



ON INEQUALITY

Tessa Bending

BIG IDEAS III

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BIG IDEAS

Does Europe have an inequality problem? Amid the COVID-19 pandemic, many Europeans are certainly struggling. The rise of populist movements is another signal that something is awry. Many Europeans no longer see their economy as fair. But is this a problem of too much inequality, or just a problem of ideology? Is inequality even a bad thing?


We need to consider the statistics on economic inequality, but also look beyond towards the lived experience of trying to make ends meet. We need to consider different ideas on the impact and significance of the inequality we see.

Does inequality drive entrepreneurship, and thus innovation, through the struggle for upward social mobility? Or does inequality affect life chances, becoming entrenched, blocking social mobility and innovation?

And does anyone really need a billion euros? If we have a euro to spare, do we create more happiness by giving it to the rich or to the poor? An old, once infamous, now oft-forgotten question in economics.

Tessa Bending conducts research on social inclusion, social development and impact measurement at the Economics Department of the European Investment Bank (EIB). The department provides in-depth analysis on critical investment issues to support international policy debates.

This is the sixteenth essay in the Big Ideas series created by the European Investment Bank. The EIB has invited international thought leaders and experts to write about the most important issues of the day. These essays are a reminder that we need new thinking to protect the environment, promote equality and improve people's lives around the globe.

A large, diverse crowd of people in winter clothing, with a European Union flag in the center. The crowd is dense and fills the frame, with people of various ages and ethnicities. The flag is a prominent blue rectangle with twelve yellow stars arranged in a circle. The background is a bright, sunny outdoor setting.

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A DIVIDED EUROPE?

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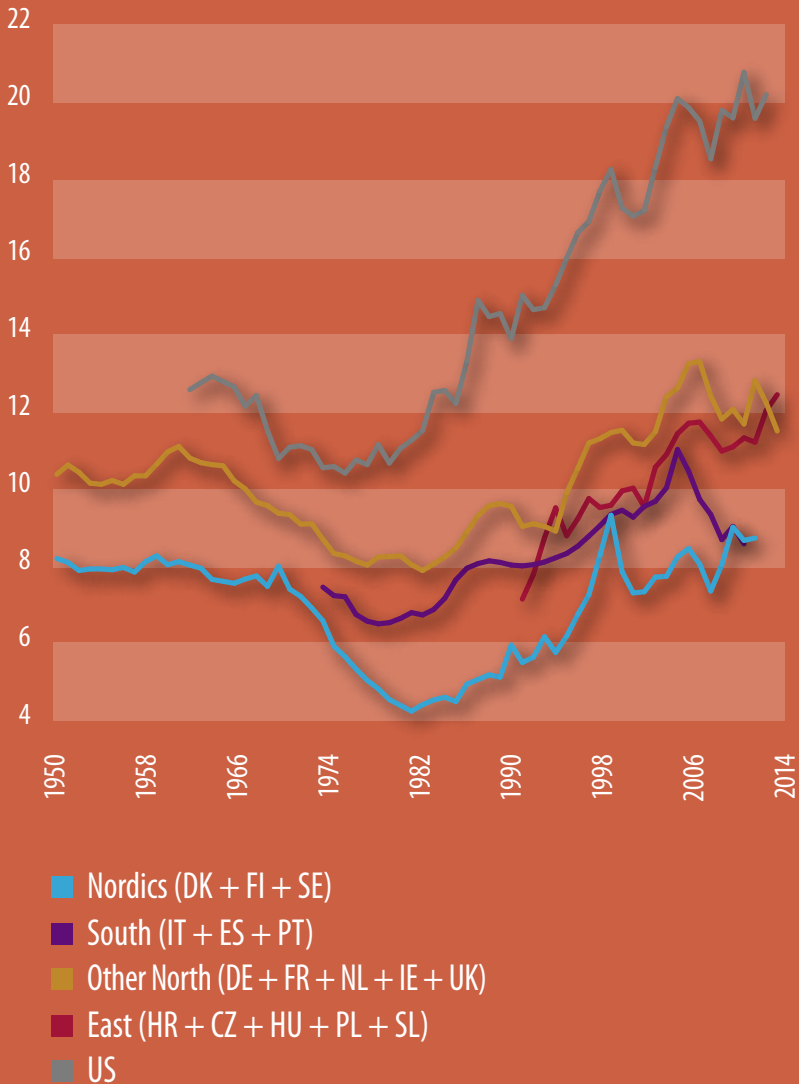
Perhaps we should first remind ourselves of Europe's comparative strengths. It is a great place to live and work, a place of relative freedom and tolerance. It is among the best places in the world to face life's troubles, like job loss, illness, or suddenly needing the care of others. The European model has been a success, combining a competitive market economy with a strong welfare system to underpin a high quality of life. As the European Union has expanded, it has facilitated upward convergence of living standards across the bloc. It remains one of the most egalitarian regions of the world.

