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Income Inequality Within and Between European Countries

Especially in the context of the EU cross-country inequality analysis is a matter of particular interest. Investigating the development of income inequality in the different member countries helps identifying the current state of social cohesion in this area. To shed some additional light on this question this paper focuses on the evolution of income inequality in the EU-15 as a whole as well as in the different member countries throughout the time period 1993-2005. Additionally, for the years 2004 and 2005, the effects of the inclusion of the new EU member countries on overall EU inequality are analysed.

Concerning the datasets, we combine annual micro data from different sources, such as the ECHP (European Community Household Panel), EU-SILC (Statistics on Income and Living Conditions) and the micro data output of the microsimulation model EUROMOD to derive comparable inequality measures across countries and over time. The methodology applied is using mainly the Theil index from the Generalized Entropy family of inequality indices because of its property of additive decomposability. Therewith we can determine the development of each country’s contribution to overall income inequality.

Also this enables us to discriminate the different effects on the overall Theil index, when integrating the new member countries to the entity. Because of their readily intuitive interpretation Gini coefficients are also calculated.

Seeing the EU as one single economic unit, the Gini coefficients of disposable income indicate a steadily decreasing trend until 2000, followed by significantly higher levels of inequality at the beginning of the twentieth century. This overall inequality trend is also reflected in most individual countries. The Theil inequality decomposition further reveals that the overall inequality trend is mainly driven by changing within-country inequality and we cannot find any evidence for a significant reduction of the inequality between countries. This finding contradicts the expectation of a convergence process of mean incomes across EU member states. Including the new EU member countries only slightly increases overall inequality, but substantially rises the between inequality component.