SOCIAL EXPENDITURE UPDATE

Social spending is falling in some countries, but in many others it remains at historically high levels

Insights from the OECD Social Expenditure database (SOCX), November 2014

OECD

Directorate for Employment, Labour and Social Affairs

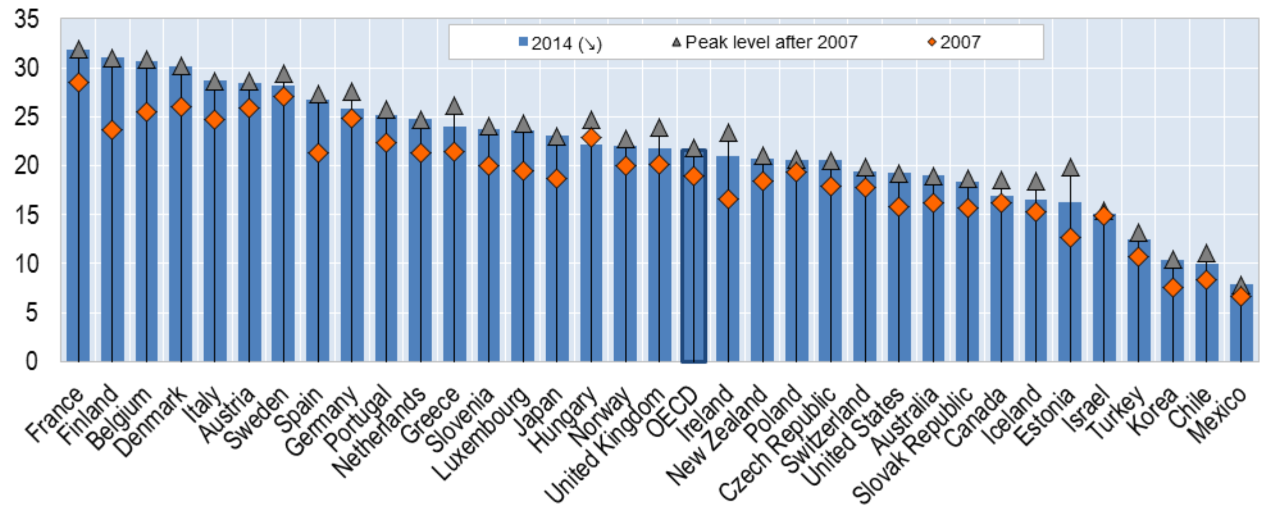
New OECD data show that in recent years Canada, Estonia, Germany, Greece, Hungary, Iceland, Ireland and the United Kingdom have experienced substantial declines in social spending as a percent of GDP, but in most countries social spending remains at historically high levels. Public spending in some emerging economies is below the OECD average, lowest in India and Indonesia but highest in Brazil where – as in OECD countries – pensions and health expenditure are important areas of social spending. New SOCX data also shows that income-testing in social protection systems is much more prevalent in Anglophone and non-European OECD countries than in continental Europe. Finally, when considering the role of private social benefits and the impact of tax systems, social spending levels become more similar across OECD countries, and while France remains the biggest social spender, the United States moves up the rankings to second place.

Public social expenditure is worth more than 20% of GDP on average across the OECD

In 2014, OECD countries devote more than one-fifth of their economic resources to public social support. Public social spending-to-GDP ratios are highest at over 30% of GDP in Denmark, Belgium, Finland and France (highest at almost 32% of GDP), with Italy, Austria, Sweden, Spain and Germany also devoting more than a quarter of their GDP to public social spending (Figure 1). At the other end of the spectrum are non-European countries as Turkey, Korea, Chile and Mexico which spend less than 15% of GDP on social support. Spending levels in the latter three countries are now similar to what they were in Europe in the 1960s. Indeed, social protection systems in many European countries, Japan and the United States have developed over 50 years into the comprehensive state they are in now (Figure 2).

1 Public social spending is worth 22% of GDP on average across the OECD

Public social expenditure as a percent of GDP, 2007, peak level after 2007, and 2014



Note: Throughout this document, (↗) (or ↘) in the legend relates to the variable for which countries are ranked from left to right in increasing (or decreasing) order.

