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The Policy Response: Boosting Employment and Social Investment

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11.1 Introduction

By the turn of the century the idea that having more people in paid work was key to improved social inclusion, poverty, and equality outcomes had become central to policy reform in many OECD countries. This notion was at the core of influential new policy doctrines at the time, for example the ‘Third Way’. Disproving fears of a future characterized by ‘jobless growth’ and ‘the end of work’, the fifteen years prior to the crisis of 2008 were marked by strong net employment gains so that just prior to the crisis employment rates had reached historically high levels in many countries. Yet it also became clear that employment growth in and of itself had not produced the expected social improvements. Marked increases in employment rates had for the most part gone accompanied with rising or stagnant relative poverty rates for the working-age population. Income inequality had mostly increased.

Despite this, and the crisis, employment growth ambitions remain strong. The Europe 2020 growth strategy has the objective of reaching an employment rate of 75% by 2020. Following its two high-profile reports on income inequality, the OECD (2011) has stated that ‘policies for more and better jobs are more important than ever’.

Yet it is also increasingly recognized that job growth alone may not suffice to make sure that everybody has its share of prosperity if this is not actively supported by government investment in human capital and in services that make it easier for people to realize their earnings potential. The OECD (2011) stresses the crucial importance of human-capital investment in the fight against growing inequality and poverty. By the same token, the European
Commission (2013) has launched a ‘Social Investment Package’ also emphasizing human-capital investment. Publicly provided or subsidized services of various kinds, and particularly education and care services, are seen as key instruments in this package.

All this is in tune with thinking among a number of scholars (Esping-Andersen et al., 2002; Vandenbroucke et al., 2011; Morel et al., 2012; Hemerijck, 2013; Nolan, forthcoming; Cantillon, 2013). Some advocate a radical shift from cash to care/social investment. In an influential report to the Presidency of the European Union, Esping-Andersen et al. (2002) called for a radical overhaul of welfare-state architectures in Europe, stating, ‘As the new social risks weigh most heavily on the younger cohorts, we explicitly advocate a reallocation of social expenditures towards family services, active labour market policy, early childhood education and vocational training, so as to ensure productivity improvement and high employment for both men and women in the knowledge-based economy.’

In view of the centrality of activation and human-investment strategies in current policy discourse, this chapter specifically considers the empirical evidence on the redistributive impacts of such policies. First we consider the role of activation and employment policies in promoting more egalitarian societies. Special attention is paid to the links between individual employment outcomes, household work intensity, and poverty. We then investigate the distributive role of the services that are often seen as an instrument ‘par excellence’ for fulfilling the social-investment strategy. We examine whether the various services—including education, health, childcare, and other social services—foster egalitarianism, thereby distinguishing between first- and second-order redistributive effects.

11.2 Does High Employment Foster Egalitarianism?

11.2.1 Introduction

Observing the debate, it is striking that widely different, in some cases diametrically opposed, assumptions are entertained about the relative merits of alternative courses of action for policy when it comes to reducing inequality and poverty. This is perhaps none more true than with respect to the link between work and poverty. An important section of opinion basically holds that more people in work equals fewer people in poverty and, by implication, that an elaborate welfare state with large-scale redistributive efforts is not a prerequisite for a low level of poverty.

The idea that, ultimately, the best and most sustainable anti-poverty strategy is a work-based strategy has long been advocated. There is some intuitive
appeal to the notion that ‘the best protection against poverty is a job’—a ubiquitous political slogan with popular appeal. People who are not in work tend to occupy the lower strata of the income distribution. If more jobs become available and low-income people take up these jobs and improve their income position, the result is a selective rise of incomes at the lower end and thus a reduction in income inequality and the share of the population in poverty relative to the median. The important proviso, of course, is that work pays more on average than remaining inactive.

An alternative view holds that we are effectively confronted with a trade-off between employment (that is, non-government employment) and income equality. The idea here is that high levels of non-subsidized employment can in present-day economic circumstances only be achieved at the cost of a large low-paid (service) sector and increased, though perhaps temporary, ‘poverty in work’. Deindustrialization, economic globalization, and technological progress play a central role in arguments that the industrialized economies are increasingly faced with a choice between more structural labour market exclusion or more low-paid employment, unless government is willing to provide adequately paid employment. Iversen and Wren (1998) called this the ‘trilemma of the service economy’. The contrast is drawn with the golden years of welfare capitalism when manufacturing industry provided stable, well-paid employment even for those with little or no formal education. As Esping-Andersen et al. (2002) put it, ‘We no longer live in a world in which low-skilled workers can support the entire family. The basic requisite for a good life is increasingly strong cognitive skills and professional qualifications... Employment remains as always the sine qua non for good life chances, but the requirements for access to quality jobs are rising and are likely to continue to do so.’ In a similar vein, Bonoli (2007: 496) states, ‘Postindustrial labour markets are characterised by higher wage inequality with the result that for those at the bottom end of the wage distribution, access to employment is not a guarantee of a poverty-free existence.’

Such statements are in line with an important stream in the academic and popular literature on the devastating effects of economic globalization and skill-biased technological change on the labour-market position of less qualified workers in rich countries. Research by labour economists shows that this picture of a uniform shift away from low-skilled work needs nuance (Autor et al., 2003). The impact of technological change, real as it is, has not simply entailed a demand shift away from lower-skilled labour and towards more highly educated workers. Studies have shown that there is growth in employment in both the highest-skilled (professional and managerial) and lowest-skilled occupations (personal services) with declining employment in the middle of the distribution (manufacturing and routine office jobs). Goos et al. (2009) document this trend towards ‘job polarization’ throughout
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Europe, albeit with varying intensity. This research does, however, provide legitimate concern about a possible rise of low-paid work (Lucifora and Salverda, 2009). We also refer back to the findings reported in Chapter 3 in this volume, which details developments in labour markets.

11.2.2 The Activation Drive

The period before the current crisis saw a strong rise in employment levels in the EU. These did not come about by accident (Van Rie and Marx, 2012). In most EU countries a marked policy shift had taken place towards boosting labour-market participation levels and reducing benefit dependency among those of working age. Many examples can be found in the country case studies in the companion volume from the GINI project. The Netherlands stands out as one of the most striking earlier examples of a radical turn towards activation. Later on many countries followed suit. The German Hartz reforms provide another much discussed illustration.

Some countries pursued macro-economic policies to foster job growth, such as the Netherlands, where a policy of sustained wage moderation was central to boosting labour participation levels—and with considerable success, it must be added. In other countries, changes in macro-economic conditions (low interest rates following the EMU and euro membership) had major impacts on employment performance, as for example in Spain, where unemployment dropped spectacularly prior to the crisis.

At the same time, an increased policy emphasis on micro-level activation has become evident in many European countries, certainly at the level of rhetoric, and gauging by some indicators also in terms of actual policy (Barbier and Ludwig-Mayerhofer, 2004; Kenworthy, 2008a; Immervoll, 2012; Marchal and Van Mechelen, 2013; Weishaupt, 2013). Within the broad set of activation strategies deployed, an important number specifically target the long-term unemployed, including social assistance recipients. The general purpose is to get these people into a job, in the private market or in the subsidized sector. Most of these are relatively low-paid/minimum-wage-level jobs. In the case of Belgium, for example, the main activation measure for social assistance recipients is a public employment scheme offering temporary employment at the minimum wage. Similar programmes exist elsewhere. Employment subsidies and employers’ social security contribution reductions also generally aim to stimulate the creation and take-up of relatively low-paid jobs.

