

Comments on presentations by A. B. Atkinson & S. Scarpetta

Juan J. Dolado (UC3M & CEPR & IZA)

**Session II: Fairness and Prosperity- Fostering Human Capital
and Inclusive Growth in the EU**

ARC 2011 Conference

Brussels, 21 november2011

1. Prosperity and Fairness (A.B. Atkinson)

- **Stiglitz Commission Report:** Recommends use of Household Disposable Income (HDI) but what really matter for welfare are consumption (C) and leisure (1-L) over the life-cycle

$$\max_{C_s, L_s} U(C, L) = \sum \beta^s \{ u(C_s) + \phi u(1-L_s) \}$$

$$\text{s.t. } w(1-\tau_L)L + b(1-L)(1+r)A(1-\tau_K) + TR = C + A'(1-\tau_K)$$

$C_s \approx$ Permanent Income

- Income = f [Permanent shocks (PS), Transitory shocks (TS)]

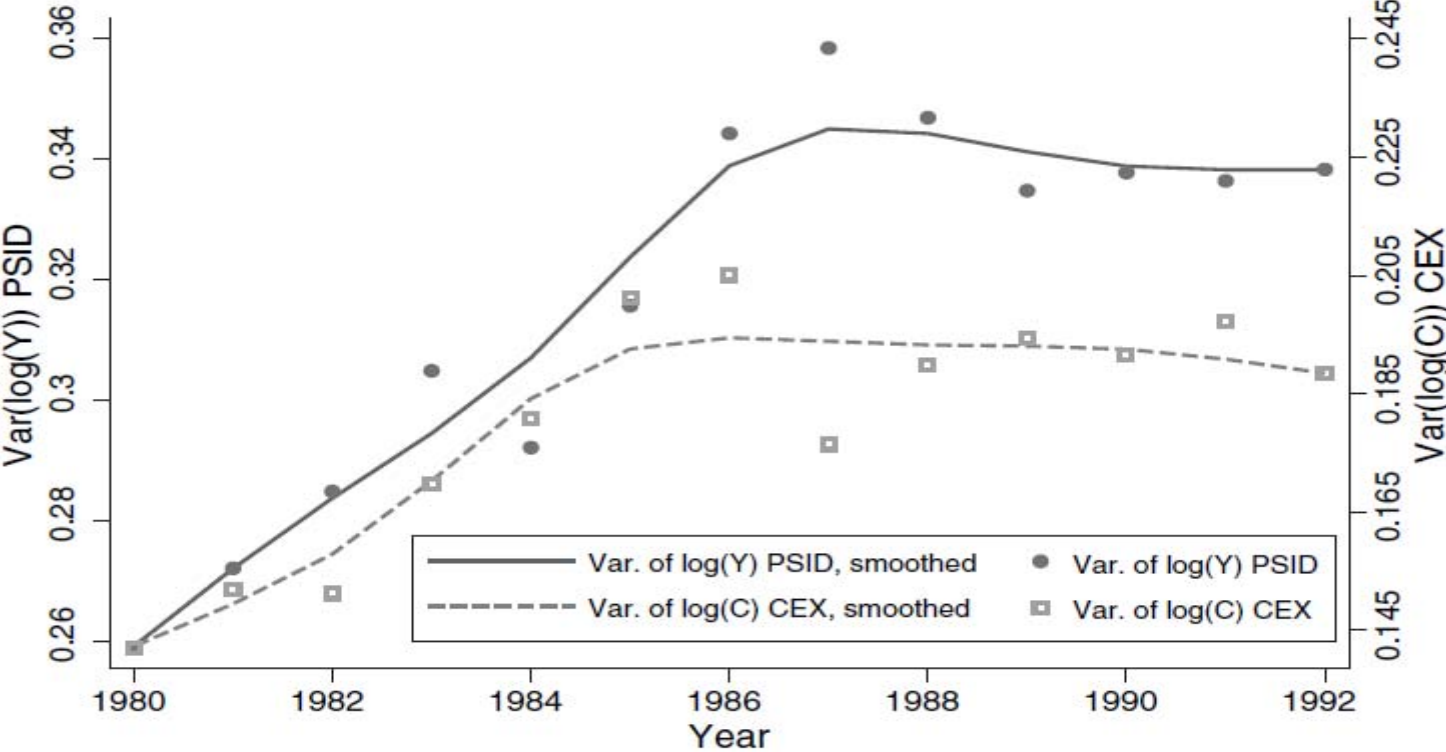
$$\Delta C = \gamma_P PS + \gamma_T TS$$

Institutions, family arrangements, taxes + transfers and income/wealth distribution affect the insurance parameters γ_P & γ_T

