

What about Low Incomes?

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The GREAT RECESSION and the DISTRIBUTION of HOUSEHOLD INCOME

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A REPORT FOR THE FONDAZIONE RODOLFO DEBENEDETTI

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The Great Recession and the Distribution of Household Income

The subject: the impact on household incomes of the major economic downturn that began at the end of 2007 (the ‘Great Recession’, GR)

- we track real income levels, poverty rates, and income inequality

Headline findings: for most of the countries we study,

- in the two years following the downturn, little change in household income distributions, but ...
- ... in the medium- to longer-term, much greater change likely due to fiscal consolidation and slow pace of economic recovery

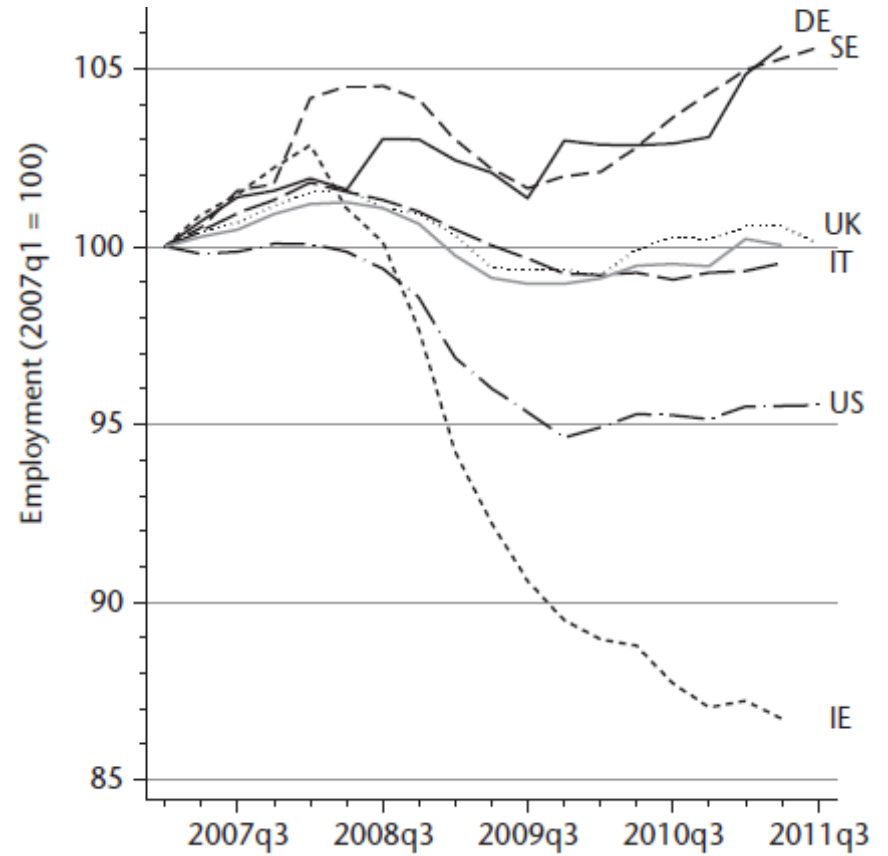
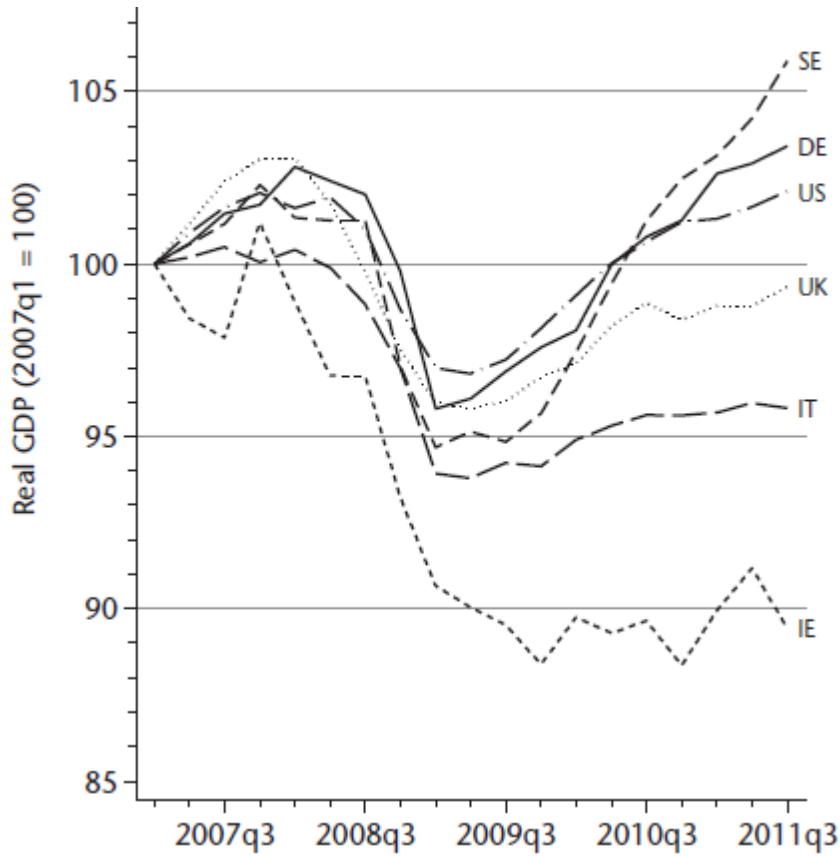
Features & problems of the study

1. Living standards measured in terms of household net income
 - the sum of labour earnings, cash transfers, income from investments and savings, etc., after the deduction of income taxes, and adjusted for differences in household size
 - Income, not consumption expenditure, ‘happiness’, ‘capabilities’, or other indicators of personal living standards and well-being, including wealth and other asset measures
2. Household incomes of all individuals in the population
 - whether young, old, working or not working
 - cf. narrower focus on e.g. wages for prime-aged employees
3. Cross-national perspective
4. Timely data availability
5. Counterfactuals

The Great Recession 2007-09

- Economic slowdown in OECD area late 2007, ... Lehmann Bros bankruptcy in September 2008 (USA), financial crises, housing busts, trade collapses, ... and significant declines in output across OECD countries
 - ‘The first contraction in the global world economy since the Second World War’ (Keeley & Love’s *OECD Insights book*, 2010)
 - Worst macroeconomic downturn in most OECD countries since the Great Depression of the 1930s ...
 - ... but heterogeneous macroeconomic dynamics

Real GDP and employment



Source: Jenkins, Brandolini, Micklewright and Nolan, 2013.

