

# **WELFARE AND NORDIC CRISIS MANAGEMENT STRATEGIES**

**– A COMPARATIVE PROJECT –**

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Draft Report for the Nordic Council of Ministers

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## Summary

The Global Financial Crisis culminated in the winter of 2008-09 as financial institutions around the world teetered on the brink of collapse. As the crisis developed, significant differences in government policy choices across countries became apparent. The response in several countries, including Greece, Ireland, the UK, Spain, and Portugal, was characterized by harsh austerity measures, which relied primarily on significant cuts to government spending. Iceland stands out in this regard among deep crisis countries, as it emphasized revenue increases more than expenditure cuts in their fiscal policy response.

While fiscal policy choices differed significantly during the crisis, overall changes to social policy were more characterized by continuity than change, when looking at all European countries. However, that differed greatly between countries depending on depth of the crisis and capabilities for countries to respond. Thus, the extent to which countries were prepared to deal with a deep recession at the onset of the crisis mattered a great deal. While some countries, such as the Nordic countries, had forceful automatic stabilizers and generous unemployment benefit systems in place to cushion the most severe effects of the crisis, other countries were neither fully prepared nor in a position to implement measures to adequately redistribute the costs of the crisis. Thus, the social policy setting at the onset of the crisis played a crucial role in shaping the effects of the crisis on economic wellbeing.

Individuals who are economically vulnerable to start with are most often those most sensitive to the effects of crises on their level of living. The welfare state and government policy responses more generally, play a crucial role in protecting those groups during crises episodes. Some welfare regimes are more generous, provide stronger automatic stabilizers and redistribute incomes to a greater extent, thus reducing poverty risks, in good as well as in bad years. When correlating wellbeing developments to institutional factors and political-economic positions we find that the depth of the crisis is the most consequential factor for producing large wellbeing consequences in the crisis years. However, welfare regimes are the second largest explanatory factor in wellbeing consequences. Thus, how the welfare state is employed during times of economic crises is crucial for the wellbeing consequences of the general population.

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## 1 Introduction

The effects of the global financial crisis of 2008 on the economic wellbeing of individuals and societies were extensive. The crisis sparked the “Great Recession”, the most severe economic contraction experienced by advanced economies in the post-World War II period (Reinhart and Rogoff 2009). Millions suffered from increasing economic insecurity, became unemployed, or were plunged into poverty. Even so, the Great Recession is only the latest example of the negative effects of economic turmoil on wellbeing. A multitude of prior crises have adversely affected societies in recent history, with the infamous Great Depression of the 1930s the quintessential example of the potential for economic hardship to not only disrupt individual lives, but also the very fabric of society.

Government action — or inaction — during economic crises can have profound effects on wellbeing. Whether governments take a hands off approach, are actively involved in ameliorating the effects of the crisis, or a mix of the two can matter a great deal for the human cost of economic crises. In this report we ask what policies European governments pursued to ameliorate the disruptive effects of the global financial crisis on individuals and societies during the past eight years.

We bring two types of empirical evidence to bear on our research questions: First, a number of country case studies by leading welfare state experts were commissioned as part of the project, providing detailed information on policy responses by governments. These case studies inform much of the qualitative discussion in the empirical chapters. Second, we employ the European Union Survey of Income and Living Conditions (EU-SILC) to provide an empirically rich account of household wellbeing developments across Europe throughout the Great Recession. Bringing the two types of empirical evidence together allows us to compare and contrast how governments reacted to the economic crisis and how those actions impacted upon the economic wellbeing of the general population.

The report consists of four substantive chapters, drawn from the forthcoming book, *Welfare and Nordic Crisis Management Strategies*, edited by Stefán Ólafsson, Mary Daly, Olli Kangas, and Joakim Palme. In chapter 2, we discuss major theories used to account for government policy responses during times of economic crises. Chapter 3 outlines the depth and duration of the Great Recession and how governments employed fiscal and social policy to combat the effects of the crisis on the economic wellbeing of the population. Chapter 4 turns the attention to the effects of the crisis on individuals and households, while chapter 5 combines the preceding macro and micro discussions to account for the major determinants of changes in wellbeing over the course of the crisis through the lens of economic vulnerability. Chapter 6 provides a short summary of the four substantive chapters.

## 2 Theories and Approaches

Policymaking during times of economic crises has long been understood to be qualitatively different than during “normal” times. While the latter is generally characterized by public policy theorists as being times where only small-scale, incremental changes to policies are possible and feasible (e.g. Lindblom 1959), many argue that times of crises are more susceptible to radical reform. Kingdon (1984), for example, argues that crises open a “window of opportunity” for policy reform, while Gourevitch (1986) contends that crises can instigate “critical realignments”, whereby existing political coalitions that sustain particular policies are broken up, making dramatic changes to policy possible. Yet another stream of research considers economic crises fertile ground for so-called “critical junctures”; brief phases of institutional flux when structural constraints on policymaking are temporarily relaxed and the range of possible policy changes becomes larger (Capoccia and Kelemen 2007).

Policymaking — even in times of crisis — does not, however, occur in a vacuum. Preexisting policies form what Mettler (2015) calls a “policyscape”: That is to say, a mosaic of policies that generate feedback effects that influence political behavior, policy agendas, and, ultimately, constrain subsequent policymaking. Importantly, the policyscape not only defines the *status quo* faced by policymakers during crises, but also forms the set of policies that are in effect at the onset of a crisis. This suggests that the extent to which states are “prepared” for crises, i.e. have in effect a set of policies which automatically ameliorate the effects of crisis on the general population, reduces the need for explicit, discretionary, reaction by the government (Starke et al. 2013).

While there are a variety of policies that can ameliorate the effects of economic crises on wellbeing, they can broadly be classified according to their scope: On the one hand, there are general policies that affect the broader population throughout the crises. Such policies are generally meant to support aggregate demand and stave off the loss of output, unemployment, and major economic disruption. On the other hand, there are specific policies that directly affect those individuals who have been affected by the crises – unemployed persons, those



who have been pushed into poverty, and those struggling to make ends meet. Those are ideal types, as many policies will have elements of both approaches in their design.

Previous research on policy responses to economic crises has tended to focus on either one of these broad categories of policies: Gourevitch (1986), for example, focuses on economic policymaking, without considering social policy in particular, while Starke et al. (2013) and van Kersbergen et al. (2014), for example, give prominence to social policy, with economic policy playing a more limited role. In the following two sections, we will discuss these separate literatures and shed light on major theories of economic and social policymaking both during normal times and during times of crises. In particular, we will review the extent to which preexisting policies may automatically buffer the effects of economic crises on the general population, but also cases in which economic crises are likely to induce fundamental policy change that impact upon the wellbeing of individuals and societies.

## 2.1 Fiscal Policy: Stimulus or Austerity?

When the Great Depression plunged societies into a deep economic crisis in the 1930s, the dominant view among economists and policymakers was that fiscal policy had no effect on economic output and unemployment, and as such, the government shouldn't actively use fiscal policy to stimulate aggregate demand and contain unemployment while the economy recovered from the downturn. The view, often referred to as the "treasure view" of fiscal policy, since it characterized the position of the British Chancellor of the Exchequer in the early 1930s, is based on the assumption that any government spending crowds out an equal amount of private spending, such that any increases in public spending are always matched by decreases in private spending. The premise of the assumption is that money has to be spent on something and that any borrowing (or tax increases) by the government to fund increased spending necessarily implies that there is less money to borrow (or spend) for other actors in the economy. As a consequence, government spending was assumed to have no net effect on the economy.

As the Great Depression unfolded and governments were unable to recover from the crisis, the English economist John Maynard Keynes (1936) forcefully argued against the prevailing view, offering instead a theory of how activist government policies could raise aggregate demand and hasten the economic recovery. At the core of Keynes' theory is the suggestion that the biggest problem of any economic crisis is involuntary unemployment caused by inadequate economic demand and that such a situation wouldn't necessarily self-correct with due time. Indeed, a destructive cycle could be set in motion: As individuals and firms prudentially start saving more of their income, aggregate demand falls even more since less is consumed, which in turn reduces the aggregate income of individuals and firms and, paradoxically, leads to less total saving (Krugman 2012). Keynes argued that this cycle, sometimes referred to as the "paradox of thrift", could entrap an economy in a permanent state of depression if the government didn't react appropriately.

Keynes argued that the government could stimulate the economy through either monetary or fiscal policy or a combination of the two. On the one hand, by increasing the money supply ("printing money"), monetary policy could be used to hold back the drop in aggregate income, as well as reduce interest rates, making savings less attractive and stimulating investment (Krugman 2012, 32). On the other hand, by increasing government spending (or decreasing government revenue), fiscal policy could be used to stimulate aggregate demand and counteract the effects of underconsumption by individuals and firms. Such fiscal policy measures could both be automatically induced by the state of the economy (i.e. let lower tax receipts from households due to lower income and corporations due to lower profits and higher spending on unemployment benefits "automatically" stabilize the economy) or determined at the discretion of the government in response to the state of the economy. In any case, Keynes' argument implies that the two broad policy tools of monetary and fiscal policy could collectively allow governments to break the cycle of more savings and less income and, thus, return the economy to normal functioning.

### **2.1.1 The Keynesian Welfare State of the Post-War Era**

Keynes's theory revolutionized the field of macroeconomics and was highly influential among economists and policymakers in establishing the political-economic institutional framework of advanced democracies following World War II. At the international level, a multilateral system of *embedded liberalism* was established, which involved the creation of a number of formal institutions, such as the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) to regulate monetary and trade relations among advanced economies (Eichengreen 2008; Ruggie 1982). The defining feature of the system was that it was predicated upon interventionism at the domestic level, allowing governments to pursue expansive social and economic policies.

This was the environment in which the Keynesian welfare state blossomed. Economic policies were actively employed to stabilize economies and pursue the goal of full employment, while generous welfare policies were developed to provide income replacement to those needing further support. In most advanced European countries, corporatism also played a key role, with unions accepting wage restraint and employers committed to reinvest profits in human and physical capital. While the extent to which such policies were followed differed across countries due to a number of factors (e.g. Hall and Soskice 2001), on the whole this was a period in which policymakers across advanced economies subscribed to a similar set of views about the proper role of the state in the economy (Hall 1989).

### **2.1.2 The Breakdown of Keynesianism**

The *Trente Glorieuses*, the golden years of the Keynesian welfare state, came to an abrupt end in the early 1970s. Multiple factors caused the decline: At the domestic level, economic growth began to slow-down, productivity growth stalled due to the increasing size of the service sector, and skill-biased technological change put pressure on collective wage bargaining, while at the international level, the Bretton Woods system of fixed exchange rates came to an end, financial markets were becoming more open and integrated, and the price of oil increased sharply. With slowing economic growth, rising inflation, and

growing budget deficits, Keynesianism was seen by critics to have failed and the consensus around the Keynesian welfare state dissolved (Hall 1999).

As Keynesianism lost credibility, monetarist economist theory gained ground and played an important role in changing beliefs about the proper role of the state in the economy at the beginning of the 1980s (Blyth 2002; Hall 1993). The primary goal of macroeconomic policymaking shifted from maintaining full employment to controlling inflation, with most advanced economies adopting an explicit inflation target and endowing an independent central bank with the authority over setting monetary policy. For many countries of the European Union, this culminated in the establishment of a common currency, which further limited the room to manoeuvre for national governments (McNamara 1998).

Importantly, the role of fiscal policy in stabilizing the economy was undermined, and was mostly limited to automatic stabilizers rather than activist, discretionary stimulus spending (Hall 1999). Indeed, following the 1970s and right up until 2008, a period of “Great Moderation” in advanced economies, i.e. of stable, but modest, economic growth and low inflation, lent strong confidence to the belief that monetary policy was best suited to stabilize the economy (Blanchard et al. 2010). As such, activist fiscal policy was considered by mainstream economists to be ineffective and attempts at “fine tuning” the economy were seen as bound to fail (Auerbach et al. 2010; Taylor 2000). Thus, the overwhelming consensus within the economics profession and policymaking circles at the onset of the Great Recession was rather aligned with the view that governments should not use discretionary fiscal policy to ameliorate the effects of recessions on the economy.

### **2.1.3 The Case Against Discretionary Fiscal Stimulus**

Several reasons were given for such a strong position against activist fiscal policy. First of all, policymaking occurs with a considerable lag. From the time policymakers become aware of an economic recession, they must formulate a policy response, enact legislation, and implement the policy, and there might be some lag from the time a policy is implemented until it has the desired effect. With such a long lag, critics argue that a recession might be over well before the

fiscal policy response became effective. As such, this argument applies specifically to discretionary fiscal policy, rather than automatic stabilizers, since the latter are implemented automatically as the state of the economy changes.

Second, as suggested by Lucas's (1976) critique, the rational expectations of individuals, firms, and investors can undermine the effectiveness of any fiscal stimulus during a recession. Thus, for example, if the government implements a stimulus which is funded through government borrowing, rational actors should reduce their own spending, since they anticipate higher taxes and higher interest rates in the future, to repay the loans the government took out during the recession. The net effect of increases in government spending should therefore be minimal, since reactions by individuals, corporations, and investors to government actions would counteract the effects of the stimulus itself.

Third, fiscal stimulus funded through government borrowing increases sovereign debt, which can bring the long-term solvency of the country into question and increase the interest rate premium charged by international financial markets (Garrett 1998; Mosley 2003). As such, stimulating the economy in the present might burden the future budget of the country with interest payments, which in turn might limit the country's potential for maintaining current spending and tax levels in the future, as well as reducing economic growth. In the extreme, countries which have a high risk of sovereign default might lose access to international funding markets and face sovereign default without external assistance.

In a series of influential papers, Alesina and collaborators (Alesina and Ardagna 1998, 2010, 2012; Alesina and Perotti 1997) warn of the dangers of unsustainable spending during recessions for future economic growth and even go on to argue that rather than use fiscal stimulus to recover from an economic recession, austerity — or fiscal consolidation — is more likely to renew economic growth. The strategy, generally referred to as “expansionary austerity”, suggests that the confidence of households and markets in the solvency of the government is critical for economic growth. By pursuing austere policies, authorities increase confidence in the future solvency of the government, which reduces expectations of high taxation and high interest rates in the future. As such, the theory implies

that less public spending (austerity) leads to more private spending and, thus, actually causes an economic expansion. Alesina et al., furthermore, maintain that to be successful, a fiscal consolidation must be expenditure-based, or in other words, that governments should focus on reducing transfer payments to benefit recipients and the wages of public employees, rather than raising taxes on the general public.

Collectively, these points suggest that governments should either refrain from pursuing a plan of fiscal stimulus during downturns, as their actions would in most likelihood have little or no effect, or actually pursue a plan of austerity, in an effort to increase confidence in the solvency of the government. Thus, rather than employing discretionary fiscal policy to stabilize the economy over the business cycle, authorities should primarily employ monetary policy to affect aggregate demand.

#### **2.1.4 The Case for Discretionary Fiscal Stimulus**

While this was the mainstream view prior to the crises, many argued that the mainstream view was wrongheaded, both during minor recessions, but especially when faced with major disruptions, such as the Great Recession. Harking back to the prescripts of Keynes himself, many forcefully argued for a policy of fiscal stimulus at the onset of the Great Recession, dismissing concerns from major adherents of austerity (Blyth 2013; e.g. Krugman 2012). The case against austerity builds on multiple pillars: Surely, Keynes' theoretical insight plays an important role, but so do concerns about the distributional fairness of austerity, and the track record of austerity in the recent past.

On the one hand, austerity, especially the expenditure-based variety advocated by Alesina and Ardagna, is distributionally unfair (Blyth 2013). In its simplest form, governments pursuing an austere fiscal policy, aim to spend considerably less than they collect in revenues, accumulating a budget surplus and lowering government debt. There are, of course, many ways in which governments can go about pursuing such a goal: Governments can raise taxes on the general public or the wealthy, they can reduce spending overhead or operational costs, on infrastructure spending, on defense spending, or a number of government

programs that do not directly contribute to maintaining the economic wellbeing of the national population. However, in the expenditure-based variety, the individuals who bear the weight of austerity on their shoulders are the members of society least likely to be able to do so, since such a policy is specifically aimed at reducing the costs of welfare policy programs and the government wage bill. As such, benefit recipients and government employees are likely to suffer disproportionately under austerity. The effects are likely to be doubly harmful during economic recessions, when more individuals are likely to seek benefits due to unemployment and underemployment. Thus, austerity can have very specific distributional implications, especially for the most vulnerable members of society.

On the other hand, recent research suggests that austerity simply doesn't have the effects claimed by its advocates. A number of recent studies find that the short-term effects of austerity are in line with arguments made by Keynesian economists, rather than the expansionary effects argued by Alesina and others. Romer and Romer (2010), for example, find that a tax increase of 1 percent of GDP reduces output over the next three years by close to three percent, while Guajardo et al. (2014) find that fiscal consolidations reduce economic output and increase unemployment in the short-term and that the short-term effects are contractionary regardless of whether a country is perceived to have a high sovereign default risk. In addition to these findings, the case against austerity has further been supported by the debunking of an influential paper by Reinhart and Rogoff (2010), which argued that when a country's external debt levels are in excess of 90 percent of GDP, economic growth is considerably lower than at lower debt levels. Indeed, Herndon et al. (2014) show that the findings are largely due to serious methodological errors by the authors and, once the errors are rectified, there does not appear to be a consistent relationship between debt levels and economic growth.

While the overall verdict on the macroeconomic effects of fiscal stimulus and austerity are becoming clearer, the distributional consequences are what matter most for the effects of economic crisis on wellbeing. By maintaining economic activity and containing unemployment, a plan of fiscal stimulus can limit the

costs imposed by crises on individuals and societies. While it is important that such plans are fiscally responsible, i.e. that they do not jeopardize the future solvency of the government, it is important to note that they limit other kinds of costs: Most importantly, human capital is protected from erosion and suffering due to poverty and material deprivation is limited. In this regard, Keynesian fiscal stimulus is likely to play a particularly important role in maintaining economic wellbeing during crises.

## 2.2 Social Policy: Retrenchment or Resilience?

The welfare state is the primary policy mechanism through which governments protect populations from the vagaries of the market economy. Unsurprisingly, the increasing economic insecurity caused by economic turmoil often brings about intense pressure for expanding the welfare state by those directly affected by crises, as well as risk-averse individuals concerned for their economic security. Thus, as Polanyi (1944) famously argued, the vagaries of the self-regulating market can spontaneously bring about a movement towards increasing social protection (the “double movement”).

There is much evidence to suggest that major economic downturns played such a role in Western societies during the early 20th century. Cutler and Johnson (2004), for example, attribute the introduction of major social insurance programs in multiple countries to deep economic recessions and Miron and Weil (1998) argue that without the Great Depression, Roosevelt’s landmark Social Security Act of 1935 might not have been introduced in the United States. Similarly, Castles (2010) suggests the Great Depression had a catalytic effect on social policy developments in Sweden and New Zealand. More generally, rising economic insecurity among the general public in the early 20th century is commonly thought to have played an important role in the development of generous welfare policies that protect individuals from a variety of social risks associated with the market economy (Baldwin 1990).

The period following World War II marked what many consider to be the height of welfare state expansion. However, much like with Keynesian fiscal policy, the generous welfare state of advanced democracies came under increasing pressure



from the 1970s onward (Hall 2013; Korpi 2003; Scharpf 2000). Many even went so far as to predict the ultimate collapse of the welfare state (e.g. Offe 1984; Svallfors and Taylor-Gooby 1999). The implications were clear: In the period following the 1970s, the golden years of the Keynesian welfare state were gone and a period of welfare state reconstruction or retrenchment was upon advanced democracies.

### **2.2.1 The New Politics of the Welfare State**

Even so, there is considerable disagreement over the extent of retrenchment achieved. Writing about the governments of Margret Thatcher in the UK and of Ronald Reagan in the US -- two most likely cases -- Paul Pierson claims that “the welfare state stands out as an island of relative stability” (1994, 5), compared to other policy areas. Pierson (1994, 1996) makes the central claim that welfare states themselves have changed the context in which they operate. Because of this, retrenchment is not simply expansion in reverse -- there are entirely different factors at work. While the politics of expansion involve enacting popular policies in an underdeveloped interest group environment, posing only diffuse costs through taxation, retrenchment involves dismantling popular policies with concentrated benefits that enjoy the support of entrenched interest groups.

