Global Income Inequality

GLENN FIREBAUGH

Abstract

This essay describes the evolution of global income inequality over the past two-and-a-half centuries, and its likely evolution during the twenty-first century. Global income inequality—the sum of inequality within and between nations—is massive today, the legacy of uneven growth in the world's regions since the advent of the Industrial Revolution. Because incomes shot up in the West while lagging behind in Asia and Africa over most of this period, between-nation income inequality grew dramatically, and most global income inequality now lies between nations. Economic growth remains uneven across the world's regions, but the fastest growth is occurring in populous poor regions of the world, compressing between-nation inequality. As a result, global income inequality is currently receding, according to most (but not all) investigations of the matter. The compression of global inequality is attributable to rapid economic growth in China and India: If the rate of economic growth in China and India were the same as in the rest of the world, global income inequality would not be declining. The slow rate of economic growth in sub-Saharan Africa, on the other hand, is retarding the decline. A high level of global income inequality is problematic in large part because it results in abject poverty for masses of people. If average income in the world continues to rise, alleviating abject poverty in the twenty-first century, for future generations the level of global income inequality might matter much less than the level of income inequality within local communities.

INTRODUCTION

Global income inequality refers to the disproportionate distribution of income among the world's citizens. Over the past two-and-a-half centuries, dramatic growth in the world's average income has benefited some regions and population groups much more than others. As a result, the level of global inequality observed in today's world is massive. If you live in Germany or Switzerland or the United States, you most likely are enjoying a standard of living that your ancestors could scarcely imagine. If you live in a tribal village in central Africa, on the other hand, your standard of living may be roughly similar to that of your great-great grandparents.

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Because nationality is the single most important determinant of income in today's world, investigations of global income inequality most often focus on the question "Why are some countries and regions so rich and other countries and regions so poor?" It is useful to think of global income inequality as consisting of two components: Inequality in the average income across nations, or *between-nation inequality*, and inequality in the incomes of individuals within a nation, or *within-nation inequality*. That is:

$$I_G = I_B + I_W \tag{1}$$

where I_G refers to global income inequality, I_B refers to between-nation inequality, and I_W refers to within-nation inequality. The between- and within-nation components are weighted by the population size of each nation. That weighting is necessary to give every citizen of the world equal weight; otherwise, the income of an individual in less populous countries (such as Luxembourg) would carry more weight than the income of an individual in a more populous country (such as China or India).

To conceptualize global income inequality as the sum of between-nation and within-nation income inequality, imagine that in every nation we redistributed incomes by taking from the rich and giving to the poor, so that everyone in a particular nation possessed the average income of that nation. In doing so we would eliminate within-nation inequality. However, because average incomes vary greatly from country to country, substantial global inequality would remain. In fact, the differences in national incomes are so large that at least two-thirds of global income inequality would persist if we eliminated all inequality within nations (Goesling, 2001).

Because the majority of global income inequality is attributable to national differences in average income, foundational research in this area has focused on differences in the national and regional rates of income growth historically. A central finding is that world productivity has grown much faster than world population over the past 250 years, so individuals in today's world generally are many times richer than individuals living in the 1700s. At the same time, income is much more unequally distributed among the world's citizens today. In the next section I briefly overview the historical trends. In the sections that follow I describe current trends in income inequality research and discuss potential areas of future research.

FOUNDATIONAL RESEARCH

Period of Rising Inequality, Mid-Eighteenth Century to Mid-Twentieth Century

The Industrial Revolution ushered in a period of history characterized by dramatic growth over the long run both in average income and in global

income inequality. Average income grew because, contrary to the dire predictions of Thomas Malthus (1798), unprecedented world population growth was accompanied by an even faster rate of growth in world production. At the same time, global income inequality also grew because the income growth was highly uneven. Incomes shot up rapidly in the Western world in particular, while growth lagged behind in Asia and sub-Saharan Africa.

Given the uncertainty of income estimates for the world's regions in the mid-eighteenth century, how do we know that since then there indeed has been, in the words of Pritchett's (1997) title, "divergence, big time"? First, the level of global inequality witnessed today—where incomes in the world's richest and poorest regions differ by a factor of 20 or more—are implausible in the context of the much poorer world of our ancestors. In 1750, a large portion of the population would not survive under the level of global inequality existing today. Second, on the basis of the best income estimates available, Bourguignon and Morrisson (2002) find that between-nation inequality increased greatly from 1820 (their first data point) until the mid-twentieth century, thereby boosting global income inequality. Finally, even with the uncertainty in income estimates, it is clear that during the period of Western-led industrialization (the period from about 1750 to about 1950) the growth poles in the world economy were located in the richest regions. When income grows faster in richer units than in poorer units, income inequality rises by definition. That is what happened in the two centuries after 1750: Income generally grew the fastest in the richest regions of the world and the slowest in the poorest regions, resulting in the immense degree of global inequality observed today.

