The Inequality Economy

How New Corporate Practices Redistribute Income to the Top

Leslie McCall

A Working Paper

Dēmos
A NETWORK FOR IDEAS & ACTION

The Inequality Economy

How New Corporate Practices Redistribute Income to the Top

Leslie McCall

A Working Paper

Dēmos A NETWORK FOR IDEAS & ACTION

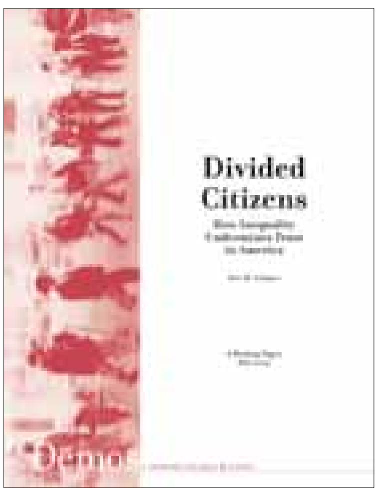
About the Author

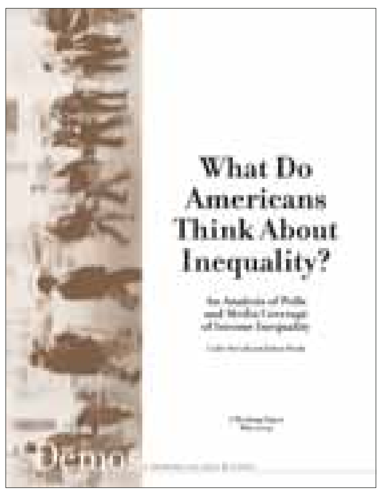
Leslie McCall is Associate Professor of Sociology and Women's and Gender Studies at Rutgers University and a Senior Fellow at Demos. Her work on inequality has appeared in a number of top journals and she is author of *Complex Inequality: Gender, Class, and Race in the New Economy* (2001). This working paper is part of an ongoing project that explores the relationship between corporate restructuring and rising inequality.

About Demos

Demos is a public policy organization that seeks to strengthen U.S. democracy and to achieve a broadly shared prosperity characterized by greater opportunity. Founded in 1999, Demos' work combines research with advocacy—melding the commitment to ideas of a think tank with the organizing strategies of an advocacy group. To learn more about Demos and its research, visit www.demos-usa.org.

Other Working Papers on Inequality:





For more Demos publications, visit www.demos-usa.org/publications.

Demos: A Network for Ideas and Action
220 Fifth Avenue, 5th Floor
New York, NY 10001
212-633-1405
212-633-2015
www.demos-usa.org

Contents

Introduction

The link between corporate practices and the economic security of Americans has become a major focus of public debate over the past several years. The off-shoring of new kinds of jobs has garnered the most attention, but cutbacks in employee health benefits and the under funding of pension plans has also drawn scrutiny at a time when corporate profits have been robust and executive mismanagement has been widespread.

Recent changes in corporate practices—and the new economic anxieties that result—continue a trend that began more than thirty years ago. Since the heyday of the large conglomerate firm in the 1960s, corporations have restructured and re-engineered, decentralized and networked, divided and merged, downsized and up-sized. Whereas once managers resisted such changes, now the stock market is firmly in charge. Some call this a shift from managerial capitalism to investor capitalism. Others call it a shift from financial control to shareholder control.[1] Whatever one calls it, no one questions a generational shift in the business strategy of corporate America. A new and more market-centered model has emerged, tarnished only slightly by the scandals and the recession.

At the same time these corporate changes took place, the labor market underwent equally dramatic changes: inequality between high-income earners and everyone else increased substantially; wages for most workers failed to keep up with inflation, at least throughout the 1980s and most of the 1990s; layoffs became commonplace in non-recessionary years and even when employers posted profits; and worker benefits were reduced.

Although sharp increases in economic insecurity were not registered in surveys on worker and consumer confidence, there was a widespread sense in the '90s that workers were less certain about their current and future job and financial security than they used to be.[2] That anxiety, which simmered below the surface during the boom, has become far more visible in recent years, enduring even after a brief recession. In 2003 and 2004—a period when corporate earnings soared but wages stagnated—economic insecurity remained a major focus of public debate.

So what does the first change (corporate restructuring) have to do with the second change (increased inequality)? And why does it matter? The answer seems obvious, at least to the first question: workers work in corporations and corporations have changed, thus workers inevitably got tossed about in the maelstrom of restructuring. But corporate America has been advocating less hierarchy and more teamwork, which suggests a movement toward greater equality and shared sacrifice, not the reverse. Greater inequality does not inevitably follow, at least not from the *rhetoric* of corporate restructuring.

For this and many other reasons, it's been much harder to make the connection between corporate restructuring and rising inequality than you might think. Many have tried, including such widely read scholars as Bennett Harrison and Barry Bluestone in *U-Turn: Corporate Restructuring and the Polarizing of America* (1988), Harrison's *Lean and Mean: the Changing Landscape of Corporate Power in the Age of Flexibility* (1994), and David Gordon's response in *Fat and Mean: the Corporate Squeeze of Working Americans and the Myth of Managerial "Downsizing"* (1996).

But beyond these important efforts, there's been remarkably little empirical analysis of the impact of corporate restructuring on rising overall inequality (see the Appendix for an overview of previous research). This was especially true in the 1990s, the heyday of research on the "new inequality", when the focus shifted to other explanations of inequality, and particularly to those that stressed the role of technological change.

Thanks largely to new debate about the off-shoring of jobs, as well as the recent spate of corporate scandals, it is now possible to refocus the discussion. Even among skeptics, it no longer strains credulity that new corporate practices could be a much more important piece of the inequality puzzle than was once thought. For example, in a May 2004 article on the working poor, *Business Week* fingered the intense bottom line practices of corporations like Wal-Mart as one reason for the growing wage gap between skilled and unskilled workers.[3] Academic researchers also are in the midst of rethinking the role of technology, or at least how its impact on inequality cannot be separated from how corporations choose to implement the new technologies.[4]

In light of this rethinking, earlier arguments about the impact of corporate restructuring on rising inequality need to be re-examined and updated. To that end, this report has four main objectives.

1) The primary objective is to piece together the big picture of how a number of new corporate practices—separately and in combination—had a significant impact on rising *overall* inequality in the United States. Such practices include deregulation, mergers and acquisitions, rising executive pay, subcontracting, and technological re-engineering. With the exception of technological change, these practices have not been examined in the main empirical literature on the sources of rising overall inequality, though speculation about their impact on inequality has certainly been voiced before.

2) In showing the specific ways in which these new corporate practices contributed to higher inequality, a second objective is to make the new corporate practices a more central part of the discussion of how to reduce inequality. In the analysis of rising inequality, corporations have been criticized for moving high-paying jobs overseas and crushing unions. But much less has been said about new corporate practices in primarily domestic and/or non-union segments of the economy, which constitute the majority of the workforce. This report focuses on changes in corporations that are not necessarily confined to any particular sector of the economy, and include globalizing and unionized sectors as well. These practices are widespread enough, in other words, to constitute general business doctrine and to have had a significant impact on *overall* inequality.

3) A third objective is more speculative: to raise questions about whether these new corporate practices were the only possible response to the economic turmoil of the 1970s and thereafter. If they were unnecessary, then the inequality that was created as a result of these new corporate practices was unnecessary as well.

4) A fourth and final objective is simply to provide the kind of background that has been lacking in most media accounts of the corporate scandals. How exactly did the stock market come to dictate the terms of corporate success and what does it have to do with rising inequality? What are mergers and acquisitions and why should someone who cares about inequality also care about them? Isn't deregulation primarily an issue of consumer and worker protection rather than of inequality? What was the "shareholder revolution" and how did it affect the economic security of workers? This report synthesizes a large and fragmented research literature on these topics in order to give at least a preliminary answer to some of these important questions.

Executive Summary

1) When considered as a whole, a new set of seemingly disparate corporate practices were likely to have had a significant impact on rising overall inequality in the United States.

The 1970s is widely considered a turning point in which business and government forged an alliance in favor of market-based solutions to a newly competitive environment. This alliance became solidified with the election of Ronald Reagan in 1980, but it was under formation in the 1970s and marked a clear breaking point with the politics of business and government in the early postwar period.

In the "old" corporate model, *equity norms* limited the distance in pay, benefits, and job quality between workers at the top and bottom of major U.S. corporations. Equity norms helped to minimize conflict and turnover and maximize effort and loyalty to the firm, which ultimately enhanced productivity. Although these practices took workers and unions years to build and solidify, once they were in place, they were no less popular than the current model is today. In fact, it was the "old" model that brought the U.S. to economic supremacy and the peak of industrial capitalism in the 1960s.

But the economic turmoil of the 1970s and the guiding light of free-market ideology ushered in a "new" corporate model. Whether in the form of mergers and acquisitions, skyrocketing executive compensation, new technology, or subcontracting, key economic actors—managers, boards of directors, investors, competitors, academic experts, and politicians—sought to fundamentally change the way firms conduct business, from top to bottom and side to side.

Corporations, then, ought be seen as the primary *conduit* through which some of the leading explanations of rising inequality, such as technological change and global competition, were translated into a redistribution of economic rewards from the bottom and middle of the corporate ladder to the top. Even given new technological and globalizing forces, corporations were forced to formulate *new* strategies in response—there were no precedents on which to rely. As important, features of the old model were identified as an *independent* cause of mismanagement and lagging performance at large firms, quite apart from technological and globalizing pressures. How employers responded and its impact on inequality is the primary focus of this report.

I discuss four such responses that facilitated the upward redistribution of income: two under the heading of corporate control (mergers and acquisitions and CEO compensation) and two under the heading of production strategy (technological re-engineering and subcontracting). Generally speaking, in the first set of changes (in corporate control), resources were redistributed upward to top management. In the second set of changes (in production strategy), resources were redistributed away from everyone else, particularly those at the bottom.

2) New corporate practices need to become a more central part of the discussion of how to reduce inequality.

Much has been made about the role of globalization and technology in fostering rising inequality. But these changes rocked countries around the world, without the same increase in inequality that occurred in the United States. Moreover, the United States has long had a higher degree of economic inequality than other advanced capitalist nations.[5] Why?

In answering this question, this report attempts a subtle but crucial shift in emphasis from big, seemingly inevitable economic changes—such as globalization and technology—to the distinctly market-based ways that American corporations responded to such changes. In doing so, corporations are transformed from black boxes to critical actors, and corporate reform takes its rightful seat along side a set of other, more commonly promoted forms of institutional change, such as increasing minimum wages, progressive taxation, and unionization. *Thus this report does not dispute the need for these other forms of institutional reform; it seeks only to offer an additional and neglected avenue of reform.*

3) These new corporate practices might not have been the only possible response to greater economic competition and uncertainty.

It is clear that corporations were faced with a new, more competitive and uncertain economic environment beginning in the early 1970s. This cannot be questioned. What can be questioned is the justification of any and all corporate action—eventually across profitable as well as troubled industries—as necessary for maintaining or improving competitiveness in the new economy. *Remarkably, such justifications were used even in the prosperous late 1990s as executive pay and corporate earnings grew dramatically.* Similar justifications have also been heard more recently for the off-shoring of new kinds of jobs by corporations whose profits were already healthy.

Although certain general shifts in business strategy can be identified in retrospect—for example, from acquiring firms in unrelated business sectors to focusing acquisitions in core niches, or from hiring workers directly into the firm to hiring them through temporary agencies—these general shifts were not natural solutions at the time they were first introduced, nor should their appropriateness be considered "timeless". Best practices only become so over time; they don't start out that way (even assuming that there is a single best practice rather than a range of equally-optimal practices or an ensemble of practices whose successful combination depend on particular contexts and conditions). Many crucial actors, so-called "first-movers", had an intentional strategy. But many others acted under a considerable cloud of uncertainty, following the advice of leading executives, directors, investors, and experts or feeling the pressure to do so.

It is important to see market ideology, therefore, as underlying a vast array of targeted *experiments* that eventually became standard business strategy in industry after industry, far exceeding justifications based on economic turmoil alone.[6] Implementation was and continues to be in fits and starts and of the two-steps-forward, one-step-back variety, but proceeds nonetheless.

Although we can never prove the "counterfactual"—that American businesses would have rebounded as quickly and as successfully if they followed a more equitable path—we can demystify the hegemony of the new American model by showing that it emerged more from a series of twists and turns in corporate strategy than from a set of tried-and-true economic principles. It gained ascendancy not only because it promised to be more efficient (because there were no guarantees that it would be) but because it aligned nicely with the interests of those who were making the decisions to restructure: executives and owners of capital.

