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# Social Observatory of "la Caixa"

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April 2020

The redistributive  
effects of  
**social benefits  
and taxes:**  
a review of the  
current situation

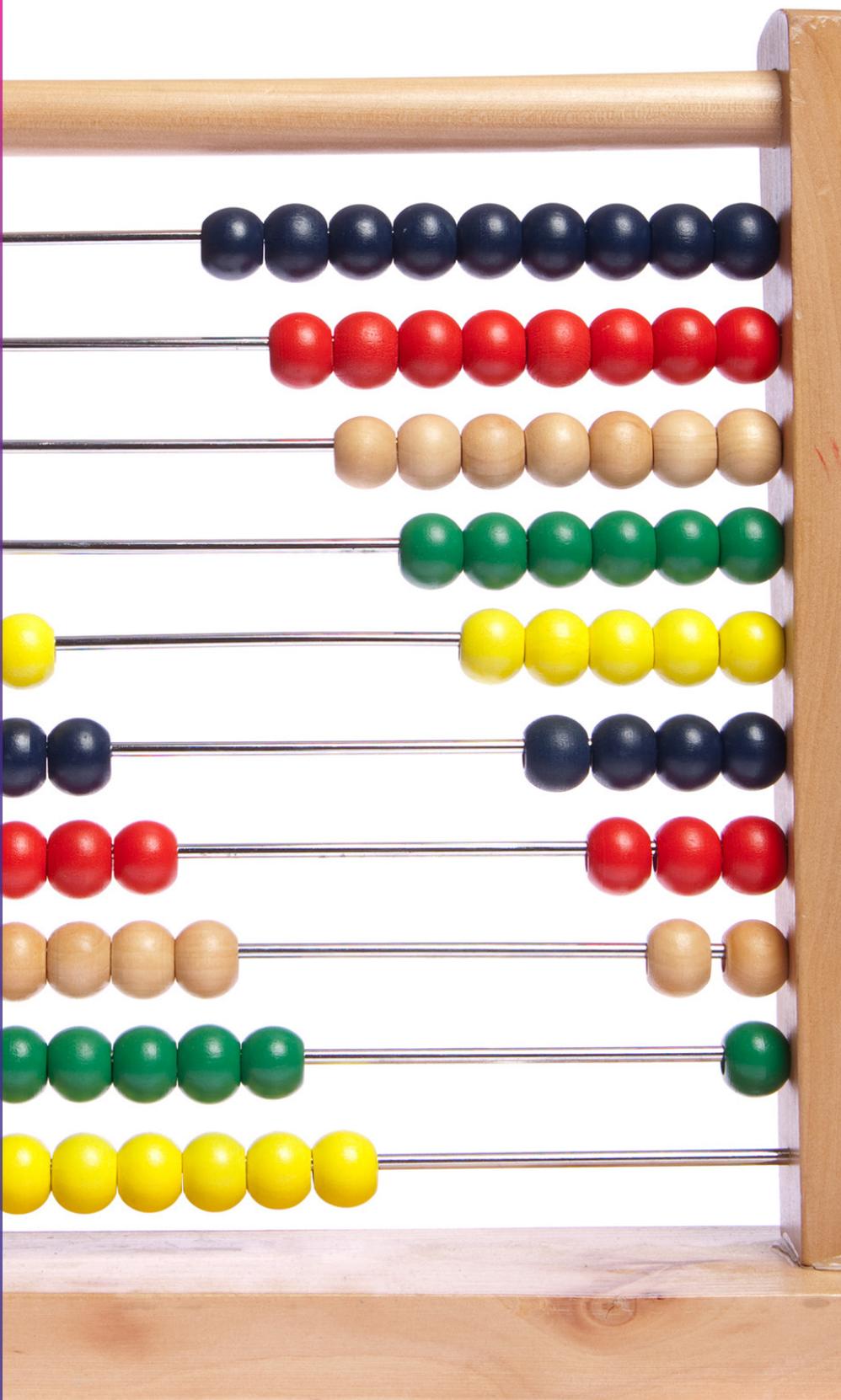
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Spain is in the group of European Union countries with the highest income inequality. One key reason is the decreased capacity of public policies to reduce inequality. This capacity is highly concentrated in specific benefits and taxes and several factors limit the impact of various redistributive instruments on inequality.

