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EUROPEAN INTEGRATION AND INCOME INEQUALITY*

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EUROPEAN INTEGRATION AND INCOME INEQUALITY

ABSTRACT

Globalization has attained a prominent place on the sociological agenda, and stratification scholars have implicated globalization in the increased income inequality observed in many advanced capitalist countries. But sociologists have given much less attention to a different but increasingly prevalent form of internationalization: regional integration. Regional integration, or the construction of international economy and polity within negotiated regions, should matter for income inequality. Regional *economic* integration should raise income inequality, as workers are exposed to international competition and labor unions are weakened. Regional *political* integration should also raise income inequality, but through a different mechanism: where the regional polity advances market-oriented policies, political integration should drive welfare state retrenchment as states adopt liberal policies in a context of fiscal austerity. Evidence from random-effects and fixed-effects models of national income inequality in Western Europe supports these arguments. The significant effects of regional integration on income inequality are net of several controls, including two established measures of globalization, suggesting that a sociology of regional integration adds to our understanding of rising income inequality in Western Europe.

EUROPEAN INTEGRATION AND INCOME INEQUALITY

INTRODUCTION

The construction of a regional political economy in Western Europe through the creation, expansion, and institutionalization of the European Union (EU) raises a critical sociological question: What role has European integration had in the recent widely-noted increase in income inequality within Western European societies? Many political scientists and EU scholars have speculated on the implications of European integration for national income inequality. Most argue that European integration should exacerbate income gaps in EU countries (Boje, van Steenberg and Walby 1999; Kosonen 1995), while others suggest that European integration may actually insulate EU countries against the polarizing effects of globalization (Moses 1995). Although sociologists of stratification – especially American sociologists – have not yet devoted sustained empirical attention to European integration (Therborn 1999), sociological approaches to income inequality readily extend to regional integration, and these approaches suggest that regional integration should affect income inequality. Given the centrality of economic inequality to the discipline of sociology (Kenworthy 2005), and the historic significance of the European integration project, sociologists should examine the consequences of European integration for income inequality.

The formation of the 6-nation European Economic Community (EEC) in 1957, its expansion and transformation into the 15-nation European Union by 1995, and its further expansion to 25 nations in 2004, is a dramatic and far-reaching contemporary development in international political economy that encompasses over 375 million people

and is restructuring society, culture, economy, and polity in the advanced capitalist countries of Western Europe. The European Union (EU) has progressed further toward integration than other regionalist efforts such as the North American Free Trade Agreement, the Common Market of the Southern Cone, and the Association of Southeast Asian Nations (Fligstein 2005; Mann 1997; Stone Sweet, Fligstein, and Sandholtz 2001). The EU has introduced a common currency, eliminated many internal border controls, and established a supranational polity. This polity includes the European Commission, which proposes legislation, sets the agenda for integration, and monitors compliance with European law; the European Parliament, which debates legislation; and the Council of the European Union, which enacts legislation. The EU also includes the European Court of Justice (ECJ), which has been essential to the process of integrating regional law into national law through its judgments, and thereby institutionalizing the fundamental rules of regional integration in Europe (Fligstein and Stone Sweet 2001).

Two essential dimensions of European integration are political integration (the creation of the regional polity and the diffusion of regional rules) and economic integration (the intensification of regional economic exchanges such as trade and investment). The relative progress of economic and political integration in the EU is debated, with some finding deeper economic integration (Scharpf 1997) while others see political integration as more advanced (Therborn 1999), and still others find that economic and political integration reinforce each other (Fligstein and Stone Sweet 2002). I argue that political and economic integration affect income inequality through different mechanisms. The sociological approaches to income inequality and regional integration developed below suggest that political integration should increase income inequality

through its effects on the welfare state, while economic integration should increase income inequality by undermining the position of labor through the pressures of international wage and employment competition.¹

This paper extends sociological approaches to income inequality and develops hypotheses concerning the impact of regional political and economic integration on income inequality. These hypotheses are tested with data on Western European countries for the 1973-1997 period, and panel methods that account for unmeasured heterogeneity between countries. Using novel measures of regional political and economic integration, this analysis finds evidence that regional integration is associated with income inequality: political and economic integration increase income inequality, though the effect of economic integration is attenuated at the highest levels of integration. The finding that regional integration is associated with income inequality in Western European countries holds across several statistical models, including fixed-effects models, and models that incorporate controls for economic development, national welfare spending, and globalization.

BACKGROUND

Much writing on regional integration, and especially the European Union, centers on inequality. Some accuse the EU of expanding inequalities by contracting the welfare state (Boje et al. 1999), while others predict that inequality will grow with future integration (Kosonen 1995). Still others view the EU as a way for member states to resist

¹ Both of these arguments imply that the precise pattern of change in income inequality should be one of “polarization” (Morris, Bernhardt and Handcock 1994). The observed pattern of change in core societies where income inequality has risen, including the Western European societies scrutinized here, is one of polarization (Alderson, Beckfield, and Nielsen 2005).

globalization's effect on inequality (Moses 1995). Finally, some argue that the impact of regional integration on inequality is uneven, with certain inequalities (viz., gender inequality) alleviated by the "regulatory supra-state" (Walby 1999). Although there is no shortage of *interest* in the consequences of regional integration for inequalities, sociological *research* on income inequality has largely neglected the role of regional integration. Instead, this work, and related work on poverty, has focused on economic development (Nielsen and Alderson 1995, 1997), the welfare state (Brady 2003; Brady and Leicht 2003; Esping-Andersen 1990; Kenworthy 1999), and globalization or investment dependence (Alderson and Nielsen 1999, 2002; Bluestone and Harrison 1982; Dixon and Boswell 1996; Firebaugh 1992, 1996) as the key social forces that drive national income inequality in advanced capitalist societies. Nevertheless, it is possible to extend sociological approaches to income inequality to identify pathways from regional political and economic integration to inequality. Below, I develop arguments that bring regional integration in to the explanation of rising income inequality in Western Europe.

