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The Fiscalization of Child Benefits in OECD Countries

Tommy Ferrarini, Kenneth Nelson and Helena Höög

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General contact: gini@uva.nl

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Tommy Ferrarini

Swedish Institute for Social Research

Kenneth Nelson

Stockholm University

Helena Höög

Institute for Futures Studies

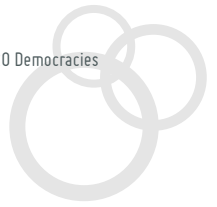




Table of contents

1. INTRODUCTION	7
2. INSTITUTIONAL STRUCTURES OF CHILD BENEFIT SYSTEMS	9
3. CHILD BENEFIT DATASET (CBD)	13
4. CHANGING LEVELS AND TRAJECTORIES OF CHILD BENEFIT SYSTEMS	15
4.1. The universalist trajectory	16
4.2. The fiscal trajectory	17
4.3. The mixed trajectory	18
5. UNIVERSALISM AND TARGETING	21
6. CONCLUSION	23
REFERENCES.....	25
TABLES AND FIGURES.....	29
GINI DISCUSSION PAPERS	35
INFORMATION ON THE GINI PROJECT.....	39





1. Introduction¹

Welfare states have been subject to a subtle and a sometimes unrecognized transformation: the fiscalization of social benefits. This change of national policy is notable in the area of family policy, where various forms of child tax benefits have been introduced. The composition and level of child benefits varies therefore not only across countries, but also over historical time (Kammerman and Kahn, 1981; MacNicol, 1992; Wennemo, 1994; Gauthier, 1996). In the immediate Post-War period many countries either complemented or replaced various types of income-tested child benefits with universal ones, introducing a shift in the distributive profile of the system. However, far from all welfare states relied only on the principle of universalism in the design of child benefits. Child tax benefits and fiscal policy has often been used as an alternative or complement to social policy legislation. During the era of welfare state stagnation and decline since the mid-1970s some countries have relocated parts of the child benefit package from social policy to the income tax system. During this process of fiscalization, elements of income-testing have once again been introduced to child benefits, thus, adding stronger elements of vertical redistribution between socio-economic groups. The change of scenery involves not only a shift in the relative emphasis of social and fiscal policies in the redistributive budgets of the European countries, but also a greater degree of selectivity and low-income targeting is introduced to the provision of child benefits.

Maybe it is to blunt to speak of a retreat from the broader ideas of universalism and solidarity that distinguished the introduction of universal child benefits in the immediate post-war decades. Nonetheless, the fiscalization of child benefits seems to have moved family policy closer to the traditional forms of low-income targeted responses to social protection that used to be the dominant strategy for income distribution to families with children before the principle of universalism appeared on the political agenda of policy reform. The transformation of child benefits therefore is closely integrated with the wider discussion about the provision of minimum incomes and the distinction between universal and targeted approaches to redistribution and poverty alleviation (e.g. Lerman and Townsend, 1974; Le Grand, 1982; Korpi, 1983; Tullock, 1983; Lee, 1987; Barry, 1990; Besley, 1990; Creedy, 1996; Rothstein, 1998; Kenworthy, 1999; Nelson, 2004; Brady, 2005).

This remarkable example of social change in the provision of financial resources to families with children raises several questions of relevance for both the composition and generosity of child benefits. In this explorative study we present a first attempt to disentangle complex institutional change in child benefit programs using a new comparative and longitudinal dataset that we have assembled for 18 advanced welfare states. The purpose is to analyze the European development of child benefits in an international perspective, covering the period

¹ Tommy Ferrarini and Kenneth Nelson share equal responsibility for this paper.

1960-2005. In what ways has the balance between social policy and fiscal policy in the provision of child benefits changed? Which trajectories in the social and fiscal policy mix of child benefit systems can be identified? To what extent do levels of child benefits vary according to those trajectories? Since the non-European liberal welfare democracies in several ways were pioneering in the fiscal transformation of child benefits, the study is broadened beyond the European context and covers also developments in long-standing English speaking welfare democracies. The following countries are included in the study: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom and the United States.

As noted above comparative analyses need to take both social and fiscal policy into consideration in order to account for potential long-term shifts in the provision of child benefits. Some studies have integrated the income tax system into the comparative analysis of child benefits (e.g. Wennemo 1994; Montanari 2000; Battle et al., 2001; Bradshaw and Finch 2002; Ferrarini 2006; O'Donoghue and Sutherland, 1999). However, potential shifts from social to fiscal policy in the design of child benefits have not been examined in sufficient detail, in large part due to lack of longitudinal and comparative institutional data. Some recent studies have focused on the more comprehensive structures of in-work tax benefits that sometimes also have special rates for families with children (Immervoll and Pearson, 2009; OECD, 2009), but the organization of child benefits has yet to be explicitly analyzed. In this paper, the fruitfulness of using institutional indicators to analyse long-term socio-political change is highlighted in the focus on broader policy trends and country specific peculiarities in the design and development of child benefit systems.

The study is structured as follows. Next, the institutional structure of child benefit systems is discussed and the prevalence of different programs is presented. Thereafter the new dataset on child benefits is presented. The empirical sections analyse the levels of child benefits and the different trajectories that can be identified; and the paper is concluded by a discussion.



2. Institutional structures of child benefit systems

Countries use different types of benefits to compensate for the increased costs related to child raising. The programs analyzed in this study are non-contributory and restricted to those that are paid throughout childhood and early adolescence. Programs that are not covered include parental leave benefits, which mainly are paid during the child's first life years (Ferrarini, 2006), as well as general means-tested benefits providing minimum financial resources to low-income households, often referred to as social assistance (see Nelson, 2010). In the following we make a distinction between six different types of child benefits, involving both social and fiscal policy: universal child benefits, employment-based child benefits, income-tested child benefits, child tax allowances, child tax credits and child tax rebates. The categorization of benefits into these broader types is not always mutually exclusive and some programs may share institutional elements common to more than one category. The most obvious case concerns the income-tested feature, which may apply to both employment-based child benefits and child tax credits. In the instances where employment-based benefits and tax credits are income-tested, they are generally categorized into the respective sub-type rather than as belonging to the income-tested category. This, for example, applies to child tax credits, which typically are income-tested.

Table 1 lists the various broader forms of child benefits. Universal, employment-based and income-tested child benefits belong to the social policy branch where benefits are paid as cash transfers to the family. Tax allowances, tax-credits and tax rebates belong to fiscal policy and are generally distributed via the income tax system. For families with earned income, child tax benefits increase disposable income by reducing the amount of income tax paid. Child tax allowances reduce the level of income subject to taxation, whereas child tax credits are deducted directly from the income tax liability. Child tax credits can be wasteable or refundable. Wasteable tax credits may only be used as long as tax liability of the tax-payer is positive, whereas refundable credits can be used although tax liability is zero. In the latter case the remaining part of the credit is paid as a cash transfer. Income-tested and fully refundable child tax credits show strong institutional resemblance to the income-tested child benefit above. Flat-rate and fully refundable child tax credits are in character related to universal child benefits, albeit credits are connected to fiscal rather than social policy. In some special cases families with dependent children qualify also for certain child tax rebates, which involve lower rates of social security contributions paid on earned income.

The introduction of child benefits of the types described above has tended to follow a certain sequence in time. Table 2 shows the prevalence of different types of child benefits in the 18 countries at three years: 1960, 1980 and 2005. It should be noted that since countries may have several complementing benefits the sum of programs for

each year may be more than the number of included countries. The overall pattern indicates that the occurrence of child benefits distributed via the social policy system (i.e. universal, employment-based and income-tested child benefits) have declined, particularly since 1980. The number of child tax benefit programs (i.e. allowances, credits and rebates) shows a different development and an increase since 1960. Most notable is the increase in the number of child tax credits in the 1970s. The number of child tax credits has continued to increase after 1980, although at a much slower pace. In this latter period there was also a substantial decline in the number of child tax allowances. Thus the most substantial change in the development of child tax benefits since 1980 concerns the composition of tax expenditure, which now foremost takes the form of credits instead of allowances.

