The intergenerational divide in Europe

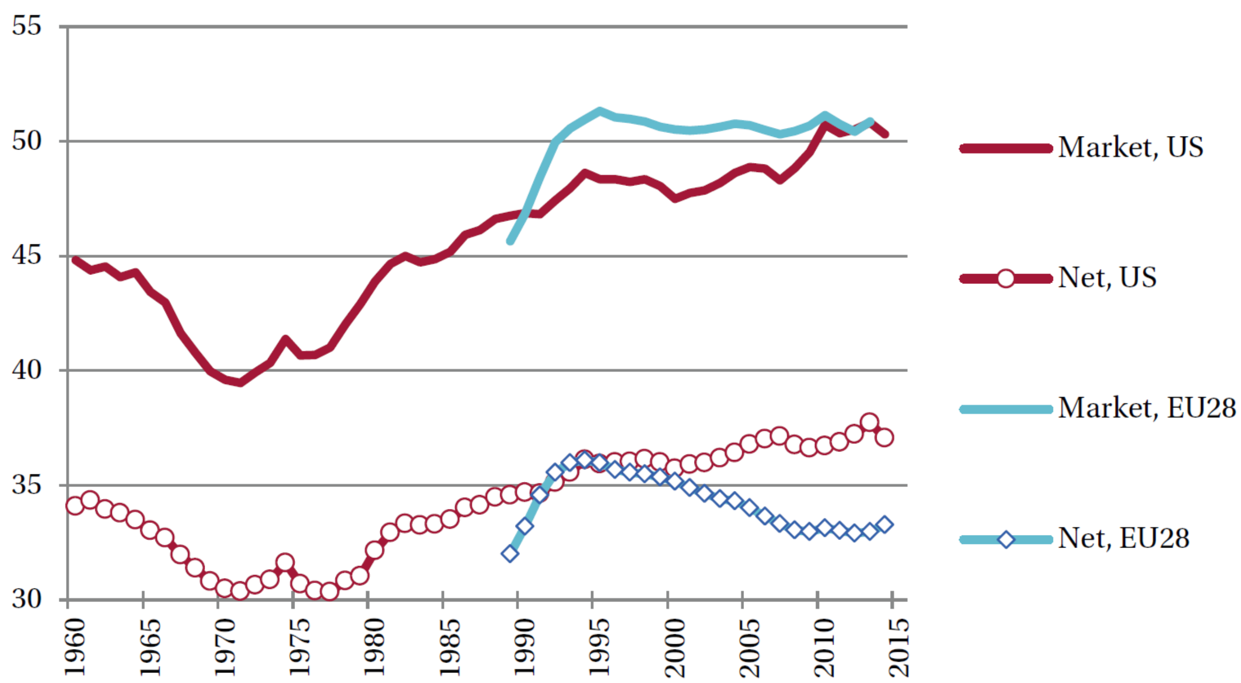
Guntram Wolff

Outline

- An overview of key inequality developments
- The key drivers of intergenerational inequality
  - Macroeconomic policy
  - Orientation and composition of government spending
  - Pension reforms
  - Efficiency of welfare systems
- Way forward: Policy measures to address the intergenerational divide
  - Address dualism in labour markets
  - Create a fiscal stabilization mechanism
  - Prioritise investment, including in education, family, children and research investment
  - Strengthen intergenerational equity in pension schemes

EU is getting less unequal (thanks to convergence & redistribution)

Figure 2: Gini coefficient of market (before taxes and transfers) and net (after taxes and transfers) income inequality: comparing the EU as a whole with the US, 1960-2014



Source: Bruegel based on US data: the Standardised World Income Inequality Database (SWIID) from Solt (2016); EU28 data: Darvas (2016b), which is based on the individual country data from Solt (2016); thereby the US and EU28 data reported in this figure are comparable. Note: A Gini index of zero represents perfect equality (ie incomes are perfectly evenly distributed) and a Gini index of indicates 100 perfect inequality (all incomes are owned by one person).

