
TRANSFORMATIONS OF THE STATE SERIES

Welfare State Transformations and Inequality in OECD Countries

Edited by

Melike Wulfgramm,
Tonia Bieber and
Stephan Leibfried



Transformations of the State

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Melike Wulfgramm • Tonia Bieber • Stephan Leibfried
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Welfare State Transformations and Inequality in OECD Countries

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Editors

Melike Wulfgramm
Department of Political Science
University of Southern Denmark
Odense, Denmark

Tonia Bieber
Federal Ministry of Education and Research
Germany

Stephan Leibfried
SOCIUM
University of Bremen
Bremen, Germany

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“This outstanding volume examines the impact of welfare state transformations on the development of social inequality. Recent decades have witnessed a rise in market income inequality across post-industrial democracies that has only partially been offset by redistribution through the welfare state. The authors, all well known welfare state experts, examine the causes of this the rise in market income inequality and the consequences of welfare state changes for the emerging patterns of inequality and redistribution in both the aggregate and in a number of specific policy areas. This volume is a must read for social scientists interested in the vitally important topics of the welfare state and inequality.”

—John D. Stephens, *University of North Carolina, USA*

“This impressive volume brings together first-rate research on the welfare state’s changing role in shaping economic, social and political inequality in OECD countries. The authors meticulously explore recent empirical trends and developments in all major social policy fields and convincingly show that the shift to supply-side social policies has increased inequality. The welfare state may not have become slimmer, but social policies have certainly become much less protective and less redistributive. This book is a must-read for anyone interested in social policies and their impact on inequality.”

—Kees van Kersbergen, *Aarhus University, Denmark*

This important volume bridges literatures on welfare-state transformations and on rising inequality in OECD countries. The volume breaks new ground by looking beyond income inequality, taking into account other forms of social and economic inequality. The editors and contributors explore how welfare-state responsiveness to market-generated inequality has changed over time, but also how institutional changes across a wide range of policy domains have themselves generated inequality. The volume strikes a sensible balance between cross-national diversity and OECD-wide trends. More importantly, it brings out the importance of looking at specific policy domains in order to understand how welfare-state transformations relate to rising inequality.

—Jonas Pontusson, *University of California, Berkeley, USA*

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Notes on Contributors

Tonia Bieber is currently Policy Advisor to the Federal Ministry of Education and Research, Germany. Before, she was Senior Researcher at the Kolleg-Forscherguppe “Transformative Power of Europe” of Otto-Suhr-Institute, Free University of Berlin, and at the Collaborative Research Center “Transformations of the State”, University of Bremen. She has published on multilevel governance, international organizations, European integration in education and training policies, and policy convergence. She is the author of *Soft Governance, International Organizations and Education Policy Convergence*.

Irene Dingeldey is the head of the research unit “Changes in the Working Society” since 2009, and deputy director of the Institute of Work and Labour in the University of Bremen since 2014. She has worked on various comparative EU research projects on family tax systems and labour market policies. She has edited “Governance of Welfare State Reform” and contributed to several books on labour market reforms in a comparative perspective. A book on the coordination of policies within activating welfare states was published in Germany in 2011. Her articles were published in peer-reviewed journals like the *European Journal of Political Research*, *Journal of Social Policy* and *Feminist Economics*.

Timm Fulge is a research fellow at the Department for Political Science, University of Bremen, Germany.

Ralf Götze is currently Head of Section for Fundamental Issues and Benefits Assistance at the National Association of Statutory Health Insurance Funds, German Liaison Agency Health Insurance – International (GKV-Spitzenverband,

DVKA). He is also an affiliated member of the SOCIUM at the University of Bremen.

Stefan Gosepath is Professor of Practical Philosophy at the Free University of Berlin, Germany. He is also the director of the Centre for Advanced Studies “Justitia Amplificata: Rethinking Justice: Applied and Global” <http://www.justitia-amplificata.de/>. Before coming to Berlin he was Professor of International Political Theory and Philosophy at the Johann Wolfgang Goethe University, Frankfurt-am-Main, in the Cluster of Excellence, “The Formation of Normative Orders”. Previously he had been a professor at the universities of Bremen, Giessen, Potsdam, Vienna and a visiting fellow at Harvard University and Columbia University.

Olaf Groh-Samberg is Professor of Sociology at the University of Bremen, Germany.

