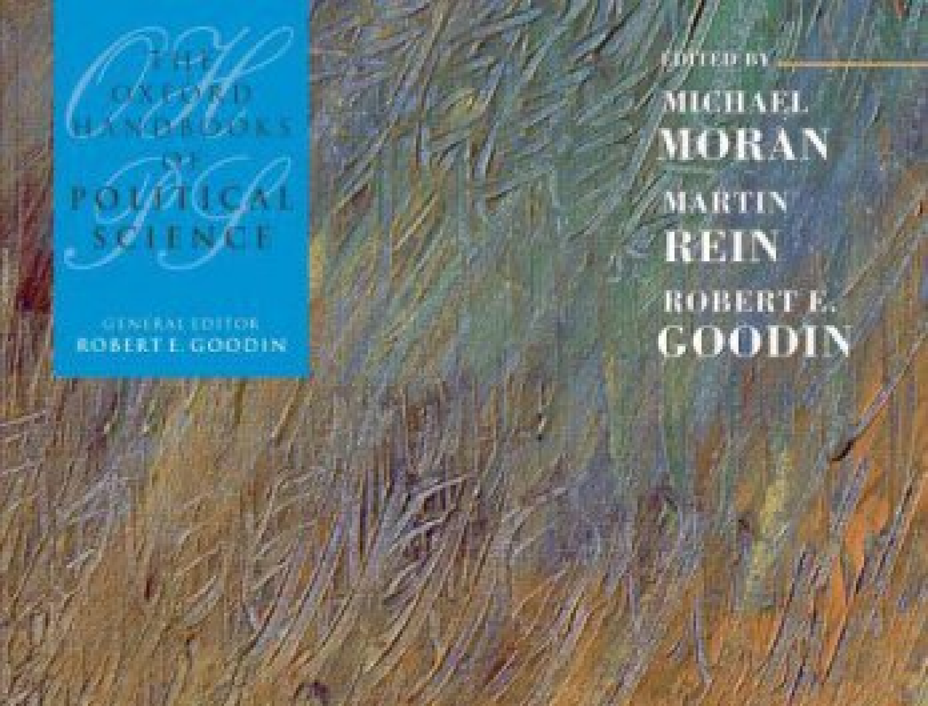

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welfare state effort. They argue that a euro spent on an earnings-related civil servant pension does not represent the same degree of welfare state effort as a euro spent on social assistance. Another simple but important drawback of this line of comparative research of welfare states is that total expenditure is not really an input indicator, certainly not a policy-input indicator, but at best an intermediate indicator. Governments after all do not each year set down the total budget for welfare state expenditure; social security budgets tend to be open ended. Total expenditure is the result of incremental policy making in the past, as well as social and economic developments on which the government has little influence.

Esping-Andersen (1990), Korpi and Palme (1998), and others have tried to characterize welfare states by way of a typology. Having collected a smaller or larger number of indicators of welfare state characteristics, they try to capture similarities and differences into a limited number of types. Mostly this is done analytically, i.e. the authors formulate a number of ideal types, and typecast actual welfare states according to how closely they resemble one of those types. Alternatively, De Beer, Vrooman, and Willeboer Schut (2001) follow an empirical strategy, investigating whether fifty-eight institutional characteristics of welfare states cluster together to form distinct types (though they use indicators that other researchers would regard as outcomes, such as labor market participation rates). While different typologies employ different names, and produce somewhat different country groupings, the basic pattern is always the same; see Sefton, this volume for a description of Esping-Andersen's (1990) typology.

Korpi and Palme (1998, 675) find the expected relation between welfare state type and budget size (which is here regarded as an outcome of institutions, not as a characteristic): welfare states that rely heavily on means testing or on flat-rate benefits tend to have smaller total expenditure levels than welfare states where earnings-related benefits play a larger role. For this reason, the former perform worse in terms of the impact on income inequality and poverty. This leads the authors to formulate the "Paradox of redistribution:" "The more we target benefits at the poor and the more concerned we are with creating equality via equal public transfers to all, the less likely we are to reduce poverty and inequality" (Korpi and Palme 1998, 661).

