

## INTRODUCTION

by Daniel Vaughan-Whitehead

---

The aim of this special issue is to address the question of income inequality from two different angles: first, identifying what elements and trends in the world of work may have contributed to income inequality; second, tackling inequalities not only from the two extremes – the top and the bottom – but from the perspective of middle-income groups or what we generally categorise as the ‘middle class’. Are increasing income inequalities and increased polarisation leading also 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? And how did the financial and economic crisis affect the middle class? On this basis, what are the driving forces in the world of work that we should develop to limit and even reduce income inequalities in the future?

La presente sezione monografica si prefigge lo scopo di affrontare il tema della disuguaglianza di reddito sotto due punti di vista: innanzitutto, individuando quali elementi e tendenze nel mondo del lavoro possono aver contribuito alla disparità di reddito; in secondo luogo, analizzando le disuguaglianze non solo partendo dai due estremi – il livello più alto e quello più basso della distribuzione del reddito – ma anche nell’ottica delle fasce a medio reddito o di quella che genericamente viene definita “classe media”. Disuguaglianze di reddito sempre più forti e una maggiore polarizzazione stanno comportando l’erosione della classe media? Quali sono le principali trasformazioni nel mondo del lavoro dell’ultimo ventennio che hanno interessato la classe media? E in che modo la crisi economica e finanziaria ha colpito la classe media? Alla luce di tutto ciò, su quali fattori determinanti nel mondo del lavoro dovremmo far leva al fine di limitare o financo ridurre le disuguaglianze di reddito negli anni a venire?

---

1. Recent debates have multiplied on inequalities, literature increased on this topic, and a consensus emerged in 2015 among international organisations on the very urgent need to tackle increasing inequalities in the world (the reports published in 2015 by the Organisation for Economic Co-operation and Development – OECD, the International Monetary Fund – IMF, and the International Labour Organization – ILO). As recently emphasised by the OECD (2015), «income inequality is at its highest level for the past half-century», and the IMF (2015) recognised that increased inequalities were bad for economic growth. Also the

European Commission (EC) retained the reduction of inequalities as one major policy goal, especially within its work on the social pillar.

At the same time (with the possible exception of Gornick and Jänti, 2013), research on inequalities has so far concentrated on the differences between the top and the bottom (see, for instance, EC, 2015). There was a need to address the question of income inequalities from a different perspective, and in particular to tackle inequalities from the perspective of all the different income groups: not only those at the two extremes, the bottom and the top, but also in the middle of income distribution, what we generally categorise as the ‘middle class’. This more comprehensive overview is important in enabling us to better identify whether some categories may have less access to social mobility and, for instance, lead to possible intergenerational or gender gaps. This overview is also relevant on the economic front, given the importance of the middle class for consumption and economic growth (Dabla-Norris *et al.*, 2015).

The collection of articles presented in this issue is the outcome of a project carried out by the ILO in cooperation with the EC<sup>1</sup> with the aim of assessing the situation of the middle class in EU Member States on the basis of detailed empirical evidence and concrete examples.

The project was aimed at identifying, among the root causes behind inequalities, what elements in the world of work – like developments in the labour market, work contracts, wages and incomes, social dialogue, and the public sector – may have contributed to increasing inequalities. In fact, recent reports have recognised that the roots of inequalities may well lie in the different labour market and industrial relations systems (OECD, 2015).

Approaching inequalities from these two different but complementary perspectives – the world of work and middle-income groups – also allows us to respond to such questions as: are increasing inequalities and increased polarisation combined with a sort of erosion of the middle class? While the position of the bottom groups seems to have deteriorated over the past decade, especially since the financial and economic crisis of 2007-2008, has this movement also affected middle-income groups? If so, what are the driving forces in the world of work that may have contributed to such an erosion of bottom and middle-income categories? And on this basis, what are the policies and institutions in the world of work that will be able to limit and even reduce inequalities in the future?

2. To carry out our analysis, we first defined the middle class (in terms of income) and we then identified in a systematic way its trends over time.

