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Social structure and social policy: About the institutional flexibility of three modern welfare states

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Luxembourg Income Study Working Paper Series

Working Paper No. 501

Social Structure and Social Policy: About the Institutional Flexibility of Three Modern Welfare States

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Social Structure and Social Policy

About the institutional flexibility of three modern welfare states

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Abstract: This paper addresses the question of the institutional flexibility of three major European welfare states. Using Data from the second and fifth wave of the Luxembourg Income Study (LIS), we measure first how effectively the German, British and Italian welfare state have responded to changes in their country-specific poverty risks profile. Further, we apply a macro-simulation to evaluate the performance of the three welfare states in terms of poverty reduction. We find that the social policy institutions of Germany and Britain are more able to deal successfully with changing age and household structures as the Italian welfare state.

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1. Introduction

The evaluation of the distributive outcomes of welfare state institutions has developed only in the last decade, not simply because of insufficient and lacking data. The emergence of new social risks and a widespread public debate about the return of high levels of income inequality have in the last two decades increased the interest of social and economic scholars in questions concerning the relationship between institutional design and distributive

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outcomes (see for a brief overview: Palme 2006). This paper wants to contribute to this branch of research by addressing the question of the inherent “flexibility” of welfare state arrangements: that means, how effective in poverty alleviation welfare state institutions remain, if confronted with different or changing social risks patterns. How much of the outcomes welfare state institutions exhibit would change if this are now confronted with more or less favourable social structure?

To investigate this issue we need a counterfactual strategy. In by fare the most studies about the distributional outcomes of the welfare state, the impact of different social benefits on inequality or poverty risk is typically assessed trough intra-country comparison. For each country, for example, the poverty risk produced by the market is compared with the poverty risk after transfer, social contributions, and income taxes. This “conventional” method allows one to investigate the ability of the national welfare state to cope with *country-specific* social risks over time. Of course, since one only know how the outcomes of each national welfare state changes over time with regard to developments *in their own social structure*, the conventional method does not allow any conclusion about the *inherent* adoptiveness capacity of a welfare state to cope with a different social risk structure.² By simply comparing welfare outcomes over time or across countries one cannot intuitively deduce or forecast the performance of a welfare state in fighting poverty when confronted with a new social structure dissimilar from its own. Thus, to shed more light on the institutional flexibility of the three welfare states we need a counterfactual reasoning. We want to ask, how good welfare states *would perform* if they were *confronted* with the social structure and social risks profile of other welfare states. Such a counterfactual experiment is seen by various authors as a fruitful method to investigate the intrinsic institutional flexibility of welfare states confronting a changing social risk structure (see e.g. Fritzell 1993; Rainwater/Smeeding 1998; Kangas/Ritakallio 1998; Fritzell/Ritakallio 2004).

In this paper, we compare Germany, Great Britain,³ and Italy in order to explore the institutional flexibility of these three modern welfare states with very different institutional arrangements and social risk structures. We analyse first the change of the income distribution and poverty profile in each country over time with the conventional method. Then we utilize a

² That does not mean of course *how easy can institutions be reformed*, but *how efficaciously do institutions respond in different contexts*.

³ In this paper, we use “Great Britain” and “UK” as interchangeable terms. All our calculations only apply for Great Britain, ergo for the United Kingdom minus Northern Ireland. This is due to the fact, that LIS only provides data for Great Britain and not for Northern Ireland.

macro- simulation to assess *how effectively institutions would respond in a simulated context*. In the macro simulation (or re-weighting methodology), the income distribution of one country is combined with the social structure of another country, so that we can investigate how changes in the basic characteristics of the social structure affect the overall performance of welfare state institutions on inequality and poverty. Both strategies, the conventional and the counterfactual strategy, can be interpreted as measurement methods of the institutional flexibility and capacity of the three welfare states to adapt to changing social risks. In the case of the conventional method, we test the institutional flexibility over time and with the macro simulation, we compare the outcomes of different welfare state arrangements confronted with dissimilar social structural conditions.

Because the simulation method is less established than the conventional method, it needs some elaboration. Therefore, we want to look at some other studies, which used this method. Kangas and Ritakallio (1998) for example adopt this technique comparing France with Scandinavia⁴. They showed that linking the French tax and transfer system with the Scandinavian household structure would reduce income poverty in France massively. In a similar way, Reinwater and Smeeding (1998) combined the transfer system of the Netherlands with the social structure of various countries, with the result that the adoption of the Dutch income packaging would reduce the relative poverty rates of all other countries.⁵ Annemette Sørensen (1992) combined in her analysis the conventional method and macro simulation in a comparison of Canada, Germany, Sweden, and the US and worked out the way in which country specific family patterns and welfare state transfer structures account for the different income distribution between man and woman. All these studies confirmed one of welfare states research working hypothesis. Namely, that the development of social stratification in modern welfare states are very country specific and that the country risks structure and institutional design of the welfare state are both important sources for cross-national as well as for cross- time variation in the inequality pattern e.g. poverty pattern (e.g. Titmuss 1974, Flora 1986, Esping-Andersen 1990, 1999).

⁴ For their comparison Kangas und Ritakallio built a hypothetical macro region named Scandinavian by pooling the households- and income structure of Sweden, Finland, Denmark and Norway, arguing that these countries are to be considered belonging "...to a relatively uniform cluster in terms of, (...), women's labor market participation and some other socio-demographic indicators". (Kangas/Ritakallio 1998: 6)

⁵ As an explanation for the stronger effect of income packaging and social protection of the income distribution differences among the countries in question, one can argue, that the egalitarian and universal structure of the Dutch welfare state has a relatively broad impact with respect to different poverty patterns and social structures of other countries.

In the first part of the paper, we further develop the theoretical framework of the study and postulate some hypotheses about the different institutional flexibility of the three welfare states. After a description of the social transfer systems and the social structure of the three countries, we introduce the conventional method and – more in depth - the technique of the macro simulation. In the second part of the paper, we primarily investigate the change of poverty risks of different social groups over time. Secondly, we test the institutional flexibility or adaptiveness of each welfare state to the social structure of the other countries. We use the re-weighting methodology to estimate the change of poverty rates due to changes in the social structure of the countries. In the last section of the study, we combine the main results and give an outlook for further research.