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## Credits

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## Research and writing of report

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This issue forms part of the Collection  
"Reports on the **Redistributive Economy**"  
which is made up of the following publications:

- **The redistributive effects of social benefits and taxes: a review of the current situation**

Luis Ayala, UNED and Equalitas, and Olga Cantó, Universidad de Alcalá and Equalitas

- **The redistributive effects of the system of taxes and transfers in Europe**

Amadeo Fuenmayor, Rafael Granell and Teresa Savall,  
Universitat de València

- **The redistributive effects of family policies**

Olga Cantó and Andrea Sobas, Universidad de Alcalá

- **The redistributive effects of special taxes**

José M. Labeaga, UNED

- **The redistributive effects of wealth tax**

José María Durán and Alejandro Esteller, Universitat de Barcelona  
and Institut d'Economia de Barcelona

## Summary

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Spain is one of the EU countries with the highest levels of income inequality. This feature is not exclusive to recent times, although the intensity and length of the latest economic crisis caused the indicators to increase more than in other countries. In the recent stage of recovery of economic activity and employment, inequality has shown some reluctance to fall, which indicates that it possesses a significant structural component. The most usual explanations have revolved around two key factors: the unique nature of the Spanish labour market, with high levels of unemployment and high job insecurity in the comparative context, and the weakness of the redistributive capacity of the tax and social benefit system. Any attempt to explain inequality in this country must involve identifying which instruments within that tax and transfer system have an equalising effect on income and which do not.

## Main Ideas

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- // One of the main reasons why Spain has such high levels of inequality is the lower capacity of the system of taxes and benefits to reduce the inequalities that occur in the distribution of primary income.
- // The main advances in the reduction of inequality in Spain took place in the 1980s with the development of social benefits and progressive taxation. During the last crisis inequality grew and during the recovery it has decreased very slowly in comparison with the revival of employment.
- // Pensions are the instrument with the largest redistributive effect, as happens in other high-income countries. Unemployment benefits have a stronger effect on income distribution than in other countries, but their role has been waning due to the fall in the coverage rate and the increasing importance of the welfare mode, with lower protective intensity than the contributory mode.
- // The redistributive capacity of the last economic safety net – the system of income guarantee benefits – is very limited. Unlike other countries, Spain has no one single safety net but rather a complex mosaic of benefits, with protection gaps and major regional differences in protection against the risk of poverty.
- // In clear contrast with what happens in those European countries with more robust welfare states, family benefits in Spain have very little effect on income redistribution.
- // Health spending in Spain has a strong redistributive effect, the largest of social benefits in kind. Over the last decade, the cuts made in some areas, such as pharmaceutical expenditure, have diminished its progressivity.

- // The overall effect of spending on education in Spain is redistributive, although less so than that of health expenditure. However, not all spending is progressive, and significant problems connected to inequalities of social origin persist, including early school leaving.
- // Income tax in Spain is the second most redistributive instrument after pensions. Its capacity to correct inequality has lessened over time owing to the process of tax rate reduction.
- // Spain is no exception to the rule whereby indirect taxation is gaining more and more importance within public revenue as a whole. VAT is a regressive tax and its reforms have reinforced this feature. Albeit with a minor impact, other consumption taxes, such as excise taxes, are also regressive.
- // Wealth taxes contribute little to redistribution and are significantly limited by the low levels of tax compliance, certain exemptions, regional inequalities and problems of tax evasion and avoidance.