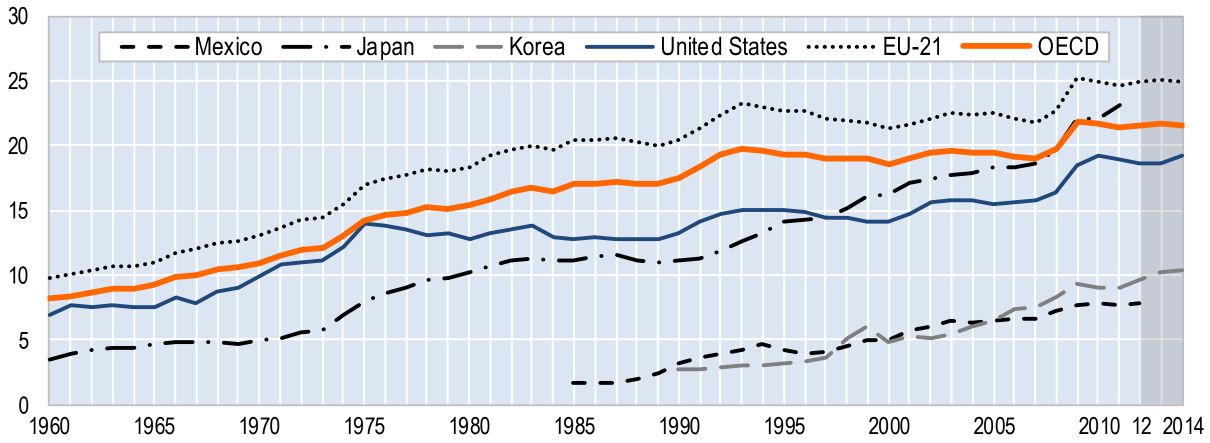
"Peak level after 2007" refers to the highest level social spending-to-GDP-ratio over the period 2007-2014, i.e. to 2009 except for the United States (2010), Japan and Slovenia (2011), Greece and Mexico (2012), Belgium, Denmark, France, Italy, Poland, Portugal, the Slovak Republic, Spain, Switzerland(2013), Australia, the Czech Republic, Finland, Korea and the Netherlands (2014).

For detail on the underlying methodology regarding estimates for recent years, and the detailed social expenditure programme data, see the box "What is in SOCX?" below. Data for the most recent year for Japan concern 2011, 2012 for Mexico and 2013 for Chile, Israel, New Zealand and Turkey.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

2 Comprehensive social welfare systems were developed over a long period of time

Public social expenditure as a percent of GDP in 1960-2014



Social spending is coming down in some countries, but in many countries it remains high.

In an economic downturn, social spending-to-GDP ratios usually increase as public spending goes up to address greater need for social support, while simultaneously economic growth falters (GDP as in the denominator). At the onset of the Great Recession both these features contributed to a rapid increase in public social spending-to-GDP ratios on average across the OECD from 18.9% in 2007 to 21.9% in 2009, and estimates for recent years suggest it has declined a little since: it was 21.6% of GDP in 2014.

However, while in most countries social spending has not fallen much in recent years, in some OECD countries there has been a significant decline since spending peaked in 2009. Since then spending-to-GDP ratios declined by 1.5 to 2.5 percentage points in Canada, Germany, Hungary, Iceland, Ireland, the United Kingdom, and by 3.5% of GDP in Estonia. The most rapid decline was recorded for Greece, where the social spending-to-GDP ratio fell by almost 2 percentage points since peak in 2012 (Figure 1).

When comparing current social spending levels with pre-crisis levels in 2007, public social-spending-to-GDP ratios are more than 4 percentage points higher in 2014 in Belgium, Denmark, Ireland, Japan (2011), Luxembourg, Spain and, particularly, in Finland. Only in Hungary are public social-spending-to-GDP ratios now lower (by almost 1 percentage point) than in 2007, while Canada, Germany and Israel have public social spending-to-GDP ratios that are within 1 percentage point of 2007 levels.

What is in SOCX?

The new release of the OECD Social Expenditure database (SOCX) includes detailed social expenditure programme data for 1980-2011/12 for 34 OECD countries. SOCX presents public and private benefits with a social purpose grouped along the following policy areas: old age, survivors, incapacity-related benefits, health, family, active labour market programmes, unemployment, housing and other social policy areas. SOCX includes public spending on early childhood education and care up to age 6, but SOCX does not include public spending on education beyond that age. In addition to the detailed information available for 1980-2011 (including 2012 for Australia, Canada, Korea, New Zealand, and the United States; and 2013 for Chile, Israel and Turkey), SOCX includes indicators on aggregate public social spending for 2012-2013 based on national aggregates and estimates for 2014. The 2014 data were estimated on the basis of national sources for non-European OECD countries, and/or OECD (2014), *OECD Economic Outlook 95 A*, as in May 2014 and EC DG ECFIN (2014), the European Union's Annual Macro-economic database (AMECO) as in May 2014. COFOG data have been used in the case of Switzerland.

SOCX also includes indicators on net (after tax) social expenditure for 33 countries for 2011 (information on taxation of benefits often does not become available until two years after the fiscal year). Time series for the majority of countries are available since 2001. Relevant fiscal detail involves direct taxation of benefit income, indirect taxation of consumption out-of-benefit income, and tax breaks with a social purpose.

Data for 24 European countries were provided by Eurostat as based on the information in their European system of integrated social protection (ESSPROS), while information for other countries is provided by national correspondents. Data on health and active labour market programmes were taken from OECD Health Data and the OECD/Eurostat database on Labour Market Policies. Information on the direct taxation of benefit income and tax breaks with a social purpose was provided by the delegates to the Committee on Fiscal Affair's Working Party No. 2 on Tax Policy Analysis and Tax Statistics.

