On the Redistributive Policies: a Comparison between EU and USA

Marco Mele
University of International Studies, Rome, Italy marco.mele@unint.eu

Floriana Nicolai
University of International Studies, Rome, Italy Flo_88@live.it

Abstract

This work aims to investigate the redistributive policies in US and EU. In particular, our study will conduct a comparison between the determinants of redistribution of wealth. We will study, therefore, the following determinants: government spending and its composition for both EU and US; Government revenue and effects on redistribution and finally the study will focus on the political determinants of redistribution. We will conclude by saying that in the presence of crisis US and EU are acting differently and with different effects on redistribution.

Keywords: Redistributive policies; government spending; Government revenue
JEL codes: D31, D60, H20

1. Introduction

The concept of the redistribution and especially that of income has experienced an evolution in economic theory that have exceeded those who were the contributions Neoclassical and Keynesian. In particular, in the economic literature, for redistribution of income refers to all those economic policy measures designed to changing the distribution of income among a group of individuals in a country. Usually, the policies used to increase the welfare conditions of those who are regarded as less well-off are the taxation and redistribution of spending. With regard to the first instrument it is driven by the contributive capacity which provides for the direct tax marginal rates gradually increasing and exemptions and deductions which the weight decreases as income increases.

On the expenditure side, however, the redistribution can be make or with the so-called benefits in kind or in money, although the main effects arise from the combination of both instruments. Benefits in kind include the set of public goods and services provided free or at affordable prices to those who appear to be low-income earners: the aim of this maneuver is to facilitate the consumption of goods deemed meritorious by poor social classes. The service in money, consisting of real monetary transfers made by the State in order to ensure income by the tax authorities deemed too low. Among these may include social pensions, family allowances, unemployment benefits and unemployment insurance for those who have temporarily lost their jobs.

In the context of the analysis on the redistribution of income many authors such as Kuznets (1955) affirmed as such concept is especially important for developing countries because they have a higher degree of inequality than developed countries. The explanation for this phenomenon lies in the fact that the same development would seem to be a sequential process and unbalanced: instead to benefit all at the same time, the process appears to favor certain groups of individuals, at least in an early stage. The time required to move from one stage of development to a stage of redistribution of wealth and income, will depend on several factors may be numbered among the so-called Hirchmann’s tunnel. He along with Rothschild (1973) asserted that the amplitude and the duration of inequality in the redistribution depends on various reasons, such as tolerance to inequality in the redistribution from the people. In particular, the study showed how a society more heterogeneous tend to be less tolerant. This analysis, however, is influenced by the socio-political context of the country if given a certain social structure, the tunnel effect will be weak (ie. the tolerance for inequality is low) a strategy characterized by the phase “grow up and then redistribute” will not have any success. But even in a context where the tunnel effect is kind of strong, if policy makers will be insensitive to the time that elapses between the development and redistribution, the latter will be adversely affected. The research conducted over
the years through time series models in more robust not always confirm the Kuznets’ analysis. In particular, a certain skepticism is born on the causal relationship between economic growth and inequality, since the former would imply an increase of the average of the distribution, while the inequality indicates a change in shape of the distribution or, at least, of the dispersion around the mean (Deininger, K., Squire L., 1996; Bénabou, R., Ok, E. A., 2001). However, although the economic theory addresses the concept of redistribution mainly with regard to developing countries, there are some contributions that seek to give an economic explanation also to the differences in the redistribution of income between developed countries and in particular between Europe and the United States of America.

In the context of differences in policies on redistribution one of the most common explanations is that inherent in the distribution of gross income: more unequal it is higher the demand will be in favour of redistribution. According to the economic literature, a rate higher inequality means that there will a greater number of individuals who will receive an income below the average and therefore will support electorally those policy makers who will tax high incomes. If we accept that assertion it follows that Europe, as a record level of income more unequal, is more redistributive than in the USA. Benabou and Ok (2001) pointed that this claim turn out to be approximate when the redistribution cannot prescind from consider the future expectations of individuals. The two economists, in fact, claimed that the redistribution also passes by the concept of mobility and potential income over a lifetime, an issue that was deepened by econometric models also by Alesina and La Ferrara (2004).

