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Research Highlights

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How continental Europe resembles North America: challenging the assumptions through a new approach to lifetime earnings inequality

Does the United States deserve its reputation as "more unequal than others"? Not according to an international comparison of lifetime inequality levels to be published in the *Journal of the European Economic Association*. This study finds that a large part of the "equality advantage" over the USA enjoyed by France and Germany disappears once some key, yet often ignored, elements are introduced into the analysis of inequality levels.

Economists Audra Bowlus and Jean-Marc Robin use panel data to compare earnings inequality levels at the turn of the century in five countries: the United States, Canada, the United Kingdom, France and Germany. At first sight, the data confirm that earnings inequality is the greatest in the United States. In 1998, the base year for the study, high-earning American men (90th percentile) earned close to five times more (4.88) than low earners (10th percentile) – a level that was almost double that found in France (2.55) or Germany (2.66). Canada ranked second, with a level of inequality closer to the USA and the UK than to continental Europe.

Men's 90/10 Ratios of Base-Year Earnings Compared to 90/10 Ratios of Lifetime Income Annuity Under Various Mobility Assumptions

	U.S.	Canada	U.K.	France	Germany
FIXED EFFECT MODEL					
Base-year earnings	4.88	4.02	3.20	2.55	2.66
Earnings mobility only	4.09	3.38	2.77	2.42	2.40
Employment mobility only	4.71	3.67	3.18	2.68	2.91
Lifetime values (full mobility)	4.15	3.48	2.89	2.68	2.74
Equalization ratio	0.85	0.87	0.90	1.05	1.03

This ratio, however, only measures *current earnings inequality*. It fails to take into account variations in the amount individuals earn over time, as earnings rise with experience or fall as hours are cut. Although economists agree that *lifetime earnings* provide a more accurate indicator of equality, studies which take this approach have encountered a number of problems.

First, the data requirements are immense. Measuring earnings over a lifetime requires data collected from the same individuals over decades. An international comparison requires these data for each country during the same time period.

Second, in order to have a complete earnings history, studies that take this approach tend to include only individuals with an uninterrupted work history. With unemployment a key factor in lifetime earnings, excluding individuals who have been unemployed is bound to affect the results. This problem is all the more serious when comparing countries with very different patterns of employment mobility.

Bowlus and Robin tackle these problems head on, testing the effectiveness of a more restricted data set, and incorporating spells of unemployment into the calculations. They first examine the earnings inequality levels in 1998, and check how it compares to levels of lifetime earnings inequality estimated by their model. They then explore how the results change in each country once employment mobility is included in the analysis.

The findings are fascinating and at times unexpected. They challenge some deeply held views about earnings inequality, and suggest that employment security policies can have some unforeseen consequences. The very policies that in France and Germany are designed to protect employees from low wages and lay-offs, for example, may actually increase lifetime earnings inequality - greater employment stability and longer spells of work can also mean lower job creation and longer periods of unemployment.

To find out more about the findings, about the creative solutions to the data and methodology challenges, and to discuss why this study “goes a long way towards an assessment of cross-country welfare differences,” join us at the UWORDC Brown Bag on Wednesday, April 13, 2011, Social Science Centre Room 5220.

Note: Summary prepared by Heather Juby, CRDCN Knowledge Transfer Coordinator, based on Bowlus, Audra J. And Jean-Marc Robin. An International Comparison of Lifetime Inequality: How Continental Europe Resembles North America. *Journal of the European Economic Association*, forthcoming. Contact: abowlus@uwo.ca for more information.

The analysis was carried out at the University of Western Ontario Research Data Centre. The Research Data Centre program is part of an initiative by Statistics Canada, the Social Sciences and Humanities Research Council, the Canadian Institutes of Health Research and university consortia to strengthen Canada's social research capacity.