# Inequality and Social Relations

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# Inequalities and Social relations

- Income inequalities have always existed
- The last two centuries have seen
  - a large rise in income per capita in most countries around the world
  - a rise in income inequality across countries (the "Great Divergence")
- The last two decades have seen in rise in within-country income inequality
- There is a rising concern about inequality and its policy implications.
- Economic inequalities can be evaluated based in fairness.
  - But fairness can be inconsistent with economic efficiency
  - Fairness can depend on social relations
- This lecture examines the **linkages between fairness, economic efficiency and social relations, with implications for policy.**

# Inequalities, Fairness and Social relations

- Man is a social animal
  - Society benefits from cooperation among individuals
  - Human ethics and justice: “Treat others as you would like them to treat you”
  - Individuals often reject “sharing contracts” that are “very unequal” (e.g., dividing a cake)
- **Fairness is an important part of socio-economic evaluations**
- Social scientists differ on the importance of inequality and fairness
  - **sociologists and anthropologists** see economics as embedded in social relations
  - **economists** focus on economic efficiency, with a limited role for social relations
- **<u>Fairness</u> can be defined as the <u>absence of envy</u> among individuals**
  - Fairness can be easily integrated with economic efficiency
- But efficiency and fairness can be **inconsistent** with each other
  - There exist **tradeoffs between efficiency and fairness** (Pazner and Schmeidler)

# Inequalities and market economies

- How important is fairness?
- Puzzle #1: **Fairness issues do not seem very important in market exchange**
- In a globalized world, **market exchange** often takes place between producers and consumers in different locations and different socio-economic groups
- Fairness is about distribution (and not about exchange)
- Does this mean that fairness is not important in market economies?
  - **No.** It means that non-market institutions are crucial in addressing fairness issues
- The challenge: **How to analyze and manage fairness and inequality issues in market economies**?

# Fairness and social relations

- Puzzle #2: **Fairness concerns can vary in different groups or different societies**
- Fairness evaluations requires information about the socio-economic situations of different individuals
  - This information depends on social structure
- **Fairness evaluations depend on social structure**
- Fairness concerns are better expressed within social networks
  - Examples: the family, the state
- Fairness concerns are less relevant outside of social networks
  - Example: market exchange among individuals in different social networks
  - Can explain why fairness is not very important in market exchange
- The challenge: **How to analyze fairness under different social structures**?

# Fairness, efficiency and social structure

- Efficiency: allocations are efficient if they **maximize the aggregate benefit** of society
- Fairness: allocations are fair if they support "**no envy**" among all individuals
  - "no envy" constraints can be easily introduced in economics and efficiency analysis
- Fairness evaluation depends on social structure
- Social relations among individuals can be measured by their "social distance"
  - Social distance is "small" among individuals belonging to the same social network
  - Social distance is "large" among individuals in different social networks
- Social distance can be introduced in fairness evaluations (where fairness is defined as "no envy")
  - Fairness concerns are more (less) likely to arise within (outside) social networks
- **Efficiency, fairness and social structure can be analyzed in an integrated framework**

# Integrating fairness, efficiency and social structure

- **Integrating fairness and efficiency**
  - Introduce "no envy" constraints in the maximization of aggregate benefit
  - Efficiency and fairness are **consistent** when these constraints are not binding
    - in this case, fairness implies **no efficiency loss**
  - Efficiency and fairness are **inconsistent** when some of these constraints are binding
    - in this case, fairness implies an **efficiency loss** (Pazner and Schmeidler)
    - this **efficiency loss** can be measured by the associated reduction in aggregate benefit
- **Integrating fairness, efficiency and social structure**
  - Introduce social distance in the evaluation of fairness and efficiency
  - Efficiency and fairness are **likely to be consistent** when social distances are "large"
  - Efficiency and fairness are **more likely to inconsistent** when social distances are "small"

# Fairness and the rise of the state

- The **family** has been a corner stone of all human societies
  - Fairness and redistribution schemes are extensive within the family
  - Example: no children would survive under selfish parents
- The role of the **state** has risen over the last few centuries
  - The state has been associated with a “social contract” among individuals
  - The rise of the state has reduced social distances and stimulated fairness evaluations
  - The rise of the state has been associated with
    - economic development and globalization
    - a rise in capital accumulation (both physical and human capital)
    - income redistribution policies
- This raises several questions:
  - What is the **role of the state in economic development? in redistributing income**?
  - How **can the state manage fairness concerns in a global economy**?

