THE PARADOX OF REDISTRIBUTION AND STRATEGIES OF EQUALITY: WELFARE STATE INSTITUTIONS, INEQUALITY, AND POVERTY IN THE WESTERN COUNTRIES*

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Debates on how to reduce poverty and inequality have focused on two controversial questions: Should social policies be targeted to low-income groups or be universal? Should benefits be equal for all or earnings-related? Traditional arguments in favor of targeting and flat-rate benefits, focusing on the distribution of the money actually transferred, neglect three policy-relevant considerations: (1) The size of redistributive budgets is not fixed but reflects the structure of welfare state institutions. (2) A trade-off exists between the degree of low-income targeting and the size of redistributive budgets. (3) Outcomes of market-based distribution are often more unequal than those of earnings-related social insurance programs. We argue that social insurance institutions are of central importance for redistributive outcomes. Using new data, our comparative analyses of the effects of different institutional types of welfare states on poverty and inequality indicate that institutional differences lead to unexpected outcomes and generate the paradox of redistribution: The more we target benefits at the poor and the more concerned we are with creating equality via equal public transfers to all, the less likely we are to reduce poverty and inequality.

Social scientists and social reformers have long debated how the welfare state and social policies should be designed so as to best reduce poverty and inequality. This debate involves two different issues. One question concerns whether social policies should be targeted or universal, that is, should they be organized for the poor only or should the welfare state include all citizens? In the context of nontargeted programs, another question concerns the level of benefits: Should benefits be equal for all, or should they be related to previous earnings and income? These issues are of central importance for addressing the question of whether the "middle classes" should be included in the welfare state in a way that protects their accustomed living standards. Our purpose in this paper is to examine the different types of social policy programs operating in capitalist democracies and evaluate their effectiveness in reducing inequality and poverty.

BACKGROUND

Policymakers and students of social policies are divided on the issues of targeting versus

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universalism and flat-rate versus earnings-related benefit levels. As the following sampling of the nature of arguments indicates, their views on these issues have varied over country and time. Targeting harks back to the traditions of the Poor Laws, but it continues to play a more or less significant role in all Western countries. In the United States, legislation of 1935 introduced nontargeted old-age pensions and unemployment insurance as well as what was to become a large means-tested[1] program, Aid to Families with Dependent Children (AFDC). Since World War II, the targeting issue has been prominent in the United States. Thus, the large programs in the War on Poverty initiated in the 1960s were explicitly directed at the poor (Quadagno 1994). The basic question for antipoverty programs was: "What does it do to the poor?" (Lampman 1971). Social scientists evaluating antipoverty programs chose as their main criterion for program success, the degree of "target efficiency," defined as the proportion of program expenditures going exclusively to those below the official poverty line—the greater the targeting efficiency, the better the program is evaluated (Barth, Cargano, and Palmer 1974). Because of the visibility of targeted social assistance programs like AFDC and food stamps in the United States, the targeting/universalism question continues to be central in U.S. social policy debates. In Europe, however, the issue of the earnings-relatedness of universalistic social insurance benefits has come to the fore.

Referring to the assumed negative effects of social benefits on labor supply and savings, economists have typically been cool toward universalistic earnings-related social insurance and have regarded programs targeted at the poor as the most efficient way of reducing poverty and inequality. For example, Tullock (1983) writes:

> There is a rough rule of thumb by which we can detect which projects are designed to help the poor and which are not designed to help them. This rule of thumb is that if there is a means-test, *i.e.*, if aid is so arranged that it cuts off at a reasonably low level, then it is designed to help the poor. . . . [T]he switch from a means-tested program to a general aid program would, in all probability, hurt the poor. (P. 97)

Evaluating the effects on inequality of universal social services in postwar Britain, Le Grand (1982) concludes:

> Public expenditure on the social services has not achieved equality in any of its interpretations. Public expenditure on health care, education, housing and transport systematically favors the better off and thereby contributes to inequality in final income. (P. 137)

Among political scientists, Barry (1990) maintains that

> . . . the Poor Law by its nature brings about a net transfer between classes, whereas the welfare state has no inherent tendency to bring about such net transfers. . . . By contrast, a welfare state characteristically transfers money within income strata. (P. 505)

Sociologists express similar views. Thus, in his famous lectures on "Citizenship and Social Class," Marshall (1950) compared the equalizing effects of social insurance schemes involving the total population, insurance schemes limited to lower income groups, and means-tested programs and concluded that "a total scheme is less specifically class abating in a purely economic sense than a limited one, and social insurance is less so than a means-tested service" (p. 55).

This assumption, that social policies directed at the needy constitute the most efficient strategy for reducing poverty and inequality, has been called into question. British historian Tawney (1952) argued that "the strategy of equality" in a society should involve

> . . . the pooling of its surplus resources by means of taxation, and the use of the funds thus obtained to *make accessible to all, irrespective of their income, occupation, or social position*, the conditions of civilization which, in the absence of such measures, can be enjoyed only by the rich. (P. 130, italics added)

Thus, according to Tawney, social policy should not be directed to the poor alone but should include all citizens.

[1] Means-testing implies that the claimant of a benefit may be disqualified for the benefit if her or his property or wealth exceeds a certain limit, or receive the benefit at a reduced rate if the property or wealth is small. The property or wealth of other family members are usually taken into consideration, and, in some cases, the property or wealth of parents or children not living in the household is also taken into account. Income-testing is a less strict testing of the claimant insofar as only incomes are taken into consideration.

In an early critique of the emphasis on targeting in the U.S. policy debate, Korpi (1980a, 1983) contrasted a marginal social policy model with minimum benefits targeted at the poor with an institutional model based on universal programs intended to maintain normal or accustomed standards of living. He argued that while a targeted program "may have greater redistributive effects *per unit of money spent* than institutional types of programs," other factors are likely to make institutional programs more redistributive (Korpi 1980a:304, italics in original). This rather unexpected outcome was predicted as a consequence of the type of political coalitions that different welfare state institutions tend to generate. Because marginal types of social policy programs are directed primarily at those below the poverty line, there is no rational base for a coalition between those above and those below the poverty line. In effect, the poverty line splits the working class and tends to generate coalitions between better-off workers and the middle class against the lower sections of the working class, something which can result in tax revolts and backlash against the welfare-state.

In an institutional model of social policy aimed at maintaining accustomed standards of living, however, most households directly benefit in some way. Such a model "tends to encourage coalition formation between the working class and the middle class in support for continued welfare state policies. The poor need not stand alone" (Korpi 1980a: 305; also see Rosenberry 1982). The hypothesis here is that the size of the budget available for redistribution is not fixed and that the institutional structures of welfare states are likely to affect the definitions of identity and interest among citizens. Thus, an institutional welfare state model based on a universalistic strategy intended to maintain normal or accustomed standards of living is likely to result in greater redistribution than a marginal one based on targeting.

Since the 1980s, many social scientists in Europe and the United States have become increasingly critical of the targeting of social policies at the poor. Weale (1990) argues that "there is a series of connections both of practice and of principle that link universalistic forms of provisions to the pursuit of equality" (p. 475). Studies of poverty among racial minorities and children increasingly take a dim view of the effects of targeted policies (Garfinkel, Hochschild, and McLanahan 1996; Lawson and Wilson 1995). Scholars focusing on gender relations point out how means-tested social programs tend to disadvantage women (Harrington Meyer 1996; Hobson 1990; O'Connor 1993; Orloff 1993).

Nevertheless, while support for targeting has decreased among social scientists, it has increased among policymakers in Western countries. Thus, for example, on the international scene, institutions such as the International Monetary Fund and the World Bank have argued that "a comprehensive approach to poverty reduction . . . calls for a program of well-targeted transfers and safety nets" (World Bank 1990:3).

The idea that high-income earners should be included in the universalistic welfare state via earnings-related benefits also tends to meet strong resistance from scholars. According to Goodin and Le Grand (1987), the failure of social policies to reduce inequality lies in the beneficial participation of the nonpoor in the welfare state. If the goal of social policy is limited to the reduction of poverty, then universal programs that also benefit the nonpoor are a waste of resources. If the goal is to reduce inequality between the poor and the nonpoor, however, their verdict is even more severe:

> In egalitarian terms . . . the beneficial involvement of the non-poor in the welfare state is not merely wasteful—it is actually counterproductive. The more the non-poor benefit, the less redistributive (or, hence, egalitarian) the impact of the welfare state will be. (Goodin and Le Grand 1987:215)

In the same vein, Castles and Mitchell (1992) argue that while universalism is likely to lead to greater equality than targeting, "earnings-related (or status-related) benefits will clearly have a less equalizing effect, all other things being equal, than flat-rate benefits" (p. 4).

Other social scientists, however, have defended earnings-related benefits. In a study of pensions, Palme (1990) observed that universalistic earnings-related pension systems tend to produce less inequality in the distribution of final income among the elderly than do flat-rate systems. He concluded, "*[T]here is a paradox here* in the sense that comparatively unequal public pensions

might produce the most equal income distributions by crowding out even more unequal income sources" (p. 154, italics added), such as private pensions (also see Kangas and Palme 1993). In Finland, the change from flat-rate to earnings-related pensions reduced inequality and poverty among the elderly between 1966 and 1990 (Jäntti, Kangas, and Ritakallio 1996). Åberg (1989) shows how the distributive profiles of welfare states combine with their size to generate redistribution. Some comparative empirical evidence indicates that universalistic welfare states tend to be associated with greater equality and redistribution than do marginalistic welfare states (Fritzell 1991; Hicks and Swank 1984; Mitchell 1991; O'Higgins, Schmaus, and Stephenson 1990; Ringen 1987, chap. 8; Ringen and Uusitalo 1991; Uusitalo 1984).

