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Poverty and Inequality in Europe

Underestimated in Official Figures, but Showing Slight Improvement in Recent Years

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AT A GLANCE

Official EU statistics mask the extent of inequality and poverty in Europe, both of which are alarmingly high: there are, for instance, over 140 million people in the EU at risk of poverty. Although matters improved slightly between 2015 and 2016, the continued dangerous scale of the problem threatens Europe's social and political cohesion.

On 22 February 2018, in response to a governmental statement made by chancellor Angela Merkel to the German parliament regarding the upcoming meeting of EU-27 heads of state and government, SPD parliamentary group leader Andrea Nahles made her much-discussed remarks on the dramatic levels of inequality and poverty in the EU, which she identified as drivers of immigration and populism. But what is the true extent of these problems: just how high is inequality, just how skewed is the distribution of income?

OFFICIAL STATISTICS MASK THE SCALE OF THE PROBLEM

Eurostat, the EU's statistical office, has published official figures on pan-European poverty and inequality since 2005 in the form of the poverty rate and the S80/S20 ratio (the latter is a measure of inequality). The poverty rate is the percentage of the population that earn less than 60% of median income; since this is a measure of relative rather than absolute poverty (defined by the World Bank as less than US$ 1.25 per day), it is also referred to as the at-risk-of-poverty rate. The S80/S20 ratio is the ratio between the incomes of the richest and poorest quintiles (= 20 percent) of a population. The Eurostat figures for the EU as a whole are calculated based on averages of the national rates weighted according to population size.

This way of calculating the figures is methodologically flawed and massively underestimates the actual extent of poverty and inequality, as was already noted back in 2010 in an EU publication by leading income distribution expert Anthony B. Atkinson (Atkinson et al. 2010: 109). This is due to the fact that it neglects the vast differences in income between the member states. These differences come out especially high if the incomes are compared using market exchange rates, and substantially lower if they are compared using purchasing power parity (PPP) exchange rates, which take account of the fact that the same earnings are equivalent to higher purchasing power in poorer countries where prices are lower.

ALMOST 142 MILLION EUROPEANS ARE AT RISK OF POVERTY

For several years now, we have been publishing more realistic estimates of pan-European inequality (most recently in 2017; see for example Dauderstädt & Keltek 2017) that take account of both intra- and intercountry income differences. The present study supplements this analysis with an estimate of the pan-European poverty rate that utilises essentially the same method (see the textbox below for more details). The values calculated using this method are significantly higher than the official figures. It might be objected that it is inappropriate to classify people who are relatively well off in their own country as belonging to the poor of Europe. But this nation-centric view, which also underlies the EU statistics, underestimates the extent to which the social situation in different countries has become Europeanised (Heidenreich 2006), with consequences for immigration and social cohesion.

National poverty rates in the EU vary between over 25 % in Romania and less than 10 % in the Czech Republic. For Germany, the figure is 16.5 % (2016). The official Eurostat figure for the EU as a whole is 17.3 %, which puts poverty in the EU only slightly higher than the level in Germany. However, if an EU-wide poverty threshold is calculated using the method described in the textbox, the figure comes out significantly higher.

We estimate the at-risk-of-poverty threshold for the EU as a whole (60 % of median EU income) to be around € 9,760 based on market exchange rates or € 9,780 based on PPP exchange rates. The bulk of households that are poor on an EU-wide comparison, with an income below the threshold, are in poorer member states, primarily Bulgaria and Romania, which not only have the lowest per capita income in the EU but also the highest poverty rates. Practically all households in these member states count as poor on a pan-European comparison, since they have less than 60 % of median EU household income at their disposal. In other member states, correspondingly fewer households fall into this category. In Scandinavian countries, for example, no quintiles are below the threshold. The map (figure 1) offers a rough overview of how matters stand for each individual country.