4) The kind of background that has been lacking in most media accounts of the corporate scandals is necessary for fully understanding the origins and consequences of corporate restructuring.

Amid a new debate about off-shoring, and in post-Enron and post-technology bubble times, it is much easier to gain a hearing for the kind of analysis put forward in this report than it was before. While undoubtedly useful for this reason, corporate restructuring is a much larger issue with more serious consequences than even the much-needed scrutiny of accounting rules, mutual fund abuses, and CEO pay lets on. The focus of attention in the popular press and in political and regulatory circles continues to be aggrieved shareholders. Consequently we hear much less about the impact of excessive executive pay on declining wages at the bottom and even in the middle, or CEO fraud on the liquidation of pension assets.

This is especially troubling because shareholders—through institutional investors—had a big hand in creating many of today's corporate scandals. Institutional investors were critical players in the hostile takeover movement in the 1980s, which in turn led to the hiring of immensely powerful CEOs given a mandate to restructure at any cost. The costs were indeed high, and they were distributed to the advantage of top management and to the disadvantage not only of ordinary shareholders and pension recipients (eventually) but of employees.

While the mutual fund scandals are finally addressing the shortchanging of ordinary shareholders, there is no similar chorus of voices concerned about the shortchanging of employees. Simply put, mutual fund reform completely ignores the deeper conflict between shareholders and employees. While not necessarily at odds with each other, especially when employees *are* shareholders, currently shareholders and employees are at best loosely overlapping groups. Thus a focus on shareholders means a neglect of employees' interests in a fairer redistribution of the gains to restructuring.

In sum, the basic underlying terms of investor capitalism are still intact—that shareholder interests should rule—despite the fact that there is little evidence that shareholders are in a position to seriously evaluate or responsibly alter corporate strategy, beyond lending a seal of approval when fashionable but untested reforms are announced.[7]

Thus understanding the evolution of the new model will not only reveal the full extent of upward redistribution that took place and what it will take to reverse it; it will also lead us to a different understanding of how to curb the kinds of corporate abuses that have seriously compromised the integrity and viability of corporate America.

A Brief Review of Trends in Inequality

It is well known that income and wealth inequality have soared over the past thirty years. While much attention has focused on falling wages for those near the bottom of the economic ladder, equally dramatic has been the growing concentration of riches at the top. This section highlights this latter trend, which has obvious relevance to the central claim of this report that new corporate policies have facilitated the upward redistribution of income, resulting in a rise in overall inequality.

In a study of national income growth between 1961 and 1996, David Ellwood (2000) found that real national income per capita—the amount of income gained by each individual if total national income growth was distributed equally—grew by 35 percent between 1973 and 1996. In contrast, income for male wage and salary workers in the bottom two thirds of the income distribution declined. Prior to 1973, income per capita and median male earnings rose at about the same rate. This was a period of what Ellwood calls *shared prosperity*.

Since 1973, however, the growth in income has been concentrated primarily among two groups: (1) owners of capital (i.e., as measured by profits, rents, proprietor's income, and net interest) and (2) men and women in the top third of the distribution. The remaining share (some 17 percent) went to women in the bottom two thirds of the distribution, a result mainly of increased hours and experience, as was the case for the top third of women as well. Overall, Ellwood calls the latest period one of *divergent prosperity and decline*.[8]

But even more revealing are the results from a detailed study of pretax income reported to the IRS.[9] The winners appear to have been heavily concentrated at the very top—the top one percent. The share of national income growth gained by the top one percent began to rise sharply in the early 1970s and now stands at pre-World War II levels. Furthermore, income growth was driven mainly by growing wage income (and not capital or self employment income), suggesting the importance of shifts in compensation schemes for wage and salary workers. The sharp rise in CEO compensation including stock options also began to rise sharply in the late 1970s.

This "top-loaded" increase in income is not well accounted for by existing institutional explanations, such as declines in the minimum wage and in unionization, which affect the bottom half of the distribution. Nor is it fully consistent with a crisis of competitiveness brought on by globalization, which presumably requires across-the-board sacrifice, as in the downsizing of management.

Increases at the top are potentially consistent with a technology-induced increase in the demand for higher skills, but it is difficult to find conclusive evidence for this explanation because it is notoriously difficult to measure changes in productivity (brought on by technical change). Ellwood, for example, believes that everything hinges on better productivity data: “Perhaps low-skill workers really are not any more productive than they used to be. If so, the only hope for improving their wages is to improve their productivity. But if their productivity is rising, then all the benefits of that higher productivity seem to be going to other workers or to the firm’s owners, and then a very different set of solutions might be proposed.”[10]

However important, the scale (e.g., in the case of CEOs) and the concentration of the increases at the very tip of the income distribution do not suggest that technological change can ever be the entire story. Rather, the economists Piketty and Saez (the authors of the study using IRS data) pinpoint social norms around executive pay: “The marginal product of top executives in large corporations is notoriously difficult to estimate, and executive pay is probably determined to a significant degree by herd behavior. Changing social norms regarding inequality and the acceptability of very high wages might partly explain the rise in U.S. top wage shares observed since the 1970s.”[11] Though once thought of as “irredeemably fuzzy-minded” by economists, Paul Krugman agrees that shifts in social norms must now be taken seriously.[12]

Both the technology and social norms stories are difficult to document. Much has been written on the former. This report examines the latter.

Prelude to the Inequality Economy: Equity Norms in the Old Model

The past three decades have witnessed sweeping changes in how corporations operate. In roughly chronological order, this and the next two sections describe the evolution of a new, more market-based set of corporate practices—all justified as a response to the economic crises of the 1970s and rising competitive pressures. I first briefly describe the "old" corporate model, which was marked by strong equity norms and a social compact between employers and workers. Next, I describe the crucial transition of the 1970s. Finally, I describe key elements of the "new" corporate model, including changes in the organizational structure of the firm (e.g., CEO compensation and mergers and acquisitions) and in the production strategy of the firm (e.g., subcontracting and new technologies). Each section incorporates an analysis of the consequences of such changes for increasing inequality among workers.

THE OLD MODEL

The model against which current corporate behavior is compared—and not favorably, at least in terms of inequality—developed over the course of the twentieth century. For our purposes here, federal legislation during the New Deal era and World War II, which significantly improved the working conditions of workers, is less important than how the structure of the firm developed in response to changing economic conditions and increasing worker rights. In particular, two interrelated aspects of firm structure are central: (1) *internal labor markets*, which provided opportunities for advancement within the same firm, and (2) *equity norms*, which limited pay and benefits gaps among workers within the same firm. These were integral aspects of the *social compact* between managers and workers, in which managers provided security in exchange for cooperation.

Labor markets internal to the firm were an outgrowth of the development of mass production industries. As the scale of production and cost of production technology grew in the late 19th century, so did the size of the modern corporation (and, parenthetically, so did the number of owners through the development of the stock market). Ironically, from our perspective today, corporations grew in size because they brought more and more of their operations under one roof by fully *internalizing* pieces of the production process that had previously been performed by suppliers and contractors. They did this in order to better stabilize, control, and coordinate the inputs and outputs of the increasingly elaborate production process. Workers were one such input that needed to be kept under stricter control now that they would be operating expensive machinery requiring specialized skills. These skills could only be learned on the job, and so a more extensive system of supervision was needed to train workers as well as to standardize and coordinate the increasingly far-flung production process.

Fueled by the virtuous circle of higher productivity, lower prices, and increasing wages, the mass production era of mass consumption and mass marketing was firmly established by the end of WWII. The production process and the system of coordination and control it required grew in tandem. Production and managerial job hierarchies proliferated. Promotion and seniority became the incentives given to managers and production workers to maintain high levels of loyalty, effort and productivity, especially during periods of labor shortage (e.g., during and after WWII).

For managers, Peter Cappelli provides an excellent description of the maturation of this system in the postwar years:

> The gentleman's agreement of lifetime security in return for loyalty and adequate performance that governed executives in the early years of American business now applied to a much larger group of managers, and it was possible in these large, integrated organizations to think of an entire career made up of increasingly important jobs within the same firm. The prospect of lifetime careers in a managerial hierarchy helped produce a workplace culture and a set of management practices in corporations that we now think of as being the norm, and the contemporary challenges are seen as revolutionary.[13]

Further, the "company man" implied in this passage was one who denied aspirations for individual glory and absorbed the norms and values of the corporation. The greater security of the large corporation was highly sought after in post-Depression and postwar America. It contrasts sharply with the entrepreneurial spirit of an earlier age or of today.

For production workers, the transition to a more stable and secure employment situation developed over a long period of violence and conflict. Employers had no interest in relinquishing control over any part of their operations but eventually were forced to do so by the labor movement and the collective bargaining rights that they secured through federal legislation in the 1930s and later. Large, profitable, non-union firms often adopted the same employment policies as a union avoidance strategy. For both union and non-union firms in core mass production industries, this involved moving from a piece-rate system fluctuating with demand to an hourly wage system with routine pay raises based on cost-of-living adjustments and seniority, opportunities for additional training and advancement, and employer-provided pension and health benefits. In these ways, large employers functioned as a sort of "private" welfare state to those fortunate enough to be employed by them.

IMPACT ON INEQUALITY

This story is necessarily an overly brief and simplified one, but the important point is that a different model of organizing corporations—at least large, high-growth, and profitable corporations—prevailed during the most consistently productive years of economic growth in American history. The interests of employers in stability were joined with the interests of workers in security. Whether the model enabled growth or the other way around, the *social compact* it enabled between workers and employers was considered "best practice" employment policy for the most respected corporations in the country.

Especially in retrospect, the benefits of the American compact to a large and influential group of core-sector workers were clear: gains from productivity were shared with workers, which limited gaps in pay among managers and workers; layoffs were temporary and for economic reasons only; and expansions were to result in more opportunities for promotion and advancement up the corporate hierarchy. Top employers relied on these practices to secure good reputations and lure top recruits. In all these respects and more, *equity norms* were firmly ensconced in American corporations up until quite recently.

Before moving on, it is important to understand that this model was by no means extreme in its non-market (i.e., firm-based) and redistributive (toward workers) orientation. At its height in the 1960s and 1970s, the American system of training and security paled in comparison to the highly touted Japanese model of lifetime employment and the German model of apprenticeship training (in both cases, mainly for the predominantly male core-sector workforce). Moreover, the underlying foundation of the social compact between American employers and workers was riddled with tensions and lack of trust. Particularly in times of labor shortage or labor surplus, employers or labor would gain the upper hand and demand concessions. In retrospect, then, the "old" model is a more equitable one, but it did not always seem that way, particularly in comparison to more equitable systems abroad.

The Beginning of the Transition: The 1970s and Deregulation

The old mass production model began to unravel in the 1970s. Many have suggested that what replaced it was not entirely novel but reminiscent of an earlier, more competitive and market-based model that relied on outsourcing and subcontracting to a much greater extent.[14] According to this view, the postwar decades were an aberration in which worldwide economic dominance and an expanding economic pie insulated businesses from the short-term vagaries of the market and permitted an unusual degree of profit-sharing with workers.

An expanding pie also permitted a range of redistributive and regulatory policies to be pursued by the federal government. These included a progressive tax system, social programs for the needy, and, importantly for our purposes, social regulation of the environment, workplace, and consumer markets (e.g., through the National Environmental Policy Act of 1969, the Clean Air Act of 1970, the Occupational Safety and Health Act of 1970, the Consumer Product Safety Act of 1972, etc.).

Once economic growth began to slow in the 1970s, both business and federal policy returned to their more typical, long-term affinities for market-based solutions to both economic and social problems. The past thirty years constitutes the long and tangled, but nevertheless successful, movement to do so.

Whether one sees the 1970s as an entirely new era or a return to the principles of a previous one, it is widely considered a turning point in which business and government forged an alliance in favor of market-based ideologies and solutions, beginning with deregulation. This alliance became solidified with the election of Ronald Reagan in 1980, but it was under formation in the 1970s and marked a clear breaking point with the politics of business and government in the 1950s, 1960s, and early 1970s.

NEW CONDITIONS

Several factors set the stage for this transformation, creating an environment of instability where there had been little before—again, at least not for the core sectors of the economy. If we rely simply on the most impressionistic issues of the day, they would tell a large part of the story: inflation, unemployment, taxes, earnings and productivity.