Economic integration, labor, and income inequality

The argument that *globalization* increases income inequality rests on the idea that the labor/capital balance of power is a key determinant of income inequality. Many take for granted the idea that labor strength reduces inequality (Harrison and Bluestone 1988). Cross-national work shows that globalization harms labor by creating an international labor pool (Alderson and Nielsen 2002; Brady and Wallace 2000; Volgy et al. 1996). These insights are readily extended to *regional integration*: because economic integration creates a larger labor market and increases wage competition between workers (Alderson

and Nielsen 2002; Western 1997), economic integration can be expected to increase income inequality as workers are exposed to the competition of regional labor markets.² Although these ideas have not been synthesized in this way and subjected to empirical analysis, there is evidence on the operation of these mechanisms: the formation of the EEC created a regional market by raising the volume of international trade and investment (Ben-David 1993), economic openness raised the likelihood of union decline in the advanced capitalist countries (Western 1997), and income inequality is lower where labor unions are stronger (Alderson and Nielsen 2002). Also, there is evidence that economic insecurity among workers increases in industries where foreign investment increases (Scheve and Slaughter 2004) – suggesting that workers accurately perceive international competition.

In considering trade openness in the European context, it is important to appreciate that the small, open economies of Western Europe have historically developed institutions to insulate workers against the pressures of international competition (Cameron 1978; Huber and Stephens 2001:7; Katzenstein 1985). Strong welfare states with generous unemployment benefits and training programs; along with corporatist bargaining that coordinates the state's macroeconomic policy, labor unions' wage demands, and corporations' employment decisions; stabilize the national economy against the vicissitudes of international markets (Katzenstein 1985). These corporatist states (such as Belgium and the Netherlands) are deeply embedded into the regional

² Actual labor migration is not necessary for the expansion of the labor pool and the intensification of economic competition, given that the relocation of manufacturing facilities and cross-border capital investments – i.e., capital mobility – can substitute for labor mobility.

European economy.³ This suggests that the effect of economic integration on income inequality should be dampened at the high levels of economic integration exhibited by small, open corporatist states. In sum, regional economic integration – the expansion of markets to the regional level from the national level – should increase income inequality as workers are exposed to the wage competition of a larger labor pool, but this effect should be dampened or even reversed in the most deeply regionally-integrated economies, because those economies are stabilized by strong welfare states and corporatist institutions.

Although regional integration may affect income inequality in part through market expansion, regional integration and globalization are not equivalent (Huber and Stephens 2001:7; Kim and Shin 2002; Scharpf 1997; Walby 1999). Regional integration and globalization can be conceptualized as alternative *forms* of international embeddedness. There are three key distinctions between these forms. First, regional integration is geographically bound. Globalization is defined most simply and most often as the intensification of cross-border flows, and the borders crossed are any national borders: US-Germany trade is as much globalization as France-Germany trade. But regional integration involves the intensification of international interaction within bounded regions.

A second difference between regionalization and globalization is political: regional polities are more strongly institutionalized than the world polity. Regional polities like the European Union can compel compliance with their directives. For instance, the EU required its members to meet budgetary and other requirements before

³ Nearly 50% of total world exports and imports are within the boundaries of Western Europe (Fligstein and Merand 2002).

joining the currency union. Only a select few global organizations, such as the World Trade Organization (WTO), have such coercive power, and its power is not nearly as far-reaching across policy domains as the EU's.

Finally, regional integration differs from globalization in that regionalization has progressed further than globalization; indeed, much of what is referred to in the literature as globalization may be characterized as regionalization (Fligstein 2001:196-203) or even Europeanization (Fligstein and Merand 2002). For instance, Fligstein and Stone Sweet (2002) show that nearly half of all world trade occurs within the EU, and Alderson (2004) finds that the vast majority of the "globalization" of production occurs among advanced industrial economies, most of which are located in Europe and North America.

Globalization and European integration are distinct processes, and as such may be related to income inequality in different ways.

Political integration, the welfare state, and income inequality

The sociological approach that ties income inequality to the welfare state also has implications for the relationship between integration and inequality. Research along these lines demonstrates that state policies profoundly structure stratification: economic policy produces and reproduces social cleavages (e.g., tight monetary policy restricts inflation and benefits the privileged stratum, while full employment policy benefits the disadvantaged [Boix 1998; Hibbs 1987]). The welfare state shapes stratification directly through income transfers (Korpi and Palme 1998), and ample research shows that the welfare state reduces inequality and poverty (Alderson and Nielsen 2002; Brady 2003,

2005; Brady and Leicht 2003; Kenworthy 1999; Moller, Bradley, Huber, Nielsen, and Stephens 2003).

If the welfare state dampens inequality, then the question becomes what effect European integration has on the welfare state. Many welfare-state scholars implicate European integration in the retrenchment of Western European welfare states (Huber and Stephens 2001; Korpi 2003; Scharpf 1996). Four arguments link regional integration to welfare-state retrenchment through political mechanisms: first, regional integration constrains welfare spending via policy feedbacks; second, regional integration constrains welfare spending through the diffusion and adoption of classical-liberal policy scripts; third, regional integration facilitates retrenchment through the politics of blame avoidance; and fourth, regional integration limits national autonomy by tying the economic fortunes of the national economy to the regional economy.

The first argument highlights the so-called “convergence criteria” in the 1992 Maastricht treaty that set the path to Economic and Monetary Union (EMU). The criteria require that state budget deficits be no greater than 3% of GDP, and this requirement initiated proposed welfare-state cutbacks (Huber and Stephens 2001). This can be understood as a policy feedback effect, whereby accession to EMU pressures states to reform social welfare policy (Boje et al. 1999; Pierson 1996; Pitruzzello 1997; Rhodes 1996; Schulz 2000). As Huber and Stephens write, “the convergence criteria contained in the Maastricht accord pressed further austerity on all member governments” (2001:234). Likewise, although Pierson (2001) is skeptical of the argument that globalization is linked to welfare-state retrenchment, he does argue that EMU is one force that pressures European countries toward austerity.

The second argument, that the EU diffuses market-oriented policy scripts, is more general.⁴ The EU is a market-led project where “negative integration,” or the removal of barriers to trade and market regulations, surpasses “positive integration,” or regional regulations that correct market dysfunctions (Scharpf 1996, 1999). Very generally, the EU advances market-centered policies, such as deregulation, privatization, tax competition, and “market compatibility requirements” (Pierson and Leibfried 1995; Rhodes 1995; Scharpf 1997). Huber and Stephens cite “the move to financial deregulation that had begun in the early 1970s [that] was essentially completed in western Europe by the beginning of [the 1990s] due to the Europe 1992 [single market] project” as a force for retrenchment in the 1990s. Scharpf calls this dynamic “regulatory competition,” and he specifically cites political integration through the European Commission and the European Court of Justice as forces that bring EU member states into this competition. More broadly, the EU has established several mechanisms for the generation, diffusion, and adoption of common policy objectives, including, most recently, the Open Method of Coordination (Hemerijk 2005; Zeitlin 2005).

