



**INEQUALITY**

**IN**

**EUROPE**

**SOCIAL EUROPE DOSSIER**

# INEQUALITY IN EUROPE

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FRIEDRICH-EBERT-STIFTUNG

HANS BÖCKLER STIFTUNG    SOCIAL EUROPE



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## PROLOGUE

“ Inequality is the defining issue of our time.

This is what then US President Barack Obama said about inequality at the end of 2013. Almost half a decade later we unfortunately have to conclude that it still is one of the defining issues of our time and that we have seen the beginning of a political feedback loop. The unresolved inequality challenges amongst other things contributed to the the Brexit vote in the United Kingdom and the election of Donald Trump in the United States. It was not just the persistent patterns of huge inequalities between different parts of society but also the growing frustration that political systems have become unresponsive to the concerns of people suffering from the current state of affairs. When analysing the challenge of right-wing populism it is crucial not to do so at a superficial level only trying to dissect the communication techniques and understanding the current electoral appeal of populists - as important as this is. It is at least equally important to try to understand the socio-economic and political condi-

tions that enabled those communication techniques to develop electoral appeal. Inequality is a huge part of this background story.

For this reason, Social Europe teamed up again with the Europe Office of the Friedrich-Ebert-Stiftung and the Institute of Economic and Social Research of the Hans Böckler Stiftung in a project investigating various aspects of the inequality issue with a specific perspective on the European dimension of inequality. Over the course of several months we collected fifteen contributions by globally leading experts to help getting a grip on what inequality means today. These contributions form the three parts of this dossier starting with a general section on understanding inequality and related issues such as globalisation, migration and populism followed by chapters on inequality in Europe and a final part investigating the inequality dimension in specific policy areas.

Inequality will be an important public policy issue for years to come and we hope this dossier will promote understanding of some of the underlying issues and inform the development of effective policy solutions.

***Henning Meyer***

Editor-in-Chief

Social Europe

**PART I**

**UNDERSTANDING  
INEQUALITY IN CONTEXT**





## Chapter 1

# GLOBALISATION, MIGRATION, RISING INEQUALITY, POPULISM...

*Conversation with Branko Milanovic*

### **Why is inequality such a big issue? Why is it so corrosive to societies?**

I think it became a big issue essentially because of the crisis. What the crisis did was make people realise that when, for example, their houses were repossessed, or they couldn't repay the mortgage and so on, actually, they had to pay debts. They realised that for a long time the middle class in the United States and less so in Western Europe, but still the case, was living well by being able to borrow and/or keeping up with the Joneses. Whereas real incomes have not risen.

Then they have noticed that, of course, some people at the top have done extremely well over that time. I believe that it was realisation of this issue that brought inequality to the fore. Now, why is inequality in general important? I think it is important, even for economic growth. Let me just put it in very simple terms. We know that in societies, where inequality is extremely high, we

have a cementing of privileges across generations. We don't have intergenerational mobility. We have lots of people who are never able to contribute to society by working, or by studying or anything else, because, simply, they don't have money to actually engage in that.

Very high inequality is clearly not good. On the other hand, we have the example of formerly socialist economies that actually reduced inequality to such an extent that there was no incentive to even work harder or to study. That low level of inequality was unsustainable too and bad for growth. Clearly, I think, that we have to realise that not only there is some kind of optimal level of inequality, but there are two different types of inequality. Just like there are two different types of cholesterol. There is an inequality which is good, which actually, prompts us to take risks, work hard or study. There is inequality, which is bad, which essentially enables an elite to maintain its position without contributing much to society.

**Okay, and if you look at the main drivers of inequalities, globally and, also, maybe particular trends within Europe. What do you consider them to be?**

Well, you know, globally we have the situation now, that global inequality measured by the standard indicators, like the GINI, is down. Now, it is down because of the increase of incomes and the rise of Asia, essentially, China, India and so forth. However, we are also not capturing well the very top incomes. First of all, because in surveys, these people are few in numbers and they don't participate, or they reveal incomes that are lower than actual incomes.

Or they try to hide incomes as we have seen in the Panama Papers or now in the Paradise Papers. It could be, when we make some adjustments for that, we actually find it's very difficult to

reverse the decline of global inequality, even after the adjustment. Further, if we were to compare the incomes of the very top with the incomes through the median, then, inequality by that measure, has gone up. That's about global inequality.

Now, at individual country levels, the situations, obviously, vary. They vary, especially after the crisis. If we take a longer term view, and compare the mid-1980s to today, we see an increase in inequality, practically, in all rich countries. I think in the case of OECD countries, with the exception of two or three, inequality went up everywhere. Then, of course, we see an increase in inequality in China, Russia, India. South Africa, for example, which already had a high inequality, even went up.

The only exceptions to that are countries in Latin America, which are really at a very high level of inequality, like Brazil, but experienced a decline over the last 15 years.

**Europe in particular, do you see any specific trends?**

Well, in Europe, the basic trend for all individual countries, again, over that long term, is an increase. We have a situation of countries, like Sweden, that are of course, still hailed as exemplars of social democracy. The increase of inequality in Sweden has been pretty significant. That doesn't make Sweden an unequal country, but while its level of inequality was significantly below the EU average, it has now converged towards inequality in other countries.

We see inequality increase after the crisis in particular in Spain, Greece, Portugal. Then central European countries, that used to be and remain countries with relatively low inequality, but they are also small countries, very homogeneous in terms of education, ethnically as well. Like, Hungary, Austria, Slovak Republic,

Czech Republic, Slovenia, they are countries with relatively low inequality.

**If we take a bit of a broader view and link inequality to some of the other key, and dominating issues at the forefront of political debate – namely, globalisation and migration – how do you see inequality interacting with these?**

You see, I would actually see globalisation on top. In other words, I would see globalisation as this framework that exists now, because we are now, much more interdependent and interconnected than we ever were in history. When I say ‘we’, it’s just like citizens of the world. Capital flows today much more freely, probably, even with the possible exception of the end of the 19th century. Labour is somewhat less mobile than then, because in terms of the flows over the population, which existed then, they were bigger than they are now. These flows are definitely increasing nowadays.

Obviously, thanks to technology, we are much more interdependent. The globalisation is, I think that framework, and within that framework we have changes in inequality. Some of them, as I mentioned before, are quite favourable, like a decline of global inequality due to the growth rates of China and India. Some of them, I think, also related to globalisation are unfavourable. That’s the increase of inequality in most of the rich countries, and the hollowing-out of the middle class.

I would really take, as I said, globalisation as the main framework. Now, within that framework, we talk about inequality and we also talk about migration, because migration is simply one of the manifestations of globalisation. That is a very difficult topic, because there again, you find it’s sort of a trade-off between the two levels. You can argue, I think quite persuasively, that greater

migration would reduce global inequality. It would certainly reduce global poverty. That's something which is good.

On the other hand, migration might lead to increases of inequality in some countries, as migrants actually put further pressure on wages, domestically. It might lead to political problems. Basically, there is a trade-off there. We cannot opt, I believe, for the extreme solutions. Free migration would not be politically feasible and then cutting migration to zero, I think, would be economically self-destructive, even for the countries that do do that.

**Inequality has also been recently linked to the rise of right-wing populism across western societies. How do you see this particular link?**

Yes. They have been linked. I think that there is a consistent, I think, pattern or consistent story that can be told. We don't have, as of yet, too many empirical studies. Actually, I've seen only two. One for the United States and one for Europe. What these studies tend to suggest is that the underlying reason for what is called 'populism' or, I suppose, election or support of non-mainstream leaders or parties, was economic. That it was channelled through the cultural channel.

In other words, what I think is that the story which is being told there, is that it arises because of a lack of economic advancement, because of dissatisfaction with economic position, maybe, insecure jobs. Decline in wages, loss of job, for example, for your partner. Inability to send your kids to good schools, because they are expensive. You, of course, have a pool of dissatisfied people. Then they are expressing dissatisfaction by blaming somebody else for what happened.

They could blame the elite, they could blame the Chinese, they

can blame migrants, but I really believe, and I think this study has confirmed that actually the main driver is economic dissatisfaction.

**It is often seen now, in recent research that is, basically an interplay here of socio-economic factors as well as cultural factors. One of the discussions we had recently with Peter Hall from Harvard showed that even though you can explain a lot of the rise in right-wing populism in the United States and Europe, with socio-economic factors that kind of explanation doesn't sit as easily with countries such as Hungary and Poland that have had a very good economic development. Nevertheless, they turned towards right-wing populism.**

**Do you see any sort of cultural factors, that play into this as well?**

I think that what is happening in Eastern Europe, an unwillingness to accept migrants, stems from two developments, which have sort of been either neglected or forgotten. One is that all those countries, over the history of the last 200 years and in some cases longer, have been countries that have been in a difficult position, between different powers, and they've tried to create their own state – to the extent that's possible, to have a homogeneous, ethnically homogeneous state.

This is exactly what we see, what happened, particularly after the end of the communism, the fall of the Berlin Wall. If you look at, for example, Poland, it obviously didn't happen then, but it happened after 1945. A society that was very heterogeneous, where you had Germans, Ukrainians, Jews and Poles, became 99% Polish. You see that with the Czech and Slovak republics. Hungary was always, after the World War I, homogeneous. You

see it also in Croatia with the disappearance of the Serb minority.

All these countries became homogeneous. The revolutions of 1989 had a very strong nationalistic element. Now, one is asking these countries to overturn two centuries of history, where they were trying to create their own nation-state, by accepting people who are very different from them. I think this is what is in the background and which explains this reluctance of Poland or Hungary, or indeed the Czech Republic or Slovakia, or any of these countries to accept migrants from outside Europe.

**Looking at, for instance, the recent German election result, I know you can see a very big distinction in electoral results between eastern and western Germany. It relates to this, because former Eastern bloc countries do not seem to have an equivalent history of immigration, as for instance, western Germany had after the war with Italian and Turkish immigration to rebuild the country and economy.**

**The pattern seems to be that the arriving populace seems to be doing well, in areas where there are literally problems, the parallel societies. Also, in areas where there are no immigrants whatsoever. The theory then goes that the people who don't have a history or experience with immigration, look at the hotspots, think, "We do not want to become like them." Ignoring the 98% of cases where it just works fine, and therefore you have the manifestation of a cultural rejection. Would you agree with that?**

Yes. It's very difficult to draw conclusions but I really am a firm believer that economics is very important. As I explained, in the case of eastern Europe, I think there is also historical background

that matters. Very often, and we saw that in the case of Brexit, we find that the areas with the lowest percentage of foreign-born people have apparently voted the strongest against more migration. That too, I think, can be explained, not only by the fact that, of course, they are afraid of London, for example. I believe that the large cities that have had, as you said, experience for many years, or actually, in some cases centuries, with migrants are actually able to absorb it. They have seen this happen and they were basically functioning very well nevertheless.

Another case is Vienna. Vienna has, for example, I think more than one third of the population which is not Austrian born. In smaller cities, where basically, you have a couple of shops and one cafe or a restaurant, maybe, I don't know, 50 people or 200 people or 2000 people, I think there is a kind of a fear, that your way of life would be really radically changed by the introduction of a relatively small number of people, who are very different from you.

I think that may be the reason behind more rural areas and smaller areas being, paradoxically, more afraid of migration than the bigger ones.

**Yes, Brexit is another good example for this. I think you have a very strong socio-economic explanation for why a large part of the de-industrialised north of England was supporting Brexit. The economic argument becomes more difficult, when you look at Sevenoaks in Kent, which is a rich commuter town.**

It's rich.

**It seems to be that cultural factors seem to be applied there as well. Towards the end of this, if we can pull it back towards inequality, in the matter of the frame-**



**work of globalisation and also, maybe, the migration issue which is set to become more pronounced going forward. If you look at the reasons why people migrate and put yourself into the shoes of policymakers, in Europe or even elsewhere, what would your key policy priorities be to address the most dramatic effects?**

You know, it's good that we talked about migration. I'm not, obviously, a migration specialist, I simply came to migration as another manifestation of globalisation. Technically speaking, migration is no different than studying the movement of capital. One factor production, another factor production. There is a difference, because politically it is different. What I would like, if one is to have a policymaker focus, is look at the longer term and particularly for Europe, the question of how to deal with migration. The reason why, I think it's really so crucial for Europe, is because of two developments. One, is that Europe as we know it now, is composed of countries with generally either stagnant or declining populations.

We know, basically, that Europe will decline in terms of population within the next 50 years. This may not be a huge decline, but it will be stagnation or slight decline. On the other hand, we have sub-Saharan Africa that has about twice as many people as the EU. That ratio will become something like 5 to 1 towards the end of this century. With large gaps, and that's the second point, large gaps in income which are unlikely to be bridged in any significant manner between now and then. We have really an incredible pressure for migration, which can only get greater and will be exacerbated.

I think the policy makers in Europe should really think about a sustainable, or somewhat sustainable way, and somewhat controlled way, to channel this migration. I believe that should be

done jointly by the European Union and by the African Union, probably through some joint financial support systems. I also believe that there should be so-called circular immigration. That people go to rich countries, work there for five years and go back home.

In any way, whatever model one chooses, I think that it's something that Europe and Africa have really an incentive to look forward to – in the sense of preempting the emergence of the problem, to the extent that it's possible. Rather than solving the problem every summer, by sending Frontex, more ships and having, of course, all these intra-European issues between, of course, Italy and Greece as recipients on one hand and the rest of Europe.

I really think that's really something that needs leaders who can think about the future. It would include also, much greater, probably, help for Africa. One small detail there, which ironically may be good for Europe, is that if Chinese investments in Africa are actually bearing fruit, and they help Africa grow faster, that will be good for Europe too because the migration pressure from Africa would be less.

