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## HOW WELL IS SOCIAL EXPENDITURE TARGETED TO THE POOR?\*

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### ABSTRACT

Some countries are more effective in poverty reduction than others. What can explain these variations in effectiveness? This paper analyzes the effectiveness of social transfers in alleviating poverty. We focus especially on EU countries, but also include other OECD countries into our analysis. We compare poverty rates at the levels of market and disposable incomes, that is before and after transfers, in order to analyze the effect of tax and transfer policies in reducing poverty, i.e. to determine the target efficiency of social transfers. We perform several tests with the most recent data.

In case pensions are treated as transfers, we find a strong relationship between levels of social spending and antipoverty effects of social transfers and taxes. Social spending seems to be an important determinant of a country's poverty outcome. Our analysis highlights some cross-country differences in targeting of social expenditures on poverty alleviation in EU15 and non-EU15 countries around 2005. We introduce an indicator of Public Policy Effectiveness on Poverty Alleviation across countries. Each percentage point of social expenditure alleviates poverty in both EU15 and non-EU15 countries by .7 percentage points on average. Relatively high scores in EU15 countries are found for Ireland and the Scandinavian countries, while Italy, Greece and Spain score lowest. Outside Europe the poorest scores are reported for Korea and the United States. Country ranking appears to be rather stable over time when outcomes for 1995 and 2005 are compared, although some of our results may be sensitive to cyclical factors.

JEL-codes: H53, H55, I32

Keywords: poverty, welfare states, social expenditure

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## **1 INTRODUCTION**

Poverty alleviation has been a European objective already since the Treaty of Rome in 1957. In 2000 the European Council adopted the goal that besides economic growth social cohesion should be strengthened in the EU (the Lisbon Agenda). The Lisbon Agenda has renewed the interest in poverty alleviation across member states. However, still a sizable proportion of the EU15 population lives in poverty (17 percent), although both poverty structure and poverty rates vary across countries from 10 percent in the Netherlands to about 20 percent in Greece, Italy and Spain. Moreover, the average at-risk-of-poverty rates – an official EU social cohesion indicator – even have risen since the adoption of the Lisbon Agenda. Obviously, not only in the EU, but in many other countries poverty reduction is an important issue.

Some countries are more effective in poverty reduction than others. What can explain these variations in effectiveness? Obviously, a range of policy strategies may be chosen to tackle poverty, including improving educational outcomes, improving job opportunities and stimulating labor force participation and reducing inequalities in health outcomes.

This paper analyzes the effectiveness of income transfer policies in alleviating poverty. The focus is on EU15 countries, but other OECD countries will be included in the analysis as well.<sup>1</sup> We compare poverty rates at the levels of market and disposable incomes, that is before and after taxes and social transfers, in order to analyze the effect of tax and transfer policies in reducing poverty, i.e. to determine the target efficiency of social transfers. We will perform several tests with data from Eurostat (ECHP/EU-SILC), OECD (2008) and SOCX (2008) and confront our results with earlier findings on cross-country poverty research. This kind of cross-country comparisons may guide us to cross-country differences on poverty alleviation.

The paper is organized as follows. In section 2, we discuss the policies on poverty alleviation, especially in the EU. In section 3 we present the research design. Next (section 4), we turn to the reduction of poverty rates through taxes and transfers and its relationship to welfare state effort. Section 5 closes the paper.

## **2 POLICY ON POVERTY ALLEVIATION**

### **2.1 THE LISBON AGENDA**

As far as social policy in the EU is concerned, an important step was taken at the European Council in Lisbon 2000. For the EU, the strategic goal was set that is become the most competitive and dynamic knowledge-based economy with sustainable economic growth and greater social cohesion before (the decade ending in) 2010. The economic and social agendas were thus explicitly coupled. To achieve these aims, the social model needs to be modernized. To ensure long-term sustainability of the social security systems in the light of the ageing process, participation rates should be increased.

The Treaty of Nice of 2001 took the social agenda further. It was agreed to advance social policy on the basis of the open method of coordination, first employed with respect to employment policies. In Nice it was decided that member states should implement action plans for combating poverty and social exclusion and to define common objectives on social indicators. The indicators encompass financial poverty, income inequality, long-term unemployment, regional variation in employment rates, life expectancy and poor health.

