



# **TRABAJO FIN DE GRADO**

**“The effect of the economic crisis on inequality  
and poverty in Spain”**

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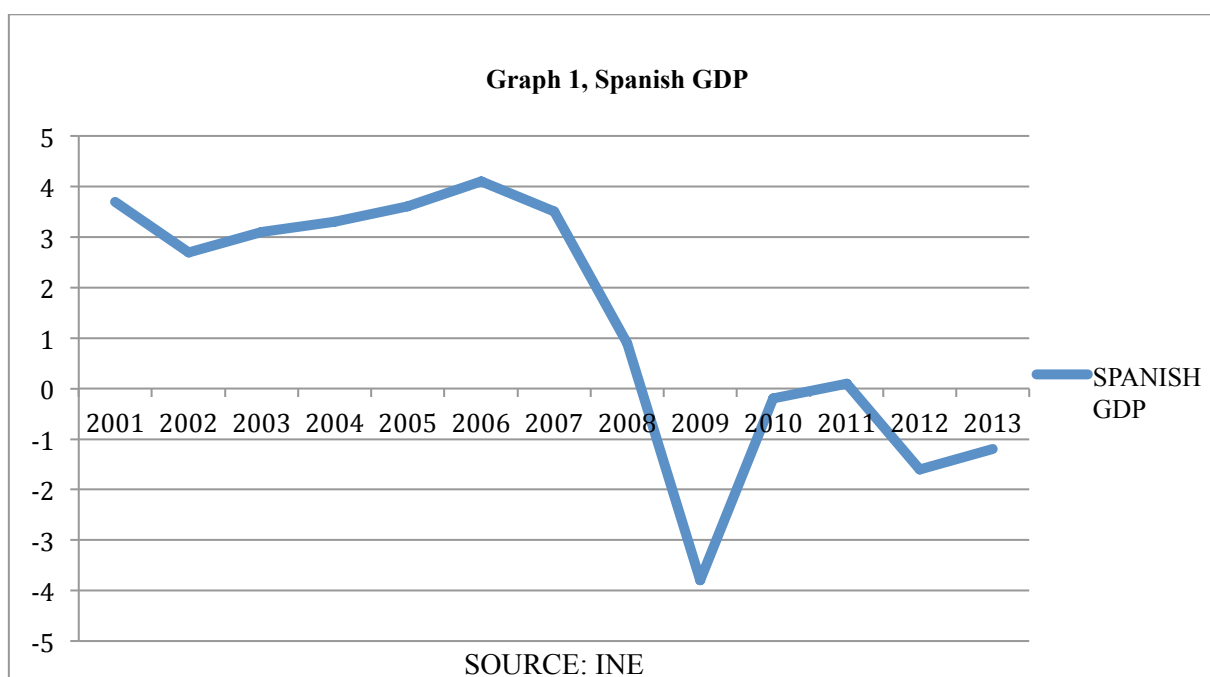
## 1.INTRODUCTION.

This will be a final degree Project (TFG), of Economics degree, the topic that is going to be studied, is the effect that some issues have on inequality and poverty, but paying special attention to how the current economic crisis has affected those elements in the Spanish society.

The justification to make this analysis of Spanish economy in terms of inequality and poverty is that there are very interesting areas, not only for the researches, the society is interested on it. Due to this fact, analysis always have ethical connotations because of its connection to the social welfare, which is well known to be something very important for our nowadays society. Even more in an economic crisis environment, an example of the importance of this analysis could be seen in the United Nations Millennium Developments Goals, where fighting inequalities and poverty is one of them. Concretely reducing the population who lives with less than a dollar per day to the half in 2015, at the same time the Europe 2020 Strategy has the goal of rescuing at least 20 million of people from poverty and social exclusion in the period 2010-2020.

In the current economic context the existence of huge levels of inequality and poverty is perceived as a big problem for our governors and citizens.

The analysed period will start from 2008 until 2013. 2008 will be taken as the first year because, in this one started the decrease in country's GDP, growing only a 0,9% and with the final depression in 2009 when GDP decreased a -3,8%. The impact this reduction had on inequality and poverty will be studied.



The most useful variables to analyse inequalities are personal incomes and expenses. Their evolution and consequences during this six years period will be reviewed. Those variables are the most commonly used; despite this, it should be said that the typical tool used by economist for analysing inequalities are LORENZ curve and GINI index.

The way the task is going to be organised is shown in the following four parts: first a theoretical background will be exposed in order to clarify key terms and give some theoretical support to the following analysis. There some key variables and their relation to inequality and poverty will be explained, interpreting after that, if their increase or decrease affects and in which way to inequality.

The next part of this project will be composed by an historical context, in order to understand the economic and sociological changes in which we were involved, it is important to understand the economic situation during the previous years to 2008, but paying special attention to the construction sector, due to its relevance in Spanish economy during those years. In the forth part the Spanish case will be studied, from 2008 until 2013 and the greater or smaller effect that economic crisis has had among its population. In this part all the mayor indicators previously described in relation to inequality and poverty, like personal income, unemployment rate, social transfers and GINI index in comparison to other European countries, all this elements will be revised.

The main aim of this project is to determine how the current economic situation has affected Spanish society in terms of inequalities and poverty, also to find out if the government measures have been successful or not in their attempt to fight against those problems.

## **2. THEORETICAL BACKGROUND.**

### **2.1 poverty**

Since the beginning of the economic thought, authors have been worried about the issue of income or wealth and their distribution among the population. Also inequality and poverty have been very important elements in the economic history. The first example could be seen in Adams Smith´s research, where in his explanation of poverty he said, “as necessary goods I understand not only the unavoidable for life, but all those whose lack is according to the tradition of the country, something unseemly among people of good reputation, even among the lover class”. Was also maintain that poverty is extremely unfavourable for the children growth, which at the end is detrimental for the society, he concluded maintaining

that the variability of wealth among nations is caused by health, nutrition, ability and knowledge of their population, that is what nowadays is known as human capital, (Smith, A., & Ros, A. L, 1961).

Typically poverty had been analysed in relation to three issues: economic welfare, personal income and social exclusion. The most used indicator is economic welfare, on that way poverty had been measured through three different ways, income, consume and welfare. The most used indicator is personal income, but there is not a scientific consensus about using that indicator to analyse poverty, because it can disregard some elements related to an approach from a social perspective, rather than from a more economic view.

There have been many approaches about inequality and poverty along the history of economics, but as a social science that it is, there is not a completely correct one of any theme, here will be exposed some of the most common poverty definitions.

### **2.1.1 Poverty as a material concept**

The most widely used approach is seen poverty as a material concept. That way of studies understood, that population is poor because lacks of something that they need or some resources which are not available. For Vic George (1988) “poverty consists in a core of basics necessities and other necessities that change in time and in space”. Baratz and Grigsby (1971), talk about poverty like “a huge privation of physical and mental wealth, very related with inappropriate economic resources and consumes”. In general poverty is known as a self-deprivation suffered during a period of time, Deleek (1992) manifests that “poverty it is not limited to an only dimension like income, for example, it is manifested in all the dimension of life like dwelling, education and health” to be more accurate, poverty is defined by a deprivation patron more than its self deprivation.

Another way of defining poverty related with resources, is exploring their limitation. Poverty refers to circumstances where lack of income, wealth or resources, affects people’s ability to acquire or consume elements that are necessary. Booth (1971) affirms that “poor are those whose sources are not enough for a decent and independent life, and are considered as very poor, those whose life sources are not enough if they are compared with the normal level of life of this country”. Ashton (1984) maintains, “Without any doubt the self-deprivation, refers to essential necessities that are not satisfied, that may be attributed to a lack of monetary resources, so poverty should refer itself to the lack of the necessary money to satisfy necessities.

UN (1995) had defined poverty as “ the condition characterized for a huge deprivation of basic human necessities including, food, water, hospitals, house, education and information, poverty depends not only of the monetary income, access to services are also very important”.

From the point of view of Jaques Hagenars (1991), poverty could be divided into different levels, absolute, relative and subjective. “The lowest level of economic welfare is absolutely poverty, in that level a person doesn’t have the basic income to survive, described in the amount of necessary income to acquire a minimum quantity, but the level enough of income needed to avoid this level of poverty is difficult to quantify, sometimes it is measured as the amount of money necessary to have a daily minimum intake of food, a minimum shopping basket or an individual level of welfare.”

### **2.1.2 poverty as an economic situation**

If poverty is associated to lack of resources, it could be understood in economic terms. One of the elements most used to measure poverty are incomes, even some researches considered to be the same thing poverty and low income.

The International Labour Organization (1995) considers that “at the lowest level, individuals and families are considered poor, when their level of life measured in terms of income of consumption is lower than a specific standard”. Ringen (1998) supports that poverty is a “consumption level that is below of what generally is considered as a decent minimum”. The World Bank (1999, 2001) explains poverty as “ the incapacity to reach a minimum level of life” that institution as other like IMF or UN in their program for development have fixed that minimum level at the amount of 1\$ of income per day, this quantity has been fixed through international agreements and is considered as the minimum to get away from poverty all over the world.

Poverty and inequality are linked in some definitions because people can be considered poor due to a disadvantaging situation compared to others in society. O'Higgins and Jenkins (1990) claim that " virtually all definitions of poverty used in economically developed countries about the last half century, have been concerned established, the level of income to guarantee access to minimum levels of living quality, considered acceptable in that society at that time. Therefore, there is a connection between poverty and inequality: some dimensions of inequality, make people be below the minimum acceptable levels of income, leading to a polarised society, with huge income differences. It is “economic distance”. In this point greatest inequalities constitute poverty.

This does not mean that always there will be poverty when inequality appears, only if economic inequality implies a distance beyond the critical level.

This approach has important limitations. Defining poverty in these terms would have as a consequence, that a possible reduction of rich people's resources would be equivalent to a reduction in poverty. However, this does not mean that the use of this definition is necessarily illegitimate or not widespread.

### **2.1.3 Poverty as a social condition.**

Definitions related to social classes are commonly referred to social conditions of a poor population. The idea of "social class" identifies the socioeconomic position with socioeconomic status. The concept of class is used both as a mean to conceptualize the position of the poor in structural terms, as well as a reference to empirical research on the distributional impacts of public policies. (Edgell , (1993). In recent years, the main description of the poor as a "class" was in terms of "underclass", in that sense was roundly condemned by many observers, who see this term a stigma and a condemnation of the poor.

Another approach of poverty as a social condition is exclusion. This issue has become a dominant paradigm in the discussion of poverty in the European Union, where it is perceived as a means to reduce political controversy that had accompanied the concept of poverty.

Tiemann (1993) holds that "Social exclusion affects people and geographical areas. It can be seen in terms of income levels, but linked to issues such as health, education, access to services, housing and debt. Thus, the arising phenomena of social exclusion include elements such as; homeless people, urban crisis, ethnic tensions, increase in long-term unemployment and the persistence of highly levels of poverty".

Approaches to exclusion emphasize multidimensional nature of the problems, although a similar argument has been discussed in relation to poverty.

Poverty can be seen as a set of social relationships, in which people are excluded from participating in a normal social life. The European Community (1985) has defined poverty as exclusion resulting from the limitation of resources, " the individuals, families and groups of people, are considered poor whose are limited to the extent, that they are excluded from minimally acceptable style for the Member State in which they live "

This definition goes further than the idea of deprivation; it includes problems resulting from stigmatization and social rejection, although there is a tendency to associate "exclusion " with materials needs due to the characteristics of our nowadays society.

## **2.2 inequalities**

Inequality or equality could be judged when we compare some specific situations of a person, like income, wealth, freedom, and rights with the same conditions of others. On that way the judgement and measurement of inequality depends essentially on which variable it is chosen, after that, comparison is established using the decided variable. Normally the one chosen is personal income. That indicator is directly related to unemployment rate, because as it will be explained in the following paragraphs, a variation in the unemployment rate of a country, will necessarily affect the income distribution and wages among the society. That issue can be analysed and compared from two different perspectives, inequalities among people, and inequalities among territories, like countries or regions.

There are some researches as SEN (1995), that don't agree with the use of personal income as an indicator to analyse inequality, because they maintain that other variables should be taken into account due to personal or social characteristics, that affect their lives and their capability to get income. Their studies are based on the theory that there are other methods to achieve targets, apart from personal income. Those types of studies evaluate in a better way the effect of personal inequalities on wealth rather than the based on personal income.

