Explaining Middle Class Trends During the Great Recession:
Comparing the Role of Different Welfare State Regimes

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Paper Abstract: It is generally accepted that the dimension of the middle classes, both in terms of population and income, is one of the main supports of the currently developed countries’ Welfare regimes. The trends in the dimension of the middle-class in a particular country are generally a result of two main potential effects: First, the impact on middle-income households of deep labour market changes related to job losses (gains) or hourly wage drops (increases) experienced by household members of a particular age-range and, secondly, the way in what the main characteristics of the tax-benefit system rules affect the middle classes and how welfare state reform impacts on them. Up to now still only a limited number of papers have aimed to explain how the characteristics of the welfare state regime in place may affect middle-class trends in different rich societies. An exception is Chauvel (2013) who actually points to the urgent need to further investigate how cohort dynamics across welfare state regimes may influence their future sustainability. The main issue here is that the differential labour market opportunities between the current youth and that of previous generations inserted in the so-called “contributive-wage-earner-regimes” that are in place in most Southern European countries may have large consequences on the future of the system. In fact, it would be expected that the perverse consequences of the current youth labour market difficulties would be of a much smaller range in a more universalistic model such as the social democrat one that more equally supports the population in need across all the age range (Pressman, 2007).

In this paper we aim to analyze to what extent the characteristics of the tax-benefit system –its structure, its progressivity and the relative dimension of effective taxes or benefits over household’s gross incomes– play a relevant role in determining the evolution of the middle classes in a variety of affluent countries during the Great Recession. For this purpose we consider the distribution of incomes in eight developed countries that represent different welfare state models: Nordic (Sweden and Denmark), Continental (France and Germany), Anglo-Saxon (United Kingdom and United States) and Mediterranean (Italy and Spain). The data on household incomes is obtained from largely comparable sources: the Survey of Income and Living Conditions (EU-SILC) for all countries belonging to the European Union and the 2013 Annual Social and Economic (ASEC) Supplement from the Current Population Survey (former March Supplement) for the US.

Regarding the identification of the middle class - which is not an easy task (see Banerjee and Duflo, 2008) - we use a variety of methods, ad-hoc definitions, endogenous classification in
income groups using a polarization approach and non-parametric statistical tools that allow us to analyze to what extent the characteristics of the tax-benefit system have played a relevant role in determining the evolution of the middle classes during the Great Recession. Using this methodology we can investigate in what way the gap between pre and post-tax and transfers income is significantly different before and after the Great Recession for individuals in the middle of the distribution compared to those located anywhere else. Results will allow us to check if evidence supports the hypothesis that a country’s particular welfare state model has a relevant role in determining the capacity of a tax-benefit system to cushion a middle class shrink during recessions.

Based on our preliminary results we can argue that countries can be generally divided in two groups: those with a low level of pre-recession period inequality such as Denmark, Germany, France and Sweden and those with a high level of pre-recession inequality such as Spain, Italy, the UK and the US. The former have a large lower middle class group and similar percentages of poor individuals while the latter have a relatively large group of poor, small group of individuals within the lower middle classes and a large number of rich individuals.

The Great Recession has given rise to some changes in the relative weight of the middle income groups in all the countries considered. However, some heterogeneity is clearly observable. In countries where lower middle classes were larger, income inequality grew strongly (but in Sweden) and the lower middle classes progressively reduced their relevance (except in France). In contrast, in the US and Spain, countries where lower middle classes were small, this group changed little in dimension. The proportion of individuals belonging to the middle class –as measured by income– has generally decreased and has only grown slightly in Italy, France and Sweden. These changes have not been followed by a parallel fall in the proportion of total income across groups, even if in most countries the proportion of income corresponding to the middle class also fell with the economic downturn. This has been the case even in those countries –like France or Sweden– where the percentage of people in the middle-class has become larger. In the case of Germany during the recession, the upper middle class, the rich and the poor grew in relative terms at the expense of the lower middle class. Regarding the role of the tax-benefit system in shaping disposable income for the middle classes in developed countries, our results seem to suggest that it definitely has played a relevant role during a deep economic recession.

