

Inequality and Welfare: Is Europe special?

Alain Trannoy
AMSE

Prepared for Coeure
Cooperation for European Research in Economics

Europe special because

- Inequality and welfare do not directly belong to the fields covered by the European treaties
- On the background they are however important.
- On the policy agenda of many European States in a way that is unknown at this scale in other continents.

European special focus on Inequality and Welfare

- Angela Merkel « Europe represents 7% of the population, 25% of the World GDP and 50% of the total of social spending at the world level”
- A fear it won't last forever
 - Because the preferences of “others” will prevail
 - Because we will become so weak that it will not be sustainable.
 - To some extent, the focus on Inequality and Welfare is a luxury good at a collective level. OK when you are rich or richer than the others.

Main Goal

- Bring together the agenda of the scientific community and the policy agenda in Europe
 - Common issues
 - Neglected issues that need to be deeply investigated in the near future because of their social importance

Translated into a range of 9 specific targets

- 1. Why is the topic important, both in general and in the European economic policy context?
- 2. How can economics contribute to our understanding and analysis of this political and societal topic? (A comparison with potential contributions from other relevant social sciences may be useful, as well as areas of synergies with these other disciplines).

Cont'd 1

- 3. What are the key questions (both novel and long-standing) in the area? What do and what don't we know about them? Do we need to better understand the facts or to develop better theories?
- 4. What are the key points of agreement and disagreement in the academic literature on the subject? Where is the research frontier?

Cont'd 2

- 5. What are the key open questions, that is to say, new questions or old questions which have not been addressed in economic research but are of vital importance for policy making?
- 6. Where does Europe stand in terms of research and expertise in this area compared to other contributors to research, in particular the U.S.?

Cont'd 3

- 7. What is the role of scientific advice in EU policy decision-making (see for example the European Commission's 2001 White Paper on European governance)? How does it compare to U.S. economic policy-making governance?
- 8. What is the research methodology currently used to address questions in this area?
- 9. What specific challenges do Europe-based researchers working in this area face (including data access, availability or quality, methods, funding and any other relevant issue)?

Challenging task

- Coping with a lot of demands.
- If there are too many tasks to be assigned by the principal, then the agent has more discriminatory power.
- To limit my own discriminatory power, I choose simply to address them successively
- To go from upstream (scientific agenda and results to downstream (policy challenges)

Roadmap

- 1. Setting the scene: Inequality and Welfare two interconnected notions
- 2. Normative and positive issues involving several sciences
- 3 Europe inequality pattern viz the US
- 4 Europe at the forefront of research on many topics
- 5 Data are improving but remains largely incomplete when looking at more specific issues
- 6 Inequality as a transversal issue
- 7 Cutting edge research issues
- 8 Issues more specific to Europe
- 9 Conclusion and an agenda for research

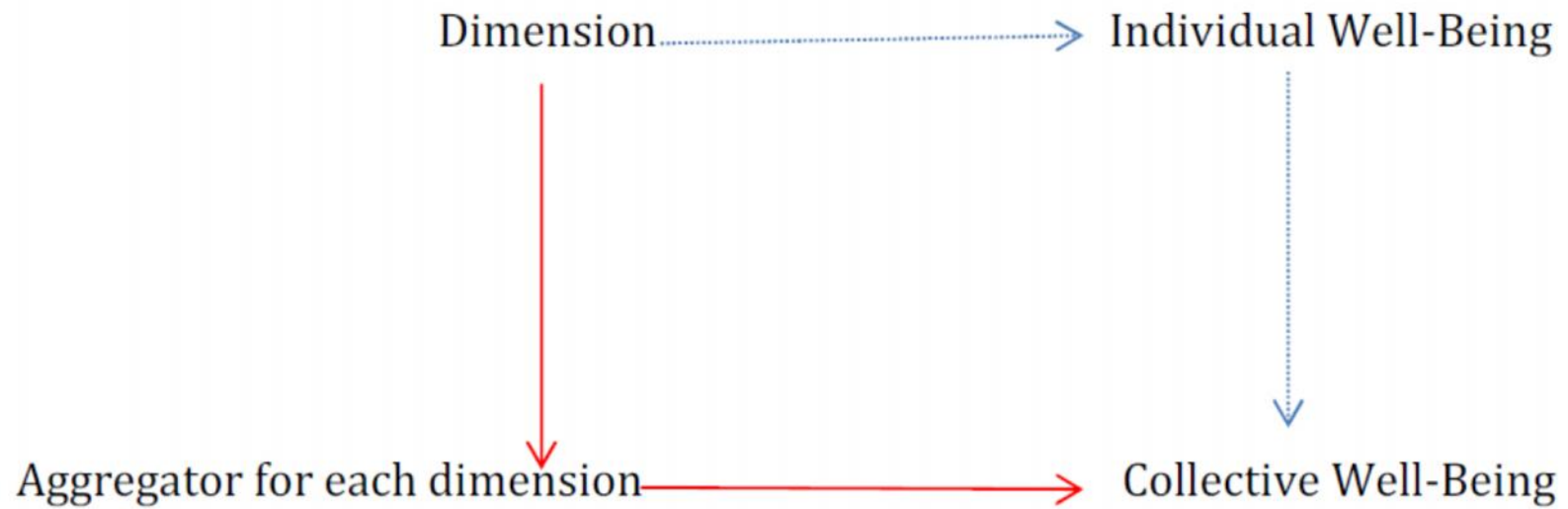
1. Inequality and Welfare

- Inequality (both dimensions ex ante and ex post)
- Welfare (still a debate among economists)
 - Those who defend the view that we should organize the scientific and policy debate using social welfare functions
 - Those who think that we can bypass their construction

An example : constructing an indicator of social welfare in a multidimensional setting

