



Contents lists available at ScienceDirect

Labour Economics

journal homepage: www.elsevier.com/locate/labeco

Has performance pay increased wage inequality in Britain?

Mark Bryan^a, Alex Bryson^{b,*}

^a University of Sheffield, UK

^b University College London, UK

HIGHLIGHTS

- Performance pay (PP) incidence in Britain was broadly flat from 1998–2008.
- The wage return to PP was substantial and appears to have increased over time.
- PP led to a modest rise in upper-half earnings dispersion, mainly via bonuses.
- Simulations of PP expansion predict only small increases in wage dispersion.

ARTICLE INFO

Article history:

Received 31 July 2015

Received in revised form 30 April 2016

Accepted 1 May 2016

Available online xxxxx

Keywords:

Wages

Wage inequality

Performance pay

Bonuses

ABSTRACT

Using data from the British Household Panel Survey (BHPS) we show performance pay (PP) increased earnings dispersion among men and women, and to a lesser extent among full-time working women, in the decade of economic growth which ended with the recession of 2008. PP was also associated with some compression in the lower half of the wage distribution for women. The effects were predominantly associated with a broad measure of PP that included bonuses. However, these effects were modest, typically not exceeding a 0.05 log points change in log wage differentials over the decade. Moreover there is no indication that PP became increasingly prevalent, as some had predicted, over the decade prior to recession.

© 2016 Elsevier B.V. All rights reserved.

1. Introduction

Income inequality has grown in English-speaking economies in recent decades, largely due to growing wage inequality (see Atkinson et al., 2011, for international evidence; and Brewer and Wren-Lewis, 2016, who show that over 1978–2008 in the UK, rising earnings inequality counteracted falls in inequality due to other income components). A variety of explanations for rising wage inequality have been proffered, including increasing returns to skill induced by skills-biased technological change (SBTC) (Autor et al., 2008), changes in labor market institutions, most notably de-unionisation (Dustmann et al., 2009; Card et al., 2004) and increased trade (Autor et al., 2013). In their seminal paper for the United States Lemieux et al. (2009) (henceforth LMP) show that performance pay (PP) accounted for one-fifth of the growth in wage inequality among men between the late 1970s and early 1990s, and most of the growth

in wage inequality among high earners in the top quintile. They show that PP became more widespread between the 1970s and early 1990s, was closely tied to individuals' productive characteristics, and that the returns to these characteristics were rising faster in PP jobs than in fixed wage jobs. Their findings are consistent with a world in which SBTC increases the rewards for more productive workers and induces firms to resort to PP to both attract and incentivise those workers.

LMPs (2009) model, which draws on the work of Lazear (1986, 2000) and Prendergast (1999), indicates PP generates higher wage dispersion than fixed rate pay (FP) due to the sorting of high ability workers into PP jobs – a labor market segmentation type argument – and because PP reflects individuals' marginal product more accurately than fixed wage schedules. Growth in PP jobs allows high ability workers to recoup returns to their ability in a way that is not possible with fixed wages, while the higher incidence of PP at the top end of the earnings distribution will also generate higher wage dispersion.

LMP attribute the increased use of PP to SBTC and the declining costs of worker monitoring due to advances in technology. These trends are

* Corresponding author.

E-mail address: a.bryson@ucl.ac.uk (A. Bryson).

likely to have continued in the period since the mid-1990s which LMP were studying, both in the United States and in other industrialised countries. For instance, Sommerfeld (2013) documents an almost continuous rise in the share of PP jobs between 1984 and 2009.

And yet LMP's findings have recently been challenged in a series of papers using data for the United States. Using establishment data from the Bureau of Labor Statistics' Employer Costs for Employee Compensation (ECEC) series (which derives from the National Compensation Survey) Gittleman and Pierce (2013) show the proportion of jobs with PP rose in the 1990s, only to fall in the 2000s such that, by 2013, it had declined by about one-fifth since LMP's study period, irrespective of how one measures PP. This decline is apparent throughout the wage distribution but is concentrated among low earners. Furthermore, in a second paper, Gittleman and Pierce (2015) show that the contribution of PP to growth in the earnings distribution in the first decade of the 21st Century has been small – in the order of 9% of the growth in variance. Sommerfeld's analysis for Germany also showed that despite the expansion of PP, it did not lead to increased wage inequality because it was associated with higher wages across the board and not just for high earners.

Two more papers find LMP's basic results do not hold for some parts of the working population. Like LMP, Heywood and Parent (2012) analyze the Panel Survey of Income Dynamics (PSID). They find that, during the period 1976–1998, the tendency for PP to be associated with greater wage inequality at the top of the male earnings distribution applies to white workers but not to black workers. In a second paper using the National Longitudinal Survey of Youth (NLSY), Heywood and Parent (2013) find skilled fathers select into PP jobs, whereas skilled mothers select out of PP jobs, a finding which is not consistent with standard assumptions regarding workers sorting into PP jobs on ability. This, in turn, raises questions about the effects of PP on wage inequality.