The most useful indicators to measure income inequality in a society are the LORENZ curve and the GINI index. In a simple way this curve represents an accumulated percentage, received by a determined group of population, classified in ascending order according to the amount of income, (Medina H. 2001). GINI index measures the extent to which the distribution of income among individuals or household, within an economy away from a perfectly equal distribution. This indicator is complementary to the LORENZ curve, because it measures the area between the L. curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum under the line. (World Bank, 2001)

As in poverty research, there have been many different approaches since the beginning of the economic theory, the first who developed theoretic models about inequality analysis, were Physiocrats especially with Quesnay and his Table, where was detailed a circular



flow diagram, showing what and who produces and in what and who spent the money, through this theory he explained the causes of economic growth.

Authors included in classic economic thought, started to worry about the distribution of wealth and income among society. Since Adam Smith (1776), in the same line of classical economic thought David Ricardo (1891) argued that inequality was necessary for economic development, because people with high income use to save more money, which stimulated the capital accumulation and the economic progress. If inequalities are seen from the perspective of neo-classical represented by Stuart Mill (1848) and others, inequality is not so important to understand the process of economic growth because “distribution of the wealth depends on the laws and the manners of the society not by the economy”. From a more orthodox perspective developed by Simon Kuznet (1955), it is important to remember the huge development that meant for inequalities measurement, the discovery of the graph and the curve that bears his name. He established that inequality fluctuates in a predictable way depending on the development of a society, extremely poor societies used to have less inequality because almost everybody lived below the subsistence level. He supported that “societies which are involved in an industrialization process are more unequal, because manufactured sector income’s are higher than agriculture’s”. The other reason is that the difference between workers and entrepreneur create salary differences. Post- industrial societies are less unequal, due to redistributive politics and better access to education.

John M. Keynes (2003) introduced a new vision of Economic development related to inequalities. Before him authors maintained that capital growth depends only on the increase of the savings of high-income people, he argued that the best method to increase the production of an economy which is operating below its capabilities, is through private consumption. The biggest difference with the Classical authors, which he introduced, was related to Say’s law, which supports that every supply creates its own demand.

Keynes maintained in his General theory, that occupation level and production of the economy are determined by demand, focusing his research in this area, especially in the consumption and investment. Those elements of the economy need to be stimulated during an economic downturn.

One element many economic experts have noticed to be key when studying inequalities is unemployment, because of its direct relationship with personal income.

Actually it is maintained by most of them that, there is not a linear relationship between the movements in GDP and movements in the unemployment rate, so a decline in the first one

doesn't necessarily mean a fall in the rate of employment. But from a theoretic point of view there is a clear agreement that real wages will react on a countercyclical way to a demand shift and completely, the opposite if the shift comes from the supply acting in a procyclical way, (Abraham and Haltiwanger, 1995)

About the behaviour of wages there are different points of view depending of the theoretic approach we are taking into account. In a Keynesian analysis, where an economic downturn is caused by a fall in demand, nominal wages will remain constant but prices will decrease, that will mean at the end higher real wages.

From a neoclassical theoretic point of view, downturns in economy are caused by supply shocks, which at the end mean lower labour productivity for a period of time. That happened because real wages are equal to productivity, so a fall in productivity will lead to a wage reduction for workers.

From a theoretic perspective, the impact of an economic crisis respect to income distribution is not clearly defined. Parker (1998) maintains that "Because selective job losses will change the composition of the labour force. That will affect especially low-skilled workers who tend to be more affected during an economic downturn". This segment of workers usually are the worst paid and in a critical situation will be the most affected, losing their jobs and with wages reductions. So if the number of low paid workers is reduced the wage dispersion may be compressed. An economic downturn will affect employment rather than wages, if that happened earnings inequality would decrease.

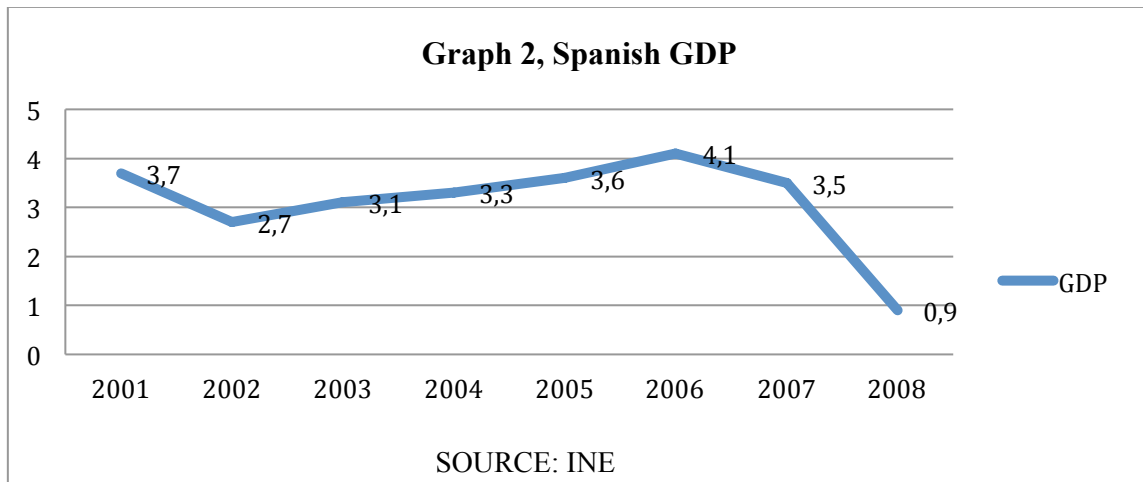
"Many researches have found a negative correlation between the business cycle and income inequality or poverty, that is, inequality and poverty seemed to increase during a downturn and fall during a upturn" (De Beer Paul, 2012)

This section cannot be complete without mentioning one of our nowadays best known economist, due to his studies related with economic inequalities, Thomas Piketty, and his publication, "Le Capital au XXIe siècle." On it he exposes how wealth concentration is performed and its distribution in the latest 250 years. He supports that when capital accumulation rate grows faster than economy, inequality in society increases. To avoid that inequality and what he calls *patrimonial capitalism*, he proposed progressive taxes and a global tax over wealth, in order to help reducing the current problem of inequality increase, (Piketty, T. 2014).

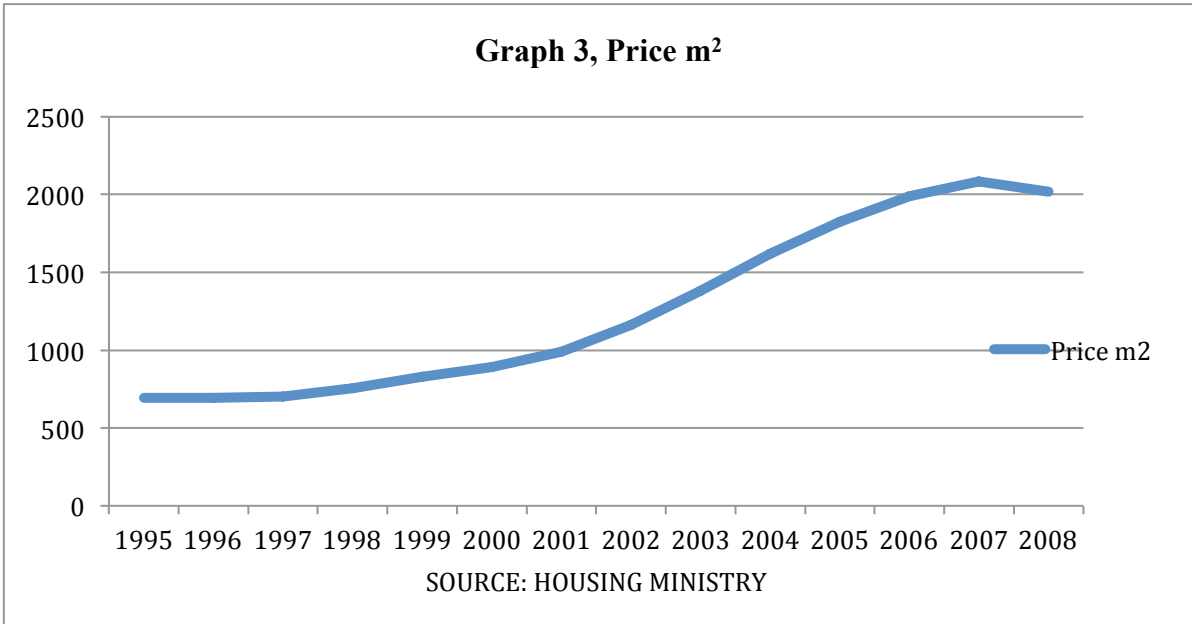
### 3.HISTORICAL CONTEXT IN SPAIN.

#### 3.1 inequality

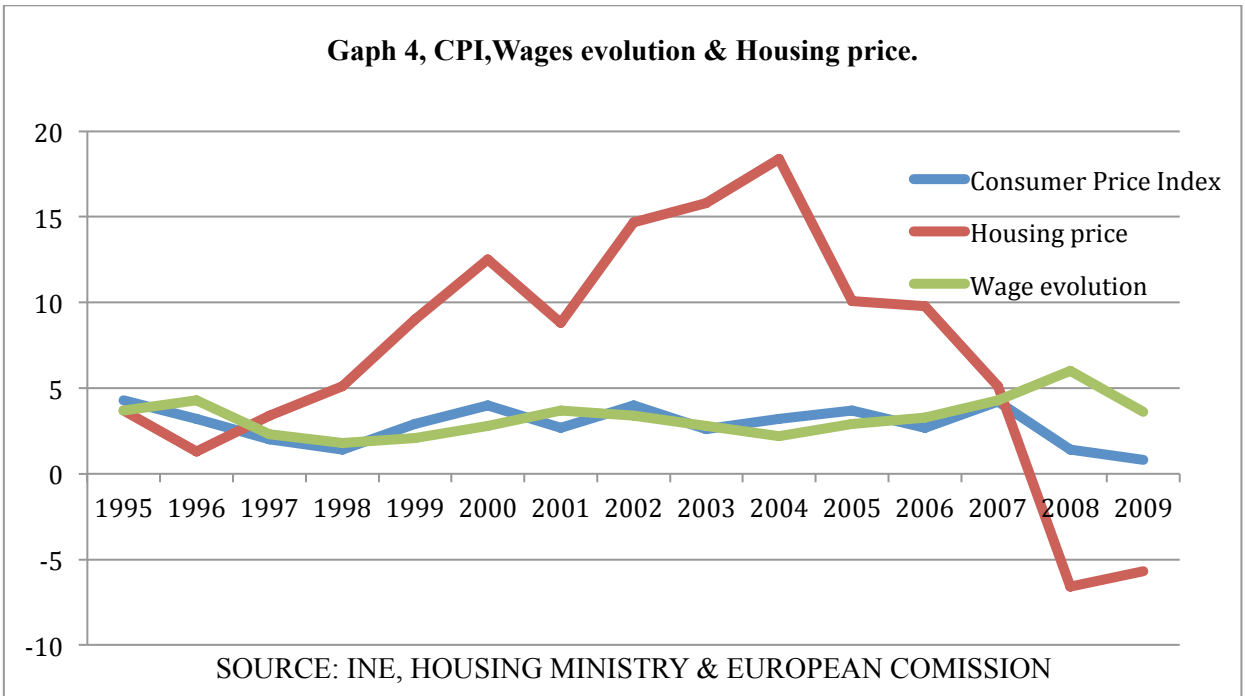
In order to understand the current Spanish's situation of inequality and poverty, it will be necessary to make an overview at some previous years in perspective, to see the behaviour of the analysed variables. After making a general overview at the available statistics database, a general and simply idea can be obtained about the evolution of inequality and poverty in the previous decades to the studied period. During those years Spanish society has suffered an important process of political, social and economical transformation. In this period, economic development, expansion of welfare state, increase of personal income and specially in the latest years, with a huge economic growth and access to credit that allowed a greater material welfare of population. However this tendency has changed since the beginning of the economic downturn in 2008.



