

Reforming Family Transfers in Southern Europe: Is there a Role for Universal Child Benefits?

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The drive to reduce child poverty is of particular interest in southern Europe, where public assistance to low-income families with children is often meagre or not available at all. The paper examines the effect of income transfers to families in Greece, Italy, Spain and Portugal using a benefit-tax model. The distributional impact of actual programmes is shown to be weak, hence the scope for reform great. As an illustration, the European benefit-tax model EUROMOD is used to simulate universal child benefits equivalent to those in Britain, Denmark and Sweden. The anti-poverty effect of such benefits is found to be in proportion to their fiscal cost.

Introduction

Child poverty has risen to prominence as a distinct issue of social policy over the last few years. In Britain, the Labour government committed itself to halving child poverty by the year 2010. A variety of policy instruments have been employed, including substantial improvements to universal Child Benefit and of the child supplements to means-tested Income Support, as well as the extensive use of in-work benefits (Piachaud and Sutherland, 2001; Brewer, 2003). In Europe, the Commission submitted to the March 2000 Lisbon summit a proposal to halve child poverty by 2010. The proposal was not endorsed by the Council, but the Social Inclusion Process confirmed the greater visibility of anti-poverty policy at EU level. Indeed, drawing up biennial National Action Plans since 2001 has been in many countries occasion for initiatives specifically targeted to children. Recently, the March 2005 Brussels summit made explicit reference to 'target groups such as children in poverty' (CEU, 2005: 11).

The drive to reduce child poverty is of particular interest in southern Europe. If anything, 'familialism' has long been identified as a special ingredient of south European

welfare states (Ferrera, 1996; Rhodes, 1996; Saraceno, 1997). At first glance, it might be thought that in such a context families and children are well looked after. Rather paradoxically perhaps, this is not always the case. On the one hand, family activism in the domain of social policy has proved far from fully effective in terms of preventing child poverty. The mobilisation of family resources to bail out relatives at risk of poverty requires that such resources are adequate in the first place, even when the existence of families or their willingness to help is not an issue. On the other hand, the 'subsidiary' role of the state in family policy has often implied that formal programmes of public assistance to poor children are meagre or not available at all (Matsaganis et al., 2003).

The limited role of social assistance for low-income families with children in the countries of southern Europe is in sharp contrast to the extensive, and apparently uncontested, reliance on tax benefits. Fiscal welfare, mostly taking the form of non-refundable income tax credits for dependent children, is alive and well, causing the regressive outcomes first pointed out half a century ago (Titmuss, 1955): poor families are often too poor to pay tax, while richer families see larger reductions to their tax bill. Extensive recourse to fiscal benefits combines with limited social assistance to result in uneven coverage, with gaps where protection is needed most. The provision of categorical family allowances on a contributory basis compounds fragmentation.

This paper aims to assess the impact of family transfers on child poverty in Greece, Italy, Spain and Portugal. Family transfers are broadly defined as all income transfers that are specifically targeted at families with children, irrespective of whether they are provided through social security or through the tax system. These include contributory family allowances, non-contributory child benefits and tax relief for dependent children.¹

The analysis relies on EUROMOD, a cross-country comparative benefit–tax model for the 15 'older' members of the EU. The model simulates a variety of policies, including social insurance contributions, income taxes, social assistance benefits, unemployment benefits, housing benefits, family benefits and, where possible, social insurance benefits. The data used in this paper are derived from the Bank of Italy Household Income Survey and from the European Community Household Panel (ECHP) for the other three countries. Income data were updated to 1998 using appropriate adjustment factors by country and income source. Policy rules also refer to 1998. Microsimulation models allow users to evaluate the impact of existing tax and benefit measures and to simulate the impact of alternative policy reforms. Both features are brought to use here.

The next section offers a brief account of family transfer programmes and assesses their distributional impact in the four countries. The effect of reforms is then considered. The paper concludes with a discussion of key findings and their policy implications.

