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“Progress for the Poor, Chapters 6, 8 and 9”

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SCHEDULE FOR 2012 NYU TAX POLICY COLLOQUIUM

(All sessions meet on Tuesdays from 4:00-5:50p.m. in Vanderbilt Hall-208, NYU Law School)

1. January 17 – Michelle Hanlon, MIT, Sloan School of Management. “Taking the Long Way Home: Offshore Investments in U.S. Equity and Debt Markets and U.S. Tax Evasion.” (with Edward L. Maydew and Jacob R. Thornock).
2. January 24 – Amy Monahan, University of Minnesota Law School. “Will Employers Undermine Health Care Reform by Dumping Sick Employees?” (with Daniel Schwarcz).
3. January 31 – Alex Raskolnikov, Columbia Law School. “Accepting the Limits of Tax Law and Economics.”
4. February 7 – Victor Fleischer, University of Colorado Law School. “Tax and the Boundaries of the Firm.”
5. February 14 – Heather Field, Hastings College of Law. “Binding Choices: Tax Elections & Federal/State Conformity.”
6. February 28 – Daniel Shaviro, New York University School of Law. “The Financial Transactions Tax Versus (?) the Financial Activities.”
7. March 6 – Edward Kleinbard, USC Gould School of Law. “The Sorry State of Capital Income Taxation.”
8. March 20 – Susan C. Morse, Hastings College of the Law. “International Corporate Tax Reform and A Corporate Offshore Excise Tax.”
9. March 27 – Stephen Shay, Harvard Law School. “Unpacking Territorial.”
10. April 3 – Jon Bakija, Williams College Economics Department. “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from U.S. Tax Return Data.”
11. **April 10 – Lane Kenworthy, University of Arizona Sociology Department. “Progress for the Poor, Chapters 6, 8 and 9.”**
12. April 17 – Yair Listokin, Yale Law School. “‘I Like to Pay Taxes’: Lessons of Philanthropy for Tax and Spending Policy.” (with David Schizer)
13. April 24 – Alan Auerbach, Berkeley Economics Department and NYU. “The Mirrlees Review: A U.S. Perspective.”
14. May 1 – Rosanne Altshuler, Rutgers Economics Department, and Harry Grubert, U.S. Treasury Department. “A New View on International Tax Reform.”

Progress for the Poor

LANE KENWORTHY

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"Why is there so much poverty in the United States?" If low wages need not mean low household incomes, why is it that the country with the largest low-wage sector, the United States, has comparatively low incomes at the bottom of its distribution? The question is particularly pointed given that the United States has precisely the type of program that I suggest can help to reduce the connection between low wages and household incomes—an employment-conditional earnings subsidy.

Begin by recalling that most comparative analyses of poverty rates use a relative poverty measure, in which households are deemed poor if their income is below 50% (or 60%) of each country's median. The United States looks bad in these types of analyses in part because its median income is higher than those of most other rich nations. When we use an absolute measure, the United States is closer to the middle of the pack (Chapter 2). Then again, if we turn to a measure of absolute material deprivation, the United States once more is near the bottom of the performance ranking (Chapter 4).

The chief reason the United States has not only low wages but also comparatively low household incomes and material well-being is the stinginess of its government transfers and services. Modest, regularized increases in the Earned Income Tax Credit, unemployment compensation, social assistance (TANF and Food Stamps), housing assistance, public services such as health care and child care, and in the statutory minimum wage would yield significant reductions in income poverty and material deprivation.²⁹

CONCLUSION

Low-wage jobs are a prominent feature of the U.S. economy. To the surprise of many observers, the same can now be said of Germany. Changes in economic pressures, institutions, and policies—and also, perhaps, shifts in views about the best way to help immigrants, the young, and the near-elderly into the labor market—make it likely that other countries will follow Germany's lead. But citizens and policy makers should worry far less about low wages for individuals than about low incomes for households. Policy can help to ensure that low wages do not result in low incomes.

6

Targeting May Not Be So Bad

Generous government transfers are a key antipoverty device. But three developments have converged to constrain policy makers: population aging, slower productivity growth, and barriers to higher tax rates imposed by capital mobility.¹ The deep 2008–9 economic downturn has produced severe government budget deficits, which compound the problem.

One possible response is to make greater use of targeting in social policy.² Targeted transfers are directed (sometimes disproportionately, sometimes exclusively) to those with low incomes and assets, whereas universal transfers are provided to most or all citizens. Targeted programs are more efficient at achieving redistribution; each dollar or euro or kroner transferred yields a greater reduction in poverty. Increased targeting therefore could be an effective way to maintain or enhance redistribution in the face of diminished resources.

But targeting has a significant potential drawback. Targeted programs tend to have political constituencies that are smaller and less cohesive, engaged, and influential. Such programs thus enjoy less political support.³ Targeted programs may be more efficient at reducing poverty, but because of their narrower political base the amount transferred via targeted programs may be much smaller than via universal programs. The result, some analysts predict, will be less redistribution.⁴

Walter Korpi and Joakim Palme state the hypothesis in the following way:

By discriminating in favor of the poor, the targeted model creates a zero-sum conflict of interests between the poor and the better-off workers and the middle classes who must pay for the benefits of the poor

without receiving any benefits. . . . The debate about the redistributive outcomes of welfare state programs has focused almost exclusively on how to distribute the money available for transfer and has largely ignored variations in the size of the redistributive budget (i.e., the total sum available for redistribution). The degree of redistribution finally achieved depends on the size of the redistributive budget as well as on the degree of low-income targeting. . . . We can expect a trade-off between the degree of low-income targeting and the size of the redistributive budget, such that the greater the degree of low-income targeting, the smaller the redistributive budget.⁵

Korpi and Palme posit a paradox of redistribution: “the more we target benefits to the poor . . . the less likely we are to reduce poverty and inequality.”⁶

Is this correct?

TARGETING, UNIVERSALISM, AND REDISTRIBUTION ACROSS COUNTRIES AT COMMON POINTS IN TIME

Do nations that rely more heavily on targeting achieve less redistribution? Korpi and Palme find exactly that.⁷ Their measure of targeting-universalism is an index of concentration; it ranges from -1 if the poorest household gets all of the government transfer income (targeted) to 0 if all households get an equal amount of transfer income (universal). Their measure of redistribution is the percentage difference between pretransfer-pretax and posttransfer-posttax income inequality. The data are from the Luxembourg Income Study (LIS).⁸ Korpi and Palme examined eleven affluent nations as of the mid-1980s. The pattern among these countries suggested strong support for the hypothesis that greater use of targeting in transfers yields less redistribution.

Figure 6.1 updates the Korpi–Palme analysis. The plots have redistribution on the vertical axis and the targeting-universalism index on the horizontal axis. Included are the ten countries for which data are available for (nearly) the full period from 1980 through the mid-2000s. The LIS data are available in five-year intervals during this period.

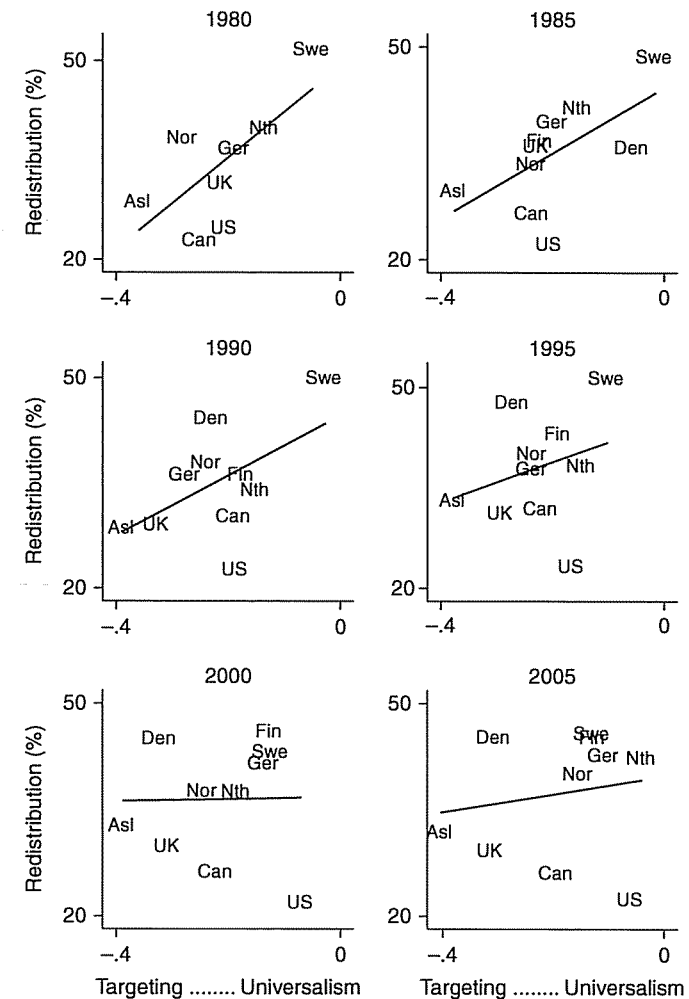


Figure 6.1. Redistribution by targeting-universalism: across countries at common points in time

Note: Redistribution is measured as inequality reduction via transfers, in percentage (rather than absolute) terms. Vertical axes are truncated. For data definitions and sources, see the appendix.

For the first three years—1980, 1985, and 1990—the pattern across the ten nations is consistent with Korpi and Palme’s conclusion; countries with greater targeting tend to achieve less redistribution. That is true for 1995 as well, though by that year the pattern begins to get a bit muddled and the slope of the regression line is not as steep.

By 2000 and 2005 the positive association essentially disappears; there is little or no indication of a relationship between targeting and redistribution.

Recall that there are two steps in the hypothesized causal process. First, universalism is thought to increase the size of the redistributive budget. Second, larger redistributive budgets are said to increase redistribution. Universalism's direct impact on redistribution is negative, because benefits go to everyone rather than mainly to the poor. But its indirect effect, via the size of the redistributive budget, is said to be positive and to be much larger in magnitude than its direct negative effect.

What do the data tell us about these two steps in the causal chain? To measure the size of the redistributive budget I use government social expenditures as a share of GDP, adjusted for the unemployment rate and the size of the elderly population (this "social policy generosity" measure is described in the book's appendix).⁹ Here's what the data suggest: In each year from 1980 through the mid-1990s, there is a very strong positive association between the size of the redistributive budget and redistribution, exactly as predicted. But the relationship between targeting-universalism and the size of the redistributive budget weakens considerably over time, until by the mid-2000s the positive association has disappeared. The quantity of government social expenditures remains a major determinant of how much redistribution takes place. But the universalism of transfer programs no longer seems to have much impact on the quantity of government social expenditures.

What changed? One key to the story is the shifting position of Denmark. In recent decades, government transfers in Denmark have become more targeted. By the 2000s it had, along with Australia and the United Kingdom, one of the most targeting-heavy transfer profiles among these nations. This runs counter to the stereotype of the highly universalistic Nordic welfare state. And it differs from Finland and Norway; those two countries shift slowly to the right along the horizontal axis in Figure 6.1, in the direction of greater universalism. Sweden barely budges; it begins and ends as one of the most universalistic.

Another surprise is the United States. The United States has long been the poster child for targeting. The standard reference is to its chief social assistance program, known as Aid to Families with Dependent Children (AFDC) up to 1996 and Temporary Assistance for Needy Families (TANF) since then. AFDC/TANF is means-tested

and has all of the features commonly associated with "poor relief": a degrading in-person application process, extensive discretion by case-workers, heavy stigma. But AFDC/TANF is a relatively small part of the American welfare state, particularly since the mid-1990s welfare reform.¹⁰ By the early 2000s the share of Americans receiving TANF had dropped to just 2–3 percent. Food Stamps, the other principal means-tested benefit for low-income households, were received by about 7 percent of the population. By that time these two programs were swamped by the Earned Income Tax Credit (EITC), which went to approximately 20 percent of Americans. The EITC is means-tested, but its benefits go only to those with some earnings, so its recipients tend to be a bit higher in the income distribution.

