Crisis, Austerity and Cohesion

Europe's Stagnating Inequality

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Europe's high inequality, systematically underestimated by the EU, has been falling for many years thanks to catch-up growth in the poorer countries and despite often increasing inequality within member states. Crisis and austerity have curbed this development, however. After inequality rose again during the great recession of 2009 and the subsequent brief recovery things are now going sideways in the context of generally weak growth.

Inequality in Europe has two dimensions: (i) differences between the now 28 member states of the European Union (EU) measured in terms of per capita income; (ii) differences within countries, measured by the ratio between the incomes of the richest and the poorest quintiles of the population (quintile ratio S80/S20).

Income Convergence since 2000

Since 2000 the first class of differences has diminished as the poorer member states have caught up significantly. On average the economies of the poorest 15 countries have grown in nominal terms (at current prices) three to four times as rapidly as those of the 12 richest member states. As a result, since 2008 they have had an average per capita income of almost three-quarters of the EU average, while in 2000 it was still below two-thirds. The per capita income of the richer countries remained at around 30 per cent above the EU average. In the same period income distribution within countries has deteriorated only slightly in the EU on average, from an S80/S20 ratio of a little under 5 to 5.1. In some countries inequality has fallen (for example, in Poland, Portugal and the Baltic states), while in others (for example, Greece and Spain) it has risen sharply.

Both forms of inequality provide only a partial perspective on the development of inequality in the EU as a whole, however. If one looks only at inequality in a single country and calculates weighted averages based on national S80/S20 values to get values for the EU as a whole or country groups, such as the new member states or the euro zone, which is what the EU's Statistical Office (Eurostat) does, one underestimates the level of inequality dramatically because one thereby leaves out major differences between per capita incomes. Gross domestic product (GDP) per capita in the richest country (Luxembourg) is five times as large measured in terms of purchasing power and fifteen times as large measured in euros than that of the poorest member state, Bulgaria. This also underestimates the trend because inequality in the EU as a whole has, due to the above mentioned catch-up processes, fallen much more rapidly than inequality within countries.

Inequality in the EU: high, but declining

In order to achieve a more realistic estimate of inequality in the EU as a whole we need to take both dimensions of inequality into consideration. This is possible by assessing the quintile ratio for the EU as a whole (see box for the method). This ratio, with values between 9 and 10 (in terms of exchange rates) or between 6 and 7 (in terms of purchasing power) is well above Eurostat's official, false average of around 5, although since 2005 (for the EU25) and since 2007 (for the EU27) the trend has been downwards (see Figure 1). By comparison, other major economies, according to the data of the UN Human Development Report,[1] have values of 4.9 (India), 7.3 (Russia), 8.4 (United States) and 9.6 (China).

1. http://hdr.undp.org/sites/default/files/reports/14/hdr2013_en_complete.pdf

How do we estimate EU inequality?

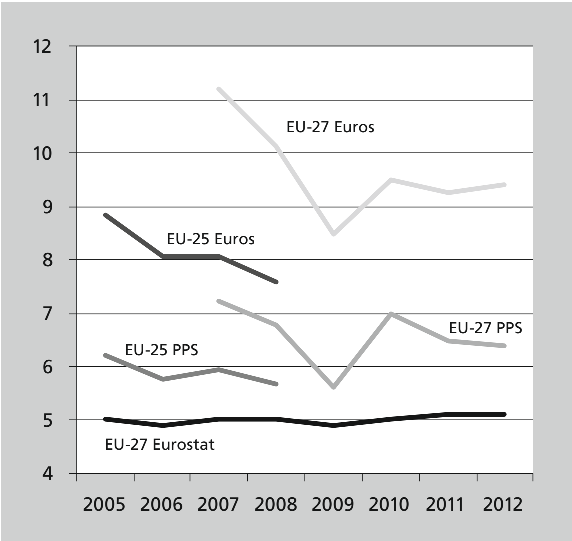
In order to arrive at a realistic estimate that takes into account both dimensions of inequality we construed the richest and the poorest EU quintiles, which comprise around 100 million people each. We based this on the 135 national quintiles derived from the EU-SILC data (household survey). We ordered these 135 quintiles by average per capita income. For the poorest EU quintile we began from the bottom, for the richest quintile from the top and selected as many national quintiles as necessary to make up 100 million people each (= a fifth of the EU population). We were then able to sum the total income of these quintiles in order to get the income of the EU quintile. The ratio between the incomes of the poorest and the richest quintiles thus construed yields the S80/S20 ratio for the EU as a whole.[2]

