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The Role of Tax-Benefit Systems in Shaping Economic Insecurity in the EU

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In recent years, economic insecurity has revealed itself as a threat to quality of life. Individuals' expectations about the future determine their present level of well-being apart from current experience, so it seems clear that insecurity needs to be included as another dimension in well-being analysis (Osberg, 2018). Even though academics have not yet reached an agreement about the exact definition and way of measuring this phenomenon they generally agree that economic insecurity is related to risk exposure and to the current individual feeling of anxiety due to the lack of insurance against a probable future shortfall (Bossert and D'Ambrosio, 2013; Hacker et al., 2014; Osberg and Sharpe, 2005; Rohde and Tang, 2018). This notion affects many aspects of individuals' lives and crucially conditions many individual economic and political decisions (Stiglitz, Sen and Fitoussi, 2009). Moreover, current and future inequality could also be affected by these dynamics of individual behaviour (Boarini and Osberg, 2014).

There have been several attempts to measure economic insecurity and its possible effects. Nevertheless, the impact that tax-benefit policies may have on individual insecurity has received little attention in the literature. While many papers have shown that welfare regimes play a crucial role in shaping the income distribution (Atkinson et al., 1994; Jäntti, 1997), it is clear that tax-benefit systems have also an insurance component beyond redistribution. The literature on optimal taxation acknowledges that if income includes an idiosyncratic component and insurance markets are incomplete, redistributive taxation helps individuals to insure against risk (Hoynes and Luttmer, 2011; Varian, 1980). Therefore, one of the functions of modern welfare states in Europe is to provide security by reducing the risk of several hazards or by shifting the risk relocating the costs of an adverse event (Western et al., 2012).

Our purpose in this paper is twofold. First, we want to investigate if there is a significant impact of tax-benefit systems on individual economic insecurity, namely if differences in insecurity levels among countries can be explained by disparities in their welfare systems. We start from the idea that a more generous social protection policy will reduce economic insecurity. Secondly, we want to test if macroeconomic variables play a role in shaping insecurity in EU countries beyond individuals’ characteristics, as has been already shown for poverty and material deprivation (Bárcena-Martín et al., 2014; Chzhen, 2014). For the measurement of insecurity, we use an individual multidimensional approach proposed in Romaguera-de-la-Cruz (2019) which combines subjective and objective dimensions. We then explore the effect of micro and macro variables on individual economic insecurity in 28 European countries making use of multilevel modelling techniques. In a second step, we study the role of a variety of social protection functions to determine which are the specific welfare benefits that most help mitigating economic insecurity.

We find that in the European context being young (between 16 and 30), low educated and unemployed has a positive effect on economic insecurity, while homeowners and those living in a multigenerational household are significantly more secure. At a macroeconomic level, those countries with larger Gross Domestic Product (GDP) with respect to EU-28 average show lower levels of insecurity, whereas higher levels of unemployment typically increase insecurity. Regarding the role of the tax-benefit system, both higher social protection expenditure as percentage of GDP and a larger personal tax revenue have a negative impact on economic insecurity, meaning that a more generous welfare state steadily financed by taxes helps mitigate individual current anxiety about future economic losses. Regarding the role of different benefits, we find that both means-tested and non-means-tested benefits reduce economic insecurity in a similar way which seems to suggest that the role of non-means tested benefits on the levels of insecurity of individuals in the middle classes is relevant. When looking at the impact of social protection functions separately, we find that expenditures on health, survivors and old age pensions, unemployment benefits and social exclusion benefits are those with a larger efficacy on reducing insecurity, while family and children benefits do not show any significant effect.

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