



Michael Dauderstädt

European Cohesion

Progress at a Snail's Pace

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AT A GLANCE

Both Europe-wide inequality and the at-risk-of-poverty rate again fell slightly from 2016 to 2017. This was largely due to the strong growth in the poorer new EU member states between the Baltic and the Balkans. In particular, the number of people below the poverty threshold of 60 per cent of European median income fell by several million. Inequality and the at-risk-of-poverty rate Europe-wide, however, remained well above the level in individual EU member states.

In the recent European elections Eurosceptic parties enjoyed unprecedented success. They have been able to mobilise widespread disappointment in the European Union (EU) and are looking to pin the blame for social problems on Brussels and Europe's open borders. Concerns about immigration from other EU member states, itself a consequence of substantial income differentials within Europe, also drove the Brexit vote in the United Kingdom. Inequality and poverty in the EU are indeed scandalously high, but just recently progress has resumed, albeit rather slowly.

A EUROPEAN PERSPECTIVE ON INEQUALITY AND POVERTY

From a national perspective what we see is that, within countries, incomes are unequally distributed and people at the low-

er end of the distribution are living in poverty. Generally speaking, households are deemed to be at risk of poverty if they earn below 60 per cent of the median income. The at-risk-of-poverty rate indicates the proportion of people in this position in the total population. In 2017, the national rate in the EU member states stood at between 24 per cent and 11 per cent, with an EU average of 16.9 per cent. Inequality is often measured using the S80/S20 ratio, which gives the income ratio between the richest and the poorest quintiles in a given country. In 2017, the national values of this indicator in the EU member states lay between 8.2 (Bulgaria) and 3.4 (Slovenia).

One can calculate the same indicators for the EU itself, as an economic area. Such an estimation is, however, hindered by the fact that account has to be taken of the distribution both within individual member states and between them. As a result, values vary substantially because income differentials between the countries of Europe are considerable. For example, gross domestic product (GDP) per capita in Germany is over five times that of Bulgaria. Income differences between countries can be reduced, however, if one expresses them in terms of purchasing power standards (PPS). Because the price level tends to be lower in poorer countries the purchasing power of a given amount of money is correspondingly higher there.

Eurostat's measure of inequality in the EU neglects these differences between countries. For Eurostat, the richest and the

poorest European quintiles are the sum of the poorest and richest national quintiles, respectively, even though, for example, households in the poorest French quintile are not among the poorest in Europe and even the richest Romanian quintile, on average, is among the poorest in the EU. The upshot is that Eurostat gives a methodologically bogus value of 5.1 for EU inequality (bottom line in Figure 3).

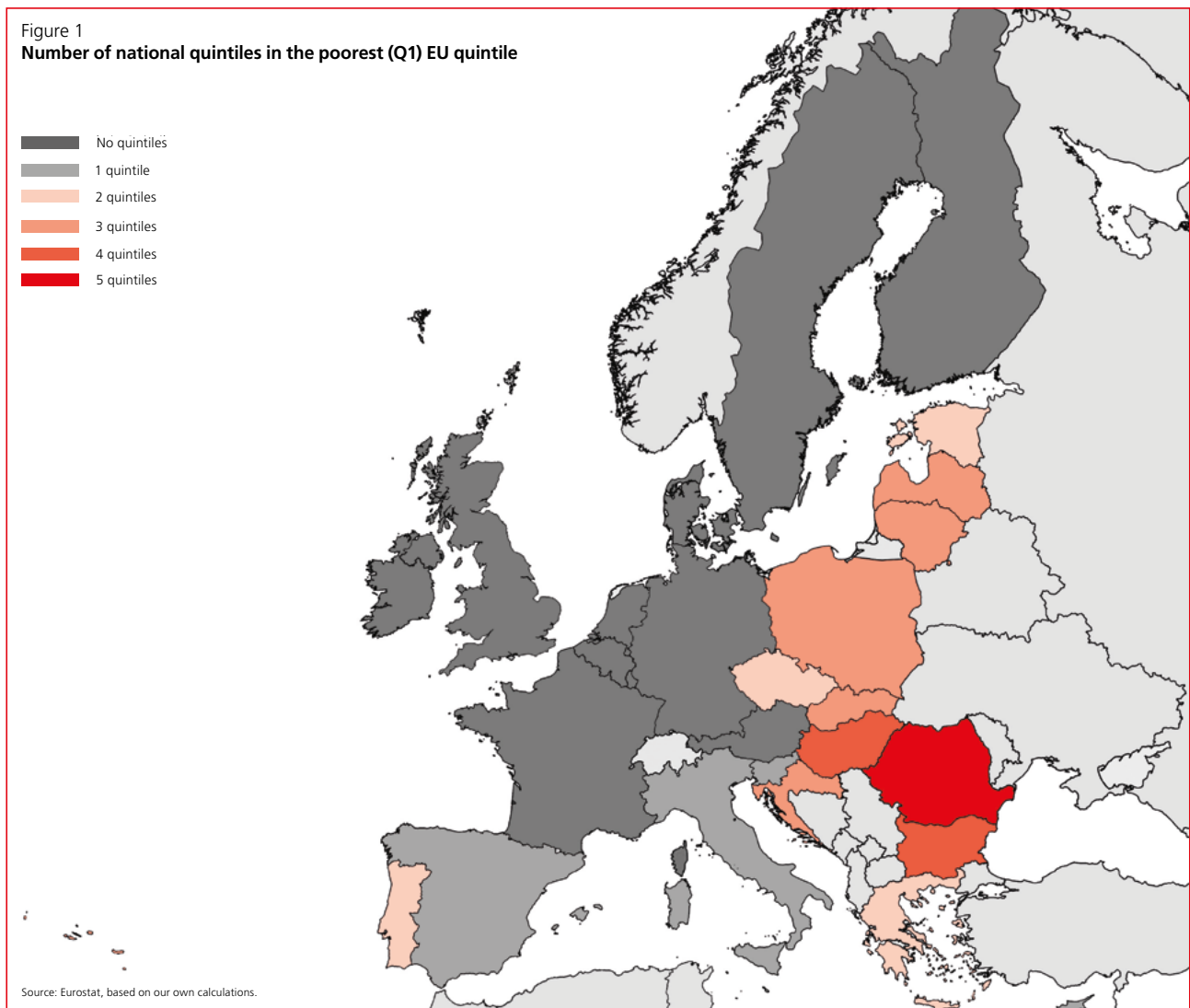
In order to estimate inequality across Europe we need to calculate the S80/S20 ratio using the poorest and richest quintiles of the total EU population (each of which numbers over 100 million people). For that purpose we have to sort national quintiles by per capita income and sum their total incomes until the population covered by these national quintiles reaches 100 million. Figures 1 and 2 indicate the extent to which (in other words, with how many national quintiles) the individual member states contribute to the poorest and the richest EU quintiles.

