Others examine the growing complexity of skills required to compete for top-end jobs in markets that have expanded beyond narrow internal, industry, and national boundaries (Garicano & Rossi-Hansberg 2006, Sassen 1991). If markets have expanded more extensively in the United States, this might explain its higher CEO premium as well as the premium on English language skills

⁴In particular, the volume of mergers and acquisitions and the protection of minority shareholders were significant in models in which neither wage bargaining coordination, union density, nor government employment was significant. Moreover, a measure of globalization performed weakly as well, consistent with previous findings (Alderson & Nielson 2002, Beckfield 2006, Roine et al. 2009).

in other countries (Saez & Veall 2005). A strong competing residual explanation is that compensation has been artificially ratcheted up owing to changes in social norms or other reasons (anomalous cases of large increases in pay) that are exacerbated by herd behavior and compensation consultants (DiPrete et al. 2010, Khurana 2002, Piketty & Saez 2003).

Two sets of questions remain underdeveloped in this literature yet crucial for the study of income inequality. First, exactly how do changes in compensation practices at the top affect the rest of the income distribution (see Frank 2007 for a related discussion in the realm of consumption)? If increasing top income shares are associated with economic growth in the United States as well as elsewhere (Frank 2009, Roine et al. 2009), most or some of the population could be absolutely better off even if they are relatively worse off. Andrews and coauthors (2009) identify these as the growth-promoting and share-reducing components of rising top incomes, and their preliminary work estimates that it takes more than a decade for the former to dominate the latter in the post-1960 era in the United States.⁵ Similarly, Lemieux and colleagues (2009) estimate that the increasing prevalence of performance pay among high-skilled workers explains up to a quarter of rising wage inequality among American men, but it is unclear whether (assumed) increases in efficiency benefit other employees and/or affect their morale and productivity (e.g., through equity norms in the distribution of bonuses and equity within the firm) (Blasi et al. 2003, Lazear & Shaw 2007). Data from the macro to the firm level are needed to examine these issues of market-based distribution and redistribution.

Second, to what extent does the debate over the sources of rising top-end pay and related

income inequality unhelpfully reproduce the debate between technological and institutional explanations of rising wage and earnings inequality? Recent technology and skills-based explanations can benefit from earlier work on how organizational and technological forms evolve in concert and not in a strictly predetermined way (Batt 2001, Bresnahan et al. 2002, Fernandez 2001). Likewise, institutional explanations can benefit from greater attention to how social norms and institutions are distinct but interconnected phenomena.⁶ For example, if social actors such as business elites and the general public vary in their social norms about income inequality, social institutions may change because of an exogenous change in the balance of power among social actors—brought on by economic crises, for example, as in the 1970s (Kochan et al. 1986)—and not because of a shift toward more permissive social norms. In fact, most Americans prefer less income inequality than exists, and this share has only increased since the late 1980s (McCall & Kenworthy 2009). Economic sociologists and stratification scholars can join forces, then, to fill an important void by linking corporate and organizational changes to changes in employment conditions and outcomes.⁷

Social Policy and Political Institutions

Political institutions are receiving much greater attention in recent research on income inequality. Although it is well known that progressive taxes and government transfers reduce income inequality, there is renewed interest in the idea that market income inequality itself admits of political origins. We consider this argument after first briefly discussing the more developed

⁵ However, Leigh (2009) reports that poverty rates are positively correlated with top income shares, and several other authors note the coincidence of high growth and low inequality in the post-World War II era or find no long-term relationship between inequality and growth whatsoever (see Voichovsky 2009 for a review).

⁶ In several recent papers, “social norms” appears instead of “social institutions” as a catch-all category of social explanations in the list of causes of rising inequality (i.e., along with skill-biased technological change, trade/immigration, etc.).

⁷ This approach is suggested in several recent studies, e.g., Fligstein & Shin (2004), Hollister (2004), Kim & Sakamoto (2008), Krippner (2010), Mizuchi (2010), Rosenfeld (2006), Sorensen & Sorensen (2007).

literature on the redistributive impact of social welfare policies.