Individuals $\left(\begin{array}{c} \text{Dimensions} \end{array} \right)$

The two routes



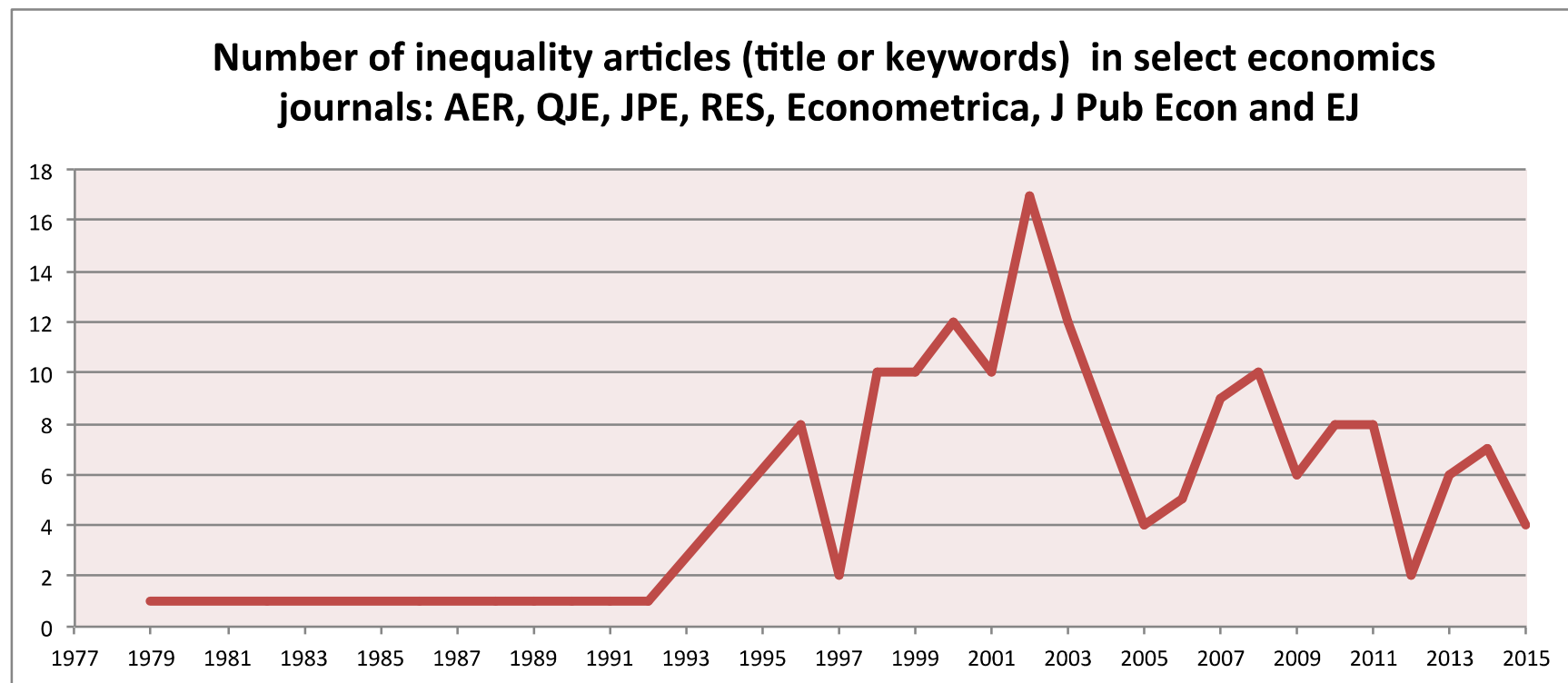
Link between Inequality and welfare

- Inequality entails a loss of welfare
- The reasoning of Edgeworth
 - Marginal utility is decreasing and here the happiness literature is useful to provide empirical evidence that it is true
 - Identical marginal utility
 - The departure from this assumption only based on some objective characteristic (handicap, health, family needs, maybe age)

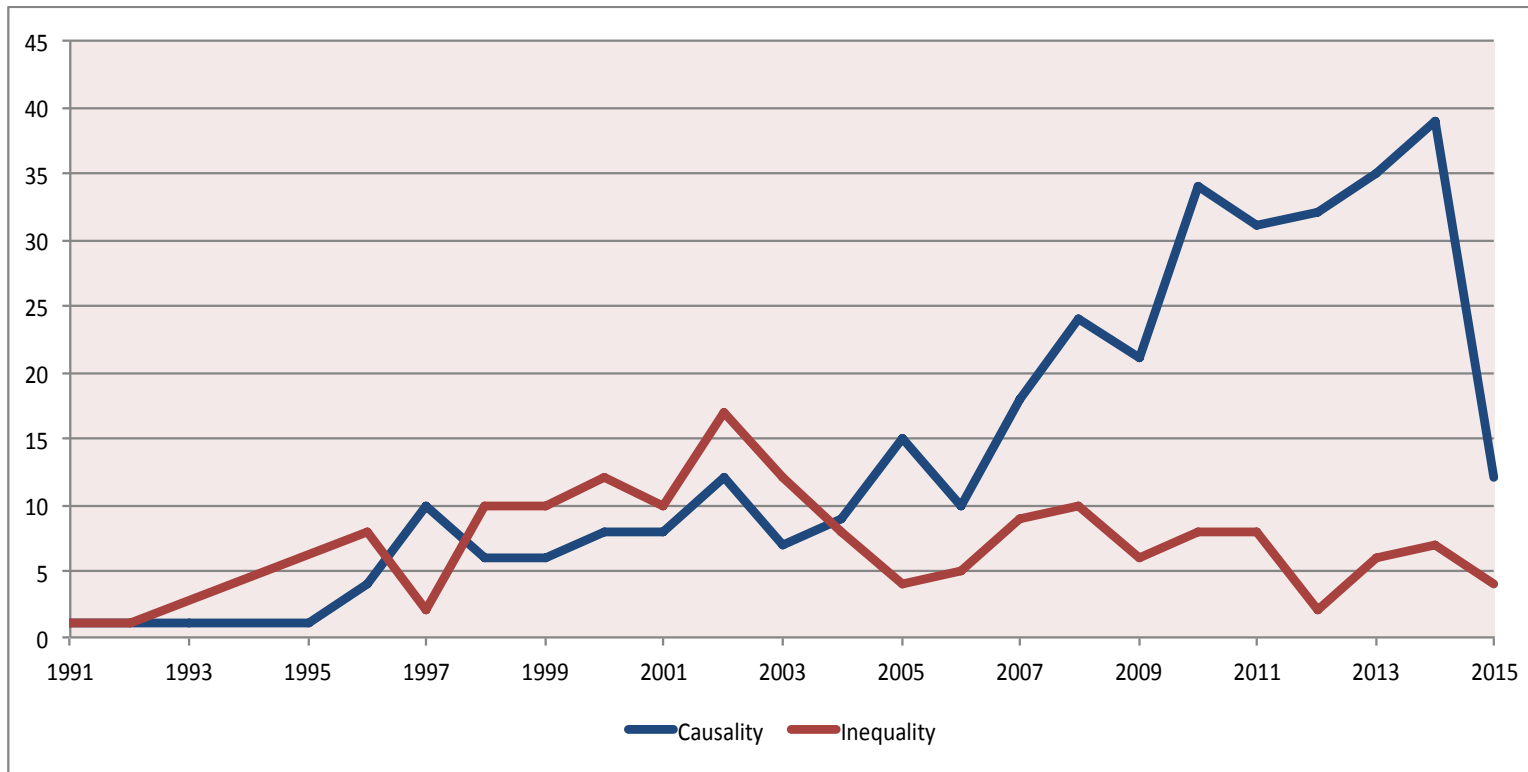
2. Normative and Positive issues involving other sciences

- Political philosophy
 - Ex ante inequality vs Ex post inequality
- History
 - The long view
- Sociology
 - The issue of autonomy of the individual
- Political Science
 - Understand the political gridlock about inequality
- Psychology
 - To build questionnaire about happiness and to interpret the answers correctly
- Neurosciences
 - To obtain an “objective” measure of pain and pleasure

Fortunately other sciences because for economics ...

