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On Addressing the Puzzle of Extreme Income Inequality: A Response to Agarwal and Holmes

We welcome Agarwal and Holmes’s (2019) contribution to the dialogue on income inequality. Their perspectives and contributions are quite different from what we tried to convey to *AMR* readers. In this response we provide some clarifications of possible misunderstandings by them of our essay, “Income Inequality in the United States” (Tsui, Enderle, & Jiang, 2018).

Agarwal and Holmes raise three major objections to the ideas in our essay. First, they argue that heterogeneity in ability and motivation is the primary if not the only cause of income inequality. Second, they argue that the government should not be involved in reducing income inequality in order to protect political equality. Third, they contend that it is more useful to study poverty, income mobility, and value creation. In sum, they “hope to have added to a heterogeneity in perspectives, guiding management scholars who can voluntarily choose their own research agendas in light of their own motivations and abilities, and also their beliefs” (2018: 457).

We cannot agree more with their final words that management scholars have the freedom to choose the research topics that appeal to them based on their interests, competencies, and beliefs. We also

agree with the value of heterogeneity in perspectives. Yet we are surprised by their title—“Let’s Not Focus on Income Inequality.” In our essay we do not take the position that everyone should study income inequality; instead, we simply encourage more research on this topic because of the severe negative consequences of extreme income inequality for society in terms of health, safety, education attainment, or even life expectancy (Wilkinson & Pickett, 2009). Our essay was to echo the call for more attention to analyzing the causes and consequences of income inequality by many distinguished scholars (Krugman, 2009; Piketty, 2014; Stiglitz, 2012; Wilkinson & Pickett, 2009).

We sense that Agarwal and Holmes—like us—care about poverty and justice. Where we depart is the level of analysis and the focus of the issue. We focus on income inequality at the society and especially the firm level, looking at the ratio of CEO pay to average employee pay. They focus on the individual level (i.e., individual differences in ability and motivation). We consider multiple actors having the opportunity and responsibility to reduce extreme income inequality, including corporate leaders and governments. Agarwal and Holmes believe in the merit of the market and strongly disagree with the role of the government. We propose ideas to reduce extreme income inequality, while they are against a focus on income inequality entirely. Because of these very drastic differences, we believe that Agarwal and Holmes either did not understand our essay or purposely aimed to be provocative. We assume the latter. In this response we focus on the three major points of disagreement and choose not to “nitpick” many other issues that are less central, although also important, to our focus on understanding “extreme income inequality” at the firm or society level.

POINT 1: ROLE OF HETEROGENEITY IN ABILITY AND MOTIVATION FOR INCOME INEQUALITY

Our discussion of income inequality is about income distribution in a society or a firm, which reflects the ways societies or firms place value on different types of jobs, resulting in a hierarchy of wages with higher-level jobs being paid more than lower-level jobs. Most research on income dispersion in the management literature is about differences in pay by people in the same jobs (Shaw, 2014), where heterogeneity in ability and judgment of their contributions may be the primary although not the only determinant.

We agree that such heterogeneity would result in inequality of income in the organization, but that is *not the only cause*. We assume that CEOs have more skills and they deserve to be paid more, an argument consistent with the heterogeneity logic. This logic might also explain why CEOs are paid more in some industries—for example, dynamic and complex industries would value the contribution of CEOs more than that in more stable and traditional industries. However, this heterogeneity in ability logic does not explain why one CEO (e.g., Costco) has a lower overall compensation than another CEO (e.g., Walmart) in the same industry and with similarly impressive performance. This fact suggests that other factors—for instance, firm scale, CEO power, and legacy—may also contribute to CEO pay. In our essay we explain how the political process is more important than the market factor in CEO compensation, at least in the United States. At the lower end of the income distribution, one firm might pay their frontline workers more than another firm in the same industry. These differences are less about individuals’ heterogeneous skills and more about firm ideology.

We can also find national differences in a similar industry. The CEO-employee pay ratio of General Motors in 2017 was 295:1,¹ while the same ratio for Nissan Motor in 2017 was 128:1.² It is difficult to imagine that CEOs in the United States are much more talented or much more motivated than the CEOs of other countries. Some historical facts may provide further insight into this problem. In the United States the average compensation of workers, adjusted for inflation, has increased (by 2017) by 11.2 percent since 1978. During the same period, CEOs’ compensation increased 937 percent. The CEO-employee pay ratio increased from roughly 30 times in 1978 to almost 300 times in 2017 (Mishel & Schieder, 2017). What may account for the huge difference in the increasing value of CEOs’ jobs relative to that of workers’ jobs? We can ask if the rapid increase in the CEO-employee pay ratio is consistent with the perceived fairness in both the results (distributive justice) and the decision processes (procedural justice). Both Piketty (2014) and Stiglitz (2012) proposed that it is the political power of the wealthy CEOs that brought further increases in their

¹See <https://aflcio.org/paywatch/company-pay-ratios>.