2. The welfare state and Income Distribution

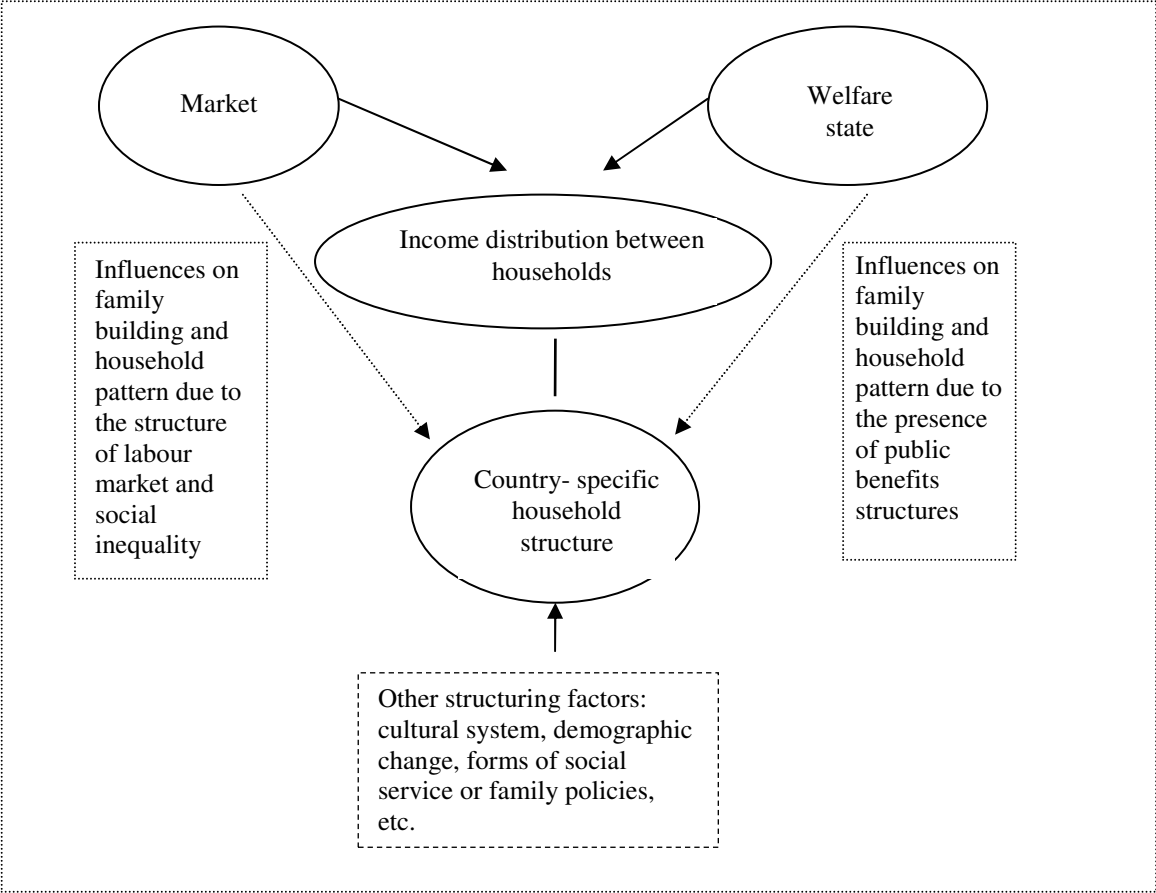
Basic Assumption about income distribution in modern welfare states

Before proceeding to the empirical part of the paper, it is appropriate to give a short introduction about the central mechanisms of the income distribution and the way the welfare state and socio demographic factors are involved. The scheme in figure 1 shows the basic conceptualization, which is common ground in the comparative research. Strongly simplifying, it shows that the national income is primarily produced and distributed through the market, and then, to some extent, redistributed via the various institutions of the welfare state. The market distribution inequality depends to some extent on specific features of the labour market institutions and economical structures, which more or less systematically vary across countries. For example, the degree of coverage of collective wage agreements, the presence of minimal wage regulation, and an extended public sector are positively correlated to little income inequality and contribute to the reduction of the incidence of low pay across countries (see Lucifora 2000). On the other side, increasing wage inequality is associated with deep changes of economic structures and workplace characteristics, e.g. a high level of female part time employment, a spreading of self-employment and particularly the emergence of a post-industrial economy with a large low skill, low productivity job sector (see Iversen/Wren 1998, Wright/Dwyer 2003). At the same time, many country comparisons found an increasing trade-off between wage equality and jobs. Affluent service economies are thus facing a dilemma between low unemployment by higher wage inequality and low wage differentials but increasing unemployment (see for a discussion Kenworthy 2004).

The redistribution of the welfare state is organised by their tax- and transfer system. What population groups (or individuals) are contributing or profiting from this redistribution - and to what extent this occurs - can be quite different due to the country specific historical development of the welfare states arrangement. To a certain degree of generalisation, however, one can distinguish various principles welfare states adopt to face different social risks and redistribute resources over the life cycle or between social groups (see Korpi/Palme 1998). Targeting strategies foster a re-distribution of resources from the rich to the poor by financing exclusive means tested benefits from (progressive) taxation. The British social assistance, the German *Sozialhilfe* or the Australian old-age system are examples for institutions with deep targeting principles. The basic social security system encloses universal flat rate benefits, which are as means tested benefits financed from taxation but are provided to all people irrespective of their financial situation (e.g. German family allowance and to some extent the Dutch old-age system). Traditional corporatist systems redistribute resources between members of closed social groups, whose contributions exclusively finance the system. This strategy is typical for an occupational earning-related old-age system or sickness insurance (e.g. mandatory company pension and to some extent the Italian old-age system). Encompassing systems finally provide earnings - related social benefits without distinguishing between social groups or corporations. To gain acceptance for the system, which often provides a basic social security to persons in need, the redistribution is low and gives in fact more to those who already have (e.g. Sweden pension systems).

In addition to the labour market and the welfare state institutions one must finally take into account the specific household and family structures of a country. As a system of solidarity and obligations, it is very strongly correlated with the distribution of income and access to wealth. Clearly, to which extent family relations can influence the (re-)distribution of income and wealth varies from country to country, following cultural values and legal definitions (e.g. inheritance legislation). To some extent also the demographic and household structure of a country determines in return the size of risk groups due to a lack of family resources (e.g. single mothers) or due to the burden of family obligations (e.g. families with many children).

Figure 1: The relationship between the market, the institutions of welfare state and the household structure.



Source: own illustration.

Institutional flexibility of welfare states

The relationship - as stated above - between the social security system and the social structure is embedded in a country specific macro constellation, depending on the industrial order, the family structure, intermediary institutions, and the state. The institutional structure of the security system has evolved around common but also very specific social problems and political conflicts, about the interpretation and solution of these problems. Today, our societies are confronted with major changes in their demography and labour markets. One central issue responds to the ability of the social security systems coming to terms with these changes. Apart from the political possibilities to reform elements of the social security systems adapting these to a changing environment (e.g. globalization of the economy, new

social division of labour between sexes, et cetera), one may ask, how the historically deep-rooted national social security systems were institutionally able to absorb new social poverty risks arising from predicted transformations. To forecast the country specific outcomes resulting from changing environment, one needs, of course, complex dynamic models. The static macro simulation has, conversely, a simpler claim; it makes it possible to test in which way the actual social systems, (without changing them institutionally), may counter poverty distributions, which are induced by another *real existing* demography and labour market structure. Therefore, following hypothesis can be established:

- a) A country with a social security system that accounts for a broad spectrum of social risks should only show minor changes in poverty rates even if confronted with quite different social structures. Conversely,
- b) a country, which has built its welfare institutions along some very country specific poverty risks, should show institutional inadequacies when challenged with different poverty patterns, and should, therefore, display mostly higher poverty rates.