From a poverty perspective, it matters who is targeted for activation into such low-paid jobs and under what conditions this is done. If activation measures stimulate single persons to move from long-term benefit dependency into minimum-wage jobs, this will impact positively on poverty if minimum
wages (and net incomes at minimum wage) exceed poverty thresholds and when benefits for the long-term unemployed (be it social insurance or social assistance) are below poverty thresholds. Similarly, if such measures stimulate potential second earners into low-paid jobs there may also be a positive effect on (in-work) poverty, provided they are living in a household with a disposable income not far below the poverty threshold. There may be an indirect effect, however, in that poverty thresholds may be pushed up if these jobs are mainly taken up by people in households with disposable incomes already in the middle and upper ranges of the distribution. This could then cause median equivalent income and hence the relative poverty thresholds to rise, other factors held constant.

If, however, single parents are the target of activation efforts, without there being affordable/available childcare, there is a potential problem in that they may be forced to take part-time jobs. This may imply that they remain stuck in financial poverty. Even a full-time minimum-wage job may not suffice if the minimum wage is not sufficiently high relative to the poverty threshold, or if taxes and social security contributions cause net disposable income to drop below the poverty line. Similarly, unemployed sole breadwinners with a dependent spouse and children (and possibly others) to support may not be lifted from poverty if they are forced to take up a low-paid job unless there are supportive measures such as child benefits or in-work benefits. Hence, the potential impact in each country will depend on compositional factors (the household composition of the non-active population) and contextual factors (minimum wage levels, the presence of child benefits and childcare facilities, the presence of in-work benefits, or earnings disregards).

11.2.3 Employment, Income Inequality, and Poverty

The notion that ‘a job is the best protection against poverty’ was key to efforts to boost activity rates in the EU and elsewhere (Cantillon, 2011). So how did employment growth affect the economic position of people at the bottom of the distribution? Figure 11.1 shows employment rates and Gini coefficients for overall income inequality and relative poverty rates as averages for the EU countries over the period 1995–2010. Between 1995 and 2008 the employment rate increased on average by about 7 percentage points in the EU-15. For all EU member states we present data from 2000 and onwards. In this larger group of countries the increase in employment was particularly pronounced in the mid-2000s. Yet, as the figures clearly show, this increase in employment is not reflected in a corresponding decrease in income inequality or in the relative income poverty rate. At the very minimum it can be said that highly significant net employment gains did not yield lower household inequality levels and that in more than one instance employment growth was in fact
accompanied by rising inequality and relative income poverty, as is extensively documented in the country chapters in Nolan et al. (2013). Projections of the probable poverty impact of the Europe 2020 employment-rate target of 75% produce a picture that is in line with past experience; net gains in the number of people employed will result only to a very limited extent in reductions in the number of people in relative poverty (Marx, Vandenbroucke, and Verbist, 2012).
In its report *Growing Unequal*, the OECD (2008) performed a comprehensive analysis of the role of earnings and employment trends in income inequality trends at the household level. Amid a considerable degree of variation across countries, the general pattern was for increases in male earnings inequality, while the wage gap between men and women narrowed. The growth of non-standard employment did, however, contribute to a widening in the dispersion of personal earnings. This increase in earnings inequality was partially offset by higher employment rates and the continued proliferation of dual-earnership.

Distributive outcomes result from a large number of often complexly interrelated factors, and many factors not immediately related to labour-market trends account for observed inequality and poverty trends. There are three principal reasons why past job growth did not produce poverty declines: (i) because past job growth did not sufficiently benefit poor people, while at the same time the adequacy of minimum income protection deteriorated, (ii) because getting a job does not always raise income enough to escape poverty, and (iii) because median equivalent income shifted upwards in association with job growth and the policies that stimulate job growth. There are many other factors, often country-specific, that play a role, as is documented elsewhere in this volume and Nolan et al. (2013), but we restrict our discussion here to three main mechanisms.

First, most at risk of poverty are persons living in so-called ‘workless households’, i.e. households where no adult at working age has an attachment to the labour market (OECD, 2009; de Graaf-Zijl and Nolan, 2011). People of working age living in such workless households face the highest poverty rates by far and they also tend to experience the most severe financial hardship, including their dependent children if any. More generally, poverty at working age is more strongly associated with work intensity at the household level than with individual labour-market status, for the obvious reason that a non-employed person may well live in a household where others have earnings. A household where no one has earned income, or very little of it, is almost always reliant on transfer income.

Household joblessness tends to be higher than the distribution of individual non-employment risks would lead one to expect (Corluy and Vandebroucke, forthcoming). The concentration of non-employment within the same households may be due to many factors (Gregg, Scutella, and Wadsworth, 2010). A correlation between the employment statuses of household members may reflect a tendency for individuals who share common characteristics to live together. Since persons with fewer educational qualifications typically experience higher unemployment and non-employment rates, households whose members all have a low level of educational attainment are likely to be over-represented among workless households. Household members are usually...
looking for work in the same local labour market and a depressed labour market will have a common impact on them. The disincentive effects of tax and benefit systems can also play a role. It is often the case that if one person in the household gets a benefit, another is penalized if he or she accepts a job. To get out of this dependency trap, all members of the household must find a job simultaneously, which may be particularly hard if both partners have low educational attainment. This problem may be more severe in countries with extensive means-testing of welfare benefits based on family income.

In this light, it is perhaps not altogether surprising that employment growth did not produce commensurate drops in workless household rates. In many countries job growth resulted in more double- or multi-earner households, but only to a more limited extent in fewer no-earner households (Corluy and Vandenbroucke, forthcoming). While the position of households that acquired additional income improved, the relative income position of (near) jobless households deteriorated because of the general erosion of minimum income protection levels, certainly at the level of social assistance, but also in some cases at the level of social insurance. For a discussion of direct income support trends we refer back to the previous chapter and to the country chapters in Nolan et al. (2013).

A second reason why employment growth does not necessarily result in less poverty is that a job may not pay enough to escape poverty. This is what is commonly referred to as ‘in-work poverty’. What poor jobless persons often require is not just a job, but a job that pays significantly more than their benefit. In the case of non-employed poor persons living in a household with already one earner, the additional income required to escape financial poverty may be quite limited. Indeed, a small part-time job may suffice (Maître, Nolan, and Whelan, 2012). For sole breadwinners the required income gain is often quite substantial. From an anti-poverty perspective, the issue is not just ‘making work pay’ (i.e. tempting people to move out of dependency), but to make work pay sufficiently to ensure that a move from dependency to work also implies a move from poverty to an adequate living standard. The living standard of poor households with weak or no labour-market attachment is often so far below the poverty threshold (especially in the case of single parents and child-rich households) that it is quite possible that a job that pays significantly above the minimum wage will not suffice to lift them from poverty (Marx et al., 2013).

A host of recent comparative studies have documented patterns and trends of in-work poverty in rich countries (Andress and Lohmann, 2008; Crettaz, 2011; OECD, 2009; Fraser et al., 2011; Maître, Nolan, and Whelan, 2012; Marx and Nolan, 2013). As many as a quarter to a third of working-age Europeans living in poverty are actually already in work. In most EU member states the
majority of children living in a financially poor household have at least one
working parent.

It is not the case, however, that in-work poverty rates are higher in coun-
tries with more elevated employment levels. It is also not the case that in-work
poverty increased most strongly in countries where employment increased
most strongly. In fact, despite across-the-board increases in employment in
the pre-crisis decade, in-work poverty remained stable in most European
countries (Marx and Nolan, 2013). That may have something to do with
the way in-work poverty is conventionally measured. The ‘working poor’
as conventionally defined in the statistics are those individuals who have
been mainly working during the reference year (either in employment or
self-employment) and whose household equivalized disposable income is
below 60% of the median in the country in question. Combining two lev-
els of analysis—the individual’s labour-market status and the household’s
income (adjusted for household size)—inherently complicates interpreta-
tion, since the labour-market status of other persons in the household, rather than
that of the individual being considered, may be crucial, as may the number
of dependent children if any. This definition/measure makes it difficult to
identify the different factors potentially underlying the phenomenon and
thus the locus(es) of policy failure, which could include low (household)
work intensity, inadequate out-of-work benefits, inadequate earnings, inade-
quate earnings supplements, the number of dependent people (children)
relative to income, etc.

