

## Europe's disappearing middle class? Evidence from the world of work

Edited by Daniel Vaughan-Whitehead

International debate has recently focused on increased inequalities and on their adverse social and economic effects, and income inequality is at its highest level in the past half century. This book addresses income inequality from two different angles: first, by identifying which elements and trends in the world of work may have contributed to income inequality; and second, by tackling inequalities from the perspective of different income groups – and not only from the two extremes, the top and the bottom – but in particular from the perspective of middle-income groups or what we generally categorize as the “middle-class”.

To prepare this book, the ILO and the European Commission enlisted a group of high-level national experts to carry out research (collecting statistics and case studies) and provide evidence on the general trends relating to inequalities and middle-income groups, and on their inter-relationship with the world of work.

The volume comprises 13 country-specific chapters and an introductory chapter with a comparative overview. It explores such questions as: Are increasing income inequalities and increased polarization leading to the erosion of the middle class? What are the main transformations in the world of work over the past 20 years that may have affected the middle class? How has the middle class been affected by the financial and economic crisis? What are the driving forces in the world of work that may contribute to limiting and even reducing income inequalities in the future?

### **Main results: The growth and erosion of the middle class**

The middle class in most European countries experienced rapid growth in the 1980s and 1990s. Labour market participation has increased over time and represents an important factor in the growth of the middle class. In particular, higher labour market participation among women since the 1980s and 1990s fundamentally changed the number of working adults in households and also increased the probability of belonging to the middle class. For instance, in Spain, the female participation rate grew from 29 per cent in 1986 to 53 per cent in 2014 alongside fairly regular growth. A number of national reports confirm that the development of a dual household model helped to increase the size of the middle class in the Netherlands, Portugal, Spain, Sweden and many other countries.

A rapid expansion of jobs in the public sector in the last two decades in Europe also contributed to significant job growth in the middle class. The public sector hosts many of the professions traditionally associated with the middle class – schoolteachers, doctors and civil servants, for example.

At the same time, the past decade seems to have brought some erosion of the middle class. The expansion of the number of middle-income households below median income levels is evident in most countries. The changing structure of jobs and occupations and additional factors brought about by the recent financial and economic crisis, such as further increases in unemployment, especially among young people, has furthered real wage moderation or decline and reform of social dialogue institutions. In addition, cuts in both employment and wages in the public sector appear to have contributed to this erosion. Involuntary part-time work in almost all professions and in both the public and the private sectors has also increased significantly since the crisis. As described in a number of country chapters, a sort of vicious circle has developed: the crisis has weakened the middle class, which in turn has reduced aggregate demand, thereby deepening and prolonging the downturn.

The experts' findings make a direct link between increased income inequalities and the erosion of middle income groups

Some occupations that have traditionally represented the middle class, for example teachers, may not systematically belong to the middle income groups anymore. The number of temporary contracts in the public sector has increased rapidly throughout Europe. Employment security is thus no longer the norm in a public sector that does not seem to represent a lever for employment growth for the middle class, as witnessed in the past.

Women have been particularly affected by this process. The public sector is not only a major source of employment for women, it also provides many jobs for highly qualified women, and the above processes therefore directly affect the dual household model and the growth of the middle class. Lower supply and sometimes lower quality of public services is also affecting the middle class, which traditionally demands such services, especially women who wish to continue their participation in the labour market.