Each of these programs in turn pays out far less than the largest U.S. public transfer program—Social Security. Like public pensions in most countries, Social Security benefits are roughly proportional to earnings, so large transfers end up going to middle-class households. The large (and growing) size of the public pension program relative to other government transfers is the reason America's transfer system ends up scored as heavily universalistic.

This point about the importance of pensions raises a measurement question. Pension payments are a significant portion of government transfers in all rich countries. On one interpretation, counting public pensions in a measure of targeting-universalism or redistribution is misleading, because pension programs are best conceptualized as forced saving. The government requires employed citizens to put money away during their working years and then returns it to them (with interest) in their retirement years. In retirement many people have no income from employment, so the pension they receive appears in the calculations as though it is going to a very poor household. The measures therefore, according to this view, overstate the degree of targeting and the degree of redistribution achieved by transfers.

Peter Whiteford has some calculations of targeting-universalism and redistribution that address this concern.¹¹ He uses households' position in the income distribution *after* transfers are added and taxes subtracted, rather than before. If a retired couple's income consists solely of a public pension payment, they will be at the very bottom of the distribution according to the calculations in Figure 6.1. In Whiteford's calculations they instead might be at the twentieth percentile or even higher, depending on how large their pension check is.¹² An

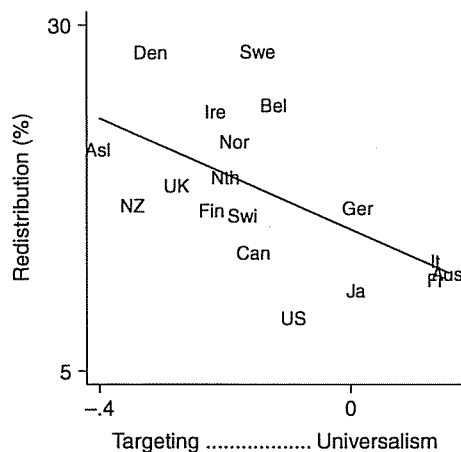


Figure 6.2. Redistribution by targeting-universalism using alternative measures: across countries as of the mid-2000s

Note: Redistribution is measured as inequality reduction via transfers, in percentage (rather than absolute) terms. Unlike in Figures 6.1 and 6.3, redistribution and targeting-universalism are measured here using households' positions in the income distribution after (rather than before) transfers are added and taxes subtracted.

Source: Whiteford 2008: Tables 4.5, 4.6.

additional advantage of Whiteford's calculations is that he is able to include a larger number of countries. A drawback is that the OECD data he uses are less reliable for cross-country comparison than the data from the Luxembourg Income Study.¹³

Figure 6.2 shows that according to Whiteford's calculations, as of the mid-2000s the degree of universalism correlates *negatively* with redistribution; nations that score higher on universalism tend to score lower on redistribution. This by no means settles the question, but it does suggest additional reason to rethink the notion that targeting is an impediment to effective redistribution.

TARGETING, UNIVERSALISM, AND REDISTRIBUTION WITHIN COUNTRIES OVER TIME

What if we look over time within countries? All of the rich countries have faced pressures for reductions in social policy generosity over

the past several decades, due to economic globalization and to changes in the balance of power between unions and social democratic parties on one side and employers and right parties on the other. If universalism is good for redistribution, nations with more universal social policy should have fared better in resisting these pressures for cutbacks.

An early skeptical assessment came from Robert Greenstein, who examined the pattern of attempted cuts and successful cuts to targeted programs by the Reagan administration in the United States in the 1980s.¹⁴ Greenstein concluded that these programs fared surprisingly well. Paul Pierson reached a similar conclusion in an analysis of social policy developments under the Reagan administration in the United States and the Thatcher government in the United Kingdom.¹⁵ These are cases in which, according to the conventional view, we might expect to observe significant cutbacks. Recently, Christopher Howard has updated the U.S. story through the mid-2000s. His conclusion echoes those of Greenstein and Pierson:

Inclusive social programs might have greater moral appeal than targeted programs, based on considerations of equal treatment and social solidarity. Inclusive social programs might have greater technical appeal because of their lower administrative costs. But greater political appeal? Not lately. Evidence from recent decades indicates no significant difference in the political fortunes of upper-tier [universal] versus lower-tier [targeted] social programs. In both tiers, one can find notable examples of political success and political failure. Prescription drug benefits for Medicare were added (1988), repealed (1989), and added again (2003). National health insurance failed (1993–94). Welfare and Food Stamps were periodically retrenched (1981, 1996); Medicaid and the Earned Income Tax Credit were repeatedly expanded (1984–93). Between 1980 and 2000, annual spending grew by 4 percent in the upper tier and 5 percent in the lower tier.¹⁶

A more systematic comparative analysis of eighteen countries by Kenneth Nelson finds little difference in the trajectories of means-tested benefits (mainly social assistance) and social insurance benefits (old-age pensions, unemployment insurance, and sickness insurance) during the 1990s and early 2000s.¹⁷

In Figure 6.3 I plot each country's change in redistribution from the mid-1980s to the mid-2000s by its average level of targeting-universalism over this period. (These two dates are at similar points in the business cycle.) The conventional view leads us to expect a

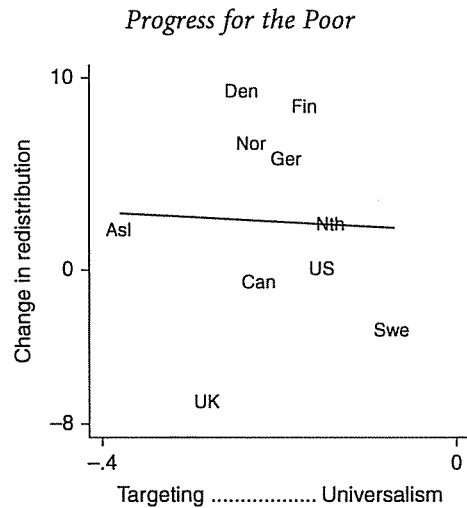


Figure 6.3. Change in redistribution mid-1980s to mid-2000s by level of targeting-universalism

Note: Redistribution is measured as inequality reduction via transfers, in percentage (rather than absolute) terms. Targeting-universalism is measured as the average level from the mid-1980s to the mid-2000s. For data definitions and sources, see the appendix.

positive association; countries with greater targeting (to the left on the horizontal axis) should experience greater declines (or smaller increases) in redistribution over time. That turns out not to hold. Over this two-decade period we see no meaningful association in either direction. The degree to which a country's public transfers are universal does not appear to have had an impact on shifts in its redistributive generosity.

A MORE NUANCED VERSION OF THE HYPOTHESIS

So far I have considered two versions of the universalism-is-better-for-redistribution hypothesis. One suggests that a transfer system more oriented toward universalism than targeting is likely to be larger and to remain so, and it therefore will tend to be more redistributive. The patterns shown in Figure 6.1 suggest this may no longer be true. A second version suggests that within countries, universalistic programs will tend to grow and targeted programs will

tend to shrink over time. The studies referenced in the previous section and the pattern shown in Figure 6.3 offer reason for skepticism about that version.

There is, however, a more nuanced version that I have not yet considered. It suggests that what matters is that a nation have universalistic social insurance programs that convey a sense that the country's welfare state mainly serves to provide insurance against risk—old age, sickness, disability, and so on—rather than to redistribute money from rich to poor. In these conditions a country's policy makers will be able, if they wish, to make extensive use of targeting in other programs, because those programs will be seen by the middle class as subsidiary.

This logic might help to explain the over-time developments we observe in Denmark and the United States in Figure 6.1. Denmark's transfer system has shifted from being heavily universalistic in the mid-1980s to comparatively targeting-heavy in the mid-2000s. Yet the size of Danish transfer programs has not declined, and neither, therefore, has its degree of redistribution. In this version of the hypothesis, Denmark was able to do this without a decline in the size of its redistributive budget because it had previously put in place large universalistic programs that succeeded in bringing the middle class on board politically.

The American transfer system has moved in the other direction, from moderately targeted to comparatively universalistic. Yet the size of its redistributive budget has remained relatively low. In this version of the hypothesis, that has happened because, apart from Social Security, the United States never had the kind of large universalistic social insurance programs that would give the American middle class the sense they, rather than the nonworking poor, are key beneficiaries of the welfare state.

This reformulated version of the hypothesis might be correct, but it is difficult to test. The problem is that there are other factors apart from the structure of social programs—union strength, left party influence, government structure, public opinion, and perhaps others—that might account for the fact that Denmark has been able to make greater use of targeting without experiencing a shrinking of its welfare state and that the United States has become more universalistic without a noteworthy increase in the size of its redistributive budget.

CONCLUSION

The hypothesis that targeting in social policy reduces political support and thereby lessens redistributive effort is a sensible one. Yet the experience of the rich countries in recent decades suggests reason to question it. Targeting has drawbacks relative to universalism: more stigma for recipients, lower take-up rates, and possibly less social trust.¹⁸ But targeting is less expensive. As pressures to contain government expenditures mount, policy makers may therefore turn to greater use of targeting. That may not be a bad thing.

7

Public Services Are an Important Antipoverty Tool

Governments in affluent nations provide or subsidize a host of services and public goods. Here is a partial list:

- Physical safety: policing, military
- Assurance of basic liberties: freedom of thought, speech, political participation, religious practice
- Money
- Enforcement of property rights and contracts
- Financial safeguards: limited liability for passive investors, bankruptcy, bank deposit insurance, protection against unauthorized use of credit cards
- Clean air and water
- Street cleaning, removal and disposal of sewage and garbage
- Housing
- Health care
- Disability services
- Elderly services
- Workplace safety
- Consumer safety
- Disaster prevention and relief: firefighting, levies, cleanup, compensation to uninsured victims
- Schooling: early education, K-12, university
- Child care
- Job training

The Tax Mix Matters Less Than We Thought

To provide transfers and services, governments must tax. In affluent countries the principal sources of government revenue are taxes on income (individual and corporate), payroll, and consumption. What is the optimal mix among these three types of taxes?

From the point of view of effective social policy, there are three chief desiderata: progressivity of the tax system, the quantity of tax revenues generated, and compatibility with economic growth and employment growth. How do the three types of taxes contribute to the achievement of these goals? Current wisdom suggests the following:

- Income taxes tend to be progressive, whereas taxes on payroll and consumption usually are regressive.
- Payroll and consumption taxes are more useful than income taxes for increasing revenues.
- Taxes on income and payroll are the least conducive to economic growth. Payroll taxes impede growth of employment.

What should governments do? I begin with some descriptive information on cross-country differences and over-time trends in the tax mix in affluent nations. I then examine the empirical evidence on tax progressivity, the quantity of revenues raised via taxation, and the effects of taxes on economic growth and employment growth. The comparative experience of the past few decades yields some surprises.

THE TAX MIX ACROSS COUNTRIES AND OVER TIME

Figure 8.1 shows tax revenues as a share of GDP in 2007, the peak year of the most recent complete business cycle, in twenty rich nations. It also shows revenues as a share of GDP for taxes on income and for taxes on consumption plus payroll. There is considerable variation across the countries both in total tax revenues and in the tax mix. Taxes total just over a quarter of GDP in the United States and Japan compared to half of GDP in Denmark and Sweden. In most countries, revenues from consumption and payroll taxes are greater than those from income taxes, but in Denmark, New Zealand, Canada, Australia, and the United States the reverse is true.