Once more, we see this interdependency of the world there.

**It seems to me, especially, in the wake of the refugee crisis in Europe, we have to start by disentangling a few things that are lumped together: one is the freedom of movement within the European Union. The second one is non-EU immigration into European countries and asylum. Especially in the UK, you can see all of these different elements lumped together and it doesn't help you deal with it.**

Absolutely.

**It seems to me that, of course, we have a strong framework of freedom of movement within the European Union. We need a framework for the discussion. Germany's is about an immigration law for non-EU immigration.**

Absolutely.

**At the same time, I think you should have an interface between asylum policy and immigration law, because you would like to set an incentive. For instance, if someone arrives as an asylum-seeker their stay might be temporary, due to their legal status. For instance, the Civil War in Syria ends. If that person then fulfils certain criteria, such as speaks the language, is integrated into the labour market and so on and so forth, they might stay or go home. There should be an interface for transitioning an asylum seeker/refugee towards the migration route.**

**I don't personally see too many of these interfaces developing at the moment. Would you see that?**

I totally agree, and actually, I think that it's good that you mentioned these three different types. I think with two of them, we have more or less clear rules and migration within the EU is very clear. The UK may not participate in that but the rules, I think, are clear. Then when it comes to asylum, these are international rules which go back to a period between the two wars. There again, the rules are clear. The conflicts, of course, lead to the movements of people. I'm from the former Yugoslavia, I'm from Serbia. Lots of people move from Bosnia, actually, 2 million people, I think, were at some point displaced, internally displaced or actually looked for asylum in other countries.

This was a conflict, but the conflict ended. Then the part which is totally regulated and is very unclear is migration from outside the EU into the EU. There we actually face every summer two issues and we conflate the two things. We conflate Syria with immigration from Bangladesh, Pakistan or Mali, Madagascar, Mauritania, into Europe. These are really two different issues and we have seen, actually, people who claim to be from Syria but they are from somewhere else, because they want to go under the package of the asylum. That's a different rule there.

I think what Europe needs and I think what the African Union needs is that middle part which is really quite defined.

**Exactly, because the absence of this clear framework for non-EU immigration, actually sets the incentive for people to claim asylum, even though their immigration might be due to economic reasons. Finally, apart from sorting out migration, which will, I'm sure, be at the forefront of policy discussions in the next three years, are there any other policy measures to address inequality in particular? What can the European Union do and what should individual member states do to address the biggest problems related to inequality?**

You know, when we talk about individual countries or individual EU member states, the contrast, which is so obvious for any individual country, is that our incomes are more and more determined at global level, because we are competing, one way or another, with the rest of the world. Many of the jobs even that we are doing, for example, people who give lectures and so on. Actually, they can give these lectures remotely, so you don't have to be physically present there. Which may be good for some professors who might make, actually, lots of money because their lectures are being listened to, but they put others out of a job.

We are really competing globally. However, whenever we lose, whenever we have a problem with jobs, whenever we have trouble with our incomes or wages and so on we still have to go to the national level because there is no global level. There is a disconnect in some sense. In the past, when the economies were relatively close, your problem, your income, was nationally determined and your problem solver was the national government. Now, national government is merely in the operation of mopping up the issues that are very often raised by globalisation.

The tools are at the level of national governments, so when we talk about taxation, when we talk about unemployment, health policy, they are all national. It is very well known that you can, of course, by increasing the minimum wage, by giving greater trade union rights and so on you can do things better for the labour force. Particularly, what I meant with trade unions, I meant the United States, in particular, not Europe. We have the means to do that, making education much more accessible and so on. They're at the national level but what nations can do nowadays is limited by globalisation.

There's this difficulty. Maybe some countries would actually like to increase taxation, but they're really limited to the extent that they can do that because of tax competition. Because of the ability of capital and labour to move. There is a limit to what national governments can do to solve the problems which arise, in many instances, because of globalisation. That's where I see this being a very difficult contrast, and that's why I'm not too critical of the policies because I see policymakers working within a framework, which does not allow them to become more generous to all the population. Simply because becoming more generous would be, in some cases, destructive of their advantage in terms of worldwide competition.

**We also have, in the first instance, to solve a lot of collective action problems?**

We also have huge collective action problems, because there is a collective action problem which is at the global level. We talked today (*at a separate conference: Ed*), for example, about labour rights, which should be quantified globally. We do have this problem there, because, obviously, the labour rights are very different in different countries. They're not being quantified, and the role of the ILO has been relatively limited, and we don't even, as we heard today, have very clear knowledge or an index for these rights across the countries. That's one problem which is an interstate problem at the global level.

Then we have a collective action problem at each individual country level. The two, of course, are interdependent. I believe if we were actually doing better at being nation-states, globally, then part of that collective action problem would be more soluble at the level of nation-state. Maybe it's too absurd, but one can say the following: if we were to agree on minimum labour rights, then that enables the country then to follow more pro-labour policies because it knows that it cannot be undercut by somebody else. That's the basic story.

## Chapter 2

# INEQUALITY MORE THAN MATTERS

*By Javi Lopez*

Inequality is the biggest challenge of our time. It undermines social confidence and reduces support for democratic institutions. It lurks behind the new toxic relationship that western societies have established with their future and explains much of recent resentment-driven electoral phenomena and the surge of identity politics with its disruptive backlash.

As for the economic dimension, according to institutions such as the IMF or OECD, inequality hinders growth and the creation of quality employment.

They also affirm that excessive and increasing inequality levels imply direct social costs, prevent social mobility and may also inhibit sustainable growth now and in future.

The polarisation of incomes and unemployment restricts effective demand, frustrates innovation and can cause further financial fragility. High and increasing levels of inequality obstruct not

only progress towards poverty eradication, but also efforts to improve social inclusion and cohesion.

In fact, the OECD highlights that reducing inequality by one Gini point would translate into an accumulated increase in growth of 0.8% during the following five years. In this respect, Europe has moved in the opposite direction. Between 2005 and 2015, the Gini coefficient rose from 30.6 to 31 and income disparities between the top and bottom 20% have increased from 4.7 to 5.2. As the proportion of people at risk of social exclusion is closely related to income inequality, poverty has grown constantly since 2005, and between 2008 and 2014 several member states experienced an increase in inequality in terms of household disposable income.

While one of the five goals of the Europe 2020 strategy aspired to reducing by at least 20 million the number of people in or at risk of poverty and social exclusion (from 115.9 million in 2008 to 95.9 million in 2020), in 2015 these citizens already accounted for 117.6 million in the EU-28. Moreover, 32.2 million disabled people were at risk of poverty and social exclusion in 2010, as well as 26.5 million children, taking the overall percentage to unacceptably high levels (23.7%). The rise in inequality since the economic crisis has especially impacted women, exacerbating poverty among them and excluding them even more from the labour market.

Several factors have contributed to getting us into this situation. The extensive changes in the labour market should be at the centre of our worries: the proliferation of “atypical” jobs, the weakening of collective bargaining, the deterioration in working conditions, increased temporary working, and policies of internal wage devaluation. In short, the labour market has stopped being a stable source of prosperity for many people.



At the same time, other factors have strongly come to the fore. Globalisation and the opening up to international markets have left some traditional and important industrial sectors in western economies unprotected. The gains have been unfairly distributed due to the absence of the necessary compensation mechanisms. Robotisation and digitalisation have had a similar impact. Meanwhile, aggressive policies of fiscal consolidation have weakened our redistribution armoury and left millions out in the rain.

### **Moving Ahead?**

These are some of the conclusions of the report “Combating inequalities as a lever to create jobs and economic growth”, for which I have been rapporteur and that has recently been adopted in the European Parliament (building upon valuable contributions by Social Europe and the Friedrich Ebert Foundation).

It is a report in which the European Parliament establishes combating inequalities as a political priority of the EU and proposes a roadmap with norms, tools and resources to achieve this. It establishes the need to balance the European Semester by introducing genuine monitoring of the Union’s social dimension and feeding this data and any conclusions into the country-specific recommendations. It focuses on the need to reinforce European labour legislation in order to strengthen working rights and incomes, and to introduce new EU-wide solidarity mechanisms to combat child poverty, the gender gap and social exclusion. Finally, the report emphasises the need to improve our fiscal coordination and harmonisation in the fight against tax fraud, evasion and disloyal unethical fiscal engineering that happen in this field.

It is no coincidence that the adoption of this report accompanies the signing of the European Pillar of Social Rights. The Pillar

represents a modest step that commits the European institutions to twenty goals and derived rights that must be secured via binding mechanisms over the coming years. Though still inadequate, it is a step in the right direction. Inequality more than matters and must be at the centre of Union policies when it comes to economic growth, institutional stability and social protection: the three pillars of the European integration.

## Chapter 3

# THE VICIOUS CIRCLE OF INEQUALITY

*By Sandro Scocco*

For more than a decade, organisations such as the IMF, OECD, ILO and even World Economic Forum have issued stern warnings that the global trend of increased inequality will harm growth, social cohesion and the business community. So, is Europe doing anything about it? No, and the real question is: Why not?

One reason is that there is no consensus about how to describe what is really going on in Europe – or elsewhere. In the *New York Times* the economist J.W. Mason stated:

“ On Mondays and Wednesdays, economists argue that wages are low because robots are taking people’s jobs. On Tuesdays and Thursdays, it’s that we can’t have wages rise because productivity growth is low. Both can’t be true.

I am a Tuesday and Thursday economist concerning productiv-

ity. Productivity growth lost traction in the industrialised world in the seventies, and since the financial crisis of 2008 productivity has fallen even further. This is not just a case of bad statistics, which some Monday and Wednesdays economists argue.

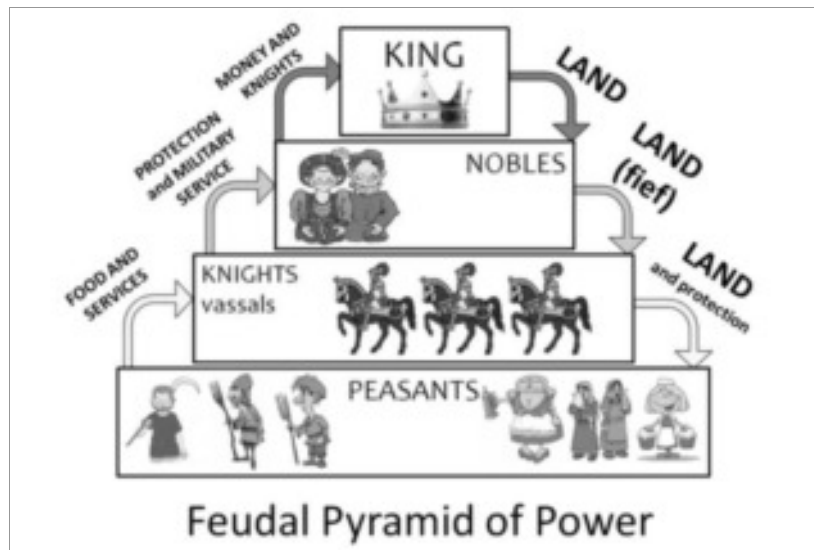
Low productivity growth is, of course, one reason why income development has been disappointing for an average worker, but not the only one. Another is increased wage disparities and decreased income share, since wages haven't kept up with even the poor productivity growth. And finally, public redistribution has been significantly reduced through tax cuts for the wealthy and lower social transfers for the rest. All these trends are, in various degrees, common to both Europe and the rest of the industrialised world. The result is the famous and depressing Elephant curve of Branko Milanovic.

One can also make an eyeball econometric observation. When productivity growth was high, between 1945 and 1975, income inequality decreased and since the eighties, a period of low productivity growth, inequality has increased. Is this just a coincidence or is there a causality?

## **Kings And Nobles**

Let us for pedagogical reasons consider two extremely oversimplified and stylised cases, an economy with zero and another with five percent productivity growth.

The first is a rather good description of the medieval world. Since the economy isn't growing by any other means than population growth, the only way to become wealthier is to redistribute income, in effect taking your neighbour's land.



*Image via Quizlet*

This will, of course, also determine which types of investment are profitable. For grabbing your neighbour's land you need political support (legitimacy) from those who control property rights (i.e. the king) and your own military force. Since larger armies tend to beat smaller ones, and the same goes for bribes, the system favours concentration of power and income – the rise of the rich and the mighty noble. The king, however, doesn't just give political protection; he also needs it from his noble friends.

In a world where investors expect zero productivity growth, investment in new machines and knowledge (real/human capital) seems both risky and unprofitable, especially when compared with bribing the king. This means that any future productivity growth is also unlikely (even though it did eventually happen for reasons too long to explain here). That is the vicious circle of inequality.

On the other hand, in an economy with five percent productivity growth, you can more than double your fortune within just fifteen years – without stealing your neighbour's land. The fight will be over the new land – growth. The name of the game is now new

machines and knowledge (and not rent-seeking investments in politics or military). Knowledge-based investment in labor increases workers' bargaining power and hence favours equality. The virtuous circle of equality.

## **Medieval Relations**

Unfortunately, the vicious circle of inequality seems a rather good description of what's going on now. Since the seventies, growth in both machines (real investments) and knowledge (human capital) has fallen. Investments in politics have on the other hand increased sharply, with the US Presidential campaign the most stunning example. The political preferences of the new patrons of politics for fewer taxes and upwards redistribution have also been very popular the last two decades among European politicians. After the mid-1990s inequality trends have mainly been driven by reduced public redistribution, not market forces.

