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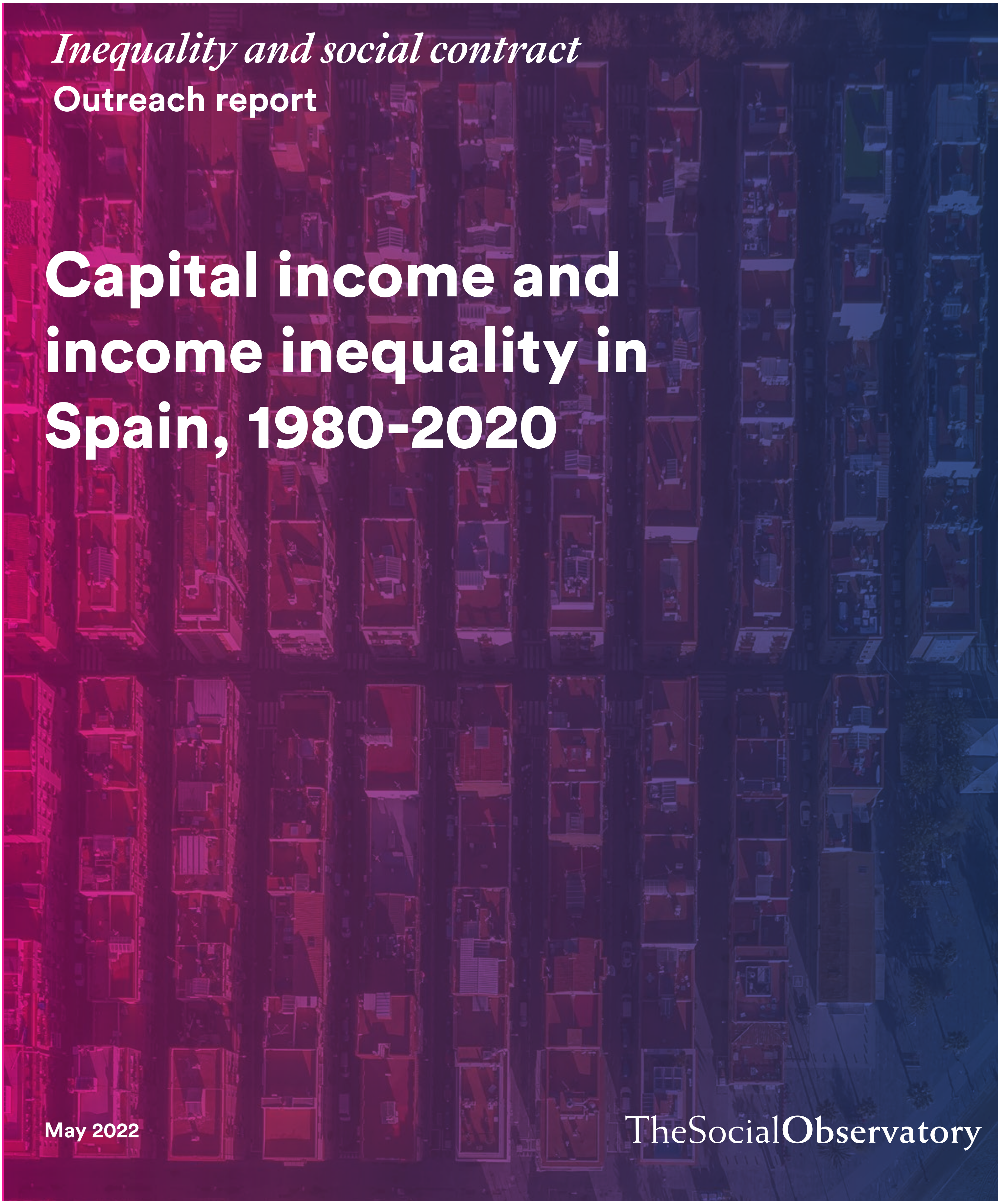

