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A EUROPEAN SOCIAL AGENDA: POVERTY BENCHMARKING AND SOCIAL TRANSFERS

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Abstract

Development of the social dimension of Europe was advanced by the Lisbon Summit in March 2000, and this paper considers the future direction of social policy. The first step towards a social agenda could take the form of benchmarking, based on national competencies in this field, with Member States learning from best performance in the Union; this step would be parallel to the first phase of the Maastricht process towards macro-economic convergence. Initially, this benchmarking would focus on financial poverty: people living in households with economic resources below the level used by Eurostat (60% of the median in the Member State), with this being accompanied by a measure of child poverty. Social investment in improving labour market skills and employability, or an "active welfare state", is an important part of anti-poverty policy, but is not a complete substitute for social spending. The European countries which perform best in terms of reducing poverty tend to have higher social spending. Such statistical performance indicators need however to be accompanied by evaluation of the relationship between policy instruments and poverty reduction, showing the trade-off between poverty reduction and social spending at the level of individual policies. Illustrative estimates using EUROMOD suggest that employing universal social transfers to reduce a country's poverty rate from the EU-average of 18% to the best-performing average of 12% would necessitate an increase in social transfers of some 2% of GDP. More targeted schemes may allow sizeable expenditure savings but at the cost of increased disincentives; the design of Europe's social agenda has to confront well-known issues of economic trade-offs; economic and social policy cannot be divorced.

A European Social Agenda: Poverty Benchmarking and Social Transfers[1]

A B Atkinson

Introduction

The social dimension of Europe has progressed less rapidly than the economic, but a powerful impetus has been given by the Lisbon European Council in March 2000. The Presidency Conclusions stressed the need to promote a socially inclusive Europe. It stated that

> "the number of people living below the poverty line and in social exclusion in the Union is unacceptable. Steps must be taken to make a decisive impact on the eradication of poverty by setting adequate targets to be agreed by the Council by the end of the year." (EN version, page 11).

The Council is pursuing its reflection on the future direction of social policy on the basis of a Commission initiative to be presented by June 2000, with a view to reaching agreement on a European Social Agenda at the European Council in Nice in December 2000. The preparation of this Social Agenda will therefore be an important responsibility of the French Presidency. At the same time, it is clear that the development of the social agenda has significant economic implications. It is therefore important that economic branches of national governments be fully involved. Social policy and economic policy cannot be considered in isolation. Social policy impacts on economic performance, and macroeconomic decisions have major implications for social inclusion.

1. Poverty Benchmarking as a First Step

This section sets out the case for poverty benchmarking as the first stage of the Social Agenda. Many people have drawn a parallel with the progress made by the European Union in realising the Internal Market and in achieving European Monetary Union. They ask why similar progress cannot be made in the social field:

> "Europe is heartless if there is no poverty target beside the Maastricht targets. What was possible for the euro - clear objectives - must be possible for the fight against poverty" (Frank Vandenbroucke, Belgian Minister of Social Security, 1999, page 16).

The parallel with Maastricht is very relevant. There can be little doubt that the targets covering price stability, interest rate convergence, public deficits etc. were not only a valuable device for communicating and legitimising policy, but also secured impressive results. The Maastricht criteria provided the framework for the convergence of European macro-economic performance to the point where it became possible for the European Central Bank to be established with a common inflation objective.

The social agenda is less advanced and for this reason the first stage is closer to the convergence phase of Maastricht than to the present stage of a unified policy goal. Benchmarking is taken here to be the adoption of a standard based on best performance by Member States. The proposal of the Belgian Government, for example, is that all Member States should seek to match the performance of the three best States in combating poverty. Just as with the Luxembourg process on employment, the emphasis is on national competencies, with Member States learning from a comparison of the experience of other countries.

Poverty has many dimensions, and social exclusion is susceptible of still wider interpretation. Homelessness, precariousness of employment, insecurity on the streets, poor skills, and ill-health are all social concerns which come under this general rubric (see for example Paugam, 1996). It is proposed however that the first step in benchmarking across Member States should focus on *financial* poverty: people living in households with economic resources which fall short of a prescribed level. Lack of resources is not the only problem, but it has major consequences for people's lives.

