Session 1: Are Inequalities Compatible With Prosperity ?

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Growth and inequality are a complicated pair in economy: while inequality is inherent to advancing economies, recent political events have taught us that prosperity does not go hand-in-hand with inclusion. Rejection of our globalised development model, open to the world and its flows, has been the strongest in the United States and United Kingdom, where growth has been the highest and unemployment the lowest.

The ability of liberal democracies to absorb cultural, economic, social and territorial inequalities appears to be struggling. What's more, these votes reflect the rejection of growth that divides the world between those who embrace globalisation and those who are frightened by the changes it brings. Are disparities in wealth as well as lifestyles within a nation or, more broadly, advanced economies, sustainable over the long term?

This is an even more burning question given the vigorous political debate the issue has provoked, which could affect the prosperity of future decades. There are two opposing options to bridge the gap between globalisation's insiders and outsiders. The first option is protectionism, with all parties withdrawing from the world and taking cover behind their own borders. This option often coincides with higher taxes on higher incomes, with both labour and capital, and even a refusal to acknowledge existing debts. The second option is to continue an outward-looking policy, with close attention paid to inclusion. These types of policies seek to redistribute revenues from globalisation and expand opportunities to be a part of and benefit from globalisation through fair access to quality education, continuous professional training and an opening to other cultures.

This session will provide an opportunity to evaluate policy diagnostics and recommendations beyond the economy. It is less about comparing supply and demand policies, and more about comparing outward- and inward-looking policies.

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In a typical economist type of discussion, there is little agreement about inequality and growth.

Arguments supporting that inequality is essential to economic developments have long existed. The prospect of economic returns incentivizes innovation and investment, raising entrepreneurship, producing stronger economic growth and higher income –even among those not belonging to the top highest income earners. Also, and especially in developing countries, inequalities resulting from higher income generate savings, which in turn are invested in the economy for production and innovation. Another line of argument is that taxing wealth and transferring to less well-off entails lost resources in bureaucracy and administration. Hence, in this context, increases in inequality correspond with sharper rises in living standards also for the middle class and the lower income earners.

However, recent research provide ample evidence that growing inequalities can have negative consequences for economic growth and prosperity. It is not so much the rising share of the top income earners which raises issues, but the lower share of prosperity of the middle and lower working class, around 40% of the population in OECD countries, which threatens growth and prosperity. First, the OECD has shown that many developed economies would reach higher growth if the growth of income inequality had been better contained over the last decades. Second and perhaps more importantly, research shows that these 40% of the population have less capacity to invest in education and skills, thus reducing social mobility. Inequality may also lead to lower average health status of the population. More recently, concerns has risen that inequality may impair political and economic stability and thus reduce the attractiveness of an economy for investment. Similarly, inequality impairs the social consensus needed to have the flexibility to adjust to shocks and sustain growth, both in terms of greater labour market flexibility, acceptation of taxation for redistribution, and openness to trade.

Far from being theoretical, the recent political events have demonstrated that such concerns are at the heart of voting behavior, threatening the global economic development model of the past decade, which has lifted a third of the world (developing economies) population out of poverty…but with the less attractive effect of subjecting developed economies middle class to stagnant or declining income for some, fear for their jobs and the ability of their children to live a better life. Although it is difficult to disentangle some of these effects from the impact of new technology, it is fair to say that pursuing globalization, in the digital era, without caring about inclusion does not look sustainable.

Against this background, policies both at the national and international level are needed, first to empower individuals facing competition and digital disruption, and second to regulate global capitalism.

Policies empowering individuals

Economic policies in this field are well known, from investment in human capital, public goods, to well-balanced redistribution. They cover : tackling child poverty, investing in education especially at an early age, improving labour market functioning, strengthening social cohesion, improving access to high quality healthcare, reducing intergenerational inequalities.

Tackling children poverty is essential to establishing greater equality of life chances. It is not only a developing country issue : in 20 out of 34 OECD countries, child poverty has increased since 2008. Family policy, including targeted support through a well-developed transfer system aimed at disadvantaged families (child benefit and allowances, housing benefits, school benefits) are key, as well as ensuring children have access to education and support for this education.