It should be borne in mind that the quality of data on the effect of tax systems (frequently estimates based on tax models), and private and social spending and spending by local government (because of under-reporting), is not as high as the quality of information on budgetary allocations towards social purposes. For more detail regarding the sources and methodology underlying SOCX and its indicators on social spending, see Adema, W., P. Fron and M. Ladaique (2011), "Is the European Welfare State Really More Expensive? Indicators on Social Spending, 1980-2012 and a Manual to the OECD Social Expenditure database (SOCX)", *OECD Social, Employment and Migration Working Paper* No. 124 (www.oecd.org/social/expenditure.htm).

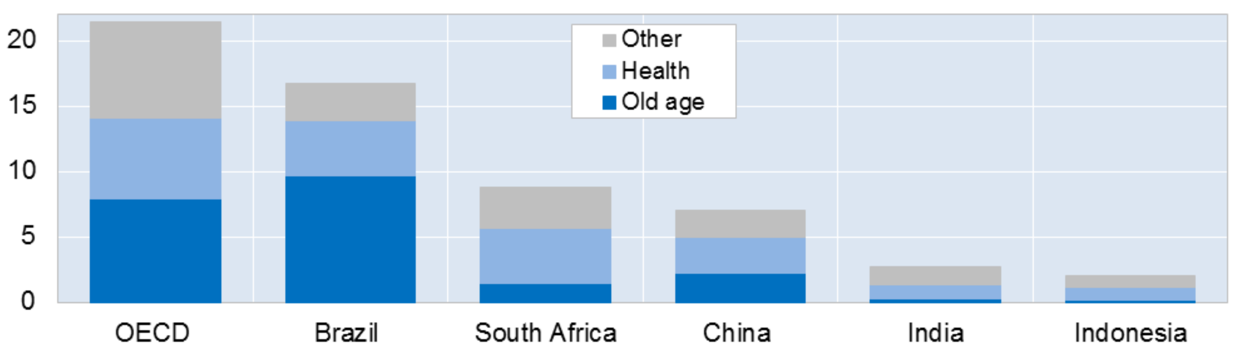
Public social expenditure in Brazil, China, India, Indonesia and South Africa

Amongst emerging economies, such as Brazil, China, India, Indonesia and South Africa there is huge variation in type and levels of social spending. Public social spending is closest to the OECD average in Brazil at just over 15% of GDP. In Brazil, public spending on pension benefits amounts to almost 10% of GDP (which is a conservative estimate, see the note to Figure 3), compared to 8% of GDP on average across the OECD. This is all the more poignant since Brazil is a relatively young country with eight persons of working age to one senior citizen, twice as many as in the OECD on average. Compared to public spending on pensions, spending on other social programmes, as for example, "Bolsa Familia" which supports very low-income families with children is relatively limit.

In 2009 public social spending in China amounted to around 7% of GDP, comparable to average social spending in the Asia/Pacific region (OECD, 2014, *Society at a Glance, Asia/Pacific*). Spending on old-age cash benefits amounted to about 2.5% of GDP with social assistance payments making up just over half a percent of GDP. By comparison public social spending in India (with spending on labour market programmes at 0.6% of GDP) and Indonesia is much lower. However, the available data on public social spending is likely to underestimate public social effort as outlays by state and other local governments in these populous countries is under-reported.

Finally, public spending in South Africa amounted to around 8.7% of GDP in 2012, of which about half is public expenditure on health. "Other spending" includes important support programmes for the working age population, such as the "Community Work Programme", the "Extended Public Works Programme" and the "Child Support Grant". Pension spending is low in comparison with some other emerging economies as it is focused on social pensions with basic amounts paid to the poor elderly.

3 Public social expenditure as a percent of GDP in 2012 or last year available



Note: Public spending on heath was taken from the World Health Organisation (WHO), Global Health Expenditure database (http://apps.who.int/nha/database): other sources used were cleaned for health items where necessary to avoid double counting. Data for *Brazil* refer to federal social expenditure as taken from Castro, J. de, J. Ribeiro, J. Chaves and B Duarte (2012), *Gasto Social Federal: prioridade macroeconômica no período 1995-2010*, Brasília, September. These data do not include spending by local authorities, including on former State and municipal civil servants. Benefits for federal civil servants (mostly pensions) amounted to 2.3% of GDP in 2009 covering 450 000 retired civil servants, at the time there were 535 000 retired local and state civil servants (Ministério da Previdência Social, 2009, *Overview of Social Welfare in Brazil*, 2nd Edition, January). Hence, public spending on pensions for former State and local government employees – not included in the figure – could well amount to around 2.5% of GDP. Data for *China*, *India* and *Indonesia* were taken from the Asian Development Bank Social Protection Index database (http://spi.adb.org/spidmz/index.jsp); and, data for *South Africa* were taken from the National Treasury of the Republic of South Africa (2014), National Budget 2014, estimates of national expenditure.

Pensions and health are the largest areas of social spending

Countries on average spent more on cash benefits (12.3% of GDP) than on social and health services (8.6% of GDP), but Nordic countries, Canada, the Netherlands, New Zealand and the United Kingdom had a more equal balance in spending on cash and in-kind benefits. Low-spending countries like Mexico and Korea have a greater focus on services in social support (Figure 3).

