European Commission

SCIENCE FOR POLICY BRIEFS

Drivers and socio-economic impacts of inequalities in the EU[1]

Headlines

- Among the main determinants of inequality are the overall economic situation and the quality of institutions prevailing in a country.
- Other factors may affect aspects of inequality, such as unemployment, spending on social protection and education, and political stability.
- To reduce inequality, it is not sufficient to adopt policies that simply increase the size of the economic 'pie'. High-quality institutions are also needed to ensure that the 'pie' is distributed fairly. Education also plays a key role in alleviating inequality.
- In most cases, higher inequality is associated with less happiness and life satisfaction. This is particularly true for measures of vertical inequality, which are based on hard data rather than subjective observations.
- When it comes to measures of horizontal inequality (based on people's perceptions of inequality) there are instances where higher inequality is actually associated with greater happiness. This reflects the relative positions of different groups, with some more successful groups seeing inequality as a favourable state.
- Policies should aim to reduce inequality by (a) increasing the size of the 'pie' for all, and (b) improving social cohesion through the integration of all groups.

Uncovering inequality drivers and impacts

Inequality is a long-lasting phenomenon with major economic and social implications for individuals and societies. There are several challenges associated with studying inequality: how to define it properly; which of its multiple facets to capture; how to study its implications; and how to identify its major drivers.

Relying on the newly developed Multidimensional Inequality Monitoring Framework for the EU (EU MIMF), this policy brief discusses the results of an analysis of the major determinants of the multiple facets of inequality, and the implications of those aspects of inequality for individual happiness and life satisfaction.

Drivers of inequalities

Undoubtedly, there are a multitude of drivers for the aspects of inequality considered in the EU MIMF, as well as factors that mitigate or exacerbate the problem. Thus, it is essential to identify the main drivers of inequality that also point to clear policy principles.

This analysis takes account of a wide range of factors, such as income per capita, level of education, quality of institutions, spending on education and social protection, unemployment, ageing, urbanisation, and adult training.

It sheds light on three key conclusions with important implications for policymaking.

First, the size of the economic 'pie' (i.e. income per capita) is important. The most effective way to reduce inequality is to make societies and individuals more prosperous. And there are many ways of achieving this, such as expanding employment for all age categories or directing resources to the more vulnerable groups in society.

Second, and directly related to the first point, education is essential for the reduction of inequality, as a means of enabling all groups to access a wide range of job opportunities and escape poverty, and at the societal level as a way of raising awareness on a series of topics.

And finally, institutional quality also matters. High-quality institutions are important for the proper distribution of the 'pie' as well as ensuring that money is not allocated to shadow activities. Prosperity is not enough on its own. Strong institutions are needed for societies to prosper, for people to feel protected, to establish entrepreneurship, and to instill confidence in the economic system and among citizens.

[1] This policy brief has been prepared by Athanasios Lapatinas and Anastasia Litina. It builds on Chapter 4 of the JRC Science for Policy Report *Monitoring multidimensional inequalities in the European Union* (JRC123911). The policy brief and the full report can be downloaded from https://composite-indicators.jrc.ec.europa.eu/multidimensional-inequality.

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Socio-economic impacts of inequalities

The macroeconomic effects of inequality are analysed extensively in the literature, as inequality is one of the most important problems societies and economies face. However, less is known about the microeconomic implications of inequality for various aspects of individual outcomes.
This analysis exploits the wealth of inequality dimensions covered by the EU MIMF to assess their effect on individual happiness and life satisfaction.
The multilevel approach adopted makes it possible to capture the personalised effect of an aggregate variable in each individual outcome i.e. to understand how the same problem is perceived by different people.
This yields major economic implications as it makes it possible to capture the differential effects of different types of inequality.
The broad findings are in line with what would commonly be expected i.e. that more inequality is in most cases associated with less happiness and life satisfaction. This applies particularly to measures of vertical inequality (measures that are qualitatively more objective and based on actual data rather than subjective observations). However, what becomes clear is that there are also instances where higher inequality is actually associated with more happiness. This is particularly true with measures of horizontal inequality (those reflecting people's own perceptions of inequality, quite often in relation to other groups).
This points to two major implications for policy. It suggests that a first category of policies should be aimed at improvements in inequality that are visible and understood by all members of society e.g. equal employment legislation.
A second category of policies should focus on changing people's mindsets to encourage a more inclusive approach to different groups. For example, policies could seek to reduce frictions between men and women, young and old, and immigrants and those born in a country. Individuals should feel that equal treatment is essential in a society and not see themselves as in opposition to other groups, with one group's losses representing another group's gains. This could be achieved through growth-related policies that increase prosperity and reduce competition, as well as through cohesion and social integration policies.

Related and future JRC work

This policy brief is one of the deliverables of the JRC pilot research project on monitoring multidimensional inequalities in the EU. The complete project findings and the accompanying online tool for visualising and monitoring multidimensional inequalities in the EU are available at: https://composite-indicators.jrc.ec.europa.eu/multidimensional-inequality

Quick Guide

Analysis of inequality drivers
A series of cross-country analyses were conducted using the indicators of the Multidimensional Inequality Monitoring Framework for the EU (EU MIMF) as outcome variables and macroeconomic controls such as income per capita, level of education and quality of institutions as main explanatory variables.
For each of the 10 dimensions of the EU MIMF, additional explanatory variables, directly relevant to the themes of each dimension, were also included.
Country-level data were collected from a range of sources including Eurostat and the World Bank. Ordinary Least Square regressions show correlations between the set of determinants and the EU MIMF indicators.

Analysis of inequality impacts
A multilevel analysis was adopted to associate individual-level outcomes with macro-level and individual-level explanatory variables. This makes it possible to study how a common phenomenon such as inequality affects individuals in a society differently.
Two individual-level outcomes — life satisfaction and happiness — were selected from the topics covered in the European Social Survey (ESS). The ESS is a cross-national survey that collects information about the attitudes, beliefs and behavioural patterns of citizens in several European countries. Our study used 2018 data for the following countries: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Germany, Spain, Estonia, Finland, France, the United Kingdom, Croatia, Hungary, Ireland, Italy, Lithuania, Latvia, Netherlands, Poland, Portugal, Slovakia, Slovenia and Sweden.
The EU MIMF indicators were used as the main macro-level explanatory variables in this analysis. Other country-level variables such as income per capita and quality of institutions, as well as a series of individual-level controls that are potential confounders of individual happiness and life satisfaction outcomes were included in the set of additional explanatory variables.

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