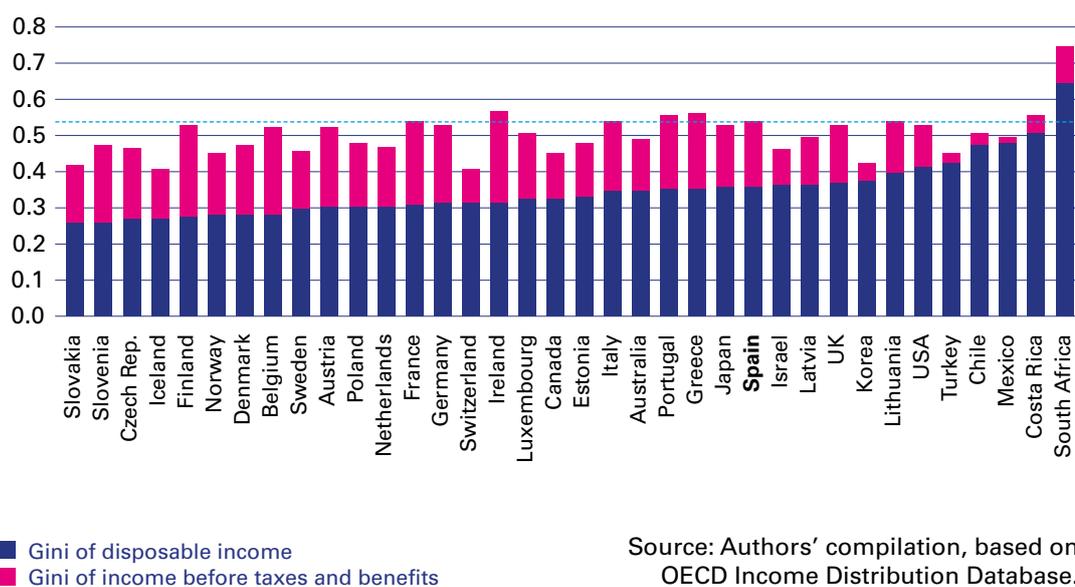
## **Such high levels of inequality in Spain are caused by both the malfunctioning of the labour market and the lower capacity of the tax and benefit system to reduce inequality**

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Spain is one of the EU countries with most inequality in the distribution of household income. The differences, however, are much less marked when comparing income inequality before taxes (income tax, consumption tax, etc.) and benefits (pensions, unemployment benefit, etc.), known as primary income. This divergence reveals that one of the main reasons for such high levels of inequality is the lower capacity of the tax and benefit system to reduce the inequalities that occur in the distribution of primary income.

As Graph 1 shows, inequality measured in terms of the Gini index (the values of which range from 0, maximum equality, to 1, minimum equality) before the tax and benefit system comes into play is not very different from that of other high-income countries, whereas when it is measured using disposable income (after applying taxes and benefits) Spain is one of the European countries where these differences are largest. Any attempt to explain inequality in this country must therefore involve identifying which instruments within that tax and transfer system have an equalising effect on income and which do not.

**Graph 1. Inequality of primary income (before taxes and benefits) and disposable income (after taxes and benefits), 2016**



## Inequality only shrank in Spain in the 1980s and grew substantially during the crisis

Comparisons over time of income distribution in Spain are subject to frequent methodological disruptions and changes in the size and reliability of surveys. The only surveys that enable us to study inequality in the long term are the various Household Budget Surveys (*Encuestas de Presupuestos Familiares* or EPF) that have been conducted periodically since the early 1970s. On analysing them we find that in the 1970s the intense economic crisis did not give rise to a large increase in inequality. Even though unemployment grew rapidly, its effect on inequality was offset in part by the notable increase in wages and the development of the basic instruments of the welfare state, including the implementation of a much more ambitious system of progressive taxation.

During the 1980s there was a notable reduction in inequality, in which the growth in social spending in the second half of the decade was a determining factor. After something of an upturn in inequality in the first half of the 1990s as a result of a brief but intense period of recession, inequality indicators remained very stable through the lengthy economic boom that lasted from the mid 1990s to 2008. The sharp rise in unemployment and the widening wage gap, together with cuts in redistributive policies, caused inequality to increase very notably during the crisis, and to do so, moreover, faster than in most European countries. As we can see in Table 1, while lower incomes fell much more than the median, the same cannot be said of the opposite end of the distribution.

