PERSPECTIVE

Austerity and Income Distribution in Europe

Cohesion despite Weak Growth

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Europe has reacted to the sovereign debt panic in the Euro area primarily with austerity. The bailouts which were implemented, initially were too small, and the European Central Bank (ECB) has been buying up government bonds, only late in the crisis, after some controversy and with reluctance, while austerity programmes have largely been applied. However, these efforts to consolidate budgets only made things worse, to the surprise of the European Union (EU). The experts of creditor institutions had underestimated the level of the multipliers that indicate how much GDP and thus also employment will fall if one cuts government spending. In the meantime Europe is sliding into an ever more intractable recession, with alarming unemployment in many member states.

What have been the effects of this development on income distribution in Europe? The present analysis relies on the most recent available data from Eurostat (Statistics on Income and Living Conditions – SILC), which now also include the year 2011. In 2011, the EU showed average real growth of 1.5 per cent. The real recession began in 2012 when real GDP fell by 0.3 per cent. However, growth rates already fell significantly in 2011. In order to assess the effects on inequality in the EU, however, we must first take a closer look at its structure.

The Distribution of Income between and within the Member States

In a multinational integration area such as the EU, income distribution has two dimensions: within states and between states. The EU itself regards these two sides of inequality as strictly separate, which leads to highly distorted (under)estimates of the inequality within the EU.[1] Eurostat does not provide realistic data on income distribution in the EU27, but only a falsely construed average value. The indicator applied here, also used by Eurostat, for income distribution is the income quintile share ratio, also known as the S80/S20 ratio, which gives the ratio between the incomes of the poorest fifth of the population and the richest fifth.

In 2011, this ratio fluctuated – for distribution within states – between 3.5 in Slovenia and 6.8 in Spain. In Germany, the value remained unchanged at 4.5. For the EU as a whole the average value was around 5.1 and had thus again deteriorated since its relative low of 4.9 in 2009, at the peak of the recession. Hence a trend continued in the old member states (EU15) towards increasing inequality, which raised the average income quintile share ratio of 4.5 at the beginning of the century to 5.1. In the 12 new member states, by contrast, inequality within states had fallen constantly, on average, since 2004 (from 7.4 to 5.0 in 2010), rising slightly in 2011 to 5.1. This outcome was to be expected given austerity, weaker growth and higher unemployment.

Underestimated Level, False Trend

However, these average values imply that the poorest and the richest fifths of the EU population (just under 100 million people) comprise the poorest and richest national fifths. In fact, however, the poorest fifth of the EU comprises predominantly inhabitants – and not only from the poorest fifth there! – of the poorest member states

1. Atkinson, A.B.; Marlier, E.; Montaigne, F.; Reinstadler, A. (2010): 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.

(including Romania and Bulgaria), while the average income of the poorest 20 per cent in the rich countries – for example, Germany – is too high to end up in the poorest fifth of the EU. Thus the Eurostat value for the EU lies below the real value and considerably underestimates actual inequality.

Table 1: The poorest (light grey) and richest (dark grey) quintile in the EU in PPS and in euros, 2011

