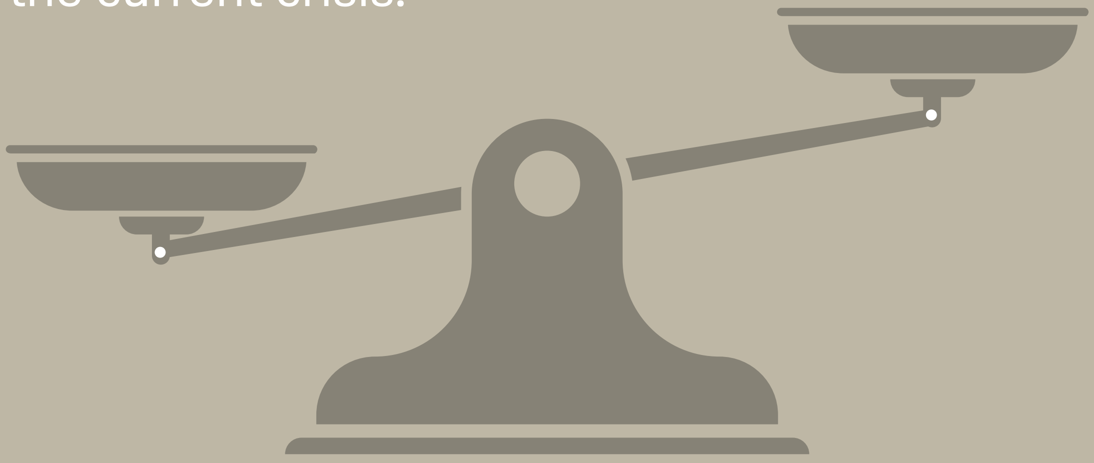
With effects pushing on both ends of the income and wealth spectrums, it seems that a reduction in inequality is a likely consequence of the current crisis.



How the virus could reduce inequality

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Though the entire world has been affected by the covid-19 pandemic, those on low incomes have been amongst the most heavily affected. They are more likely to be in occupations where working from home is not viable, and are less likely to have emergency savings to fall back on. Furthermore, in countries without universal health coverage, they are less likely to have insurance which means they have disproportionately poor health outcomes.

In spite of these factors, however, covid-19 may actually lead to lower levels on inequality, particularly in developed countries where the poor may, in some ways, be less affected than those in higher income groups. In fact, we have already seen redistribution to lower income groups through the salary protection programmes many countries have initiated. In the UK, the government covers 80 per cent of furloughed employee's wages up to £2,500 per month. In the US, unemployed people receive an extra $600 per week for up to six months. As a proportion of a staff member's paypacket, those on low incomes have been better protected than those on higher incomes.

Beyond direct monetary transfers, the pandemic has also revealed key vulnerabilities in social safety nets that will become a priority of governments to fix. Consider benefits such as paid sick leave or good quality healthcare coverage. We are now discovering that it is not just individuals who benefit from this, but society as a whole, particularly when the people involved are essential workers, many of whom are in lower-income brackets.

Large and positive externalities are also being recognised by governments. For example, the UK has changed the rules surrounding statutory sick pay so that people are now able to receive it from the first-day of self-isolating, rather than the fourth. The change meant that workers, who could well have been struggling financially, would no longer face the invidious choice between going into work when suffering from ill health and potentially transmitting the disease further, or being worse off financially from choosing to self-isolate.

Meanwhile in the US, amidst concerns that people could be reluctant to be tested for covid-19 because of the financial implications, the federal government subsequently legislated for free tests. This approach recognised that there is a public health interest in people knowing if they have come into contact with someone infected by the disease, as well as for epidemiologists to be able to track the extent of its spread.

As we learn to live with the virus, countries will likely maintain social distancing measures for some time. And as these measures benefit society as a whole and not just the direct beneficiaries support for them will likely continue, as well as for governments to take action in similar areas.

Support for action will not be limited to the health sphere but it will entail an economic response that may see governments act to redistribute resources to those on lower incomes. This is not least because those on low incomes are less likely to be able to work from home and so are disproportionately affected by the virus. The support for such redistributionist measures can also be expected to increase over time, given that unemployment is projected to rise to its highest levels in decades as many countries fall into their worst recession since the Great Depression.

Even once the immediate crisis is over, one of its legacies will be the question of how governments deal with heightened levels of public debt that have been incurred from the various relief measures put in place (see our piece "How will we pay for it?"). The IMF forecasts that the gross debt levels of governments in the advanced economies will rise from 105 per cent of GDP in 2019 to 122 per cent in 2020, with countries such as Italy, Greece and Portugal projected to rise to higher levels still. Once again however, there are strong reasons to suspect that the impact of measures to reduce public debt burdens will fall hardest on rich individuals and large corporations.

