The distributional effects of fiscal consolidation in 9 EU countries

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DG-EMPL conference
Microsimulation for Policymaking in Times of Crisis
21st November 2012, Brussels

Motivation

- The economic crisis and the fiscal consolidation measures have an impact on income distribution:
  - inequality, and any driver of growth in it, matters in its own right
  - prospects for macroeconomic recovery depend on composition of fiscal adjustment
  - political acceptability

Motivation

- Fiscal consolidation literature is mainly macro-oriented and often overlooking the distributional effects
  - *"The crucial question, however, remains the impact of fiscal consolidations on the distribution of disposable income. On this, there is very little information, because very rarely does the timing of income-distribution surveys allow an analysis of its evolution before and after a fiscal consolidation, and because there are well-known difficulties in assessing the impact of the various budget items on income distribution"* (Perotti, AER, 1996)

Introduction

- Based on a microsimulation approach, we provide ex ante estimates of the distributional impact of fiscal consolidation measures implemented in the EU countries since the start of the Great Recession and up to mid-2012

- Focus on **measures** of fiscal consolidation with a direct impact on **income distribution**
  - ☐ Public wages, public pensions, cash benefits, direct taxes/SIC
  - ☐ VAT

- A follow up to last year first comparative study (Callan et al. 2011)

Methodological issues

- Emphasis on consistent cross-country analysis
- Counterfactual: How would tax-benefit systems have evolved by now (2012) without fiscal consolidation?
  - Pre-FC policies indexed using national rules/conventions
  - Compare with actual 2012 systems
- Period: all fiscal consolidation up to mid-2012
- Measures of fiscal consolidation
  - Fiscal measures aimed to cut the public deficit or limit its growth
  - Exclude measures part of other policy agenda, rolling back of stimulus measures and expired measures
- [Adjustment for labour market changes]
  - Simulating transitions into and out of unemployment using info from LFS
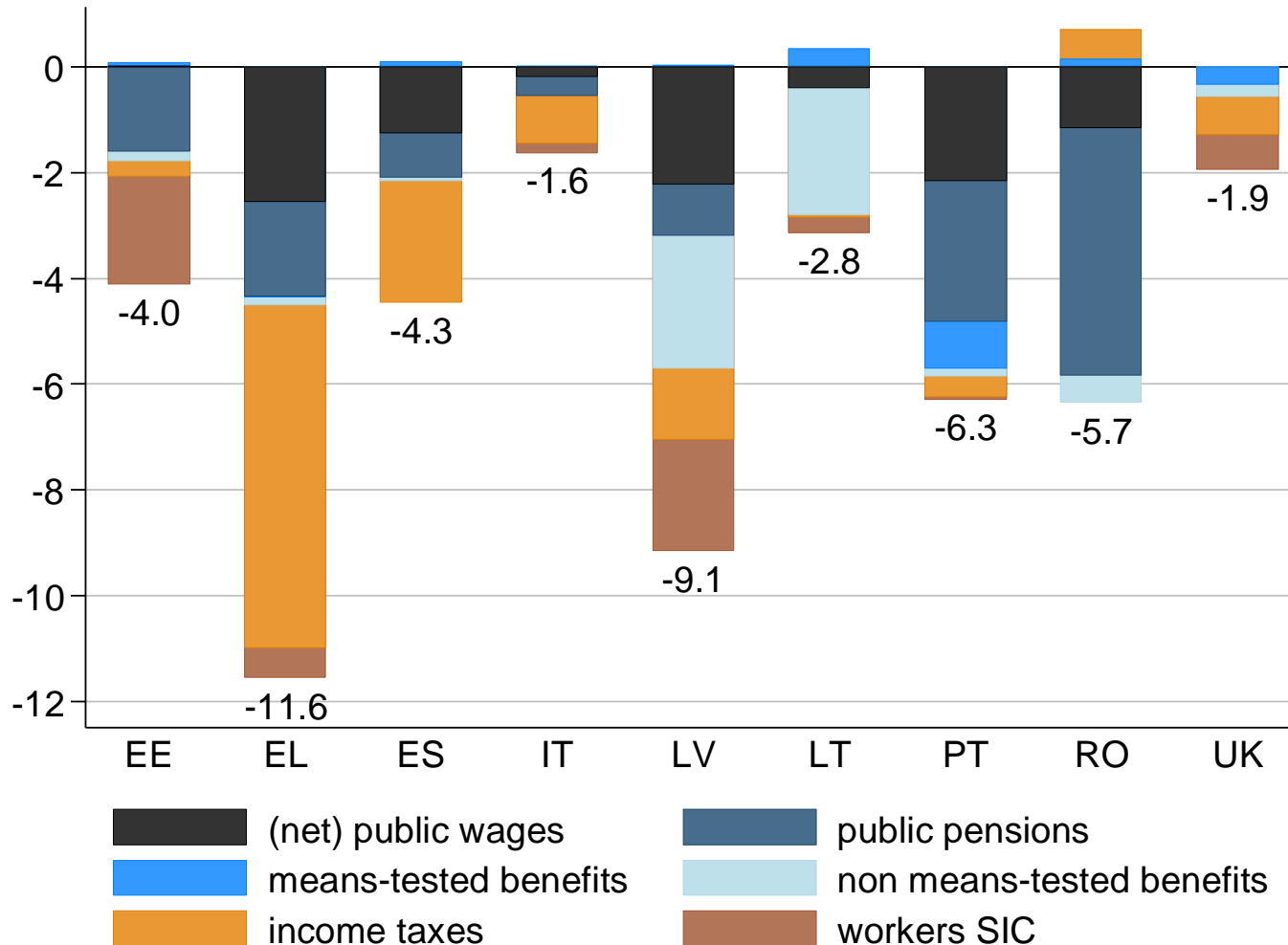
Model, data and countries

