



European  
Research Area

# EUROPEAN POLICY BRIEF



## Europe's Inequality Challenge

Policy Implications of INEQ, an EU-funded research project involving seven institutions led by the Centro di ricerche interuniversitario sullo stato sociale.

March 2009

### INTRODUCTION

Embracing 27 distinct countries, the European Union naturally exhibits inequalities in the socio-economic sphere. While each of these inequalities presents its own specific policy challenge, one serves as a particularly potent indicator of the EU's institutional legitimacy: income inequality.

Despite a lack of consensus on what constitutes a 'fair' level of income inequality (and competing views on how best to measure it), there is no disputing the fact that too much income inequality can have a profoundly negative impact on society. At the very least, it can lead to social segregation and polarisation.

Over the past two decades, income inequality has not declined significantly in any EU country. In fact, in most European countries it has grown. Several EU countries now show disturbingly high and persistent levels of income inequality. Sizeable income gaps are also evident at the regional level, especially between Europe's northern and Mediterranean countries.

Surveys suggest that the current level of income inequality in the EU conflicts with the values shared by a majority of European citizens. Allowed to grow unchecked, this inequality has the potential to jeopardise the EU's basic principle of cohesion.

Fortunately, policy instruments have been identified that can promote greater equality without undermining economic growth. To tackle the problem, policymakers are urged to look beyond redistributive instruments and adapt a more structural approach.

## KEY OBSERVATIONS

**How have incomes developed in Europe over the past decade?**

**EU countries show large and persistent differences in economic inequality. There has been a widespread decline in real wages in Europe in recent years, and this has fuelled an increase in inequalities and social problems. Unfortunately, the current recession is likely to exacerbate this situation.**

During the past decade, the share of European workers experiencing a *decline* in real wages has risen dramatically. Between 1996 and 1999, hourly compensation (wages plus social contributions) in major EU countries declined by 16.5%. Within just a few years – between 2003 and 2006 - the figure doubled to 33%.

**Have wages kept pace with productivity growth?**

The gap between labour compensation and productivity growth has also been widening. During the 1996 to 1999 period, 48% of the workforce saw their hourly compensation rise more slowly than their productivity. Between 2003 and 2006 the gap widened to include 61% of the workforce. Moreover, during that same period, 23% of the workforce saw their hourly compensation *drop* while their labour productivity rose. The ability of wages to capture productivity gains has clearly been diminished.

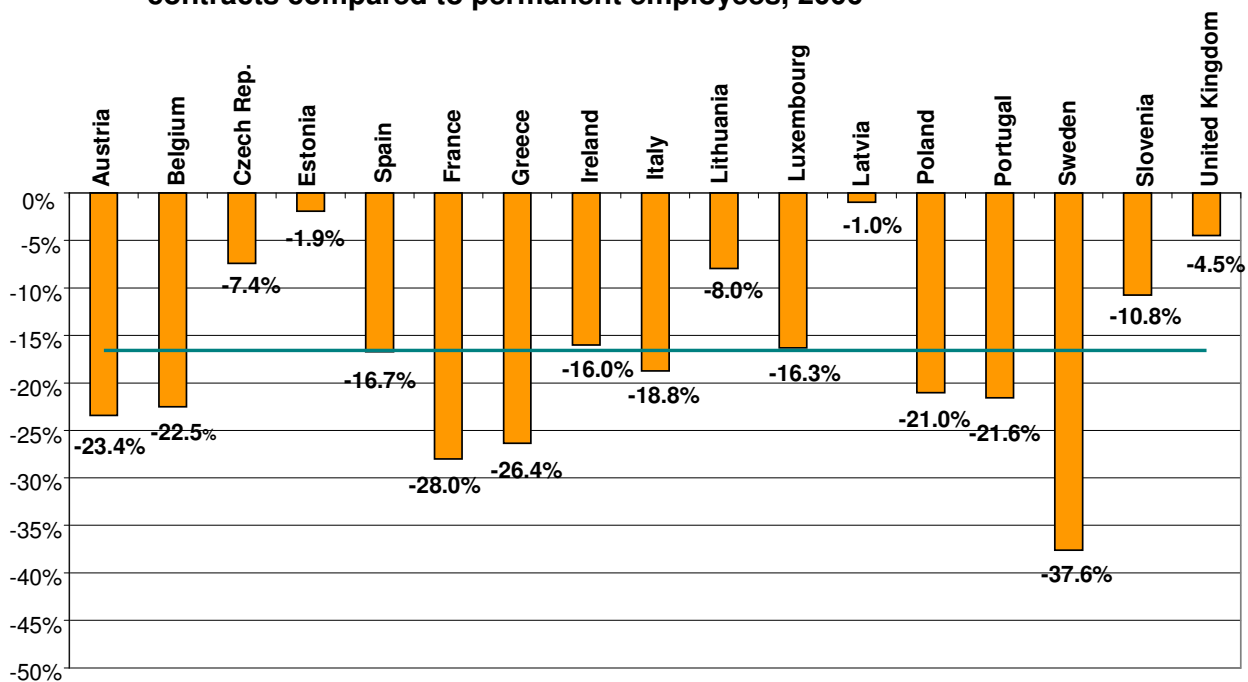
The inability of labour to capture an adequate share of productivity gains constitutes a major problem in Europe.