In the previous period, however, between the mid-1980s and 1990s, the main driver for inequality was the market. All economists have their own take on this, whether the culprit is technology, trade or policy, but it's rather clear that politics has played a part in market-driven inequality. Deregulation of the labor market, lower unemployment benefits, union busting and higher unemployment have weakened the wage bargaining power of workers. These institutional changes have especially hit those with routinised job assignments and low individual bargaining power. This has not only increased wage disparities, but also in many countries reduced the total wage share.

Usually, this is understood as an increased share for capital. But a new paper from Chicago University by Simcha Birkai challenges this perception. He argues that capital's share has fallen as much

as the labor's, since the cost (real rate) of capital has fallen rather dramatically in recent decades. He argues that what we have experienced is a growing gap between production costs (capital and labor) and revenues, which implies increased mark-up of prices.

### **Corporate Clout**

Barkai's explanation is that big business market power is so strong that they can influence prices. This would also explain why we often see mergers of market dominant companies, even though there seems to be no return to scale in production. There is, however, a gain in greater influence on prices.

The cost of mergers for large companies should therefore probably be understood as an investment in rent-seeking and not in productivity growth. What they are buying is power to reduce market competition and redistribute from consumers to managers and owners, the beneficiaries of the mark-up. Professor Luigi Zingales at the University of Chicago described this "being pro-business [as] basically being pro-S&P 500, it protects large corporations and doesn't promote growth and innovation".

So why is nothing happening? One explanation could be that all agents – politics, business and households – are adapting to an environment of low productivity and have increased their investments in rent-seeking while cutting those in real and human capital: the vicious circle of inequality.

How do we get back to a virtuous circle? The medicine isn't that difficult to prescribe; restore fiscal transfers' redistributive power, increase the wage bargaining power of workers, increase real and human capital investments to boost productivity and restore free competition in product markets. So, to battle inequality we need

much more pro-productivity and much less pro-business. But who will be the capable agent of this? Not big business. Not the one percent. Not ruling politicians in need of powerful friends. As Pink Floyd asked: “Is there anybody out there?” Let’s hope there is because we badly need a Renaissance.



## Chapter 4

# THE TRUE – AND FALSE – COSTS OF INEQUALITY

*By Kate Pickett and Richard Wilkinson*

The first research papers showing that health was worse and violence more common in societies with large income differences were published in the 1970s. Since then a large body of evidence has accumulated on the damaging effects of inequality.

Countries with bigger income differences between rich and poor tend to suffer from a heavier burden of a wide range of health and social problems. Physical and mental health are worse, life expectancy is lower, homicide rates are higher, children's maths and literacy scores tend to be lower, drug abuse is more common and more people are imprisoned. All these are closely correlated with levels of inequality both internationally and among the 50 states of the USA.

People are often surprised at the length of the list of problems which are worse in more unequal countries. The key is that all these outcomes have social gradients making them more common at each step down the social ladder. That makes the ba-

sis pattern easy to understand: problems which we know are related to social status within societies get worse when the status differences are increased. Bigger material differences make the social distances between us greater. The vertical dimension of society – the social pyramid of class and status differences – becomes more important. The material differences between us provide the framework or scaffolding to which all the cultural markers of status and class – from where we live to aesthetic taste and children's education – attach themselves.

### **Unequal Across The Board**

We should not regard the scale of income inequality as a new determinant of health and social problems; rather, it tells us more about the familiar class gradient in outcomes that we have always recognised. Few people can be unaware that the poorest areas of our societies tend to suffer the worst health as well as having the lowest educational performance of school children and usually the highest levels of violence. The additional insight is merely that all these problems get worse when income differences are increased. However, they don't just get a little worse. In our analyses of rich developed countries, we found that mental illness and infant mortality were at least twice as common in more unequal countries, and in some analyses, homicide rates, imprisonment and teenage birth rates have been found to be as much as ten times as common in more unequal societies – for example in the USA, the UK and Portugal compared to the more equal Scandinavian countries or Japan.

The explanation of these large differences is that inequality does not confine its effects to the poor. Outcomes are less good among the vast majority of the population. Although the poor suffer the biggest effects of inequality, the advantages of living in a more

equal society extend even to the very comfortably off. The data are not available to tell us whether or not the super-rich also suffer disadvantages of inequality, but it seems implausible to think that they are immune to the increased rates of violence or drug and alcohol addiction in more unequal societies.

### **Rich But Unequal**

That the effects of inequality go so far up the income scale fits the pattern of social gradients. Problems with social gradients are rarely confined to the poor. Like the effects of inequality, they go right across the whole society: even people just below the richest have health which is slightly less good than those even better off than them. Indeed, if you take away the contribution which poverty makes to poor health, most of the pattern of health inequalities would remain.

Politicians, even some conservative politicians, have proclaimed their desire to create a classless society, but evidence of many different kinds shows that this cannot be done without decreasing the differences in income and wealth that divide us. There are numerous indications that bigger income differences ossify the social structure: social mobility is slower in more unequal societies; there is less interclass marriage; residential segregation of rich and poor increases and social cohesion decreases. Bigger material differences make the vertical dimension of society an ever more effective social divider.

### **Fear Of The Other**

The toll which inequality exacts from the vast majority of society is one of the most important limitations on the quality of life – particularly in developed countries. It damages the quality of

social relations essential to life satisfaction and happiness. Numerous studies have shown that community life is stronger in more equal societies. People are more likely to be involved in local groups and voluntary organisations. They are more likely to feel they can trust each other, and a recent study has shown that they are also more willing to help each other – to help the elderly or disabled. But as inequality increases, trust, reciprocity and involvement in community life all atrophy. In their place – as numerous studies have shown – comes a rise in violence, usually measured by homicide rates. In short, inequality makes societies less affiliative and more antisocial.

If you look at some of the most unequal societies such as South Africa or Mexico, it is clear from the way that houses are barricaded, with bars on windows and doors and fences and razor wire round gardens, that people are frightened of each other. That is dramatically confirmed by a quite different indication of exactly the same process: studies have shown that in more unequal societies a higher proportion of a society's labour force is employed in what is classified as 'guard labour' – that is security staff, police, prisons officers etc.. Essentially, these are the occupations people use to protect themselves from each other.

### **The Self And Others**

As the vertical dimension of society becomes more prominent, it looks as if we judge each other more by status, money and social position. The tendency to judge a person's internal worth from their external wealth becomes stronger and, with that, we all become more worried about how we are seen and judged. A series of psychological studies shows that we are particularly sensitive to worries of this kind. An analysis of results from over 200 studies shows that the stressors which most reliably push up

levels of stress hormones – such as cortisol – include ‘threats to self-esteem or social status in which others can negatively judge performance’. These kinds of stressors are central to the causal mechanisms which make outcomes worse in more unequal societies. For example, acts of violence are very often triggered by loss of face, people feeling disrespected and looked down on. Similarly, long-term stress compromises many physiological systems and its health effects have been likened to more rapid ageing.

Important to understanding the effects of inequality is the way it affects mental health. An international study has shown that more unequal societies have higher levels of status anxiety – not just among the poor, but at all income levels, including the richest decile. Living in societies where some people seem extremely important and others are regarded as almost worthless does indeed make us all more worried about how we are seen and judged. There are two very different ways people can respond to these worries. They may respond by feeling overcome by a lack of confidence, self-doubt and low self-esteem, so that social gatherings feel too stressful and are seen as ordeals to be avoided and people retreat into depression. Alternatively, and yet usually still a response to the same insecurities, people may go in for a process of self-enhancement or self-advertisement, trying to big themselves up in other’s eyes. Instead of being modest about their achievements and abilities, they flaunt them, finding ways of bringing references into conversation of almost anything which helps them present themselves as capable and successful.

As consumerism is partly about self-presentation and status competition, it too is intensified by inequality. Studies show that if you live in a more unequal area, you are more likely to spend money on status goods and a flashy car.

But the real tragedy of this is not simply the costs of so much additional security or the human costs in terms of increasing violence. It is, as research makes very clear, that social involvement and the quality of social relations, friendship and involvement in community life, are powerful determinants of both health and happiness. Inequality strikes at the foundations of the quality of life. Status insecurity and competition makes social life more stressful: we worry increasingly about self-presentation and how we are judged. Instead of the relationships of friendship and reciprocity which add so much to health and happiness, inequality means we prop ourselves up with narcissistic purchases or withdraw from social life. Though this suits business and sales, it is not a sound basis for learning to live within the planetary boundaries.

## Chapter 5

# TURNING THE TIDE ON INEQUALITY

*By Danny Dorling*

It is hard to believe that it is any coincidence that by far the most economically unequal large country in the European Union, the UK, was the one that narrowly voted to leave it in 2016. The UK has severe social problems due to severe economic inequality. These include an inability to see unfairness as a problem, and a susceptibility to simplistic immigration-blaming arguments.

The rest of Europe enjoys greater equality. In every other large European country the ruling elite are far more closely connected to the people because they are economically less separated. Living standards for the median family in France and Germany are higher than in UK, and the quality of housing is higher.

The UK provides the best warning within Europe of what goes wrong when you allow inequality to rise and rise ever higher. Nevertheless, there remain wide variations in economic inequality within mainland Europe that may well also be very instructive.

After the UK, the second most unequal large country in the EU is Spain. For those of us that have studied inequalities for many years there is a somewhat depressing regularity emerging between where a country ranks on the league table of economic inequality, and then its economic, social, and political difficulties.

People may say that the issue of separatism in Spain has little to do with economic inequality; but higher inequality between households within a country is often a symptom of so much more going wrong. As the former BBC economics editor Duncan Weldon recently put it when trying to explain the rise of Trump in the USA: “it’s the inequality, stupid”. Weldon was not talking about the inequality between US states, but the inequality between families within those states.

Spain is not as unequal as the UK or USA. It is at no risk of leaving the EU or starting a war with North Korea. But you might be left wondering whether its national government would deal better with devolution, identity and autonomy in Catalonia if Spain taken as a whole were more equitable as a society. The ruling elite in Madrid might make fewer mistakes were Spain as cohesive as France and Germany have become. What matters most is the inequality between individuals and households in a country. The most equitable countries in the world, Norway, Sweden and Japan have few secessionist movements, no militaristic posturing, and tend not to elect fools to high office.

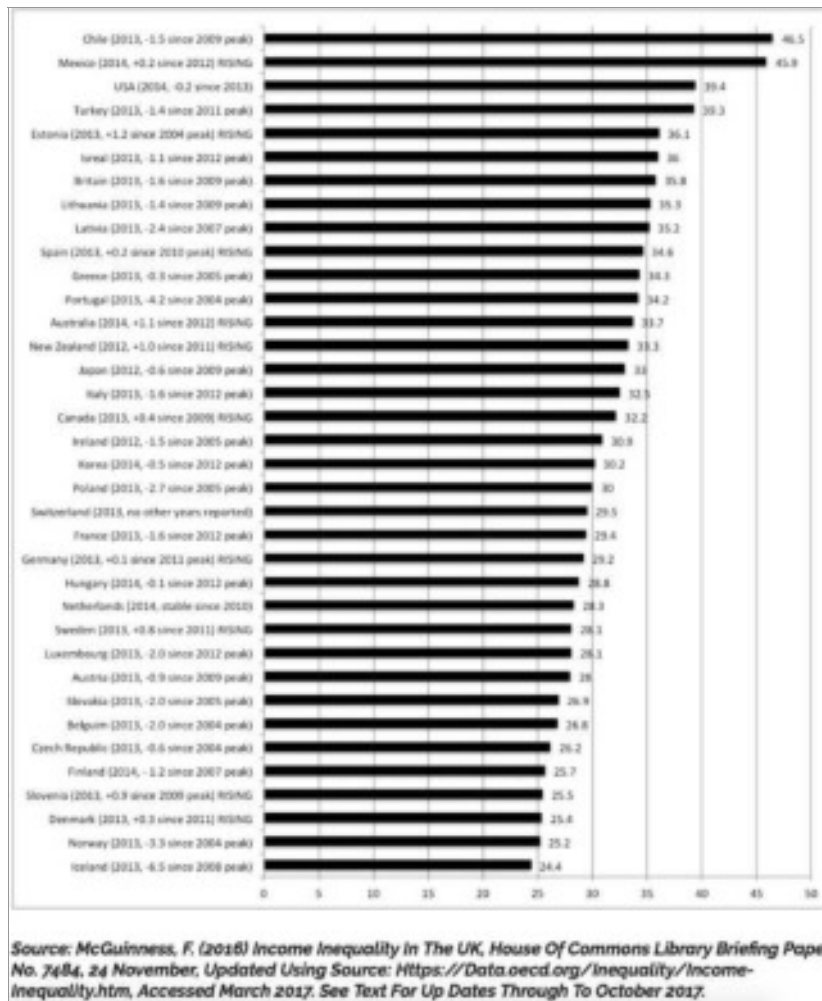
### **Inequality And Poverty**

Economic inequality is characteristically high in poorer countries of the world. Without exception, all high standard of living countries usually only became very affluent by at first reducing economic inequalities within their own country, although sometimes at the expense of exploiting overseas territories.



Among OECD countries inequalities are highest outside of Europe, as the table below shows. Very unequal OECD countries tend to have severe problems of crime, social disharmony, political instability and poor health. The most unequal OECD countries are Chile, Mexico, the USA and Turkey. Nowhere within the EU yet suffers the kind of problems that routinely effect people living in these four countries. The USA still practices capital punishment. Turkey is threatening to reintroduce it. Mexico suffers from very high crime and poverty rates and in Chile students protest routinely about attempts to further privatize universities and raise students' fees and loans.

The table below shows both how unequal each country in Europe is and how it compares with other countries in the OECD outside of Europe. Furthermore, it shows whether the rate of inequality is still rising, or when the peak was reached if inequality is now lower. In most rich countries in the world inequality has now peaked. The measure of inequality used here is the OECD favoured measure of the Gini coefficient of income inequality.