The EU in the world: inequality

From Darvas and Wolff (2016)

		No. countries	Poverty (%)	Income inequality	Unemployment rate (%)
EU	EU15 (ex. south & UK)	10	0.5	27	7.8
	Southern EU	4	2.3	34	19.4
	United Kingdom	1	0.5	35	6.2
	Baltics	3	1.5	34	9.6
	Other newer EU members	10	1.7	30	10.3
Non-EU	United States	1	1.3	37	6.1
	Non-EU advanced (ex. US)	7	0.3	29	4.8
	China	1	19.3	53	4.1
	Asia (ex. China & CIS)	19	23.6	40	4.5
	Latin America	19	12.1	44	6.9
	Africa	36	72.5	44	12.0
	CIS (former USSR)	10	19.3	35	6.9

Source: Bruegel based on World Bank World Development indicators (poverty), the Standardised World Income Inequality Dataset (income inequality), International Monetary Fund World Economic Outlook (unemployment rate). Note: Poverty refers to the percent of population living below $2.50 a day. Income inequality refers to the Gini coefficient after taxes and transfers. For each country and indicator, the latest available data is used, which is typically available for 2012 or 2013 for poverty and income inequality and 2015 for the unemployment rate.

Inequality in the EU

- EU as a whole, and individual EU countries, tend to be characterised by *lower income inequality than the US and most emerging/developing countries*;

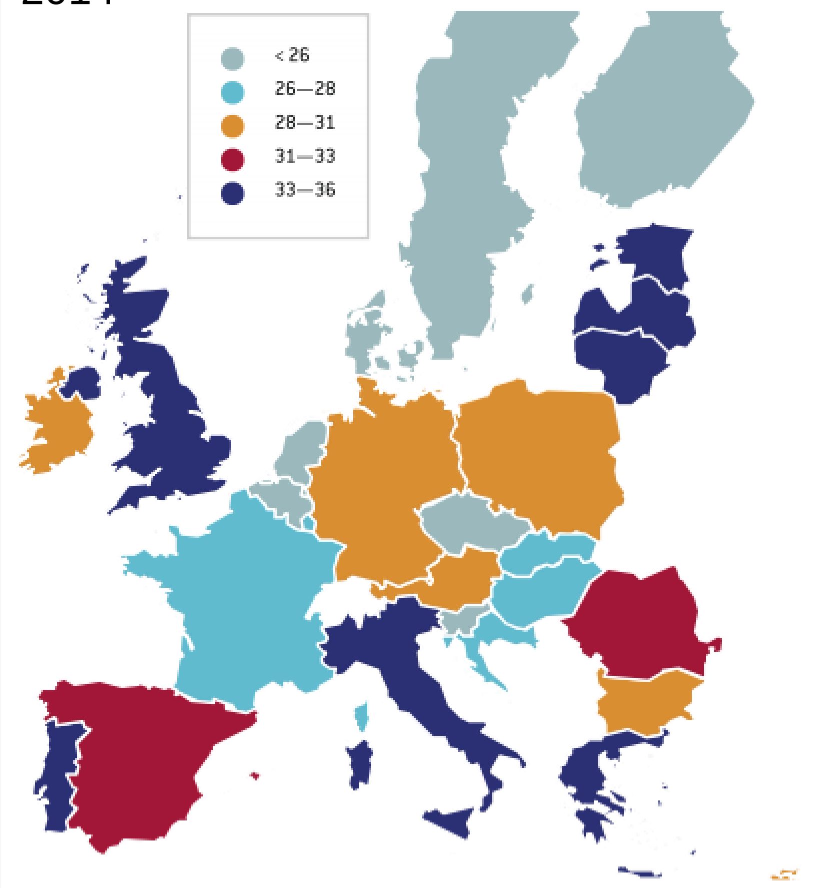
- Mediterranean countries, Baltic countries and the United Kingdom exhibit relatively high Gini coefficients, while Nordic countries and 'core' continental EU countries are characterised by lower income inequality levels;

- *Europe's social problems widened* with the increase in unemployment and material deprivation in some parts of Europe;

- Polarisation between the *south and the north* of the EU has increased, as well as between the *young and the old*;

- There was *increasing intergenerational polarisation* during the economic crisis years.