In this previous chart it in can be easily seen how the Spanish economy experiment a great increase of its GDP in the previous years to the period analysed. With an average growth higher than an annual 3% since 2002 until 2007, this is due to some factors, but especially because of the huge increase experimented by construction sector, which lead to the development of a financial bubble. This can be seen in the following graph, where it is shown how the price per m2 has suffered an incredible rise from 2000 until 2007 without any reasonable cause.



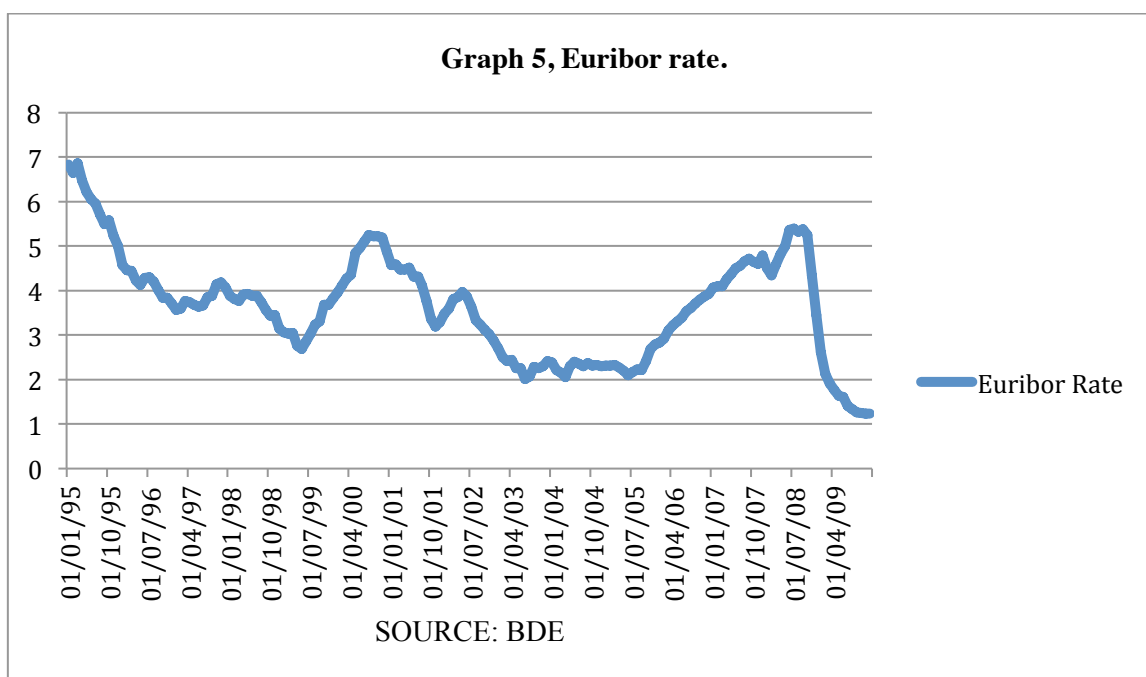
**3.1.1 real state sector**



As said before, in the previous year to the analysed period, real state sector was a key element in the development of Spanish economy. In the graph above this lines, it can be seen the evolution during the same period of time of the consumer price index, housing price and real wages. Consumer price index is the variation of the majority of the shopping

basket products for families, and salaries evolution is normally linked to the behaviour of this indicator, so with an analysis at first sight, we easily see that CPI has maintained more or less stable during this period, so purchasing power of population hasn't been increased. Salaries has maintained the same level of inflation as they suppose to be, but prices of houses grew more, that is the reason why we talk about a bubble, because prices of real state properties rise more than their real value, and population wages, without any logical reason.

Another important issue that affected that situation, was the interest rate fixed by the European Central Bank (ECB). With the entrance of the Euro currency in Europe, Spain got access to very cheap credit, linked to a very low inflation in comparison with Europe. Leading to a negative real interest rate that favoured indebtedness and real state bubble. In the following chart, can be appreciated the reduction on the interest rate between 2000 and 2005. Even it was at a lower level than CPI in this period, that means a negative real interest rate. That financial condition was very favourable to credits, mortgages, sale of houses and any operation that depends on credit to be sold.

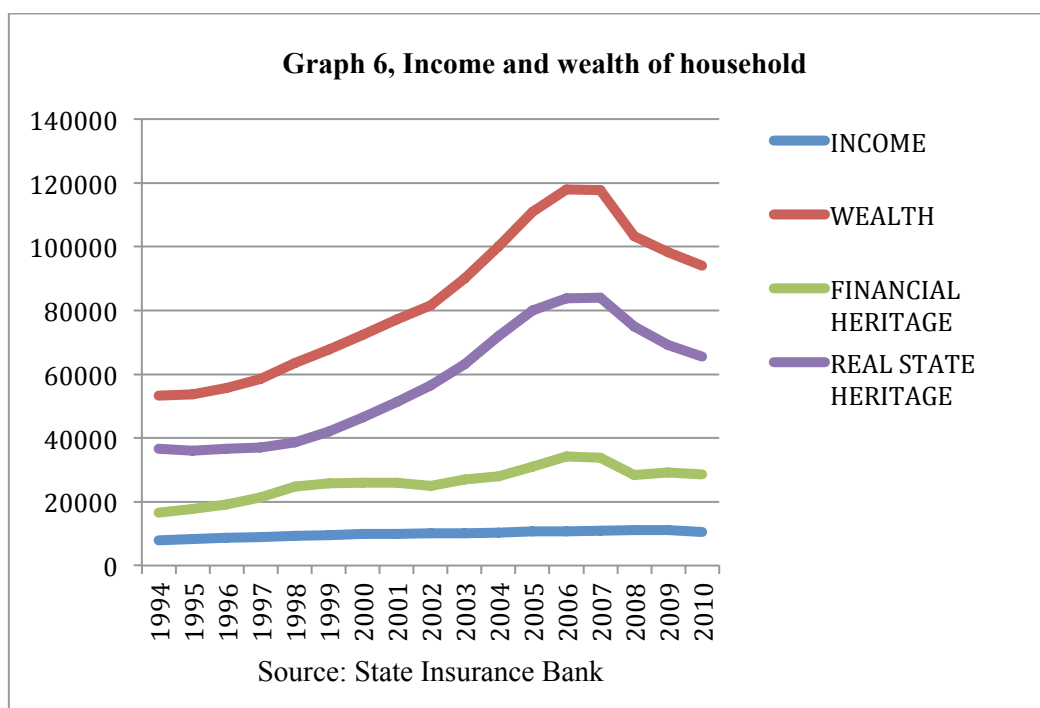


All those elements propitiated a fast increase in the number of mortgages to families, making their heritage rise faster than their income did. Following graph shows that inequalities started to appear here. Paying attention to how families heritage increase three times faster than their income until 2007, when it started to decrease. Income per capita

also increased until 2009 but in a more moderated way. The majority of speculative elements of heritage explain the huge variation rates.

In 1994 average heritage was seven times higher than annual income per capita, in the period 2005-2007 it was ten times higher, so we face an important process of wealth accumulation. Between 1994 and 2009, personal income growth annually 2,7%, until 2010, when it started to decrease. Financial patrimony per person, growth 8,8% per year until 2006. From 2007 and forward, economic crisis make it decrease 4,1% annually, the worst year was 2008 when it evolution was -10,8%.

Respect to the key element of those years, issues related with real state sector. Property assets per person, suffered a wild growth in the previous year to economic crisis, increasing annually an average quantity of 9,9%.

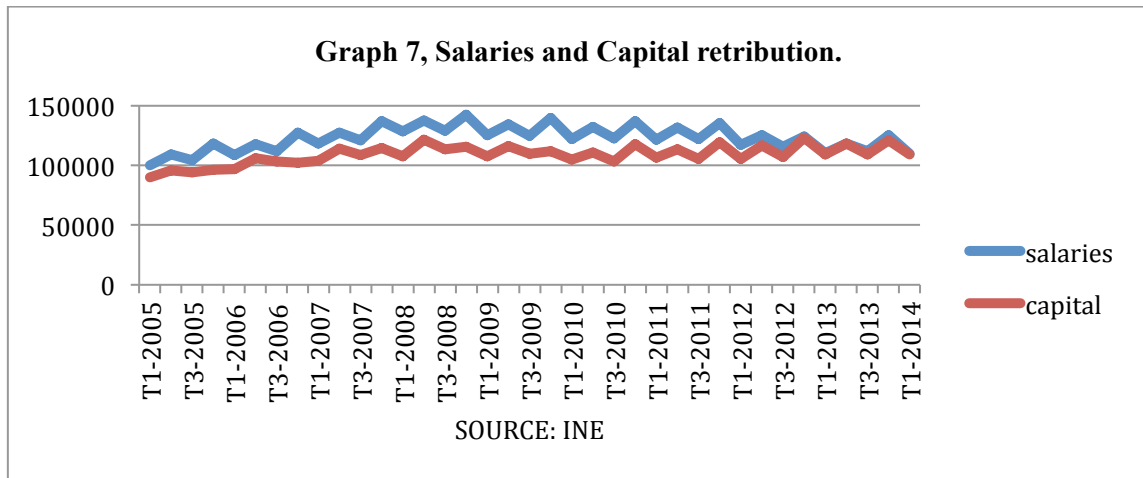


### **3.1.2 Income distribution.**

Income distribution will be studied, using GINI index provided by INE and EFF (financial family survey). Spain usually has had higher inequality index higher than the average of the EU, although in the period 2001-2007 it has been reduced.

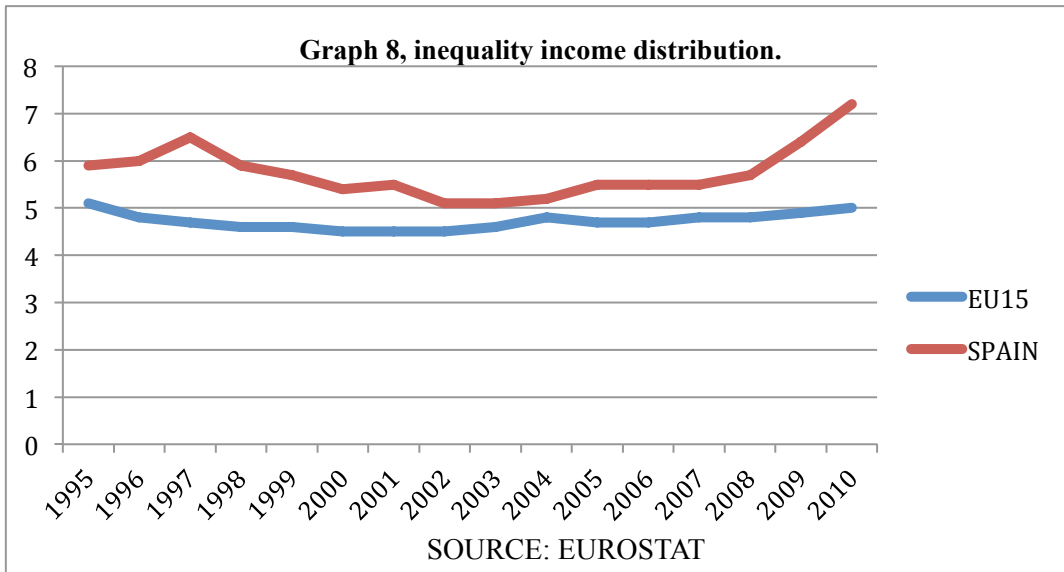
The distribution of the GDP shows that since 1995 until 2008, employees have perceived 48,8% of GDP, and company's 41,7%. Enterprises are five times less than employees, however they perceived 3,4 more income than workers. Distribution of GDP was improved for salaries between 1995 and 2000, but later until 2007 company's profits increased their

result. The inflexion point although happened in 2012 when enterprises profits overtake employee's salaries.