Inequality and social contract

Outreach report

Capital income and income inequality in Spain, 1980-2020

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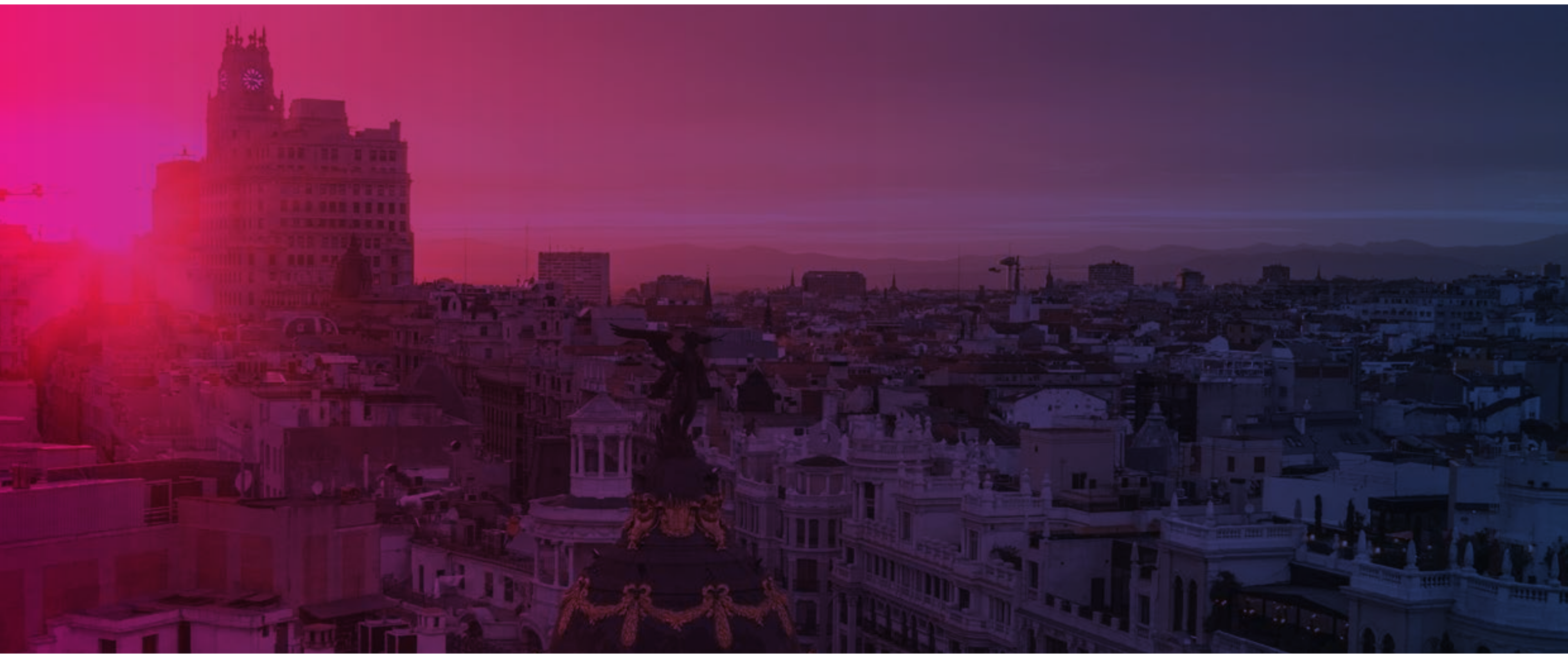
Abstract

Income inequality has grown steadily in Spain over the past two decades. This paper uses a new methodology to attribute the total national income to adult residents in Spain. The national income items that have increased most are rents and retained earnings of companies. Given that the latter form of income is concentrated among the richest groups, income inequality among individuals has increased. Similarly, income dispersion across age groups has been accentuated by higher unemployment and lower wages among younger cohorts. These trends are some of the reasons why Spain has much higher levels of pre-tax income inequality than the European average.



Main ideas

1

The proportion of capital income has increased by 6 percentage points in Spain since 2006. Rising rental income and corporate profits account for most of this trend. A growing share of capital income is not declared for personal income tax (IRPF) purposes.

2

The increase in capital income predominantly favours higher-income households, thereby increasing levels of inequality.

3

The share of national income of the richest 1% of the population is at record levels. This group accounted for 18% of national income in 2018, approximately three points more than in the first decade of the century. The bulk of this increase is due to the rise of capital income.

4

Spain has high levels of inequality compared to other developed economies. The top 1% of income earners receives 2 percentage points more of national income than in other countries with similar estimates.