**KEY OBSERVATIONS**

**What role do part-time and temporary jobs play in income inequality?**

Atypical (part-time and temporary) employees increasingly belong to the working poor and contribute significantly to rising inequality in some countries. This is due in large part to the frequently high wage differential between them and permanent employees (Figure 1).

**Figure 1. Wage Gap. Difference in wages earned by employees working with temporary contracts compared to permanent employees, 2006**



Percentage values estimated using a Mincerian wage equation based on net annual wages.  
**Source:** Elaborations on EU-SILC 2006

**Part-time and temporary workers in the low-wage sector often embody a high level of human capital. Their underemployment reflects a serious flaw in labour market efficiency.**

The richest workers in Europe have seen their earnings rise during the last ten years. For the first time, wealthy people in several countries can now be classified as 'labourers' and not 'capitalists'.

**KEY OBSERVATIONS**

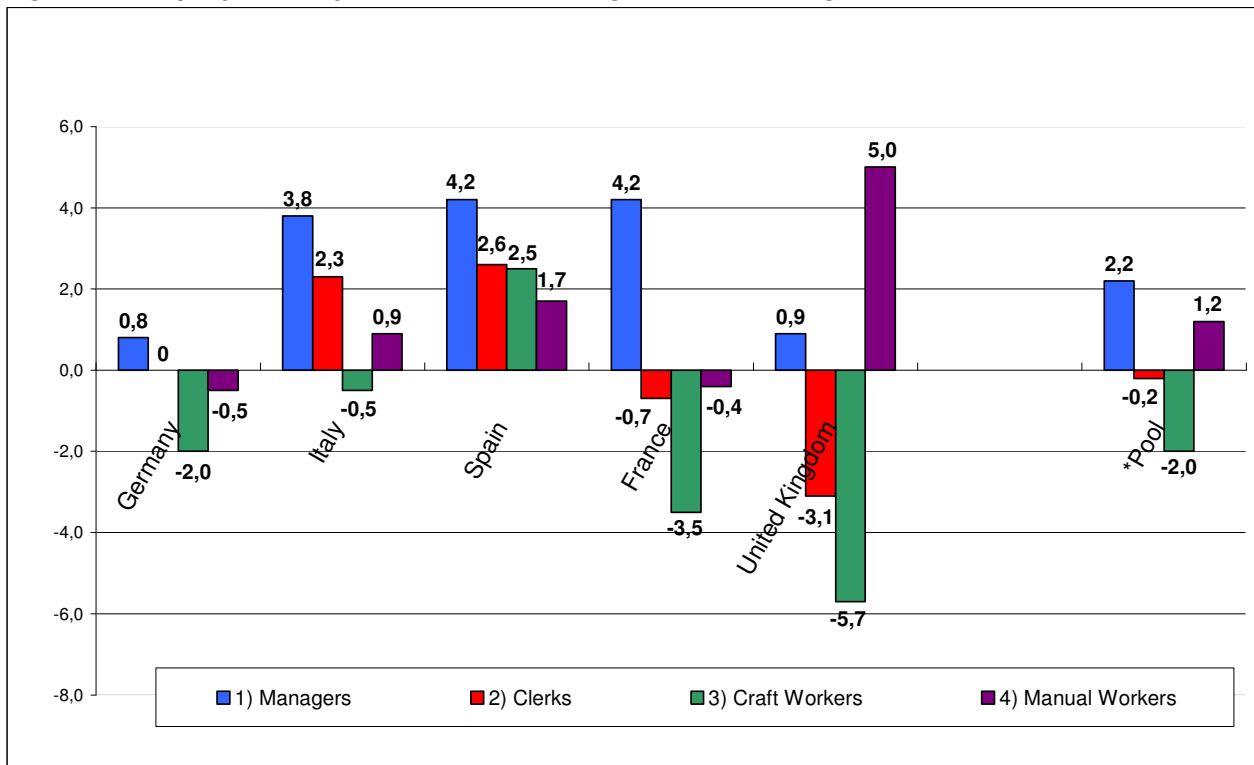
**Is income inequality compatible with equal opportunity?**