**Table 1. Differences in income levels of the 10% with the highest income, the 10% with the lowest income and the median of the population**

	D9/D1	D9/D5	D5/D1
1973	3.98	1.95	2.04
1980	4.18	1.97	2.12
1990	3.72	1.89	1.97
1996	3.87	1.97	1.97
2007	3.66	1.80	2.03
2017	4.09	1.86	2.20

**D9:** income level above which one belongs to the 10% of the population with the highest income

**D5:** income level that divides the population into two equal halves

**D1:** income level below which one belongs to the 10% of the population with the lowest income

Source: Authors' compilation, based on Household Budget Survey (1973, 1980 and 1990: baseline survey; 1996: continuous survey; 2007 and 2017: new survey)

## **Contributory pensions are the instrument with greatest redistributive impact and unemployment benefits have a greater impact on income distribution than in other countries**

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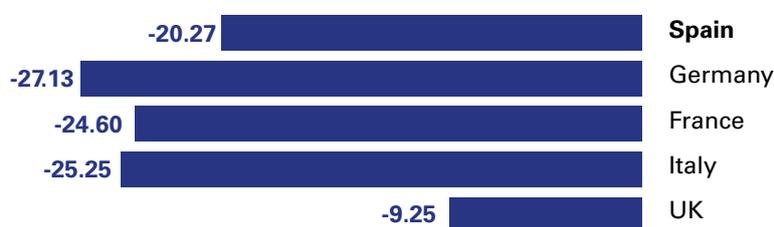
Contributory pensions are the chief instrument for equalising income gaps in Spain and reduce the Gini index by 20 percentage points (Graph 2). Although a distribution system is not designed with explicit redistribution goals in mind, there are several channels through which an income gap moderating effect of this sort occurs. The main redistributive effect of pensions occurs through redistribution from higher wage earners to those who have lower wages and shorter contribution periods. The existence of minimum and maximum pensions helps, by definition, to narrow the gap between the incomes paid to the recipients of these benefits. Furthermore, the system redistributes among the different generations of workers, since, given that pensions are not funded through past individual contributions but present ones, improvements in income levels and wages result in a transfer of income from present generations of workers to past ones.

Unemployment benefits constitute one of the most important instruments of public intervention in the field of income maintenance programmes. The mere fact that the public sector provides a safety net in the face of the impossibility of lower-income workers being able to cover their own risk of unemployment implies redistribution. The definition of this form of protection makes no explicit link between contributions paid and the probability of unemployment; rather, they depend on each worker's wage. In practice, workers with lower wages and higher risk tend to receive more benefits in relative terms, in comparison with individuals with higher contributions.

Owing to its weight in total spending on cash benefits, far greater than in neighbouring countries, in Spain economic benefits that cover the risk of unemployment have a greater redistributive effect than average for the European Union. This greater relative expenditure and this stronger effect than in other countries can be explained by the persistence of much higher rates of unemployment than in other countries. Studies that analyse the redistributive effect of the various benefits coincide in pinpointing unemployment benefit as the benefit with most effect on income distribution after pensions. This effect increased moderately during the crisis, above all due to the greater relative weight of this type of transfer within household income in the case of unemployed people.

**Graph 2. Redistributive effects of contributive pensions in a comparative context, 2018 (reduction of Gini index, in %)**

Contributive pensions



Source: Authors' compilation, based on EUROMOD H 1.0+.