5

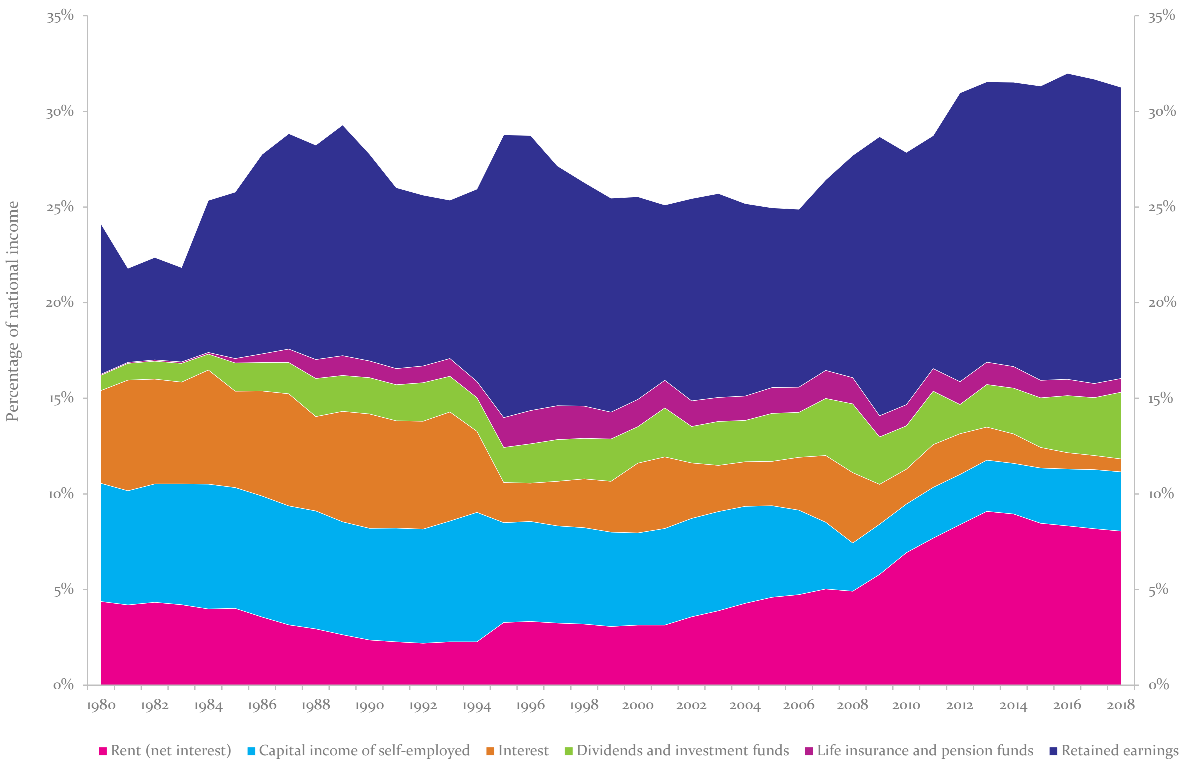
Inequality by age group has become more pronounced. Labour incomes fell most among young people during the 2008 crisis. Furthermore, strong inequality when it comes to distributing capital income has been compounded, as these cohorts have been less able to save and diversify their wealth.

1 The proportion of capital income has increased by 6 percentage points in Spain since 2006

Capital income (interest, dividends, rent, retained earnings, etc.) has risen systematically since 1980 in all developed economies. This rise in Spain was more restrained until the turn of the century, but it gained momentum from 2007 onwards, at the end of the real estate boom. This increase in capital income (a total of 6 percentage points of national income) is explained by an increase in income from housing rents and corporate profits. Both processes are in turn driven by a strong increase in house prices and high levels of real estate investment. On the other hand, slowing economic growth and limited wage growth complement these trends.