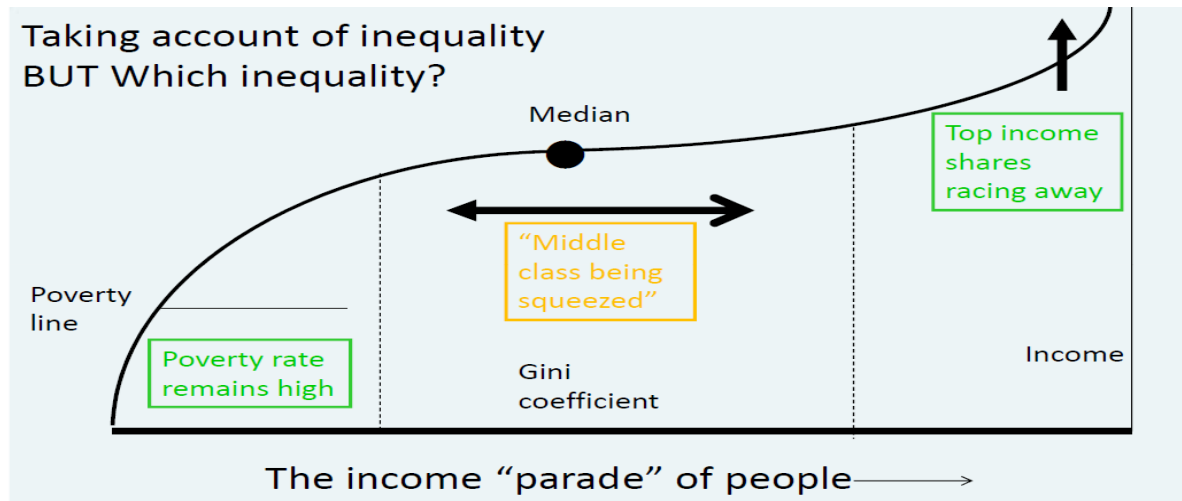
Isn't it better to focus directly on C ? (Blundell et al., Deaton & Paxon)

How do we evaluate welfare gains from 1-L ? (Easterlin paradox)

Consumption smoothing



An alternative interpretation of the middle class squeeze: Hollowing out hypothesis [D. Autor & D. Dorn)



Unstoppable SBTC: ↓ codifiable job tasks vs. ↑ in-person (services) job tasks

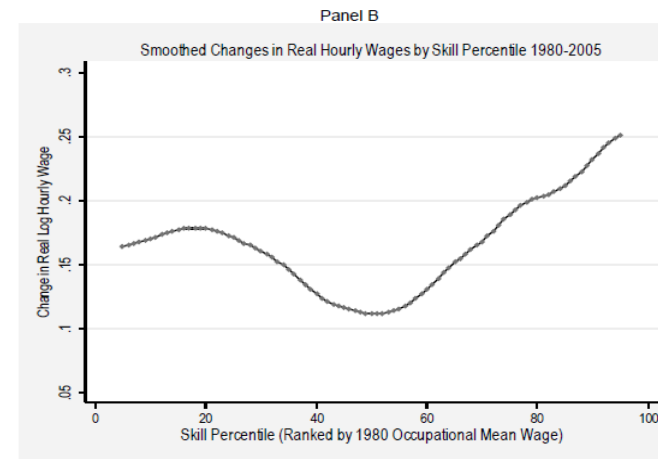
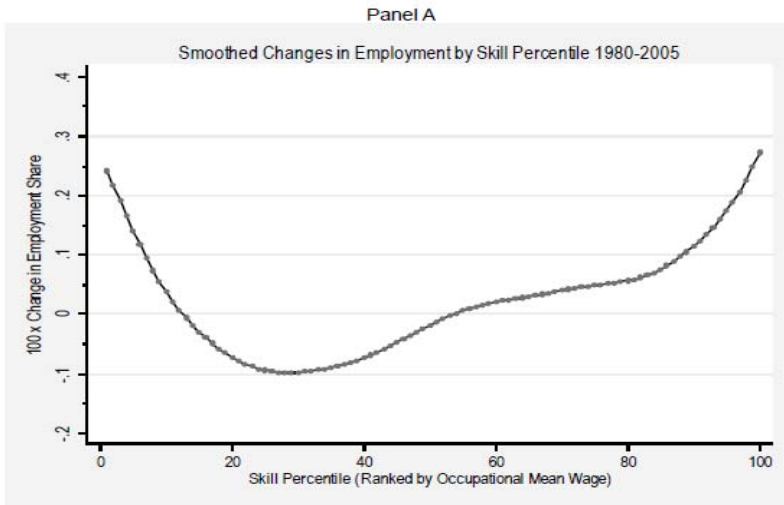


Figure 1.
Smoothed Changes in Employment (Panel A) and Hourly Wages (Panel B) by Skill Percentile, 1980-2005.

Did inequality fuel the Great Depression & Great Recession ?