- EUROMOD + 2008 EU-SILC data
  - ☐ Market incomes adjusted to 2012 levels
- 9 countries: Estonia (EE), Greece (EL), Spain (ES), Italy (IT), Latvia (LV), Lithuania (LT), Portugal (PT), Romania (RO) and the UK
- Measures introduced since 2009-10 (except IT: 2011)
  - ☐ All (but UK): cuts in public wages (or freezing)
  - ☐ All: cuts in public pensions/benefits (or freezing)
  - ☐ Majority: increased income taxes and worker SIC
  - ☐ Some: increased employer SIC and property taxes
  - ☐ All: increased standard rate of VAT
- Interactions between policy instruments
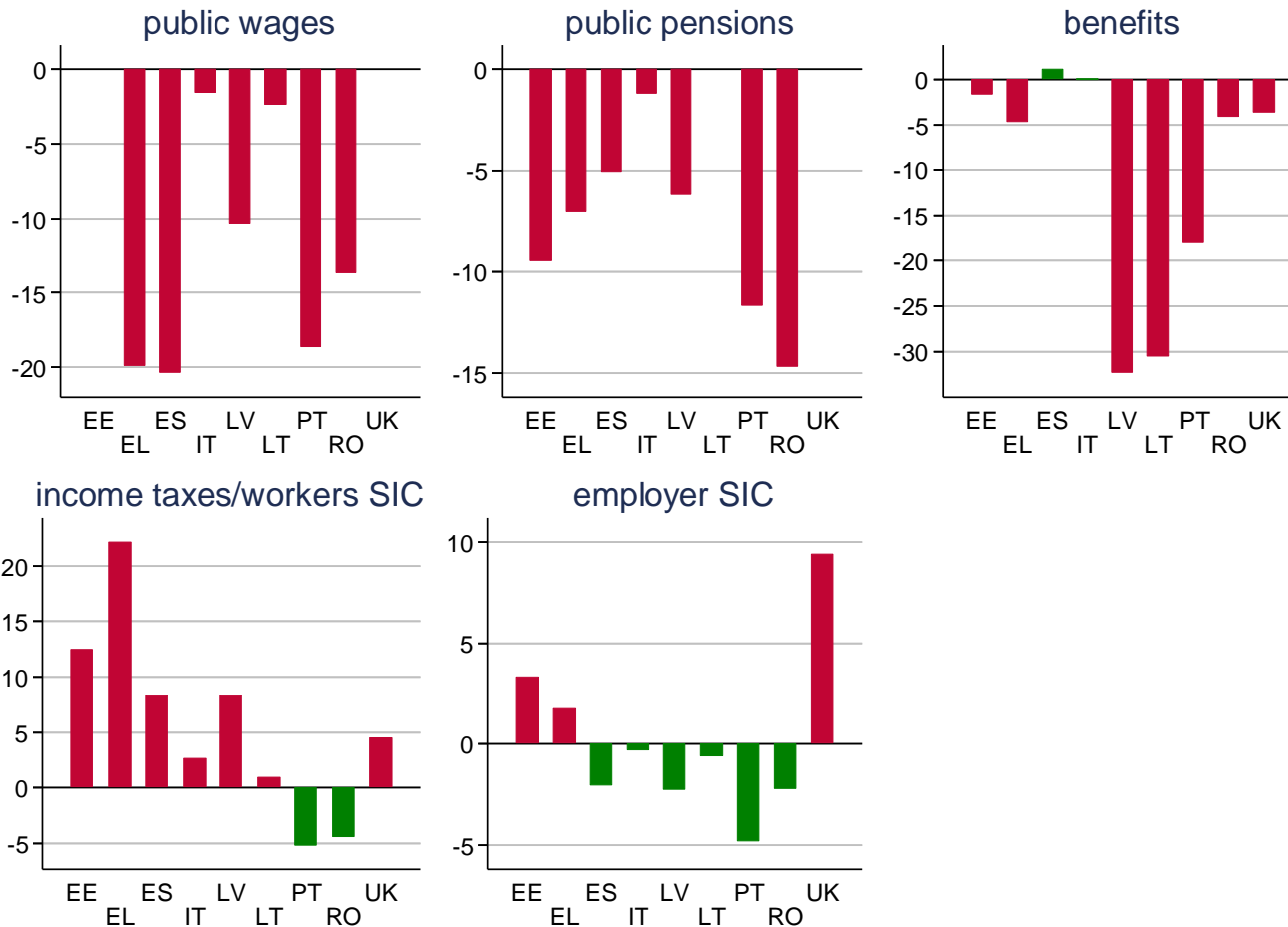 - ☐ Taxes on public wages and (some) benefits; means-testing

Types of fiscal consolidation measure: summary

Country/ Start of FC measures	EE 09	EL 10	ES 10	IT 11	LV 09	LT 09	PT 09	RO 10	UK 09
Cuts in **benefits or public pensions** (or freezing)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Increased **income taxes** and/or reduced tax concessions	Yes	Yes	Yes	Yes	Yes	No	Yes	No	Yes
Increased worker **social insurance contributions** (SICs)	Yes	Yes	No	Yes	Yes	No	Yes	No	Yes
Public sector **pay cuts** (or freezing)	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	(Yes)
Increased **employer SICs**	Yes	Yes	No	Yes	No	No	No	No	Yes
Increased **property taxes**	No	Yes	(Yes)	Yes	(Yes)	(Yes)	No	(Yes)	No
Increased standard rate of **VAT**	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Aggregate change in household disposable income by income component %

Legend:
- (net) public wages
- public pensions
- means-tested benefits
- non means-tested benefits
- income taxes
- workers SIC

Values by country: EE -4.0, EL -11.6, ES -4.3, IT -1.6, LV -9.1, LT -2.8, PT -6.3, RO -5.7, UK -1.9