As experienced with the Maastricht criteria, it may not be easy to agree on the definition of common objectives. Behind esoteric statistical debate about definitions may lie strong national interests. But, in the measurement of financial poverty, considerable progress has already been made, notably as a result of the efforts of Eurostat. There is wide agreement that a reasonable starting point is to measure poverty in terms of people living in households whose disposable income, adjusted for household size, is less than 60% of the median in the Member State. This definition is that which was recommended by the Task Force on Statistics on Social Exclusion and Poverty (Eurostat, 1998). The variable under consideration is, of course, incomplete as a measure of the welfare of households: it excludes the benefits from public spending such as that on health care, housing or education, it is static, ignoring the evolution of income over the life-cycle, and it is household-based, assuming a degree of income-sharing within the household which may not take place. It is however a measure which can be implemented across Member States, using the European Community Household Panel (ECHP) or harmonised national household surveys (Hagenaars et al, 1994, Chambaz, 1997, and Atkinson, 1998).

Benchmarking by financial poverty is a first stage in two senses. It is based on national benchmarking, as opposed to setting a Union-wide poverty target (such as reducing the EU-wide poverty rate to 10%), and it is concerned solely with financial deprivation. It is however an important first stage. Figures for financial poverty in 1994 are shown in Figure 1 for 13 Member States (Finland and Sweden were not covered by the ECHP). Overall, the percentage is 18%. Extrapolated to the European population of 370 million as a whole, the Eurostat figures give a total of 66.6 million for EU15. The countries in Figure 1 are ranked in descending order of the poverty percentage. The countries with high proportions of their populations below the poverty line tend to be in Southern Europe. However, poverty is not just a matter for the less well-off countries. Some 70% of the 67 million are to be found in France, Italy, West Germany and the United Kingdom. 14%, or over 9 million, are to be found in France alone. For France the figure shown in Figure 1 is rather higher than in the inquiry Budget de famille (Hourriez and Legris, 1997), but the European ranking in Figure 1 accords with their description of the position of France as worse than Denmark but better than the UK and Southern Europe. On the

basis of the estimates in Figure 1, the three best performing countries are Denmark, Netherlands and Luxembourg, with an (unweighted) average of 12%. (We might expect Finland and Sweden to contest this accolade if they were included.) If all Member States performed as well as the three best in combating poverty, then the number of poor people in Europe would be reduced by a third: ie from 18% to 12%.

Recently, Member States have begun to pay particular attention to the position of children living in poor households. Poverty among children is important not only in its own right but also because there is concern that poverty is thereby transmitted from one generation to the next. A (now dated) study in the United Kingdom showed that children from a low income family in 1950 were 50% more likely, a quarter century later, to be in poverty themselves than if there were no intergenerational link (Atkinson, Maynard and Trinder, 1983). This study focused on one locality, but intergenerational transmission may be particularly associated with neighbourhood as well as family effects. The present United Kingdom government has given priority to child poverty, setting the ambitious target of abolishing child poverty in 20 years, and more immediately of achieving a reduction of 700,000 (16%) by 2002. Member States differ in the degree to which children are over- or under-represented among those in poverty - see Figure 2 (based on ECHP data for 1994 and Income Distribution Survey data for Finland and Sweden, and applying a criterion of 50% of *mean* income). Member States where poverty is greater among children by more than 20% are Ireland, Germany, Austria and the UK. In France, poverty among children is 10% higher than the overall rate, a situation which may be contrasted with the Nordic countries, where poverty rates among children are relatively significantly lower (and hence absolutely much lower). There may be a good case for including a measure of child poverty alongside the total performance indicator.

It is interesting to speculate as to the reasons for differences in poverty rates between Member States. A wide range of hypotheses suggest themselves. It is noteworthy, for instance, that the three best-performing countries are small in size, although this is also true of the three with the highest recorded poverty rates in Figure 1.