**Taula 3. Redistributive effects of contributive pensions and unemployment benefits in Spain**

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
<b>Pensions</b>	●	●	●	<ul style="list-style-type: none"> <li>• Stronger effect than in other countries</li> <li>• Less risk of poverty for elderly people</li> <li>• Regional and gender differences</li> </ul>
<b>Unemployment</b>	●	●	●	<ul style="list-style-type: none"> <li>• Stronger effect than in other countries</li> <li>• Shift towards welfare</li> <li>• Less cover</li> </ul>

● Strong effect or improvement  
 ● Moderate effect or no change  
 ● Weak effect or decline

# The redistributive capacity of the last economic safety net (income guarantee system) is severely limited

The last economic safety net, which exists in all European countries, is another leading instrument for correcting inequality. Although there are different models, in all welfare states these benefits seek to mitigate the insufficiency of the financial resources of citizens with less income. They are fundamental for reducing poverty insofar as they affect, above all, lower-income households. In this respect, being by definition very progressive benefits, they can also be an important instrument for reducing inequality in the distribution of disposable income.

Although their ultimate goal is to reduce poverty, in recent years they have undergone major transformations in an attempt to respond to other objectives. A large part of these changes have consisted in establishing more restrictive conditions of access and a growing emphasis on introducing measures intended to encourage the transition from benefit collection to labour force participation. This stressing of labour integration led to the succession of reforms in almost all high-income countries, which generally speaking have reduced their contribution to the reduction of inequality.

The system of income guarantee benefits in Spain includes some features that are found nowhere else in the region. Unlike in most European countries, there is no last economic safety net as such that covers different segments and regions across the board. The current system is the sum of very diverse benefits that were introduced gradually with a variety of aims and purposes. The result is a complex mosaic of benefits that offer different levels of protection to individuals or households with similar needs depending on how they access the system, which moreover shows serious gaps in the protection of certain population groups. Levels of protection also differ widely depending on the region in which a given beneficiary household resides.

The amounts of the various benefits that make up this last safety net are also very small in comparison with the poverty threshold and fall far short of the European average. Problems in this respect became particularly evident during the economic crisis, with growing deficits in coverage as households exhausted the right to access to unemployment benefits.

**Table 4. Redistributive effects of the last safety net in Spain**

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Guarantee of income	●	●	●	<ul style="list-style-type: none"> <li>• Inequality between benefits</li> <li>• Regional inequalities</li> </ul>

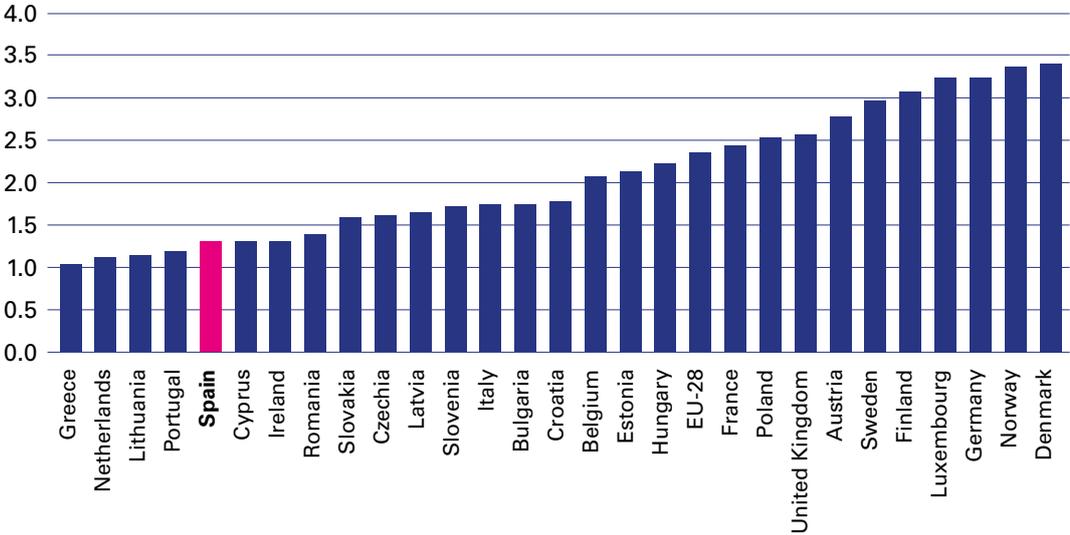
- Strong effect or improvement
- Moderate effect or no change
- Weak effect or decline