The Great Recession 2007-09

- According to business cycle dating, the Great Recession ends in 2009, with return to positive GDP growth
 - But in several countries, including Italy, new recession ('double dip')
 - Austerity policies implemented to reduce public deficits contribute to depress growth

Austerity packages, Italy in 2011

Measures with an impact on personal incomes or wealth holdings

- Solidarity contributions on high incomes (3% of income above €300,000) for 2011–13
- Solidarity contributions on high pensions (5% of pension income above €90,000; 10% of pension income above 150,000) for 2011–14
- Tax rate on income from financial assets equalised at 20 per cent (except for government and equivalent securities and supplementary pension plans)
- Increase in stamp tax on securities accounts
- Pension system (freezing of cost-of-living adjustment above certain levels, increase in retirement age)
- Measures against tax evasion and rules on tax collection
- Public employment measures (postponement of payment of severance benefits)

Measures with an impact on expenditure

- Increase in VAT rate from 20% to 21% as of September 2011
- Increase of excise taxes
- Surtax on luxury cars, aircrafts and boats

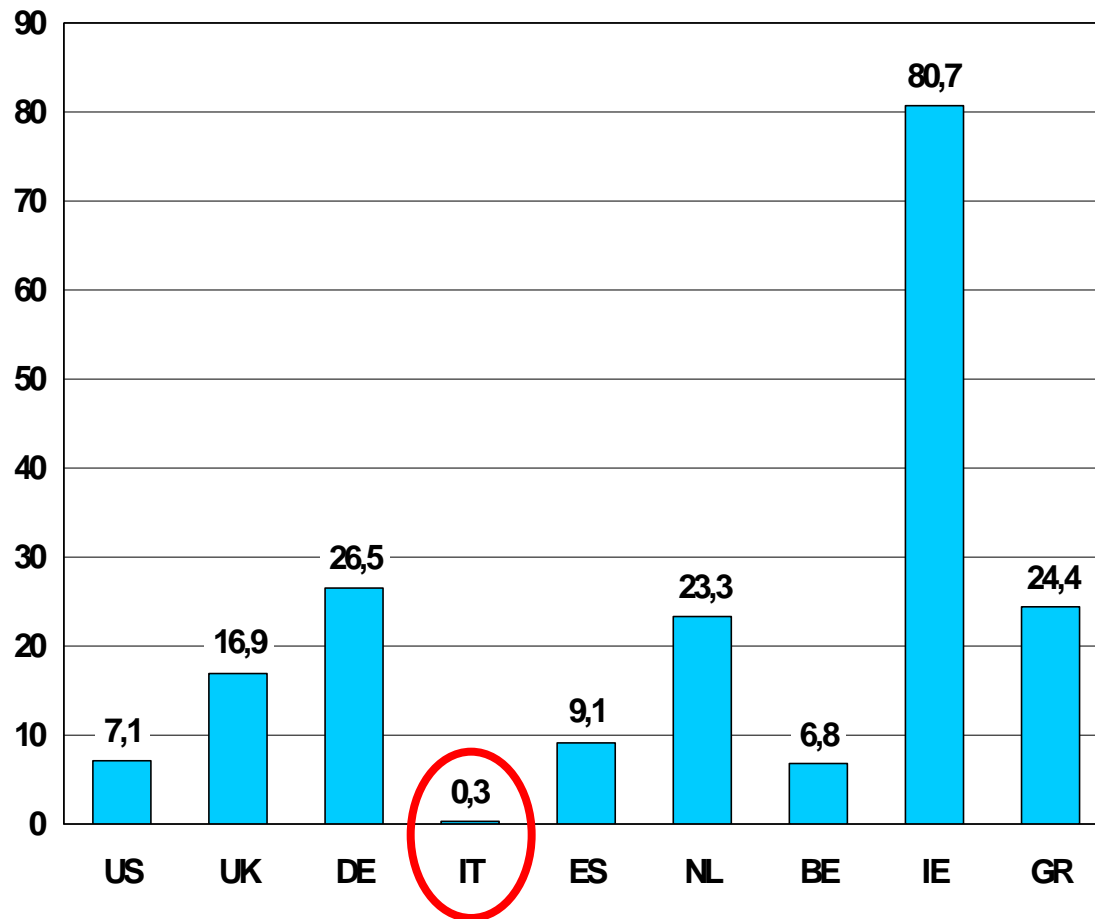
Measures with an unspecified impact

- Savings from fiscal and welfare reform to be enacted by September 2012 (if not implemented, flat across-the-board cut in tax allowances, increase in VAT)

Measures that may lead to cuts in the provision of public services

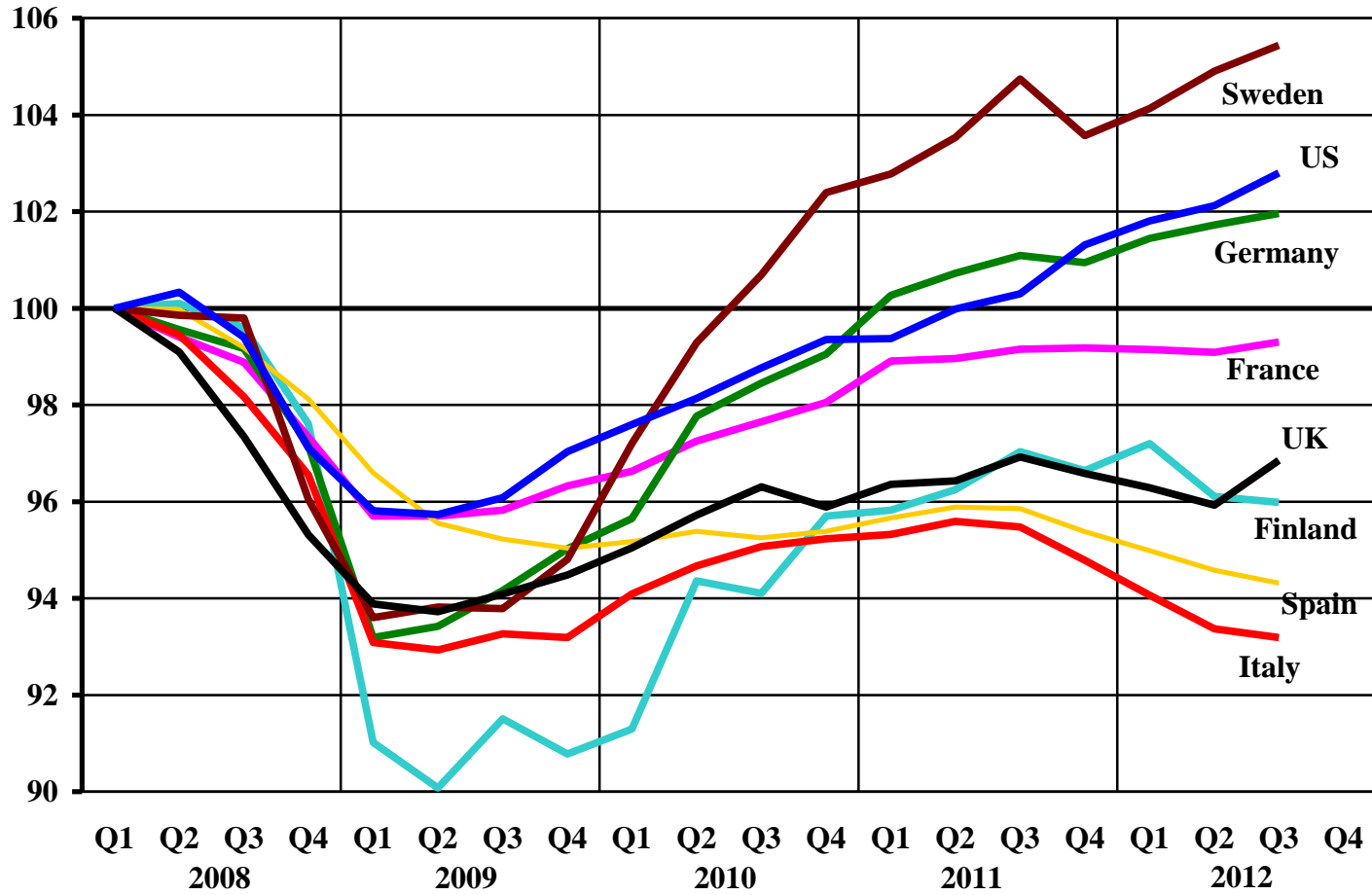
- Rationalization of health spending, reduction of ministries' and local government spending

Government support to the financial sector (as a percentage of 2011 GDP)



Source: based on IMF and Bloomberg. 1) Sum of direct support (capital injections and purchases of assets) and cumulated issuance of guaranteed bank bonds.

