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A MORAL RESPONSE TO INCREASING INCOME INEQUALITY:

SETTING UP A VOLUNTARY SOLIDARITY FUND

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Introduction

“One needs not be altruistic to support policies that will improve the income of poor and middle classes. Everyone will win because these policies are essential to make possible a more vigorous, supportive and sustainable economic growth” (Lagarde, 2015).

This is how Christine Lagarde, Managing Director of the International Monetary Fund, addressed the issue of rising income inequality in her speech on 17 June 2015 during *les Grandes Conférences Catholiques* in Brussels. Increasing income inequality has become a phenomenon of widespread concern as it has worsened within most advanced, emerging and developing countries. It has recently received considerable attention from academics, politicians and economists. It is no mere accident that various international organisations such as the IMF and OECD have been increasingly vociferous about the negative effects of increasing income inequality during a period of subdued economic growth. President Obama called widening inequality the “defining challenge of our time”. World Economic Forum members identified worsening income inequality as being the top issue that will have the largest impact on the world in the next year.

As the world’s wealthiest continue to accumulate wealth at record rates, the middle class is struggling. Over the last 25 years, the average income of the top 0.1% in the U.S. has grown 20 times compared to that of the average citizen (World Economic Forum, 2015.) Latest data suggest that the top 10% of the population in OECD countries have an average income of around 9.5 times that of the bottom 10%. In the 1980s, this ratio was 7 to 1 which implies a worsening by more than 30% in the income gap between these two groups. The Gini coefficient, as will be discussed below, is the most widely accepted measure of developments in a country’s income distribution. It takes into account the whole spectrum

of income groups, and the coefficient ranges from a minimum of 0 to a maximum of 1.¹ The closer the coefficient is to 1, the more unequal is the income distribution of a population in a particular country. A recent study among the OECD group of 34 mostly advanced countries shows that in the mid-1980s, the Gini coefficient was at 0.29, on average. However, by 2011-12, it had risen by 3 points to 0.32 or 10% (Cingano, 2014). This reflects a significant worsening in how income is distributed, on average, within the membership of OECD countries – a group of countries that in general have reached a more advanced economic capacity to produce goods and services.

While in advanced economies, the gap between the rich and poor is at its highest level in decades, inequality trends have been more mixed in emerging markets and developing countries. Although a few countries in this category experienced declining inequality, most of this group have pervasive inequities in access to education, health care, and finance. Indeed, the Gini coefficients of a number of developing and emerging economies, such as India and China, have a coefficient that is around the 0.5 level – much higher than the average of the OECD. (See Chart 6 in Annex 1) Not surprisingly then, the extent of developments in income inequality, its drivers, and the possible measures to reduce it have become some of the most debated issues by policymakers and researchers alike.

It is fair to note that until not so long ago, the prevalent opinion in the economics profession was that rising economic development would benefit everybody. “Growth is a rising tide that lifts all boats.” (Kuznets, 1955). Such optimism seemed for a while to be supported by the significant economic growth that took place in the post-World War II period until the mid-1970s and early 1980s and the apparent improvement in the distribution of income and reduction in income inequality. However, various developments, both political and economic in nature, and improved data measurement capacity in recent years, have increasingly indicated that the previous paradigm suffered from a false optimism given actual developments in income distribution in many countries. In fact, the overwhelming evidence points to a worsening situation since the early 1980s, with income inequality increasing and threatening the well-being of society.

Growing income inequality is negatively affecting growth by depriving the ability of middle and lower income families to accumulate physical and human capital. Inequality of opportunity is at the core of social injustice that has dragged an increasing number of

¹ The Gini coefficient is derived from the Lorenz Curve that plots the cumulative percentage of total disposable income against the cumulative percentage of the corresponding population, ranked in increasing size of share. It thus provides information how income after tax and social security benefits or contributions is distributed across the population ranked by income size. Typically, the lower income groups have a lower share of national income, while the higher income groups have a higher share. This makes the Lorenz curve sag below the 45-degree line that represents equal shares of income for equal percentages of households. The degree of sag is measured by the Gini coefficient that ranges from 0 to 1. The bigger the Gini coefficient and hence the higher the sag of the curve becomes, the bigger the share that is going to higher income groups and the lower the share that is going to lower income groups. The distribution of disposable income is then said to become more unequal.

families towards the brink of poverty. The orientation of the market towards the common good has been deficient, and the financial crisis has worsened the situation as millions were thrown out of work and out of their homes, and now we have empty homes and millions of unemployed homeless people. This situation embodies the inefficient allocation of resources and the disutility of increased inequality.

In view of this disconcerting reality of social injustice and unequal opportunity, there is a moral obligation to react. It is not enough to expect somebody else to take care of this worsening inequity, or perhaps hope for some new technological development to somehow lift everybody's standard of living, irrespective of distributional issues. Increased income inequality is currently affecting the quality of human life within the society that we live in and, if ignored, can develop into a degeneration of our very societies. In essence, I will argue that more can be done to tackle and diffuse this increasing malady. Furthermore, our reaction should be based on the conviction that the marginalised can be empowered to improve their skills and to be given the opportunity to participate in the economy and live a fulfilling life with dignity.

Against this background, the objectives of this paper are three-fold. First, I evaluate the recent trends in increasing income inequality, using different sources to demonstrate its extent and progression. The effects of increasing income inequality on growth and productivity are examined, in line with the theoretical literature on the subject.

Second, the question is raised as to what is the responsibility of individuals who are better off. What are the moral and ethical issues that are derived from Catholic Social Teaching? In answering this question, the proposal is made to set up a Voluntary Solidarity Fund (VSF) as a way to address, in a practical way, the impact of increasing income inequality and low productivity growth that is so evident in many countries and regions. It is suggested that there is much that can be done, especially by those in the upper middle and higher income groups, in alleviating the situation of those who are less fortunate and struggling to keep their heads above water. This is a proposal that advocates solidarity in practice.

Drawing from the parable of the talents, the vast amount of money or liquidity that is sitting idle in the current economic environment corresponds to an unused 'talent' buried underground - in the present context, in bank accounts or even safety deposit boxes - and which through the VSF initiative could be utilised to empower people and give them the opportunity to develop themselves and 'become better fishermen'. This could be done through various methods. Contributions can be channelled in a number of ways, leading to the deployment of financial resources that promote both individual and social development. This perspective is also inspired from the parable of the talents as we are expected to make good use of our talents in a way that they can multiply. The VSF can adopt this evangelical message for a social purpose. It would complement the actions and efforts of the Church

and other associations such as Caritas that are inspired more by charity than by an economic and financial logic. It would also demonstrate the ethical dimension of the financial sector and that financial tools and resources can be the spring of a noble act.

The VSF is envisaged as a concrete reaction, serving as a vehicle to mobilise financial resources to combat increasing income inequality and low productivity growth so as to provide sustainable economic opportunities. The VSF would fill the gap between the traditional charitable giving and the more recent emergence of foundation-based donations. In terms of target beneficiaries, the VSF would be focused on being a catalyst in the empowerment of vulnerable segments of our society.

The third section deals with the implementation and governance of such a fund and presents a number of proposals on how the VSF can operate over various programmes in the short and medium to long term. Its purpose is to complement existing structures and utilise resources, both human and financial, in a better way.

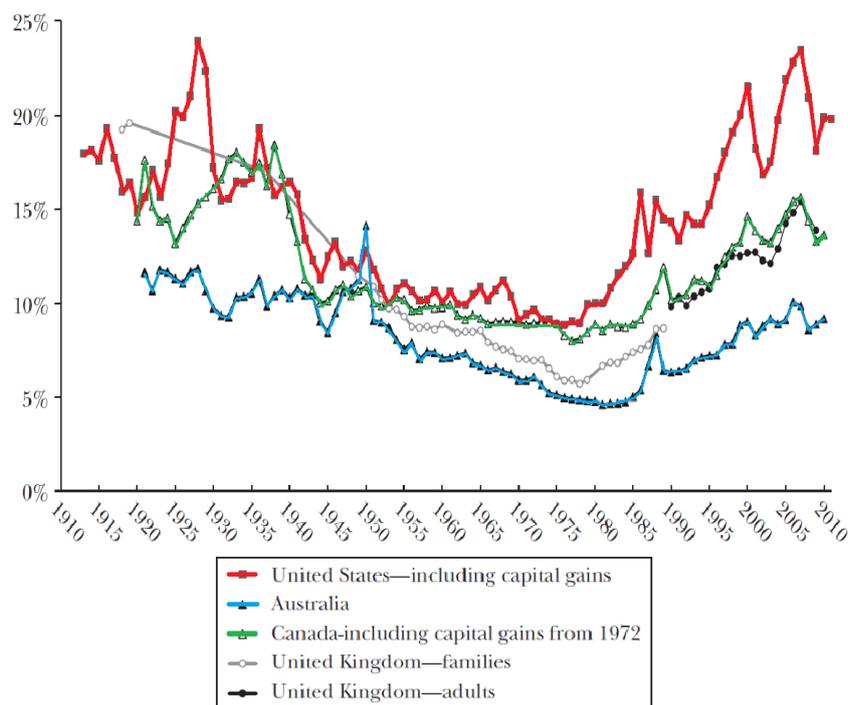
1. Empirical findings of rising income inequality

1.1 Trends leading to growing disparities

According to the renowned Kuznets hypothesis, income inequality should acquire an inverse-U shape along with technological progress, first increasing with industrial development and then declining, as employment in the high technological sectors of the economy increases (Kuznets, 1955). This theory formed the basis of a widely accepted paradigm that predicted that economic development would eventually trickle down to all parts of society. The Kuznets curve has been questioned, especially in the United States, where initially inequality decreased during the first half of the twentieth century, but then rose again from the 1970s onwards.