Indeed, inequality in education is possibly the most harmful element of a socially inclusive society. International organization have provided large evidence that children with a socially more comfortable background succeed increasingly better than the other, symmetrically poorer children score less well throughout the education life[1]. This is not only a financial issue (the free education French system is in many ways more socially discriminant than others), but also encompasses early education (kindergarden), social inclusion in school, when needed with special care for children with a less supportive social background, and targeted benefits where needed.

[1] Rumberger (2010) shows that the odds of completing college for a student in the US from a high SES background are more than six times higher than for a student from a lower social class background.

All measures making labour market more efficient and inclusive have been well known for two or three decades. Yet, while a more flexible labour market results in less long term or structural unemployment, it is not enough to increase well-being or even reduce inequality. More attention is now being devoted to the quality of jobs[2], supplementary benefits for those whose productivity is not growing enough to be matched by higher wages, improving the functioning of unions, and harmonizing labour contracts so as not to create a two speed labour market. As well, life-long learning is of the essence and such state-supported systems should clearly target less skilled workers, something which is far from being the case in practice.

Social discrimination impedes labour growth. Reducing urban, rural or social fragmentation through a better access to all public services (education, health, transport, labour market policies) allows better integration, but also increases the quality of human capital and therefore growth and prosperity for all. It is a no-brainer that more populist votes are stronger in areas where the level of public services has sharply declined.

Structural policies are not enough and the question of the "optimal" level of redistribution should be the object of more research. The subjects has so far been largely dominated by T. Piketty and and his co-authors[3]… as well as evidence : where redistribution is higher (France, northern European economies), populism and rejection of globalization has increased but not to the extent that it has in anglo-saxon countries where the extent of redistribution is much more contained, particularly harming the middle and lower middle class, whose income has not increased for decades and even receded in some places with the Great financial crisis.

Stronger global governance

Traditionally a topic that raised little interest, both recent threat to free trade and regional agreement, including in Europe, have been an eye opener on the lack of check and balances of the global market place. This has materialized in several forms: global arbitrage for the parking of profits, locating headquarters so as to gain tax advantages or transfer prices. This is impairing resources for national governments to invest in the previous policies and safety nets, reskilling ..etc. In that sense, the Base Erosion Profit Shifting of the OECD, aimed at unveiling and correcting such practices is a major step forward, whose benefits should materialize in the coming years. As well, globally coordinated financial re-regulation is instrumental in ensuring a level-playing field of good practices, if only to avoid a repetition of the last financial crisis, but also global arbitrage.

In addition, regional, such as the EU, organization, can foster the promotion of more equalitarian social models as well as weigh on the shape of globalization.

More imaginative global efforts could also be promoted, for example in diffusing digital tools, that are so instrumental to ensure developing economies activities. This would also take the forms of "quick wins" which will be crucial in ensuring that benefits from globalization for all appear visible quickly.

[2] As recommended by the OECD in "In It together: Why less inequality benefits all". Between 1995 and 2013, more than 50% of all jobs created in OECD countries were part-time, temporary of self-employed jobs.
[3] "Optimal taxation of top labour incomes: a tale of three elasticities", Thomas Piketty, Emmanuel Saez, Stefanie Stantcheva, 2014, American Economic Journal

Conclusion

Policies aiming at strengthening individuals, empowering them to address the challenges raised by globalization and the disruption caused by the digital transformation should complemented with deeper global governance. The global, open model of the past decades has succeeded in lifting a large part of the word out of poverty and raising global living standards. Yet it has failed in two areas: it has resulted in less inclusion, more fragmentation of societies in the developed world, while not succeeding (yet) with some of the poorest countries, in Africa especially. Deepening our understanding of policies needed to reduce the developed economies fragmentation (from education, labour market and health policies), to regulate global capitalism and avoid harmful competition in some fields (though global regulation and a reduction of tax ans social arbitrage), while continuing fostering effects for the countries which have been left out of this prosperity is essential. For the latter, the digital technology can help as it provides easy access to many left out to information, support for production, easier education and financing, in a very rapid way. And we need quick demonstration of these benefits for the current generation of voters to gain from it and renew with openness and appetite for innovation and risk.