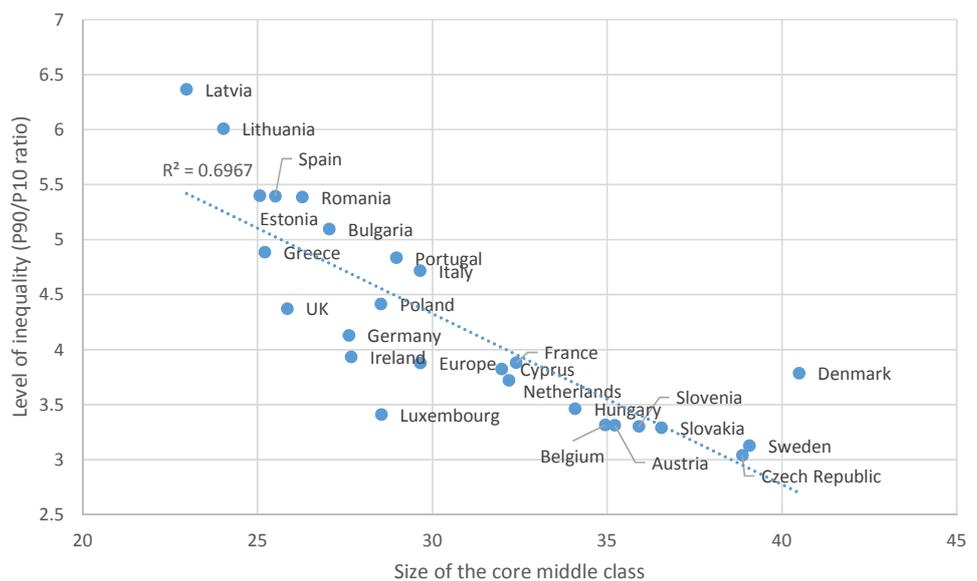
A number of chapters show how very high youth unemployment rates can result in a lower probability of being part of the middle class in the future, and thus lead to a form of inter-generational gap. By contrast, lower youth unemployment rates as in Belgium or Germany could help younger generations to achieve or maintain middle class status.

The situation of older workers has also had an impact. Employment rates for older workers (55–64 years old) have increased during the past decade. The postponement of exit at the end of the job career entails a lengthening of working life and provides a means of sustaining middle class status.

### The link between polarization and the middle class

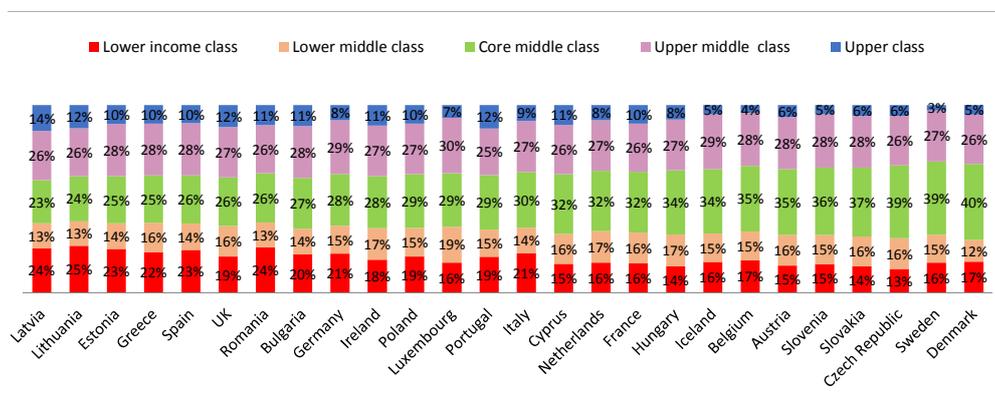
The experts' findings make a direct link between increased income inequalities and the erosion of middle income groups, and confirm the need to tackle inequalities also by looking at what is happening to the “middle class”. The figure below shows a direct correlation (as shown by the red line and by a R-squared or coefficient of determination of 0.71 for 2011) between the level of income inequalities and the size of the core middle class. The volume also finds a direct correlation between the trends of these two indicators over time. On this basis, we can predict that the increase in inequalities documented recently by several international organizations (OECD, IMF, ILO and EC) must have been accompanied by an erosion of the middle class.

**Figure 1. Correlation between the level of inequality and the size of the middle class, selected EU countries (R<sup>2</sup>= 0.71)**



Another relationship emerges from the data, one between the decline in the middle class and its original size.<sup>1</sup> The size of the core middle class in Europe varies considerably from country to country, from 23 per cent in Latvia to 40 per cent in Denmark (2011). A comparison of EU countries shows a more substantial middle class in the Nordic countries – Denmark and Sweden – and a smaller middle class in both the south (Greece and Spain) and in central and eastern Europe (Estonia, Latvia and Lithuania,).