- First, due in large part to large outlays for the Vietnam War and to the oil price shock of 1973, the average rate of inflation per year rose from less than 2 percent during the early 1960s to roughly 5 percent during the late 1960s, 7 percent during the early 1970s and close to 10 percent during the late 1970s. Wages for workers covered by automatic cost-of-living-adjustment clauses rose in step, exacerbating inflationary pressures, even though overall average wages for non-supervisory workers began to decline for the first time in the postwar period.

- Second, there were recessions in 1970, 1974, and 1980, with the unemployment rate never returning anywhere close to its pre-recessionary low of 3.9 percent during any of the short-lived upswings. As we now know, unemployment never returned to 3.9 percent until the final years of the great 1990s expansion.
- Third, inflationary pressures sent families with even modest incomes into higher and higher tax brackets as never before, resulting in "tax bracket creep" for increasing numbers of families, as well as for the rich. This was true for property taxes as well (e.g., sparking the property tax revolt in California with Proposition 13 in 1978).
- Finally, productivity growth came to a virtual halt in 1980, after posting growth rate declines beginning in the late 1960s. The rate of output growth also steadily declined and neither rate would return to its postwar annual yearly levels until the late 1990s.

Writing in 1984 about the 1970s, Thomas Byrne Edsall aptly captured the popular sentiment of the decade: "The issues of inflation, tax rates, and productivity had reached—by any standard, conservative or liberal—a critical point at which the likelihood of a substantial change in the direction of economic policy became a realizable goal".[15]

Below the surface of stagflation, businesses were facing mounting pressures from a number of sources that were at the root of the slowdown in growth, productivity, and ultimately profits.[16] First were a set of interrelated factors having to do with trade, including (1) increased international competition from both industrial countries (i.e., Japan and Germany) and industrializing countries, and (2) "saturation" or the decline in the growth of mass consumer markets for U.S. products, both in other countries and in the United States.

Another crucial set of factors concerns the business strategy of American corporations in the context of dominant market share and stable demand. Focusing on long-term growth instead of short-term stock market value, top-level managers sought acquisitions and mergers in unrelated product lines as a way to grow without violating antitrust laws, which at the time were strictly enforced to limit both horizontal acquisitions (of competitors) and vertical acquisitions (of suppliers and/or customers). Acquisitions were also justified by the argument that it was more efficient to allocate capital and managerial expertise across divisions within the firm than across firms within the broader market. A final motivation for acquisitions was that managerial compensation was tied to firm size and accounting profitability.[17] In sum, the focus on expansion and avoidance of downsizing led to the "conglomeration" wave of mergers and acquisitions in the 1960s.

It is debatable whether this form of conglomeration is inherently inefficient (e.g., General Electric is a good counterexample) or only became so under the particular conditions of the 1970s. No one disputes, however, that the conglomeration wave became a *symbol* of managerial inefficiency against which a wave of shareholder-initiated "de-diversification" would be pitched in the 1980s and 1990s (and which is discussed in detail in a later section).

BUSINESS RESPONSE: UNION BUSTING AND DEREGULATION

Businesses responded in a number of ways to this new environment. Primarily, large employers sought to contain labor costs and reverse government regulations. Other responses, such as mergers and acquisitions oriented toward de-diversification, did not come until the 1980s. Although subcontracting began in the 1970s as well, it was not as concerted and organized an effort as union busting and deregulation. Because de-unionization has been considered extensively in previous work on inequality, I discuss it only briefly here before focusing on deregulation in the rest of the section.

In terms of the drive to contain costs, evidence is best on employers' assault on unions. Despite the fact that the economy was slowing, the union/non-union wage differential grew substantially during the 1970s because of inflation-boosted cost-of-living-adjustments (COLAs) set in place in more prosperous times. In reaction, employers mobilized: they expanded operations in non-union locations more than in unionized locations; they fought union certification elections with more gusto and more success than in earlier periods; they formed the Business Roundtable in 1972 to legislatively curtail the power of unions; they successfully and surprisingly fought major pro-labor law and pro-consumer protection legislation in the late 1970s; they took advantage of new entrants to the workforce that were traditionally less organized, such as women and immigrants; and they created new human resource departments and policies that sought to improve working conditions in non-union workplaces as a way to thwart interest in unions.[18] Corporate political action committees also ramped up considerably over the course of the decade, overwhelmingly favoring Republicans by the end of the decade.

Meanwhile, unions, the strongest interest group supporting policies of broad interest to workers, were losing power. Membership steadily declined from its peak in the mid-1950s (at 35 percent of the private sector as compared to 24 percent of all public and private workers in 1973) and newly empowered corporations were increasingly likely to trump labor in the struggle to deliver election victories to Democrats.

Deregulation was the second major business response to the new environment.[19] The long shadow of deregulation was first cast in the 1960s and then intensified in the 1970s. For example, in communications, the Federal Communications Commission ruled on many cases involving competitors seeking entry with new technologies in the 1960s and 1970s, well before the breakup of AT&T in 1982; in finance, "the U.S. financial revolution took on full force in 1975" when the Securities and Exchange Commission forced the NYSE to allow discount brokerage houses to earn commissions on stocks listed with the NYSE; and, in transportation, "deregulation of the airline industry began in 1974 when the Civil Aeronautics Board first encouraged experiments with discount fares."[20]

Although I emphasize the role of investors in igniting corporate-level restructuring in other sections of this report, other actors proved equally influential in challenging regulation.[21] First, conservative economists, think-tanks and foundations, such as the Heritage Foundation and the American Enterprise Institute, either got their start or were rejuvenated in the 1970s largely on issues related to cutting taxes on capital and eliminating government regulations. Economist Clifford Winston, for example, appears to agree with the assessment of political scientists Martha Derthick and Paul Quirk (1985) that deregulation "would never have occurred if economists—especially microeconomists—had not generally supported it through their research".[22]

Second, competitors were especially active in challenging regulated monopolies that prevented them from entering the market with new and better technologies (e.g., in telecommunications and financial services). Third, consumer movements were active where prices were inflated by monopolies, creating a liberal flank in support of deregulation (e.g., in airlines, telecommunications, and energy). Finally, investors were active where declining industries, which still enjoyed high rents because of regulation, had no incentive to modernize and invest in new technologies (e.g., oil).

While the argument for deregulation put forward by economists, consumer advocates, and competitors was similar—to reduce monopolistic inefficiencies and increase competitive pressures, for both private and public gain—the particular actors and rationales varied significantly by industry. High, monopolistic prices and technological pressures to break down barriers to entry are certainly common themes, but over the decades restructuring followed markedly different paths, breaking apart monopolies in some cases (phone service) and merging them "synergistically" in other cases (finance/insurance/brokerage and broadcasting/entertainment).

IMPACT ON INEQUALITY

The triumph of deregulation is an important part of the inequality story for several reasons.

First, deregulation was the prototype of a market-oriented response to the crisis that was consistent in theme, widely influential, and yet fundamentally experimental in application. Proponents of deregulation stepped into the vacuum created by economic turmoil, but they were guided by theory and ideology, not a set of tried and true models of successful business strategy.

Nevertheless, deregulation was widely believed by the press, politicians, and selected economists to increase overall consumer welfare even though major deregulatory failures were to follow—in such catastrophic cases as the savings and loans industry, the energy industry, and the accounting industry. These failures did provoke backlash against corporate abuses of deregulation, but the question has become "how" to deregulate rather than "whether" to deregulate. Failures could even prompt re-regulation, especially given the extremely decentralized and legalistic approach to regulation that we have in the United States, but these concessions are considered minor within the overall framework of deregulation.

Second, because deregulation became so acceptable and widespread, it altered employment conditions in large sectors of the economy, including transportation, telecommunications, banking, and utilities. In particular, to the extent that deregulation reduced the rents accruing to regulated industries, it reduced the extent of rent-sharing with workers. Real wages declined disproportionately for workers in several deregulated industries in the post-regulation period, even for workers in non-unionized industries such as banking. Moreover, levels of inequality increased within at least one of them—telecommunications—the only one to have been studied specifically in terms of its impact on inequality. As of yet, these changes in wages and inequality have not been shown to be large enough in and of themselves to have contributed substantially to the overall rise in inequality, but there's been little research on this subject and no research that links deregulation's impact across disparate industries or to that of related forms of corporate restructuring.[23]

Finally, as we shall soon see, deregulation prompted other key forms of corporate restructuring that are linked to rising inequality, such as mergers and acquisitions and technological re-engineering.

The New Model

Although the roots of a new business strategy lay in the late 1960s and 1970s, and businesses made some changes immediately, such as busting unions and deregulating industries, corporate restructuring did not gain real momentum until the 1980s and did not become thoroughly routine and essentially unquestioned until the late 1990s.

To understand the new model, it is useful to think about changes as having occurred in two principal areas: the control structure and production strategy of the firm. The control structure of a firm refers simply to who makes the major decisions in the corporation—top management, the board of directors, the shareholders, the banks, etc. The production strategy refers to the way a firm produces its goods and/or services—does it produce low-cost, mass-produced items or high-cost, custom-made items? Does it produce goods across a wide range of unrelated industries or specialize in a niche market segment?

From these two vantage points, then, firms changed in two significant ways: (1) they shifted control from managers and manager-controlled boards of directors to powerful CEOs (theoretically) aligned with shareholders and other owners,[24] and (2) they shifted from an in-sourced, rigidly organized system of mass production to a more out-sourced, flexibly organized system of customized production based on newer and more versatile technologies. Oftentimes these changes were meant to go hand-in-hand. As a response to more competitive markets and lagging performance, activist shareholders lobbied for new CEOs to radically re-engineer the firm's production strategy. Stock market analysts and investors tended to take top-to-bottom restructurings of this sort more seriously than restructurings limited to job or division cutting.[25] It is important to keep in mind, however, that rhetoric often exceeded reality. Change has been both groundbreaking and exaggerated, with a lot of variation in between.

I will discuss four major changes, two under the heading of corporate control (mergers and acquisitions and CEO compensation) and two under the heading of production strategy (flexible specialization and subcontracting). In terms of the discussion of inequality, the first set of changes in corporate control represent the process by which resources were redistributed upward to executives whereas the second set of changes in production strategy represent the process by which resources were redistributed away from everyone else, particularly those at the bottom.

Part I. Changes in Corporate Control: Mergers and Acquisitions and CEO Pay

Although it may be hard to appreciate from our vantage point today, mergers and acquisitions are not normally considered a routine part of business. Indeed, they can be "quite extraordinary events".[26] Citing the latest year of statistics on valuations of mergers and acquisitions available at the time, economist Hal Varian (1988) asked why "merger mania" had occurred so suddenly in the early 1980s.[27] He relied on data up to 1984 and missed the even larger spike in merger activity that occurred in the mid-1980s and then again in the 1990s.[28] Compared to both the 1980s/1990s and the 1960s, merger activity was down in the 1970s. While that makes the 1970s look like the exception, the other major periods of merger activity took place way back in the late 19th century and in the 1920s. Moreover, the type, scale, and industry concentration of mergers varies significantly across all the periods. Merger activity is therefore typically characterized in terms of distinct (and, until recently, infrequent) "waves".

In addition to the various factors that arose in the 1970s, three factors unique to the 1980s facilitated the 1980s wave: (1) lax antitrust enforcement under Reagan, which permitted mergers in related industries, (2) the microelectronics revolution, and (3) investor activism. In one sense, the first two factors suggest that the 1980s were simply an acceleration of the growing market orientation of public policy and the development of computer and information technologies, to which I will return later. But in another sense, the third factor, investor activism, adds a crucial new dimension. It's not that experimentation with financial instruments prior to the 1980s was unheard of; top management had become increasingly under the control of financial experts throughout the postwar period.[29] Rather, at the behest of outside investors and corporate raiders, the financial orientation of large firms became more focused on creating stock market value rather than accounting value. Accounting value remained important, of course, but it was increasingly subordinated to, and used in service of, stock market value.

Why did this transformation take place? There are two interrelated reasons: the rise of institutional investors and the temporary weakness of the stock market. In the 1970s, the growing size of pension funds fueled the expansion and concentration of the stock market at the same time that the stock market was undervalued and firms were undercapitalized relative to assets.[30] This ratcheted up the need for financial experimentation because large mutual and pension funds found that their investment shares were too large to be withdrawn from underperforming companies. Even if buyers could be found, severe disruptions in the market and in the sector could result. In addition, large mutual and pension funds usually contained stipulations to invest in certain kinds of stocks (i.e., "indexing" to the S&P 500), many of which were equally unattractive.

