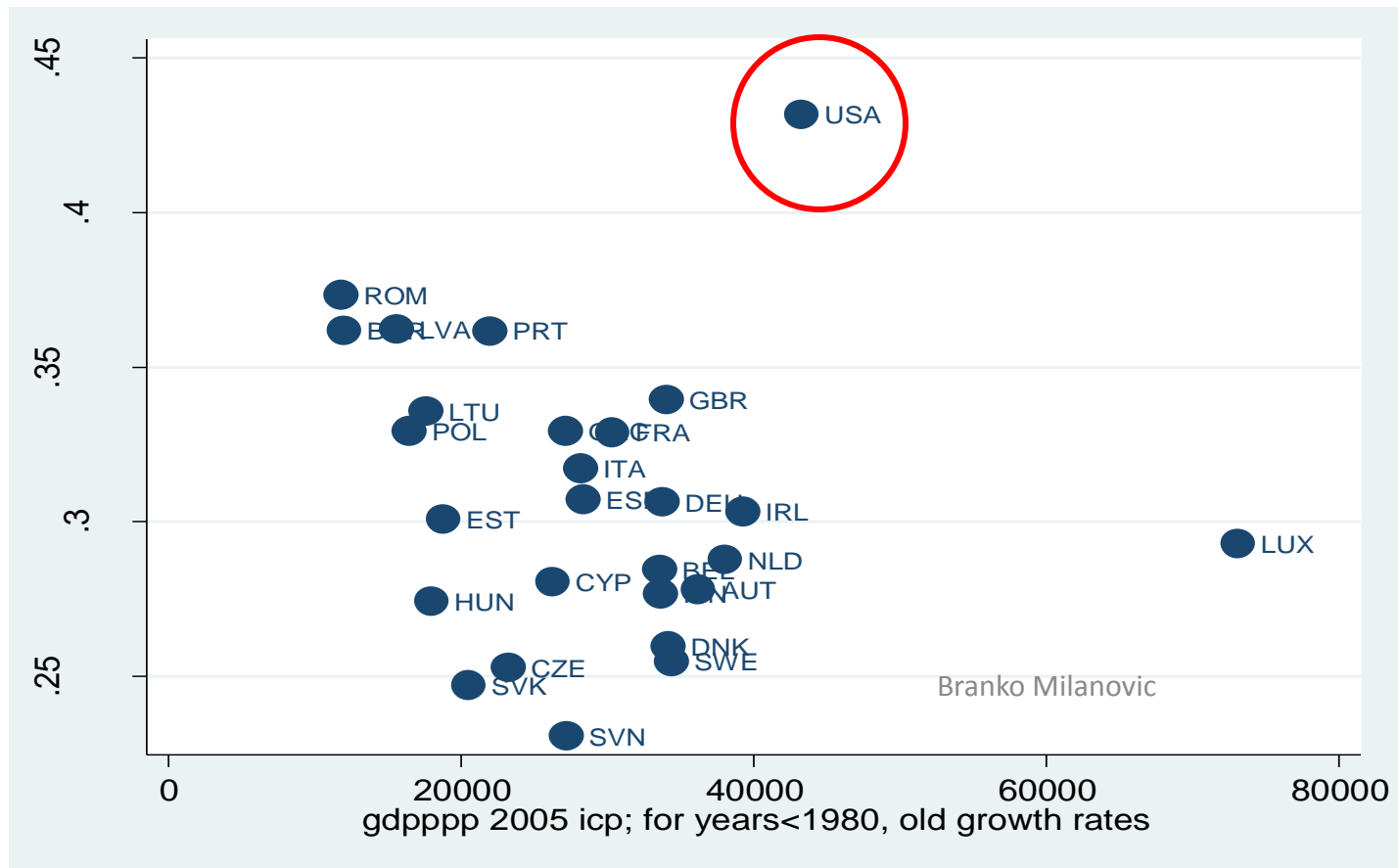


# Does economic inequality sets the limits to EU expansion?

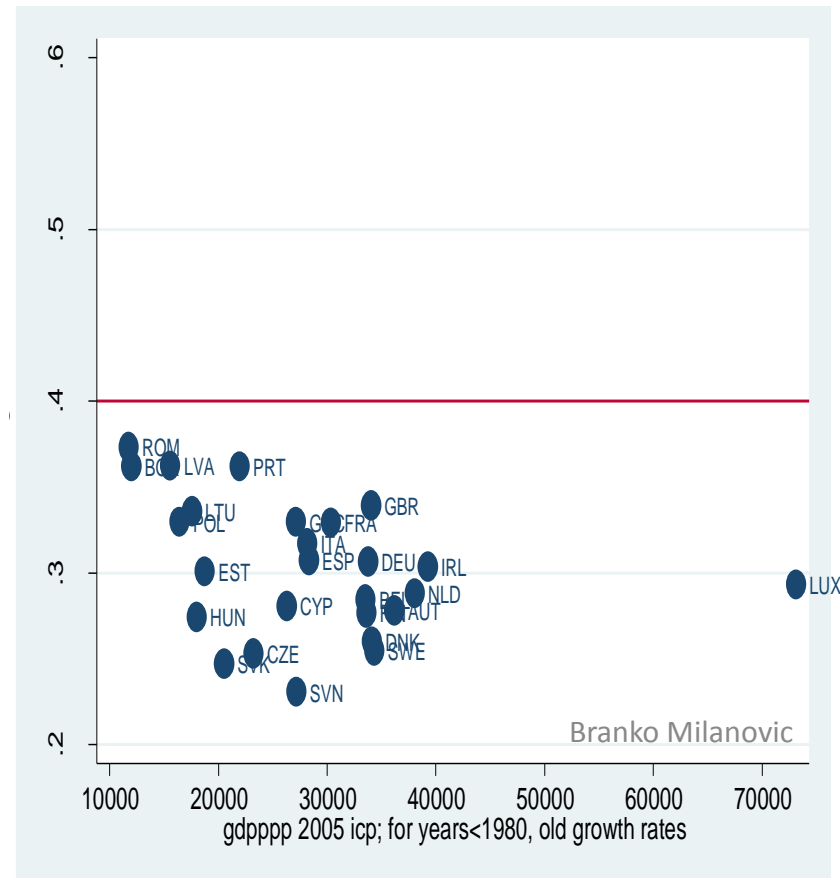
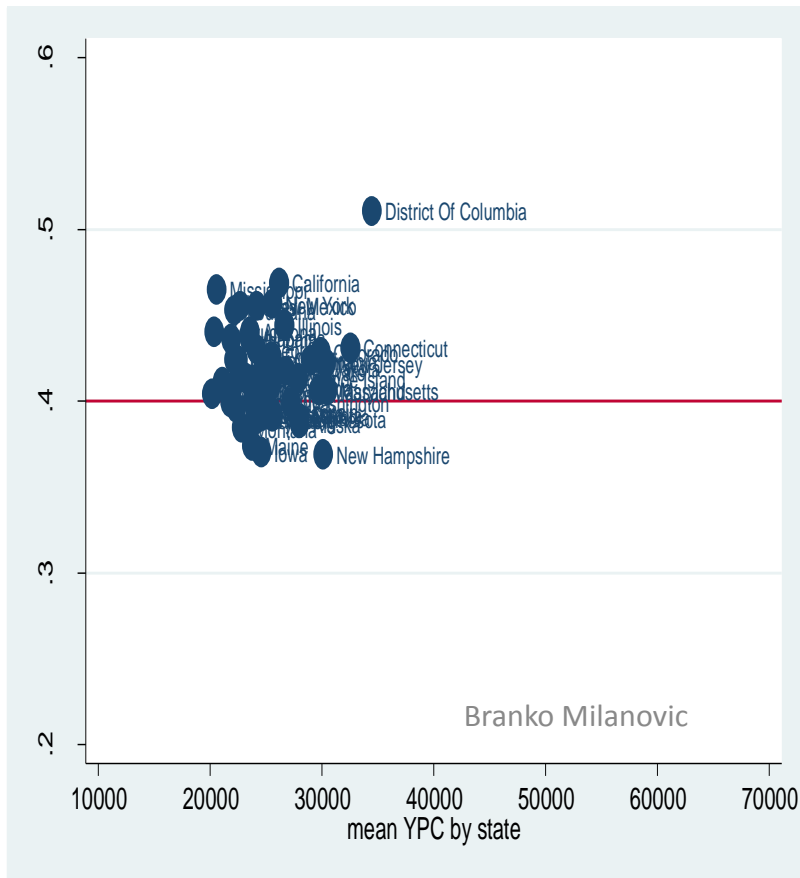
Branko Milanovic  
Conference on Sovereign Insolvency  
Opatija, Croatia  
November 9-10, 2012

Based on B. Milanovic, *The haves and the have-nots: A short and idiosyncratic history of global inequality*, Basic Books, 2011