It may be more relevant to ask whether high-employment countries have
more households at full work intensity unable to make ends meet. A num-
ber of studies have looked at poverty and poverty trends through the lens
of work intensity at the household level. These studies show that zero and
very low work intensity households face much higher poverty risks than
households with very high levels of work intensity, i.e. households in which
all adults of working age put in significant work effort. The difference is in
fact quite significant, with workless households often facing poverty risks of
around 40% and upwards. For households with at least some work intensity,
that risk is much lower, from around 5% to 15%. At the same time it is the
case that because relatively high-work-intensity households make up such a
large part of the working-age population, poverty at working age is to a very
considerable extent concentrated among high-work-intensity households. As
can be seen from Figure 11.2, in a significant number of EU countries, people
in relatively high-work-intensity households actually make up the majority
of poor persons at working age. A significant share of poor people of working
age in each country live in full-work-intensity households, i.e. households
where every work-able adult in that household works full-time.
A third reason why past employment growth did not translate into lower relative poverty rates is because of the poverty line dynamics associated with employment growth and, more indirectly, the policies, particularly at the macro level, that stimulate job growth. The difference can be seen when poverty trends are considered using an anchored-in-time poverty line. With this approach the poverty threshold does not increase in line with median living standards, it only adjusts for increases in prices. Clearly, against a fixed poverty line, countries experienced much sharper drops in poverty prior to the crisis than was the case within a relative poverty framework (see also Chapter 6 of this volume). Note, however, that even against a fixed threshold, employment gains never resulted in proportional drops in poverty. As we have already indicated, the main reason why the poverty-reducing impact of employment growth is limited is because the first beneficiaries from employment growth tend to be people who do not live in poverty in the first place. Everything depends on where in the overall income distribution the newly created jobs end up, and in the past that has not always predominantly been in the bottom half of the distribution. If employment growth results in rising median living standards, but not in rising living standards in the lower
segments of the distribution, the effect may well be a rise in relative income poverty. This is in effect what we observe in a number of countries. The poorest did not manage to take full advantage of growing demand for labour where and when this happened, and their plight was further exacerbated by the fact that passive protection levels, as provided through social insurance and social assistance, were eroded relative to wages and living standards.

11.2.4 What Can Policy Do to Promote a Better Linkage between Work and Poverty Reduction?

Which policy action, or set of policy actions, is most appropriate cannot be seen as entirely independent from normative notions that underlie the various ways in which the causes of working-age poverty in relation to work can be construed. Take, for example, a two-adult household with three dependent children and only one adult working. The breadwinner, in this particular example, has a low-paid job, yet is paid well above the minimum wage. Child benefits are modest in the country where they live. The household finds itself living in financial poverty. Whether, and to what extent, their poverty status is construed as a problem of insufficient breadwinner earnings, or as a problem of partner non-participation, or as a problem of insufficient child support makes a fundamental difference as to what type of policy action is to be examined and possibly favoured. In the case of traditional breadwinner-type households with insufficient earnings, the preponderance of opinion appears to be that this is to be seen as a matter of partner non-participation or under-participation. But other cases may be less clear-cut. Even if in-work poverty is construed as largely a problem of low household work intensity, the question arises as to what can be deemed a sufficient level of work intensity. It is not self-evident that this is shall require all working-age, work-capable adults in the household to be in full-time work the whole year round. Societal norms may differ across countries. In the Netherlands, for example, four-fifths of a job per adult appears to be closer to the norm of full-work intensity. Also, household composition may be deemed to matter. It is not self-evident that a lone parent with young children is expected to work full-time all year before additional income support is to be considered legitimate if his or her earnings fall short of the poverty threshold.

Poverty is to a large extent, yet not exclusively, associated with low work intensity at the household level. This brings into view a wide variety of potential policies that can help households to increase, if not maximize, their work intensity. These include policies aimed at boosting the demand for workers, and particularly the demand for people with low levels of education or little work experience. Employer subsidies or reductions in employers’
social-security contributions are an example here.\footnote{Employer subsidies account for a significant share of expenditures on active labour-market programmes in Europe. There are basically two types of subsidy. First, there are subsidies aimed at boosting the employment prospects of very specific groups, such as the long-term unemployed. These tend to be quite substantial, but are provided only for a limited time. Second, there are subsidies (or social security reductions) aimed at low-skilled workers in general. These tend to be permanent, but they also tend to be more modest in magnitude compared to highly targeted subsidies. Empirical evaluation studies include Card et al. (2010) and OECD (2009).} On the supply side, policy can stimulate (e.g. through fiscal reform) or support (e.g. through childcare) people to take up work or to increase working hours. What mix of policies will work best in a given context will depend on the composition of the low-work-intensity population and on the underlying causes of low work intensity.

Yet, and this is crucial, it must be recognized that even if such policies succeeded in getting every single non-employed person into work, or every household to a level of full work intensity for that matter—and all empirical evidence to date suggests this to be highly unlikely—this would not guarantee the elimination of poverty. What policy can do to help households in these circumstances is again likely to depend on such factors as the institutional and policy context in place, labour-market conditions, and the profile of the population in need of support.

Minimum wages can play an important role. In some countries minimum wages remain non-existent or low relative to average wages. As we have seen in Chapter 10, minimum wages in a range of countries do suffice to keep single persons out of poverty. Thus it would appear sensible for countries with non-existent or very low minimum wages to contemplate introducing or increasing these. However, the route of introducing minimum wages or boosting their level (relative to average earnings) to the upper ranges currently prevailing in advanced economies would, even in the absence of negative employment effects, not be sufficient to eradicate in-work poverty. Even in countries where minimum wages are comparatively high they do not suffice to keep sole-breadwinner households out of poverty, especially when there are dependent others or children. Minimum wages have probably become inherently constrained in providing minimum income protection to sole-breadwinner households, especially in countries where relative poverty thresholds have become essentially determined by dual-earner living standards.

For low-earnings households, only direct household income supplements offer a reasonable prospect to a poverty-free existence, especially when there are dependent children. Such ‘in-work benefits’ are now often associated with Anglo-Saxon-type ‘tax credits’ such as the EITC in the United States and the WTC in the United Kingdom. In Chapter 10 we have emphasized that
the socio-demographic, economic, and institutional context varies widely across other advanced countries and that such ‘tax credits’, while demonstrably effective in particular settings and for particular groups, do not appear to offer a model for wholesale emulation. Moreover, Anglo-Saxon-type tax credits are strongly targeted, which implies a potential cost in terms of mobility ‘traps’ and wage erosion. From the perspective of public support, there may also be limits to such strongly targeted measures. By contrast, less strongly targeted income supplements, such as child benefits, can have an immediate impact on poverty among those at high risk (i.e. ‘child-rich’ households) without adversely affecting work incentives between workers and non-workers, although an income effect may have a dampening effect on labour supply among both categories. But for such benefits to be effective across the board as an anti-poverty device they need to be high, even when to some extent categorically differentiated (e.g. higher benefits for lone parents) or income-modulated. This inevitably comes at a significant budgetary cost. This fact is important because increased spending on direct income support runs contrary in many respects to current policy discourses. There it is argued that policy should focus less on compensating people for their low incomes and more on making sure that people are capable of economic self-reliance in the first place. We now turn to such social-investment policies.

