Redistribution of Household Income: A New Size Measure Based on National Accounts

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With the rise in inequality across the developed world, tax and transfers policies that mitigate income disparities have moved back into public and academic focus alike. With the surge in interest, the question how fiscal redistribution can best be measure has gained new importance. Here, the empirical literature has converged onto two main measurement concepts. The first approach is to measure the impact that fiscal redistribution has on income inequality, usually expressed as the change in the Gini coefficient as one moves from the distribution of primary incomes to the distribution of disposable incomes. The second approach is concerned with the scale of redistributive government interventions, or the size of redistribution. The established practice is to rely on government finance statistics to construct a proxy indicator, most commonly public social expenditure as a percentage of GDP.

These two well-established concepts have complementary functions: the size redistribution approach tries to quantity how much of households' market incomes are appropriated by the state and then redistributed, whereas the change in the Gini coefficient assesses the impact that taxes and transfers have in income inequality. While some theoretical models of fiscal redistribution assume that the two measures can be used interchangeably, in the real world they capture two different aspects of redistribution and, if properly operationalized, can help to answer two distinct questions: How much does the state redistribute? And: How effective is fiscal redistribution in reducing inequality?

In contrast to the mainstream of the literature that has sought to track the effects of redistribution on income inequality, the main concern of this paper is the size of redistribution. It argues that the most common measure – social spending as a percentage of GDP – has been borrowed from the related literature on welfare states and is a flawed proxy for the magnitude of fiscal redistribution. However, this does not mean that the question how much states redistribute has become irrelevant. As an alternative to the reliance on an imperfect proxy, this paper suggests operationalizing the underlying concept directly and points to a data source that has been underutilized in the literature on redistribution, national accounts. They allow tracking the size of transfer payments received by households, and capture how much of gross (pre-tax) household incomes are collected by the state in the form of taxes and social security contributions. In other words, national accounts allow us to follow and quantify the size of redistributive transaction that lead from primary to disposable incomes.

The paper makes three main contributions to the literature on redistribution. Firstly, it highlights that the old distinction between the scale of a government intervention and its effect is still relevant to research on redistribution, even though it has gone largely lost. Secondly, it proposes an indicator that measures the size of redistribution from the perspective of households on the basis of the secondary distribution of income account that can usefully complement the established indicators that measure the change in inequality. Thirdly, it introduces a new secondary data-set that provides easy access to data for the size of redistribution across countries and time with 1,590 observations from 80 countries and territories, covering the period 1950 to 2014. It provides illustrative examples for its potential uses, adding the necessary caveats regarding limitations to comparability and other potential drawbacks of the data.