*Income Inequality Gini Coefficient, 0 = Complete Equality; 1 = Complete Inequality, 2013*

In Europe in March 2017 the most unequal country was Estonia. However, Estonia is a very small country and so the estimates of inequality are based on a very small survey. By October 2017 it was no longer the most unequal country. Latvia and Lithuania are similar, and all have an inequality level on a par with that of Israel.

When considering large Europe countries, for many years it has been the UK which is most economically unequal. In 2015 the arithmetically average household in the best-off 10% of the income distribution in the UK had 17 times more money to live on each year than the arithmetical average household in the

poorest tenth of UK society. This seventeen-fold gap is enormous and has only become so large by growing relentlessly decade after decade from the very late 1970s onwards.

Gross inequality colours almost every aspect of life in Britain in a way the British find hard to see because they have become acclimatized to living in such an inequitable society. The British private and ‘public’ (the even more elite private) schooling system is only maintained by very high income inequalities. Furthermore, the incredibly high annual incomes of Britain’s best-off 1% are key in making the 17:1 discrepancy so large. The table below shows how that inequality ratio in the UK compares with other large European countries.

UK	17:1
Spain	14:1
Italy	11:1
Germany	10:1
France	7:1

*Stokesbury, N. And Dorling, D. (2015) Understanding Income Inequality And Its Implications: Why Better Statistics Are Needed Statistics Views, 21st October*

*Note: Income Is Disposable Household Income: Income From Wages, Self-Employment And Capital, Plus Social Transfers, Minus Direct Taxes Paid. Household Income Is Adjusted ('Equivalised') To Take Account Of The Amount Of Scale Economies That Different Sizes Of Households Can Achieve.*

*Annual Income Of The Best-Off 10% To Worse-Off 10% Of Households (2015)*

This table shows the inequality ratio for the five most populous countries of Europe. A very wide range of inequality experiences are now seen across Europe. Note that here France and Germany appear more different by this measure because the top 1% in Germany take more than in France, but their Gini coefficient of income inequality is more similar to each other. Because of this

wide spread of experiences Europe has become the home of natural experiments to determine the effects of economic inequality.

### **Elite Education And Stupidity**

When tested up to age 24 children and young people in France and Germany are found to be far more able at mathematics than those in Spain and Italy; but in turn they are more able than children and young adults who have recently grown up in the UK. Educational outcomes across European countries are generally better in more equal countries. And the elite in unequal countries are less educationally able than the elite in more equitable countries. What is more they tend to assume they are superior.

If you ever balk at the brashness and rudeness and stupidity of so many British politicians please understand that it is not entirely their fault that they are so often so awful. They were brought up in Britain at a time when it was becoming a more and more unequal society. This has often affected them adversely. In the worse cases they come to celebrate high inequality as a rewarding of 'top talent'. It would be funny if the educational implications were not so sad.

Similarly, better health is enjoyed by older people living in more equitable countries. Middle-aged people are all on average more productive at work and do not need to work as many hours in a week to get by when their pay is more equitable. People in more equitable European countries are far more innovative, they invent more medicines, machines, and make better jobs of managing themselves. And again, on average, everyone in a more equitable European country also pollutes less and consumes more sensibly, eats better and becomes less often obese.

As yet we have not been able to identify any European country that has suffered any problem from becoming too economically equal. The most economically equal countries in Europe are also those that score most highly on the world happiness index: Norway, Denmark, Iceland and Switzerland. These also happen to be the happiest countries in the world.

We first discovered that inequality mattered hugely for everything from health to imprisonment almost ten years ago when Richard Wilkinson and Kate Pickett published “The Spirit Level”. Since then an enormous increase in evidence that inequality matters has emerged, from happiness to carbon footprints, from education to political behaviour. Far right political parties and ideas are more popular in more economically unequal countries. Fewer people bother to vote when inequality is high; democracy suffers greatly.

In recent years almost everyone, from American and Chinese presidents to the Managing Director of the International Monetary Fund, the Pope and the Business leaders that meet at Davos, they have all identified the problem of economic inequality as being key:

- ‘income inequality is the defining challenge of our time’  
Barack Obama 2013
- ‘divide the pie correctly.’ Xi Jinping 2014
- ‘working for a just distribution of the fruits of the earth ... is a commandment.’ Pope Francis 2015
- ‘inequality is sexist’. Christine Lagarde 2016
- ‘rising inequality threatens the world economy’ World Economic Forum 2017

## Changing The Climate

It is also becoming clear that economic inequality has a great effect on climate change. People in the most unequal of affluent countries unnecessarily consume and pollute far more than do people in more equitable affluent countries – and it doesn't even make them happier!

Four years ago Thomas Piketty spelt out very clearly what would happen if inequalities were not contained in his book *Capital in the Twenty First Century*. Since then, and with the help of a huge amount of additional evidence, it is just becoming possible to see that we are finally beginning to curtail inequality again. We last turned the tide towards greater equality in the years after 1914.

It requires a huge amount of work and commitment to change the direction of the tide, to say that it is wrong that the rich become ever richer, to realize that it does not benefit anyone – even them. Back in the 1920s and 1930s across Europe there was a change in the moral sentiment. Greater equality became seen as essential. The rich were taxed to pay for the First World War, and the old order was recognized as both having been unjust and dangerous. Unfortunately, economic inequality was allowed to rise in Germany and Japan in the 1930s. It took decades to establish greater economic equality across all of Europe and the USA did not even begin this process until after World War Two.

So far, almost a decade after the great economic crash of 2008, we can finally see that in a majority of countries around the world economic inequality has begun to fall, albeit only slightly. Most importantly hardly anyone is impressed when they hear of another's high salary or great wealth anymore. The moral sentiment has again changed and we have already become used to

that change. But a few with great wealth and high incomes will try as hard as they can to hold on to that money, what they see as their money. After all, they only ever became so rich by being excessively greedy.

In the UK the Brexit campaign was lead by a small number of very rich newspaper proprietors who did not want to see their wealth and power diminish in an ever more equal and unified continent. A few rich individuals, some of who remain anonymous, funded most of the Brexit campaign. These include people who wanted the tax avoidance islands that Britain protects to remain places where they could store some of their wealth. They scared the British people with stories of how immigrants would take away their houses and jobs. They want Britain to remain as the most economically unequal country in Europe, and London its most expensive capital.

## Chapter 6

# FIVE RADICAL IDEAS FOR BEATING INEQUALITY

*By Neal Lawson*

Scratch the skin of any social democrat and s/he bleeds equality. Because of structural weakness we water the concept down into social justice or fairness or we try and dress equality up with more complex ideas like ‘capabilities’.

The problem is that we aren’t getting it, indeed we’re moving further away from it. The great convergence of the post-WW2 decades has been replaced by the great divergence as we return to an era of huge private wealth for the few and public and private/public squalor for the many. The Gini coefficient is out of the bottle and will not return any time soon.

The stock response of social democrats is to enact the same policies and expect a better outcome as in: this time it’ll be different. Set targets, dictate more from the centre, get up earlier and go to bed later. It isn’t working. If we want a more equal society then we have to adopt new ideas and strategies. Here are few key ideas for debate:



**Stop being a movement of resistance and start becoming a movement of transformation.**

Social democrats and trade unions were created to resist/combat/overcome the inequality caused by unregulated capitalism. For a while regulation worked but only while the working class was unified and strong. Today globalisation and financialisation fatally undermine the old ways of doing social democracy and achieving equality. Instead of resisting from a position of structural weakness, we must seize the moment to offer this tired society a new society – a different way of being and doing. It's time to propose a good society and not just oppose a bad one.

**This is the moment for a paradigm shift.**

We are ripe for such a transformation: 1945, 1979 and now! Capitalism is at the very least morally wounded. Another cash lurks. That doesn't inevitably mean socialism as we saw to our cost after 2008 – the crisis could even get worse. But it's a moment of possibility. At the same time the networked society is emerging and gives us some of the tools to confront neoliberalism and to build a more equal and democratic society through the flatter interconnections that now fill our lives. Again, it's not inevitable. It has to be fought for. Politics is essential. But a durable good society was never going to be built via 20th century hierarchies; it could be created through the egalitarian and democratic spirit of the networked society.

**We must embrace the idea of abundance and lives of significance.**

The social democratic psyche is twisted by the notion of scarcity – of there never being enough. If this is the popular mood then a

Hobbesian ‘war of all against all’ is inevitable. While we must ensure everyone has the wherewithal to live in comfort (a basic income anyone?), we have to resist a life of turbo-consumption that destroys solidarity as much as the planet. What’s the point of a bigger TV screen if your kids cannot breathe and flood water is seeping under the door? In a digital world we can have all the information and connection we need virtually for free. If technology gives us more time to care, create, learn, play and innovate then good – as long as the spoils of productivity are shared. Our vision of the future must be more compelling and seductive than that of the right-wing and tap into deep desires for what it means to be truly human and free. Few die wishing they owned more stuff. We die wishing we had more time to do the things we love and be with the people we love. If we consume less, then we can consume more equally. Let’s use that insight to build a good society.

### **Recognize that means always shape ends.**

We cannot end poverty in the old ways of administering from the top down – however well meant. The state has a key role to play but we cannot just reproduce inequalities of power. Social democrats must be humbler and recognise our role is to build power with others, not lord it over them. We start with a belief in the best in people – and build systems of social security on that basis – so no humiliation, means-testing, no talk of scroungers.

### **Admit that change is complex.**

The Fordist society of the 20th century meant that the machine metaphor for economics, politics and society could work – at least for a while. But today, in our interconnected and global world, things are more contradictory and chaotic. The answer to the

problem is in part electing a social democratic government but bigger, broader and deeper alliance are going to be required. Inequality is now so closely linked to climate change that a red/green alliance is essential. If it is to be collaborative and succeed in a networked society then it will have to be open and liberal: A future not imposed by us but negotiated with everyone. Social democracy might be the biggest tent – but only within a campsite shared by other parties, groups and ideas – a rich and diverse eco-system of alliances and blocs that can and must work together to make society more equal, not just for a while but for good. There are many things we must fight – inequality and climate change above all – but what we cannot fight is the *Zeitgeist*. That spirit is open, enquiring and more than anything collaborative. This is how we must be too.

We are all born amazingly different and each of us deserves the best and equal chance to make most of all the talents, hopes and dreams we have. Life can be nasty, brutal and short. Or it can be long and fulfilling. Social democrats can bend modernity to our values of solidarity and equality – but only if we do the only thing we really can change: ourselves.



**PART II**

**UNDERSTANDING  
INEQUALITY IN EUROPE**



## **Chapter 7**

# **INEQUALITY IN EUROPE: COMPLEX AND MULTIDIMENSIONAL**

*By Michael Dauderstädt*

Talking about inequality in Europe brings one face-to-face with a complex pattern of possible issues and dimensions, which can be measured in different ways. As Table 1 shows, inequality exists regarding different characteristics such as income, wealth or life expectancy between different entities such as persons, households, sexes, labour and capital, regions or countries. Economics and statistics provide various indicators to measure these inequalities and the choice of indicator is by no means value-free.

Distribution		
Of what	Between whom	Measured by
Income	Persons	Gini indicator
- market income or disposable income	Households	Theil indicator
- net equivalent income	Gender	S80/S20 ratio
- exchange rates or purchasing power	Production factors	Palma ratio
Wealth	Regions	Standard deviation
Life expectancy	Countries	Max/Min

*Table 1: Dimensions Of Inequality*

This article focuses mainly on income inequality. But even if we focus on income inequality, caution is required, since income and prosperity, their development and distribution, point to many problems and pitfalls that also appear in Europe's development, especially from an international point of view. Income is often defined as Gross Domestic Product (GDP) per capita or as household income based on household surveys. In the EU that is the EU Survey of Income and Living Conditions (SILC). The market income of households is much more unequally distributed than the disposable income, which includes transfers and social benefits while subtracting taxes. Household income can be further adjusted by taking into account household size (net equivalent income) or the non-monetary benefits resulting from public goods or services.

### **The Three Dimensions Of European Inequality**

Inequality in Europe has three main dimensions: within member states, between member states and in the European Union (EU) altogether. Within member states, inequality has increased in most countries over the last decades. This is the well-known

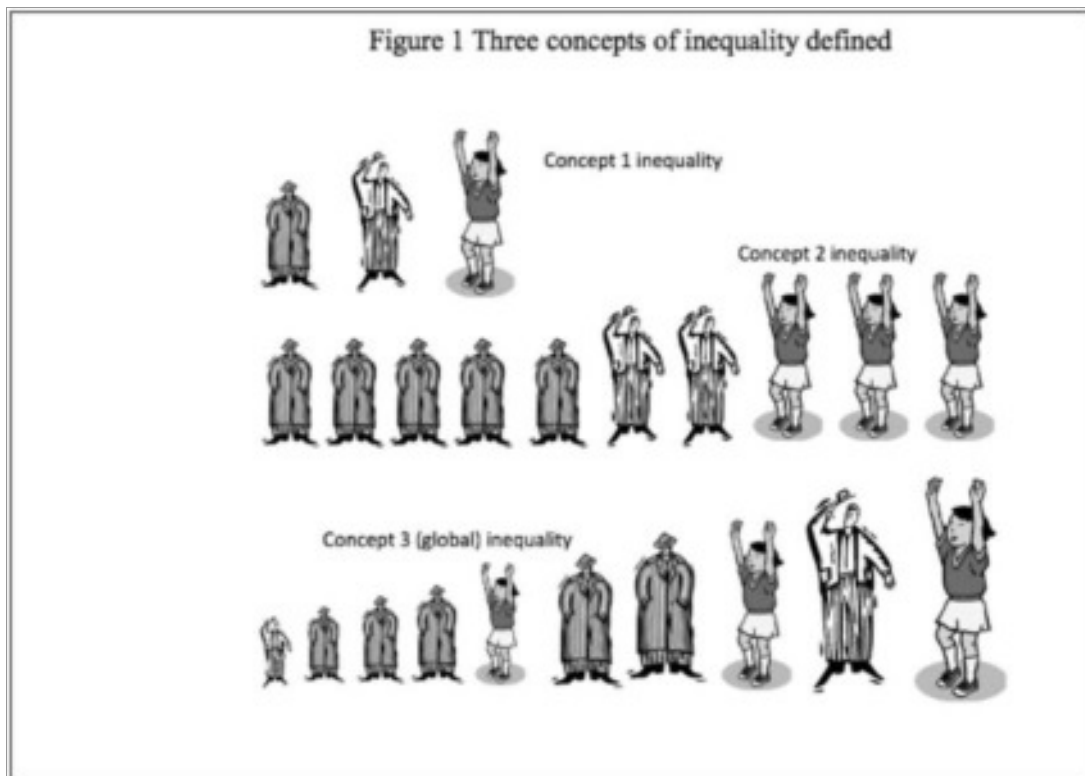


phenomenon that contributed to the rise of populism. Between member states, the analysis has to take into account the effects of changes in the exchange and inflation rates, too. Accordingly, when comparing real incomes, the use of purchasing power parities (PPP) makes more sense than a comparison at exchange rates.

