



# Social dimension of austerity measures

## Cases of four EU countries in receipt of financial assistance

**SUMMARY** *The economic and financial crisis has been affecting the EU since 2008. The effects of growing budgetary deficits have included the increase in governments' borrowing costs to unsustainable levels in Greece, Portugal, Ireland and Spain, forcing them to request financial assistance. In return, they committed themselves to reducing the deficits through spending cuts and increases in taxation, with a series of so-called austerity measures. The collapse of the financial sector has more recently led Cyprus to do the same.*

*Current analyses show that the austerity measures are likely to contribute to a failure to achieve the employment and reduction of poverty goals of the Europe 2020 growth strategy. Research suggests there are causal relationships between large spending cuts, economic contraction and rising unemployment and income inequalities. Other possible adverse effects of austerity include its disproportionate impact on youth and women unemployment and lower income groups. In the future, austerity measures may also affect the attainment of the education targets of Europe 2020 in all four countries.*

*The European Parliament states that austerity measures exacerbate the negative social consequences of the crisis and that a comprehensive impact assessment of their social repercussions should be carried out.*

### In this briefing:

- Background
- Effects on selected Europe 2020 targets
- European Parliament
- Annexes

### Background

The financial and economic crisis has been affecting Europe since 2008. In 2009 it [caused](#) a 4.3% reduction in EU GDP, ending a decade of economic growth. Falling GDP, rising unemployment and shrinking tax revenues caused governments' finances to deteriorate. Greece (EL) and Portugal (PT) had high government debt levels before the crisis, while Ireland (IE) and Spain (ES) were forced to deploy public funding to prevent collapse of their financial institutions (which had been severely affected by the burst of property bubbles). Higher risks associated with lending to these heavily indebted countries increased the costs to levels [unsustainable](#) for their governments.

Between spring 2010 and spring 2011, the European Commission (EC), European Central Bank (ECB) and International Monetary Fund (IMF) started providing EL, PT and IE with financial assistance conditional on reducing government deficits, debt accumulation and implementing structural reforms. In 2012 ES was forced to request assistance from the euro area Member States (MS) for its hard-pressed financial sector. All four countries<sup>1</sup> started fiscal consolidations [considered](#) very large in

**Austerity as % GDP**

	2009 - 2011 implemented	2012-2015 planned
EL	10.3	8.2
IE	12.7	5.2
PT	5.7	6.5
ES	2.7	4.6

Source: [OECD](#)



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a historical perspective. The attempts to reduce the budget deficit (austerity measures) [combine](#) expenditure measures such as spending cuts ([fiscal consolidation](#)) and revenue measures such as tax rate rises or base broadening. Country-specific information is in Annex 1. The more recent case of Cyprus is also discussed although in less depth due to data limitations.

### Effects on selected Europe 2020 targets

This section examines the effects of austerity measures on [national Europe 2020 targets](#) concerning employment, risk of poverty and education as set by governments in 2011. Some economists [claim](#) that the impact of reduced government spending is magnified in worsening economies and therefore such measures work [better](#) in times of economic [boom](#). Furthermore, many [argue](#) that the crisis caused radical [marginalisation](#) of European social policy, in comparison with macroeconomic and financial [concerns](#), and hence these EU 2020 targets are [likely to be missed](#).

#### Employment

*Impact of fiscal consolidation on employment*  
IMF research [shows](#) that fiscal consolidation in an economy with a high perceived risk of sovereign default contributes to its contraction<sup>2</sup> - firms are likely to [adjust](#) to it by reducing employment. Economists suggest that each GDP percentage point of fiscal consolidation [increases](#) unemployment on average by almost one-tenth of a percentage point, with the impact larger for expenditure-based measures. In addition, when high unemployment is already present, even a small reduction of public deficits through austerity measures [results](#) in a high cost in unemployment terms. Lower public investment reported in all four countries also [increases](#) unemployment.

