

# Growth and inequality in the European Union

By [Catherine Mathieu](#) and [Henri Sterdyniak](#)

“Growth and Inequality: Challenges for the Economies of the European Union” was the theme of the 14th EUROFRAME Symposium on Economic Policy Issues in the European Union held on 9 June 2017 in Berlin. [EUROFRAME](#) is a network of European economic institutes that includes DIW and IFW (Germany), WIFO (Austria), ETLA (Finland), OFCE (France), ESRI (Ireland), PROMETEIA (Italy), CPB (Netherlands), CASE (Poland) and NIESR (United Kingdom). Since 2004, EUROFRAME has organized a symposium on an important subject for the European economies every year.

This year, 27 contributions from researchers, selected by a scientific committee, were presented at the symposium, most of which are available on the conference [web page](#). This text provides a summary of the studies presented and discussed at the symposium.

As DIW President Marcel Fratzcher pointed out in his opening remarks, the rise in inequality over the last 30 years has meant that inequalities that were previously subjects of study reserved for researchers in social policy have now become subjects for numerous economists. Several questions were posed: why this rise in inequality? Is the increase in inequality in each country a necessary consequence of the reduction in inequality between countries, in Europe or at the global level? What are the macroeconomic consequences of this increase? What economic policies could avoid this?

**Income inequality: the facts.** Mark Dabrowski (CASE, Warsaw) – “Is there a trade-off between global and national inequality?” – stresses that the growth of inequalities within each country

(especially in the United States and China) goes hand in hand with the reduction of inequalities between countries, as both are fuelled by commercial and financial globalization. However, some advanced countries have succeeded in halting the growth in internal inequalities, which shows the continuing importance of national policy.

Oliver Denk (OECD) – “Who are the Top 1 Percent Earners in Europe?” – analyses the structure of the 1% of employees earning the highest incomes in the EU countries. They represent between 9% of total payroll in the United Kingdom to 3.8% in Finland (4.7% in France). Statistically, they are older than the mass of overall employees (this is less clear in the East European countries), more masculine (this is less clear in the Nordic countries), and more highly educated. They are more numerous in finance, communication and business services.

Tim Callan, Karina Doorley and Michael Savage (ESRI Dublin), analyse the growth in income inequality in the countries most affected by the crisis (“Inequality in EU crisis countries: Identifying the impacts of automatic stabilisers and discretionary policy”). In these five countries, Spain, Greece, Ireland, Portugal and Cyprus, primary income inequalities have increased due to the crisis, but thanks to automatic tax and social transfers, inequalities in disposable income have remained stable in Ireland and Portugal and (to a lesser degree) in Greece.

Carlos Vacas-Soriano and Enrique Fernández-Macías (Eurofound) – “Inequalities and employment patterns in Europe before and after the Great Recession” – show that income inequality decreased overall in the EU before 2008, as new entrants caught up with the older members. Since 2008, the Great Recession has deepened inequalities between countries and within many countries. The growth of internal inequality is due mainly to rising unemployment; it is striking traditionally egalitarian countries (Germany, Sweden,

Denmark); and it is mitigated by family solidarity and social protection, whose roles are nevertheless under question.

**Modelling the growth / inequality relationship.** Alberto Cardiac (University of Cattolica del Sacro Cuore, Milan) and Francesco Saraceno (OFCE, Paris) – “Inequality and Imbalances: An open-economy agent-based model” – present a two-country model. In one, the search for external surpluses leads to pressure on wages and a depression of domestic demand, which is offset by export earnings. In the other, the growth of inequality leads to a downward trend in consumption, which is offset by the expansion of credit. The result is an endogenous debt crisis when the household debt of the second country reaches a limit value.

Alain Desdoigts (IEDES, University of Paris 1 Panthéon-Sorbonne) and Fernando Jaramillo (Universidad del Rosario, Bogota) – “Learning by doing, inequality, and sustained growth: A middle-class perspective” – present a model where innovations can be applied in production only in sectors with a sufficient size, hence those that produce the goods purchased by the middle class (so neither in the luxury goods sector nor in the low-end goods sector). Growth is therefore stronger as the middle class expands. Redistribution is favourable to growth if it is made from the rich to the middle class, and unfavourable if it goes from the middle class to the poor.

