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## Does redistribution hurt growth? An empirical assessment of the redistribution-growth relationship in the European Union

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Vienna, February 2024

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February 2024

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Keywords

growth, redistribution, inequality, European Union

## ABSTRACT

This paper analyzes the relationship between economic growth, inequality and redistribution. In a cross-country setting for 25 EU countries over the period 2007-2019, we show that market income inequality is associated with higher growth in the short run. To estimate the impact of redistribution to low-income earners, we introduce a new measure, the so-called net benefit share (NBS). Contrary to other findings, we show that this (targeted) redistribution to low income earners (Q1 NBS) boosts growth in the short run, driven by the consumption and private investment channels. On the other hand, untargeted redistribution to higher income earners reduces growth.

# Does redistribution hurt growth? An Empirical Assessment of the Redistribution-Growth Relationship in the European Union

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## Abstract

This paper analyzes the relationship between economic growth, inequality and redistribution. In a cross-country setting for 25 EU countries over the period 2007-2019, we show that market income inequality is associated with higher growth in the short run. To estimate the impact of redistribution to low-income earners, we introduce a new measure, the so-called net benefit share (NBS). Contrary to other findings, we show that this (targeted) redistribution to low-income earners (Q1 NBS) boosts growth in the short run, driven by the consumption and private investment channels. On the other hand, untargeted redistribution to higher income earners reduces growth.

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# 1 Introduction

The relationship between inequality and growth, and between redistribution and growth, has been extensively analyzed empirically in recent decades. While there is more or less a consensus on the empirical regularity that inequality is detrimental to growth, at least in the medium term, the impact of redistribution on growth is more controversial in the literature.

While there is considerable evidence that inequality and growth are related and that redistribution affects growth, we still know relatively little about how the two variables are related. As argued by Berg et al. (2018), *"the literature almost without exception does not examine the role of both redistribution and inequality in growth in a common empirical framework"*. Following this argument, we analyze the impact of both pre-tax inequality and redistribution on economic growth in the short run in a cross-country setting of 25 European countries over the period from 2007 to 2019.

So far, cross-country studies such as Berg et al. (2018) have measured redistribution using the Redistributive Effect (RE), defined as the difference between the Gini coefficient of market income and the Gini coefficient of disposable income. However, data on these measures are often scarce and incomplete. As argued by Hammer et al. (2023), the RE might additionally confound redistribution across age groups via pension benefits and redistribution to low-income households, a property that might lead to wrong implications when analyzing the impact of redistribution on growth, especially when it comes to economic policy making.

For this reason, we introduce a new redistribution measure, which we call the Net Benefit Share (NBS), based on EU-SILC microdata. The NBS measures the effective redistribution of a tax-benefit system to a given subpopulation. In this paper we use the Q1 NBS, the share of total net benefits received by the poorest 25% of the population. This allows us to analyze the impact of effective redistribution specifically to low-income individuals in a cross-country setting.

We show that market income inequality has a positive impact on short-run economic growth, as suggested by some authors. However, in contrast to most previous findings, we show that targeted redistribution to low-income households significantly increases economic growth in the short run. More precisely, we show that an increase in the Q1 NBS (indicating more redistribution to low-income households, defined as the poorest 25% of the income distribution) from the level of Spain (18.1% in 2019) to the level of the Netherlands (39.3% in 2019) would increase economic growth by about 1.1 pp in the short run.

In addition, we analyze the transmission channels of inequality and redistribution on growth. Our results suggest that inequality affects economic growth through the productivity channel. Higher inequality leads to higher productivity and thus to higher growth in the short run. For the redistribution-to-growth channel, we find that redistribution to low-income households has a significant and positive impact on private investment and consumption, suggesting that more targeted redistribution leads to higher consumption growth, as well as higher private investment and hence higher economic growth. This result is not surprising, given that low-income households have a higher propensity to consume, so targeted redistribution potentially increases consumption and thus short-term growth. In addition, more targeted redistribution is associated with less public intervention and may therefore allow for more private investment as public money is used more effectively.

Our results are consistent across different estimation methods and robustness checks. Our two main approaches (FE estimation and sGMM) lead to similar results, both for the impact of inequality and for the impact of redistribution on economic growth. In addition, we show that countries that redistribute a significant amount of resources to high-income households have lower economic growth than countries that redistribute less. In sum, it seems unlikely that our results are driven by the techniques we apply to the data.

The policy implications of our results are quite substantial. First, the results suggest that the relationship between redistribution and growth is more complex than is usually discussed in policymaking. Many European countries redistribute large amounts of tax money to higher income groups, for example through public pension entitlements or subsidies to specific industries such as agriculture. In order to promote growth, this type of redistribution should be reduced and replaced by measures that specifically target the poor. Second, looking at the Gini coefficient is not a good measure of the impact of redistribution. Third, and more profoundly, the trade-off between efficiency and equity may be much less pronounced than is sometimes believed - provided that equity is the result of targeted redistributive policies.

The rest of the paper is organized as follows: Section 2 describes the literature on the relationship between inequality and growth, the relationship between inequality and redistribution, and the relationship between redistribution and growth. Section 3 introduces our new measure of redistribution used in the analysis. Section 4 describes the data and methodology used in this paper. Section 5 presents the results of our analysis, and Section 6 concludes.



## 2 Related Literature

There are two strands of literature that are most relevant to this paper: the relationship between inequality and growth, and the relationship between inequality and (preferences for) redistribution that indirectly affect growth.

The relationship between economic growth and inequality has long been debated. There are several theoretical channels that are thought to link inequality to economic growth. A causal relationship from growth to inequality can be assumed for several reasons. First, as argued by Kuznets (1955), the sectoral transformation of the economy associated with growth will cause inequality to first increase and then decrease due to changes in factor prices. When an economy undergoes a transformation from employment primarily in the agricultural sector, the per capita income of those individuals increases because their skills are in demand in those sectors. Individuals who remain in the agricultural sector continue to earn low incomes. Over time, labor shortages in the agricultural sector will cause the price of this factor to rise, reducing inequality again. This view has also been supported by, for example, Robinson (1976).

The second channel has to do with technological change. In the early stages of technological development, innovative ideas in the economic sector lead to an increase in income inequality. This is because the new technology requires highly skilled labor and training, which raises wages in these sectors relative to sectors using old technology. As the economy moves to the more mature stage of technological development, income inequality decreases as more labor shifts to the sector using the new technology and factor prices equalize. While this channel has long been discussed, e.g. by Galor and Tsiddon (1997), it became more relevant in the context of the changes in labor rents associated with the digitization of the economy Acemoglu (2002) - "the skill-biased technological change" (see also Card and DiNardo, 2002).

While there are reasons to believe that growth affects inequality, the reverse is also theoretically possible: causality runs from inequality to growth. Galor and Zeira (1993) argue within a theoretical model framework that income and wealth inequality is detrimental to growth by harming investment in human capital. As they note, their theoretical results "underscore the importance of a large middle class for economic growth. Another direct channel revolves around political-economic issues: the rise of socio-political unrest, stemming from high income inequality, may dampen growth because people engage in strikes, crime, and other unproductive activities (Barro, 2000; Benhabib and Rustichini, 1996) or through the effect on savings (Venieris and Gupta, 1986), which would decrease in unstable political conditions. Moreover, social polarization may reduce the

security of property and contract rights (Keefer and Knack, 2002) or impede the social solidarity needed in times of crisis and to sustain growth (Rodrik, 1999). Furthermore, high inequality could be associated with the abuse of political power through lobbying and rent-seeking, preventing the efficient allocation of resources and harming growth (Banerjee and Duflo, 2003).