The third argument is that regional integration facilitates welfare-state retrenchment through the politics of blame avoidance. Pierson (1996) subtly argues that under the “politics of retrenchment” – whereby strategic political actors seek to avoid blame for rolling back popular welfare programs – EU member states can blame the EU for retrenchment. This suggests that retrenchment may go further inside the EU than outside of it since non-EU member states may be unable to shift blame so easily.

⁴ Gillingham applauds the classical-liberal character of European integration, writing that the EU has produced “an invisible hand that is no longer lamed” (Gillingham 2003:xii).

A fourth argument that links regional integration to the welfare state identifies a logic that ties policy options to economic forces. Regional *economic* integration may constrain the welfare state by placing common economic pressure on all members of a regional economy. For instance, national welfare states may find it difficult to maintain policies to promote full employment when intensified trade ties their economic fortunes to developments in other national economies within the integrated regional economy (Korpi 2003:603).

In sum, EU scholars have argued that European integration is related to various inequalities, and the sociology of income inequality can be developed in a way that incorporates regional integration, but the possible role of regional integration in increasing income inequality in Western Europe has not been assessed. Below, I discuss the evidence this paper brings to these claims.

DATA AND METHOD

The dependent variable is the Gini coefficient, a common measure of inequality that varies from 0 to 1, where 0 is perfect equality and 1 is perfect inequality (Firebaugh 1999). The primary data source is the Luxembourg Income Study database (LIS 2003). The LIS calculations of the Gini coefficient are based on post-tax and post-transfer incomes. As a robustness check, I also use data from another popular database, the “high-quality” data published by Deininger and Squire (1996, 2003). The Luxembourg Income Study contributes 48 observations (from 12 Western European nations) for which data are also available on the key independent variables, and the larger Deininger and Squire dataset contributes 100 observations for which data are also available on the key

independent variables. An important difference between the LIS and Deininger and Squire datasets is that the LIS data tend to come from later years (the average year is 1988, compared to 1982 for the Deininger and Squire data). For ease of presentation in the tables, the Gini coefficient is multiplied by 100.

Consistent with conceptualization of regional integration as having both political and economic dimensions (Fligstein and Stone Sweet 2002), the key independent variables are political and economic integration.

Political integration is measured as the number of cases referred from national courts to the European Court of Justice (ECJ) under Article 177 of the Rome Treaty.⁵ This measure improves on measures of integration used in previous work on other consequences of EU membership.⁶ Under Article-177 of the 1957 Rome Treaty establishing the European Economic Community, if a case is relevant to EU law, the national court may and sometimes must forward the case to the ECJ, the judicial body with final and binding authority to interpret EU law. Under this so-called “preliminary reference” procedure, the ECJ issues rulings that are incorporated into national law by the national courts (Stone Sweet and Brunell 1998a, 1998b). In the language of integration theory within political science, the number of cases forwarded from member states of the EU in a given year is an indicator of “jurisdictional integration” (Nye 1968:867). An increase in the cases sent to the regional court indicates increasing integration of regional law into national law in that the measure faithfully reflects the ECJ’s role in laying “the

⁵ Fligstein and Stone Sweet (2002) use the number of Article-177 cases, measured at the regional level of analysis and disaggregated by policy domain, as an indicator of the political institutionalization of the EU. I use the number of Article-177 cases, measured at the national level of analysis, as an indicator of integration into the regional polity.

⁶ For instance, in studies of regional integration and economic growth, integration has been measured with an indicator variable for “member of the EU” (Henrekson, Torstensson and Torstensson 1997) or a count of the number of years a state has been a member of the EU (Bornschier, Herkenrath and Ziltener 2004).

legal foundation for an integrated European economy and polity” (Burley and Mattli 1993:42).⁷ The preliminary reference procedure forms “vertical networks” between national and supranational actors that “enable the supranational institution to be maximally effective” (Slaughter 2004:13-14) and are “instrumental in promoting European integration” (Carrubba and Murrah 2005:399). Indeed, the European Commission tracks the number of Article-177 cases as an indicator of the “application of Community law by the national courts” (Commission 1989). Data are available through 1997 and come from Stone Sweet and Brunell (1999).⁸

Economic integration is measured as the percentage of a country’s total exports that go to European Union countries, or the intraregional trade share (Frankel 1997). Because the EU has expanded from 6 members in 1957 to 15 members by 1995, I use two versions of this intraregional trade share measure: in one version, the EU is defined as the 6 original members of the EU (then the European Economic Community, or EEC), and in the other version, the EU is defined as the 15 members of the EU as of 1995.

These measures tap the extent to which the national economies of the EU are embedded

⁷ Alter (2000) argues that the preliminary reference procedure may have provoked a backlash in national societies that are skeptical of European integration. While this argument may well apply to the current European political environment, and may explain the recent slowdown in preliminary references, it is likely less relevant to the pre-1998 period examined here.

⁸ I assessed the validity of the Article-177 cases measure of political integration by calculating Pearson correlation coefficients between it and each of several alternative measures, most of which are available for fewer country-years. The number of Article-177 cases is significantly and positively correlated with the number of years a state has been a member of the EU ($r = .70; p < .05$), as well as the square of the number of years ($r = .69; p < .05$). The proportion of European Council directives integrated into national law is also significantly and positively correlated with the cases measure ($r = .80; p < .05$). The cases measure is also significantly and positively correlated with the percentage of the population who approve of efforts toward European integration ($r = .35; p < .05$). Finally, the cases measure is positively and significantly associated with the number of regional non-governmental organizations ($r = .55; p < .05$), but not with the number of regional intergovernmental organizations ($r = -.02; p > .70$). It is not possible to enter all of these alternative measures into the regressions below in place of the preferred Article-177 cases measure, because most are available for only a very narrow range of countries or years. For instance, replacing Article-177 cases with INGO or IGO memberships reduces the sample size to 34 (results are mixed, with significant effects of IGO ties and insignificant effects of INGO ties, but the shifting sample complicates the interpretation of these results).