In response, and virtually without precedent, investors resorted to external governance mechanisms to influence both the structure and strategy of firms. Investors fomented more adversarial relations between management, boards of directors, and shareholders with the ultimate aim of making both managers and boards more accountable to owners. Investors also teamed up with corporate raiders using new financial instruments such as junk bonds and other forms of highly debt-leveraged financing (i.e., bonds and loans) to issue external threats and takeovers. Remarkably, nearly half of all major U.S. corporations received a takeover bid in the 1980s.[31] Whereas competitors, consumers, and academic experts were the main actors pushing for deregulation, investors (both large institutional investors and investment bankers/managers) were the main drivers behind "merger mania" in the 1980s.

Initially, managers resisted external pressures that threatened their managerial philosophy as well as their jobs. The Business Roundtable, having defeated major labor legislation in the late 1970s, turned its attention in the mid-to-late 1980s to legislation at both the federal and state levels that would make hostile takeovers illegal. By the end of the 1980s, over forty states had implemented some form of anti-takeover legislation.[32] In addition, managers and boards of directors implemented "poison pill" policies that increased the cost of a takeover bid by, for example, providing a stock discount to pre-takeover shareholders.

The level of hostility eventually changed over the course of the 1980s and 1990s. Hostility subsided as competitive pressures continued and the "de-diversification" solution to such pressures became the sole solution demanded by the market. In particular, firms were to acquire other firms in line with their "core competencies" (however that was determined) and sell off divisions that weren't.[33] In such an environment of emergent orthodoxy, the range of possibilities actually expanded for incumbent managers and boards to partake in the merger windfall. For example, in some cases managers pre-empted takeovers and initiated their own restructurings. In other cases they teamed up with investor groups, bought all publicly owned shares, and took the company private, otherwise known as a leveraged buy-out (LBO). As is well known now, CEOs were offered extraordinary retirement packages or "golden parachutes" in the event of forced resignation, and stock options became a regular part of CEO compensation packages.[34] To reinforce the message that restructuring was necessary, dismissal rates of CEOs shot up significantly during the late 1980s and then again in the early 1990s.[35]

Such incentives theoretically aligned the interests of managers with those of shareholders in taking the necessary steps and risks—downsizings of divisions and employees—to increase the stock market value of the firm (as long as the doling out of stock options did not go so far as to dilute the power of large shareholders, something that would become an issue as the "options" option multiplied).[36] So-called "change agents"—independent and outsider CEOs, with compensation tied to stock performance rather than to growth—were forced upon corporations by external investors and shareholders concerned about lagging stock market returns.[37] Seen in this light, *the issue of exorbitant CEO compensation was actually the stepchild of the shareholder revolution*. Although the extraordinary compensation and power of CEO's at such places as Enron and WorldCom is typically blamed on the cozy relationships they had with their hand-picked boards of directors, CEO/board relationships have *always* been accused of being too cozy. Ironically, current arrangements were put in place beginning in the 1980s as a way to *minimize* the coziness factor.

But although managers had been converted and hostilities between investors and top managers had declined by the early 1990s, the public continued to be disapproving. The recession of the early 1990s and the subsequent jobless recovery, laced with highly publicized downsizings, kept the heat on executives. According to economist Kevin J. Murphy:

> The CEO pay debate achieved international prominence in the early 1990s. The controversy heightened with the November 1991 introduction of Graef Crystal's expose on CEO pay, *In Search of Excess*, and exploded following President George Bush's ill-time pilgrimage to Japan in January 1992, accompanied by an entourage of highly paid US executives. What was meant to be a plea for Japanese trade concessions dissolved into accusations that US competitiveness was hindered by its excessive executive compensation practices as attention focused on the "huge pay disparities between top executives in the two countries" (Murphy 1997:418).

Much legislative activity also swirled around the issue of CEO pay in the early 1990s (see my later section on public policy options).

It was not until the upswing in the late 1990s that CEOs emerged as heroes and celebrities of the new economy.[38] Grand entrances and exits were intimately tied up with the merger process, which reached extraordinary levels. Merger activity amounted to some 15 percent of GDP in 1998, compared with a high of 4-5 percent in the 1980s, and a long-term average of 2-3 percent. The industry concentration of merger activity also changed from the 1980s to the 1990s, reflecting not only the influence of ongoing external shocks (e.g., technology and international competition) and the emerging orthodoxy of the merger solution, but the role of deregulation and other public policy changes.

In particular, companies were increasingly merging with or acquiring other companies in their own industries, eventually accounting for nearly half of all such transactions in the 1990s.[39] Among the top five industries involved in merger activity in the 1980s are oil and gas and non-depository credit, key industries undergoing deregulation. The other three industries fell victim to unfavorable trade conditions and increasing automation: textile, miscellaneous manufacturing and food. Again in the 1990s, two newly deregulated industries appeared in the top five: media and telecommunications and banking. But this time only one of the five was a casualty of trade competition (metal mining).

In short, while declining industries with excess capacity were clearly vulnerable and became the poster child of "lean and mean" restructurings, especially in the 1980s, the big players in the 1990s were in industries that were expanding and converging as a result of new technologies and newly lowered barriers to entry, such as media/telecommunications and banking. In fact, economists Andrade et al. (2001:104) characterize the 1990s wave as the "decade of deregulation". In their estimates, deregulation explains nearly half of all mergers and acquisitions in the 1990s, compared to less than half that in the 1980s.

The hand of public policy in facilitating expansionary mergers was also evident in the relaxation of antitrust enforcement beginning with Reagan, who reversed Nixon's policy in the early 1970s of slapping large conglomerates with antitrust lawsuits. Merger activity, then, was intimately related not only to executive pay but to deregulation and other federal policies that limited public oversight and governance of the market.

IMPACT ON INEQUALITY

Like deregulation, and perhaps even more so, mergers and acquisitions are an integral part of the inequality story.

First, mergers and acquisitions represent a major market-oriented response to the crisis that was consistent in theme, widely influential, and yet fundamentally experimental in application. Although the recent waves were initially concentrated in troubled and declining industries, and in poorly performing conglomerates, the idea of mergers and acquisitions (or the threat of mergers and acquisitions) as a tool to impose greater market discipline on inefficient firms eventually became orthodoxy, spreading to industries outside initially targeted industries.[40] Thus began the reign of investor and shareholder capitalism, a reign that even today has not been clearly linked with improvements in performance.[41]

Second, given the extent and significance of the shareholder revolution, its direct and indirect impact on overall inequality cannot be underestimated. Enormous resources went into and continue to go into M&A activity. And immensely powerful CEOs were given lucrative mandates to restructure. Such investor-style restructurings had a very particular distributional character, in which resources were redistributed to the advantage of top managers and to the disadvantage *not only of ordinary shareholders but of employees*. While employees and shareholders do not necessarily have to be at odds with each other, especially when employees *are* shareholders, currently shareholders and employees are at best loosely overlapping groups. Thus a focus on shareholders can mean, and has meant in the past, a neglect of employees' rights to a fairer redistribution of the gains of restructuring. Even today, relative to the chorus of sympathy for aggrieved shareholders, we hear little about the impact of excessive executive pay and mergers and acquisitions on declining wages and increasing inequality.

Certainly the massive increase in the "executive pay gap"—the gap between the compensation of the CEO and that of the average worker—has been well publicized. The gap is nearly ten times as high today as it was in the 1970s and early 1980s, climbing from roughly 40-to-1 to over 400-to-1.[42] Moreover, the increases occurred during the 1980s as well as the 1990s, underscoring the importance of reforms that took place *before* the stock market boom of the 1990s.

Perhaps even more important for understanding how resources are redistributed from the bottom and middle to the top, is the little remarked upon *shift towards sharing leadership responsibilities (and thus rewards) among a larger number of top-level managers*. According to Gerald Davis and Michael Useem, "a central thrust of company restructuring during the past two decades has been to transform the chief executive's office into the office of the executive…many companies have expanded the concept of top management to include one, two, or even three hundred senior managers whose decisions have significant bearing on firm performance…predictably, stock analysts and professional investors frequently came to appraise not only the capabilities of the chief but also the lieutenants before they recommend stock or buy shares".[43]

In sum, as we will see again in other areas, the story of rising overall inequality is not simply one about rising rewards at the top and declining rewards at the bottom, as indicated by the soaring executive pay gap. It is also fundamentally about rising disparities *among* individuals within the same occupation. The upper echelon of managers has grown increasingly distant in terms of both compensation and status from the lower and even middle echelons of managers (i.e., the "downsized" class of managers). While select teams at the top share all the rewards (even where performance is lagging), teams at the bottom and in the middle (including other managers and professionals) share all the sacrifices. This is the unfortunate reality of the team concept in corporate America today.

Part II. Changes in Production Strategy: Technology and Subcontracting

To get a better handle of what happened to employees throughout the corporation, and not just at the top, we need to look far beyond changes in corporate control. In order to satisfy shareholders and pay off debt, changes were taking place up and down the corporate hierarchy. What was happening at the top was only a starting point for what was intended to reverberate throughout the firm and throughout the economy. Even if a firm was not part of a merger deal, or even if it was profitable, it could not evade the pervasive pressure to restructure. Other forms of restructuring, besides in the arena of corporate control, were a response not only to the demand for increased shareholder value, but to the need for fundamental transformations in the way goods and services are produced and marketed.

Although issues of corporate control have grabbed the spotlight for the moment, these other aspects of corporate restructuring—technological change and subcontracting (or, more popularly, "downsizing")[44]—have both had their day in the sun. Indeed, in the ever changing world of global capitalism, "white-collar outsourcing" has gained new attention as a possible cause of the jobless recovery. However, outsourcing in this case refers to outsourcing of services, even professional services, primarily to India, whereas in earlier incarnations, outsourcing referred to subcontracting domestically, which I explore here, and to moving manufacturing production overseas. The common denominator is the transfer of secure jobs in high-wage firms to less secure and lower wage locations.

NEW TECHNOLOGIES

This finally is where the issue of technology—often considered the leading cause of rising inequality—becomes central, although not in the usual way. Corporations had choices in how they deployed new technologies, and these choices had consequences for inequality.

Technological changes have been transforming how goods and services are produced for centuries, but much has changed in recent decades. In particular, the possibility that new technologies could be skill-enhancing rather than simply skill-replacing has grown dramatically. This is not only because of the advancement of technology itself—becoming smaller and more sophisticated—but because of the wider accessibility and application of technology to jobs up and down the occupational hierarchy. Computer technologies have the potential to upgrade factory and clerical jobs as well as computer programmer and financial analyst jobs.

This kind of widespread skill-enhancing potential prompted a debate over the choices that corporations have in introducing new technologies. Do they introduce technologies in ways that automate and routinize jobs, and thus lower skill and wage levels? Or do they introduce technologies in ways that automate the *routine* aspects of jobs while enabling the *non-routine* aspects of jobs, thus lifting skill and wage levels?

The former strategy has become known as the "low road" and the latter as the "high road". The low road uses technology that deskills and automates jobs to mass-produce a small number of standardized products (e.g., checking accounts or local phone service). This allows firms to compete on the basis of lower cost. The high road uses technology that upgrades and expands jobs to custom-produce a large number of specialized products (e.g., home equity loans or cable modems). This allows firms to compete on the basis of higher quality and rapidly changing consumer tastes. To the extent that firms can choose between the two or some mix of the two, they also choose between a low-skill/low-wage strategy and a high-skill/high-wage strategy.

But this is not the only choice that firms must make when it comes to introducing new technologies. Even if skill-enhancing technologies are introduced, a key question is *how* they are introduced; in particular, whether they *require* the substitution of more educated workers for less educated workers (e.g., engineers for assembly-line workers, financial advisors for tellers), or whether there is more latitude in the educational requirements of technology use.

If the relationship between technology and education is more or less fixed, in the sense that technology *X* requires a college education to get the most of it, this would explain the increased wage premium for college-educated workers over the past couple decades. However, if the relationship between technology and education is not as determinate, then less-educated workers might be able to benefit from the technology revolution as well. It should be clear that this is not a question of whether technology has, overall, been upskilling—all the evidence points to a steady, long-term increase in skills and skill requirements spanning many decades. Rather, it is a question of how to measure such skills (is years of education the only way?) and how to develop and compensate such skills in a way that maximizes the technology's productive value.