The income per capita in PPP is usually higher in poorer member states than the one measured in exchange rates, since many things are cheaper there. Thus, inequality between countries is lower if measured at PPP. In the context of a catch-up process, when between-country inequality decreases and the income level of poorer member states comes closer to that of the richer ones, a real re-evaluation usually takes place, mostly accompanied by a nominal currency appreciation and/or a higher inflation rate, thus tending to reduce the difference between the purchasing power and the exchange rate.

### **Three Concepts Of Europe-Wide Inequality**

Determining Europe-wide inequality requires analysing the distribution of income within and between countries. Analogous to Branko Milanovic's three concepts of inequality (see Figure 1) one can differentiate between three variants: international inequality, which disregards the different sizes of populations, (concept 1), population-weighted international inequality (concept 2) and true global inequality, which compares all people regardless of their nationality (concept 3).



In order to measure concept 3 inequality for the EU, one has to consolidate all national SILC household survey data. A shorter approximation uses the S80/S20 ratio (see below) and constructs the quintiles of the EU population using the appropriate national quintiles. EU-wide inequality is determined by the gap between poorer and richer member states and the inequality within member states. The level of inequality increases from concept 1 to concept 3.

### **Measuring Inequality Depends On Distributional Preferences**

In order to measure the distribution of income, one can use a variety of indicators (see last column of Table 1). The Gini ranges between Zero (equal distribution) and 1 (or 100), when one person gets all the income. The Theil is useful because it can be decomposed between inequality between and within member

states. The S80/S20 ratio is the relation between the income of the top 20 percent and the bottom 20 percent of the income distribution. The Chilean economist Palma has introduced a similar ratio of the relation between the top 10 percent and the bottom 40 percent as he had observed that the share of the middle 50 percent remains relatively constant while overall inequality varies dramatically.

While these latter indicators measure relative inequality, others such as standard deviation look at absolute inequality. The picture of the development of inequality can appear quite different depending on the use of indicator. When lower incomes grow faster than higher incomes (economists call that “beta convergence”), the distance between the lower and higher incomes can still continue to grow for a while (depending on the original relationship). In this case, the standard deviation increases, too (so no “sigma convergence” in economists’ terminology). Thus, the use of an indicator involves moral and political preferences: Are you more concerned with the absolute difference between income levels or their relative ratio?

## **Chapter 8**

# **REDUCING EUROPEAN INEQUALITY: COHESION THROUGH CONVERGENCE**

*By Michael Dauderstädt*

When founded in 1957, the then European Economic Community comprised six relative prosperous countries, albeit including a very poor region, the Italian Mezzogiorno. With the first enlargement in 1972, poor Ireland joined the Community, bringing a start to its regional policy to promote growth in its poorer regions. The EU publishes regularly cohesion reports that assess the progress. This effort had to be strengthened substantially after the Southern enlargements (Greece in 1981, Spain and Portugal in 1986). But these challenges pale in comparison with the impact of the Eastern enlargements in 2004, 2007 and 2013, when much poorer post-communist countries joined the EU.

### **Convergence: The Record So Far**

When Ireland and the Mediterranean countries joined, their Gross Domestic Product (GDP) per capita was about 60 to 70

percent of the EU average at purchasing power parities (PPP). Measured at exchange rates, they reached about 30 to 60 percent with Portugal being by far the poorest and Ireland the relatively richest country of the periphery. Joining the EU did not trigger a rapid catching-up process. Indeed, Greece and Ireland even fell back after their entry. Portugal and Spain performed better thanks to more favourable global economic circumstances in the late 1980s. The only true success has been Ireland after 1990 when it turned into the famous “Celtic tiger” overtaking all other EU countries except super-rich Luxemburg by the end of that decade.

The GDP/capita of the post-communist countries of Central and Eastern Europe (CEE) has been even lower than that of the Southern peripherals. Measured at exchange rates, their income in 2004 ranged from about 10 percent of the Euro area average to about 30 percent with Bulgaria and the Baltics being the poorest. At purchasing power parities the picture improves, reaching between 30 and 50 percent of the Eurozone average.

Table 1 presents the development of the GDP/capita in three subsets of member states since 1998, differentiated in the period before and after the crisis: The rich North West (NW) of the EU provides the benchmark; the Southern periphery (SP) comprises the poorer Mediterranean countries that have been subject to austerity programs, and the CEE plus Cyprus and Malta (CEE+) are the new member states that joined after 2004.

	Level (in €)			Change (in%)		
	1998	2007	2015	98-15	98-07	07-15
NW GDP/cap	22,800	34,342	37,792	65.8	50.6	10.0
SP GDP/cap	15,000	23,633	22,967	53.1	57.6	-2.8
CEE+ GDP/cap	10,627	18,718	21,744	104.6	76.1	16.2
NW – SP	7,800	10,708	14,825	90.1	37.3	38.4
NW – CEE+	12,173	15,623	16,048	31.8	28.3	2.7
NW/SP	1.52	1.5	1.6	8.3	-4.4	13.2
NW/CEE+	2.14	1.8	1.7	-19.0	-14.5	-5.3
Standard deviation	7,501	11,187	12,233	63.1	49.1	9.4
<i>Source: Eurostat; Author's Calculations (Unweighted Averages Of The Country Groups)</i>						
<i>NW = Sweden, Finland, UK, Ireland, Belgium, Netherlands, Luxemburg, France, Germany, Austria, Italy</i>						
<i>SP = Greece, Portugal, Spain</i>						
<i>CEE+ = Baltics, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Bulgaria, Romania, Croatia, Cyprus, Malta</i>						

*Table 1: Convergence And Divergence In Euro (PPP) 1998-2015*

As table 1 shows, growth in both poorer regions was stronger than in the rich core until 2007. But, while the three Southern countries fell back afterwards due to austerity, CEE growth continued to outpace the core's. Economists call this kind of convergence "beta convergence". It leads to a better relative quotient, improving the relation between the GDP/capita in CEE+ and NW from 2.14 to 1.7. Perhaps surprisingly, this does not imply "sigma convergence", i.e. a decline in the absolute inequality measured by the standard deviation (last line in table 1) or the absolute difference between the GDP/capita (NW-CEE+ or NW-SP in table 1). These absolute measures are still increasing in spite of higher growth in the poorer member states. The most shocking fact is the divergence between the core and the Southern periphery, reversing decades of convergence.

**Causes: Real And Nominal Convergence**

The major cause of the gap between different countries' GDP/capita is the different level of labour productivity (per hour or per employee). Employees in poorer member states tend, in fact, to work more hours (often more than 2000 hours per year) than those in rich countries (mostly less than 1500 hours). Still much lower productivity (at about 20% of the more advanced countries) leads to a big gap in income levels.

Labour productivity depends primarily on the amount of capital used, the technologies employed and the speed of innovation. Thus, capital flows into poorer member states, in particular when they incorporate better technologies, should accelerate productivity growth. Structural reforms are supposed to alleviate adjustment and change from less productive companies and industries to more productive ones. Securing the poor countries' access to capital remains crucial. The regional funds and cohesion policies are not sufficient to counteract private flows, driven by volatile market sentiments.

Successful catching-up growth processes (as in most countries of the European periphery until the crisis) depend on these structural changes leading to real convergence. But catching-up requires nominal convergence, too. Nominal incomes must appreciate in comparison to richer countries by the way of currency appreciation or higher inflation. The latter is a necessary feature of catching up as incomes and prices in industries with slower or no productivity growth must increase in step with the average productivity growth of the whole economy. Thus, the request for low inflation and stable exchange rates is a recipe to stop or slow down cohesion.

## **The Consequences Of High Inequality**

Persistent high inequality between member states leads to migration from poorer into richer countries. Indeed, some countries in CEE such as Romania, Latvia and Lithuania have lost more than ten percent of their labour force due to emigration. Often, this implies a serious brain drain when the most qualified people (doctors, engineers) leave for better-paid jobs in the core regions of the EU. The low wages in the poorer countries attract foreign investment in labour-intensive, low-skill industries at the same time. Both processes are likely to increase the gross national income, which includes the earnings of national citizens abroad, although only the latter has a direct positive impact on GDP.

In the richer member states, these developments will probably increase inequality as wages of low-skilled workers are under pressure from job-seeking immigrants and the threat of offshoring, i.e. the relocation of parts of the production to low-wage locations. The best remedies are statutory minimum wages and social investment in education and training.



## **Chapter 9**

# **EUROPE-WIDE INEQUALITY**

*By Michael Dauderstädt*

Inequality within member states has become a much debated and researched issue over the last decade. Reducing the inequality between member states (i.e. convergence) is a target the European Union (EU) has set itself in its treaties and monitors through its cohesion reports.

But what about the EU as a whole? If we consider the EU as a single economy, society and polity in the making, how large is the inequality in this Union and how did it change over time? There is far less analysis looking into EU-wide inequality. But some studies exist such as a recent Eurofound study on income inequalities in Europe, which provides an overview over other studies as well.

## **Measuring EU-Wide Inequality**

To measure Europe-wide inequality can be cumbersome as one

must take into account the distribution of income between and within member states. The most exhaustive approach takes all 28 national (or EU-SILC) household surveys and orders the households according to their income. This way one can calculate the EU-wide Gini, which ranges from zero (complete equality) to one or hundred (one person gets all the income) or other indicators of inequality. Current studies give values of about 0.336 for the EU-wide Gini of disposable income in 2014 (USA: 0.39), down from 0.355 in 2004. National Gini values are lower for most member states.

Since the Gini is hard to grasp, one can use another indicator, which is easier to understand: the S80/S20 ratio that gives the relation between the income of the richest and poorest quintile (20 percent) of the population. The European average of the national value of that ratio is about 5 (see figure 1, lowest line). That average hides substantial differences: While in Scandinavia and some Central European countries, the rich earn less than four times as much as the poor, in Romania, Bulgaria or the Baltic countries the value is above 6.

To calculate the EU-wide value, we built the approximate top and bottom quintiles of the whole EU (each comprising approximately 100 million people) out of the national quintiles. Then we compared the income levels at purchasing power standards (PPS) and at exchange rates. The resulting EU-wide S80/S20 inequality was 6.26 (PPS) and 9.47 (exchange rates) for the EU-27 (see figure 1).

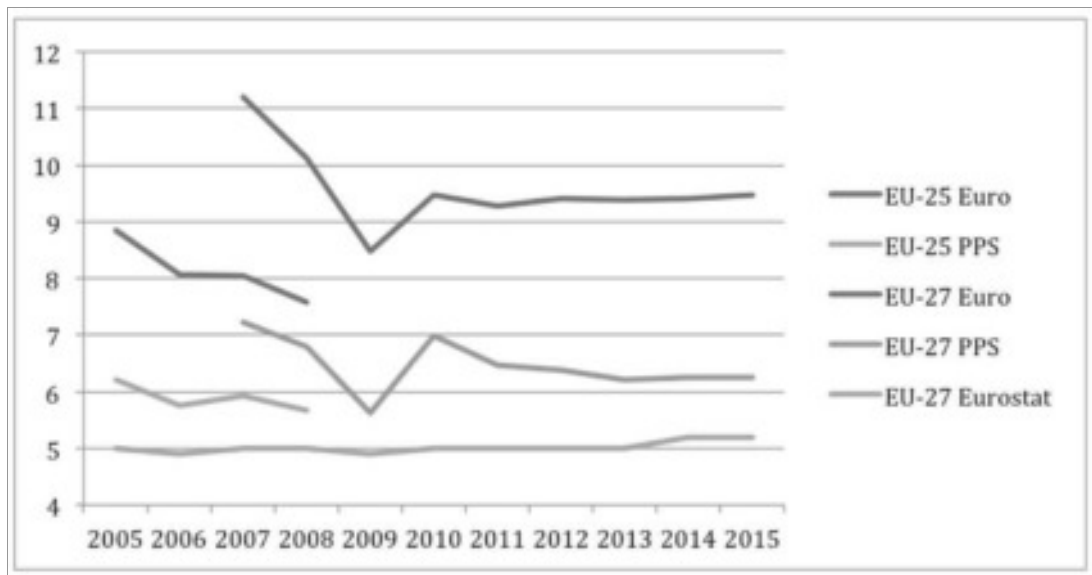


Figure 1: Development Of Inequality In The EU

With the 2007 enlargement to Romania and Bulgaria, two large and very poor countries, that value has jumped. But after 2007, it has declined substantially from more than 11 to less than 9 (or from more than 7 to less than 6 at PPS). According to the UN Human Development report, the American value is 9.8. The crisis of 2009 reversed that European trend briefly. After 2010, there was little further progress.