Figure 1: Rents and corporate profits lead capital income growth

Share of capital income by item as a percentage of national income, 1980-2018

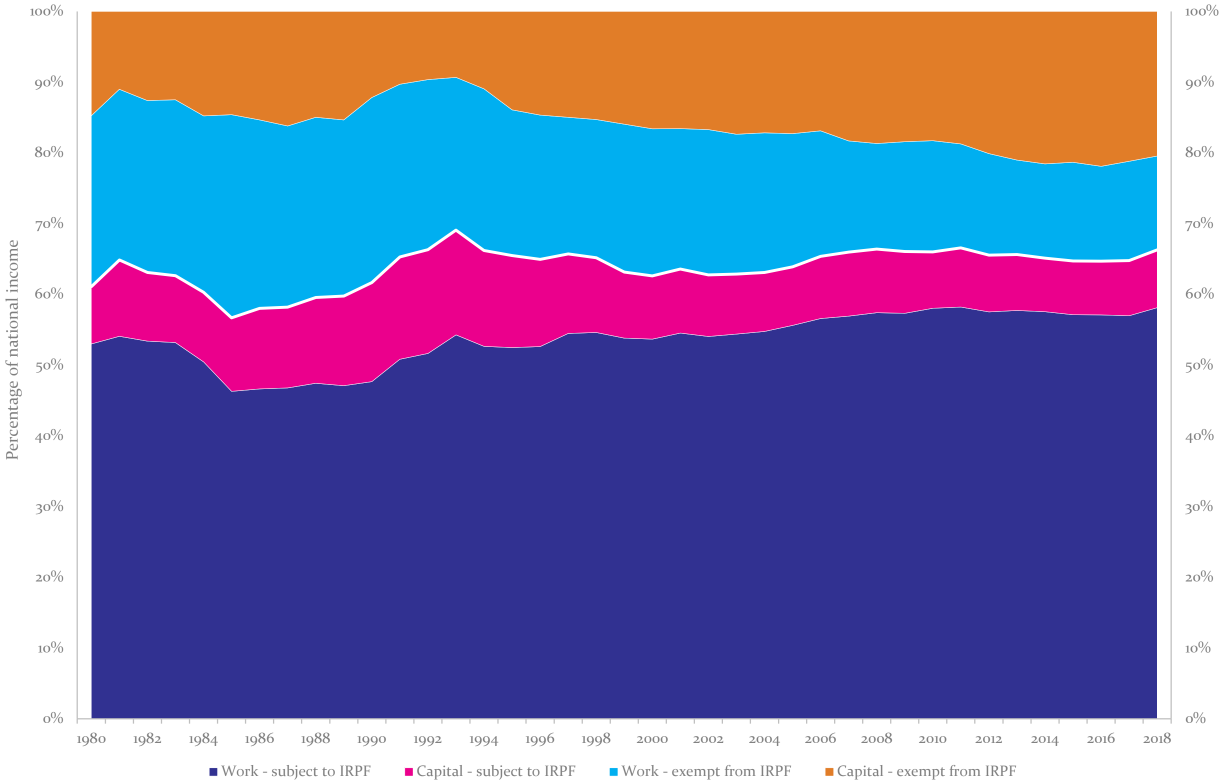


Source: INE (1987, 2021).

Although a decreasing share of labour income is exempt from taxation (11 percentage points less on national income between 1980 and 2018), a rising share of capital income is legally exempt from taxation (5 percentage points more on national income between 1980 and 2018). The main exempted capital incomes are imputed rents of main residences or those not received directly by households (income from investment funds and undistributed corporate profits). Given that the proportion of capital income is higher at the upper reaches of income distribution, this implies an increase in the regressivity of income taxation due to a lack of reforms that would apply a higher tax burden to capital income rather than labour income.

Figure 2: A rising share of capital income is undeclared for personal income tax (IRPF) purposes

Labour and capital income by personal income tax (IRPF) as a share of national income, 1980-2018



Source: INE and AEAT (2019, 2020).

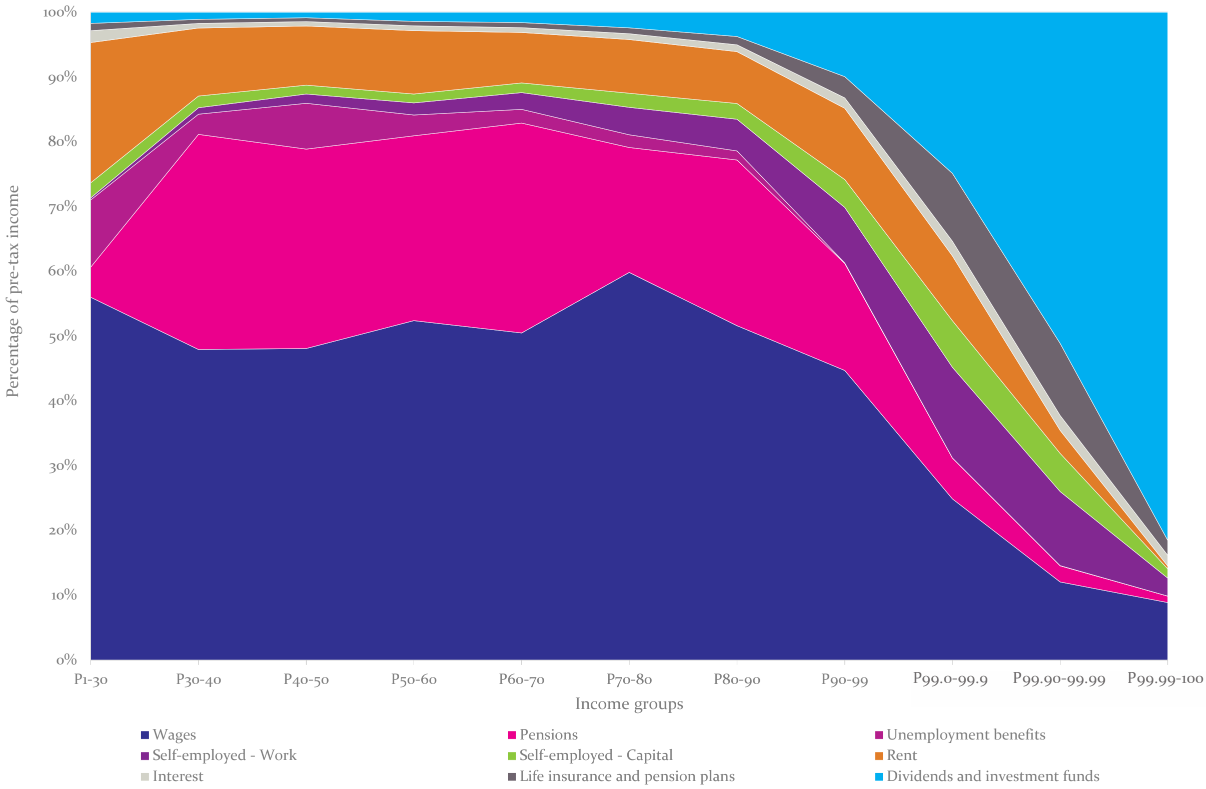
2 The increase in capital income predominantly favours higher-income households