Contours of Global Income Inequality

In the pre-industrial world, before the rise of the middle class, the majority of global income inequality was located within nations. With industrialization the fraction of global income inequality attributable to between-nation inequality grew, as rising between-nation inequality was accompanied by stable or falling within-nation inequality (Bourguignon & Morrisson, 2002). The result, as noted earlier, is that nationality has become the single most important determinant of an individual's income. Although still paramount, the importance of nationality now may be lessening, as recent evidence suggests a reversal of the trends in between-nation and within-nation inequality (Bourguignon & Morrisson, 2002; Firebaugh, 2003). That is, within-nation income inequality is rising in many regions of the world whereas between-nation inequality is declining.

BETWEEN-NATION INEQUALITY

It is not an easy task to compare the relative incomes of nations. Nations produce different commodities and services and value them differently (what is the value of a ton of steel relative to a thousand haircuts?), and the mix of products and services is constantly changing (the nineteenth century knew nothing of computers or airplanes or cell phones). Despite these complications, even casual inspection indicates that Swedes generally enjoy higher living standards than Chinese, and great efforts are expended in data collection worldwide to try to quantify these differences by measuring the quantity and price of goods and services produced in nations around the world. (It is also the case that within China residents of Shanghai generally enjoy higher standards than do peasant farmers. But that bears on within-nation inequality, which we examine in the next section.)

After two centuries of growth, between-nation inequality stabilized in the final decades of the twentieth century and is now declining. To be clear on this point, it is important to distinguish the trend in between-nation income inequality (component I_B in Equation 1) from the trend in *unweighted* between-nation income inequality (Milanovic, 2005). Because we want to give everyone in the world equal weight when calculating global inequality, it is weighted between-nation inequality (I_B)—not unweighted inequality—that bears on global income inequality. Some early research caused confusion by inferring the trend in global income inequality on the basis of the trend in unweighted between-nation inequality. Many small poor nations in sub-Saharan Africa have experienced little or no income growth in recent decades. As a result, there are more poor *nations* where incomes are growing slowly than there are poor nations where incomes are growing rapidly, so *unweighted* between-nation inequality has been growing. Yet *many more people* live in the poor nations where economies are growing rapidly, so weighted between-nation inequality has been declining.

In short, the trends in weighted (I_B) and unweighted between-nation income inequality are going in opposite directions. The issue of whether between-nation income inequality is boosting or compressing global income inequality turns on whether incomes are rising faster on average for *individuals* in rich nations or in poor nations—on the trend in I_B—and in recent decades the overall rate of income growth has been faster for individuals in poorer nations. This is the case because of rapid economic growth in China and India, where 40% of the world's people live. Outside of China and India, between-nation income inequality is not declining. And if between-nation inequality were not declining, global inequality would not be declining either, since it is the decline in between-nation inequality that is driving the decline in global inequality.

The rate of economic growth in China and India, then, is a principal determinant of the direction and rate of change in global income inequality today. Another key is the rate of economic growth in sub-Saharan Africa. The vast majority of the world's poor live either in Asia or in Africa. In sharp contrast to the robust income growth experienced by many Asian nations in recent decades, many nations in sub-Saharan Africa have lagged behind economically, resulting in the "Africanization" of world poverty. This slower-than-world-average income growth in sub-Saharan Africa has operated to retard the decline in global income inequality. In other words, if incomes in sub-Saharan Africa grew as fast as in the rest of the world, global income inequality would be declining faster than it is.

In short, in the two regions where most of the world's poor live, the rates of growth of national economies have had opposing effects on global income inequality (Firebaugh & Goesling, 2004):

- Faster-than-world-average income growth in Asia has worked to narrow global income inequality.
- Slower-than-world-average income growth in sub-Saharan Africa has worked to increase global income inequality.

Because many more people live in Asia than in Africa, recent studies (Hung & Kucinskas, 2011; Sala-i-Martin, 2006) find that the net effect has been a reduction in global income inequality over the past several decades.

WITHIN-NATION INEQUALITY

Within-nation inequality is the second component of global income inequality (Equation 1). Measuring within-nation inequality is as challenging as measuring between-nation inequality. In the case of between-nation inequality, there is the formidable challenge of quantifying differences in societies that produce and consume different products and services. To calculate between-nation inequality, we need data and methods for generating per capita income figures that reliably reflect the relative economic standing of average citizens of different nations.

