

Social Income Transfers and Income Poverty Alleviation in the EU and in the USA: An Empirical Analysis of Effectiveness of Poverty Reduction.



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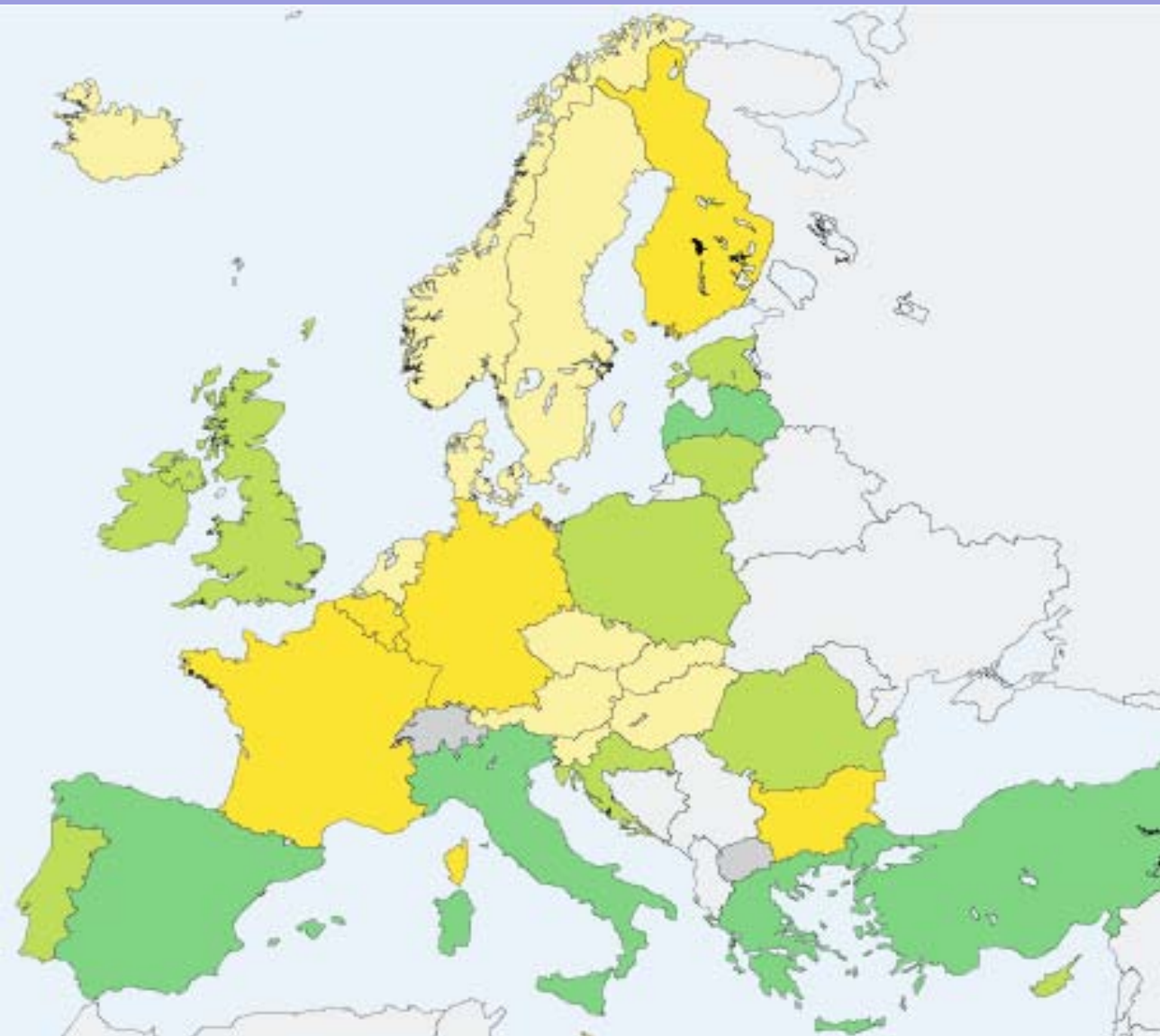
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Seminar Institute for Research on Poverty
Madison-Wisconsin, May 14th, 2009

Universiteit Leiden. University to discover.

At-risk-of-poverty rate after social transfers (PL 60), 2007



Poverty rate EU15:

PL 40 = 5

PL 50 = 10

PL 60 = 17

PL 60 → EU25 = 16

PL EU60 = 22.5

Poverty line:

PL EU = 60

PL USA = 25

Poverty rate USA

2004 (LIS / OECD):

PL 40 = 11

PL 50 = 17

PL 60 = 24

10-12

12-15

15-19

19-26

Background (1)

Research embedded in Europeanization literature.

EU Millennium Goals:

(1) Economic Performance

(2) Social Inclusion

- Targets agreed upon
- Social Inclusion - A set of Social Indicators
- Among them: Poverty (breakdown age / gender)
- Formal protocol measuring social indicators
- Benchmarking – best practices -mutual learning
- Open Method of Coordination – Soft Law

Background (2)

USA: New York Times, Sunday May 9th, 2009

“Variations in Government Aid Across the Nation”

Social programs that reach some and reject others, often for reasons of geography rather than differences in need.

<http://www.nytimes.com/interactive/2009/05/09/us/0509-safety-net.html>

The States Safety Net ↔ Federal Coordination:

- Targets agreed upon?
- Social Inclusion - A set of Social Indicators?
- Formal protocol measuring social indicators
- Benchmarking – best practices -mutual learning?
- Open Method of Coordination – Soft Law?

Background (3) – Agenda

1. Impact of European integration on social protection – convergence or divergence?
2. Are (high) levels of social expenditures and (high) poverty rates related (OECD-setting)?
 - public expenditures
 - private arrangements
3. Best-practices of poverty reduction in EU15 – comparison with other OECD countries

Comparative analyses – reforms – social indicators – EU – empirical analysis

Part I: Patterns of Welfare State Indicators in EU

- Traditional hypothesis: economic integration leads to improvement and convergence of social protection systems in member states (Treaty of Rome)
- 'Modern' hypothesis: economic integration leads to migration flows and policy competition which will lead to a social race to the bottom (Sinn and others)

EU social policy

- Convergence of social protection systems is an explicit EU-objective
- Lisbon Agenda: greater social cohesion
- Open Method of Coordination is used to achieve convergence and improvements with respect to social cohesion → social indicators, such as poverty rates