Capital income increases should not per se determine the income inequality of individuals, as total income also includes labour income. Nonetheless, an increase in inequality is inevitable to the extent that higher-income households concentrate a larger share of this income (for example, the top 10% accumulated 70% of capital income in 2018). Most adults in Spain receive income from real estate to supplement their income (around 5% of their total income). But income from financial capital (interest, dividends, investment funds, etc.) is predominantly distributed among the richest groups, and this concentration has become more intensified since the real estate crisis.

This duality is mainly explained by the preference of many households to own real estate assets, both primary and secondary residences. Tax incentives and public policies could explain this strong bias towards home ownership. In contrast, wealthier groups accumulate a larger share of income from financial assets, and these directly or indirectly depend on corporate profits.

Figure 3: Income composition per adult in Spain, 2017

Pre-tax income group ranking by income type



Note: *the scale of the last decile has been increased to better appreciate changes in income composition at the upper reaches of distribution. Income in the lowest decile has been excluded because the income received is negative (mainly losses from self-employed businesses).*

Source: compiled by the authors based on the Institute of Fiscal Studies and AEAT (2017), INE (2017) and Bank of Spain (2017).

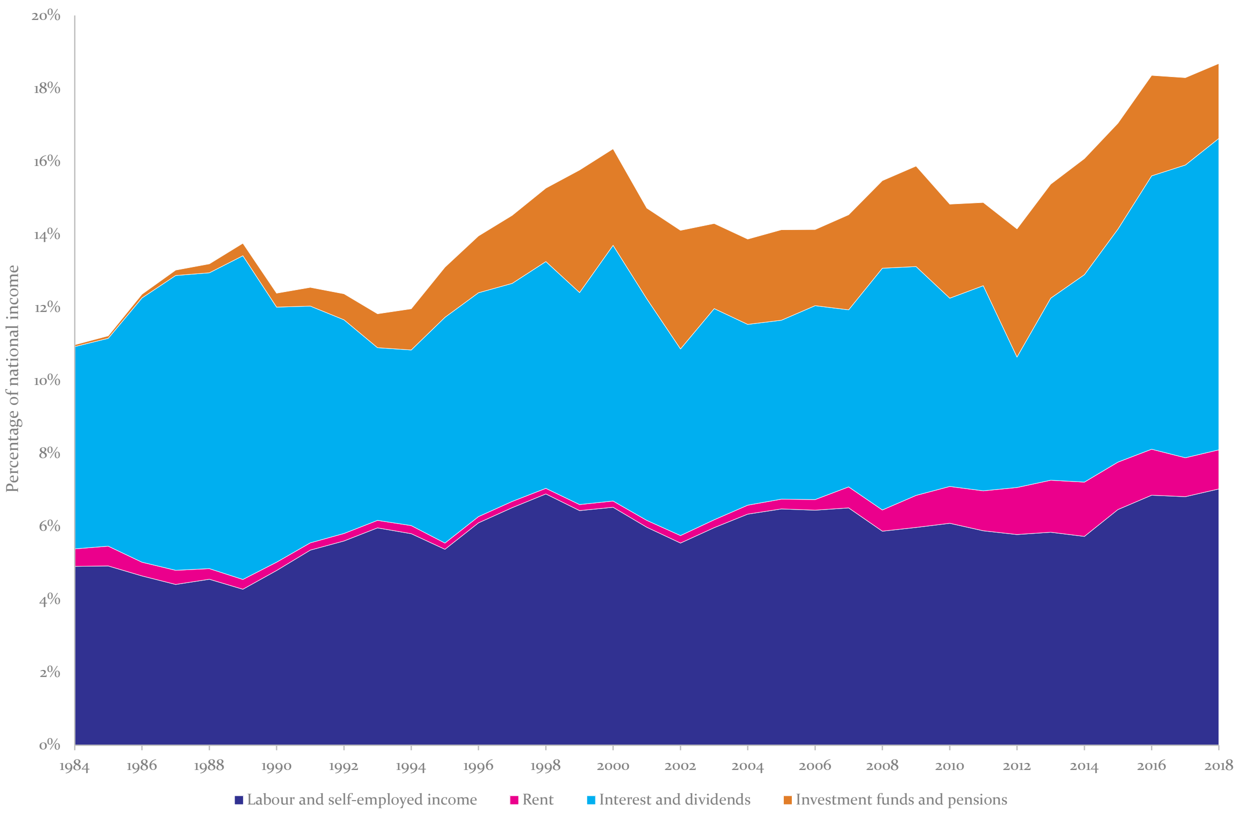
3 The share of national income of the richest 1% of the population is at record levels