in exchanges with other EU countries, and as such these indicators of economic integration have face validity. Economic integration increases if countries within the region trade with each other more, and economic integration decreases if countries within the region trade with each other less, as a proportion of their total trade. The EU-15 measure more faithfully reflects European integration since an aspect of European integration is the expansion of the EU, but I also use the EEC-6 measure as a robustness check, and I find that the results are consistent (details are available upon request). Data come from the IMF's *Direction of Trade CD-ROM* and were kindly provided in dyadic format by Andrew Rose.⁹

The analysis includes controls for year, real GDP per capita, social security transfers, and outflow of foreign direct investment per worker. Year is included in the models to control for the linear increase in income inequality in these countries, and to guard against spurious associations among variables with common trends. Year is coded as follows: 1950=1, 1951=2, ..., 1997=48. Real GDP per capita is included to control for the strong relationship between development and inequality demonstrated in previous work (Nielsen and Alderson 1995, 1997). GDP data come from the Penn World Table (Heston, Summers, and Aten 2002), and real GDP per capita is coded in thousands of 1996 dollars. The measure of social security transfers as a percentage of GDP is incorporated into the models because welfare state effort has been shown to reduce inequality and poverty (Duncan et al. 1995; Kenworthy 1999; Korpi and Palme 1998). Data come from the OECD's *Historical Statistics* (2001) and *Statistical Compendium*

⁹ Figures for Germany refer to West Germany through 1990. Export data are reported for the Belgium-Luxembourg Economic Union (BLEU) rather than separately for Belgium and Luxembourg. Thus, the data on economic integration for Belgium refer to the BLEU, and I do not use data on the other variables for Luxembourg. This results in the loss of three observations on income inequality.

(2003). Finally, outflow of foreign direct investment (FDI) per worker (capital flight) is included to control for the role of globalization in the U-turn on inequality (Alderson and Nielsen 2002). FDI data come from the IMF's International Financial Statistics (IMF various years), and labor force data come from the OECD (1995, 1998, various years [b]). Consistent with previous work, this variable is logged. In light of the clear directionality of the expected effects of these controls (positive for year, GDP, social security transfers, and capital flight), I perform one-tailed hypothesis tests.

The data form an unbalanced panel, with countries contributing different numbers of observations, depending on data availability. OLS estimation is often inappropriate for use with panel data, since the errors are likely to be correlated within panels, and the unmeasured heterogeneity that causes this correlation may bias parameter estimates (Greene 2000). Two common solutions to this problem are the random-effects GLS model (REM) and the fixed-effects OLS model (FEM). The REM adjusts for within-panel error correlation by including a normally-distributed panel-specific error term; therefore, the REM is often thought of as a better choice if the data reflect a random sample. The REM also preserves both between-country and within-country variation. This is in contrast to the FEM, which differences away all between-country variation in subtracting each observation from the within-country mean. The FEM is often thought of as a better choice where the analyst has data on the entire population of interest. It should also be noted that the REM estimator does not require a large number of observations per country for consistency, whereas the FEM does. Because the number of years in the data is small relative to the number of countries, and because much of the meaningful variation in income inequality is between-country rather than within-country, for this

study the REM is more appropriate than the FEM. However, as a robustness check, I also estimate fixed-effects models. The fixed-effects models provide a stringent test of the hypothesis that regional integration affects income inequality, given that the associations between the regional integration covariates and income inequality are estimated net of all unmeasured between-country effects. The fixed-effects model is equivalent to a model with indicator variables for each country.¹⁰

The small size of the sample raises methodological challenges. One problem is that there are insufficient degrees of freedom necessary to estimate coefficients for all the controls that could conceivably be drawn from the literature. The central objective of this study is to assess the relationship between regional integration and national income inequality, but because it is necessary to include a few key controls, I employ the following strategy to deal with the small-N problem: the baseline model has only four covariates (political integration, the linear and squared terms for economic integration, and year), each of the other three controls is added sequentially, and then a model is estimated with a full complement of controls. Another methodological concern is outliers, which can be especially problematic in small-N studies. Examination of residual-versus-predicted value plots suggests outliers are not a problem here, as no residual is more than 2.6 standard deviations from the regression line.

¹⁰ The fixed-effects model simulates statistical “control” for other between-country differences as well, including stable differences in natural resource endowments, population size, and other factors. It also guards against the possibility that enduring cross-national differences (in orientation toward liberal economic policy, for instance) lead to integration *and* income inequality, causing a spurious association.

RESULTS

Table 1 shows results from random-effects models of national income inequality that control only for year of observation. Model 1 includes just the year covariate, in order to obtain a baseline estimate of the trend in income inequality. The upward trend is statistically significant at the .05 level but not especially strong: net of the unmeasured heterogeneity captured by the country-specific error term in the REM, each decade brought a 1.3-unit increase in the Gini coefficient, which corresponds to an increase of about .38 standard deviations for this sample (recall that the theoretical range of the Gini is 0-100).¹¹ This trend is similar to the recent increase in inequality among OECD countries (Alderson and Nielsen 2002).¹²

Does European integration explain this trend? Consistent with the argument that regional integration increases income inequality, there is a positive, statistically significant relationship between the Gini coefficient and the number of Article-177 cases forwarded to the European Court of Justice. To gauge the substantive significance of this effect, I used the estimated regression equation to simulate the expected change in income inequality for an increase from the minimum level of integration to the maximum level of integration (in this sample, the minimum number of Article-177 cases is 0, and the maximum is 56). Such an increase in political integration is expected to raise the Gini coefficient from 27.55 to 30.64, or about .8 of a standard deviation. This is a

¹¹ The standardized coefficient is calculated by dividing the product of the unstandardized coefficient and the standard deviation of the independent variable by the standard deviation of the dependent variable.

¹² Alderson and Nielsen (2002) show a clear U-shaped relationship between inequality and development. Their study uses the Deininger and Squire data, which includes many observations from earlier years and lower levels of development. Consistent with their results, a plot of inequality against development using the Deininger and Squire data for Western European countries shows a U-shaped relationship. Thus, it appears that the linear increase shown here is a result of using the LIS data, which come from later years and higher levels of development.

substantial change. For instance, the difference between Germany's and Norway's average Gini coefficients is also about .8 of a standard deviation.¹³ But political integration does not fully explain the trend: the coefficient estimate for the year term decreases in magnitude from .133 to .105 but remains statistically significant after political integration is incorporated into the model.

