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REVISITING REAL SOCIAL SPENDING ACROSS COUNTRIES: A BRIEF NOTE

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INTRODUCTION

Adema (1997) argued that standard data on budgetary allocations to social spending gives an incomplete picture of the extent of social protection across countries for two main reasons. First, government expenditure does not fully capture the effects of the tax system. Governments may pursue social objectives through giving tax advantages for social purposes (*e.g.* child-tax allowances); they may also tax cash benefits, so the net value of transfers is less than the gross expenditure. Second, the budget does not account for transfers which, although obligatory and motivated by social concerns, are not paid by government (OECD, 1999). The calculations in Adema (1997) approximate to a comprehensive measure of the extent to which governments *directly* determine expenditure for social purposes, either through their own spending or by requiring the private sector to provide social benefits. This note updates and extends these measures. First, the country coverage is expanded to cover thirteen countries. Second, as described in the following section, the notion of social spending has been enriched to also cover voluntary social spending by the private sector.

VOLUNTARY PRIVATE SOCIAL SPENDING

Governments often encourage employers/individuals to take up private protection by awarding tax advantages whose value can be considerable. For example, tax advantages towards employment-based health insurance plans in the United States amounted to almost 1 per cent of GDP in 1995. Estimates of the cost of these tax advantages were included in the calculations in Adema (1997), but the value of the private sector spending which benefits from the tax advantages was excluded. As a result of the tax advantages, the purchaser faces a price, which is not based on his or her individual risk-profile (or, in other words, the price is not that which would prevail in the absence of the tax advantage). Hence, governments introduce an element of *interpersonal redistribution* in these programmes,[1] and the out-of-pocket cost to private individuals might reasonably be described by an apparent oxymoron as being "private social expenditures". In principle, benefits that derive from private benefit plans taken out at prevailing market prices and risk profiles are not included in the calculations. They are *not* considered "social", as they have no deliberate interpersonal redistributive element (relevant pension benefits represent pure re-distribution of purchasing power over time without interpersonal redistribution). This note quantifies the importance of such spending which, although voluntarily made by private individuals and companies, has nevertheless been promoted by tax breaks.

Examples of such voluntary private social benefits include the employment-based pension benefits that are paid in Australia, Canada, Denmark, Ireland, the Netherlands, Sweden, the United Kingdom and the United States. Employment-based health benefits are also of considerable importance in the United States. Benefits stemming from individual-based tax-advantaged private pensions exist in Australia, Belgium, Canada, Denmark, the United Kingdom and the United States.[2] The importance of these private social benefits is expected to grow as plans mature (Adema and Einerhand, 1998). Other examples of voluntary private social benefits included in the calculations are disability benefits (Belgium, Finland, Germany, the Netherlands, Sweden, the United Kingdom and the United States); sickness benefits (Finland, the Netherlands, the United Kingdom and the United States); family benefits (Germany) severance payments (Italy and the United Kingdom); and supplementary unemployment compensation (the United States).[3] Accounting for voluntary private social benefits and direct and indirect taxation levied on such benefits enables the quantification of that part of an economy's domestic production which is devoted to social expenditure, be it private or public. This indicator is referred to as *net total social expenditure*.[4]

CROSS-COUNTRY COMPARISONS

The coverage of estimates on net social expenditure has been expanded to thirteen countries: Australia, Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, the Netherlands, Norway, Sweden, the United Kingdom and the United States. As discussed in Adema *et al.* (1996), since benefits have been adjusted for the value of indirect taxation, social spending is better related to GDP at factor cost rather than at market prices.

The starting point for the calculations is gross public expenditure on social purposes (first line in Table 1) and the first correction concerns the way taxation affects spending by the public sector on social protection. The importance of particular tax items across countries can be summarised as follows (Adema, 1999):

- D*irect taxes and social security contributions*. Australia, Ireland, the United Kingdom and the United States tax public transfers lightly. Taxes and social security contributions on transfers do not exceed 2 per cent of GDP in Germany, Canada and Belgium. By contrast, Denmark, Finland, the Netherlands and Sweden tax public benefits rather heavily: levies exceed 5 per cent of GDP.
- I*ndirect taxes*. There is a sharp difference in the value of benefit income clawed back through taxes on consumption between the European countries on the

Table 1. **Net social expenditure indicators, 1995**

Percentage of GDP at factor cost

	Australia	Belgium[1]	Canada	Denmark	Finland	Germany	Ireland	Italy	Netherlands	Norway	Sweden	United Kingdom	United States
. Gross public social expenditure	20.3	30.1	20.8	37.6	35.7	30.4	21.8	26.5	30.1	31.5	36.4	25.9	17.1
. Net current public social expenditure	18.7	..	17.9	23.6	25.1	25.9	17.4	20.9	21.2	21.9	25.4	22.3	17.5
. Gross mandatory private social expenditure	0.3	1.8	..	0.6	0.2	1.8	..	..	0.8	1.0	0.4	0.4	0.5
. Net direct mandatory private social expenditure	0.3	..	..	0.3	0.0	1.0	..	..	0.5	0.6	0.2	0.3	0.5
. Net publicly mandated social expenditure [2 + 4][1]	19.0	26.5	17.9	23.9	25.2	26.9	17.4	20.9	21.6	22.5	25.6	22.6	18.0
. Gross voluntary private social expenditure	3.2	0.7	5.1	1.0	1.2	1.0	2.0	1.9	4.9	..	2.3	4.8	8.6
. Net direct voluntary private social expenditure	2.7	..	3.5	0.5	0.7	0.8	1.5	1.4	3.4	..	1.4	3.6	7.8
. Net direct private social expenditure [4 + 7]	3.0	..	3.5	0.8	0.8	1.8	1.5	1.4	3.8	..	1.6	3.9	8.3
. Net total social expenditure[2]	21.6	..	21.2	24.4	25.7	27.7	18.7	22.3	25.0	..	27.0	26.0	24.5
emorandum item:													
Tax breaks towards pensions	1.9	..	2.2	..	0.0	0.1	2.1	..	2.1	0.0	..	2.8	1.0

. Available information on taxes and social security contributions for Belgium is of an aggregate nature and does not facilitate a separate allocation of tax levied over public and mandatory private social benefits. Hence, only net publicly mandated social expenditure can be estimated for Belgium.