One of the most consistent indicators for analysing inequality is the percentage of national income that goes to the top 1% of the population. Although a small group by definition, it accounts for a considerable share of income in Spain. This group has traditionally received around 14% of national income. Slightly less than half of this percentage remunerates labour in a broad sense (wages, pensions and self-employed income) and the rest remunerates capital.

Although it may seem paradoxical, the share of national income flowing into the top 1% tends to increase during times of economic growth and low unemployment (late 1990s, mid-2000s) and to contract during years of crisis (2000-2002, 2008-2012) due to the sharp reduction in corporate profits. Nonetheless, the latest economic cycle (2012-2019) has been exceptional, as top 1% incomes have recovered very quickly, bringing income concentration to its highest levels since the advent of democracy, above 18%.

Figure 4: Top 1% incomes lead rising inequality

Top percentile income by type of income as a percentage of national income, Spain, 1984-2018



Note: *each line indicates the percentage of income received by age group in the national average income from labour and capital.*

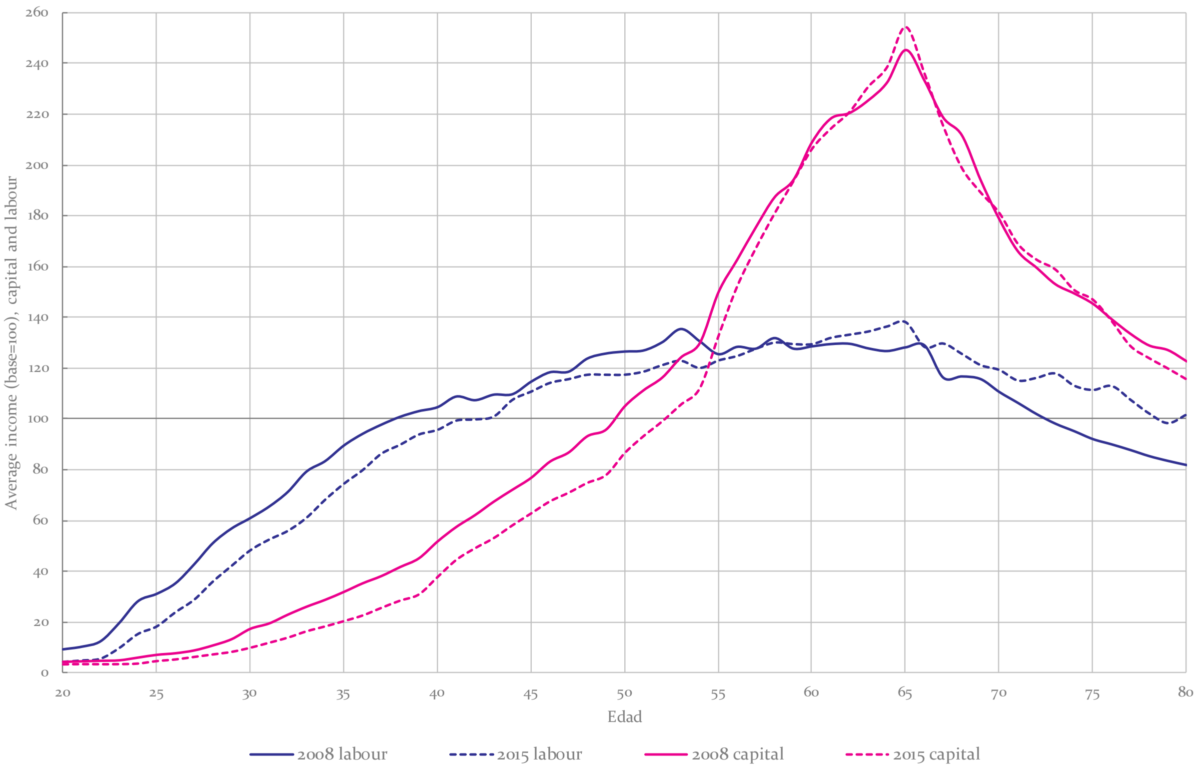
Source: compiled by the authors based on the Institute of Fiscal Studies (2020) and Bank of Spain (2004).