TABLE 1 ABOUT HERE.

Model 3 includes the measure of regional economic integration, the percentage of total exports from a national economy that is sent to the European Union (specifically, the EU-15). This model also includes the square of this measure, to assess the hypothesis that the effect of economic integration decreases in the most regionally-integrated economies.¹⁴ The results are consistent with the argument that regional economic integration raises income inequality, and that this effect is attenuated at high levels of economic integration. The inflection point, where the effect equals zero, is about 60%, indicating that regional economic integration raises income inequality where exports to the EU constitute less than a distinct majority of total exports (Belgium and the Netherlands have surpassed this level of economic integration). For instance, an increase in economic integration from the minimum level found in these data, 44%, to the inflection point, is associated with an expected increase in the Gini from 24.89 to 28.69, or about one standard deviation. This is similar to the increase in income inequality that

¹³ The fully-standardized coefficient is .22: a standard deviation increase in political integration is associated with a .22-standard deviation increase in income inequality, net of the time trend.

¹⁴ Supplemental analysis shows that a quadratic specification fits better than a linear specification, although the linear term reaches significance at the .05 level ($b = .0012$; $SE = .0006$).

the U.K. observed over this period. Increasing economic integration from 53% to 60% (approximately Sweden's change) yields an expected increase in the Gini from 27.83 to 28.69, or about .22 standard deviations.

Table 2 shows results from fixed-effects models that control for all unmeasured country effects. Again there are three models: a baseline model that estimates the trend, a model that adds political integration, and a model that adds economic integration. The results are consistent with those shown in Table 1, except that the effect of political integration does not reach significance in the second model. In Model 3, which includes both political and economic integration, the political integration coefficient is statistically significant and approximately the same size as in the random-effects model (.062 vs. .055). The economic integration coefficients are also slightly larger in the fixed-effects model (1.836 vs. 1.639 for the linear term and -.015 vs. -.013 for the squared term). It is especially interesting that the coefficient for the year trend fails to reach significance in Model 3, suggesting that regional integration explains the rise in income inequality within these Western European nations.

TABLE 2 ABOUT HERE.

The evidence shown in Tables 1 and 2 suggests that regional integration matters for national income inequality. Consistent with the argument that political integration raises income inequality by constraining the welfare state, the association between the Article-177 cases measure of political integration and the Gini coefficient is positive and statistically significant. Consistent with the argument that economic integration raises

income inequality by exposing labor to international markets, the export share measure of economic integration is positively and significantly associated with the Gini coefficient, and this association does, as expected, decrease at high levels of integration. But do these estimates of the effects of regional integration hold up to controls?

Table 3 shows results from random-effects models that control for year, economic development (real GDP per capita), the welfare state (spending on social security transfers as a percentage of GDP), and globalization (capital flight, or outflow of foreign direct investment per worker). Model 1 introduces GDP per capita, and the results suggest that regional integration affects income inequality net of economic development. The coefficient for economic development is negative, suggesting that increasing national wealth decreases income inequality. This negative coefficient is surprising in light of the U-turn literature, but it must be remembered that the model also controls for year, and year and GDP per capita are highly correlated ($r = .77$). Since these covariates are in the model as controls, and it is not the objective of this analysis to disentangle their effects, this collinearity is not especially troublesome.¹⁵ Model 2 introduces spending on social security transfers, and the results suggest that regional integration affects income inequality net of the welfare state. It is surprising that the effect of welfare spending is not itself significant.¹⁶ Model 3 introduces FDI outflow, and the results suggest that regional integration affects income inequality net of globalization. Finally, Model 4 includes all the controls, and once again the results for regional integration are consistent

¹⁵ Dropping year from the model changes the sign of the GDP effect, but the positive effect does not reach significance at the .05 level.

¹⁶ This nonsignificant result for the welfare-state effect may be due to measurement error. Replacing the classic social security transfers measure with total public social expenditure (the OECD's "SOCX" measure) produces significant results for welfare spending, as does replacing the transfers measure with Lyle Scruggs' decommodification index (Scruggs and Allan 2004). In analogues to Model 2 of Table 3, the effects of these alternative welfare-state measures are significant and negative, and the results for the regional integration covariates are substantively identical to those shown.

with those shown in Table 1. It is noteworthy that the coefficient estimates for the regional integration covariates retain not only their statistical significance, but also their size, across the various model specifications. Another notable finding is that FDI outflow does not significantly affect income inequality in either Model 2 or Model 4. This suggests that globalization may not matter for income inequality, net of regionalization. To assess whether this null result is driven by measurement error, I replaced FDI outflow with another common measure of globalization, economic openness (imports plus exports as a percentage of GDP, with data from the *Penn World Table* [Heston et al. 2002]), and the results were substantively identical to those shown.

TABLE 3 ABOUT HERE.

Table 4 shows results from fixed-effects models. The results for regional integration are consistent with those shown in Table 3: across the models, the effect of political integration is positive and statistically significant, and the effects of the economic integration terms are statistically significant (positive and negative, respectively). Surprisingly, the effect of year is no longer significant. Indeed, none of the controls reaches significance, but in this context it should be reiterated that this fixed-effects model can be interpreted as a model that includes an indicator variable for each of the 12 countries that contribute observations. As such, the fixed-effects model represents a conservative test (see Halaby [2004] on the advantages of the fixed-effects model).

TABLE 4 ABOUT HERE.

I have argued that the positive effect of economic integration on income inequality is attenuated at high levels of integration because the most deeply-integrated economies have developed institutions that insulate labor from the pressures of international competition, but the analysis so far has demonstrated only that the effect of economic integration does in fact decrease at high levels – not why it does so. Empirical assessment of the argument that the impact of economic integration varies according to the strength of the welfare state and the level of corporatism is straightforward, and can be accomplished by introducing interaction terms. If my argument is correct, we would expect negative interactions between economic integration and both welfare effort and corporatism.