There is no clear evidence showing that high levels of economic inequality are favourable to economic growth. Where inequality is larger, economic growth is not systematically faster. Though we do not know precisely how economic inequality influences growth and other desirable economic goals, current levels of income inequality can be regarded as unacceptably high and not compatible with equality of opportunity.

**Does innovation help overcome inequalities in the labour market?**

Technological change has not resulted in a general trend toward 'upskilling' in Europe. Instead, there has been a strong increase in the polarisation of the professional structure, with jobs going mainly to managers and professionals and to unskilled manual workers (Figure 2).

**Figure 2. Employment by Profession. Average annual change, 2000-2003**



\* Pool refers to the sum of the five EU countries shown in the graph.  
 1) Managers include: legislators, senior officials and managers, professionals, technicians and associate professionals.  
 2) Clerks include: clerks, service workers and sales workers in shops and markets.  
 3) Craft workers include: skilled agricultural and fishery workers, craft workers and workers in related trades.  
 4) Manual workers include: plant and machine operators, assemblers and elementary occupations.

**Source:** Nascia, Leopoldo & Pianta, Mario (2008). Skill Bias or Polarisation? Innovation and Job Growth by profession in Europe.

Within European industries, higher wage polarisation is found in sectors with:

- a) strong innovation (new products and new markets) and a high proportion of workers with university education;
- b) high proportion of university-educated workers.

### What role does the family play in income inequality?

Income inequality shows a strong transgenerational tendency: it is regularly transmitted from parents to children. A disadvantaged family background negatively affects a child's prospects in terms of both educational attainment and wage earnings.

**The influence of family background on a child's economic future goes well beyond the effects of education. Preventing child poverty, therefore, is at least as important as trying to reduce its effects by improving access to education.**

With respect to income inequality, intergenerational transmission levels vary from country to country in the EU, suggesting a determining role for the welfare state.

One reason education may fail as a social mobility vehicle is the very low income earned in several countries by people with high degrees.

Inequality is often regarded as inevitable, even by those who suffer from it. This reflects an inability to identify effective ways of escaping inequality and the belief that society is more mobile than it actually is.

### What obstacles stand in the way of overcoming income inequality?

Obstacles to overcoming income inequality include:

1. Lack of policy coordination.
2. 'Tolerance' of or limited aversion to inequality.
3. Insufficient political and institutional opposition to inequality
4. Lack of coordination among decision centres at various levels of government, both national and supranational.

