Was the period since 2001 a "missed opportunity" for poverty reduction? The effects of policy change

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Credits

- Hills J., A. Paulus, H. Sutherland and I. Tasseva "A lost decade? Decomposing the effect of 2001-11 tax-benefit policy changes on the income distribution in EU countries", *ImPRovE Working Paper*, forthcoming.
- De Agostini P., A. Paulus, H. Sutherland and I. Tasseva, "The effect of tax-benefit changes on income distribution in EU countries since the beginning of the economic crisis" *Social Situation Monitor* RN2/2013 forthcoming.

Outline/introduction

- A decade plus since Lisbon
- Effects of (direct) tax-benefit policy changes on household disposable income
- Comparing policies in 2001, 2007, 2011
- On a constant population (2007)
- Using EUROMOD
- 7 countries: Belgium, Bulgaria, Estonia, Greece, Hungary, Italy, UK
  - Average/fiscal effects
  - Contribution to reducing poverty (direction and size)
- Similar evidence for 8 more countries in the post-crisis period

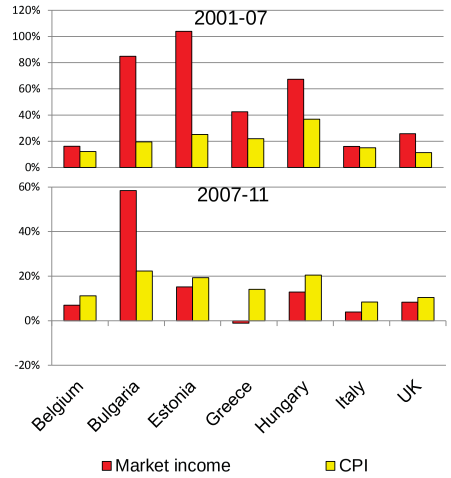
Questions

- Did the policy changes increase or reduce household incomes (reduce or increase government revenue)?
- Were they poverty-increasing or poverty-reducing?
- What was the relative contribution of ***structural reforms*** to policies and ***indexation effects***?
- Were there differences in these effects in the period of growth and the period including the onset of the crisis?
- Are there lessons we can learn for Europe 2020 (and beyond)?

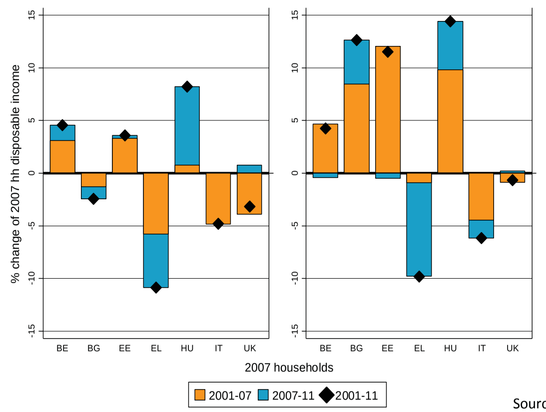
Policy changes

- Policies considered: elements of household disposable income
  - Income tax
  - Social Insurance contributions (employee and self-employed)
  - Other personal direct taxes
  - Cash benefits including public pensions
- Not active labour market policies, indirect taxes, employer contributions, in-kind benefits and public services…
- No behavioural reactions are modelled
- Market incomes (including private pensions) fixed as in 2007, along with personal/household characteristics
- Policy systems from 2001 and 2011 adjusted to 2007 levels
  - how this is done matters for the results