Figure 8.2 shows trends over time in the average levels (not weighted by country size) for the twenty nations. The average for total tax revenues rose from 25 percent of GDP in 1960 to 38 percent in 2007. Virtually all of that increase occurred by the late 1980s, when the average reached 37 percent. Since then the mean level has been

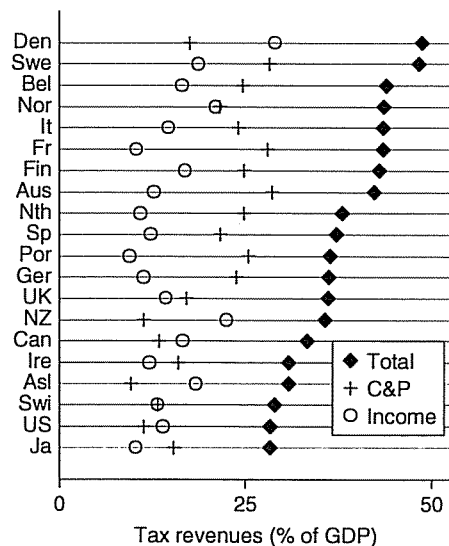


Figure 8.1. Total tax revenues and the tax mix, twenty countries, 2007
Note: C&P = consumption and payroll. For data definitions and sources, see the appendix.

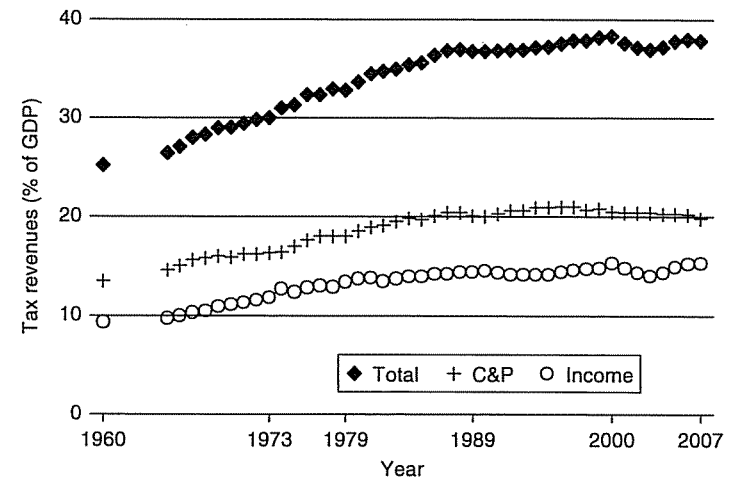


Figure 8.2. Total tax revenues and the tax mix, twenty countries, 1960–2007
Note: C&P = consumption and payroll. For data definitions and sources, see the appendix.

essentially flat. A similar pattern holds for income taxes and for consumption plus payroll taxes.

PROGRESSIVITY

Taxes can redistribute. If those with high incomes pay a larger share of their income in taxes than do those with low incomes, the tax system is “progressive”—that is, redistributive. If the rich and poor pay a similar share of their incomes, the tax system is termed “proportional”; it does not alter the pretax distribution of income. If the poor pay a larger share than the rich, the tax system is “regressive.”

Income taxes almost always are progressive; those with higher incomes pay at higher rates. Deductions and exemptions often reduce the degree of progressivity, but they do not eliminate it. Consumption taxes and payroll taxes usually are regressive.¹ Typically they are levied at a flat rate, which in principle should make them proportional. But the poor (by necessity) tend to spend a larger share of their income than the rich, which means a larger share of their income is subject to consumption taxes. And payroll taxes often are capped;

earnings above the cap are not subject to the tax. This means a larger portion of the earnings of low and middle earners is subject to payroll taxes.

Given these considerations, from a redistributive point of view it seems logical to prefer income taxation over taxes on consumption and/or payroll. In practice, though, taxation tends to affect the degree of redistribution to only a limited extent regardless of the tax mix. In the world's affluent nations, redistribution is achieved mainly via government transfers and provision of services, rather than via taxation.²

Figure 8.3 compares the differing redistributive impact of taxes with that of transfers in nations for which such a calculation is possible using Luxembourg Income Study data.³ Inequality reduction via taxes is measured as the Gini coefficient for pretransfer-pretax household income minus the Gini for pretransfer-posttax income. Inequality reduction via transfers is measured as the Gini coefficient for pretransfer-pretax income minus the Gini for posttransfer-pretax income. In many countries the tax system achieves little or no reduction of income inequality. And in fact, the picture shown here overstates the degree of inequality reduction by taxes, because consumption taxes, which are regressive, are not included.⁴ By contrast,

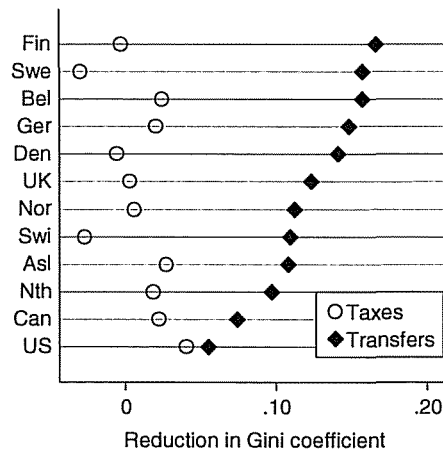


Figure 8.3. Inequality reduction via taxes and government transfers, 2000

Note: Taxes include income and payroll, but not consumption. For data definitions and sources, see the appendix.

transfers do redistribute. In some countries they reduce income inequality quite substantially.

The principal contribution of taxes to redistribution is indirect: taxes provide the revenues that fund government transfers and services. Figure 8.4 makes this clear. In the top chart, the amount of inequality reduction achieved via government transfers is on the vertical axis and total tax revenues as a share of GDP is on the horizontal. The association is positive and quite strong ($r = +0.74$). The lower chart switches the vertical axis from redistribution via transfers to redistribution achieved via public services. Here too we observe a positive association. It is not as strong ($+0.41$). This is in part because expenditures on some important types of government services and public goods are not well-measured (see Chapter 7). It also is partly because the most expensive services provided by governments are health and education, and the rich countries spend similar amounts on these; if expenditures on health and education are removed, the positive association between tax revenues and inequality reduction via services is stronger ($+0.60$).

What matters most from the point of view of redistribution, then, is the quantity of tax revenues rather than the progressivity of the tax mix. The choice between income taxes versus consumption and payroll taxes is not irrelevant to progressivity, but the progressivity of the tax system matters far less than how much revenue is raised.

A comparison of two high-tax countries with sharply differing tax mixes sheds further light. Denmark and Sweden have the largest tax takes among the rich countries; in 2007, at the peak of the 2000s business cycle, taxes accounted for half of GDP in both countries (Figure 8.1). But these revenues were generated in very different ways. In Denmark, taxes on personal and corporate income collect 29 percent of GDP, consumption taxes 16 percent, and payroll taxes just 1 percent. In Sweden, income taxes collect roughly 20 percent of GDP, consumption taxes 13 percent, and payroll taxes 15 percent.

Denmark's tax system relies much more heavily on income taxes than Sweden's. Indeed, Denmark draws far more revenue from income taxes than any other rich country. Yet in Figure 8.3 we see that Sweden's tax system is only slightly more regressive than Denmark's (that is true in other years as well). And since consumption taxes cannot be included in those calculations and Denmark is a bit heavier

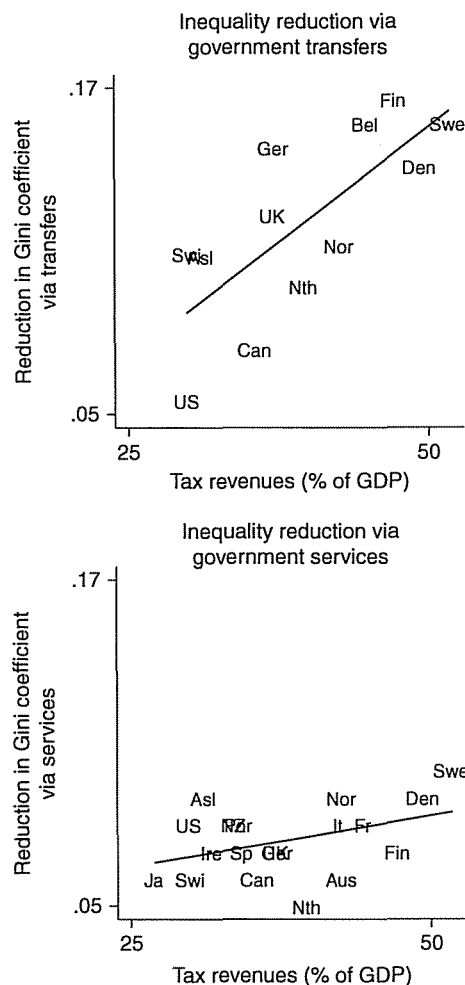


Figure 8.4. Inequality reduction via government transfers and government services by tax revenues, 2000

Note: The range of values on the vertical axis is the same in both charts. For data definitions and sources, see the appendix.

than Sweden in consumption tax use, it is possible that the two countries are virtually identical in their degree of tax progressivity. Moreover, even if the Danish tax system is slightly less regressive than Sweden's, the difference is swamped by the amount of redistribution achieved via transfers and services in both countries.

THE QUANTITY OF TAX REVENUES

What tax mix is most conducive to generation of a large quantity of revenues? The dominant view is that consumption and payroll taxes are more effective revenue sources than taxes on income.⁵ There are three reasons why.

First, taxes on consumption and payroll may be less visible to citizens and therefore generate less political opposition. Income tax payments are highly visible. For those with middle or high incomes, they tend to be large. And even though they typically are deducted from one's paycheck on a regular basis, once a year at tax time we see the cumulative total. This leads taxpayers to perceive income tax payments as a large lump sum quantity.

Consumption taxes too may be large. But they are paid in small increments, and there is no point during the course of the year when the taxpayer is made aware of the total amount paid. The same is true of payroll taxes (including social security contributions). They too may be quite large, and the taxpayer can easily check her or his end-of-the-year pay stub to see the grand total deducted over the course of the year. But many do not, so like consumption taxes they are likely to be perceived as smaller than the income tax.

Second, consumption and payroll taxes are considered by many economists to be more efficient than income taxes, because they vary less by income. More efficient taxes might induce less opposition from citizens and interest groups to increases in taxation.⁶

Third, income taxes are viewed as more vulnerable than consumption and payroll taxes to cross-national competition. That is particularly true for corporate income taxes, since firms are more mobile than people. But individuals too are thought to be more likely to decamp in search of a lower income tax rate than a lower tax rate on consumption or payroll.

A dissenting voice is Steffen Ganghof, who notes that Denmark has very high tax revenues (as a share of GDP) and yet relies heavily on income taxation.⁷ Ganghof suggests that pressure for low income tax rates applies mainly to a particular type of income: corporate profits and capital income. There is much less pressure on taxation of wage and salary income. Hence, if policy makers are willing to tax wage and salary income at a different rate than capital income and corporate profits (a so-called "dual income tax"), as Denmark does, they can

choose to rely mainly on income taxes rather than consumption and payroll taxes to finance a large welfare state.

The standard view suggests both a cross-sectional pattern and an over-time one. Countries that collect a larger share of GDP in taxes should rely more heavily on consumption and payroll taxes to do so; that is, we should observe a positive cross-country association between total tax revenues as a share of GDP and consumption and payroll tax revenues as a share of total tax revenues. And countries that have increased tax revenues as a share of GDP over the past several decades should have done so mainly by increasing consumption and/or payroll tax revenues; we should observe a positive over-time association within nations.

