

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

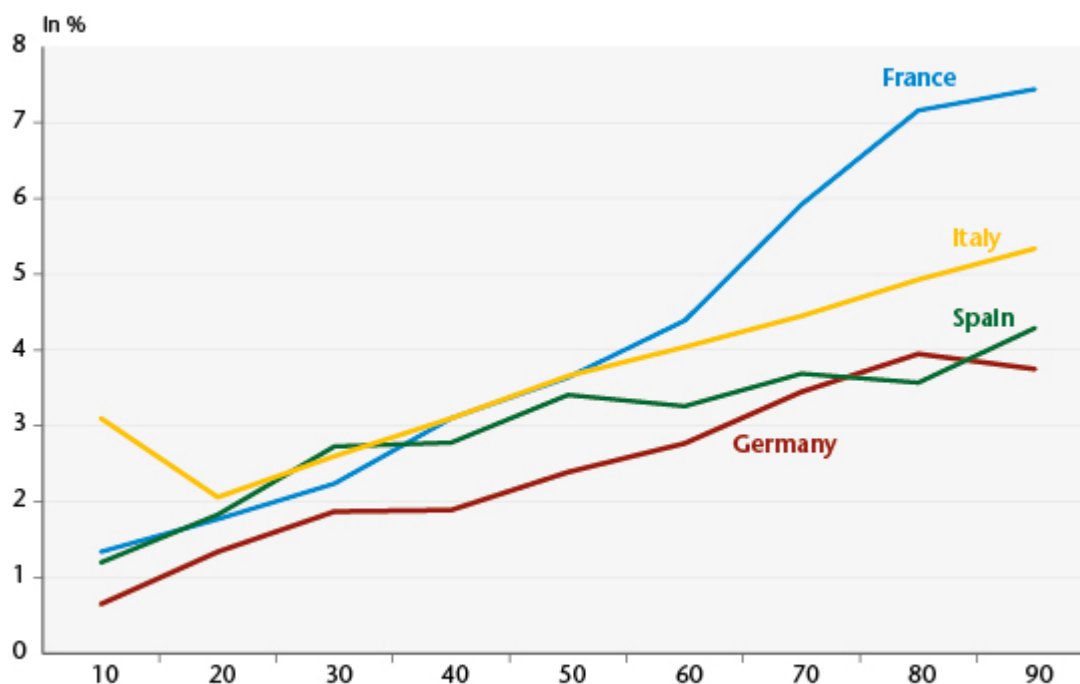
each decile of the son's earnings distribution, with a higher decile corresponding to higher individual abilities. The parental background coefficient should be interpreted as the percentage increase in earnings following a one-decile increase in the relative social position of the parents.[\[2\]](#)

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.

The American dream (finally) proven?

By [Maxime Parodi](#)

In a recently published short article, Thomas Hirsch and Mark Rank (2015) give us some astonishing figures about American society – numbers that, taken seriously, would lead to a significantly more nuanced view of income inequality in the United States. Indeed, their study suggests that American society is much more fluid than we think. While Americans undoubtedly live in a very unequal society, most of them would experience wealth at some point in their lifetimes. There is, in reality, a high turnover between rich and poor, which would explain why Americans are not very critical of inequality.

According to this study, during their working lives (age 25 to

60), 69.8% of Americans have enjoyed at least one year of household income sufficient to be included among the richest 20%. And 53.1% of Americans have made it – for at least one year – into the richest 10%. An even more exclusive 11.1% of Americans have spent at least one year in the illustrious club of the wealthiest 1%.

But before accepting these outlandish figures, a more serious look needs to be taken of the study by Hirschl and Rank. It turns out that the numbers do not in fact offer a simple description of American society, but are rather the result of a modelling exercise. Behind these figures lie certain assumptions and methods that have been adopted, and which deserve discussion.

In the latest [Note de l'OFCE \(no. 56 of 12 January 2015\)](#), I show that the assumptions made are unrealistic and that the method used does not support the presence of missing data in the biography of the respondents. All in all, the results are heavily biased in favour of the American dream. It is possible, however, to partially correct this bias, yielding the results in the table below.

Table. Cumulative percentage by age and averages, after correction for bias, of belonging at least once in one's life to the richest 20%, 10%, 5% or 1% of households

In %

H* age	Q20		Q10		Q5		Q1	
	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate
25	7,6	3,4	4,1	1,4	2,4	0,7	0,4	0,1
30	19,1	8,6	10,8	3,8	6,1	1,8	1,0	0,2
35	27,6	12,7	17,2	6,1	10,2	3,0	2,4	0,6
40	33,1	15,5	22,6	8,2	14,5	4,3	4,0	0,9
45	37,2	17,6	26,9	9,9	18,4	5,6	5,4	1,3
50	39,6	18,9	30,8	11,5	21,7	6,6	6,6	1,6
55	41,0	19,7	33,2	12,5	24,3	7,5	7,9	1,9
60	41,3	19,8	34,4	13,0	25,6	7,9	8,7	2,1
Average	31		24		17		5	

Source : Author's calculations.