Measuring *within-nation* income inequality requires data on the distribution of incomes within each nation—not just income means for each nation. Standard national currencies make it easier to quantify the level of income inequality within nations than between them. The task of estimating within-nation inequality for every nation nonetheless is difficult. The first challenge is the absence of nationally representative individual-level income data for many nations. In some instances, there are no individual-level income data at all. In other instances, the data that exist are for a sample of

residents (e.g., urban dwellers only) that are not nationally representative. Even when nationally representative data exist, they might not be comparable across nations. Some are based on pre-tax incomes and others on post-tax incomes; some include unearned income and some do not. And nations vary significantly in terms of the services (health, housing, etc.) they provide their citizens. How are these services factored in when comparing the level of income inequality within one nation versus another?

On the basis of current data, income inequality most likely is rising in the average nation, thus slowing the decline in global income inequality caused by reductions in between-nation income inequality. The precise contribution of the within-nation trend to the global trend is uncertain. Although there is a vast research literature on income inequality within nations, that literature focuses largely on trends in inequality within a particular nation or group of kindred nations. Very often the objective is to determine why inequality is rising or falling in a particular country (e.g., there is an extensive literature on the causes of rising income inequality in the United States). No attempt is made in this literature to estimate the contribution of those trends to the more general trend in global income inequality. Because income inequality appears to be rising in the world's most populous nations (China, India, United States, and Russia), most agree that the world-average trend in within-nation income inequality is tracking upward. In the absence of falling between-nation income inequality, then, it is thought that global income inequality would be rising, as within-nation inequality is increasing on average.

To summarize, world population has increased dramatically since the advent of the Industrial Revolution, but world productivity has increased even faster. As a result, a world where most people were poor has evolved to a much richer world. In this much richer world, incomes are very unevenly distributed because, historically, income growth in richer regions has far outpaced income growth in poorer regions. I now describe how current research finds different patterns of growth in today's world.

CUTTING-EDGE RESEARCH

Global income inequality shot up during the period of Western-led industrialization (from the mid-eighteenth century to the mid-twentieth century) as the West took off economically while Asia and Africa lagged behind. This pattern of growth changed in the waning decades of the twentieth century, with some of the poorer regions of the world experiencing the fastest income growth. Because the fastest growth was concentrated in Asia, where a majority of the world's poor live, the regional growth differential this time operated to compress global inequality, as many of the billions of individuals

living in China, India, and adjacent regions saw their incomes rise toward the world average. Because of this great compression from below, the period of "divergence, big time" ended, and we have entered a new historical epoch marked by declining inequality between nations and rising inequality within them (Firebaugh, 2003).

Has the shifting of the world's income growth pole to Asia reversed the trend in *global* income inequality? Empirical research in the past decade has been devoted to addressing this issue (Hung & Kucinskas, 2011; Milanovic, 2005; Sala-i-Martin, 2006). Most of this new research finds that global income inequality is now declining. That conclusion is not universally accepted, for two reasons. First, it runs contrary to theories stressing the ability of richer nations to maintain their advantaged position through unequal economic transactions with poorer nations (but not contrary to convergence theories stressing diminishing returns to scale as nations become richer). Second, some believe that the attempt to describe the trend in global income inequality is a fool's errand because the data on between- and within-nation income inequality are so problematic (Anand & Segal, 2008).

The fool's errand criticism is the more serious. It is fair to say that attempts to estimate the trend in global income inequality have been hindered historically by the absence of reliable data on the relative incomes for many nations. More recent studies have attempted to alleviate the problem by using data sets that calibrate economic activity for different nations on the basis of purchasing power parity (PPP) rather than on the basis of foreign exchange rates. Foreign exchange rates are seen as unreliable bases for determining the relative economic standing of nations because rates of exchange apply only to goods that are traded, and are subject to manipulation by governments. Although far from perfect, PPP methods for calibrating economic activity are regarded by most as a significant advance over foreign-exhange-based methods for estimating the relative living standards enjoyed by individuals in different nations.

At the least, the new empirical studies have been able to rule out some once-fashionable theories. Dependency theory, a popular theory in the 1980s and 1990s, was based on the assumption that international trade and other forms of international transactions constitute a type of zero-sum game rigged to favor rich nations, inevitably resulting in greater and greater global income inequality. Some proponents of the theory referred to this process as the "*development* of underdevelopment" to stress the point that poor countries are poor *because* rich countries are rich. It is now clear, however, that the massive inequality seen today resulted from growing incomes in some regions of the world, not from growing incomes in some regions combined with *declining* incomes in other regions. Moreover, the empirical work that appeared to support the development-of-underdevelopment argument was

found to be based on an erroneous interpretation of cross-national regression coefficients (Firebaugh, 1992).