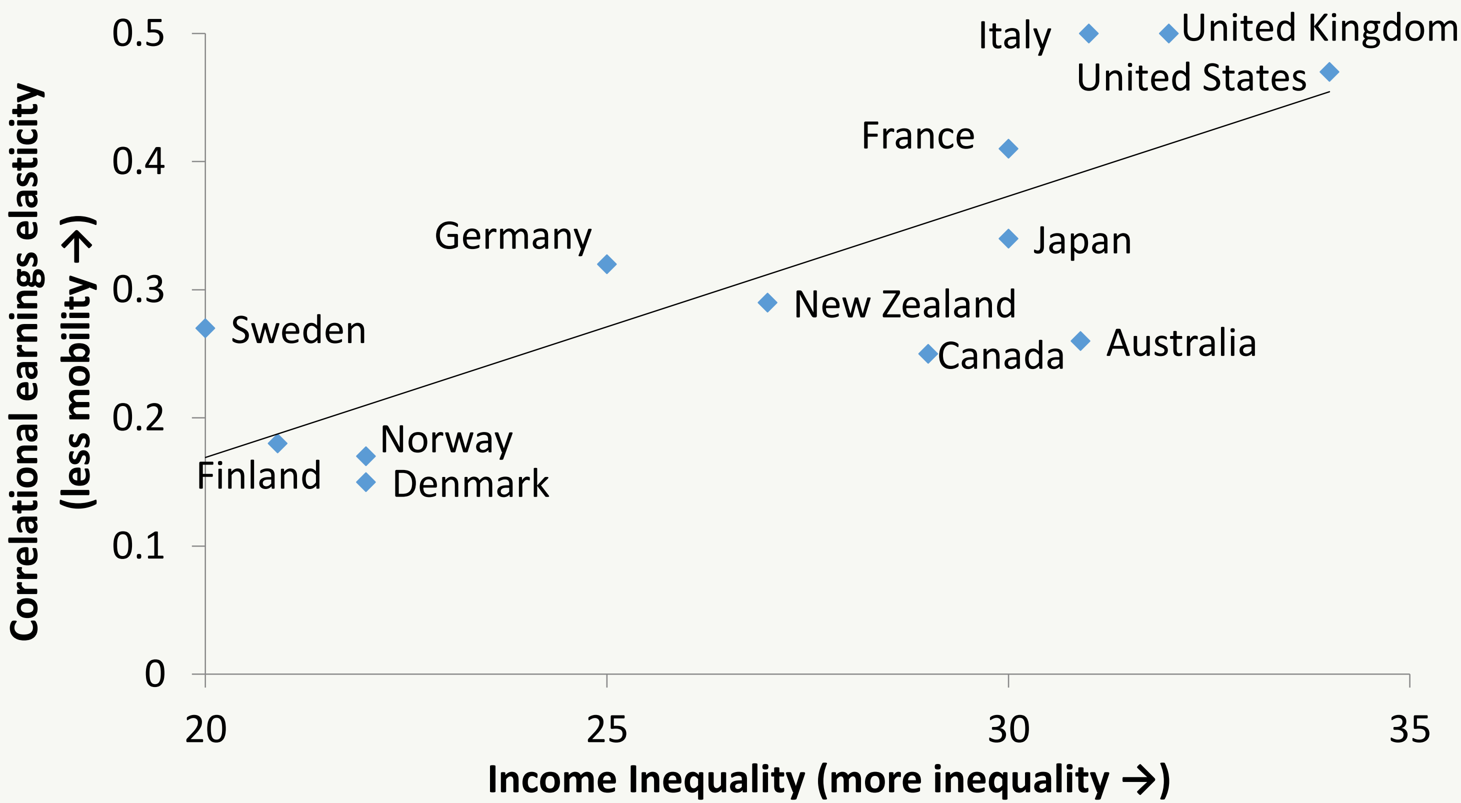
Inequality in the EU, average 2000-2014



Source: Bruegel based on the Standardized World Income Inequality Database (SWIID). Note: Gini coefficient is after taxes and social transfers.

Intergenerational mobility and polarization

The Great Gatsby Curve: more inequality is associated with less mobility across generations



Source: Reproduced with permission from Corak (2013), Figure 1.