Redistribution is typically measured as the difference between market and disposable income inequality at the household level and varies widely across countries. According to one recent study of 16 OECD countries, the reduction in market inequality ranged from a high of 47% in France (in 1994) to a low of 20% in Switzerland (in 1999), with an average of 33% and a U.S. ranking near the bottom of the pack at 22% (Brandolini & Smeeding 2009). Although the United States is a well-known laggard in its redistributive effort, with high levels of both earnings inequality and disposable income inequality, its level of market inequality is more on par with other countries because of its fuller employment record.⁸ Looking at market inequality, one sees not only increases in nearly all countries from the 1970s to at least the mid-1990s but roughly proportionate increases in redistribution as well (with the exception of the United States) (Brandolini & Smeeding 2009, Kenworthy & Pontusson 2005). Cutbacks in welfare state generosity such as benefit replacement rates were less than predicted, allowing existing income transfer programs to blunt the impact of rising earnings inequality and unemployment (Pierson 1996). The increase in redistribution was not enough to fully offset the rise in market inequality, however, so disposable income inequality rose in many countries as well.

Politics may also affect the distribution of income in ways that are not as routinely discussed in the comparative literature on welfare states, such as their impact on pretax and pretransfer market income inequality (Bradley et al. 2003). Two sets of dynamics are of interest here. First, there may be exogenous political shocks that

affect all countries in a relatively similar and momentous way. Second, there may be specific policies and policy changes within countries that are either inconsistent with the overall welfare regime type or, even when broadly consistent, are more noteworthy in their temporal impact on income inequality (both before and after taxes and transfers) than are static differences in welfare state regimes across countries.

Regarding global shocks, in virtually all countries involved in the world wars of the early and middle twentieth century, fortunes were destroyed by the wars themselves and by taxes levied on high incomes to finance the wars (Atkinson & Piketty 2007, Roine et al. 2009). This damage was in addition to the loss of capital incomes caused by the banking and economic crises of the late 1920s and the 1930s. In the United States, incomes throughout the rest of the distribution were also buoyed by strong demand for labor, the minimum wage, unionization, and price and wage controls during World War II (Goldin & Margo 1992, Lichtenstein 1989). In other countries, states and economies weakened by the wars were vulnerable to demands for strong employment regulations and wage-setting institutions (Strasser et al. 1998). Together, these shocks and social institutions significantly reduced earnings and income inequality around the globe for several decades. The current global banking crisis could have a similarly pervasive effect in reducing top incomes.

Regarding the importance of within-country dynamics and particularities, we highlight three important areas of recent research. First is an effort to expand the definition of welfare state generosity to include the value of in-kind government and private services such as health care and public education. Although estimating the exact redistributive impact of such spending requires strong assumptions, the value of government expenditures on services and employer-subsidized health and education benefits is probably larger than that of government cash transfers, and this is especially so for leaner welfare states. Once these services are included in a measure of

⁸Market inequality includes part-timers and, in some instances, the unemployed, and the United States has fewer of both. Note that these common measures of redistribution exclude government spending on services such as health care and education, which is discussed below. Finally, note that redistribution comes mainly from transfers rather than from taxes, even though in the United States taxes are progressive in effect as well as design (Piketty & Saez 2007a).

government transfers, the level of bottom-end inequality in the United States is much closer to the norm (this result also includes the impact of indirect taxes, e.g., taxes on transfers, which are greater in generous welfare states) (Adema & Ladaique 2005; Garfinkel et al. 2006, 2010; Hacker 2002).

The persistence of inequality across generations (i.e., intergenerational immobility) also tends to be lower when education expenditures are higher and more equitably distributed, particularly at the elementary level (Bergh 2005, Björklund & Jantti 2009, Mayer & Lopoo 2008). Because of data constraints, the precise social and economic mechanisms underlying the relationship between income inequality and intergenerational immobility (a weakly positive one) are not well understood, and changes over the period of rising income inequality have been difficult to estimate precisely, although existing evidence points to less rather than more mobility in the United States (Björklund & Jantti 2009).

Second is an effort to determine the impact of tax policy changes on pretax and pretransfer income. There is considerable debate on the causal impact of changes in top marginal tax rates since the 1980s (down in the 1980s, up in the 1990s, down in the 2000s) on rising top incomes in the United States (Goolsbee 2000; Piketty & Saez 2003, 2007a; Roine et al. 2009). On the one hand, top incomes began to rise prior to large declines in the top tax rates in the 1980s, have continued to rise throughout the last several decades, and rose in Canada despite smaller shifts in tax policy, all of which suggest a long-term secular shift. On the other hand, there have been intensive short-term movements in pretax income in the predictable direction during periods of tax rate changes. It is therefore likely that changes in tax regulations affect incentives regarding the mix of compensation (i.e., options, dividends, restricted stock, retirement, cash and bonuses) but not the overall long-term level of pretax income and income inequality, unless they are dramatically altered as in the World War II and post-World War II period.

