30 March 2021

Eurozone

Covid-19 hits European cohesion

The Covid-19 pandemic has not only had an unequal impact on public health, it has also widened economic divergence and threatens to spread future economic inequality, which could put European cohesion at risk. One year after the first lockdown measures were taken, we find that the risk of higher inequality is present in various forms within the European labour market. Here are our main findings:

- Government support measures kept unemployment and employment relatively stable. However, the numbers of hours worked shows large divergences across eurozone countries. In the eurozone, this number dropped by 17% in 2Q20, but the decline ranged from 7.5% in the Netherlands to 26% in Greece.
- The divergence in hours worked is clearly related to the relative dominance of sectors that were hit hardest by lockdown measures (manufacturing of vehicles and transport material; wholesale and retail trade; hotels, restaurants and air travel; professional and real estate services; arts and entertainment). These represent up to 40% of the national gross value added in Greece, but less than 25% in Ireland.
- These sectors present shared characteristics across countries, making these countries vulnerable to a rise in inequality: the sectors are intensive users of non-standard contracts (where lower-educated and young workers are concentrated) and low-paid jobs. The former represents 30.5% of employment in Covid-vulnerable sectors in the eurozone, the latter, 23%.
- The risks of seeing a surge in inequality due to Covid emerge in two dimensions along which we can map countries: the share of employment covered by either non-standard or low-wage contracts in vulnerable sectors. This shows that vulnerabilities can be different from one country to another: low-wage workers in Germany and Ireland, non-standard contract workers in Portugal and Spain, and both in Greece and the Netherlands.
- The most recent data shows that in 4Q20, vulnerable sectors were still far from recovery, in sharp contrast with the rest of the economy. This confirms that the current slack in the labour market is heavily concentrated and lasting, which increases the need for specific policy actions to hamper any surge in inequality.

Most striking figure

-8.3%

The gross value-added loss (GVA) that is still measured in the most vulnerable sectors of the eurozone in 4Q20 while the rest of the economy is only 0.9% below pre-crisis levels.

When the Covid pandemic hit the world in 2020, we all faced new responsibilities, with each of us tasked to do simple things to protect others. For a time, it seemed that we were all in the same boat. However, job market realities served as a swift reminder that not everyone would be hit equally in Western economies. With specific sectors and some worker categories hit more than others, a number of inequality measures have been at risk of rising ever since. These measures are multi-dimensional: the Covid crisis and its accompanying episodes of lockdowns have had heterogeneous macroeconomic effects, between countries, age and education categories, and even between genders. The risk of seeing inequality rise because of the pandemic is real, both in the short- and long-run.

Measuring inequality is a long and difficult process: most data is annual (the last Gini indicators date back to 2018 in most cases) or delayed, or lacking the granularity required to make macroeconomic observations between income or age groups in a timely manner. Given the nature of the Covid crisis, we concentrate here on country divergences and labour market developments. Eurostat's labour force surveys, which are available for 2020, allow us to understand what actually happened in the job market and where the

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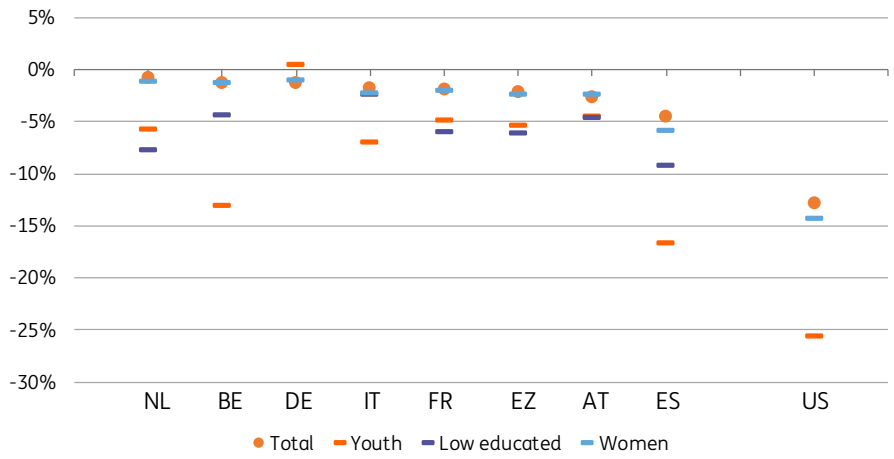
1 Job market evolution during the pandemic

When looking at employment figures in the eurozone, the Covid crisis seems barely visible. Figure 1 shows that the eurozone's contraction in employment in the second quarter (2.1%) was relatively mild compared to the economic shock (GDP was down 15% compared to 4Q19) or what was observed in the US (-12.8% of total employment). Employment statistics are therefore grossly underestimating the true scale of the labour market distress during the current pandemic.