Europe-wide inequality is calculated as the quotient of total income of the richest and poorest European quintiles constructed in this way and amounts to a little over 6 at purchasing power standards (PPS) and a little over 9 at exchange rates. In the latter case therefore it still exceeds the value of the member state with the highest inequality.

Using the same approach, we can estimate a Europe-wide at-risk-of-poverty rate. For that purpose first of all we have to determine median European income: exactly half of the EU population earn more than this value and the other half less. This stands at about 16,500 euros, with the poverty threshold (=60 per cent) at just under 10,000 euros. Calculating these values at exchange rates or at PPS barely alters the threshold, but the number of people whose incomes are below the threshold varies considerably (see Table 1).

Measured in PPS 'only' 100 million people are below this level, while at exchange rates 135 million people earn below 60 per cent of median income. The corresponding values for the poverty rate (number of people in poverty, on this definition, in the total population) are just under 20 per cent (PPS) and almost 27 per cent (euros). Both values are well above the official Eurostat figure of just under 17 per cent.

People with incomes below the at-risk-of-poverty threshold are poor by European comparison, even if they belong to the middle class in their own countries. To that extent, this finding has little resonance in national politics, but for Europe as a whole it indicates potential tensions, first and foremost due to the migration it tends to trigger.



THE DEVELOPMENT OF POVERTY AND INEQUALITY IN EUROPE

Although the levels of poverty and inequality in the EU presented above are alarming, they nevertheless conceal substantial progress in comparison with previous years. These improvements were not really the result of advances within member states (where in fact distribution has generally deteriorated), but rather because the poorer countries have been catching up with the richer ones. In particular, GDP in the new member states between the Baltics and the Balkans grew by 184 per cent between 2000 and 2017, compared with only 53.4 per cent in the countries of the rich centre. Only the EU's southern periphery fared badly, afflicted by the euro crisis and the austerity policy imposed on them.

