

Income Inequality and Growth in Europe

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Measurement is Complex and Ambiguous



Other covariates

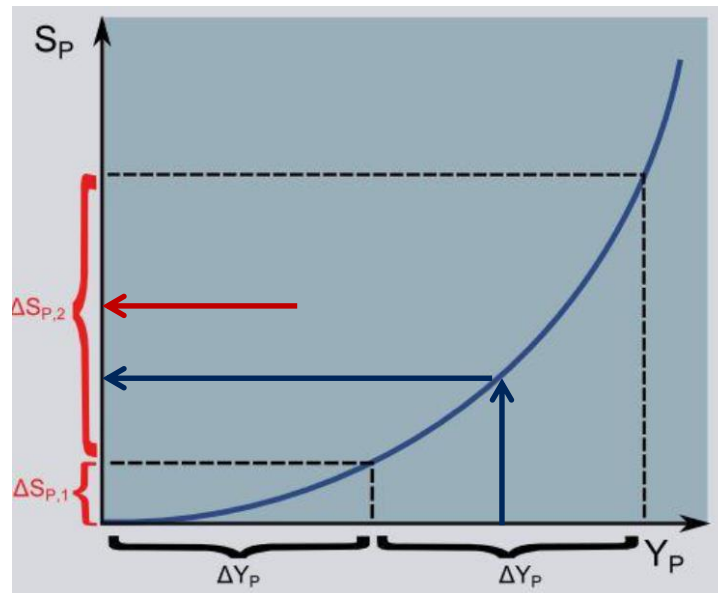
- Political institutions
- Infrastructure (education, health, physical)
- Financial development, trade liberalization
- Financial integration
- Productivity
- Volatility
- External shocks

- Which economic region?

(+) Pro Growth Effects of Inequality

■ Growth effects of inequality

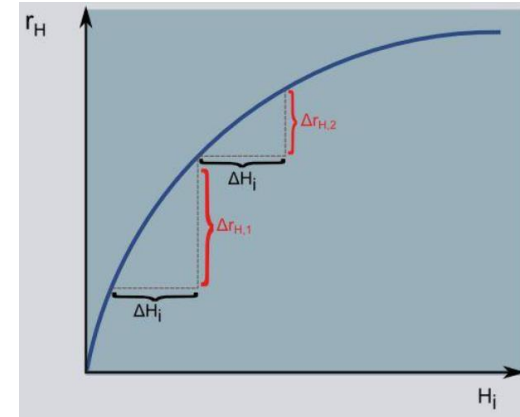
- **Incentives:** individuals strive through aspiration and reward
- **Investment Channel:** inequality lifts average physical investment due to convex savings functions (e.g. Josten, 2007)



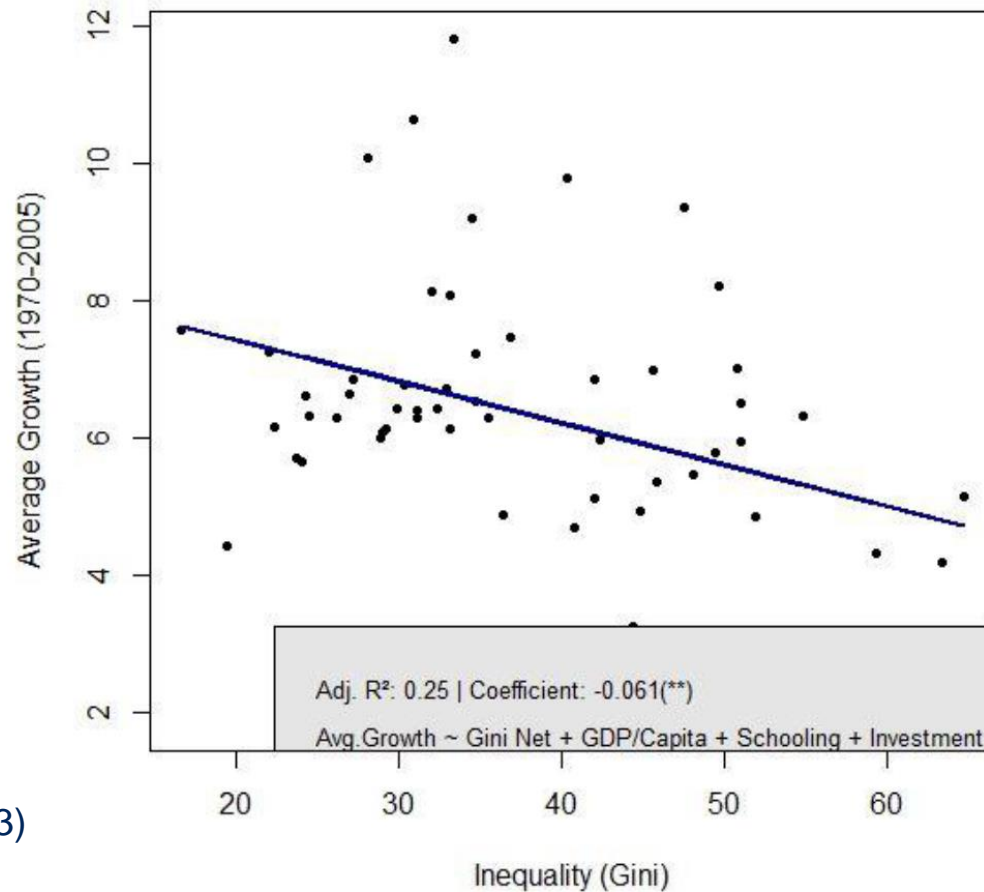
Source:
Ramolla (2013)