The transplantation strategy of the macro simulation can be understood as a natural and beyond that realistic experiment, because the country specific macro constellation is not changed on one indicator or randomly but *virtually* by placing a family structure of another *real existing* country into its own institutional and economic frame. Later we will examine the ability of the German, British, and Italian transfer system to deal with changing social structures by combining them with the household structures of their fellow countries. However, before we do this, let us turn to a description of the social transfers systems and the social structure of Great Britain, Germany and Italy.

3. Country profiles I: the social transfers systems in Germany, Great Britain and Italy

Germany is well known as a typical exponent of a conservative-corporatist welfare state. The main bulk of the social transfers is distributed over the huge social insurance system, which is financed through contributions. Its main aim is to protect employees groups in case of/from illness, unemployment, or retirement differently, according to their relative income and social status. The insurance system is supplemented by social assistance and other means tested benefits, which explicitly aim on poverty reduction. Along this Germany has a universal child benefit program and a progressive tax system, which discriminates families positively.

The income transfers system of Great Britain, which was built along the recommendations of the Beveridge-plan (1943) is a universal insurance system, obligatory for the whole workforce, not only for the employees as in Germany. Benefits are flat rate, mainly financed through contributions by employees and employers and only modest compared to the German system, corresponding to the original aims to protect against poverty and not to preserve status. Along this, similar to Germany, there exists a national social assistance scheme and some programs to assist families with children.

Italy follows mainly the social insurance approach of Germany. Benefits are income related and financed through contributions. Compared to Germany, however, both unemployment insurance and pension insurance systems are more fragmented. There exist very different pension schemes and unemployment insurance programs, which reflect occupational and industrial differentiations. Unlike Germany, but similar to Great Britain, Italy has a public health service and not a contribution based health insurance as Germany. The social assistance system is also very fragmented. Apart from means-tested social benefits for old-people, there is not a national wide social assistance scheme like the UK or Germany. A network of communally organized programmes provides in many regions very low means-tested benefits for selected people in need. However, these programs are chronically underfunded and are a typical hotbed for client-politics. The benefits of the family allowance program, *assegni familiari*, are not like in Germany (the German *Kindergeld*) universally ensured, but are income supplements for employees, short-term unemployed and retired people. To do this the family allowance system discriminates families with long-term unemployed. The tax system is progressive but unlike the UK and Germany there was no tax-free annual income until 2006. Some tax relief is granted to families up to a middle income according to the number of dependents. Only middle class families really benefit from this system, which assures higher tax exemptions to those, who already have more.

The last twenty years saw pressure on the welfare state not only produced by the economic and social developments but also from politics. In the **Federal Republic**, the *budgetoriented* social policy was the leitmotif of these years. Main aim was the consolidation of the public households. Therefore, social policy saw moderate but widespread cuts over the whole income system (e.g. Alber 2000, 2001). However, with the introduction of the care insurance in 1994, the insurance element of the system was further strengthened. One exception from the consolidation politics was the extension of family related benefits and the recognition of family work in the insurance system (Bleses/Seeleib-Kaiser 1999, Jochem 1999, Meyer 1998,

Clasen 2005, Bahle 2007). In recent years structural reforms in the benefit-system were introduced for the long-term-unemployed (Hartz IV) and in the pension system (more state subsidies for private insurance to compensate cuts in the social retirement scheme). Both reforms have the potential to lead to a more severe break with the insurance tradition of the German welfare state (e.g. Clasen 2005). In **Great Britain**, the focal point of the reforms was the refreshing and the extension of the means-tested parts of the system and the promotion of private insurance. Both led to a diminishing roll of the national insurance. Today social assistance and various forms of in-work benefit is the centrepiece of the British welfare state (Hills 2003, Clasen 2003, 2005). Like in Germany also in Britain, an expansion in family policies and care policies has been visible since the second half of the 1990s (Clasen 2005, Bahle 2007, Schommer 2008) Alike Germany **Italy** followed the road of consolidation in social policy. Since the collapse of the Italian political system in 1992, more and more attempts have been made to substantially reform above all the pension system and to decentralize the health system. In course of *targeting* welfare programmes, the income supplements of the child benefit system were subject to means testing (Ferrera/Gualmini 2000). Yearly family income up to 7500 Euro has been tax-free since 2003, but the attempts to build up a nationwide social assistance scheme have failed. On the contrary, the few initiatives developed to contrast poverty in the last years - e.g. a special program for families with many children have increased the fragmentation of the Italian social security system.

4. Country Profiles II: Social structure in Great Britain, Germany, and Italy

Before analysing the performance of the three welfare states, we need to compare differences and changes over time of relevant social structural and demographic factors, which are very closely correlated with the pattern of poverty risks and inequality in affluent societies. As discussed above in section 2 the *income position* of a person depends largely (aside from welfare states taxes and transfers) on his market position and living arrangement. Thus, distributional macro outcomes are strongly correlated with the pattern of household characteristics and market distribution in a country. In a recent study, Kenworthy (2008) finds for example that the distribution of individual earnings, the diffusion of zero-earner households, the share of single household, and the extent of dual income households with similar earnings (marital homogamy) are important sources of pre- tax and transfers inequality across countries. To capture basic relevant differences in the household structure of a country, which lead to different risks patterns and market factor inequality, we thus make use of four household dimensions, namely the age of the household's head, the number of the

household's children, the number of earners and the number of persons in the household. This allows us to discuss the degree of institutional flexibility of the three welfare states in the light of the real societal shift in several dimensions, which took place in the last decades.

In table 1, one can see the distribution of all households along the four factors, which are the column of our matrix. Unfortunately, since LIS has not yet published data for recent years, we show data for the mid 1980s and the year 2000.⁶

A short glance on the table shows some expected developments and some notable differences between them. All societies are ageing, in Germany and Italy the share of the elderly (60 +) rose from the mid 1980 to 2000 by stunning 10 percentage points respectively 6 points. The share in Great Britain, however, even also rising in the long run, has stagnated since the 1980s. In Italy, both the comparative as well as the absolute small number of young households (18-29) is shrinking further since the mid 1980s. In Germany and Great Britain, it is true that the share of young households seems to be falling, but in 2000 they still take a share of around 11 percent respectively 8 percent of all households. With respect to the position of the households in the labour market, the now common wisdom that the breadwinner model of the post-war-decades is losing its importance is proved in all three countries. Notable is, that in Britain already in the mid 1980 the one-earner family has lost its dominant position, when it was still predominant in Germany and Italy. Another notable fact is the high number of households with no market income in Great Britain. Taking into account the high employment rates and the comparatively small share of the elderly, it is no wonder that the Britain society becomes polarised. Deakin and Reed (2000) report for instance that, even excluding the households of elderly people, the share of households with no members active in the labour market at all has doubled since 1975. The household size has been declining in all three countries since the mid 1980s, but in Italy not to the same extent as in Germany and Great Britain. The rise of the single households in all three countries is eye catching. The development with regard to the number of children in a household shows an increase of childless households in all three countries. The share of childless households has risen in Italy and Great Britain from the mid-1980s to 2000 to figures somewhat above 69 percent and in Germany to over 78 percent!

⁶ LIS is working on this. Data release to the public is expected in second half of 2008.

