Session 1: Trends in Equality and Growth in Canada and the United States

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"Earnings Instability of Women and Men in Canada: 1982-1997"

Thanks France. I want to thank Andrew for inviting me to come and discuss this paper. And I always have a disclaimer that these are not the official views of the World Bank. This paper addresses a key dimension of earnings and equality and I think the final comment that Ross Finnie made really addressed the point that I was going to concentrate on in my remarks. This is a clear paper and in a sense I found it quite an elegant paper in terms of how it handled what is a complex analytical issue in what was an efficient manner. So, although the dynamics that are being addressed in this paper are complex in many ways, I encourage you to go through the paper -- even if technically you're concerned about making your way through it -- because all of these issues are addressed in a very clear and understandable manner.

This a challenging paper because it is looking at the issue of income inequality in quite a different way than much of the literature does. As Charlie Beach mentioned, there have not been many papers that have taken this longitudinal approach to earnings inequality and we need to think differently about what the results of an analysis like this mean compared to the results of a more traditional cross sectional data analysis. I think from a policy maker's point of view as well, there's an awful lot in this kind of approach, but here too we need to look at it quite differently from the standard type of analysis.

What I want to do is to talk about the context for the paper; review a bit about the database; and then very briefly draw some conclusions and implications. The major contribution of this paper, at this point anyway, stems from the database which is quite unique in the Canadian context and what insights into inequality it can provide.

Because it's so different, let me reiterate the point of the paper. In a sense, it starts from a counterfactual situation where everybody has the same earnings every year. And what it does is take this tax based file and see how the reality departs from that counterfactual. At any point in time, the departure from the counterfactual, that is the total variation in earnings, will reflect two different things. One is the fact that people have different long run earnings profiles because of their skills or whatever characteristics you think are important (depending on the labour market theory you ascribe to). And second of all, the fact that people have good years and bad years -- they may have years when they're laid off, when they get a bonus, when for one reason or another their earnings depart from that long run trajectory. The LAD database allows us to evaluate what the relative weights of those two components are.

What's really interesting about these two components is that each of them addresses a very controversial and high profile aspect of the inequality debate. The permanent component looks at the more conventional aspect of earnings inequality and that is the changing returns to different characteristics of workers. We've seen this touched upon already this morning and we're going to see it many more times over the next two days -- that over the last 10-15 years in Canada and even more so in the US, certain types of workers are getting higher returns for their characteristics than they used to; other types of workers are not, at least in a relative sense, with the result that earnings distributions became more unequal. There are various explanations for that, which I'm sure we'll also be talking about: globalization, different labour market institutions, technological change. It's a vast literature and many of the people in this room have been important contributors to it.

The unique contribution of this paper is that it can address the second issue, which is the year to year change in what an individual earns. It can observe how, in a transitory way, an individual earns more or less in a given year than he or she might over the longer term. And this addresses the second key debate around the growing public concern (if not academic concern) about income inequality in the labour market -- insecurity and instability. Public opinion surveys in both Canada and the United States, but even in a number of other countries, have documented increases in workers' sense of their employment insecurity. And I think that there's a general perception that because of rapid technological change, because of more ruthless managerial strategies, because of the growth of non-standard employment forms, that the pace of job destruction has accelerated and that there is much more instability in the labour market. However, unlike the diverging earnings component (the permanent component), where there's a lot of empirical proof in support, there is really very little empirical proof in support of this perception of growing instability in the labour market. Researchers in Canada and the United States have looked at job tenure for example, to see if in fact job tenures have been shortening. This would obviously help to empirically support the notion of growing insecurity and instability. In fact the story's not very clear. This is not really a very well analyzed issue though because you need longitudinal data and this is where the LAD comes in. There are many advantages to it. Presumably it gives quite an accurate reflection of wages and salaries. It's got a very large sample. And it has a 16-year sample period, which is quite remarkable. So the data set itself is quite an achievement which took a long time … it must be almost 10 years because I can remember discussions with Ross Finnie at the Economic Council about this, to show you how long ago this project started.

Before turning to the findings, I wanted to make a couple of points about the analysis in the paper. One concerns the use of terminology. The paper situates the analysis as an examination of earnings instability with two components, a permanent component and a transitory component. I would argue that it's really just the transitory component that is

looking at instability. The permanent component should be cast as something else but not instability so we can really focus on the instability connection with the transitory component.