2. Role of Social Protection

The parallel drawn in the previous section with macro-economic policy is illuminating, but incomplete. The European Central Bank has the power to set interest rate policy for the euro zone as a whole, but anti-poverty policy is a Member State responsibility. Any attempt to transfer the same kind of power to a European Poverty Agency would run against the principle of subsidiarity. Moreover, even at a national level, there is no direct link with policy instruments of the kind between inflation and interest rates. If predicted inflation exceeds the target rate, then the central bank has only to think about how large a change to make, not which lever to pull.

There are clearly many policies that national governments can invoke in order to reduce poverty. The Lisbon Summit stressed investment in people and building an active welfare state. There is general agreement on the importance of measures, such as learning opportunities, which

increase the capacity of people to raise themselves above the poverty line. These are likely to be doubly rewarding in that they reduce poverty and reduce dependence on state benefits. But social investment is not a complete substitute for social spending. The European countries which achieve lower poverty rates are also those which tend to have higher social spending - see Figure 3. On the left hand side of the diagram are those countries, such as Portugal, which have not yet

developed social transfers to the same level as the European average, or countries, such as the United Kingdom, which have cut back extensively on social programmes. These countries have above-average poverty rates.[2]

In statistical terms, there is a clear negative relation across Member States between total social transfers as a % of GDP and poverty rates. The fitted regression line has a coefficient such that each 1 percentage point increase in transfers as a percentage of GDP is associated with a poverty reduction of 0.85 percentage points. Taken at face value, it would suggest that reducing a country's poverty rate from the EU-average of 18% to the best-performing average of 12% would necessitate an increase in social transfers of some 7% of GDP. However, it is clear that we need to look behind this relationship, which is open to many interpretations. One cannot simply treat country observations as based on different choices from the same "supply curve". Countries differ in many respects which affect on the one hand their poverty rates and on the other the level of social transfers. Just to give one example, Member States differ in the institutions by which social protection is provided. There are different levels of government, varying from centralised social insurance schemes to locally-provided social assistance; there are different mixes of public and private, with occupational welfare being more important in some countries than others; there may be fiscal advantages, such as tax allowances for children, which play the same role as social transfers.

What we must do is examine at the micro-level the relationship between policy instruments and poverty reduction. It is here that the statistical performance indicators need to be accompanied by policy assessments and evaluations. Suppose that we take child poverty. Within a Member State, it is possible to make projections of the likely development of child poverty, taking account of policies already in train. With the aid of a tax-benefit simulation model, one can calculate the relationship between changes in benefit parameters and the level of poverty. For example, Figure 4 shows for the United Kingdom the relation between the rate of child poverty and the level of child benefit (which is paid at a uniform rate, currently £10 a week, for all children, with a £5 premium for first or only children).[3] The horizontal axis shows the total budgetary cost expressed as a % of GDP. It is the nature of these calculations that they are complex. There are important interactions between different elements of the tax benefit system. An increase in child benefit in the UK does not in itself help those on means-tested Income

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[2] The role of social transfers in Europe is discussed in Cohen-Solal et al, 1999, and Marlier et al, 1999.

[3] I thank Jo Webb for carrying out these calculations, under the guidance of Holly Sutherland, using POLIMOD, which is the tax-benefit microsimulation model constructed by the Microsimulation Unit at the University of Cambridge. It uses data from the Family Expenditure Survey which are Crown Copyright. They have been made available by the Office for National Statistics (ONS) through the Data Archive and are used by permission. Neither the ONS nor the Data Archive bears any responsibility for the analysis or interpretation of the data reported here.

Support, since the increase is fully taken into account when assessing means, and in these calculations it is assumed that it is accompanied by an increase in the allowed amounts for Income Support, Housing Benefit and Council Tax Benefit.

In interpreting the results for the United Kingdom in Figure 4, it should be noted that the horizontal axis extends to 0.8% GDP (compared to 20% GDP in Figure 3). The slope of the frontier is in fact considerably steeper than that in Figure 3: the implied reduction in poverty per 1% GDP is 3.5 percentage points, or 9.7 percentage points for the child poverty rate. Extrapolating, halving child poverty would be achievable at a net cost of some 1.5 % GDP.

