

August 21, 2007

**Proposal for paper to be presented at the 30th General Conference
of the International Association for Research in Income and Wealth
August 24-30, 2008; Portoroz, Slovenia**

Title:

Is the increase in annual earnings inequality linked to increasing lifetime earnings inequality?

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Summary:

A substantial body of research has documented the increase in U.S. annual earnings inequality since the 1970s and there appears to be growing public concern about its role in the nation's economic well-being. Of greater potential concern, although more difficult to quantify, is a related increase in lifetime earnings inequality. Lifetime earnings inequality would increase if the greater variance in annual earnings is largely driven by an increase in the variance of the permanent component of individuals' earnings. Evidence on these magnitudes is still in a preliminary state, often compromised by limitations imposed on researchers by commonly used micro data sets.

This research will first set out a framework for linking annual and lifetime earnings inequality measures. The first part of the empirical work will present detailed descriptive statistics on the behavior of annual and lifetime earnings inequality measures over the past 25 years. We then implement a more parametric approach of the type described in Baker and Solon (*Journal of Labor Economics*, April 2003).

The data used in this project are drawn from the Social Security Administration's Continuous Work History Sample (CWHS), a longitudinal file that contains the earnings histories of approximately 3 million workers. The individual records contain basic demographic information (year of birth, sex, and race) and employment histories that document taxable earnings each year. Although the recorded annual earnings amounts in the CWHS were capped at the annual maximum earnings subject to Social Security payroll taxes prior to 1978, since then total compensation as reported by employers on IRS Form W-2 (Wage and Tax Statement) are available.

A substantial increase in lifetime earnings inequality has potentially large repercussions for public policy, especially if that trend persists and public discontent grows. For example, Social Security's Old-Age and Survivors Insurance program is designed to transfer income during retirement from higher to lower lifetime earners via a progressive benefit formula that provides higher income replacement rates for low earners. In the continuing discussion about solvency reform, the social welfare implications of the redistributive aspects of the program may merit greater consideration if they are seen as a key policy to address the problems associated with greater lifetime inequality.