This is because workers on temporary unemployment schemes ("furloughed" workers) were actually not counted as unemployed: they were unable to go to work, sometimes losing a sizeable share of their incomes (as benefits did not always cover all of their revenue losses), but at the same time they were not looking for a job, as they still had one. As several studies have recently[1] shown, up to 35% of all employees in France (and 30% in Italy) were under such schemes at the height of the crisis. In the eurozone, this represented 32 million workers at the peak, which was three times the number of unemployed at the time.

Employment data nevertheless shows that different categories of workers were hit in different ways. For example, in the eurozone, the drop in female employment was only marginally higher than the average, while employment declined more for workers with a lower[2] educational level or a younger age: respectively -6.1% and -5.0% compared to the -2.1% average. As a consequence, the eurozone youth unemployment rate increased from 15.5% at the end of 2019 to 17.7% in June 2020 and was still at 18.5% at year end, even though total unemployment abated in the course of 2020. From Figure 1, one can see that countries presented various heterogeneity levels in the employment contraction, with Belgium and Spain seeing the largest gaps between young workers and the national average.

Fig 1 Employment drop in 2Q20 (vs 4Q19; in %) per category



Source: Labour Force Surveys (15-64 y.o. population, seasonally adjusted data, not calendar adjusted data) and own computations

So, employment data shows that the crisis hit some people more than others but overall underestimates the scale of the shock. Eurostat's labour force surveys can teach us more about what actually happened: while the unemployment rate in the eurozone peaked at 9% in July, it shows that 17% of workers did not work a single day during 2Q20, something that looks more comparable to US figures where the unemployment rate peaked at 15%.

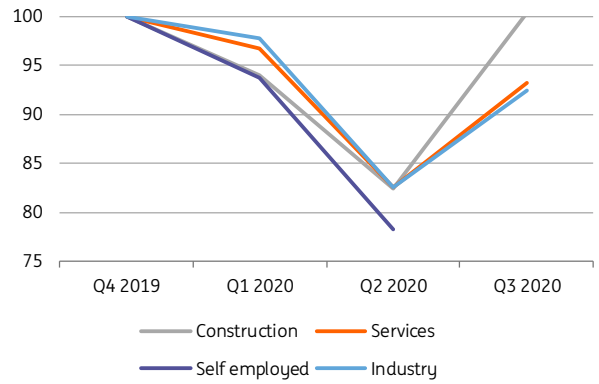
[1] Source: ECB Economic Bulletin 2020-08 ; see also our recent ING Think article.

[2] Defined here as the percentage of the population aged 25-64 who have completed, at most, lower secondary education (ISCED 0-2; Eurostat) (low educated) and 15-24 years old (young workers).

Looking at the hours worked component of the survey for example offers a more accurate picture of the labour market evolution. As Figure 2 shows, hours worked in the eurozone decreased by more than 15% in all sectors in the second quarter and by more than 20% for the self-employed. This compares to the 2.1% employment rate drop we described above (vs Q4 2019). Since then, data has shown that the economic recovery lifted hours worked in the construction sector, while hours worked in services and industry were 6.7% and 7.5% below their pre-pandemic levels in 3Q20, respectively.