Yet many feel that Europe has lost its way. The last few decades have witnessed a shift from a largely social-democratic and Keynesian big-state policy agenda, to a more neoliberal, small-state one. The Great Financial Crisis of 2008-2009 undermined the neoliberal consensus and reignited the controversy on the role of the state. In this context, the debate over inequality tends to be framed less about whether there is too much, or too little, than about whether recent events and policy shifts have caused it to increase.

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At this point, it is easy to get bogged down in statistics. Measuring inequality is not easy. Survey data tend to miss the very rich, simply because they are very few in number. Tax data must be supplemented by many assumptions. Different metrics show different things. The emerging field of inequality studies is mostly concerned with measurement, and arguing over just how much inequality there is.

Top 1% – share of income (% of gross national income, pre-tax)



Source: World Inequality Database, WID.world.

The broad conclusion we can reach is that, yes, income inequality has risen, as has wealth inequality. This rise started in the 1980s and 1990s with the neoliberal era, although the state, in Europe, has continued to play a strong role in evening out incomes. Europe's rise in inequality has been much less dramatic than that in the United States.

For example, while incomes for the bottom 80% of the European population have grown by an estimated 40% on average since 1980, the top 1% have seen their pre-tax income more than double.⁽¹⁾ The Global Financial Crisis and its fallout was not a big driver of inequality in Europe. In fact, falling profits served to temporarily dent top percentile incomes, while the crises also increased hardship and economic insecurity among lower-income groups. It is too early to tell what effect COVID-19 will have. However, there are strong indications that people in low-paid, insecure, service sector occupations have been hit much harder than most.

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Yet having learned this much, we also realise how little we know. Is inequality now too high in Europe, or should we rather follow America's lead?

The issue of inequality often serves as a proxy for an argument over economic policy paradigms. It is also a proxy for the discontent many people feel over much more tangible things: the fear of sudden unemployment or penniless old age, the stress of competing financial demands, the exhaustion of overwork, the resentment at

NANCY KETT WITH HER DAUGHTER LUCY. IN BERLIN, THE JULE PROJECT HELPS SINGLE PARENTS WITH HOUSING, CHILD CARE, JOB PLACEMENT AND TRAINING.



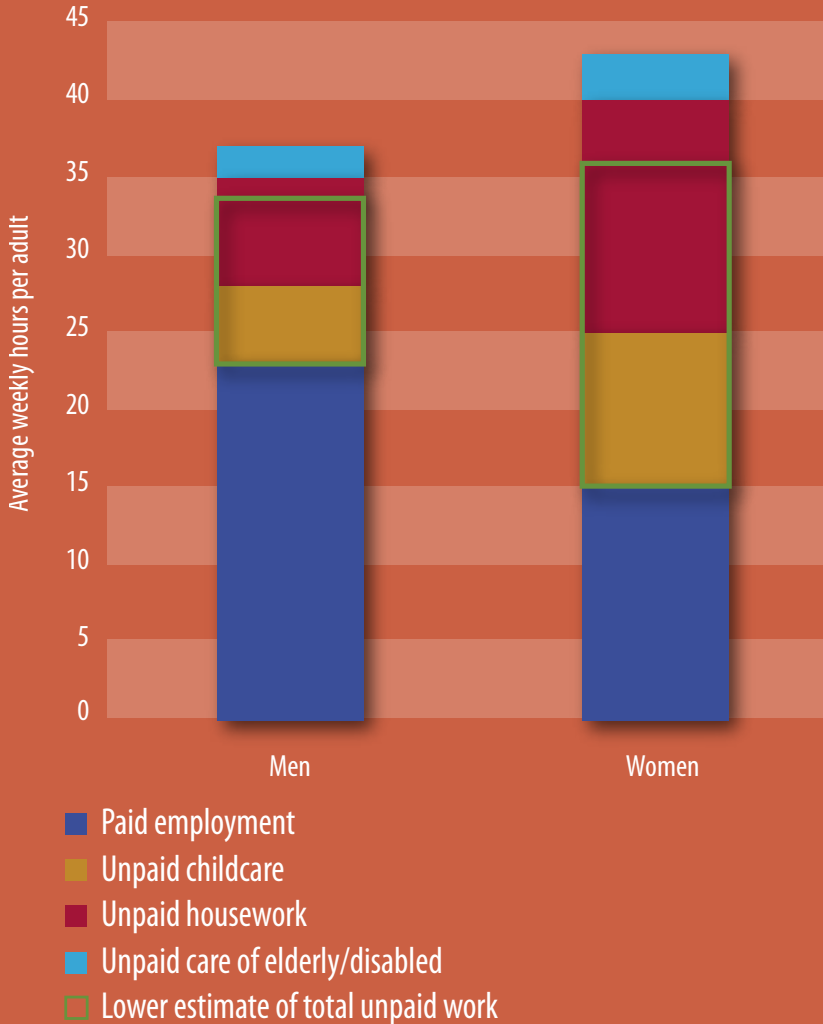
others seeming to lead much easier lives and the anger at being talked over and ignored. Making “inequality” stand for all this fulfils the technocratic demand for simple measurable indicators, but many dimensions are lying behind the concern for abstract inequality and they all matter.