Real GDP (2008:1=100)



Source: elaboration on OECD data.

The Great Recession 2007-09

- According to business cycle dating, the Great Recession ends in 2009, with the return to positive GDP growth
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What happened to household incomes, income poverty and economic inequality?

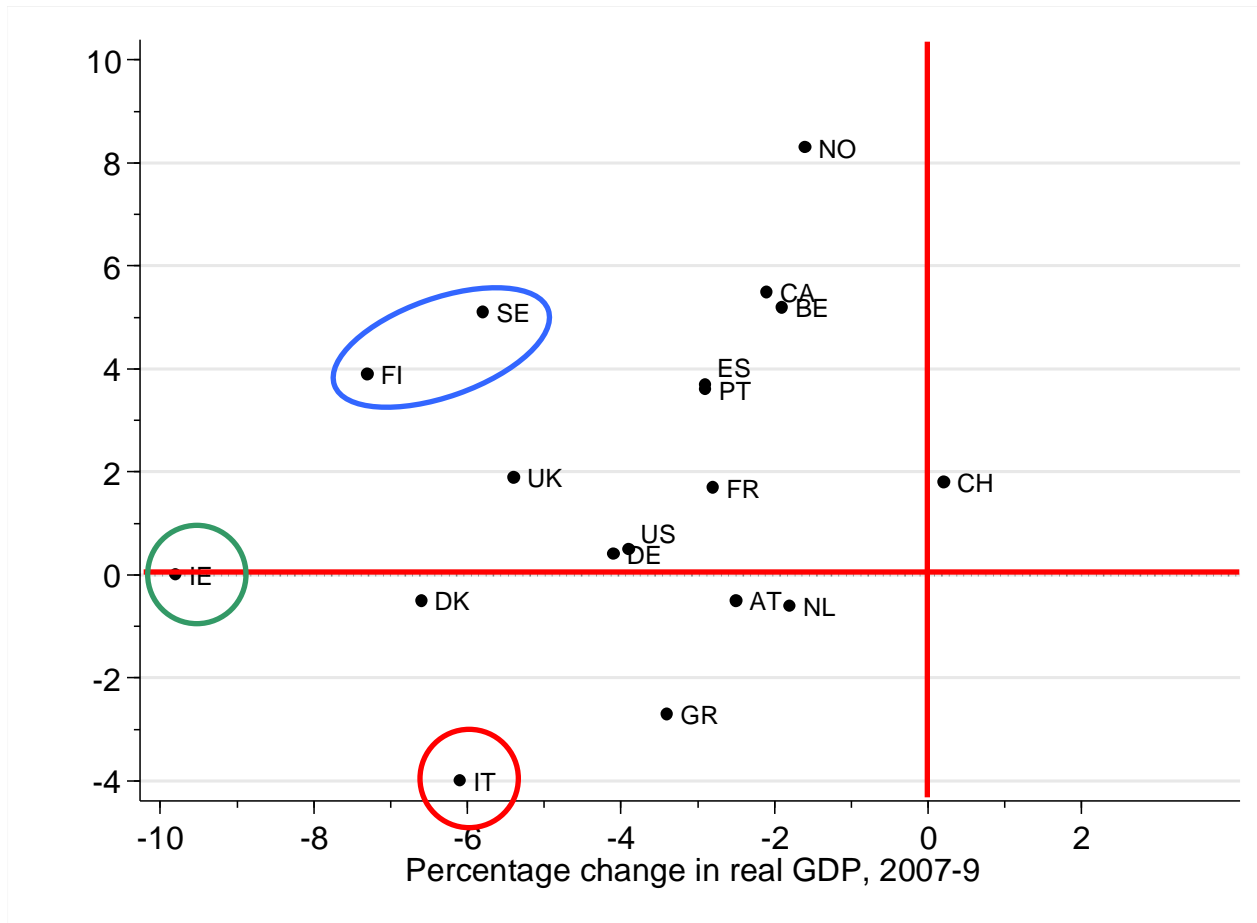
→ Distinguish short from medium-long period

Analytical predictions

1. Lower real income levels throughout the income range
2. Absolute poverty rate tend to rise
 - Incomes fall relative to a poverty line that is fixed in real income terms
3. Relative poverty rate need not rise if the poverty line also falls sufficiently
 - Poverty line is a fraction of median or mean income, so changes over time
 - EU social exclusion indicator: poverty line = 60% median income
4. Impact on income inequality is not clear cut
 - Depends precisely on who is affected and where located in the distribution
5. Demographic effects: population changes
 - Endogenous family formation (US 'doubling up'), migrants returning home
6. Differences in effects across population subgroups
 - Some predictions with knowledge of who is to be found in the bottom, middle and top ranges to start with, and their income sources

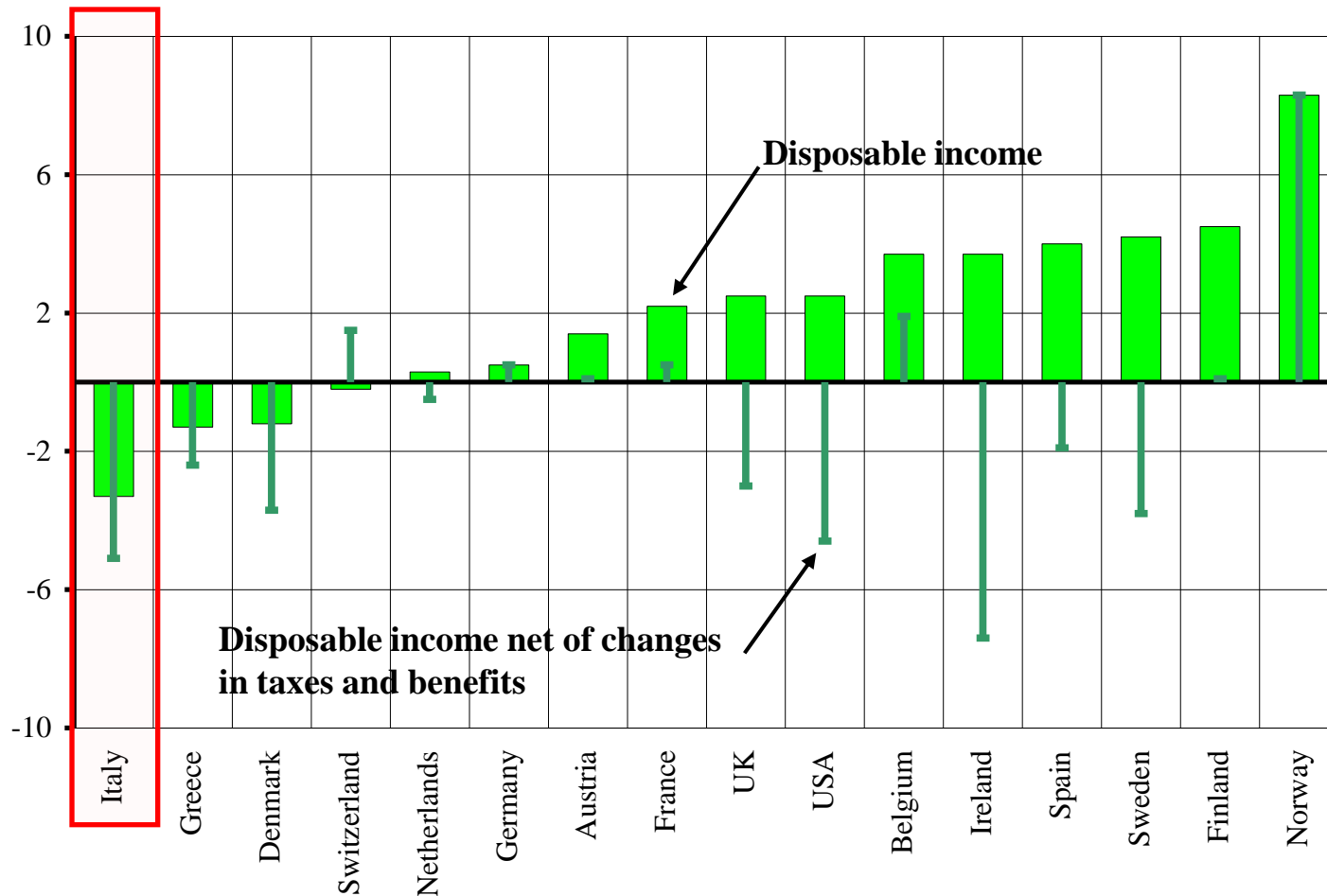
In most nations, total household sector income rose though GDP fell