The composition of the EU quintile has changed only slightly over the years. The poorest quintile generally comprises the four or five poorest quintiles of Bulgaria and Romania, the three or four poorest in the Baltic states, Poland and Hungary, the two poorest in the Czech Republic, Slovakia and Portugal and one each from Greece, Malta, Spain, Slovenia and Italy. The richest EU quintile comprises the three richest quintiles of Luxembourg and Denmark, the two richest of Ireland, Sweden, the Netherlands, Finland, Austria and France, as well as the richest from the United Kingdom, Belgium, Germany, Cyprus, Italy and Spain.

This process suffered a setback after the great recession in 2009 when, after several years of falling inequality, it began to increase again. The process then resumed, albeit much more slowly, but came more or less to a standstill in 2012. Measured in terms of purchasing power parities (PPP) the further decline of – in any case lower – inequality was somewhat greater than when measured in terms of exchange rates, with regard to which the value of the quintile ratio is always higher. The difference can probably be explained by exchange rate fluctuations.

For 2012 (the last year for which data are available) the data presented in Figure 1 are based on the newly defined EU quintiles. Table 1a shows the composition of the quintiles if incomes are compared in terms of euro exchange rates, table 1b if incomes are compared in terms of purchasing power parities.

Figure 1 Development of inequality in the EU



Note: PPS = purchasing power standards.
Source: Eurostat; authors' calculations.

2. For more details on method see: Michael Dauderstädt: »Ungleichheit und sozialer Ausgleich in der erweiterten Europäischen Union«, *Wirtschaftsdienst,* Vol. 88, 4, April 2008, pp. 261–269, as well as Michael Dauderstädt and Cem Keltek, »Immeasurable Inequality in the European Union«, *Intereconomics* 2/2011.

Table 1a: The poorest (light grey) and richest (dark grey) quintiles in the EU (per capita income in euros), 2012

Member state	Q1	Q2	Q3	Q4	Q5
Bulgaria	1,081	2,065	2,864	3,769	6,598
Romania	755	1,507	2,132	2,910	4,763
Latvia	1,790	3,210	4,426	6,178	11,571
Lithuania	1,904	3,220	4,373	6,037	10,055
Poland	2,341	3,846	5,090	6,716	11,514
Estonia	2,612	4,431	6,022	8,396	14,127
Hungary	2,434	3,769	4,758	5,963	9,629
Slovakia	3,507	5,497	6,949	8,751	13,071
Czech Republic	4,440	6,457	7,814	9,631	15,479
Portugal	3,714	6,290	8,338	11,207	21,691
Greece	3,255	6,617	9,421	12,506	21,566
Malta	5,822	8,690	11,390	14,529	22,946
Spain	3,958	8,531	11,992	16,610	28,290
Slovenia	6,330	9,744	12,124	14,898	21,757
Italy	6,491	11,893	16,061	20,930	35,640
Cyprus	8,610	13,084	16,933	22,282	40,161
Germany	9,449	15,122	19,624	25,263	40,636
France	10,661	16,312	20,671	26,489	48,358
Belgium	9,791	15,328	20,094	25,470	38,348
United Kingdom	8,584	14,465	19,063	25,341	45,988
Austria	10,628	17,252	21,904	27,742	44,563
Finland	12,124	17,907	22,712	28,353	44,632
Netherlands	11,221	16,743	20,602	25,730	40,453
Sweden	12,009	19,505	24,728	30,420	44,621
Ireland	9,633	14,916	19,893	27,511	50,416
Denmark	11,601	21,000	26,612	32,946	52,142
Luxembourg	16500	24948	32665	42567	67837

Source: Eurostat; authors' calculations; the two darker coloured quintiles (Q2 Greece and Q4 Belgium) count only proportionately with regard to the relevant EU quintile.

