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Deaton Review on
Inequalities

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Innovation and inequalities



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- Innovation can affect inequalities in many ways – increasing some inequalities and decreasing others
 - the impact will depend importantly on who controls the property rights to exploit the innovation and what they decide to do with it
- Around 1/3 of innovation in the UK is in the public sector
- We focus on the 2/3 in the private sector
- and on the **impact of firm level innovation on income inequality**

- Innovation affects income inequality
- and inequalities in income also affect the incentives and ability to innovate

Impact of innovation on inequality

- On the one hand, innovation typically increases top income inequality
 - it generates economic profits for the owner of the invention
- On the other hand, innovation involves creative destruction
 - meaning that new entrants replace old incumbents (firms or workers), so innovation can also increase social mobility
- New technologies tend to benefit more skilled workers
 - but innovation isn't only about new technologies, it is also about doing things better
 - and innovating firms also create more 'good jobs' for low-skilled workers
 - jobs that have longer tenure, more intense training on the job, and stronger earnings growth

- Important caveats:
 - innovation promotes social mobility, but yesterday's innovators tend to become entrenched incumbents
 - they try to prevent future innovation and new entry
 - this speaks to the importance of rigorous competition policy – in particular regulation of mergers and acquisitions – that does not allow superstar firms to become hegemonic and thereby discourage innovation and entry by other firms
 - not everyone has an equal opportunity to become an innovator
 - parental income, parental education and parental occupation each play an important role in the probability for an individual to become an innovator

- The probability of becoming an inventor increases with parental income
 - this partly reflects the fact that richer parents also tend to be more educated,
 - but parental education is a key input in the individual's own education, and obtaining an MSc or a PhD is in turn a key input to becoming an innovator
- Richer parents also tend to be more able to transmit 'aspirations' and 'ambitions' to their children, and these are also key inputs to becoming an innovator
- Broader access to 'knowledge in the making' is a way to mitigate these important sources of inequality in innovation opportunities across individuals.

- Private sector innovation without policy intervention will probably increase income inequalities
 - competition policy to ensure limits to exploitation of property rights,
 - technology policies to encourage diffusion
 - training and education policies to enable equality of opportunity
 - policies that tackle financial market failures to ease entry
- Importantly, innovation increases productivity
 - thus increasing economic wealth and enabling the possibility of redistributive policies

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