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Repairing the middle

Policy recommendations

Evert-jan Quak | April 30, 2015

Europe's economic progress and political stability after the Second World War would not have been possible without the rise of the European middle class. This dossier shows that further progress and stability is seriously under threat, partly due to a struggling middle that is increasingly insecure about its employment, income and wealth, due to dismantling of the welfare state, de-standardization of labour, automation, globalization and financialization. Deliberate policies led to the rise of the European middle class and they will determine its future, too.

For many decades after the Second World War, the middle class was the trusted beacon of stability and economic progress in Europe. With a booming middle, there was optimism that each generation could do better. For middle-class families, this meant better jobs, economic stability, the opportunity to buy a house and save money to educate their children. The higher purchasing power and optimism of the middle class provided a solid basis for European economic integration, economic diversification and modernization, which ultimately resulted in economic growth. For politicians in Europe, a stable and buoyant middle class was also of crucial importance in assuring political stability and tax revenues.

It was deliberate policies that made the rise of the middle possible. For example, progressive taxes and social security guaranteed that wealth was redistributed to a larger part of the population. State pensions and national insurance schemes provided long-term stability and stimulated purchasing and investment by the middle class. Better education and adaptation to new technology meant that job mobility was mostly upward. Jobs were protected and promoted by a policy of full employment. And European economic integration enabled businesses from all EU member states to benefit from the rise of the middle on a larger scale.

About the author



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New policy agenda

This [dossier](#) shows that the rise of the middle class in Europe and the optimism associated with it for so long is a thing of the past. Today's reality is that the middle is increasingly struggling due to fundamental changes in technological progress (see the article '[Better skills will not save middle-class jobs from automation](#)' by Jo Michell), global competition, financialization of the economy, and the de-standardization of labour (see my article '[Making globalization work for the European middle class](#)'), and cuts in the welfare state (see the article '[A divided middle](#)' by Ursula Dallinger).

It is true that the European middle class is not a homogeneous group, nor has it ever been. And that European countries have implemented different policies to support middle-income groups. The Nordic countries, for example, tax the middle class heavily, but they can benefit from many social policies, tax credits and social security. The Anglo-Saxon model prefers low taxes, but offers far less social protection and fewer redistribution measures. As Ursula Dallinger and I show in our articles in this dossier, the European middle class is more divided than before, with a lower and upper end moving in opposite directions and having different interests in most European countries. This divide within the middle class is having a fundamental impact on traditional European centralist political parties. The middle classes no longer vote automatically for centralist parties, and are seeking alternatives among the rising populist parties on the left and right. Consequently, the state and future of the middle class will not only shape the economy, but also the political structure, of Europe.

The different interests within the middle class complicate the design of policies that suit and could save the middle in Europe. As the articles by Jo Michell and me show, there is evidence that even the higher end of the middle class is not immune to threats. Most new jobs are being created in sectors with low-productivity growth, like the financial sector, are increasingly concentrated in non-tradable sectors like health care and security, and are under threat from automation. The assumption is that, in time, this will also have an impact on higher-skilled jobs. This would suggest that the higher middle classes have similar interests to their lower counterparts, even if they do not yet perceive them as such.

The decline of the middle class must be a wake-up call for policy-makers that past performance will not guarantee future results. A new era calls for new innovative policies that not only put employment at the core but mainly focus on the short-term needs and long-term interests of the people behind the jobs. That will set the policy agenda for the state and future of the European middle class. And Europe should take the lead in this search for a new vision on repairing the middle class, which must simultaneously address social security, the labour market, automation, globalization and financial market policies.

Automation

Although social policies aimed at redistribution and social protection are important to compensate the struggling middle, this is not enough to save the middle classes because it does not tackle the structural causes of their decline. Technological progress was hailed for many decades for creating more and better jobs in Europe. But there are now serious concerns, with increasing evidence to support them (as shown by Jo Michell's [article](#) and the expert opinions by [Jeremy Bowles](#) and [Robert Went](#) in this dossier), that productivity gains due to automation and other technological improvements will destroy more jobs than they create. And it is not only lower skilled jobs that are losing out. Due to routinization, many typical middle-class jobs can be automated easily in the near future. This means that productivity will grow even faster, but without improvements in employment and wages.

The days when better education and skills were enough to adapt to technological changes are over. Policy that focuses mainly on better education and skills will therefore not be sufficient to guarantee enough employment and wages for the current middle class. There are two directions of thinking in seeking a solution. The first is about governments stimulating investments in job-intensive and productive sectors of the future, rather than in technological innovations that will ultimately destroy jobs in the long term. The other way of thinking is to admit that job losses due to automation are irreversible and to seek solutions to redistribute the gains of future productivity more evenly among the population.

Economist Dani Rodrik comes up with a solution for the latter. He argues in a [blog post](#) for Project Syndicate that, as states already play a significant role in funding new technologies, they should use that role to acquire a stake in the commercialization of successful technologies. If they do not lay claim to the spill-over effects of their investments, governments leave the profits entirely to private investors. Rodrik's idea is therefore that governments should benefit from new technologies to redistribute the wealth gains among the population through a 'social innovation dividend'. The suggestion is that policy should not focus entirely on creating jobs, as automation and technological change will ultimately lead to fewer jobs. To protect society from rising inequality and political unrest, policy-makers must look to alternative ways to redistribute wealth.