# Family benefits in Spain have a very minor effect on income redistribution because the amount is very small

In most European countries, family benefits play a significant role not only in child protection but also in the reduction of inequality and, above all, in the improvement of lower-income households. The most widespread model is that of universal benefits, usually funded through general taxation, although in some countries through social contributions. At present, only 11 EU countries do not possess some sort of universal benefits per child, basically southern European and some eastern European countries. It is these countries that have the worst indicators of economic vulnerability for households with children.

Family benefits in Spain represent a major anomaly with regard to the model and the average amount in European countries (Graph 5). The child benefit paid by Social Security can be described as extraordinarily low in a comparative context. The ratio between the level of the benefit (€291 per annum up until 2018) and average income is the lowest in the 28 countries of the European Union. In 2008 the government doubled the amount of child benefit for children under three years of age (from €291 to €500), but in June 2010 it was cut again to almost half. Similar cuts were made in some autonomous communities that had decided to implement their own systems of financial assistance to families. In 2019 the amount was increased from €291 to €341, still well below average EU levels.

**Graph 5. Spending on family policies as percentage of GDP, 2016**



Source: Authors' compilation, based on Eurostat data (Social Expenditures on Family & Children).

Table 6. Redistributive effects of family policies in Spain

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Family benefits	●	●	●	<ul style="list-style-type: none"> <li>• Weakest effect in the EU</li> <li>• Tax benefits are much more significant</li> </ul>

- Strong effect or improvement
- Moderate effect or no change
- Weak effect or decline

## Health spending in Spain is redistributive, its impact being the greatest of all social benefits in kind

All studies that have evaluated the redistributive impact of this type of expenditure show that its overall effect is clearly redistributive and greater than that of other social benefits in kind, with a very large impact on the 20% of the population with least income. Furthermore, this effect has increased over time, studies conducted at different times showing an ongoing improvement, at least until the onset of the economic crisis. The few studies that have been conducted on the effect of health spending on income distribution since then show a reduction of the redistributive effect and the progressivity of health spending as a consequence of the drop in economic activity and the budget cuts this gave rise to.

Some studies have sought to identify which components of health spending are more progressive and which contribute more to reduce inequality. The most progressive items are those corresponding most of all to primary care, and also emergency services. Up until the crisis, pharmaceutical spending was the most progressive item, but the legislative reforms that were introduced took a higher toll on low-income households.

Table 7. Redistributive effects of health benefits in Spain, 2018

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Health	●	●	●	<ul style="list-style-type: none"> <li>• Significant effect of primary care</li> <li>• Inequality in access by income level</li> <li>• Negative effect of copayments</li> </ul>

- Strong effect or improvement
- Moderate effect or no change
- Weak effect or decline

# The overall effect of spending on education in Spain is redistributive, although less so than health spending

Spending on education is the most important expenditure in reducing inequality of opportunities. The lack of educational mobility between generations is a manifestation of inequality that not only affects those who suffer it but also limits the improvement of productivity and the economic growth of a country. This loss of efficiency is added to the costs for a society of permanently concentrating income in a small segment of the population that benefits from the relational advantages associated with social status. Only with more investment in education and more effective allocation of this expenditure to the whole population is it possible to overcome the barriers raised by circumstances of origin.

Studies on the redistributive effect of educational spending in Spain confirm its redistributive nature (Graph 8). When this spending is allocated to households through different procedures the result is a greater improvement in lower-income than in higher-income households. Moreover, as in the case of health spending, this effect has improved in recent decades. The few studies that have been conducted since the beginning of the economic crisis do not seem to indicate that the downturn caused a clear reduction of this effect. However, not all spending is progressive; spending on charter schools, university education and scholarships and grants are not. Some significant problems affecting the system, such as early school leaving, are closely connected to inequalities of origin.