In an innovative and influential study, Esping-Andersen (1990) appears to take an inconsistent position on the consequences of earnings-related benefits. On one hand, he applauds the "social democratic welfare state regime" (p. 27), which promotes equality on the highest levels and makes for "universalism of middle-class standards" (p. 69). On the other hand, he takes the difference between the social insurance benefits of an average production worker and the maximum legal benefit—an indicator of the degree of earnings-relatedness—as a main criterion for distinguishing between "socialist" and "conservative" welfare state regimes. "The benefits-differential measure should in principle facilitate a sharp distinction between 'socialist' and 'conservative' cases. In the former, an accent on equality should induce low differentials; in the latter, the principles of maintaining status and hierarchy should result in sharp inequalities" (Esping-Andersen 1990:75). Thus, we should expect "the socialist-inspired regimes to accentuate benefit equality, while in the conservative regimes inequalities should be greatest" (p. 69) and therefore "the socialist regime ought to exhibit the lowest level of benefit differentials" (p. 73).[2]

As the above review indicates, in the late 1990s Western policymakers are renewing the old stress on the targeting of social policies, and social scientists are disagreeing on the best strategy for reducing poverty and inequality. While universalism has gradually become accepted in many scholarly quarters outside economics, the earnings-relatedness of social insurance benefits is still strongly questioned. Within the countries of the European Union, this questioning has been strengthened by increasing pressures to reduce budget deficits and to reduce the public sector. Comparative analyses involving countries with different kinds of welfare state institutions are likely to promote our understanding of the consequences of different strategies to decrease poverty and inequality.

In this paper, we carry out a comparative analysis of the capacity of what Titmuss (1974) refers to as different models of social policy to reduce inequality and poverty in capitalist democracies. The analysis centers on the role of the institutional structures of welfare states in the redistributive process. These institutional structures reflect differences in the roles played by markets and politics in distributive processes within countries and, in Tawney's terms, embody different "strategies of equality." The shape of societal institutions is affected by the actions of different interest groups, but we also expect that institutional structures affect the ways in which citizens come to define their interests and preferences (Hechter, Opp, and Wippler 1990; Korpi 1980a, 1980b, 1985; March and Olsen 1989; Pierson 1995; Powell and DiMaggio 1991; Steinmo, Thelen, and Longstreth 1992). Thus, welfare state institutions can be viewed as "intervening variables" (Lazarsfeld 1962), on one hand reflecting causal factors such as actions by coalitions of interest groups, and on the other hand potentially having feedback effects on distributive processes via their effects on the formation of interests, preferences and coalitions among citizens. Therefore a fruitful hy-

[2] It would appear that Esping-Andersen (1990) here reflects the dualist views on earnings-related social insurance benefits long found in the Nordic labor movements. Thus, for example, Gustav Möller, longtime Minister of Social Affairs in Social Democratic governments and generally regarded as the founding father of the modern Swedish welfare state, strongly opposed the introduction of earnings-related benefits in the Swedish sickness insurance program.

pothesis is that, while the institutions of the welfare state are to an important extent shaped by different types of interest groups, once institutions are in place they tend to influence the long-term development of definitions of interests and coalition formation among citizens. This makes it likely that institutional structures will have significant effects on redistributive processes and on the reduction of inequality and poverty.

DATA

This analysis is based on two new data sets. One is the Social Citizenship Indicator Program (SCIP), which contains information on the development of social insurance programs in 18 OECD countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, and the United States.[3] The other data set is the Luxembourg Income Study (LIS), which contains micro-data on income distribution in a number of countries.[4] These two data sets represent major advances in the opportunity for the comparative study of social policies and their effects.

A TYPOLOGY OF SOCIAL INSURANCE INSTITUTIONS

Welfare state institutions in industrialized countries demonstrate differences as well as family resemblances which are likely to be of relevance for their redistributive consequences. Attempts to capture similarities and differences by creating typologies of welfare states have run into familiar problems. By specifying ideal types, we hope to crystallize similarities among countries and to gain a better understanding of the background to variations among them. However, ideal types will never have a perfect fit with existing realities, and such typologies may obscure the actual variations among countries. The fruitfulness of typologies depends, therefore, on our ability to construct them using variables that are of heuristic value for understanding the background to and consequences of variations among ideal types, and on the extent to which empirically observed variation among types is greater than variation within types.

Typologies of welfare states can serve different purposes and can focus on variables related to causes, institutions, and/or outcomes. Esping-Andersen (1990) offers the most influential attempt to create a welfare state typology (also see Korpi 1980b; Mishra 1981; Titmuss 1974). He uses the concept of welfare state regimes to characterize and describe the complex relationships among the state, the labor market, and the family. By emphasizing the multidimensional nature of variation in welfare states, Esping-Andersen's typology is fruitful and has stimulated much research. His three clusters of welfare states regimes are labeled according to the main ideological currents assumed to underlie them—Conservative, Liberal, and Social Democratic. Because Esping-Andersen's primary interest was to describe the contours of the relationships among states, labor markets, and families, his typology is based on a broad set of indicators referring to both outcomes and institutions.[5]

Our interest is primarily analytical—on one hand to study the causal factors affecting the institutional aspects of the welfare state and, on the other hand, to examine the

[3] These 18 countries are selected according to the principle of most comparable cases (Lijphart 1975). They include only countries with a history of uninterrupted political democracy during the post–World War II period and with more than 1 million inhabitants.

[4] The Social Citizenship Indicator Program (SCIP) is based at the Swedish Institute for Social Research at Stockholm University and is directed by the present authors (for presentations of the data files, see Korpi 1989; Palme 1990). For a presentation of the Luxembourg Income Study, see Smeeding, O'Higgins, and Rainwater (1990) and Buhmann et al. (1988). Analyses are restricted to the 11 countries for which LIS data were available in 1994 and for which information was detailed enough to enable us to follow the various steps in the income formation process.

[5] Esping-Andersen (1990:69–77) uses seven indicators for his typology: the number of occupationally distinct pension schemes, insurance coverage in the population, the difference between average and maximum benefit levels, and the size of expenditures in terms of the relative size of government employee pensions, means-tested benefits, private sector pensions, and private sector health care.

Table 1. Ideal-Typical Models of Social Insurance Institutions

Model	Bases of Entitlement	Benefit Level Principle	Employer-Employee Cooperation in Program Governance
Targeted	Proven need	Minimum	No
Voluntary state-subsidized	Membership, contributions	Flat-rate or earnings-related	No
Corporatist	Occupational category *and* labor force participation	Earnings-related	Yes
Basic security	Citizenship *or* contributions	Flat-rate	No
Encompassing	Citizenship *and* labor force participation	Flat-rate and earnings-related	No

effects of institutions on the formation of interests, preferences, and identities as well as on the degree of poverty and inequality in a society. For these purposes we base our typology of welfare states on their institutional characteristics. Institutional structures reflect the role of conflicts among interest groups, for example, regarding the relative roles of markets and politics in distributive processes. Yet, institutional structures in turn are likely to affect outcomes by forming important frameworks for the definitions of interest and identities among citizens. Thus, they can be expected to affect the formation of coalitions among citizens that are relevant for income redistribution and poverty. While the complex of relationships characterizing welfare state regimes makes it difficult to study change, a typology of institutions facilitates the study of change by making it possible to relate causes and outcomes to intervening variables.

The major social insurance programs catering to citizens' most important needs during the life course constitute a key part of the welfare state.[6] The institutional structures of two such programs—old-age pensions and sickness cash benefits—are here taken as bases for a welfare state typology. These two programs respond to basic features of the human condition—the certainty of aging and the risk of illness. Unlike unemployment and work-accident insurance, for which the relevant risks differ greatly among socioeconomic categories, old age pensions and sickness insurance are important for all citizens. Because these two programs also have a major economic impact they likely have great relevance for the formation of interest groups.

As a basis for our typology, we classify the institutional structures of old-age pension and sickness insurance programs according to three aspects (see Table 1). (1) Relevant to the issue of targeting versus universalism, the first aspect refers to the definition of *bases of entitlement* and involves four qualitatively different criteria indicating whether eligibility is based on need determined via a means test, on contributions (by the insured or employers) to the financing of the social insurance program, on belonging to a specified occupational category, or on citizenship (residence) in the country.[7] These four criteria for eligibility to entitlements have been used in different combinations in different countries. (2) The second aspect concerns the underlying principle guiding the determination of benefit levels—that is, the extent to which social insurance benefits should replace lost income. The *benefit-level principle* can be seen as a continuous variable, going from means-tested minimum benefits, to flat-rate benefits given equally to everyone, and to benefits that in different degrees are related to previous earnings. (3) The third aspect is qualitative and refers to the *forms for*

[6] The social services constitute another major part of the welfare state but cannot be included here.

[7] As a result of immigration, in most countries an increasing proportion of residents are not citizens. For convenience, the term "citizens" includes residents as well.

