Matching efficiency with fairness:
Labour market and distributional issues

Discussion of papers by T. Picketty and T. Andersen, ARC 2010 Conference, DG EcFin,
Brussels, 23 November 2010

Andrew Watt, European Trade Union Institute (ETUI), Brussels

Restatement of some key messages: T. Andersen

Main message: Careful application of a fairly orthodox (political-)economy approach shows that orthodox and pre-dominant views about the detrimental effects of welfare state and LM institutions do not/need not apply

WS and LMs replace missing or imperfect markets

Negative distortions are offset by improved micro incentives (risk sharing) and macro stabilisation effects

Public goods like education are valuable (even if financed by distortionary taxes)

Negative incentive effects can be minimised by clever policy design

Strong automatic stabilisers do not seem to worsen LM persistence problems

For best-practice countries there is an equity-efficiency trade-off but ‘economic deprivation is not necessary to create incentives’ and thus efficiency

Assessment

Welcome (re-)statement of the case for WS and LMIs (Nordic model) using a clear-sighted application of standard economic reasoning and careful use of comparative data

Of a piece with a shift in perception of leading policymaking institutions (notably 2006 Review of OECD Jobs Strategy)

Scope for developing and strengthening some of the arguments, incorporating more heterodox perspectives

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A more forceful case

Most countries are not at the best-practice frontier: no reason for them not to improve equity and/or efficiency. Make more of the fact that ‘more equity tends to be associated with more efficiency’ (5)

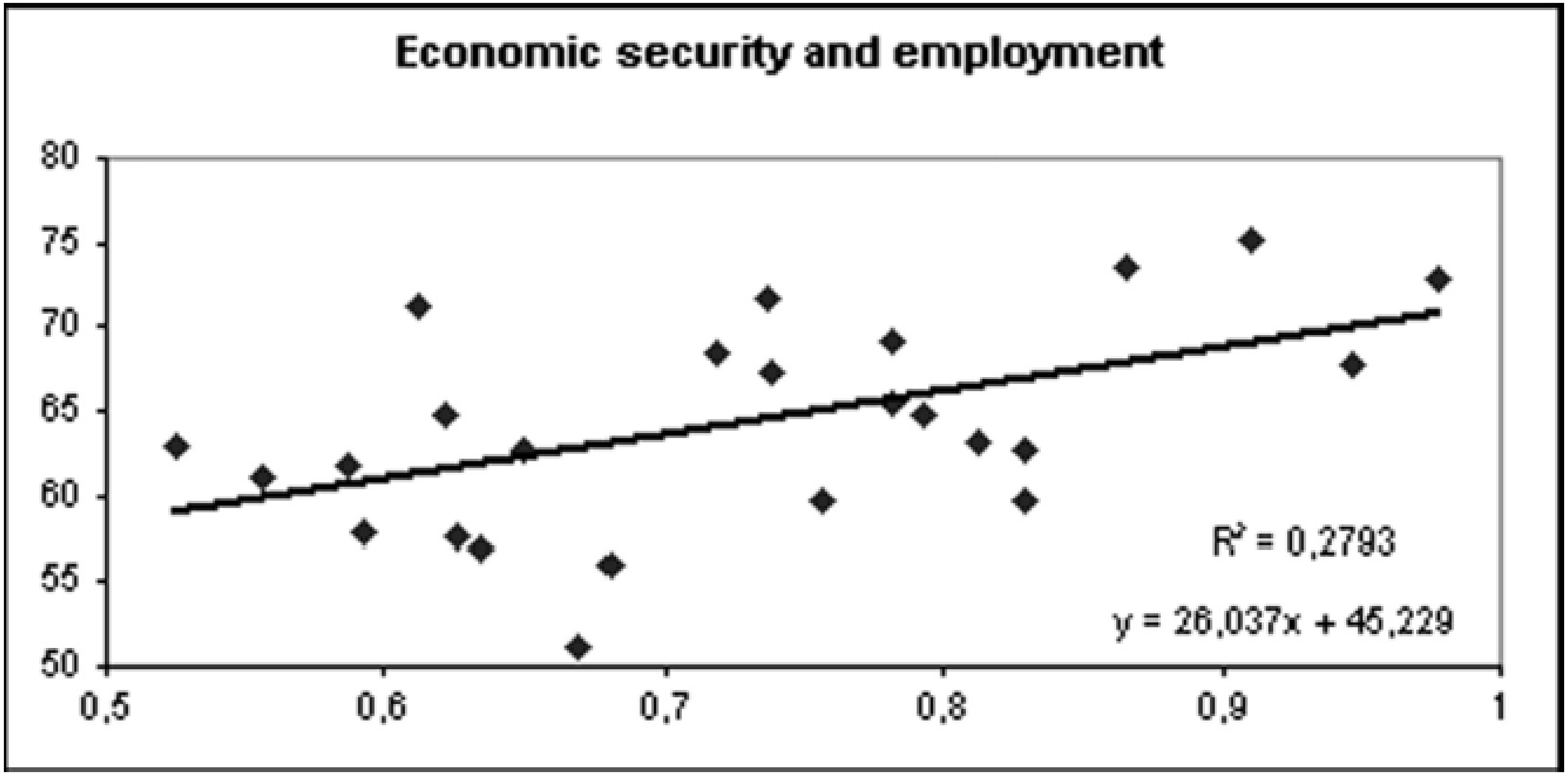
That positive correlation also applies to employment (graph)