Chart 1 measures the share of national income of the top 1% income group on the vertical axis, during the twentieth and early-twenty-first centuries. The red line depicts the Kuznets curve for the US, where the share of the top 1% increased from around 15% in 1915 to almost 25% in 1930 and then fell to around 10% by 1970 – giving a kind of inverse U curve. However, from around 1980 onwards, the share of the top 1% has been on an upward path once more, reaching levels of 25% as in 1930 - indicating a worsening income distribution. Other countries shown in the chart also depict similar behaviour – if perhaps to lower levels than the US.

Chart 1: Top 1 percent income shares in English-speaking countries (U Shape)



Source: *Facundo, Atkinson, Piketty and Saez (2013)*

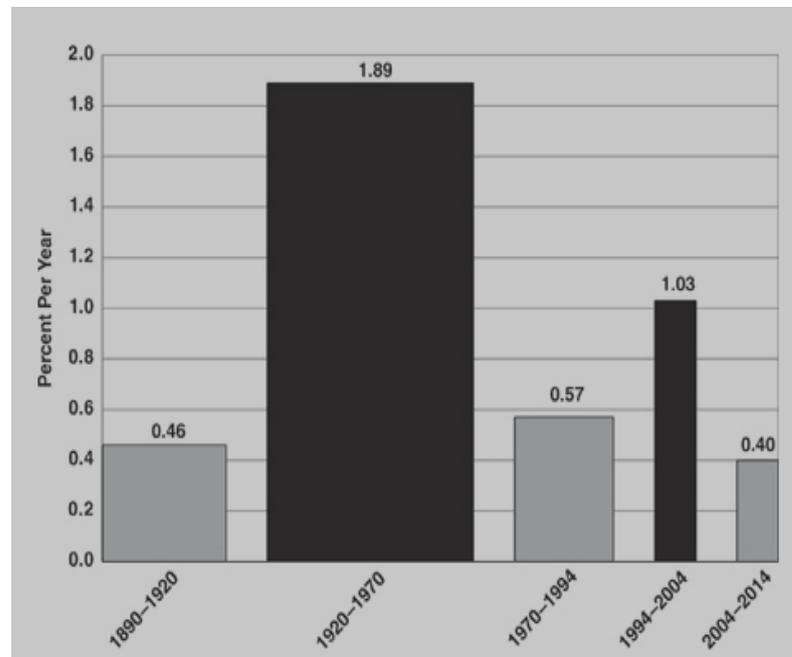
This finding of a trend to increased income inequality is also corroborated by one of the latest empirical studies of the OECD on increasing income inequality confirming that in three fourths of OECD countries, the top 10% household incomes grew faster than those of the poorest 10% over the 20 to 25 years preceding the global financial crisis, causing a broadening of income inequality (Cingano, 2014). This does not necessarily invalidate the Kuznets' hypothesis. It is relevant to question whether since the 1970s a new industrial revolution has occurred, and the latter represents a new hypothesised inverse-U curve with first, increasing inequality, and then, eventually inequality decreasing again at some point, as more workers join the high productivity economic sectors (Piketty and Saez, 2003).

However, such an explanation would rely on the premise that there is currently a new industrial or economic revolution taking place that will eventually lift the incomes of those currently falling behind. The evidence of such an occurrence is, unfortunately, lacking.

Robert J. Gordon examines this aspect in a historical framework and provides a thorough assessment of current and likely future developments. In his wide-ranging study of US productivity developments published in 2016, he identifies three industrial revolutions that shaped the modern world (Gordon, 2015, 2016). In each case Total Factor Productivity growth (or TFP which is a measure of how quickly output is growing relative to the growth of labour and capital inputs) reflects the gains achieved due to technological progress. For example, the first light grey bar in Chart 2 reflects the gains in TFP during the 1890-1920

period from the industrial revolution of the mid 1800s, resulting from the introduction of steam engines, railroads, steamships and the transition from wood to metal.

Chart 2: Annualised growth rates of Total Factor Productivity, 1890 – 2014



Source: Gordon (2016)

The second industrial revolution relates to the invention of electricity and the combustion engine. The rapid TFP growth during 1920-1970 (depicted by the wide dark bar in the chart) reflects the dynamics of the industrial revolution that created the modern economy. These gains in productivity have also resulted in lower inequality as reflected in the downward trend of the red Kuznets curve (Chart 1) up until 1970.

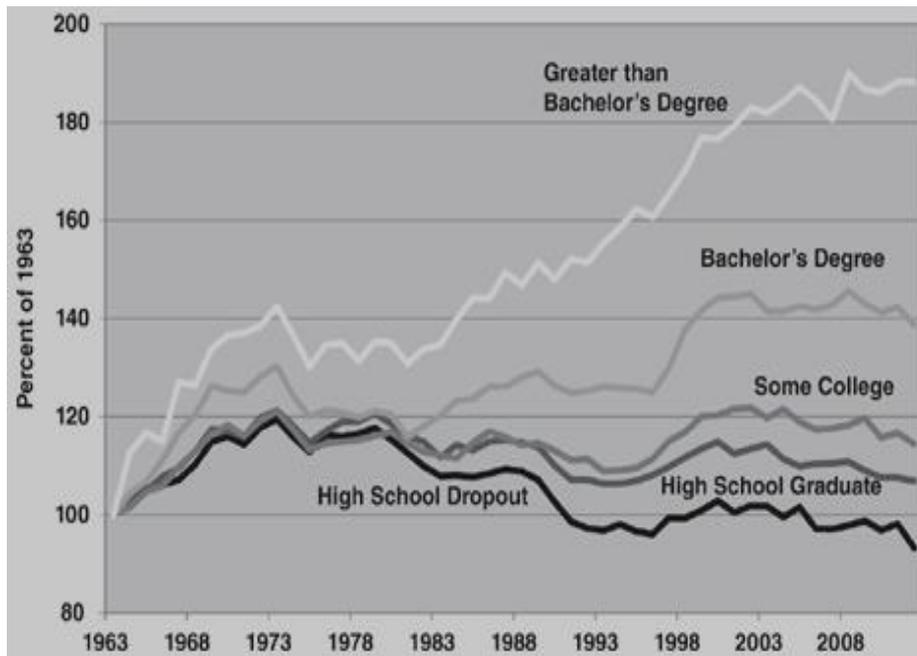
At about the same time that the second industrial revolution began to encounter diminishing returns after 1970, along came the digital electronic third industrial revolution, the gains of which are clearly reflected in the productivity upsurge of 1996-2004. This surge in TFP is depicted by the narrow dark bar, indicating that the benefits of this third revolution were short lived when compared to the benefits gained from the second revolution. In Gordon's words, this was "followed by mediocre productivity growth in the decade after 2004". Gordon shows that the benefits from the Internet and web revolution have been largely absorbed by 2004 and the methods of production have been little changed over the past decade. He argues that the many accomplishments of the third industrial revolution are largely completed. It should also be noted that the benefits of the digital revolution often cannot be easily adopted across the whole income spectrum as they require an element of advanced human capital that the lower income groups often lack.

In terms of the Kuznets curve, the above argument suggests that we are now stuck at the high end of the curve with high income inequality and with productivity as measured by TFP increasing at the paltry rate of 0.4 over the latest decade – the lowest rate since the period 1890-1920 as shown in Chart 2. Unless a new technological revolution materialises, or unless the middle to lower income groups upgrade the quality of their human capital that would allow them to reap the benefits of the third industrial revolution, TFP growth is expected to remain restrained.

Going forward, TFP growth seems to be stagnating on two fronts. First, as already noted, there are the diminishing returns from the third industrial revolution; and secondly; to the extent that educational attainment is rising less rapidly than in the past, the future growth rate of productivity will tend to be slower. If we take the US as an example, TFP after 1970 grew at barely a third the rate achieved between 1920 and 1970. A number of headwinds to economic progress can be identified. Chief amongst these headwinds is the “rise in inequality that since 1970 has steadily directed an even larger share of the fruits of growth to the top of the income distribution.” (Gordon 2016)

In commenting on the US, Gordon notes, “the cost of a university education has risen since 1972 at more than triple the overall rate of inflation”. Moreover, “the increased number of children growing up in single-parent households is likely to cause further erosion in educational achievement”. Gordon refers to the impact of this changing family structure as ‘socioeconomic decay’, which implies that “for the first time, America’s children will almost certainly not be as well educated, healthy or wealthy as their parents.” This argument is supported by the evidence he gathers on the development of real income – that is after adjusting for inflation – and educational attainment, as shown in Chart 3.

