

# The Unequal Crisis

How did income inequality evolve during the financial crisis?

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### Consumer Economics at ING

This report is part of ING's growing research into consumer economics. Our aim is to deepen understanding of economic and financial decision-making of individuals and households. The first step is to examine the impact of economic, social, political, and technological change. We are looking not just at the household sector as a whole, but also at particular socio-economic segments. The second step is to analyse how individual behaviour is changing. What are the challenges and opportunities that people face? The third, and most important, step is to address the question: **how can we help people make better financial decisions?**

To that end, we are also drawing on the expertise of external partners through the Think Forward Initiative, an open-source collaboration aimed at helping people make better financial decisions.

Seeking ways to improve people's financial decision-making will need not just combining macro and micro-economics. It will take us beyond economics, to the tools of other disciplines. Helping people to learn or avoid mistakes will call upon psychological and educational insights. Addressing social influences on decisions will pull in other social sciences such as sociology and social anthropology.

We invite readers to join the debate. You can contact us directly, or on Twitter @thinkforward, or via the Think Forward Initiative LinkedIn community.

**Mark Cliffe**  
Chief Economist

## Main observations

- **If income inequalities increase in bad times, they do not necessarily revert back in good times**

Before the 2008 financial crisis, the disposable income of the lowest income group evolved less favourably than the average in many countries (although not in Europe as a whole), while incomes increased more rapidly for the highest decile of incomes (than for the lowest) in 3 out of 4 OECD countries.

During the crisis, income inequality increased almost everywhere, but the situation tended to be worse in the United States. Indeed, in Europe as a whole, the lowest income groups did not fare much worse than the average. Even versus the highest incomes the cumulative gap was limited to 2% over 6 years, against 5.3% in the Eurozone, but there were national discrepancies. In most countries, they indeed fared worse, which led to higher inequality. In Greece for example, the lowest incomes decreased twice as fast as the average (-8% per year between 2007 and 2013 against -4% on average). This might seem as the worst case scenario, but in fact in Spain for example, the shock came much earlier and the gap was the worst of the Eurozone until 2012. Afterwards, the poorest group caught up thanks to a decrease in unemployment while the poorest Greek saw the hardest part of crisis coming.

Besides, income inequality remained unchanged in Germany and actually decreased in countries like Portugal, Belgium or the Netherlands (where the middle-class fared relatively better than both extremes of the income distribution).

- **Youngest age groups suffered more than the oldest during the crisis**

The youngest part of the active population (16 to 24 years old) was hit harder than the oldest (65+ years old) in all countries except Belgium and Germany, and generally also saw incomes evolving less favourably than the average population. In some countries the income growth discrepancy between older and younger can also be linked to variations in the Gini coefficient (a broadly used measure of inequality), showing that intergenerational inequality also matters for a country's inequality as a whole.

In the US, the incomes of the 65+ increased on average by 4.5% a year between 2007 and 2013 while those of the youngest increased only by 1%, leading to a cumulative gap of 23% over six years. In the Eurozone, the disposable incomes of the 65+ increased on average by 3.5% a year between 2007 and 2013 while those of the youngest increased only by 2%, leading to a narrower cumulative gap of 9% over six years.

- **New types of labour contracts are often among the reasons for rising inequality**

Data show that non-standard workers (those not working on a full-time permanent contract) are more likely to be young, less-educated, and living in a Southern European country when they are not voluntarily on such contracts. We find that the vulnerability of the non-standard workers, in particular the youngest, matters in explaining inter-generational and cross-income inequality increases. Indeed, the crisis first hit the most vulnerable types of employment: temporary, part-time and self-employed. They contributed as much as 9ppt and 5ppt to the drop in employment measured respectively in Spain and Portugal between 2007 and 2013.

This illustrates the fact that more flexible labour markets can increase inequality when flexibility comes without a substantial degree of social protection (we examine here income redistribution measures and automatic stabilisers).



- **Less generous welfare states saw inequality rise**

The likelihood of seeing a rise in inequality was higher where the welfare state was less generous, especially as the employment shock primarily happened there (in countries like Greece, Spain, or Italy). As a consequence, the employment shock was disproportionately felt by the poorest which saw a more negative disposable income evolution (measured after the redistribution has taken place) than their national average. Moreover, the austerity period that followed the first shock of the crisis also contributed to the differences.

- **Inequality and poverty go hand in hand for the younger population**

The incidence of poverty increased in almost all countries analysed (at least one measure of poverty increased everywhere except in Germany). In France and the Netherlands, all poverty measures show a similar result (a 1ppt increase in the poverty rate during the crisis period), but in Southern Europe (Portugal, Italy, Spain and especially Greece) changes in absolute poverty testifies of the consequences of dramatic income losses: in Greece the absolute poverty rate reached 33% in 2013 when the 2005 reference income is taken into account, followed by Italy (15%), Spain and Portugal (both 13.5%).

Moreover, we find that younger households became more at risk of poverty during the crisis: poverty incidence increased among the young while it decreased among the elderly. The only exceptions are Germany (where both groups saw their poverty rate decrease at the same pace) and Poland (where both groups saw their poverty rate increase at the same pace). The largest discrepancies between both age groups were observed in southern Europe (Greece, Spain and Portugal).

Life satisfaction did not appear to be correlated with inequality during the crisis; the evolution of income seems to have mattered far more.

- **We need more than a classic economic recovery to get out of the growing inequality trend**

The inequality challenge is different in the various country groups previously identified. However, as labour income is the most important driver of incomes for the poorest, a stronger labour market would logically be the most important driver of their income. It may even be that poorer households will finally benefit more than the richest from higher employment growth, allowing for inequality to decrease. For this to be true, we need to see a relatively higher income growth among the poorest in times of growing employment, which unfortunately was not the case everywhere before the crisis.

As a result, if an economic recovery brings higher growth and more jobs, this is generally not sufficient to bring inequality down. This reminds us that if an economic recovery can create the tide that will lift all boats (or increase the likelihood of finding a job for everybody), structural reforms are also needed to ensure that all boats remain together (or that inequality does not increase further as a result). Here, we see that there are conditions for the recovery to decrease income inequality: more redistributive welfare systems together with labour market reforms that allow for faster employment growth amongst the poor and that make a non-standard contract only either an individual choice or a step towards more permanent, full-time contracts. Creating non-standard jobs is not wrong per se, but a flexible labour market must allow for an upward mobility across the different contract types. Without that, stronger employment growth can make that poorer unemployed have more chance to get a job, but not necessarily that their income growth will stick to the averages.

# Introduction

The financial crisis worsened the upward trend in inequality

This report discusses how inequality evolved in the US and EU<sup>1</sup> during the crisis and afterwards. We concentrate here on income inequality although other types of inequality (in wealth and indebtedness distribution for example) are also in the Think Forward Summit<sup>2</sup>'s scope. As such, this report is the logical extension of ING's recent reports on the evolution of income during and after the crisis. Indeed, incomes did not converge before the crisis, and they even diverged between countries afterwards as we showed previously<sup>3</sup>, and trends in income were also different inside each country. These different trends have been behind the rise in inequality over the last three decades, with the recent crisis years even worsening the picture. To discuss these evolutions and their sources is not only important for what they say about the consequences of the income evolutions previously described and to compare inequality evolutions between countries, but also for their impact on economic growth.

Indeed, growing income inequality in so many countries has renewed interest on its possible economic effects and addressing this trend has moved to the top of the policy agenda in many places. This is not only because of its impact on social outcomes, although in some countries there are indeed worries that growing inequality will result in social resentment, fuelling populist and protectionist sentiments and leading to political instability. It is also because cumulatively large and sometimes rapid increases in income disparity might have an effect on economic growth and therefore on the pace of exit from the current recession. Does a greater dispersion of incomes across individuals undermine growth? Or is inequality a pre-requisite for growth?

This could damage growth as inequality has been shown to be harmful for long-term growth

This is by no means a new debate and economic theory has long argued that the relationship between inequality and growth can go either way. This is especially true at early stages of economic development. However, in advanced economies, growing inequality has been shown to be harmful for long-term economic growth according to the OECD<sup>4</sup>: for example, *"the rise of income inequality between 1985 and 2005 is estimated to have knocked 4.7 percentage points off cumulative growth between 1990 and 2010, on average across OECD countries for which long time series are available"*. This represents on average 23bp of GDP growth per year.

How does inequality harm growth? In developed economies, the OECD found that the main transmission mechanism between inequality and growth is human-capital investment: *"while there is always a gap in education outcomes across individuals with different socio-economic backgrounds, the gap widens in high-inequality countries as people in disadvantaged households struggle to access quality education. This implies large amounts of wasted potential and lower social mobility"*. As such, if reducing inequality indeed allows for higher growth (15bp of yearly GDP growth for each drop of 1 point in one country's Gini coefficient

<sup>1</sup> BE Belgium, DE Germany, EU European Union (28), ES Spain, EZ Eurozone, FR France, GR Greece, HU Hungary, IT Italy, NL Netherlands, PL Poland, PT Portugal, RO Romania, UK United Kingdom, US United States

<sup>2</sup> Think Forward Summit 2016 (25/02/2016 – Brussels) [www.thinkforwardinitiative.com](http://www.thinkforwardinitiative.com)

<sup>3</sup> ING Economic Research (2016) "Seven fat years, seven lean years" [www.thinkforwardinitiative.com](http://www.thinkforwardinitiative.com)

<sup>4</sup> OECD (2015) "In it together: Why less inequality benefits all" (Chapter 2 and Annex 2)

<http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm>: "The estimated impact of inequality on growth turns out to be sizeable. Based on the coefficient reported in column 1 of Table 2.1, for example, lowering inequality by 1-Gini point would translate into an increase in cumulative growth of 0.8 percentage point in the following five years (or 0.15 point per year). Annex 2.A1 details how the estimated coefficients can be used to infer the consequences of changes in inequality over the longer run in light of the Solow growth model. Focusing on a 25-year horizon, the estimated coefficients imply that a 1-Gini point reduction in inequality would raise average growth by slightly more than 0.1 percentage point per year".

according to OECD computations<sup>4</sup>), showing how inequality evolved in recent years and which groups were most affected certainly suggests at least two things:

- in which countries efforts in inequality reduction would ensure the largest GDP growth gain, among the Eurozone and in other countries;
- that different population groups are facing different challenges for the development of their financial future, which also imply different financial behaviors.

