

# Social spending makes up 20% of OECD GDP

November 2020

<http://www.oecd.org/social/expenditure.htm>

## Key findings

- Over the past decade, public social expenditure has slowly declined to 20% of GDP on average across the OECD in 2019.
- At just over 30% of GDP public social spending is highest in France, while Austria, Belgium, Denmark, Finland, Germany, Italy, Norway and Sweden also devote more than a quarter of their GDP to public social support.
- At 7.8 and 5.6% of GDP on average across the OECD respectively, pensions and health are the main areas of public social spending.
- At over 12.5% of GDP, private social spending on health insurance and pensions is highest in the Netherlands and the United States.
- The amount of benefit income clawed back through direct and indirect taxation and was highest at 7.7% of GDP in 2017 in Denmark and exceeded 5% of GDP in Austria, Finland, Luxembourg, the Netherlands, Norway and Sweden.
- The United States is the only OECD country where the value of tax breaks for social purposes (TBSPs) (2.8% of GDP) exceeds the tax claw-back over benefit income (1% of GDP).
- After accounting for private social expenditure and the impact of the tax system, France is the biggest social spender at over 31% of GDP, but the United States moves up to second place at just below 30% of GDP.

## OECD welfare states have grown to about 20% of GDP on average

The size of welfare states differs markedly across OECD countries (Figure 1). At just over 30% of GDP public social spending is highest in France. But Austria, Belgium, Denmark, Finland, Germany, Italy, Norway and Sweden also devote more than a quarter of their GDP to public social support. In contrast, public social spending in countries such as Chile, Colombia, Costa Rica, Ireland, Korea, Mexico and Turkey, accounts for less than 15% of GDP.

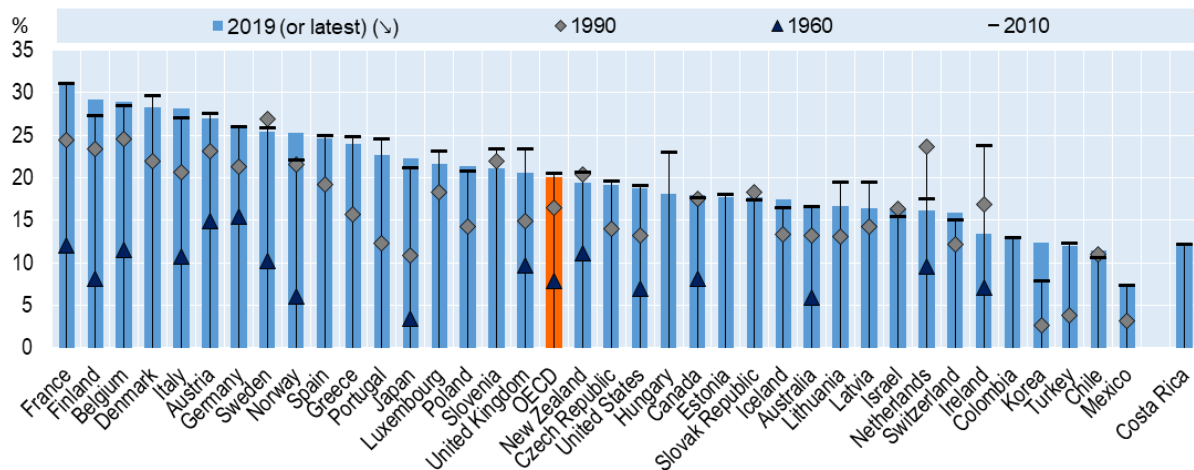
It takes some time for social protection systems to develop into comprehensive welfare states. In many European countries, Australia, Japan and the United States social systems doubled in size between 1960 and 1990. Across the 17 OECD countries (which were members at the time and for which data is available) public social spending to GDP-ratios increased on average from 7.8% in 1960 to 16.5% in 1990 Figure 1. This trend also played out in other countries, but at a later stage: although still low in international comparison, since 1990 public social expenditure-to-GDP ratios more than tripled in Korea 2.6% and Turkey (3.8%) to 10.1% and 12.1% respectively, in 2017.

