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Tackling income security inequalities

Ronald Dekker

“Excessive inequality is corrosive to growth; it is corrosive to society. I believe that the economics profession and the policy community have downplayed inequality for too long”. Christine Lagarde (IMF at the 2012 Annual Meetings of the IMF and the World Bank).

High levels of inequality are a hindrance to economic development. Recently OECD and IMF researchers have put forward serious evidence suggesting that high levels of inequality mean less stable economic expansions and sluggish growth. As I will set out below, one of the key drivers of inequality is the increasing flexibilisation of labour markets. This trend has contributed to the creation of uneven growth which hinders our economies today. Labour market policies need to be evaluated to account for this problem by not only focusing on income disparities but also on the divide in job security.

1. Labour markets are a major source of income inequality

Labour markets have consequences for income inequalities beyond the wage distribution. The main distributional mechanism of income in modern economies is the labour market. Wages are determined on the one hand on the basis of differences in supply and demand of different skills, and on the other hand by the amount of skills (the level of human capital) of the individual. This means that people with a high skill level that is in short supply earn higher wage incomes. At the short end of the stick we find people with lower skill levels, for which there is lower demand. This is a major source of income inequality. Depending on your position in the political spectrum you can regard this as an efficient outcome or as a market failure.

This form of inequality has received ample attention in the academic literature and in the policy debate. But many other inequalities exist in and are produced by the labour market. Examples are (fringe) benefits (e.g. access to healthcare), autonomy at work, job quality and development potential in a job. The inequality dimension discussed here is inequality of income security that can be derived from one's attachment to the labour market.

2. Flexibilisation is not alleviating rising levels of insecurity

Traditionally income security came from two sources: job security, derived from a permanent job and social security, derived from social benefits to compensate for the lack of labour income. Over the course of the last three decades both job security and social security have been eroded. Job security is declining through the process of flexibilisation of labour markets. Social security is reduced through general cutbacks in government spending and specific cutbacks in social spending. The latter austerity measures have become even more relevant since the global recession of 2009.

The recent development of flexibilisation has resulted in a labour market in which fewer people than before can rely on job security. The more successful flexiworkers (either temporary employees or the self-employed) derive a sufficient level of income security from a string of jobs (or assignments). This is referred to as "employment security". But the flexibilisation trend has also resulted in a rising number of less successful workers who experience multiple spells of unemployment and limited access to social security because of their fragmented careers. For this group of people the term "Precariat" was coined by Guy Standing. Below this there remains a group for which the goal of deriving any income security from the labour market is more or less utopic: people with serious disabilities and those who have not had a paid job for more than 10 years. Social security is their primary source of income, either by relying on their families (in Southern European welfare states) or by receiving social assistance (in most Northern European welfare states).

3. Labour markets are increasingly polarised

Reflecting different sources of income security, the potential workforce can be

subdivided into four "security segments". Firstly, there is a "high job security" segment. This segment is made up of employees with permanent contracts that move (voluntarily) from one job to the next without experiencing spells of unemployment very often. Second, we find the "low job security but high employment security" segment, with temporary or otherwise flexible employees and successful self-employed workers. Their income is relatively secure because they can, on the basis of their skills, find new employment relatively easy. Third is the "low job security and low employment security" segment, or "the precariat". Their income security is low and this is only partially compensated for by social security. And finally, the "social security" segment which consists of people who derive virtually no income security from the labour market.

Between the upper and lower two segments is the "divide". This means that fewer transitions take place between the lower and the higher tiers or, put another way, labour market "outsiders" making the transition to labour market "insiders". The current direction of policy needs to be re-evaluated to alleviate this polarisation:

4. Income security inequality should be treated as a significant indicator

Labour market policies should be evaluated not only for their effect on income inequality, but also for their effect on income security inequality. Progressive labour market policies should aim for "employment security for all". This means aiming at increasing labour force participation rates but at the same time safeguarding the level of income security for those at the bottom end of the labour market. In particular, "Work First" is a valuable principle, but should not lead to an increase in the number of working poor.

5. Question the all-out drive towards "flexibilisation"

The thrust towards more flexible labour markets should be handled more carefully. The general advice from mainstream economists for labour market policy still seems to be "flexibilisation". Their mistaken idea that labour markets are, or rather should be, perfectly competitive markets, is apparently so strong that the only solution to all labour market ills is to reduce employment

protection, reduce the power of unions and reduce wages. However, more flexible labour markets have a tendency to increase labour income inequality and in particular to increase inequality in terms of labour income security. Even when this is compensated for, in developed welfare states, by a high level of social security, the differences in employment security are threatening economic and social development. When social security is also lacking, differences in employment security can pose a real threat to social cohesion and could lead to the type of social unrest some southern European countries are now facing.

6. Income security distribution through the labour market

Progressive politics is meaningless without ideas about the distribution of social progress and mobility. Increasing the level of employment security is not "progressive" if at the same time the level of job security for the low-skilled is lowered. Getting people out of social security is not "progressive" if the only alternative is joining the ranks of the working poor or the "precariat". Progressive politics should develop clever ways of distributing income and income security more equally on the labour market. Further flexibilisation of labour markets and lowering job security will do the opposite. If that's progressive, one would rather be conservative.

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