The labour market has a huge impact on equality of income and life chances. Employment across the European Union actually achieved record levels in 2019. Even before the pandemic, however, these aggregate figures hid a divergence in employment opportunities across countries and regions, age groups and skill levels. Whilst there has been convergence across EU regions on many social and economic indicators, the Global Financial Crisis triggered a sharp divergence with respect to unemployment rates.^[2] These recently ranged from less than 2% in Prague to more than 20% in parts of Greece, southern Spain and southern Italy.^[3] In addition, rapid technological change seems to be leading to a process of job polarisation, with many medium-skilled workers feeling increasingly vulnerable and pushed to accept low-skilled jobs.

Gender represents another important and underemphasised aspect of economic inequality. Because women still tend to occupy lower-paid jobs, they still earn some 13% less than men on average, across the European Union. Survey evidence suggests that women in the European Union also do more work, but less paid work. Adult men (including retired) do 23 hours of paid work per week on average, compared to 15 hours for women. However, while on average

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Average paid and unpaid work per adult, per week



Note: Upper estimates assume no overlap in hours mentioned by survey respondents (i.e. childcare hours reported do not overlap with housework hours reported). Lower estimate assumes maximum overlap possible between different activities for each respondent.

Source: European Quality of Life Survey and European Working Conditions Survey.

men do up to 14 hours of unpaid housework and taking care of children and other family members, women do up to 28 hours per week of these unpaid tasks. In total, women work up to six hours longer.^[4] To give a sense of scale, if we were to value this total unpaid work by women and men at the EU median wage it would be worth nearly €6 trillion, or 40% of EU GDP.

The strains of combining paid and unpaid work are revealed in work-life balance indicators. Middle-aged men are most likely to state that work means too little time for the family; on the other hand, women are more likely to report that paid work leaves them too tired for household tasks, and that family responsibilities impair their ability to concentrate on their paid work. These concerns appear consistently to be getting worse for both women and men.^[5] With societal ageing set to increase care responsibilities, this issue is only likely to grow in importance.

In the 2019 Eurobarometer survey, when people across Europe were asked to name the two most pressing issues facing themselves personally, 18% mentioned health and social security, 15% pensions, 14% the environment and 13% their own financial situation. Other economic and social issues followed, with crime (6%), immigration (5%) and terrorism (2%) trailing at the rear.^[6] This emphasises the importance of public goods and services and social transfers to the amelioration of market-generated inequality, and to our actual well-being. More than abstract measures of inequality, public services in

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LA LUNA RESERVOIR IN LEON, SPAIN, WAS SEVERELY AFFECTED BY THE 2017 SUMMER DROUGHT. THE YEAR WAS ONE OF THE DRIEST ON RECORD IN THE COUNTRY, BADLY THREATENING AGRICULTURE AND WATER SUPPLIES.



the areas of health, education, housing, childcare and long-term care are central to our perception of economic fairness.

Even the environment is an inequality issue. With climate change, it will become an ever more important one. Contributions to global emissions are very unequal and correlated with income, simply because wealthy people consume more. Likewise, both climate disruption and the needed transformation of our economies will have very unequal impacts across different regions of Europe and the world. Just within Europe, some regions will face intensifying water shortages, others are very dependent on coal or carbon-intensive industries, while others are much better placed to reap benefits from the wave of innovation and new technologies that the energy transition will require. As with regions, the ability of households to adapt will depend a lot on their income and wealth. Not every family can afford to renovate their home, if they even own one, or to buy a new electric car.

“ Even the environment is an inequality issue. With climate change, it will become an ever more important one.

ELIZABETA ŽALAC WORKS AS A BATTERY ENGINEER AT RIMAC, CROATIA'S SOLE HOME-GROWN CARMAKER AND AN EIB BENEFICIARY. PERHAPS THE STRONGEST ARGUMENT FOR INEQUALITY IS THAT IT PROVIDES AN ESSENTIAL SPUR TO ENTREPRENEURSHIP AND INNOVATION.



IS INEQUALITY GOOD FOR GROWTH?

IS INEQUALITY GOOD FOR GROWTH?

Moral arguments around inequality often focus on whether riches are deserved, or whether they represent, in some way, ill-gotten gains. Economics cannot really answer these moral and philosophical questions. It can only describe how economies work. As the philosopher David Hume put it, you cannot get an “ought” from an “is”.