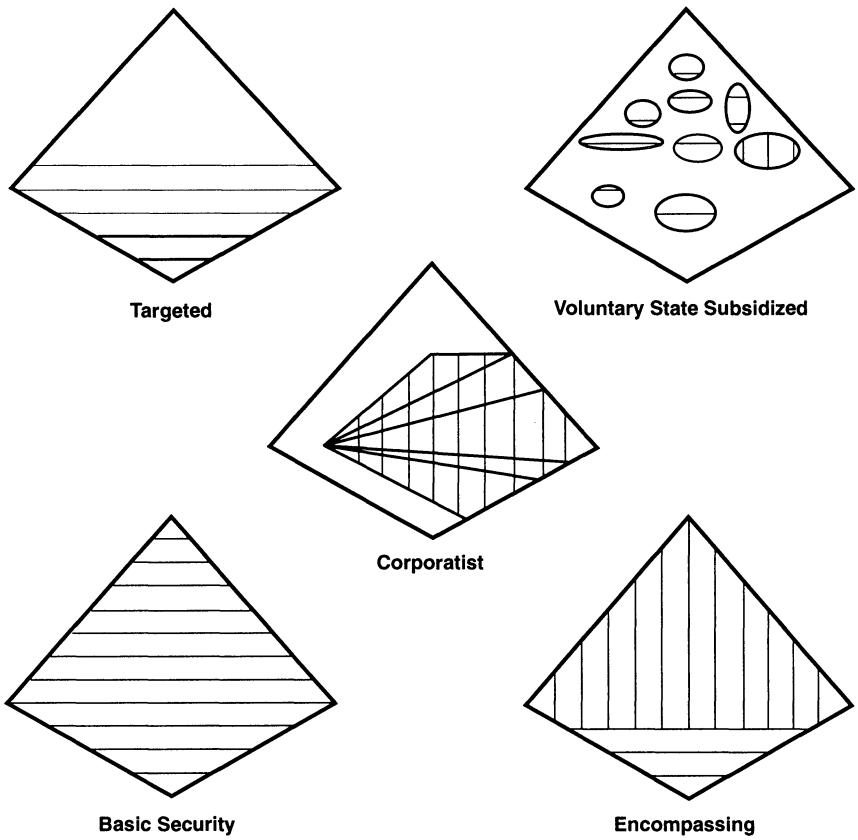

Figure 1. Ideal-Typical Models of Social Insurance Institutions

Note: The *four-sided figures* represent the social structure of society with high-income earners at the top and low-income earners at the bottom. *White areas* represent the noncovered population. *Horizontal lines* indicate flat-rate benefits. *Vertical lines* indicate earnings-related benefits. *Ellipses* in the voluntary state subsidized model indicate separate insurance programs. *Angled lines* in the corporatist model indicate insurance programs organized separately for different occupational categories.

governing a social insurance program. This aspect receives its significance via its combination with the previous two aspects. Here we create a dichotomy based on whether representatives of employers and employees cooperate in the governing of a program.

On the basis of these three aspects of social insurance programs, we delineate five different ideal types of institutional structures. In a rough chronological order according to their historical appearance in the Western countries, these ideal institutional types are characterized as the *targeted, voluntary state-subsidized, corporatist, basic security,* and *encompassing models.* Figure 1 characterizes the ideal-typical features of these institutional structures. The diamond-shaped figures symbolize the socioeconomic stratification system—high-income earners are at the top and low-income earners and the poor are at the bottom. Citizens with rights to flat-rate or minimum benefits are indicated by horizontal lines; citizens with rights to earnings-related benefits are indicated by vertical lines. Note, however, that some social insurance programs that formally give earnings-related benefits have relatively low benefit ceilings, which in practice results in relatively equal benefits for most part of the insured.

In the *targeted model* eligibility is based on a means test, which results in minimum or relatively similar benefits (horizontal lines) to those who fall below a poverty line or are defined as needy. Although targeted programs have traditions going back to the Poor Laws, the criteria for determining need

can vary considerably in terms of punitiveness and generosity. During this century, many countries relaxed the criteria used for means-testing. For example, in Australia targeting has gradually come to be focused on excluding top-income earners rather than including only the poor. This possibility is indicated by thinner lines above the poverty line.

The *voluntary state-subsidized model* uses tax money to help mutual-benefit societies and other voluntary organizations provide insurance to protect their members against loss of earnings. Because eligibility for benefits is based on voluntary contributions that give membership in the respective schemes, they have been more important for skilled workers and the middle class than for the unskilled and the poor. Voluntary schemes can have flat-rate or earnings-related benefits, but the latter often approach flat-rate benefits because of relatively low ceilings for earnings replacements.

The pioneering social insurance programs initiated in Germany by Bismarck in the 1880s broke with means-testing and voluntarism by introducing programs with compulsory membership that gave specified occupational categories the right to claim benefits when their normal earnings were interrupted for reasons beyond their control. Thus, German social insurance came to follow the *corporatist model* central to Catholic social teaching and nineteenth-century conservative thought (Durkheim [1902] 1964; Leo XIII [1891] 1943; Messner 1936, 1964; Pius XI [1931] 1943).[8] The corporatist model can be said to create "sociopolitical communities" within different segments of the labor force and to induce cooperation between employers and employees within these segments. In the corporatist model, programs are directed at the economically active population. Eligibility for benefits is based on a combination of contributions *and* on belonging to a specified occupational category. Separate social insurance programs with differing entitlements are organized for different occupations or branches of industry, creating a segmentation among occupational categories. Starting with the industrial working class, over the decades new occupational categories gradually have been added and accorded separate insurance programs. Benefits are clearly earnings-related (vertical lines), but entitlements and rules can differ significantly among the programs for different occupational categories. In contrast to the other four institutional types and reflecting the basic idea of creating sociopolitical communities and cooperation among the potential antagonists in the labor market, programs in the corporatist model are governed by elected representatives of employees and employers, often with the state present as a minor third party. Programs are financed primarily via contributions from employers and employees. Being limited to the economically active population, this model excludes housewives and others outside the labor force. Typically, an income ceiling for coverage is also introduced, with high-income earners being expected to find private solutions.

In the *basic security model*, eligibility is based on contributions *or* on citizenship (residence). This model comes close to the central ideals expressed by Beveridge (1942). One ideal was to have flat-rate benefits or a low ceiling on earnings replacement in order to leave room for high-income groups to protect their standard of living through private insurance programs. According to Beveridge (1942),

> [T]he first fundamental principle of the social insurance scheme is provisions of a flat rate of insurance benefit, irrespective of the amount of earnings which have been interrupted. . . . This principle follows from the recognition of the place of voluntary insurance in social security. (P. 121)

Another basic idea was to achieve wide or universal coverage of the relevant population categories. Within the basic security model there are two variants with somewhat different levels of coverage. In the "citizenship" variant, eligibility is based on citizenship or residence (i.e., the idea of "People's Insurance" or universal coverage). In the "insur-

[8] Here, the term "corporatism" is used in its original meaning of state-induced cooperation between employers and employees within specific sectors of industry. In the address of the German emperor to the *Reichstag* on February 15, 1881 announcing the coming social insurance legislation, the term "korporative Verbände" (corporatist associations) was used to describe this type of organizations (Deutsche Reichstag 1881).

ance" variant, however, eligibility is acquired through contributions by the insured and/or employers, entailing less than universal coverage. In contrast to the corporatist model, however, in the basic security model all insured are covered by the same program. In the basic security model, benefit levels have come to vary to some extent, and although the differences between the "citizenship" and "insurance" variants are relatively small, in some contexts they can be significant.

The *encompassing model* combines ideas from Bismarck and Beveridge into a new pattern. In this model, eligibility is based on contributions *and* citizenship. Universal programs covering all citizens and giving them basic security are combined with earnings-related benefits for the economically active population. This model reduces the demand for private insurance and has the potential of encompassing all citizens within the same program.

SOCIAL INSURANCE INSTITUTIONS IN 1985

Can the institutional models described above be discerned among the welfare states now existing in Western countries? We use the SCIP data to classify the institutional structures of old-age pensions and sickness insurance programs existing in 1985 in our 18 OECD countries. Here, one must remember that a typology based on ideal types can never fit the real world exactly. As a result of a century of efforts by different interest groups to place their stamp on the institutional structures of the welfare state, we must expect to find crossbreeds, not purebreds; alloys, not elements. We also must recognize that the institutional structures of welfare states change over time. Moreover, the ideal-typical models refer to single social insurance programs in a particular insurance area. However, more than one program, and thus more than one institutional type, may exist in a given insurance area. Furthermore, institutional forms may differ between the two program areas. Thus, the clustering of countries must sometimes be based on tendencies and gradations rather than on clear-cut criteria close to ideal types.

In fitting the institutional structures of pension and sickness programs into the typology, we follow a step-wise decision procedure. First we separate out means-tested programs. Next we separate out the voluntary state-subsidized programs. These steps are not problematic, because the relevant qualitative criteria are established by legislation. This is also true of the third step, identifying the corporatist model in terms of the existence of multiple programs directed at separate occupations or branches of industry, each program governed by elected representatives of employers and the insured.[9] The fourth step distinguishes the basic security and encompassing programs, which are based on the degree of earnings-relatedness of benefits and the program's coverage (see Appendix A for details). In the basic security programs, earnings-relatedness is absent or marginal; in encompassing programs, it is substantial. In encompassing programs, relevant population groups receive universal coverage. In basic security model, however, "citizenship" programs have universal coverage, while in the "insurance" variant, in which entitlements are based on contributions, coverage can be substantially lower.

In 1985, in 14 of our 18 countries sickness insurance and pensions insurance programs had the same institutional structures. In three of the remaining four countries—the Netherlands, New Zealand, and Switzerland—institutional structures differ between program areas reflecting processes of change. The fourth country, the United States, lacks a national sickness insurance program for the working-age population. In these four countries, the organization of pension insurance, in many ways the single most important program, is used to characterize the country. In 1985, the voluntary state-subsidized model is found only in sickness insurance programs and thus no longer characterizes any of our 18 countries.[10] This reflects the fact that although some countries introduced voluntary state-subsidized pension programs early on, it has proved difficult to organize large-scale pension programs in this institutional form.

[9] The existence of separate legislated programs for different occupational groups is always combined with earnings-related benefits.

[10] In 1985, in three countries unemployment insurance programs were also organized according to the voluntary state-subsidized model.

In all of our 18 countries, some social policy programs are targeted at those defined as poor.[11] Australia, however, bases eligibility for old-age pensions and sickness insurance benefits on means-tests, and thus it is the only country to follow the targeted model.[12]

In 1985, an easily recognizable cluster is the corporatist one found in five countries of continental Europe—Austria, Belgium, France, Germany, and Italy. Japan also has a corporatist model with separate programs for different parts of the labor force as well as for enterprises of different sizes.[13] These six countries have corporatist institutions in sickness insurance and in pensions.