Furthermore, some austerity measures may have exacerbated unemployment problems. Oxfam [reports](#) on the negative effects of the

cuts in public sector employment, as well as labour law reforms which facilitate redundancies and dismissals<sup>3</sup>, but some argue that there is [no evidence](#) that maintaining employment protection regulation would have resulted in better employment results.

Some economists also suggest that austerity measures have a particularly crucial impact on increasing unemployment in countries like ES and PT where it is predominantly [cyclical](#) in nature (caused by recession and a drop in domestic demand). Indeed, recent data suggest that - while structural unemployment is on the rise - cyclical unemployment may be [substantial](#) in all four countries (which also experienced subdued domestic demand and persistent recession). Notably, in 2013 IMF researchers concluded that in 2010 its forecasters had [under-estimated](#) significantly the rise in unemployment and the shrinking domestic demand associated with fiscal consolidation. In September 2013, an IMF paper suggested that even for countries under fiscal pressure there may be a "[speed limit](#)" for the pace of fiscal adjustment, beyond which it becomes counter-productive.

#### Female and youth unemployment

In all four countries, unemployment for women and young people has risen between 2009 and 2012<sup>4</sup>(see Annex 2). In PT and ES women's unemployment has been [rising](#) at a similar rate to men's, in EL slower, and in IE faster.

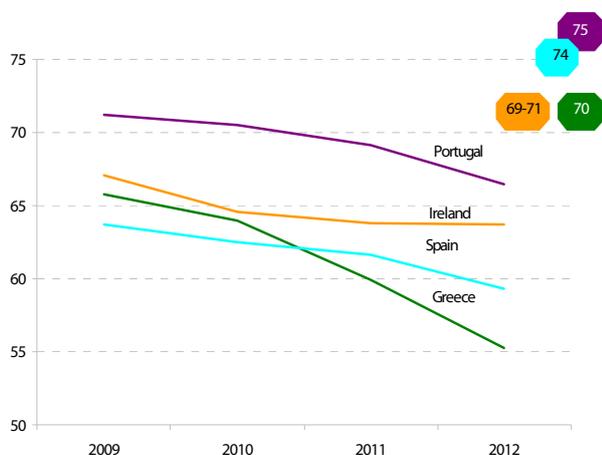
National experts (e.g. from EL, IE, PT) agree that austerity measures such as staffing cuts in the public sector are likely to have a [direct effect](#) on female employment levels as their representation in these jobs is higher than in the commercial sector. Women's organisations [argue](#) that in EL, ES, and PT austerity measures also significantly affected employment in female-dominated sectors such as education, health and social services. In all four countries, after progress recorded up to 2008, women's employment rates have fallen below, or close to, 2005 levels.

Youth unemployment (15-24 years old) has been rising at an alarming pace since 2009 reaching rates higher than unemployment for both men and women in all four countries. Data for selected OECD countries [illustrates](#) that the correlation between fiscal tightening and youth unemployment is the highest for EL, ES and PT and also very high for IE: estimates show that a one percentage point increase in the fiscal balance increases youth unemployment by 1.5 percentage points. Research also confirms that variations in youth unemployment are strongly [correlated](#) with variations in fiscal policy. Austerity affects youth in [many ways](#): they have to compete with a larger number of more experienced job-seekers for fewer jobs due to a general rise in unemployment, they are usually employed in sectors with high sensitivity to economic contraction (e.g. manufacturing) and they are disproportionately present among those on less secure temporary contracts or in part-time jobs (whose numbers are rising due to labour market reforms).

### *Effect on reaching the EU 2020 target and outlook*

In all four countries, employment levels have been on a downward trajectory during the crisis, and the EC [acknowledges](#) that the employment targets do not appear feasible.

**Figure 1 - Employment rates and EU 2020 targets**



Source: [Eurostat](#)

Some researchers forecast that continuing to focus policy on reducing public deficits will result in further severe [deterioration](#) of unemployment in EL, ES and PT (and to a lesser extent in IE) in the mid-term (up to 2017). Others estimate that austere fiscal policy increases cyclical unemployment and the effects are likely to be mostly [temporary](#).