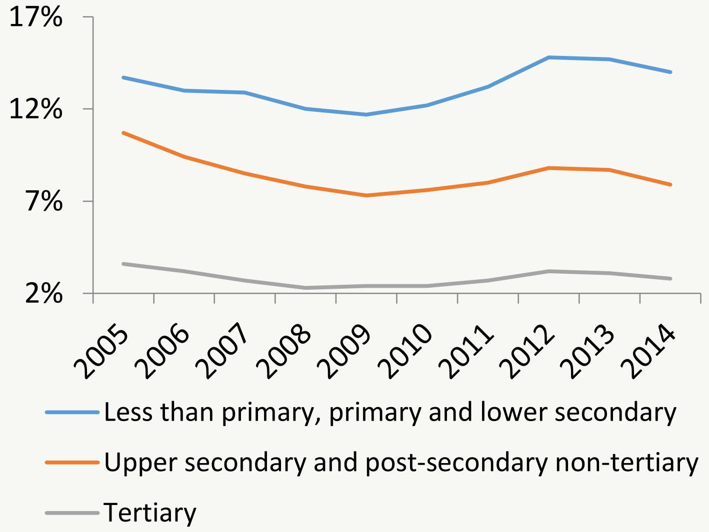
Intergenerational mobility and polarization

Intergenerational and educational divide

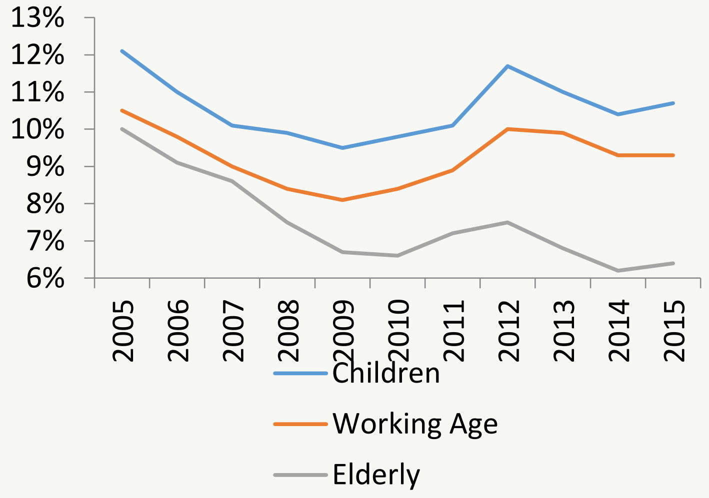
- Poverty is much more widespread among low-educated people and they suffered more during the crisis;
- The gap between young and old widened during the crisis.

Severe material deprivation rate

EU27, by educational attainment



EU27, different age groups



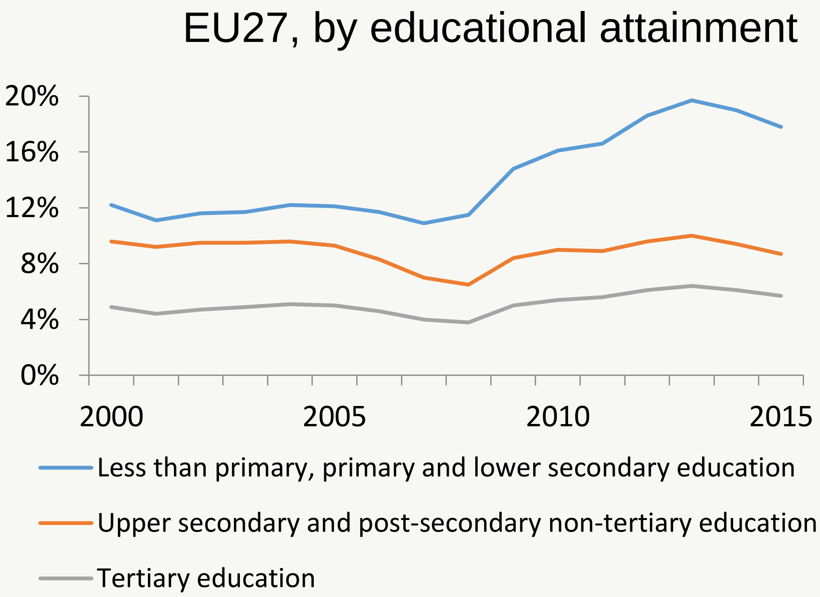
Source: Eurostat. Note: The severe material deprivation rate represents the proportion of people who cannot afford at least four of the nine following items: 1) (arrears on) mortgage or rent payments, utility bills, hire purchase instalments or other loan payments; 2) one week's annual holiday away from home; 3) a meal with meat, chicken, fish (or vegetarian equivalent) every second day; 4) unexpected financial expenses; 5) a telephone (including mobile phone); 6) a colour TV; 7) a washing machine; 8) a car and 9) heating to keep the home adequately warm.