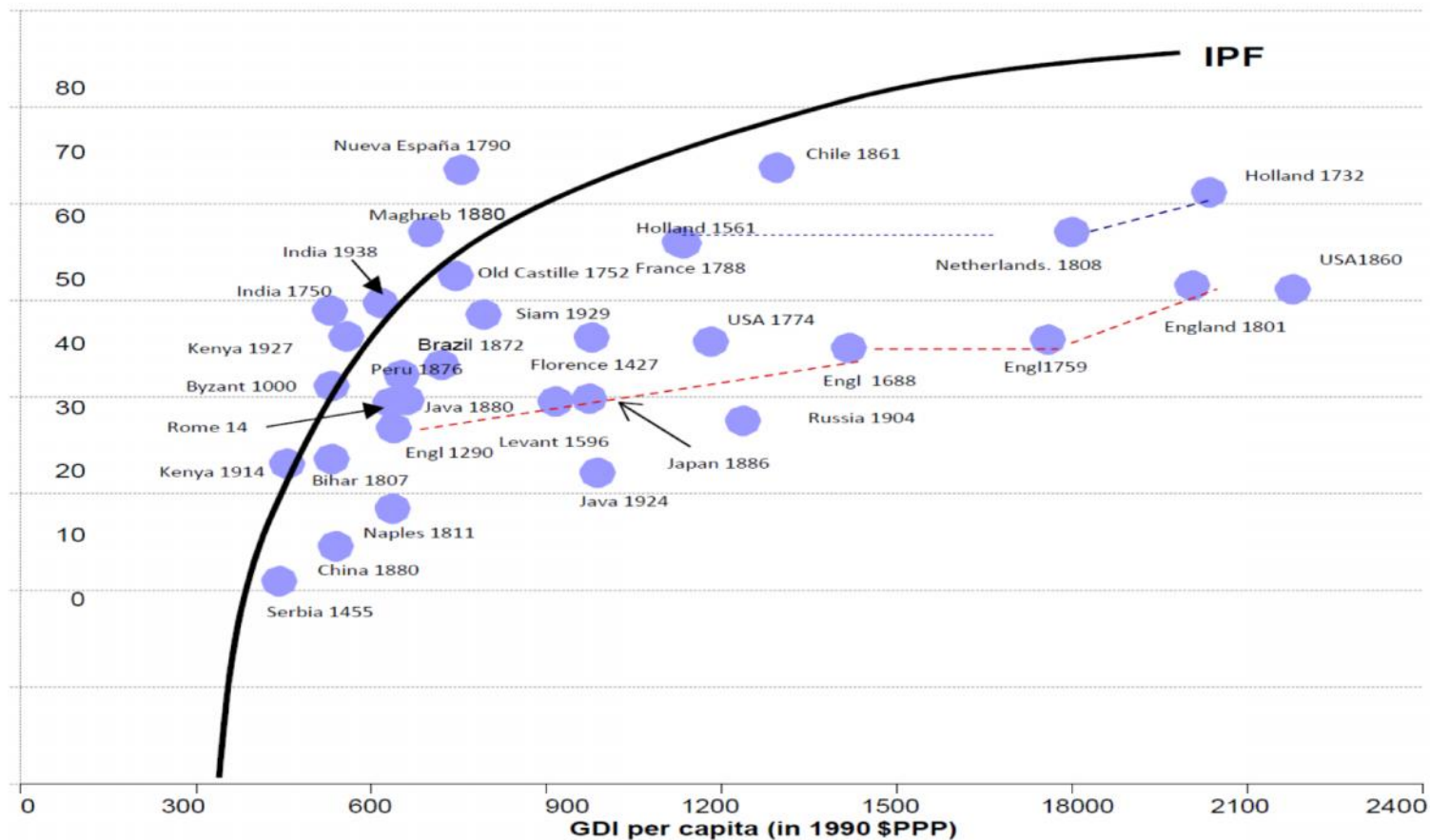


Not publish and perish



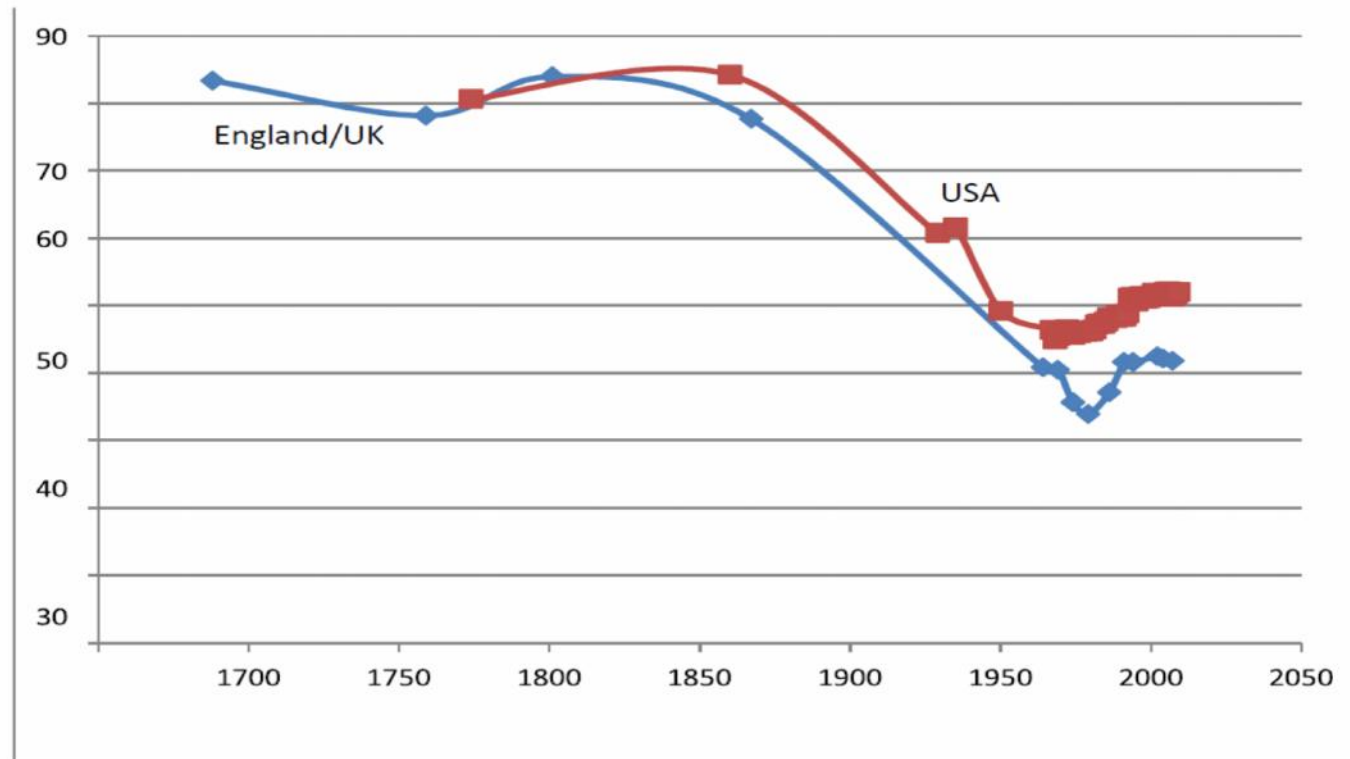
An example for historical data

Figure 3. Estimated Gini coefficients and the Inequality Possibility Frontier (pre-industrial economies) Source: Milanovic (2013). Updated from Milanovic, Lindert and Williamson (2011).