This path dependent nature of the welfare state constrains policy changes that reform-minded politicians can pursue. Politicians, being both policy and office seekers, will have to take that into account when balancing those two objectives. Those wanting to retrench the welfare state due to ideological reasons and stay in office, will try to minimize the associated political costs of retrenchment by manipulating the information available to possible opponents and voters about the policy changes. This can be achieved by lowering the visibility of unpopular policies, obscuring responsibility, hiding information about possible consequences of reform, making side-payments to politically important groups for lost benefits, or achieving changes through decrementalism (Pierson 1994, 19–22). Whenever possible, governments will seek to gain broad support for their agenda and thus spread the blame. For governments that do not enjoy a

wide electoral margin to “buffer” unpopular decisions, such “blame avoidance” will become even more important (Weaver 1986).

Pierson argues that in this new environment it is justifiable to talk about an entirely “new politics” of retrenchment, which is quite different from the “old politics” of expansion. Pierson thus challenges the relevance of the power resources approach in this new context, maintaining that labor unions, left-wing parties and other social movements that expanded the state are no longer of central relevance to its sustainability. Instead, the welfare state has taken on a life of its own with the continuation of individual programs depending on their popularity and the associated interest groups. Retrenchment will thus only be possible when politicians can pursue the strategies outlined above and “hide” their success from the watchful eyes of the public and beneficiaries. More recent work by Huber and Stephens (2014) suggests that this is indeed the case for political partisanship — i.e. while left-wing parties played an important role in the expansion of the welfare state, they are less important for the sustainability of the welfare state, once it is in place.

### **2.2.2 The Welfare State Retrenched?**

Pierson’s claim about the resilience of the welfare state to radical restructuring has, however, been met with considerable skepticism, with himself acknowledging more recently that the resilience of the welfare state might be overstated in his earlier work (Pierson 2015). Three lines of arguments are especially salient.

First, as Pierson focuses on the US and the UK in his study, two liberal welfare states, he disregards potential differences in institutional dynamics under alternative welfare state regimes. Later studies critiqued Pierson for exactly this and pointed out that his main conclusions did not hold in different settings (e.g. Anderson 2001; Swank 2001). This is especially so regarding his treatment of the “old politics” and thus, the distinctiveness of the “new politics”. While the liberal welfare states are dominated by narrow, fragmented interest groups, the social democratic welfare states are characterized by encompassing, solidaristic labor market movements. In such an environment, the interests of those that

depend on the social programs in question will not be represented by client-based interest groups, but rather the encompassing labor movement (Anderson 2001, 1069). As Swank (2001, 208) shows, such large encompassing interest groups are likely to constitute a major barrier to radical reform of the welfare state. Thus, Pierson's argument about the dominance of concentrated interest groups has limited relevance in the social democratic regimes.

Second, Korpi and Palme (2003) argue that Pierson overstates the distinctiveness of politics in mature welfare states *vis-a-vis* politics during welfare state expansion. As they suggest, the expansion of the welfare state was not simply a popular credit claiming affair, welcomed by all voters. Indeed, concerns over high levels of taxation and the growth of "big government" were highly salient throughout the golden years of the welfare state, suggesting that the politics of expansion are not qualitatively different from the politics of retrenchment. Korpi and Palme (2003), furthermore, claim that the primary beneficiaries of the welfare state are not necessarily client-based interest groups, but rather the mass of risk-averse citizens, who benefit from the existence of social insurance schemes, whether or not they actually claim benefits over their lifetime. Again, the implication is that the two periods of welfare state developments are not as different as Pierson maintains.

Finally, a number of scholars critique Pierson's narrow conceptualization of the welfare state and his policy-based approach. By focusing only on observable changes in policy, Pierson overlooks the social context of those policies and the goals they are meant to achieve (Hacker 2004). Thus, while the working class predominantly used its resources to protect male breadwinners from losing their ability to provide for their families due to unemployment, sickness, invalidity or old age at the dawn of the modern welfare state, the risks facing citizens have changed substantially in the last thirty years (Bonoli 2001). Furthermore, as Clayton and Pontusson (1998) point out, in the context of rising inequality and insecurity an unchanged welfare state will effectively have been retrenched. Ignoring these changes and focusing only on spending cuts or reforms of social programs will thus overlook how the welfare state affects the labor market and vice versa.

In later work, Pierson (2001) makes his analysis of welfare state change and how governments deal with pressures differently more nuanced. Instead of focusing only on retrenchment per se, he accepts that reducing change to a single dimension is counterproductive. The resulting dimensions suggested by Pierson are three: i) re-commodification, which entails dismantling social programs and making individuals more reliant on the market, ii) cost containment, which consists of those measures taken to make the welfare state more efficient and streamlined without sacrificing quality services, and iii) recalibration, which entails modifying programs to better achieve historical goals (rationalization) and adapting them to changing risks and norms (updating). These three dimensions do not play out in the same way in all welfare state regimes. Indeed, Pierson argues that “there is not a single ‘new politics’ of the welfare state, but different politics in different configurations” (2001, 455). Consequently, the welfare states of advanced industrial societies do not seem to be converging, as many have predicted, but rather growing apart (Swank 2002).

What are the implications of these developments for wellbeing in times of economic turmoil? On the one hand, they suggest that preexisting policies of social protection are likely to matter a great deal for the effects of economic crises on wellbeing. Generous social policies already in place will be difficult to retrench and are likely to enjoy support from a large part of the population. Moreover, since they will “automatically” be triggered at the onset of an economic crisis, they will buffer the effects of turmoil on wellbeing without any lags in policymaking. On the other hand, however, they suggest that focusing solely on preexisting policies might be misguided. As Hacker (2004) highlights, “hidden” retrenchment can undermine preexisting policies, making it critical to analyze not only what governments do, what also what they do not do in response to changes in social risks faced by the general population. Indeed, as Hacker and Pierson (2010) argue, such “hidden” retrenchment has played a critical role in undermining welfare policy and economic equality in the United States.

### 2.3 Analytical Framework

The preceding discussion suggests that we can analyze policy responses to economic crises along two dimensions, each with implications for the wellbeing of the general population. First, we can analyze the extent to which governments expand, maintain, or retrench, social policy programs which provide income replacement or income support for economically vulnerable individuals and households. These can be individuals who are directly affected by the economic crises due to the loss of their employment or increased debt burden, but also recipients of benefits due to old age, disability, and sickness, social assistance, or family benefits (e.g. children's allowance or parental leave). Second, we can analyze the extent to which governments seek to stimulate the economy to maintain aggregate demand while the private sector recovers, or alternatively, the extent to which they pursue austerity, with limited concern for stimulating demand. This latter dimension primarily affects the wellbeing of the general population indirectly and indiscriminately, i.e. such policies are not targeted specifically at those affected by the crisis condition.

These two dimensions are commonly collapsed into a single dimension, with welfare state retrenchment associated with austere fiscal policies and, likewise, welfare state expansion (or maintenance) associated with Keynesian fiscal stimulus. However, while the two pairs of policies can certainly go together, they do not necessarily go together. Thus, a government might pursue austere policies, but at the same time protect important social policy programs to protect the economically vulnerable. Likewise, a government might stimulate the economy by deficit spending, but pursue welfare state reforms that curtail social rights. Furthermore, each of these different combinations might impact upon the wellbeing of individuals and household differently.

In the following chapter, we will analyze government crises strategies using a variety of indicators that map onto these two dimensions. Our primary focus will be on whether countries pursued a strategy of austerity or stimulus in fiscal policy, on the one hand, and to what extent social policies were employed to buffer the effects of the crises on the affected population, on the other hand. This entails outlining both discretionary policymaking during and in the aftermath of

the crisis, but also analyzing the extent to which policy at the onset of the crisis was equipped with dealing with the sudden changes in wellbeing due to the crises, for example through automatic stabilizers.

### **3 Welfare and Government Policy Responses to the Great Recession**

In the fall of 2007, the first casualties of the Global Financial Crisis emerged. The U.S. subprime mortgage crisis erupted and several other countries experienced difficulties due to slowdowns in construction and real estate. In the next couple of months, the trouble spread from one country to another, culminating in a full-blown global crisis following the fall of Lehman Brothers in September 2008 (Cameron 2012). The deepest recession to hit advanced economies since the Great Depression ensued (Reinhart and Rogoff 2009), commonly dubbed the “Great Recession”. As the recession abated, the Eurozone crisis erupted, which further impacted societies on the European periphery (Copelovitch et al. 2016).

While the initial policy response by governments was focused on saving financial institutions and staving off a global recession, the effects of the crisis on the economic wellbeing of individuals and households came to the fore as the crisis unfolded. Unsurprisingly, such effects were particularly consequential in the countries hit hardest by the crisis, as painful, and highly controversial, austerity measures were implemented in efforts to consolidate government finances, often under the tutelage of international institutions (Bermeo and Pontusson 2012).

In the following two sections, we begin by outlining the macroeconomic environment that formed the backdrop of government policy responses in the aftermath of the Global Financial Crisis.<sup>1</sup> We then take up the task of describing the main contours of government policy responses, focusing on how governments employed fiscal policy to ameliorate the effects of the crisis on the general population and, in particular, to what extent policies of social protection were altered in response to the economic turmoil that ensued.

We find that there are broad similarities in how governments initially responded to the crisis, although the direct costs of refinancing financial institutions and the

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<sup>1</sup> For detailed discussions of the various causes of the crisis, see Reinhart and Rogoff (2009) and Baldwin et al. (2015).

precarious fiscal position of the state limited the policy options available to the countries that were hardest hit by the crisis. The pre-crisis situation in Greece was particularly dire, although several other economies, including the Baltics, Iceland, and Ireland, were particularly vulnerable to the effects of sudden changes in the flow of international capital. At the same time, core EU countries were relatively well positioned financially to respond effectively to an economic contraction.

As it turned out, the most vulnerable countries at the onset of the crisis stand out in terms of the size of the economic contraction caused by the financial crisis. The contraction in Greece was particularly large, with GDP dropping by over 25% from the pre-crisis peak to the post-crisis trough. The Baltics, Iceland, and Ireland, also suffered large decreases in GDP following the financial crisis, but unlike Greece, economic recovery began soon after the global recession in the winter of 2008-09. The same cannot be said for Spain, Portugal, and Italy, which, like Greece, were strongly affected by the Eurozone crisis, which culminated in 2012. Eight years after the financial crisis erupted, the effects of the crisis still linger across OECD countries. Thus, GDP in a third of the 30 countries under consideration is still below the pre-crisis peak value of GDP, underlining the long-term disruptive effects of the crisis on economic activity. Again, Greece stands out as the country most affected by the crisis. However, there are also countries which have enjoyed significant economic recoveries since the depths of the crisis: Both the Icelandic and Irish economies, for example, suffered greatly during the crisis, but have since then surpassed their pre-crisis peak GDP.

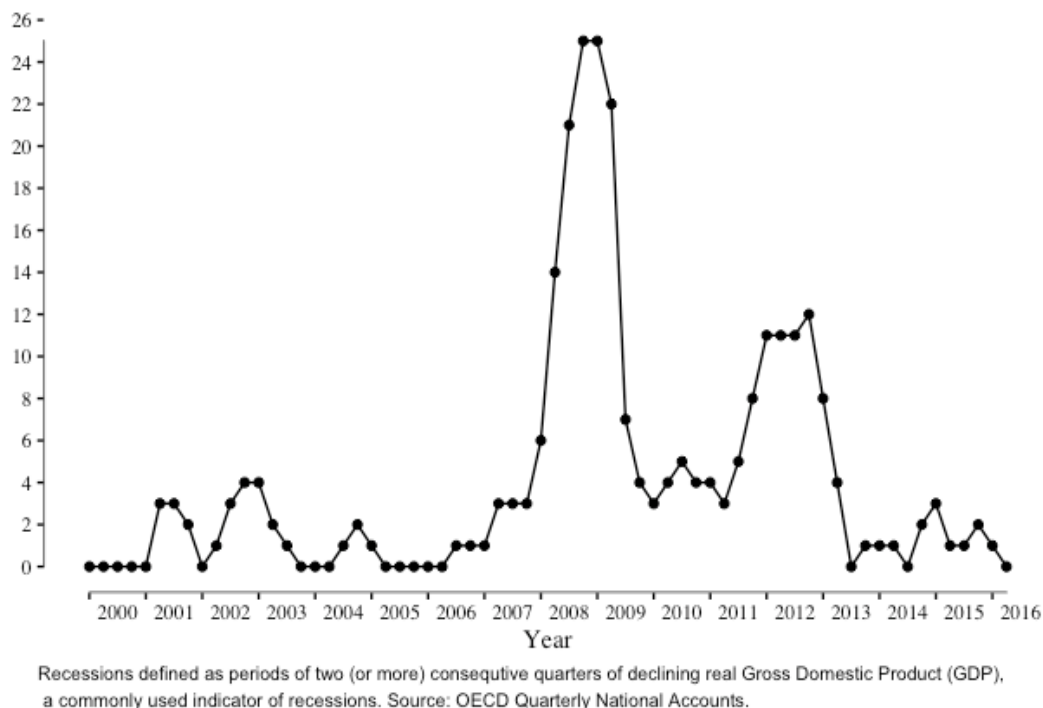
As the crisis developed, significant differences in fiscal policy choices across countries became apparent. The response in several countries, including Greece, Ireland, the UK, Spain, and Portugal, was characterized by harsh austerity measures, which relied primarily on significant cuts to government spending. Iceland stands out in this regard, as it was the only deep crisis country which emphasized revenue increases rather than expenditure cuts in their fiscal policy response. Other countries, less affected by the crisis, pursued a mix of stimulating fiscal policies that were more conducive to maintaining aggregate demand and supporting economic wellbeing.



While fiscal policy choices differed significantly during the crisis, overall changes to social policy were rather characterized by continuity than change. Thus, the extent to which countries were prepared to deal with a deep recession at the onset of the crisis mattered a great deal. While some countries, such as the Nordic countries, had forceful automatic stabilizers and generous unemployment benefit systems in place to cushion the most severe effects of the crisis, other countries were neither fully prepared nor in a position to implement measures to adequately redistribute the costs of the crisis. Even so, Ireland and Greece stand out as cases of significant social policy retrenchment, while Iceland and Slovenia stand out as cases where redistributive measures played a larger role as the crisis evolved. In any case, the social policy setting at the onset of the crisis played a crucial role in shaping the effects of the crisis on economic wellbeing.

### 3.1 The Global Financial Crisis Unfolds

Less than a year after the U.S. subprime mortgage crisis erupted, the global economy teetered on the brink of collapse. Figure 3.1 traces the international scope of the crisis in over 30 advanced economies from 2000 onward, showing the number of countries experiencing recession in any given quarter. While only three of the economies were in recession in the final quarter of 2007, 22 were in recession in the fall of 2008 and 26 out of 30 countries were in recession at the peak of the crisis, in the first quarter of 2009. The global economy picked up steam later in 2009, with GDP recovering in most countries. However, as the Eurozone crisis unfolded another widespread downturn took place between 2011 and 2012, with just under half of the economies experiencing another deep recession. In 2013, economic recovery had resumed in most countries, albeit at differing speeds.



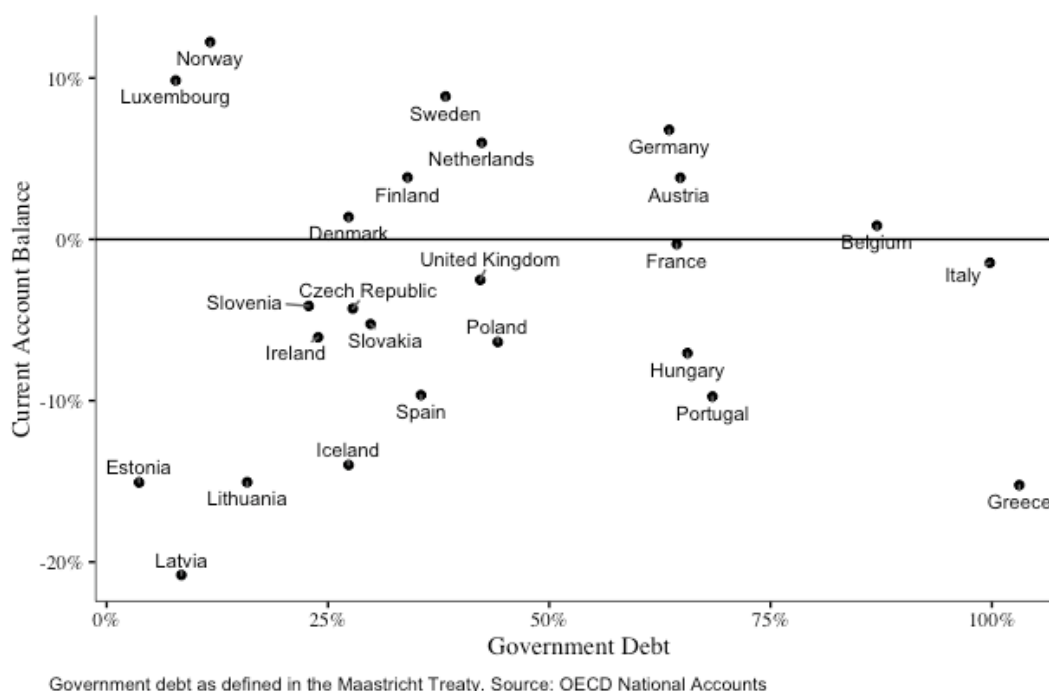
**Figure 3.1: Number of Advanced Economies (out of 30) in Recession, by Quarter**

Long-lasting and deep economic contractions sparked by a financial crisis, such as the Great Recession, can have dire consequences for the economic wellbeing of the general population (Dao and Loungani 2010). On the one hand, contractions generally reduce domestic economic activity, which leads to lower household income and increased unemployment. To maintain the economic wellbeing of the population, governments, thus, have to increase the resources dedicated to social protection and to support aggregate demand. On the other hand, however, financial crises can be costly for governments, especially as overall government revenues contract with the recession. These directly limit the resources available to governments to pursue such policies of social protection. Thus, governments must in many cases dedicate considerable resources to bailout ailing financial institutions or, alternatively, be forced to consolidate their finances due to the rising costs (or in the extreme, inability) of borrowing capital to fund their activities.

### 3.1.1 Constraints on Government Responses

The direct costs of financial crises, as well as the size of the contraction they spark, are thus likely to be important constraints on government policy

responses, especially for countries that enter a recession already in a precarious financial situation.



**Figure 3.2: Government Debt and the Current Account Balance in 2007 (% of GDP)**

Indeed, the state of public finances did differ considerably among advanced economies at the onset of the crisis, with the position of several countries being such that there was limited room for governments to respond effectively to the crisis that lay ahead. Figure 3.2 shows two important measures of such constraints, gross general government debt and the current account balance at the onset of the crisis. The former measure can be seen as an indicator of the cumulative sustainability of government finances. To the extent that the Great Recession led to great demands on government resources, either directly due to the resurrection of financial institutions or due to the turmoil caused by a large economic contraction, governments faced quite different constraints based on the level of their debt. Thus, countries with low levels of public debt were able to meet such demands to a greater degree than countries deep in debt, although low levels of debt in no way guaranteed acquiescence to such demands.

The latter measure, the current account balance, can be seen as an indicator of the reliance of the domestic economy on foreign capital, or alternatively, the

difference between what a country invests and saves abroad. After the establishment of the Euro and in the lead up to the crisis, such imbalances became especially large within the European Union, with capital flowing from core countries to countries on the periphery (Copelovitch et al. 2016). Rather than invest the inflow of credit in productive resources, it was generally used to fuel domestic consumption and asset bubbles, with governments doing little to counteract the growing imbalances (Lane 2012). As the crisis unfolded and fears of defaults on debt increased, cross-border lending came to a sudden stop, causing a balance of payment crisis in periphery countries, which would later develop into a full-blown sovereign debt crisis (Baldwin et al. 2015).