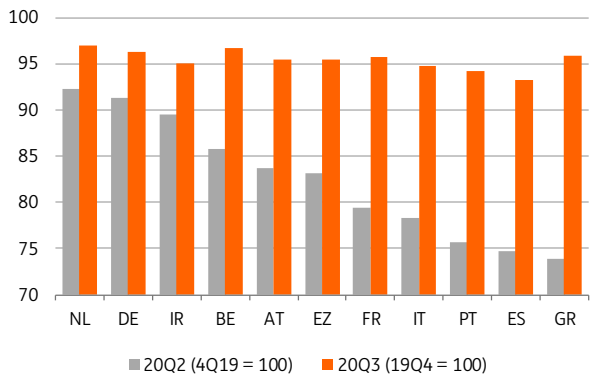
At the country level, Figure 3 shows that while the shock had a very different impact between countries (hours worked contracted by less than 10% in Germany and more than 25% in Spain), the third quarter put countries back on a similar footing. However, if divergences are less obvious in 3Q20, they nevertheless remain relatively high: hours worked in 3Q20 ranged from 97% of the pre-crisis level in Belgium and the Netherlands to just 93.2% in Spain, for example.

Fig 2 Hours worked per sector in the EZ (4Q19 = 100)



Source : ECB Data Warehouse

Fig 3 Hours worked per country in the EZ (4Q19 = 100)



Source: ECB Data Warehouse (NBB for Belgium) Data are seasonally adjusted

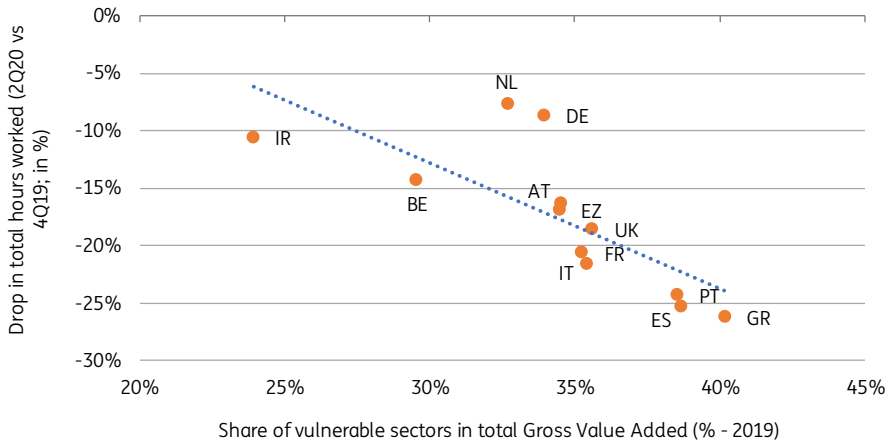
This data shows that the effort needed to catch up to pre-crisis levels is still very high: during the financial crisis, it took 10 quarters (from mid-2013 to the end of 2015) to return from 95% to 100% of pre-crisis hours worked in the eurozone. To be sure, a part of this slack is directly linked to lockdown measures and so once these measures have disappeared with the vaccination campaign, some catch-up will occur. However, we believe that it is very likely that the labour market slack, measured in hours worked, is concentrated in sections of the labour market (see below), which – given the lengthening of the lockdown in 2021 – could end up having a long-term impact on inequality.

2 Covid-vulnerable sectors were key

During the pandemic, the economic impact was heavily concentrated in sectors where demand relies on mobility or human contacts, which we will here define as the following sectors[3]: Manufacturing of vehicles and transport material; Wholesale and retail trade; Hotels, restaurants and air travel; Professional and real estate services; Arts and entertainment. This follows previous research by the OECD[4] except we have chosen to exclude construction where (as can be seen from Figure 2) employment quickly surpassed its pre-crisis level. These sectors represent a share of the local job market that ranges from 25% in France to 34% in Spain.

Figure 4 confirms that the drop in hours worked that we described above mainly took place in countries heavily specialised (in % of their total gross value added or GVA) in these Covid-vulnerable sectors: for example, they make up to 40% of economic activity in Greece, Spain and Portugal, partly explaining why these countries saw hours worked plummet by 25% in the first weeks of lockdown.

Fig 4 Hours worked contracted most in countries specialised in vulnerable activities



Source: Eurostat, ECB, own computation

From there, we conclude that job market divergences between countries were linked to their economic structure and their specialisation in sectors particularly vulnerable to Covid, something that was already well-documented.

In what follows, we show that these sectors have shared characteristics across countries which make them vulnerable to a rise in inequality along several dimensions (low wage vs high wages, gender, old vs young, skilled vs unskilled, standard contracts vs others).