For the US and the UK

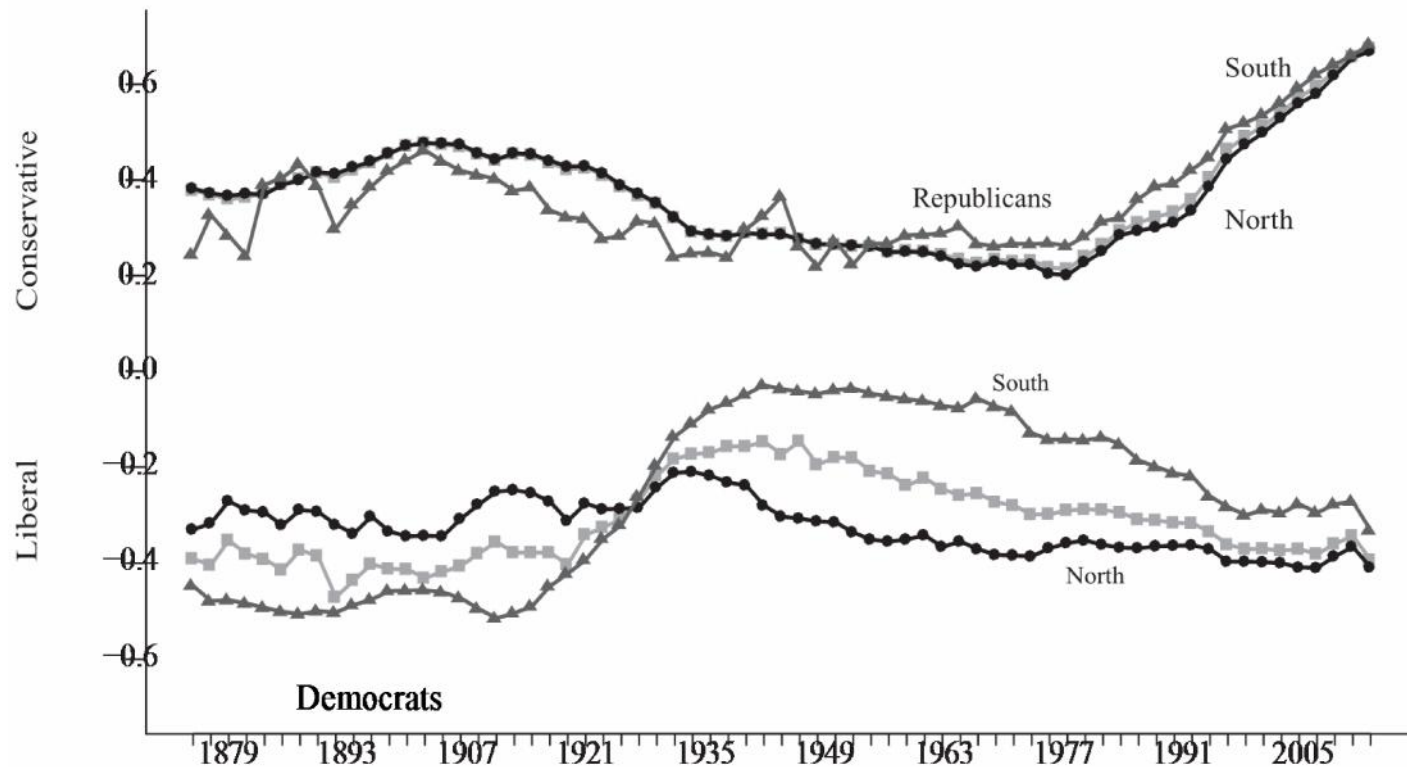
Figure 4. UK and US historical inequality extraction ratios (elasticity of the social minimum with respect to mean income = 0.5) Source Milanovic (2013)



Political economy: the gridlock in the US

Figure 5 Republican-Democrat distance on Liberal-Conservative Dimension for the US House of Representatives, 1879-2012

Source: *Bonica, McCarty, Poole, Rosenthal* 2013

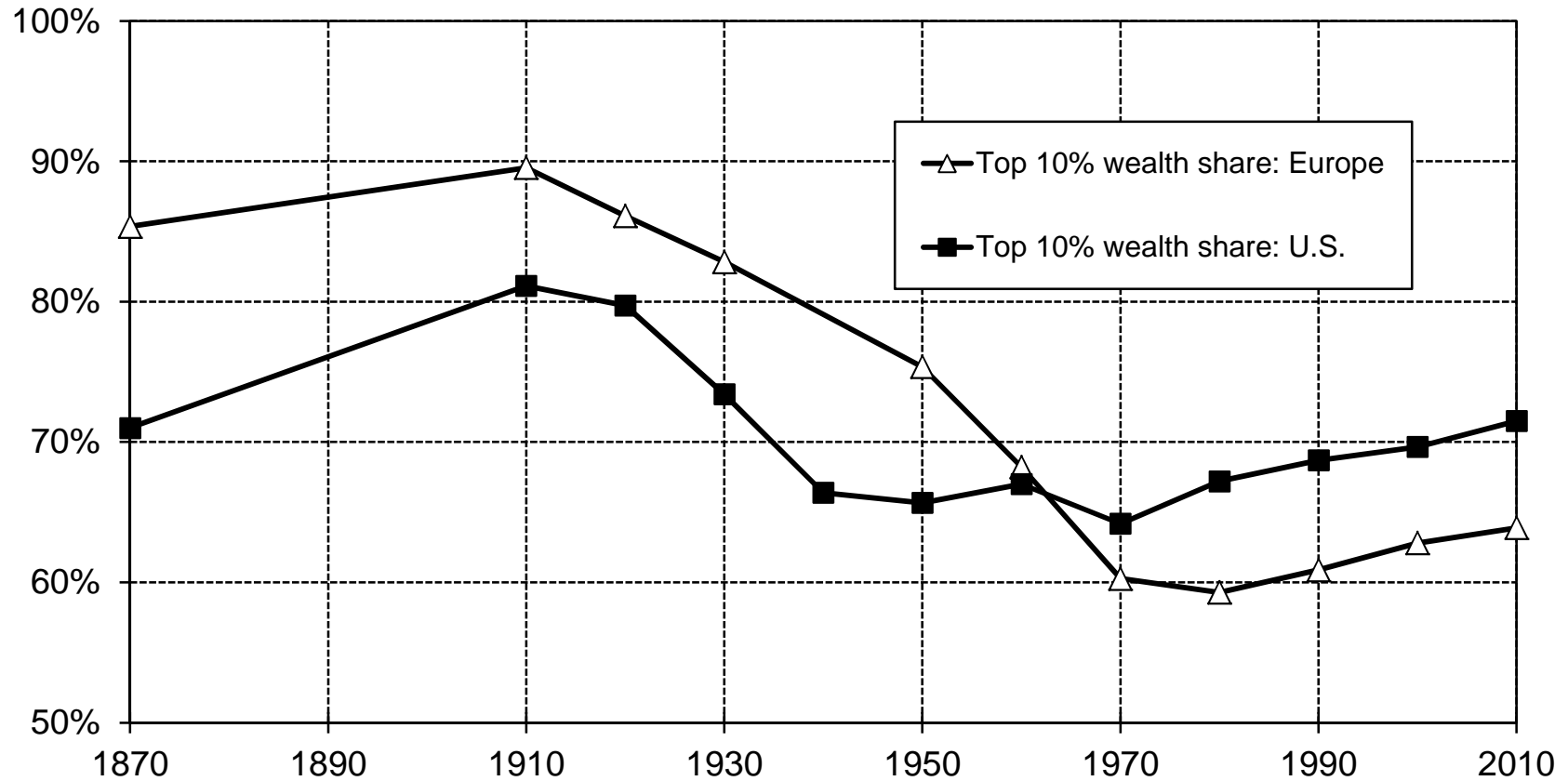


Part1. Europe inequality Keys facts

- 1. Europe is a continent of **low inequality**
- 2. Even if European countries perform quite remarkably, the inequality among European citizens is **as high as** in the US.
 - The between-state inequality is high and compensate for the low within-state inequality.
- 3. Inequality has been **under control** in most European countries but not in the US since the 80s
- 4. **Convergence process** in many European states in terms of disposal income inequality and in terms of the redistributive power of the states

Viz the US (not always be the case)

