Eurocrisis

Inequality Is Growing Again in Europe

MICHAEL DAUDERSTÄDT AND CEM KELTEK

September 2012

The crisis in the Euro area dominates European politics and public debate, its dynamics driven by market panic and scarcely restrained by governments. Apparently, the only game in town is consolidating state budgets, placating investors and restoring competitiveness. Only in recent weeks has growth as a condition of overcoming the debt crisis come back into play, albeit belatedly and half-heartedly. The actual objectives that have to be achieved in Europe remain largely neglected: higher welfare and social cohesion. The first decade of the euro – 1998–2008 – is now often regarded only as a period of underestimated risks and running up debts. Interest rates on government bonds were supposedly too low, wage rises on the periphery were too high and the ECB's monetary policy was too hard for Germany and too soft for everyone else. The fact that for long periods during this time Germany in particular registered weak growth and high unemployment helped bring it about that the positive side of this decade was readily forgotten and disregarded. During these ten years, thanks to growth on the periphery, inequality in the EU fell significantly, although primarily between member states and to hardly within them.

Hidden Inequality within and between States

In a multinational integration area such as the EU inequality has two dimensions: within states and between states. The EU itself, through Eurostat, its statistical lens, regards these two sides of inequality as strictly separate. There are extensive data on income differences between countries – and regions – and their changes and there are data on income distribution within member states. But Eurostat has no realistic data on income distribution in the EU as a whole, but rather only a misconstrued average value (see below). One vivid indicator of income distribution that Eurostat does use is the income quintile share ratio S80/S20, which gives the ratio between the incomes of the poorest fifth of the population and the richest fifth. This ratio varied in the member states in 2010, between 3.4 in Slovenia and 7.3 in Lithuania. In Germany, its value was 4.5. In the crisis it had thus improved significantly since 2007, when it was 4.9. The trend in the EU overall was rather different: on average, the value was around 5.0; only at the peak of the recession did it stand at 4.9 since apparently the incomes of poorer households were less affected by the recession than those of richer households. Wages and transfers fell less than profits.

Eurostat gives the average of national ratios as the value for the EU. This approach is methodologically untenable, as Atkinson (2010) has remarked in an official EU publication.[1] This is because this average value assumes that the poorest or richest fifth of the EU population – around 100 million people – is composed of the poorest or richest national fifths. In fact, however, the poorest fifth of the EU is made up overwhelmingly of inhabitants – and actually not only from the poorest fifth there – of the poorest member states (Romania, Bulgaria and so on), while the average income of the poorest 20 per cent in the rich countries (for example, Germany) is too high to fall into the poorest fifth of the EU. Thus the Eurostat value for the EU lies below the real value and underestimates real inequality enormously.

In order to obtain a more realistic estimate one can try to identify the roughly 100 million poorest and richest inhabitants by ordering national quintiles according to

1. Atkinson, A. B.; Marlier, E.; Montaigne, F.; Reinstadler, A.: Income poverty and income inequality, pp. 101–131, here p. 109, in: Atkinson, A.B.; Marlier, E. (eds.): *Income and living conditions in Europe,* Eurostat, Publications Office of the EU, Luxembourg 2010.

per capita incomes and then adding up quintiles until one reaches the desired 100 million. Thus one starts for the poorest EU quintile in the order of rank of per capita income from below and for the richest from above. This better approach, although it still undoubtedly underestimates inequality, has thus far provided figures for 2005–2008.[2] They show that the methodologically wrong Eurostat value, which has stood fairly consistently at 5.0,[3] not only considerably underestimates the level of inequality, but also falsely evaluates its development, since it ignores the decrease in inequality in the EU as a whole as a result of catch-up processes in the poorer countries during this period and primarily reflects the simultaneous increase in within-state inequality.

Table 1: S80/S20 ratios for the EU25 and EU27

Year	EU25		EU27	
	Euro	PPS	Euro	PPS
2005	8.85	6.21		
2006	8.07	5.75		
2007	8.05	5.93	11.20	7.23
2008	7.58	5.67	10.13	6.79
2009			8.47	5.62
2010			9.48	6.99

Source: Eurostat; authors' calculations.

Table 1 presents the values for 2009 and 2010, giving us a first impression of the effects of the crisis. They rest on a new construction for each year of the poorest and richest EU quintiles according to the described method (see Table 2). The data for 2009/2010 are perhaps not entirely comparable with those of previous years since the database is not identical. Nevertheless, the important trends are adequately reflected. The trend (increase in inequality between 2009 and 2010) for these years (coincidentally) is in line with that of the methodologically wrong Eurostat indicators (2009: 4.9; 2010: 5.0).[4]

2. On the method and earlier results, see Dauderstädt, M.: Ungleichheit und sozialer Ausgleich in der erweiterten Europäischen Union, in: Wirtschaftsdienst, Vol. 88, No. 4, April 2008: 261–269; as well as Dauderstädt, M. and Keltek, C.: Immeasurable Inequality in the European Union, in: Intereconomics 1/2011: 44–51.