% changes in real Gross Household Disposable Income (GHDI) and real GDP, 2008-09



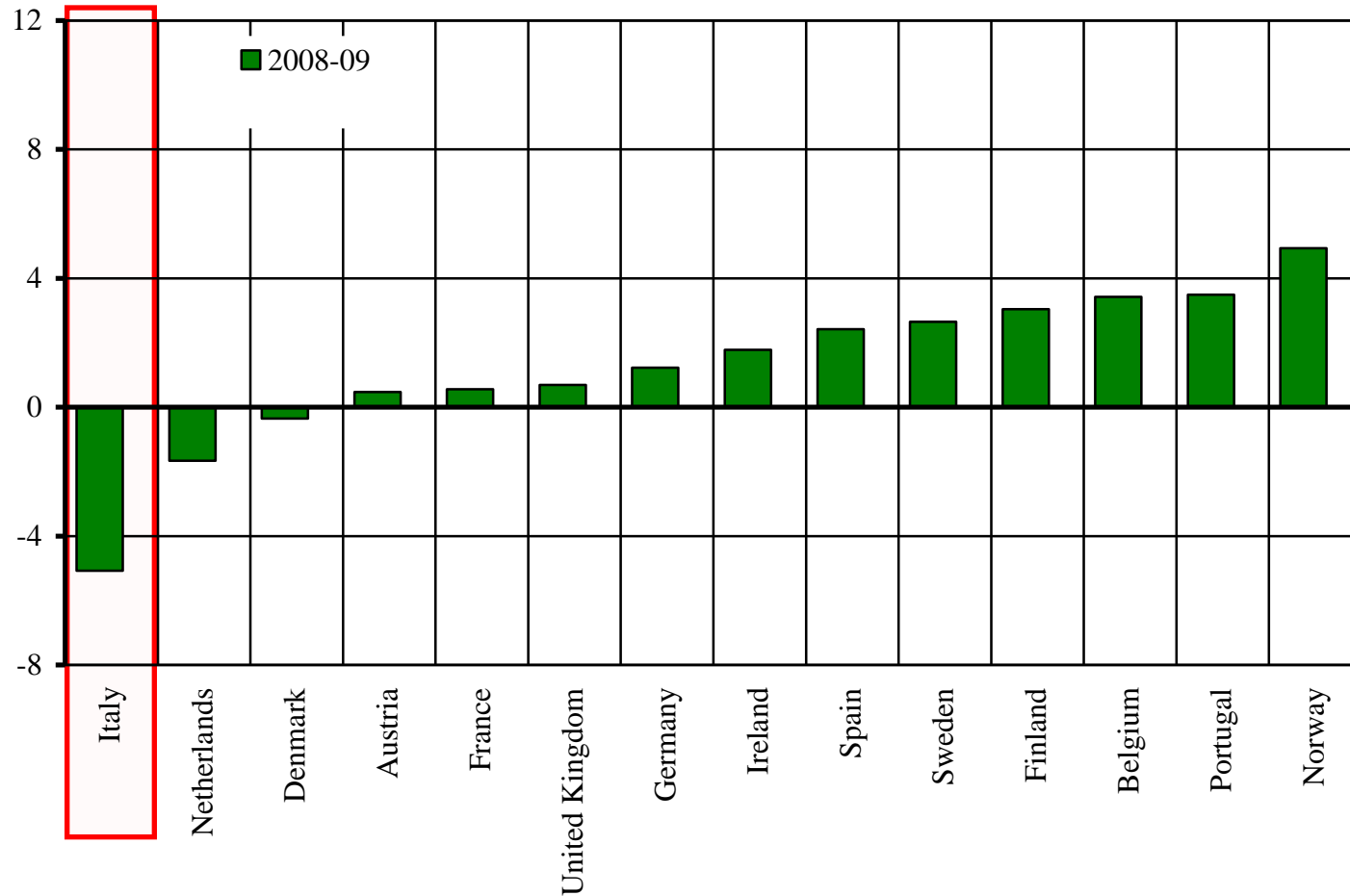
Source: Jenkins, Brandolini, Micklewright and Nolan, 2013.

