

SHOULD INEQUALITY BE THE PRIMARY CONCERN FOR EUROPE'S POLITICAL ECONOMY?

Carlo Bastasin

DURING A PUBLIC SPEECH IN APRIL, German Finance Minister Wolfgang Schäuble famously attacked the ECB's expansive monetary policy, accusing it of fueling rancor among eurosceptic voters. Negative interest rates were painful for thrifty German households, who were becoming increasingly susceptible to the appeals of Alternative for Germany—the new xenophobic political formation currently scuppering the German political system. Although many interpreted his words through the lens of German nationalist overtones, Schäuble may have unconsciously captured one of the most critical factors determining political dynamics throughout the Eurozone. The sense of decline gripping the middle class is stoking radicalism and eroding the consensus for democracy and a unified Europe. It is important to acknowledge and address the implications of a destabilized middle class, reassuring voters of the long-term prospects for average individuals in a tumultuous economic and social landscape.

There are many structural reasons for the erosion of the central layer of European (and, even more so, American) society. One of them is globalization. Job automation and demographic factors are also endangering the sustainability of the welfare state. However, lax monetary policy is currently playing an unusual and amplifying role. Although very low interest rates are ultimately necessary for rekindling consumption and investment, they can also contribute to the erosion of the sense of economic stability highly valued by the middle class, particularly in Germany. This can happen in three ways: interest rates close to zero endanger the stability of pension systems; lower yields on personal savings heighten uncertainty over the future value of today's earnings; finally, the decline in financial yields disproportionately increases the wealth accumulated by the upper class and widens the income gap.

The disappearance of the middle class should be a matter of serious concern for European policymakers since it plays a central role in the political and economic stability of all democracies. Against the backdrop of political radicalization, nationalistic compulsions, and lack of common trust, a strong middle class provides a source of trust that greases social interactions in a “moral” community. Economically, it is a stable consumer base that drives

productive investment and is widely acknowledged as a prerequisite for entrepreneurship. Holding together society, the inter-median layer normally creates a collective demand for better governance, as well as individual impulses to improve education and promote long-term investments. Revealingly, the middle class has contracted in only five countries in this century. Four of them are part of the most critical borders of the European Union: Egypt, Greece, Russia, and Turkey. In each case, the middle class expanded between 2000 and 2007, then shrank as a result of the financial crisis and continued to shed members from 2008 onwards. After trebling in size by 2007, Russia has lost more middle-class members since 2008 than any other country. As with Greece and Turkey, the middle class in Russia is smaller now than in 2000. The middle class in Egypt is half the size it was at the turn of the century.

All these countries have become politically unstable or misaligned with the democratic premises that inspire Europe. Most of them have, at the minimum, a very conflictual relation with Europe.

Europe is most exposed to a global phenomenon

One third of adult Europeans qualify as middle class, slightly less than the analogous proportion in North America (39%). However, despite a higher incidence in North America, the U.S. has only 105 million middle-class adults (16% of the global total), significantly less than the 171 million (26%) in the Asia-Pacific region (excluding China and India) or the 194 million in Europe (29%). In fact, the number of middle-class adults in North America has fallen below that of China, the second largest middle-class region after Europe.

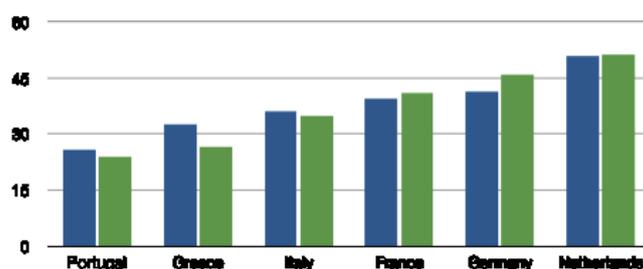
The extent of the middle class' decline is not always correctly captured by the standard measures of median income. In particular, the decline is more acute if gauged on the wealth dynamics in advanced economies. Even though the European middle class outnumbers those in other regions, its development has been following the trend in the United States. The relative wealth of the middle class has clearly been outpaced by wealth increases in the upper class. This is particularly visible in the U.S., where, according to a recent survey by Credit Suisse, the population share of the middle class exceeds their share of wealth—in other words, the middle class as a group has less-than-average wealth. In fact, the average wealth of middle-class adults in North America is barely half the average for all adults. In contrast, middle-class wealth per adult in Europe is 130% the regional average; the middle class in China is three times better off in wealth terms than the country as a whole; and the average wealth of the middle class in both India and Africa is ten times that of the rest of the population.