Universal child benefits are essentially an invention of the early post-war period and the timing of the first reforms of universal child benefits has been related to a number of factors, including fertility (Therborn, 1987), child poverty (Atkinson, 1975), wage bargaining (Lewis, 1991) and more broadly to the realization of gender equality (Wennemo, 1994) and to shifting morals towards the deservingness of children as such (Montanari, 2000). By 1960 almost half of the countries had introduced universal child benefits. Five additional countries joined this group by 1980, whereas the number of countries with universal child benefit programs has receded during the most recent decades. By 2005 universal child benefits were used in the Nordic countries and in Austria, France, Ireland, the Netherlands and the United Kingdom.² Generally speaking, income-tested child benefits were the most common type before the First World War (Wennemo, 1994). These early forms of income-tested child benefits were often separated from the old poor-relief and targeted to specific categories of needy families, including lone parents and orphans. Income-tested child benefits as such are nearly absent today in the longstanding industrialized welfare democracies, except for a few countries. By 1960 income-tested child benefits existed in Denmark, Finland and France. By 2005 only Japan relied on an income-tested child benefit, although the program was transformed into a universal child benefit in 2010. Nowadays, purely income-tested child benefit systems are mainly found in emerging economies, such as Latin America and Sub-Saharan Africa (Esser et al., 2009).

Another program that clearly is on the decline is employment-based child benefits, which used to characterize the systems of many Continental European countries. By 2005 employment-based child benefits are present only in Belgium, Italy and Japan. Similar developments characterize the use of child tax allowances. In the 1960s and the 1970s more than half of the countries had tax allowances for families with dependent children. By 2005 this number was down to four countries, including France, Italy, Japan, Switzerland and the United States. Child tax rebates on social security contributions have always been quite rare and also here the number of programs has been reduced since the 1980s. Child tax rebates appeared in Canada in the 1960s, but were subsequently abolished in

² Policy-makers in the United Kingdom have recently discussed the adding of an income-test to child benefits.

the late 1970s. By 1980 both Finland and Switzerland had child tax rebates on social security contributions, which were removed from the fiscal system a few years later. At the end of the period child tax rebates existed only in Germany.

The prevalence of child tax credits shows the opposite trend of increased pervasiveness. By 1960 only Denmark had a child tax credit. At this time the majority of countries with fiscal child benefits relied on tax allowances. Nine additional countries introduced child tax credits up to 1980, and another couple of countries had done so by 2005. Consequently child tax credits have become the most common type of program by the end of the period. Many of these child tax credits are income-tested in character and thus involve a clear element of vertical redistribution between the rich and the poor similar to that of social assistance and other minimum income protection schemes. By 2005, for example, 9 out of 11 countries had attached an income-test to child tax credits.

The extensive use of income-testing in child benefit systems may reflect the increased influence of neo-liberal political perspectives in policy making and the broader trend of re-commodification in social protection reform (Huber and Stephens, 2001; Castles, 2004; Swank, 2005). Typically, the strong reliance of low-income targeting in the area of social protection has been one of the essential trademarks of the co-called liberal welfare state regimes, characterizing particularly the Anglo-Saxon welfare democracies (Esping-Andersen, 1990). Although countries such as Australia, Canada and the United States seem also to be the main forerunners in terms of implementing various forms of income-tested child tax credits, vertical redistribution and child welfare seem nowadays to correspond more closely also to policy making in the European context. However, in order to analyze this aspect of the child benefit packages in closer detail we must go beyond the mere prevalence of program types and focus also on developments in the actual size of benefits. Before we continue with this analysis of benefit levels we will present our new comparative dataset on child benefits programs that we use.





3. Child Benefit Dataset (CBD)

Indicators on the level of child benefits complement expenditure based figures on the structure of social protection. The empirical analyses in this paper are based on the *Child Benefit Dataset (CBD)*, which is being developed to form a policy module in the wider *Social Policy Indicator Dataset (SPIN)* detailed in Marx and Nelson (forthcoming). The CBD covers the prevalence, structure and levels of child benefit systems in 18 OECD countries 1960-2005. Previous datasets on child benefits do exist (e.g. Wennemo 1994; Gauthier 1996; Bradshaw and Finch 2002), but none of these enable a detailed separation of various types of child benefits for a greater number of countries and years. In our data, benefit levels are calculated on the basis of a model family approach, where entitlements refer to national legislation and regulation for a standardized one-earner family with two children (2 and 7 years of age). The model family is assumed to have earned income corresponding to the wage level of an average production worker (APW).³ Although this earnings-level is above legislated or negotiated minimum wages, it provides a natural baseline for an assessment of the general trends in the composition and generosity of child benefit systems. In addition this wage level makes it possible to assess the degree of low-income targeting and to initiate a discussion about potential drifts toward minimum income protection in child benefit reform. The lower earnings-level for this part of the empirical analysis is set at half the average production worker's wage. Benefit levels are expressed as fractions of the net APW wage, i.e. after deducting income taxes and social security contributions from earnings. Similar approaches to collect institutional data are commonly applied in the comparative welfare state literature (Korpi 1989; Esping-Andersen 1990; Bradshaw et al., 1993; Bradshaw, 1995; Eardley et al., 1996; Ferrarini 2003; Nelson 2003; OECD, 2004; Scruggs and Allan 2006; Palme et al., 2009).

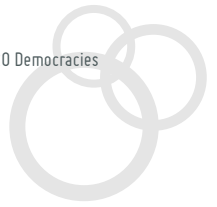
Universal child benefits have been taxable in some countries and for reasons of comparability only the net amounts are analyzed. Similarly, only the real value of child tax allowances is included, which most often is considerably lower than the formal levels expressed in tax legislation. The real value of child tax allowances is the amount of increase in disposable income due to the lowering of taxable income. The value of the child tax credit is often straightforward according to the levels established in tax legislation. However, sometimes the model family cannot use the total amount of wasteable child tax credits due to low tax liability of the taxing unit, which is either the wage-earner or the couple depending on national regulations. In other cases earned income may reduce the level of the credit due to the income-test embodied in tax legislation. The real value of the child tax credits may therefore be lower than the formal rates. The real value and the formal rates of flat-rate and fully refundable child

³ The one-earner household is not representing the average family type in contemporary welfare states. This model family is merely used to increase comparability to similar datasets on other parts of social security. In addition the fixation of the model family is a means to increase comparability over time.

tax credits are always the same. The value of the child tax rebate on social security contributions is established with reference to the level of contributions paid by a one-earner household without dependent children.

Besides the child tax benefits above families with children are in some countries allowed to deduct parts of child care fees or expenditure related to children's education from the tax liabilities (O'Donoghue and Sutherland, 1999). Tax exemptions directly related to childcare costs are not included in the CBD. Household expenditure and associated social and fiscal benefits can of course contribute substantially to the capacity of households to purchase other goods. To that extent, the costs for child care, housing, health care and medicine, and work-related expenses are relevant to consider in the comparative analysis of fiscal and social policy systems. For example, the *OECD Benefit and Wages Database* (OECD, various years) includes the value of tax exemptions for childcare in the comparison of out-of-work replacement rates. However, such analyses should preferably also take the costs for child care into consideration (Bradshaw and Finch, 2010). Child care costs are not included in this study, but analyzed by Bradshaw and Van Mechelen (forthcoming). Deductions for ordinary work related expenses are included, where appropriate according to national income tax regulations.