Existing family transfers and child poverty

In Italy, the main programme for households with children was *assegno per il nucleo familiare* (family allowance), a contributory benefit reserved for dependent workers, active or retired. The amount of benefit increased with household size and was inversely related to household income. That left income tax credit for dependent children as the only scheme providing support to nearly all children. In Spain, families with children aged under 18 could be eligible for means-tested dependent child benefit (*prestación*

Table 1 Impact of family transfers: percentage reduction in the number of poor children

	Greece	Italy	Spain	Portugal
couple with 1 child 0–17	0.0	17.6	2.7	5.9
couple with 2 children 0–17	3.3	25.6	9.2	17.6
couple with 3+ children 0–17	32.0	23.4	7.8	34.6
lone parent with all children 0–17	4.1	14.1	8.4	9.8
lone parent with at least 1 child 18+	0.0	0.0	2.3	4.0
couple with at least 1 child 18+	5.5	10.1	5.7	14.4
other household types	9.4	8.1	9.4	24.1
all households with children	8.1	19.0	7.3	20.8

Note: The poverty line is set at 60% of national median equivalent disposable income, held constant as policies are simulated. The child poverty rate is the headcount ratio. Children are defined as individuals below 18 years of age. The modified OECD equivalence scale is used, assigning a value of 1.0 to the first adult, of 0.5 to other adults and of 0.3 to children below 14.

econòmica por hijo a cargo), claimed by families accounting for 13 per cent of all children. Tax relief took the form of non-refundable child tax credits, rising more than proportionally with the number of children. In Portugal, assistance to families was provided under the family benefit to children and youngsters (*subsídio familiar a crianças e jovens*). Benefit rates were inversely related to family income and varied by the age and number of children. Eligibility was limited to children of dependent workers covered by social insurance, but the scheme was open to the self-employed on a voluntary basis, while those outside social insurance also had access to benefit if they met a more stringent income test. Tax credits for dependent family members were also provided under the income tax system. In Greece, where social security is fragmented, means-tested assistance to large families was provided through third child benefit and large family benefit, while a lower unprotected child benefit was available to single parents. Civil servants received family allowance, while a lower allowance, conditional on contributory record and inversely related to income, was claimed by private sector employees. Non-refundable child tax credits were paid at a flat rate.

Here, family transfers are analysed as in 1998. Changes to such programmes have taken place in the meantime, while new programmes were also introduced. A full discussion of these is beyond the scope of this paper, but note that cash benefits improved rather selectively, with changes to tax relief usually reinforcing the regressive effect discussed earlier.² Obviously, this hardly negates the need for a more up-to-date analysis as soon as better data and techniques become available, but it does offer some reassurance that the results about to be presented reflect fairly the current state of affairs.

What is the distributional impact of existing arrangements of family transfers in southern Europe? Table 1 (above) presents some estimates of first-order effects, produced with the aid of the benefit–tax model EUROMOD,³ in terms of number of children lifted over the poverty line, conventionally set at 60 per cent of median per capita equivalent disposable income (the main EU common indicator of social inclusion, known as ‘Laeken indicator 1’).

Family transfers appear to be more effective in Portugal and Italy (reducing child poverty by about 20 per cent) than in Greece and Spain (7 to 8 per cent). Clearly, this

pattern is at least partly a function of the relative weight of such policies in the four countries. Indeed, as shown later, family transfers account for a higher proportion of aggregate disposable income in Portugal and Italy than in Greece and Spain.

With respect to household types, poverty reduction is strongest among larger families in all countries. By contrast, with the exception of Italy, where the impact of transfers is distributed more evenly between household types, existing arrangements seem to fail one-child families. Lone-parent families, especially those with older children, fare no better.⁴

On the whole, existing arrangements leave much to be desired. Too many poor families with children are ineligible for social security (as in Greece or Italy) or receive low benefits (as in Spain or Portugal). Non-refundable tax relief compounds coverage gaps, excluding poor families by design.⁵ As a result, current policies seem to perform better in Italy and Portugal, but rather modestly overall. Conversely, the scope for improving the redistributive performance of income transfers to families with children by redesigning their structure seems ample. This is examined next.

The impact of universal child benefits

The introduction of universal child benefits, with the advantage of being easy to explain and simple to implement, is an obvious, though contentious, response to the problem of coverage gaps. For the sake of good policy design, not to mention fiscal prudence, such benefits are assumed to replace, rather than be added on to, existing family transfers (leaving otherwise intact child-related elements in social assistance and other benefits).

