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The Welfare State across Selected OECD Countries: How much does it really cost and how good is it in reducing poverty?

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This chapter argues that the conventional measures of public spending are incomplete measures of welfare state effort. They can be improved upon by accounting for private social spending and the effects that tax systems have on social expenditure: direct taxation of benefit income; indirect taxation of consumption by benefit-recipients; and the award tax breaks with a social purpose. There are significant differences in the extent to which private spending and tax systems affect levels of social support, so accounting for these issues is crucial to international comparisons of the welfare state.

Public and private social expenditure programmes may also have different redistributive effects. However, cross-national differences in redistribution are not just related to individual programme design, but also to the overall level of social spending, and the nature of tax systems. Net spending indicators may give a better idea of “true” levels of social spending they do not cover employer social security contributions and private pension contributions which limit their use for assessing re-distribution in tax/benefit systems. In particular, research on the redistributive nature of employer social security contributions would be a most welcome addition to the expanding areas of social welfare research.

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1. Introduction

1. The welfare state is once again in the spotlight. In the aftermath of the financial crisis that unfolded in 2008/9 public budgets are being reconsidered with an eye on potential savings. Since public welfare spending constitute almost half of general government spending, it is not surprising that social spending programmes are being re-assessed.
 2. But what is social welfare? Is it largely public provided or does the private sector play a role? How is it measured, what is included and what not? Most analyses on the size of the welfare state are based on social expenditure data as on public budgets, and relating this spending aggregate to gross domestic product (GDP) then gives a comparison of the size of welfare states across countries. Such an analysis has many advantages, not least that it allows for a detailed examination of different social spending programmes. But it has its shortcomings: it ignores the effect of tax systems as well as private social spending.
 3. Tax systems can significantly affect the degree to which expenditure budgets reflect true public social effort. In particular, account should be taken of: direct taxation of benefit income; indirect taxation of consumption out of benefit income; fiscal supports to households that are similar to cash benefits; and, tax breaks to encourage individuals and/or commercial and non-commercial entities to provide social support (e.g. through favourable tax treatment of private pension contributions or tax breaks to charities). Accounting for these effects of the tax system on budgetary allocations with a social purpose leads to indicators of net, *after tax*, public social expenditure.
 4. Furthermore, public authorities are also instrumental in generating delivery of social benefits by the private sector. Most directly, governments can mandate individuals to take up certain types of insurance, or employers to provide pension coverage or continued (partial) wage payment in case of sickness. Governments can also
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stimulate private provision of benefits or take-up of insurance through favourable fiscal treatment of such arrangements. In all, through regulation and fiscal stimulation governments affect redistribution within private sector arrangements, thereby enhancing their social nature.

5. Inevitably, the analysis of social expenditure starts with outlining methodological concepts. This section is kept short, and may therefore appear somewhat dense: for more detail the interested reader is referred to Adema and Ladaique (2009). On the basis of new and preliminary data in the *OECD Social Expenditure database* (SOCX), the paper then provides new data on gross public and private social expenditure, and indicators on the effect of the tax system on social expenditure (OECD, 2010a). The different public and private spending measures, as adjusted for the effect of taxation on social spending are then considered in view of poverty outcomes, and the paper concludes with considering the overall effect of tax and cash transfers on the redistributive nature of welfare systems.

2. Setting the scene: what is the social domain?

6. The OECD defines social expenditures as:
“The provision by public and private institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer.”
 7. Since only benefits provided by institutions are included in the social expenditure definition, transfers between households – albeit of a social nature, are not in the social domain (Adema, and Ladaique, 2009).
 8. There are two main criteria which have to be simultaneously satisfied
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for an expenditure item to be classified as social in SOCX. First, the benefits have to be intended to address one or more social purposes. Second, programmes regulating the provision of benefits have to involve either a) inter-personal redistribution, or b) compulsory participation

2.1 Social purposes

9. Expenditures with a social purpose towards circumstances that adversely affect welfare include: *Old-age benefits* – pensions and home-help and residential services for the elderly; *Survivor benefits* – pensions and funeral payments; *Incapacity-related benefits* – disability benefits and services, employee sickness payments; *Health expenditure* – spending on in- and out-patient care, medical goods, and prevention; *Family benefits*³ – child allowances and credits, supports for early childhood care and education⁴, income support during leave, sole-parent benefits; *Active Labour Market Policies* – employment services, training, youth measures, subsidised employment, employment measures for the disabled; *Unemployment benefits* – unemployment compensation, early retirement for labour market reasons; *Housing*⁵ – housing allowances

³ SOCX does not include public supports for married couples, as there is no international consensus on whether marriage support is a social policy objective or not. Such support can be substantial, and in some countries married couples are viewed as the appropriate unit for taxation (OECD, 2006).

⁴ To improve comparisons of public spending on early childhood and education supports, indicators have been adjusted for cross-national differences in the compulsory age of entry into primary school (which vary from age 5 to 7 across the OECD). Expenditures concerns formal supports for children age 0 to and including 5 years of age (OECD, 2010b, *OECD Family database*).

⁵ Rent subsidies are considered social, as is residential support for the elderly, disabled and other population groups (as recorded under Old-age, Incapacity-related benefits, etc.). Mortgage relief for low-income households has some similarities with such programmes. However, it is unclear up to what level of income, or what level of property value, such support should be considered social. Relevant thresholds differ across countries, and, in any case, cross-nationally comparable data is not available. Therefore, mortgage relief and capital subsidies towards construction of housing are not considered here.

and rent subsidies; and, *Other contingencies*, other support measures, including non-categorical cash benefits to low-income households, legal aid, supports towards substance abuse, etc.

10. The detailed recording of spending data in SOCX allow for a thorough assessment of quality whilst limiting the risk of double counting. There remain some gaps in data quality, particularly in areas which are the remit of local government. For example, expenditure data on early childhood care and education services or social assistance benefits in federal countries as Canada and Switzerland are deemed of lesser quality than in most OECD countries.
11. SOCX includes data on the magnitude of private social spending across the OECD, but this data is nevertheless deemed of lesser quality than information on budgetary allocations for social support.