Welfare states expanded particularly rapidly during the 1960s and 1970s when new social programmes were either introduced or increased in generosity. Since 1990 growth has been much lower (Figure 1), as budgetary constraints led many countries to tighten eligibility criteria to access social support, and/or curtail the real growth of payment rates and/or “privatise social spending” by increasing the responsibility of employers for supporting sick and disabled workers. For example, at 17.5% of GDP in 2010 in the

Netherlands, the public social spending-to-GDP ratio was over 6 percentage points lower than in 1990: this was in large part related to health care reform in 2006 which led to a shift away from public spending – since then compulsory basic health insurance is being financed through private funds, while mandated employer-provided sick pay was introduced in 1994.

### Figure 1. Public social spending is worth 20% of GDP on average across the OECD

Public social expenditure as a percentage of GDP, 1960, 1990 and 2019 (or latest year available)



Note: Data refer to 2019, except 2018 for Canada, Colombia, Costa Rica and New Zealand, 2017 for Australia and Japan and 2015 for Switzerland. For EU countries and Turkey data for 2018-19 were estimated on basis of DG ECFIN (2020), the European Union's Annual Macroeconomic database (AMECO) as at November 2020. For Korea and the United States, data for 2019 were estimated based on national budget data. Data for Costa Rica refer to 2011 instead of 2010. Data for Chile, Israel and the Slovak Republic refer to 1995, for Slovenia to 1996, and for Latvia to 1997 instead of 1990. Data for 1960 are only available for Australia, Austria, Belgium, Canada, France, Finland, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, the United Kingdom and the United States.

The real GDP growth rate for Ireland jumped up in 2015 to just over 25%. This was related to a small number of multinational enterprises relocating their intellectual property assets to Ireland, which resulted in a huge increase in the Irish capital stock and was accompanied by a substantial increase in exports through contract manufacturing production of goods by one firm under the label of another firm (OECD, 2018<sup>[1]</sup>). Source: OECD (2020) OECD Social Expenditure database, <http://www.oecd.org/social/expenditure.htm>.

Over the years population ageing has started to exercise upward pressure on social spending through demands for health care and income support in retirement (see below), while in times of economic downturns social spending increases with unemployment and social assistance payments. Hence, social spending reached its most recent peak with the great financial crisis, when public social expenditure amounted to 21% of GDP on average across the OECD, also reflecting a decline in GDP in many countries. As economies rebounded over the past 10 years or so, the public social spending-to-GDP ratio declined to 20% of GDP on average across the OECD (the sharp decline in the spending-to-GDP ratio between 2010 and 2019 in Ireland is related to a jump in GDP in 2015, see the notes to Figure 1).