Some consider these common indicators and the national action plans for social inclusion as significant progress towards integration along the social dimension (Atkinson, 2002). Others question this so called open coordination (Leibfried, 2002). At least, this new mode of governance and the Lisbon agenda in general, have renewed the debate on poverty reduction in EU member states.

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<sup>1</sup> The paper of Beblavy (2009) analyses social protection expenditure and poverty profiles for the new EU member states.

## **2.2 COMBATING POVERTY**

In September/October 2006, member states adopted renewed National Action Plans for Social Inclusion under the new streamlined open method of coordination as one chapter of the National Report on Strategies for Social Protection and Social Inclusion. They presented the key priorities in member states efforts to promote greater social inclusion and make a decisive impact on the eradication of poverty and social exclusion (European Commission, 2007). A year later, the Commission gave special attention to the poverty among vulnerable groups, especially children, in their *Joint Report on Social Protection and Social Inclusion 2008* (European Commission, 2008). In most member states, children are at greater risk of poverty than the overall population. In some countries more than 25 percent of the children are at risk of poverty. Child poverty may have a strong damaging effect on future life opportunities and also on the future capacity of these children to contribute to society (European Commission 2008, p6). In general, the Report indicates that social inclusion and social protection remains high on the political agenda for most member states. Some member states have reinforced their commitments by setting quantitative targets to reduce poverty (p101). The most recent *Joint Report 2009* (European Commission 2009, pp2-3) states that a boost must be given to Member States' efforts to implement comprehensive strategies against poverty.

Progress of social inclusion and poverty reduction is monitored considering the performance in each member state on the basis of national indicators, based on the Social Indicators report of Atkinson et al (2002). In the European Union people are said to be in income poverty if their incomes are below 60 per cent of the median disposable income of households in their country, after adjusting for household size (equivalence scales).<sup>2</sup> Based on this EU-criterion, the proportion of the EU15-population who was at risk of poverty in 2007 is 17 percent, with lower figures for the Nordic countries and higher poverty rates for Mediterranean countries. In EU15 around 54 million citizens are considered as at risk of poverty.

The poverty problem is also striking in other highly-developed welfare states. Industrialized countries spend a large share of their income on social security, but poverty and social exclusion have not been eradicated. A sizeable proportion of the population lives in economic poverty in all industrial welfare states. According to the most common standards used in international poverty analyses, on average roughly one in ten households live in relative poverty in OECD countries (cf. Atkinson et al, 1995; OECD, 2008). The persistence of poverty in industrial welfare states calls for an explanation. If these welfare states offer elaborate systems of income maintenance, why is there still a considerable amount of poverty? Why are some countries more effective than others in this respect? What can explain these variations in effectiveness?

## **3 RESEARCH DESIGN**

This paper assesses the relationship between welfare state effort and poverty alleviation. We analyze the reduction of poverty rates through social transfers and taxes and its relationship to welfare state effort. Our research design starts with the data to be used, because poverty rates and social expenditure rates can be collected from several sources. Next, we discuss how to measure social effort and the effect of social transfers on poverty.

### **3.1 MEASURING POVERTY INCIDENCE**

For various reasons we use poverty rates from different databases. The official EU-indicator for social cohesion is the at-risk-of-poverty rate after social transfers. This rate is defined as the share of persons with an equivalized disposable income below the risk-of-poverty threshold, which is set at 60 percent of the national median equivalized disposable income in each country. For this indicator, Eurostat data (ECHP/EU-SILC) are available for the period 1995-2007, but not for all member states. For a further comparison, we will also use OECD poverty rates. The OECD poverty rate is usually defined as the proportion of individuals with equivalized disposable income less than

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<sup>2</sup> The evolution of the European Union will lead increasingly to question poverty-issues in an EU-wide perspective, about both Europe-wide data and the underlying concepts (Atkinson, 2002, p626).