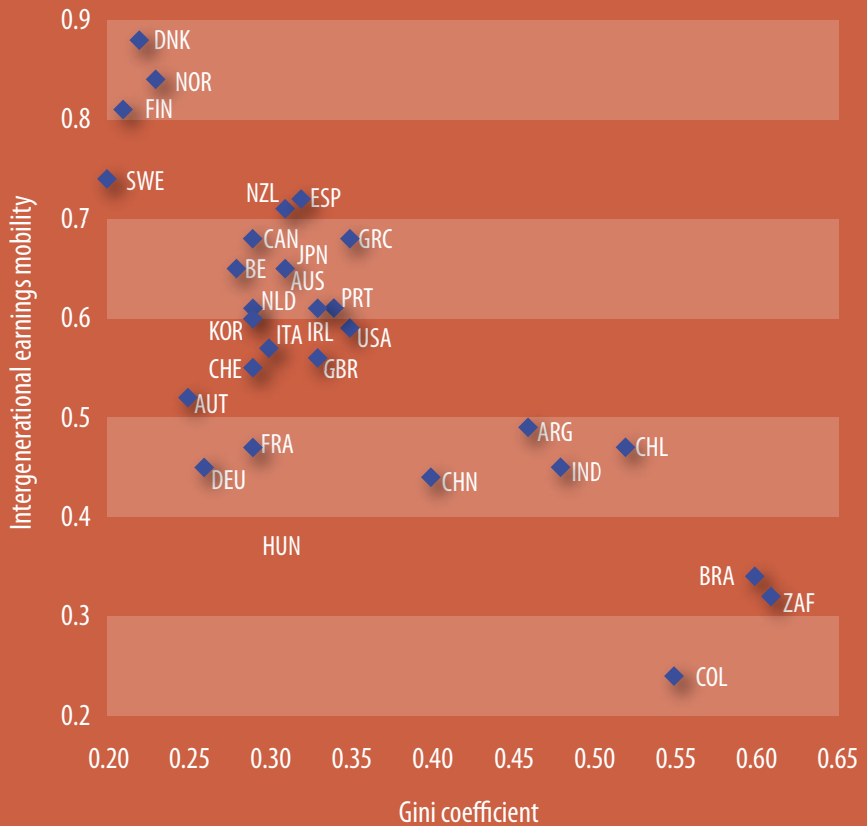
One thing economists can ask is whether an unequally shared cake leads to having a bigger cake to share amongst everyone in the future. With less inequality, would we all be poorer? Would the economy be less efficient or innovative?

Perhaps the strongest argument for income inequality – or at least for a few people being allowed to have very high incomes – is that it provides an essential spur to entrepreneurship and innovation, without which the high-tech, industrialised society of today might never have happened.

Joseph Schumpeter famously theorised that new inventions disrupt the balance of existing markets and create temporary monopolies for successful entrepreneurs. This sometimes allows them to capture huge returns from their investment and from other market players. These “entrepreneurial rents” are short-lived, however, as other entrepreneurs introduce new competing products, or even better ones, in what is a continuous process of “creative destruction”.

“ With less inequality, would we all be poorer? Would the economy be less efficient or innovative?”

Intergenerational earnings mobility and income inequality



Note: Intergenerational earnings mobility is estimated on the basis of education and occupation of different parent and child generations. Gini coefficients are from the mid-1980s to early 1990s.

Source: OECD (2018), *A Broken Social Elevator? How to Promote Social Mobility*.

Income inequality is important for entrepreneurial dynamism, but there are other drivers of innovation, such as ordinary competition between established firms, public investment in research and development and public procurement promoting new technologies. Do we overstate the importance of entrepreneurial rent? And does the absolute level of wealth acquired matter so much as pride, fame and relative social status?

There are also downsides to inequality. One is that high inequality hinders equality of opportunity and social mobility. The more income and wealth become concentrated, the more they also tend to become inherited. In fact, long-term data on occupations suggest that social mobility may have stalled or even declined in many European countries over recent decades.

Whereas baby boomers experienced more mobility than their parents, Generation X has tended to experience less.^[7] Improvements in mobility in terms of education outcomes have also stalled for younger generations in Europe.

Low social mobility, in turn, is bad for innovation and growth. It means that the most important resource of an economy – the talents and skills of its workforce – are not allocated as efficiently as they could be, undermining productivity and competitiveness. The availability of skills is one of the most-reported barriers to investment by EU firms, with innovative firms more skill-constrained than most.^[8]