²See https://www.nissan-global.com/EN/DOCUMENT/PDF/AR/2018/AR18_E_All.pdf.

compensation by influencing legislation that gives much discretion in determining CEO pay.

Given the complexity of a multitude of causal factors influencing the income of different jobs in a society, we think that the heterogeneity of ability argument alone is too simplistic in explaining income inequality at the firm or society level, especially the growth of extreme income inequality in the United States in the past three decades.

POINT 2: GOVERNMENT SHOULD NOT INTERFERE WITH INCOME INEQUALITY

Agarwal and Holmes argue for the complete separation of business and government, with inequality in economic terms and equality in political terms. Therefore, the government would introduce *political inequality* if it protected some individuals' rights more than the rights of others in the population. In contrast, in Tsui et al. (2018) we argue that government intervention would increase political equality. Along this line, we agree with Agarwal and Holmes that greater political equality is good for everyone, at least theoretically. However, unpacking their argument reveals a flawed assumption, which is a baseline of the same level of political equality for both the rich and the poor. Therefore, government intervention to lift the income of the poor would reduce the political equality of the rich. Empirically, as both Piketty (2014) and Stiglitz (2012) have observed, there is a great deal of political inequality in the status quo, with great political power among the wealthy and little or none for the poor. Further, powerful businesses have been able to further increase their political advantage through lobbying or under-the-table dealings. Extreme income inequality, with its enormous imbalance of power, negatively affects political equality.

Moreover, Agarwal and Holmes rely on the questionable distinction of "positive" and "negative" rights. As Shue (1996/1980) forcefully argued, this distinction applies to the duties vis-à-vis right holders; it does not apply to basic rights, such as security rights and subsistence rights, which are essential to the enjoyment of all other rights. The government should provide protection for every citizen (regardless of economic status) and vital public goods (available for all to use). An economic or government system built on the principle of exclusive self-interest, with no regard for other interests or public interests, is doomed to fail when those who are not fortunate enough to

be endowed with either natural or inherited resources are stripped of their human dignity and lose their right to a decent living. That is why we argue for analyzing the role of corporate actors and government actors in reducing extreme income inequality. To ignore income inequality as a social, economic, and political issue and, hence, a legitimate topic for social science research is short-sighted at a scholarly level and immoral at a practical level.

A more sophisticated and well-founded understanding of the economic system would take income inequality seriously. It would not turn a blind eye to the distribution of ownership and rights of disposal. It would account for the different demands of information and coordination implied in the production of private and public goods. And it would distinguish and value the need for both self-regarding and other-regarding motivations (Enderle, 2018a).

We agree with Agarwal and Holmes about the desirability of a political system guaranteeing political equality to every citizen, not only because it protects the rich and poor equally but also because it has the potential to improve the economic well-being of people who are stuck in the lower rungs of the tall income inequality ladder. Citizens with low economic power but with the same political power as the rich may be able to bring about a higher minimum wage, which would immediately reduce income inequality, assuming no corresponding increase at the top of the income hierarchy. Enderle (2018b) offers many ideas on what firms can do to decrease income inequality. At the same time, the government can take care of the activities it is in the best position to perform, such as providing the public goods of health care, education, safety, and a clean environment. In such ways the quality of life of everyone and the quality of the workforce can be improved for more productive and innovative work benefiting both the rich and the poor.

POINT 3: DO NOT FOCUS ON INCOME INEQUALITY ALONE

Agarwal and Holmes advise against focusing on income inequality *in and of itself*, a position that seems to be based on a truncated understanding of income inequality that excludes income poverty and income mobility. Income inequality is about the *entire distribution* of income within a population, in both its cross-sectional and longitudinal dimensions. It is an essential part of a comprehensive

conception of economics that encompasses both "(1) the overall growth of the economy over time and the determinants of that growth (or stagnation or decline) and (2) the distribution of income within that economy in the course of its growth or decline" (North, 1972: 468). Interestingly, Agarwal and Holmes write:

We do not want to be misunderstood—issues of poverty, income mobility, and unequal protection of political equality urgently deserve scholarly attention, and they warrant a careful analysis of how markets and governments can hinder or help progress on these dimensions (2018: 457).