**Inequality, financialisation, monetary policy.** The article by Dirk Bezemer and Anna Samarina (University of Groningen) – “Debt shift, financial development and income inequality in Europe” – distinguishes between two types of bank credit: credit for financial and real estate activities, and credit for non-financial enterprises and consumption. They explain the growth of inequality in the developed countries by the growing role of credit that finances finance to the detriment of credit that finances production.

The article by Mathias Klein (DIW Berlin) and Roland Winkler (TU Dortmund University) – “Austerity, inequality, and private debt overhang” – argues that restrictive fiscal policies have little impact on activity and employment when private debt is low (because there is a full Barro effect); they have a restrictive effect on activity and increase income inequality when private debt is high. Therefore, fiscal restraint should be applied only once private debt has been reduced.

Davide Furceri, Prakash Loungani and Aleksandra Zdzienicka (IMF) – “The effect of monetary policy shocks on inequality” – point out that the impact of monetary policy on income inequality is ambiguous. An expansionary policy can reduce unemployment and lower interest rates (which reduces inequality); it can also lead to inflation and raise the price of assets (which increases inequality). Empirically, it appears that a restrictive policy increases income inequality unless it is caused by higher growth.

**Inequalities and social policy.** Alexei Kireyev and Jingyang Chen (IMF) – “Inclusive growth framework” – advocate for growth indicators that include trends in poverty and in inequality in income and consumption.

Dorothee Ihle (University of Muenster) – “Treatment effects of Riester participation along the wealth distribution: An instrumental quantile regression analysis” – analyses the impact of Riester pension plans on the wealth of German households. They significantly increase the wealth of the participating households at the bottom of the income distribution, but these are relatively few in number, while this mainly has wealth redistribution effects for middle-class households.

**Inequality, poverty and mobility.** Katharina Weddige-Haaf (Utrecht University) and Clemens Kool (CPB and Utrecht University) – “The impact of fiscal policy and internal migration on regional growth and convergence in Germany” –

analyse the factors for convergence of per capita income between the old and new German Länder. Convergence has been driven by internal migration, investment subsidies and structural funds, but fiscal transfers in general have had no effect. The 2008 crisis favoured convergence by hitting the richest regions in particular.

Elizabeth Jane Casabianca and Elena Giarda (Prometeia, Bologna) – “From rags to riches, from riches to rags: Intra-generational mobility in Europe before and after the Great Recession” – analyse the mobility of individual incomes in four European countries: Spain, France, Italy and the United Kingdom. Before the crisis, this was strong in Spain and weak in Italy. It declined markedly after the crisis, particularly in Spain; it remained stable in the United Kingdom.

Luigi Campiglio (Università Cattolica del S. Cuore di Milano) – “Absolute poverty, food and housing” – analyses absolute poverty in Italy using an indicator based on food consumption. He shows that poor families bear particularly high housing costs, which cuts into their food consumption and health care spending. Poor families with children are tenants and were hit especially hard by the crisis. Social policy should offer them better protection through targeted transfers in cash or in kind (health, education).

Georgia Kaplanoglou and Vassilis T. Rapanos (National and Kapodistrian University of Athens and Academy of Athens) – “Evolutions in consumption inequality and poverty in Greece: The impact of the crisis and austerity policies” – point out that the crisis and austerity policies have reduced GDP and household consumption by about 30% in Greece. This has been accompanied by an increase in inequality in consumption, which the paper documents in detail. It analyses in particular the effect of VAT hikes. Families with children were especially hard hit.

**Labour market.** Christian Hutter (IAB, German Federal

Employment Agency) and Enzo Weber (IAB and Universität Regensburg) – “Labour market effects of wage inequality and skill-biased technical change in Germany” – use German data to estimate a structural vector model for analysing the link between wage inequalities, employment, neutral technical progress and technical progress favouring skilled labour. The latter raises labour productivity and wages, but also wage inequalities, and it reduces employment. Wage inequalities have a negative impact on employment and overall productivity.