Chart 3: US Real Weekly Earnings by Educational Attainment, 1963 = 100, 1963– 2012



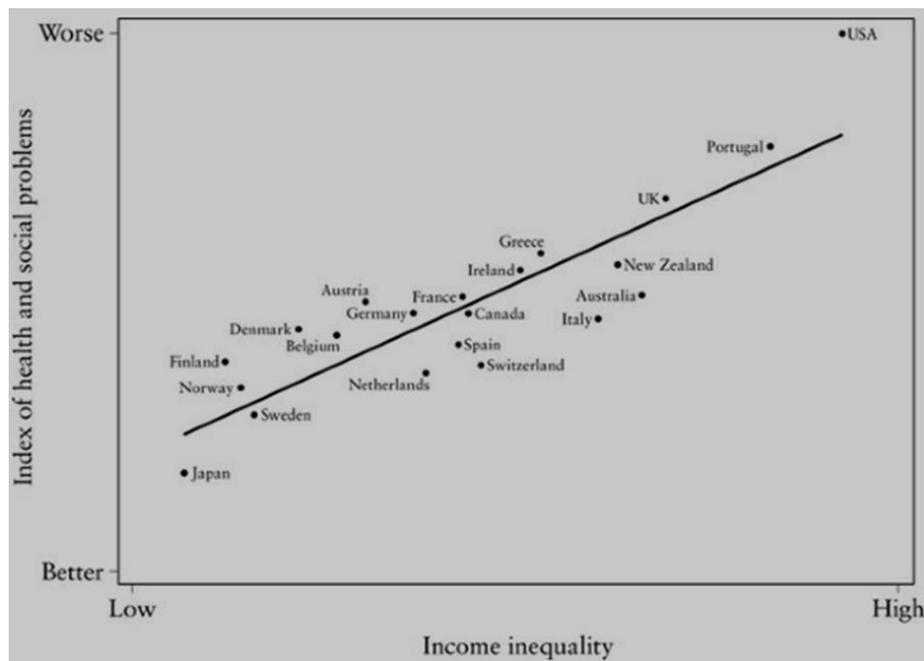
Source: Gordon (2016)

The various lines in Chart 3 track the developments of real weekly earnings over a long period since 1963, and sets the starting real wage equal to 100 at the beginning of the period for all educational levels. The diagram clearly shows that in the US, those at the lower end of educational attainment have seen their real earnings going down since the late 90s while for those with a Bachelor's Degree real earnings stagnated during the same period. Only those with an educational attainment greater than a Bachelor's Degree experienced steady growth in real earnings. This finding is highly significant, especially in the context of higher costs of university education. It means that education attainment has not only become less accessible, but also that the consequences of the inability to fund a high level of education are aggravating, leading to lower real earnings for a significant portion of the population from the middle to the more vulnerable parts of society. This observation embodies the worsening repercussions that come from increasing inequality of opportunity.

In a study on the effects of increasing inequality, Pickett and Wilkinson (2011) develop an index of health and social problems based on a number of measures, including life expectancy, teenage births, obesity, mental illness, homicides, imprisonment rates, mistrust, social mobility, education and the infant mortality rate. This index is plotted on the vertical axis of Chart 4. The horizontal axis plots an indicator of income inequality measuring how much richer the richest 20 per cent of the population is compared to the poorest 20 per cent.

This impressive chart - which also featured in an article in *The Economist*, *The World in 2016* (April 2016) – demonstrates that health and social problems are more common in countries with higher income inequalities and the correlation between the two variables is strong.² “Inequality seems to make countries socially dysfunctional across a wide range of outcomes” (Pickett and Wilkinson, 2011). This finding also supports Gordon’s argument on the impact of increasing income inequality on socio-economic decay.

Chart 4: The relationship between the occurrence of health and social problems and income inequality among rich countries



Source: Pickett, Kate; Wilkinson, Richard (2010)

1.2 Empirical findings of rising income inequality

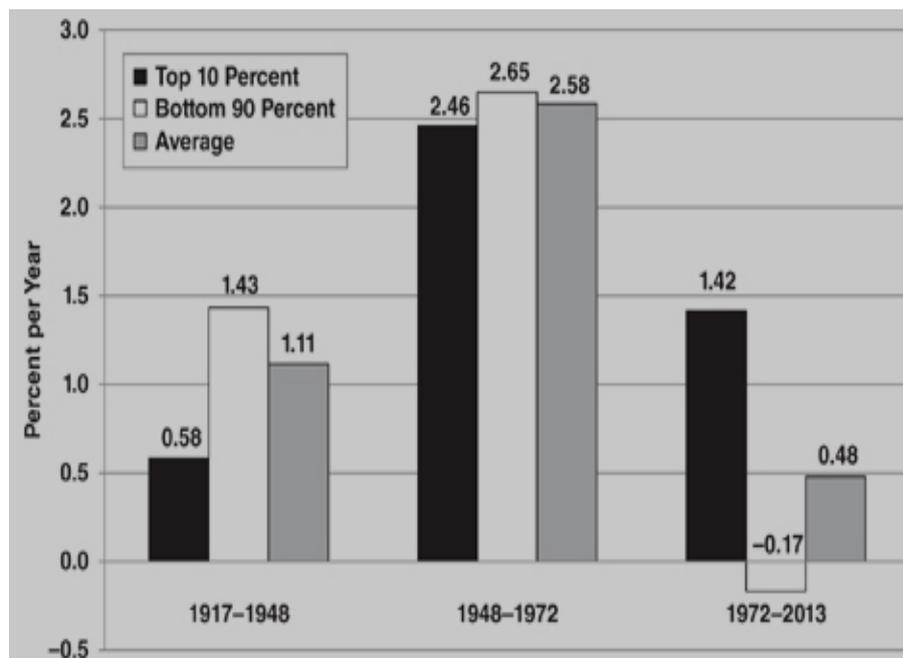
The previous section provided a broad ranging long-term analysis of various economic trends relevant to the issue of rising income inequality. This section will focus more directly on numerous studies that have appeared in recent years on the incidence of rising income inequality. As has already been noted, there is strong empirical evidence that indicates a long-term trend towards higher income inequality (See for example, Cingano, 2014). During the last financial crisis, most OECD countries registered historical highs of income inequality. As already noted in the first section, latest data suggest that the richest 10% of the population in OECD countries have an average income of around 9.5 times that of the lowest 10%. In the 1980s, this ratio was 7:1. However, results diverge amongst OECD

² As a robustness check, Pickett and Wilkinson replicate the exercise on the fifty states of the USA. The evidence from the United States confirms the international picture.

countries. Inequality is less pronounced in the Nordic and many Continental European countries, but is relatively high in Italy, Japan, Korea, Portugal and the United Kingdom, and reaches its highest levels in Mexico and Chile.

For the US, Gordon analyses the period between 1917 and 2013 split into three time intervals (Chart 5) and looks at the growth rate of income (before tax and including capital gains) for the bottom 90 percent, the top 10 percent and the average in the US. During the period 1948-1972 (which corresponds to the downward trend of decreasing inequality in the Kuznets curve in Chart 1 and the upsurge in TFP in Chart 2 referred to earlier), real incomes grew more rapidly than in the other periods and was evenly spread between the three income groups considered. The period that followed (1972 - 2013) saw the emergence of a significant gap between the top 10% and the bottom 90%, to the extent that the growth rate in the average real income in the bottom 90 percent was actually negative over the period 1972 to 2013.

**Chart 5: Growth rate of real income in the US:
top 10 percent, bottom 90 percent and average; 1917 – 2013**



Source: Gordon (2016)

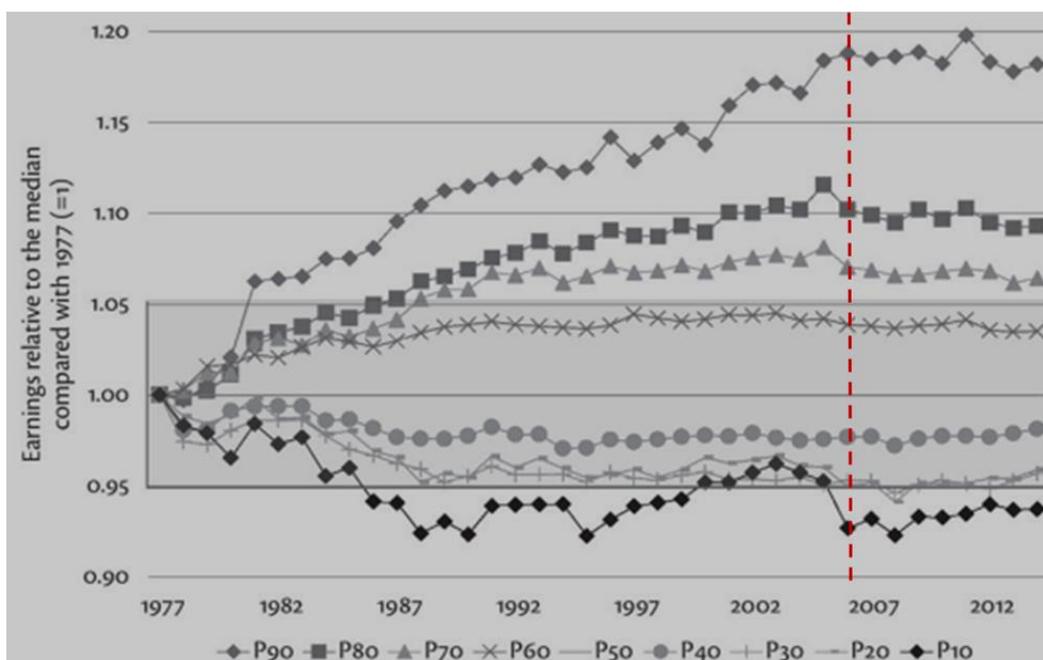
In other words, for the US, in the case of the lower 90% income group, the level of real income was lower in 2013 than it was in 1972. This is consistent with developments in real weekly earnings of the groups not having a higher level of education than a Bachelor's degree, as was shown in Chart 2.

