Virus Vulnerability: Private and Public Safety Nets in Times of Pandemics

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ABSTRACT

The outbreak of Covid-19 forces economic policy to assess the economy's resilience to pandemic shock. Focusing on public and private safety nets, this paper devises a modified concept of asset poverty that better reflects population economic vulnerability. In contrast to conventional measures, we consider households' capacity to weather unemployment, drawing on private assets and given different welfare institutions. Hence, we incorporate income security as provided by the social safety into the concept of economic vulnerability. Additionally, our contribution assesses the additional cushioning effect of short-time work arrangements and informal support between households. Drawing on microdata from wealth surveys and the OECD TaxBEN model for 18 OECD economies, we find that social insurance mechanisms compensate for vulnerability resulting from high asset poverty in some countries. Yet others lack both private and public safety nets to cushion unemployment spells due to lock-down, in particular in the long term. The indicator helps research and policy-making to assess the pandemic's consequences for well-being, aggregate demand and financial stability.

Introduction and Background

Covid-19 is hitting the world economy at an unprecedented scale. The spread of the disease grinds production to a halt, forcing many workers to stay at home. While some work from home or benefit from short-time work arrangements, unemployment figures soar. Economists anticipate a long-term impact on the labour market. This begs questions about the performance of different economies in maintaining living standards, financial stability and aggregate demand, as worsening conditions loom following the unemployment spells. Social security systems and discretionary policy will play a pivotal role. Yet, what is their current shock absorbing capacity, especially vis-à-vis other forms of private insurance, such as wealth ownership and family networks? To what extent can conventional measures of household economic buffers provide helpful answers?

A well-known indicator to measure a household's vulnerability to shocks is the concept of asset poverty, measuring the private capacity of households to weather income loss using their assets. Economic turbulence ahead, this is valuable information. Yet in policy, asset poverty is a rather niche indicator, especially in Europe. In parts, scepticism might be rooted in the importance of assets as buffers to shocks across countries. Indeed, extensive social safety nets, bold labour market interventions or informal familial support can render asset poverty less pressing. We aim at establishing just by how much economic policy compensates asset poverty, relying on a multidimensional measure of safety net adequacy inspired by the literature on asset-based poverty measurement.

Methods

Building on the literature on asset-based measurement of poverty[1], we extend the idea of asset-based poverty to arrive at our measure of vulnerability. The conventional approach considers whether households can maintain a living standard at the poverty line for a given period of time drawing on their liquid assets. We go further by considering assets only to the extent to which unemployment insurance is insufficient to prevent poverty. Next, for some countries we measure the potential impact of short-time working schemes, which usually grant higher replacement rates than social insurance. In a final step, we investigate to what extent financial assistance from

relatives and friends is available to households with low buffers. For our analysis, we draw on survey data from the most recent wave of the ECB's Household Finance and Consumption Survey and the US Survey of Consumer Finances. As both sources lack adequate information on net disposable incomes, we use information from the OECD tax-benefit model to impute a proxy of disposable income.

Results

Adjusting asset poverty measures for the US and 17 European countries to include unemployment insurance policies, we find that in Europe, many social insurance systems mitigate asset poverty substantially. In contrast, the reliance on private insurance in the US leaves substantial shares of the population with inadequate buffers. However, private assets and even unemployment schemes become more fragmented over time in some European economies as well. Shedding light on discretionary policies, we find that their effect is limited compared to the importance of social security systems already in place. While in some countries such as Greece, social networks play a decisive role in resource provision, these mechanisms might not be available at full shock absorbing capacity as labour market incomes fall.

Policy Implications

The measure we design better suits the needs of policymakers who have to consider asset poverty within their national institutional context. At the same time, through identifying vulnerabilities opening up as countries enter into lock-down, this approach can contribute to identifying increasing risks of falling living standards, weak demand and financial instability. In addition to serving as a practical tool to monitor policies and living conditions following large scale disruptions on the labour markets, our analysis also provides some important insights to consider the future of social insurance.

Firstly, the European Monetary Union's (EMU) incompleteness in view of the shallow integration of its automatic stabilizers might prove a weakness in responding to the crisis. Our analysis reveals that countries differ markedly in their capacities to buffer the pandemic's economic fallout. This constitutes a serious threat to the EMU, as differences in vulnerability can trigger asymmetric consequences to unfold. Already in the aftermath of the financial crisis a decade ago, differences in the way Member States were affected by the crisis challenged the EMU in its foundations. As a consequence, the idea of a European unemployment (re-)insurance scheme was increasingly debated[2]. The challenges ahead might give additional clout to such arguments.

Secondly, we find the US to maintain large vulnerabilities, the public safety net hardly compensating for weak private buffers. To some extent, this begs for a reassessment of placing strong emphasis on private safety nets, and reducing the scope of social insurance to relatively low levels by international comparison. Indeed, the pandemic's effect might lead to increased recognition that public institutions are required to manage risk[3], which will be particularly relevant in countries that have less generous public systems.

Track

At the Congress, *Track 5: Wohlfahrtsstaat: Vermögen der Republik* will provide the most appropriate environment for the presentation. Social insurance can be considered as the wealth of the public, contrasting with private wealth used to weather contingencies. By focusing on the interplay of private and public safety nets and substitution effects between both, we address questions at the heart of welfare state research.

References

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