Box A

Income Support Policies in Advanced Economies During the COVID-19 Pandemic

Government income support for households and businesses limited the contraction in economic activity in the first half of 2020 in many advanced economies. These policies, including wage subsidies and transfers to households, helped to support the cash flows of households and firms, and underpinned private sector demand. Indeed, household and business incomes in many advanced economies have fared much better during the first half of the year compared with previous recessions despite a larger contraction in GDP. This should support these economies in the next stage of the recovery, even as some forms of income support are scaled back in the period ahead.

Household incomes have been supported through a range of measures

Household incomes have been supported by a range of measures through the government-mandated lockdowns and subsequent shock to private demand. Wage subsidies have been used extensively in advanced economies to protect jobs and support employee incomes.[1] Expanded social benefits were provided to people who lost their jobs or were unable to work. Some fiscal authorities made sizeable one-off cash transfers. Other measures, such as early access to superannuation in Australia, also supported household cash flows.

In some economies, such as Australia, Canada and the United States, aggregate household disposable income rose strongly over the first half of the year as increased unemployment benefits and other transfer payments more than offset the decline in labour and other types of income (Graph A.1). In Australia, social assistance benefits in the June quarter were 50 per cent higher than the previous year. In Canada, government transfer payments to households doubled over the year to the June quarter. In the United States, transfers to households, including direct cash payments and increased unemployment benefits, doubled between March and April; in fact, the increase was so large that two-thirds of those unemployed earned more than in their previous employment.[2] In contrast, social assistance benefits did not increase significantly in most European economies as they mainly relied on enhancing existing wage subsidy schemes.

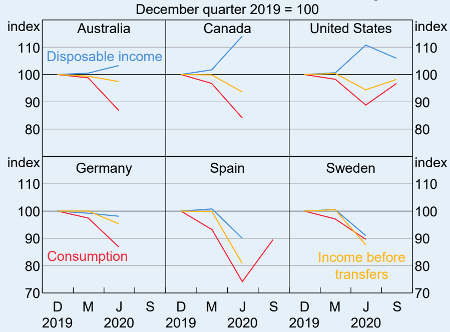
Wage subsidies have been critical to supporting household incomes and employment. Participation in wage subsidy schemes has been significant; in some economies, up to 60 per cent of the labour force have received these subsidies at some point. In Europe, while wage subsidies have supported household incomes by keeping workers attached to their employers, they have not prevented a decline in income. In Australia and New Zealand, wage subsidies have involved a minimum payment to workers and, in some cases, this exceeded the original earnings for some participants.[3] Importantly, beyond directly supporting incomes, wage subsidy schemes have limited the initial increase in unemployment, reduced income uncertainty and supported household confidence. By helping to maintain relationships between employees and their employers, wage subsidy programs will also limit longer-term scarring effects in the labour market that can result from unemployment.

The significant support to household incomes has enabled a shallower downturn and faster rebound in some forms of consumption, especially for goods, and has boosted household savings. Some of this increase in savings has been forced: activity restrictions prevented the purchase of many services.[4] The increases in incomes in the United States and Canada in the early stage of the pandemic were so large that it is unlikely households would have spent them immediately even if consumption opportunities were unconstrained. The boost to household savings should support consumption in the period ahead as some income support measures are scaled back.

Graph A.1

Real Household Income and Consumption

December quarter 2019 = 100



Sources: national sources; OECD; RBA; Refinitiv

Policy support for business has so far prevented a large increase in insolvencies

Government support for businesses has been important in directly offsetting large declines in revenue, thereby limiting job losses and business closures. In most advanced economies, this support has come principally in the form of wage subsidies, and to a lesser extent from other business subsidies and measures such as tax deferrals and loan guarantees (Graph A.2). Wage subsidies have supported business viability by sharply reducing the effective wage bill and thereby firms' operating costs.

Other direct business subsidies have also been important in some economies. In Australia, the value of non-wage subsidies in the June quarter was equivalent to just under one-third of the total value of government assistance for businesses; in Canada, the comparable figure was around 15 per cent. In the United States, effectively one-quarter of government business subsidies were non-wage subsidies because the small businesses using the Paycheck Protection Program could use up to one-quarter of their loans for eligible non-wage expenses and still qualify for loan forgiveness.

