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Distributive effects of the crisis and austerity in seven EU countries: some key lessons

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The global economy has been in trouble since 2007. Some authors have referred to this on-going crisis as the "Great Recession", not only because so many parts of the world are affected, but also because of the unprecedented duration and depth of the downturn. In this policy brief, we draw some key conclusions regarding how the impacts of the crisis have interacted with country-specific tax and benefit policies, and how this has in turn occasioned changes in inequality and poverty. These are some of the central research questions addressed in the EU-funded ImPRovE project.

Using the microsimulation model EUROMOD and adjusting 2010 EU-SILC data for changes in the labour market, we have estimated how the burden of the crisis is shared across income groups. We distinguish between the first-order effects of government policies on the income distribution, and the full effect of the crisis (including developments in the wider economy, such as the rise in unemployment). The countries under examination include four Southern European EU Member States that were severely hit by the crisis (i.e. Greece, Spain, Italy and Portugal), Romania, a Balkan country that also felt the full impact of the downturn and that has since implemented a sweeping austerity package, and Latvia and Lithuania, two Baltic states that seem to be recovering sooner than other EU countries.

The most important findings and policy conclusions may be summarised as follows:

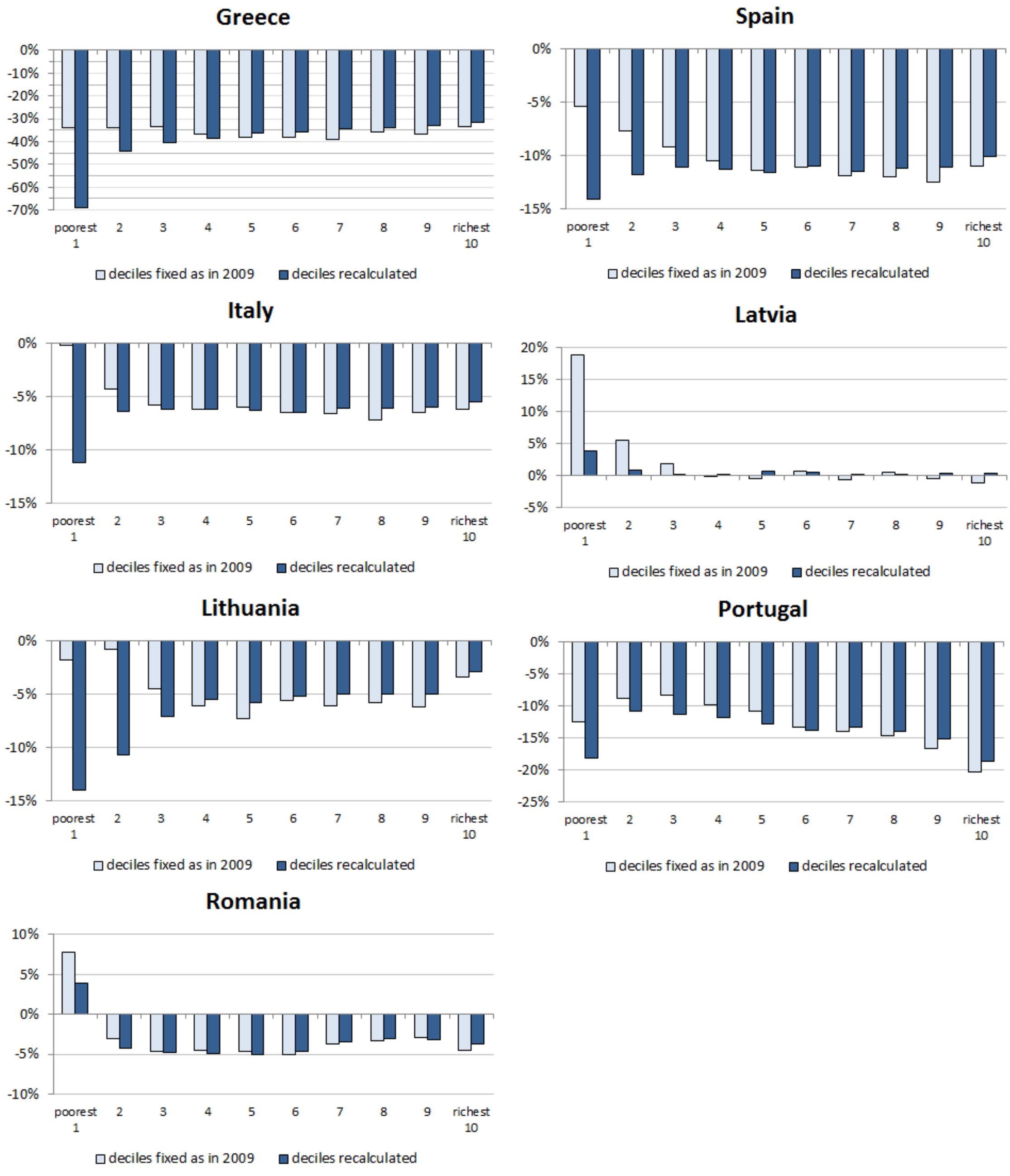
- Poverty and inequality in Greece have risen to alarming levels. In other countries where median incomes have declined considerably, including Portugal and Spain, anchored poverty (by reference to a poverty line fixed to its 2009 level in real terms) has increased, though far less so than in Greece.
- The position of the elderly has improved in relative terms in Greece, Spain and Portugal (and, to a lesser extent, in Italy and Romania too). This is due to the fact that older persons on low incomes, while not fully protected, have suffered smaller income losses than other population groups. Note, however, that health care costs (which are not taken into account here) may have risen.
- The Great Recession seems to have affected the composition of the population in poverty. The group at the bottom of the income distribution is younger than

it was before the crisis, and it faces a greater likelihood of low-paid work and unemployment. Furthermore, today's poor are found to be considerably poorer than the poor were prior to the outbreak of the current crisis.