4 Labour incomes fell most among young people during the 2008 crisis

The 2008-2013 crisis and subsequent economic recovery had a very uneven impact across age groups. Young people initially experienced a bigger increase in unemployment and subsequently gained access to jobs with lower wages than before the crisis. By contrast, the over-65s, whose income from work depends mainly on pensions, barely saw a drop in their incomes and their economic position was strengthened in relative terms. Young people had lower incomes, and thus lower savings, during this ten-year period, so they were not able to invest as much in the most profitable assets (mainly housing and shares) than young people of the same age before the crisis. This meant that young people were able to accumulate less wealth in 2015, as they had been earning lower capital income for more years.

Figure 5: Those aged 65 and over receive higher pensions and maintain high capital income, and the opposite is true for young people

Labour and capital incomes in Spain by age group, 2008 and 2015



Note: *each line indicates the percentage of income received by age group in the national average income from labour and capital.*

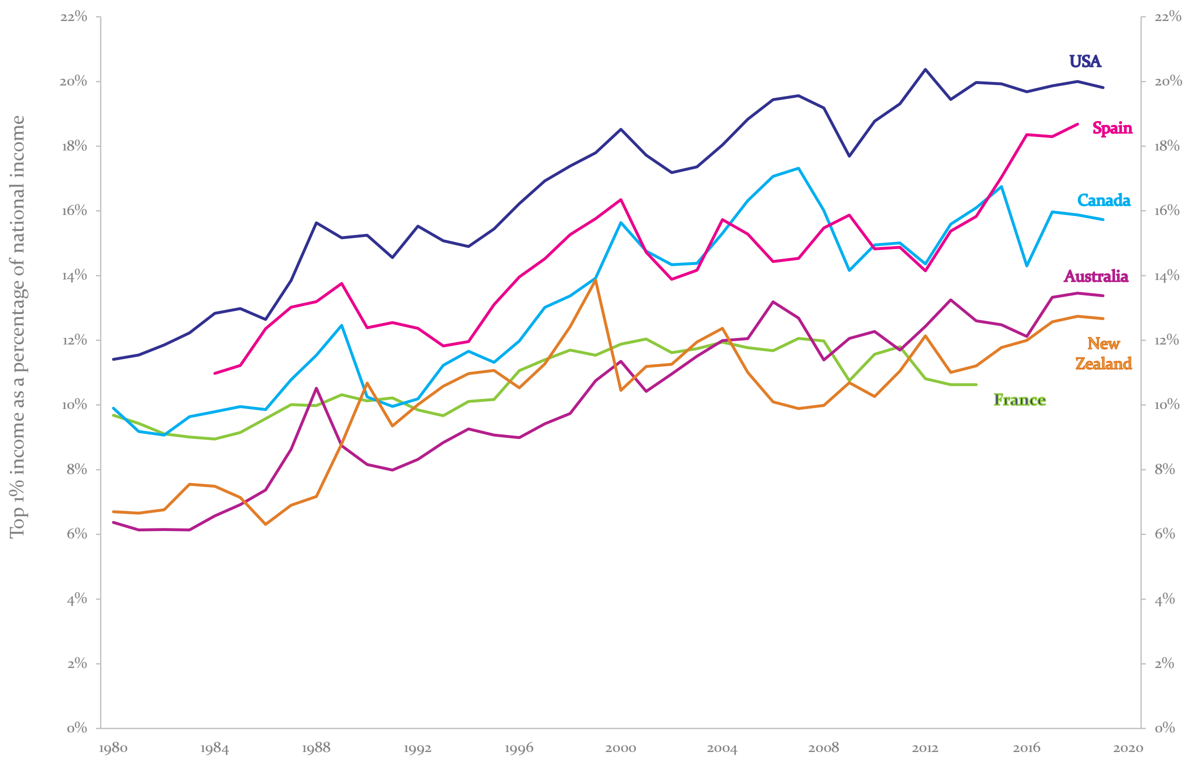
Source: compiled by the authors based on the Institute of Fiscal Studies and AEAT (2008, 2015), INE (2008, 2015) and Bank of Spain (2008, 2014, 2017).

