Describing Compensation

Nicholas Ray

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1 Introduction

Recent work in political science and economics has demonstrated a causal relationship in Western countries between exposure to international economic competition (i.e., globalization) and support for far-right political actors (e.g., Scheiring et al. 2024). The existence of this relationship has increased scholarly attention to compensation (e.g., Kim and Gulotty 2024) since economic theory suggests that compensation to the losers of globalization may mitigate voting for non-incumbents such as the far-right (e.g., Rodrik 2018). However, there has been a lack of consensus on how to measure compensation and therefore little systematic work describing how compensation has varied.

In this article, I aim to fill this gap by documenting how popular measures of compensation have changed over time and within Western countries. In doing so, I revisit the economic theory of compensation and relate each measurement to the theoretical concept. The intended contribution is that scholars can better understand the extent to which a particular measure represents the concept of compensation and better evaluate claims such as a "failure of compensation" (Frieden 2019, 182) in the West and its theoretical ability to moderate the relationship between globalization and far-right politics.

In particular, there are three broad classes of measures used in studies related to compensation. The first is social spending, with scholars such as Milner (2021) using unemployment spending as a measure of compensation and Mendendez (2016) using active labor market policy (ALMP) spending more generally. More general still is total social spending, which is mainly advocated by scholars interested in social safety nets at large (e.g., Huber and Stephens 2001; Rodrik 2018). The second is tax and transfer redistribution (e.g., Causa, Browne, and Vindics 2019; Rodrik 2018) that measures government interventions in the income distribution. The third measure is spending on programs that specifically address trade related job losses, such as trade adjustment assistance (TAA) in the United States (e.g., Autor, Dorn, and Hanson 2016) and the European Globalization Fund (EGF). I collect data where available on each of these measures to provide a systematic description of compensation.

The paper is laid out as follows. In the next section I define compensation as a theoretical concept before detailing how compensation has been variously measured previously in section 3. In section 4 I describe the data to reveal how compensation has varied. I close with suggested opportunities for future work.

2 Compensation as a Theoretical Concept

In this section I detail compensation as a theoretical concept in welfare economics.[1] To fix ideas, suppose that there are two households in an economy, $H \in \{1, 2\}$. The utility each household attains in the current state of the economy, A, can be written as $U_{1,2}(A) = (u_{1A}, u_{2A})$. Now suppose that a policy is proposed such that the state of the economy would become B (e.g., from autarky in state A to free trade in state B). The households' utilities over state A and B are graphed in Figure 1.

[1] This section is heavily based on Johansson (1991) and Moore (2007)

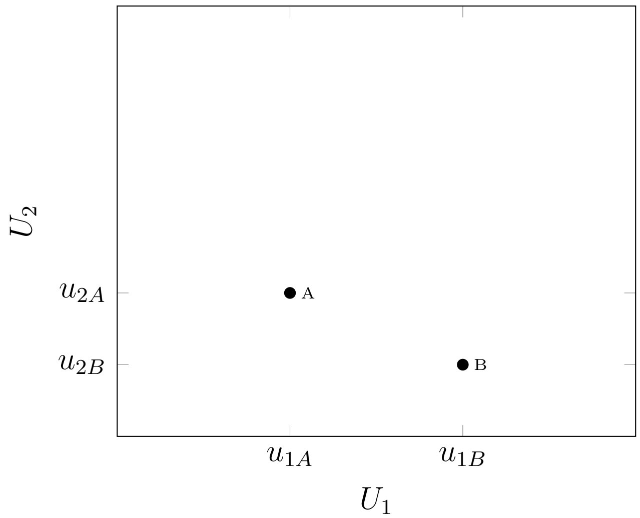

Figure 1: States A and B

The policy is said to satisfy the (strict) Pareto criterion and be a Pareto improvement if moving from state A to state B increases the utility of at least one household while no household loses utility. As can be seen in Figure 1, this is not the case since $U_2(B) < U_2(A)$. Household 1 gains utility (by $u_{1B} - u_{1A}$ utils) but household 2 loses utility (by $u_{2A} - u_{2B}$ utils).

However, if household 1's income gain from the policy can hypothetically be redistributed to household 2 such that state C is attainable (Figure 2), for example, then the policy is said to satisfy the compensation principle.

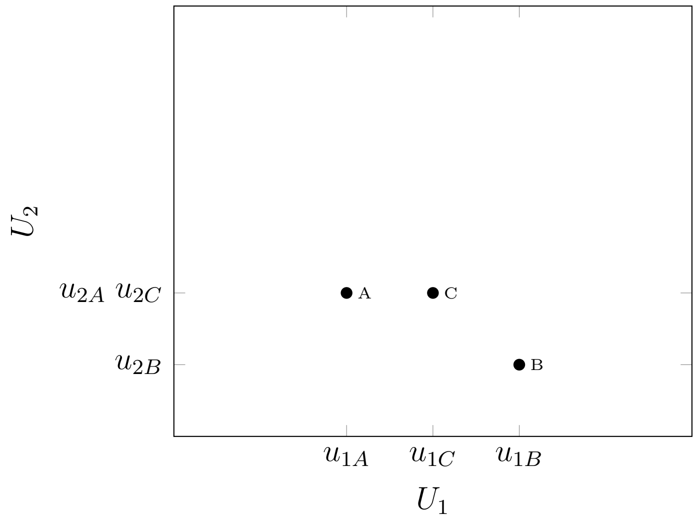

Figure 2: States A, B, and C

The compensation principle states that a policy is desirable if a hypothetical redistribution of income after the policy change can result in at least one household increasing its utility while no households lose utility. Thus, compensation is the income needed to be redistributed from the gainers of a policy to the losers such that the latter do not experience a loss in utility. Note that if compensation is made actual, the policy satisfies the (strict) Pareto criterion and represents a Pareto improvement.

Implicit in this discussion is the assumption that households get utility from their income and only their own income. It is also necessary to state that compensation must account for possible price changes induced from a redistribution of income (although commodity and factor markets are ignored here). Further, it should be mentioned that the compensation principle cannot be used to compare between states that are both Pareto improvements. It is generally impossible to compare the gains in utility for different households. See Moore (2007) for greater detail.

3 Measurements of Compensation

Political scientists and economists have sought to test hypotheses about compensation to the losers of free trade by measuring compensation in various ways. For example, studies on the U.S. have typically relied on trade adjustment assistance (TAA) while comparative studies have mainly used active labor market policy (ALMP) spending or other social spending. In this section, I define and describe each.

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