WHAT DRIVES INEQUALITY?

Edited by Koen Decancq
and Philippe Van Kerm

RESEARCH ON
ECONOMIC INEQUALITY

VOLUME 27

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United Kingdom – North America – Japan
India – Malaysia – China

Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2020

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN: 978-1-78973-378-5 (Print)
ISBN: 978-1-78973-377-8 (Online)
ISBN: 978-1-78973-379-2 (Epub)

ISSN: 1049-2585 (Series)

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PREFACE

This is the 27th volume of *Research on Economic Inequality* and concerns about inequality seem as vivid as ever since the start of this series. Researchers now dispose of a more mature methodological machinery and of new, increasingly rich, data sources. Inequality trends have become well-documented in many countries and the main determinants of recent trends are increasingly well-understood. Much less is known however about the driving forces behind international differences in inequality.

By soliciting contributions addressing the question 'What drives inequality?', we aimed to throw new light on the underlying drivers of inequality and to unpack the reasons for the wide variations in inequality across countries and over time. This endeavour may appear futile since these reasons may be so diverse and deep-rooted in the cultural, historical or geographical characteristics of countries that one can hardly expect comprehensive models or clear-cut causal inference. Yet, we are convinced that a better understanding of differences in inequality across countries (and over time) is important to address the next key question: 'What can be done?'

For this volume, we sought to attract papers discussing the role of labour markets, taxation, social protection and redistributive policies, but were also interested in papers studying the role of 'deeper drivers' such as political institutions, norms and attitudes and preferences for redistribution. Advancements to methodology and critiques on the cross-country comparability of inequality measures were also welcome. While the main discussion may be about income inequality, we hoped to attract contributions about wealth, consumption or other forms of inequalities.

The nine chapters collected in the volume address these dimensions. Chapters 1–4 examine income or expenditure inequality and discuss the role of tax policy and redistribution, demographics or labour market factors. Chapters 5–7 broaden the concept of welfare beyond income by incorporating measures of wealth, public goods and non-monetary dimensions in the analysis of inequality. Chapters 8 and 9 provide insights about individual perceptions, preferences and beliefs about inequality and redistribution.

Chapter 1, by Tsvetana Spasova, examines trends in income distributions and inequality in the European Union using data from the European Union Statistics on Income and Living Conditions. She uses the estimates of a parametric income distribution model to study the contribution of individual countries to inequality in broader regional aggregates – the 'old' and 'new' Member States – and shows that the 'new' EU countries have become richer and less unequal over the observed years, while the 'old' ones have experienced a small increase in inequality over the Great Recession years.

Chapter 2, by Maurizio Bussolo, Carla Krolage, Mattia Makovec, Andreas Peichl, Marc Stöckli, Iván Torre and Christian Wittneben, addresses the redistributive impact of taxes and benefits in 28 European Union countries across the Great Recession. Unlike most research on this topic, they examine impacts on both vertical and horizontal inequality. While they observe a significant degree of heterogeneity across countries, their results highlight horizontal inequality concerns as a dimension which policy-makers should take into account when reforming tax and transfer systems.

Chapter 3, by Franziska Deustchmann, zooms in on long-term income inequality trends and on the East–West contrast in Germany. Using various counterfactual methods, the paper quantifies the impact on inequality of differences in socio-economic characteristics over time and across East and West Germany. The prevalence of singlehood accounts to a large extent for the observed increase in inequality over time (along with a change of employment among males and single females). Differences in employment and household sizes also drive the difference in inequality observed between East and West Germany.

Chapter 4, by Arip Muttaqien, Cathal O'Donoghue and Denisa Sologon, offers a novel cross-national contrast with an analysis of differences in inequality in household expenditure between India and Indonesia (which together account for about 20% of the world population). Despite many similarities between the countries, Indonesia now exhibits higher inequality than India following a relatively sharp increase over the last 15 years. The decomposition of the difference across countries reveals that the gap is mostly accounted for by differences in education and the return to education, rather than by differences in work and employment structures. A large part of the gap remains 'unexplained' however.

The volume then moves beyond the sole income and expenditure dimensions.

Chapter 5, by Gerlinde Verbist and Michael Förster, examines the distributional implications of publicly provided free or subsidised services. Many important services are not provided (exclusively) through the market such as, for example, education, housing, health care, etc. They are not fully paid from household income but contribute to household welfare, so ignoring their contribution in the assessment of social inequality is potentially misleading, especially in international comparisons. This chapter reviews the main methodological approaches and presents empirical results for 27 OECD countries. The authors find that indicators of inequality based on extended income measures that add an imputed value of public services to household cash incomes can be up to a third smaller than inequality in cash income alone. This finding is important for cross-country policy comparisons.

Chapter 6, by Louis Chauvel, Anne Hartung, Eyal Bar-Haim and Philippe Van Kerm, brings wealth into the picture. The importance to study wealth inequality alongside income inequality is increasingly appreciated by economists and sociologists alike. The study exploits the 'isograph' as a tool to describe income and wealth distributions, and to present fine-grained information about the upper tail of these distributions. Using combined data from the Eurozone Household Finance and Consumption Survey and the US Survey on Consumer Finance, this chapter illustrates how much more unequal is the distribution of wealth, especially in the United States when compared to 16 European countries.

Chapter 7, by Marko Ledić and Ivica Rubil, introduces a multidimensional measure of well-being that incorporates unemployment, health, housing, crime and environment besides income. This chapter uses tools from the literature on taxation and redistribution to decompose the difference between the inequality in the multidimensional well-being measure and standard income in two parts: a vertical and reranking effect. The authors implement the decomposition with data from the European Quality of Life Survey for 27 European Union countries in 2011. They find that inequality is higher for the multidimensional measure and that the reranking effect accounts for a large part of the inequality difference, with health contributing most to both effects.

The last two chapters of the volume examine how people perceive inequality, and how perceptions and beliefs can shape attitudes towards redistribution policies.

Chapter 8, by Antoine Genest-Grégoire, Jean-Herman Guay and Luc Goodbout, studies who believes to belong to the middle class and how that affects their support for higher taxes on the rich. According to the so-called reference-group theory, most citizens perceive to be situated in the middle of their (non-representative) reference group. The authors test this theory with an online survey in the Canadian province of Quebec. They find that a sizeable share of objectively rich persons place themselves in the middle class. These respondents are found to support higher taxes on the rich, without realising that they are actually part of this group.

Chapter 9, by Begoña Cabeza and Koen Decancq, investigates how beliefs about the influence of effort have been affected by the Great Recession in Spain. The beliefs about the influence of effort have been found in the literature to be an important determinant of the demand for redistribution. The authors use a series of Spanish public opinion surveys between 2010 and 2018, matched with regional-level unemployment data and find that people attribute a larger role to luck in provinces where the unemployment rate increased more during the Great Recession. Moreover, lower educated individuals and those who position themselves as more left-wing, are found to have adjusted their beliefs more.

We trust the nine chapters collected in this volume provide useful contributions towards a better understanding of the question 'What drives inequality?', although they far from exhausted the theme! The chapters in this volume are steps forward and will hopefully help addressing the bigger 'What can be done?' challenge.

To conclude, we want to thank John Bishop and Juan Gabriel Rodriguez, the series editors, for having invited us to edit this 27th volume. We also thank all contributors and reviewers who made the compilation of this book possible. Their efficient, professional and timely work made our task as guest editors easy and stress-free. Funding from LISER, the University of Luxembourg and the University of Antwerp for the organisation of a thematic workshop in October 2018 at the early stage of preparing the volume is gratefully acknowledged.

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