2011	Per capita income in € (PPS)					Per capita income in €				
Member state	**Q1**	**Q2**	**Q3**	**Q4**	**Q5**	**Q1**	**Q2**	**Q3**	**Q4**	**Q5**
Bulgaria	2,212	4,161	5,892	7,951	14,415	1,093	2,056	2,911	3,928	7,121
Romania	1,281	2,506	3,519	4,769	7,929	773	1,511	2,122	2,876	4,781
Latvia	2,193	4,144	5,679	8,006	14,473	1,618	3,058	4,191	5,908	10,681
Lithuania	2,392	4,399	6,088	8,168	13,963	1,574	2,895	4,006	5,375	9,188
Poland	3,876	6,380	8,487	11,089	19,178	2,298	3,783	5,033	6,576	11,373
Estonia	3,120	5,382	7,206	9,820	16,616	2,431	4,192	5,614	7,650	12,944
Hungary	3,678	5,562	7,053	8,982	14,375	2,369	3,582	4,542	5,785	9,257
Slovakia	4,449	7,118	8,763	10,946	16,916	3,221	5,153	6,345	7,925	12,247
Czech Republic	5,550	8,059	9,787	12,139	19,625	4,246	6,165	7,487	9,286	15,013
Portugal	4,441	7,291	9,672	13,152	25,166	3,868	6,351	8,424	11,455	21,920
Greece	4,462	8,199	11,424	15,355	26,607	4,265	7,838	10,921	14,679	25,437
Malta	7,004	10,675	13,927	17,997	28,254	5,456	8,316	10,849	14,020	22,010
Spain	4,309	9,193	12,886	17,690	29,228	4,188	8,935	12,525	17,194	28,410
Slovenia	7,304	11,303	14,008	17,197	25,273	6,267	9,698	12,019	14,755	21,684
Italy	6,065	11,341	15,311	20,008	34,081	6,332	11,840	15,984	20,888	35,580
Cyprus	9,954	15,062	19,484	25,039	42,365	8,849	13,390	17,322	22,260	37,663
Germany	8,750	14,267	18,498	23,813	38,936	9,030	14,724	19,090	24,575	40,182
France	9,378	14,322	18,173	23,242	43,569	10,335	15,783	20,027	25,613	48,013
Belgium	8,893	13,761	17,928	22,531	34,303	9,872	15,274	19,900	25,009	38,076
United Kingdom	7,839	12,811	16,936	22,811	41,966	7,996	13,068	17,275	23,267	42,805
Austria	10,436	15,878	20,030	24,982	39,759	11,104	16,894	21,312	26,581	42,303
Finland	9,310	13,793	17,524	21,914	34,276	11,610	17,200	21,853	27,327	42,742
Netherlands	9,825	15,196	18,798	23,574	36,836	10,631	16,442	20,340	25,507	39,857
Sweden	8,853	14,112	17,790	21,749	31,896	11,190	17,838	22,486	27,490	40,316
Ireland	8,283	12,825	17,105	23,655	43,350	9,633	14,916	19,893	27,511	50,416
Denmark	8,051	14,547	18,423	22,767	35,780	11,553	20,875	26,438	32,671	51,345
Luxembourg	13,588	20,473	26,550	34,483	53,925	16,713	25,182	32,656	42,414	66,328

Source: Eurostat; authors' calculations.

In order to obtain a more realistic estimate we shall try to identify approximately the real 100 million poorest by ordering national quintiles in accordance with their average per capita incomes and then adding as many quintiles as necessary to obtain the desired 100 million. Thus one starts from the bottom for the poorest EU quintile in the ranking and for the richest one starts at the top (see Table 1 for 2011). This more accurate approach – although it certainly still underestimates inequality – has so far provided values from 2005 to 2011.[2] They showed that the methodologically false Eurostat value not only considerably underestimates the level of inequality but also wrongly evaluates its development. It primarily depicted the simultaneous increase in inequality within states and ignored the reduction in inequality in the EU as a whole due to the catch-up processes of the poorer countries during this period.

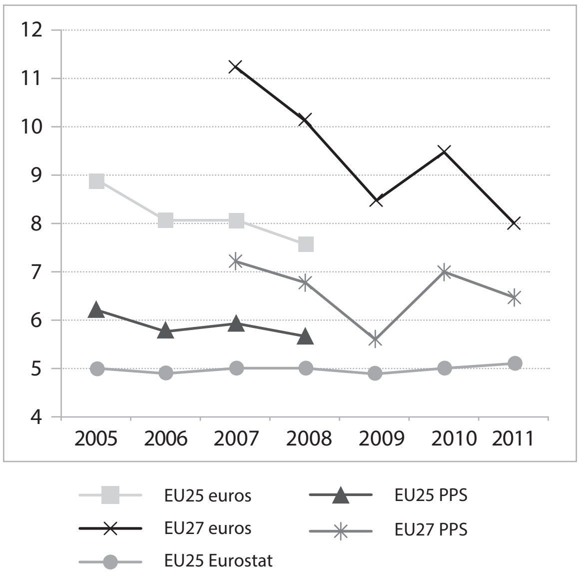
When one compares per capita incomes between nations either exchange rates or purchasing power standards (PPS) can be used in order to convert them into a common currency. Since prices – especially of many services in poorer countries – are lower, real income, measured in terms of purchasing power, is higher than a comparison in terms of exchange rates would seem to indicate. Accordingly, inequality appears to be less acute (see also Figure 1). The composition of the EU quintiles is also changing. Thus the richest one-fifth of the poorest countries is no longer in the lowest EU quintile (see Table 1).