The basic security model in its two variants is found in a relatively heterogeneous group of eight countries. "Citizenship" pensions with universal coverage exist in Canada, Denmark, the Netherlands, New Zealand, and Switzerland. In Denmark, the Netherlands, and New Zealand, pensions are paid on a flat-rate basis, whereas in Canada and Switzerland, a limited earnings-related component is added to flat-rate pensions. The "insurance" variant, with eligibility based on contributions and therefore less than universal coverage, is found in Ireland, the United Kingdom, and the United States. In contrast to the corporatist countries, however, these three countries include all insured in the same program. In the United Kingdom and the United States, pensions are to some extent related to the level of contributions and therefore to previous earnings, but because of relatively low ceilings for maximum benefits, their degree of earnings-relatedness is clearly lower than it is in the encompassing countries (see Appendix A). Reflecting changes during past decades, the basic security countries are also more heterogeneous in that the institutional structures of sickness insurance in three of these countries differ from those of pension insurance: In sickness insurance, the Netherlands retains the corporatist model, Switzerland the voluntary state-subsidized model, and New Zealand the targeted model.

The encompassing model is found in Finland, Norway, and Sweden where it developed from the basic security and the voluntary state-subsidized forms. In these countries, encompassing pension programs are based on universal, flat-rate "People's Pensions" supplemented with clearly earnings-related programs for the economically active population. Sweden initiated the encompassing model by replacing its voluntary state-subsidized sickness insurance scheme with a universal earnings-related program in 1955 and by supplementing its universal basic security pensions with an earnings-related pension program for all economically active persons in 1959. Norway and Finland introduced similar reforms in the 1960s and 1970s.

Whereas characterizing countries on the basis of global policy regimes gives an impression of relative stability and permanence, our focus on the structures of social insurance institutions facilitates the study of change. The institutional structures in 1985 are only a snapshot in a process of long-term, intermittent change. These changes are documented and analyzed in another context (Korpi 1998).

INSTITUTIONS, STRATEGIES OF EQUALITY, AND REDISTRIBUTION

The types of social insurance institutions outlined above can be expected to affect redistributive processes through differences in the role they accord to markets and to politics as well as through the direct and indirect ways in which they tend to encourage or discourage the formation of risk pools with varying degrees of homogeneity in terms of socioeconomically structured distribution of risks and resources. The targeted model ap-

[11] Thus, for example, according to our classification, in the United States the old-age insurance (Social Security) is a basic security program of the "insurance" variant with somewhat less than universal coverage and only moderately earnings-related benefits, but it coexists with targeted programs such as AFDC and food stamps.

[12] In Australia, the issue of targeting versus universalism has been significant. Regarding old-age pensions, the targeted category of citizens has gradually been expanded. Because the targeted model plays an important role in social policy debates, and since Australia retains targeting in all major social insurance programs, it is worth analyzing the consequences of this model (Castles 1985).

[13] During the Meiji Restoration, the Japanese government was influenced by the then new German social insurance legislation and attempted to modify it for domestic use.

parently involves the lowest degree of political interference with market distribution, followed by the voluntary subsidized model and the basic security model. The basic security model establishes a base for market-based stratification. The corporatist model involves greater encroachment on market distribution than does the basic security model, but, because of its occupational segmentation and its exclusion of the economically nonactive population and top-income earners, it encroaches less than the encompassing model.

In traditional insurance terminology, social insurance involves the creation of risk pools within which risks and resources are shared. In the Western countries, economic risks and resources are unequally distributed along lines that tend to follow socioeconomic cleavages. For social insurance, the socioeconomic structure therefore offers opportunities to delineate risk pools that are more or less homogeneous in terms of risks and resources. We hypothesize that the structures of social insurance institutions can emphasize differences in risks and resources by increasing homogeneity within risk pools in terms of their socioeconomic composition, or they can play down these differences by pooling resources and sharing risks across socioeconomically heterogeneous categories. Social insurance institutions thereby can shape the processes of defining interests and identities among citizens, the rational choices citizens are likely to make, and the ways in which they are likely to combine for collective action.[14] Of special interest in this context is the extent to which institutional structures discourage or encourage coalition formation between the poor citizens and better-off citizens and between the working class and the middle class, thus making their definitions of interest diverge or converge. Divergence can be fostered by either institutional structures that directly segment risk pools along socioeconomic lines, or indirectly via redistributive strategies that create differences of interest between the poor and the nonpoor, between workers and salaried employees.

The institutions of the corporatist and the voluntary state-subsidized models have direct effects on the segmenting of risk pools. The corporatist model is based on a direct segmentation of risk pools along socioeconomic lines. By creating programs specific to branches of industry and occupational status, corporatist programs separate citizens into relatively homogeneous risk categories that are accorded more or less differing conditions, contributions, and benefits. Thus, this model brings to the fore the potential lines of socioeconomic cleavages among citizens, creates differences in short-term economic interests among occupational categories, and tends to institutionalize these differences. Furthermore, the corporatist model limits the pooling of risks and resources by excluding the economically nonactive population and top-income earners.

In the voluntary state-subsidized model, social insurance institutions reflect socioeconomic differences. By organizing relatively homogeneous categories of citizens defined in terms of occupation or domicile and by relying largely on contributions by members, voluntary state-subsidized insurance often is dominated by middle-class groups, while low-income earners are less well covered. Thus, the voluntary state-subsidized model can be expected to discourage coalition formation between the disadvantaged and the more fortunate citizens and to generate segmentation along socioeconomic lines.

Institutional structures also affect coalition formation and the definition of interests among citizens in indirect ways through the various "strategies of equality" they can be seen as embodying. These strategies can be defined by their *degree of low-income targeting*, (i.e., the extent to which budgets used for redistribution go to those defined as poor). The degree of low-income targeting varies between institutional types. The targeted model can be said to follow the *Robin Hood strategy* of taking from the rich and giving to the poor. The flat-rate benefits in the basic security model (as well as those in many voluntary state-subsidized programs) reflect a *simple egalitarian strategy* with equal benefits for all, but in relative terms giving more to low-income earners than to

[14] Risk groups play a role in the development of social policies, as stressed by Baldwin (1990), but not primarily as independent driving forces. Instead, risk groups are created in part by social insurance institutions, and once formed, act to safeguard their specific interests.

the better off. The earnings-related benefits found in the corporatist and encompassing models follow the biblical *Matthew principle* of giving more, in absolute terms, to the rich than to the poor, and also, in relative terms, having limited low-income targeting.

By discriminating in favor of the poor, the targeted model creates a zero-sum conflict of interests between the poor and the better-off workers and the middle classes who must pay for the benefits of the poor without receiving any benefits. The targeted model thus tends to drive a wedge between the short-term material interests of the poor and those of the rest of the population, which must rely on private insurance. It gives the better-off categories no rational basis for including the poor, and leaves the poor to trust in the altruism of the more fortunate.

As made explicit by Beveridge (1942), in the basic security model flat-rate benefits are intended only to provide a safety net for the working class, while the middle classes are expected to safeguard their standards of living through various forms of private insurance. Social insurance systems in the basic security model therefore tend to become a concern primarily for manual workers, while as in the targeted model, private insurance is likely to loom large for salaried employees and other better-off groups. Therefore, the basic security model is also likely to separate the interests of high-income strata from those of workers and the poor.

In contrast to voluntary and corporatist programs, the encompassing model includes all citizens in the same programs. By giving basic security to everybody and by offering clearly earnings-related benefits to all economically active individuals, in contrast to the targeted and basic security models, the encompassing model brings low-income groups and the better-off citizens into the same institutional structures. Because of its earnings-related benefits, it is likely to reduce the demand for private insurance. Thus, the encompassing model can be expected to have the most favorable outcomes in terms of the formation of cross-class coalitions that include manual workers as well as the middle classes. By providing sufficiently high benefits for high-income groups so as not to push them to exit, in encompassing institutions the voice of the better-off citizens helps not only themselves but low-income groups as well (Hirschman 1970).

The debate about the redistributive outcomes of welfare state programs has focused almost exclusively on how to distribute the money available for transfer and has largely ignored variations in the size of the redistributive budget (i.e., the total sum available for redistribution). The degree of redistribution finally achieved depends on the size of the redistributive budget as well as on the degree of low-income targeting. Without specifying the functional form or all other relevant factors, the degree of redistribution achieved can be seen as including a multiplicative element—*final redistribution* is a function of *degree of low-income targeting* × *redistributive budget size.*

The neglect of budget size is all the more unfortunate, since, as the discussion above indicates we can expect a trade-off between the degree of low-income targeting and the size of the redistributive budget, such that *the greater the degree of low-income targeting, the smaller the redistributive budget.* This trade-off indicates that it is impossible to maximize both the degree of low-income targeting and budget size. In so far as welfare state institutions contribute to the pooling of risks and resources and to the formation of coalitions that include the middle classes as well as the working class and the poor, they are likely to affect the size of the redistributive budget.[15] Therefore, encompassing institutions are expected to generate the broadest base of support for welfare state expansion and the largest budget size. However, although corporatist institutions exclude the economically inactive population and segment different occupational categories, because of their earnings-related benefits they are expected to generate relatively large budgets. In spite of a high level of coverage, the basic security countries with relatively low benefits are expected to have smaller budgets than either the corporatist welfare states or the encompassing welfare

[15] Redistributive budgets are financed through taxation with different degrees of progressivity. Thus, this redistributive formula can also be applied to the financing side of the redistributive process. We study the combined redistribution achieved via the tax and transfer systems.

states. The smallest budget is expected in the targeted welfare state.

To test the above hypotheses empirically, we look first at the overall correlation between institutional structures and outcomes in terms of the degree of inequality and the level of poverty in the countries for which relevant data are available. Such a correlation highlights the need to open the black box of causal processes assumed to mediate the effects from institutions to redistributive outcomes. Within the scope of this paper and with the data now available, it is possible to take only a partial look into this black box—by following the subsequent stages in the causal processes and attempting to verify these different steps.