And we believe that these behaviours can be better understood given each group's situation in the income distribution spectrum. In what follows, we show in Section 1 in which countries inequality increased (income, age and country groups) and in Section 2 how the phenomenon is linked to the labour market. In Section 3, we look at how fiscal redistribution helped limit inequality in some countries and worsened things in others. In Section 4, we consider the consequences of these developments, at a social level (namely a differentiated progression of poverty between generations and income classes, together with their impact on life satisfaction). Finally, in Section 5, we conclude on the prospects of the current recovery as far as inequality reduction is concerned: as growth will not necessarily bring down inequality by itself, we identify where (and which) supplementary conditions to growth are needed to ensure lower income inequality.

# 1 Rising income inequality

## Inequality increases in bad times, but continues likewise in good times

Inequality increased in the 20 years prior to the financial crisis...

### 1.1 Inequality and income groups

The disposable income of the lowest income group evolved less favourably than the average in many countries, but not in Europe as a whole before the financial crisis.

In the 20 years prior to the financial crisis, incomes increased more rapidly for the highest decile of incomes than for the lowest in 3 out of 4 OECD countries. This picture looks also valid when looking at the pre-crisis period of the Eurozone (1999-2007): incomes of the lowest decile grew by 2.8% a year during this period while incomes of the highest decile grew by an average of 3.7%. In our sample however, some important countries did not witness this phenomenon: in France and the Netherlands, but also in Portugal, incomes were increasing faster in the lowest decile before the crisis<sup>5</sup>.

...and continued likewise in the recent years

If inequality increased during the pre-crisis period, it continued to increase during the crisis, although less quickly in the Eurozone where incomes of the lowest decile grew by 1.9% a year during the years 2007 to 2013 while incomes of the highest decile grew by an average of 2.3%, leading to an income growth gap of 2%.

At an aggregate level, the lowest incomes lagged behind only modestly...

If we compare the disposable income<sup>6</sup> evolution of the 5% of the population having the lowest income (20% for the US) with the country average during the financial crisis (from 2007 to 2013, the last available data point for all countries), we see in Figure 1 that in the US<sup>7</sup>, the EU and the EZ, their income growth lagged behind only modestly. In Germany and the UK, the poorest even fared marginally better.

...but their situation deteriorated well beyond their national average in some countries

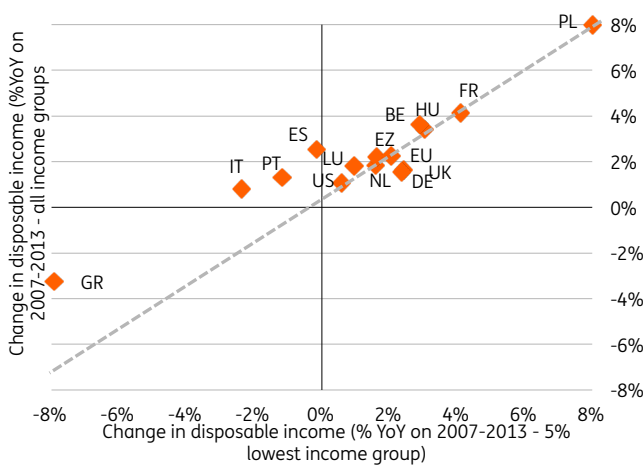
Some particular cases however stand out. In southern countries (Spain, Portugal, Italy and Greece), the poorest 5% saw their income decrease more than average. Greece was the worst case with the lowest incomes decreasing twice as much as the average (no less than 8% a year between 2007 and 2013, representing a cumulative fall of 40%). The situation in Spain has been worse than in Greece during the early stages of the crisis, but there the poorest caught up after 2011 thanks to a decrease in unemployment.

<sup>5</sup> Note that looking at Figure 21 gives an idea of how things worked between 2001 and 2007 for a sample of countries (not all of them as Eastern EU countries only entered in 2004 and have no data before).

<sup>6</sup> The source used here is Eurostat (Income and Living conditions database – ILC). The total disposable income of a household is calculated by adding together the personal income received by every household members plus income received at household level. Missing income information is imputed. As the ILC is a survey, amounts are **nominal**. Disposable household income includes: (1) all income from work (employee wages and self-employment earnings), (2) private income from investment and property, (3) transfers between households as well as (4) all social transfers received in cash including old-age pensions. The current definition of total household disposable income used for the calculation of EU-SILC based indicators excludes imputed rent and non-monetary income components, in particular value of goods produced for own consumption, social transfers in kind and non-cash employee income except company cars. **Note that only the cut-off point of each quintile of the distribution is available and not its average.** UK, PL, RO, HU and US are presented in nominal national currencies.

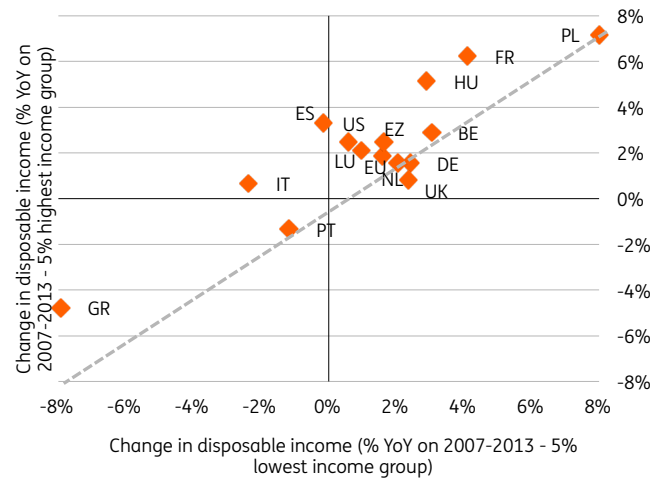
<sup>7</sup> The US data are not part of Eurostat publications. The definition of income differs as the US statistics does not give a gross disposable income at a detailed level. Note that there is no data for the 5% lowest incomes, but well for the 5% highest. **In the sample, the US figure for the 5% lowest is the first quintile figure.** Data used here for the US are closer to our gross income definition. As defined by the US Census Bureau, data on income collected in the ASEC by the Census Bureau cover money income received (exclusive of certain money receipts such as capital gains) before payments for personal income taxes, social security, union dues, Medicare deductions, etc. and does not reflect the fact that some families receive non-cash benefits.

Fig 1 Change in disposable incomes (2007-2013) : comparison between income groups, lowest vs average



Source: Eurostat (ILC Database), ING calculations

Fig 2 Change in disposable incomes (2007-2013) : comparison between income groups, lowest vs highest



Source: Eurostat (ILC Database), ING calculations

**Inequality did not increase everywhere...**

Comparing the lowest incomes' evolution to the highest shows a larger income growth gap for the Eurozone...

Another way of looking at it is to compare the lowest income earners to the highest ones rather than the average. Figure 2 shows that, in the Eurozone as a whole, the highest incomes increased slightly more than the lowest during the financial crisis (on average 2.5% and 1.6% respectively, which lead to a cumulated income gap of 5.3% - see also Annex 2). With the exception of Portugal, Figure 2 also confirms Figure 1 findings for the three other southern countries (Spain, Italy and Greece).

...than for the EU as a whole

The Eurozone saw a cumulated income gap larger than the EU as a whole (where the gap is almost zero over the six years) as the UK actually saw a higher income growth of its lowest income group during the crisis. France also played a role in the Eurozone cumulated income gap. Indeed, in the second largest Eurozone economy, most households (quintiles 2, 3 and 4) saw their incomes increase broadly at the same pace (4.4% a year) but the 5% highest saw their incomes increase by 6.2% a year on average (the fastest growth in the Eurozone) while the first quintile only saw an increase of 3.9%. This resulted in one of the largest inequality increases in our sample (Figure 3) even though France has seen the quickest income increase in the bottom 5% income during the crisis (+4.1% a year on average against an Eurozone average of 1.6%) among Eurozone countries. It is also notable that the lowest earners in Germany saw their incomes increase faster than the highest (2.4% a year on average, against 1.5%), probably as a consequence of strong employment gains

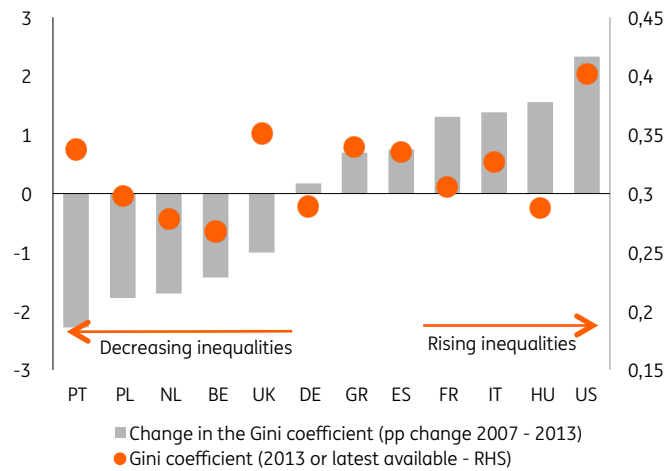
Notably because of the rise in inequality observed in France...