2. Public spending and redistribution

Talk about government spending means to, in economics, to enter into the debate on what is the role of the state in the economy of a country. This concept dates back to the contribution of Adam Smith in his essay “The Wealth of Nations”, where the economist described the three “functions” of the state: to protect society from internal violence and/or the external ones and implement interventions that do not involve public an individual citizen, but the community as a whole. In particular, for Smith, although the market should be left to act from the normal forces “invisible” supply and demand, in exceptional cases -which today we recognize the so-called failures of the market-, public intervention appeared justifiable. However, the classical economists have always been opposed to such a type of public action. In contrast, the Keynesian school has invoked the use of fiscal policy to support the economy during the downturn.

A different categorization of the functions of the State, however, was developed by Musgrave (1959), according to which the economic policies of national governments pursue three main objectives: the stabilization of the economic cycle, the redistribution of wealth and efficiency in resource allocation. For stabilization, which has been in mainly with the politics of revenue (in the case of the EMU is obvious when monetary policy is delegated to the ECB), the economist studied mainly the level of public expenditure and the ability to activate programs spending for Keynesian short-run. Different and in some ways more complex, however, is the distinction of public spending when you want to deal with its impact on the redistribution of resources. In this context, for a good allocation of social resources, the policy maker cannot consider the effects of the maneuvers on the market. In especially, in the face of market failures, it is necessary to evaluate the social costs of possible imperfections that generate public failures of the state.

The diffusion of the social doctrine of the welfare state and then back to the dictates of the setting Keynesian, has meant that since World War II in the Western world the role of the public sector became gradually more and more important especially in its function of redistribution of wealth.

From the point of view of electoral cycles economic thought began, therefore, to evaluate the actions of governments in relation to the marginal role of the maneuvers in the context of social welfare, a fact that led governments to justify the accommodative policies in deficit as necessary to tackle poverty and unemployment. These policies met in the eighties an abrupt transformation that led to the sudden change of political majorities at the expense of long-established social-democracies. In England the Thatcher and Reagan in the USA, reduced state intervention in the economy, leaving the market free to act. However, the desire to lower the fiscal pressure but also public spending on services he clashed
with the now acquired rights, with the resistance of the bureaucracy as well as high unemployment existing in those years. Ensuring the welfare state redistributive and try to limit spending and unemployment still led Western countries to a sort of justification of public expenditure that goes through a strict selection of the needs of citizens.

Now, the comparison of the levels of public spending between Europe and the United States of America and the composition of the same -useful to check certain redistributive effects- requires a study in the time series. In particular, we use the Rosen’ reconstruction (2003).

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<th>Tab.1 Public spending/GDP</th>
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Source: Rosen 2003

As we can see from the table above the time period is divided into three distinct periods. The first is the liberal age, and from 1870 to 1914; the second is the period characterized by the two great world wars ie between 1914 and 1945, and the last time period includes the second post-war period. At the economic level, we can say that in the first period of state intervention in the economy was moderate and occurred, contradicting what was the economic theory of the time, due to the prolonged economic growth. The second period was marked by the experience of warfare-state and then to a predominant role of the state in the economic context: the First World War caused not only a high level of public spending, but also an expansion of state functions dictated by the same necessity war. The third period is characterized instead by setting macroeconomic developed by John Maynard Keynes during the 30s and characterized by the unfolding of aggressive policies of public spending and the growing state intervention in the economy. The State hired three functions: resource allocation, redistribution and stabilization of the business cycle to combat unemployment. Since the 80s, the Keynesian approach quickly lost ground in favor of a neo-liberal approach, in favor of a drastic reduction in the role of the state in the economy.