[3] NACE codes C29, C30, G, H51, I, L, N, R.

[4] OECD (2020), OECD Economic Outlook, Volume 2020 Issue 1, OECD Publishing, Paris, https://doi.org/10.1787/0d1d1e2e-en.

3 Inequality and the job market

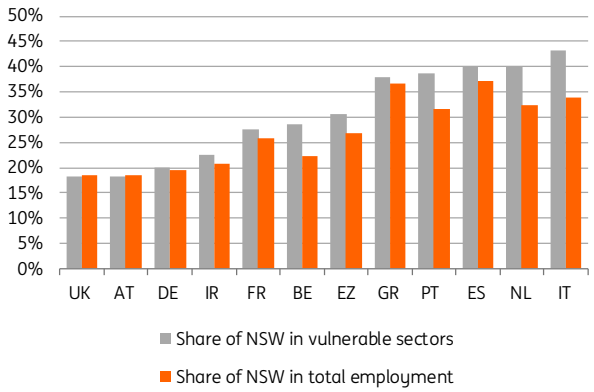
As Mario Draghi once said, in a crisis "the biggest cause of inequality is unemployment". Therefore, creating jobs is the best way to decrease inequality as a labour market recovery is always more beneficial to those who were also the first to lose their job. In the current crisis, the lengthening of lockdown measures that affect the most vulnerable sectors is a risk for inequality because these sectors are intensive users of non-standard work schemes and low-paid jobs.

Be it because they are young (last ones to arrive at the firm) or without a diploma (easily interchangeable), vulnerable workers can generally be pushed out of employment easily because they are in what economists call Non-Standard Work (NSW) contracts: temporary contracts and self-employment, to which part-time contracts are also sometimes added (we will not take them into account in what follows as the very nature of the current crisis disproportionately hit the first two and these include part-time self-employed and temporary workers).

The prevalence of NSW in a given job market or country is therefore an important risk component as far as inequality is concerned. For example, when the pandemic hit, temporary contracts were simply terminated, representing the bulk of the unemployment increase in 2Q20, which implied that these workers did not benefit from the same conditions as furloughed workers. Moreover, unemployment benefits are generally much less generous (although it depends on countries) for small self-employed workers that have gone out of business or young workers on temporary short-term contracts than for workers on standard contracts.

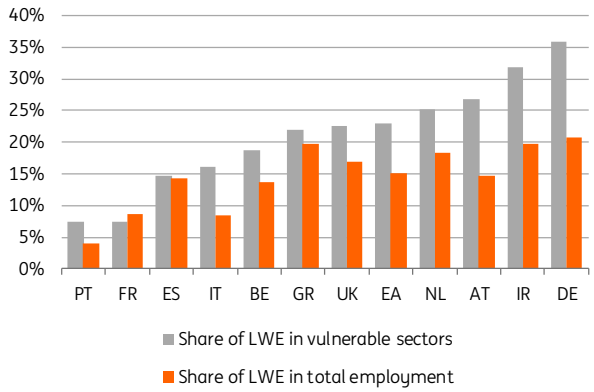
Another risk stems from the prevalence of low-wage earners as their replacement revenues, once unemployed, is generally lower than their already low working wage. Few countries outside the US managed to reverse that situation during the pandemic shock. On Figures 5 and 6, we show that the Covid-vulnerable sectors identified earlier happen to be intensive users of NSW contracts and low-paid workers, compared to other sectors.

Fig 5 Share of NSW contracts in vulnerable sectors (% of employment, vs average)



Source: Labour Force Surveys and own computations

Fig 6 Share of low-wage earners[5] in vulnerable sectors (% of employment, vs average)



Source: Labour Force Surveys and own computations

Indeed, Figure 5 shows that NSW contracts (self-employed and temporary contracts) represent 30.5% of the eurozone's employment in the vulnerable sectors identified above, which is larger than the 26.8% share they have in total employment. We see that the gaps are larger in Italy, the Netherlands, Portugal and Belgium where the vulnerable sectors make a much larger use of NSW contracts than the average, with proportions reaching 40% in the Netherlands and Spain and 43% in Italy.

[5] Eurostat defines LWE as workers (excluding apprentices) earning two-thirds or less of the national median gross hourly earnings in a given country.