- The distributional effects of policies have varied over recent years. In Greece, half of the total increase in anchored poverty in 2010-2011 was attributable to the first-order effect of austerity policies alone; in 2012-2013 those policies accounted for a much more modest share in the total poverty increase. In Spain, policies alone had an important poverty-reducing effect in 2010, while in 2011 they accounted largely for the overall increase in anchored poverty. In Italy (all years except 2010) and Portugal (all years except 2012), the rise in anchored poverty was more a first-order policy effect than a combined effect of policies *and* changes in the wider economy, with the impact of the latter often being negative (i.e. poverty-reducing). This was even more the case in the two Baltic republics (especially from 2011 onwards) and Romania (throughout the period).
- In Greece and Spain, the wider recession has made the income distribution consistently more unequal, while the first-order effect of prevailing policies was partly to compress it back. A similar picture emerges for Italy, Portugal and Romania, where changes in inequality have been less substantial, with the inequality-reducing (first-order) effect of policies occasionally quite strong (as was the case in Portugal in 2012 and Romania in 2011).
- Cuts in public sector pay seem to have been progressive especially in Greece (particularly in 2010 and 2013), but also in Portugal (in 2011-2012) and the Baltic republics (in 2010). This effect stems largely from the fact that the adversely affected groups have tended to be situated towards the upper end of the income distribution.
- Pension cuts and related austerity policies (such as special levies on pensions) appear to have had a progressive distributional impact in Portugal and, to a lesser extent, in Greece (in 2010-2012). This effect is due largely to the actual design of the measures, which partly or fully protected those on low incomes. On the other hand, the uniform pension cuts that were implemented in Greece in 2013 seem to have had significantly regressive effects.
- Changes in taxes and social contributions have (*ceteris paribus*) also mostly rendered the income distribution less unequal. This was especially so in Portugal (in 2011 and, even more so, in 2013) and Romania (in 2011), but also in Greece (2010), Spain (2010 and 2012), Italy (2011) and Latvia (2010).
- Some changes in social benefits have had a progressive distributional effect in countries such as Latvia (improvements in unemployment benefit and minimum guaranteed income in 2010), Greece (introduction of a new child benefit scheme in 2013) and Romania (improvements in minimum guaranteed income in 2010). Elsewhere, changes are found to have had a regressive impact. This has been the case in Lithuania (changes in unemployment insurance benefit and child allowance in 2010), Portugal (changes in social assistance in 2011 and 2013), and Romania (reductions in unemployment benefit and changes to means-tested family allowances and heating benefit in 2011).

To conclude, the crisis and ensuing austerity policies have resulted in a serious decline in incomes in many of the countries hardest hit by the downturn. However, some governments have been able to moderate the impact of the crisis on income inequality by redesigning the tax-benefit system and balancing public sector pay cuts. This suggests that the actors involved in pressing for and designing austerity measures have retained some room to mitigate policy impacts on those at the lower end of the income distribution. At the same time, it should be noted that the analysis presented in this policy brief has focused on redistributive effects on household incomes only, while neglecting redistributive effects associated with changes in indirect taxes and cuts in public services. To the extent that these changes disproportionately affect those on low incomes, the drop in living standards at the bottom end of the income distribution is therefore likely to have been underestimated, while the redistributive effects may have been more regressive than observed in this research. Finally, we note that the crisis and ensuing austerity have adversely affected poverty among young people and families with children, who may therefore require better protection in subsequent rounds of reform.

Figure 1: Changes in disposable income by decile (2009-2013)



Notes: Household disposable income is measured in real terms (i.e. adjusted for inflation), averaged for each decile. It is equivalised according to the OECD modified equivalence scale.

The dark bars represent the percentage change in average disposable income between 2009 and 2013 assuming that the composition of deciles is subject to change (i.e. by calculating average income per decile for 2009 and 2013, allowing for re-ranking, and then estimating the difference), while the light bars represent average percentage change in disposable income assuming that deciles are fixed on the basis of the 2009 income distribution (i.e. not allowing for re-ranking). The charts are drawn to different scales, although the interval between gridlines is identical.

Source: EUROMOD version G1.0; own calculations.

Key Resources

Matsaganis, M., and Leventi, C. (2014), *Distributive effects of the crisis and austerity in seven EU countries*, ImPRovE Discussion Paper 14/04, Antwerp: Herman Deleeck Centre for Social Policy, University of Antwerp.

The ImPRovE partners

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