2.2 Compulsion and/or inter-personal redistribution.

12. Expenditure programmes are considered ‘social’ if participation is compulsory⁶ and/or if they involve inter-personal redistribution of resources among programme participants; in other words, if entitlements are not the result of direct market transactions by individuals given their individual risk profiles. The provision of social services (by public authorities and/or non-government organisations) and social insurance and social assistance programmes practically always involves redistribution across households. Such programmes are either financed through general taxation or social security contributions, which lead to the redistribution of resources across the population or within population groups (*e.g.* all members of an unemployment insurance fund).

⁶ In theory, it is possible that public and private pension programmes do not involve redistribution of resources across households, but only over time. However, if participation is compulsory that reflects a policy judgement that coverage of these plans is desirable, and hence, these programmes are considered social.

13. Inter-personal redistribution in private programmes is often introduced by government regulation or fiscal intervention. Governments may force individuals and/or employers to take up protection provisions regardless of their risk-profiles or the prevailing market prices. For example, through risk-sharing (*e.g.* through forcing insurance companies to have one price for both sick and healthy people) public policy can subsidise sick people, and thus ensure redistribution between households. Public fiscal intervention to stimulate private take-up on a collective or individual basis also means that the take-up decision is not fully determined by the individual risk-profile or prevalent market prices (the same holds for social benefits derived from collective agreements or taken out by employers on a collective basis). There is a high degree of similarity between legally-stipulated private arrangements and tax-advantaged plans.

2.3 Public, private social and exclusively private expenditure

14. The distinction between public and private social protection is made on the basis of whoever controls the relevant financial flows; public institutions or private bodies. Public social spending concerns programmes whose financing is controlled by different levels of government and social security funds, as income support payments. All social benefits not provided by general government are considered 'private'.
15. Private social benefits can be categorized in two broad groups. First, there are mandatory private social benefits, including legally stipulated employment-related incapacity-related cash transfers, such as sickness, disability and occupational injury benefits and, pensions derived from mandatory contributions. Second, there is a range of voluntary private social expenditure items, including: social services provided by NGOs, employer-provided income support during child-related leave or sickness, and pensions derived from employer contributions or fiscally advantaged individual contributions (as in the National Accounts, SOCX records pensions

paid to former civil servants through autonomous funds as a private spending item, e.g. Denmark, Sweden and the United Kingdom).

16. Take-up of individual insurance, even with a social purpose, is a matter for the persons concerned, and premiums are based on the individual preferences and the individual risk profile. For example, if someone takes out private pension insurance which is actuarially fair, then there is no *ex ante* redistribution across households. The insurance company sets the price so that the individual can expect to receive back in compensation payments exactly what it costs him or her. Such spending is not considered social, but ‘exclusively private.’ Table 1 summarizes which expenditures are social and which are not.

Table 1: Categorisation of benefits with a social purpose ^{1,2}

	Public		Private	
	<i>Mandatory</i>	<i>Voluntary</i>	<i>Mandatory</i>	<i>Voluntary</i>
Redistribution	Means-tested benefits, social insurance benefits	Voluntary participation in public insurance programmes. Self-employed ‘opting in’ to obtain insurance coverage.	Employer-provided sickness benefits, benefits accruing from mandatory contributions to, for example, pension or disability insurance.	Tax-advantaged benefits, e.g. individual retirement accounts, occupational pensions, employer-provided health plans
No redistribution	Benefits from government managed individual saving schemes		Non tax-advantaged actuarially fair pension benefits	<i>Exclusively private:</i> Benefits accruing from insurance plans bought at market prices given individual preferences.

- (1) By definition transfers between individuals, also when of a social nature, are not considered to be within the social domain.
- (2) The shaded cells reflect benefits that are NOT classified as social.

3. The size of the welfare state: indicators on social spending

3.1 Public social spending before taxation

17. Since 1980, gross public social expenditure has increased from about 16.0% to 20.6% of GDP in 2003/4 before falling back to 20% on average across the 30 OECD countries (Chart 1). Experiences differ across OECD countries, but on average, public social spending-to-GDP ratios increased most significantly in the early 1980s, early 1990s and, again in the beginning of this millennium, when the average public spending-to-GDP increased by almost 1.5% of GDP from 2000 to 2003. Except for Denmark, Ireland, and Sweden, spending-to-GDP ratios were considerably higher in 2007 than they were in 1980 in most selected countries⁷. During the 1980s social spending-to-GDP ratios in Ireland reached 20%, but with sustained GDP-growth outpacing spending increments, spending-to-GDP ratios have oscillated around 15 percentage points until 2008. In 2008/9, the contraction in GDP and the increase in unemployment and social assistance spending will have led to a marked increase of social spending-to-GDP ratios in most OECD countries (Box 1).
18. On average across the OECD, spending on cash benefits (11.3% of GDP) is 3 percentage points higher than spending on health and social services (Chart 2). Public pension transfers to the retired population and survivors at 7.2% of GDP and public spending on health care services at 6.1% of GDP are the largest spending items. By comparison,

⁷ At the time of writing, work on updating OECD gross and net social expenditure indicators was ongoing. The data concern 2007, as estimates on taxation of benefits income become available two to three years after the relevant year. Because of this as well as presentation reasons, in parts of the paper the analysis has been restricted to a limited group of OECD countries, broadly representing the different groupings of welfare systems and the geographical spread of OECD countries. The selected countries included Ireland, the larger European countries, France, Germany, Italy and the United Kingdom, two Nordic countries (Denmark and Sweden) as well as Japan and the United States.

public spending on income transfers to the working-age population is on average considerably lower across the OECD at just over 4.1% of GDP in 2007, while spending on social service other than health is around 2.2% of GDP. Only Nordic countries spend considerable more, because of the comprehensive system of early childhood care and education supports as well as services for the elderly.