**Table 8. Redistributive effects of spending on education in Spain, 2018**

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Education	●	●	●	<ul style="list-style-type: none"> <li>• Positive impact of spending on public sector schools</li> <li>• Regressivity of spending on charter schools</li> <li>• Regressivity of university spending and scholarships</li> </ul>

- Strong effect or improvement
- Moderate effect or no change
- Weak effect or decline

# Income tax is the second most redistributive instrument after pensions, but its capacity has lessened in recent decades

In all OECD countries the effect of taxes on income distribution is less than that of social benefits. There is no country in which the impact of taxes amounts to more than a third of that exerted by cash benefits. However, this is not to say that the fiscal side of public finance does not continue to play an important role in narrowing the income gap between households. Although tax systems have tended for the most part to simplify the different categories and fix lower rates, taxation – especially personal income tax – still plays a leading role as an instrument for offsetting inequality. Comparative studies find that the redistributive effect of these taxes is determined more by their size (revenue) than by their progressivity. The common tendency to cut rates without losing progressivity would therefore explain the gradual loss of redistributive capacity of the tax.

In the case of Spain, all studies, without exception, confirm the inequality-reducing effect of personal income tax. Those studies that analyse the redistributive effect of taxes as a whole show that it is this tax that almost singlehandedly manages to reduce the income gap among households. Simulations with EUROMOD tools reveal that it is the second instrument with most capacity to correct inequality, after contributive pensions, and that it achieves a reduction of the Gini index of more than 10 percentage points (Graph 9).

**Graph 9. Redistributive effect of Spanish income tax from a comparative perspective, 2018 (reduction of the Gini index, in %)**



Source: Authors' compilation, based on EUROMOD H 1.0+.

**Table 10. Redistributive effects of different direct and indirect taxes and social contributions, 2018**

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Personal income tax	●	●	●	<ul style="list-style-type: none"> <li>• Almost the only tax that reduces inequality</li> <li>• Inequality by sources</li> <li>• Inequality in fraud</li> </ul>
VAT	●	●	●	<ul style="list-style-type: none"> <li>• Redistributive limits of reduced rates</li> <li>• Loss of efficiency: avoidance and fraud</li> </ul>
Social contributions	●	●	●	<ul style="list-style-type: none"> <li>• Effect of contribution ceilings</li> <li>• Greater weight in Spain</li> </ul>

- Strong effect or improvement
- Moderate effect or no change
- Weak effect or decline

## Indirect taxation has gained importance within public revenue as a whole. VAT is the main indirect tax and is of a regressive nature

In almost all EU countries, indirect taxes have gained importance in recent years within total revenue. This trend has been particularly intense in countries like Spain. In other European countries, even though the shift from direct to indirect taxes has not been so strong, there is still a clearly increasing trend in indirect taxation (Graph 10). Moreover, this trend has been endorsed by the European institutions through various documents and reports, and also by some researchers, who advocate a greater presence of indirect taxation as they consider it to be less negative for economic growth than the direct sort. It should also be borne in mind that in the face of the difficulty of increasing the tax burden, levies are increasingly imposed on those taxable items that are easiest to control, such as consumption, to which VAT is applied, and earned income, subject to personal income tax.

Studies that analyse the redistributive effects of VAT from a comparative perspective reveal its regressive nature when its impact is measured as a percentage of household income. These studies also confirm that the effect is proportional or even slightly progressive in some countries when it is measured as a percentage of household expenditure. The effect on income is usually more significant, especially when the object of the analysis is the immediate impact of the tax, and also when considering the overall effect of taxation as a whole.

In the case of Spain, the late introduction of the tax in comparison with neighbouring countries has meant that estimates of the redistributive effects of VAT cover a relatively short period. The structure of the tax, however, has not been substantially modified in recent decades, albeit with certain changes in rates and in the lists of goods that are exempt or eligible for reduced rates. Studies that have analysed this impact confirm the existence of a clearly regressive effect on the income of Spanish households.