5 Spain has high levels of inequality compared to other developed economies

Income inequality is rising in most countries throughout the world, both in developed and emerging economies. The reasons driving this increase in inequality are similar: increase of capital income and wealth accumulation, polarisation of labour market or generation gap, among others. However, the increase in (pre-tax) income inequality has not been the same across countries. This fact shows that there are differences depending on (public and private) institutions and policies implemented by states. Spain is notable as one of the countries in Europe with the highest levels of income inequality.

Figure 6: Spain has a high level of inequality among developed countries

Top 1% income as a percentage of national income in selected countries, 1980-2019



Note: *distribution of income among adults at an individual level.*

Source: WID (2021).

Conclusions

Inequality has become a focus of public debate in recent years. The evidence presented in this report indicates the need to look at inequality from many angles, including the concentration of capital income, the rise of top 1% incomes and the widening generation gap. The forces pushing for rising inequality are diverse, and so far public policies in various areas (labour market, housing, taxation or through benefits) are not correcting the income gap of the adult population.

The information available until now underlines the uneven impact of the economic crisis that began in 2020 as a result of the global pandemic, thereby increasing the urgency to act with greater decisiveness. Lower-income populations and once again younger cohorts have been hardest hit by this crisis. Increased spending on benefits (temporary lay-offs and the like) alone cannot offset this effect, and major changes in income distribution need to be considered. In terms of taxation, an ambitious reform of direct taxes that would bolster progressivity by extending revenue coverage would have a clear redistributive effect in the long run. Public administrations should also address the limited impact of housing policies thus far, as well as the possibility of redistributing capital income in more diligent ways.

Proposed actions

1

An increasing share of capital income has not been subject to personal income tax (IRPF), which is the main progressive tax in Spain's fiscal system, for two decades now. The country's tax architecture needs to be reformed in order to ensure greater coverage and complementarity between taxes.

2

Emphasis should be placed on fighting tax fraud and ensuring that corporate profits are taxed in the country where they originate, not in tax havens. Even without any consensus, the government could establish a minimum rate at which these profits should be taxed. Tax harmonisation also needs to be promoted to avoid downward competition among autonomous communities, as this mostly benefits individuals at the upper reaches of income and wealth distribution.

3

A public register of owners of financial assets (shares, bonds, distributed income and other instruments) should be created. Such a procedure would facilitate the techniques to avoid tax avoidance and help to ascertain the real degree of concentration of wealth and financial income.

4

The government should commission the INE to prepare distributive national accounts that would calculate the distribution of national income among the resident population. Public policies (in the labour market, social protection and taxation) would be better adapted to current needs.

5

While inheritance remains the main means of wealth accumulation, public administrations should consider the introduction of a universal public inheritance, whereby all young people in the country would receive an endowment to buy a home, start a business or complete their education. This project could be financed by a complete reform of Spain's inheritance and gift tax (ISD).

Study characteristics

It is vital to measure capital income and its distribution in order to understand inequality trends. Most household income comes from labour, either directly (wages and self-employment income) or deferred over time (pensions and unemployment benefits). These incomes traditionally receive more attention and are best recorded in micro-data (e.g. household surveys). In contrast, capital income is more poorly measured in these sources. This report addresses this issue from a new perspective based on National Accounts, which involves distributing the entire pre-tax national income across the adult population. This requires starting with income declared or subject to personal income tax (IRPF) withholding and then including income that is legally exempt or under-declared.

The income concentration levels we obtain are higher than those obtained from surveys, as the tax data allow us to better record financial incomes that are more concentrated at the upper reaches of distribution and the DINA methodology allows us to take into account incomes such as undistributed profits, which are also more concentrated at the upper reaches of distribution.

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