There has been much trial and error and little systematic (though painstaking) research on the best way to deploy new technologies, but the variation indicates that exactly how workers are trained and how work is redesigned are key factors in how much new technologies contribute to increases in productivity, as well as a fair distribution of the gains from increases in productivity.

On the whole, research shows that workers in high road workplaces benefit from new technology in terms of more cognitively demanding jobs, better working conditions and higher wages.[45] However, the benefits extend above and beyond what one would expect from years of education alone (and employers do tend to hire workers with greater years of education in higher tech jobs).

Crucially, either this reflects greater ability on the part of more educated workers *or* the training and responsibility that *firms invest in them*. In the former case, the arrow goes from worker to wages; in the latter case, the arrow goes from firms to workers. How one interprets the direction of the arrow is of great consequence. If it is a matter of training and not years of education, then firms, and perhaps high-end clients, have indulged a preference for college-educated workers beyond what is required by technology and transaction costs (e.g., relying on a college degree as a "signal" for higher ability). In excluding less formally educated workers from the benefits of new technologies in this way, the inequality-producing aspects of technology must be seen as more social in nature than economic.

The telecommunications industry provides an illustration of exactly how decisions around the deployment of new technologies can lead to greater inequality. Rosemary Batt describes how the new telecommunications technologies resulted in a proliferation of new product lines and consumer groups: "the shift from mechanical to digital systems has led to the proliferation of voice, video, data, and Internet services, but consumer groups vary substantially in their demand for these products" (Batt 2001:428). The workforce grew more segmented as high-end customers demanding high-end products were serviced by high-end/high-wage employees, whereas low-end customers were serviced by low-end/low-wage employees. Overall, this created greater wage dispersion among workers within the industry.

The key question is: to what extent is the decision to segment workers and wages along product and customer lines strictly required by the technology? If it is, to what extent can career ladders between high and low segments make up for the resulting increase in inequality? Case studies have suggested that despite the tendency for new technologies to upgrade the skills of some workers more than others, the degree to which both wage inequality and job insecurity increase can be minimized by employers who choose to do so.[46]

SUBCONTRACTING

The buzzword "flexibility" has yet to be raised, but it is useful in thinking about the connection between the two main changes in production strategy that firms undertook in response to lagging performance and increasing competition—adopting new technologies and subcontracting workers and services, which first occurred "on-shore" in the 1970s but is gaining renewed attention now that it is occurring "off-shore." As we have already seen, new technologies expand the "functional" flexibility of a firm by permitting it to produce a wider range of products and services. By contrast, subcontracting expands the "numerical" flexibility of a firm by making it easier to alter the size and cost of the work force, especially in response to temporary or unpredictable changes in demand and particularly for firms that want to rid themselves of "long-term employment, no layoffs, and a social-welfare ethos".[47]

In such firms, contracts with employees hired by the firm are costlier and harder to break than contracts with external firms. Workers hired by the firm expect benefits and job-security contracts commensurate with other workers in the firm and wages commensurate with the overall pay structure of the firm. In practice, this entails an equivalent benefits package for all workers, a reasonable or "fair" pay gap between low-skilled and high-skilled workers, and the same wages for workers in the same occupations.[48] Recall that these *equity norms* were central features of the old model.

If employers thought these features were burdensome in the 1950s and 1960s, they were even more likely to think so in the 1970s (underlining once again the importance of that decade). Employee rights to pension benefits and against job dismissal were strengthened in Congress and in the courts in three major ways. First, the Employee Retirement Income Security Act (ERISA) was passed in 1974, requiring equivalent investments in benefits packages for all full-time workers of the same firm. Second, anti-discrimination law made it potentially more costly to dismiss anyone who could charge discrimination on the basis of gender, race, color, creed, or age. Age was particularly an issue in the event of a large-scale layoff in which firms preferred to dismiss older, more costly workers. Finally, a number of highly publicized judicial decisions in the 1970s led to the erosion of the "employment-at-will" doctrine, in which employers under common law have the right to fire employees for any reason, at any time. Employers were found guilty of breaking "implicit contracts" with employees to whom they had given verbal assurances of employment and then abruptly terminated.

The option of subcontracting gave employers room to maneuver around all this. From their perspective, it is one thing to reward high-skilled workers if they possess firm-specific knowledge and perform tasks "essential" to the firm (e.g., product designers), but it is quite another to do so for low-skilled workers. Good benefits packages and high wages are often required to retain high-skilled workers. Low-skilled workers, however, typically possess general knowledge and perform tasks considered "nonessential" to the firm (e.g., janitors). Benefits packages and wages for such workers will often exceed the costs charged by an external provider. In the words of an early observer of the temporary help industry:

> [m]any employers carefully select a core groups of employees, invest in them, and take elaborate measures to reduce their turnover and maintain their attachment to the firm. Many of these same employers, however, also maintain a peripheral group of employees from whom they prefer to remain relatively detached, even at the cost of high turnover, and to whom they make few commitments.[49]

This core-periphery theme is a standard one and has many variants beyond subcontracting—one being the high-end/low-end product segmentation that resulted in high-end/low-end sales personnel that Batt described in the telecommunications industry. The subcontracting variant adopted in recent years in the U.S. is more akin to the Japanese model, in which there is lifetime employment for the core workforce (mainly men) and part-time employment for the buffer workforce (mainly women), although the core workforce in the US was never as secure as it was in Japan, and is becoming less so.

Both the telecom and the Japanese core-periphery models do share something important in common, though: they are segmentation strategies *pursued by firms, within firms*. In other words, this is not the old kind of segmentation in which entire industrial sectors were considered *either* core or periphery (i.e., there are core industries such as manufacturing and peripheral industries such as personal services). More important still, both are core-periphery strategies pursued *by core firms in core industries*.

As with other turns to the market, parts of this theory worked in practice and other parts did not, naturalizing, expanding, and evolving over time. Like deregulation and technological change, subcontracting began in earnest in the 1970s even though its greatest periods of growth were in the 1980s and 1990s.[50] From 1970 to 1984, the temporary help industry grew at a rate nearly twice GNP and 21 percent greater than the electronic computing equipment industry.[51] Between 1972 and 1982, employment grew by 9.6 percent per year in the personnel supply industry whereas it grew by only 2 percent per year in the economy as a whole.[52]

While new regulations were not the only reason for employers to reduce their responsibilities to workers, the evidence shows that large firms with more costly benefit-structures were indeed more likely to increase their supply of temp workers during this period. Not surprisingly, the volatility of the economy was another key reason employers turned to subcontracting, as firms with either high growth or negative growth and variable demand were also more likely to hire temp workers.[53] For example, in manufacturing, temp employment grew enormously in the aftermath of the "deindustrializing" recessions of 1980 and 1982.

While there is much focus on the rise of temp work, there was actually significant growth in high-end business services as well, such as computer and data processing services (13.1 percent per year) and management and public relations (9 percent per year) during the 1970s and early 1980s. Typical temp work performed by clericals declined significantly over time as a share of overall temp work and other business services. The new off-shoring of white-collar jobs, therefore, is new only in the sense that the *location* of subcontractors has changed, from on-shore to off-shore, not in the sense that it involves white-collar workers.

The original transformation of temp work from clerical to blue-collar and higher-waged white-collar work reflects two new developments. First, in-house professionals who are not centrally involved in producing a firm's core products or services—employees whose general knowledge exceeds their firm-specific knowledge, such as lawyers or accountants or, increasingly, computer specialists—could be taken off the firm's payroll to reduce per employee costs and to reduce permanent employment, which is the "denominator" for many performance statistics (e.g., dollar sales per employee). If any service or product was not deemed essential in this sense, and could be done more cheaply or more expertly elsewhere, it was a candidate for subcontracting. As an added benefit, reductions in permanent employment justified reductions in supervisory staff, including personnel officers.[54] Second, firms could avail themselves of new technologies and new business ideas from subcontractors who knew far more about them than they did.[55] Subcontracting could be a cost saving device at the low-end of the labor market as well as at the high-end, offering greater scale and/or knowledge economies in both cases.

IMPACT ON INEQUALITY

Firms have transformed their production strategies in order to make use of new technologies and subcontracted labor. These changes have divided and segmented workers along several new lines, and they have created new forms of wage inequality in their wake.

As many authors have argued, technological re-engineering holds out the promise of greater equity, and in fact full-blown employee involvement is increasingly prevalent. However, the potential wage benefits of technological re-engineering are not yet the norm for most workers. In 1997, 70 percent of a representative national sample of establishments with 50 or more employees had instituted two or more high performance practices for at least 50 percent of their core workforce. However, such organizations were disproportionately associated with layoffs and were no more likely to have higher wages or greater wage increases between 1992 and 1997.[56] And other research has shown a correlation between technological innovation and increasing wage inequality (e.g., in the telecommunications industry). While it is possible that the late 1990s produced a more equitable outcome, the boom was probably too short-lived to have made a major impact.

Subcontracting is also widely used, but unlike technology it has never held out the promise for greater equity. Firms have honed in on their core competencies and outsourced as much as they can without severely damaging reputation and morale (both serious concerns).[57] As in the case of firms installing new technologies, the core-periphery distinction in subcontracting doesn't mean what it used to. Whereas once it referred to the divide between manufacturing and service industries, now it refers to whether a worker is considered "essential" or not, measured in terms of firm-specific knowledge. Riches can be lavished upon employees with essential knowledge—the bottom line is of no consequence here. But if non-essential, even professionals desperately needed to fill critical shortages can be hired externally as independent contractors. And, as of late, they can be either imported or hired from abroad.

Temporary nurses, who have general knowledge and are in short supply, are a case in point. Since high demand means they can fetch higher hourly wages than their permanently employed counterparts, employers prefer to keep them off the permanent payroll because their higher wages would ripple through the entire organization (i.e., increase the hourly wages of all other comparable workers and their superiors because of equity norms and wage contracts, etc.). Unless and until a permanent, dedicated worker is needed, new non-essential employment can be outsourced, holding down wage costs for permanent employees.[58] Alternatively, instead of investing in the training of new nurses, both native and foreign born already living in the U.S., hospitals have evidently found it more cost-effective to recruit nurses from outside the United States, in particular from the Philippines.

Particularly when it comes to hiring new workers or replacing old workers, subcontracting has emerged as a multifaceted strategy to redistribute a firm's responsibility from those who are peripheral/nonessential to those who are core/essential. Employers have used new technologies to devise similar strategies of segmentation along high-tech/low-tech lines. Both strategies have fostered greater inequality between skilled and non-skilled workers, but also, crucially, among similarly skilled and educated workers (e.g., among nurses, among lawyers, among sales representatives, etc.).

As was emphasized in the previous section on corporate control, then, disparities among similarly skilled workers are an important feature of the new inequality; and a feature that is remarkably consistent with the experimental nature of the new corporate practices. If the new inequality were simply a matter of rewarding those with the right skills in the new economy and penalizing those with the wrong skills, we would see *greater equality* in wages among workers with the *same skills*, not less. A more plausible explanation of the new inequality is that those who are best able to control and transform corporate compensation schemes have stepped into the vacuum created by increased market competition and redistributed the spoils of restructuring decisively in their own favor.

Conclusion

Corporations were the conduit through which the economic crises of the post-1960s era were translated into a redistribution of resources from the middle and bottom of the corporate ladder to the top. In response to the economic crises, corporations pursued new strategies that, in total, were likely to have had a large impact on overall or aggregate inequality. This is so for two reasons.

First, restructuring strategies were widely diffused, tightly integrated, and experimentally applied without any regard for the potential havoc they could wreak. Investors pressured U.S. firms to make stock performance their number one priority—this was the original shareholder revolution. But there was one problem: the methods for doing so, such as tying CEO compensation to stock options, were not known to be effective, either then or now. Deregulation facilitated this process by reducing barriers to entry in a wide range of industries and allowing the development of new financial instruments with which to "make the deal". Deregulation also served as the first major market-based solution to the economic crises of the 1970s, with the merger and acquisition waves following in the 1980s and 1990s. Experimentation with the benefits as well as the harms of these new corporate practices continues to this day.

Second, restructuring policies affected all levels of the corporate hierarchy and all types of compensation. Firms chose to invest mightily in executives, other top managers, and select high-tech employees while effectively disinvesting in most other workers—or at least to the greatest extent possible given new technological demands. "Cost-cutting", in other words, was a highly selective strategy, as David Gordon's *Fat and Mean* counter to Bennett Harrison's *Lean and Mean* makes clear.

