

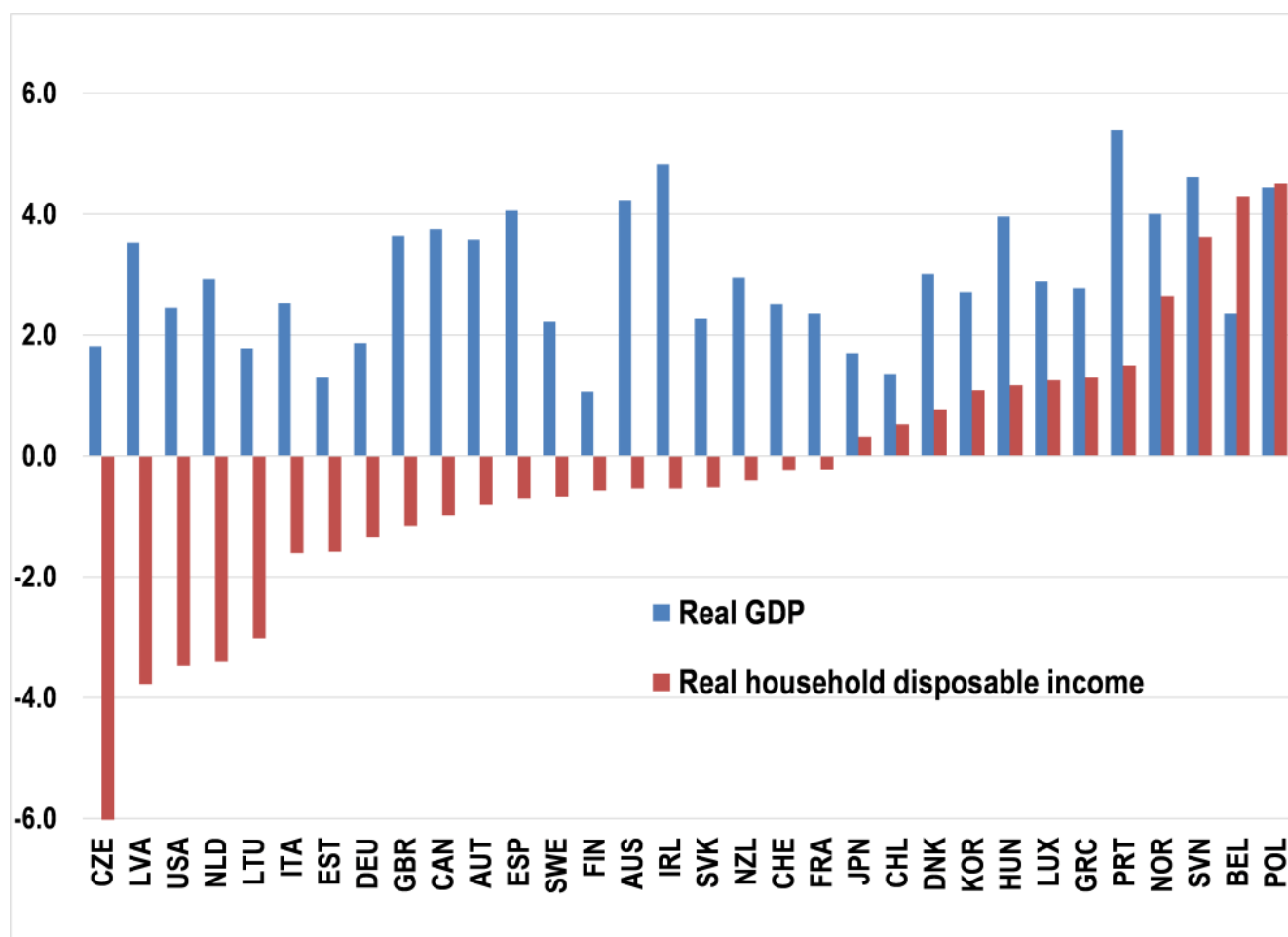
Structural reforms to help address the cost of living crisis

By David Turner, Balázs Egert and Jarka Botev, OECD Economics Department.

In the latest forecasts published by the OECD, the growth rate of GDP expected this year is positive for every OECD country, but the growth rate of real household disposable income is consistently lower and is negative for a majority of them (Figure 1). Moreover, the magnitude of this differential has not been experienced in some countries since at least the 1970s, leading to what is often referred to as a ‘cost of living crisis’. This difference is all the more important given the long-standing argument that income measures based around household disposable income provide a superior measure of welfare to GDP; adjusted household disposable income¹ is used as an alternative income measure to GDP in the OECD flagship publication *“How’s Life: Measuring Well-being”*, is a component of the *OECD Better Life Index* and is more consistent with the recommendations of the Stiglitz-Sen-Fitoussi Commission on *Measuring Economic Performance and Social Progress* to focus on household income and consumption rather than output (Stiglitz et al, 2009).