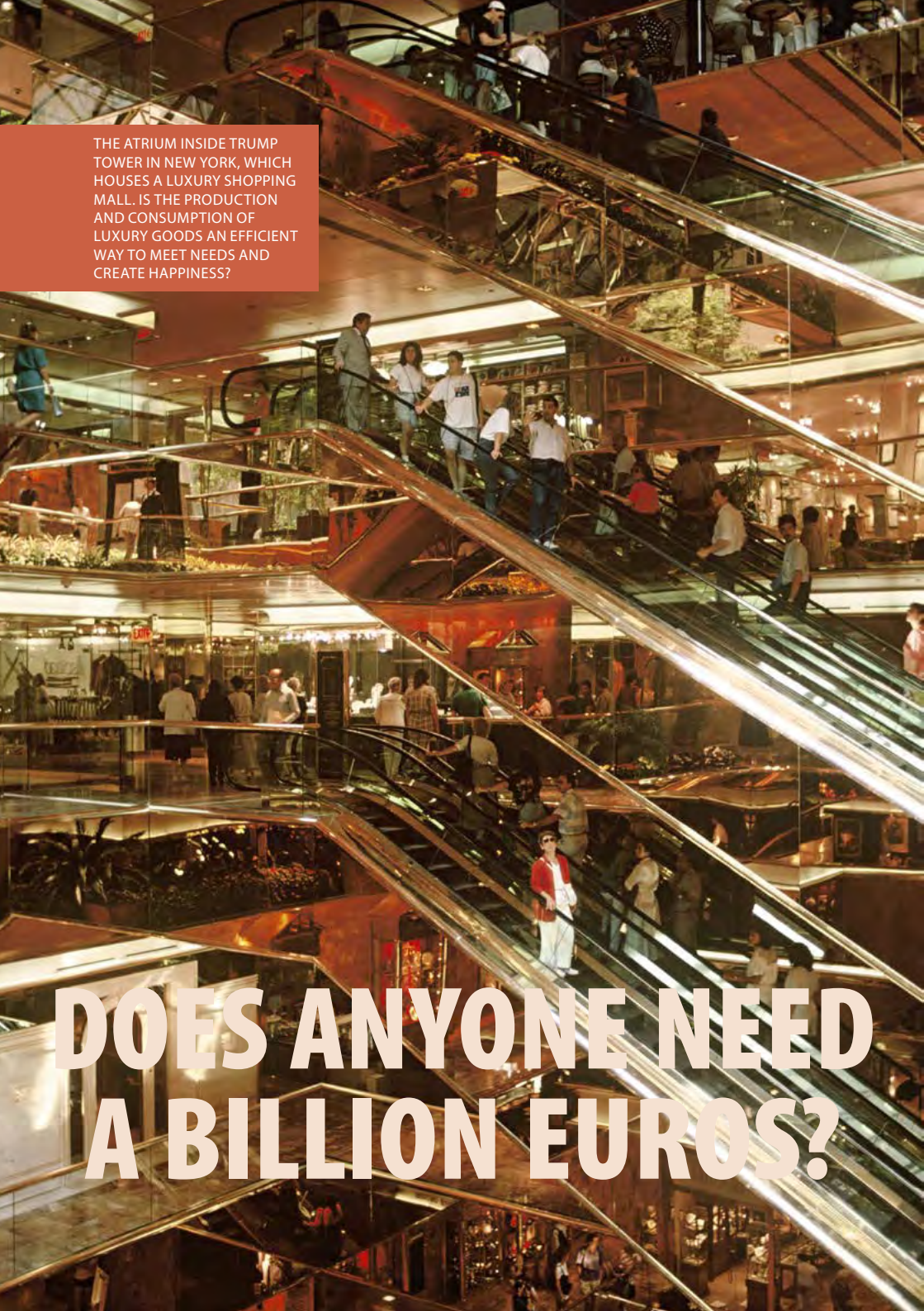
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Inequality has both positive and negative effects on economic performance, therefore. It is difficult to say which is more important. But there is also a more fundamental question to be answered: whether high inequality – across classes, genders, geographies and so on – is really the best and most efficient way to use the output of our economy to satisfy our wants and needs.

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THE ATRIUM INSIDE TRUMP TOWER IN NEW YORK, WHICH HOUSES A LUXURY SHOPPING MALL, IS THE PRODUCTION AND CONSUMPTION OF LUXURY GOODS AN EFFICIENT WAY TO MEET NEEDS AND CREATE HAPPINESS?

**DOES ANYONE NEED
A BILLION EUROS?**

DOES ANYONE NEED A BILLION EUROS?

Many families struggle to heat their homes and pay rent. Others can jet off to tropical islands for their holidays. Is this an efficient way to use the current output of our economy? Given the resources we have, is this the best way to meet human needs and create human happiness?

This is actually an old controversy in economics, but one that has been rather brushed under the carpet. One of the roots of modern economics is the 19th century utilitarianism of economist-philosophers like Jeremy Bentham and John Stuart Mill. They proposed that social and economic policy should simply aim to create the maximum aggregate happiness, or “utility”. This was a radical idea. Policy was not to be judged by moral principles or its contribution to the achievement of some long-term transformation, but simply by whether it maximised the sum of everyone’s happiness. In this sense, modern economics is still fundamentally utilitarian.

“ This is the idea that we cannot limitlessly increase our happiness by buying food, for example, because there is only so much we can eat.

In the tradition of Adam Smith, the utilitarians believed that aggregate happiness could be maximised by each individual competing to maximise their own happiness in the marketplace. They were neither anti-market nor anti-capitalist. However, in common with most classical economists, they also believed in diminishing returns. This is the idea that we cannot limitlessly increase our happiness by buying food, for example, because there is only so much we can eat. Spending €110 on a bottle of wine, instead of €100, is unlikely to achieve the same increase in utility as having €10 to spend on a meal, when otherwise you would go hungry.