But, as explained in our essay (Tsui et al., 2018), wealth creation and wealth distribution are intricately related. We are puzzled by how and why Agarwal and Holmes could conclude no relationship between income inequality and income poverty or income mobility.

Inspired by Agarwal and Holmes's ideas, we summarize several additional research questions, beyond those suggested in our original essay. First, the extreme income inequality in the United States is an empirical puzzle that deserves systematic analysis. If Agarwal and Holmes took the problems of income mobility and income poverty seriously, they could not ignore the problem of income inequality. Investigating their relationship and identifying different antecedents and consequences of each issue is a worthwhile research agenda. Second, political equality with a sound foundation of basic rights does not contradict income inequality reduction. The interdependent relationship between political equality and income equality should be of interest to social scientists and may have implications for public policy. Third, we may investigate whether and how perceptions of distributive justice differ between those occupying the lowest and the highest ends of the extreme income inequality distribution within organizations. Fourth, the proposed concept of procedural justice ignores the unequal initial resource endowments of market participants. The government may reduce or slow down extreme income inequality by direct redistribution (e.g., by taxes) or by restoring some degree of political equality to the working poor (e.g., allowing unions and collective bargaining). Research can compare different forms of government intervention to ensure both distributive and procedural justice. Fifth, governments in market-based economies are responsible for ensuring,

at least, the basic rights (of security and subsistence) of all citizens. To the extent that extreme income inequality contributes to the violation of these rights through the neglect of the poor and the power grabbing of the rich, governments may need to correct the power imbalance, reduce extreme income inequality, and restore political equality. Based on sound principles of distributive and procedural justice, governments in market-based economies can reduce extreme income inequality by policies of redistribution. Identifying the optimal forms of government intervention will require comparative analysis across nations.

To conclude, we thank Agarwal and Holmes for opening the debate on the role of government, firms, and civil society, as well as the heterogeneity of individual ability, in understanding the extreme income inequality in the United States. This is an important research agenda for economists, political scientists, sociologists, management scholars, and multidisciplinary teams. Atkinson (2015: 153f.) called for "a national conversation" about the distribution of income. We call for research attention to the puzzle of extreme income inequality not only in the United States but also in other developed or emerging economies. This is necessary for a comprehensive understanding of both universal and contextual factors as potential causes and consequences of extreme discrepancy in income among people in some societies (Tsui, 2018; Van de Ven, Meyer, & Jing, 2018).

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Microfoundations of Institutions: A Matter of Structure Versus Agency or Level of Analysis?

In his January 2018 article, Cardinale seeks to advance new microfoundations for institutional theory by reformulating two assumptions underlying the structure versus agency debate—that structure constrains and enables action and that agency is mostly associated with reflexivity—which, he argues, have hindered the field's ability to make substantive theoretical progress. While an intriguing proposition, we argue that equating the microfoundations of institutions with the structure versus agency dichotomy produces two problems that limit our advancement of this stream of work. First, it leads to the

mistaken assumption that the best way to advance our theorizing is to provide another solution to the paradox of embedded agency. Second, it also leads to the mistaken assumption that by "micro" in microfoundations, we are focusing on the role of individuals in institutional processes. We outline the strengths of Cardinale's argument and then argue that a focus on levels of analysis, which is backgrounded in Cardinale's theorizing, would serve as a more promising platform upon which to advance our understanding of the microfoundations of institutions.

STARTING WITH STRUCTURE VERSUS AGENCY

Cardinale's two major reformulations to the structure-agency debate are to claim (1) that structure not only constrains and enables action but also "orients" action toward certain possibilities and (2) that agency is not only reflective but can also be pre-reflective in nature. To make these claims, Cardinale draws on a practice perspective lens (Smets, Aristidou, & Whittington, 2017) so that he can conceptualize social structure as social positions and habitus. Conceptualizing social structure in this manner, instead of as more macro constructs (e.g., logics, fields, complexity, etc.), is an important theoretical move for Cardinale. In particular, it allows him to explain that social structure does not influence individual behavior in an automatic or mindless fashion—which more macro structural concepts are often accused of doing—but, rather, in an orienting and pre-reflective fashion that is guided by our historical positioning and habitus. We find this point insightful insofar as it provides one reasonable solution to the paradox of embedded agency (Battilana & D'Aunno, 2009; Garud, Hardy, & Maguire, 2007). By defining social structure as social positions or habitus, Cardinale is able to critique the oversimplified parallel sometimes made between structure only producing mindless individual behavior and individuals shaping structure only in a deliberate fashion. Yet does it move us toward new microfoundations for institutional theory?

WHAT ARE MICROFOUNDATIONS?

From our point of view, a microfoundational approach to institutions seeks to explain the