Focusing on the European context, there is clear evidence that growth in total disposable income in the period 1980 – 2012 was slower than in the rest of OECD countries (OECD 2012). Over the past 25 years, household disposable income per capita rose on average by 3.1% annually in the OECD while the average annual growth in Europe was 2.5%. In both cases, smaller annual growth was registered over the past 15 years.

Moreover, the benefits gained from aggregate disposable income growth depend on how its distribution evolves. Income growth can be highly concentrated in a few hands, and there is evidence that this is increasingly the case for advanced economies. In general, the 10% highest income recipients have seen their incomes grow much more rapidly than the rest of the population over the past 25 years. In contrast, the 10% poorest of the population are losing out in terms of average annual income growth between 1980 and 2008, indicating that the gap has widened further.

A very relevant result on income developments in the UK is provided by Atkinson (2015) and reproduced in chart 6. Data points in the chart represent comparisons of different earnings groups with the median earnings indexed at 1977 = 1.0. The graph shows that the relative earnings of people in the top half of the earnings distribution (P90, P80, P70, P60) have grown between 1977 and 2014, while the relative earnings of people in the bottom half (P40, P30, P20, P10) have fallen. Furthermore, during the last decade shown in the chart, relative earnings in the UK stagnated for all income groups except for the top 10%.

Chart 6: Change in earnings in the UK since 1977



Source: Atkinson (2015)

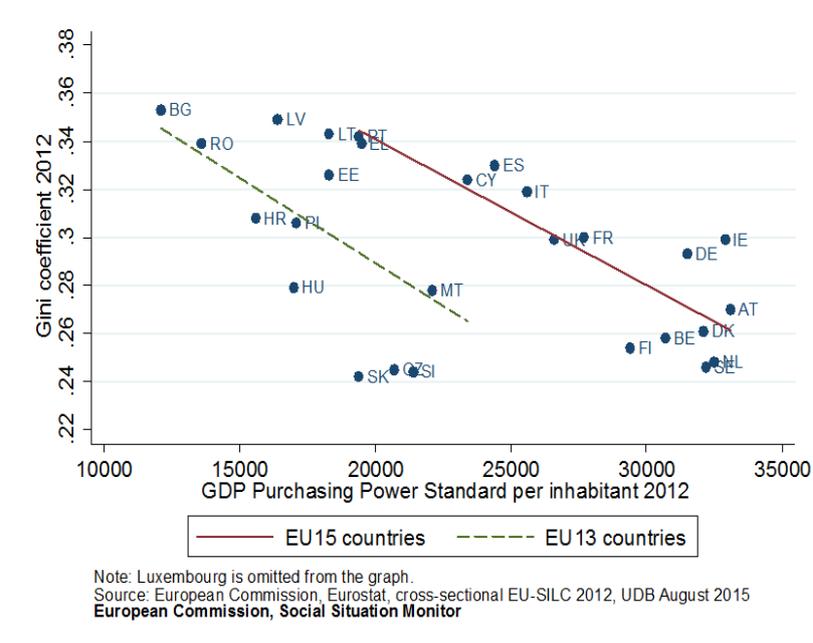
Looking at the Gini coefficients for individual European countries, from the mid- 1990s to 2008 – just before the crisis - the Gini coefficient decreased (meaning more equality) in Greece, Hungary and Italy, while it increased in all other European countries for which data for the two periods are available (European Commission). It is worth noting that both Italy and Greece, and to a lesser extent Hungary, have experienced a significant increase in unemployment following the financial crisis, so that it is likely that the situation with regard to income distribution deteriorated after the financial crisis, probably very rapidly in the case of Greece. More evidence on the income distribution of various countries using the Gini coefficient is presented in Annex I.

1.3 Empirical evidence showing the negative effect of inequality on economic growth

There are various studies that find a clear negative correlation between the level of income inequality and growth. The OECD study mentioned earlier presents an econometric analysis using harmonised data for the OECD countries over the past 30 years, and finds evidence that income disparity has a “negative and statistically significant impact on subsequent growth” (Cingano, 2014). In particular, the income inequality difference between the poor households and the rest of the population seems important. The OECD study “also evaluates the human capital accumulation theory finding that human capital is a channel through which inequality may affect growth. Analysis based on micro data from the Adult Skills Survey (PIAAC) points out that rising inequality weakens skills development for individuals with poorer parental education background, both in terms of the quantity of education attained (e.g. years of schooling), and in terms of its quality (i.e. skill proficiency)” (Cingano, 2014). This finding concurs with that of Gordon mentioned earlier.

Chart 7 below depicts the relationship between the Gini coefficient and GDP per capita of European countries as at 2012. The analysis is broadly divided into two groups of countries – those that entered the EU after 2004 (the EU 13) and those that were members before 2010 (the EU 15). Clearly, for both fitted lines, a higher Gini coefficient and therefore higher income inequality tends to be associated with a lower GDP per capita, indicating a lower level of economic development in a country.

Chart 7: Correlation between GDP per capita and the Gini Coefficient



A number of IMF studies have also found that income inequality (as measured by the Gini coefficient) has a negative effect on growth and its sustainability (Ostry, Berg and Tsangarides, 2014; Berg and Ostry, 2011). A recent IMF study develops this analysis further. (Dabla-Norris et al., 2015). It evaluates the impact of individuals' income shares on growth by using an exhaustive sample of advanced economies and EMDCs. A higher net Gini coefficient is concomitant with lower output growth over the medium term. So higher income inequality damages economic growth in the medium term. This is consistent with previous findings noted earlier. Furthermore, the study finds an inverse relationship between the income share attributed to the rich (top 20 percent) and economic growth. If the incomes share of this better off group increases by 1 percentage point, GDP growth is affected negatively, and decreases by 0.08 percentage points in the following five years. A similar rise in the income share of the poor (the bottom 20 percent) results in a 0.38 percentage point increase in economic growth. This positive correlation between greater equality in disposable income shares and higher economic growth is valid also for the second and third quintiles (the middle class). This result is also consistent with recent research results for a smaller sample of advanced economies (OECD, 2014).

Widening income disparities affect growth because they weigh on its drivers. For example, higher inequality dampens growth by reducing the ability of lower-income households to access medical care and accumulate physical and human capital (Galor and Moav, 2004), (Aghion, Caroli, and Garcia-Penalosa 1999). Moreover, high income inequality has a negative impact on the social mobility across generations, since the poor parental background would

tend to be transmitted to the generations that follow (Corak, 2013). This result is in line with Gordon's concept of socioeconomic decay (Gordon, 2015).

In addition, increasing income inequality discourages investment, and consequently growth, by creating economic, financial, and political instability (Dabla-Norris et al., 2015). More importantly, economic analysis finds that a global financial crisis could be triggered by a prolonged period of higher income inequality in advanced economies by augmenting leverage and by altering credit dynamics (overextension of credit, and a relaxation in mortgage-underwriting standards) (Rajan, 2010).

2. Combatting income inequality through a Voluntary Solidarity Fund at the national or regional level

The preceding sections lead to the conclusion that income distribution is worsening in most countries. This increasing income inequality is in turn negatively affecting economic growth and leading to an increasing number of marginalised households. In addition economic growth has slowed down, which in itself seems to be worsening income inequality. Productivity growth has entered a much more subdued phase, with smaller contributions by technological development to overall economic productivity.

2.1 Motivation

In a period of vibrant economic and productivity growth, the impact of increasing income inequality may be subsumed by a rising standard of living, albeit at different speeds. However, in today's context of slower growth, the economic and social impact of increasing income inequality becomes an issue of significant importance, possibly also a danger to the cohesiveness of societies and fundamental economic relationships.

While this economic and social dimension is important and very relevant, the fundamental driving force that would address income inequality has to originate from the individual's value of solidarity which is defined by Pope Emeritus Benedict XVI in his *Caritas in Veritate* (2009) as "first and foremost a sense of responsibility on the part of everyone with regard to everyone". Solidarity requires therefore that we work towards the common good; in other words, towards the creation of communities in which all people are able to flourish and achieve fulfilment. This is probably best described by Pope Saint John Paul II in *Sollicitudo Rei Socialis* (1987): "When interdependence becomes recognized in this way, the correlative response as a moral and social attitude, as a 'virtue', is solidarity... not a feeling of vague compassion or shallow distress at the misfortunes of so many people, both near and far...[but] a firm and persevering determination to commit oneself to the common good; that is to say to the good of all and of each individual, because we are all really responsible for all."