The next stage in the analysis is to compare these trade-offs across Member States. The EUROMOD project currently underway (preliminary results from which were used in Bourguignon, 1998) allows one to put side by side micro-simulation results for 15 Member States (as well as producing results for the European Union as a whole). The important question is whether the cost of poverty reduction, measured in terms of increased total transfers, can be reduced, for individual Member States, well below that shown by the cross-country relation in Figure 3. Comparisons across countries may allow national governments to learn from practice elsewhere. For this purpose, development of an analytical tool such as EUROMOD seems essential.

Illustrative (not definitive) results from one such exercise are shown in Figure 5.[4] For three EU countries, EUROMOD has been used to examine the relation between proportional increases in social transfers (except public pensions) and poverty rates. The slope is definitely steeper than the cross-country relation would suggest: a 1% GDP net expenditure would achieve a 2.6 percentage point reduction in France and in the Netherlands and a 4 percentage point reduction in the UK. Taking an average figure of 3 would mean that reducing a country's poverty rate from the EU-average of 18% to the best-performing average of 12% would necessitate an increase in social transfers of some 2% of GDP, which is much more readily envisaged than the 7% figure which might be derived from the cross-country diagram. For the individual Member States, it may be seen that the 12% target is already achieved in the Netherlands, that it would involve an additional expenditure of about 0.6% of GDP in France, and 2% of GDP in the UK.

These calculations are purely arithmetic, in the sense that they take no account of possible behavioural responses, to which I turn in the next section. In this respect, they are like the

calculations of poverty before and after transfers (see for example Cohen-Solal et al, 1999, G.04).

3. Economics of the Social Agenda

The new Social Agenda impinges on the economy of Europe in two related but distinct ways. The first is the cost of social transfers for the government budget, which has to be seen in the light of Member State budgetary policy and their undertakings as part of the Stability and Growth Pact. At a macro-economic level, even the more favourable relationship illustrated in Figure 5 may seem too costly. A back of the envelope calculation suggests that, if the poverty line is approximately 1/3 of GDP per head, and if the average poverty gap is 1/3 of the poverty line, then a 6 percentage point reduction in poverty would require only a 2/3 percentage point of GDP increase in income being transferred. The higher cost, even for simulated national trade-offs, must, on this argument, reflect inadequate targeting. The same kind of argument can be made about the social transfer budget as a whole. In the United States,

> "outlays on means-tested cash assistance totalled $31 billion. ... the poverty gap, measured before the receipt of any means-tested transfers, was $63 billion. If all of the money had been effectively targeted on the poor, it should have reduced the poverty gap to $32 billion, essentially cutting it in half." (Sawhill, 1988, p 1101).

But in fact

> "the poverty gap measured after the receipt of transfers was still $47 billion, implying that only $16 billion actually reached the poor" (Sawhill, 1988, p 1101).

Targeting as a way of reducing the economic cost is an attractive idea. The drawback comes, however, with the second relationship with the working of the economy, which is the impact of the specific form of transfers (and taxes) on economic behaviour. Simply stated, concentration of benefits on those in need comes very often at the expense of creating poverty and unemployment traps. This may be illustrated by the case of child benefit. Even if in the UK one child in three is living in a family in poverty, this still means that two-thirds of a general increase in benefit goes to those above the poverty line. On the other hand, paying the increase only to families where there is no parent in paid work (86% of whom are in poverty: Piachaud and Sutherland, 2000) immediately increases the financial advantage to remaining out of work, intensifying the unemployment trap. It is for this reason that successive UK governments have moved towards paying in-work benefits for low earning families, currently the Working Families Tax Credit. The way in which this reduces the net cost of achieving poverty reduction is shown in Figure 6. The slope means that, with the Working Families Tax Credit, a 0.5% GDP net expenditure would achieve a 3.9 percentage point poverty reduction.