The data included in the CDB is based on a large number of different sources. The average production workers' wage is based on information provided by the US Bureau of Labour Statistics, which is the same source used for the *Social Citizenship Indicator Program, SCIP* (Korpi and Palme, 2003) and the Comparative Welfare Entitlements Dataset (Scruggs and Allan 2006). Besides various national sources on social benefit and tax legislation the data provided by the CDB have been established in close correspondence with the following publications: *The Tax/Benefit Position of Production Workers* (OECD, various years); *Taxing Wages* (OECD, various years); *The Tax/Benefit Position of Employees* (OECD, various years); *The Tax/Benefit Position of Selected Income Groups in OECD Member Countries* (OECD, 1978); *Personal Income Tax Systems Under Changing Economic Conditions* (OECD, 1986); *Social Protection in the Member States of the European Union* (European Commission, various years); *Social Security Programs Throughout the World* (U.S. Department of Health and Human Services, various years); *European Tax Handbook* (International Bureau of Fiscal Documentation, various years); and *Social Protection in the Nordic Countries* (Nordic Social-Statistical Committee, various years).



4. Changing levels and trajectories of child benefit systems

Have child benefit systems changed when the analytical focus is broadened from the mere prevalence of program types to the composition and levels of benefits? This section evaluates the development of child benefit programs using the benefit level indicators described above. Figure 1 shows the composition of child benefits in percent of the net wage 1960-2005. Only averages for the 18 countries are analyzed here. The three lower fields describe the average level of child benefits distributed as part of the social policy system, whereas the three top fields denote child tax benefits provided through fiscal policy. The period from the mid-1970s and onwards are sometimes described in terms of social policy stagnation and decline (Pierson, 1996; Clayton and Pontusson, 1998; Korpi and Palme, 2003; Montanari et al., 2007). The development of child benefits does not conform to this pattern. The level of the child benefit package has increased almost continuously over the period, from an average around 7 percent of the net wage in 1960 to about 12 percent in 2005. Thus, child benefits show instead a trend of continuous expansion, similar to the developments in other family policy areas, such as parental leave benefits (Ferrarini, 2006), and in health care provision (Montanari and Nelson, 2012). The decline in 1975 is mainly explained by child benefit reductions in Australia, Denmark, Ireland, Norway, New Zealand and the United States. In Denmark and Norway it is the levels of universal child benefits that declined, whereas the erosion of benefit levels in Australia, Ireland, New Zealand and the United States is due to the lowering of child tax allowances. Universal, employment-based and income-tested child benefits together increased on average from around 6 to 8 percent of the net wage between 1960 and the mid-1980s, where after a slight downward trend can be discerned. The total level of child tax benefits has increased almost throughout the entire period, rising from an average around 1 percent of the net wage in 1960 to over 5 percent in 2005. Thus, the fiscal shift in the provision of child benefits is not only confined to the prevalence of programs. The trend of an increased fiscal redistribution also appears in the composition and level of child benefit systems. In terms of benefit levels the evolution entails a gradual reallocation of benefits from social policy to systems emphasizing both social policy and fiscal redistribution.

The development differs to some extent between the various types of benefits. The level of child tax credits has increased almost continuously since they started to appear in the mid-1970s, on average from initially very low values to slightly over 4 percent of the net wage in 2005. Tax allowances demonstrate the opposite trend of declining benefit levels; the level of universal child benefits more than doubled from around 2 percent of the net wage in 1960 to around 6 percent in the mid-1980s. Between 1995 and 2005 the level of universal child benefits decreased on average by about one percent of the net wage. The level of employment-based child benefits has

nearly halved over the period, from an average of about four percent of the net wage in the 1960s to a fairly stable level of around 2 percent in the 1980s and onwards. Compared with the other program types the average level of income-tested child benefits and in particular child tax rebates are modest, the latter only visible as a small break of the surface in the top of the diagram. .

The analysis above conceals important cross-national differences, motivating a more detailed analysis of developments in each country. On the basis of the long-term policy trends and main institutional trajectory identified at the end of the observation period we have divided the countries into three broad groups. The first group includes countries where child benefits of the social policy type, mainly in the form of universal child benefits, have come to form the main way of such redistribution to families with children. The second group of countries in this context relies on various child tax benefits, whereas the third group of countries uses a mix of benefits belonging both to social and fiscal policy.

4.1. The universalist trajectory

Countries with the universalist trajectory include Denmark, Finland, Ireland, Norway and Sweden. The strong Nordic representation among countries with universal child benefits has been linked to politics and the representation of social democratic parties in state government (Wennemo, 1992). *Figures 6-2a-e* shows the composition of child benefits in countries with the universalist trajectory. In this category, child benefits range between 8 and 12 percent of the net wage in 2005. The most substantial changes appear in Finland and Ireland. In Ireland the universal child benefit increased from around 4 to 12 percent between the mid-1990s and 2005, something that was part of a larger restructuring of family policy. Whereas the nominal value of the child-dependent additions in the social assistance benefit was frozen, additional financial resources were placed on the universal child benefit. This shift in family policy made the rights of children and their parents less contingent on labour market status and employment income (Callan et al., 2006). Ireland had a child tax allowance until the mid-1980s, when the program was considered inequitable and consequently abolished. A tax exemption for children in low-income families was introduced a few years later. The exemption limits are very tight compared to those granted for single and married families and they have been raised only moderately (Daly and Clavero, 2002).

In Finland the almost opposite development occurred, where the level of the universal child benefit was reduced almost by a third between 1995 and 2005, due to constrained public finances in the aftermath of the early 1990s economic crisis in Finland. The rates of the universal child benefit were cut by 8 percent in 1995 and over subsequent years the benefit was not indexed (Taylor-Gooby, 2002). During substantial parts of the early observa-

tion period Finland also had various forms of child tax benefits, which were abolished along with the major tax reform of the mid-1990s (Nielsen, 2004).

During the observation period Norway both introduced and phased out a child tax credit, while neither Denmark nor Sweden have had any child tax benefits over the period 1960-2005. The Norwegian child benefit system has become somewhat less generous since 1990, whereas benefit levels in the Danish and Swedish systems have slightly increased, at least since the 1980. The increase has been somewhat more marked in Denmark than in Sweden. Whereas the universal child benefit is yearly indexed in Denmark, the same benefit is instead updated according to ad-hoc decisions by the parliament in Sweden. Along with the restructuring of the Swedish economy in the aftermath of the early 1990s financial crisis the universal child benefit was reduced in absolute terms along with the abolition of the supplementary child allowance for families with many children. This supplement was later reinstated and integrated into the universal child benefit.

4.2. The fiscal trajectory

Besides the market-liberal countries of Australia, Canada, New Zealand and the United States, also Germany joins the group of countries with a fiscal trajectory of child benefits. *Figures 6-3a-e* shows the composition of child benefits in these countries. Germany is categorized into this group on the basis of the refundable child tax credit introduced in the 1990s, although the credit usually is paid by the family office. The child tax credit in Germany continued the slow expansion of family policy that characterized the universal child benefit in the mid 1980s, partly as the response of rulings by the Federal Constitutional Court concerning compensation for insufficiencies in the financing of social protection, but also in relation to legislatives preventing the state to tax families into poverty (Seeleib-Kaiser, 2006). The child tax rebate in Germany is very small and hardly visible in the figure, amounting only to 0.3 percent of the net wage in 2005.