By our estimate, if market exchange rates are used the EU-wide poverty rate is 28.2 % (equivalent to around 142 million out of a total EU population of around 500 million), which is higher than in any individual member state. If PPP exchange rates are used instead, the figure falls to 23.2 % (equivalent to around 117 million people), which is higher than the Bulgarian poverty rate. The official Eurostat poverty rate of 17.3 % is equivalent to a figure of just under 87 million people in the EU at risk of poverty. This figure thus leaves out either 30 or 55 million people below the at-risk-of-poverty threshold, depending whether this threshold is measured based on market or PPP exchange rates.

The poverty rate has decreased slightly since 2015, with the number of people at risk of poverty in the EU falling by around four million. This fall is equivalent to just under one percentage point. The clear progress may be due to relatively strong growth, especially in the poorer countries.

Data and Methodology

The **data** used in this study comes from Eurostat and is the same as that used by Eurostat to calculate its own figures. It was collected by means of household surveys (EU-SILC) and refers to equivalised disposable income (i.e. income after tax, including income from sources such as pensions, adjusted for household size). For most countries, this figure is around one third lower than GDP per capita. We have only used Eurostat's average income per income quintile (not the complete sample from the household survey). Consequently, our analysis does not take account of income differences within the quintiles; this results in distortions in the richest quintile in particular. For example, the richest quintiles of Bulgaria and Romania are among the poorest in Europe due to their low averages, even though there are some households in those quintiles that are rich even on a pan-European comparison.

The **method** that we use to calculate inequality consists in constructing European quintiles out of national quintiles: the national quintiles are ordered by average income and then added together until they comprise approximately 100 million people, i.e. one fifth of the EU population. The ratio between the richest and poorest quintiles constructed using this method gives the pan-European S80/S20 ratio.

To estimate the European poverty rate, a two-stage method is used. Firstly, median European income is determined by adding up the national quintiles until the resulting segment of the European population makes up half the total population. The threshold income at the boundary between the two halves is the median income. Secondly, we identify all national quintiles with an average income below 60 % of this median income. The number of people in these quintiles is summed and expressed as a percentage of the total EU population.