...although all income categories continued to rise in this country during the crisis

Finally, in the US, income growth (before the redistribution effect of taxes) increased with the quintiles: the higher the income, the higher the income growth between 2007 and 2013: 1.1% a year on average, but 0.6% a year for the lowest quintile and 2.5% a year for the highest 5%, meaning that inequality is likely to be on the rise, even after redistribution effects (Section 3).

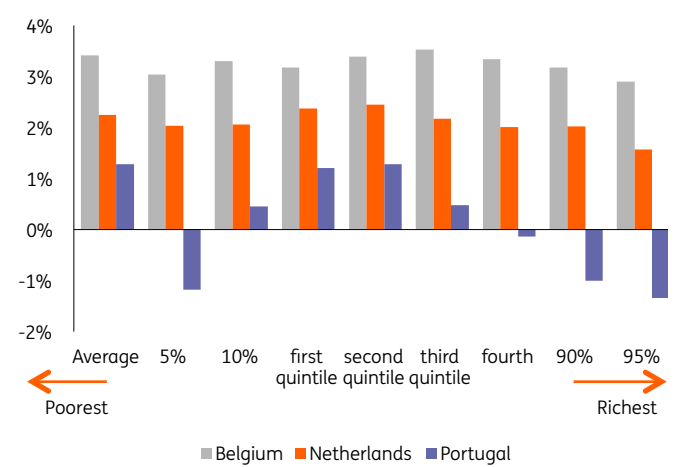


Fig 3 Inequality did not increase everywhere



Source: OECD\* (2015 database update)

Fig 4 Disposable income evolution per income group (%YoY avg; 2007-2013)



Source: Eurostat (ILC Database), ING calculations

**...and it decreased where the middle-class managed to maintain a comparatively high level of income growth**

If the highest incomes increased as much as the lowest during the financial crisis in the EU as a whole, only Belgium, the Netherlands and Portugal share this feature with the European average in our sample. This hides a particular phenomenon (Figure 4). In Portugal for example, the lowest and highest earners were affected likewise by the crisis, and much more than the middle-class: the 5% highest and lowest earners saw their income decrease by 1.2% a year on average between 2007 and 2013 while the two first quintiles of the Portuguese population saw their income increase by 1.2% a year on average.

A similar phenomenon can be observed in Belgium and the Netherlands, although at a lesser amplitude (in the sense that income growth rates in the different income categories were much closer to average). In Belgium, the 5% and 10% lowest income categories saw their incomes increase more rapidly than the 5% and 10% highest (3.0%/3.3% against 2.9%/3.2%, respectively) while the middle incomes increased more rapidly (+3.5% a year on average for the 3rd quintile for example). In the Netherlands, it is mainly the highest 5% incomes that increased less rapidly (which was mainly due to self-employed witnessing a decline in their billable hours), while the highest growth was observed in the 2nd quintile. As a result, inequality as measured with a Gini coefficient for example (see below - Figure 3<sup>8</sup>) actually decreased in the three countries. There was therefore some convergence of incomes in these three countries despite the fact that the lowest income earners endured one of the worst evolution of the country's income groups. As a matter of fact, we can also note that the only countries where the incomes of the lowest 5% category decreased were southern economies (Greece -8%, Italy -2.4%, Portugal -1.2% and Spain -0.15% per year on average).

Therefore, the importance of the middle-class resistance in the inequality variation process can be underlined. The income distribution is illustrated for the Eurozone in Figure 5 where we find that the median yearly disposable income in the Eurozone was 17,400€ per capita in 2013 (implying that 50% of the

**In some countries, inequality decreased because the middle-class fared better than the extremes**

**What is the “middle-class” ?**

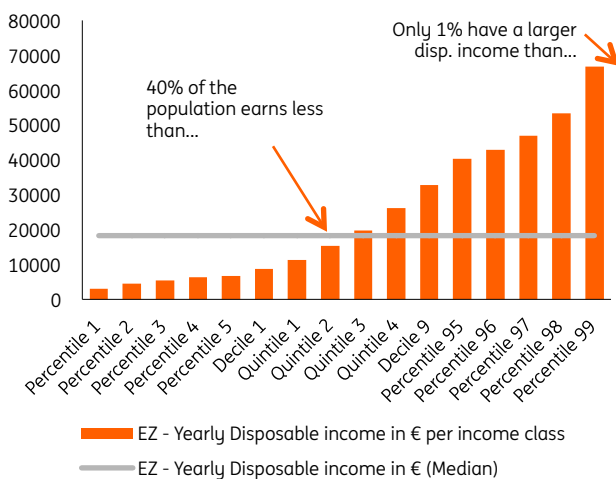
<sup>8</sup> The datasource being the OECD, EU, EZ and Romania have no published figures for their Gini coefficients. The Gini index measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of zero represents perfect equality and 1, perfect inequality.

**The middle-class income growth was the highest in France, Belgium and Spain during the crisis**

population therefore earned less than that in that particular year) while only 10% of the Eurozone population actually had a disposable income higher than 32,700€ a year (per capita).

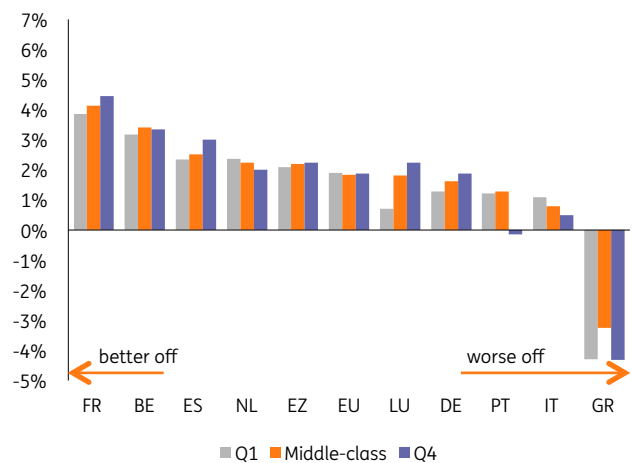
In figure 6, we therefore define the “middle-class” as the population whose yearly income is close to the median income. By comparing the average growth rate (yearly, over 2007-13) of incomes in the middle-class (median income, meaning that 50% of households have a lower income) to other incomes (20% lowest and 20% richest), we can already identify countries where the middle-class fared better than other classes, and than in other countries. For example, the Greek middle-class has been the hardest hit of all, but fared much better than the richest and poorest Greeks during the crisis. France is the country where the middle-class saw the largest income progression during the crisis, though it increased less rapidly than the richest incomes. As described before, in Belgium and Portugal, the middle-class saw the highest income progression of all income groups. As we will see in what follows, countries where the middle-class incomes were hardly hit by the crisis are also the most prone to a rise in inequality.

Fig 5 The income distribution in the Eurozone (in 2013)



Source: Eurostat (ILC Database), ING calculations  
 Please look at Annex 1 to have an idea of the income distribution per country

Fig 6 Disposable income evolution of the middle-class in the Eurozone (vs other income groups; %YoY avg; 2007-2013)



Q1: first cut-off point of the quintile distribution, 20% of the population is earning less - Q4 last cut-off point of the quintile distribution: 20% of the population is earning more  
 Source: Eurostat (ILC Database), ING calculations

**The largest increase in income inequality was observed in the USA...**

**In general, the situation has been worse outside the Eurozone**

To summarize (let's look back at Figure 3), the variation in each country's Gini coefficient confirm that Germany has seen barely any change in inequality since the start of the crisis, while in the US, France, Italy, Spain and Greece, inequality increased as the highest incomes saw a higher growth than the lowest. We can also note that the situation was worse in the United States where the higher the income class, the higher the income growth.

**...and the largest drop in Portugal**

At the other end of the spectrum, some countries actually saw a drop in inequality (like Portugal, Poland, the Netherlands, Belgium and the UK - Figure 3). This is however not necessarily positive in a Pareto sense (an evolution where nobody would have been worse off): in a case like Portugal, where only the middle-class fared better, income groups at the extremes (both poorest and richest) saw drops in incomes. Note that in Poland, incomes generally continued to catch up (increasing by a fast 8.0% on average), and that inequality ended up lower.

## 1.2 Inequality and age groups

### The youngest part of the active population (16 to 24 years old) was hit harder than the oldest (65+ years old) in all countries except Belgium and Germany...

**Inequality also increased between age groups...**

**...as the youngest appeared to be more vulnerable to the labour market shock**

As we analyzed in a previous report<sup>3</sup>, the financial crisis hit households' incomes in several ways, but the main drivers were labour market and investment incomes (total labour compensation and property income contributing negatively to income growth). These two sources of shocks were likely to hit households differently also depending on their age. The labour market shock was indeed more likely to affect the youngest while the property income shock was more likely to affect older households which had been saving money for longer to ensure their retirement.

We showed in the previous report<sup>3</sup> (Figure 7) that lower labour compensation contributions to disposable income growth was the main factor behind the income drop during the crisis and that property incomes contributed negatively to disposable income growth.

**Only in Belgium and Germany young and old saw their situation evolve in a similar way...**

Here, the age decomposition of income variations also shows that the youngest part of the active population (16 to 24 years old) was hit harder than the oldest (65+ years old). Figure 7 shows that it was the case in all sample countries except Belgium and Germany where income growth was similar in both age groups, and Poland where the still dynamic labour market favoured the youngest.