Jan Paul Heisig is a senior researcher at WZB Berlin Social Science Center, Germany. His research interests include social inequality, education, labour markets, ageing and retirement as well as quantitative methods.

Alexandra Kaasch is an assistant professor at Bielefeld University, Germany.

Stephan Leibfried is a research professor at the University of Bremen and Jacobs University, Bremen and has written widely on state and welfare state transformations.

Hanna Lierse completed her PhD at the University of Hamburg in 2011, and in the following years she worked as a postdoctoral fellow at the research centre on the transformation of the state located in Bremen. Her research interests pivot around the political economies, particularly linked to issues of taxation, welfare and redistribution. She is a recipient of the John F. Kennedy Memorial Fellowship for the academic year 2016-2017 at Harvard University. During her stay, she will examine the rise and the transformation of income and wealth taxation in Europe since the nineteenth century and gauge redistributive implications.

Herbert Obinger is Professor of Comparative Public and Social Policy at the University of Bremen, Germany.

Christof Roos is a research professor at the Institute for European Studies (IES), Vrije Universiteit, Brussels. In the migration and diversity cluster of IES, his research focuses on EU immigration politics as well as single market issues

such as freedom of movement, Schengen cooperation, the common European asylum system and the political theory of inclusion and exclusion.

Achim Schmid is a research associate at the Research Center on Equality and Social Policy (SOCIUM) at the University of Bremen, Germany.

Hanna Schwander is a senior researcher at the SOCIUM-Research Center of Social Policy and Inequality of the University of Bremen, Germany. Her research areas include comparative politics and political economy with a special focus on the politicization of labour market changes and welfare state transformations.

Laura Seelkopf works at the Research Center on Inequality and Social Policy, University of Bremen, Germany. She holds an MA degree from the University of Konstanz, Germany, and a PhD from the University of Essex, United Kingdom. Her research focus is on the comparative political economy of tax and social policy inside and outside the OECD.

Pascal Siemsen is a researcher in Bremen Germany.

Peter Starke is an associate professor at the Department of Political Science and Public Management, University of Southern Denmark. His research is mainly about the comparative politics of welfare state change.

Melike Wulfgramm is Assistant Professor at the Centre for Welfare State Research, University of Southern Denmark. Her research focusses on effects of labour market and social policy on disparities in political attitudes, well-being, social inclusion, labour market reintegration and healthcare coverage. She holds a PhD from the University of Bremen.

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1

Introduction: Welfare State Transformation and Inequality in OECD Countries

Melike Wulfgramm, Tonia Bieber,
and Stephan Leibfried

Inequality is on the rise: across Organization for Economic Cooperation and Development (OECD) countries, the distribution of economic, social, and political resources has become increasingly unequal since the ‘Golden Age’ of the welfare state (Esping-Andersen 1996), in the decades following World War II. At the same time, ongoing change in central social policy fields—prominently health, labour market, or pension policy—reflects deep welfare state transformation. This volume analyzes the link between

M. Wulfgramm (✉)

Institute for Political Science, University of Southern Denmark,
Odense, Denmark

e-mail: wulfgramm@sam.sdu.dk

T. Bieber

Federal Ministry of Education and Research, Germany

S. Leibfried

Socium, University of Bremen, Bremen, Germany

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these two phenomena: How has welfare state transformation in core policy fields shaped development of the main dimensions of social inequality?

Disadvantaged groups of society are adversely affected by the increase in inequality, but not exclusively so; the middle class also faces stagnating or even falling real wages and a fear of joining the lower social strata in their struggle to maintain their living standards in spite of precarious employment or unemployment. Gains in economic growth have been concentrated at the upper end of the distribution scale, with both top incomes and especially return on capital exceeding the overall rate of economic growth (Piketty 2014; see also Frank 2013 or Foster and Wolfson 2010 on inequality and the declining middle class). Factors such as skill-biased technological change, demographic developments, mass unemployment, decreasing trade union power, and globalization have reinforced these distributional patterns (see Huber and Stephens 2014; Hurst 2016, 205). Thus, the richest percentiles in society are getting richer in terms of both income and accumulated wealth, while the middle and especially lower classes are falling increasingly behind.