Within countries, labour market mechanisms are primarily responsible for income inequality.

The effects of redistributive activity by welfare states vary widely. Nordic welfare states have been much more effective in reducing market income inequality than Mediterranean countries.

While redistributive policies are important for tackling income inequality, they are only one part of the solution.

**RECOMMENDATIONS FOR POLICYMAKERS**

- Commit the EU to reducing economic inequality both within and between member countries. Establish this as an explicit goal and devise harmonized policies to achieve it.
- Develop welfare and educational policies to reduce intergenerational transmission of inequalities.
- Act on the national and European levels to reverse the broad-based decline in real wages.
- Reverse labour market policies that have made work more precarious and weakened the bargaining power of workers.
- Design a better system for allowing productivity increases to be shared between labour and capital.
- Support innovations that increase productivity and boost wage distribution.
- Rejuvenate industrial policy to enable economic systems to create an adequate number of jobs for skilled workers.
- Give intolerance of inequality a 'voice' that resonates in political and policy-making circles.
- Create educational programs discouraging group-dominated behaviours that reject opportunities offered by the welfare state.
- Prevent child poverty in order to foster an easy access to education system and to avoid the direct affects child poverty may have on future earnings.
- Where appropriate, introduce negative income tax schemes for low income families and provide benefits to cover education costs.
- Restructure social expenditures to improve the living conditions of a larger number of families and design unemployment subsidies to avoid discrimination among workers.
- Shield pensions from the vagaries of financial markets to assure more equitable and efficient risk sharing.
- Promote universal welfare systems in countries where those systems are underdeveloped.
- Develop an integrated approach to inequality; pay special attention to the interaction of measures, even in seemingly unrelated policy fields.

**RESEARCH PARAMETERS**

**INEQ (Inequality: Mechanisms, effects and policies) was an EU-funded research project that sought to increase our understanding of the economic and social mechanisms that are producing inequality within and between European countries.**

**Objectives of the research**

The general aim of the project was to draw together different dimensions of inequalities in a coherent framework that allows a deeper understanding of their complexity and helps to identify effective policy action.

Specifically, the project sought to:

- Understand the mechanisms and effects of inequality in EU countries.
- Integrate the economic and social dimensions of inequality also to explain its persistence.
- Suggest policy measures aimed at reducing inequality and mitigating its more negative effects.

At the policy level, after clarifying the need for inequality-reducing policies in many countries, the main objective has been to broaden the view as to the most appropriate measures. In particular, the limitations of redistributive policies have been analysed.

**Methodology**

The INEQ project focussed mainly, but not only, on income inequality. The project was developed at both theoretical and empirical levels. The basic methodology consisted of collecting data; using appropriate quantitative techniques to highlight correlations and causal relationships between various phenomena; interpreting the results on the basis of the best existing theoretical models or, as needed, on the basis of models developed within the project; integrating the results and interpretations of various phenomena in a more general and working out the policy implications, especially with reference to economic inequality.

## PROJECT IDENTITY

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<b>Funding Scheme</b>	STReP (Specific Targeted Research Project), funded under the 6th Framework Programme for Research of the European Community, Thematic Priority 7 - Citizens and Governance in a Knowledge-based Society
<b>Budget</b>	€ 1 200 000.00
<b>Duration</b>	34 Months: April 2006 – February 2009
<b>Website</b>	<a href="http://www.criss-ineq.org">www.criss-ineq.org</a>
<b>For More Information</b>	<a href="mailto:f.marzo@gmail.com">f.marzo@gmail.com</a>
<b>Further reading</b>	All the research papers and all work packages reports are available at <a href="http://www.criss-ineq.org">www.criss-ineq.org</a> . A number of papers are forthcoming on a special issue of the <i>International Review of Applied Economics</i> (May 2009). Some papers have been published in Italian in the issue n. 59-60 of the journal <i>Meridian</i> . Two books are in preparation.