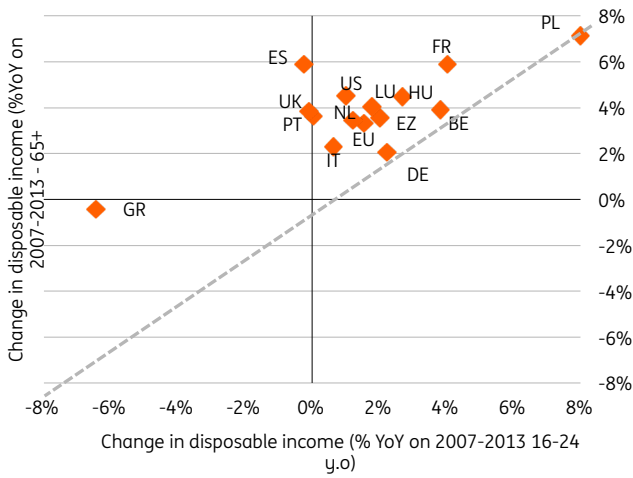
**...while in the US the cumulative growth gap reached 23% after 6 years**

In the US, the incomes of the 65+ increased on average by 4.5% a year between 2007 and 2013 while those of the youngest increased only by 1%, leading to a cumulative gap of 23% over six years. In the Eurozone, the disposable incomes of the 65+ increased on average by 3.5% a year between 2007 and 2013 while those of the youngest increased only by 2%, leading to a narrower cumulative gap of 9% over six years.

**In the Eurozone, it is Spain which saw the largest gap between young and old**

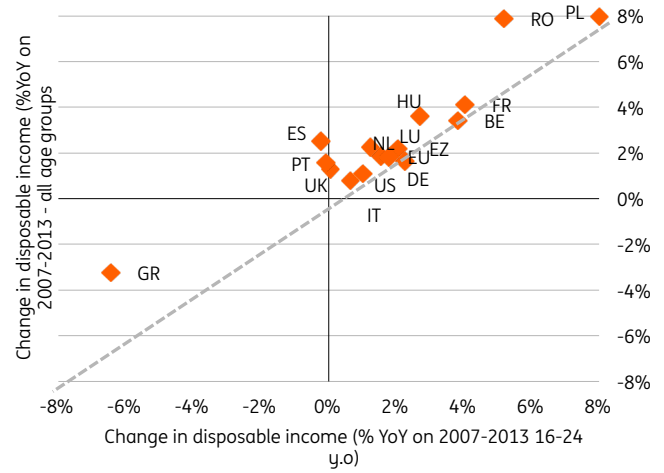
The countries where the incomes of the 65+ increased most in the Eurozone were France and Spain (both 5.9%), followed by Belgium (+3.9) and the UK. On the other side, the incomes of the youngest decreased most in Greece (-6.4%). In the UK, Spain and Portugal, they barely changed during the crisis. It is therefore Spain which saw the largest discrepancy between young and old (and is also the most far away from the diagonal in Figure 7), while in Greece for example, both categories saw large income drops. It can be explained in Spain through the fact that 2007 represents the end of booming years in the construction sector which were particularly supportive for young employment, while 2013 represents the peak of job destruction with the youth unemployment rate reaching 56.9%.

Fig 7 Disposable income evolution per age group (%YoY avg; 2007-2013)



Source: Eurostat (ILC Database), ING calculations

Fig 8 Disposable income evolution per age group (%YoY avg; 2007-2013)



Source: Eurostat (ILC Database), ING calculations

**...and it also saw its income evolve less favorably than the average population**

Finally, Figure 8 also shows that the youngest were particularly vulnerable to the crisis developments, not only compared to the oldest, but also compared to the average population, most probably through the labour compensation shock. In all countries, their income increased at best as rapidly as the national average. In the case of Greece, the youngest's incomes decreased faster than the average.

**The crisis hit the youngest disproportionately when their situation is compared to the average**

The largest growth gaps between the youngest and the average are to be found in Spain, Greece, Portugal, the UK and the US. This analysis therefore confirms the widespread perception that the crisis hit the youngest disproportionately, not only because the labour market compensation was the main factor behind households' income drop, but also because the youngest were the most vulnerable on the labour market, as we show in Section 2. In some countries the income growth discrepancy between older and younger can also be linked to variations in the Gini coefficient, showing that intergenerational inequality also matters for a country's inequality level as a whole.



## 2 The labour market can reinforce inequality

Non-standard workers are more likely to be young, less-educated, and living in a Southern European country if they are not voluntarily on non-standard contracts

**Variations in labour conditions naturally have an impact not only on incomes but also on their distribution**

As labour compensation was found to represent 75% of a household disposable income in our country sample (Cf. our previous report<sup>3</sup>, p20 Figure 21), a figure also valid as the OECD average, variations in labour conditions naturally have an impact not only on incomes but also on their distribution. The crisis indeed first hit the most vulnerable types of employment: temporary, part-time and self-employed (named as NSW, non-standard work).

Eurostat (Labour Force Survey<sup>9</sup>) data shows that in 2013 some European countries were making an extensive use of NSW contracts (Figure 9). The record is observed in the Netherlands (57.6% of contracts) because the survey exceptionally uses a threshold of 35 hours to define part-time work in that case.

**Among these, the importance of non-standard job contracts must be underlined for its role in inequality developments**

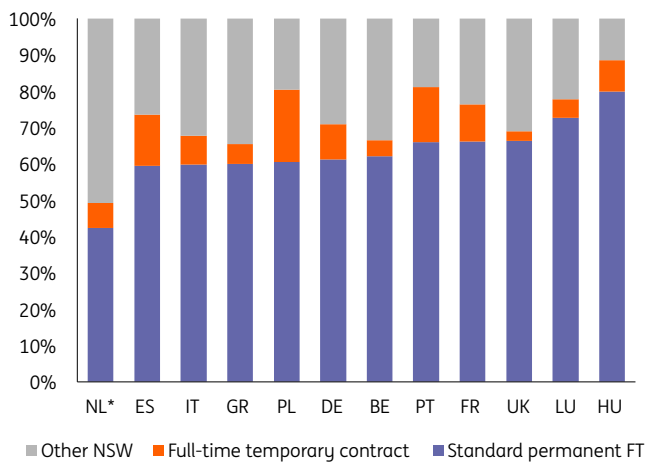
More significantly, we find that in half of our country sample, at least 40% of contracts were not standard (full-time permanent contracts) in 2013, with France, Portugal, Spain and Poland making a more extensive use of full-time temporary contracts than others. The same dataset also shows that NSW workers are likely to be paid less (from 30% less in Belgium and Poland to 20% in Greece and the UK – for a full-time temporary contract, compared to the standard permanent one); and to be young and low-skilled. As Figure 10 shows: this is especially true in some southern countries (Italy, Spain and Greece), Germany and the Netherlands where NSW is more present among the youngest or less educated (sometimes both) parts of the working population than in the country average.

One should however note here that part-time employment for example is not necessary an involuntary choice. In Eurostat labour force survey (2013), 90% of Belgian and Dutch respondents declared that part-time working was voluntary. At the other end of the scale, less than 35% of part-time workers surveyed in Greece, Spain and Italy said so.

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<sup>9</sup> The survey allows to characterise the respondents' main job in full-time/part-time categories. The distinction between full-time and part-time work is generally based on a spontaneous response by the respondent. The main exceptions are the Netherlands and Iceland where a 35 hours threshold is applied, Sweden where a threshold is applied to the self-employed. Note that involuntary part-time employment is when respondents report that they work part-time because they are unable to find full-time work. For more information: [http://ec.europa.eu/eurostat/statistics-explained/index.php/EU\\_labour\\_force\\_survey\\_-\\_methodology#Employment\\_-\\_principal\\_activities\\_and\\_professional\\_status](http://ec.europa.eu/eurostat/statistics-explained/index.php/EU_labour_force_survey_-_methodology#Employment_-_principal_activities_and_professional_status)

Fig 9 Where was NSW used most in 2013?



\*see footnote 9  
Source: Eurostat, OECD, ING calculations

Fig 10 NSW workers are more likely to be young and less educated (2013)



Source: Eurostat, OECD, ING calculations

**NSW growth helped the incomes of the poorest grow during the crisis, but it is unlikely to put the lowest incomes on a sustainably higher income growth path**

The prevalence of non-standard job contracts help explaining why inequality can keep rising in periods of employment growth

In a recent report based on the same dataset, the OECD showed that growing levels of NSW help to explain the puzzle of increasing inequality despite aggregate employment growth prior to the global economic crisis as “while not all low-wage non-standard workers live in low-income households, households with non-standard work arrangements are overrepresented at the lower end of the household income distribution” (OECD<sup>10</sup>). The report showed that up to 20% of the increase in inequality in the OECD prior to the crisis (1995-2007) could be attributed to the rise in non-standard contracts.

Non-standard job contracts helped the income growth of the poorest (though not everywhere)...

Afterwards, during the crisis, standard employment fell in most countries (Figure 11), while temporary contracts were not renewed, so that the main positive contributors to employment growth were the other types of NSW (part-time or self-employment). On the one hand, we can say that it improved conditions of low income groups: Figure 12 shows that countries that saw the largest NSW growth contribution also saw the quickest income increase of the lowest 5% of incomes (France, Germany, Belgium and the UK). One could therefore wonder what would this growth have been without these more flexible type of employment.

...but did little to limit the rise in inequality

However, on the other hand, this expansion of NSW is unlikely to put the lowest incomes on a sustainably higher income growth path: firstly because NSW did not grow everywhere. In countries like Greece, Spain<sup>11</sup> or the Portugal (where NSW actually decreased during the crisis), the lowest incomes behaved less positively between 2007 and 2013. And secondly because NSW is not necessarily a stepping stone to more permanent contracts: for example, only 20% of French temporary workers in 2008 moved into full-time, permanent contracts by 2011, compared with 49% in the UK, OECD data showed. The increase in job insecurity is therefore likely to continue to raise inequality.

<sup>10</sup> OECD (2015) “In it together: Why less inequality benefits all” (pp136-138) <http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm>

<sup>11</sup> Labour market rigidities in Spain led to an overuse of temporary contracts in pre-crisis years (in particular in the construction sector) and therefore to a dramatic cut in the aftermath of the financial crisis.