ANGEL PEREZ FERNANDEZ
AND HIS WIFE MARIA REGINE
LOST THEIR JOBS WHEN
SPAIN'S HOUSING BOOM
COLLAPSED DURING
THE 2007-2008 GLOBAL
FINANCIAL CRISIS.



But this led the utilitarians to a conclusion that was perhaps inconvenient. As consumption achieves diminishing returns, spreading income out equally is likely to achieve greater happiness. It looks better to ensure that ten families can eat than to indulge one person's penchant for expensive wine. Skewing the distribution of income towards a lucky few looks to be a hugely inefficient way of using economic output to meet needs and create happiness.

Unsurprisingly, these inconvenient conclusions came under attack, and it was an attack on liberalism itself.

Classical liberalism arose amidst the revolutions in England, America and France. Against the old feudal order, it declared that "all men are created equal". But mid-19th century England – now the industrial heart of a global empire – saw the rise of a new anti-egalitarianism. Inspired by Darwin's theory of natural selection, eugenicists proposed that the goal of public policy should not be the greatest aggregate happiness now, but a better human society in the future, one made of biologically superior humans.

These were not the views of cranks at the margins of public discourse. The liberal belief in human equality was largely displaced by the popular idea that differences in the economic success of races, classes and genders of people were mostly down to innate, biological differences in ability. One might offer charity for the poor at home or in the colonies, but such charity was often deemed wasted on people seen as naturally prodigal and indolent.

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With humans increasingly seen as born unequal, many economists questioned whether people even have the same capacity for happiness. Maybe the extra €10 spent on expensive wine does create as much happiness for the refined palate of the wine connoisseur as €10 of cheap food for the hungry? F. Y. Edgeworth was one of the leading originators of modern, neoclassical utility theory. He was also a convinced eugenicist. What if, he argued, someone's capacity for happiness is low? Then the utility they get from consumption might not outweigh the disutility of work, which would explain laziness and poverty. Rich people are rich, he suggested, because they have a greater capacity for happiness, find consumption to be more rewarding, and thus work harder and are, in Darwinian terms, "fitter".^[9]

“ The problem, economists realised, is that you cannot objectively measure someone else's happiness, nor their capacity for it.

Who was right? The problem, economists realised, is that you cannot objectively measure someone else's happiness, nor their capacity for it. So economists switched approach, all but abandoning the idea of measurable "cardinal" utility and turning instead to observable preferences or "ordinal utility": the order in which things are preferred. Abandoning the idea of aggregate happiness, economists have ever since held up Pareto efficiency as the ideal. An economy is Pareto-efficient when no one can obtain a more preferred outcome without causing someone else to obtain a less preferred outcome.^[10]

The problem is that we keep talking as if economics could say something about actual cardinal utility or happiness, when all it can talk about is the order in which people prefer things. We have the habit of thinking that markets are efficient at meeting our needs, when all we can really say is that they might be Pareto-efficient. And


WHAT IF WE ARE BORN EQUAL,
WITH EQUAL CAPACITIES TO
CONTRIBUTE TO SOCIETY
AND TO ENJOY ITS FRUITS?



by proceeding as if market outcomes are efficient at creating happiness, we tacitly side with eugenicists like Edgeworth; we tacitly declare that, yes, for the sake of maximising happiness overall, some people really do need a billion euros more than a billion people need a euro.

“ We have the habit of thinking that markets are efficient at meeting our needs, when all we can really say is that they might be Pareto-efficient.

But what if the truth is closer to the assertions of the classical liberals and utilitarians? What if we are born equal, with equal capacities to contribute to society and to enjoy its fruits? Then the inequality we see could be a massive waste of resources and a vast lost opportunity to meet need.



A GAY PRIDE PARADE: POLITICS
AS THE APPLICATION OF
HUMAN RELATIONS TO THE
PROBLEM OF TRUTH.

DEMOCRACY, EUROPE'S ANSWER TO THE PROBLEM OF INEQUALITY

DEMOCRACY, EUROPE'S ANSWER TO THE PROBLEM OF INEQUALITY

Europe does have an inequality problem. At the very least, it is a problem of legitimacy. For while economics can answer questions about the relationships between inequality and innovation, social mobility and growth, it cannot show that the current distribution of income is at all efficient at meeting our needs and fostering our collective happiness. Meanwhile, ever fewer people believe that it does.

Yet Europe potentially has an inequality solution. Europe has been a haven and pioneer of democracy and of an open, participative civil society. It is by building on that strength that the inequality problem can be tackled.

The political theorist Benjamin Barber has written, “politics is not the application of Truth to the problem of human relations, but the application of human relations to the problem of truth”.^[1] As a technocratic discipline, economics has tried to apply Truth to politics, advising decision-makers on the best policy. But on inequality, we need to declare the limits of our knowledge and turn the question over to the body politic. For as participants in society, we do indeed have something meaningful to say.