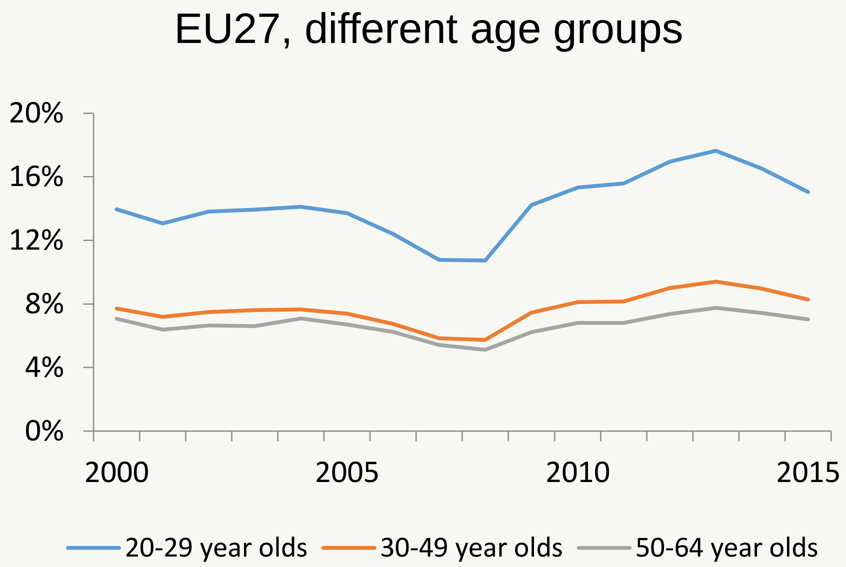
Intergenerational mobility and polarization

Intergenerational and educational divide

- Unemployment is higher among low-educated people;
- The unemployment for the young increased much more and the gap between young and old widened during the crisis.

Unemployment rate



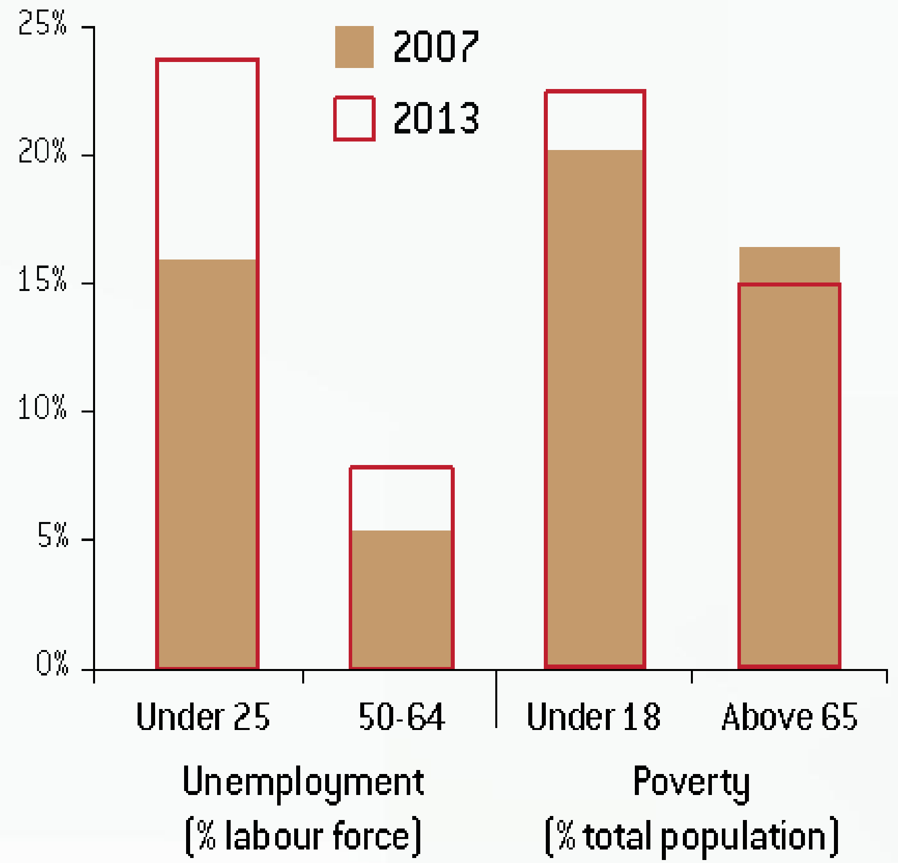


Source: EU LFS.