But this is only half of the story of increasing inequality. The other half is that even those with job experience and advanced degrees, such as mid-level managers and professionals, were no longer immune from the uncertainties of the market. This is becoming increasingly clear with the off-shoring of white-collar jobs, but from the beginning it was one of the singular accomplishments of the "new" model. Inequality has increased among workers with the same skills, including high skills, as firms and entire industries have increasingly segmented their workforces along core-periphery lines, subcontracting out all work that is deemed "nonessential" to the core functions of the firm. Thus the new segmentation consists of core-periphery relations *within* dominant firms in dominant industries, not just between core industries and peripheral industries.

In sum, in assuming a single rational way for corporations to respond to the new environment of heightened competition and rapid technological change, prevailing explanations of inequality are woefully incomplete.[59] They need to be supplemented with an account of how external constraints and shocks create a vacuum into which leading actors construct particular responses that then set in motion the direction and legitimacy of future responses. This report has offered such an account by showing that the dominant, market-oriented responses to the economic crises of the 1970s and later were neither established "best practices" at the time of adoption nor immune to significant economic inefficiencies.[60] This does not mean that they should not have been *part* of the solution to the economic downturn, only that their diffusion and acceptance far exceeded what could be justified by existing theory, the downturn and, perhaps most importantly, the vast amount of wealth and inequality that was created over the very same period.

Public Policy and Private Activism

What, then, are the limits to the kind of upward redistribution that has occurred over the past several decades? Proponents of investor capitalism may argue that the recent upward redistributions of wealth and income were a necessary component of the great prosperity of the late 1990s and therefore benefited everyone. But this report (and other research that shows increasing hardship for many at the bottom and in the middle) not only disputes that contention, it views this line of reasoning as beside the point because it begs the more important question of *exactly how much* upward redistribution the new corporate practices ought to foster, if any at all.

In post-Enron and post-technology-bubble times, it is much easier to gain a hearing for this kind of question than it was before. While undoubtedly useful for this reason, the corporate scandals—and, more recently, the mutual fund scandals—have unfortunately focused too much attention on executive compensation, accounting abuses and stock market fraud. As this report documents, corporate restructuring is a much larger issue with more serious consequences than even the much-needed scrutiny of these abuses, often of criminal proportions, lets on. The recent debate about off-shoring has played a useful role in broadening the conversation about corporate practices and their impact on American society.

These conversations now need to be connected to a serious national conversation about inequality. A broader discussion of the redistributive consequences of corporate restructuring must begin with at least these five points.

- **First, the corporate excesses and scandals that have now become a routine part of business-page reporting must be seen as, quite literally, the tip of the iceberg.**

Employees are all too intimately aware of the breakdown of equity norms, even if they have never heard of the term. The truly extraordinary distance between American executives and everyone else is readily apparent. Even if the vast majority of corporations were not engaged in the kind of massive fraud witnessed at Enron and WorldCom, they *were* involved in the kind of everyday restructurings—prompted by deregulation, mergers and acquisitions, technological re-engineering, and subcontracting (both on-shore and off-shore)—that involved significant disruptions in the terms of compensation, the conditions of work, and the opportunities for advancement. Such disruptions are not only costly for workers but for the bottom line, since lack of investment in workers can increase insecurity and turnover and decrease loyalty and productivity. At the same time, they signal the risky diversion of resources for short-term gain, without any clear economic justification.

- **Second, the experimental nature of all forms of restructuring—deregulation, mergers and acquisitions, technological re-engineering, and subcontracting—makes it clear that there is no single best and most "efficient" practice that we know of.**

This is an important wedge in the debate between market and non-market solutions to market failures, since it exposes the reality that there are multiple incarnations of both market and non-market approaches. This is helpful in broadening the range of possibilities, even within a market-based framework. The challenge, however, is that regulatory and anti-trust policies are highly technical and legalistic. The debate is dominated by the infighting of large telecommunications, energy, and financial institutions (e.g., those who seek entry versus those who are protected by barriers to entry), and currently workers and consumers interests are poorly represented.[61] The SEC, FCC, and other regulatory boards need to be seen as increasingly important targets of activism.

- **Third, shareholder activism sounds good, but in fact it was a principal cause of the corporate and mutual fund scandals to begin with. The focus must be shifted to the mass of ordinary shareholders, rather than large investors, and, more importantly, to employees.**

That *some* shareholders ended up with the raw end of the deal is *not* a reflection of the lack of shareholder power in general, but of the lack of shareholder power for the small, individual investor, something that the whistleblowers on mutual fund abuses have recently come to realize. In fact, in large part the advent of shareholder activism *led* to the current scandals. Large institutional investors teamed up with corporate raiders to put pressure on boards of directors to put pressure on executives to pay more attention to stock performance. The hostile takeover movement and the market for superstar CEOs were born at that moment, well before the stock market boom of the late 1990s. Beginning in the 1980s, outsiders were brought in to institute what David Gordon called "fat and mean" restructurings without worrying about hurting anyone's feelings, something long-time insider managers were seen as incapable of doing. Among other things, insiders were accused of being too cozy with both their employees and their boards of directors. Now the same thing is said about today's renegade CEO's (but not, of course, with regard to their employees).

The point here is twofold. First, investors *in and of themselves* cannot successfully diagnose or direct what the strategic trajectory of a firm should be. They simply do not have the necessary information, nor necessarily do "outside" directors or CEOs. Second, investors are not the only stakeholders with rights and interests in the strategic trajectory of a firm—employees are too. Interestingly, new research suggests that stock performance and productivity are higher precisely in those firms in which shareholders and employees are overlapping, that is, in which stock options are more equitably distributed among the firm's employees.[62] Giving more power to both ordinary shareholders and employees (e.g., via representatives on boards of directors, profit-sharing, etc.) will eliminate waste, enhance performance, and result in greater equity.

- **Fourth, public policy advocates can learn from the fact that we have been down this road before.**

Turning once again to the history of mergers and acquisitions, public policy has been used as an instrument *by businesses* to curb the abuses *of other business actors*. For example, the Business Roundtable lobbied for laws to prevent hostile takeovers. They lost in Congress but won in statehouses across the country. During the early 1990s, another time of popular outcry against excessive executive compensation, Congress took up the mantle of curbing pay through proposals to disallow "deductions for compensation exceeding 25 times the lowest-paid worker", and a bill called the Corporate Pay Responsibility Act was introduced in the Senate to give shareholders' more rights in setting compensation-related policies. Many people also point to the IRS rules of 1992 that limited corporate tax deductions for non-performance related executive compensation in excess of a million dollars, but unfortunately that only had the perverse effect of further encouraging the growth of stock options. The point is clear: in the past Congress and state legislatures have seen the need to rein in corporate excesses and inequities. We can and should revisit some of these possibilities today.

In conceiving of new public policies to curb executive compensation, shareholder rights and oversight, we should remember that there is a long and popular history of using social policies to protect the interests of workers and residents by, for example, establishing minimum public health and environmental standards that corporations must abide by. To the extent that such essential protections have eroded as a consequence of deregulation and the inevitable "cutting of corners" to meet investor demands, a drive to involve public policy in curbing the new excesses of corporations needs to be expansive in its mission.[63]

- **Finally, firms can make changes on their own, but such changes must go beyond the current voluntary (and as yet minimal) decisions by some executives to count options against earnings or to take pay cuts when performance lags. Though it sounds radical, redistribution is the ultimate goal, one that is no more radical in fact than the popular slogan "it takes a village" implies.**

Voluntary restraints on executive compensation is a good first step, but firms need better information and stronger incentives to restructure in ways that redistribute resources back to workers. This territory is well-known to human resource and industrial relations specialists. It involves sharing the gains from new and more efficient technologies by re-organizing work and training workers, especially less-educated workers, in skill-enhancing ways. It also involves the reconstruction of internal labor markets and career ladders in order to minimize turnover and retain quality workers, or the construction of external labor market intermediaries that facilitate the matching of good workers with good jobs. Regional training consortia are becoming a crucial resource for facilitating these kinds of "high-road" restructurings. Such consortia bring corporations, workers associations, community colleges, and local government together to share the costs of screening, training, and placing workers into good jobs demanding state-of-the art skills.[64]

Lastly, and particularly in today's climate of widespread distrust, profligate corporations ought to introduce, or reintroduce as the case may be, equity norms. Such norms would bring compensation gaps in pay and benefits between the top and bottom to where they should be as matter of equity. Americans believe firmly in rewarding individuals for both hard work and talent. Exactly how much ought to go to different kinds of talents and different kinds of hard work is not always clear, which is why pay systems are so variable and vulnerable to the balance of power between employers and employees. What does seem clear, however, is that the balance of power has shifted decisively in favor of executives and top managers, who in turn have received a disproportionate share of the rewards, rewards that were generated from the hard work of tens of millions of shortchanged employees throughout America.

This point was brought home recently by a brilliantly illuminating attempt at shareholder activism.[65] The chairman of a fund company proposed that CEO pay be limited to 100 times that of the average worker (as opposed to today's average of 400 times), unless it can be proved that the chief executive was primarily responsible for achieving a specific performance goal. Seven companies with unusually high CEO pay (by American standards!) were singled out in the proposal to the Securities and Exchanges Committee.

One of the companies singled out submitted a letter of protest to the S.E.C. It asked, quite justifiably, "[h]ow will the company distinguish between those achievements stemming from the CEO's contribution versus those that are a result of favorable economic conditions or other factors?" Although a rhetorical question, in an interview the general counsel of the targeted firm nevertheless provided an answer: "In terms of the performance of the company, we're saying that in reality you cannot pinpoint performance based on the efforts of one particular person." In other words, not only are favorable economic conditions important, but so are the efforts and contributions of a company's entire workforce. Unfortunately, that contribution has been almost entirely ignored by the architects of today's divisive economic prosperity.

Appendix: Gaps in Previous Research on Rising Inequality

There are at least three reasons why it has been difficult to establish the relationship between corporate restructuring and inequality. First, there is no reason why certain kinds of corporate changes—such as mergers and acquisitions—should necessarily result in greater inequality. There are several other explanations of increasing inequality that are equally compelling, such as globalization and technological change. Unfortunately, these other explanations have been seen only as alternatives to corporate restructuring when in reality they are analytically separate but potentially complementary explanations. Second, existing evidence for the *direct* relationship between corporate-level restructuring and inequality is piecemeal, leaving a rather shaky empirical foundation upon which to make the connection. Third, many aspects of corporate change have been examined in isolation, giving little sense of how such changes are connected to one another or how significant their overall impact on inequality is. I briefly discuss each of these three issues.

- **First, factors other than corporate-level changes have been the focus of research on the causes of rising inequality.**

Empirical research on rising wage inequality as an aggregate, national-level trend has virtually ignored corporate restructuring as a possible cause. The only organization-level change to have received considerable attention thus far is deunionization. The leading alternative causes have included market forces such as globalization and technological change, demographic shifts such as the rise of immigration and the slowdown in the college graduate rate, and policy decisions such as allowing the minimum wage to decline. Indeed, for the entire decade of the 1990s, the main period of research on inequality, debates centered on the relative importance of technological and non-technological explanations. The prevailing sentiment among economists was that the former predominated, suggesting that the gradual acquisition of technical skills by workers would ultimately lift wages and reduce inequality. Only recently have researchers come to a more nuanced appreciation of how corporations are responsible for the implementation and thus impact of the new technologies on firm performance as well as on labor market outcomes.[66]

- **Second, direct evidence on the corporate restructuring/inequality nexus has been piecemeal.**

Despite it being the prevailing explanation, technology's role has been notoriously difficult to prove. This is also the case for the corporate explanation. In both cases, the problem of evidence is first and foremost a problem of data. In terms of corporate-level explanations, we simply lack data linking organizational changes to changes in wage, promotion, and benefit structures for a large cross-section of corporations. We have large-scale data on corporations and large-scale data on individuals, but not on the intersection of the two—data on workers linked to data on the corporations in which they work. What we really need are the personnel records of a large and representative cross-section of corporations. Personnel records, however, are either confidential or laborious to collect for the isolated employer who is willing to hand them over for the greater good of science.

In the absence of such detailed information on workers and the corporations for which they work, we can conduct surveys of workers or ask human resource specialists if they could provide summary information on changes in worker outcomes. We can get permission to observe individual workplaces, plants, board meetings, and so on and use this data to show that a corporation restructured in one way that improved worker outcomes and remained profitable while another corporation's restructuring effort made things worse for both workers and the bottom line. For example, it was the murkiness of the "technology" explanation—along with little solid evidence—that finally led researchers to peer into the internal dynamics of individual firms to figure out exactly how technology was deployed in ways that deskilled or upskilled, lowered wages or lifted them. These are all enormously important and useful ways to study the question, and I rely on them in my report, but they are not generalizable to the economy as a whole or to the overall level of inequality because they examine individual firms and industries only.