19. Cross-national variation in social spending is considerable, in particular for public pension expenditure. Public pension spending is highest in France, Germany and Italy and much lower in the US, Denmark, the UK and Ireland. The reasons for this are many and include: the relative importance of in-kind benefit provision to the elderly (Denmark); low gross mandatory pension benefit replacement rates in Ireland, the UK and the US (OECD, 2009a); the US and particularly Ireland have old-age dependency rates well below the OECD average (OECD, 2009b); and, the relative importance of private pensions (see below).

3.2 Private social expenditure

20. In terms of benefits paid and services delivered private pension payments are the largest private social expenditure item across the OECD area at almost 2% of GDP. Health services covered by private health insurers amount to almost 5.5% of GDP and 1.5% of GDP in France. Employer-provided sick-pay is most important in Germany and Sweden. Social services by NGOs are important, but these organisations are not obliged to report to central agencies. Hence, there is no comprehensive dataset on the magnitude of social benefits provided by NGOs.

Box 1. Austerity measures and family and child policies: an initial overview

Over the years, the unfolding ageing of populations has led to pension reform in many OECD countries. Frequently, such reform involved increasing retirement ages, as part of a more general drive to put pension systems on a more financially sustainable footing (OECD, 2009a).

The financial crisis which started to unfold in 2008 has put welfare programmes under more pressure, although initially many European governments increased the generosity (in terms of eligibility criteria, and/or duration, and/or supplementary payments) of income supports for unemployed low-income families (Richardson, 2010).

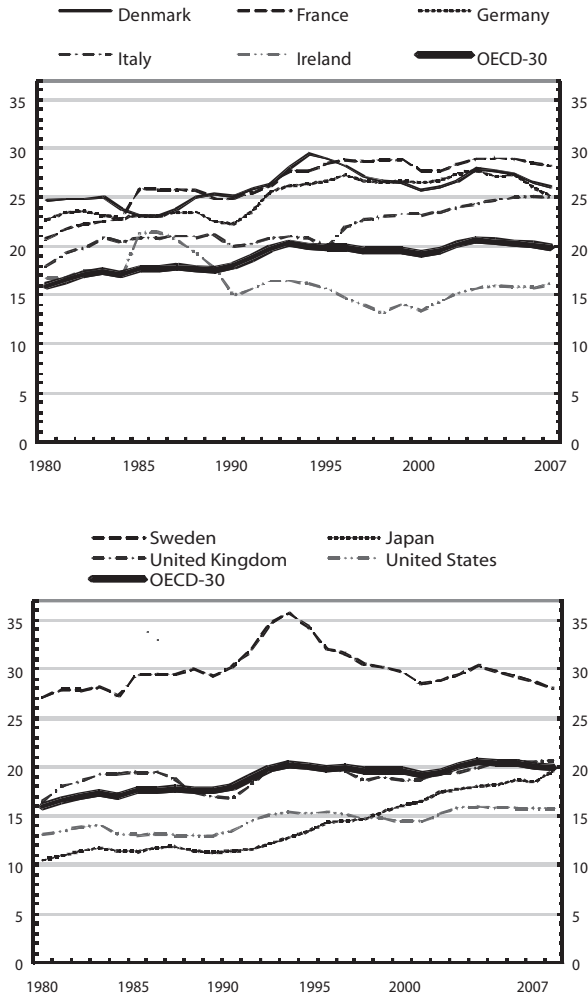
In the area of family policy (including child allowances, fiscal supports for families, income support during leave, and family services including early childhood care and education supports), many European governments are planning austerity measures. Austerity packages have been approved or are under approval in Denmark, Germany, Greece, Ireland, Italy, Portugal, Spain and the United Kingdom. Austerity packages have been announced in Estonia, France, Hungary, Luxembourg, and Slovenia. Discussions are ongoing following elections in Belgium, the Czech Republic, Finland, the Netherlands, the Slovak Republic and Sweden. There are no austerity measures in the family policy area in Poland and Austria; indeed, in Austria family supports were increased in response to the unfolding crisis.

Family policy supports in both Korea and notably Japan are being extended with the aim to support families to have more children (OECD, 2007). In the US the “Recovery Act” included special measures extending family policies to the working poor including in-work benefits and the Earned Income Tax Credit. Australia plans to roll out paid parental leave supports in 2011. Following elections in New Zealand plans to extend free early childhood care and education services to 2-year olds have been shelved, and reform to limit unconditional income support for sole parents to when children are in primary school is being considered.

Thus far, most of the measures are of a temporary nature, the few benefits that have been scrapped altogether include the first child tax break in Estonia, and the baby / maternity / trust fund / health grants in Spain and the UK. Up to now, there has been no reform which added an income or means-test to universal benefits (Richardson, 2010).

Chart 1: Social expenditure has increased significantly since 1980

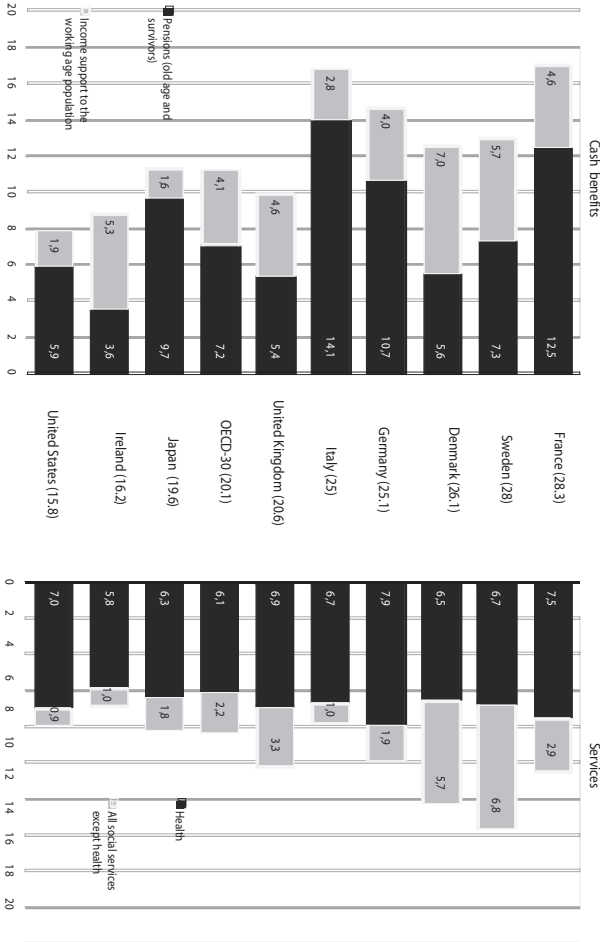
Public social expenditure-to-GDP ratio, 1980-2007, preliminary data



Source: OECD (2010a), *OECD Social Expenditure database*.