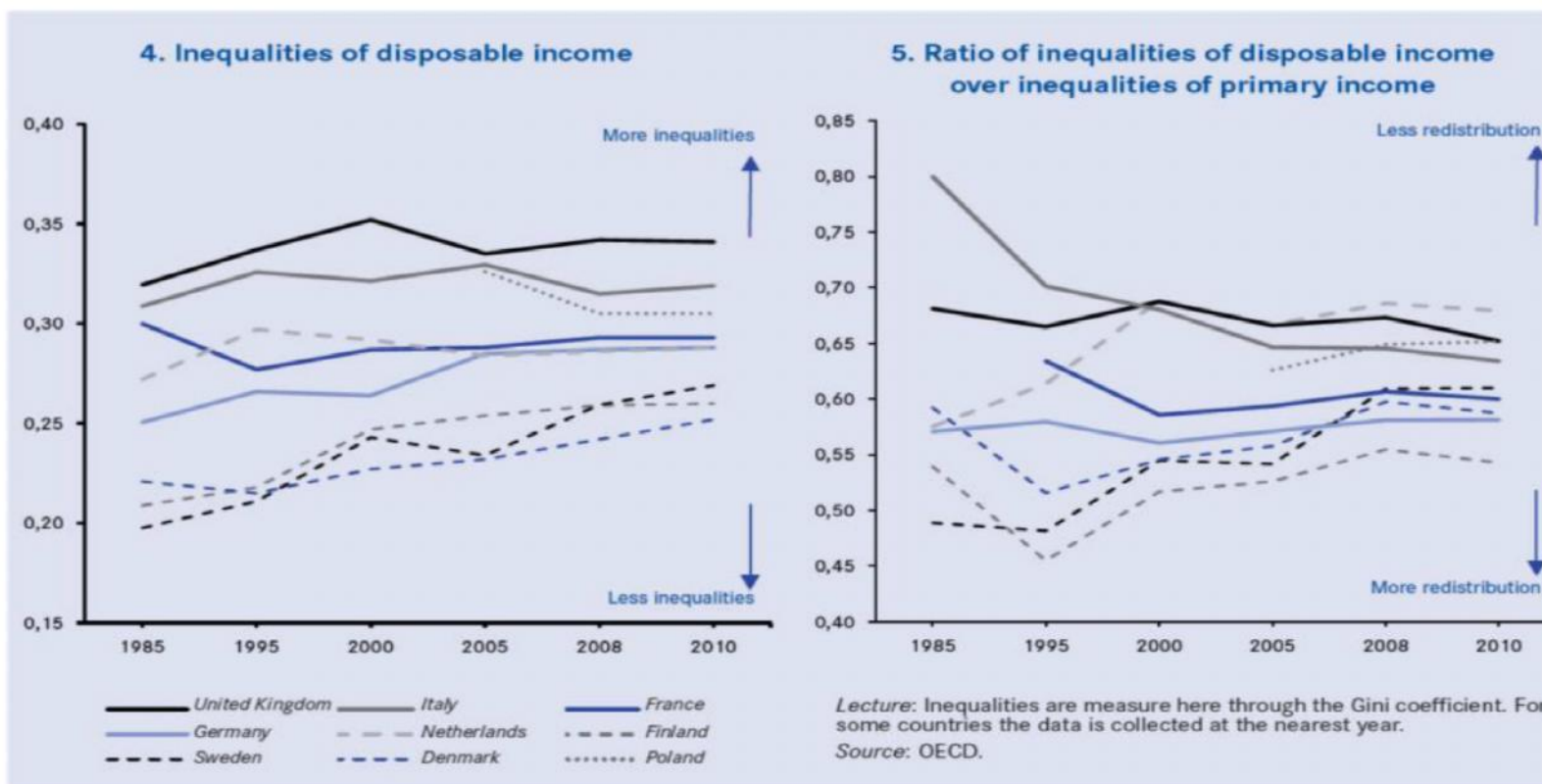
Figure 7. Wealth inequality: Europe and the U.S. (Source Piketty and Saez 2014)



Convergence in Europe

.Figure 9: Convergence in Europe of the redistributive power of the state. Source OECD and Bénassy-Trannoy-Wolf (2014)

- Inequalities (Gini) of disposable income
- Ratio of inequalities (Gini disposable income/Gini primary income)

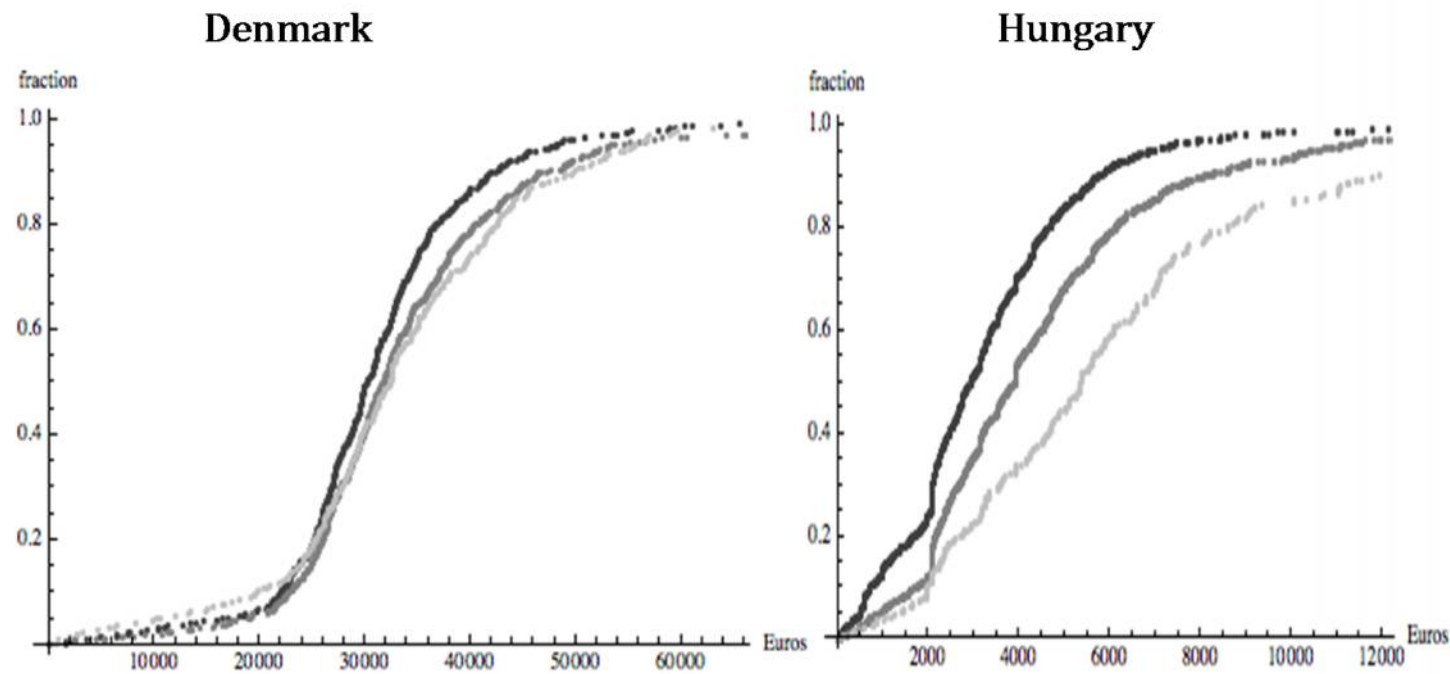


Europe intergenerational-mobility pattern viz the US

- Key facts
- 1. Great heterogeneity in Europe (in the US too)
- 2. The great achievers in terms of equality of outcome are also good performers in terms of low heritability of economic advantages. (Nordic countries). The US perform badly in both dimensions.
- 3. However the relation does not mean perfect correlation

An illustration

Figure 11. Distribution of chances to get an annual earning (male) according to three different parental education (primary, secondary, tertiary education). Source Roemer 2014