Cash income support to the working age population accounts for 4.4% GDP on average across the OECD (Figure 3), of which 1% GDP towards unemployment benefits, 1.8% on disability/sickness benefits, 1.3% on family cash benefits and another 0.4% on other social policy cash supports.

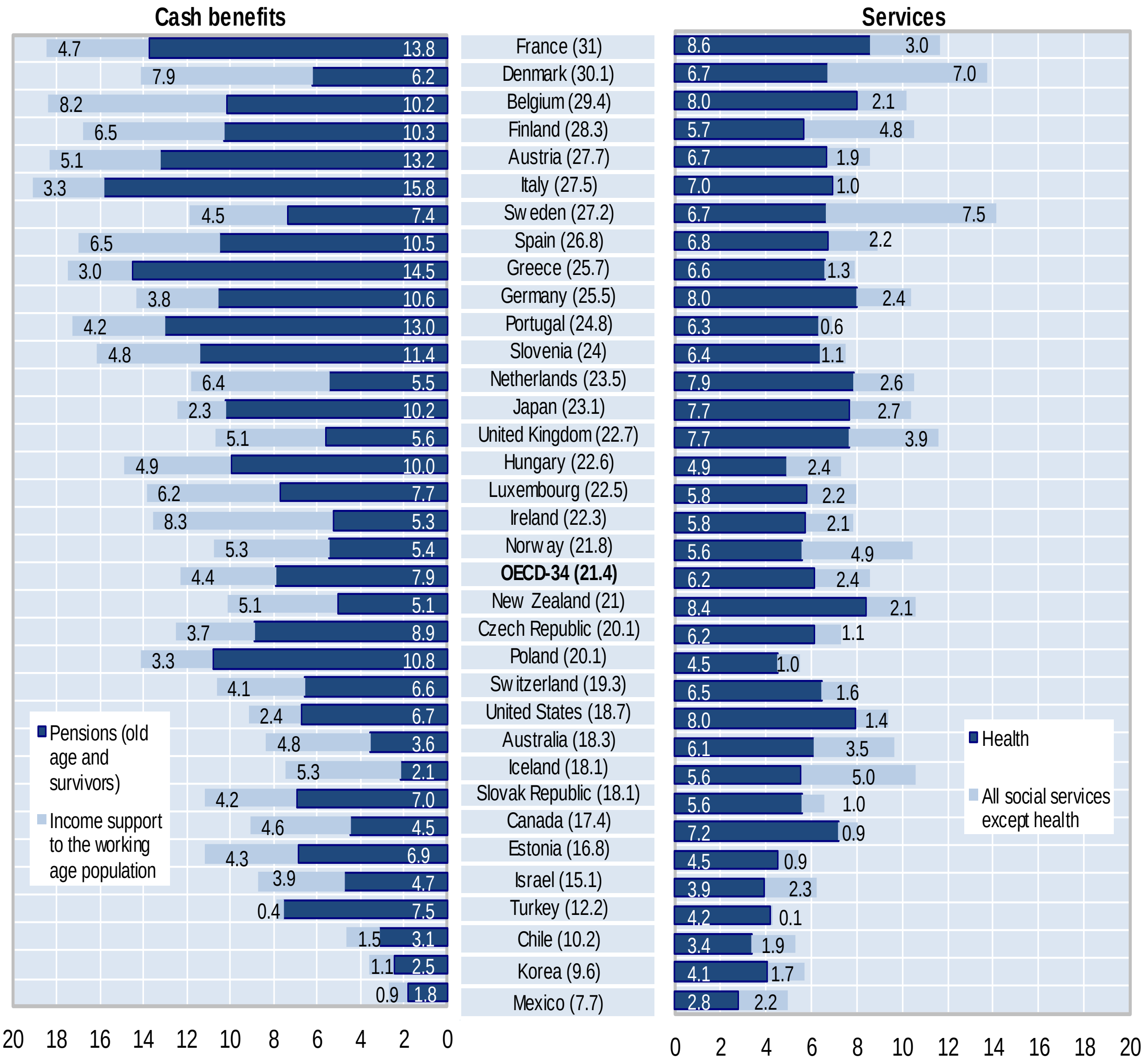
Public expenditure on health is another important social policy area (Figure 3). On average across the OECD, public expenditure on health has increased from 4% in 1980 to 6% of GDP. This increase was related to various factors including rising relative health prices and the cost of medical technology (OECD, 2014, *Health Statistics 2014*), and to a lesser extent the increase in the proportion of the elderly population.

In terms of spending, public pension payments constitute the largest social policy area with spending at just below 8% of GDP. There is great variety across countries in pension spending which to some extent is related to differences in population structures. For example, public spending on pensions in Italy accounted for 15.8% of GDP while this was only 1.8% of GDP in Mexico, but Mexico is a relative young country with nine persons of working age per senior citizen, three times as many as in Italy. (OECD, 2014, *Society at a Glance*). At the same time, Italian and Japanese populations have a similar age profile, but public pension spending in Italy is 5.6 percentage points of GDP higher than in Japan: the nature of pension systems also plays a key role in determining pension spending.