In social policy research, inequality can be analyzed both as a determinant and an outcome of welfare state transformation. Similarly, the welfare state and its policy-makers can be seen as reactive or proactive actors with respect to societal developments. Regarding inequality as a force *explaining* social policy change, rising market inequalities and the spread of so-called ‘new social risks’ (Taylor-Gooby 2004; Armingeon and Bonoli 2006) have posed new challenges to the welfare state. Social and economic pressures have forced policy-makers to reconsider the ever more generous social-policy path of the post-war decades. Furthermore, inequality may actually trigger political dynamics that weaken—rather than strengthen—the redistributive capacities of the welfare state, which, for instance, was the argument in the political reinforcement hypothesis of Barth et al. (2015) and contradicts the famous but empirically largely unsustainable Meltzer and Richard (1981) model. This rather reactive framing asks whether and to what extent increased societal needs have overburdened the welfare state’s capacities with demands to compensate for market inequalities.

While we acknowledge this focus on inequality as a determinant of social policy change, contributions to this volume are even more *à propos* to the second perspective: namely, what distributional implications the recent welfare state transformation has brought about. We stress that

policy-making has not only defensively reacted to existing market pressures, but it has also actively shaped the inequality patterns that can be observed today. While the market pressures mentioned above have been major forces driving inequalities since the 1980s, selective cuts in the generosity of social transfers, tax-policy reforms, and the overall paradigmatic shift from compensation to supply orientation in social policy have contributed to the stratification of society. Our comparative study thus seeks to shed light on how transformations of the welfare state affects economic, social, and political inequalities. We study this relationship in OECD countries at the threshold of the twenty-first century. Using both quantitative as well as qualitative research methods, we intend to capture the complexity of reforms across different policy fields, which, taken together, cover all crucial aspects of welfare state transformation.

Inequality on the Rise

Market Inequality, Predistribution and Redistribution

For the empirical analysis of inequality, we begin by examining measures of inequality between countries and across time. To demonstrate the extent of overall redistribution through the welfare state, we depict the Gini coefficient both before and after taxes and transfers, where the distribution before taxes and transfers is often called ‘market inequality’. This term is somewhat misleading, as it suggests that product, capital, and labour markets are independent from the institutional settings they operate in and that the welfare state only affects inequalities through direct cash transfers. However, we argue that this gross distribution is also shaped by welfare state interventions and other institutional configurations, a concept that has recently been coined ‘predistribution’ (Hacker 2011; Chwalisz and Diamond 2015). In its intentional political variant, predistribution comprises strategies of social investment and ‘market reforms that encourage a more equal distribution of economic power, assets and rewards even before government collects taxes or pays out benefits’ (Chwalisz and Diamond 2015, 3). While predistribution is a new political label, institutions that equalize gross incomes

have traditionally been at the heart of especially coordinated economies (see Hall and Soskice 2001). The coordinated European, but also Antipodean, democracies have built their welfare states on institutions that balance wages through collective wage-bargaining agreements. The decline of trade-union power and collective bargaining coverage in the past decades (Hall and Thelen 2009; Schnabel 2013) is yet another reason for diverging gross incomes, a divergence which needs to be counterbalanced with new predistributive policy tools or increased redistributive transfers in order to keep net inequality in check. Despite this disclaimer about the term ‘market inequality’, an examination of inequality before and after taxes and transfers reveals interesting patterns of distribution and redistribution across both time and countries.

Income Inequality Before and After Taxes and Transfers: Empirical Trends

Figures 1.1 and 1.2 show levels and time trends of income inequality before and after taxes and transfers between 1985 and 2013. Figure 1.1 displays the development of the Gini coefficient before taxes and transfers. The solid line reveals that the mean Gini coefficient before taxes and transfers has increased substantially in core OECD member states over the past three decades, rising by almost 7 points on a scale that potentially varies between 0 and 100. The three remaining lines show that this upward trend is pronounced across all typical examples of social democratic, liberal, and conservative welfare regimes (Esping-Andersen 1990), that is, Sweden, the United States (US), and Germany. While the Swedish Gini coefficient fluctuates much more than the coefficient of the US and Germany, it shares their pronounced trends towards higher inequality of gross incomes. Interestingly, the German distribution of incomes before taxes and transfers resembles to a strikingly large degree the pattern of the US both in terms of level and direction of change, which means that the tale of ‘Social Europe vs. Liberal America’ (Pontusson 2005) mainly holds after redistribution has occurred. In the US, increasing inequality and its accompanying debate are particularly driven by shifts from the middle to the richest income strata (Gornick and Jäntti 2013), while the corresponding German development shows an increase in poverty and thus the falling behind of the lowest deciles.