Equality of Opportunity

Diagram 2 : The decomposition of inequality of opportunity

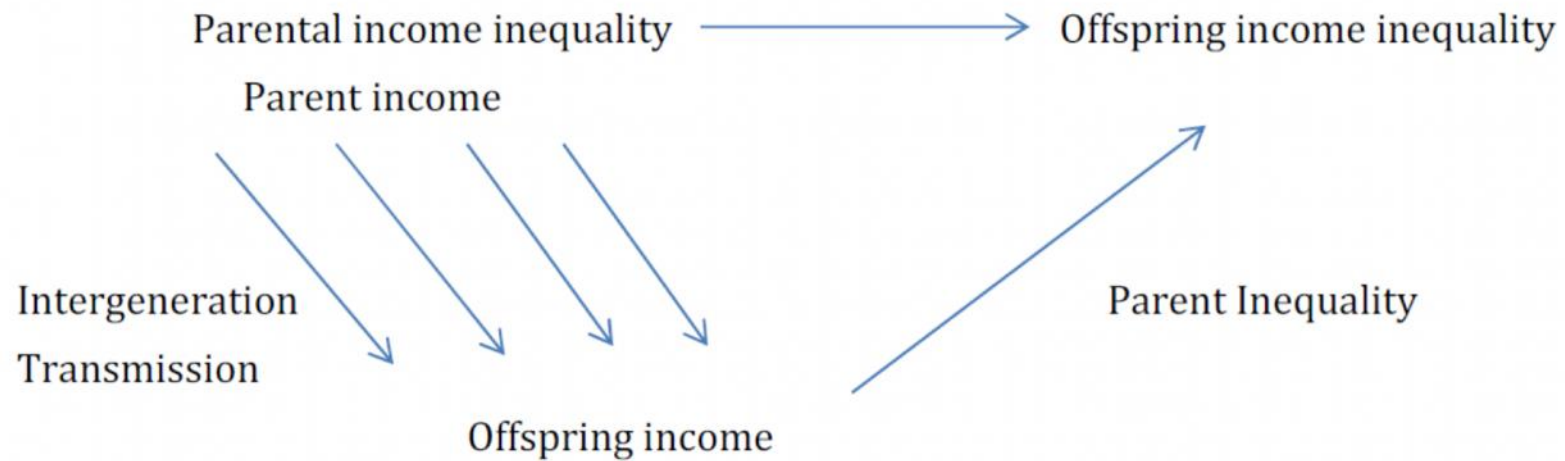
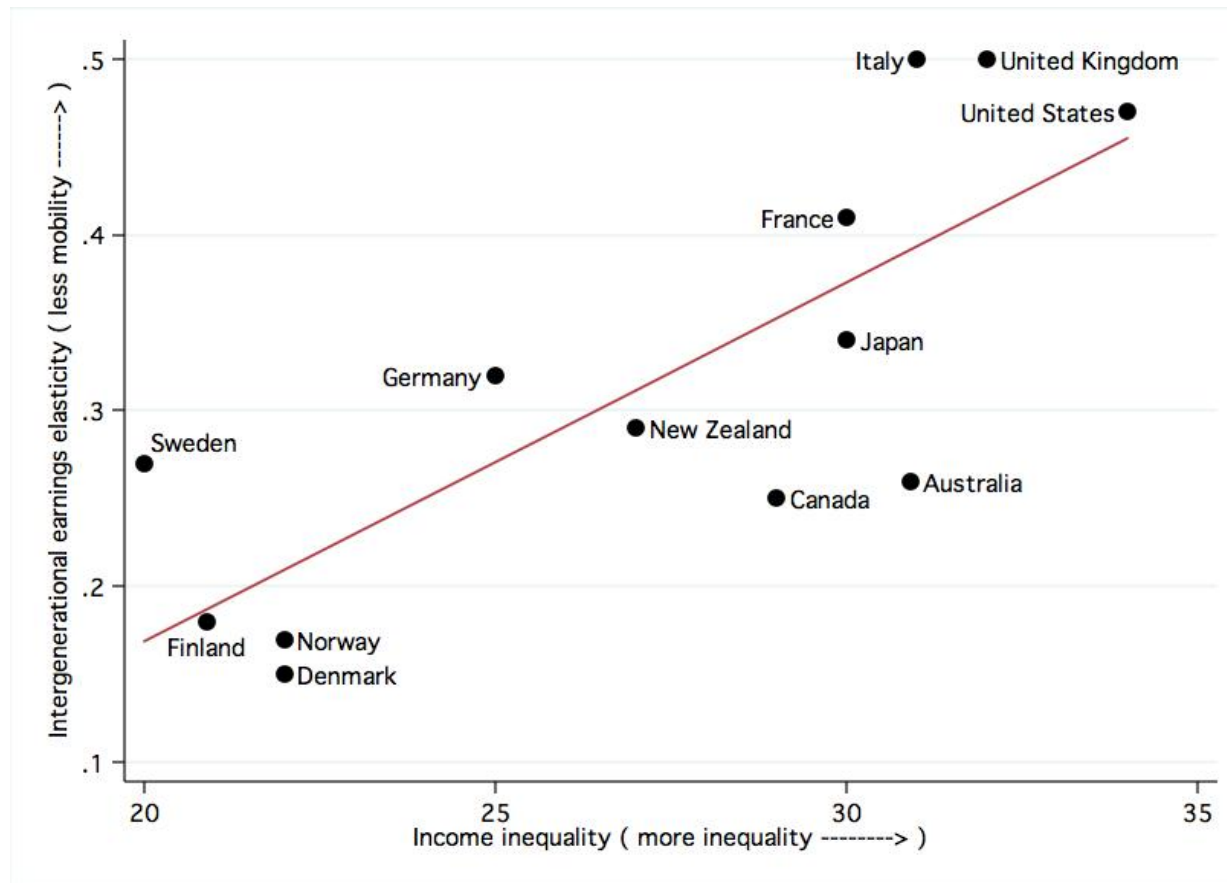


Illustration of points 2 and 3: The Great Gatsby curve (source Corak 2013)



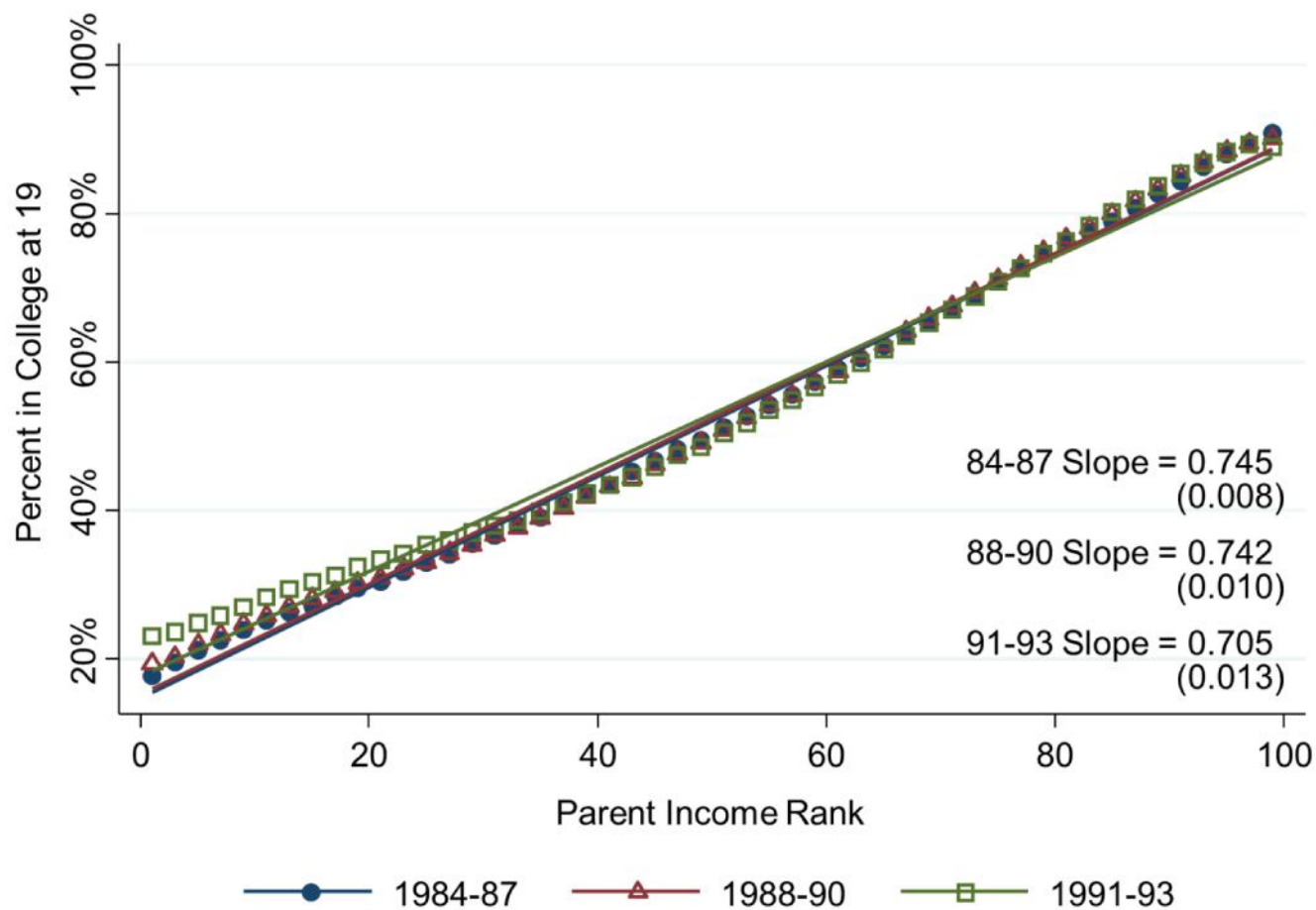
The US billionaires : Heirs or Self-Made Men