In Britain wage inequality among full-time workers has been rising since the late 1970s, although the rate of change slowed dramatically in the 2000s, with all the growth being confined to the top part of the wage distribution (Machin, 2011; Lindley and Machin, 2013). Over the whole period the graduate wage premium rose, despite growth in the graduate share in employment and hours, suggesting demand for highly skilled labor was exceeding its supply (Lindley and Machin, 2013). This is consistent with SBTC, and the authors find direct evidence of greater demand for more educated workers in more technologically advanced industries (Lindley and Machin, 2013: 175–176). They also point to the introduction of the national minimum wage in 1999 and its subsequent up-rating as a reason for the stability in the 50–10 wage differential in the 2000s.

Although they point to the potential importance of SBTC in the British context, Lindley and Machin do not consider the potential role played by PP in growing wage inequality. There is some evidence that annual bonuses have contributed to an increase in wage inequality at the top of the earnings distribution in the last decade or so, primarily as a result of a large bonus receipt by bankers, traders and other well-paid professionals in the Finance sector (Bell and Van Reenen, 2010, 2011, 2013).¹ These employees may be sharing in the substantial rents generated by a lack of competition in the sector. Alternatively, they may be benefiting from productivity “scaling” effects that accrue to highly productive employees when changes such as increased firm size and capital intensification “scale up” worker productivity, increasing returns to their employer. This is the type of effect identified by Gabaix and Landier (2008) and Kaplan (2012) in relation to “superstars” such as CEOs.

But, aside from the effects of bonus payments at the very top, what effects has PP had on the overall wage distribution in Britain? Two

studies using cross-sectional linked employer–employee data come to different conclusions. Manning and Saidi (2010) show that, although there is a wage premium attached to the receipt of PP, it had a negligible effect on wage dispersion in 2004. However, using data from the 2011 Workplace Employment Relations Survey Bryson et al. (2014) find PP results in a sizeable widening in wage differentials relative to a counterfactual wage distribution, and that this effect is larger higher up the earnings distribution. The premium rises markedly as one moves up the hourly wage distribution: it is seven times higher at the 90th percentile than it is at the 10th percentile in the wage distribution (.42 log points compared to .06 log points). This, coupled with the higher incidence of PP among those with wage-enhancing attributes, means PP contributes substantially to higher wage dispersion in Britain. However its overall effect on the wage distribution is less marked than it might have been due to the relatively low proportion of employees on PP contracts in Britain.

This paper contributes to the literature in a number of ways. First, in light of the debate in the US about the changing role of PP, we track the incidence of PP using the British Household Panel Survey (BHPS) for the period 1998–2008 that immediately preceded the recession. We consider alternative broad and narrow definitions of PP and estimate their individual, job and workplace correlates. Next we estimate the premium associated with PP jobs and look at how it changed over the decade. Finally we estimate the effects of PP on wage dispersion and changes in the wage distribution over the period, accounting for the changing PP premium as well as changes in the prevalence of PP at different parts of the distribution.

We find no indication that PP jobs (broadly or narrowly defined) are becoming increasingly prevalent. Depending on the measure used and splitting by gender, we find either gradual declines or broad stability, although PP jobs may have picked up slightly among full-time women in the two years before the recession. Nonetheless the returns to PP remain positive, even when controlling for unobserved personal characteristics, and in fact seem to have increased over the period. Confirming other recent studies, we show that wage inequality grew somewhat during the decade of economic growth that ended abruptly with the recession, largely due to growing earnings dispersion in the top half of the wage distribution (with some reduction in inequality at the bottom for women). Estimates of PP effects on the counterfactual wage distribution confirm PP increased earnings dispersion among men and women, including the sub-group of full-time working women. PP also appears to have contributed to reduced wage dispersion at the bottom among women. In both cases, the changes are largest for the broad measure of PP, which includes bonuses. Nevertheless the effects overall are reasonably modest – while overall PP remains a disequalising force on the wage distribution in Britain, the fact that it has not become more widespread has limited its impact on wage inequality.

In the next section we outline the theoretical links between wage dispersion and PP. Section 3 then introduces the data while Section 4 which presents results relating to the incidence and correlates of PP followed by its links to wages and wage dispersion in Britain. Finally Section 5 discusses the implications of the findings and draws some conclusions.

2. Wage dispersion and performance pay

In perfectly competitive labor markets in which firms and workers have perfect information employees would be paid their marginal product, that is, they would be paid for their performance. However, employers and employees often prefer fixed wage contracts based on time rather than effort or output. Employers may find fixed wages less costly to administer, especially if labor inputs or outputs are costly to monitor: it can be costly for firms to identify the contribution of individual employees to output, while factors beyond the control of the employee, and even the firm, mean output is affected by factors other than employees' talent and

¹ However, bonuses account for only a small proportion of total earnings for those outside the top decile of earners (Bell and Van Reenen, 2013, 10–11).

Download English Version:

<https://daneshyari.com/en/article/7371629>

Download Persian Version:

<https://daneshyari.com/article/7371629>

[Daneshyari.com](https://daneshyari.com)