50 percent of the median income. In this paper, we will use OECD poverty data from the mid-1990's until the year 2005 based on the OECD study (2008) entitled 'Growing unequal? Income distribution and poverty in OECD countries'.<sup>3</sup>

Following international standards, we use the relative rather than the absolute approach in measuring income poverty. This means that we define those households that have an equivalent disposable income below a certain threshold representing the level of well-being of the population in a specific country as being poor. In most comparative studies the poverty threshold has been set at 50 percent of median equivalent disposable income, but we focus especially on the EU's definition of the poverty line. For comparison, the official United States poverty line was just about 30 percent of median United States disposable post-tax household income in 2007.<sup>4</sup>

It should be noted that there have been controversial arguments regarding the issues in the measurement of poverty. These arguments have their own merits and shortcomings, and there has been little professional consensus among research with regard to the theoretical superiority of a particular way of measuring poverty (Haveman, 2008). The aim of this paper is *not* to review definitional issues that arise in assessing the extent of, and change in, poverty in western industrialized countries. We simply refer to a vast literature on the sensitivity of measured results to the choice of income definitions, poverty lines, appropriate equivalence scales, and other elements that may affect results in comparative poverty research.<sup>5</sup>

### **3.2 MEASURING SOCIAL EFFORT**

The overall result of quantitative studies seems to be that there is strong negative correlation between poverty and social expenditures across European countries over the last 25 years; see among many others Cantillon (2009), Esping-Andersen and Myles (2009), Behrendt (2002), and Kenworthy (1999). Problems with social expenditure as an indicator for differences in social protection across countries are related to differences in the public/private mix in the provision of social protection and differences in features of the tax system. Adema (2001) has developed indicators that aim at measuring the share of an economy's domestic production recipients of social benefits really draw on, net total (public and private) social expenditure. For private programs to be considered 'social', they need to have a social purpose and contain an element of interpersonal redistribution and/or compulsory participation. The distinction between public and private social protection is made on the basis of whoever controls the relevant financial flows. Private social benefits may be important for our analysis. In so far they contain an element of redistribution, they may also have an impact on poverty reduction across countries. For example, private but mandatory pensions (in the second pillar) may have an effect on poverty incidence among the elderly. However, the impact of private social benefits is likely to be smaller than the impact of public social transfers.

The most recent figures of the net social expenditure as percentage of GDP, based on the 2008 edition of the Net Social Expenditure data, indicate that accounting for the impact of taxes and of private social expenditure has an equalizing effect on levels of social effort across countries (cf. Caminada and Goudswaard, 2005).

### **3.3 MEASURING THE ANTI POVERTY EFFECTS OF TAXES AND SOCIAL TRANSFERS**

Usually, the impact of social policy on income poverty is calculated in line with the work of Musgrave et al (1974), i.e. statutory or budget incidence analysis. A standard analysis of the anti-

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3 For this analysis we prefer using OECD-data; LIS also presents poverty rates for market income and for disposable income, however, their Fiscal Redistribution Dataset covers only 13 countries between 1979-2002.

4 U.S. Census Bureau's Current Population Survey reports for 2007 a poverty threshold for a 4-persons family (weighted average) of \$21,203; median disposable income for 4-persons families amounts \$69,654. Although US poverty is much higher than poverty in Europe when a relative poverty measure is used, using the official absolute poverty measurement from the US (Orshansky-poverty) alters the picture; see Notten and De Neubourg (2007).

5 Among others, see Atkinson (1987), Hagenaars and De Vos (1987), Atkinson et al (1995), Behrendt (2002), Gottschalk and Smeeding (1997), Marcus and Danziger (2000), Atkinson and Brandolini (2001), Caminada and Goudswaard (2001), and OECD (2008). Recent comprehensive reviews on methodological assumptions underlying international levels and trends in inequality are found in Brandolini and Smeeding (2008).