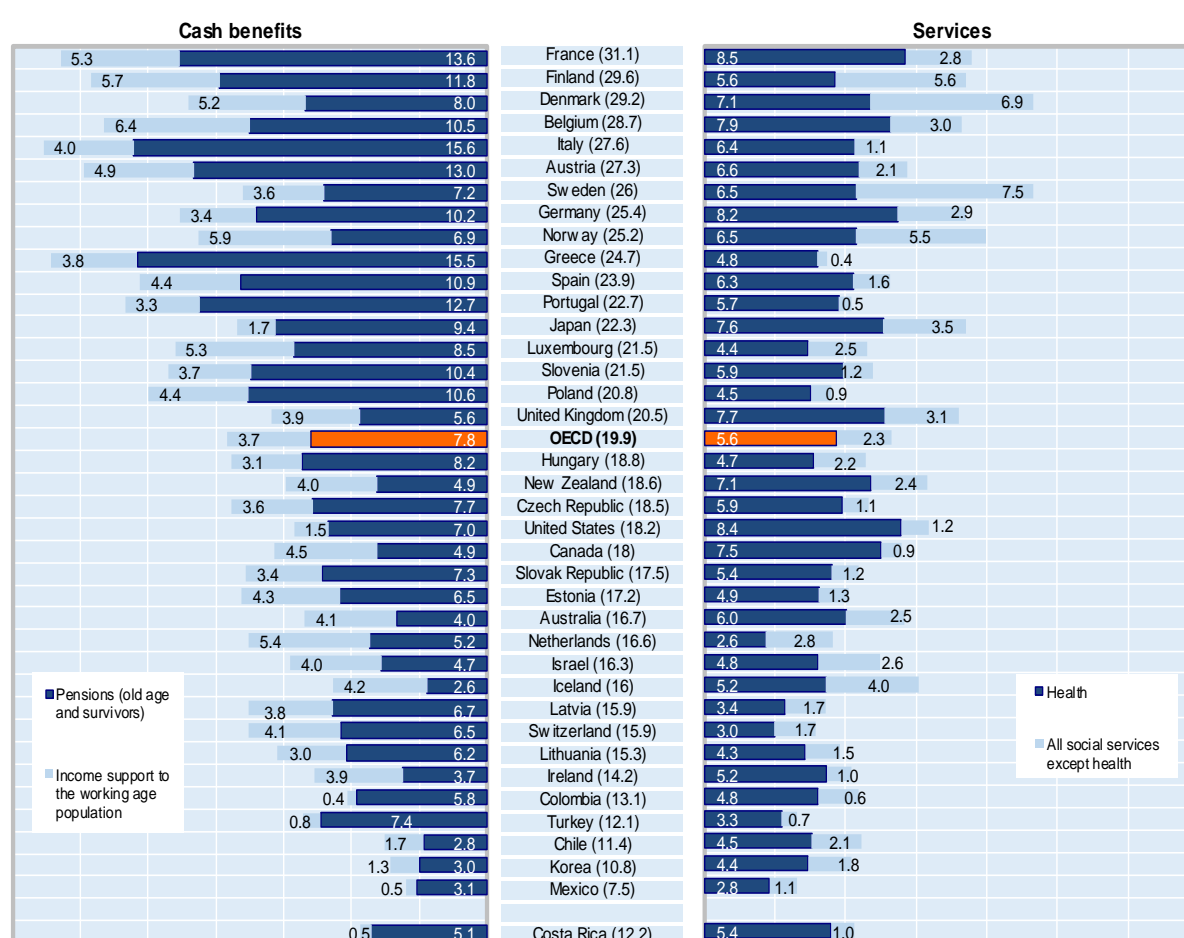
The COVID-19 pandemic of 2020 is expected to lead to a marked increase in social spending (OECD, 2020<sup>[2]</sup>). Demands on health care systems have obviously increased, and a wide array of social supports were put in place or expanded to help people cope with the economic effects of the pandemic. The range of supports included the introduction of short-time work schemes, increased expenditures for unemployment compensation and social assistance payments, and school closures led some countries to extend income support schemes for parental leave to care for children and/or increase formal childcare supports (OECD, 2020<sup>[2]</sup>). COVID-19 will have spending across a range of social policy areas in 2020, but it is as yet unclear how large the overall effect will be (OECD, 2020<sup>[4]</sup>; 2020<sup>[5]</sup>; 2020<sup>[6]</sup>).

## Pensions and Health are the main areas of public social spending

Across the OECD on average, public spending on old-age and survivor pension payments (7.8% of GDP) and health (5.6% of GDP) are the largest areas of social spending. Variation across countries is large. At over 15% of GDP, public pension spending is highest in Italy and Greece and lowest in Chile, Korea and Mexico at around 3% of GDP. In France and Germany public expenditure on health is over 8% of GDP, while it is less than 3% of GDP in Mexico and the Netherlands (Figure 2). These *public* spending differences are related in the age structure of populations, the number of older people who have access to pensions and health care, and the nature of health and pension systems – i.e. the generosity of systems and the extent to which countries make use of private health- and pension insurance plans.

**Figure 2. Pensions and health expenditure are the main items of public social spending**

Public social expenditure by broad social policy area, in percentage of GDP, in 2017/19 (or latest year available)



Note: Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on Active Labour Market Programs (ALMPs) cannot be split by cash/services breakdown; they are however included in the total public spending (shown in brackets). Across the OECD on average, 59% of public social spending is on cash benefits and 41% on services. Income support to the working-age population refers to spending on the following SOCX cash categories: Incapacity benefits, Family cash benefits, Unemployment and other social policy areas categories. Data for Chile, Israel, Mexico refer to 2019, for Canada, Colombia, Costa Rica, France, Hungary, Korea, the United States to 2018, Switzerland to 2015, otherwise they refer to 2017.

Source: OECD (2020) OECD Social Expenditure Database, <http://www.oecd.org/social/expenditure.htm>.