Since 1980 public spending on pensions has increased by 2 percentage points of GDP on average across the OECD, and demographic change continues to exert upward pressure on pension expenditure. *Pensions at a Glance* (OECD, 2013) and *Pensions Outlook*

4 Pensions and health are the main areas of public social spending

Public social expenditure by broad social policy area, as a percent of GDP, in 2012 or latest year available[1]



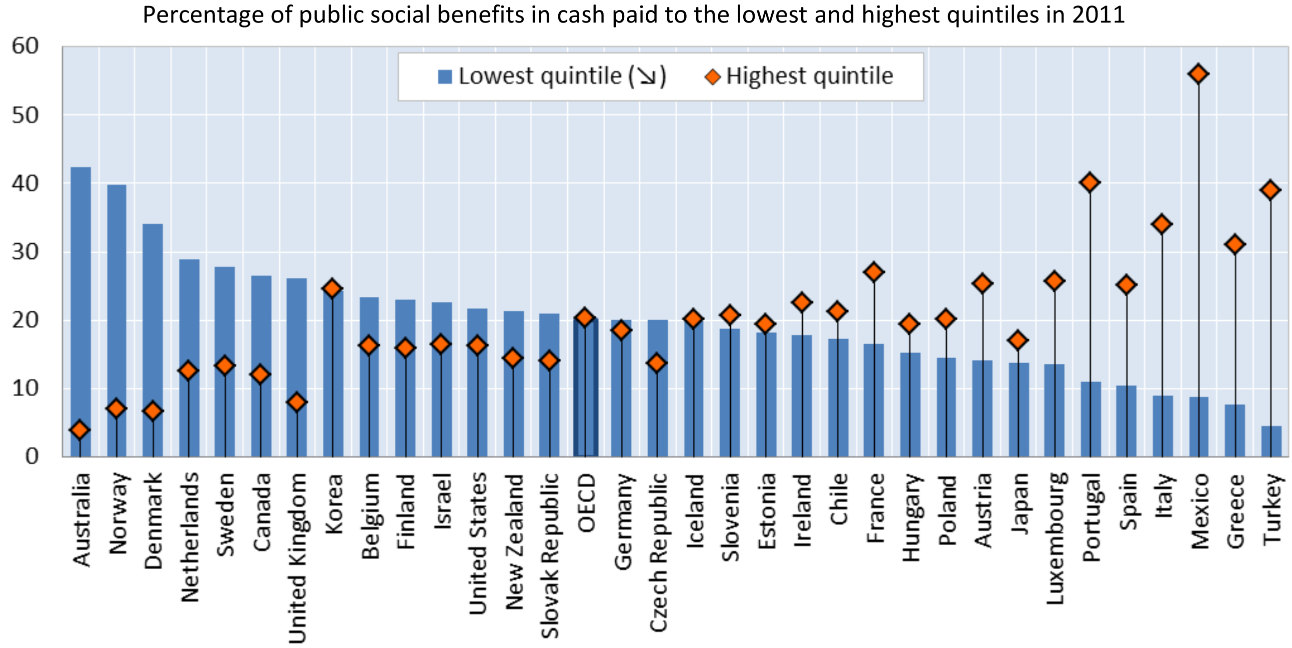
Note: Countries are ranked by decreasing order of public social expenditure as a percent of GDP. Spending on active labour market programs (ALMPs) cannot be split by cash/services breakdown; they are however included in the total public spending (shown in brackets). Income support to the working-age population refers to spending on the following SOCX categories: incapacity benefits, family cash benefits, unemployment and other social policy areas categories. Data for Australia, Canada, Chile, Israel, Korea, New Zealand and the United States refer to 2012; other data reflect 2011.

(OECD, 2012) show that in many countries pension reforms have improved the financial sustainability of pensions systems through, e.g. less generous indexation procedures for benefit payments, a greater reliance on private and/or defined contribution schemes, or higher retirement ages. For example, the gradual increase in the minimum age for "New Zealand Superannuation" from 60 to 65 over the 1992-2001 period contributed to a decline in public pension spending in New Zealand from 6.8% to 4.6% of GDP over the 1992-2001 period.

Are social transfers made to richer or poorer households?

Social cash benefits can be made for different reasons to different households, including because people are retired, disabled, unemployed, or otherwise without source of income, or to help out with the cost of children or support households when they are on leave taking care of very young children or sick and/or elderly dependents. Benefit receipt can thus depend on different contingencies; it does not necessarily mean the receiving household is poor.

5 The share of social benefits going to low income households varies considerably across OECD



Note: Lowest/highest quintile is defined as 20% of the population living the lowest/highest equivalised disposable income. *Source:* OECD Income Distribution database via http://oe.cd/idd.

Figure 5 shows the share of cash social benefits paid to the lowest quintile and the highest income quintiles in OECD countries. Clearly, there is considerable variation across OECD countries in the extent to which social transfers are made to low and high-income households. The share of cash benefits paid to household in the bottom income exceeds 25% of all cash benefits in the United Kingdom, Canada, the Netherlands and is highest in Norway and Australia at 40%, compared to around 10% in Mediterranean countries and 5% in Turkey. By contrast, in these latter countries social transfers often go to richer households, because these benefit payments are often related to a work history in the formal sector, and often concern pension payments to retired workers. Earnings related social insurance payments also underlie substantial cash transfers to the top income quintile in Austria, France and Luxembourg.