What would be the implications of universal child benefits, introduced at the same time as actual programmes of family transfers are abolished? Using a benefit–tax model like EUROMOD enables us to give specific answers to that question.

Universal child benefits appear straightforward enough. However, one still has to define parameters such as the value of benefit and eligibility conditions with respect to age. In this section, four variations to the general theme are explored. All four involve replacing existing family transfers for children aged 0–17 by a universal child benefit. In the case of reform I, the flat rate of benefit in each country was set so as to match existing family transfers exactly in terms of fiscal costs (budget neutral reform). Reforms II–IV simulate actually existing child benefits: the British, Danish and Swedish schemes respectively. The three schemes were chosen to illustrate the effect of benefit structures. To account for variations in living standards, the level of each benefit is fixed as a proportion of average male full-time earnings. For example, the eldest child rate under reform II (British CB) is set in all four countries at 3.9 per cent of average male full-time earnings, as in Britain in 1998. The amount payable under each version is shown in Table 2.

Would universal child benefits be more effective than current policies at fighting child poverty? Table 3 reveals that the impact of simulated reforms would be mixed. Reform I (budget neutral UCB) would increase, except in Greece, the headcount child poverty rate by 1 to 2 percentage points. Reform III (Danish CB) would raise child poverty a little in Italy, but would reduce it by up to 4 percentage points elsewhere. Reforms II (British CB) and IV (Swedish CB) would reduce headcount child poverty in Spain and Greece, but raise it slightly in Portugal and significantly in Italy.

Table 2 Simulated reforms: annual value of universal child benefits

		Greece	Italy	Spain	Portugal
reform I: budget neutral	UCB	197	582	135	284
Reform II:	eldest child	401	676	555	369
British child benefit	all other children	326	551	452	300
reform III:	children aged 0–3	594	1 003	824	547
Danish child benefit	children aged 3–7	540	912	749	498
	children aged 7–18	422	711	584	388
Reform IV: Swedish child benefit	first two children	354	597	490	326
	third child	448	756	621	413
	fourth child	637	1 074	883	586
	fifth + children	707	1 194	981	651
average earnings of male f-t employees		10,253	17,300	14,212	9,441

Note: All reforms involve the replacement of existing family transfers for children aged 0–17 by a universal child benefit. In the case of reform I, the flat rate of benefit in each country matches exactly existing family transfers in terms of fiscal cost. In the case of reforms II–IV, the level of benefit in each country is exactly equivalent to the British, Danish and Swedish child benefits as a proportion of average male full-time earnings. All values are 1998 euros.

Table 3 Impact of simulated reforms: child poverty

	Greece	Italy	Spain	Portugal
existing family transfers	17.0	26.5	21.6	23.1
reform I: budget neutral UCB	17.1	28.4	22.5	25.4
Reform II: British CB	16.0	28.1	18.9	23.5
reform III: Danish CB	15.5	27.1	17.9	19.6
reform IV: Swedish CB	15.9	28.1	18.9	23.2

Note: The poverty line is held constant as policies are simulated. See Notes to Table 1 and 2.

The results indicate that a universal child benefit could have a considerable redistributive impact in southern Europe if pitched at a high enough level. At this point, a question arises: would such a policy shift be affordable? Clearly, the fiscal effect of introducing a universal child benefit would be a function of the level and scope of the benefit itself. However, it would also depend on the demographic profile of each country and the generosity of the family transfer programmes it would replace. The fiscal implications of existing programmes and simulated reforms are shown in Table 4.

As the cost of current family transfers is low (0.5 to 1.5 per cent of aggregate disposable income), the reforms simulated here appear costlier. Reform III (Danish CB) would be the costliest of all, raising expenditure to between 1.8 and 2.4 per cent in the four countries. Reforms II (British CB) and IV (Swedish CB) would have a softer fiscal impact, increasing spending on family transfers to 1.4–1.8 per cent of total disposable income.