- The deregulation and rapid expansion of banking in the US in the early XX century was a response to small and medium-sized farmers (the Populist movement) who, falling behind the growing numbers of industrial workers, demanded easier credit. Excessive rural credit was one of the important causes of bank failures during the Great Depression.
- The political response to rising inequality in the Clinton & Bush adms. (but also in several EU countries) was to expand (subprime/fragile) lending to low-income households.. The benefits – growing consumption and more jobs – were immediate, whereas paying the inevitable bill could be postponed into the future. ([R. Rajan](#))



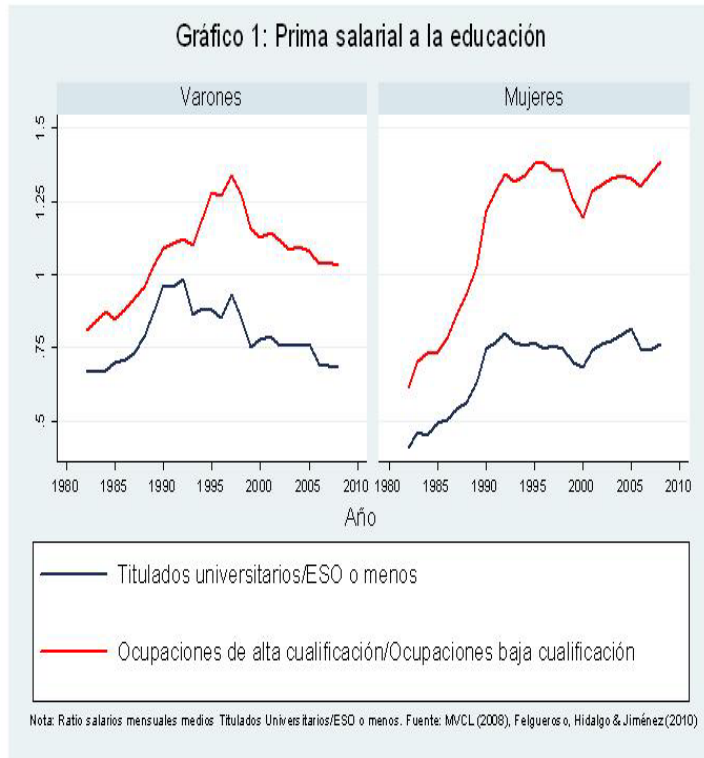
Inequality and Human Capital (HK) accumulation

- \downarrow Wage premium \rightarrow \downarrow Higher education enrolment and signaling \rightarrow \downarrow Sec. education students' effort + literacy+ numeracy \rightarrow \downarrow Wage premium \rightarrow \downarrow HK accumulation
- (Rawlsian) Equality of opportunities is key but unequal outcomes are unavoidable for HK accumulation

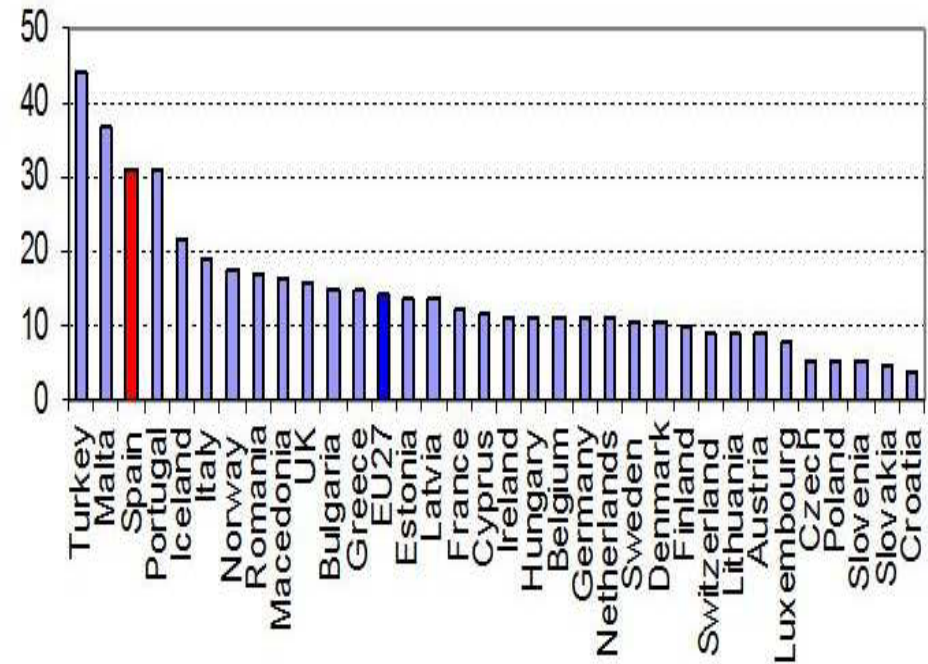
Does Sen's monotonic criterion, **HDI* (1-Gini)**, account for an *optimal* degree of inequality ?.

