INCLUSIVE GROWTH: TOWARDS EQUALITY AND SOCIAL COHESION IN EUROPE?

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Abstract

The overall aim of this study is to examine the concept of inclusive growth and decide whether it can be useful to incorporate it into the European social model. In the beginning, the whole issue, which has recently become a frequent topic especially in some Asian developing countries, is put into context with European social strategy, including the Europe 2020. The concept is presented as a multi-layered socioeconomic strategy with particular focus on its social aspects. The examined part include draft of solution whether inclusive growth can be really effective in raising the level of social conditions and cohesion. This is further extended by possible connection between social-related issues and economic growth. Examined dimensions include those dealing predominantly with poverty or unemployment rates and associated national targets of some countries and their recent performance. Criticism and concerns over the potential vagueness and diversity of interpretations of the concept is also included.

Key words: inclusive growth, inequality, cohesion, Europe 2020

JEL Code: J11, J19

Introduction

In recent times, it is becoming easier to accept the view that economic growth itself will ensure better living conditions. This growth is largely possible due to the fact that the economies of individual countries are more open and maximised economic growth can be deciding factor in reducing poverty. When connected with increasing standards of living, it is even speculated that growth in average incomes explains 70 percent of the variation in poverty reduction (as measured by headcount ratio) in the short run, and as much as 97 percent in the long run (Kraay, 2004). Therefore, this issue along with increasing life expectancy (Caréfalvaiová, Dotlačilová, & Langhamrová, 2013) has become important topic in developing countries in Asia and more recently – due to the economic crisis – in Europe.

However, growth alone may not be sufficient to bring in any major improvement to those, who are located at lower levels of the socio-economic ladder. From the historical experience, it has been learned that an important determinant of economic growth is industrialisation, which could result in labour demand for the unskilled or semi-skilled workers. With major deviations from this path – caused by expending tertiary sector – many countries are faced with employment challenges (Mitra, 2013). There was a need for theoretical base or "all-embracing" word that would emphasise focus on human development or human capital rather than on GDP or income.

That is included in the term "inclusive growth" that was not known until long after World War II and has been in circulation in the last few decades. Currently, it is becoming a crucial part of some European initiatives, such as the Europe 2020, indicating that affiliated problems can be tackled in a slightly different way.

1 The definition of inclusive growth

Some of the concepts of inclusive growth are vague and difficult to quantify, while others are more specific but do not grasp the essence of the concept. Although there is no single definition, there are definitely some "points of contact" which are shared. Despite this, inclusiveness itself seems to be rather elusive concept. From the sociological point of view, the term "inclusion" is most often paired with its opposite meaning – "exclusion". As Luhmann (2013) argues, inclusion can exist only if exclusion is possible and it is the existence of non-integrable persons or groups that renders social cohesion visible and makes it possible to specify conditions for it. It is also logical that intensive growth supports GDP gains and widen the gap between rich and poor simultaneously, whereas the essential part of inclusive growth is rather focused on more equal distribution of wealth. As mentioned above, the concept of inclusive growth is connected with GDP and income, but it also includes poverty and redistribution aspect and encompasses some other dimensions which are rather not tangible – such as participation in social life. Traditionally, it deals with poverty, inequality, human development and also "marginal" subjects like the sustainable use of natural resources. Investment in human capital is universally recognised as a key pillar of achieving inclusive growth. Investments in health or education have been also statistically linked to better economic development outcomes and to how inclusive growth works in practice as it enables poor people to participate and benefit from economic growth (Ravallion, 2004).

There is also a little clarity in distinction between the terms “inclusive growth” and “pro-poor growth” – sometimes both terms are even interchangeable. Nevertheless, two competing definitions of pro-poor growth emerged in literature. One of them focuses on poverty reduction, thus connecting pro-poor growth with any growth episode during which there is a drop in poverty rate (Ravallion & Chen, 2003). The other one simply requires the income of poor to grow at higher rate than that of wealthier and thus reducing relative inequality. The usage of the term “inclusive” in the characterisation of growth episodes can be traced back at least to the turn of the century and it came to light amidst the unfolding of the debate over pro-poor growth. Beyond an attempt to clarify the meaning of pro-poor growth, the emergence of the concept of inclusive growth may be seen as relating to the realisation that growth processes – apart from income – may have impacts on ethnic and gender groups or geographical regions as well (Ranieri & Ramos, 2013). Klasen also argues that pro-poor growth focuses on people below poverty line, whereas inclusive growth is more general in the sense that whole society – including the poor, the near poor, middle income groups, and even the rich – may benefit from it (Klasen, 2010). According to this, inclusive growth reduces disadvantages of the most disadvantaged, while pro-poor growth might be achieved either in the absence of benefits to one or more groups or at expense of one or more groups (Ranieri & Ramos, 2013).