Note: OMC = soft law

Earlier research

- Since 1980's higher protection levels, especially in Mediterranean countries, and a quite strong convergence → no clear signs of a social race to the bottom
- Most studies use social expenditure ratios as welfare state indicator
- However, this indicator may not be representative for the welfare state at large

Framework empirical analysis (1)

- Variety of welfare state indicators
 - Social expenditure ratios, controlled for differences in taxes, private social benefits, demographics and unemployment
 - Social expenditures at program level
 - Replacement rates of benefits
 - Poverty indicators (EU and OECD)

Joint work with Kees Goudswaard and Olaf van Vliet , Journal of Common Market Studies (forthcoming, 2009)

Framework empirical analysis (2)

- σ - and β -convergence tests
 - σ_1 = standard deviation, σ_2 = coefficient of variation
 - β -convergence: negative correlation between initial level and growth rate (of social protection levels) (cf. Sala-i-Martin, Barro)
- Convergence tests for EU and larger group of OECD-countries

Results

Indicator	Classification	Time Period	Improvement	Finding
Gross total public social expenditure	Macro level	1980-2003	Yes	Convergence, especially within EU
		1985-2003	-	Beta convergence of EU-15
Net total social expenditure	Macro level	1995-2003	No	Divergence within EU
Expenditure on different social programs	Program level	1980-2003	Yes (most)	Convergence of most social security functions
Replacement rates of unemployment benefits	Individual	1981-2005	Yes	Convergence, especially within EU
Net social assistance levels	Individual	1992-2001	No	No convergence
Poverty rates after social transfers	Individual	1995-2005	Yes	Weak convergence (Eurostat)
		1985-2000	No	Divergence (OECD poverty rates)
		1985-2000	Yes	Convergence, less within EU (OECD poverty gap)

Convergence?

- Convergence of public social expenditure, but not in recent years
- Several other welfare state indicators provide mixed evidence: convergence not obvious
- EU social initiatives not very effective yet, especially as far as poverty is concerned

Part II

Welfare state effort and poverty

- Background

- European objective / Lisbon Agenda
- EU15: 17 percent lives in poverty
- Poverty rates have risen since 2000

- Persistence of poverty calls for an explanation

- Why is there still sizable poverty?
- Some countries are more effective: why?
- What can explain cross-country differences in effectiveness?

Our focus: impact of income transfers on poverty

Policy strategies to combat poverty

- Education
- Job opportunities
- Labor force participation
- Health care
- **Income transfers (policy)**
- Et cetera

Research design

- Cross-country analysis (EU15, OECD28)
- Measuring poverty incidence
 - Official EU-indicator: EU-SILC: 60% threshold
 - OECD: 50% threshold (40% and 60%)
 - LIS: 40%, 50%, and 60% threshold
- Measuring social effort / expenditure
 - Gross public versus Net public
 - Capturing of private social arrangements

Research design (continued)

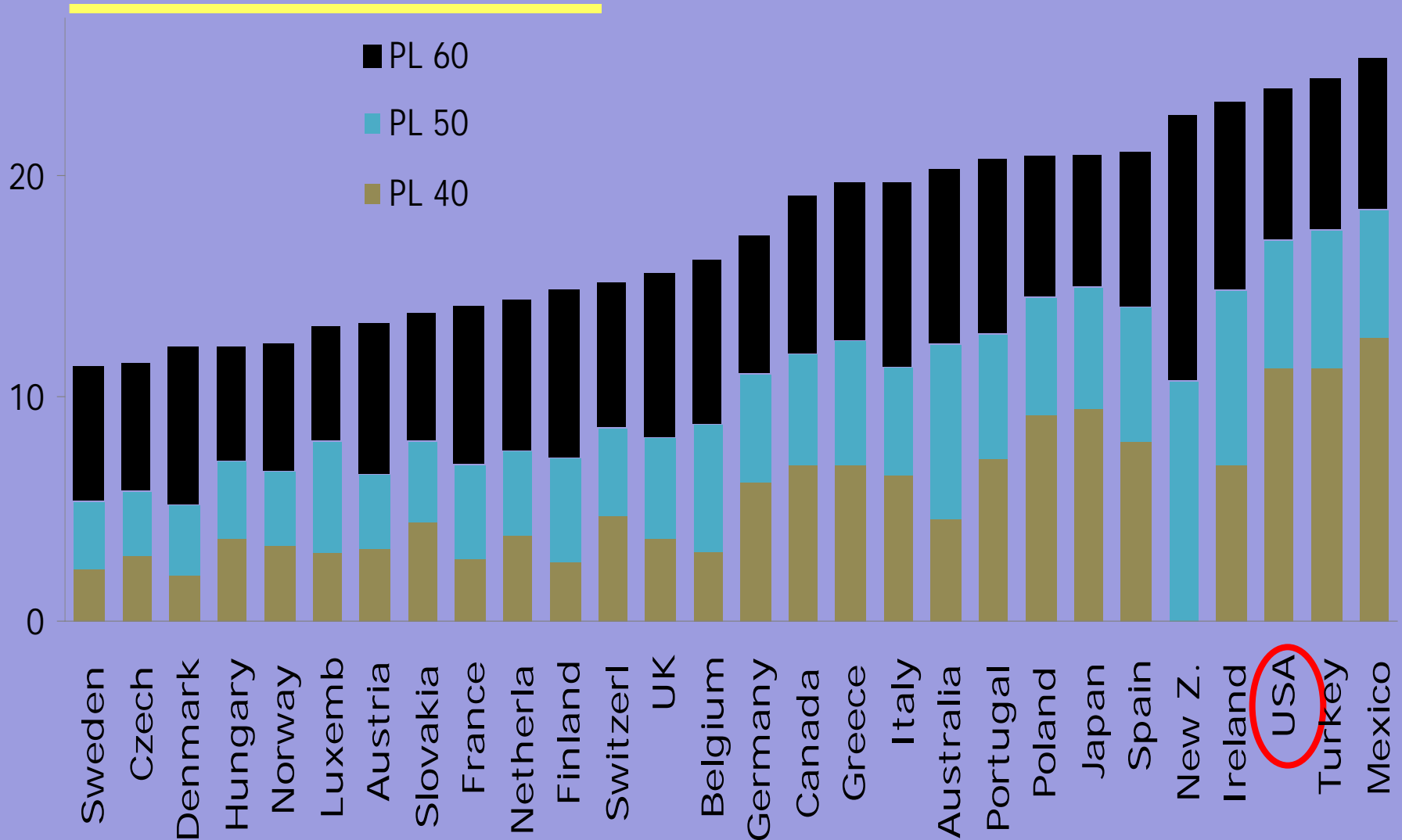
- Measuring effects of taxes and transfers
 - Pre-tax-transfer poverty
 - Post-tax-transfer poverty
 - Absolute antipoverty effect
- Linkages social protection $\leftarrow \rightarrow$ poverty
 - Step 1: Are high social expenditure rates associated with low poverty rates?
 - Step 2: Antipoverty effect taxes and transfers
 - Step 3: Social policy areas (children and elderly)

Research design (final)

- Focus on social expenditure
 - Familiar claim: higher social expenditures goes along with lower poverty levels and higher antipoverty effects across countries
- Remarks
 - Controversial debate: absolute or relative poverty?
 - Comparative analyses are rather sensitivity for data source, income concepts, equivalence scales, poverty lines (thresholds), etc
 - Literature study / References

Poverty Rates, 2003-2005

from OECD (2008)



Welfare state effort and poverty levels

High social expenditure, low poverty?