Basically, the Hirschl & Rank figures are cut in half! Thus,

31% of Americans will have a sufficient household income for at least one year (between age 25 and 60) to be among the richest 20%. And 5% of Americans will have a sufficient household income for one year to be in the richest 1%.

Given the magnitude of this correction, it is clear that the study by Hirschl and Rank distorts reality by suggesting that social destinies in the United States are very chaotic – as if the entire society were at the roulette table. Other articles by Hirschl and Rank further fill out the picture. It is not in fact the first time that these authors have come up with such figures using this method. In 2001, they examined the other end of the income distribution, evaluating the percentage of Americans who have experienced an episode of poverty during their lifetime (Hirschl and Rank, 2001). They again came up with striking figures. For example, 54% of Americans experienced an episode of poverty [\[1\]](#) before age 40. In 2005, they again applied this method to recipients of food stamps (food vouchers), and estimated that 50% of Americans will have made use of food stamps at least once in their lives (before age 65). This order of magnitude is, yet again, barely credible. A less costly and more direct method would certainly be revealing: it would suffice to ask Americans whether they have ever received food stamps. While some Americans may prefer to hide such an event, this bias of omission will never be as large as that of the preceding survival analyses. Let's be clear: their method is a machine for producing the outlandish.

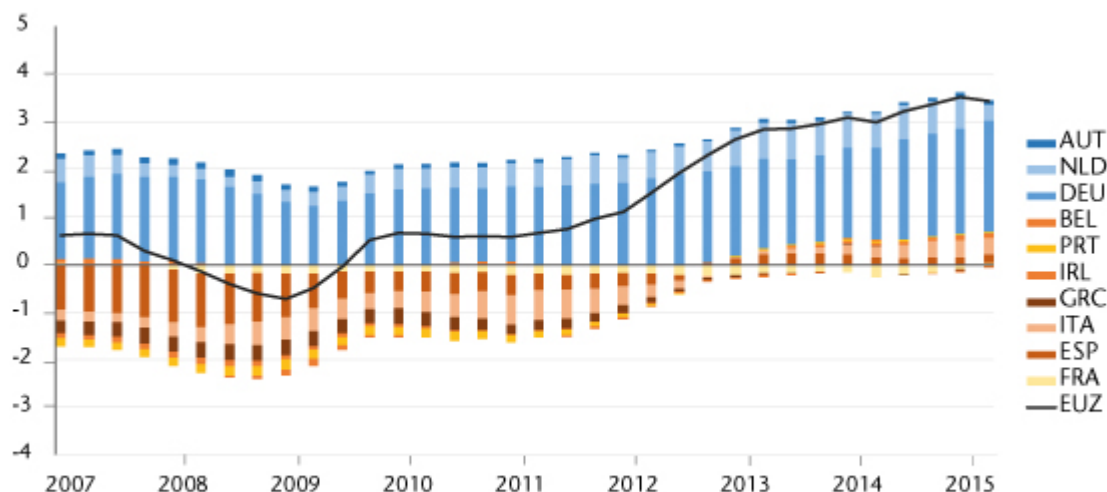
[\[1\]](#) The poverty threshold adopted here is 1.5 times the value of the basket of goods needed to meet basic needs.

What strategy for internally rebalancing the euro zone?

By [Sébastien Villemot](#) and [Bruno Ducoudré](#)

The euro zone has made significant efforts to reduce its trade imbalances since the outbreak of the financial crisis. In 2009, only Germany, the Netherlands and Austria had a current account surplus, while all the other countries, in particular France, Italy and Spain, ran current account deficits, resulting in a deficit for the zone as a whole (-0.7% of GDP). Five years later, in 2014, the situation had changed radically. The euro zone had a large current account surplus -3.4% of GDP - with almost all the countries running a surplus (figure).

Figure. Current account in % of euro area GDP



Note: The upward shift in the current account is the result of lower prices for raw materials, low internal demand, and unconventional monetary policy.

Source: National accounts, ECB, iAGS 2016 calculations. The current account is cumulated over 4 quarters.

It should nevertheless not be concluded that the euro zone has corrected its trade imbalances, as there are still several reasons for concern. Firstly, some of the current account surplus is cyclical, particularly in southern Europe, due to

depressed domestic demand. Secondly, the magnitude of the euro zone's current account surplus comes with deflationary risks: while for the moment the ECB's expansionary monetary policy is helping to contain upward pressure on the euro, this pressure will eventually materialize once the monetary cycle enters a phase of normalization, leading to imported deflation and losses in competitiveness vis-à-vis the rest of the world.