% change in household incomes in selected OECD countries, 2008-09



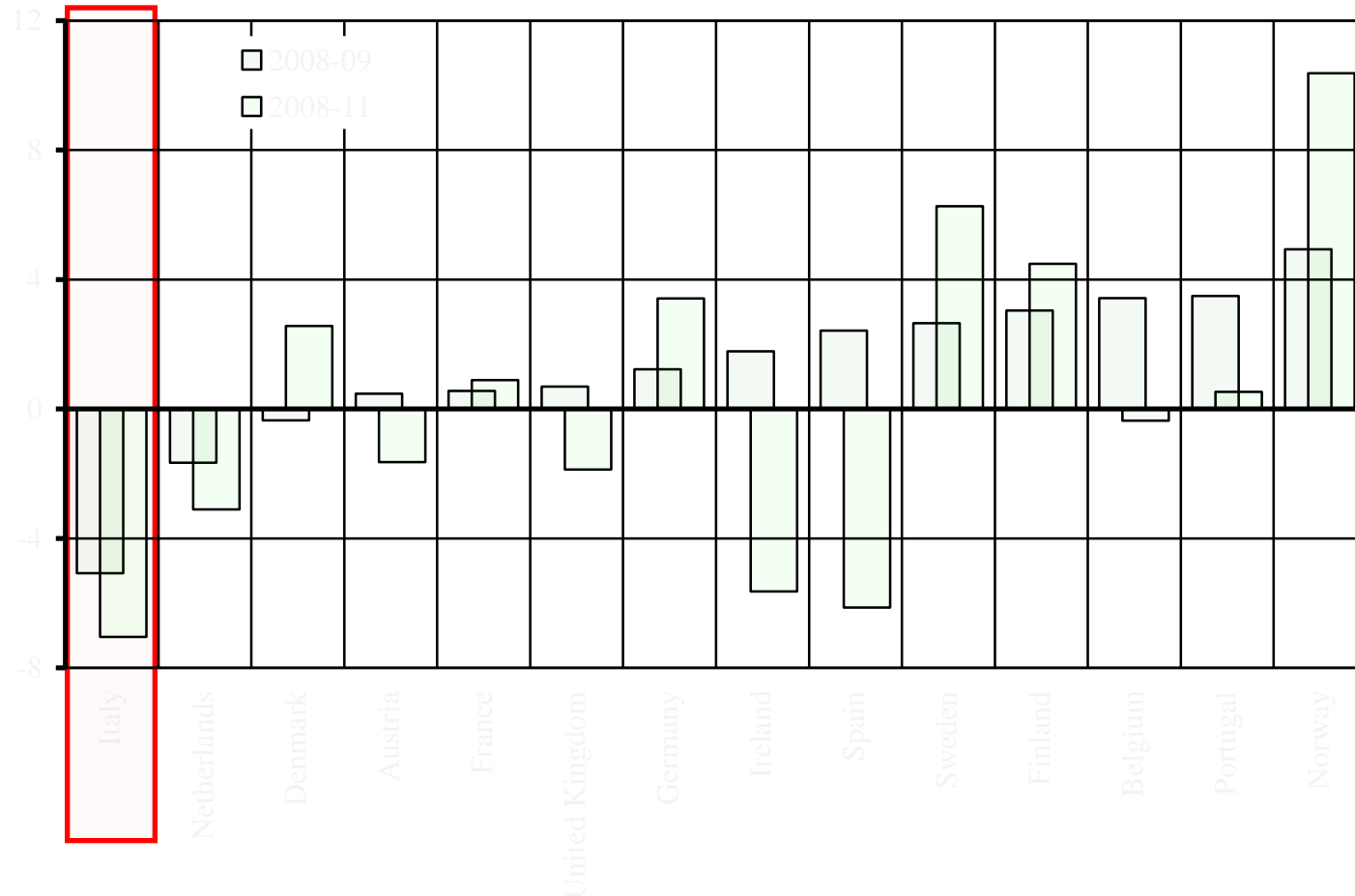
Source: Jenkins, Brandolini, Micklewright and Nolan, 2013.

% change in per capita household incomes in selected OECD countries, 2008-09



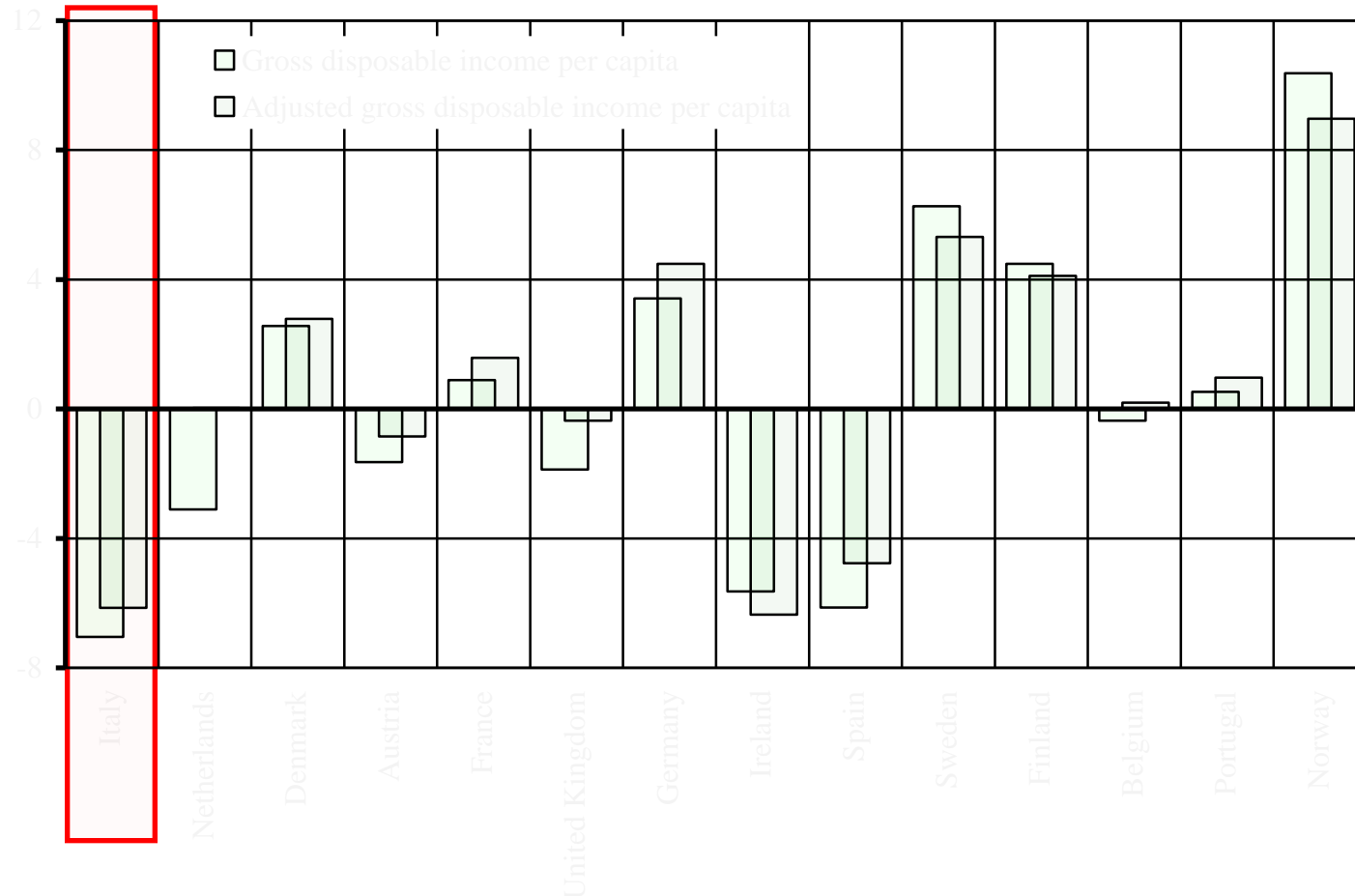
Source: elaborations on Eurostat data. Gross disposable income at 2005 prices.

% change in per capita household incomes in selected OECD countries, 2008-09 and 2008-11



Source: elaborations on Eurostat data. Gross disposable income at 2005 prices.

