SCOR Presentation

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July 7, 2022

If you look back at the last 20 years, what is striking is that global crises have grown in frequency and intensity, with worrying implications for future economic development. The World Bank warns that the effort to reduce poverty has suffered its "worst setback" in a quarter-century, owing to the COVID-19 pandemic and now to the war in Ukraine. Inequalities are deepening within and between countries, and across many key sectors, from education to health. Indeed, they are highly multidimensional. An important takeaway: large economic or geopolitical organizations, such as the European Union and NATO matter: an isolated country will be more impacted.

It is easy conceptually to prioritize equality of opportunity over opportunity of outcome, although one quickly realizes that the two goals are actually more related than one can think at first sight: it is doubtful that real equality of opportunity can occur without satisfying minimum outcome levels. And what do we mean by equal opportunity anyway? How do we define the level plaining field for individuals and companies? The debate goes far beyond good education for all children and fair concurrence rules for companies. Here again, the question is highly multidimensional and spans human capital, mobility, rent extraction, discriminations, externalities, security, public services, internet access, corruption, fraud - the list is very long!

And so the book is exploring all these directions, in time and space, going back to history and philosophical schools of thought, yet tries to stay as practical as possible and focuses on public policies that are operationally feasible.

The title of the book can seem provocative because capitalism is often associated with an increase in inequalities. But our main thesis is precisely that capitalism can be reformed in such a way that there is no need to arbitrate between equity and economic efficiency. The key question we are facing is the following: do we want to solve a number of complex but well identified problems, or do we want to try uncertain social experimentation as some people propose, alongside huge resource reallocations on a scale not seen since Mao's China?

So our talk today will focus on exactly that: the dynamics between equity and efficiency and prosperity, and how they actually work both ways: more equity can certainly generate more growth, and, conversely, more growth can, under certain conditions, yield more equity.

A. First part of the dynamics: more equity can trigger more growth:

That is what we can call the business case. Let's take two concrete examples:

(1) if the black american population was economically more integrated (in terms of salaries, education, access to housing, access to credit), then the economy could generate 1000 billion dollars each year, that is about 5% of the US GDP. This is according to a study by Citigroup.

(2) if the film industry was more diverse, it could produce 10 billion dollars of additional revenues, that is about 7% of the total revenues of the industry (according to McKinsey).

So 5% on one side, 7% on the other side, these estimates are not trivial and show a significant impact.

In the public sector, the challenge is the same, except that when facing so many potential projects with so few resources, we must really pick social policies with the highest return on investment. Let's look at one example and two counter-examples.

Example 1: Let's consider the truly remarkable work conducted by the American Nobel Prize James Heckman on early childhood education programs. Obviously, this is not about academic knowledge here, but soft skills, such as attention, curiosity, respecting others and their opinions, perseverance, etc. He was able to actually quantify the return on investment of these enrichment programs over the entire life of the children (we are talking about two digit returns, up to 15%), in terms of additional revenues, but also in terms of increased quality of life: more stability of her future family, less use of drugs, etc.

More generally, the developpement of what we call human capital (education and health) is a formidable instrument to reinforce the level playing field, at a national

level, but also within the EU - by teaching of foreign languages, scientific, technical, cultural exchanges, and usage of European funds for Continuing Education.

Example 2 (counter-example): policies towards homeless people: they are necessary in terms of fighting poverty and in terms of minimum social standards, but they are expenses, not investments. In New York, for instance, you have about 65,000 homeless people on a full time basis, a third of children, at an annual cost to the city of $30,000: you do the maths, that's a budget of 2 billion dollars - that's a lot of teachers, nurses, firefighters, policemen who could be hired with that money.

Example 3 (counter-example): it pertains to Frontex, the European Border and Coast Guard Agency. The lack of security is arguably the most important inequality. Public opinions in Europe are often critical of European policies towards immigration, and populist parties exploit this frustration by painting a very bleak picture of the situation. Yet, too little data is available to the general public to get a better sense of the real situation. In particular, Frontex doesn't make public the fact that about 20% of people entering the EU are not subject to sufficient background checks. It would be better policy to make these numbers known and debated publicly because it would most likely force governments to commit to improving the shortcomings, with checkpoints over time controlled by public opinions. The lack of transparency that prevails here is in fact totally counterproductive.

