

Accounting for Differences in Income Inequality across Countries: A New Framework with Application to Ireland and the UK

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This paper proposes a framework for studying international differences in the distribution of household income. Integrating ‘micro-econometric’ and ‘micro-simulation’ approaches, we quantify the role of tax-benefit systems, employment and occupational structures, labour prices and market returns, and demographic composition in accounting for differences in income inequality across countries. This integrated framework builds upon the EUROMOD tax-benefit simulator and uses its harmonized input data. It is therefore portable and can be implemented for cross-country comparisons within the EU. An application to the UK and Ireland—two countries that share many similarities, while displaying different levels of inequality—is presented. Differences in tax-benefit rules between the two countries account for roughly half of the observed difference in disposable household income inequality. Demographic differences play negligible roles. The Irish tax-benefit system is more redistributive than UK’s due to a higher tax progressivity and higher average transfer rates. These are largely attributable to policy parameter differences, but also to differences in pre-tax, pre-transfer income distributions.