A: Indicator

- Gross public social expenditure: traditional
- Gross total social expenditure: impact of private social arrangements
- Net total social expenditure: impact of tax system

B: Data source: OECD / LIS

C: PL applied: 40, 50, 60

Private social expenditures

- Most analyses of social protection are focused on public programs, but social policy is not restricted to the public domain
- All kinds of private arrangements are substitutes to public programs
- OECD has developed a data set on private social expenditures

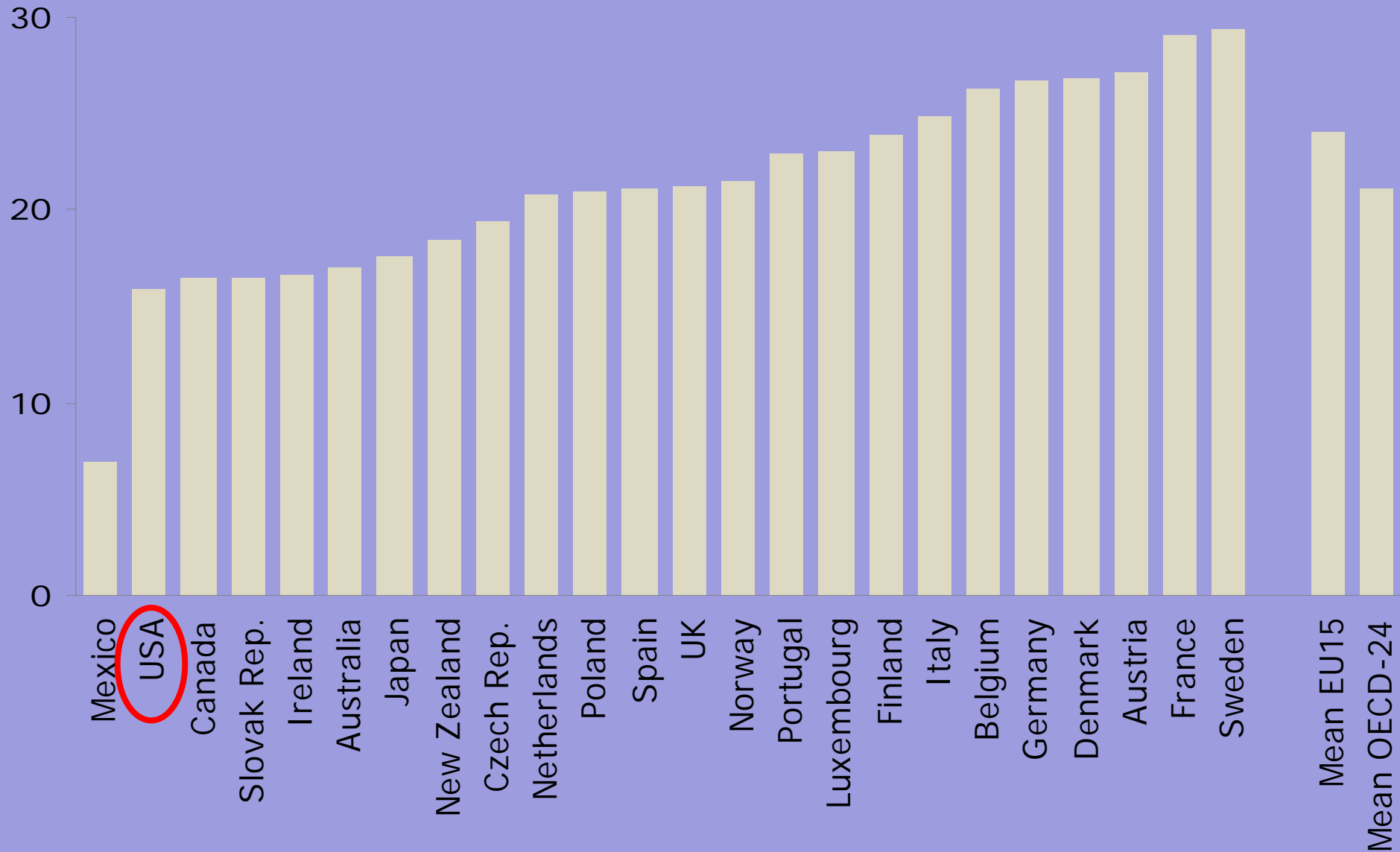
Definition

- Programs with a social purpose
- Programs which contain an element of redistribution
- Government involvement: compulsory participation or regulation or tax support