EU-WIDE INEQUALITY HAS FALLEN SLIGHTLY

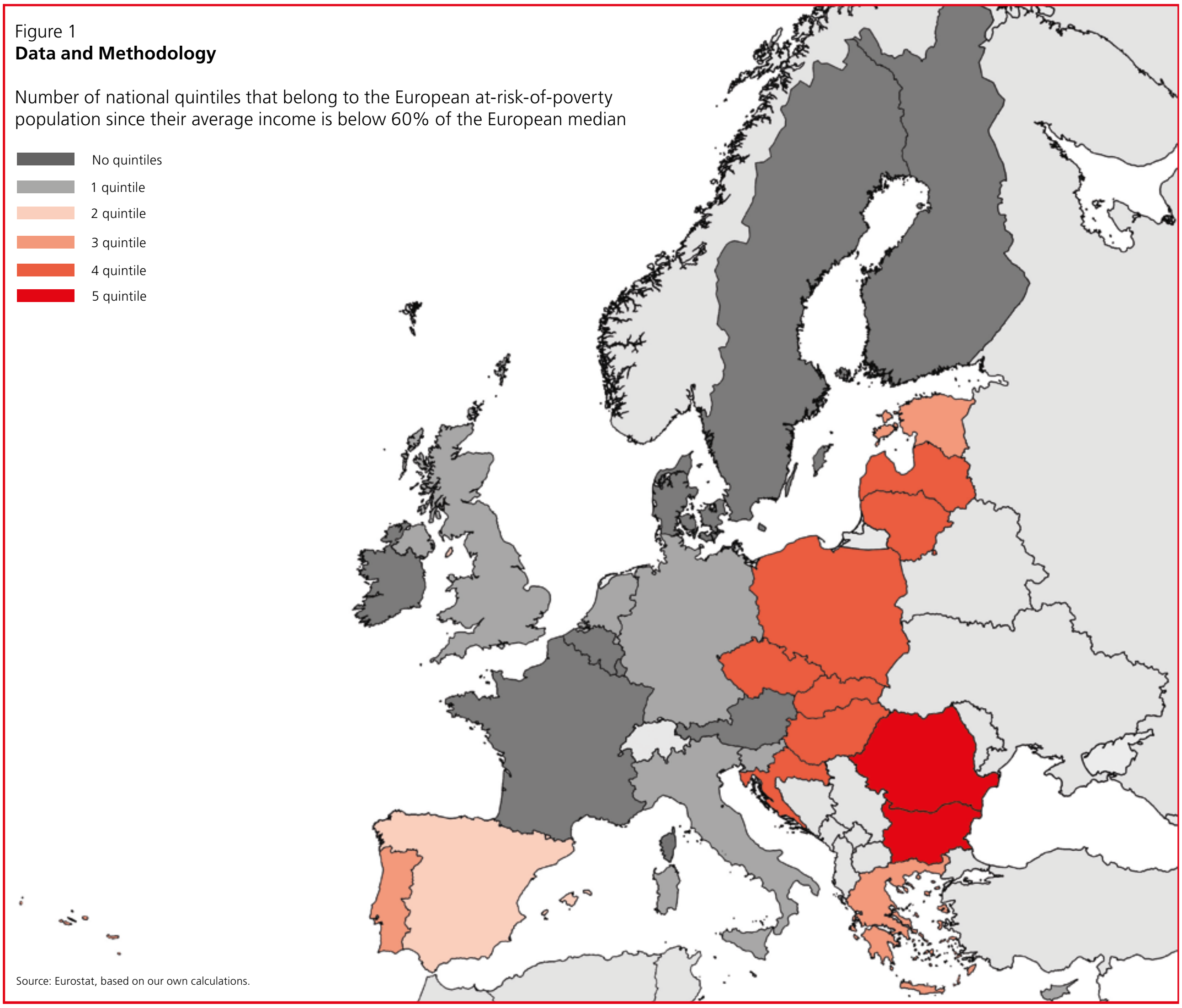
As figure 2 illustrates, pan-European inequality (see the textbox above for a definition and explanation of how this figure is calculated) fell rapidly up until 2009, rose again in 2010 and has been coming down only slowly since then. As a result of two relatively poor and populous countries, namely Bulgaria and Romania, joining the EU in 2007, inequality in the EU-27 is significantly higher than inequality in the EU-25. Meanwhile, the accession of Croatia, which has a relatively small population and intermediate income levels, only marginally increased inequality in the EU-28 compared with the EU-27. The departure of the UK from the EU would probably only reduce inequality slightly, since it would primarily bring about a (small) income reduction in the richest EU quintile.

By contrast, factoring in differences in purchasing power does have a significant impact. Inequality is significantly lower if measured using PPP exchange rates, since real incomes are considerably higher in poorer countries with lower prices. The official Eurostat figure for the S80/S20 ratio, calculated on a methodologically flawed basis, continues to oscillate around the value of 5, though it too has fallen slightly (by 0.1).

As welcome as the slight fall in inequality between 2015 and 2016 is, the rate of reduction is still far slower than between 2005 and 2009. It is virtually just a continuation of the stagnation that has been observable since 2011 (especially when measured using market exchange rates). The causes lie, firstly,