This being said, welfare state types are not always very distinguishable as regards their impact. Even the correlation between welfare state type and budget size of which Korpi and Palme (1998, 675) make so much is not very strong, and "some countries in the basic security [mainly Anglo-Saxon] and corporatist [mainly European continental] categories have total expenditures levels approximating those in the encompassing group [Scandinavia]." De Beer, Vrooman, and Willeboer Schut (2001, 5) find that "the liberal welfare states perform consistently worse on the indicators for income levelling, income (in)equality and poverty ... There is however no consistent difference between the social-democratic countries and the corporatist countries. [Both] achieve roughly comparable results in terms of income protection by using quite different institutions." The qualification "in terms of income protection" is important here; as regards labor market outcomes social democratic welfare states radically differ from corporatist ones: whereas the former are characterized by high labor market participation, in particular of women, the opposite is true of the latter.

3.3 The Impacts of US Welfare Reforms

As each year brings a few or more, smaller or larger, changes in the institutions of each welfare state, and many of these are evaluated in some way, it is impossible and probably fruitless to attempt a review of all "particularistic" studies of separate measures, programs, and reforms. In this section we focus on one particular reform, namely the US social policy reforms during the Clinton presidency in the years after 1993. The reason for this choice is that this reform was radical, wide ranging, and has been well studied, and is therefore a good case to illustrate a number of points. An implication is that we will not only review the impact on poverty and income distribution, since other outcome variables were equally, if not more, important for this reform.

Objectives of the Clinton reform included "to make work pay," and to get people out of welfare and into work. To this end the Earned Income Tax Credit program was greatly expanded. This program provides persons with children who are working with a refundable tax credit for each dollar earned up to a maximum, thereby in effect topping up low earnings. (A refundable tax credit is not just subtracted from taxes to be paid, but actually paid out to households when no taxes are due.) Furthermore, among other reforms, a lifetime limit of five years was set on federal-funded welfare. For further detail, we refer to Blank and Ellwood (2001). The budget implications of the reform were huge: between 1992 and 1999, annual real federal spending on new or expanded programs increased by over $30 billion, which is nearly twice as much as total spending on Aid to Families with Dependent Children (AFDC), the main pre-reform welfare program. As a result, the net gain from working for single mothers on welfare dramatically increased (Blank and Ellwood 2001, 7).

It is instructive to compare the Clinton welfare reform with a simple earnings disregard program, where welfare recipients can keep part of their benefit up to a point if they start earning. This does have the desired effect of creating financial incentives for non-working welfare recipients to enter the labor market, but also creates unwanted incentives for current non-recipients to reduce their work effort (Blank, Card, and Robins 1999, 12). This appears to be one of the key reasons for the disappointing results of the negative income tax experiments of the 1970s. By contrast, the Clinton welfare reforms contained a number of provisions to limit this unwanted side effect, including eligibility restrictions that target benefits to long-term welfare recipients, and hours restrictions that limit benefits to full-time workers (Blank, Card, and Robins 1999, 40).

What was the impact of those changes? Perhaps surprisingly, given the scale and size of the reforms, this question is not easy to answer. Certainly, at the end of Clinton's second term, the number of people on welfare had more than halved compared with the start of his first term. Labor force participation among single women with children increased by more than 10 percentage points in this period. Poverty fell significantly. However, at the same time the US economy went through a period of strong growth and labor force expansion. It turns out to be quite difficult to disentangle the impact of policies from the effects of the booming economy. As Blank and Ellwood (2001, 31) write, it is relatively easy to document that outcomes changed at the same time as policy. To establish causality is another matter.

Researchers have spent considerable effort on doing just that, using a variety of methods and data, but relying mostly on difference-in-difference studies on the state level (see Section 2). These studies indicate that policy changes were important in getting people off welfare. Regarding labor market participation, researchers tend to agree that the Clinton policy changes dramatically increased work by single parents, though it is less clear what was the relative contribution of EITC and other work supports versus welfare reform (Blank and Ellwood 2001, 39).

The focus on labor market participation entails a danger of increased poverty, if earnings are no greater than the welfare income they replace, and if some persons are taken off the welfare books without any alternative source of income. Overall, however, the net effect of the policy reforms appears to be positive: poverty declined, and the income of female-headed families with children rose. At the same time, some single-mother families at the very bottom probably became worse off. The most serious question concerns what will happen if the economy stops growing (Blank and Ellwood 2001, 53–4). The policy changes are such that the welfare system is most effective during an economic upturn (when people find it easy to find a job); how it will perform during a recession remains to be seen.