This seems to be somehow connected with “absolute” and “relative” definition of pro-poor growth. Ravallion and Chen (2003) add that under the absolute definition, growth is considered to be “pro-poor” as long as poor people benefit in absolute ways, while relative definition recognises growth as “pro-poor” only if incomes of the poor grow faster than those of the population as a whole. To sum up, absolute pro-poor growth can be achieved by redistribution schemes, while – for growth to be inclusive – the economy must be enlarged and entrepreneurship and employment opportunities must be created.

1.1 Economic dimension of inclusive growth

At first glance, economic growth and poverty analyses have nothing in common, but current approach to this question is shifting. Kuznets (1955) argues that growth produces inequality in the early stages of development and there comes a turning point after which inequality declines – that is caused by rise in per capita income. This hypothesis by Kuznets is also known as “inverted U” hypothesis because of the described phenomena of rise and consequent fall of inequality. In liberal policy regimes where markets are the dominant mechanisms for allocating resources, social development and poverty reduction is rather modest, compared to the experience in social democratic regimes where the government plays a much greater role in influencing the economy (Venkataraman, 2013). However, higher growth rates can be attained only by strengthening its source, which basically means necessary improvements in the utilisation and share of workforce in the population.

It follows that not all means of growth can be effective in reducing poverty. Between 1990 and 2010 extreme poverty was cut by one half, implying that the eradication of extreme poverty within a generation is possible (Ravallion, 2004). However, it will be now much more difficult to continue in a set pace because the second half of these people was initially immersed in the deepest kinds of poverty. Moreover, it was estimated that in the 1980s it took 3% GDP growth to generate a 1% increase in employment, but in the 1990s this changed significantly and it then took 8% increase in GDP to achieve the same result (Felipe & Hasan, 2006). The situation is even worse nowadays as Lee (2013) predicted that 600 million new job positions will have to be created in the next fifteen years just to keep employment levels constant. Therefore, the conduct of fiscal and monetary policies at the aggregate level is crucial in how successful each nation is in achieving the aim of inclusive growth (Lavopa, 2011).

2 The Europe 2020

The financial crisis that broke out in 2008 has struck markets of EU Member States. Unemployment levels and the levels of debt have risen and the positive trend of economic growth has been at least severely hampered. The Europe 2020 Strategy was introduced in 2010, partly as a response to the crisis and partly according to the framework of a longer-term growth and reform agenda. In that year it formally replaced the Lisbon Strategy for Growth and Jobs which was in force since 2000. The Lisbon Strategy ultimately failed in delivering its goals based on the idea of most competitive economy of the world, capable of sustainable growth and greater social cohesion. The Europe 2020 has been the first serious attempt to incorporate inclusive growth in broad strategy of the EU, set its tangible targets and connect it to smart and sustainable growth. The whole strategy resembles the Lisbon as it calls for structural change and focuses not only on economic aspects but also on employment-related or social policies (Jordan, 2014). At the uppermost level, the Europe 2020 is divided into three dimensions: smart growth (effective investments in education, research and innovation), sustainable growth (climate change and energy objectives) and inclusive growth.

According to the European Commission (2014), inclusive growth generally means raising employment rates all over Member States, helping young people or older workers find more and better jobs, modernising labour markets, and more. National governments have a major role in making the strategy a success. Countries have set their national targets which are politically binding and have been agreed by EU leaders.