% change in per capita household incomes in selected OECD countries, 2008-11

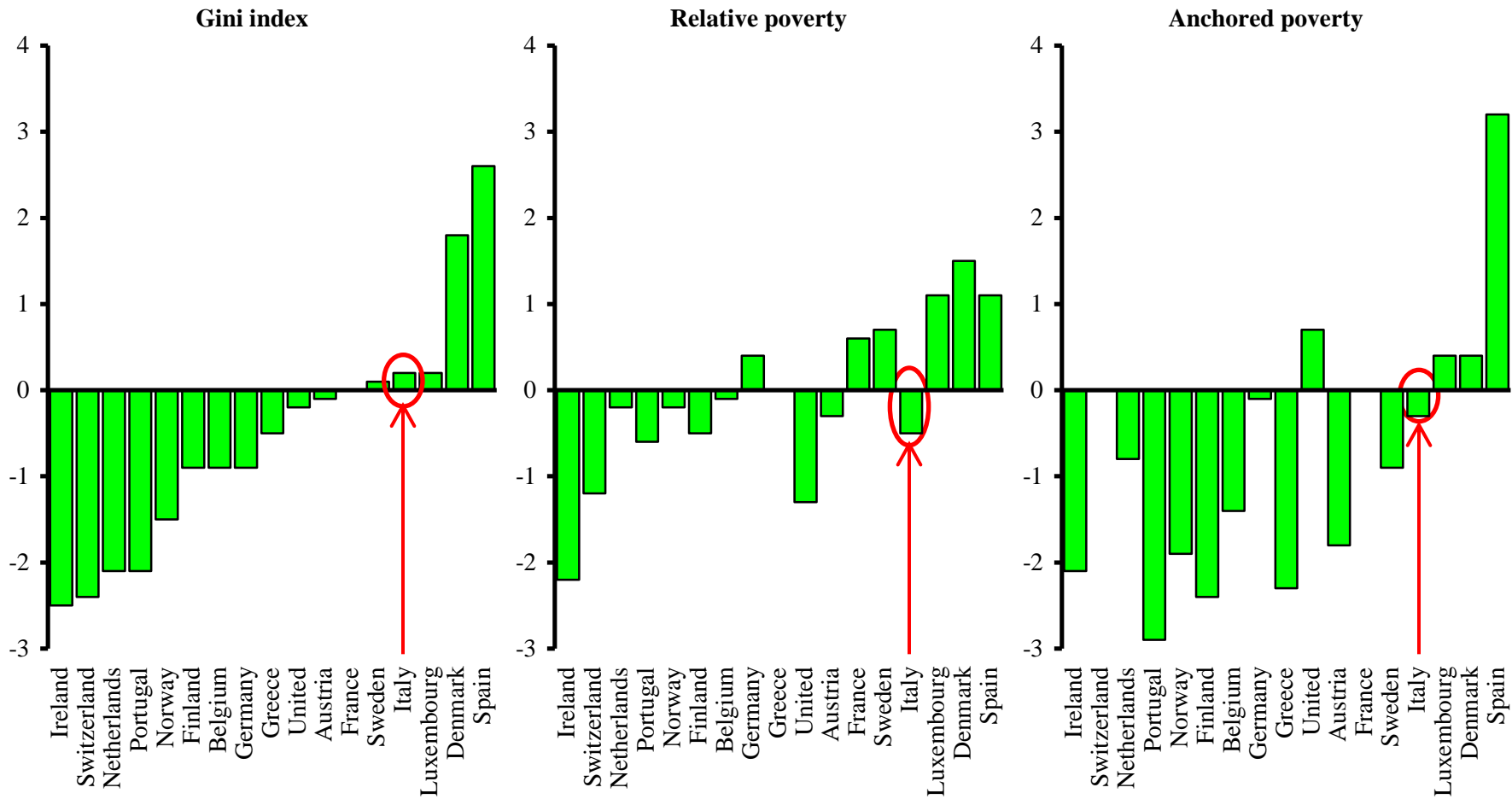


Source: elaborations on Eurostat data. Gross disposable income at 2005 prices 'unadjusted' and 'adjusted' for the individual consumption expenditure of general government.

Great recession & distribution

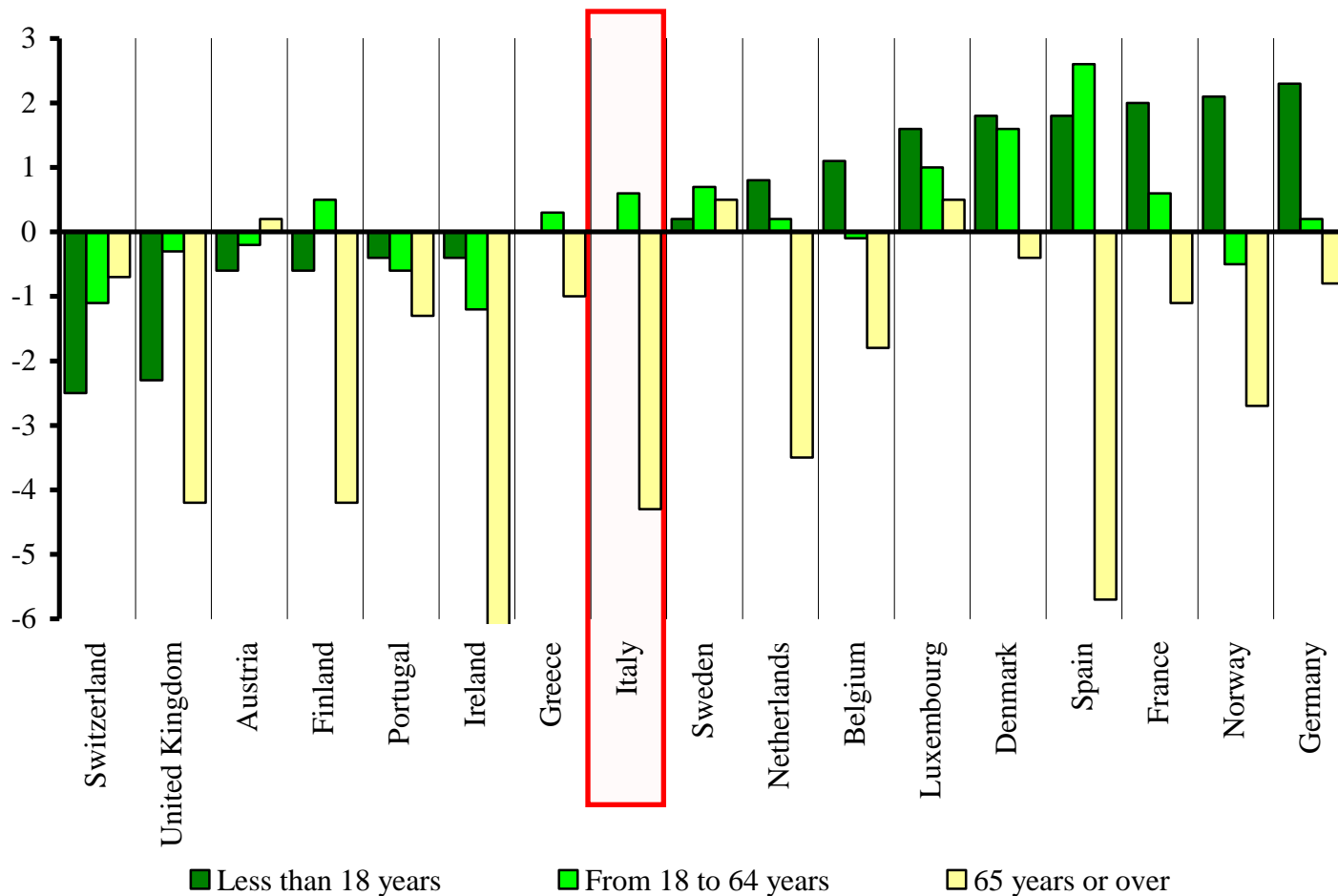
- Equivalent disposable income, modified OECD equivalence scale; source EU-SILC.
- Three indicators:
 - Gini index
Inequality index ranging from 0 to 1
 - Headcount relative poverty ratio
Share of individuals with equivalent income below 60% of median national equivalent income
 - Headcount anchored (pseudo-absolute) poverty ratio
Share of individuals with equivalent income below 60% of median national equivalent income of 2005, annually adjusted for price changes

Great recession and income distribution (% point changes 2007-09)



Source: elaborations on EU-SILC data. Countries are ranked by absolute change in Gini index.

