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Has performance pay contributed to the rise of inequality in the United States?

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The tremendous amount of attention paid to Thomas Piketty's book *Capital in the Twenty-First Century*, as well as the French economist's more academic writings, have helped raise awareness of rising economic inequality in the United States.

Maury Gittleman and Brooks Pierce, economists at the Bureau of Labor Statistics, examine one facet of inequality in the United States, the widening gap between the pay of those at the top of the distribution and that of those at the bottom, in "Pay for performance and compensation inequality: evidence from the ECEC" (ILR Review, January 2015). They assess the influence of the use of performance pay on this rising dispersion, where such pay takes the form of piece rates, commissions, and bonuses. Economists consider performance pay to be a tool that better aligns the compensation of workers with their productivity. Firms use piece rates and other pay-for-performance compensation practices to elicit higher levels of effort, to attract more productive workers, or both. If, over time, a greater proportion of jobs use such a tool, perhaps because new technology makes it easier to monitor worker output, then inequality is apt to increase; more workers would be paid on the basis of their varying productivity levels, rather than having everyone paid a similar rate for the same job. It is also possible for performance pay to widen inequality through a second channel. In situations where technological change and globalization create rising demand for skilled workers, firms may find it advantageous to use performance pay to distinguish highly productive workers from less productive ones. In this case, dispersion will be increased both from an expanded use of performance pay and from a boost in its inequality-enhancing impact.

Gittleman and Pierce do indeed find that, at any point in time, performance pay is associated with higher levels of inequality. Their results suggest, however, that jobs using performance-based pay have made only a modest contribution to increased inequality during the 1994 to 2010 period they examine.