(-) Impediments for Growth from Inequality

- Credit market imperfections
 - Financial constraints to schooling for lower income
 - Diminishing returns of individual human capital
- Political Risk increases with inequality,
 - curbs investment
 - impairs countries' deftness to react to external crises (Rodrik, 1999)
- Financial Markets channel: inequality pressures politicians to ease credit and pressure borrowers to overleverage
- High levels of market income inequality creates need for growth-hampering redistribution (in societies where political power is more equally distributed than economic power)



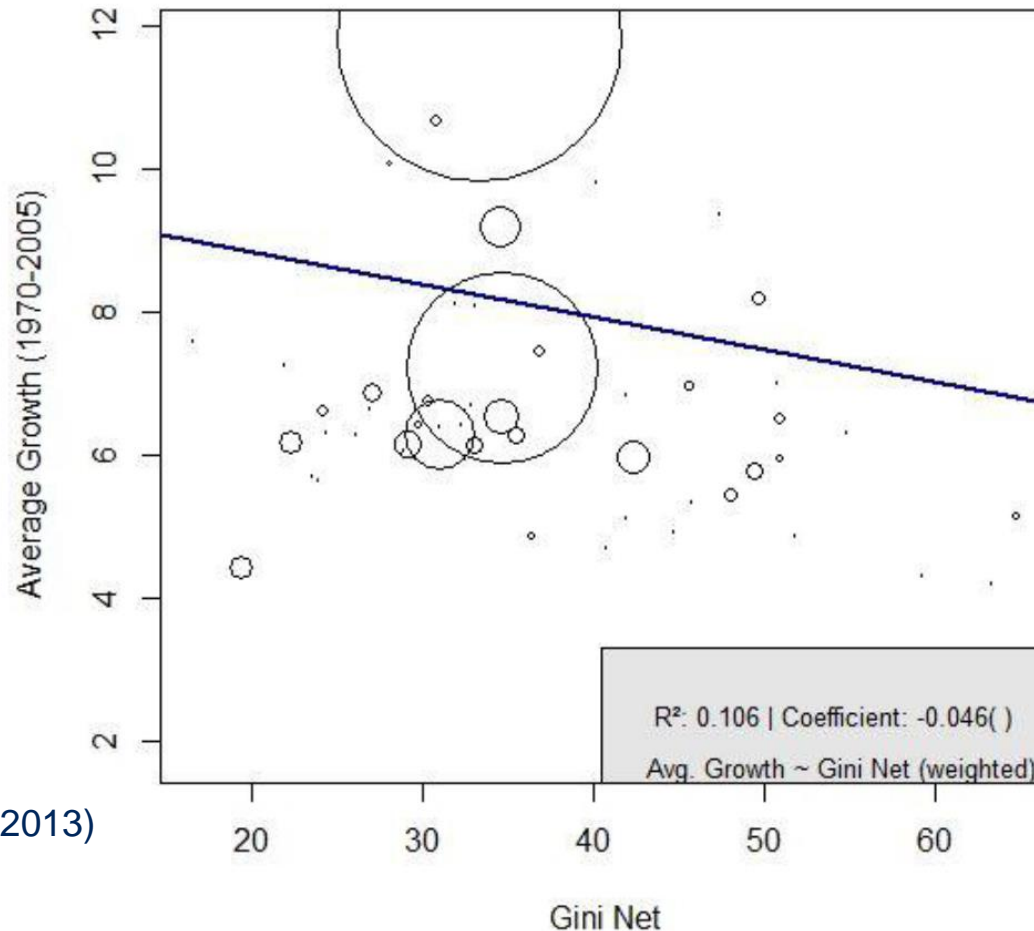
Correlations



Source:
Ramolla (2013)

Data for 55
countries from
PWT and
SWIID (Solt
2011)

Correlation from an Individual Perspective

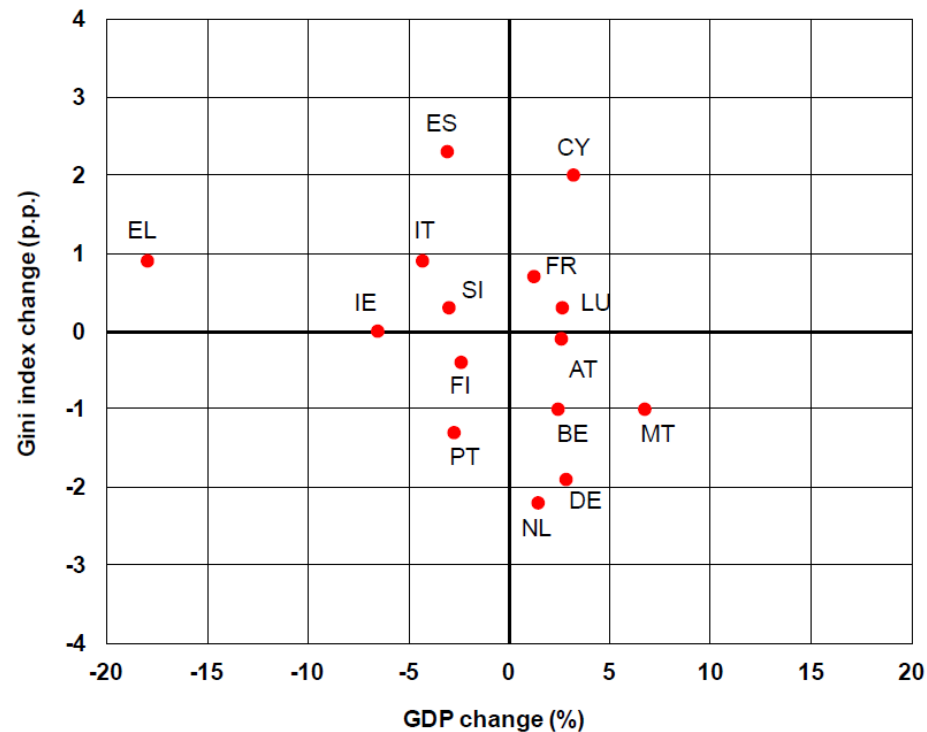


Source:
Ramolla (2013)

Data for 55
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2011)

Recent Developments in Europe

GDP and inequality change, 2007–11 Euro Area



Source:
Brandolini
(2015)

Source: elaboration on Eurostat data.