poverty effect of taxes and income transfers is to compare pre-tax-transfer poverty and post-tax-transfer poverty. To compare the antipoverty effectiveness of taxes and income transfers among countries, poverty rates will be decomposed into the level of market-generated poverty and poverty after taxes and transfers (cf. Kim, 2000). When calculating poverty rates for both market and disposable income, people are ranked by their disposable incomes, so that the re-ranking effect is eliminated. It should however be noted that the indicator of poverty risk before social transfers must be interpreted with caution. This approach assumes unchanged household and labor market structures, thus disregarding any possible behavioral changes that the situation of absence of social transfers would involve. However, behavioral responses – especially effects on work effort – have been at the heart of the policy debates shaping the evolution of antipoverty policy.<sup>6</sup> Kim (2000) showed that both the generosity and efficiency of the tax/transfer system may influence the level of pre-tax-transfer poverty. So, this standard approach overestimates the antipoverty effectiveness of generous and/or targeted welfare systems.

A special feature in our analysis is a technique for the treatment of pensions. Public pension plans are generally seen as part of the safety net, generating large antipoverty effects through transfers and taxes (contributions). But countries differ to a large extent in public versus private provision of their pensions (OECD, 2008, p120). Private occupational pensions are not antipoverty programs per se, although they too have a significant effect on poverty reduction when pre-tax-transfer poverty and post-tax-transfer poverty are measured at one moment in time, particularly among the elderly. The standard approach treats contributions to government pensions as a tax that finances the retirement pensions paid out in the same year, while contributions to private pensions are effectively treated as a form of private consumption. This affects international comparisons of antipoverty effects of social transfers and taxes. Overcoming this bias requires a choice: should pensions be earmarked as market income or as a transfer? We deal with this bias rather pragmatically and will do both. Recent data of Eurostat allow for such a (new) approach. Comparing at-risk-of-poverty rates with and without pensions identifies the partial effect neglected thus far in this kind of statutory incidence analysis.

We perform a cross-national analysis of the relationship between (public and private) social expenditures and poverty rate reduction through transfers and taxes. We will investigate this relationship at two moments in time (1995 and around 2005) to analyze the influence of the business cycle. The material presented is only descriptive and does *not* explain poverty alleviation or poverty structure. Such an analysis should address much more determinants, including social and demographic factors. Such a comprehensive approach is beyond the scope of this paper.

Another important point to keep in mind is that we only analyze the impact of transfers on poverty, while, as we mentioned before, several other strategies can be chosen to alleviate poverty. In fact, several EU member states are increasingly emphasizing strategies to facilitate labor force participation of lower income groups (European Commission, 2008, p101). This may also be an effective strategy to tackle poverty.

## **4 ANTIPOVERTY EFFECT OF SOCIAL TRANSFERS AND TAXES**

### **4.1 POVERTY BEFORE AND AFTER SOCIAL TRANSFERS**

In spite of differences in the measurement of poverty and the databases used, most studies have consistently found that there is a large difference in poverty rates among welfare states, depending on the poverty line applied. Reports on poverty profiles for EU15 and other OECD countries for the latest data year available from LIS (2009), OECD (2008) and Eurostat (2009) consistently show – in general – Scandinavian and Benelux countries have the lowest poverty rates, followed by continental European countries. Anglo Saxon welfare states have relatively higher poverty rates. Among them, the level of poverty is highest in the United States.<sup>7</sup> However, country clustering

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<sup>6</sup> We refer to the seminal review by Danziger et al (1981).

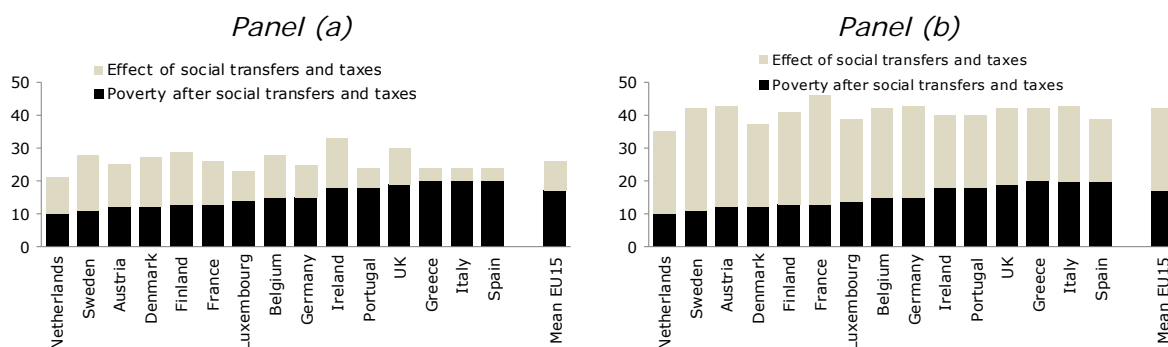
<sup>7</sup> See Caminada and Goudswaard (2009) for a review. Data on poverty rates and poverty alleviation among 28 OECD countries, and correlation tests (relationship with social income transfers) are posted at and available from [Caminada's webpage](#).