Progress with Cohesion despite the Recession

The values presented here (see Figure 1) for the years up to 2011 rest on a new construction in each year for the poorest and richest EU quintile according to the described method. The data since 2009/2010 are possibly not exactly comparable with those of previous years since the database is not identical. Nevertheless, the important trends should be adequately represented. They point, by contrast to the official EU figures (in the figure the lowest curve with values around 5), to a falling trend which rests primarily on the catch-up process of the poorer countries, which was only interrupted in 2010.

The data also provide a first impression of the effects of the austerity policy. Despite the rising inequality within countries the long-term trend of falling inequality in the EU27 apparently continued in 2011. The collapse in growth seems to have hit the richer countries harder than the poorer ones. The falling incomes in the indebted crisis countries have hardly affected distribution since they contribute to both the poorest and the richest EU quintiles. Furthermore, many poorer new member states are by no means as highly indebted and thus have not had to subject themselves to massive austerity policies. The reduction in inequality is more marked in relation to exchange rates than purchasing power parities, with regard to which the low value of 2009 was not achieved again. This suggests that especially nominal growth measured in euros was higher in the poorer countries thanks to real appreciation (in other words, higher inflation and/or possibly also appreciation of the currency against the euro).

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



Source: Eurostat; authors' calculations.

If one wishes to know how this dynamic developed in detail it is worth looking at the respective growth of quintile incomes (see Table 2). It should be pointed out that between 2009 and 2010 the incomes of the poorest fell even nominally, while that of the richer quintiles grew. In the period 2010–2011, by contrast, incomes rose further in the richest EU quintile, although more slowly than in the preceding period and much more slowly than in the now rapidly catching up poorest EU quintile.

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.; Keltek, C.: Immeasurable Inequality in the European Union, in: Intereconomics 1/2011: 44–51; Dauderstädt, M.; Keltek, C.: Eurokrise: Die Ungleichheit wächst wieder in Europa. Friedrich-Ebert-Stiftung, WISO direkt, Bonn 2012.

Table 2: Growth in quintile incomes, 2009–2011

	Total income in billion euros			
	At PPS		At exchange rates	
	Poorest quintile	Richest quintile	Poorest quintile	Richest quintile
2009	545.04	3,064.32	405.81	3,436.85
2010	469.87	3,283.97	375.74	3,561.56
2011	527.73	3,415.44	453.73	3,632.94
	Growth rates (%)			
2009–2010	–14	7	–7	4
2010–2011	12	4	21	2

Source: Eurostat; authors' calculation.

This development indicates once again how problematic the false methodology of inequality calculation by Eurostat is also in terms of its results. For 2011 Eurostat reported an increase in overall European inequality, while in reality it declined. In the preceding period the estimates of Eurostat and of the authors of the direction of development agreed because distribution within and between countries deteriorated at the same time. In 2011, the EU returned to the familiar pattern of rising inequality within countries and converging income levels between the member states.

Crisis and Cohesion

According to the currently available data, the Euro crisis thus seems to have interrupted the trend towards greater cohesion in Europe observable since at least 2005 only briefly, in 2010. The poorer member states on average have recorded higher growth rates than the richer ones. However, this has taken place while growth rates were overall lower. For 2012 there are no EU data on household income (from EU-SILC) but only on average GDP growth rates. According to them, GDP shrank in the EU as a whole in 2012 and to a greater extent in the Euro area than outside it. Richer and poorer countries are distributed across the different currencies in the EU. There are poorer euro countries (for example, Greece, Portugal, Slovenia, Slovakia, Estonia and Spain) and richer member states outside the Eurozone (United Kingdom, Sweden, Denmark). Nevertheless, a comparison of growth rates shows that in particular large poorer countries, such as Bulgaria, Romania and Poland – which contribute considerably to the composition of the poorest EU quintile – grew further, albeit slowly. However, most richer countries grew even more slowly.

On the other hand, austerity hit debtor countries much harder in 2012 than in 2011. In Spain, Greece and Portugal growth fell dramatically. How this affects cohesion overall also depends on how falls in income within the debtor countries are distributed. If it affects especially the poor, then inequality will increase. Failing that, it could diminish, even if improved cohesion by means of general, albeit asymmetric shrinking of incomes is certainly hardly a desirable way to reduce inequality.

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