How can one defend the 1%?

By Guillaume Allègre

In a forthcoming article in the *Journal of Economic Perspectives*[1], Harvard Professor and bestselling textbook author Greg Mankiw defends the income earned by the richest 1% and denounces the idea of taxing them at a marginal rate of 75%. For Mankiw, people should receive compensation in proportion to their contributions. If the economy were described by a classical competitive equilibrium, then every individual would earn the value of his or her own marginal productivity, and it would be neither necessary nor desirable for the government to redistribute income. The government would limit itself to correcting market distortions (externalities, rent-seeking).

In a *OFCE's* Note (no. 4, 19 July 2013), we show that the economy in which the 1% live is very different from a classic competitive equilibrium in ways that Mankiw does not discuss, which seems to us to be a significant limitation in his argument. It is *because* the 1% do not live in a world of perfect competition that they are able to secure astronomical incomes. The incomes received on the market by the 1% do not therefore correspond to their marginal social contribution. This does not mean that their social contribution is null, but rather that the market is unable to measure this contribution. These astronomical incomes cannot therefore be defended on the basis of "merit measured by marginal contribution", as proposed by Mankiw.

See the following OFCE blogs on the same subject: "Superstars and equity: Let the sky fall" and "Pigeons: how to tax capital gains".

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[1] G. Mankiw, 2013, "Defending the one percent", forthcoming *Journal of Economic Perspectives*. http://scholar.harvard.edu/files/mankiw/files/defending_the_one_percent_0.pdf

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Does inequality hurt economic performance?

By Francesco Saraceno

Economic theory has long neglected the effects of income distribution on the performance of the economy. Students were taught right from Introduction to Economics 101 that the subject of efficiency had to be separated from considerations of equity. The idea is that the size of the cake had to be expanded to the maximum before it is shared. It was implicit in this dichotomy that economists should address the issue of efficiency and leave the question of distribution (or redistribution) to the politicians. In this framework, the economist's role is simply to ensure that choices about the channels for redistribution through taxation and public spending do not affect growth by interfering with the incentives of economic agents. Echoes of this view can be found both in the debate about the taxation of very large incomes envisaged by the French Government as well as in authors like Raghuram Rajan who justify inequality with references to technical progress and international trade, a view refuted by Paul Krugman.

Since the work of Simon Kuznets in the 1950s, some economists have of course questioned whether excessive inequality might not inhibit economic growth, in particular by blocking the accumulation of human capital. But this has long been a minority view among economists. Indeed, the dramatic increase in inequality documented among others by Atkinson, Piketty and Saez as well as by institutions such as the OECD and the IMF failed to give rise to a deep-going reflection about the relationship between inequality and economic performance.

It was the crisis that revived this concern. Growing inequality is now suspected of being a source of increasing household debt and speculative bubbles, leading to the accumulation of internal and external imbalances that have set off the current crisis. This is the argument developed by authors like Joseph Stiglitz and James Galbraith.

Today the dichotomy between efficiency and distribution is no longer tenable. Inequality is becoming an essential theme in economic analysis, for both the short and long terms. To stimulate discussion on this topic, the OFCE and the SKEMA Business School are holding a workshop on "Inequality and Economic Performance" in Paris on 16 and 17 October 2012.

A boost for the minimum wage or for income support?

By Guillaume Allègre

The government has made a commitment to an exceptional, "reasonable" boost to the French minimum wage, the "SMIC", and to indexation based on growth, and no longer just on workers' purchasing power. In *Les Echos*, Martin Hirsch has argued for strengthening the RSA [the French income support scheme] rather than the SMIC. The point is not to oppose the working poor, the target of the RSA, and low wages: redistribution policies need to attack, not just poverty, but inequality throughout the income chain.

In terms of reducing inequalities, there are several strategies: one strategy aims to reduce inequality in individual earnings; a second aims to reduce inequalities in living standards between households, the level at which people are presumed to live in solidarity. There are legitimate grounds for both these strategies. The RSA *activité* [the income supplement for the working poor] and the SMIC are thus not substitutable (see also [“le SMIC ou le RSA?”]() in French). Unlike the RSA, the fight against poverty is not the objective of the SMIC. The SMIC aims “to ensure that employees with the lowest salaries share in the country’s economic development”. A high minimum wage has the effect of reducing inequalities across the bottom of the wage scale, with increases in the minimum wage [impacting up to two times the SMIC](). Given the increase in unemployment, in precarious jobs and in part-time work, full-time employees on the minimum wage are certainly not the poorest in society, but they are far from well-off. The SMIC reduces the income gap between the working class and the middle class, which is an objective in itself (though some in the middle class may take a dim view of this: by its very nature, reducing inequality isn’t going to satisfy everyone). In particular, it is not the same thing to receive a high salary or to receive a low salary supplemented by targeted social benefits. These benefits do not confer any rights to a pension or to unemployment benefits. In terms of dignity, the minimum wage level is the value that a society places on work. Social benefits targeted at the poorest people put them in a position of being assisted, which has consequences in terms of social representations (individual and collective). As work is performed by individuals, it is not illegitimate to try to reduce inequalities between employees and not only between the employees' households.