The reason for the relative poverty of the American middle class lies in the exceptional wealth accumulated by the upper class. The middle and upper class own between 97 and 99% of total growth in America and Europe. The upper class, a numerically small fraction of the middle class, owns roughly five times more wealth than the middle class. The trend toward wealth disparity has strengthened over the previous decades and represent a pattern that has been heightened by the decline in interest rates and the good performance of financial assets outside the 2007-2008 period. The relatively low growth in Europe has heightened mistrust in rhetoric linked to the trickle-down effect, which is being disputed even in America, where the income of workers has declined relative to the aggregate output—from 65.4% in 1947 to 57.9% in 2015. In the same period, the real income of the upper 10% of the American population increased almost by a factor of four. Since most of the causes are acknowledged by European citizens as non-national, or outright global, the lack of political initiative for

changing the course has been blamed, both by national politicians and the public, on the European Union.

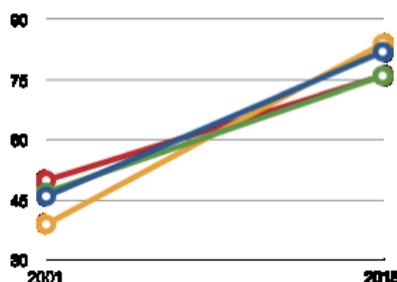
A problem of trust

The decline of the middle class goes hand-in-hand with political instability. A reflection of this is the strong anti-establishment sentiments among the electorate. Forms of the relative decline of the middle class are specific to each country. In Italy, middle class income, though more stable than elsewhere, is lowest relative to household wealth. Austrians have household income that has grown the least relative to the national aggregate. In both countries, anti-European sentiment, once non-existent, have erupted to such a degree that freedom of circulation has been limited due to concerns over migrants. Inequality, immigration, and the establishment's perceived impotence are firing up electorates in a way rarely seen before.



Incomes in Euro-area countries since 2009, stagnating or declining

The increase in youth unemployment, over 46% in Spain and Greece, has contributed to the radicalization of new anti-establishment movements. Parents are sharing their children's concerns and show sympathy for previously shunned radical positions. In the UK, 82% of parents expressed concern over the future of their children. In Spain, France, Greece, and the U.S., about two thirds of families share the same concern. The sudden increase in the number of migrants and the lack of job opportunities have exacerbated the dim perception of future household welfare. The refugee crisis has exposed these anti-establishment sentiments to xenophobic overtones, allowing some voters to fall prey to populist demagogues. In Germany, only 3% of the population thought migrants were a top concern in 2005. Now, 39% consider them the most critical issue.



Growing mistrust in national governments in Greece (blue), Spain (yellow), Italy (green), and France (red)

Most people in the European Union support the EU and the Euro and believe there should be more political and economic integration within Europe. At the same time, they have a critical

view of EU policymaking and fear it is not progressing in the right direction. According to a poll conducted for the Bertelsmann Foundation, overall, 71% of the survey's respondents say that if a referendum were held, they would vote in favor of continuing EU membership for their country and 63% say they would vote in favor of staying in the Eurozone. In addition, 59% of the EU's citizens feel that the Union's political and economic integration should be increased, a figure that rises to 64% within the Eurozone. This general support does not, however, mean that people in the EU have a favorable view of recent policy decisions or are confident about the future. In fact, 72% of respondents say that European politics is moving "in the wrong direction." People living in the Eurozone view the situation even more critically (77%). These attitudes are accompanied by dissatisfaction over national politics, with 68% of respondents throughout the EU saying that policymaking in their own country is on the wrong path.

This will not change unless Europe and the Member States help each other create a stable framework for its people and cease fighting over short-term strategies. Limiting inequality, consolidating the welfare state, and favoring investment should be the *raison d'être* of European politics.