### **Risk of poverty or social exclusion**

#### *Distributional effects of fiscal consolidation on household income*

IMF research [shows](#) that spending-based and large-sized fiscal consolidations tend to significantly increase income inequality: 15-20% of this increase is due to unemployment resulting from austerity measures. A 2011 [study](#) states that the austerity programmes in EL, IE, PT are dominated by spending [cuts](#) (others assert [the same](#) for ES). Further [research](#) argues that spending cuts are mostly regressive in nature (affecting lower income groups to a greater extent) and likely to widen income inequalities<sup>5</sup>. EC data shows that between 2008 and 2012, income distribution inequality has indeed [grown](#) in EL, ES and IE and remains a major concern in PT. Cuts in social benefits and unemployment resulting from austerity measures, and [lowered wages](#) due to structural reforms also feed into rising poverty levels. Furthermore, a Commission report found relatively high levels of [in-work poverty](#) in ES, EL and PT due to low minimum wages (cut or frozen by the [austerity measures](#)).

In all four countries, pre-austerity spending on benefits reportedly [protected](#) incomes from the effect of the early crisis. A 2011 OECD study [found](#) that in countries with a sovereign debt crisis, initial crisis responses generally increased social protection, while later pension reforms and reductions of pension levels subsequently resulted in widening income gaps, affecting mainly the poor. The Euromod 2013 [study](#) concluded that household incomes were reduced because of austerity by 11.6% in EL, 8% in IE (earlier [study](#)), 6.3% in PT and 4.3% in ES.

The distributional effects varied among these countries depending on the design of the package: cuts to benefits and pensions affected lower income households more (ES, IE, PT), while increased taxes affected the middle (all but EL) and higher income groups (all) more. Overall, richer income groups were found to be more affected by the income cuts in relative terms in EL and ES, whereas in IE and PT the proportional reduction in income was higher for low and high income groups than the middle group. The report finds that in all countries the risk of poverty has risen<sup>6</sup> due to a general fall in household incomes.

An early Commission-financed [study](#) has somewhat contradictory findings and argues that austerity packages in EL and ES were designed to minimise losses for lower income groups and their impact is less significant than expected.

### Effect on reaching the Europe 2020 target

The number of people at risk of poverty or social exclusion increased in all four countries, and the EC [acknowledged](#) that only strong reversal of current trends would

#### People at risk of poverty

	2009 - 2012 (in 1000s)	Target
EL	+788	- 450
IE	+169 (in 2011)	- 186 (by 2016)
PT	+17	-200
ES	+1858	-1400 /1500

Source: [Eurostat](#)

enable the targets to be met. The researchers argue that national responses to the crisis do not appear appropriate for the [mitigation](#) of its social effects. In contrast, austerity measures are indeed likely to lead to poverty and social

exclusion and as such are considered by some to [counter](#) the poverty-reduction target. Therefore, [poverty](#) experts consider attainment of this target unlikely.

### Early school leavers and tertiary education attainment

#### Fiscal consolidation's impact on education

Austerity policies have led to overall budget and salary cuts in the [education sector](#) in all four countries, although the measures

differed, [including](#): increased university fees (ES), increased class sizes ([all four](#)) reduction in number of teachers (EL, [ES](#), PT), [limiting curriculum](#) and decreased funding for specific support programmes (e.g. preventing early school leaving), and construction, maintenance and renovation of buildings (IE), and decreased financial support for students or families with children in education (ES, PT).

#### Recent trends and outlook

Levels of early school leavers (now aged 18-24 years old) are decreasing in all four countries. The 2013 [monitoring report](#) of the Committee of Regions (CoR) suggests this trend may be partially explained by young school leavers having increased difficulty in finding a job, and therefore prolonging their education.