The ‘efficiency’ concept is narrow (GDP/cap). A broader measure of welfare would decisively strengthen the positive equity-‘efficiency’ correlation (Wilkinson/Pickett: ‘Spirit Level’ pathological know-ck-on effects on inequality)

Role of social norms is underplayed: people do not only react to other things than pecuniary incentives; moreover, these norms are endogenous in that individual behaviour is likely to be more altruistic if society is perceived to be fair

Positive correlation also applies to employment

Figure 3: Economic security and employment



Source: Watt 2003

A more forceful case

Education is but one example of the positive role that public spending can play for growth promotion: this argument can be generalised (a fortiori regarding green transition)

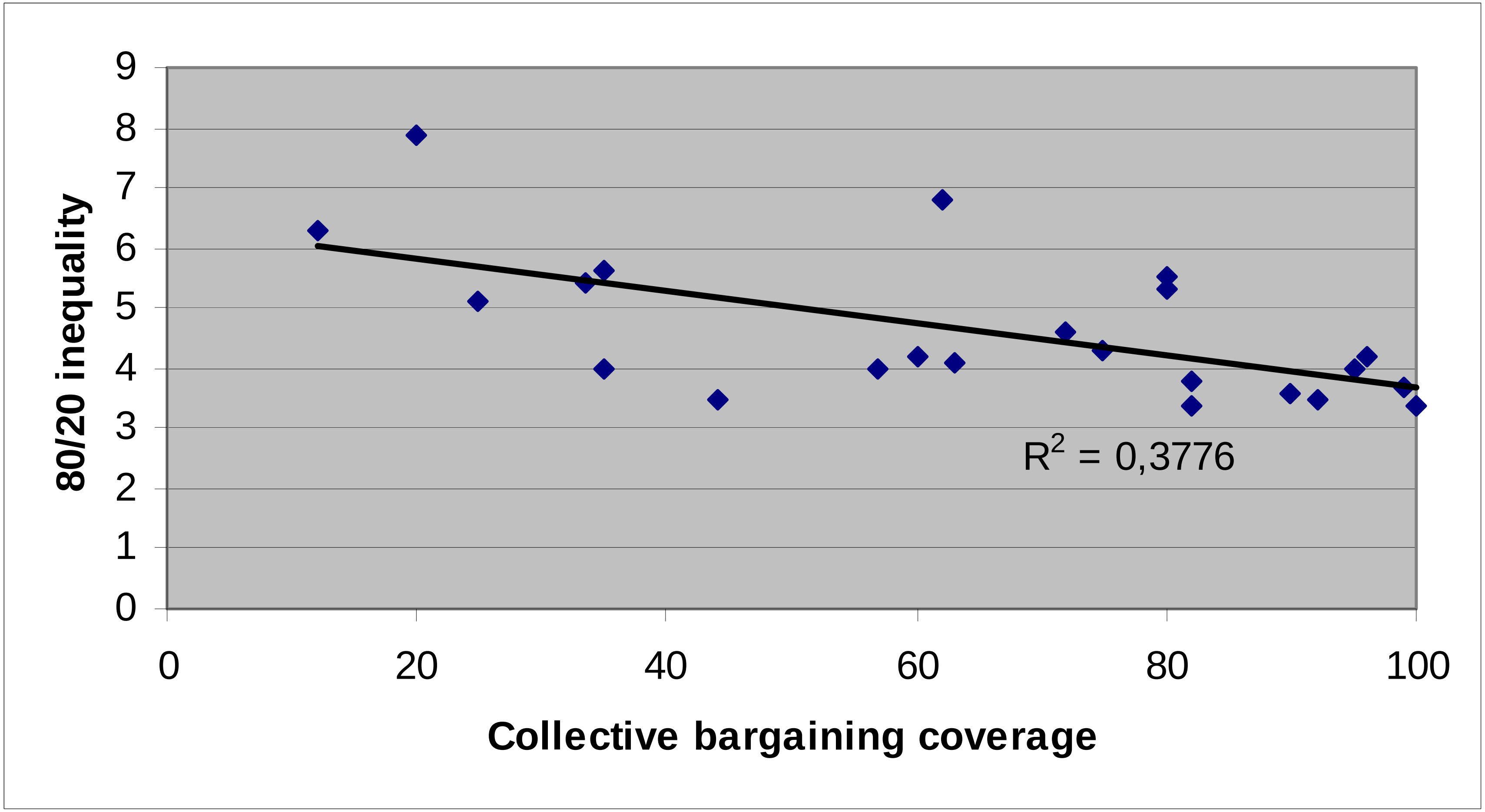
Hysterisis/persistence argument needs to be discussed in the context of demand-side policy: lack of WS makes bringing U down more urgent (US) but strong/expensive WS makes it vital in medium run (EU: mistakes 1980s and 1990s). Current concerns that cyclical U will become ‘structural’

Automatic stabilisers: need to be strengthened irrespective of size of WS using dedicated measures (proposal for OMC to try to internalise positive externalities – Watt 2010)

Trade unions are good for equality! (graph)

Case for a European minimum wage norm (Schulten/Watt 2008)

Trade unions good for equality!



O'Farrell/Watt 2009

Restatement of some key messages: T. Picketty

Overall argument: ‘high time to put distribution back into mainstream economics’

Back to the early 20th century in English-speaking countries

Monopolisation of productivity increase by top income-earners

Doubtful about role of inequality in the crisis (more due to financial fragility)

Dystopic future: with g small & r>g, inherited wealth is bound to dominate again self-made wealth in the future

This requires policy (tax) coordination

Assessment

Hugely influential empirical work

Welcome aim to refocus economics on distribution

Paper not available: assessment only based on slides – some questions and suggestions

Crisis-inequality link?