3. See: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_di11&lang=en (accessed on 14.8.2012).

4. Ibid.

The international comparison of per capita incomes can be based on exchange rates or purchasing power standards (PPS). Since prices, especially of many services, are lower in many poorer countries real income, measured in terms of purchasing power, is higher there than a comparison based on exchange rates shows. Inequality thus turns out to be weaker (second column in Table 1). The composition of the EU quintile also changes. Thus the richest quintile in the poorest countries now no longer belongs to the lowest EU quintile (see Table 2).

Crisis and Inequality

According to these calculations, inequality in the EU stood at an all-time low in 2009. The EU27, even with the two populous »poorhouses« Bulgaria and Romania, was less unequal at that time than the EU25 in 2005 before the accession of these two countries. This welcome state of affairs at the peak of the great recession – with a fall in EU GDP of around 4.6 per cent – is probably a delayed effect of the previous boom or of the staggered onset of the recession in the poorer and the richer EU countries. In 2008, most poor countries registered respectable growth, while the GDP in the richer countries began to contract. Another reason is the abovementioned relatively positive development of domestic income distribution in the crisis, based on asymmetric effects on wages and profits. In 2009 the wage share in the EU, after falling for several years, reached 58.9 per cent (or 66.3 per cent at factor cost – both from the Ameco database), a temporary peak. But this low level of inequality also represents a turning point. In 2010, inequality increased again, even though it remained below the 2008 level. Here, too, the causes are to be found both within and between states. The countries on the poor periphery were harder hit by the crisis in 2009 than the centre and in 2010 did not grow more quickly, as a result of which the catch-up process stalled or even went into reverse. Domestic distribution in 2010 was again more unequal than in 2009, which is reflected in the wage share (which fell back to 58 per cent or 65.6 per cent).

The synchronous development of inequality within and between states also explains the concordance (despite constantly enormous differences in level) with the false Eurostat indicator. In the growth years before 2009 it was usually the other way around. Convergence between states went hand in hand with an increase in domestic in-

Table 2: The poorest (light grey) and richest (dark grey) quintiles in the EU in euros and purchasing power standards, 2009 and 2010

