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Impact of the economic crisis: greater income equality but less well-being?

Claire Dhéret and Fabian Zuleeg

BACKGROUND

It is no coincidence that, one and half years into the economic crisis, the social dimension features prominently in the European Commission's proposals for the new Europe 2020 Strategy, the successor to the Lisbon Agenda.

Some direct effects of the economic downturn, such as the rise in unemployment, are now becoming apparent. The EU unemployment rate now stands at about 10%, up from 7% in 2008, and the risk of more persistent long-term unemployment, poverty and social exclusion will remain high for some time to come.

Policy-makers must, however, choose their focus carefully. Relative income and wealth inequalities might well be inaccurate indicators: indeed, the crisis may have resulted in a narrowing of these inequalities, for the reasons explained below, but this does not mean that the situation for the least well-off has improved. On the contrary, they risk suffering disproportionately from a reduction in – and increased competition for – public services as government budgets tighten and the need for such services grows simultaneously.

Hunting for social targets

Decisions related to defining EU common social policies remain extremely sensitive politically. Greater coordination at EU level to enhance social inclusion is recognised as a shared objective within the context of Europe 2020, and delivering social cohesion is clearly one of the priorities for the coming decade. But criticism of the proposed poverty reduction target demonstrates the lack of willingness in some EU countries to adopt a common approach in this area and fears about EU 'interference' in national social policy-making.

Even with political will, setting meaningful targets is difficult, not least because using relative indicators such as income inequalities to measure cohesion can be misleading when making comparisons between countries.

The indirect impact of the crisis on income and wealth also requires a shift in the focus of social policy: away from measures to address issues such as income inequality, and towards access to – and the delivery and quality of – public services such as public transport, healthcare, education and labour market programmes. These are major determinants of Europeans' well-being and any detrimental effects of the crisis on them will have a direct impact on citizens.

Declining wealth

One impact of the crisis is that income and wealth have been seriously affected, right across societies. These indirect effects of the crisis are difficult to evaluate, not least because of a lack of data and uncertainty over the future value of assets. There are also key differences between EU Member States: not only has the magnitude and direct impact of the crisis differed significantly, but the indirect impact has also varied depending on how assets have been affected.

Overall, it is clear that the economic crisis has prompted a substantial drop in asset values, with severe consequences for many people's savings and wealth, whether held in stocks, savings accounts, pension rights or property. The house price crash in some Member States has had serious repercussions for homeowners, especially in countries with high owner-occupier ratios and where much of the

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purchase was funded by private borrowing. While prices have begun to recover in some countries (up by 10.5% in the year to April 2010 in the UK after a fall of over 25% between October 2007 and February 2009), they are doing so from a lower base.

In some other countries, the property crisis is not yet over and housing prices will take time to return to pre-crisis levels. For example, in March 2010 the Irish Harmonized Index of Consumer Price for housing was still 5.2% lower than a year before and countries like Ireland and Spain face a significant increase in the number of families defaulting on their mortgage payments, facing repossession or high rates of over-indebtedness.

Pension schemes have also been affected, although the impact has varied depending on the model in each country (e.g. public and private, funded and unfunded, collective and individual pension arrangements) and the composition of an individual's pension assets (e.g equities, government bonds, deposits or property). For example, pension funds were affected across the developed world in 2008, losing 23% of their value according to the Organisation for Economic Cooperation and Development (OECD). Member States such as the UK where pension funds invest mainly in the stock and property markets appear to have been affected most, with the stock market and property price falls leading to a drop in the return on investments.

Some have become more equal than others

Assets such as equities, private pensions and real estate are disproportionately accumulated by more affluent households, not only because they have 'spare' money to invest, but also because they tend to be better educated and have access to a broader network and more managerial skills, which are prerequisites for investment. With the value of all assets initially falling significantly, the wealth of this group has been particularly affected by the crisis.