Therefore, the starting point of any measure aimed at reducing income inequality is the individual. In line with Catholic Social Teaching, the VSF would provide solidarity in practice, with the aim of reducing the negative impacts of increasing income inequality and “enhance human fullness” (Pope Francis, *Evangelii Gaudium*) It will be well placed to propel the line of thinking expressed by Pope Emeritus Benedict XVI and Saint John Paul II on solidarity and responsibility for each other. The VSF would also respond to Pope Francis’ appeal in *Evangelii Gaudium* (182): “...there is a need to draw practical conclusions (from the Church’s teaching) so that they will have greater impact on the complexities of current situations”. The VSF is not intended to compete with other voluntary contributions at the institutional or charitable level but would complement the work of other organisations. The VSF would be built around the principles of Catholic Social Teaching, would focus on the idea of self-realisation and ‘voluntary willingness’ that need to be mobilised as the starting point to address increasing income inequality.

In other words a solidarity fund on a voluntary basis and motivated by the moral standards of the individual’s conscience - with the central objective of combatting the effects of increasing income inequality - would enable individuals to better their capacity to participate in the economy and earn a dignified living through their work. Consistent with the principle of subsidiarity that asserts that problems should be dealt with at the most immediate or local level, the solidarity fund would be more effective to organise at the national or regional level, but with the guiding principles established by a central board. As will be discussed below, the initial phase would involve a number of pilot schemes, so that the central direction may be more important initially until the process of the VSF is set fully in motion.

The principle of the VSF being eventually administered at the local or regional level is important to add to the individual’s incentive to contribute, and at the logistical level, it would be more practical to implement. An additional motivating factor would be to structure the fund in a way that gives the donor the faculty to determine how the contribution would be invested to address the ultimate objective of combatting increasing income inequality. This is not to overemphasise conditionality, but rather to encourage participation in a viable and effective project.

This perspective is not Utopian. For instance, in the US, the Bill & Melinda Gates Foundation is the largest private foundation in the world. The primary objective of the foundation is, globally, to enhance healthcare and reduce extreme poverty, and in America, to expand educational opportunities and to broaden access to information technology. Another example is the Susan Thompson Buffett Foundation, which is a charitable organization, formed by US investor Warren Buffett as a vehicle to manage his charitable giving. In June

2006 Buffett announced that he would give 85% of his wealth to the Bill and Melinda Gates Foundation.

It is also worth noting that the concept of giving a share of one's income is practised in a number of other religious faiths. In Judaism, for example, a mandatory system of dues, in which members are asked to pay between 1 and 2.5 percent of their incomes, is common in many synagogues and is similar to the Christian *tithes* as practised in some countries. In recent years, a number of synagogues in the US have introduced, instead, a voluntary scheme. As another example, in Islam one finds the *zakat* (that which purifies), which is a form of contribution, recently more voluntary and is customarily 2.5% of total savings and wealth above a minimum amount known as *nisab*.

The successful establishment of a Voluntary Solidarity Fund may be viewed from two perspectives, namely the sources of funds, or the process of raising the contributions to the VSF, and the uses of funds or the manner in which the funds raised are allocated to specific programmes. These aspects are interconnected: the sources or raising of funds is influenced by the way the funds are used.

2.2 Funding sources

The first aspect that will be considered relates to the motivation and organisation of the sources of funds. One way to implement this Voluntary Solidarity Fund (VSF) is to bring together a number of middle to high net worth individuals, including prominent individuals that embrace the concept of solidarity that would be encouraged by the VSF. Besides monetary contribution, this private non-profit entity would propagate the notion that more income equality is beneficial both from an economic as well as from an ethical dimension. To this end, the act of contributing part of the wealth or income (in the form of a grant) is deemed as a noble act in itself and part of taking responsibility for the well-being of others.

In terms of motivation, the key here is that those who are better off feel the moral conviction to contribute to the betterment of others. Better off can be interpreted in various ways, but I would suggest that we focus on those who are at a stage in their career where they have succeeded in achieving a standard of living which allows them to go beyond the threshold where one is just surviving, merely meeting the requirements of a basic and dignified standard of living for themselves and their families. This concept is, as already noted, relative and may imply different things to different people depending on the cities or countries that they live in. The important point here is that the VSF needs to stimulate the desire to help others on the part of those who can do something about it, even in a limited way.

As a concrete proposal, I would suggest that the broad parameters would have the following guidelines. Starting with individuals earning the equivalent of EUR 100,000, these would

contribute 1% of their income annually, while those earning above EUR 200,000 would contribute 2% of their income annually. These percentages are not mandatory but a guide. It is after all a voluntary fund. Individuals earning less than EUR 100,000 may decide to contribute at the same or a lower rate. Similarly, individuals earning a higher income than EUR 200,000 may contribute at a higher rate. The ideal scenario would be for the individual to know that she or he are meeting their moral obligation to be responsible for others who are less fortunate than themselves and who may be caught in a low-income or even a poverty trap. Turning to corporate participants, the shareholders of a company could also decide to contribute from the company's earnings. Corporations could be invited to present their shareholders with a proposal to contribute 1 or 2% of the company's profits, and this would be subject to shareholders' approval.

Besides the stimulation of the wish to donate, it is also important to provide an attractive and effective programme for the use of the funds so generated. This will be further discussed below under the section relating to the uses of the funds collected in the VSF. In terms of the organisational aspect from the donor's perspective, it would require the establishment of an appropriate website which makes it easy to enrol and commit contributions utilising a user-friendly approach.

However, such a mechanism, although necessary, will not be sufficient by itself to lead to success. The VSF needs promoters, and it would be relevant to consider approaching high net worth and prominent individuals that embrace the concept of solidarity being encouraged by this proposal and who would also support the setting up of the Fund. I believe it is necessary to have human contact with an ability to explain and persuade in a world that is probably somewhat sceptical to start with. This is a challenge that should not be underestimated. However, challenges are there to be overcome, and the scope of this project and the good it is intended to achieve merit every effort to meet the challenges involved.

Once the relevant structure is in place, the launching of the project can be designed in a way that would provide the necessary level of encouragement and follow-up so that a certain momentum can be built up. Initially, the VSF could be composed of a Central Fund located in an appropriate jurisdiction that offers operational efficiency. It would be wise to start with a pilot project covering only a few regions initially. The considerations in choosing the regions would include the available support network that will increase the likelihood of success in meeting the objective of solidarity. The funds could also be mobilised in such regions on the basis of a formula that takes into consideration not only need but also sources of the funds – so as to build a link or identification between the donors and the projects receiving support. This structure would also enable the development of the programme to the next level by opening more funding possibilities through success stories

and by further strengthening the governance framework and transparency of the whole structure.

2.3 Use of funds

Moving on to the uses of the funds, there are both short term and medium to long term perspectives. Since the VSF is envisaged as an enabler, then the projects should focus on providing the appropriate ingredients to make the use of the funds effective. VSF funds could be mobilised to support and empower beneficiaries in two main areas of marginalisation; first where individuals may lack the appropriate finance to launch a small enterprise or business, and second, where individuals lack the necessary human capital that could see them improve their capacity to contribute to society and earn a dignified living.

Under the first area of marginalisation, the fund could be used to promote entrepreneurship. There is scope for potential partnerships with financial institutions such as NGO's, cooperative banks, promotional or development banks or even private banks that with the backing of the VSF, could provide assessment, management and mentoring expertise that would support and fund self-initiative, especially for those that have been excluded from financial markets. In addition, such financial institutions could also be donors by allocating a small proportion of their profits to be transferred to the Fund, as proposed in the previous section.

On a more global scale, the World Bank could also become a potential partner as its philosophy and initiatives are conducive to those envisaged by the VSF. In fact, the World Bank works together with a large number of other institutions towards responsible financial inclusion. It has an active lending portfolio for financial inclusion of \$4.3 billion and 117 lending projects in more than 70 countries. World Bank support includes policy advice, data and diagnostics, technical assistance for legal and regulatory reforms, institutional development, risk sharing, and financing. With their expertise, such financial institutions could play an important role by providing functions such as assessment, management and mentoring while on its part, the VSF could use a proportion of its funds to carry part of the risk for the financing of such projects. In Malta, for example, APS Bank is a bank with a social dimension and in which the Catholic Church owns the equity. The VSF may therefore provide a significant part of the funding necessary for microfinance, while the partnering institution would identify the projects, and vet them for their soundness and the genuineness of the proposal, and to ensure that they meet the criteria of the VSF. This would help empower those who are constrained financially, to break out and be able to earn their way through their effort. An annex to this paper deals at greater length about various elements of microfinance in Europe.

The second aspect of marginalisation is a prime objective for the VSF in that it is a major cause for increased income inequality. This concerns the so called human capital, or put simply the ability of an individual to be sufficiently trained and educated to enable that person to rise to a more dignified and fulfilling level of involvement in society. Support from the fund can be in the form of providing favourable and affordable funding for scholarships and training courses and in general increasing the capacity of persons who can benefit from the educational upgrading necessary in today's more demanding society.

As a concrete example, the VSF could be set up as a revolving fund providing interest-free loans that would then be repaid gradually once the beneficiary starts earning income from employment. Identifying meritorious cases would require focusing on target groups say, single-parent households where individuals are forced to abandon education and start working at a tender age in order to provide financial support to their struggling families.

The identification of meritorious cases could be supported by the networks at the parish level. These networks can contribute by choosing the people with the right credentials (perhaps retired people) to take up role as mentors, providing opportunity to contribute in a direct way while earning an income that would see them improve their own standard of living.

