Welfare regimes and income inequality in Europe

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In recent years, there has been a rising concern about income distribution in academia and international organisations, resulting in a vast number of studies addressing the issue. Evidence shows increasing gaps between high- and low-income households as well as between the top and bottom wage earners. It further suggests that the level of inequality in a country is to a large extent determined by the labour market and social policies in place, i.e. the welfare system. In his seminal work *The Three Worlds of Welfare Capitalism*, Esping-Andersen (1990) established a typology of countries based on the institutional design of welfare policies. Given these similarities of the welfare system, one would expect that countries belonging to the same type of welfare system display similar outcomes regarding the effective distribution of income. In our paper, we try to assess the common features within a type as well as the differences across types. Does the classification hold true when we look at real-world outcomes? Has there been a change in welfare systems over the past decade? Has the global economic crisis led to a weakening of welfare systems and/or to a convergence between different types?

Data and Methodology

In order to assess these questions, we use the European Union's Statistics on Income and Living Conditions cross-sectional micro-data. The analysis is done for most European countries, using two points in time – one in the mid-2000s and the latest year available. We use an improvised version of Esping-Andersen's (1999) classification, classifying countries into six groups: (i) social-democratic (Finland, Norway, Sweden), (ii) Christian-democratic (Austria, Belgium, France, Luxembourg), (iii) liberal (Iceland, Ireland, Switzerland, United Kingdom), (iv) corporatist (Greece, Italy, Portugal, Spain), (v) Baltic (Estonia, Latvia, Lithuania), and (vi) Central and Eastern European (CEE; Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia).

We structure total income into different components, namely labour income (wages and self-employment income), capital incomes, community transfers, and social transfers (contributory and non-contributory). In order to get to disposable incomes, we deduct taxes and contributions to social security from total income.

In the first part of the analysis, we start by assessing the shares of the different income sources in total household income. We then decompose the level of disposable household income inequality in a country using Lerman and Yitzhaki's (1985) factor decomposition method. This analysis is done for two points in time and it enables us to identify to what extent each income source contributes to income inequality. Additionally, the results of this analysis will allow us to assess whether the outcomes for countries within the same type of welfare regime show similarities and whether these similarities have increased or decreased over time. In order to check for (dis)similarity (between) within the regimes, we further plan to implement a cluster analysis based on the results obtained. In addition, the cluster analysis will help us to assess in which group the Baltic and CEE countries can be classified, as these countries have rarely been included in welfare state analyses.

The second part of the analysis looks at the decomposition of the change in income inequality over time. Using Azevedo et al.'s (2012) decomposition method, we analyse which factor sources contributed to the change of inequality from the mid-2000s to the latest year available. These changes, together with a thorough review of the policy changes implemented over the past decade, and in particular since the crisis, will help us to assess whether a weakening and/or convergence of the welfare states can be observed.

Preliminary findings

Our preliminary results show that labour income accounts for the largest share of income and is the biggest contributor to inequality, throughout the regimes. However, there are some differences across the regimes with regard to other income sources. In particular, the share of social transfers is larger in social-democratic countries than in others. The inequality decomposition further brings out that contributory social transfers had an inequality-increasing effect, in particular in Christian-democratic, corporatist, and CEE countries. Interestingly, while their effect was inequality-decreasing in the social-democratic countries in the mid-2000s, data for the most recent year show that contributory social transfers have a neutral or very small inequality-increasing effect. Non-contributory social transfers have a small inequality-increasing effect in the countries belonging to the three "original" regimes (i-iii), and no or mixed effects in the other regimes.

With regard to the changes in inequality over time the picture is quite mixed and it is hard to find common patterns within the regimes; while inequality was reduced in some countries, others have experienced an increase over the period analysed. These results along with the cluster analysis would help us to gain a better understanding of the welfare regimes in Europe, and to assess whether they have weakened over time or whether there is a convergence, which would be quite useful from a policy perspective.

References

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