Table 1: Household structure⁷

		1985/86			1999/00		
		UK	BRD	ITALY	UK	BRD	ITALY
Age of head of household	18-29	14,4	11,9	5,2	11,3	8,4	3,1
	30-44	29,2	25,6	28,6	28,7	28,4	27,3
	45-59	22,2	28,6	33,5	26,8	23,6	27,7
	60 +	34,2	33,8	32,7	33,3	39,5	41,8
Number of household's members	1	24,3	32,6	13,2	28,7	39,1	20,7
	2	33,9	28,8	23,6	35,5	32,2	28,2
	3	16,5	17,6	24,4	15,6	13,4	22,4
	4	16,6	14,9	24,9	13,4	9,8	20,8
	5+	8,8	7,5	13,9	6,8	3,6	7,6
Number of earners	0	37,6	33,9	27,1	37,2	34,5	34,3
	1	32,0	38,5	43,6	27,3	35,7	35,4
	2+	30,4	27,7	29,3	35,6	29,7	30,3
Number of children (under 18)	0	64,3	71,4	57,8	70,7	78,6	69,8
	1	14,3	15,5	21,2	12,0	11,5	16,4
	2	14,5	10,9	16,6	11,6	7,5	11,1
	3+	6,9	3,3	4,5	5,7	2,5	2,6

Source: Luxembourg Income Study, own calculations.

To sum up, all three countries face the same sorts of social changes: ageing, individualization, decreasing numbers of children and increasing labour-market participation of household members. However, the individualisation of the household structure is much stronger in Germany and Britain than in Italy. Conversely, in Italy the “ageing” of the society is even more pronounced than in both other countries. While growing in all three countries, the double-income households have a higher share in Great Britain than in Germany and Italy.

⁷ Our information on the development of the social structure based on calculation with the LIS Micro-data are in line with the information of European Social Indicator System (EUSI): www.esis.org.

2. Methodological Discussion

Methodological procedures of conventional approach and macro simulation

The methodological procedure of both approaches can be specified by our empirical analysis. We have calculated the relative poverty rates before transfers and taxes⁸ of Germany, Great Britain and Italy on the basis of the micro data from the Luxembourg Income Study (LIS). The market income includes all income from self-employment, dependent employment and capital gains (e.g. from private insurance). We have calculated it for the single household. The household is also the basis we have used to calculate the relative post-transfer poverty rates, by adding the social transfers each household receives to the household budget and subtracting all taxes and social contributions of a household from its budget. In each calculation the household income is weighted with equivalence scales, to control for economies of scales.⁹ We compared and discussed the results relating these to our knowledge of the institutional and the demographic structure of the three welfare states. The focus of this study is on the social transfer system as a whole. Other studies have applied micro simulation strategies to analyse the impact of special transfer schemes of the welfare state on the income distribution, like income transfers for families and children (e.g. Levy 2003), social assistance (e.g. Behrendt 2000a, O'Donoghue and Immervoll 2001) or pensions (e.g. Behrendt 2000b).

The macro simulation is an extension of the conventional approach in so far, as it combines micro data to control for many variations, e.g. in the country demographics structure. Kangas and Ritakallio refer to this technique as transplantation strategy. As indicated above, information about the household structure of one country is combined with the income structure of another country. Methodologically, the transplantation can be described in three steps. First, to control for the socio demographic structure, we define some household dimensions. These are pooled to build up a household matrix. Our dimensions were size of the household, age of the head of household, number of earners, number of children in the household. In the second step, the relative poverty rates for each household type (cell in the matrix), as an alternative for each value of household characteristics, are calculated. The overall simulated poverty rate is, therefore, simply the poverty rate sum of each household

⁸ The data sets and all relevant information about the data are documented in appendix 1.

⁹ We used the square root equivalence scale, which is the most common in the LIS papers. However, one should have in mind that each equivalence scale affects the income distribution differently. To keep this scale related bias under control one should use simultaneously two or three different scales. In respect to our relatively crude comparison, it is justifiable to stick only to one poverty rate. The application of other equivalence scales should not produce results in this case, which would lead to other interpretations of our data.

type (or matrix cells), which are weighted according to their size in the socio demographic structure of another reference-country. (Technically, the cells of the household matrix of one country, representing household types, were re-weighted for the size of the same cell in the household matrix of another country). In this way, one can determine the impact of different (national) income systems (market and the welfare state) on poverty, by equalizing the household structure across countries (cross-country comparison). Alternatively, varying the national household structure, and holding constant their *market and institutional frame*, one can determine the supposed different outcome (in terms of overall poverty rate) of an income system in the case of variation of social demographics characteristics (within-country comparison).

However, we would like to point to some restrictions of the macro simulation especially when compared to micro simulation. The first restriction of the technique against micro simulation¹⁰ is the higher level of manipulation itself, as household types are weighted and not the individual micro data. Since information gets lost, inferences to the micro level become problematic. Due to the aggregation, only information for a specific set of self-defined household types is available (e.g. median income, poverty risk, income variance within the type, and so on). As consequence, one cannot make causal inference to the individual level (the actual households) without risking ecological fallacy.¹¹ Nevertheless, a “good” household typology as well as the possibility to control for other factors, allowed by the availability of micro data, enables us to use a household typology to explore the macro relationship between household features, social programmes, and poverty outcomes. A second limitation of the macro simulations concerns its static nature. Dynamic effects, like over time changes in the household structure or *behavioural dynamics* cannot be considered.

Nonetheless, the macro simulation has some appeal to use it in the comparative analysis of welfare states. In this paper, we prefer simulating on the aggregate level mainly for two reasons, both technical and strategic. Firstly, simulating household types is technically something more straightforward than the micro simulation. Secondly, since we want to focus on the relationship between social structure and welfare state, not simply looking at the overall outcomes of benefit systems, we need macro analysis dimensions, e.g. household structure. Therefore, even if one uses micro simulation, one needs a comparable dimension

¹⁰ Micro simulation is normally used by policy advisors to determine the effect of various demographic, institutional, or economic developments. The simulation strategies are manifold. In the so-called *tax-benefit models*, the simulation is done by recoding single variables. Therefore, it is possible to account for the effect of changes in the regulations of the tax- and social transfer systems on household incomes or in the income structure of a given country. (e.g. Immervoll et. al. 1999, Cantillon et. al. 2002)