The drawback with this approach, combining the targeted increase to those out of work with an in-work benefit for low earning families, is that it creates a poverty trap for working families. In

the UK, under the Working Families Tax Credit (WFTC), the tax credit is reduced at the rate of 55% as net income rises. If the person increases his or her earnings by £100 a month, then the government takes £33 in income tax and social insurance contributions, and then the remaining £67 is reduced by 55%, leaving £30. In other words, the marginal tax rate is 70% - which is much higher than the top income tax rate (40%). With the expansion of the Working Families Tax Credit necessary to reduce poverty by a half or more, a much larger fraction of the population face high marginal rates. This tax rate applies not only to additional earnings by existing workers (for example the disincentive to seek a better-paid job), but also to the earnings of other family members if they seek employment. It is not just a poverty trap but also an unemployment trap for additional earners. The calculations in Figure 6 take no account of the effect of increased marginal tax rates on household decisions. We should also note that there are diminishing returns, reflecting the fact that the WFTC approach cannot overcome the problem of incomplete take-up of means-tested benefits.

Conclusions

- The first step towards a social agenda should take the form of *benchmarking*, based on national competencies in this field, with Member States learning from best performance in the Union; this step would be parallel to the first phase of the Maastricht process towards macro-economic convergence,

- initially, this benchmarking should focus on *financial poverty*: people living in households with economic resources which fall short of a prescribed level (60% of the median in the Member State, as recommended by Eurostat),

- there may be a good case for including a measure of child poverty alongside the total performance indicator, particularly in the light of concerns about the intergenerational transmission of disadvantage,

- social investment in improving labour market skills and employability, an "active welfare state", is an important part of anti-poverty policy, but is not a complete substitute for social spending; the European countries which perform best in terms of reducing poverty tend to have higher social spending,

- statistical performance indicators need to be accompanied by evaluation of the relationship between policy instruments and poverty reduction, showing the trade-off between poverty reduction and social spending at the level of individual policies,

- illustrative estimates using EUROMOD suggest that employing a proportionate increase in social transfers to reduce a country's poverty rate from the EU-average of 18% to the best-performing average of 12% would necessitate an increase in social transfers of some 2% of GDP,

- more targeted schemes may allow sizeable expenditure savings but at the cost of increased

disincentives; the design of Europe's social agenda has to confront well-known issues of economic trade-offs; economic and social policy cannot be divorced.

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Appendix: Sources

(a) The poverty figures are from the European Community Household Panel (ECHP) wave 2 and relate to 1994; the findings have been revised at different dates, and those used here are from European Commission (2000, page 15), which are identical to those in Marlier (1999, Tableau 6) but differ from those in the report of the Eurostat taskforce (1998, Table 3.1).

(b) The relative child poverty rates in Figure 2 are from Immervoll et al (2000), Table 1.

(c) The social transfer data in Figure 3 are from OECD, 1997, Table 6.3. They relate only to social security transfers, excluding other government transfer payments. They differ from the SESPROS statistics for social protection expenditure published by Eurostat which include certain benefits in kind, reimbursement of medical expenses, and expenditure on public health services.