This aspect helps reinforce the work that can be done at the level of the parish, and at the same time serves the purpose of not only opening a new dimension of support but also strengthens the capacity of parishes to cater for those marginalised. The VSF would be seen not as competitor but as a complement to the activities currently undertaken, based on the overall objective of the VSF, namely to empower individuals to break out from the trap of a low level of education and poor living standards.

Since the objective of the VSF is to be truly effective and not simply to pay for courses and training, it would be necessary to establish a number of mentors to ensure that the assistance given is meeting the objectives established at the beginning of each programme. One way of dealing with this aspect is to open or set up a scheme for appropriately chosen retired people with the right credentials to take up this role of mentors and therefore to ensure that the moral and perhaps professional support is available. It is suggested that such retired people involved in the programme would also be able to benefit from a small remuneration for the contact hours they perform. This would help the many pensioners who may be living in marginal conditions but at the same time have great experience and time available that they could utilise to contribute to the strengthening of their neighbourhoods. The details of such a scheme, the guidelines, objectives and other practicalities will be further elaborated, following consultation with a number of persons who can contribute sound advice on how such a scheme would be organised.

2.4 Governance

An eventual establishment of a VSF would need to be built around a strong governance framework supported by adequate technical and managerial competence, organisational capacity, accountability and transparency. The VSF would inevitably include an internal audit process as a catalyst for ensuring its governance, risk management and management controls. Moreover, the VSF would be audited externally to ensure full transparency. These are fundamental pre-requisites for the Fund's success in bringing together a network of individuals or groups of individuals that share this philosophy and are ready to take initiative.

In view of achieving a heightened level of transparency and accountability, the outcomes of the VSF projects and initiatives need to be measurable. This would enable accurate assessment of the VSF's efficiency and effectiveness and in so doing the Fund would be fully accountable to its donors. In addition, this would facilitate the prioritisation of efforts to focus on those projects that will have a material impact.

With a strong governance framework and supported by a network of important and trustworthy people, the VSF could earn an important role within the civil society, eventually placing itself at the negotiating table with other members of the civil society and the public administration where it could voice its philosophy and actively stir the public discussion towards its target of combating increasing income inequality. The VSF would be in a strong negotiating position, as it would have the capacity to actively contribute even financially. There is also scope for the VSF to raise awareness about the existing incentives and programmes and also to coordinate and enable individuals to benefit from such programmes. This would avoid duplicating what is already in place and instead focus on new initiatives or ways to improve the existing ones. The status of the Fund would enable it to fulfil its role in civil society without prejudice. Based on the fundamental principle of solidarity, it has the potential to have a universal appeal to all segments of society, whatever the religion, race, colour, or political belief. The Foundation would not only give voice to the weakest members of society but it would also influence policy makers to take political decisions that would favour the well-being of those most in need or those in danger of being marginalised.

2.5 Medium to longer-term considerations

Eventually, the VSF may develop a role similar to that of the European Investment Bank (EIB) or other well-established development banks such those found in Germany, France, and in many other countries. The EIB acts as a catalyst for investment, providing finance and expertise for sound and sustainable investment projects that contribute to furthering EU policy objectives. It fulfils its role in a three-way manner by lending, blending and advising

with its ultimate priority being the contribution to growth and employment in Europe. Consistent with the philosophy of the EIB, the VSF could utilise its funds to contribute to reducing income inequality by addressing fundamental issues such as access to education, access to the labour market for young people, access to adequate healthcare, supporting the elderly and so forth.

It could do this by directly funding projects or else by acting as a strategic partner with the government where the VSF could act as a catalyst for addressing long-standing issues that would improve income equality and enable an environment where all members of society can achieve fulfilment. In this way the VSF could leverage on its funds to extend its reach and scope.

At a future date, it may also issue its own bonds rather than rely purely on contributions from individuals. Though this is a medium term consideration, since it requires an organisational structure appropriately developed to cater for such an activity. However, in a low interest rate and high liquidity environment, one should not exclude the attraction of people loaning their funds for a social purpose even at little or no pecuniary return, while still owning such funds. This would be the concept of a VSF bond. Society would be benefiting from the use of such funds, rather than leaving them idle in some bank account or worse stashed in a safety deposit box.

For the medium to the longer-term perspective I envisage an ambitious attempt to discuss this proposal with other Christian denominations and even go beyond that and cooperate with non-Christian religious organisations. The underlying principles of the Foundation are universal and highly agreeable. They can bring together different denominations and religions in a historic cooperation among people of different beliefs towards a common goal – a more dignified and fulfilling life. This dimension would further enable the Foundation to carry out its mission without prejudice.

A VSF of this nature is envisaged to be offering an opportunity for those who are willing to contribute but are usually uneasy on the methods and uses of funds. The VSF ensures an efficient use of resources by introducing a business-oriented dimension to the Fund. It would focus on the common and shared values of most religions and on solidarity as a universal value. With this structure, the VSF could target segments of the society we live in that would provide the contributor with an immediate and visible result.

Conclusion

Increasing income inequality is a top concern at the global level. There is general consensus that inequality is on a rising trend and that it is having a negative effect on growth and on the well-being of society. At the personal level there is conviction that increasing income inequality is everyone's responsibility that goes beyond giving charity to the poor. It involves

the transformation of society into a more capable and caring one that would ultimately result in the enhanced well-being of everyone and a contribution to the common good.

Unfortunately, those individuals that embrace this commitment towards the common good may not be currently presented with the appropriate channels to contribute for this purpose. The VSF aims to bring together those individuals that have a vision of a better society and are ready to contribute for that purpose. Recent economic studies suggest that human capital is one of the main channels through which inequality has risen. In view of that, the VSF is envisaged to focus on access to education, healthcare, labour market access and other enhancements to the capacity of individuals to live a more dignified and fulfilling life, as God intended. This is a distinctive dimension of solidarity in the sense that it promotes a longer-term investment that would empower in a lasting manner the parts of our society that have been falling behind.

For reasons of practicality and logistical efficiency, the VSF would initially be set up at the national or regional level. On the funding side, the VSF would start with irrevocable donations – not loans – and based both on ‘high worth’ families or individuals, and small contributions from a larger number of catholic homes. At the operational level, the VSF could adopt a similar philosophy to that of the EIB whereby it could use the funds to lend, blend and advise. Moreover, the priorities of the VSF may at times coincide with those of the EIB and in that case, the VSF could use its funds as collateral to borrow from the EIB and implement projects that fulfil the aims of both the EIB and the VSF.

At the management level, the VSF would be supported by a very strong governance framework that would be needed to lift the VSF to prominence, empowering it to actively participate in the civil society and to stir the public debate towards its genuine objectives. In partnership with the government, and with the monetary support of its funds, the VSF could embark on important projects that improve income equality.

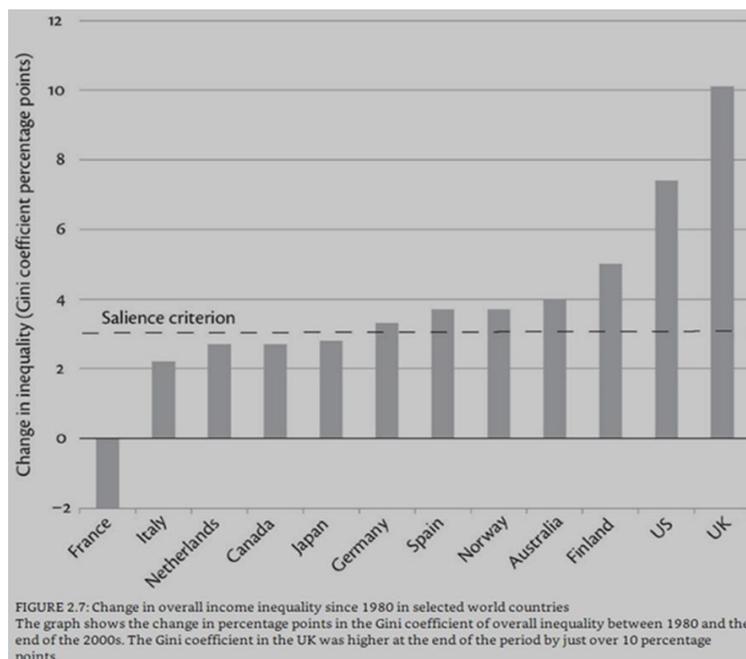
With this structure the VSF is envisaged to fulfil its objectives efficiently, effectively and economically, enabling it to extend its scope and reach, with its primary role being to enhance the capacity of individuals to earn a decent income and live a fulfilling life. It will also provide a major avenue for individuals who are in the medium-to-higher income groups to contribute to the betterment of others, to enable them to provide solidarity in an effective and practical way.

Annex I - Further evidence about increasing income inequality

The Gini coefficient measures income distribution by taking into account the whole income distribution of a country, including the social welfare benefits that a country provides. The Gini coefficient ranges from zero to 1, with higher values within this range indicating worsening income inequality.

In the mid-1980s, the Gini coefficient stood at 0.29, on average, among OECD countries. However, by 2011-12, it had risen by 10 percent or 3 points to 0.32 (Cingano, 2014). Atkinson (2015) refers to this 3 percentage point increase in the Gini coefficient of OECD countries as the 'salience criterion' or benchmark and compares the developments in particular countries to this criterion (Chart 8). For most of the countries for which long time series are available, the Gini coefficient followed an upward path, increasing by more than 5 points in Finland, Israel, New Zealand and Sweden and by more than 7 points and 10 points in the United States and the United Kingdom respectively. Only Greece and Turkey registered a marginal decrease.