We can reflect on our own experience. If we spent ten times more on food, on our car, or on our summer holiday, would we get ten times the satisfaction? How much happier would we be if

“ Yet Europe potentially has an inequality solution. Europe is a haven and pioneer of democracy and of an open, participative civil society. It is by building on that strength that the inequality problem can be tackled.

SISTERS NATALIA VARGA
AND CAMILIA ISTVAN IN THE
ECONOMICALLY DEPRIVED
ROMA SETTLEMENT OF
PONORATA IN ROMANIA, 2013.



we had twice the income, or 100 times? How less happy would we be if our income was halved and we struggled to make ends meet? We can reflect, maybe, on times when we did struggle to make ends meet, or on times when things were easier.

We can also listen. We can turn our attention to how others try to express what it is like to encounter success and hardship. We cannot see into the subjective experiences of each other, but we can work to imagine what it must be like to be in their shoes, through a process of dialogue and empathy.

No expert can measure the happiness of everyone, but each of us may have something meaningful to say about how any outcome may harm or benefit others and ourselves. Such reflection does not generate a Truth that can be fed into an economist's model, but it does give meaning to the process of democratic deliberation. This is politics applied to a problem of truth. It is also the old classical and utilitarian idea of democracy as a mechanism to solve moral problems of political economy.

“ How much weight should we give to growth and the well-being of one generation over another? How much weight should we give to social mobility and productive efficiency? ”

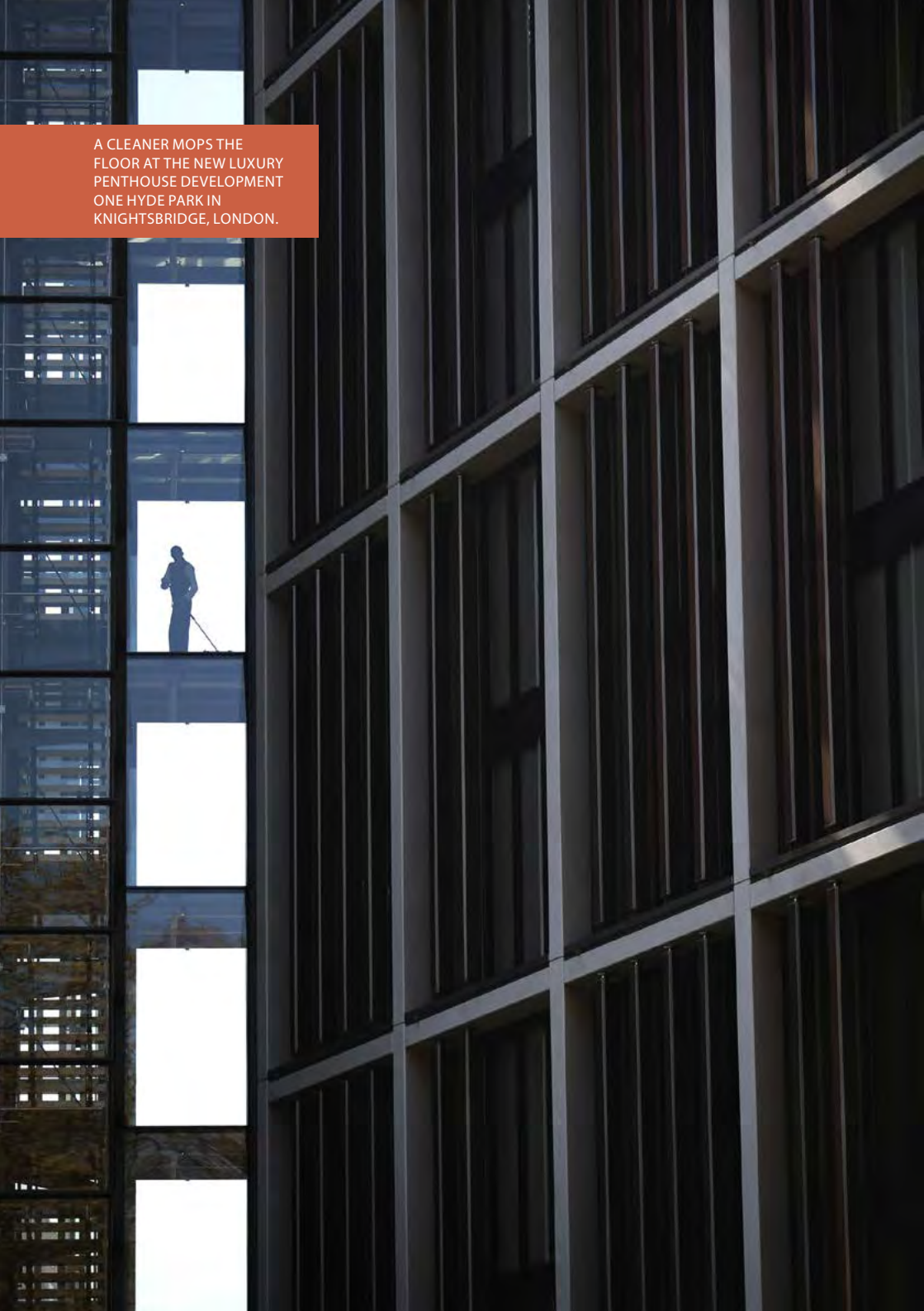
Economics needs to answer questions about the technical relationships between inequality, the size of the economy and growth. How much does inequality spur innovation? How much does inequality block social mobility?