Table 4 Impact of simulated reforms: fiscal costs

	Greece	Italy	Spain	Portugal
existing family transfers	0.9	1.3	0.5	1.5
Reform I: poverty neutral UCB	0.9	2.2	0.7	1.9
reform II: budget neutral UCB	0.9	1.3	0.5	1.5
Reform III: British CB	1.6	1.4	1.8	1.8
reform IV: Danish CB	2.1	1.8	2.4	2.3
reform V: Swedish CB	1.7	1.4	1.8	1.8

Note: Fiscal costs are shown as proportion of aggregate disposable income. See Note to Table 2.

Conclusions

The aim of this paper is to assess the effect of actual family transfers in southern Europe (looking at both cash benefits and tax relief), and to predict the impact of universal child benefits. The results presented above offer some useful insights to these questions. A key finding is that replacing current policies by universal child benefits may not reduce the number of children in poverty by much, and could even raise it. This can happen if current policy provides relatively generous assistance to a large number of low-income families (as in Italy, where family allowance is income tested and categorically targeted).

Is this surprising? In the first place, universal benefits were never intended as the only ingredient of anti-poverty policy. The case for universality rests on wider considerations: embodying social citizenship, promoting individual autonomy, preventing poverty traps. Universal child benefits in particular are instruments of horizontal redistribution, from single taxpayers to families with children. If children are viewed as a partly public good, then shifting to society at large some of the costs involved will enhance social welfare.⁶

This is not to say that universal child benefits are irrelevant as anti-poverty instruments. Where existing policies leave coverage gaps, as in the countries examined here, such benefits will improve the position of families at the bottom of the income scale (often ineligible for assistance under current policies). Headcount poverty rates, concerned with movements across the poverty line, cannot capture such improvement, but other indicators can.⁷

Moreover, this contest of universal child benefits vs. existing family transfers is less than fully fair due to imperfect targeting. A 100% rate of benefit take up is assumed here – a reasonable approximation of the real world with respect to universal benefits, but not to means-tested ones (Hernanz *et al.*, 2004). Allowing for imperfect targeting would tilt the balance of the assessment firmly in favour of universal child benefits. The same holds for other features associated with universal programmes, such as lower administrative costs compared with means-tested benefits etc.

In any case, combining a universal (if low) income base with targeted policies could be an effective way to reduce child poverty in southern Europe at a reasonable cost to the tax payer. But not if targeted policies remain categorical. A key element of an inclusive social safety net, potentially open to all poor families irrespective of their characteristics, is a guaranteed minimum income scheme. Sadly, with the exception of Portugal, recent initiatives to that purpose in southern Europe have been inconclusive (Ferrera, 2005).

Among the child benefits simulated, the Danish one clearly emerges ahead of the rest: it would be costlier, but would also have the highest impact on poverty. Generally, a basic trade off between fiscal cost and poverty reduction is at work: more generous universal child benefit schemes will have a stronger distributional impact at a higher fiscal cost.⁸ In a sense, this finding is trivial. However, current spending on family transfers in southern Europe is so low that it would be naïve to expect a mere reallocation of resources within this policy area to reduce poverty significantly.

On another note, the work presented here is restricted to income transfers, ignoring in-kind benefits and their distributional effect. In view of the methodological complexities of accounting for the distributional impact of in-kind benefits, this is now common practice in current research on income and wealth (see for an exception Smeeding *et al.*, 1993). Still, the omission is regrettable. Arguably, a concerted effort to combat child poverty ought to assign a higher priority to family services than to child benefits. To take an example, making good-quality child care affordable to allow all mothers to have careers may be a more promising route out of child poverty than relying on cash benefits alone, however generous the latter may be (Esping-Andersen *et al.*, 2002). Naturally, care should be taken to avoid the other extreme, too: cash benefits and public services are complements, not substitutes (Atkinson, 1998). A penniless family will be poor no matter how broad the range of services it has free access to. In other words, the design of income transfers to families with children matters.

The final point concerns methodology. Significant policy questions such as the one posed here ('what would be the effect on child poverty and fiscal costs of a universal child benefit introduced in place of existing programmes of family transfers?') are so complex and to a certain extent counterfactual that they cannot be fully answered without recourse to a benefit-tax model. Such models are not immune from limitations of their own, some of which were discussed earlier. Nonetheless, they do have a unique advantage, which is precisely the ability to simulate the impact of policy reforms.