The social innovation dividend is just one solution. Other options must be studied and discussed openly (and The Broker welcomes all suggestions!). But the future of the middle class in Europe depends on policies that look at the concepts of productive work and investments differently, and redefine them more socially, extending well beyond the limits of 'gainful work', which specifically refers to activities that generate private profits.

Doing nothing is risky, as Jo Michell highlights in his article. If today's technological revolution is ignored, the current trend of increasing skill and capital-intensive technologies – which is putting the creation of better and new jobs at risk – will continue, and will result in unprecedented levels of inequality and the threat of widespread social and political conflict. The debate about automation cannot therefore be conducted only by labour market experts but must be a broad political concern. The good news is that the threat is being recognized, and the debate on automation, or 'robotization', has started in many countries, including the Netherlands, Germany and the UK.

Economic globalization

Where economic integration in Europe after the Second World War strengthened the position of the European middle class, current global competition is doing the opposite. Governments often say that there is no alternative than to increase international competition. However, in my [article](#), I argue that there are alternatives. To start with, by giving redistribution and social protection measures an important role in the globalization agenda, to give people time to adjust to shocks. Employment subsidies in particular are an effective tool in addressing the loss of sector-specific skills because they increase workers' incentives to invest in new skills.

To address the structural causes of the crisis facing the middle class in Europe, however, one extra step is necessary: an alternative economic globalization agenda is needed if we are to reverse the global race to the bottom. This includes an alternative trade regime that gives governments more tools to increase job opportunities. One of the conclusions of The Broker's [debate on employment](#) was that smarter trade agreements would propagate a 'gradual' approach to liberalization. This would help spread reallocation costs over time and allow affected workers to adjust. Second, a race for global market share driven by trade liberalization and trade agreements should be accompanied by parallel agreements on minimum standards of job quality that are rigorously enforced internationally, for example by the WTO. This would avoid a race to the bottom in which middle-class workers around the globe compete against each other by accepting lower quality jobs.

Governments could do much more to combat financial globalization and push companies to invest in productive sectors in Europe instead of speculating, which can induce credit bubbles, encouraging especially the lower middle classes to go deeper into debt to keep up their living standards. This is in line with recommendations in the Broker's [Employment dossier](#) and the conclusions of its employment debate. Policy-makers could, for example, start by taking steps to discourage the high-risk use of debt by financial institutions. Taxing interest, capital gains and dividend income for non-financial companies at higher rates than income generated from their core business will encourage them to refocus on productive investments and long-term sustainability that could in the end improve employment.

Social protection

The cutbacks in welfare states of the last two decades, accelerated by the economic and financial crisis in Europe, have been defended as an economic necessity to give people a greater incentive to find better and productive work and therefore promote upward job and social mobility. This would lead to economic growth and everyone would benefit. But this is an illusion. Austerity policies in Europe have resulted in a decreasing total income position for lower income groups, including the lower end of the middle class. Cuts in tax credits and employment subsidies, for example, have negatively affected the demand side of the economy, creating the risk of even more economic turmoil.

Secondly, as already mentioned above, social security and protection are necessary to provide people with a safety net in times of transition and adaptation to new circumstances. Without the right social security policies, there will be no transition and people will not be able to adapt. Furthermore, as the article '[Who are the 'middle'?](#)' by Josefine Ulbrich and the expert opinion by [Andrea Falanga](#) show, the idea that the middle class would be able to cope with the cuts, because they are well insured, have savings and often own their house, was too simplistic. Many have eaten up their savings and are struggling to pay their mortgages, while selling their houses would leave them with debts.

It is certainly not true that governments in Europe are not taking action. In 2014, for example, Germany finally agreed to establish a minimum wage of €8.50, in the UK the minimum wage was increased by 20 pence an hour to £6.70 in March 2015,

the Dutch government is considering legislation against 'bogus constructions' in labour contracts, and there is a debate about ways to insure workers who have no standard contracts. However, the broader picture is of a shrinking welfare state without an alternative route map to a comprehensive social policy for Europe. Suggestions for such a policy include encouraging companies to take steps to improve the contracting of workers with a minimum level of flexible work hours, differentiated by sector. Jo Michell's article and his previously published [expert opinion](#) for The Broker both conclude that a reconsideration of the de-standardization of labour contracts, flexibilization and the rolling back of progressive taxation regimes by governments will restore and protect the income position and rights of workers.

Furthermore, workers need more bargaining power and empowerment. One solution could be to link these to the search for innovative ways of redistributing wealth. One way in which this can be achieved was mentioned in The Broker's [debate on employment](#): to allow employees to share in company profits, paid out not in cash but in shares. This would gradually give workers an increasing share in the equity of a firm. As employees become shareholders of their own company, the dividing line between employees and shareholders would gradually fade. Profits will be invested in the future of the company and its employees.

The future of the European middle will depend on deliberate and comprehensive policies that set an agenda for a new era that moves away from the economic policy discourse based on neoclassical theory that has dominated since the 1980s. The good news is that now there is greater recognition that the middle class, as the political cornerstone of democratic states, is struggling. European politicians are more aware of the consequences and are more willing to act than in the past decade.

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