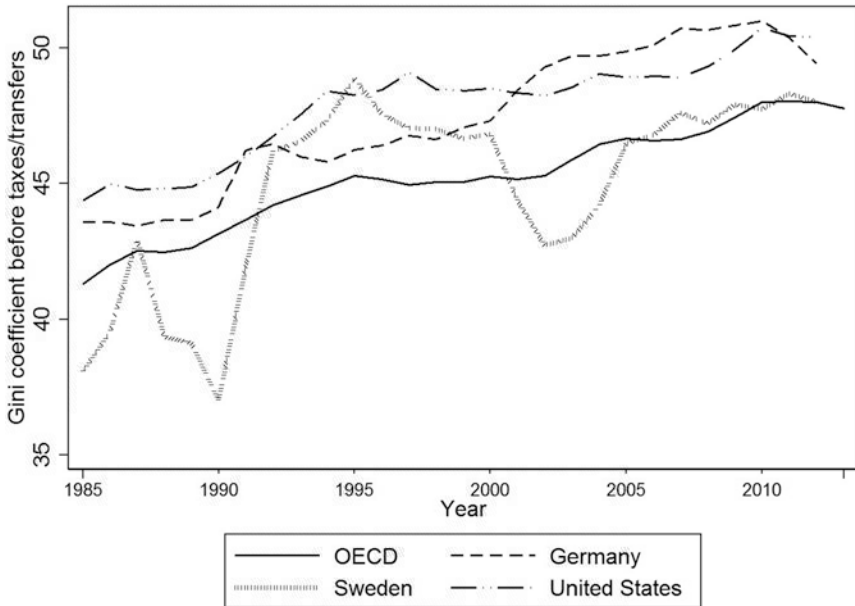


Fig. 1.1 Gini coefficient before taxes and transfers, 1985–2013.
Data source: Solt (2014)

Figure 1.2 demonstrates that the rising disparities in incomes before taxes and transfers have translated into higher overall net inequality across advanced economies, although the slope is considerably less steep than in Fig. 1.1. Sweden, Germany and the US follow this overall upward trend, yet specific national patterns emerge to a far larger degree after redistribution of income through both taxation and transfers through social policies. While Sweden shows a marked increase in its Gini coefficient comparable to the US, the considerably more equal starting position is matched by a still relatively equal income distribution in 2013. Germany exhibits an upward, but comparatively moderate, change over time and keeps its rather average Gini coefficient slightly below the OECD mean. The trend depicted is followed by the vast majority of advanced economies: 20 of 22 OECD countries analyzed (OECD 2015, 24) display increased net inequality between 1985 and 2013, while only Turkey and Greece show a slight decrease in their nevertheless high Gini coefficient scores after taxes and transfers. While incomes are already quite unequally distributed, wealth accumulates in an even more concentrated fashion (Piketty 2014).

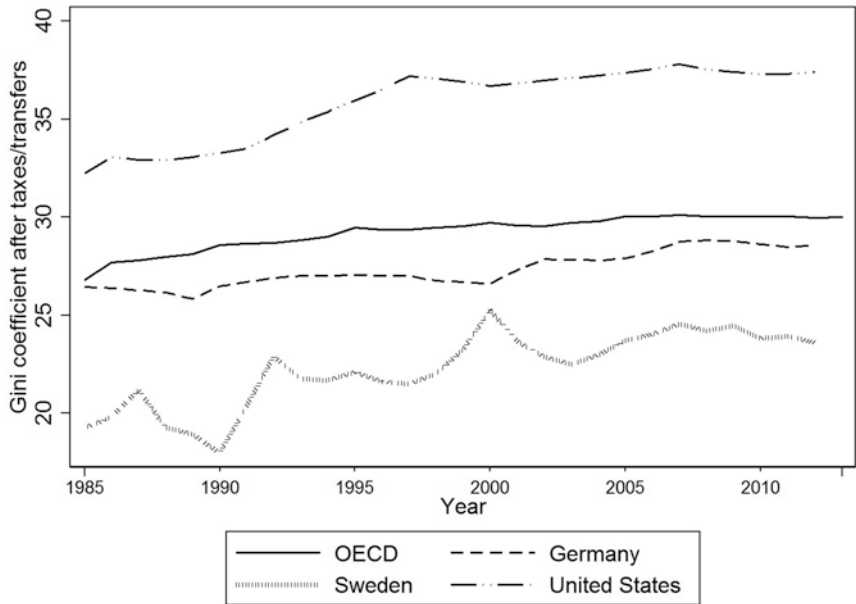


Fig. 1.2 Gini coefficient after taxes and transfers, 1985–2013. Data source: Solt (2014)