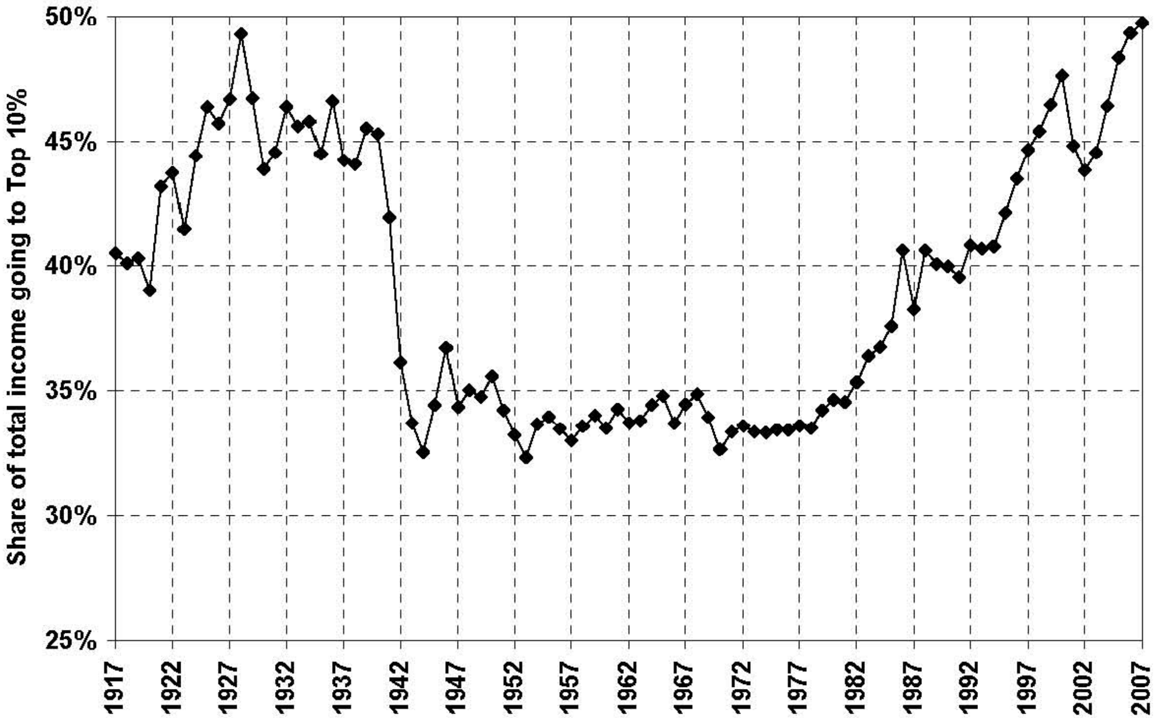


FIGURE 1
The Top Decile Income Share in the United States, 1917-2007

Source: Piketty and Saez (2003), series updated to 2007.
Income is defined as market income including realized capital gains (excludes government transfers).

Prima facie empirical link between peak in share of top 1% and following crisis.

But also crisis of mid/late 1970s – profit squeeze

Suggests balanced income development key for crisis avoidance.

Crisis-inequality link?

Standard view on political left:

Immiseration of working class -> unsustainable borrowing

Concentration of incomes at the top led to speculative frenzy

An additional proposed mechanism:

Kaleckian model (tradition of Marglin/Bhaduri) where declining wage share (graph) leads to slower demand growth

Offset by ever lower interest rates by the CB

-> search for yield/speculative excesses: combines heterodox (distribution) and orthodox (MP) explanations