To the extent that we can verify the working of the hypothesized processes in the subsequent stages of the redistributive process, we can consider our hypotheses to be supported. Accordingly, we will here rely on the combined pattern of evidence from different parts of the redistributive process in evaluating the support for our hypotheses.[16] Institutional structures, however, are only one of many factors that affect the distribution of income in a country (Hicks and Misra 1993; Huber, Ragin, and Stephens 1993). Political traditions, demographic composition, labor force participation rates, levels of unemployment, wage setting practices, and industrial structures are also important.[17] At best we can hope for a partial agreement between our hypotheses and comparative empirical data. As is often the case in comparative research, we lack good quantitative indicators for some relevant variables and will have to use available proxies.

INSTITUTIONS, INEQUALITY, AND POVERTY

The causal processes outlined above lead us to expect considerable differences among our institutional types of welfare states and their distributive outcomes in terms of the extent of poverty and inequality. We expect poverty and inequality to be highest in countries with the targeted and basic security models and lowest in countries with the encompassing model, with the corporatist countries falling somewhere in between.

For 11 of our 18 countries, we are able to use micro-surveys on household income included in the Luxembourg Income Study (LIS).[18] Limitations in the LIS-data restricted this part of the analysis to the following countries (years for income data are in parentheses): Australia (1985), Canada (1987), Finland (1987), France (1984), Germany (Federal Republic) (1984), the Netherlands (1987), Norway (1987), Sweden (1987), Switzerland (1982), United Kingdom (1986), and the United States (1986). Analyses are carried out for the total population, the working-age population (25 to 59 years of age), and the elderly (over age 65) (Appendix A presents a full description of methods and indicators).

For the study of income distribution, the household is generally taken as the income-receiving unit within which members' economic resources are likely to be pooled,[19] but, when using the income distribution to judge economic well-being, individuals should be the units of observation. When comparing households of different sizes, it is reasonable to weight family income by the sizes of the family and to account for economies of scale by giving different weights to the first and "other" family members (Buhmann et al. 1988). Therefore, the income of each household is divided by an equivalence scale, and this adjusted disposable income is then weighted so that each individual gets an equal count (see Appendix A). Using the so-called standard model of income distribution analysis, disposable income refers to net cash income after direct taxes, social security contributions, and public cash transfers (Ringen

[16] In view of the relatedness of the hypotheses concerning different parts of the redistributive process and the small number of countries for which information is available, quantitative statistical analyses have been kept to a minimum.

[17] Some of these factors can partly be controlled for by an examination of the change in inequality when we move from market income to gross and disposable income (cf. below).

[18] The LIS data offer great flexibility in terms of definitions and in the selection of income units and variables. Although the accuracy of the data is also much better than those in previous studies, some problems of comparability remain.

[19] It should be noted, however, that within families we may find gender differences in the availability of economic resources.

Table 2. Inequality (Gini) and Poverty Rates in Disposable Income by Age and Type of Social Insurance Institution: 11 OECD Countries, ca. 1985

Type of Social Insurance Institution/Country	Inequality (Gini Coefficient)			Poverty Rate (Percentage)[a]		
	Total Population	25 to 59 Years	65 or Older	Total Population	25 to 59 Years	65 or Older
Encompassing						
Finland	.231	.205	.219	4.1	1.6	3.9
Norway	.232	.218	.241	3.5	2.9	2.6
Sweden	.215	.194	.182	4.9	2.6	1.4
Corporatist						
France	.292	.292	.287	8.5	8.0	1.9
Germany	.243	.235	.278	5.8	5.3	5.3
Basic Security						
Canada	.279	.277	.257	10.9	10.9	4.9
Netherlands	.252	.254	.220	5.8	3.5	.2
Switzerland	.320	.305	.355	7.4	5.8	11.9
United Kingdom	.293	.293	.242	13.2	11.0	9.2
United States	.333	.327	.355	17.9	17.8	17.5
Targeted						
Australia	.310	.301	.279	9.1	9.3	5.2

Source: Luxembourg Income Study.

[a] Percentage below 50 percent of the median income.

1987; see Whiteford 1993 for a critique). There are strong arguments for viewing needs and welfare in relative terms (i.e., an individual's welfare is to some extent determined by her or his position relative to others [Goodin 1990]). Therefore, we use the traditional Gini coefficient to describe the overall degree of income inequality. We also look at those with the lowest incomes. As is well-known, the measurement of poverty involves a number of problems and considerable arbitrariness (Kangas and Ritakallio 1995). Thus, among the elderly, for example, we find a clustering of persons around income levels provided by minimum pensions. This clustering makes the indicator of cross-national differences in poverty highly sensitive to the choice of the poverty line (Palme 1998). Here we define *poverty rates* for each country as the percentage of the population below 50 percent of the median income.

Table 2 indicates the overall relevance of our institutional welfare states typology for income equality and poverty. It presents the results from LIS-based analyses that describe the distribution of disposable household income in the 11 countries for which full data on the income formation process are available. We find considerable differences in income inequality and the extent of poverty among countries using different institutional models. For the total population, the working-age population, and the elderly, the lowest income inequality is found in the three encompassing countries—Finland, Norway, and Sweden. Among the basic security countries, variation in Gini coefficients is relatively large—the Netherlands has a relatively low coefficient and the United States has the highest coefficient. The highest income inequality figures occur in the basic security and targeted models, especially in the United States, Switzerland, Australia, and the United Kingdom. The two corporatist countries, France and Germany, occupy intermediate positions.

A similar pattern emerges for poverty rates. With a few exceptions, the lowest poverty rates are found among countries in the encompassing category. Again, the variation

in poverty rates among the basic security countries is high. The Netherlands again resembles the encompassing countries, and the United States has the highest poverty rate. With its targeted model, Australia also has comparatively high poverty rates. Again, the two corporatist countries, France and Germany, occupy intermediate positions. These results thus give considerable support for our hypothesis about the overall role of welfare state institutions in the distributive processes of the Western countries.

BUDGETS, TARGETING, AND REDISTRIBUTION

As indicated above, we expect to find the largest redistributive budgets in the encompassing countries, followed in descending order by corporatist, basic security, and targeted categories of countries. As the best available proxy for the size of redistributive budgets in our 18 countries, we use International Labour Office (ILO) data on social expenditures, which include expenditures for cash transfers as well as for noncash benefits (International Labour Office 1992).[20] Expenditures refer to 1985. At that time, unemployment levels varied greatly among the OECD countries: The percentage of GDP spent on unemployment benefits ranged from .7 percent in Norway to about 3.5 percent in Belgium, Denmark, and Ireland. The direct cost of income maintenance for the unemployed depends in part on benefit replacement levels, but in practice reflects primarily the level of unemployment (Kangas and Palme 1991b). Table 3 presents total benefit expenditures as well as total benefit expenditures minus expenditures for the unemployed as a percentage of GDP.

Table 3. Social Benefit Expenditures as a Percentage of GDP, by Type of Social Insurance Institution: 18 OECD Countries, 1985

Type of Social Insurance Institution/ Country	Percentage of GDP for: Total Benefit Expenditures	Total Expenditures minus Unemployment Insurance Benefits
Encompassing		
Finland	21.3	20.8
Norway	28.0	27.3
Sweden	29.5	28.8
Average	26.3	25.6
Corporatist		
Austria	24.3	23.5
Belgium	26.4	22.5
France	27.3	24.5
Germany	23.3	21.8
Italy	20.5	19.7
Japan	11.1	10.7
Average	22.5	20.5
Basic Security		
Canada	15.6	12.3
Denmark	27.5	24.3
Ireland	21.8	18.2
Netherlands	28.2	24.9
New Zealand	14.6	14.0
Switzerland	13.5	13.2
United Kingdom	19.4	17.6
United States	12.0	11.6
Average	19.1	17.0
Targeted		
Australia	9.9	8.6

Source: International Labour Office (1992).

The results in Table 3 confirm the expected general rank-order among institutional types and budget size. However, some countries in the basic security and corporatist categories have total expenditure levels approximating those in the encompassing group. After excluding expenditures for unemployment benefits, two of the three encompassing countries, Sweden and Norway, have the highest expenditure levels. Finland, however, still has relatively low levels, which may partly reflect its relatively young population (also see text below for a discussion on problems of comparability). With the exception of Japan, expenditure levels are relatively high in the corporatist countries. In the basic security countries, the average is lower, but here

[20] The costs of social security in these data cover nine branches of social security, related to medical care and benefits with respect to sickness, unemployment, old-age, employment injury, family, maternity, invalidity, and survivors. In contrast to the OECD definition of social expenditures, the ILO definition does not include the cost of education, which is less relevant in this context.

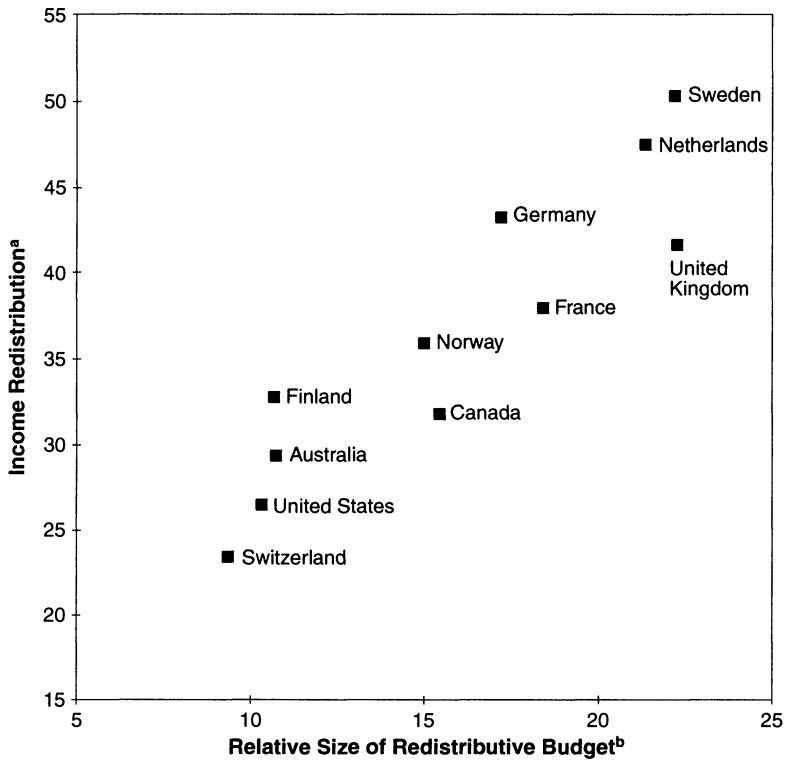

Figure 2. Relative Size of the Redistributive Budget and Income Redistribution: 11 OECD Countries

Source: Luxembourg Income Study.