Chart 2: In terms of spending are pensions and health the most important social policy areas?

Public social expenditure by broad social policy area, in percentage of GDP in 2007, preliminary data

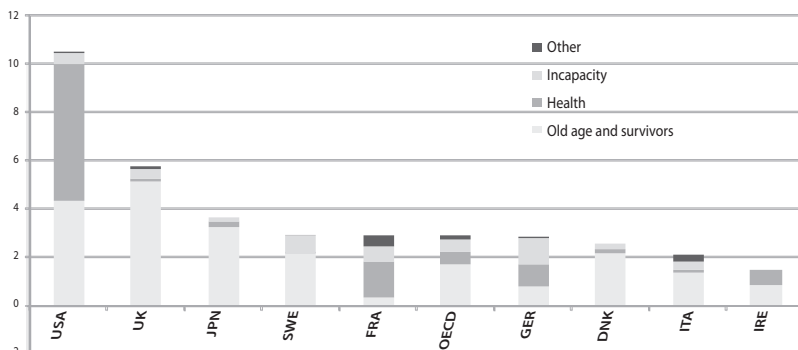


Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on Active Labour Market Programs (ALMPs) cannot be split by cash/services breakdown; they are however included in the total public spending-to-GDP ratios shown in brackets.

Source: OECD (2010a), OECD Social Expenditure database, preliminary data.

Chart 3: Private social expenditure largely concerns pensions across the OECD, but not in France, Germany or the US

Private social expenditure by broad social policy area, in percentage of GDP in 2007, preliminary data



Source: OECD (2010a), OECD Social Expenditure database, preliminary data.

21. Already in the mid-1990s, the value of spending on private pension benefits in Ireland amounted to around 1% of GDP (Hughes and Whelan, 1995). Available data indicate that the spending-to-GDP ratio had not increased much until 2007. This suggests that spending on tax expenditures on pensions (See Table 2 below and Hughes, 2008) is about as high as spending on current private pension payments.

3.3 *The tax system and social spending*

22. Taxation, including social security contributions, is used to finance social support (OECD, 2009c), and the manner in which this is done influences the redistributive effects of tax/benefit systems (OECD, 2008). Tax systems also affect levels of social expenditure, and broadly speaking they do so through direct and indirect taxation of

benefit income, and the provision of social supports through the tax system, so-called tax breaks with a social purpose.

23. There is a range of methodological and measurement issues involved in the estimation of the effects of tax systems on social expenditure. This discussion is not presented here, but can be found in Adema and Ladaïque (2009). For our purposes here, it suffices to say that generally, the quality of estimates on the size of taxation of benefit income and tax breaks with a social purpose is considered lower than the quality of information on public social expenditure.

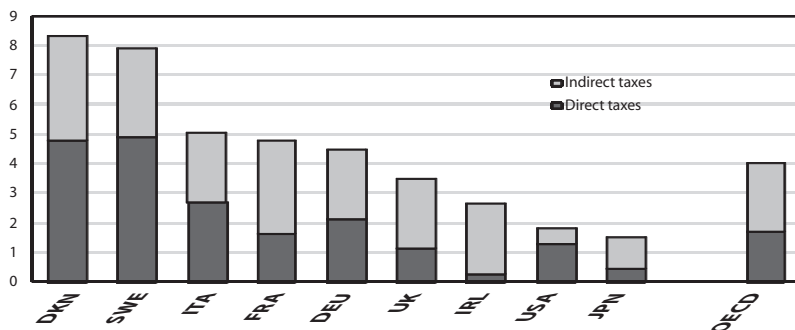
3.3.1. *Clawing back benefit income through direct and indirect taxation*

24. Tax systems are also used to claw back social support in two ways. First, through *direct taxation of benefit income*, Governments levying income tax and social security contributions on cash transfers to beneficiaries. Second, benefit income is provided to finance consumption of goods and services by recipients and consumption is subject to indirect taxation.
25. The extent to which benefit income is taxed varies hugely across countries, and thus affects international comparisons of social support. For example, in Sweden a sole parent with two children on unemployment benefit who previously was on average earnings, pays about 20% of his/ her income to the government through income taxation and social security contributions, whereas unemployment benefit income in Germany and Japan is not subject to taxation (OECD, 2010c). This means that in net terms, i.e. after tax, differences in aggregate spending on unemployment benefits between Sweden and Germany and Japan are not as large as suggested by gross spending indicators. Apart from variation across countries, different benefits are also taxed differently. Child benefits, social assistance and housing support are generally not taxed across the OECD; pensions and income support payments during periods

of child-related leave, sickness and invalidity are often part of taxable income.