Chart 8: Change in inequality since 1980³



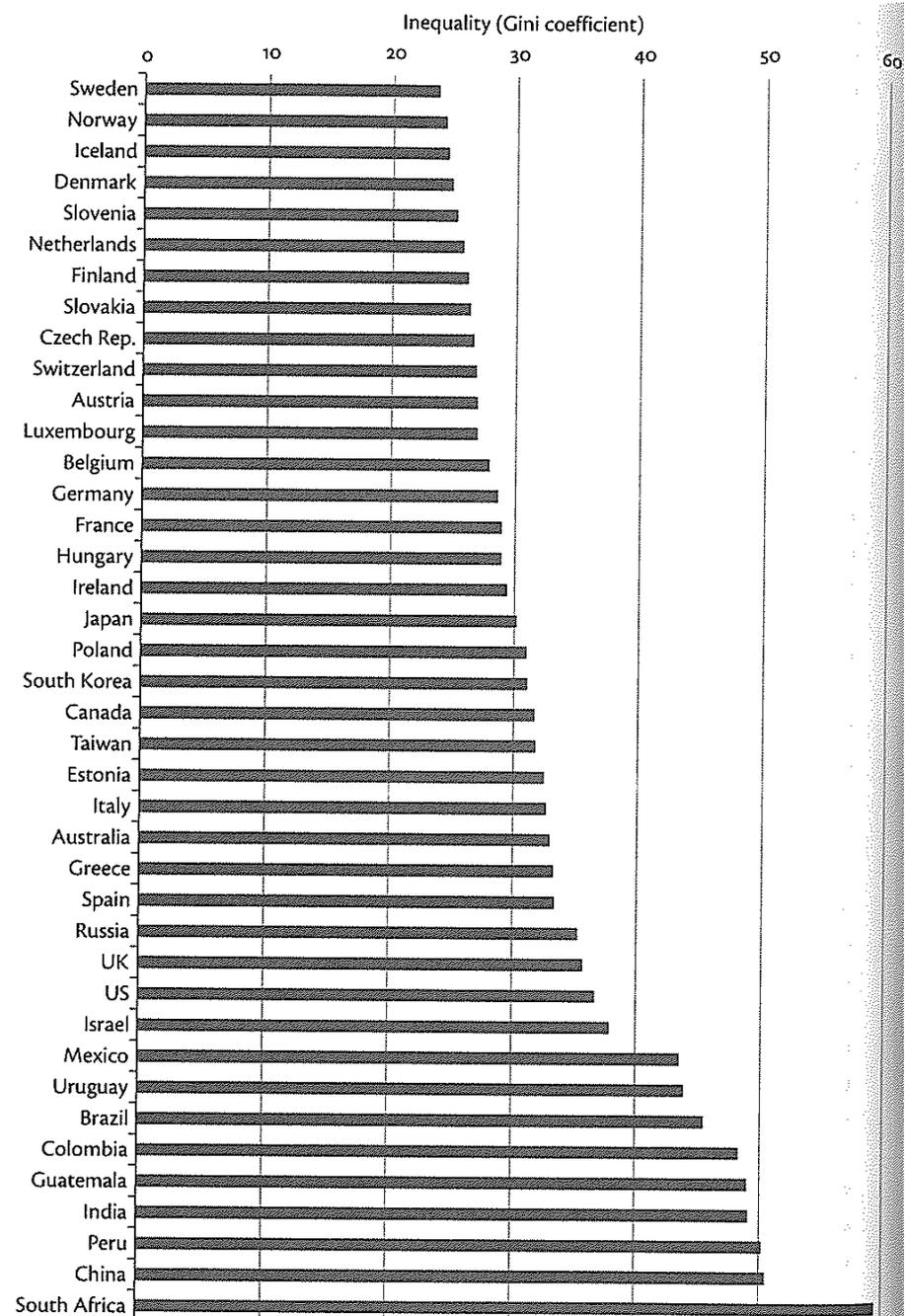
Source: Atkinson (2015)

Looking at a wider spectrum of countries, Chart 9 shows the Gini coefficient of various countries as at 2010. A number of countries are very close to the salience criterion - identified by Atkinson at the 0.32 mark - while other countries exceed this benchmark by a wide margin. It can also be observed that a number of advanced economies have a relatively

³ In France, the Gini coefficient increased from 28.9% in 2004 to 30.6% in 2011, but this still leaves it 2 percentage points below its 1979 value and hence its negative change in Chart 6.

high Gini coefficient, including European countries such as Italy, Greece, Spain and the UK. As noted earlier, the Gini coefficient for the US is one of the highest among the advanced economies.

Chart 9: Gini coefficients of selected countries, 2010



Source: Atkinson (2015)

Income inequality among advanced economies and emerging and developing countries (EMDCs) can also be studied through an analysis that is based on the poor and the middle class. A recent study by the IMF (Dabla-Norris et al., 2015) builds on a larger sample of

countries while considering the income shares of the poor and the middle class, the main growth drivers. A panel econometric approach is used to put together different interrelated parameters that matter for inequality with year and country fixed effects. A sample of almost 100 advanced economies and EMDCs over the period 1980–2012 is assembled to determine the causes of country variations of income inequality. This research uses a large group of countries and examines if the determinants of inequality change across advanced, emerging markets and developing economies, and across different measures of inequality. In addition to the Gini coefficients, it develops the argument that income distribution itself is a precondition for growth by analysing “the determinants of the disposable income shares of the poor (bottom 10 percent), the middle-class (fifth decile), and the rich (top 10 percent)” (Dabla-Norris et al., 2015). A greater emphasis is then attributed to the determinants of income concentration in recent years, especially as regards to the poor and middle class income shares.

This analysis suggests that

- The rise of inequality in both advanced economies and EMDCs is, in part, due to technological progress and the consequential rise in the skill rewards. Globalization has provided contribution to growing inequality.
- Social policies focused on the low and the middle class can reduce inequality. Health care and eased access to education, as well as optimal social policies can be inclusive and thus, reduce inequality for the poor and the middle class.
- There are various approaches to combat inequality. In advanced economies, measures against inequality should aim at developing human capital and skills, while implementing a more progressive taxation system. In EMDCs, since the results of the IMF study suggest that financial complexity results in higher income inequality, improved financial inclusion and “incentives for lowering informality would be important”... More generally, complementarities between growth and income equality objectives suggest that policies aimed at raising average living standards can have an impact on the distribution of income by ensuring a more inclusive prosperity” (Dabla-Norris and al., 2015).

Annex II - Microfinance in Europe

Introduction

Microfinance may present different characteristics and may have targets that vary according to the different contexts in which it is applied. Microfinance extends beyond lending and may consist in a broad range of banking services such as credit services, savings products, current accounts, payment services and funds transfer. Microfinance within the EU banking industry normally refers to small loans (“microcredit” or “micro-loans”) and to small commercial customers (“micro-entities”). It is typically associated with other financial services such as advisory or providing guarantees.

The lack of a consistent and commonly-used definition of microfinance in particular for banks’ internal reporting implies that reliable figures for the volume of microfinance for the EU are not available. They are more often than not referred to as consumer loans or SME finance. The loan element of microfinance is in many cases indistinguishable from a corporate loan, although loan sizes are at the lower end of the scale. The average size of microcredits appears to be around €10,000-15,000, sometimes even lower. The European Commission in its Communication on a European initiative for the development of microcredit in support of growth and employment (COM(2007) 708 final) of 13 November 2007 (the “European Commission Communication”) considers microcredit in the EU to be loans under €25,000 for business initiatives, and has observed that, typically, the average is €10,000 for the older (15) Member States and €3,800 for the newer Member States.

The role of banks in microfinance

Private banks are among the main providers of microfinance within the EU. They supply microfinance both on their own and in partnership with other providers, such as public bodies, international institutions such as the European Investment Bank and specialised Microfinance Institutions (MFIs). Private banks typically provide microfinance lending to “bankable” borrowers, who are deemed to have a viable business with a relatively high probability of being able to repay debt. Other MFIs and public bodies are more likely to provide microfinance to “non-bankable” borrowers, being individuals or very small companies that do not have a credit history or the ability to provide adequate collateral.

The lending of money to non-bankable entities is normally undertaken to support the development of sustainable business and for social or financial inclusion. An innovative method for the financial inclusion of projects is the establishment and management of partnerships between banking and non-banking institutions such as bank foundations and service industry organisations. The latter have a role to play in retrieving the data necessary to evaluate each request. They primarily carry out an informal screening of the applicants

for financing and then offer them support after credit has been granted. The banks may then provide their services on the basis of the information made available.

Banks in the EU are also channelling finance to small businesses on behalf of EU institutions such as the EIB or with government support e.g. taking the form of subsidisation. In order to mitigate the higher risk facing banks in microfinance (especially in the absence of a borrower track record and the uncertainties connected with start-ups), microfinance is often backed by collateral or guarantees provided by public or non-profit entities. For the lending banks these forms of support are economically important, as successful micro-lending will tend to create new business ventures and clients for the future.