- **Third, aspects of corporate change have been examined in isolation, giving little sense of how such changes are connected to one another or how significant their overall impact on inequality is.**

The issues involved under the heading of corporate restructuring are new, large and complex enough to have spawned separate research tracks along a number of different lines. One, for example, is the issue of how executives are compensated. Have superstar executives selected from outside the firm outperformed long-time, dedicated insiders? Have stock options for executives led to greater shareholder value and improved productivity? These questions may seem tangential to the problem of increasing inequality but they go to the heart of how structures of compensation have changed for *all* workers within firms. Inflated executive compensation often comes from deflated expenses somewhere else. If executive compensation has not improved performance, it might seem less justified and easier to challenge, thus freeing up resources for other workers.

In addition to executive compensation, there is research on at least four other key components of restructuring at the firm or organizational level in the private sector that I focus on in this report: (1) deregulation, (2) mergers and acquisitions in the 1980s and then again in the 1990s, (3) subcontracting of work to temporary agencies, independent contractors (mainly on-shore but also off-shore), and other kinds of contingent arrangements, and (4) technological re-engineering of the production process. Research on these topics has examined whether mergers with layoffs are more successful than mergers without layoffs, whether wages decline for workers in deregulated industries, and so on. Each of these questions, and others, is the subject of ongoing research, but as yet the results have not been tied together, particularly in terms of their overall impact on inequality.[67]

In sum, when inequality is the focus of interest, corporate restructuring is not seen or studied as one of its leading causes. Nearly all rigorous research on aggregate inequality examines explanations at the national or state level, rather than at the level of the firm. By the same token, when corporate restructuring is the focus of interest, inequality is not seen or studied as one of its major consequences. Nearly all rigorous research on corporate restructuring examines the impact on performance, growth, productivity, and wage outcomes at the firm level, rather than on inequality among individuals and families overall, albeit because of data limitations. Finally, and just as important, most firm-level research tends to be either production and worker-centered or finance and executive-centered, not both. This report surveys and synthesizes the available research on these topics in an attempt to rescue the forest from the trees.

Notes

1. For investor capitalism, see Useem (1996). For shareholder capitalism, see Fligstein (1990, 2001). The transition to investor capitalism does not mean that managers currently exercise no power or that investors and outsiders are always fully in control, only that these were the intentions of investor-initiated reforms that began in the 1980s. So-called outsiders eventually become insiders and investors cannot maintain constant vigilance, which is why the issue of greater investor control is arising again in the wake of the Enron and WorldCom, and so on, scandals. These issues are discussed in more detail later in the report.
2. For an excellent survey of evidence on increased insecurity, see Kruse and Blasi (2000).
3. Michelle Conlin and Aaron Bernstein, "Working and Poor," *Business Week*, May 31, 2004.
4. Black and Lynch (2001), Bresnehan, Brynjolfsson, and Hitt (2000).
5. For an analysis and discussion of cross-national differences in economic performance and inequality, see Kenworthy (2004).
6. For an early exposition and example of the theory of institutional diffusion, in which at some point new practices become widely accepted and therefore widely adopted for reasons other than their original intent (e.g., to solve a specific source of inefficiency), see Tolbert and Zucker (1983).
7. Westphal and Zajac (1998) show that stock prices increase after fashionable reforms are announced and before they are enacted. Indeed, some reforms are never even enacted.
8. Ellwood (2000:12).
9. Piketty and Saez (2003).
10. Ellwood (2000:32).
11. Piketty and Saez (2003:35).
12. Krugman (2002).
13. Capelli (1999: 64).
14. See the beginning of previous section. Also see Jacoby (1990), Cappelli (1999), and Piore and Sabel (1984).
15. Edsall (1984:215). Blyth adds, "these factors combined with the general perceived antipathy toward government in the wake of Vietnam and Watergate to make the supply-side message all the more effective. Academic concern with inflation, aggressive business lobbying, Congressional supply-siders, press proselytizers [e.g.,Wall Street Journal], and tax revolutionaries all combined to bring conservative opposition to the political assaults and economic uncertainties of the 1970s under one banner, that of the 'supply-side revolution'. This revolution's solutions may have been economically dubious at best, but these ideas did successfully diagnose uncertainties, identify causal relationships, encourage new patterns of collective action through the renarration of interests, and advocate alternative institutional solutions to the crisis in a way that the defenders of liberalism could not do" (2002: 166).
16. Profit rates began to decline in the late 1960s.
17. Jensen (1988), Murphy (1997).
18. Kochan, Katz, and Kersie (1994), Edsall (1984), Goldfield (1987).
19. Theoretically, the purpose of regulation is to correct market failure. The classic example is the involvement of commercial banks in the securities business, which collapsed along with the stock market in 1929. Later, because of the speculative and risky history of such collaborations, the 1933 Glass-Steagall Act established federal deposit insurance and prohibited commercial banks from engaging in brokerage services. Another type of market failure potentially occurs in the case of natural monopolies, which require an integrated and standardized infrastructure with universal access. Before the break-up of the Bell System in 1984, for example, AT&T employed over 90 percent of the workers in the industry, developed the entire infrastructure of phone service, and conducted advanced technological research at the famed Bell Labs (Batt and Strausser 1998). The purpose of deregulation, in contrast, is to (re)introduce competition where regulated industries begin to operate inefficiently or monopolistically, harming competitors and consumers alike. Deregulation is accomplished by withdrawing the state's legal powers from directing the pricing, entry, and exit of nongovernmental bodies.

20. Vogel (1996:224), Winston (1998:89), Andrade et al. (2001:108) provide a summary of industry deregulation by year: airlines (1978), broadcasting (1984, 1996), entertainment (1984), natural gas (1978), trucking (1980), banks and thrifts (1994), utilities (1992), and telecommunications (1996). In terms of overall impact, from 1977 to 1988 alone, the share of GNP generated from regulated industries, including oil and gas extraction, a large part of transportation and public utilities, and finance and insurance, declined from 17 to 6.6 percent (Winston 1993:1263).

21. In terms of origins, this sets the deregulation movement apart from the other forms of corporate-led restructuring but it is probably no longer the case that deregulation is as widely supported outside business circles.

22. Winston (1993:1263).

23. It should be noted, however, that if our concern was gender or racial inequality, the conclusions would be quite different. Rents were shared primarily with white male workers, thus deregulation appears to have contributed to lower levels of gender and racial inequality in deregulated industries (Peoples and Talley 2001; Black and Strahan 2001). On inequality in the telecommunications industry, see Batt and Strausser (1998).

24. As I discuss in more detail in this and the final section, the extraordinary power of CEO's at such places as Enron and WorldCom is often attributed to their cozy relationship with their boards of directors. However, relationships between top management and boards have always been accused of being too cozy. Current arrangements were actually put in place beginning in the 1980s as a way to exert external, independent control over corporate strategy by outside investors, boards of directors acting in the interests of investors rather than managers, and CEOs hired from outside the firm.

25. Useem (1996). Recent evidence seems to support this: "Leaving out many details, downsizing firms typically increase their profitability by decreasing their unit labor costs. But downsizing does not achieve these cuts in unit labor costs by raising productivity. Instead, downsizing firms somehow manage to squeeze wages. And perhaps ironically, this transformation of what were once wages into profits does not seem to enhance a downsizing firm's stock market valuation. This last result is curious and may reflect the market's assessment that the profit gains are transitory. It is also possible that the market views downsizing either as a public admission that a firm is already in more trouble than was previously recognized or as an indicator of trouble down the line" (Baumol, Blinder, and Wolff 2003:233).

26. Andrade et al. (2001: 109).

27. For example, "during the 1981-1984 period, there were at least 45 transactions of over a billion dollars apiece; prior to this period there were only a dozen or so transactions of such magnitude" (Varian 1988: 3).

28. All acquisition volume as a percent of GDP averaged 2-3 percent from the late 1800s to the mid-1980s. It was at that level in 1981, rose to 4-5 percent in the mid and late-1980s and then rose steadily from below 2 percent in 1991 (during the recession) to roughly 15 percent in 1998. For comparison, the rate was 10 percent in 1900 (Holstrom and Kaplan 2001:124).

29. Fligstein (1990).

30. On the growth of pension funds, Peter Drucker had already written a quasi-prescient book in 1976 entitled *The Unseen Revolution: How Pension-Fund Socialism Came to America*. More generally, the institutional fraction of corporate stocks rose from about 15 percent in 1970 to over 30 percent in 1980 and nearly 50 percent in 1990. Institutional investors include private pension funds, open-end mutual funds, state-local government retirement funds, and insurance companies (Khurana 2002).

    On the weakness in the stock market in the 1970s, inflation-induced high interest rates made investments in the bond market more attractive than in the stock market, lowering stock prices. This was one factor that led to a lower market capitalization of firms relative to their net worth in assets. But even apart from inflation-induced problems, investors estimated that conglomerates were worth less than the sum of their parts would be on the open market (i.e., independent firms that were similar in profile to divisions of conglomerates performed better in sum than the conglomerate as a whole).

31. Mitchell and Mulherin (1996).

32. Useem (1996:29).

33. Andrade et al. (2001); Davis and Greve (1997).

34. Only 20 percent of CEO compensation was tied to stock market performance in 1980, as compared to nearly 60 percent today (Holmstrom and Kaplan 2001).

35. Khurana (2002).

36. This is referred to as "agency theory", in which the primary purpose of institutions of corporate governance when ownership is disperse and separate from control is to constrain agents (managers) to act in the interests of principals (owners). The degree of separation between owners and managers is extreme in the United States, as is the size of

the stock market and the extent of investor protections. Other countries are more likely to have controlling shareholders, such as families, the state, or investment groups. Davis and Useem (2003) refer to the latter as "relationship-based capitalism" and the former (i.e., the U.S.) as "market-based capitalism".

37. But this is not to say that all actors had the same level of insight or intent. As Holmstrom and Kaplan, supporters of the capital market solution, write: "[m]anagers were slow to respond [to deregulation and technological innovations], partly because of misaligned incentives, but likely also because they were confused and couldn't figure out the appropriate response (and didn't believe that the capital markets knew any better)". Moreover, not all investors sought in a premeditated fashion to take advantage of unsuspecting managers and the cozy relationship they had with their boards of directors. Large institutional investors were not always eager to be thrust into the spotlight of restructuring and many small investors were experimenting with new financial instruments. While in some respects this lifts the burden of responsibility from key actors, in other respects it exposes the confusion and uncertainty surrounding the implementation of new, more market-oriented solutions.

38. Khurana (2002).

39. Andrade et al. (2001).

40. Fligstein (2001) refers to this as the "political-cultural" explanation of changes in corporate control and business organizations more generally.

41. Although some evidence shows that shareholders in target firms do benefit from greater short-term (5-year) returns on average, the verdict on long-term returns is still out (Scherer 1988). And there's no evidence on other kinds of performance gains from mergers and acquisitions (i.e., such as productivity). There's more evidence on the issue of CEO compensation, which has been shown to have little or no impact on corporate performance (for an overview, see Khurana 2002). Anecdotal evidence from the universe of Enrons and WorldComs confirms this. Finally, there is still little agreement or evidence about what constitutes "best practice", since a whole range of changes in governance structures (such as appointing outside directors and having directors that are centrally located on many key boards) have been shown to have an impact on corporate strategy but not on performance (see Mizruchi 1996; Davis and Useem 2003).

42. For reports on trends in executive pay and pay gaps, see United For a Fair Economy (www.ufenet.org).

43. Davis and Useem (2003:240). See also Gordon (1996).

44. Subcontracting can be a component of downsizing, in which some permanent workers are laid off and replaced with temporary workers; however, subcontracting is analytically and empirically distinct from downsizing. Downsizing is not discussed in any detail here because there is very little research on downsizing, not to mention its relationship to wages and wage inequality. Contrary to popular claims, recent research on changes in firm size have shown that average firm size has declined in the manufacturing sector but grown in the service sector (Baumol, Blinder, and Wolff 2003). Overall, average establishment size declined most in the 1980s and then grew again in the 1990s (McCall 2004). Regarding wage inequality, preliminary research by the author indicates that employment in large establishments was associated with lower levels of inequality in cities, particularly over the 1970s and 1980s when presumably internal labor markets and equity norms were still intact (McCall 2004).