4. The Impact of Income Transfers on Activity

It is often alleged that the welfare state, while perhaps a good thing in principle, has a number of unwanted side effects, which reduce its real impact. The perverse effects of welfare state programs haven been most forcefully put forward by Murray (1984). He argues that in the USA, the numbers of poor stopped shrinking in the early 1970s, and then began growing, despite the combination of economic growth and huge increases in expenditures on the poor. Other basic indicators of well-being also took a turn for the worse in the 1960s, most consistently and most drastically for the poor.

The reason for this turn of events, according to Murray, was precisely the huge expansion of welfare state programs, which encouraged behavior that perpetuated the state of poverty, through early school drop-out, weak attachment to the labor market, and family break-up. These failures were then masked through too generous transfers. While many analysts have argued that Murray's thesis does not fit the facts (e.g. Jencks 1992), much time and energy have been devoted to identifying the possible perverse side effects of welfare state programs. In this section we will look at two such side effects, namely discouraging people from working, and crowding out informal care by relatives.

4.1 Impact on Labor Supply

The impact of welfare state programs on labor market participation is the subject of an enormous literature, often of great technical complexity, which is impossible to do justice to in one section of a short chapter. Below, we present certain highlights which give some impression of the variety of issues and results.

The standard economic textbook model (Danziger, Haveman, and Plotnick 1981, 979; Atkinson 1993*a*) is that persons trade off work against leisure, and that *ceteris paribus* they will prefer leisure over work. Under these assumptions, transfer programs that provide income support without requiring work will unambiguously reduce labor supply through the income effect, that is, people will use the extra income to "buy" extra leisure time. Some persons will work fewer hours, and others will stop working altogether. Transfers that are means tested will have an additional labor supply reducing effect, as for each euro or dollar earned a part of the benefit is withdrawn. The effect of taxes is ambiguous: the fact that taxes reduce net earnings may induce persons either to work more to make up for the lost earnings (income effect), or to work less, as each hour worked brings in less in net earnings (substitution effect).

This bare-bones economic textbook model ignores many dimensions of work and labor supply, as explained by Atkinson (1993*a*). One is the assumption that people are completely free to choose their hours of work, implying that there is no involuntary unemployment, or compulsory early retirement. Another is the disregard for the institutional context of labor supply decisions, e.g. the presence of collective bargaining, restrictions on laying-off employees, or the fact that real-world tax systems often produce non-linear budget constraints. Income-tested benefits moreover may imply that the budget constraint is non-convex, and effective marginal tax rates may be higher at low earnings than higher up the scale. People living on social assistance may even find themselves in a so-called "poverty trap," as any effort to obtain additional earnings may not bring them any advance in net-income terms. Furthermore, labor market decisions are not made individually, but within families, which may be taxed jointly, and where there is also unpaid but essential household production work to be done. The trade-off is therefore not simply one between net income and leisure, but between consumption goods bought in the market and having more time for household activities, and also between the incomes and non-working time of husband and wife. Moreover, lifetime considerations may be important, as people may work hard during their prime-age years to provide for their (early) retirement.

Thus, economic theory, certainly when some model assumptions are relaxed, cannot provide a clear-cut answer as regards the direction of the effect of real world tax-and-transfer systems, and moreover, theory is silent on the *magnitude* of the effects, which is as important as the direction. Empirical studies only can provide useful answers. There are several approaches in this domain. One is to use real-world socioeconomic experiments, of which the best-known example is probably the New Jersey negative income tax experiment (Pechman and Timpane 1975). The broad conclusion from this and other similar experiments was that there was a noticeable but not massive reduction in work effort (Atkinson 1993*a*, 43). Yet, although the evidence produced by such experiments is unique, it cannot be regarded as conclusive, for the reasons set out in Section 2. Other studies have followed the before-after method, or the modeling approach outlined in Section 2.

Atkinson (1993*b*, 297), reviewing a number of such studies, concludes that, overall, "a number of the effects that have been identified are relatively small in size," and "there are relatively few situations in which a disincentive effect has been clearly established." There is evidence that taxation causes married women to work less, but little evidence of a negative response by prime-age male workers. There is also little clear evidence that *benefits* represent a major discouragement to take up work. One reason for this is that, though the tax-and-transfer system in many countries creates a poverty trap, this may affect relatively few people. Also, transfers may have a positive impact (the so-called entitlement effect), as people keep working or looking for work in order to become or remain eligible for benefits.