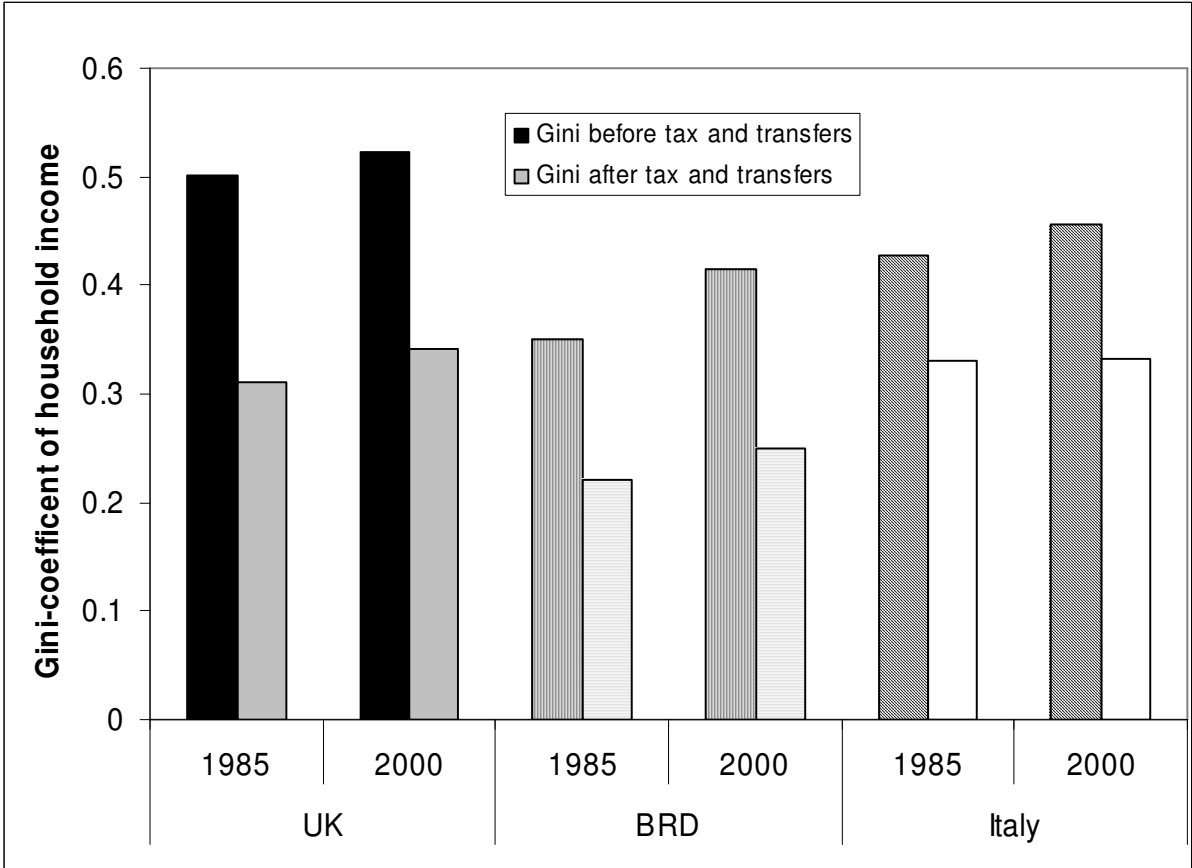
¹¹ Since we cannot know the distribution of other potentially causal factors, a causal inference on the individual level from the causal relationship on the aggregate level become difficult.

like a typology, e.g. a household typology, in order to compare countries. The macro simulation offers the possibility to build a reasoned household typology and check the usefulness of this typology for comparative aims.

6. Adjusting to real world changes

How successful was social policy in the three countries in the past to limit inequality and poverty in the face a changing social structures? After a short glance on the topic of overall income inequality, we want to discuss the question of adjustability of the welfare state more in depth for poverty amelioration.

Diagram 1: Income inequality and the welfare state



Note: Owen calculation with the LIS Data. The household income is adjusted for household size with the square-root equivalence scale.

Literature on the income distribution reports increasing income inequality in most of the OECD Countries (e.g. Gottschalk/Smeeding 1997, Eurostat 2002). The figures in diagram 1 confirm this trend for Germany and Great Britain. However, the inequality over all

households measured by the Gini-coefficient¹² did not rise in a dramatic way. In Italy, the inequality before transfers and taxes rose also slightly, but the inequality after tax- and transfer did not change between the mid eighties and 2000. These developments also meant that the well-known contrast in the picture of inequality between these countries was very stable between the two time points. Great Britain has a visible higher income inequality than both other countries.

The difference between the inequality measures before and after taxes and benefits gives us, as discussed above, an impression of the redistributive impact of the welfare state. We see from diagram 1 that redistribution in Germany is substantially higher than in the other two countries. In Germany the Gini-coefficient drops down around 40 percent after taxes and benefits, in Italy and Great Britain it drops only 30 percent. When it comes down to the question of welfare states capacity to adopt over time, the diagram underlines the following: for all three countries we can state that on the field of overall inequality the welfare state did not lose its capacity to redistribute resources from bottom to top. However, in Germany and Great Britain the welfare state was not able to counter rising market inequality, which means that there are adaptation problems of the social security system to the changing economic and social fabric of these countries.

The development of inequality and the power of the welfare state to redistribute are – that is for sure - an important issue in modern societies. Nevertheless, from a social policy point of view the development of poverty rates should be more intensely examined. Therefore, we want to judge the capacity of the welfare state more profoundly now, by looking at the changing structure of poverty and the effect the social benefit systems of the three countries have on poverty by comparing pre- and post poverty rates.

The poverty figures with respect to the whole population (in the last row of the two tables) report for Italy and Germany in the pre-transfer and -tax-rates a strong but in the post-poverty rates only a small increase between 1985 and 2000. In Britain, poverty-rates saw a small increase for pre-transfer and -tax rates but a small fall for post-transfer and -tax rates.

The poverty risk varies strongly with the household structure as tables 2 and 3 report. Obviously, households that have a tight link to the labour market have the lowest poverty

¹² The Gini coefficient is a measure of statistical dispersion most prominently used as a measure of inequality of income distribution or inequality of wealth distribution. It is defined as a ratio with values between 0 and 1: A low Gini coefficient indicates more equal income or wealth distribution, while a high Gini coefficient indicates more unequal distribution. 0 corresponds to perfect equality (everyone having exactly the same income) and 1 corresponds to perfect inequality (where one person has all the income, while everyone else has zero income).

rates in the pre- as also in the post transfer perspective. The u-shape relationship between the age structure as well as the household size and poverty figures is not surprising, either. “Young” and “Old” households as well as “small” and “large” households have on average a higher poverty risk in comparison to middle age respectively middle sized households. However, it has to be mentioned that the high pre-transfer poverty rates of households with one or two members are caused by the fact that these are mainly pensioner households, whose disposable income depended mostly on their state pensions. Accordingly, the poverty rates of the elderly decline enormously after transfers. Whereas in Germany the poverty rates of the elderly are somewhat above the national average, they still remain substantively above the average poverty rate in Great Britain and Italy.

Table 2: Household structure and poverty rate (pre transfer net income)

		1985/86			1999/00		
		UK	BRD	ITALY	UK	BRD	ITALY
Age	18-29	32,5	25,5	21,1	38,5	35,3	21,2
	30-44	22,9	9,1	10,0	24,8	10,5	14,9
	45-59	21,8	10,2	21,3	21,1	15,3	22,3
	60 +	67,6	80,3	75,8	67,9	80,1	75,7
Number of household's member	1	65,7	60,0	79,4	61,9	57,1	70,9
	2	38,8	41,2	58,0	36,6	44,1	57,9
	3	24,7	14,0	20,0	26,0	16,2	24,1
	4	22,0	6,4	14,5	20,0	5,8	18,1
	5+	28,8	12,4	23,4	32,5	11,7	30,7
Number of earners	0	86,8	88,9	98,7	86,1	95,8	95,4
	1	18,8	13,0	18,1	23,9	20,1	24,0
	2+	2,2	1,3	4,3	3,2	3,1	4,5
Number of children	0	44,2	45,5	50,7	43,0	48,8	53,0
	1	28,3	9,8	14,8	28,5	12,9	15,3
	2	28,4	9,2	15,5	28,1	13,3	18,6
	3+	39,4	14,4	20,2	46,4	15,6	39,2
Total (all household)		39,3	35,5	36,0	39,7	41,2	42,6

Note: Luxembourg Income Study, own calculations. The household income is adjusted to household size with the Square-root equivalence scale.