11.3 Services, Social-Investment Strategy, and Inequality

Within the social-investment strategy, services are a key instrument (Morel et al., 2012: 13). This is advocated very explicitly by Esping-Andersen et al. (2002), who recommend a reallocation of social expenditure towards services, and then especially those services that support families in coping with the work–family life balance, and those that enhance human capital. The social-investment strategy intends to sustain the knowledge-based economy, which ‘rests on a skilled and flexible labour force, which can easily adapt to the constantly changing needs of the economy but also be the motor of these changes’ (Morel et al., 2012: 1). This investment through services should improve productivity and employment levels by creating a ‘healthy, well-educated and more productive and mobile work force’ (European Commission, 2012b: 177). The underlying idea is that advantages will be found at two levels: namely an increase of economic efficiency and employment, as well as a reduction in inequality and poverty (Nolan, forthcoming). The focus on investment and work in the social-investment strategy, however, risks relegating the distributive aspect to the background: both among researchers and policymakers the question of redistribution tends to be ignored (Cantillon, 2011). To some extent, this is understandable, as
services do not have vertical redistribution as their primary aim. But as social inclusion is to be enhanced through this strategy, it is important to study the equalizing properties of social investment through services, which we aim to do here.

The inequality impact of services is far from clear. Le Grand (1982: 137), for instance, claimed that ‘[p]ublic expenditure on health care, education, housing and transport systematically favours the better off and thereby contributes to inequality in final income’, while Esping-Andersen and Myles (2009) conclude ‘that services are generally redistributive in an egalitarian direction, albeit less so than are cash transfers’. But gauging the distributive characteristics of services is difficult, as they do not only affect net disposable incomes, but also shape market incomes. A typical example is how service-intensive Nordic welfare states have defamiliarized caring responsibilities for children and the elderly, which resulted in virtually identical employment rates for men and women. Consequently, the Nordic countries have low child-poverty rates even before social benefits are taken into account. Ignoring these indirect effects of publicly provided social services on the distribution of market incomes risks seriously misjudging their real distributional impact (Verbist and Matsaganis, 2013). Hence, it is important to distinguish between first- and second-order distributive effects of publicly provided social services. With first-order effects, we mean that one tries to estimate the value of these benefits for individuals and households in order to have values comparable to cash transfers, and then perform a pre-post analysis, i.e. what would inequality be if the value of these services were incorporated in the income concept. These effects are the topic of Section 11.3.2. In this approach no account is taken of any possible second-order effects, such as behavioural reactions or long-term effects; these will be discussed in Section 11.3.3. But first we look in section 11.3.1 at the importance of services in social spending in OECD countries. We start from an overall picture of total publicly provided social services, and then focus on the most visible social-investment services, notably education and childcare.

11.3.1 The Importance of Services in Social Spending

Increased spending on services is often seen as an indicator of commitment to a social-investment strategy. It is undeniable that services constitute an important part of government social spending (see Figure 11.3). Spending on publicly provided services corresponds to around 13% of GDP on average across the thirty-four OECD countries, which is more than spending on cash social transfers (11%). The evolution of these shares is difficult to capture for all OECD countries. For the EU-15 (the European Union member states prior to 2004) a longer statistical series is available, which shows that spending on
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social services as a share of GDP has on average increased by one percentage point between 1998 and 2008, while spending on cash decreased by one percentage point. Also, in the 1990s relative service investments increased for these countries (Kauto, 2002).

As Figure 11.3 shows, there is considerable cross-country variation in in-kind spending, ranging from close to 8% of GDP in Turkey and Chile to 20% in Denmark and Sweden. In-kind expenditures consist mainly of healthcare (6% on average) and education services (5%). Care services to the elderly and to families represent together more than 1% of GDP, but there is more variation in spending across countries than there is for the two major categories. Care services are particularly important in the Nordic countries, Australia, and Japan. Kauto (2002) found three different groups of countries in terms of cash versus services redistribution strategies in 1990s, and Figure 11.3 suggests that this categorization still applied just before the financial and economic crisis. The first group is called the ‘service approach’ group and is characterized by high service effort and average or high cash-transfer effort. As in Kauto (2002), countries belonging to this group in 2007 are Denmark, Sweden, Norway, Finland, France, Germany, and the United Kingdom, but now also Belgium, Austria, and Hungary have joined this

Figure 11.3. Public expenditure for in-kind and cash transfers, in percentage of GDP, 2007

Notes: Countries are ranked in increasing order of total expenditure on all social services. 2005 data on education services for Greece, Luxembourg, and Turkey.

(a) Social services to the elderly, survivors, disabled persons, families, unemployed, as well as those in respect of housing and social assistance.

(b) Cash transfers to the elderly, survivors, disabled persons, families, unemployed, as well as those in respect of social assistance.

group. The ‘transfer approach’ group is characterized by high cash-transfer effort, and average or low service effort. Southern European countries belong to this group, as well as Poland and Slovenia. The third group in Kauto (2002) combines low service effort and low cash-transfer effort, with Turkey, Chile, Mexico, and Korea as main examples. Given the (increasing) importance of services in social spending, let us now turn to a discussion of their distributional impact.

11.3.2 First-Order Redistributive Effects of Social Services

Most studies on the redistributive impact of the in-kind benefits from social services deal with first-order effects, i.e. the impact on inequality of incorporating these benefits into the income concept. This literature strand stemmed from the observation that most empirical studies on cross-national differences in the levels of inequality and poverty use cash incomes only. Given that more than half of social spending in OECD countries is provided through non-cash benefits in the form of publicly provided services, and that there is wide variety across countries in their relative share of cash and in-kind spending, such ‘cash-income-only’ studies miss an important part of welfare-state efforts, and might give a misleading picture of redistributive outcomes. As both in-kind and cash transfers have an impact on the inequality of living standards, a measure that includes these in-kind benefits is theoretically superior to the more conventional cash-income measures (Atkinson et al., 2002; Callan et al., 2008; Canberra Group, 2011).

Incorporating the value of publicly provided services in household income raises a range of methodological issues (see, for example, Aaberge et al., 2010a, 2010b; OECD, 2008, 2011; Verbist et al., 2012). How should one value the benefits households derive from these services (valuation)? How should we distribute the aggregate value of these services among individuals (allocation)? How should the equivalence scale be adapted to take account of the needs associated with these services (equivalence scales)? As public services are provided outside market settings, there is no market price valuation, which makes the valuation of these services particularly difficult. In the literature, the standard practice is to value the benefit deriving from public services at their production cost, i.e. its measurement is based on the inputs used to provide these services rather than on the actual outputs produced (see, for example, Aaberge and Langørgen, 2006; Marical et al. 2008; Smeeding et al., 1993). This means, however, that it does not necessarily reflect the user’s valuation of the service. Another problem with using the production cost is that it does not take account of the quality and efficiency in the provision of these services.
The second question relates to the allocation of these benefits across individuals: who are the beneficiaries to whom the value of public services is attributed? The literature distinguishes two approaches, namely the ‘actual consumption approach’ and the ‘insurance value approach’ (see, for example, Marical et al., 2008). The actual consumption approach allocates the value of public services to the individuals who are actually using the service; it can of course only be applied if actual beneficiaries can be identified. This approach is typically used in the case of education services (Antoninis and Tsakloglou, 2001; Callan et al., 2008), childcare services (Matsaganis and Verbist, 2009; Vaalavuo, 2011; Van Lancker and Ghysels, 2012), and social housing (Verbist et al., 2012). For healthcare, most empirical studies use an insurance value approach, imputing the value of coverage to each person based on specific characteristics (such as age and sex). It is based on the notion that what the government provides is equivalent to funding an insurance policy where the value of the premium is the same for everybody sharing the same characteristics (Smeeding, 1982; Marical et al., 2008). The insurance value approach also incorporates the value of access to this type of service.2

As the needs of a household grow with each additional member in a non-proportional way, equivalence scales are commonly used in distribution analyses to take account of such economies of scale. But as some types of non-cash income may have needs associated with them that are unmeasured in usual equivalence scales, using a cash-income equivalence scale when non-cash income components are included in the income concept may give rise to what Radner (1997) has called the ‘consistency’ problem. Service-related needs do not necessarily depend on economies of scale as captured by a standard cash-income equivalence scale, and may therefore require an alternative approach. Recent studies that experiment with such alternatives are Aaberge et al. (2010a, 2010b) and Paulus et al. (2010). A comparison of the empirical application of these two approaches can be found in Verbist et al. (2012).