Eckhard Hein and Achim Truger (Berlin School of Economics and Law, Institute for International Political Economy) – “Opportunities and limits of rebalancing the Eurozone via wage policies: Theoretical considerations and empirical illustrations for the case of Germany” – analyse the impact of wage increases in Germany on the rebalancing of current account balances in Europe. They show that these play a role not only through a competitiveness effect, but also through a demand effect by modifying the wage / profit distribution and by boosting consumption. They must therefore also be supported by an increase in public spending.

Camille Logeay and Heike Joebges (HTW Berlin) – “Could a wage formula prevent excessive current account imbalances in euro area countries? A study on wage costs and profit developments in peripheral countries” – show that the rule “wages must grow in line with labour productivity and the inflation target” should have had stabilizing effects in Europe both on the competitiveness of the member countries as well as on their domestic demand. This nevertheless assumes that companies do not take advantage of this to boost their profits and that no country seeks to increase its competitiveness.

Hassan Molana (University of Dundee), Catia Montagna (University of Aberdeen) and George E. Onwordi (University of Aberdeen) – “Reforming the Liberal Welfare State: International Shocks, unemployment and household income shares” – construct a model to show that a free market

country, such as the United Kingdom, could improve the functioning of its labour market by reducing flexibility to move towards a flexi-security model: higher unemployment benefits, restrictions on redundancies, greater spending on training, and support for hiring. By boosting labour productivity, this strategy would reduce the structural unemployment rate and increase the share of profits.

Guillaume Claveres (Centre d'Economie de la Sorbonne, Paris) and Marius Clemens (DIW, Berlin) – “Unemployment Insurance Union” – propose a model for European unemployment insurance that would cover part of the expenses of unemployment benefits. This could reduce fluctuations in consumption and unemployment resulting from specific shocks. This assumes, however, that it would apply only to cyclical unemployment, which is difficult to define.

Bruno Contini (Università di Torino and Collegio Carlo Alberto), José Ignacio Garcia Perez (Universidad Pablo de Olavide), Toralf Pusch (Hans-Boeckler Stiftung, Düsseldorf) and Roberto Quaranta (Collegio Carlo Alberto) – “New approaches to the study of long-term non-employment duration via survival analysis: Italy, Germany and Spain” – analyse involuntary non-activity (people who would like to work but have given up looking for a job and lost their rights to unemployment benefits) in Germany, Italy and Spain. This is particularly important and sustainable in Spain and Italy. They caution against measures to encourage redundancies, job insecurity and incentives for undeclared work.

**Taxation.** Markku Lehmus, (ETLA, Helsinki) – “Distributional and employment effects of labour tax changes: Finnish evidence over the period 1996-2008” – uses a general equilibrium model with heterogeneous agents to evaluate the impact of the reduction in the taxation of employment in Finland from 1996 to 2008. He shows that this explains only a small share of the rise in employment (1.4 points out of 16%) and of the rise in income inequality.

Sarah Godar (Berlin School of Economics and Law) and Achim Truger (IMK and Berlin School of Economics and Law) – “Shifting priorities in EU tax policies: A stock-taking exercise over three decades” – analyse the evolution of taxation in the EU states: from 1980 to 2007, taxation became less progressive with lower marginal rates of income tax and corporation tax, and preferred treatment of capital income. The crisis of 2008 and the difficulties with the public finances temporarily slowed this trend; an increase in revenues was, however, often sought by raising VAT.

Alexander Krenek and Margit Schratzenstaller (WIFO) – “Sustainability-oriented future EU funding: A European net wealth tax” – argue for the introduction of a European household wealth tax, which could help finance the European budget.

**The macroeconomic consequences of inequalities.** Bjoern O. Meyer (University of Rome – Tor Vergata) – “Savings glut without saving: Retirement saving and the interest rate decline in the United States between 1984 and 2013” – explains 60% of the decline in the interest rate in the United States, despite the decline in the overall household saving rate, by demographic factors (the differential rise in life expectancy), the slowdown in labour productivity gains and the increase in income inequality.

Marius Clemens, Ferdinand Fichtner, Stefan Gebauer, Simon Junker and Konstantin A. Kholodilin (DIW Berlin) – “How does income inequality influence economic growth in Germany?” – present a macroeconomic model in which short-term income inequalities increase the productivity of each asset (incentive effect), but reduce overall consumption (savings effect); in the long term, they have a negative impact on the formation of the human capital of young people in the working classes. Hence an exogenous increase in income inequalities first has a negative effect on GDP (demand effect), then positive (individual incentive effect) and then again negative



in the long term (human capital effect). The effect is always negative on household consumption and positive on the external balance.