However, analysis for the income position of elderly persons in Great Britain for more recent years saw a remarkable fall in their poverty rates in the years 2000 to 2004, now only slightly above the German levels. A fall related to the pension politics of Labour, which raised the minimum pension quit substantially (e.g. Sutherland et. al 2003, Schommer 2008). Remarkable is the fact that the pre- transfer and -tax poverty rates for elderly people have significantly fallen since the mid 1980s, presumably an indicator that more elderly households

in all three countries have previously built up private income through occupational pensions, as well as capital and insurance market. After transfers, poverty rates for elderly households have nevertheless slightly risen in Great Britain and Germany, and only in Italy, they have fallen in the meantime.

Table 3: Household structure and poverty rate (post transfer income)

		1985/86			1999/00		
		UK	BRD	ITALY	UK	BRD	ITALY
Age	18-29	9,5	18,7	14,8	14,5	30,0	14,5
	30-44	6,0	4,5	7,6	7,6	5,3	12,1
	45-59	5,9	4,4	8,6	6,9	5,9	10,1
	60 +	16,0	9,8	17,2	17,3	11,9	15,5
Number of household's member	1	22,9	14,3	22,1	21,4	15,9	20,5
	2	8,3	6,4	7,9	7,6	6,8	9,2
	3	5,2	4,7	5,5	7,4	7,8	9,4
	4	4,5	2,7	5,7	6,8	1,2	11,4
	5+	5,5	4,4	6,9	8,1	2,9	22,0
Number of earners	0	28,2	16,5	23,5	24,3	18,2	21,8
	1	5,2	5,5	9,9	7,0	9,9	13,3
	2+	0,8	1,0	2,6	1,4	0,9	2,7
Number of children	0	11,4	9,2	12,1	12,3	11,0	12,5
	1	6,7	4,8	8,8	7,7	7,3	10,6
	2	6,7	3,9	11,4	9,2	6,4	15,0
	3+	10,8	8,5	16,5	12,9	4,1	33,8
Total (all household)		12,5	8,0	11,5	11,4	10,1	13,0

Note: Owen calculation with the LIS Data. The household income is adjusted for household size with the square-root equivalence scale.

It should not be puzzling that, before transfers, households with children show lower poverty rates than households without children. One can argue that on average at least one member of the household is economically active. Nevertheless, the pre-transfer poverty rates in Great Britain are much higher than in Germany and Italy, whereby these differences sharpened since the mid-1980s. In the post-transfer perspective, however, the picture changes somewhat: in Great Britain and Germany the poverty risk of families with children are below the national average, although they witnessed a moderate increase since the 1980s. Contrastingly, the poverty rates after transfers of child rearing households are higher in Italy compared to both other countries. The poverty rate for families with two and more children is above the national average in Italy. Is there an appropriate interpretation for this? An economical reasoning could be appropriate. Compared to Germany and Great Britain the high Italian poverty rates

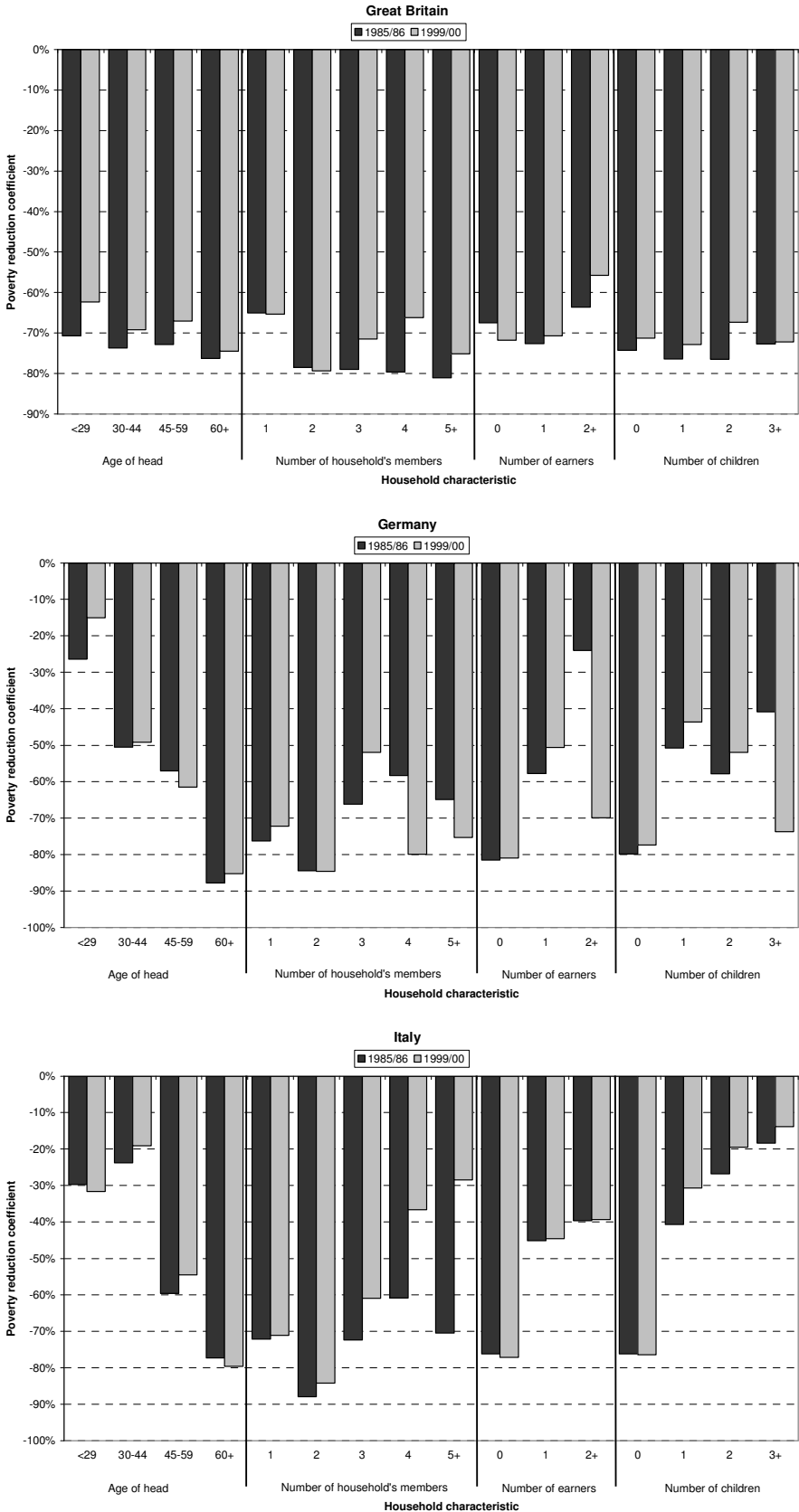
of larger families go also along with a smaller share of these households in Italy. It seems that Italians try to avoid building great families because of the visible poverty risk of this group. Against this, in Germany it seems that people on average want to achieve a secure financial base before raising children. In Britain – it can be argued – people know that the state is caring for them, even when they have no own sufficient financial means to care for their children. We have to admit that our picture of the income situation for German families is somewhat behind the newer developments. Data for the years since 2000 show that the worsening of the income situation of families in Germany could not be stopped (e.g. Butterwege/Klundt 2002, Schommer 2008).