Figure 1. Comparing projections of GDP and household disposable income

% growth pa in 2022



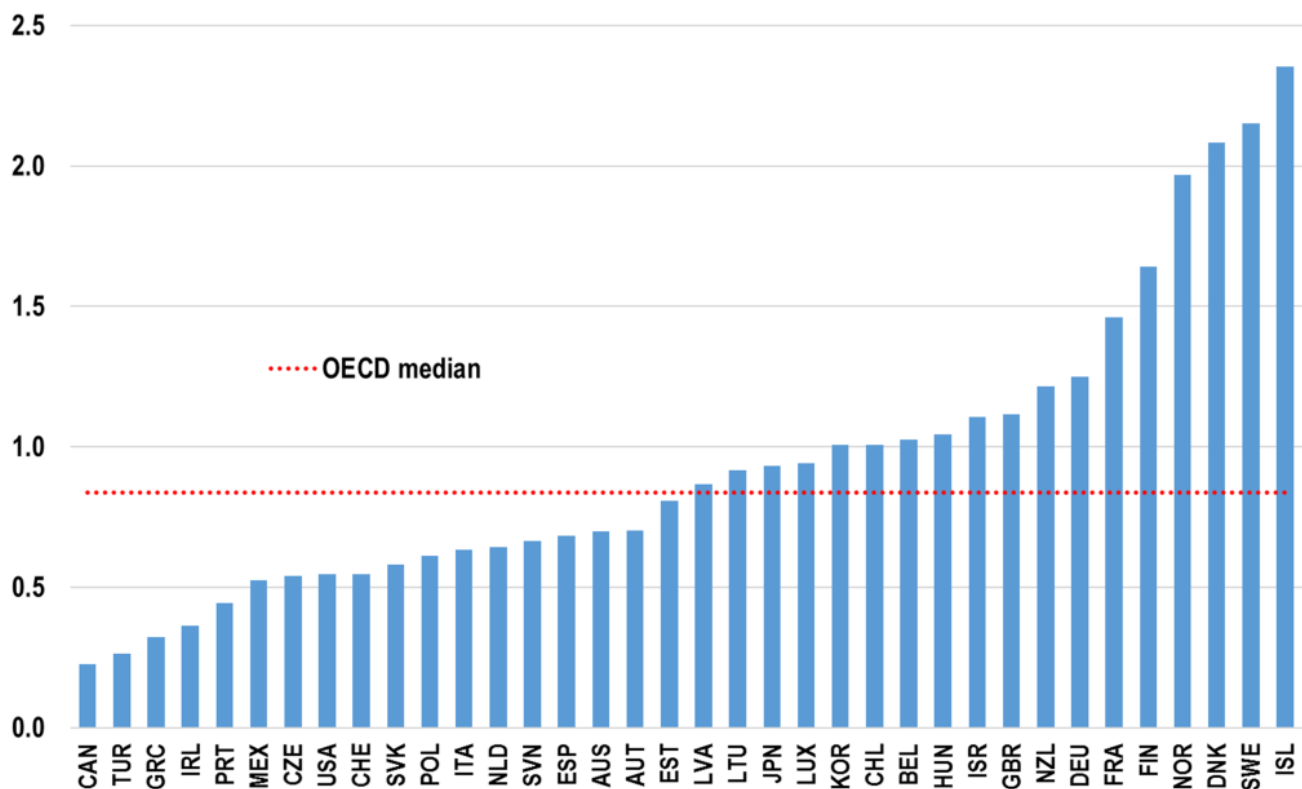
Note: The chart compares recent OECD projections for 2022 of growth in real GDP and real household disposable income. Only OECD countries for which national accounts data on real household disposable income is readily available are shown. Source: OECD Economic Outlook, June 2022.

In response to the cost of living crisis, governments are rolling out temporary, timely and well-targeted fiscal support to vulnerable households. Such policies might be contrasted with structural reform measures, which are typically more permanent in nature and usually take many years to raise the supply-side potential of the economy. However, just-published OECD research considers the differential impact of a range of structural reforms on adjusted household disposable income as compared to GDP and finds that some structural reforms – including family in-kind benefits, family cash benefits and cuts in the income tax wedge – have a disproportionately large effect on household disposable income compared to GDP (Botev et al, 2022).

In addressing the cost of living crisis, these results provide a particularly strong case for increasing support to early childhood education and childcare, which represents over 70% of family in-kind benefit payments across OECD countries. Not only would such policies boost long-run employment, especially for women, and have a rapid and magnified effect on household disposable incomes, but even prior to the current episode they were identified as being among the top structural reform priorities in no fewer than 22 OECD countries, including all G7 countries (Botev et al, 2022; OECD, 2021). Government spending on family in-kind benefits varies widely across OECD countries (Figure 2), with Nordic countries spending as a share of GDP more than double the OECD median. While there may be diminishing returns to additional such spending at higher initial levels, this still leaves substantial scope to increase spending in the majority of OECD countries. Finally, it should also be noted that there may be an additional long-run supply-side benefit from boosting spending on early childhood education via a long-run improvement in human capital and total factor productivity (Égert et al, 2022).

Figure 2. Public spending on family in-kind benefits

Percent of GDP, 2019 or nearest year available



Source: OECD Social Expenditure Database.

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[1] The adjustment in ‘adjusted’ household disposable income reflects an imputed value from public services such as education and health that provides a better basis to compare performance across countries.