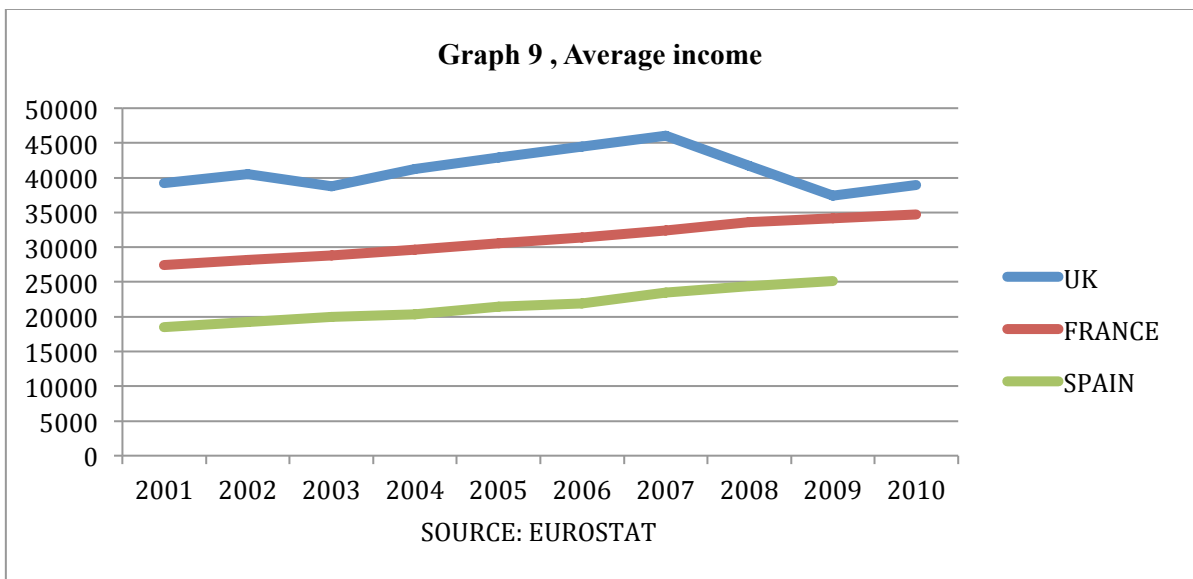


According to National Agency of taxes and administration (AEAT), payroll has increased in a 69,3% between 1994-2010, due to the number of people that work for a salary has been increased from 11 to 18 millions. Although average salary has only increased 1,9%, but capital income have appreciated the listing of its shares 371% according to BdE. That means that company's incomes and shareholders had been much higher than employees', which has widened the gap between the social class resources.

Based on the researches done by INE through their household budget survey, some characteristics of that household seems to determine particular economic situations, being determinant some factors to explain inequality. However the higher growth of disposable income until 2008 was not enough to reach the average income of the EU. It will be explained later, but during the crisis period starting in 2008, inequality in Spain in comparison to the UE has exploded, because the reduction on personal income was greater in Spain than in the rest of Europe.

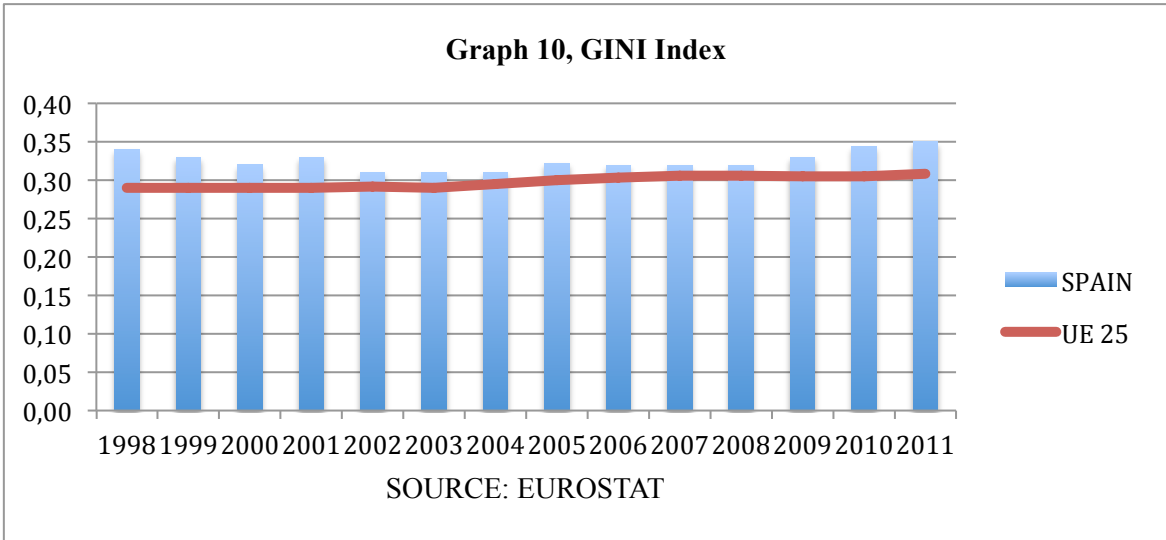


If Spain is compared to some surrounding countries, it is easily appreciated the lower position of Spaniards in comparison with the European neighbours, in relation to personal income. In France or in the UK their is an average income of 34329€ and 40171€ respectively, which are much higher than in Spain situated around 25435€. This amount is also lower than the average of the UE 28, which means in terms of PPA that Spaniards have an income equivalent as the 68% of French's or 71% of British's

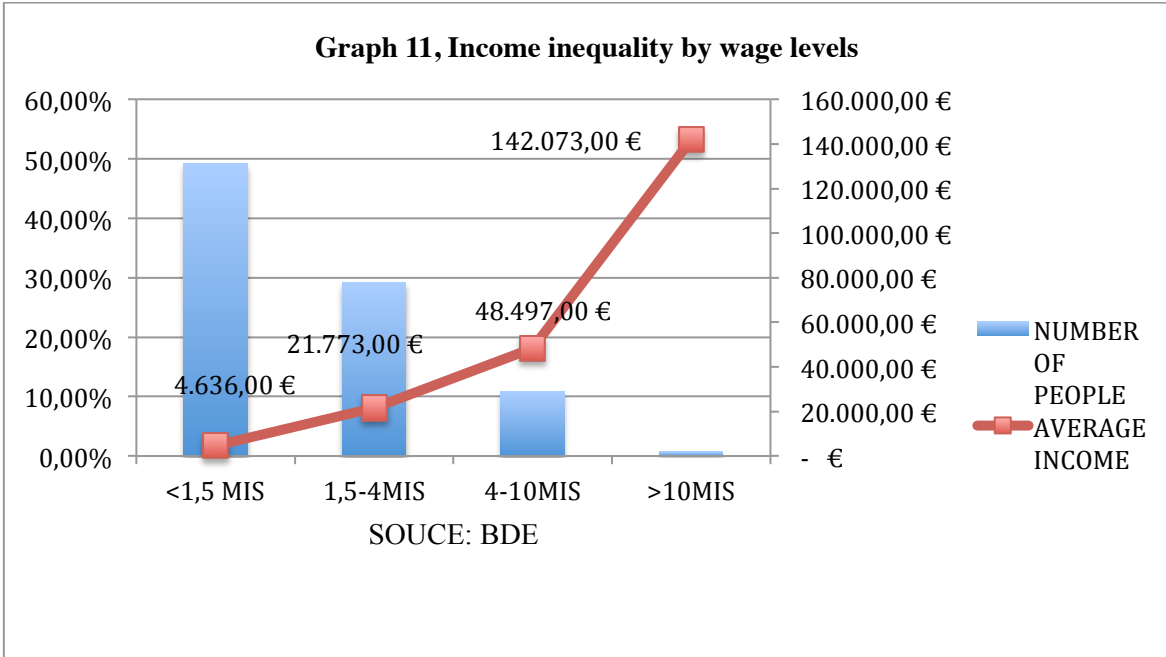


Based on the research done by Goerlich and Villar (2009), was proved that inequality shows a decrease tendency since 70's until 2003, because population with the lowest and highest income, had improved their economical situation, which lead to a reduction in inequality. But with the peculiarity that people who perceived the lowest income had increased their incomes more than people with high incomes did.





When a balance of inequality during all those years is made, a positive result is obtained because it had been reduced. But a disturbing stagnation appeared in the last years. As shown on the previous graph from 1998 until 2011 GINI index has been reduced but not too much, even with a high employment rate linked with high wages and wealth. Those result confirm that in an era of economic development inequality has been reduced but in a very mild way. Spanish experience reinforces the theory that economic expansion and employment development only by themselves doesn't guarantee inequality reduction. This is because a great economic development and increase was experimented by Spanish economy but inequality was reduced in a very little way.



This chart shows inequality in income distribution in 2005, the first group is formed by who received salaries 1,5 times lower than the minimum wage, people who earn less than

1000€/month, the second stretch corresponds to intermediate segments of workers who receive a salary between 1000 and 2500€/per month, the third and fourth are segments with higher incomes, in this last segment there are a minority of 156000 workers who receive an average salary of 12000€/month, in that group could be located companies CEO's and entrepreneurs.

Wages inequalities by gender and age are high and have increased in the last decade. In 2000 average income of women was 27,7% lower than average salary, this disadvantage change into 31,5% in 2010, meanwhile youth employees who received less than the minimum wage change in this decade from 54,1% to 60,6%. BdE EFF (2010)

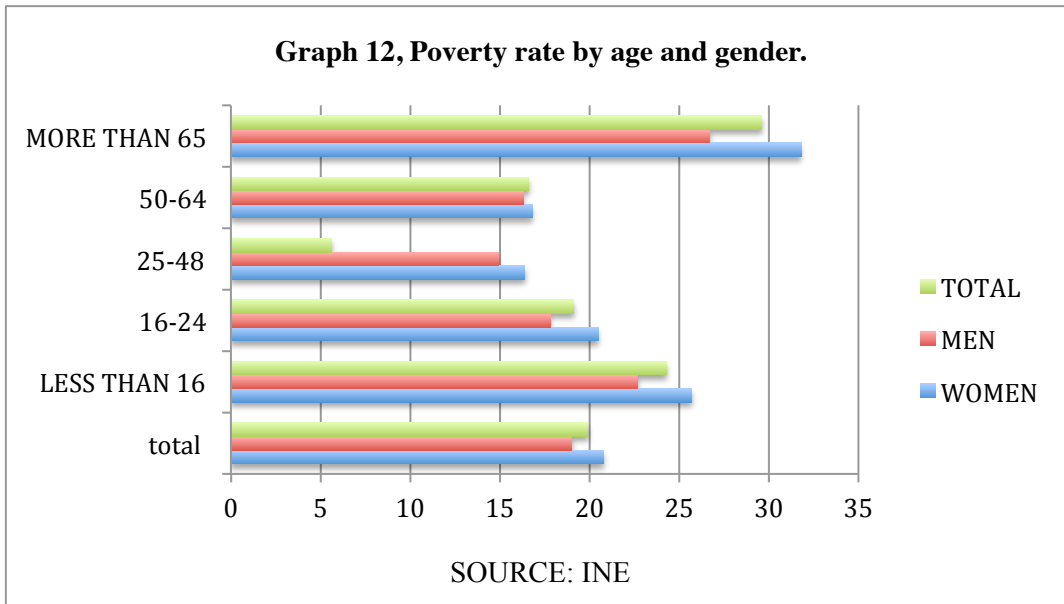
At this point somebody may ask himself, why if Spain had experimented an economic growth, its personal income distribution has not improved also?

Well there are some key issues that answer that question. This long period of economic development had been accompanied with structural changes in labour market that reinforce income inequality, for example: a huge creation of employment but with low productivity and low wages. (Muñoz de Bustillo, R. and Antón, J.I.,2007). In that point employment creation is not enough to avoid poverty, because people in that situation may have a job, but during a small period of time and with very low wages.

### **3.2 poverty**

To analyse poverty in Spain during the previous years to economic crisis, the survey of living conditions done by INE every year will be used. In the precedent years to the economic downturn period, in the years 2004-2005 the line of income to indicate poverty threshold was 6728€ per person and year, that is 60% of the median of annual income per consumption unit. Since the middle of the ninety's, the improvement of poverty levels that were given in the previous decades began to stagnate, starting to be an important problem for Spain and the UE. However during the great economic expansion, poverty levels were not reduced. In the graph bellow this lines could be observed the poverty rate of Spanish population, classified by gender and age, it is important to notice that the fifth part of Spanish population is below the poverty line exactly 19,9%. (INE, 2004).