Figure 8.5 shows the cross-country pattern in 1960 and in 2007. If Denmark is excluded as a special case, the correlation jumps from +0.20 in 1960 to +0.50 in 2007. At first glance, this change in the cross-country pattern appears to support the hypothesis that consumption and payroll taxes are the key to revenue increases. It seems to imply that countries in which tax revenues increased are ones in which the consumption and payroll tax share rose; in other words, they generated more tax revenues via increased consumption and/or payroll taxes.

It turns out, however, that this is not what occurred. If it had, the nations with rising tax revenues would have moved not only higher

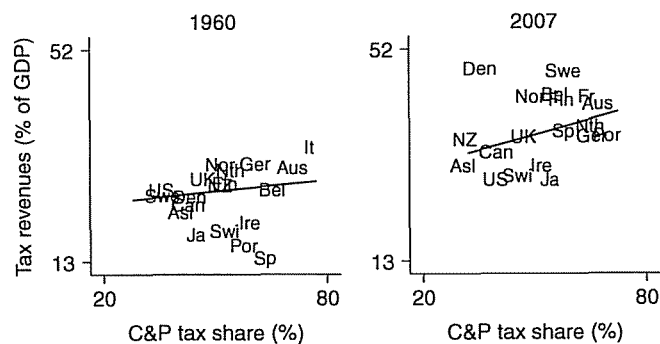


Figure 8.5. Total tax revenues by the consumption and payroll tax share: across countries, 1960 and 2007

Note: C&P tax share = consumption tax revenues plus payroll tax revenues as a share of total tax revenues. Regression lines are calculated with Denmark omitted; see the text for discussion. For data definitions and sources, see the appendix.

on the vertical axis in the second chart in Figure 8.5 but also to the right on the horizontal axis. Yet that is not what we observe. Instead, countries that began to the right on the horizontal axis in 1960 moved higher on the vertical axis but not farther to the right. This means these countries were increasing tax revenues, but not disproportionately via consumption and/or payroll taxes.

Figure 8.6 allows us to better explore the over-time patterns within countries. The charts plot total tax revenues by the consumption and payroll share of total tax revenues for each country. I include six years: 1960, 1973, 1979, 1989, 2000, and 2007. Aside from 1960, which is the earliest year for which the data are available, these are business-cycle peak years, which makes them useful for comparison. What we observe is inconsistent with the conventional view. Tax revenues grew in most countries. But in only two of the twenty nations, Sweden and the Netherlands, do we observe the hypothesized positive over-time association. In a number of countries—Austria, Canada, Finland, Germany, Ireland, New Zealand, Norway, Portugal, Switzerland, the United Kingdom—total tax revenues rose but with no change in the share from consumption and payroll taxes. In others—Australia, Belgium, Denmark, France, Italy, Spain—a rise in tax revenues occurred despite a reduction, rather than an increase, in the consumption and payroll tax share.⁸

Countries with expanding tax revenues have not accomplished this primarily via increased revenues from consumption and/or payroll taxes. Nations that had a larger consumption and payroll tax share as of 1960 tended to raise their tax take more in the ensuing several decades. But apart from Sweden and the Netherlands, they did so as much via heightened income taxes as via increased consumption and/or payroll taxes.⁹

COMPATIBILITY WITH ECONOMIC GROWTH AND EMPLOYMENT GROWTH

A key worry about generous social policies is that they may reduce economic growth. Yet comparative research suggests little if any negative impact of social policy on growth performance.¹⁰

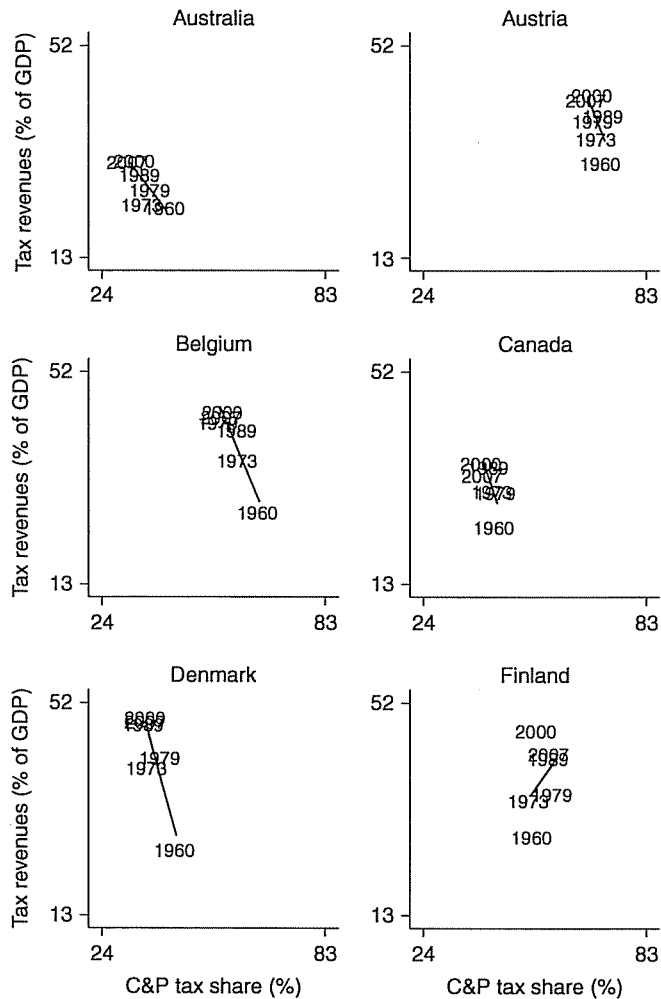


Figure 8.6. Total tax revenues by the consumption and payroll tax share: over time within countries

Note: See the note to Figure 8.5. For data definitions and sources, see the appendix.

What about the taxes that fund government transfers and services? Figure 8.7 shows economic growth rates from 1979 to 2007 by tax revenues as a share of GDP averaged over those years. Nations that began this period with lower per capita GDP tended to grow more rapidly simply by virtue of starting behind; I adjust the growth rates

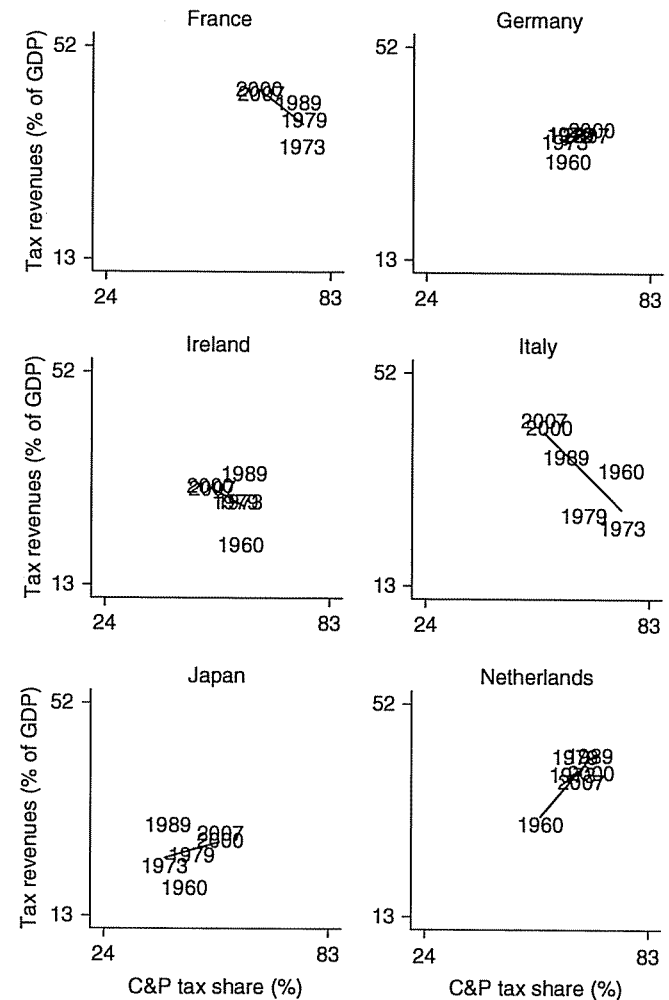


Figure 8.6. Continued

for this “catchup” effect. There is no noticeable association between the quantity of tax revenues and the (catchup-adjusted) rate of economic growth across these twenty countries. Of course, this simple picture does not fully answer the question. But more detailed studies tend to reach a similar conclusion.¹¹

Why is that? In an influential contribution, Peter Lindert suggests that it is a function of the tax mix.¹² Lindert points out that the

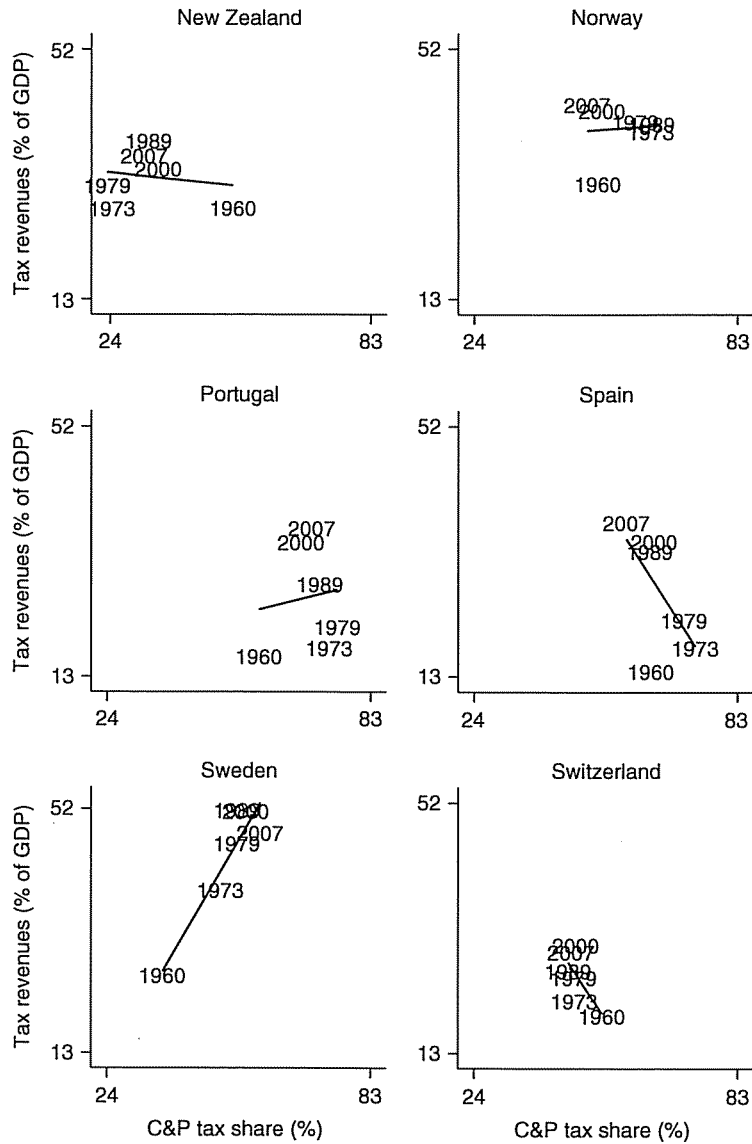


Figure 8.6. Continued

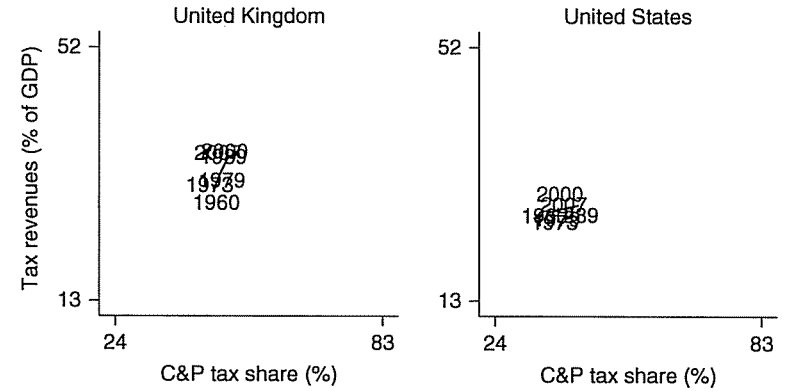


Figure 8.6. Continued

nations with the most generous social policies, the Nordic ones, rely disproportionately on consumption taxes. These, he says, create far less in the way of investment and work disincentives than do taxes on individual and corporate income.