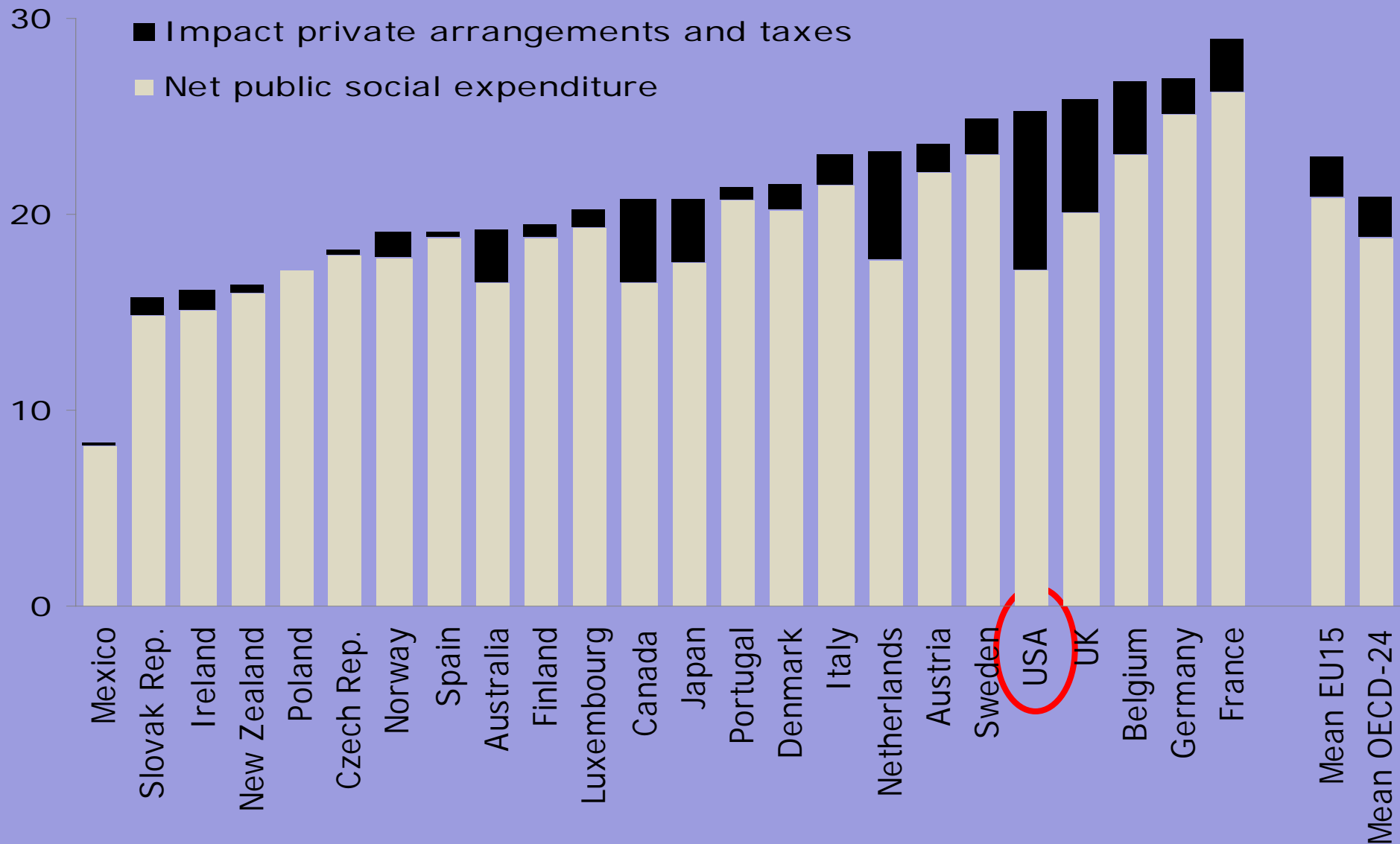
Examples

- Supplementary employment-based pension plans (mandatory contributions, tax advantaged)
- Private health insurance, but with legal stipulations
- Supplementary disability benefits (agreed upon in collective negotiations)
- Obligations for employers to provide sickness benefits

Public social expenditure, % GDP, 2005



Net public *and* private social expenditure, % GDP, 2005



Trend Private Social Expenditure, 1985-2005

	<i>1985</i>	<i>1995</i>	<i>2005</i>		<i>1985</i>	<i>1995</i>	<i>2005</i>
Hungary		0.0	0.1	Norway	0.9	1.7	2.1
Mexico		0.1	0.2	Denmark	1.3	2.4	2.6
Czech Rep.		0.1	0.3	Sweden	1.1	2.4	2.8
New Zealand	0.1	0.5	0.4	France	0.7	2.0	3.0
Spain	0.2	0.3	0.5	Germany	2.8	3.1	3.0
Slovakia		0.6	1.0	Australia	0.7	4.5	3.7
Finland	1.0	1.3	1.1	Japan	0.4	0.4	3.8
Luxembourg			1.1	Belgium	0.9	2.1	4.5
Ireland	1.6	1.7	1.3	Canada	2.3	4.4	5.5
Greece		1.9	1.7	UK	4.6	6.7	7.1
Austria	2.3	2.1	1.9	Netherlands	4.9	6.8	8.3
Portugal	0.9	1.1	1.9	Switzerland	3.0	7.6	8.4
Italy	0.9	4.1	2.1	USA	6.3	8.4	10.1

Why more private?

- Welfare state reforms, public budget cuts
- Ideology / type of welfare state
- Efficiency gains (private providers have stronger incentives to reduce costs)
- Other

Redistributive impact?

- Private employment-related social benefits mostly re-allocate income between the (formerly) employed population
- Tax advantages towards private pensions and health plans are more likely to benefit the rich
- Expectation: private schemes will generate less redistribution
- Cross country linkage: poverty rates \leftrightarrow social expenditures, around 2005

Correlation tests across countries

- Coefficient estimated using a linear OLS regression model of cross-sectional data
- Form: $Y_{i,t} = A + \beta X_{i,t} + u_i$

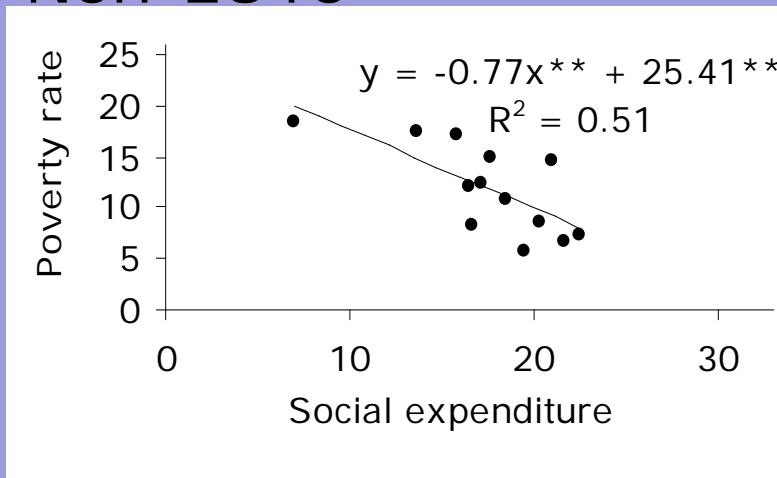
$Y_{i,t}$ = level poverty indicator of country i at time-period t

$X_{i,t}$ = level of social expenditure as percentage of GDP in country i at period t