On the other hand, inequality can theoretically promote growth by increasing saving and investment, because rich people tend to save more (Kaldor, 1957). As income rises, so does the savings rate, and vice versa. In the presence of high income inequality, rich people earn high incomes that help them save more because their marginal propensity to save is relatively high. This increases aggregate saving, which leads to an increase in capital accumulation, and thereby increases economic growth in the long run (Aghion et al., 1999; Rebelo, 1991; Bourguignon, 1990). Moreover, it can create incentives for innovation and entrepreneurship (Lazear and Rosen, 1981), and by creating incentives to start businesses (Barro, 2000). It can also create positive incentives for innovation through price effects, as shown by Foellmi and Zweimüller (2006).

The empirical evidence is mixed. Early on, Persson and Tabellini (1994); Perotti (1996); Alesina and Rodrik (1994) find a negative relationship between inequality and growth, but generally ignore the endogeneity issues. Panizza (2002); Wan et al. (2006) look at individual countries and also find negative relationships, both in the short run and in the long run. More recently, several cross-country studies have looked at the relationship in a more nuanced way. Knowles (2005); Royuela et al. (2019); Braun et al. (2019); Breunig and Majeed (2020); Berg et al. (2012) all find a negative relationship between inequality and economic growth for the full sample. When countries were divided by income level, Knowles (2005) found a significant negative relationship in low-income countries, but an insignificant relationship in high- and middle-income countries. On the other hand, in Braun et al. (2019) the negative relationship between growth and inequality is stronger in the group of countries with more developed financial markets. Berg et al. (2012) looks at the duration of growth periods and concludes a positive relationship with the degree of equality of the income distribution. Finally, in Breunig and Majeed (2020) the negative impact of inequality on growth was concentrated in countries with high poverty rates. Deininger and Squire (1998) also finds a strong negative relationship, but additionally shows that the effects are heterogeneous with respect to different income groups within an economy. Similarly, Voitchovsky (2005) shows that income inequality at the top decile of the income distribution has a positive effect on growth, while inequality at the bottom decile has a negative effect on growth. A positive relationship has been found in, among others, Partridge (1997); Li and Zou (1998); Forbes (2000); Scholl and

Klasen (2019). However, Forbes (2000) notes that the effect is driven by the subset of transition economies. Further literature can be found in recent reviews by Neves and Silva (2014) and Mdingi and Ho (2021) and in a meta-analysis by Neves et al. (2016). In particular, Neves and Silva (2014) suggests that the differences found in the results are due to differences in the type of countries and time periods included in the samples, the variable used to measure inequality, the structure of the data, and the estimation techniques. Neves et al. (2016) find a meta-effect of about  $-0.0111/-0.0145$  (FE and RE, respectively), implying that an increase of 10 percentage points in the Gini coefficient reduces the average annual growth rate by 0.111/0.145 percentage points.

The second relevant strand of literature concerns the effect of inequality on (public support for) redistribution. If high inequality affects support for redistribution (positively or negatively), one would expect it to affect growth.

Theoretically, higher inequality should lead to preferences for more redistribution (Meltzer and Richard, 1981). Furthermore, (Alesina and Rodrik, 1994) also argues that higher inequality leads to more redistribution. In his view, this further dampens growth by introducing distortions. When the mean income is higher than the median income, people support the redistribution of income and resources (from the rich to the poor). Redistribution takes place through a transfer of payments and public spending, but it could reduce growth in the long run by discouraging innovation and investment (Alesina and Rodrik, 1994; Perotti, 1993).

As for the empirical evidence, Kerr (2014) finds that rising inequality is indeed associated with greater support for government-led redistribution. Magni (2021) also finds that when inequality is high, people become more supportive of redistribution as long as it is targeted at native citizens. These works would suggest that inequality could dampen growth by introducing distortions associated with the need to finance a larger welfare state.

However, theories of redistributive preferences imply that informing people that they are relatively poorer than they thought would lead to greater concern about inequality and support for redistribution (Meltzer and Richard, 1981; Benabou and Ok, 2001; Piketty, 1995). However, the empirical evidence does not point in this direction. (Hoy and Mager, 2021) finds that informing people about their relative position in the income distribution does not lead to a greater preference for redistributive policies. However, there is some evidence to the contrary, e.g. from (Hvidberg et al., 2023). Furthermore, (Roth and Wohlfart, 2018) find that people who experienced more inequality during their childhood are *less* in favor of redistribution. Similarly, Sands (2017) find that exposure to inequality in the form of observing homelessness reduces support for redistribution among

the affluent. Several other papers have also emphasized the role of social beliefs about the sources of inequality in shaping redistributive preferences (Almås et al., 2020; Buser et al., 2020). For a more detailed review of the literature, see a recent survey by (Mengel and Weidenholzer, 2022).

On the other hand, there are several reasons to believe that redistribution is beneficial for growth, especially if taxes are spent efficiently and increase the consumption of the poor (Paul and Verdier, 1997; Benabou, 2000). Moreover, redistribution can also directly improve the efficiency of the economy by allowing low-income individuals to invest in their human capital and thus contribute to overall productivity growth.

One group of studies that should be mentioned separately are those that consider wealth inequality instead of income inequality, such as Castelló and Doménech (2002); Deininger and Squire (1998). These more recent studies argue that inequality in wealth distribution should be used instead of inequality in income distribution because wealth distribution, proxied by land or human capital distribution, is associated with less measurement error and is the relevant distribution in many theoretical analyses. In general, these studies find that land- and human-capital inequality have a more significant negative impact on growth than income inequality (Neves et al., 2016).

### 3 Measuring public redistribution

Previous studies have tried to measure the extent of redistribution using various proxies such as social spending, tax revenues or tax rates (Benabou, 1996; Perotti, 1996; Bassett et al., 1999). However, these measures do not necessarily measure redistribution, as already criticized by (Berg et al., 2018). In their paper, they therefore decided to use a microdata-based measure to account for redistribution - the so-called Redistributive Effect (RE). The RE measures the difference between the Gini index of market income and disposable income. They find that lower net inequality is correlated with faster and more sustained growth, and at the same time, redistribution appears benign in terms of its impact on growth.

However, as argued and empirically shown by Hammer et al. (2023), the RE is strongly correlated with redistribution across age groups and with the generosity of the pension system, especially to richer households in European countries. It has been argued in the literature that pensions aim to redistribute income over the life-cycle. As a result, pensions often redistribute relatively little across individuals. As argued by Paul and Verdier (1997); Benabou (2000), targeted redistribution from rich to poor households may dampen household consumption and thus economic growth. In

addition, as highlighted by O'Reilly (2018), policies that reduce the share of pension spending (especially if this spending is targeted at the top of the income distribution) would increase the growth-enhancing effects of public spending.

To construct a redistribution measure that accurately measures redistribution to low-income households, we follow (Hammer et al., 2023), who use the micro-data concept of *net benefit ratios* (*NBR*). We follow a similar approach, but since we are interested in the targeted redistribution of a country, we introduce a new measure, namely *net benefit shares* (*NBS*), which is defined as the total net benefits targeted to a specific subpopulation relative to the disposable income in the economy. Net benefits are defined as the sum of all benefits received by a household minus all taxes paid by a household. By measuring net benefits to specific subpopulations relative to total net benefits, the NBS can be interpreted as the share of effective redistribution to the specific subgroup under consideration, in our case low-income (and high-income) households. A country could have high overall redistribution, but only partially protect low-income households, as shown by (Hammer et al., 2023). Therefore, accounting for the specific type of redistribution can potentially be very important when assessing the impact of redistribution on economic growth.