26. Taxation of consumption using benefit income is lowest in non-European OECD countries, since indirect tax rates are lower. Adema and Ladaïque (2009) estimated that in 2005, on average indirect tax rates on consumption in Japan (6.6%) and the US (4.3%) were very low compared to Sweden (20.5%), Ireland (21%) and Denmark (25.9%). Consequently, in non-European countries with limited indirect taxation, gross spending levels can also be relatively low to generate the same net income level for benefit recipients in European countries.
27. At just below 5% of GDP at factor cost in 2007, direct taxation of benefit income (including private transfers) is particularly high in large welfare states such as Denmark and Sweden, three times as high as the OECD average at 1.7% (Chart 4). Direct tax on public benefit income is 0.5% of GDP or less in Japan and Ireland. Indirect taxation of consumption out of benefit income is around 3 to 3.5% of GDP in Denmark, France and Sweden, and about 2.5% of GDP in the other selected European countries. In Japan and the US it amounted to 1 percentage point of GDP or less.
28. Taken together, through direct and indirect taxation of benefit income Danish and Swedish Exchequers claw back about 8 percentage points of GDP_{fc}, while this is about 3 to 5 percentage points of GDP_{fc} in other European countries, and less than 2% of GDP_{fc} in Japan and the US.

Chart 4: Benefit income in Denmark and Sweden is taxed heavily



Direct and Indirect tax of benefit income, percentage of GDP at factor costs, 2007, preliminary data

Data for the United States refer to 2005. Data for indirect taxes refer to 2005
 GDP at market prices is the most frequently used indicator on the size of an economy. However, net social spending indicators are better related to GDP at factor cost, because both Net spending indicators and GDPfc are adjusted for the value of indirect taxation. Source: OECD (2010a), OECD Social Expenditure database, preliminary data.

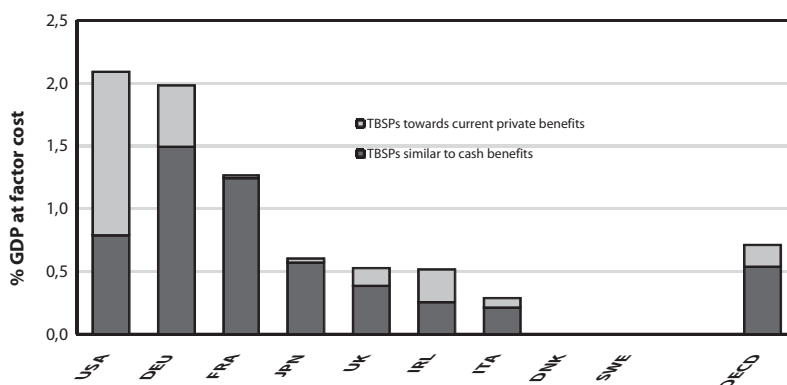
3.3.2. Providing social support through the tax system

29. The tax system can be used to directly provide social support to clients, and this delivery channel is often used to support families with children, most notably in France, Germany and the United States (Chart 5). In Germany in 2007 tax relief for children amounted to EUR 36.6 billion of which EUR 20.9 was off-set against tax liabilities and EUR 15.7 billion paid out in transfer income. Similarly, in 2005, the cost of the Earned Income Tax Credit in the US amounted to USD 43.2 billion, of which USD 5.0 billion off-setting tax liabilities of clients and USD 38.2 billion in cash payments. In many OECD countries, support for families with children is also embedded in the tax unit. In France, fiscal support towards children through a variety of fiscal measures (including the ‘Quotient Familial’) amounted to EUR 13.6 billion in 2007. In all, the role of the

tax system in providing family support was most pronounced in France, Germany and the United States with fiscal benefits towards families amounting to around 1% of GDP^f.

Chart 5: Tax breaks with a social purpose are most important in France, Germany and the US

Tax breaks with a social purpose (excluding pensions), 2007, preliminary data



Data for the United States refer to 2005. Data for indirect taxes refer to 2005
 Source: OECD (2010a), OECD Social Expenditure database, preliminary data.

30. Governments also use the tax system to stimulate the take-up of private protection insurance coverage by individuals and/or employment-related plans. These tax breaks can be categorised in two broad groups. First, there are ‘Tax breaks towards *current* private social benefits’, *i.e.* favourable tax treatment aimed at stimulating the provision of private social benefits in the current year such as voluntary private unemployment coverage or private health insurance. This type of tax break is important in Germany (where about 18% of the population is covered by private health insurance) and, particularly in the US where the exclusion of employer

contributions for medical insurance premiums and medical care amounted to about 1.0% of GDP (Chart 5).

31. Second, there are tax breaks towards pensions. These are important, but there is, as yet, no comparable data set available on the value of tax breaks for pensions. Favourable tax treatment of pensions can be in three different forms: tax exemptions for contributions to private pensions; tax relief for investment income of capitalised pension funds; and tax relief for pension benefits. These three forms of support should be netted out against each other according to a common methodology to facilitate international comparison. However, at present such a data set does not exist. Consequently, the information which is available has been included in Table 2 (below) as a memorandum item. Nevertheless, it is clear that fiscal supports for private pensions are important in Germany, Japan, the United States and Ireland.

3.3.3. *From gross public to net total social expenditure*

32. Considering gross public spending indicators and information on the effects of the tax system on social spending gives an indicator of *net current public social expenditure*. This indicator gives an impression of the real magnitude of budgetary efforts in the social field. Also considering information on private social spending and taxation of such benefit income identifies that proportion of an economy's domestic production to which recipients of social benefits can lay claim: *net total (public and private) social expenditure*.
 33. At about one-third of GDPfc gross public spending is highest in France and Sweden among the countries selected here as well as across the OECD. Gross spending is lowest in Ireland (19%) and the US at 17% of GDPfc.
 34. In most countries, governments claw back more money through direct and indirect taxation of public transfer income than they
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award in tax advantages for social purposes. Hence, net public spending is often lower than gross amounts. But the effect of tax systems varies considerably across countries. For example, in France net public social expenditure, is close to 30% of GDP_{fc}, only 3 percentage points below gross spending levels. This is because direct taxation of benefit income in France is limited, while French policy (as in Germany) also makes intensive use of fiscal supports for families. By contrast, net public social spending is around a quarter of GDP_{fc} in Denmark and Sweden

35. In the United States, gross public spending is actually lower than net public spending, because they tax benefit income at very low rates, but use their tax system relatively intensively to deliver social support directly or indirectly subsidise its private provision.