The emergence of an intergenerational divide

During the crisis:

- under-25s most hit by unemployment
- NEET in crisis-countries > 30 %
- young people became poorer, while pensioners' poverty rates decreased



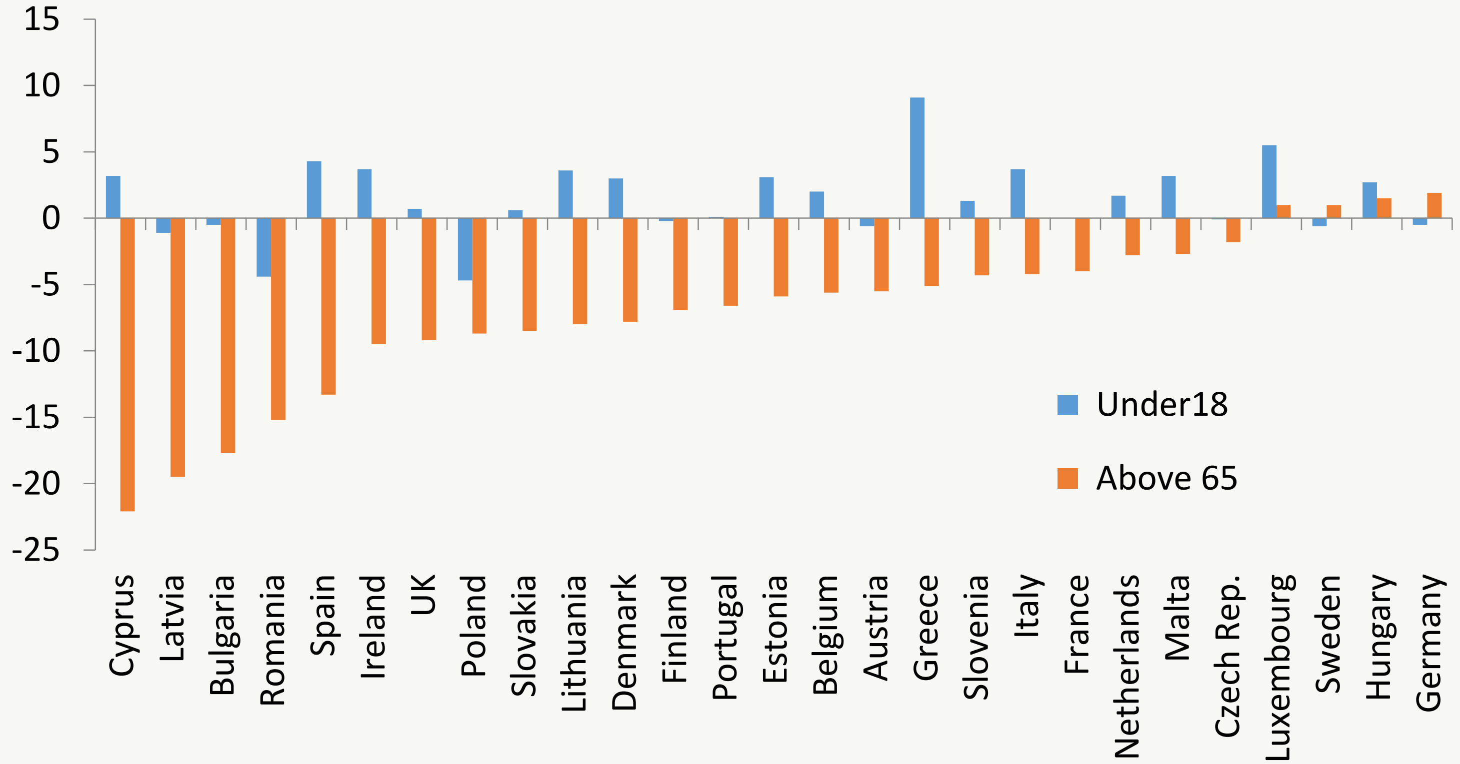
Source: Eurostat; Note: EU

Intergenerational mobility and polarization

Intergenerational divide

In most EU countries the *old have experienced a substantial reduction in AROP rate* while the *young have seen a substantial increase*, suggesting that the income position of the old has improved, while the relative income position of the young has deteriorated.