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# Intergenerational inequality in four large EU countries: Does one model fit all?

[Francesco Vona](#)

The extent to which social mobility differ across countries is subject of much debate in political and academic circles. The two poles of the relatively egalitarian Scandinavian countries and the relatively unequal Anglo-Saxon ones have been taken as key examples to corroborate a simple human capital-based explanation of cross-country differences in social mobility. In fact, stark differences in educational systems (e.g. private vs. public financing) and returns to skills well account for the gap in social mobility between Scandinavian and Anglo-Saxon countries. However, in a recent paper using comparable individual data for these four countries (*i.e.* EUSILC), I show that this explanation does not suffice in accounting for differences in social mobility across the four largest EU economies: Germany, France, Italy and Spain.[\[1\]](#)

To gauge insight on the validity of the human capital story, we observe that worker's skills on which earnings depend are the result of two inputs: family background (including genetic transmission of intelligence if any) and individual abilities independent on family background. Our working hypothesis is that these two inputs are complements and thus that coming from a good family pays especially for talented individuals

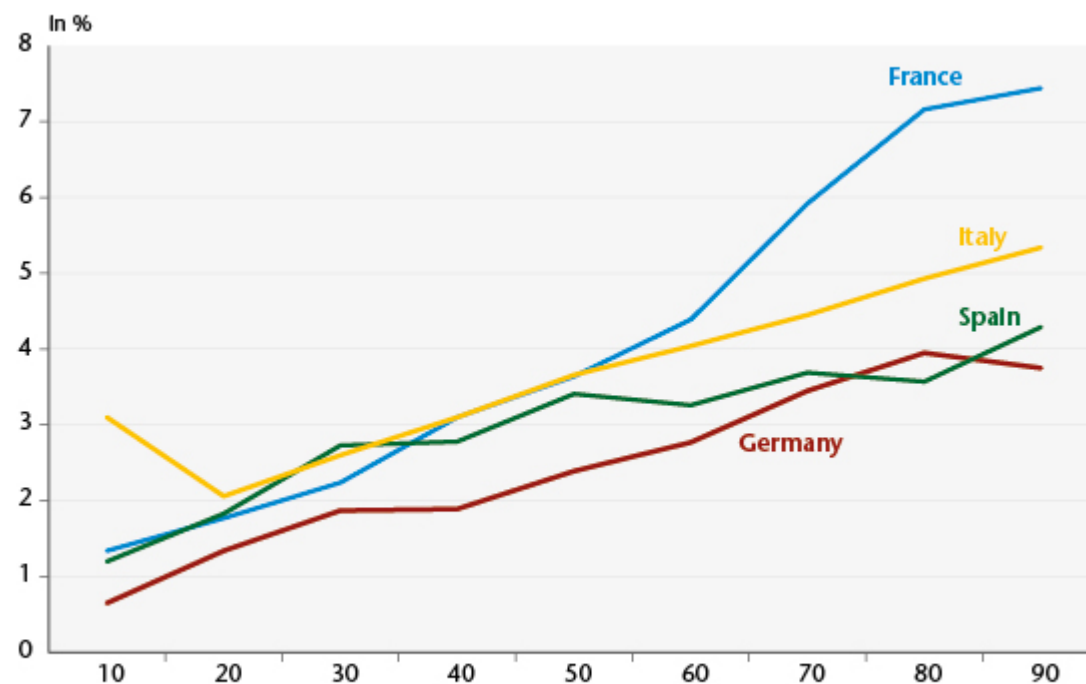
who not only don't face any spatial and financial constraint to access best schools but are also exposed to a more stimulating cultural environment (Cunha and Heckman, 2007). We test this hypothesis using regression techniques that allow to estimate returns to family background conditional on individual abilities (Firpo *et al.*, 2009). The figure below shows the effect of family background in correspondence of each decile of the son's earnings distribution, with a higher decile corresponding to higher individual abilities. The parental background coefficient should be interpreted as the percentage increase in earnings following a one-decile increase in the relative social position of the parents.[\[2\]](#)