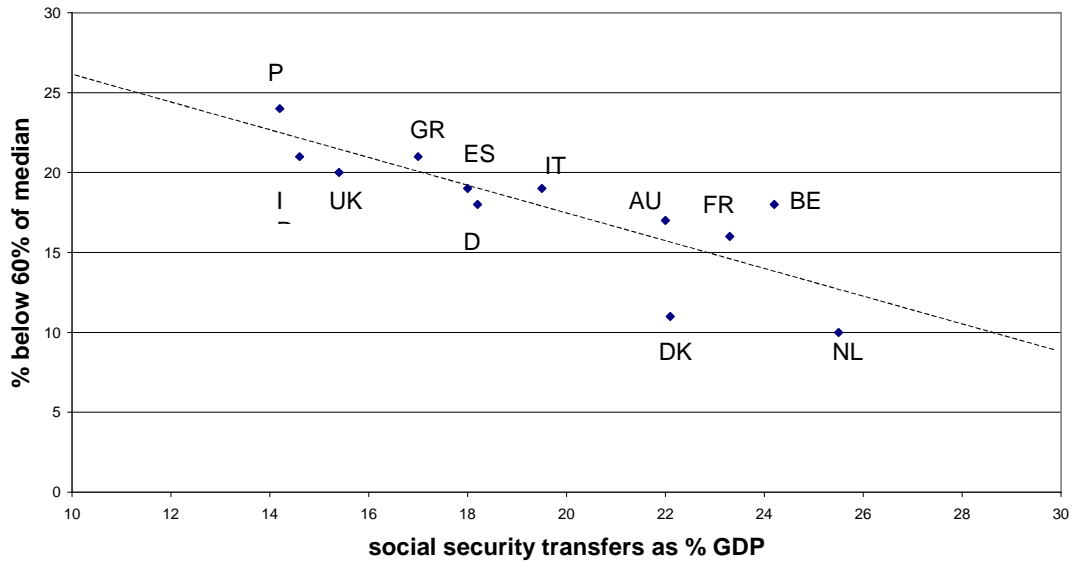**Figure 1 Financial Poverty in EU 1994**
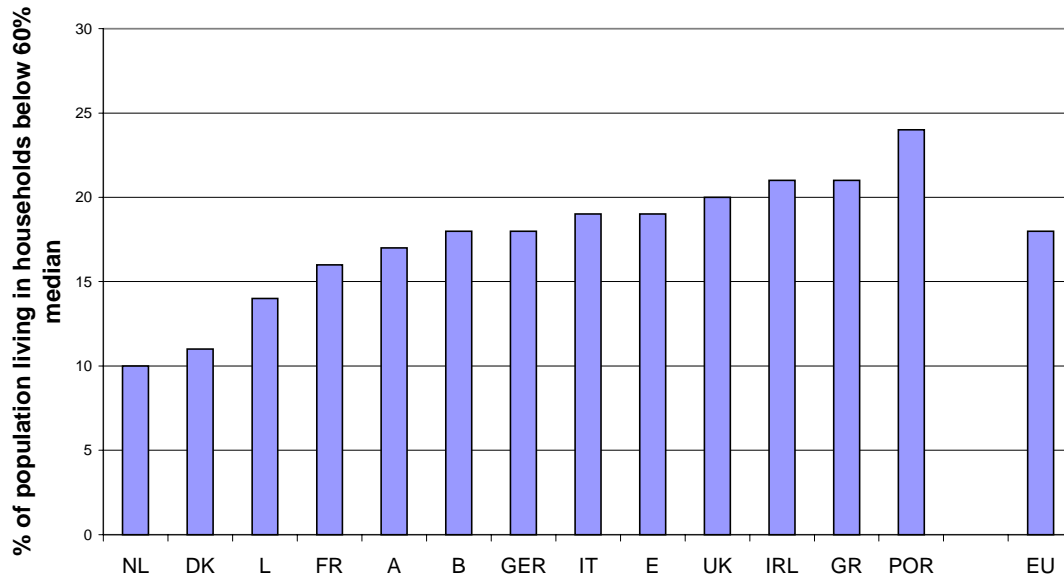
Source: see Appendix