45. For example, new information technologies can spew out mountains of information but someone has to interpret and decide whether and how to act on them (e.g., workers need to use more discretion in responding to constantly changing product and customer information). High-involvement and high-performance work practices that are related to lower turnover, higher sales, and higher wages (above and beyond worker skills) include self-directed work teams, in which workers supervise their own work, and quality circles, in which workers regularly meet to discuss improvements in products and services, total quality management, and job rotation (Appelbaum et al. 2000; Osterman 2000).

46. See, for example, Fernandez (2001).

47. Pfeffer and Baron (1988: 273).

48. Frank (1985).

49. Mangum, Mayall, and Nelson (1985: 599).

50. Although temp work is highly pro-cyclical—growing as employers tentatively hire after a recession and declining as employers encounter tight labor markets and eventually a downturn—the trend line over time is upward.

51. Pfeffer and Baron (1988).

52. Abraham (1990:88-89).

53. Mangum et al. (1985).

54. Pfeffer and Baron (1988).

55. Segal and Sullivan (1997).

56. Osterman (2000).

57. Outright elimination is the alternative to subcontracting. It is reserved for jobs, products, and divisions that are unrelated to a firm's new sense of its core products and services.

58. Subcontracting plays the additional useful role of reducing search costs because workers can be "screened" through temporary employment first.

59. In addition, the technology explanation has often been faulted for its lack of fit with the timing of the increase in inequality. During the largest increase in technology use, in the late 1990s, inequality leveled off. Wages grew at the top but they grew disproportionately at the bottom, more likely because of tight labor markets than because of technology. In contrast, the types of corporate restructuring considered here—especially deregulation, subcontracting, and mergers and acquisitions—were set in place in the 1970s and increased rapidly in the 1980s, the main period of increasing inequality.

60. Briefly, examples of inefficiencies cited elsewhere in the text include: the savings and loan bail out and the California energy crisis; perverse incentives arising from stock options for CEOs and excessive CEO pay; mergers and acquisitions that boost short-term stock market value but sacrifice long-term investment and that put consumers at risk of conflicts of interest between providers of previously separated services (e.g., banking and retirement funds); lost morale and loyalty among outsourced and permanent workers alike, increasing the costs associated with higher turnover; underused and misused technologies; and lack of trust in the stock market. And this list includes only items that impact a firm's bottom line, increase a firm's legal liabilities, or have a large adverse impact on the public at large; items, in other words, that are clearly in the interest of employers or the government to address.

61. Even in the 1970s, businesses were heavily arrayed against the new consumer rights movement spearheaded at the time by Ralph Nader.

62. Blasi, Kruse, and Bernstein (2003).

63. For a comprehensive proposal along these lines, see Block (2003).

64. For excellent examples along these lines, see Parker (2004) and Giloth (2003).

65. Gretchen Morgenson, "Explaining (or Not) Why the Boss Is Paid So Much." *New York Times*, 1/25/04, page C1.

66. Black and Lynch (2001), Bresnehan, Brynjolfsson, and Hitt (2000), Appelbaum et al. (2000).

67. But see Fortin and Lemieux (1997).

References

Abraham, Katherine. 1990. "Restructuring the Employment Relationship: The Growth of Market-Mediated Work Arrangements." Pp. 85-120 in K. Abraham and R. McKersie, eds., *New Developments in the Labor Market*. MIT Press.

Appelbaum, Eileen, Thomas Bailey, Peter Berg, and Arne Kalleberg. 2000. *Manufacturing Advantage: Why High-Performance Work Systems Pay Off*. Cornell University Press.

Andrade, Gregor, Mark Mitchell, and Erik Stafford. 2001. "New Evidence and Perspectives on Mergers." *Journal of Economic Perspectives* 15(2):103-120.

Batt, Rosemary. 2001. "Explaining Wage Inequality in Telecommunications Services: Customer Segmentation, Human Resource Practices, and Union Decline." *Industrial and Labor Relations Review* 54(2A):425-449.

Batt, Rosemary, and Michael Strausser. 1998. "Labor Market Outcomes of Deregulation in Telecommunications Services." *Proceedings of the 50th Annual Meetings of the IRRA*. Madison, WI: IRRA Series.

Baumol, William, Alan Blinder, and Edward Wolff. 2003. *Downsizing in America: Reality, Causes and Consequences*. Russell Sage Foundation.

Black, Sandra E., and Lisa M. Lynch. 2001. "Have to Compete: the Impact of Workplace Practices and Information Technology on Productivity." *The Review of Economics and Statistics* 83(3): 434-445.

Black, Sandra E. and Philip Strahan. 2001. "The Division of Spoils: Rent-Sharing and Discrimination in a Regulated Industry." *American Economic Review* 91(4):814-831.

Blasi, Joseph, Douglas Kruse, and Aaron Bernstein. 2003. *In the Company of Owners: the Truth about Stock Options*. Basic Books.

Block, Fred. 2003. "A Strategy for Corporate Reform." University of California, Davis, and Rockridge Institute.

Blyth, Mark. 2002. *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century*. Cambridge University Press.

Bresnahan, Timothy, Erik Brynjolfsson, and Lorin Hitt. 2000. "Technology, Organization, and the Demand for Skill." Pp. 145-193 in M. Blair and T. Kochan, eds., *The New Relationship: Human Capital in the American Corporation*. Brookings Institution.

Cappelli, Peter. 1999. *The New Deal At Work*. Harvard Business School Press.

Davis, Gerald, and Henrich Greve. 1997. "Corporate Elite Networks and Governance Changes in the 1980s." *American Journal of Sociology* 103(1):1-37.

Davis, Gerald and Michael Useem. 2003. "Top Management, Company Directors and Corporate Control." Pp. 233-259 in A. Pettigrew, H. Thomas, and R. Whittington, eds., *Handbook of Strategy and Management*. Sage Publications.

Derthick, Martha and Paul Quirk. 1985. *The Politics of Deregulation*. Brookings Institution.

Edsall, Thomas Byrne. 1984. *The New Politics of Inequality*. W.W. Norton and Company.

Ellwood, David. 2000. "Winners and Losers in America: Taking the Measure of the New Economic Realities." Pp. 1-41 in D. Ellwood et al., *A Working Nation: Workers, Work, and Government in the New Economy*. Russell Sage Foundation.

Fernandez, Roberto. 2001. "Skill-biased Technological Change and Wage Inequality: Evidence from a Plant Re-tooling." *American Journal of Sociology* 107(2):273-320.

Fligstein, Neil. 1990. *The Transformation of Corporate Control*. Harvard University Press.

Fligstein, Neil. 2001. *The Architecture of Markets*. Princeton University Press.

Fortin, Nicole and Thomas Lemieux. 1997. "Institutional Changes and Rising Wage Inequality: Is There a Linkage?" *Journal of Economic Perspectives* 11(2):75-96.

Frank, Robert. 1985. *Choosing the Right Pond: Human Behavior and the Quest for Status*. Oxford University Press.

Giloth, Robert. 2003. *Workforce Intermediaries for the Twenty-First Century*. Temple University Press.

Goldfield, Michael. 1987. *The Decline of Organized Labor in the United States*. University of Chicago Press.

Gordon, David. 1996. *Fat and Mean*. New York: The Free Press.

Harrison, Bennett. 1994. *Lean and Mean*. Basic Books.

Harrison, Bennett and Barry Bluestone. 1988. *The Great U-Turn*. Basic Books.

Holstrom, Bengt and Steven Kaplan. 2001. "Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s." *Journal of Economic Perspectives* 15(2):121-144.

Jacoby, Sanford. 1990. "Norms and Cycles: the Dynamics of Nonunion Industrial relations in the United States, 1897-1987." Pp. 19-58 in K. Abraham and R. McKersie, eds., *New Developments in the Labor Market*. MIT Press.

Jensen, Michael. 1988. "Takeovers: Their Causes and Consequences." *Journal of Economic Perspectives* 2(1):21-48.

Kalleberg, Arne. 2000. "Non-Standard Employment Relations: Part-time, Temporary, and Contract Work." *American Review of Sociology* 26: 341-66.

Kenworthy, Lane. 2004. *Egalitarian Capitalism? Jobs, Incomes, and Equality in Affluent Countries*. Russell Sage Foundation.

Khurana, Rakesh. 2002. *Searching for a Corporate Savior: the Irrational Quest for Charismatic CEOs*. Princeton University Press.

Kochan, Thomas, Harry Katz, and Robert McKersie. 1994. *The Transformation of American Industrial Relations*. Cornell University Press.

Krugman, Paul. 2002. "For Richer." *The New York Times Magazine*. October 20.

Kruse, Douglas and Joseph Blasi. 2000. "The New Employer-Employee Relationship." Pp. 42-91 in D. Ellwood et al., *A Working Nation: Workers, Work, and Government in the New Economy*. Russell Sage Foundation.

Mangum, Garth, Donald Mayall, and Kristin Nelson. 1985. "The Temporary Help Industry: A Response to the Dual Internal Labor Market." *Industrial and Labor Relations Review* 38(4).

McCall, Leslie. 2004. "The Impact of Organizational Changes on Aggregate Inequality: The Case of Downsizing." Paper presented at the Annual Meetings of the American Sociological Association, San Francisco.

Mishel, Lawrence, Jared Bernstein and Heather Boushey. 2003. *The State of Working America, 2003/2004*. Ithaca: Cornell University Press.

Mitchell, Mark and J.Harold Mulherin. 1996. "The Impact of Industry Shocks on Takeover and Restructuring Activity." *Journal of Financial Economics* 41:193-229.

Mizruchi, Mark. 1996. "What Do Interlocks Do? An Analysis, Critique, and Assessment of Research on Interlocking Directorates." *Annual Review of Sociology* 22:271-298.

Murphy, Kevin J. 1997. "Executive Compensation and Modern Industrial Revolution." *International Journal of Industrial Organization* 15:417-425.

Osterman, Paul. 2000. "Work Reorganization in an Era of Restructuring: Trends in Diffusion and Effects on Employee Welfare." *Industrial and Labor Relations Review* 53(2):179-96.

Parker, Eric. 2004. "The Wisconsin Regional Training Partnership." *Perspectives on Work* 8(1).

Pfeffer, Jeffrey and James Baron. 1988. "Taking the Workers Back Out: Recent Trends in the Structuring of Employment." *Research in Organizational Behavior* 10:257-303.

Peoples, James. 1998. "Deregulation and the Labor Market." *Journal of Economic Perspectives* 12(3):111-130.

Peoples, James and Wayne Talley. 2001. "Black-White Earnings Differentials: Privatization versus Deregulation." *American Economic Review* 91(2):165-168.

Piketty, Thomas and Emmanuel Saez. 2003. "Income Inequality in the United States, 1913-1998." *Quarterly Journal of Economics* CXVIII(1): 1-39.

Piore, Michael and Charles Sabel. 1984. *The Second Industrial Divide: Possibilities for Prosperity*. Basic Books.

Scherer, F. M. 1988. "Corporate Takeovers: The Efficiency Arguments." *Journal of Economic Perspectives* 2(1):69-82.

Segal, Lewis and Daniel Sullivan. 1997. "The Growth of Temporary Services Work." *Journal of Economic Perspectives* 11(2):117-136.

Tolbert, Pamela S. and Lynne G. Zucker. 1983. "Institutional Sources of Change in the Formal Structure of Organizations: The Diffusion of Civil Service Reform, 1880-1935." *Administrative Science Quarterly* 43:127-53.

Useem, Michael. 1996. *Investor Capitalism: How Money Managers are Changing the Face of America*. Basic Books.

Varian, Hal. 1988. "Symposium on Takeovers." *Journal of Economic Perspectives* 2(1):3-5.

Vogel, Steven. 1996. *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*. Cornell University Press.

Westphal, James D. and Edward J. Zajac. 1998. "The Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholder Reactions." *Administrative Science Quarterly* 28:22-39.

Winston, Clifford. 1993. "Economic Deregulation: Days of Reckoning for Microeconomists." *Journal of Economic Literature* XXXI:1263-1289.

Winton, Clifford. 1998. "U.S. Industry Adjustment to Economic Deregulation." *Journal of Economic Perspectives* 12(3):89-110.

Dēmos
A NETWORK FOR IDEAS & ACTION

Dēmos: A Network for Ideas & Action
220 Fifth Avenue
5th Floor
New York, NY 10001
Phone: 212.633.1405
Fax: 212.633.2105

www.demos-usa.org