Another group for which tax-and-transfer arrangements may have an important effect on labor market participation (apart from married women) is men aged 50–64. In many countries participation rates for this group have fallen drastically during the last four decades. Gruber and Wise (1998) show that, across a number of OECD countries, labor force participation of older persons is strongly related to the implicit social security tax on work. This implicit tax arises because in many countries, staying on for one more year in the labor force for older persons implies a reduction in the present discounted value of total pension benefits during the remaining lifetime. In some cases, this reduction is even larger than the net wages earned during the extra period in work! The "tax force to retire" is especially strong in Italy, Belgium, the Netherlands, Germany, and France. However, as Gruber and Wise note, in some countries (e.g. Belgium) the reduction in labor market participation of older persons was not an unwanted side product; rather, encouraging older workers to leave the labor force was an explicit goal, with a view to easing labor market tension and reducing unemployment among younger workers.

Welfare state arrangements and even public transfers can also help to keep persons *in* work. This was after all one of the objectives of the Clinton social policy reforms discussed in Section 3.3. Another illustration is provided by an interesting cross-national study by Gornick, Meyers, and Ross (1996) on the employment of mothers with young children. Gornick et al. note that easier (cheaper) access to child care will increase mothers' employment rate, either (and equivalently) because it reduces the value of time spent at home, or because it increases the net wage mothers can earn. The effect of paid maternity leave cannot be predicted unambiguously—on the one hand it may strengthen mothers' attachment to paid work, on the other it may induce some women to stay at home (temporarily) who would otherwise have kept on working. The direction and especially the magnitude of these effects is therefore an empirical matter. Gornick et al. look at what they call the "child penalty:" the decrease in the probability of employment of mothers, given the presence of young children, all else equal. Compared with an analysis of employment rates per se, this has the advantage that all kinds of institutional and macroeconomic variables are implicitly controlled, insofar as it can be assumed that these other factors affect mothers of young children and other women, e.g. mothers of teenage children, equally. Gornick et al. compare the "child penalty" with a pair of indices that integrate a range of measures of public support for child care and parental leave. They find that these two are strongly related—in some countries which do not strongly support maternal employment the "child penalty" is as large as 35 (Australia) or 45 percentage points (UK), while in Sweden there appears to be no "child penalty" whatsoever.

4.2 The Impact of Welfare State Provisions on Family Care

Some observers maintain that the welfare state not only carries an economic cost in lost hours of work, but also crowds out compassion and activity from private life (Burenstam Linder 1970, quoted in Ringen 1989, 119). One relationship that should be particularly sensitive to such perverse influences is that between the elderly and their children. Formal, social, and emotional ties are less strong than they are between spouses, and between parents and young children within the nuclear family. Old-age care is generally seen as more burdensome than child care (Ringen 1989, 129–30). So what is the evidence as regards the effect of increasing, the supply of public old-age care on family care? According to Ringen (1989, 134) "informal care in the family sector is still the dominant form of old-age care." "There are no signs ... of a decline in family activity, of less vitality or compassion in the sensitive relationships between the elderly and younger family members." However, since Ringen wrote those conclusions, much new research on this topic has been published.

Many writers on this topic take the position that family care and public provisions, far from being substitutes, are actually complements. Several arguments are advanced in this regard. Families will be more willing to provide help when burdens are not too heavy. Also, generous pensions enable the older generation to reciprocate support from the younger generation. Public services may allow families to specialize in psycho-social support rather than instrumental help (Daatland 2001, 18–19). Three kinds of evidence can be called upon to determine whether the substitution or the complement effect predominates. First of all, there are cross-country differences. These indicate that substitution effects are likely, as countries with the highest level of services seem to have the lowest level of family care (Daatland 2001, 19). However, these differences may be due to the more familistic culture of Germany and Italy (which may be associated with both less public care and more private care), compared with the (allegedly) more individualistic societies of Scandinavia. Secondly, there are cross-sectional studies which investigate whether elderly people tend to receive help from one source only, or whether public services and family help appear together. Such studies typically suggest that family care and public provisions are indeed complements, as many elderly persons use both even when controlling for need (e.g. Künemund and Rein 1999, in a five-country study). In a literature review with a focus on longitudinal studies, Penning and Keating (2000) conclude that the findings suggest that formal services are not used to displace or substitute for informal care but rather, that formal services tend to be used to supplement and complement the care provided by the informal network.