We are particularly interested in the subpopulation of low-income households, so we look at households in the bottom quartile of the income distribution ( $Q1 - NBS$ )<sup>1</sup>

$$Q1-NBS = \frac{\sum_{j \in Q1, b_j \geq t_j} (b_j - t_j)}{\sum_{j \in N, b_j \geq t_j} (b_j - t_j)} \quad (1)$$

Where  $N$  is the total size of the population,  $Q1$  is the number of individuals in  $Q1$  who receive net benefits ( $b_j \geq t_j$ ).

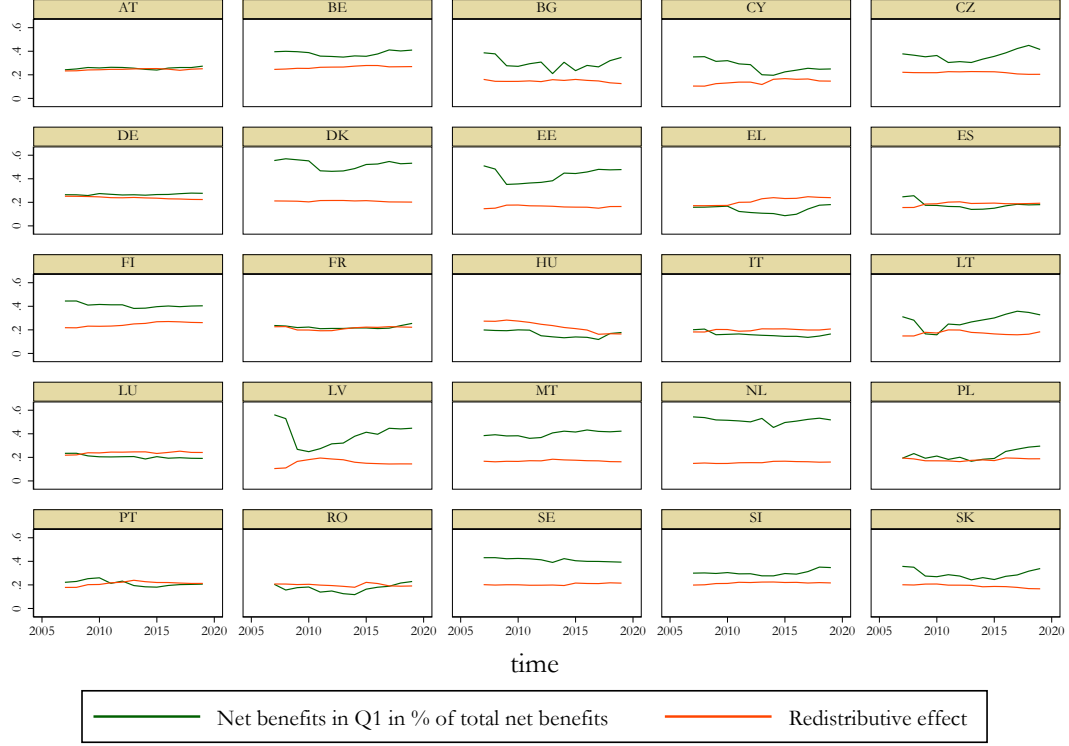
Tax-benefit systems redistribute resources not only to low-income households, but also to high-income households (through family benefits, pensions, and the like). The NBS can specifically account for this fact. Our measure helps to proxy the amount of redistribution within a tax system to a particular subgroup. For our analysis, we are particularly interested in whether the targeted redistribution to low-income households has an impact on growth in the short run. The use of the NBS allows us to test this hypothesis empirically.

Figure 1 shows the evolution of the  $Q1$  NBS and the redistributive effect over our sample period from 2007 to 2019.  $Q1$ -NBS vary considerably across countries, from very low levels of redistribution to  $Q1$  in countries such as Greece (13.7%), Italy (16.1%), Hungary (16.5%), Romania

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<sup>1</sup>For robustness checks, we also estimate the NBS for the bottom two quartiles of the income distribution ( $Q1Q2 - NBS$ ).

**Fig. 1** 1st Quarter Net Benefit Share (Q1-NBS), 2007 – 2019



(17.1%) or Spain (17.9%) to levels of more than 50% redistribution to Q1 in countries such as Denmark or the Netherlands.

Comparing the Q1-NBS (green line) with the redistributive effect (red line), we find no substantial differences between the measures across countries. Not only is the Q1-NBS more volatile over time, but there are also significant differences in the trends across countries. For example, while in Germany the Q1-NBS increases slightly over time, the redistributive effect suggests a slight decrease in redistribution. The opposite is true for Finland, where the RE suggests an increase in redistribution, while the Q1-NBS suggests a decrease in the share of redistribution received by low-income households.

## 4 Data and Methodology

Early studies estimating growth determinants used a simple OLS regression setup to estimate correlations between growth and inequality and redistribution Alesina and Rodrik (1994); Persson and Tabellini (1994); Deininger and Squire (1998). Since we are interested in the impact of inequality and redistribution in Europe using new micro data estimates for redistribution, where the data

used are limited to observations after 2007, such an approach is problematic. In such a setting, the dynamic panel bias is particularly pronounced due to the small number of time points  $t$  and a large number of countries  $n$ . Therefore, similar to Berg et al. (2018), Ferreira et al. (2018) and Marrero et al. (2019), we estimate growth regressions using System GMM (Blundell and Bond, 1998).

System GMM overcomes the problem of dynamic panel bias, but faces some other problems. The model estimates both the equation in levels, using the lagged first difference variables as instruments, and the equation in first differences, using the lagged dependent variable as an instrument. The system GMM is currently the most widely used method for estimating the effect of inequality on economic growth. However, since the lagged variables are used as instruments in this method, system GMM may result in a large number of instruments, leading to over-fitting of the model. If the model is over-fitted, the results will be no more reliable than the biased OLS results. To avoid over-fitting the model, Roodman (2009) suggests to limit the number of instruments to no more than the number of countries used in the sample. He suggests either reducing the number of lags used or using only the first difference of each variable as an instrument. Both approaches run the risk of losing important information. Therefore, Bontempi and Mammi (2015) proposed the principal components approach (PCA), which tries to minimize the loss of information when reducing the number of instruments. This is the approach we follow here.

Consistent with the empirical literature on cross-country comparisons of economic growth (Caselli et al., 1996; Mankiw et al., 1992), our specification models the level of economic growth per capita as a function of initial income per capita ( $\log(Y_{i,t-1})$ ), inequality ( $I_{i,t}$ ), redistribution  $R_{i,t}$ , and other controls ( $Z_{i,t}$ ) such as the stock of human capital, the stock of physical capital, and trade openness. Thus, the empirical model can be formally written as

$$g_{i,t} = \lambda_1 \log(Y_{i,t-1}) + \lambda_2 I_{i,t} + \lambda_3 R_{i,t} + \lambda_4 Z_{i,t} + \alpha_i + \beta_t + \epsilon_{i,t} \quad (2)$$

Our dependent variable  $g_{i,t}$  is the growth rate of GDP per capita (from year  $t-1$  to year  $t$ ). We are interested in the effect of both inequality and redistribution on the growth rate of GDP per capita.

Therefore, we follow the approach of Berg et al. (2018) to include both the inequality variable  $I_{i,t}$  and the redistribution variable  $R_{i,t}$  in the growth equation. We use the Gini coefficient of market income as the measure of inequality. Instead of using a standard redistribution variable

as in Berg et al. (2018), we use our indicator that measures the extent of redistribution to low-income households, the Q1-NBS (see section 3). In addition, we use several other control variables  $Z_{i,t}$  that are usually related to economic growth. To account for the stock of physical capital, we use investment by sectors (private and public), measured as the investment share of institutional sectors in GDP. In addition, we add a measure of human capital, a measure of trade openness, and we also control for initial level of development by including the lagged logarithm of GDP per capita.