Australia, Germany, Canada and New Zealand all operated universal child benefits until the early 1990s, when they were replaced mainly by tax credits. The United States has throughout the observation period relied on child tax allowances, ranging between 3 and 6 percent of the net wage. In 1975 the *Earned Income Tax Credit* (EITC) was introduced. The EITC has been expanded on several occasions, both in case loads and expenditure. However, our model family did pass the income-test for the benefit until the end of the observation period. The child tax allowance and the EITC in sum amount to around 9 percent of the net wage in 2005. To some extent the decision to tie the benefit to income taxation rather than to social welfare legislation was made by the Democratic party to

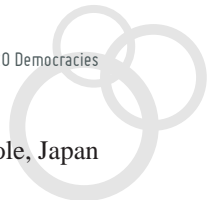
avoid too much opposition by the Conservatives, who traditionally have tended to dislike social policy expansion (Howard, 1997).

The level of child tax benefits amount approximately to about 15 percent of the net wage in Australia, 9 percent in Canada, 13 percent in Germany and 7 percent in New Zealand. Particularly the development of child tax credits in Australia at the end of the period is notable. The Australian child tax credit was part of a major tax reform launched in 2000. By 2005 the level of the credit had increased by more than 10 percent of the net wage. Despite this perhaps positive testimonial the tax reform as such has received some criticism, particularly due to the high effective marginal tax rates on secondary earners imposed by the system. Worries about the potential negative effects on women's labour force participation and fertility concerns spurred further changes in 2004, whereby the withdrawal rate of the child tax credit was reduced (Brennan, 2011).

Canada has accomplished several major restructurings of the child benefit system since the Second World War, although benefit levels have increased only by a few percentage points of the net wage since the 1960s. The rates for the universal child benefit were raised in the 1970s when both indexation and taxation of benefits were introduced. In addition to these reforms a child tax credit was implemented. The different benefits were integrated into a single child tax credit in 1993, where working families could receive extra supplements. The link to employment income was removed in 1998 as a means to create a more equal system. The provinces were also provided financial stimulus to set up own child benefit programs. By the turn of the century almost all provinces either offered an income-tested child benefit or employment earnings supplements for families with children (Battle and Mendelson, 2001). The opposite development of reduced benefit levels can be observed for New Zealand, where a gradual shift from universal child benefits to child tax credits appeared in the 1980s (Shaver 1999).

4.3. The mixed trajectory

The remaining eight countries have been placed in a more diversified group where the trajectories by the end of the observation period have formed systems that in different ways mix social and fiscal child benefits. Included here are Austria, Belgium, France, Italy, Japan, the Netherlands, Switzerland and the United Kingdom. *Figures 6-4a-h* shows the composition of child benefits in these countries. In this group of countries only Japan lacked a child benefit with broad coverage in the target population during the period 1960-2005, although a universal child benefit was introduced recently. In 1971 the child tax allowance was complemented by an income-tested child benefit. The income-tested child benefit was initially paid from the third child, but was gradually extended in 1991 to cover also the first child under the age of three. For our type-case the income-tested child benefit is compara-



tively modest, providing benefit levels equivalent to about 3 percent of the net wage in 2005. On the whole, Japan has provided comparatively low child benefit levels throughout the observation period, ranging between 1 and 5 percent of the net wage.

Several of the Continental European countries have had substantial employment-based child benefits, something that has been related to the longstanding influence of confessional Christian democratic parties (Wennemo, 1992). Belgium, Italy and Switzerland still have child benefits related to employment, while Austria, France and the Netherlands shifted from employment-based programs to universal child benefits in the 1970s. In Belgium the universal child benefit has been comparatively generous, ranging between 12 and 15 percent of the net wage during the observation period, and from 1975 until 2000 a child tax credit at levels between 1 and 4 percent of the net wage was also in force. Italy had employment-based benefits above 15 percent of the net wage in the earliest part of the period, decreasing to levels around 6 percent in the mid-1970s. At the end of the period the levels of the Italian employment-based benefit increased somewhat and during the latter period an income-test was added to the benefit. The total level of benefits in Italy was around 7 percent of the net wage in 2005. The U-shaped pattern can partly be explained by the indexation of benefits, where formal procedures to up-rate benefits according to prices were absent until the second half of the 1980s (Fausto, 1998). In Switzerland the level of the employment-based child benefit has increased throughout most of the period, reaching about 8 percent of the net wage in 2005. There is also a child tax allowance, provided at levels around 3 percent of the net wage.

The generosity of the French child benefit system is tilted towards the lower end of the country ranking in this group with mixed trajectories, something that partly is related to the structure of the universal child benefit, which applies from the second child only. In addition families have been able to receive a child tax allowance of no more than 2 percent of the net wage. The allowance was still in force at the end of the period, although the value reached close to zero for our model family. Austria and the Netherlands introduced child tax credits by the end of the observation period, reaching levels between 3 and 6 percent of the net wage. A universal child benefit has been in force over the entire period in the United Kingdom. In 1999 the *Working Families Tax Credits* (WFTC) program was introduced, something that led to a substantial increase in the generosity of the child benefit system. Besides being more generous the basic structures of the WFTC program were fairly similar to its predecessor, the *Family Credit* program introduced in 1988.⁴ In-work benefits often have several objectives and partly as a means to further strengthen the incentives for paid work in households with dependent children the *Child Tax Credit* was introduced in 2003 (Millar, 2008). Together, the level of the universal child benefit and the child tax credit approximates 17 percent of the net wage in 2005.

⁴ The model family used in this study did not qualify for Family Credit, nor its predecessor the Family Income Supplements program.

While the evidence so far gives no clear indication of convergence in the institutional composition of child benefits, countries have become more similar in terms of the total level of the child benefit package directed to our model family. In the beginning of the period the child benefit levels differed by about 6 percent of the net wage between the most generous group of countries and the less generous category. At the end of the period this difference was down to 1 percent. The intra-group variation has decreased substantially among the countries with the universalist and mixed trajectories, whereas benefit levels among countries categorized in the fiscal trajectory have become more different.⁵ Since there are good reasons to believe that the fiscalization of child benefits identified above may have long-term consequences for the extent and direction of redistributive efforts we next provide some preliminary examinations concerning the issue of universalism and low-income targeting in the design of child benefit systems.

5 Also the coefficient of variation indicates that benefit levels have become more similar across countries. Between 1960 and 2005 the coefficient of variation for the total benefit package by about 25 percent in this group of 18 OECD countries. In the universalist and mixed categories of countries the coefficient of variation has decreased by half and by about 30 percent, respectively. In the fiscal category the coefficient of variation has almost tripled.



5. Universalism and targeting

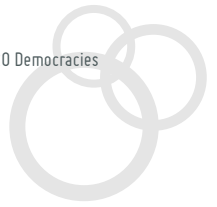
The transferring of child benefits from the social policy system to the income-tax system has generated an increased focus on redistribution towards families with children at the lower end of the income distribution. The income gradient inherent in most child tax credits of course vary across countries. Nonetheless, the fiscalization of child benefits involves a reorganization of policies away from universalism towards a greater emphasis on low-income targeting. Figure 5 shows the income gradient institutionalized in the child benefit systems of 18 OECD countries 1960-2005. There is one series of figures for all countries together and separate series for countries belonging to the different benefit trajectories discussed above. The income gradient shows the percentage difference in benefit levels between a low-income family and the family earning the full wage above. A gradient below one implies that the low income family receives lower benefits than the family earning the full wage. Values above one indicate that the low income family receives the highest benefit. The data shows that selectivity and low-income targeting has become more prominent in the area of child benefits. Since 1960 the income gradient increased on average from .80 to 1.21 for the longstanding OECD member countries. A major shift occurred over the 1990s, when the cross-over point was researched. The income gradient thereafter continued to increase until 2000, particularly due to the developments of income-tested child tax credits in countries with fiscal trajectories. At the end of the period the relaxed income-test for the EITC in the United States causes a slight reduction in the income gradient for the latter group of countries. For the other countries with fiscal trajectories the income gradient continued to increase between 2000 and 2005.

