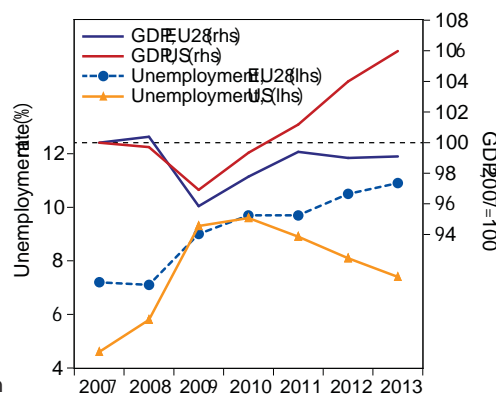


EUROPE'S SOCIAL PROBLEM AND ITS IMPLICATIONS FOR ECONOMIC GROWTH

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3. For example Alvaredo et al (2013).

4. Three quarters of the reduction in inequality is due to transfers, while the remaining quarter is the consequence of direct household taxation, according to OECD (2012a).

5. For a comprehensive overview of the developments of social indicators in Europe, see Darvas et al (2014).

6. In Table 1 we grouped countries into a few broad groups for readability.



in the long term. In the short-term, there are different dynamics. Deep recession can lead to significant increases in unemployment and thereby affect long-term growth. A number of different channels can be identified.

A first and important line of argument is that rising income inequality has led to excessive borrowing by low-income households, which eventually became unsustainable. In the US, there is strong evidence¹¹ that with the decreasing amount of income going to the bottom 95 percent of the income distribution, those

households borrowed on a substantial scale and they did so to

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9. Poverty among the elderly declined up to 2010, but increased slightly in 2011-12, though there was a decline overall between 2007 and 2012, as Figure 4 shows.

10. Ostry et al (2014).

11. Rajan (2010), and Cynamon and Fazzari (2014).



countries. Interestingly, countries with increasing household debt tend to be those that have higher levels of inequality (Figure 5). Therefore, one cannot exclude the hypothesis that large increases in borrowing in a number of EU countries was related to the higher levels of inequality, and that this inequality contributed to the build-up of the problems of today.

High household debt levels are a significant drag on consumption growth (Figure 6) and undermine the correction of social imbalances. History shows that the deleveraging process exerted a protracted negative impact on economic growth¹². Low economic growth, in turn, undermines the ability of economies to create new jobs and to find ways to reduce income inequality. The substantial debt problems of many euro-area countries therefore not only undermine growth, but in themselves are also an obstacle to the reduction of social problems in the monetary union.

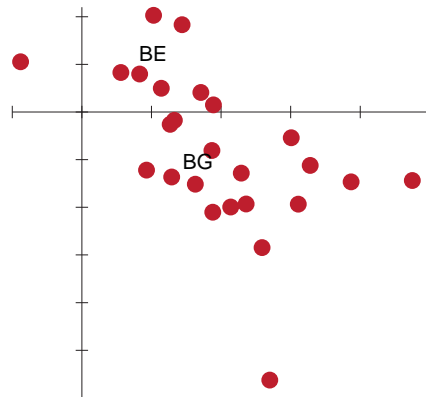
High and persistently high levels of unemployment undermine

both short-term and long-term growth potential, and increase inequality. Three factors are central. First, unemployed people do not contribute to the current productive process, thereby increasing the pressure on those working to provide all the resources needed. Second, the unemployed consume less and thereby domestic demand is weaker in countries with higher unemployment rates¹³. Third, the longer unemployment persists, the more work-related skills are lost and the more difficult re-integration into the active labour market becomes. Unemployment among young people, which is at record high in a number of EU countries, is especially alarming because a long period of unemployment after graduation, when a worker should acquire the first skills in the workplace, can undermine whole careers – creating a lost generation and also having trickle-down effects on fertility rates and child support. When children grow up in families in which parents do not work for long periods or work irregularly, their opportunities are curtailed com-

pared to children whose parents work. Unemployment therefore increases income inequality for those directly affected and it might also have lasting effects on income inequality for the next generation. Long-term unemployment is also a major determinant of poverty. While short-term unemployment can usually be bridged by households thanks to savings and unemployment benefits, the longer a period of unemployment lasts, the greater the risk of falling into poverty¹⁴.

Poverty and persistent unemployment also undermine the ability of households to provide for adequate healthcare for the family and education of children. The resulting inequality of opportunity, ie the ability to access education on equal terms with families in which the parents are in jobs, is an important problem. The OECD (2012b) finds that in all OECD countries, higher levels of economic, social and cultural status of parents is associated with higher educational attainments for their children. Rising unemployment, reductions in wealth and relative social decline therefore undermine the educational opportunities for children.

Unemployment can also undermine growth and financial stability by affecting social stability and undermining support for positive change. Eurobarometer surveys show that the change in citizens' trust in the EU and in national governments has evolved in a broadly similar way and in general there was a greater decline in trust in countries facing high unemployment. When trust in EU and domestic political insti-



12. See McKinsey Global Institute (2012) and Ruscher and Wolff (2012).

13. See, for example, Hurd and Rohwedder (2011) and Christelis et al (2011).

14. In a panel regression framework, Duiella and Turrini (2014) found that long-term unemployment appears the most significant and robust explanatory factor for severe material deprivation, stronger than income-per-capita variables.

tutions is low, the acceptability of painful structural reforms and fiscal consolidation measures is lower, which could diminish the reform momentum and may even lead to political instability.

Overall, a number of EU countries face a serious unemployment and poverty challenge, undermining the opportunities for personal fulfilment, reducing economic growth and threatening public finances. With households under pressure and social support budgets affected, support for national and EU authorities has tumbled to record lows.

IMPLICATIONS FOR POLICY

A number of conclusions can be drawn from the analysis.

First, addressing unemployment and poverty should remain a high priority not only for its own sake, but also in view of the sustainability of public debt and the growth rates of our economies.

- High levels of unemployment undermine long-term growth;
- Youth unemployment in particular can have lasting negative effects, as skills are undermined over the whole lifetime, with trickle-down effects on fertility rates and child support;
- Poverty undermines the ability to access educational and health services, with a knock-on negative effect on long-term productivity;
- Excessive income inequality might raise the risk of excessive household borrowing leading to later periods of subdued consumption growth;
- Poverty and unemployment

15. 'Actions to foster youth employment in the Member States', Declaration of the EUeomi.al in