Extent of changes by income component %

Interval for grid lines: 5pp

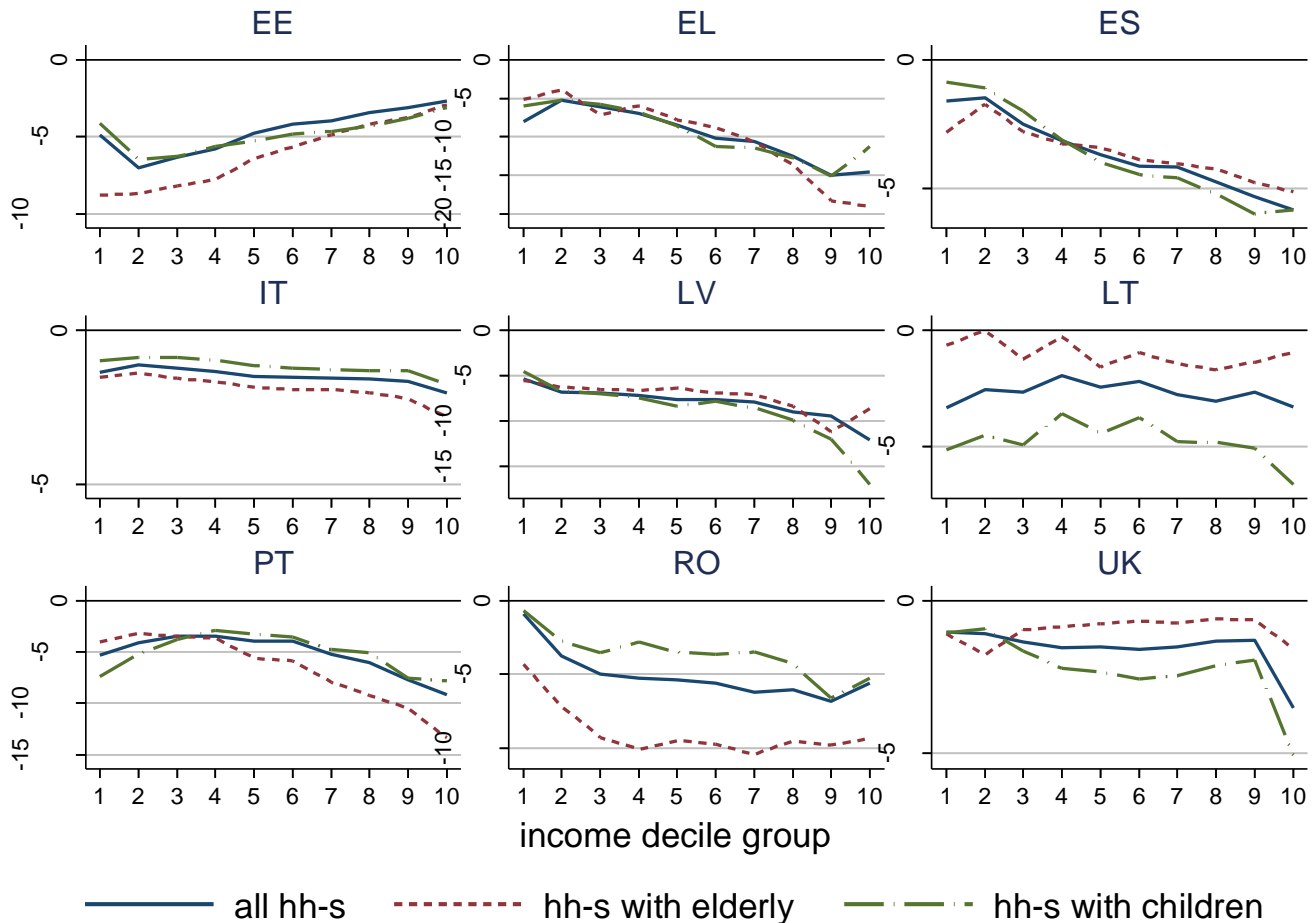Note: results for taxes and benefits also include effects due to the changes in public wages.

Change in household disposable income by income decile group %

Interval for grid lines: 2pp
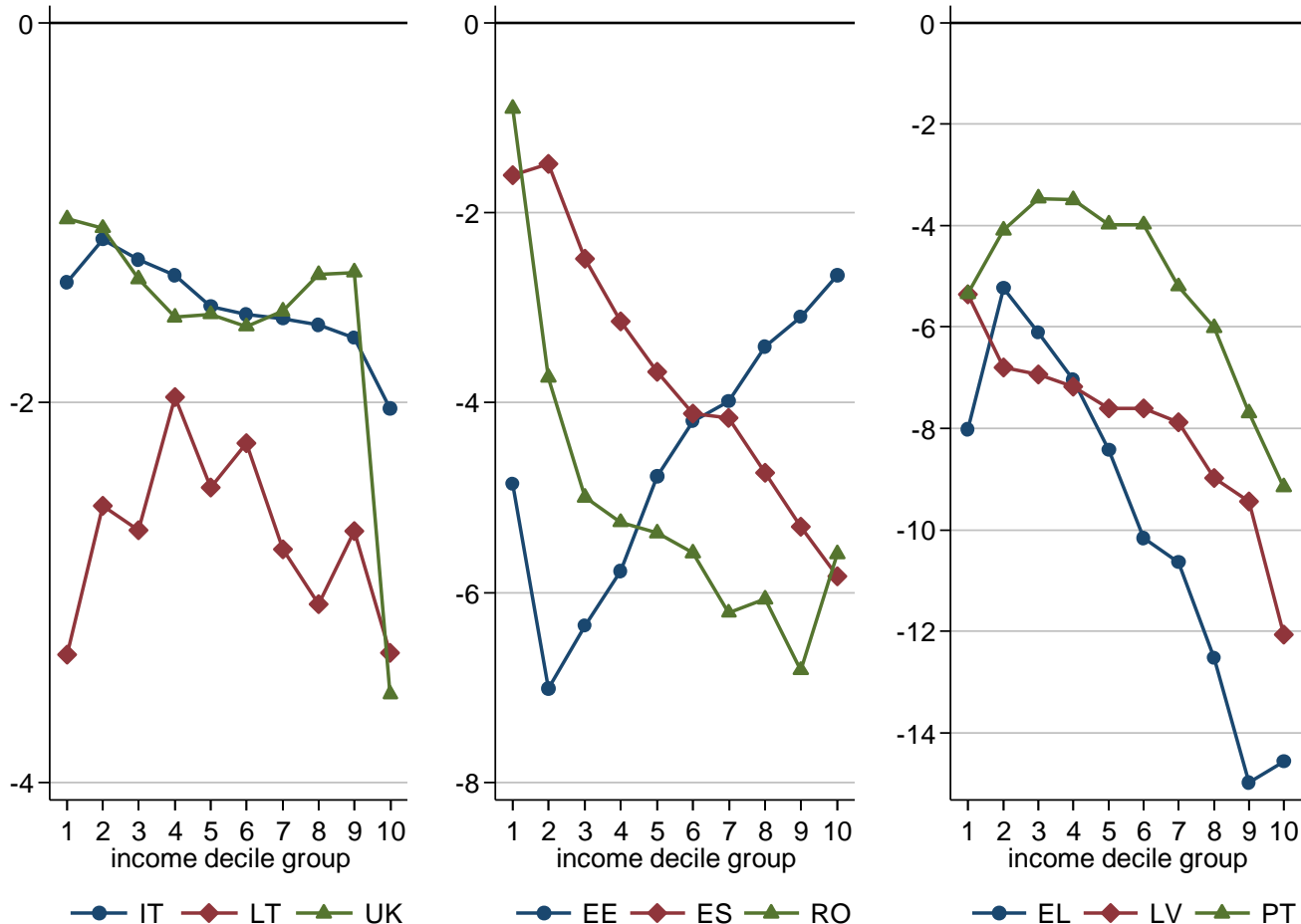
Change in hh disposable income by household type (and by decile group) %

