Earnings fluctuations and social policy
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Outline

- Three points
  - Inequality can be decomposed into a long- and a short-term component
  - Short-term inequality (earnings fluctuations) has risen
  - Rising short-term inequality has policy implications
Inequality decomposition

- A measure of inequality can be divided up into two parts
  - One measuring long-term (average, permanent) differences
  - Another measuring short-term variation around the long-term differences, a.k.a. fluctuations, volatility, temporary variability, transitory variance & uncertainty

Beach et al. (2003)
Inequality decomposition

Consider two persons with average annual earnings of 20,000 euro

Leaving average earnings unchanged, imagine one person suffering a 5000 euro drop in one year and an identical increase in the subsequent year

The other person goes through the opposite experience

This would lead to larger earnings inequality in each of the two years compared to a situation in which earnings showed no variability over time

Any rise in inequality could thus have been caused by either a surge in permanent inequality and/or a jump in temporary variability
Inequality trends

- Rise in inequality in many (but not all) industrialized countries
- Long-term or short-term?
  - Evidence from five countries
    - Canada
    - Italy
    - Sweden
    - the UK
    - the USA
  - Period approx. 1980 to 2000
  - All countries with increases in earnings inequality

Inequality trends: the US

Figure 1. Transitory variance of log male annual earnings, by year

Source: Gottschalk and Moffitt (2009), Figure 1
Inequality trends: the US

- Fluctuations account for 50% of the rise in inequality in 1980’s
- The importance of fluctuations for overall income has risen from 30 to 40% over the whole period 1970-2000

Inequality trends: an aerial view

Table 2. Summary of country specific trends in temporary earnings variability

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<thead>
<tr>
<th></th>
<th>USA</th>
<th>Canada</th>
<th>UK</th>
<th>Sweden</th>
<th>Italy</th>
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<tr>
<td>1975-1979</td>
<td>+</td>
<td>0</td>
<td>-</td>
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<tr>
<td>1980-1984</td>
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<td>1985-1989</td>
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<td>1990-1994</td>
<td>0</td>
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<td>1995-1999</td>
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<td>2000-2005</td>
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Note: + signifies increase, 0 stability, and - a decrease in temporary earnings variability. No cross-country comparisons of the size of the changes are possible.
Inequality trends: causes

- New field of research = little is known
- Different causes have been suggested, e.g.
  - Increased unemployment
  - Increased job instability
  - Globalization
  - Reduced employment protection
  - De-unionization/decentralization of bargaining
- Although unemployment and job instability are important, no single factor seems sufficient and a combination appears necessary

Social policy implications

- Good and bad fluctuations
  - Increases vs. decreases
  - Voluntary vs. involuntary
- However, uncertainty generally seen as negative in itself
  - and involuntary decreases clearly problematic
- Types of social policy
  - Proactive policy (ex. education)
  - Reactive policy (ex. unemployment compensation)
Social policy implications

• The rise in earnings fluctuation requires
  – Retaining/strengthening income protection
  – “Transferable” benefit eligibility
    • Unemployment and job instability imply weakened connections between employer and employee, so firm based benefits risky
• Yet social policy trends often the opposite
  – General reduction of benefits
  – Danger of increasing employer significance