It is difficult to assess how much within-country and between-country inequalities contribute to EU-wide inequality. The Gini and the S80/S20 ratio are not easily decomposable. Another indicator of inequality, the Theil index, is decomposable and studies suggest that within-country inequality is now responsible for about 80 percent of the EU-wide inequality. That share was higher ten years ago. Still, that value is based on PPS. At exchange rates, it might be much higher, perhaps 50 percent, given the disparities between the two values visible in figure 1.

In so far as inequality declined it was due to higher growth in the poorer member states rather than reduced inequality within

member states. On average throughout the EU, that latter value has remained almost unchanged since 2005 (lowest curve in figure 1). Eurostat gives that average of national values, which neglects the huge income discrepancies between countries, as the EU value, thus misrepresenting the level and the trend of the EU's inequality.

### **Does EU-Wide Inequality Matter?**

Political debates and conflicts focus primarily on inequality within member states. People worry about huge income discrepancies within their societies as they are accompanied by social problems and inequalities of life expectancy, health and many other things. Nonetheless, an increasing “Europeanisation of income inequality” can be observed, according to some studies (e.g. Martin Heidenreich “Exploring Inequality in Europe”).

Indeed, the incomes of households in the EU tend to depend more and more on European factors. EU-enforced austerity policies affected growth, wages and social benefits in Greece, Spain, Portugal, Ireland and Cyprus. European liberalisation, integration and regulation of markets determine the economic opportunities of people and companies. From a purely economic point of view, EU-wide income inequality in an integrated economy has noticeable effects. Poor EU citizens are likely to migrate to richer member states in order to improve their income chances. Large companies with the capacity to offshore part of their production processes will locate labor-intensive manufacturing to low-wage countries. Both processes affect the income and employment opportunities of low-skill workers in high-wage countries, thus contributing to higher inequality there.

Politically, the frustrating development of wages and employment

in many richer member states contributed to the rise of nativist populism. Brexit voters have been motivated by the fear of too much immigration from poorer member states. Thus, the stagnation of inequality levels since 2011 (see figure 1) bodes ill for the future of Europe.

## **Chapter 10**

# **INEQUALITY IN EUROPE: WHAT CAN BE DONE?**

*By Patrick Diamond*

Since the 1940s, the Left in most western European countries has relied on a combination of four strategies to tackle inequalities in the distribution of income and wealth. Firstly, the pursuit of full employment through Keynesian demand management. Secondly, state planning and nationalisation of the means of production. Thirdly, collective bargaining and the promotion of trade union power through the wage setting process. Fourthly, redistribution using the fiscal levers of the tax and benefits system to alter the income distribution along progressive lines. By the early 1980s, however, traditional egalitarian social democratic politics had been undermined in many countries.

For different reasons, each of these policy strategies developed problems, and steadily unraveled in the crisis years of the late 1970s. Keynesian principles became more difficult to operationalise in open economies where capital mobility and exchange rate fluctuations negated government policy action. Nationalisation of major public utilities proved problematic for economic

efficiency and consumer welfare. Moreover, trade unions became increasingly unpopular among the working class with the growth of strikes and violent industrial unrest; the unions were too often seen as a producer interest in a world where voters increasingly perceived their interests as consumers. Finally, it was evident that redistribution had limits given the growth of tax resistance and hostility to public expenditure.

After a period in the electoral wilderness, the Left sought to devise a new egalitarian strategy centred on deploying the fiscal surplus from growth to invest in the welfare state and public services, alongside limited fiscal redistribution. That was the so-called ‘third way’ approach of the 1990s pioneered by Bill Clinton, Tony Blair and Gerhard Schröder. The third way involved a process of serious rethinking and a ‘new revisionism’ on the European Left; but because it enthusiastically embraced the liberalisation of markets, particularly capital and financial markets, the 2008 financial crisis exposed the weaknesses in third way political thought. The crash revealed the essentially unstable and dysfunctional qualities of markets which had long been recognised by social democracy, but which the third way had failed to properly acknowledge.

### **New Strategy**

Today, in the light of such developments, social democrats have to devise a new strategy to make European societies and citizens more equal. Rather than simply returning to the tried and tested remedies of the post-war era, the Left has to shape an egalitarian programme that is relevant to contemporary economic and social circumstances. The descaling of economic production, the growth of flexibilisation and specialisation, the emergence of global production chains, and the impact of emerging digital

technologies necessarily entails new egalitarian policies. In essence, it means a renewed focus on increasing the economic power of workers and wage earners in predominantly private sector markets. Such an approach is based around the rather inelegant term ‘predistribution’, but those measures have to be pursued alongside, not instead of, intelligent redistributive policies.

Predistributive policies fall into several categories. The first is concerned with boosting the relative earning power of low-paid workers: high quality, vocational education and training will help to increase productivity, but there should also be targeted support for low income households to improve human capital and labour market access, such as widening the availability of childcare. Empowering workers means tackling the drivers of labour market discrimination which result in persistent gender pay gaps, as well as discrimination against disabled employees and older workers. Raising wages for workers also entails increasing the supply of secure, well-paid jobs in labour-absorbing sectors such as social care.

The second category of predistributive policies are about cracking down on excessively high pay, unequal rewards and large wage differentials. Of course, it is essential to properly enforce minimum wages, harshly penalizing rogue employers. Moreover, the role of trade unions as labour market institutions providing a countervailing force against low wages and deteriorating terms and conditions ought to be encouraged. Corporate governance reforms such as worker representation on company boards can help to limit executive pay awards and maintain a fair ratio between the lowest and highest paid. There should be targeted action against unjustified rewards in the financial services sector, which too often sets a bad example to the rest of the economy. The case for global taxation of financial transac-



tions remains compelling, but it requires international co-operation which has been lacking until now.

The third axis of predistributive policies is the reform of product, capital and consumer markets. The active state should use competition policy to drive down prices, especially in energy and utilities markets which have a disproportionate impact on vulnerable consumers. Despite the problems associated with state nationalisation in the 1940s and 1950s, governments should be willing to use models of public or social ownership where natural monopolies allow private sector companies to indulge in egregious rent-seeking or price-fixing behaviour that is detrimental to consumer welfare.

The fourth category of predistribution is to address growing precariousness among the younger generation that has suffered declining real incomes and living standards since the 2008 crisis. Government intervention should include increasing the supply of high quality social housing with fair rents, giving local public authorities the freedoms and resources to build more homes. There should be stronger incentives for students in low income households to enter university (including maintenance grants to help with living costs), but also much greater support to undertake vocational training and apprenticeships. Capital grants and ‘baby bonds’ funded through inheritance and wealth taxation will help to further equalise the distribution of assets, property and capital.

### **Beyond The Nation-State**

This is not an exhaustive list but illustrates the breadth of predistribution as an egalitarian strategy. In conclusion, three points ought to be made. Firstly, ‘redistribution’ and ‘predistribution’ are not mutually exclusive. Egalitarians need both. If predistributive

measures are effective, they ought to raise the overall tax take by boosting employment participation; greater resilience in the tax base then increases the potential for redistribution and ‘social’ investment over the long-term.

The second point is that predistribution is often politically more difficult than traditional redistribution. Predistribution involves taking on entrenched vested interests, especially in the financial sector. It is important to highlight that lower inequality of primary incomes is positive for economic efficiency as well as social justice. Greater equality helps to create more stable market economies, balanced by societies where democratic politics rather than market forces prevail.

Finally, policy experience since the Second World War demonstrates that equality cannot be achieved solely within the boundaries of the nation-state. There is a growing need for co-ordinated action internationally to tackle tax avoidance and tax evasion, and to enforce common labour standards to prevent a race to the bottom in global markets.

**PART III**

**SPECIFIC POLICY ISSUES**



## Chapter 11

# A BIG LEGACY: WEALTH IN EUROPE

*By Anita Tiefensee*

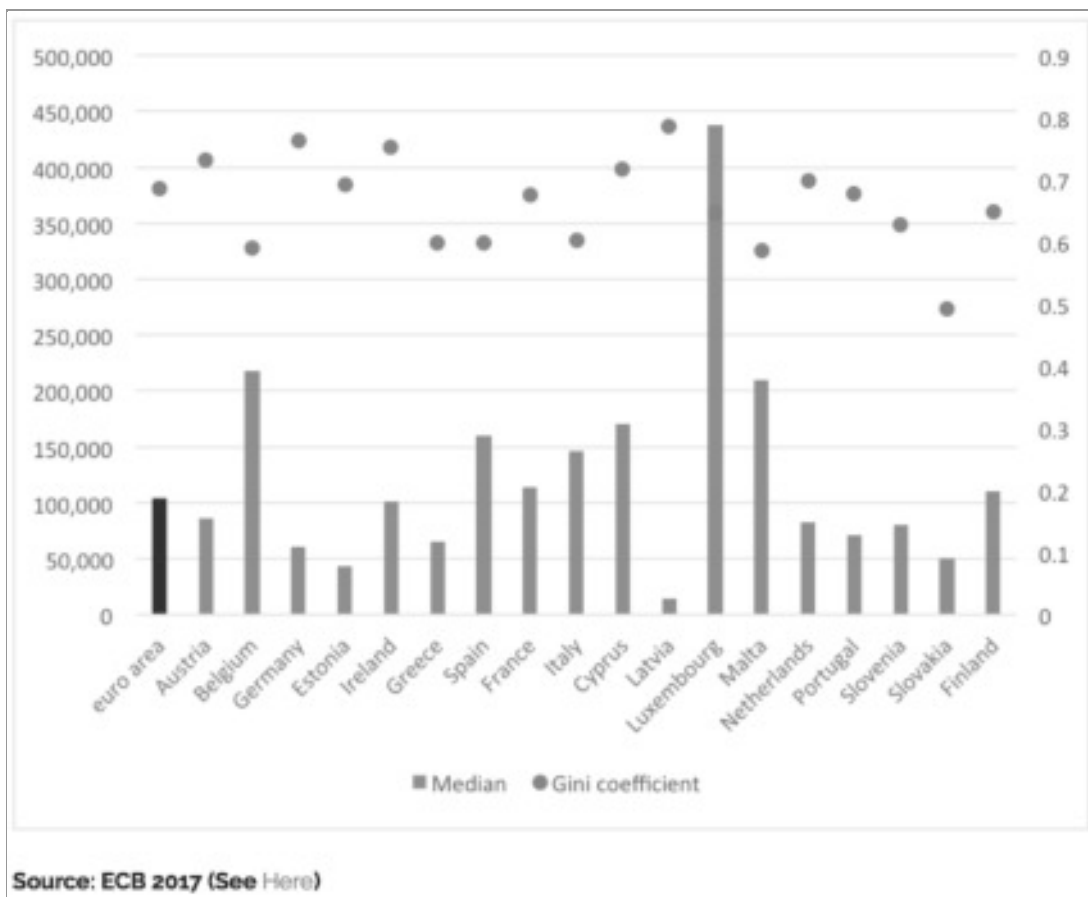
The material prosperity of people consists of two main resources: income and wealth. The possession of wealth, in particular, offers extended consumption options, can make good a loss of income and secures one's own pension – for example, via owner-occupied housing. Furthermore, it can finance the education of children and is built up to enable bequests. Thus, wealth creates a financial independence and great wealth may enhance economic and political power. Therefore, knowledge of the distribution of wealth and its key determinants represents an important factor in the decision-making of social and political actors. So, what does the current situation in Europe look like?

In the euro area around the year 2014 the distribution of household net wealth (real + financial assets – liabilities = net wealth) is heavily skewed. If all households are divided into 100 equal groups (= percentiles) sorted by increasing levels of net wealth, the 50th percentile (median) household holds net wealth of €104,100. However, the 10th percentile holds only €1,000 and

the 90th percentile €496,000 – the 95th percentile even €743,900. This means the top 10 percent of households in the wealth distribution hold over half of total net assets.

### Differences Between Countries

Looking at the 19 individual countries in the euro area (apart from Lithuania, for which no comparable data is available) we see large differences: Households in Luxembourg (€437,500) and Belgium (€217,900) have the highest median net wealth, those in Latvia (€14,200) and Estonia (€43,500) have the lowest.



*Figure: Median Net Wealth And The Gini Coefficient In The Euro Area*

The most important real asset in all countries is owner-occupied housing. Home ownership and the value of these homes is one

important source for differences in net wealth levels between countries. The structure of the welfare state also plays an important role. In countries with an effective and well-developed welfare state, households accumulate less private wealth, as the (welfare) state takes over some of the securing functions that private wealth performs such as compensating for income loss. Part of the differences between the countries can also be explained by structural differences such as household size. For example, in southern European countries more people live on average within one household compared with in central European countries. However, as it is not clear who holds the assets and liabilities, a per capita calculation is inappropriate.

### **Differences Within Countries**

Differences are not only visible between countries, but also within them. A standard measure of inequality is the Gini coefficient. The closer the Gini is to the value one, the greater the inequality. The highest Gini can be found in Latvia and Germany with 0.785 and 0.762 respectively. The lowest are found in Slovakia and Malta with 0.492 and 0.586.