# The standard view of EU and the United States: US is much more unequal



# US states and EU members in two pictures: what area is more homogeneous and/or more equal?



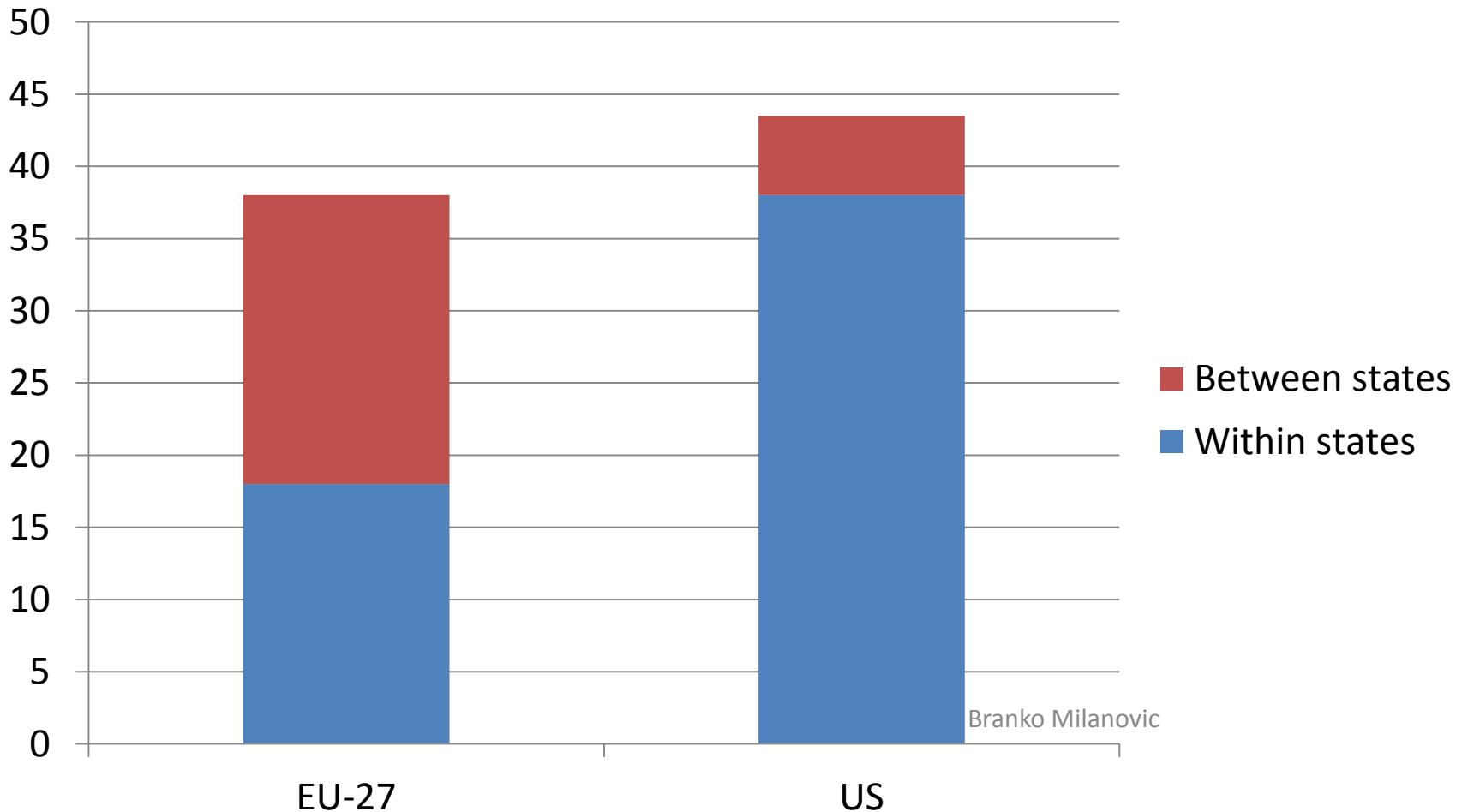
For US: twoway scatter gini\_state mean\_state\_income if nvals==1, msize(vlarge) mlabel(gestcen) ylabel(0.2(0.1)0.6) xlabel(10000(10000)70000) yline(0.4); cpsmar08.dta

For EU: twoway scatter gini\_gdpppp if group==1 & EU==1, msize(vlarge) mlabel(contcod) ylabel(0.2(0.1)0.6) xlabel(10000(10000)70000) yline(0.4); final08.dta

# Two types of inequalities

- The American: all constituent units are unequal internally, but the differences in their mean incomes are small
- The European: constituent units are equal internally, but mean income differences between them are large
- In the American type, poverty is an individual attribute; in the European type, poverty is a collective attribute
- Policies must be different too: pro-poor in one case, “regional cohesion” in the other

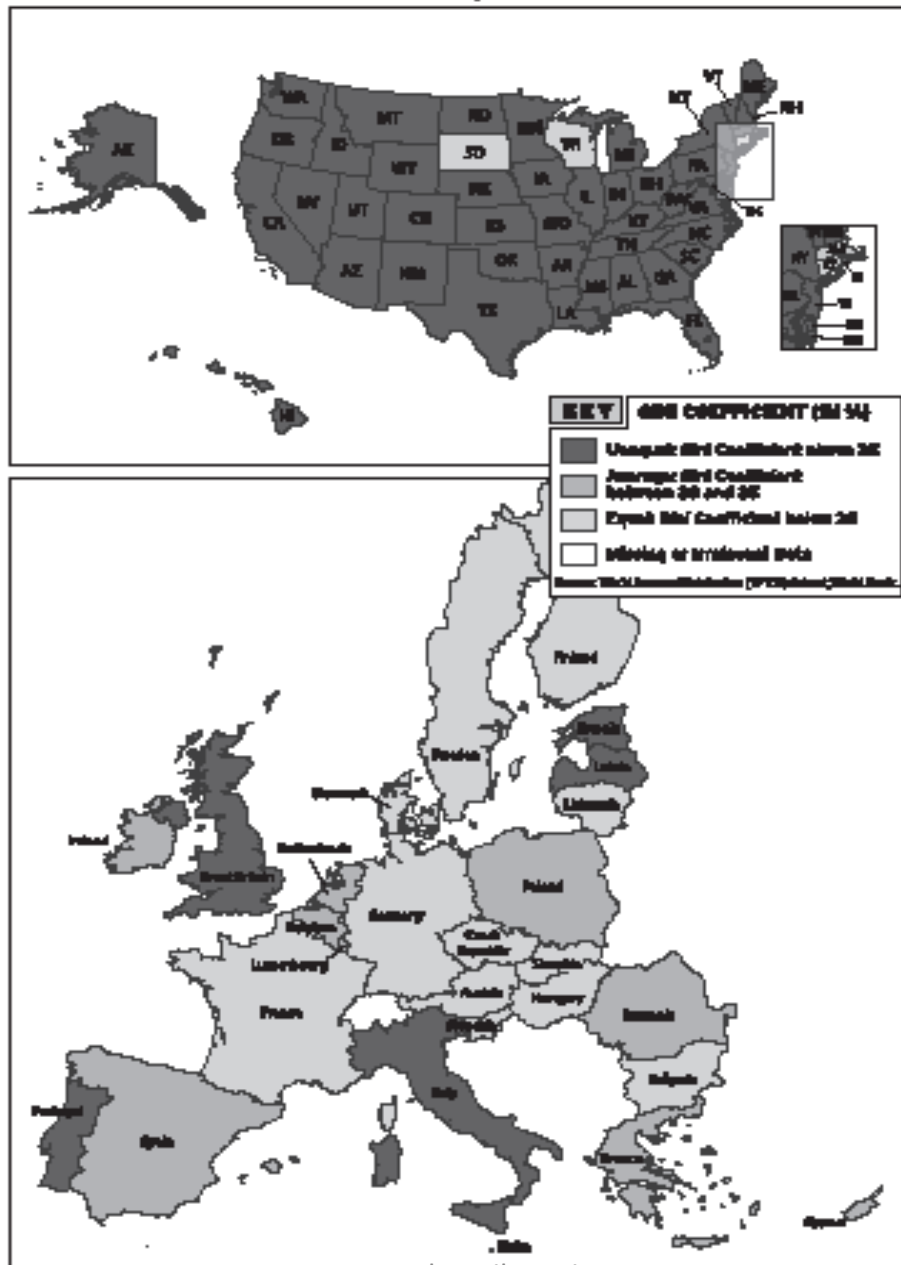
# The unconventional view of EU and US inequality : Gini decomposition