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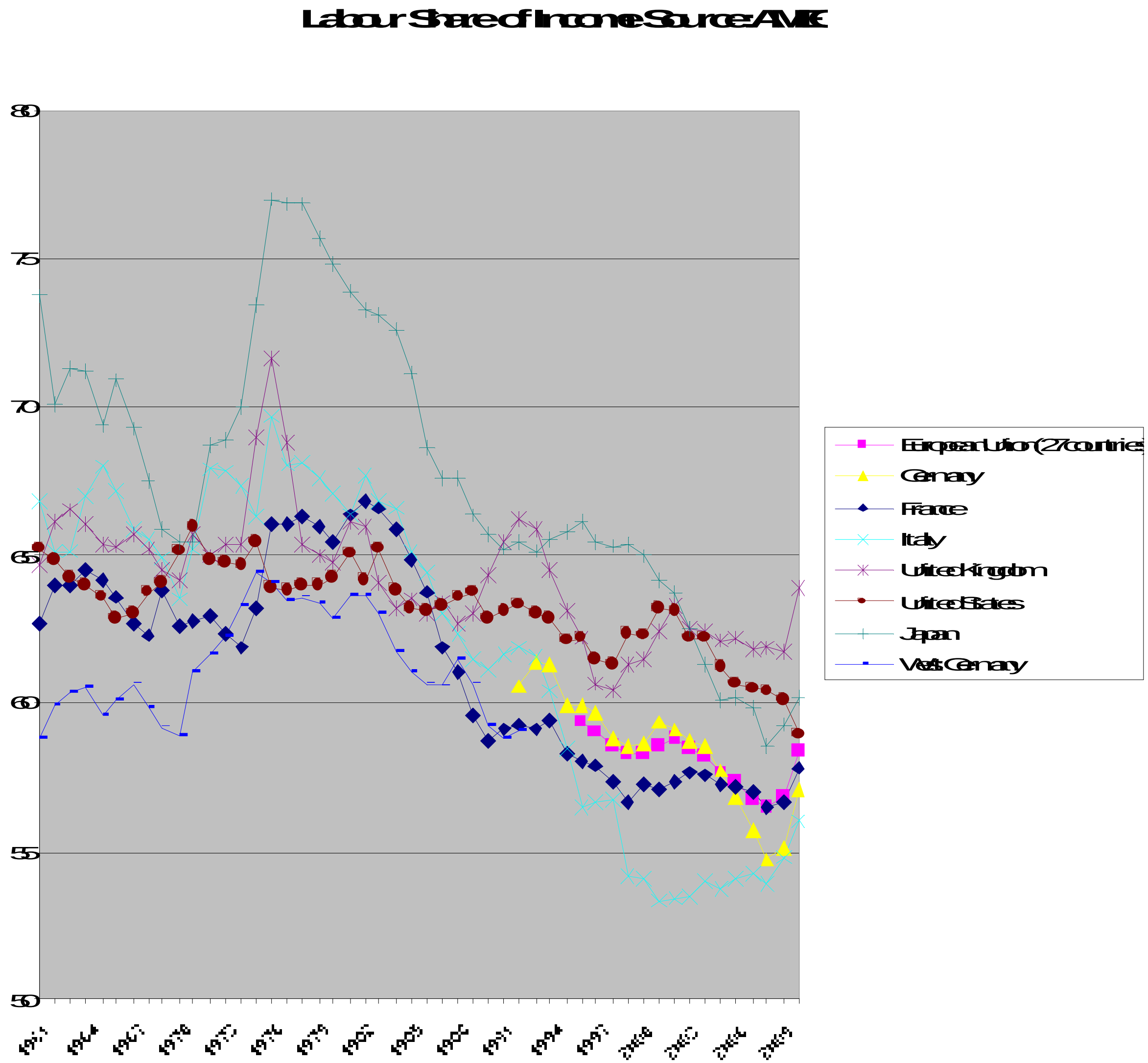
Long-term down ward trend of the labour share



Policy and taxation

Need to work to change distribution of market incomes

- Education (Andersen)
- Increased competition ‘at the top’; reduce rents and implicit subsidies; fight western style ‘crony capitalism’

But taxation critical

- Single market/globalisation has weakened taxation capacity on mobile factors (next slide)
- Tax coordination key need
- Alternative revenue sources that are distrotionary in a positive sense (carbon, FTT)
- These are missed opportunities of COM/Taskforce economic governance reform proposals

Declining progressivity of tax system (EU27)

Top rate of personal income tax

1995: 47.3%

2010: 37.5%

Top rate of corporation tax

1995: 35.3%

2010: 23.2%

Implicit tax rate on consumption

1995: 19.4%

2010: 19.1%

Source: EU Commission: Taxation in Europe Report 2010

References

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Source: EU Commission: Taxation in Europe Report 2010