The corollary of social investment is experimentation and testing: theoretical first through big data and simulation, then practical (on limited area or population), with the ability to make changes before moving to the final stage. Without this kind of cautious scientific approach, it is impossible to guarantee that policies will be effective on a large scale. And of course, we need to make sure that while fixing existing inequalities, we don't introduce new ones…

Finally, it is important to measure what we intend to change. Started in 2008 by Joseph Stiglitz and now maintained by the OECD, well-being indices can be useful to understand macro trends. But we probably have the tools and the data today to build quasi-individual indices that can express specific situations in all its dimensionality: financial data of course such as income and wealth, but also human capital, the quality of infrastructures, quality of the environment (air/water quality, noise level), cultural activities, security level, etc, etc. In case you are skeptical, just one example:

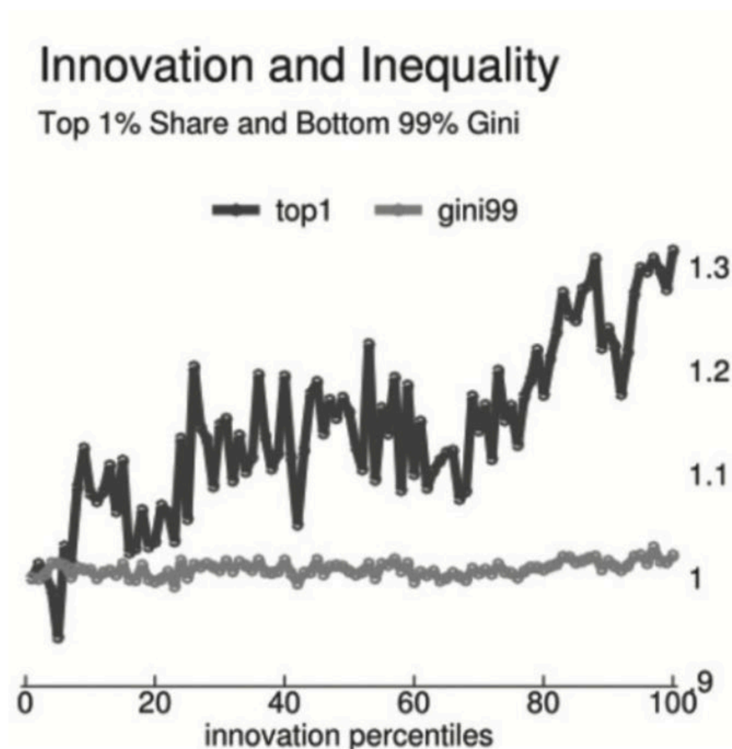
one can now assess the toxicity of air particules in relatively small areas of 50 by 60 kms (according to a study by Harvard University).

B. The other side of the dynamics: can more growth yield more equity?

The answer is far less obvious than previously.

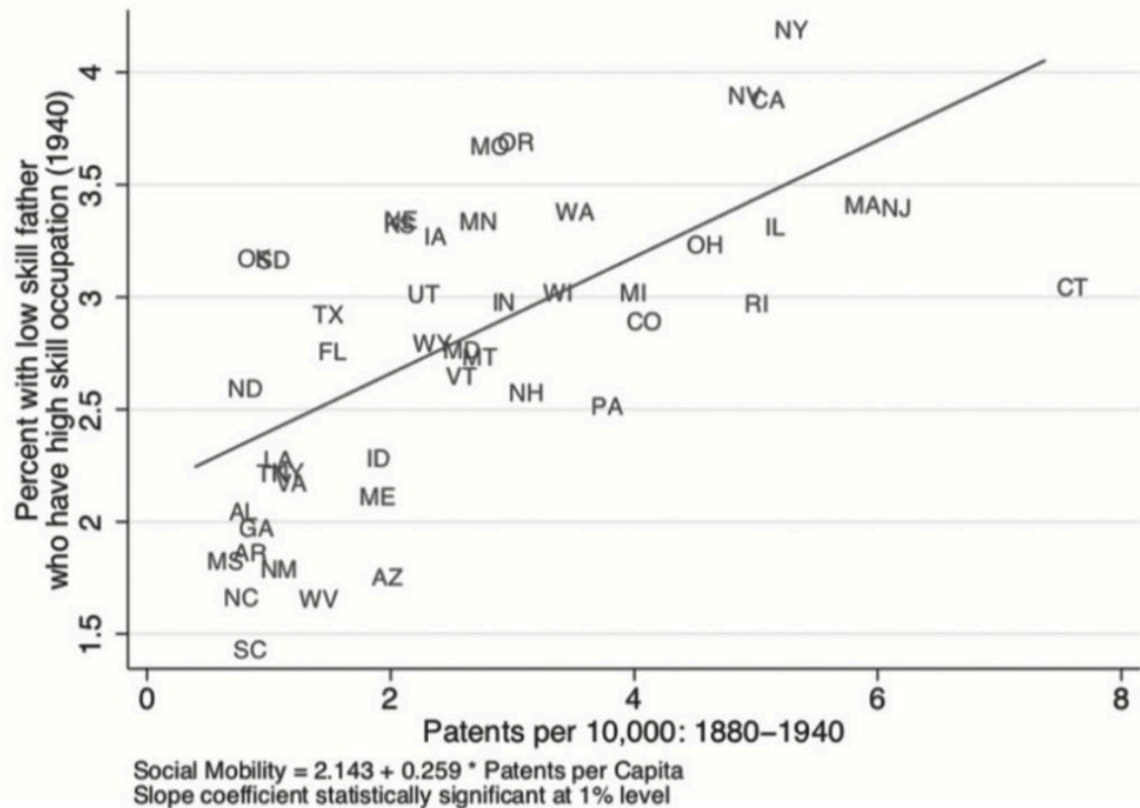
Let's look at the good news first. We owe to Philippe Aghion and his colleagues a remarkable result on innovation. While innovation generates winners and can therefore increase the weight of the top 1%, it can have two positive impacts on inequalities:

(1) the structure of inequalities on the remaining population doesn't change in terms of a global index such as Gini:



Source: Aghion, P., Akcigit, U., Bergeaud, A., blundell, R., & Hemous, D. (2019, January). Innovation and Top Income Inequality. *The Review of Economics Studies, 68*(1), pp. 1-45.

(2) Social mobility tends to increase: à son or a daughter will get a job significantly better than their parents:



Source: Akcigit, U., Grigsby, J., & Nicholas, T. (2017). *The Rise of American Ingenuity: Innovation and Inventors of the Golden Age.* Harvard Business School.

This is an important result, especially in light of the fact that in many countries mobility is a significant issue. In France for instance, it take six generations to reach the median income level when you start from the bottom 10%, as opposed to Danemark for instance, where it takes only two generations.

Now the bad news. This virtuous and theoretical growth based on innovation is not compatible with the excessive "market power" of large companies which take advantage of a competitive framework often no longer suitable. Some striking elements of this evolution:

(1) the top 10% of companies today have a rate of return on capital five times higher than the median rate - this ratio was closer to two 25 years ago,
(2) the top 1% of exporters represent 67% of all exports,
(3) the top 1% of patented firms control 91% of patents, and even 98% of the most useful patents,
(4) the margins of the top 10% of companies have also increased by 35% since the beginning of the 2000s, while they have stagnated for the other companies.

This increasingly extreme concentration should prompt lawmakers to review competition policy in particular, moving from a policy based on prices to a policy based on the capacity to innovate and which therefore encourages the emergence of new entrants and new markets.

These excessive rents that we describe as a sort of “private tax”, levied by private institutions, are not the only ones to create market distortions: externalities also contribute to it and impose damages without compensation on individuals, companies or society as a whole. An example: the cost of manufacturing plastic bags is negligible, but it should logically include the cost of cleaning up the oceans, an externality largely left to future generations.

So the question is: how can externalities be internalized? In particular, how can we better integrate environmental costs? A simple way for the Nobel Prize winner William Nordhaus is to replace the treaties such as the COP 26 with a club, where member countries commit to quantified objectives and a precise timetable, The idea is to encourage nonmember countries to join the club by establishing customs tariffs on all their imports to participating countries, for example a single rate of 5%. Maurice Allais had expressed similar ideas on the issue of social dumping.

In a world where economic convergence is slowing down, such a policy does not constitute primary protectionism, but a restoration of equal opportunity between companies. In any case, it is a better system than lowering the quality of social services to face global competition in a perspective of the Washington consensus, now more and more decried.

Let’s make a very important observation here: all this does not mean that we, rich countries, should ignore the development of the rest of the world: it is in our long-term interests, both economic and geopolitical interests, if not ethical. It is Dani

Rodrik who points out that China's attitude towards intellectual property is not much different from that of the young republic of the United States towards England in the 19th century. And to come back to the existential issue of climate change, should we set the counters to zero and forget that advanced economies have been polluting for much longer than emerging countries?