Inequality in Europe? National Perspectives

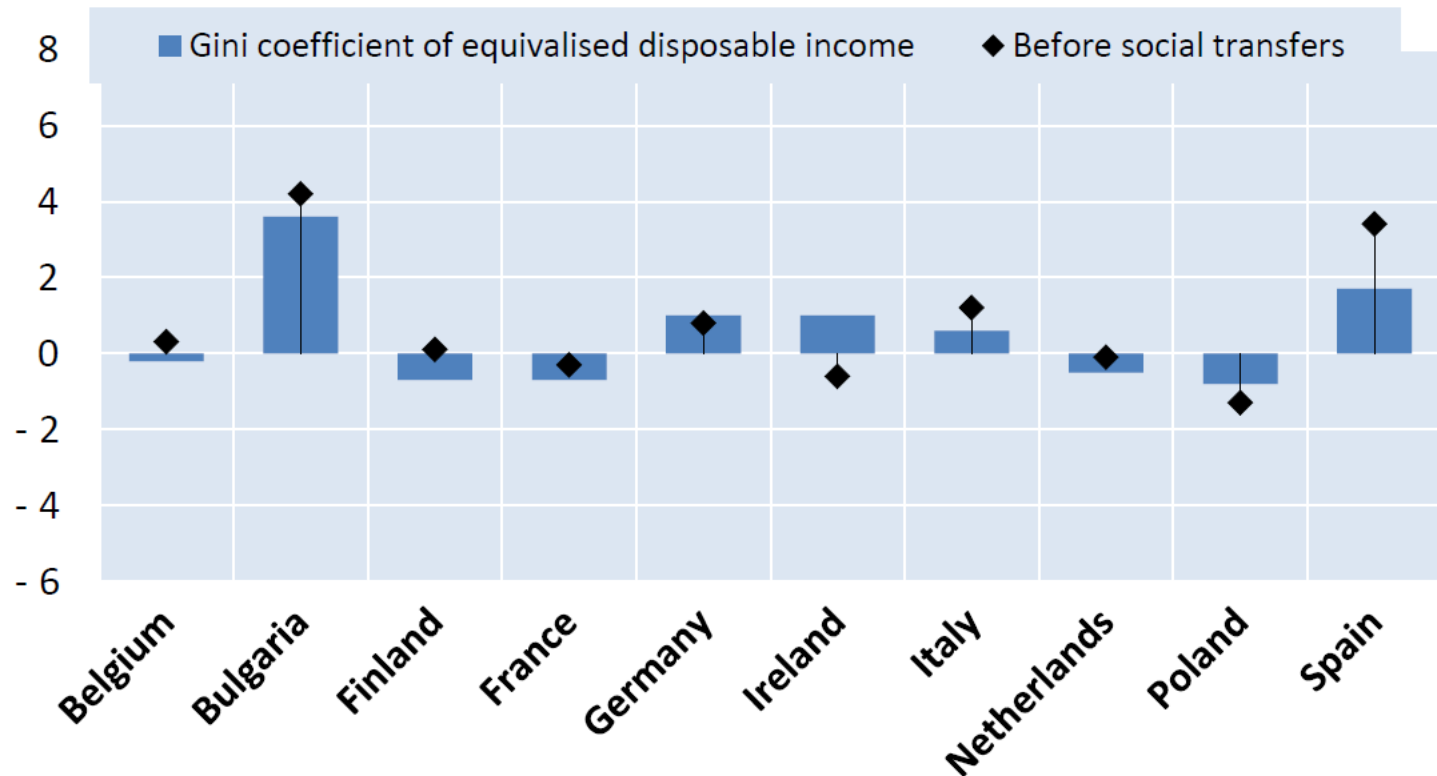
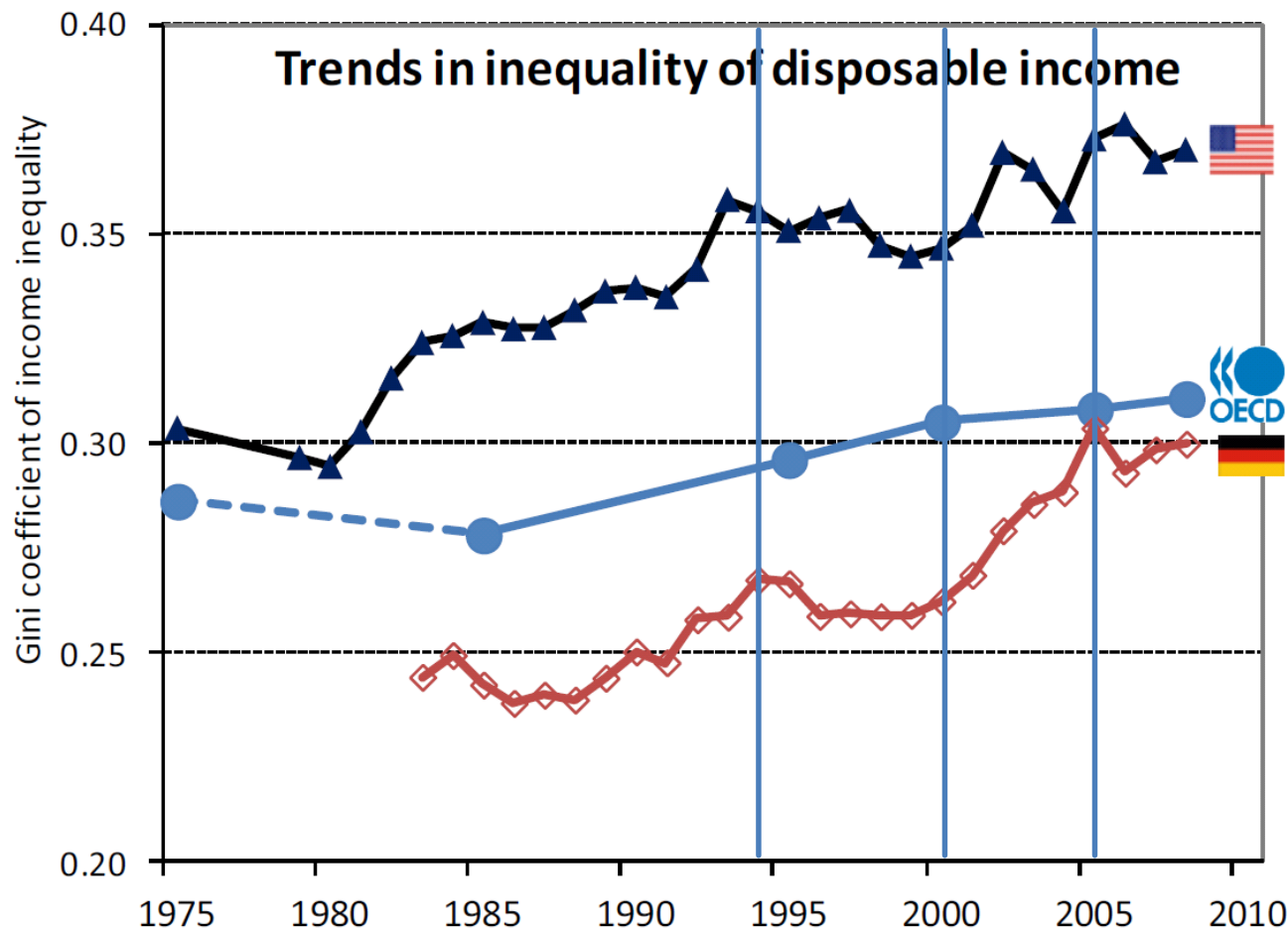