Thus, pension spending in Mexico is much lower than in Italy, because it has a relative young population (OECD, 2019<sup>[3]</sup>), but also because Italian retirees are much more likely to receive a pension than in Mexico where fewer than half of the older people receive a pension. The Netherlands has a similar age structure as Italy and almost all Dutch retirees receive a pension. But in Italy, public spending on pensions is over 10 percentage points of GDP higher than in the Netherlands. This is in part related to the relatively low effective retirement ages in Italy (OECD, 2019<sup>[8]</sup>), but also to the fact that relatively high earnings-related contributory pensions in the Netherlands are paid through private pension plans: private social pension expenditure (including survivor pensions) in the Netherlands exceeded 5% of GDP compared to about 1.3% in Italy (see below).

### Box 1. What is in the OECD Social Expenditure Database (SOCX)?

The new release of the OECD Social Expenditure Database (SOCX) includes detailed social expenditure programme data for 1980-2017/19 for 37 OECD countries and Costa Rica. 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 for children under age 6, but SOCX does not include public spending on education beyond that age. SOCX includes indicators on aggregate public social spending for 2018-19 based on national aggregates where data is available and estimates otherwise. For EU countries data for 2018-19 were estimated on basis of the European Union's Annual Macro-economic database (AMECO), DG ECFIN, November 2020. SOCX also includes indicators on net (after tax) social expenditure for 36 countries for 2017 (information on taxation of benefits often does not become available until two years after the fiscal year it concerns). 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 26 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 Affairs 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 the OECD 2019 Manual to the OECD Social Expenditure Database (SOCX) at [www.oecd.org/social/expenditure.htm](http://www.oecd.org/social/expenditure.htm).

Income support to the working-age population accounted for almost 4% of GDP on average across the OECD in 2017/19. This amount includes spending worth 1.6% of GDP on sickness and disability cash payments; 1.1% on family cash benefits such as child allowances and parental leave payments; 0.6% of GDP is spent on unemployment benefits, and another 0.4% on other social supports in cash. Spending on social services other than health was on average around 2.3% of GDP, of which almost 1% of GDP on family services – mostly Early Childhood Education and Care services for children age 0-5 inclusive. Public spending on services for the elderly and disabled was just below 1% of GDP across the OECD on average, such spending is typically highest in Nordic Countries it amounts to around 3 to 4% of GDP (e.g. spending on home help services as well as residential services).

## Accounting for private social spending and the impact of tax systems, social spending levels become more similar across countries

### *Private social expenditure*

Private social expenditure concerns social benefits delivered through the private sector (not including transfers between individuals) which involve an element of compulsion and/or inter-personal redistribution, for example through pooling contributions and risk sharing in terms of health and longevity, or fiscal support for taking out social protection coverage, e.g. a pension plan such as an Individual Retirement Account in the United States (see the notes to Figure 3). Private social expenditure can be mandatory (stipulated by law) or voluntary. Mandatory private social expenditure includes compulsory private health insurance schemes, pensions based on compulsory contributions, or sickness payments by employers. Voluntary private social expenditure includes, pension benefits based on past voluntary contributions, employer-provided childcare support, or benefits provided by charitable non-government organisations (NGOs). In 2017, private social spending totalled, on average, about 3.2% of GDP across the OECD, of which 1.4 percentage points was mandatory and 1.7 percentage points voluntary. Private social expenditure is largest in the Netherlands (13.5% of GDP in 2017), the United States (12.4%) and Switzerland (11.5%); it amounted to around 6.5% of GDP in Australia, Iceland and the United Kingdom (Figure 3).

#### *Mandatory private social expenditure*

Mandatory private health expenditure amounts to 5-6% of GDP in the Netherlands, Switzerland and the United States. In Switzerland, mandatory private health insurance has long been important, while it increased markedly in the Netherlands with the health reform in 2006 (see above). Mandatory health insurance in the United States received additional impetus (in some states workers compensation legislation is operated by private agencies and includes some medical benefits) with the introduction of the Affordable Care Act (“Obama Care”) in 2014. As the Affordable Care Act (“Obama care”) made compulsory a significant part of already existing employer-provided health plans, voluntary private health spending in the United States declined with its introduction from 6.4% of GDP in 2013 to around 0.8% in 2018.