KEY ISSUES FOR FUTURE RESEARCH

Better Inequality Data

The discussion points clearly to the primary issue facing global income inequality researchers: data quality. Despite earnest efforts to collect comparable data for every nation in the world, data quality is uneven, and our estimates of both I_B and I_W are far from perfect. Because the data are so noisy, it is generally not possible to draw firm conclusions about global trends on the basis of a few years of data. A longer period of observation is required to detect meaningful change. A key issue for future research involves the steady expansion and improvement of data collection operations throughout the world. The success of this endeavor cannot be taken for granted because it will depend on the cooperation of governments and on adequate funding. Because international agencies such as the United Nations have other priorities, it is not certain that researchers can count on better income data in the future.

In addition to the attempt to improve the measurement of income itself, there are movements a foot in the social sciences that could shed new light on global income inequality by altering the conceptualization and measurement of income inequality. One approach is to expand measures of global income inequality to incorporate poverty and inequality in the same framework (Atkinson & Brandolini, 2010). Alternatively, future research on global income inequality might draw on the burgeoning literatures in psychology and behavioral economics on subjective well-being. “Happiness studies,” as they are sometimes called, seek to compare happiness and life satisfaction across individuals and societies. Whether measures of happiness and satisfaction are seen as substitutes or complements for measures of income, they are likely to infiltrate research on global income inequality. As cross-national investigations of happiness and life satisfaction become more standard, a literature on “global happiness inequality” might be close behind.

Whither Global Income Inequality?

Barring a collapse of the global economic system, what is the likely course for global income inequality in the twenty-first century? For the foreseeable future, the direction of change in global inequality will be driven by the direction of change in between-nation inequality. First, as noted earlier, the majority of global income inequality lies between nations. Second, the other component of global income inequality, I_W, is unlikely to change drastically

over a short period of time. Change in the income inequality in a particular nation is the result of many factors that are unlikely to be the same across all nations. At any point in time, income inequality grows in some nations and declines in others. Because change in I_W is the net result of national trends that generally are, to some degree, offsetting, we expect change in I_W to be relatively gradual.

Hence, the relative income growth rates of richer and poorer nations will determine the direction of change in global income inequality over the next few decades. If economic growth in Asia—and China and India in particular—continues to outstrip growth in the West, we can anticipate compression of global inequality. This compression will slow as average incomes in China and India approach the world income average; and if incomes in China and India eventually surpass the world average, continued faster-than-world-average income growth in these two countries will work to boost, not compress, global income inequality.

A key issue for future research, then, is whether the income growth poles we see in today's world will continue to be the growth poles throughout this century. If current patterns prevail, at some point we can expect a reversal of the current decline in the between-nation component of global income inequality.

Although between-nation inequality will drive most of the change in global income inequality, this does not mean that the within-nation component is inconsequential. Especially relevant here will be the direction and magnitude of changes in within-nation inequality in populous nations, as it is the big national differences that matter with respect to global income inequality. We do not need to know, for instance, whether the degree of income inequality is larger in Norway or in Sweden; it suffices to obtain a reasonable estimate of income inequality in both societies, which will show that it is substantially less than inequality in South Africa, for example. Because within-nation inequality constitutes only about one-third of global income inequality, and is weighted by population size, conclusions about the direction of change in global income inequality are relatively impervious to measurement uncertainty for small nations. For the most populous nations, though, it is important to obtain reliable estimates of the magnitude of income inequality to reduce the uncertainty in estimates of global income inequality. Increasing the reliability of estimates of global income inequality will require more accurate estimates of income growth and income inequality for China and India. Future debates over the magnitude and change in global income inequality are likely to hinge on alternative methods for estimating the incomes of China and India.

Will *Global* Income Inequality Matter as Much in the Future?

Growing world income raises the possibility that abject poverty—income levels insufficient to provide for basic human needs—could largely disappear in the twenty-first century despite the continuation of massive global inequality. There would still be poverty in a relative sense because under the current level of global income inequality some individuals would be much poorer than others, even if everyone had enough income to provide for adequate food, shelter, and clothing. That raises the issue of why global income inequality matters in the first place. Does global income inequality matter only (or mainly) because it bears on poverty in the absolute sense? Or are there other compelling reasons—such as social stability—for concern about a high level of global income inequality?