Finally, we can see that countries where the largest gap between the income growth of the youngest and the average population was observed on Figure 8 are also countries where between 40% and 60% of the young working population are in NSW on Figure 10: Greece, Spain, Italy and Portugal (where a majority of part-time work is involuntary). Also note that in France (where as we showed the rise in inequality is rather due to the highest incomes' quicker growth), almost one out of two young workers is also in a NSW contract whereas NSW contracts represent only 34% of total employment.

Fig 11 Standard work decreased in most countries during the crisis

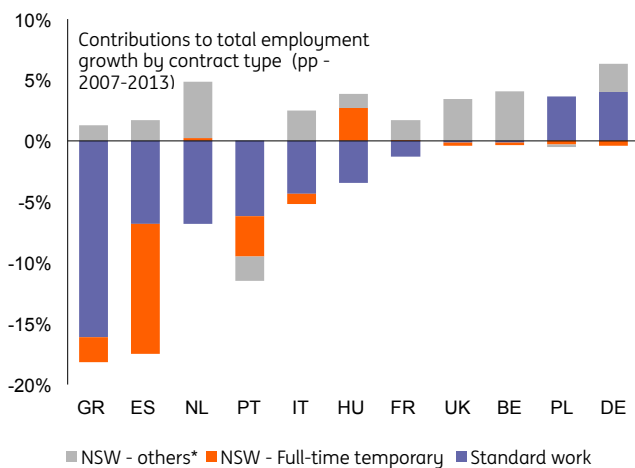
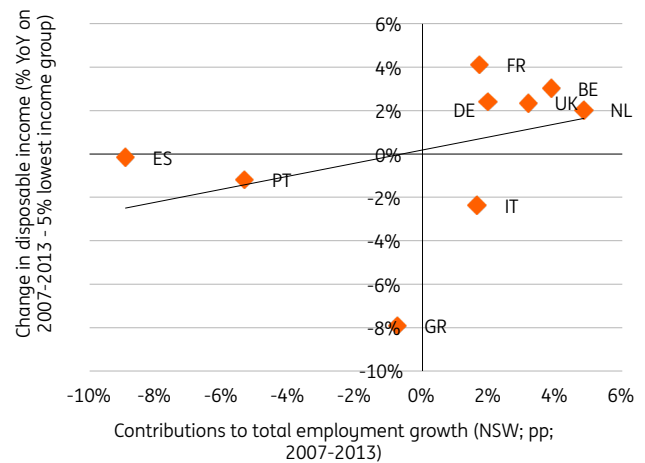


Fig 12 NSW growth helped the poorest incomes



\*Others include self-employment, permanent part-time and temporary part-time  
Source: Eurostat, OECD, ING calculations

Source: Eurostat, OECD, ING calculations

**More flexible labour markets can increase inequality**

All in all, the vulnerability of the NSW workers, in particular the youngest, and more generally the flexibility of the labour market, matter in explaining intergenerational and cross-income inequality increases. This illustrates the fact that more flexible labour markets can increase inequality when flexibility comes without strong redistribution mechanisms (social transfers<sup>12</sup> that benefit the poor most – see below) or automatic stabilisers (that ensure high replacement incomes – see below). This is why we examine the different social policies put in place in our sample countries to help explain the increase in income inequality in general, and the increase in intergenerational inequality in particular.

<sup>12</sup> While earnings constitute the bulk of household income, other income components such as taxes and benefits play a role in the evolution of income as we saw in a recent ING report (<http://www.thinkforwardinitiative.com/news/2016/seven-fat-years-seven-lean-years>). In some countries the total share of social transfers can represent up to one fifth of household incomes. They therefore also play a role in shaping inequality, especially in countries where they benefit the rich disproportionately.

## 3 How and where fiscal redistribution did help...or not

The risk of seeing a rise in inequality was higher where the welfare state was less efficient...

In this section, we come back to the fact that labour compensation and property income variations were the main engines behind the drop in income growth during the crisis. We showed in sections 1.1 and 1.2 that different evolutions in inequality can be observed in our sample of countries, and we showed in section 2 that a way to explain them was the evolutions of the labour market itself, before and during the crisis, that particularly hit the most vulnerable workers.

The way welfare states helped the most hardly hit to overcome the labour market shock also explains the rise in inequality

A second way to explain the diversity in inequality trajectories is to look at the efficiency of the different mechanisms put in place in the various welfare states of our sample to compensate for the shocks, whether they stem from the labour market (in particular for the youngest workers) or the drop in saving income or austerity-induced pension adjustments (in particular for the 65+ population). As these are OECD data, the US can be included in the sample countries, but Romania cannot and there is no aggregated data for the EZ or the EU.

Automatic stabilisers and redistribution intensity can be measured...

Figure 13 shows in which countries automatic stabilisers<sup>13</sup> were less effective and where the redistribution intensity of social transfers<sup>14</sup> was weak. The likelihood of seeing inequality rising was therefore larger in these countries after the first income shock of the crisis. Indeed, if redistribution intensity is important, the strength of automatic stabilisers also matters because as the lower income groups are more dependent on labour compensation, the extent to which its loss is compensated will determine the jump in inequality between those still on a job and those who lost it.

...and were both weaker in the US and southern Europe

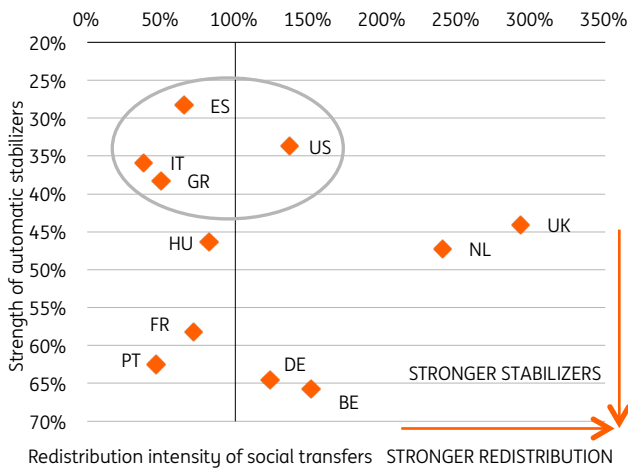
In Spain, Italy, Greece and the US (to a certain extent, Hungary too), we see that automatic stabilisers were weaker (less than 40% of a negative shock is compensated for by the welfare state) and that the redistribution intensity of social transfers was relatively weak (the poorest actually benefit less from the welfare state than others in Hungary, Spain, Italy and Greece).

<sup>13</sup> The “*Strength of automatic income stabilisers*” is a coefficient that shows how changes in market income translate into changes in disposable income. The higher the coefficient, the stronger the stabilisation effect – eg, a coefficient of 0.4 denotes that 40% of the earnings shock due to higher unemployment is absorbed by the tax benefit system. The income changes are simulated based on EUROMOD (EU countries) and TAXSIM (United States) for an increase in unemployment of 5 percentage points. **Source: OECD**

<sup>14</sup> The ratio expresses how much more social transfers (than the highest 30% income group) the lowest 30% income group does receive. For example, if the lowest income group receives on average 120 (with the average transfer in the country being 100) and the highest income group receives on average 80, the index will be  $120/80 = 150\%$ . Hence countries where redistribution is stronger and the poorest receive more social transfers than the richest on average will have an index above 100%. **Source: OECD**

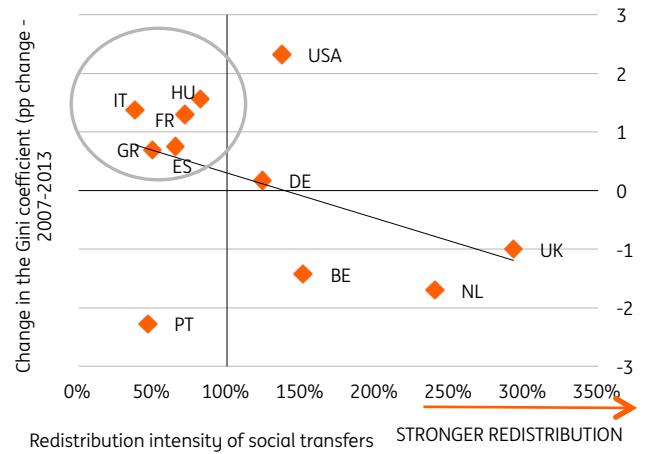


Fig 13 Some countries had less generous and less redistributive social systems...



Source: OECD (2012 data)

Fig 14 ...which gave rise to more inequality



Source: OECD, ING calculations

By contrast, countries like Belgium or Germany have a higher level of income shock compensation (more than 65% of the shock is absorbed through social transfers) while their poorest population generally benefits more than the richest from social transfers. In the Netherlands and the UK, the poorest population benefits even more from social transfers than in Belgium or Germany, but less than half of an income shock is compensated in these two countries. Finally, France and Portugal both have strong automatic stabilisers as more than 55% of an income shock is compensated for by the welfare state, but their redistribution system is prone to inequality as the richest households benefit from it disproportionately.

**...especially as the employment shock primarily happened there...**

**The countries that endured the largest shock to employment are also those whose welfare state was the least prone to compensate the poorest**

If we look back to Figure 11 where employment growth was presented, we see that the countries that endured the largest shock to employment are also those whose welfare state was the least prone to compensate the poorest households against this shock (Greece, Spain, Italy). As a consequence, the employment shock was disproportionately felt by the poorest who saw a more negative disposable income evolution (measured after the redistribution has taken place) than their national average (which is why these countries were also identified on Figure 1 above). As a result, these countries were also identified in Figure 3 where we presented the rise in inequality.