While the middle class is generally defined between 60% and 200% of the median income, we decided to split the middle class into three groups, the lower-middle class, between 60% and 80% of the median income, the core-middle class, between 80% and 120% of the median income, and the upper-middle class between 120% and 200% of the median income. Then we have the two extremes: the bottom, the lower-income group below 60% of the median income, which also corresponds to the low-pay threshold, and the top for the income above 200% of the median income. The advantage of this method is

<sup>1</sup> The project consists of a comparative analysis of all EU countries and national chapters on the following countries: the Baltic countries, Belgium, France, Germany, Greece, Hungary, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. The results are presented in details in D. Vaughan-Whitehead (2016).

that one can monitor over time the shift between two income groups also within the middle class itself. It is to be noted that we took the decision to adopt a definition of middle class based on the median equivalised household disposable income, so as to take into account the household composition (number of kids) and the role of income distribution. We used the EU-SILC database.

Table 1. Selected range of income groups

	Bottom	Lower-middle class	Core-middle class	Upper-middle class	Top
Percentage of median income	Up to 60	60-80	80-120	120-200	Above 200

From the analysis of the size of the core and extended middle class (as defined above) in European countries, a rather diversified picture emerges: the core-middle class varies from 40% in Denmark, and generally speaking in Nordic countries, to 23-29% in some Central and Eastern European countries (Latvia, Lithuania, Estonia and Romania), in Southern countries, like Greece and Spain, but also in others, like the UK, Germany and Ireland.

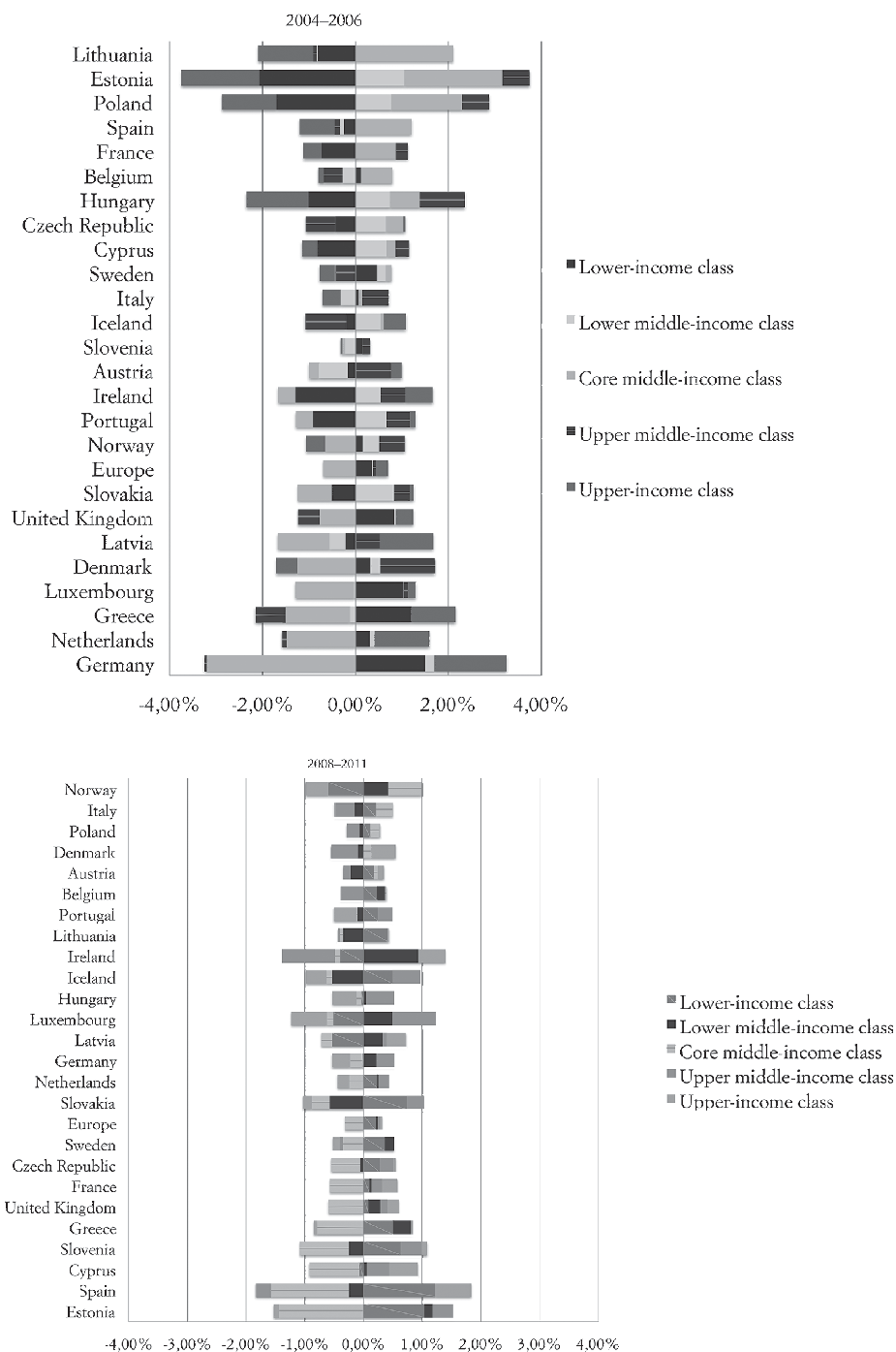
What is the picture that emerges when looking at the dynamics thereof? We distinguished between the period before the crisis, comparing the changes that occurred between 2004 and 2006, and the period after the crisis, comparing the situation in 2008 and 2011.