Over the past decades the number of studies investigating the first-order redistributive impact of social services has grown considerably (for overviews, see, for example, Marical et al., 2008; Vaalavuo, 2011; Verbist et al., 2012). These studies differ in terms of country coverage as well as types of services studied. Pioneering work was done by Smeeding (1977, 1982), who

2 The actual consumption approach has also been used for public healthcare services, based on detailed data on the effective use of healthcare services by individuals (see, for example, Evandrou et al. (1993) and Sefton (2002) for the UK). Marical et al. (2008) have applied the insurance value and the actual consumption approach for healthcare services in eight European countries. On average, the reduction in inequality when including healthcare expenditures in the income concept turned out to be considerably lower on the basis of the actual consumption approach than with the insurance value approach. This rather surprising outcome is largely due to the effect of re-ranking (see Marical et al. (2008) for more details).
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investigated the poverty impact of in-kind food, housing, and medical-care benefits in the United States. Evandrou et al. (1993), Sefton (2002), Lakin (2004), and Jones (2008) look at the United Kingdom, and Harding et al. (2006) at Australia, with a focus on healthcare, education, and social housing. For Norway, Aaberge and co-authors (Aaberge and Langørgen, 2006; Aaberge et al., 2010a, 2010b) investigate the distributive impact of municipal services, while Caussat et al. (2005) look at healthcare spending in France, and Spadaro et al. (2012) in Spain. The outcomes of these (and other) national studies are not directly comparable to one another due to differences in methodology and data; but in general it appears that these services have an inequality-reducing effect.

International comparative evidence is on the increase, starting with Smeeding et al. (1993), who study the distributive effect of healthcare, education, and public housing in seven countries (Australia, Canada, Netherlands, Sweden, United Kingdom, United States, and West Germany), using the LIS (Luxembourg Income Study) data for years between 1979 and 1983. Garfinkel et al. (2006) supplement this analysis by using more countries (including also France, Belgium, and Finland) and more recent LIS data (2002 or earlier). More recent evidence is presented in Paulus et al. (2010), who investigate the inequality effect of the same three services in five EU countries, as well as in OECD (2008) and OECD (2011), which present the widest country coverage. OECD (2008) investigates for fifteen OECD countries the inequality impact of the three services that have received most attention in the literature: public healthcare, education, and housing (for more details, see also Marical et al., 2008). OECD (2011) extends the analysis both in terms of number of countries (twenty-seven OECD member states) and type of services, as it also studies childcare and long-term elderly care (for more details see Verbist et al., 2012). The outcomes of these studies all go in the same direction: including the value of publicly provided social services has a considerable equalizing effect on the income distribution. We now illustrate this with empirical material from the most recent OECD publication on this topic (OECD, 2011; Verbist et al., 2012).

Table 11.1 shows the first-order impact of incorporating social services in the income concept on the Gini coefficient when moving from cash to extended income. The difference between cash and extended income consists of the monetary value of five types of publicly provided services, namely healthcare, education, social housing, childcare, and long-term

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3 Wolff et al. (2005) provide a broader picture by looking at total public expenditure to households (so not only social spending). A similar broad scope is found in O’Higgins and Ruggles (1981) for the United Kingdom.

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elderly care. The first-order inequality reduction of services is important: on average across the countries considered here, the Gini coefficient is reduced by about one-fifth when moving from cash to extended income. Even though this is less than inequality reduction through cash transfers (which is about one-third), it is still considerable (OECD, 2008, 2011; Verbist and Matsaganis, 2013). For all countries healthcare and education services are by far the most important contributors to inequality reduction; the impact of early childhood education and childcare (ECEC), long-term elderly care, and social housing is much smaller, mostly because their size is much more modest than the two ‘big’ services.

The five types of service considered here should contribute to a ‘healthy, well-educated, and productive workforce’, and can thus be seen as instruments of social investment. But as investment in human capital and family policy as a productive factor are essential ingredients of this strategy (Cantillon, 2011; Morel et al., 2012), education and ECEC services stand out as its most direct manifestations. We therefore pay more attention to the extent of inequality reduction in these two categories. For education, the redistributive impact is likely to vary across education levels. Compulsory education can be expected to be more redistributive than higher education, since the former is supposed to benefit equally all school-age children.

Inequality reduction through education services stems indeed mainly from compulsory education, which reduces inequality by 5% on average (Table 11.1, measured by Gini coefficient). In budgetary terms, the total of primary and lower secondary education (ISCED 1 and 2) carries most weight of all education categories, corresponding to more than 6% of disposable income on average (while total education expenditures correspond to 12%; Figure 11.4). This is one reason why inequality reduction is strongly related to spending on this education category. But a more important driving factor is the socio-demographic composition of the beneficiary population, namely children in primary and lower secondary education. Pupils in compulsory education tend to be more concentrated in the lower parts of the income distribution, which is shown in Panel B of Figure 11.4. The bars (Q1/Q5) represent the share of all beneficiaries located in the bottom income quintile over that in the top quintile. On average, the bottom quintile contains about 23% of compulsory education pupils of this education category, compared to only 14% for the top quintile, resulting in a Q1/Q5 ratio of 1.6. This pattern is strongest in Austria, Hungary, and the Czech Republic, where the