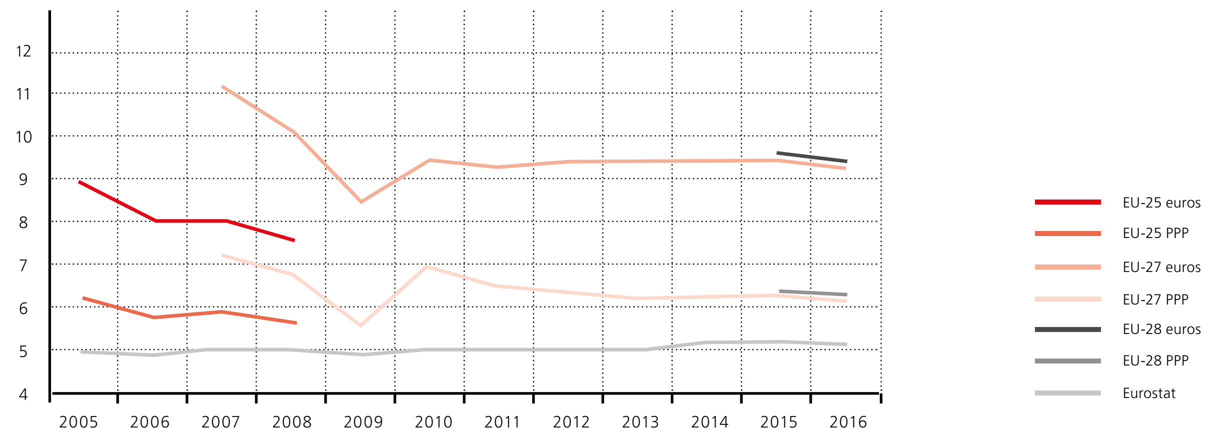
Figure 1
Data and Methodology

Number of national quintiles that belong to the European at-risk-of-poverty population since their average income is below 60% of the European median



Source: Eurostat, based on our own calculations.

Figure 2
Pan-European inequality (S80/S20 ratio), 2005–2016



Source: Eurostat, based on our own calculations.

in a slight decline in average intracountry inequality (as evident in the fall in the official Eurostat figure) and, secondly, in the continued successful beta convergence[1] between the EU member states.

EXPEDITING THE REDUCTION OF POVERTY AND INEQUALITY

As noted earlier, inequality is one of the key drivers of higher immigration, which in turn fuels feelings of anxiety and insecurity and the rise of populism. Immigration was a key factor behind Brexit, and is a central rallying cry for many populist parties across all parts of Europe, including Scandinavia, France, the Netherlands, Germany, Italy and Central and Eastern Europe. High income differences between countries with close economic ties also contribute to the outsourcing of labour-intensive production stages, which in turn threatens wages and employment in regions that previously had enjoyed greater economic prosperity while hosting low-skilled manufacturing industries. These are all reasons to place greater emphasis on reducing inequality. EU-wide inequality and poverty can be brought down in two ways: either (a) by reducing *intra*country inequality or (b) by reducing *inter*country inequality.

(a) Intracountry inequality is increased by welfare cuts and labour market deregulation, technological change and globalisation. All three causes can be addressed by government policy. For example, in Germany the introduction of a minimum wage has halted the rise in inequality that had been observable since 1995. In the EU, a stricter Posted Workers Directive could curb wage competition. In his most recent book, Atkinson (2015) presents numerous suggestions for how intracountry inequality can be reduced, covering all three categories of cause. Unfortunately, the EU's economic policy advice and the requirements it has imposed on indebted countries have instead tended to increase inequality.

(b) Intercountry inequality is rooted in complex historical causes with social, political and economic dimensions. However, several countries have managed to close the historic gap with other countries by means of successful growth policies. Worthy of particular note in the EU is Ireland, which rose from being one of the poorest members of the EU-15 to the second-richest – though this was achieved in part by problematic and not easily generalisable methods (e.g. tax competition, transfer pricing manipulation). But Southern and Central–Eastern Europe have also enjoyed sustained periods of higher growth than the rich EU core countries. Although the EU supported this growth through its regional policy, it then undermined it again through its misguided response to the sovereign debt panic (namely, to impose austerity) (Dauderstädt 2014). In its new medium-term financial plan for 2021–2027, the EU should give high priority to promoting growth, employment and social security in the poorer member states on its periphery, and adopt appropriate fiscal policies (e.g. a eurozone budget and eurozone finance minister) to support investment activity, stabilise banks in all countries by introducing EU-wide deposit insurance, and protect sovereign debts from market panic.

The recent drop in Europe's poverty and inequality rates is a welcome break from the stagnation of the preceding years, but given the vast scale of the problem, which is underestimated in official figures, it represents far too small a step in the right direction. Moving forward, stronger progress and more decisive policies will be needed if the disintegration of Europe is to be prevented.

NOTES

1 Beta convergence occurs if the poorer countries are growing faster than the rich ones. However, it does not automatically lead to sigma convergence (i.e. a reduction in dispersion) in the short term, since growth in absolute differences can persist for some time. On this point, see Dauderstädt & Keltek (2017).

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