A source of different wealth levels within countries is age. Wealth is accumulated via savings from income over the life cycle until retirement age and then consumed or passed on as wealth transfers (gifts or inheritances). Current research e.g. from Thomas Piketty suggests that wealth transfers are (again) an important factor for household wealth in European countries. In 2010 the shares of current household net wealth due to inheritances and gifts vary between close to 13 percent in Cyprus and over 31 percent in western Germany. Looking solely at households, which are already in receipt of a transfer, the shares of current net wealth due to inheritances and gifts are already between over 30

percent in Cyprus and more than 52 percent in western Germany.

### **Inheritances And Gifts Are A Dominant Factor**

For high-income households, transfers are less relevant to their current net wealth position. However, they receive significantly higher amounts than low-income households. This can be explained as follows: High-income households are able to build high wealth levels from their regular incomes. Substantial inheritances and gifts point to low intergenerational mobility. It seems that parents of high-income households also shared high incomes and the ability to save.

Inheritances and gifts can be seen as a way of accumulating wealth without effort and here high transfers pose a particular threat to equal opportunities. This development needs to be watched carefully, particularly because taxes on gifts and inheritances has tended to decrease in the euro area and in countries like Austria were even abolished over the last couple of years. Therefore, it is important to discuss how inheritances and gifts can be tapped to co-finance the social welfare state in each country.



## **Chapter 12**

# **GENDER PAY GAP IN EUROPE**

*By Alexandra Scheele*

Though the two principles “equal pay for equal work” and “equal pay for work of equal value” have been legally fixed with the European Treaty of Rome 1957 as well as with the subsequent Equal Pay Directive 1975, the EU still shows – latest data from 2015 – an average (unadjusted) gender pay gap of 16.3%. That means that the average gross hourly earnings of female employees are 16.3 % below those of men.

Even so, there are huge differences among the 28 member states: While the gender pay gap in Italy and Luxembourg is only at 5.5%, it is at 26.9% in Estonia.



Research gives evidence that the gender pay gap is caused by several interrelated factors: (1) labour market segregation by gender and the corresponding unequal distribution of women and men in sectors, occupations, and positions (horizontal and vertical segregation); (2) the fact that women (more often than men) take career breaks and/or work part-time due to care responsibilities, which has negative effects on their service length (seniority); (3) the fact that so-called ‘women’s jobs and sectors’ are often lower-paid jobs and sectors owing to existing collective agreements; (4) opaque and unsystematic wage-setting processes and individual pay agreements that are often less advantageous for women.

These factors show that closing the gender pay gap is still a challenge. But what needs to be done? Some European countries have introduced laws designed to narrow the gender pay gap. Belgium can be seen as good example for such legal framework. Though at 6.5% its gender pay gap is rather low, specific legislation came into force in 2012. This law follows the idea that the

gap should be discussed by the social partners at all levels of collective bargaining (national, sector, company). Further all job classification systems have to be analysed with regard to their gender neutrality by the FPS for Employment, Labour and Social Dialogue. Social partners play a decisive role in this process.

In Germany, on the contrary, where the gender pay gap is at 22% and therefore relatively high, this kind of state intervention in collective bargaining is pretty unlikely since unions defend the principle of autonomous negotiations. Instead the German government has recently agreed on a new act of law through which income structures are to become more transparent. The new Law on Pay Transparency which came into force on July 6 this year entitles workers in companies with more than 200 employees to receive information on the wages paid to colleagues doing comparable work. In companies bound by collective bargaining agreements, works councils will administer this legal entitlement; in companies without works councils, employees have to take their case to the employer. Furthermore, an evaluation procedure has been introduced for companies with more than 500 employees. This procedure needs to be carried out at least every five years. Incorporated companies with more than 500 employees are to report on equal opportunities measures as well as on equal pay on a regular basis.

Employer bodies in particular (e.g, the Federal Association for medium-sized businesses) have called the new law over-bureaucratic and not practicable. It is further argued that pay inequalities result from different career patterns and individual choices of women (and men): If women were working in the same sectors and professions as men and if they were working full-time and did not interrupt their professional careers, the wage differences between women and men would be much lower.

The argument that the gender pay gap results from individual choices or women's preferences needs to be questioned for several reasons: First, so-called individual choices are embedded in institutional structures such as the welfare system and its gender regimes. Second, wage composition is a complex process and is often based on gender stereotypes, historical developments and power relations. Therefore it is necessary to contextualise and interpret wage differences against this institutional background. What's more, we need an approach that understands the complexity of the gender pay gap, and how it interfaces at different levels — professional, organisational, and that of the state.

What does this mean for political actors? The Belgian approach provides some orientation regarding the different valuation of so-called women's and men's work. Bargaining parties and political actors are asked to work on a revision of current job classifications and replace them with gender-neutral ones in order to end the undervaluation of 'women's' professions. At organisational level this requires active measures against gender stereotypes accompanied by enhanced career opportunities for part-time workers so as to tackle horizontal and vertical segregation. And at welfare state level, institutional frameworks need to be enhanced as regards the number and quality of affordable childcare facilities so as to improve employment opportunities for parents (especially mothers).

## **Chapter 13**

# **ACTIVATION INTO IN-WORK POVERTY?**

*By Daniel Seikel*

A job is the best way out of poverty. This is a widely held belief among European policy-makers. Therefore, labour market reforms in European countries during recent decades focused on creating jobs. Yet, job growth was not supposed to be achieved by demand-stimulating economic policies but by supply-sided labour market reforms. ‘Activation policy’, at European level often labelled as a ‘social investment’ approach, became the guiding principle of European labour market policy and many national reform paths.

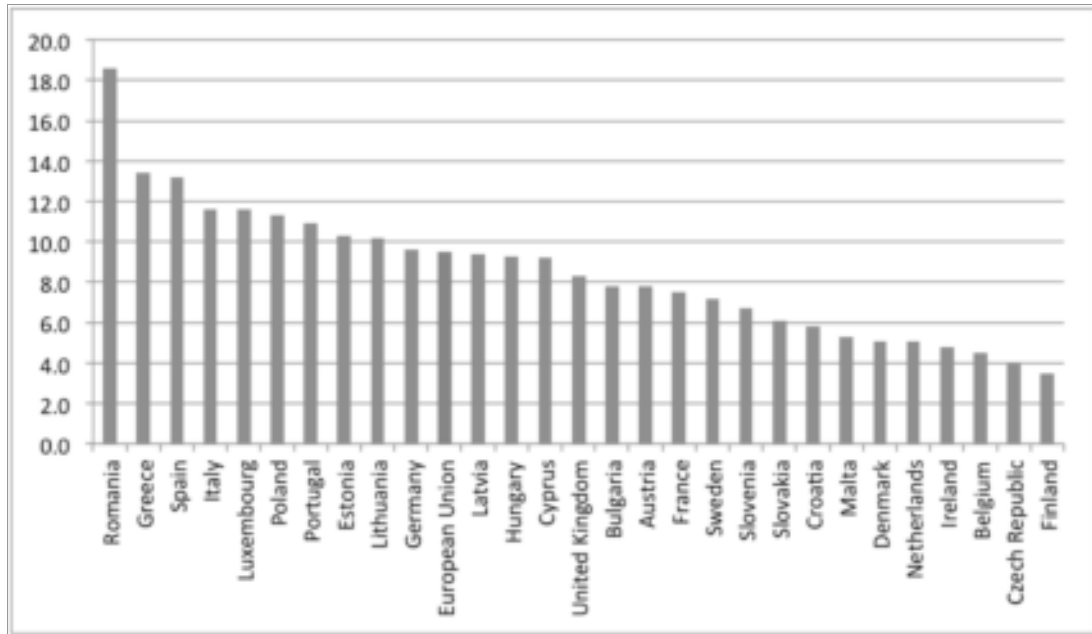
## **What Is Activation Policy?**

In order to ‘activate’ unemployed individuals, the pressure on the jobless to take up employment was increased. For that purpose, the receipt of social benefits was made more conditional upon the behaviour of the unemployed. For instance, rejecting job-offers below the qualifications and former pay level of an unem-

ployed person was rendered more difficult and sanctioned by penalties. Furthermore, in the perspective of the activation paradigm, social benefits were seen as negative incentives for labour market participation. Thus, the generosity and duration of social benefits have been reduced while eligibility criteria have been tightened. This ‘re-commodification’ of labour increased the economic pressure on unemployed individuals even further. On the other hand, active labour market policy measures such as vocational training and soft skill development were promoted which aimed at improving the ‘employability’ of the unemployed. In the scientific literature, this development was characterised as ‘activation turn’.

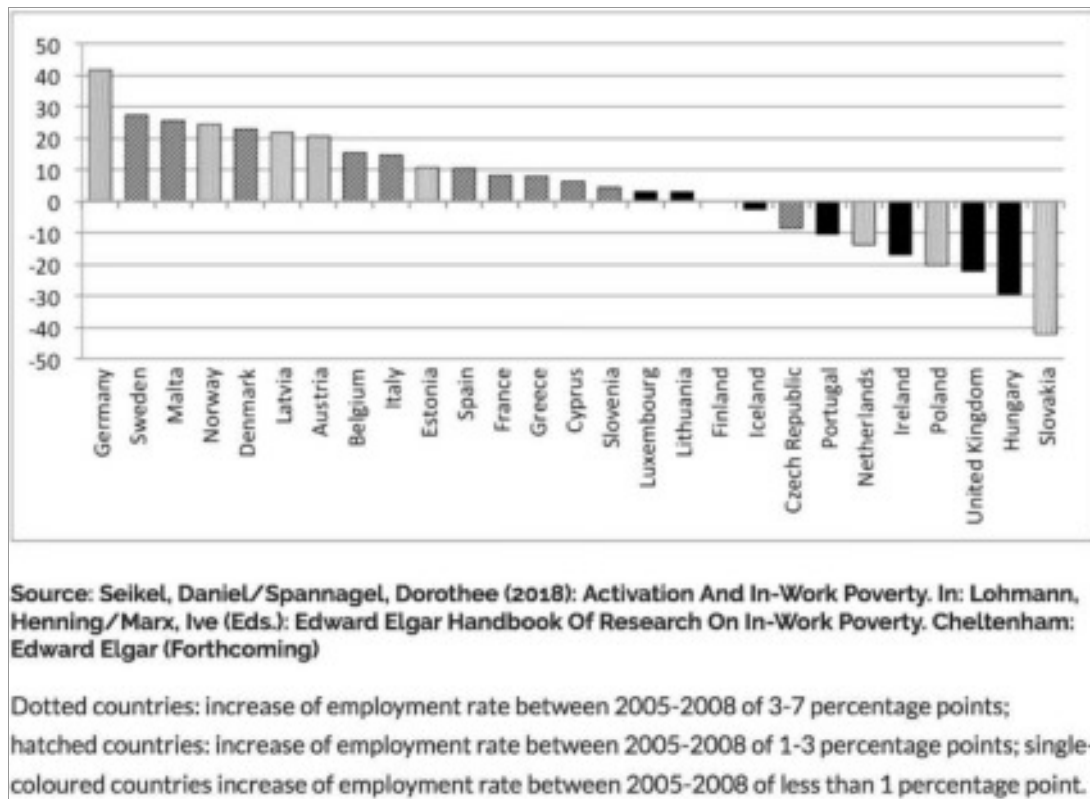
### **Activation Policy And In-Work Poverty**

In-work poverty is a widespread problem throughout the EU (see figure 1). Obviously, the labour market performance with regard to in-work poverty of EU countries varies greatly. Whereas the in-work poverty rate in Finland is only 3.5 percent, in Romania 18.8 percent of the employed are working poor.



*Figure 1: In-Work Poverty Rates In The EU In Percent Of The Employed In The Age Of 18 To 64 Years For The Year 2014 (source: Eurostat)*

The central question is how the problem of in-work poverty can be tackled effectively. At first sight, it is plausible to assume that employment growth reduces poverty. However, the increase in in-work poverty before the crisis in countries where at the same time employment was growing (see figure 2) shows that things are more complicated.



*Figure 2: Change Of In-Work Poverty Rates 2004-2008 In % (2004=100)*

If it were true that employment is the best route out of poverty, including in-work poverty, then, logically, the share of working poor should at least not increase if there is significant employment growth. The combination of employment growth and increasing in-work poverty suggests that activation policies might shift poor jobless persons/households to poor working persons/households. Therefore, it is necessary to analyse the effects of different labour market policies on in-work poverty. In particular, what impact do the different elements of activation policy – conditionality, re-commodification and active labour market policies – have?

In theory, two effects are possible. First, active labour market policies can improve the qualification of job-seekers and enable them to get better paid jobs. This can lift formerly poor households above the poverty threshold (disposable household income



below 60 percent of national median income). Second, the demanding elements of activation – strict conditionality and a high degree of re-commodification – can force unemployed individuals to accept job-offers even if the pay-levels are low. In this case, the income of the successfully activated might be too low to lift the household above the poverty threshold – poor unemployed would become working-poor.

In a forthcoming study (‘Activation and In-Work Poverty’. In: Lohmann, Henning/Marx, Ive (eds.): *Edward Elgar Handbook of Research on In-Work Poverty*. Cheltenham: Edward Elgar, 2018), my colleague Dorothee Spannagel and I analyse the impact of the different elements of activation policy on in-work poverty on the basis of EU-SILC and OECD data across 18 EU member states. The results show that high expenditures for active labour market policies reduce the in-work poverty risk. Strict conditionality and a high degree of re-commodification, on the other hand, increase the risk of in-work poverty. According to these findings, the combination of well financed active labour market policies and generous social benefits is the most promising strategy to fight in-work poverty. This combination is typically associated with the ‘enabling welfare state models’ of Scandinavian countries.

### **Lessons For European Labour Market Policy**

These findings have consequences not only for national but also for European labour market policy, especially for the EU’s anti-crisis strategy. In-work poverty cannot be reduced by cutting wages and social benefits as happened in the cases of the ‘Troika’ countries. On the contrary, those measures increase the risk of becoming working poor.