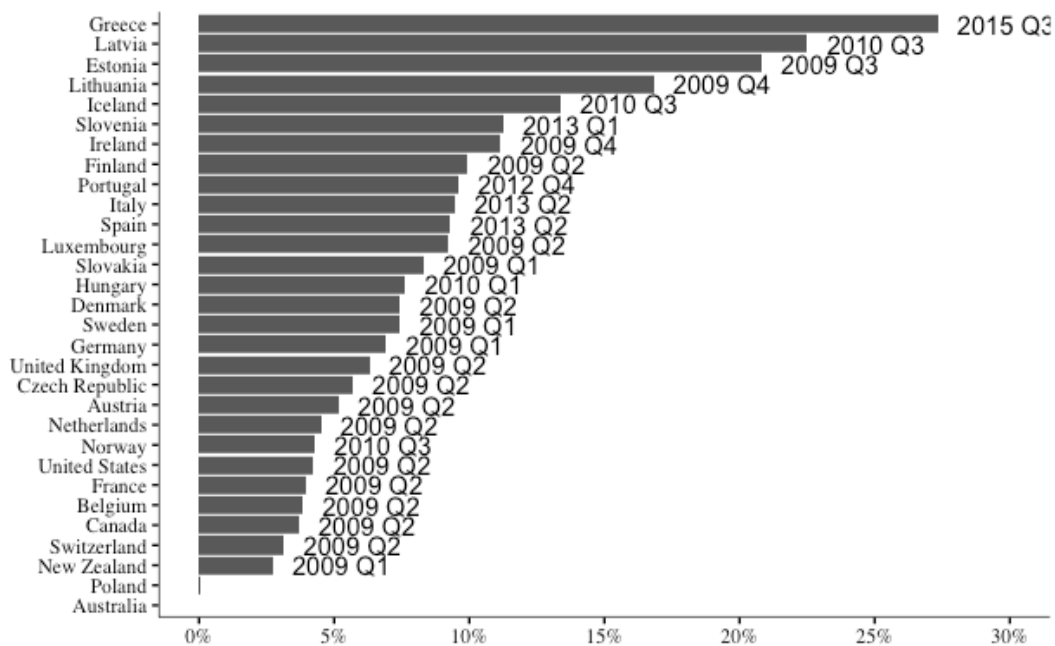
As the figure shows, Greece was unique in its precarious position on both indicators, having accumulated large public debts as well as being reliant on capital inflows before the crisis began. Italy and Belgium also had extremely high levels of public debt, although they were not as reliant on foreign capital. Several other countries, however, entered the crisis with a large exposure to cross-border lending, including the Baltic States, Iceland, Spain, and Portugal.

As it turned out, the countries in the most precarious position at the onset of the crisis also incurred the largest direct costs due to the failure of financial institutions. The biggest direct costs were suffered by Iceland and Ireland, which each contributed over 40% of GDP from 2008 to 2011 to recapitalize financial institutions, with Greece already suffering the third largest costs, at just under 30% of GDP (Laeven and Valencia 2013). Greece's cost of the crisis increased even further as the crisis lingered on. The Netherlands and the United Kingdom also had considerable losses, with Denmark being the only other Nordic country (apart from Iceland) to bear considerable direct costs due to the restructuring of financial institutions. Most advanced economies, however, suffered negligible direct fiscal costs due to a banking crisis.

### **3.1.2 A World in Recession**

Even though an outright banking crisis only occurred in a couple of countries, their effects were felt throughout the global economy. Figure 3.3 shows the decline in quarterly real GDP from pre-crisis peak to post-crisis trough in 30

OECD/EU economies. The effects of the crisis on Greece stand out as particularly dire, with GDP contracting by well over 25% over the course of the crisis. The contraction in the other two countries most affected by banking crises, Iceland and Ireland, were considerably smaller at just over 10%. Several other countries experienced a similar or greater downturn in the Great Recession, even though their direct exposure to the fiscal costs of the Global Financial Crisis were limited. Thus, the economies of the three Baltic countries, Latvia, Estonia, and Lithuania, contracted by 23%, 20%, and 17% respectively and the economies of Italy, Portugal, and Spain each contracted by about 10%. Of the Nordic countries, Finland suffered the second largest drop in GDP after Iceland, at about 10%, while the contraction in Sweden, Denmark, and Norway amounted to 7%, 7%, and 4%, respectively.

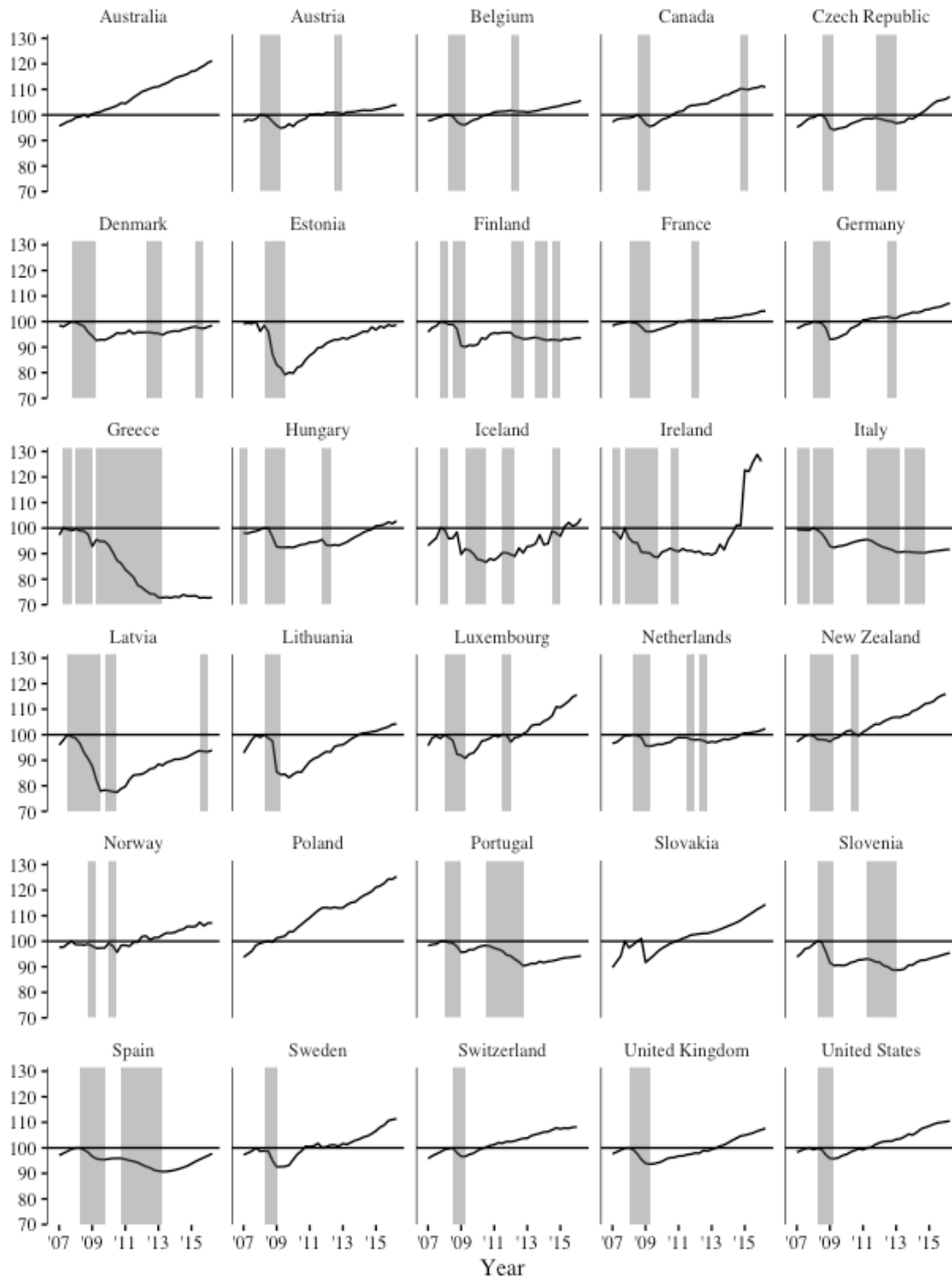


Source: OECD Quarterly National Accounts. Label shows quarter of trough.

**Figure 3.3: Decline in Quarterly Real GDP from Pre-Crisis Peak to Post-Crisis Trough (% , Seasonally-adjusted)**

In addition to varying in depth, the duration of the contraction differed considerably across countries, as well as the extent to which economies recovered from the drop in GDP. This was especially so for Eurozone countries on the periphery of Europe. While they were already in a precarious situation following the financial crisis, the announcement by Greek authorities in late

2009 that their budget deficit was much higher than previously believed fueled concerns about the sustainability of the government finances in Greece, as well as in Italy, Ireland, Portugal, and Spain (or the “GIIPS” countries, as they came to be collectively known) (Copelovitch et al. 2016).



Shaded areas show periods of two (or more) consecutive quarters of declining real Gross Domestic Product (GDP), a commonly used indicator of recessions. Source: OECD Quarterly National Accounts.

**Figure 3.4: Quarterly Real GDP, seasonally adjusted, 2007-2015 (Index, Pre-crisis Peak=100)**

Figure 3.4 shows how quarterly real GDP developed in our sample of 30 countries from 2007 to 2015, with periods of recession highlighted in gray. Comparing and contrasting the timelines of each case, shows several features which deserve emphasis.

Firstly, the toll of the crisis in Greece is without parallel in terms of depth, duration, and lack of recovery. After a long period of continuous contraction, GDP had settled at about a 30% lower value in 2015 than before the crisis. Second, Iceland and Ireland had both passed their pre-crisis peak GDP in 2015, with growth in Ireland being especially fast in the last couple of years.<sup>2</sup> Third, the Baltic states have enjoyed continuous growth for multiple years after sharp declines in economic output during 2008-9. Fourth, the Southern European neighbours of Greece — Italy, Portugal, and Spain — all experienced a sizable recession around 2012, amid fears of a default on sovereign debt. Both Italy and Portugal remain well below their pre-crisis GDP peak. Finally, the Nordic countries have fared quite differently over the course of the past six years. While Norway and Sweden (and Iceland) are recovering, economic growth in Denmark and Finland remains sluggish and they are still below their pre-crisis peak at the time of writing. This is so, even though these countries entered the recession with relatively low public debt and suffered limited costs due to restructuring of financial institutions.

The overall picture of the effects of the crisis on economic conditions, thus, varies considerably across countries with seemingly little connection to the extent of the initial costs of the Great Recession. The Greek case is a clear outlier with respect to the depth and duration of the crisis, and their poor recovery. However, in several other deep crisis countries, such as Iceland, Ireland, and the Baltics, the recovery has been strong, with little to indicate the initial severity of the crisis. Conversely, the initial effects of the crisis in Portugal, Italy, and Spain were

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<sup>2</sup> Note that in the first quarter of 2015, the Irish economy grew by over 20%. This phenomenal growth rate is largely attributable the relocation of large multinational companies to Ireland in the period, rather than changes in the underlying economy. See European Commission (2016a) for further details.

rather limited, but with the escalation of the Eurozone crisis, the crisis situation lasted for a relatively long period and even still the economic outlook remains bleak, at least in Portugal and Italy. Finally, several countries, such as Denmark, Finland, and the Netherlands, did not suffer a large economic contraction following the crisis, but have nonetheless not experienced a return to pre-crisis growth in the period since the Great Recession. Clearly, factors other than the severity of the initial downturn affected how countries recovered from the crisis.

### 3.2 Economic Wellbeing and Government Policy Responses

While the initial policy response by governments was focused on saving financial institutions and staving off a global recession, the effects of the crisis on the economic wellbeing of individuals and households came to the fore as the crisis unfolded. How governments subsequently acted was heavily characterized by two dimensions of “rebalancing”, internationally and domestically (Frieden 2015).

Internationally, countries running a large current account deficit in the lead up to the crisis were forced to swiftly reduce aggregate consumption and increase exports, to regain their current account balance. As cross-border lending came to a sudden stop, this required several countries to seek assistance from international institutions to buffer the speed of the required adjustment.

Iceland was the first when it entered an IMF program in November 2008, Latvia entered into an agreement with the IMF and European Union in December 2008, while Greece, Ireland, Portugal, and Cyprus each entered macroeconomic adjustment programs with the “Troika” of the IMF, the European Commission, and the European Central Bank. Greece agreed to its first bailout in May 2010, a second bailout in February 2012, and a third bailout in July 2015; Ireland entered into an agreement with the Troika in November 2010; Portugal in May 2011, and Cyprus in March 2013. Furthermore, Spain sought out assistance from the Troika in June 2012 to recapitalize the banking system, but did not enter a macroeconomic adjustment program as the other six countries. The adjustment programs each involved conditions requiring the countries to take rapid steps to reduce the budget deficit, effectively forcing the countries to give up their policy



autonomy and eroding their ability to provide social protection to the general population (Baldwin et al. 2015). The required austerity measures caused a heated conflict between creditor and debtor countries, with creditors demanding swift domestic adjustment from debtors and debtors requesting a longer adjustment period (2015, 6).

Domestically, governments sought to minimize the effects of the crisis on aggregate demand. Their ability to do so, however, was constrained by the state of public finances at the onset of the crisis, the direct fiscal costs of the crisis, as well as the extent to which international rebalancing was required. For current account deficit countries with an independent currency, e.g. Iceland, an exchange rate depreciation could shoulder part of the necessary adjustment. For other countries, however, much of the adjustment was accomplished internally, through painful macroeconomic austerity (Copelovitch et al. 2016).

In what follows, we outline changes and continuity in government policies aimed directly at ameliorating the effects of the crisis on economic wellbeing. As argued by Pontusson and Raess (2012), the policy menu available to governments was much narrower than in earlier crises. Thus, protectionism, currency devaluations, nationalizations, and industrial policies were mostly off the table, and although monetary policy played a crucial role in stimulating economies throughout the crisis, it is no longer directly under the control of elected national official, making it more uniform across countries (e.g. see Mandelkern 2016). Thus, fiscal policy came to play a central role in the crisis response of governments.

We begin by outlining whether governments employed fiscal policy to maintain aggregate demand throughout the crisis by way of a fiscal stimulus or whether they focused on austerity measures to balance the budget and current account. We go on to delineate the relative effects of automatic stabilizers and discretionary policymaking, focusing separately on changes in government taxation and expenditures. Finally, we outline the extent to which tax and benefit systems were changed in response to the crisis. Ultimately, government policy reactions along these dimensions had much to do with how well or poorly the

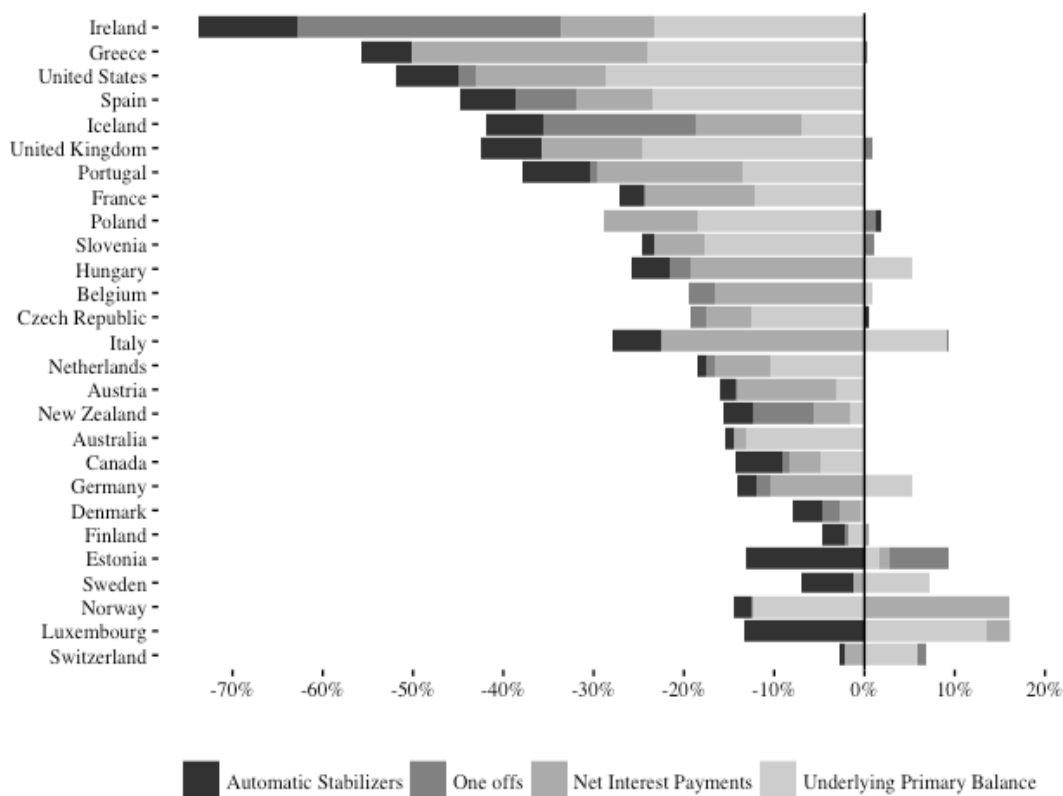
economic wellbeing of the general population was shielded from the effects of the crisis.

### 3.3 Fiscal Policy

The Great Recession led to a deterioration of the budget deficit for almost all advanced economies. While the shift was mild for most countries, several countries amassed significant amounts of new debt. Figure 3.5 shows the cumulative budget balance for OECD countries over the first four years of the crisis. The countries on the figure are ordered from the most negative to the most positive cumulative budget balance and the balance itself is decomposed into four main components, which are further discussed below.

Looking at the total cumulative budget balance reveals that the countries hit hardest by the crisis generally accumulated the most debt in the years following the onset of the crisis. Ireland amassed over 70% of GDP in new debt, with Greece, the United States, Spain, the United Kingdom, Portugal, and Iceland also accumulating significant debt. For the aforementioned countries in the EU (all but Iceland), as well as 21 other EU countries, the deficits triggered the excessive deficit procedure (EDP) of the EU's Stability and Growth Pact, which stipulates that yearly deficits should not exceed 3 percent of GDP unless they are "exceptional and temporary" (European Commission 2016b). With the EDP triggered, governments were expected to restore fiscal balance rapidly by pursuing austere policies in the next two to three years (Cameron 2012, 102).

However, not all deficits are created equal in terms of their impact on the economy and economic wellbeing. In particular, the cumulative budget balance combines the results of discretionary policymaking following the crisis, the workings of automatic stabilizers, net interest payments, and direct fiscal costs due to the crisis. Thus, it does not allow one to easily gauge the overall fiscal policy choices made by authorities, nor their incidence over the course of the crisis.



Countries ordered from largest to smallest cumulative budget deficit. Positive (negative) values indicate a budget surplus (deficit). Norwegian data is for mainland Norway. Source: Author calculations based on OECD Economic Outlook No. 98.

**Figure 3.5: Decomposed General Government Cumulative Budget Balance, 2008-2012 (% of GDP)**

The decomposition of the budget balance in figure 3.5 shows, in admittedly crude fashion, the relative shares of the four constituent parts. While interpretations based on such a decomposition can be problematic (e.g. Devries et al. 2011), it allows one to compare rough estimates of the different components for each country, as well as across countries.

Two components — one-offs and net interest payments — reflect constraints on fiscal policymakers, rather than policies enacted to affect the macroeconomy directly. The former includes bank recapitalizations, while the latter includes interest payments on loans, which often accrue to actors outside of the economy. However, the other two components — automatic stabilizers and the underlying primary balance — come closer to capturing the parts of fiscal policy which impact more directly upon current economic wellbeing.

Automatic stabilizers consist of automatic changes to revenues from taxes and expenditure on social benefits due to the position of the business cycle. In

downturns, when economic activity contracts, automatic stabilizers will automatically inject a fiscal stimulus into the economy, since less revenue will be collected from taxes (e.g. due to lower income and less profit) and more will be spent on social benefits (e.g. due to more unemployment). The size of automatic stabilizers — i.e. the sensitivity of taxes and transfers to changes in GDP — differs across countries and as such their effects will differ due to policy differences, as well as due to differences in the size of the economic contraction.<sup>3</sup>

Finally, the underlying primary balance reflects the budget balance net of the effects of the previous three components. It is often taken as an indicator of discretionary policymaking by governments, i.e. the budgetary policy changes actually made by policymakers.<sup>4</sup> As such, a more negative underlying primary balance from one year to another is associated with a fiscal stimulus, while a more positive balance is associated with austerity measures.

The figure shows the cumulative size of these four components over the first four years of the crisis, revealing several patterns of interest. On the one hand, the decomposition reveals the massive costs of one offs and net interest payments for the deep crisis countries, especially Ireland, Greece, and Iceland. These reflect the costs associated with bailing out and/or recapitalizing financial institutions, as well as interest payments due to loans granted by the IMF and EU institutions. Countries entering the crisis with high levels of public debt, such as Italy and Belgium, similarly contribute a significant share of their budget towards interest payments. Importantly, when analyzing the implications of policy responses for economic wellbeing it is necessary to look beyond the costs of one offs and net interest payments.

On the other hand, the decomposition reveals that almost all 27 countries accumulated significant deficits due to the workings of automatic stabilizers and/or discretionary fiscal policy over the period from 2008 and 2012. In this

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<sup>3</sup> Price et al. (2015) provides further information on the methodology used by the OECD in calculating the size of the automatic stabilizers.