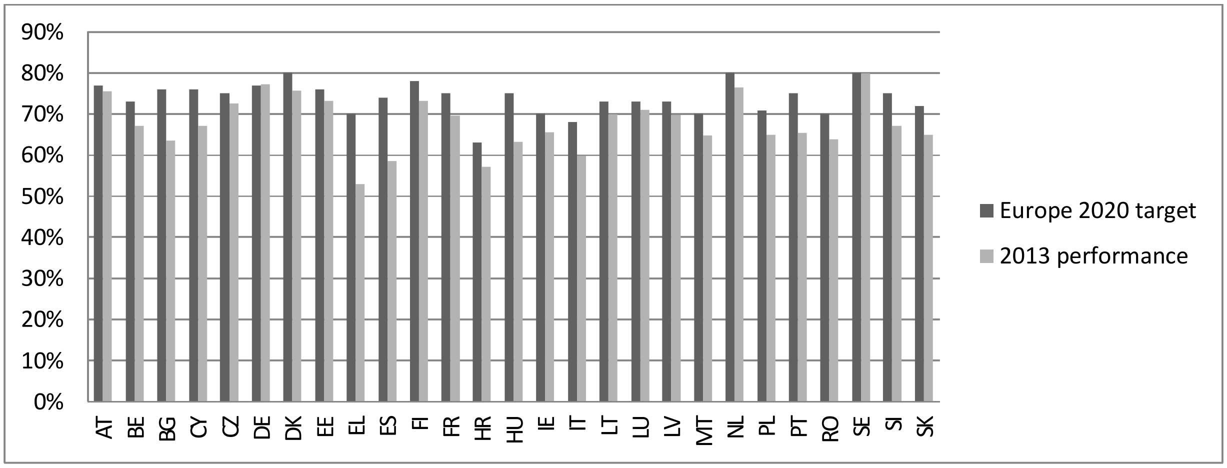
2.1 The current situation and target performance

Inclusive growth targets have set ambitious goals – to reach 75% employment rate for men and women aged 20-64 and to ensure 20 million fewer people are in or at risk of poverty or social exclusion. Other less "pressing" matters include education aspects dealing with the reduction of school drop-out rates (below 10%) or striving to increase the level of people with a third-level degree (at least 40% of 30-34-year-olds completing it). Main targets are supposed to be achieved through flagship initiatives "Agenda for new skills and jobs" and "European platform against poverty" (European Commission, 2014).

Nevertheless, the overall performance of the European Union is expressed in rather disappointing figures and trends. Significant progress would be needed to reach the employment rate target by 2020. Although the employment rate rose from 66.6% to 70.3% between 2000 and 2008, it then began to fall due to the crisis. In the most recent years it has been stabilised at roughly 68.5%, still deep below the target. If "business as usual", the European Commission (2014) estimated that the employment rate would reach 71.8% in 2020 and the EU would need additional 16 million people to meet the target by 2020. If national targets are met, it would rise to 74% and therefore roughly 5 million people would be needed according to Eurostat data. However, the gap between national targets and performance of some countries is so enormous that it raises doubts. This is obvious according to Figure 1 which shows all national targets and their performance in 2013[1]. The underperformance of countries in Southern Europe such as Greece or Spain is connected with social difficulties caused by persisting effects of crisis. Nevertheless, countries in Northern and Western Europe generally show better outcomes. The difference between national target and performance ranges from 0.2% in the case of Sweden to 17.1% in the case of Greece.

[1] Except for the United Kingdom with no national target in examined section.

Fig. 1: The Europe 2020 employment rate national targets and the performance in 2013



Source: Eurostat database, own construction

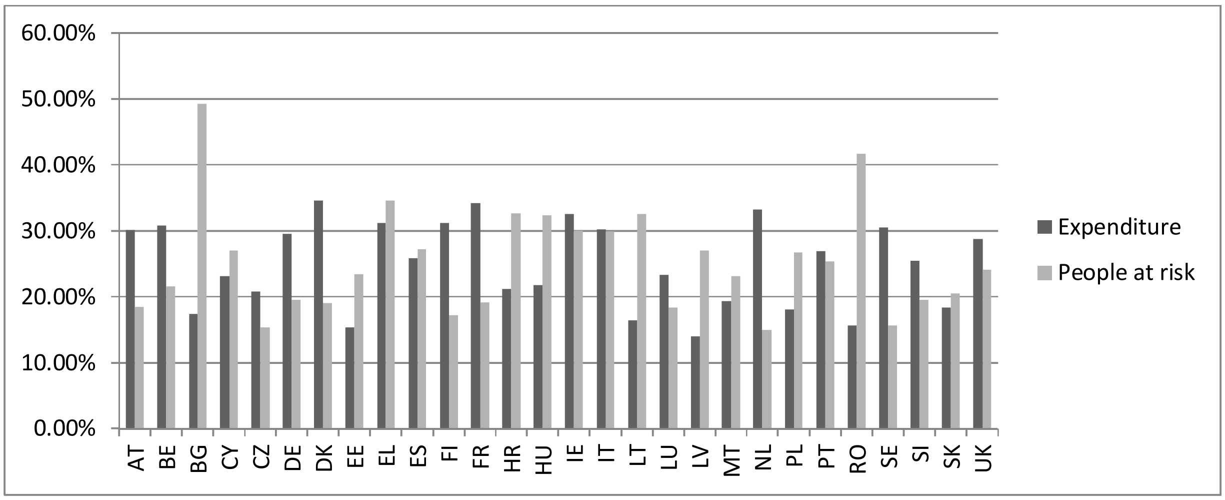
Figures for poverty target show similar trends. The crisis undermined efforts to decrease the number of people exposed to poverty or social exclusion. Transferred into absolute figures, the target corresponds to a situation where approximately 96.4 million people are affected by these conditions in 2020. Again, figures between 2005 and 2009 indicated promising decline (124 million people in 2005 compared to 114 million in 2009). At this rate, the target would be met by 2017. But as of 2013 there are 121.6 million people at risk of poverty or social exclusion, currently failing the objective by more than 25 million people. Some countries simply set this target in absolute figures, while the others set it according to their past experience[2]. This indicator probably will not intersect the 100 million line by 2020 and will remain somewhere close above it.