# Inequality in the United States and European Union constituent units (Gini points, around 2005)

|                | Most equal                                | Average                        | Most unequal                    |
|----------------|---|--------------------------------|---------------------------------|
| United States  | <b>34</b><br>(South Dakota;<br>Wisconsin) | <b>39</b><br>(Delaware; Idaho) | <b>45</b><br>(Texas; Tennessee) |
| European Union | <b>24</b><br>(Hungary;<br>Denmark)        | <b>31</b><br>(Netherlands)     | <b>38</b><br>(UK; Portugal)     |
| Difference     | <b>10</b> points                          | <b>8</b> points                | <b>7</b> points                 |

# INCOME INEQUALITY IN THE UNITED STATES AND EUROPEAN UNION, AROUND 2008



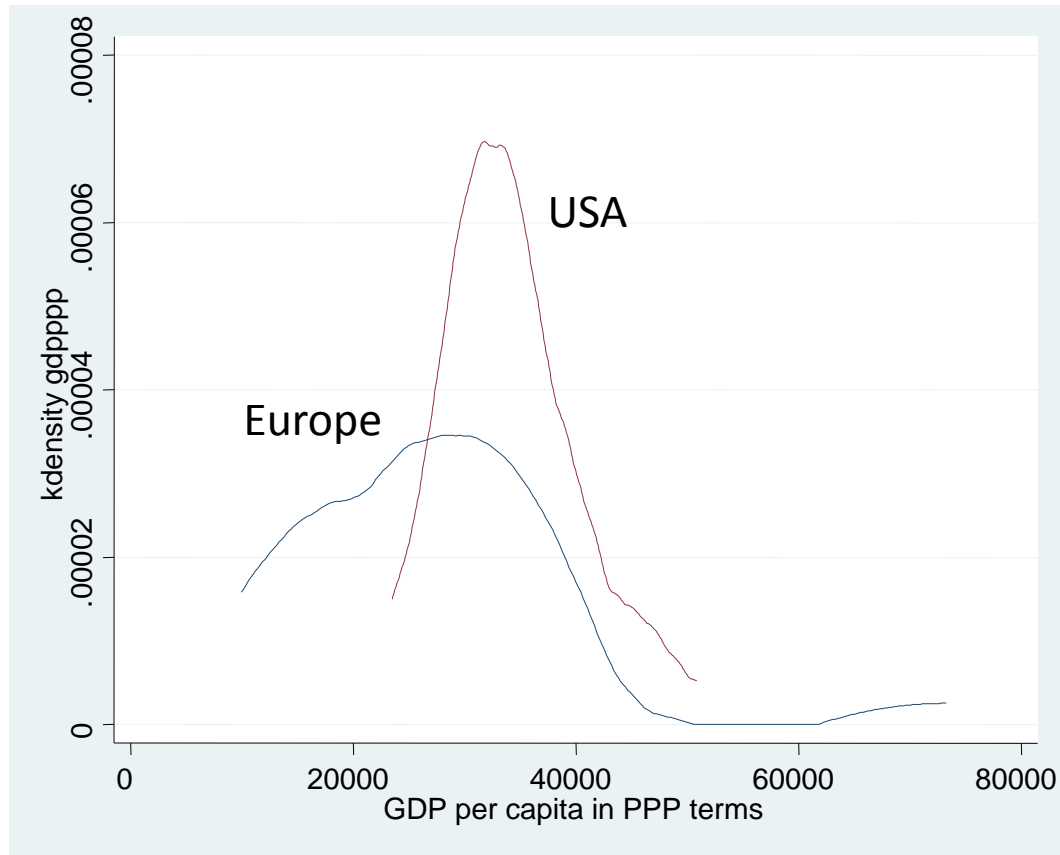
From *The Haves and Have-Nots*,  
Basic Books, 2010,  
Vignette 3.3.