Mandatory private cash benefits often concern pension payments that accrue from past mandatory contributions, and such spending amounted to 3.5% of GDP in Iceland and over 4% of GDP in Australia (Superannuation) and Switzerland. Occupational injury and accident legislations can provide for cash benefits to claimants, while countries sometimes also oblige employers to continue wage payments (at least in part) to employees who are absent from work because of illness. Such mandatory incapacity benefits amounted to 1% of GDP or more in Germany, the Netherlands and Norway and was highest at 2.5% of GDP in Iceland.

#### *Voluntary private social expenditure*

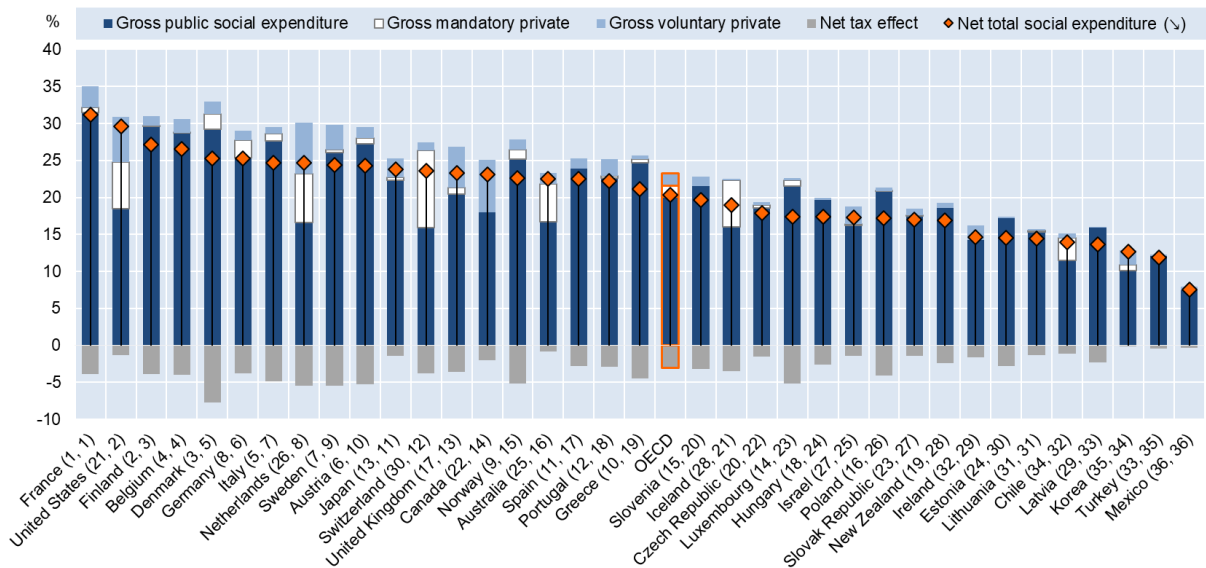
Voluntary private pension spending often concerns collective (often employment-related) health insurance plans or pension payments based on past voluntary contributions to pension plan. Private pension provision can be an important part of national social protection systems. Pension payments based on occupational and industry-wide programmes or tax-supported collective or individual plans amounted to around 5% of GDP in Canada, the Netherlands, the United Kingdom and the United States.

Individual out-of-pocket spending on health services is not regarded as social spending, but many private collective 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 0.5% of GDP in 2017, and was largest in Australia and Canada at around 1.5% of GDP.

Private social spending also includes social services and benefits provided by non-government organisations (NGOs) to those most in need, but as such outlays are often not centrally recorded, this type of spending is under-reported in SOCX.

### Figure 3. After France, the United States is the biggest social spender when accounting for private social health and pension benefits and support through the tax system

From gross public to total net social spending, as a percentage of GDP at market prices, 2017



Note: Data for Switzerland refer to 2015. 2017 tax data are estimated based on 2015 tax data for Denmark, Iceland, Japan and Poland.

The figures in brackets refers to the ranking of countries in term of gross public and net total social expenditure from number 1 being the highest spender to the lowest; i.e. the United States ranks 21 in OECD in term of gross public social expenditure and 2nd in term of net total social expenditure.