Are consumption taxes more conducive to economic growth than income (individual and corporate) and payroll taxes? The com-

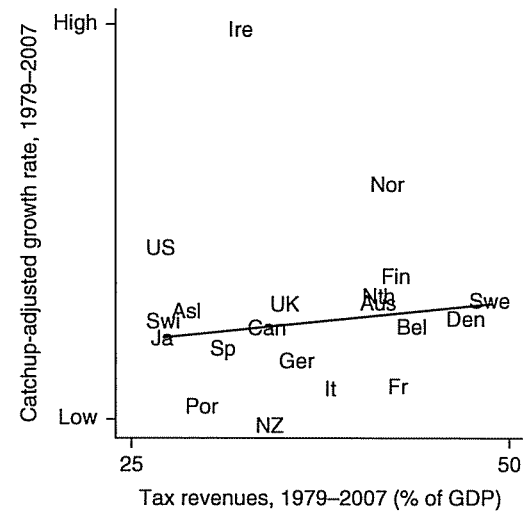


Figure 8.7. Economic growth by tax revenues, 1979-2007

Note: Economic growth is adjusted for catchup; see the text for discussion. The regression line is calculated with Ireland omitted. For data definitions and sources, see the appendix.

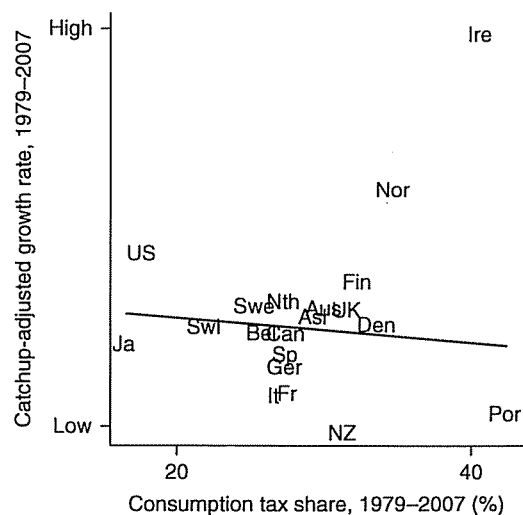


Figure 8.8. Economic growth by the consumption tax share, 1979–2007

Note: Economic growth is adjusted for catchup; see the text for discussion. The regression line is calculated with Ireland omitted. For data definitions and sources, see the appendix.

parative experience of the past three decades offers little support. Figure 8.8 plots catchup-adjusted economic growth rates by the share of tax revenues that come from consumption taxes. Ireland appears to fit the hypothesis nicely, but Ireland's growth experience during these three decades was exceptional in so many respects that attributing it to the country's tax mix seems dubious. If Ireland is discounted we see no association. The same is true if the quantity of total tax revenues is controlled for.

Above a certain level, taxes on income surely do impede economic growth. They will reduce investment or work effort, lead to capital and/or labor flight, or generate a problematic level of popular opposition. But it may well be that none of the existing rich countries exceeds that level. Consumption taxation is a complement, not a substitute; it allows policy makers to generate revenues well beyond what would be growth-compatible via income and payroll taxes alone.

What about employment? Here research has tended to suggest reason for worry about heavy use of payroll taxes. The concern has to do mainly with the way in which these taxes raise the price of labor in low-productivity services. Fritz Scharpf put the point as follows:

The negative impact on service employment is particularly acute in those countries which, like Germany and France, rely to a large extent on payroll taxes for the financing of the welfare state. In Germany, for instance, 74% of total social expenditures were financed through workers' and employers' contributions to social insurance systems in 1991, and in France that was true of 82%. In Germany, these contributions presently amount to about 42% of the total wage paid by the employer. . . . If the net wage of the worker cannot fall below a guaranteed minimum [the level of unemployment benefits and social assistance], the consequence is that any social insurance contributions, payroll taxes, and wage taxes that are levied on jobs at the lower end of the pay scale cannot be absorbed by the employee but must be added to the total labor cost borne by the employer. . . . As a consequence, a wide range of perfectly decent jobs, which in the absence of payroll taxes would be commercially viable, are eliminated from the private labor market.¹³

Several studies have found supportive evidence: employment, particularly in low-end services but also overall, has tended to grow more slowly in nations with heavier taxes on payroll.¹⁴

Figure 8.9 plots change in the employment rate between the peak business cycle years of 1979 and 2007 by the payroll tax share during

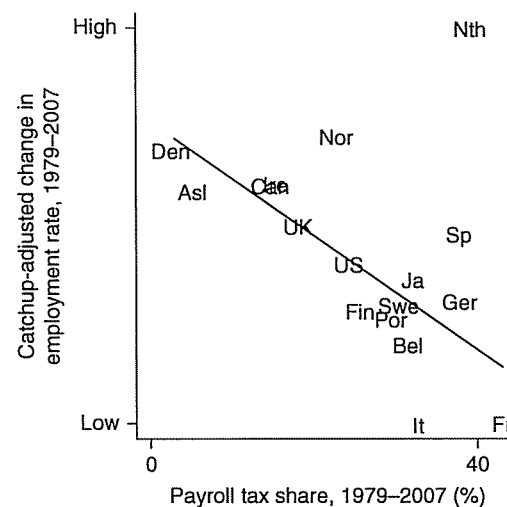


Figure 8.9. Employment change by the payroll tax share, 1979–2007

Note: Employment change is adjusted for catchup; see the text for discussion. The regression line is calculated with the Netherlands omitted. Austria, New Zealand, and Switzerland are missing due to lack of 1979 employment-rate data. For data definitions and sources, see the appendix.

this period. As with economic growth, I adjust employment change for the countries' starting (1979) employment rates, as those beginning lower should have had an easier time generating an increase. The pattern suggests a fairly strong negative association. There are a number of other policies and institutions that may influence employment growth and with which a high payroll tax share is correlated across these countries, but controlling for them does not make the association go away.¹⁵

On the other hand, controlling for those other institutions and policies does reduce the estimated magnitude of the effect. And there also is the matter of the Netherlands, which relies heavily on payroll taxes but nevertheless has enjoyed successful employment performance since the 1970s. Looking at changes in the employment rate overstates the degree of Dutch success somewhat, as much of its employment rise took the form of short-hour part-time jobs.¹⁶ Still, it was genuine success.

Is there a rationale for heavy payroll taxes? In the countries in which payroll taxes are most significant—France, Germany, the Netherlands, and Spain—the welfare state is “Bismarkian.”¹⁷ Pensions, unemployment benefits, and sickness benefits are administered jointly by unions, employers, and the state. These programs are financed by payroll taxes, paid by both employers and employees. In these systems, payroll tax payments are referred to as “social security contributions” rather than taxes. Though the programs operate on a pay-as-you-go basis—money paid in goes directly to current beneficiaries—they are popularly viewed as akin to private insurance. People tend to think of their contributions as investments set aside to benefit them directly in the event of job loss, illness, disability, or retirement. This is an illusion, but it is an illusion that has, arguably, underpinned the generosity of these programs. Were the programs to be financed largely by income and/or consumption taxes, they might end up less generous because public support would be narrower and shallower.

Nevertheless, there now is relatively widespread sentiment that the employment cost of such heavy reliance on payroll taxes outweighs this advantage. And several of these countries have moved, if somewhat tentatively, to alter this financing structure and/or its impact on employment.¹⁸ In 1990, France introduced a new tax on personal income (the CSG) in order to reduce reliance on payroll taxes. This was only a partial step, though, with payroll taxes still accounting for

four-fifths of the revenues that support French social policy.¹⁹ Shifting taxation from payroll to general income taxes was a key item of discussion in Germany's “Alliance for Jobs” in the late 1990s. But agreement to reform the tax system was not reached, and as a result, in the early 2000s, Gerhard Schroeder's social democratic government imposed cuts in unemployment benefit levels and duration.²⁰ More recently, Germany reduced the social security contribution rate slightly, and compensated with an increase in its consumption (value-added) tax rate. Low-paying jobs in Germany (“mini-jobs”) are exempt from social security contributions. The Netherlands and France also have introduced partial or full exemptions on social contributions for certain types of low-end jobs.

Why have the shifts been relatively limited? This is a classic “insider-outsider” dilemma.²¹ Heavy payroll taxes impose costs on the nonemployed. Yet because they underwrite generous social insurance programs, they are happily paid and strongly supported by those with steady jobs and their families. It is in the (short-term) interest of these “insiders” to maintain the status quo.

CONCLUSION

Does the tax mix matter for effective social policy? If so, how much and in what ways? Current thinking holds that it matters a great deal. Income taxes are viewed as better for progressivity. Consumption and payroll taxes are seen as more conducive to revenue generation. Taxes on consumption are believed to be less of an impediment to economic growth than taxes on income and payroll. Income and consumption taxes are thought to be better for employment growth than payroll taxes.

The comparative empirical record offers little or no support for three of these four propositions. Instead, it suggests the following:

- Income taxes are indeed the most progressive of the three major types of taxes. But taxation tends to have relatively little direct impact on the income distribution. Transfers and services are far more important.
- Consumption and payroll taxes have not been the key to expansion of tax revenues in recent decades. The nations that have

increased revenues (as a share of GDP) have done so as much via income taxes.

- Countries relying more heavily on income taxes have not suffered slower economic growth.
- Nations that rely more heavily on payroll taxes do appear to have had slower employment growth over the past few decades, though the Netherlands is a significant exception.

What do these findings imply for policy makers seeking an optimal tax mix? Perhaps most important, they suggest that countries have a good bit of leeway to choose.²² Apart from the adverse employment consequences of very high payroll taxes, the tax mix appears to neither impose large costs nor generate substantial benefits.

For countries that currently raise enough tax revenues to fund generous transfers and services, adjusting the tax mix therefore probably need not be a priority. The one exception is nations in which payroll taxes are especially heavy.

For a country seeking to increase tax revenues, the chief constraint may be its current mix. From a political perspective, diversity of tax types is helpful. The affluent nation with the least diverse mix is Denmark, which relies heavily on income taxes, moderately on consumption taxes, and very little on payroll taxes. In some respects that is a desirable mix. But it would be difficult for other countries to get to a Danish-style tax mix now, as for most that would require a sizeable increase in income taxation. Instead, countries that deem it desirable to increase tax revenues are likely to find it most politically feasible to generate new revenues from taxes that currently are low. In the United States, for instance, if the political will existed to increase taxation by around 5 or 10 percent of GDP, the easiest way to do that might be via a national consumption tax, as consumption taxes currently account for a relatively small share of American taxation.