Income-testing in cash benefits

Getting a relatively high level of spending on cash benefits to lower-income households can be related to high levels of overall expenditure on cash benefits and/or a high degree of targeting within social programmes (Adema et al. 2014). The provision of social support can be made directly contingent on household income and/or means (e.g. assets), and, governments are increasingly looking at income-testing as a tool to ensure delivery of social support to the least well-off in the face of budgetary pressures.

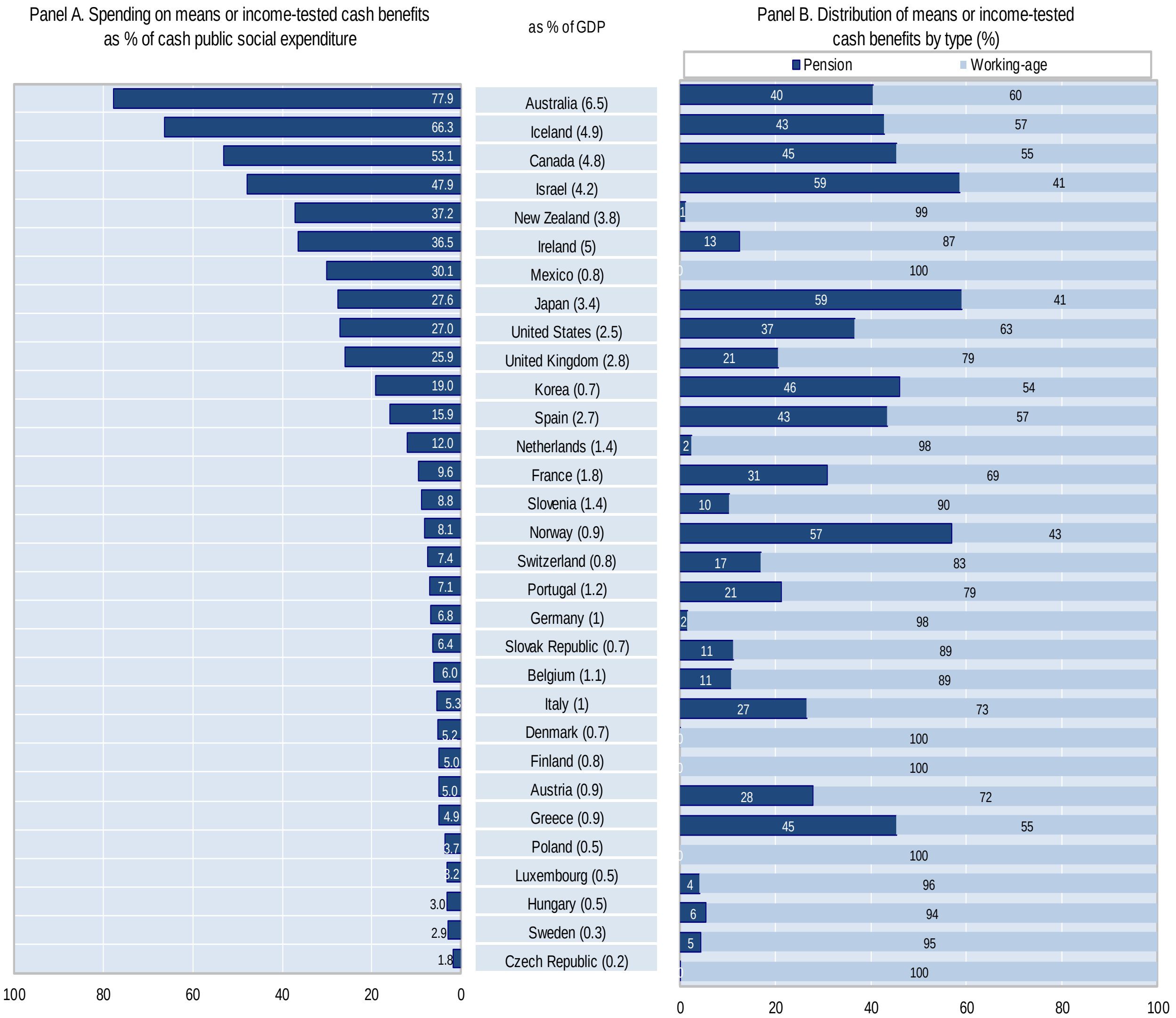
For the first time this year, SOCX collected comprehensive information on whether social expenditure programmes were income and/or means-tested or not, with “income-tested benefits” defined as those benefits that aimed to prevent household income to fall below a certain level and for which eligibility and entitlements are conditional on the recipient's current income, and assets in the case of means-testing.

Figure 6, Panel A shows that income-testing is most prevalent in non-European and/or Anglophone countries, and plays a much more limited role in continental European social protection systems. For example, in Australia, social spending through income-tested programmes amounts to 6.5% of GDP or almost 80% of all public social cash spending that is made. By contrast, most cash benefit payments in continental Europe are not subject to an income and/or means-test and income-tested support concerns less than 2% of GDP except in Spain, where spending income-tested unemployment benefits is now 2.5 times as high as it was before the crisis.

