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HOW INEQUALITY IS RISING AMONG IDENTICAL WORKERS AS COMPANIES' FORTUNES DIVERGE

By Josh Zumbrun
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Imagine two workers – the same age, same gender, same race, same education, same geography, same occupation, same industry. In theory, you might expect them over time to have similar earnings. In practice, they don't.

The reason, according to a new paper from Harvard University's Richard Freeman, is that over time inequality is growing between different companies.

"The earnings of workers with near-clone similarity in attributes diverged so much by the place they worked that rising inequality in pay among employers has become the major factor," in rising inequality, Mr. Freeman said.

This may sound obvious: Of course some firms do well and others don't. But if inequality is growing sharply among workers with the same attributes, it casts doubt on theories that peg inequality to primarily demographic, educational or geographic factors. The link is tighter than one might expect. From 1992 to 2007 (the period in which the data in this study was available, and also the period over which much of the rise in inequality occurred), the average worker at a given percentile, and the average firm of a worker at that same percentile had almost equal earnings increases.

Why would a company pay someone $80,000 if most people with an identical background – clones, in the paper's parlance – earn $40,000? Conversely, why would someone with that background stay in the job earning $40,000 if another company will pay $80,000 for the same work?

"We're missing a whole part of the inequality story by looking at people rather than looking at their employers as well," Mr. Freeman said.

His work was published today by the Washington-based think tank Third Way. It is based on research published earlier this year with co-authors Erling Barth of the Institute for Social Research Oslo, Alex Bryson of University College London and James C. Davis of the Census Bureau. Other researchers have also begun to look at the effect on earnings due to the divide between successful and unsuccessful companies. The economist Jae Song of the Social Security Administration led a team of researchers who have documented a similar finding in Social Security data.

There are a few possible explanations, but because the finding is relatively novel, no consensus has emerged that explains the phenomenon. One possibility is that successful companies have become increasingly effective at identifying skills that other companies cannot identify (and the available data do not capture), and therefore the inequality is driven by hard-to-measure skills. Another possibility is that existing data are not capturing the importance of people's social connections.

One possibility raised by Mr. Freeman that other research has also considered is that a number of firms are increasingly monopolistic, and are able to boost their profits through anticompetitive practices.

The question is not why some companies do well and others fail. A healthy economy will always have creative destruction, with some companies falling by the wayside as others grow. The question is why is the difference has been increasing so widely over time compared with the past.

“It’s a balancing act,” Mr. Freeman said. “You do want a successful firm to share its profits and its revenues with the workers, but I find it hard to imagine that this can just keep growing and growing so massively.”