Aggregate change: market incomes and prices

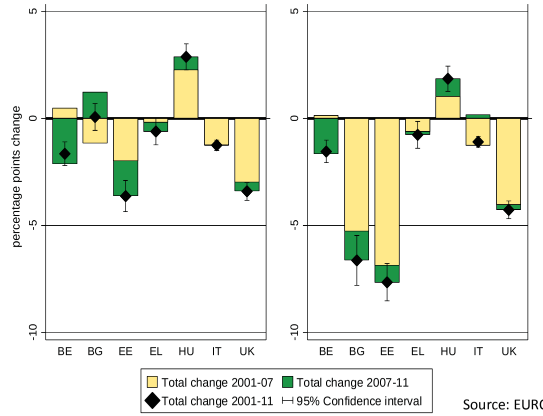


Aggregate change: % change in household disposable income due to policy changes



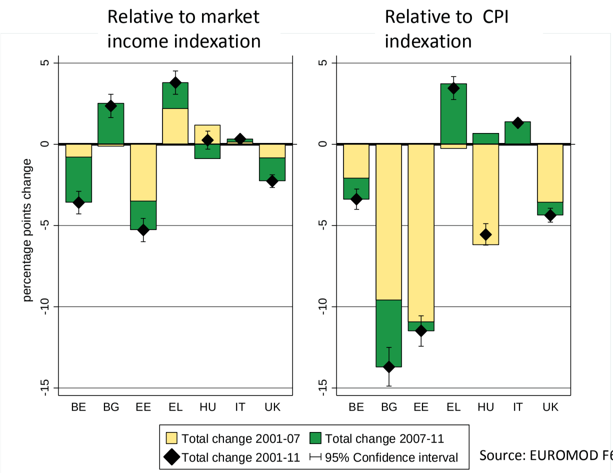
Source: EUROMOD F6.36

Effect of policy changes on the risk of poverty (threshold: 60% median, floating)



Source: EUROMOD F6.36

Effect of policy changes on the risk of poverty (threshold: 60% median, anchored)

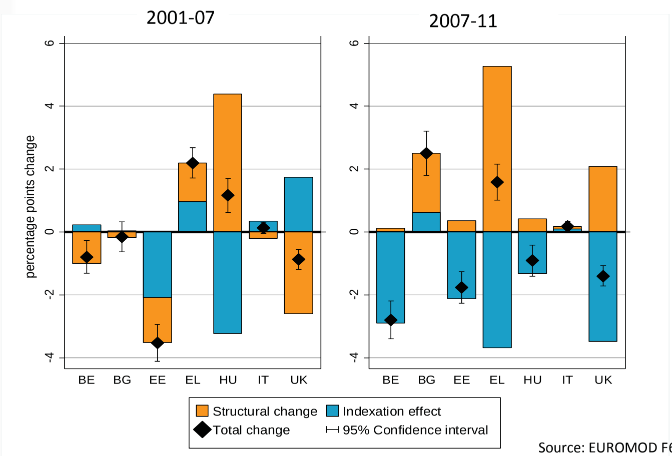


Source: EUROMOD F6.36

Structural changes and the indexation effect

- We consider two components of policy change separately
  - *Indexation effect* – that due to changes in level of benefit payments, tax thresholds etc which we might expect to keep pace with the evolution of economic variables; includes both "silent" regular indexation and more visible ad hoc increases.
  - *Structural changes* – reforms to the structure of the system e.g. to tax/withdrawal rates
- Of interest because
  - Only the indexation effect is directly affected by the counterfactual indexation assumption
  - Governments can establish expectations about future indexation practice
  - This matters for public debate and understanding of policy change
- The distinction is defined explicitly as part of the decomposition
  - any actual major reform package will typically include both elements

Effect on risk of poverty: structural change and indexation effect (market income indexed counterfactuals; threshold: 60% median, anchored)