Still looking at Figure 11, Portugal and the Netherlands also endured large employment shocks. In Portugal, where the income shock was still strongly felt in 2013 (Figure 11), we see on Figure 13 that this income shock was highly compensated, which explains why the middle-class finally saw a relatively favorable evolution of incomes, hampering an increase in inequality (the Gini coefficient dropped). However, the fact that social transfers benefited less to the poor than in other countries may explain partly why the poorest saw their incomes decrease while the national average grew (Figure 1). By contrast, the Netherlands – which in 2013 were also still enduring the effects of the employment shock – have a more redistributive social system that may help explaining why the poorest saw their income growing as fast as the national average.

**The austerity period that followed did not improve the situation**

Finally, we also see in Figure 13 that France has a weaker compensation system than Germany: not only is the income shock less compensated by transfers, but the redistribution is also less intensive, which helps explaining the rise in inequality.

**...and was often followed by austerity**

The austerity period that followed the first shock of the crisis also helps explaining cross-country differences. Indeed, during 2007 and 2010, all countries in our sample (except Hungary) saw a drop in their (cyclically-adjusted<sup>15</sup>) primary balance to GDP ratio. As the figures are adjusted for automatic stabilisers, this shows that fiscal policy had to go well beyond the traditional adjustments to face the crisis, notably to face the financial part of it (the worst cyclically-adjusted primary balance developments took place in Spain, the UK and Portugal).

In the years that followed (2010-13), the (cyclically-adjusted) primary balance-to-GDP ratio deterioration registered between 2007 and 2010 was reversed almost everywhere (not in Greece - Figure 15), with some countries seeing large reversals: more than 8% of GDP in Spain, 7.5% in Italy and 7.3% in the UK. The largest correction was observed in Portugal where the cyclically-adjusted primary balance improved by almost 12% of GDP between 2010 and 2013.

In other countries, the efforts were more limited, allowing for more room in terms of social spending: France and the Benelux countries saw a correction in their (cyclically-adjusted) primary deficit to GDP ratio of less than 5% in four years.

**Finally, the weakest welfare states also experienced the largest employment shocks, and therefore saw a larger rise in inequality**

In Figure 14, we can see that the redistribution intensity of social transfers may indeed be linked to the rise in inequality observed between 2007 and 2013 (the exceptions being Portugal and the US). It is also an indication that more generous welfare states (Belgium, the Netherlands and Germany) can afford a more flexible labour market (characterized by a more intensive use of NSW): as long as they ensure a reasonable degree of redistribution, inequality does not increase necessarily as a consequence. Flexibility of these regimes should however not be overstated: in the Netherlands for example a large part of non-standard contracts are permanent part-time, often reflecting personal choices, which are not necessarily more flexible contracts than the standard ones. Finally, France is again a special case from this point of view as despite the good reputation of the French social system, it failed to compensate the poorest more than the others and to protect non-standard workers through a more intensive redistribution system.

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<sup>15</sup> To highlight the discretionary change in fiscal policy (and hence the fiscal effort beyond automatic stabilisers), we use the cyclically-adjusted balance. As such, the cyclically-adjusted balance is computed to show the underlying fiscal position when cyclical or automatic movements are removed.

## 4 Poverty risks are on the rise, but for whom?

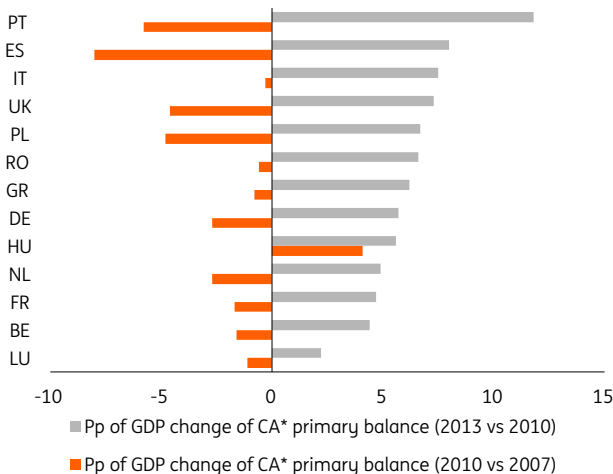
Now that we have shown how inequality evolved and that we examined two possible sets of explanations for the different evolutions observed in our country sample (labour market organisation and welfare state discrepancies), let's look at its consequences. We will look at two types of consequences: first on society, then on economic recovery prospects (Section 5).

### The poverty risk increased almost everywhere...

One side-effect<sup>16</sup> of rising inequality after a strong economic shock as the financial crisis can be the rise in poverty<sup>17</sup>, especially where the welfare state is weaker. This can have consequences on society as a whole as the rise in poverty can vary between the different age groups, or as it drives the average life satisfaction downwards. In terms of poverty, the previously described patterns (Sections 1-3) led not only to a rise in poverty, but also to a deepening of poverty (the poorest becoming poorer) and to differentiated impacts in the various age groups (Figures 17-18).

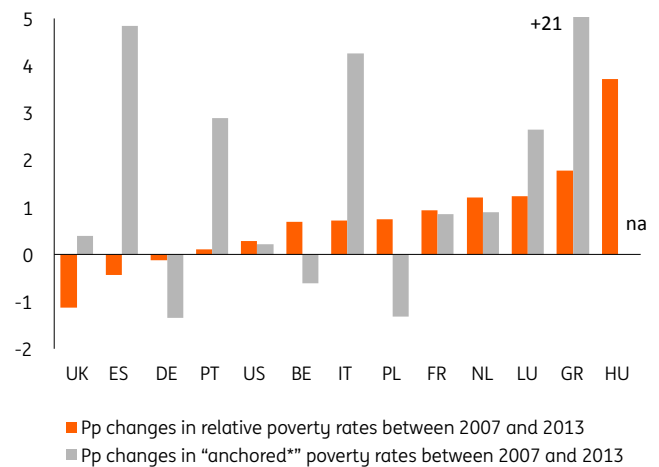
The increase in inequality goes hand in hand with higher poverty, both absolute...

Fig 15 Austerity added to the woes



\*CA: cyclically-adjusted  
Source: EU Commission

Fig 16 Some countries endured a large jump in poverty



\*or absolute poverty, see text below for more explanation  
Source: OECD, ING calculations

### ...and relative

As changes in relative poverty (referring to the current median income - orange bars) can be difficult to interpret during recessions (when the current median income decreases fast, the benchmark gets lower and relative poverty may just not move), more "absolute" poverty indices, linked to past living standards,

16 Note that in general there is no reason for more inequality to imply higher poverty. For example, in developing countries where a urban class emerges, inequality increases as some get richer, without the others becoming poorer. In the present case however, given that we use a measure of poverty which uses a benchmark income, the different variations of incomes during the crisis (which gave rise to inequality variations) also have implications for poverty.

17 People are classified as poor when their equalised household income is less than 50% of the median prevailing in each country. The use of a relative income threshold means that richer countries have the higher poverty thresholds. Higher poverty thresholds in richer countries capture the notion that avoiding poverty means an ability to access to the goods and services that are regarded as customary or the norm in any given county. The poverty rate is a headcount of how many people fall below the poverty line.

Source: Data are from the OECD Income Distribution Database available at [www.oecd.org/social/income-distributiondatabase.htm](http://www.oecd.org/social/income-distributiondatabase.htm).

provide interesting information to complement the picture provided by relative income poverty. In Figure 16, changes in poverty are also presented using an indicator which measures poverty against a benchmark “anchored” to half the median real incomes observed in 2005 (grey bars).

We see that in France and the Netherlands, both measures show a similar result (a 1pp increase in the poverty rate during the crisis period), but that in Southern Europe (Portugal, Italy, Spain and especially Greece) changes in anchored poverty testifies of the consequences of dramatic income losses: in Greece the absolute poverty rate reached 33% in 2013 when the 2005 reference income is taken into account, followed by Italy (15%). Even the relative poverty rate was higher in 2013, reaching between 12% and 15% in Southern Europe (Italy Portugal, Spain, Greece from the lowest to the highest) and 17.6% in the US while the relative poverty rate remained below 8.5% in the Netherlands and France.

**At least one of both measures of poverty increased everywhere except in Germany**

In Figure 16, we see that at least one of both measures of poverty increased everywhere except in Germany where relative poverty increased marginally between 2007 and 2011 (from 8.5% to 8.7%) but came back to 8.4% in 2013. However, in some countries, only one of them increased. For example, in Belgium, Germany or Poland, absolute poverty decreased as all incomes continued to increase during the crisis, lowering the risk of poverty as growing incomes are kept being compared to past medians. However, as each country’s median income also increased as a result, relative poverty ended up higher.

#### **...but old and young are not equal in terms of poverty**

**Data shows that poverty risks are higher for the younger households in all countries except the UK and the US,...**

We can also look at poverty risks from an intergenerational point of view. Looking at 2012 (last available year for the age decomposition) data shows that poverty risks are higher for the younger households in all countries except the UK and the US (Figure 17). Moreover, Figure 18 shows that during the crisis, poverty increased among the young while it decreased among the elderly. The only exceptions are Germany (where both groups saw their poverty rate decrease at the same pace) and Poland (where both groups saw their poverty rate increase at the same pace).

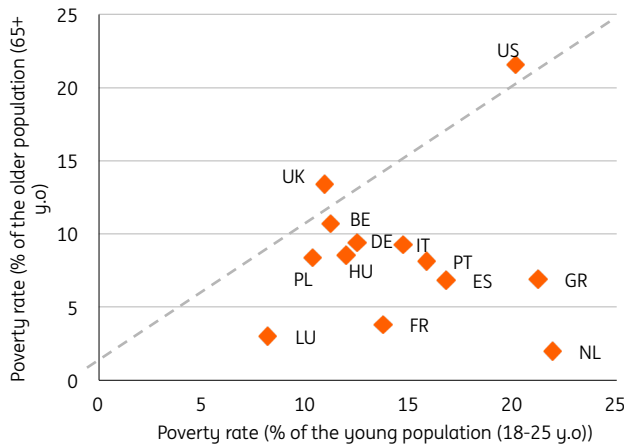
**...with the largest discrepancies between old and young being observed in southern Europe**

The largest discrepancies between both age groups were observed in southern Europe (Greece, Spain and Portugal). In other words, the discrepancy in income developments between old and young created discrepancies in poverty risks between age groups. Finally, note that it can of course also be linked to non-standard work occurrence described in Section 2: for example, the OECD<sup>18</sup> points to the fact that “poverty risks are ten times higher if NSW is the (household’s) main source of earnings rather than if NSW live with a standard worker”. In the Netherlands for example, which appear to have the young population most at risk of poverty, we observed (Figures 9 and 10) that NSW has a higher occurrence among the young than among the average population while the average is already very exposed (more than half of contracts are not standard).