Another more puzzling result is the high post-transfer poverty rate of the young households in Germany, twice as high as the poverty rate of the same group in Great Britain and Italy. A comparison between the poverty rates of this group with those of the mid 1980s makes clear that a high poverty rate among young households is a new phenomenon in Germany. However, also here some more knowledge of the societies would be helpful. We can only give a cautious and preliminary explanation. As we saw earlier, this household group is very small in Italy compared to Germany and Great Britain – so one assumption could be, that people do not establish an independent household until they have sufficient financial means (surely, this is combined with cultural factors). In Germany however, it is common for young people to move out earlier, because (in combination with cultural factors) they expect that they are going to go up the income ladder in later years (e.g. students). In Great Britain, the share of independent households is comparable to Germany. The fact that the poverty rates of British households is far below the poverty rates of their German counterparts probably reflects simply the fact that duration of education in Great Britain is by far shorter than in Germany.

Obviously, the social security transfers have overall a great and substantial influence in reducing the poverty rates in all three nations. Graph 1 also documents this for the mid-1980s and the end of the 1990s. Here we have measured the impact of social transfers with the poverty reduction coefficient¹³. We have measured this coefficient for the mono-dimensional indicators of the household matrix. The more negative the value is, the higher is the relative income reduction of the social security program for a household type.

¹³ The poverty reduction coefficient (PRC), based on the so-called Beckerman ratios (Beckerman 1979: 53), is calculated as the difference between the post transfer and the pre transfer poverty rate, divided by pre transfer poverty rate and multiplied by 100. Against the absolute values of the poverty reduction, the PRC allows a comparison of effectiveness across countries and over time without having to account for different country specific market induced poverty patterns.

Diagram 2: Effectiveness of benefit systems of poverty reduction



Notes: Own calculation with the LIS Data. The household income is adjusted for household size with the square-root equivalence scale.

Four results are remarkably:

(1) The British welfare state reduces income poverty for all groups more or less *equally*. In Germany and Italy, the impact differs much more along the groups. According to other studies about social expenditure¹⁴, the data confirms that both countries have a strong imbalance in their social systems in favour of the protection of the elderly. The reduction in both countries is much higher for the elderly confronted to the other groups. This is directly indicated by the values for the population group age 60plus and is indicated indirectly with the high reduction for households with no member in the labour market (v0) at all – mostly pensioners and the high reduction for single households and households with no children (k0). It can be assumed, that the high poverty reduction of single households and childless households would be reduced massively if we controlled the share of single elderly households.

(2) The British welfare state and the German welfare state are significantly reducing the poverty of child rearing households, while Italy does really worse in poverty reduction within the groups of households with children. This mainly explains the high poverty rates after transfers for these groups in Italy shown above.

(3) The British welfare state reduces the income poverty of the middle-aged household group to a much higher extent than the German and Italian welfare state. This means in other words that income maintenances via the state are much more relevant for the working aged group in Great Britain, than in Germany and Italy.

(4) Comparing both points of time it can be said that the general pattern in each country has not changed that much. However, the data for Germany indicates that the effectiveness of benefits on poverty reduction becomes higher for large and double-income families respectively. In Italy, the effectiveness of the welfare states erodes even further in respect to the poverty alleviation for families with children, leading in its consequence to increasing poverty rates for these groups as is shown in table 3.

The analysis of poverty reduction through the welfare state points out that the three countries differ in the dominant logic of income distribution. The British welfare state shows a rather universal distribution pattern with few difference in the effectiveness of poverty reduction

¹⁴ See for instance: Castles (2001)

between different household dimensions. The standard deviation of the overall poverty reduction index alongside all dimension is only 0.05, nearly constant over time (see table 4).

Table 4: Effectiveness of welfare state institutions in poverty reduction
(Overall relative poverty reduction)

	GB		GER		ITA	
	1985	2000	1985	2000	1985	2000
	(not weighted)					
Mean	-0.74	-0.70	-0.60	-0.64	-0.55	-0.44
Std. deviation	0.05	0.06	0.19	0.19	0.22	0.24
	(weighted for the relative frequency of the household dimensions)					
Mean	-0.73	-0.70	-0.62	-0.68	-0.58	-0.58
Std. deviation	0.05	0.06	0.19	0.16	0.20	0.22

Notes: Own calculation with the LIS Data. The household income is adjusted for household size with the square-root equivalence scale.

The analysis of the distributional impact of the German and the Italian welfare state confirms the qualitative analysis of their institutional arrangement. Both countries have developed more specific social security systems based upon social insurance, which leave some social risks partly uncovered. However, the presence of a developed universal social assistance scheme in Germany accounts for their lower over-all selectivity as measured through the comparison of household-specific poverty reduction rates. The standard deviation of the overall poverty reduction index is higher in Germany than in the UK but lower compared to Italy. This country shows not only the worst overall performance in the poverty reduction but also the most unequal performance in fighting poverty over the various household-types. Furthermore, the unbalanced treatment of the various Italian households is even growing over time. The standard deviation of the overall poverty reduction rate is passing the millennium four times higher than in Britain and significantly higher than in Germany.

5. The macro simulation – adjusting to hypothetical changes

The question is now: what would happen if the three welfare states were confronted with a unfamiliar and new social structure and the social risks, which arose out of these changes.

What can macro simulation teach us about the ability of different welfare states to cope with different household structures? Table 5 gives us some information about the effectiveness of the welfare state when confronted with changing household structures. The poverty reduction index, displayed in table 5, corresponds to the reduction of poverty rate *as a consequence of social benefits*. We argue that the *dissimilar variation* of this index across the country (along the line) may be associated with different institutional arrangements of the national social security systems.

The combination of the German transfer system and the household structures of Great Britain and Italy shows that the effectiveness of social benefits, measured with the poverty reduction coefficient and the absolute poverty reduction, is not altered very much by the changes in the social structure. Even by transferring the British and Italian social structure to the German system, the effectiveness indicators even raise to somewhat above the real figures. The effectiveness of the German transfer system is relatively independent from the social demographic structure concerning poverty alleviation. The reasons for this are quite obvious. The distributional effects of the German welfare state are robust against changing demographic forces, because the transfer system has historically developed to a de facto universal system. Beside the market related social insurance systems, the German welfare state has comparatively strong universal elements in its family policy and in its nationwide social assistance scheme.