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 can also include favourable tax treatment of household pension saving, tax relief for employers and private funds that ultimately benefit households e.g. favourable tax treatment of employer-benefits provided to households, favourable tax treatment of private funds. The value of these is not reflected here, as this item is equivalent to financing of private social benefits, and needs to be excluded to avoid double counting when calculating net total (public and private) social spending. For most countries this would not matter as amounts are relatively small, except for the United States where the value of such TBSPs exceeds the tax claw-back over benefit income. 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.

Source: OECD (2020) OECD Social Expenditure Database, <http://www.oecd.org/social/expenditure.htm>.

### The impact of tax systems on social spending levels

Tax systems can affect social spending aggregates in three different ways:

- Governments can levy direct income tax and social security contributions on cash transfers to beneficiaries. In 2017, the Danish Government clawed back almost 5% of GDP through direct taxation of benefit income, while tax levied over benefit payments amounted to just over 1% of GDP across the OECD on average.
- Governments can levy indirect taxation on consumption out of benefit income. On average across the OECD, this was worth almost 2% of GDP 2017. 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, such tax revenue is close to 3% of GDP in Austria, Denmark, Finland, Greece, Hungary, Luxembourg and Slovenia.

- Governments can also use so-called “tax breaks with a social purpose” (TBSPs) to directly provide social support or with the aim to stimulate the private provision of social support.
  - 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 were closest to 1% of GDP in the Czech Republic, France and Germany.
  - TBSPs to stimulate provision of “current” private social benefits is largest in the United States at just over 2% of GDP, of which more than 50% concerns exclusion of employer contributions of medical insurance contributions.

Accounting for these features results in a “net tax effect” (Figure 3). The value of benefit income clawed back through direct and indirect taxation exceeds the value of TBSPs in almost all countries, particularly in Europe. The “net tax effect” was 5% of GDP or more in Austria, Finland, Luxembourg, the Netherlands, Norway and Sweden and was highest at 7.7% of GDP in 2017 in Denmark. The value of TBSPs is generally negligible in these countries so that the net tax effect equals the claw back, except for the Netherlands where the TBSPs for the Netherlands where it amounted to 0.6% of GDP (again, TBSPs measured here do not include TBSPs towards pensions). The “net tax effect” is smallest in Korea, Mexico and Turkey at around 0.3% of GDP. The United States is the only OECD country where the value of TBSPs (2.8% of GDP) exceeds the tax claw-back over benefit income by 1 percentage point of GDP.

### ***Cross-country rankings***

France is the biggest social spender according to both gross public and net total social expenditure indicators. However, taking together public and private social spending as well as impact of tax systems on social spending results in a very different ranking of countries in spending terms (Figure 3). For example, because of a relatively large “net tax effect” (reducing gross spending by 3.5% of GDP or more) and the limited role of private social spending (1% of GDP or less), Greece, Luxembourg and Poland move down significantly (7 places or more) the rankings when moving from gross to net total social expenditure indicators. The “net tax effect” is considerable in Iceland, the Netherlands and Switzerland, but this is more than compensated by the size of private social expenditure in these countries. As a result they move up the rankings by 7 places or more when considering net total social expenditure.

The combination of small “net tax effects” and considerable private social spending ensures that Australia, Canada and, in particular, the United States move up the international net total social spending ladder. Private social spending (including health and pensions) is much larger in the United States than in most other countries, and its inclusion moves the United States from 21st in the ranking of the gross public social spending to 2nd place in the international comparison of net total social spending. However more social spending through private agencies and fiscal arrangements does not necessarily mean more redistribution and solidarity. Tax advantages often benefit the well-to-do more than those on low-incomes (certainly when tax breaks are not paid in cash to those with limited or no tax liabilities) and often low-income workers do not have access to private social benefits (Adema, Fron and Ladaique, 2014<sup>[4]</sup>). A higher ranking in total net social spending does not necessarily contribute to more equal outcomes.

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## Citation

Please cite as: OECD (2020), Social Expenditure (SOCX) Update 2020: *Social spending makes up 20% of OECD GDP*, OECD, Paris, <http://www.oecd.org/social/expenditure.htm>.

## Notes

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.

OECD in figures refers to unweighted average of OECD countries for which data are available.

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The contribution by Baptiste Albertone is gratefully acknowledged.

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