based on poverty rates is quite different from that of welfare state regimes. Among the countries with low poverty rates we find representatives of the social democratic regime and the corporatist regime. Likewise, the nations with higher rates of poverty represent several regime types and both members of the EU15 and the new member states.

In every nation, benefits from governments, net of taxes, reduce relative income poverty. This is shown in Figure 1.1, panel (a) for the EU15. We compare the different at risk-of-poverty rates before and after social transfers and taxes. In each country, these rates are calculated with the same threshold, namely the nationally-defined 60 percent threshold calculated on the basis of total household income. A comparison of the number of people on low incomes before and after social benefits illustrates one of the main purposes of such benefits: their ability to alleviate the risk of poverty and reduce the percentage of population (having to manage) with a low income. In 2007, the average at-risk-of-poverty rate in EU15 countries was 26 percent before social transfers and 17 percent when calculated after all social transfers and taxes. So, social transfers were successful in lifting 35 percent of persons with low income above the poverty line. Social benefits reduce the percentage of people at risk of poverty in all the countries, but to very disparate degrees. The reduction is smallest (less than 25 percent) in some Mediterranean States. The reduction is greatest in Sweden (61 percent); Denmark, Finland, the Netherlands, Austria and France also record reductions due to social transfers of 50 percent or more.

Note that in the EU-reports (2007, 2008, and 2009) retirement and survivor's pensions are usually counted as income before transfers and not as social transfers, because the prime role of old age (and survivors') pensions is not to re-distribute income across individuals but rather over the life-cycle of individuals. Alternatively, pensions could be included transfers; those figures are presented in Panel b in Figure 1.1. This makes a lot of difference: the antipoverty effect of social transfers (and taxes) is much higher. Pensions are obviously very important in reducing poverty among the elderly. In another paper we have shown that the poverty rate among elderly in the EU15 falls from 90 percent to 21 percent through taxes and transfers, when pensions are counted as transfers (Caminada and Goudswaard, 2009).

**Figure 1.1: Antipoverty effect of social transfers and taxes, EU15, total population, 2007**



Panel (a) Pensions are included in social transfers in at risk of poverty rates before social transfers  
 Panel (b) Pensions are excluded from social transfers in at risk of poverty rates before social transfers

Source: Eurostat: ECHP/EU-SILC (2009); own calculations

#### 4.2 THE IMPACT OF WELFARE STATE EFFORT IN THE EU15 AROUND 2005-2007

Next we turn to the reduction of poverty rates through social transfers and taxes and its relationship to welfare state effort. Table 1.1 presents the linkage between poverty reduction and social expenditure ratios for EU15 countries. This gives a picture of the targeting of social protection efforts across EU15 countries at one moment in time (around 2005-2007). Absolute antipoverty effects are divided by net social spending ratios to see which country targets best per one point of GDP spent on social expenditure. This way we provide for an indicator on Public Policy Effectiveness on Poverty Alleviation across countries.

Our analysis highlights some cross-country differences of poverty alleviation in the EU15. When we rank countries according to their 'effectiveness' of combating poverty (column 7), each percentage point of net social expenditure alleviates poverty in Ireland and the Scandinavian countries by .7-.9 percentage points, while the lowest scores are found in Italy and Spain (.2). Relative to their level of net social expenditure, Sweden was expected to have a good performance in alleviating poverty. In contrast, France and Germany realize less reduction in poverty rates, but on a markedly higher level of net social expenditure.