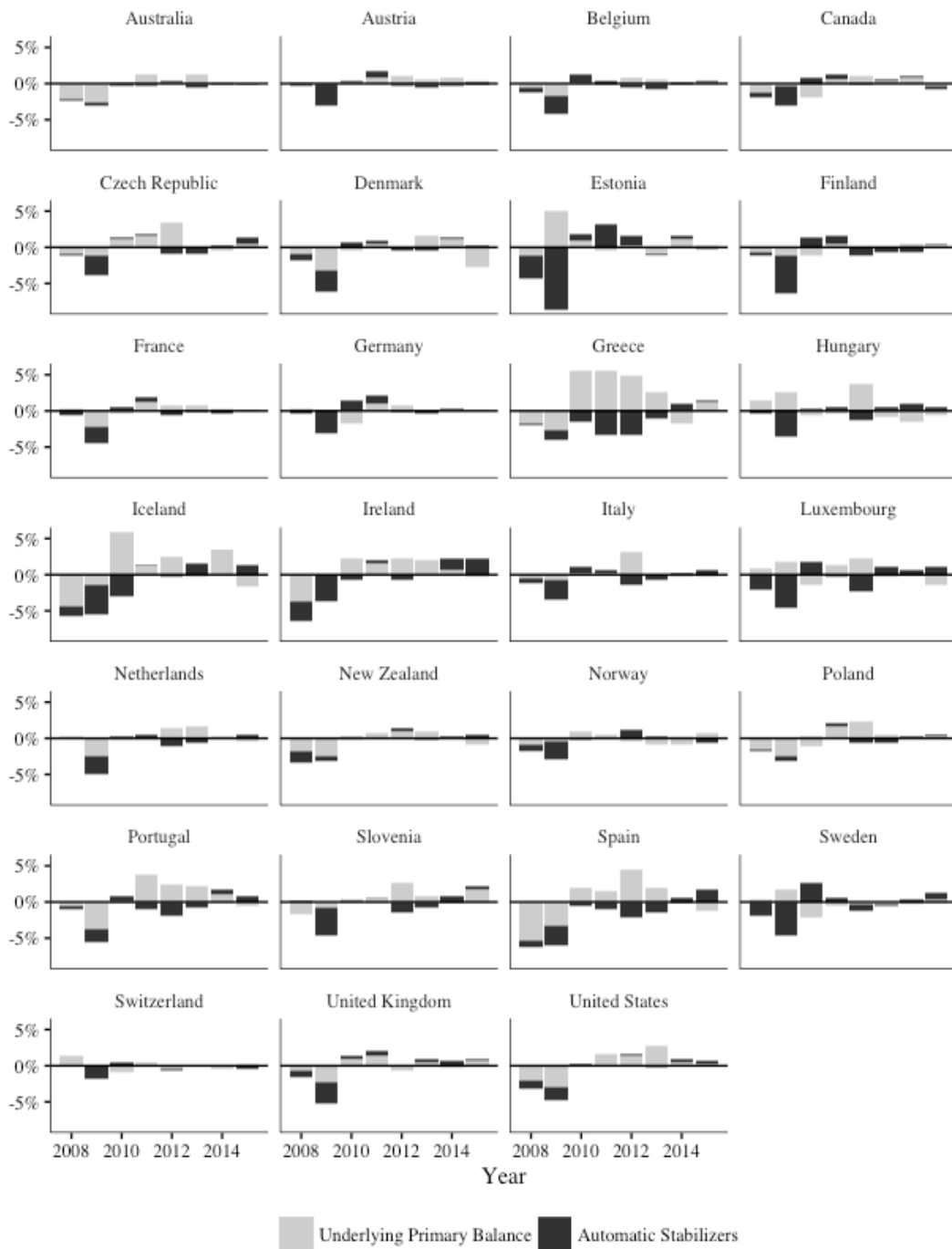
<sup>4</sup> See, for example, Raess and Pontusson (2015) and Armingeon (2012). For a critique of the measure, see Guajardo et al. (2014).

regard, the liberal market economies (the US, the UK, and Ireland) stand out, accumulating over 30% in new debt due to these two factors, with deep crisis countries in Southern Europe (Greece, Spain, and Portugal) following suit with over 20% accumulated. Interestingly, discretionary spending seems to have played the most significant role in countries with weak automatic stabilizers, such as the liberal market economies, which underlines how each of the two components can partly substitute for the other.

### **3.3.1 Automatic Stabilizers and Discretionary Fiscal Policy in the Crisis**

While figure 3.5 highlights the cumulative build up of budget deficits, it does not reveal the extent to which countries pursued a policy of fiscal stimulus or austerity. Figure 3.6 takes up this task by showing year-on-year changes in spending due to automatic stabilizers and discretionary fiscal policy, with positive values indicating fiscal tightening and negative values indicating a fiscal stimulus. Trends in these factors are shown for 27 OECD countries, although most of the variance in the measures can be attributed to the countries hit hardest by the crisis.

Several factors reveal themselves in the figure. For one thing, automatic stabilizers played a crucial role in stimulating the economy at the onset of the crisis. Since they respond automatically to downturns, they are more likely to provide a timely response than any discretionary measures passed by policymakers, since the latter have to go through all parts of the policymaking process before being felt in the real economy (Baunsgaard and Symansky 2009). Unsurprisingly, automatic stabilizers provided the largest stimulus in countries most affected by the crisis. However, they also provided a relatively large buffer in the Nordic countries most affected by the crisis. This is so, since the size of the stabilizers are determined by both the size of the economic contraction, as well as the overall sensitivity of the budget balance to the business cycle, with tax and transfer policies in the Nordic countries structured to respond strongly to drops in GDP (Price et al. 2015).



Positive (negative) values indicate that the component decreases (increases) the budget deficit. Norwegian data is for mainland Norway. Source: Author calculations based on OECD Economic Outlook No. 98.

**Figure 3.6: Year-on-Year Changes in Components of the Budget Balance, 2008-2015 (% of GDP)**

Thus, in 2009 automatic stabilizers accounted for a strong fiscal stimulus in all five Nordic countries, with discretionary measures, furthermore, playing a limited role in stimulating the economy in Sweden, Finland, and Norway. As the countries progressed through the crisis, automatic stabilizers continued to

dominate the policy response in these three countries, while discretionary policy played a larger role in Iceland and Denmark. As countries recovered from the crisis, the effects of the automatic stabilizers diminished, although they continued to have a sizable impact in the countries most affected by the Eurozone crisis; Greece, Portugal, and Spain.

More importantly, policymakers in most countries responded initially by enacting discretionary measures designed to support the automatic stabilizers in stimulating the economy (Armingeon 2012; see also Cameron 2012). Such forceful Keynesian policies were strongly supported by mainstream economists and international institutions at the time to stave off a global recession (e.g. Spilimbergo et al. 2008). However, from 2010 onward there was a decisive shift toward balancing the budget. Thus, governments of the countries most affected by the crisis all implemented strong austerity measures and, by doing so, decreased the underlying primary deficit. The reversal in Greece is especially prominent, with the government implementing a multi-year package, greatly reducing the underlying primary balance deficit.

Overall, government fiscal policy responses was quite varied across countries and through the different stages of the recession. Automatic stabilizers played a particularly important stimulating role during the earlier stages of the Great Recession, especially in deep crisis countries and the Nordic countries. Such automatic policies buffered the effects of the crisis on household income. As time passed and the global financial crisis abated, discretionary fiscal policy measures began to play a larger role. In all deep crisis countries, governments pursued a variety of austerity measures, which were designed to rapidly reduce the budget deficit, exactly at a time when further stimulus spending would have provided a larger buffer to the economic wellbeing of households still greatly affected by the crisis. Greek authorities implemented the most severe austerity measures, although Iceland, Ireland, Portugal, and Spain each reduced the budget deficit significantly in the years after 2009. During that time, Greece, Iceland, Ireland, and Portugal, were each participants in IMF programs.

### 3.4 Social Protection

A great deal has been written about the effects of austerity on economic growth, with the emerging view suggesting that episodes of fiscal consolidation reduce aggregate output (Guajardo et al. 2014). Furthermore, these negative effects seem to be especially dire when they are tax-based, rather than expenditure-based (Alesina et al. 2015). That is to say, fiscal consolidation plans driven by tax increases seem to be more damaging to economic growth than those driven by expenditure cuts.

#### 3.4.1 The Consequences of the Composition of Austerity Measures

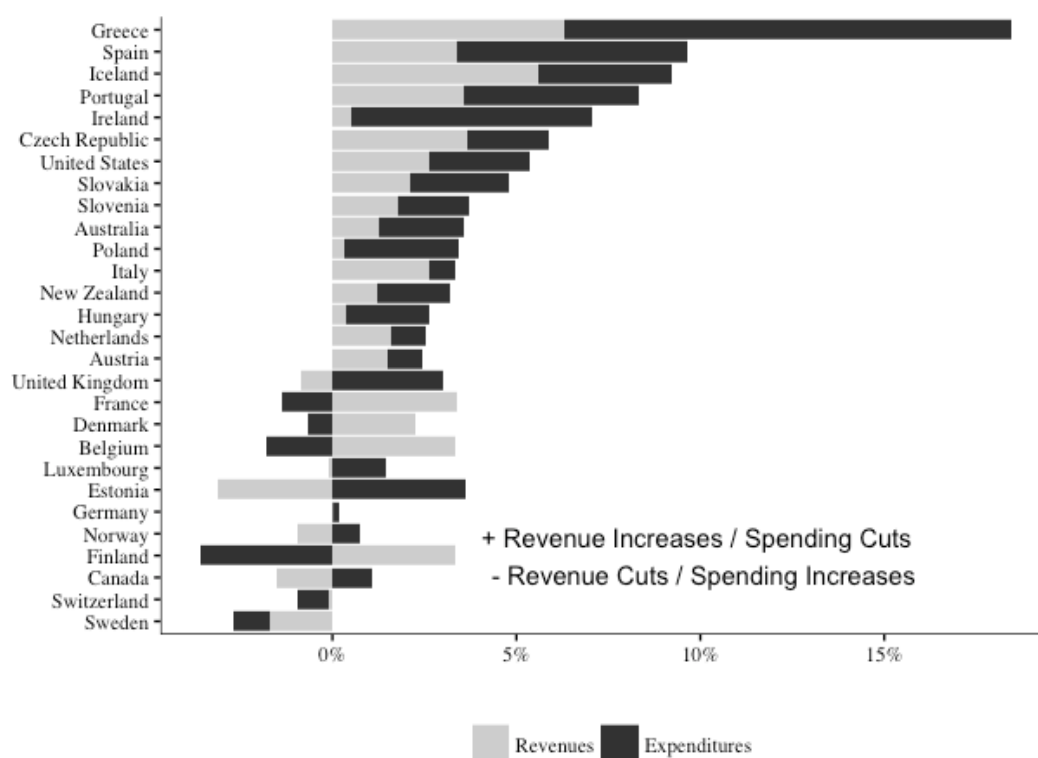
When analyzing the effects of austerity on wellbeing, however, the reverse association seems to hold true. Thus, both Ball et al. (2013) and Agnello and Sousa (2014) find that tax-based fiscal consolidation episodes reduce income inequality, but that expenditure-based episodes are associated with sharp increases in inequality. This is perhaps unsurprising, since expenditure-based austerity measures are generally focused on reducing benefit generosity and the government wage bill, which hit lower and middle income groups the hardest, while tax-based measures are more likely to fall on the better off. The composition of austerity measures, thus, matters a great deal to the effects of austerity on economic wellbeing.

Figure 3.7 decomposes the cumulative underlying primary balance for the period 2009 to 2013 (the main years of fiscal consolidation) into its revenue and expenditure parts, thus allowing for the comparison of the relative sizes of tax-based and expenditure-based austerity measures. Positive values on the measures indicate fiscal tightening, i.e. that higher revenues are collected or that expenditures are lower in 2013 compared to 2009, while negative values indicate fiscal stimulus, i.e. that lower revenues are collected or that spending has increased.

Again the figure demonstrates the severity of the crisis and policy response in Greece, with the authorities implementing both large revenue increases as well as expenditure cuts. Trailing Greece by some margin come the other four countries most affected by the crisis, Spain, Iceland, Portugal, and Ireland.



Interestingly, while the balance of tax-based and expenditure-based austerity measures in Spain and Portugal are similar to Greece, Iceland and Ireland pursued considerably different compositions. Thus, a relatively large share of the Icelandic measures were based on revenue increases, primarily affecting the higher income groups, with more limited expenditure cuts (Ólafsson 2016a). Meanwhile, the bulk of the Irish measures were based on expenditure cuts. In terms of their effects on wellbeing, these compositional differences should have quite different distributional implications, as highlighted by Blyth (2013).



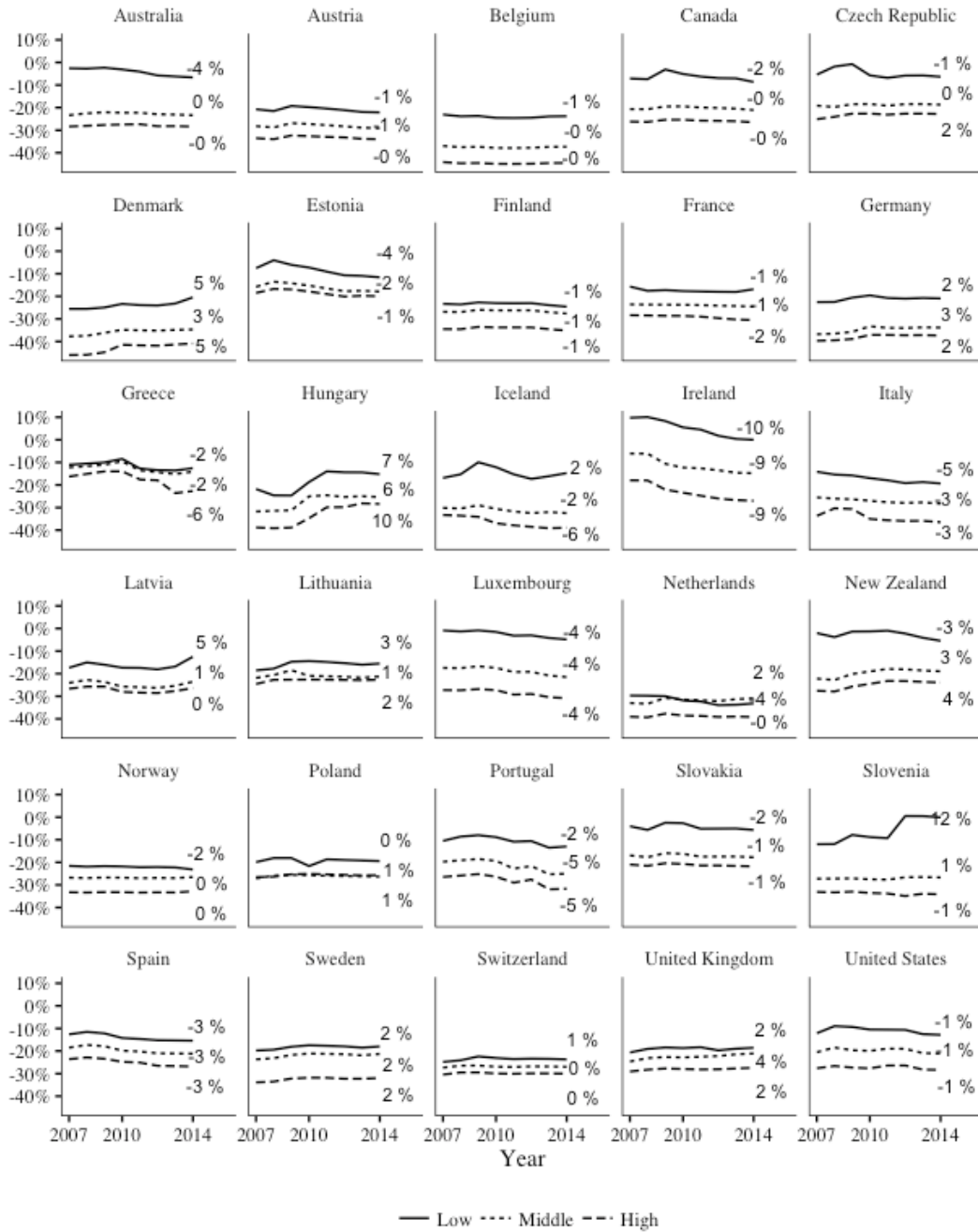
The bars show cumulative changes to underlying primary revenues and spending from 2009 to 2013. Positive (Negative) values indicate an austere (stimulating) budget position. The countries are ordered by the sum of the two bars. Source: OECD Economic Outlook No. 98.

**Figure 3.7: Cumulative Changes to Underlying Primary Revenues and Expenditures, 2009-2013 (% of Potential GDP)**

### 3.4.2 Income Support for Working Households

Figure 3.8 attempts to shed light on these policy differences with the help of the OECD Tax-Benefit Model (2016). The model includes yearly national policy profiles on various redistributive policies and allows for a rough and ready analysis of how cumulative changes to these policies affect the disposable income of selected household types. While such a model necessarily involves the

comparison of a restricted set of household types, it gives insight into the broad contours of policy changes over the period in question (for an early application of this approach to comparative policy analysis, see Bradshaw et al. 1993).



Note that earnings for the reference worker in Ireland are based on an 'Average Production Worker', rather than an 'Average Worker', which inflates the net effect. Numbers shown to the right of each line show the cumulative change (in percentage points) from 2007 to 2014 for each household type. For additional details, see surrounding text and OECD (2016).

**Figure 3.8: Net Effects of Taxes and Transfers by Household Income, 2007–2014 (% of Market Income)**

Developments in the net effects of taxes and transfers on household income are shown in the figure. Transfers consist of family benefits, housing benefits, in-work benefits, and social assistance, while taxes consist of income taxes and employee social security contributions. The examples in the figure are based on a model of two earner families with two children at three levels of market income: i) Low: 100% of Average Worker (AW) market income and nonworking spouse, ii) Middle: couple each with 100% AW income, and iii) High: 200% of AW income and spouse with 100% of AW income. Since the only factor varying among the three model families is market income, it allows for a direct comparison of changes in the distributional effects of redistributive policies. Finally, by standardizing income with current average worker income, the comparison is focused squarely on how policies change over the time period and affect identical households differently.<sup>5</sup>

Overall, the figure reveals considerable stability in the overall effect of the main redistributive policies on households not directly affected by the crisis (e.g. due to unemployment). Thus, the global financial crisis did not usher in a period of great retrenchment or expansion of income support for working families. Similarly, in most cases the developments for the three household types within each country are parallel, suggesting that tax-benefit systems generally did not become more or less progressive over the course of the crisis.

There are, however, a couple of notable exceptions. Ireland stands out as a case of considerable change, with the net effect of taxes and transfers for all household types declining by 9-10 percentage points from 2007 to 2014. Thus, for example, while the net effect for families with low income was about +10% of their market income in 2007, it was down to 0% in 2014 (i.e. they paid as much in taxes then as they received in benefits). This is in line with the data shown in figure 3.7, which suggests that the austerity measures enacted by Irish authorities were mostly expenditure based.

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<sup>5</sup> For additional details, see OECD (2016)

Similarly, developments in Iceland stand out, although for different reasons. As the figure highlights, developments of redistributive policies differed considerably based on household income, with tax-benefit policies becoming slightly more generous for low income households, but considerably smaller for high income households. The data, thus, underline how the “strategy of redistribution” shifted the burden of adjustment from low to high income households in the Icelandic case (Ólafsson 2016a).

In addition to Iceland, Slovenia stands out as exceptional with regard to increasing the redistributive effects of taxes and benefits during the crisis. Besides Ireland, other notable regressive cases include Estonia, Greece, Italy, Portugal, and Spain. For most countries, however, the overall effects of taxes and transfers on household income for working families remained roughly constant over the crisis period.