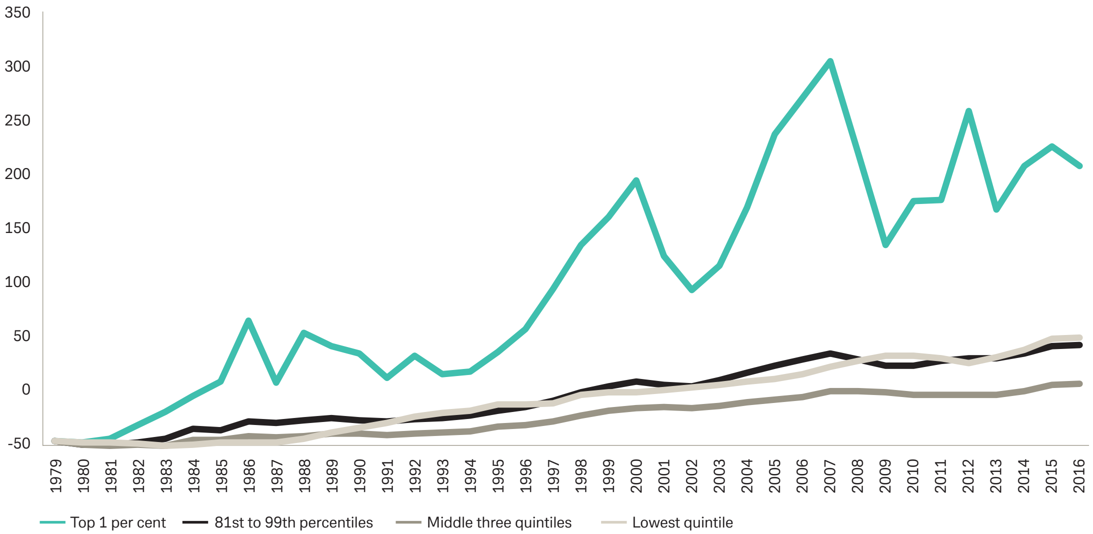
This may be particularly so given the experience of fiscal restraint following the financial crisis. In the 2010s, many governments across the developed world moved to cut expenditure in order to reduce their budget deficit, particularly in the early part of the decade against the backdrop of the sovereign debt crisis in Europe. Yet many countries continued to cut corporate tax rates whilst doing so, at the same time as various benefits were slashed. The legacy of these measures is a factor behind the success of populist parties since.

In the covid-19 recession, however, it appears that governments are taking a very different tack. Companies have already come under pressure not to issue dividends or bonuses. It will be no surprise therefore if governments act carefully to ensure that those on low and middle incomes bear a much lighter burden than the richest and large corporations, particularly given the explicit pledges from many to support those left behind from the benefits of globalisation. Higher taxes, both income and corporate, could be inevitable.

A more immediate way in which the coronavirus pandemic is helping to reduce inequality is through the sizeable corrections already seen in global equity and other asset markets – where the rich hold a greater proportion of their wealth compared with those on lower incomes.

The 2008 financial crisis offers a precedent for how these market declines, coupled with a recession, coincide with lower inequality. This is illustrated for the US on the following chart. The cumulative income growth for the top one per cent fell sharply around 2008, and by 2016 had still not reached its peak in 2007. Furthermore the Gini coefficient that measures overall inequality also fell in the US after the financial crisis, with the measure that takes into account transfers and taxes falling from 0.453 in 2007 to 0.413 in 2009. This is not to say it is inevitable that recessions lead to lower inequality, but depending on the cause of the downturn and the government's response to it, inequality can be lower in the aftermath.

United States, Cumulative Growth in Average Income After Transfers and Taxes



Source: Congressional Budget Office

Looking further back into history, there is a strong case that the covid-19 pandemic will be another event that leads to widespread recognition of the key roles that many workers play in the economy and society, and a desire to be more formally rewarded. This would be akin to what happened after the world wars and other major crises that have galvanised societies. While health workers may be the most obvious candidates for such recognition, being at the frontline of the response to this crisis, this could also extend to other essential workers such as supermarket delivery drivers or charity workers protecting the vulnerable and who are continuing to work in spite of the risks and low pay.

This desire to reward those on the frontlines has regularly been seen before. In the US, after the second world war, the GI Bill was passed and provided a range of benefits to returning veterans, including help to attend college or with applying for a mortgage. Similarly, a post-9/11 GI bill was later passed to help veterans pay for college or job training. In the UK after the first world war, the realisation that a number of the returning soldiers would not be able to vote saw this right extended to all men over 21 for the first time.

It would therefore be no surprise to see governments implement measures after the covid-19 crisis that recognise the essential workers who have risked their lives to provide for others. And because many of these people are on low incomes, these measures will likely extend to others in the same income groups. At the same time, financial restrictions have already been made on companies who are generally owned by the wealthy. Measures could soon follow on wealthy individuals as governments seek to pay for the current stimulus. So with effects pushing on both ends of the income and wealth spectrums, it seems that a reduction in inequality is a likely consequence of the current crisis.