We use an unbalanced panel of 25 EU countries from 2007 to 2019. We exclude the COVID-19 years due to several data collection issues. Due to data problems, we have dropped Ireland and Croatia from our sample.<sup>2</sup> Table A1 in the Appendix shows the summary statistics for all variables included in our analysis. We use GDP per capita and its growth rate from Eurostat. The Gini index for both market income and disposable income are calculated using EUROMOD, which is based on micro data from EU-SILC. The same is true for our redistribution measures, the RE and the Q1-NBS. In addition, we include private (corporate and household) and government investment from Eurostat, measured as the share of institutional investment in GDP. To account for changes in the skills of a country's labor force, we include the share of the population with a high level of education from Eurostat (the share of the population over 25 with an education of ISCED 3 or higher). To account for the openness of the economy, we include a standard WTO indicator of trade openness, namely merchandise trade as a share of GDP, which is defined as the sum of merchandise exports and imports divided by the value of GDP, all in current US dollars.

Looking at our variables of interest, Figure 2 shows the correlation between the growth rate of GDP per capita and the inequality and redistribution measures. We can see a weak and positive relationship between inequality, measured as the Gini coefficient of market income, and the GDP per capita growth rate. When we look at the relationship between redistribution as measured by the Redistributive Effect (RE, the difference between the Gini coefficients of market income and disposable income) and the GDP per capita growth rate, we see a weak negative correlation. However, when we use our newly introduced measure of redistribution, the Q1-NBS, the negative relationship between redistribution and GDP per capita growth disappears and we see evidence of a positive relationship between redistribution and subsequent growth. Consequently, the Q1-NBS is negatively correlated with the redistributive effect. This may seem surprising since both

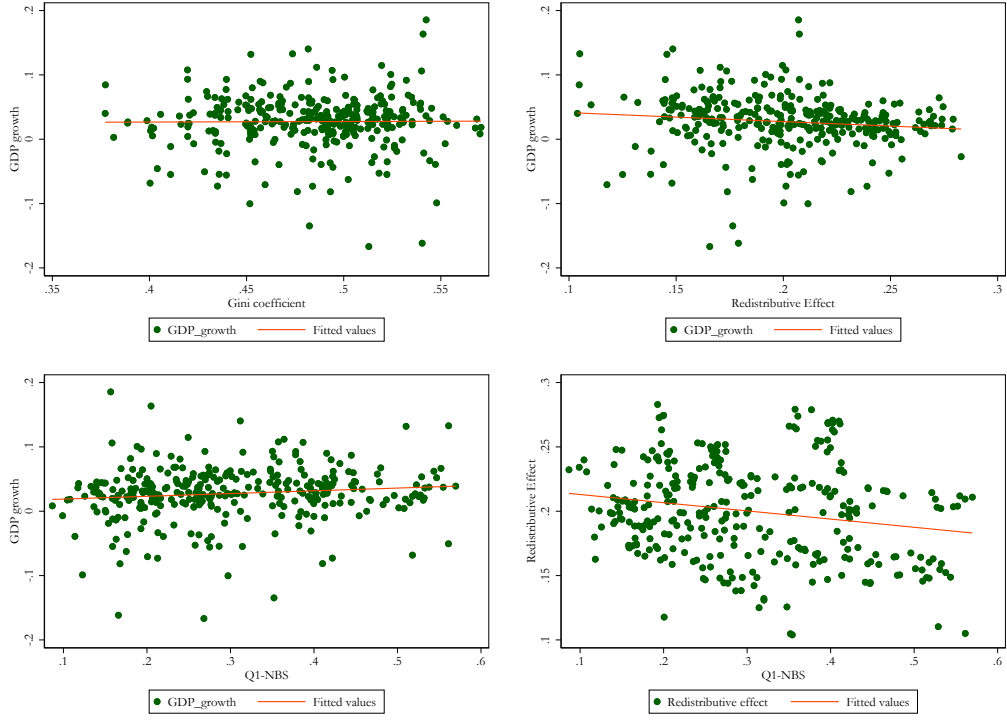
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<sup>2</sup>Ireland's growth rates are strongly driven by multinational companies, which makes a comparison with other EU member states very difficult. For Croatia, the number of observations was simply too small, so we decided not to include the country.



measures are supposed to measure redistribution. However, one has to keep in mind that the Q1-NBS is intended to measure redistribution specifically to low-income households, while the RE measures general redistribution within a tax system - which, as explained above, is more often than not directed at the higher-income population.

**Fig. 2** Correlation between GDP growth and inequality/redistribution



## 5 Results

### 5.1 Short-run Growth and the Redistributive Effect

As a first step, we set up a model similar to Berg et al. (2018) to estimate the effect of both inequality and redistribution on the short-term growth rate in our set of countries. It is worth noting that our results may differ because of the different country focus (Europe instead of a set of developed and developing countries), but also because of the focus on short-term growth instead of long-term growth (5-year growth spells).

Table 1 shows different specifications of our model using the redistributive effect as the redistribution measure. First, we estimate the very simple model that includes only the initial level of GDP, inequality, and redistribution as explanatory variables (Column 1). Then we gradually

add a number of additional standard growth determinants, such as private and public investment (Column 2), an estimate of human capital (Column 3), and trade openness (Column 4), using the lagged values of the endogenous variables as instruments. Columns 5-8 are the same models using the Principal Component Approach (PCA) to minimize the loss of information when reducing the number of instruments.

We can see that in all models the Gini coefficient has a positive effect on economic growth, which would indicate that more unequal countries tend to have higher growth rates. However, this result is only significant in Specifications 4 and 8. Looking at the coefficient of RE, we can see that the results indicate a negative relationship between redistribution and economic growth. Again, however, the results are only significant in Models 4 and 8. In line with previous literature, private investment is positively and mostly significantly related to economic growth, while public investment has a negative effect on growth. The higher the share of highly educated population in a country, the higher the growth, and also the coefficients on trade openness indicate that higher openness is correlated with higher growth.

**Table 1** Growth Regression, standard model

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.log(GDP)	-0.010 (0.0083)	-0.037 (0.023)	-0.025* (0.015)	0.00066 (0.016)	0.0033 (0.017)	-0.027 (0.037)	-0.014 (0.021)	0.015 (0.016)
Gini coefficient	0.048 (0.082)	0.0099 (0.14)	0.093 (0.13)	0.25*** (0.094)	0.11 (0.12)	0.033 (0.20)	0.12 (0.15)	0.34** (0.15)
Redistributive effect	-0.074 (0.080)	-0.067 (0.15)	-0.14 (0.10)	-0.27*** (0.097)	-0.14 (0.11)	0.0046 (0.20)	-0.096 (0.13)	-0.28** (0.12)
private investment		0.086*** (0.034)	0.035 (0.023)	0.023 (0.024)		0.040** (0.016)	0.038*** (0.015)	0.033* (0.018)
public investment		-0.072*** (0.021)	-0.054*** (0.015)	-0.039*** (0.011)		-0.0090 (0.013)	-0.012 (0.011)	-0.0057 (0.011)
high education			0.089*** (0.032)	0.050 (0.033)			0.034** (0.017)	0.018 (0.015)
open				0.024** (0.010)				0.029*** (0.0059)
Constant	0.12 (0.084)	0.32 (0.24)	0.17 (0.15)	-0.23 (0.20)	-0.032 (0.19)	0.32 (0.38)	0.16 (0.22)	-0.32* (0.19)
Observations	300	298	298	298	300	298	298	298
No. of instruments	80	35	80	81	27	26	30	31
AR1 (p-value)	0.00032	0.00054	0.00040	0.00044	0.00021	0.00017	0.00027	0.00044
AR2 (p-value)	0.068	0.0076	0.020	0.037	0.064	0.049	0.047	0.068
Hansen-J (p-value)	1.00	0.79	1.00	1.00	0.41	0.25	0.47	0.45
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$

A concern with system GMM estimation is that the sensitivity of the results depends crucially on the selection of instrumental variables. A proliferation of instruments may reflect problems of weak or invalid instruments. Therefore, we present Hansen tests of joint instrument validity.