### **3.4.3 Income Support for the Unemployed**

A similar story of stability can be told about unemployment benefits, which are the primary tool for income replacement for those directly affected by the crisis through the loss of employment.<sup>6</sup> Figure 3.9 shows the initial net unemployment replacement rate (NURR) in 2007 as a share of previous earnings for a two earner family (one spouse unemployed) with two children, each earning 100% of average worker (AW) market income prior to the unemployment spell. The figure also shows the change in the rate (in percentage points) from 2007 to 2014.<sup>7</sup>

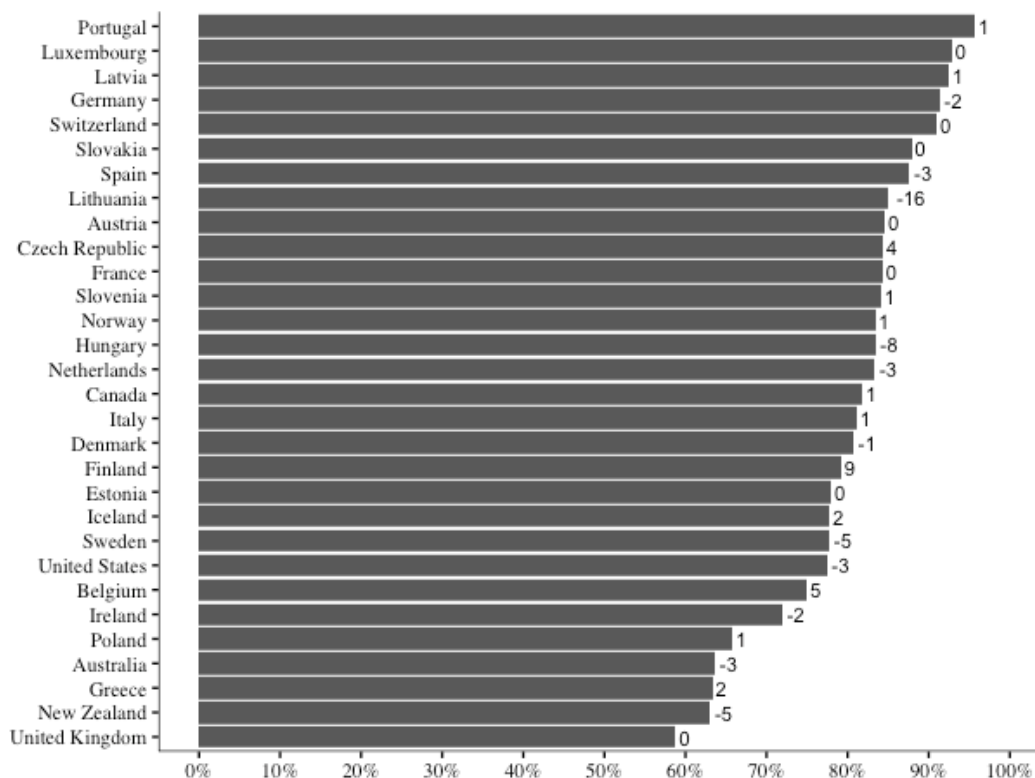
For most countries, the rate was next to constant over the time period. Lithuania, though, stands out as a case of significant retrenchment, with a 16 point drop in the rate, from 85% in 2007 to 69% in 2014. The rate also dropped significantly

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<sup>6</sup> It should be noted that initial replacement rates for particular household types are only one of many relevant dimensions of unemployment benefit generosity. Other important dimensions include benefit duration, as well as the extent to which benefits are earnings-related (Esser et al. 2013). Furthermore, for those not eligible for unemployment benefits, developments of minimum income protections are more important. These dimensions are not further examined here. (see Marchal et al. 2016 for minimum income protection in the crisis.)

<sup>7</sup> Supplements are included. For additional details, see OECD (2016).

in Hungary (8%), Sweden (5%), and New Zealand (5%), countries affected quite differently by the crisis. In only two countries did the rate increase significantly: In Finland by 9 points and in Belgium by 5 points.



See surrounding text for further details. The number to the right of each bar shows the change from 2007 to 2014, in percentage points. For additional details on the methodology, see OECD (2007).

**Figure 3.9: Initial Net Unemployment Replacement Rates in 2007 (% of Previous Earnings)**

While the aftermath of the crisis did not bring about much change in the rate, the absolute level of income replacement did differ significantly between countries. Thus, while the average worker becoming unemployed in Portugal would receive over 90% of his/her previous earnings during the initial phases of unemployment, an identically situated individual in the United Kingdom would receive less than 60% of his/her previous income. In fact, the countries most affected by the crisis are widely distributed along this measure: Along with Portugal, the replacement rate is fairly high in Spain, Iceland is around the middle, while it is quite low in Ireland and Greece. Clearly, these differences in national unemployment policy profiles suggest that individuals that lost their

employment during the Great Recession and thereafter fared quite differently, based on their country of residence.

Overall, social policy developments from 2008 onward have, thus, been more characterized by continuity than change. While specific elements of tax and benefit systems may have changed, the relative importance of taxes and transfers have remained constant throughout the crisis and post-crisis period for different income groups in most countries. This further highlights the importance of the policy setting at the onset of the crisis. However, there are notable exceptions to this trend, which can be seen as more representative of fundamental changes. In that regard, Ireland stands out as a particularly regressive case, with the net effects of taxes and transfers being reduced for low, middle, and high income groups alike. At the other end of the spectrum, Iceland stands as a progressive case, with taxes and benefits becoming more generous for low income households, while becoming less generous for high income households. These differences in social policy developments are likely to have divergent consequences for the economic wellbeing of households in the two countries.

### 3.5 Discussion

The Global Financial Crisis culminated in the winter of 2008-09 as financial institutions around the world teetered on the brink of collapse. The crisis spawned the Great Recession, which involved the largest economic contraction in advanced economies in the post-war era. While the effects of the crisis were particularly devastating in Greece, multiple countries experienced severe domestic recessions in the years following the peak of the crisis. This was especially so for countries that entered the crisis in a precarious fiscal position, as they were highly vulnerable to the sudden stop in cross-boarder lending that developed amid fears of banking and sovereign defaults. The countries most affected, including Latvia, Ireland, Iceland, and Portugal, were forced to seek out the assistance of international lenders of last resort to stave off an economic collapse. Although the effects of the Great Recession were most pronounced in

these deep crisis countries, almost all OECD countries experienced a recessionary period in the aftermath of the crisis.

The crisis led to a deterioration in the budget balance of most countries in the first years after the crisis. While the restoration of financial institutions and interest payments due to debt obligations were particularly costly for the deep crisis countries, all governments provided some form of fiscal stimulus in the initial stages of the Great Recession. Automatic stabilizers played a particularly large role in buffering the initial effects of the crisis on aggregate demand, while discretionary stimulus measures were also employed to support their workings at the height of the crisis. However, from 2010 onward harsh austerity measures were generally introduced, most markedly in deep crisis countries.

Even so, not all austerity measures were designed in a similar fashion. Governments in several countries, including Greece, Spain, Ireland, and the United Kingdom, focused on spending cuts, which were likely to have dire consequences for individuals and households most in need of social support after the crisis. Meanwhile Iceland stands out as a deep crisis country that went the opposite route, prioritizing revenue increases over spending cuts in their fiscal consolidation plans. Although not hit as hard by the crisis, a similar pattern can be seen in the other Nordic countries.

Although these policy differences are likely to be consequential for economic wellbeing, the overall story for tax and benefit policies in the crisis is one of continuity rather than change. This suggests that the policy setting at the onset of the crisis was substantially more important for the wellbeing of those affected by the crisis than any discretionary policy changes made during the crisis years. On balance, countries with more generous welfare states at the onset of the crisis were, thus, better positioned to shield the wellbeing of the general population.

## 4 Wellbeing Consequences of the Crisis

Following the overview of macro policies of governments in response to the crisis we focus in this chapter on the micro level of households. The aim is to give an overview of wellbeing consequences of the crisis for the general public in our countries – how the crisis affected the level of living.

It is of course well known, often seen as almost self-evident, that crises reduce the level of living of the general population. Crises are typically seen as bad for everybody. We have seen how almost all Western nations experienced a contraction of their gross national product following the onset of the crisis. The extent of contractions was however very variable.

Some European countries were only very lightly touched by the crisis. For them the crisis perhaps primarily reflected reduced opportunities for further growth – a small temporary setback. For those that went deep into the crisis it was a completely different affair. Hence we will in much of our presentation of wellbeing indicators look to start with at the situation either for the whole group of about 30 European countries, or work with groups of countries, including deep-crisis countries and others that did not go as deep into crisis.

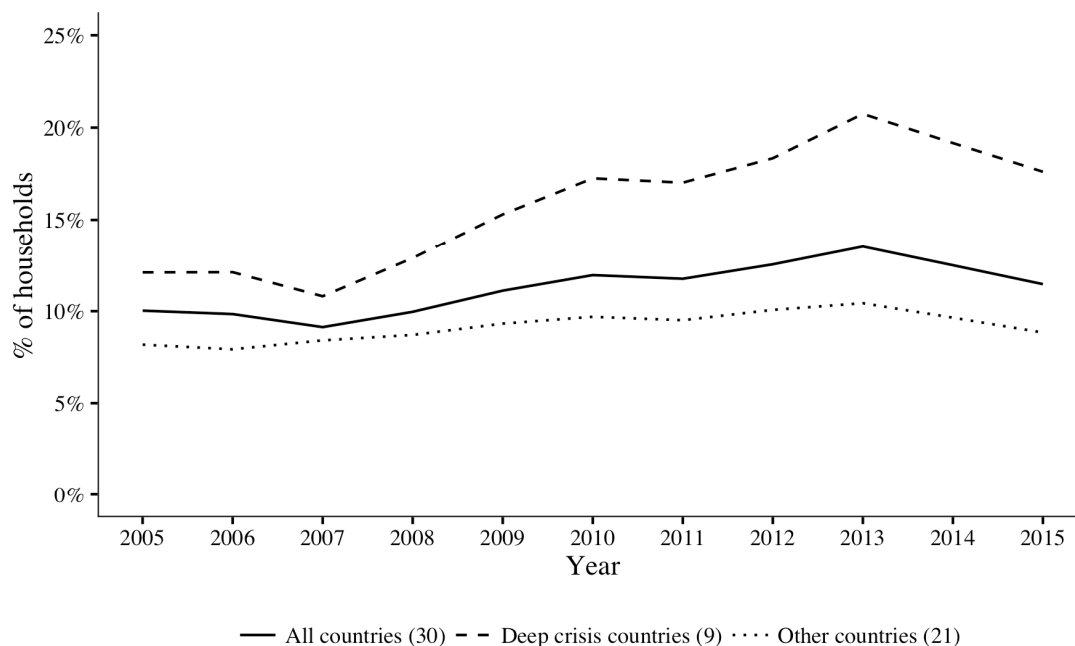
We mainly profile unemployment developments, relative poverty (anchored in 2005) and financial hardship experienced (“great difficulty in making ends meet”). We also look at developments of disposable incomes and inequality. These are all important indicators of levels of living or wellbeing of the populations. We are particularly interested in how the burdens of the crisis were shared amongst different income or socio-economic groups.

### 4.1 Unemployment Experiences

First we look at unemployment developments, shown in figure 4.1. In the years leading up to the crisis there was a mild trend towards lower unemployment levels (from 7.1% to 6.2% for all the 32 Western countries). From 2007 to 2010 there was then a swift increase, from 6.2% to 9.7% in 2010 for the whole group. Most of the increase came in late 2008 and in 2009. The 11 deep-crisis countries



experienced a significantly greater increase, from 5.6% to 13.1%, a more than doubling. The unemployment level peaked at 13.8% in the deep-crisis countries in 2012-2013, before gradually coming down.<sup>8</sup> For all the countries the unemployment rate in 2015 is about the same as in 2009, so the problem has not at all been fixed yet. The deep-crisis countries still have almost twice as high a rate of unemployment in 2015 as they had in 2007.



Source: Eurostat. Proportion of households making ends meet with great difficulty

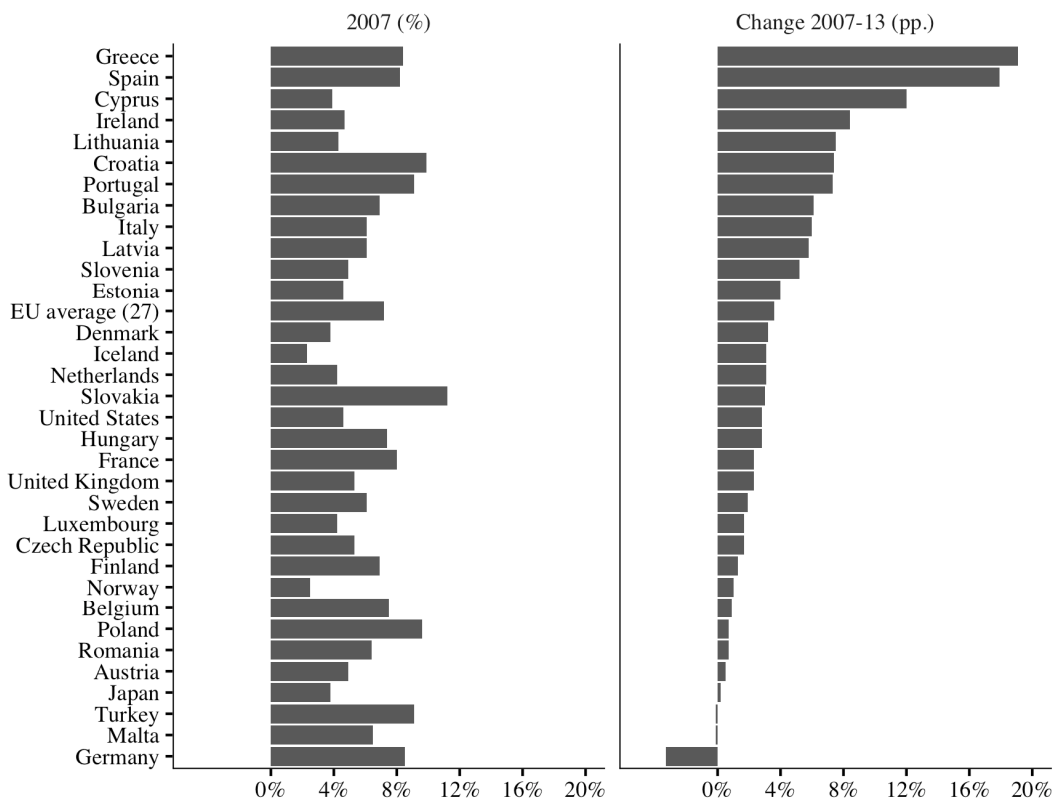
**Figure 4.1: Unemployment in Western countries, 2006-2015 (% of active population)**

If we focus on the 22 countries that did not go so deep into the crisis we can see that the rise was from 6.5% in 2007 to 8.1% in 2010 and 8.6% in 2013, before coming down to 7.9% by 2015.

So these countries that did not go so deep into the crisis are still in 2015 at a considerably higher level of unemployment than they were before the start of

<sup>8</sup> The deep-crisis countries in this data set are Greece, Estonia, Latvia, Lithuania, Iceland, Ireland, Spain, Portugal, UK, USA and Cyprus. This selection is somewhat arbitrary, in the sense that a few more countries should arguably have been included, such as Croatia, Italy, Bulgaria, Hungary and Slovenia. These countries experienced a considerable increase in unemployment level up to 2013. But as we show later the developments of other wellbeing indicators were to some extent different for individual countries.

the crisis in 2007-2008 (6-6.5%). Another interesting feature is that the deep-crisis countries were at a lower level of unemployment in their initial position in 2006 and 2007 than the countries that then did not go so deeply into the crisis. Hence the swing for the worse was quite dramatic for the deep-crisis countries. In figure 4.2 we show the change from 2007 to 2013 for all the 33 countries, as well as their initial position in 2007. Some were increasing from an already high level, while others were coming from a more modest unemployment level.



Source: Eurostat, EU-SILC data. The left column shows the unemployment rate in 2007. The right column shows the change in the rate (in percentage points) from 2007 to 2013.

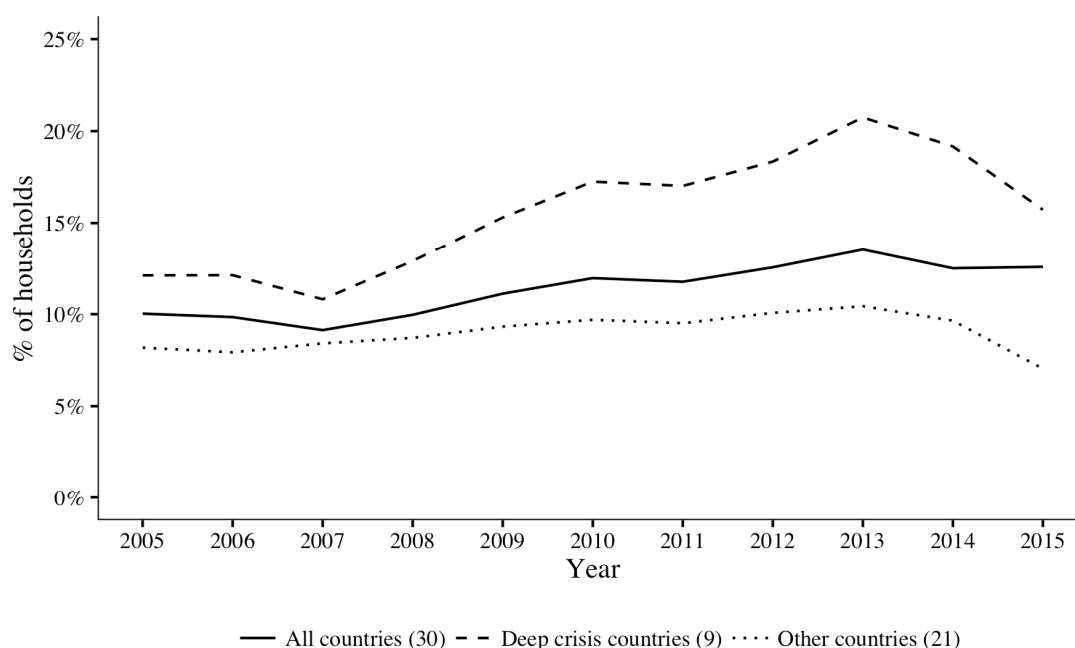
**Figure 4.2: Change in unemployment rates (%-points) and initial positions in 2007 (%) amongst European nations**

Greece and Spain stand out by far with the biggest unemployment problem in the crisis. Their unemployment increased massively from an already high level, peaking at about 26-27% by 2013. Croatia, Portugal, Bulgaria, Italy, Latvia, and Slovenia also suffered large increases on top of an already high unemployment level. Cyprus, Ireland and Lithuania, on the other hand, experienced large increases on a relatively low initial level. Iceland is quite different from Ireland in this context. Iceland's unemployment grew modestly on top of the lowest initial

level in this group of countries, when the reference period is 2007 to 2013. Unemployment in Iceland had, however, reached its peak in 2010 and had already come significantly down by 2013, and more so by 2015. So Iceland had a relatively good outcome on this variable amongst the deep-crisis countries. In comparison to the other Nordic countries, Iceland did in fact better on the employment front than Denmark, Sweden and Finland, that all started at a higher level than Iceland. Still Iceland's crisis was of course much deeper than that of these other Nordic nations. Germany is the deviant at the lower end, being the only country that significantly reduced its unemployment rate during the height of the crisis (up to 2013).

#### 4.2 Financial Hardship of Households

If we now look at financial hardship of households, shown in figure 4.3, we observe a quite similar overall pattern.

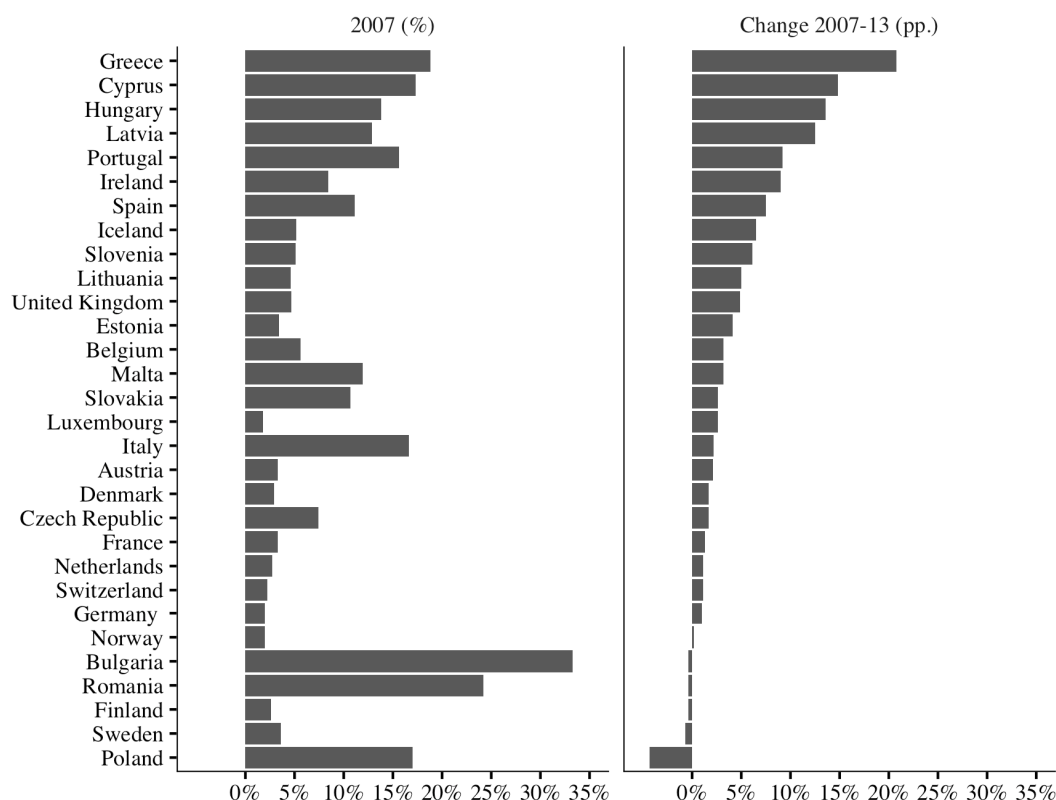


Source: Eurostat. Proportion of households making ends meet with great difficulty

**Figure 4.3: Financial Hardship of Households, 2005-2015**

The increase in financial hardship is more pronounced already in 2008 than was the case with the unemployment rate. But from 2007 to 2013 there was almost a doubling of the share of households in financial difficulties amongst the deep-crisis countries, from 10.8% to 20.7%. Amongst other countries the increase

went from 8.4% in 2007 to 10.4% in 2013. As with the unemployment rate the effects of the crisis are still very visible, since the deep-crisis countries are still a little above the level they had reached in 2009 (about 15%, up from 10.8% in 2007) and the other countries are closer to the level of 2008. The latter group is thus recovering somewhat better than the deep-crisis ones in this respect.