Interval for grid lines: 5pp

What differences do VAT increases make?

Interval for grid lines: 5pp
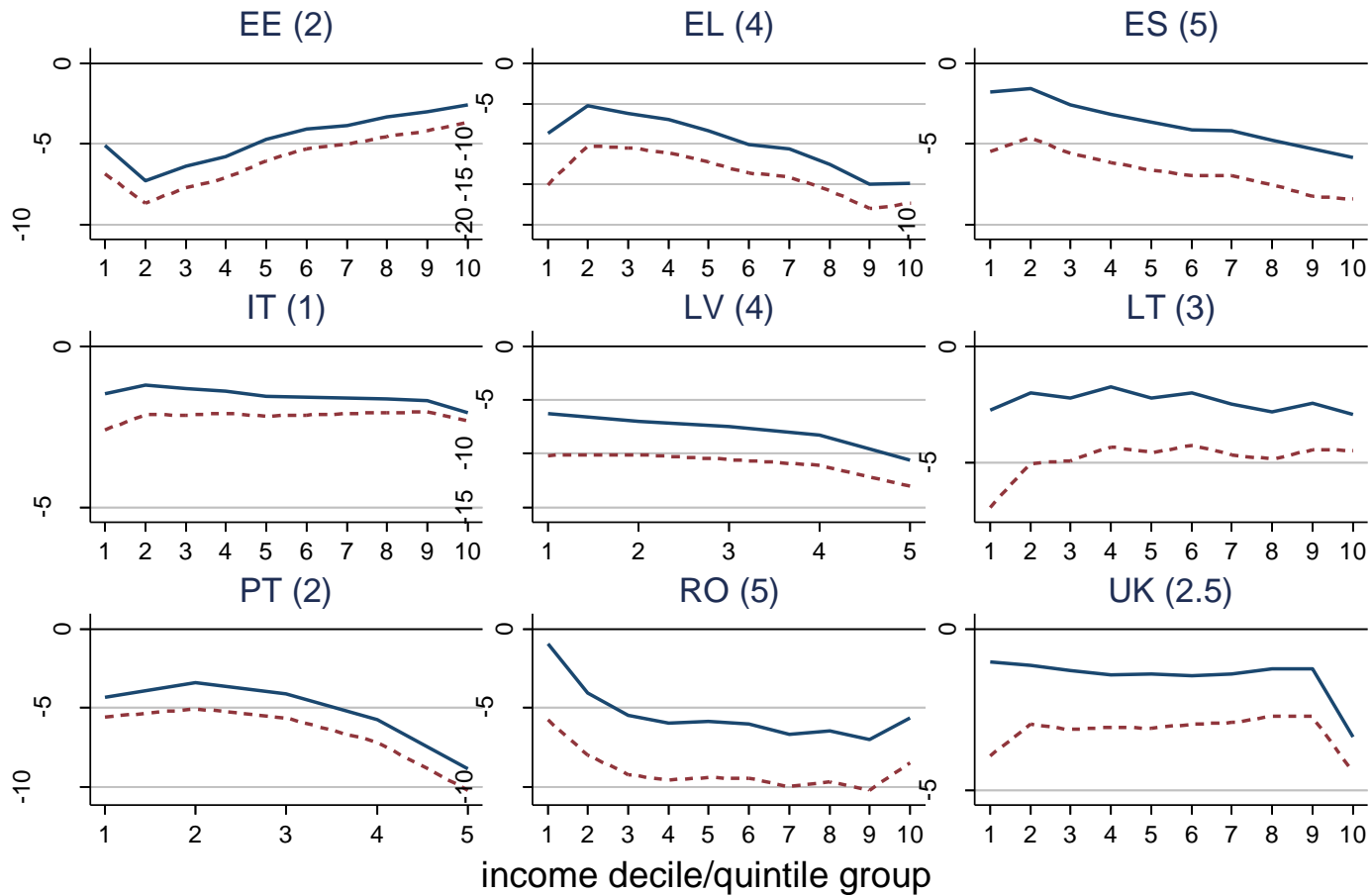
Distribution of Austerity measures taking into account Labour Market Adjustments