36. Pulling together all the information on public and private social benefits and the importance of tax systems facilitates comparisons of net total social expenditure. This proportion is highest at 33% of GDP_{fc} in France. Denmark, Germany, Italy, the United Kingdom and the United States all spend about 25 to 29% of GDP_{fc} on social effort. Total social spending is around 24% of GDP_{fc} in Japan and on (a preliminary) average across the OECD. Total social spending is considerably lower in Ireland at 18%, but as noted that does not include an estimate on private pension expenditure. The similarity of net spending levels is driven by including private social spending, particularly in the UK and the US, and the relatively high level of direct and indirect taxation on income transfers and ensuing in European countries vis-à-vis non-European countries

The Welfare State across Selected OECD Countries:
How much does it really cost and how good is it in reducing poverty?

Table 2: From gross public to net total social spending, 2007

Social expenditure, in percentage of GDP at factor cost, 2007, preliminary data

	DNK	FR	GER	IRL	ITL	JPN	SWE	UK	US	OECD
1 Gross public social expenditure	30.7	33.0	28.1	18.9	28.8	21.3	32.9	23.9	17.1	24.3
- Direct taxes and social contributions	3.8	1.6	1.5	0.2	2.5	0.4	4.1	0.3	0.5	1.5
2 Net cash direct public social expenditure	26.9	31.3	26.6	18.6	26.3	20.8	28.8	23.2	16.6	
- Indirect taxes (on cash benefits)	3.0	2.8	2.0	2.1	2.1	0.8	2.5	1.5	0.3	2.0
3 Net direct public social expenditure	23.8	28.5	24.6	16.5	24.2	20.1	26.3	21.6	16.2	
+ T1 TBSPs similar to cash benefits	0.0	1.2	1.5	0.3	0.2	0.6	0.0	0.4	0.8	
- Indirect taxes	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.1	0.0	
4 Net TBSPs similar to cash benefits	0.0	1.0	1.3	0.2	0.2	0.5	0.0	0.3	0.8	
+ T2 TBSPs towards current private benefits	0.0	0.0	0.5	0.3	0.1	0.0	0.0	0.1	1.4	
5 Net TBSPs (not including pensions)	0.0	1.1	1.8	0.5	0.3	0.6	0.0	0.5	2.2	0.6
6 Net current public social expenditure	23.8	29.7	26.4	17.0	24.5	20.6	26.3	22.5	18.4	21.5
7 Gross mandatory private soc. Exp.	0.3	0.4	1.2	0.0	1.8	0.6	0.5	0.9	0.4	0.5
- Direct taxes and social contributions	0.1	0.0	0.4	0.0	0.2	0.0	0.1	0.0		
- Indirect taxes	0.0	0.1	0.1	0.0	0.2	0.0	0.1	0.1	0.0	
8 Net current mand. private soc. exp.	0.1	0.3	0.7	0.0	1.4	0.5	0.3	0.7	0.3	0.4
9 Net publicly mandated soc. exp. [6+8] ^b	24.0	29.9	27.1	16.9	25.8	21.2	26.6	22.8	18.8	21.8
10 Gross voluntary private soc. exp.	2.7	3.0	2.0	1.7	0.7	3.3	3.0	7.8	10.6	2.5
- Direct taxes and social contributions	0.9	0.0	0.2	0.1	0.0	0.0	0.6	0.7	0.6	
- Indirect taxes	0.4	0.1	0.1	0.2	0.0	0.2	0.5	0.7	0.2	
11 Net current voluntary private soc. exp.	1.4	2.8	1.7	1.5	0.6	3.1	1.9	6.3	9.8	2.1
12 Net current private soc. exp. [8+11]	1.6	3.2	2.4	1.5	2.0	3.7	2.1	7.0	10.2	
13 Net total social expenditure [6+12-T2] ^c	25.4	32.9	28.3	18.2	26.4	24.3	28.5	29.4	27.2	23.8
Memorandum items										
TBSPs towards pensions ^d	..	0.0	0.9	1.4	0.0	0.8	0.0	..	0.9	..

Data for the United States refer to 2005. Data for indirect taxes refer to 2005.

GDP at market prices is the most frequently used indicator on the size of an economy. However, net social spending indicators are better related to GDP at factor cost, because both Net spending indicators and GDP_{fc} are adjusted for the value of indirect taxation.

Source: OECD (2010a), OECD Social Expenditure database, preliminary data.

4 Re-distribution of income

4.1. *Social expenditure indicators and income poverty*

37. Considered together the social expenditure and income poverty outcomes (as measured in terms of disposable income) provide an indication of the redistributive power of social expenditures. Chart 6 shows poverty rates as cross-plotted against gross public social expenditure (Panel A); gross private social expenditure (Panel B); net public social expenditure (Panel C) and net total social expenditure (Panel D) using preliminary data on income poverty (based on EU-SILC for EU countries) and social expenditure for 26 OECD countries.⁸
38. The picture emerges that gross public expenditures are effective in reducing poverty, while private social expenditures have the opposite effect. Furthermore, once account has been taken of the effect of taxation on benefit income and tax breaks with a social purpose, the linkage between net public social spending and poverty is much smaller than for gross spending, and almost disappears when net total social expenditures is considered (see also Castles and Obinger, 2007; Goudswaard and Caminada, 2009; and, Caminada, Goudswaard and Koster (2010)).⁹

⁸ Outcomes for Korea and Mexico have been excluded from the analysis here for reasons of robustness. These are countries with relatively low public spending and above average poverty rates (Chile would be similar) and are thus statistical outliers.

⁹ These four indicators of social expenditure can also be linked with indicators on poverty reduction (differences in poverty rates at market income and poverty rates at disposable income) or indicators on the reduction of inequality (the Gini coefficient measured at market prices and the Gini-coefficient at disposable income) and generate similar results (not reported here). Gross public social spending reduces further poverty reduction and reduces inequality, with weaker effects for net public and total social expenditure, while private spending as measured here, is associated with reduced poverty reduction and reduced income inequality. However, it seems inappropriate to link private social spending and changes in poverty and income inequality at market income and disposable income, as private transfers are included in market income, and thus do not affect the difference between market income and disposable income in the way public spending does.

