The effectiveness and efficiency of the welfare state in reducing inequality

Although the storm caused by the COVID-19 pandemic is not yet over, we can already analyse what impact the response from the public administrations has had on wage inequality. Public sector payments to workers on furlough or those unemployed cushioned the fall in income for many workers, but to what extent did they dampen the rise in inequality? Internal CaixaBank data allow us to answer this question already, as well as allowing us to assess what would be the implications of greater efficiency in the management of these benefits.
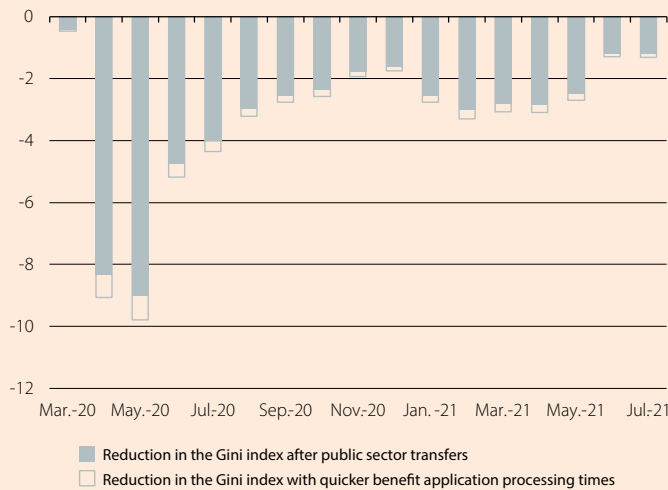
The welfare state mitigated most of the increase in inequality

The actions of the public administrations played a vital role in this crisis. At the height of the pandemic in April and May of last year, unemployment benefits and, above all, payments to workers on furlough cushioned 80% of the increase in wage inequality.[1] In recent months, the crisis generated by the pandemic has moderated, but even so, between April and July this year public sector transfers still offset around 56% of the rise in wage inequality.

All of this has entailed an enormous effort for the general government, and not just in monetary terms. The massive

*Average processing time for an unemployment subsidy application by the SEPE ***
(Number of days)

Catalonia — Madrid — Balearic Islands
Basque Country — Andalusia

Notes: * Average processing time for unemployment benefit applications by the Public Employment Service (SEPE) in each autonomous community region. 2-month moving average of the average processing time in each province weighted by population.
Source: CaixaBank Research, based on data from the public employment service (SEPE).

*Impact of the welfare state on reducing inequality and improvements in its efficiency ***
Change in the Gini index (pps)

■ Reduction in the Gini index after public sector transfers
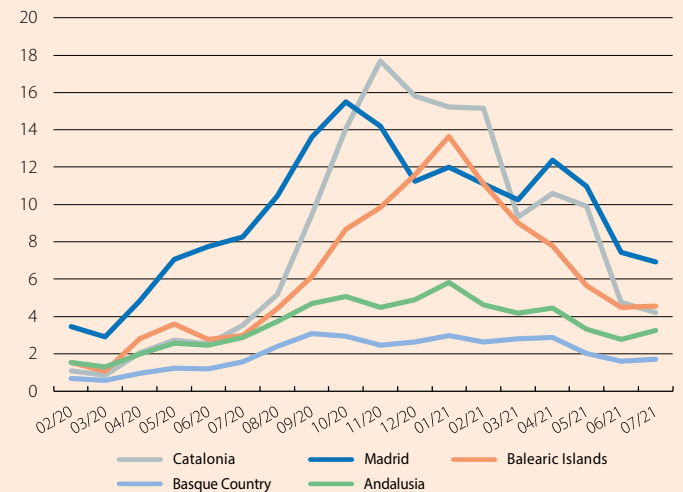□ Reduction in the Gini index with quicker benefit application processing times

Notes: * The chart shows the difference between the Gini index before and after public sector transfers. Simulation of the impact of 5% faster unemployment benefit processing times on the reduction of inequality. Impact estimated using a regression of the differences between the Gini index before and after public sector transfers, according to the processing time for an unemployment benefit application (in days), after controlling the mobility restrictions, the percentage of urban population, as well as the month in question. For further details on the estimate, see O. Aspachs et al. (2021), «Real-time inequality and the welfare state in motion: evidence from Covid-19 in Spain», Economic Policy, soon to be published.
Source: CaixaBank Research, based on internal data.

increase in benefit applications has been very difficult to manage, and in many cases processing times have become longer (see first chart).[2]

Greater efficiency in the management of public sector transfers would have a major impact

Reducing inequality not only requires a good system of public aid, but the efficiency with which it is managed is also key. As an example, if in November 2020 unemployment benefit applications had been processed 5% quicker, then the Gini index would have been reduced by 0.2 points (see second chart).[3,4] Viewed another way, if the processing time for unemployment benefit applications in Catalonia and Madrid had increased by only half as much as it did between October and December 2020, then the Gini index would have increased by 0.9 points less. This is a substantial figure, but it should be borne in mind that this effect refers only to the delay due to processing times, since individuals entitled to a benefit end up receiving the arrears. In any case, this illustrates the potential impact of a more efficient public

1. In April and May 2020, the Gini-pre index (excluding public sector transfers) registered an increase of 11 points. In contrast, the Gini-post index (which takes into account public sector transfers) rose by 2.3 points.
2. In 2019, the average processing time for an unemployment benefit application in Spain was 1.22 days.
3. Alternatively, a 1% increase in the number of cases resolved in less than 15 days would reduce the inequality gap before and after transfers by 9.2%.

administration. Reducing the processing time for unemployment benefit applications, for instance through greater digitalisation of public employment services, has a direct and significant impact on the welfare of families.

Greater action by the welfare state in reducing inequality boosts political participation

Better functioning of the welfare state may also have implications in other areas, such as politics. To prove a point: we analysed whether the reduction in inequality provided by public sector transfers had any impact on the regional elections in Galicia and the Basque Country in July 2020. The results leave no room for doubt. In towns and cities where the welfare state had a greater dampening effect on the rise in inequality, there was greater electoral participation. Specifically, a narrowing of wage inequality measured by a 1-point reduction in the Gini index boosted voter turnout by 0.3%.[5] On the other hand, the vote for the ruling party was penalised in areas where state action was most needed to reduce inequality. Both results show the relationship between the public response to the crisis and voting in elections.

In most developed countries it will take years until we have reliable information on the impact of the crisis on wage inequality and the effectiveness of public-sector measures. In Spain, on the other hand, it is already known that the public sector response has been key, effective and has had implications in many spheres. Spain can boast of being the first country in the world to have this type of information. If it is also incorporated into decision-making, then this could provide a significant boost to the effectiveness of the public sector.

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4. To this end, we produced a regression at the regional level of the change in inequality due to public sector transfers (Gini-pre/Gini-post) month by month, according to the processing time for an unemployment benefit application, controlled by the mobility restrictions, the percentage of urban population, the sectoral composition of the region as well as the month in question:

$$Ln\ (GiniPre_{i,t} - GiniPost_{i,t}) = \gamma_0 + \sum_{j=1}^{J} \gamma_j X_{ijt} + \pi_{i,t}$$

For more details on the methodology used, see O. Aspachs *et al.* (2021), «Real-time inequality and the welfare state in motion: evidence from Covid-19 in Spain», Economic Policy, soon to be published.

5. *Ibidem*, for the detailed results, as well as for the complete specification of the analysis.