In short, we are faced with a very difficult equation, perhaps even facing the squaring of the circle, and this comes from the fact that a global optimum is not the juxtaposition of national or local optima. Patrick Pouyanné noted that in the fight against global warming, an investment in India or China has a much higher return than an investment in France. At least, let's not lie to ourselves.

C. How do we improve individual preparedness to crisis?

Crisis often require governments to take swift actions. But acting in an emergency situation can hardly yield efficiency and fairness. More thoughts must therefore be given to imagining anti-crisis mechanisms that better protect individual welfare and dignity, and revamp post-war, sometimes antiquated, welfare systems. A concrete way to shield people from significant personal risks is to replace most existing social benefits by either a universal income, or a universal capital grant, or a combination of both.

Universal income is now widely understood. But universal capital has also been a known concept since at least the 18th century: Thomas Paine for instance proposed that an initial capital be paid by the state to all citizens when they reach the age of majority. Closer to us, John Rawls, James Meade, Bruce Ackerman have all proposed some form of universal capital.

Like classic welfare, both the universal income and the universal capital are directed towards fighting poverty and inequalities. But they have additional important goals: they allow the empowerment of people by effective citizenship and political freedom, in particular by reconciling the citizens with long term political horizons.

There is a fairly large consensus today on universal income, simply because it already exists in many ways, if not formally, at least in the sense of existing social transfers:

for instance, in France, the median income after redistribution has increased by more than 50% over the last 40 years, adjusted for inflation (source : INSEE).

Therefore without additional taxpayer money, we could transform the current welfare system into a new system based on universal income and negative tax rates, that would be much more efficient, as we explain in our book.

Universal capital on the other hand, would be something entirely new that would probably require massive fiscal resources, at least initially. For some people, like Thomas Piketty, there is in fact a great opportunity to kill two birds at the same time: for one, a significant universal capital (he's proposing about 120,000 euros for anyone reaching age 25) would provide every individual with actual, strong capabilities (to reuse the concept coined by Amartya Sen), and second, since its financing would be ensured by large wealth and inheritance taxes, we would also reduce wealth inequalities. So indeed, we would kill two birds at the same time.

But there are significant drawbacks. First, such a plan on such a magnitude would bear an important macroeconomic risk: that is, diverting resources from high return projects to low return ones. Besides, should inequalities be reduced a priori, no matter what? As Thomas Paine puts it: "I care not how affluent some may be, provided that none be miserable in consequence of it."

Therefore the key question for me, when deciding for or against universal capital, is (1) whether universal capital is absolutely necessary (that is nothing else can play its role), and (2), whether it is practically viable.

(1) Is universal capital strictly necessary?

One needs to ask a simple question: what purpose would universal capital serve? Not everybody wants to be or can be an entrepreneur, and if you are an entrepreneur, all what you need if fair access to financing and credit. The market is still a formidable force to decide which projects are viable and how to allocate resources that are rare. It would be a waste not to leverage those skills. Governments still have an essential role in promoting fairness and fixing market flaws, but any economic project not trusted by the market is almost guaranteed to fail.

So while universal capital could be useful, it is hard to imagine situations where it has no substitute. In fact it looks like universal income could cover most needs. At some level, universal income and universal capital are equivalent: any capital can be decomposed into a stream of cash-flows, at least as long as they are guaranteed, arguably a big if. But there would probably be less moral hasard in the way we use universal income: compulsive consumption would certainly be possible in both cases, but it would only be a fatal mistake in the case of universal capital - it is a one off chance.

Based on all this, we have to reject the hypothesis that universal capital is absolutely necessary.

(2) Second question: is universal capital viable from an operational perspective?

Precisely because of the risk of moral hasard, some intellectuals have imagined a tutoring system. But how practical is it to put in place a mentoring program for every eligible young person? Presumably any training would need to continue over a long period of time, clearly making the resource problem very acute, not to mention possible conflicts of interest, mismanagement, fraud, etc. As a society we fail at providing less advantaged people with basic financial training, it is hard to conceive that we would have the skills needed collectively for a much more ambitious goal.

There is also an important, and double, intergenerational problem. First, as we allocate capital for the first time to new generations, how do we compensate previous generations that never received anything? Second, it would be difficult to guarantee a stable level of capital through time in real terms (that is, adjusted for inflation): most likely different economic conditions and different budget bandwidths would imply different levels of capital grants. So there is a fairness problem right there.

In conclusion, what we tried to show in this book, is that synergies are possible between equity and prosperity, and that in many ways equity is today a prerequisite to prosperity - that is certainly the case of climate change, since our very survival depends on how we manage it.