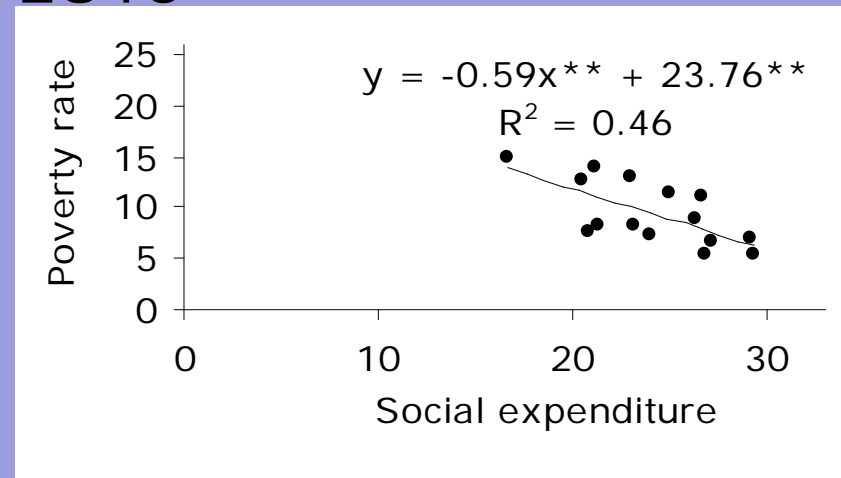
u_i = disturbance term

Linkage **gross public** social expenditure and OECD poverty rates (PL 50), 2003-05

Non-EU15



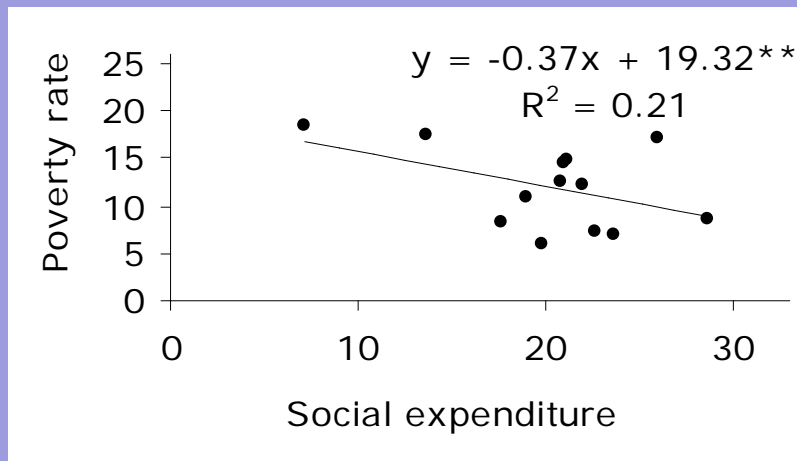
EU15



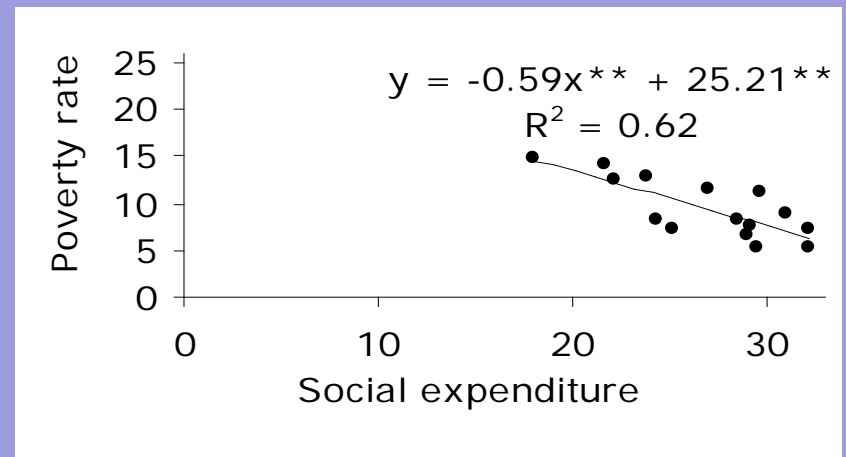
- All 28 countries: **
- PL 40 and PL 60: same results
- LIS 24 countries: same results
- Mid-1980's and mid-1990's (OECD24): same results

Linkage gross public **and private** social expenditure and OECD poverty rates (PL 50), 2003-2005

Non-EU15



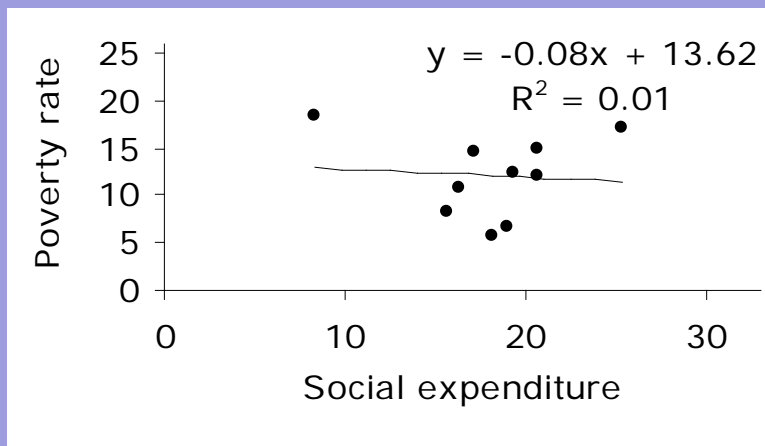
EU15



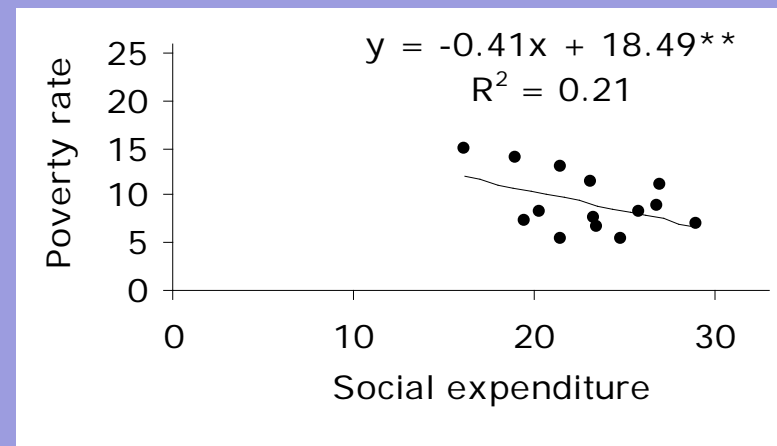
- All 28 countries: **
- PL 40 and PL 60: same results
- LIS 24 countries: similar results
- Mid-1980's and mid-1990's (OECD24): same results