4 The value of publicly provided education, childcare, and social housing is allocated on the basis of the actual consumption approach. For public healthcare and long-term care an insurance value approach is used. Incomes are equivalized with the square root of household size (for more details, see Verbist et al., 2012).
Table 11.1. Impact on the Gini coefficient of including public services in the income concept, 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>Cash</th>
<th>Extended income</th>
<th>All services</th>
<th>Healthcare</th>
<th>Education</th>
<th>ECEC</th>
<th>Long-term care</th>
<th>Social housing</th>
<th>Compulsory education</th>
<th>Tertiary education</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS</td>
<td>0.312</td>
<td>0.260</td>
<td>-16.6%</td>
<td>-10.3%</td>
<td>-6.6%</td>
<td>-0.4%</td>
<td></td>
<td></td>
<td>-5.7%</td>
<td>-0.1%</td>
</tr>
<tr>
<td>AUT</td>
<td>0.267</td>
<td>0.219</td>
<td>-18.0%</td>
<td>-10.5%</td>
<td>-6.3%</td>
<td>-1.4%</td>
<td></td>
<td></td>
<td>-0.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td>BEL</td>
<td>0.264</td>
<td>0.209</td>
<td>-21.0%</td>
<td>-14.3%</td>
<td>-4.4%</td>
<td>-1.5%</td>
<td></td>
<td></td>
<td>-1.5%</td>
<td>0.1%</td>
</tr>
<tr>
<td>CAN</td>
<td>0.319</td>
<td>0.259</td>
<td>-18.7%</td>
<td>-9.6%</td>
<td>-9.1%</td>
<td>-1.2%</td>
<td></td>
<td></td>
<td>-5.7%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>CZE</td>
<td>0.261</td>
<td>0.207</td>
<td>-20.7%</td>
<td>-13.3%</td>
<td>-5.1%</td>
<td>-1.6%</td>
<td></td>
<td></td>
<td>-0.8%</td>
<td>-4.7%</td>
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<td>DEU</td>
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<td>0.249</td>
<td>-16.9%</td>
<td>-10.4%</td>
<td>-5.1%</td>
<td>-1.2%</td>
<td>0.1%</td>
<td>-0.3%</td>
<td>-3.3%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>DNK</td>
<td>0.250</td>
<td>0.194</td>
<td>-22.3%</td>
<td>-10.0%</td>
<td>-5.7%</td>
<td>-1.1%</td>
<td>-5.0%</td>
<td></td>
<td>-1.2%</td>
<td>-3.8%</td>
</tr>
<tr>
<td>ESP</td>
<td>0.310</td>
<td>0.248</td>
<td>-19.9%</td>
<td>-11.6%</td>
<td>-6.4%</td>
<td>-1.4%</td>
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<td>-0.4%</td>
<td>-5.6%</td>
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<tr>
<td>EST</td>
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<td>-17.1%</td>
<td>-11.3%</td>
<td>-6.0%</td>
<td>-1.0%</td>
<td>-0.3%</td>
<td>-0.1%</td>
<td>-4.1%</td>
<td>0.4%</td>
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<tr>
<td>FIN</td>
<td>0.266</td>
<td>0.218</td>
<td>-18.2%</td>
<td>-10.8%</td>
<td>-4.3%</td>
<td>-1.0%</td>
<td>-2.5%</td>
<td>-1.1%</td>
<td>-2.2%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>FRA</td>
<td>0.264</td>
<td>0.209</td>
<td>-21.0%</td>
<td>-13.0%</td>
<td>-5.8%</td>
<td>-1.8%</td>
<td>-0.8%</td>
<td>-1.1%</td>
<td>-4.4%</td>
<td>-0.4%</td>
</tr>
<tr>
<td>GBR</td>
<td>0.330</td>
<td>0.252</td>
<td>-23.6%</td>
<td>-12.5%</td>
<td>-7.0%</td>
<td>-0.7%</td>
<td>-1.6%</td>
<td>-4.6%</td>
<td>-5.2%</td>
<td>-0.5%</td>
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<tr>
<td>GRC</td>
<td>0.342</td>
<td>0.288</td>
<td>-15.9%</td>
<td>-9.6%</td>
<td>-5.9%</td>
<td>-0.5%</td>
<td></td>
<td>0.0%</td>
<td>-3.7%</td>
<td>-0.5%</td>
</tr>
<tr>
<td>HUN</td>
<td>0.262</td>
<td>0.201</td>
<td>-23.3%</td>
<td>-10.5%</td>
<td>-8.2%</td>
<td>-2.8%</td>
<td>-1.3%</td>
<td>-0.5%</td>
<td>-6.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>IRL</td>
<td>0.317</td>
<td>0.242</td>
<td>-23.5%</td>
<td>-12.5%</td>
<td>-10.1%</td>
<td>-0.1%</td>
<td></td>
<td>-3.4%</td>
<td>-7.5%</td>
<td>0.0%</td>
</tr>
<tr>
<td>ISL</td>
<td>0.291</td>
<td>0.227</td>
<td>-22.1%</td>
<td>-11.4%</td>
<td>-7.9%</td>
<td>-2.5%</td>
<td>-3.1%</td>
<td>-0.5%</td>
<td>-5.8%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>ITA</td>
<td>0.320</td>
<td>0.262</td>
<td>-18.2%</td>
<td>-9.2%</td>
<td>-7.8%</td>
<td>-1.5%</td>
<td>0.0%</td>
<td>-0.5%</td>
<td>-5.0%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>LUX</td>
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<td>-20.1%</td>
<td>-10.7%</td>
<td>-7.6%</td>
<td>-2.3%</td>
<td>-0.3%</td>
<td>-6.1%</td>
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<td></td>
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<tr>
<td>MEX</td>
<td>0.475</td>
<td>0.375</td>
<td>-21.1%</td>
<td>-11.2%</td>
<td>-11.5%</td>
<td>-1.3%</td>
<td></td>
<td>-10.9%</td>
<td>0.4%</td>
<td></td>
</tr>
<tr>
<td>NLD</td>
<td>0.272</td>
<td>0.220</td>
<td>-19.0%</td>
<td>-8.1%</td>
<td>-6.4%</td>
<td>-1.8%</td>
<td>-2.9%</td>
<td>-5.4%</td>
<td>-0.7%</td>
<td></td>
</tr>
<tr>
<td>NOR</td>
<td>0.242</td>
<td>0.193</td>
<td>-20.2%</td>
<td>-9.1%</td>
<td>-5.8%</td>
<td>-1.1%</td>
<td>-4.6%</td>
<td>-0.4%</td>
<td>-3.5%</td>
<td>-2.4%</td>
</tr>
<tr>
<td>POL</td>
<td>0.317</td>
<td>0.259</td>
<td>-18.2%</td>
<td>-8.6%</td>
<td>-9.9%</td>
<td>-1.1%</td>
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<td>-0.1%</td>
<td>-7.1%</td>
<td>-0.2%</td>
</tr>
<tr>
<td>PRT</td>
<td>0.370</td>
<td>0.291</td>
<td>-21.3%</td>
<td>-13.6%</td>
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<td>-0.9%</td>
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<td>-0.5%</td>
<td>-6.5%</td>
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<tr>
<td>SVK</td>
<td>0.251</td>
<td>0.204</td>
<td>-19.1%</td>
<td>-12.1%</td>
<td>-6.7%</td>
<td>-0.6%</td>
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<td>0.0%</td>
<td>-4.1%</td>
<td>0.2%</td>
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<tr>
<td>SVN</td>
<td>0.236</td>
<td>0.196</td>
<td>-17.2%</td>
<td>-11.3%</td>
<td>-5.8%</td>
<td>-0.9%</td>
<td>-0.1%</td>
<td>-0.1%</td>
<td>-4.6%</td>
<td>1.0%</td>
</tr>
<tr>
<td>SWE</td>
<td>0.237</td>
<td>0.181</td>
<td>-23.4%</td>
<td>-12.4%</td>
<td>-5.6%</td>
<td>-1.5%</td>
<td>-4.2%</td>
<td>-0.1%</td>
<td>-3.1%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>USA</td>
<td>0.372</td>
<td>0.303</td>
<td>-18.5%</td>
<td>-9.8%</td>
<td>-9.0%</td>
<td>-0.9%</td>
<td></td>
<td>-6.7%</td>
<td>-0.6%</td>
<td></td>
</tr>
<tr>
<td>OECD−27</td>
<td>0.298</td>
<td>0.239</td>
<td>-19.8%</td>
<td>-11.0%</td>
<td>-7.0%</td>
<td>-1.3%</td>
<td>-1.9%</td>
<td>-0.8%</td>
<td>-5.0%</td>
<td>-0.5%</td>
</tr>
</tbody>
</table>

Note: Averages are calculated over countries with non-zero values only. Due to data limitations no estimates for long-term elderly care are available for Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Greece, Ireland, Luxembourg, Mexico, Portugal, Poland, Slovakia, and the United States. For six countries, no estimates of the impact of social housing are provided, namely Australia, Canada, Denmark, Mexico, the Netherlands, the United States. Education includes primary, lower secondary, upper secondary, post-secondary non-tertiary, and tertiary education. ECEC includes both childcare services and pre-primary education. Compulsory education is here defined as the total of primary and lower secondary education.

Source: Verbist et al., 2012.
Figure 11.4. Quintile-share ratio of beneficiaries of education and childcare services, and in-kind benefit of these services as a share of disposable income

Notes: Countries are ranked in decreasing order by relative inequality reduction of the service category (see Table 11.1). ‘Q1/Q5’ is the share of beneficiaries located in the bottom income quintile over that in the top quintile. ‘% of dpi’ is the share of the in-kind benefits in disposable income.

Source: Authors’ calculations based on Verbist et al., 2012.
share of pupils in Q1 is about twice that in the top quintile. Much more even distributions, indicated by a Q1/Q5 ratio close to 1, are found in the Nordic countries and Belgium. The position of these children in the income distribution is closely related to how successful countries are in combating child poverty, either by changing market income through high employment or by well-designed tax-benefit policies. These outcomes confirm the better performance in this domain of the Nordic countries, and the challenges other countries face to better protect children against income poverty and social exclusion (see, for example, Gornick and Jäntti, 2012).