Table 5 shows results from models that introduce these interaction terms. Model 1 includes an integration-by-corporatism interaction, where the measure of corporatism is Kenworthy's 11-item scale made available in the *Comparative Welfare States Data Set* (Kenworthy 2003; Huber et al. 2004). Because of missing data on this key measure, this model uses just 36 observations. The results are consistent with the argument that the effect of economic integration is attenuated in corporatist countries: where corporatist bargaining insulates labor against some of the pressure of international competition, the effect of economic integration is reduced. In other words, exposing labor to a regional market fails to have the expected effect of raising income inequality – where corporatism protects labor. Model 2 includes a regional integration-by-social security transfers interaction. These results are inconsistent with those from Model 1: the economic

integration effect is not significant, and neither is the interaction term.¹⁷ Model 3 tests this hypothesis using an alternative, programmatic rather than spending-based, measure of the welfare state, Lyle Scruggs' decommodification index (Scruggs and Allan 2004). The results show that economic integration raises income inequality, but this effect is significantly weaker in highly-decommodifying welfare states.

TABLE 5 ABOUT HERE.

Table 6 shows results from fixed-effects models that include these interaction terms, and the results are generally consistent with those in Table 5, except for Model 2. In the random-effects estimation of Model 2, the main effect of economic integration and its interaction with social security transfers were nonsignificant, but in the fixed-effects estimation of Model 2 shown in Table 6, these effects are statistically significant. In all three models, the association between economic integration and the Gini coefficient is positive and statistically significant, and the interaction term for economic integration and the welfare state is significant and negative. This suggests that the effect of economic integration on income inequality is buffered in strong welfare states and corporatist political economies.

TABLE 6 ABOUT HERE.

¹⁷ An F-test of the joint significance of the economic integration and integration-by-transfers interaction term also fails to reach significance at the .05 level.

Additional controls

I also estimated models controlling for other factors that may explain the increase in income inequality: unemployment, female labor force participation, and union density (Alderson and Nielsen 2002). Unemployment can be expected to raise income inequality by shifting wage earners toward the bottom of the income distribution. Rising unemployment in Western Europe (Korpi 2003) is a prominent alternative explanation for rising income inequality, but random-effects and fixed-effects models suggest that regional integration affects income inequality, net of a control for the standardized unemployment rate (data come from the OECD's *Quarterly Labor Force Statistics* [1999] and *Main Economic Indicators* [2002]). Interestingly, while the regional integration coefficients retain their statistical significance in these models, they also retain their magnitude – except in the random-effects model, where the economic integration coefficients shrink in size. This suggests that the effect of economic integration may be partly explained by cross-national differences in unemployment, which is consistent with the “employment competition” argument outlined above. By contrast, the stability of the political integration coefficient implies that political integration impacts income inequality through a different mechanism.

The increasing participation of women in the paid labor force may also affect income inequality. As women enter the paid labor force, income inequality may increase given women's lower average earnings (Thurow 1987), or it may decrease given that women's increased wage-earning may result in more middle-income *households* (Cancian, Danzinger, and Gottschalk 1993), or the effect may depend on which societies are examined (cf. Alderson and Nielsen 2002; Nielsen and Alderson 1997). Using data

on women as a percentage of the total paid labor force (United Nations 2002), I added this control to the Model 3 specification from Tables 1 and 2, and the results for regional integration in these models are substantively identical to those shown. Interestingly, while the female paid labor force participation covariate is not significant in the fixed-effects model, suggesting that women's presence in the paid labor force does not explain rising income inequality *within* societies, its negative and highly significant coefficient in the random-effects model suggests important cross-national differences *between* societies.

The decline of unions in advanced capitalist countries (Western 1997) is another prominent explanation for the rise in income inequality, and, as I argue above, it is one factor that may connect regional integration to rising income inequality. Alternatively, variation in the strength of labor unions may create a spurious association between regional integration and income inequality, if union weakness promotes both income inequality (as the existing literature suggests) and the entry of states into the European Union. To evaluate these alternatives, I added a measure of union density to the Model 3 specification from Tables 1 and 2 (data on total reported union members as a percentage of the labor force come from Visser [1996], Ebbinghaus and Visser [2000], and OECD [1995, 1998]). Consistent with previous work, union density has a strong negative effect on income inequality, and this is true for both the random-effects and fixed-effects model. More interesting is the change in the regional integration coefficients: the political integration effect *increases* slightly (suggesting that political integration works through other mechanisms), while the economic integration coefficients decrease substantially (but retain their statistical significance). Specifically, in the fixed-effects

model, the economic integration effects decrease from 1.836 to 1.104 in the linear term, and from -.015 to -.010 in the quadratic term. This pattern of results lends some support to the argument that economic integration increases income inequality (at least in part) by weakening unions through the expansion of market competition.

Cross-validation with an alternative dataset

To evaluate the robustness of these results, I re-estimated the models shown in Tables 1-6 using the “high-quality” dataset on income inequality published by Deininger and Squire (1996). These data have been used in many cross-national studies of income inequality (see Moran [2003] for a review), but the dataset has become the object of debate in the literature, with some authors questioning its quality (Atkinson and Brandolini 2000; Moran 2003). While it is important to acknowledge the skepticism directed toward the Deininger and Squire data, the dataset nevertheless provides an unusual opportunity to cross-validate the results of this analysis with out-of-sample data. Generally, the results from models estimated using the Deininger and Squire data are consistent with those from the LIS data. The exception is that the effect of political integration is not significant in these models. This might be because the Deininger and Squire data tend to come from earlier years than the LIS data (the data exhibit the clear U-turn noted in recent studies of income inequality), and it is possible that the effect of regional political integration intensified with the acceleration of European integration in the 1990s. For instance, if the Maastricht convergence criteria put downward pressure on welfare spending, and this downward pressure raised income inequality, this effect would not appear in the data before the Maastricht treaty was signed in 1992.

The results for economic integration, however, are substantively identical using the Deininger and Squire data. In random-effects and fixed-effects models that control for the time trend (with these data, a second-order polynomial is necessary to capture the U-turn) and political integration, the linear term for economic integration is always positive and statistically significant, while the squared term is always negative and statistically significant. This is also the case in models that include the controls in Tables 3 and 4 (the only control that reaches significance is the curvilinear year trend). In models that include interaction effects for economic integration by the welfare-state and corporatism measures (as in Tables 5 and 6), the economic integration main effect is always positive and statistically significant, while its interaction term is always negative and statistically significant. That the results for economic integration can be replicated using a different dataset suggests that the results shown here are robust.

