The distributional impact of austerity and the recession in Southern Europe

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aim of paper

- estimate changes in income distribution associated with the austerity and the recession
- in Greece, Spain, Italy, Portugal
- over the period from 2009 to 2013
the distributional effects of a recession cannot be taken for granted

may vary substantially, depending on interactions between:

- the income position of those affected
- the employment status and earnings of other members of the households in which those affected live
- the capacity of the tax-benefit system to absorb macroeconomic shocks
what we know (2/2)
austerity policies interact with wider economy

- ‘Keynesian effects’ of fiscal consolidation (via aggregate demand)
  
- IMF: fiscal multipliers in countries worst hit by the crisis in the range of 0.9 - 1.7, rather than 0.5 as assumed initially

- lessons from previous research:
  
  - the nature of this interaction depends on the size and content of fiscal consolidation, and on the characteristics of the economy in question
  
  - the direction and magnitude of the relevant effects remains a matter of debate
methodology (1/5)

general approach

- as economic activity slows down, policy makers may react
  - either by taking (counter-cyclical) measures to reduce taxes or increase public spending
  - or by attempting (pro-cyclical) fiscal consolidation

- in the latter case, the income distribution will change
  - as a result of the direct impact of fiscal consolidation policies
  - as a result of decreases in market incomes due to developments in the wider economy
    - both unrelated to policies and *indirectly* related to policies
methodology (2/5)
what we estimate

- the full distributional impact of the crisis between two consecutive years $t$ and $t-1$:

$$ C = f(Y_t, P_t) - f(Y_{t-1}, P_{t-1}) $$

- the effects of changes in tax-benefit policies between years $t$ and $t-1$ as assessed on the income distribution in year $t-1$:

$$ A = f(Y_{t-1}, P_t) - f(Y_{t-1}, P_{t-1}) $$
methodology (3/5)
some warnings...

- the effect of changes in government policies (A) is assessed on the income distribution which is prevalent at the time policies are announced/legislated
  - the only distribution known to policy makers when they take decisions

- the difference between the two scenarios (C - A) should not be interpreted as equal to the independent effect of changes in market incomes over and above the effect of government policies

- it also incorporates the indirect effects of policy changes
...and some caveats

- Changes in non-monetary incomes (such as those resulting from cuts in the funding of public services) are not taken into account.
- Changes in indirect taxes are not taken into account.
- Some developments in the wider economy (modelled here as part of C) are in fact directly attributable to government policy (e.g. changes in minimum wage legislation).
we use the European tax-benefit microsimulation model EUROMOD

we draw on EU-SILC 2010

we account for changes in employment status by using EU-LFS data to adjust EUROMOD input data (see Navicke et al. 2013, Leventi et al. 2013)

incomes are updated and policies are simulated up to 2013

tax evasion and benefit non take-up are (partly) taken into account
changes in poverty rates

Table 1. Changes in anchored poverty rates by sex and age (2009-2013)

<table>
<thead>
<tr>
<th></th>
<th>EL</th>
<th>ES</th>
<th>IT</th>
<th>PT</th>
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<tbody>
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<td>-1.1</td>
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</table>

Notes: Changes in anchored poverty rates (2013 vs. 2009) in percentage points. Poverty threshold at 60% of 2009 median equivalised disposable income (in real terms). All estimated changes are statistically significant at 99% confidence level. Source: EUROMOD version G1.0.
results (2/5)
changes in real disposable income (2009-2013)
re-ranking effects

Greece

Spain

Italy

Portugal

Light bars: deciles fixed in 2009
Dark bars: deciles recalculated

Source: EUROMOD version G1.0.
results (3/5)
effect of policies vs. full effect: changes in anchored poverty rates (in ppts)

Greece

Spain

Italy

Portugal

Light bars: policies alone

Dark bars: full effect

Source: EUROMOD version G1.0.
results (4/5)
effect of policies vs. full effect: changes in Gini (%)
results (5/5)

inequality effects of policy changes by policy area

<table>
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<tr>
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<th>2012</th>
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<td>-0.18</td>
<td>1.97</td>
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Note: Percentage change between the values of the Gini index if the policy in question had remained as in year t-1 relative to its actual value after the implementation of each policy in year t.
Source: EUROMOD version G1.0.
as a result of the current crisis, poverty and inequality in **Greece** have risen to alarming levels

in **Portugal** and **Spain**, where median incomes also declined considerably, anchored poverty went up by much less than in Greece (and by even less in **Italy**)

**older persons** on low incomes, though not fully protected, suffered lower income losses than other groups

  - however: funding cuts and other changes in health care (not considered here) may have raised the costs of healthcare services
conclusions (2/4)

re-ranking

- the crisis has changed the composition of the population in poverty: those at the bottom of the income distribution are younger than before the crisis, and more likely to be unemployed (or on low pay) than pensioners.

- as a result, income changes are less pronounced when deciles are fixed as in the base year (in this case, 2009) than when they are recalculated each year.

- those in the bottom of the income distribution today are considerably poorer than those occupying the same position before the outbreak of the current crisis.
we have attempted to clarify the various interactions between austerity, recession and inequality (or between tax-benefit policies, growth and income distribution)

tax-benefit policies act both directly and indirectly (through their effects on jobs and earnings)

as a result, the full effects of tax-benefit policies cannot be reduced to the first-order effects estimated here

isolating the first-order effects of policies is of interest

... and may help identify policies that reduce budget deficits while minimising adverse distributional effects
conclusions (4/4)
fiscal consolidation ‘progressive’?

- ‘micro-simulation studies indicate that these fiscal adjustments relied on progressive measures’ (IMF 2014 p. 51)

- while the first-order impact of policies on inequality can be described as neutral to positive (i.e. inequality-reducing), this does not imply that fiscal adjustment has been a success in overall distributional terms

- our estimates suggest that in all countries examined here poverty increased, and the policies implemented accounted for a major part of that increase
Thank you very much for your attention!