In 2013, as shown in the graphic representations of the available OECD data, the incidence of public spending on GDP as regards the United States recorded a value of 41% which, although lower than that for the year 2009 (42.5%) is maintained at higher levels compared to the pre-financial crisis.

![Fig.1 Public spending/GDP USA](source: OECD, 2013)
However, the incidence of USA’ public expenditure remained at lower levels than the European Union considered - always with reference to OECD data - without including the United Kingdom around the value of 48.34%. In the analysis of total public expenditure, namely that we have seen, includes the central and local governments through specific analysis carried out by the OECD in order to make such a consistent value at the international level.

For added distinction and in order to highlight those that are the most significant differences between the USA and Europe, we have obtained data on the incidence of public spending/GDP of some EU countries, also considering government revenue.

**Fig.2 Government revenue and expenditure, 2013 (% of GDP)**

![Graph showing government revenue and expenditure, 2013 (% of GDP)](image)

Source: EUROSTAT, 2013

As can be seen from the figure, there are profound differences in the composition between the various EU countries. In particular, in the EU-28, total expenditure amounted to 49.0% of GDP (down from 49.3% in 2012). In the euro area (EA-18), total general government expenditure amounted to 49.7% of GDP in 2012 and total revenue to 46.7% of GDP. In absolute terms, total general government expenditure grew steadily over the period from 2003 to 2013, both in the EU and in the euro area. Only from 2010 to 2011 did total general government expenditure decrease slightly in absolute terms, both in the EU and in the euro area. Revenues also grew steadily through to 2008 in the EU and the euro area, decreased in 2009 and then increased again from 2010 onwards. By 2011, total revenue exceeded pre-crisis levels both in the EU and the euro area.

The largest proportion of EU-28 government expenditure in 2013 concerned the redistribution of income in the form of social transfers in cash or in kind (see Fig.3). Social transfers made up 44.4% of total expenditure in the EU-28 and 47.7% in the euro area (EA-18). Compensation of employees accounted for 21.6% of government expenditure in the EU-28 and 21.0% in the euro area (EA-18). Property income paid - of which by far the largest part is made up of interest payments - accounted for 5.7% of government expenditure in the EU-28 and 5.8% in the euro area (EA-18).
General government expenditure can be analyzed in more detail using the Classification of the functions of government (COFOG), fig 4. In 2012, social protection measures accounted for the highest proportion of government expenditure in all EU Member States (except that in Cyprus general public services were equally important), with an EU-28 average of 19.9 % of GDP. The share of the social protection function ranged from 25.2 % of GDP in Denmark, 24.8 % in Finland and 24.4 % in France, to 11.3 % in Latvia; in Iceland the share was 11.2 %. The next COFOG functions, in order of their relative importance within the EU-28, were health (7.3 % of GDP), general public services (6.7 %) and education (5.3 %). Spending on economic affairs in the EU-28 was 4.1 % of GDP in 2012, while less than 2 % of GDP was devoted to each of the following functions: defense, public order and safety, environmental protection, housing and community affairs, recreation, or religion and culture.

3. Government revenue: redistribution

Analysis of tax systems and especially the comparison between European countries and the United States is complex because the parameters of taxation differ greatly. In fact, the only consideration of parameters such as the income tax of individuals (as well as in the progressive bands of the same), the taxation on capital accumulation, facilities Tax VAT and excise duties, would be incomplete. Therefore, we will treat the income as normally considered by the general economic literature.
As can be seen from the above figure, the total tax revenue of the United States of America is less than that of European countries considered. In this context, the most obvious differences appear to be those relating to social security contributions where the United States count on 25% of revenue, while the countries considered to belong to the EU recorded values ranging from 35% and 37% in England and Germany, 43% in Italy and 44% in Sweden.