More importantly, the reversal of the euro zone's current account position vis-à-vis the rest of the world does not mean that the zone's internal imbalances have been corrected. The analysis that we made in the [2016 iAGS report](#) shows that there are still significant imbalances, although they have diminished since the start of the crisis.

Based on a model to simulate changes in the current accounts of the euro zone countries in terms of price competitiveness differentials [1], we calculated the nominal adjustments within the euro zone needed to achieve balanced current accounts for all the countries. A balanced position is defined here as stabilization of the net external position, at a level compatible with EU procedures (i.e. greater than -35% of GDP), and with the output gaps closed in all the countries.

The table below shows the results of these simulations and helps to take stock of the adjustments made since the beginning of the crisis as well as the adjustments still needed relative to Germany, which is used as a reference point.

Table. Nominal adjustments needed to achieve balanced current accounts relative to Germany

	2008	2009	2010	2011	2012	2013	2014
Germany	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Austria	20,2	15,9	13,3	1,0	2,8	6,5	1,4
Belgium	-32,9	-29,9	-15,7	-30,7	-23,8	-22,2	-23,2
Spain	-46,8	-32,8	-30,6	-29,9	-21,9	-15,3	-18,5
Finland	4,8	-1,2	-7,9	-29,0	-30,7	28,4	-24,7
France	-18,9	-16,1	-16,6	-19,1	-19,8	-15,2	-19,1
Greece	-89,1	-87,9	-80,8	-73,0	-48,5	-39,7	-39,8
Ireland	-26,8	-28,7	-25,6	-26,9	-28,7	-19,8	-14,9
Italy	-29,2	-25,2	-32,7	-31,9	-19,9	-12,0	-9,9
Netherlands	-4,5	6,1	6,2	4,4	5,1	6,8	0,8
Portugal	-68,5	-65,3	-59,2	-43,1	-30,9	-17,1	-21,4

Source: Authors' calculations.

There were still significant nominal misalignments in the euro zone in 2014. Several groupings of countries can be identified. Austria and the Netherlands are on level footing with Germany. In contrast, Greece must undergo a nearly 40% depreciation compared to Germany, despite its previous sacrifices; even if the Greek current account is close to balanced today, this is due to the output gap that has widened considerably (-12.6% in 2014 according to the OECD) and artificially improved the external trade balance by shrinking domestic demand. Between these two extremes lies a group of countries, including France, Spain, Portugal, Belgium and Finland, which need a depreciation of about 20% relative to Germany. Italy meanwhile is in a somewhat better position, with a relative depreciation of about 10% required, thanks to its current account surplus (1.9% of GDP in 2014) and a relatively favourable net international investment position (-27.9% of GDP).

These nominal imbalances cannot be solved by changes in exchange rates, since the countries all share the same currency. The adjustment thus has to be made through relative price movements, i.e. by differentials in inflation rates between countries. Thus, inflation in Germany (and the Netherlands and Austria) needs to stay higher for a while than in the intermediate group, which itself needs to be higher than in Greece. And, given the importance of wages in

determining the price of value added, this outcome will be achieved mainly by differential changes in nominal unit labour costs.

There are several possible ways to achieve this goal. The one that has been followed so far has been to make the reduction of labour costs the norm, based on a non-cooperative race for competitiveness. With Germany making extensive efforts to hold down its prices and wages, other countries could adjust only by cutting their own costs, whether through wage cuts (as in Greece and Spain) or by lowering corporate tax (as in France). While these strategies have indeed helped to reduce imbalances in the zone since 2008, as our table shows, the adjustment is still far from complete, and the economic cost has been high. Lowering wages in the southern European countries undermined demand, and therefore business, while deflationary pressures were strengthened and are still threatening, despite the ECB's energetic policies.

Another approach would be to coordinate wage developments in the euro zone countries in order to allow the ECB to meet its inflation target of 2%, while making nominal readjustments. Each country would set a target for changes in its unit labour costs. Countries that are currently undervalued (Germany, Netherlands, Austria) would set a target of over 2%, while overvalued countries would set a target that was positive, but below 2%. Once the imbalances were absorbed, which would require a number of years, the targets could be harmonized to 2%.

The relative adjustment of unit labour costs could also be made through differential gains in productivity. This point highlights the importance of investment stimulus policies in the euro zone, so as to improve the productivity and competitiveness of countries that need to make significant nominal adjustments. Using this approach to adjust unit labour costs would release some of the downward pressure on wages and domestic demand in the euro zone.

A policy like this would represent a profound change in the economic governance of the euro zone, and would call for enhanced cooperation. This is, however, the price for maintaining the cohesion of the monetary union.

[\[1\]](#) Although non-price competitiveness also plays a role in trade dynamics, we have ignored it due to lack of an adequate quantitative measure.