When it comes to low-paid jobs (Figure 6), other countries stand out: the share of LWE in vulnerable sectors is disproportionately high (compared to the national average) in Austria, Germany and Ireland, with 36% of employment in vulnerable sectors being in the LWE category in Germany, against a eurozone average of 23%.

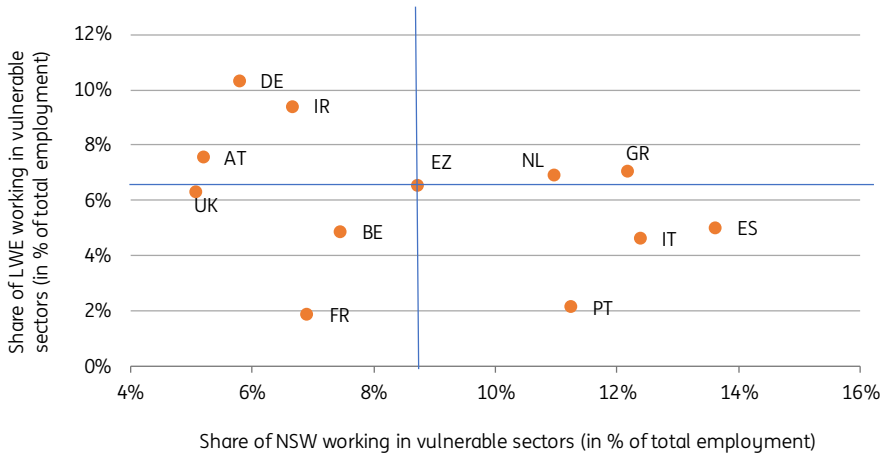
We think that these characteristics encompass several dimensions of inequality: education and age (with lower-educated and younger workers often in non-standard work contracts), and wages. Since we know how these sectors evolved in 2020, we believe that the analysis of the evolution (below) will also illustrate inequality evolution.

4 Mapping inequality risks

As the Covid crisis threatened sectors which traditionally use vulnerable workers more than others, it is natural that it did not hit worker groups (young and old, standard and non-standard contracts, low and high wages) equally. Given that countries have different degrees of specialisation in vulnerable activities, the asymmetric shock to worker groups also implies divergence in inequality risk among countries. Therefore, it is interesting to show the countries which have a large share of their job market in either non-standard contracts occupied in vulnerable sectors and/or low-paid jobs in vulnerable sectors.

In Figure 7, we map countries along these two dimensions: the share of total employment represented by **(1)** NSW contracts in Covid-vulnerable sectors and **(2)** LWE in Covid-vulnerable sectors. We take the eurozone average as a reference to show four groups: low-risk countries (FR, BE, UK) and high-risk countries (NL, GR) having an above-average share of (1) and (2), with the rest being countries mostly vulnerable on the low-wage side (AT, DE, IR) or on the NSW side (ES, IT, PT). This mapping shows that the sources of vulnerabilities may not be the same across countries, and therefore require local policies to prevent inequality risks from deepening.

Fig 7 Mapping inequality risks

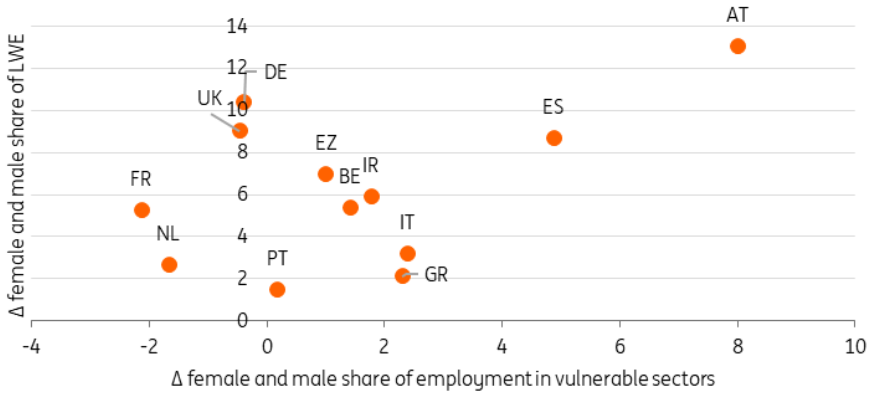


Source: Eurostat, ECB, own computation

Box 1: Gender inequality and the Covid crisis

Along the two dimensions we analysed above, we can also look at inequality through the lense of gender. Figure 8 shows the difference between the share of female and male employment in the vulnerable sectors and among low wage earners. The closer one country's dot moves to zero on both axes, the more aligned the male and female labour market situations. The eurozone average is only taken as point of reference.

