Network for Studies on Pensions, Aging and Retirement

Family and Government Insurance: Wage, Earnings, and Income Risks in the Netherlands and the US

"Family and government insurance reduce but do not eliminate earnings risk in both countries"

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The dynamics and magnitude of earnings shocks have direct consequences for the pension accrual of employees and the optimal investment policy of pension assets. This study documents the distribution of male earnings shocks for different age and income groups. Furthermore, we examine the extent to which spousal income, government transfers, and progressive taxation mitigate earnings shocks.

Principal Findings

- Male earnings shocks are relatively large at the start and end of working life and in the upper and lower parts of the income distribution. At the end of working life and in the lower part of the income distribution, adverse shocks are often due to reduced hours worked. In contrast, in the upper part of the income distribution, reductions in hourly wages play an important role.
- In the Netherlands, adverse earnings shocks are largely but not entirely mitigated by social security, early pensions, and progressive taxes. Low-income households reduce earnings risk by pooling income, but spouses do not increase hours worked if the primary earner becomes unemployed or incapacitated for work.
- In the US, earnings risk is higher than in the Netherlands. While insurance through spousal income is higher, insurance through government transfers and progressive taxation is less substantial in the US.

Key Takeaways for the Industry

- This study increases our understanding of the distribution and nature of earnings risk over the lifecycle, which is key in determining the optimal investment profile of pension funds.
- Later retirement and reduced government insurance due to less generous transfers, including abolishing early retirement schemes, will likely increase income risk for older employees and lower the optimal amount of risky pension investments.

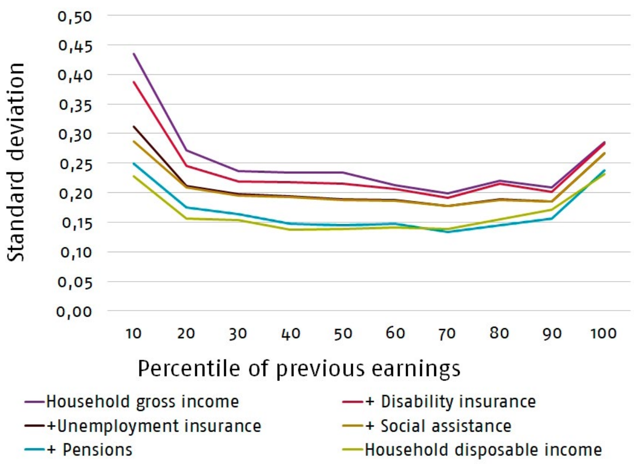

Figure: shows the extent to which government transfers and progressive taxation reduce household earnings shocks (standard deviation of yearly household gross income changes) for workers aged 55+ across different parts of the income distribution.

Want to know more? Read the paper **'Family and government insurance: Wage, earnings, and income risks in the Netherlands and the U.S.'**