What does this overview reveal about the redistributive power of social policy? Have welfare states been able to contain the push towards income inequality through redistribution? Both optimistic and pessimistic readings of the empirical evidence are possible. In defence of the welfare state, we see that taxes and transfers have a larger equalizing capacity than before, cushioning a large share of the increased gross differences in incomes. However, the data also show that the welfare state is fighting—and losing—an uphill battle, failing to keep net inequality in check. Furthermore, the design of the welfare state itself shapes and partly exacerbates existing inequalities, which will be elaborated in the remainder of this volume. Undesirable consequences of rising disparities and intrinsic concerns about inequality are discussed in the following section.

Why We (Should) Care About Rising Inequality

As a result of growing disparities and fuelled even more by social consequences of the global financial and economic crisis that began in 2007, political, public, and scholarly debate has zoomed in on inequality trends. Among the most influential social science publications of the decade, Thomas Piketty's watershed success *Capital in the Twenty-First Century* (2014) has hit a nerve with its critical analysis of historical wealth accumulation and income data. This topicality stems from both intrinsic and instrumental concerns about rising inequality (Atkinson 2015, 11). Intrinsic concerns are based on our perceptions of fairness and equity rooted in political and moral philosophy, as discussed most famously in John Rawls' *Theory of Justice* (1971). Rawls argues that any concept of a fair society needs to be developed under a hypothetical veil of ignorance and entails a set of basic freedoms that foster equality of opportunity. Similarly stressing freedom, the capabilities approach of Martha Nussbaum (2011) and Amartya Sen (1999) links distribution of material well-being explicitly to social, political, and economic freedom. These are deemed necessary to ensure human dignity, which should be safeguarded as an expression of our common humanity. In general, social inequality means that resources such as wealth, prestige, or power accrue to certain groups, and one thus speaks of 'societally anchored forms of privileging some over others' (Mau and Verwiebe 2010, 193). In contrast to intrinsic concerns, instrumental arguments focus on the consequences for society, the economy, and democracy. Inequality is found to undermine social cohesion, increase crime rates (Wilkinson and Pickett 2010; Stiglitz 2012), inhibit economic growth (OECD 2015), and challenge political representation (Verba et al. 1995; Schlozman et al. 2004; McCarty et al. 2006). For both intrinsic and instrumental reasons, dealing with the different dimensions of inequality lies at the heart of advanced welfare states and of welfare state studies.

Welfare State Transformation: Trends Across OECD Countries

Since the 1970s, structural patterns of state transformation in OECD countries have emerged (Leibfried et al. 2015). Processes of internationalization (Zürn and Deitelhoff 2015), transnationalization (Mattli 2015), and privatization of governance have altered the core institutions and functions that define the classical nation-state and thus the political process of social policy-making. Traditionally, the nation-state was in charge of producing the normative good of welfare. In the new constellation of statehood, private and supranational actors additionally play a leading role in fulfilling these functions. The maturation and expansion of the European Union (EU) increasingly demand that we consider supranational policy-making in the redesign of nation-states. In addition, privatization tendencies (Mattli 2015, 297) have shifted the attention of policy-makers from direct implementation and supply of public services to the formulation of rules and laws for private providers. In this section, we discuss how this general state transformation has translated into social policy-making across OECD countries.

Although levels and changes in generosity and welfare state expenditure differ between both policy fields and countries, we argue that there is a common trend towards a supply side-oriented social policy (see also Obinger and Starke 2015). Due to social, political, and economic pressures, policy-makers have re-examined the generous and ever-expanding social policy of the post-war decades. Rather than focussing on compensatory transfers that take market outcomes as given exogenous influences, welfare states increasingly aim at altering primary outcomes by providing services and setting incentives. In particular, in a shift away from passive policies, activation and social investment policies intend to foster employment and change citizens' human capital endowments. Although not part of what has traditionally been regarded the core of welfare states, education is becoming increasingly focal in policy-makers' attempts to equalize outcomes by improving equality of opportunity. In addition, contemporary welfare states are shifting responsibility for welfare outcomes to the individual, for instance, by strengthening private pensions in multi-pillar structures.