Interval for grid lines: 5pp
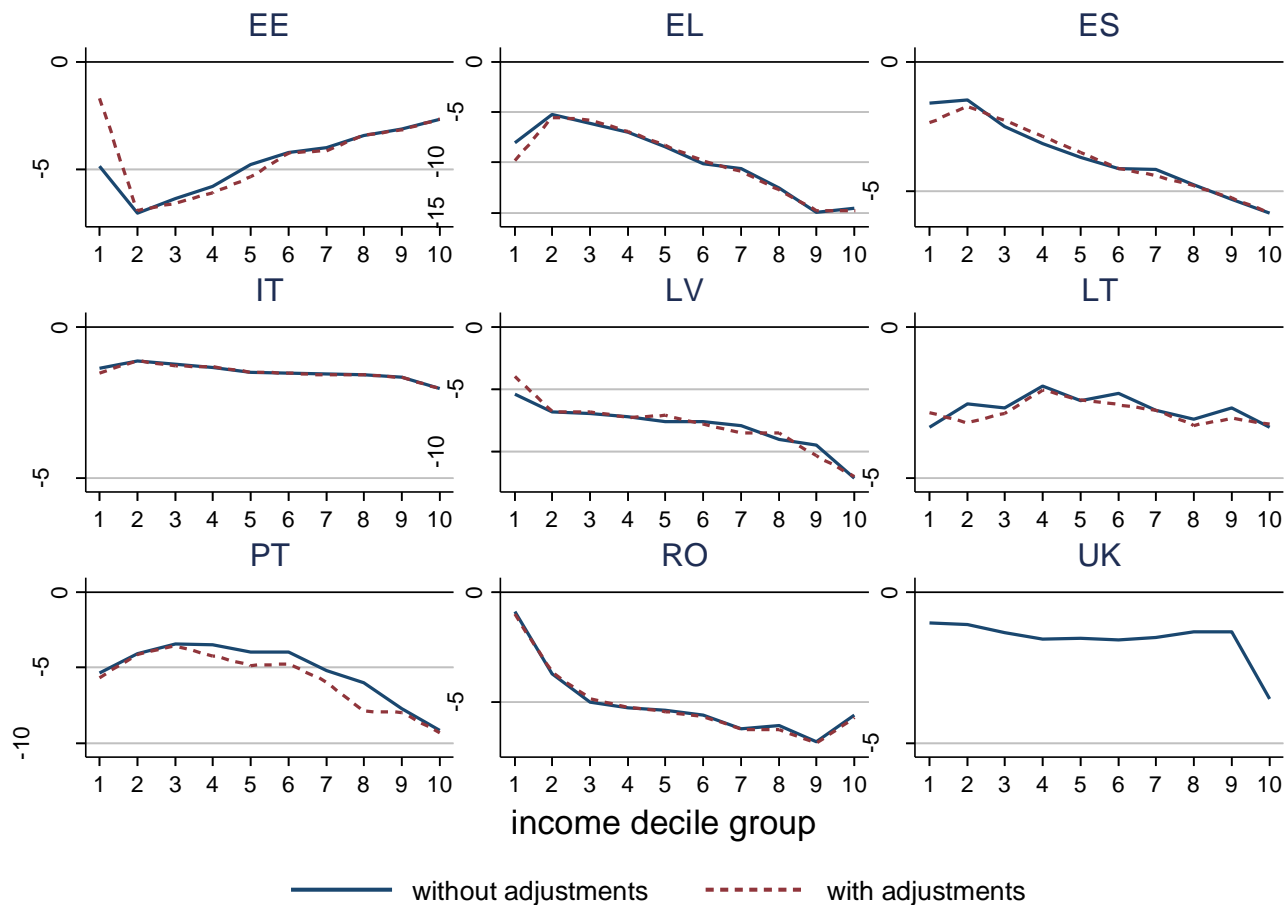
Fiscal consolidation in context: the effect of all tax-benefit changes 2008-2012

Interval for grid lines: 5pp

income decile group
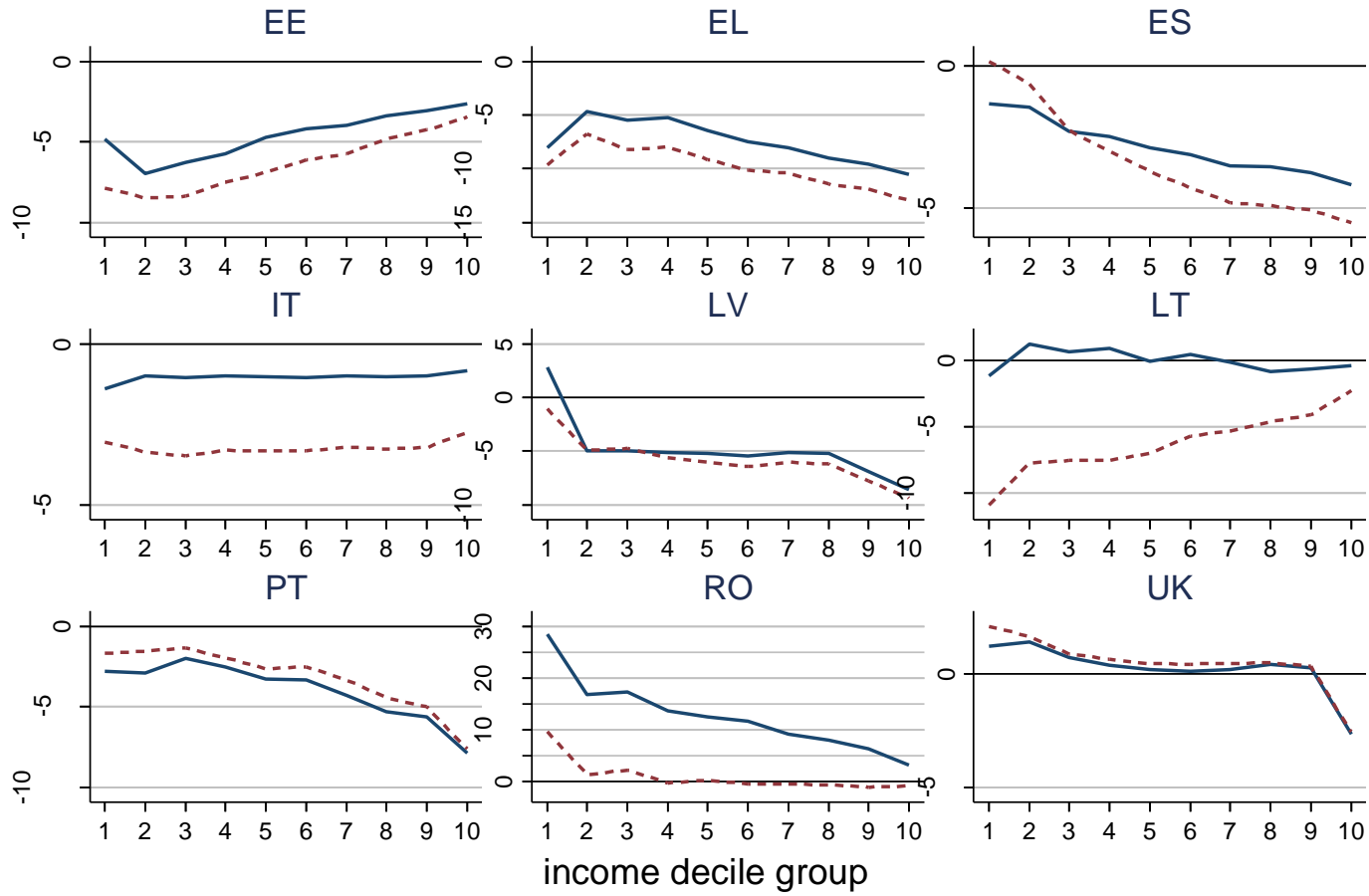
——— usual indexation   - - - - HICP indexed