Share of people a-risk-of-poverty or social exclusion (AROP) by age group, percentage point change from 2008 to 2015



Source: Eurostat. Note: Germany, Ireland, Italy, Cyprus, Luxembourg, Poland data are for 2014 instead of 2015. Croatia is omitted due to missing data.

2. Key drivers of the intergenerational divide

- Macroeconomic management
  - Unemployment responds to the business cycle, with **youth unemployment reacting more strongly** to recessions
  - **Financial conditions diverged** considerably in the euro area before OMT, aggravating the recessions
  - Darvas and Barbiero (2014) find that **gross public investment declined**
  - the fiscal stance for the euro area as a whole was far **too restrictive** in 2011-2013
- Level of government expenditure
  - **In 2008:** EU governments spent around 7.8% of GDP on pensions, 6.2% on health and 4.3% on education (family and children, unemployment benefits play marginal role)
  - Southern countries are **pension-biased**, invest less in 'social investment' policies

2. Key drivers of the intergenerational divide (i)

- Change of government expenditure during crisis
  - GR, IE, PT experienced the **highest increase in unemployment** expenditure and the **highest cuts in health** expenditure
  - **Spending on education decreased** on average, and fell sharply in UK and Italy.
  - **Pensioners were the main beneficiaries** across all countries, with major increases in the UK and programme countries.

Table 2: General government expenditure by function, % change 2009-12 (in current prices and constant exchange rates)

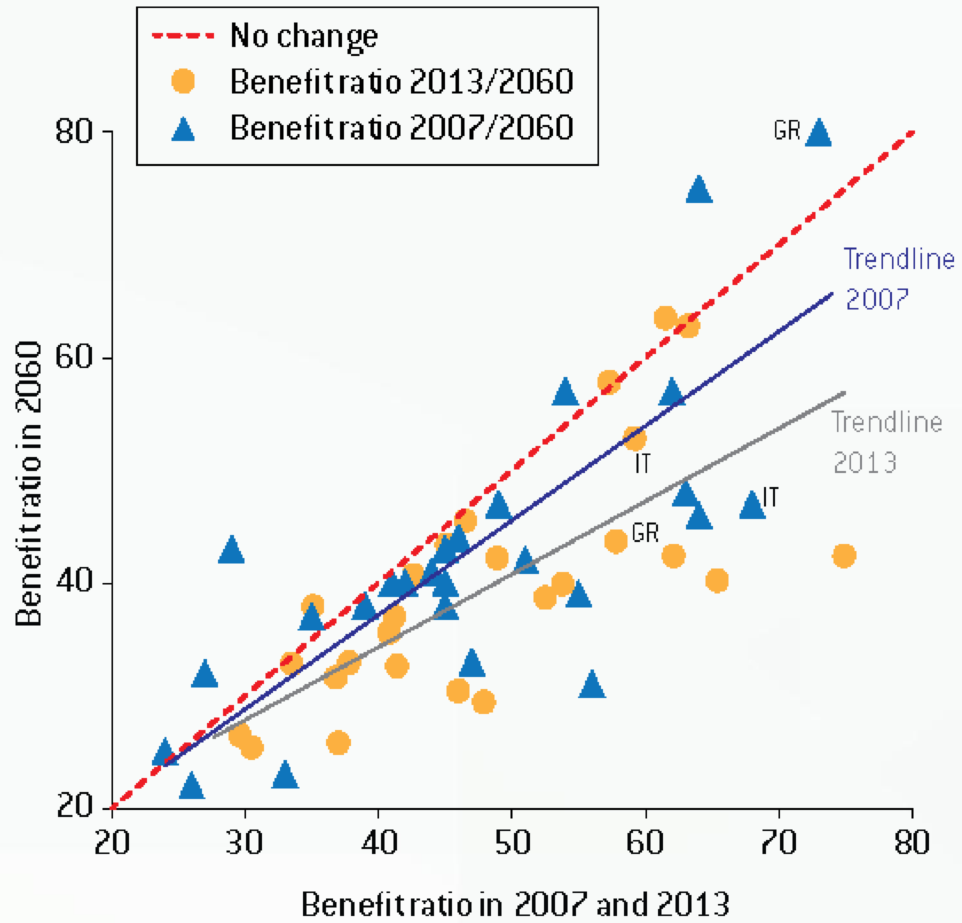
	Share	Percent change in current prices, 2009-2012					
	EU24	EU24	Greece, Ireland, Portugal	Italy, Spain	9 other EU15	Baltics 3	7 other NMS
Total general government expenditures	**100**	**4**	**-12**	**1**	**6**	**-3**	**7**
Interest payments	5	23	14	32	19	164	22
Broad services	17	-2	-12	-11	2	-15	-1
Economic affairs	9	-5	-45	5	-6	-20	-4
Environment protection	2	-5	-26	-8	-4	-6	21
Health, recreation	17	4	-20	-7	8	-6	12
Education	11	2	-14	-10	5	-7	8
Old age	20	10	0	8	10	15	13
Family and children	4	0	-19	-10	3	-14	1
Housing	1	12	-30	6	13	23	20
Unemployment	4	0	11	14	-5	13	-11
Sickness and disability	6	7	-7	-1	9	-5	12
Other social protection	5	7	-11	5	9	26	8
Memorandum: inflation		**8**	**6**	**8**	**7**	**12**	**10**