At a first glance, our results lend to support to the hypothesis of a widespread background-ability complementarity. Returns to family background are higher at the top of the distribution not only in Germany and France, where parental influence on education is particularly important because of, respectively, the early tracking and the *grandes écoles* system, but also in the two Mediterranean countries, where usually non-meritocratic mechanisms are stronger.[\[3\]](#) However, one model does not fully fit all. First, the curve of returns to background is significantly steeper in the two central European countries than in the two Mediterranean countries, consistent with the idea that in Mediterranean countries family background affects children career prospects through social networks and nepotism.[\[4\]](#) Second, the effects of family background are significantly larger in France compared to the other three countries. While the extremely large effect in the top decile is broadly consistent with the parental influence on the probability of entering *grandes écoles* in France, large returns in the 7th and 8th decile indicate an increasingly polarized distribution of opportunities depending on family origins.[\[5\]](#)

This increasingly high social immobility correlated with children abilities questions the foundation of the French

school system and cannot be accounted for by a simple private vs. public school argument. A possible explanation is residential segregation and thus a radical rethinking of school admission policy based on neighborhood of residence is needed. Targeted policies promoting the mixing of students from different socio-economic background in the same school appear in high need to allow the talented but disadvantaged children to benefit from the positive peer effect from the well-off ones. Recent policy experiments carried out in the US show that these policies are particularly effective in increasing the career prospective of disadvantaged students (see Chetty *et al.* 2015).

**Figure: Effects of parental background along the income distribution**



Note: in France, for children in the last decile of income, an increase of one decile of parental background increases children's income by 7,5%.

Source: EUSILC, 2011.

[1] See Raitano, M., Vittori, C., Vona, F., 2015, 'The effect of parental background along the sons' earnings distribution: does one model fit for all?', OFCE working paper, n° 2015-18 and *Applied Economic Letters*, forthcoming. We use the information provided by the 2011 EU-SILC wave that includes a

specific section with information on family characteristics when the interviewed was around 14 years old.

[2] We build a comprehensive measure of family background combining various family characteristics (mainly educational and occupational attainments of the parents) to obtain a distribution of parental social positions and associate each child to a given social position ranked from one to ten for convenience.

[3] Note that the parental background coefficient is always statistically different from zero, apart from in the first decile in Germany and Spain.

[4] Raitano, M., Vona, F., (2015). "[Measuring the link between intergenerational occupational mobility and earnings: evidence from eight European countries](#)", *Journal of Economic Inequality*, vol. 13(1), 83-102.

[5] Note that in the previous wave of the EU-SILC survey on intergenerational mobility, France displayed lower intergenerational inequality than Italy, Spain and the UK.

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## **Better abilities or stronger social ties? Drivers of social immobility across EU countries**

par [Francesco Vona](#)

A high level of income inequality is commonly regarded to be more acceptable when associated with high social mobility. Empirical evidence has however shown that unequal countries are rarely able to ensure high social mobility to their citizens. On the contrary, countries that rank high in the level of inequality are also the worst in term of social mobility[\[i\]](#). The simple reason is that a given level of social immobility is amplified when rewards to individual characteristics, which are transmitted from parents to child, are larger. For instance, when the earning advantage for the high skilled is large, intergenerational inequality (that is: the correlation between parent and child incomes) increases because, on average, high skilled workers come from better family backgrounds.

Economists tend to attribute cross-country differences in social mobility to the working of the educational system and its influence on the effective skills possessed by individuals coming from different family backgrounds. In particular, several empirical studies using standardized test scores show that there exist substantial background-related differences in competences and skills at a given level of educational attainment[\[ii\]](#). Among OECD countries[\[iii\]](#), the influence of family background on test scores achievements is particularly strong in France (the second worst country after the USA in terms of intergenerational educational inequality), Germany and the UK, while it is relatively weaker in Italy and Spain. Whereas background-related differences in the effective level of skills certainly play a major role in creating persistency in socio-economic statuses, the working of labour markets is also an important, yet neglected, source of social immobility. On the one hand, labour market institutions reduce the observed level of intergenerational inequality whereby institutions compressing wages (i.e. centralized wage bargaining, high unionization or minimum wage) are present. On the other hand, family ties constitute a labour market network that can help well-off individuals in finding good jobs and

obtaining promotions.