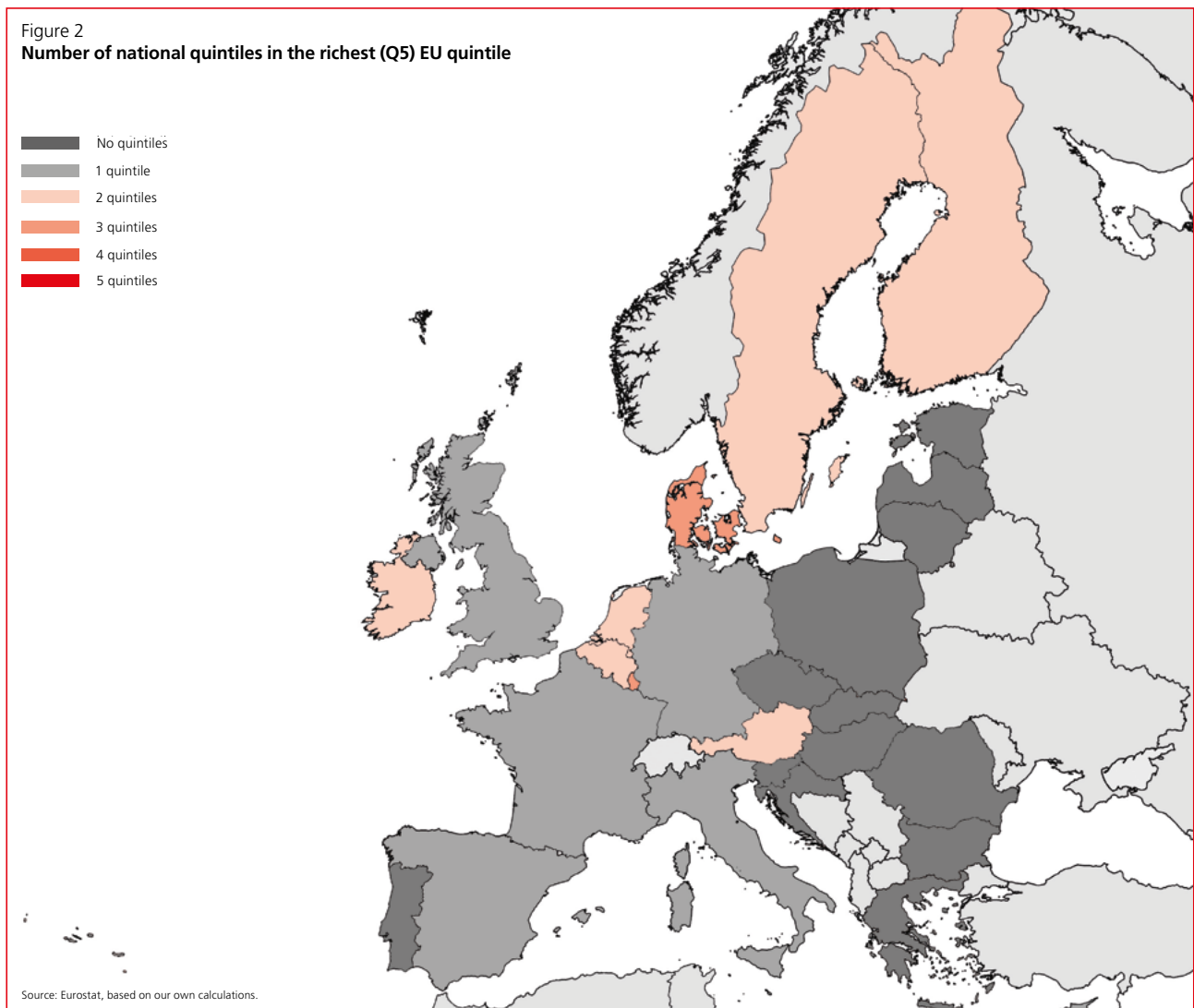
These processes were, however, reflected differently in the development of the S80/S20 indicator (see Figure 3). In 2005, before the EU accession of Bulgaria and Romania, two very poor and relatively populous countries, in 2007, this value was around 6 (PPS) and 9 (exchange rates). On their accession it shot up to over 7 and 11, respectively. Between 2007 and 2009, however, it fell rapidly and substantially. Then the financial market crisis and the ensuing recession put the brake on this convergence process. After a brief recovery in 2010 the

values remained largely unchanged, standing at a little over 6 (PPS) and over 9 (euros).

The official Eurostat value of around 5 fluctuated only a little over the period in question and presented a somewhat sanitised picture. Croatia's EU accession in 2013 again increased inequality, albeit minimally. There has been a welcome downturn in the past couple of years for which data are now available, however, namely 2016 and 2017. The possible exit of the United Kingdom ('Brexit') would probably have little effect on the figure because it contributes to both European quintiles.

A similar, although somewhat protracted downturn can be discerned in the at-risk-of-poverty rate (see Table 1), which fell by over 3 percentage points in PPS and by 1.4 percentage points in euros. The number of people affected fell – depending on the measure used – by 17 or 7 million, respectively. In the official Eurostat figures, which do not take into account income differences between countries, the changes were much more modest.

The main driver of this encouraging development is the higher income growth on the poorer European periphery. This so-called 'beta convergence' has been discernible for some time now. Since 2000 GDP in Central and Eastern Europe has grown more than twice as strongly as in the EU's rich centre. During





our brief reference period of 2016–2017 growth rates on the eastern periphery, again, lay between 4 and 8 per cent, while the EU average was only 2.6 per cent.