In the Silicon Valley

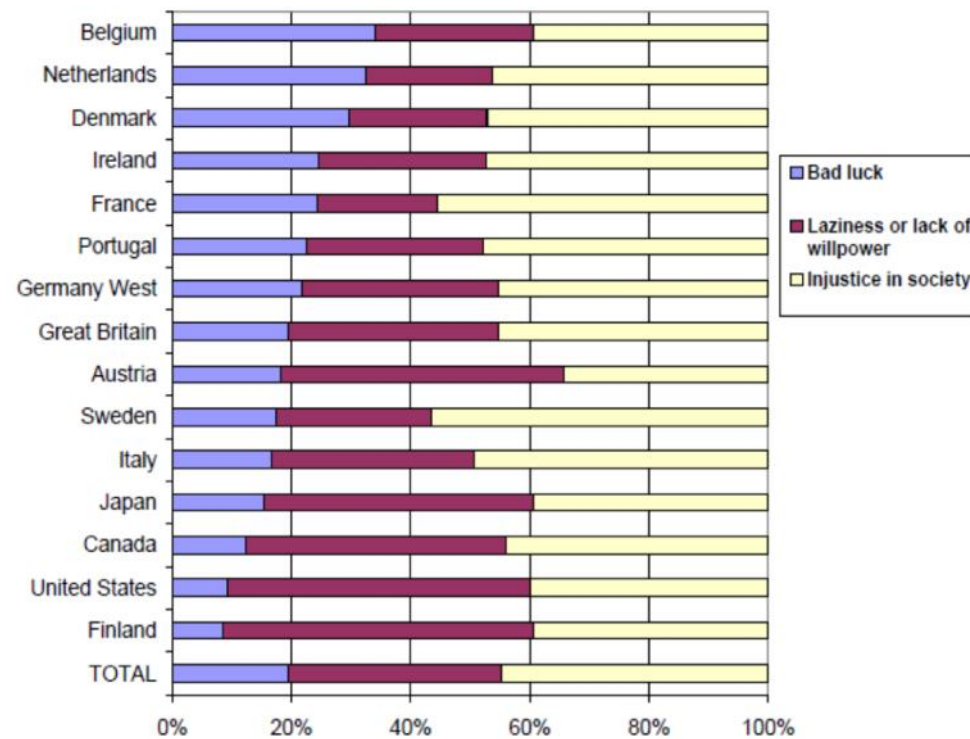
- Facebook: Mark Zuckerberg (Harvard)
- [Google: Larry Page](#) and [Sergey Brin](#), (Ph.D. students at [Stanford University](#))
- Amazon: Jeff Bezos (Princeton)
- Apple : Steve Job ([Homestead High School Reed College](#))
- Tesla : Elon Musk (BS in Physics in U Penn + BA in Economics Wharton)

Attendance rate in college in the US

(source: Chetty, Hendren, Kline and Saez (2014))