Additionally, the first and second-order residual autocorrelation tests are presented. By using the PCA approach in specifications 5 to 8, the number of instruments used is substantially reduced, the Hansen Test is still not significant, and the number of instruments is about the same as the number of countries we have in our sample.

## 5.2 Short-Term Growth and the Q1 Net Benefit Share

Given that we do not observe significant results when using the standard measure of RE, in the next step we analyze the impact of our specific measure of redistribution, the Q1 NBS, which measures the share of benefits going to households in the first quartile of the income distribution. Table 2 highlights different specifications of our model.

We again find that the Gini coefficient positively affects economic growth in the short run, and the effect is now significant in most specifications. The coefficient ranges between 0.14 and 0.24, indicating that a 1 pp increase in the Gini coefficient leads to a 0.2 pp higher growth rate. The coefficient on our variable of interest, redistribution to low-income households measured as the Q1 NBS, is positive and significant in all model specifications except specification 8. This indicates that more redistribution to the poor has a significant and positive impact on economic growth. The coefficient ranges from 0.087 to 0.029, indicating that a 1 percentage point increase in the share of redistribution to households in Q1 increases the growth rate by about 0.05 percentage point, holding the market Gini constant. That is, assuming that the redistributive measures do not affect the market Gini, an additional growth effect can be expected from targeted redistribution. This assumption seems more likely in the case of targeted redistribution, which would be associated with lower distortions, as it is associated with a lower volume of public spending than untargeted redistribution.

We find no evidence that the additional controls increase the impact of inequality or redistribution on growth. Consistent with the literature, private investment is positively and mostly significantly related to GDP growth, as is the share of highly educated population and trade openness. The level of GDP per capita is mostly negatively but not significantly correlated with GDP growth, suggesting that less developed countries grow faster, consistent with the convergence hypothesis.

**Table 2** Growth Regression, Q1 Net Benefit Share

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.log(GDP)	-0.028*** (0.0099)	-0.033*** (0.011)	-0.031*** (0.011)	-0.019* (0.011)	-0.011 (0.018)	-0.030 (0.029)	-0.032 (0.025)	0.0022 (0.021)
Gini coefficient	0.15** (0.078)	0.14** (0.071)	0.16** (0.070)	0.21*** (0.075)	0.17* (0.093)	0.14 (0.096)	0.15 (0.092)	0.24** (0.099)
Q1-NBS	0.087*** (0.032)	0.071** (0.034)	0.067** (0.033)	0.051* (0.029)	0.075** (0.034)	0.063* (0.036)	0.062* (0.033)	0.029 (0.034)
private investment		0.030** (0.013)	0.028** (0.014)	0.023 (0.015)		0.032** (0.015)	0.029* (0.015)	0.027 (0.017)
public investment		-0.0093 (0.010)	-0.015 (0.010)	-0.0096 (0.011)		-0.0087 (0.014)	-0.015 (0.013)	-0.0025 (0.014)
high education			0.029** (0.013)	0.015 (0.013)			0.029** (0.013)	0.013 (0.016)
open				0.019*** (0.0066)				0.023*** (0.0087)
Constant	0.20** (0.10)	0.29*** (0.100)	0.24** (0.10)	0.031 (0.15)	0.032 (0.20)	0.27 (0.28)	0.27 (0.24)	-0.18 (0.25)
Observations	300	298	298	298	300	298	298	298
No. of instruments	80	82	83	84	27	29	30	31
AR1 (p-value)	0.00034	0.00033	0.00033	0.00044	0.00021	0.00014	0.00017	0.00030
AR2 (p-value)	0.071	0.055	0.052	0.069	0.071	0.058	0.054	0.088
Hansen-J (p-value)	1.00	1.00	1.00	1.00	0.41	0.46	0.46	0.45
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$ 

### 5.3 Robustness Checks

To check the robustness of our results regarding the effect of our key variable of interest, redistribution to poor households (measured as the share of net benefits going to low-income households in Q1), on economic growth, we first report the results of the standard FE model, adding time and country fixed effects.

Table 3 reports the results. We can see that in the specifications where we use the Redistributive Effect as our redistribution variable ( Specifications 1 to 4), we see a negative and significant relationship between the Gini coefficient and economic growth. In addition, the Redistributive Effect is also negatively correlated with economic growth, but only significantly so in Specification 4. This is consistent with our results from the sGMM model.

Turning to our redistributive measure of interest, the Net Benefit Share of Q1 (NBS Q1, Specifications 5-8), we see that the results change. While the significantly negative effect of income inequality (measured by the market Gini coefficient) prevails, our redistributive measure is now positively correlated with economic growth, indicating that a 1pp increase in NBS Q1 leads to an increase in economic growth of about 0.3pp. We conclude that the effect of an increase in redistribution is even larger using the FE model compared to the sGMM results.

**Table 3** Growth Regression, FE model

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.log(GDP)	-0.63*** (0.088)	-0.87*** (0.078)	-0.87*** (0.074)	-0.74*** (0.057)	-0.29*** (0.060)	-0.86*** (0.077)	-0.86*** (0.071)	-0.73*** (0.059)
Gini coefficient	-0.92* (0.47)	-0.54** (0.21)	-0.53** (0.22)	-0.49** (0.20)	0.050 (0.21)	-0.40** (0.17)	-0.38** (0.17)	-0.35* (0.20)
Redistributive effect	-0.55 (0.43)	-0.26 (0.26)	-0.30 (0.26)	-0.40* (0.23)				
NBS Q1					0.48*** (0.074)	0.27*** (0.080)	0.29*** (0.085)	0.33*** (0.074)
private investment		0.22*** (0.018)	0.22*** (0.018)	0.19*** (0.018)		0.19*** (0.019)	0.19*** (0.017)	0.15*** (0.016)
public investment		0.046*** (0.015)	0.046*** (0.015)	0.044*** (0.015)		0.045*** (0.016)	0.046*** (0.015)	0.043** (0.016)
low education			-0.048 (0.065)	-0.023 (0.066)			-0.081 (0.073)	-0.054 (0.067)
open				0.11*** (0.040)				0.12*** (0.037)
Constant	-28.4*** (3.01)	-40.3*** (2.89)	-37.8*** (5.23)	-32.8*** (4.22)	-14.8*** (2.78)	-38.9*** (2.84)	-34.5*** (5.39)	-28.9*** (4.33)
Observations	300	298	298	298	300	298	298	298
$R^2$	0.415	0.661	0.663	0.701	0.322	0.684	0.688	0.731
Adjusted $R^2$	0.355	0.623	0.624	0.665	0.312	0.648	0.652	0.698

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$ 

As a second robustness check, we broaden our definition of low-income households: we allow for less targeted redistribution by estimating the model with the net benefit share that considers households in the first and second quartiles of the income distribution. Ex ante, we would expect the effect of redistribution to be weaker, since the redistributive approach is now extended to the middle of the income distribution.