Such an approach builds into the lending relationship a high degree of monitoring and advice. In more developed markets for microfinance, services offered tend to include advisory services (e.g. business support and mentoring). This is an important safeguard to ensure that new start-ups and small enterprises receiving funding can benefit from the experience of others and are more likely to survive.

The European Commission Communication

In terms of the European Commission Communication, whilst microfinance can take many forms, it is often used as a means of encouraging the growth of self-employment and the formation of micro-enterprises. It thus plays an important role in the realisation of the Lisbon strategy for growth and jobs, and the promotion of social inclusion. The Communication invites Member States, *inter alia*, to adapt the appropriate national institutional, legal and commercial frameworks necessary to promote a more favourable environment for the development of micro-credit.

The Communication makes seven proposals for Member States to improve the national legal and institutional environment:

- i. Create an environment allowing the development of micro-finance institutions (MFIs) and covering all segments of the clientele. Banks should be encouraged to develop micro-credit operations by granting access to a wider provision of loan guarantees and, as portfolios develop, by securitisation. Credit unions or similar institutions involved in micro-credit operations should be allowed to keep or receive the authorisation of collecting savings and are entitled to finance income-generating activities.
- ii. Help micro-credit to become sustainable by relaxing interest caps for micro-credit operations. It is deemed advisable to fix interest rate caps at a sufficiently high level to allow lending institutions to cover costs, while evaluating its economic and social impact regularly. Thus, it is understood that given the small size and short duration of loans, the absolute value of the interest, even with a high rate, is small.

- iii. Allow MFIs access to borrower databases and facilitate their evaluation of the risks. Thus, in the UK, community development finance institutions are encouraged to supply data to credit bureaux in order to support the assessment of risk.
- iv. Reduce operating costs by applying favourable tax schemes. More favourable tax regimes are equally important for an emerging industry, whether they consist of tax exemptions for MFIs or reductions in taxes for individuals or enterprises that invest in their activities or intervene by way of grants.
- v. Adapt national regulation and supervision to the specificity of micro-finance. In the EU, MFIs fall under the scope of EU prudential regulation if they receive deposits and other repayable funds from the public. If not, they are not subject to specific harmonised capital requirements. Any further regulation and supervision put in place must be proportionate to its cost and to the risks facing MFIs.
- vi. Ensure single market rules are applied to micro-credit. It is suggested that similar to the banking passport system in the EU, it is examined to what extent and under what conditions similar passport rights could be enjoyed by micro-credit providers that are not banks.
- vii. Incorporate micro-credit into regulation and accounting standards. Whilst over-regulation may have a negative impact on the development of micro-credit, risks may be reduced by making a prior inventory of best practices and by confronting the proposed legislative framework with the reality of national micro-credit operations. A way to increase visibility of micro-credit in the long run would be to categorize it as such in banking industry practice and the new accounting standards (IFRS).

The EU has also provided financial assistance to favour the development of micro-credit. The financial instruments of the EU's Competitiveness and Innovation Framework Programme (CIP), in particular the microcredit guarantee window of the SME Guarantee Facility, offer substantial resources to support microcredit. This was supplemented by the JEREMIE (Joint European Resources for Micro to Medium Enterprises) initiative, launched jointly by the European Commission and the EIB in 2006, which enables the Member States and regions of the EU to use part of their Structural Fund allocations for financial products designed for SMEs. More recently in 2007 the JASMINE (Joint Action to Support Microfinance Institutions in Europe) initiative is targeted at the institutions serving the non-bankable segment of the market. In 2009, the EU announced a new European Microfinance Facility for Employment and Social Inclusion, amounting to €100 million, with a possible leverage of €500 million, managed jointly with international financial institutions, in particular the EIB. This facility started to be made available from 2010.

Member State Legislative Frameworks

The European Microfinance Network regularly updates the position on country microfinance legislative profiles in its report on an Overview of the Microcredit Sector in the EU. The latest report available on its website is dated September 2014. This report reviews the situation in 17 jurisdictions. The most developed national legal frameworks are the following:

France

Following the establishment of the first MFI in France, ADIE, in 1989, the banking laws were amended in significant ways to take into account this new facility. In 2001 amendments allowed microcredit associations to obtain financing from banks. In 2005 a Social Cohesion Fund was created as a mechanism that guarantees up to 50% of microcredit loans. In 2009 the state created the NACRE operation which permits the development of interest-free loans by banks. In 2010 consumer laws governing consumer credit and specifying the legal framework for microfinance were amended to allow associations to receive interest-free loans from individuals. These may now participate in the financing of projects through crowdfunding platforms such as Babyloan or Xetic. Banks are obliged to provide an annual statement on microloan activity to the Banque de France and INSEE. In France, microloans are normally made available to unemployed persons and more generally to those excluded from the traditional banking system.

Germany

Germany does not have a special microcredit law. Three types of organisations provide microfinance: MFIs, the promotional banks and the local employment agencies (Job Centres). A cooperation model has been developed by MFIs. While the MFIs support clients through direct contact during the whole duration of the credit, a cooperating bank distributes the microloan and the risk of default is secured partly by the MFIs and partly by a guarantee fund. Two guarantee funds have been raised based on this cooperation: from 2006 to 2009 the "Mikrofinanzfonds Deutschland" worth €2 million and from 2010 the Mikrodreditfonds Deutschland" operated by the Federal Ministry of Labour and Social Affairs with €100 million. By 31 December 2013 the Government terminated the operation of this fund with a number of MFIs. Promotional banks have set up microloan schemes below €25,000 in line with their general business promotion programmes. Local employment agencies are entitled to distribute small loans to those fresh out of long-term unemployment. The job centre decides whether to grant the loan and the size of the loan. Generally speaking, promotional banks reach out to bankable entrepreneurs while MFIs target the non-bankable segment.

Italy

Italy introduced a comprehensive legal framework in 2010 by Legislative Decree n. 141/2010. The law defines the distinctive features of the microcredit activity (entrepreneurial and social), it establishes a register of authorised microlenders and it provides for the role of a supervising authority. Only commercial banks, with a few exceptions, are allowed to grant microcredit and other institutional bodies are mostly restricted to provide non-financial services and guarantee funds as well as the preliminary selection of borrowers. The public sector is involved in the subsidisation of short-lived microcredit projects through local municipalities and regions. Microcredit in Italy mainly targets persons excluded from mainstream financial services.

The Netherlands

MFIs in the Netherlands can operate without any supervision as long as they do not engage in raising money from the general public. They can establish themselves as a foundation, association or cooperative. They may their microfinance operations after registering with the Chamber of Commerce. Registration with the Chamber automatically results in registering with the national fiscal authorities. Government programmes (e.g. offered by the Ministry of Social Affairs and Employment) offer comprehensive training and business advisory services for those wishing to set up microenterprises. The facility targets the larger SMEs and is mainly intended to address unemployment.

Portugal

Although there is no specific microfinance legislation in Portugal, the State has established a credit line with the banking sector for disbursing microloans at low interest rates, giving a grace period of two years. The State also offers guarantees to these banks. Microfinance target groups include individuals willing to start up or consolidate a business but who are excluded from the formal banking system such as youths, and the unemployed, especially if they seek self-employment as a solution.

Spain

In Spain, there is no regulatory framework for the microfinance sector. The microfinance model has been traditionally based upon the cooperation and joint work between savings banks, public institutions and Social Microcredit Support Organizations (SMSOs). Regarding the provision of microloans, savings banks either implemented microcredit programmes with their own resources or linked the programmes to public sector initiatives. Unfortunately, the credit crunch in Spain led to the closure of most microcredit programmes. However, in 2010, the Working Group on Microfinance Regulation in Spain

was set up to gather a variety of interested stakeholders on microfinance with the aim of facilitating the implementation of a legal framework for the development of the microfinance sector in Spain. From the work developed in the II National Microfinance Meeting, it was decided to incorporate microfinance into existing law rather than create an independent framework. Consequently, the experts started consulting different political formations to develop a communication and lobbying strategy. By the end of 2012, the Working Group developed a document for lobbying the Spanish government compiling the main points to push forward regulation of the microfinance sector. These points include the ability for Spanish MFIs to be eligible for the aid programmes of the European Social Fund (ESF) and other institutions such as the European Investment Bank (EIB) under the umbrella of the Spanish Microfinance Association.

United Kingdom

MFIs in the UK are typically not-for-profit organisations that have social missions to benefit their local communities. The regulatory framework changed in 2013 and supervision is now centralised in the Financial Conduct Authority which regulates all forms of providing consumer credit. Higher fees have been introduced for registering MFIs intended to create a more ethical financial services industry in the UK, so in the end MFIs themselves will benefit from these fees. In addition, the smaller MFIs are eligible for concessions from some of the FCA's fees and regulatory requirements. The typical microfinance approach in the UK is to provide loan finance and support, mentoring and advice to customers that cannot access finance from mainstream banks. The government is involved through many mechanisms, including policies such as tax reliefs and guarantee schemes that support great microfinance. Government also provides some sources of funding for MFIs such as grants targeted for specific market failures or public needs. Banks and MFIs have a referral partnership, where banks refer their declined customers to MFIs. Banks are also a source of commercial funding to MFIs to on-lend.

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