We can observe that, before the crisis, 12 countries had experienced an increase in the middle class, with also a sort of catching-up scenario in a number of countries, such as Spain, Poland, Estonia and Lithuania, where the middle class was low and increased rapidly over the period of expansion. Conversely, 13 countries had already experienced an erosion of their middle class, particularly severe in Germany but also in other developed economies such as Greece, Luxembourg, Denmark and the United Kingdom.

However, the impact of the crisis is obvious since in the years of the crisis, only eight countries featured a (very slight) increase in their middle class whereas 19 countries experienced an erosion. The catching-up effect was no longer visible.

The two strong results that were reported for the two periods were: first, a strong correlation between polarisation and the size of the middle class; and second, an equally strong correlation between increased inequalities and the declining size of the middle class. As for the former result, high inequality is correlated with a low middle class in the Baltics, Spain, Romania, Greece and the United Kingdom. Conversely, countries with low inequalities, such as the Nordic countries, more precisely Denmark and Sweden, but also the Czech Republic and Slovakia, are associated with a middle class of larger size ( $R^2$  or coefficient of determination of 0.71 for 2011). The project also found a direct correlation between the trends of these two indicators overtime. On this basis, we can predict that the increase in inequalities documented recently by several international organisations (OECD, IMF, ILO and EC) must have been accompanied by an erosion of the middle class.

Figure 1. Changes in the size of the middle class, EU, 2004-2006 and 2008-2011



3. The articles in this special issue identify the impact of various elements in the world of work. The factor that played the greatest influence is labour market participation. In particular, higher labour market participation of women since the 1980s and 1990s has changed the number of working adults in households, thus helping many households reach the middle-class status. The emergence of the 'dual-earner household' model explains the rapid growth of the middle class in Europe (as in the Netherlands, Portugal, Spain, Sweden and in many other countries).

Wages and incomes are also an essential factor of growth, but also of decline, as shown by the decline in middle income during the crisis.

The progressive decline of collective bargaining is also a key factor explaining the long-term decline of the middle class: the crisis brought a further weakening of social dialogue, notably through the removal of extension mechanisms, the development of clauses derogating from central agreements, and the decline in the number of collective agreements, all factors that will directly affect the middle-income groups. Interestingly, it is in those countries featuring more stable industrial relations, such as Belgium, the Netherlands, France and Sweden, that the middle class shows greater stability. On the contrary, countries dismantling social dialogue mechanisms, as in the extreme case of Greece (Aranitou, 2014), are those that experience the sharpest fall in the middle class.

The changes in public-sector employment and wages have also directly affected the middle class: while a number of countries experienced an increase in public-sector employment for their middle class still in 2004-2006, almost all countries faced a fall in 2008-2011. Some occupations that traditionally represented the middle class, such as 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. Thus, employment security is no longer the norm in the public sector, which does no longer seem to represent the lever for employment growth for the middle class, as witnessed in the past. The decreased quality of public services has also affected the middle class in different ways.

4. We also tried to monitor the impact of changes beyond the world of work, and we could identify a definite impact of taxation, education and social protection.