Reforms of this tax over the last decade have also attracted the attention of researchers interested in quantifying its redistributive effect. In 2010 the standard rate was increased by two percentage points and the reduced rate by one point. Two years later both rates were raised again, the first by three percentage points and the second by two. Subsequently, in 2015, a different rate was applied to some goods. The studies that have evaluated the impact of these reforms show that in general they accentuated the regressivity of the tax.

## **Wealth taxes contribute little to redistribution and their importance within public revenue as a whole has diminished.**

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Wealth taxes have been removed in almost all EU countries on the grounds that they are a form of over-taxation. In Spain, wealth tax was formally suspended in 2008 and then reinstated to varying degrees in some autonomous communities. Those studies that have estimated its redistributive effect find that the potential redistributive capacity of the tax in the short term is limited, although it has a certain impact in the long term. This effect is hampered, in any event, by low levels of compliance and certain exemptions, such as those concerning family businesses, main residences and combined income and wealth thresholds.

Inheritance tax contributes very little to total revenue, in most countries falling short of 0.5% of the GDP. Studies that have evaluated its redistributive impact in Spain show that that this tax helps to reduce inequality in the distribution of wealth, although very moderately. They also highlight the presence of considerable equity problems in its functioning, such as the existence of excessive rates for certain forms of wealth, major regional inequalities and again problems of tax evasion and avoidance.

The purpose of excise taxes is seldom specifically to redistribute or indeed to raise revenue in any country, but rather to moderate consumption of certain goods. Comparative studies confirm that these taxes are regressive. Studies focusing on Spain likewise confirm this finding.

Table 11. Redistributive effects of wealth taxes and excise taxes in Spain

	Capacity to correct inequality	Progressivity	Trend of the effect	Most important features
Wealth taxes	●	●	●	<ul style="list-style-type: none"> <li>• Low levels of compliance</li> <li>• Regional inequality</li> </ul>
Excise taxes	●	●	●	<ul style="list-style-type: none"> <li>• Purpose not redistributive</li> </ul>

● Strong effect or improvement  
● Moderate effect or no change  
● Weak effect or decline

## Conclusions

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- // Spain is one of the EU countries with most inequality in the distribution of household income. One of the main reasons for this is the lower redistributive capacity of the tax and benefit system.
- // Inequality has not decreased significantly in Spain for several decades. It failed to diminish during the long boom before the crisis, in spite of notable job creation. The indicators rose to very high levels during the crisis, and in the more recent period of recovery they have fallen very slowly.
- // Pensions are the instrument with the largest redistributive effect in the tax and benefit system as a whole. Furthermore, this effect has increased over time.
- // The redistributive impact of unemployment benefits is greater in Spain than in other countries, above all due to the persistence of much higher unemployment rates.
- // The redistributive capacity of the benefits that constitute the last economic safety net is severely limited, owing to problems of coverage of the vulnerable population, the small amounts paid, and inequalities between segments and regions.
- // Family benefits, which provide the lowest-intensity protection in the EU-28, have a very minor effect on income redistribution.
- // Health spending in Spain has a clearly redistributive effect, which has even increased in recent decades, although during the crisis the cuts made in some areas caused its progressivity to diminish.

- // The overall effect of spending on education in Spain is redistributive, although less so than that of health expenditure, and not all types of educational spending are progressive.
- // As in other high-income countries, the redistributive effect of taxation is significantly smaller than that of social benefits.
- // Income tax in Spain has a greater redistributive effect than that of other instruments of the tax and benefit system, with the exception of pensions. This effect has diminished over time.
- // VAT is a clearly regressive tax when its impact is measured in relation to household income. The reforms of the last decade have reinforced this feature.
- // Social contributions have a negative effect on income distribution, wealth taxes contribute little to redistribution, and excise taxes are regressive.

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