This result of country ranking is open to debate, mainly because pensions could also be counted as social transfers. In that case our country ranking alters somewhat: best-practices are found in Finland and Ireland, while the United Kingdom is found at the bottom of the list.

**Table 1.1: Targeting effect of net social expenditure on poverty reduction EU15, around 2005-2007**

	Poverty rate total population (PL 60) before and after social transfers and taxes, 2007			Effect of social transfers and taxes		Net total social expenditure % GDP, 2005	Targeting effect	
	Before pensions excluded <sup>a</sup>	Before pensions included <sup>b</sup>	After	(1)-(3)	(2)-(3)		(4):(6)	(5):(6)
	(1)	(2)	(3)	(4)	(5)		(7)	(8)
Austria	25	43	12	13	31	23.5	0.55	1.32
Belgium	28	42	15	13	27	26.8	0.49	1.01
Denmark	27	37	12	15	25	21.6	0.70	1.16
Finland	29	41	13	16	28	19.5	0.82	1.43
France	26	46	13	13	33	29.0	0.45	1.14
Germany	25	43	15	10	28	27.0	0.37	1.04
Greece	24	42	20	4	22	n.a.	n.a.	n.a.
Ireland	33	40	18	15	22	16.1	0.93	1.37
Italy	24	43	20	4	23	23.1	0.17	1.00
Luxembourg	23	39	14	9	25	20.3	0.44	1.23
Netherlands	21	35	10	11	25	23.3	0.47	1.08
Portugal	24	40	18	6	22	21.4	0.28	1.03
Spain	24	39	20	4	19	19.1	0.21	1.00
Sweden	28	42	11	17	31	24.8	0.68	1.25
UK	30	42	19	11	23	25.9	0.42	0.89
Mean EU15	26	42	17	9	25	23.0	0.39	1.09

- (a) Pensions are excluded from social transfers in at risk of poverty rates before social transfers
- (b) Pensions are included in social transfers in at risk of poverty rates before social transfers

Source: Eurostat: ECHP/EU-SILC (2009), SOCX (2008), and own calculations

Within the group of EU15 countries, we do not find a significant relationship between (high) levels of net social expenditure in 2005 and (high) antipoverty effects of social transfers and taxes. Evidently, social spending is not the only determinant of a country's poverty outcome. However, when pensions are treated as transfers - instead of as primary income - the antipoverty effect of social transfers and taxes is enormous. As a result the relationship between levels of net social expenditure and antipoverty effects of social transfers and taxes becomes significant ( $R^2=.38$ ;  $p<.01$ ).

### 4.3 THE IMPACT OF WELFARE STATE EFFORT IN EU15 OVER TIME

The figures on 'effectiveness' of combating poverty may be influenced by economic performance in specific years. For this reason we employed a sensitivity analysis for the year 1995.<sup>8</sup> Again absolute antipoverty effects are divided by social spending ratios to see which country targets best per one point of GDP spent on social expenditure around 1995 and around 2005-2007. See Table 1.2.

**Table 1.2: Targeting effect of gross total social expenditure on poverty reduction in the EU15, around 1995 and around 2005-2007**

	Around 1995		Around 2005-2007		Change over time	
	Pensions excluded <sup>a</sup>	Pensions included <sup>b</sup>	Pensions excluded <sup>a</sup>	Pensions included <sup>b</sup>	Pensions excluded <sup>a</sup>	Pensions included <sup>b</sup>
Austria	0.38	0.98	0.45	1.07	0.07	0.09
Belgium	0.39	0.92	0.42	0.87	0.03	-0.05
Denmark	n.a.	n.a.	0.51	0.85	n.a.	n.a.
Finland	n.a.	n.a.	0.59	1.03	n.a.	n.a.
France	0.36	0.88	0.40	1.03	0.04	0.15
Germany	0.24	0.78	0.34	0.94	0.10	0.16
Greece	0.05	0.83	0.18	0.99	0.13	0.16
Ireland	0.86	1.32	0.83	1.22	-0.03	-0.10
Italy	0.13	0.83	0.15	0.85	0.02	0.02
Luxembourg	0.63	1.35	0.37	1.03	-0.26	-0.32
Netherlands	0.42	0.88	0.38	0.86	-0.04	-0.02
Portugal	0.22	0.77	0.26	0.94	0.04	0.17
Spain	0.37	1.01	0.18	0.88	-0.19	-0.13
Sweden	n.a.	n.a.	0.53	0.96	n.a.	n.a.
UK	0.45	0.78	0.39	0.81	-0.06	0.03
Mean EU12	0.36	0.94	0.35	0.96	-0.01	0.02