Furthermore, deregulation at the margins of the labour market while core workers enjoy broad job protection shows that flexibility requirements and social protection are unequally distributed across different labour market groups, leading to dualization (Emmenegger et al. 2012; Rueda 2014) in both a predistributive as well as redistributive sense. Continental countries in particular have cultivated an insider-outsider divide in terms of labour market risks through differential job protection and benefit schemes (Häusermann and Schwander 2012).

The Volume

The volume focuses on the causal relationships between welfare state transformation and the different dimensions of social inequality. To cover this topic comprehensively, this volume's four parts take different perspectives on these relationships.

Part I discusses core concepts of the book and shows overarching trends of both inequality and welfare state transformation. In Chap. 2, Peter Starke, Melike Wulfgramm, and Herbert Obinger analyze welfare state transformation from a broad comparative perspective. Long-term developments and challenges to advanced welfare states that arose after the oil crises of the 1970s and 1980s are portrayed. The main argument is that there is convergence between social policies in OECD countries towards a supply orientation in the welfare state, dualization of labour markets and an individualization of outcome risk. The concept of supply orientation and the implications for inequality are discussed.

In Chaps. 3 and 4, the authors study the concept of inequality from two different disciplinary angles. Olaf Groh-Samberg starts from a social science and particularly sociological angle by stressing the linkage between different dimensions of social inequality, such as equality of opportunity, health or political participation. Equally important is the question of 'inequality between whom?' as, for instance, social class, gender, age, or nationality can guide the analysis of distribution. The author develops these different conceptual considerations for the study of inequality and analyzes conflictual and competitive theoretical approaches to inequality. Empirically, the author describes how inequalities of life chances have remained largely stable, although absolute levels of life chances increased for all classes.

In Chap. 4, Stefan Gosepath approaches inequality from a philosophical perspective, discussing the question of why we are or should be concerned about rising social disparities on the grounds of our common humanity. The concept of inequality is linked to the moral notion of justice and to the question of what it actually means to be equal or unequal according to theories of political and moral philosophy. Related to this debate, the contribution discusses which type of inequality is acceptable from a philosophical standpoint. The author argues that advanced welfare states adhere to the principles of formal, proportional, moral, and ultimately social equality. Those inequalities that are in themselves unjust or that produce injustices tied to other dimensions of inequality are morally objectionable and should be remedied by the welfare state.

Part II comprises chapters that offer analyses of transformation in particular policy fields of the welfare state and of how these policy changes have shaped different dimensions of social inequality. After a broad conceptualization in Part I, the authors give a more nuanced picture of welfare state transformation and its distributional implications, with each zooming in on one specific policy field. While all chapters analyze the consequences of welfare state transformation on inequality, the exact specification of inequality in terms of the cleavages studied reflects the different focus of social policy fields in their approach to shaping distributional outcomes. For instance, while the chapter on healthcare focuses on solidarity and redistribution between groups with different health risks, the chapter on labour market policy concerns the dualization tendencies between labour market insiders and outsiders. In combination, the chapters of Part II give a comprehensive overview of the linkage patterns that emerge in welfare state transformation across policy fields and different dimensions of inequality.

Given that all states rely on taxes and social contributions to finance their increasingly costly welfare states and that these financing measures themselves are redistributive, Laura Seelkopf and Hanna Lierse start Part II in Chap. 5 by studying the implications of tax competition for the redistributive capacity of welfare states. The authors see globalization as a major driving force of tax policy changes, yet they argue that governments still have space to manoeuvre. The author, however, concludes that global competition has translated into a situation wherein all principles

of equity that are relevant regarding taxes have been breached, that is, into negative consequences of tax policy transformation for vertical, horizontal, and international equality.

In Chap. 6, Achim Schmid, Pascal Siemsen, and Ralf Götze analyze the transformation of eleven OECD healthcare systems and develop the Index of Risk and Income Solidarity to demonstrate the distributional consequences of healthcare policy change. They define ‘risk solidarity’ as the extent to which resources are redistributed between the healthy and the unhealthy across different risk groups, while ‘income solidarity’ refers to redistribution between income groups through the financing of healthcare. Interestingly, the authors find rather stable income solidarity and even an upward convergence of risk solidarity. Thus, healthcare transformation as part of social investment in supply side-oriented welfare states has resulted in an equalization of distributional outcomes.