# GDP per capita differences in the United States and European Union, around 2005

|                | Poorest                               | Average                  | Richest                           | Ratio top to bottom |
|----------------|---------------------------------------|--------------------------|-----------------------------------|---------------------|
| United States  | 66<br>(Mississippi;<br>West Virginia) | 100<br>(Rhode Island)    | 137<br>(Connecticut;<br>Delaware) | 2 to 1              |
| European Union | 36<br>(Bulgaria;<br>Romania)          | 100<br>(Spain)           | 140<br>(Netherlands)              | 4 to 1              |
| Difference     | -30 points                            | 0 points (by definition) | +3 points                         |                     |

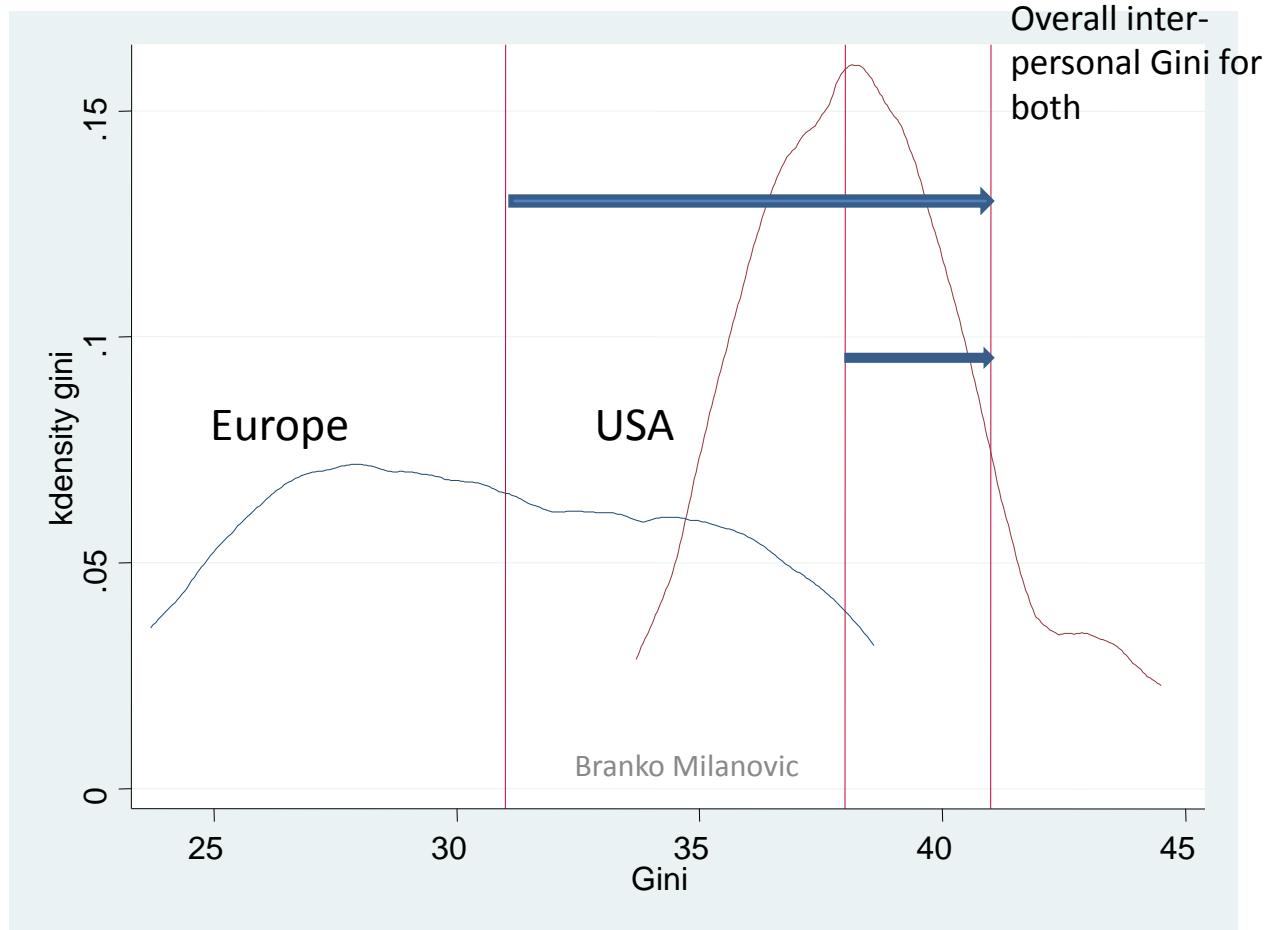


# GDP per capita in countries of the European Union and states of the USA (unweighted)



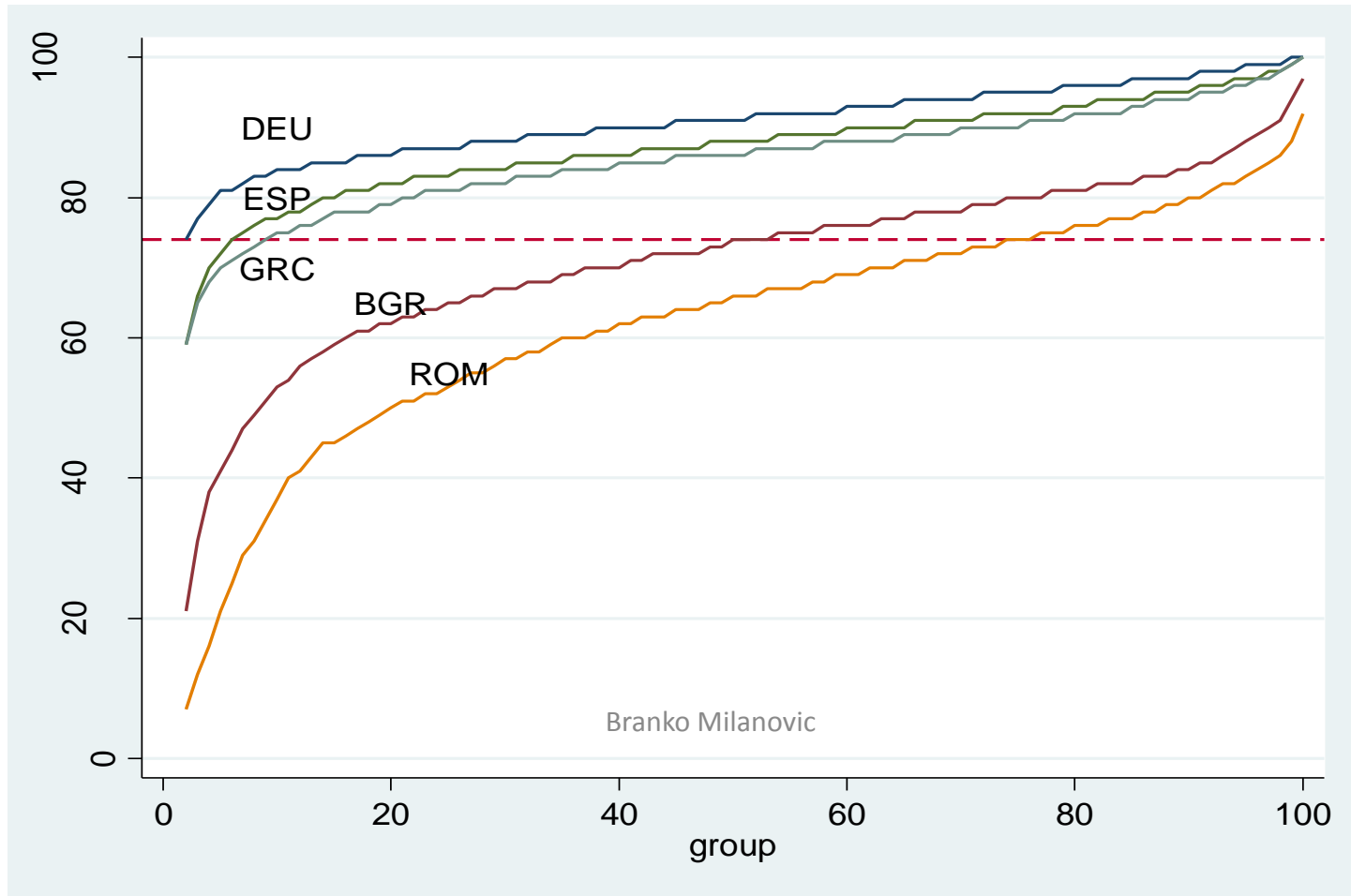
```
twoway (kdensity gdp PPP if Deurope_inc==1) (kdensity gdp PPP if Deurope_inc==0, legend(off) xtitle(GDP per capita in PPP terms))  
Using sources\US_EU\US_vs_EU.dta
```