- (a) Pensions are excluded from social transfers in at risk of poverty rates before social transfers

- (b) Pensions are included in social transfers in at risk of poverty rates before social transfers

- EU12: excluding Denmark, Finland and Sweden

Source: Eurostat: ECHP/EU-SILC (2009), SOCX (2008), and own calculations

On average, the targeting effect of social spending did not change much during the period 1995-2007. Our indicator of Public Policy Effectiveness on Poverty Alleviation improved in seven countries and declined in five EU15 countries. As far as the targeting effect of welfare state effort within EU15 concerned, both top and bottom positions of our ranking are rather steady over the business cycle. Note, however, that country ranking depends on how pensions are treated.

### 4.4 BENCHMARKING WITH OTHER OECD COUNTRIES

Next, we also include eleven non-EU15 countries as a benchmark into our analysis, using up-dated figures from the OECD (2008, p141), applying a 50 percent poverty line.

In all OECD countries, public cash benefits and taxes significantly reduce poverty. Table 1.3 highlights differences across countries. These differences in the scale of redistribution partly reflect differences in the size and structure of social spending. OECD countries redistribute in a variety of ways – some through universal benefits, others with more targeted programs, some mainly relying on transfers, others mainly granting tax rebates to low-income families (for instance the EITC in the United States).

EU15 countries show an antipoverty effect of 19.0 percentage points on average, while non-

<sup>8</sup> Note that there is a disruption in the time series of poverty indicators. Until 2001, data were provided by the European Community Household Panel survey (ECHP). Since 2005 all EU-15 countries provide data from the new European Union Statistics on Income and Living Conditions (EU-SILC). Unfortunately, we have to use gross rather than net total social expenditures (due to data availability) from this point forward.

EU15-countries produce on average a lower antipoverty effect of 14.7 percentage points among their population. Remarkably, the United States relative poverty rate *before* taxes and social transfers is actually below average for the selected countries, even though the United States ranks the highest of all the countries in this comparison group in relative poverty rates *after* taxes and transfers.

Again, we calculated the targeting effect of social expenditure on poverty reduction. Unexpectedly, each percentage point of total social expenditure alleviates poverty in both EU15 and non-EU15 countries on average by .7 percentage points. For EU15 countries we (again) find a top-position for Ireland, while surprisingly Finland scores lowest in this ranking. Outside EU15, each percentage point of total social expenditure alleviates poverty with 1.1-1.3 percentage points in the Czech Republic, Slovakia and Poland, while the lowest scores are found in Korea and the United States (.3-.4). Especially the targeting effectiveness of the United States is remarkably low, and lies just below half of the average of all countries presented in Table 1.3.<sup>9</sup>

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9 One could argue that cross-national comparison of social spending is rather sensitive with respect to expenditures related to health care programs, especially when EU15 countries and non-EU15 countries as the United States are compared. Indeed, excluding health expenditures improves the targeting effect of (remaining) social spending on poverty reduction of the United States considerably. However, excluding health expenditure generates higher targeting results for other countries as well (although to a lesser extent), leaving the cross-national ranking of the targeting scores in Table 3 more or less unaltered. The lowest scores are still found for Korea and the United States.

