Disposable income stabilisers

The COVID-19 pandemic triggered a historic fall in household consumption in 2020. In the euro area, the decline reached 15.4% in Q2 and stood at –8.1% for the year as a whole, with bigger reductions in the countries hardest hit by the first wave of the pandemic. Unlike previous crises, however, the declines in consumption were not accompanied by similar declines in households' disposable income.

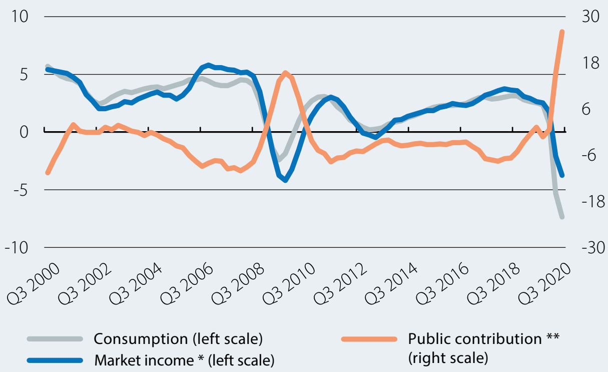
The evolution of disposable income in the euro area during the pandemic

In 2020, household gross disposable income (GDI) remained virtually unchanged in the euro area compared to the previous year.[1,2] This consistency can be explained by the performance of the labour market and the multitude of public programmes introduced to support jobs and household income.

Firstly, in the face of an unprecedented of collapse in GDP of 6.8% in 2020, the rise in the unemployment rate was very moderate (going from 7.6% to 8.0%). This was largely thanks to programmes which supported employment income – including some already in place but extended and others created in response to the pandemic – such as furlough schemes, which generally involve a subsidised temporary reduction in working hours (either «partially or in full»).[3] In the absence of these measures, it is estimated that the increase in the unemployment rate would have been between 1 and 1.5 pps higher in the EU on average.[4] In addition to the programmes aimed at directly supporting employee wages, others were introduced to support self-employed workers and businesses, which indirectly helped protect jobs and incomes. All in all, as the second chart shows, employment incomes in the euro area as a whole fell by just 2%, a relatively small figure compared to the collapse in economic activity. In fact, the third chart shows how the sensitivity of gross income to the fall in GDP has been much lower in this crisis than in the previous major recession.

Secondly, direct public aid (in the form of either grants or the deferral/reduction of taxes and social security contributions) offset the decline in wages at the aggregate level. Major fiscal measures directly aimed at supporting households were implemented. These included both public spending measures – with a large number of social benefits either created or extended to deal with months of turbulence – and taxation measures – mainly temporary measures aimed at giving households a temporary financial lifeline to help them meet unforeseen needs, such as the extension of sick leave benefits, child care allowances and the deferral of tax payments, among others.

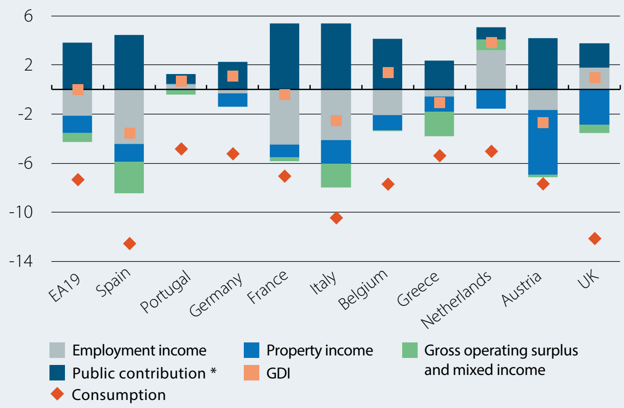
Automatic stabilisers, income and consumption



Notes: *Year-on-year change in the three-quarter cumulative balance up to Q3 2020. * Equivalent to employment income, property income, gross operating surplus and mixed income. ** Equivalent to social benefits net of personal taxes and social security contributions.*
Source: *CaixaBank Research, based on data from Eurostat.*

Consumption, disposable income and household support policies

Year-on-year change (%)