Comparison of expenditures on social protection and number of people at risk of poverty or social exclusion provides another interesting insight. Expenditure on social protection contain transfers to households and individuals according to defined risks or needs, administration and other costs. The second indicator corresponds to the sum of persons who are at risk of poverty (below 60% of the national median equalised disposable income) or severely materially deprived (experienced at least 4 of 9 designated deprivation items) or living in households with very low work intensity (work less than 20% of their total work potential during the past year). Roughly a quarter of the EU population (25.23%) was at risk of poverty or social exclusion in 2012 while average expenditure on social protection represented 25.01% of GDP. It is understandable that there is no direct correlation between

[2] For example the Czech Republic intends to maintain the number of persons at risk of poverty or social exclusion at the level of 2008 (15.3% of total population) with efforts to reduce it by 30,000 persons.

these two indicators. The main reason is that expenditure on social protection is measured as a percentage of GDP while people at risk of poverty or social exclusion as a percentage of total population. GDP of some country totally focused on social protection would not automatically mean the eradication of poverty. Therefore, although definite conclusion can not be drawn, an inverse proportionality can be found in the case of many countries as seen in Figure 2.

Fig. 2: Social protection expenditure levels (% of GDP) and people at risk of poverty or social exclusion (% of total population) in 2012



Source: Eurostat database, own construction

2.2 Criticism

In recent decades, it has become "comfortable" for some countries to suggest that all policy considerations tackling poverty and social exclusion are subjugated to fiscal consolidation and other goals. GDP growth rates have been on higher level than income growth rates in countries like Germany or the Czech Republic. The crisis and the subsequent austerity measures have further emphasised these tendencies. The predominance of public finance concerns over inclusive growth is particularly striking in the cases of countries that have been performing below the average in terms of poverty or social exclusion, but have no particular problems in terms of the sustainability of their public finances (Jordan, 2014). Also, unemployment has become a policy tool to reduce inflation rather than a policy target, and governments have been even encouraged to generate budget surpluses (Lavopa, 2011). The macroeconomic approach of the EU is also not much in accordance with the strategy of inclusive growth.

Moreover, the overall level of poverty has not decreased, but increased in the last few years and it is unlikely that the Europe 2020 targets will be met. There are now wide inequalities in the distribution of income in the EU: on average, the top 20% earned 5.1 times as much income as the bottom 20% in 2012. This ratio varied significantly across the EU, from 3.4 in Slovenia and 3.5 in the Czech Republic to 7.2 in Spain (European Commission, 2014). The problem of the very definition of inclusive growth was mentioned in the beginning.

Conclusion

It seems that the Europe 2020 targets regarding inclusive growth will conclude with "business as usual". The rates of employment and poverty have been unsatisfactory since the beginning of the crisis and most predictions indicate that this situation will improve just slightly in the coming years. Moreover, national targets have uncovered several gaps between EU Member States and austerity policy is further worsening it.

Inclusive growth is rather vague term and it is sometimes interchangeable with pro-poor growth which adds more confusion to policy-making. It is still not clear whether inclusive growth means equity or equality of opportunity or participation or something else. The relationship between economic and inclusive growth needs to be explained in greater depth. Also, two indicators (employment rate and poverty or social exclusion levels) are not sufficient to grasp the whole concept and provide any coherent outcome. More indicators and clearly defined objectives would be needed to enhance the overall performance of the Europe 2020.

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