As noted above, child benefit systems with high income gradients may be more efficient in terms of the relative size of benefit expenditure that reaches the poor families, but may not be equally effective in reducing the number of poor families. One reason for this may be that programs mainly involved with vertical redistribution tend to produce fairly modest benefit levels, something that partly is related to feedbacks into the system generated by the popular support for public spending (Nelson, 2006). The child benefit level data used in this study confirm this pattern. Figure 6 shows the size of the average benefit for respective benefit type in 2005. The denominator (i.e. number of countries) for this computation is shown above the staples for each program.

The average child tax allowance and the average child tax credit seldomly reach those levels guaranteed by universal child benefits. In fact, only Australia and Germany provide child tax credits that are more generous than the average universal child benefit (not shown).⁶ The comparatively low level of child tax benefits explain why countries with fiscal trajectories tend to have the least generous benefit packages. The most notable exception to this pattern is Australia, where the amount of the child tax credit is substantially higher than in the other countries with fiscal trajectories. Countries with mixed social and fiscal policy trajectories tend to provide higher benefit levels than countries that have come to developed purely fiscal solutions, something that to large extent is explained by the generosity of the universal or employment related components in the mixed benefit package. Thus, if the size of benefits are of most concern, universalism rather than low-income targeting should perhaps be the guiding principle for successful child benefit reform. Still, the most common strategy to realize the universalist principle is by providing universal child benefits of the social policy type.

Besides the rates of benefits another concern that often are raised in connection with child tax credits in particular is incomplete take-up, which for various reasons tends to be lower when entitlements need to be claimed. For example, the take-up rate of the WFTC program in the United Kingdom has been estimated at 62-65 percent (Inland Revenue, 2000), 81-86 percent for the U.S. EITC program (Scholz, 1996) and 80 percent for *Family Tax Benefit* in Australia (Salma and Whiteford, 1999). Some child benefits may also have problems with incomplete coverage, particularly at the lower end of the income distribution. For example, this applies to the employment-based and income-tested child benefit in Italy (Matsaganis et al., 2003). At the moment it is not possible to present any comparative data on take-up and coverage of child benefits. Nonetheless, both latter aspects need to be taken into consideration in future research when benefit levels are to be evaluated in distributional terms.

6 The average employment-based child benefit is somewhat less generous than its universal counterpart. Nonetheless, the size of the average employment-based child benefit are in most occasions higher than corresponding child tax benefits.



6. Conclusion

All advanced welfare states use child benefits to increase the economic resources of families with dependent children. While universal and employment-based child benefits of the social policy type have received scholarly recognition in the past, the rapid development in the area of child tax benefits has been less analyzed. Based on new comparative data on program existence and benefit levels this paper has analyzed the changing social and fiscal policy mix of child benefit systems in 18 longstanding welfare democracies from 1960 to 2005.

The results show that child benefit levels have become more similar and generous since the 1960s. This expansion of benefits occurred even during the period of welfare state retrenchment since the mid-1970s. However, the composition of child benefit packages varies extensively across countries; and we have in this study discerned three different trajectories in the social and fiscal policy mix of child benefits. The Nordic countries and Ireland have come to rely predominantly on universal child benefits. In Australia, Canada, Germany, New Zealand and the United States it is instead the tax system that provides the channel for redistribution to families with dependent children. Contrary to universal and employment-related programs, child tax benefits are often phased down with earned income and sometimes related to tax liability. Problems of both non take-up and incomplete coverage of benefits can be expected here. A third group of countries including Austria, Belgium, France, Italy, Japan, the Netherlands, Switzerland and the United Kingdom combines child benefits of both the social and fiscal policy types.

Benefit generosity is also related to these trajectories. Particularly, benefit levels tend to be higher among countries that have included universal elements in the composition of the policy package. The average universal child benefit also tends to be more generous than the other benefit types. On this account, the fiscalization of child benefits may not be of greatest benefit for low-income families with children. In addition, the income gradient inherent in child tax credit programs seems to be a retreat back to the old forms of targeted approaches to family policy that characterized social protection at the outset of welfare state expansion during the immediate Post-War decades. To that extent the development in countries following the fiscal trajectory in child benefit development mirrors the expression of old wine in new bottles, giving low-income targeting and selectivity in the area of child benefits a new disguise.

Cross-national variation and the development of child benefits raise further issues concerning the formation of institutional structures, or at least bring old questions concerning welfare state development back to the frontier of comparative research. One broad question has to do with the political, economic and institutional legacy of policies. Another question relates to the redistributive consequences of enacted reforms and to the different strategies

in the development of child benefits. To what extent is institutional diversity in the area of child benefits driven by political motives surrounding the ideas of equality and justice? What are the roles of economic development, labour market transformation, changing family patterns, gender relations and institutional inertia? With reference to income redistribution, the fiscalization of child benefits brings back the century-old issue on the merits and drawbacks of targeted and universal policy responses to income redistribution. Questions also arise around the ways in which child benefits interlink with other welfare state arrangements, thus shaping the well-being and behaviour of parents with dependent children, not least regarding broader family policy structures also influencing care work and employment patterns among parents.

The findings in this paper clearly indicate that in order to comprehensively address the redistributive effect of welfare states it may not suffice to focus the analysis on social policy. For a better understanding of developments also fiscal policy and the income tax system may successfully be integrated in comparative analyses, not least concerning child benefits. The type of indicators that we have collected and used in this study contributes with some of the basic research efforts that are necessary to continue scholarly work around the development of child benefit system. Such data can also fruitfully be applied to studies that stretch the analytical framework and further investigates causes and consequences of child benefits in contemporary welfare states, thus bringing new evidence to the wider and expanding research field of welfare state analysis.



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Tables and Figures

Table 1. Institutional types of child benefits.

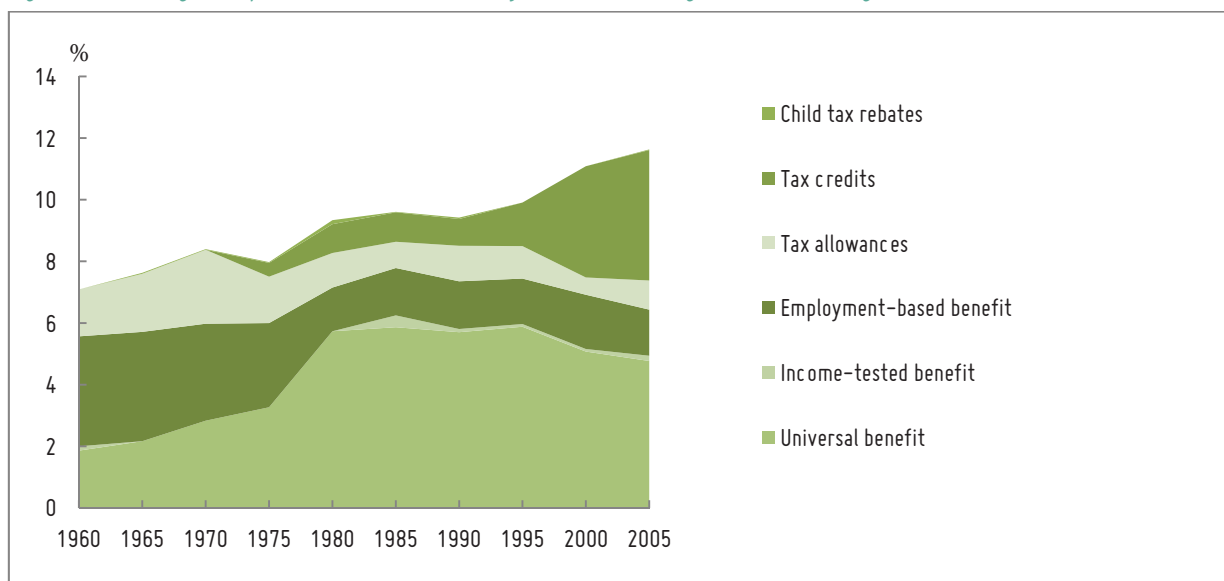
CHILD BENEFIT	POLICY TYPE	MAIN ELIGIBILITY CRITERIA
Universal child benefit	Social policy benefit	Citizenship or residence
Employment-based child benefit	Social policy benefit	Gainful employment
Income-tested child benefit	Social policy benefit	Income- or means-testing
Child tax allowance	Fiscal policy benefit	Taxable income
Child tax credit	Fiscal policy benefit	Tax liability (in case of wasteable)
Child tax rebate	Fiscal policy benefit	Social security contributions liability

Table 2. Prevalence of child benefit programs in 18 countries 1960, 1980 and 2005.