Early school leavers (%)

	2009	2012	Target
EU	14.2	12.7	10
EL	14.5	11.4	9.7
IE	11.7	9.7	8
PT	31.2	20.8	10
ES	31.2	24.9	15

Source: [Eurostat](#)

However, a Council of Europe [report](#) warns that austerity-driven cuts in education spending may later lead to an increase in the numbers of early school leavers. A Eurostat [report](#) shows that reducing the drop-out rates and meeting the Europe 2020 target is still a key challenge for ES and PT. The 2013 Caritas report on austerity [considers](#) the targets are realistic for EL and IE, and may be challenging for PT, while ES needs more comprehensive measures. In 2012 the EC [set](#) a country-specific recommendation for ES to address high levels of early school leavers.

Between 2009 and 2012 the tertiary education attainment levels (age group 30-34) have been rising in all four countries. According to the same 2013 CoR report, tertiary education as a phenomenon does not

Tertiary education (%)

%	2009	2012	Target
EU	32.1	35.7	40
EL	26.5	30.9	32
IE	48.9	51.1	60
PT	21.1	27.2	40
ES	39.4	40.1	44

Source: [Eurostat](#)

depend entirely on short-term economic trends and the austerity policy effects may emerge with a time gap. Also, some may have returned to or prolonged education in order to [improve](#) their future labour market chances.

PT, which is furthest off the target, [reported](#) severe effects of austerity measures on tertiary education organisation (including limiting [social support](#) for students) - but EL, ES and IE are also [affected](#). Countries which are scoring well at the moment in tertiary education (IE, ES) already have or plan to introduce higher fees, which [may](#) compromise their meeting their targets (a Caritas report on austerity expects [difficulties](#) for the two countries). Indeed, cuts to scholarship schemes in ES have started to [result](#) in higher drop-out rates.

## European Parliament

In its [resolution](#) of 31 January 2012, the EP stated that the already far-reaching social consequences of the crisis have now been exacerbated by the austerity measures. The MEPs deplored the fact that economic policy guidelines initiated by the Commission lack parliamentary involvement and therefore democratic legitimacy.

The EP also called on the Commission to ensure that the implementation of the

measures agreed with the EC, ECB and IMF is fully compatible with the employment and poverty reduction targets of Europe 2020.

In its [resolution](#) of 4 July 2013, the EP called on the Commission to carry out social impact assessments of austerity measures. MEPs considered that austerity measures should not under any circumstances deprive citizens of access to basic social services, and should not reverse positive trends in policy development.

In its [resolution](#) of 8 October 2013 the EP stated that there is consensus that austerity and budgetary cuts alone do not revitalise the economy, and expressed concern that prolonged austerity measures risk reducing the scope of local policies targeted at accomplishing the goals of the Europe 2020 strategy.

### Austerity measures in Cyprus

Following the November 2012 provisional staff-level agreement with the EC, ECB, and IMF, Cypriot authorities [adopted](#) a number of austerity measures for the period 2012-14, amounting to 2.6% of GDP for the first two years. The bulk of these measures are on the [expenditure side](#), and concern the public sector.

Because the measures are so recent there is as yet little research measuring their impact. It is hard to disentangle the effects of austerity measures from those of the crisis and prolonged recession. The Euromod 2013 [study](#) found that pre-bailout austerity measures have had more impact on medium and higher income groups (the government even introduced a new benefit to support lone parents). However, the study concludes that the bailout-related second wave of measures is likely to increase the social costs: "Austerity measures, even if they target middle and high incomes, are responsible for falling economic activity and rising unemployment, and thus indirectly raise the material deprivation of the poor given that unemployment risk is asymmetrically distributed."

Considering the Europe 2020 targets, on 29 November 2013, Eurostat [reported](#) that compared with a year ago Cyprus saw one of the highest unemployment rate increases in the entire EU. Employment has been [worsening](#) from 70.7% in mid-2012 to 67.3% in mid-2013 (the target is 75%). Poverty has been on the rise, but the latest [published](#) data come from 2012.

