Thinking Like a Sociologist about Earnings Inequalities

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What would a truly sociological study of earnings distributions look like? It would focus first on where the money comes from and second on the social relationships that both produce and distribute the cash. Simple.

It would not look like human capital theory, the dominant model used in sociology today to explain income distributions. It certainly would not start with the baseline assumption that individuals have skills, deploy these at work, produce contributions to value added, and then mechanically get these contributions back as wages, with deviations from this individual productivity story being either unjust deviations from meritocracy or discrimination. There is a somewhat more sophisticated approach in sociology that focuses on occupations. In this approach a more or less static occupational structure is posited to exist, and earnings hang off that structure like fruit on a tree. If you can creep out on a good branch, you can get a high wage; otherwise life is small, rotten apples.

The human capital model fails in its obviously false individualism. The occupational model reifies structure. Both for the most part ignore social relationships in their organizational and institutional context. We can do better.

Where does the money come from? It comes from organizations that contain internal divisions of labor and organizational synergies in production matched to external relationships with suppliers, customers, and the state that determine their power to convert organizational products into realized organizational income. How is the cash distributed? Via the internal social relationships between actors, where relatively powerful actors get more money. Charles Tilly (1999) in Durable Inequality highlighted the internal processes. Economic sociologists, in a less synthetic fashion, have shed some light on the external processes through which value pools in organizations (e.g., Burt 1983; Uzzi and Lancaster 2004; Wilmer 2018).

These approaches are more authentically sociological in that they share an assumption that value creation and distribution are relational processes, dependent on the type and quality of relationships both within and between organizations. Recently, with others, I have become a proponent of relational inequality theory (RIT) as the sociological alternative to individualistic human capital or structurally static occupational models (Avent-Holt and Tomaskovic-Devey 2014; Roscigno and Wilson 2014; Tomaskovic-Devey 2014; Wilson and Roscigno 2014). In the RIT model, organizational resource pooling, exploitation, closure, and claims-making are the central processes distributing inequalities. Which mechanisms dominate and which categorical distinctions operate are products of the confluence of external organizational fields and internal inequality regimes.

Old models have large scientific advantages. They have often dictated earlier rounds of data collection, they have cognitive priority in explaining novel situations, and they are self-legitimizing. I can't count the number of times that sociologists, confronted with a gender gap in earnings, have suggested to me that there might be unmeasured gender differences in productivity. These people do not usually believe that this is the explanation; but since the other explanations—discrimination and self-selection to low-wage jobs—are also not observed, they default to a human capital explanation. I find this irritating.
This brings me to the book at hand, Olivier Godechot’s *Wages, Bonuses and Appropriation of Profit in the Financial Industry: The Working Rich*. An earlier version of this book was published in French (Godechot 2007) before the financial crisis. The English-language book has been updated to take into account the global financial crisis and new research on the global financial industry. Most centrally, the volume proposes both a method and a theory of how we should understand income distribution processes and inequality more generally. Godechot employs a holistic analysis, incorporating his own participant observation of a trading desk, interviews with many financial service employees in multiple firms and countries, analyses of both firm and administrative data on financial firm income distributions, close readings of others’ research as well as memoirs of financial service employees, and a strong theoretical analysis of both relational models of inequality and counternarratives from economics.

Employees in financial service firms, particularly in their investment arms, have seen an explosion in their income; thus the subtitle of this book, “The Working Rich.” This allows us to explore the first question, “where does the money come from?” We can begin with the flow of resources. The combination of new investment instruments, the shift from production to shareholder value ideologies, the growing appetite of the wealthy for financial over production investments, and the importance of financial firms for organizing increasingly global production all led to the great growth of income in the finance sector. Basically, all of these expanding financial transactions were taxed by financial service firms as they accelerated across the world economy. This led to very large volumes of money available for distribution to these firms’ stakeholders.

Godechot shows that the structure of financial service firms is an important part of this story—owners and clients provide capital; salespeople develop relationships with clients who place orders for stocks, bonds, foreign exchange, and increasingly complex financial instruments like credit default swaps, derivatives, and the like; traders make deals in the financial markets to buy and sell and in some cases create these financial instruments; and there is a back office that includes clerical roles, IT, HR, accountants, and managers of various sorts. These are the social roles in the production process, and all are necessary to generate the fantastic revenue streams. Together the job of these actors is not simply to assign a fee structure to transactions, but also to produce spreads between the cost of the transaction and the client’s return in order to produce additional profit for the firm. Financial incomes mushroom because these types of investments are accelerating and fees proliferate; but also, opportunities for exploitation of clients, politely disguised as technical “spreads,” are sought by traders in every transaction.

What about the internal division of these super-profits? Godechot focuses primarily on the investment arms of financial service firms. It is here that the very high earnings of traders and salespeople are found and where the bonus culture has been most extreme. These are the working rich, not owners or even CEOs, reaping the rewards of being in an income-rich organization. Top bonuses in the millions of dollars are not uncommon, and the highest 10 percent of earners often take home a quarter of the firm’s wage bill. So while earnings are pooling in these firms, they are distributed very unequally.

How do employees in general and traders in particular come to appropriate so much of the economic profit of these firms?