Source: Bruegel using Eurostat's 'General government expenditure by function' (COFOG) database. Note: Belgium, Croatia, Slovakia and Romania are not included

2. Key drivers of the intergenerational divide (ii)

- Pension reforms
  - Governments under pressure during the crisis implemented pension reforms
  - Put into context of the challenge of rising life expectancy and declining

→ Entitlements have been curtailed in many countries, but the burden seems not to have been shared equally, favouring current over future pensioners



Source: EC

3. Way forward: Policy measures to address the intergenerational divide

- **On youth unemployment:**
  - two-tier system is a major factor behind the youth unemployment
  - Possible solution: labour market reforms that allow for **graded job security** as workers acquire tenure

  → However, this will only have positive effects once countries get our of recession

- **On macroeconomic management:**
  - Better fiscal policy coordination?
  - European instruments for investment?

3. Way forward: Policy measures to address the intergenerational divide (i)

- On pension reforms:
  - **Safeguarding a constant benefit ratio over generations** by adjusting contribution rates for the working population and benefit levels for pensioners: better intergenerational burden-sharing
- On the reorientation of government spending:
  - **Policies aimed at education and child care**, one of the pillars of the social investment strategy, could play a major role, foster productivity and growth.
  - **Education** is also important to reduce income inequality and intergenerational gaps (OECD)

Thank you for your attention

References:

Hüttl, P., Wilson, K. and G. Wolff (2015) 'The growing intergenerational divide in Europe', Policy Contribution 2015/17, November

Darvas and Wolff (2016) ' An anatomy of inclusive growth in Europe", Bruegel Blueprint

Annex: projected benefit ratios

Table 2: Projected benefit ratios, 2007-2060 and 2013-2060

	2007	2060	2013	2060
Belgium	45	43	45	43
Bulgaria	44	41	37	32
Czech Rep.	45	38	43	41
Denmark	64	75	62	64
Germany	51	42	41	36
Estonia	26	22	31	25
Ireland	27	32	30	27
Greece	73	80	58	44
Spain	62	57	65	40
France	63	48	53	39
Italy	68	47	59	53
Cyprus	54	57	75	42
Latvia	24	25	28	20
Lithuania	33	23	35	38
Luxembourg	46	44	57	58
Hungary	39	38	41	33
Malta	42	40	47	46
Netherlands	74	81	63	63
Austria	55	39	41	37
Poland	56	31	48	29
Portugal	47	33	62	42
Romania	29	43	37	26
Slovenia	41	40	38	33
Slovakia	45	40	46	30
Finland	49	47	49	42
Sweden	64	46	54	40
United Kingdom	35	37	34	33

Source: European Commission *Ageing Report* (2009 and 2015)