Linkage **net** total social expenditure and OECD poverty rates (PL 50), 2003-2005

Non-EU15



EU15



- All 28 countries: PL 40*, PL 50*, PL 60 (0)
- LIS 24 countries: not significant in all cases
So separately for non-EU15 and EU15: same results
- Mid-1980's and mid-1990's: lag of data

Summary: R² and significance (LIS)

	Non-EU15 countries	EU15 countries	All countries
<i>Gross public</i>			
- PL40, LIS data	0.631 **	0.367 *	0.467 **
- PL50, LIS data	0.580 **	0.467 **	0.413 **
- PL60, LIS data	0.533 *	0.429 *	0.365 **
<i>Public and private</i>			
- PL40, LIS data	0.107 --	0.483 **	0.237 *
- PL50, LIS data	0.097 --	0.617 **	0.216 *
- PL60, LIS data	0.069 --	0.520 **	0.164 *
<i>Net total</i>			
- PL40, LIS data	0.013 --	0.138 --	0.146 --
- PL50, LIS data	0.007 --	0.211 --	0.126 --
- PL60, LIS data	0.002 --	0.172 --	0.089 --

Multiple tests across countries

- Linear OLS model of cross-sectional data
- Form: $Y_{i,t} = A + \beta X_{1i,t} + \dots + \epsilon X_{ni,t} + u_i$

$Y_{i,t}$ = poverty rate country i at time-period t

X_1 = gross total social expenditure ratio

X_2 = ratio of the elderly population

X_3 = unemployment rate of total labor force

X_4 = GDP per capita \$ (current prices and PPS)

Tests for mid-1980's, mid-1990's and mid-2000's

Multiple tests across countries

	1985	1995	2005
• X1 is taken into account:			
- gross total expenditure	**	**	**
- 65+ (% population)	0	0	0
- unemployment rate	*	0	0
- GDP per capita	0	0	0
• Without X1 → partial effects:			
- 65+ (% population)	*	0	*
- unemployment rate	0	0	0
- GDP per capita	0	0	0
• Multicollinearity			
• Results are rather steady over time (1985, 1995 and 2005)			

Social spending driving force as far as differences in poverty levels across countries concerned?

Multidimensional approach poverty

- Complex undertaking (Haveman, 2008)
- Main difficulty: estimation of interaction between dimensions of poverty. One has to define a list of attributes to be taken into account and decide how much weight to give to each of these dimensions.

Multidimensional approach poverty

- Thorbecke (2007, p. 17-18): "It should be clear that a complete mapping of combination of attributes into the utility space appears daunting, if not altogether utopian." "..., there are too many unresolved questions left over to consider seriously using multidimensional measures in any truly operational sense."

On this: Kakwani and Silber (2007 and 2008)

Summary of findings Part II

- Correlation poverty and social spending

	Non-EU	EU	All
– Gross public	---	--	---
– Public and private	0	--	--
– Net total	0	0	-/0

- Familiar claim (higher social expenditures goes along with lower poverty levels) must at least be toned down
- A shift from public to private social arrangements – as we've seen in some countries - implies less redistribution → Effect on poverty alleviation?

Antipoverty effectiveness of social spending – Part III

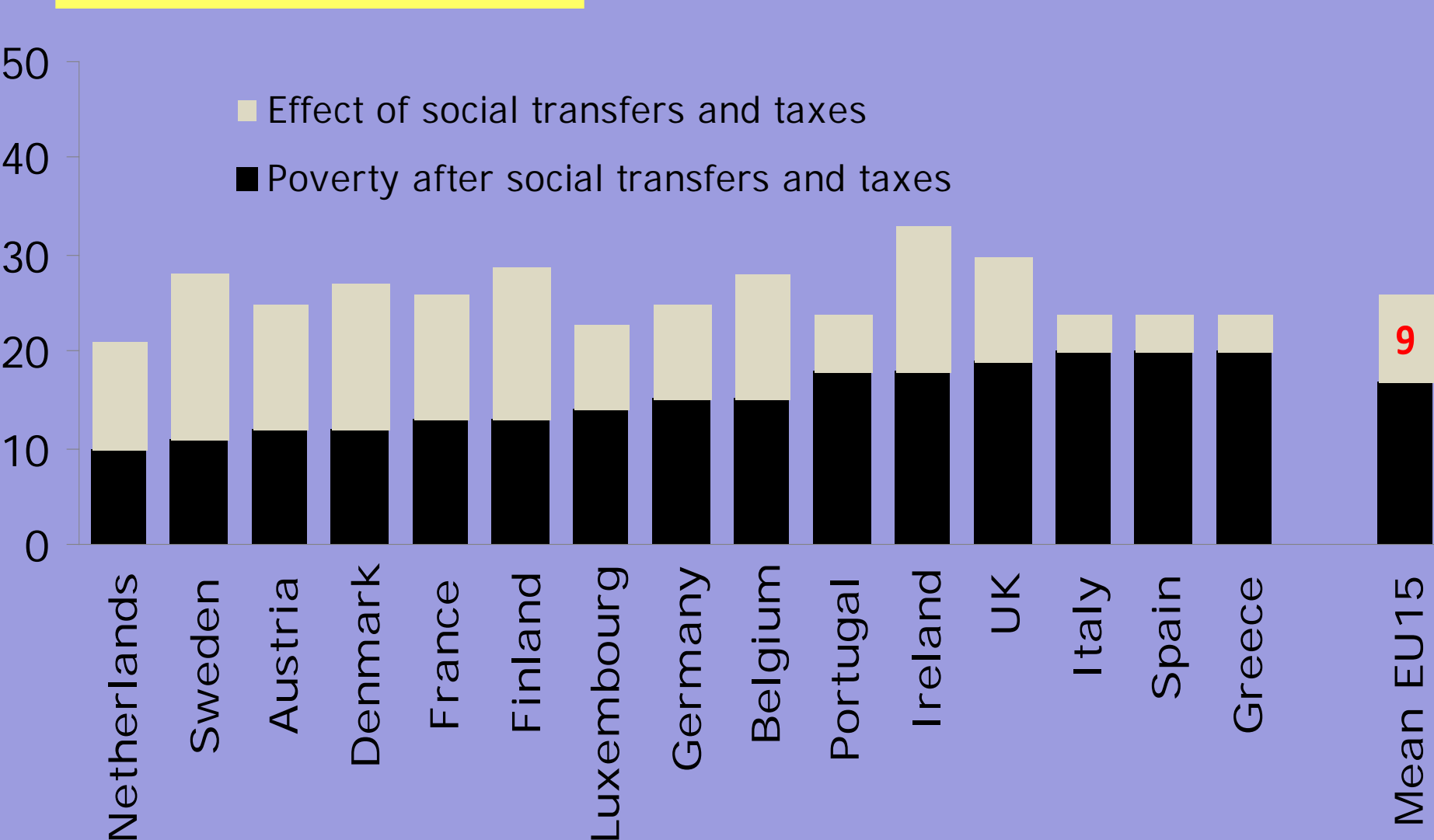
Standard approach:

- Market income versus disposable income
- Antipoverty effect social transfers and taxes =
 - (a) pre-tax-transfer poverty –/-
 - (b) post-tax-transfer poverty
- Targeting effect (antipoverty effectiveness):
poverty reduction per percentage point social spending GDP
= [(a) – (b)] / social spending % GDP

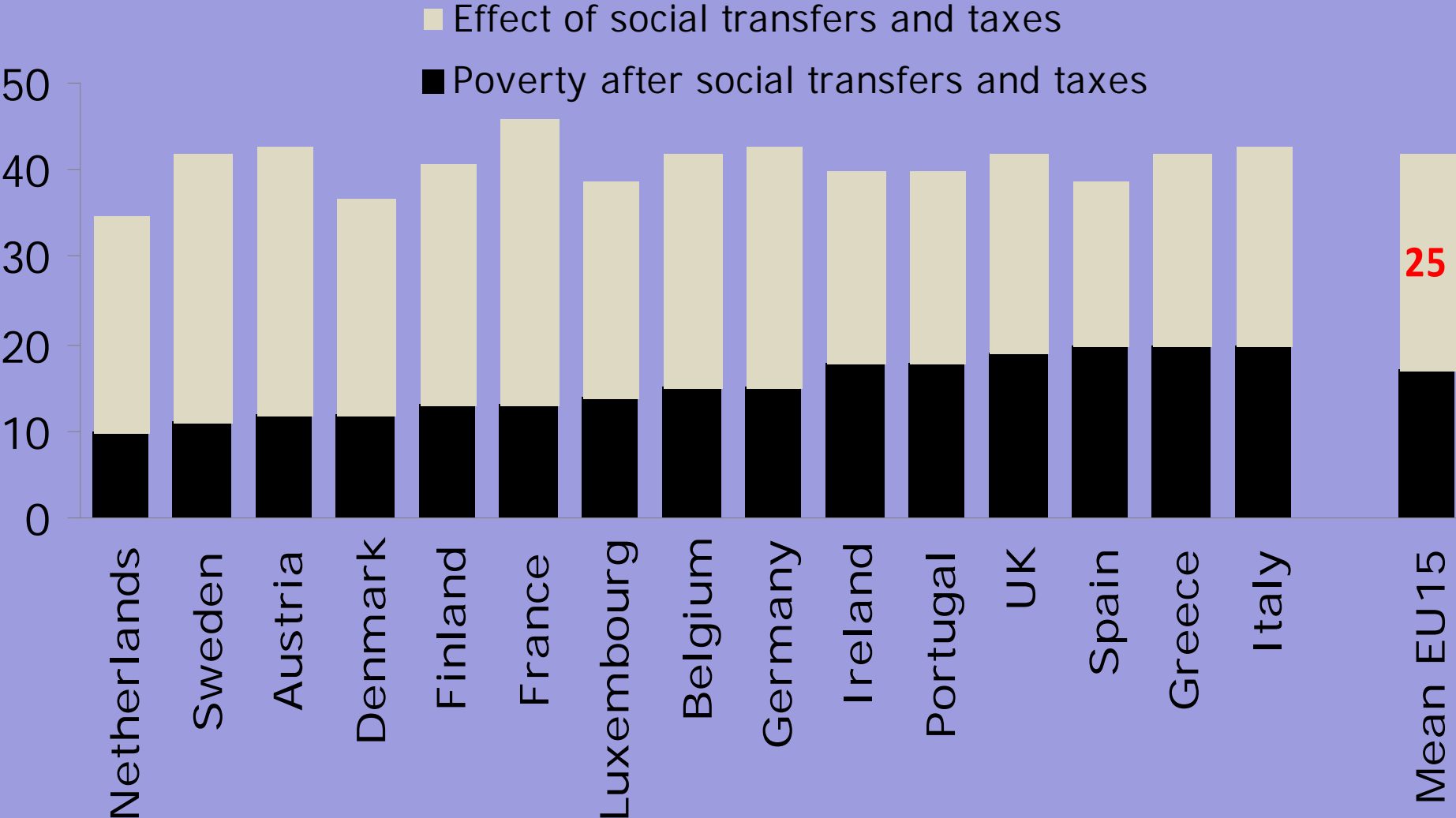
Broadening the standard approach

- Framework Musgrave et al(1974) and Ringen (1987), i.e. statutory or budget incidence analysis. Behavioral responses are ignored. Recent application OECD (2008).
- Special feature: treatment of pensions. Public versus private pension plans, and their antipoverty effects through transfers and taxes (contributions) *at one moment in time*.
- Overcoming this bias (pragmatically) by broadening the framework. We also compute the antipoverty effect of taxes and social transfers *other than pension*. Recent data of Eurostat allow such a (new) approach.

Total population: Antipoverty effect transfers and taxes, EU15, 2007



Total population: Antipoverty effect transfers and taxes, EU15, 2007



Targeting effect of social expenditures on poverty reduction in the EU

	Poverty rate (PL 60), 2007			Net social expenditure 2005 (d)	Targeting effect	
	Before (a)	Before (b)	After (c)		(a-c)/d	(b-c)/d
Ireland	33	40	18	16.1	0.93	1.37
Finland	29	41	13	19.5	0.82	1.43
Denmark	27	37	12	21.6	0.70	1.16
Sweden	28	42	11	24.8	0.68	1.25
Austria	25	43	12	23.5	0.55	1.32
Belgium	28	42	15	26.8	0.49	1.01
Netherlands	21	35	10	23.3	0.47	1.08
France	26	46	13	29.0	0.45	1.14
Luxembourg	23	39	14	20.3	0.44	1.23
UK	30	42	19	25.9	0.42	0.89
Germany	25	43	15	27.0	0.37	1.04
Portugal	24	40	18	21.4	0.28	1.03
Spain	24	39	20	19.1	0.21	1.00
Italy	24	43	20	23.1	0.17	1.00
Mean EU15	26	42	17	23.0	0.39	1.09