The proposed boost to the RSA is ambiguous, as the term "RSA" designates both the minimum social benefits for the unemployed and the inactive population (the "base" RSA, formerly the RMI and API benefits) and the income supplement for the working poor (RSA *activité*). If the proposal for a boost applies only to the RSA *activité*, it would then be inconsistent with the objective of targeting the most disadvantaged households. If, on the contrary, it concerns the RSA as a whole, which would be legitimate, then it is necessary to be more explicit and to assume that it will benefit mainly the unemployed and the inactive [1]. In March 2012, there were 1.59 million people receiving just the base RSA, and 689,000 the RSA *activité* (all France), *i.e.* only one-third of RSA recipients received the *activité* component.

The implementation of the RSA *activité* has up to now failed in two ways ("The failings of the RSA income support scheme"): according to the final report of the National Evaluation Committee, it has had no discernible impact on employment, and poverty reduction has been severely limited because of a major lack of take-up of the *RSA activité* component. We can move quickly over the first point, as there is little emphasis these days on the incentive aspect of the RSA. The main problem of a boost to the RSA *activité* is indeed the lack of take-up: in the report, take-up for the RSA *activité* component alone is estimated at 68% in December 2010 [2]. And this is not a matter of the programme coming on line: between December 2010 and March 2012, the number of RSA *activité* beneficiaries increased only marginally in mainland France, from 446 000 to 447 000. Linking eligibility for the RSA *activité* to both earned income and family expenses and mixing into a single instrument beneficiaries of a social minimum and the working poor, who are sometimes very well integrated into the labour market, poses problems both in terms of improper assessment of eligibility for the provision and stigmatization. This highlights two causes of the lack-of take-up of the RSA *activité*: insufficient awareness of the scheme, on the one hand, and voluntary lack of take-up, on the other: 42% of non-applications who do not exclude themselves from eligibility declare that they did not file a claim because they "get by financially otherwise", and 30% did not file a claim because they did "not want to depend on welfare, to owe something to the state" (p.61). Better information would not be sufficient to solve the problem of lack of take-up. Increasing the minimum wage, on the contrary, has the great advantage of automatically benefitting those affected without fear of stigmatization, since it involves labour income.

Unlike the RSA, increasing the gross SMIC increases labour costs. However, there are several strategies to raise the minimum wage that would not have a net effect on labour costs: the increase could be offset by a reduction in employers' social contributions. One could also ease employee social security contributions on low wages. But this proposal would probably be censured by the Constitutional Council, which in 2000 knocked down the exemption of the CSG tax on low wages on the grounds that the progressivity of the CSG would then no longer depend on the household's ability to pay [3]. Finally, a more extensive reform aimed at merging the CSG tax and the income tax would make it possible to reduce taxes on low wages and thus increase the net minimum wage. The integration of the PPE in-work negative income tax would also make it possible to show the amounts involved directly on the payslip.

The fight against inequality clearly should not stop with inequalities in wages between full-time workers. It is also necessary to attack involuntary part-time work, by enabling the workers concerned to move into full-time work and/or by making part-time work more costly by lowering the rate of general tax relief on employer social contributions.

Basically, there is no reason to want to vary the level of the base RSA relative to the minimum wage. However, since the base RSA is indexed to prices, its level has fallen sharply relative to the minimum wage since the early 1990s (see Périvier, 2007). It would therefore be legitimate to significantly raise the base RSA (even if this means reducing the rate of accumulation of the RSA *activité* component) and to index it to the minimum wage level. This would definitively solve the question of whether to boost the minimum wage or the RSA.

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[1] Here it can be seen that the "simplification", which consists of combining two instruments into one, is not facilitating public debate.

[2] This lack of take-up is partially due to the fact that, for some of those who are eligible (about a third), the potential gains are very low or even non-existent due to the deduction of the sums paid under the RSA *activité* from the PPE in-work negative income tax. But the lack of take-up is nevertheless high even when looking at the potential gainers (and not simply all those eligible).

[3] Decision No. 2000–437 DC dated 19 December 2000: "Whereas, while the legislature has the right to change the base of the general social contribution to alleviate the burden on the poorest taxpayers, this is subject to the condition that it does not undermine the existence of conditions of equality between taxpayers; that the provision in question does not take account of the taxpayer's income other than from an activity or of income of other household members or of dependents within it; that the choice made by the legislature to not take into consideration all the contributory capacities does not create, between the taxpayers concerned, a manifest inequality that violates Article 13 of the Declaration of 1789."