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The Role of Non-labor Household Income in Shaping Intergenerational Inequality Trends in Spain

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The growing disparities in the distribution of household incomes over the course of the past decades in most OECD countries, especially since the onset of the crisis, has pushed the attention of academic analysis towards explaining its determinants. The trend of market income inequality is frequently analysed to determine if the evolution of disposable income inequality, after taxes and transfers, is more connected to the allocation of primary income or to the effects of redistributive policies. In fact, the OECD (2015) points out that during the recent weak economic recovery in developed economies, income inequality before taxes and benefits has continued to rise while the cushioning effect of taxes and benefits has become weaker, accelerating the overall upward trend in disposable income inequality. This result underlines the growing relevance of primary income inequality to explain changes in individual well-being.

In a previous study, the OECD (2012) highlighted that, before taxes and transfer, income dispersion mainly reflects labour market outcomes. For the working age population in the late 2000s, labour market income represents around 75% of the dispersion on average in the OECD, as compared with just 25% for self-employment and capital income combined. Most of the previous literature, therefore relates such growing income dispersions to the functioning of labour markets, mainly due to increasing unemployment rates or growing wage dispersion (mostly at the top versus the rest) and this has implied that the focus has been on labour earnings (also in gross and net income inequality), with capital and self-employment income hardly been addressed.

With the important exception of Piketty and Saez (2014), non-labour market income: capital income and other income have hardly been considered relevant to explain changes in market income inequality. Nevertheless, it is well-known that capital gains, asset property and wealth are much more unequally distributed than labour income in developed countries and their distribution has strong implications for individual well-being. In this context, we believe that it would very interesting to complete the study of market income inequality considering the different flows of capital income to households at different positions of the income distribution.

In fact, as Brun and Gonzalez (2017) show, owners of equity benefit from the rise of its value (due to monopoly mark-up) and from increasing equity returns, while households whose income relies on labour suffer from the decrease of the returns from human capital formation.

The first aim of this paper is to provide a detailed analysis of the weight of the different income sources divided into labour income and non-labour income in shaping market income inequality in Spain, one of the countries that experienced a larger GDP contraction during the recession and with a high percentage of homeownership. We will pay attention to the measurement of the income value (as an approximation to well-being) accruing from homeownership and other assets. We base our calculations on Wolff et al. (2012) methodology for the US and calculate an imputed rent for the main owner-occupied housing net of mortgage debt. We also check the robustness of our results computing the income generated by the household financial asset portfolio as a lifetime annuity.

To impute the rent for the homeownership we use the rent to value approach and distribute the Gross Value Added (GVA) of imputed rents among homeowners, according to the value of their home. To obtain accurate home values, we estimate the evolution of the price of households per square metre since the purchase year and subtract the mortgage debt, calculated as a lifetime annuity, using the interest rate that captures the total cost of the mortgage. For the rest of household real estate, we compute the lifetime annuity considering the revaluation of the real estate assets recorded in National Accounts as the rate of return. Additionally, following the taxation of real estate rules in Spain, we impute an income of 2% on the value of the properties that are not used for commercial purposes nor rented.

To determine the annuity of financial assets, we take into account the weighted average interest rate of each asset from 1998 to 2014. The weights represent the importance of these assets in total financial assets held by the household sector, following the National Accounts definition.

A key question to answer when analysing an upward inequality trend in developed societies is who the gainers and losers are. In general, the literature on labour market income inequality trends has concluded that it has been the younger generation of workers who have lost labour income while older generations have been able to keep their position, increasing inter-generational wage inequalities. Much less in known about the role of non-labour market income in contributing to an intergenerational gap between younger and older cohorts. Therefore, the second purpose of the paper is to compare the weight of the different income sources for different generations, with special attention to the market income after the incorporation of the asset value as a flow. We analyse if there is an increasing gap between younger and older cohorts' market income in Spain. For the whole analysis we will make use of the detailed information on income and assets in the Spanish Survey of Household Finances (Encuesta Financiera de las Familias, EFF) a largely reliable wealth data source provided by the Bank of Spain and available from 2001 up to 2013 using three different waves that cover more than a decade.

The paper is structured as follows: Section 1 presents a review of the main conclusions of previous analyses both on the relationship between non-labour market income and inequality and on the intergenerational gap in non-labour market income for cohorts born in different decades. Section 3 discusses the different methodologies that have aimed to measure the income value accruing to households from home (or other assets) ownership and describes our methodological choices to implement an accurate well-being measure for Spain. Section 4 describes the data and discusses our main results. The last section concludes.