[a] Income redistribution equals the reduction in the Gini coefficient from market income to disposable income expressed as a percentage of the Gini for market income.

[b] Relative size of the redistribution budget equals transfer income as a percentage of gross income.

again we find relatively wide variation. Australia, with its targeted social insurance programs, has the lowest expenditure levels.

Do size of the redistributive budget and degree of low-income targeting reduce income inequality? To control for variations in market income inequality among countries, we examine *income redistribution* in terms of the relative reduction in Gini coefficients when we move from market income to disposable income (i.e., after taxes and transfers; for definitions of terms see Appendix A). We present results for the total population (results are similar for the working-age population, ages 25 to 59). *Redistributive budget size* in a country is measured as the size of transfers as a percentage of gross income (defined as post-transfer but pre-tax income).

Figure 2 presents the bivariate plot of the relative size of the redistributive budget by the degree of income redistribution achieved through the tax and transfer systems. The correlation between these two variables is strong ($r = .92$). The lowest level of redistribution is found in two basic security countries—Switzerland and the United States—as well as in the targeted model Australia; these three countries also have the smallest welfare states. The Netherlands and Sweden have the largest redistributive budgets, and they also have the highest redistributive effects. The two corporatist countries, France and Germany, have fairly large transfer budgets and also show relatively large reductions in Gini coefficients.

We run into problems, however, of lack of comparability between different data sets—problems that are all too familiar to comparative social scientists. Thus, in terms of the LIS data, Finland with its encompassing institutions appears among countries with

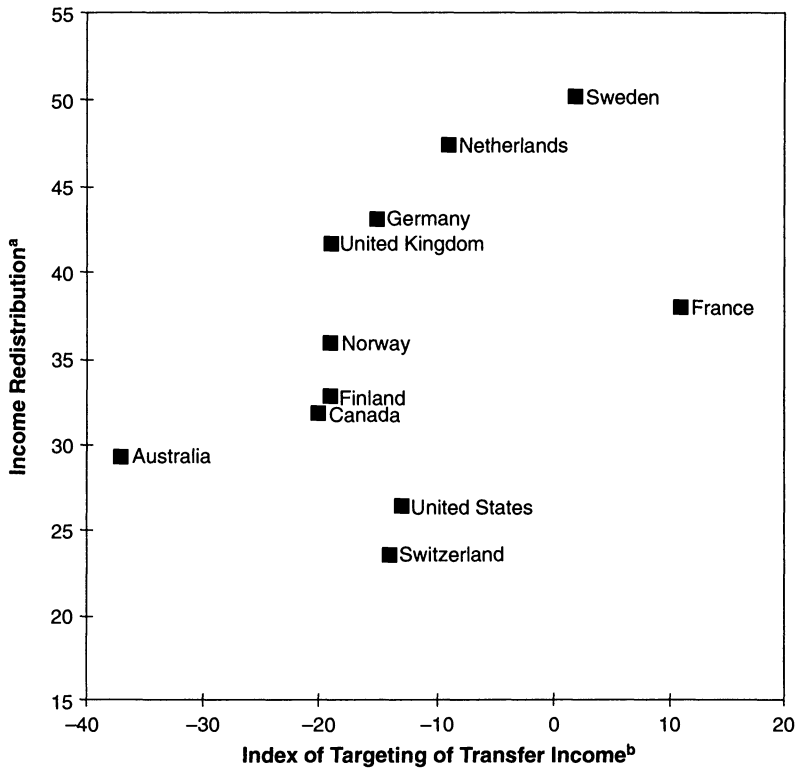

Figure 3. Index of Targeting of Transfer Income and Income Redistribution: 11 OECD Countries

Source: Luxembourg Income Study.

[a] Income redistribution equals the reduction in the Gini coefficient from market income to disposable income expressed as a percentage of the Gini for market income.

[b] Negative values indicate low-income targeting for transfer income; positive values indicate the targeting of transfer income to residents who are economically better-off.

small transfer budgets. This largely reflects the fact that the Finnish earnings-related pension schemes are inappropriately treated as private programs in the LIS data. Although the Finnish pension programs are administered by private insurance companies, they were created and are financed through legislation and should thus be regarded as public programs. In the LIS data, Norway, despite its encompassing institutions, also appears as an average welfare spender. This partly reflects Norway's high pension age (67 years) and partly the use of legislated employer wage-continuation in sickness and work accident insurance that, in the LIS data, is defined as market income.[21] Canada has an intermediate transfer rate but less redistribution than Norway. Contrary to expectations based on the ILO data, in the LIS data the United Kingdom has the same transfer size as Sweden and the Netherlands, probably reflecting the high levels of unemployment.

To assess the degree of low-income targeting, we use an *index of the degree of targeting of transfers*. This index takes on negative values when transfers are targeted at individuals with low gross incomes, and takes on positive values when transfers are concentrated on those with higher gross incomes. Values around zero indicate, in distributive terms, neutral outcomes. Figure 3 indicates, as our hypotheses predict, that the lower the degree of targeting at low-income groups (i.e., the higher the value indicated by the index), the greater the redistribution. The correlation between the index of trans-

[21] Also, Germany has wage-continuation periods in sickness and work accident insurance.

fer targeting and income redistribution in the transfer system is positive although relatively low (r = .45). The transfer systems in Sweden and the Netherlands, which have little or no targeting to low-income groups, bring about the largest redistribution. France, with the largest positive value on the index of targeting, achieves a medium level of redistribution. In contrast, although Australia targets much more of its transfers at the less well-off than does any other country, with the exception of Switzerland and the United States, it achieves less redistribution than any of them. Several countries with low to intermediate levels of targeting achieve very different degrees of redistribution.

The correlation between the index of targeting of transfers and the size of transfers is positive, although relatively low (r = .49). This correlation indicates that, as expected, there tends to be a trade-off between the degree of low-income targeting and the size of budgets made available for transfers. Thus, the more that countries target benefits to low-income categories, the smaller their redistributive budgets.

It could be argued that in countries with basic security programs, meager social insurance payments are compensated for by more generous income-tested or means-tested benefits. Nevertheless, we find a positive, although relatively weak, correlation (r = .48) between our index of targeting of transfer income via social insurance programs and the relative size of income-tested or means-tested social assistance program benefits in a country.[22] Thus, countries in which social insurance programs target benefits to low-income categories not only have relatively small redistributive social insurance budgets, but they also have restricted general means-tested programs. Countries with large welfare states, like the Nordic countries, not only have high transfer rates via social insurance programs but also gain legitimacy for increased spending on income-tested benefits outside the social insurance programs.

[22] Total expenditures on means-tested and income-tested programs as percent of GDP are taken from the International Labour Office (1992).

INCOME INEQUALITY AMONG THE ELDERLY

In the analysis of the effects of the social insurance institutions on inequality and poverty, the elderly provide an interesting test case. The economic situation of the elderly is determined by their previous economic activities as well as by public transfers. Thus, their situation reflects the cumulative effects of forces operating in markets and in politics, but public transfers play a greater role in their income than they do for the working population. The goal of eradicating poverty and achieving relatively low income inequality probably commands more support with respect to the elderly than it does with regard to economically active citizens. Many fear that "earnings-related systems may . . . perpetuate existing income inequalities over the life cycle" (Mitchell, Harding, and Gruen 1994:324).

Because of the relationship between old-age benefits and previous income, public pensions probably exhibit the highest degree of inequality in the encompassing and corporatist countries, and the lowest degree of inequality in the basic security countries. In the targeted model, however, transfers are directed primarily at low-income categories. LIS data allow us to study the consequences of these differences in public pensions on inequality among the elderly in nine countries during the mid-1980s.[23] Thus, in terms of the index of targeting of transfer income, the highest positive values (i.e. the highest degree of inequality) occur for public pensions in the three encompassing countries—Finland, Sweden, and Norway—as well as in corporatist Germany, all countries with relatively high maximum pensions (see Figure 4). In the basic security countries—the United States, the Netherlands, the United Kingdom, and Canada—public pensions are relatively neutral in terms of distribution. In the targeted country, Australia, however, the negative value of the index of targeting indi-

[23] Figure 4 is constructed from the LIS data, except for Finland and Sweden, where we had to reanalyze the original national data sets in order to get a proper division between public and private pensions (see Kangas and Palme 1993).