As for new European economic governance, the dominant activa-

tion paradigm of the European labour market policy needs critical reassessment. Combating in-work poverty is not only a matter of labour market policy but also of classic social policy. Making people work, no matter how, does not automatically reduce in-work poverty. The focus should be on creating good jobs that enable people to make a decent living. The ‘demanding’ elements of activation – strict conditionality and a high degree of re-commodification – have an adverse effect. Therefore, activation policy that follows a ‘workfare’ approach will aggravate the problems, not reduce them. Finally, the critical stance of the advocates of activation policy/social investment towards social benefits as negative incentives for labour market participation is problematic. Social transfers remain an indispensable instrument to reduce poverty, including in-work poverty.

## Chapter 14

# WHY WON'T WAGES IN EUROPE RISE AS THEY SHOULD?

*By Thorsten Schulten and Malte Luebker*

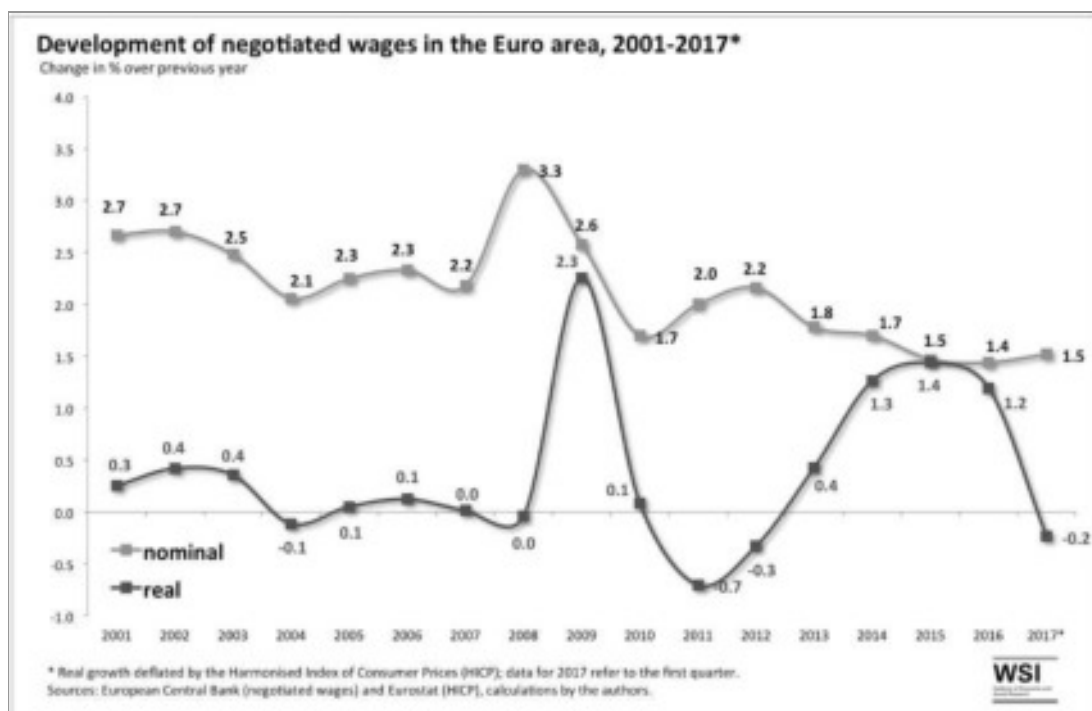
The economic mainstream is perplexed: growth is finally taking hold across Europe, economic forecasts have been revised upwards, and employment is expanding. The only indicator that stubbornly refuses to follow suit is wage growth, defying textbooks and economic orthodoxy alike. Bloomberg has called it the “mystery of missing wage growth,” the *Financial Times* writes about the “Eurozone’s strange low-wage employment boom,” and the European Commission has put forward the diagnosis of a “wage-poor recovery”. Moreover, there is a growing consensus among economic policy-makers that wages should indeed grow much faster than they do.

An unlikely cheerleader for higher wages is the European Central Bank (ECB), whose failure to nudge inflation upwards has led it to look for outside help. “The case for higher wages is unquestionable,” Mario Draghi has neatly put it. Likewise, the Commission argues that “the outlook for wages has now moved centre-

stage for the sustainability of the recovery,” and even the IMF – pointing fingers at Germany – has discovered the virtues of wage growth. It looks as if the European trade union movement has found some improbable allies in its campaign, “Europe needs a pay rise”.

To make stagnant wage growth worse, there is now a clear danger that the purchasing power of wages could stagnate or even fall as energy and food prices have started to rise again.

This is bad news for private consumption, currently the main engine behind European growth. For some years, low inflation had at least ensured modest real wage gains despite low pay settlements. Across the Euro area, these have remained far below of what they used to be prior to the crisis of 2008/09 (see Chart 1).



So, what is holding wages back? Ask any economist with a neo-classical outlook, and she – or, more likely, he – will tell you that

wages follow prices and productivity. Both have, of course, grown at an anaemic pace of late. But are low inflation and the lacklustre productivity performance the cause of subdued wage growth, or merely a symptom? Start with inflation. Traditionally, central bankers have been obsessed about wage-price spirals and called for wage moderation to rein in inflation. Now, they are discovering to their detriment that wage-price spirals work in reverse, too. The poor performance of wages is, in fact, seen as one of the key reasons why domestic price pressures have been subdued and core inflation has disappointed consistently over the past few years.

The case of productivity is more complex. Economists like to treat productivity growth as exogenous, determined by hard-to-quantify factors such as technical change. For all the buzz about the digital revolution, by this account the 1960s and 1970s were the heydays of rampant innovation, producing productivity growth at up to ten times the current pace. Strange, also, that productivity growth went into a sudden reverse in 2008/09, just as the financial crisis hit, and has been stuck in low gear ever since. Did technical change come to an abrupt halt, by sheer chance at about the same time Europe faced the biggest demand drop in a generation?

Some find this story hard to swallow. Surely, if wages were to rise, entrepreneurs would buy new machinery and find ways to make more efficient use of scarce workers? In the economic jargon, this is called capital–labour substitution and is generally recognised as a driving force behind long-run productivity growth. But it is no longer happening. According to the ECB, capital deepening has been virtually absent since 2013. But then, why should firms invest in labour-saving technologies when there is no cost pressure from the wage front and aggregate demand remains feeble? Accept this logic, and productivity growth

becomes endogenous – something that is itself driven by macro-economic factors, with wages playing a prominent role.

But maybe we are about to witness a return to robust wage growth? All the signs seem to point that way. “As economic activity gains momentum and the labour market tightens, upward pressures on wages are expected to intensify,” was the ECB’s assessment just over a year ago. Now, the verdict is that “Euro area wage growth remains low”. In fact, the ECB has a long history of predicting that wage growth is just around the corner, only to revise forecasts downwards again and again. For Europe’s workers, it’s a case of always jam tomorrow, never jam today.

So why do standard economic models keep on predicting wage growth that then fails to materialise? One possibility is that they are fed with wrong or misleading labour market data. There are indeed good reasons to believe that headline unemployment rates underestimate slack in the labour market, given that everyone who works for at least an hour per week counts among the employed. With the spread of precarious contracts and often involuntary part-time employment, there now are millions of workers in Europe who would happily move to a regular job.

The more worrying possibility is that the models were trained to predict the behaviour of wages in a world that no longer exists. In the name of flexibility and competitiveness – and often at the behest of the Commission, the ECB and the IMF – post-crisis labour market reforms have put the axe to centralised collective bargaining and a myriad of other protections. Taking into account that wage-setting institutions have been severely weakened, the failure of wages to grow looks much less surprising.

Almost everyone now seems to agree that wages have to grow if Europe wants to escape the cycle of weak demand, low inflation,

stagnant capital deepening and low productivity growth for good. But wage growth will not pick up in response to a magic wand held by central bankers. Instead, Europe needs to re-build wage-setting institutions – chiefly by actively supporting collective bargaining, by providing for extension mechanisms that increase coverage of collective agreements, and by developing a European minimum wage policy that guarantees a decent living wage to all.

## **Chapter 15**

### **THE EUROPEAN SOCIAL PILLAR – TOWARDS AN EU MINIMUM WAGE POLICY?**

*By Torsten Müller and Thorsten Schulten*

On 26 April, the European Commission launched its proposal for a European Pillar of Social Rights (EPSR) as a flagship initiative to strengthen the EU's social dimension. The EPSR consists of 20 key principles, not legally enforceable, that are primarily addressed to the EU member states and European institutions and intended to serve as a “compass” guiding their future activities in various policy areas.

#### **Commitment To “Fair Wages” And “Adequate Minimum Wages”**

Under Key Principle number six, which deals with wages, the EPSR lays down the following three commitments: one, the right of workers “to fair wages that provide for a decent living standard”; two, the commitment to ensure “adequate minimum wages ... in a way that provide for the satisfaction of the needs of



the worker and his / her family”; and three, the commitment to prevent “in-work poverty”.

Even though the EPSR has been criticised as being contradictory and merely mirroring the good intentions of the EU it might nonetheless provide further political support for an alternative approach towards wages and collective bargaining — an approach that finally moves away from the narrow supply-side view of wages as cost factors which has so far dominated the Commission’s approach and moves towards a more demand-side-oriented approach which also recognises the important role of wages in boosting internal demand and social cohesion.

The EPSR could support such a shift in two respects: it can contribute to a change in the narrative which shapes the Commission’s approach towards wages, and it could also be used to drive forward the actual implementation of such an alternative approach, in particular, by strengthening minimum wages in Europe.

### **Shift In The Dominant Discourse On Wages At European Level**

Recently, some important shifts in the European institutions’ public discourse about wages could be observed. For example, the Commission acknowledged in its Annual Growth Survey 2017 that if wage developments are too modest, this may lead to weaker aggregate demand and growth. Another example is the ECB’s repeated call for higher wages to ensure price stability and to avoid deflationary tendencies. Just recently, Peter Praet, a member of the bank’s executive board, argued in favour of higher wages in order to reach the ECB’s inflation target of 2%. All this can be seen as pointing to greater awareness of the importance of a demand-side oriented approach to wages.

Against this backdrop, the explicit commitment in the EPSR to “fair wages” that ensure a decent living standard and to “adequate minimum wages” that satisfy the needs of workers and their families can be seen as another example of a more comprehensive view of the role of wages. With these commitments, the EPSR picks up on central aspects of the trade unions’ demands as formulated for instance in the resolution on low and minimum wages adopted by the European Trade Union Confederation (ETUC) in March 2017. Indeed, the EPSR implicitly even states that minimum wages should be living wages – i.e. wages that provide more than mere subsistence and that are based on the needs of workers and their families to lead a decent life. However, as usual, the proof of the pudding is in the eating. In the past we have unfortunately all too often experienced that promising words did not translate into a change in concrete EU policies. In the field of wages and collective bargaining in particular, the EU institutions’ concrete policies have still been dominated by the objectives of wage moderation and decentralisation of collective bargaining.

### **EPSR As A Tool Supporting The Implementation Of An Alternative Approach To Wages**

As the Commission has recognised in its accompanying document the commitment to “fair wages” and “adequate minimum wages” is nothing new. Both the European Social Charter adopted in the framework of the European Council in 1961, and the Community Charter of the Fundamental Social Rights of Workers of 1989 already contain almost identical wording. A new feature of the EPSR is, however, its close link to follow-up and monitoring mechanisms – such as the European Semester and the European Social Scoreboard – which can be seen as an attempt to implement these rights more stringently.

The EPSR could support such a more stringent implementation in two different ways. First, once adopted by the member states, the EPSR provides a kind of shield against all measures taken by the Commission that endanger the implementation of the key principles by national governments. Second, the key principles of the EPSR themselves define important points of reference for the Commission's future activities. Both elements apply in particular to the country-specific recommendations (CSRs) issued in the context of the European Semester.

Thus, the first real test of the Commission's seriousness in promoting "fair wages" and "adequate minimum wages" with the EPSR was this year's CSRs issued by the Commission on 22 May. The result is rather disappointing. On the positive side, Germany and the Netherlands were recommended to create the conditions for higher (real) wage growth. With regard to minimum wages, however, the recommendations still reflect a highly critical view of most recent minimum wage increases in many countries. In particular, those countries which meet or come close to the widely acknowledged threshold for adequate minimum wages at 60% of the national median wage (such as France and Portugal) were urged to ensure that minimum wages are consistent with the objectives of job creation and competitiveness and do not hamper the employment opportunities for low-skilled workers. By the same token, the recent increases in minimum wages in Bulgaria and Romania – both countries with very low absolute minimum wage levels – were viewed highly critically because they are seen as threatening the balance between the objectives of supporting employment and competitiveness and safeguarding labour income. Both countries therefore received the recommendation to establish more transparent mechanisms for setting the minimum wage – a criterion which in

Commission-speak is often a euphemism for ensuring more modest increases.

All in all, this illustrates that despite the opportunities offered by the EPSR in terms of reversing the dominant approach to wages and collective bargaining, in practice we are still a long way off from realising this objective. Trade unions and other progressive forces in society therefore have to keep up the pressure on the European institutions and national governments to ensure that the promising words in the EPSR are followed up by concrete action. One first step to strengthen the EPSR would be to revise the European Semester by making sure that the social dimension and social rights really have the same standing as economic objectives. For the same reason, it would also be essential to include a Social Progress Protocol in any future Treaty changes. Finally, if the EPSR's commitment towards "fair wages" is ever to attain any real substance, it would require a European minimum wage policy which promotes the idea that all minimum wages should be set at a living wage level.

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