Note: ** «Public contribution» includes social benefits net of personal taxes and social security contributions. Year-to-date figures up to Q3 2020.*
Source: *CaixaBank Research, based on data from Eurostat.*

1. GDI includes workers' wages and capital income (including property income, such as rents, interest income or dividends, gross operating surplus and mixed income), international remittances and publicly-provided social benefits net of income taxes and social security contributions.
2. For comparison, at the height of the financial crisis the euro area's GDI amassed a decline of 0.9% in Q3 2009.
3. Furlough and other temporary workforce reduction schemes have helped to sustain some 50 million jobs in the OECD during the first wave of the pandemic, 10 times more than during the 2009 financial crisis (see OECD, 2020, «Job retention schemes during the COVID-19 lockdown and beyond»). It is therefore clear that the reduction was predominantly in the «intensive margin»: in Q3, the percentage of adults employed in the euro area fell by 1 pp compared to the previous year, while the number of hours worked decreased by around 5 pps.
4. That said, there are significant differences from country to country, and it is estimated that the increase in the unemployment rate could have been as much as 4 pps higher in some countries. See European Commission (2021) «SURE: Taking Stock After Six Months - Report on the European instrument for Temporary Support to mitigate Unemployment Risks in an Emergency (SURE) following the COVID-19 outbreak pursuant to Article 14 of Council Regulation (EU) 2020/672)».

Specifically, as the fourth chart shows, social benefits in the euro area contributed around 3 pps to helping to stabilise GDI and offset declines in household incomes. On the other hand, and unlike previous crises, tax measures also significantly helped to stabilise GDI, contributing 1 pp.

Differences between countries: the fiscal mix

The evolution of GDI and of the labour market in the euro area hides significant differences between countries, reflecting the varying severity of the pandemic and the resulting restrictions on activity, the differing sensitivity to these restrictions of each country's economic structure and the diversity of the fiscal policies implemented. Wages were harder hit in Spain, France and Italy, where they fell by around 4%, while in Germany and Portugal they remained almost unchanged and, at the other extreme, in the Netherlands they rose by 3%. In parallel, there were also substantial differences in the fiscal policy mix, illustrating countries' different strategies to address the immediate effects of the pandemic. The response in Spain, Portugal and Germany largely focused on social spending policies. In France and Italy, in contrast, tax measures played an important role in stabilising GDI (+3 and +2 pps, respectively).[5]

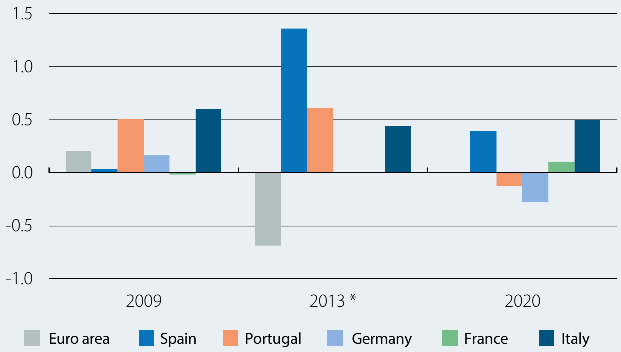
A large part of the differences between countries can also be explained by the varying design and generosity of the labour market support measures in place. For instance, these programmes may offer a subsidy for hours not worked (in the case of Spain, Portugal, Germany and France), a wage subsidy (equivalent to a subsidy for hours worked, as in Australia and Poland) or a hybrid system where companies receive a subsidy proportional to their loss of income (Netherlands).[6] There are also significant differences in the programmes' wage replacement rate, their upper limits, the types of contracts covered, their duration and the contribution from companies. All these differences are reflected in the effective replacement rate: if we focus on workers with average wages who endured a full reduction in their working hours, whilst in Spain, Italy and Belgium the effective replacement rate is around 50%, in Portugal, Germany and France these programmes guarantee between 60% and 70% of the worker's previous income. In the Netherlands, the effective replacement rate is 100%.[7] Many countries also limited these subsidies only to cases with a full reduction in working hours (the UK and Greece).