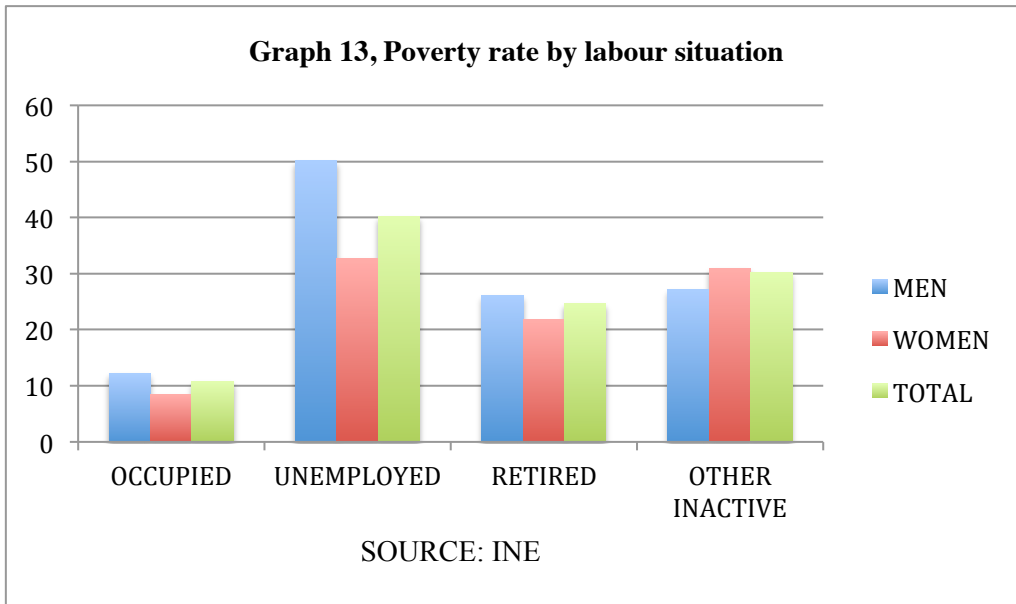
It is important to highlight that women have more risk to fall into poverty than men, because the total poverty rate is two points higher in women than in men. That detrimental situation for women appears in all age levels. If we pay attention to age groups, it is seen without any doubt that the worst situated groups are teenager below sixteen and retired population older than 65, being 24,3% and 29,6% respectively.



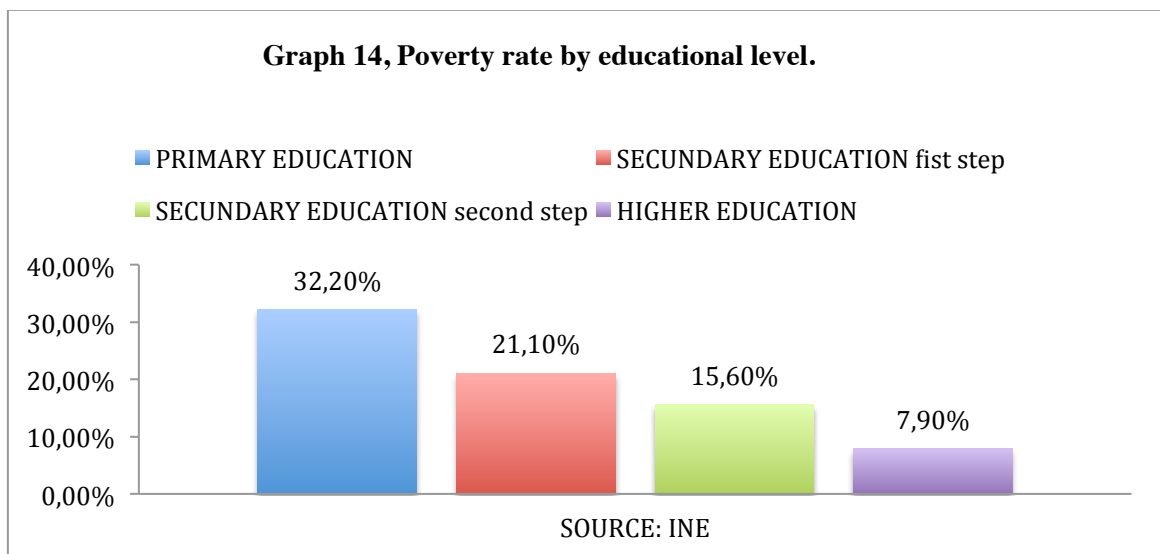
Poverty is drastically reduced among population in working age, between 16 and 65 years old. Population with more than 65 years old have the greatest percentage of people living below poverty line, which is closely to 30%

It is interesting in the poverty analysis to study the relationship between poverty and the most frequently employment status of the individuals affected by it. Searching through the chart, it can be observed that the most affected segment by poverty is the unemployed population. Analysing it by gender could be said that, unemployed men have a higher risk of poverty, because 50,1% of them is living below poverty line. Unemployed woman are the second group of population at risk of poverty, 32,7% of them live with less than 6728€ per year. In the group of unemployed people, it is also seen the greater difference between poverty affecting men and women.

The following group affected by poverty is other inactive, with a 30,2% of people living below poverty line. I think it is important to highlight, that the percentage on inactive women that are not retired is quite high (45%), which increase definitely poverty rate among women and because of this, it is higher than men's.



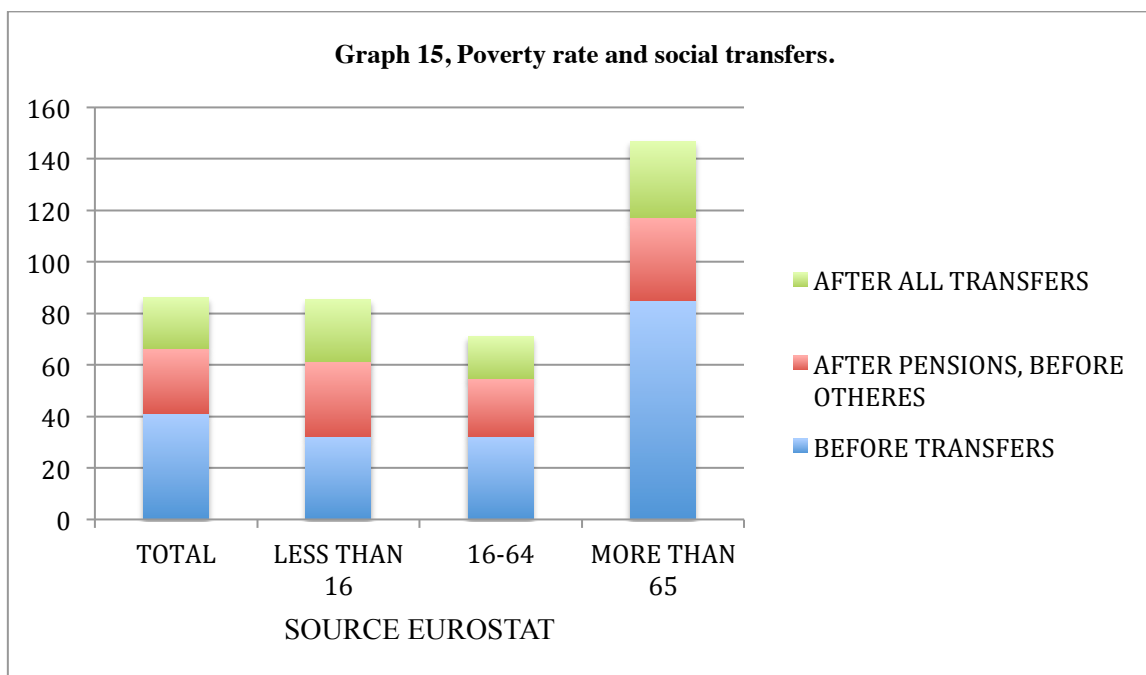
On the other hand the group of population with less risk of poverty are occupied people. They are only around 10%, that supports the theory that employment help people to avoid poverty, but there is a group of population, which is employed and they still belong to the poverty group. This situation happened because of structural changes in the labour market like: low productivity jobs with low wages, temporally and seasonal procurement. Other element, which is directly related to the possibility to find a well, paid job, is education level.



There is an inverse relationship between educational level and poverty. Population with higher academic training are less riskier to live below poverty line. Population with higher education degrees who are poor are only 7,9%, while around a third part of population with only primary education is affected by poverty.

The last issue at the time to analyse poverty in the previous year to the economic downturn in Spain, are social transfers to household. They are essential in a poverty analysis, because of their importance as a redistributive issue in society, trying to avoid extremely poverty situations and income inequalities.

To study the effect of those transfers, it is necessary to study poverty rate after and before being received by population as an income.



Poverty rate for the total population comes from 41,3% to a 25% after all transfers, this data confirms the theory that social transfers help to reduce and avoid poverty rate.

As could be seen on the graph retirement pensions, have a greater influence reducing poverty than other transfers, that it is because most of the population, older than 65 have retirement pension as the only income in their homes, so if pensions are eliminated, their income will be drastically reduced and poverty rate will grow. Data shows that in this segment before any transfers poverty is situated at a 84,9% of population, but after all of them it is reduced to 29,6%.

#### **4. THE SPANISH CASE, 2008-2013.**

##### **4.1 introduction.**

That is the central part of this final degree project. Here will be analysed the effect that economic crisis has caused on inequality and poverty in Spanish society. In order to do that some key variables, that are the most typical in empirical studies about inequality and poverty, will be reviewed, paying special attention to personal income and its distribution among population and poverty level. Also all the issues that affect it, like unemployment

rates, social spending by governments, wages evolution and GINI index, in the context of the European union, which is the most used indicator at the moment to analyse income inequalities.

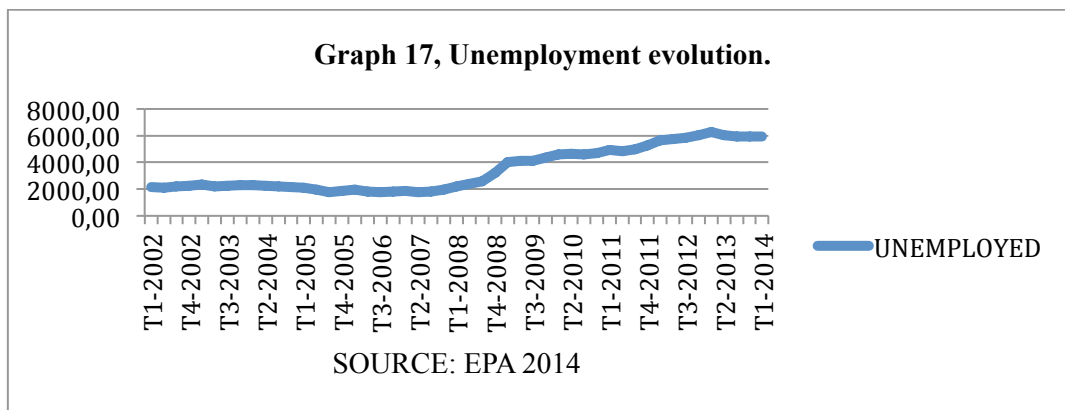
In the middle of 2008 a huge economic recession started in Spain, continuing in 2009, followed by a little increase of economic activity in 2010 and the beginning of 2011. However the escalation of tensions in the euro area, in a context of severe imbalances in Spanish economy, brought this weak recovery truncated at the end of 2011, becoming a second recession, less intense in the reduction of GDP, but longer than the first one. So even with a positive average growth of GDP during 2011 the last trimester of this year ended with a negative result of -0,4 and in 2012 the average fallen was 1,6%. (Graph 1)

Also some demographic issues that were presented during expansion period have changed their evolution to the opposite way. Until 2009 the new immigrants coming to our country looking for a job explained population growth that was experimented in our country, but since 2010 this process has been inverted and in 2012, 15000 (-0,3%) immigrants abandoned our country.

#### **4.2 unemployment.**

Without any doubt, the clearest indicator of the effect that the economic crisis has had over our country is unemployment rate. Some years before 2008, the huge employment creation experimented by the Spanish economy, was possible due to creation of jobs with low wages in a favourable environment, because Spanish's integration in the UEM.

In the immediately previous years to 2008, this element becomes more acute. This issue linked with a increase of profitability in some sectors, specially construction and real state services, explain why unemployment rate was so low and stable, around the structural amount of Spanish unemployment, about 2 million of people.