Fig 8 Two Dimensions of Gender Inequality



Source: Eurostat, ING Financial and Economic Analysis

Two key results stand out: **(1) Women are represented more than men among low-wage earners[6] in all countries**. Looking at the difference, Austria ranks a sad first place, as 22% of women are LWE, which is 12ppt higher than the proportion of male LWE. Germany is second, with 26% of working women being LWE against only 16% of working men. **(2) Women do not seem to be overrepresented in vulnerable sectors.** The exceptions are Spain and, again, Austria. There, the share of female employment is respectively 5 and 8ppt higher than the share of male employment in vulnerable sectors.

However, the risk of higher gender inequality stemming from the current crisis cannot only be read from LFS data. On average, women were more affected than men not because they were employed in vulnerable parts of the economy, but because of the temporary closure of schools and kindergartens. Even for those who had the option to work from home, this clearly increased the additional time spent on unpaid work. While recent studies[7] have shown that additional care work is indeed mainly absorbed by women rather than by men, we would highlight that men also increased the time spent on unpaid work when they had the option to do so (e.g. due to short-time-work arrangements). The European Institute for Gender Equality found[8] that men's time spent on unpaid work increased from 6.8 to 12.1 hours per week during lockdowns. Women dedicated 15.8 hours per week on unpaid work before the pandemic already, while they spent 18.4 hours a week on household acitvities during lockdowns. We do not see an issue of gender equality in the long run, nor an increase in inequality due to the crisis. What we do see are structural issues that already existed before the crisis and somewhat deepened during the pandemic. Strong reforms are rquired to reduce them in the long run, however these reforms go well beyond Covid-related fighting tools.

[6] The fact that more women than men are working part time is not affecting the share of female LWE, as median gross hourly earnings instead of monthly earnings are considered to define this group (see footnote 5)

[7] Whose time to care? Unpaid care and domestic work during Covid-19; UN Women (Nov 2020)

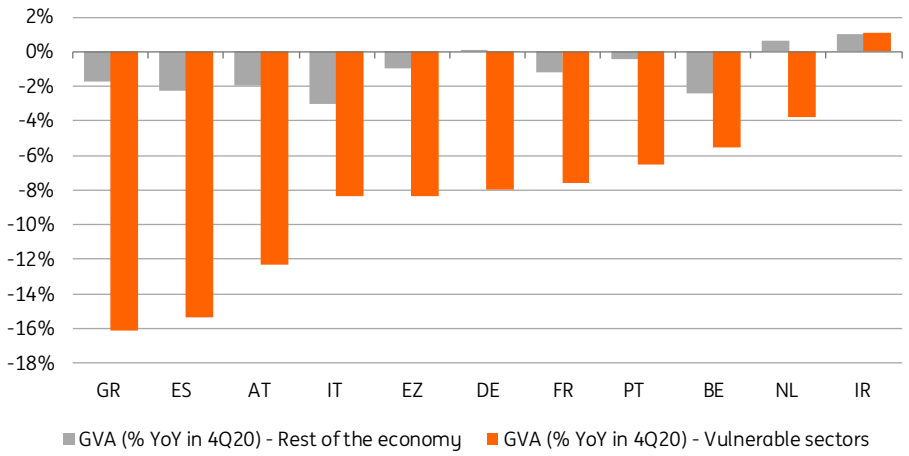
[8] https://eige.europa.eu/covid-19-and-gender-equality/unpaid-care-and-housework

5 Recovery prospects and long-term inequality risks

The growth patterns observed in the eurozone economy in the second half of 2020 show that the recovery, so far, has been as imbalanced as the shock itself. Some sectors have seen their gross value added (GVA) catch up to and even sometimes surpass their pre-crisis level, while the output gap remains concentrated in the most vulnerable sectors.