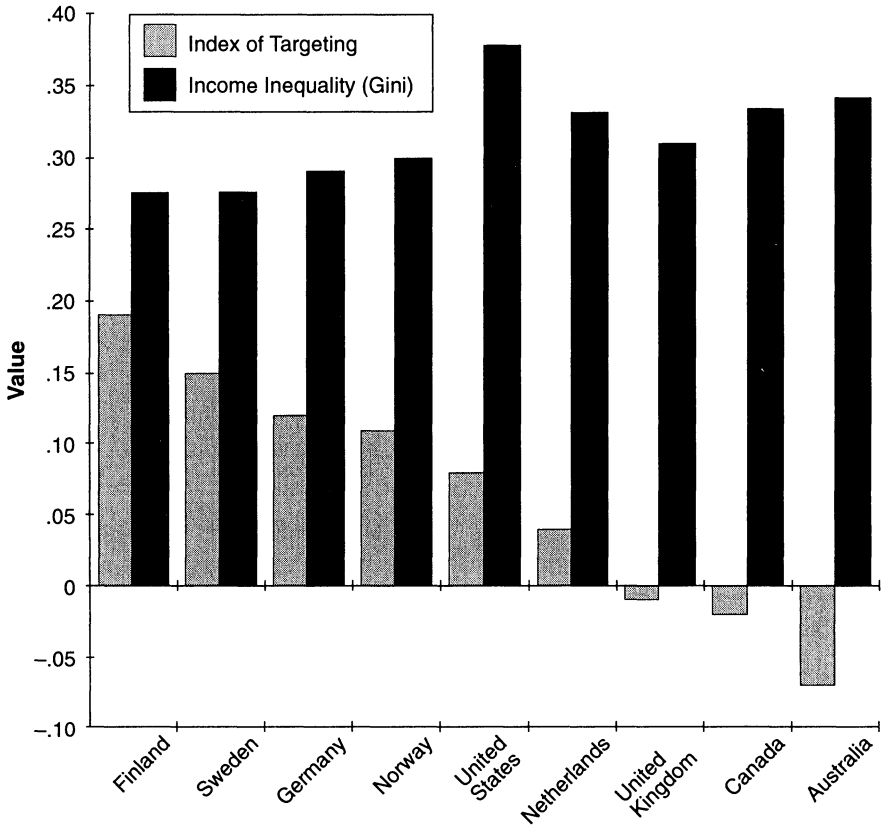

Figure 4. Index of Targeting of Public Pensions and Income Inequality (Gini) in Gross Income among the Elderly: Nine OECD Countries

Sources: Luxembourg Income Study; Kangas and Palme (1993).

cates that public pensions go primarily to low-income earners.[24]

Public pensions are only one of the factors determining total income inequality among the elderly. When we look at inequality in total gross income among the elderly (including private and occupational pensions as well as income from savings and earnings), the picture is largely reversed. *The lowest inequality in total gross income* occurs in the four countries with *the most unequal public pensions*—Finland, Sweden, Germany, and Norway. In contrast, Australia, with pensions targeted at low-income groups, has much higher inequality in total gross income among the elderly, second only to the United States. Countries with relatively flat-rate pensions—the Netherlands, the United Kingdom, and Canada—also have higher inequality in total income among the elderly than do the earnings-related countries.

How can we account for these rather surprising results? One factor generating differences in income inequality between various social insurance models is the relative roles played by public and private transfer systems. Social insurance institutions affect the public/private insurance mix in a country. Economically better-off citizens are more likely to acquire private pension insurance than are low-income earners. Thus, the demand for private pension insurance depends partly on the maximum benefit levels of the public systems, which determine whether the middle classes and high-income earners are given earnings-related pensions or are pushed toward private pension programs.

[24] In the 1970s, the degree of income targeting in Australian social programs decreased, reaching a low in 1977–1978. Since then, targeting has gradually increased. By 1985, the income test for the old-age pension had been reintroduced (SCIP-data).

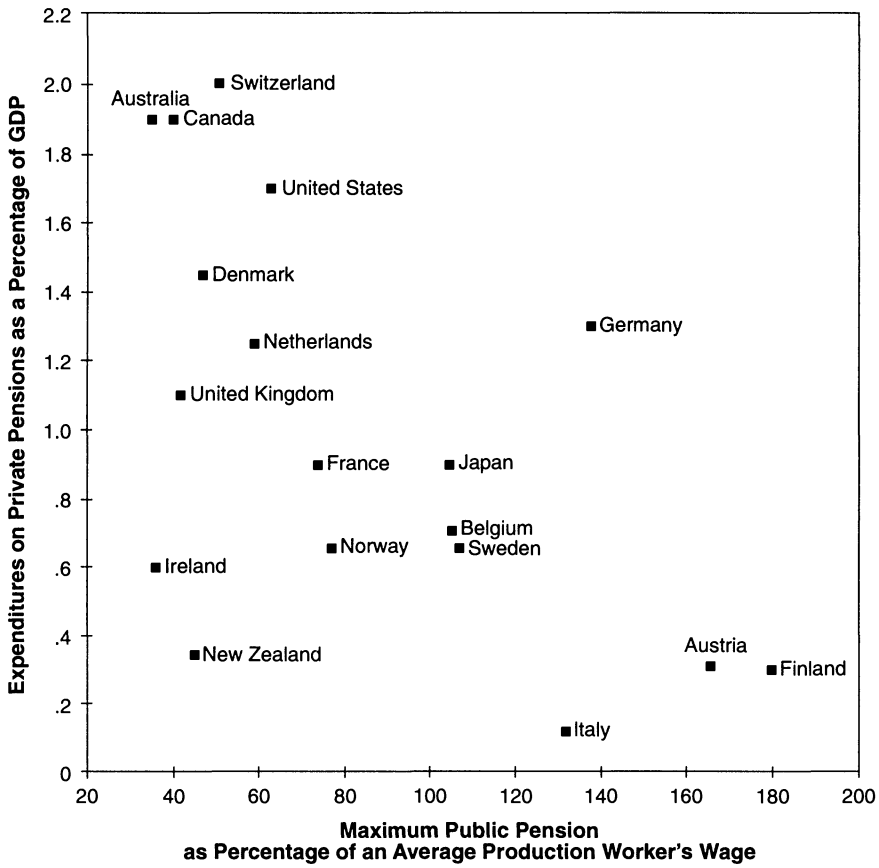

Figure 5. Maximum Public Pensions and Private Pension Expenditures: 18 OECD Countries, ca. 1980

Sources: Social Citizenship Indicator Program (SCIP), Esping-Andersen (1990); Kangas and Palme (1991a).

The encompassing institutional countries, which provide clearly earnings-related benefits for all citizens, are expected to generate the lowest level of private insurance. In contrast, the targeted or basic security countries are likely to have high levels of private insurance because high-income earners in these countries must rely on private channels for income security. The demand for private insurance should be lower in the corporatist model because of its earnings-related benefits for those insured. However, because of income ceilings for coverage and sizable categories of noncovered citizens, we expect private insurance to play a larger role in the corporatist model than in the encompassing model.

These hypotheses are tested using estimates of the size of private pension expenditures relative to GDP available for 1980 (Esping-Andersen 1990:84; Kangas and Palme 1991a). From the SCIP data, we take information for 1980 on the level of net maximum public pensions for a single person, expressed as a percentage of average net earnings (after taxes and social security contributions) among production workers. Figure 5 portrays a negative moderate correlation (–.53) between maximum pension levels and the relative size of private pension expenditures. On average, private pension expenditures as a percentage of GDP are low in the encompassing countries (Finland, Norway, and Sweden), followed closely by the corporatist group, while the basic security countries and the targeted country have higher expenditure levels.[25] Thus, the high-

[25] The earnings-related system in Norway had not fully matured for those retiring in 1980, but future retirees could expect higher maximum pensions, something contributing to small private

est private pension expenditures are found in Australia, the targeted country, and in the basic security countries—Switzerland, Canada, the United States, Denmark, the Netherlands, and the United Kingdom—in which maximum public pensions represent less than 60 percent of an average production worker's wage. Ireland and New Zealand, which have basic security institutions, are outliers with low private pension expenditures in spite of low maximum public pensions.[26] The highest maximum pensions (representing 120 to 180 percent of an average production worker's wage) are found in the three corporatist countries—Austria, Italy, and Germany—and in Finland, an encompassing country. Except for Germany, these countries also have the lowest private pension expenditures. The exception of Germany is partly related to the fact that the corporatist German public pension system for salaried employees traditionally excluded the very high-income earners, who had to turn to private pensions.[27] In addition, economically nonactive persons in Germany, primarily women, were excluded from compulsory insurance.

These results indicate that the institutional structure of public pension systems, primarily the extent to which they include and provide income security for high-income earners, is important for the relative size of private pension programs. In the encompassing countries and the corporatist countries, the relatively high maximum public pensions tend to reduce the demand for private pensions. In the basic security and targeted countries, however, better-off citizens must rely on private pensions to attain income security. Among the nine countries for which data are available, the size of private pension expenditure is relatively strongly correlated with inequality in total gross income for the elderly (rank correlation = .83). These data are thus congruent with the hypothesis that when public pensions provide high-income earners with income security, they crowd out private pensions and other sources of income that are likely to be even more unequal than public pensions. The final outcome is that earnings-related universal public pensions tend to generate less gross income inequality among the elderly than do targeted or basic security pensions.

THE PARADOX OF REDISTRIBUTION

The social insurance models outlined here developed over a century of conflicts among different interest groups concerning the distribution of people's worldly goods. These models are associated with different strategies of equality and different roles for markets and politics in distributive processes, and they can have different consequences for income distribution and poverty among citizens. We find that by providing high-income earners with earnings-related benefits, encompassing social insurance institutions can reduce inequality and poverty more efficiently than can flat-rate or targeted benefits. This finding may surprise many scholars and policymakers. The traditional arguments favoring low-income targeting and flat-rate benefits have focused on the distribution of money actually transferred and overlook three basic circumstances. (1) The size of redistributive budgets is not necessarily fixed but tends to depend on the type of welfare state institutions that exist in a country. (2) There tends to be a trade-off between the extent of low-income targeting and the size of redistributive budgets. (3) And because large categories of citizens cannot or are not willing to acquire private earnings-related insurance and because of the socioeconomic selection processes operating, the outcomes of market-dominated distribution tend to be more unequal than the distribution found in earnings-related social insurance programs. Recognition of these factors helps us understand what we call the *paradox of redistribution: The more we target benefits at the poor only and the more concerned we are with creating equality via equal public transfers*

pensions. In Sweden, relatively large private occupational pension systems existed prior to the establishment of earnings-related pensions, and because the ceiling in this system is only moderately high, these systems have been retained.

