The Great Recession and the Distribution of Household Income

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The paper analyses the impact on household incomes of the 'Great Recession' (GR) that began at the end of 2007. The paper first outlines the main lessons from the past about the relationships between macroeconomic change and the household income distribution. Recessions typically reduce real income levels throughout the income distribution and raise poverty rates when these are measured using a poverty line that is fixed in real income terms; but relative poverty rates need not rise if the poverty line (which is expressed as a fraction of average income) falls sufficiently, and income inequality may move up or down, depending precisely on who is affected by the recession and where they are located in the distribution in the first place.

The analysis of data for 21 rich OECD member countries shows that the GR was the largest macroeconomic downturn since WWII but there was considerable heterogeneity across countries, with real GDP falling, from 2007 to 2009, by between zero (Australia) and 13% (Ireland). Nevertheless, during the same period gross household disposable income, as measured in national accounts, rose in 12 out of the 16 countries for which data are available: the household sector in aggregate was protected from the impact of the downturn by additional support of governments through the tax and benefit system (largely concentrated on households in the bottom half of the distribution). Employment fell in many countries but the relationship between output change and employment change was relatively weak; employment rates fell more for men than women, and declines were particularly large among young people; average earnings among workers rose slightly, probably because lower-paid workers were more likely to be laid off. Although little information is available, trends in households' income from capital should have had an equalising impetus. In 2007, government balances were negative in 9 countries of the 21; by 2009, balances were negative in 19 countries. Most countries are now confronting 'structural' deficits caused by the GR, and these this will impact on household incomes through lower public expenditures and higher taxation.

Summary results from detailed case studies for six countries show that there were marked divergences across countries in the GR's nature, impact on the labour market, and its fiscal consequences. Changes between 2007 and 2009 in the distribution of household income among the population as a whole were generally modest, whether measured in terms of real income levels, income inequality, or relative poverty rates. Germany, Sweden, and the UK are the clearest examples of this pattern. In Ireland, where the macroeconomic downturn was the largest among the six countries, income inequality declined slightly between 2007 and 2009 and the relative poverty rate fell as a consequence of strong social transfers. In Italy and the USA, increases in inequality and in relative poverty were a little more apparent. There is some evidence from all six case study countries that elderly people have been relatively well protected over the GR.

In brief, for most of the countries studied, there was little change in household income distributions in the two years following the GR but, in the medium- to longer-term, there is likely to be much greater change as a result of fiscal consolidation measures that are being put into place. The longer-term distributional consequences will depend on the mix of policies that governments adopt to rebalance public budgets as well as future growth rates. However, the main policy lesson is that stabilisation of the household income distribution in the face of macroeconomic turbulence is an achievable policy goal, at least in the short-term; especially so, in the presence of a strong welfare state which provides greater ‘automatic stabilisation’.