Chart 6: Income poverty and different indicators of social expenditure

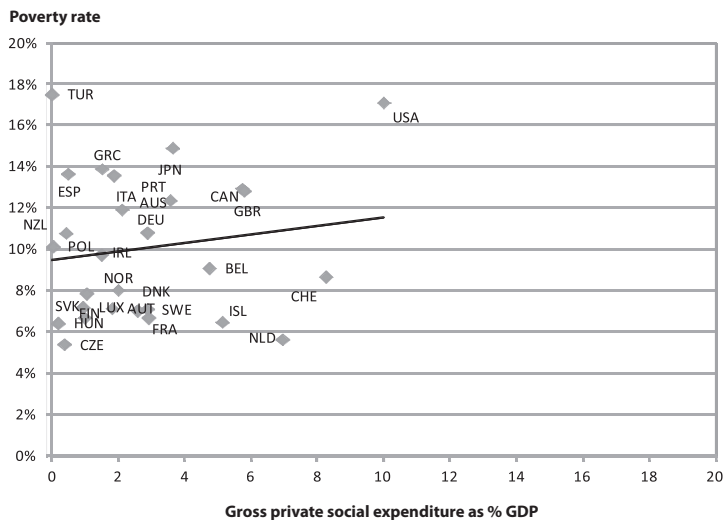
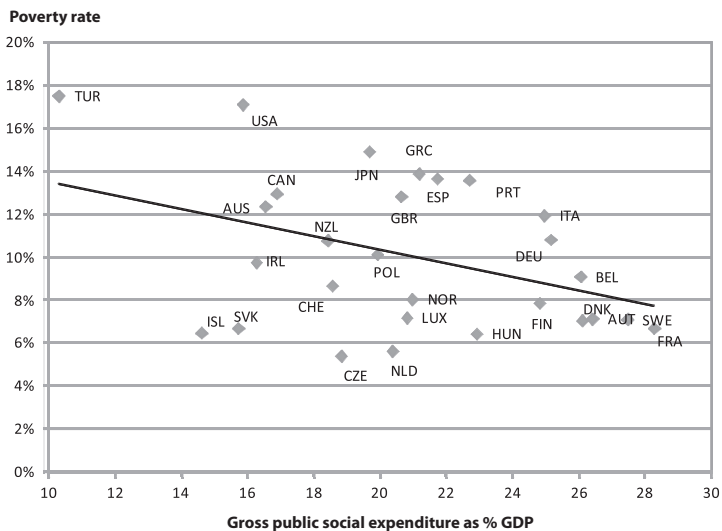
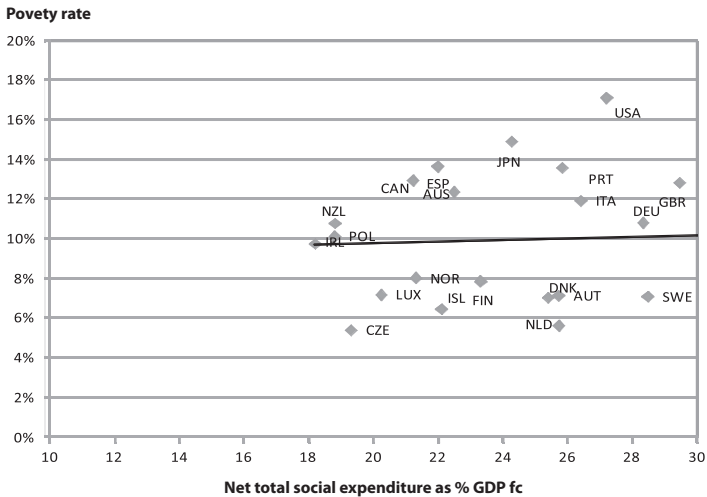
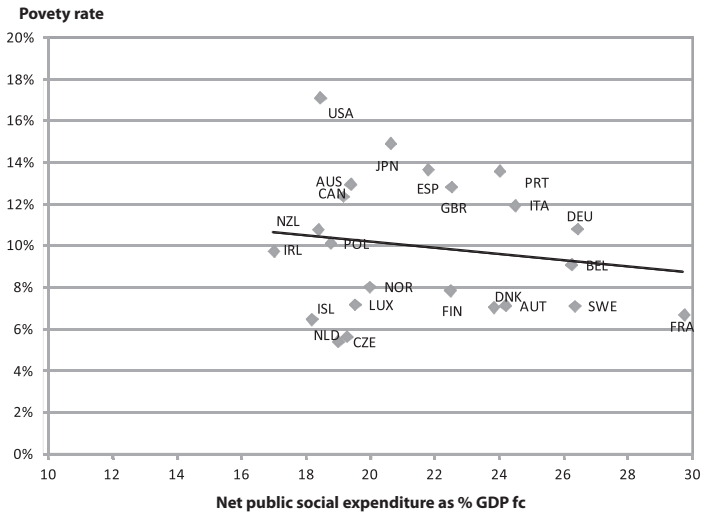


Chart 6: Poverty and different indicators of social expenditure
(continued)



The income poverty rate is measured against the usual threshold of 50% of median equivalized household income.

Source: EU-SILC and preliminary OECD data on poverty and income distribution and social expenditure.

39. Poverty indicators are income-based and are limited in the sense that they do not account for differences in access to services across the population. That is a drawback, but not one which invalidates the use of poverty rates. However, there are different items that are not covered in the indicators of social expenditure whose omission is likely to affect the results, including (see Adema and Whiteford, 2010, for more detail):
- Private social spending by charities: more comprehensive data on such spending would enhance the distributive effect of private spending.
 - Personal income tax and social security contributions by workers not in receipt of benefit income, are not covered in the analysis.
 - Employer social security contributions are not covered in the calculations; these are insignificant in Denmark while they account for more than a quarter of tax revenue in France (OECD, 2009c).
 - Employer contributions to pension and other employer-provided supports are not covered.