<sup>18</sup> OECD (2015) “In it together: Why less inequality benefits all” (pp138-139)  
<http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm>.

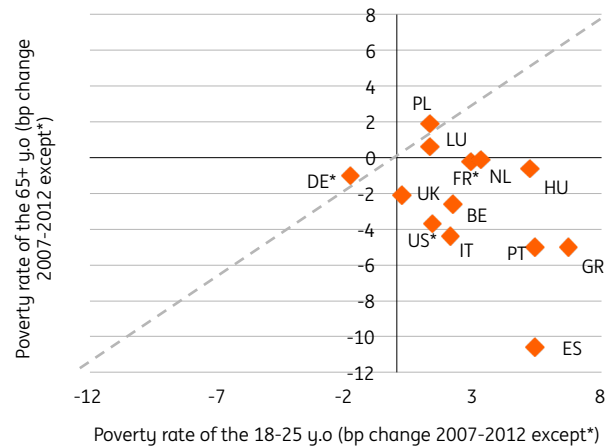


Fig 17 The younger are more at risk of poverty...



NB: 2012 is the last available data  
Source: OECD, ING calculations

Fig 18 ...and have been getting poorer



NB: 2012 is the last available data; \*where 2007 was not available, 2008 was used instead  
Source: OECD, ING calculations

The perceived level of inequality can impact life satisfaction...

The perceived level of inequality has an impact on life satisfaction

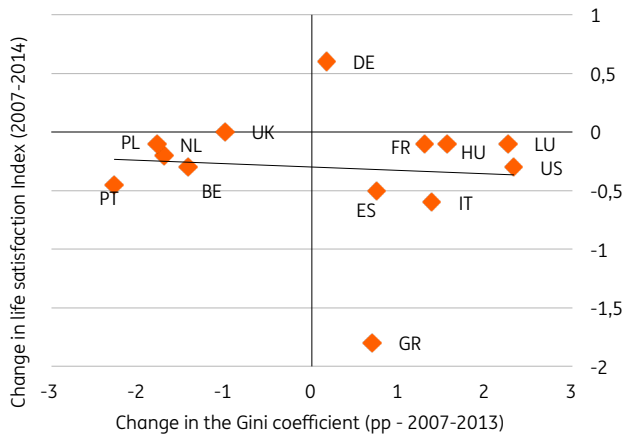
More generally speaking, there can be a relationship between life satisfaction and the perceived level of inequality, simply (as suggested by Dawes<sup>19</sup> for example) because people have a genuine dislike for inequality, or because (as suggested by Piketty<sup>20</sup>) they feel they could be better off if society was more equal. Behavioural economists<sup>21</sup> have also emphasised the importance of relative incomes in driving people’s happiness and self-esteem. A complete literature review on this theme can be found in a recent report by Ferrer-i-Carbonell and Ramos<sup>22</sup> which reviews the reports that estimate or examine the relationship between inequality and self-reported happiness to conclude that inequality correlates negatively with happiness in Western societies (and that evidence for non-Western societies is more mixed and less reliable).

...but during the financial crisis life satisfaction decreased foremost because of the negative income shock

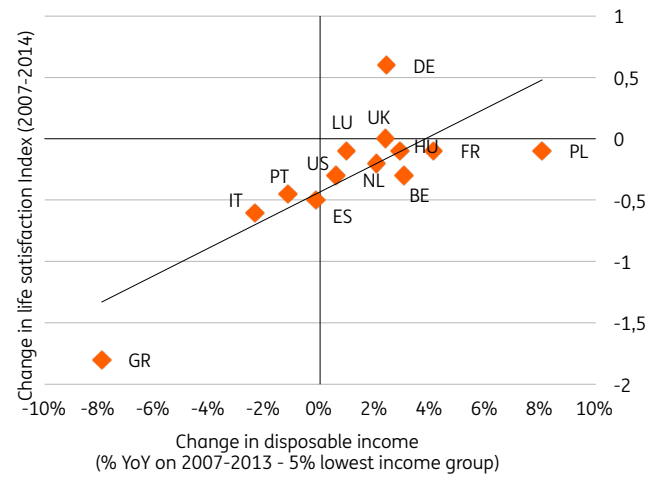
In Figure 19, we simply show the relationship between the Gini index and changes in life satisfaction during the crisis. We see that life satisfaction decreased everywhere except in Germany, independently of the rise in inequality. Of course countries where inequality increased a lot saw a drop in life satisfaction, but in countries where the drop in the Gini index is due to some kind of income convergence (Belgium, the Netherlands and Portugal), life satisfaction decreased as well. This shows that not only the relative evolution of incomes matters, but that – in cases as extreme as the financial crisis – so does the absolute level of income growth. This is what we see in Figure 20 where the correlation between life satisfaction changes and income evolutions of the poorest is more clearly positive.

<sup>19</sup> Dawes, C.T., J.H. Fowler, T. Johnson, R. McElreath, and O. Smirnov (2007), “Egalitarian motives in humans”. *Nature*. 446, 794–796.  
<sup>20</sup> Piketty, T. (1995), “Social Mobility and Redistributive Politics”. *The Quarterly Journal of Economics*, 110, 551–84.  
<sup>21</sup> Like Nobel prize winner Daniel Kahneman or Dr J-E De Neve recently in the Harvard Business review: <https://hbr.org/2016/01/income-inequality-makes-whole-countries-less-happy>.  
<sup>22</sup> Ferrer-i-Carbonell and Ramos (2014) “Inequality and Happiness”; *Journal of Economic Surveys* Vol 28 issue 5.

Fig 19 The correlation between life satisfaction and inequality does not appear during the crisis... Fig 20 ...as income evolutions seem to matter more



Source: OECD, ING calculations



Source: OECD, ING calculations

## 5. A recovery is no guarantee of poverty reduction

The inequality challenge is different in the various country groups previously identified...

In the previous sections, we showed where and how inequality increased (income, age and country groups), and the role that labour market developments played in this trend. We then looked at different welfare systems and at their efficiency in limiting the inequality increase and avoiding large jumps in poverty. We saw that in countries where inequality increased most and where the poorest incomes decreased most, there was a heightened risk of poverty and life dissatisfaction. In countries like Spain, Italy, Greece or the US, the shock was worsened by the lack of efficient safety nets.

Conversely, some countries with more efficient welfare systems succeeded in limiting the rise in inequality: in Belgium, the Netherlands and Portugal, the middle-class fared well, with the poorest faring better than the richest in Belgium or the Netherlands, while in Portugal only the middle-class fared better (with the lowest and highest income classes being affected more negatively). In Germany, inequality barely changed during the examined period (2007-13), whether between income classes or between age groups. An efficient welfare state and a limited contribution of NSW to total employment growth were certainly helping factors.

Finally, France stands out with a more mixed result: although the welfare system compensates for most of an income loss, it is one of the least redistributive (like in Italy or Spain). We therefore saw that inequality increased even if all income groups saw their income increase (because the higher the income, the higher the income growth). Here also, the redistribution system is not the only factor at play: another explanation could be the importance of NSW for the younger population and the fact that NSW was the main engine of the very weak employment growth registered in France in the past years. We therefore have different situations, with different degrees in inequality developments and different engines behind it.

### **...but employment growth appears at the center of inequality reduction everywhere**

As labour income is the most important driver of incomes for the poorest, a stronger labour market would logically be the most important driver of their income (which is the lowest quintile in the income distribution). It may even be that poorer households will finally benefit more than the richest from higher employment growth, allowing for inequality to decrease. For this to be true, we need to see a higher income growth among the poorest in times of growing employment (than among the richest). If and where it is not the case, any successful economic recovery (even in terms of growth and job creations) will not reduce inequality.

### **But is employment growth really benefiting the poor most?**

So, in the years before the crisis (2000-07), when employment growth was stronger, did incomes increase faster among the poorest (than among the richest)? In fact, it was not the case (which mirrors the lack of cross-country convergence shown in a recent ING report<sup>3</sup>), or at least not everywhere (Figure

The inequality challenge is different in the various country groups previously identified...

...but employment growth should appear at the center of inequality reduction everywhere...

...if employment growth benefits the poor most

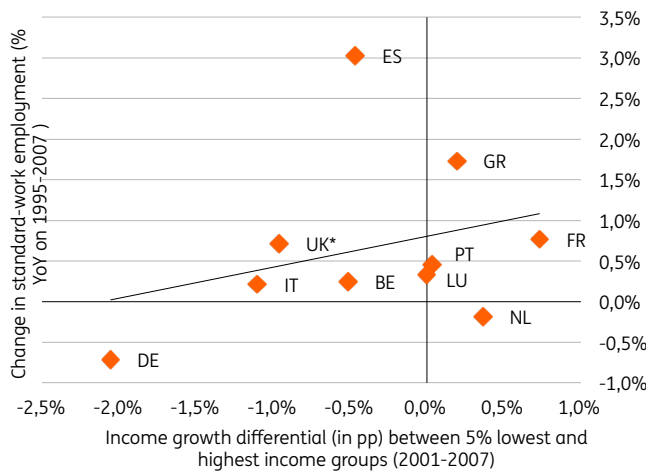
We cannot say that in our sample a higher employment growth allowed for lower income inequality before the financial crisis...