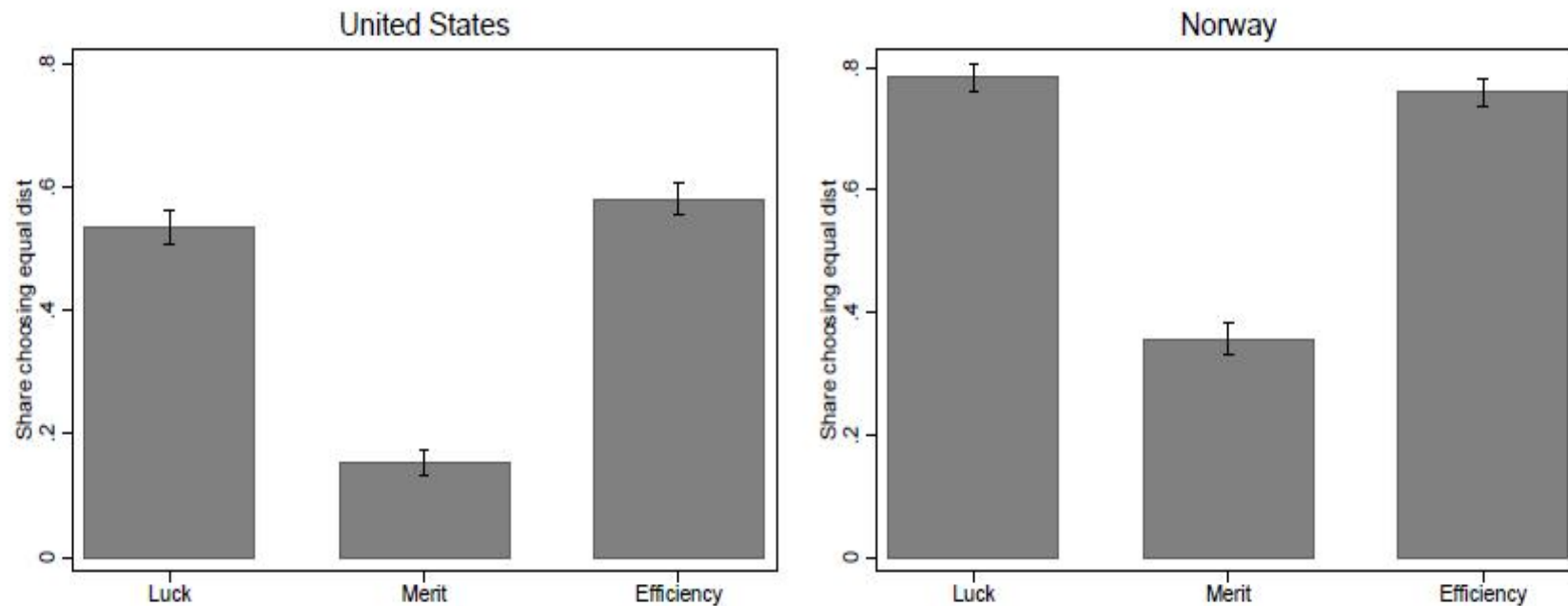


European attitudes to inequality



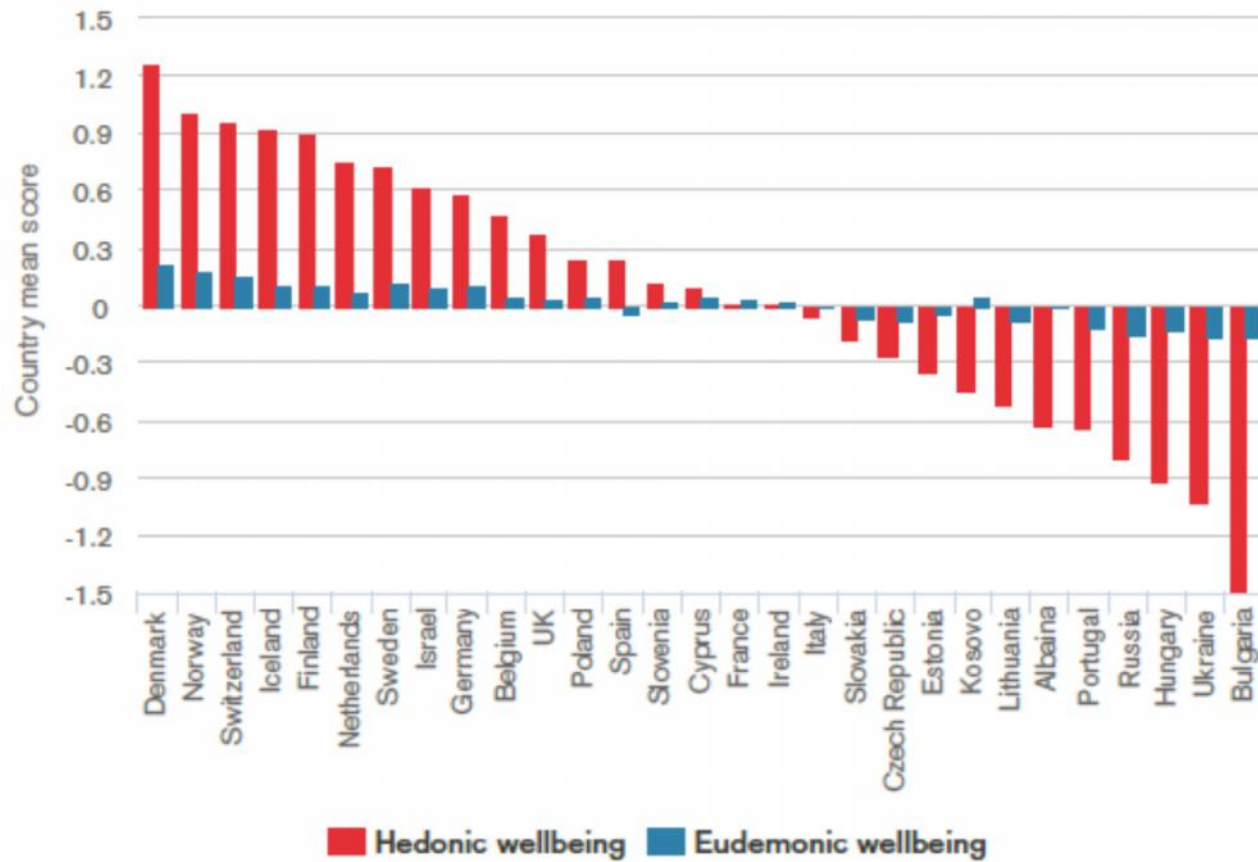
Source : World Values Survey (1990). Answers to the question : "Why are there people living in need ?". Authors' computations excluding the following answers : It is an inevitable part of modern progress; None of theses; Don't know.

In the background: Difference in inequality aversion (source Almas, Cappelen and Tungodden 2015)



Happiness in Europe

Hedonic and eudemonic wellbeing across Europe by country



Data source: ESS Round 6 (2012/13). Design weights applied.

Europe is special because it is very heterogeneous

- Europe is the low-inequality continent
- However, on mobility, inequality of opportunity and happiness, Europe is very heterogeneous
- Deeper integration will be a failure if we do not cope with this heterogeneity
- Fifth research proposal in the paper: The issue of convergence of Southern and Eastern societies to the social model of Northern Societies
 - Massive transfers from the North to the South is not the solution
 - The key is to understand the social and economic process

4. European research is at the forefront on many topics

- In a nutshell
 - Decisive contributions on empirical and conceptual issues regarding inequality and welfare
 - However, on trying to understand the causes of inequality, the US is taking the lead
 - Example, the Center for Economics of human development in Chicago around James Heckman for understanding how we can progress to reduce inequality of opportunity
 - First proposal : To build a European research network on equality of opportunity (bringing together labour education and urban economists and specialists of EOP)

5. Data are improving but remain incomplete

- Europe took the lead
 - for international comparison with LIS
 - For top income (World top income data basis)
- Panel data at European level
- But our knowledge remains insufficient mainly at the bottom.
 - In survey data, many poor declare a consumption greater than their income
- Second proposal. European panel data specific on the bottom part of the distribution to understand how people get in poverty, how people get out.
 - Only consumption
 - Health (included mental health), family and social relations, labor market, housing.

6. Inequality as transversal issues

- Inequality and global warming
- Inequality and migration
- Inequality and ageing
- Inequality and growth
- Inequality and technical progress
- Inequality and borrowing
- Inequality and globalization

All these issues are on the research agenda. There is a continuous flow of new results. I do not see a need to foster research. Basically we have data, we have models, but we lack good calibrated models.

7. Cutting edge research issues

- In the wake of Piketty's book, the role of wealth inequality
- The increasing gulf between CEO pay of large companies and the earnings of employees
 - Evolving social norms or size-linked risk of bad management?
- The link between mental health (John Layard) and poverty
 - Temporary, people may become bad-equipped to evolve in a complex and competitive society. They cannot cope any more with issues regarding employment or family.
 - It can have long-term consequences on their destiny and that of their offspring.
- Third proposal: To build a research program on a “standing-up” policy (the goals and the means)

8. Issues more specific to Europe

- Europe is an emerging fiscal federation.
- Mobility of mobile factors (capital and some types of labor).
 - This mobility is fueled by tax-regime heterogeneity
 - At the same time, taxes are the symbol of sovereignty
 - Mobility erodes sovereignty
 - Conflict between free mobility and sovereignty
- Acute issue for capital taxation with consequences on wealth inequality

Sustainability of the welfare state designed at the national level

- Globalization and mobility introduces a more severe competition between states which may reduce the heterogeneity of social preferences that can be implemented at the country level
- Additional concern in the Eurozone in case of divergence since migration from countries hurt by an adverse shock and the others is seen as a way to mediate the impact of the shock
- PAYGO system is likely unsustainable in case of long-term migration of young.
- **Forth proposal : to look at the sustainability of nation welfare states with mobility of factors with and without monetary union**

Five areas where further research would help European policy makers.

- A network of researchers in economics and social sciences to understand the fabric of equality of opportunity
- The building up of panel data specific to study the dynamics of poverty, how people are getting in, how people are getting out.
- To prepare the ground for a standing-up policy to fight poverty and promote equal opportunities
- To look at the sustainability of nation welfare states in an environment where capital and labor are mobile
- The issue of the convergence of Southern societies to the social model of Northern societies.
- Without the impulse of the European Commission, the research effort and output will be lower than needed.