In the analysis of the comparison between the tax that characterizes the United States and Europe that are interested in the concept of redistribution because it is serious about the rich and the poor. In this regard, it is necessary to analyze the aggregate data on the different tax brackets income tax in USA and Europe. With regard to the maximum rate on income, as you can see from the graph below, it is important to emphasize that the higher you are registered in time of war because of the need to finance the war, are then gradually decreased and then increased again in the last 25 years.

However, it is not enough only observation of the maximum and minimum rates to get an idea about the tax burden on the poorest people, those wealthy and the middle class of USA. In particular, over the historic 44 year old that is between 1960 and 2004, so soon after the commencement of the
Bush presidency, about 40% of taxpayers—those with the lowest income—benefited from a slight decrease in the average rate of tax. In the context of the same period as the tax burden increased slightly, the middle-income bracket—low—underwent a decrease in income tax during the 90s, a trend that was later reversed by the famous relief of the Bush administration. But what is most significant for our analysis is the fact that people with higher incomes, or 1% of the American population, have enjoyed a substantial reduction in the tax burden from the 60s up to record, after a small peak in the early 70s a true minimum in the Bush era.

Now, the income-tax rate in the USA has six tranches: the rate of 10% which includes the income threshold between 0 and $8,700; that of the 15% that affects income from $8,701 to $35,350; the rate of 25%, which is addressed to income in the range of $35,351–$85,650 USD; that of 28% for incomes not exceeding $178,650 and finally the band instead of the 33% that affects incomes ranging from $178,651 up to 388,350 USD (OECD Economic Outlook Database, 2013).

These numbers when compared with Europe, the United States show that these rates are higher than in the Old Continent for those on lower incomes, and lower for higher incomes. In addition, the difference between the USA and Europe gradually becomes larger in the moment in which the income begins to become higher.

As we show the data of the OECD, examining the personal income tax in the member countries of the Euro area, the maximum rates increased from 53.5% in Belgium to 38.23% in Spain, with a minimum of 30% registered in Cyprus. However, it is interesting to note that the average rate of taxation on income is equal to 43.53%, or 10.53 percentage points higher than in the United States. Therefore we can say that the United States has a less equitable distribution of income in the countries of continental Europe, and indeed the personal tax in the United States appears to be among the least progressive.

4. Political determinants and redistribution

From the previous analysis showed that European countries are more generous than in the United States with regard to the level of public spending. Economic models suggest that redistribution is a function of the variance in pre-tax income, volatility of income, social cost of taxation. However, in addition to these factors, there are others unable to provide an explanation of the differences between Europe and the United States. Most of the differences in the redistribution reflect those of the political structure and heterogeneity/racial homogeneity.

Among the political factors may include the electoral system, the system of checks and balances and the federal structure. With regard to the electoral system it is possible to say that a proportional system can more easily engage in redistributive policies with respect to a majority or single-member constituencies as the United States. In fact, in single-member constituencies systems (with colleges geographically delimited) the legislature will prioritize spending projects of local interest, while those proportional favorite spending projects will be of general interest. Among the various theoretical and empirical studies conducted on the relationship between electoral rules and fiscal policies, Milesi-Ferretti, Perotti, Rostagno (2002) and Person, Roland and Tabellini (2000) have tested the hypothesis that in majoritarian systems give priority to the government’s spending projects targeted, while in proportional spending projects they favor universal. I accentcd the analyzes seem to support the initial hypothesis, that is, at least for the OECD countries, the level of proportionality is positively correlated with the amount of public transfers. A second difference between Europe and the United States relates to the fact that the American Constitution is focused on a mechanism of checks and balances that has helped to prevent radical changes in government policy and has hindered the measures to increase the levels of redistribution. In addition, European countries, including Germany, appear to be more centralized than in the United States. The American system has various incentives to limit the scope of government deficits and redistributive policy. For example, in many states constitutions provide for the rules requiring a balanced budget and the majority of local governments cover most of the costs through local taxation. Moreover, many public services important from the point of view of redistribution are provided at the local level. This has two consequences. First, tax competition and
mobility shall ensure that the level of taxation is lower and, secondly, do not exist, at least in relation to the goods provided by local authorities, redistributive flows from rich to poor regions.