	1960	1980	2005
Universal child benefits	8	13	9
Employment-based child benefits	8	4	3
Income-tested child benefits	3	1	1
Child tax allowance	11	11	5
Child tax credit	1	10	13
Child tax rebate	0	2	1

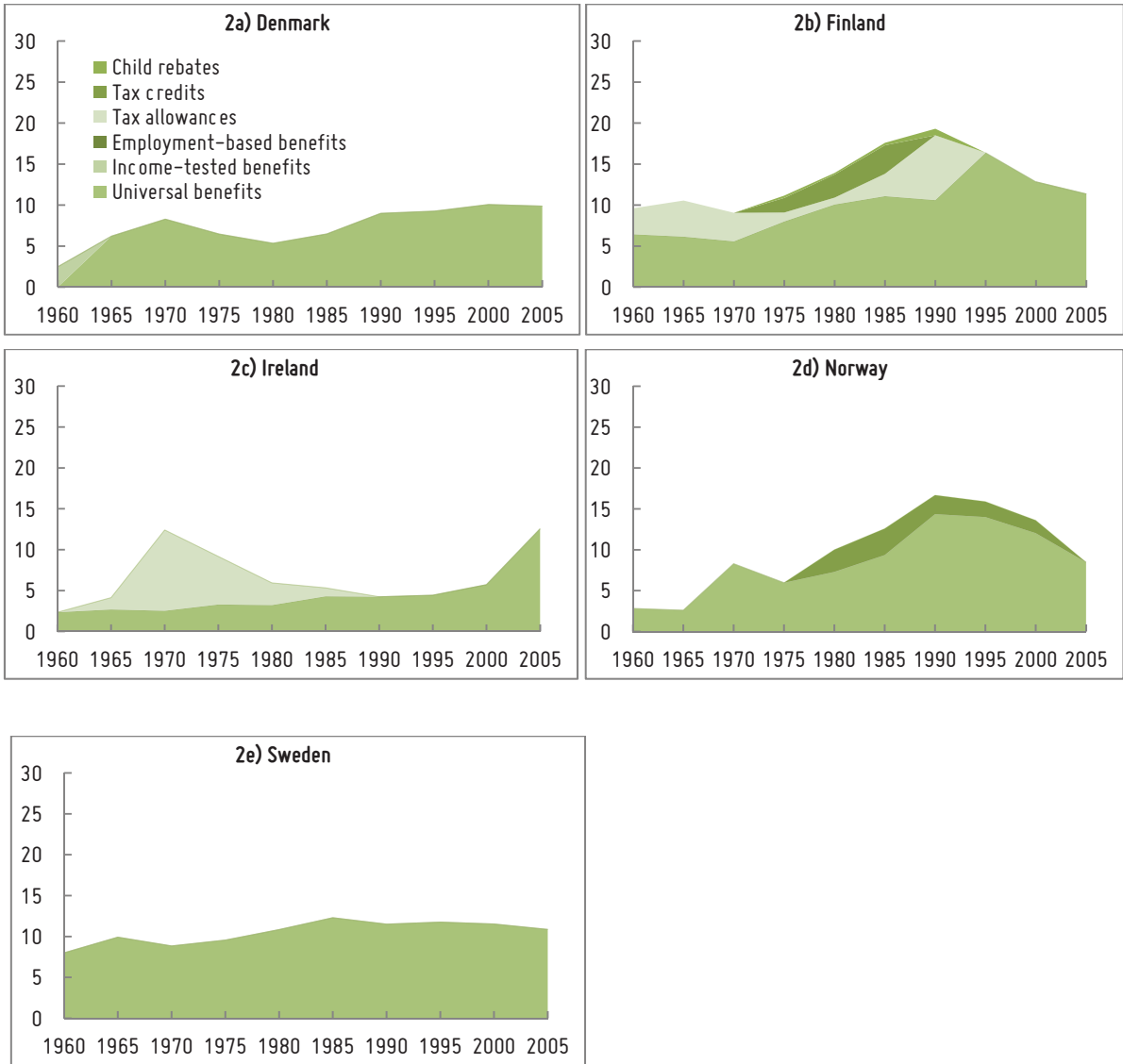
Source: CBD

Figure 1. Average composition of child benefit systems. Percentages of the net wage in 18 Countries 1960–2005.



Source: The CBD.

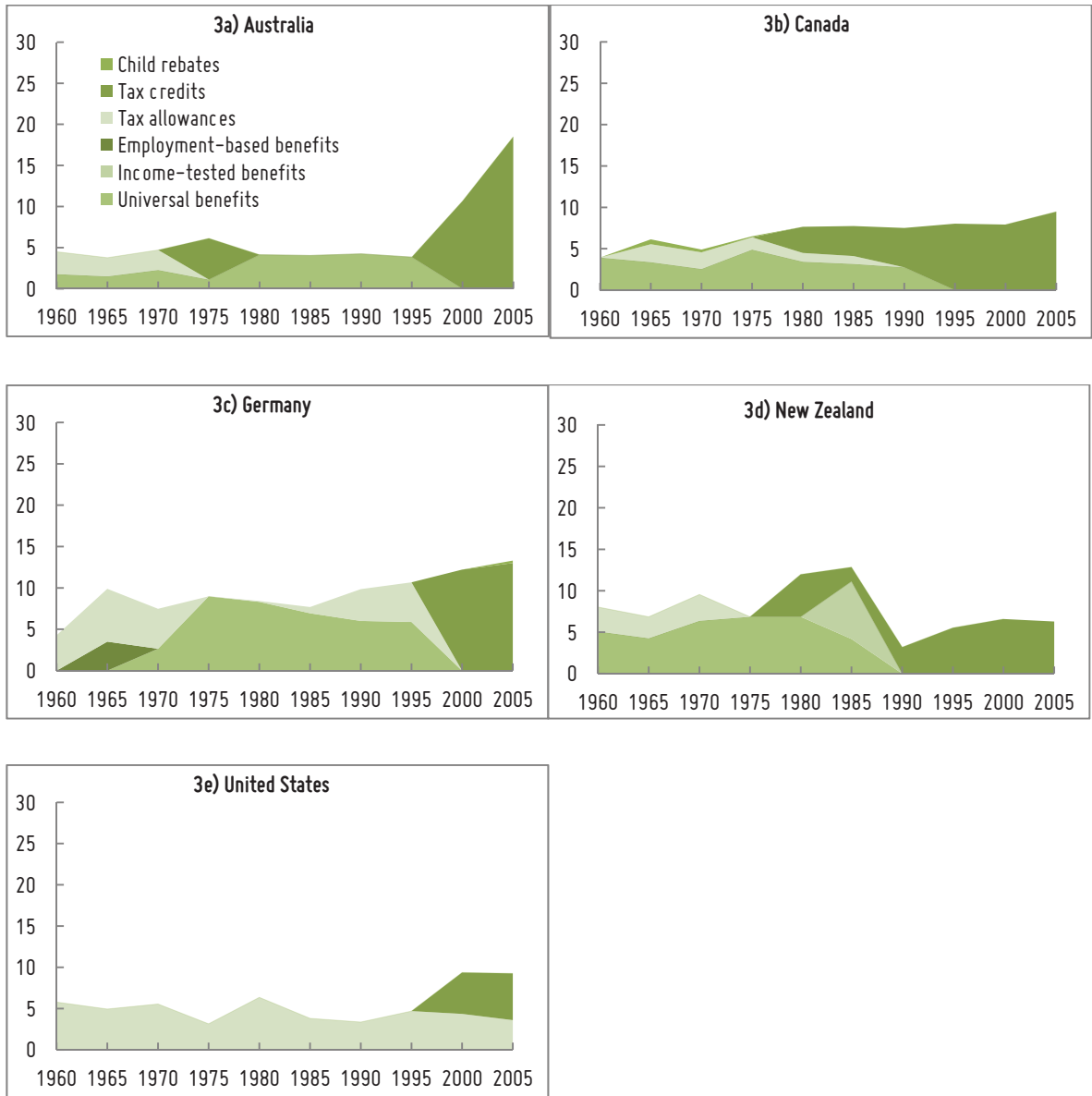
Figure 2a-e Composition of child benefit systems in countries with universalist trajectories. Percentages of the net wage in Denmark, Finland, Ireland, Norway, Sweden, 1960-2005.