. Net total social expenditure is not simply the sum of net current public social expenditure [line 2] and net direct private social expenditure [line 8], as some public expenditure items are tantamount to financing current private benefits, *e.g.* private health provisions. Estimates on net total social expenditure [line 9] account for this potential double counting, see Adema (1999).

ource: Adema (1999).

one hand and the non-European countries, particularly the United States, on the other.

- *Tax breaks for social purposes* (excluding those towards pensions, see Adema, 1999). This form of social provision is generally less important in countries with relatively high direct tax levies such as Denmark, Finland, the Netherlands, Norway and Sweden. Tax breaks for social purposes are more prominent in Belgium and Germany (towards families with children) and the United States (towards medical care and employer contributions for medical insurance).

Taking into account the corrections for taxation, **net current public social expenditure** (line 2 in Table 1) is highest in, Germany, Sweden and Finland at over 25 per cent of GDP, and lowest in Canada, Ireland and the United States at less than 18 per cent. However, if data on the value of tax concessions to private pensions had been available for all countries on a comprehensive basis (partial information is given as a memorandum item in Table 1), it is likely that Australian, British, Canadian, Dutch, Irish and US spending levels would have increased relative to those of the other countries.

Except in Australia, and the United States, the overestimate of public social expenditures due to a failure to account for taxes on transfers exceeds the underestimate arising from neglect of tax advantages and mandatory expenditures by non-public bodies. Hence, **net publicly mandated direct social expenditure** is significantly lower than suggested by gross budget data (compare lines 1 and 5 in Table 1). For Denmark, Finland, the Netherlands, Norway and Sweden, the adjustments lead to the net indicators being 9 to 14 percentage points of GDP at factor cost lower than the gross measure. In contrast, the budget data for the United States slightly *under*estimate publicly controlled social effort.

Once private social expenditure is added (to give **net total social expenditure** – see line 9 in Table 1), it emerges that recipients of social benefits in Denmark, Finland, the Netherlands, the United Kingdom and the United States claim about one quarter of the economy's domestic production.[5] The lowest proportion (18.7 per cent) is recorded in Ireland and the highest (27.7 per cent) in Germany.

The upshot of these adjustments is a marked convergence of social expenditure levels across countries, driven by two factors: *a*) the inclusion of private social benefits, which are particularly important in the United States; and *b*) the impact of the tax system. Across the 11 countries for which comprehensive data are available, the standard deviation in 1995 was 7.2 for gross public social expenditure as a share of GDP, but only 2.8 once adjustments to take account of differences in tax systems and private social expenditures have been made to give estimates of net total social expenditure. It follows that observations on social expenditure levels across countries that do not account for private social benefits and the impact of the tax system risk being misleading.

NOTES

1. This note does not adjudicate the extent of interpersonal redistribution within a social programme. The degree of interpersonal redistribution of private pension plans is deemed much lower than in public social assistance programmes, but may not be dissimilar in redistributive nature from public pension benefits to former government employees.
2. In practice life insurance policies are marketed as general savings instruments and are frequently linked to individual mortgage policies. Nevertheless, life-insurance policies can have a clear social purpose when such policies are paid out to survivors or when they specifically concern old-age cash benefits. However, separate data on the "survivors component" in life-insurance disbursements are not available. When information on specific benefits for retirement through life-insurance companies is available (*e.g.* Denmark and the United States), these expenditures are included.
3. Individual co-payments may be made for medical interventions, which are only covered in part by health insurance plans. Co-payments to medical interventions covered by public and private health insurance plans with a redistributional element should also be treated as private social expenditure since the price is determined by government intervention. However, they are not included in this note because of data limitations. Similarly, other private social benefits such as employer-provided child-care and benefits provided by charitable non-governmental organisations cannot be included. The figures given in this note, therefore, underestimate somewhat the magnitude of private social expenditures. Adema (1999) includes a detailed overview of the methodological developments, programme information and estimation methods underlying the indicators presented here.
4. Net *public* social spending is an indicator of the public spending effort on social protection. This indicator takes account not only of what governments actually spend on social protection but also includes an estimate of what it claws back in taxation of benefits. Looking at it from the perspective of beneficiaries, it is a measure of the "net value" of social support directly provided by the government. Estimates on net *private* social expenditure measure the aggregate of privately provided support as received by beneficiaries. Hence, net *total* social expenditure is an indicator of the total spending effort on social protection with an element of interpersonal redistribution to which recipients of public and private benefits lay claim.
5. Supplementary pensions are taxed relatively heavily in Canada, Denmark, Finland, the Netherlands, and Sweden. By contrast, Germany, Ireland, the United Kingdom, and particularly the United States tax such benefits relatively lightly. Some countries, *e.g.* Denmark, also tax income generated by pension funds over accumulated assets. This is not reflected in the calculations (Adema, 1999).

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