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<http://www.library.ep.ec>  
<http://libraryeuroparl.wordpress.com>

## Annex 1: Selected state austerity measures (data gathered in November 2013)

### Selected state expenditure austerity measures / Retirement age increases

	Public sector pay		Public sector pensions		Civil service	Retirement age	Unemployment benefits	Minimum wage		Reduced budgetary expenditure	
	Freeze	Cut	Freeze	Cut	Reduction	Increase	Reduction	Freeze	Cut	Welfare	Education
Greece	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓
Ireland	✓	✓	✓	✓	✓	(2014)	✓		✓	✓	✓
Portugal	✓	✓	✓	✓	✓	(2014)	✓	✓		✓	✓
Spain	✓	✓			✓	✓	✓	✓		✓	✓

Sources: Eurofound [Reports](#), Irish Presidency [2013 Survey](#), European Semester [Documents](#), Intereconomics [Forum](#), OECD [Report](#).

### Selected state revenue austerity measures

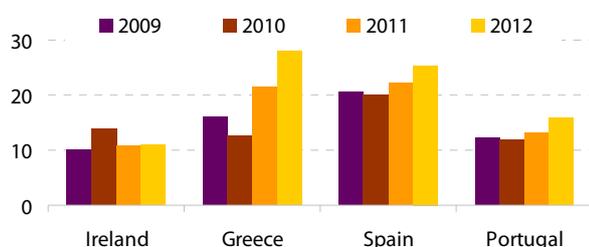
	Rate increase					Tax base broadening					Property Tax	Other taxes
	VAT	PIT*	CIT*	SSC*	ED*	VAT	PIT	CIT	SSC	ED		
Greece	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓
Ireland	✓	✓		✓	✓		✓		✓	✓	✓	✓
Portugal	✓	✓	✓	✓	✓	✓	✓	✓	✓		✓	
Spain	✓	✓			✓	✓	✓	✓		✓	✓	✓

Sources: Commission's [taxation papers](#), KPMG tax rates [online tool](#), Tax Journal [2012 Report](#).

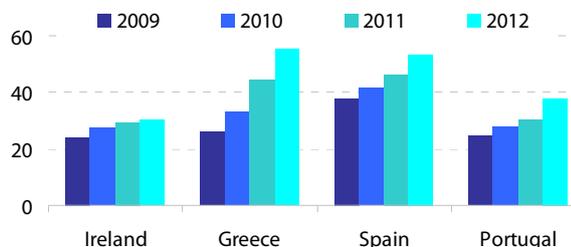
\* PIT: Personal Income Tax, CIT: Corporate Income Tax, SSC: Social Security Contribution, ED: Excise

## Annex 2: Female and youth unemployment (2009-2012)

**Fig.1 Female unemployment**



**Fig.2 Youth unemployment**



Source: Eurostat

## Endnotes

<sup>1</sup> [Greece](#), [Ireland](#) and [Portugal](#) implement austerity measures under their Economic Adjustment Programmes negotiated with the EC, ECB and IMF. For [Spain](#) assistance was provided first by the [European Financial Stability Facility](#) and then taken over by the [European Stability Mechanism](#). Spain implements austerity measures under commitments stemming from [Excessive Deficit](#) and [Macroeconomic Imbalances](#) Procedures.

<sup>2</sup> Data [shows](#) that all four MS had very large fiscal balance changes (as% of GDP) and very large contractions of GDP.

<sup>3</sup> All four countries have undertaken labour market reforms encouraged by the [Commission](#), with a view that flexible labour markets encourage employers to hire more staff and stimulate growth.

<sup>4</sup> Part of the explanation behind the sudden spike and then slower increase in Ireland may be contributed to slower downsizing of the public sector, (which has a heavy presence of women) due to the [Croke Park agreement](#) between the government and the trade unions. The ILO [report](#) says however, that they still have much to lose due to public job cuts.

<sup>5</sup> Some revenue measures like increasing VAT are also [known](#) to affect lower income groups disproportionately.

<sup>6</sup> Eurochild [reports](#) that children are especially vulnerable to poverty and criticises austerity measures affecting them in IE and PT.