It is then up to democratic deliberation to answer the moral questions, those that have to do with happiness and harm, for others and ourselves. How much weight should we give to growth and the well-being of one generation over another? How much

WE CANNOT SEE WHAT IT IS LIKE TO BE SOMEONE ELSE, BUT WE CAN WORK TO IMAGINE WHAT IT MUST BE LIKE, THROUGH A PROCESS OF DIALOGUE AND EMPATHY.



weight should we give to social mobility and productive efficiency?
And how much should we weigh these considerations against the
need to spread the fruits of economic activity according to our
collective judgement of how we can create the most happiness?



A CLEANER MOPS THE
FLOOR AT THE NEW LUXURY
PENTHOUSE DEVELOPMENT
ONE HYDE PARK IN
KNIGHTSBRIDGE, LONDON.

NOTES

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- [1] Blanchet, T. Chancel, L. and Gethin, A. (2019), "How Unequal Is Europe? Evidence from Distributional National Accounts, 1980–2017", WID.world Working Paper 2019/06.
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- [2] Bending, T. and Bubbico, R. (2019), Three foundations: A competitive, sustainable and inclusive Europe, Luxembourg: European Investment Bank.
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- [3] 2018 data, 15-74 year olds, NUTS2 level. Source: Eurostat.
-
- [4] These are upper estimates which assume no overlap in work hours reported by survey respondents (i.e. childcare hours reported do not overlap with housework hours reported). There is no way to determine the exact extent of overlap. If maximum overlap were assumed, total unpaid work hours would be 11 for men and 20 for women. Women would then work two hours longer than men in total. Source: European Quality of Life Survey; European Working Conditions Survey; Bending and Bubbico, op. cit. p. 38.
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- [5] Eurofound (2017), European Quality of Life Survey, 2016, Publications Office of the European Union, Luxembourg; Bending and Bubbico, op. cit. p. 39.
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- [6] <https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/General/index>
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- [7] Based on the relative likelihood of survey respondents being in a different occupational category from their parents, thereby abstracting from structural changes in the economy. Source: Eurofound (2017), Social Mobility in the EU, Publications Office of the European Union, Luxembourg.
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- [8] EIB (2019), Investment Report 2019/2020: accelerating Europe's transformation; EIB (2021), Investment Report 2020/2021: Building a smart and green Europe in the COVID-19 era.
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- [9] "[T]here appears a deeper sentiment in favour of aristocratic privilege – the privilege of man above brute, of civilised above savage, of birth, of talent, and of the male sex. This sentiment of right has a ground of utilitarianism in supposed differences of capacity. Capacity for pleasure is a property of evolution, an essential attribute of civilisation." F. Y. Edgeworth (1881), *Mathematical Psychics: An essay on the application of mathematics to the moral sciences*, London: Kegan Paul, p. 77.
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- [10] Pareto efficiency (or Pareto optimality) is typically expressed as the possibility of making someone better off without making someone else worse off. This is, in fact, an example of how economists speak as if they are talking about actual welfare or cardinal utility, when in fact Pareto efficiency is only concerned with orders of preferences and says nothing about efficiency in achieving actual welfare or happiness. See Amartya Sen "Markets and Freedoms: Achievements and Limitations of the Market Mechanism in Promoting Individual Freedoms", *Oxford Economic Papers*, New Series, Vol. 45, No. 4, p. 519-541.
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- [11] Barber, B. (1984) *Strong Democracy: Participatory Politics for a New Age*, Berkeley: University of California Press, p. 64.

BIOGRAPHY

Tessa Bending is an economist and anthropologist at the Economics Department of the European Investment Bank.

She joined the EIB in 2014, with a focus on the impact of the Bank's development activities and a broad remit to help its Economics Department better convey its research and policy messages. Her current work also looks at social inclusion in the European Union and the social impacts of the climate transition.

Born and educated in the United Kingdom, Tessa began her career studying land rights conflict in Malaysia. Her work *Penan Histories* (KITLV Press, 2006) recounts how members of an indigenous community in Sarawak, Malaysian Borneo, sought to manage relations with the state, logging companies and Western environmentalists. Amid rival stories told from different sides, it is also about the traps we fall into when we tell other people's histories, and the hard task of trying to do justice to what might have happened.

Tessa received her doctorate from the School of Development Studies, University of East Anglia, UK. After moving to Rome in 2007, she worked as a consultant with the United Nations and civil society organisations on land rights issues.

Tessa lives with her three children in Luxembourg.





**European
Investment
Bank**

The EU bank

A circle of twelve five-pointed stars, arranged in a ring, representing the European Union flag.