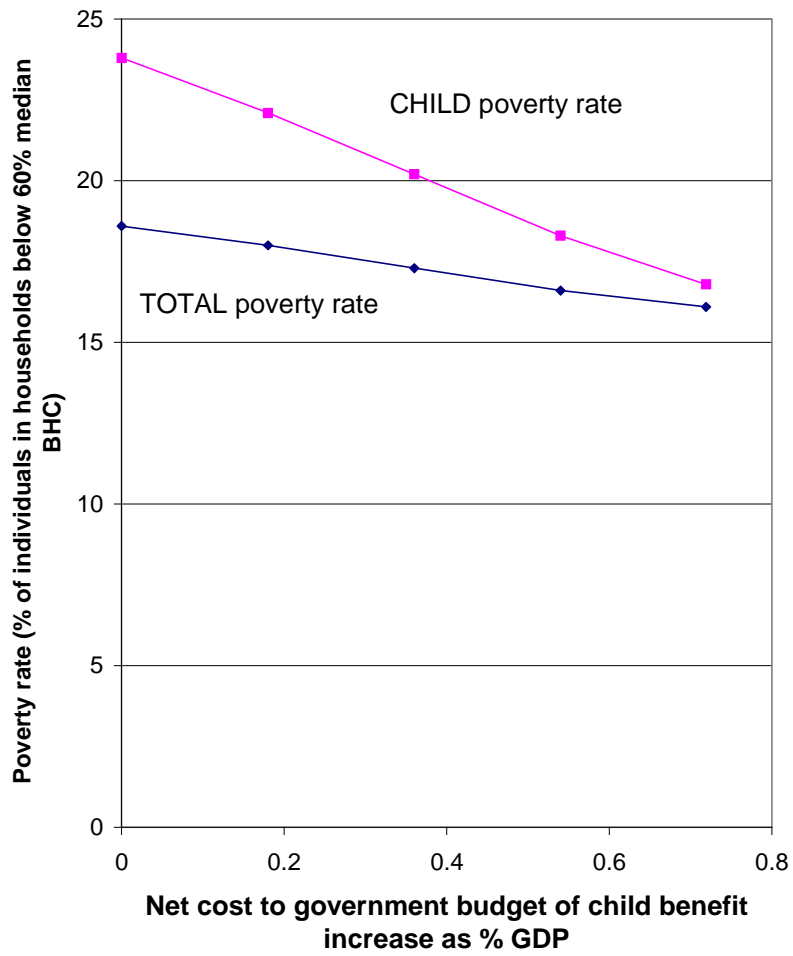**Figure 2 Child Poverty Rate relative to Total Poverty Rate**
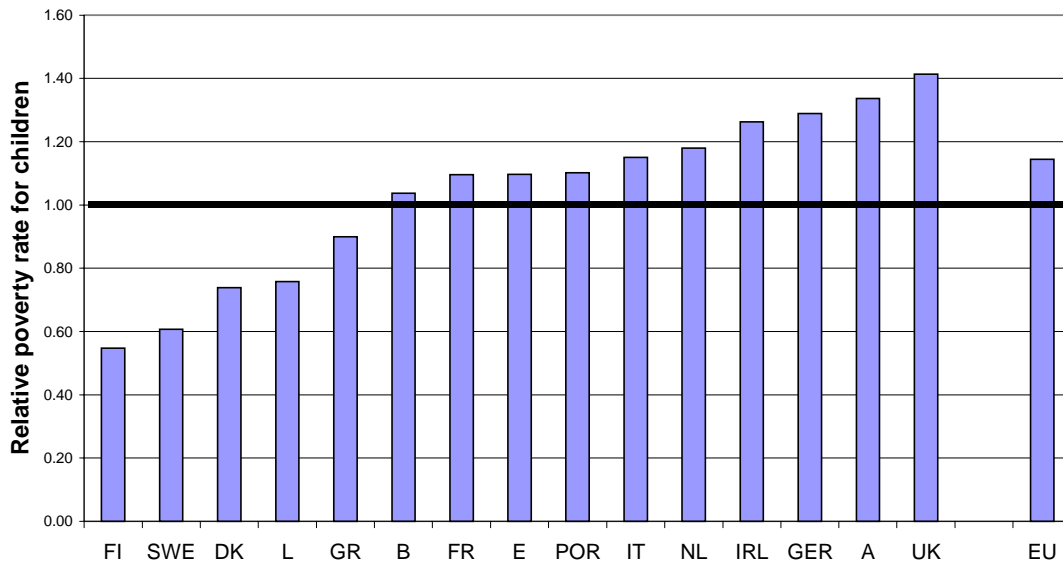
Source: see Appendix