Finally, and relatedly, changes in the party that controls government could affect government policies in various ways (taxes being just one example) that in turn affect levels of pretax income inequality. For example, the representation of the interests of low-income voters in left-leaning parties has received the most attention in the large literature on cross-national variation in the establishment of strong wage-setting and employment protection institutions (Bradley et al. 2003, Korpi 2006, Scheve & Stasavage 2009). More recently, Bartels (2008) finds a pattern of increased government spending during Democratic presidential administrations in the United States that disproportionately benefits people at the bottom of the income distribution and reduces income inequality. Across countries, Roine et al. (2009) also find that government spending lifts pretax incomes among the bottom 90% and not among the top 10% or 1%, but they do not assess the specific impact of partisan spending dynamics. Adding to the debate, however, Scheve & Stasavage (2009) do not find a significant impact of left party incumbency in their cross-national study of long-term changes in income inequality.

Other policy changes between administrations of different political hues could significantly impact incomes and income inequality. The extent and partisan flavor of political polarization have been linked to growing income inequality in the United States, with rightward polarization potentially inhibiting a wide range of policy changes that could mitigate inequality (McCarty et al. 2007). Changes in financial and corporate regulatory policy may also be related to rising income inequality. For example, if growing firm size, market capitalization, and dispersion in size are correlated with growing incomes at the top and growing dispersion of incomes, it would be useful to understand how antitrust, financial, and other regulatory policies facilitated the giant mergers and acquisitions waves of the 1980s and 1990s (Andrade et al. 2001, Sjöberg 2009). Although scholars of earnings inequality were attuned to the potential role of deregulation in the 1990s (Fortin

& Lemieux 1997), there has been relatively little attention paid to this timely subject.

CONCLUSION

In this review, we focused on three topics that have received growing attention in the literature on income inequality and that reflect the new characteristics of contemporary income inequality. These topics—new family formation patterns that have altered income pooling and family income inequality, changes in labor markets that have increased the income share and composition of incomes held by the very top of the distribution, and social policies and political institutions that have affected both market inequality and posttax and posttransfer inequality—correspond to the three spheres of the family, markets, and politics studied by welfare state scholars. This breadth marks an important shift from a more narrow focus on wage inequality to an expansive view of how income inequality is produced.

Although many questions related to these topics remain unresolved, social scientists have made substantial strides toward better understanding the changing and complex nature of income inequality as well as the consequences of elevated levels of inequality (as reviewed in Neckerman & Torche 2007). Whereas previous reviews of economic inequality lamented the paucity of sociologists studying the subject (e.g., Morris & Western 1999), the same cannot be said today. Sociologists from various subfields have contributed significantly to this field, although it does continue to be heavily

influenced by the contributions of economists and, more recently, political scientists.

Among the many flourishing areas of research related to income inequality absent from this review, a few are particularly noteworthy. These include how income inequality patterns vary by geography and how increasing income inequality is related to intra- and intergenerational mobility. Geographic variation in income inequality covers a wide range of questions. The one we have yet to mention is the changing nature of global inequality (e.g., Atkinson & Brandolini 2008, Firebaugh 2003). Key issues here include the shift from growing inequality between nations to within nations and from measuring inequality in relative terms to measuring it in both relative and absolute terms (i.e., considering poverty levels as well). The latter area, related to instability and mobility, is less developed. The PSID is the only national household survey with a long enough history of incomes to sustain the necessary analyses, forcing scholars to look toward administrative data (e.g., from Social Security records) and creative methods to overcome data constraints. Key issues here include whether increasing inequality is counterbalanced by increasing earnings mobility and thus less permanent inequality averaged over a lifetime (which does not appear to be the case) and whether increasing inequality has restricted intergenerational mobility (Gangl 2005, Kopczuk et al. 2010). We expect exciting new research in the future in all these areas of long-standing interest to sociologists and other social scientists.

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