Stabilisers for the economic revival: time to reactivate targeting

In 2020, the fiscal policy response was better coordinated, larger and quicker than in previous crises, and it managed to isolate the economy from deeper

Sensitivity of GDI to GDP change

(Δ%RBD / Δ%GDP, year-on-year changes)

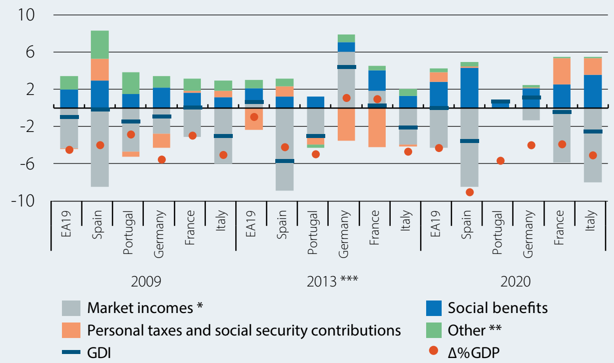


Notes: ** The change between Q3 2013 and Q3 2011 is calculated to reflect the double contraction of GDP in Spain, Portugal and Italy. Countries which did not experience a fall in GDP between 2011 and 2013 are excluded (namely, Germany and France: Δ%GDP -1.1% and 1.0%, Δ%GDI -4.4% and 0.3%, respectively). Values below 1 indicate that fiscal policy has managed to isolate GDI from changes in economic activity. On the other hand, values above 1 indicate that fiscal policy has a limited countercyclical effect (or even that it has a procyclical effect). The negative value observed in 2013 for the euro area as a whole is the result of a sharp contraction in GDP in countries such as Spain and Italy, and widely varying changes in GDI from country to country.*

Source: *CaixaBank Research, based on data from Eurostat.*

Social benefits and direct taxation as GDI stabilisers

Year-on-year change (%)



Notes: ** «Market incomes»: employment income, property income, gross operating surplus and mixed income. ** «Other»: all other categories not included above (capital transfers, other current transfers, etc.), in terms of both household incomes and household payments. Year-to-date figures up to Q3 2020. *** The change between Q3 2013 and Q3 2011 is calculated to reflect the double contraction of GDP in Spain, Portugal and Italy.*

Source: *CaixaBank Research, based on data from Eurostat.*

5. For more details on the various fiscal responses to the pandemic in euro area countries, see Bruegel (2020), «The fiscal response to the economic fallout from the coronavirus» and S. Haroutunian *et al.* (2021). «The initial fiscal policy responses of euro area countries to the COVID-19 crisis» ECB Economic Bulletin, 1.

6. The case of the Netherlands is somewhat unique. Companies receive a subsidy which can reach up to 90% of their loss of income. However, they are also required to maintain a minimum contribution of 10% of the salary (in the case of a full reduction of working hours) while employees have their wages 100% guaranteed. Furthermore, similar to wage subsidy systems, the state subsidy can be used to compensate for hours worked.

7. In general, the effective replacement rate is higher for workers on lower wages. For workers with a full reduction in their working hours and two-thirds of average wages, the effective replacement rate rises to more than 70% in Spain, Belgium and France. For more details on the design of the temporary workforce reduction programmes, see OECD (2020), «Job retention schemes during the COVID-19 lockdown and beyond».

scars in the labour market and the business fabric. Across euro area countries, automatic stabilisers and exceptional fiscal measures have also managed to protect households from significant fluctuations in their employment and capital incomes. Resilience was one of the key words of the year, but this would not have been possible without Germany's *Kurzarbeit*, France's *Activité partielle* or Spain's ERTE and a multitude of public programmes in place to support households and businesses. Going forward, fiscal policy will continue to play a key role. On the one hand, the recovery phase and the Next Generation EU funds now represent a unique opportunity to revive and transform the European economy. On the other hand, fiscal policy will have to refocus on its strengths: continue to help the most vulnerable social groups, provide assistance to the most sensitive economic sectors, and align private incentives to help build a more dynamic, inclusive and sustainable economy.

Luís Pinheiro de Matos