9

The Aim Is Not Spending Per Se

A commonplace view holds that a market-liberal political economy is best for the rich while a social-democratic one is best for the poor. Some recent research suggests reason to question this. Analyses by Willem Adema of the OECD, by Adema and Maxime Ladaïque, and by Price Fishback conclude that the quantity of social expenditures in the United States is similar to or greater than in Denmark and Sweden, two nations long considered large-welfare-state exemplars.¹

How so? Government social transfers account for a much larger share of GDP in Sweden and Denmark. But the U.S. government distributes more benefits in the form of tax breaks rather than transfers than do the two Nordic countries; Denmark and Sweden tax back a larger portion of public transfers than the United States does; private social expenditures, such as those on employment-based health insurance and pensions, are greater in the United States; and America's per capita GDP is larger.

Is social spending in the United States really similar to that of the world's most generous welfare states? If so, are America's poor better off than we thought?

A MORE COMPLETE MEASURE OF SOCIAL EXPENDITURES

The standard indicator of social policy effort is gross public social expenditures as a percentage of GDP. The first row in Table 9.1 shows that, unsurprisingly, Denmark and Sweden are much higher than the United States on this measure.

Table 9.1. Social expenditures and bottom-income-decile living standards in Denmark, Sweden, and the United States, mid-2000s

	Denmark	Sweden	United States
Gross public social expenditures as a share of GDP, mid-2000s (%)	27	29	16
Net public and private social expenditures per person, mid-2000s (2000 U.S. dollars)	\$7,400	\$9,100	\$10,000
Average posttransfer-posttax income of households in the bottom income decile, mid-2000s (2000 U.S. dollars per equivalent person)	\$9,600	\$8,200	\$5,900
Average net government transfers received by households in the bottom income decile, mid-2000s (2000 U.S. dollars per equivalent person)	\$6,800	\$5,300	\$2,900
Average share of the population reporting deprivation in seven areas, mid-2000s (%)	5	5	13

Note: Row 1 source: OECD 2010; Row 2 source: Author's calculations using data in Adema and Ladaïque 2009: Table 5.5; Rows 3 and 4 source: Author's calculations using Luxembourg Income Study data; Row 5 source: OECD 2008: 186-8.

Now shift to net (rather than gross) public and private (rather than public alone) expenditures per person (rather than as a percentage of GDP, with purchasing power parities used to convert Danish and Swedish kroner into year-2000 U.S. dollars). According to the calculations by Adema and Ladaïque, we get a very different picture.² By this measure the United States is the biggest spender. These numbers are in the second row in Table 9.1.

ARE AMERICA'S POOR BETTER OFF THAN WE THOUGHT?

This looks like good news for the poor in the United States. Is it? Unfortunately, no. These adjustments change the story with respect to the aggregate quantity of resources that goes to social protection in the three countries, but they have limited bearing on poverty reduction and on the living standards of the poor.

Begin with tax breaks. Researchers count as "social" those designed to provide support in circumstances that adversely affect people's well-being. In the United States these disproportionately go to the affluent and the middle class. The chief ones are tax advantages for employer contributions to private pensions and to private health insurance. These do little to help people at the low end of the distribution, who often work for employers that do not provide retirement or health benefits. One important tax benefit for low-income households is the Earned Income Tax Credit (EITC), but it is already included in the standard OECD data on government social expenditures. Another is the child tax credit, but it is only partially refundable and so of limited value to low-income households, many of whom do not owe any federal income tax.

Next consider tax "clawbacks" in the Nordic countries. Public transfer programs in Denmark and Sweden tend to be "universal" in design: a large share of the population is eligible for the benefit. This is thought to boost public support for such programs. But it renders them very expensive. To make them more affordable, the government claws back some of the benefit by taxing it as though it were regular income. All countries do this, including the United States, but the Nordic countries do it more extensively. Does that hurt their poor? Very little. The tax rates tend to increase with household income, so much of the tax clawback hits middle- and upper-income households.

What is the impact of private social spending? In the United States this accounts for roughly two-fifths of all social expenditures. It consists mainly of employer contributions to health insurance and employment-based pension benefits. Here too the picture changes a great deal on average, but not much for the poor. Employer-based health insurance and pension plans reach few low-income households.

So how well-off are the poor in the United States, with its "hidden welfare state",³ compared to social-democratic Denmark and Sweden? If you have read Chapters 2 and 4, you know the answer. If not, here is a brief summary.

One measure is average posttransfer-posttax income among households in the bottom decile of the income distribution. The third row in Table 9.1 shows my calculations using the best available comparative data, from the Luxembourg Income Study (LIS).⁴ (The numbers are adjusted for household size. They refer to a household with a

single adult. For a family of four, multiply by two.) There is a pretty sizeable difference, not in America's favor.⁵

What is the source of this cross-country difference in the incomes of low-end households? It is entirely a function of government transfers. Again using the LIS data, I have calculated mid-2000s averages for households in the bottom income decile for the three chief sources of household income: earnings, net government transfers (transfers received minus taxes paid), and "other" income (money from family or friends, alimony, etc.). Average earnings are virtually identical across the three countries, at about \$2,500. The same is true for "other" income, which averages around \$500 in each of the three. Where bottom-decile Danish and Swedish households fare much better than their American counterparts is in net government transfers, as shown in the fourth row of Table 9.1.⁶

Price Fishback points to one other key difference between these countries: "Public services not counted in disposable income, like health care and education, likely are better for the very poor in the Nordic countries than in the United States."⁷ It is difficult to measure the impact of services on living standards with any precision. One indirect way to assess their effect is to switch from income to material deprivation. As described in Chapter 4, two OECD researchers, Romina Boarini and Marco Mira d'Ercole, have compiled material deprivation data from surveys in various rich nations as of the mid-2000s.⁸ Each of the surveys asked identical or very similar questions about seven indicators of material hardship: inability to adequately heat one's home, constrained food choices, overcrowding, poor environmental conditions (e.g., noise, pollution), arrears in payment of utility bills, arrears in mortgage or rent payment, and difficulty in making ends meet. Boarini and Mira d'Ercole create a summary measure of deprivation by averaging, for each country, the shares of the population reporting deprivation on questions in each of these seven areas. The shares for Denmark, Sweden, and the United States are shown in the fifth row of Table 9.1.⁹

Government services—medical care, child care, housing, transportation, and so on—reduce material hardship directly. They also free up income to be spent on other needs. The comparative data, though by no means perfect, are consistent with the hypothesis that public services help the poor more in the Nordic countries than in the United States. The gap between the countries in material deprivation is larger than in low-end incomes.

How is it that despite its greater social expenditures, the United States does less well by its poor than Denmark and Sweden? First, public cash and near-cash transfers in the United States are both smaller and less targeted (Figure 6.1) than in the Nordic countries. They therefore achieve less poverty reduction. Second, private transfers in the United States are large, but they consist mainly of employer contributions to employee retirement funds (company pensions and 401ks) and little of this money goes to the poor. Third, public services are less extensive in the United States. They certainly provide some benefit to the poor, but likely less than in Denmark and Sweden.¹⁰ Fourth, private spending on services is quite hefty in the United States, but much of this money consists of employer contributions to private health insurance, and once again few among the poor are recipients.

CONCLUSION

Helping the poor is not the only thing we want from social spending. But it surely is one thing. The United States spends more money on social protection than is often thought, yet that spending does not do nearly as much to help America's poor as we might like. Gøsta Esping-Andersen once remarked, in the course of assessing the historical development of social protection programs, that "It is difficult to imagine that anyone struggled for spending per se."¹¹ The U.S. experience illustrates the sense in this.

I want to thank Dominic Byatt at Oxford University Press, along with Oxford's fine editorial and production staff.

My most important thanks go to my family: Kim, Mia, Hannah, Noah, and Josh. In ways small and large, they make my life a treasure.

APPENDIX

Data Definitions and Sources

The data used in this book are available at www.u.arizona.edu/~lkenwor.

COUNTRIES

Asl	Australia	Ja	Japan
Aus	Austria	Nth	The Netherlands
Bel	Belgium	NZ	New Zealand
Can	Canada	Nor	Norway
Den	Denmark	Por	Portugal
Fin	Finland	Sp	Spain
Fr	France	Swe	Sweden
Ger	Germany	Swi	Switzerland
Ire	Ireland	UK	The United Kingdom
It	Italy	US	The United States

C&P tax share. Consumption and payroll tax revenues as a share of total tax revenues. *Source:* Author's calculations using data from OECD 2010.

Capabilities 1: secondary education. Share of persons age 25–34 that have completed upper secondary education or better. Measured in 2007. *Source:* OECD 2009a: Table A1.2a.

Capabilities 2: literacy. Average PISA literacy score in math, science, and reading among 15-year-olds. Measured in 2006. *Source:* OECD 2010.

Capabilities 3: life expectancy. Life expectancy at birth. Measured in 2007. *Source:* OECD 2010.

Capabilities 4: safety. Share of the population reporting that in the previous year they were not a victim of either a robbery or an assault or threatened assault. Measured in 2004. *Source:* van Dijk, van Kesteren, and Smit 2007: Tables 11–13.

Community: trust. Index: 100 + (share of responding saying “most people can be trusted” – share responding “you can never be too careful when dealing with others”). Measured in 1999–2005. *Source:* Medrano 2010, using World Values Survey data.

Consumption tax share. Consumption tax revenues as a share of total tax revenues. *Source:* Author's calculations using data from OECD 2010.

Economic health 1: GDP per capita. Gross domestic product per person. In year-2000 U.S. dollars, with currencies converted using purchasing power parities. Measured in 2007. *Source:* Author's calculations using data from OECD 2010.

Economic health 2: economic competitiveness. Index that aims to assess the quality of nine components of a nation's economy: public and private institutions, infrastructure, macroeconomic policy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication, and innovation. The index ranges from a low of 1 to a high of 7. Measured in 2007–8. *Source:* World Economic Forum 2008.

Economic health 3: employment rate. Employed persons as a share of the population age 15–64. Measured in 2007. *Source:* OECD 2010.

Education. Average years of schooling completed among the population age 25 and over. *Source:* Barro and Lee n.d.

Employment. Employed persons as a share of the population age 15–64. *Source:* Author's calculations using data from OECD 2010.

Employment in agriculture. Employed persons in agriculture as a share of the population age 15–64. *Source:* Author's calculations using data from OECD 2010.

Employment in manufacturing. Employed persons in manufacturing as a share of the population age 15–64. *Source:* Author's calculations using data from OECD 2010.

Fiscal discipline: government debt. General government gross financial liabilities as a share of GDP. *Source:* OECD 2010.

GDP per capita. Gross domestic product (GDP) per capita, adjusted for inflation and converted into U.S. dollars using purchasing power parities (PPPs). *Source:* Author's calculations using data from OECD 2010.

Global embrace: foreign-born share of the population. *Source:* OECD 2010.

Government transfers per person. Government transfers per capita. The data include public spending on old age, survivors, incapacity-related benefits, family, unemployment, and "other." *Source:* Author's calculations using data from OECD 2010.

Imports. Imports as a share of GDP. *Source:* Author's calculations using data from OECD 2010.

Inequality reduction via government services. Gini coefficient for posttransfer-posttax income minus Gini coefficient for posttransfer-posttax income plus imputed value of public services. *Source:* Marical et al. 2006: Annex Table A.9.

Inequality reduction via government transfers. Gini coefficient for pretransfer-pretax income minus Gini coefficient for posttransfer-pretax income.

Incomes are adjusted for household size using the square root of the number of persons in the household as the equivalence scale, top-coded at 10 times the unequivalized median, and bottom-coded at 1 percent of the equivalized mean. *Source:* Author's calculations using data from LIS 2010a.

Inequality reduction via taxes. Gini coefficient for pretransfer-pretax income minus Gini coefficient for pretransfer-posttax income. Incomes are adjusted for household size using the square root of the number of persons in the household as the equivalence scale, top-coded at 10 times the unequivalized median, and bottom-coded at 1 percent of the equivalized mean. *Source:* Author's calculations using data from LIS 2010a.