Table 1b: The poorest (light grey) and richest (dark grey) quintiles in the EU (in purchasing power parities), 2012

Member state	Q1	Q2	Q3	Q4	Q5
Bulgaria	2,237	4,276	5,929	7,803	13,661
Romania	1,362	2,719	3,849	5,252	8,597
Latvia	2,500	4,483	6,181	8,628	16,161
Lithuania	2,980	5,040	6,843	9,447	15,736
Poland	4,129	6,784	8,977	11,845	20,306
Estonia	3,397	5,762	7,832	10,918	18,370
Hungary	4,037	6,250	7,890	9,889	15,968
Slovakia	4,981	7,808	9,871	12,430	18,567
Czech Republic	6,150	8,944	10,823	13,339	21,439
Portugal	4,324	7,322	9,707	13,047	25,252
Greece	3,534	7,185	10,229	13,579	23,416
Malta	7,484	11,170	14,641	18,675	29,494
Spain	4,171	8,989	12,636	17,503	29,810
Slovenia	7,635	11,754	14,624	17,971	26,245
Italy	6,333	11,603	15,669	20,420	34,771
Cyprus	9,852	14,970	19,375	25,494	45,950
Germany	9,346	14,957	19,410	24,988	40,194
France	9,862	15,090	19,123	24,504	44,734
Belgium	9,015	14,114	18,503	23,453	35,311
United Kingdom	7,369	12,417	16,363	21,752	39,474
Austria	10,074	16,353	20,762	26,295	42,240
Finland	9,962	14,714	18,662	23,297	36,674
Netherlands	10,428	15,560	19,147	23,913	37,596
Sweden	9,338	15,168	19,228	23,655	34,697
Ireland	9,633	14,916	19,893	27,511	50,416
Denmark	8,257	14,947	18,941	23,449	37,112
Luxembourg	13,513	20,433	26,753	34,862	55,558

Source: Eurostat; authors' calculations; the two darker coloured quintiles (Q5 Romania and Q4 France) count only proportionately with regard to the relevant EU quintile.

The Consequences of the Crisis and Austerity

The global financial crisis and the recession triggered by it affected the EU countries differently. Between 2008 and 2009 growth fell on average by 6.4 per cent in the 12 richest member states and by 8.2 per cent in the 15 poorest member states. This largely explains the resumption of rising inequality. Especially countries with high external debts, such as the Baltic states, plunged into deep depressions, although they differed in length and severity. The GDP falls in the Baltic and other post-communist countries were dramatic, but fairly short (see Table 2).

Table 2: Crisis and recovery: central and eastern Europe and the GIPS countries (percentage change in per capita income)

	2008–2009	2009–2012
Latvia	–18.1	+26.7
Lithuania	–16.8	+31.0
Estonia	–14.0	+ 25.0
Poland	–14.7	+22.2
Romania	–15.4	+12.7
Hungary	–13.3	+7.7
Czech Republic	–8.1	+7.4
GIPS:		
Greece	–1.4	–16.1
Ireland	–10.7	–0.3
Portugal	–1.9	–1.9
Spain	–4.6	–2.2
New member states (CEE)	–10.9	+16.3
12 richer member states	–6.4	+10.5

Source: Eurostat; authors' calculations.

The subsequent euro-crisis, which was triggered primarily by the EU's disastrous reaction to Greece's unexpectedly high debts, stopped the economic recovery that started to emerge in 2010 dead in its tracks, especially for the GIPS countries (Greece, Ireland, Portugal and Spain), which at first had not been so hard hit (see Table 2). In contrast to the generally even poorer new member states from central and eastern Europe they were unable to return to growth because of the implementation of drastic austerity policies.

Nevertheless, the relatively good growth performance of the poorer countries of central and eastern Europe (CEE), despite the crisis in the euro-countries implementing austerity policies, was enough to cause inequality in the EU as a whole to fall again slightly or at least not to rise again. It must be borne in mind, however, that especially Ireland is (was) among the richest member states and its decline, ironically, has tended to abate income disparities in Europe.

These changes can also be discerned in smaller changes in the composition of the EU quintiles (see box on method and Table 1a&1b). In 2011 and 2012 more quintiles from Bulgaria, Romania and Greece went into the set of quintiles that form the poorest EU quintile. Greece's richest quintile, furthermore, exited the group of national quintiles that make up the EU's richest quintile. Spain is still represented in both quintiles. Portugal, measured in terms of euros or purchasing power, comes somewhere in-between. Germany's relative strength is reflected in the fact that from 2011 its second-richest quintile also belonged to the richest EU quintile, albeit only in terms of purchasing power.

The future development of inequality and cohesion in the EU will depend on the extent to which the east and the south-east continue to grow and the euro-crisis countries emerge from the pit of austerity. Given the rising inequality within Greece and Spain, rich households in those countries will have to contribute to this.

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