Figure 9 confirms that in most countries, vulnerable sectors are lagging the rebound that occurred in the rest of the economy: in Spain, vulnerable sectors still have a GVA that is 15% below pre-pandemic levels while the rest of the economy is only 2% below that level. In Germany, Portugal, the Netherlands and Ireland, the rest of the economy has even fully recovered. This is important because it means that the "90% economy[9]" does not exist: most sectors have (almost) fully recovered, while some of them are living in an "85% economy". In terms of inequality, it heightens the risk, as these sectors are heavy users of more vulnerable forms of employment. What is more, we know that given the slowness of the vaccination campaign in Europe, lockdown measures will take time to disappear so the crisis will last longer for these sectors. While government measures taken in the first few months of the pandemic may have worked for all sectors in a time-limited shock, it is likely that the 18-month shock faced by vulnerable sectors will require more specific measures, if the risk of rising inequality is to be contained..

Fig 9 Vulnerable sectors make up most of the current growth drag



Source: Eurostat, ECB, own computation

There are several reasons why we think a greater portion of the working population is at risk of falling into poverty as long-term inequalities persist. First, lockdown measures have been renewed throughout the continent recently, hitting the same sectors again in the first half of 2021. Second, there is no prospect of getting back to levels of human contact that allow these sectors to work at capacity before the end of 2021 when most of the population will be vaccinated. Third, post-pandemic times could potentially bring a toxic "new normal" for workers in vulnerable sectors as the number of employers will have shrunk due to bankruptcies, probably capping wages and contract durations for longer. Low-wage and NSW workers in vulnerable sectors represent 5% to 15% of employment in European countries, which is far from negligible.

To counter these risks, some countries have taken measures to ensure that vulnerable workers who have fallen through the safety net do not fall into poverty. But some countries could do more. What our findings show is that after broad-based measures, which were justified at the beginning of the epidemic, more targeted measures aimed at specific groups of workers now need to be planned until year end. As it is much easier to

[9] The 90% economy is a famous title of The Economist (30/04/2020) acknowledging the fact the upcoming rebound would be incomplete.

fall into poverty than to get out of it, forthcoming recovery plans will have to focus on vulnerable employment which other measures have failed to address.

6 Tightening safety nets

Targeted measures could take the form of temporary subsidies, participation in broader furlough schemes or training. For example, temporary workers could be supported to switch from vulnerable to recovering sectors. For the self-employed, who are at risk of bankruptcy once moratoriums are lifted, the need for help will probably increase. Some countries have already taken steps here, although the time it has taken for beneficiairies to actually access funds has varied greatly across juridictions.

Austria for example, has a retraining plan for low-skilled workers, with increased unemployment benefits as well as a hardship fund for those without classic unemployment benefits. **Germany** has targeted measures for the solo self-employed but only limited incentives to keep the youngest workers on companies' payrolls. **France** has suspended (until June) rules that limit the renewal of temporary contracts to keep temporary workers on the job and has targeted measures to young workers. It also created a solidarity fund in the early days of the pandemic to support the self-employed. **Belgium** has temporary relief cheques for the self-employed that were later extended to other vulnerable workers (in the culture sector notably). **Italy**, for the time being, has been sticking to emergency-type measures, mostly in the form of monetary compensation for the self-employed, but it might do more within the framework of the recovery and resilience plan. In the **Netherlands**, the furlough scheme was augmented by penalties (under certain conditions) for companies reducing their payrolls. For more vulnerable workers that were not able to benefit, a specific temporary fund provided €550/month (from January 2020) to the most vulnerable workers (students with a side job, on-call workers or interim). Finally, in the **United Kingdom**, the furlough scheme has been extended to small self-employed workers (earning less than £50,000 per year) while unemployment benefits have been raised and the hiring of young workers encouraged through financial incentives.

It is an interesting point for the forthcoming recovery plan: as all these measures will have to be supported over a longer period in the most vulnerable sectors, part of the recovery plans will have to be spent on employment boosting programmes for the most vulnerable workers so that the current, abnormally high levels of youth unemployment are finally tackled and the entrepreneurial spirit of a generation of self-employed is preserved.

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