Figure 2. Size of income classes based on net household income, selected EU countries, 2011



**Policies and institutions can make a difference**

Considering the importance of labour market participation, all measures that contribute to increasing such participation tend to have a direct impact on the stability and even growth of middle-income groups. For instance, the use of vocational training and short-time working schemes in a number of EU countries during the recent crisis contributed to limiting unemployment and helped younger generations to maintain some basis to achieving middle class status.

Similarly, the long term trend of jobs polarization reported in this book calls for an ambitious programme of upgrading to ensure that employees acquire the necessary new skills to match those required in the labour market. Sweden and Germany provide interesting developments in this regard.

Industrial relations, as a process for influencing the world of work and thus inequalities, was found to play a particular role. Even if industrial relations systems are very different between, for instance, Belgium, France and the Netherlands, its resilience in those three countries appears to be one major reason for relatively lower inequalities and a greater middle class stability.

Conversely, the weakening of a number of mechanisms for social dialogue since the crisis began seems to have had a direct impact on the world of work, with significant effects on inequalities and the middle class. Long-term transformations in industrial relations and the labour markets can also explain the growth of the low pay segment and the erosion of the middle class. In this context, minimum wage policies contribute to lifting the income position of those at the bottom of the wage scale and facilitate their households' progression towards the middle group categories.

<sup>1</sup> Within entire distribution, we capture the middle class size through three middle-income groups: lower middle (below 60 to 80 per cent of median income), core middle (80 to 120 per cent) and upper middle (120 to 200 per cent), complemented by the two other extremes, namely the lower income group (below 60 per cent) and the upper income group (above 200 per cent).

Resilient industrial relations systems appear to be a major reason for relatively lower inequalities and greater middle class stability in some countries

Mechanisms of wage fixing and wage bargaining were also found to play some role. While the removal of the wage indexation mechanism in Italy in the early 1990s was accompanied by an immediate increase in inequalities, the survival of the indexation system in Belgium seems to have contributed to limiting inequalities and to stabilizing the middle class. Extension mechanisms and coordinated collective bargaining in a number of countries also contributed to more coherence along the income scale and less inequalities between the two extremes. This should induce policy-makers to think more about these mechanisms that may have been put on hold in the recent years. More generally, the role of the social partners in collective bargaining talks at both national and EU levels can help to ensure a fair and efficient redistribution of productivity at national, sectoral and enterprise levels.

The public sector should be seen from a dual perspective, as a major source of employment and income and as a provider of public services, both important aspects for various income groups, including the middle class. We have seen how childcare facilities have facilitated women's participation and the growth of the dual earners' model. The provision of care services for the elderly is also an important source of employment to match the needs of an ageing population while providing work to a considerable number of workers, especially women.

Other institutions and policies outside the world of work have also greatly contributed to the outcomes in terms of inequality and the middle class. Effective tax policies are essential to avoiding increases in both income extremes and also to reducing inequalities, while at the same time can augment the number of people belonging to middle-income groups. The various chapters in this volume also highlight the importance of education for moving people into middle- or upper-income groups, even if higher education does not seem to represent a sufficient asset anymore for middle-income groups to avoid employment and income insecurity. Public services also affect income groups from both employee and user perspectives, and must be integrated into this equation.

The erosion of the middle class is worrying – especially when it seems to hurt young people most of all, thus leading to an intergenerational gap – and calls for policy initiatives. Increased inequalities and the progressive erosion of the middle class require policy action specifically aimed at arresting these trends. This volume shows how such initiatives could be launched in the world of work as well as in related areas such as taxation, education and social protection. This calls for a new and comprehensive policy agenda aimed specifically at the middle class, leading to both sustained economic growth and improved living standards.

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