Figure 4: Percentage change in the Gini coefficient 2009-2015

This figure shows the percentage change in the Gini-coefficient for equivalised disposable income inequality, between 2009 and 2015. Pensions are excluded as social transfers. Source: Eurostat.

Closer Look at National Stories Needed in Order to Identify and Fight Drivers of Ineq.



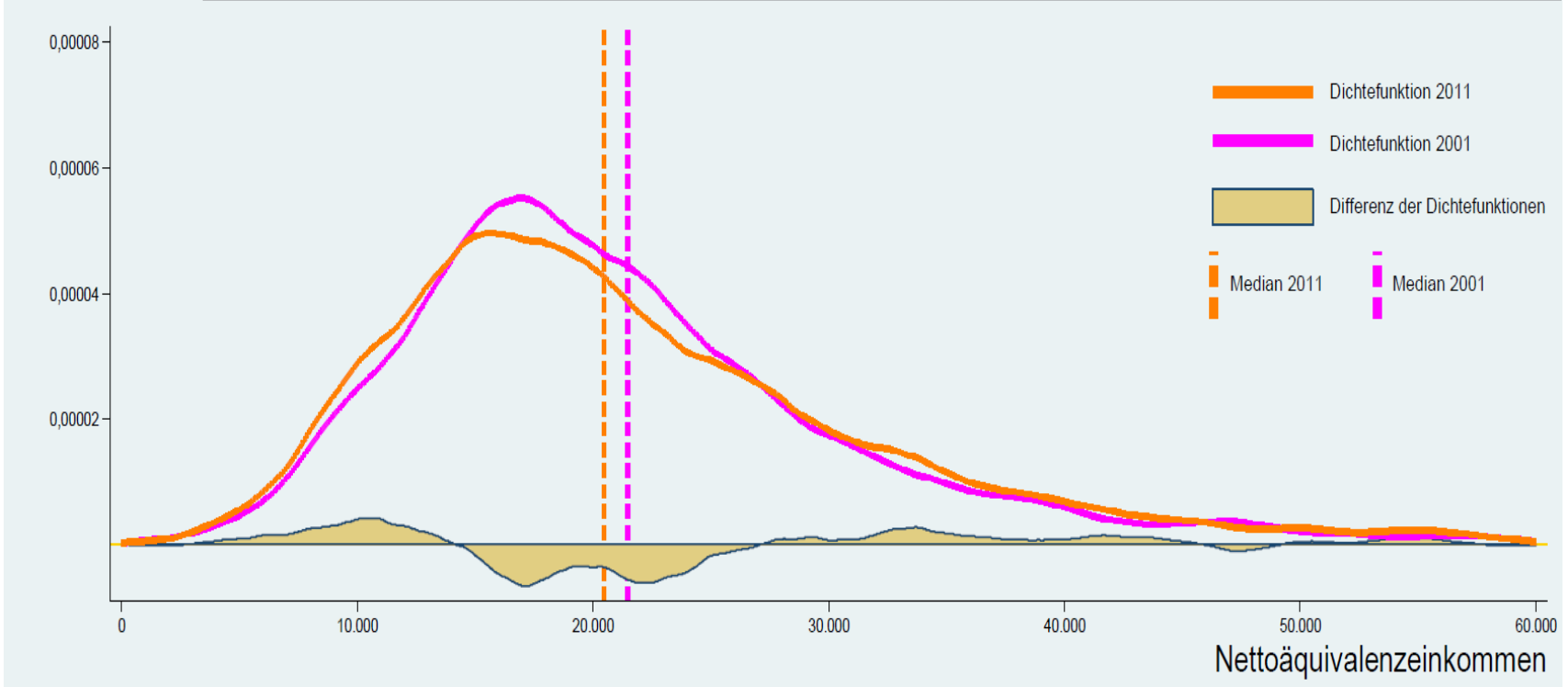
Closer Look at National Stories Needed in Order to Identify and Fight Drivers of Ineq.

- Long-run determinants for Germany
 - Skill biased technological change
 - Unequal change in work intensities
 - Diminishing wage bargaining power
 - Demographic trend (e.g. Peichl et al. 2012)
- Strong increase of income inequality 1999-2005 (IAW/UniTue 2012)
 - Increasing unemployment (50%)
 - Changes in income tax formula (25%)
 - Polarization of wages (25%)