Source: Eurostat, EU-SILC data. The left column shows the rate in 2007. The right column shows the change in the rate (in percentage points) from 2007 to 2013.

**Figure 4.4: Change in financial hardship rates (%-points) and initial positions in 2007 (%) amongst European nations**

Greece comes on top again, with a massive increase in financial hardship on top of an already high level, ending with almost 40% of households saying they make ends meet only with great difficulty. Cyprus comes second, also with a large increase on top of a high level of financial hardship. Spain however does not rank as highly on financial hardship as might be expected in light of its great increase of unemployment. That indicates a relatively generous unemployment benefit system in Spain (see figure 3.9). Hungary and Latvia rank higher on the list of increased financial hardships than expected from the unemployment record, but Portugal and Ireland rank similarly on both measures.

Iceland however ranks somewhat higher on financial hardship, which most likely has more to do with its large decline of disposable earnings, due to the large devaluation of its currency at the beginning of the crisis. The same applies to the UK. Finland, Sweden and Norway did not experience any real increase in financial hardships of households and Denmark had only a modest rise. Italy, Malta and Slovakia had modest increases of financial hardships, but they came on top of an already high level.

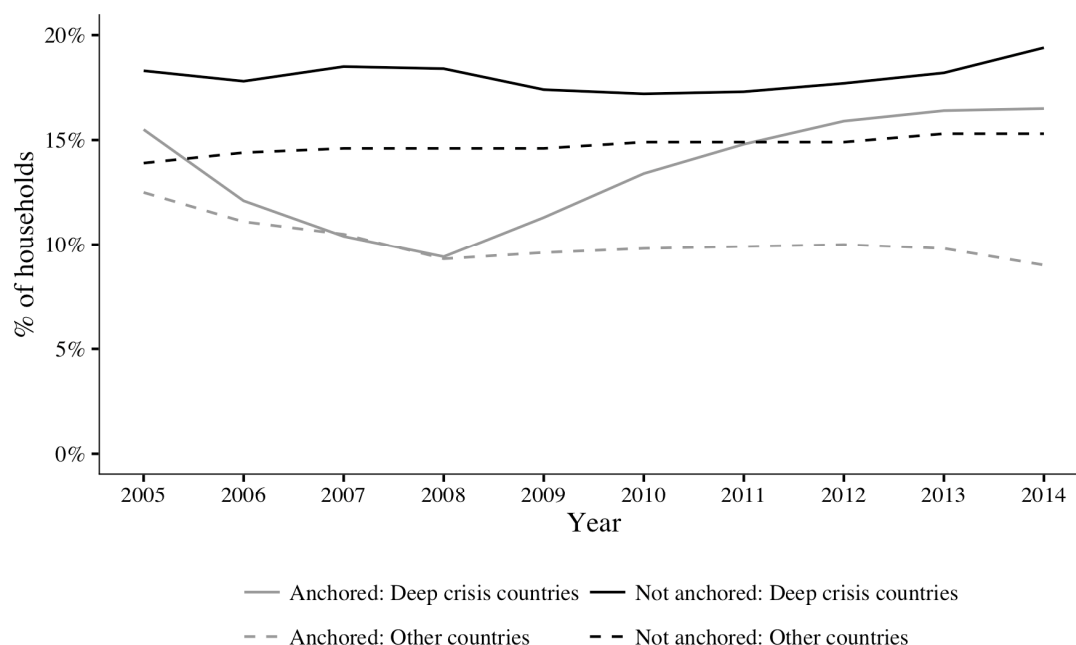
Romania and Bulgaria had the highest rates of financial hardship in 2007, but they decreased their rate slightly and Poland that also had a high rate in 2007 improved its position by some 4 %-points. Sweden and Finland similarly improved their position on that front a little, albeit from a very low level, as already indicated.

While there are a few deviations in the outcomes from these two measures of wellbeing we have covered so far, the general pattern is similar. The deep-crisis countries all experienced greatly increased unemployment problems and many of them also experienced large increases in felt financial difficulties amongst households in general.

### 4.3 Poverty Developments

Now we turn to measures of relative poverty development through the crisis. We use two poverty measures, with 60% of median equivalised household income as the poverty line in both cases: yearly relative poverty rates on the one hand and then poverty rates anchored in 2005 (with the poverty line from 2005 fixed through the period). This produces somewhat different results, with different interpretations. The former rate, the yearly relative poverty rate, indicates the size of the low-income group in relation to the yearly median income. A time series of that measure indicates then how the income of the low-income group developed in relation to the median. Did the lowest do better or worse than the median? If they did worse, we can say that the burden was disproportionately landed on their shoulder. The median households did better in those cases. The anchored measure shows how the lowest and the median did fare in relation to the standard they enjoyed in 2005 (the reference/anchor year). Figure 4.5 shows

how these two measures developed through the crisis, for deep-crisis countries and other countries.



Source: Eurostat, EU-SILC data.

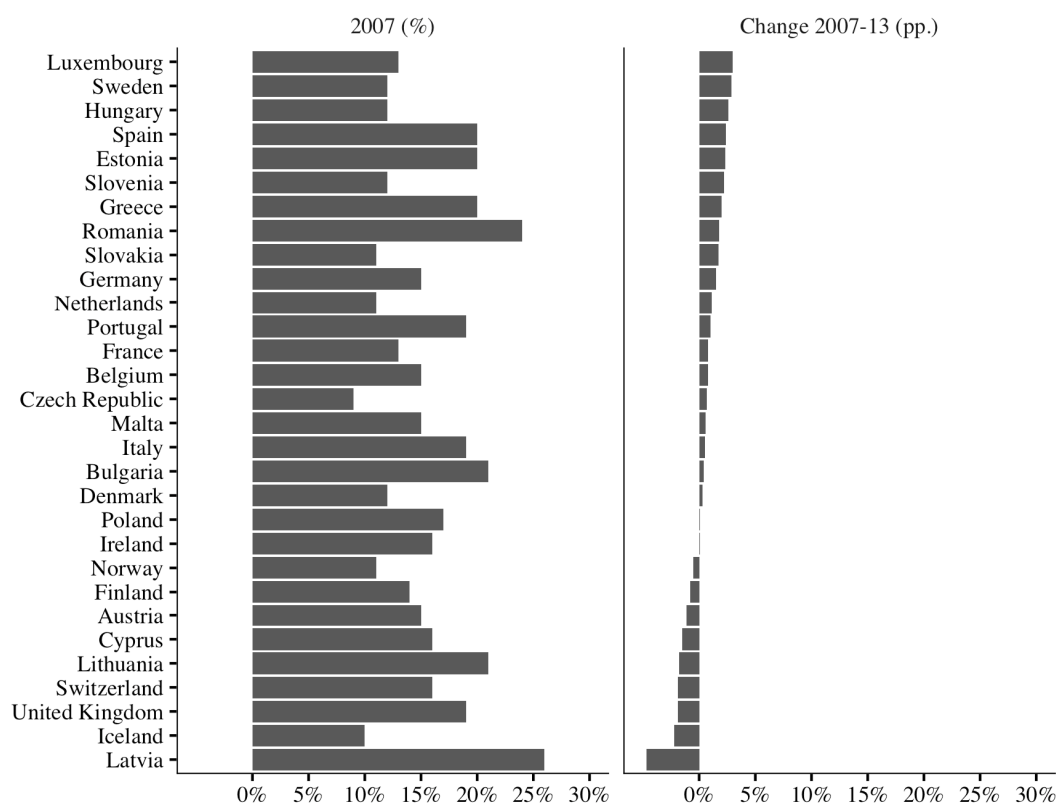
**Figure 4.5: Relative poverty rates (60% poverty line) from 2005 to 2014: Anchored in 2005 and not anchored compared.**

For the deep-crisis countries the relative poverty rate (the unbroken black line) declined with the onset of the crisis, indicating that the lowest income groups were sheltered to some extent in some countries, in the early stages of the crisis. Then it increased again after 2010, albeit modestly, indicating that the lowest did worse than the middle on the upswing. For other countries (not so deep in crisis – the broken black line) the relative poverty rate was gradually rising more or less throughout the period, indicating that the income growth of the lowest was slower than that of the middle in those countries. This is somewhat in line with the trend of the time towards increasing inequality in many countries.

The anchored poverty rates (the two grey lines) are more in line with the developments we saw on unemployment and financial hardship measures. The most decisive trend there is the great swing upwards for deep-crisis countries, indicating a significant worsening of the income situation of low-income groups. This development was most rapid from 2009 onwards but slowed down from 2012 to 2014, yet still continued upwards to the end of the period. The other

countries (not so deep in crisis) have a relative stability through the crisis, contrary to the deep-crisis countries, and even show a little improvement in the last year.

If we look at the developments in individual countries through the height of the crisis the picture becomes more nuanced and mixed, as can be seen in figure 4.6.



Source: Eurostat, EU-SILC data. The left column shows the rate in 2007. The right column shows the change in the rate (in percentage points) from 2007 to 2013.

**Figure 4.6: Development of relative poverty rates (60%; not anchored) from 2007 to 2013 (in %-points), and the initial position in 2007 (% of households under the poverty line).**

If we look first at the lower end of the diagram we see that a few deep-crisis countries experienced lowered relative poverty rates from 2007 to 2013, i.e. the real disposable income decline was less amongst the lowest income group than amongst those in the middle. The lowest were sheltered to some extent in these countries (Latvia, Iceland, Lithuania and Cyprus). Latvia had the greatest lowering (4.7 %-points), but from the highest initial position in 2007, i.e. they had the highest poverty rate of all these countries then. Iceland lowered its poverty rate on the other hand from the second lowest position in 2007.

Lithuania and Cyprus both had rather high poverty rates to start with in 2007. Ireland had an above average poverty rate in 2007 but did not change that either way during this part of the crisis period.

At the upper end of the diagram we see some other deep-crisis countries that increased their relative poverty rates during the height of the crisis (Spain, Greece, Estonia, Portugal – all with quite high poverty rates to begin with in 2007). Some other countries increased poverty levels during this period, like Hungary and Romania (both from a high starting point in 2007), and Slovenia and Slovakia, who both had relatively low starting points in 2007. At the top we lastly have the two affluent countries that were only very modestly affected by the crisis, yet increased their relative poverty rates the most of all the countries in the sample (low-income households fared worse than the middle income groups in those countries).

So the outcome is mixed: some deep-crisis countries sheltered the lowest income group but others did not – and some affluent countries that were modestly affected by the crisis left the lower income groups behind.

Before looking closer at real disposable income developments we provide an overview of average level of living developments from 2007 to 2013 for about 30 European countries in figure 4.7.

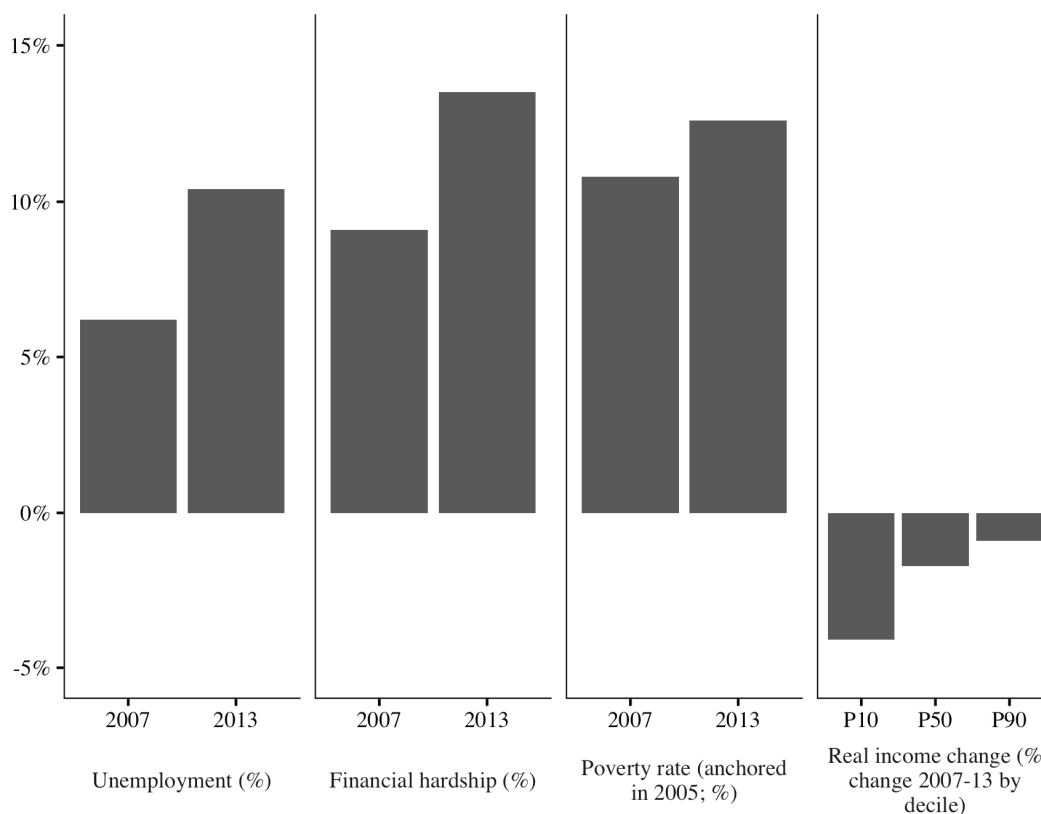
The overall rise in unemployment is of a similar proportion as the rise of financial hardships for households (“making ends meet with great difficulty”), but the rise in anchored poverty rates is of a somewhat smaller order. The percentage-point change is in fact only about a half for the poverty rate.

If we look more directly at real disposable income development between 2007 and 2013 (the right hand side of the diagram) an interesting overall pattern emerges. The real incomes of the lowest income group contracted the most (-4.1%), the median came second (-1.7%), but the ninetieth percentile declined the least (-0.9%).

This should be indicative of increased relative poverty levels in the whole group of 30 European countries. That was indeed what figure 4.6 showed. In 19 countries relative poverty levels increased in this period, in two countries there



were no changes, but declining poverty levels were only found in 9 countries (including in 4 deep-crisis countries).



Source: Eurostat, EU-SILC data.

**Figure 4.7: The broad picture: wellbeing developments in 30 European countries during the height of the crisis (up to 2013): unemployment, anchored poverty rates and financial hardship, along with broad real income developments at three decile points (low, median, high)**

The overall pattern is quite clear. The old dictum that crises erode the level of living of nations clearly emerges, but we should be equally aware of the fact that the crisis was experienced very differently amongst European nations. The deep-crisis countries had a significantly greater setback in their households' living standards than other countries. Amongst those there were still differences, the crisis was harsher in some than others. But hardship increased also in some countries that were not particularly deeply affected by the crisis. Policies of social protection and redistribution worked in varying directions.

We do a more systematic comparison of how different kinds of welfare states (welfare regimes) were differently affected in their living standards by the crisis in the next chapter. But before that we look more directly at real disposable income developments in Europe during the height of the crisis.

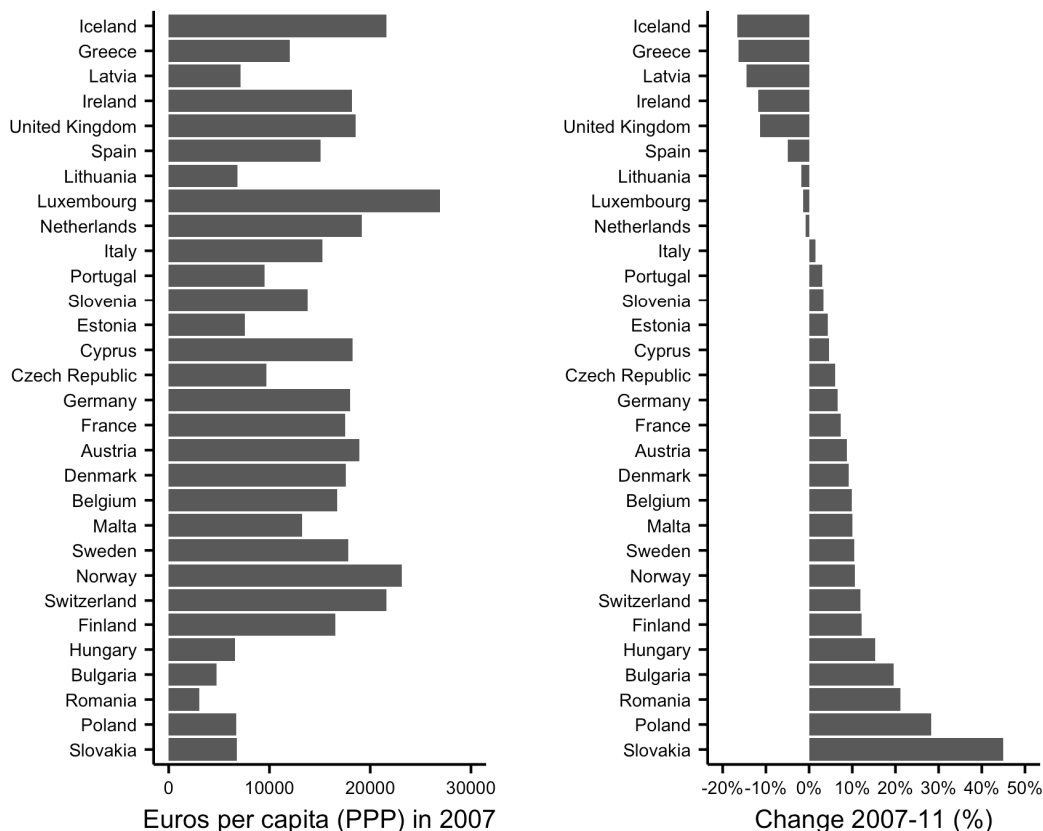
#### 4.4 Real Income Developments

On the whole real disposable incomes of households did not come down in nearly as many countries as were hit by increased unemployment or experienced increased financial hardship. Thus we see that between 2007 and 2011 real median incomes came down in 9 countries, but actually increased in 21 countries. The biggest cuts in real incomes were already in place by 2011, except in Greece. Many of the deep-crisis countries had already improved their income position by 2013.

Iceland had the greatest contraction of median incomes by 2011 (-17%), due to a very large devaluation of its independent currency (the Icelandic Krona). If the reference period is 2007 to 2013 the loss is only about -2% for Iceland, so the Icelandic situation improved from 2011 onwards. Greece is second after Iceland, with -16%. But unlike Iceland the Greek figure had increased to -28% by 2013, reflecting the later onset of the Greece recession and its larger size and longer duration.

Another important difference is that Iceland was falling from the third highest income level whereas Greece fell from a relatively low-income level. After Iceland and Greece came Latvia, UK and Ireland, with a 11-15% cut in median real household incomes – and after that came Spain and Lithuania with 2-5% cuts. Latvia and Lithuania fell from very low-income levels, while Spain was just below the average for these countries.

The five countries at the other end, with the largest increases in real incomes during this period, were all at a very low-income level to begin with. These countries did not figure strongly as deep-crisis countries, even though they felt its consequences.