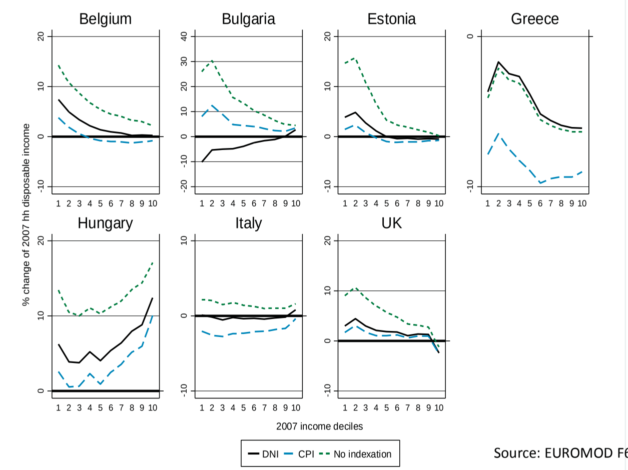


Source: EUROMOD F6.36

Summary

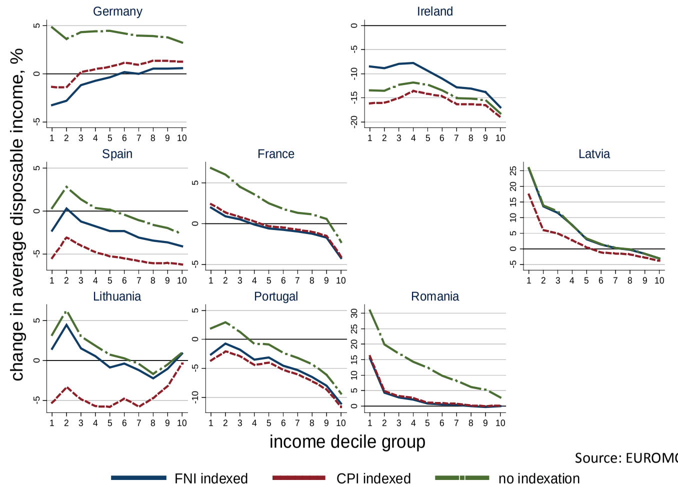
- For "anchored poverty" policy changes were poverty-reducing in Belgium, Estonia and the UK, and poverty-increasing in Greece and Italy.
- For "floating poverty" policy changes were poverty-increasing only in Hungary.
- In the crisis period the indexation effect contributed most to poverty reduction; monetary parameters were adjusted ahead of prices (and also relative to market incomes which were falling in real terms).
- Structural changes were typically poverty-increasing.
- Policies since the crisis achieved less in terms of poverty reduction compared to the pre-crisis period (except in Belgium).
- ➢ There are periods when governments reformed their systems resulting in spending less/raising revenue but in ways that avoided increasing poverty.
- ➢ There are also examples when policy changes that involved spending more also resulted in higher poverty.

Effect of policy change on disposable income across the income distribution 2007-11



Source: EUROMOD F6.36

Effect of policy change on disposable income across the income distribution 2008-13



Source: EUROMOD G1.4

Important caveats/reminders

- The results are conditional on the use of mid-period (2007) market incomes and population structure. The effects of policy changes on data from another period (e.g. the start or the end) would not necessarily look the same.
- We abstract from changes in market incomes and household characteristics, except for the way changes in prices/incomes affect the evolution of counterfactual policies.

Lessons for 2020 and beyond: Indexation

- Indexation by the growth in market incomes
  - Keeps public support in line with changes in private incomes
  - Does not contribute to increases in relative poverty
  - Implies that benefit levels are cut in times of economic hardship.
- Indexation by changes in the price level
  - Means that public support lags behind private incomes in times of growth
  - Will then contribute to increases in relative poverty
  - But protects living standards in periods when real market incomes are falling
  - (Hence has the potential to contribute to automatic stabilisation).
- Pensions indexation is particularly important because pensions are a high proportion of the incomes of the elderly and a large part of the system
- Policy on indexation should be transparent and open for public debate.

Lessons for 2020 and beyond

- 2001-11 was not an entirely "lost decade" for poverty reduction for the countries considered (except perhaps in Hungary).
- Even in adverse economic or fiscal situations it is possible to carry out fiscal consolidation without contributing to increases in relative poverty.
- (But if incomes are falling, how relevant is this?)
- If it is hard to increase the real incomes of the poor in times of crisis then more should be done in good times.
- In times of growth, keeping public support in pace with private incomes, through some combination of regular indexation and poverty-reducing structural change is necessary. Otherwise other types of poverty-reducing policy will have to work much harder.