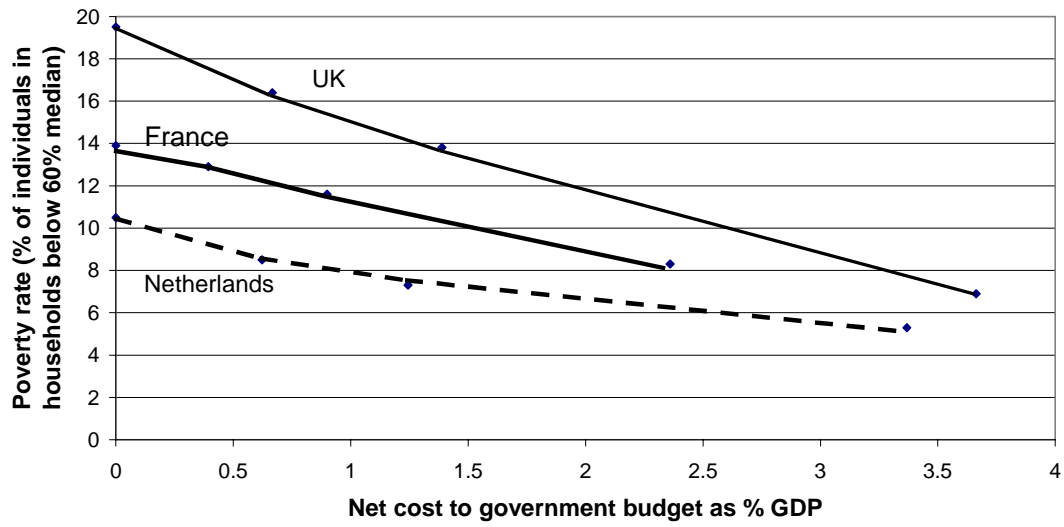**Figure 3 Financial poverty and social transfers**

Source: see Appendix

Figure 4 Relationship between child benefit increase (in cost as % GDP) and Poverty Rates in UK
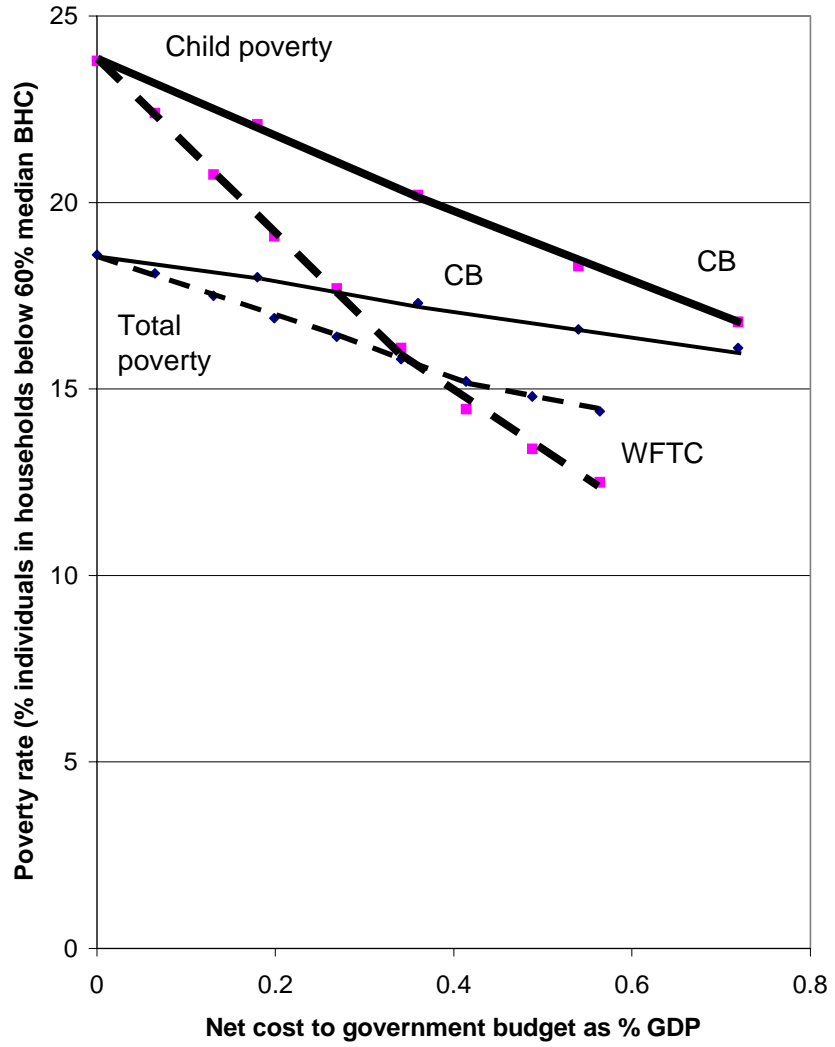

Source: POLIMOD

Figure 5 Relationship between benefit increases and poverty using EUROMOD

Source: EUROMOD

Figure 6 Different policies for poverty reduction in the UK

Source: POLIMOD