The Unequal Crisis – Summary

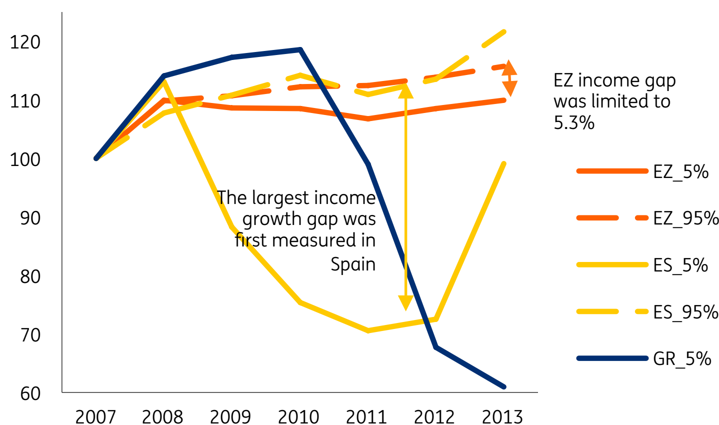
How did income inequality evolve during the financial crisis?

This report discusses how income inequalities evolved in the US and EU during the crisis and afterwards. As such, this report is the logical extension of ING's recent reports on income evolutions during and after the crisis. Indeed, incomes have not been converging before the crisis, they have even been diverging between countries afterwards as we showed in a recent report, and trends in income were also different inside each country. These different trends have been behind the rise in inequalities 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 described in recent research 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. As such, 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. The main findings of this paper can be summarized as below:

- **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.

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



Source: Eurostat (ILC Database), ING calculations

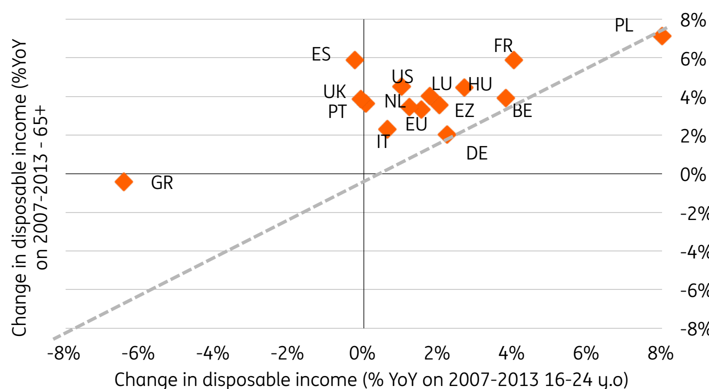
Besides, income inequality remained unchanged in Germany and actually decreased in countries like Portugal, Belgium or the Netherlands (where the middle-class fared relatively better than both extremes of the income distribution).

- **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.

Change in disposable incomes (2007-2013) : comparison between age groups



Source: Eurostat (ILC Database), ING calculations

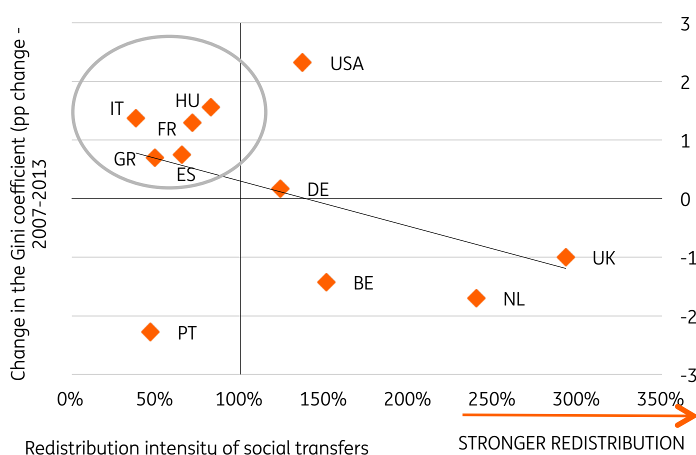
- **New types of labour contracts are often among the reasons for rising inequality**

  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.

Some countries had less generous and less redistributive social systems which gave rise to more inequality



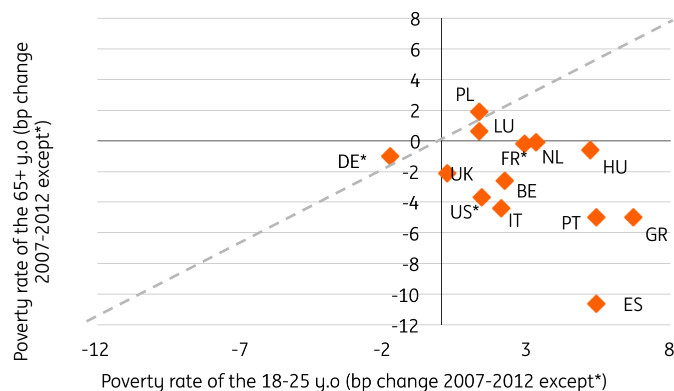
Source: OECD, ING calculations

- **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.

The younger are more at risk of poverty 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

- **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.

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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?