Household surveys are used to look at how broad categories of public transfer income are allocated to households across the income distribution, although often not on a programme by programme basis. However, employer contributions to public and private social benefits are not covered by these surveys, and little is therefore known about their redistributive effect on household incomes.

4.2 Taxes and public cash transfers

40. Considering the effect of tax and public cash transfer systems, rather than social expenditure levels, is a better, though imperfect (see below), way of looking at the redistribution of resources in societies.
41. Table 3 illustrates the nature of redistribution towards people in the lowest quintile of the income distribution, and does so by separately identifying the role of gross public transfers (the first three columns)
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and then taxes and social security contributions (data for 2007/8 is not yet available). The role of cash transfers in supporting the income of people in the bottom quintile is computed by first estimating the average ratio of cash transfers as a percentage of household disposable income measured in income surveys (Column A); second, by calculating how much of this share goes to the poorest 20% of the population (Column B); and finally, by multiplying the size of spending by the progressivity of its distribution to calculate gross benefits accruing to people at the lower end of the distribution (divided by 100, in Column C). The same procedure is used to calculate how much tax is paid by people at the lower end of the distribution, while the difference between the two values (in Column G) represents the “net” cash transfers to the lowest income quintile.

42. The results in Table 3 include:

1. Further evidence corroborating the finding that Anglophone countries pay less generous transfers, place a limited tax burden on low-income families, and in these countries the value of the public transfers to people in the lowest quintile (Column C) is at least 15 times that of the household taxes they pay (Column F). By contrast, Denmark and Sweden transfer large amounts of gross benefits to low-income people but also levy a significant amount of household taxes on them.
2. Public cash transfers are more targeted to the poorest 20% of the population in Denmark, Ireland and the United Kingdom (where the lowest income quintile receive more than 30% of all transfers, and; in this sense the level of targeting is roughly similar in Sweden, and the United States).
3. There are large differences in the overall size of the redistribution towards low income households: this ranges from almost 6% of household disposable income in Denmark and Sweden, to values of around 2% in Japan and the United States (Column G).

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Table 3: Denmark, Ireland and Sweden are successful in transferring public social spending to low-income groups

Redistribution through cash transfers and household taxes towards low-income groups, mid-2000s

	Gross public transfers paid to households			Direct taxes and social security contributions paid by households			G. Net transfers to lowest quintile (C-F)
	A. Average ratio of household disposable income	B. Share of public transfers paid to lowest quintile	C. Transfers to lowest quintile (A*B/100)	D. Average ratio of household disposable income	E. Share of taxes paid by lowest quintile	F. Taxes from lowest quintile (D*E/100)	
Denmark	25.6	36.0	9.2	52.5	6.1	3.2	6.0
France	32.9	16.2	5.3	26.0	5.6	1.5	3.9
Germany	28.2	17.4	4.9	35.5	2.1	0.7	4.2
Ireland	17.7	30.8	5.4	19.4	0.9	0.2	5.3
Italy	29.2	12.6	3.7	30.2	1.8	0.6	3.1
Japan	19.7	15.9	3.1	19.7	6.0	1.2	2.0
Sweden	32.7	25.9	8.5	43.2	6.5	2.8	5.7
United Kingdom	14.5	31.4	4.6	24.1	1.7	0.4	4.1
United States	9.4	24.8	2.3	25.6	1.6	0.4	1.9
OECD-23	22.0	24.4	5.4	28.3	4.2	1.2	4.2

Note: Values in Columns A and D are the ratios of public transfers and household taxes, respectively, in the disposable income of the entire population; Columns B and E show the shares of public transfers and household taxes received and paid, respectively, by people of the bottom quintile of the population. Data refer to the mid-2000s for all countries.

Source: OECD (2008), *Growing Unequal?*

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43. Thus, redistribution as measured in Table 3 depends on size of spending, the targeted nature of the social protection programme, and the progressivity in the tax system. Table 3 underestimates redistribution in Denmark and Sweden as it does not capture the redistributive effects of tax-financed provision of social services to different population groups. And Chart 2 showed that both these countries spend much more on public social services for the elderly, and early childhood care and education facilities for families of working age than the other countries (and most other OECD countries).

5. Conclusions

44. Conventional measures of public spending are incomplete measures of welfare state effort. They can be improved upon by taking account of private social expenditures which are legally mandated or financially stimulated by government intervention. Furthermore, account should be taken of: tax advantages for social purposes (*e.g.* child tax allowances); direct taxation of benefit income; and indirect taxation of consumption by benefit-recipients.
45. There are significant differences across countries in the extent to which social policy goals are pursued through the tax system or in the role of private provision within national social protection systems. These differences point to substantial variance in the redistributive nature of social systems. Some private social programmes may generate a more limited re-distribution of resources than public ones, and tax advantages towards private pension and health plans are more likely than not to benefit the relatively well-to-do. Private employment-related social benefits mostly re-allocate income between the (formerly) employed population, and the same holds largely true for fiscally-advantaged individual or group retirement plans. Cross-national differences in redistribution are not just related to individual programme design, but also to the overall level of social spending. Income re-distribution
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in a high public spending country such as Denmark tends to be larger than in, for example, the US, where private social spending plays a much more substantial role.

46. Although net after-tax measures of social expenditure give a better idea of levels of social effort, important items are missing from the net spending framework, which limit their use for assessing redistribution in tax/benefit systems. Arguably, most important is the lack of good information on employer social security contributions and private pension contributions and their redistributive effect, and innovative studies in this regard would be a very welcome contribution to social research.
47. Finally, the financial crisis which started to unfold in 2008 will exert further pressure on social spending. Initially, many countries extended income supports to help those affected by the crisis, but in an increasing number of European countries austerity packages are being introduced that will limit access to social welfare provisions. The challenge will be to cut smartly and spend wisely: public welfare programmes will be re-assessed on their efficiency in providing support to people, supporting people of working-age back to work and investing in human capital the moment it matters most.

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