In a recent paper (Raitano and Vona, 2014a) [\[iv\]](#), we assess the role played by labour market networks and individual skills in the transmission of socio-economic inequalities. We argue that high levels of intergenerational inequality can be due to: 1. formal educational attainment; 2. other (empirically unobservable) dimensions of human capital affected by family background, i.e. soft skills or better quality of education; 3. family and social ties affecting labour market outcomes and occupational sorting. Our main idea is to use intergenerational occupational mobility to distinguish between two types of association between family background and child earnings. A standard type emerges because, especially in top occupations, the well-off child should have a higher level of human capital (a glass ceiling effect) due to the fact that he attended top schools or inherited better soft skills. In contrast, the second type is associated with insurance for the children of the well-off ending up in bottom occupations (a parachute effect), who clearly display a low level of skills for a given level of education. To implement this idea, we use the 2005 module on intergenerational mobility of the EUSILC dataset and examine these two effects in eight EU countries characterized by different levels of intergenerational inequality and belonging to different welfare regimes. Our empirical analysis is motivated by the claim that returns to upward and downward social mobility could arguably stem from different sources. A glass ceiling of upward mobility is likely to depend on both network effects and unobservable skills that are positively correlated with family background. Conversely, it is hard to believe that the parachute effect can be associated with better unobservable skills; hence, in this case, family networks should be of paramount importance.

By way of an example, imagine that a child is in the first tercile group (low social position) of its distribution but that his father was in the third tercile group (high social

position). This individual clearly has a good background, but his relative position signals that he has a low ability. In this case, a positive association between family background and earnings (i.e., a parachute effect) would depend on the family network rather than on unobservable skills related to the child's background. Conversely, it is not easy to infer the true unobservable skills of individuals who maintain their positions and earn more than others while sharing the same occupation but coming from a worse background. Hence, the identification of the glass ceiling effect is more problematic.

We find that family ties can create a considerable earning advantage for Spanish and Italian workers [\[v\]](#). In these two countries, the high observed intergenerational inequality is mainly explained by a parachute effect for the well-off worsening their social position. In Italy, this parachute effect is particularly high: all else equal, the child of the well-off who worsens its social position earns annually 12% more than the child of the worse-off who stays in the same position. This result is consistent with a sociological view of social mobility where families play a key role both in the allocation of workers to jobs and in determining earning increases within a job [\[vi\]](#). Interestingly, this result does not hold for other immobile European countries, such as the UK and to a lesser extent France. In these cases, the earning advantage of the well-off is fully driven by a penalty for those climbing the social scale, i.e. glass ceiling effect. While this result seems consistent with the classical human capital view of intergenerational inequality (where access to elite educational institutions is highly dependent on family background), our study cannot discriminate between the two explanations because a glass ceiling at the top could also be engendered by social networks. However, since the glass ceiling effect is widespread across all countries, including more equal ones (i.e. Germany, Finland, Ireland and Denmark), this effect is most likely due to unavoidable features either

of the educational system or of the cumulative process of skill formation, at least in countries where students with similar socio-economic backgrounds are sorted into the same school.[\[vii\]](#)

Overall, our study suggests that intergenerational transmission of inequality strongly depends on the features of the country's labour market, especially in Mediterranean countries where family ties are extremely important in finding good jobs. Further research is required to understand which part of intergenerational inequality emerges during the educational period and which part emerges during the working career, accounting for the learning advantage possessed by high skilled individuals and thus for their steeper earning profiles. In future research[\[viii\]](#), we aim at decomposing the two effects in a more precise way for a cohort of Italian workers that we observe during their entire careers.

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[\[i\]](#) See: Corak, M., 2012. How to Slide Down the 'Great Gatsby Curve': Inequality, Life Chances, and Public Policy in the United States. Center for American Progress, December. Available at <https://mileskorak.files.wordpress.com/2012/12/corakmiddleclasses.pdf>.

[\[ii\]](#) See: Fuchs T., Wößmann, L., 2007. [What accounts for international differences in student performance? A re-examination using PISA data](#), *Empirical Economics* 32.

[\[iii\]](#) See: <http://www.oecd.org/centrodemexico/medios/44582910.pdf>.