Source: The CBD.

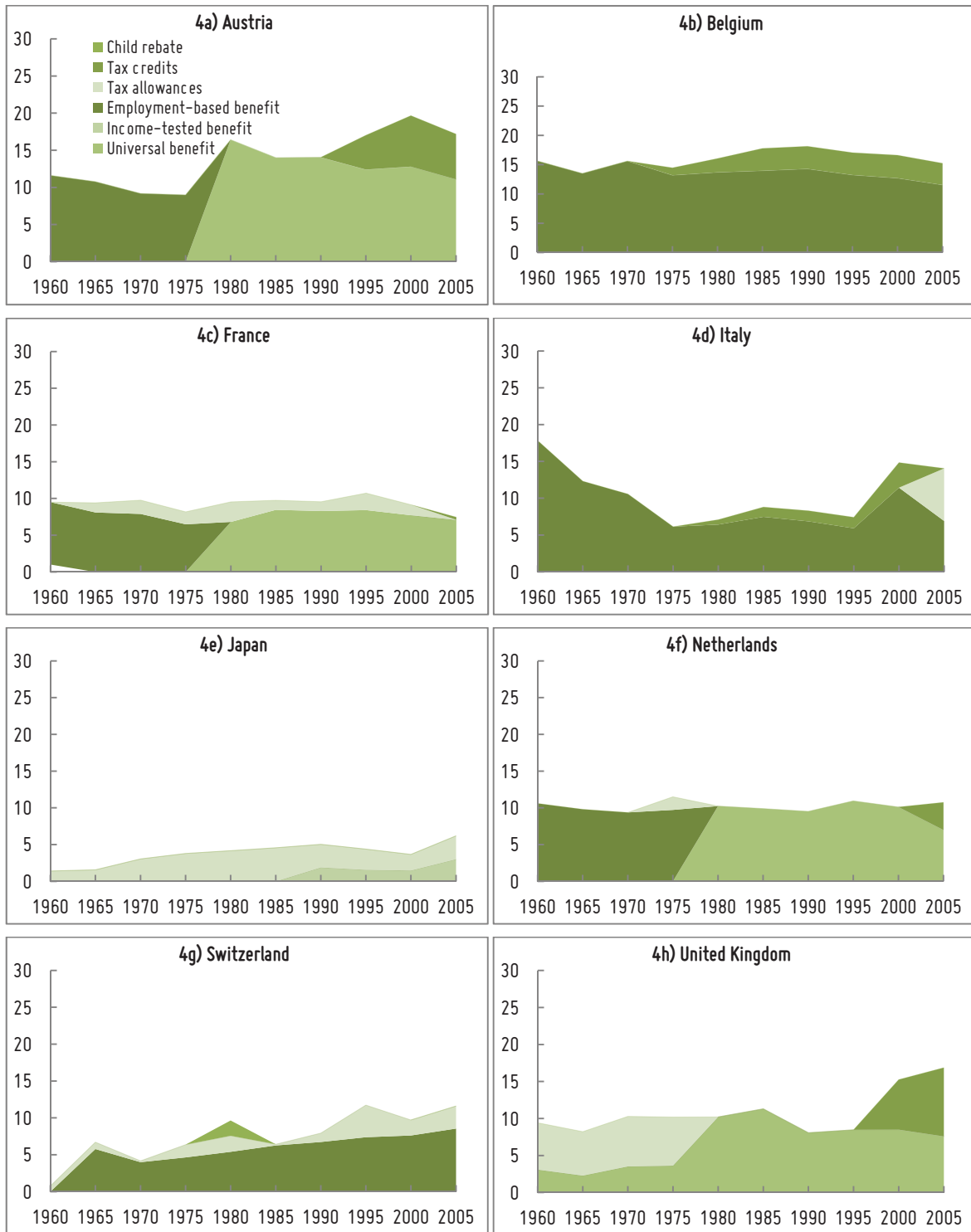


Figure 3a-e. *Composition of child benefit systems in countries with fiscal trajectories. Percentages of the net wage in Australia, Canada, New Zealand, the United States and Germany 1960-2005.*



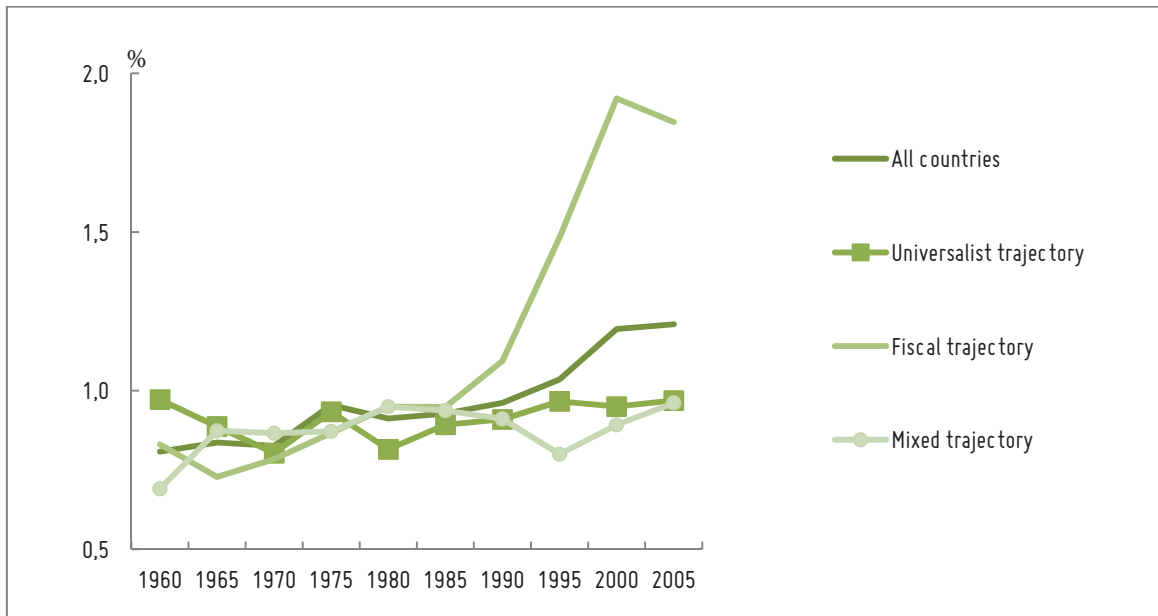
Source: The CBD.