DISCUSSION

Although the process of European integration can be identified as one potential explanation for rising income inequality in Western European nations, empirical evidence on this important question is scarce. This analysis is the first to assess the impact of regional political and economic integration on national income inequality in Western Europe. I use data on income inequality for 12 countries over the 1973-1997 period, novel measures of political and economic integration, and panel methods that account for unmeasured heterogeneity between countries to test hypotheses drawn from extensions of sociological approaches to income inequality. The results show that regional integration

affects income inequality: economic integration has a positive effect that is attenuated at high levels of integration, while political integration has a linear, positive effect.

The central implication of this study is that regional integration is a significant part of the political and economic context that should be taken into account in work on income inequality. National and global processes have been highlighted in work on economic inequality, and the results of this study show that regional processes also matter. And they matter *net* of national economic development, the national welfare state, globalization, and other factors. While globalization accounts for some of the recent increase in income inequality in advanced capitalist countries (Alderson and Nielsen 2002), regional integration also accounts for some of this increase. Taking this a step further, the nonsignificant effects of direct investment outflow, a common measure of globalization, imply that regional integration is more powerful than globalization in explaining recent trends in income inequality in Western European countries.¹⁸ This finding makes the relationship between globalization and regional integration of paramount importance. The presence of a significant association between regional integration and income inequality *net* of globalization provocatively implies that regionalization does not mediate globalization, but several more complex scenarios are still possible. For instance, does regional integration counteract globalization? Or reinforce globalization? Or lead globalization?

The results also hold important implications for world polity theory (Meyer et al. 1997; Boli and Thomas 1999). In general, world polity theory highlights the institutional

¹⁸ Replacing the FDI measure with an alternative, established measure of globalization – economic openness – does not change the results. In models that include openness as a control, the coefficient for openness does not reach significance at the .05 level, and the regional integration coefficients retain their signs and statistical significance in the random-effects as well as the fixed-effects model.

mechanisms for the policy effects of political integration. Thus, an implication that can be drawn from this study is that the *regional* polity should be better incorporated into the theory. The findings of this study are consistent with the claim that the “policy scripts” diffused by the European Union include (classical) liberal scripts that foster welfare state retrenchment. This is in contrast to world polity research that shows largely progressive effects of embeddedness in the world polity on civil rights and education policy (Frank et al. 2000; Frank and McEneaney 1999; Ramirez et al. 1997; Schafer 1999; True and Mintrom 2001). It could be that regional scripts and world scripts are contradictory, and if this is the case, then under what circumstances do regional scripts prevail over world scripts? If regional and world scripts are instead reinforcing, and becoming integrated into the European regional polity increases income inequality at least in part by contracting the welfare state, then this lends some support to the argument that the world polity diffuses a package of scripts consisting of liberal economic policies and progressive civil rights policies (Beckfield 2003). This line of reasoning also suggests that world polity research should attend to the impact of global political institutionalization on global economic inequality.

The issue of global economic inequality has received increased attention (Firebaugh 2000), and the finding that European integration increases income inequality is an important one in light of this work. Some argue that since between-country inequality has stabilized in recent decades after a long-term divergence (Firebaugh 2000), any change in total world income inequality has been driven by within-country inequality. As national income inequality in Western Europe has increased, and is at least partly explained by regional integration, regional integration may be a force for

increased world income inequality. Of course, this depends on income inequality trends within other countries, though there is compelling evidence that income inequality in many countries has risen in recent years. Another important issue in this context is the relationship between not just European integration and inequality, but regional integration more generally and inequality. The question of what impact regional integration in other parts of the world has on inequality is one that future research should address.

Finally, this analysis implies that the globalization debate in the welfare state literature may be misdirected. It may be regional integration, not globalization, that structures the welfare state in the advanced capitalist countries of Western Europe. The results of this study suggest a central role for the welfare state in mediating the effects of regional integration on income inequality, as welfare effort dampens the effects of both political integration and economic integration. There is also evidence that regional political integration may increase inequality through its negative effects on the welfare state, but it seems that these negative effects may be transmitted through some other welfare state domain than social security transfers. The crucial question, then, is what precisely is the impact of regional integration on the welfare state? Are stronger welfare states more resistant to the pressure of regional integration?

While this study has a number of implications and suggests a variety of directions for future work, it is also important to note the limitations of the analysis. Perhaps the key limitation is the one that plagues many studies of national income inequality: the small-N problem. The best data on national income inequality in Western Europe come from the Luxembourg Income Study, and this dataset provides only 48 country-years for

which information on the key independent variables is also available. The consequence of the small- N problem for this study is that there are simply not enough observations to incorporate all the controls that are suggested by the literature. The random-effects and fixed-effects models used here help by statistically accounting for all those unmeasured time-invariant factors that might be included in synthetic models of income inequality, but these models cannot completely solve the problem.

Another limitation concerns the measurement of political integration. The concept of national polities joining together to form a regional polity with common, region-wide policies is difficult to operationalize in a way that captures cross-national and longitudinal variation in the process. The measure used here, a count of the number of cases forwarded from the national court to the European Court of Justice under Article-177 of the Rome Treaty (itself a modification of the measure employed by Fligstein and Stone Sweet [2002]), is appealing because it has face validity (in that more cases forwarded suggests that the national polity is ceding more judicial authority to the regional polity), and because it is relatively sensitive (in that it allows both international and longitudinal variation). The obvious alternatives seem worse. One alternative is an indicator variable for membership in the European Union, while another is a count of the number of years a country has been a member of the EU. These alternatives would introduce serious measurement error. Future work should pursue improved measurement of regional political integration.¹⁹

¹⁹ The classical econometric errors-in-variables approach shows that the OLS estimator suffers from attenuation bias and inflated standard errors in the presence of measurement error (Wooldridge 2003:306). This implies that the statistically significant political integration coefficients in the models shown above, if affected by this kind of measurement error, are likely to be conservative estimates.