Table 5: Simulated effectiveness of benefits systems

		Impact of income transfer systems in poverty reduction Poverty reduction coefficients (absolute impact in brackets)		
		Income transfer system of		
		Italy	Germany	United Kingdom
Household Structure of	Italy	-66,9 (29,02)	-81,7 (39,17)	-78,6 (36,24)
	Germany	-56,0 (17,44)	-74,7 (30,46)	-73,6 (29,71)
	UK	-46,3 (14,47)	-72,6 (34,01)	-70,1 (26,37)
<i>Range of variance</i>		20,6	9,1	8,5

Notes: Own calculation with the LIS Data. The household income is adjusted for household size with the square-root equivalence scale.

A similar interpretation can be made for the British welfare state, whose effectiveness is also largely independent from changes in the household profile, as simulated by imputing the German and Italian household structure. The relative and absolute effectiveness is increasing compared to the original British context (poverty reduction coefficient: 70 absolute reduction: 26). The British income transfer system transformed to Italy would have a poverty reduction coefficient of 79 (absolutely reducing income poverty by 36 percentage points) and transformed to Germany a PRC of 74 (30 percentage points). By offering to all poverty risk groups a universal social assistance network and a nearly universal state pension, the British system is quasi naturally independent from *realistic* changes in the social structure and country specific poverty rates. Even more, as the example shows, it would be better its effectiveness under the conditions of the German and Italian demography of Germany.

Quite another story is the effectiveness of the Italian welfare state. Confronted with the social structure of Germany and Great Britain, the effectiveness of the Italian welfare system diminished considerably. With the effectiveness originally being above 20 percent, it falls down to somewhat above 11 percent when the Italian transfer system is combined with the German and British household structure. The reason for this is obvious: the welfare state of Italy is heavily pension biased and generally not as universal as the two other welfare states, lacking a universal social assistance scheme, and having only a modest child benefit system.

The interpretation of the effectiveness of the three welfare states has to be qualified in the light of the results of the pre and post transfer poverty rates in the simulations for the case of Italy. The pre-transfer poverty rates in combination with the Italian income distribution and the household structure of Germany and Great Britain are ten percentage points lower than in the Italian context. This is presumably mostly a counter image of the imbalance of the pensions play in Italy. There are simply much more elderly people in Italy than in Germany and in the UK, and so the share of people, who mostly rely on state transfers (in this case pension) is higher than in Germany and Great Britain. Consequently, the pre poverty rates in Italy must be higher controlling for the transfer system.

The results of the contra factual comparison of the institutional flexibility of our three countries to adapt to changing social structures and to absorb the poverty risks, which are generated by these changes, are mainly in line with our two leading hypotheses. While Britain and Germany with their universal and nationwide social safety nets do absorb new risk

structures quite well, the efficiency of the Italian welfare state, which has already only a mediocre performance in the “real world”, further diminishes in the face of major changes in the social structure.

6. Conclusion and Outlook

It is appropriate to separate the conclusion into two parts. One that deals with the empirical findings of our work and one that deals with the evaluation of the value of the macro simulation for comparative research. Looking forward, we can also give some recommendation for further application of the aggregation methods, which is the basis of the macro simulation.

On the empirical side, this paper underlines the general differences in the institutional structure of the three welfare states and their influence on the income distribution. Most remarkable surely is the still underdeveloped and ineffective social assistance side of the Italian systems. In addition, the results underscore the important role of the welfare state, when it comes to the question of the affordability of children. Together with the social services for families with children, the “supply” of income security by the state plays a dominant role in the further demographic development of these three countries, representing more than half of the EU population. Here the paper shows that the welfare states in Germany and Britain seem to provide somewhat more income security for families than the Italian welfare state does.

The different institutional logic and interwovenness of the welfare states with the labour markets is also underlined by our results. The Italian and German welfare states are, regarding the transfers system, still oriented in the elderly population. The working population is still the financing group of the welfare system, it benefits from the distributive mechanisms only in the case of unemployment benefits and family allowances. In Great Britain, on the other hand, the welfare state gives benefits also to people on the labour market and this not only via universal child benefits, like in Germany, but also through negative income tax schemes, which are established to subsidize the low income of the *working poor*. The macro simulation also has suggested that the German and the British welfare states are able to confront changing demographics with regard to the alleviation of poverty. The Italian welfare state, in contrast, has a weaker record in this respect, mainly as result of its lacking universalism and

strong unbalancement in the coverage of social risks due to the absence of effective social assistance programs.

Finally yet importantly, the empirical evidence suggests that the three countries object of our analysis are interesting cases for further comparisons because of their promising crosswise differences and similarities in the demographic and household structure as well as in the institutional arrangements of their welfare systems.

From the methodological point of view, we saw that the macro simulation is quite helpful to supplement the conventional method. Mixing the social structures with the income distributions produces very different results in respect of poverty rates, thus reminding us of the very country specific nature of the interplay between social structure and welfare states. In addition, the macro simulation, understood as a realistic experiment, allows us to make statements about the responsiveness of welfare states to changing demographics. Nevertheless, the paper showed that the macro simulation is not able to recognize the country specific interplay between household structure and social policy itself. For this, one is thrown back to the conventional method. Here it is important to look inside this relationship. With this regard, the paper presents – as a by-product – an interesting perspective: the building of a household typology based on micro data. This creation of aggregates out of micro data allows, with a large degree of freedom, to paint the social structure of a country along a restricted set of variables, chosen on the theoretical and empirical knowledge of the countries. This provides a promising frame to analyse the interaction between social structure and institutional arrangement, as well as their change over time.

Appendix

Appendix I: Data sets

All calculations are based on the Luxembourg Income Study (LIS). For twenty years, LIS has collected national micro data sets and provided them to the international research community free of charge. We have used them in table A documented data sets. The data sets provide information about the income sources of households and their socio-demographic characteristics. Although LIS provides data sets for five waves since the early 1980s, we have documented and worked only with two points of time for each country. We only conducted the macro simulation for the newest data sets of each country. We sampled the British and Italian data sets to a size of 6367 households, to adopt them to the size of the smaller German data set. A full account of the data sets is given by O'Higgins (1990) und Smeeding (2001).

Country	Wave	Year	Original Source	Observations (households)
Germany	II.	1984	Sozio-ökonomisches Panel (SOEP)	5159
Germany	V.	2000	Sozio-ökonomisches Panel (SOEP)	6367
Great Britain	II.	1986	The Family Expenditure Survey	7178
Great Britain	V.	1999	The Family Ressource Survey	24988
Italy	II.	1986	The Bank of Italia Survey	8022
Italy	V.	2000	The Bank of Italia Survey	8001

Appendix II: Poverty rates in Germany, Great Britain, and Italy

Poverty rates	Germany	Great Britain	Italy	Germany	Great Britain	Italy
	mid-1980s			around 2000		
severe poverty (< 30 per cent of median income)	1,23	1,36	2,16	3,10	2,88	3,61
poverty ($30 < X \leq 50$ per cent of median income)	6,54	8,47	8,70	6,87	9,97	8,62
poverty rate (≤ 50 % des Medians)	7,77	9,83	10,86	9,97	12,85	12,23

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