# The process of economic development

- Economic growth comes from two main sources:
  - capital accumulation
  - productivity growth
- Capital accumulation comes from investments in
  - physical capital
  - human capital (education)
- Productivity growth comes from
  - Innovations and t**echnological progress**, stimulated by investments in R&D and education
  - Improvements in efficiency (from technology adoption, training, trade, …)
- Income inequality can affect economic growth
  - by affecting capital accumulation
  - by affecting productivity growth

# Inequality and economic development

- Income inequality can affect **capital accumulation**
  - The effects are positive when rich people invest relatively more
  - The effects are negative when poor people invest relatively less
  - Which effects dominate? This is an empirical issue...
    - There are concerns that income inequality has significant adverse effects on human capital and labor productivity
- Income inequality can affect **productivity growth**
  - Income inequality can have adverse impacts on education and human capital
  - This can imply
    - Less innovation
    - Lower labor productivity
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# Social relations and economic development

- Social relations can affect **capital accumulation**
  - The effects are positive when cooperation stimulates investments
  - The effects are negative when conflicts reduce physical and human capital
  - Which effects dominate? This is an empirical issue...
    - There are concerns that income inequality has significant adverse effects on human capital and labor productivity
- Social relations can affect **productivity growth**
  - Social networks can stimulate inventions and innovations
  - Social networks can help “social learning”, stimulating
    - Technology adoption (over time)
    - Technology transfer (across space)
    - Social learning is an important part of innovations and productivity growth

# Fairness and economic policy

- Economic inequality depends on redistribution schemes
- Income redistribution can be motivated by fairness concerns
  - Fairness concerns can motivate redistribution from “the rich” to “the poor”
- Redistributions occur
  - Within the family (e.g., remittances)
  - Within the state: role of economic policy
  - Across states: international aid
- Redistribution and economic policies
  - Progressive taxes
  - Disaster assistance
  - Welfare programs targeted toward the poor
  - In these cases, economic policies redistribute income from “the rich” toward “the poor”

# Redistribution policies in market economies

- Market exchanges are not motivated by fairness considerations
  - Fairness issues are managed through non-market institutions
- How do economic redistribution policies interact with markets?
- In market economies,
  - individual income is determined by markets (e.g., in the labor market)
  - Fairness can be managed by redistributing individual purchasing power
  - Redistributing purchasing power can be done through nonlinear pricing and targeting
    - Tax policy: Tax rate increases with individual income
    - Food stamps: Food subsidies for low-income individuals below the “poverty line”
    - Price floor policies: e.g., minimum wage policy
    - Welfare payments targeted toward low-income individuals
- **Nonlinear pricing and targeting** are important parts of income redistribution policies that can help support **fair allocations**
  - Redistribution policies require effective state institutions and good information about income distribution

# Inequality and fairness in global society

- Globalization has been associated with lower information costs
- **Lower information costs have reduced "social distances",** thus stimulating
  - the role of fairness in society (e.g., NGO's using the internet for fundraising)
  - the implementation of redistribution policies in developed countries (but less in developing countries where state institutions are weaker)
- But social networks work in complex ways
  - Social networks can help spread any kind of information
    - Social media can stimulate "us versus them" views
  - This can contribute to
    - reducing the role of fairness in policymaking (e.g., immigration)
    - reducing support for income redistribution policies (e.g., welfare programs)
- This stresses **important interactions between social relations and economics**

# Some key challenges

- Economic policies are motived by both economic (economic growth, efficiency) and fairness considerations
- There are important interactions between social relations and economics
- Fairness considerations
  - depend on social relations
  - can affect economic efficiency
  - evolve over time and across countries
  - affect redistribution policies
- Some **key challenges** remain:
  - The definition of "poverty lines" in the design of redistribution policies
  - The assessment of "within country" versus "across countries" inequality
  - The role of information in fairness perceptions
  - The effectiveness of state institutions in dealing with inequality issues

Thank you!