A final limitation is that, by design, this analysis addresses only the political and economic dimensions of regional integration. Although I argue that the political and economic dimensions are essential in the context of European integration, future work should consider the role of cultural and social integration.²⁰ That is, if it can be argued that European nations are becoming more oriented toward “Europe” culturally (possibly through increasing consumption of EU cultural goods or the increasing production of EU-wide understandings and meaning structures), then what are the consequences of this process for economic inequality? Moreover, if social interaction and migration patterns are becoming more regional as they are structured by the EU, this social integration may also have consequences for inequality.²¹ These questions fall beyond the scope of this study, but a full understanding of the consequences of European integration is impossible without appreciation of all its dimensions.

Limitations aside, this paper shows that the recent rise in income inequality within Western European societies, cases of the general increase in income inequality observed across several advanced industrial societies (Alderson and Nielsen 2002; Kenworthy and Pontusson 2005; Mahler 2004), is partly explained by regional integration. As Western European states have grown more deeply integrated into the regional polity of the European Union, and as national markets have opened to more intense international competition, income inequality has risen. This relationship between regional integration and income inequality appears net of statistical controls for other factors which have been offered as explanations for the “Great U-turn” on inequality (Harrison and Bluestone

²⁰ See Duina and Breznau (2002) on cultural construction in the EU.

²¹ International migration within Western Europe is quite limited, despite the relaxation of border controls, introduction of the common Euro currency, and implementation of various policies meant to encourage labor mobility (Favell 2003).

1988), including economic development, welfare retrenchment, union decline, unemployment, corporatism, and, most prominently, globalization. Both the political and economic dimensions of regional integration are associated with income inequality, supporting the argument that both the expansion of economic competition and the deepening of political institutionalization matter for inequality.

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Table 1. Random-Effects Regressions of Income Inequality on Regional Integration and Year, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>
Political Integration		.052* (.031)	.055* (.029)
Economic Integration			1.639* (.514)
Economic Integration ²			-.013* (.004)
Year	.133* (.039)	.105* (.041)	.071* (.042)
Constant	21.847* (1.910)	22.251* (1.903)	-24.917 (15.541)
R ²	.238	.289	.474

Notes: Unstandardized coefficients.
Standard errors in parentheses.
* $p \leq .05$ (one-tailed tests)

Table 2. Fixed-Effects Regressions of Income Inequality on Regional Integration and Year, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>
Political Integration		.054 (.035)	.062* (.031)
Economic Integration			1.836* (.558)
Economic Integration ²			-.015* (.005)
Year	.132* (.040)	.102* (.043)	.063 (.043)
Constant	21.638* (1.569)	21.969* (1.552)	-30.582* (16.569)
R ²	.238	.289	.477

Notes: Unstandardized coefficients.
Standard errors in parentheses.
*p ≤ .05 (one-tailed tests)

Table 3. Random-Effects Regressions of Income Inequality on Regional Integration and Other Covariates, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>	<u>Model 4</u>
Political Integration	.050* (.029)	.055* (.029)	.060* (.029)	.058* (.030)
Economic Integration	1.242* (.547)	1.656* (.527)	1.340* (.563)	1.248* (.578)
Economic Integration ²	-.010* (.004)	-.014* (.004)	-.011* (.004)	-.010* (.005)
Year	.309* (.106)	.085* (.050)	.130* (.064)	.346* (.117)
GDP Per Capita	-.665 (.279)			-.573* (.319)
Social Security Transfers		-.073 (.143)		-.206 (.141)
FDI Outflow			-.411 (.347)	-.253 (.402)
Constant	-9.765 (17.064)	-24.823 (15.819)	-15.941 (17.100)	-8.387 (17.679)
R ²	.394	.469	.485	.424

Notes: Unstandardized coefficients.
Standard errors in parentheses.
* $p \leq .05$ (one-tailed tests)

Table 4. Fixed-Effects Regressions of Income Inequality on Regional Integration and Other Covariates, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>	<u>Model 4</u>
Political Integration	.063* (.032)	.063* (.032)	.067* (.032)	.068* (.033)
Economic Integration	1.851* (.574)	1.834* (.577)	1.633* (.604)	1.602* (.624)
Economic Integration ²	-.015* (.005)	-.015* (.005)	-.013* (.005)	-.013* (.005)
Year	.044 (.130)	.062 (.053)	.107 (.066)	.018 (.181)
GDP Per Capita	.057 (.358)			.303 (.481)
Social Security Transfers		.003 (.165)		.026 (.203)
FDI Outflow			-.317 (.353)	-.453 (.412)
Constant	-31.369* (17.546)	-30.547* (16.916)	-24.397 (17.994)	-25.666 (18.612)
R ²	.477	.477	.490	.499

Notes: Unstandardized coefficients.
Standard errors in parentheses.
* $p \leq .05$ (one-tailed tests)

Table 5. Random-Effects Regressions of Income Inequality on Regional Integration and Other Covariates, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>
Economic Integration	.220* (.100)	.212 (.187)	.516* (.260)
Neo-corporatism	10.640 (9.873)		
Neo-corporatism × Economic Integration	-.338* (.153)		
Social Security Transfers		1.073 (.803)	
Social Security Transfers × Economic Integration		-.017 (.011)	
Decommodification			.777 (.567)
Decommodification × Economic Integration			-.018* (.009)
Year	.004 (.049)	.129* (.061)	.161* (.046)
Constant	18.365* (5.910)	9.167 (11.768)	-.757 (15.819)
R ²	.323	.316	.284

Notes: Unstandardized coefficients.
Standard errors in parentheses.
* $p \leq .05$ (one-tailed tests)

Table 6. Fixed-Effects Regressions of Income Inequality on Regional Integration and Other Covariates, 12 Western European Countries, 1973-1997 (n=48)

<u>Variable</u>	<u>Model 1</u>	<u>Model 2</u>	<u>Model 3</u>
Economic Integration	.410* (.145)	.398* (.193)	.588* (.300)
Neo-corporatism	27.215 (16.108)		
Neo-corporatism × Economic Integration	-.521* (.265)		
Social Security Transfers		1.971 (.842)	
Social Security Transfers × Economic Integration		-.028* (.013)	
Decommodification			1.235 (.697)
Decommodification × Economic Integration			-.020* (.011)
Year	.002 (.059)	.073 (.059)	.119* (.048)
Constant	3.510 (9.385)	-3.571 (11.782)	-13.384 (17.780)
R ²	.395	.350	.350

Notes: Unstandardized coefficients.
Standard errors in parentheses.
* $p \leq .05$ (one-tailed tests)