Table 4 highlights the results using the broadened concept of redistribution. The results show that the impact of an increase in the NBS Q1+Q2 on economic growth is still significant, but much smaller. The model suggests that a 1pp increase in the NBS Q1+Q2 implies an increase in economic growth of around 0.058pp to 0.010pp. This is smaller than the effect we found using NBS Q1 (see table 1). The coefficients for the other variables are similar and in line with those reported using the NBS Q1.

As a third robustness check, we switch from our definition of redistribution to low-income households to one that measures redistribution to high-income households by estimating the net benefit share model that considers households in the fourth quartile of the income distribution. Ex ante, we would expect the effect of redistribution to be even negative, since the concept of redistribution is now reversed, measuring redistribution to high incomes.

**Table 4** Growth Regression, Q1+Q2 NBS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.log(GDP)	-0.022** (0.0099)	-0.028*** (0.010)	-0.025** (0.0099)	-0.015 (0.011)	0.00013 (0.018)	-0.017 (0.028)	-0.019 (0.024)	0.013 (0.020)
Gini coefficient	0.14** (0.068)	0.13** (0.063)	0.14** (0.062)	0.18** (0.072)	0.18** (0.086)	0.15 (0.10)	0.15 (0.098)	0.25** (0.11)
Q1+Q2 NBS	0.060*** (0.021)	0.046** (0.022)	0.042* (0.022)	0.023 (0.022)	0.058** (0.023)	0.041* (0.022)	0.037* (0.022)	0.0098 (0.025)
private investment		0.031** (0.014)	0.029** (0.014)	0.025* (0.015)		0.034** (0.015)	0.032** (0.015)	0.029 (0.018)
public investment		-0.0085 (0.0099)	-0.014 (0.010)	-0.0090 (0.011)		-0.0052 (0.014)	-0.011 (0.013)	0.00060 (0.015)
high education			0.029** (0.013)	0.015 (0.012)			0.029** (0.014)	0.012 (0.017)
open				0.019*** (0.0065)				0.026*** (0.0085)
Constant	0.14 (0.100)	0.24** (0.093)	0.20** (0.097)	0.013 (0.14)	-0.098 (0.20)	0.14 (0.28)	0.15 (0.24)	-0.28 (0.24)
Observations	300	298	298	298	300	298	298	298
No. of instruments	80	82	83	84	27	29	30	31
AR1 (p-value)	0.00036	0.00036	0.00036	0.00046	0.00021	0.00015	0.00019	0.00032
AR2 (p-value)	0.075	0.058	0.055	0.071	0.075	0.063	0.060	0.095
Hansen-J (p-value)	1.00	1.00	1.00	1.00	0.39	0.44	0.48	0.46
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$ 

Table 5 shows our standard specifications of the model, but changing from the Q1 NBS to the Q4 NBS. We find a positive relationship between pre-tax income inequality and economic growth, consistent with the results of the models using different redistributive measures. Looking at the coefficients of our variable of interest, we can see that the results indicate a negative relationship between growth and the strength of redistribution to rich households. The effect is significant in most of the specifications and indicates that a 1 percentage point increase in net redistribution to households in Q4 leads to a reduction in economic growth of between 0.08 and 0.01 percentage points.

In addition to the above checks, we apply leave-one-out cross-validation for panel data, meaning that we rerun all regressions on a smaller dataset (randomly excluding one country). This allows us to see if our results are driven by a single country in the data set. The results can be found in Table A2 for the standard model and in Table A3 for the model where the instruments are chosen via the principal components approach. Overall, we find that the coefficients of our inequality measure are very robust across the different datasets, and the significance level of the coefficient is also stable across different dataset choices.

In conclusion, our results are stable across model choices, as well as across the concepts of redistribution that we use. We can see that the effect of redistribution on economic growth seems to

**Table 5** Growth Regression, Q4 NBS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.log(GDP)	-0.020** (0.0100)	-0.027*** (0.010)	-0.025** (0.0100)	-0.014 (0.011)	0.0051 (0.018)	-0.014 (0.027)	-0.016 (0.024)	0.015 (0.019)
Gini coefficient	0.12* (0.069)	0.12* (0.064)	0.13** (0.062)	0.17** (0.073)	0.17** (0.083)	0.14 (0.10)	0.14 (0.100)	0.25** (0.11)
Q4 NBS	-0.079*** (0.023)	-0.066*** (0.025)	-0.058** (0.025)	-0.027 (0.029)	-0.082*** (0.027)	-0.063** (0.025)	-0.055** (0.025)	-0.012 (0.030)
private investment		0.032** (0.013)	0.030** (0.014)	0.027* (0.015)		0.034** (0.015)	0.033** (0.015)	0.030* (0.018)
public investment		-0.011 (0.010)	-0.015 (0.010)	-0.0094 (0.011)		-0.0065 (0.014)	-0.012 (0.014)	0.00096 (0.014)
high education			0.027** (0.013)	0.014 (0.012)			0.027* (0.015)	0.011 (0.017)
open				0.019*** (0.0069)				0.026*** (0.0085)
Constant	0.18* (0.096)	0.27*** (0.097)	0.24** (0.097)	0.029 (0.14)	-0.094 (0.19)	0.15 (0.27)	0.16 (0.24)	-0.30 (0.23)
Observations	300	298	298	298	300	298	298	298
No. of inst	80	82	83	84	27	29	30	31
AR1 (p-value)	0.00037	0.00038	0.00038	0.00047	0.00022	0.00016	0.00020	0.00033
AR2 (p-value)	0.075	0.056	0.052	0.067	0.076	0.063	0.059	0.094
Hansen-J (p-value)	1.00	1.00	1.00	1.00	0.40	0.46	0.46	0.48
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$ 

be stronger when redistribution is more concentrated on low-income households. And it also turns out that strong redistribution to high-income households has a detrimental effect on economic growth, findings that are consistent with economic theory.

## 5.4 Transmission Channels in the Growth Regressions

As shown in the previous subsection, we find a positive effect of redistribution on short-run economic growth and of inequality before taxes and transfers on short-run economic growth. We want to investigate the transmission channels behind these relationships. We formally consider the potential channels through which inequality and redistribution could potentially affect short-term growth. More specifically, we examine the role of private and public investment, private consumption (measured as private consumption growth), and productivity (measured as real labor productivity growth). To study the transmission channels, we estimate the effect of inequality and redistribution not on economic growth but directly on the channels with the following model:

$$Z_{i,t} = \lambda_1 \log(Y_{i,t}) + \lambda_2 I_{i,t} + \lambda_3 R_{i,t} + \alpha_i + \beta_t + \epsilon_{i,t} \quad (3)$$

where our dependent variable  $Z_{i,t}$  is the potential transmission variable,  $\log(Y_{i,t})$  is the log of GDP, which should reflect the different economic development of countries,  $I_{i,t}$  is our inequality

variable, namely the pre-tax Gini coefficient, and  $R_{i,t}$  is our redistribution variable, namely the Net Benefit Share (NBS) of country  $i$  at time  $t$ . We use sGMM to estimate the model in order to overcome a potential dynamic panel bias given the nature of our data.