In most countries, income-tested benefits mainly concern income support of the working-age population (Figure 6, Panel B). However, in Australia, Iceland, Canada, Greece, Israel, Japan, Korea, Norway and Spain at least 40% of income-tested payments go to old-age and survivor pension recipients.

6 Income testing of social support plays a limited role in continental Europe

Public spending on income and means-test benefits as a percent of public social spending on cash benefits (and GDP in brackets), 2012 or latest year available



Note: The following cash income-tested spending items are included: spending on "other contingencies - other social policy areas" as in the OECD Social Expenditure database (SOCX), income-tested spending on the unemployed (e.g. unemployment assistance payments for Germany), income-tested support payments to elderly and disabled (e.g. Belgium and the UK), other income tested payments (survivor payments, family cash transfers) but do not include spending on ALMPs, housing or income-tested medical support.

In the United States public social spending is relatively low, but total social spending is the second highest in the world

Thus far, the discussion focussed on public social spending on cash benefits and social and health services, and in the United States and other non-European OECD countries such spending is lower than in most European countries. However, a focus on public budgets misses two important features that affect social spending totals and international comparisons of social expenditure: 1) private social expenditure and 2) the impact of tax systems.

Private social expenditure

Private social expenditure concerns social benefits delivered through the private sector (not transfers between individuals) which involve an element of compulsion and/or inter-personal redistribution, for example through the pooling of contributions and risk sharing in terms of health and longevity. Pensions constitute an important part of both public and private social expenditure. Private pension payments can derive from mandatory and voluntary employer-based (sometimes occupational and industry wide) programmes (e.g. in the Netherlands or the United Kingdom), or tax-supported individual pension plans (e.g., individual retirement accounts in the United States). In 2011, private pension benefit payments were around 3% of GDP in Canada, Iceland,

and Japan, around 5% of GDP in Denmark, the Netherlands, the United Kingdom and the United States, and highest in Switzerland at around 6% of GDP.

Private social benefits are much less likely to concern cash transfers to the working age population. In terms of spending, sickness and disability-related benefits were most important in Austria, France, Germany, the Netherlands, Norway and Switzerland where they amounted to 1% of GDP and were around 2% of GDP in Iceland. Private social spending also includes social services and benefits provided by non-government organisations (NGOs) to those most in need, but such outlays are often not centrally recorded, and relevant spending is under-reported in SOCX.

Individual out-of-pocket spending on health services is not regarded as social spending, but many private health insurance plans across the OECD involve pooling of contributions and risk sharing across the insured population. On average across the OECD, such private social health expenditure amounted to 0.6% of GDP in 2012. It was 1.5% of GDP in France and 2.5% of GDP in Chile, but across OECD countries private health insurance is most important in the United States where it amounted to 5.7% of GDP. Taken together with public spending on health amounting to 8% of GDP in the same year, and the value of revenue foregone on tax breaks on health premiums (just over 0.5% of GDP), total social health spending in the United States amounted to over 14% of GDP - 4 percentage points higher than in France which is the second biggest "health spender" among OECD countries.

In all, in 2011/12 private social spending was on average 2.6% of GDP across the OECD. Private social spending plays the most important role in the United States where it amounted to almost 11% of GDP, while it ranged from 4 to 7.5% of GDP in Chile and Canada, 5 to 6 % in Denmark, Iceland and the United Kingdom and over 7% in the Netherlands and Switzerland.

The impact of tax systems

Tax systems can affect social spending in three different ways:

1. Governments can levy direct income tax and social security contributions on cash transfers to beneficiaries. In 2011 the Danish Government clawed back more than 5% of public social spending through direct taxation of benefit income, and tax levied over benefit payments also exceeds 2.5% of GDP in Austria, Italy, Finland, the Netherlands and Sweden.
2. Government also levy indirect taxation on consumption out-of-benefit income and on average across the OECD this was worth 2% of GDP in 2011. Tax rates on consumption are often considerably lower in non-European OECD countries where tax revenue on consumption out-of-benefit income often amounts to less than 1% of GDP. In Europe, relevant tax revenue ranges from 1.8 to 3% of GDP.
3. Governments can also use so-called "tax breaks with a social purpose" (TBSP) to directly provide social support or with the aim to stimulate the private provision of social support.
   a) TBSPs which directly provide support to households are similar to cash benefits and often concern support for families with children, e.g. child tax allowances or child tax credits. Such TBSPs amounted to around 1`% of GDP in the Czech Republic, France, Germany, Portugal and Hungary - which introduced a Child Tax Credit in 2011.
   b) TBSPs to stimulate provision of "current" private social benefits is largest in the United States at around 1.4% of GDP, of which almost 80% concerns exclusion of employer contributions of medical insurance contributions.