Outcomes for tertiary education services are quite different: inequality reduction is very limited (on average 0.5%). In most countries, inequality is hardly affected at all, or it even increases after the inclusion of the value of tertiary education. Again, these outcomes are largely driven by the distribution of participants in education, with some countries having very regressive patterns, as indicated by an interquintile ratio well below 1 (Panel C of Figure 11.4), and very progressive patterns in the Nordic countries. In Denmark, Norway, and Sweden the bottom quintile accounts for around half of the participants in higher education, resulting in very high Q1/Q5 ratios. Consequently, in these countries inequality is reduced when including the value of these services in the income concept. These participation patterns reflect both socioeconomic differences that are important in terms of access to higher education, and also institutional differences in, for example, the structure of earlier levels of education (in terms of preparation for the labour market or for higher education), affordability, etc. The Nordic countries are characterized by accessible and affordable tertiary education institutions, which translates in high enrolment rates (Usher and Cervenan, 2005; Vaalavuo, 2011). An issue that complicates the interpretation of these outcomes, however, is the fact that many students live away from their parents in the Nordic countries and are thus classified as a separate household. Due to their low incomes, students are often concentrated in the poorest 20% of the population. This partly reflects cultural differences, but is from a poverty perspective also partly an artefact, because students living away from their high-income parents have temporary low incomes during their student years, while the literature on the returns to education indicates that their probable position in the earnings distribution later will be towards the top (Callan et al., 2008). But even when controlling for this artefact, Vaalavuo (2011) finds that Sweden and Norway still have the most equal distribution of tertiary education expenditures.

Spending on early childhood education and childcare (ECEC) services is associated with an average decline of the Gini by 1.3% (Table 11.1). When looking at Figure 11.4, Panel D, we see again how compositional factors drive these outcomes: in countries like the Czech Republic and Hungary
the bottom quintile makes up around 30% of beneficiaries, while in Ireland the poorest quintile is heavily underrepresented. In contrast to compulsory education, where almost all children of that age group are in school, the pattern is also driven by differential use of ECEC services. Table 11.2 provides an indication of whether poorer or richer households are more likely to enrol their young children in public ECEC facilities. In most countries, children in higher-income households are more likely to be enrolled than those in lower-income households. The difference between childcare and pre-primary education is relevant in this context: for the youngest age group (0 to 3 years) enrollment is much more stratified along socioeconomic lines, with dual-earner couples (and hence higher incomes) making relatively more use of childcare (Fürster and Verbist, 2012; Van Lancker, 2013). For children

### Table 11.2. Actual ECEC beneficiaries as a share of potential beneficiaries (children aged 0–5), by income quintile

<table>
<thead>
<tr>
<th>Country</th>
<th>Q1 (%)</th>
<th>Q2 (%)</th>
<th>Q3 (%)</th>
<th>Q4 (%)</th>
<th>Q5 (%)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS</td>
<td>33.0</td>
<td>35.0</td>
<td>50.8</td>
<td>39.3</td>
<td>42.4</td>
<td>40.1</td>
</tr>
<tr>
<td>AUT</td>
<td>38.1</td>
<td>44.7</td>
<td>46.6</td>
<td>42.8</td>
<td>47.7</td>
<td>43.2</td>
</tr>
<tr>
<td>BEL</td>
<td>54.2</td>
<td>69.9</td>
<td>71.6</td>
<td>75.7</td>
<td>79.0</td>
<td>69.2</td>
</tr>
<tr>
<td>CAN</td>
<td>30.9</td>
<td>32.9</td>
<td>29.2</td>
<td>27.5</td>
<td>26.3</td>
<td>29.8</td>
</tr>
<tr>
<td>CZE</td>
<td>44.1</td>
<td>45.6</td>
<td>46.9</td>
<td>40.0</td>
<td>40.7</td>
<td>43.8</td>
</tr>
<tr>
<td>DEU</td>
<td>65.8</td>
<td>59.9</td>
<td>67.9</td>
<td>61.0</td>
<td>57.1</td>
<td>62.8</td>
</tr>
<tr>
<td>DNK</td>
<td>68.1</td>
<td>80.4</td>
<td>86.0</td>
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*Source: Fürster and Verbist, 2012.*
aged 4–5 years, pre-primary education is much more widespread, with often very high enrolment rates when getting closer to the age of compulsory schooling. An important element in this context is that pre-primary education is in general free of charge, while parents have to pay a fee for childcare use. Even though in many countries these fees are income-dependent in order to limit the private cost of childcare for low-income families, the use of childcare is still often biased towards higher incomes. A number of studies have shown that availability of childcare places is often more important than its price (see, for example, Wrohlich (2011) for Germany; Vandelannoote et al. (2013) for Belgium).

Summarizing, we find a substantial first-order redistributive effect of services, also for those services that are key instruments in the social-investment strategy. This sizeable redistributive role of services in Western societies is an important finding, especially given the fact that inequality reduction is seldom a primary aim of delivering most of these services. Note, however, that in line with their universal coverage, services such as compulsory education are in most countries substantially more egalitarian than tertiary education and ECEC.

11.3.3 Second-Order Effects on Inequality of Publicly Provided Services

So far we have only discussed first-order inequality effects of publicly provided services. But these are only part of the story. Services (as well as cash transfers) also have other effects, relating to behavioural reactions and long-term impacts. Trying to study the second-order inequality effects of public policies empirically is, however, a hazardous task because finding a pre-government counterfactual is problematic (Jesuit and Mahler, 2010): we do not know what the distribution of market income would be without cash and in-kind transfers. The few studies that try to take account of such second-order effects (e.g. Jesuit and Mahler, 2010; Doerrenberg and Peichl, 2012) concentrate on cash redistribution only. Nevertheless, the second-order effects due to services merit further attention as they are at the heart of the social-investment strategy. Preparing individuals for the knowledge-based economy and increasing their employability are central themes in the social-investment rhetoric. But, interestingly, despite the fact that social inclusion is also part of this rhetoric, a recent book on social investment (Morel et al., 2012) hardly discusses the poverty and inequality effects of services or other key instruments in the social-investment paradigm. It is rather assumed that a well-implemented social-investment welfare state will be egalitarian by increasing employment. But that this is not an inevitable outcome already became clear in Section 11.2. We therefore think it is important to try to grasp these second-order effects, and we now turn to consider short-run and long-run second-order effects of education and ECEC services.
In the short run, education services can often have negative effects on labour supply. As the public provision of education stimulates participation in both compulsory and non-compulsory education, these participants obviously cannot spend their school time on the labour market. There is little question in the literature that primary and secondary education in the longer run consistently increase labour supply, so not surprisingly these types of education are heavily subsidized in almost all OECD countries and are to a large extent compulsory. They provide the human capital that society deems to be the absolute minimum to be attained. The expectation that job training programmes would have similar positive effects is not corroborated by empirical evidence. The vast literature on evaluating such programmes shows only modest gains in terms of labour supply and earnings (Currie and Gahvari, 2008). It is argued that this is due to the fact that these programmes are often too short and too superficial to generate a more substantial impact (Lalonde, 1995).

How education services impact on income inequality in the longer term is difficult to assess, and until now hardly any studies have undertaken this difficult task, mainly due to conceptual and methodological limitations, as well as lack of information. Exceptions are Sylwester (2002) and Bergh (2005). By combining data on public education spending between 1960 and 1969 with changes in Gini inequality indicators for later years (between 1970 and 1990), Sylwester demonstrates that a country with higher education expenditures (as a share of GDP) has lower income inequality in later years. Bergh (2005) then shows that this equalizing effect is entirely due to public spending on primary and secondary education. The effect of public higher-education expenditures, in contrast, is either not significant or even negative. Intuitively, one would expect higher public spending on tertiary education to lead to higher enrolment rates and subsequently lower income inequality. Bergh and Fink (2008), however, show that if public subsidies raise the incentive to enrol in tertiary education, this in the first instance increases inequality if the group enjoying the wage premiums associated with higher education is small. As enrolment increases, this effect will become less and eventually will be egalitarian.