Targeting effect non-EU15 (PL 50), 2005

EU15		Non-EU15	
Austria	0.70	Australia	0.84
Belgium	0.89	Canada	0.53
Denmark	0.85	Czech Republic	1.23
Finland	0.53	Iceland	0.70
France	0.81	Japan	0.58
Germany	0.84	Korea	0.31
Ireland	1.00	New Zealand	0.96
Italy	0.97	Norway	0.90
Luxembourg	1.03	Poland	1.33
Netherlands	0.73	Slovakia	1.22
Portugal	0.75	United States	0.36
Sweden	0.86		
United Kingdom	0.70		
<hr/> Mean EU15	<hr/> 0.82	<hr/> Mean non-EU15	<hr/> 0.81

Linkage social spending and poverty reduction

2005 - EU15: significant relationship (high) levels social spending and (high) antipoverty effects of social transfers and taxes across countries

2005 - non-EU15 countries: no significant relationship

Country-ranking of effectiveness of social spending for alleviating poverty didnt alter (that much) since 1995.

1995 and 2005. The effectiveness of antipoverty effects of social transfers and taxes faded away.

Social policy areas / Vulnerable groups

Child poverty alleviation per point social spending on family programs

Best practice

Ireland (8.4)

Austria (8.2)

Lowest scores

Luxembourg (3.6)

Greece (3.6)

Correlation gross social expenditure family programs and LIS24 poverty rates children:

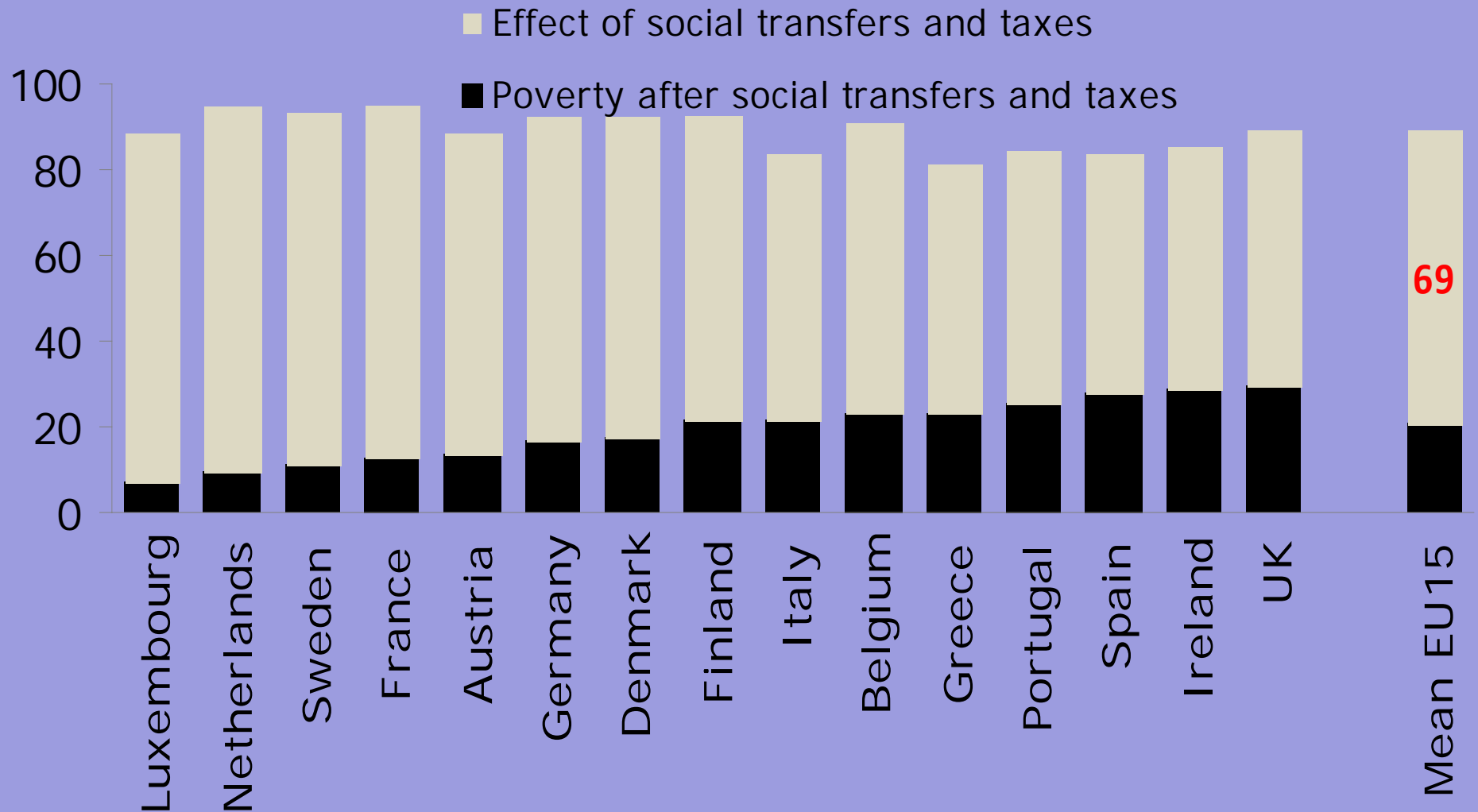
R^2 non-EU = 0.50 **R^2 EU = 0.12**

Stability over time: Mid-1980's, mid-1990's and mid-2000's

Elderly: Antipoverty effect transfers and taxes, EU15, 2007



Elderly: Antipoverty effect transfers and taxes, EU15, 2007



Social policy areas / Elderly

Best practice

Ireland (2.9 resp. 12.7)

Denmark (1.7 resp. 8.0)

Lowest score

Germany (0.1 resp. 6.2)

Italy (0.1 resp. 4.0)

No significant correlation gross social expenditure old age pension and survivors programs and LIS₂₄ poverty rates:

R² non-EU15 = 0.15

R² EU15 = 0.18

Summing-up

- Poverty alleviation important objective
EU → poverty rates rose since Lisbon →
OMC not very effective (yet)
- Correlation poverty and social spending

	Non-EU	EU	All
– Gross public	---	--	---
– Public and private	0	0	--
– Net total	0	-	-

- Claim - higher social expenditures goes along with lower poverty levels - must be mitigated.

Summing-up (final)

- Each point GDP net social spending alleviates poverty in both EU15 and non-EU15 countries on average by .8 percentage points.

- Practices of poverty alleviation

Best practice

Ireland

Scandinavia

Low score

Italy

Greece

Spain

- Mutual learning and policy exchanges

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