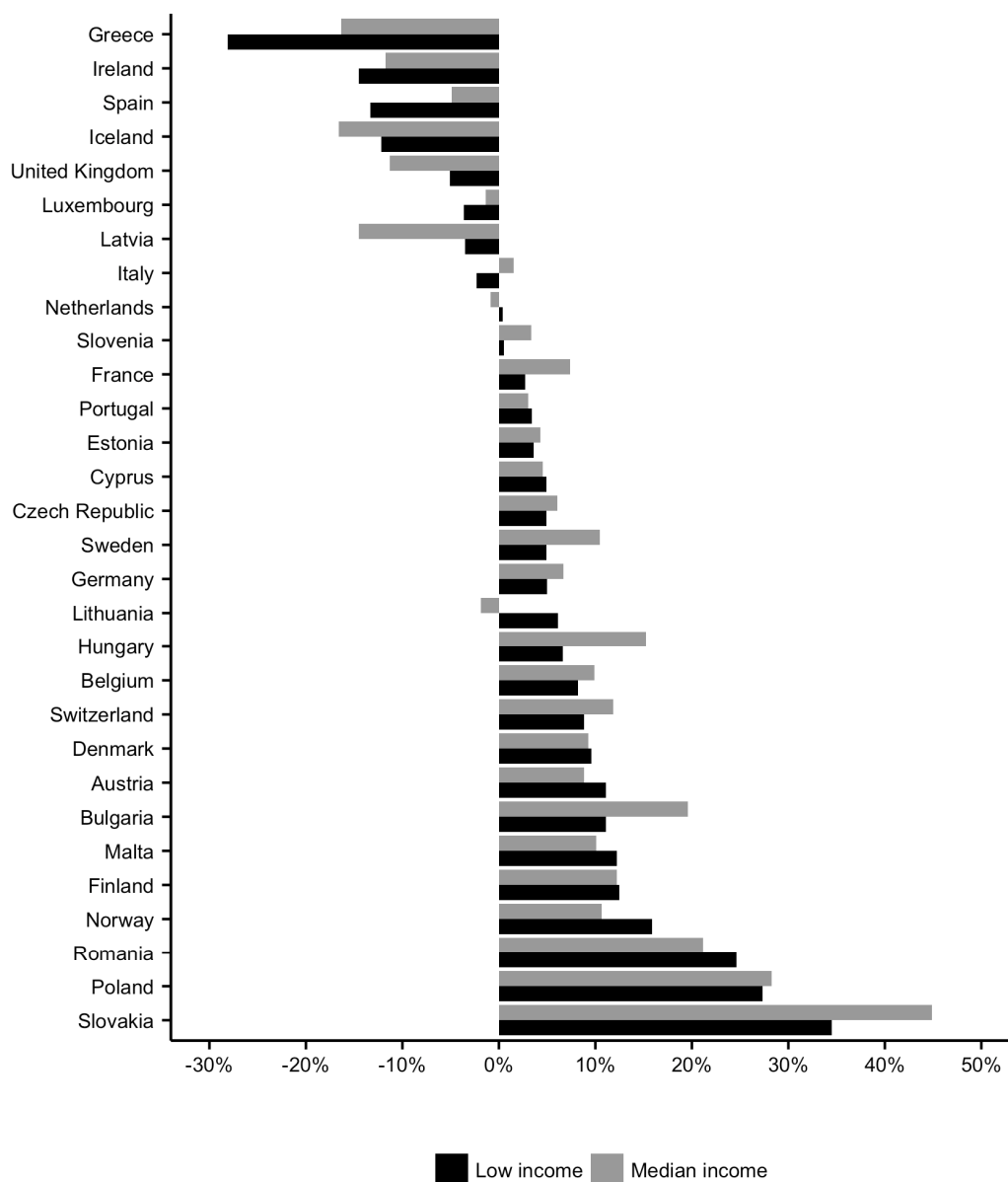
Source: Eurostat, EU-SILC data. The left column shows the base position in 2007. The right column shows the change (in percentages) from 2007 to 2011.

**Figure 4. 8: Real disposable income development from 2007 to 2011 and initial position in 2007 (medians). Euros per capita, with purchasing power parities (PPPs)**

It is also interesting to see that in a few of the deep-crisis countries median real incomes actually increased somewhat, such as in Portugal, Estonia and Cyprus, as well as in Italy and Hungary.

Figure 4.9 compares the development of median incomes and low incomes between 2007 and 2011.

There we see that in Greece, Ireland and Spain the incomes of the lowest income group (lowest decile) decreased more than that of the middle income groups. This indicates that the burdens were disproportionately placed on the lower income groups in those countries. In Iceland the situation was opposite, with lower incomes declining less than the incomes of the middle groups (Ólafsson and Kristjánsson, 2012). The same applies to the UK and Latvian cases. These countries thus softened the income loss of the lower groups to some extent, in the earlier stages of the crisis, unlike Greece, Ireland and Spain.



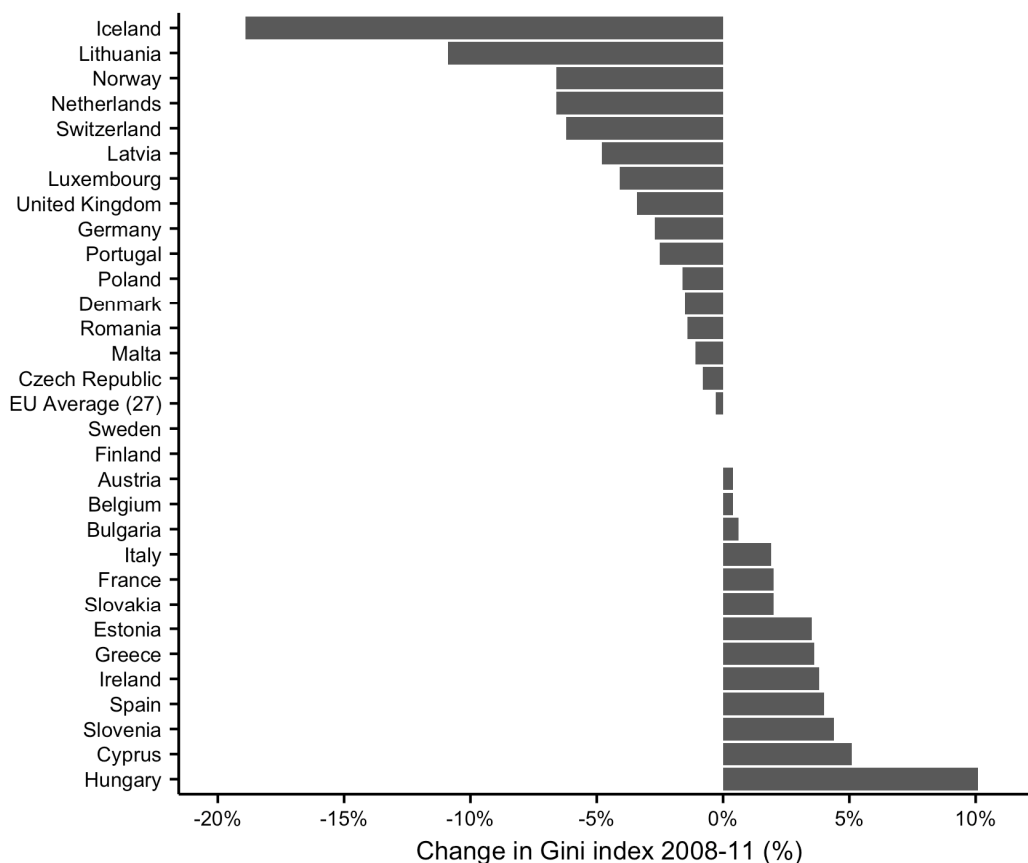
Source: Eurostat, EU-SILC data. Ordered by changes to low income.

**Figure 4.9: Real disposable income developments from 2007 to 2011: low and median incomes (PPS) compared, by country.**

When we look at the countries in figure 4.9 that increased the incomes during the height of the crisis (2007-2011) we find that it was more common that the middle incomes increased more than those of the lower income groups, i.e. in 12 countries, while the lower income groups increased more in 5 countries. In the rest of countries the change was similar for both income levels.

So incomes did not decline drastically except in a few countries, including some (but not all) of the deep-crisis countries. This draws the attention to the fact that

in economic recessions the increase in financial hardships can affect special groups decisively (such as the unemployed), while the rest of the population may be less affected. How the crisis impacts on inequality of income distribution gives an important indicator of how the burdens of the crisis were shared in our countries. Figure 4.10 shows the change of Gini inequality indices from 2008 to 2011.



Source: Eurostat, EU-SILC data.

**Figure 4.10: Changing income distribution during the height of the crisis, 2008 to 2011. Change of Gini inequality indices (in %).  
Equivalized disposable incomes, after tax and transfers.**

Iceland appears to have a special status on that front. Inequality of equivalized disposable household incomes declined by far the most in Iceland, by almost 19%. Lithuania followed with almost 11% equalization. Other deep-crisis countries that equalized their incomes during the height of the crisis were Latvia (by 4.8%), UK (-3.4%) and Portugal (2.5%). Some very affluent countries that were only modestly affected by the crisis equalized their income distribution in these years, such as Norway, Netherlands, Switzerland, Luxembourg and

Germany. Towards the lower end of the affluence scale Poland, Romania and Malta also equalized their incomes.

Hungary had the greatest increase in inequality between 2008 and 2011, by some 10%. Of the deep-crisis countries that increased income inequality during these crisis years the most prominent were Cyprus (5.1%), (Spain (4.0%), Ireland (3.8%), Greece (3.6%) and Estonia (3.5%). In those early stages of the Great Recession income distribution became more equal in 16 countries while it became more unequal in 13 countries. Two countries showed no change of the Gini coefficients from 2008 to 2011. If the reference period were 2008 to 2014 equalization was effected in 14 countries but increased inequality in 17 countries.

The discrepancy in the outcomes that we see in figure 4.9 and 4.10 indicates that in some of the countries that equalized incomes, it may have been due to significant contraction of top incomes. Financial incomes contracted greatly in many countries after the onset of the crisis and that primarily affected the top incomes.

Those who are economically vulnerable to start with should though most often be the groups most sensitive to crisis effects on their levels of living. We turn now to a more detailed analysis of how the Great Recession affected the most vulnerable through the crisis and compare how different welfare regimes may explain some of the crisis consequences in European countries.

Some welfare regimes are more generous, provide stronger automatic stabilizers and redistribute incomes to a greater extent, thus reducing poverty risks, in good as well as in bad years. When correlating wellbeing developments to institutional factors and political-economic positions we find that the depth of the crisis is the most consequential factor for producing large wellbeing consequences in the crisis years. We have already shown how this has affected levels of unemployment, poverty rates, financial hardship and income levels.

Welfare regimes are the second largest explanatory factor in wellbeing consequences. Other significant factors are debt level of government before the

crisis started (which limits government possibilities for softening the crisis effects on households).

Let us now turn to the analysis of economic vulnerability developments through the crisis in different welfare regimes.

## 5 Economic Vulnerability during the Crisis

One of our key interests was to determine the extent to which the Great Recession increased the number of people finding themselves in dire straits financially as well as whether different groups were more exposed than others to financial hardship. One way to do this would be to rely on conventional poverty thresholds, e.g. 60% of the median income. Such thresholds reflect a conception of poverty as being relative to population standards and as such they work well enough when comparing countries at a similar level of economic development or tracking gradual changes within countries over time (Nolan & Whelan, 2011).

Recessions, however, render poverty thresholds problematic. Firstly, during “normal” times the gradual change in question is the growth of the economy. During recessions the economy contracts. Secondly, the contraction of the economy is anything but gradual. This raises at least two problems. The first problem has to do with consumption standards. Whereas it may be reasonable to assume that consumption standards rise in line with increasing affluence during protracted periods of gradual economic growth, there are good reasons to doubt that such standards are lowered as quickly and to the same extent as the economy contracts. One way to think about this is in terms of loss-aversion (Kahneman, Knetsch, & Thaler, 1991), i.e. people feel loss more keenly than gains and are consequently likely to resist revising their consumption standards downwards and thus experiencing deprivation not so much relative to others as to earlier and more affluent periods in their own lives.

The second problem is that recessions tend to affect the distribution of incomes in ways that are mediated through the policy responses that are of interest to the present study. For instance, in Iceland the government emphasized sheltering what it deemed to be the most vulnerable groups while the incomes in the upper reaches of the income distribution also declined sharply (Ólafsson, 2016b). This led to an overall reduction in inequality and to a decline in the proportion of people with below 60% of the median income. If taken at face value one might conclude erroneously that poverty had in fact declined at a time when most Icelandic households saw their purchasing power decline drastically and their



debt burden rise due to their mortgages being indexed to the Consumer Price Index.

There are various other approaches. One could use an anchored poverty line but findings are very sensitive to the selection of baseline years. Furthermore, interpreting changes over time in a comparative study containing countries with different initial levels of poverty and at different levels of economic development is anything but straight-forward. One could use deprivation indicators such as Eurostat's Material Deprivation indicator (Fusco, Guio, & Marlier, 2013) or the Consumption Deprivation indicator used by Nolan and Whelan (2011). While these constitute a substantial improvement over income poverty thresholds when it comes to comparing countries they pose the opposite problems to such thresholds, namely that while the items that can be used to construct deprivation indexes in the EU-SILC may be adequate to reflect differences between countries they may not be sufficiently sensitive to national contexts to reflect developments over time. Lastly, one might use subjective indicators such as people's assessment of their ability to make ends meet. These are obviously subject to various response biases and do not necessarily give an adequate reflection of people's actual circumstances.

While all these indicators are to some extent flawed they all have some advantages and all point towards one underlying construct, i.e. poverty or at least to being in a vulnerable economic position. In order to take advantage of the various strengths of different indicators we composed a measure of economic vulnerability using latent class analysis of material deprivation, low incomes and subjective sense of people's ability to make ends meet. This approach to economic vulnerability rests on the work of Nolan and Whelan (2011) who construct their measure of economic vulnerability in the same way except they use their own composite indicator of deprivation whereas we use Eurostat's material deprivation indicator. Details on the construction of this indicator are given in a forthcoming technical paper to be published on the project website.

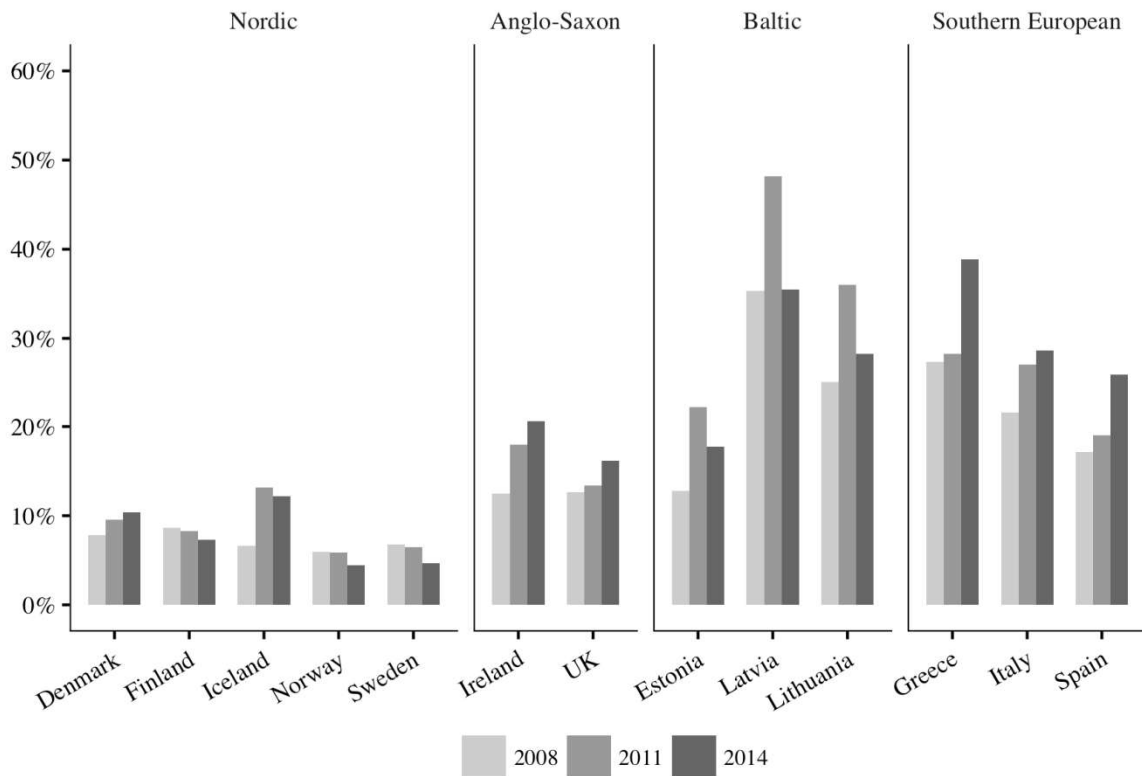
In what follows we present some descriptives as examples of findings based on our measure of economic vulnerability. We group countries into four groups, i.e.

the Nordic countries, the Anglo-Saxon countries, Southern European countries and the Baltic countries. While the countries within these groups share to some extent certain social, economic and cultural traits, and in some cases certain similarities in how the Great Recession played out, the grouping here is primarily for heuristic purposes as we are not attempting anything like a causal analysis. To do so is well beyond the scope of this report as it would require a great deal of attention to the specifics of each case, requiring a lengthy exposition. More sophisticated analysis will be presented in a book forthcoming from this project.

Finally, for ease of presentation we select three years, 2008, 2011 and 2014. 2008 reflects the situation before the onset of the recession, or at least before its consequences materialized. 2011 can be seen as the height of the recession, giving an indication of the initial consequences. 2014 has some countries moving into recovery and is indicative of the effects of the recession over the medium term.

## 5.1 Results

Figure 5.1 shows the prevalence of economic vulnerability within the population overall in the twelve countries under study. The first thing to note is that there are regime differences in terms of overall levels of vulnerability. The lowest rates are found in the Nordic countries, ranging from 4.4% in Norway to 12.2% in Iceland in 2014. The Nordic countries are followed by the Anglo-Saxon countries with 16.2% in the UK and 20.6% in Ireland in that same year. As a group the Southern European countries have the third highest rates though there are substantial differences between them as well, with the lowest rate being in Spain, 25.9%, and Greece standing out with the highest rate among the twelve countries in 2014, namely 38.9%. The highest prevalence of vulnerability is among the Baltic countries as a group, though they also differ considerably among themselves, with Latvia having the highest rate, i.e. 35.5% and Estonia the lowest, or 17.7%, which places Estonia in the vicinity of the Anglo-Saxon countries.



**Figure 5.1: Proportion of people who are economically vulnerable**

As for changes throughout the Great Recession we also see considerable differences. To begin with economic vulnerability declined slightly in three of the Nordic countries, i.e. Finland, Norway and Sweden. This reflects in part that the recession was less severe in these countries than in many of the others. Denmark and Iceland stand out among the Nordic countries. In Denmark economic vulnerability rose gradually, from 7.8% in 2008, to 9.5% in 2011 and in 2014 some 10.4% of the population experienced economic vulnerability. Iceland, on the other hand, saw a steep increase in economic vulnerability between 2008 to 2011, from 6.6% to 13.1%, but a small decline between 2011 and 2014 to 12.2%.

The Anglo-Saxon countries and the Southern European countries have a similar pattern with all countries showing at least some increase in economic vulnerability between 2008 and 2011 and again between 2011 and 2014. Two of these countries show a larger increase during the earlier period, i.e. Ireland and Italy, while the UK, Greece and Spain experienced a larger increase in vulnerability the latter period. The Baltic countries have a distinct pattern. They

all experienced a sharp increase in economic vulnerability between 2008 and 2011 but also a significant decline between 2011 and 2014.