# Ginis in countries of the European Union and states of the USA



```
. twoway (kdensity gini if Deurope==1) (kdensity gini if Deurope==0, legend(off) xtitle((Gini) xline(31 38) xline(41, lwidth(thick)))  
Using US_vs_EU.dta in c:\perseus\sources
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# Heterogeneity of the European Union

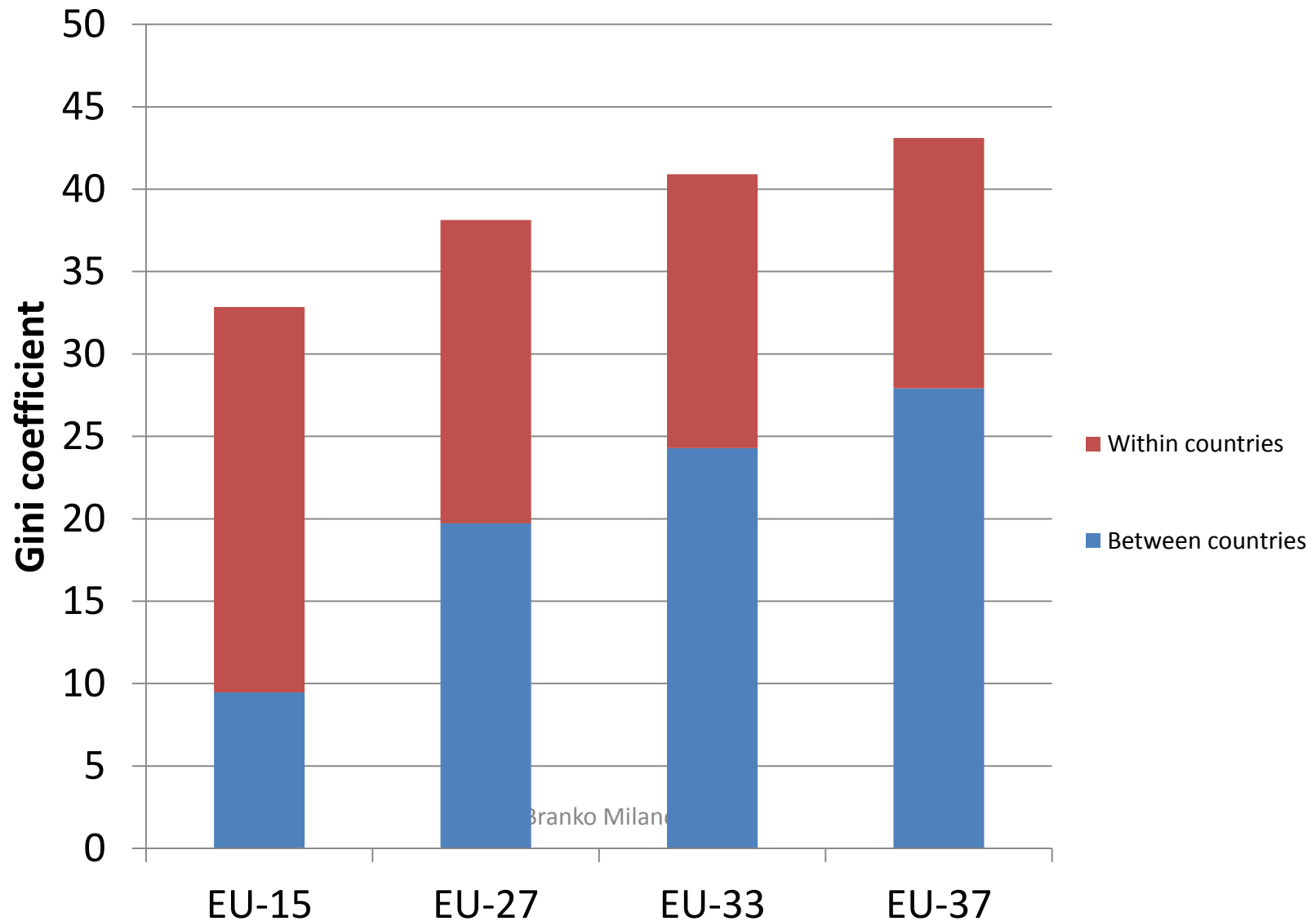


## Between-unit and total inequality in selected countries, around year 2005

|                                     | <b>Between-states or countries</b> | <b>Total (between individuals)</b> | <b>Share of inter-state inequality in total (%)</b> |
|-------------------------------------|------------------------------------|------------------------------------|---|
| USA (50 states)                     | 6                                  | 40+                                | ~15   |
| EU-15 countries (pre-enlargement)   | 10.2                               | 33.4                               | 30  |
| EU-27 (post enlargement)            | 23.1                               | 40.3                               | 57  |
| China (29 provinces)                | 24                                 | 40+                                | ~60   |
| EU-34 (all of Europe, incl. Turkey) | 30.1                               | 44.8                               | 67  |

EU data calculated from world2002.dta US from the same source:

# The inequality “costs” of EU expansion



# Pan-European convergence was driven by three factors:

- Economic integration: poorer countries grow faster because they benefit more from the transfer of K and technological integration (so-called  $\beta$  convergence).
- Political integration: safer and more advanced institutional environment.
- Redistribution.

# Integration and redistribution

- Political integration (measured by the number of Article 177 cases and number of EU directives) at least as important as economic integration for both EU-6 and EU-15 (Jason Backfield, 2012).