Closer Look at Countries needed, here: Germany

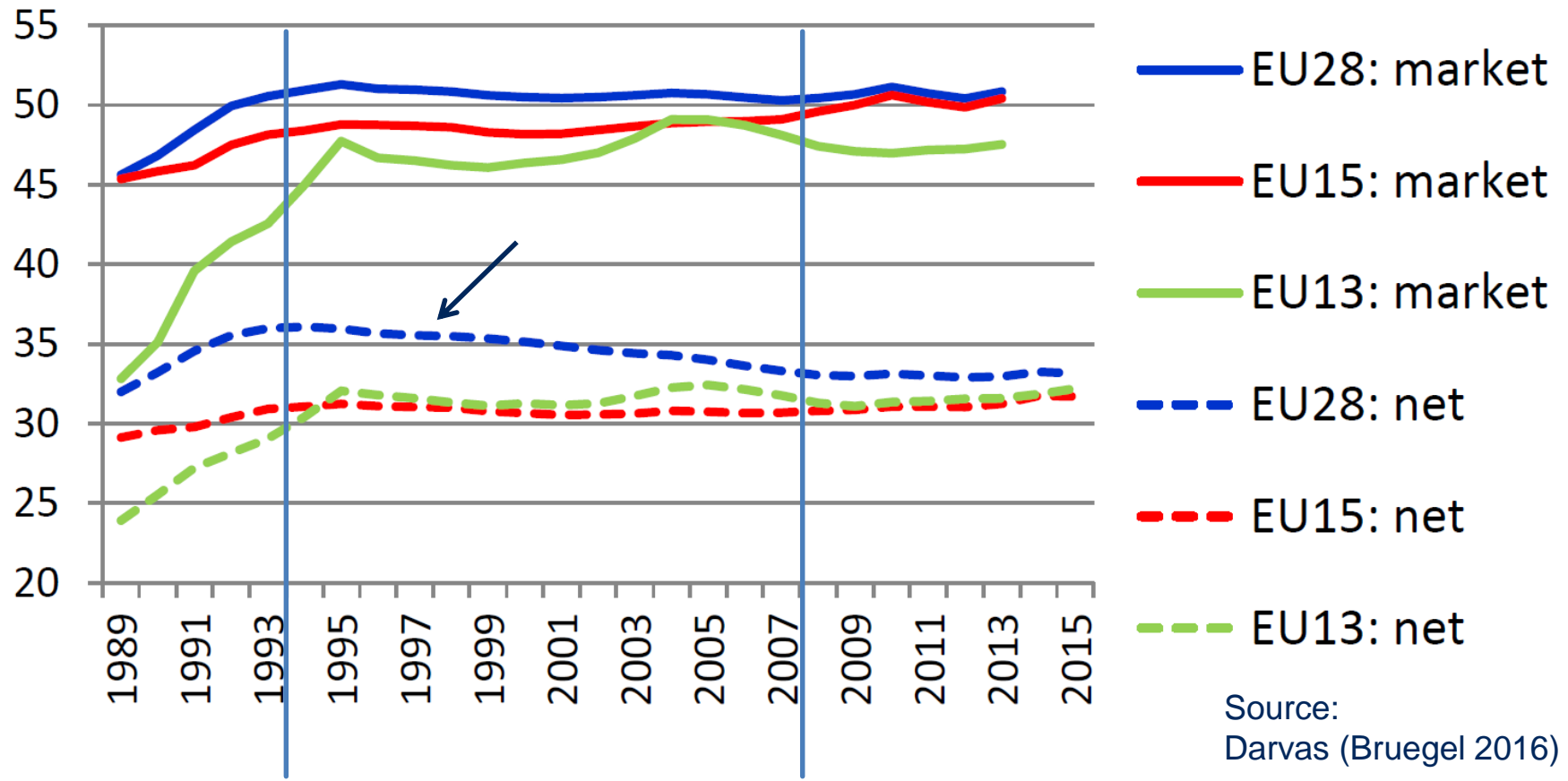
A 3.10

Net equivalent incomes p.a., 2001 and 2011



What about an EU-perspective?

Inequality in Europe? The EU-wide Perspective



Policy Conclusions

- Increased inequality runs growth risks
- Caution principle
- Poorly designed efforts threaten to distort incentives and strangle growth, though
- (for the rich and for the poor)

- Mind other possible afflictions from inequality
 - Populism
 - Poor access to health