It has also put pressure on those with high salaries and large bonuses, especially in the financial sector, where bonus payments have been a key component of employees' incomes. Public opinion has become more sensitive to inequalities, opposition to those perceived to be 'overpaid' is stronger than ever and recent statements by European political leaders indicate a willingness to act. This raises the prospect of tougher regulation, particularly in the financial sector, with a likely curb on large bonuses at the top end of the income spectrum. This, combined with the impact of the crisis, could lead to a further reduction in average incomes among the well-off.

Equality in misery

Middle-income households are also coming under increasing pressure as a result of the crisis. Unemployment has risen significantly in all EU Member States and is affecting people who were not at risk in the past. New categories of workers, such as highly-educated young people who graduated just before or during the crisis, are struggling to find jobs and having to compete with more experienced workers.

The significant reduction in asset values has also had a substantial effect on living standards in middle-income households, which lacked the breadth of investments required to cushion the impact. While assets prices have recovered to some extent recently, wealth inequality indicators are likely to fluctuate significantly for some time to come.

By contrast, those already at the lower end of the income scale have not been hit as hard in most EU countries, thanks to the predominance of publicly financed social benefits and (at least initially) low inflation/deflation, which helps those on fixed benefits.

They are benefiting from the automatic stabilisers, which have been reinforced by governments to tackle the crisis. Most countries have allocated significant additional resources to labour market and social programmes to boost demand, minimise the risk of poverty and avoid the collapse of Europe's economic and social model(s). European Commission forecasts suggest a rise in social expenditure from 27.5% to 30.8% of GDP between 2007 and 2010.

In the short term, these income-support measures will be available to all those who lose their jobs. But for those on low incomes, such as the working poor, the drop in income for those who need to access this support will be much smaller than for those in middle-income groups.

STATE OF PLAY

Given these effects, the current downturn might well lead to a reduction in relative income and wealth inequalities in the midst of the crisis, driven by its disproportionate impact on more affluent households. If their income and wealth falls without a corresponding drop among those at the bottom, the gap between the very rich and the very poor could narrow.

This does not, however, mean that those who were least well-off before the crisis will be better off. On the contrary, the 'equality' gap may well increase in other areas, with the crisis likely to lead to greater inequalities in accessing high-quality public services and social protection.

A higher demand for public services

The squeeze on income and assets could generate a sharp rise in the number of people relying on public services, with rising unemployment among more affluent households increasing their dependence on public assistance, adding to those already reliant on such assistance before the crisis.

This new group will have a greater need for social services than in the past and fewer opportunities to use the private services they could afford before the crisis, leading to a growing number of people requiring (or choosing to use) public services, significantly increasing the pressure on those services.

Harder times to come...

EU Members States have been relatively successful in mitigating the impact of the crisis on households and individuals by adopting targeted measures and maintaining social provisions.

But these measures are financially unsustainable. The need to reduce budget deficits will begin to affect local services in the near future, and the long-term prospects are not much brighter. For example, the funding of public pension schemes is also under pressure: the fall in earnings and employment has had a knock-on impact on revenues from pension contributions, adding to the pressures generated by ageing populations in most EU Member States.

The current consensus on steering public finances back onto a sustainable path will force policy-makers to rethink and adjust their policies in the medium to long term. The need to reduce budget deficits will inevitably lead to pressure for cuts in spending on public services and social protection, coinciding with increased demand for those services.

In short, public services will have to deliver more for the money spent, through increased efficiency and productivity, against the backdrop of cuts in the funds available.

Race to the bottom

While the fall in income and wealth may affect more affluent sections of society disproportionately, in many cases this will have a more limited impact on their living standards. It is the least well-off and most vulnerable who will be most affected by the growing strain on public services, as they are generally most dependent on such services. In addition, cuts in public spending are likely to focus on non-universal services such as targeted programmes for those furthest away from the labour market, potentially putting those who need them most at an added disadvantage.

To access public services, they will also have to compete with people who are better off, better integrated into society, and better able to get around administrative barriers and put pressure on local administrations. Where services need to be paid for, access for the most vulnerable will be even more restricted.