For childcare services, Currie and Gahvari (2008) assert that they have short-term positive effects for the parents, in particular for young mothers. Childcare services reduce the relative price of childcare and should facilitate employment of parents, especially mothers. The European Commission (2009) reports evidence from country studies according to which the availability of childcare facilities intensifies mothers’ labour-market participation rates. On the basis of a literature review, however, they conclude that there is little empirical evidence that these positive short-term effects will offset the deadweight loss associated with the tax system (studies
examining the elasticity of maternal employment include Bassanini and Duval (2006), Blau and Currie (2006), and Gelbach (2002)). Moreover, if the use of childcare is biased against vulnerable socioeconomic groups (such as low-skilled mothers), then investment in ECEC will not necessarily be inequality-reducing (Van Lancker, 2013). One may expect larger long-term effects than short-term, as these services may limit potential losses in future earnings stemming from longer career interruptions. But stimulating maternal employment is not the only channel through which childcare services should foster social inclusion in the longer run. They also aim to enhance school readiness of children, in order to have a positive impact on human-capital formation of young children and their potential wages later in life. There is empirical literature that offers some support for the idea that in-kind transfers to children may be productivity-enhancing in the long run. The Perry pre-school programme and other similar initiatives highlight the beneficial effects of high-quality early-intervention services targeted at underprivileged children (for an overview, see Karoly et al., 2005). It is not straightforward, however, to simply transfer these American interventions to a European context where inequalities in child conditions are less extreme. Nevertheless, these results illustrate that such early-intervention programmes can be effectively equalizing, as they support the most vulnerable groups (Esping-Andersen, 2008). Various studies demonstrate that the quality of childcare provision is an important condition in order to derive beneficial effects from pre-school programmes (for an overview, see Esping-Andersen et al., 2012). Moreover, a comparison of programmes in Denmark and the United States (Esping-Andersen et al., 2012) indicates that investment in high-quality services is not of itself sufficient. This should be connected to the quality of the subsequent school system, parental leave arrangements, and broader welfare programmes (Van Lancker, 2013).

The long-term effects of both education and childcare services may provide a justification for the more paternalistic arguments that are traditionally seen as underpinning the provision of public services over cash transfers. Provision in kind steers families towards education and childcare, which might not be the case if the value of these provisions was given in cash to families. According to Currie and Gahvari (2008), such paternalistic arguments become more powerful ‘when the intended recipient of a transfer program is a child but the transfer goes to parents. Parents may not take full account of the utility of their children when making decisions or they may neglect to factor in externalities. For example, suboptimal spending on children’s education may lead not only to poorer individual prospects, but also to slower future economic growth.’
11.4 Conclusion

In current policy discourses higher levels of employment, together with ‘social investment’ in human capital, are increasingly seen as the way forward in bringing about structural and sustainable social progress. What can we expect from activation and social-investment policies if our concern is with inequality and poverty?

A first important point is that while giving more people access to work is important for a wide range of reasons, increasing the proportion of people in work does not automatically translate into less poverty and inequality. This is what past experience teaches us and also what projections suggest. Part of the problem here is that those most in need of extra work and income do not tend to be the first beneficiaries of an increased demand for labour if and when this happens. The prime beneficiaries tend to be people with the strongest profiles in terms of age and skills. These tend to be school-leavers or new entrants not living in poverty in the first place. Another problem is that gaining access to a job does not necessarily imply a significant move up the income ladder and out of poverty. Even if policy succeeded in getting every single person into work, or every household to a level of full work intensity for that matter—and all empirical evidence to date suggests this to be highly unlikely—this would not guarantee the elimination of poverty. This points to the key role of direct income-support policies, including for those in work. What policy can do to help households in these circumstances depends on such factors as the institutional and policy context in place, labour-market conditions, and the profile of the population in need of support.

Introducing or boosting effective minimum wages to the upper range of those currently prevailing in OECD countries (relative to average earnings) would, even in the absence of negative employment effects, not be sufficient to eradicate in-work poverty. Minimum wages and other wage regulation mechanisms have probably become inherently constrained in providing minimum income protection to sole-breadwinner households, especially in countries where relative poverty thresholds have become essentially determined by dual-earner living standards. For low-earnings households, only direct household-income supplements may offer a reasonable prospect for a poverty-free existence, especially when there are dependent children. Such ‘in-work benefits’ are now often associated with Anglo-Saxon-type ‘tax credits’ such as the EITC in the United States and the WTC in the United Kingdom. However, it is important to keep in mind here that socio-demographic, economic, and institutional contexts vary considerably across the rich countries. While demonstrably effective in particular settings and for particular groups, tax credits do not offer a model for wholesale emulation in other
settings. Child benefits are an alternative or complementary way of offering direct income support. These can have an immediate impact on poverty among those at high risk (i.e. child-rich households) without adversely affecting work incentives between workers and non-workers. But for such benefits to be effective across the board as an anti-poverty device these need to be high, and this inevitably comes at a significant budgetary cost. Increased spending on such forms of direct income support is not self-evident in view of current calls for more spending on indirect support policies, in the form of what is now referred to as social investment.

Even though services are a key instrument of the social-investment strategy, researchers and policymakers often neglect their impact on income inequality and poverty. To some extent, this is understandable, as income redistribution is not the primary aim of these services. Moreover, there are many methodological challenges if one wants to assess both first- and second-order inequality effects of services. Interestingly, when bringing together empirical literature on this topic, it is clear that services matter for making societies more egalitarian. If we take the example of compulsory education, then empirical outcomes from both a first- and a second-order perspective are unequivocal: this type of investment in children is good for income equality. Probably the compulsory character is of high importance here: within the relevant age group, almost all children participate, and hence acquire a minimum level of skills. Empirical evidence on tertiary education and ECEC services tells a different story, with a variety of experiences across countries. In most countries these two types of services are more socially stratified, with often relatively more beneficiaries towards the top of the income distribution. Consequently, simply increasing spending on these services will not be enough to foster egalitarianism. The wider social context is important, and crucial parameters, such as access, availability, and quality of the services, need to be considered and integrated into the policy perspective. If, for example, childcare is provided almost free of private costs, then this may still not guarantee that more vulnerable groups will benefit if there are not enough places available. So this may call for extra policy efforts in this domain targeted at these groups. Moreover, if quality of childcare is not similar within a country and low-income families typically mainly use lower-quality care, then this may hamper egalitarian outcomes in the longer run. So investment in equal quality is also important, as well as connections with other policy domains, e.g. complementary parental-leave systems and the quality of the regular school system.

Particularly relevant for the wider socioeconomic context are the dramatic decreases in labour demand associated with the crisis. This puts the social-investment strategy in a different perspective: a call on childcare for
(young) parents who do not have any job prospects at all may then not be the first policy priority for countries hit by very high (youth) unemployment rates. The policy priority in such a context must surely lie with providing adequate direct income support. A balanced approach is needed at any rate. As Vandenbroucke et al. (2011: 14) put it, ‘We know that egalitarian societies are more successful in implementing social investment policies. The fact that it is a precondition urges us to remember the merits of traditional social protection and anti-poverty programmes, and suggests that reducing income inequality should remain high on the social investment agenda. Hence, there is a need for a balanced approach, with an ‘investment strategy’ and a ‘protection strategy’ as complementary pillars of an active welfare state.’

In sum, it is clearly important to think about effective policies that prevent situations of need arising in the first place. However, one also needs to be cautious about radically shifting resources towards policies that seek to impact on inequality and poverty in a structural but indirect way, at the expense of social policies of proven effectiveness in terms of direct poverty alleviation and inequality reduction, especially in times of high unemployment. The best performers among the rich countries in terms of economic, employment, social cohesion, and equality outcomes have one thing in common: a large welfare state that does several things at the same time, investing in people, stimulating and supporting them to be active, and also adequately protecting them and their children when everything else fails.