Liberty 1: political rights. Sum of Freedom House scores for three items: electoral process, political pluralism and participation, and functioning of government. Measured in 2007. *Source:* Freedom House 2007.

Liberty 2: civil liberties. Sum of Freedom House scores for four items: freedom of expression and belief, associational and organizational rights, rule of law, and personal autonomy and individual rights. Measured in 2007. *Source:* Freedom House 2007.

Liberty 3: ease of doing business. Each country is scored in five areas: the cost of starting a business (percentage of income per capita), the cost of registering property, the difficulty of hiring employees (index), the difficulty of firing employees (index), the cost of enforcing contracts (percentage of debt). These scores are aggregated and the countries are rank-ordered. Measured in 2005. *Source:* World Bank 2007: Table 1.2.

Low-end incomes. Tenth-percentile (P10) household income per equivalent person. Incomes are adjusted for inflation and converted into year-2000 U.S. dollars using PPPs, adjusted for household size using the square root of the number of persons in the household as the equivalence scale, top-coded at 10 times the unequivalized median, and bottom-coded at 1 percent of the equivalized mean. *Source:* Author's calculations using household income data from LIS 2010a (variable: DPI) and inflation and PPP data from OECD 2010.

Material deprivation. Average share of respondents reporting deprivation as of the mid-2000s in seven areas: inability to adequately heat home, constrained food choices, overcrowding, poor environmental conditions, arrears in payments of utility bills, arrears in mortgage or rent payments, and difficulty making ends meet. *Source:* OECD 2008: 186–8, using data from the Survey on Income and Living Conditions (EU-SILC) for European countries, the Household Income and Labour Dynamics in Australia survey (HILDA) for Australia, and the Survey of Income and Program Participation (SIPP) for the United States.

Opportunity 1: intergenerational income mobility. Strength of association between fathers' earnings and their sons' earnings. *Source:* Björklund and Jantti 2009: Figure 20.1.

Opportunity 2: women's opportunity. A composite measure of women's share of parliamentary seats, women's share of legislators, senior officials, and managers, women's share of professional and technical positions, and the ratio of female to male earned income. Measured in 2000–7. *Source:* UNDP 2007: Table 29 (“gender empowerment”).

Progress for the poor. Combination of the slopes in the tenth-percentile-income-by-GDP-per-capita charts in Figure 2.1 with the material deprivation rates in Figure 4.1. Each of these is rescaled to vary from 0 to 1 and then they are averaged.

Quality of work life: work autonomy. Average number of the following five aspects of the work process that employees report they are able to choose or change: the order of tasks, the methods of work, the speed of work, working partners, take a break when desired. Excludes the self-employed. The data are available for European countries only. Measured in 2005. *Source:* Eurofound 2007: Figure 6.1.

Redistribution. Degree of inequality reduction relative to the degree of market inequality. Calculated as: $((\text{pretransfer-pretax Gini coefficient} - \text{posttransfer-posttax Gini}) / \text{pretransfer-pretax Gini}) \times 100$. *Source:* Author's calculations using data from LIS 2010a.

Social inclusion 1: relative poverty rate. Share of persons in households with size-adjusted posttransfer-posttax income less than 50 percent of the country median. Measured in 2000–5. *Source:* LIS 2010b.

Social inclusion 2: top 1 percent's income share. Share of pretax income (excluding capital gains) going to the top 1 percent of taxpaying units. Measured in 2000. *Source:* Atkinson, Piketty, and Saez 2009.

Social inclusion 3: long-term unemployed. Share of the labor force unemployed for twelve months or longer. Measured in 2007. *Source:* OECD 2010.

Social policy generosity. Government social expenditures as a share of GDP, adjusted for the share of the population age 65 and over and for the unemployment rate. The adjustment is as follows: $\text{adjusted government social expenditures} = \text{government social expenditures} + (0.5 \times (21 - (\text{elderly share of the population} + \text{unemployment rate})))$. (This implies that each percentage point of the elderly share and/or unemployment costs about 0.5 percent of GDP. Twenty-one is the average across all countries and years for the elderly share plus the unemployment rate.) The data include public spending on transfers and services in nine areas of social policy: old age, survivors, incapacity-related benefits, health, family, active labor market

programs, unemployment, housing, and “other.” *Source:* Author's calculations using data from OECD 2010.

Subjective well-being: life satisfaction. Country mean for responses to the question “All things considered, how satisfied or dissatisfied are you with your life as a whole these days?” Possible range of scores is 0–10. Measured in 2008. *Source:* Veenhoven 2010, using World Gallup Poll data.

Targeting-universalism. Index of concentration, which equals -1 if the household with the lowest pretransfer-pretax income gets all of the government transfer income, 0 if all persons get an equal amount of transfer income, and $+1$ if the household with the highest pretransfer-pretax income gets all of the transfer income. Included are the following types of public transfers: pension benefits, child and family allowances, unemployment compensation, sick pay, accident pay, disability pay, maternity pay, military/veterans/war benefits, “other social insurance,” means-tested cash benefits, and “near-cash” benefits. *Source:* Author's calculations using data from LIS 2010a.

Tax revenues. Government tax revenues as a share of GDP. *Source:* OECD 2010.

Tax revenues: consumption taxes. Government revenues from taxes on goods and services as a share of GDP. *Source:* OECD 2010.

Tax revenues: income taxes. Government revenues from taxes on income and profits as a share of GDP. *Source:* OECD 2010.

Tax revenues: payroll taxes. Government revenues from social security contributions and payroll taxes as a share of GDP. *Source:* OECD 2010.

Unemployment. Unemployed persons as a share of the labor force. *Source:* OECD 2010.

Unionization. Union members (minus retired workers, independent workers, students, and unemployed workers) as a share of wage and salary earners in employment. *Source:* Visser 2009 (variable: UD).

Wage-bargaining coverage. Share of employees whose wages are determined by collective bargaining. *Source:* Visser 2009 (variable: ADJCOV).

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Education. Persons age 25–64 with less than a high school degree as a share of all persons age 25–64. *Source:* Authors' calculations using data from the Current Population Survey (NBER MORG Extracts).

Employment. Employed persons age 25–64 as a share of the population age 25–64. *Source:* Authors' calculations using Current Population Survey data (IPUMS March Extracts; see King et al. 2004).

Employment hours in low-end households. Average annual hours worked in working-age (“head” age 25–64) households in the bottom quartile of the pretransfer-pretax income distribution. *Source:* Authors’ calculations using data from the Current Population Survey (IPUMS March Extracts; see King et al. 2004).

Female-headed households. Persons in households with a single female adult age 25–64 as a share of persons in all households with a “head” age 25–64. *Source:* Authors’ calculations using data from the Current Population Survey (IPUMS March Extracts; see King et al. 2004).

Gross state product (GSP) per capita. Adjusted for inflation using the CPI-U-RS. *Source:* Authors’ calculations using GSP and population data from the Bureau of Economic Analysis and inflation data from the Bureau of Labor Statistics.

Low-end hourly wages. Hourly wage at the tenth percentile of the distribution, adjusted for inflation using the CPI-U-RS. Sample includes wage and salary workers age 16–64 with positive potential experience. This excludes self-employed individuals and those with negative potential experience, where potential is defined as respondent’s age minus years of education minus 6. In the CPS, workers paid by the hour are asked directly about their hourly rate of pay. This response is used as the hourly wage measure for this group of workers. For non-hourly workers, the hourly wage is computed by dividing usual weekly earnings by usual hours per week. *Source:* Authors’ calculations using wage data from the Current Population Survey data (IPUMS March Extracts; see King et al. 2004) and inflation data from the Bureau of Labor Statistics.

Low-end market incomes. Tenth-percentile (P10) pretransfer-pretax household income per equivalent person. Incomes are adjusted for inflation using the CPI-U-RS and adjusted for household size using the square root of the number of persons in the household as the equivalence scale. Households with a “head” age 25–59. *Source:* Authors’ calculations using income data from the Current Population Survey data (IPUMS March Extracts; see King et al. 2004) and inflation data from the Bureau of Labor Statistics.

Unemployment. Unemployed persons as a share of the labor force. *Source:* Bureau of Labor Statistics.

Notes

CHAPTER 1

1. Rawls 1971.
2. I disagree with part of Rawls’s argument. If a rise in inequality is very large, it may be objectionable despite an absolute improvement for the poor. See Kenworthy 2008*b*: ch. 2.
3. In experiments in which five or so participants are placed in a situation approximating Rawls’s original position, most do not choose his distributive principle. Instead, they tend to choose a principle in which the average income is maximized with a floor under the incomes of those at the bottom. See Frohlich, Oppenheimer, and Eavey 1987.
4. Friedman 2005.
5. Citro and Michael 1995; Atkinson et al. 2002, 2005; Rainwater and Smeeding 2003; Brady 2009.
6. This is true when comparing across countries as well. For example, Mexico and Russia have relative poverty rates only slightly higher than the United States, and the rates in Poland and Romania are far lower than in the United States; see LIS 2010*b*. Because the U.S. median income is comparatively high, 50 percent of its median is high, resulting in a fairly large share of American households having income below that cutoff. In Poland, Romania, Russia, and Mexico, by contrast, the median income is comparatively low, so the poverty line ends up being quite low. Similarly, the level of relative poverty in Mississippi is the same as in Connecticut; see Iceland, Kenworthy, and Scopolitti 2005; Burkhauser 2009.
7. Kenworthy 2008*a*; Nolan 2008.
8. See Chapter 4. Also Slesnick 2001; Haveman and Wolff 2005; Meyer and Sullivan 2009; Garfinkel, Rainwater, and Smeeding 2010.
9. Even direct measures of living standards miss something important. Though I do not pursue it further in this book, I share Amartya Sen’s view that antipoverty efforts should aim not just at securing improved material well-being but also at enhancing people’s capabilities. By this Sen means the ability to develop informed preferences about life goals and to act on those preferences. Income is a key resource that increases one’s capability. But there are many others: education, physical health, safety, employment, the freedom to start a business, to engage in trade, to participate in social life, and so on. Government has an important role

- between per capita GDP and material deprivation; see OECD 2008: ch. 7.
13. See Boarini and Mira d'Ercole 2006: 18.
 14. Nolan and Whelan 2010.
 15. See the appendix for details. We decided against two alternative measures of social policy generosity. One is the difference between pretransfer-pretax income inequality and posttransfer-posttax income inequality (Bradley et al. 2003; Kenworthy and Pontusson 2005; Mahler and Jesuit 2006). The other is a measure of decommodification (Esping-Andersen 1990; Scruggs and Allan 2006)—a composite indicator of eligibility rules, benefit duration, and benefit levels for unemployment compensation, sickness compensation, and old-age pensions. Each of these measures has merit. But both have a significant drawback: they do not include government services. Like transfers, public services are redistributive and improve the living standards of the poor. (Also problematic for the decommodification measure is that it includes only three programs.) For more discussion of the strengths and weaknesses of these measures, see Bergh 2005; Castles 2008; Adema and Ladaïque 2009; Garfinkel, Rainwater, and Smeeding 2010.
 16. This association remains strong with controls for GDP per capita, education, unemployment, employment in agriculture, and imports.