[\[iv\]](#) Raitano, M., Vona, F., 2014a. [Measuring the link between intergenerational occupational mobility and earnings: evidence from eight European countries](#), *Journal of Economic Inequality*



forthcoming.

[v] The results are obtained running regressions for samples of representative individuals for each country.

[vi] See: Ganzeboom, H., Treiman, D., 2007. Ascription and achievement in comparative perspective, Russell-Sage University Working Group on Social Inequality, University of California-Los Angeles.

[vii] Mixing students from different background in the same schools tends to reduce the influence of family background on individual student achievement without having negative effects for the average student achievement in the school. See: Raitano, M., Vona, F., 2013. [Peer heterogeneity, school tracking and students' performances: evidence from PISA 2006](#), [Applied Economics](#) 45.

[viii] Raitano, M., Vona, F., 2014b. From the Cradle to the Grave: the impact of family background on carrier path of Italian males, mimeo.

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## Why read Piketty?

By [Jean-Luc Gaffard](#)

Thomas Piketty's book *Capital in the twenty-first century* has met with an extraordinary reception, one that is commensurate with both the empirical work performed and the political issue addressed, that is to say, the spectacular increase in inequality in the United States. Paul Krugman and Joseph Stiglitz, both of whom are concerned about current trends in American society that they consider are threatening democracy,

believe Piketty's work confirms their fears.

Armed with an impressive mass of data and a solid historical knowledge reinforced by a reading of the great novels of French and English literature, Piketty foresees the advent of a second *Belle Epoque*, the decades-long period preceding the First World War. This would mean a return to a patrimonial capitalism based on inheritance, when income and capital are concentrated in the hands of the top percentile of the population and the ratio of capital to income rises significantly. More fundamentally, Piketty highlights the existence of a longstanding trend towards stagnation and rising inequality, which is reflected in a rate of return on capital that is sustainably higher than the economy's rate of growth, a little like Marx insisted on the existence of a tendency for the rate of profit to fall. The twentieth century, and in particular the period following the Second World War, was characterized by strong growth associated with decreases in inequality and in the importance of capital relative to income – but this period was merely a parenthesis that is now closed. The thesis defended is that capitalist society has returned to low growth and rising inequalities fuelled more by the transmission of wealth than by the remuneration of individual talent.

The book is nevertheless ambivalent. There is a gap between the wealth of data collected and the simplicity of the theory that is supposed to account for it. On the one hand, an overly simple, essentially a-institutional model adopts a growth rate that is ultimately exogenous and ignores the heterogeneity of capital, making distribution a technical given that does not feed back into growth. On the other hand, the wealth of the data and the insights associated with it encourage reflection about the ins and outs of the distribution of income and wealth, returning it to its central place in economic theory and restoring its social dimension.

A belief runs through the book: that, regardless of what

economic policies are implemented, growth is again returning to a low level because there is no longer any catch-up going on and potential productivity gains are largely exhausted. Inheritance then begins to play a key role in the distribution of wealth and feeds the rise of inequality. This fundamental pessimism justifies the simplicity claimed for the theoretical explanation. If this pessimism is to be shared, however, the foundation needs to be improved by examining the causes and effects in the formation of rent and by breaking with a neo-classical analysis of growth that is without any real relevance to the subject at hand. There is nothing natural about the evolution of the distribution of income and wealth, which depend on political choices and social norms. The question, then, is whether the choices and norms of the years of the *Belle Epoque* still have any meaning, and whether policy can still counteract the forces of what must be called decline that threaten modern capitalist societies.

Reading Piketty thus gives rise to an implicit challenge: to develop an analysis that, following an intuition that we owe to the classical economists, is based on the idea that the growing importance of rent, as distinguished from profit, would fuel an increase in the purchase of nonperforming assets or luxury goods at the expense of the accumulation of capital, and would thereby constitute an obstacle to growth.

These various issues are examined in the *Note de l'OFCE*, no. 40 of 2 June 2014, ["Le capital au XXI<sup>e</sup> siècle : un défi pour l'analyse"](#) [*Capital in the twenty-first century : a challenge for analysis*], which follows on from the previously published working document by Guillaume Allègre and Xavier Timbeau (see the blog [here](#)).