Chapter 7 covers pension policy transformation and its consequences for between- and within-cohort inequalities at pension age. Against the backdrop of broad OECD pension policy trends, Jan Paul Heisig conducts an in-depth analysis of the German and the US case. He shows how welfare states across different welfare regimes have shifted towards higher individual responsibility rather than solidarity in pension policy, as disability, labour market history, and fluctuations in financial markets directly translate into inequalities between different groups of retirees. Furthermore, retirement is related to far higher losses of income today than it was in the 1980s.

While Chap. 7 focuses on inequality of outcomes at retirement age, Chap. 8 is dedicated to the distribution of life chances at a much earlier age, as it studies the distributional consequences of education policy. Timm Fulge analyzes which higher education system characteristics affect class-based inequality of opportunity. His multi-level analysis shows that high public investments in tertiary education equalize opportunities, while acceptance of a larger share of students does not lead to the expected egalitarian results. The author argues that there is a trend towards higher enrolment rates at the expense of per-student subsidization levels, and that this broad social investment strategy actually intensifies rather than modifies inequality in higher-education enrolment and thus in life chances.

In Chap. 9, Hanna Schwander analyzes the selective transformation of four continental welfare states in the sphere of labour market policy and the results in terms of labour market risk distribution. She argues that flexibility requirements for outsiders have led to severe generational labour market inequalities, particularly in France, Italy, and Spain, while skill level is the major dividing line for German labour market risks. Both market forces and institutional factors lead to structural segmentation in terms of risks between labour market insiders and outsiders. Furthermore, she argues that the differential reduction in benefit generosity perpetuates rather than mitigates these predistributional inequalities.

As the final contributor to Part II, Irene Dingeldey, in Chap. 10, also investigates institutional dualization but incorporates the tie between family and labour market policy. The focus is placed here on gender inequality and compensating mechanisms at the household level. Incentives in wage structures, labour market policy, and family policy affect the within- and between-household distribution of labour market participation and incomes. The author shows how these factors modify or amplify inequalities between households and gender.

While a large share of the literature, including the majority of the book's chapters, is concerned with national welfare states and within-country inequality, a comprehensive analysis of the topic needs to broaden the horizon to take into account global inequalities (see for instance Holton 2014) and global social policy (see also Deacon et al. 1997; Yeates 2014). *Part III* of this volume therefore goes beyond the analysis of purely national policy-making to focus on supranational actors and between-country inequalities. In Chap. 11, Alexandra Kaasch analyzes how global social-policy players affect local policy-makers and global inequality. Global inequality patterns and trends are shown and discussed. Furthermore, the discussion on social justice is extended to include overall distribution and redistribution of resources at a global scale. The main question is whether and how the justice principles that moral and political philosophers developed for national contexts apply to global inequality. Finally, the author studies whether global redistribution actually decreases different dimensions of global inequalities and how the empirical trends connect to principles of justice.

While the previous chapter thus takes a broad geographical perspective on inequality, in Chap. 12 Christof Roos analyzes welfare state transformation and inequality in the European Union. The connection between spatial and social mobility is discussed. On the one hand, inequalities between EU member states and the right to freedom of movement are major drivers for spatial mobility between countries; on the other hand, mobility requires resources exist in the first place, excluding the poorest Europeans from the opportunity of social through spatial mobility. Analyzing policy trends in Germany, the United Kingdom, and Sweden, the author argues that selective mobility and social inequality is reinforced by the recent trend towards welfare state closure in the EU.

Overall, this volume explores the relationship between welfare state transformation and inequality both conceptually and empirically. The authors assess how welfare state changes have actively shaped the pattern of both gross and net inequality by selectively cutting back generosity and by redesigning social policy from compensation towards supply orientation. The implications of this trend towards supply side-oriented policies for market inequality are contradictory and depend on the particular policy. While policies of social investment aim (yet often fail) at equalizing (pre)distribution, policies that individualize risk (for example, private pension policy, deregulation of marginal employment) tend to widen the income spread. Regarding net inequality, the trend is rather uniform across traditional policy fields: replacement rates are gradually declining across OECD countries, thus limiting the redistributive efforts of OECD economies. However, welfare state expenditure is not reduced as a result of this decline in traditional replacement rates. Rather, we see that the focus shifts towards policy areas that are likely to contribute to future economic successes such as education and family policy. Once market inequalities become manifest, though, the decreasing focus on compensatory transfers means that market inequalities translate into net inequality. In Chap. 14 of *Part IV*, these conclusions are elaborated by the editors based on the contributions in the volume.

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