**Table 5.1: Economic vulnerability by income**

	Bottom quintiles			Middle quintiles			Top quintiles		
	2008	2011	2014	2008	2011	2014	2008	2011	2014
<b>Denmark</b>	22.7%	27.3%	30.9%	4.0%	5.2%	5.1%	0.4%	0.4%	0.2%
<b>Finland</b>	27.8%	27.3%	23.7%	2.7%	2.8%	2.9%	0.5%	0.2%	0.1%
<b>Iceland</b>	21.3%	32.4%	35.4%	2.6%	9.6%	7.3%	0.1%	1.0%	0.3%
<b>Norway</b>	19.5%	20.1%	17.5%	2.2%	2.2%	1.0%	0.2%	0.1%	0.1%
<b>Sweden</b>	21.5%	24.5%	17.8%	2.5%	1.8%	1.0%	0.3%	0.1%	0.1%
<b>Ireland</b>	35.0%	46.9%	51.6%	7.0%	12.2%	13.1%	0.2%	1.1%	1.4%
<b>UK</b>	37.5%	38.0%	44.3%	5.4%	7.1%	9.1%	1.4%	1.0%	1.0%
<b>Estonia</b>	39.9%	56.4%	46.8%	5.0%	12.1%	9.1%	0.7%	1.9%	1.3%
<b>Latvia</b>	74.3%	84.1%	74.7%	30.5%	47.3%	31.0%	7.5%	14.3%	5.7%
<b>Lithuania</b>	60.0%	65.0%	64.5%	17.2%	35.2%	21.6%	3.3%	11.7%	5.2%
<b>Greece</b>	74.0%	78.8%	94.7%	16.9%	20.5%	28.1%	0.1%	0.0%	0.7%
<b>Italy</b>	61.2%	66.7%	72.2%	13.3%	18.8%	19.2%	1.1%	3.9%	3.9%
<b>Spain</b>	49.0%	53.6%	70.9%	10.8%	10.5%	14.2%	0.5%	1.2%	1.4%

There is necessarily a relationship between income and economic vulnerability since the former plays a role in constructing our measure of the latter. It is nevertheless interesting to examine how this relationship changes over time. Table 5.1 shows the prevalence of economic vulnerability of the top, middle and bottom quintiles of the income distribution.

There are some differences between the Nordic countries in how different parts of the income distribution fared during the Great Recession. The bottom quintile in Finland and Norway remained stable between 2008 and 2011 but saw rates of economic vulnerability decline between 2011 and 2014. Sweden, on the other hand, saw economic vulnerability among the bottom fifth increase somewhat between 2008 and 2011 but decline sharply by 2014. Denmark and Iceland, on the other hand, saw economic vulnerability increase in the bottom quintile

between 2008 and 2011 and again between 2011 and 2014, the change being more pronounced in Iceland than in Denmark.

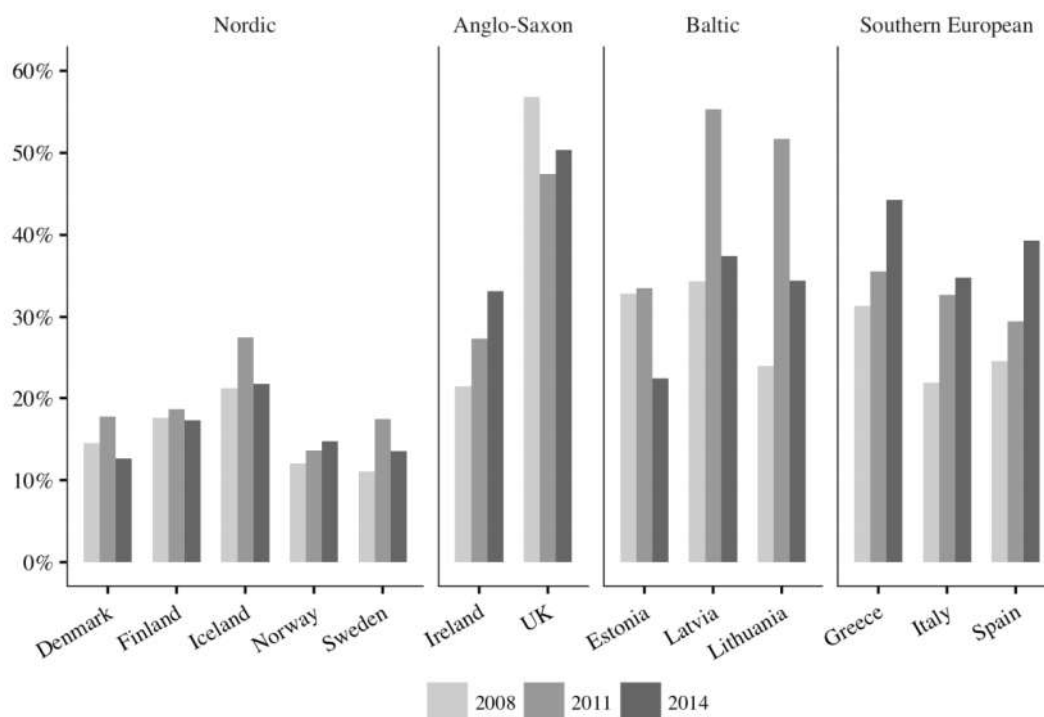
As for the middle quintile economic vulnerability remained for the most part stable between 2008 and 2014, especially in Denmark and Finland but declined slightly in Norway and Sweden. Iceland is a notable exception with the proportion of the middle income group rising sharply from 2.6% in 2008 to 9.6% in 2011 though it had declined slightly again by 2014. The rates of economic vulnerability among the top 20% were negligible in the Nordic countries and did not change significantly during the period under study. There is, however, one exception, namely Iceland that saw economic vulnerability in the top quintile rise from 0.1% in 2008 to 1% in 2011 though by 2014 it was down again to 0.3%. In sum: In the Nordic countries economic vulnerability only became more common among the bottom 20% in Denmark and the bottom quintile and the middle income group in Iceland, which experienced by far the deepest crisis.

The Anglo-Saxon countries have a somewhat different pattern. In Ireland the rate of economic vulnerability among the bottom fifth increased sharply between 2008 and 2011, from 35% to 46.9% and continued to rise and until 2014, when it stood at 51.6%. In the UK the rate of economic vulnerability remained stable between 2008 and 2011 but rose from 38% in 2011 to 44.3% in 2014. The middle income groups also saw an increase in economic vulnerability in both Ireland and the UK. In Ireland there was a sharp increase between 2008 and 2011, from 7% to 12.2% and a more modest increase between 2011 and 2014. The UK saw a more gradual increase from 5.4% in 2008 to 9.1% in 2014. As for the top quintile rates of economic vulnerability are quite low in both countries though they increased in Ireland from 0.2% in 2008 to 1.4% in 2014 while remaining stable in the UK.

The Baltic countries are somewhat distinct as two of them have relatively high rates of economic vulnerability in the top quintile, namely Latvia and Lithuania. The general pattern for these countries, i.e. vulnerability rising between 2008 and 2011 and declining again between 2011 and 2014, holds for all quintiles under scrutiny in all three countries with the exception of the bottom quintile in Lithuania that saw vulnerability rates rise by modest (noting though the initial

high rate) five percentage points between 2008 and 2011 and then remaining at a similar level in 2014.

Finally, the Southern European countries saw rates of economic vulnerability rise by quite a lot among the bottom fifth, from already high levels, with the sharper increase occurring between 2011 and 2014 in both Greece and Spain. In Spain economic vulnerability among the middle income group remained stable between 2008 and 2011 but increased thereafter, whereas the increase in vulnerability for this group in Italy occurred mostly between 2008 and 2011. The middle income group in Greece saw economic vulnerability rise throughout the period under study, though more so during the latter half. As for the top quintile Italy saw an increase from 1.1% in 2008 to 3.9% in 2011 but no change between 2011 and 2014. Spain, on the other hand, saw a very slight increase over the period, from 0.5% in 2008 to 1.4% in 2014. As for Greece vulnerability rates remained negligible for the top fifth.



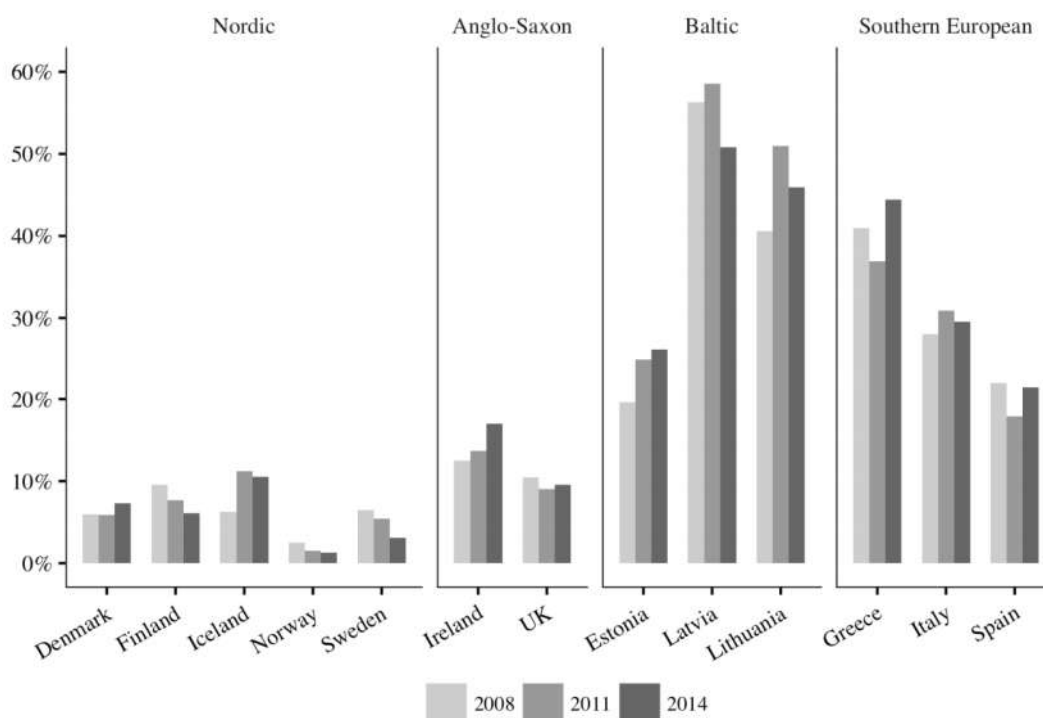
**Figure 5.2: Economic vulnerability among unemployment benefits recipients**

Figure 5.2 shows the incidence of economic vulnerability among recipients of unemployment benefits. The Nordic countries stand out in terms of low rates, ranging from 13.5% in Sweden to 21.7% in Iceland in 2014. All of the Nordic

countries saw an increase in economic vulnerability among the recipients of unemployment benefits between 2008 and 2011, though the increase was typically modest. But Iceland and Sweden saw a somewhat sharper increase during this period, or by 6.3 and 6.4 percentage points respectively.

The Anglo-Saxon countries differ in both levels and changes in economic vulnerability among recipients of unemployment benefits. On the one hand such vulnerability is less prevalent in Ireland than in the UK, though Ireland has seen a sharp and steady increase (from 21.4% in 2008 to 33.2% in 2014), whereas the UK saw vulnerability rates drop between 2008 and 2011, from 56.8% to 47.4%, before rising again in 2014 to 50.4%.

The Southern European countries have a very distinct pattern. Rates of economic vulnerability among recipients of unemployment benefits rose in both periods in all three countries. In the Baltic countries the prevalence of vulnerability rose sharply between 2008 and 2011 in both Latvia and Lithuania but remained stable in Estonia, but declined in all three countries between 2011 and 2014.

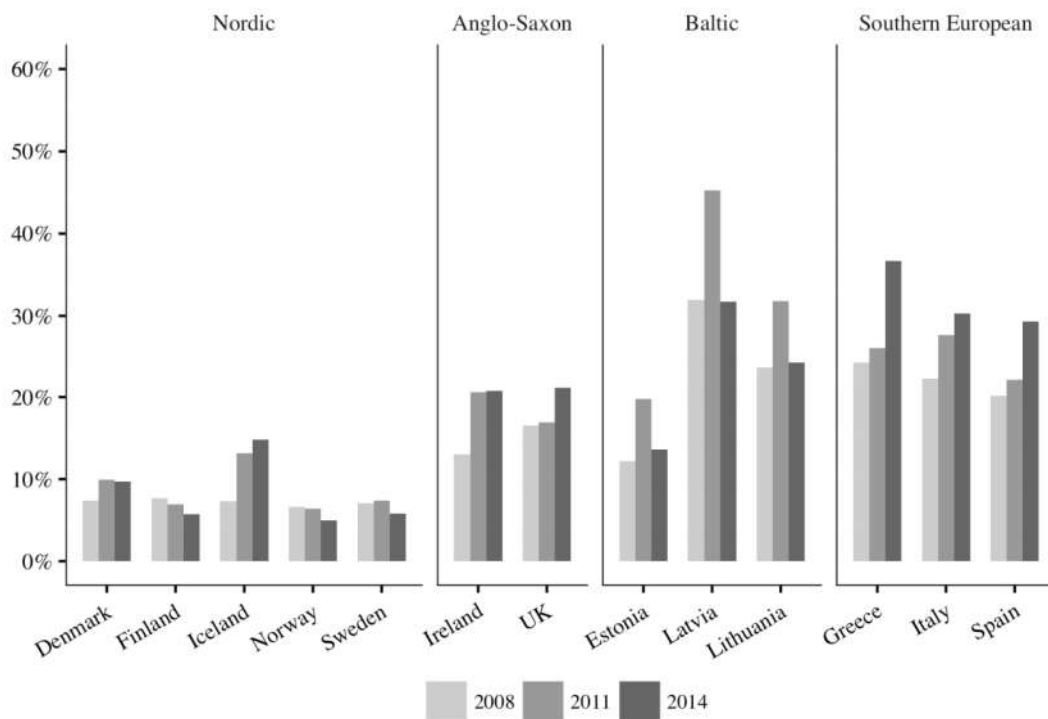


**Figure 5.3. Economic vulnerability among >64 year olds**

Next we consider the elderly population, i.e. people who are 65 years old or older (Figure 5.3). This population relies to a large extent on social transfers that make

them vulnerable though much depends on the occupational pensions system and the pension entitlements people have accumulated.

As for other groups the prevalence of economic vulnerability is lower in the Nordic countries than in the other countries when it comes to the elderly and appears to have declined steadily in Finland, Norway and Sweden but remained stable in Denmark over the period under study. Iceland stands out with an increase between 2008 and 2011, from 6.2% to 11.2%. Rates of economic vulnerability among the elderly are also quite low in the Anglo-Saxon countries. Ireland saw a slight but gradual increase between 2008 and 2014 whereas the UK remained more or less stable.



**Figure 5.4. Economic vulnerability among <18 year olds**

Estonia stands out among the Baltic countries in that economic vulnerability is much less frequent among their elderly population than in the other Baltic states. Economic vulnerability amongst the elderly became more prevalent in all the Baltic countries between 2008 and 2011. Between 2011 and 2014 vulnerability rates declined among the elderly in both Latvia and Lithuania but remained relatively stable in Estonia. The Southern European countries vary a great deal in terms of vulnerability levels for this population group. In 2014 the highest rates



were in Greece, 44.4%, and the lowest in Spain, 21.4%, with Italy in between, though closer to Spain at 29.5%. Both Greece and Spain saw vulnerability rates among the elderly decline between 2008 and 2011 and rise again by 2014. The obverse pattern is observed in Italy.

It is worth noting that economic vulnerability was less common among the elderly in the Nordic and the Anglo-Saxon countries as well as in Spain, where as it was more frequent among the elderly in Greece and the Baltic countries.

Children are another vulnerable group. Figure 5.4 shows the vulnerability rates of people below the age of eighteen. Once again the Nordic countries stand out in terms of low rates that remain for the most part stable between 2008 and 2014. The exception is Iceland that saw a sharp increase between 2008 and 2011, from 7.3% to 13.1% and standing at 14.8% in 2014. Children tended in 2014 to have higher rates of economic vulnerability than the elderly in the Nordic countries, with the exception of Finland where they are quite similar.

In the Anglo-Saxon countries economic vulnerability among children increased over the period. In Ireland the proportion of children deemed vulnerable went from 13% in 2008 to 20.6% in 2011 but remained stable between 2011 and 2014. In the UK the rate was fairly stable just under 17% between 2008 and 2011, but rose to 21.2% in 2014. In both countries children were more likely to be in economically vulnerable households than the elderly in 2014, though the difference was much larger in the UK than in Ireland (21.2% compared to 9.5% among the elderly).

In the Baltic countries we see a familiar pattern, i.e. a sharp increase between 2008 and 2011 followed by a sharp decline between 2011 and 2014. In all three countries in 2014 children were substantially less likely to live in economically vulnerable households than the elderly.

There is also a familiar pattern in the Southern European countries with an increase over both intervals, with most of the increase occurring between 2011 and 2014 in Greece and Spain. Economic vulnerability was less prevalent among children than among the elderly in Greece in 2014 but the obverse is observed in

Spain. In Italy children and the elderly have similar rates of economic vulnerability.

## 6. Policy Responses in a Comparative Focus

The Global Financial Crisis culminated in the winter of 2008-2009 as financial institutions around the world teetered on the brink of collapse. The crisis spawned the Great Recession, which involved the largest economic contraction in advanced economies in the post-war era. While the effects of the crisis were particularly devastating in Greece, multiple countries experienced severe domestic recessions in the years following the peak of the crisis. This was especially so for countries that entered the crisis in a precarious fiscal position, as they were highly vulnerable to the sudden stop in cross-boarder lending that developed amid fears of banking and sovereign defaults. Some of the countries most affected, including Latvia, Ireland, Iceland, and Portugal, were forced to seek out the assistance of international lenders of last resort to stave off an economic collapse. Although the effects of the Great Recession were most pronounced in the deep crisis countries, almost all OECD countries experienced a recessionary period in the aftermath of the crisis.<sup>9</sup>

The crisis led to a deterioration in the budget balance of most countries in the first years after the crisis. While the restoration of financial institutions and interest payments due to debt obligations were particularly costly for the deep crisis countries, all governments provided some form of fiscal stimulus in the initial stages of the Great Recession. Automatic stabilizers played a particularly large role in buffering the initial effects of the crisis on aggregate demand, while discretionary stimulus measures were also employed to support their workings at the height of the crisis.

As the crisis developed, significant differences in fiscal policy choices across countries became apparent. The response in several countries, including Greece,

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<sup>9</sup> For a more detailed discussion of the crisis, government policy responses, and wellbeing consequences, see Ólafsson, Daly, Kangas, and Palme's forthcoming edited volume, *Welfare and Nordic Crisis Management Strategies*. The book contains nine case studies of deep crisis countries, both in the Great Recession and the Nordic banking crisis of the 1990s, as well as a more comprehensive discussion of the role of the welfare state in ameliorating the effects of the crisis on the general population.

Ireland, the UK, Spain, and Portugal, was characterized by harsh austerity measures, which relied primarily on significant cuts to government spending. Iceland stands out in this respect, as it was the only deep crisis country that emphasized revenue increases more than expenditure cuts in their fiscal policy response. Iceland did better in containing unemployment increases, relative poverty and increased financial hardship than the countries that went harsher in expenditure cuts, such as Greece and Ireland, despite large real income losses for Icelandic households. An effective strategy of redistribution seems to have had a role in cushioning the wellbeing losses of lower and middle-level households in Iceland. Other countries, less affected by the crisis, pursued a mix of stimulating fiscal policies that were more conducive to maintaining aggregate demand and supporting economic wellbeing.

While fiscal policy choices differed significantly during the crisis, overall changes to social policy were more characterized by continuity than change, when looking at all European countries. However, that differed greatly between countries depending on depth of the crisis and capabilities for countries to respond. Thus, the extent to which countries were prepared to deal with a deep recession at the onset of the crisis mattered a great deal. While some countries, such as the Nordic countries, had forceful automatic stabilizers and generous unemployment benefit systems in place to cushion the most severe effects of the crisis, other countries were neither fully prepared nor in a position to implement measures to adequately redistribute the costs of the crisis. Even so, Ireland and Greece stand out as cases of significant social policy retrenchment, while Iceland and Slovenia stand out as cases where redistributive measures played a larger role as the crisis evolved. In any case, the social policy setting at the onset of the crisis played a crucial role in shaping the effects of the crisis on economic wellbeing.

When analyzing the wellbeing consequences of the crisis, the overall pattern is quite clear. The old dictum that crises erode the level of living of nations clearly emerges, but we should be equally aware of the fact that the crisis was experienced very differently amongst European nations. The deep-crisis countries had a significantly greater setback in their households' living standards

than other countries. Amongst those there were still differences, the crisis was harsher in some than others, which was further compounded by the implementation of harsh austerity measures. But hardship increased also in some countries that were not particularly deeply affected by the crisis. Policies of social protection and redistribution worked in varying directions.

Those who are economically vulnerable to start with are most often the groups most sensitive to the effects of crises on their level of living. The welfare state and government policy responses more generally, play a crucial role in protecting those groups during crises episodes. Some welfare regimes are more generous, provide stronger automatic stabilizers and redistribute incomes to a greater extent, thus reducing poverty risks, in good as well as in bad years. When correlating wellbeing developments to institutional factors and political-economic positions we find that the depth of the crisis is the most consequential factor for producing large wellbeing consequences in the crisis years. However, welfare regimes are the second largest explanatory factor in wellbeing consequences. Thus, how the welfare state is employed during times of economic crises is crucial for the wellbeing consequences of the general population.

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