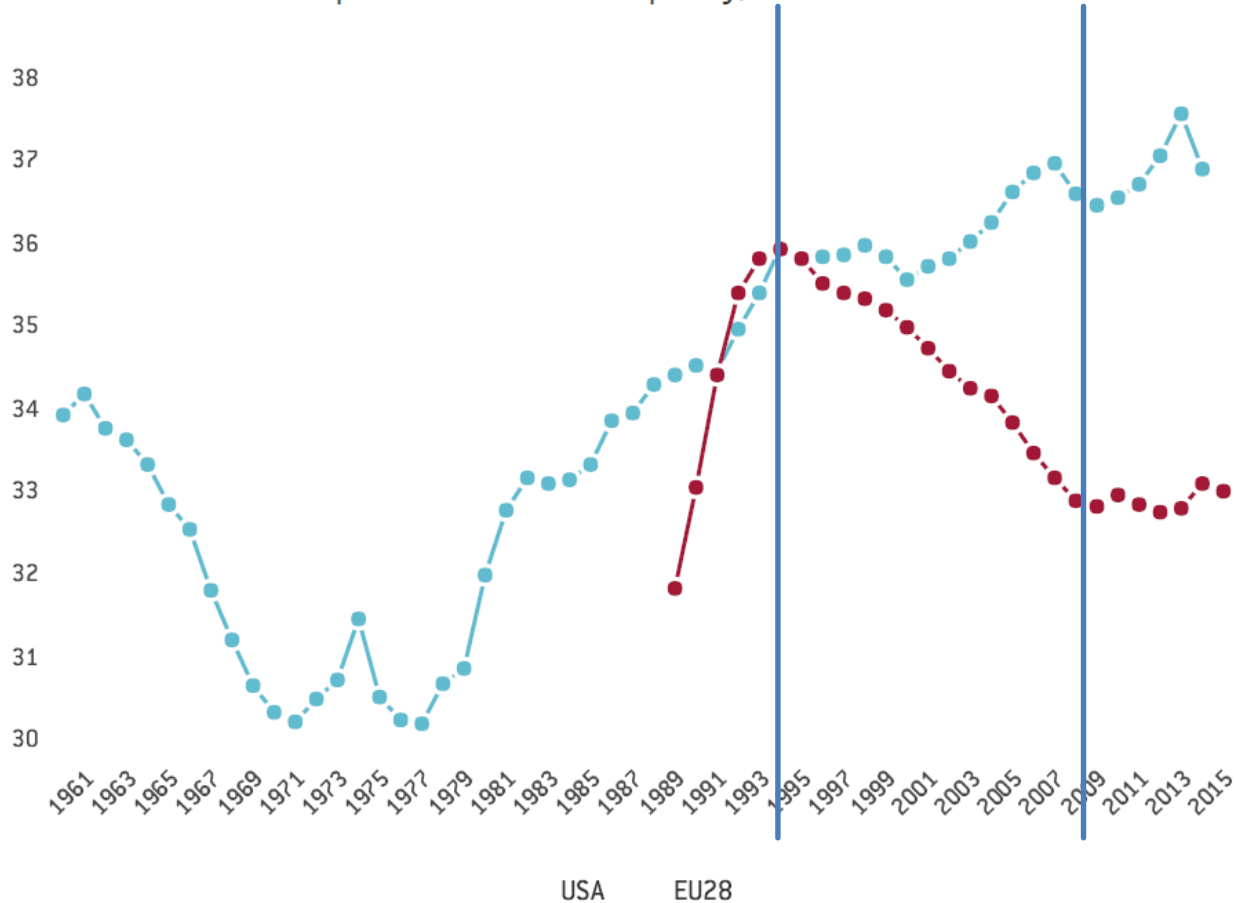
Win-Win-Policies:

- Active labor market policies: fight unemployment as biggest driver of inequality and stagnation
- Education with equal access promotes growth AND equality
- Equal pay and access to labor market
- Focus on Economic opportunities and vertical mobility, especially for the poor
- Subsidies of goods that are mainly consumed by the poor (Coady et al. 2010).
- Secure bargaining power for labor
- Appropriate regulation of credit markets to corral overlending and overborrowing

Thank you for your attention

Inequality in Europe? The EU-wide Perspective

Gini coefficient of disposable income inequality, 1960-2015



- **Estimates**
- **High** compared to national levels.
- **But declining**
- **Lower** than in other parts of the world
- **Convergence**
- **Recently halting**

Source:

Darvas/Bruegel (2016)

Note: A Gini index of zero represents perfect equality (incomes are perfectly evenly distributed) and a Gini index of 100 indicates perfect inequality (all incomes are owned by one person).

Source: US data is from the Standardised World Income Inequality Database (SWIID) from [Solt \(2016\)](#), while EU28 data is from [Darvas \(2016\)](#), which is based on the individual country data from [Solt \(2016\)](#); thereby the US and EU28 data reported in this figure are comparable.