Alesina and Glaeser (2004) argue that the American racial heterogeneity arises, together with the institutional framework, as a factor explaining the absence of a strong welfare state as the European one. European countries have a high level of homogeneity that has facilitated and made more natural redistribution. On the contrary, the United States has a large racial fragmentation, with rates of more heterogeneity within many states. According to the two authors of the divisions and racial preferences seem to discourage redistributive measures so that they become more restricted in the fragmented society, where people’s generosity is limited by racial cleavages. Some research (Bénabou R, 2000) conducted on American cities show that participation in social activities, interpersonal trust, the provision of public goods and redistributive interventions are lower in communities with greater racial fragmentation. To verify the importance of the redistribution Alesina and Glaeser have tested the hypothesis that countries with greater ethnic fragmentation have levels of redistribution as a percentage of GDP lower, coming to the conclusion that in countries with a GDP per capita greater than $15,000 the correlation between the index of fragmentation racial and social expenditure is greater than 50% (and statistically significant at 99%). Moreover, taking into consideration the EMU countries they were able to observe that “the percentage of spending on social services is equal to 14.27%, the average level of racial fragmentation is of 0.057%. The United States spends 6.96% of GDP for the social services and their racial fragmentation of 12.49%, the gap between the United States and Europe in the racial fragmentation is of 0.433, which implies that the fragmentation of American racial enables us to predict that the United States spends 4.8% less for social services. The overall gap is 31.7 percentage points”.

5. Conclusion: US-EMU crisis and redistributive tax policies toward a paradox

This job requires a different conclusion from the normal paper. We want to ask what between US and EMU there is in different about the redistribution of wealth in a time of international crisis. The federal government has provided financial assistance at the state and sub-state in response to three of the six recessions according to the National Bureau of Economic Analysis have come and gone since 1973 In response to the most recent one which began in December 2007 believed to be the worst since the Great Depression, Congress passed the ARRA through which they were transferred from the federal government to state governments about 282 billion dollars. The latest recession has led to a renewed interest on the subject of tax assistance to states. Recent economic research has shown that although recessions tend to have simultaneous effects of two levels of government, some states may enter or exit the recessionary situation at earlier or later than the national level. The federal government has used fiscal policy by letting the automatic stabilizers, unemployment benefits and income tax, were to act independently and through fiscal stimulus programs has sought to sustain aggregate demand. These tax incentives have taken the form of tax cuts for families and businesses, transfers and grants-in-aid to the states. Therefore, the federal government, marking a significant difference compared to the case of the EU, has an interest in intervening through transfers to the Member since in this way may reduce the actions undertaken at sub-federal level that could exacerbate the effects of recessions.

The financial and economic crisis of sovereign debt in EMU and the interventions put in place to stem the crisis, have important impact on the income distribution of individuals and families. In particular, faced with an excessive level of taxation in the EMU we wonder if is still valid the relationship about Okun (1975) inequalities, and why policy makers do not act accordingly. In fact, it can be said that a higher tax reduces disposable income, savings, and therefore investment, in essence, the higher the taxes, the lower the willingness to work or invest. It would, therefore, a trade-off, since any attempt to reduce inequality will lead to efficiency losses (see also Kaldor, 1957). However, this situation is exactly what is happening inside the EMU. The austerity policies, which are based on the reduction of public debt, are generating negative effects on the economies. Fiscal pressure...
has increased, government spending has been gradually decreasing in order to control the primary deficit. All this is translating into an increase in unemployment which is followed, therefore, a decrease in the redistribution of wealth in the form of happiness and well-being. Therefore we are in our opinion are facing a paradox: overcoming the crisis with the sacrifices that will also lead to less redistribution of income.

Reference


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