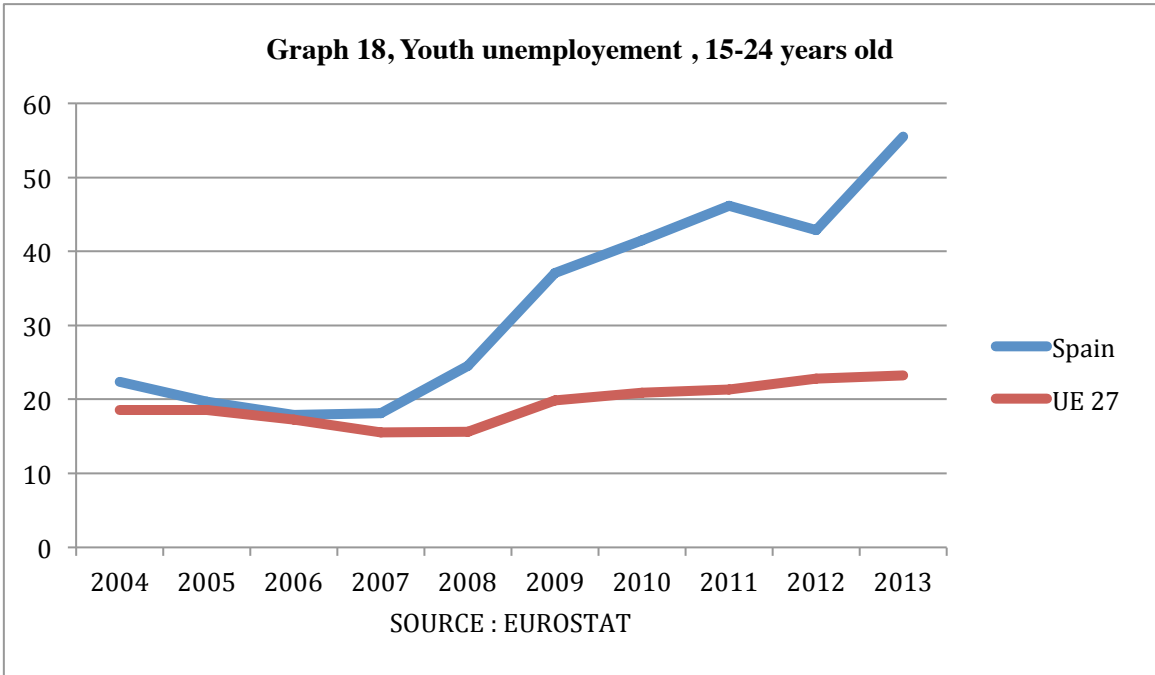


Most of the people who lose their job in the first part of this period (2008-2013) belonged to low skilled workers, from manufacturers and construction sector, specially from the second. That showed that the economic systems characterized by the presence of real state bubbles, like USA, Ireland or Spain has suffered a greater impact of recession in their economy and in their labour market.

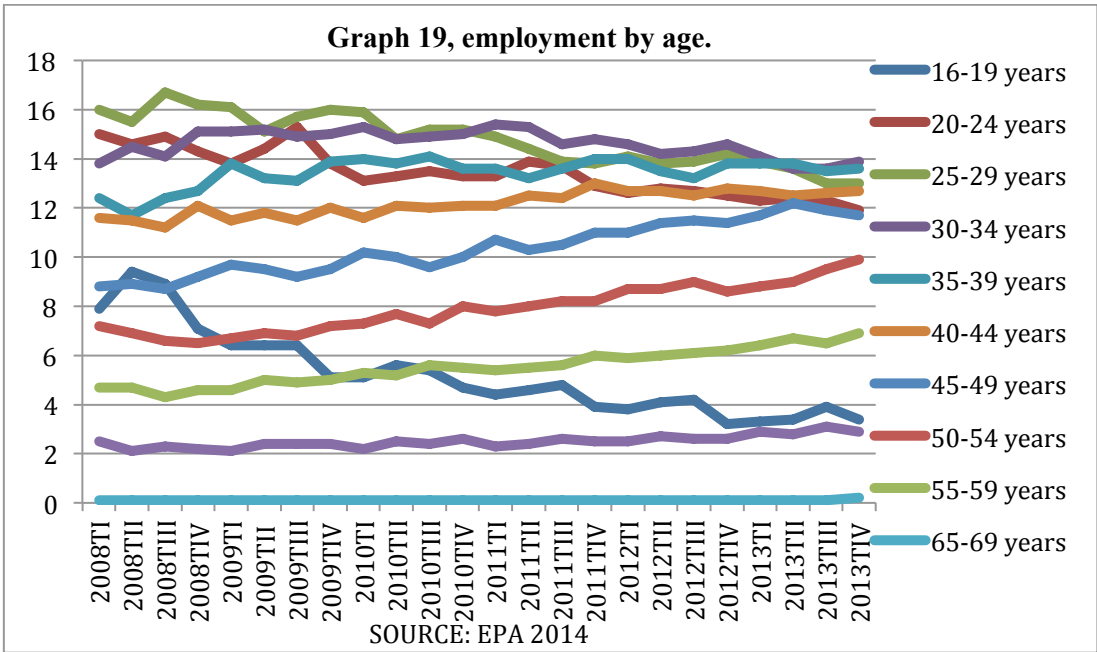
During crisis years Spain had suffered a great process of employment destruction, specially concentrated in low paid jobs. Making a process that exacerbates income inequalities, because of a skewing to better paid employees composition of the labour force. The suddenly decrease of the sectors, that were core elements in Spanish economy at the moment of the crisis, like construction, real state and financial services, was the factor that explain most of this evolution, because the growth experimented by the country was very dependent of those sectors, and when they fell, economy fell down too.

Since 2010 unemployment started to affect segments of employees that were better paid, and a reduction in the weight of salaries over the total GDP started. This can be explained due to salary restraint accorded with social agents and also the wages reduction of civil servants, determined by national government. This is the first inequality appreciated in this period apart that unemployment affected in a greater way to low paid employees, who normally are low skilled workers.

At the same time, low wages extended themselves, cuts in working hours, internal reorganizations as an alternative to dismissal or to wage freeze, means more people below poverty line and social exclusion. That is the reason why unemployment rate is a key variable at the time to study the effect of the economic crisis among the society, (zugasti,2012)

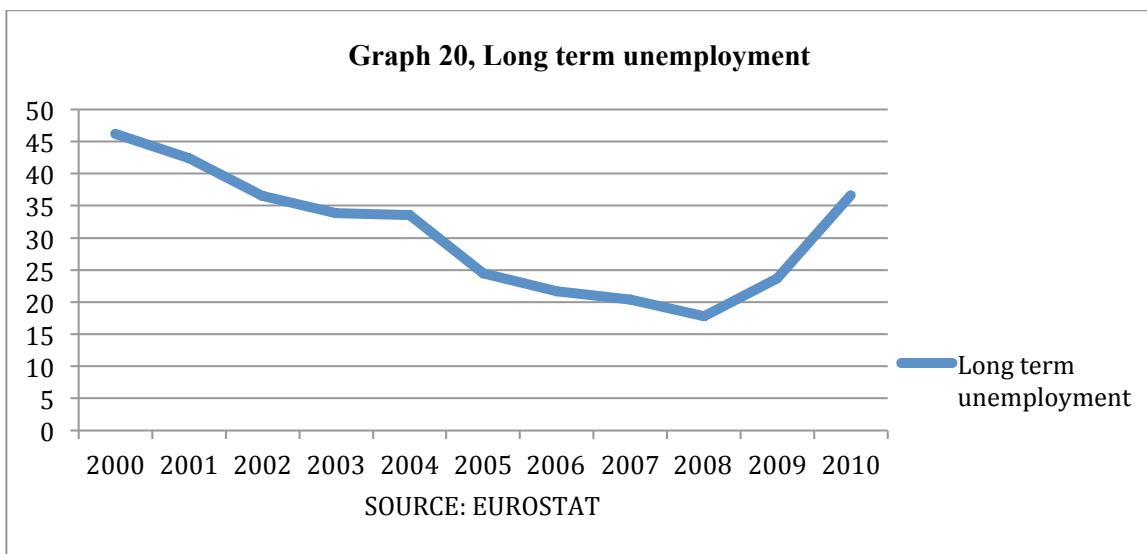


If a segmentation of the unemployment rate is done in the EU, all the countries have a very high young unemployment rate, but the most critical case is the Spanish one, where its level among youth population is the highest, with an average of 50% of the active population at those ages unemployed. But data shows an interesting result, it is that in some years during the crisis period, youth unemployment has experimented a very light decrease tendency, while older population from age 40 has the opposite behaviour, that could be explained because older people, probably were employed in mature sectors as construction and its auxiliary industry, which now is completely stopped.





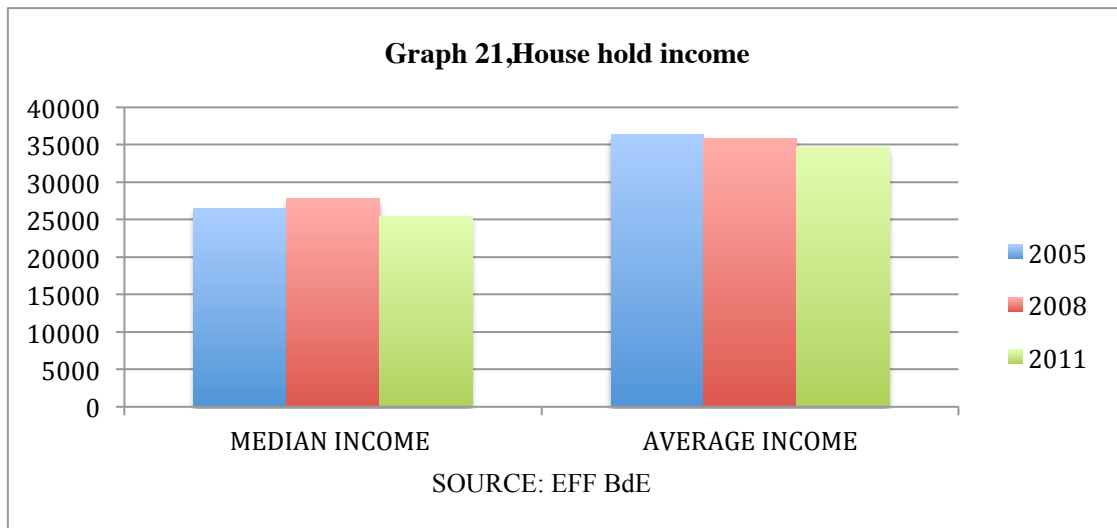
Another option that could explain that change in age composition may be the tendency, to have a more flexible labour market, being cheaper for enterprises to have two young employees for working only half day each, instead of hiring only one. That tendency means that many old people, that have some work stability, are starting to lose it and being replaced by youth employees, but in worst labour conditions, normally with less remuneration. That leads to a dangerous situation because older workers, are more indebted than youth and are responsible for the maintenance of their homes, so if that situation continues like that and older worker could not find a job again, the number on long term unemployed (population without a job more than 12 months) ,will be increased even more than actually is. All those elements will increase inequality among workers.



The result of reforms in the European labour market depends on factors like productive structure, productivity level, distribution of working time or relation between flexibility and security in the labour relations. It is not casual that the economic model of Spain based on low-skilled sectors, less productivity and high temporally rates, has destroyed employment during the economic crisis. In the rest of European countries as some theoretic models support, the economic downturn hasn't affected as much as in Spain the employment destruction.

#### **4.3 income**

In this section it is more reliable to use household as units to measure income rather than personal income. Normal people do not leave alone; they live in family units and share their incomes, so a more accurate result will be obtained if household are used in this analysis. It is also important to highlight the importance of income redistribution, developed by the State through taxes system, transfers and public goods and services.