**Table 6** Growth channels

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	pub inv	priv inv	cons	prod	pub inv	priv inv	cons	prod
L.log(GDP)	-0.34* (0.18)	0.16 (0.15)	-0.012 (0.0096)	0.045** (0.020)	-0.38** (0.18)	-0.11 (0.086)	-0.019 (0.028)	0.14*** (0.048)
Gini coefficient	-1.73 (1.12)	-0.38 (0.79)	-0.023 (0.10)	0.25** (0.13)	-2.08* (1.17)	-0.59 (0.86)	-0.059 (0.10)	0.37* (0.21)
Q1 NBS	0.29 (0.46)	0.52* (0.31)	0.082** (0.038)	0.050 (0.057)	0.15 (0.46)	0.67*** (0.24)	0.083** (0.042)	-0.0021 (0.11)
Constant	0.87 (1.94)	-3.40** (1.33)	0.14 (0.098)	4.00*** (0.21)	1.43 (1.98)	-0.55 (1.00)	0.23 (0.29)	3.00*** (0.45)
Observations	298	298	300	300	298	298	300	300
No. of instruments	80	80	80	80	24	24	29	24
AR1 (p-value)	0.13	0.031	0.0067	0.24	0.12	0.017	0.0057	0.47
AR2 (p-value)	0.0030	0.061	0.14	0.044	0.0028	0.038	0.14	0.21
Hansen-J (p-value)	1.00	1.00	1.00	1.00	0.30	0.21	0.58	0.24
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$

Table 6 reports the results of our panel regressions for the growth channels. We can see that income inequality seems to have a negative but insignificant effect on our short-run channels, but we can see that pre-tax inequality has a positive and significant effect on productivity.

Looking at redistribution, we find that redistribution to low-income households, measured as the share of net benefits received by households in the first quarter, has a significant and positive impact on two of the four channels analyzed, namely on private investment and consumption, suggesting that better targeted redistribution leads to higher consumption growth, as well as higher private investment, and thus higher economic growth.

From a theoretical point of view, these results are not surprising. Higher pre-tax inequality leads to higher productivity in the short run. This is consistent with the findings of Lloyd-Ellis (2003), who argues that *"although reduced inequality and higher productivity need not be conflicting goals, a balance must be struck between the short-run disincentive effects and the long-run average investment effects of reduced inequality"*.

Focusing on redistribution, economic theory suggests that low-income households have a higher propensity to consume, so that more targeted redistribution may dampen consumption and thus short-run growth. In addition, more targeted redistribution is associated with less public intervention and may therefore allow for more private investment as public money is used more efficiently.



To confirm our result, we can also look at the growth channel assuming significant redistribution to high-income households, as in the Q4 NBS. Table 7 shows that when the redistribution to high income households in a country is higher, the growth rates are significantly lower. And again, we see that both channels, the public investment channel and the private consumption channel, are responsible for this effect. The productivity channel, which suggests a positive impact of pre-tax inequality on economic growth, remains visible even when we change our definition of redistribution in the model.

**Table 7** Growth channels for redistribution to high incomes

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	pub inv	priv inv	cons	prod	pub inv	priv inv	cons	prod
L.log(GDP)	-0.28* (0.16)	0.19 (0.16)	-0.0078 (0.0076)	0.049** (0.021)	-0.36** (0.16)	-0.023 (0.085)	-0.0082 (0.025)	0.15*** (0.045)
Gini coefficient	-1.34 (0.88)	-0.57 (0.78)	-0.070 (0.10)	0.18 (0.13)	-1.73* (0.95)	-1.00 (1.01)	-0.091 (0.12)	0.42** (0.20)
Q4 NBS	-0.57 (0.38)	-0.51** (0.25)	-0.072** (0.029)	-0.0035 (0.043)	-0.44 (0.37)	-0.48** (0.19)	-0.072** (0.028)	-0.019 (0.075)
Constant	0.32 (1.85)	-3.35** (1.46)	0.16** (0.077)	4.02*** (0.24)	1.24 (1.92)	-0.96 (1.04)	0.17 (0.28)	2.90*** (0.49)
Observations	298	298	300	300	298	298	300	300
No. of instruments	80	80	80	80	24	24	29	24
AR1 (p-value)	0.13	0.042	0.0066	0.29	0.12	0.024	0.0055	0.40
AR2 (p-value)	0.0034	0.077	0.13	0.048	0.0032	0.051	0.13	0.23
Hansen-J (p-value)	1.00	1.00	1.00	1.00	0.27	0.21	0.57	0.26
PCR	No	No	No	No	Yes	Yes	Yes	Yes

Standard errors in parentheses

\*  $p \leq 0.10$ , \*\*  $p \leq 0.05$ , \*\*\*  $p \leq 0.01$

## 6 Conclusion

In this paper, we construct a new comprehensive dataset for 25 European countries from 2007 to 2019, including a new microdata-based redistribution measure, Net Benefit Shares (NBS), which allows us to estimate the amount of targeted redistribution to low-income households as well as untargeted redistribution to high-income households. In this cross-country setting, we focus on the impact of both inequality and redistribution (targeted and untargeted) on economic growth in the short run.

We show that market income inequality is a driver of economic growth: developed countries with higher market inequality experience higher economic growth in the short run. We show that this higher growth is driven by the productivity channel, implying that countries with higher inequality are more productive. However, in contrast to other studies, we show that targeted redistribution is also a positive driver of economic growth. For example, an increase in targeted redistribution (as measured by the Q1 NBS) from the level of Spain (18,1% in 2019) to the level of

the Netherlands (39,3% in 2019) would increase economic growth by about 1.1 percentage points in the short run. This higher growth can be attributed to two main channels, the consumption channel and the private investment channel. We show that these results are very robust to different estimation methods used (sGMM and FE), and to different instrumental variables used in our sGMM estimations. In addition, we show that reducing targeting reduces the positive growth impact of redistribution.

The policy implications of our results are quite substantial. First, the results suggest that the relationship between redistribution and growth is more complex than usually discussed in policymaking and in most of the literature. Many European countries redistribute large amounts of tax money to higher income groups, for example through public pension entitlements or subsidies to specific industries such as agriculture. In order to promote growth, this type of redistribution should be reduced and replaced by measures that specifically target the poor. Second, a mere reduction in Gini coefficients is not a good proxy for the impact of redistribution. Third, and more profoundly, the trade-off between efficiency and equity may be much less pronounced than is sometimes believed - provided that equity is the result of targeted redistributive policies.

However, we need to be cautious about over-interpreting these results. It can be difficult to draw firm conclusions about causality from such results. Nevertheless, our empirical analysis underlines an important observation. Within European countries, regardless of the level of market income inequality, targeted redistribution is a pro-growth policy in the short run. And in the same vein, our results show that untargeted redistribution is detrimental to short-run growth. This is an important conclusion that suggests that by refocusing on policies targeted at the poor, policymakers can increase economic growth in the short run.