Those questions have remained largely in the background before because of more pressing concerns about alleviating abject poverty. To this point we have lived in a world where a high level of global income inequality necessarily meant abject poverty for a significant fraction of the world's population. Until the waning decades of the twentieth century, mass poverty had been the norm in the most populous region of the world, and it continues to be all too prevalent in some regions today. In today's world we want to reduce global income inequality in large part because we want to reduce the level of abject poverty in the world.

The motivation might be different in a world in which all poverty is relative. Of course we are far from such a world today. But suppose average world income quadrupled during the twenty-first century as it did during the twentieth century [based on Maddison's (2001) income data]—an average annual rate of about 1.4%. Even if global income inequality persisted at its current level, growth of this magnitude would substantially reduce abject poverty by the end of the century. In the long run, then, there might be less urgency in reducing global income inequality to alleviate the misery of abject poverty.

In a world where everyone has enough, how much does it matter that some have lots more than others? More than a century ago Veblen (1899, Chapter 2, paragraph 16) asserted that "the end sought by accumulation is to rank high in comparison with the rest of the community in the point of pecuniary strength." Veblen's assertion has been supported by subsequent research. People desire not just to be rich, but to be richer than others like them. Moreover, as incomes rise so that everyone has enough to meet basic needs, relative income matters all the more, compared to absolute income.

If relative income effects increasingly trump absolute income effects as incomes rise, future research on global income inequality will need to pay

more attention to the largely unresearched question of how much global income inequality actually matters to individuals as they go about their daily lives. In a world where global inequality is predominantly between nations, it is not clear how much global income inequality matters to ordinary citizens who are largely interested in comparing their well-being to that of those who are "like them" in their own nation.

The point I am making is similar to David Miller's (1999) point about justice. Inequality within communities or nations differs qualitatively from inequality between nations. As an American, I may protest if the standard of medical treatment I am offered is vastly inferior to that of other Americans, but I am not as offended if the standard is inferior to that available in France. From the viewpoint of an individual, inequality is more problematic within a community than across communities. If relative income effects matter most in a rich world, and if relative income effects are based on comparison to others in one's community, within-nation inequality is more salient than between-nation inequality in individuals' daily lives.

Ascertaining the human costs of global income inequality for the twenty-first century will depend on the rate of world economic growth as well as on the magnitude of global inequality. If world income continues to grow and abject poverty becomes less common, there will be important work for social scientists in linking global income inequality to the emerging research on relative income effects and subjective well-being. If history ordains instead a sharp decline in global economic fortunes in the remainder of the twenty-first century, then the foregoing argument is turned on its head. In that case, the costs deriving from relative income differences become secondary to the more urgent issue of the contribution of global income inequality to absolute poverty in the world.

How is Global Income Inequality Related to Globalization?

The question is difficult to answer because we do not know what the level of global income inequality would be today if the level of globalization were different (either higher or lower). The fact that global income inequality recently has leveled off or declined in the face of the rising economic integration globally may provide pause for those who believe that globalization exacerbates global income inequality. But other things have changed as well, so it is difficult to single out the causal effect of globalization itself on global inequality; perhaps global inequality would be declining even faster under lower levels of intercountry economic integration. Because a definitive resolution is unlikely, the debate over the globalization–global inequality link is likely to continue well into the future.

CONCLUSION

Global income inequality is important in large part because it is linked to poverty in today's world. By redistributing income to the poor globally, we could reduce poverty. But world poverty rates could also be reduced by continued world economic growth, absent any reduction in global income inequality. Inequality constant, poverty in an absolute sense becomes increasingly delinked from global income inequality as the world become richer, and the focus of global inequality research then naturally shifts from the effect of income inequality on objective well-being to its effect on subjective well-being. A poorer future world implies the opposite. In a poorer world, global income inequality is more closely linked to the objective well-being of the world's citizens because redistributing the world's income in favor of the poor is even more imperative for reducing the rate of absolute poverty in a poor world than in a rich world.

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GLENN FIREBAUGH SHORT BIOGRAPHY

Glenn Firebaugh—currently Roy C. Buck Professor of American Institutions, Sociology, and Demography at the Pennsylvania State University—has also held regular or visiting appointments at Vanderbilt, the University of Michigan (Summer Institute), and Harvard. Firebaugh served as Editor of the *American Sociological Review* from 1997 to 1999 and as Head of the Sociology Department at Penn State from 2001 to 2004. He has lectured and published widely in the areas of stratification, social demography, and methods. In work in progress, Firebaugh is investigating racial inequality in neighborhood conditions as well as investigating the "final inequality"—inequality in age at death. He is author of *The New Geography of Global Income Inequality* (Harvard, 2003) and *Seven Rules for Social Research* (Princeton, 2008). Website: http://sociology.la.psu.edu/people.

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