SPEED UP COHESION!

Promoting cohesion is enshrined – as ‘convergence’ – in the Preamble of the European Treaties as an official aim of the EU. The EU publishes regular Cohesion Reports and a total of 351.8 billion euros are available in the EU budget for cohesion policy for the period 2014–2020. By and large, however, EU regional policy has been only a modest success. Regions such as southern Italy’s Mezzogiorno or eastern Germany have for decades been major beneficiaries of national and European funding, but have still been unable to reach the level of the richer parts of the two countries, in the north or the west, respectively. By contrast, the prospect of convergence between the member states is more favourable. But even here, more rapid income convergence would help to alleviate some of Europe’s problems, such as migration. But how can growth be speeded up?

Although growth plays an important role in official pronouncements, in fact European economic policy remains afflicted by

an unbalanced supply-side orientation and a tilt towards stability. This starts in a central policy area, monetary policy. Price stability has top priority for the European Central Bank (ECB): only after that has been guaranteed can it turn its attention to growth and employment. By contrast, for the US Federal Reserve these goals are on an equal footing. In fact, the ECB was slow to react to the global financial market crisis and squandered two precious years, from 2010 to 2012, in the European sovereign debt crisis before Mario Draghi made his famous commitment and defused the crisis in the euro zone.

Candidate countries seeking euro-zone accession are required to have low inflation at the lower end of the euro zone and a fixed exchange rate against the euro. Unfortunately that prevents real appreciation in the accession country, even though catch-up growth is unattainable without it. The fact is that the prices of non-tradable goods and services also have to rise if every economic sector and the incomes of those employed in it are to benefit from growth (the so-called Balassa-Samuelson effect). In other words, the income of a hairdresser must and should rise just like wages in industry. But whereas the latter rise in the wake of increasing productivity hairdressers, who cannot boost their physical productivity, have to raise their prices.

Table 1
Poverty risk in the EU (rate and number of people)

	2016	2017
At-risk-of-poverty rate €	28.2%	26.8%
Number	142 million	135 million
At-risk-of-poverty rate PPS	23.2%	19.9%
Number	117 million	100 million
At-risk-of-poverty rate (Eurostat)	17.3%	16.9%
Number	87 million	85 million

Source: Eurostat, based on our own calculations.

The EU generally looks askance at boosting demand. Significantly, the EU regards a current account deficit of 4 per cent of GDP as hazardous, while a surplus is only regarded as problematic from 6 per cent. When southern European countries were engulfed by a sovereign debt panic in 2010 the EU saw fit to impose austerity policies, including wage cuts, which sent GDP into a nosedive. The multipliers that specify by how much GDP changes in the event of changes in public spending and revenues were severely underestimated. As a result, debt to GDP ratios increased and poverty rose sharply in the countries affected.

Europe needs a progressive economic policy that balances supply and demand, as well as stability and growth. The one-sided fixation on competitiveness and exports, which, on top of everything else, are achieved by means of wage cuts, overlooks the importance of the domestic market and consumption, which primarily depend on wages. All too often necessary reforms are confined to labour market liberalisation, ultimately aimed at curbing wages. Many studies have shown that growth is wage-led in most EU member states. Even Germany, which feted itself as a paragon of reform with its Agenda 2010, has achieved stronger and more fairly distributed growth in the past five years than in the first ten years after the reforms by focussing more on domestic market demand and expanding public services.

Europe needs more investments on the periphery in order to accelerate cohesion. The European Fund for Strategic Investments (the so-called Juncker Fund) was a belated step in the right direction, although too little focussed on the poorest countries and too small. A one-off sum of 315 billion euros (assuming that is even realised) cannot make up for an annual investment gap of 450 billion euros (taking 2007 investment volumes as a benchmark).

In terms of fiscal policy the EU should not concentrate too narrowly on the arbitrary Maastricht criteria (maximum 3 per cent budget deficit, 60 per cent national debt to GDP ratio), which are unjustifiable both empirically and theoretically. The 'golden rule' for funding public investments would be a better rule of thumb. Europe needs a finance ministry that responds to shortfalls in demand resulting from excessive private savings and deficient investment with compensatory debt-financed spending. Emmanuel Macron's modest proposals deserved much more support, especially from Germany.

In sharp contrast, key institutions and policies in Europe continue to pursue obsolete policy approaches championed by experts in bodies lacking in democratic legitimacy (ranging from the ECB to national productivity boards). More democracy and less technocracy would boost the EU's approval ratings and at the same time dry up the wellsprings of populism.

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NOTES

- 1 See Michael Dauderstädt 2019: Deutschlands unabsichtliches soziales Wachstum [Germany's unintentional social growth], in: *spw – Zeitschrift für sozialistische Politik und Wirtschaft*, Issue 231, pp. 40ff.

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