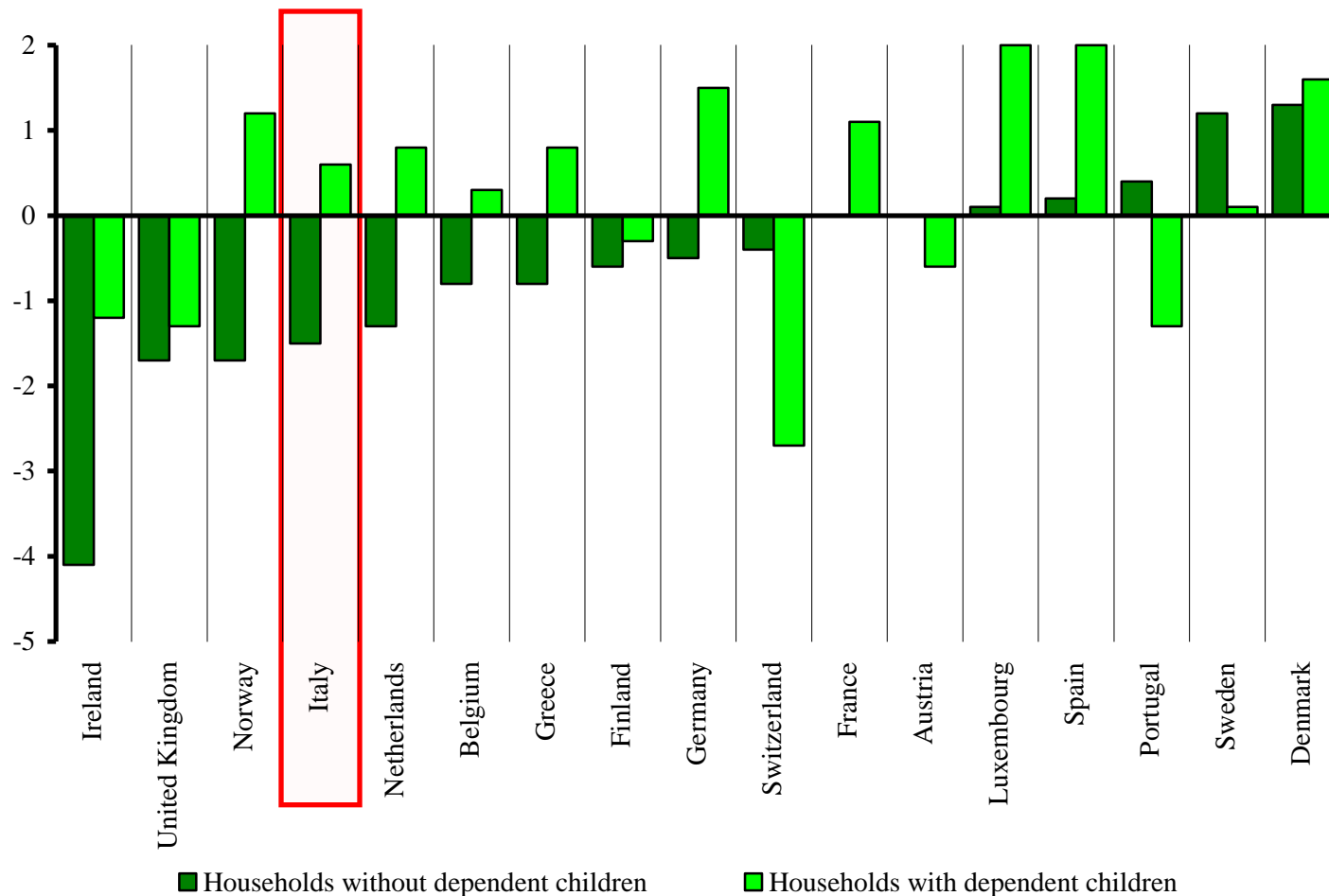
Great recession and relative poverty (% point changes 2007-09)



Source: elaborations on EU-SILC data.

Share of individuals with equivalent income below 60% of median national equivalent income.

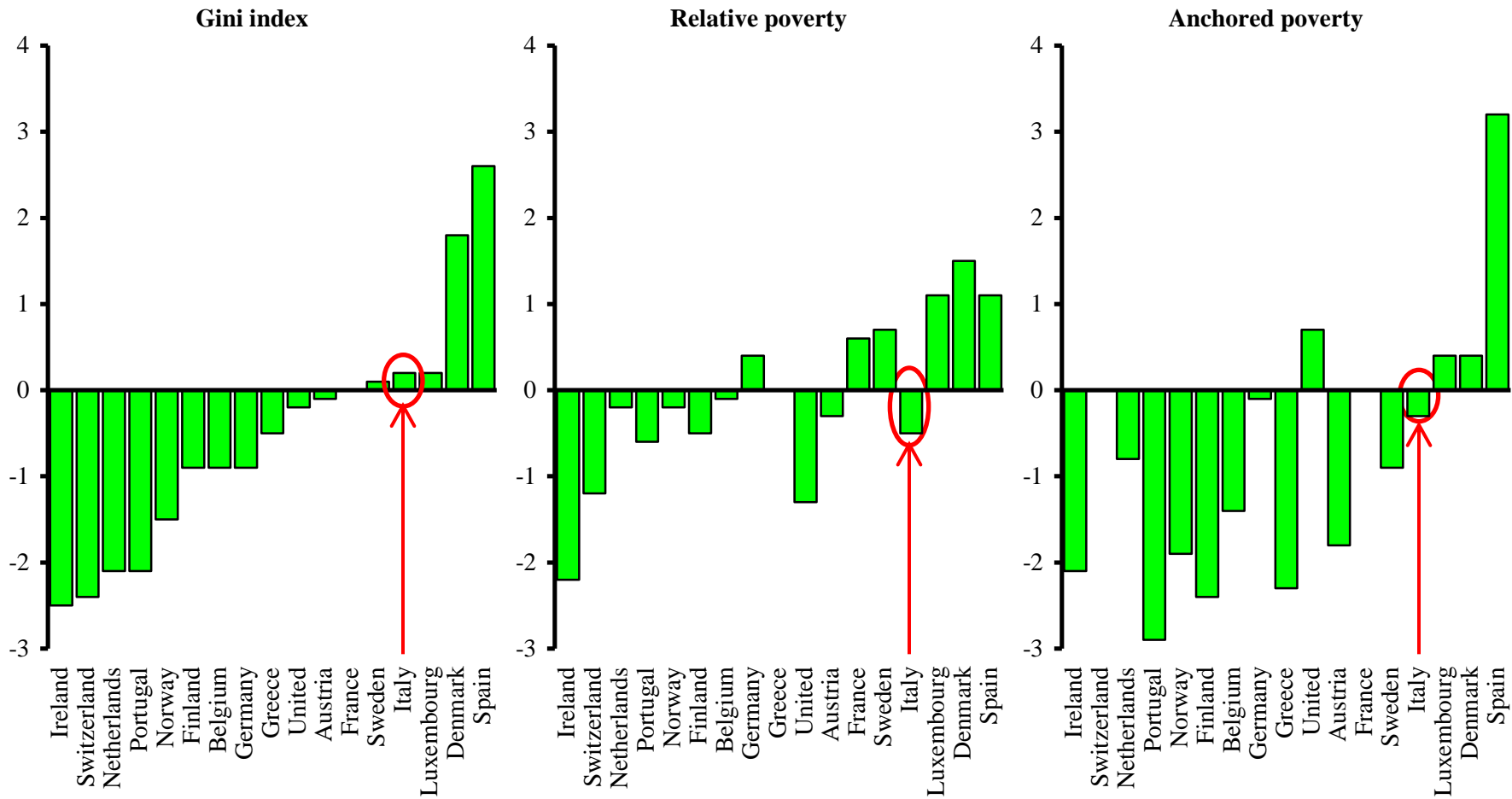
Great recession and relative poverty (% point changes 2007-09)