**Table 1.3: Targeting effect of gross total social expenditure on poverty reduction in 25 countries, around 2005**

	Poverty rates (PL 50) total population before and after social transfers and taxes, mid-2000's		Effect social transfers and taxes	Gross public and private social expenditure % GDP, 2005	Targeting effect
	Before	After			
<i>EU15</i>					
Ireland	31	15	16	18.0	0.89
Luxembourg	29	8	21	24.3	0.86
Italy	34	11	22	27.1	0.83
Belgium	33	9	24	30.9	0.77
Germany	34	11	23	29.7	0.76
France	31	7	24	32.2	0.73
Sweden	27	5	21	32.2	0.66
Portugal	29	13	16	25.0	0.65
United Kingdom	26	8	18	28.4	0.63
Denmark	24	5	18	29.5	0.62
Netherlands	25	8	17	29.2	0.58
Austria	23	7	16	29.1	0.57
Finland	18	7	10	27.2	0.38
<i>Non-EU15</i>					
Czech Republic	28	6	22	19.8	1.13
Slovak Republic	27	8	19	17.6	1.09
Poland	38	15	23	21.0	1.09
New Zealand	27	11	16	18.9	0.84
Australia	29	12	16	20.8	0.78
Norway	24	7	17	23.7	0.73
Iceland	20	7	13	21.8	0.59
Japan	27	15	12	22.4	0.53
Canada	23	12	11	22.0	0.50
United States	26	17	9	26.0	0.35
Korea	18	15	3	9.3	0.31
Mean OECD-25	26.6	9.9	16.7	24.4	0.70
Mean EU15	27.8	8.8	19.0	27.9	0.68
Mean non-EU15	25.3	11.1	14.3	20.3	0.72

Source: OECD (2008, p141), SOCX (2008), and own calculations

One could argue that the results presented so far could be sensitive to the data year chosen (around 2005). Therefore, we performed a sensitivity analysis for those countries where data around 1995 and 2005 are available. We find that the effect of social transfers and taxes in reducing poverty did not change very much on average across countries last decade. Targeting declined modestly in EU15 countries and increased somewhat in non-EU15 countries.

According to our results, less targeting hardly offers an explanation for higher poverty rates today than in 1995. Obviously, more factors should be taken into consideration (see OECD, 2008). Market income inequality is an important source of cross-national variation in poverty. Also specific differences in both the social and the tax system should be taken into account in the assessment of the antipoverty effect of welfare states. Moreover, international variations in poverty profiles are driven by variations in socio-demographic and socio-economic structures, as these factors put different restraints on income transfer schemes. And also, besides social transfers, several other policy instruments may be used to alleviate poverty. For example, several countries put relatively

much emphasis on improving job opportunities and stimulating labor force participation of lower income groups.

## **5 CONCLUSION**

Poverty alleviation is an important objective of the EU. A wide variety of poverty rates are found within Europe. Some countries are more effective in poverty reduction than other countries. Remarkably, average at-risk-of-poverty rates – an official EU social cohesion indicator – have risen since the adoption of the Lisbon Agenda. This suggests that recent EU-initiatives regarding combating poverty are not very effective yet. Obviously, several policy strategies may be chosen to combat poverty. This paper analyzes the effect of social transfer policies on poverty alleviation for EU15 countries, but also for other OECD countries.

We analyzed the reduction of poverty rates through taxes and transfers (the difference between poverty rates calculated for market incomes and poverty rates calculated for disposable incomes) and its relationship to welfare state efforts. Within the group of EU15 countries, we do not find a significant relationship between levels of social expenditure and antipoverty effects of social transfers and taxes in case pension is earmarked as primary income. This picture alters when pensions are treated as transfers. In that case the relationship between social expenditures and antipoverty effects of social transfers and taxes across countries becomes significant. So, social spending seems to be an important determinant of a country's poverty outcome, especially among the elderly, when pensions are considered as transfers.

Our analysis highlights some cross-country differences in targeting of social expenditures on poverty alleviation in EU15 and non-EU15 countries around 2005. We provide an indicator of Public Policy Effectiveness on Poverty Alleviation across countries. Each percentage point of social expenditure alleviates poverty in both EU15 and non-EU15 on average by .7 percentage points. Relatively high scores in EU15 countries are found for Ireland and the Scandinavian countries, while Italy, Greece and Spain score lowest. Outside Europe the poorest scores are reported for Korea and the United States. Remarkably, country ranking is rather stable over time when outcomes for 1995 and 2005 are compared, although some of our results may be sensitive to cyclical factors.

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