Summary

- Distributional implications of gov-s choices about fiscal consolidation: effects on <u>income</u> up to mid 2012

Progressive	**Greece** – though large even for bottom decile **Spain** – low income pensioners lose more **Italy** – flat with VAT **Latvia** – top decile children lose more **Romania** – pensioners lose more **UK** – top decile and children lose more
Inverted U-shape	**Lithuania** – children lose more, regressive with VAT **Portugal** – low income children lose more
Regressive	**Estonia** – especially for pensioners

Thank you!

Acknowledgements and further information
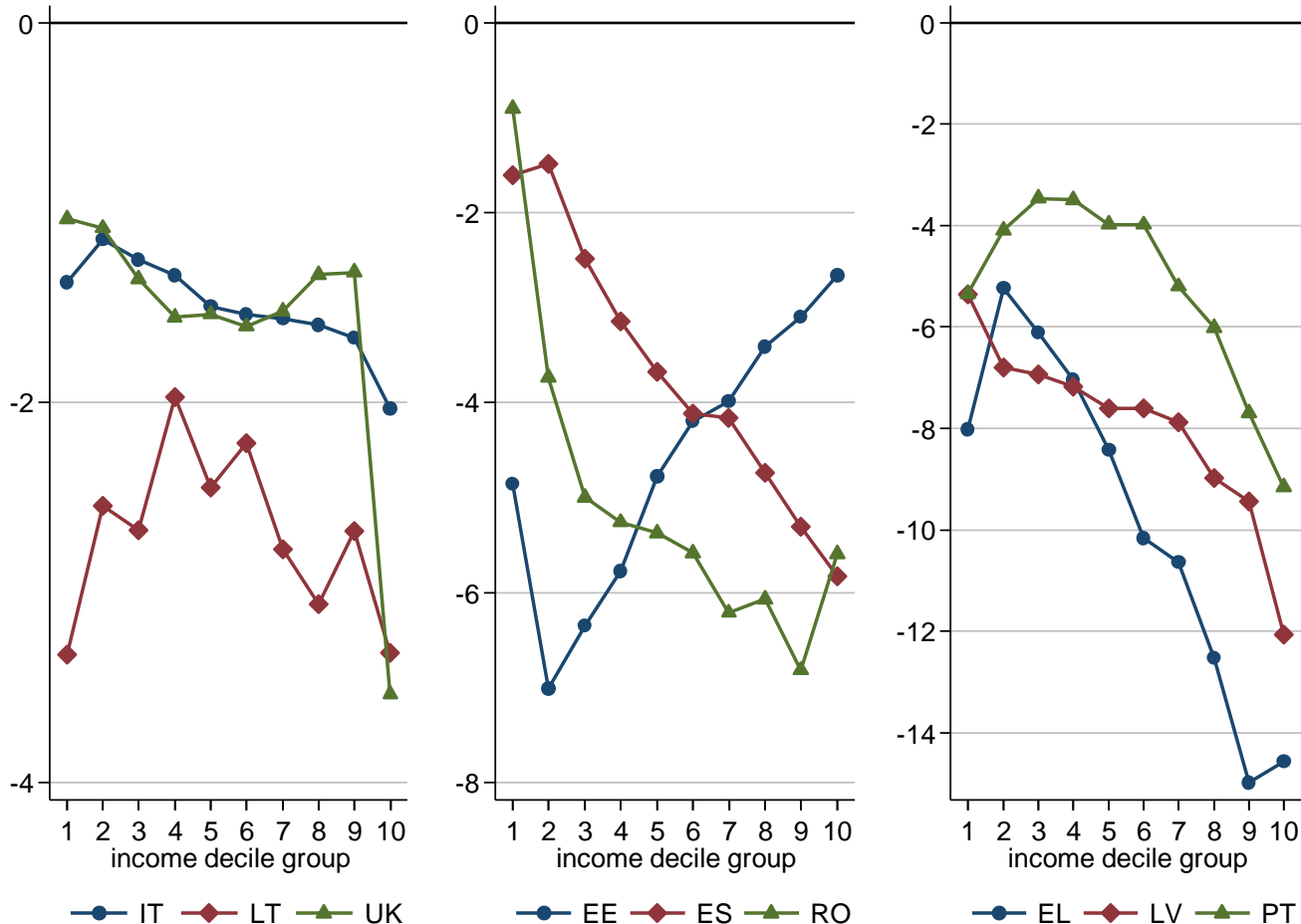
Extent of changes by income component % - LMA
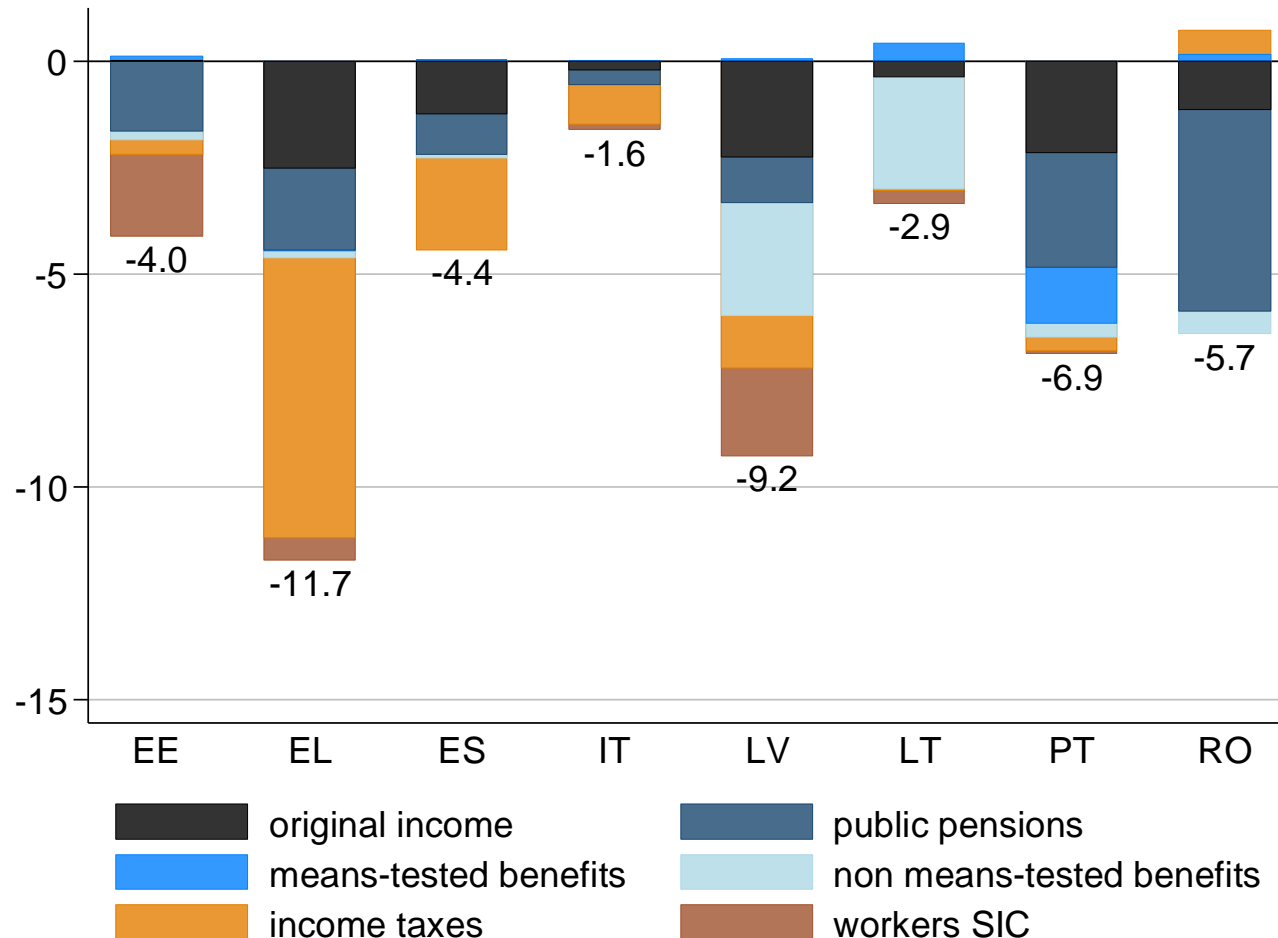
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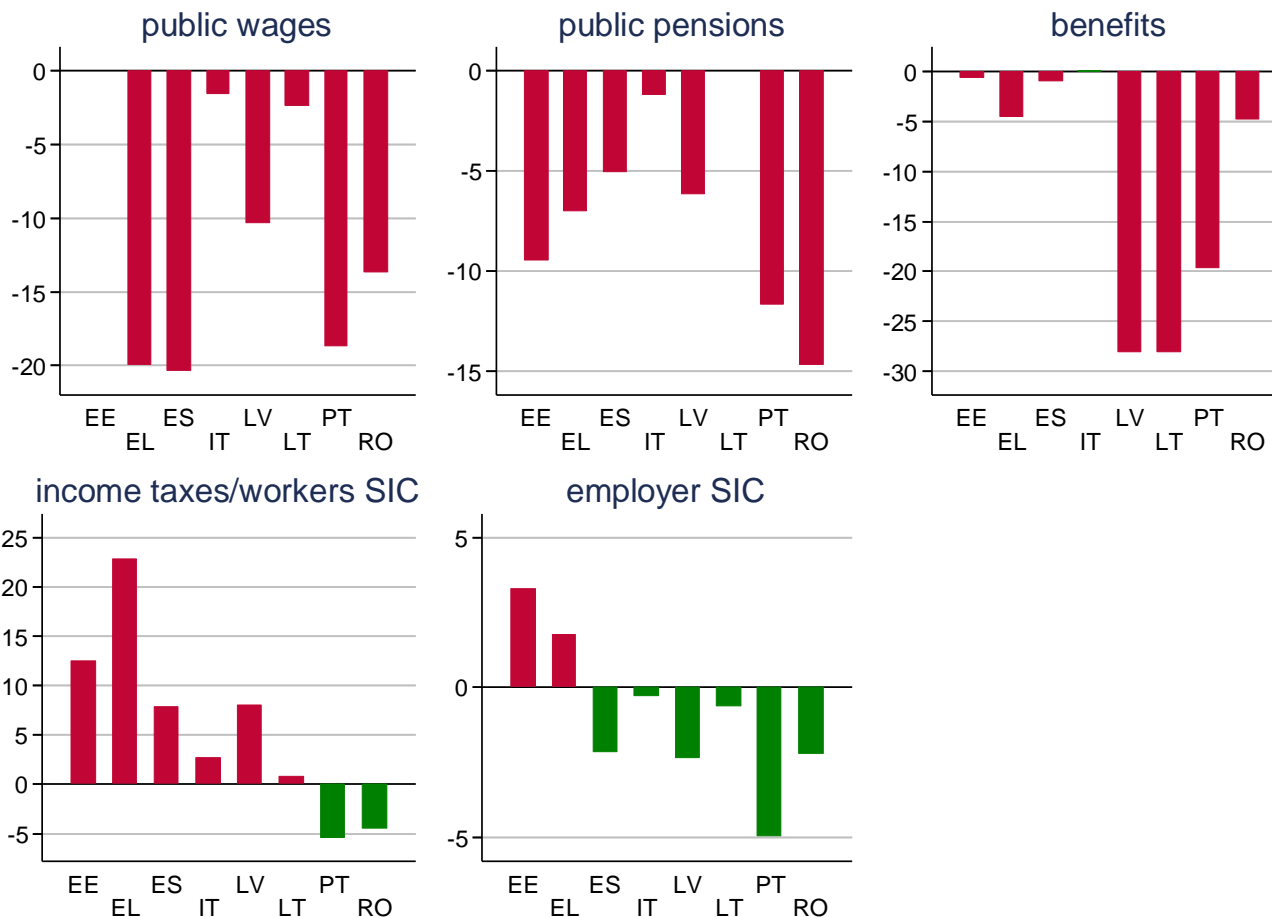
Note: results for taxes and benefits also include effects due to the changes in public wages.