Taxation tends to reduce the upper and lower classes and to favour the middle class. This balancing effect is stronger in countries with progressive income tax (for instance Denmark, Sweden and Norway but also Belgium and Slovenia). This effect persists also after the crisis, when the income tax has clearly helped to maintain or expand the middle class in many European countries.

Social protection was also found to play a role before the crisis. The increased female employment was generally facilitated by an increase in welfare policies, such as the expansion of childcare, parental leave and long-term care insurance for the elderly. Conversely, the cuts in social protection and the progressive shift away from a universal social protection system have affected not only low-income workers but also the middle class.

Finally, education is representing a leverage for attaining and remaining in the middle class. Thus, the share of high education (tertiary and secondary education) is related to the share of the middle class. Moreover, countries where the middle class is highly educated feature a middle class of the largest size – for instance the Czech Republic or Slovakia, where 80% of the middle class holds a high-school degree, or Denmark and Norway, where 30% of the middle class features an education level above a high-school diploma. At

the other extreme is Portugal, where 45% of the middle class features the lowest education level.

The level of education among the middle class is also positively correlated with the skill level, as in Denmark, the Netherlands, Norway, Sweden and Belgium. High skills not only contribute to the large size of the middle class, but they also increase the chances of households to remain in the middle class or to move to an upper class. Thus, in general, the lower the skills, the lower the share of the middle class.

5. To conclude, the research has reached two main results. First, it has provided evidence of a progressive erosion of the middle class over the decade, further exacerbated by the recent financial and economic crisis. If the crisis persists, the middle class – together with the lower class – will continue to lose ground. Second, the results also highlight the role played by the world of work, employment and work contracts, and in particular social dialogue and industrial relations, in the explanation for such middle class decline. The erosion of the middle class is especially worrying when it seems to hurt young people, leading to an intergenerational gap. The results we present in this special issue call for a new and comprehensive policy agenda – or a new policy mix – extended to different and complementary fields (in the world of work as well as in related areas such as taxation, education and social protection), specifically aimed at the middle class as a target group, capable of reducing inequality and of leading to both sustained economic growth and improved living standards.

## REFERENCES

- ARANITOU V. (2014), *The collapse of the middle class in Greece during the era of the Memoranda (2009-2014)*, Draft paper for the Conference on “The decline of the middle classes around the world?”, Madrid, 28-30 September.
- BERG J. (ed.), *Labour markets, institutions and inequality – Building just societies in the 21<sup>st</sup> century*, Edward Elgar-ILO, Cheltenham-Geneva.
- EUROPEAN COMMISSION (2015), *Research findings – Social situation monitor – Income inequality in EU countries*, Employment, Social Affairs and Inclusion, Brussels.
- EUROPEAN PARLIAMENT (2015), *Wage and income inequality in the European Union*, Study for the EMPL Committee, Directorate General for Internal Policies, Policy Department A. Economic and Scientific Policy, European Parliament (IP/A/EMPL/2013-05) January, pp. 1-423.
- GORNICK J. C., JÄNTI M. (eds.) (2013), *Income inequality – Economic disparities and the middle class in affluent countries*, Stanford University Press, Stanford.
- IMF (DABLA-NORRIS E., KOCHHAR K., SUPHAPHIPHAT N., RICKA F., TSOUNTA E.) (2015), *Causes and consequences of income inequality: A global perspective*, IMF Staff Discussion Note, June, SDN/15/1, pp. 1-39.
- OECD (2015), *In it together: Why less inequality benefits all*, OECD Publishing, Paris.
- NOLAN B., SALVERDA W., CHECCHI D., MARX I., MCKNIGHT A., TÓTH I. G., VAN DE WERFHSOT H. (2014), *Changing inequalities and societal impacts in rich countries – Thirty countries' experiences*, Oxford University Press, Oxford.
- VAUGHAN-WHITEHEAD D. (ed.) (2015), *The European social model – Is Europe losing its soul?*, Edward Elgar-ILO, Cheltenham-Geneva.
- ID. (ed.) (2016), *European middle class disappearing – Evidence in the world of work*, Edward Elgar-ILO, Cheltenham-Northampton-Geneva, forthcoming.