- EU direct redistribution was always minimal: EU cohesion and CAP funds less than 1% of Union GDP (compare with 20-25% of GDP of social transfers in federations like Germany)

# The European conundrum

- If EU expands further, it would bring in countries more dissimilar in terms of income, and inter-country as well as inter-personal inequality will increase
- For such a Union to be politically sustainable and cohesive, both types of inequalities need to be reduced
- But if political integration does not advance and redistribution remains minimal, the key factors that have historically enabled convergence will be missing



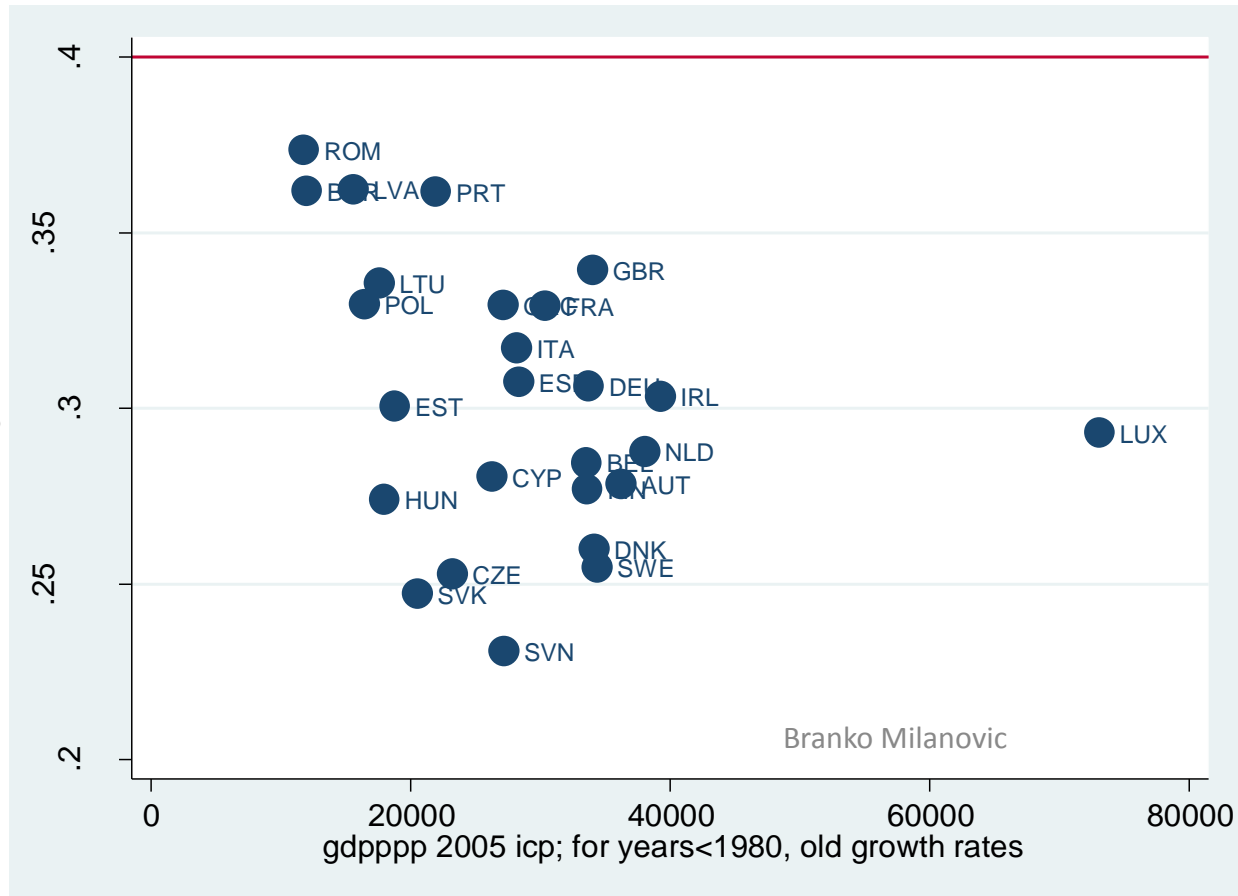
- Then, convergence will have to depend on economic factors alone which, as the example of NAFTA shows, may not be enough
- If the EU expands then it must, for its viability, move forward in terms of political integration
- If there is no political will for integration, then there is no sense in including poorer countries because membership would not bring income convergence and would tear apart the Union.

# Extras

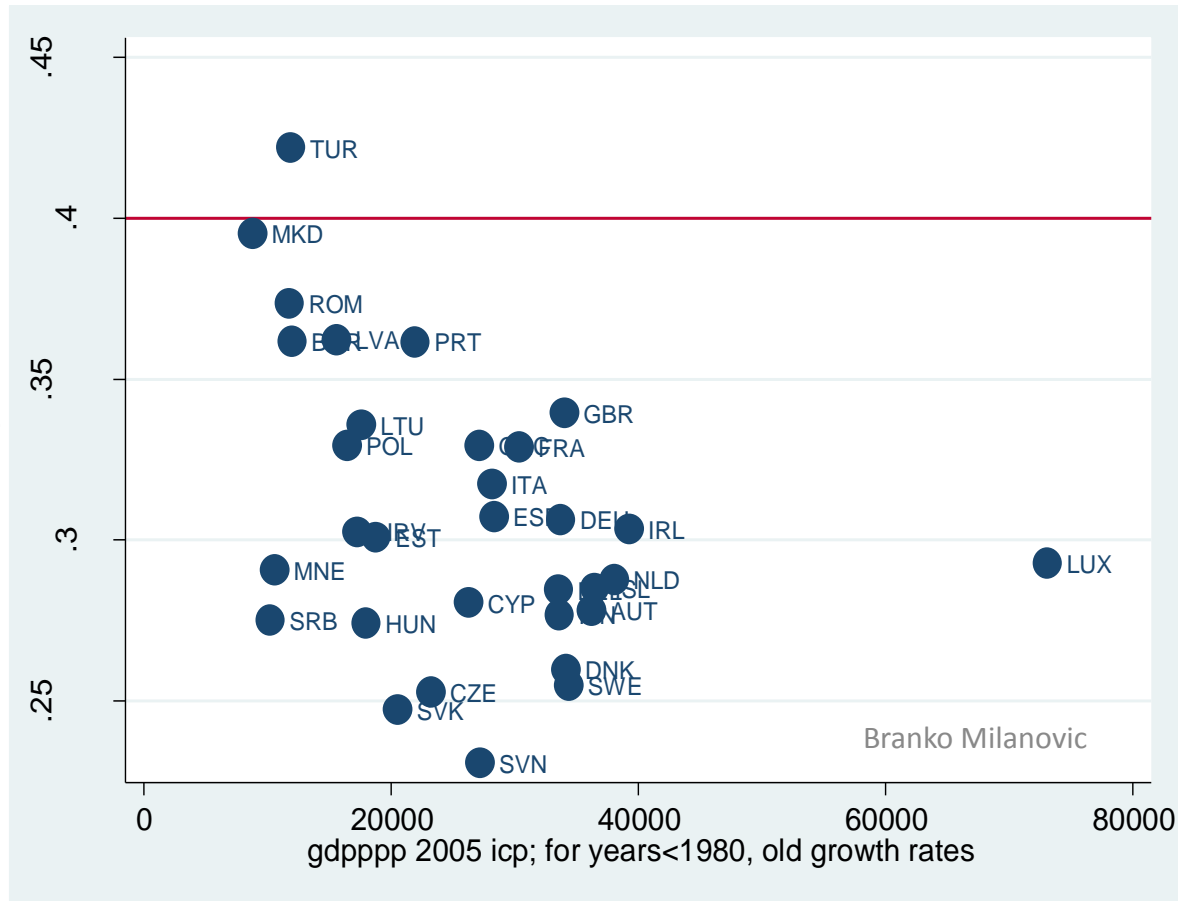
# Implications and questions

- How far can EU's expansion continue?
- With the last 2 expansions, EU has moved away from an American type of inequality
- With Turkey, EU's Gini would come close to 45, so Europe would come to resemble Latin America: does this set a limit to EU expansion?
- China has a similar structure of inequality like Europe
- Such huge inter-national differences in mean incomes set also a limit to a possible political unity of Asia (leaving even aside the two giants): Asia is by far the most income heterogeneous continent

# European Union (EU-27), SILC 2008



# EU-33 (EU-27 + Croatia + 5 candidate countries)



Notice how strongly Gini decreases with GDP per capita

# United States, CPS 2008