Source: elaborations on EU-SILC data.

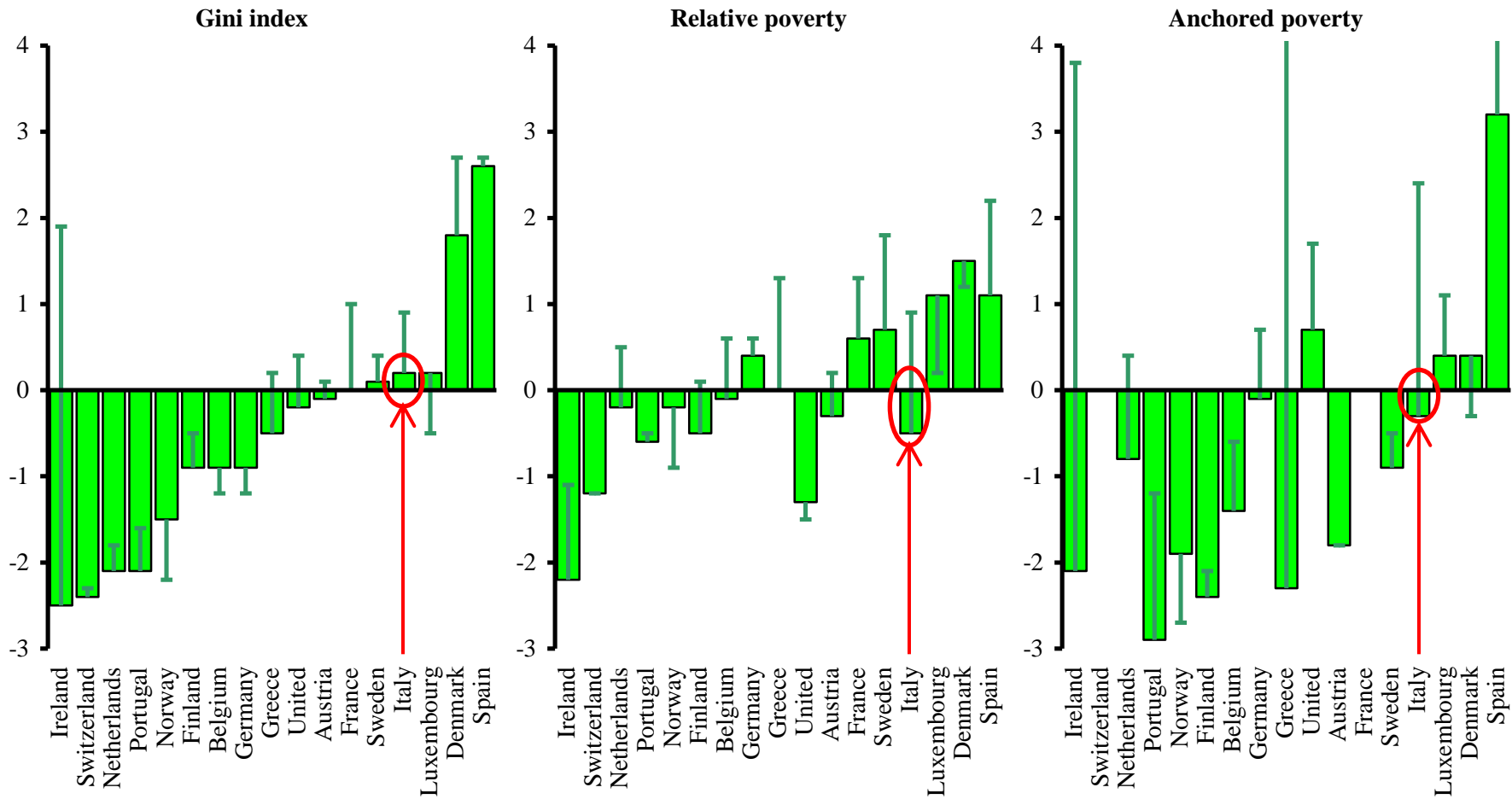
Share of individuals with equivalent income below 60% of median national equivalent income.

Great recession and income distribution (% point changes 2007-09)



Source: elaborations on EU-SILC data. Countries are ranked by absolute change in Gini index.

Great recession and income distribution (% point changes 2007-09)



Source: elaborations on EU-SILC data. Countries are ranked by absolute change in Gini index.

Conclusions

The headline with 3 caveats

- Short-term (2008-09) impact of GR modest (and elderly did relatively well) – largely thanks to public redistribution
1. Analysis of period during and immediately after the GR; distributional impacts will differ between short-, medium-, and longer-term
 - the medium-term consequences depend on the policy mixes adopted, and on future economic growth rates
 2. Our household income measure misses ‘non-cash’ income received from government services and reductions in purchasing power arising from increases in indirect taxation
 - But cuts in spending on services, and changes in indirect taxes, are features of many countries’ fiscal consolidation packages
 3. No analysis of middle- or low-income countries

Five policy lessons

1. Cross-country heterogeneity
2. Stabilisation of the household income distribution in the face of macroeconomic turbulence is an achievable policy goal, at least in the short-term (cf. 1930s)
3. Stronger welfare states provide greater ‘automatic stabilisation’: countries with greater stability in the income distribution after the GR are ones that already had relatively strong welfare states
 - Among our 6 case study countries, the softest landings were experienced by DE, SE and the hardest by IT and the USA

Five policy lessons (continued)

4. Timely monitoring of distributional outcomes essential
 - Important to maintain and extend cross-national databases such as those at OECD and Eurostat
 - National accounts data about the household sector, available more quickly than household survey data, deserve more use
 - Make more systematic use of microsimulation modelling
5. Substantial cut-backs in welfare states as part of fiscal consolidation packages are likely to produce greater instability in household distributional outcomes
 - Whether this matters depends on whether distributional issues are a political priority, and have public support
 - From era with broad consensus to era of sharp distributional conflicts (cf. Greece, UK): rich vs. poor; old vs. young

Thank you for your attention!