Accounting for these features, results in a "net tax effect" (Figure 7). The value of benefit income clawed back through direct and indirect taxation exceeds the value of TBSPs in almost all countries, particularly in Europe, and the claw-back is 5% of GDP or more in Austria, Finland, Luxembourg, the Netherlands, Norway, Sweden, and is highest at 8-9% of GDP in Denmark. In non-European OECD countries, the overall tax claw-back over social spending is much smaller and negligible in Korea and Mexico, and in the United States the value of TBSPs and the tax claw-back over benefit income is broadly similar.

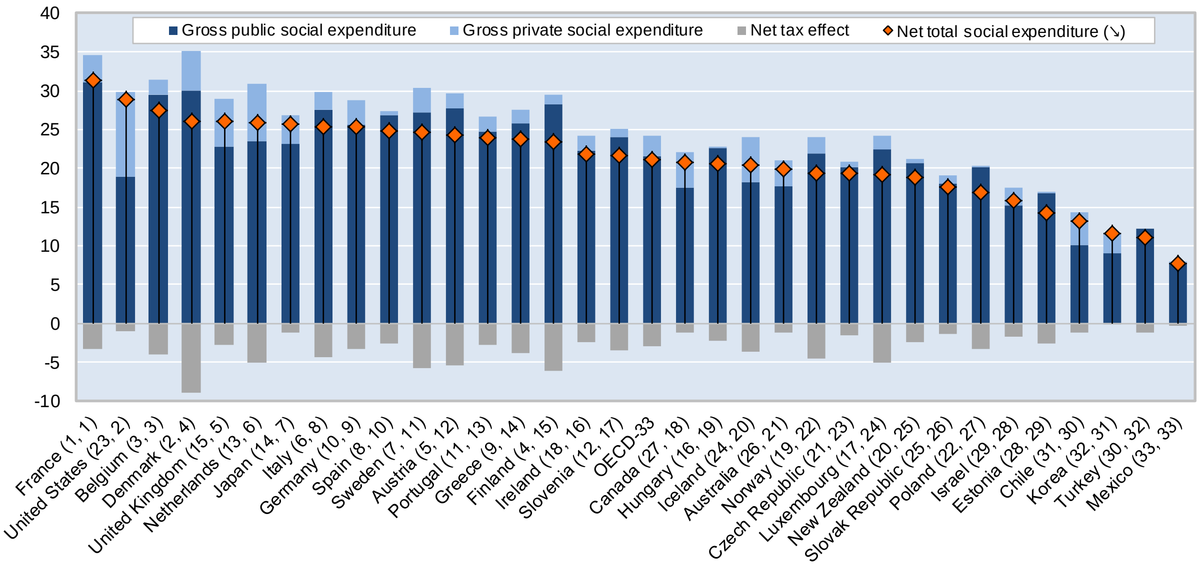
Cross-country rankings

Putting together the information on gross public and private social spending and the impact of tax systems leads to an indicator on net total social expenditure (Figure 7). This indicator shows greater similarity in spending levels across countries and changes in the ranking among countries.

Because of the large "net tax effect" Austria, Luxembourg and Scandinavian countries drop down the rankings (Figure 7). The "net tax effect" is also considerable in Iceland, the United Kingdom and the Netherlands, but the large role of private social benefits ensures that in spending terms these countries move up the rankings when considering net total social expenditure.

The combination of small "net tax effects" and considerable private social spending ensures that Australia, Canada, Japan and in particular the United States move up the international social spending ladder. As private social spending (including health) is so much larger in the United States compared with other countries, its inclusion moves the United States from 23rd in the ranking of the gross public social spending to 2nd place when comparing net total social spending across countries.

7 From gross public to total net social spending, as a percent of GDP at market prices, 2011



Note: The figures in brackets refers to the ranking of countries in term of gross public social expenditure from number 1 being the highest spender to the lowest 33: i.e. the United States ranks 23rd in OECD in term of gross public social expenditure and 2nd in term of net total social expenditure. 2011 data on TBSPs for New Zealand were estimated using available information for 2009; indicators on direct taxation of benefit income and TBSPs for Poland were also estimated on basis of available information for 2009. The "Net tax effect" includes direct taxes and social contributions, indirect taxes and net tax breaks for social purpose similar to cash benefits (TBSPs). TBSPs also include favourable tax treatment of "current" private social benefits (e.g. donations to charities or exemptions of private health insurance contributions) and favourable treatment of pension saving that "ultimately" benefits households (e.g., favourable tax treatment of private funds). The value of the TBSPs toward "current" private benefits is not included in this figure, as it is equivalent to financing of private social benefits, and thus has to be excluded to avoid double counting when calculating total net (public and private) social spending. For methodological reasons there is no comprehensive cross-nationally comparable dataset on the value of TBSPs for pensions.
Because of the complexities with calculating the value of tax reliefs for pension that are given at various stages (e.g. including tax exemptions for contributions to private pensions and tax relief for investment income of capitalised pension funds) there is no fully comparable cross-national data set available on TBSPs for pensions. Hence, available data are not included in the overall calculation of net total social spending.

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OECD Income Distribution database (http://oe.cd/idd).

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SOCX is available via the OECD statistical browser OECD.Stat. To facilitate international comparisons, this information is related to gross domestic product, gross national income, total government expenditure, and in purchasing power parities per head.