In this sense, the contribution of microsimulation can best be thought as an input in the policy making process: informing policy questions and thereby promoting a more rational and dispassionate political debate on benefit-tax reform. There is little doubt that these goods are in relatively short supply in southern Europe. We only hope this paper adds to their stock.

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Notes

1 Recently, Levy (2003) and Corak *et al.* (2005) adopted a still broader definition of child transfers: one that included all child-related elements, anywhere in the social benefit system. Since the practice of adding special allowances for dependent children to instruments as diverse as old age pensions, unemployment

benefits, housing benefits etc. is diffuse, this is a promising approach. On the other hand, comparative social spending databases take a more restrictive approach, counting only cash benefits (OECD-SOCX) or cash benefits plus some in-kind benefits (ESPROSS). A middle way is followed here, looking at income transfers alone, specifically targeted at children, whether provided via social security or via the tax system.

2 As regards cash benefits, in Italy the introduction of a means-tested benefit to large families favoured low-income families with three children or more (1999). In Portugal high-income families were made ineligible for child and youth family benefit (2003). In Greece the abolition of income tests for family allowance to private sector employees (1999), and for 3rd child benefit and large family benefit had the opposite effect (2002). With respect to tax relief, in Italy the tax credit was made to rise with the number and age of children and to fall beyond a certain level of income (2001). In Spain, tax credit was replaced by a child tax allowance, whose per child level rose with the number of children and diminished with age (1999). In Greece child tax credits were also replaced by a tax allowance especially favourable to middle-income families with three children or more (2003). Note that under progressive taxation tax allowances tend to be regressive because they reduce taxable income, while tax credits merely reduce (at a flat rate) the amount of tax due.

3 Pre-transfer poverty rates, as implied by combining the last row of Table 1 with the first row of Table 3, were 18.5 per cent in Greece, 32.7 in Italy, 23.4 in Spain and 29.2 per cent in Portugal. Note that EUROMOD does not (and cannot) exactly reproduce poverty figures such as those based on the ECHP - for various reasons. For instance, EUROMOD does not always rely on ECHP data, e.g. for Italy it uses the Household Income Survey, which is generally regarded of superior quality. Moreover, while in the ECHP (some) social transfers can be read off the data, benefits (and taxes) are simulated in EUROMOD. On the other hand, simulation relies on the twin assumption, known to be unrealistic on both counts, of perfectly targeted benefits and full compliance of tax payers. For these reasons, benefit-tax models are used primarily for evaluating policies and the difference they make. At any rate, child poverty rates derived from EUROMOD matched the ranking of countries (if not the exact figures) implied by the primary database used in each case. For a comparison of the EUROMOD baseline with ECHP and national statistics see Mantovani and Sutherland (2003).

4 Note that the distribution of children by household type in the four countries is similar: the share of children in one-child families ranged from 14.5 to 16.1 per cent, while single-parent families accounted for almost 7 per cent of children in Portugal and 4 per cent in the other three countries (EUROMOD estimates).

5 More recently, refundable tax credit schemes were actually introduced in Greece in 2002 (for low-income families with children aged 6–16 at school) and in Spain in 2003 (for working mothers with children aged below 3). While a full estimation of their effect is the subject of future research, these schemes seem unlikely to alter the regressive nature of tax relief for dependent children in the two countries, as the number of beneficiaries is limited and the amount of benefit paid low.

6 Analogous arguments apply to existing transfers: family allowances reinforce the assumption of a male breadwinner, non-contributory benefits to large families often reflect natalist objectives, tax relief for dependents may partly compensate middle-class families for a rising tax burden (for a historical review see Montanari, 2000). Anti-poverty considerations seem to have played a small role.

7 To illustrate, we estimated the impact of reform III (Danish CB) on the Foster-Greer-Thorbecke index for $a=2$ (a poverty indicator attaching greater weight to larger poverty gaps) to be strong in all countries: 7 per cent poverty reduction in Italy, 21 per cent in Greece, 28 per cent in Portugal and Spain.

8 The cost estimates shown in Table 4 take no account of benefit taxation. Universal benefits are usually taxed as normal income, which reduces fiscal costs but not their anti-poverty impact. Note also that since gross domestic product exceeds disposable income, the estimated cost of simulated reforms is equivalent to a lower proportion of GDP.

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