	Per capita income in euros 2009					Per capita income in euros 2010					Per capita income in euros (PPS) 2009					Per capita income in euros (PPS) 2010				
Member state	Q1	Q2	Q3	Q4	Q5	Q1	Q2	Q3	Q4	Q5	Q1	Q2	Q3	Q4	Q5	Q1	Q2	Q3	Q4	Q5
Bulgaria	1.125	2.028	2.828	3.781	6.624	1.201	2.203	3.014	4.028	7.034	2.192	3.954	5.513	7.371	12.912	2.364	4.336	5.933	7.930	13.847
Romania	773	1.531	2.154	2.943	5.177	789	1.483	2.046	2.814	4.737	1.342	2.658	3.739	5.109	8.988	1.342	2.522	3.479	4.786	8.056
Latvia	1.949	3.672	5.492	7.720	14.287	1.693	3.241	4.557	6.377	11.709	2.565	4.832	7.226	10.158	18.798	2.344	4.489	6.311	8.832	16.218
Lithuania	1.984	3.500	4.824	6.671	12.463	1.495	2.966	4.061	5.649	10.911	2.943	5.192	7.157	9.897	18.490	2.297	4.557	6.239	8.677	16.760
Poland	2.380	3.867	5.101	6.755	11.814	2.020	3.314	4.417	5.798	10.025	4.090	6.644	8.764	11.607	20.299	3.264	5.354	7.135	9.367	16.196
Estonia	2.817	4.543	6.195	8.366	14.109	2.654	4.343	5.772	7.850	13.285	3.683	5.938	8.098	10.936	18.443	3.548	5.806	7.717	10.494	17.760
Hungary	2.581	3.816	4.733	5.829	9.045	2.318	3.422	4.251	5.257	7.904	4.071	6.019	7.465	9.193	14.266	3.572	5.272	6.550	8.100	12.178
Slovakia	3.082	4.653	5.684	7.060	10.971	3.148	4.961	6.127	7.713	11.970	4.187	6.322	7.723	9.592	14.906	4.391	6.920	8.545	10.757	16.695
Czech Republic	4.250	6.059	7.314	8.974	14.711	4.081	5.880	7.073	8.720	14.144	5.814	8.289	10.005	12.276	20.124	5.426	7.819	9.406	11.596	18.809
Portugal	3.741	6.236	8.304	11.218	22.442	3.936	6.461	8.689	11.716	21.876	4.194	6.991	9.309	12.576	25.160	4.462	7.325	9.852	13.283	24.803
Greece	4.734	8.668	11.523	15.373	27.196	5.016	8.830	12.015	15.971	27.961	4.983	9.125	12.129	16.182	28.628	5.275	9.285	12.634	16.794	29.401
Malta	5.457	8.146	10.685	13.880	21.625	5.171	8.076	10.474	13.544	22.058	6.961	10.390	13.629	17.704	27.583	6.630	10.354	13.428	17.364	28.279
Spain	4.811	9.778	13.330	17.922	28.897	4.288	9.436	13.016	17.597	29.366	4.920	9.998	13.630	18.326	29.547	4.416	9.718	13.404	18.123	30.243
Slovenia	6.514	9.746	11.912	14.461	21.077	6.240	9.469	11.734	14.493	21.326	7.609	11.386	13.916	16.894	24.623	7.375	11.192	13.870	17.131	25.208
Italy	6.707	11.660	15.677	20.790	34.992	6.715	11.916	16.003	21.027	34.880	6.394	11.115	14.945	19.819	33.357	6.488	11.513	15.462	20.316	33.700
Cyprus	8.730	13.308	17.409	22.017	36.766	8.730	13.308	17.409	22.017	36.766	9.690	14.770	19.322	24.436	40.805	9.367	14.710	19.207	24.988	42.200
Germany	8.946	14.542	18.643	23.840	40.078	9.064	14.614	18.868	24.245	40.807	8.432	13.706	17.571	22.469	37.774	8.690	14.011	18.090	23.245	39.125
France	10.441	15.689	19.825	25.050	46.022	10.279	15.784	20.089	25.635	45.461	9.289	13.958	17.638	22.286	40.945	9.277	14.246	18.131	23.137	41.030
Belgium	9.486	14.920	19.327	24.244	37.025	9.682	15.065	19.490	24.598	37.920	8.447	13.286	17.210	21.589	32.970	8.691	13.524	17.496	22.081	34.040
United Kingdom	7.451	12.291	16.348	21.867	38.798	7.792	12.836	17.205	23.153	41.638	7.714	12.724	16.924	22.637	40.163	7.769	12.798	17.154	23.084	41.513
Austria	10.658	15.903	19.906	24.975	39.067	11.151	16.568	20.615	25.809	41.637	9.869	14.725	18.432	23.125	36.173	10.490	15.586	19.394	24.280	39.169
Finland	11.067	16.543	20.938	25.957	41.080	11.472	16.962	21.363	26.459	41.370	8.875	13.266	16.791	20.815	32.943	9.289	13.735	17.298	21.424	33.498
Netherlands	10.545	16.309	20.160	25.091	41.833	11.012	16.469	20.376	25.445	40.134	9.782	15.129	18.702	23.275	38.806	10.234	15.306	18.937	23.648	37.299
Sweden	10.473	16.983	21.236	25.877	38.551	9.951	15.752	19.680	23.997	35.151	9.653	15.653	19.572	23.850	35.531	8.183	12.954	16.184	19.734	28.907
Ireland	11.339	16.901	22.383	29.516	48.000	9.633	14.916	19.893	27.511	50.416	8.950	13.339	17.666	23.296	37.885	8.088	12.524	16.703	23.099	42.331
Denmark	9.641	20.082	25.039	30.284	44.426	10.598	20.290	25.619	31.368	46.672	6.705	13.966	17.412	21.060	30.895	7.442	14.249	17.991	22.028	32.775
Luxembourg	16.139	24.441	31.633	40.552	69.568	16.297	24.648	32.323	41.929	66.835	13.349	20.216	26.165	33.542	57.541	13.525	20.455	26.824	34.796	55.464

Source: Eurostat and authors' calculations.

equality. Against the background of the debt crisis in the coming years, the synchronous rise of inequality might, as in 2010, continue, but that is not entirely clear. Such a development is to be expected in the debtor countries of Greece, Spain, Ireland and Portugal, in which recession and growing inequality are likely to be combined. But Ireland and Spain, based on average per capita income, belong to the group of richer countries (see also Table 2 in which Ireland contributes only to the richest EU quintile and the larger Spain to both quintiles). Their relative decline thus reduces inequality between states, even though in hardly desirable ways. The other poor countries, especially in Central and Eastern Europe, appear to be growing again more quickly than the centre. The EU could thus to some extent return to the growth model of the pre-crisis period, although at a slower rate. However, this could spare the European economy the painful implosive consequences of economic bubbles.

About the authors

Dr Michael Dauderstädt is director of the division for economic and social policy of the Friedrich-Ebert-Stiftung.
Cem Keltek is a student of economics and mathematics and has a Friedrich-Ebert-Stiftung scholarship.

ISBN 978-3-86498-278-1

Friedrich-Ebert-Stiftung | International Dialogue | International Policy Analysis
Hiroshimastr. 28 | 10785 Berlin | Germany | Tel.: ++49-30-269-35-7745 | Fax: ++49-30-269-35-9248
E-Mail: info.ipa@fes.de | www.fes.de/ipa