They will also face fierce competition in the labour market, with those who were unemployed before the crisis finding it even more difficult to re-enter the labour market and running the risk of losing their eligibility for benefits.

People with low levels of education, who often have difficulties accessing public services because they do not know enough about how the system works, may thus face sharp and accelerated exclusion as a result of the crisis. Hence, the most vulnerable sections of society risk becoming increasingly disconnected from services provided at the local level, which is often their main link into the system and their only way of maintaining a minimum standard of living.

Thus, despite a potential reduction in relative income and wealth inequalities resulting from this crisis, the negative effect on exclusion and well-being could well be accelerated.

PROSPECTS

The ambivalent impact of the crisis on inequality levels and the risk of permanent exclusion highlight the need to focus on access to – and the availability of – local public services (rather than levels of material inequality), as these are the key determinants of social cohesion - one of the key priorities of Europe 2020.

To maintain the same quality of public services and ensure access for everyone, especially the most vulnerable groups in society, governments will have to not only address short-term pressures but also push ahead with longer-term reform. Maintaining and reforming public services must be given priority over other areas of public policy if social cohesion in Europe is to be maintained.

Meeting demand in the short term

In the short term, governments will have to ensure that local public services are adequately resourced to respond to the immediate increase in demand and help those in greatest need, while at the same time finding innovative ways of delivering services. Temporary but ambitious and targeted state interventions are needed to provide local public services with sufficient human and capital resources.

Measures to preserve employment, support incomes and provide effective safety-nets focused on the most vulnerable have significantly limited the social consequences of the crisis to date. In this respect, local authorities have a key role to play in delivering targeted and appropriate policies. They are best placed to assess people's needs and adjust services accordingly, making this level of governance of critical importance if Member States want to implement active labour market policies, provide high levels of education and deliver healthcare services to everyone.

Long-term reform vital

Governments will also have to lay the foundations for a more accountable and sustainable public sector in the medium to long term. Public authorities will have to consider how to reengineer public services while continuing to meet the needs of the least well-off and ensuring equality of opportunity in terms of access.

EU leaders have correctly identified education as one of the key priorities for the next decade. Raising the overall quality of all levels of education within the EU and introducing measures to empower people through skills training will help the most vulnerable groups in society to access public services and employment. Despite the pressure on resources, more investment in education is thus essential and must be prioritised over all other areas of public spending.

This will not be easy: everyone must recognise the need to tighten our belts in the aftermath of the crisis. Deciding which groups in society should shoulder the greatest burden in this process remains a political choice. But without action to help the most vulnerable through the targeted provision of high-quality public services, they are likely to fall even further behind.

Europe's role

The EU must first focus on identifying a meaningful indicator for measuring social cohesion within the Europe 2020 Strategy. Relative measurements are clearly difficult to apply in the aftermath of the current crisis, for the reasons outlined above, with absolute poverty indicators likely to be more meaningful.

However, achieving greater cohesion – one of the main focuses of Europe 2020 – will be near impossible unless more attention is paid to the availability and quality of public services for all groups in society.

The public sector needs to feature more prominently in Europe 2020, with a strong emphasis on investment and sustainability. The effectiveness of policies should now be measured by their capacity to meet the increasing need for high-quality public services and be subject to monitoring at the EU level. Benchmarking and exchanging best practices should be applied to public services as part of the new Strategy.

This will meet resistance: many EU Member States and regions fiercely defend their public services from any European 'interference'. But if the EU is to achieve its economic and social goals and defend Europe's economic and social model, we need to work together and learn from each other. Without more 'Social Europe', with a greater emphasis on the issues which matter most to the public, the hard times for citizens might well translate into hard times for European integration.

Claire Dhéret is a Junior Policy Analyst and Fabian Zuleeg is Chief Economist at the European Policy Centre.

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European Policy Centre ■ Résidence Palace, 155 rue de la Loi, 1040 Brussels, Belgium
Tel: +32 (0)2 231 03 40 ■ Fax: +32 (0)2 231 07 04 ■ Email: info@epc.eu ■ Website: www.epc.eu

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