...so that the link between growth and inequality reduction is not straightforward

21). Besides, before the crisis, unemployment did not decrease faster in population groups where the poor are overrepresented (the population with the lowest education level for example, as unemployment data is not available per income groups). This suggests that the link between growth and inequality reduction is not straightforward. As a result, we cannot say that in our sample a higher employment growth allowed for lower income inequality before the financial crisis (or a quicker income growth for the lowest incomes than for the highest).

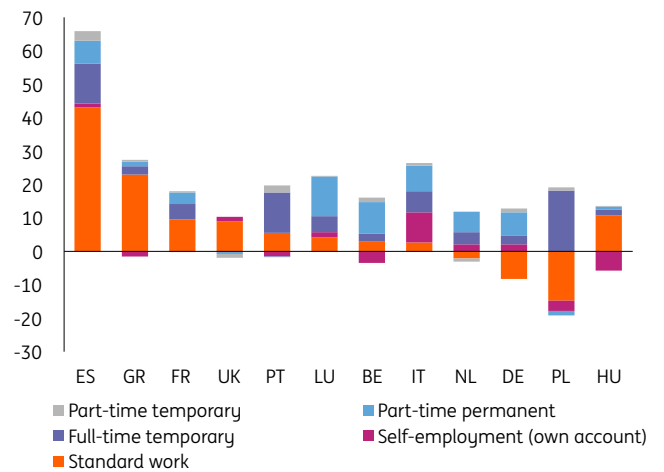
However, countries where a higher standard-work growth (growth in the number of full-time permanent contracts) was observed (Figures 21 and 22) saw less inequality growth than others. In other words, countries where standard work contributed most (ES, GR, FR, UK) to employment growth saw a lower income growth gap (between low and high incomes) before the crisis.

Fig 21 Before the crisis, standard work growth helped reducing inequality in the Eurozone



\*UK (1<sup>st</sup> and 9<sup>th</sup> deciles cut-off points)  
Source: OECD, ING calculations

Fig 22 Contributions (in pp) of different employment types to the total growth of employment (1995-2007)



Source: OECD

**The recovery brings higher growth and more jobs, but this is generally not sufficient to bring inequality down**

More growth is therefore no guarantee for less inequality

This is an important result, as even if an economic recovery takes place and indeed creates more employment growth, it is not a guarantee to see income inequality decrease as a result. Of course, it does not mean that the poorest do not benefit from the economic recovery: as they are disproportionately represented among the unemployed, even growth in NSW work brings them more income than no work at all so that they end up better in absolute terms. But if they do not benefit more than others from it, income inequality can keep increasing. For this to be the case, unemployment should fall faster than average amongst the poor and the recovery cannot produce only non-standard contracts. The good news is that one indeed observes that the unemployment rate has decreased faster in the most vulnerable groups (the lowest educated, a group in which the poorest are overrepresented) since 2013. Though it is possible that the likely recent decline in inequality has probably been hampered by the importance of non-standard contracts.

All in all, this reminds us that if an economic recovery can create the tide that will lift all boats (or increase the likelihood of finding a job for everybody), structural

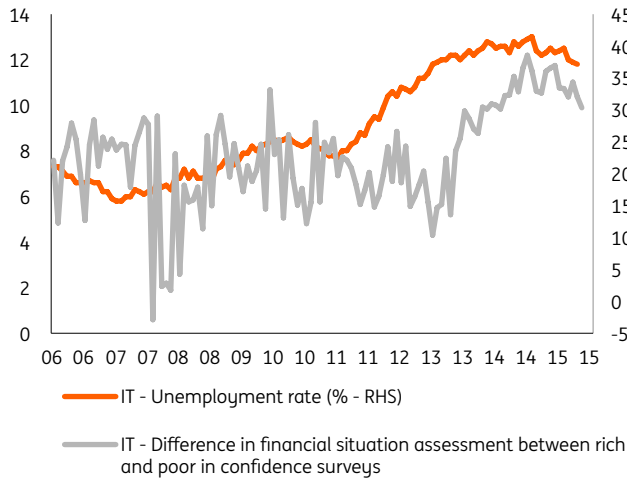


**Without labour market reforms, higher employment growth may well continue to come together with higher inequality**

reforms are also needed to ensure that all boats remain together (or that inequality does not increase further as a result). Here, we see that there are conditions for the recovery to decrease income inequality: more redistributive welfare systems together with labour market reforms that allow for faster employment growth amongst the poor and that make a non standard contract only either an individual choice or a step towards more permanent, full-time contracts. Creating non-standard jobs is not wrong per se, but a flexible labour market must allow for an upward mobility across the different contract types. Without that, stronger employment growth can make that poorer unemployed have more chance to get a job, but not necessarily that their income growth will stick to the averages.

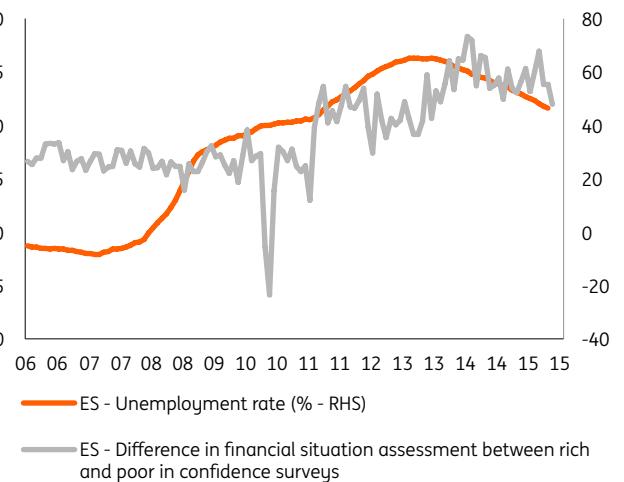
For example, in countries like Italy and Spain, where the poorer and younger quartiles of the population suffered disproportionately during the crisis (Figures 2 and 8), it is possible that the recovery will also benefit them more. At least, that is what the European Commission confidence survey seem to suggest: in both countries, the poorer households are expressing a faster recovery (than the richer) in the assessment of their own financial situation thanks to the decrease in unemployment (Figures 23 and 24). In countries where income inequality decreased simply because the middle-class fared particularly well (Belgium, the Netherlands and Portugal), policies targeted to the lowest income workers will be key to continue reducing inequality when the recovery will bring more employment growth.

**Fig 23 The decrease in unemployment induces a quicker improvement of the poorest income...**



Source: European Commission

**Fig 24 ... groups' financial situation in Italy and Spain, allowing for a decrease in inequality**



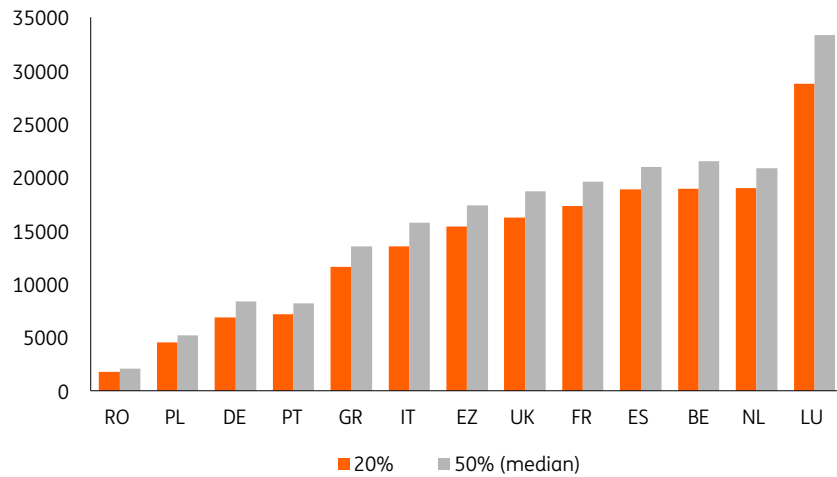
Source: European Commission

Finally, the case of Germany stands out as what strikes is its remarkable social cohesion: marginal changes in inequality (from a very low level), marginal changes in poverty, and no significant difference between old and young although the young are more in NSW.

# Annex 1

The income distribution in EURO: what is the maximum income earned by the poorest 20% of the population and how it compares to the median income

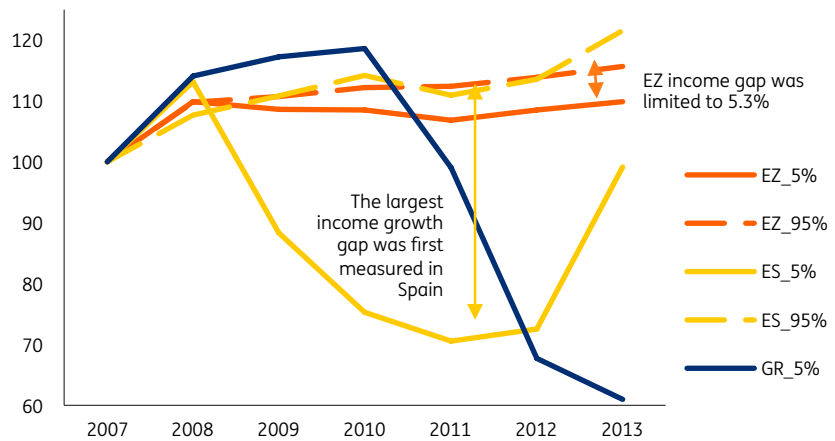
Fig A.1



Source: Eurostat (ILC Database)

# Annex 2

Gaps in income growth  
(5% poorest and richest – 2007 Disposable Income = 100)



Source: Eurostat (ILC Database), ING calculations

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