A key part of the answer has to do with the ability to both claim and recognize profit. One might expect that the salespeople, who cultivate close personal relationships with powerful clients, would be the most powerful actors. They control the flow of orders and the investment activity that generates fees for the bank. In fact, salespeople make claims along exactly these lines; but they lack the ability to directly say how much profit they generated because the firms’ accounting systems count profits from trades, and it is the traders that execute trades. Because each trade is inherently risky and the bank makes its money not only on fees but on small spreads on the trading floor, it is only after a trade is executed that the profit is known. Thus the accounting system generates recognizable profit among traders, who come to believe and claim that they, and
they alone, are responsible for that profit. Clearly this is never true—the whole division of labor outlined above is required—but profit only becomes visibly tied to particular groups of product-specialized traders.

A second part of the answer is that investment banks have bonus-based systems of compensation. In these systems, investment capital—the owners—is not treated as having an unchallenged claim on the super-surpluses but rather is “paid” a fair rate of return given the riskiness of the investment; and then the remaining surpluses are split between a bonus pool, which can be up to 50 percent of the remaining surplus, and shareholders’ cut of the super-profits. Employees, including traders, salespeople, and various back-office personnel, make claims on this bonus pool.

The most powerful departments are the traders, particularly the trading desks that, according to the accounting software, have had very good years. Among the trading desks there is considerable negotiation as to who is most deserving in any given year. This is true for individual traders as well. There is substantial closure around trading desks, with each desk guarding its financial instrument from incursions by other desks. If salespeople or back-office IT engineers want access to super-incomes, they generally must get hired onto a trading desk. Occupational closure keeps the big paydays in the hands of traders.

Salespeople come next, but their power is dispersed not only because of their inability to appeal to the accounting system, but also because they typically work with clients who are buying and selling across various financial instruments; and in any given year, some do well and others do not. Thus their potential claims-making power is dispersed. The back office comes last and never realizes incomes in the millions of dollars, but they may take home bonuses equivalent to their annual salary. The system of compensation is driven by the relative power of actors to make claims over resources, but even the losers in this negotiated order benefit from the super-profits of their firms.

There is a third structural source of power, enjoyed by salespeople and, especially, traders, that Godechot refers to as “hold-up” power. Although both salespeople and traders accumulate their social connections, trade secrets, and effective trading and sales practices socially within the firm, they control these specialized “joint investments” in their relationships. Salespeople can threaten to leave for other firms and take their clients with them. Traders can threaten to take their know-how, firm-developed algorithms and other specialized trading routines, and even on occasion whole offices of coworkers if their bonuses are insufficient. It is the ability to transfer firm assets to other firms that allows these actors to exploit their employers and co-workers via the hold-up mechanism. Godechot shows that firms sometimes attempt, but generally fail, to counter hold-up power with non-compete clauses.

Godechot does not document what happened to lower-level employees’ earnings. For the United States, Ken-Hou Lin (2015) has shown that during this period of financialization, lower-level employees’ wages dropped, particularly after the financial crisis of 2008, while upper-level employees’ incomes soared. Since these super-profits were coming from the investment arms of these firms, one might suppose that those lower-level employees, because they were not directly implicated in the division of labor producing super-profits, were simply excluded and, after the financial crisis, took wage cuts in order to support the dropping incomes of traders and salespeople during the financial crisis.

Finally, Godechot demonstrates that this negotiated inequality regime is produced structurally, as just outlined, but also discursively. Traders and salespeople make claims based on the generation of profits, and their claims are often the most compelling. Traders claim to have “created value” for the firm and own a share of “their profit.” The back office makes claims based on their hard work, devotion to the firm, and clever computer systems. There are recurring negotiations as to what constitutes the value pool to be distributed, which shares go to which departments, and who has the strongest legitimate, even moral, claim on organizational resources. Godechot describes this process as “opportunistic calculation” because actors use whatever claim works. If the claim to have generated profit is not treated seriously, then a claim of effort, or
citizenship rights, or merit or seniority or the threat to leave may all be deployed strategically until the pool of income is distributed. Power is both structural and discursive, and the two reinforce each other.

One of the key insights of this study is that while the distribution of income is explained and justified by discourses of individual skill, productivity, and “market forces,” the actual distribution of income is a function of the power of actors in specific relationships. Some of this power is personal, located in the social capital lodged in relationships with coworkers and clients, but much is structural, lodged in divisions of labor. The super-incomes of the heads of trading desks are fundamentally tied to their ability to understand and coordinate the activity of many specialists, none of whom can control the whole. There are no causal stories of individual skill or occupational power in this book. There are, however, many claims-making stories of individual skills and occupational functions told as legitimating devices in the relational struggle for larger shares of the profits of firms.

Late in the book Godechot points out that the power of heads of trading desks is not unlike the power of subcontractors in the early putting-out system of capitalism. They control the production process and so have substantial power not only over the people they employ, but also over the capitalist that employs them. Power lies in control of assets, of knowledge and authority to coordinate tasks, and in the ability to mobilize legitimate claims over the distribution of surplus, for oneself and also for one’s favored subordinates. This book provides a model for what a relational study of income distributions can look like. Godechot largely ignores occupational models in sociology, resolutely sticking to the relational evidence in the data, while making clear that individualistic

and market models of income distribution processes have only a passing resemblance to the actual processes generating organizational resources and dividing them up.

I am very enthusiastic about this book and recommend it highly to anyone looking for a truly sociological model of the processes by which income gets distributed. The hardback is very expensive, but the ebook is not. The earlier French version (Godechot 2007) is also available and quite reasonably priced. Read this book.

**References**