Figure 4a-h. Composition of child benefit systems in countries with mixed social and fiscal policy trajectories. Percentages of the net wage in Austria, Belgium, France, Italy, Japan, the Netherlands, Switzerland and the United Kingdom 1960-2005.



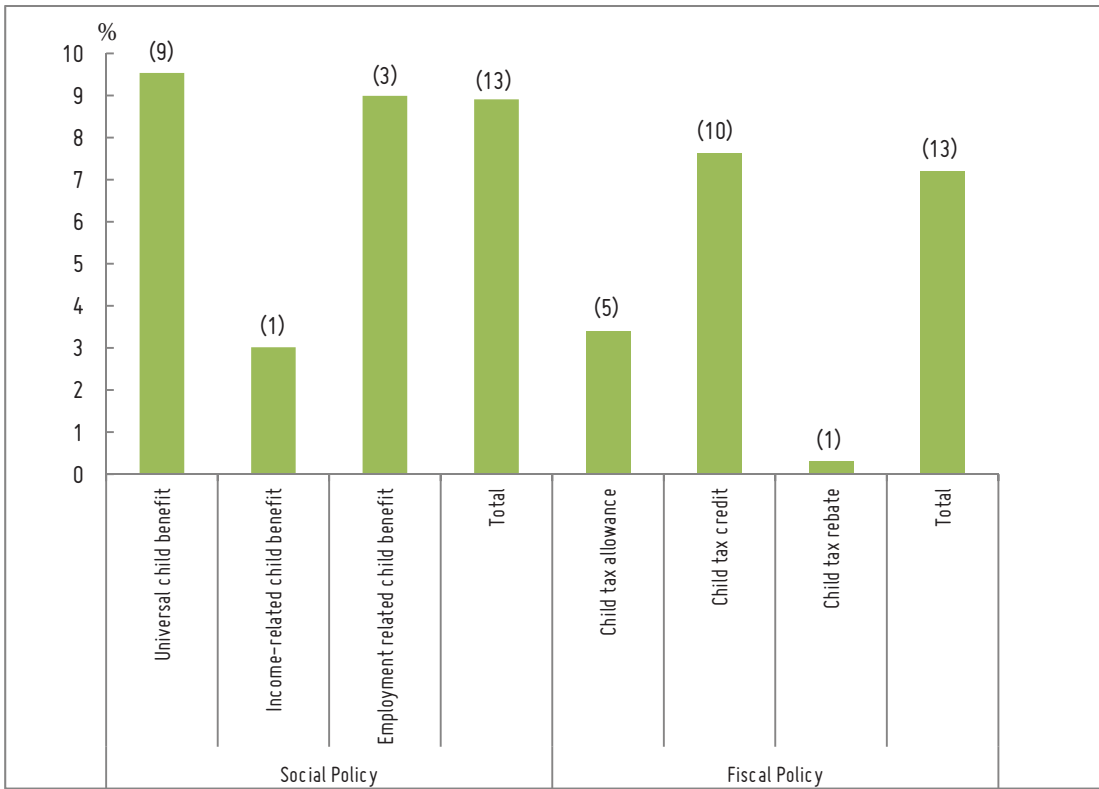
Source: The CBD.

Figure 5. Income gradient of child benefits in 18 OECD countries 1960–2005. Benefits for a two-parent family earning half the average production worker's wage as percentage of benefits for a two-parent family earning the average production worker's wage.

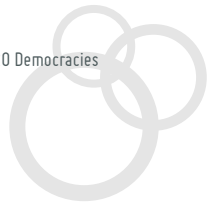


Source: The CBD.

Figure 6. The size of the average child benefit for different programs in 18 countries, 2005. Percentages of the net wage (figures in parenthesis show the number of countries with each type of benefit).



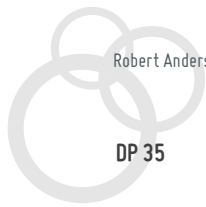
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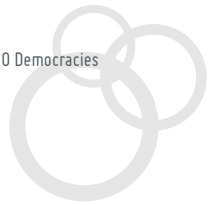
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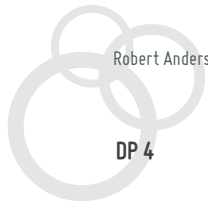
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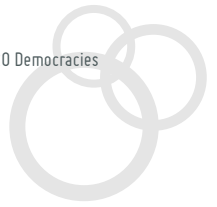


- DP 4** **Inequality Decompositions – A Reconciliation**
Frank A. Cowell and Carlo V. Fiorio
December 2010

- DP 3** **A New Dataset of Educational Inequality**
Elena Meschi and Francesco Scervini
December 2010

- DP 2** **Are European Social Safety Nets Tight Enough? Coverage and Adequacy of Minimum Income Schemes in 14 EU Countries**
Francesco Figari, Manos Matsaganis and Holly Sutherland
June 2011

- DP 1** **Distributional Consequences of Labor Demand Adjustments to a Downturn. A Model-based Approach with Application to Germany 2008–09**
Olivier Bargain, Herwig Immervoll, Andreas Peichl and Sebastian Siegloch
September 2010



Information on the GINI project

Aims

The core objective of GINI is to deliver important new answers to questions of great interest to European societies: What are the social, cultural and political impacts that increasing inequalities in income, wealth and education may have? For the answers, GINI combines an interdisciplinary analysis that draws on economics, sociology, political science and health studies, with improved methodologies, uniform measurement, wide country coverage, a clear policy dimension and broad dissemination.

Methodologically, GINI aims to:

- exploit differences between and within 29 countries in inequality levels and trends for understanding the impacts and teasing out implications for policy and institutions,
- elaborate on the effects of both individual distributional positions and aggregate inequalities, and
- allow for feedback from impacts to inequality in a two-way causality approach.

The project operates in a framework of policy-oriented debate and international comparisons across all EU countries (except Cyprus and Malta), the USA, Japan, Canada and Australia.

Inequality Impacts and Analysis

Social impacts of inequality include educational access and achievement, individual employment opportunities and labour market behaviour, household joblessness, living standards and deprivation, family and household formation/breakdown, housing and intergenerational social mobility, individual health and life expectancy, and social cohesion versus polarisation. Underlying long-term trends, the economic cycle and the current financial and economic crisis will be incorporated. Politico-cultural impacts investigated are: Do increasing income/educational inequalities widen cultural and political ‘distances’, alienating people from politics, globalisation and European integration? Do they affect individuals’ participation and general social trust? Is acceptance of inequality and policies of redistribution affected by inequality itself? What effects do political systems (coalitions/winner-takes-all) have? Finally, it focuses on costs and benefits of policies limiting income inequality and its efficiency for mitigating other inequalities (health, housing, education and opportunity), and addresses the question what contributions policy making itself may have made to the growth of inequalities.

Support and Activities

The project receives EU research support to the amount of Euro 2.7 million. The work will result in four main reports and a final report, some 70 discussion papers and 29 country reports. The start of the project is 1 February 2010 for a three-year period. Detailed information can be found on the website.

www.gini-research.org





GINI GROWING INEQUALITIES' IMPACTS

Amsterdam Institute for Advanced labour Studies

University of Amsterdam

Plantage Muidergracht 12 1018 TV Amsterdam The Netherlands

Tel +31 20 525 4199 Fax +31 20 525 4301

gini@uva.nl www.gini-research.org



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