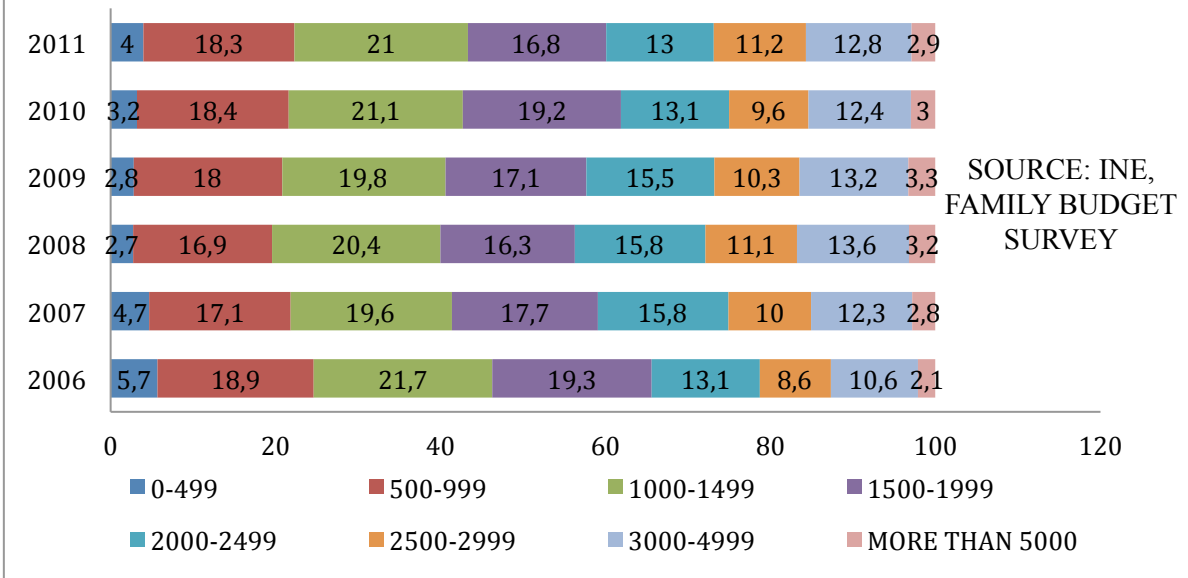


Based on the EFF developed by BdE, average income of household in 2011 was 34700€ and the median 25400. If a comparison is done between data of 2008 and 2011 average income have been reduced around a 8,5%, this is a consequence of the economic downturn experimented by the Spanish economy, the increase of unemployment and wages reduction. In 2008 the increase on income tendency started in the previous years was truncated. But even with this previous increment, Spanish data didn't reaches UE 27 average household income. Also since 2008 the decrease of Spanish indicator was greater than the European's, so differences were intensified.

Based on Eurostat results, the inferiority could be appreciated between Spanish personal income and some European countries, in terms of parity of purchasing power.

That means in numbers, that Spaniards obtain the equivalent to 68% of the personal income of French and 71% perceived by British, only the countries that have recently been incorporated to the EU as well as Portugal and Greece are behind Spain (EUROSTAT, 2012).

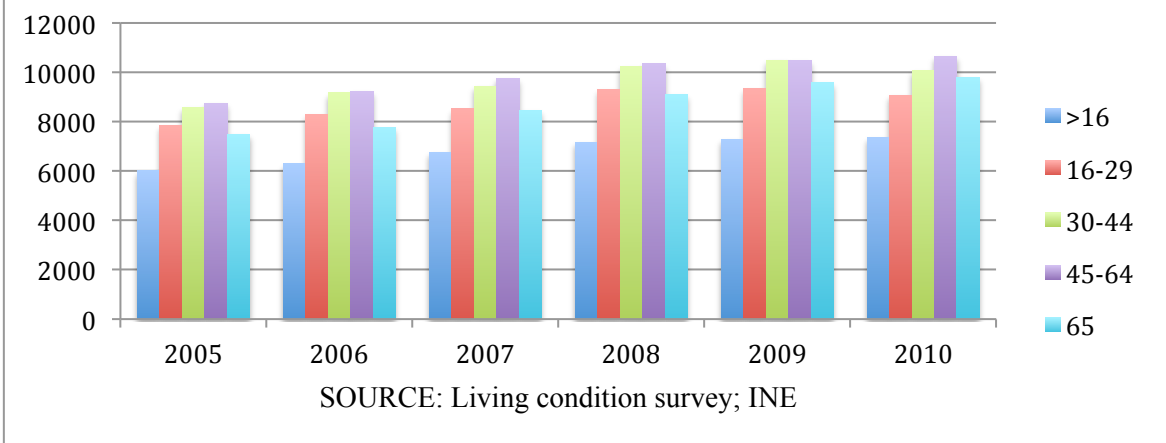
**Graph 22, Income distribution among population.**



About distribution of this income among the total population, it comes from a very positive period, where the number of household in the lowest level of income, was reduced and the number of families with the highest incomes increased. But since 2008 this tendency changed and the lowest part of the classification started to increase again and one year later the population with the highest income decreased too

But the most important problem of distribution is general reduction of income in all segments of population since 2008. Some of them have recovered the growing tendency, specially the second and the third segments with income between 500-1499.

**Graph 23 Income distribution by age.**



Regarding to the distribution of income by different ages of the population, it is important to remember the key relationship between working situation and income, this lead to lower income in both ends of working life, people with less than 24 years old because they are

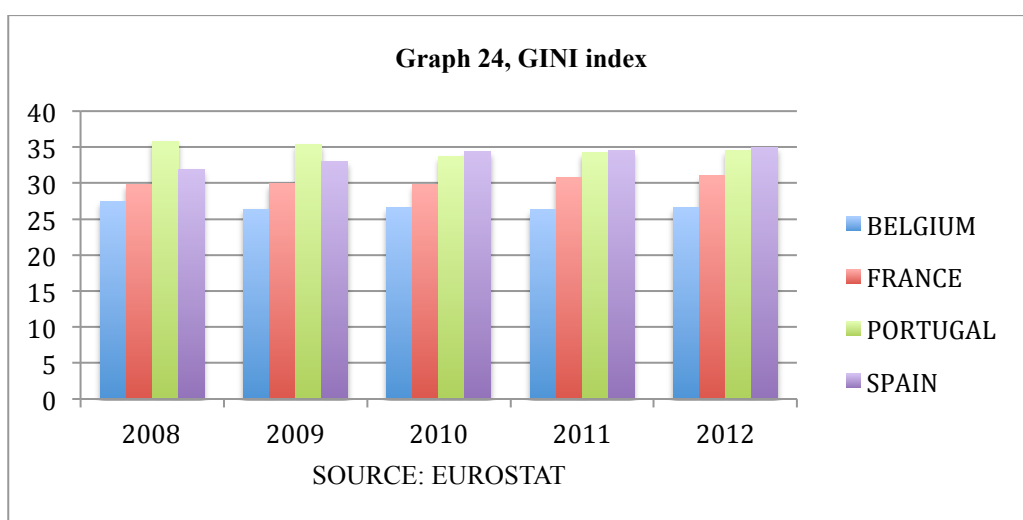
not completely academically trained and their working carriers are not developed at all. The other group of population, which needs to be studied, are those who are older than 65 years old, because they normally are outside of labour market. Since this age they used to start perceiving a retired payment, which normally means less income. That inequality among different ages, leads to a situation where people with an age between 25 and 64 have a purchasing power of 2000€ higher in average, respect to the population situated at the end and the beginning of their working life.

After analysing the data, from the living condition survey of income distribution by ages, there is not any clear evidence that economic crisis has increased this inequality, there is not any sign showing that inequalities, based on the income distribution by the age had increased since 2008.

#### **4.4 Gini index in European perspective and wages.**

As said previously, GINI index is one of the most used indicators for measuring inequality in societies, using this data to analyse inequality in Spain since 2008, some issues can be observed. Income inequality followed by Spanish economy, shows a different tendency of the one followed by the majority of the nearest developed countries.

Using the ratio evaluation of 80/20 (shows the relative position of the 20% of the richest population respect the amount of income of the poorest 20%), the top position of Spain about inequalities is clear, even before the crisis period, Spain was more unequal than other European countries. Since 2008 and while in Europe inequality levels remained constant or even were reduced, in Spain they suffered a huge growth.



Exactly the income of the 20% of the population with more earnings was 5,3 times higher in 2007, than the income of the 20% of population with lowest income. In 2012 it was 6,8

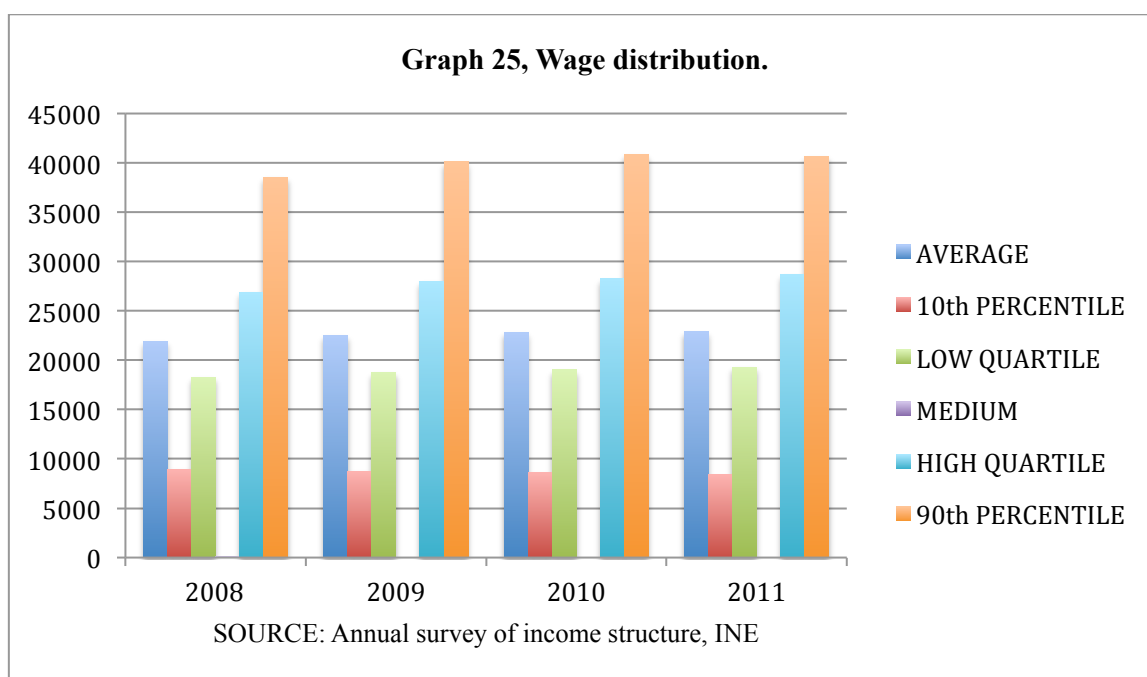
times higher, that means an increase of 1,3 points in only 4 years, the largest and the most pronounced of the whole EU during crisis period.

Thereby economic crisis has affected with particularly intensity unemployment, which leads to an increase in inequalities, however in other countries like Italy or Portugal, an increase of unemployment has not have so a consequence.

So Spanish result in terms of inequality has as a consequence the interruption of European convergence project, executed in previous years.

This behaviour of Spanish inequality was caused by some factors; the most important was evolution of labour income, specially it dispersion, due to the importance of work as a source of incomes. The other issue is the exponential increase of unemployment during this period, with lost of net income as a logical result.

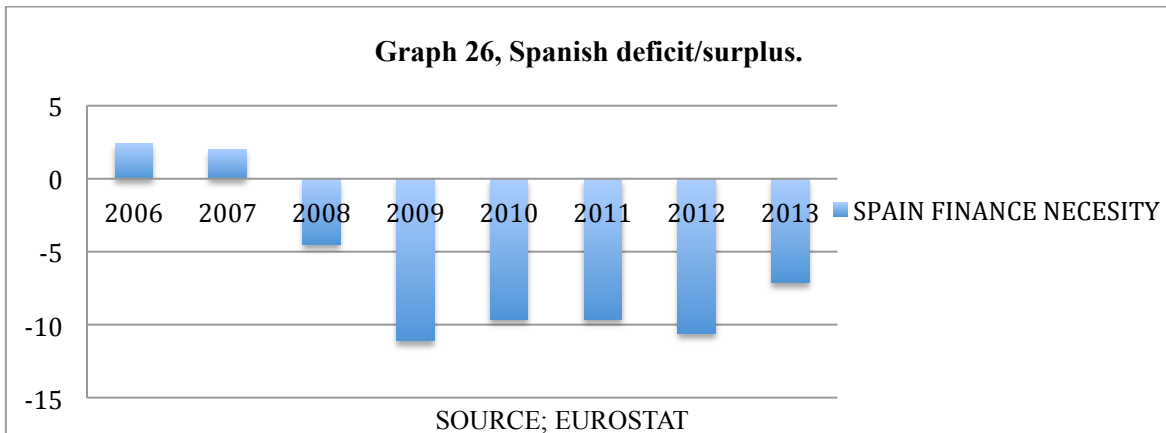
That dispersion of salaries was very influenced by construction sector, which registered a great increase in employment and wages, during previous years to 2008 in comparison to other sectors. That great increase of employment and wages was especially focused on young people with low education levels.