The second point that I think we need to think about concerns the choice of the periods for this two period analysis. The analysis compares the 1982-89 period with the 1990-97 period. But these are not comparable from a cyclical point of view. The authors, at least in the current draft, do note this. But in my mind -- at least at present -- it's not adequately recognized or discussed. The first period starts at the tail end of the 1982 recession. As we saw in the earlier presentations today, the 80's then had a relatively quick recovery, and this period ends in 1989, the last year of the expansion. So you've got one period with overall quite good economic conditions and then you have a second period of 1990-1997 which is characterized first by a very deep and severe recession between '90 and '92, a very slow recovery, and then this sample period ends just at the time that the Canadian economy is really starting to grow at robust rates. In terms of GDP per capita, the first period that the authors look at had an overall growth of 17%, the second period 5%. Hours worked for employee: the first period had a growth of 17%, the second period 4%. So if you believe that the cycle matters in determining earnings distributions, then the choice of sample periods should be reconsidered.

Essentially the authors have findings of two types. One is the relative balance of permanent versus transitory variance in earnings. This is largely unaffected by the choice of time periods. They show that roughly 2/3 of the variance is accounted for by permanent differences as opposed to the transitory differences. In other words the differences in what you and I earn over a long term period because of our characteristics matters twice as much as any year to year fluctuations. I think you'd expect that this would be the case and to the extent comparable analysis exists, at least in Canada, it has more or less found the same thing, although there is very little literature. Finally, they find that if anything the permanent component is increasing as opposed to the transitory component.

The second set of findings has to do with comparing the 90's to the 80's in terms of earning instability. I think that some kind of sensitivity analysis should be used in order to get more robust findings about the differences between the two decades. I'm not going to go over all of the results from the paper. But essentially, assuming for now that the time period differences are confirmed by more careful examination, the authors conclude that the overall variance is greater in the second period than the first. This really is only very minor for women. Almost all of the increase in instability, if that in fact happened, happens with respect to men.

So let me conclude by making a couple of comments. First of all about what this tells us about what's been happening in the labour market and those great debates of the 80's and

the 90's about inequality and instability. And then second of all, some very cursory remarks on the policy implications. On the first, I see this analysis doing is confirming the story, which we've gotten from cross sectional data, about diverging earnings profiles, especially for men. And I think that, given the accuracy of reporting and the size of the sample, this finding with the LAD is important confirmation. On the other hand, the data offers no support, at least at this point, for the perception of growing instability in the labour market. As we've seen, there's no evidence of the temporary component increasing and I would certainly look forward to seeing that confirmed by experimenting with different time periods to handle the cyclical issue.

Let me end by talking very briefly about what this analysis means for policy makers. And again, the longitudinal nature of it does force you to think differently about things. Presumably, a policy maker would want to think about what if anything to do about the two sources of variation that are described in this paper. Obviously if you want to reduce the overall variance in earnings, you're going to look first at the permanent component because that accounts for at least 2/3 of it. And that would bring you into issues of education and training, a whole range of issues that have to do with human capital development, perhaps tax issues as well. As Andrew mentioned in his opening remarks, there is a normative aspect to this question of how much you want to change overall earnings distributions. Certainly some people believe that it's very important to narrow them, other people believe that it's important for efficiency to have wide differences. I hope we're going to get some interesting discussion on this issue in this conference.

The transitory component is one that I think there's more consensus that there's a rationale for governments to deal with it. Obviously unemployment insurance or employment insurance is the classic instrument. The fact that there's no evidence of an increase in the transitory variance and the fact that it only accounts for 1/3 of the total variance doesn't necessarily mean that we shouldn't be worried about the instruments to handle transitory variances in earnings. And I think it would be very interesting to use these data to see how unemployment insurance payments and social assistance payments complemented transitory changes in earnings, especially for low paid workers who are the most vulnerable. The authors have talked at the end about additional research that they could do on this data file and exploring this relationship would be really useful. In terms of diagnosing the permanent component and thinking about solutions if you want to change the permanent element of the earnings distribution, my own view is that this is not the best database. It doesn't have richness in terms of human capital and demand side characteristics. But I would welcome ideas from the authors about how they could look at that. But certainly in terms of issues related to vulnerability to transitory falls in income, this is a really important database. And also the links to growth, especially how different growth rates effect this incidence of transitory variation. Thank you.

END DISCUSSION