Finally, one can follow developments over time: when public services expand, does family care go down, and vice versa? Here the available evidence is mixed. A study by Lingsom (1997, quoted in Daatland 2001) for Norway suggests that this does not happen. Families were not crowded out, nor did they withdraw, when alternative sources of help were available. On the other hand, Johansson et al. (2003) claim that results show that relatives more often provided care to older people half a century ago than in contemporary Sweden. More recently, cutbacks in public services in Sweden have led to a substantial reversal in care patterns. Increased input from families matches the decline of public services. A positive reading of these results would be that even in individualistic Sweden the welfare state has not destroyed the bonds between elderly persons and their children: when needed (again), the latter are ready to provide help.

5. Conclusion

Since this chapter as a whole is fairly short and rather synthetic in nature, it hardly needs summary. However, we would like to make some general points, first on methodological issues and then on substantive ones.

First, a methodological point that is perhaps rather uncontroversial, but still worth making. Theory, certainly economic theory, is in general insufficient to predict the impact of policies. Theory can guide us as to what to look for, but often the direction of the effects, and almost always their magnitude, can only be established empirically. Often, effects that loom large in the theoretical literature turn out to be insubstantial in the real world.

A second, perhaps less obvious point is that, even though the tool kit of policy analysts contains a variety of methods, it is often very hard to identify, let alone quantify the impact of particular policies with a reasonable degree of accuracy. Even the consequences of the US welfare reform under Clinton turned out to be hard to pinpoint, despite the scope of the reforms, and the wealth of data seemingly available. Social experiments are perhaps inherently the most powerful method, but they are suitable only for programs that are not yet in place, and that can be enacted on a small scale. For larger and existing programs the difference-in-difference method is perhaps the most valid and convincing way to measure policy impacts, whenever it can be applied. The problem of finding a suitable comparison group is often not trivial, though. The fundamental problem seems to be that the impacts of policy changes are often small compared with those of exogenous social and economic developments. It then becomes difficult to tease out the message from the noise.

Thirdly, macro-social comparative studies, which look at large institutions such as welfare states as a whole, have given us important new insights in the past decades. However, the fact that multivariate analysis is nearly impossible with fifteen or twenty cases (rich democratic nations) limits crucially the power of this approach. It therefore has no answer to the basic fact that each welfare state is embedded in a different society, making it very difficult to distinguish impact from association. Welfare state typologies are very useful to get some grasp on the otherwise bewildering variety of institutional characteristics, but appear to have limited potential as predictors of impacts. Perhaps the most fruitful approach is represented by comparative studies which look at the impact of policy packages offered by different welfare states to particular groups, such as mothers with young children, or males at pre-retirement ages. At this middle-of-the-road level, policies can be described, or even quantified with a fair degree of precision; there is often more variety in outcomes; and the relationship between policies and outcomes is more easily established, and easier to interpret.

The main *substantive* conclusion we can draw from the material presented above (despite some methodological reservations) is that policies do have an impact, in the sense of making a difference to people's actual living circumstances. There can be little doubt that large welfare states are more equalizing than smaller welfare states, although it is probable that large welfare states can only flourish in societies that are rather egalitarian in the first place. Their impact is not entirely frittered away through unintended side effects. The experience of US welfare reform under Clinton indicates that a well-designed package of programs can induce people to move off welfare rolls and into work. Comparative research shows that older people retire early when pension and other benefit systems contain clear incentives to do so. Studies suggest strongly that mothers with young children continue working, or return to the labor force after a time, if a package of benefits and services is in place that helps them to do so.

Secondly, the examples just quoted suggest that a large policy impact requires a large program—or package of programs. Measures need to be well designed, well funded, and sustained over time. Attempts to get results "on the cheap" can backfire. The largest example of this is perhaps the "paradox of redistribution" (Korpi and Palme 1998). Welfare states that attempt to target resources onto the poor tend to have lower redistributive budgets, resulting ultimately in more poverty and more income inequality, compared with welfare states that rely on more universal benefits.

The third conclusion is an instance of the previous one, but worth mentioning in its own regard: people react to incentives, provided these are clear and large. Welfare mothers in the USA move back to work if it is made clearly worth their while to do so. Older men in some continental welfare states retire early in great numbers, when the rules of existing pension and other benefit systems minimize the gains of continuing to work (calculated on a lifetime basis).

Fourthly, we do not intend to imply that getting a large impact is just a matter of spending a large amount of money. In all of the examples just quoted the impact was produced by a package of programs, not by just a single measure. Such a package needs to be well designed, so that the different parts work together towards the same objectives. The comparison of the complicated welfare reforms under Clinton with the rather simple negative income tax proposals indicates that real-world policy packages are often quite complex and detailed, and need to be so, in order to contain unwanted side effects, and to keep costs in check.

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