Example: Wage premium and dropout rate (Spain)

Wage premium (Coll-Non-Coll)
(High -Low skill)



Dropout rate (sec. educ.)



Fuente: Eurostat

	College	Sec.	<Sec
Spain	29	19	52
UE	25	45	30

2. Still divided ... (S. Scarpetta)

- **Pre-crisis:** *increases in income inequality largely driven by widening wage dispersion*
.... But isn't this the natural outcome of higher employment opportunities for youth, female and less-skilled workers ?. (short-term inequality vs. long-term inequality) + wage inequality (US with high W dispersion and low U-rate) vs. income inequality (EU with low W dispersion but high U)
- **Globalization and SBTC** → ↓ supply and ↑ demand EPL & UB → ↑ price of social protection → need of better policies (flexicurity, single contract, ALMP)
- **PM** (↑ W/P) & **LM deregulation** (↓ W/P) are complements to ensure no worsening of inequality in the short run
- **One-size does not fit all** (Irish low corporate tax rates vs. Nordic countries' high income tax rates). Key for success is that higher tax rates lead to higher expenditure in education and health.
- **Further public expenditure cuts are socially unfeasible in EZ countries under financial stress** (internal devaluations: ↑VAT, ↓ SSC)

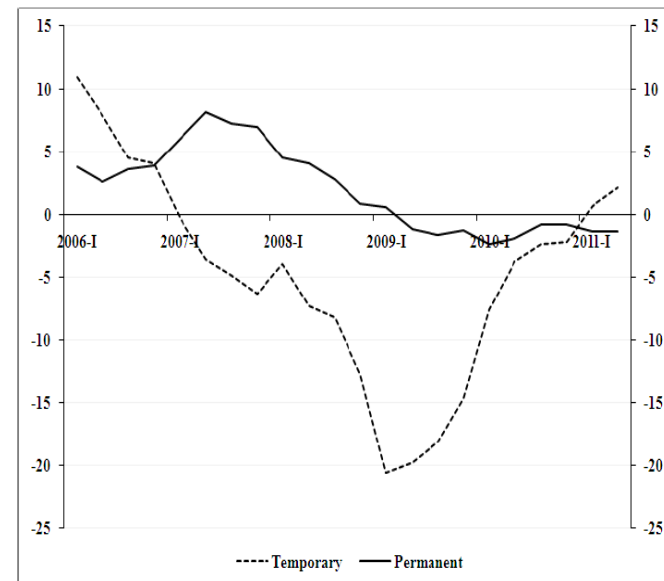
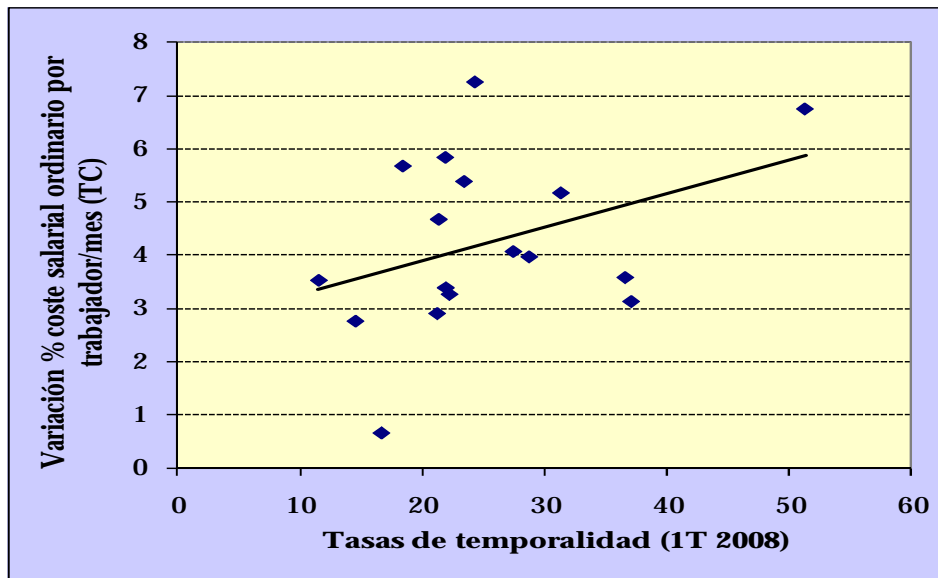
One last lesson: avoid dual LMs (they lead to inequality)



Unions protect insiders (perms) & use temps as a buffer (Spain again !!)

Growth rate of sectoral bargained wages at t (y-axis)
during the crisis against rate of temp. workers at $t-1$ (x-axis)

Employment adjustment during
the crisis



Thanks for your attention !!!