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## A Additional Tables

**Table A1** Summary Statistics

Variable	Panel	Mean	Sd	Min	Max	Observations
GDP growth	Overall	0.03	0.04	-0.17	0.19	N = 325
	Between		0.02	-0.01	0.07	n = 25
	Within		0.04	-0.19	0.15	T = 13
log(GDP)	Overall	10.12	0.38	9.21	11.29	N = 325
	Between		0.37	9.44	11.20	n = 25
	Within		0.11	9.79	10.49	T = 13
private investment	Overall	17.74	3.53	6.91	30.81	N = 323
	Between		2.52	10.76	22.29	n = 25
	Within		2.51	12.32	28.87	T = 12.92
public investment	Overall	3.78	1.09	1.54	6.64	N = 323
	Between		0.83	2.23	5.44	n = 25
	Within		0.73	1.67	6.38	T = 12.92
high education	Overall	0.72	0.12	0.29	0.89	N = 325
	Between		0.12	0.40	0.86	n = 25
	Within		0.04	0.58	0.87	T = 13
Gini coefficient	Overall	0.48	0.04	0.38	0.57	N = 325
	Between		0.04	0.41	0.54	n = 25
	Within		0.02	0.42	0.53	T = 13
Redistributive Effect (RE)	Overall	0.20	0.04	0.10	0.28	N = 325
	Between		0.03	0.14	0.26	n = 25
	Within		0.02	0.13	0.25	T = 13
Net benefit share in Q1	Overall	0.30	0.11	0.09	0.57	N = 325
	Between		0.11	0.14	0.52	n = 25
	Within		0.04	0.16	0.47	T = 13
Net benefit share in Q1 and Q2	Overall	0.58	0.15	0.32	0.88	N = 325
	Between		0.14	0.40	0.86	n = 25
	Within		0.04	0.44	0.71	T = 13
Net benefit share in Q4	Overall	0.20	0.11	0.02	0.52	N = 325
	Between		0.11	0.04	0.41	n = 25
	Within		0.03	0.10	0.35	T = 13
openess	Overall	90.38	41.29	29.97	181.34	N = 325
	Between		40.82	39.10	170.35	n = 25
	Within		10.02	54.08	117.27	T = 13
productivity growth	Overall	0.01	0.02	-0.08	0.10	N = 325
	Between		0.01	-0.02	0.04	n = 25
	Within		0.02	-0.10	0.08	T = 13
consumption growth	Overall	0.03	0.05	-0.21	0.25	N = 325
	Between		0.01	-0.00	0.06	n = 25
	Within		0.05	-0.21	0.23	T = 13



**Table A2** Leave-one-out regression results - coefficients for Q1-NBS

	model (1)		model (2)		model (3)		model (4)	
	coefficient	p-value	coefficient	p-value	coefficient	p-value	coefficient	p-value
AT	0.088	(0.01)	0.066	(0.06)	0.058	(0.08)	0.049	(0.12)
BE	0.090	(0.01)	0.072	(0.04)	0.067	(0.04)	0.062	(0.05)
BG	0.076	(0.01)	0.056	(0.08)	0.052	(0.09)	0.043	(0.14)
CY	0.081	(0.02)	0.061	(0.08)	0.057	(0.09)	0.053	(0.10)
CZ	0.087	(0.01)	0.065	(0.06)	0.059	(0.07)	0.049	(0.12)
DE	0.087	(0.01)	0.066	(0.05)	0.060	(0.07)	0.051	(0.10)
DK	0.091	(0.01)	0.066	(0.07)	0.059	(0.11)	0.043	(0.20)
EE	0.091	(0.01)	0.073	(0.03)	0.068	(0.04)	0.060	(0.05)
EL	0.071	(0.01)	0.056	(0.08)	0.052	(0.09)	0.043	(0.14)
ES	0.083	(0.01)	0.060	(0.08)	0.059	(0.08)	0.050	(0.10)
HU	0.097	(0.00)	0.077	(0.04)	0.071	(0.05)	0.057	(0.10)
IE	0.087	(0.01)	0.067	(0.05)	0.062	(0.06)	0.052	(0.09)
IT	0.086	(0.01)	0.065	(0.07)	0.062	(0.07)	0.053	(0.09)
LT	0.079	(0.01)	0.055	(0.11)	0.054	(0.11)	0.048	(0.13)
LU	0.107	(0.00)	0.093	(0.01)	0.087	(0.01)	0.073	(0.01)
LV	0.082	(0.02)	0.060	(0.09)	0.057	(0.10)	0.046	(0.14)
MT	0.083	(0.01)	0.063	(0.07)	0.047	(0.14)	0.039	(0.21)
NL	0.088	(0.01)	0.066	(0.06)	0.059	(0.09)	0.054	(0.11)
PL	0.097	(0.00)	0.080	(0.03)	0.075	(0.03)	0.068	(0.04)
PT	0.089	(0.00)	0.068	(0.04)	0.060	(0.07)	0.052	(0.09)
RO	0.089	(0.01)	0.071	(0.04)	0.066	(0.04)	0.057	(0.07)
SE	0.087	(0.01)	0.067	(0.05)	0.062	(0.06)	0.052	(0.09)
SI	0.088	(0.01)	0.066	(0.05)	0.061	(0.07)	0.052	(0.09)
SK	0.096	(0.01)	0.075	(0.04)	0.066	(0.06)	0.052	(0.12)
FR	0.087	(0.01)	0.066	(0.07)	0.061	(0.08)	0.054	(0.10)
FI	0.096	(0.00)	0.076	(0.02)	0.072	(0.02)	0.061	(0.04)

**Table A3** Leave-one-out regression results - coefficients for Q1-NBS (PCA)

	model (5)		model (6)		model (7)		model (8)	
	coefficient	p-value	coefficient	p-value	coefficient	p-value	coefficient	p-value
AT	0.083	(0.00)	0.055	(0.05)	0.049	(0.08)	0.044	(0.12)
BE	0.084	(0.00)	0.062	(0.03)	0.058	(0.04)	0.057	(0.04)
BG	0.069	(0.01)	0.043	(0.12)	0.040	(0.15)	0.034	(0.22)
CY	0.075	(0.01)	0.049	(0.09)	0.046	(0.12)	0.046	(0.11)
CZ	0.081	(0.00)	0.054	(0.05)	0.050	(0.08)	0.044	(0.12)
DE	0.081	(0.00)	0.055	(0.05)	0.051	(0.07)	0.045	(0.11)
DK	0.085	(0.00)	0.052	(0.09)	0.045	(0.14)	0.031	(0.32)
EE	0.084	(0.00)	0.060	(0.03)	0.057	(0.04)	0.052	(0.06)
EL	0.067	(0.01)	0.046	(0.11)	0.044	(0.13)	0.039	(0.17)
ES	0.078	(0.00)	0.049	(0.09)	0.049	(0.09)	0.044	(0.12)
HU	0.091	(0.00)	0.065	(0.03)	0.060	(0.04)	0.049	(0.10)
IE	0.082	(0.00)	0.055	(0.05)	0.052	(0.06)	0.046	(0.10)
IT	0.081	(0.00)	0.054	(0.06)	0.052	(0.07)	0.047	(0.10)
LT	0.077	(0.00)	0.048	(0.07)	0.048	(0.07)	0.044	(0.10)
LU	0.111	(0.00)	0.094	(0.00)	0.091	(0.00)	0.082	(0.01)
LV	0.079	(0.00)	0.051	(0.07)	0.049	(0.08)	0.042	(0.14)
MT	0.075	(0.01)	0.049	(0.08)	0.038	(0.19)	0.032	(0.26)
NL	0.082	(0.00)	0.054	(0.06)	0.048	(0.10)	0.046	(0.11)
PL	0.092	(0.00)	0.066	(0.02)	0.061	(0.03)	0.056	(0.05)
PT	0.085	(0.00)	0.058	(0.04)	0.052	(0.07)	0.047	(0.10)
RO	0.087	(0.00)	0.066	(0.02)	0.064	(0.02)	0.059	(0.04)
SE	0.082	(0.00)	0.055	(0.05)	0.052	(0.07)	0.045	(0.11)
SI	0.082	(0.00)	0.055	(0.05)	0.051	(0.07)	0.045	(0.11)
SK	0.086	(0.00)	0.059	(0.05)	0.051	(0.09)	0.037	(0.21)
FR	0.081	(0.00)	0.053	(0.07)	0.049	(0.09)	0.045	(0.11)
FI	0.091	(0.00)	0.064	(0.03)	0.062	(0.03)	0.053	(0.07)