Salaries' evolution and specially their dispersion, looks to be the key to understand inequality increase registered in the recession period. But it is not enough to understand why it has behaved in a countercyclical way, being increased during recessions and being reduced in an economic expansion period, in the Spanish case the construction sector has played a very important role.

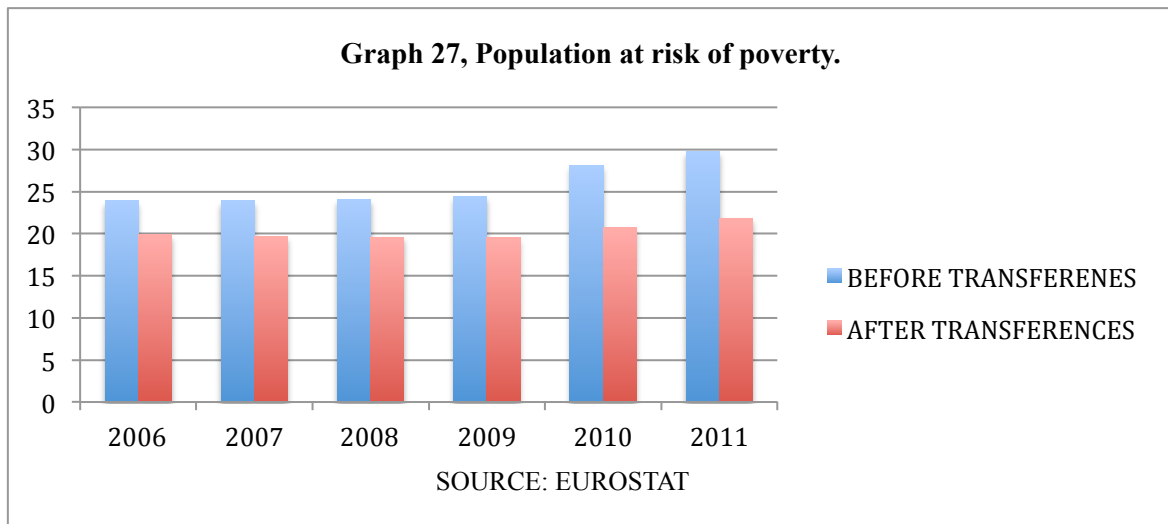
#### **4.5 social spending by public sector and poverty.**

It is clear that in actual economic situation, one of the most important issues to fight against inequality are public policies and the way they are performed. The most important target for governors is fighting against inequality, trying to achieve a fairer distribution of income. One of the most relevant themes that had jumped into public opinion is sustainability of welfare state, however the international pressure for deficit control, has generated some changes in public expenses, in order to reduce and rationalize them.



As it could be seen in the previous chart, in the years before economic crisis, public budget was equilibrated, it was even in a little surplus, but since 2008 a dramatic change happened. Expenses remain constant while income were terribly reduced, that leads to a -4,5% of the Spanish GDP needed to be financed. That amount growth even more in 2009 when it becomes at a -11,1%, after this year, it stabilizes itself.

Social transfers, with a 47,1% of the total increase, mainly started that increased of expenses. After analysing that increase we obtain that in is mainly divided into 2 areas unemployment protection with around 26000 million € and retired payment with more than 120000 million €. So budget in Spain was not reduced until 2010 as the same as the social transfers.



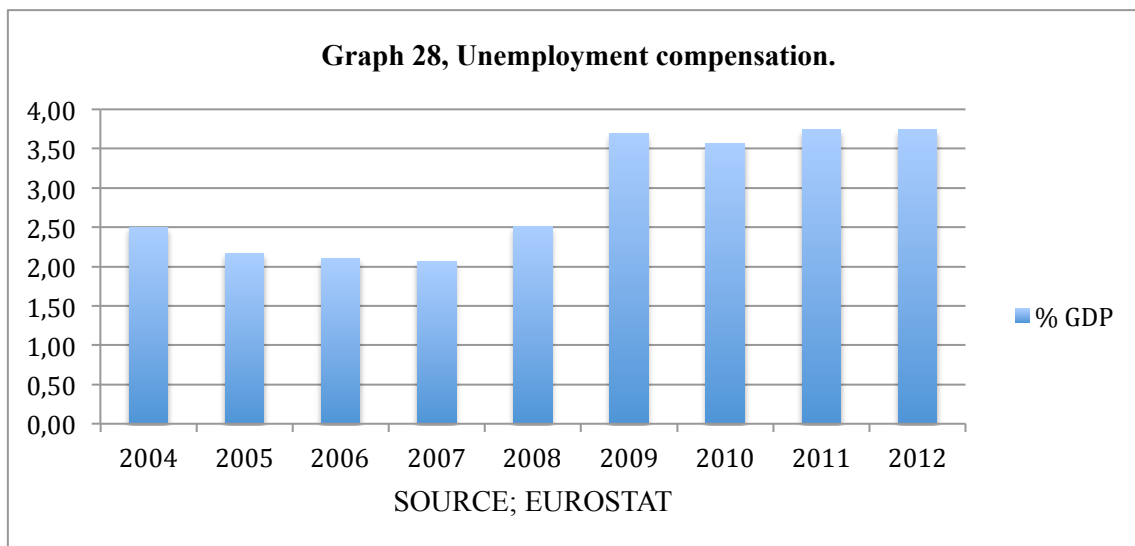
To measure the incidence of social expenses in the economic situation of household, is used the evolution of the amount of population at risk of poverty, which is people who live with less than the 60% of the median income of the total population.

In 2010 many of Spanish population would have been at risk of poverty with out social transfers. It can be seen how economic crisis has increased since 2008 population at risk of poverty in an exponential way.

The greatest impact of reducing population at risk of poverty are retirement expenses in population over 65 years old, because retirement pensions are the most important income in this segment of population. Pensions system is the biggest programme of public transfers and with more redistributive potential, because it is the main source of income of more than 6 million of people.

The main characteristic of this programme is that it is a shared programme, instead of a capitalization one, due to this; solidarity between generations is one of its more important characteristics, which leads to a high dependency of actual employment rate. So the actual high unemployment rate is affecting the pensions system sustainability.

Because the effect of economic crisis, Spanish state has react extending coverage capacity. However this process has divided society in two opposite segments, because social policies tend to respond giving resources to population that had already received them before. It tend to protect more old segment of people than the rest, for example in 2010, all the population had the same possibility of falling into poverty before transfers, but after being paid by the government, the segment of population who was most benefited where the people older than 65 years.

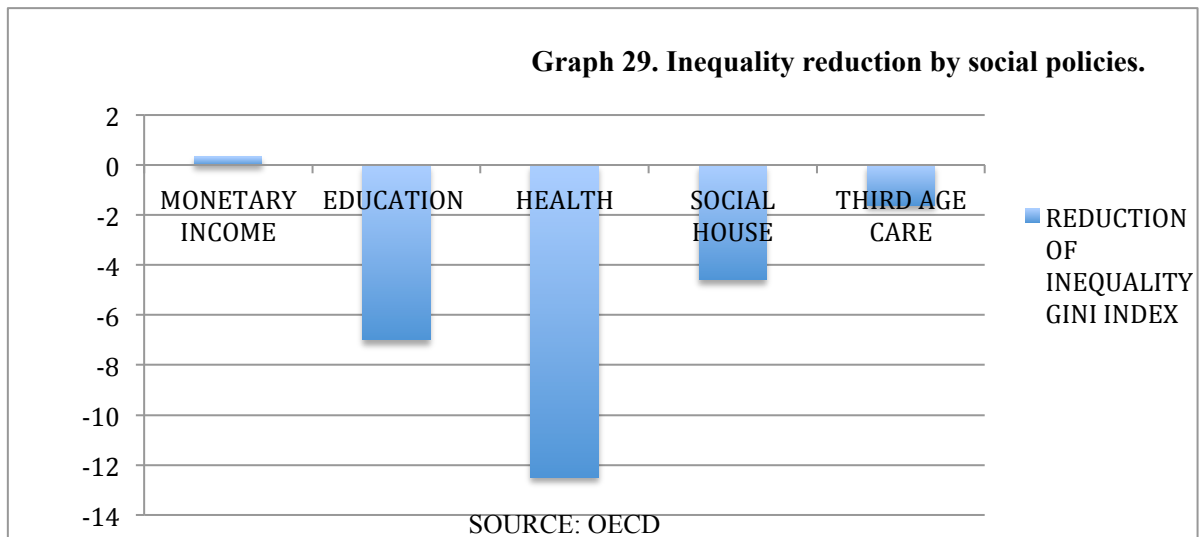


Since 2008 unemployment benefits meant a higher percentage of GDP, due to the great unemployment increase, growing above European average expense. Since 2010 it started to stabilize and a little reduction was experimented, because unemployment benefits of the first unemployed of the crisis, started to end after two years of inactivity. In consequence of that situation, which could mean a higher risk of poverty for a group of population, the State took the decision to continue providing 426 €/month of social transfer to all population without unemployment benefits.

Spanish system of unemployment compensation owns elements with a clearly redistributive nature, because after applying a system of maximum and minimum amount of social help, at the end the most favoured workers, are the ones with the lowest income. Even with this data, OCDE and European Commission support that the level of Spanish cares assistance, in comparison with the rest of countries who belong to OCDE, is one of the lowest, typically below poverty level.

Another very important element when studying the relationship between public sector and inequality is no monetary income, received by household coming from the State. Since OECD (2011) supported that public services and social benefits in kind, reduce inequalities and risk of poverty, specially in the most recently years. From all public services, the couple, which are considered to be more important, are education and health, because they have a greater influence in inequality reduction.





After studying the graph, it is clear the contribution of each issue related with social policies and public expenses. It is plenty confirmed that education and health are the two kind transfers, that have a greater impact reducing inequality in our country. This two benefits have universal access, specially health and education before university, the main problem since 2008 have been trying to maintain this services to population, due to the decrease of families income, economical activity, reduction of tax collection and the necessity of reach budget stability targets.

## 5.CONCLUSION.

This TFG project had the objective of making a review over the elements that have affected in a great or in a less way inequality and poverty in Spain. Focusing on the period 2008-2013, it was chosen because of the economic crisis, that took place during those years and we are still suffering nowadays. After all the work that has been done can be concluded that:

- Inequality has a countercyclical behaviour respect to the economic cycle, as can be seen in the chart of the GINI index from Eurostat, inequality has increased during Spanish recession. The richest percentile of population has increased their income over the poorest percentile 1,3% in this period, that is a very high amount for a very short period of time.

- During those years, the most damaged group in relation to income have been, youth workers, with low education level, because the increase of unemployment has focused specially on them. The group of population with greater incomes has continued being citizens between 45 and 65 years old as in the previous years of 2008. In general the most common wage is between 500€-1500€, which is not very high. Population has concentrated in this range of salary since 2008, leaving the highest income segments.

-Inequality reduction is not necessarily linked to employment creation. In the previous years to the economic downturn, Spain experimented an expansion process with a great employment creation, but inequality was not reduced, as it should do.

-Inequality increase during recession, is more associated with the level of academic formation of a specific segment of population, rather than linked to the general employment evolution of all the country.

-Public sector has played an important role in the reduction and control over inequality and poverty with social transfers, even more in the period 2008-2013, due to the increase of unemployment and the increase of household with the only income of unemployment benefits, also some transfers in form of public services, like education and health care can help to reduce inequality too. So we can conclude that public transfers help to reduce population at risk of poverty even if they are monetary or in kind.

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