Private sector incomes during the COVID-19 shock have so far held up better than in past recessions

The increase in net government transfers to households and business subsidies to date have far exceeded the increases seen in past recessions (Graph A.3).

Net transfers to households generally increase during a recession because less tax is collected and government payments increase as people lose their jobs (reflecting the effect of 'automatic stabilisers'), but the unprecedented policy measures have boosted this effect. As a result, recent trends in private sector incomes have been atypical compared with other economic contractions.

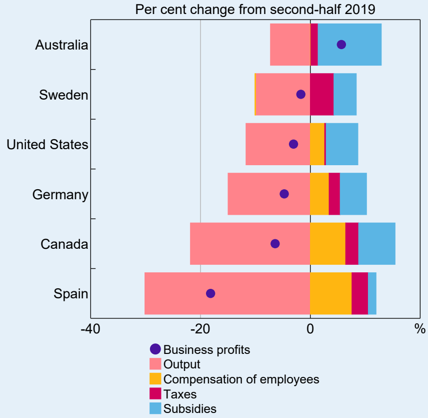
The unusually strong support to household incomes and business viability has contributed to a stronger and quicker recovery in a number of economies than was widely anticipated before lockdowns were lifted. The recovery has been especially rapid in sectors that have been less constrained by remaining social distancing requirements, such as goods consumption and production. Moreover, consumer and business confidence have also been supported, and business failures and personal defaults have been limited so far.

The fragility of the recovery has led many governments to extend their wage subsidy schemes into 2021. At the same time, there has been an effort to make them more targeted (by narrowing the schemes' scope through tightened eligibility) and to reduce the value of the benefits paid. Some governments have also announced substantial further fiscal support, including for labour markets beyond the initial wage subsidies and investment initiatives to boost the recovery phase.[5] ✠

Graph A.2

First-half 2020 Business Profits and Contributions*

Per cent change from second-half 2019



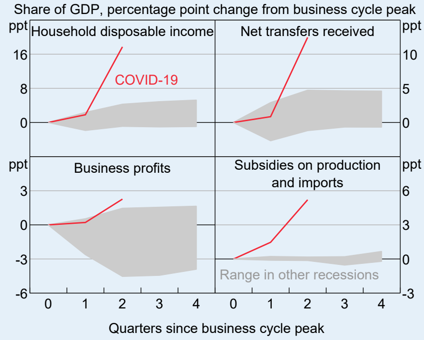
* Business profits include gross operating surplus and mixed income

Sources: ABS; OECD; RBA

Graph A.3

Advanced Economies – Incomes and Income Support*

Share of GDP, percentage point change from business cycle peak



* Sample includes Australia, Canada, Germany, Spain, Sweden and the United States; median change shown for COVID-19

Sources: national sources; NBER; OECD; RBA; Refinitiv; The Conference Board

Endnotes

[1] For more information on wage subsidies, see RBA (2020), 'Box A: Using Wage Subsidies to Support Labour Markets Through the COVID-19 Shock', *Statement on Monetary Policy*, August, pp 19–22. Available at <https://www.rba.gov.au/publications/smp/2020/aug/box-a-using-wage-subsidies-to-support-labour-markets-through-the-covid-19-shock.html>

[2] Ganong P, P Noel and J Vavra (2020), 'US Unemployment Insurance Replacement Rates During the Pandemic', BFI Working Paper No 2020-62 .

[3] New Zealand's wage subsidy scheme paid a fixed amount for full-time and part-time workers, whereas Australia's JobKeeper payment was a single rate for all eligible workers until late

September. New Zealand is not included in the sample of comparison economies due to lack of timely income data.

[4] Dossche M and S Zlatanos (2020), 'COVID-19 and the Increase in Household Savings: Precautionary or Forced?', ECB *Economic Bulletin*, Issue 6/20, viewed 2 October. Available at <https://www.ecb.europa.eu/pub/economic-bulletin/focus/2020/html/ecb.ebbox202006_05~d36f12a192.en.html>.

[5] For further discussion, see RBA (2020), 'Box B: Fiscal Policy Support for the Recovery Phase in Advanced Economies', *Statement on Monetary Policy*, August, pp 23–26. Available at <https://www.rba.gov.au/publications/smp/2020/aug/box-b-fiscal-policy-support-for-the-recovery-phase-in-advanced-economies.html>