CHAPTER 5

1. Bosch and Weinkopf 2008; Gautié and Schmitt 2010.
2. Visser 2006; Eurofound 2009.
3. See Kenworthy 2009c; Visser 2009.
4. Gautié and Schmitt 2010.
5. Venn 2009.
6. It is not only the political right that has favored policy changes to promote expansion of low-wage employment. In Germany, mini-jobs and the Hartz reforms were key developments; both were implemented by a Social Democratic government. In the Netherlands a central part of the story is the slow but steady drop in the statutory minimum wage, which was part of a compromise to which the union confederations and Social Democratic party policy makers assented; see Visser and Hemerijck 1997.
7. Gautié and Schmitt 2010.
8. Marx and Verbist 1998; Nolan and Marx 2000; Bardone and Guio 2005; Andreß and Lohmann 2008.
9. Gießelmann and Lohmann 2008; Halleröd and Larsson 2008; Lohmann 2008; Lohmann and Marx 2008; Marx and Verbist 2008b; Snel, de Boom, and Engbersen 2008; Whiteford and Adema 2008; OECD 2009.

10. See also Kenworthy 2004: ch. 6.
11. OECD 2009b.
12. Blank, Card, and Robbins 2000; Hoffman and Seidman 2003; Hotz and Scholz 2004.
13. Immervoll and Pearson 2009.
14. Kenworthy 2008b: ch. 7.
15. Immervoll and Pearson 2009: 16.
16. Immervoll and Pearson 2009: Table 3.
17. Ehrenreich 2001; Thompson 2010.
18. Gallie 2003; Kenworthy 2008b: 308–10.
19. Gallie 2002.
20. Esping-Andersen 1999, 2009; Esping-Andersen et al. 2002; Andersson, Holzer, and Lane 2005; Fitzgerald 2006.
21. Herzberg, Alic, and Wial 1998.
22. Pontusson 2011.
23. E.g., Hall and Soskice 2001; Hall and Gingerich 2004; Barth and Moene 2009.
24. Streeck 2009.
25. Kenworthy 2006; Campbell and Pedersen 2007.
26. Kenworthy 2008b: Table 7.2.
27. Rothstein 1998.
28. Goodin et al. 1999.
29. Blank 1997a; Currie 2006; CAPTFP 2007; Haskins and Sawhill 2009.

CHAPTER 6

1. Esping-Andersen 1999; Scharpf and Schmidt 2000; Huber and Stephens 2001; Pierson 2001b; Kenworthy 2004, 2008b; OECD 2005, 2006; Hemerijck 2012.
2. Blank 1997a: ch. 6; Gilbert 2002: ch. 5; Schuck and Zeckhauser 2006.
3. Wilensky 1975; Korpi 1980; Rainwater 1982; Ringen 1987; Esping-Andersen 1990; Skocpol 1991; Gelbach and Pritchett 1995; Korpi and Palme 1998; Rothstein 1998; Moene and Wallerstein 2001; van Oorschot 2002; Pontusson 2005; Campbell 2007; Larsen 2008.
4. Korpi and Palme 1998; Kim 2000; Pontusson 2005.
5. Korpi and Palme 1998: 672.
6. Korpi and Palme 1998: 663.
7. Korpi and Palme 1998: 677.
8. LIS 2010a.
9. This is similar to a measure used by Korpi and Palme 1998: Table 3.
10. Howard 2007; Alber 2010.
11. Whiteford 2008, 2009.

12. Note that this reduces the estimated degree of redistribution; compare the vertical axis values in Figure 6.2 to those in Figure 6.1. It also allows some countries to have “reverse targeting,” whereby more government transfers go to households with high incomes than to those with low incomes; compare the horizontal axis values in Figure 6.2 to those in Figure 6.1.
13. Atkinson and Brandolini 2001.
14. Greenstein 1991.
15. Pierson 1994.
16. Howard 2007: 106.
17. Nelson 2007: Figure 1.
18. See van Oorschot 2002; Matsaganis et al. 2004; de Neubourg, Castonguay, and Roelen 2007; Rothstein 2010.

CHAPTER 7

1. OECD 2008: ch. 9; Garfinkel, Rainwater, and Smeeding 2010: Table 4.1; Paulus, Sutherland, and Tsakloglou 2010.
2. Kenworthy 2009a, 2009b.
3. OECD 2008: ch. 9.
4. Goldin and Katz 2008; Garfinkel, Rainwater, and Smeeding 2010.
5. Kozol 1991.
6. Hoxby 2003.
7. Currie 2006.
8. OECD 2008: Figure 9.4.
9. Gornick and Meyers 2003; Huo, Nelson, and Stephens 2008; Kenworthy 2008b; Esping-Andersen and Myles 2009; Pontusson 2011; Hemerijck 2012.

CHAPTER 8

1. Warren 2008; Prasad and Deng 2009.
2. Ringen 1987: ch. 8; Mitchell 1991; Steinmo 1993; Mahler and Jesuit 2006; Kenworthy 2008b.
3. LIS 2010a.
4. Information on consumption taxes paid is very difficult to capture accurately in surveys.
5. Wilensky 1976, 2002: ch. 10; Becker and Mulligan 2003; Kato 2003; Cusack and Beramendi 2006; Beramendi and Rueda 2007; Kemmerling 2009.
6. Becker and Mulligan 2003.
7. Ganghof 2005, 2006, 2007.
8. This is not a function of beginning in 1960. Starting in 1973 or 1979 does not yield a different story.

9. How did previous analyses miss this? As best I can tell, two factors probably contributed. First, Becker and Mulligan and Kato estimated regressions that include a variety of control variables. The question of interest here is: Have countries that increased tax revenues in recent years done so mainly by increasing consumption and payroll taxes? To answer this question it is not necessary to estimate a multivariate regression model; this is an accounting question, not a question about causality. It may be that the addition of controls, such as political partisanship and globalization, hid the lack of over-time association between tax revenues and the tax mix.

Second, Becker and Mulligan and Kato each pooled cross-sectional with over-time data. Because the cross-country variation is more pronounced than the longitudinal variation, it is possible that in those pooled analyses the positive association across countries (see Figure 8.5) masked the lack of positive association over time (Figure 8.6). (This is common in macrocomparative analysis. See Griffin et al. 1986; Kittel 1999; Kenworthy 2007, 2009d; Shalev 2007.)

In addition to her quantitative analysis, Kato examined developments in the tax mix in several individual countries. However, the principal country she looked at that significantly increased tax revenues over time is Sweden, which turns out to be one of only two countries whose experience conforms to her hypothesis. Had she included Austria, Belgium, Denmark, Finland, or Italy among her case studies, she might have reached a different conclusion. Kato (2003: 94–110) did examine France, which experienced a rise in tax revenues without any increase in the share accounted for by consumption and payroll taxes. But it does not appear that she looked closely at over-time developments in the tax mix. Instead, her discussion focuses on changes in France’s tax rates for payroll and consumption. Ganghof (2006: 364) notes that increasing income (and property) tax revenues played an important role in France.

10. Korpi 1985; Atkinson 1999; Lindert 2004: chs. 10, 18.
11. Slemrod and Bakija 2004: ch. 4; Myles 2009. Some studies that add a group of moderate-tax high-growth countries have found a negative association between taxation and economic growth. See Fölster and Henrekson 2001; Bergh and Karlsson 2010.
12. Lindert 2004: 235–45.
13. Scharpf 1997.
14. Scharpf 2000; Kemmerling 2005, 2009; OECD 2007; Kenworthy 2008b.
15. Kenworthy 2008b: ch. 8.
16. Visser 2002; Kenworthy 2008b: ch. 4.
17. Esping-Andersen 1990; Palier and Martin 2007.
18. Palier and Martin 2007; Hemerijck and Eichhorst 2009.
19. Palier 2000.

20. Streeck 2009: ch. 4.
21. Palier and Martin 2007; Rueda 2007.
22. See also Ganghof 2006.

CHAPTER 9

1. Adema 2001; Adema and Ladaïque 2009; Fishback 2010. See also Adema 1997; Howard 1997, 2007; Hacker 2002; Garfinkel, Rainwater, and Smeeding 2010; Gilbert 2010.
2. Adema and Ladaïque 2009: Table 5.5; Fishback 2010: Table 5.
3. Howard 1997.
4. LIS 2010a.
5. Consumption tax rates are higher in the Nordic countries than in the United States. But these are incorporated in the purchasing power parities used to convert incomes to a common currency, so the income figures in third row of Table 9.1 are adjusted for differences in consumption taxes.
6. See also Figure 2.2.
7. Fishback 2010: 21.
8. OECD 2008: ch. 7.
9. See also Figure 4.1.
10. Currie 2006.
11. Esping-Andersen 1990: 21.

CHAPTER 10

1. Using the tenth-percentile-income-by-GDP-per-capita slopes from Figure 2.1 instead of the composite “progress for the poor” measure allows a focus on change over time (the material deprivation rates are for a single point in time) and inclusion of Canada and Switzerland. Doing so does not alter the conclusion suggested by the patterns in the charts in Figure 10.1.
2. Some of the indicators could serve for more than one outcome. For instance, political rights is an indicator of both liberty and capabilities. The share of 25-to-34-year-olds with at least an upper secondary education is an indicator of capabilities, opportunity, and social inclusion. And so on.
3. A similar pattern is found if instead of the level of per capita GDP I use the rate of per capita GDP growth over the period from 1979 to 2007, adjusted for “catching up” by initially poorer nations.
4. Its dominance, though, is increasingly questioned. See Stiglitz, Sen, and Fitoussi 2009.

5. The employment rate also serves as an indicator of reciprocity—the principle that all who are able to contribute do so. See Bowles and Gintis 1998; Galston 2001; Rawls 2001; White 2004.
6. Sen 1992, 1999; Robeyns 2005; Nussbaum 2006.
7. See Green 2006; Eurofound 2007; Gallie 2007; Antón et al. 2011.
8. The three social inclusion indicators I use are suggested in Atkinson et al. 2002, 2005.
9. The study of subjective well-being has proliferated. See for instance Layard 2005; Diener et al. 2009.
10. On the worry that generous social policies and/or other egalitarian institutions impede fiscal rectitude, see Iversen and Wren 1998; Scharpf 2000.
11. See, for example, Korpi 1985; Esping-Andersen 2004; Sjöberg 2010.

CHAPTER 11

1. Blank 1997a; Currie 2006; CAPTFP 2007; Haskins and Sawhill 2009.
2. See Castles et al. 2010.
3. Hicks 1999; Huber and Stephens 2001.
4. Gornick and Meyers 2003.
5. Immervoll and Pearson 2009.
6. Cohn 2010: 25.
7. Inglehart 1977; Inglehart and Abramson 1994.
8. McCall and Kenworthy 2009; Kenworthy 2010b.
9. Friedman 2005.
10. Meltzer and Richard 1981.
11. McCall and Kenworthy 2009.
12. Kenworthy and McCall 2008.
13. Hochschild 1981; Kluegal and Smith 1986; Gilens 1999; McCall and Kenworthy 2009; Page and Jacobs 2009; Kenworthy 2010b; McCall 2011.
14. Page and Jacobs 2009; Kenworthy 2010b.
15. Kenworthy 2010b.
16. Cohn 2010.
17. Page and Shapiro 1983; Shapiro and Young 1989; Burstein 1998; Alesina and Glaeser 2004; Brooks and Manza 2007; Howard 2007: ch. 6.
18. Svallfors 1997, 2007; Rothstein 1998; Blekesaune and Quadagno 2003; Mettler and Soss 2004; Jaeger 2006; Larsen 2008; Kenworthy 2009d; Jordan 2010; Newman and Jacobs 2010.
19. Pierson 1994.
20. Pierson 2001; Castles 2004.
21. Hills, Sefton, and Stewart 2009; Smeeding and Waldfogel 2010; Waldfogel 2010.

22. Sefton, Hills, and Sutherland 2009: Figure 2.5.
23. Hills 2004: Table 8.3.
24. Amenta 1998; Moss 2002; Weaver 2009; Cohn 2010; Gitterman 2010.

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