Redistribution and Stabilization: A microeconomic approach using the Spanish population

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Extended Abstract:
Musgrave (1975) develops a wide conceptualization of the role of the Public Sector. Following his perspective, the Fiscal Policy has to solve three primary economic problems to reach an optimum welfare: the redistribution problem, the stabilization problem and the allocation of the resources problem. Despite interrelations between them, this classification offers a useful guide to the empirical study of the functions of the Fiscal Policy.

The present work focuses on the study of redistribution and stabilization. The aim of the redistribution function is to reduce the structural income differences and getting a more egalitarian income distribution between individuals. It reflects the concern for equity and social cohesion. The redistribution system leads automatically to a more egalitarian income distribution because taxes are mainly paid by individuals with a high income and transfers are mainly received by those with low incomes.

On the other hand, the stabilization function tries to smooth the economic cycle of regions\(^1\). Stabilization is related to dynamic changes in the economic conditions, that is, changes in the expenses and the tax burden in response to income fluctuations, without taking into account the initial levels.
After the pioneer work of MacDougall (1977), who anticipates to the rest of literature of fiscal federalism, several empirical studies on redistribution and stabilization of interregional fiscal transfers appear in the nineties. First, Sala-i-Martín and Sachs (1992) get a 40% of stabilization for the US, but their methodology does not allow distinguishing between redistribution and stabilization. Bayoumi and Masson (1995) express the variables in differences and relative terms to split redistribution and stabilization and obtain a level of stabilization between 23% and 30%. Mélitz and Zumer (2002) go one step further. Following the methodology of Bayoumi and Masson (1995), they use panel data econometrics to estimate the effects, reporting a smaller stabilization effect (20%). Asdrubali et al. (1995) seek a wider aim and analyse the stabilization offered by the federal budget and other instruments like capital markets. Several papers have focused on the Spanish case. All of them agree that the stabilization is smaller (or even inexistent) than in the US. In the early nineties, Císcar (1992) estimates the stabilization using panel data and following a specification close to Sala-i-Martín and Sachs (1992). More recently, Alberola and Asdrubali (1997), De la Fuente (1999), Lago (2001), Bosch et al. (2002) and Capó and Oliver (2002a and 2002b) estimate the stabilization and the redistribution with different sources of data and methodologies.

Previous empirical literature is characterised by using aggregate regional data, which force them to assume that each region is integrated by a representative agent. The present work uses a similar theoretical and econometric frame. But in contrast to them, it exploits the microeconomic data provided by the European Union Household Panel (ECHP) for the Spanish population. The ECHP is an annual survey of private

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1 Eichengreen (1990) points that stabilization through fiscal transfers is justified exclusively if social protection mechanisms are not provided by the market.
households undertaken in the EU states covering a wide range of areas: demographic characteristics, the labour market, income sources, housing, health, education, etc. It is published by EUROSTAT and it is based on a harmonized questionnaire, created at the Community level and adapted to the various national realities by the different national statistical offices. It goes from 1994 to 2001 and collects information of more than 7,000 Spanish households.

The ECHP allows us to consider the heterogeneity of the population and avoids using the representative agents’ approach. One of the goals of the work is to compare the results in Capó and Oliver (2002a), which use the same methodology but with aggregate data, to test the validity of the representative agents’ approach.

Apart from the methodological question, the interest of the Spanish results is twofold. First, because there is a higher income inequality than in other countries of the EU and the stabilization power of the labour market is quite limited. Second, Spain is moving to a greater political and financial decentralisation. Thus, the authorities have to keep in mind the impact of potential reforms on horizontal equity between the Spanish citizens, and on the power of the stabilization mechanism to mitigate the idiosyncratic disturbance of the regions.

References