Change in household disposable income by income decile group %
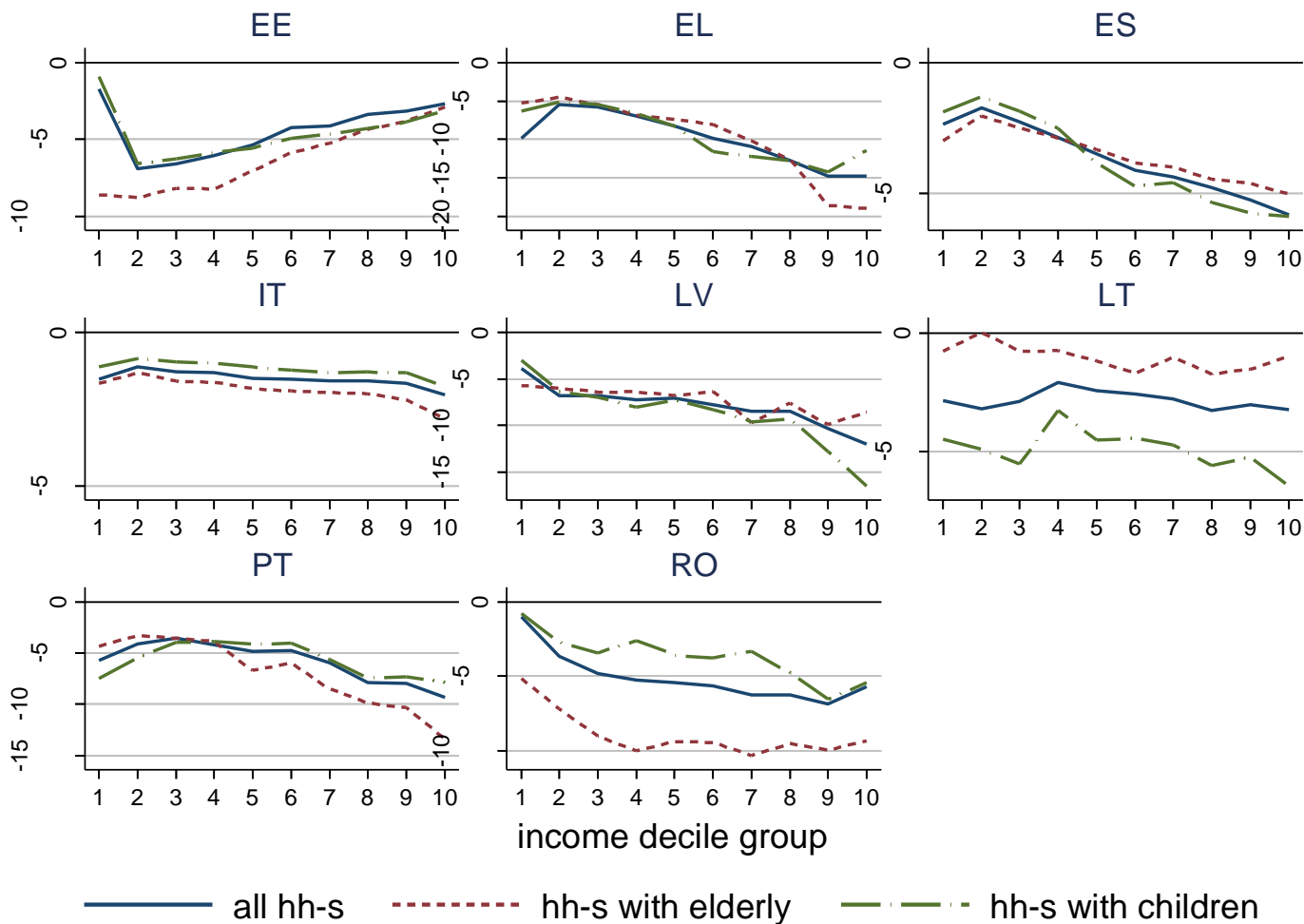
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Aggregate change in household disposable income by income component % - LMA

Change in hh disposable income by household type (and by decile group) % - LMA

Interval for grid lines: 5pp

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