[26] The Irish case may partly reflect the importance of agriculture in this country. In New Zealand, private savings for old age in the form of homeownership is encouraged (Davidson 1994).

[27] The ceiling for coverage of pensions was abolished in Germany in 1967, making it formally possible for all salaried employees to join the public program.

to all, the less likely we are to reduce poverty and inequality.

The LIS and SCIP data sets have enabled us to test hypotheses on causal processes among welfare state institutions, redistributive processes, and distributive outcomes. Yet, in view of the difficulties involved in carrying out comparative research in these areas, some of our results are primarily suggestive of future research. Our analyses indicate that the institutions of the welfare state are of key importance in producing the paradox of redistribution. These institutions affect the relative roles of markets and politics in distributive processes and the types of coalitions formed among interest groups. The effects on poverty and inequality appear to be largest in countries with encompassing institutions and lowest in the basic security countries. The Australian experience indicates that targeting—excluding the better-off citizens—is not highly effective in reducing poverty and inequality. The corporatist countries occupy an intermediate position. In all categories of countries, however, additional factors that could not be considered here are also relevant, such as the relative strength of political parties and economic factors affecting the distribution of market incomes. In some countries, such as the United States where racial cleavages are correlated with income, institutional demarcations may be reinforced by racial ones (Quadagno 1994).

We view institutions as intervening variables that reflect conflicts of interest among different interest groups and affect the definitions of interests and coalition formation among citizens, which in turn have consequences for the size of budgets available for redistribution and the final degree of redistribution achieved. The empirical testing of the macro-micro links among institutions and the formation of interests and coalitions provides a major challenge to social scientists, but comparative micro-data currently are lacking. Of indirect relevance in this context is the fact that in the countries with encompassing institutions, surveys have shown that universal and encompassing programs receive considerably more support among citizens than do means-tested or income-tested programs (Forma 1996; Kangas 1995; Kangas and Palme 1993; Svallfors 1996).

Contrary to many scholars' expectations, earnings-related benefits appear to be a condition for, rather than a hindrance to, the reduction of inequality. Because of their low ceilings for earnings replacement, targeted programs and basic security programs stimulate program exit among the middle classes and increase the demand for private insurance. From the point of view of equality, the problem with the corporatist model is not that benefits are earnings-related. The main difference between the corporatist and the encompassing models is that by organizing the economically active citizens into occupationally segmented social insurance programs, the corporatist model highlights socioeconomic distinctions among different categories of citizens and creates divergent interests among these categories. In contrast, encompassing institutions pool the risks and resources of all citizens and thus create converging definitions of interest.

The encompassing model requires high taxes and generates large social security transfers, often described as unnecessary "churning." This has generated concern among social scientists and policymakers who fear that universalistic earnings-related welfare state programs will be unsustainable because of the economic inefficiencies, budget deficits, and the tax revolts they are expected to generate. Thus, neoclassical economic theory assumes that through "tax wedges," high taxes create serious distortions in market mechanisms, reduce work incentives, and thereby reduce economic efficiency and growth. Careful empirical analyses, however, indicate no major negative effects on the labor supply (Atkinson and Mogensen 1993). In Sweden, the prototype of the encompassing welfare state, it has not been possible empirically to demonstrate slowdowns of economic growth that can be attributed to the welfare state (Dowrick 1996; Korpi 1996).

By providing earnings-related benefits and non-means-tested benefits, the encompassing model generates incentives to work and also avoids poverty traps. Furthermore, if citizens find that they get significant benefits in return for their taxes, their take-home pay is no longer the only basis for work incentives. If tax payments are seen as providing individual benefits and the free-rider problem

can be overcome, the effects of tax wedges will tend to decrease. Such factors make it difficult to find empirical support for the hypothesis of neoclassical economics that taxes have serious negative effects on efficiency. What can be demonstrated, however, is the superior capacity of the encompassing welfare state to reduce inequality and poverty. It would require much "churning" to transfer some of the surplus cream in the capitalist democracies to their poor citizens. Many fear that although universalistic earnings-related programs are popular, citizens will balk at the tax levels required to sustain them and at the budget deficits they may generate. Empirical evidence, however, does not support such arguments.[28]

In the Western countries, the emphasis on targeting has been increasing in recent years. If the goal is to reduce poverty and inequality, this is an unfortunate development. Lawson and Wilson (1995), reflecting on the War on Poverty in the United States, argue that policies to support the poor "should begin with a new public rhetoric that does two things: focuses on the problems that afflict not only the poor, but the working and middle classes as well; and emphasizes integrative programs that promote the social and economic improvement of all groups in society, not just the truly disadvantaged segments of the population" (p. 706). Our analyses here support this recommendation.

To paraphrase an old saying, if we attempt to fight the war on poverty through target-efficient benefits concentrated on the poor, we may win some battles, but we will probably lose the war. Universalism is not enough, however. To be effective, universalism must be combined with a strategy of equality that comes closer to the preaching of Matthew than to the practices in Sherwood Forest.

[28] For the period 1980–1990, the average deficit in general government financial balances was 4.8 percent in our corporatist countries, 4.2 percent in the basic security countries, and 1.1 percent in Australia, the targeted country. Among our three encompassing countries, however, only Sweden had a deficit (1.1 percent), while Finland and Norway ran surpluses, giving an average surplus of 2.3 percent in the encompassing countries. For the countries and years for which we have income data in the LIS data set, there is zero correlation between budget position and size of redistributive budgets.

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Appendix A. Methods and Indicators

The distinction between basic security programs and encompassing programs is based on the degrees of earnings-relatedness and coverage. Because of the difference between short-term and long-term forms of income replacement when determining the degree of earnings-relatedness, we use different indicators for pension programs and sickness programs. In both cases, however, the critical factor is whether the maximum benefits in the legislated programs give higher provisions than the benefits of average production workers and hence include the middle classes within the framework of the statutory system.

In the pension area, we have used the net maximum pension to measure the degree of earnings-relatedness. *Maximum pension* relates the net maximum pension to the net wage of an average production worker. In the eight basic security countries, the maximum pension equals the pension for an average production worker, except in Switzerland and the United Kingdom, where the maximum pension replaces 52 percent and 61 percent of an average production worker's wage, respectively (less than 10 percentage points higher than the replacement rate of an average production worker's pension). In the encompassing countries, the maximum pension in relation to the average production worker's wage is 76 percent in Norway and 101 percent Sweden (more than 10 percentage points higher than the replacement rate of an average production worker's pension). For Finland, which has no formal maximum pension (ceiling), we use the pension level of a person with earnings three times the level of an average production worker. In basic security countries of the "insurance" variant, pension coverage (as a percentage of the population aged 15 to 64 years)

in Ireland, the United Kingdom, and the United States is 52 percent, 59 percent, and 67 percent, respectively. In the other basic security countries and in the encompassing countries, pension coverage is universal.

For sickness insurance, the indicator of earnings relatedness is the relationship between gross maximum legislated benefit and the gross wage of an average production worker. In 1985, in the eight basic security countries, the maximum sickness benefit equals the sickness benefit for an average production workers, while in the encompassing countries, maximum benefits are more than 10 percentage points higher than the sickness benefit of an average production worker. In terms of coverage in the labor force, the "insurance" variant of the basic security programs has a 73 percent coverage in Ireland, 80 percent in the United Kingdom, and 89 percent in Canada. In the other basic security countries and in the three encompassing countries, sickness insurance coverage is universal.

In analyses based on the Luxembourg Income Study (LIS) on inequality and poverty in different population categories, our purpose was to examine populations above and below normal pension age. Because the pension age differs among nations and is associated with different degrees of flexibility, to improve comparability we have defined the elderly as those age 65 or older (except for Norway, where the age limit is set at 67, the normal pension age). In defining the working-age population, we wanted to exclude students and young people living with their parents. Hence, we defined the working-age group as those between 25 and 59 years of age. In order to improve comparability, in the analysis of the total population we have excluded households headed by persons under 20 years of age (e.g., in Swedish income statistics, all persons above age 18 are misleadingly defined as separate households).

The equivalence scale used here gives a weight of 1.0 to the first adult, .7 to the second adult and .5 to each additional person, regardless of age. This scale has been used by the OECD and is a "middle-of-the-road" choice compared to other alternatives. The choice of scale is especially important when different kinds of households are compared (e.g., families with children are compared with other families). The choice of scale is less crucial when similar household categories are compared (e.g., the elderly, see Buhmann et al. 1988).

To control for variations in market income inequality, we examine *income redistribution* in terms of the relative reduction in income inequality when we move from market income to disposable income (i.e., income after taxes and transfers). Thus, following Kakwani (1986), we define:

$$\textit{Income redistribution} = \frac{\text{Gini}_{\textit{Market income}} - \text{Gini}_{\textit{Disposable income}}}{\text{Gini}_{\textit{Market income}}}.$$

Redistributive budget size is expressed as the size (percentage) of transfers relative to the mean size of gross income (post-transfer but pre-tax income). To indicate the way in which benefits are distributed among citizens with differing incomes, we use an *index of targeting of transfer income*. To compute this index we ranked income units according to the size of gross income and then distributed transfers along this continuum. This index is equivalent to what Fields (1979) has labeled the "factor Gini coefficient" and what Kakwani (1986) has called the "index of concentration." It takes a value of –1.0 if the poorest person gets all the transfer income, 0 if everybody gets an equal amount, and +1.0 if the richest person gets all the transfer income. The indexes that appear in the figures have been multiplied by 100.

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